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Legal Update
June 5, 2018

Volcker Rule Revisions Proposed by Agencies

The Board of Governors of the Federal Reserve System ("Federal Reserve"), the Federal Deposit Insurance Corporation ("FDIC"), the Office of the Comptroller of the Currency ("OCC"), the Securities and Exchange Commission ("SEC") and the Commodity Futures Trading Commission ("CFTC") (collectively, the "Agencies") have approved the release of a notice of proposed rulemaking ("Proposal") that, if adopted as a final regulation, would significantly revise the Volcker Rule.[1]

Subject to the statutory requirements, the Agencies are seeking to clarify the requirements of the Volcker Rule in order to (i) adopt a more risk-based approach, (ii) make the implementation of the regulation more efficient and less burdensome by reducing its complexity and (iii) make changes based on the experience of the industry and the regulators with the current regulations (including addressing matters from the staffs' Frequently Asked Questions ("FAQs")). While the proposed revisions address many of the implementation and compliance issues raised by the current regulation, the Proposal also requests comment on other potential changes that the Agencies are considering.[2] The comment period on the Proposal will end 60 days after it is published in the *Federal Register*. We have summarized below the proposed revisions.

Tailored Compliance Requirements

The Proposal would seek to better tailor the application of the Volcker Rule to banking entities by creating categories of banking entities based on their levels of trading activity. Specifically, banking entities would be divided into the following categories:

- Entities with "significant trading assets and liabilities," meaning consolidated gross trading assets and liabilities of at least $10 billion (excluding obligations of or guaranteed by the United States or any agency of the United States)
- Entities with "moderate trading assets and liabilities," meaning consolidated trading assets and liabilities of less than $10 billion, but greater than or equal to $1 billion
- Entities with "limited trading assets and liabilities," meaning consolidated trading assets and liabilities of less than $1 billion

Non-US banking entities would determine if they have significant trading assets and liabilities by reference to the aggregate assets of their *combined US operations* but would use aggregate assets of their *worldwide operations* to determine if they have limited trading assets and liabilities.[3] Thus, non-US banking groups that do not trigger the definition of significant trading assets and liabilities would be included in the moderate category, unless they have less than $1 billion in trading assets and liabilities on a global basis.

Banking entities with significant trading assets and liabilities would be required to have a comprehensive six-pillar Volcker Rule compliance program similar to that required by the current regulation. Banking entities with moderate trading assets and liabilities would be subject to reduced compliance obligations tailored to their trading activities. Banking entities with limited trading assets and liabilities would be presumed to be in compliance with the Volcker Rule unless an Agency determined that they were engaged in a prohibited activity and overcame the presumption of compliance.

The Agencies also would have the authority to put a banking entity in a more stringent compliance category based on an individualized determination. In the Proposal, the Agencies state that approximately 40 top-tier banking entities would have sufficient trading assets and liabilities so as to be ineligible for a presumption of compliance, but do not identify the affected banks or the allocation between US and non-US banking groups.[4]

While the stratification of banking entities would be based solely on the banking entity's trading assets and liabilities, the applicable level of compliance program obligations resulting from that trading measure would apply equally to covered fund activities. Thus, banking entities with "significant" trading operations would be subject to the most onerous compliance program requirements not only with respect to their trading activities, but also with respect to their covered fund activities. Likewise, banking entities with only "moderate" or "limited" trading activities would be eligible for reduced compliance obligations with respect to both their trading and covered fund activities.

The potential implications of the proposed stratification of banking entities into categories based on their trading assets and liabilities is discussed in more detail below under "Covered Funds."

Banking Entity Status of Controlled Funds

The Proposal does not include any proposed amendments that would affect the Agencies' current approach, established through a series of FAQs and no-action relief, with respect to the potential "banking entity" treatment of registered investment companies ("RICs"), foreign public funds ("FPFs") or "foreign excluded funds." Rather, the Proposal indicates that the Agencies will continue not to regard RICs and FPFs as banking entities, provided that the banking entity sponsor reduces its ownership interest to not more than 25 percent of any class of voting shares after a seeding period and conducts its investment advisory and other services in accordance with applicable law.

With respect to the potential banking entity status of foreign excluded funds, the Proposal preserves the status quo established by the Agencies' policy statement of July 21, 2017, which set out a no-action position pursuant to which "qualifying foreign excluded funds" established and operated as part of a bona fide asset management business would, in effect, not be characterized as banking entities pending further consideration of the issue by the Agencies. The Proposal includes an announcement that this no-action position will be extended for an additional year, until July 21, 2019, as the Agencies continue to consider the issue. The Proposal also requests further comment on how the Agencies should address foreign excluded funds, particularly in light of the proposed changes to the exemptions for proprietary trading that occurs solely outside of the United States ("TOTUS") and for covered fund activities solely outside the United States ("SOTUS") (as defined below) and whether the industry would find it helpful to have the option to treat foreign excluded funds as covered funds (since covered funds are exempt from the definition of banking entity).

Notably, the Proposal appears to address a recurring question among many industry participants regarding the permissible length of a RIC or FPF seeding period, which the Agencies in their July 2015 FAQ had stated "may take some time, for example, three years." In the Proposal, the Agencies characterize the reference to three years as being an "example" that was provided "without setting any maximum prescribed period for a RIC or FPF seeding period." On the other hand, Question 14 to the Proposal goes on to ask whether "commenters believe that there is uncertainty about the length of permissible seeding periods for RICs, FPFs, and SEC-regulated business development companies due to the Agencies' description of a seeding period … without specifying a maximum period of time." Accordingly, this issue may still require further industry engagement during the comment process.

Proprietary Trading

CHANGES TO TRADING ACCOUNT DEFINITION

The Proposal would significantly revise the definition of a "trading account" by eliminating one of the three prongs in the current definition, eliminating the 60-day rebuttable presumption of proprietary trading, revising the market risk capital rule prong of the current definition and establishing a presumption of compliance for certain banking entities.[5]

Elimination of Short-Term Intent Prong and the 60-day Presumption

The Proposal would revise the definition of trading account in _.3(b)(1) by deleting the "short-term intent" prong (subparagraph _.3(b)(i) (the "short-term intent" prong) and the rebuttable presumption that holding a financial instrument or related risk for fewer than 60 days is prohibited proprietary trading (subparagraph_.3(b)(2)). The short-term intent prong would be replaced by a new prong, the "accounting prong," under which a trading account would be any account used to purchase or sell a financial instrument that is recorded at fair value on a recurring basis under GAAP or other appropriate accounting standards (as is generally the case with derivatives, trading securities and available-for-sale securities).[6]

Although the 60-day presumption under the current regulation was never characterized by the Agencies as providing a "safe harbor" for positions held beyond that period, certain market participants had come to view that time period as establishing an informal "rule of thumb" for identifying the short-term trading activity that the Agencies would view as most problematic and had developed policies and procedures related to such activities in order to ensure that positions were held open for some period of time in excess of 60 days. It will be interesting to see whether the proposed shift from a "short-term intent" approach, coupled with a 60-day marker approximating the meaning of "short-term," to a test driven solely by accounting treatment may result in an expansion of positions that are viewed as falling within the trading account.

Moreover, because this new accounting test replaces an existing test (as opposed to clarifying or narrowing a test), it may result in additional compliance burdens to the extent previously held positions that are not grandfathered must be reassessed under the changed rule.

Revised Market Risk Capital Prong of Trading Account Definition

The Proposal would add a new prong to the definition of a trading account for non-US banking entities that is analogous to the current "market risk capital" prong. Trading account would include any account used by a non-US banking entity to purchase or sell financial instruments (as defined by the Volcker Rule) that are subject to capital requirements under a non-US regulator's market risk framework that is consistent with the Basel Committee on Banking Supervision's market risk framework.

Presumption of Compliance

New _.3(c) would create a presumption of compliance for each desk that trades for a trading account (as defined under the accounting prong, but not the market risk capital or "dealer" prongs[7]) if the sum of the absolute values of the daily net gain and loss figures for the preceding 90-day calendar period do not exceed $25 million. It appears that the Agencies designed this formula to roughly exclude trading desks focused on customer-driven trading activities and avoid trade-by-trade compliance assessments for trading activity that does not justify the extensive ongoing compliance costs of the current regulation.

If a trading desk's activity exceeds that threshold, then the banking entity would need to demonstrate the desk's compliance with the proprietary trading ban.[8] Further, this presumption of compliance would be optional, meaning that a trading desk could instead elect to demonstrate compliance with the prohibition against proprietary trading.

EXPANSION OF LIQUIDITY MANAGEMENT EXCLUSION

The Proposal would expand the current liquidity management exclusion to the proprietary trading prohibition by allowing banking entities to use certain financial instruments that are not "securities" as part of liquidity management activities. As proposed, banking entities would be authorized to use foreign exchange forwards, foreign exchange swaps and physically settled cross-currency swaps[9] for liquidity management purposes if these are entered into in accordance with a documented liquidity management plan and comply with the other requirements of the current liquidity management exclusion for securities. Under the current regulations it is not clear that these instruments are eligible.

ERROR CORRECTION EXCLUSION

The Proposal would add a new exclusion to the proprietary trading prohibition for purchases or sales of financial instruments that (i) were made in error while the banking entity was engaged in a permitted or excluded activity or (ii) are undertaken to correct such an error. The Agencies expect banking entities to make reasonable efforts to prevent errors from occurring, and the exclusion will only be available if relevant facts and circumstances indicate that the trade was truly made in error. To reinforce this approach, the Agencies will require the banking entity to transfer erroneously acquired financial instruments to a separately managed trade error account for disposition by personnel who are independent from the traders who made the initial error.

RESERVATION OF AUTHORITY

The Proposal would add a reservation of authority to the Volcker Rule that would allow an Agency to determine on a case-by-case basis and subject to notice-and-response that the purchase or sale of a financial instrument either is or is not for the trading account.

CHANGES TO THE UNDERWRITING AND MARKET-MAKING EXEMPTIONS

As with the current regulation, under the modestly changed underwriting and market-making exemptions in _.4, trading desks' positions established in reliance on these exemptions cannot exceed the reasonably expected near-term demands ("RENTD") of clients, customers and counterparties. However, compliance with the RENTD condition would be presumed, under new sections _.4(a)(8) and _.4(b)(6), if a banking entity maintains and enforces internal risk limits for each trading desk.

The changes to the underwriting and market-making exemptions, while favorable to the banking industry, will likely have a modest impact for most banking entities because they do not eliminate the RENTD condition. Rather, as discussed below, they replace the RENTD condition with a rebuttable presumption of compliance tied to internal risk limits that are (i) determined by banking entities at a trading desk level and (ii) subject to reporting to and supervision by the Agencies.

As revised, the underwriting exemption would require the banking entity to establish internal risk limits for each trading desk based on the: (i) amount, types and risk of its underwriting position; (ii) level of exposures to relevant risk factors arising from its underwriting position; and (iii) period of time a security may be held. For the market-making exemption, the banking entity would be required to establish the internal risk limits for each trading desk based on the: (i) amount, types and risk of its market maker positions; (ii) amount, types and risks of the products, instruments and exposures the trading desk may use for risk management purposes; (iii) level of exposures to relevant risk factors arising from its financial exposure; and (iv) period of time a financial instrument may be held. The processes for setting and reviewing trading desk-level limits would need to be subject to internal policies and procedures and banking entities would need to report increases to limits and limit exceedances to the appropriate Agency. The Agencies would retain authority to oversee and review internal risk limits and may refute the presumption of compliance if facts and circumstances indicate that the banking entity is engaging in an activity that is not based on the trading desk's RENTD.

For the underwriting and market-making exemptions, only banking entities with significant trading assets and liabilities will be required to have a compliance program under subpart D (i.e., reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing products, instruments, exposures, limits, authorization and escalation related to the trading desk's exempted activities). This means that while all banking entities will be required to establish internal risk limits and comply with the other terms of the exemptions, banking entities with moderate or limited trading assets and liabilities will not need to implement an exemption-specific compliance program.

REVIEW OF LOAN-RELATED SWAPS

The Proposal requests comment on whether loan-related swaps and related hedges should be deemed to be exempt from the proprietary trading prohibition by virtue of the market-making exemption, even if a smaller banking entity does not routinely engage in such swaps. Alternatively, the Agencies are considering establishing a new exclusion or exemption for such transactions. The Agencies note that purchasing and selling such instruments in the absence of regulatory relief would be expected to trigger the new accounting prong of the trading account definition because "any derivative transaction would constitute proprietary trading pursuant to the definition of 'trading account' if it were recorded at fair value on a recurring basis under applicable accounting standards."

REVIEW OF MARKET-MAKING HEDGING

Under the current regulation, it is unclear how affiliated trading desks should treat certain intra-entity trades. The Proposal requests comment on whether affiliated trading desks should be permitted to treat each other as a client, customer or counterparty for purposes of establishing internal risk limits or RENTD levels under the market-making exemption.[10] Alternatively, the Agencies seek comment on whether one desk should be allowed to treat a transaction as permissible market-making and the other, affiliated desk treat the same transaction as a risk-mitigating hedge.

EASING THE CONDITIONS OF THE RISK-MITIGATING HEDGING EXEMPTION

The Proposal includes four significant proposed revisions to the risk-mitigating hedging exemption to the prohibition against proprietary trading, which together would relax the eligibility restrictions and compliance obligations for banking entities relying on the exemption. First, the Agencies propose to eliminate the correlation analysis requirement. Second, they propose to eliminate the requirement to show that a hedge "demonstrably reduces or significantly mitigates" an identifiable risk. Third, as with the underwriting and market-making exemptions, only banking entities with significant trading assets and liabilities will be required to have a compliance program under subpart D.[11] Fourth, the Agencies propose to eliminate certain documentation requirements for banking entities with significant trading assets and liabilities that rely on the risk-mitigating hedging exemption. Accordingly, as revised, banking entities with significant trading assets and liabilities would not be required to comply with enhanced documentation requirements with respect to common types of hedging transactions that are listed on a pre-approved list of financial instruments and comply with pre-approved hedging limits.

LIBERALIZED TOTUS EXEMPTION

The Proposal would ease the conditions imposed on non-US banking entities seeking to rely on the TOTUS exemption.[12] Specifically, it would remove the requirements that (i) no financing for the banking entity's purchase or sale be provided by any US branch or affiliate of the banking entity and (ii) the purchase or sale generally not be conducted with or through any US entity.[13] It also would revise the US-based personnel restriction so that it applies only to personnel engaged in the non-US banking entity's decision to purchase or sale the financial instrument and thus would no longer apply to personnel engaged solely in arranging, negotiating and executing trades.

Covered Funds

In contrast to the approach taken with respect to the proprietary trading rules, the Proposal includes just a few proposed incremental adjustments to limited aspects of the covered fund regulations, coupled with extensive requests for industry comment on "all aspects" of certain elements of the covered fund rules, including most significantly the "covered fund" definition itself. Among other topics, the Agencies specifically request comment on issues such as the Volcker Rule's treatment of securitization activities, which has already been subject to several years of extensive commentary throughout the rulemaking process as well as other forms of formal and informal dialogue between and among market participants and the Agencies. In addition, the Proposal solicits industry views regarding the effectiveness of prior guidance issued through FAQs as well as a range of specific issues that have attracted Agency attention since implementation of the current regulation in 2013. We summarize in this section key aspects of the covered fund provisions of the Proposal.

REVIEW OF COVERED FUND DEFINITION

The Proposal does not include any specific proposals to amend the definition of "covered fund" or any of the exclusions to the definition set out in section _.10 of the current regulation. Instead, the Proposal provides an extensive discussion of the statutory framework for defining covered funds and comprehensive lists of questions regarding the "base definition" of the term as well as current and potential exclusions. A number of recurring themes emerge from the Agencies' discussion of covered fund issues, including their effort to navigate a somewhat complex and not entirely coherent statutory framework for covered fund activities, as well as an apparent inclination to consider as part of any future amendments the extent to which some of the most disruptive aspects of the covered fund rules may already have been addressed by the industry and the costs and benefits potentially associated with further revisions.

With respect to exclusions from the definition of "covered fund," the Proposal includes a particularly extensive discussion, including 14 multi-part questions, related to "foreign public funds." The Proposal also poses questions related to specific types of vehicles that have been the subject of inquiries to the Agencies, either because they did not receive exclusions in the current regulation or because exclusions that were implemented may not have had the intended effect. Specifically, the Proposal includes questions related to securitizations, joint ventures (including the effectiveness of the Agencies' June 2015 FAQ), family wealth management vehicles, certain small business investment companies ("SBICs") and municipal tender option bond vehicles. With respect to securitizations, the Proposal specifically acknowledges the rule of construction in section 13(g)(2) of the statute, which states that nothing in the Volcker Rule "shall be construed to limit or restrict the ability of a banking entity … to sell or securitize loans in a manner otherwise permitted by law," and requests comment regarding various aspects of the regulation that were intended to achieve that objective.

COVERED FUND ISSUES FOR SECURITIZATION

The Proposal requests comment regarding the scope of the definition of "ownership interest." In particular the Proposal recognizes that the inclusion of a right to participate in the selection or removal of a fund manager or trustee other than as an exercise of creditor rights upon an event of default may be interpreted not to permit banks as investors in collateralized loan obligations ("CLOs") to exercise remedies upon certain manager triggers that do not equate to an event of default. The Proposal also asks for views regarding the inclusion in "other similar interests" of a right to share in the distributions of profits of a fund. While acknowledging that tranched securitization debt securities might be caught in this prong of the definition even if the securities provide only for fixed payments of periodic interest and principal, the Proposal asks for commenters to differentiate between the distribution of profits in a securitization versus the distribution of profits in other covered funds.

As noted above, the Proposal recognizes the statutory exclusion for securitizations, but does not propose to change the current exclusions for loan securitizations, qualifying asset-backed commercial paper ("ABCP") conduits or qualifying covered bond. However, the Proposal seems to acknowledge that the existing securitization exclusions may not be adequate to fully encompass the statutory requirement not to prohibit the securitization of loans. Consequently, the Proposal requests comment regarding whether changes need to be made to the current loan securitization exclusion (with carryover effects in the ABCP and covered bond exclusions) to permit additional ancillary assets to be included or to permit a five-percent or 10-percent bond bucket, as has been requested by the CLO industry since adoption of the current regulation in 2013.

RELAXATION OF RESTRICTIONS ON THE UNDERWRITING AND MARKET-MAKING EXEMPTIONS FOR CERTAIN COVERED FUND INTERESTS

The Proposal would expand the ability of banking entities engaged in underwriting and market making activities to engage in those activities with respect to ownership interests in third-party funds. Under the current regulation, a banking entity is permitted to act as an underwriter or market maker for covered fund ownership interests, provided that banking entity includes the aggregate value of all ownership interests of a covered fund acquired or retained by the banking entity acting as underwriter or market maker in its aggregate covered fund ownership limit and subjects those interests to the capital deduction requirement. The Proposal provides that, for any covered fund that a banking entity does not organize and offer, ownership interests acquired in connection with permissible underwriting or market making activity would no longer count toward the aggregate fund limit and would not be subject to the capital deduction. These limits, as well as the three-percent "per fund" limit, would continue to apply to a covered fund that the banking entity organizes or offers.

EXPANSION OF THE RISK-MITIGATING HEDGING EXEMPTION FOR FUND-LINKED PRODUCTS

The Proposal would address a longstanding issue raised under the current regulation that had precluded certain banking entities from serving in an intermediary capacity by providing clients and customers with indirect exposure to covered funds. Specifically, the Proposal would expand the risk-mitigating hedging exemption from the covered fund restrictions (which currently applies only in a very narrow context related to employee compensation arrangements) by permitting a banking entity to acquire or retain an ownership interest in a covered fund as a hedge when acting as an intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund.

ADJUSTMENTS TO THE SOTUS EXEMPTION

The Proposal would make two minor adjustments to the SOTUS exemption. Similar to the proposed amendment to the TOTUS exemption, the Proposal would eliminate from the SOTUS exemption the requirement that no financing for the banking entity's purchase or sale of a covered fund ownership interest is provided by any US branch or affiliate of the banking entity. In addition, the Proposal would incorporate into the regulation the Agencies' February 2015 FAQ guidance regarding the scope and content of the US marketing restriction.

REVIEW OF SUPER 23A PROHIBITION

As with most of the covered fund rules, the Proposal does not include any specific proposals with respect to the "Super 23A" prohibition on "covered transactions" with any covered fund organized and offered by a banking entity or with respect to which the banking entity serves as investment manager, investment adviser, commodity trading advisor or sponsor. However, the Proposal does request comment on a longtime industry concern regarding the Agencies' decision in the current regulation not to incorporate the exemptions in section 23A of the Federal Reserve Act and Regulation W into section _.14 of the regulation.

The Proposal also requests comment on certain aspects of the prime brokerage exemption from Super 23A and the CFTC's March 2017 interpretive letter effectively providing futures commission merchants ("FCMs") with no-action relief in relation to the Super 23A prohibition when providing futures, options and swaps clearing services to covered funds otherwise in scope of the prohibition based on relationships with affiliates (e.g., where an affiliate of the FCM acts as investment manager).

Compliance Program, Reporting and Recordkeeping

TAILORING OF GENERAL COMPLIANCE PROGRAM REQUIREMENTS

The Proposal would revise the general compliance program requirements so that banking entities with:

(i) *significant* trading assets and liabilities would remain subject to the comprehensive compliance program requirements (including the CEO attestation);

(ii) *moderate* trading assets and liabilities would be subject to a simplified compliance program requirement and the CEO attestation requirement; and

(iii) *limited* trading assets and liabilities would have no compliance program requirements because they would be presumed to be in compliance with the Volcker Rule.

The Agencies retain the authority to require a banking entity with limited trading assets and liabilities to implement a compliance program if an Agency determines that the entity is engaged in prohibited proprietary trading or covered fund activity.

Among other impacts, this new structure would have the effect of eliminating the covered fund documentation requirement for banking entities with moderate trading assets and liabilities, all of which would under the Proposal be permitted to rely on the simplified compliance program requirement previously available to a more limited set of banking entities. This simplified compliance program generally consists of including appropriate references to Volcker Rule compliance in pre-existing policies and procedures, which has proven relatively easy to implement for smaller banking entities. As discussed below, however, there is a question whether banking entities with moderate trading assets and liabilities would, as a practical matter, abandon newly built Volcker Rule compliance programs to rely instead on the simplified compliance program relief or whether those programs would be retained (potentially in some hybrid form), particularly given the apparent need to support the CEO attestation requirement.

RESTRUCTURING OF APPENDIX B ENHANCED MINIMUM STANDARDS FOR COMPLIANCE PROGRAMS

The Proposal would eliminate the enhanced minimum standards for large banking entities and banking entities engaged in significant trading activities as being unnecessary in light of current compliance and risk management efforts and because banking entities may individually tailor their compliance programs to achieve the same level of compliance. The Proposal includes a chart showing how the compliance program requirements would change from the current Volcker Rule, which is reproduced as Appendix A to this update.

CONTINUED CEO ATTESTATION REQUIREMENT

Notwithstanding considerable criticism of the requirement that a banking entity's CEO must review and annually attest in writing that the banking entity has implemented an appropriate Volcker Rule compliance program, the Proposal implements a CEO attestation requirement for all banking entities other than those with limited trading assets and liabilities.[14]

While this generally continues the CEO attestation requirement that has applied under the Appendix B enhanced minimum standards, it may increase the number of banking entities that are subject to the attestation requirement. This is because the requirement currently applies to US banking entities with $50 billion or more in total assets or $10 billion or more in trading assets and liabilities and non-US banking entities with $50 billion or more in combined US assets or $10 billion or more in combined US trading assets and liabilities. However, the Proposal would require all banking entities with significant or moderate trading activities to comply with the CEO attestation requirement, which will pick up banking entities with more than $1 billion in trading assets and liabilities.

In addition to this scoping issue, the retention of the CEO attestation requirement for banking entities with moderate trading activities is likely to present other challenges, in part because this requirement seems inconsistent with the approach to reducing compliance burden taken elsewhere in the Proposal. In particular, the Proposal would permit a banking entity with moderate trading assets and liabilities generally to satisfy its compliance program obligations by "including in its existing policies and procedures appropriate references to the requirements of" the Volcker Rule, without satisfying the six-pillar compliance program requirements. Given the challenges market participants have already had developing an internal framework sufficient to support a CEO compliance attestation under the current regulation, it is difficult to envision CEOs presiding over banking entities with moderate trading activities and, thus, no comprehensive compliance program, obtaining sufficient comfort to provide this written attestation solely on the basis of policies and procedures that include “appropriate references” to the Volcker Rule requirements.

STREAMLINED METRICS REPORTING AND RECORDKEEPING REQUIREMENTS

The Proposal would implement a dozen revisions to the metrics, reporting and recordkeeping requirements, as follows:

1. Limit the applicability of certain metrics only to market making and underwriting desks.
2. Replace the Customer-Facing Trade Ratio with a new Transaction Volumes metric to more precisely cover types of trading desk transactions with counterparties.
3. Replace Inventory Turnover with a new Positions metric, which measures the value of all securities and derivatives positions.
4. Remove the requirement to separately report values that can be easily calculated from other quantitative measurements already reported.
5. Streamline and make consistent value calculations for different product types, using both notional value and market value to facilitate better comparison of metrics across trading desks and banking entities.
6. Eliminate inventory aging data for derivatives because aging, as applied to derivatives, does not appear to provide a meaningful indicator of potential impermissible trading activity or excessive risk-taking.
7. Require banking entities to provide qualitative information specifying for each trading desk the types of financial instruments traded, the types of covered trading activity the desk conducts and the legal entities into which the trading desk books trades.
8. Require a Narrative Statement describing changes in calculation methods, trading desk structure or trading desk strategies.
9. Remove the paragraphs labeled “General Calculation Guidance.” The form instructions generally would provide calculation guidance.
10. Remove the requirement that banking entities establish and report limits on Stressed Value-at-Risk at the trading-desk level because trading desks do not typically use such limits to manage and control risk-taking.
11. Require banking entities to provide descriptive information about their reported metrics, including information uniquely identifying and describing certain risk measurements and information identifying the relationships of these measurements within a trading desk and across trading desks.
12. Require electronic submission of the Trading Desk Information, Quantitative Measurements Identifying Information and each applicable quantitative measurement in accordance with the XML Schema specified and published on each Agency’s website.

Conclusion

While not a wholesale revision of the Volcker Rule or a comprehensive treatment of areas previously raised by the OCC in its 2017 request for information, the proposed changes in the Proposal represent a meaningful step forward in rationalizing the regulation, and the numerous additional requests for comment suggest that the final regulation could go further than merely the proposed rule edits. In light of the sheer number of questions put forward by the Agencies, it is difficult to anticipate that the proposed revisions could be finalized in 2018. However, we expect continuing developments with respect to the Volcker Rule as the newly installed heads of the Agencies leave their mark on Volcker Rule supervision and enforcement and craft a final regulation based on public comment.

Appendix A

Summary of Proposed Changes to Compliance Program Requirements

REQUIREMENT (CITATION TO 2013 FINAL RULE)	BANKING ENTITIES SUBJECT TO REQUIREMENT IN 2013 FINAL RULE	BANKING ENTITIES SUBJECT TO REQUIREMENT IN PROPOSAL
6-Pillar Compliance Program **(Section __.20(b))**	Banking entities with more than $10 billion in total consolidated assets	Banking entities with significant trading assets and liabilities
Enhanced Compliance Program **(Section __.20(c), Appendix B)**	Banking entities with: • $50 billion or more in total consolidated assets or • Trading assets and liabilities of $10 billion or greater over the previous consecutive four quarters, as measured as of the last day of each of the four prior calendar quarters, if the banking entity engages in proprietary trading activity permitted under subpart B. Additionally, any other banking entity notified in writing by the Agency	Not applicable. Enhanced compliance program eliminated (but see CEO Attestation Requirement below).
CEO Attestation Requirement **(Section __.20(c), Appendix B)**	Banking entities with: • $50 billion or more in total consolidated assets or • Trading assets and liabilities of $10 billion or greater over the previous consecutive four quarters, as measured as of the last day of each of the four prior calendar quarters. Additionally, any other banking entity notified in writing by the Agency	• Banking entities with significant trading assets and liabilities • Banking entities with moderate trading assets and liabilities • Any other banking entity notified in writing by the Agency

REQUIREMENT (CITATION TO 2013 FINAL RULE)	BANKING ENTITIES SUBJECT TO REQUIREMENT IN 2013 FINAL RULE	BANKING ENTITIES SUBJECT TO REQUIREMENT IN PROPOSAL
Metrics Reporting Requirements **(Section __.20(d), Appendix A)**	• Banking entities with trading assets and liabilities the average gross sum of which over the previous consecutive four quarters, as measured as of the last day of each of the four prior calendar quarters, is $10 billion or greater, if the banking entity engages in proprietary trading activity permitted under subpart B. • Any other banking entity notified in writing by the Agency	• Banking entities with significant trading assets and liabilities • Any other banking entity notified in writing by the Agency
Additional Covered Fund Documentation Requirements **(Section __.20(e))**	Banking entities with more than $10 billion in total consolidated assets as reported on December 31 of the previous two calendar years	Banking entities with significant trading assets and liabilities
Simplified Program for Banking Entities with No Covered Activities **(Section __.20(f)(1))**	Banking entities that do not engage in activities or investments pursuant to subpart B or subpart C (other than trading activities permitted pursuant to § __.6(a) of subpart B)	Banking entities that do not engage in activities or investments pursuant to subpart B or subpart C (other than trading activities permitted pursuant to § __.6(a) of subpart B)
Simplified Program for Banking Entities with Modest Activities **(Section __.20(f)(2))**	Banking entities with $10 billion or less in total consolidated assets as reported on December 31 of the previous two calendar years that engage in activities or investments pursuant to subpart B or subpart C (other than trading activities permitted pursuant to § __.6(a) of subpart B)	Banking entities with moderate trading assets and liabilities
No Compliance Program Requirement Unless Agency Directs Otherwise (N/A)	Not applicable.	Banking entities with limited trading assets and liabilities subject to the presumption of compliance

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Endnotes

1 *Federal Reserve Board asks for comment on proposed rule to simplify and tailor compliance requirements relating to the "Volcker rule"* (May 30, 2018), available at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180530a.htm. The FDIC approved the release of the Proposal on May 31, 2018, at which time the Comptroller signaled that he had approved the release on behalf of the OCC. The CFTC approved the release on June 4, 2018, and the SEC met on June 5, 2018, to do the same. *Agencies ask for public comment on proposal to simplify and tailor "Volcker rule"* (June 5, 2018), available at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180605a.htm.

2 On May 24, 2018, certain amendments were adopted to the statutory Volcker Rule as part of the Crapo Act ("Economic Growth, Regulatory Relief, and Consumer Protection Act"). Please see our Legal Update on the Crapo Act at https://www.mayerbrown.com/Congress-Passes-Regulatory-Reform-for-Financial-Institutions-05-22-2018/. The Agencies plan to issue amendments to the current regulation to implement these legislative amendments and state that they will not enforce the current regulation in a manner inconsistent with the amendments until such time as the Agencies have issued regulations implementing the amendments.

3 The Proposal requests feedback on whether the Agencies should further tailor the application of the Volcker Rule to banking entities that operate on a separate and independent basis from an affiliated banking group.

4 Vice Chairman Randal Quarles disclosed in the Federal Reserve's open meeting on May 30, 2018, that only 18 top-tier banking entities had significant trading assets and liabilities.

5 The Proposal notes that the term "trading account" is "a statutory concept and does not necessarily refer to an actual account." It "is simply nomenclature for the set of transactions that are subject to the prohibitions on proprietary trading."

6 The Proposal requests feedback on whether the proposed revision to the definition should be further expanded to include financial instruments that are valued using a "practical expedient" to fair value measurements such as the net asset value method under ASC 820.

7 The Proposal requests comment on how often registered dealers identify trading positions that are not covered by the dealer program and if those positions would be covered by the new accounting prong.

8 The Proposal would not revise the definition of a trading desk, but the Agencies have solicited comment on alternatives to the current definition. The alternative definition could contain a multi-factor analysis that is generally keyed to a banking entity's organizational structure. Additionally, the Proposal requests comment on whether the Agencies should further tailor their approach to reflect that the SEC and CFTC operate with different supervisory and examination approaches than do the banking regulators.

9 The Proposal would define a cross-currency swap as "a swap in which one party exchanges with another party principal and interest rate payments in one currency for principal and interest rate payments in another currency, and the exchange of principal occurs on the date the swap is entered into, with a reversal of the exchange of principal at a later date that is agreed upon when the swap is entered

into." The Agencies believe that this definition is consistent with the swap margin and capital regulations under Title VII of the Dodd-Frank Act.

[10] The Proposal does not expressly state when banking entities would need to establish RENTD levels under the market-making exemption, but presumably such levels would be necessary if an entity's risk limits were found not to satisfy the presumption of compliance discussed above.

[11] As discussed in the "Covered Funds: Review of Covered Fund Definition" section of this update, all banking entities with significant trading assets and liabilities will be required to implement a comprehensive compliance program under subpart D.

[12] The Agencies request comment on whether these changes that are designed to provide relief to non-US banking entities will disadvantage US banking entities, for which no similar exemption is or would be made available.

[13] While the Proposal would remove the counterparty prong that restricts purchases or sales with or through any "US entity" in what appears to be an inadvertent drafting error, it does not remove the otherwise unused definition of "US entity" at _.6(e)(4).

[14] The Proposal requests comment on whether larger banking entities (i.e., greater than $50 billion in assets) should be required to comply with the CEO attestation requirement, even if they have limited trading assets and liabilities.