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THE CONTINUING IMPACT OF

Dodd-Frank

Agenda
June 18, 2014

8:30 a.m. REGISTRATION/BREAKFAST

9:00 a.m. WELCOMING REMARKS

9:15 a.m. DERIVATIVES REGULATION

- Update on CFTC and SEC rulemaking and interpretation
- The European Market Infrastructure Regulation (EMIR) in the context of Dodd-Frank
- Extraterritorial reach, comparability determinations, and substituted compliance for US and European regulations

Panelists:

Joshua Cohn, Ed Parker, and Jerome J. Roche

10:15 a.m. BREAK

10:30 a.m. THE VOLCKER RULE

- Compliance with final rule and conformance period
- Key interpretive issues under the final rule
- Impact on structured finance
- International developments, including Vickers and Liikanen

Panelists:

Alexandria Carr, Julie A. Gillespie, Michael Lewis, and David R. Sahr

11:30 a.m. DEVELOPMENTS IN BANK REGULATION

- Section 165 enhanced prudential standards: capital, liquidity and risk management implications for domestic and foreign banks, including the intermediate holding company requirement
- Designation and supervision of non-bank systemically important financial institutions (SIFIs)
- Regulatory capital developments

Panelists:

Scott A. Anenberg, Thomas J. Delaney, and Jeffrey P. Taft

12:30 p.m.	LUNCHEON SPECIAL PRESENTATION: EU FINANCIAL SERVICES REGULATION 101 Speaker: *Alexandria Carr*
2:00 p.m.	THE “NEW NORMAL”: REGULATORY, SUPERVISORY AND ENFORCEMENT CHALLENGES IN THE POST DODD-FRANK ENVIRONMENT • The evolving supervisory relationship and options to reduce regulatory risk • Contending with parallel investigations and enforcement actions by state, federal and international authorities • Addressing the policy and practical implications of escalating fines and potential criminal penalties on financial services firms • Expanding “bank-like” regulation and supervision beyond traditional banking organizations Panelists: *Marcus Christian, Marc R. Cohen, Andrew J. Pincus, and Jeffrey P. Taft*
3:15 p.m.	BREAK
3:30 p.m.	RECENT DEVELOPMENTS IN SECURITIZATION • The Basel Committee’s proposed new securitization capital framework • Mortgage securitization developments, including the impact of qualified mortgage rules; qualified residential mortgage loans and risk retention • Status and update on other recent regulatory developments, including Regulation AB II and shelf availability; risk retention, conflicts of interest; the Volcker Rule; money market fund diversification rules; and rating agency reforms Panelists: *Jason H.P. Kravitt, Stuart M. Litwin, and Jon D. Van Gorp*
4:45 p.m.	CLOSING REMARKS

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Derivatives Regulation

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US Perspective

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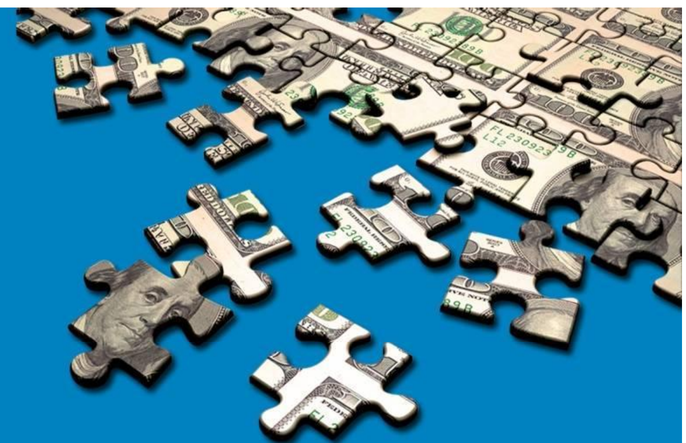

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Overview of Title VII of Dodd-Frank

- Registration requirements for:
  - Swap Dealers (SD) and Security-Based Swap Dealers (SBSD)
  - Major Swap Participants (MSP) and Major Security-Based Swap Participants (MSBSP)
- Substantive regulation of swaps activities, including:
  - Mandatory clearing and trade execution requirements
  - Margin requirements for uncleared swaps
  - Recordkeeping and data reporting requirements
  - Internal and external business conduct standards
  - Large trader reporting and position limits
- Authority for implementing swaps regulation allocated to CFTC (swaps), SEC (security-based swaps), and both together (mixed swaps)

Product Definitions

- What is a swap?
  - A "swap" is broadly defined to include any transaction involving, on an executory basis, the exchange of payments based on the value of commodities, securities or other financial instruments
- What is a security-based swap?
  - A "security-based swap" is defined to include any swap based on a narrow-based security index or on a single security (excluding a US government security, but including non-US government securities) or a loan
- What is a mixed swap?
  - A "mixed swap" is defined as a subset of SBS that also are based on the value of one or more interest or other rates, commodities, or other financial instruments, or economic interests or contingencies

Intermediary Definitions

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- A SD or SBSD is a person who engages in any of the following activities
  - Holding oneself out as a dealer in swaps or security-based swap (SBS)
  - Making a market in swaps or SBS
  - Regularly entering into swaps or SBS as an ordinary course of business for one's own account
  - Engaging in any activity causing oneself to be commonly known in the trade as a dealer or market-maker in swaps or SBS
- MSP/MSBSP is a non-SD/non-SBSD that meets any of the following criteria:
  - Maintains a "substantial position" in swaps or SBS for any of the major swap or SBS categories, not including positions held for hedging or mitigating commercial risk
  - Outstanding swaps or SBS create "substantial counterparty exposure" that could have serious adverse effects on the financial stability of the US banking system or financial markets
  - A financial entity that is highly leveraged, not subject to US bank capital requirements, and maintains a "substantial position" in any category of swaps or SBS

Key Statutory Provisions For Extraterritorial Application of Title VII

- For CFTC, Dodd-Frank section 722(d) provides:
  - "The provisions of [the CEA]relating to swaps that were enacted by [Title VII of the DFA] shall not apply to activities outside the United States unless those activities—

    ‘‘(1) have a direct and significant connection with activities in, or effect on, commerce of the United States; or

    ‘‘(2) contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of this Act . . . "

- For SEC, Dodd-Frank section 772(b) provides:
  - "No provision of [the Securities Exchange Act of 1934] that was added by [DFA Title VII], or any rule or regulation thereunder, shall apply to any person insofar as such person transacts a business in security- based swaps without the jurisdiction of the United States, unless such person transacts such business in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate to prevent the evasion of any provision [added by DFA Title VII]."

CFTC Cross-Border Guidance

- On July 12, 2013, the CFTC issued final interpretive guidance and an exemptive order regarding the cross-border application of the swaps provisions of DFA Title VII
  - Based on proposed interpretive guidance and exemptive orders issued in July and December 2012
  - Defines US person status and effect of status on registration requirement
  - Establishes requirements applicable to certain cross-border swaps
  - Describes process to determine comparability of other nation swap requirements for purposes of substituted compliance

Swap Dealer *De Minimis* Calculation under CFTC Cross-Border Guidance

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- A US person or a guaranteed or conduit affiliate must include all dealing swaps
- A non-US person not guaranteed by, or an affiliate conduit of, a US person must (subject to exceptions) include all dealing swaps with:
  - US persons (other than foreign branches of SDs); and
  - Counterparties that are guaranteed affiliates of a US person, unless the counterparty is a SD, a SD affiliate engaged in *de minimis* dealing, or is guaranteed by a non-financial entity
- A non-US person not guaranteed by, or an affiliate conduit of, a US person may exclude swaps entered into anonymously on a DCM, SEF or FBOT and cleared
- A person (US or non-US) must aggregate relevant dealing swaps of all commonly controlled affiliates (US and non-US), except those of any affiliates that are registered SDs

Substantive Swap Regulation under CFTC Cross-Border Guidance

- In determining how Title VII will apply extraterritorially under the July 2013 Interpretive Guidance and Policy Statement, the CFTC has divided substantive swaps regulations conceptually into (i) "Entity-Level Requirements" and (ii) "Transaction-Level Requirements."
- **Entity-Level Requirements (ELR)**
  - **First Category**: capital adequacy; chief compliance officer; risk management; swap data recordkeeping (other than complaints and marketing/sales materials)
  - **Second Category**: SDR reporting; recordkeeping for complaints and marketing/sales materials; "large trader" reporting of physical commodity swaps
- **Transaction-Level Requirements (TLR)**
  - **Category A**: clearing and swap processing; margining and segregation for uncleared swaps; trade execution; swap trading relationship documentation; portfolio reconciliation and compression; real-time public reporting; trade confirmation; daily trading records
  - **Category B**: external business conduct standards

Substituted Compliance under CFTC Cross-Border Guidance

- In the case of certain parties and certain rules compliance with another country's rules may satisfy CFTC in lieu of its own
  - Parties –Generally swap dealers and MSPs
  - Rules – Entity-Level (1st and 2nd) and Category A Transaction-Level
  - Under the exemptive order, the CFTC's temporary relief for the EU, Australia, Canada, Hong Kong, Japan, and Switzerland (Six Jurisdictions) expired in December 2013
- Noted areas of concern
  - Data repository direct access
  - Privacy laws
  - Clearing and trading venue recognition

CFTC's Comparability Determinations

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- In December 2013 the CFTC issued:
  - Limited ELR determinations for the EU, Australia, Canada, Hong Kong, Japan, and Switzerland; and
  - Very limited TLR determinations for the EU and Japan.
- CFTC did not issue reporting rules determinations, but issued limited no-action relief for certain requirements:
  - CCO annual reports;
  - SDR reporting (NAL 13-75); and
  - Periodic risk exposure reports.

November 2013 CFTC Staff Advisory

- On November 14, 2013, CFTC staff issued an advisory (No. 13-69) that interpreted the cross-border guidance to require compliance with the TLRs if persons located in the US are regularly arranging, negotiating, or executing swaps for a non-US SD when entering into swaps with non-US persons.
  - NALs 13-71, 14-01, and 14-74 delay the effectiveness of the November advisory until December 31, 2014
- Effectively would require full compliance with TLRs (no substituted compliance)

Further CFTC Guidance

- On November 15, 2013, CFTC staff issued a guidance letter that interpreted the cross-border guidance and SEF rules to require multilateral trading facilities (MTFs) to register as SEFs or DCMs if they provide the ability to trade or execute swaps to US persons or *US-located persons*
- Effectively would require SEF registration for many non-US MTFs
- On February 12, 2014, NAL 14-16 provided relief to qualifying EU Multilateral Trading Facilities (MTFs)
  - NAL 14-16 superseded on April 9, 2014 by NAL 14-46
  - MTFs or participants must comply with real-time reporting and SDR reporting requirements

What Next for CFTC Cross-Border Guidance?

- In December 2013, trade associations sued the CFTC seeking to have the cross-border guidance and related pronouncements invalidated; case is currently pending
- In January 2014 the CFTC issued a request for comment on the applicability of CFTC regulations to swaps of non-US swap dealers and non-US counterparties involving persons or agents in the US
- In April 2014, Acting Chairman Wetjen was reported in the press to have said he did not believe the November advisory was the right decision (at least as to non-availability of substituted compliance)

SEC Cross-Border Rulemaking

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- On May 1, 2013, the SEC released its proposed rules and interpretive guidance regarding the cross-border application of the security-based swaps provisions of DFA Title VII
  - Also the SEC re-opened for public comment all other proposed SBS rules
  - Public comment period ended in August 2013
  - No action taken since then; on SEC's regulatory agenda for Q1 2015
- Key Aspects of the proposed guidance
  - Definition of US person (different than CFTC)
  - *De minimis* calculation for non-US SBSDs and threshold calculations for non-US MSBSPs
  - Treatment of branches and agencies for registration purposes
  - Applicability of substantive security-based swap regulations to non-US registered persons and "substituted compliance" regime (a first for SEC)

Still to come

- Margin for uncleared swaps – No regulators have finalized their rules
- Re-proposed position limits – Necessity and fundamental premise remain in question
- Resolution of CFTC cross-border guidance
- Adoption of SEC SBS rules and cross-border application
- Review of reporting rules

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European Perspective

Edmund (Ed) Parker

Partner and global co-head of Derivatives and Structured Products

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G20 Commitments in Europe

- The key G20 commitments required creation of new legislation and amendment of existing directives.
- EMIR
- MiFID
- MiFIR
- CRD IV
- National regulation?

European Union – 28 members

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EU Regulations and Directives

- Regulations
  - Binding legislative act
  - Immediately enforceable as law
  - Across the whole EU

- Directives
  - Legislative goal
  - Method of implementation up to individual member states
  - In principle, no effect until transposed into national law
  - But can have effect in member states if badly implemented or not implemented at all

EMIR

- Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (**EMIR**)
  - Part of the G-20 agenda (April 2009)

    "All standardised OTC derivatives contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end 2012 at the latest.
    OTC derivatives contracts should be reported to trade repositories."
  - Published in Official Journal on 27 July 2012

EMIR Parties and Their Obligations

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Parties	Obligations
Financial counterparties	• Clearing obligation • Risk mitigation techniques • Reporting obligation
Qualifying non-financial counterparties	• Clearing obligation • Risk mitigation techniques (save in relation to the increased capital requirements and the reporting of unconfirmed trades) • Reporting obligation
Non-financial counterparties below the clearing threshold	• Certain risk mitigation techniques (timely confirmation, portfolio reconciliation and compression, dispute resolution) • Reporting obligation

EMIR: Requirements and timetable

Phase I: 2013

Reporting and operational standards

- Report all derivative contracts to Trade Repositories
- Minimum operational standards
  - daily valuation, timely confirmation, portfolio reconciliation and compression, and dispute resolution

Timing in Europe:

- Operational standards: from March 2013, and Sep 2013
- Reporting: from 12 Feb 2014 (and 11 Aug 2014 for exposure and collateral)

Phase II: 2015?

Mandatory clearing

- Specific contracts to which it applies determined by ESMA
- Requirement to clear certain derivative transactions
- Exemptions for intra-group transactions and pension schemes

Timing in Europe:

- NASDAQ-OMX authorised as a CCP on 18 March 2014 – start of the frontloading window
- 18 September 2014 – ESMA must produce draft RTS on the clearing obligation

Phase III ?

New collateral requirements for non-cleared trades

- Bilateral collateralisation requirements
- Initial margin requirement likely to apply to the largest users of derivatives, in particular bank and other systemically important entities
- ***Only very large non-financial entities (those with over €8bn non-cleared swaps) likely to be caught and then only from 2019***

Likely earliest timing in Europe:

- Rules finalised Q3 2014, with long phase-in period of 2015 to 2019 (IOSCO-BCBS published report in September 2013)

EMIR and Extraterritoriality

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Clearing obligation Article 4(a)(iv)-(v)	• EU + non-EU – applies if non-EU would be subject to clearing if in EU • Non-EU + non-EU – applies if *“contract has direct, substantial and foreseeable effect within the EU or where such an obligation is necessary or appropriate to prevent evasion of provisions of”* EMIR
Risk mitigation Article 11(2)	• Non-EU – applies if (1) entity would be subject to obligations if established in EU and (2) if *“contract has direct, substantial and foreseeable effect within the EU or where such an obligation is necessary or appropriate to prevent evasion of provisions of”* EMIR • Otherwise, non-EU entities are not obliged to comply with the requirements, although their EU counterparties will be bound by the rules and may ask non-EU entities to assist them with their compliance
Recognition of non-EU CCPs Article 25	• Non-EU CCPs are prohibited from providing clearing services to entities in EU unless recognised by ESMA • Non-EU CCPs had to apply to ESMA for recognition by 15 September 2013 – 30 have applied • Commission must declare equivalence of CCPs’ jurisdiction
Recognition of non-EU TRs Article 77	• Non-EU TRs must apply to ESMA for recognition • Commission must declare equivalence of TRs’ jurisdiction • ESMA has approved 6 – DTCC Derivates Repository Ltd (UK), UnaVista Ltd (UK), Regis-TR S.A. (Lux) , Krajowy Depozyt Papierów Wartosciowych S.A. (7 Nov 2013), IntercontinentalExchange and CME Group (29 Nov 2013)

Extraterritorial Rules

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Technical Advice on Equivalence

Extraterritorial Application Rules

esma

Phase I
3 September 2013:
Australia, Hong Kong, Japan, Singapore, Switzerland, US

Phase II
2 October 2013:
Canada, India, South Korea

The final regulations published on 21 March. Most of rules will start applying as of 10 October 2014.

Principles – coherence, proportionality, "articulated text", clarification, analysis

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Extraterritoriality: Cross-Border RTS

When does an OTC derivative have a direct, substantial and foreseeable effect?

When one of the parties is guaranteed by an EU financial counterparty for at least €8bn of the gross notional amount of OTC derivatives and for an amount of at least 5% of the OTC derivatives exposure of the EU financial counterparty

Or

When the parties execute their transactions via their EU branches, and would qualify as financial counterparties if established in the EU

When is it necessary or appropriate to prevent evasion of provisions of EMIR?

When a contract's primary purpose is deemed to be the avoidance of EMIR, including as part of an artificial arrangement, such as an arrangement intrinsically lacking business rationale, commercial substance or relevant economic justification

Equivalence Determination: Background

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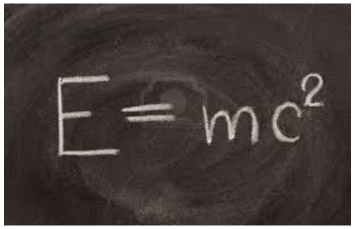

Similar to the CFTC's "substituted compliance" decisions

- By contrast, in the EU there are no mechanisms for deferral, such as a non-action letter

Determinations made by the European Commission

- ESMA's technical advice is not binding

Three main areas of equivalence: CCP, TR and RMT

Why is Equivalence Determination Important?

CCP equivalence

- Prohibition on the use of unrecognised non-EU CCPs
- A third country CCP may only be recognised if the European Commission determines that its regime is equivalent
- Transitional provisions

TR equivalence

- A non-EU TR may provide services to EU entities only if the European Commission determines that its regime is equivalent
- Transitional provisions

RTM equivalence

- Relevant if either (a) an EU entity transacts with a non-EU entity or (b) a contract between two non-EU entities has a "direct, substantial and foreseeable effect"
- The parties do not need to comply with EMIR if the regime of one of the non-EU entities has been determined as equivalent

ESMA's Technical Advice on Equivalence

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	CCPs	TRs	Clearing, reporting, risk mitigation
US	I	I	I
Japan	I	II	I
Australia	I		II
Canada			II
Hong Kong	I	II	II
India	II		To be determined
Singapore	I	II	To be determined
Switzerland	I		II
South Korea	II		To be determined
Dubai	Withdrawn		

Phase I – published 3 September 2013
Phase II – published 2 October 2013

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ESMA's Technical Advice on Equivalence: 3 September 2013

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Australia

- Regulatory regime for CCPs equivalent to EU rules

Switzerland

- Regulatory regime for CCPs equivalent to EU rules

ESMA's Technical Advice on Equivalence: 3 September 2013

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Hong Kong

- Conditional equivalence for CCPs

Japan

- Conditional equivalence for CCPs
- Conditional equivalence for central clearing, requirements for non-financial counterparties and risk mitigation techniques for uncleared trades

Singapore

- Conditional equivalence for CCPs

US

- Conditional equivalence for CCPs
- Conditional equivalence for central clearing, requirements for non-financial counterparties and risk mitigation techniques for uncleared trades
- Conditional equivalence for trade repositories

ESMA's Technical Advice on Equivalence: 2 October 2013

India

- Partial Conditional equivalence for CCPs

Canada

- Equivalence for data protection

South Korea

- Equivalence for CCPs providing clearing services to South Korean OTC derivative markets, but not in respect of other financial instruments

ESMA's Technical Advice on Equivalence: 2 October 2013

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Australia

- Equivalence for trade repositories
- Conditional equivalence for clearing obligation

Hong Kong

- No conclusive analysis can be done as regulatory regime for clearing obligation, non-financial counterparties, risk mitigation techniques for uncleared trades and for trade repositories is not yet in place

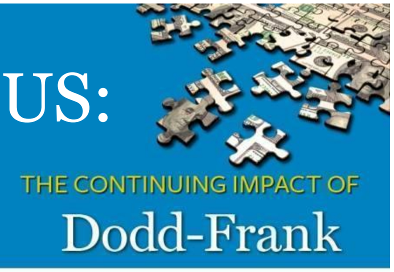
Singapore

- Conditional equivalence for trade repositories

Switzerland

- No conclusive analysis can be done as regulatory regime for clearing obligation, non-financial counterparties and risk-mitigation techniques for uncleared trades is not yet in place

Equivalence determination with respect to the US: areas where ESMA has found no equivalence



The US legal, supervisory and enforcement arrangements are not equivalent to the requirements laid down in Art. 9 (the reporting obligation) of EMIR for the purpose of Art. 13 (prevention of duplicate compliance) of EMIR.

The regime for the dispute resolution is not equivalent to that of EMIR

Questions?

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The Volcker Rule: A Moving Target

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Key Recent Developments

- Proprietary Trading
- Covered Funds
- International Issues
- Conformance Planning and Schedule

Proprietary Trading: Interpretive Questions

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- Recent Volcker Rule FAQ released by the US regulators
  - Provided limited guidance and covered only six topics
  - Clarifies the collecting and reporting periods for banking entities required to report metrics
  - States that quantitative reports should be at trading desk level
- Outstanding interpretive issues
  - Trading in foreign government obligations
  - Consequences of inadvertent compliance failures related to individual trades

Proprietary Trading: Underwriting and Market Making in Securitizations

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- Exemption for purchases and sales in connection with underwriting and market making may be of limited value in securitizations
  - Any "ownership interest" in a covered fund held for underwriting or market making activities must be added to other retained amounts for purposes of the per-fund limitation
  - Aggregate value of ownership interests of a banking entity and its affiliates may not exceed 3 percent of Tier 1 capital

The EU Proposal on Proprietary Trading

- Does not apply to all banks. Applies to largest banks.
- Proprietary trading is prohibited within the banking group.
- Will apply to US branches and subsidiaries of EU banks and EU branches of US banks unless equivalence decision in respect of US – unlikely.

The EU Proposal on Proprietary Trading

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- Very narrow definition of prop trading with very few exemptions:

  using own capital or borrowed money to purchase, sell or otherwise acquire or dispose of a financial instrument or commodity for the sole purpose of making a profit "*without any connection to actual or anticipated client activity or for the purpose of hedging the entity's risk as a result of actual or anticipated client activity*" through specifically dedicated desks, units, divisions or individual traders.

- Plus Vickers-style ring-fence of trading entity from deposit-taking entity.

Covered Fund Provisions: Interpretive Questions

- Treatment of fund seeding vehicles
  - As “covered funds” and as “banking entities”
- Complex fund structures
  - Potential integration of parallel fund and feeder fund structures
  - Law firm consensus position
- Illiquid funds
- Name-sharing prohibition—FAQ guidance
- Other covered funds questions

Covered Funds Provision: CLOs

- 3 industry letters; Barr bill
- On April 7, the Federal Reserve Board issued a statement that it intends to exercise its authority to give banking entities two additional one-year extensions
- LSTA efforts for industry consensus to amend CLOs 1.0

Covered Funds Provision: Other Securitizations That Are Covered Funds

- Ownership interests: "other similar interests" creates ambiguities for typical ABS
- ABCP conduit exclusion
- Loan Securitization Exclusion (LSE)
  - Prohibition on holding "securities" creates ambiguities; recent FAQ's clarified securities that are servicing assets must meet requirements for permitted securities
  - SUBIs: are leased assets "servicing or incidental assets" under the LSE?

The EU Proposal on Alternative Investment Funds

- Prohibition on using own capital or borrowed money:
  - to invest in or hold shares in AIFs (or certificates/derivatives linked to these); or
  - entities that engage in proprietary trading or invest in AIFs,

  if the sole purpose of the bank's activity is to make a profit for its own account.
- Unleveraged and close-ended AIFS established or, if not established, marketed in EU excluded
  - also venture capital funds, social entrepreneurship funds and the proposed European Long Term Investment Funds excluded.

International Issues: Impact on Foreign Securitizations

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- The Volcker covered fund prohibitions apply across the globe, including with respect to any foreign fund that relies on sections 3(c)(1) or 3(c)(7), unless the activity or covered fund is excluded or exempt.
- Foreign private funds are not "covered funds" from the perspective of non-U.S. banking organizations if they do not rely on sections 3(c)(1) or 3(c)(7) because none of their securities are offered in the United States.
- However, a foreign fund that is sponsored by or invested in by a US banking entity or by a foreign banking entity that is controlled by a US banking entity is a covered fund with respect to the US banking entity, even if the fund does not offer securities in the US.
- The SOTUS exemption permits investments in covered funds if done "solely outside of the United States," including that interests are not sold in an offering that targets US residents - not available to US banks

International Issues: Treatment of Foreign Funds as Banking Entities

- Scope of “banking entity” definition is a key issue
- Reduction of extraterritorial application of the definition of “covered fund”
  - Revised proposed definition and added exclusions
- But “banking entity” contains an exclusion only for covered funds
- “Controlled” foreign non-covered funds themselves become subject to the Volcker Rule
- Will regulatory clarification be forthcoming?

EU Proposal on Bank Structural Reform: Scope

- Proprietary trading ban applies to
  - EU G-SIIs (& all their branches and subsidiaries); and
  - following entities that for 3 years have total assets of at least 30 billion Euros and trading assets of 70 billion Euros or 10% of total assets:
    - EU bank that is not a parent or subsidiary + all branches;
    - EU parent of EU bank + all branches and subsidiaries in group;

    and
    - foreign subsidiaries of EU banks;
    - EU branches of foreign banks,

    unless equivalence decision in respect of foreign jurisdiction.
- Ring-fencing provisions have same extraterritorial reach but query whether have same limited scope or apply to all deposit-taking banks in the EU.

Volcker Conformance Planning - General

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- General conformance period currently scheduled to end July 21, 2015
  - Are extensions likely?
- What should banks do during the conformance period?
  - Good-faith efforts to conform by the end of the period
  - Develop and implement a written conformance plan
  - Promptly divest or terminate standalone prop trading desks
  - Not make new investments with the expectation of extensions
  - FAQ clarified timing of capital deduction

Volcker Conformance Planning - Securitization

- Renewals of warehouse facilities and potential restructuring of warehouse facilities that rely on 3(c)(1) or 3(c)(7)
- CLOs
  - Potential for amendments
  - Two additional on year extensions expected for CLOs

When Will EU Rules Enter Into Force?

- Very early days. Currently only have a proposal for legislation subject to negotiation.
- If there is an agreement on a final version of the legislation by June 2015, the proposal is that:
  - The prohibition on proprietary trading would apply from 1 January 2017; and
  - The provisions on separation of the trading activity would apply from 1 July 2018.
- This timetable could precede the UK implementation of its ring-fence—2019?

When Will EU Rules Enter Into Force?

- Renewals of warehouse facilities and potential restructuring of warehouse facilities that rely on 3(c)(1) or 3(c)(7)
- CLOs
  - Potential for amendments
  - Two additional on year extensions expected for CLOs

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Developments in Bank Regulation

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June 2014

THE CONTINUING IMPACT OF
Dodd-Frank

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Section 165 Enhanced Prudential Standards

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Background

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- On February 18, 2014, the Federal Reserve (FRB) adopted rules to implement Section 165 of the Dodd-Frank Act (the enhanced prudential standards)
- Primarily affects US BHCs and FBOs with $50 billion or more in total consolidated assets
  - Some requirements apply to BHCs and FBOS with $10 billion or more in total consolidated assets; none of the enhanced standards apply to a banking organization with less than $10 billion in consolidated assets
- Requirements include: Intermediate holding companies (IHCs); risk-based and leverage capital; risk management, risk committees, and chief risk officers; liquidity management (including liquidity stress testing) and liquidity buffers; and capital stress testing
  - Single counterparty credit limit (SCCL) proposal and early remediation proposal deferred for later action; Basel Committee finalized its SCCL in April 2014
  - IHC triggers significantly scaled back from proposal; IHC requirements remain comprehensive and application of requirements (e.g., anti-evasion language) remains unclear

Affected Entities

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Mid-Size US BHCs ($10B+ assets; 46 est.)	Larger US BHCs ($50B+ assets; 24 est.)	Smaller FBOs ($10B+ global assets; 102 est.)	Mid-Size FBOs ($50B+ global assets and under $50B US assets)	Larger FBO ($50+ global assets and $50B+ US assets; 41 est.)
• Annual company-run capital stress tests; and • Risk committee and appropriate risk management framework (only if publicly traded)	• Capital plan and stress testing requirements; • Chief risk officer, independent director on the risk committee, and other enhanced risk management standards • Liquidity risk management and liquidity buffer requirements; and	• US risk committee (can be part of head office); and • Compliance with home-country capital stress testing requirements	• Basel III-consistent home-country capital requirements; and • Annual company-run liquidity stress tests	• Form a US IHC (if US non-branch assets exceed $50B; 17 est.) • US chief risk officer, independent director on the risk committee, and other enhanced risk management standards • Liquidity risk management and liquidity buffer requirements; and • Annual home-country capital stress-testing

Intermediate Holding Companies (IHCs)

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- All FBOs with $50 billion or more in US non-branch assets must consolidate nearly all US non-branch operations under a separately capitalized IHC
  - IHC subject to Section 165 requirements on consolidated basis
- Covered US subsidiaries
  - All subsidiaries (including non-US subsidiaries held through a US subsidiary) an FBO is deemed to "control" per BHCA definition
  - Branches and agencies excluded, but not their subsidiaries
  - 2(h)(2) and DPC subsidiaries excepted
- Timing
  - Generally, July 1, 2016 – 90% of FBO's assets; remainder by July 1, 2017
  - Implementation plan due Jan. 1, 2015

IHCs: Implications of Restructuring

- For entities controlled through means other than equity ownership (e.g., ABCP conduits, co-issuers), analysis of whether entity is a covered subsidiary is complex
- Forming an IHC likely involves complex corporate, tax, regulatory, capital and liquidity issues
  - FRB may authorize multiple IHCs or alternative organization structures
  - Transferring ownership interests into IHC and out of other structures creates US and non-US tax issues
    - Choice of corporate structure for IHC may have impact (LLC, corporation)
    - Differing treatment between US and non-US laws
      - Tax treaty benefits could be affected by the interposition of an IHC
    - IHC may create new state and local tax exposures

IHCs: Moving Assets/Activities into US Branches and Agencies

- FRB to monitor whether FBOs reduce US non-branch assets to avoid IHC requirement by relocating activities to US branches/agencies
  - Avoidance versus evasion
- Other advantages to conducting activities in US branch/agency:
  - Funding, reliance on parent resources/capital, structural simplification
- Must consider legal and regulatory implications
  - Authority under state and federal law
  - Interaction with other laws (e.g., swaps push-out/Title VII, securities laws/broker-dealer push-out, sections 23A/B affiliate transaction limits, Volcker Rule, liquidity buffer)
- Some FBOs considering moving repo books into branches

Risk Management and Risk Committee Requirements

- FBOs with ≥ $50 billion in US assets
  - Must establish a US risk committee for its combined US operations (branch and non-branch) having at least one member with risk-management expertise and one independent member
  - Must appoint qualified US chief risk officer
- FBOs with ≥ $50 billion and publicly-traded FBOs with ≥ $10 billion in total consolidated assets
  - Must establish and certify annually to the FRB that it maintains a US risk committee of its global board of directors (or equivalent) having at least one member with risk management expertise (no independence requirement)
- Covered US BHCs
  - Must establish an independent enterprise-wide risk committee with an independent chair and at least one member with risk-management expertise
  - US BHCs with ≥ $50 billion in total consolidated assets must appoint qualified chief risk officer
- Impact of other regulatory initiatives, e.g., OCC Part 30 “heightened expectations”

FBO Head Office Risk Committee Arrangements

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- Requirement of US risk committee (if no IHC) to be committee of global board of directors is extraterritorial imposition on home country governance standards and practices
  - May choose freestanding committee versus part of larger enterprise-wide risk committee to limit FRB intrusion on home country governance structures
  - No ability to use management-level or local US risk committee
  - Inclusion of risks (e.g., liquidity) within purview of US risk committee that are within purview of other FBO home country board committees
  - No differentiation based on size of US operations

Home-Country Holding Company Issues

- FBO ownership structure may lead to incongruous application of Section 165 standards if, e.g.:
  - Top-tier FBO does not directly operate US banking entities
    - But US risk committee must be located as part of global board of directors of top-tier FBO
  - Top-tier FBO not subject to home country capital or liquidity requirements
- FBOs in these situations should consult with the FRB about compliance with specific requirements

Single-Counterparty Credit Limits (SCCL) Proposal

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- 2012 FRB SCCL proposal provided that:
  - IHCs and combined US operations of an FBO with $50B in global assets would be limited to an aggregate net credit exposure to any single unaffiliated counterparty not to exceed 25% of IHC or FBO capital
  - IHCs and combined US operations of an FBO with $500B in global assets would face a likely 10% limit with respect to counterparties with $500B in global assets
  - Federal and FBO home-country sovereign exposures would be exempt, but non-home country foreign or US municipal exposures would not
  - FRB proposal does not reflect BCBS final standard issued in April 2014: Supervisory Framework for Measuring and Controlling Large Exposures; BCBS standard becomes effective January 1, 2019

FRB SCCL Proposal v. BCBS Large Exposures Framework

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	Federal Reserve SCCL Proposal	Basel Committee LE Framework
Limit	25% for FBOs w/ $50B global & IHCs; 10% for FBOs and IHCs w/ $500B and a $500B counterparty	15% for G-SIB to G-SIB exposures; 25% for all others Reporting of large exposures (generally, ≥ 10% of Tier 1 capital, and top 20 counterparties);
Counterparty Aggregation	Counterparty and subsidiaries in which counterparty holds of 25% of voting securities or 25% of equity or has consolidated financials	Counterparty, directly and indirectly controlled parties, economically interdependent parties, and exposures to credit protection providers
Excluded/ Exempt Exposures	Federal government, Fannie/ Freddie while under conservatorship, intra-day and settlement exposures	QCCP and SFT exposures temporarily exempted subject to further guidance
Measurement Methods	CET1/Capital Stock and Surplus for limit ratio numerator; CEM for OTC derivatives; add-on approach for SFT	Tier 1 capital for limit ratio numerator; SA-CCR for OTC derivatives

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Bank Regulatory Capital and Liquidity Developments

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June 2014

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US Regulatory Capital Framework

- In July 2013, the FRB, FDIC (interim final), and OCC approved a new comprehensive regulatory capital framework for US banking organizations (the Final Rule)
- The Final Rule combines the three June 2012 NPRs and includes several elements:
  - Implementation of Basel III international framework
  - Replacement of the Basel I risk-based capital regime with a new Basel II Standardized Approach
  - Revision of Basel II Advanced Approaches rules
  - Implementation of Dodd-Frank Act (“DFA”) capital-related requirements

US Regulatory Capital Framework: Scope

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- Final Rule applies to national banks, state member and nonmember banks, federal and state savings associations, top-tier US bank holding companies with more than $500M in consolidated assets and most top-tier savings and loan holding companies (banks)
  - Numerator of capital ratio and the Standardized Approach (SA) apply to all banks (SA also serves as Collins Amendment floor for Advanced Approaches (AA) banks)
  - AA apply to banks with more than $250B in consolidated assets, more than $10B in on-balance sheet foreign exposures, or that choose to opt in

US Regulatory Capital Framework: Scope

  - Market Risk Rule applies to banks with trading assets and trading liabilities equal to at least 10% of total assets or $1B
  - Leverage Ratio applies to all banks
  - Supplementary Leverage Ratio applies only to AA banks
    - Separate Supplementary Leverage Buffer proposal (discussed below) would apply to 8 US Global Systemically Important Banks (G-SIBs)
- Effective Date – January 2014 for AA banks and January 2015 for SA banks, with certain phase-in periods applicable to individual requirements
- Final Rule released with a separate proposal to conform the Market Risk Rule, which was adopted in December 2013

US Regulatory Capital Framework: Key Changes from June 2012 NPRs

- Residential Mortgages – Final Rule abandons proposed 35%-200% risk-weights based on LTV ratio and other loan characteristics
  - Retains existing 50% (first liens, prudently underwritten, less than 90 days past due, not modified (except HAMP)) and 100% (all others) risk-weights
- Accumulated Other Comprehensive Income (AOCI) – Final Rule requires AA banks to recognize AOCI in CET1 capital, but permits SA banks a one-time opportunity to opt-out of AOCI recognition on the March 31, 2015 Call Report and Form FR Y-9C (if applicable)

US Regulatory Capital Framework: Changes from June 2012 NPRs

- Collins Amendment – AA banks must apply the Collins Amendment capital floor (lower of AA or SA-calculated risk-based ratios) to calculate capital conservation (and any countercyclical) buffer (as well to calculate their minimum ratios)
- TruPS – Banks with less than $15B in assets may retain pre-DFA TruPS up to 25% of Tier 1 capital
- Early Payment Default Repurchase Obligations – Retains 120 day safe harbor for credit-enhancing representations and warranties on residential mortgage loan sales

US Regulatory Capital Framework: Changes from June 2012 NPRs

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- Non-US Sovereigns – Retains OECD (0%)/non-OECD (100%) distinction for countries not subject to OECD Country Risk Classifications (CRC)
- Mortgage Servicing Assets – Eliminates the existing 10% haircut on the fair market value for MSAs

US Regulatory Capital Framework: Numerator – Key Changes From Existing Rules

- New 4.5% Common Equity Tier 1 (CET1) ratio; 6% Tier 1 Capital ratio (up from current 4%); and 8% Total Capital ratio (same)
  - New 2.5% CET1 Capital Conservation Buffer to avoid limits on dividends/bonuses
  - AA banks subject to additional Countercyclical Capital Buffer of up to 2.5%

US Regulatory Capital Framework: Numerator Changes

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- 4% leverage ratio for all banks
  - Based on more restrictive Tier 1 Capital per numerator changes
  - Separate 3% supplementary leverage ratio (including off-balance sheet exposures) for only AA banks beginning in 2018
    - Federal banking agencies proposed modifications to the supplementary leverage ratio in April 2014
    - Proposed modifications reflect BCBS finalization of leverage ratio in January 2014 and would generally increase a bank's total leverage exposure (e.g., less favorable treatment for certain credit derivatives)

US Regulatory Capital Framework: Numerator Changes

- PCA Well-Capitalized Standards – 6.5% CET1 (new); 8% Tier 1 (up from 6%); 10% Total (same); 5% leverage ratio (same); and 3% supplementary leverage ratio for AA banks (new)
- More restrictive definitions of capital
- Stricter deductions/adjustments
  - TruPS
  - DTAs
  - Investments in unconsolidated financial institutions
  - AOCI
  - MSAs
  - Minority interests

US Regulatory Capital Framework:
Standardized Approach – Denominator Components

- Standardized total risk-weighted assets
  - Sum of
    1. Total risk-weighted assets for general credit risk
    2. Total risk-weighted assets for cleared transactions and default fund contributions (new)
    3. Total risk-weighted assets for unsettled transactions (new)
    4. Total risk-weighted assets for securitization exposures
    5. Total risk-weighted assets for equity exposures
    6. If applicable, standardized market risk-weighted assets
       Note: No operational risk add-on
  - Minus
    - Allowance for loan and lease losses not included in tier 2 capital

US Regulatory Capital Framework: Standardized Approach – Key Changes From Existing Rules

- Use of OECD CRC for non-US sovereign exposures
- 150% risk-weight for certain commercial real estate loans and for loans 90 days or more past due
- 20% credit conversion factor for short-term commitments
- Removes 50% risk-weight cap for OTC derivatives and provides more favorable treatment of cleared derivatives
  - US regulators indicated in the Final Rule that they would consider changes to QCCP exposure treatment in light of planned BCBS changes; BCBS issued a final standard in April 2014, but US regulators have not indicated how they intend to respond

US Regulatory Capital Framework: Standardized Approach – Key Changes From Existing Rules

- BCBS standardized approach (SA-CCR) for measuring counterparty credit risk exposures (March 2014)
  - Will replace the Current Exposure Method (CEM) and the Standardized Method (SM) in the capital adequacy framework on January 1, 2017 (internal models method remains)
  - US likely to adopt
  - Applicability in other contexts: supplementary leverage, SCCL, 23A, etc.

- Greater recognition of collateral and guaranties
- Securities firm exposures risk-weighted at 100% (up from 20%)
- More capital for equity exposures
  - See also BCBS December 2013 final standard

US Regulatory Capital Framework: Standardized Approach Changes

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- Final Rule securitization framework changes (covered in separate panel)
  - Broader scope of securitization exposures for SA banks
  - Replacement of ratings-based approach with Simplified Supervisory Formula Approach (SSFA)
  - 20% risk-weight floor for securitization exposures
  - 1250% risk-weight penalty for inadequate due diligence
  - In December 2013 the Basel Committee (BCBS) released a second proposal regarding changes to its securitization framework
    - Final Rule did not reference first BCBS proposal or explain how the final BCBS securitization framework would be integrated into the US Basel III rules

US Regulatory Capital Framework:
Advanced Approaches – Denominator Components

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- Advanced approaches total risk-weighted assets
  - Sum of
    1. Credit risk-weighted assets */
    2. Credit Valuation Adjustment risk-weighted assets
    3. Risk-weighted assets for operational risk
    4. If applicable, advanced market risk-weighted assets (i.e., advanced market risk measure x 12.5)
  - Minus
    - Excess eligible credit reserves not included in tier 2 capital

*/ <u>Credit – risk-weighted assets</u>
1.06 x (total wholesale and retail risk-weighted assets plus risk-weighted assets for securitization exposures plus risk-weighted assets for equity exposure)

US Regulatory Capital Framework:
Advanced Approaches – Key Changes From Existing Rules

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- Implements Basel 2.5 and III requirements addressing credit risk, credit valuation adjustment (CVA) risk, and wrong-way risk
  - Pending May 2014 proposal to expand the list of eligible guarantors for non-securitization exposures
- Incorporates DFA Section 939A credit ratings elimination
- Requires Internal Models Method (IMM) revisions that include stressed inputs and periodic review and validation
- Imposes increased capital requirements for exposures to all non-regulated financial institutions and large (over $100B) regulated financial institutions to address the correlation of credit risk among financial institutions

US Regulatory Capital Framework: Advanced Approaches – Parallel Run Exit

- In February 2014, the FRB and OCC permitted eight BHCs and twelve of their bank subsidiaries to exit their parallel runs and calculate regulatory capital using the Advanced Approaches method
  - BHCs: The Bank of New York Mellon Corporation, Citigroup Inc., The Goldman Sachs Group, Inc., JPMorgan Chase & Co., Morgan Stanley, Northern Trust Corporation, State Street Corporation, and US Bancorp

US Regulatory Capital Framework:
Market-Risk Rule – Key Changes From Existing Rules

- Final Rule incorporates into its framework the market-risk capital rule as amended in June 2012
- In December 2013 the FRB, FDIC, and OCC adopted amendments to the market-risk capital rule to conform its risk weights for sovereign exposures, non-publicly traded mutual funds, and certain student loans to the Final Rule

US Regulatory Capital Framework:
Enhanced Supplementary Leverage Ratio "Add-on"

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- In April 2014, the FRB, FDIC, and OCC adopted a:
  - 2% supplementary leverage buffer on top of the 3% supplementary leverage ratio for the 8 US G-SIBs; and a
  - 6% supplementary leverage ratio for insured depository institution ("IDI") subsidiaries of the 8 US G-SIBs to be considered well-capitalized under the prompt corrective action regime of the FDIA
    - Applies to JPMorgan Chase, Citigroup, Bank of America, Wells Fargo, Goldman Sachs, Morgan Stanley, Bank of New York Mellon, and State Street and their IDI subsidiaries
    - Ratio must be reported beginning in Q1 2015, but compliance is not required until the effective date of January 1, 2018
    - Takes into account lower BCBS ratio, but rejects competitive inequality arguments
  - Separate NPR proposing denominator changes (largely based on BCBS January 2014 revisions) for supplementary leverage ratio for all AA banks; comments due June 13, 2014
    - Includes sold protection under credit derivatives, modified exposure calculations for derivatives and repo-style transactions, and revised credit conversion factors for off-balance sheet exposures

US Liquidity Coverage Ratio

- US LCR proposal released October 24, 2013; published November 29, 2013; comment period closed January 31, 2014
- Requires sufficient amount of unencumbered high quality liquid assets (HQLA) to meet 30-day stressed liquidity needs
- Similar in structure to BCBS final rule from December 2010 (as amended in January 2013), but stricter in many respects
  - Issued prior to January 2014 BCBS modifications which permit greater use of central bank committed liquidity facilities as HQLAs, and contain disclosure standards and guidance to regulators to promote consistency

US Liquidity Coverage Ratio: Scope

- US proposal would apply only to largest US banks:
  - AA banks (i.e., $250 billion or more assets or $10 billion or more on-balance sheet foreign exposures)
    - And insured depository institutions subsidiaries with $10 billion or more in assets
    - But not banks that have opted into Advanced Approaches
  - Non-bank SIFIs
- US banks with $50-$250 billion in assets would get less stringent version (21 v. 30-day stress period; reduced outflow test)
- Regulators retain discretion to add others/increase ratio
  - US branches/agencies and foreign bank parents were separately addressed in the February 2014 Section 165 enhanced prudential standards

US Liquidity Coverage Ratio: Components

- HQLA is the sum of Level 1 and Level 2 Assets
  - Level 1 assets include FRB balances, US government securities, and certain marketable securities backed by 0% risk-weighted non-US sovereigns and central banks
  - Level 2 assets is the sum of Level 2A assets and Level 2B assets
    - Level 2A assets include certain US GSE obligations, obligations of 20% risk-weighted sovereigns (subject to 15% haircut; total can't exceed 40% of HQLA)
    - Level 2B assets include investment grade publicly-traded corporate bonds, publicly-traded common shares included in S&P 500 index or equivalent (subject to 40% haircut; total can't exceed 15% of HQLA)
  - Amount of HQLA is its fair value regardless of its value for financial reporting purposes

US Liquidity Coverage Ratio: Calculations

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- Denominator is total net cash outflows = expected cash outflows, minus total expected cash inflows, for the 30 (or 21)-day stress period
- Outflows and inflows are calculated by multiplying balances in various categories by standardized expected runoff rates based on various factors
  - runoff rates range from 3% for stable retail deposits that are fully FDIC insured, to 40% for uninsured retail brokered swap deposits (irrespective of maturity)
  - range from 25% for certain operational deposits (deposits in return for services) to 100% for commercial paper or nonoperational deposits from financial entities (including central banks and multilateral banks)
    - General outflow rate is 40%

US Liquidity Coverage Ratio: Calculations

- Outflows for secured short-term borrowings range from 0% (collateral=Level 1 HQLA) to 100% (collateral is not HQLA)
- Outflows for commitments range from 5% (for retail credit) to 40% (for most corporate credit facilities) to 100% (SPEs, nonbank financial institutions)
- Similar approach for inflows (e.g., 50% for retail customers and non-regulated financial institutions; 100% from regulated financial institutions)
  - Subject to overall cap of 75% of outflows

US Liquidity Coverage Ratio: Differences Between US and BCBS LCRs

- Accelerated Transition Period for LCR Compliance

Final Compliance US LCR: 1/1/17

Phase in:	80%	1/1/15
	90%	1/1/16
	100%	1/1/17

Final Compliance BCBS LCR: 1/1/19

Phase in:	60%	1/1/15
	70%	1/1/16
	80%	1/1/17
	90%	1/1/18
	100%	1/1/19

- Peak Net Outflow Day Test

US test: highest net outflow day in 30-day period with first day assumption for non-contractual deposits and commitments

BCBS Test: highest net outflow on last day of 30-day period

Liquidity Coverage Ratio: Differences Between US and BCBS LCRs

- More restrictive HQLA definition (closer to BCBS Dec. 2010 original version than the more expansive BCBS Jan. 2013 version)
  - No GSE obligations in Level 1 (rather Level 2A)
  - No highly rated AAA ABS or MBS in Level 2B
  - Proposed exclusion of covered bonds state/municipal securities from HQLA (though comment requested)
  - Investment grade corporate bonds as Level 2B rather than 2A (higher haircuts/caps)
  - FFELP ABS apparently excluded as not wholly guaranteed

Key Industry Comments on US LCR Proposal

- Departures from BCBS LCR only when US unique circumstances warrant
- Relief from impact of assumed first day outflow for all non-contractual deposits and commitments in calculating "peak day" net cash outflows
- At least temporary deferral of daily calculation requirement due to operational burdens
- Eliminate separate LCR requirement for bank subsidiaries
- Broaden definition of HQLA, including in particular elevating Fannie and Freddie ABS to Level 2A or removing 40% cap
- Modify calculation methods for net cash outflows

US Capital Plans and Stress Testing

- CCAR v. Dodd-Frank stress tests (DFAST)
  - Both include supervisory and company-run stress tests; DFAST uses standardized capital action adjustments (e.g, no changes in dividend levels), CCAR uses company's own plans
  - CCAR and DFAST apply only to $50B+ BHCs, but company-run component of DFAST applies to all $10B+ BHCs and banks; FBOs covered in Section 165 enhanced prudential standards
  - CCAR has qualitative assessment of capital planning; DFAST is purely quantitative
  - CCAR is annual; DFAST is semi-annual
  - Both involve disclosure of supervisory stress test results; CCAR includes disclosure of FRB decision on capital plan
  - DFAST pre-tax net income forms the basis for CCAR post-stress capital levels and ratios

US Capital Plans and Stress Testing

- March 2014 – CCAR review results announced
  - 25 banks passed; 4 failed for qualitative reasons; 1 failed for quantitative reasons
    - First year all $50B+ BHCs were included in CCAR and D-FAST
    - All BHCs could adjust proposed distributions after preliminary CCAR post-stress capital analysis (not just if rejected)
    - FRB released nature, but not details, of objections
    - One bank that initially passed was forced to suspend its dividend and re-submit its plan in May 2014 after discovering errors in its capital treatment of certain realized gains and losses on structured notes
  - DFAST results were re-stated by the FRB the week after they were released due to errors in calculations

Global Systemically Important Banks (G-SIBS)

- November 2013 – FSB progress report and designations
  - Annual G-SIB provisional designations updated: Industrial and Commercial Bank of China added; none removed
    - Each G-SIB assigned to capital surcharge bucket (1-2.5%)
    - Final designations in November 2014; surcharges phased in from January 2016 to January 2019
  - Governor Tarullo signaled in February 2014 testimony that the FRB would implement G-SIB surcharges based the BCBS's approach that sets the size of the surcharge for an individual G-SIB based on the firm's systemic importance

Domestic Systemically Important Banks (D-SIBs)

- October 2012 – D-SIB framework released by BCBS
  - Scales down the G-SIB regime for the impact that the distress or failure of banks would have on a domestic economy
    - Higher capital and enhanced supervision
    - Arrangements for home-host country coordination
    - Keyed to same timeline as G-SIB regime
  - FRB has not released a US D-SIB proposal, but is taking steps to identify US D-SIBs and is considering the appropriate framework for regulation
    - Use $50B threshold for enhanced prudential standards?
    - OCC considering as well

US Regulatory Capital and Liquidity: Still to Come

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- Liquidity Coverage Ratio
  - FRB to finalize October 2013 NPR with target effective date of January 1, 2015
- Net Stable Funding Ratio (NSFR)
  - FRB proposal to be issued; BCBS released proposed revisions to its NSFR standard in January 2014
- Supplementary Leverage Ratio
  - Agencies to finalize April 2014 proposed modifications to the denominator calculation to reflect changes made by BCBS in January 2014; comment period ended June 13, 2014

US Regulatory Capital and Liquidity: Still to Come

- Minimum long-term debt requirement NPR for G-SIBs
- Short-term Wholesale Funding ANPR
  - FSB issued a policy framework in August 2013 to address the shadow banking risks in the securities lending and repos market
  - Governor Tarullo outlined two potential proposals to address the risks posed by short-term wholesale funding in a November 2013 speech
- Internal Ratings-Based (IRB) Approach
  - Governor Tarullo indicated in a May 2014 speech that US, ideally through BCBS, should discard the IRB approach because of its risks of gaming, mistake, and monitoring difficulty

BCBS Regulatory Capital: Pending Initiatives

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- BCBS Regulatory Consistency Assessment Program
  - Level 1: ensuring the timely adoption of Basel II/III
  - Level 2: ensuring regulatory consistency with Basel II/III
  - Level 3: ensuring consistency of risk-weighted asset (RWA) outcomes
- Level 1: Basel III rules finalized in all 27 member jurisdiction (April 2014)
- Level 2: Jurisdictional consistency assessments (January 2013, July 2013, and December 2013):
  - Preliminary assessments complete: European Union and United States
  - Final assessments found Basel III compliance: Australia, Brazil, China, Japan, Singapore, and Switzerland
  - Final assessments underway: Canada, European Union, Hong Kong, Mexico, United States
  - Final assessments planned: South Africa, Saudi Arabia, Russia, Argentina, Turkey, South Korea, Indonesia

BCBS Regulatory Capital: Pending Initiatives

- Level 3:
  - Second report on the regulatory consistency of RWAs for market risk in the trading book found, consistent with the findings from the first report, significant variation in the outputs of market risk internal models (December 2013)
    - Also found that variability typically increases for more complex trading positions
    - Second report included a re-run of a number of portfolios from the first report and extended the analysis to more representative and complex trading positions drawn from all major asset classes: equities, interest rates, foreign exchange, commodities and credit.
  - First report on banking book found a high degree of consistency in banks' assessment of the relative riskiness of obligors, but found differences in the levels of estimated risk that banks assign to portfolios due to variation in the average RWAs for credit risk (July 2013)
    - Effect of variation in the banking book on Tier 1 capital ratio ranged from -2.2% to +1.8%

BCBS Regulatory Capital: Pending Initiatives

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- Implementation
  - Implementation of the standardized approach (SA-CCR) for measuring counterparty credit risk exposures (March 2014)
    - Will replace the Current Exposure Method (CEM) and the Standardized Method (SM) in the capital adequacy framework on January 1, 2017
- Proposals
  - Proposed comprehensive revisions to the trading book capital requirements (May 2012 and October 2013)
  - Proposed fundamental changes to securitization framework (December 2012 and December 2013) (covered in afternoon panel)
  - Proposed changes for high-cost credit risk protection (March 2013)

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NONBANK SIFI

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Nonbank SIFI Designation by FSOC

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- Section 113 of Dodd-Frank Act authorizes Financial Stability Oversight Counsel (FSOC) to determine that a nonbank financial company (predominantly engaged in financial activities) should be subject to supervision by Federal Reserve if material financial distress at nonbank financial company could pose threat to financial stability of US
- Three stage process for designation outlined in FSOC final rule and guidance (April 2012)
- Designation criteria intended to apply to all financial entities regardless of sector but may tailor criteria

Nonbank SIFI Designation by FSOC

- Company advances to stage 2 if meets total consolidated assets threshold **and** any of the other thresholds:
  - Total consolidated assets – more than $50 billion
  - Credit default swaps outstanding - $30 billion in gross notational credit default swaps outstanding
  - Derivatives liabilities – $3.5 billion of derivatives liabilities
  - Total debt outstanding – $20 billion of outstanding debt
  - Leverage ratio – 15:1 ratio of total consolidated assets to total equity
  - Short-term debt ratio – ratio of total debt outstanding (w/ maturity of less than 12 months) to consolidated assets of 10%

Nonbank SIFI Designation by FSOC

- In stage 2, FSOC will perform comprehensive analysis of potential for nonbank financial company to pose a threat to US financial stability
- Analysis based on a broad range of quantitative and qualitative information available to FSOC through existing public and regulatory sources, and information obtained from company voluntarily
- Consider impact that resolving company could have on US financial stability
- Consult with primary regulator of each significant subsidiary

Nonbank SIFI Designation by FSOC

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- In stage 3, company will receive a notice that it is under consideration by FSOC
- Notice will include a request that company provide information that FSOC deems relevant to the FSOC's evaluation
- Stage 3 analysis will build upon stage 2 analysis and include an evaluation of the company's resolvability
- FSOC must provide notice to company when its evidentiary record is complete and make a proposed determination within 180 days after the notice

Nonbank SIFI Designation by FSOC

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- FSOC may, by a vote of two-thirds of its members, make a proposed determination
- FSOC will provide written notice of proposed determination to the company with explanation
- Company has 30 days to request nonpublic hearing before the FSOC
- FSOC has 60 days to make a final determination
- Company can contest final determination in US district court but review limited to whether determination was arbitrary and capricious

Nonbank SIFI Designation by FSOC

- FSOC has designated three entities to date: AIG, GE Capital and Prudential
- Public reports indicate that MetLife is in Stage 3 of the evaluation process
- FSOC considering other sectors (e.g., asset managers, finance companies, reinsurance)

Nonbank SIFI Designation by FSOC

- Ramifications of designation by FSOC
  - Supervision by the Federal Reserve
  - Subject to the prudential standards in Section 165 of the Dodd-Frank Act as modified by the Federal Reserve
    - Federal Reserve has not yet issued standards for designated entities
    - Federal Reserve has hired former Connecticut Insurance Commissioner and indicated that it will hire other individuals with subject matter expertise to assist
  - Possibly at competitive disadvantage to peer firms not designated as nonbank SIFIs

Nonbank SIFI Designation by FSOC

- Public and political criticism of the process
  - Recent Congressional hearings have been critical of level of transparency and due process in designating firms
  - Process influenced by international determinations by Financial Stability Board and G-SIFI designations
  - Supervisory standards not yet determined by Federal Reserve
  - Limited knowledge of underlying industries (e.g. OFR report on asset management and financial stability)
  - "Turf" battle between federal agencies on FSOC

Nonbank SIFI Designation

- Next steps
  - FSOC to address concerns and possibly increase transparency
  - Federal Reserve to develop regulatory standards and hire necessary personnel
  - Large participants in certain sectors will try to mitigate risk of designation
    - Educate FSOC about industry
    - Develop Congressional allies
    - Actively manage balance risk and risk profile

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Contending with the "New Normal": Regulatory, Supervisory and Enforcement Challenges in the Post-Dodd-Frank Environment

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Forecasting the Impact of Whistleblowing

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Background

- Dodd-Frank Act Section 922 created a new whistleblower program and protections at the SEC that:
  - Provide for awards to individuals who inform the SEC of violations of the their enabling statutes;
  - Prohibit employers from retaliating against whistleblowers; and
  - Grant whistleblowers a private cause of action for retaliation against them by their employer
- The SEC adopted rules in 2011 to implement its program and interpret the statutory provisions more fully

Whistleblower Definition

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- Dodd-Frank Act Section 922

  The term “whistleblower” means any individual who provides, or 2 or more individuals acting jointly shall provide, information relating to a violation of the securities laws to the Commission, in a manner established, by rule or regulation, by the Commission.

  17 C.F.R. Section 240.21F-2

“A whistleblower must be an individual. A company or another entity is not eligible to be a whistleblower.”

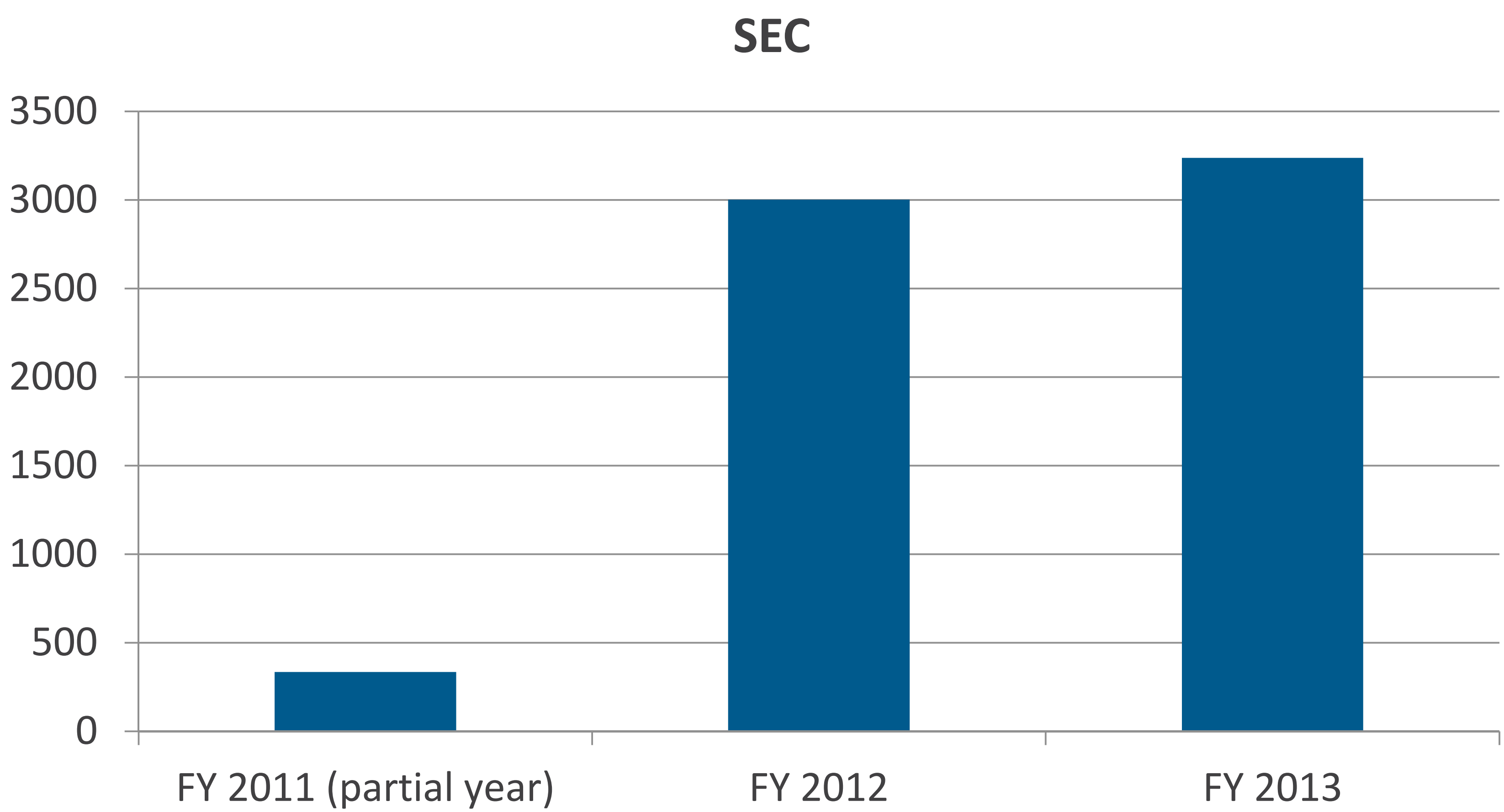
General Program Procedures

- First, a person submits original information to the SEC about a violation of the respective enabling statutes
- Second, the agency obtains monetary sanctions in excess of $1M through a judicial or administrative action or a related action by another agency
- Third, the agency publishes a notice indicating that whistleblowers may claim an award for the action
- Fourth, the person who submitted the original information files a request for an award
- Fifth, the agency reviews the request and grants an award of 10%-30% of the amount of the monetary sanction actually collected by the agency

Program Statistics

- During the 2012 fiscal year, the SEC:
  - Received 3,001 whistleblower tips;
  - Published 143 notices of cases eligible for an award;
  - Granted one request for an award to one whistleblower
- During the 2013 fiscal year, the SEC:
  - Received 3,238 whistleblower tips;
  - Published 118 notices of cases eligible for an award; and
  - Granted 4 requests for awards to whistleblowers

Whistleblower Complaints



Notices of Covered Action

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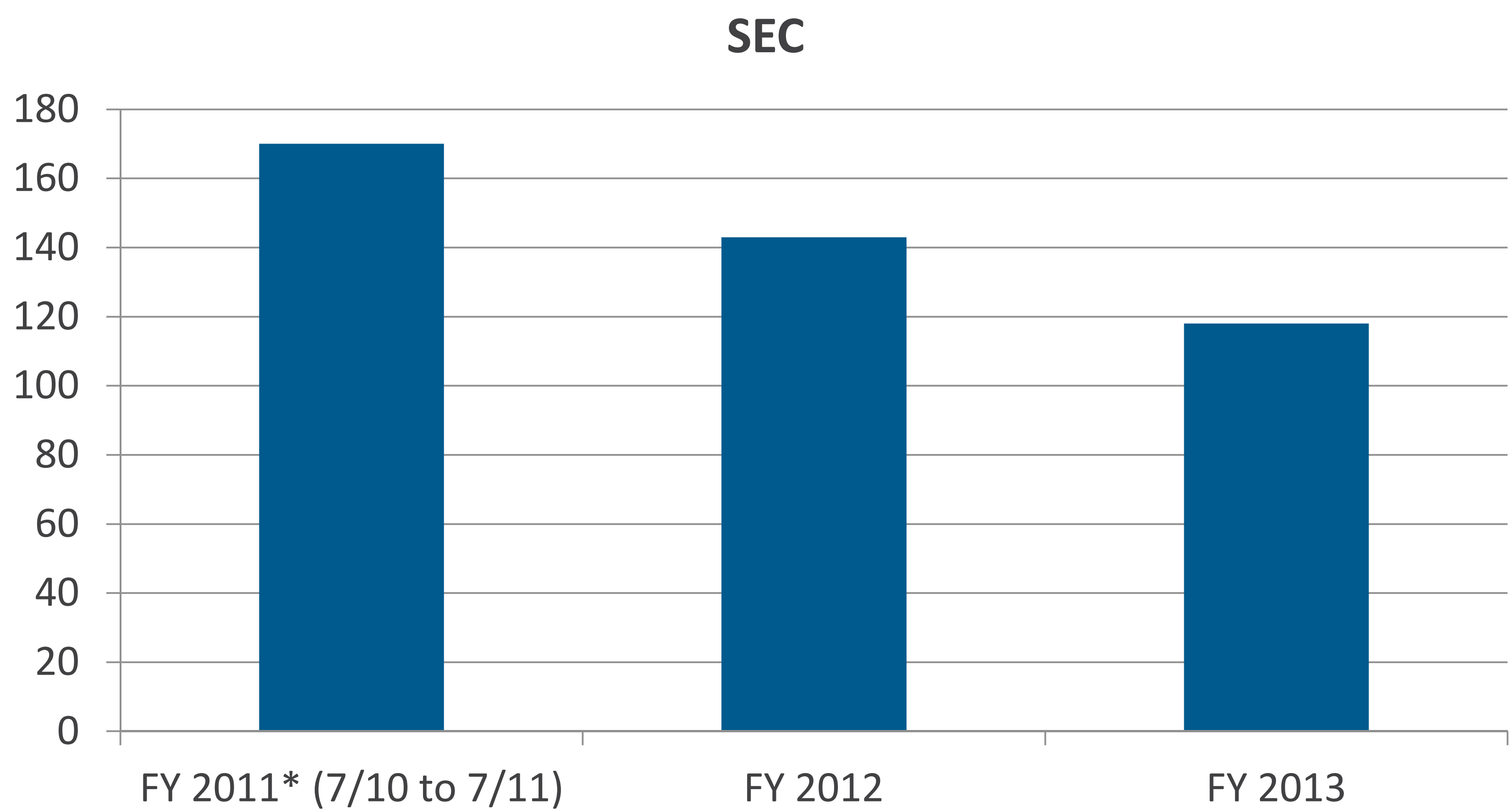

Other Whistleblower Programs

- Commodity Futures Trading Commission
  - Dodd-Frank Act Section 748
- Internal Revenue Service
  - Title 26, United States Code, Section 7623(a)
- False Claims Act
  - Title 31, United States Code, Sections 3729-3733

Qui Tam/False Claims Act Claims Over Time

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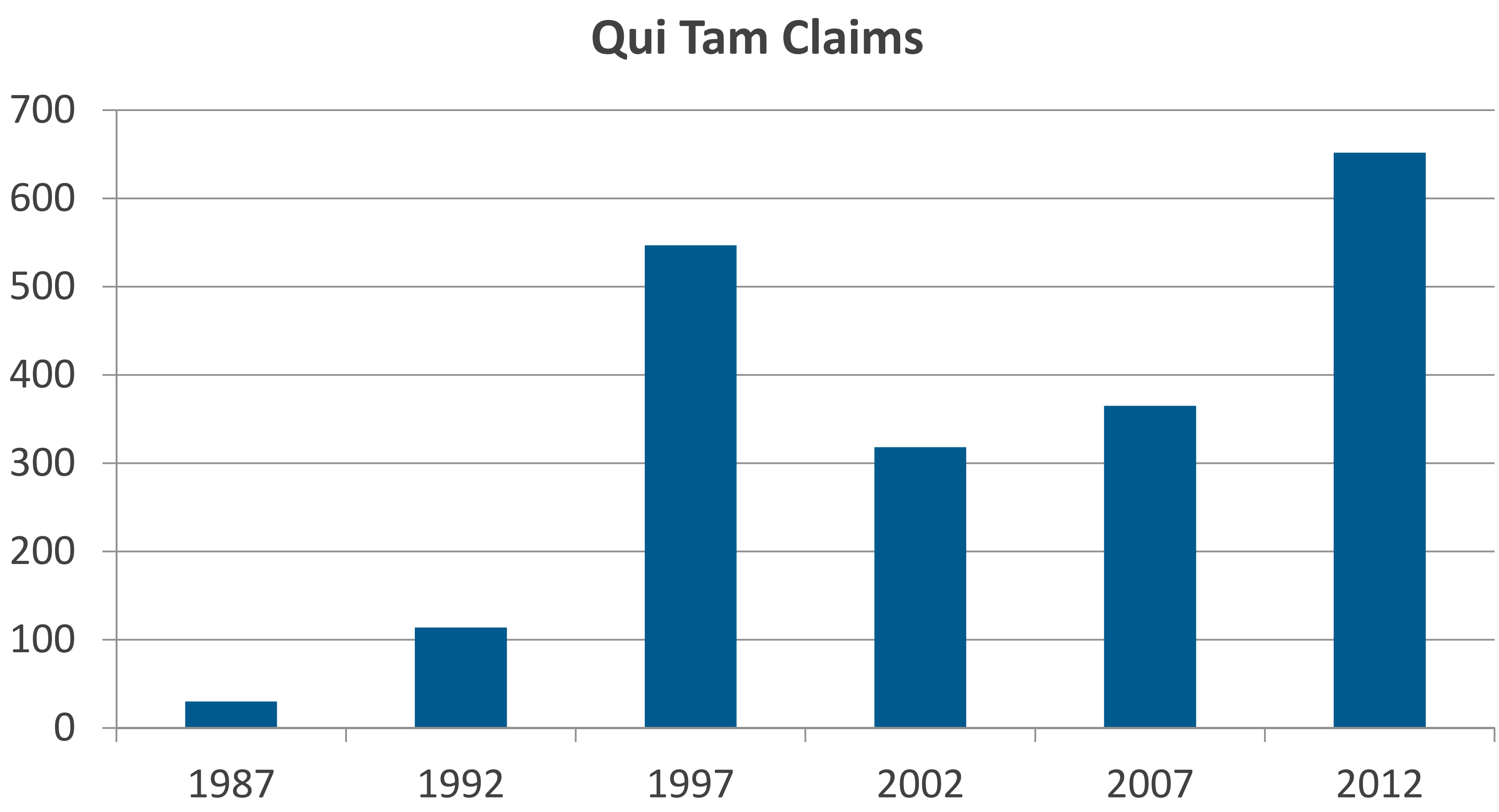

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Protections

- Separate from the agency-run programs, whistleblowers are protected against retaliation by their employer when they:
  - Submit information under the agency-run programs;
  - Cooperate in an agency action or investigation related to such information; or
  - In the case of the SEC, make disclosures that are required or protected by Sarbanes-Oxley or another federal securities law
- Protections may be enforced by private plaintiffs, who may obtain reinstatement, back-pay, and litigation costs

Scope of Protections

- In 2013, *Asadi* limited the scope of the protections to individuals who provide information to the agencies
  - Fifth Circuit in *Asadi* rejected SEC's regulatory definition of a whistleblower as inconsistent with the statutory text
  - Currently unsettled law that is on appeal before Second Circuit in *Liu;* district courts all over the map in adopting *Asadi*
- Trial courts in *Asadi* and *Liu* rejected extraterritorial application of protections
  - *Liu* on appeal before the Second Circuit
- Unsettled question of agencies' extraterritorial enforcement authority for the private right of action

Hot Topics/Areas to Watch

- Possible Trends
  - Foreign Corrupt Practices Act violations (complaints up 30%)
  - Offering fraud (complaints up 19%)
  - Trading and pricing violations (complaints up 17%)
  - Market manipulation (complaints up 15%)
- Activities
  - SEC enforcement of anti-retaliation protections

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When Regulated Entities are Expected to Regulate

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Indirect Regulation

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- State and federal regulators, State Attorneys General and the Department of Justice are directly and indirectly pressuring banks and other regulated entities to police the financial services industry
- Regulators view indirect regulation as a faster way of addressing difficult regulatory and jurisdictional issues
- While not a new practice, the frequency and potential penalties have increased over the past few years
- Potential for increased use as more products are offered by the shadow banking industry rather than banks

Indirect Regulation

- DOJ's Operation Choke Point
  - DOJ initiative intended to cut-off access to payment services for certain businesses (including online payday lenders)
  - Issued subpoenas to numerous banks processing payments
  - Negative impact on lawful businesses seeking payment services
- NYSDFS (August 2013)
  - Issued cease and desist orders against 35 payday lenders
  - Sent letters to 100+ banks asking not to process payments
  - Sent letters to licensed debt collectors asking not to collect

Indirect Regulation

- Dealer mark-ups
  - CFPB investigating banks and finance companies paying discretionary compensation to motor vehicle dealers for loan originations
  - CFPB lacks authority over the dealers but trying to change compensation practices through pressure on lenders
- Vendor oversight
  - CFPB and banking agency guidance regarding vendor oversight
  - Enforcement actions for failure to oversee service providers
  - Agencies have authority over vendors but lack resources

Indirect Regulation

- Assignee liability imposed on secondary market purchasers of certain types of mortgage loans
  - Ability to repay requirement (Qualified Mortgages)
  - HOEPA/Section 32 mortgage loans
  - State high-cost mortgage loans
- Assignee liability has been ineffective way of regulating and highlights one of problems with indirect regulation
  - Secondary market participants have stayed away
  - Led to elimination of products rather than enhanced regulation

Is There a Capital Markets Angle?

- Recent focus on payment processors but others could face similar scrutiny
- DOJ, CFPB and state regulators could easily expand indirect regulation approach to others providing assistance to same businesses
- Potential targets could include -
  - Financing sources for these businesses
  - Purchasers of consumer credit receivables
  - Persons structuring, arranging or developing consumer financial products or services

Jurisdiction and Theories of Liability

- CFPB has jurisdiction over persons offering consumer financial products, service providers to those persons and related persons
- Section 1031 of Dodd-Frank Act prohibits any covered person or service provider from engaging in any unfair, deceptive or abusive act or practice
- Section 1036 of Dodd-Frank Act makes it unlawful for any person to knowingly or recklessly provide substantial assistance to a covered person or service provider who is violating Section 1031

Ways to Mitigate the Risk

- Customer due diligence is essential
- Understanding the business and regulatory climate
  - Customer's business model and affiliated entities
  - Customer's primary regulators
  - Litigation, enforcement actions and consumer complaints
- Identifying those activities with higher risks
  - Consumer-related services
  - Developing consumer financial products or services
  - Establishing marketing, origination or collection practices

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Recent Developments in Securitization

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Regulatory Update

THE CONTINUING IMPACT OF
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- Introductory Remarks
- Regulation AB Proposals (Reg AB II)
- GSE Reform
- Bank Regulatory Capital
- Risk Retention
- Qualified Mortgages, CFPB Servicing Rules
- Leverage Ratio, LCR and NSFR
- Some Effects on Market of Bank Regulatory Changes
- Money Market Fund Reform
- Conflicts of Interest

Reg AB II and Shelf Availability

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- Process and timing for Reg AB II
  - Pre-Dodd-Frank original Reg AB II Release
  - Dodd-Frank addressed several of the topics covered in the original Reg AB II Release
  - Subsequent Release issued on July 26, 2011 with additional SEC questions and proposals. Comment Period ended more than 15 months ago
  - SEC re-opened comment period on Reg AB 2; Comment period ends April 28, 2014
  - Expect a one year transition period after final rules are issued -- new Rules probably won't apply until some time in 2015 at earliest
- Some important original Reg AB II proposals
  - Public-style disclosure for private offerings
  - Changes to eligibility requirements for shelf registration
    - Replacement of investment grade rating requirement with Executive Officer Certification
    - Five business day waiting period prior to pricing/sale of securities
  - "Pay as you go" Registration fees
- Holdup is privacy issues on loan-level data, which would be required both in prospectus and ongoing reports

Reg AB II – Web site proposal for asset-level data

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- New SEC proposal on asset-level data, comment period has expired
- Instead of filing asset-level data, issuers would be required to make it available on an issuer web site
  - Access could be restricted for potentially sensitive data
  - Intended to address privacy concerns
  - Issuers could determine who is a potential investor and determine their own procedures and controls to comply with privacy laws
  - Issuers could require confidentiality agreements
  - All of the asset-level data would be available on the web site
- A copy of the sensitive information would be filed with SEC in a non-public filing
  - SEC "believes" it would be exempt from FOIA requests
- Prospectus would disclose the web site address and would incorporate the web information by reference
- Web site must be free of charge for investors and potential investors
- Data must remain on web site for five years

Reg AB II Web site proposal – US Privacy Laws

- Gramm-Leach-Bliley Act (GLBA) and state laws addressing safeguarding customer information
- State data breach notification laws
- Unfair or deceptive acts or practices
- Fair Credit Reporting Act (FCRA)
  - Imposes obligations on "consumer reporting agencies"
  - There's no safe harbor from FCRA liability: Uncapped statutory damages, and a private right of action under FCRA for non-compliance.
    - Courts have characterized the FCRA liability scheme as "ruinous," "annihilating," "crippling," and "catastrophic"
- State credit reporting laws

Reg AB II Web site proposal – Some Issues

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- Can you share info under Gramm-Leach Bliley Act exceptions?
  - There's a "Required by Law " exception, but you're not required by law to securitize
- What about security of personal information posted to website and potential breaches (e.g., hackers)?
- What are implications under FCRA of disclosing credit scores and other information to investors?
  - Risk of data being re-identified or de-anonymized would remove exemption for ananymized data
- Industry comments are requesting safe harbors from liability under privacy laws
  - CFPB is sympathetic, but there won't be a quick fix

Reg AB II Website Proposal – Some Issues

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- Can anything released to investors truly be expected to remain confidential?
  - What if an investor wants to buy a small amount of bonds but really wants to steal the private information?
  - Sponsor has liability and reputational risk if an investor breaches its confidentiality agreement
  - How do you confirm who is a "real" investor?
  - Could there be indemnification from investors? Could you require assurance that the investor is creditworthy?
  - Can you watermark or otherwise have metadata that would identify who violated their confidentiality agreements?
  - Can you just provide the information to investors in subordinated or non-investment grade bonds?

Reg AB II Website Proposal – Some Issues

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- Hard to evaluate proposal without knowing what information final rule will require, including:
  - Not just at the time of the prospectus, but also in periodic reporting.
  - Not just public deals but also 144A and other private deals
  - How does this affect floorplan grouped data proposal?
- What access controls will be permissible? Can you restrict competitors from getting the information?
- Why would someone want to get a loan from a securitizer if they could get a loan from someone who would never disclose their information?
- Selective disclosure concerns if issuer does not allow access to a particular investor
  - Will underwriters accept strict liability for omissions if the asset-level data not made available to all investors?
- Investors are insisting that they get the data
  - They want to manipulate the data, and to track the loans over time
  - Some investors have proprietary models, and others will engage third parties to help them manage the data
  - Investors currently do not want duties to preserve confidentiality
  - Liquidity risk: If you're an investor, how do you know issuer will make it easy for potential future buyers to get the information?

Reg AB II Website Proposal – Some Issues

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- Contractual considerations
  - Agreement with credit bureaus may preclude disclosure of credit scores to third parties
  - Company's privacy policy may be more restrictive than applicable law
- Will anyone ever do a public ABS deal again?
- Possible solution: Can you hire a licensed credit reporting agency to host the loan-level website?
- International Issues
  - Inefficient for non-US sponsors who might have other asset-level reporting regimes (e.g., Bank of England liquidity program) which don't track these requirements
  - Might you potentially be required to violate privacy laws of other countries if you are securitizing non-US receivables?

Reg AB II – How it Might Affect the Market

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- Regulation AB currently affects only registered public offerings of asset-backed securities
- The proposed rules would affect all 144A transactions, and possibly could also affect ABCP conduit financings

Regulatory Update

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A Brief Background

1989
- Basel I adopted in US
- Sets minimum capital requirements for banking institutions based on risk weighted (RW) assets
- Assets grouped into five categories and assigned RW based on credit risk

1996
- Market risk rule issued by Basel and adopted in US
- Add-on to risk-based capital requirements to cover "trading book" exposures

2002
- US Basel I modified to add recourse rules and ratings based approach (RBA) for ABS ("Modified Basel I")

2004
- Basel II issued internationally

2007
- Basel II Advanced Approaches adopted in US ("US Basel II")
- (2008) Basel II Standardized proposed in US but never adopted

2009
- BCBS 2.5 (regarding resecuritiza-tions, changes to market-risk rules re VaR and others ("Basel 2.5")

2010
- Basel III issued internationally
- Dodd-Frank (939A ratings ban; Collins Amendment)

2012
- (May) Basel proposes revised market risk framework
- (June) US regulators adopt three notices of proposed rule making ("US NPRs"), and final rule which would implement Basel 2.5 revisions to Market Risk Rule, Basel III, Basel II SA, and Dodd Frank 939A
- (December) Basel Consultative Document issued with global revisions to Securitisation Framework ("December 2012 Proposal")

2013
- (July) FRB, FDIC (interim final) and OCC approve comprehensive regulatory capital framework (similar to US NPRs) (the "US Final Rule")
- (December) Basel issues a second consultative document with global revisions to Securitisation Framework ("December 2013 Proposal")

2014
- Basel releases formal text for and guidance on leverage and liquidity requirements under Basel III

US Final Rule Introduction

- In July 2013, the FRB, FDIC (interim final), and OCC approved a new comprehensive regulatory capital framework for US banking organizations

- The US Final Rule combines the three June 2012 NPRs and includes several elements:
  - Implementation of Basel III international framework
  - Replacement of the Basel I risk-based capital regime with a new Basel II Standardized Approach
  - Revision of Basel II Advanced Approaches rules
  - Implementation of Dodd-Frank Act (DFA) capital-related requirements

Scope of US Final Rule

- US Final Rule applies to national banks, state member and nonmember banks, federal and state savings associations, top-tier US bank holding companies with more than $500M in consolidated assets and most top-tier savings and loan holding companies (banks)
  - Numerator of capital ratio and the Standardized Approach (SA) apply to all banks (SA also serves as Collins Amendment floor for Advanced Approaches (AA) banks)
  - AA apply to banks with more than $250B in consolidated assets, more than $10B in on-balance sheet foreign exposures, or that choose to opt in

Scope of US Final Rule

- Market Risk Rule applies to banks with trading assets and trading liabilities equal to at least 10% of total assets or $1B
- Leverage Ratio applies to all banks
- Supplementary Leverage Ratio applies only to AA banks
    - Separate Supplementary Leverage Buffer proposal would apply to 8 US Global Systemically Important Banks ("G-SIBs")

- Effective Date – January 2014 for AA banks and January 2015 for SA banks, with certain phase-in periods applicable to individual requirements

US Final Rule Numerator Nutshell

- Better Quality Capital Required
- Stricter Deductions
- More Capital Required
- New Leverage Requirement (for AA Banks) and New Common Equity Tier 1 Requirement
- Phase-in Through 2019

US Final Rule Numerator – Key Changes From Existing Rules

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- New 4.5% Common Equity Tier 1 (CET1) ratio; 6% Tier 1 Capital ratio (up from current 4%); and 8% Total Capital ratio (same)
  - New 2.5% CET1 Capital Conservation Buffer to avoid limits on dividends/bonuses
  - AA banks subject to additional Countercyclical Capital Buffer of up to 2.5%
- 4% leverage ratio for all banks
  - Separate 3% supplementary leverage ratio (including off-balance sheet exposures) for only AA banks beginning in 2018

US Final Rule Numerator Changes

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- PCA Well-Capitalized Standards – 6.5% CET1 (new); 8% Tier 1 (up from 6%); 10% Total (same); 5% leverage ratio (same); and 3% supplementary leverage ratio for AA banks (new)
- More restrictive definitions of capital
- Stricter deductions/adjustments
  - TruPS
  - DTAs
  - Investments in unconsolidated financial institutions
  - AOCI
  - MSAs
  - Minority interests

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Capital Rules Denominator Nutshell for Practitioners

- Smaller is Better/Less is More
- Most Transactions Create a Bank Exposure that adds to Denominator
- Potential to Shrink, Restructure, Recharacterize

Comparing Capital Ratio Denominators Under Modified Basel I, US Basel II, US Final Rule and December 2013 Proposal

Modified Basel I Denominator Components

- Asset risk weights
  - OECD sovereigns: 0%
    - Others: 100%
  - OECD banks: 20%
    - Others: 20% short-term; 100% long-term
  - Residential mortgages: 50%
    - 100% if not prudently underwritten
  - Asset-Backed Securities (optional): Ratings Dependent
  - Everything else: 100%

- Sample capital calculation

$$\frac{\text{Required Capital}}{\text{RWA}} = 8\%$$

  - $100 million corporate exposure
  - 100% risk weight = $100 million risk weighted assets (RWA)
  - Capital charge =
  - Capital charge: $8 million

Modified Basel I Denominator Components

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- Off-balance sheet exposures
  - **Credit conversion factors**
    - Unfunded commitments under one year (or unconditionally cancellable): [0% changed to 10% for US banks]
    - Unfunded commitments over one year: 50%
    - Guarantees: 100%
    - Assets sold with recourse: gross up
  - **Sample capital calculation**
    - $1 billion long-term corporate loan commitment
    - 50% Credit Conversion Factor (CCF) x 100% (risk weight)
      $1 billion x 50% x 100% = $500 million
    - Capital charge = $\frac{\text{Required Capital}}{\text{RWA}}$ = 8%
    - Capital charge = $40 million

US Basel II (Advanced) Denominator Components

Sum of:

1. Wholesale Exposures
   - Use PB, LGD, EAD and M inputs, loan by loan
2. Retail Exposures
   - Use PD, LGD and EAD inputs, segment by segment
3. Equity Exposures
4. Securitization Exposures
   - Hierarchy of Approaches
     – Ratings Based Approach (including inferred)
     – SFA/IAA
     – Deduction from Capital

US Final Rule Standardized Denominator Components

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- Standardized total risk-weighted assets
  - Sum of
    1. Total risk-weighted assets for general credit risk
    2. Total risk-weighted assets for cleared transactions and default fund contributions (new)
    3. Total risk-weighted assets for unsettled transactions (new)
    4. Total risk-weighted assets for securitization exposures
    5. Total risk-weighted assets for equity exposures
    6. If applicable, standardized market risk-weighted assets
       Note: No operational risk add-on
  - Minus
    - Allowance for loan and lease losses not included in tier 2 capital

US Final Rule Advanced Approaches Denominator Components

- Advanced approaches total risk-weighted assets
  - Sum of
    1. Credit risk-weighted assets */
    2. Credit Valuation Adjustment risk-weighted assets
    3. Risk-weighted assets for operational risk
    4. If applicable, advanced market risk-weighted assets (i.e., advanced market risk measure x 12.5)
  - Minus
    - Excess eligible credit reserves not included in tier 2 capital

*/ Credit – risk-weighted assets
1.06 x (total wholesale and retail risk-weighted assets plus risk-weighted assets for securitization exposures plus risk-weighted assets for equity exposure)

Residential Mortgages

- Modified Basel I treatment
  - 50% RW if first, prudently underwritten, owner-occupied, not 90 days past due; otherwise 100%
- US Basel II and US Final Rule (Advanced): Use retail or wholesale inputs as applicable
- US Final Rule (Standardized)
  - Retains existing 50% (first liens, prudently underwritten, less than 90 days past due, not modified (except HAMP)) and 100% (all others)
  - US Final Rule abandoned proposed 35%-200% risk-weights based on LTV ratio and other loan characteristics in the US NPRs

Other Wholesale and Retail Exposures

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- Modified Basel I: 100% (with some exceptions)
- US Final Rule (Standardized): 100% (with some exceptions)
- US Basel II and US Final Rule (Advanced):
  - Bank must have approved internal risk-rating system to assess rating grades for each wholesale obligor and retail segment
  - RWs a function of:
    - PD (probability of default, based on at least 5 yrs data) (subject to .03 floor unless gov't guaranteed)
    - LGD (loss given default, based on at least 7 yrs severity data) (10% floor for unguaranteed resi-mortgage segments)
    - EAD (exposure at default, based on at least 7 or 5 yrs data for wholesale or retail, respectively)
    - M (for wholesale only, maturity) (must be between 1 and 5 years unless not part of bank's ongoing financing of obligor)
    - If defaulted, EAD multiplied by .08 then multiply total defaulted by 12.5 (or effectively, 1250%)

What Is a Securitization Exposure?
(Same for Standardized and Advanced Approaches US Final Rule)

- Securitization exposure is an on- or off-balance sheet credit exposure (including credit-enhancing representations and warranties) arising from a traditional or synthetic securitization or an exposure that directly or indirectly references such a securitization exposure
- To qualify as a traditional securitization, a transaction must meet all four of the criteria listed below:
  1. All or a portion of the credit risk of one or more underlying exposures is transferred to one or more third parties (other than through credit derivatives or guarantees)
  2. The credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority
  3. Performance of the securitization exposure depends on the performance of the underlying exposures
  4. All or substantially all of the underlying exposures are financial exposures.

What Is a Securitization Exposure?

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- Securitization Exposure "outs" when underlying exposures are owned by:
  - Operating companies
    - Companies that produce goods or provide services beyond the business of investing, reinvesting, holding, or trading in financial assets. Examples of operating companies are depository institutions, bank holding companies, securities brokers and dealers, insurance companies, and nonbank mortgage lenders. Accordingly, an equity investment in an operating company, such as a bank, generally would be an equity exposure under the final rule; a debt investment in an operating company, such as a bank, generally would be a wholesale exposure under the final rule

What Is a Securitization Exposure?

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- Small business investment companies (SBICs)
- Community development investment vehicles
- Other regulatory agencies "outs" as deemed appropriate if underlying exposures owned by an investment firm with unfettered control over its assets and liabilities

- Securitization Exposure "outs" for investment fund (company whose assets are financial assets and has no material liabilities), collective investment fund, pension fund, synthetic exposure to the capital of a financial institution that is deducted from capital, or 40 Act regulated (added to US NPRs and US Final Rule – not in US Basel II)

- Regulatory agencies can scope <u>in</u> transactions if appropriate based on transaction's leverage, risk profile or economic substance

US Final Rule – Definition of Resecuritization

- No relief for a *de minimis* securitization exposure (e.g., CLO with 5% basket for structured securities) or for proportionate treatment as had been requested
- Clarification that a single-asset retranching (e.g., re-REMICs) is not a resecuritization
- ABCP liquidity not a resecuritization if program-wide credit enhancement is for 100% of program

Securitization Exposure Approach Hierarchies

Modified Basel I	US Basel II (Advanced)	US Final Rule (Standardized)	US Final Rule (Advanced)	December 2013 Proposal
1. RBA, if opt-in - for ABS only - 20% floor 2. Otherwise, 100% RW	1. RBA - 7% floor - can use RBA for unrated position senior to a rated position 2. SFA/IAA 3. Otherwise, deduction from capital	1. SSFA - 20% floor - data ≤ 91 days old 2. Gross-up - RW of underlyings allocable to exposure plus all senior positions 3. Otherwise, 1250%	1. SFA - 20% floor 2. SSFA - 20% floor 3. Otherwise, 1250%	• IRBA (15% floor) • ERBA/IAA (15% floor) • SA (15% floor) • Otherwise, 1250% * All resecuritizations must use a modified SA

US Final Rule and December 2013 Proposal SSFA/SA Parameters

K_G = weighted average capital for underlying exposures (between zero and 1)

- December 2013 Proposal refers to this as K_{SA}

W = ratio of delinquent underlying exposures to ending balance of underlying exposures

A = attachment point (when losses first are allocated to tranche) (includes subordinated tranches and funded reserves)

D = detachment point (when total loss occurs – i.e., tranche thickness)

p = supervisory calibration parameter = .5 for securitization (December 2013 Proposal increases this to 1.0) and 1.5 for resecuritization

K_A = $(1 – W) \bullet K_G + (.5 \bullet W)$

- If $D \leq K_A$, then RW = 1250%
- If $A \geq K_A$ use SSFA/SA equation
- If $A < K_A$ but $D > K_A$ then RW = weighted average of 1250% and RW per SSFA/SA equation

US Final Rule – Securitization Changes

THE CONTINUING IMPACT OF
Dodd-Frank

- Major change is in SSFA and *W* parameter (delinquency adjustment) now excludes contractual deferrals if either a Federally guaranteed student loan or another consumer asset for which the contractual deferral was agreed before funds were advanced and is not credit-related

US Basel II and US Final Rule Version of SFA – Advanced Approaches Only

- The SFA capital requirement for a securitization exposure is UE (underlying exposure) multiplied by TP multiplied by the greater of (i) [multiplier][1/*] T; or (ii) S[L+T] – S[L], where:

$$K_{SSFA} \frac{e^{a*u} - e^{a*l}}{a(u-l)}$$

where,

$$a = -\frac{1}{p * K_A}$$

$$u = D - K_A$$

$$l = A - K_A$$

$e = 2.71828$ (the base of the natural logarithms)

$$RW\ for\ exposure\ = K_{SSFA} \times 1250\%$$

(i) $S[Y] = \begin{cases} Y & when\ Y \le K_{IRB} \\ K_{IRB} + K[Y] - K[K_{IRB}] + \frac{d \cdot K_{IRB}}{20}(1 - e^{\frac{20 \cdot (K_{IRB} - Y)}{K_{IRB}}}) & when\ Y > K_{IRB} \end{cases}$

(ii) $K[Y] = (1-h) \cdot [(1 - \beta[Y; a, b]) \cdot Y + \beta[Y; a+1, b] \cdot c]$

(iii) $h = \left(1 - \frac{K_{IRB}}{EWALGD}\right)^N$

(iv) $a = g \cdot c$

(v) $b = g \cdot (1-c)$

(vi) $c = \frac{K_{IRB}}{1-h}$

(vii) $g = \frac{(1-c) \cdot c}{f} - 1$

(viii) $f = \frac{v + K_{IRB}^2}{1-h} - c^2 + \frac{(1-K_{IRB}) \cdot K_{IRB} - v}{(1-h) \cdot 1000}$

(ix) $v = K_{IRB} \cdot \frac{(EWALGD - K_{IRB}) + .25 \cdot (1 - EWALGD)}{N}$

(x) $d = 1 - (1-h) \cdot (1 - \beta[K_{IRB}; a, b])$

[1/] 0.016 for US NPRs, or 0.0056 for US Basel II

US Basel II and US Final Rule Version of SFA Parameters

THE CONTINUING IMPACT OF
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TP = Tranche Percentage (ratio of bank's exposure to amount of tranche that contains such exposure)

K_{IRB} = Ratio of RBC for underlying exposure plus expected credit losses to UE

L= Credit enhancement level (ratio of (x) subordinated tranches to tranche that contains bank's exposure to (y) UE). May include funded reserve accounts and any first loss discount

T= Thickness (ratio of tranche containing bank's exposure to UE)

N = Effective number of exposures per formula

EWALGD = Exposure – weighted average loss given default per formula; for US NPRs, assumes 100% LGD for each securitization exposure in a resecuritization exposure

- If $K_{IRB} \geq L+T$ the RW is 1250%

Recent Regulatory Guidance re US Final Rule

On October 2013, the OCC published guidance ± on supervisory expectations for determining the capital requirements on the underlying exposures input (K_{IRB}) to the SFA. The key points in the guidance include

- A bank must make a good faith effort to obtain data to support its risk quantification processes
- In light of data shortcomings , a bank is afforded some flexibility in using approaches to estimating K_{IRB} that are less sophisticated than what the bank might use for similar assets that it originates, services, and holds directly
- Given data limitations that introduce material uncertainty and less confidence in the accuracy of the K_{IRB} input, a bank is expected to demonstrate that its process for determining K_{IRB} incorporates appropriate conservatism
- The process for estimating risk parameters for the pool of underlying exposures should be sufficiently granular to capture material variations in credit quality within the pool both initially and over time
- Process must be empirically grounded, well documented and independently validated
- A bank is expected to benchmark its estimates when calculating K_{IRB} against both internal and external data for similar types of exposures, including data from economic downturn conditions

± - *BCC-13-7: Implementing the Supervisory Formula Approach for Securitization Exposures*

US Final Rule New Due Diligence Requirements
(Same for Standardized and Advanced Approaches)

- Failure to comply results in 1250% RW
- Bank must demonstrate comprehensive understanding of each securitization exposure by conducting analysis of risk characteristics prior to acquiring and documenting same within 3 business days after acquisition:
  - Material structural features, such as waterfall, triggers, credit enhancements, liquidity enhancements, market value triggers, servicer performance, and default definitions
  - Underlying exposure performance such as % of 30, 60 and 90 day past dues; default rates; prepayment rates; average-credit scores; average-LTVs; and diversification data
  - Market data such as bid-ask spread, price history, trading volume, implied market rating, and depth of market
  - If a resecuritization, performance information for underlying exposures
- Bank must review and update analysis at least quarterly

December 2013 Proposal Internal Ratings – Based Approach (IRBA)

- Formula similar to SSFA/SA.
- Key parameters are K_{IRB}, (A) and (D).
- Capital surcharge parameter (p) varies based on factors such as tranche contractual maturity, loss given default, K_{IRB}, number of loans, seniority and wholesale (granular or non-granular) vs. retail.
- Like SFA approach, requires supervisor approval.
- More flexible "mixed pool" approach permitted if assets without IRB parameters available are assigned a RW of 1250% when calculating K_{IRB}.

December 2013 Proposal External Ratings Based Approach (ERBA)

- A single look-up table shows RWs for senior and non-senior (thin) tranches of 1 and 5 year maturities.
  - Banks must use linear interpolations for tranche maturities between 1 and 5 years and to adjust for thickness of non-senior tranches
- RWs on table based on external credit rating, as well as seniority, thickness and maturity, but not granularity
- Same method and RWs for SA and IRB
- Requires only one eligible credit rating
- Inferred rating would work for SA as well as IRB
- Floor 15% RW for AAA tranche with 1-year maturity (whether senior or thin non-senior)
- Maturity increases RW, e.g. 25% RW for 5-year senior tranche AAA
- 1250% RW only for tranches below CCC- and non-senior tranches at or below CCC+ (vs. all at or below B+ under Basel II RBA)

Modified Basel I and US Basel II Ratings Based Approach

<table>
<tr><th rowspan="3">Long Term Ratings*</th><th rowspan="3">Modified Basel I Risk Weights</th><th colspan="3">Risk Weights Under Basel II US Final Rules</th></tr>
<tr><th colspan="2">Granular Pool</th><th rowspan="2">Non-Granular Pool</th></tr>
<tr><th>Senior Exposure</th><th>Non-Senior Exposure</th></tr>
<tr><td>AAA</td><td rowspan="2">20%</td><td>7%</td><td>12%</td><td>20%</td></tr>
<tr><td>AA</td><td>8%</td><td>15%</td><td>25%</td></tr>
<tr><td>A+</td><td rowspan="3">50%</td><td>10%</td><td>18%</td><td rowspan="3">35%</td></tr>
<tr><td>A</td><td>12%</td><td>20%</td></tr>
<tr><td>A-</td><td>20%</td><td>35%</td></tr>
<tr><td>BBB+</td><td rowspan="3">100%</td><td>35%</td><td colspan="2">50%</td></tr>
<tr><td>BBB</td><td>60%</td><td colspan="2">75%</td></tr>
<tr><td>BBB-</td><td colspan="3">100%</td></tr>
<tr><td>BB+</td><td rowspan="3">200%</td><td colspan="3">250%</td></tr>
<tr><td>BB</td><td colspan="3">425%</td></tr>
<tr><td>BB-</td><td colspan="3">650%</td></tr>
<tr><td>B, below or unrated</td><td>RBA Not Available</td><td colspan="3">Deduct from tier 1 and tier 2 capital</td></tr>
<tr><td>Short-Term Ratings</td><td></td><td colspan="3"></td></tr>
<tr><td>A-1</td><td>20%</td><td>7%</td><td>12%</td><td>20%</td></tr>
<tr><td>A-2</td><td>50%</td><td>12%</td><td>20%</td><td>35%</td></tr>
<tr><td>A-3</td><td>100%</td><td>60%</td><td>75%</td><td>75%</td></tr>
</table>

*** For investing banks, one rating is sufficient. If there are multiple ratings on a particular position, the lowest solicited rating governs.**
*** US NPRs not depicted because DF 939A eliminated RBA in US.**

December 2013 Proposal ERBA Illustrative RWs

Illustrative ERBA risk weights				
(Source: BCBS 269 Table 2; +/- rating levels omitted)				
Rating	Senior tranche		Non-senior (thin) tranche	
	Maturity (years)		Maturity (years)	
	1y	5y	1y	5y
AAA	15	25	15	80
AA	25	50	30	130
A	50	75	80	190
BBB	90	130	220	320
BB	160	230	620	770
B	310	420	1050	1050
CCC±	460	530	1250	1250
< CCC-	1250			

Biggest Problems Under US Final Rule and December 2013 Proposal

- 20% floor too high for senior tranches (US Final Rule); 15% floor in December 2013 an improvement but still high
- Few exposures actually fall between floor and caps
- Overall capital for different positions in a single securitization can be many multiples of capital for unsecuritized underlying exposures
- SFA and IRBA improved but still difficult to use for banks as investors
- SSFA/SA a blunt instrument with counterintuitive effects
- For December 2013 Proposal only, inclusion of maturity factor is unnecessary and too conservative

Basel Consultation on Cost of Credit Protection

- Basel Committee on Banking Supervision (BCBS) in March 2013 issued Consultative Document on Recognising the cost of credit protection purchased (BCBS 245)
- BCBS proposes to amend Basel II provisions on credit risk mitigation (CRM) as follows:
  - Banks must in some cases calculate present value (PV) of premiums for credit protection purchased and not yet recognised in earnings
  - This applies where (a) risk weight (RW) of protected position before CRM was at least 150% or (b) supervisors otherwise determine
  - Premiums' PV (PPV) given 1250% RW
    - equivalent to deduction from capital at 8% minimum capital requirement; more than deduction at higher capital requirement
  - Under securitisation framework, include PPV in significant risk transfer (SRT) assessment as retained position; if no SRT then 1250% RW will not apply
- Technical guidance annex shows application of proposed rules, calculation of PPV etc., but does not give binding rules on these points
- Comment period ended June 21, 2013; final or revised proposal expected 2014

Cost of Credit Protection - Comments

- Proposal would burden a wide range of legitimate activity in order to capture a small number of potentially abusive trades
- Pending changes in accounting standards may at least partly address concerns
- Use Pillar 2 supervision, existing Pillar 1 rules and additional guidance
- Exempt transactions should include:
  - Trading book and other assets marked to market through income
  - Traditional securitisations without third party credit protection
  - Ordinary loan guarantees etc. given at time of credit granting
  - Government guarantees, trade finance and SMEs
- Apply only where 150% RW ***and*** other features
- Specify appropriate methods to calculate PPV

Regulatory Update

THE CONTINUING IMPACT OF
Dodd-Frank

- Introductory Remarks
- Regulation AB Proposals ("Reg AB II")
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Risk Retention Re-Proposal

- Original proposal was more than two years ago
- Comments were due October 30, 2013. Our firm drafted the SFIG Comment Letter and comment letters for other clients.
- Base Requirement:
  - **Sponsor** of a **securitization transaction** (or majority-owned affiliate) must retain an economic interest in the credit risk of the securitized assets
  - Generally 5% is required
  - "Sponsor" organizes and initiates a securitization transaction by selling or transferring assets directly or indirectly to the issuing entity
    - NOTE: If you don't organize the transaction or transfer assets, you aren't the sponsor. and are not subject to risk retention
    - NOTE: If the transaction does not involve a "security" (e.g., a commercial loan), it's not an "asset-backed security" or a securitization transaction subject to risk retention
- Majority-owned affiliates includes not only the traditional control test, but also ownership of a controlling financial interest in an entity as determined under US GAAP
  - If you consolidate an entity under GAAP, that entity is your majority-owned affiliate.

Standard Risk Retention

- Sponsor of a securitization transaction generally must retain either:
  - Eligible vertical interest,
    - Can be either:
      - A single vertical security or
      - An interest in each class of ABS Interests issued as part of the securitization transaction
  - Eligible horizontal residual interest,
  - Eligible horizontal reserve account; or
  - Any combination thereof
    - Note: No longer need to have any "L-Shaped" limitation of 2.5% each
- Amount retained by the sponsor must equal at least 5% of fair value of all ABS Interests in the issuing entity issued as part of the securitization transaction
- Does not include representative sample from original proposal
- The Re-Proposal does not permit participation interests as a form of retention.
- Special Rules for CMBS, master trusts and ABCP.

Standard Risk Retention

- "ABS Interest" means any type of interest issued by an issuing entity if payments are primarily dependent on the cash flows
  - Intended to be broad
  - Does not include right to receive payments for services provided by the holder of that right, including servicers, trustees and custodians
- Risk Retention percentages calculated based on the *fair* value of ABS interests instead of the *par* value.
  - Determined in accordance with US GAAP
  - The Re-Proposal eliminated the premium cash capture reserve account concept.
  - Determined on the day on which pricing of the ABS Interests occurs
  - The Re-Proposal mandates additional disclosures related to the calculation of fair value including:
    - the material terms of the ABS interests retained;
    - the methodology used to calculate the fair value, specifically the key inputs, assumptions, reference data and historical information used.
- Industry comment: Fair value calculations are a significant burden and expense and potential increased liability with additional disclosure

Eligible Horizontal Residual Interest (EHRI)

- Can be a single class or multiple classes
- Has the most subordinated claim to both principal and interest by the issuing entity
  - Note: Can't use a rated subordinated note as part of the EHRI because you can't pay subordinated interest on EHRI before senior principal
- Shortfalls must reduce amounts paid to the EHRI prior to other ABS Interest
  - Can occur through any contractual provisions, including operation of the priority of payments

Eligible Horizontal Residual Interest - Required Calculations

- Fair Value for each ABS Interest, including the EHRI
- Closing Date Projected Cash Flow Rate
  - For any payment date, means the percentage obtained by dividing:
    - Fair value of all cash flow projected, as of closing date, to be paid to EHRI holder through and including that payment date, by
    - Fair value of all cash flow projected, as of closing date, to be paid to EHRI holder through maturity of the EHRI
  - Must use same assumptions and discount rates used in determining the Fair Value of the EHRI
- Closing Date Projected Principal Repayment Rate
  - For any payment date, means the percentage obtained by dividing:
    - Amount of principal projected, as of closing date, to be paid on all ABS Interests through and including that payment date, by
    - Aggregate principal amount of all ABS Interests issued in the transaction
      - Note: What's the "principal amount" of the EHRI?

Disclosure for Eligible Horizontal Residual Interests

- Key inputs and assumptions used in measuring fair values, including quantitative information about the following:
  - Discount rates
  - Defaults; Loss given default (recovery); Lag time between default and recovery
  - Prepayment rates
- Reference data set or other historical information used to develop the key inputs and assumptions, including defaults and loss given default
- Certify to investors that Closing Date Projected Cash Flow Rate for each payment date does not exceed the Closing Date Projected Principal Repayment Rate for such payment date
  - This is a disclosure of projections, which will dramatically expand liability in these transactions.
  - This will always happen if you have excess spread in the transaction
  - De-leveraging structures, in which enhancement increases over time, won't work
- Number of payment dates for securitizations during past five years in which an EHRI was retained in which actual payments on EHRIs exceeded projected cash flows in determining Closing Date Projected Cash Flow Rate

Eligible Horizontal Residual Interest - Issues

- Industry Comment: Can we have a "Simplified Approach" for "Simple Structures" where it is obvious that size of the EHRI is more than 5%?
  - Discuss possible alternative proposals
- Re-proposal does not contemplate a revolving deal where the balances of the ABS Interests are regularly changing
  - Do you need to do it every day? Every time you add assets?
  - Note: How do you calculate "fair value" for a trade receivables deal?
- Sponsors must disclose their experience in retaining EHRIs under the Horizontal Method and the number of payment dates in prior securitizations in which the actual payments to the sponsor exceeded the projected payments for that payment date.
- Industry comment: In a true "private" deal (e.g., a VFN), investors are doing due diligence. Can we potentially get relief from disclosure in that situation?

Transfer and Hedging of Risk Retention; Non-Recourse Financing

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- Can't sell or otherwise transfer any interest required to be retained
  - OK to transfer to an entity that is and remains a majority-owned affiliate
- Can't pledge any ABS Interest required to be retained unless the secured obligation is with full recourse to the sponsor or affiliate.
- Hedging Restriction: Sponsor, affiliate or issuing entity can't enter into any agreement if:
    - Payments under the agreement are materially related to the credit risk of either ABS Interests required to be retained, or securitized assets that collateralize the ABS, and
    - The agreement in any way reduces or limits the financial exposure of the sponsor
    - Restriction applies to sponsor and ALL of its AFFILIATES (and not just the majority-owned affiliates that may hold the retained risk).
  - Permitted Exceptions:
    - Interest rate or currency exchange rate hedges (other than hedges of credit risk or "spread risk")
    - Hedging an index if:
      - ABS Interests of the issuing entity represent not more than 10% of the dollar weighted average of the index, and
      - ABS interests in all issuing entities in which the sponsor was required to retain an interest represent in the aggregate not more than 20% of the dollar weighted average of the index

Duration of Transfer and Hedging Limitations

- Expiration the latest of:
  - Later of reduction of unpaid principal balance of securitized assets or ABS Interests to 33% of closing date balance
  - Two years after closing date
- RMBS expiration at the later of:
  - Five years after closing date, or
  - Reduction of unpaid principal balance of mortgages to 33% of closing date balance
- RMBS favoritism:
  - RMBS transfer and hedging restrictions end seven years after closing date
  - Other long term asset classes have to wait for reduction to 33%

Subsequent Advocacy

- Representative Sample
  - We'll get this if representative and not just random
  - Concern that we'd pick 1000 random samples until we got the cherry-picked "good" pool.
- Participations
  - We'll get securitization of the entire pool with retention of a 5% participation.
  - Less open to securitization of participations.
- Limitations on EHRI Distributions
  - Ford's suggestion: Focus on the value of the remaining residual rather than the cash distributed to the residual holder
- Revolving & Self Adjusting: They liked the idea
- Simplified Approach: Will we get anything?
- Qualifying Auto Loans: Regulators are not willing to make changes

Risk Retention for Mortgages

Regulatory Update

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US Liquidity Coverage Ratio for Large Banking Organizations and Systemically Important Non-Banks

- Purpose: to strengthen the liquidity positions of large financial institutions
- Creates for the first time a standardized minimum liquidity coverage ratio
- Who does it apply to?

  Banks with:

  - $250 billion or more assets
  - $10 billion or more on-balance sheet foreign exposures
  - Systemically important non-banks
  - Different system for $50 billion or more asset banks
  - Discretion to add appropriate companies

  $10 Billion or more insured depositary institution subsidiaries of covered banks
- Note: US branches/agencies of foreign banks not included
- Similar to Basel, but stricter in certain respects

US Liquidity Coverage Ratio

THE CONTINUING IMPACT OF
Dodd-Frank

- Intended to insure a bank has an adequate stock of unencumbered high-quality liquid assets (HQLA) that can be converted into cash easily and immediately in private markets to meet its liquidity needs for 30-calendar-day stress scenario
- numerator = value of stock of HQLA

  denominator = total net cash outflows for a specified period in a stress scenario (30 days) >100%
- Basel:
  - HQLA = Level 1 and Level 2 Assets

    Level 1 assets = cash, central bank reserves, and certain marketable securities backed by sovereigns and central banks

    Level 2 assets = Level 2A assets + Level 2B assets

US Liquidity Coverage Ratio

Level 2A assets = certain government securities, covered bonds, corporate debt securities (rated AA (or equivalent) or higher)

Level 2B assets = lower rated corporate bonds, residential mortgage backed securities and equities that meet certain conditions

Level 2 assets cannot exceed 40% of HQLA

Level 2B assets cannot exceed 15% of HQLA

Certain Level 2 assets are subject to haircuts

US Liquidity Coverage Ratio

- Denominator equals total net cash outflows = expected cash outflows, minus total expected cash inflows, for the 30-day stress period
- Outflows are calculated by multiplying balances of categories by expected runoff rates
- Inflows are calculated by multiplying balances of categories of receivables by rates at which they are expected to flow in; inflows are subject to a cap of 75% of outflows

US Liquidity Coverage Ratio

THE CONTINUING IMPACT OF
Dodd-Frank

Differences Between US and Basel LCRs

- Accelerated Transition Period for LCR Compliance

  Final Compliance US LCR: 1/1/17

Phase in:	80%	1/1/15
	90%	1/1/16
	100%	1/1/17

  Final Compliance Basel LCR:

	60%	1/1/15
	70%	1/1/16
	80%	1/1/17
	90%	1/1/18
	100%	1/1/19

- Peak Net Outflow Day Test

  US test: highest net outflow day in 30-day period

  Basel Test: highest net outflow on last day of 30-day period

US Liquidity Coverage Ratio

- More restrictive HQLA Definition (closer to Dec. 2010 original version than the more expansive Basel Jan. 2013 version) (Amount of HQLA is its fair value regardless of its value for financial reporting purposes.)
  - Level 1 assets: highest quality and most liquid
    - (1) excess reserves at FRB
    - (2) withdrawable reserves at foreign central bank
    - (3) securities issued, or guaranteed, by the full faith and credit of the US
    - (4) certain claims on, or guaranteed by, sovereign entities, central banks and other zero risk weight international entities (OECD sovereign debt unless defaulted or restructured)
  - Level 2A assets: subject to 15% haircut and limit of 40% of total HQLA (when combined with 2B Assets)
    - (1) claims on or guaranteed by a US GSE
    - (2) claims on or guaranteed by a sovereign entity or multilateral development bank with 20% risk weight (under standardized approach)

US Liquidity Coverage Ratio

- Level 2B assets: subject to 50% haircut and limit of 15% of total HQLA
  - (1) investment grade, publicly traded corporate debt securities issued by entities with proven record as a reliable source of liquidity during times of stress
  - (2) publicly traded equities included in S&P 500 Index or equivalent

- Of note:
  - No GSE obligations in Level 1 (rather Level 2A)
  - No highly rated AAA ABS or MBS in Level 2B
  - The Proposal states that covered bonds, and securities issued by any state, local authority or other governmental entity below the national level (including states and municipalities) would probably not be liquid enough to be included in HQLA
  - FFELP ABS apparently excluded as not wholly guaranteed
  - Investment grade corporate bonds at Level 2B (rather than in 2A)

US Liquidity Coverage Ratio

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Cash Outflows

- Unsecured retail funding: deposits from individuals and small businesses, and would range from 3% for stable retail deposits that are fully FDIC insured, to 40% for uninsured retail brokered swap deposits (irrespective of maturity)

- Unsecured wholesale funding: most sources of unsecured funding from customers and counterparties that are not individuals or small businesses, and would range from 25% for certain operational deposits (deposits in return for services) to 100% for commercial paper or nonoperational deposits from financial entities (including central banks and multilateral banks).
  - General outflow rate is 40%.

US Liquidity Coverage Ratio

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Dodd-Frank

Cash Out Flows

- Secured, short-term funding: increases based on characteristics of underlying collateral.

  (1) secured short-term funding backed by Level 1 assets would have a zero outflow rate

  (2) secured short-term funding backed by Level 2A assets would have a 15% outflow rate

  (3) secured short-term funding backed by Level 2B assets would have a 50% outflow rate

  (4) secured short-term funding backed by non-HQLA assets would have a 100% outflow rate

US Liquidity Coverage Ratio

Cash Outflows

- Commitments

  (1) retail credit and liquidity facilities would have a 5% outflow rate

  (2) wholesale credit and liquidity facilities would have a 10% and 30% outflow rate, respectively

  (3) credit facilities and liquidity facilities to non-bank regulated financial entities would have a 40% and 100% outflow rate, respectively

  (4) liquidity and credit facilities to banks would have a 50% outflow rate

  (5) commitments (whether credit or liquidity) to SPEs would have a 100% outflow rate (other than liquidity facilities to consolidated SPEs)

  (6) ABCP maturing in 30 days would have a 100% outflow rate

Note: General working capital facilities (including revolvers) are not liquidity facilities

US Liquidity Coverage Ratio

Cash Outflows

- Sponsored Structured Transaction Outflow Amount
  - whether issuer is consolidated or not
  - amount is greater of (A) 100% of maximum available funding support to issuer in next 30 days and (B) sum of issuer's debt maturing in 30 days and commitments to purchase assets within 30 days

US Liquidity Coverage Ratio

Cash Outflows

- Federal Reserve Borrowings
  - Federal Reserve borrowings of any kind are treated as other secured wholesale borrowings.
  - Borrowings due within 30 days are assumed not to be renewed and reflect the outflow rate of the underlying collateral.
  - Capacity to borrow from Federal Reserve is not included in HQLA.

US Liquidity Coverage Ratio

Cash Inflows

- Net Derivatives: sum of the payments and collateral that a covered company will receive from each counterparty less the sum of payments and collateral that the covered company will make or deliver to each counterparty under a master netting agreement
- Retail Contractual Payments: including 50% of all contractual payments a covered company expects to receive from retail customers and counterparties
- Unsecured Wholesale Inflow: consisting of (i) wholesale inflows from regulated financial companies, investment companies, non-regulated funds, pension funds, investment advisers and identified companies and from central banks (100% inflow rate) and (ii) inflows from wholesale customers or counterparties who are not regulated financial companies or any of the other entities listed in (i) above (50% inflow rate)

US Liquidity Coverage Ratio

THE CONTINUING IMPACT OF
Dodd-Frank

Cash Inflows

- Securities: including inflows from securities owned by a covered company that would not be included in a covered company's HQLA amount. Securities are assigned a 100% inflow rate.
- Secured Lending Transactions: cash inflows from any lending transaction that gives rise to a cash obligation of a counterparty to a covered company that is secured under applicable law by a lien on specifically designated assets owned by the counterparty and included in the covered company's HQLA that gives the covered company certain priority in insolvency situations. The inflow rates depend on the type of assets constituting security. (Asset exchanges could qualify as well in certain circumstances.)

US Liquidity Coverage Ratio

Cash Inflows

- What is not included:

  (1) deposits at other regulated financial companies

  (2) amounts expected to be received from forward sales of mortgage loans and mortgage commitments

  (3) amounts arising from any credit or liquidity facility extended to a covered company

  (4) amounts of any asset included in a covered company's HQLA and any amount payable with respect to those assets

  (5) amounts related to non-performing assets

  (6) items with no maturity date or that mature after the 30-day stress period

US Liquidity Coverage Ratio

Cash Inflows

- Miscellaneous
  - Regulators are given flexibility in responding to instances where a bank's LCR falls below the minimum requirements.
  - A covered bank must submit a plan to its primary Federal regulator on how it would achieve compliance with the proposed LCR requirements if it remains below 100% for 3 consecutive business days or longer or the bank is otherwise determined to be materially out of compliance.

SPE Unfunded Commitments Comparison

THE CONTINUING IMPACT OF
Dodd-Frank

	Basel LCR	EU LCR	US LCR	Basel Leverage Ratio
Liquidity and Credit Facility to SPE	100%	100% but 10% for amount over actual assets then available	100%	100%* or 50% (eligible liquidity or eligible servicer advance facility)
Commitments to non-SPEs / non-financials	10% (credit) / 30% (liquidity)	10%	10% (credit) / 30% (liquidity)	20% (1 year) / 50% (longer)

* The CCF of 20% or 50% to commitments generally excludes only “securitization liquidity facilities” but 100% CCF purports to apply to all securitization exposures (other than eligible liquidity and servicer advances). Therefore not clear if credit commitments to SPEs actually fit in the 20%/50% category.

Basel III Net Stable Funding Ratio

- Consultative Document published January 2014
- Comments due April 11, 2014
- Full implementation by January 1, 2018

The NSFR Ratio

THE CONTINUING IMPACT OF Dodd-Frank

$$\frac{\text{Available Stable Funding (ASF)*}}{\text{Required Stable Funding (RSF)}} \text{ must be at least 100\%}$$

*ASF is the portion of capital and liabilities expected to be reliable over a one year horizon

ASF Calculation:

Carrying value of ASF Category times ASF Factor (bigger is better)

THE CONTINUING IMPACT OF
Dodd-Frank

ASF Category	ASF Factor
Regulatory capital and other liabilities with ≥ 1 year remaining maturity	100%
Stable non-maturity deposits and term deposits with remaining maturity < 1 year from retail and SME customers	95%
Less stable non-maturity deposits and term deposits with remaining maturity < 1 year from retail and SME customers	90%
Funding with remaining maturity < 1 year from non-financial corporates, sovereigns, PSEs and multilateral and national development banks; operational deposits; all other funding with maturity between 6 months and 1 year	50%
Excess (if any) of derivatives payable over receivable and all other liabilities (including liabilities without stated maturity)	0%

RSF Calculation:

Sum of (A) carrying value of RSF Category <u>times</u> RSF Factor <u>plus</u> (B) off balance sheet activity <u>times</u> RSF factor (smaller is better)

RSF Category*	**RSF Factor**
Cash, central bank reserves, bank loans with remaining maturities < 6 months	0%
LCR Level 1 Assets	5%
LCR Level 2A assets	15%
LCR Level 2B assets; HQLA; bank loans with 6 months – 1 year remaining maturities (was 0% in first version); operational deposits at other financial institutions; all other assets with remaining maturity < 1 year	50%
Resi-mortgages and other non-financial institution loans with remaining maturity ≥1 year and RW ≤ 35%	65%
Other performing loans with RW > 35% under Standardized Approach and remaining maturity ≥ 1 year (other than to financial institutions); physically traded commodities; non-defaulted securities	85%
All assets encumbered for ≥ 1 year; excess (if any) of derivatives receivable over payable and all other assets	100%

*Any RSF category that is encumbered for ≥ 6 months has a floor of 50% RSF factor

RSF Calculation

THE CONTINUING IMPACT OF
Dodd-Frank

Off Balance Sheet Calculations

RSF Category	RSF Factor
Irrevocable and conditionally revocable credit and liquidity facilities to any client	5% of undrawn
All others	Subject to specification by national supervisors

Regulatory Update

THE CONTINUING IMPACT OF
Dodd-Frank

- Introductory Remarks
- Regulation AB Proposals ("Reg AB II")
- GSE Reform
- Bank Regulatory Capital
- Risk Retention
- Qualified Mortgages, CFPB Servicing Rules
- Leverage Ratio, LCR and NSFR
- **Some Effects on Market of Bank Regulatory Changes**
- Money Market Fund Reform
- Conflicts of Interest

Bank Regulatory Changes – Some effects

THE CONTINUING IMPACT OF
Dodd-Frank

- The “Frightful Five”:
  - Low return on assets (ROA)
  - Higher capital charges
  - Future leverage ratios
  - Liquidity Coverage Ratio
  - Net Stable Funding Ratio
- These elements will :
  - Make it more difficult for banks to hold low ROA assets on their balance sheets
  - More difficult for banks to provide a “real” commitment to issuers
  - Make ABCP or bank funding less attractive, less available and more costly to Issuers
- Solutions:
  - Banks will increasingly try to get their ABCP conduits and low ROA assets off balance sheet (i.e., TradeMAPS)
  - Issuers will use more term ABS
  - Warehouse funding in capital markets (i.e., Ford 2014-REV)

Regulatory Update

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- Conflicts of Interest

Money Market Fund Reform

THE CONTINUING IMPACT OF

Dodd-Frank

- Comment period ended September 17, 2013.
- Two Proposed Alternatives
  - Floating NAV
  - Liquidity Fees and Redemption Gates
- Proposals to Change Diversification Requirements
  - Aggregation of Affiliates (majority ownership test) for Issuer Diversification Rules
    - Limited to 5% of Fund’s assets
      - Note: Unintended effect of ownership by SPE service companies
    - Also aggregated for determining 10% Obligors (except Restricted SPEs)
    - Request for comment on inclusion of consolidated entities
  - Treatment of ABS Sponsors as guarantors unless Fund’s Board has determined (and maintains a written record) that Fund is not relying on:
    - Sponsor’s financial strength
    - Sponsor’s ability or willingness to provide liquidity, credit Support, or other support
      - Will MMFs determine that a mere sponsor/servicer does not provide “support”?
    - Limited to 10% of Fund’s assets

Money Market Fund Reform - How will it affect the Market?

THE CONTINUING IMPACT OF Dodd-Frank

- The proposed changes to the diversification rules would require aggregation of affiliates and sponsors
  - Money market funds will be required to aggregate all of their securities of all asset-backed securities in the same group of sponsors and affiliates
  - ABCP conduits will now be required to apply the “look through” to the entire group of affiliated and sponsored issuers
  - Real problem for orphan entities owned by SPE Service Companies

Regulatory Update

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- Money Market Fund Reform
- **Conflicts of Interest**

Conflicts of interest

- D-F Section 621 prohibits "material conflicts of interest" with ABS investors for year after closing
  - Both public and private deals
- SEC Rule was broad and vague, with only very narrow exceptions
  - But Release made clear that only short transactions were intended to be prohibited
- Synthetic securitizations might be completely prohibited
- Final Rules could be adopted at any time

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Legal Update
July 15, 2013

Bank Regulators Approve Final Rule to Implement Basel III Capital Requirements in the United States

On July 2, 2013, the Board of Governors of the Federal Reserve System ("Board") approved a final rule ("Final Rule") to establish a new comprehensive regulatory capital framework for all US banking organizations.[1] On July 9, 2013, the Final Rule was approved by the Office of the Comptroller of the Currency ("OCC") and (as an interim final rule) by the Federal Deposit Insurance Corporation ("FDIC") (together with the Board, the "Agencies").

The Final Rule brings the United States substantially into compliance with the Basel III capital framework agreed upon internationally in December 2010, replaces the existing US modified Basel I risk-based capital regime (the "Current Rules") with one based in part on the Basel II standardized approach (previously proposed but not adopted in the United States) and in part on the Basel II advanced approaches, and implements several changes to the US regulatory capital regime required by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). The new US capital framework imposes higher minimum capital requirements, additional capital buffers above those minimum requirements, a more restrictive definition of capital, and higher risk weights for various assets, which in combination result in substantially more demanding capital standards for US banking organizations.

For large US banking organizations subject to the "advanced approaches" method of computing risk-based regulatory capital ("Advanced Banks") – i.e., those with $250 billion or more in total consolidated assets or $10 billion or more in foreign exposures, as well as other banking organizations that successfully opt-in – the Final Rule takes effect on January 1, 2014. For the majority of US banking organizations that will operate only under the "standardized approach" ("Standardized Banks"), the Final Rule takes effect one year later, on January 1, 2015.

Aside from a handful of key changes primarily responding to the concerns of smaller, less complex banking organizations and some technical clarifications, the major elements of the capital framework adopted in the Final Rule are largely unchanged from the Agencies' capital proposals issued in June 2012 (collectively, the "Proposed Rules").[2] In particular, Advanced Banks received little relief from the most controversial aspects of the Proposed Rules. Moreover, during the Board's consideration of the Final Rule, Governor Tarullo stated that although the Final Rule represents the "last step" in reform of the US regulatory capital framework for the vast majority of US banks,[3] four significant additional capital measures are still to come for the eight US banking organizations that have been identified by the Basel Committee on Banking Supervision (the "Basel Committee") as Global Systemically Important Banks ("G-SIBs"). In fact, on July 9, 2013, the Agencies released a joint notice of proposed rulemaking (the "Leverage Ratio NPR") to implement the first of these four additional capital measures: an enhanced supplementary leverage ratio for US G-SIBs.[4]

This Legal Update identifies key aspects of the Final Rule and highlights and places in context the forthcoming additional capital requirements for the largest US banking organizations, including the enhanced supplementary leverage ratio requirement set forth in the Leverage Ratio NPR.

I. Scope

The Final Rule applies to all banking organizations currently subject to minimum capital requirements, including national banks, state member banks, state nonmember banks, state and federal savings associations, top-tier US bank holding companies ("BHCs") with more than $500 million in total consolidated assets, and most top-tier savings and loan holding companies ("SLHCs"). In a change from the Proposed Rules, SLHCs with significant commercial or insurance underwriting activities are not subject to the Final Rule. The Board has stated that it will take additional time to evaluate the appropriate regulatory capital framework for these entities.[5]

II. Minimum Capital Requirements[6]

New Minimum Risk-Based Capital Ratios. The Final Rule adopts new minimum capital ratios that are consistent with the Basel III international package and unchanged from the Proposed Rules. These include a new 4.5% common equity tier 1 ("CET1") capital requirement, a 6.0% tier 1 capital requirement (increased from 4.0% under the Current Rules), and an 8.0% total capital requirement (same as under the Current Rules). All US banking organizations will calculate the numerator of their minimum capital ratios using the more restrictive definitions of capital under the Final Rule. Standardized Banks, which as noted above constitute the vast majority of US banking organizations, will apply only the standardized approach under the Final Rule to compute the denominator (i.e., risk-weighted assets) of their risk-based capital ratios. Advanced Banks will calculate their risk-weighted assets using the Final Rule's advanced approaches. However, for Advanced Banks, the standardized approach will be used to establish the minimum "generally applicable" capital floor requirements for purposes of section 171 of Dodd-Frank, commonly referred to as the Collins Amendment.

Capital Buffers. In addition to the minimum capital ratios, the Final Rule requires that all banking organizations maintain a "capital conservation buffer" consisting of CET1 capital in an amount equal to 2.5% of risk-weighted assets in order to avoid restrictions on their ability to make capital distributions and to pay certain discretionary bonus payments to executive officers. Thus, the capital conservation buffer effectively increases the minimum CET1 capital, tier 1 capital, and total capital requirements for US banking organizations to 7.0%, 8.5%, and 10.5%, respectively. Banking organizations with capital levels that fall within the buffer will be forced to limit dividends, share repurchases or redemptions (unless replaced within the same calendar quarter by capital instruments of equal or higher quality), and discretionary bonus payments. The limits consist of a sliding scale, so that as the buffer decreases, so does the maximum payout as a percentage of the banking organization's net income over the past four quarters. For Advanced Banks, the capital buffer may be increased during periods of "excessive credit growth" by an incremental "countercyclical capital buffer" of up to 2.5% of risk-weighted assets. In a change from the Proposed Rules, Advanced Banks would (after completing the "parallel run" process for migrating to the advanced approaches regime)[7] be required to use the lesser of their standardized and advanced approaches risk-based capital ratios as the basis for calculating their capital conservation buffer (and any applicable countercyclical capital buffer). This change likely will increase the capital buffer for at least some Advanced Banks compared to the Proposed Rules.

Leverage Ratios. Consistent with the Proposed Rules, the Final Rule imposes a tier 1 minimum leverage ratio of 4.0% for all banking organizations and an additional supplementary tier 1 leverage ratio of 3.0% for Advanced Banks. The 3.0% supplementary leverage ratio (which, consistent with Basel III, will take effect in January 2018 but be reported beginning in January 2015) incorporates in the denominator certain off-balance sheet exposures that are not included in the standard leverage ratio.[8] Despite significant criticism from the industry, the Final Rule continues to include in the supplementary leverage ratio derivatives exposures based on potential future exposure (without collateral recognition) and 10 percent of unconditionally cancellable commitments.[9]

As noted above, the Agencies on July 9, 2013, approved the Leverage Ratio NPR, which would apply to US top-tier BHCs with at least $700 billion in total consolidated assets or $10 trillion in assets under custody (i.e., the eight largest and most interconnected US banking organizations already identified as G-SIBs) and any insured depository institution subsidiary of these BHCs. For BHCs subject to the proposal, the Leverage Ratio NPR would establish a new 2.0% tier 1 "supplementary leverage buffer" requirement above the 3.0% supplementary leverage ratio requirement established in the Final Rule for all Advanced Banks, effectively increasing the supplementary leverage ratio requirement to 5.0% for these largest BHCs. The leverage buffer would function like the capital conservation buffer under the Final Rule, in that a BHC subject to the requirement that failed to maintain a leverage buffer of tier 1 capital in an amount greater than 2.0% of its total leverage exposure would be subject to restrictions on distributions and discretionary bonus payments.

PCA Regime. The Final Rule makes certain conforming changes to the prompt corrective action ("PCA") regime for insured depository institutions based on the new minimum capital requirements. Among other things, the Final Rule introduces the minimum CET1 requirement into the PCA regime, incorporates changes to the capital definitions and deductions, adds the supplementary leverage ratio as a new PCA category for Advanced Banks, and increases the tier 1 risk-based capital requirement for each PCA category other than "critically undercapitalized." Under the Final Rule, the "well capitalized" standards consist of a minimum 5.0% leverage ratio requirement (same as under the existing PCA regime), plus the 3.0% supplementary leverage ratio for Advanced Banks; a 6.5% CET1 risk-based capital requirement (new); an 8.0% tier 1 risk-based capital requirement (increased from 6.0% required under the current PCA regime); and a 10.0% total risk-based capital requirement (same as under the existing PCA regime). The Leverage Ratio NPR would (if adopted) increase the supplementary leverage ratio "well capitalized" requirement for insured depository institutions that are subsidiaries of US G-SIBs to 6.0%.

III. Capital Definitions; Deductions and Adjustments

Consistent with the Proposed Rules and the Basel III international approach, the Final Rule includes more restrictive definitions for the components of capital and eligibility criteria broadly intended to promote the use of capital instruments better able to absorb losses in times of financial stress. The eligibility criteria for the different components of capital have been adopted essentially as proposed, with some technical clarifications. CET1 capital consists primarily of common stock and retained earnings. Additional tier 1 capital is limited to other paid-in amounts recognized as equity under GAAP, thus excluding contingent capital and going somewhat beyond what is required by Basel III and, potentially, what has been implemented in the European Union. The Final Rule permits recognition of a broader range of items in tier 2 capital, including loan loss reserves up to 1.25% of total risk-weighted assets for Standardized Banks and the excess of eligible credit reserves over expected credit losses up to 0.6% of credit risk-weighted assets for Advanced Banks.

In addition to restricting the instruments that may qualify as capital, the Final Rule also imposes much stricter deductions from and adjustments to capital. Several key provisions are summarized below.[10]

Phase-Out of TruPS and Other Non-Qualifying Capital. As required by section 171 of Dodd-Frank, the Final Rule requires that capital instruments such as trust preferred securities ("TruPS") and cumulative preferred shares be phased-out of tier 1 capital by January 1, 2016, for banking organizations that had $15 billion or more in total consolidated assets as of December 31, 2009. However, unlike the Proposed Rules, which would have required even banking organizations with less than $15 billion in assets to phase out TruPS and similar instruments (albeit over a longer ten-year transition period), the Final Rule adheres to Dodd-Frank and permanently grandfathers as tier 1 capital such instruments issued by these smaller entities prior to May 19, 2010 (provided they do not exceed 25 percent of tier 1 capital). The Final Rule also permanently grandfathers as tier 2 capital TruPS issued before May 19, 2010, by Standardized Banks with assets of $15 billion or more. Advanced Banks, however, will be permitted to include such instruments only as tier 2 capital until year-end 2015, after which they must begin phasing them out from tier 2 capital as well.

Accumulated Other Comprehensive Income. Consistent with the Basel III international approach, the Proposed Rules would have required all banking organizations to include most components of accumulated other comprehensive income ("AOCI") in CET1 capital, including most notably unrealized gains and losses on "available-for-sale" debt securities. Many commenters objected that reflecting AOCI in CET1 capital would introduce too much volatility into the regulatory capital measure, making it more difficult for banking organizations to manage liquidity and interest rate risk and potentially leading to other unintended consequences such as difficulties complying with legal lending limits. In response to these concerns, the Final Rule provides Standardized Banks with a one-time "opt-out" right to continue excluding AOCI from CET1 capital. Advanced Banks, however, will be required to recognize AOCI in CET1 capital as proposed.

Goodwill. The Final Rule requires that goodwill and other intangible assets (other than mortgage servicing assets ("MSAs"), which are discussed below), net of associated deferred tax liabilities ("DTLs"), be deducted from CET1 capital, including any goodwill embedded in the valuation of significant investments in the common stock of an unconsolidated financial institution (as defined below). Unlike most of the CET1 deductions required in the Final Rule, the deduction for goodwill is not subject to any transition period and, therefore, will apply from the effective date, a result the Agencies believe is required by statute.

DTAs, MSAs, and Significant Investments in Unconsolidated Financial Institutions. Under the Final Rule, deferred tax assets ("DTAs") that arise from net operating loss and tax credit carryforwards, net of associated DTLs and valuation allowances, are fully deducted from CET1 capital. However, DTAs arising from temporary differences that could not be realized through net operating loss carrybacks, along with MSAs and "significant" (defined as greater than 10% of the issued and outstanding common stock of the unconsolidated financial institution) investments in the common stock of unconsolidated "financial institutions" (collectively, "Threshold Deduction Items"),[11] are partially includible in CET1 capital, subject to deductions consistent with the Proposed Rules.

Thus, under the Final Rule, a banking organization generally must take a deduction from CET1 capital to the extent that (i) any Threshold Deduction Item, net of associated DTLs, individually exceeds 10% of CET1 capital (after other adjustments and deductions) or (ii) Threshold Deduction Items in the aggregate (again net of associated DTLs) exceed 15% of CET1 capital. All Threshold Deduction Items would be risk-weighted at 250% to the extent they are not deducted from capital. Notably, in a change from the Proposed Rule, the Final Rule eliminates the existing 10% haircut on fair market value for MSAs.

Investments in the Capital of Other Financial Institutions. As noted above, significant investments in the capital of unconsolidated financial institutions in the form of common stock are among the Threshold Deduction Items under the Final Rule and, up to the limits stated above, need not be deducted from CET1 capital. If a banking organization holds a significant investment in an unconsolidated financial institution, any holdings not in the form of common stock are fully deducted from capital using the "corresponding deduction approach" (i.e., the investing banking organization must make deductions from the component of capital—CET1, tier 1, or tier 2—for which the underlying instrument would qualify if it were issued by the banking organization). Non-significant investments in the capital of unconsolidated financial institutions (i.e., investments consisting of 10% or less of issued and outstanding common stock of the unconsolidated institution) are deducted using the corresponding deduction approach, but only to the extent that such investments in the aggregate exceed 10% of the investing banking organization's CET1 capital.[12]

Minority Interest. The Final Rule also adopts without change the proposed treatment of capital issued by consolidated subsidiaries and not owned by the parent banking organization (i.e., "minority interest"). Thus, the Final Rule permits, subject to various restrictions, the recognition of minority interest in a fully consolidated subsidiary as capital of the parent banking organization. In order for any minority interest to be recognized, the instrument giving rise to the minority interest must meet all of the criteria for recognition as capital (i.e., CET1 capital, additional tier 1 capital, or tier 2 capital) that would apply if the instrument had been issued by the parent banking organization. Moreover, only CET1 capital issued to third parties by a subsidiary that is an insured depository institution or a foreign bank may be recognized (subject to applicable limits) as CET1 of the parent banking organization. The Final Rule retains the Proposed Rules' complex limitations designed to limit the amount of "surplus capital" at the subsidiary level that can be included as regulatory capital by the consolidated parent. Despite negative comments from the industry, the Final Rule also subjects "REIT preferred" to this minority interest regime, including the requirements that dividends be cancellable (although consent dividends may be used to satisfy this requirement) and that the subsidiary be actively managed to earn a profit (which will likely disqualify many REIT subsidiaries established for the purpose of raising tax-advantaged tier 1 capital).

IV. Standardized Approach for Risk-Weighted Assets

Consistent with the Proposed Rules, the Final Rule requires all banking organizations to calculate standardized risk-weighted asset amounts for on- and off-balance sheet exposures and, for "market risk banks" (i.e., those with aggregate trading assets and trading liabilities equal to (i) 10% or more of total assets or (ii) $1 billion), standardized market risk-weighted assets. Standardized risk-weighted asset amounts generally are determined by assigning on-balance sheet assets to broad risk weight categories according to the counterparty (or, if relevant, the guarantor or collateral). Risk-weighted asset amounts for off-balance sheet items are calculated by: (1) multiplying the amount of the off-balance sheet exposure by a credit conversion factor ("CCF") to determine a credit equivalent amount and (2) assigning the credit equivalent amount to a relevant risk weight category. Set forth below is a discussion of how certain key assets will be risk-weighted under the Final Rule.

Residential Mortgages. The Final Rule abandons the highly controversial treatment of residential mortgages under the Proposed Rules. As originally proposed, residential mortgage exposures would have been subject to a risk-weighting of 35% - 200% based on a combination of characteristics of the loan, including the loan-to-value ("LTV") ratio. In response to criticism that the proposed risk-weighting framework failed to properly categorize the relative riskiness of certain loans, entailed unnecessary regulatory burden, and, combined with the still uncertain effects of the Consumer Financial Protection Bureau's recently adopted "Qualified Mortgage" standards, ultimately would inhibit lending to creditworthy borrowers, the Final Rule retains the treatment of residential mortgage loans that applies under the Current Rules. Thus, under the Final Rule, residential mortgage loans secured by a first lien on a one-to-four family residential property that is owner-occupied or rented, that are prudently underwritten, that are not 90 days or more past due or in nonaccrual status, and that have not been modified or restructured (other than pursuant to the Home Affordable Modification Program) will continue to receive a 50 percent risk weight. All other residential mortgage loans, including exposures secured by a junior lien on residential property, will continue to be assigned a 100 percent risk weight.[13]

Although the Final Rule retains the existing risk weights for residential mortgages, higher capital requirements for perceived higher risk mortgages could still be imposed through other means. For example, banking organizations with $50 billion or more in assets are subject to the Board's stress testing requirements, which could effectively require more capital for certain residential mortgages. In addition, the Agencies retain substantial discretion under the "prudently underwritten" standard to preclude reliance on the 50% risk weight for residential mortgage loans with perceived high-risk features.

Non-US Sovereigns. The standardized approach under the Final Rule continues to risk-weight exposures to non-US sovereign entities, foreign banks, and non-US public sector entities according to OECD Country Risk Classifications ("CRC") as proposed, albeit with changes necessary to account for the OECD decision to cease providing CRCs for certain high-income jurisdictions.[14] Under the Final Rule, sovereign exposures would be risk-weighted from 0% (for OECD members with no CRC, and those rated 0-1) to 150% (for those rated 7 and those in default).

High-Volatility CRE Exposures. Consistent with the Proposed Rules, high-volatility commercial real estate ("HVCRE") exposures will receive a risk-weighting of 150% under the Final Rule's standardized approach, as compared to 100% under the Current Rules. However, in response to industry comment, the Agencies have revised the definition of HVCRE exposures to exclude loans used to finance (i) the acquisition, development, or construction of real property that would qualify as a community development investment and (ii) the purchase or development of agricultural land.

Past Due Exposures. Also consistent with the Proposed Rules, exposures that are more than 90 days past due will receive a risk weight of 150% under the standardized approach, up from 100% under the Current Rules.

Off-Balance Sheet Items. As proposed (and consistent with the Current Rules), off-balance sheet exposures are risk-weighted under the standardized approach by applying a CCF and assigning the resulting credit equivalent amount to the appropriate risk weight category. The Final Rule retains without change the CCFs for off-balance sheet exposures that had been included in the Proposed Rules, including a 20 percent CCF for commitments with an original maturity of one year or less that are not unconditionally cancelable by a banking organization, a provision that represents a significant increase over the current 0% CCF and had been opposed by many commenters.

Early Payment Default Repurchase Obligations. Under the general risk-based capital rules as well as the Final Rule, a banking organization is generally subject to a capital charge when it provides credit-enhancing representations and warranties on assets sold or otherwise transferred to third parties. The Agencies had proposed to eliminate the safe harbor that permits a banking organization to avoid incurring such a regulatory capital charge for residential mortgage loans sold subject to early default clauses or similar warranties that permit the return of a loan for a period not to exceed 120 days from the date of transfer. Significantly, however, in the Final Rule, the Agencies elected to retain the 120-day safe harbor, thus avoiding substantially higher capital requirements for banks that sell large volumes of mortgage loans. The Final Rule also clarifies that the capital requirement applies to the maximum contractual exposure (e.g., refunds of servicing premium and other fees), not to the underlying loan, and confirms that representations about the value of the underlying collateral will not trigger additional capital requirements.

OTC Derivatives and Cleared Transactions. Consistent with the Proposed Rules, the Final Rule generally retains the treatment of OTC derivatives (now including certain unsettled securities, commodities or foreign exchange transactions) under the current risk-based capital rules for both Standardized and Advanced Banks. Accordingly, OTC derivatives exposures will be calculated using the "Current Exposure Method," consisting generally of current mark-to-market exposure, plus potential future exposure calculated by applying a specified set of conversion factors (multipliers that vary based on the type and remaining maturity of the specific derivatives contract) to the notional principal amount, with only limited recognition of netting.[15] An Advanced Bank would have the option to use internal models, but only if approved by its regulator. Special rules apply to equity derivatives and credit derivatives.[16] Despite industry opposition, the Final Rule removes the 50% risk weight cap for OTC derivatives exposures under the Current Rules. Consistent with the current advanced approaches rules and the Proposed Rules, the Final Rule also provides greater recognition of collateral and guaranties than the Current Rules. Under the Final Rule, derivatives transactions between a clearing member bank and its client are treated as OTC derivatives exposures (rather than cleared transactions) but benefit from a reduced exposure calculation.

The Final Rule generally incorporates more favorable capital treatment for cleared derivatives (as well as securities financing) transactions, based on the Basel Committee's July 2012 interim framework.[17] The requirements differ based on whether (i) the clearing organization meets certain requirements (and is therefore a "Qualifying Central Counterparty" or "QCCP"); (ii) the bank is a clearing member or a client of a clearing member; (iii) the exposure is a trade exposure (generally, risk-weighted at 2% or 4% for QCCPs; 100% for non-QCCPs) or default fund contribution (capital charge calculated using either a three-step formula (with more liberalized netting benefits recognition than originally proposed) or by applying a 1250% risk weight capped at 18% of the bank's overall trade exposures to the QCCP); and (iv) if the bank is a clearing member, whether it is facing its client (as noted above, generally treated as an OTC derivative) or the CCP (generally treated as a cleared transaction).

In addition to maintaining capital against their OTC derivatives exposures, Advanced Banks also must maintain capital to cover "credit valuation adjustment" ("CVA") risk (i.e, the risk of mark-to-market losses to a derivatives contract resulting from deterioration in the counterparty's credit risk). The Final Rule provides Advanced Banks with a choice of a "simple" or "advanced" CVA approach. The Final Rule clarifies that the CVA requirement is calculated on a portfolio rather than counterparty-by-counterparty basis, but explicitly rejects commenters' proposals to exclude certain counterparties (such as sovereigns, pension funds and corporate end-users) from the CVA requirement.[18]

Equity Exposures. The Final Rule substantially revises the risk weights for equity exposures as compared to the Current Rules, adopting a range of risk weights from 0% (for sovereigns and other entities whose debt securities are eligible for a 0% risk weight) to 400% or 600% (for non-publicly traded equity exposures and equity exposures to certain leveraged investment firms that otherwise meet the definition of "traditional securitization," respectively). Publicly traded equities generally attract a risk weight of 300%, while (as discussed above) that portion of a significant investment in the common stock of an unconsolidated financial institution that is not deducted from capital attracts a risk weight of 250%. In order to obtain the risk weight amount for an equity exposure under the Final Rule, the adjusted carrying value of the exposure is multiplied by the appropriate risk weight. For off-balance sheet equity exposures, the adjusted carrying value is equal to the effective notional principal amount of the exposure (i.e., the amount of a hypothetical on-balance sheet position in the underlying equity instrument that would evidence the same change in fair value for a given small change in the price of the underlying equity instrument).

Equity exposures to investment funds are subject to a separate regime, which consists of three different options for risk-weighting these exposures: (1) a new "full look-through approach" where the aggregate risk-weighted asset amounts for all investments held by the fund are multiplied by the banking organization's proportional interest in the fund; (2) a "simple modified look-through approach," similar to one of two methods available under the Current Rules, pursuant to which a banking organization multiplies its exposure to the fund by the highest risk weight of the assets in the fund (excluding derivatives used for hedging purposes); and (3) an "alternative modified look-through approach," similar to the other method currently available for risk-weighting equity exposures to investment funds, pursuant to which a banking organization assigns risk weights on a pro rata basis according to the investment limits in the fund's offering documents. Each method is subject to a risk-weight floor of 20%. The Agencies acknowledged in the preamble to the Final Rule that investment funds that hold securitization exposures may be subject to punitive risk weights under these look-through approaches if a banking organization lacks the information needed about the underlying securitization exposure to apply the SSFA or even "gross-up" treatment (discussed below), and banking organizations thus would potentially be forced to apply a 1250% risk weight to the investment fund. However, rather than offer any relief, the Agencies simply indicated their belief that this aspect of the Final Rule provides appropriate incentives for banking organizations to perform the necessary diligence on the underlying securitization exposures.[19]

V. Securitization Framework

The Final Rule adopts the more restrictive securitization framework generally as proposed.

Accordingly, consistent with Section 939A of Dodd-Frank and with the Proposed Rules, the existing ratings-based approach under the Current Rules is replaced by the Simplified Supervisory Formula Approach ("SSFA") for both Standardized and Advanced Banks. The SSFA calculates capital for securitization exposures based on the risk-weights and performance (measured by delinquencies) of the underlying exposures, and the relative position of the exposure in the structure—i.e., attachment (when losses are first allocated to the tranche) and detachment (when the tranche suffers total loss) points.[20] Standardized Banks must use either the SSFA or "gross-up" approach (calculate risk weight of underlying assets allocable to the securitization exposure plus all senior positions). Advanced Banks must, if possible, use the Supervisory Formula Approach ("SFA"), or otherwise the SSFA. Compared to the SSFA, the SFA requires substantially more data on the underlying exposures in order to compute loan-level parameters such as probability of default, exposure at default and loss given default that are used by Advanced Banks to determine the risk weights for the underlying exposures. Significantly, the Final Rule retains the controversial 20% risk weight floor under both the SFA and the SSFA, as well as the new due diligence requirements and accompanying 1250%[21] risk weight penalty for inadequate due diligence.[22]

The Final Rule retains in the definition of "traditional securitization exposure" the proposed distinction between operating companies and investment firms, as well as the Agencies' discretion to "scope out" certain investment firms from the definition based upon various factors intended to distinguish structured finance transactions (such as managed CDOs and SIVs) from certain hedge funds and private equity firms that are deemed to "exercise substantially unfettered control over the size and composition of [their] assets, liabilities and off-balance sheet exposures." In this regard, the Final Rule simply repeats language from the Proposed Rules and the existing advanced approaches rule and offers no additional guidance on various ambiguities that have arisen, including treatment of various types of exposures to hedge funds.

The Agencies explicitly rejected adopting a blanket exclusion for short-term loans to support day-to-day investments of investment firms. The Final Rule does add an exclusion for pension funds, however. Helpfully, the Agencies also clarified that specialized loans to finance the construction or acquisition of large-scale projects or commodities would not be securitization exposures since the assets backing the loans are non-financial (the facility or commodity being financed).

The Final Rule continues to treat as a resecuritization any securitization exposure in which even a minimal amount of the underlying assets are securitization exposures (explicitly rejecting comments that suggested a proportionate treatment), but it does exclude retranched single underlying exposures (e.g., re-REMICs) from treatment as a resecuritization. The Final Rule also provides clarification as to when an exposure to an asset-backed commercial paper ("ABCP") program must be treated as a resecuritization.[23]

Consistent with the Proposed Rule and the Basel III international framework, the Final Rule permits an eligible ABCP liquidity facility to be risk-weighted based on the highest risk weight applicable to any of the underlying exposures, and permits a securitization exposure that is in a second-loss position or better to an ABCP program to be risk-weighted at the higher of 100% or the highest risk weight applicable to any of the underlying exposures, provided certain conditions are met.

One of the major objections to the securitization framework as set forth in the Proposed Rules was the potential impact on the competitive position of US banks relative to non-US banks, especially as a result of the 20% risk weight floor for securitization exposures, which as noted above has been retained in the Final Rule. The Basel Committee answered that objection in December with a new proposal for the securitization framework,[24] which includes the 20% floor that has now been adopted in the United States as well as other measures that would substantially increase the risk weights for many securitization exposures. It is likely that the Agencies will adopt at least some of these changes as amendments to the Final Rule once the new securitization framework is finalized internationally by the Basel Committee.

VI. Credit Risk Mitigation

The Final Rule permits a broader range of credit risk mitigation ("CRM") techniques than is recognized under the Current Rules, including through the use of guarantees, credit derivatives, and collateral, essentially extending the CRM principles available to Advanced Banks to Standardized Banks as well. In order to apply CRM under the Final Rule, a banking organization must implement operational procedures and risk-management processes sufficient to ensure that all documentation used in collateralizing or guaranteeing a transaction is legal, valid, binding, and enforceable under applicable law in all relevant jurisdictions. This includes a "legal review" requirement to ensure documentation meets applicable standards and an ongoing monitoring obligation.

Guarantees and Credit Derivatives. Like the Current Rules, the Final Rule permits a banking organization to apply a "substitution approach" to recognize the CRM effect of an eligible guarantee or credit derivative from an eligible guarantor. The Final Rule permits a broader range of eligible guarantors than what is currently permitted under the general risk-based capital rules, including sovereigns, various international development organizations, the Federal Home Loan Banks, depository institutions, BHCs and SLHCs, and foreign banks. Eligible guarantors also include entities (other than special purpose entities and monoline insurers) that have issued and outstanding unsecured debt securities (without credit enhancements) that are investment grade. In a change from the Proposed Rules, the Final Rule adds QCCPs to the list of eligible guarantors to accommodate the use of the substitution approach for credit derivatives that are centrally cleared. Provided that the guarantor is an eligible guarantor and the guarantee or credit derivative meets applicable eligibility requirements, including as to enforceability, the substitution approach permits a banking organization to substitute the risk weight applicable to the guarantor or credit derivative protection provider for the risk weight applicable to the hedged exposure to the extent that the protection amount exceeds the amount of the hedged exposure. The protection amount is determined by applying any applicable haircuts for maturity mismatch, lack of restructuring coverage, or currency mismatch to the effective notional amount of the guarantee or credit derivative.

Collateral. The Final Rule also expands the definition of "financial collateral" that may be recognized for CRM purposes beyond what is permitted under the Current Rules. Under the Final Rule, eligible financial collateral includes: (1) cash on deposit with the banking organization (including cash held for the banking organization by a third-party custodian or trustee); (2) gold bullion; (3) investment grade debt securities (long-term and short-term) other than resecuritization exposures; (4) publicly traded equity securities; (5) publicly traded convertible bonds; and (6) shares of money market funds and mutual funds that are publicly quoted on a daily basis.[25] Thus, despite industry objections, the Final Rule adopts the Proposed Rules' exclusion of resecuritizations, conforming residential mortgages, and non-investment grade debt securities as eligible financial collateral. For items (2) through (6), the banking organization must have a perfected, first-priority security interest in the collateral or, if outside the United States, the "legal equivalent thereof," in order to recognize the collateral for CRM purposes.

Provided all applicable eligibility and risk management requirements are satisfied, the Final Rule permits recognition of financial collateral using either the "simple approach" (which can be applied for any type of exposure) or the "collateral haircut approach" (which can be applied only with respect to repo-style transactions, collateralized derivative transactions, eligible margin loans, or single-product netting sets of such transactions). Under the simple approach, the collateralized portion of an exposure generally receives the risk weight applicable to the financial collateral, subject in most cases to a 20% floor (with exceptions for exposures collateralized by cash on deposit, certain OTC derivatives marked-to-market daily, and exposures to sovereigns that qualify for a 0% risk weight). Under the collateral haircut approach, a banking organization uses a supervisory formula and either supervisory or its own estimates of collateral haircuts in order to arrive at the measure of exposure for eligible transactions. The supervisory haircuts adopted under the Final Rule for securitization exposures and other financial collateral provide some relief from the Proposed Rules (e.g., a reduction in the standard supervisory market price volatility haircuts for financial collateral issued by non-sovereign issuers with a risk weight of 100% from 25% to a range of 4.0% to 16.0% based on maturity).

VII. Revisions to the Advanced Approaches for Risk-Weighted Assets

The Agencies in June 2012 proposed a number of revisions to the existing advanced approaches rule to incorporate Basel 2.5 and III requirements to hold more appropriate levels of capital for counterparty credit risk, CVA risk, and "wrong-way" risk (i.e., the risk that arises when an exposure to a particular counterparty is positively correlated with the probability of default of that counterparty), as well as to strengthen the risk-based capital requirements for certain securitization exposures. The Proposed Rules also included revisions intended to meet the requirements of section 939A of the Dodd-Frank Act regarding elimination of references to credit ratings. The Final Rule adopts these revisions to the advanced approaches framework largely as proposed (with some technical and clarifying changes), and in a manner consistent with the international framework.

Among the revisions to the existing advanced approaches rule is a set of requirements to enhance the internal models methodology ("IMM") for calculating exposures, including through the use of stressed inputs and periodic review and validation; new risk management requirements intended to ensure that Advanced Banks monitor and control wrong-way risk; and measures related to CVA risk as described above with respect to derivatives transactions. The Final Rule also imposes (through the "asset value correlation" or "AVC" factor) increased capital requirements for exposures to non-regulated financial institutions and to regulated financial institutions with total consolidated assets in excess of $100 billion in order to address risks related to the correlation of credit risk among financial institutions.

VIII. Disclosure Requirements

Under the Final Rule, each Advanced Bank and each top-tier US BHC or SLHC with $50 billion or more in total consolidated assets that is a Standardized Bank is subject to quantitative and qualitative disclosure requirements with respect to its regulatory capital. These disclosures will be required on a quarterly basis, beginning in 2015. Advanced Banks that do not complete their parallel run phase by the beginning of 2015 will be subject to the disclosure obligations set forth under the standardized approach until the parallel run is complete. The Final Rule includes ten separate tables of quantitative and qualitative information that must be disclosed by Standardized Banks and 12 tables for Advanced Banks, addressing topics such as the scope of capital reporting and consolidation; capital structure, including a detailed breakdown of the individual components of a banking organization's reported capital levels; risk-weighted assets broken down by category; capital buffer information; CRM practices; securitization; and risk management.

IX. Implementation Schedule and Transition Provisions

As proposed, Advanced Banks will be required to begin transitioning to the new minimum capital requirements imposed by the Final Rule on January 1, 2014. As of that date, Advanced Banks will be required to comply with the Final Rule's advanced approaches for determining risk-weighted assets, while still computing risk-weighted assets under the Current Rules as their Collins Amendment "floor." In addition, this will begin the transition to the higher Basel III minimum regulatory capital ratios (other than the capital buffers) as well as the more restrictive definition of regulatory capital and stricter regulatory adjustments and deductions. Beginning January 2015, the Collins Amendment risk-weighted assets floor would be determined based on the standardized approach under the Final Rule rather than the Current Rules. In January 2016, Advanced Banks would begin to phase-in the capital conservation and (as applicable) countercyclical capital buffers.

Standardized Banks received a one-year delay under the Final Rule and will not be required to begin implementing the standardized approach under the Final Rule until January 1, 2015. Like Advanced Banks, Standardized Banks also would begin to phase-in the capital conservation buffer in January 2016.

The specific transition rules and schedules for different aspects of the new capital regime for both Standardized and Advanced Banks are complex and highly detailed (e.g., with different schedules for the phase in of the capital buffers and the new deductions from/adjustments to capital, phase out of non-qualifying capital instruments). The Final Rule sets out these transition arrangements in a series of charts and timelines. Of course, market expectations and other considerations often force banking organizations to comply with new or emerging capital requirements even before they formally take effect.

X. Market Risk Rule

The Final Rule incorporates the Agencies' existing market risk capital rule into the comprehensive US capital framework.[26] In conjunction with adoption of the Final Rule, the Agencies are also issuing a market risk NPR that would, among other things, make changes to the risk weights for sovereign exposures, non-publicly traded mutual funds, and certain student loans to conform to the Final Rule. The market risk NPR will be subject to a 60-day comment period upon publication in the *Federal Register*.

XI. Additional Capital Requirements for G-SIBs

As noted above, while the Final Rule may constitute the last major step in the reform of the US regulatory capital regime for the vast majority of banking organizations, significant additional measures remain pending for those US banks designated as G-SIBs. In remarks offered at the July 2 Board meeting, Governor Tarullo summarized those additional measures as follows:

- An NPR to impose a significantly higher supplementary leverage capital requirement beyond that which is currently required under Basel III and incorporated in the Final Rule. As discussed above, the Leverage Ratio NPR was approved by the Agencies on July 9, 2013, and would impose this enhanced

supplementary leverage requirement on US G-SIBs and their depository institution subsidiaries.
- Within the next several months, the Board expects to issue another NPR imposing requirements with respect to the combined amount of equity and long-term debt these firms should maintain in order to facilitate orderly resolution, including a new minimum long-term unsecured debt requirement.
- After the Basel Committee has completed its framework for risk-based capital surcharges on G-SIBs, the Agencies intend to issue another NPR to implement the risk-based capital surcharge framework in the United States. This proposal, which, based on the work of the Basel Committee to date, is expected to include capital surcharges of 1.0% to 2.5% beyond existing minimum requirements, is expected in late 2013.
- Finally, Board staff is working on an advanced notice of proposed rulemaking ("ANPR") to address risks associated with reliance on short-term wholesale funding, including the possibility of additional capital requirements for large firms that rely substantially on such funding.

XII. Conclusion

With the approval of the Final Rule, the United States joins the 23 other members of the 27-member Basel Committee (including the EU members) that have adopted final regulations implementing the Basel III capital regime.[27] Despite this significant step, however, the post-financial crisis evolution of regulatory capital requirements in the United States (and elsewhere) remains far from complete.[28] In the United States, separate proposals to implement enhanced capital requirements for various categories of the largest banks, as discussed earlier, are already well under way, and the first of these (the recently released Leverage Ratio NPR) by itself raises significant policy and practical considerations. At the international level, the Basel Committee, as noted throughout this Update, has issued proposals that would affect many areas covered by the Final Rule, including the Basel III supplementary leverage ratio, capital treatment of exposures to central counterparties, capital treatment of equity investments in funds, methodologies for measuring counterparty credit risk exposure under derivatives transactions, and the securitization framework.[29] In most instances, the Agencies already have indicated they will likely consider reflecting in the US regime any final changes made by the Basel Committee. More broadly, policy debates over the proper purpose, calibration, consistency, complexity, and economic impact of regulatory capital requirements continue and, if anything, grow in intensity. As a result, at the same time US banking organizations begin the difficult work of navigating a completely overhauled regulatory capital landscape, they must do so with the understanding that yet more changes are likely and that regulatory capital requirements are themselves only part of a series of fundamental changes taking place in the overall regulatory environment.

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Endnotes

[1] "Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule," Federal Register publication pending, available in draft at http://www.federalreserve.gov/bcreg20130702a.pdf.

[2] The Final Rule incorporates and consolidates three separate notices of proposed rulemaking: "Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action," 77 Fed Reg. 52792 (Aug. 30, 2012) (the "Basel III NPR"); "Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements," 77 Fed. Reg. 52888 (Aug. 30, 2012) (the "Standardized Approach NPR"); and "Regulatory Capital Rules: Advanced Approaches Risk-Based Capital Rule; Market Risk Capital Rule," 77 Fed. Reg. 52978 (Aug. 30, 2012) (the "Advanced Approaches NPR"). For a summary of the June 2012 NPRs, please see our Legal Update available at http://www.mayerbrown.com/publications/detail.aspx?publication=8039. Because it represents a complete restatement of existing US regulatory capital requirements, the Final Rule eliminates often subtle differences among the capital rules of the different Agencies.

[3] As discussed later in this update, however, the Basel Committee has recently adopted or proposed revisions to several important elements of the Basel III international framework that could, in fact, lead to additional changes to the Final Rules, even for Standardized Banks.

[4] "Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and their Subsidiary Insured Depository Institutions," Federal Register publication pending, available in draft at http://www.federalreserve.gov/newsevents/press/bcreg/20130709a.htm. The FDIC's decision to approve the Final Rule as an interim final rule appears to have been based on its view that the Leverage Ratio NPR is a critical piece of the overall US regulatory framework and its desire to receive comments on the interrelationships between the Final Rule and proposed enhanced supplementary leverage standards.

[5] Under separate proposals issued by the Board pursuant to the enhanced prudential standards contained in Section 165 of Dodd-Frank, the Final Rule also would apply to US intermediate holding companies required to be established by large foreign banking organizations with significant US operations and (subject to modification) to nonbank financial companies designated as systemically important. For more information on the Section 165 proposal for FBOs, see our Legal Update available at http://www.mayerbrown.com/Federal-Reserve-Proposes-Enhanced-Prudential-Standards-for-Non-US-Banking-Organizations-12-20-2012/.

[6] The Final Rule emphasizes that these requirements are in fact minimums, and that banking organizations, especially those contemplating significant expansion or raising other supervisory concerns, are generally expected to operate with capital levels "well above" the minimum ratios.

[7] As of the date of this update, no US banking organization has yet received approval to exit the parallel run.

[8] On June 26, 2013, the Basel Committee published a consultative paper proposing certain revisions to the supplementary leverage ratio, primarily related to the treatment of derivatives and securities financing transactions, and setting forth the public disclosure requirements that would apply beginning in January 2015. The paper, "Revised Basel III leverage ratio framework and disclosure requirements," is available at http://www.bis.org/publ/bcbs251.htm. In the Leverage Ratio NPR and the Final Rule, the Agencies indicated they will consider the appropriateness for US banking organizations of any adjustments ultimately made by the Basel Committee.

[9] The denominator of the supplementary leverage ratio, or "total leverage exposure," includes the full notional amount of all off-balance sheet exposures other than securities financing transactions, derivatives and unconditionally cancellable commitments (the latter two of which are incorporated as described above).

[10] In addition to the adjustments discussed below, the Final Rule also retains the proposed deductions from CET1 of any after-tax gain-on-sale associated with a securitization exposure, but clarifies that any recognized mortgage servicing asstes ("MSAs") that would already be subject to deduction (as discussed below) would not be subject to double deduction.

[11] The term "financial institution" for this purpose (and other aspects of the Final Rule requiring deductions for investments in the capital of "financial institutions") remains broadly defined to include all manner of regulated entities (e.g., banks and BHCs; savings and loan holding companies; nonbank financial institutions supervised by the Board; foreign banks; credit unions; industrial loan companies and similar entities; insurance companies; SEC-registered brokers and dealers; futures commission merchants and swap dealers and security-based swap dealers) as well as entities "predominantly engaged" in financial activities. In a change from the Proposed Rules, the definition of "financial institution" under the Final Rule does not include "commodity pools" or Volcker Rule "covered funds," and several explicit exceptions to the definition of "financial institution" have been added, including for ERISA plans and investment funds registered with the SEC under the Investment Company Act of 1940. In addition, in recognition of the burden of applying the functional "predominantly engaged" test, the Final Rule requires that functional test to be used only for large investments (i.e., those in which the banking organization has an investment of at least $10 million or 10% of the outstanding common shares).

[12] The rules regarding capital treatment of investments in other financial institutions are complex, and the Final Rule includes a helpful flow chart on page 190 of the draft Federal Register notice (see link in note 1 above).

[13] Consistent with the Proposed Rules and the Current Rules (and as required by statute), the Final Rule retains the 50% risk weight for residential construction and multi-family residential loans that meet certain criteria.

[14] Under the revisions in the Final Rule, exposures to unrated sovereigns that are OECD members would be risk-weighted at 0%, while those to unrated sovereigns that are not members of the OECD would be risk-weighted at 100% (i.e., the approach to all sovereign exposures under the Current Rules).

[15] The conversion factors are the same as under the Current Rules, with new categories added for credit derivatives in accordance with the existing risk-based capital rules for Advanced Banks. On June 28, 2013, the Basel Committee published a consultative paper proposing to improve the methodology for assessing the counterparty credit risk associated with derivative transactions. The proposal would replace the Basel III international capital framework's existing non-internal model methods (the Current Exposure Method and the Standardised Method) with a new Non-Internal Model Method that contains updated supervisory factors, provides a more meaningful recognition of netting benefits, reduces the scope for discretion by banks, and avoids undue complexity. The paper, "The non-internal model method for capitalising counterparty credit risk exposures," is available at http://www.bis.org/publ/bcbs254.htm. The Agencies will likely consider amending the Final Rule to implement any new method ultimately adopted by the Basel Committee.

[16] Equity derivatives generally will be treated as equity exposures, rather than being subject to a counterparty credit risk capital requirement, unless they are subject to the market risk rules. A bank that purchases a credit derivative as protection for a banking book exposure generally will not have to compute a separate counterparty credit risk capital requirement, and a bank that provides protection under a credit derivative will treat the exposure as an exposure to the underlying reference asset with no counterparty credit risk capital requirement unless the protection-providing bank treats the credit derivative as subject to the market risk rules.

[17] On June 28, 2013, the Basel Committee published a consultative paper proposing certain revisions to the July 2012 interim framework, intended primarily to ensure that banks' exposures to qualifying central counterparties are adequately capitalized, while also preserving incentives for central clearing. The paper, "Capital treatment of bank exposures to central counterparties," is available at http://www.bis.org/publ/bcbs253.htm. Again, the Agencies indicated they will consider whether to adopt any changes ultimately made by the Basel Committee.

[18] Failure to exclude these counterparties places the Final Rule at odds with the European Union's approach in CRD IV. The potential for placing US banking organizations at a competitive disadvantage has already become a political issue, with the House of Representatives recently passing a bill (HR 1341) directing the Financial Stability Oversight Council to assess the impact of differences between the US and other jurisdictions in implementing the CVA requirement.

[19] On July 5, 2013, the Basel Committee published a consultative paper proposing certain revisions to the prudential treatment of banks' equity investments in funds, primarily related to clarification of the treatment of the risk of a fund's underlying investments and its leverage. The paper, "Capital requirements for banks' equity investments in funds," is available at http://www.bis.org/publ/bcbs257.htm.

[20] In response to comments, the Final Rule modifies the delinquency parameter ("W") of the proposed SSFA to exclude non-credit-related deferrals of payments on student (and other consumer) loans.

[21] Although conceding that a 1250% risk-weight is more onerous than a simple deduction for those banks that

maintain capital above the required minimums, the Final Rule retains the 1250% approach "for consistency and simplicity."

[22] Under the due diligence standard, banking organizations must demonstrate a "comprehensive understanding of the features of a securitization exposure that would materially affect the performance of the exposure" through an analysis (conducted prior to acquisition and documented within three business days) of specified structural, performance and market data that is "commensurate with the complexity of the…exposure and the materiality of the position in relation to regulatory capital…." While not changing the actual regulatory standard or the 1250% penalty from the Proposed Rules, the preamble to the Final Rule suggests that the Agencies will permit appropriate flexibility where, for example, market data is not available (e.g., for foreign exposures) or loan-level data is not available (in which case the Agencies indicate that pool-level data can be used).

[23] For example, the Final Rule indicates that a pool-specific liquidity facility for a typical multi-seller ABCP conduit generally will not be a resecuritization exposure, whereas a program-wide credit enhancement that does not cover all losses above the seller-provided credit enhancement generally will be a resecuritization exposure.

[24] Basel Committee, "Revisions to the Basel Securitisation Framework" (December 2012), available at http://www.bis.org/publ/bcbs236.pdf.

[25] Under the Current Rules, eligible collateral is generally limited to cash, US government and agency securities, obligations of certain international organizations and non-US central governments.

[26] The Agencies adopted final amendments to the market risk rule in June 2012 in conjunction with the issuance of the Proposed Rules. "Risk-Based Capital Guidelines: Market Risk," 77 Fed. Reg. 53060 (Aug. 30, 2012).

[27] Basel Committee, "Progress report on implementation of the Basel regulatory framework" 6-7 (April 4, 2013), available at http://www.bis.org/publ/bcbs247.htm. The EU has adopted Basel III in the form of a new Regulation, known as the Capital Requirements Regulation or CRR (Regulation (EU) No. 575/2013, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:176:0001:0337:EN:PDF), and a Directive known as the Capital Requirements Directive IV or (sometimes together with the CRR) as CRD IV (Directive 2013/36/EU, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:176:0338:0436:EN:PDF). The Regulation (which includes rules on capital requirements for credit institutions and investment firms, as well as large exposure limits and other prudential rules) will apply directly in EU member states without further legislative action, while the Directive (which governs among other things the framework for member states' authorisation and supervision of those institutions) will need to be separately adopted in each member state. CRR and CRD IV together supersede and replace the existing Capital Requirements Directive or CRD (which refers collectively to the Banking Consolidation Directive, 2006/48/EC, and the Capital Adequacy Directive, 2006/49/EC), as amended. The CRR and CRD IV were published in final form on Jun. 26, 2013, and will become effective beginning Jan. 1, 2014, subject to various transition rules generally consistent with those in Basel III. The existing CRD already incorporated the Basel II framework and several later amendments.

[28] Moreover, of course, the Final Rule does not include the liquidity aspects of the Basel III international framework. The Agencies are expected within the next several months to publish a proposal to implement the Basel III liquidity coverage ratio ("LCR") in the United States, which itself was revised by the Basel Committee in January of this year. Basel Committee, "Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools" (January 2013), available at http://www.bis.org/publ/bcbs238.pdf. The second even more controversial Basel Committee liquidity measure—the net stable funding ratio—remains a work in progress at the Basel Committee level so any US action on that aspect of Basel III remains some time away.

[29] The Basel Committee also recently released a discussion paper designed to establish the framework for efforts to simplify the existing Basel capital regime. Basel Committee, "The regulatory framework: balancing risk sensitivity, simplicity and comparability" (July 8, 2013), available at http://www.bis.org/publ/bcbs258.htm.

taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.

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Securitization Provisions Contained in Final Rule to Implement Basel III Regulatory Capital Framework in the United States

Each of the US bank regulators[1] (collectively, the Agencies) has recently adopted a final rule[2] (in the case of the FDIC, an interim final rule) to implement the Basel III regulatory capital framework[3] for banking organizations in the United States.[4] This update will describe the Final Rule's securitization provisions in more detail since, while arguably containing no significant surprises (at least to those familiar with the June 2012 NPRs and US Basel II), the securitization provisions of the Final Rule are nevertheless likely to cause some disappointment to affected banking organizations insofar as many objections and requests for relief were not reflected in the Final Rule. Moreover, the Final Rule reflects the recognition that the securitization framework is something of a "work-in-process" with ongoing BCBS work-streams and other activities that could – even significantly - impact the securitization framework, as well as the Agencies' ongoing supervisory review of the effects and other consequences of the implementation of the Final Rule.

Final Rule Generally Adopts Proposed Rules

As noted in our recent Legal Update, the Final Rule generally adopted the rules for the treatment of securitization exposures under the regulatory capital framework that had been previously proposed[5] without significant change, except as noted below.[6]

Just as the June 2012 NPRs had proposed, the Final Rule substantially revises the risk-based regulatory capital framework for securitization exposures for all US banking organizations. These revisions include removing references to, and reliance on, credit ratings to determine risk weights for these exposures, as required by section 939A of the Dodd-Frank Act. As noted below, the Final Rule includes the controversial floor or minimum risk weight of 20 percent for any securitization exposure as well as the 1,250 percent risk weight in many circumstances in which the industry had sought relief.

Consistent with the securitization approach in effect for US advanced approaches banks under Basel II (US Basel II),[7] the Final Rule updates the terminology for the securitization framework to include a definition of securitization exposure that encompasses a wider range of exposures with similar risk characteristics. In addition, as was proposed in the June 2012 NPRs, the Final Rule implements new due diligence and other operational requirements for securitization exposures.

No Mention of BCBS Consultation Document 236

Somewhat curiously, the Final Rule makes no mention of the BCBS' December 2012 Consultative Document,[8] which proposed additional changes to the Basel III securitization framework. These changes included the introduction of a new maturity feature throughout the framework, starting with the modified supervisory formula approach or MSFA, that is based on the supervisory formula approach (SFA). Industry comments on this proposal have been critical of the significant increase in capital resulting from the new maturity factor as well as the relatively limited risk sensitivity in those approaches most likely to be used by banks as investors and the lack of consistency in resulting capital charges under the various alternative approaches. In rather sharp contrast to the absence of discussion of BCBS 236, the Final Rule extensively references the ongoing BCBS work-streams in other areas, including exposures to central counterparties (CCP) and over-the-counter (OTC) derivatives exposures, and specifically notes that the Final Rule will likely be revised when that other work is concluded.

Definitions of Securitization and Securitization Exposure

Consistent with the June 2012 NPRs and US Basel II, the Final Rule defines a securitization exposure as an on- or off-balance sheet credit exposure (including credit-enhancing representations and warranties) that arises from a traditional or synthetic securitization (including a resecuritization), or an exposure that directly or indirectly references a securitization exposure. The Agencies rejected objections to the proposal that the definition resulted in an overly broad scope and should be limited to exposures that tranche the credit risk associated with a pool of assets. According to the Agencies, both the designation of exposures as securitization exposures (or resecuritization exposures) and the calculation of risk-based capital requirements for securitization exposures under the Final Rule are guided by the economic substance of a transaction rather than its legal form. Provided there is tranching of credit risk, securitization exposures could include, among other things, ABS and MBS, loans, lines of credit, liquidity facilities, financial standby letters of credit, credit derivatives and guarantees, loan servicing assets, servicer cash advance facilities, reserve accounts, credit-enhancing representations and warranties, and credit-enhancing interest-only strips (CEIOs). Securitization exposures also include assets sold with retained tranches.

Traditional Securitization Defined

The Final Rule generally adopts the June 2012 NPRs' (and, in turn, US Basel II's) definition of traditional securitization, which requires that credit risk of one or more underlying exposures has been transferred to one or more third parties (other than through the use of credit derivatives or guarantees), where the credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority. It also includes certain other conditions, such as requiring all or substantially all of the underlying exposures to be financial exposures.

However, the Final Rule also excludes certain exposures from the securitization framework. Specifically, while tranching of credit risk associated with financial assets is often indicative of a securitization, the Agencies found that the securitization framework was not appropriate for tranched credit exposures to commercial or industrial companies or associated with non-financial assets. For example, the Final Rule explicitly states that specialized loans to finance the construction or acquisition of large-scale projects or commodities would not be securitization exposures since the assets backing the loans (the project facility or commodity being financed) are non-financial.

Exclusion for Operating Companies

The Final Rule retains the June 2012 NPR's proposed exclusion (currently in US Basel II) of an operating company from traditional securitizations, even if substantially all of its assets are financial. Operating companies generally refer to companies that are established to conduct business with clients with the intention of earning a profit in their own right and generally produce goods or provide services beyond the business of investing, reinvesting, holding, or trading in financial assets. Accordingly, an equity investment in an operating company generally would be an equity exposure. Under the Final Rule, banking organizations are operating companies and do not fall under the definition of a traditional securitization. However, investment firms that generally do not produce goods or provide services beyond the business of investing, reinvesting, holding, or trading in financial assets would not necessarily be operating companies under the Final Rule and, if so, would not qualify for this general exclusion from the definition of traditional securitization.

Despite comments that requested broader exclusions from traditional securitization for certain investment firms, the Final Rule only adds certain pension funds to the proposed exclusions. The Final Rule also retains the proposed discretion for the primary Federal supervisor of a banking organization to exclude from the definition of a traditional securitization those transactions in which the underlying exposures are owned by an investment firm that exercises "substantially unfettered control" over the size and composition of its assets, liabilities and off-balance sheet exposures.

In determining whether to exclude an investment firm from the securitization framework, the Agencies are to consider a number of factors, including the assessment of the transaction's leverage, risk profile, and economic substance. This supervisory exclusion gives the primary Federal supervisor discretion to distinguish structured finance transactions, to which the securitization framework is designed to apply, from those of flexible investment firms, such as certain hedge funds and private equity funds. Only investment firms that can easily change the size and composition of their capital structure, as well as the size and composition of their assets and off-balance sheet exposures, are eligible for the exclusion from the definition of traditional securitization under this provision. The Agencies do not consider managed collateralized debt obligation (CDO) vehicles, structured investment vehicles (SIVs), and similar structures, which allow considerable management discretion regarding asset composition but are subject to substantial restrictions regarding capital structure, to have "substantially unfettered control." As a result, such transactions will still meet the definition of traditional securitization under the Final Rule. These provisions largely repeat language from the June NPRs and existing US Basel II and thus offer no additional guidance on ambiguities that have arisen, including treatment of various types of exposures to hedge funds.

Scope-in Discretion Retained

In noting that the line between securitization exposures and non-securitization exposures may be difficult to identify in some circumstances, the Final Rule retains the power for the primary Federal supervisor to expand the scope of the securitization framework to include other transactions if doing so is justified by the economics of the transaction. Similar to the analysis for excluding an investment firm from treatment as a traditional securitization, the Agencies will consider the economic substance, leverage, and risk profile of a transaction to ensure that an appropriate risk-based capital treatment is applied. The Agencies will consider a number of factors when assessing the economic substance of a transaction including, for example, the amount of equity in the structure, overall leverage (whether on- or off-balance sheet), whether redemption rights attach to the equity investor, and the ability of the junior tranches to absorb losses without interrupting contractual payments to more senior tranches.

Synthetic Securitizations Defined

As in the proposal and US Basel II, a synthetic securitization is defined as a transaction in which: (1) all or a portion of the credit risk of one or more underlying exposures is transferred to one or more third parties through the use of one or more credit derivatives or guarantees (other than a guarantee that transfers only the credit risk of an individual retail exposure); (2) the credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority; (3) performance of the securitization exposures depends upon the performance of the underlying exposures; and (4) all or substantially all of the underlying exposures are financial exposures (such as loans, commitments, credit derivatives, guarantees, receivables, asset-backed securities, mortgage-backed securities, other debt securities, or equity securities). The Final Rule further clarifies that transactions in which a portion of credit risk has been retained, not just transferred, through the use of credit derivatives is subject to the securitization framework.

Resecuritizations

Rejecting requests for an exclusion or at least a proportionate treatment for resecuritizations that include only a *de minimis* amount of another securitization exposure (for example, a collateralized loan obligation (CLO) transaction with a "basket" for up to 5% of its portfolio to include structured securities), the Final Rule retains the June 2012 NPRs' proposed definition of resecuritization. The definition of "resecuritization" is an on- or off-balance sheet exposure to a resecuritization; or an exposure that directly or indirectly references a resecuritization exposure and, consistent with Basel III, provides that an exposure to an asset-backed commercial paper (ABCP) program is not a resecuritization exposure if either: (1) the program-wide credit enhancement does not meet the definition of a resecuritization exposure; or (2) the entity sponsoring the program fully supports the commercial paper through the provision of liquidity so that the commercial paper holders effectively are exposed to the default risk of the sponsor instead of the underlying exposures. A pool-specific ABCP liquidity facility generally is not a resecuritization exposure under the Final Rule because the pool-specific liquidity facility represents a tranche of a single asset pool (that is, the applicable pool of financial exposures), provided that the pool itself contains no securitization exposures.

However, the Final Rule helpfully clarifies that a re-tranching of a single exposure (for example, a re-REMIC) is not a resecuritization and that pass-through securities do not tranche credit protection and, accordingly, are not securitization exposures.

Securitization Due Diligence Requirements

Consistent with the proposal, the Final Rule requires banking organizations to satisfy specific due diligence and other operational requirements for securitization exposures, including the requirement that the banking organization demonstrate, to the satisfaction of its primary Federal supervisor, a comprehensive understanding of the features of a securitization exposure that would materially affect its performance. The banking organization's analysis would have to be commensurate with the complexity of the exposure and the materiality of the exposure in relation to capital of the banking organization. On an ongoing basis (and no less frequently than quarterly), the banking organization must evaluate, review, and update as appropriate the analysis required under the Final Rule for each securitization exposure. The analysis of the risk characteristics of the securitization exposure prior to acquisition, and periodically thereafter, will have to consider:

1) structural features of the securitization that materially impact the performance of the exposure; for example, the contractual cash-flow waterfall, waterfall-related triggers, credit enhancements, liquidity enhancements, market value triggers, the performance of organizations that service the position, and deal-specific definitions of default;
2) relevant information regarding the performance of the underlying credit exposure(s); for example, the percentage of loans 30, 60, and 90 days past due; default rates; prepayment rates; loans in foreclosure; property types; occupancy; average credit score or other measures of creditworthiness; average loan-to-value (LTV) ratio; and industry and geographic diversification data on the underlying exposure(s);
3) relevant market data of the securitization; for example, bid-ask spread, most recent sales price and historical price volatility, trading volume, implied market rating, and size, depth, and concentration level of the market for the securitization; and
4) for resecuritization exposures, performance information on the underlying securitization exposures; for example, the issuer name and credit quality, and the characteristics and performance of the exposures underlying the securitization exposures.

Failure to satisfy these due diligence requirements results in a 1250% risk weight to the securitization exposure. However, while the Agencies rejected requests for more moderate consequences depending on the degree and frequency of the failure, the preamble to the Final Rule suggests that the Agencies may permit appropriate flexibility where, for example, market data is not available (e.g., for foreign exposures) or loan-level data is not available (in which case the Agencies indicate that pool-level data can be used).

Securitization Operational Requirements

General. As for related operational requirements, under the Final Rule and consistent with the proposal and US Basel II, a banking organization that transfers exposures it has originated or purchased to a securitization SPE or other third party in connection with a traditional securitization can exclude the underlying exposures from the calculation of risk-weighted assets only if each of the following conditions are met:

1) the exposures are not reported on the banking organization's consolidated balance sheet under GAAP;
2) the banking organization has transferred to one or more third parties credit risk associated with the underlying exposures; and
3) any clean-up calls relating to the securitization are eligible clean-up calls.

An originating banking organization that meets these conditions must hold risk-based capital against any credit risk it retains or acquires in connection with the securitization. An originating banking organization that fails to meet these conditions is required to hold risk-based capital against the transferred exposures as if they had not been securitized and must deduct from common equity tier 1 (CET1) capital any after-tax gain-on-sale resulting from the transaction.

In addition, consistent with the proposal and in a change from the current rules, if a securitization (1) includes one or more underlying exposures in which the borrower is permitted to vary the drawn amount within an agreed limit under a line of credit, and (2) contains an early amortization provision, the originating banking organization is required to hold risk-based capital against the transferred exposures as if they had not been securitized and deduct from CET1 capital any after-tax gain-on-sale resulting from the transaction.

Special Requirements for Synthetic Securitizations. In general, the operational requirements for synthetic securitizations under the Final Rule are similar to those for traditional securitizations. However, these operational requirements are more detailed to ensure that the originating banking organization has truly transferred credit risk of the underlying exposures to one or more third parties. Under the June 2012 NPRs, an originating banking organization would have been able to recognize for risk-based capital purposes the use of a credit risk mitigant to hedge underlying exposures only if each of the conditions in the definition of "synthetic securitization" was satisfied. However, to ensure that synthetic securitizations created through tranched guarantees and credit derivatives are properly included in the securitization framework, the Final Rule amends the operational requirements to recognize guarantees and credit derivatives that meet all of the criteria set forth in the definition of eligible guarantee or eligible credit derivative except the requirement that the guarantee [or obligation] be unconditional. As a result, a guarantee or credit derivative that provides a tranched guarantee would not be excluded by the operational requirements for synthetic securitizations.

Failure to meet these operational requirements for a synthetic securitization prevents a banking organization that has purchased tranched credit protection referencing one or more of its exposures from using the securitization framework with respect to the reference exposures. Instead, the banking organization must hold risk-based capital against the underlying exposures as if they had not been synthetically securitized. If the operational requirements are met, a banking organization that holds a synthetic securitization as a result of purchasing credit protection may use the securitization framework to determine the risk-based capital requirement for its exposure. Alternatively, it may choose to disregard the credit protection and use the general credit risk framework. A banking organization that provides tranched credit protection in the form of a synthetic securitization or credit protection to a synthetic securitization *must* use the securitization framework to compute risk-based capital requirements for its exposures to the synthetic securitization even if the originating banking organization fails to meet one or more of the operational requirements for a synthetic securitization.

Clean-Up Calls

As proposed, and consistent with US Basel II, the Final Rule requires that, to satisfy the operational requirements for securitizations and enable an originating banking organization to exclude the underlying exposures from the calculation of its risk-based capital requirements, any clean-up call associated with a securitization would need to be an eligible clean-up call. In the case of a traditional securitization, a clean-up call generally is accomplished by the originator repurchasing the remaining securitization exposures once the amount of underlying exposures or outstanding securitization exposures falls below a specified level. In the case of a synthetic securitization, the clean-up call may take the form of a clause that extinguishes the credit protection once the amount of underlying exposures has fallen below a specified level.

The Final Rule continues to define an eligible clean-up call as a clean-up call that is a contractual provision that permits an originating banking organization or servicer to call securitization exposures before their stated maturity or call date and that (1) is exercisable solely at the discretion of the originating banking organization or servicer; (2) is not structured to avoid allocating losses to securitization exposures held by investors or otherwise structured to provide credit enhancement to the securitization (for example, to purchase non-performing underlying exposures); and (3) (a) for a traditional securitization, is only exercisable when 10 percent or less of the principal amount of the underlying exposures or securitization exposures (determined as of the inception of the securitization) is outstanding; or (b) for a synthetic securitization, is only exercisable when 10 percent or less of the principal amount of the reference portfolio of underlying exposures (determined as of the inception of the securitization) is outstanding.

When a securitization SPE is structured as a master trust, a clean-up call with respect to a particular series or tranche issued by the master trust meets criteria (3) of the definition of "eligible clean-up call" as long as the outstanding principal amount in that series or tranche was 10 percent or less of its original amount at the inception of the series.

Alternative Approaches to Determine Risk-Weighted Capital

Consistent with the June 2012 NPRs, the framework for assigning risk-based capital requirements to securitization exposures in the Final Rule will require banking organizations generally to calculate a risk-weighted asset amount for a securitization exposure by applying either (i) the simplified supervisory formula approach (SSFA) or (ii) if the banking organization is a Standardized Bank that is not subject to the market risk rule, a "gross-up" approach similar to an approach provided under the general risk-based capital rules. A banking organization would be required to apply either the SSFA or the gross-up approach consistently across all of its securitization exposures. If an Advanced Bank has the required data to do so (which may include loan level in some cases), such bank must instead use the more risk sensitive supervisory formula approach as in US Basel II, but with changes to the formula that yield a higher capital charge. The gross-up approach is not available to Advanced Banks.

Pursuant to Section 939A of Dodd-Frank, the ratings-based approach in the US existing capital rules (including US Basel II) has been eliminated. The Agencies determined that the SSFA is an appropriate substitute standard to credit ratings that can be used to measure risk-based capital requirements and may be implemented uniformly across institutions. In addition, despite industry objections that it adversely affected banks that maintained capital ratios above the regulatory minimums, the Agencies retained use of a 1,250 percent risk weight rather than a capital deduction for certain securitization exposures (and for similar treatment elsewhere in the Final Rule) noting that use of the 1,250 percent risk weight was simpler and provided for comparability in risk-weighted asset amounts for the same exposure across institutions.

There are some exceptions to the general provisions in the securitization framework that parallel the general risk-based capital rules. First, a banking organization is required to assign a risk-weight of at least 100 percent to an interest-only MBS. The Agencies state that a minimum risk-weight of 100 percent is prudent in light of the uncertainty implied by the substantial price volatility of these securities. Second, as required by federal statute, special rules continue to apply to securitizations of small-business loans and leases on personal property transferred with retained contractual exposure by well-capitalized depository institutions.

Consistent with the proposal, the Final Rule provides for an alternative treatment of securitization exposures to ABCP programs and certain gains-on-sale and credit-enhancing interest-only (CEIO) exposures, both as further described below. Similar to the general risk-based capital rules, the Final Rule also includes a minimum 100 percent risk-weight for interest-only mortgage-backed securities and exceptions to the securitization framework for certain small-business loans and certain derivatives, also as described below. A banking organization may use the securitization credit risk mitigation rules to adjust the capital requirement under the securitization framework for an exposure to reflect certain collateral, credit derivatives, and guarantees.

Amounts of Exposures for Which Risk-Based Capital Required

Under the Final Rule, the exposure amount of an on-balance sheet securitization exposure that is not a repo-style transaction, eligible margin loan, OTC derivative contract, or derivative that is a cleared transaction is generally the banking organization's carrying value of the exposure. However, if a securitization exposure is an OTC derivative contract or derivative contract that is a cleared transaction (other than a credit derivative) that has a first priority claim on the cash flows from the underlying exposures (notwithstanding amounts due under interest rate or currency derivative contracts, fees due, or other similar payments), a banking organization may choose to set the risk-weighted asset amount of the exposure equal to the amount of the underlying exposure.

The exposure amount of an off-balance sheet securitization exposure that is not an eligible ABCP liquidity facility, a repo-style transaction, eligible margin loan, an OTC derivative contract (other than a credit derivative), or a derivative that is a cleared transaction (other than a credit derivative) is the notional amount of the exposure.

For purposes of calculating the exposure amount of an off-balance sheet exposure to an ABCP securitization exposure, such as a liquidity facility, consistent with the June 2012 NPRs, under both the standardized and advanced approaches, the notional amount may be reduced to the maximum potential amount that the banking organization could be required to fund given the ABCP program's current underlying assets (calculated without regard to the current credit quality of those assets).

Under the Final Rule's standardized approach, the exposure amount of an eligible ABCP liquidity facility that is subject to the SSFA equals the notional amount of the exposure multiplied by a 100 percent credit conversion factor (CCF). However, a Standardized Bank can use a 50 percent CCF to calculate the exposure amount of an eligible ABCP liquidity facility that is not subject to the SSFA. The exposure amount of a securitization exposure that is a repo-style transaction, eligible margin loan, an OTC derivative contract (other than a purchased credit derivative), or derivative that is a cleared transaction (other than a purchased credit derivative) is the exposure amount of the transaction as calculated under section 34 [OTC derivative contracts] or section 37 [Collateralized transactions] of the Final Rule, as applicable.

Double-Counting Avoided

Consistent with the proposal and US Basel II, the Final Rule includes provisions to limit the double-counting of risks in situations involving overlapping securitization exposures. If a banking organization has multiple securitization exposures that provide duplicative coverage to the underlying exposures of a securitization (such as when a banking organization provides a program-wide credit enhancement and multiple pool-specific liquidity facilities to an ABCP program), the banking organization is not required to hold duplicative risk-based capital against the overlapping position. Instead, the banking organization must apply to the overlapping position the applicable risk-based capital treatment under the securitization framework that results in the highest risk-based capital requirement.

Servicer Advances

A traditional securitization often employs a servicing banking organization that, on a day-to-day basis, collects principal, interest, and other payments from the underlying assets of the securitization and forwards such payments to the securitization SPE or to investors in the securitization. Servicing banking organizations often provide a facility to the securitization under which the servicing banking organization may advance cash to ensure an uninterrupted flow of payments to investors in the securitization, including advances made to cover foreclosure costs or other expenses to facilitate the timely collection of the underlying exposures. These servicer cash advance facilities are treated as securitization exposures for regulatory capital purposes. Consistent with the proposal, under the Final Rule a banking organization must apply the SSFA or the gross-up approach, as described below, or a 1,250 percent risk-weight to a servicer cash advance facility. The treatment of the undrawn portion of the facility depends on whether the facility is an eligible servicer cash advance facility. An "eligible servicer cash advance facility" is a servicer cash advance facility in which: (1) the servicer is entitled to full reimbursement of advances, except that a servicer may be obligated to make non-reimbursable advances for a particular underlying exposure if any such advance is contractually limited to an insignificant amount of the outstanding principal balance of that exposure; (2) the servicer's right to reimbursement is senior in right of payment to all other claims on the cash flows from the underlying exposures of the securitization; and (3) the servicer has no legal obligation to, and does not make, advances to the securitization if the servicer concludes the advances are unlikely to be repaid.

Consistent with the proposal, a banking organization that is a servicer under an eligible servicer cash advance facility will not be required to hold risk-based capital against potential future cash advances that it may be required to provide under the contract governing the facility. Under the proposal, a banking organization that provides a non-eligible servicer cash advance facility would have determined its risk-based capital requirement for the notional amount of the undrawn portion of the facility in the same manner as for other off-balance sheet securitization exposures. The Final Rule clarifies that a banking organization that is a servicer under a non-eligible servicer cash advance facility must hold risk-based capital against the amount of all potential future cash advance payments that it may be contractually required to provide during the subsequent 12-month period under the contract governing the facility.

SSFA

To replace the ratings-based approach as a method to assign risk weights to securitization exposures, the June 2012 NPRs introduced a simplified version (SSFA) of the supervisory formula approach (SFA) that had existed in US Basel II. In the Final Rule, the Agencies acknowledge that there may be differences in capital requirements under the SSFA and the ratings-based approach in the Basel capital framework and note that any alternative standard developed by the Agencies may not generate the same result as a ratings-based capital framework under every circumstance. However, the Agencies state that they have designed the SSFA to result in generally comparable capital requirements to those that would be required under the Basel ratings-based approach without undue complexity. The Agencies will monitor implementation of the SSFA and, based on supervisory experience, consider what modifications, if any, may be necessary to improve the SSFA in the future.

The Agencies have adopted the SSFA largely as proposed, with revisions to the delinquency parameter (parameter *W*) that are intended to clarify the operation of the formula when the contractual terms of the exposures underlying a securitization permit borrowers to defer payments of principal and interest, as described below. The SSFA applies a 1,250 percent risk-weight to securitization exposures that absorb losses up to the amount of capital that would be required for the underlying exposures under subpart D (the standardized approach) of the Final Rule had those exposures been held directly by a banking organization. In addition, the Final Rule implements the controversial proposed supervisory *risk weight floor* or *minimum risk weight* for a given securitization of *20 percent*.

At the inception of a securitization, the SSFA requires more capital on a transaction-wide basis than would be required if the underlying assets had not been securitized. That is, if the banking organization held every tranche of a securitization, its overall capital requirement would be greater than if the banking organization held the underlying assets in its own unsecuritized portfolio. In response to industry criticism of this aspect of the proposal, the Agencies simply stated their belief in the Final Rule that this overall outcome is important in reducing the likelihood of regulatory capital arbitrage through securitizations.

The June 2012 NPRs had proposed that data for SSFA parameters may not be more than 91 days old. Commenters had requested that this requirement be relaxed for securitizations of underlying assets with longer payment periods. In response, the Final Rule requires that the most current available data be used, but retains the specific 91 days' requirement for exposures with monthly or quarterly payments.

In order to use the SSFA, a banking organization must obtain or determine the weighted-average risk-weight of the underlying exposures (K_G), as well as the attachment and detachment points for the banking organization's position within the securitization structure. "K_G" is calculated using the risk-weighted asset amounts in the standardized approach and is expressed as a decimal value between zero and 1 (that is, an average risk weight of 100 percent means that K_G would equal 0.08). The banking organization may recognize the relative seniority of the exposure, as well as all cash funded enhancements, in determining attachment and detachment points. Commenters to this aspect of the proposal expressed concern over the level of detail necessary to calculate K_G (particularly for residential mortgage-backed exposures). In response, the Agencies noted that the Final Rule's abandonment of the more complex and controversial risk-weighting regime for residential mortgage significantly mitigated any such concerns. In addition, despite commenters characterizing the K_G parameter as not sufficiently risk sensitive and specifically as not taking into account sequential pay structures or other cash-flow waterfall structures, the Final Rule adopts the K_G parameter as proposed, which includes the K_A parameter that first appeared in the Market Risk Rule (the K_G parameter adjusted for delinquencies among the underlying assets) to make the SSFA more risk-sensitive and forward-looking. K_A is set equal to the weighted average of the K_G value and a fixed parameter equal to 0.5.

$K_A = (1\text{-}W).K_G + (0.5.W)$

Under the June 2012 NPRs, the *W* parameter would have equaled the ratio of the sum of the dollar amounts of any underlying exposures of the securitization that are 90 days or more past due, subject to a bankruptcy or insolvency proceeding, in the process of foreclosure, held as real estate owned, in default, or have contractually deferred interest for 90 days or more divided by the ending balance, measured in dollars, of the underlying exposures. Commenters had expressed concern that the proposal would require additional capital for payment deferrals that are unrelated to the creditworthiness of the borrower (such as the case for guaranteed student loans). The Agencies did respond favorably to this comment by excluding from *W* in the Final Rule contractual deferrals on Federally-guaranteed student loans or on other consumer loans if the contractual deferral was in place at the time funds were disbursed and not related to the borrower's creditworthiness.

Gross-Up Approach

The gross-up approach is available for Standardized Banks only and is designed to allow such banks to use a simple method to calculate required capital against their securitization exposures. To calculate risk-weighted assets under the gross-up approach, a banking organization determines four inputs: the *pro rata* share, the exposure amount, the enhanced amount, and the applicable risk weight. The *pro rata* share is the par value of the banking organization's exposure as a percentage of the par value of the tranche in which the securitization exposure resides. The enhanced amount is the par value of all the tranches that are more senior to the tranche in which the exposure resides. The applicable risk weight is the weighted-average risk weight of the underlying exposures in the securitization as calculated under the standardized approach (similar to K_G in the SSFA).

Under the gross-up approach, a banking organization is required to calculate the credit equivalent amount, which equals the sum of (1) the amount of the banking organization's securitization exposure and (2) the *pro rata* share multiplied by the enhanced amount. To calculate risk-weighted assets for a securitization exposure under the gross-up approach, a banking organization is required to assign the applicable risk weight to the gross-up credit equivalent amount. As noted above, in all cases, the *minimum risk weight* for securitization exposures is *20 percent*.

Alternative Treatments For Certain Types of Securitizations

Under the Final Rule a banking organization generally would assign a 1,250 percent risk weight to any securitization exposure to which the banking organization does not apply the SFA, the SSFA or the gross-up approach. However, the Final Rule provides alternative treatments for certain types of securitization exposures described below, provided that the banking organization knows the composition of the underlying exposures at all times.

Eligible Asset-backed Commercial Paper Liquidity Facilities. Under the Final Rule, consistent with the Basel capital framework, under the standardized approach a banking organization is permitted to determine the risk-weighted asset amount of an eligible ABCP liquidity facility by multiplying the exposure amount by the highest risk weight applicable to any of the individual underlying exposures covered by the facility.

A Securitization Exposure in a Second-loss Position or Better to an Asset-backed Commercial Paper Program. Under the Final Rule, under the standardized approach a banking organization may determine the risk-weighted asset amount of a securitization exposure that is in a second-loss position or better to an ABCP program by multiplying the exposure amount by the higher of 100 percent and the highest risk weight applicable to any of the individual underlying exposures of the ABCP program, provided the exposure meets the following criteria:

1) The exposure is not an eligible ABCP liquidity facility;
2) The exposure is economically in a second-loss position or better, and the first-loss position provides significant credit protection to the second-loss position;
3) The exposure qualifies as investment grade; and

4) The banking organization holding the exposure does not retain or provide protection for the first-loss position.

Credit Risk Mitigation for Securitization Exposures

Under the Final Rule, the treatment of credit risk mitigation for securitization exposures would differ slightly from the treatment for other exposures. To recognize the risk-mitigating effects of financial collateral or an eligible guarantee or an eligible credit derivative from an eligible guarantor, a banking organization that purchases credit protection uses the approaches for collateralized transactions under the Final Rule [section 37] or the substitution treatment for guarantees and credit derivatives described in the Final Rule [section 36]. In cases of maturity or currency mismatches, or, if applicable, lack of a restructuring event trigger, the banking organization must make any applicable adjustments to the protection amount of an eligible guarantee or credit derivative as required by section 36 [Guarantees and credit derivatives; substitution treatment] for any hedged securitization exposure. In addition, for synthetic securitizations, when an eligible guarantee or eligible credit derivative covers multiple hedged exposures that have different residual maturities, the banking organization is required to use the longest residual maturity of any of the hedged exposures as the residual maturity of all the hedged exposures. In the Final Rule, the Agencies clarify that a banking organization is not required to compute a counterparty credit risk capital requirement for the credit derivative provided that this treatment is applied consistently for all of its OTC credit derivatives. However, a banking organization must calculate counterparty credit risk if the OTC credit derivative is a covered position under the Market Risk Rule.

A banking organization that purchases an OTC credit derivative (other than an n^{th}-to-default credit derivative) that is recognized as a credit risk mitigant for a securitization exposure that is not a covered position under the market risk rule is not required to compute a separate counterparty credit risk capital requirement provided that the banking organization does so consistently for all such credit derivatives. The banking organization must either include all or exclude all such credit derivatives that are subject to a qualifying master netting agreement from any measure used to determine counterparty credit risk exposure to all relevant counterparties for risk-based capital purposes. If a banking organization cannot, or chooses not to, recognize a credit derivative that is a securitization exposure as a credit risk mitigant, the banking organization must determine the exposure amount of the credit derivative under the treatment for OTC derivatives in the Final Rule. The Final Rule clarifies that if the banking organization purchases the credit protection from a counterparty that is a securitization, the banking organization must determine the risk weight for counterparty credit risk according to the securitization framework. If the banking organization purchases credit protection from a counterparty that is not a securitization, the banking organization must determine the risk weight for counterparty credit risk according to general risk weights under the Final Rule. A banking organization that provides protection in the form of a guarantee or credit derivative (other than an n^{th}-to-default credit derivative) that covers the full amount or a *pro rata* share of a securitization exposure's principal and interest must risk weight the guarantee or credit derivative as if it holds the portion of the reference exposure covered by the guarantee or credit derivative.

N^{th}-to-default Credit Derivatives

Under the Final Rule, the capital requirement for credit protection provided through an n^{th}-to-default credit derivative is determined either by using the SSFA (for a Standardized Bank; an Advanced Bank must use the SFA if the required data is available), or applying a 1,250 percent risk weight. A banking organization providing credit protection must determine its exposure to an n^{th}-to-default credit derivative as the largest notional amount of all the underlying exposures. When applying the SSFA, the attachment point (parameter *A*) is the ratio of the sum of the notional amounts of all underlying exposures that are subordinated to the banking organization's exposure to the total notional amount of all underlying exposures. In the case of a first-to-default credit derivative, there are no underlying exposures that are subordinated to the banking organization's exposure. In the case of a second-or-subsequent-to default credit derivative, the smallest (n-1) underlying exposure(s) are subordinated to the banking organization's exposure. Under the SSFA, the detachment point (parameter *D*) is the sum of the attachment point and the ratio of the notional amount of the banking organization's exposure to the total notional amount of the underlying exposures. A banking organization that does not use the SSFA to calculate a risk weight for an n^{th}-to-default credit derivative would assign a risk weight of 1,250 percent to the exposure. For protection purchased through a first-to-default derivative, a banking organization that obtains credit protection on a group of underlying exposures through a first-to-default credit derivative that meets the rules of recognition for guarantees and credit derivatives under the Final Rule must determine its risk-based capital requirement for the underlying exposures as if the banking organization synthetically securitized the underlying exposure with the smallest risk-weighted asset amount and had obtained no credit risk mitigant on the other underlying exposures. A banking organization must calculate a risk-based capital requirement for counterparty credit risk according to section 34 of the Final Rule [OTC derivative contracts] for a first-to-default credit derivative that does not meet the rules of recognition of section 36(b).

For second-or-subsequent-to-default credit derivatives, a banking organization that obtains credit protection on a group of underlying exposures through an n^{th}-to-default credit derivative that meets the rules of recognition of section 36(b) of the Final Rule (other than a first-to-default credit derivative) may recognize the credit risk mitigation benefits of the derivative only if the banking organization also has obtained credit protection on the same underlying exposures in the form of first-through-(n-1)-to-default credit derivatives; or if n-1 of the underlying exposures have already defaulted. If a banking organization satisfies these requirements, the banking organization determines its risk-based capital requirement for the underlying exposures as if the banking organization had only synthetically securitized the underlying exposure with the n^{th} smallest risk-weighted asset amount and had obtained no credit risk mitigant on the other underlying exposures. For an n^{th}-to-default credit derivative that does not meet the rules of recognition of section 36(b), a banking organization must calculate a risk-based capital requirement for counterparty credit risk according to the treatment of OTC derivatives under section 34 of the Final Rule [OTC derivative contracts].

Pillar 3 Disclosures for Securitization

Stating that significant market uncertainty during the recent financial crisis was caused by the lack of disclosures regarding banking organizations' securitization-related exposures, the Final Rule adopts the enhanced disclosures proposed in the June 2012 NPRs, including the following:

1) The nature of the risks inherent in a banking organization's securitized assets,
2) A description of the policies that monitor changes in the credit and market risk of a banking organization's securitization exposures,
3) A description of a banking organization's policy regarding the use of credit risk mitigation for securitization exposures,
4) A list of the special purpose entities a banking organization uses to securitize exposures and the affiliated entities that a bank manages or advises and that invest in securitization exposures or the referenced SPEs, and
5) A summary of the banking organization's accounting policies for securitization activities.

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Footnotes

[1] Namely, the Federal Reserve Board of Governors (FRB), the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC).

[2] The final rules (and, in the case of the FDIC, the interim final rule) as adopted and sharing substantially common text are available at: http://www.federalreserve.gov/bcreg20130702a.pdf (FRB); http://occ.gov/news-issuances/news-releases/2013/2013-110a.pdf (OCC); and http://fdic.gov/news/board/2013/2013-07-09_notice_dis_a_res.pdf (FDIC).

[3] More details of which are available at: http://www.bis.org/bcbs/basel3.htm?ql=1 and with which we assume readers of this update will be generally familiar.

[4] Our recent related Legal Update summarizes the Final Rule and is available at: http://www.mayerbrown.com/Bank-Regulators-Approve-Final-Rule-to-Implement-Basel-III-Capital-Requirements-in-the-United-States-07-15-2013/.

[5] The Final Rule incorporates and consolidates three separate notices of proposed rulemaking (collectively, the June 2012 NPRs): "Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action," 77 Fed Reg. 52792 (Aug. 30, 2012) (the Basel III NPR); "Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements," 77 Fed. Reg. 52888 (Aug. 30, 2012) (the Standardized Approach NPR); and "Regulatory Capital Rules: Advanced Approaches Risk-Based Capital Rule; Market Risk Capital Rule," 77 Fed. Reg. 52978 (Aug. 30, 2012) (the Advanced Approaches NPR). For a brief summary of the June 2012 NPRs, see our related Legal Update available at http://www.mayerbrown.com/publications/detail.aspx?publication=8039.

[6] Except as otherwise indicated, the revisions discussed herein apply both to banking organizations that are subject to the advanced approaches method of computing risk-based capital (Advanced Banks) and to those subject only to the standardized approach of computing risk-based capital (Standardized Banks).

[7] Federal Register, Vol. 72, p. 69288 (December 10, 2007).

[8] BCBS, Revisions to the Basel Securitisation Framework – Consultative Document (December 2012), available at http://www.bis.org/publ/bcbs236.pdf. Our related Legal Update discussing these proposals is available at: http://www.mayerbrown.com/revisions-basel-framework/.

17 July 2013 *Mayer Brown Legal Update*

The CFTC's July 12, 2013 Cross-Border Exemptive Order

On July 12, 2013, the Commodity Futures Trading Commission ("CFTC") issued a time-limited exemptive order (the "Order") under Commodity Exchange Act ("CEA") section 4(c) to allow a phase-in period for the implementation of its finalized interpretive guidance and policy statement regarding cross-border application of the Dodd-Frank Title VII swap provisions (the "Guidance"), adopted on the same date.[1] The Order in large measure continues the relief afforded under the CFTC's prior order (the "January Order"),[2] which expired on July 12. The CFTC is soliciting comments on the Order for 30 days. This update addresses the Order independently of the Guidance, which we will address in a subsequent alert and which may shed further interpretive light on the Order. This summary is based on the version of the Order bearing a creation timestamp of 5:38 p.m., July 16.

US Person Definition; SD and MSP Registration Thresholds

Market participants may continue to apply the "US person" definition and the swap dealer ("SD") *de minimis* and major swap participant ("MSP") threshold calculations as set out in the January Order (including aggregation rules) until 75 days after Federal Register publication of the Guidance. A non-US person required to register as a SD as a result of changes to the definition of US person or the *de minimis* calculation will not be required to register until two months after the end of the month in which the person exceeds the *de minimis* threshold.

Entity-Level Requirements – Non-US SDs/MSPs

Non-US SDs and non-US MSPs established in Australia, Canada, the EU, Hong Kong, Japan or Switzerland (collectively, the "Six Jurisdictions") need not comply with "Entity-Level Requirements for which substituted compliance is possible" under the Guidance until the earlier of December 21, 2013 or 30 days following the issuance by the CFTC of the applicable substituted compliance determination.[3] This in large part continues the relief from entity-level requirements under the January Order, except that Large Trader Reporting (for which substituted compliance is not possible under the Guidance)[4] is no longer included as an Entity-Level Requirement. In addition, it appears that relief may no longer be available from certain aspects of swap recordkeeping relating to complaints and marketing and sales materials for transactions with US counterparties.[5]

Exemption from CFTC Regulations Part 45 and Part 46 reporting remains available, for the same period as described above, to a non-US SD/MSP established in one of the Six Jurisdictions that is not part of an affiliated group of which the ultimate parent is a US SD or MSP, US bank, US financial holding company or US bank holding company, subject, however, to a new condition that such non-US SD or MSP either (i) is in compliance with swap data reporting and recordkeeping requirements in its home jurisdiction or (ii) where no swap data reporting requirements have been implemented in the home jurisdiction, complies with the recordkeeping and identifier requirements of CFTC Rules 45.2, 45.6, 46.2, 46.4.

If a non-US SD or MSP established outside the Six Jurisdictions files a registration request and a concurrent substituted compliance request before December 21, 2013, the CFTC may consider a request for deferring compliance with the Entity-Level Requirements.[6]

Transaction-Level Requirements – Non-US SDs/MSPs and Foreign Branches of US SDs and MSPs in the Six Jurisdictions

Non-US SDs and MSPs established in, and foreign branches[7] of a US SD or MSP located in, one of the Six Jurisdictions may comply with any law and regulations of the home jurisdiction where it is established (or where the foreign branch is located), and only to the extent required by such home or branch jurisdiction, in lieu of any "Transaction-Level Requirements for which substituted compliance would be possible" under the Guidance until the earlier of December 21, 2013 or 30 days following the issuance of the relevant substituted compliance determination, except as set out below:

A. A non-US SD or MSP or foreign branch that was not required to clear under the January Order may delay complying with clearing requirements under CEA section 2(h)(1), CFTC Regulations Part 50 and CFTC Rule 23.506 until 75 days after Federal Register publication of the Guidance.
B. The Order does not provide relief from the trade execution requirements under CEA section 2(h)(8) and CFTC Rules 37.12 or 38.11.[8]
C. For swap transactions with a guaranteed[9] non-US affiliate of a US person, until September 30, 2013, the non-US SD or MSP or foreign branch may comply with any law and regulations of the home jurisdiction where it is established (or where the foreign branch is located) related to real-time reporting (and only to the extent required by such home or branch jurisdiction) in lieu of Part 43.

Transaction-Level Requirements – Non-US SDs/MSPs and Foreign Branches of US SDs and MSPs outside the Six Jurisdictions

For swap transactions with a guaranteed non-US affiliate of a US person, non-US SDs and MSPs established in, and foreign branches of a US SD or MSP located in, a jurisdiction other than one of the Six Jurisdictions may comply with any law and regulations of the home jurisdiction where they are established (or where the foreign branch is located), and only to the extent required by such home or branch jurisdiction, in lieu of any Transaction-Level Requirements for which substituted compliance would be possible under the Guidance until 75 days after Federal Register publication of the Guidance.[10]

Transaction-Level Requirements – Guaranteed Affiliates and Affiliate Conduits

The Order provides relief from Transaction-Level Requirements for swap transactions between non-SD/MSPs in which both counterparties are guaranteed non-US affiliates of US persons. In such cases, the guaranteed affiliates may comply with any law and regulations of the jurisdiction where they are established (and only to the extent required by such home jurisdiction) for the relevant Transaction-Level Requirement in lieu of any Transaction-Level Requirement for which substituted compliance would be possible under the Guidance until 75 days after Federal Register publication of the Guidance. Under a different but partially overlapping provision of the Order, guaranteed non-US affiliates of US persons and affiliate conduits for US persons need not comply with Transaction-Level Requirements relating to swaps with non-US persons and foreign branches of US SDs and MSPs until 75 days after Federal Register publication of the Guidance.

Obligations under Inter-Affiliate Clearing Exemption Unaffected

The CFTC's clearing exemption for inter-affiliate swaps[11] imposes certain conditions on swaps between group entities relying on the exemption and unaffiliated third parties, including that such outward-facing swaps be cleared if they are within scope of the CFTC's clearing mandate, unless an exception or alternative compliance method is available. In cases where one of the counterparties to a swap is electing the inter-affiliate clearing exemption, the Order does not relieve any party of the obligation to comply with the conditions of the exemption, including those related to clearing of outward-facing swaps.

For more information on the topics raised in this Legal Update, please contact Joshua Cohn, Curtis A. Doty, Jerome J. Roche, David R. Sahr or Donald S. Waack.

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Footnotes:

[1] Exemptive Order Regarding Compliance with Certain Swap Regulations (July 12, 2013), http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister071213.pdf; Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations (July 12, 2013), http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister071213b.pdf.
[2] Final Exemptive Order Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 858 (Jan. 7, 2013); see also Mayer Brown, CFTC Issues a Final, Time-Limited Exemptive Order and Proposes Further Guidance Regarding Cross-Border Regulation of Swaps (Dec. 31, 2012), available at http://www.mayerbrown.com/CFTC-Issues-a-Final-Time-Limited-Exemptive-Order-and-Proposes-Further-Guidance-Regarding-Cross-Border-Regulation-of-Swaps-12-31-2012/.
[3] Non-US SDs and MSPs may require additional time after a substituted compliance determination in order to phase in compliance with home jurisdiction requirements. The CFTC and its staff intend to address the need for further transitional relief in connection with the substituted compliance determination. See preamble to the Order ("Preamble"), footnote 41.
[4] See Preamble, footnote 27.
[5] See Preamble, footnote 40. An additional difference from the January Order is that Rule 23.607 (antitrust considerations) is no longer included as an Entity-Level Requirement. Rule 1.3 (books and records), while not listed as an Entity-Level Requirement in the text of the Order (as it was in footnote 87 of the January Order), is referred to as an Entity-Level Requirement in footnote 30 of the Preamble.
[6] Preamble, footnote 41.
[7] The Preamble cites the Guidance for a discussion regarding the types of offices which the CFTC would consider to be a "foreign branch" and the circumstances in which a swap is with such foreign branch. Preamble, footnote 43.
[8] As of the date of the Order, there were no swaps as to which an "available to trade" determination had been made and, consequently, no swaps were subject to a trade execution requirement. The CFTC has adopted a compliance schedule for the trade execution requirement. Process for a Designated Contract Market or Swap Execution Facility To Make a Swap Available to Trade, Swap Transaction Compliance and Implementation Schedule, and Trade Execution Requirement Under the Commodity Exchange Act, 78 Fed. Reg. 33606 (June 4, 2013).
[9] For purposes of the Order, the term "guarantee" generally includes not only traditional guarantees of payment or performance, but also other formal arrangements that, in view of all the facts and circumstances, support the non-US person's ability to pay or perform its swap obligations. Exemptive Order, footnote 67. Footnote 65 of the Order states that, to the extent that a guaranteed affiliate "is given exemptive relief from any particular Transaction-Level Requirement under this Exemptive Order, the same exemptive relief would apply to affiliate conduits."
[10] In an amendment to the text of the Order after its initial release, the limitation to swap transactions with guaranteed non-US affiliates of a US person was removed from the relief for foreign branches, but not from that for non-US SDs/MSPs. See Order, paragraphs 10 and 14.
[11] Exemption for Swaps Between Certain Affiliated Entities, 78 Fed. Reg. 21750 (Apr. 11, 2013).

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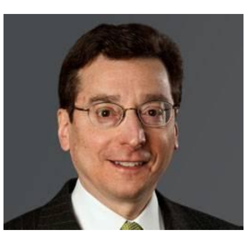

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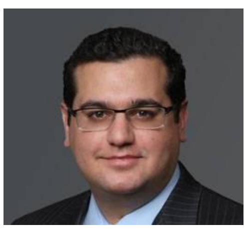

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23 July 2013 *Mayer Brown Legal Update*

Will Creditors Face Actions Over Debt-Collection Practices by the CFPB or the Class-Action Bar?

Companies that provide credit to their customers are well aware that the Fair Debt Collection Practices Act (FDCPA), which authorizes suits against violators for statutory damages of up to $1,000, applies only to “debt collectors”—not creditors. 15 U.S.C. § 1692k.

But a recent bulletin (pdf) by the CFPB—whose commissioner Richard Cordray was just confirmed by the Senate—may open the door to actions against creditors (albeit under the Dodd-Frank Act rather than the FDCPA). That bulletin states that entities covered by the Dodd-Frank Act must “refrain from committing unfair, deceptive, or abusive acts or practices” in “collecting consumer debts.”

The bulletin makes clear that the CFPB will be using the Dodd-Frank Act to apply the FDCPA to creditors. The bulletin then sets forth a “non-exhaustive list” of debt-collection practices that it says *could* violate Dodd-Frank and that the CFPB “will be watching … closely.” The list is essentially a compilation of alleged misrepresentations and coercive tactics that have gotten debt collectors sued under the FDCPA:

- “Collecting or assessing a debt and/or any additional amounts in connection with a debt (including interest, fees, and charges) not expressly authorized by the agreement creating the debt or permitted by law.”
- “Failing to post payments timely or properly or to credit a consumer’s account with payments that the consumer submitted on time and then charging late fees to that consumer.”
- “Taking possession of property without the legal right to do so.”
- “Revealing the consumer’s debt, without the consumer’s consent, to the consumer’s employer and/or co-workers.”
- “Falsely representing the character, amount, or legal status of the debt.”
- “Misrepresenting that a debt collection communication is from an attorney.”
- “Misrepresenting that a communication is from a government source or that the source of the communication is affiliated with the government.”
- “Misrepresenting whether information about a payment or nonpayment would be furnished to a credit reporting agency.”
- “Misrepresenting to consumers that their debts would be waived or forgiven if they accepted a settlement offer, when the company does not, in fact, forgive or waive the debt.”
- “Threatening any action that is not intended or the covered person or service provider does not have the authorization to pursue, including false threats of lawsuits, arrest, prosecution, or imprisonment for non-payment of a debt.”

In a separate bulletin (pdf) issued the same day, the CFPB suggested that statements that repaying a debt will improve the debtor’s “credit report,” “credit score,” “creditworthiness,” or “likelihood” of getting more credit or credit on “more favorable terms” may also be actionable under the Dodd-Frank Act.

What's not on the list in these bulletins? They omit the various affirmative duties that the FDCPA imposes on debt collectors to inform debtors of particular facts, such as that the purpose of the communication is to collect a debt and that the debtor has the right to insist upon verification of a debt. *See* 15 U.S.C. §§ 1692e(11), 1692g.

The implicit warning of these bulletins, of course, is that violators may face enforcement actions brought by the CFPB. And one of the bulletins hints that even entities *not* covered by the Act may be named defendants; a footnote observes that the Act prohibits *anyone* from "knowingly or recklessly" providing "substantial assistance" to a violation of the Act.

But the threat of new litigation against businesses does not end there. Thankfully, the Dodd-Frank Act doesn't create a private right of action. But it's only a matter of time before the plaintiffs' bar files lawsuits alleging that the conduct discussed by the bulletin violates *state* consumer-protection laws that do authorize private suits. For example, it is inevitable that plaintiffs will argue that California's notorious Unfair Competition Law (UCL), Cal. Bus. & Prof. Code §§ 17200 *et seq.*, allows them to "borrow" violations of the CFPB's interpretation of Dodd-Frank and recast them as violations of the UCL.

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MAYER • BROWN

Legal Update
August 2, 2013

CFTC Issues Interpretive Guidance Regarding the Cross-Border Application of US Swap Regulations

On July 12, 2013, the US Commodity Futures Trading Commission ("CFTC") approved the issuance of an interpretive guidance and policy statement (the "Guidance") regarding the cross-border application of the swaps provisions of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[1] Although the CFTC may continue to refine its approach to the cross-border regulation of swaps, the Guidance is intended to finalize the proposed interpretive guidance and policy statement issued on July 12, 2012 (the "Proposed Guidance").[2] Like the Proposed Guidance before it, the Guidance represents the CFTC's attempt to meet its statutory mandate to (1) regulate swaps that "have a direct and significant connection with activities in, or effect on, commerce of the United States" and (2) prevent the evasion of the swaps provisions of the Dodd-Frank Act.[3]

In brief, the Guidance: (1) defines "US person" and "non-US person," which are key for applying the CFTC's extraterritorial framework; (2) establishes the calculation and aggregation methodologies used for determining whether non-US persons engage in swap transactions at levels that trigger swap dealer ("SD") or major swap participant ("MSP") registration; (3) categorizes "Entity-Level Requirements" and "Transaction-Level Requirements" and describes their extraterritorial application; (4) discusses the "substituted compliance" framework; and (5) describes the requirements applicable to non-registered swap participants ("Non-Registrants").

The CFTC also issued an exemptive order (the "Order") that effectively provides for the phased implementation of certain aspects of the Guidance.[4] The Order, in many respects, builds upon relief granted in prior CFTC exemptive orders.[5]

Notably, the Guidance was issued solely by the CFTC, despite recent calls in Congress for a harmonized approach with respect to cross-border application of Title VII of the Dodd-Frank Act.[6] While the Guidance states that the CFTC consulted with the US Securities and Exchange Commission (the "SEC") and considered the SEC's recently proposed rules and interpretive guidance that address the cross-border regulation of security-based swaps, the CFTC continues to chart a different course from that of the SEC (and non-US regulators).[7]

I. Definition of "US Person" and "Non-US Person"

US Person. Several commenters recommended that the CFTC adopt the definition of US person contained in the SEC's Regulation S and limit the broad scope of the prefatory phrase "includes, but is not limited to" found in the Proposed Guidance. The CFTC rejected these comments and interprets the term "US person" largely the same as in the Proposed Guidance (except as noted below), and therefore more broadly than the intervening definition contained in its December Order.[8] The Guidance defines "US person" "generally to include, but not be limited to":

i. any natural person who is a resident of the United States;

ii. any estate of a decedent who was a resident of the United States at the time of death (changed from Proposed Guidance by looking to the status of the decedent at the time of death instead of whether the estate is subject to US income tax);

iii. any corporation, partnership, limited liability company, business or other trust, association, joint-stock company, fund or any form of enterprise similar to any of the foregoing (other than an entity described in prongs (iv) or (v), below) (a "legal entity"), in each case that is organized or incorporated under the laws of a state or the United States or having its principal place of business in the United States;[9]

iv. any pension plan for the employees, officers or principals of a legal entity described in prong (iii), unless the pension plan is primarily for non-US employees of such entity (changed from the Proposed Guidance by adding the non-US employee carve-out);

v. any trust governed by the laws of a state or other jurisdiction in the United States, if a court within the United States is able to exercise primary supervision over the administration of the trust (changed from the Proposed Guidance by looking to whether US law governs/a US court has jurisdiction over a trust instead of whether a trust is subject to US income tax);

vi. any commodity pool, pooled account, investment fund, or other collective investment vehicle that is not described in prong (iii) and that is majority-owned by one or more persons described in prong (i), (ii), (iii), (iv), or (v), except any commodity pool, pooled account, investment fund, or other collective investment vehicle that is publicly offered only to non-US persons and not offered to US persons (changed from the Proposed Guidance by insertion of the exception for vehicles publicly offered only to non-US persons);

vii. any legal entity (other than a limited liability company, limited liability partnership or similar entity where all of the owners of the entity have limited liability) that is directly or indirectly majority-owned by one or more persons described in prong (i), (ii), (iii), (iv), or (v) and in which such person(s) bears unlimited responsibility for the obligations and liabilities of the legal entity (changed from Proposed Guidance by requiring majority ownership by US persons with unlimited liability); [10] and

viii. any individual account or joint account (discretionary or not) where the beneficial owner (or one of the beneficial owners in the case of a joint account) is a person described in prong (i), (ii), (iii), (iv), (v), (vi), or (vii) (changed from Proposed Guidance by inclusion of joint accounts).

The Guidance omits a prong from the Proposed Guidance that would have treated as a US person any commodity pool operated by a person subject to CFTC registration as a commodity pool operator.

The Guidance retains the "single entity" approach to branches and agencies and, thus, includes foreign branches and agencies of US persons as being covered by the "US person" definition, because branches "are neither separately incorporated nor separately capitalized and, more generally, the rights and obligations of a branch are rights and obligations of its principal entity."[11] However, notwithstanding this adherence to the single entity doctrine, foreign branches and agencies of US SDs are, in certain contexts, treated differently from the US principal office (e.g., for *de minimis* calculation purposes, as discussed below).

Non-US Persons. "Non-US person" was not formally defined in the Proposed Guidance. As a clarification, the CFTC states in the Guidance that it will interpret the term "non-US person" to refer to any person that is not a "US person."[12]

Timing. The Order states that market participants may continue to rely on the definition of a US person from the December Order until 75 days after publication of the Guidance in the Federal Register, i.e., October 9, 2013.[13]

II. SD and MSP Registration

SD *De Minimis* Calculation for US Persons. The Guidance requires US persons, non-US persons who are "guaranteed affiliates" of a US person, and non-US persons who are "conduit affiliates" of a US person to count all of their swap dealing activity, whether with US or non-US counterparties, toward their *de minimis* threshold calculation.

SD *De Minimis* Calculation for Non-US Persons. The Guidance provides that non-US persons who are not guaranteed or conduit affiliates of a US person generally should count only swaps with US persons (other than swaps with foreign branches of registered US SDs) and certain swaps with guaranteed affiliates of US persons toward the *de minimis* threshold.[14] Non-US persons also may exclude cleared swaps that are anonymously entered into on a designated contract market ("DCM"), swap execution facility ("SEF"), or foreign board of trade ("FBOT").

Foreign Branches. The Guidance undertakes to clarify what is meant by the term "foreign branch" and when a swap will be deemed to be "with the foreign branch" of a US SD. The two-part clarification is complex and generally requires a foreign branch to satisfy all of the conditions. A foreign branch of a US SD or US MSP generally would include, but is not limited to, any "foreign branch" of a US bank that:

- is subject to Regulation K or the FDIC's International Banking Regulation (Part 347), or otherwise designated as a "foreign branch" by the US bank's primary regulator;
- maintains accounts independently of the home office and of the accounts of other foreign branches, with the profit or loss accrued at each branch determined as a separate item for each foreign branch; and
- is subject to substantive regulation in banking or financing in the jurisdiction where it is located.

A swap generally will be considered to be "with the foreign branch" of a US SD if the following conditions are satisfied:

- The employees negotiating and agreeing to the terms of the swap (or, if the swap is executed electronically, managing the execution of the swap) are located in the foreign branch or in another foreign branch of the US SD. Purely clerical or ministerial functions may be performed by US employees.
- The foreign branch or another foreign branch is the office through which the US SD makes and receives payments and deliveries under the swap pursuant to a master netting agreement, and the documentation of the swap specifies that the office for the US SD is the foreign branch.
- The swap is entered into by the foreign branch in its normal course of business.
- The swap is treated as a swap of the foreign branch for tax purposes.
- The swap is reflected in the local accounts of the foreign branch.

Affiliate Aggregation. Under the aggregation rules adopted in the Guidance, non-US persons will be required to include in their *de minimis* calculation the swap dealing activities of all US *and* non-US affiliates other than those that are registered as SDs. This represents an expansion of the CFTC's prior aggregation rules for non-US persons because it includes US affiliates, whereas under the December Order, non-US entities aggregated only with their non-US affiliates. The Guidance preserves the approach from the December Order of excluding the swap dealing activities of a registered SD from the *de minimis* calculation for other affiliated entities.[15]

MSP Threshold Calculations. The Guidance includes a complicated approach to the MSP calculation with respect to non-US persons. It would require non-US persons who are not guaranteed or conduit affiliates of US persons to include in their calculation the aggregate notional value of (i) any swap position with a US person; (ii) any swap position with a guaranteed affiliate of a US person; and (iii) any swap position between a person guaranteed by the non-US person and a US person or guaranteed affiliate of a US person. If the non-US person is a guaranteed affiliate of a US person, it would follow the same analysis except it would not have to include swaps with a guaranteed affiliate of a US person, because the first non-US person's guarantor would include the exposure in its own calculations.

The Guidance also provides that a non-US "financial entity" that is not a guaranteed affiliate of a US person would exclude from its MSP calculation exposure from a swap with a foreign branch of a US SD or guaranteed affiliate that is a SD if the swap is cleared or subject to daily margining. If the non-US person is not a financial entity, it may exclude from its MSP calculations swaps with foreign branches of US SDs or guaranteed affiliates that are SDs without condition.

For example, if a German bank enters into a swap with the London branch of a US swap dealer, the German bank would include the aggregate notional value of the swap in its MSP calculation unless the swap is cleared or subject to daily margining.

Timing. The Order states that market participants may continue to rely on the method for calculating the SD and MSP registration thresholds from the December Order until 75 days after the publication of the Guidance in the Federal Register, i.e., October 9, 2013. Going forward, if a non-US person must register as an SD because of changes made to the Guidance, they will not be required to register until two months after the end of the month in which the person exceeds the *de minimis* threshold.[16]

III. Entity-Level and Transaction-Level Requirements

Entity-Level Requirements. The Guidance generally adopts the framework of Entity-Level and Transaction-Level Requirements from the Proposed Guidance. Entity-Level Requirements are those that relate to the core operations of a firm and should be applied to the firm as a whole. The Guidance further divides the Entity-Level Requirements into two categories, the "First Category" and the "Second Category." The First Category of Entity-Level Requirements includes capital adequacy, chief compliance officer, risk management, and swap data recordkeeping under CFTC regulations 23.201 and 23.203 (except certain aspects of swap data recordkeeping relating to complaints and sales materials). The Second Category of Entity-Level Requirements consists of SDR reporting (including historical reporting), certain aspects of swap data recordkeeping relating to complaints and marketing and sales materials under CFTC regulations 23.201(b)(3) and 23.201(b)(4) and large trader reporting.

The applicability of the Entity-Level Requirements to US and non-US SDs and MSPs is summarized in Appendix A to this Legal Update. Entity-Level Requirements, other than swap data recordkeeping, SDR reporting and large trader reporting, do not apply to Non-Registrants.

Transaction-Level Requirements. The Transaction-Level Requirements of Title VII, which apply on a transaction-by-transaction basis, are divided into "Category A" requirements and "Category B" requirements, as indicated below. The CFTC clarified in the

Guidance that the position limits and anti-manipulation provisions are neither Entity-Level nor Transaction-Level requirements, as they relate to market integrity and would apply regardless of the counterparty's status.

Category A of the Transaction-Level Requirements includes required clearing and swap processing, margining (and segregation) for uncleared swaps, mandatory trade execution, swap trading relationship documentation, portfolio reconciliation and compression, real-time public reporting, trade confirmation, and daily trading records. Category B of the Transaction-Level Requirements consists solely of the external business conduct standards.

Appendix B to this alert describes via a chart how the Category A and Category B Transaction-Level Requirements will be applied under the Guidance to US and non-US SDs and MSPs.[17]

IV. Substituted Compliance

Overview. "Substituted compliance" is compliance by non-US SDs and MSPs with local, non-US swap regulations determined to be comparable to US regulation by the CFTC, in place of compliance with US regulation. In describing the process by which the CFTC will make the necessary comparability determinations, the Guidance largely tracks the approach of the Proposed Guidance, although the CFTC has now expressed a clear willingness to focus on comparable, albeit undefined, outcomes rather than conducting a specific requirement-by-requirement comparison.

Eligibility. A non-US regulator, an individual or group of non-US entities, a US bank that is an SD or MSP with respect to its foreign branches, or a trade association composed of similarly-situated entities may apply to the CFTC for a comparability determination as to whether one or more of the thirteen categories of regulatory obligations are satisfied by comparable and comprehensive non-US regulatory requirements. This is an expansion of the eligibility criteria from the Proposed Guidance in that the CFTC added trade associations to the list of persons eligible to request a comparability determination.

Comparability Analysis. The Guidance states that the CFTC will use an outcomes-based approach to review the requirements of a non-US jurisdiction for rules that are comparable to and as comprehensive as the requirements of the Dodd-Frank Act, but it will not require that the non-US jurisdiction have identical requirements. The CFTC will take into consideration all relevant factors, including but not limited to, the comprehensiveness of those requirement(s), the scope and objectives of the relevant regulatory requirement(s), the comprehensiveness of the non-US regulator's supervisory compliance program, as well as the home jurisdiction's authority to support and enforce its oversight of the registrant.

However, if the CFTC finds that the non-US regulatory requirements lack critical elements, it will work with the non-US regulator and registrants in the jurisdiction to consider alternative approaches that may result in a determination that substituted compliance applies. These, alternative approaches may include (i) coordinating with the non-US regulators in developing appropriate regulatory changes or new regulations, particularly where changes or new regulations already are being considered or proposed by the non-US regulators or legislative bodies or (ii) including in the substituted compliance determination a description of the means by which certain swap market participants can achieve substituted compliance within the construct of the non-US regulatory regime.

The CFTC expects that, in connection with a determination that substituted compliance is appropriate, it would enter into an appropriate MOU or similar arrangement with the relevant non-US regulator(s), not only as to information-sharing and enforcement arrangements, but also for supervisory cooperation and coordination.[18]

Timing. Under the Order, non-US SDs and MSPs that are established in Australia, Canada, the European Union, Hong Kong, Japan or Switzerland (the "Six Jurisdictions") do not need to comply with Entity-Level Requirements for which substituted compliance is possible before the earlier of December 21, 2013, or 30 days following the CFTC's issuance of a substituted compliance determination. SDs and MSPs and foreign branches of a US SD or MSP located in one of the Six Jurisdictions may comply with mandatory home jurisdiction laws in lieu of any Transaction-Level Requirements for which substituted compliance is permitted (with some exceptions) until the earlier of December 21, 2013 or 30 days following the issuance of the relevant substituted compliance determination.[19]

Non-US SDs and non-US MSPs (including guaranteed and conduit affiliates) that are not located in one of the Six Jurisdictions may comply with any mandatory laws and regulations of the home jurisdiction where they are established when transacting swaps with a guaranteed affiliate of a US person, in lieu of any Transaction-Level Requirements for which substituted compliance would be possible under the Guidance, until October 9, 2013. Non-US foreign branches of US SDs and MSPs that are not located one of the Six Jurisdictions may comply with any mandatory laws and regulations of the home jurisdiction where they are established, in lieu of any Transaction-Level Requirements for which substituted compliance would be possible under the Guidance, until October 9, 2013.

V. Regulation of Non-Registrants

US Non-Registrant. If at least one party to the swap is a US person and neither party is an SD or MSP, both parties would be expected to comply with (i) clearing; (ii) trade execution; (iii) real-time public reporting; (iv) large trader reporting; (v) SDR reporting (including historical reporting); and (vi) swap data recordkeeping. Substituted compliance generally would not be available. A swap anonymously executed on a DCM, SEF, or FBOT between two Non-Registrants that is cleared on a derivatives clearing organization ("DCO") would not need to comply with the remainder of the Non-Registrant Requirements.

Non-US Non-Registrants. If both of the parties are non-US Non-Registrants, Title VII swap regulations generally would not apply to the transaction (with the limited exception of large trader reporting in the case of non-US clearing members with significant positions in swaps linked to specified US-listed physical commodity futures contracts).[20] If both of the parties are also guaranteed or conduit affiliates, they would be required to comply with (i) clearing; (ii) trade execution; (iii) real-time public reporting; (iv) large trader reporting; (v) SDR reporting (including historical reporting); and (vi) swap data recordkeeping, and all except the large trader reporting requirement would be eligible for substituted compliance.[21]

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Endnotes

1 Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45292 (July 26, 2013) (the Guidance became effect on July 13, 2013, subject to the phase-in periods described in the exemptive order discussed below), *available at* http://www.gpo.gov/fdsys/pkg/FR-2013-07-26/pdf/2013-17958.pdf.

2 *See* Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, 77 Fed. Reg. 41,214 (proposed July 12, 2012), *available at* http://www.gpo.gov/fdsys/pkg/FR-2012-07-12/pdf/2012-16496.pdf. *See also* our Update "Proposed CFTC Guidance Regarding the Cross-Border Application of US Swap Regulations," available at http://www.mayerbrown.com/Proposed-CFTC-Guidance-Regarding-the-Cross-Border-Application-of-US-Swaps-Regulations-07-02-2012/. The CFTC also proposed further guidance on certain aspects of the Proposed Guidance in December 2012. *See* Further Proposed Guidance Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 909 (Jan. 7, 2013), *available at* http://www.gpo.gov/fdsys/pkg/FR-2013-01-07/pdf/2012-31734.pdf. *See also* our Update "CFTC Issues a Final, Time-Limited Exemptive Order and Proposes Further Guidance Regarding Cross-Border Regulation of Swaps," available at http://www.mayerbrown.com/CFTC-Issues-a-Final-Time-Limited-Exemptive-Order-and-Proposes-Further-Guidance-Regarding-Cross-Border-Regulation-of-Swaps-12-31-2012/.

3 Section 2(i) of the Commodity Exchange Act (as amended by the Dodd-Frank Act).

4 Exemptive Order Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 43,785 (July 22, 2013), *available at* http://www.gpo.gov/fdsys/pkg/FR-2013-07-22/pdf/2013-17467.pdf. For more information, see our Update "The CFTC's July 12, 2013 Cross-Border Exemptive Order," available at http://www.mayerbrown.com/The-CFTCs-July-12-2013-Cross-Border-Exemptive-Order-07-17-2013/.

5 *See* Exemptive Order Regarding Compliance With Certain Swap Regulations, 77 Fed. Reg. 41,110 (July 12, 2012), *available at* http://www.gpo.gov/fdsys/pkg/FR-2012-07-12/pdf/2012-16498.pdf, and Exemptive Order Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 858 (Jan. 7, 2013) (the "December Order"), *available at* http://www.gpo.gov/fdsys/pkg/FR-2013-01-07/pdf/2012-31736.pdf. For more information, see our update "CFTC Proposes Phased Compliance Program for Certain Swaps," available at http://www.mayerbrown.com/CFTC-Proposes-Phased-Compliance-Program-for-Certain-Swaps/.

6 *See*, *e.g.*, Swap Jurisdiction Certainty Act, H.R. 1256, 113th Cong. (2013), *available at* http://hdl.loc.gov/loc.uscongress/legislation.113hr1256.

7 Cross-Border Security-Based Swap Activities, Exchange Act Release No. 69,490, 78 Fed. Reg. 30,968 (proposed May 23, 2013), *available at* http://www.gpo.gov/fdsys/pkg/FR-2013-05-23/pdf/2013-10835.pdf.

8 The Guidance provides that parties may reasonably rely on written representations from counterparties as to the counterparty's US person status in the absence of indications to the contrary.

9 The Guidance generally defines a principal place of business as where the entity's "officers direct, control, and coordinate the corporation's activities" or where it maintains its "nerve center"; which is normally where the company maintains its actual headquarters. The Guidance also includes a specific interpretation of how a collective investment vehicle would determine its principal place of business. Under this interpretation, a collective investment vehicle's principal place of business is generally in the United States if the senior personnel responsible for the formation and promotion of the vehicle or implementation of the vehicle's investment strategy are located in the United States (notwithstanding, for example, where its named directors and officers may be located, where the vehicle has registered offices, or where its books and records are maintained).

10 While this prong excludes owners of limited liability companies, limited liability partnerships, and other similar entities from consideration, it would apply to general partners of limited partnerships.

11 Guidance, 78 Fed. Reg. at 45315.

12 Guidance, 78 Fed. Reg. at 45317. This was the approach taken in the December Order.

13 The December Order defined a US person using the same prongs that are used in the Guidance for a natural person, pension plan, estate, trust, and individual or joint account and a different prong that incorporated a corporation, partnership, limited liability company, business or other trust, association, joint-stock company, fund or any form of enterprise similar to any of the foregoing, that in each case was (A) organized or incorporated under the laws of a state or other jurisdiction in the US or (B) effective as of

April 1, 2013 for all such entities other than funds or collective investment vehicles, had its principal place of business in the US.

14 Non-US persons who are not guaranteed or conduit affiliates of US persons do not need to include swaps with (i) guaranteed affiliates that are registered as SDs, (ii) guaranteed affiliates that are guaranteed by non-financial entities, or (iii) guaranteed affiliates who are not SDs, but engage in *de minimis* levels of swap dealing activity and are affiliated with a registered SD.

15 The CFTC suggested that once an affiliated group reached the *de minimis* threshold, one or more members would register as SDs, thus bringing the group's calculation below the *de minimis* threshold.

16 The CFTC noted in the Guidance that commenters had requested that swaps with international financial institutions, such as the World Bank and International Monetary Fund, should not be included in threshold calculations However, the CFTC did not provide clarification in the Guidance as to how such entities should be treated in registration threshold calculations.

17 Despite the single entity approach, the CFTC stated that a US branch of a non-US SD or MSP would be subject to all of the Transaction-Level Requirements with respect to swaps with US and non-US persons. Substituted compliance would not be available to a US branch.

18 The Guidance states that the CFTC expects that it would have real time direct electronic access to all of the reported swap data elements that are stored in a non-US trade repository as part of making a comparability evaluation and to determine whether the data may be effectively used in furtherance of the purposes of the Dodd-Frank Act. The Guidance recognizes that the CFTC's expected level of access may be in conflict with blocking, privacy, or secrecy laws of other jurisdictions. The Guidance indicates that the CFTC will consider reasonable alternatives and strongly encourages regulators and registrants to consult directly with CFTC staff.

19 A non-US SD or MSP or foreign branch that was not required to clear under the December Order may delay complying with clearing requirements until October 10, 2013. Relief as to the real-time reporting requirements for swaps with a guaranteed non-US affiliate of a US person will terminate on September 30, 2013.

20 Non-US, non-clearing members with significant positions in swaps linked to specified US-listed physical commodity futures contracts would need to maintain records of such swaps in the format used in the normal course of business operations for inspection by the CFTC.

21 Where at least one of the parties is a conduit affiliate, the CFTC expects the parties to comply with the conditions of the inter-affiliate exemption (if elected) and part 43 real-time reporting requirements.

Appendix A

Application of Entity-Level Requirements[22]

APPLICATION OF THE ENTITY-LEVEL REQUIREMENTS TO SDS AND MSPS			
	US person counterparty	Non-US person counterparty who is a guaranteed or conduit affiliate	Non-US person counterparty who is not a guaranteed or conduit affiliate
US SD or MSP (including affiliates of non-US persons or when a US SD or MSP is acting through a foreign branch)	First and Second Categories of Entity-Level Requirements apply and may not be satisfied through substituted compliance	First and Second Categories of Entity-Level Requirements apply and may not be satisfied through substituted compliance	First and Second Categories of Entity-Level Requirements apply and may not be satisfied through substituted compliance
Non-US SD or MSP (including an affiliate of a US person)	First Category of Entity-Level Requirements apply and may be satisfied through substituted compliance. Second Category of Entity-Level requirements apply for US person counterparties and may not be satisfied through substituted compliance.	First Category of Entity-Level Requirements apply and may be satisfied through substituted compliance. Second Category of Entity-Level requirements apply and all except large trader reporting.	First Category of Entity-Level Requirements apply and may be satisfied through substituted compliance. Second Category of Entity-Level requirements apply and all except large trader reporting may be satisfied through substituted compliance.[23]

[22] Tables adapted from appendices to the Guidance, which may be inconsistent or incomplete without reference to the text of the Guidance.

[23] The SDR reporting requirement may be satisfied through substituted compliance only if the CFTC has direct access to the swap data stored at the foreign trade repository.

Appendix B

Application of Transaction-Level Requirements

APPLICATION OF CATEGORY A TRANSACTION-LEVEL REQUIREMENTS TO SDS AND MSPS				
	US person (other than a foreign branch of a US bank that is an SD or MSP)	Foreign branch of a US bank that is an SD or MSP	Non-US person who is a guaranteed affiliate or conduit affiliate of a US person	Non-US person who is not a guaranteed affiliate or a conduit affiliate of a US person
US SD or MSP	Applies	Applies	Applies	Applies
Foreign branch of a US bank that is an SD or MSP	Applies	Applies and may satisfy through substituted compliance	Applies and may satisfy through substituted compliance	Applies and may satisfy through substituted compliance
Non-US SD or MSP (including an affiliate of a US person)	Applies	Applies and may satisfy through substituted compliance	Applies and may satisfy through substituted compliance	Does not apply

APPLICATION OF CATEGORY B TRANSACTION-LEVEL REQUIREMENTS TO SDS AND MSPS				
	US person (other than a foreign branch of a US bank that is an SD or MSP)	Foreign branch of a US bank that is an SD or MSP	Non-US person who is a guaranteed affiliate or conduit affiliate of a US person	Non-US person who is not a guaranteed affiliate or a conduit affiliate of a US person
US SD or MSP (including an affiliate of a non-US person)	Applies	Applies	Applies	Applies
US SD or MSP (when it solicits and negotiates through a non-US subsidiary or affiliate)	Applies	Does not apply	Does not apply	Does not apply
Foreign branch of a US bank that is an SD or MSP	Applies	Does not apply	Does not apply	Does not apply
Non-US SD or MSP (including an affiliate of a US person)	Applies	Does not apply	Does not apply	Does not apply

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Digging into SEC Mineral Disclosure Policies

Editor's Note: After this bylined article appeared (in June 2013), the SEC's resource extraction payments disclosure rule was vacated on July 2, 2013 by the U.S. District Court for the District of Columbia. The findings indicated the Court's disagreement with the SEC's construction of a provision in the statute upon which the new rule was based, and that the SEC's arguments for not providing an exemption for certain disclosures meant that some complying companies would be competitively disadvantaged. On September 2, 2013, a spokesperson for the SEC indicated that it would not appeal the decision, but that it would re-propose the rule informed by the court's decision.

Law360, New York (June 17, 2013, 11:25 AM ET) -- On May 30, 2013, the Division of Corporation Finance of the U.S. Securities and Exchange Commission provided guidance in the form of frequently asked questions with respect to two recent SEC rules: (i) disclosure requirements regarding the use in products manufactured or contracted to be manufactured by an issuer of conflict minerals originating in the Democratic Republic of Congo or an adjoining country (DRC), and (ii) disclosure requirements for certain payments to governments by resource extraction issuers.[1]

The SEC adopted these rules on Aug. 22, 2012, pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, creating new Form SD for these specialized disclosure requirements.[2] The conflict minerals disclosure rules require issuers to follow a three-step process in determining whether, and to what extent, to make the required disclosures. The first step is to determine whether a company is subject to the rule. If it is, the second step is to conduct a reasonable country of origin inquiry to determine whether the conflict minerals originated in the DRC. Depending on the outcome of that inquiry, the third step is to conduct supply chain due diligence and, if necessary, to prepare a conflict minerals report.

The resource extraction payments disclosure rules require resource extraction issuers to disclose annually certain information on payments they make to the US government and foreign governments for the purpose of the commercial development of oil, natural gas or minerals.

Although both sets of rules were accompanied by extensive adopting releases, ambiguities remain, which have resulted in a substantial number of compliance questions as issuers analyze the applicability of the new rules to their operations and what disclosures, if any, must be provided. The FAQs do not address all of the questions that issuers are struggling with, but they do provide helpful interpretations with respect to some of the more commonly raised issues and also provide insights into how the staff may be looking at applying these new rules.

FAQs Applicable to Both the Conflict Minerals and Resource Extraction Payments Rules

Form S-3 Eligibility

The FAQs made clear that the failure to timely file a Form SD regarding conflict minerals or resource extraction payments will not make an issuer ineligible to use a Form S-3 registration statement. While the Form SD is a mandatory filing to the extent required by applicable SEC rules, a failure to file that form timely will not prevent an issuer from raising capital using the streamlined procedures of a short- form registration statement if the issuer is otherwise eligible to use Form S-3. Even though the failure to timely file a Form SD will not impact Form S-3 eligibility, it remains important that issuers develop appropriate disclosure controls and procedures as the Form SD is a report that is filed with the SEC and is therefore covered by the certifications filed by an issuer's chief executive officer and chief financial officer.

Subsidiaries

The issuer must include applicable disclosures with respect to subsidiaries. In the case of conflict minerals, the disclosure is required with respect to the issuer and all of its consolidated subsidiaries. In the case of resource extraction payments, the disclosure is required with respect to the issuer and its subsidiaries, as well as any other entity over which the issuer has control (e.g., a joint venture with a national oil company). Accordingly, issuers should implement disclosure controls and procedures to make appropriate inquiries throughout their organizations when determining if they are subject to the conflict minerals and/or resource extraction payment disclosure rules.

Key Points of the Conflict Minerals FAQs

Voluntary Filers

The conflict minerals FAQs make clear that the conflict mineral rules apply to issuers that voluntarily file reports with the SEC under Sections 13(a) or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act"). This means that any issuer that files reports with the SEC, whether or not it is required to do so, must comply with the conflict minerals disclosure rules, if applicable.

Customary Mining Activities

Issuers that only engage in mining and ancillary activities customarily associated with mining, such as transporting, crushing, milling, mixing and smelting the mined ore, are not considered to be manufacturing those minerals. The staff's position is a helpful clarification that mining companies do not become subject to the conflict minerals disclosure rules as a result of these ancillary activities. For example, the staff noted that gold mining of lower grade ore can involve a number of ancillary activities and the performance of those activities does not subject an issuer to the new conflict minerals disclosure rules.

Etched Logos

Issuers specifying that a logo, serial number or other identifier be etched on a generic product manufactured by a third party is not considered to be "contracting to manufacture the product." In other words, a company may direct that the branding of an "off-the-shelf" product be accomplished through a permanent marking of the product, as opposed to being affixed to the product, without being deemed to be contracting to manufacture the product for the purpose of the conflict minerals disclosure rules.

Generic Components

The FAQs make clear that if an issuer purchases generic components containing conflict minerals to include in a product, it must conduct a reasonable country of origin inquiry with respect to conflict minerals included in the generic components, even if it did not contract to manufacture such components. Accordingly, as a disclosure control, issuers should confirm that they are evaluating the content of generic parts used when they manufacture or contract to manufacture their products.

Packaging

The packaging or container sold with a product is not to be considered part of the product, even if a product's package or container is necessary to preserve the product following purchase. The staff interpretation explains that the packaging or container sold with a product is not considered part of the product and is generally discarded. On the other hand, if a company manufactures and sells the packaging or containers independent of the product inside, the packaging or container itself would be a product, subject to the conflict minerals disclosure rules.

Equipment Used to Provide Service

When an issuer uses equipment in order to provide a service that it sells, the staff does not consider such equipment to be the issuer's product for the purpose of the conflict minerals disclosure rules, even if the issuer manufactures or contracts to manufacture such equipment. As an example, the staff noted that a cruise line company that contracts to manufacture cruise ships does not have to file reports on Form SD regarding cruise ships. In its response, the staff made clear that it does not interpret equipment used to provide services to be products subject to the conflict minerals disclosure rules.

Resale of Equipment

Issuers do not have to file reports on Form SD with respect to tools, machines or equipment used in the manufacture of their products, even if they subsequently resell such equipment. Entry of used tools, machines or equipment into the stream of commerce after a company no longer needs them does not transform these items into products of that company for the purposes of the conflict minerals disclosure rules.

Model Numbers

Issuers do not need to disclose in Form SD the model numbers of products that have not been found to be DRC conflict free or that are DRC conflict undeterminable. The staff reiterated that the conflict minerals disclosure rules permit an issuer to describe its products based on its own facts and circumstances because each individual company is in the best position to describe its products in terms commonly understood within its industry. While issuers have flexibility in describing their products, they nevertheless must clearly disclose that such products "have not been found to be 'DRC conflict free'" or are "DRC conflict undeterminable," as applicable.

Report and Audit Needed Even if "DRC Conflict Free"

Issuers that manufacture or contract to manufacture products that contain conflict minerals from the DRC must file a Form SD with a conflict minerals report and obtain an independent private sector audit, even if they determine the products to be "DRC conflict free." However, issuers do not have to disclose "DRC conflict free" products in their conflict minerals report or make certain other disclosures (such as describing processing facilities and country of origin) with respect to the "DRC conflict free" products.

IPO Transition Period

Following an issuer's initial public offering, the staff clarified that it will not object if the issuer starts conflicts mineral reporting for the first reporting calendar year that begins no sooner than eight months after the effective date of its IPO registration statement. This staff interpretation will provide a useful transition period for newly public companies, comparable to the transition period directly provided in the conflict minerals disclosure rules in the acquisition context.

Key Points of the Resource Extraction Payments FAQs

Contract Drilling and Other Oil Field Services Companies

The staff clarified that issuers involved only in providing contract drilling and other oil field services (and presumably equipment) associated with exploration, extraction, processing and export activities would generally not be considered resource extraction issuers for purposes of the resource extraction disclosure rules. While noting that these activities are "related to" the commercial development of resources, the staff took the same approach as the Extractive Industries Transparency Initiative (EITI) did, in providing that only companies directly engaged in the extraction or production of oil, natural gas or minerals should disclose payments to governments or governmental agencies.[3]

The staff's position resolved a major uncertainty that many service and equipment companies had been grappling with since the effective date of the rules. This staff Interpretation also stated that in the event that any payment otherwise falling within the definition of "payment" under the rules is made by a service provider to a government or governmental agency on behalf of a resource extraction issuer, that payment must be disclosed by the resource extraction issuer.

What is a "Mineral" for Purposes of the Resource Extraction Disclosure Rules?

A "resource extraction issuer" is defined in the statute and resource extraction disclosure rules as an issuer engaged "in the commercial development of oil, natural gas, or minerals." There is no specific definition of the word "minerals" in the statute or rules. The FAQs provide that for purposes of the statute and rules, disclosure is required with respect to "any material commonly understood to be a mineral," and would include any material for which disclosure is required under the SEC's Industry Guide 7 under the Securities Act of 1933 — "Description of Property by Issuers Engaged or to Be Engaged in Significant Mining Operations."

Exporting Without an Ownership Interest in the Resource

An issuer engaged in transportation activities moving a resource from one country to another country is generally considered to be "exporting" the resource. However, the issuer generally would meet the definition of "resource extraction issuer" and be subject to the requirements to disclose its payments to governments if the issuer has an ownership interest in the resource being transported. If the issuer does not have an ownership interest in that transported resource, then the transportation activities generally are not considered to be directly related to the export of the resource, and the issuer generally would not be considered to be a resource extraction issuer.

Types of Payments and Disclosures

The FAQs also clarified a number of questions with regards to specific types of payments made by resource extraction issuers to governments. For example, a question was raised whether payments from a resource extraction issuer to a majority-owned government transportation service that supplies people or materials to a job site are required to be reported. The staff responded that because the payments are made in connection with a service activity that is considered to be "ancillary or preparatory" to the commercial development of resources, disclosure of those payments is not required.

Payments of penalties and fines to governmental agencies related to resource extraction activities are not reportable as "fees." For purposes of the resource extraction disclosure rules, disclosure is required of specified payments including, among other categories, fees and other material benefits that the SEC determines, consistent with the EITI guidelines, are part of the commonly recognized revenue stream for the commercial development of resources. Penalties and fees, according to the staff, are not within the type of fees mentioned in the EITI guidelines, and therefore they are not part of the commonly recognized revenue stream for the commercial development of the subject resources.

Payment information presented by a resource extraction issuer cannot be provided on an accrual basis for financial accounting purposes. The staff noted that the rules only contemplated the payment information to be presented on an unaudited, cash basis for the year in which the payments are made.

A resource extraction issuer may have many sources of income from a particular country. That resource extraction issuer likely pays corporate-level income tax to that country's government based on the consolidated amount of its income in that country and not segregated out by resource extraction activity.

According to the FAQs, the income taxes that are paid with respect to the issuer's covered commercial development activities that must be disclosed for that country may be reported in one of two ways:

- either on a segregated basis, separating out the amounts of income taxes that the issuer pays on its other business activity income in that country, which may be difficult to do if the provider of the resource extraction activities is not a separate taxpayer, or
- on an aggregate basis, reporting the total income taxes paid for that country but noting that the disclosed aggregate amount includes payments made for purposes other than the commercial development of oil, natural gas or minerals.

As noted earlier, there are a number of open questions issuers are trying to address in determining how to apply the new requirements. While the FAQs address some of these questions, there are a number that remain unanswered and we hope that the staff will continue to issue FAQs providing additional guidance interpreting the application of the new rules.

Endnotes

1. The FAQs relating to the conflict minerals disclosure rules are available at http://www.sec.gov/divisions/corpfin/guidance/conflictminerals-faq.htm. The FAQs relating to the resource extraction payments disclosure rules are available at http://www.sec.gov/divisions/corpfin/guidance/resourceextraction-faq.htm.

2. For a detailed description of the conflict minerals disclosure rules, see Mayer Brown LLP's Legal Update dated Sept. 5, 2012, entitled Securities and Exchange Commission Adopts Final Conflict Minerals Disclosure Rule, which is available at http://www.mayerbrown.com/US-Securities-and-Exchange-Commission-Adopts-Final-Conflict-Minerals-Disclosure-Rule-09-05-2012/. For a detailed description of the resource extraction payments disclosure rules, see Mayer Brown LLP's Legal Update dated September 4, 2012, entitled SEC Adopts Dodd-Frank Resource Extraction Payments Disclosure Rules, which is available at http://www.mayerbrown.com/SEC-Adopts-Dodd-Frank-Resource-Extraction- Payments-Disclosure-Rules-09-04-2012/.

3. Section 13(q)(1)(C) under the Exchange Act directs the SEC in its rulemaking to determine the types of payments to be included as "part of the commonly recognized revenue stream for the commercial development of oil, natural gas or minerals." It provides that the payments and benefits to be included should be "consistent with the guidelines of the EITI (to the extent practicable)."

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MAYER • BROWN

4 December 2013 *Mayer Brown Legal Update*

CFTC Sued on Extraterritorial Application of Dodd-Frank Swap Rules

On December 4, 2013, the International Swaps and Derivatives Association, the Securities Industry and Financial Markets Association and the Institute of International Bankers sued the CFTC for defects in the CFTC's "Interpretive Guidance and Policy Statement Regarding Compliance with Certain "Regulations" (the "ET Guidance").

The multi-count complaint faults the CFTC for, among other things, failing to follow complete rulemaking procedures (including failing to provide a cost-benefit analysis) and producing an arbitrary and capricious result. The suit, which challenges aspects of other CFTC Dodd-Frank swap rules as well, seeks broad relief, including that the ET Guidance be vacated.

Mayer Brown counseled ISDA with respect to aspects of this action.

For more information about the matters raised in this Legal Update, please contact Joshua Cohn, Curtis A. Doty, Jerome J. Roche or David R. Sahr.

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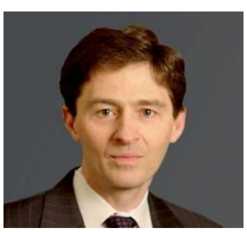

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MAYER • BROWN

Legal Report

Final Regulation Implementing the Volcker Rule

The US federal financial regulators recently approved the much-anticipated joint final regulation implementing the Volcker Rule, a key element of the 2010 Dodd-Frank financial reform legislation, which is intended to curtail the proprietary trading and private fund activities of US and non-US banking groups. The final regulation represents, in certain respects, a significant improvement upon the proposal released in fall 2011, particularly as it relates to limiting the extraterritorial impact of the regulation on non-US banking organizations. On the other hand, the final regulation leaves important questions from the proposal unresolved and creates new issues of its own, not least among them the manner in which Volcker Rule compliance will be supervised and enforced for complex banking organizations subject to the jurisdiction of multiple US regulators.

This report summarizes the final regulation, including a banking entity's obligations in advance of the termination of the Volcker Rule conformance period, now scheduled for July 2015, and highlights select issues of concern for many financial services firms.

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Final Regulation Implementing the Volcker Rule

Introduction

On December 10, 2013, the five US federal financial regulators (the "Agencies") approved joint final regulations (the "Final Regulation") implementing Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), commonly referred to as the Volcker Rule.[1] Section 619 added a new Section 13 to the Bank Holding Company Act of 1956 (the "BHCA") that generally prohibits any banking entity from engaging in proprietary trading and from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a hedge fund or a private equity fund, subject to exemptions for certain permitted activities.

Over 70 pages in rule text and nearly 900 pages of supplementary information (the "Preamble"), the Final Regulation made numerous changes to the regulations proposed in October 2011 (the "Proposal"), which was subject to an unprecedented number of comment letters.[2] These changes address many of the concerns raised in the comment letters, while leaving some questions unanswered and raising a number of new issues. In many respects the Final Regulation is an improvement over the Proposal. For example, the Final Regulation substantially mitigates concerns about the extraterritorial impact of the Volcker Rule, and adopts a more flexible approach to certain key exemptions. On the other hand, some changes will result in a regulation that is potentially more restrictive than the Proposal, such as the requirement for hedging to be tied to "specific, identifiable" risks with ongoing "recalibration" and extensive documentation requirements. This Legal Report provides an initial assessment of the Final Regulation and notes a number of new interpretive issues that will likely need to be clarified by further guidance.

At this early juncture, it is evident that the Final Regulation will place a substantial compliance burden on many banking entities. Moreover, it is not yet clear how the Agencies will ultimately implement the authority to supervise and examine certain banking entities. For example, the CFTC has stated in its release that it will be the primary regulator for registered swap dealers, whereas many swap dealers will

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1 The Agencies are the Board of Governors of the Federal Reserve System (the "FRB"), the Federal Deposit Insurance Corporation (the "FDIC"), the Office of the Comptroller of the Currency (the "OCC"), the Securities and Exchange Commission (the "SEC") and the Commodity Futures Trading Commission (the "CFTC"). The FRB, FDIC, OCC, and SEC issued a joint release, and the CFTC issued a separate release with text that, with exceptions noted herein, is generally identical to the joint release. The joint release is available here, and the CFTC's release is available here. Page number references in the Legal Report are to the pre-Federal Register publication draft of the joint Agency release, unless otherwise indicated. The rule text, which is common to all of the Agencies, is available here.

2 For a discussion of the Proposal, see our Legal Report available here.

already be subject to the primary jurisdiction of one of the other Agencies, such as the OCC in the case of national banks and the FRB in the case of foreign banks.[3]

Fortunately, there will be a period of time in which to resolve some of this uncertainty. While the Final Regulation has a technical "effective date" of April 1, 2014, no specific provisions of the Volcker Rule will actually go into effect on that date. Rather, as result of an FRB order issued in connection with the approval of the Final Regulation, the Volcker Rule conformance period has been extended for all banking entities until July 21, 2015 (although certain banking entities with large trading operations will be required to begin reporting trading metrics during the conformance period). The key requirement for all banking entities during the conformance period will be to continue making good faith efforts to be in a position to comply with the Final Regulation by the end of the conformance period. The FRB order includes two specific additions to this general good faith conformance obligation: (i) a directive to "promptly" shut down stand-alone prop trading desks and (ii) a directive "not to expand activities and make investments during the conformance period *with an expectation that additional time to conform those activities or investments will be granted*."[4]

This Legal Report addresses the following topics: the scope of the Final Regulation, in particular the definition of "banking entity" (pages 2-4); the prohibition on proprietary trading and the exemptions thereto (pages 4-14); the prohibition on covered fund activities and the exemptions thereto (pages 14-32); the "Super 23A" prohibition on covered transactions with certain covered funds (pages 33-34); the limitations on permitted activities, including conflicts of interest (pages 34-35); and the extensive compliance program requirements that banking entities are required to implement by the end of the conformance period, including metrics reporting obligations for entities with significant trading activities (pages 35-43).

Banking Entities Subject to the Volcker Rule

The Volcker Rule applies to every "banking entity," which is defined in Section _.2(c)(1) of the Final Regulation as:[5]

(i) **Any Insured Depository Institution**. This includes any bank, thrift, industrial loan company, or other entity the deposits of which are insured by the FDIC.

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3 See CFTC release at 12.

4 FRB, "Order Approving Extension of Conformance Period," available here (emphasis added).

5 Citations in this Legal Report to the text of the Final Regulation adopt the convention employed in the pre-Federal Register publication draft, which is to refer to sections with a "_" preceding the subsection designation, e.g., "Section _.2(c)(1)." Each Agency will ultimately use its own section designation based on where the Final Regulation appears in its section of the Code of Federal Regulations. The subsection numbers should be consistent for all of the Agencies.

(ii) **Any Company That Controls an Insured Depository Institution**. This includes any bank holding company ("BHC"), any savings and loan holding company ("SLHC"), and any foreign bank or company that has a US insured depository institution subsidiary.

(iii) **Any Company Treated as a BHC for purposes of the International Banking Act of 1978 (the "IBA")**. This includes any foreign bank that has a US branch, agency, or commercial lending company subsidiary and the parent company of such a foreign bank.

(iv) **Any Affiliate or Subsidiary of the Foregoing**. This includes any company, on a global basis, that controls, is controlled by or is under common control with the foregoing, as defined in the BHCA.[6] Thus, it includes, wherever located, broker-dealers, insurance companies, commodities and derivatives firms, investment advisers, investment funds, and any other entity that is affiliated with one of the foregoing entities.

The Final Regulation does *not* apply to financial groups that do not contain a US depository institution or a foreign bank with a US branch or agency.

Exclusion of Covered Funds. Section _.2(c)(2) of the Final Regulation excludes from the definition of banking entity any covered fund that is not itself an insured depository institution, a company that controls an insured depository institution, or a company treated as a BHC under the IBA. Accordingly, covered funds controlled by a banking entity are not prohibited by the Volcker Rule from engaging in proprietary trading or covered fund activities (e.g., investing in other covered funds in a fund of funds structure).

Non-Covered Funds as Banking Entities. A fund that is *not* a covered fund, including any entity that is excluded from the definition of covered fund by Section _.10(c) of the Final Regulation (discussed below, pages 17-21), would be a banking entity subject to all of the restrictions of the Volcker Rule if it is affiliated with a banking entity for BHCA purposes. The Preamble confirms that SEC-registered investment companies and SEC-regulated business development companies would not be considered subsidiaries or affiliates of a banking entity "solely by virtue of being advised or organized, sponsored and managed by a banking entity in accordance with the BHCA."[7] It also notes FRB precedents that certain director/officer interlocks with and investments in less than 25 percent of the voting shares of such SEC-regulated funds would not constitute control. However, to the extent that other entities covered by the Section _.10(c) exclusions may be controlled by a banking entity, these excluded entities—which might include, for example, securitization vehicles and asset-backed commercial paper ("ABCP") conduits that

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6 Under the BHCA, one company generally is deemed to control another if it (i) owns, controls, or has the power to vote 25 percent or more of the outstanding shares of any class of voting securities of the other company; (ii) controls in any manner the election of a majority of the directors, trustees, or general partners of the other company; or (iii) has the power to exercise, directly or indirectly, a "controlling influence" over the management or policies of the other company, as determined by FRB after notice and opportunity for hearing.

7 Preamble at page 497.

are bank affiliates—would themselves be prohibited from engaging in proprietary trading or covered fund activities unless a specific Volcker Rule exemption is available.

Exclusion of Merchant Banking Investments. A portfolio company held pursuant to merchant banking authority under the BHCA is not a covered fund, nor is any "portfolio concern" controlled by a small business investment company ("SBIC") as defined in the Small Business Investment Act of 1958, unless such portfolio entities trigger any of the first three definitions of banking entity listed above.[8]

Nonbank Financial Companies Supervised by the FRB. Section 13 of the BHCA authorizes the FRB to impose additional capital requirements, quantitative limits and other restrictions with respect to proprietary trading and covered fund activities on nonbank financial companies that are not "banking entities," but that become subject to FRB supervision upon designation by the Financial Stability Oversight Council (the "FSOC") as systemically important financial institutions ("SIFIs"). The Final Regulation does not address the extent to which the Volcker Rule restrictions might be applied to SIFIs.

Proprietary Trading Activities

Prohibition on Proprietary Trading

Section 13 of the BHCA broadly prohibits any banking entity from engaging in proprietary trading. Section _.3(a) of the Final Regulation defines "proprietary trading" as "engaging as principal for the trading account of the banking entity in any purchase or sale of one or more financial instruments."[9] In rejecting many of the requests in the comment letters that the proposed definitions of proprietary trading, trading account, and financial instrument be narrowed, the Agencies generally take the view that these concerns are best addressed in the context of the exclusions and exemptions from proprietary trading.

Definition of "Financial Instrument"

The Final Regulation replaces the term "covered financial position" used in the Proposal with the term "financial instrument," but defines it in substantially the same manner. A financial instrument includes any security, any derivative,[10] any contract of sale of a commodity for future delivery, and any option on

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8 In addition, the Final Regulation excludes the FDIC acting in a corporate capacity or as a conservator or receiver.

9 The Final Regulation defines what is a "purchase" and "sale" for a variety of financial instruments. For example, with respect to a derivative, purchases and sales include the execution, termination (prior to scheduled maturity), assignment, exchange, or similar conveyance of, or extinguishing of rights or obligations under, as derivative, as context may require.

10 The definition of "derivative" in the Final Regulation is substantively unchanged from the Proposal. Among other things, it excludes any "identified banking product" as defined in the Legal Certainty for Bank Products Act of 2000. The Agencies declined to adopt the suggestion of many commenters that foreign exchange swaps and forwards that are generally exempt from the definition of "swap" under Title VII of the Dodd-Frank Act also be excluded from the definition of "derivative" and, thus, be treated as non-financial instruments for Volcker Rule purposes.

any of the foregoing instruments. The definition of financial instrument specifically excludes loans (including any leases, extensions of credit, or secured or unsecured receivables that are not securities or derivatives), certain commodities (i.e., those defined as excluded commodities under the Commodity Exchange Act of 1936 (the "CEA")), and foreign exchange or currency. In this context, "foreign exchange or currency" is not further defined or interpreted by the Agencies.

Definition of "Trading Account"

Substantially as proposed, Section _.3(b) of the Final Regulation adopts a three-pronged definition of "trading account," and an activity need only fall within one prong of the definition to constitute proprietary trading.

Intent Test. The Final Regulation first defines the trading account as any account used to buy or sell a financial product principally for the purposes of short-term resale, benefitting from short-term price movements, realizing short-term arbitrage profits, or hedging positions resulting from any of the above transactions.

Market Risk Capital Rule Test. The trading account also includes any account used for the purchase or sale of a financial instrument that is both a "covered position" for purposes of the US market risk capital rule and a "trading position" (including hedges of those positions). This test applies to any banking entity that is, or that has an affiliate that is, an insured depository institution, BHC, or SLHC that calculates risk-based capital ratios under the market risk rule.

Status Test. The trading account also includes any account used for the purchase or sale of financial instruments by a banking entity that is licensed or registered, or required to be licensed or registered, as a dealer, swap dealer, or security-based swap dealer, and the purchase or sale is being made in connection with the entity's dealing activities. This prong also applies to banking entities engaged in business as a dealer, swap dealer, or security-based swap dealer outside of the United States.

Rebuttable Presumption. The purchase of a financial instrument by a banking entity is presumed to be for its trading account if the banking entity holds the position for fewer than sixty days or substantially transfers the risk of the position within sixty days of the purchase. A banking entity may rebut the presumption by demonstrating that it did not purchase the financial instrument principally for any of the short-term trading purposes described above in connection with the trading account "intent test." There is no opposite presumption for positions held longer than sixty days.

Excluded Activities

Section _.3(d) of the Final Regulation expressly excludes the following activities from the definition of proprietary trading:

Repurchase and Reverse Repurchase Transactions. The proprietary trading ban does not apply to a repurchase or reverse repurchase agreement in which a banking entity has simultaneously agreed, in writing, to both purchase and sell a stated asset, at stated prices, on stated dates or on demand, with the same counterparty. The Agencies agree that repos are the equivalent of secured loans. The collateral or position that is being financed by a repo, however, is not excluded from the definition of proprietary trading.

Securities Lending and Borrowing. Securities lending and borrowing transactions are not proprietary trading, provided that the banking entity lends or borrows a security temporarily to or from another party pursuant to a written securities lending agreement, under which the lender retains the economic interest of an owner of such security and has the right to terminate the transaction and to recall the loaned security on terms agreed by the parties. The same rationale and limits apply to securities borrowing and lending transactions as to repos.

Liquidity Management. Securities transactions conducted in accordance with a documented liquidity management plan are also excluded from the definition of proprietary trading, provided that the plan:

(i) Specifically contemplates and authorizes the particular securities to be used for liquidity management purposes, the amount, types, and risks of the securities that are consistent with liquidity management, and the liquidity circumstances in which the particular securities may be used;

(ii) Requires that any purchase or sale of securities under the plan be principally for the purpose of managing the liquidity of the banking entity, and not for prohibited short-term trading purposes;

(iii) Requires that any securities purchased or sold for liquidity management purposes be highly liquid and limited to securities that the banking entity does not reasonably expect to give rise to appreciable profits or losses as a result of short-term price movements;

(iv) Limits securities purchased or sold for liquidity management purposes to an amount that is consistent with the banking entity's near-term funding needs, as estimated and documented pursuant to methods specified in the plan;

(v) Includes written policies and procedures, internal controls, analysis, and independent testing to ensure compliance; and

(vi) Is consistent with supervisory requirements, guidance, and expectations regarding liquidity management applicable to the banking entity.

In a footnote, the Agencies state that they plan to construe "near-term funding needs" in a manner consistent with applicable laws, regulations and issuances related to liquidity risk management including liquidity coverage ratio requirements.[11] They also declined the request of commenters to expand the exclusion to cover asset-liability management activities more generally.

Clearing Organization Transactions. Purchases and sales of financial instruments by a banking entity that is a derivatives clearing organization ("DCO") or a clearing agency are excluded from the definition of proprietary trading, under the rationale that the banking entity provides clearing as a service to third parties and not to profit from short-term resale or short-term price movements.

Clearing Activities. A banking entity may engage in "excluded clearing activities" if the banking entity is a member of a DCO, clearing agency or designated financial market utility. Excluded clearing activities include purchases and sales by a banking entity arising in connection with errors, defaults, or threatened defaults by one or more participants in the clearing process of a DCO, clearing agency, or designated financial market utility.

Trading as Agent, Broker or Custodian. A banking entity purchasing and selling financial instruments solely as an agent, broker, or custodian is not engaged in proprietary trading. The Preamble provides that this exclusion includes agency, brokerage, and custodial transactions on behalf of an affiliate, but notes that the exclusion does not exempt an affiliate on whose behalf transactions are carried out from complying with the Volcker Rule (i.e., to the extent such affiliate is engaged in proprietary trading as principal).

Trading in Satisfaction of Delivery Obligations. The Final Regulation adds an exclusion that permits a banking entity to purchase or sell a financial instrument (i) to satisfy an existing delivery obligation of the banking entity or its customers in connection with delivery, clearing, or settlement activity or (ii) to satisfy an obligation of the banking entity in connection with a judicial, administrative, self-regulatory organization, or arbitration proceeding.

Trading on Behalf of Employee Benefit Plans. The Final Regulation permits a banking entity to purchase and sell financial instruments through a deferred compensation, stock-bonus, profit-sharing, or pension plan of the banking entity, if the banking entity is acting as trustee acting for the benefit of persons who were or are employees of the banking entity.

Debt Collection Activities. The Final Regulation permits a banking entity to purchase or sell a financial instrument if the banking entity effects the sale or purchase in the ordinary course of collecting a debt previously contracted in good faith, so long as the banking entity divests itself of the financial instrument as soon as practicable and in compliance with its regulator's maximum retention period.

11 See Preamble at Footnote 242.

Permitted Trading Activities

Permitted Market-Making Activities

The Final Regulation makes substantial revisions to the Proposal in exempting market-making-related activities from the prohibition on proprietary trading. The Agencies have discarded lengthy guidance from the Proposal discussing indicia of market-making in favor of streamlined rule text. Under Section _.4(b) of the Final Regulation, a trading desk, which may operate across one or more legal entities, must "routinely stand ready" to trade and be "willing and available" to quote and otherwise enter into trades "through market cycles" on a basis appropriate given the liquidity, maturity, and market depth of the financial instruments for which it acts as market-maker. This exemption does not require trade-by-trade analyses, but instead a banking entity must monitor (i) "financial exposure"—i.e., the aggregate risks of financial instruments and any associated loans, commodities, or foreign exchange or currency held as part of its market-making-related activities—and (ii) for each trading desk, its "market-maker inventory." Consistent with the Proposal, the amount, types, and risks of the financial investments in the market-maker inventory must be designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties based on, among other things, demonstrable analysis of historical demand.

In another change from the Proposal, the Final Regulation permits market-making related hedging under Section _.4(b) without requiring a banking entity to separately comply with the risk-mitigating hedging exemption set forth in Section _.5. Moreover, the Proposal would have required market-making to generate revenues primarily from fees, commissions, bid/ask spreads, or other income not attributable to appreciation in value in covered financial positions (or hedges thereto), which a number of comment letters had identified as problematic for certain types of market-making activities. This revenue requirement has not been incorporated in the Final Regulation, although compensation arrangements for market-making personnel must be designed so that they do not reward or incentivize prohibited proprietary trading.

Compliance Obligations. A banking entity relying on the market-making exemption must establish and maintain an appropriate compliance program as required by subpart D of the Final Regulation (discussed below, pages 35-43) that (i) addresses the conditions noted above, including identification of the financial instruments that the trading desk is permitted to buy and sell as market-maker and the products and strategies it may use for risk management purposes; (ii) sets limits for each trading desk based on the desk's market-making activities; (iii) implements controls and ongoing monitoring for compliance with the limits; and (iv) establishes authorization procedures for any trade that would exceed the limits. These compliance requirements generally apply at the "trading desk" level of an organization, and thus will potentially require tailoring depending upon the characteristics of a particular trading desk's activities.

Interdealer Limitation. The Final Regulation defines clients, customers, and counterparties in the context of the market-making exemption to exclude large trading desks of other banking entities—i.e., entities with $50 billion or more in total trading assets and liabilities—unless the trading desk documents why such an entity should be treated as a customer or the transactions are anonymously conducted on an exchange that permits trading on behalf of a broad range of market participants. The Agencies expressed concern that the market-making exemption could be used to facilitate interdealer trading, activities which will "bear some scrutiny" by the Agencies going forward.

Clarifications in the Preamble. The Agencies note that, if a banking entity's primary dealer activities for a sovereign government fall outside of the underwriting exemption in Section _.4(a) of the Final Regulation, discussed below, the sovereign government and its central bank are each a client, customer, or counterparty for purposes of applying the market-making exemption. Further, the Agencies also state that the market-making exemption generally may be used by so-called "authorized participants" who create and redeem shares of, and engage in various trading activities in connection with, exchange-traded funds ("ETFs"). Commenters had been unsure whether such ETF transactions would be exempt under the proposed market-making or underwriting exemptions.

Permitted Underwriting Activities

Section _.4(a) of the Final Regulation adopts the underwriting exemption from the proprietary trading prohibition substantially as proposed, but the scope of the exemption has been broadened to apply to members of an underwriting syndicate and selling group members (rather than a single, lead underwriter), smaller offerings based on a change to the definition of "distribution," and selling security holders (in addition to issuers). The exemption also now permits banking entities to engage in stabilizing activities and to retain unsold allotments.

In brief, a banking entity may permissibly engage in proprietary trading activities under the underwriting exemption if:

(i) It is acting as an "underwriter" for a "distribution" of securities of an issuer or selling security holder;

(ii) Its trading desk's "underwriting position" is related to the distribution;

(iii) The amount and type of the securities of the trading desk's underwriting position are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties;

(iv) Reasonable efforts are made to sell or otherwise reduce the underwriting position within a reasonable period, taking into account the liquidity, maturity, and depth of the market for the relevant type of security;

(v) The banking entity establishes and maintains a compliance program that addresses various underwriting-related requirements;

(vi) Compensation arrangements for relevant personnel are designed not to reward or incentivize prohibited proprietary trading; and

(vii) The banking entity is licensed or registered to engage in the underwriting activity.

Although the Final Regulation still defines the term “distribution” by reference to the SEC’s concept of “special selling efforts and selling methods” from Regulation M, it does not require compliance with the “magnitude” requirement from that same regulation. Accordingly, the exemption is now available for distributions of smaller size than those historically meeting the Regulation M definition of distribution. The Agencies also note that offerings that qualify as distributions include, among others, private placements in which resales may be made in reliance on the SEC’s Rule 144A or other available exemptions, as well as commercial paper being offered as a security.

Compliance Obligations. As under the market-making exemption, a banking entity relying on the underwriting exemption must establish and maintain an appropriate compliance program as required by subpart D of the Final Regulation that (i) addresses the conditions noted above; (ii) sets limits for each trading desk based on the desk’s underwriting activities; (iii) implements controls and ongoing monitoring for compliance with the limits; and (iv) establishes authorization procedures for any trade that would exceed the limits.

Permitted Risk-Mitigating Hedging Activities

Section _.5 of the Final Regulation implements the exemption for risk-mitigating hedging activities, which generally permits a banking entity to trade financial instruments in order to hedge specific risks to the banking entity arising in connection with the individual or aggregated positions, contracts, or other holdings of the banking entity. The Final Regulation circumscribes the risk-mitigating hedging exemption originally described in the Proposal and imposes significant additional documentation and compliance-oriented obligations. However, the retention of the reference to hedging of “aggregated position” indicates that some degree of portfolio hedging remains permissible, provided that the risks being hedged are sufficiently identifiable and other specific requirements of the exemption (e.g., related to documentation) are satisfied.

Under the Final Regulation, in order for a position to qualify as permitted hedging, the putative hedge must, from inception, demonstrably (via some type of analysis) reduce or mitigate the specific identifiable risks of specific identifiable positions or aggregated positions.[12] In contrast, the Proposal only required that a hedge be reasonably correlated to a risk or risks being mitigated. In any event, a hedge must not itself give rise to any significant new or additional risk that is not contemporaneously hedged, and banking entities are required to engage in ongoing recalibration of hedging activities to ensure continuing compliance with the conditions of this exemption. Compensation arrangements for risk-mitigating hedging personnel must be designed so that they do not reward or incentivize prohibited proprietary trading.

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[12] A specific identifiable risk may include market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or other similar risk.

These new conditions reflect the Agencies' view that hedging should be connected to "identifiable" positions and risks, as opposed to being conducted on a macro basis. Notably, the Agencies state that it would be inconsistent with Congressional intent to permit hedging designed to "reduce risks associated with the banking entity's assets and/or liabilities generally, general market movements or broad economic conditions; profit in the case of a general economic downturn; counterbalance revenue declines generally; or otherwise arbitrage market imbalances unrelated to the risks resulting from the positions lawfully held by the banking entity."[13] Accordingly, the Preamble provides that the hedging exemption may not be used for "scenario hedging," "revenue hedging" or general asset-liability management.

In at least one aspect, the Final Regulation liberalizes the proposed exemption. Anticipatory hedging remains permissible if conducted in accordance with the conditions noted above, but now such hedging need not be conducted "slightly" before a banking entity becomes exposed to a specific, identifiable risk. The Agencies effectively agreed with commenters' concerns that this now-deleted modifier was potentially unduly limiting.

Compliance Obligations. A banking entity relying on the risk-mitigating hedging exemption is subject to compliance obligations similar to those that apply for underwriting and market-making, including establishing and maintaining a compliance program as required by subpart D of the Final Regulation. The Final Regulation imposes additional documentation requirements for hedges that are created or maintained (i) to hedge aggregated positions across two or more trading desks, (ii) in a financial instrument not previously listed among the products used for hedging by the hedging trading desk, or (iii) at a different trading desk from the trading desk that established the underlying positions creating the risks being hedged. These additional records must be maintained for a period no less than five years.

Permitted Trading Activities of Foreign Banking Entities

The Final Regulation modifies the proposed exemption for trading activities conducted by foreign banking entities solely outside of the United States ("SOTUS"). In response to comments, some key aspects of the Proposal have been revised or eliminated, including the definition of "resident of the United States" and the requirement that a transaction be executed wholly outside the United States in order to be covered by the exemption. Under Section _.6(e) of the Final Regulation, foreign banking entities may engage in "foreign trading activities" under the following conditions:

(i) The banking entity is not organized, or directly or indirectly controlled by another banking entity that is organized, under US law;

(ii) The banking entity engages in the transaction pursuant to the authority in Section 4(c)(9) or Section 4(c)(13) of the BHCA, which is deemed to be satisfied if the banking entity is either a qualifying foreign banking organization ("QFBO") under Regulation K or, if it is a not a

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[13] Preamble at 346.

foreign banking organization under Regulation K, it meets at least two of three tests showing a foreign predominance in its operations;[14]

(iii) The banking entity, including any personnel of the banking entity arranging, negotiating or executing the purchase or sale, or deciding to make the purchase or sale, is not located in the United States;

(iv) The transaction, including any related risk-mitigating hedging, is not accounted for as principal on the books of any US-located or US-organized branch or affiliate of the foreign banking entity;

(v) No financing for the banking entity's purchase or sale is directly or indirectly provided by any US-located or US-organized branch or affiliate; and

(vi) The banking entity's purchase or sale is not conducted with or through any US entity, except as discussed below.

Permissible US Counterparties. A foreign banking entity is permitted to trade with the foreign operations of a US entity, such as the non-US branch of a US bank, provided that no personnel of the counterparty that are located in the United States are involved in the arrangement, negotiation, or execution of the transaction. In addition, a foreign banking entity is permitted to trade with any unaffiliated US market intermediary acting as principal, provided that the trade is promptly cleared and settled through a clearing agency or DCO. The exemption also permits a foreign banking entity to trade through an unaffiliated US market intermediary acting as agent, if the transaction is anonymously conducted on an exchange or similar trading facility and is promptly cleared and settled through a clearing agency or DCO.[15]

Permitted Trading in US Government Obligations

Section _.6(a) of the Final Regulation permits a banking entity to purchase and sell, anywhere in the world, obligations issued or guaranteed by the United States or an agency thereof, Ginnie Mae, Fannie Mae, Freddie Mac, Farmer Mac, a Federal Home Loan Bank, or a Farm Credit System Institution. This represents an expansion of the proposed exemption because it permits trading in obligations guaranteed but not issued by the United States. The Final Regulation also permits a banking entity to purchase and sell obligations of any US state or any political subdivision thereof, including municipal securities. The

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[14] The three tests, of which a non-QFBO banking entity must satisfy at least two to be eligible for the foreign banking entity exemption, are (i) whether the banking entity holds more than 50 percent of its assets outside of the United States; (ii) whether the banking entity derives more than 50 percent of its revenue from business outside of the United States; and (iii) whether the banking entity derives more than 50 percent of its net income from business outside of the United States.

[15] An unaffiliated market intermediary is defined as (i) a broker, dealer, or security-based swap dealer registered with the SEC or exempt from registration or (ii) a swap dealer or futures commission merchant registered with the CFTC or exempt from registration.

Final Regulation does not permit a banking entity to buy or sell derivatives referencing US government obligations in reliance on this exemption.

Permitted Trading in Foreign Government Obligations

Many foreign governments and other foreign entities filed comment letters requesting that an exemption for foreign sovereign obligations be adopted similar to the exemption for US government obligations. Section _.6(b) of the Final Regulation includes a new exemption to address these concerns. As detailed below, separate exemptions have been adopted for the US operations of foreign banking entities and certain foreign affiliates of US banking entities.

US Operations of a Foreign Banking Entity. Under Section _.6(b)(1) of the Final Regulation, a banking entity organized under, or directly or indirectly controlled by a banking entity organized under, the laws of a foreign sovereign may purchase and sell obligations issued or guaranteed by the entity's "home country" foreign sovereign or any agency or political subdivision of the foreign sovereign. The exemption is not available to any banking entity (i) that is directly or indirectly controlled by a top-tier banking entity organized under US law or (ii) that is an insured depository institution. Although the exemption in Section _.6(b) is not by its terms limited solely to US operations of foreign banking entities, the Preamble indicates that trading in foreign sovereign obligations by the non-US operations of a foreign banking entity would be conducted pursuant to the foreign trading exemption set forth in Section _.6(e) of the Final Regulation (discussed above, pages 11-12) rather than the Section _.6(b)(1) exemption.[16] Thus, these exemptions when read together appear to be intended to permit a foreign banking entity to trade in home-country government obligations in almost all circumstances.

Foreign Affiliates of a US Banking Entity. Section _.6(b)(2) of the Final Regulation permits a foreign affiliate of a US banking entity to purchase or sell an obligation of, or issued or guaranteed by, a foreign sovereign or any agency or political subdivision of a foreign sovereign if (i) the foreign affiliate is a foreign bank under FRB's Regulation K or is regulated by the foreign sovereign as a securities dealer; (ii) the financial instrument is issued by the entity's "host country" foreign sovereign, or by a political subdivision of the host country foreign sovereign (including any multinational central bank of which the foreign sovereign is a member); and (iii) the financial instrument is owned by the foreign affiliate and is not financed by an affiliate located in the United States or organized under US law. The Section _.6(b)(2) exemption does not appear to be available to foreign branches of US banks.

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[16] Provided that the requirements of the Section _.6(e) exemption are satisfied, a foreign banking entity is permitted to trade in the obligations of any foreign sovereign under that exemption (i.e., in addition to any other financial instrument), so trading would not be limited to "home country" sovereign obligations as under Section _.6(b)(1). This would include, for example, the trading of German Bunds by the Frankfurt branch of a Japanese bank. We also note that trading by a foreign banking entity under Section _.6(e) is not subject to mandatory metrics reporting obligations under Appendix A of the Final Regulation, which do apply to trading under Section _.6(b)(1) (as well as trading pursuant to the market-making, underwriting, hedging, and US Government obligations exemptions).

Permitted Trading on Behalf of Customers

Section _.6(c) of the Final Regulation permits banking entities to purchase and sell financial instruments on behalf of, or for the account of, customers in two separate ways:

In a Fiduciary Capacity. A banking entity is permitted to purchase or sell a financial instrument if it (i) is acting as a trustee or in a similar fiduciary capacity; (ii) is conducting the transaction on behalf of, or for the account of, a customer; and (iii) does not have or retain beneficial ownership of the financial instrument.

As a Riskless Principal. A banking entity is permitted to purchase or sell a financial instrument as a riskless principal (i) after receiving an order to purchase or sell from a client and (ii) if it does so to offset a contemporaneous sale to or purchase from the customer.

Permitted Trading by Regulated Insurance Companies

Section _.6(d) of the Final Regulation permits a banking entity that is an insurance company or an affiliate of an insurance company to purchase or sell financial instruments for (i) the general account of the insurance company or (ii) a separate account established by the insurance company. The purchase or sale must be made in compliance with applicable insurance company investment laws of the jurisdiction in which the insurance company is domiciled. The exemption is not available if the federal banking agencies have determined, after consultation with the FSOC and the relevant insurance commissioners, that the insurance company investment laws of the jurisdiction in question are insufficient to protect the safety and soundness of the banking entity or the financial stability of the United States.

Covered Fund Activities

Prohibition on Covered Fund Activities

Section _.10 of the Final Regulation implements the prohibition under Section 13 of the BHCA against acquiring or retaining an ownership interest in, sponsoring or having certain other relationships with, a covered fund. While the prohibition itself is substantially unchanged from the Proposal, the Final Regulation incorporates significant changes to the definition of "covered fund," which in the aggregate substantially limit the scope of the prohibition. As a result, the Final Regulation more faithfully implements the statutory intent to restrict banking entity activities related to "hedge funds" and "private equity funds," while also more appropriately limiting the Volcker Rule's extraterritorial impact. Like the Proposal, the Final Regulation provides several exemptions that permit a banking entity to invest in or sponsor covered funds under certain circumstances. The Final Regulation generally prohibits a banking entity from entering into "covered transactions" with certain covered funds (i.e., the so-called "Super 23A" prohibitions), although some of the most harmful potential effects of Super 23A under the Proposal have been remedied, or at least mitigated, by the substantial narrowing of the definition of "covered fund" in the Final Regulation.

Definition of "Covered Fund"

The Proposal defined "covered fund" very broadly and provided targeted exemptions for certain permitted activities. The Agencies have taken a different approach in the Final Regulation, defining covered fund more narrowly in the first instance and also providing 14 key exclusions from that definition (i.e., before turning to the exemptions for permitted activities). Thus, the analysis of covered fund status under the Final Regulation involves two basic questions: (i) does the entity come within the three-prong threshold definition of covered fund and (ii) if so, does it qualify for an exclusion? We address below the definition of covered fund under the Final Regulation, as well as the impact of the final definition on the foreign fund activities of foreign banking entities.

Private Investment Companies. As under the Proposal, the first prong of the definition of covered fund includes "an issuer that would be an investment company, as defined in the Investment Company Act of 1940, *but for* section 3(c)(1) or 3(c)(7) of that Act."[17] These two exclusions are traditionally used by a wide variety of entities, including most private investment funds with US investors.

Commodity Pools. The second prong of the covered fund definition applies to commodity pools. As defined under the CEA, a "commodity pool" is an investment trust, syndicate, or similar form of enterprise operated for the purpose of trading in commodity interests.[18] While the Proposal included *all* commodity pools in the definition of covered fund, the final definition includes only those commodity pools for which either:

(i) The commodity pool operator (the "CPO") of the pool has claimed an exemption under CFTC Rule 4.7 (which applies to registered CPOs whose pools are available only to sophisticated investors); or

(ii) The CPO is registered with the CFTC in connection with the operation of such pool, substantially all of the interests in the pool are owned by "qualified eligible persons,"[19]

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17 Final Regulation, Section _.10(b)(1)(i). The exclusion in Section 3(c)(1) of the Investment Company Act of 1940 (the "1940 Act") is generally available to issuers whose outstanding securities are beneficially owned by not more than 100 persons, while the exclusion in Section 3(c)(7) is generally available to issuers the outstanding securities of which are owned exclusively by persons who, at the time of acquisition, are "qualified purchasers." In each case, the issuer may not make a public offering in the United States.

18 Commodity interests include, among other things, commodity options, commodity futures, security futures, and, as a result of the Dodd-Frank Act, swaps. The definition of commodity pool has historically been given a broad interpretation by the CFTC, and the addition of swaps to the definition of "commodity interests" has had the attendant result of a wide variety of entities potentially being classified as commodity pools even based on only a *de minimis* level of swaps activity.

19 As defined in CFTC Rules 4.7(a)(2) and (3).

and units in the pool have not been publicly offered to persons who are not "qualified eligible persons."[20]

Foreign Funds – US Banking Entities. The Agencies have replaced the third prong of the covered fund definition, which under the Proposal included the "foreign equivalent" of any covered fund, with a more tailored definition that would apply *only* to a banking entity that is, or is directly or indirectly controlled by a banking entity that is, located in or organized under the laws of the United States or of any State (for ease of reference, we refer to any such entity as a "US-Controlled Banking Entity").[21] For these US-Controlled Banking Entities, a covered fund includes an entity that:

(i) Is organized outside the United States and the ownership interests of which are offered and sold solely outside the United States;

(ii) Is or holds itself out as being an entity or arrangement that raises money from investors for the purpose of investing or trading in securities; and

(iii) Is sponsored by the US-Controlled Banking Entity (or an affiliate) or has issued an ownership interest that is owned directly or indirectly by the US-Controlled Banking Entity (or an affiliate).

The Final Regulation specifies that an issuer would not be a covered fund under this third prong of the covered fund definition if the issuer can rely—or would be able to rely, if it were subject to US securities laws—on an exemption or exclusion from the definition of "investment company" *other than* the exclusions contained in Sections 3(c)(1) and 3(c)(7) of the 1940 Act. Accordingly, funds that can rely on other exclusions, such as Section 3(c)(5)(C) (available to many real estate funds) or Rule 3a-7 (available to certain securitization vehicles) would not be captured by this prong of the definition. The revised third prong of the definition means that a fund could potentially be treated as a covered fund with respect to a US-Controlled Banking Entity but *not* with respect to a foreign banking entity.

Foreign Funds – Foreign Banking Entities. The private investment company prong of the covered fund definition under the Final Regulation (i.e., the first prong discussed above) applies only to funds that actually rely on Section 3(c)(1) or (7). A fund that is organized outside the United States and that has no US investors generally would *not* need to rely on any exclusion or exemption from investment company status under the 1940 Act, including Section 3(c)(1) or (7), and, therefore, would not be a covered fund on that basis. Because the third prong of the definition no longer requires a foreign banking entity to analyze

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20 Thus, only commodity pools whose CPOs are registered with the CFTC will constitute covered funds. As a result, many pools whose CPOs rely on exemptions from registration (such as the *de minimis* exemption provided in CFTC Rule 4.13(a)(3)) would not be covered funds unless they otherwise satisfy another prong of the definition. The final commodity pool prong of the definition in the Final Regulation also eliminates the need for many banking entities to contend with questions regarding whether certain entities that engage in swap transactions are (or "would be") commodity pools.

21 For these purposes, the Final Regulation makes clear that a US branch, agency, or subsidiary of a foreign banking entity *is* located in the United States, but that the foreign banking entity itself is not considered to be in the United States merely because it operates or controls such a branch, agency, or subsidiary.

whether a foreign fund "would rely" on these exemptions if it were offered in the United States, with respect to a foreign banking entity, most foreign funds without US investors will not be covered funds.

A foreign fund that has no US investors as result of its initial offering may, however, later come to have US investors. For example, a US person may invest in a foreign fund that is publicly listed outside the United States in the secondary market, an existing non-US investor in a foreign fund may transfer its interest in the fund to a US person, or a non-US investor in a foreign fund may relocate to the United States and continue to acquire additional interests the foreign fund. In these types of scenarios, the foreign fund potentially would need to rely on Section 3(c)(1) or (7) under the 1940 Act. SEC staff has provided limited guidance in this area suggesting that a fund that "does not use US jurisdictional means in connection with the offer or sale of any of its securities … [is not required to rely on Section 3(c)(1) or (7)] if US residents purchase the [fund's] securities in transactions that occur outside the United States."[22] Ultimately, the question of whether a foreign fund with these types of limited US nexus issues relies on Section 3(c)(1) or (7) will depend on the specific facts. In the event that a foreign fund does rely on Section 3(c)(1) or (7), a banking entity sponsoring or investing in the fund may need to rely on the exclusion available to "foreign public funds" (if applicable) or the exemption for covered fund activities solely outside the United States, each of which is discussed below.

Excluded Funds

Section _.10(c) of the Final Regulation provides 14 exclusions from the definition of "covered fund." Thus, even if an entity relies on Section 3(c)(1) or (7) of the 1940 Act or is a commodity pool meeting the criteria set forth above, the entity is not a covered fund if it falls within an exclusion. A banking entity may, therefore, not only invest in or sponsor the excluded entity without needing to comply with a Volcker Rule exemption but it also may engage in covered transactions with the entity without regard to the Super 23A prohibition. As noted above (pages 3-4), the primary drawback of falling under a covered fund exclusion is that the entity is potentially subject to being treated as a banking entity in its own right (and thus subject to the Volcker Rule proprietary trading and covered fund restrictions).

The entities discussed below have been excluded from the definition of covered fund. The Agencies have also reserved the right to revoke any of these exclusions and to add additional entities to the list of exclusions. The Agencies specifically declined to exclude financial market utilities, venture capital funds, pass-through REITs, municipal tender option bond vehicles, credit funds, cash management vehicles and cash collateral pools.

Registered Investment Companies and Related Entities. The Final Regulation provides an exclusion from the definition of covered fund for any issuer is that is a registered investment company under the 1940 Act, as well as any issuer that has elected to be treated as a regulated business development company pursuant to the 1940 Act. This—along with the narrowed scope of commodity

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22 *Goodwin, Proctor & Hoar*, SEC No-Action Letter (Feb. 28, 1997).

pools included in the definition of covered fund—resolves an ambiguity under the Proposal that could have caused certain US registered investment companies to be covered funds under certain circumstances.

The Final Regulation also excludes entities that are in the seeding stage prior to registration. It is relatively common for some funds that intend to register (or to be regulated as a business development company) to operate for a limited period of time as an unregistered fund either for purposes of initial seeding, or to develop a track record prior to registration. The Final Regulation permits these entities to remain excluded from the definition of covered fund during this seeding period provided that the entity is formed and operated pursuant to a written plan to be registered or regulated (as applicable), and further provided that the entity complies with the restrictions on leverage that apply to registered investment companies or regulated business development companies, as applicable.

Foreign Public Funds. In response to requests from many commenters, the Final Regulation includes an exclusion for certain funds that are available to the public in non-US jurisdictions. Thus, any foreign fund that is otherwise picked up by the definition of covered fund (e.g., it is sold or offered in the United States under Section 3(c)(1) or (7)) will be excluded if it meets the following requirements:

(i) The fund is organized or established outside the United States;

(ii) The fund is authorized to offer and sell ownership interests to "retail investors" in the issuer's home jurisdiction;[23] and

(iii) The fund sells ownership interests predominantly through one or more public securities offerings outside of the United States. The Preamble states that "predominantly" for these purposes would be satisfied if 85 percent or more of the interests are sold to investors that are not residents of the United States. The Final Regulation specifies that in order to be considered a "public" offering for these purposes (i) the distribution must comply with local requirements; (ii) the distribution may not restrict availability to investors having a minimum level of net worth or assets;[24] and (iii) the issuer must file *publicly available* offering disclosure documents with the appropriate regulatory authority in the jurisdiction.

The Final Regulation restricts the use of the foreign public fund exclusion by US-Controlled Banking Entities in order to avoid potential evasion of the Volcker Rule. Specifically, a US-Controlled Banking Entity may sponsor a fund that makes use of this exclusion only if ownership interests are sold

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[23] Although the Final Regulation does not define "retail investors," the Preamble indicates that it should be construed to mean members of the general public who generally lack the sophistication of institutional investors and high net worth investors and who therefore would be entitled to the full protection of local securities laws.

[24] The Preamble makes clear that general suitability requirements imposed under local law would not jeopardize a fund's status under this exclusion.

predominantly (i.e., at least 85 percent) to persons *other than* the sponsoring US-Controlled Banking Entity, the issuer itself, or the affiliates, directors or employees of the foregoing.

Wholly-Owned Subsidiaries. Recognizing that internal structuring entities were not intended to be captured by the term covered fund, the Final Regulation excludes entities all of the outstanding ownership interests of which are owned directly or indirectly by the banking entity (or an affiliate), including, for example, intermediate holding companies. The Final Regulation further permits that up to 5 percent of the entity's ownership interests may be held by current and former employees or directors of the banking entity, so long as the former employees and directors acquired their ownership interest while they were at the banking entity.[25] In addition, up to 0.5 percent of the entity's ownership interests can be held by a third party for the purpose of establishing corporate separateness as may be required under foreign law or to address bankruptcy, insolvency, or similar concerns.[26] Such wholly-owned subsidiaries would of course be banking entities subject to the prohibitions of the Volcker Rule.

Joint Ventures. While the Proposal provided a limited exemption from the prohibition against covered fund activities for joint ventures that are operating companies, the Final Regulation expands the scope of what it means to be a joint venture and excludes eligible joint ventures from the definition of covered fund. An entity is considered a joint venture for these purposes if it: (i) has no more than ten unaffiliated co-venturers; (ii) is in the business of engaging in activities that are permissible for the banking entity *other than* investing in securities for resale or other disposition;[27] and (iii) is not, and does not hold itself out as being, an entity that raises money from investors primarily for the purpose of investing or trading in securities. By removing the requirement that joint ventures must be operating companies, the Final Regulation permits the use of joint ventures for a variety of other uses, such as risk sharing. Joint ventures may not rely on this exclusion if they are engaged in merchant banking activities as defined under the BHCA.

Acquisition Vehicles. Similar to joint ventures, while the Proposal provided an exemption from covered fund prohibitions for entities engaging in merger and acquisition activities, the Final Regulation instead excludes these entities from the definition of covered fund. Specifically, the Final Regulation provides that entities formed solely for the purpose of engaging in a *bona fide* merger or acquisition transaction and existing only for the period necessary to effectuate the transaction are not covered funds.

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25 To the extent that a current or former director or employee transfers his or her interest to a third party, this exclusion would cease to be available.

26 Any amounts owned by a third party pursuant to this provision are counted against the five percent that may be owned by current and former employees and directors.

27 The precise set of activities that may be engaged in by a joint venture will depend on the status of the banking entity that is participating in the joint venture. For example, while an insured depository institution's activities may be circumscribed by relevant statutes and rules, an affiliated investment adviser, broker-dealer, or insurance company may be subject to completely different restrictions, or no restrictions at all.

Foreign Pension or Retirement Funds. While US pension funds typically may rely on an exclusion from the definition of "investment company" provided in Section 3(c)(11) of the 1940 Act, that exclusion is not available to foreign pension and retirement funds which can cause them to instead rely on the exclusions in Section 3(c)(1) or (7) to the extent that they have US person beneficiaries. In order to avoid treating these foreign pension and retirement funds as covered funds, the Final Regulation excludes a fund that is (i) organized and administered outside the United States; (ii) a broad-based plan for employees or citizens that is subject to regulation as a pension, retirement, or similar plan under the laws of its local jurisdiction; and (iii) established for the benefit of citizens or residents of one or more foreign countries (or any political subdivisions thereof). A pension or retirement fund that meets these conditions would not be a covered fund even if some beneficiaries reside in the United States or become US residents.

Insurance Company Separate Accounts and Bank-Owned Life Insurance. Insurance company separate accounts are generally considered under US law to be issuing securities to the policyholder and, therefore, may need to register under the 1940 Act or else rely on Section 3(c)(1) or (7).[28] In order to avoid treating these separate accounts as covered funds, the Final Regulation excludes them so long as no banking entity other than the insurance company that established the separate account may participate in the account's profits and losses. The Final Regulation also provides an exclusion from the definition of covered fund for bank-owned life insurance.

Loan Securitizations and Qualifying ABCP Conduits. The Final Regulation excludes loan securitizations and ABCP conduits that are backed by "loans" and certain other qualifying assets, including contractual servicing rights associated with those loans, and interest rate and certain foreign exchange derivatives used for hedging purposes. Securitization vehicles relying on this exclusion generally are not permitted to own securities, including asset-backed securities.

Securitizations that rely on the exemption from "investment company" status found in Rule 3a-7 under the 1940 Act are not covered funds in the first instance under the Final Regulation, and, therefore, will not need to rely on this separate exclusion. However, many securitizations, including most securitizations organized outside the United States that make offers and sales to US investors, typically instead rely on Section 3(c)(1) or (7) under the 1940 Act.

As noted above, a securitization vehicle or ABCP conduit that relies on the Section _.10(c) exclusions would potentially be subject to regulation as a banking entity in its own right, to the extent it is deemed to be controlled by a banking entity for BHCA purposes. Please refer to our Legal Update concerning the impact of the Volcker Rule on securitizations for more information.

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[28] Section _.2(bb) of the Final Regulation defines a separate account as "an account established and maintained by an insurance company in connection with one or more insurance contracts to hold assets that are legally segregated from the insurance company's other assets, under which income, gains, and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company."

Qualifying Covered Bond Structures. The Final Regulation excludes from the definition of covered fund entities that hold loans and certain other assets for the benefit of holders of covered bonds that are issued by or guaranteed by foreign banks. Please refer to our Legal Update concerning the impact of the Volcker Rule on securitizations for more information.

SBICs and Public Welfare Investment Funds. The Final Regulation generally permits activities involving SBICs, but rather than provide an exemption as originally contemplated in the Proposal, the Final Regulation excludes SBICs from the definition of covered fund.

The Final Regulation also more broadly excludes issuers that are in the business of making certain investments that are designed primarily to promote the "public welfare" (e.g., certain investments for housing, services and jobs for low- and moderate-income communities or families) or certain expenditures related to the rehabilitation of historic sites under state and federal law.

Issuers in Conjunction with FDIC Receivership or Conservatorship. Finally, the Final Regulation excludes issuers formed by or on behalf of the FDIC for purposes of disposing of assets that the FDIC acquires in the course of acting as conservator or receiver under the Federal Deposit Insurance Act or the Dodd-Frank Act.

Ownership Interests Held as Principal

To the extent that an entity is a covered fund as defined in the Final Regulation and is not covered by an exclusion, a banking entity is generally prohibited from acquiring or retaining any "ownership interest" in the covered fund as principal. There are two key components to this prohibition: the definition of "ownership interest," and the carve-out for interests not held as principal.

Ownership Interest. Similar to the Proposal, Section _.10(d)(6) of the Final Regulation defines "ownership interest" to mean any equity, partnership, or "other similar interest." The Final Regulation provides that "other similar interest" includes an interest that (i) has the right to participate in the selection or removal of a general partner, director, investment manager, or similar entity (excluding certain creditor's rights); (ii) has the right to receive a share of the fund's income, gains, or profits; (iii) has the right to receive underlying assets of the fund after all other interests have been redeemed or paid in full (excluding certain creditor's rights); (iv) has the right to receive excess spreads under certain circumstances; (v) has exposure to certain losses on underlying assets; (vi) receives income on a pass-through basis; or (vii) has a synthetic right to receive rights in the foregoing. Accordingly, while a debt interest generally would not be considered an ownership interest, to the extent that a debt security or other interest in a covered fund exhibits substantially the same characteristics as an equity or other ownership interest (e.g., certain control rights, or a right, however remote, to receive a portion of the fund's profits or gains), it would be considered an ownership interest.[29]

Carried Interest. The definition of ownership interest specifically excludes "restricted profit interests" (i.e., carried interest). The Final Regulation defines restricted profit interests to include interests held by a covered fund's investment manager, investment adviser, commodity trading advisor, or other service provider, for which the purpose and effect of the interest is to allow the holder to share in the profits of the covered fund as performance compensation for the services rendered to the fund, and provided that certain other conditions are met.

Non-Principal Capacities. Even if an ownership interest is held by a banking entity, the Final Regulation provides that the prohibition does not apply in situations where the banking entity is acting solely as agent, broker, or custodian. Similarly, a banking entity may hold ownership interests in covered funds as trustee, or in another similar fiduciary capacity, on behalf of customers that are not themselves covered funds. However, each of the foregoing exemptions are limited to situations where the activity is conducted for the account of, or otherwise on behalf of, a customer, and the banking entity (and its affiliates) do not have or retain beneficial ownership. Thus, in the normal course, banking entities will be permitted to act as broker, custodian, nominee, or trustee for a customer account that holds interests in covered funds.

Under the Final Regulation, ownership interests in covered funds may be held in deferred compensation, pension plans, and certain other employee compensation plans established by a banking entity, if the banking entity holds the ownership interest as trustee for the benefit of the plan's participants who are or were employees of the covered banking entity (or affiliate).

Workout Structures. Finally, to address situations where a banking entity may take possession of covered fund ownership interests as a result of exercising a lien, or otherwise in connection with collecting on an outstanding debt, the Final Regulation permits such acquisitions so long as the banking entity divests the ownership interest as soon as practicable and in no event beyond the holding period permitted by the relevant Agency.

Acting as "Sponsor"

Banking entities are generally prohibited from "sponsoring" covered funds absent an exemption. Under Section _.10(d)(9) of the Final Regulation, as in the Proposal, the definition of "sponsor" focuses on the ability to control decision-making and operational functions of the fund. Specifically, a sponsor would include an entity that:

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[29] Among other things, residual interests in tender option bond structures and senior securities of collateralized debt obligations may raise concerns under the definition of ownership interest.

(i) Acts as a general partner, managing member, trustee of a covered fund (or serves as a CPO of a pool that is a covered fund due to its commodity pool status);

(ii) In any manner selects or controls a majority of the directors, trustees, or management of a covered fund (including having employees, officers, directors or agents who constitute that majority); or

(iii) Shares the same name, or a variation of the same name, with a covered fund for corporate, marketing, or other purposes.

Status of Trustees. The Final Regulation specifically excludes from the definition of "trustee" for these purposes (i) directed trustees, (ii) trustees under foreign law that are subject to substantially similar fiduciary standards as directed trustees, and (iii) any other trustee that does not exercise investment discretion. The Preamble clarifies that a trustee would not be a sponsor based solely on the power to replace an investment adviser with an unaffiliated investment adviser. It also indicates that a trustee that has "formal but unexercised power to make investment decisions" or that acts only upon the instruction or direction of another party would not be considered a sponsor.[30] A "trustee" would include any person that directs the actions of a "directed trustee" and any person who possesses authority and discretion to manage and control the assets of a covered fund for which a directed trustee serves as trustee.

Permitted Covered Fund Activities

Like the Proposal, the Final Regulation identifies a number of covered fund activities that are permitted, subject to regulatory restrictions. However, some changes have been made from the Proposal. As discussed above, certain activities that would have been permitted activities under the Proposal are now addressed by exclusions from the definition of covered fund. Other permitted covered fund activities have been expanded or modified. Generally, the Final Regulation permits banking entities to invest in or sponsor a covered fund in connection with (i) organizing and offering a covered fund for customers as a bona fide fiduciary, including a variation of the exemption tailored to an issuer of asset-backed securities that is not eligible for the loan securitization exclusion; (ii) underwriting or market-making activities; (iii) risk-mitigating hedging activities; (iv) activities occurring solely outside of the United States; and (v) regulated insurance company activities. Each of these permitted activities is subject to certain specific conditions described below, as well as the prohibition on covered transactions under Super 23A (discussed below, pages 33-34) and to limitations on conflicts of interest (discussed below, pages 34-35).

30 *See* Preamble at 627, 632-33.

Asset Management Exemption

Section _.11(a) of the Final Regulation allows a banking entity to acquire or retain an ownership interest in, or act as sponsor to, a covered fund in connection with organizing and offering the fund if certain conditions are met. The exemption under the Final Regulation is substantially the same as under the Proposal, but some changes have been made in response to comments. The final conditions are as follows:

(i) The banking entity provides *bona fide* trust, fiduciary, investment advisory, or commodity trading advisory services.

(ii) The covered fund is organized and offered only in connection with the provision of such services and only to persons that are customers of such services of the banking entity or its affiliate, pursuant to a written plan outlining how such services will be provided to its customers through the covered fund. The Preamble notes that the banking entity's relationship with the customers does not need to be pre-existing and can be established in connection with the organization and offering of the covered fund. The Final Regulation clarifies that the banking entity may also provide distribution, brokerage and other services to the covered fund.

(iii) The banking entity and its affiliates do not acquire or retain an ownership interest in the covered fund except a *de minimis* ownership interest permitted under Section _.12 of the Final Regulation. This restriction is discussed below.

(iv) The banking entity and its affiliates comply with the Super 23A restrictions with respect to the fund (discussed below, pages 33-34).

(v) The banking entity and its affiliates do not guarantee, assume or otherwise insure the obligations or performance of the covered fund or other covered funds in which it invests.

(vi) The covered fund does not share the same name or a variation of the same name with the banking entity or its affiliates, and does not use the word "bank" in its name. Despite many comments objecting to the name-sharing restriction, the Final Regulation is identical to the Proposal in this respect.[31] The scope of the application of this condition has, however, been reduced by other changes in the Final Regulation, in particular the substantial narrowing of the definition of covered fund as applied to foreign funds.

(vii) No director or employee of the banking entity or an affiliate receives an ownership interest in the covered fund, except for a director or employee that is directly engaged in providing investment advisory, commodity trading advisory, or other services to the

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[31] For example, some comments pointed out that the name-sharing restrictions would be incompatible with regulatory requirements in some foreign jurisdictions, which occasionally require that the fund's name indicate the connection with the fund's sponsor.

covered fund at the time of receipt.[32] In response to comments, the Agencies clarified that the services provided to the fund by a director or employee are not limited to investment advisory or investment management services. Services that enable the provision of investment advisory or investment management services—such as oversight and risk management, deal origination, due diligence, administrative or other support services (presumably including legal and compliance services)—will also make a director or employee eligible to invest in the fund for purposes of this condition.

(viii) The banking entity makes certain disclosures to prospective and actual investors in the covered fund, including that losses will be borne by investors and not the banking entity, that investors should read the fund documents prior to investing, and that interests in the fund are not FDIC-insured, as well as disclosure describing the role of the banking entity in sponsoring or otherwise providing services to the fund.

Asset-Backed Securitization Exemption

As described above, Section _.10(c)(8) of the Final Regulation excludes certain securitizations that are backed by loans and a very limited group of related assets. For securitizations that are not eligible for the Section _.10(c)(8) exclusion and are not able to rely on Rule 3a-7 or some other exemption under the 1940 Act, Section _.11(b) of the Final Regulation establishes an asset-backed securitization exemption, the primary purpose of which is to permit a banking entity that is a securitizer to satisfy its "skin-in-the-game" obligations under Section 15G of the Securities Exchange Act of 1934 (the "1934 Act"). Section _.11(b) of the Final Regulation provides that a banking entity is not prohibited from acquiring or retaining an ownership interest in, or sponsoring, a covered fund that is an issuer of asset-backed securities in connection with organizing and offering such fund if conditions (iii) through (viii) of the asset management exemption, described above, have all been met.

The Final Regulation also clarifies that, for purposes of the asset-backed securitization exemption, organizing and offering a covered fund that is an issuer of asset-backed securities means acting as the "securitizer" of the issuer, as that term is used in Section 15G(a)(3) of the 1934 Act, or acquiring an ownership interest in the issuer as required by Section 15G. This is intended to address the activities that would be included as organizing and offering a securitization, which may differ from organizing and offering other covered funds in that the entity that organizes and offers the securitization may not always provide advisory services to the issuer. The Agencies acknowledged this by not requiring conditions (i) and (ii) from the asset management exemption to be satisfied for purposes of the asset-backed securitization exemption.

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[32] The Agencies commented that this also permits former directors and employees to receive an ownership interest in a covered fund under certain circumstances. However, the Final Regulation may result in attribution of an ownership interest held by a director or an employee (current or former) to the banking entity for purposes of the *de minimis* investment limitations.

Please refer to our Legal Update concerning the impact of the Volcker Rule on securitizations for more information.

Underwriting and Market-Making Exemption

The Proposal did not address how Section 13(d)(1)(B) of the BHCA, which provides an exemption for underwriting and market-making-related activities from both the proprietary trading and covered fund prohibitions of the Volcker Rule, would be implemented with respect to covered funds. Some commenters contended that the absence of such an exemption in the Proposal could have a negative impact on the ability of banking entities to engage in customer-driven underwriting and market-making in securities issued by many structured finance vehicles that may rely on Section 3(c)(1) or (7) of the 1940 Act, such as collateralized loan obligation issuers and non-US ETFs. In response, the Agencies provided an exemption in Section _.11(c) of the Final Regulation for underwriting and market-making-related activities involving a covered fund as long as they are conducted in accordance with the requirements of the underwriting and market-making exemptions described in Sections _.4(a) and _.4(b), respectively. Those exemptions are described in more detail above (pages 8-10). In addition, under certain circumstances, ownership interests in a covered fund held pursuant to the underwriting and market-making exemptions will count toward the *de minimis* investment limitations and the required capital deduction described below.

Investment Limitations and Required Capital Deduction

Like the Proposal, the Final Regulation allows a banking entity to retain an ownership interest in a covered fund that it organizes and offers under Section _.11 for purposes of establishing the fund—including providing it with seed capital to attract unaffiliated investors—and for holding a *de minimis* investment in the fund, generally not to exceed three percent after the seeding period ends. However, there have been some significant changes in the Final Regulation. The Section _.11 exemptions are the asset management, asset-backed securitization, and underwriting and market-making exemptions described above.

Per Fund and Aggregate Limits. The Final Regulation imposes a cap on the ownership interests that a banking entity may hold pursuant to Section _.11 in any particular covered fund (the "per fund limit") and in all covered funds in the aggregate (the "aggregate fund limit"). The per fund limit for a banking entity and its affiliates in any covered fund is three percent of the total number or value of the outstanding ownership interests in the fund, calculated as described below under "**Calculation of Per Fund Limit**." For a covered fund that is an issuer of asset-backed securities, the per fund limit is three percent of the total fair market value of the ownership interests of the fund, unless a greater percentage is required by Section 15G of the 1934 Act, in which case the limit is that percentage.[33] The aggregate fund limit for a banking entity and its affiliates is three percent of the banking entity's Tier 1 capital, calculated as of the

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33 This measurement is calculated according to a complex set of rules in Section _.12(b)(3) of the Final Regulation.

last day of each calendar quarter and as described below under "**Calculation of Aggregate Fund Limit**."

Calculation of Per Fund Limit. For purposes of the per fund limit for a covered fund (other than an issuer of asset-backed securities), a banking entity must calculate both the aggregate number of the outstanding ownership interests and the aggregate value of the outstanding ownership interests in a given fund. It must comply with the per fund limit under both calculations. The aggregate number is calculated by counting the total number of ownership interests held in the fund divided by the total number of ownership interests held by all entities in the fund, as of the last day of each calendar quarter.[34] The aggregate value is calculated by taking the aggregate fair market value of all investments in and capital contributions made to the covered fund by the banking entity and dividing it by the value of all investments in and capital contributions made to the fund by all entities, as of the last day of each calendar quarter.[35]

Master-feeder fund investments and fund-of-funds investments are required to calculate the per fund limit differently. If the principal investment strategy of a fund (acting as a "feeder fund") is to invest substantially all of its assets in another single covered fund (referred to as a "master fund"), then the per fund limit for the banking entity is measured only by reference to the value of the master fund. This would include both any investment by the banking entity in the master fund, as well as the banking entity's pro rata share of any ownership interest in the master fund that is held through the feeder fund.

If a banking entity organizes and offers a covered fund for the purpose of investing in other covered funds (a "fund-of-funds") and the fund-of-funds invests in another permissible covered fund, then the banking entity's per fund limit in the other fund will include any investment made by the banking entity directly in the other fund and the banking entity's pro rata share of any ownership interest held through the fund-of-funds.

Ownership interests in a covered fund held by a banking entity pursuant to the underwriting and market-making exemptions will count toward the three percent-per-fund limit if the banking entity is also relying on the asset management exemption, the asset-backed securities exemption, or is guaranteeing or

34 The ownership interests are measured without regard to committed funds not yet called for investment.

35 The investments and capital contributions are measured without regard to committed funds not yet called for investment. The Final Regulation requires that once a valuation methodology is chosen, the banking entity must calculate the value of its investment and the investments of all others in the covered fund in the same manner and according to the same standards. The Preamble notes that a banking entity should determine fair market value in a manner that is consistent with its determination of the fair market value of its assets for financial statement purposes and that the fair market value would be determined in a manner consistent with the valuations reported by the relevant covered fund unless the banking entity determines otherwise for purposes of its financial statements. If fair market value cannot be determined, then the value will be the historical cost basis of all investments and capital contributions made by the banking entity to the covered fund.

otherwise insuring the performance of the covered fund or any covered fund in which the covered fund invests.[36]

Calculation of Aggregate Fund Limit. The aggregate fund limit is three percent of a banking entity's Tier 1 capital. For this purpose, the aggregate fund limit includes the sum of all amounts paid or contributed by the banking entity to acquire or retain an ownership interest in a covered fund, plus any amounts paid by the banking entity or one of its employees to obtain a restricted profit interest permitted under the Final Regulation, measured on a historical cost basis.[37] In addition, the aggregate value of all ownership interests held by a banking entity and its affiliates in all covered funds held under the asset management, asset-backed securitization, underwriting or market-making exemptions in Section _.11 of the Final Regulation will count toward the aggregate limit of three percent of the banking entity's Tier 1 capital.

Under the Final Regulation, the calculation of Tier 1 capital differs depending on the type of banking entity. For banking entities required to report Tier 1 capital, the Tier 1 capital for purposes of the aggregate fund limit will be the amount of Tier 1 capital reported to the banking entity's primary financial regulatory agency as of the last day of the most recent calendar quarter. For banking entities that are not required to report Tier 1 capital, the Tier 1 capital for purposes of the aggregate fund limit will be as follows:

(i) If the banking entity is controlled, directly or indirectly, by a depository institution that is required to report Tier 1 capital, the Tier 1 capital will be that reported by the depository institution to its primary financial regulatory agency as of the last day of the most recent calendar quarter;

(ii) If the banking entity is not controlled, directly or indirectly, by a depository institution that is required to report Tier 1 capital, but is a subsidiary of a bank holding company, the Tier 1 capital will be the Tier 1 capital will be that reported by the top-tier affiliate of the banking entity to its primary financial regulatory agency as of the last day of the most recent calendar quarter; and

(iii) For other banking entities (aside from foreign banking entities and their US affiliates), the Tier 1 capital will be equal to the total amount of shareholders' equity of the top-tier affiliate within the organization as of the last day of the most recent calendar quarter.

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36 The Preamble indicates that during a covered fund's seeding period, the banking entity will have more flexibility to underwrite and make a market in the ownership interests of the fund in connection with organizing and offering it because it can go above the three percent limit during this period.

37 The Agencies reasoned that a historical cost basis measurement in this case would prevent banking entities from increasing their aggregate investments in covered funds that are losing value. This helps achieve the statutory purpose of preventing banking entities from bailing out failing funds.

For foreign banking entities, the Tier 1 capital for purposes of the aggregate fund limit will be the consolidated Tier 1 capital as calculated under applicable home country standards, unless the banking entity is located in the United States or organized under the laws of the United States, in which case the Tier 1 capital will be calculated as described above.

Attribution. For purposes of calculating the per fund limit and the aggregate fund limit, the Final Regulation requires banking entities to include ownership interests held by the banking entity and by the banking entity's affiliates. The ownership interests held by affiliates are attributed to the banking entity. SEC-regulated business development companies and foreign public funds will not be considered affiliates for this purpose as long as the banking entity (i) does not own, control or have the power to vote 25 percent or more of the voting shares of the company or fund and (ii) provides investment advisory or certain other services to the company to the company or fund in compliance with applicable limitations. Covered funds also will not be considered affiliates for this purpose. Ownership interests held by a director or employee of a banking entity will be attributed to the banking entity if it extends financing to allow the director or employee to acquire the ownership interests and the financing is used for that purpose.

Seeding Period. Section _.12(a)(2)(i) of the Final Regulation requires that a banking entity holding an ownership interest in order to establish and seed a fund must actively seek unaffiliated investors to reduce the aggregate amount of all ownership interests of the banking entity in the covered fund.[38] By one year after the date of establishment of the fund, the banking entity must have conformed its ownership interest in the fund to the per fund limit. The seeding period exception does not apply to the aggregate fund limit. The Proposal did not define the "date of establishment" of a fund. Under the Final Regulation, the "date of establishment" of a covered fund is generally the date on which the investment adviser to the fund begins making investments pursuant to the written investment strategy for the fund, but for an issuer of asset-backed securities, it is the date on which the assets are initially transferred into such issuer.

Upon application of a banking entity, the FRB has the authority to extend the seeding period for up to two additional years if the FRB finds an extension to be consistent with safety and soundness and in the public interest. Such applications much be submitted at least 90 days before the expiration of the seeding period, must provide appropriate reasons for the application and must explain the banking entity's plan for reducing the permitted investment in a covered fund. The Final Regulation lists a variety of factors that the FRB may consider in reviewing an application to extend the seeding period. In addition, the Final Regulation permits the FRB to impose conditions on the banking entity under certain circumstances during any extension of the seeding period.

Capital Deduction. In addition to its other prohibitions and limitations, the Volcker Rule imposes a capital deduction on banking entities that hold ownership interests in covered funds. For purposes of

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38 The Preamble notes that this requirement includes developing and documenting a plan for offering shares in the covered fund to other investors and conforming the banking entity's investments to the *de minimis* limits.

calculating compliance with applicable regulatory capital requirements, a banking entity is required to deduct from its Tier 1 capital the greater of (i) the sum of all amounts paid or contributed by the banking entity to acquire or retain an ownership interest in a covered fund, plus any amounts paid by the banking entity or one of its employees to obtain a restricted profit interest permitted under the Final Regulation, measured on a historical cost basis, plus any earnings received or (ii) the fair market value of its ownership interests in a covered fund, plus any amounts paid by the banking entity or one of its employees to obtain a restricted profit interest permitted under the Final Regulation, if the banking entity accounts for the profits or losses of the fund investment in its financial statements. The capital deduction is required whenever the banking entity calculates its Tier 1 capital, either quarterly or at any time that the appropriate federal banking agency requests.

The aggregate value of all ownership interests held by a banking entity and its affiliates in all covered funds held under the asset management, asset-backed securitization, underwriting or market-making exemptions in Section _.11 of the Final Regulation will count toward the deduction from Tier 1 capital for purposes of regulatory capital requirements.

The Agencies recognized in the Preamble that the minimum regulatory capital requirements in the final capital rule published in 2013 by the federal banking agencies imposes risk weights and deductions that do not correspond to the deduction for covered investments imposed by the Volcker Rule. The Agencies anticipate proposing steps to reconcile the two rules after they have reviewed the interaction of the requirements of the two rules.

Risk-Mitigating Hedging Exemption

Section _.13(a) of the Final Regulation exempts certain very limited hedging activities from the covered fund prohibitions of the Volcker Rule. The covered fund prohibitions will not apply to an ownership interest in a covered fund held by a banking entity that is designed to demonstrably reduce or otherwise significantly mitigate the specific, identifiable risks to the banking entity in connection with a compensation arrangement with an employee of the banking entity (or its affiliate) that directly provides investment advisory, commodity trading advisory or other services to the covered fund. The Final Regulation eliminates the hedging exemption in the Proposal for banking entities that act as intermediary on behalf of a customer to facilitate exposure to the profits and losses of the covered fund.[39] In order to avail itself of the employee compensation hedging exemption, a banking entity must comply with a number of requirements including the establishment and enforcement of the internal compliance program required by subpart D of the Final Regulation.

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39 The Preamble notes that after review of the comments, the Agencies considered this exemption to be a high-risk strategy that could threaten the safety and soundness of the banking entity.

Exemption for Covered Fund Activities Solely Outside the United States

Section _.13(b) of the Final Regulation broadens the exemption in the Proposal that permitted certain covered fund activities that are solely outside the United States (the so-called "SOTUS exemption"). At the same time, the need for foreign banking entities to rely on the SOTUS exemption will likely be significantly reduced because of the changes to the definition of covered fund and the exclusion of foreign public funds (discussed above, pages 15-19). The SOTUS exemption may be most important in circumstances where sales of interests in a foreign fund in the secondary market cause the fund to need to rely on either Section 3(c)(1) or (7) of the 1940 Act and, thus, to become a covered fund for purposes of the Volcker Rule.

In order to be eligible for the SOTUS exemption, the following four conditions must be satisfied:

Not Organized or Controlled in the United States. The banking entity must not be organized or directly or indirectly controlled by a banking entity that is organized under the laws of the United States. Neither a foreign subsidiary controlled by a banking entity organized under US law nor a foreign branch of a banking entity organized under US law will be eligible for the SOTUS exemption.

Business Primarily Conducted Outside the United States. The covered fund activity in question must be pursuant to Section 4(c)(9) or 4(c)(13) of the BHCA. This condition will be satisfied if the banking entity is a QFBO under the FRB's Regulation K. If the banking entity is not a foreign banking organization (for example, because it controls only a savings association or an industrial loan company), then it will satisfy this condition if it is not organized under US law and it meets certain financial tests designed to ensure that it generally conducts the majority of its business outside the United States as delineated in above (page 12, note 14).

No Offers or Sales to US Residents. No ownership interest in the covered fund may be offered for sale or sold to a resident of the United States. This condition will be met if the covered fund is sold or has been sold pursuant to an offering that does not "target" residents of the United States. The Preamble notes that absent circumstances otherwise indicating a nexus with residents of the United States, the sponsor of a foreign fund would not be viewed as targeting residents of the United States for purposes of the SOTUS exemption if it (i) conducts an offering directed to residents of one or more countries other than the United States; (ii) includes in the offering materials a prominent disclaimer that the securities are not being offered in the United States or to residents of the United States; and (iii) includes other reasonable procedures to restrict access to offering and subscription materials to persons that are not residents of the United States. In addition, the Final Regulation changes the definition of "resident of the United States" to have the same meaning as "US Person" under the SEC's Regulation S.

Sponsorship/Investment Outside the United States. The activity or investment must occur solely outside of the United States. With respect to this condition, the Final Regulation differs from the Proposal in that it adopts a "risk-based approach" rather than a "transaction-based approach." The Preamble noted this approach is designed to ensure that the principal risk of a given activity eligible for this exemption will remain solely outside of the United States. In the Final Rule, this condition has the following requirements:

(i) The banking entity acting as sponsor, or engaging as principal in the acquisition of an ownership interest in the covered fund, is not (and is not controlled directly or indirectly by) a banking entity that is located in the United States or organized under US law;

(ii) The banking entity (and its relevant personnel) that makes the decision to acquire the ownership interest or act as sponsor is not located in the United States or organized under US law;

(iii) The investment in or sponsorship of the covered fund is not accounted for as principal directly or indirectly on a consolidated basis by any branch or affiliate that is located in the United States or organized under US law; and

(iv) No financing for the banking entity's ownership or sponsorship is provided, directly or indirectly, by any branch or affiliate that is located in the United States or organized under US law.

Notably, the Final Regulation eliminated the proposed requirement that US personnel or affiliates not be involved in the offer or sale of the fund.[40] Moreover, the Preamble notes that the US personnel and operations of a foreign banking entity can act as investment adviser to a covered fund as long as that does not result in the US personnel participating in the control of the covered fund or offering or selling an interest to a US resident. Finally, administrative services or similar functions can be provided by US personnel to the covered fund as an incident to the SOTUS activity.

Complex Fund Structures. There is some ambiguity concerning the manner in which multi-tiered fund structures (including master-feeder structures and parallel funds) are treated under the SOTUS exemption. The Preamble notes that the Agencies expect activities related to certain "complex fund structures" should be "integrated" to determine whether an ownership interest is offered for sale to a US resident. It appears that the Agencies may have in mind an investment in a fund otherwise eligible for the SOTUS exemption that is organized or operated for the purpose of investing in another covered fund that targets US residents. It is not clear, however, whether the Agencies are concerned only about evasion or also expect integration with respect to certain multi-tiered fund structures under other circumstances.

Exemption for Covered Fund Activities by a Regulated Insurance Company

The Proposal did not address how Section 13(d)(1)(F) of the BHCA, which provides an exemption for certain activities of a regulated insurance company from both the proprietary trading and covered fund prohibitions of the Volcker Rule, would be implemented with respect to covered funds. In response to

40 As stated above, however, personnel that make the decision to acquire the ownership interest or act as sponsor cannot be located in the United States.

comments, the Agencies modified the Final Regulation to provide an exemption from the covered fund investment prohibition for insurance companies and their affiliates. The exemption generally tracks the corresponding exemption from the proprietary trading prohibition. For an insurance company to be eligible for the exemption, the following conditions must be satisfied: (i) the insurance company must retain the ownership interest solely for the general account of the insurance company or for a separate account established by the insurance company; (ii) the acquisition or retention of the ownership interest must comply with applicable insurance laws and regulations in the jurisdiction where the insurance company is domiciled; and (iii) the federal banking agencies, after consulting with the FSOC and the relevant insurance regulators, must not have jointly determined that the relevant insurance laws or regulations fail to sufficiently protect the safety and soundness of the banking entity or the financial stability of the United States.

Limitations on Lending and Other Financial Relationships with Covered Funds (Super 23A)

Section _.14 of the Final Regulation implements so-called Super 23A with a few important changes from the approach in the Proposal. Super 23A refers to new Section 13(f) of the BHCA, which generally prohibits a banking entity, directly or indirectly, from entering into a "covered transaction," as defined under Section 23A of the Federal Reserve Act (the "FRA"), with a covered fund for which the banking entity or any affiliate acts as sponsor, investment manager, or investment adviser.

Scope. The general approach in the Final Regulation to the definition of covered funds reduces significantly the kinds of issuers that are treated as covered funds subject to the Super 23A prohibition. It will continue to apply to private equity funds and hedge funds and to issuers that otherwise fall within the definition of covered fund. It will also apply to covered funds that benefit from an exemption from the sponsorship and investment prohibitions, including the asset management and SOTUS exemptions. However, Super 23A will not apply to issuers that have now been excluded from the definition of covered fund under Section _.10(c) of the Final Regulation (discussed above, pages 17-21).

Direct or Indirect. One commenter argued that a banking entity that delegates the responsibility for acting as sponsor, investment manager, or investment adviser to a third party should not be subject to Super 23A. In the preamble, the financial agencies state that such a banking entity would continue to be subject to Super 23A if it retains the ability to select or remove or otherwise control the sponsor, investment adviser or investment manager.

Definition of "Covered Transaction." The definition of covered transaction continues to be based on the definition in Section 23A itself and includes (i) loans and other extensions of credit to the covered fund (including a purchase of assets subject to repurchase); (ii) purchases of assets from and investments in securities issued by the covered fund; (iii) issuance of financial guarantees on behalf of a covered fund; (iv) securities borrowing or lending that that results in a credit exposure to the covered fund; and (v) a derivatives transaction that results in credit exposure to the covered fund. In one helpful clarification, the

Preamble states that covered transactions under the Final Regulation do not include loans to third parties that are secured by obligations issued by a covered fund. However, the Final Regulation does not adopt the request of many commenters that it incorporate the exemptions for covered transactions that are set forth in Section 23A itself (e.g., intraday extensions of credit). Like the Proposal, the Final Regulation would *not* incorporate the "attribution rule" under Section 23A, which provides that any transaction by a US bank with any person is deemed to be a transaction with an affiliate to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, that affiliate.

Exempt Investments. The Final Regulation confirms that a banking entity may acquire or retain an ownership interest in a covered fund that is permitted in accordance with the other provisions of the Final Regulation, including the seed capital investments permitted under the asset management exemption, the SOTUS exemption and the risk retention investment required for securitization vehicles that are sponsored by banks or their affiliates.

Market Terms Condition. The Final Regulation would also apply the "market terms" and other requirements of Section 23B of the FRA to transactions between a banking entity and a covered fund sponsored, advised, or managed by the banking entity or any affiliate, effectively requiring that any permissible transactions with a sponsored or advised fund (i.e., non-covered transactions) are conducted on an arm's-length basis. These requirements generally mean that a transaction must be on terms that are substantially the same, or at least as favorable to the banking entity, as those prevailing at the time for comparable transactions between unaffiliated third parties.

Prime Brokerage Transactions. A banking entity may enter into a prime brokerage transaction with a sponsored or advised covered fund so long as (i) a covered fund managed, sponsored, or advised by such banking entity under Section _.11 of the Final Regulation has taken an ownership interest in the covered fund (the second-tier fund) and (ii) the CEO of the banking entity certifies annually that the banking entity does not guarantee the obligations of the second-tier fund or any covered fund in which the second-tier fund invests (in the case of a foreign banking entity, this certification may be provide by the senior manager in charge of US operations). Such transactions would be subject to Section 23B. "Prime brokerage transaction" is defined as any transaction that would be a covered transaction and that is provided in connection with custody, clearance and settlement, securities borrowing or lending services, trade execution, financing, data, operational, and administrative support.

Conflicts of Interest and Other Limitations on Permitted Activities

Sections _.7 and _.15 of the Final Regulation implement the statutory requirement that a banking entity may not engage in permitted proprietary trading or covered fund activities to the extent they would involve a material conflict of interest, result in a material exposure of the banking entity to high-risk assets or trading strategies, or pose a threat to the banking entity's safety and soundness or to US financial stability. These limitations apply with respect to permitted covered funds activities to the same extent as permitted trading activities.

Conflicts of Interest. A "material conflict of interest" between a banking entity and its customers or counterparties exists if the bank engages in any transaction or other activity that would involve its interest being adverse to the interests of the customer/counterparty with respect to the transaction or activity, unless the banking entity takes one of two actions prior to effecting the transaction or activity. First, it may make timely and effective disclosure of the conflict of interest, which provides the customer the opportunity to negate or substantially mitigate any materially adverse effect arising from the conflict. Second, the banking entity may have in place information barriers reasonably designed to prevent the conflict of interest from having a materially adverse effect on the customer. The banking entity may not rely on the second solution if it has knowledge or should have knowledge that despite the barrier the conflict of interest may have a materially adverse effect on a customer.

Extraterritorial Impact. The potential extraterritorial impact of this provision has been substantially mitigated by the decision in the Final Regulation to eliminate the "foreign equivalent" prong of the covered fund definition (thus exempting non-US funds that do not actually rely on Section 3(c)(1) or (7) of the 1940 Act) and to exclude foreign public funds from the definition of "covered fund." As result of these changes to the Proposal, the universe of foreign funds subject to the conflict of interest restrictions has been significantly reduced.

Compliance Program & Quantitative Trading Metrics

Overview

Compliance obligations are a critical aspect of the Final Regulation, and the process of developing and implementing a Volcker Rule compliance program is likely to be a significant challenge for many large banking entities over the coming 12-18 months. While a number of Volcker Rule permitted activities are explicitly conditioned upon the satisfaction of compliance-oriented obligations embedded in the text of the relevant exemption, the bulk of the Volcker Rule compliance and reporting framework is set forth separately, beginning with Section _.20 of the Final Regulation. The compliance program requirements under the Final Regulation are generally similar in structure to those included in the Proposal, although the final requirements reflect an effort on the part of the Agencies to tailor the requirements to the size and characteristics of a banking entity's activities. The Final Regulation includes a few important substantive changes, perhaps most notably a greater emphasis on senior management oversight of, and responsibility for, Volcker Rule compliance.

Compliance Program Categories

No Compliance Program. Banking entities with no proprietary trading or covered fund activities other than trading in US Government obligations are not subject to a compliance program requirement under the Final Regulation. Unlike the Proposal, the Final Regulation does not require these entities to establish policies and procedures designed to prevent them from becoming engaged in activities subject to the Volcker Rule.

Limited Compliance Program. Banking entities with total consolidated assets of $10 billion or less may satisfy their compliance program obligations by incorporating appropriate references to Section 13 of the BHCA and the Final Regulation into existing policies and procedures. Unlike with respect to the enhanced compliance program, where foreign banking entities are expressly permitted to count only US assets (discussed below), the Final Regulation does not include any statement with respect to the relevant measure of assets for foreign banking entities considering their eligibility for the limited compliance program.

Standard Compliance Program. Banking entities with total consolidated assets of between $10 billion and $50 billion that are not engaged in significant trading activities requiring metrics reporting under Appendix A of the Final Regulation are subject to the standard Volcker Rule compliance program set forth in Section _.20 of the Final Regulation.

Enhanced Compliance Program. Banking entities with $50 billion or more in total consolidated assets or, in the case of a foreign banking entity, total US assets of $50 billion or more, are subject to enhanced compliance program requirements set forth in Appendix B of the Final Regulation. Banking entities required to report quantitative trading metrics under Appendix A of the Final Regulation are also subject to the enhanced compliance program requirement (i.e., even if they do not exceed the relevant $50 billion total asset threshold).

Enhanced Compliance Program, Plus Metrics Reporting. Banking entities with significant trading activities are required to measure, maintain records, and periodically report certain quantitative measurements or "metrics" related to certain trading activities under Appendix A. As noted above, each banking entity subject to metrics reporting under Appendix A is automatically subject to the enhanced compliance program requirements of Appendix B as well. Metrics reporting is to be phased in, beginning with banking entities having trading assets and liabilities the average gross sum of which (excluding trading in US Government obligations) exceeds $50 billion. In the case of a foreign banking entity, the test is whether the average gross sum of trading assets and liabilities of the combined US operations of the foreign banking entity (including all subsidiaries, affiliates, branches and agencies "operating, located or organized in" the United States) exceeds $50 billion.

Trading Assets and Liabilities. While "trading assets and liabilities" is not defined in the Final Regulation, the Preamble indicates that the measure should include even those trading assets and liabilities that do not involve "financial instruments" subject to the Volcker Rule, such as loans. For foreign banking entities, the trading assets and liability measure may be complicated by the directive to include trading assets and liabilities of subsidiaries and affiliates that are "operating in" the United States as part of the calculation. The Preamble does not clarify when a foreign banking entity would be characterized as operating in the United States for these purposes, nor does it address whether all trading assets and liabilities of such a foreign entity would be included or only its US activities (assuming the entity's trading activities can be bifurcated in this manner). Based on traditional bank regulatory interpretations of these terms, the best reading seems to be that trading assets and liabilities booked at US offices and subsidiaries should be included, but not assets and liabilities booked outside the US. However, it is possible that the Agencies may expect foreign banking entities to include transactions of non-US locations to the extent that US personnel or affiliates are involved in the transactions.

Implementation Schedule

Compliance Program. Each banking entity required to establish a compliance program under Section _.20 of the Final Regulation is required to do so "as soon as practicable and in no case later than the end of the conformance period." The Agencies have indicated they regard the development and implementation of a Volcker Rule compliance program a key aspect of a banking entity's "good faith" obligations during the conformance period.

The fact that the deadline for fully implementing a Volcker Rule compliance program is not until the end of the conformance period may have implications for Volcker Rule activities occurring during the course of the conformance period, particularly for activities carried out under the exemptions for market-making and risk-mitigating hedging. As discussed above (pages 8-11), the ability of a banking entity to engage in these and other Volcker Rule permitted activities under the Final Regulation is often explicitly conditioned upon satisfying certain compliance obligations. Accordingly, it makes little sense to characterize an activity as complying or not complying with the requirements of the market-making exemption, for example, without considering whether the relevant compliance infrastructure is in place. Banking entities will, therefore, need to be sensitive to how certain activities carried out during the remainder of the conformance period are likely to be perceived from a "good faith" and supervisory perspective, to the extent that the compliance framework for those activities is yet to be implemented.

Metrics Reporting. For banks with more than $50 billion in gross trading assets and liabilities, the metrics reporting obligations under Appendix A of the Final Regulation take effect June 30, 2014. Although the Final Regulation is not entirely clear, it appears to suggests that the first actual reporting deadline for these largest banking entities would be August 30, 2014 (i.e., taking into account the monthly reporting period for these entities and initial reporting deadline of 30 days after month-end). As noted above, the metrics reporting obligations will be phased in for banking entities with significant trading activities not rising to the $50 billion level, as that threshold reduces to $25 billion beginning April 30, 2016, and to $10 billion beginning December 31, 2016.

Standard Compliance Program

Six Elements. Each banking entity with between $10 billion and $50 billion in total consolidated assets that engages in any Volcker Rule activities or investments (other than trading in US Government securities) is required under Section _.20 of the Final Regulation to develop and implement the standard compliance program, which consists at a minimum of the following six elements:

(i) Written policies and procedures reasonably designed to document, describe, monitor and limit Volcker Rule activities and investments;

(ii) Internal controls reasonably designed to monitor Volcker Rule compliance;

(iii) A management framework delineating responsibility and accountability for Volcker Rule compliance;

(iv) Independent testing and audit of the effectiveness of the Volcker Rule compliance program conducted "periodically" by qualified personnel of the banking entity or by a qualified third party;

(v) Volcker Rule training for trading personnel, managers, and any other appropriate personnel of the banking entity; and

(vi) Maintenance of records sufficient to demonstrate Volcker Rule compliance, which must be provided promptly upon Agency request and retained for a minimum of five years.

Management Oversight. The Final Regulation places greater emphasis on the role of management in Volcker Rule compliance, including a specific requirement, not included in the Proposal, under the "management framework" requirement for appropriate management review of trading limits, strategies, hedging activities, investments, incentive compensation and other matters.

Documentation of Fund Activities. In addition to the six elements noted above, the standard compliance program for each banking entity with more than $10 billion in total consolidated assets includes additional documentation requirements for fund sponsorship activities. Significantly, these documentation requirements extend to funds that are not covered funds. Banking entities sponsoring funds that are not covered funds are required to document the alternative 1940 Act exemption(s) being relied upon and/or the banking entity's determination that the fund is not a covered fund pursuant to one of the exclusions noted above. The documentation requirements do not appear to apply to funds in which a banking entity is merely a third-party investor, but not the sponsor.

Large Investments in Foreign Public Funds. Each banking entity that is, or is controlled by a banking entity that is, located in or organized under US law is required to document ownership interests in funds held pursuant to the foreign public funds exemption in Section _.10(c)(1) of the Final Regulation, to the extent that the aggregate of such investments exceeds $50 million. A US branch, agency or subsidiary of a foreign banking entity is subject to this requirement. The obligation does not extend to foreign banking entities outside the United States.

Enhanced Compliance Program

Overview. The enhanced compliance program requirements under Appendix B of the Final Regulation include a highly prescriptive and, in certain respects, exceedingly granular set of minimum standards related to a covered banking entity's trading and covered fund activities, which apply in addition to the minimum requirements of the standard compliance program in Section _.20. In addition to heightened requirements related to covered trading and covered fund activities, Appendix B prescribes additional minimum standards related to management oversight, independent testing, training and recordkeeping. The enhanced compliance program requirements should be tailored to the size and characteristics of the banking entity's covered activities. Thus, if a banking entity's Volcker Rule activities consist of substantial proprietary trading activities but minimal covered fund activities (or vice versa), there appears to be sufficient flexibility under Appendix B to develop and implement a compliance program consistent with those activities (and not necessarily one that incorporates all of the elaborate requirements under Appendix B for activities in which the banking entity either does not engage or engages in on a more limited basis).

Proprietary Trading Standards. A banking entity subject to Appendix B is required to develop and implement extensive written policies and procedures for each "trading desk" addressing 12 different subject areas, including the authorized financial instruments for each desk and the exemption under which it trades, the types of activities and strategies permitted for the desk, risk limits and related analyses, processes for new products and strategies, and compensation arrangements, among others. The banking entity is required to have a documented risk management program for trading activities, including a description of the governance, approval, reporting, escalation, review and other processes the banking entity will use to ensure that trading activity is conducted in compliance with the Volcker Rule. Risks, instruments and products must be authorized at the trading desk level, with limits applied and monitored at the trading desk level as well. Finally, the banking entity is required to develop extensive written policies and procedures regarding the use of hedging instruments and strategies, again at the trading desk level.

Trading Desk. For many institutions, the task of developing and implementing an enhanced compliance program for proprietary trading activities will begin with the identification and mapping of trading desks across the organization. The Final Regulation defines a "trading desk" as "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 noted above, many of the key requirements imposed under Appendix B apply at this granular trading desk level. The Final Regulation permits the use of common policies and procedures, internal controls and other infrastructure for more than one trading desk where appropriate, but differences across desks must be carefully documented.

Covered Funds Standards. Appendix B includes similarly extensive requirements with respect to identifying and documenting all covered funds the banking entity sponsors or organizes and offers, and all covered funds in which the banking entity invests, including a specific mapping of units within the banking entity that are permitted to sponsor and invest in covered funds. The covered funds standards also include provisions related to heightened internal control standards, including with respect to Super 23A compliance.

Remediation. Both the proprietary trading and covered funds portions of the enhanced compliance program requirements include procedures for identifying, documenting and remedying violations of the Volcker Rule. These remediation procedures must provide for prompt notification to appropriate management, including senior management and the board of directors, of any material weakness or significant deficiencies in the design or implementation of the compliance program.

Management Oversight. A banking entity subject to Appendix B is required to establish a governance and management framework intended to prevent Volcker Rule violations. The provisions of Appendix B implementing this requirement impose significant obligations on the board and senior management of a banking entity subject to the enhanced compliance program requirements. In particular, the banking entity must adopt a written compliance program approved by the board of directors, an appropriate committee of the board, or equivalent governance body, as well as senior management. The board and senior management are expressly charged with "setting and communicating an appropriate culture of compliance."

CEO Attestation. In one of the more highly publicized features of the Final Regulation, Appendix B requires that the CEO of each banking entity subject to its requirements must, annually, attest in writing to the banking entity's primary regulator that the banking entity "has in place processes to establish, maintain, enforce, review, test and modify the compliance program established under" Appendix B and Section _.20 "in a manner reasonably designed to achieve compliance" with the Volcker Rule. The Final Regulation leaves open a number of additional questions regarding the CEO attestation requirement, including the timing for the first attestation and the manner in which it is to be provided. Because the attestation requirement is part of the enhanced compliance program requirement in Appendix B, the attestation should not be required at least until the end of the conformance period when Appendix B takes effect.

Applicability to Foreign Banking Entities. Appendix B and the Preamble include confusing and contradictory statements regarding how the CEO attestation requirement would apply to certain foreign banking entities. Appendix B itself provides that "[i]n the case of a US branch or agency of a foreign banking entity, the attestation may be provided for the entire US operations of the foreign banking entity by the senior management officer of the United States operations." In describing this provision, however, the Preamble suggests a somewhat different scope, stating that the US senior officer attestation option is available "[i]n the case of the US operations of a foreign banking entity, *including* a US branch or agency" (emphasis added). For a foreign banking entity that operates in the United States through a bank subsidiary rather than a branch or agency, the Appendix B statement is potentially inapplicable. The Preamble language, on the other hand, would permit the senior US officer of the foreign banking entity's operations in the United States (e.g., the CEO of its top-tier US holding company) to provide the attestation for all US operations. Given that only the US operations of a foreign banking entity are considered in determining whether Appendix B applies, including for a foreign banking entity that operates in the United States through a US bank subsidiary rather than a branch or agency, it would seem that the same option to provide the CEO attestation solely with respect to US operations should be available in either case. However, in light of the ambiguities of the Final Regulation, more guidance may be required from the Agencies on this issue.[41]

Beyond the CEO attestation requirement, the manner in which the enhanced compliance program requirements apply to foreign banking entities (including in particular, the non-US operations of a foreign banking entity) is far from clear under the Final Regulation. The fact that only the combined US assets of a foreign banking entity are considered for purposes of determining applicability of the enhanced compliance program, as well as the provision for CEO attestation with respect only to the US operations of a foreign banking entity, each seem to suggest that Appendix B has limited or no applicability to the non-US operations of a foreign banking entity. The Preamble discussion of the enhanced compliance program requirements for proprietary trading also makes particular reference to a foreign banking entity's non-US operations, noting that a foreign banking entity trading outside the United States in reliance on Section _.6(e) "will be expected to provide information regarding the compliance program implemented to ensure compliance with the requirements of that section, … but will only be expected to provide trading information regarding activity conducted within the United States."[42] This suggests that compliance obligations in respect of non-US trading, at least that which is carried out under Section _.6(e) of the Final Regulation, are less robust than would otherwise be required under Appendix B. Beyond these statements and the inferences one might draw from them, however, there is no definitive statement with respect to whether and to what extent the enhanced compliance program requirements of Appendix B would apply to the non-US operations of a foreign banking entity (including its non-US subsidiaries and affiliates). The plain language of Section _.20 could be interpreted to mean that, once a foreign banking entity becomes subject to Appendix B by virtue of its combined US assets calculation, the banking entity as a whole (which, in most cases, will be the top-tier entity in a large foreign banking organization) *and* its non-US subsidiaries and affiliates are in scope of the enhanced compliance program requirements. One would hope for additional guidance from the Agencies on this issue during the conformance period.

Quantitative Metrics

Overview. Appendix A of the Final Regulation imposes quantitative measurement, reporting, and recordkeeping obligations on banking entities that engage in significant trading activities. As noted above, the metric reporting requirements are subject to a phase-in period, beginning June 30, 2014, for

41 Moreover, neither Appendix B itself nor the Preamble explicitly states that the CEO attestation provided by the senior officer in the United States pertaining solely to its US operations is the only attestation required for a foreign banking entity subject to Appendix B. In other words, while the US officer attestation provision would seemingly suggest that no attestation is required with respect to non-US operations, the Final Regulation does not actually confirm that point. As discussed below, this also raises questions regarding the extent to which the heightened Appendix B standards should be interpreted as applying to the non-US activities of a foreign banking entity.

42 Preamble at 796.

the few banking entities whose trading assets and liabilities exceed the $50 billion threshold. Each banking entity subject to Appendix A is required to (i) furnish periodic reports to its primary regulator regarding a variety of quantitative measurements of its "covered trading activities," and (ii) create and maintain records documenting the preparation and content of those reports.

Once the phase-in period is complete, banking entities with $50 billion or more in gross trading assets and liabilities will be subject to monthly reporting, within 10 days of the end of the month. Banking entities subject to Appendix A but which have less than $50 billion in gross trading assets and liabilities will be subject to quarterly reporting, within 30 days of the end of the quarter. The Agencies intend to review and, as necessary, revise the specific metric reporting requirements prior to September 30, 2015, based on experience with the earliest group of reporting entities.

Covered Trading. The metrics reporting and recordkeeping obligations of Appendix A pertain only to "covered trading," which includes proprietary trading carried out under any of five exemptions: (i) underwriting; (ii) market-making; (iii) risk-mitigating hedging; (iv) trading in US Government obligations; and (v) trading in foreign sovereign obligations.[43] Thus, the scope of trading activities that are actually subject to metrics recordkeeping and reporting under Appendix A is substantially narrower than the general "trading assets and liabilities" measure that is used for purposes of the Appendix A threshold calculations.

Appendix A generally requires that data regarding covered trading activities be collected and reported at the trading desk level. While reporting of trading data occurs only periodically, banking entities subject to Appendix A are required to calculate metrics on a daily basis.

Metrics. The Final Regulation reduces the total number of metrics that a banking entity is required to calculate and report from 17 to seven. In addition to the reduction in number, the Preamble notes the Agencies' expectation that the burden associated with Appendix A will also be reduced because the metrics included in the Final Regulation either are already routinely calculated by covered banking entities, or are based on underlying data that is already routinely calculated. The final metrics include:

- Risk and Position Limits and Usage;
- Risk Factor Sensitivities;
- Value-at-Risk and Stress VaR;
- Comprehensive Profit and Loss Attribution;
- Inventory Turnover;
- Inventory Aging; and
- Customer Facing Trade Ratio.

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43 A banking entity is permitted, but not required, to include trading carried out under various other exemptions in its metrics reporting.

The Final Regulation expressly provides that "[t]he quantitative measurements that must be furnished pursuant to this appendix [A] are *not* intended to serve as a dispositive tool for the identification of permissible or impermissible activities" (emphasis in original).

Supervisory and Enforcement Jurisdiction

Section _.21 of the Final Regulation, which has been adopted substantially as proposed, implements Section 13(e)(2) of the BHCA, which authorizes each Agency to order a banking entity subject to its jurisdiction to terminate activities or investments that violate or function as an evasion of the Volcker Rule. The Final Regulation does not further delineate the jurisdictional authority of each Agency as had been requested by some commenters, and the Agencies also declined to adopt suggestions from the industry that primary interpretive authority be vested in the FRB in order to facilitate consistent approach to the regulation of Volcker Rule activities. While acknowledging industry concerns regarding overlapping jurisdictional authority, the Preamble states that "the Agencies plan to coordinate their examination and enforcement proceedings under Section 13, to the extent possible and practicable."[44] Thus, a banking entity falling under the jurisdiction of multiple agencies, such as a national bank that is registered as a swap dealer, will likely need to contend with the complexities associated with answering to multiple Agencies with different mandates and areas of expertise. The CFTC's assertion of authority to act as a primary Volcker Rule supervisory authority for swap dealers in its version of the Preamble would seem to foreshadow examination and enforcement overlap for banking entities subject to the jurisdiction of multiple Agencies. ◆

44 Preamble at 861.

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The Volcker Rule—Application to Securitization Transactions

The federal financial agencies on December 10, 2013, approved joint final regulations (the "Final Regulation") implementing section 619 of the Dodd-Frank Act, commonly referred to as the Volcker Rule. Section 619 added a new section 13 to the Bank Holding Company Act of 1956 (the "BHCA") that generally prohibits any banking entity from engaging in proprietary trading and from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with, a hedge fund or a private equity fund, subject to exemptions for certain permitted activities.

Over 70 pages in rule text and nearly 900 pages of supplementary information (the "Preamble"), the Final Regulation made numerous changes to the proposed regulations (the "Proposal") which had been subject to an unprecedented number of comment letters. These changes address many, but far from all, of the concerns raised in the comment letters. In many respects the Final Regulation is an improvement over the Proposal. For example, the Final Regulation substantially mitigates concerns about its extraterritorial impact and its excessively narrow implementation of the exemptions in the statute. Nevertheless, some changes are more restrictive than the Proposal. Given the complexity of the Final Regulation, this legal update provides a number of initial observations, but additional issues are likely to arise as financial institutions begin to implement compliance with the Final Regulation.

Fortunately, there will be a period of time in which to resolve some of the uncertainty. At the same time that the Final Regulation was approved, the Board of Governors of the Federal Reserve System approved a one-year extension of the conformance period until July 21, 2015. However, banking entities that exceed $50 billion in gross trading assets and liabilities will be required to begin reporting certain metrics on June 30, 2014.

This legal update addresses the impact of the Final Regulation on securitization activities and therefore focuses on the prohibition on covered funds activities and certain of the exceptions thereto.

Prohibition Against Covered Fund Activities

The Final Regulation retains the basic framework of the Proposal as it relates to covered fund activities but makes some significant changes that are important to securitization activities. Like the Proposal, the Final Regulation generally prohibits or restricts a banking entity from investing in, sponsoring, or having certain relationships with, a covered fund. Specifically, the Final Regulation implements the provisions in section 13 of the BHCA that:

- Prohibit a banking entity from sponsoring or acquiring "ownership interests" in a private equity fund or a hedge fund;
- Provide certain exemptions from this prohibition; and

- Prohibit a banking entity from making loans or entering into other "covered transactions" with a covered fund for which a banking entity acts as sponsor, *investment manager* or *investment adviser*, and require that any permitted transactions with covered funds be on "market terms".

Although securitization transactions generally do not utilize private equity funds or hedge funds and the statutory text of the Volcker Rule expressly required that the Final Regulation not prohibit the securitization of loans, the Final Regulation will impact securitizations in a material way due to the breadth of the definition of "covered funds."

Covered Funds

The Final Regulation retains the same basic definition of covered fund that was in the Proposal. A "covered fund" is any issuer that relies solely on the section 3(c)(1) or 3(c)(7) exclusion from the definition of "investment company" under the Investment Company Act of 1940 (the "1940 Act"). A securitization issuer that relies on any other exclusion from the definition of investment company under the 1940 Act would not be a covered fund, even if it could also rely on section 3(c)(1) or 3(c)(7). Accordingly, issuers that can rely on exemptions like section 3(c)(5)(C) or Rule 3a-7 under the 1940 Act are not covered funds.

Commodity Pools

The Final Regulation's inclusion of commodity pools as covered funds is much more narrow than in the Proposal. Only certain commodity pools with CFTC registered commodity pool operators are now covered funds, as are commodity pools if the related commodity pool operator has claimed an exemption under 17 C.F.R. 4.7.

Foreign Issuers

The Final Regulation made a significant change in respect of foreign issuers. Whereas the Proposal included as covered funds issuers organized or offered outside the United States that *would be* investment companies but for section 3(c)(1) or 3(c)(7) of the 1940 Act if the issuer's securities were offered to one or more residents of the United States, the Final Regulation does not apply to the relationships between non-U.S. banking entities and non U.S. issuers that do not offer or sell their securities to residents of the United States. Specifically, Section ___.10(b)(iii) includes non-U.S. funds as covered funds only in relation to any U.S. banking entity or banking entity controlled by a U.S. banking entity. Consequently, a foreign issuer could be a covered fund with respect to a U.S. banking sponsor or owner while not constituting a covered fund as to its foreign bank sponsor or owner.[1]

Interrelationship of Covered Funds and Super 23A

The Final Regulation provides for 14 separate exclusions from the definition of covered fund in Section ___.10(c). This is a critical change in regulatory structure from the Proposal for two reasons. Although the Proposal permitted for certain activities with respect to loan securitization issuers and foreign issuers, the Proposal nonetheless included those issuers as covered funds. As a result, under the Proposal even permitted securitization issuers were caught under the so-called "Super 23A" restrictions and could also fell under the commodity pool definition and its consequent restrictions. For example, under the Proposal a banking entity could not provide a liquidity facility or simple interest rate hedge to a permitted loan securitization issuer for which the banking entity acted as investment manager. By carving out loan securitizations and foreign funds (as well as other funds) from the definition of covered fund entirely, the Final Regulation solved these critical problems. Also, because bank relationships with covered funds are subject to other restrictions under the Volcker Rule, including limits on aggregate investments and conflicts of interest, as well as monitoring and reporting requirements, a blanket carve-out from the definition of covered fund reduces the compliance burden much more than permitting only specific activities with a covered fund.

Exclusions Relevant to Securitization

Of the 14 exclusions from the covered fund definition in Section ___.10(c), there are a handful that are likely to be important to many securitization issuers and intermediate special purpose entities.

LOAN SECURITIZATION EXCLUSION

First, not surprisingly, the Final Regulation retained the concept of a loan securitization exclusion ("LSE") in Section ___.10(c)(8). To meet the LSE, an issuer must issue asset-backed securities ("ABS") (as defined in Section 3(a)(79) of the Securities Exchange Act of 1934 (the "1934 Act")) backed solely by (a) loans, (b) rights or other assets designed to assure the servicing or timely distribution of proceeds to ABS holders and rights or other assets related or incidental to purchasing or otherwise acquiring and holding the loans, (c) interest rate or foreign exchange derivatives that directly relate to the permitted assets of the issuer so long as they reduce interest rate and/or foreign exchange risks related to the assets of the issuer, and (d) special units of beneficial interest "SUBIs" and collateral certificates issued by a special purpose vehicle that itself meets the LSE.[2] The LSE specifically excludes as permitted servicing or incidental assets (1) any security other than cash equivalents or securities received in lieu of debts previously contracted with respect to the permitted loans, (2) any derivative (other than interest rate or currency derivatives described above), and (3) any commodity forward contract.

Though more flexible than in the Proposal, the LSE continues to present challenges to many ordinary securitizations in the market today. Perhaps the most significant challenge is the definition of "loan" itself which now expressly excludes all securities and derivatives. As a threshold matter, it is a fair question to ask why a securitization issuer must consider whether it meets any 1940 Act exemption, much less those found in section 3(c)(1) or 3(c)(7), if it does not invest in any securities (as defined in the 1940 Act). That said, in practice, securitization issuers are structured to fall into an exemption under the 1940 Act, even if the pooled assets are primarily ones that would not be considered "securities" under the 1933 Act or 1934 Act. In this regard, section 3(c)(5) of the 1940 Act provides an exemption for certain entities that primarily invest in assets such as notes, loans and mortgages. While the actual text of the definition of "security" in the 1940 Act is virtually identical to that in the 1934 Act, judicial interpretations of that definition over the years has led to a more narrow reading for purposes of the 1934 Act.[3] It is within this interpretive band between the two definitions that issuers seeking to utilize the LSE will need to fall. Issuers should also consider relevant statements in the Preamble.[4] Although this legal update is not the place for a full blown analysis of judicial history in defining "security", it is worth noting that for certain types of pooled assets additional analysis may be needed to determine whether it is a security under the 1934 Act, particularly if in the form of a participation or if it is a "structured loan."[5] Notwithstanding this sobering legal context, there is very helpful commentary around footnote 1970 in the Preamble suggesting the agencies intended a more narrow construction of the term "security": "The Agencies believe that the final rule excludes from the definition of covered fund typical structures used in the most common loan securitizations representing a significant majority of the current securitization market, such as residential mortgages, commercial mortgages, student loans, credit card receivables, auto loans, auto leases and equipment leases. Additionally, the Agencies believe that esoteric asset classes supported by loans may also be able to rely on the LSE, such as time share loans, container leases and servicer advances." This comment may have been more helpful had it appeared in the LSE discussion rather than in the discussion of qualifying ABCP, but it seems logical to read it as applicable to both since both exclusions include a requirement that the pooled assets be "loans."

Another significant issue in the LSE relates to SUBIs. Although clearly not intended, as evidenced by a straightforward discussion in the Preamble about SUBIs and their use in titled-vehicle lease securitizations to permit centralized ownership of vehicles by a special purpose entity, the LSE requires that the SUBI issuer hold only assets permitted under the LSE. Because the LSE does not permit an entity to hold vehicles, as a technical matter no SUBI issuer could meet this restriction.

QUALIFYING ABCP EXCLUSION

Section __. 10(c)(9) provides a separate exemption for qualifying ABCP conduits ("QABCP"). The QABCP exclusion requires that the ABCP conduit hold only loans and other assets permitted under the LSE, but also permits the conduit to hold ABS supported by LSE permitted assets, provided the ABS is acquired by the conduit in an initial issuance. To satisfy the QABCP exclusion, the conduit's securities must be comprised solely of a residual interest and ABCP with a legal maturity of 397 days or less. In addition, similar to the ABCP safe harbor in the most recent U.S. risk retention proposal, a regulated liquidity provider must enter into a legally binding commitment to provide full and unconditional liquidity coverage with respect to all ABCP issued.

The QABCP exclusion suffers from the same uncertainty around the definition of loan as does the LSE. In addition, the QABCP exclusion serves up another significant hurdle. Any ABCP issuer that utilizes a liquidity facility with an eligible asset test cannot meet the exclusion. This precludes a significant portion of the ABCP industry from availing itself of this exclusion. It is also worth mentioning that the language is not clear that liquidity facilities with no asset tests satisfy the condition if they are provided by more than one regulated liquidity provider or if (consistent within insolvency laws) they provide for funding to stop in the event of an ABCP issuer bankruptcy. However, there is no suggestion in the Preamble that the lack of clarity here was intended to preclude the exclusion applying to conduits with multiple liquidity providers or liquidity facilities with market insolvency events that otherwise have no asset credit tests.

QUALIFYING COVERED BOND EXCLUSION

Qualifying covered bonds that meet the conditions in Section __.10(c)(10) also are exempt from all Volcker Rule restrictions applicable to covered funds. A qualifying covered bond must be either (a) a debt obligation issued by a foreign banking organization the payment obligations of which are fully and unconditionally guaranteed by a cover pool or (b) a debt obligation of a cover pool that is fully and unconditionally guaranteed by its parent foreign banking organization. A "cover pool" for this purpose is an entity owning or holding a dynamic or fixed pool of LSE permitted assets for the benefit of the holders of covered bonds. Because the assets of the covered bond entity all must be LSE permitted assets, the considerations relating to the scope of those discussed above apply equally to this exclusion.

WHOLLY-OWNED SUBSIDIARY EXCLUSION

The exclusion of wholly-owned subsidiaries in Section __.10(c)(2) is very helpful for securitization. This exemption simply requires all ownership interests (discussed below) to be owed by the applicable banking entity, directly or indirectly. It even permits a small percentage

(5%) to be owned by employees or directors and up to 0.5% to be owned by a third party to the extent needed to satisfy legal isolation or similar concerns. This exemption is important for securitization because, among other things, it permits intermediate special purpose entities that hold no assets other than an ownership interest in a securitization issuer (and therefore could not satisfy the LSE) to meet its own covered fund exemption. Banking entities should be mindful, however, that any entity that meets this exemption will itself be a banking entity and therefore subject to all the restrictions under the Final Regulation, including restrictions on proprietary trading and its relationships with covered funds.

Ownership Interest

The Final Regulation defines "ownership interest" to mean any equity, partnership, or other similar interest just as the Proposal did. However, the Final Regulation adds significant detail to the previously undefined text "other similar interest." Although the Preamble indicates that the definition focuses on the attributes of the interest and whether it would provide a banking entity with economic exposure to the profits and losses of a covered fund, the actual text creates additional issues for securitizations.

In particular, the definition now includes any interest that has the right to participate in the selection or removal of a general partner, managing member, member of the board of directors or trustees, investment manager, investment adviser, or commodity trading advisor of the covered fund (excluding the rights of a creditor to exercise remedies upon the occurrence of an event of default or acceleration event). This change has already generated significant concerns in the CLO market where senior debt tranches often have the right to replace a collateral manager in certain circumstances. The definition now also includes an interest the value of which could be reduced as a result of losses in the underlying assets of the covered fund. Because collateral certificates, such as those issued by credit card and other master trusts, typically include this feature, like the CLO concern noted above, this leads to the counterintuitive effect that even the most senior debt class in a securitization could be an ownership interest, making bank investments in those very safe investments prohibited if the issuer is a covered fund that does not have an exclusion.

Definition of Sponsor

Under the Final Regulation (as in the Proposal), the definition of "sponsor" focuses on the ability to control decision-making and operational functions of the fund. A sponsor would include an entity that: (i) acts as a general partner, managing member, trustee, or commodity pool operator of a covered fund, (ii) in any manner selects or controls a majority of the directors, trustees, or management of a covered fund, or (iii) shares the same name, or a variation of the same name, with a covered fund for corporate, marketing, or other purposes.

Separate Asset-Backed Securitization Exemption

As described above, the definition of covered fund excludes certain securitization entities that meet the LSE, QABCP or other covered fund exclusion. However, many securitizations will not meet the strict criteria of an exclusion. Some of those that are not eligible may not be covered funds if they rely on Rule 3a-7 of the 1940 Act or otherwise do not rely on section 3(c)(1) or 3(c)(7) of the 1940 Act. However, recognizing the need for the Volcker Rule to be consistent with the risk-retention mandate in the Dodd-Frank Act, the Final Regulation adds a new exemption for asset-backed securitizations that are not eligible for a complete exclusion from the definition of covered fund. The asset-backed securitization exemption is similar in structure to the asset management exemption.

Section___.11(b) of the Final Regulation provides an exemption from the Volcker Rule that is intended to give effect to the risk retention requirement. It provides that a banking entity is not prohibited from acquiring or retaining an ownership interest in, or sponsoring, a covered fund that is an issuer of asset-backed securities, in connection with organizing and offering such issuer if most of the conditions of the asset management exemption have been met.

The Final Regulation also clarifies that, for purposes of the asset-backed securitization exemption, organizing and offering a covered fund that is an issuer of asset-backed securities means acting as the "securitizer" of the issuer, as that term is used in Section 15G(a)(3) of the 1934 Act, or acquiring an ownership interest in the issuer as required by Section 15G. This is intended to address the activities that would be included as organizing and offering a securitization, which may differ from organizing and offering other covered funds in that the entity that organizes and offers the securitization may not always provide advisory services to the issuer. The Agencies acknowledged this by not requiring those related conditions in the asset management exemption to be satisfied for purposes of the asset-backed securitization exemption.

Importantly, the exemption in Section ___.11(b) does not permit a banking entity to have an ownership interest greater than that required by the U.S. risk retention rules (even if preferred by investors or mandated by a non-U.S. regime). Also, the issuer cannot share any variation of its bank sponsor's name or use the word "bank" in its name.

Because the exemption afforded in Section _____.11(b) relates only to the activity of owning or sponsoring a covered fund, this exemption does not permit the banking entity to avoid the Super 23A prohibition on covered transactions with the fund. In addition, the investments in the fund are subject to the aggregate limits on investment and the required deduction of those investments from tier 1 capital.

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Endnotes

1 For this purpose, a non-U.S. fund is one (a) organized outside the U.S. in which all ownership interests are offered and sold outside the U.S., (b) that raises money primarily for the purpose of investing in securities for resale or other disposition or otherwise trades in securities, and (c) for which the applicable banking entity (or an affiliate) has an ownership interest or acts as sponsor. It is worth noting that the Final Regulation separately excludes a foreign public fund from the definition of covered fund.

2 A permitted SUBI or collateral certificate must be (a) used for the sole purpose of transferring the economic risks and benefits of the assets permitted under the LSE, (b) created solely to satisfy legal requirements or otherwise facilitate the structuring of the loan securitization, and (c) issued by an entity established under the direction of the same entity that initiated the loan securitization.

3 Moreover, in the securitization context specifically, Rule 190 under the 1933 Act addresses situations where the assets underlying a securitization are themselves securities and imposes additional requirements on such situations (including that the underlying assets are either registered, exempt from registration, or transferrable without registration) that do not apply where the pooled assets are not "securities". In practice it is generally understood that

these additional requirements do not apply to typical securitized assets such as residential mortgages, commercial mortgages, student loans, credit card receivables, auto loans, auto leases and equipment leases.

4 The Preamble states "[w]hether a loan is a 'note' or 'evidence of indebtedness' and therefore a security under the federal securities laws will depend on the particular facts and circumstances, including the economic terms of the loan" and then includes a string cite at footnote 1831 that includes Reves among other case law.

5 The Preamble described "structured loans" as deserving additional scrutiny under the Volcker Rule, reasoning, "loans that are structured to provide payments or returns based on, or tied to, the performance of an asset, index or commodity or provide synthetic exposure to the credit of an underlying borrower or an underlying security or index may be securities or derivatives depending on their terms and the circumstances of their creation, use, and distribution. Regardless of whether a party characterizes the instrument as a loan, these kinds of instruments, which may be called 'structured loans,' must be evaluated based on the standards associated with evaluating derivatives and securities in order to prevent evasion of the restrictions on proprietary trading and ownership interests in covered funds."

MAYER • BROWN

Legal Update
April 2014

Does Volcker + Vickers = Liikanen? EU proposal for a regulation on structural measures improving the resilience of EU credit institutions

1. On 29 January 2014 the European Commission published a proposal for a regulation of the European Parliament and of the Council "on structural measures improving the resilience of EU credit institutions"[1]. This proposed legislation is the EU's equivalent of Volcker[2] and Vickers[3]. It was initiated by the Liikanen report[4] published on 2 October 2012 but the legislative proposal departs in a number of ways from the report's conclusions. There are two significant departures: the legislative proposal contains a Volcker-style prohibition, which also departs from the individual EU Member States' approach, and, although the proposal contains provisions which mirror the Vickers 'ring-fencing' approach they are not, in direct contradiction to Liikanen's recommendation, mandatory. One of the controversial aspects of the EU's proposal is the possibility that individual banks, in Member States which had equivalent national legislation in place as of 29 January 2014, are eligible to apply for a derogation from the EU ring-fencing provisions. Many consider this a "gift" to the UK but it is by no means certain that the UK's legislation will be regarded as equivalent to the EU legislation and, if it were, it does not necessarily follow that all UK banks would benefit from a derogation.

Background

2. Post financial crisis, various jurisdictions have started to overhaul bank regulation and supervision. Bank structural reform is part of that agenda and involves separating retail and commercial banking from wholesale and investment banking, as well as outright prohibitions. The objective is to protect core banking activities and depositors from the 'riskier' trading activities, which have been deemed as 'socially less important', by reducing the risk of contagion spreading from trading activities to traditional retail banking and protecting the deposits of individuals and small businesses in the case of bank failure. In addition, bank structural changes are intended to reduce complexity and so improve the resolvability of banking groups. The EU has been concerned about banks which it terms "too big to fail", "too big to save" and "too complex to manage, supervise and resolve". It has been concerned that failure of these banks would be detrimental to the financial system in the EU as a whole. The EU also believes that these banks have an unfair advantage over smaller banks: it believes that the presumption that they would be bailed out rather than be allowed to fail provides an implicit guarantee which impacts their funding costs and leads to moral hazard and excessive risk-taking. These concerns and beliefs have led to a variety of legislative proposals and legislation.

1 See here http://ec.europa.eu/internal_market/bank/structural-reform/index_en.htm

2 As implemented in section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 which created a new section 13 of the US Bank Holding Company Act of 1956.

3 As implemented in section 4 of the Financial Services (Banking Reform) Act 2013 which inserts Part 9B (sections 142A – 142Z1) into the Financial Services and Markets Act 2000.

4 See here http://ec.europa.eu/internal_market/bank/docs/high-level_expert_group/report_en.pdf

3. Different jurisdictions have taken different approaches to bank structural reform. Reference has already been made to the UK and US legislation but France[5] and Germany[6] have also adopted legislation and the Belgian coalition government reached a political agreement in December 2013 on structural reform of its banking sector which it aims to finalise before elections in May 2014[7]. One of the fundamental differences between the US and the approaches of the individual EU Member States has been the US preference for prohibition (or owner separation) as opposed to the EU Member States' preference for ring-fencing (or functional separation / subsidiarisation). This difference means that the activities which the US has prohibited cannot be carried out within a banking group at all whereas the activities on which the EU Member States have focused can be carried out within a distinct trading entity which is separate from the retail and commercial bank entity. The EU's legislative proposal, by including elements of both approaches, blurs this distinction and creates a third approach to bank structural reform which is consistent with neither the US approach nor the approaches of the individual EU Member States.

4. The second significant difference in the approaches taken to date relates to the activities which the different jurisdictions have regulated. Broadly speaking, the US approach has prohibited proprietary trading, sponsoring private equity and hedge funds (known as "covered funds"), investing in covered funds and loans (known as "covered transactions") to covered funds with which the banking group is involved. Proprietary trading is defined widely but there are a number of helpful exclusions and exemptions which narrow the scope of the prohibition, including a number of exclusions and exemptions to reduce the extraterritorial impact on non-EU banks, although, of course, there are conditions with which compliance is necessary before reliance can be placed on the exclusions and exemptions. There are similar exclusions and exemptions relating to the prohibitions on sponsoring and investing in covered funds and on covered transactions with covered funds. The Volcker rule is examined in detail in our legal reports "Final Regulation Implementing the Volcker Rule"[8] and "The Volcker Rule – Application to Securitization Transactions"[9].

5. The UK approach (Vickers) focuses on a wider range of investment and wholesale banking. By prohibiting deposit-taking entities from 'dealing in investments as principal'[10], it requires most of the derivative and trading activity currently carried out by wholesale and investment banks to be carried out by a trading entity wholly separate from the retail bank. The French and German approach follow the ring-fencing approach of the UK but, like the US, have a narrower focus. Their approaches reflect the agreement reached by the two countries to push forward arrangements in the EU for the separation of "*speculative activities*" from deposit- related and customer-orientated activities. Thus the French legislation provides that proprietary trading and unsecured financing to alternative investment funds ("AIFs") above a certain threshold (the "speculative activities") must be carried out by a trading subsidiary separate from the retail banking entity. Similarly, the German legislation specifies certain high-risk activities (above a certain threshold in terms of overall trading activity), including proprietary trading, credit and guarantee business with certain AIFS (or equivalent funds which are high leveraged or engaged in short selling) and certain forms of trading in one's own name with the exception of market-making that must be ring-fenced and transferred to a separate trading entity.

6. At the time of writing, the text of the draft Belgian legislation is not yet in the public domain, although the substance of the proposed reforms is known. The draft legislation bans all entities (Belgian or foreign) falling within the consolidation perimeter of a Belgian Deposit Bank from engaging in proprietary trading above certain limits to be

5 French law no. 2013-672 of 26 July 2013 on the separation and regulation of banking activities.

6 *Trennbankengesetz* (German Bank Separation Law) which is included in Article 2 of the *Gesetz zur Abschirmung von Risiken und zur Planung der Sanierung und Abwicklung von Kreditinstituten und Finanzgruppen* (Law concerning Separation of Risks and Restructuring and Winding-Up of Credit Institutions and Financial Groups), *BGBl. 2013 I Nr. 47, 3090*. The law was announced on 7 August 2013 and Article 2 entered into force on 31 January 2014, although most of the rules in Article 2 are not applicable until 1 July 2015.

7 The relevant legislation is draft bill numbers 3406, 3413 and 3414 and draft regulation of the National Bank of Belgium. The legislation was passed by the Belgian Parliament on 4 April 2014 but, at the time of writing, still requires approval by the Senate.

8 See here http://www.mayerbrown.com/files/Publication/f95121f8-0c01-40f8-b14b-46379c2b118d/Presentation/PublicationAttachment/ddaf0395-d75d-4456-b143-6a026db6be71/Final-Regulation-Implementing-the-Volcker-Rule.pdf

9 See here http://www.mayerbrown.com/files/Publication/b2ff45c7-4252-4bb4-8bc0-899c2914b6a8/Presentation/PublicationAttachment/9b7da3f6-47a6-4da5-8dfb-05f7f0893a0f/UPDATE-VolckerRule-Application_131219.pdf

10 Dealing in investments as principal includes buying, selling, subscribing for or underwriting securities or contractually based investments.

specified. Uncovered transactions with leveraged investment funds or equivalent investment vehicles and investments in or exposures to such funds and vehicles above certain thresholds (to be defined by secondary legislation) are considered as proprietary trading activities. Certain activities will fall outside the definition of proprietary trading provided they meet specified limits and requirements. These exempted activities will include the provision of investment services and specified ancillary services to clients, market making, hedging of own risk, sound and prudent liquidity risk management and the buying or selling of financial instruments acquired with a long term view. Once a bank exceeds the prescribed limit for proprietary trading, it will have 30 days to reduce, stop or transfer to a trading entity the prohibited activities. Thus the Belgian legislation also prescribes another form of ring-fencing.

7. Finally and amongst those jurisdictions that have chosen the ring-fencing approach, there is some difference in the strength of the ring-fence or the degree of functional separation required. The UK requires the ring-fenced body ("RFB") to be legally, economically and operationally independent, to interact with the rest of the banking group on an arm's length basis and to have its own capital and liquidity resources. The Prudential Regulation Authority ("PRA") will make additional rules to ensure the integrity of the ring-fence and the independence of the RFB. The French legislation prescribes what the trading entity can and cannot do. It must be subject to specific licensing from the French banking regulator. It must be able to be distinguished from its banking group and it cannot carry out any high frequency trading activities nor enter into OTC derivatives transactions on agricultural commodities. The trading entity must not be consolidated from a prudential perspective with its banking group. The German legislation requires the RFB to be legally, economically and operationally independent, to interact with the rest of the banking group on an arm's length basis and to have its own capital and liquidity resources, but does not give any guidance on how this should be achieved or should interact with German corporate law. The Belgian legislation requires the bank to deal with the trading entity on a third party basis and limits the bank's exposures to and investments in the trading entity.

Liikanen...but not as we knew it

8. At the same time as individual jurisdictions were considering bank structural reform to deal with the issues summarised at paragraph 2 above, the EU was considering action, believing that inconsistent national legislation increases the possibility of distortions of capital movements and investment decisions, serves to make the structure and operation of cross-border banks more complex and increases fragmentation. In February 2012, the Commission established a High-level Expert Group to examine possible reforms to the structure of the EU's banking sector, appointing Erkki Liikanen, Governor of the Bank of Finland and a former member of the European Commission, as the chairman. The Group presented its final report to the Commission on 2 October 2012, the Commission examined the possible reform options and their implications and, on 29 January 2014, it adopted a proposal for a regulation on structural measures improving the resilience of EU credit institutions plus a proposal on transparency of securities financing transactions aimed at increasing transparency in the shadow banking sector. This note focuses on the former proposal.

9. The UK government had considered adding a Volcker-style prohibition to the Vickers ring-fence established in the Banking Reform Act 2013 but rejected it because of concerns that defining proprietary trading as opposed to activities such as market-making was too problematic, the "technical challenges" that the US was experiencing in implementation and the fear that it would distract regulatory attention from the ring-fence. The EU, however, clearly did not share these concerns as their proposal departs from the approach taken by individual EU Member States and contains a Volcker-style prohibition, as well as provisions on ring-fencing. The main points of note are set out in the table below.

The main provisions of the EU proposal

Scope

(a) It is proposed that the Volcker-style rule will apply to:

(i) EU G-SIIs (and all their branches and subsidiaries regardless of their location); and

(ii) banks that for 3 years have total assets of at least 30 billion euro and trading assets of 70 billion euro or 10% of total assets.

(b) The proposal does not make ring-fencing mandatory but requires national regulators to consider the possibility in relation to each individual deposit-taking bank (termed "core credit institution") depending upon its risk profile. There is a wide definition of core credit institution. It is unclear whether the ring-fencing provisions are intended to apply to the largest banks, as described above, or whether the ring-fencing provisions are intended to have a wider scope and apply to all CCIs.

(c) The EU proposal intends to have extraterritorial effect and apply to non-EU subsidiaries of EU banks, as well as effectively to non-EU banking groups with EU branches, unless the Commission deems the relevant non-EU jurisdiction equivalent to the EU regime but, although the stated intention is to create a level playing field in the EU, these provisions raise questions of legality and enforcement. National regulators may exempt a non-EU subsidiary of an EU bank from the ring-fencing requirements of the EU proposal in the absence of an equivalence decision if the relevant national regulator is satisfied that the subsidiary's resolution strategy has no adverse effect on the financial stability of the Member State(s) where the parent and other group entities are established. There is no such additional exemption for EU branches of non-EU banks or in respect of the Volcker-style prohibition.

The rules

(d) The EU Volcker-style rule prohibits proprietary trading (which is said to be narrowly defined), investments in AIFs save for closed-ended and unleveraged AIFs and investments in other entities which themselves engage in proprietary trading or investment in AIFs. This rule is considered in more detail at paragraphs 10 - 21 below.

(e) Unlike Liikanen, the EU proposal does not make separation of trading activities from retail and commercial banking mandatory. Instead it provides that national regulators must consider separation of trading activities (which is very widely defined to include almost all activities save those related to retail and commercial banking) from retail and commercial banking depending on the risk each individual core credit institution presents. The assessment of risk will be carried out on the basis of metrics and limits set out in further legislation drafted by the European Banking Authority ("EBA") and the Commission respectively. Where the risk levels are exceeded and the national regulator determines that there is a threat to financial stability then the national regulator must impose a ring-fence on that particular bank, unless the bank can demonstrate that the regulator's conclusions are not justified. These provisions are considered in more detail at paragraphs 22 - 44 below.

Individual Member State derogations

(f) The Commission may grant individual deposit-taking banks within Member States (not individual Member States) a derogation from the ring-fencing requirements set out in the proposal where national legislation is equivalent to the EU legislation. At the time of writing, it appears that the UK legislation is most likely to meet the requirements of equivalence but that may depend on secondary legislation, which the UK has yet to adopt, which will provide the technical detail of the Vickers rule. If the UK legislation is found to be equivalent to the EU legislation, it does not necessarily follow that all UK banks will benefit from a derogation.

Timing

(g) On the basis that the final text of the Regulation is adopted by the European Parliament and Council by June 2015, it is proposed that the provisions will be phased in relatively quickly: the Volcker-style prohibition will come into effect on 1 January 2017 and the provisions on ring-fencing will come into effect on 1 July 2018.

The Volcker-style prohibition

10. The introduction of a prohibition on proprietary trading, investment in AIFs and certain other entities is a major departure from the Liikanen recommendations. As noted above, none of the EU Member States which have introduced legislation to address bank structural reforms have adopted a Volcker-style prohibition. Although the US legislation is clearly the influence behind the provisions, the Commission has not taken exactly the same approach as Volcker.

Scope

11. The first thing to note is that, unlike the US rule, the EU Volcker-style rule is not intended to apply to all deposit-taking institutions. It is intended to apply to around 30 of the largest banks in the EU, those being:

(a) EU G-SIIs (and all their branches and subsidiaries regardless of their location); and

(b) banks that for 3 consecutive years have had total assets of at least 30 billion euro and trading assets of 70 billion euro or 10% of total assets.

The rule is intended to apply to the following entities within category (b):

(i) EU banks which are neither parent institutions nor subsidiaries, plus all their branches regardless of their location;

(ii) EU parent institutions, plus all their subsidiaries and branches regardless of their location, when one of the group entities is an EU bank; and

(iii) EU branches of non-EU banks.

The intention appears to be that the assessment of total assets and trading assets is made at each individual entity level, including at branch level in the case of EU branches of non-EU banks[11], rather than that an assessment should be made on a consolidated basis. It appears that the presence of an EU bank within a group could bring entities whose assets would not otherwise have to be assessed within the scope of the EU prohibition. The proposal contains some detail on how trading assets are to be calculated and the EBA shall be mandated to draft legislation to set out the exact methodology.

12. The EU prohibition will not apply to non-EU subsidiaries of EU banks and to EU branches of non-EU banks if the Commission deems the relevant non-EU jurisdiction equivalent to the EU regime. In considering equivalence, however, the Commission will look at whether the non-EU jurisdiction has requirements equivalent to both the Volcker-style and ring-fencing provisions and whether it has a reciprocity provision[12]. It is questionable whether any jurisdiction has requirements equivalent to both these provisions in the draft EU legislation. It is expected that the Volcker rule would be regarded as effectively equivalent to the EU provisions on proprietary trading, although there are differences. US legislation does not require ring-fencing, however, and it does not contain a reciprocity provision.

13. Like the Volcker rule, the effect of the EU rule is to prevent the prohibited activities being carried out within the banking group in its entirety. Bringing EU branches of non-EU banks and non-EU subsidiaries of EU banks within the scope of the EU prohibition is an attempt to create a level playing field in the EU and not give non-EU banking groups or EU banking groups with non-EU entities a competitive advantage. This raises questions, however, including questions of effectiveness: unless a non-EU banking group is subject to similar provisions to the EU ban on proprietary trading, it is still possible that the EU branch of a non-EU bank could utilise non-EU entities within its group to carry out the activities that are prohibited in the EU. The purported extraterritorial application also raises questions as to its legality and enforcement.

14. It is worth noting that the UK and the Council Legal Services have questioned the purported extraterritorial application of other recent pieces of EU legislation. In its legal challenge to the remuneration provisions of CRD IV[13], the UK has alleged that, to the extent that the cap on bankers' bonuses is required to be applied to employees of institutions outside the EU, it infringes Article 3(5) of the Treaty on European Union and the principle of territoriality found in customary international law[14]. A similar issue is currently being debated in the context of the financial transaction tax. The UK has issued proceedings arguing the decision permitting the adoption of the tax by a subset of the EU is unlawful because it authorises the adoption of an FTT with extraterritorial effects for which there is no justification in customary international law[15] and the Council Legal Services has supported this argument. Thus the question of extraterritorial application is likely to be a contentious issue in the context of this dossier also.

The prohibitions: proprietary trading

15. Chapter II of the proposal prohibits the largest banks and entities within their group from carrying out the following :

(a) proprietary trading, which is defined as using own capital or borrowed money to purchase, sell or otherwise acquire or dispose of a financial instrument or commodity "*for the sole purpose of making a profit for own account, and without any connection to actual or anticipated client activity or for the purpose of hedging the entity's risk as a result of actual or anticipated*

11 As a strict matter of law, a branch does not have a legal identity separate to its parent but, although the drafting is not wholly clear, it does not appear to be the intention that branch assets are consolidated with those of its parent.

12 The reciprocity requirement is that the non-EU jurisdiction recognises the EU legislation in the same way as the EU legislation recognises equivalent non-EU legislation.

13 The Fourth Capital Requirement Directive which consists of a directive (2013/36/EU) and a regulation (575/2013).

14 Case C-507/13 *United Kingdom of Great Britain and Northern Ireland v European Parliament, Council of the European Union*

15 Case C-209/13 *United Kingdom of Great Britain and Northern Ireland v Council of the European Union*

client activity" through specifically dedicated desks, units, divisions or individual traders;

(b) with their own capital or borrowed money and for the sole purpose of making a profit for own account:

(i) acquiring or retaining units or shares in AIFs;

(ii) investing in financial instruments the performance of which is linked to shares or units in AIFs; and

(iii) holding any units or shares in an entity that engages in proprietary trading or acquires units or shares in AIFs.

There are some very limited exemptions to both the prohibitions at (a) and (b) above.

16. The Commission has indicated that it has learned from the US experience of implementing the Volcker rule. Rather than adopting a wide definition of proprietary trading with a number of specific exclusions and exemptions, it claims to have opted for a narrow definition with limited exclusions. Careful analysis will be required to assess both whether the definition is as narrow as the Commission claims and whether the EU approach achieves the same result as the more detailed Volcker rule.

17. The narrow definition of proprietary trading is intended to satisfy France and Germany who were concerned to ensure that market-making was not restricted. It appears that both underwriting and market making would fall outwith the definition of proprietary trading as it will be argued that they are connected to client activity and do not have the sole purpose of making a profit for the bank. Trading in EU sovereign debt is expressly permitted[16]. Entities can also trade in cash or defined cash equivalent assets (money market instruments) if they use their own capital as part of their cash management processes but concerns have been expressed that it does not seem that securities transactions for the purpose of liquidity management and riskless principal transactions will be permitted. Hedging for own purposes is permitted but only as set out in the definition of proprietary trading and so is limited to hedging as a result of actual or anticipated client activity.

16 The Commission may adopt further secondary legislation to exempt trading in the sovereign debt of third countries which have equivalent supervisory and regulatory requirements, exposures to which have 0% risk weighting under the Capital Requirements Regulation.

18. The differences in approach between the US and EU rules are marked. The US approach is more sophisticated and consists of detailed and lengthy rules setting out exclusions and exemptions individually tailored to specific activities and situations, as well as the conditions with which there needs to be compliance in order to rely on the exclusions and exemptions. Setting out so much detail has been both challenging and time consuming. It has also led to some unforeseen, and perhaps unintended, consequences. The EU approach is the diametric opposite: it consists of about a page and a half of relevant rules. Interestingly, there is no provision in the draft for significant level 2 legislation to add further detail to the high-level prohibitions set out in the proposal.

19. It could be said that the EU has taken a more pragmatic approach, opting for a principle-based, as opposed to the US rule-based, approach. It could be argued that a vast range of activities which could otherwise fall under the heading of 'proprietary trading', including securities transactions for the purpose of liquidity management, riskless principal transactions and hedging activities, are ultimately connected to actual or anticipated client activity, even if indirectly. The lack of specified exemptions and exclusions in the EU rule could be said to create uncertainty and the possibility of regulatory arbitrage, as much will depend on individual national regulator's interpretation of the provisions, and to require individual consideration of each bank's different activities but it does give banks a degree of latitude and flexibility by not setting out a finite set of permitted activities. This lack of certainty may make it difficult to draw exact comparisons with the Volcker rule in the abstract and in the absence of some indication as to how broadly – or narrowly – the national regulators will enforce the EU prohibitions.

The prohibitions: investment in AIFs and other specified entities

20. In order to prevent evasion of the prohibition on proprietary trading, the proposal also provides that banks subject to the prohibition are prohibited from using their own capital or borrowed money to invest in or hold shares in AIFs (or certificates/derivatives linked to such shares) or entities that themselves engage in proprietary trading or invest in AIFs. The sole purpose of the banks' activity must be to make a profit for their own account: this provision may give some additional flexibility.

Unleveraged *and* closed-ended AIFs established in the EU or, if not established in the EU, marketed in the EU (arguably mainly private equity funds), venture capital funds, social entrepreneurship funds and the proposed European Long Term Investment Funds are exempted from this prohibition as they are regarded as supporting the financing of the real economy. The Commission has stated that this provision is targeted at hedge funds but, as drafted, it has a far wider application as it would capture all leveraged and open-ended AIFs (plus AIFs which are unleveraged but not closed-ended) which could include, for example, a real estate fund, a fine art or wine fund, a retail investment fund or an investment company which is established or marketed in the EU. Banks to which these EU prohibitions apply will be able to continue providing banking/custody services to the AIFs within the scope of the prohibition.

21. Although the second prohibition again appears to have been mirrored on Volcker, there are disparities. The potential exemption of private equity funds from the prohibition is in direct contrast to the Volcker rule which prohibits investment in private equity and hedge funds. There is no equivalent in the EU rule to the Volcker prohibition on covered transactions with covered funds with which the banking group has other relationships. Further, the EU legislation does not, unlike earlier drafts and the Volcker rule, prohibit the sponsorship of AIFs. On the other hand, the limited exclusions as opposed to the myriad US exclusions and exemptions, means that this investment prohibition appears to go further than the Volcker rule in certain respects. In addition, and in a broader fashion than the Volcker rule, the EU rule has an indirect effect: it prohibits investment in any entity that itself engages in proprietary trading or invests in AIFs. This provision is exceptionally wide and its practical effect is questionable: it is not clear whether the Commission expects banks to carry out extensive due diligence of all entities into which they have already invested or into which they are considering investing. These disparities will be of particular concern to those banks – for example, EU branches and subsidiaries of US banks and US branches and subsidiaries of EU banks but also other third country banks with a presence in both the EU and US – which are likely to have to comply with both Volcker and the EU prohibitions.

The ring-fencing provisions

22. The discretionary nature of the ring-fencing provisions is another departure from the Liikanen Report. Chapter III of the proposal only mandates national regulators to review the trading activities of each individual deposit-taking bank (termed "core credit institution") in the EU and decide whether those activities create a threat to the financial stability of the core credit institution ("CCI") itself or to the EU financial system as a whole[17]. If so, the national regulator must prohibit the CCI from carrying out the specific risky trading activities, unless that institution convinces the regulator that such a decision is not justified. Such a decision would not prevent the identified trading activities being carried out elsewhere within the banking group.

Scope

23. The scope of the EU rules on ring-fencing is unclear in the Commission's proposal. It could be the intention that the ring-fencing provision apply only to the largest banks as set out above at paragraph 11 but the current draft indicates a much wider scope. It appears that the EU rules are generally intended to apply to all banks that take deposits eligible under the Deposit Guarantee Scheme as provided for in the Deposit Guarantee Schemes Directive[18]. This includes all deposits held by individuals and small, medium and large businesses but not financial institutions and public authorities. This is a significantly different approach to that taken by the UK. The UK approach has been to apply its ring-fencing legislation to deposit-taking banks but it intends to exempt the deposits of specified types of depositors in secondary legislation, as well as provide for a *de minimis* exemption, which together would limit the deposits and the banks which fall within the Vickers ring-fence. The draft secondary legislation provides that deposits of high net worth individuals and their relatives who have chosen to deposit outside the ring-fence, deposits of large organisations and deposits of other financial institutions are not 'core deposits'. The EU approach is, therefore, to protect a wider range of deposits and to target a wider group of banks than

17 The drafting of Chapter III is currently ambiguous. Whereas the majority of Articles in Chapter III (for example Articles 10(2), 10 (3), 11 and 12) refer to the subject of a ring-fencing decision being the EU core credit institution, Article 9(1) currently mandates the national regulator to assess the trading activities of a far wider group of entities, including the EU parent and all branches and subsidiaries in a group which contains a core credit institution, as well as EU branches of non-EU banks.

18 Directive 94/19/EC. Note that amendments to this Directive will have been adopted before the adoption of Liikanen.

the UK which may cause a problem when the UK seeks to apply for a derogation – see paragraphs 40 - 44 below - and for those UK banks which fall outside the Vickers ring-fence but are within the scope of the EU ring-fence. Even if the EU ring-fencing provisions are intended to apply only to the largest banks in the EU, the scope of those provisions would still differ from the scope of the UK provisions.

24. As with the Volcker-style prohibitions, these provisions have extraterritorial effect. In the same way as set out at paragraph 11 above, they are intended to apply to an EU parent, and all its branches and subsidiaries regardless of their location, of a CCI, as well as to an EU branch of a non-EU bank[19]. Non-EU subsidiaries of EU banks and EU branches of non-EU banks will be exempt from the ring-fencing provisions if the Commission has made an equivalence decision regarding the non-EU jurisdiction: we have already commented (at paragraph 12 above) on the likelihood of an equivalence decision given that it demands equivalence as to Chapter II (the EU Volcker-style prohibition) and Chapter III (the ring-fencing provisions) plus reciprocity. There is an additional option, however, for non-EU subsidiaries of EU banks: a national regulator may exempt the subsidiary if it is satisfied that there is a group-level resolution strategy agreed between the EU group level resolution authority and the third country authority and that strategy for the subsidiary does not have an adverse effect on the financial stability of the Member State(s) where the EU parent and other group entities are established. This exemption, therefore, necessitates the cooperation of the relevant EU resolution authority, although it does not make clear which authority ought to make the discretionary decision as to the effectiveness of the resolution strategy.

25. The intended geographical reach of the EU and the UK legislation is thus also different: the UK legislation does not have the same extraterritorial effect as the EU proposal, although the draft secondary legislation does envisage restrictions on the entities a bank within the Vickers ring-fence can establish outside the EU.

The potential ring-fencing of certain trading activities

26. National regulators appear to be given a significant degree of discretion in Chapter III. This does raise the issue of inconsistent approaches[20] but the discretion conferred on regulators is not as wide as it initially appears. National regulators are required to assess the trading activities of CCIs. A wide definition of "trading activities" is given so that it essentially means all activities other than taking deposits eligible for deposit insurance, lending, retail payment services and a number of other retail and commercial banking activities. Trading in EU sovereign debt is exempt from the obligation to review (and thus the power to separate) and the Commission has the same power as described in footnote 15 to adopt further secondary legislation to exempt trading in the sovereign debt of third countries. The regulators are directed to give specific attention to market-making (as it is closely related to proprietary trading), investing and sponsoring securitisations and trading in derivatives other than those that are specifically permitted for the purpose of prudent risk management (as the Commission believes that these latter activities played a key role during the financial crisis).

27. The national regulator must carry out its assessment of individual CCIs at least yearly and must use prescribed metrics when doing so. These metrics are:

(a) relative size and leverage of trading assets;

(b) relative levels of counterparty credit risk and market risk;

(c) relative complexity of trading derivatives;

(d) relative profitability of trading income;

(e) interconnectedness; and

(f) credit and liquidity risk arising from commitments and guarantees provided by the CCI.

The EBA will draft secondary legislation specifying how the metrics should be measured, giving further detail of the metrics and setting out a methodology for consistent measurement and application of the metrics. The Commission will also specify a limit for each metric above which the risk level of the

19 There is seemingly no requirement for the branch or the non-EU bank to fall within the definition of a CCI. Thus it appears that EU branches of a non-EU bank may be within the scope of this provision when they would not be (because they would not fall within the definition of a CCI) if they were established in the EU as a subsidiary.

20 Although the ECB will assume its full supervisory tasks from 4 November 2014 and would thus be the relevant prudential regulator for the purposes of this proposal, national regulators will be responsible for the direct supervision of "less significant" banks and will assist the ECB in the on-going day-to-day supervision of "significant supervised" banks. As a result, the possibility of inconsistent national approaches must remain.

relevant trading activity is deemed "individually significant" and set out the conditions which will trigger the exercise of the national regulator's power to separate. Finally, the Commission will also draft legislation specifying certain types of securitisations which are not considered a threat to the financial stability of the CCI or the EU as a whole. It is, therefore, important that the proposal contains metrics which accurately measure the risks associated with trading activities and also takes into account risk mitigation techniques. The proposal does not, however, currently have regard to risk mitigation techniques such as netting, offsetting, diversification and portfolio compression nor prudent risk management and hedging techniques. It is not clear how these metrics, particularly those relating to the relative size and leverage of trading assets, relate to the calculation of the trading activities necessary to determine which banks fall within the scope of the ring-fencing provisions. It is also important that the Commission sets the limits and conditions at the correct level as these will determine the parameters of ring-fencing.

28. When the national regulator has carried out its assessment and concludes that the limits and conditions set out in the secondary legislation have been surpassed, a threat to the financial stability of the CCI or the financial system of the EU is deemed to exist and the regulator must commence the process whereby the CCI would be prohibited from carrying out the trading activities in respect of which the limits and conditions have been exceeded. Indeed even where the limits and conditions are not exceeded, the national regulator may commence to consider such a prohibition if its assessment leads it to conclude that any trading activity, save trading in those derivatives that are specifically permitted for the purpose of prudent risk management, poses the threat outlined above. The regulator must consult with the EBA and communicate its conclusions to the relevant CCI, which is given 2 months to comment. Unless the CCI demonstrates that the conclusions are not justified, the national regulator shall prohibit the CCI from carrying out the specified trading activities.

29. The drafting of the provisions gives the national regulators little discretion to do other than make a decision to ring-fence the relevant trading activities away from the CCI when the limits and conditions set out in the secondary legislation are surpassed. The regulators do, however, appear to have considerable discretion as to whether they are satisfied by the representations of the CCI concerned. This could lead to further inconsistencies of approach across different jurisdictions and even across banking groups. It also gives the regulator(s) enforcing the EU ring-fence more discretion than the UK regulator.

30. Once a decision to ring-fence any trading activity has been made by a national regulator, however, further provisions are triggered which mean that any CCI which has been subject to a ring-fencing decision, regardless of which or how many trading activities are ring-fenced or the extent to which the limits and conditions have been exceeded, can only use or sell derivatives to manage its own risk or to provide risk management services to customers as set out in the proposal. These provisions seem to render a national regulator's decision to ring-fence only certain trading activities nugatory.

31. The proposal provides that a CCI that has been subject to a ring-fencing decision by a national regulator may use only credit, FX and interest rate derivatives[21] which are eligible for clearing to hedge its overall balance sheet risk. This seems to link the derivatives that a ring-fenced CCI can use or sell to ESMA's decision under EMIR on which class of derivatives are subject to the clearing obligation. Given that ESMA's decision cannot be anticipated and that it is not clear that the clearing obligation will apply to any FX derivatives, this cross-reference appears peculiar. The CCI must also demonstrate to the national regulator that such hedging demonstrably reduces or significantly mitigates specific identifiable risks of its individual or aggregated positions. This wording mirrors the wording found in the Volcker rule and does not *per se* prohibit portfolio hedging.

32. A CCI that has been subject to a ring-fencing decision is permitted to use a slightly wider range of derivatives when selling them to clients for their risk management purposes. It can use credit, FX, interest rate and commodities (including emissions allowances) derivatives (but again only those eligible for clearing) provided that the sole purpose of the sale is to hedge credit, FX, interest rate or commodity risk and subject to caps on the resulting position risk which the Commission will set out in further secondary legislation. There are also restrictions on the range of types of 'real

21 The Commission may adopt secondary legislation adding to these classes of derivatives, including those that are not cleared.

economy' clients that could benefit from such risk management services.

33. The intention behind these provisions is not entirely clear but the drafting provides that using derivatives for their own risk management purposes and selling derivatives to clients for their risk management purposes are the *only* trading activities that can be carried out by a CCI subject to a ring-fencing decision. Article 11(1) provides that "*A core credit institution that has been subject to a [ring-fencing] decision ... may carry out trading activities to the extent that the purpose is limited to only prudently managing its capital, liquidity and funding.*" The following article, which provides for the provision of risk management services to clients, is arguably inconsistent with the word "*only*" in Article 11(1) but it does appear that CCIs which have been subject to a ring-fencing decision cannot engage in any other trading activities save those specifically set out in Articles 11 and 12. For the avoidance of doubt, this would mean that those CCIs could not engage in market-making, underwriting, securitisation activities and trading in derivatives other than those set out in Articles 11 and 12 of the proposal. As a result, irrespective of the decision taken by the national regulator who may decide to separate only certain trading activities, the effect of Article 11(1) is to prevent the CCI subject to the ring-fencing decision from carrying out any trading activity other than the use of certain derivatives for the specified risk management purposes. This restriction is consistent with the UK approach to ring-fencing, which prohibits the RFB from dealing in investments as principal which means that it cannot engage in market-making, underwriting and most of the derivative and trading activity currently being carried out by wholesale and investment banks. The EU legislation does not, however,contain the same exemptions as envisaged by the UK draft legislation.

34. The synergies with the UK legislation become even more apparent when consideration is given to the draft Financial Services and Markets Act 2000 (Excluded Activities and Prohibitions) Order (Excluded Activities Order) published for consultation in July 2013. The Excluded Activities Order permits RFBs to deal in derivatives to hedge their own balance sheet risks and to sell simple derivatives as risk management products to customers subject to safeguards. It ought to be noted, however, that the UK draft legislation includes additional exemptions from the excluded activity of dealing in investments as principal: these permit own asset securitisation and acquiring and selling shares in companies through debt-equity swaps. The EU draft legislation does not currently go so far.

35. In addition, although both the EU draft legislation and the UK's draft secondary legislation places restrictions on the exposures that the deposit-taking banks can have to other financial institutions, the UK legislation contains exemptions relating to the provision of payment services, trade finance and liquidity management, which the Commission has either not considered or has not considered necessary.

36. The French and German legislation plus the draft Belgian legislation have a more narrow focus that the UK legislation, most notably exempting market making from the scope of their legislation. The rationale for the French and German approach, in particular, is that most French and German banks are traditionally set up under a universal banking model and a mandatory full separation of trading activities from retail banking activities is regarded as inconsistent with this model. The cost of full functional separation is regarded as disproportionate.

Rules on ring-fencing

37. Unlike the Volcker-style prohibition, the effect of a ring-fencing decision does not prevent the trading activities that have been separated being carried out elsewhere in the banking group. Under the EU proposal, the separated trading activities may be carried out by a trading entity which is legally, economically and operationally separate from the CCI. The proposal contains provisions to achieve this level of separation including the following:

    (a) a group which contains CCIs and trading entities shall be structured so that on a sub-consolidated basis 2 distinct sub-groups are created, only one of which contains CCIs;

    (b) CCIs may only hold capital instruments or voting rights in a trading entity in prescribed circumstances and with the consent of the national regulator;

    (c) CCIs and trading entities shall issue their own debt, provided this is consistent with the group's resolution strategy;

    (d) contracts between CCIs and trading entities shall be agreed on a third party basis;

(e) requirements regarding members of the management bodies of both types of entities;

(f) the names of CCIs and trading entities shall make clear whether they are CCIs or trading entities;

(g) limits on the intra-group exposure a CCI has to any entity outside its sub-group; and

(h) limits on the extra-group exposure a CCI can have to financial entities.

The proposal also provides that the trading entity may not carry out certain activities, those being taking deposits eligible for protection under deposit guarantee schemes and providing retail payment services as defined in the Payment Services Directive[22]. It is not clear how these provisions are intended to apply to an EU branch of a non-EU bank.

38. When a CCI has been subject to a ring-fencing decision, or an entity has decided to separate trading activities on its own initiative, it or its EU parent must submit a separation plan to the national regulator within 6 months of the ring-fencing decision or at the start of the national regulator's assessment period. The national regulator has 6 months to approve the plan or require changes to be made. If a separation plan is not submitted, the national regulator shall adopt its own plan.

39. When consideration is given to the existing EU domestic legislation, the UK requirements on ring-fencing are most consistent with these provisions. The Banking Reform Act 2013 is a framework piece of legislation which sets out the key political choices which will give effect to Vickers but much of the technical detail will be found in subsequent secondary legislation and regulatory rules. Thus the Act requires the PRA to make rules governing the degree of separation between the RFB and the rest of the group, including rules to limit the shares and voting powers a RFB may have in another company, to ensure independence of decision-making in the RFB, to ensure the RFB does not rely on the provision of capital and liquidity resources of other members of the group, to restrict payments the RFB may make to other group members and to enter contracts with other members of the group on an arm's length basis. In addition, the UK government has published draft legislation which prohibits RFBs having exposures to certain financial institutions.

22 Directive 2007/64/EC.

Derogations from the ring-fencing provisions

40. The EU proposal provides for the possibility of the Commission granting a derogation from the ring-fencing provisions at the request of a Member State which had in place on 29 January 2014 primary legislation which fulfils the criteria set out on the proposal. This means that only the UK, France and Germany would qualify for the derogation as they are the only EU Member States which have already adopted legislation. The Belgian coalition government has, however, committed to finalising its legislation on bank structural reform before the elections in May 2014 and other Member States may want an opportunity to introduce their own legislation. The Commission's choice of cut off date may, therefore, be challenged.

41. The EU proposal provides that, in order to qualify for a derogation, the aim of the domestic legislation, its material scope and provisions referring to the legal, economic and governance separation of deposit-taking entities must have an equivalent effect to the provisions of the draft EU legislation. For reasons set out above, it appears that the UK legislation is most likely to satisfy these requirements but, also as pointed out above, not all of the UK's draft secondary legislation is consistent with the EU provisions. In addition to the exemptions mentioned at paragraph 34 above which permit RFBs to engage in own asset securitisation and to acquire and sell shares in companies through debt-equity swaps, the UK's draft legislation, the Financial Services and Markets Act 2000 (Ring-fenced Bodies and Core Activities) Order,also provides for a *de minimis* threshold below which institutions will be exempted from ring-fencing and exemptions which will permit the deposits of larger organisations and high net worth individuals to be held outside the ring-fence[23]. It is not clear whether these exemptions would prevent the UK's legislation meeting the criteria necessary for a derogation. There is thus a risk that the UK will have to change its draft secondary legislation if it wishes to benefit from the derogation if the EU proposal is not amended to be brought more in line with the UK legislation which has been subject to further consideration, scrutiny and consultation than the EU proposal to date.

23 The draft Order provides that banks whose 'core deposits' do not exceed £25 billion will not be RFBs. It also provides that deposits of high net worth individuals (and their relatives) who have chosen to deposit outside the ring-fence, deposits of large organisations and deposits of other financial institutions are not core deposits.

42. Even within France and Germany, it is considered that the French and German domestic legislation is unlikely than the UK's legislation to qualify for the derogation as the scope of the French and German ring-fencing provisions is less extensive than the EU proposal. The French and German banking sectors are expressing concern at the possibility that UK banks may be the only banks which benefit from a derogation and many Member States are questioning the legitimacy of a derogation which seems designed for one Member State only. The Belgian government is not in favour of any derogation being available and will advocate that the EU proposal be amended to be brought more in line with the Belgian legislation.

43. There are 3 other points of controversy as regards the derogation. First, it appears the intention of the Commission that, despite the fact that a Member State must apply for it, any derogation should be granted on an individual deposit-taking bank basis not on a jurisdictional basis. Article 21(1) provides that a derogation may be granted "*to a credit institution taking deposits from individuals and SMEs that are subject to national primary legislation adopted before 29 January 2014 when the national legislation complies with the*" requirements set out within the Article. Article 21(2) envisages a derogation being withdrawn from a bank after the Commission has decided that the national legislation is not incompatible because that legislation no longer applies to a particular credit institution. Taking the UK's legislation as an example and supposing that the exemptions referred to in the above paragraph are maintained, it is not clear whether a deposit-taking bank which takes advantage of the proposed *de minimis* exemption, for example, would be regarded as "*subject to national primary legislation*" so as to qualify for the derogation. It would be argued, of course, that such a bank is subject to the Banking Reform Act and is merely relying upon an exemption granted in accordance with it but, if that argument is valid, it is not clear why it would be necessary for derogations to be granted on an individual bank basis and not to all banks within a jurisdiction which has adopted national legislation having equivalent effect: the provision for a derogation on an individual bank basis presupposes that different decisions can be reached in respect of different banks within the same jurisdiction. Subsequent drafting does suggest that a Member State can apply for derogations in respect of a number of deposit-taking banks at the same time and that one single derogation would be granted. Further, if domestic legislation is to be regarded as equivalent to the EU legislation, it would seem inconsistent for a decision to be reached that it is only equivalent for certain banks but the drafting and intent requires clarification to ensure certainty.

44. The second point of controversy is that the draft EU legislation gives the Commission a discretion to decide whether or not to grant the derogation. It is for the Commission to decide whether the domestic legislation is compatible with the EU legislation and it also appears that the Commission is required to consider the potential impact of a derogation on the financial stability of the EU and the functioning of the internal market. It is also unclear whether the Commission can determine that national legislation is equivalent but that the potential negative impact of granting a derogation to any or to one particular bank subject to that legislation is too great. Conferring such a discretion on the Commission will raise political and legal questions concerning whether and how the Commission can be given such a power, particularly in a regulation which is meant to apply directly to all Member States and create a harmonised EU regulatory framework.

45. Finally, the effect of the provision on derogations is that an EU cross-border banking group with a number of CCIs in different Member States (or potentially a number of CCIs in the same Member State) could obtain a derogation for some but not all of those CCIs. This could result in a banking group being faced with duplicative or even conflicting rules on ring-fencing which the banking group has to apply to ensure the integrity of the various ring-fences. Such an effect would be exacerbated in case of non-EU banking groups which would seemingly not be obliged to comply with the rules on ring-fencing across the entirety of its group.

What happens next?

46. The proposal must be adopted by the European Parliament and Council under the ordinary legislative procedure. Under this procedure the Council and the Parliament are placed on an equal footing as the co-legislature. Both institutions will consider the Commission's proposed text and reach an internal agreement as to a version that they can accept. Once they have reached this agreement, they and the Commission enter a process known as

trialogues in an attempt to reach an agreed text for adoption as legislation. The agreed text must be adopted by a qualified majority of the Council and a simple majority of the Parliament.

47. The process for adopting EU legislation is thus both complex and lengthy. France, Germany and Italy have already made clear their objection to the proposal as a whole and the UK is likely to be concerned both at the Volcker-style prohibition it contains and the process necessary to obtain a derogation from the ring-fencing provisions. Given these concerns, significant amendments to the proposal, in Council at least, are to be expected. It is less clear how the new Parliament will view the proposal.

48. Agreement on a final version of the legislation is not expected before June 2015 and, on this basis, the Commission's proposed timetable would see the prohibition on proprietary trading applying from 1 January 2017 and the provisions on separation of the trading activity applying from 1 July 2018. This timetable could precede the UK implementation of its ring-fence but is significantly behind the Volcker timetable: the Volcker conformance period ends on 21 July 2015 and banking entities must make good faith efforts to be in compliance by that date.

49. When considering the operational changes required by Volcker, Vickers, the French law on the separation and regulation of banking activities, the *Trennbankengesetz* and any Belgian legislation in force, it would be prudent to bear in mind the likelihood of additional EU requirements, although there is as yet no certainty as to exactly what those requirements may be. This increases the pressure on banks to keep up to date with regulatory developments. In addition, banks which expect to be within the scope of the EU's proposal should commence lobbying their own governments, the Commission and, after elections, the new European Parliament if, as appears likely, they are concerned by the EU proposal.

50. As currently drafted the EU proposal is not consistent with any of the existing domestic legislation on bank structural reform, in the EU or in the US. The possibility of duplicative and conflicting requirements will be a concern for banks which are active cross-border as it raises the question whether a single banking model can be designed that complies with the legislative requirements in all relevant jurisdictions. If a single model is not possible, the cost of banking, and thus bank lending, could be increased and this will impact on the real economy and EU's economic recovery. The EU's legislative proposal could, therefore, adversely affect the very people who it is designed to protect. It is also hard to see how the EU's proposal addresses the problem that the Commission itself identified of inconsistent national legislation. The EU legislation could itself increase the possibility of distortions of capital movements and investment decisions, make the structure and operation of cross-border banks more complex and increase fragmentation. In these circumstances, the necessity for this legislation may well be questioned: is EU legislation for bank structural reform necessary and proportionate in addition to banking union, CRD IV, the soon-to-be-adopted bank recovery and resolution directive and the domestic legislation already in place? It is also possible that the necessity for and the legality of having a derogation in a regulation adopted under Article 114(1) of the TFEU could be challenged.

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If you have any questions in connection with this update, please do not hesitate to get in touch with one of the contacts referred to below.

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MAYER • BROWN

Legal Update
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Federal Reserve Issues Final Regulation Implementing Dodd-Frank Section 165 Enhanced Prudential Standards for Large US and Non-US Banking Organizations

Introduction

On February 18, 2014, the Board of Governors of the Federal Reserve System (FRB) approved a final rule (Final Rule) implementing the enhanced prudential standards contained in section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) for US bank holding companies (BHCs) and foreign banking organizations (FBOs).[1] The Final Rule and accompanying preamble comprise over 400 pages and, despite substantial criticism of the proposals, in many respects closely track the separate proposals for large US BHCs (Domestic Proposal) and for large FBOs (FBO Proposal) issued by the FRB in December 2011 and December 2012, respectively.[2] Thus, under the Final Rule, US BHCs and FBOs with at least $50 billion in total consolidated assets will be subject to heightened capital, liquidity, risk management, and stress testing requirements. These requirements will generally take effect for US BHCs on January 1, 2015, and for FBOs on July 1, 2016. For a summary of the requirements that apply to various categories of FBOs and BHCs, please see the attached Tables 1 and 2.

While the Final Rule adopts many aspects of the Domestic and FBO Proposals, there are several important changes. First, the Domestic and FBO Proposals would have limited the credit exposure of large BHCs and FBOs to unaffiliated counterparties. This single counterparty credit limit proposal generated significant comment and the FRB deferred final action on this aspect of the enhanced prudential standards, noting that it continues to work on developing those limits in light of comments received on the proposal. The FRB indicated it also plans to take into account the Basel Committee on Bank Supervision's (BCBS) efforts on its pending "large exposure" proposal, as well as the results of the FRB's quantitative impact study of its own earlier proposal.[3]

Second, both of the proposals would have implemented the requirements of section 166 of the Dodd-Frank Act in addition to those specified in section 165. Section 166 of the Dodd-Frank Act requires the FRB to implement an early remediation regime for nonbank financial companies designated as systemically important financial institutions and bank holding companies with total consolidated assets equal to or greater than $50 billion. In the FBO Proposal, the FRB sought to extend the early remediation regime to the US operations of FBOs with at least $50 billion in consolidated global assets. These early remediation provisions also were not included in the Final Rule, with the FRB again indicating that it continues to review comments on its earlier proposal and that those provisions "remain under development."

Third, the proposals provided that the section 165 enhanced prudential standards that apply to BHCs and FBOs would serve as a baseline for the enhanced prudential standards to be applied to US and non-US nonbank financial companies designated for FRB supervision by the Financial Stability Oversight Council (Council). In response to commenters' substantial objections, the FRB acknowledged that companies designated by the Council for FRB supervision may have a range of businesses, structures, and activities that present differing risk profiles. As a result, rather than apply the Final Rule to those companies, the FRB decided that it would instead thoroughly evaluate the characteristics of a designated company and tailor the application of the enhanced prudential standards to those companies by order or regulation. While this approach was taken to ease the concerns of US and non-US companies that may be designated for FRB supervision, the extent to which affected companies will have an opportunity to provide input on the development of those standards outside a formal notice and comment process remains unclear.

A very controversial aspect of the FBO Proposal was the requirement that FBOs with global assets of $50 billion or more and US assets of $10 billion or more consolidate US subsidiary activities under a US intermediate holding company (IHC) that would be subject to the same enhanced prudential standards as BHCs. This proposal was vigorously opposed by international banks and non-US governmental authorities on a number of grounds, including that (i) it was not authorized under section 165; (ii) it was contrary to the well-settled principle of national treatment; (iii) it would encourage non-US governments to impose similar or more burdensome requirements and undermine efforts to develop common global prudential standards; and (iv) it would encourage non-US banks to scale back or even terminate their US operations, thus harming the US economy. Although the FRB retained and vigorously defended the IHC requirement in the Final Rule, it did raise the threshold for establishment from $10 billion to $50 billion in US non-branch assets, delay the application of US leverage capital standards to IHCs until January 1, 2018, and extend the initial compliance date for the IHC and other enhanced prudential standards for FBOs for one year until July 1, 2016. Despite these accommodations, the IHC provision stands as a fundamental departure from the US regulatory approach that historically provided non-US banks with significant flexibility to choose how to structure their US banking and nonbank operations. The FRB's decision to impose the IHC requirement on FBO subsidiary operations reflects a trend away from "national treatment" and deference to home country supervisors and raises serious policy and competitive equity issues not all of which can be justified on the basis of ensuring US financial stability. Notably, after the Final Rule's release, Michel Barnier, the European Union's financial services chief, indicated that the Final Rule may cause other jurisdictions to retaliate by imposing similar measures, and that he would seek talks with the FRB on the longer term consequences of the IHC on competitive equality for non-US banks.[4]

The IHC requirement is already beginning to cause FBOs to reduce or otherwise restructure their US operations to minimize the impact of some of the more onerous aspects of the Final Rule,[5] and it may lead other jurisdictions to impose similar requirements on US and non-US banks operating locally. In its effort to strengthen financial stability, the FRB may limit market options and reduce foreign investment and potential sources of credit and employment in the US and perhaps even global markets. Indeed, in the preamble to the Final Rule, the FRB acknowledged that if a large FBO "were to reduce its systemic footprint in response to the final rule, this would be consistent with the [FRB's] overall goal of financial stability."[6]

In addition to the IHC requirement, the Final Rule imposes enhanced risk-based and leverage capital, liquidity, risk management, and stress-testing requirements on large FBOs with US operations, as described in detail below. As is the case for domestic BHCs, the Final Rule imposes a risk committee requirement on FBOs that are publicly traded with total consolidated assets of $10 billion or more. Additionally, stress testing requirements would be imposed on all FBOs and foreign savings and loan holding companies with total consolidated assets of $10 billion, regardless of whether they are publicly traded. For BHCs, many aspects of the enhanced prudential standards contemplated by section 165 of Dodd-Frank, including capital planning and stress testing requirements, have already been implemented. As a result, these provisions are simply incorporated into the Final Rule by reference. However, the Final Rule imposes new enhanced liquidity and risk management standards on top-tier BHCs with total consolidated assets of $50 billion or more. Although the full array of risk management standards would not apply, BHCs that are publicly traded with consolidated assets of at least $10 billion would be required to establish risk committees.

As BHCs and FBOs grapple with the added compliance burdens of the Final Rule, its implications, particularly for FBOs, will become clearer over time. The FRB has said that it will evaluate reorganizations that result in the movement of US assets from FBO subsidiaries to branches. In this regard, institutions with subsidiary operations near the asset thresholds specified in the Final Rule may pursue strategies intended to put them below the thresholds.

This Update provides an overview of the significant components of the Final Rule for BHCs and FBOs.

Intermediate Holding Company

As noted above, one of the most controversial aspects of the FBO Proposal was the requirement for certain large non-US banks to consolidate nearly all US non-branch operations under a separately capitalized intermediate holding company that would be subject to prudential standards equivalent to those that apply to US bank holding companies. The FRB retained the IHC requirement in the Final Rule, but made two important concessions. First, the FRB increased the asset threshold that triggers the IHC formation requirement from $10 to $50 billion in US non-branch assets for an FBO having $50 billion or more in total consolidated assets. By doing so, according to its own estimate, the FRB reduced the number of FBOs that would be covered by the IHC requirement from approximately 25 to 30 firms to between 15 and 20. Second, the FRB lengthened the transition period for forming an IHC in order to provide additional time to address tax and other IHC-related reorganization issues. Like the Proposal, the Final Rule exempts US branches and agencies from the IHC requirement.

Key highlights and considerations relating to the final IHC requirement include the following:

- **Calculation of $50 Billion Threshold.** An FBO must calculate its US non-branch assets for purposes of applying the US IHC requirement by taking the average of the total consolidated assets of each top-tier US subsidiary of the FBO for the four previous quarters. The FRB justified the scope of the subsidiaries and assets to be included in the calculation on the basis that it is similar to the methodology used by a US BHC to measure its total consolidated assets for purposes of Section 165. Excluded from this calculation are subsidiaries held through BHCA Section 2(h)(2) authority.[7] In response to comments, the Final Rule includes an additional exception for subsidiaries of US branches or agencies (US Branches) that were acquired or formed to hold assets acquired in the ordinary course of business for the sole purpose of securing debt previously contracted (DPC). The FRB excluded DPC branch subsidiaries on the basis that the associated liabilities pertain to the US Branch, which is held outside the IHC, and because DPC assets may only legally be held for a short time. For purposes of determining the $50 billion threshold, the Final Rule provides for netting of intercompany balances among the US subsidiaries. Accordingly, FBOs will reduce their US non-branch assets by the amount corresponding to any balances and transactions between any top-tier US subsidiaries that would be eliminated in consolidation if an IHC were already in existence. However, the FBO may not exclude intercompany balances and transactions between US subsidiaries and US Branches or between the US subsidiaries and non-US affiliates.

- **Covered US Subsidiaries.** Despite vigorous opposition by commenters, the Final Rule retains the BHCA definition of control for purposes of identifying subsidiaries that would have to be transferred to an IHC. An FBO is deemed to "control" a US company if it (i) directly or indirectly, or acting through one or more other persons, owns, controls, or has power to vote 25% or more of any class of voting securities of the company; (ii) controls in any manner the election of a majority of the directors or trustees of the company; or (iii) directly or indirectly exercises a controlling influence over the management or policies of the company.[8] The FRB justified this approach as necessary to ensure parity of treatment between FBOs and US BHCs. Additionally, the FRB noted that the extended transition period provided in the Final Rule should allow FBOs time to gather necessary information on subsidiary holdings.

  An FBO that meets the US non-branch asset threshold must hold its interest in any US subsidiary, other than exempted subsidiaries, through its IHC. An IHC must also hold non-US subsidiaries held through US subsidiaries, as well as subsidiaries of US branches and agencies (other than DPC subsidiaries) of the FBO. In addition, the FBO must transfer the entirety of its ownership interests in a US subsidiary to the IHC, and may not retain any ownership interests directly or through other subsidiaries. Despite calls to do so, the FRB made no exceptions for de minimis subsidiaries, merchant banking subsidiaries, subsidiaries that function as funding conduits, and US subsidiaries engaged in or holding nonfinancial assets (such as private equity investments in nonfinancial assets). All must be held by the IHC.

- **Exemption Requests.** The Final Rule acknowledges that the application of the BHCA control definition may not be appropriate in all cases and thus provides a mechanism for FBOs to seek an exemption from inclusion within the IHC structure of specific subsidiaries through the submission of a formal written request. Requests must be submitted to the FRB 180 days before the FBO must form an IHC. The request must detail why it should be granted (e.g., the FBO should give information that demonstrates that it cannot transfer its ownership interest in the subsidiary to the IHC or cannot otherwise restructure its investment). If the FRB grants an exemption, the FRB may require passivity commitments or other supervisory agreements to limit the exposure to, and transactions between, the IHC and the US subsidiary that is held outside the IHC.

- **Implementation Plan.** An FBO must provide the FRB with an after-the-fact notice after it has formed its IHC. While the Final Rule does not require FBOs to obtain prior approval in order to form an IHC, they are required to submit by January 1, 2015 an implementation plan outlining the FBO's proposed process to comply with the Final Rule's IHC requirements. The FRB envisions that the implementation plan will facilitate dialogue between the FRB and the FBO.

Implementation plans must include: (i) a list of the FBO's US subsidiaries, including detailed information on those US subsidiaries it does not have to hold through the US IHC (i.e., the name, asset size, and a description of why the US subsidiary is a Section 2(h)(2) company or DPC branch subsidiary), or for which the FBO intends to seek an exemption; (ii) a projected timeline for the transfer by the FBO of its ownership interest in those subsidiaries to the IHC; (iii) a timeline of all planned capital actions or strategies for capital accumulation that will facilitate the IHC's compliance with the risk-based and leverage capital requirements applicable to the IHC (discussed below); (iv) quarterly pro forma financial statements for the IHC; and (v) a description of the risk management and liquidity stress testing practices of the FBO's combined US operations, and how the FBO and IHC plan to comply with those requirements. The FRB may request additional information, and the FBO should update the FRB if it will deviate materially from its submitted plan.

- **Timing of Compliance.** If an FBO meets or exceeds the US non-branch asset threshold on July 15, 2015, an IHC will be required to hold the FBO's ownership interest in any US BHC subsidiary, any depository institution subsidiary, and US subsidiaries representing 90% of the FBO's assets not held under the BHC or depository institution by July 1, 2016. The FBO has until July 1, 2017 to transfer any remaining US subsidiaries to its IHC. The FRB also extended the compliance period for FBOs who meet or exceed the asset threshold for formation of an IHC after July 15, 2015. Those FBOs would have until the first day of the ninth quarter after they meet or exceed the threshold to establish a US IHC.
- **Timing of Compliance/Applicable Standards for BHC Subsidiary of FBO.** As in the FBO Proposal, a US BHC that is designated as an IHC will be subject to the applicable US IHC enhanced prudential standards, and not to applicable US BHC enhanced prudential standards. However, prior to the formation of the IHC, a US BHC with total consolidated assets of $50 billion or more that is controlled by an FBO will be subject to the enhanced prudential standards applicable to US BHCs as of January 1, 2015. The US BHC will shift over to the IHC standards on the date that the US BHC becomes subject to the parallel requirements for IHCs under the Final Rule (e.g., generally, July 1, 2016; but October 1, 2017 for capital stress test requirements and January 1, 2018 for leverage capital requirements).
- **Alternative Organization Structures.** The Final Rule gives the FRB authority to permit an FBO to establish multiple IHCs or to use an alternative organizational structure to hold its US operations (e.g., when an FBO controls multiple lower-tier FBOs that have separate US operations or when, pursuant to home country law, the FBO may not control its US subsidiaries through a single IHC). If the FRB authorizes the formation of multiple IHCs, it will treat each IHC as if it had $50 billion or more in total consolidated assets, even if its assets are below that threshold. The FRB will not permit an alternative structure where the purpose or primary effect would be to reduce the impact of the FRB's capital rules or other prudential requirements (e.g., forming an IHC for the sole purpose of holding a nonbank subsidiary separate from banking operations, or to designate a company that is not the top-tier US company as the IHC). Not surprisingly, the FRB did not adopt the "virtual" IHC concept proposed by some commenters.
- **Corporate Form, Designation of Existing Company, and Dissolution of US IHC.** The Final Rule requires an IHC to be organized under the laws of the United States, any of the fifty US states, or the District of Columbia, and provides FBOs

flexibility with respect to the corporate form for the IHC. The FRB clarified that the US IHC may not be a foreign legal entity. The FRB also clarified that an FBO may designate an existing entity as the IHC, provided that it is the top-tier US entity.

If its US assets fall below the applicable threshold for four consecutive quarters, an FBO may dissolve the US IHC, but it must reestablish the IHC if the FBO's US non-branch assets subsequently exceed the $50 billion threshold for four consecutive quarters. As a practical matter, given the cost of establishing an IHC and restructuring its US holdings, an FBO would likely not dissolve its US IHC even if it could, unless it were making material changes in its US business.

- **Source of Strength.** The FRB confirmed in the preamble to the Final Rule that an IHC will not be required to serve as a source of strength for its subsidiaries that are not insured depository institutions.
- **Reservation of Authority.** The FRB reserved its authority to modify the application of the enhanced prudential standards during the transition period if appropriate to accommodate an FBO's organizational structure or to accommodate characteristics specific to that FBO, and if the modification is consistent with other relevant considerations. The FRB also retains authority to address "idiosyncratic issues and discontinuities" that may arise out of the application of the enhanced prudential standards to the US operations of FBOs. In addition, the FRB has cautioned that it intends to monitor any attempted evasions of the IHC requirements by FBOs (e.g., through the transfer of assets and activities by FBOs into their US branches and agencies), although the FRB indicated that the potential for such transfers would be limited because most non-branch activities are impermissible for a branch (e.g., broker-dealer activities, or activities funded by FDIC-insured deposits that cannot be moved into a branch unless the branch is a grandfathered insured branch).
- **Legal Authority.** As noted above, the FRB responded to comments that FRB did not have authority to adopt an IHC requirement by relying on the provision in Section 165 of Dodd-Frank that permits the FRB to establish any prudential standard for covered companies if the FRB determines it is appropriate. In the Final Rule, the FRB has determined it is appropriate, within the purpose of Section 165, to establish the IHC requirement because it directly addresses risks to US financial stability by increasing the resiliency of US operations of large FBOs. The FRB also stated (in what is a common theme throughout the Final Rule) that the IHC requirement creates a level playing field between domestic BHCs and FBOs, in furtherance of national treatment and competitive equality.

Risk-Based and Leverage Capital Requirements

The Final Rule adopts enhanced risk-based and leverage capital requirements for IHCs, parent FBOs, and domestic BHCs substantially as proposed. Most significantly, the FRB essentially rejected the arguments of non-US stakeholders against the imposition of local capital requirements on the US operations of FBOs, including those comprised primarily of broker-dealer and other nonbank operations. This approach appears consistent with the FRB's view, noted above, that if an FBO "were to reduce its systemic footprint" in response to the Final Rule, for example, by shedding US assets, "this would be consistent with the Board's overall goal of financial stability."[9] In addition, the FRB generally acknowledged that the imposition of local capital requirements at the IHC level, including the potential need to raise additional capital through the sale of equity in US IHCs, could result in a reduction of FBO capital for purposes of parent-only or even consolidated capital calculations, forcing some FBOs to raise additional capital in order to satisfy home country requirements. However, the FRB reasoned that requiring FBOs to maintain capital within the United States sufficient to satisfy US requirements is nevertheless an appropriate step to protect US financial stability in accordance with the mandate of the Dodd-Frank Act.

FOREIGN BANKING ORGANIZATIONS

Intermediate Holding Companies

- **Capital Requirements.** As proposed, IHCs will generally be required to hold capital sufficient to satisfy the same US risk-based and leverage capital rules that apply to US BHCs. Accordingly, IHCs must satisfy US Basel III minimum capital requirements, including the capital conservation and (to the extent applicable) the countercyclical capital buffer.[10] IHCs will also be subject to the US "generally-applicable" leverage ratio (4 percent) and, in the case of IHCs with total consolidated assets of $250 billion or more or $10 billion or more in on-balance sheet foreign exposure, the "supplementary" leverage ratio based on Basel III (3 percent, including off-balance sheet exposures). IHCs will also be subject to the same capital planning requirements as US BHCs under the FRB's Comprehensive Capital Analysis and Review (CCAR) framework, pursuant to which each IHC must submit an annual capital plan to the FRB that demonstrates the IHC's ability to maintain capital above the US Basel III minimum risk-based capital ratios under both baseline and stressed conditions over a minimum nine-quarter time horizon, taking into account any planned capital distributions. The capital stress testing requirements that will apply to IHCs under CCAR are described separately below.
- **Advanced Approaches Exemption for Certain IHCs.** Notwithstanding that IHCs will generally be subject to the same capital rules as US BHCs, the Final Rule exempts IHCs that would otherwise be subject to the US Basel III "advanced approaches" risk-based capital rules (i.e., those with total consolidated assets of $250 billion or more or $10 billion or more in on-balance sheet foreign exposure) from needing to comply with those more complex requirements. With prior FRB approval, this relief from application of the US advanced approaches rules is available even to an IHC that has a US bank subsidiary and is itself a BHC otherwise subject to the advanced approaches rule.[11] However, IHCs meeting the threshold for applicability of the advanced approaches rules generally will still be subject to other aspects of the US Basel III rules applicable to advanced approaches banks, such as the countercyclical capital buffer, the supplementary leverage ratio, and the requirement to include accumulated other comprehensive income (AOCI) in regulatory capital.
- **Timing of Compliance.** In addition to the general extension of the compliance date of the Final Rule for FBOs to July 1, 2016, the minimum leverage ratios for IHCs (both the generally-applicable leverage ratio and the supplementary leverage ratio) will not apply until January 1, 2018. According to the FRB, this transition period "should help [FBOs] manage the costs of moving capital to the United States." However, the FRB specifically reserves the right to accelerate application of the leverage ratio requirements to an IHC if it believes the FBO has taken actions to evade the IHC capital requirements.
- **Disclosure Obligations.** Although IHCs are technically subject to the same quarterly public disclosure obligations as apply to BHCs under US Basel III, the FRB expects that most IHCs will be able to rely on an exemption from this disclosure obligation that applies to any subsidiary of an FBO that is subject to

"comparable public disclosure requirements in its home jurisdiction."[12]

FBOS with $50 Billion or More in Total Consolidated Assets

- **Capital Requirements.** The Final Rule also adopts, largely as proposed, the requirement that FBOs with $50 billion or more in total consolidated assets (including those required to establish IHCs) certify or demonstrate compliance with home-country capital standards that are consistent with the Basel capital framework, which the Final Rule defines to include all Basel III minimum risk-based capital ratios, the Basel III 3 percent supplementary leverage ratio (but not the US 4 percent leverage ratio), and all restrictions arising in connection with applicable Basel III capital buffers. If a particular home country jurisdiction has not established capital adequacy standards consistent with Basel III, the FBO would be required to demonstrate to the satisfaction of the FRB that it would meet or exceed Basel III standards on a consolidated basis.
- **Consequences of Failure to Comply.** The Final Rule authorizes the FRB to impose restrictions on the US operations of any FBO that fails to satisfy the capital certification (or demonstration) requirement. However, the Final Rule incorporates an industry request that the FRB provide notice to an FBO and an opportunity to respond before imposing any such restrictions on the FBO's US operations.
- **Amendments to FR Y-7Q.** The FRB intends to propose for public comment amendments to the FR Y-7Q that would incorporate information reporting requirements related to the parent-level capital adequacy of large FBOs.

FBOs with Total Consolidated Assets of Less than $50 Billion

- **No Capital Requirements Imposed.** The Final Rule does not impose specific capital requirements on FBOs with total consolidated assets of less than $50 billion. As discussed below, however, FBOs with total consolidated assets between $10 billion and $50 billion will be subject to certain requirements related to home-country capital stress testing.

US BANK HOLDING COMPANIES

- **Large BHC Capital Requirements.** The Final Rule requires US BHCs with $50 billion or more in total consolidated assets to meet all applicable US regulatory capital requirements, including the US Basel III rules adopted in 2013, any enhanced US supplementary leverage buffer requirement ultimately adopted for the handful of largest and most complex US BHCs, and any risk-based capital surcharges ultimately adopted for any US BHCs that are global systemically important banks (G-SIBs) pursuant to the BCBS's G-SIB regime.[13] The Final Rule also simply incorporates the previously issued capital planning and stress testing requirements for large BHCs discussed above in connection with the IHC capital requirements.[14]
- **Mid-Tier BHC Capital Requirements.** US BHCs with less than $50 billion in total consolidated assets are not subject to the enhanced prudential standards of the Dodd-Frank Act, including with respect to capital. Of course, they remain subject to the applicable US Basel III requirements which apply to all BHCs with more than $500 million in assets. Moreover, the Final Rule also incorporates the previously issued capital stress testing requirements for US BHCs with total consolidated assets between $10 billion and $50 billion, as discussed below.

Risk Management and Risk Committee Requirements

The Final Rule largely adopted as proposed risk management and risk committee requirements for FBOs and BHCs (including the requirement for larger FBOs and BHCs to appoint a chief risk officer). The FRB noted that in large measure the requirements were specifically required by Section 165(h) of the Dodd-Frank Act and were needed to address the risk-management weaknesses observed during the financial crisis. The Final Rule represents the first time that large BHCs and FBOs will be required by regulation to comply with specific US risk management standards. While the failure to comply with regulatory requirements can have specific supervisory consequences, in many respects the mandatory aspects of the Final Rule, such as the establishment of risk management committees or the appointment of chief risk officers, are requirements that major banks have been implementing for some time under existing regulatory guidance and as a matter of best practices. In implementing the requirements for FBOs and BHCs, the FRB's intention is to achieve equivalent, if not identical, standards for each.

FOREIGN BANKING ORGANIZATIONS

FBOs with Combined US Assets of $50 Billion or More

- **US Risk Committee Requirements.** An FBO with combined US assets of $50 billion or more must establish a US risk committee that oversees the risk management function for its combined US operations (branch and non-branch operations). The risk committee must aggregate, monitor and report risks across all US legal entities, and assist US supervisors to understand risks posed to US financial stability by the US operations of FBOs. The FRB explained that it is not necessary that large FBOs certify to the FRB that they have established a risk committee, because the FRB will obtain all the information it requires through the supervisory process for these FBOs. At least one risk committee member must be independent.[15]
- **Responsibilities of US Risk Committee.** The US risk committee must periodically review and approve the risk-management policies of the combined US operations and oversee the operation of an appropriate risk-management framework commensurate with the capital structure, risk profile, complexity, activities, size, and other appropriate risk-related factors of the FBO's combined US operations. The US risk-management framework must be consistent with the enterprise-wide risk management policies, and must include enumerated policies, procedures, processes, and systems. An FBO may rely on its parent company's enterprise-wide risk management policies, as long as those policies fulfill the minimum requirements established by the Final Rule. The US risk committee must meet at least quarterly and fully document and maintain records of its proceedings, including risk-management decisions.
- **Risk Management Expertise.** At least one risk committee member must have risk-management expertise that is commensurate with the FBO's capital structure, risk profile, complexity, activities, size, and other appropriate risk-related factors. Risk management expertise is defined as "experience identifying, assessing and managing risk exposures," and such experience must be gained in large financial firms. All risk committee members must have an understanding of risk management principles and practices relevant to the company.
- **Placement of Risk Committee.** The US risk committee may be a committee of the FBO's global board of directors (on a stand-alone basis or jointly with its enterprise-wide risk committee) or, if the FBO is subject to the IHC requirement, as a committee of the IHC's board of directors. An IHC must have its own risk committee, which may also fulfill the responsibilities of the US risk committee. The requirement of an IHC to have its own risk committee may create an incentive to place

the US risk committee at the IHC rather than the FBO level.

- **US Chief Risk Officer Responsibilities.** The US chief risk officer must operate under dual reporting lines to the US risk committee and the global chief risk officer. The US chief risk officer will serve as a single point of contact for the FRB supervisory staff. The chief risk officer may execute his or her responsibilities by working with, or through, others in the organization, including business units. In response to comments, the Final Rule permits the chief risk officer to "oversee" the execution of certain responsibilities, rather than be directly responsible for them.

  The US chief risk officer is responsible for overseeing (i) measurement, aggregation, and monitoring of risks undertaken by the combined US operations; (ii) implementation of and ongoing compliance with the FBO's risk management policies and procedures for its combined US operations, and the development and implementation of processes and systems for implementing and monitoring compliance with the policies and procedures; and (iii) management of risks and risk controls, and monitoring and testing of such risk controls.

- **US Chief Risk Officer Qualifications.** A US chief risk officer must have risk-management expertise, gained in a large, complex financial firm, commensurate with the capital structure, risk profile, complexity, activities, and size of the FBO's combined US operations.

- **US Chief Risk Officer Reporting Requirements.** In fulfilling his or her dual reporting obligations, the chief risk officer is required to report on the nature of and changes to material risks undertaken by the FBO's combined US operations, including risk management deficiencies and emerging risks, and how those risks relate to the global operations of the company. The chief risk officer may not fulfill other roles within the FBO, including functioning as the global risk officer; rather, US risk management oversight should be his or her primary responsibility.

- **Compensation of US Chief Risk Officer.** Compensation of the US chief risk officer must be consistent with providing an objective assessment of risks.

- **Location of US Chief Risk Officer.** In order for the US chief risk officer to have appropriate exposure to the FBO's US operations, and to ensure accessibility to US supervisors, the US chief risk officer must be located in the United States, and employed by a US subsidiary or US office of the FBO.

- **Failure to Comply.** If an FBO fails to comply with the risk management requirements, the FRB may impose restrictions, conditions, or requirements on the activities or business operations of the FBO's combined US operations.

FBOs with Total Consolidated Assets of $50 Billion or More But Combined US Assets of Less than $50 Billion

- **Responsibilities of FBO and Certification to FRB.** An FBO with total consolidated assets of at least $50 billion but combined US assets of less than $50 billion must certify to the FRB on an annual basis concurrently with the FBO's FR Y-7 that it maintains a US risk committee of its board of directors (or equivalent) that (i) oversees the US risk-management policies of the combined US operations of the company, and (ii) has at least one member of the risk committee with risk management expertise in large, complex firms (which may be nonfinancial or nonbanking firms). To accommodate diversity in corporate governance practices across different jurisdictions, FBOs in this category do not need to meet any standards of independence with respect to members of the risk committee. The Final Rule requires the FBO to take appropriate measures to ensure that its combined US operations implement the risk management policies overseen by the US risk committee, and that its combined US operations provide the US risk committee sufficient information to carry out its responsibilities.

- **Placement of Risk Committee.** The risk committee must be a committee of the global board of directors.
- **Failure to Comply.** As with an FBO with combined US assets of $50 billion or more, if an FBO fails to comply with the risk management requirements, the FRB may impose restrictions, conditions, or requirements on the activities or business operations of the FBO's combined US operations. If the FRB determines to take action due to an FBO's noncompliance, the FRB will notify the FBO and describe the basis for taking such action. Within 14 calendar days or receipt, the FBO may request reconsideration, and the FRB will respond to that request prior to taking the action.[16]

Publicly Traded FBOs with Total Consolidated Assets of $10 Billion or More but less than $50 Billion

- **Responsibilities of FBO and Certification to FRB.** A publicly traded FBO[17] with total consolidated assets of $10 billion or more (but less than $50 billion) has the same risk committee requirements as detailed above for FBOs with at least $50 billion in total consolidated assets but less than $50 billion in US assets. Total consolidated assets for purposes of the risk management requirement are calculated as the average of the total assets for the two most recent periods as reported on the FBO's FR Y-7.
- **Timing of Compliance.** In general, an FBO subject to this section must comply with its requirements beginning on the first day of the ninth quarter either on the date its total consolidated assets are at least $10 billion, or on the date on which any class of stock or similar interest becomes publicly traded, whichever is later. An FBO may cease compliance with this section if its total consolidated assets fall below $10 billion for four consecutive calendar quarters, if its total consolidated assets are at least $50 billion and it becomes subject to the requirements at that level, or if it ceases to be a publicly traded FBO.

US BANK HOLDING COMPANIES

BHCs with Total Consolidated Assets of $50 Billion or More

- **Risk Committee Requirements.** A BHC with total consolidated assets of $50 billion or more must establish an enterprise-wide risk committee with the same risk management framework, member qualifications, and responsibilities as smaller BHCs, as discussed below. However, for large BHCs, the risk committee's responsibilities also include liquidity risk management. A BHC also must appoint a chief risk officer.
- **Corporate Governance Requirements.** In addition to the corporate governance requirements for smaller BHCs, the risk committee must (i) be an independent committee with risk management oversight as its sole function; (ii) report directly to the BHC's board of directors; and (iii) receive and review regular reports at least quarterly from the BHC's chief risk officer. The BHC's parent company's risk committee may still serve as risk committee for one or more of its subsidiaries as long as the requirements of the Final Rule are met.
- **Chief Risk Officer Qualifications and Responsibilities.** The chief risk officer must have risk management expertise in a large, complex financial firm. The chief risk officer is responsible for overseeing: (i) the establishment of risk limits and monitoring compliance with those limits; (ii) the implementation and ongoing compliance with appropriate policies and procedures for risk management governance, practices, and controls, including emerging risks; (iii) managing risk exposures

and risk controls; (iv) monitoring and testing risk controls; (v) reporting risk management issues and emerging risks; and (vi) ensuring that risk management issues are timely and effectively resolved. In response to comments, the chief risk officer is no longer required to have "direct" oversight over the enumerated responsibilities. Under the Final Rule, the chief risk officer may execute his or her responsibilities by working with, or through, others in the organization, including delegating responsibilities to business units.

- **Reporting Requirements and Corporate Governance for Chief Risk Officer.** The chief risk officer must report directly to both the risk committee and the chief executive officer of the BHC. Compensation for the risk officer must be structured to provide for an objective assessment of the risks taken by the company. The FRB acknowledged that a BHC may use discretion in adopting a compensation structure for its chief risk officer, so long as the compensation structure provides for an objective assessment of risks.
- **Timing for Chief Risk Officer.** The requirements to appoint a chief risk officer, including the risk management expertise requirement, will take effect on January 1, 2015, although as a practical matter, most large BHCs already have qualified chief risk officers in place.

Publicly Traded BHCs with Total Consolidated Assets of More than $10 Billion but Less than $50 Billion

- **Establishment and Responsibilities of Risk Committee.** As with similarly sized FBOs, a publicly traded BHC with total consolidated assets of $10 billion or more (but less than $50 billion) is required to establish and maintain a risk committee that approves and periodically reviews the risk-management policies of its global operations and oversees the operation of its global risk management framework. Total consolidated assets for purposes of the risk management requirement are calculated as the average of the total assets for the four most recent quarters as reported on the BHC's FR Y-9C. The BHC's risk management framework must be commensurate with its capital structure, risk profile, complexity, activities, and size must include enumerated policies, procedures, processes, and systems.
- **Risk Committee Member Requirements.** The risk committee must include at least one member with relevant risk management expertise which can be gained from prior experience working for a large, complex bank or for a large, complex nonbanking or nonfinancial firm. The committee must be chaired by an independent director.[18] All committee members must have an understanding of risk management principles and practices relevant to the BHC.
- **Corporate Governance.** The risk committee must have a formal, written charter that is approved by the BHC's board of directors, and must meet quarterly (and otherwise as needed) and fully document and maintain records of its proceedings.
- **Timing of Compliance.** In general, a BHC subject to this section must comply with its requirements beginning on the first day of the ninth quarter either on the date its total consolidated assets are at least $10 billion, or on the date on which any class of stock becomes publicly traded, whichever is later. An FBO may cease compliance with this section if its total consolidated assets fall below $10 billion for four consecutive calendar quarters, if its total consolidated assets are at least $50 billion and it becomes subject to the requirements at that level, or if it ceases to be a publicly traded BHC.

Liquidity Requirements

The Final Rule implements a set of specific liquidity requirements for US BHCs and FBOs that have at least $50 billion in total consolidated assets. Aside from a handful of changes, the liquidity requirements were adopted generally as proposed for both FBOs and BHCs. The liquidity requirements for FBOs that have less than $50 billion in combined US assets (including US Branches and either IHCs or US subsidiaries) are significantly more limited than those for FBOs that have more than $50 billion in combined US assets. Although in many cases the liquidity requirements continue to allow a company the flexibility to take into account its specific circumstances (capital structure, risk profile, complexity, activities, and size), the prescriptive nature of the specific requirements results in a substantial and complex new liquidity regime for FBOs with at least $50 billion in combined US assets. Under the Final Rule, US BHCs with at least $50 billion in total consolidated assets are also subject to a very similar liquidity regime, although those BHCs were already subject to several existing or separately proposed liquidity requirements.

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FBOs with Combined US Assets of $50 Billion or More

FBOs with combined US assets of at least $50 billion face an extensive set of new US-centric liquidity risk management and liquidity stress testing and buffer requirements in the Final Rule. The liquidity risk management framework for these FBOs includes (i) specific liquidity risk management obligations for the US risk committee and chief risk officer, (ii) an independent review function, (iii) internal cash flow projections, (iv) a contingency funding plan, (v) liquidity risk limits, and (vi) liquidity risk monitoring. Liquidity stress tests for US operations must be conducted monthly taking into account the characteristics of the FBO's operations and a range of stress scenarios. Separate liquidity buffers are required for an FBO's IHC and its US Branches, based on the results of the liquidity stress tests. The Final Rule does not impose liquidity requirements on the FBO as a whole, other than requiring FBOs to make available to the FRB the results of any liquidity internal stress tests and information about liquidity buffers required by home country regulators. These requirements are discussed in more detail below.

Framework for Managing Liquidity Risk. The Final Rule splits certain responsibilities for managing liquidity risk between the US risk committee (or a designated subcommittee of the risk committee) and the US chief risk officer of the FBO. The US risk committee (or designated subcommittee) must (i) approve the liquidity risk tolerance of the US operations at least annually, (ii) review information from management at least semi-annually to determine whether the US operations are operating in accordance with the established liquidity risk tolerance, (iii) approve the contingency funding plan at least annually, and (iv) review significant business lines and products to evaluate liquidity risk. The US chief risk officer has a longer list of responsibilities, including (i) reviewing strategies and policies and procedures for managing liquidity risk, (ii) determining whether the US operations are operating in accordance with the established liquidity risk tolerance and reporting that to the US and enterprise-wide risk committees, (iii) reviewing and approving each new business line and product offered through the FBO's US operations that could have a material impact on the liquidity of those operations, (iv) reviewing cash-flow projections at least quarterly, (v) establishing liquidity risk limits and monitoring compliance with those limits at least quarterly, and (vi) approving liquidity stress testing methodologies and assumptions, reviewing the results of liquidity stress testing, and approving the size and composition of the required liquidity buffer, all at least on a quarterly basis. The specific requirements imposed by the Final Rule for many of these responsibilities are discussed further below. In addition, an FBO with combined US assets of at least $50 billion is required to establish an independent review function to evaluate, on at least an annual basis, the liquidity risk management for its combined US operations.

- **Comprehensive Cash-Flow Projections.** The Final Rule requires each FBO to produce and frequently update comprehensive cash-flow projections for its combined US operations over short- and long-term time horizons. The methodology used to produce the cash-flow projections must meet certain specified guidelines.
- **Contingency Funding Plan.** An FBO must establish, maintain, and update at least annually a contingency funding plan for its combined US operations that addresses liquidity needs during liquidity stress events.[19] The contingency funding plan must identify and assess potential liquidity stress events and the manner in which the FBO would respond, including what funding sources and alternative funding sources the FBO would seek to use in such circumstances. The Final Rule requires that the contingency funding plan include an event management process that describes the procedures the FBO will use for maintaining liquidity during identified liquidity stress events, including (i) an action plan for responding to liquidity shortfalls, (ii) a liquidity stress event management team, (iii) the triggers for invoking the contingency funding plan and other decisions, and (iv) the measures for reporting and communication within the FBO and with outside parties. In addition, the contingency funding plan must include procedures for monitoring emerging liquidity stress events. An FBO required to maintain a contingency funding plan must periodically test certain elements of the plan and methods the FBO intends to use for accessing alternative funding sources when needed.
- **Liquidity Risk Limits.** The required liquidity risk limits must include limits on (i) concentrations in sources of funding by instrument type, single counterparty, counterparty type, secured and unsecured funding, and other forms of liquidity risk, (ii) the amount of liabilities that mature within various time horizons, and (iii) off-balance sheet and other exposures. The limits must be consistent with the established liquidity risk tolerance for the combined US operations of the FBO.
- **Risk Monitoring Requirements.** An FBO must establish and maintain procedures for monitoring liquidity risk with respect to (i) collateral both within and across legal entities, currencies, and business lines and (ii) intraday exposures, subject to specified guidelines.
- **Liquidity Stress Testing.** The Final Rule requires an FBO to conduct stress tests at least monthly to assess the potential impact of liquidity stress scenarios on the cash flows, liquidity position, profitability, and solvency of the FBO's (i) combined US operations as a whole, (ii) US Branches, and (iii) IHC. Each liquidity stress test must, at a minimum, cover three scenarios reflecting adverse market conditions, an idiosyncratic stress event for the US Branches and IHC, and combined market and idiosyncratic stresses. Each liquidity stress test must also include planning horizons that extend overnight, 30 days, 90 days, and one year. The Final Rule also imposes other assumptions and requirements with respect to the content of the liquidity stress tests, such as discounts in the fair value of assets to reflect credit risk and diversification of cash-flow sources, as well as certain governance requirements regarding the liquidity stress testing process. The FRB generally expects that any liquid assets and cash-flow sources considered for purposes of the stress tests will be in the same location and legal entity as the outflows. Finally, FBOs generally must make available to the FRB, on a timely basis, the results of any internal

liquidity stress tests and liquidity buffers required by home country regulators.

- **Liquidity Buffer.** The Final Rule requires an FBO to maintain in the United States separate liquidity buffers for its IHC and its US Branches. The liquidity buffer for the IHC must be sufficient to meet the projected "net stressed cash-flow need" over the 30-day planning horizon of the liquidity stress tests, taking into account the various scenarios required for those liquidity stress tests. The liquidity buffer for the US Branches must be sufficient to meet the projected net stressed cash-flow need over only the first 14 days of the 30-day planning horizon. The 14-day requirement for the US Branches represents a change from the FBO Proposal, which would have required the US Branches to maintain the liquidity buffer for the entire 30 days, although the portion beyond 14 days could have been maintained outside the United States. Under the Final Rule, the assets comprising the liquidity buffer for both the IHC and the US Branches must be held in the United States (i.e., reflected on their respective balance sheets). In addition, the cash component of the IHC's liquidity buffer may not be held in an account at an affiliate of the IHC (including a US branch or agency of the FBO), except that an IHC may hold cash at a subsidiary of the IHC. Similarly, the cash component of the US Branches' liquidity buffer may not be held in an account at an affiliate of the US Branches (including the IHC and its subsidiaries). The formula for calculating the net stressed cash-flow need is complex and, despite significant criticism from the industry, remains essentially unchanged from the FBO Proposal. Accordingly, the Final Rule retains the prohibition on netting of internal and external cash-flows, thus restricting the ability of the US operations of an FBO to rely on intra-group cash flows to meet external cash-flow needs.
  - **Composition of Liquidity Buffer.** Each liquidity buffer must consist only of highly liquid assets that are unencumbered. Highly liquid assets specifically include cash, and securities issued or guaranteed by the US government (including its agencies and US government-sponsored enterprises). They also include any other asset that the FBO demonstrates to the satisfaction of the FRB (i) has low credit and market risk, (ii) is traded in an active secondary two-way market, and (iii) is a type of asset that investors historically have purchased in periods of financial market distress during which market liquidity has been impaired. The FRB noted in the preamble to the Final Rule that high-quality liquid assets under the proposed US liquidity coverage ratio (LCR) (discussed below) would generally qualify as highly liquid assets under most scenarios. An asset is unencumbered if it is free of legal, regulatory, contractual, and other restrictions on the ability to liquidate or sell the asset, and is either not pledged to secure credit enhancement to any transaction or is pledged to a central bank or US-government sponsored enterprise to the extent credit secured by the pledge is not currently being extended. The Final Rule makes clear that assets pledged by a US Branch pursuant to the OCC's "capital equivalency deposit" requirement or a state-imposed asset pledge requirement cannot be used for liquidity buffer purposes. The composition of each liquidity buffer is also subject to certain valuation and diversification requirements under the Final Rule.
- **Relationship to Basel III Liquidity Coverage Ratio.** In response to comments concerning the relationship and potential overlap between the two, the FRB emphasized that the liquidity buffer and related liquidity requirements in the Final Rule are intended to complement the Basel III "Liquidity Coverage

Ratio."[20] The liquidity stress tests and buffer requirements of the Final Rule are intended to provide an individualized view of a firm under multiple scenarios, including assumptions adopted by the company in light of its specific products and risk profile. By contrast, the Basel III LCR framework and US LCR proposal are designed to provide a standardized measure of liquidity adequacy under specified and detailed supervisory assumptions regarding factors such as cash outflows and inflows, thereby facilitating transparency across companies. The FRB views both as key components of robust liquidity risk management practices. The FRB also noted that it intends through future rulemakings to apply the US LCR standards to the US operations of "some or all" FBOs with at least $50 billion in combined US assets.

FBOs with Combined US Assets of Less than $50 Billion

FBOs that have total consolidated assets of at least $50 billion, but combined US assets of under $50 billion, are subject only to very limited liquidity requirements under the Final Rule, which adopted this aspect of the FRB Proposal without material change. They must report to the FRB on an annual basis the results of an internal company-run liquidity stress test for either the consolidated operations of the FBO as a whole, or the combined US operations of the FBO. This liquidity stress test must be consistent with the BCBS principles for liquidity risk management and must incorporate 30-day, 90-day, and one-year time horizons. Notably, and unlike the parent FBO stress testing requirement for FBOs with combined US assets of at least $50 billion discussed above, this stress testing requirement appears to apply whether or not the FBO's home country regulator actually imposes such a requirement. If an FBO with combined US assets of less than $50 billion fails to comply with the liquidity stress test requirement results, then it must limit the net aggregate amount owed by the FBO's non-US offices and its non-US affiliates to the combined US operations to 25 percent or less of the third-party liabilities of its combined US operations on a daily basis.

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US BHCs with Assets of $50 Billion or More

US BHCs with total consolidated assets of at least $50 billion are subject to a set of liquidity requirements that is substantially the same as for FBOs with combined US assets of at least $50 billion. One key difference, of course, is that the requirements for BHCs apply to the BHC, whereas the requirements for FBOs that have combined US assets of at least $50 billion generally apply only to the US operations of the FBO. Because of the substantial similarity of the two regimes, this section highlights only those key aspects of the requirements for BHCs that significantly differ from those for large FBOs.

- **Framework for Managing Liquidity Risk.** Unlike the responsibilities for FBOs, which are divided between the US risk committee and the US chief risk officer, the requirements for BHCs are allocated among the board of directors, the risk committee (or a designated subcommittee), and senior management. The BHC's board of directors must (i) approve the liquidity risk tolerance of the BHC at least annually, (ii) review information from management at least semiannually to determine whether the BHC is operating in accordance with the established liquidity risk tolerance, and (iii) approve the liquidity risk management strategies, policies, and procedures established by senior management. The risk committee (or a designated subcommittee) must approve the BHC's contingency funding plan at least annually. Senior management is responsible for the remaining liquidity risk management responsibilities, including (i) establishing strategies, policies, and procedures to manage liquidity risk, (ii) developing and implementing measurement and reporting systems, (iii) determining at least quarterly whether the BHC is operating in accordance with its policies and procedures and is otherwise in compliance with its liquidity risk management requirements, (iv) reporting to the board of directors or risk committee concerning liquidity risk profile and tolerance, (v) reviewing and approving each new business line and product that could have a material impact on liquidity and reviewing them to determine whether there are any unanticipated liquidity risks, (vi) reviewing the required cash-flow projections, (vii) establishing liquidity risk limits and reviewing compliance with those limits, and (viii) approving the required liquidity stress testing practices, reviewing the results, and approving the size and composition of the liquidity buffer, all on at least a quarterly basis. In response to comments, the Final Rule does shift some responsibilities from the board of directors and the risk committee to senior management in recognition of the fact that the board of directors and the risk committee should have more of an oversight and monitoring role.

- **Liquidity Buffer.** BHCs with total consolidated assets of at least $50 billion are required to establish a liquidity buffer that, like the liquidity buffers required for FBOs with combined US assets of at least $50 billion, is comprised of similar assets and is sufficient to meet the projected net stressed cash-flow need over the same 30-day planning horizon and scenarios. However, unlike the separate liquidity buffers required for an FBO's IHC and its US Branches, there is only one consolidated liquidity buffer for a BHC. Moreover, the restrictions on netting internal and external cash-flow requirements for FBOs do not apply to BHCs under the Final Rule since the buffer is established on a consolidated basis.

Capital Stress Test Requirements

Section 165(i)(1) of the Dodd-Frank Act requires the FRB to conduct annual stress tests of US BHCs with total consolidated assets of $50 billion or more, including those owned by FBOs. In addition, section 165(i)(2) of the Dodd-Frank Act requires the FRB to issue rules that require certain regulated financial companies, including FBOs and foreign savings and loan holding companies (FSLHCs) with total consolidated assets of more than $10 billion, to conduct company-run stress tests.

The FRB has already issued final rules regarding stress testing of large US BHCs and already conducts supervisory stress tests under those rules. For example, in November 2011, the FRB issued the CCAR rules, the operation of which is informed by supervisory stress test results. In October 2012, the FRB issued rules implementing supervisory and company-run stress testing requirements for a larger group of US BHCs.[21] Finally, in November 2013, the FRB issued its annual instructions for the 2014 CCAR program applicable to BHCs with $50 billion or more of total consolidated assets and the annual scenarios for the stress tests required of BHCs, savings and loan holding companies (SLHCs), and state member banks with $10 billion or more of total consolidated assets.[22]

The Final Rule generally adopted the Domestic Proposal and FBO Proposal requirements without significant modification.

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The FBO Proposal sought to adapt for FBOs the requirements of stress testing rules already applicable to US BHCs. The Final Rule generally adopts the FBO Proposal without significant modifications. The stress test cycle will begin (i) in October 2015 for US BHC subsidiaries of FBOs that currently rely upon Supervision and Regulation Letter SR 01-01; (ii) in July 1, 2016 for FBOs with total consolidated assets of more than $10 billion but less than $50 billion; and (iii) in October 2017 for IHCs.

Stress Tests for FBOs with Combined US Assets of $50 Billion or More

- **Home-Country Stress Testing.** An FBO with combined US assets of $50 billion or more that has a US Branch must provide the FRB with information about its home-country consolidated capital stress testing activities and results by January 5 of each year. The home-country stress testing regime must include either (i) an annual supervisory capital stress test conducted by the FBO's home-country supervisor or (ii) an annual evaluation and review by the FBO's home-country supervisor of an internal capital adequacy stress test conducted by the FBO. The information the FBO is required to submit to the FRB includes: (i) a description of the types of risks included in the stress test; (ii) a description of the conditions or scenarios used in the stress test; (iii) a summary description of the methodologies used in the stress test; (iv) estimates of the FBO's projected financial and capital condition; and (v) an explanation of the most significant causes for the changes in regulatory capital ratios as shown in the stress test.

  Significantly, if the US Branches are in a net due from position to the FBO, calculated as the average daily position from a given October-to- October period, the FBO would be required to report additional information to the FRB on its stress tests, including: (i) a detailed description of the methodologies used in the stress test; (ii) detailed information regarding the organization's projected financial and capital position over the planning horizon; and (iii) any additional information the FRB requests.

- **Failure to Comply.** In the event the FBO fails to comply with the stress test requirements listed above, the FBO's US Branches must meet a 108 percent asset maintenance requirement. If the FBO has not established an IHC, it would be required to conduct an annual stress test of its US subsidiaries, either separately or as part of an FRB approved enterprise-wide stress test, to determine whether they have capital necessary to absorb losses as a result of adverse economic conditions, and to report summary information about the results to the FRB on an annual basis. In addition, the FRB may impose intra-group funding restrictions on the US operations of the FBO or may impose increased local liquidity requirements.

Stress Tests for FBOs with Total Consolidated Assets of $50 Billion or More and Combined US Assets of Less than $50 Billion and FBOs and FSLHCs with Total Consolidated Assets over $10 Billion, but Less than $50 Billion

- **Home-Country Stress Testing.** An FBO and an FSLHC with total consolidated assets of more than $10 billion must be subject to a consolidated capital stress testing regime that includes either (i) an annual supervisory capital stress test conducted by the FBO's home-country supervisor or (ii) an annual evaluation and review by the FBO's home-country supervisor of an internal capital adequacy stress test conducted by the FBO. Such an FBO is not subject to separate information requirements imposed by the FRB relating to the results of stress tests.
- **Failure to Comply.** Failure to meet this requirement will result in the FRB requiring the FBO's US Branches to meet a 105 percent asset maintenance requirement (lower than the 108 percent requirement above due to the more limited risk this category of FBO poses to the US economy) and the FBO to (i) conduct an annual stress test of its US subsidiaries, either separately or as part of an enterprise-wide stress test, to determine whether they have the capital necessary to absorb the results of adverse economic conditions and (ii) submit a report on the test to the FRB on an annual basis.

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The Domestic Proposal sought to incorporate the FRB's existing standards for capital planning and stress testing that were issued in 2011 and 2012. The Final Rule generally adopts the Domestic Proposal. The stress testing requirements applicable to US BHCs with $50 billion or more in consolidated assets also apply to IHCs.[23]

Supervisory Stress Tests for US BHCs with Total Consolidated Assets of $50 Billion or More and Nonbank Financial Companies Supervised by the FRB

- **Covered Companies.** A US BHC, including a subsidiary of an FBO, with average total consolidated assets of $50 billion or more (calculated from the four most recent FR Y-9C filings) or a nonbank financial company supervised by the FRB (collectively, a "covered company") is subject to supervisory capital stress testing by the FRB that evaluates the ability of the covered company to absorb losses in specified economic and financial conditions.
- **Submission of Information in Response to FRB Scenarios.** The FRB will notify covered companies of its planned scenarios (at least three) no later than November 15 of each year, except for trading and other components, which will be communicated by December 1. The covered company is required to submit the information needed by the FRB to conduct its analysis, and this information is covered by the FRB's confidential supervisory information regulations.
- **Summary of Results.** By March 31, the FRB will communicate a summary of the results to the covered company and publicly disclose that summary. The covered company is required to use the results of the stress testing in (i) its capital plan and capital planning process; (ii) assessing its exposures, concentrations, and risk positions; and (iii) its update to its resolution plan.

Company-Run Stress Tests for US BHCs with Total Consolidated Assets of $50 Billion or More and Nonbank Financial Companies Supervised by the FRB

- **Annual Stress Test.** A US BHC, including a subsidiary of an FBO, with average total consolidated assets of $50 billion or more (calculated from the four most recent FR Y-9C filings) or a nonbank financial company supervised by the FRB (collectively, a "covered company") is required to conduct an annual stress test by January 5 based on data as of September 30 of the preceding calendar year using scenarios provided by the FRB. The FRB will provide the scenarios no later than November 15, except for a trading and counterparty activity component or other component, which will be provided by December 1.
- **Mid-Cycle Stress Test.** In addition to the annual stress test, a covered company must conduct a mid-cycle stress test by July 5 based on data as of March 31 of that calendar year using its own scenarios. A covered company's scenarios must include a minimum of three scenarios: a baseline scenario, an adverse scenario, and a severely adverse scenario.
- **Reporting Stress Test Results.** The covered company must report the results of the annual company-run stress test to the FRB by January 5 and the results of the mid-cycle stress test by July 5. The covered company's report to the FRB is covered by the FRB's confidential supervisory information regulations, but the covered company is required to disclose summaries of the annual and mid-cycle stress tests between March 15 and March 31 and September 15 and September 30, respectively.
- **Use of Stress Test Results.** The board of directors and senior management must use the results of the stress tests in (i) their capital plan and capital planning process; (ii) assessing their exposures, concentrations, and risk

positions; and (iii) their update to the covered company's resolution plan.

Company-Run Stress Tests for US BHCs, US SLHCs, and State Member Banks with Total Consolidated Assets Over $10 Billion and Less than $50 Billion

- **Annual Stress Test.** US BHCs or US SLHCs or state member banks with total consolidated assets of greater than $10 billion, as measured by the four most recent FR Y-9C filings or Call Reports are required to conduct annual stress tests. For US SLHCs with total consolidated assets of $50 billion or more and state member banks that are subsidiaries of covered companies (defined above), the stress test must be conducted and reported to the FRB by January 5 using data as of September 30 of the preceding year. For US BHCs and US SLHCs and state member banks that are not subsidiaries of covered companies, the stress test must be conducted and reported to the FRB by March 31 using data as of September 30 of the preceding year. The FRB will notify the US BHCs, US SLHCs, and state member banks of its planned scenarios no later than November 15 of each year, except for trading and other components, which will be communicated by December 1.
- **Reporting Stress Test Results.** The report by the US BHC, US SLHC, or state member bank to the FRB is covered by the FRB's confidential supervisory information regulations, but the US BHC, US SLHC, or state member bank is required to disclose a summary of the stress test between June 15 and June 30 or March 15 and March 31, depending on its classification. The disclosures will be required for stress tests conducted during the cycle beginning October 1, 2014. A state member bank that is a subsidiary of a BHC may satisfy its disclosure obligation through its parent's disclosure, unless the FRB determines the BHC's disclosures do not adequately capture the potential impact of the scenarios on the capital of the state member bank.
- **Use of Stress Test Results.** The board of directors and senior management must consider the results of the stress tests in their normal course of business, including (i) capital planning; (ii) capital adequacy assessments; and (iii) risk management practices.

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Endnotes

[1] The Final Rule, which is currently only available in draft form, is available at http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20140218a1.pdf. The Final

Rule has not yet been published in the Federal Register. The Final Rule generally does not apply to US and foreign savings and loan holding companies, but the Final Rule does impose stress test requirements on such companies, as discussed in more detail below.

[2] The Mayer Brown Legal Update about the FBO Proposal is available at http://www.mayerbrown.com/files/Publication/c49271f3-cab0-4119-a561-e8b5cc1c8377/Presentation/PublicationAttachment/bff31254-7fe5-4784-b666-b0364bf4a79c/UPDATE-FSRE_Prudential%20Standards%20NonUS%20Bank_1212_V2.pdf.

[3] The BCBS "large exposure" proposal is available at http://www.bis.org/publ/bcbs246.pdf.

[4] *See, e.g.,* Jim Puzzanghera, *European Regulator Concerned about New Fed Rules for Foreign Banks*, L.A. TIMES, Feb. 19, 2014, available at http://www.latimes.com/business/money/la-fi-mo-federal-reserve-europe-foreign-bank-rule-20140219,0,1479375.story#axzz2uMxIqTlF; *see also* Jim Brunsden, *US Foreign Bank Rule Risks Fragmenting Markets, Barnier Says*, BLOOMBERG, Feb. 20, 2014, available at http://www.bloomberg.com/news/2014-02-20/u-s-foreign-bank-rule-risks-fragmenting-markets-barnier-says.html.

[5] For instance, Deutsche Bank recently announced that it will reduce its US operations by $100 billion in response to the Final Rule. *See, e.g., Deutsche Bank to Slash US-based Assets by $100 Billion: FT*, REUTERS, Feb. 23, 2014, available at http://www.reuters.com/article/2014/02/23/us-fed-banks-deutsche-idUSBREA1M15Q20140223.

[6] Preamble at 150.

[7] Section 2(h)(2) of the BHCA allows certain FBOs to hold interests in certain non-US nonfinancial companies that are principally engaged in business outside the United States, even when those firms conduct business in the United States, assuming certain conditions are met.

[8] 12 USC 1841(a)(2).

[9] Preamble at 150.

[10] "US Basel III" refers to the revised US capital framework adopted in July 2013, which incorporated not only the BCBS Basel III framework, but also elements of Basel II that had not previously been adopted in the United States and certain amendments to the US regulatory capital framework required by the Dodd-Frank Act. 78 Fed. Reg. 62018 (Oct. 11, 2013).

[11] All eligible IHCs are permitted to use the US advanced approaches rules if they choose to do so, either by "opting in" to the advanced approaches regime or, in the case of an IHC that is a BHC, by declining to seek FRB approval not to comply with those requirements.

[12] 12 C.F.R. 217.61.

[13] BCBS, "Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement" (July 2013), available at: http://www.bis.org/publ/bcbs255.pdf.

[14] Capital Plans, 76 Fed. Reg. 74631 (Dec. 1, 2011), available at http://www.gpo.gov/fdsys/pkg/FR-2011-12-01/pdf/2011-30665.pdf; Supervisory and Company-Run Stress Test Requirements for Covered Companies, 77 Fed. Reg. 62378 (Oct. 12, 2012), available at http://www.gpo.gov/fdsys/pkg/FR-2012-10-12/pdf/2012-24987.pdf.

[15] For FBOs with combined US assets of $50 billion or more, an independent member is a member who (i) is not an officer or employee of the company or its affiliates and has not been an officer or employee of the company or its affiliates during the previous three years; and (ii) is not a member of the immediate family of a person who is, or has been within the last three years, an executive officer of the company or its affiliates.

[16] We note that, in the text of the Final Rule as currently drafted, this notification process only applies to FBOs with total consolidated assets of at least $50 billion but with less than $50 billion in combined US assets and to publicly traded FBOs with at least $10 billion in total consolidated assets, but not to FBOs with US assets of $50 billion or more. No justification for this different treatment is given, and it may be an oversight that will be corrected when the Final Rule is published in the Federal Register.

[17] An FBO is a "publicly traded company" if any class of stock (or similar interest, such as an American Depositary Receipt) is publicly traded.

[18] The Final Rule clarifies that an independent director for a BHC is one who (i) is not an officer or employee of the BHC and has not been an officer or employee of the BHC during the previous three years; (ii) is not a member of the immediate family, as defined in Regulation Y, of a person who is, or has been within the last three years, an executive officer of the bank holding company, as defined in Regulation O; and (iii)(A) is an independent director under the US Securities and Exchange Commission's ("SEC") Regulation S-K, if the BHC has an outstanding class of securities traded on an exchange registered with the SEC as a national securities exchange; or (B) would qualify as an independent director under the listing standards of a national securities exchange, as demonstrated to the satisfaction of the FRB, if the BHC does not have an outstanding class of securities traded on a national securities exchange.

[19] The Final Rule is limited to the US operations of FBOs and does not purport, for example, to cover the FBO's global US dollar funding needs.

[20] Information about the BCBS's Basel III LCR is available at http://www.bis.org/publ/bcbs238.htm. In October 2013, the FRB, together with the other federal banking regulators, proposed a US LCR based on the Basel III LCR. The proposed US LCR would apply to all internationally active banking organizations, generally, bank holding companies, certain savings and loan holding companies, and depository institutions with more than $250 billion in total assets or more than $10 billion in on-balance sheet foreign exposure, and to their consolidated subsidiaries that are depository institutions with $10 billion or more in total consolidated assets. A modified version of the US LCR would be applied to BHCs and certain savings and loan holding companies with $50 billion or more in consolidated assets. A copy of the US LCR proposal is available at http://www.gpo.gov/fdsys/pkg/FR-2013-11-29/pdf/2013-27082.pdf. The Mayer Brown Legal Update about the US LCR proposal is available at http://www.mayerbrown.com/The-US-Federal-Reserve-Board-Proposes-a-Liquidity-Coverage-Ratio-For-Large-Banking-Organizations-and-Systemically-Important-Non-Banks-10-30-2013/.

[21] 77 Fed. Reg. 62378 (Oct. 12, 2012) (supervisory and company-run stress testing requirements for BHCs with total consolidated assets of $50 billion or more and nonbank financial companies supervised by the FRB); 77 Fed. Reg. 62396 (Oct. 12, 2012) (company-run stress test for BHCs with consolidated assets of more than $10 billion but less than $50 billion).

[22] Comprehensive Capital Analysis and Review 2014 Summary Instructions and Guidance (Nov. 1, 2013), *available at* http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20131101a2.pdf; 2014 Supervisory Scenarios for Annual Stress Tests Required under the Dodd-Frank Act Stress Testing Rules and the Capital Plan Rule (Nov. 1, 2013), *available at* http://www.federalreserve.gov/bankinforeg/bcreg20131101a1.pdf. For the 2013-2014 cycle, the CCAR program covers 30 BHCs, while approximately 60 additional BHCs, SLHCs, and state member banks are expected to be subject to non-CCAR company-run stress testing under DFAST. No FBOs are subject to DFAST for the 2013-2014 cycle; existing IHCs (i.e., US domiciled BHCs that are subsidiaries of FBOs and are currently relying on Supervision and Regulation Letter 01-01 issued by the FRB) will not be subject to DFAST until the 2015-2016 cycle.

[23] 12 C.F.R. § 252.153(e)(5).

Table 1

Scope of Application for FBOs

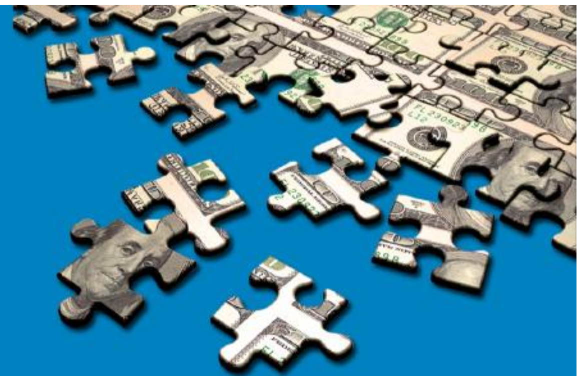
GLOBAL ASSETS	US ASSETS	SUMMARY OF REQUIREMENTS THAT APPLY TO FBOS
> $10 billion and < $50 billion	n/a	• Meet home-country annual capital stress test requirements or comply with a 105% asset maintenance requirement for US branches and agencies and conduct annual stress test of US subsidiaries • If publicly traded, have a risk committee of its global board with responsibility for risk management of US operations (can be part of an enterprise-wide risk committee) and with at least one member with risk management expertise, or face discretionary restrictions on US activities/operations
> $50 billion	< $50 billion	All of the above (including US risk committee requirement), plus: • Meet home-country capital standards, including any minimum leverage ratio and all restrictions based on any applicable capital buffers, that are consistent with global Basel III standards (including transition periods), or face discretionary restrictions on US activities/operations • Subject to an annual company-run liquidity stress test requirement consistent with BCBS principles for either the consolidated FBO or the combined US operations ("noncompliance" results in a cap on funding to head office and affiliates of 25% of third-party liabilities)
> $50 billion	> $50 billion	All of the above, plus: • Subject to US intermediate holding company (IHC) requirements if <u>non-branch</u> US assets of at least $50 billion - All US IHCs are subject to US BHC capital requirements, including any US supplementary leverage buffer and potential G-SIB surcharges (if applicable, based on size) - All US IHCs are subject to capital planning (CCAR) and capital and liquidity stress testing requirements to the same extent as large US BHCs, which include annual supervisory stress tests and mid-cycle company-run stress tests - All US IHCs must maintain their own risk committee (which can also serve as the overall US risk committee for the FBO) that oversees a formal risk-management framework • Have a local US chief risk officer, in addition to the US risk committee (which must have at least one independent member), and which together oversee and implement the risk management framework and policies and procedures for the US operations, including for liquidity risk management • Comply with extensive liquidity risk management obligations with respect to its US operations, including liquidity risk tolerance, liquidity risk limits, monthly company-run liquidity stress tests, contingency funding planning, and liquidity buffers (30 days for IHC; 14 days for US branches and agencies) • Report to the FRB the results of the annual home-country capital stress testing ("noncompliance" results in a 108% asset maintenance requirement for US branches and agencies and, if no IHC, requirement to conduct annual stress test of US subsidiaries and possible intra-group funding restrictions) and home-country liquidity stress testing (if any)

Table 2:

Scope of Application for BHCs

TOTAL ASSETS	SUMMARY OF REQUIREMENTS THAT APPLY TO BHCS
> $10 billion and < $50 billion	• Perform annual company-run capital stress tests, the results of which must be reported to the FRB and a summary of which must be publicly disclosed • If publicly traded, have a risk committee approved by the board of directors that (i) approves and periodically reviews the risk-management policies of the BHC's global operations and (ii) oversees the operation of the BHC's global risk-management framework
> $50 billion	The above, including the risk committee requirements, plus: • Comply with risk-based and leverage capital regulations and previously adopted capital planning (CCAR) and stress test requirements, which include annual supervisory stress tests and mid-cycle company-run stress tests • Comply with extensive liquidity risk management obligations, including liquidity risk tolerance, liquidity risk limits, monthly company-run liquidity stress tests, and liquidity stress event contingency funding planning • Maintain a 30-day liquidity buffer of highly liquid assets sufficient to meet net stressed cash-flow needs, as determined through the monthly company-run liquidity stress tests • Include liquidity risk management within the risk committee's responsibilities and designate the risk committee as a committee of the board of directors • Have a chief risk officer, in addition to the risk committee (which must have at least one independent member), and which together with the board of directors and senior management, approve, oversee, and implement the risk management framework and policies and procedures for the BHC, including for liquidity risk management

PANELIST BIOGRAPHIES



THE CONTINUING IMPACT OF

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"Frames issues in a business context and clearly illustrates the pros and cons of alternative strategies."
Legal 500

Scott Anenberg is co-head of the Firm's Financial Services Regulatory and Enforcement Practice. He has over 25 years of experience representing global and domestic commercial banks, thrifts, and other financial services companies, as well as their holding companies and affiliates, on a wide variety of strategic, regulatory, compliance, and enforcement issues before federal and state agencies.

Scott has consistently been ranked by *Chambers USA* and *Legal500* and he is noted for being "client focused and proactive in identifying relevant regulatory proposals and explaining their impact," *Chambers USA*. *Legal 500* says Scott is "...the 'go-to person for every complicated or nettlesome issue', and is particularly strong at advising on banking compliance matters." Additionally, Scott's has been recognized for his "longstanding experience in representing a range of financial institutions sees him well placed to tackle a wide range of issues." *Chambers USA 2014*

He regularly advises banking and financial services clients on legislative and regulatory developments; geographic and product expansion; acquisitions and reorganizations; anti-money laundering, USA PATRIOT Act and Bank Secrecy Act compliance; preemption; privacy; transactions with affiliates; regulatory capital; consumer compliance; and electronic banking and commerce.

Earlier in his career, Scott worked for the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency. He is also active in the firm's Israel-related practice.

Experience

- Advising financial institutions on the strategic and operational implications of the "Dodd-Frank Wall Street Reform and Consumer Protection Act".
- Represented the sellers in the seventh largest US bank merger announced in 2008.
- Represented a foreign bank in several transactions designed to rationalize and consolidate its US operations, including precedent-setting transfers of its FDIC-insured branches to its US bank subsidiary made possible by first obtaining an innovative ruling from the FDIC under the Riegle-Neal Interstate Banking Act.
- Helped a federal savings bank in establishing the first-of-its-kind REIT subsidiary as a vehicle to issue tax-advantaged Tier 1 capital.
- Represented a foreign bank in US matters relating to its privatization and subsequent sale of its New York bank subsidiary.

- Advised the US subsidiary of a foreign bank in its acquisition from the FDIC of a failed Florida bank, culminating in a strategy designed to enable the bank to better serve its customer base and pursue new business opportunities in Florida despite that state's restrictive interstate banking laws.
- Represented a large insurance company in various regulatory and enforcement matters relating to its ownership of a thrift.
- Assisted several banks with reviews, internal investigations and potential enforcement actions related to anti-money laundering issues.
- Helped several foreign banks apply to establish branches, representative offices and agencies in the US.
- Helped a major financial services trade group obtain amendments to various aspects of the FDIC's regulations governing US branches of foreign banks.
- Represented domestic and foreign banking clients in establishing securities brokerage subsidiaries in order to comply with the "push-out" provisions of the Gramm-Leach-Bliley Act.
- Obtained the first official interpretation involving the application of FDIC deposit insurance rules to electronic banking products.

Education

- The George Washington University Law School, JD, with high honors, 1978
- Washington University, BA, magna cum laude, 1975; Order of the Coif

Admissions

- District of Columbia, 1978

Activities

- American Bar Association, Banking Law Committee
- Contributing Editor, Electronic Banking Law and Commerce Report (2000-2008)

News & Publications

- "Federal Reserve Issues Final Regulation Implementing Dodd-Frank Section 165 Enhanced Prudential Standards for Large US and Non-US Banking Organizations," *Mayer Brown Legal Update*, 3 March 2014
- "Bank Regulators Approve Final Rule to Implement Basel III Capital Requirements in the United States," *Consumer Finance Law Quarterly Report, Vol. 67 Nos. 1 - 2*, January 2014
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- "Bank Regulators Approve Final Rule to Implement Basel III Capital Requirements in the United States," *Mayer Brown Legal Update*, 15 July 2013
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- "E-Commerce in the Financial Services Sector: A Written Course in IT Law," *IBC Global Conferences Limited*, 13 October 2000
- "Traps for the Unwary Lender: State Law Issues Related to Internet Lending," *Electronic Banking Law and Commerce Report*, 1 September 1998

Events

- Institute of International Bankers: Section 165 Seminar – Application of Enhanced Prudential Standards to Foreign Banking Organizations under Section 165 of the Dodd-Frank Act, 26 March 2014
- Final Dodd-Frank Section 165 Enhanced Prudential Standards for Foreign and US Banks, 27 February 2014
- 2013 IIB/CSBS US Regulatory/Compliance Orientation Program, 4 November 2013
- The Continuing Impact of Dodd-Frank, 26 June 2013
- 7th Annual Investment Management Regulatory University, May 2013
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- 2010 IIB/CSBS Orientation Program, 20 July 2010 - 21 July 2010
- Private Equity Investments in Bank and Thrift Institutions: What is the Current State of Play?, 14 January 2010

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Alexandria Carr is a qualified barrister practising in London as Of Counsel with the Financial Services, Regulatory & Enforcement group. She has worked for the UK government for 13 years, the last five of which she spent at the UK's ministry of finance, HM Treasury, working closely with people across government, the then FSA, the Bank of England, ministries of finance across Europe and the institutions of the EU. Legal 500 2013 praises her recent arrival for giving the group particular expertise on EU financial services regulation. She is exceptionally well-placed to advise financial institutions on critical issues concerning the new regulatory and market developments and the challenges and opportunities they create.

Alexandria was the lead legal adviser on EU financial services strategy with a specific focus on the new EU financial services supervisory architecture. She was the lawyer on the UK team who negotiated the European System of Financial Supervision (ESFS) (which established the new European Supervisory Authorities) and implemented the ESFS in the UK. Following the establishment of the ESFS in January 2011, she advised HM Treasury on the changes it made to the regulation and supervision of financial services. On joining Mayer Brown, she was seconded to HM Treasury to serve as legal advisor to a project team considering recent and projected developments in the Eurozone, including proposals for an EU banking union.

Alexandria also advised HM Treasury on the EU's response to the financial crisis more generally, as the EU seeks to reduce the discretion of individual Member States to legislate domestically and to develop a single EU rulebook for financial services, and on the new system for making subordinate EU financial services legislation (what is known as "level 2") post the Lisbon Treaty. In addition, she was the lawyer on the UK teams negotiating Solvency II, the short selling regulation and MAD II.

Alexandria's main focus is on EU financial services regulation, into which she has a unique insight as a result of her experience in government. As well as providing regulatory advice on transactional matters and advising on discrete regulatory projects, she monitors and provides training on the major regulatory developments that impact our clients. She is regularly quoted in the media, both in the press and on broadcasts.

Admissions

- England and Wales, 1997

Activities

- Member (ex Officio) of the Bar Council
- Sits on the Bar Association for Commerce, Finance and Industry
- Sits on the Bar Council EU law committee

News & Publications

- "The extraterritorial effect of the EU regulation," *Mayer Brown Legal Update*, June 2014
- "Court dashes drive to resist tax on City," *Financial Times,* 30 April 2014
- "Europe's top court rejects UK challenge on financial trading tax," *Reuters*, 30 April 2014
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- Banking Union: A Solution to the Eurozone Sovereign Debt Crisis?, 27 September 2012
- A Single European Rulebook. A Single European Regulator?, 12 July 2012

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Marcus Christian is a Washington DC partner in Mayer Brown's Litigation & Dispute Resolution practice and White Collar Defense & Compliance group. Previously, he was the executive assistant United States attorney at the US Attorney’s Office for the Southern District of Florida, the third-highest ranking position in one of America’s largest and busiest offices of federal prosecutors. In this role, Marcus worked on the senior management team with responsibility for the Criminal, Civil, Appellate, Asset Forfeiture and Administrative Divisions.

During Marcus’ career with Southern Florida’s US Attorney’s Office, he held several roles including serving as a deputy chief in the Major Crimes Section, where he trained and supervised AUSAs, led the Identify Theft and Economic Crimes Task Force and oversaw financial investigations in the Major Crimes Section. As an AUSA, he prosecuted cases involving money laundering, healthcare fraud, mail fraud, wire fraud, national security issues and other matters.

Prior to joining the US Attorney’s Office, Marcus was the chief of staff for US Representative Peter Deutsch of Florida’s 20th Congressional District. He joined the congressman after working for TSIC, Inc., a statewide nonprofit organization that provides full-tuition, four-year college scholarships to thousands of Florida's low-income students. At TSIC, Marcus served as chief operating officer and legal counsel and later as president.

Earlier in his career, Marcus was selected by the Attorney General’s Honors Program to work as an attorney in Appellate Section of the Tax Division of the United States Department of Justice in Washington DC. He also clerked for Judge H. Robert Mayer of the United States Court of Appeals for the Federal Circuit in Washington, DC.

Education

- Yale Law School, JD, 1996
- University of Oxford, MSc, 1994; Rhodes Scholar
- Williams College, BA, 1991; *Phi Beta Kappa*

Admissions

- US District Court for the District of Maryland
- US Court of Appeals for the Fifth Circuit
- US Court of Appeals for the Ninth Circuit
- US Court of Appeals for the Tenth Circuit

- US Court of Appeals for the Federal Circuit

Activities

- Member of Leadership Florida
- 5000 Role Models of Excellence Project
- Vice-chair of WLRN Public Radio & Television’s Community Advisory Board. WLRN was winner of three national Edward R. Murrow Awards in 2013, including one for National Network Radio Investigative Reporting

News & Publications

- "Guilt by Association: Anti-corruption Risks Presented by Third-arty Intermediaries," *Inside Counsel*, 28 May 2014
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- "Attorney Marcus Christian Selected for LCLD Fellowship," *The Network Journal*, 13 March 2014
- "Mayer Brown partner Marcus Christian named a 2014 Leadership Council on Legal Diversity Fellow," 4 March 2014
- "Fla. Prosecutor Joins Mayer Brown's White Collar Group In DC," *Law360*, 13 September 2013
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Events

- "Maximizing Data Security in the Age of Stolen Information Alchemy", 2014 Blue National Summit, 21 May 2014
- Global Sourcing and Technology Changes: Reboot Your Sourcing Strategies, 8 May 2014
- "Data Privacy & the Ongoing Potential for Litigation", Minority Corporate Counsel Association 2014 CLE Expo in Los Angeles, 12-13 March 2014
- The Social Media Evolution: Trends, Challenges & Opportunities, 10-11 March 2014

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Marc Cohen's practice includes litigation, banking and securities, regulatory, enforcement, legislative, and strategic counseling matters on behalf of global financial services firms. He focuses on addressing problems that require experience in several of the foregoing areas at the same time, such as private cross-border litigation with parallel regulatory or congressional investigations.

Marc works with all the US financial services regulators – the Federal Reserve, Treasury (OCC, OTS, FinCEN, OFAC), FDIC, SEC – and state banking and insurance departments, as well as with Congress. He also deals with non-US financial supervisors, including the UK FSA, German BaFin, and Swiss Financial Markets Supervisory Authority.

Marc has extensive experience with anti-money laundering issues, including those involving the USA PATRIOT Act and politically exposed persons, as well as US economic (OFAC) sanctions. He is currently counseling several leading non-US-based institutions on adoption of their global sanctions policies.

Marc clerked for the Honorable José A. Cabranes in 1984-85.

Education

- Yale Law School, JD, 1984
- Yale University, BA, 1981

Admissions

- District of Columbia, 1991
- Connecticut, 1985

News & Publications

- "US Supreme Court Dramatically Narrows Grounds for General Personal Jurisdiction," *Mayer Brown Legal Update*, 13 March 2014
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Events

- The Continuing Impact of Dodd Frank, 26 June 2012

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Josh Cohn is the head of Mayer Brown's US Derivatives & Structured Products practice and co-leader of the global Derivatives & Structured Products practice. He concentrates his practice on derivatives and has extensive experience as US counsel to the International Swaps and Derivatives Association (ISDA), and represents dealers and end-users in a wide range of transactions.

Prior to joining Mayer Brown from Allen & Overy, Josh was the Derivatives Counsel at Cravath Swaine & Moore in New York; Senior Vice President and General Counsel at DKB Financial Products, Inc.; First Vice President and Counsel at Security Pacific National Bank; an Associate at LeBoeuf, Lamb, Leiby & Macrae; and a Law Clerk at the US Court of Appeals - Ninth Circuit.

Josh is listed for derivatives law in The Best Lawyers in America while the *IFLR 1000* and *The Legal 500* list Josh as one of the world's leading derivatives lawyers. Josh has been ranked in band 1 of *Chambers USA* since 2008. In 2013, *Chambers USA* characterized Josh as a "luminary." In 2012, *Chambers Global* published clients describing Josh as having "an almost encyclopedic knowledge of the derivatives market." In 2010, sources noted his "great depth of experience and understanding of market trends." In 2008 and 2009, clients noted he "…is one of the greats in derivatives because of his extensive knowledge" and that he is "doubtless one of the best derivatives lawyers in the world."

Education

- New York University School of Law, JD
- Columbia College, BA

News & Publications

- "CFTC Seeks Comment On November 14 Advisory On Cross-Border "Transaction-Level Requirements"; Staff Extends Relief Until September 15," *Mayer Brown Legal Update*, 6 January 2014
- "Final Regulation Implementing the Volcker Rule," *Mayer Brown White Paper*, 18 December 2013
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- "CFTC Provides Derivatives Prime Brokerage Limited No-action Relief from External Business Conduct Rules," *Mayer Brown Legal Update*, 1 May 2013
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- "US Secretary of the Treasury Exempts FX Swaps and Forwards from Certain Requirements Under the US Commodity Exchange Act," *Mayer Brown Legal Update*, 20 November 2012
- "CFTC Proposes Phased Compliance Program for Certain Swaps," *Mayer Brown Legal Update*, 6 July 2012
- "Proposed CFTC Guidance Regarding the Cross-Border Application of US Swap Regulations," *Mayer Brown Legal Update*, 2 July 2012
- "Pay Practices Could Define Market Making Under Dodd-Frank," *Law360*, 31 May 2012
- "The New CFTC and SEC Swap “Entity” Definitions—Highlights," *Mayer Brown Legal Update*, 30 April 2012
- "Lehman Bankruptcy Court Holds That Pre-Petition Collateral Transfers and Guaranties to Clearing Bank Are Safe Harbored," *Mayer Brown Legal Update*, 26 April 2012
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- "Dodd-Frank Title VII (Swaps) Effectiveness—July 16 and Beyond," *Mayer Brown Legal Update*, 14 June 2011
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- "Comments Requested on Proposed “Key Definitions” of the Wall Street Transparency and Accountability Act," *Mayer Brown Legal Update*, 23 August 2010

Events

- 4th Annual Subscription Credit Facility and Fund Finance Symposium, 16 January 2014
- The CFTC’s Final Cross-Border Guidance and the EC-CFTC Path Forward, 3 October 2013
- The Continuing Impact of Dodd-Frank, 26 June 2013
- PLI’s Advanced Swaps & Other Derivatives 2012, 16-17 October 2012
- PLI’s Fundamentals of Swaps & Other Derivatives 2012, 15 October 2012
- CFTC Proposal for Cross-Border Application of US Swaps Regulations, 9 August 2012
- The Continuing Impact of Dodd Frank, 26 June 2012
- PLI’s Advanced Swaps & Other Derivatives 2011, 18 October 2011 - 19 October 2011
- Fundamentals of Swaps and Other Derivatives 2011, 17 October 2011
- Dodd-Frank: One Year Later, 27 July 2011
- Implementation of the Dodd-Frank Act – Implications for Internationally Headquartered Banking Organizations: Part 1: OTC Derivatives Regulation and the Volcker Rule, 5 April 2011

- Hot Topics in Insurance Regulation, 30 September 2010
- Greek Sovereign Default: What Happens Next?, 18 May 2010

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Tom Delaney is a partner in Mayer Brown's Washington DC office and represents a broad range of financial services organizations. He assists both US-based and international firms to anticipate and overcome regulatory, supervisory, and structural impediments to their corporate objectives. Tom possesses a comprehensive knowledge of US financial services law, with particular emphasis on funds transfer concerns that arise in the context of anti-money laundering (Bank Secrecy Act and USA Patriot Act) and sanctions compliance. He provides strategic advice to internationally active firms on cross – border matters, particularly with respect to overlapping and potentially conflicting provisions of US and international law. Recently, Tom has devoted substantial time to counseling clients on complying with the new requirements mandated by the Dodd-Frank Act. He oversees the conduct of internal investigations and defends financial services firms that are the subject of enforcement proceedings and Congressional investigations.

Tom is highly respected for his insightful corporate and regulatory counsel and for his demonstrated success in providing thoughtful strategic advice to organizations facing long-term threats to their operational viability or reputational integrity. *Chambers USA 2014* reports that Tom is recognized for "his focus on Dodd-Frank compliance. He is noted by clients for the deep expertise that he brings to his practice, and is characterized as a "thoughtful and practical" attorney."

Tom has been practicing law for more than 25 years, initially as an attorney with the US Treasury Department's Office of Thrift Supervision. He entered private practice in 1991 and joined Mayer Brown in 2006. Prior to practicing law, he served on the staff of the Committee on Financial Services of the US House of Representatives and on the staff of the US Senate. He has represented clients before the Federal Reserve, the Department of Treasury, the Federal Deposit Insurance Corporation (FDIC), the Securities and Exchange Commission (SEC), the Financial Crimes Enforcement Network (FinCEN), the Office of Foreign Assets Control (OFAC), and the Consumer Finance Protection Bureau (CFPB). Also, he has appeared before various state authorities, including in New York, California, Illinois, Florida, and the District of Columbia. In addition to financial services firms, Tom has advised foreign governments on their establishment of regulatory and enforcement systems that conform with international standards, including those specified by such bodies as the OECD's Financial Action Task Force.

Education

- American University Washington College of Law, JD, 1986
- Georgetown University, BA, 1979

Admissions

- District of Columbia, 1995
- New Jersey, 1987
- Pennsylvania, 1987

Activities

- American Bar Association, Section of Business Law

News & Publications

- "Federal Reserve Issues Final Regulation Implementing Dodd-Frank Section 165 Enhanced Prudential Standards for Large US and Non-US Banking Organizations," *Mayer Brown Legal Update*, 3 March 2014
- "Federal Reserve Proposes Enhanced Prudential Standards for Non-US Banking Organizations," *Mayer Brown Legal Update*, 20 December 2012
- "US FDIC and Federal Reserve Propose Rule on Resolution Plans and Credit Exposure Reports," *Mayer Brown Legal Update*, 2 May 2011
- "The Foreign Account Tax Compliance Act and Its Implications to Non-U.S. Banks and Brokerage Houses," *Bloomberg*, 7 September 2010
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  Ranked in 2010 Edition of IFLR1000," 9 October 2009
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Events

- Final Dodd-Frank Section 165 Enhanced Prudential Standards for Foreign and US Banks, 27 February 2014
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- Federal Reserve Board Proposes New Section 165 Rules for Foreign Banks with US Operations, 20 December 2012
- FATCA and the Implementation Timeline, 29 November 2012
- The Continuing Impact of Dodd Frank, 26 June 2012
- Update on the Recently Enacted FATCA and its Implications for Non-US-Based Financial Intermediaries, 15 September 2011
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- Implementation of the Dodd-Frank Act – Implications for Internationally Headquartered Banking Organizations: Part 2: Implementation of Other Key Provisions of Dodd-Frank for International Banks, 12 April 2011
- Banking and Financial Services Mid Term Election Impact, 29 October 2010

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In the course of her transactional practice, Julie Gillespie helps clients to address a wide variety of securitization, banking and finance issues. She has extensive experience representing commercial banks and special-purpose conduits with regard to receivables securitization and other asset-backed transactions.

In addition, Julie advises commercial banks and financial institutions concerning lease and receivables purchase programs, and she negotiates and documents secured and unsecured lending agreements.

Julie joined the Chicago Office of Mayer Brown in 1996.

Education

- Duke University School of Law, JD, 1996
- University of Maryland, Baltimore, BA, 1993; Valedictorian

Admissions

- Illinois, 1996

News & Publications

- "Overview of the Proposed Credit Risk Retention Rules for Securitizations," *Mayer Brown White Paper*, 8 April 2011
- "SEC Adopts Final Rules Related to Issuer Due Diligence Review of Assets and Disclosure of Underwriting Exceptions in Public Offerings of Asset-Backed Securities," *Mayer Brown Legal Update*, 2 February 2011
- "US SEC Proposes Rules on ABS Warranty Repurchase Reporting," *Mayer Brown Legal Update*, 6 October 2010
- "FDIC Adopts New Securitization Safe Harbors," *Mayer Brown Legal Update*, 1 October 2010

Events

- FDIC Adopts New Securitization Safe Harbors, 7 October 2010

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"An incredible legal strategist and a fantastic leader."

"'His academic and practical contribution to the field is outstanding,' say observers, adding that he 'wrote the book on securitization, literally' and 'has played a pivotal role in many regulatory initiatives.'" Chambers USA

Jason is the founder of Mayer Brown's securitization practice and was co chair of the firm from 1998-2001. He has helped the firm's clients create some of the most significant securitization products used in the capital markets today (such as the use of true liquidity in ABCP Vehicles) and is well known for being a Co-Founder of the Securitization Industry's original trade association; leading industry groups in connection with new legislation or regulation; helping to lead large securitization transactions such as MLEC ($100 billion) and Straight A funding ($60 billion) and large RMBS mortgage litigation settlements such as the BofA/BNY Mellon $8.5 billion settlement.

Jason is listed as the "pre-eminent securitization lawyer" by Chambers Global and was described as, "a quarter back figure who is 'an incredible legal strategist and a fantastic leader'" according to clients in Chambers USA. He is also an Adjunct Professor of Law at Northwestern University Law School and New York University Law School and an adjunct professor at the Kellogg School of Management at Northwestern. In 2010, Jason was chosen by the Financial Times as one of the 10 most innovative lawyers in America and was chosen as the "Best Lawyer in Securitization in NYC" by "Best Lawyers 2012 Lawyers of the Year".

Jason graduated with an AB, Phi Beta Kappa, from the Johns Hopkins University, a JD, cum laude, from Harvard Law School, and a Dipl. Comp. Law from Cambridge University in the UK.

Experience

- Creation of Straight-A Funding, LLC, a $60 billion asset-backed commercial paper conduit to finance the student loan industry with support from the Department of Education and the Federal Financing Bank.
- Creation of the form customer agreement documentation for the TALF program (and representing many of the primary dealers in their customer agreement negotiations) and several of the first TALF transactions.
- Represented industry groups such as large issuers of asset-backed securities, sponsors of ABCP Conduits, the Securities Industry and Financial Markets Association (SIFMA), and the European Securitization Forum with regard to securitization regulatory initiatives, including, for example,

the Basel Committee on Banking Supervision's Risk-Based Capital Consultative Papers, the FFIEC's Risk-Based Capital projects, the FASB's new Standards for Securitization, SFAS #125 and #140, the FASB's Standard for Consolidation, Fin 46R, and SEC Amendments to Rule 2a-7 and Reg AB.

- Served as one of the organizers and senior officers of the securitization industry's trade association, the American Securitization Forum.
- Represented the Sponsoring Banks in structuring the $100 Billion SIV rescue vehicle, Master Liquidity Enhancement Conduit.
- Helped to create some of the most significant securitization products used in the capital markets today, including the first partially enhanced, multi-seller, asset-backed commercial paper vehicle in 1989 and the first CLO, FRENDS in 1988.

Education

- University of Cambridge, 1973; Diploma, Comparative Law
- Harvard Law School, JD, cum laude, 1972
- The Johns Hopkins University, AB, 1969; Phi Beta Kappa

Admissions

- New York, 2002
- Illinois, 1974
- US Court of Appeals for the Seventh Circuit, 1974

Activities

- The Johns Hopkins University Alumni Advisory Council, 1991-1997, Advisory Board to the Dean of the School of Arts & Sciences, 1999 to 2009; Chair 2006-2007
- Chairman, The Johns Hopkins University Illinois Alumni Executive Committee, 1990-1994
- Director and Chairman, The Cameron Kravitt Foundation, 1985 to date
- Board of Managers, YMCA of Metropolitan Chicago, 1999-2001
- Principal, Chicago United, 1997-2001
- Deputy Chair, American Securitization Forum
- Director, European Securitization Forum
- Committee on Business Financing; Vice Chair Subcommittee on Securitization Litigation, American Bar Association,
- Chicago Bar Association Committees on Financial Institutions and Commercial Transactions
- Chicago Council of Lawyers
- Subcommittee on Securitization, New York City Bar Association
- Adjunct Professor of Law, Northwestern University School of Law
- Adjunct Professor of Finance, Kellogg Graduate School of Management of Northwestern University
- Fellow, American College of Commercial Finance Lawyers
- Advisory Board, The Financier and The Securitization Conduit, 1996 to date
- Advisory Board of The Securitization Conduit Publications
- Advisory Board, American Securitization
- Advisory Board, Duke University Capital Markets Center

News & Publications

- "Bank Regulators Approve Final Rule to Implement Basel III Capital Requirements in the United States," *Consumer Finance Law Quarterly Report, Vol. 67 Nos. 1 - 2*, January 2014
- "Revisions to Basel Securitisation Framework - Second Consultative Document," *Mayer Brown Legal Update*, 22 January 2014
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- "The US Banking Regulators Propose a Liquidity Coverage Ratio For Large Banking Organizations and Systemically Important Non-Banks," *Mayer Brown Legal Update*, 30 October 2013
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- "Bank Regulators Approve Final Rule to Implement Basel III Capital Requirements in the United States," *Mayer Brown Legal Update*, 15 July 2013
- "Q&A: Jason Kravitt on securitization and frequent flying," *Thomson Reuters News & Insight*, 16 May 2013
- "BofA Jumbo-Deal Delay Shows Market on Life Support: Mortgages," *Bloomberg*, 13 December 2012
- "Federal Reserve Board Approves Basel III Proposals and Market Risk Capital Rule," *Mayer Brown Legal Update*, 8 June 2012
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- "Overview of the Proposed Credit Risk Retention Rules for Securitizations," *Mayer Brown White Paper*, 8 April 2011
- "What to Look for in Securitization Regulation in 2011," *Mayer Brown White Paper*, 30 March 2011
- "Courts Uphold MERS Serving as “Nominee” on Mortgage Instruments," *Mayer Brown Legal Update*, 4 March 2011
- "Basel Committee Releases Final Text of Basel III Framework," *Mayer Brown Legal Update*, 7 January 2011
- "US SEC Proposes Rules on ABS Warranty Repurchase Reporting," *Mayer Brown Legal Update*, 6 October 2010
- "FDIC Adopts New Securitization Safe Harbors," *Mayer Brown Legal Update*, 1 October 2010
- "Financial Reform and Securitization," *Mayer Brown Legal Update*, 15 July 2010
- "FDIC Proposal Links Market Reform to the Securitization Safe Harbor," *Mayer Brown Legal Update*, 18 May 2010
- "Summary of the US SEC’s ABS Rule Change Proposal," *Mayer Brown Legal Update*, 21 April 2010
- "US SEC Proposes Massive ABS Rule Changes," *Mayer Brown Legal Update*, 8 April 2010
- "US SEC Adopts Amendments to Rule 2a-7 Affecting Money Market Funds," *Mayer Brown Legal Update*, 7 April 2010
- "FDIC Board Votes to Extend the Securitization Safe Harbor," *Mayer Brown Legal Update*, 12 March 2010
- "Basel II Modified in Response to Market Crisis," Winter 2010
- "Mortgage investors try to regroup after meltdown," *Associated Press*, 4 February 2010
- "Securitization of Financial Assets," *Aspen Law & Business (3rd ed.)*, 2010

- "A Peek at the Future of the FDIC Securitization Safe Harbor," *Mayer Brown Legal Update*, 21 December 2009
- "US Bank Regulators Provide Only Transitional Risk-Based Capital Relief for Securitization Accounting Changes," *Mayer Brown Legal Update*, 16 December 2009
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- "FDIC extends securitization safe harbor," *Institutional Investor*, 12 November 2009
- "Moody's may bear brunt of rating agency mistrust," *Reuters*, 24 September 2009
- "Will the new accounting rules kill securitization?," *Source Media*, 21 September 2009
- "The Other Shoe Drops — US Bank Regulators React to Securitization Accounting Changes," *Mayer Brown Legal Update*, 27 August 2009
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- "Financial Regulation Reform and Securitization," *Mayer Brown Legal Update*, 6 July 2009
- "Big Changes to Securitization Accounting," *Mayer Brown Legal Update*, 22 June 2009
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- "How Feasible Is the Securitization of Loans to Small and Medium-Sized Businesses," *Commercial Lending Review*, Fall 1993
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Events

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- ABS Vegas 2014 Conference, 21-24 January 2014
- The Continuing Impact of Dodd-Frank, 26 June 2013
- Basel RWA Securitization, 28 March 2013
- The Continuing Impact of Dodd Frank, 26 June 2012
- Dodd-Frank: One Year Later, 27 July 2011
- A New World for Securitization?, 18 June 2009

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Michael Lewis is a Financial Services Regulatory & Enforcement associate in Mayer Brown's Washington DC office. His practice focuses primarily on advising domestic and non-US banks and other financial services firms on a variety of regulatory, compliance, enforcement, and transactional matters. Michael has experience advising on legislative and regulatory developments, investment authority questions, affiliate transactions, payment systems, financial holding company status, regulatory reporting requirements, and branching issues. A significant portion of his practice is currently devoted to advising clients on the interpretation of, and compliance with, key provisions of the Dodd-Frank Act, particularly the Volcker Rule and enhanced prudential standards.

Michael also has experience representing both public and private financial institutions on a range of transactions, including mergers, acquisitions, divestitures, stock and asset sales, and minority investments. He has drafted and negotiated transaction agreements and prepared the corresponding applications for regulatory approval at both the state and federal levels.

Finally, Michael also has experience advising domestic and non-US financial services firms with internal investigations and enforcement matters. Michael has represented clients in connection with settlements with the Board of Governors of the Federal Reserve System, the Securities and Exchange Commission, and various state regulators and self-regulatory organizations.

Prior to joining the firm in 2013, Michael held a position at a prominent New York firm.

Education

- University of Virginia, JD, 2007
- Emory University, BA, summa cum laude, 2004

Admissions

- District of Columbia, 2014
- New York, 2008

News & Publications

- "Federal Reserve Issues Final Regulation Implementing Dodd-Frank Section 165 Enhanced Prudential Standards for Large US and Non-US Banking Organizations," *Mayer Brown Legal Update*, 3 March 2014
- "Final Regulation Implementing the Volcker Rule," *Mayer Brown White Paper*, 18 December 2013

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"Recognized for his 'responsiveness, accessibility and outstanding service.'" Chambers USA 2009

Stuart M. Litwin is a partner and co-head of the Global Finance Practice at Mayer Brown LLP. Mr. Litwin also co-heads Mayer Brown’s Structured Finance and Capital Markets Practices.

Stuart is one of the leading lawyers in the United States in the representation of originators, investment banks, ABCP conduit sponsors, hedge funds, commercial banks and investors (including mutual funds) in structuring, negotiating and documenting U.S. and international asset-backed and other securities transactions. His experience has involved the securitization of virtually all asset types, and he is recognized as an expert in the securitization and financing of retail and commercial auto loans and leases, FFELP and private student loans, dealer floorplan receivables, equipment leases and loans, global trade finance assets, rental cars, commercial and residential mortgages, cross border transactions, solar leases and power purchase agreements, synthetic risk transfers, money market fund investments and structured transactions in which banks and other clients seek advantageous treatment for accounting, regulatory capital or tax purposes. Mr. Litwin also regularly represents several funds, reinsurance companies and other investors in their “alternative investments” (i.e., unusual assets or finance companies which are more difficult to fund in securitization or banking markets).

Recent important engagements have included:

1) The creation of TradeMAPS, the first multi-issuer trade finance securitization platform to enable banks and others to fund their trade finance portfolios in an off-balance sheet manner without supporting potential losses in the portfolios of other banks. The first transaction, TradeMAPS 2013-1, a securitization of Citibank and Banco Santander portfolios, was selected by IFLR as their 2013 “Deal of the Year.”
2) Assisting Santander Consumer USA, Inc. in the creation and financing of the Chrysler Capital platform, including its $5 billion warehouse financing facility, and
3) The creation of Straight-A Funding, LLC, the $60 billion asset-backed commercial paper conduit to finance the student loan industry with support from the Department of Education and the Federal Financing Bank that saved the student loan industry during the financial crisis,
4) Creating the form customer agreement documentation for the TALF program (and representing many of the primary dealers in their customer agreement negotiations), and working on several of the first TALF transactions,
5) Several tender offers for and restructurings of student loan trusts with auction rate securities,
6) The first ABS offering in the US backed by Australian auto leases,

7) Representing Goldman, Sachs & Co. in the financing of Cerberus's acquisition of Chrysler, the largest-ever use of asset-backed securities in any M&A transaction ($47 billion of the $60 billion financing),
8) The securitization of its floorplan loans originated by a heavy equipment manufacturer to dealers in "politically sensitive" countries, mostly in Latin America.

Mr. Litwin represents virtually every major bank and investment bank in at least some aspect of its business. He also has been involved in some aspect of the financing programs of virtually every large auto finance company. Mr. Litwin has regularly been ranked as one of the best securitization lawyers in the US by, among others, Chambers Global, IFLR, Best Lawyers in America, Who's Who Legal and Euromoney.

Mr. Litwin is an Adjunct Professor of Law at the Northwestern University Law School, where he teaches "The Law of Securitization."

Mr. Litwin currently serves as Chairman of the Legal Counsel Committee of the Structured Finance Industry Group (the trade association for the securitization market).

Mr. Litwin is a frequent lecturer and writer on securitization topics. The Structured Finance Institute has produced and sold a DVD, *Introduction to Securitization Transactions,* featuring Mr. Litwin.

Mr. Litwin holds a J.D. from the University of Chicago Law School and an M.B.A. from the University of Chicago Graduate School of Business. He is also a former Certified Public Accountant and winner of the Elijah Watt Sells Award on the Uniform CPA Examination.

Education

- The University of Chicago Law School, JD, cum laude, 1985
- The University of Chicago, MBA, 1985
- University of Illinois, BS, summa cum laude, 1981; Bronze Tablet
- Certified Public Accountant (CPA), Illinois, 1981; Winner of Elijah Watt Sells Award on Uniform CPA Examination

Activities

- Adjunct Professor of Law, Northwestern University Law School
- Co-chair, Outside Counsel Sub-forum of the American Securitization Forum
- Chairman, Securities Law Committee, Chicago Bar Association, 1998–1999
- Chairman, Corporate Control Subcommittee, Chicago Bar Association, 1996–1998
- American Bar Association, Section of Corporation, Banking, and Business Law

News & Publications

- "Revisions to Basel Securitisation Framework - Second Consultative Document," *Mayer Brown Legal Update*, 22 January 2014
- "CFTC Further Clarifies Commodity Pool Treatment for Certain Securitizations and Provides Additional No-Action Relief for Others," *Mayer Brown Legal Update*, 10 December 2012

- "Proposed Regulations Implementing the Volcker Rule," *Mayer Brown Legal Update*, 20 October 2011
- "Overview of the Proposed Credit Risk Retention Rules for Securitizations," *Mayer Brown White Paper*, 8 April 2011
- "US SEC Proposes Rules on ABS Warranty Repurchase Reporting," *Mayer Brown Legal Update*, 6 October 2010
- "Cross-Border Structured Finance and the Rating Agency Web Site Rules," *Mayer Brown Legal Update*, 2 August 2010
- "Summary of the US SEC's ABS Rule Change Proposal," *Mayer Brown Legal Update*, 21 April 2010
- "US SEC Proposes Massive ABS Rule Changes," *Mayer Brown Legal Update*, 8 April 2010
- "US SEC Adopts Amendments to Rule 2a-7 Affecting Money Market Funds," *Mayer Brown Legal Update*, 7 April 2010
- "FAQ on Issuer and Underwriter Obligations Under the New Rating Agency Web Site Rules," *Mayer Brown Legal Update*, 24 March 2010
- "Signs of life in the asset-backed world," *Source Media*, 10 December 2009
- "Equipment and Auto Lease Financing: Securitization, leveraged leasing and cross border financing," 2 October 2009
- "Financial Regulation Reform and Securitization," *Mayer Brown Legal Update*, 6 July 2009

Events

- Securitization—What's In Store for 2014?, 9 January 2014
- PLI's Understanding Financial Products 2014, 6-7 January 2014
- The Continuing Impact of Dodd-Frank, 26 June 2013
- Securitization—What's In Store for 2013?, 17 January 2013
- PLI's New Developments in Securitization 2012, 29-30 November 2012
- Regulatory Developments and the Effect on Structured Finance in Europe, 13 September 2012
- PLI's Understanding Financial Products 2012, 6 February 2012
- PLI's New Developments in Securitization 2011, 1 December 2011 - 2 December 2011
- Dodd-Frank: One Year Later, 27 July 2011
- PLI's Financial Products Survey 2011, 14 February 2011 - 15 February 2011
- New Developments in Traditional ABS (Auto, Equipment Loan and Lease, Student Loan and Credit Card Securitizations), 2 December 2010 - 3 December 2010

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“Ranked Band 1 Lawyer for Structured Finance and Derivatives (Chambers 2014); Leading Individual for Derivatives and Structured Products (Legal 500, 2013); and a Selected Leading Lawyer for Derivatives (IFLR 1000, 2014).”

Edmund Parker is head of Mayer Brown London office's Derivatives & Structured Products practice. He is also co-head of the firm's global Derivatives & Structured Products practice, heads the firm’s UK Capital Markets practice, and is a Co-practice leader of the Indian Practice Group.

He advises on complex OTC and structured credit, equity and commodity derivatives (including emissions trading), as well as insurance and pensions-linked derivative structures. He advises on distressed derivatives, together with our litigators and insolvency specialists; as well as advising on central clearing issues and derivatives regulation, together with our regulatory team. Ed has strong structured finance/debt issuance skills in particular in relation to CLOs and hybrid structures.

He is ranked as a Band 1 Lawyer for Structured Finance and Derivatives (*Chambers 2014*); a Leading Individual for Derivatives and Structured Products (*Legal 500*, 2013); and a Selected Leading Lawyer for Derivatives (*IFLR 1000*, 2014). The most recent sources describe Ed as "very user-friendly and very easy to deal with," adding that "he really knows his stuff" *(Chambers UK 2014)* and is "a leader in his field" *(Legal 500 2013)*. *Legal 500 2013*, quoted market sources describing the Derivatives and Structured Products practice as "A fantastic alternative to the Magic Circle"; "has its finger on the pulse with ISDA and transatlantic regulatory work"; and provides "military-style turnaround, good value and a deep bench".

Ed has written extensively on derivatives matters. He is the industry’s most widely published lawyer on the subject, with his views regularly sought by the press and on television. His written works include an acclaimed trilogy of derivatives books, consisting of, as sole author Credit Derivatives: Documenting and Understanding Credit Derivative Products, as sole editor Equity Derivatives: Documenting and Understanding Equity Derivative Products, and as co-editor Commodity Derivatives: Documenting and Understanding Commodity Derivative Products. He is currently co-writing a new book, Equity Derivatives: A Practitioner’s Guide to the 2002 & 2011 ISDA Equity Derivatives Definitions.

Experience

- Advising global industrial commodities business Klesch on the €450m refinancing of the Heide Refinery in Germany by Barclays, using an innovative structured finance derivatives arrangement.

- Advising CIBC in transaction with Cerberus Capital Management, L.P., which agreed to invest USD 1.05 billion in CIBC's US residential real estate portfolio. The deal covered residential mortgage-backed securities and related collateralized debt obligations.
- From 2008 to present, leading a UK/US team acting for Citigroup in relation to all credit events affecting corporate reference entities in its structured products portfolio including synthetic CDOs, repackaged notes, unfunded credit derivatives and CDO squared transactions. The project was recognised by Futures and Options (FOW) in 2010 as the market leader in distressed derivatives, winning their 'Most innovative work by a law firm in the field of exchanged-traded or centrally cleared derivatives' award'.
- Advising French investment bank in establishing a USD$ 700 million collateral protection arrangement to secure indirect derivative exposure across multiple CLO structures via the back to back swap arrangements with SPVs.
- Acting for LBBW in USD 440 million fiduciary note combined issuance, with embedded repo structure.
- Advising UBS in relation to a USD $380 million dispute arising out of a series of credit default swap and synthetic CDO transaction with the city of Leipzig Water Board, Kommunale Wasserwerke Leipzig GmbH (or KWL).
- Advising Swiss bank on structuring and documenting a GBP 180 million longevity swap transaction referencing an index of life assurance policies, which themselves collateralised the transaction. The instruction required expertise in US insurance regulation, English and New York law security, English law derivatives, and English law insurance.
- Establishment of innovative Commodity Derivatives Metals Leasing Documentation Platform for use across multiple jurisdictions for UK investment bank.
- Advising on a series of life settlement derivatives transactions for Mizuho.
- Advising KPMG as administrator of Lehman Brothers Commercial Corporation Asia Limited (Lehman Brothers Asian Operation) on derivatives matters as part of cross-juridisdictional/practice team from 2008 to present.
- As co-leader of India Practice Group, advising the UK subsidiary of Indian Gulf Oil Corporation Ltd (GOCL), the India based lubricants division of the international conglomerate the Hinduja Group, on its purchase of US industrial fluids manufacturer Houghton International Inc for $1.045 billion, the largest outbound acquisition by an Indian company in 2013.

Education

- The College of Law, London, 1996; Legal Practice Course
- Queen Mary, University of London, 1995; LLM, International Business Law
- Dundee University, 1994; LLB, (Hons)

Admissions

- England and Wales, 1999

Activities

- Granted the Freedom of the Worshipful Company of Solicitors of the City of London
- Granted the Freedom of the City of London

- Member of PLC Finance (Practical Law Company) consultation board. Practical Law Company (PLC) is the leading provider of legal know-how, transactional analysis and market intelligence for lawyers. The consultation board comprises leading experts in Finance and related areas. They help to shape the service and are consulted on complex areas of law and emerging practice. Visit: http://finance.practicallaw.com/6-201-8986
- Liveryman of the Worshipful Company of Solicitors of the City of London

News & Publications

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- "Europe in securities markets shake-up," *Financial Times*, 15 January 2014
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Events

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- OTC Derivatives Market: An Update on Transatlantic Reform, 12 November 2009
- Proposed Reform of the OTC Derivatives Market: The Transatlantic Perspective, 17 September 2009

Accolades

Consistently ranked as a key individual by the legal directories

- Ranked as a Band 1 lawyer for Structured Finance and Derivatives by Chambers 2014;
- Ranked as a Selected Leading Lawyer for Derivatives, IFLR 1000, 2014.
- Sources describe him as "very user-friendly and very easy to deal with," adding that "he really knows his stuff." (Chambers UK 2014);
- Ranked as a Leading Individual for Derivatives and Structured Products by Legal 500, 2013;
- Sources enthuse over Ed Parker's "encyclopaedic knowledge of all things ISDA. Whatever the transaction thrown at him, he knows the technical points inside out." (Chambers UK 2013);
- "a leader in his field" (Legal 500 2013);
- He "is an authority on complex OTC derivatives, property and commodity derivatives" (Chambers UK 2012);
- His "encyclopaedic knowledge means he knows the technical points inside out" (Legal 500 2012);
- He is "willing to go the extra mile and gives clear, commercially focused advice" (Legal 500 2011);
- He "offers excellent levels of service, he has done a great job pushing the practice to the forefront among London firms" (Legal 500 2010);
- He embodies its "fair, objective and rigorous approach" and "is well liked throughout the industry" (Legal 500 2009);
- He "would easily fit into any top-tier derivatives practice" and "has great expertise" (Chambers UK 2009).

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Andrew Pincus focuses his appellate practice on briefing and arguing cases in the Supreme Court of the United States and in federal and state appellate courts, as well as on developing legal arguments in trial courts.

Andy has argued 23 cases in the Supreme Court of the United States, four of them in the 2010 and 2011 Terms, including *AT&T Mobility v. Concepcion*, 131 S. Ct. 1740 (2011). For his victory in *Concepcion*, Andy was named Litigator of the Week by the *American Lawyer* and Appellate Lawyer of the Week by *The National Law Journal*. Andy's work in *Concepcion* and successful defense of Chicago Mayor Rahm Emanuel's right to run for office were cited by the *American Lawyer* in its article naming Mayer Brown as one of the top six US litigation firms in the 2012 Litigation Department of the Year report.

A former Assistant to the Solicitor General in the United States Department of Justice (1984-1988), Andy co-founded and serves as co-director of the Yale Law School's Supreme Court Advocacy Clinic (2006-present), which provides pro bono representation in 10-15 Supreme Court cases each year.

According to *Legal 500* (2013), Andy "is 'one of the best Supreme Court advocates in the country' and a 'brilliant strategist.'" An "'excellent Supreme Court oralist'" (2011), he "is cited by clients as 'a total superstar' who is 'unbelievably smart,' and who 'objectively belongs on any list of leaders'" (2008). *Chambers USA* reports (2013) that commentators "praise the breadth of" Andy's Supreme Court practice, "and state that he 'gets tapped for the really important matters.'" Andy is "a superb lawyer who is involved in lots of influential cases" (2010) and "is commended for his 'masterful performances'" before the Court (2009). Andy's appellate experience has also won him recognition in *The Best Lawyers in America* (2006-2014).

Andy has filed briefs in more than 150 cases in the Supreme Court. His Supreme Court oral arguments are available here. A selection of his appellate briefs is available here.

Andy also advises clients on legislative and regulatory matters. In 2011, Andy testified before Congressional committees regarding patent reform legislation, the new Consumer Financial Protection Bureau, and the Supreme Court's decisions in cases involving businesses. Andy also successfully represented clients in connection with passage of the Private Securities Litigation Reform Act.

While serving as General Counsel of the United States Department of Commerce (1997-2000), Andy had principal responsibility for the Digital Millennium Copyright Act and the Electronic Signatures in Global and National Commerce Act. He also participated in formulation of policy concerning intellectual property protection, privacy, domain name management, taxation of electronic commerce, export controls, international trade, and consumer protection.

Before rejoining Mayer Brown, Andy served as General Counsel of Andersen Worldwide S.C. Following law school graduation, Andy was Law Clerk to the Honorable Harold H. Greene, United States District Court for the District of Columbia (1981-1982), after which he practiced with another major law firm in Washington.

Andy is a contributor to Class Defense, the firm's blog on key issues affecting class action law and policy.

Education

- Yale University, BA, cum laude, 1977
- Columbia Law School, JD, 1981; Notes & Comments Editor, Columbia Law Review, James Kent Scholar; Harlan Fiske Stone Scholar

Admissions

- New York
- District of Columbia
- US Supreme Court
- US Court of Appeals for the District of Columbia Circuit
- US Court of Appeals for the First Circuit
- US Court of Appeals for the Second Circuit
- US Court of Appeals for the Third Circuit
- US Court of Appeals for the Fourth Circuit
- US Court of Appeals for the Fifth Circuit
- US Court of Appeals for the Seventh Circuit
- US Court of Appeals for the Ninth Circuit
- US Court of Appeals for the Eleventh Circuit
- US Court of Appeals for the Federal Circuit

Activities

- Andy served as a member of the Advisory Commission on Electronic Commerce established by the Internet Tax Freedom Act, 1999-2000

News & Publications

- "CFPB Study of Arbitration and Credit Cards Seen by Both Sides as Opaque Undertaking," *Bloomberg Law (subscription required)*, 16 May 2014
- "Arbitration Three Years After *Concepcion*," *The Am Law Litigation Daily*, 13 May 2014
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- "Ninth Circuit Narrows California Exception To Arbitration Agreements, But Puts Off Deciding Whether FAA Preempts The Exception Altogether," *Mayer Brown's Class Defense Blog*, 11 April 2013
- "Out of Prison? For Some, That Might Mean Out of Luck," *The New York Times*, 1 April 2013
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- "Mayer Brown Attorneys Named In *The Washingtonian's* Big Guns: 800 Top Lawyers," 28 November 2007
- "Mayer Brown Holds First Annual Pro Bono Awards Program," 15 November 2007
- "Southern Center for Human Rights Honors Mayer Brown For Guantanamo Work," 7 November 2007

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- "National Law Journal Quotes Andy Pincus in Article On Law School Supreme Court Clinics," 1 August 2007
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- "Supreme Court Watchers" Breakfast, Washington DC, 1 July 2014
- "Supreme Court Watchers" Breakfast, New York, 30 June 2014
- US Supreme Court Dramatically Narrows Grounds for General Personal Jurisdiction, 5 June 2014
- US Supreme Court Overturns Federal Circuit on Liability for Inducing Infringement and Standard for Definiteness of Patent Claims: What Does This Mean for Patent Owners and Challengers?, 5 June 2014
- Financial Institutions and Consumer Credit Subcommittee Hearing entitled "Legislative Proposals to Improve Transparency and Accountability at the CFPB", 21 May 2014
- Arbitration and the CFPB, 16 May 2014
- Exceptional Case Awards in Patent Infringement Cases, 15 May 2014
- Sidebar with AIPLA: An inside look at the oral argument
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- Buyer Beware: General Mills and Arbitration Clauses, 1 May 2014
- A Constitutional Conversation with Andy Pincus: The IRS's Plan to Regulate Political Speech, 30 April 2014
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- Milbank Tweed Forum - The Jury Trial is Dying: Should We Mourn its Demise?, 9 April 2014
- Practising Law Institute's 19th Annual Consumer Financial Services Institute, 7-8 April 2014
- Annual Pedrick Lecture, 28 March 2014
- Erica P. John Fund & Beyond: The Past, Present, and Future of Securities Class Actions, 28 February 2014
- Record-Breaking Fines Imposed on Financial Institutions: Policy Considerations and Responsible Alternatives, 23 January 2014
- Reducing the Costs of Discovery in Litigation: How Will the Proposed Amendments to the FRCP Make Discovery More Efficient?, 5 December 2013
- USC Gould School of Law - LACBA Corporate Law Departments 2013 Institute for Corporate Counsel, 3 December 2013

- General Counsel Conference, 14-15 October 2013
- "Remedies and Recompense: An Examination of Securities Arbitration and Class Actions", The 96th Annual Conference of the North American Securities Administrators Association in Salt Lake City, Utah, 7 October 2013
- "Federal Arbitration Act/Concepcion Update", Product Liability Advisory Council's 2013 Fall Conference in Las Vegas, Nevada, 3 October 2013
- CLE International's 9th Annual Class Action Conference, 3-4 October 2013
- William & Mary Law School Supreme Court Preview 2013, 27-28 September 2013
- Washington Legal Foundation's Media Briefing: "The U.S. Supreme Court: Previewing the October 2013 Term", 19 September 2013
- Supreme Court 2012-2014 Term Preview, 16 September 2013
- 2013-2014 Supreme Court Preview sponsored by American Constitution Society for Law and Policy, 16 September 2013
- University of Cincinnati College of Law Celebrates the 75th Anniversary of the Federal Rules of Civil Procedure, 27 August 2013
- Class Actions in the Supreme Court in the 2012 Term, 2 July 2013
- Supreme Court and Business: Assessing This Term's Decisions and Looking Forward to Next Term's Docket (Part I), 27 June 2013
- Supreme Court Reaffirms Enforceability of Arbitration Agreements: The Impact of the Decision in *American Express Co. v. Italian Colors Restaurant*, 26 June 2013
- "Supreme Court Watchers" Breakfast, 26 June 2013
- AGEP Third Annual Public Policy Institute on Financial Services, 1-3 May 2013
- Class Action Arbitration and the Supreme Court: Implications for the Future of Antitrust and Arbitration Law, 6 May 2013
- Arbitration and Class Actions Two Years After Concepcion, 1 May 2013
- PLI's 18th Annual Consumer Financial Services Institute, 8-9 April 2013
- CFPB's Ability-to-Repay and Qualified Mortgage Rule and the Recent US Court of Appeals' Decision Regarding Recess Appointments, 31 January 2013
- Congressional Civil Justice Caucus Academy: The Role of State Attorneys General in Enforcing Federal Law, 25 January 2013
- 13th Annual Legal Reform Summit, 24 October 2012
- CWAG (Conference of Western Attorney Generals) 2012, 22 July 2012 - 25 July 2012
- Supreme Court and Business: Assessing This Term's Decisions and Looking Forward to Next Term's Docket, 28 June 2012
- The Continuing Impact of Dodd Frank, 26 June 2012
- 24th Annual General Counsel Conference, 12 June 2012 - 13 June 2012
- Second Annual Attorney General Public Policy Institute, "Financial Services Regulation", 3 June 2012 - 5 June 2012
- *Concepcion* After One Year: The Changed World of Arbitration and Class Actions, 15 May 2012
- Arbitration after *AT&T Mobility v. Concepcion*: Judicial, Regulatory and Strategic Legal Responses to High Court's 2011 Ruling, 8 May 2012
- Affordable Care Act Cases, 2 April 2012
- Health Care Law Oral Argument Preview, 13 March 2012
- Prepping For Judicial Surgery: A Crash Course on Healthcare Reform In the U.S. Supreme Court, 13 March 2012
- Concepcion versus the NLRB: How Should Employers React to the NLRB's D.R. Horton Decision, 19 January 2012
- Consumer Financial Protection Bureau: The First Three Months and Expectations for the New Year, 17 November 2011

- Supreme Court and Business: Assessing this Term's Decisions and Looking Forward to Next Term's Docket, 29 June 2011
- Class Actions and Arbitration Agreements: The Impact of the Supreme Court's Decision in *AT&T Mobility v. Concepcion*, 4 May 2011
- National Association of Attorneys General Presidential Initiative Summit, "America's Financial Recovery: Protecting Consumers as We Rebuild", 11 April 2011
- Advertising Law & Public Policy Conference, 15 March 2011 - 16 March 2011
- Symposium on Intellectual Property, 3 March 2011
- Emerging Challenges Facing US Accounting Firms – Chicago, 24 February 2011
- Emerging Challenges Facing US Accounting Firms – New York, 15 February 2011
- Supreme Court and Business: Assessing this Term's Decisions and Looking Forward to Next Term's Docket, 8 July 2010
- Impact of the Supreme Court's "Honest Services" Ruling, 28 June 2010
- The Most Important Supreme Court Business Decision You Haven't Heard Of, 3 August 2009
- Drafting Enforceable Arbitration Agreements and Recent Trends in Arbitration Law, 6 August 2008

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Jerome Roche is a Financial Services Regulatory & Enforcement partner in Mayer Brown's Washington DC office. His practice focuses primarily on cross-border financial services matters. He has extensive experience counseling clients regarding the US federal securities laws, the Commodity Exchange Act, the Commodity Futures Modernization Act, the Gramm-Leach-Bliley Act, the USA PATRIOT Act, and the Dodd-Frank Act. According to *Chambers USA* 2013, Jerome is a "dynamic lawyer" who has "good substantive knowledge." He also received a *Martindale-Hubbell* peer review rating of AV-Preeminent in 2012 and 2013.

Experience

- Addressing regulatory status questions for US and non-US financial institutions effecting transactions in, and providing advice with respect to, securities, commodities, foreign currency and derivatives;
- Drafting and implementing supervisory and compliance policies and procedures for regulated financial institutions;
- Counseling customers and other counterparties of US broker-dealers regarding customer protection rules, broker-dealer insolvencies, and the Securities Investor Protection Act;
- Seeking required approvals for mergers, acquisitions and restructurings of regulated financial institutions; and
- Guiding financial institutions and trade associations in complying with, and commenting on, rule-making efforts of the Securities and Exchange Commission, the Commodity Futures Trading Commission, Financial Industry Regulatory Authority, the National Futures Association, and other self-regulatory organizations.

Education

- Purdue University, BS, 1992
- The University of Michigan Law School, JD, 1997

Admissions

- Illinois, 1997
- District of Columbia, 2000

Activities

- National Hispanic Bar Association

News & Publications

- "Expect Increasing Scrutiny Of High-Frequency Trading," *Law360*, 4 June 2014
- "Increased Scrutiny of High-Frequency Trading," *Harvard Law School Forum on Corporate Governance and Financial Regulation*, 23 May 2014
- "Securities Investigations: Internal, Civil and Criminal," August 2013
- "Increased Public and Private Scrutiny of High-Frequency Trading," *Mayer Brown Legal Update*, 14 May 2014
- "CFTC Seeks Comment On November 14 Advisory On Cross-Border “Transaction-Level Requirements”; Staff Extends Relief Until September 15," *Mayer Brown Legal Update*, 6 January 2014
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- "Final Regulation Implementing the Volcker Rule," *Mayer Brown White Paper*, 18 December 2013
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- "US Commodity Futures Trading Commission Releases FAQs for CPOs and CTAs," *Mayer Brown Legal Update*, 22 August 2012
- "Sure, My Project Has Swaps (In Fact, My Lenders Required These Hedges), But Why Does That Make It A Commodity Pool and Why Am I Now A Commodity Pool Operator?," *Mayer Brown Legal Update*, 15 August 2012
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- "US Securities and Exchange Commission Adopts New Exemptions for Investment Advisers," *Mayer Brown Legal Update*, 15 July 2011
- "Financial Reform and Securitization," *Mayer Brown Legal Update*, 15 July 2010
- "US SEC Amends Custody Rule for Registered Investment Advisers," *Mayer Brown Legal Update*, 14 June 2010
- "Foreign Account Tax Compliance Act of 2009," *Mayer Brown Legal Update*, 20 April 2010
- "US SEC Adopts Amendments to Regulation SHO," *Mayer Brown Legal Update*, 26 February 2010
- "US SEC Adopts Significant Changes to Custody Rule for Registered Investment Advisers," *Mayer Brown Legal Update*, 21 December 2009
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- "US SEC Takes Additional Action to Address Short Sales," *Mayer Brown Legal Update*, 29 July 2009
- "US SEC Proposes Significant Changes to Custody Rule for Registered Investment Advisers," *Mayer Brown Legal Update*, 19 June 2009
- "US Securities and Exchange Commission Considers New Short Selling Regulation," *Mayer Brown Legal Update*, 15 April 2009
- "International Financial Law Review ranks 20 Mayer Brown lawyers; 21 practices in IFLR1000," 6 November 2008
- "Regulation R: The Beginning of the End or the End of the Beginning for Bank Brokerage Activities?," *NC Banking Institute Journal*, Spring 2008
- "Mayer, Brown, Rowe & Maw Adds New Financial Services Partner," 22 March 2007
- "Broker-Dealer 101: An Introduction to the Law and Lore of Securities Brokers and Dealers," *The Investment Lawyer*, 1 July 2003
- "New Contours of Bank Securities Activities: The “Dealer” Push-Out Rules," *The Banking Law Journal*, May 2003
- "Safe Harbour for Swaps," *UK Risk and Reward*, December 2001
- "Broker-Dealer Regulation," *Practising Law Institute*,

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- Finalizing the Volcker Rule – Sessions I and II - December 19 & 20, 2013, December 19 & 20, 2013
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- SEC Proposes Rules on Cross-Border Security-Based Swaps Transactions, 6 June 2013
- 7th Annual Investment Management Regulatory University, May 2013
- "Insurance vs. Swaps Under Dodd-Frank", Insurance vs. Swaps Under Dodd-Frank, 2 August 2012
- The Continuing Impact of Dodd Frank, 26 June 2012
- Lehman Bankruptcy and Client Monies, 10 May 2012
- Implementation of the Dodd-Frank Act – Implications for Internationally Headquartered Banking Organizations: Part 2: Implementation of Other Key Provisions of Dodd-Frank for International Banks, 12 April 2011
- "Tax and Securities Law Issues Associated with Serving US Clients", Presented at the OffshoreAlert Conference in Miami, April 2011

- Understanding the New Financial Reform Legislation, 12 July 2010
- US Equity Market Structure, June 2010
- "Broker-Dealer Fundamentals", Mayer Brown Investment Management and Regulatory University (May 2010, May 2009 and May 2008), 1 May 2010
- Managing the Risks in Serving US Clients: What Every Non-US Financial Institution Needs to Know in Today's Environment, 21 October 2009
- "Short Selling: Upticks, Down-Bids and Circuit Breakers? Now What?", Presented as a webinar with Eric Finseth on behalf of the Practising Law Institute, October 2009
- Bloomberg TV, September 2008
- "Short Selling: Has it Been Stopped Short? Now What?", Presented as a webinar with Eric Finseth on behalf of the Practising Law Institute, October 2008
- " Dealer Overview", Presented at the ALI-ABA Broker-Dealer Conference, January 2005
- "Regulation of Broker-Dealers", Presented as part of the DC Bar CLE Program, March 2003

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David Sahr advises domestic and foreign financial institutions on establishing and expanding their operations in the United States as well as on related regulatory, enforcement and compliance matters. He represents banks and their affiliates before federal and state agencies, including the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Securities and Exchange Commission. He assists financial institutions in the development and sale of new products including compliance with state and federal banking, securities and commodities laws. David also advises and represents foreign banks on federal legislative developments affecting their US banking and non-banking operations.

David has worked closely with banks and trade associations on the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). He has advised numerous clients on their response to the regulatory implementation of Dodd-Frank, including drafting comment letters on new capital rules, the Volcker Rule and new derivatives regulations.

David is also advising several foreign and US banks on their implementation of the full gamut of the requirements of Dodd-Frank. For example, he has provided in depth advice with respect to the prohibition on proprietary trading and on sponsorship of and investment in covered funds by banking entities (the Volcker Rule) and the regulation of OTC derivatives. *Chambers USA 2011* noted David's work "advising a number of foreign lenders and other financial services entities on Dodd-Frank compliance, " and according to *Chambers USA 2012*, "[h]e is widely admired by peers and clients alike, who highlight him as being 'very responsive and extremely well informed.'"

Experience

- Represented a foreign bank in the establishment of a US bank subsidiary including obtaining regulatory approvals from the chartering authority, the Federal Deposit Insurance Corporation and the Board of Governors of the Federal Reserve System.
- Represented a foreign bank in acquiring a US energy trader including obtaining approval of the Board of Governors of the Federal Reserve System for authority to engage in activities that are "complementary" to activities that are financial in nature.
- Represented a foreign bank in complying with banking, securities and other laws in connection with the development and sale of complex financial products and structures.
- Represented foreign and domestic banks in complying with Bank Secrecy Act requirements and in responding to enforcement actions brought by federal banking agencies.
- Represented several foreign banks in establishing branches, agencies and representative offices in the United States.

Education

- Georgetown University, BS, magna cum laude, 1976
- The London School of Economics and Political Science, MS, 1977
- Georgetown University Law Center, JD, magna cum laude, 1982

Admissions

- District of Columbia, 1982

News & Publications

- "Federal Reserve Issues Final Regulation Implementing Dodd-Frank Section 165 Enhanced Prudential Standards for Large US and Non-US Banking Organizations," *Mayer Brown Legal Update*, 3 March 2014
- "Does Volcker + Vickers = Liikanen?," *Mayer Brown Legal Update*, February 2014
- "Fed probes catastrophic risks in bank physical commodity trading," *Risk.net*, 18 February 2014
- "The European Court's dismissal of the UK's challenge to the short selling regulation," *Mayer Brown Legal Update*, February 2014
- "Five Cooks in Volcker Kitchen," *National Law Journal*, 10 February 2014
- "CFTC Seeks Comment On November 14 Advisory On Cross-Border “Transaction-Level Requirements”; Staff Extends Relief Until September 15," *Mayer Brown Legal Update*, 6 January 2014
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- "UK banks get break from Volcker's toughest plans," *City AM*, 11 December 2013
- "Lenders facing prop trading ban in America," *City AM*, 10 December 2013
- "Despite Some Easing, Volcker Will Pose Challenges For Banks," *Law360*, 10 December 2013
- "CFTC Sued on Extraterritorial Application of Dodd-Frank Swap Rules," *Mayer Brown Legal Update*, 4 December 2013
- "Banks Face Patchwork Volcker Rule If Agencies Fail To Agree," *Law 360*, 25 November 2013
- "Amendments to the UK Financial Services (Banking Reform) Bill," *Mayer Brown Legal Update*, October 2013
- "CFTC Issues Interpretive Guidance Regarding the Cross-Border Application of US Swap Regulations," *Mayer Brown Legal Update*, 2 August 2013
- "The CFTC's July 12, 2013 Cross-Border Exemptive Order," *Mayer Brown Legal Update*, 17 July 2013
- "Mayer Brown represents CIMC on inaugural $600 million letter of credit backed US commercial paper program," 28 January 2013
- "CFTC Issues a Final, Time-Limited Exemptive Order and Proposes Further Guidance Regarding Cross-Border Regulation of Swaps," *Mayer Brown Legal Update*, 31 December 2012
- "Federal Reserve Proposes Enhanced Prudential Standards for Non-US Banking Organizations," *Mayer Brown Legal Update*, 20 December 2012
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- "CFTC Skips `Intergalactic' Power in Dodd-Frank Guidance," *Bloomberg*, 29 June 2012
- "The New CFTC and SEC Swap "Entity" Definitions—Highlights," *Mayer Brown Legal Update*, 30 April 2012
- "Proposed Regulations Implementing the Volcker Rule," *Mayer Brown Legal Update*, 20 October 2011
- "US Securities and Exchange Commission Adopts Large-Trader Reporting System," *Mayer Brown Legal Update*, 9 August 2011
- "Dodd-Frank Title VII (Swaps) Effectiveness—July 16 and Beyond," *Mayer Brown Legal Update*, 14 June 2011
- "US FDIC and Federal Reserve Propose Rule on Resolution Plans and Credit Exposure Reports," *Mayer Brown Legal Update*, 2 May 2011
- "US Treasury to Impose Requirement on US Correspondent Banks to Obtain Iran-Related Information from Foreign Banks," *Mayer Brown Legal Update*, 29 April 2011
- "Comments Requested on Proposed "Key Definitions" of the Wall Street Transparency and Accountability Act," *Mayer Brown Legal Update*, 23 August 2010
- "Financial Reform and Securitization," *Mayer Brown Legal Update*, 15 July 2010
- "The Volcker Rule: Proprietary Trading and Private Fund Restrictions," *Mayer Brown Legal Update*, 30 June 2010
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- "Foreign Account Tax Compliance Act of 2009," *Mayer Brown Legal Update*, 20 April 2010
- "Bankaufsichtsrecht - Entwicklungen und Perspektiven," 15 December 2009
- "Technical Amendments to FDIC Rules Could Have Significant Impact on Uninsured US Branches of Non-US Banks," *Mayer Brown Legal Update*, 10 September 2009
- "OTC Derivatives—In the Crosshairs of US Legislative and Regulatory Change Part III: An Update," *Mayer Brown Legal Update*, 1 September 2009
- "FDIC Adopts Modified Policy Statement on Private Equity Investments in Failed Banks," *Mayer Brown Legal Update*, 26 August 2009
- "FDIC Proposes a Hard Line on Private Equity Investments in Failed Banks," *Mayer Brown Legal Update*, 2 July 2009
- "Client Update: Obama Administration Proposes Comprehensive Changes to Financial Services Regulation," *Mayer Brown Legal Update*, 18 June 2009
- "National Regulatory System Proposed for US Insurance Industry," *Mayer Brown Legal Update*, 14 May 2009
- "Treasury Department Releases Details on Public-Private Partnership Investment Program," *Mayer Brown Legal Update*, 26 March 2009
- "Equity Investments in Banks and Nonbanks," 22 October 2008
- "Must Private Banking Be "Pushed" Out of Banks? - Implications of the SEC's Proposed Regulation B," *The Investment Lawyer*, September 2004
- "U.S. Anti-Money Laundering Legislation," *Law and Business Review of the Americas*, Fall 2002
- "The EC's Single Banking Market and Its Implications for the U.S. Financial System: Section C of the ABA's EC 1992: Reciprocity and Market Access Issure for Financial Services," *ABA Division for Professional Development*, 1992

Events

- Die Volcker-Rule und die EU-Reform des Bankensektors, 13. Februar 2014
- Finalizing the Volcker Rule – Sessions I and II - December 19 & 20, 2013, December 19 & 20, 2013
- The Continuing Impact of Dodd-Frank, 26 June 2013
- SEC Proposes Rules on Cross-Border Security-Based Swaps Transactions, 6 June 2013
- Federal Reserve Board Proposes New Section 165 Rules for Foreign Banks with US Operations, 20 December 2012
- PLI's Fundamentals of Swaps & Other Derivatives 2012, 15 October 2012
- CFTC Proposal for Cross-Border Application of US Swaps Regulations, 9 August 2012
- The Continuing Impact of Dodd Frank, 26 June 2012
- Volcker Conformance Period and Impact on CP Conduits, 3 May 2012
- Fundamentals of Swaps and Other Derivatives 2011, 17 October 2011
- Proposed Regulations Implementing the Volcker Rule, 11 October 2011
- Dodd-Frank: One Year Later, 27 July 2011
- Implementation of the Dodd-Frank Act – Implications for Internationally Headquartered Banking Organizations: Part 2: Implementation of Other Key Provisions of Dodd-Frank for International Banks, 12 April 2011
- Implementation of the Dodd-Frank Act – Implications for Internationally Headquartered Banking Organizations: Part 1: OTC Derivatives Regulation and the Volcker Rule, 5 April 2011
- Strategies for Dealing with Financial Asset Businesses and Portfolios—Part III: Joint Ventures and Restructurings for Financial Asset Businesses and Distressed Portfolios, 22 March 2011
- Hot Topics in Insurance Regulation, 30 September 2010
- Federal Reserve Compensation Guidance and Executive Compensation Under Dodd-Frank, 23 September 2010
- The Implications of the Volcker Rule, 17 June 2010

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Jeffrey Taft is a regulatory attorney whose practice focuses primarily on banking regulations, bank receivership and insolvency issues, payment systems, consumer financial services, privacy issues and anti-money laundering laws. He has extensive experience counseling financial institutions, merchants and other entities on various federal and state consumer credit issues, including compliance with the Consumer Financial Protection Act, Truth-in-Lending Act, the Fair Credit Reporting Act, the Electronic Fund Transfer Act, the Equal Credit Opportunity Act, the Fair Debt Collection Practices Act, the Real Estate Settlement Procedures Act, state and federal unfair or deceptive practices statutes, the Bank Secrecy Act, the USA PATRIOT Act, OFAC regulations and other anti-money laundering laws; and the creation and implementation of privacy and information security programs under Title V of the Gramm-Leach Bliley Act and state privacy laws.

Jeff regularly represents banks, bank holding companies, trust companies and other financial service providers on regulatory matters, including the development and operation of multi-state fiduciary, deposit and credit card programs. He has also advised merchants and financial services companies on issues relating to credit cards, debit cards, gift cards, wire and ACH transfers and other payment products.

Prior to joining the Washington, DC office of Mayer Brown in 1998, Jeff held a senior position with a prominent Ohio law firm.

Experience

- Advised various bank and non-bank clients regarding regulation, supervision and examination of consumer financial services activities by the CFPB and the federal banking agencies.
- Advised clients regarding bank insolvency issues and the Dodd-Frank Act's Orderly Liquidation Authority.
- Advised numerous companies in connection with data security breaches involving customer or employee information and their security breach response plans and procedures.
- Advised investment funds and other secondary market purchasers on federal, state and local consumer lending laws, licensing requirements and assignee liability.
- Advised mobile payment provider in connection with its federal and state consumer credit compliance program.

Education

- Tulane University, BA, 1989
- University of Pittsburgh School of Law, JD, cum laude, 1992
- Harvard Law School, LLM, 1993

Admissions

- District of Columbia, 2001
- Ohio, 1994
- New York, 1993

Activities

- Governing Committee Member, Conference on Consumer Finance Law
- Fellow, American College of Consumer Financial Services Lawyers
- American Bar Association: Business Law Section, Cyberspace Law, Banking Law and Consumer Financial Services subcommittees
- New York State Bar Association: Business Law Section

News & Publications

- "Federal Reserve Issues Final Regulation Implementing Dodd-Frank Section 165 Enhanced Prudential Standards for Large US and Non-US Banking Organizations," *Mayer Brown Legal Update*, 3 March 2014
- "Final Regulation Implementing the Volcker Rule," *Mayer Brown White Paper*, 18 December 2013
- "Into the Breach: Managing Cyber Security Threats in the Digital Age," *Business & Technology Sourcing Review - Issue 19*, Summer 2013
- "Business & Technology Sourcing Review - Issue 19," *Mayer Brown Newsletter*, Summer 2013
- "“Into the Breach, Managing Cyber Security Threats in the Digital Age” - Highlights From Our Recent Event," 30 May 2013
- "CFPB Developments: Coordinating the Supervision of Depository and Non-Depository Institutions," *ABA Business Lawyer*, February 2013
- "Long-Expected Omnibus HIPAA Rule Implements Significant Privacy and Security Regulations for Entities and Business Associates," *Mayer Brown Legal Update*, 11 February 2013
- "District of Columbia Circuit Holds NLRB Recess Appointments Invalid, Undermining Numerous NLRB and Consumer Financial Protection Bureau Decisions," *Mayer Brown Legal Update*, 29 January 2013
- "Second CFPB Fight May Be Just as Contentious as First," *American Banker (subscription required)*, 25 January 2013
- "Banking Regulation To Watch In 2013," *Law360*, 1 January 2013
- "Federal Reserve Proposes Enhanced Prudential Standards for Non-US Banking Organizations," *Mayer Brown Legal Update*, 20 December 2012
- "Regulators To Buckle Down On Dodd-Frank After Obama Win," *Law360*, 7 November 2012
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- "CFPB Agenda Vulnerable To Election Year Shake-Up," *Law360*, 10 October 2012
- "State AGs challenge to Dodd-Frank ramps up debate over law’s constitutionality," *Bank Credit News*, 25 September 2012
- "Consumer financial agency quiet about enforcement — though that may soon change," *The National Law Journal*, 12 September 2012
- "CFPB Gives First Hint of Enforcement, but What About the Future?," *Compliance Week (subscription required)*, 24 July 2012
- "Consumer Financial Protection Bureau watchdog turns 1," *CreditCards.com*, 23 July 2012

- "On Its First Birthday, Consumer Bureau Flexes Its Muscle," *Bloomberg Businessweek*, 19 July 2012
- "In-House Lawyers Concerned About Future CFPB Enforcement Efforts," *Corporate Counsel*, 16 July 2012
- "In-House Lawyers Concerned About Future CFPB Enforcement Efforts, Survey Finds," *The Blog of Legal Times*, 12 July 2012
- "Uncertainty Over CFPB Tops Banks' Worries, Survey Says," *Law360*, 6 July 2012
- "Big Banks' Living Will Summaries To Be Released Tuesday," *Law360*, 29 June 2012
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- The Social Media Evolution: Trends, Challenges & Opportunities, 10-11 March 2014
- The Continuing Impact of Dodd-Frank, 26 June 2013
- Foreign Banking Organizations, 19 June 2013
- Into the Breach: Managing Cyber Security Threats in the Digital Age, 23 April 2013
- WESFACCA's Privacy Developments, Requirements and Practical Applications for Corporate Legal Counsel, 18 April 2013
- "Legal Issues Impacting Private Student Loan Providers", Education Finance Council Annual Meeting, 7 March 2013

- The Social Media (R)Evolution, 4-5 March 2013
- "The Consumer Financial Protection Bureau: Hits, Misses and Unfinished Business", 23rd Annual Festival of Legal Learning UNC School of Law, 9 February 2013
- "Privacy and Security 101: Understanding Technology and Key Laws", ACI Privacy and Security of Consumer and Employee Information, 5 February 2013
- "Managing a Multinational Privacy Program in Global Workforce and Preparing, Collecting, Using and Transferring Data Across Borders", ACI Privacy and Security of Consumer and Employee Information, 5 February 2013
- CFPB's Ability-to-Repay and Qualified Mortgage Rule and the Recent US Court of Appeals' Decision Regarding Recess Appointments, 31 January 2013
- "The Consumer Financial Protection Bureau: The Agency, Work Thus Far and Challenges That Lie Ahead", Mecklenburg County Bar Ass'n 12th Banking and Finance Forum, 16 November 2012
- Cross-Border Restructuring Institute Webinar Series: Regulatory Approaches to Troubled Financial Institutions—Dodd-Frank, Living Wills and Non-US Approaches
  Recording of teleconference (one hour ten minutes)
  , 10 October 2012
- "Privacy and Security 101: Understanding Technology and Key Laws and Regulations, ACI Privacy and Security of Consumer and Employee Information", ACI Privacy and Security of Consumer and Employee Information, July 2012
- "Litigation and Legislation Update: Emerging Congressional Priorities", ACI Privacy and Security of Consumer and Employee Information, July 2012
- "Data Privacy Emerging Issues: A 2012 Update", The Knowledge Congress, July 2012
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- "Implementation of the Dodd-Frank Act – Implications for Foreign Banking Organizations", Institute of International Bankers Webinar, 1 April 2011
- "Data Privacy: A Modern Day Mission Impossible?", 55th Annual Canadian Reinsurance Conference, April 2011
- Strategies for Dealing with Financial Asset Businesses and Portfolios—Part II: Structured Finance Alternatives for Financial Asset Businesses, 10 March 2011
- "The Dodd-Frank Act: An Overview", George Mason University School of Law – Attorneys General Education Program, 1 March 2011
- "The Consumer Financial Protection Act and the BCFP", UNC School of Law Festival of Legal Learning, 1 February 2011
- The Impact of the Orderly Liquidation Authority (OLA) on Finance Transactions, 27 January 2011

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- "Securitization Reform: Will the Cure Kill the Patient", American Bar Association's Annual Meeting, August 2010
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- "Financial Reform", 9th Banking and Finance Forum, Mecklenberg County Bar, North Carolina, November 2009
- Panel Discussion and Reception: The Government as Your Investment Partner: Opportunities in Real Estate, Infrastructure, Distressed Debt Sales and More - September 21, 2009, 21 September 2009
- FTC Decision Jolts Collection of Customer Data, 22 July 2009
- "The Financial Crisis: Legislative and Regulatory Responses", UNC Banking Law Institute, March 2009
- "Where is Washington Headed", BNA Regulatory Reform Briefing, March 2009
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- "Financial Rescues and Failures", 8th Banking and Finance Forum, Mecklenburg County Bar, North Carolina, November 2008
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- "Getting Under the TARP: Selling Toxic Assets to the Government & Government Purchase of Bank Stock", American Fiduciary Network, October 2008
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- The Upheaval in the Subprime Market: The Direct and Indirect Effects of Same on the Structured Finance Market, 22 January 2008
- "Privacy, Safeguarding and Information Data Security", Consumer Credit 2007, November 2007
- "Regulatory Developments", 7th Banking and Finance Forum, Mecklenburg County Bar, North Carolina, November 2007
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- "Securitization Ethics and Professional Responsibility: Perspectives on the Appropriate Handling of Customer Data in Securitization Transactions", American Securitization Forum, July 2006
- "FACT Act Implementation", UNC School of Law Festival of Legal Learning, February 2006
- "Information Security", Consumer Credit 2005, November 2005
- "FACT Act Implementation", America's Community Bankers 2005 National Compliance and Attorneys Conference, September 2005
- "Lessons From ChoicePoint and Lexis-Nexis", Stafford Publishing Teleseminar, August 2005
- "Unfair or Deceptive Practices in the Sales, Marketing and Servicing of Consumer Financial Services and Products", UNC School of Law Festival of Legal Learning, February 2005

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"A pleasure to work with and does excellent work." Chambers USA 2010

Jon Van Gorp is the leader of our Chicago office's Banking & Finance practice and co-leader of the firm's Structured Finance and Capital Markets practices. Jon's experience includes public and private securities offerings, assets sales, structured finance transactions, leveraged leases, derivatives, synthetic risk transfer programs and financial insurance. He is highly skilled at finding ways to fund difficult-to-finance assets, such as nonperforming mortgage loans, distressed ABS and MBS, mortgage servicing rights and servicing advances, and he assists clients that wish to fund their operations, sell or acquire asset portfolios and businesses, or manage and hedge their exposures by buying and selling risk.

Jon is known as an innovator. He has been part of the legal team that completed many first-of-their-kind transactions, including the first auto leveraged lease transaction funded with asset-backed debt, the first synthetic transfer of risk related to a portfolio of consumer auto leases, the first issuance of bank debt guaranteed by Farmer Mac, the first auto receivables shelf registration statement to go effective under regulation AB, the first publicly offered CDO of mezzanine MBS debt and the first securitization of Mexican mortgage loans funded in the US capital markets. Jon's reputation for innovation was recognized by the *Financial Times*, which ranked a risk protection arrangement that he helped design as the second most innovative M&A transaction of 2010. In 2013, he advised on the purchase of mortgage assets in a Section 363 bankruptcy sale, which was awarded as the "M&A Deal of the Year" in the Over $1 Billion category by *M&A Advisor*.

For several years Jon has been ranked as an outstanding lawyer by *Chambers USA*, *Chambers Global*, *Legal 500* and *IFLR 1000*.

- One client said approvingly: "We consider him a business partner and not just an outside counsel." (as noted in *Chambers USA* 2013)
- "Very thoughtful, creative and knowledgeable," he is "able to separate what can kill you from what will kill you in this space," according to *Chambers Global* 2013.
- According to Lexology's 2013 Client Choice Awards, Jon "knows his subject inside-out," "communicates efficiently and effectively" and "always adds value by offering new insight or comfort on difficult issues."
- According to *Chambers USA* 2012, Jon is "very thoughtful, creative and knowledgeable."
- *Legal 500* 2010 called him "an excellent Structured Finance lawyer, outstanding on all of the elements."
- And *IFLR 1000* 2008 noted that Jon's work receives "substantial praise from clients and competitors."

In 2008, Jon was named on *Crain's Chicago Business* "40 Under 40," a prestigious honor where he was applauded for his ability to "operate like an executive, moving beyond legal questions and offering strategic and tactical insight rare for a lawyer of his vintage." This is one of the most prestigious awards that a young professional can receive, and Jon now joins other "40 Under 40" alumni including President Barack Obama.

Jon is a frequently requested speaker on finance issues and he has published articles on a wide range of structured finance-related topics. In 2008, Jon edited and co-authored *Credit Market & Subprime Distress: Responding To Legal Issues*, a best-selling legal treatise on the credit crisis published by the Practicing Law Institute. Reviews of this book have praised it for providing "a clear analysis of the relevant issues without getting bogged down in the minutiae of the procedures."

He is also frequently sought by top-tier media such as the *Associated Press*, *Bloomberg News*, *Dow Jones Newswires*, *Financial Times*, *The New York Times* and *The Wall Street Journal* to provide insight and analysis of issues related to the finance and banking industries.

Jon is an adjunct professor at the John Marshall Law School in Chicago, and is also active in the Chicago community as a Leadership Greater Chicago fellow.

Experience

- Structured and negotiated multiple mortgage loan securitization transactions and structured warehouse facilities issuing both public and private securities, including REMIC and non-REMIC structures for commercial and residential mortgage loans, home equity lines of credit, home equity loans and nonperforming loans.
- Structured and negotiated multiple one-off and flow asset purchase arrangements for mortgage loans, mortgage servicing rights, auto loans, insurance policies, and consumer finance origination and servicing platforms, ranging in size up to $55 billion.
- Structured and negotiated multiple public auto loan and auto lease term securitization transactions, including transactions with asset-backed derivative instruments and financial guaranty insurance.
- Structured and negotiated multiple home equity loan securitization transactions issuing both public and private securities, including REMIC and non-REMIC structures for home equity lines of credit, home equity loans and nonperforming loans.
- Prepared multiple Regulation AB compliant shelf registration statements for auto receivables, mortgage loans and home equity loans, including registrations by foreign issuers.
- Negotiated asset-backed interest rate and currency swap transactions, including transactions conforming with criteria for ratings dependent swaps.
- Negotiated and documented multiple market value swaps for mortgage loan-backed and securities-backed funding vehicles.
- Negotiated credit derivatives for a large monoline insurance company.
- Structured and negotiated several cross border mortgage loan securitization transactions, including transactions issuing publicly registered asset-backed securities.

Education

- Calvin College, BA, 1991
- Southern Methodist University Dedman School of Law, JD, cum laude, 1994; Staff Editor, *The International Lawyer*

Admissions

- New York, 2004
- Illinois, 1998
- Texas, 1994

News & Publications

- "Mayer Brown represents Ocwen Financial Corporation on $350 million debut high yield note offering," 30 May 2014
- "QM Era Begins, Smaller Lenders Dig Down For Loans," *Securitization Intelligence*, 10 January 2014
- "Mayer Brown advises on transaction named “M&A Deal of the Year” in *M&A Advisor* Awards," 23 December 2013
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- "Courts Uphold MERS Serving as “Nominee” on Mortgage Instruments," *Mayer Brown Legal Update*, 4 March 2011
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- "Securitizations After Securities Offering Reform," *Journal of Structured Finance*, Winter 2006
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- "Funding Mortgage Loans With Extendible Note Funding Facilities," *Journal of Structured Finance*, Fall 2004
- "Collateral in Eastern Europe: Problems and Solutions," *29 International Lawyer, 83*, 1994

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- IMN’s Mortgage Servicing Rights Conference, 10-11 March 2014
- Securitization—What’s In Store for 2014?, 9 January 2014
- Loan Portfolio Transactions – Insights for Your Strategy, 13 November 2013
- The Continuing Impact of Dodd-Frank, 26 June 2013
- "Recent Changes to Mortgage Regulation Panel II – RMBS Litigation, Representations and Warranties, and Securities Laws", The Return of Private Capital to the Mortgage Market, NYU Leonard N. Stern School of Business, Center for Real Estate Finance Research – Winter Symposium, 5 March 2013
- "Non-Performing Loan Securitizations and Other Distressed Opportunities", ASF Conference, 29 January 2013
- Securitization—What’s In Store for 2013?, 17 January 2013
- What Fits? Capitalizing on Opportunities Created By Today’s Markets, 1 March 2012
- Strategies for Dealing with Financial Asset Businesses and Portfolios—Part I: M&A of Financial Asset Businesses, 3 March 2011
- Restructuring Bank Balance Sheets—Synthetic Risk Transfer, 20 May 2010
- Rating Agency Reform, 4 March 2010
- Subprime Lending Litigation - The Crisis Heard Round the World, 8 May 2008 - 9 May 2008

THE CONTINUING IMPACT OF Dodd-Frank

The business and legal challenges arising from financial market disruptions continue to be felt worldwide, and the ramifications for business are extensive—they include new regulations, pending and potential enforcement and litigation matters, bankruptcies, corporate dealings and financial implications.

To properly respond to the financial crisis, participants in this market need advisors with understanding and insight into a wide range of related topics including finance, financial restructuring, government investigations and prosecutions, litigation, insurance & reinsurance and regulatory practices in Asia, Europe and the United States.

Mayer Brown's Global Financial Markets Initiative (GFMI) consists of lawyers from across these practice areas. We provide our clients with comprehensive advice and a strong, coordinated response to any challenge.

To keep our clients abreast of current developments, we provide a popular teleconference program which delivers topical summaries of key market issues. Below you'll find teleconference programs from the last year relating to Dodd-Frank legislation. *Please note, listening to a teleconference requires a brief user registration.*

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