These Davis Polk flowcharts are designed to assist banking entities in identifying permissible and impermissible proprietary trading activities under the final regulations implementing the Volcker Rule, issued by the Federal Reserve, FDIC, OCC, SEC and CFTC on December 10, 2013. An introduction to the new compliance requirements is also included.

To make our summary and analysis of the final rules more user-friendly, these flowcharts graphically map the key restrictions on covered trading activities in lieu of a traditional law firm memo.

Davis Polk flowcharts analyzing the Volcker Rule’s prohibition on banking entities sponsoring or acquiring ownership interests in hedge funds and private equity funds will be available at www.volckerrule.com.
Volcker Rule Final Regulations: Proprietary Trading Overview

Is a banking entity engaged in proprietary trading under the Volcker Rule?

- Is a banking entity trading?
- Does the activity or transaction involve a purchase or sale of one or more financial instruments?
- Is the entity trading as principal for a trading account?
- Is an exclusion from proprietary trading available?

Is the activity permitted under the Volcker Rule?

- Market Making-Related Activities
- Underwriting Activities
- Risk-Mitigating Hedging Activities
- Trading in Government Obligations
- Trading on Behalf of Customers
- Trading by a Regulated Insurance Company
- Trading Activities of Foreign Banking Entities Outside the United States

Is the activity precluded by a backstop prohibition?

Does the activity:
- Involve or result in a material conflict of interest between the banking entity and its clients, customers or counterparties?
- Result in a material exposure by the banking entity to high-risk assets or trading strategies?
- Pose a threat to the safety and soundness of the banking entity or U.S. financial stability?

Tiered compliance program and reporting requirements apply

Activity is permitted proprietary trading

Activity is impermissible proprietary trading

Activity is not proprietary trading and is not within the scope of the Volcker Rule

No (or if an exclusion is available)
Step 1A: Is a Banking Entity Trading?

Is the entity:

- An **insured depository institution**?
  - Yes
  - No

- A company that controls an insured depository institution (e.g., a **bank holding company**)?
  - No
  - Yes

- A company that is **treated as a bank holding company** for purposes of Section 8 of the International Banking Act?
  - A foreign bank with a U.S. branch, agency or U.S. commercial lending company subsidiary
  - A parent company of such foreign bank
  - No
  - Yes

- An **affiliate or subsidiary**, as defined in the Bank Holding Company Act, of any of the above?
  - No
  - Yes

Does the insured depository institution function solely in a trust or fiduciary capacity?

- Substantially all of its deposits are in trust funds and are received in a *bona fide* fiduciary capacity
- None of its insured deposits are offered or marketed by or through an affiliate of the institution
- The institution does not:
  - Accept demand deposits or deposits that can be withdrawn by check or similar means for payment to third parties or others, or make commercial loans
  - Obtain payment or payment-related services from any Federal Reserve Bank
  - Exercise Federal Reserve discount or borrowing privileges

This exclusion is in the statute, not in the final regulations.

Entity is a banking entity. Go to next page.

Is the affiliate or subsidiary:

- A **covered fund** that is not itself a banking entity under any of the previous questions?
- A **portfolio company** held under the merchant banking or insurance company investment authorities of section 4(k) of the BHC Act, or any portfolio concern controlled by an SBIC, in each case, that is not itself a banking entity under any of the previous questions?
- The FDIC acting in its corporate capacity or as conservator or receiver?

Entity is NOT a banking entity and is NOT subject to the Volcker Rule.
Step 1B:
Does the Activity or Transaction Involve a Purchase or Sale of One or More Financial Instruments?

Is the banking entity purchasing or selling* as principal one or more of the following?

EXCLUDED FROM THE DEFINITION OF FINANCIAL INSTRUMENT

- Loan
  Any loan, lease, extension of credit, or secured or unsecured receivable that is not a security or derivative

- Commodity
  A commodity, except one that is:
  - An excluded commodity (i.e., financial commodities), other than foreign exchange or currency
  - A futures contract or option on a futures contract
  - A derivative

- Foreign exchange or currency

INCLUDED IN THE DEFINITION OF FINANCIAL INSTRUMENT:
SEcurities, DerIVATIVES, FUTURES

Securities
As defined in section 3(a)(10) of the Securities Exchange Act including an option on a security

Derivatives
Includes:
- Swaps and security-based swaps
- Physical commodity forwards
- Foreign exchange swaps and foreign exchange forwards
- Retail foreign exchange and retail commodity transactions
- An option on any of the above

Does not include:
- Any consumer, commercial or other agreement, contract or transaction that has been jointly determined by the SEC and CFTC not to be a swap or security-based swap
- Any identified banking product under the Legal Certainty for Banking Products Act of 2000

Futures contracts and options on futures contracts

Trade is a purchase or sale of a financial instrument. Go to next page.

ACTIVITY IS NOT PROPRIETARY TRADING AND IS NOT WITHIN THE SCOPE OF THE VOLCKER RULE

* For derivatives, “purchase” and “sale” include the execution, termination (prior to scheduled maturity), assignment, exchange or similar transfer/conveyance of, or extinguishing of rights or obligations under, a derivative.
Step 1C: Is the Banking Entity Trading as Principal for a Trading Account?

Regardless of purpose, does the banking entity meet either of the following descriptions?

- The banking entity is licensed or registered to engage in the business of a dealer, a swap dealer, or a security-based swap dealer (or required to be).

- The banking entity engages in the business of a dealer, swap dealer or security-based swap dealer outside of the United States. AND

The financial instrument is purchased or sold in connection with the activities that require the banking entity to be licensed/registered as a dealer or are in connection with the activities of such business outside the United States, as relevant.

**PURPOSE TEST**

Is the account* used to purchase or sell one or more financial instruments principally for the purpose of any of the following?

- Short-term resale
- Benefitting from actual or expected short-term price movements
- Realizing short-term arbitrage profits
- Hedging one or more such positions

A rebuttable presumption that a trade is for a trading account arises if the banking entity:

- Holds the instrument for fewer than 60 days, or
- Substantially transfers its risk within 60 days.

**STATUS TEST**

Regardless of purpose, does the banking entity meet either of the following descriptions?

- The banking entity is licensed or registered to engage in the business of a dealer, a swap dealer, or a security-based swap dealer (or required to be).

- The banking entity engages in the business of a dealer, swap dealer or security-based swap dealer outside of the United States.

**MARKET RISK CAPITAL RULE TEST**

If the banking entity, or any affiliate of the banking entity, is an insured depository institution, a bank holding company or a savings and loan company that is subject to the U.S. banking agencies’ market risk capital rule, is the account used to purchase or sell financial instruments that are both market risk capital rule covered positions and trading positions (or hedges of such positions)?

**ACTIVITY IS NOT PROPRIETARY TRADING AND IS NOT WITHIN THE SCOPE OF THE VOLCKER RULE**

Entity is trading as principal for a trading account. Go to the next page.

*Account does not refer to an account in the normal business or accounting sense. The preamble notes that trading account is nomenclature for the set of transactions that are subject to the restrictions on proprietary trading.
Does the purchase or sale meet any of the following criteria?

- **ACTIVITY IS NOT PROPRIETARY TRADING AND IS NOT WITHIN THE SCOPE OF THE VOLCKER RULE**
  - The trading activity is proprietary trading within the scope of the Volcker Rule. Go to Step 2.

Is the banking entity trading in accordance with a documented liquidity management plan that meets specified requirements?

These circumstances include any purchase or sale:
- necessary to correct trading errors made by or on behalf of a customer;
- in connection with and related to the management of a default or threatened imminent default of a customer;
- in connection with and related to the management of a default or threatened default of the clearinghouse or financial market utility;
- in connection with and related to the management of a default or threatened default of another member of the clearinghouse or financial market utility; or
- required by the rules of the clearinghouse or financial market utility to mitigate the risk resulting from the clearing by a member of security-based swaps that reference the member or an affiliate of the member.

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**SECURITIES LENDING**
- **Securities lending transaction** in which 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 interests 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.

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**LIQUIDITY MANAGEMENT PLAN**
- Purchase or sale of a security for the purpose of liquidity management in accordance with a documented liquidity management plan of the banking entity.

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**DCO/CLEARING AGENCY TRANSACTIONS**
- By a banking entity that is a derivatives clearing organization or a clearing agency in connection with clearing financial instruments.

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**LIMITED CLEARING MEMBER ACTIVITIES**
- By a banking entity that is a member of a clearing agency, derivatives clearing organization or designated financial market utility, in specified circumstances.

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**SATISFY AN EXISTING DELIVERY OR LEGAL OBLIGATION**
- To satisfy:
  - an existing delivery obligation of the banking entity or its customers, including to prevent or close out a failure to deliver.
  - an obligation of the banking entity in connection with a judicial, administrative, self-regulatory organization or arbitration proceeding.

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**ACTING AS AGENT, BROKER OR CUSTODIAN**
- Acting solely as agent, broker or custodian.

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**EMPLOYEE COMPENSATION PLANS**
- Through a deferred compensation, stock-bonus, profit-sharing or pension plan of the banking entity that is established in accordance with the law of the United States or a foreign sovereign, if the purchase or sale is made directly or indirectly by the banking entity as trustee for the benefit of persons who are or were employees of the banking entity.

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**DEBT PREVIOUSLY CONTRACTED**
- In the ordinary course of collecting a debt previously contracted in good faith, provided that the banking entity divests the financial instrument as soon as practicable, and does not retain such investment for longer than the period permitted by its primary regulatory agency.
Step 2A-1: Permitted Activities: Market Making-Related

Is the activity market making-related?

- Yes to both
- No to either

Does the relevant trading desk* routinely stand ready, and is it willing and available?

- Routinely stand ready
  - Does the trading desk that establishes and manages the financial exposure routinely stand ready to purchase and sell financial instruments related to its financial exposure?
    - Yes to both
    - No to either
  - Financial exposure means the aggregate risks of one or more financial instruments and any associated loans, commodities, or foreign exchange or currency, held by a banking entity or its affiliate and managed by a particular trading desk as part of the trading desk’s market making-related activities.

- Willing and available
  - Is the trading desk willing and available to quote, purchase and sell, or otherwise enter into long and short positions in those types of financial instruments for its own account in commercially reasonable amounts and throughout market cycles on a basis appropriate for the liquidity, maturity and depth of the market for the relevant types of financial instruments?
    - Yes
    - No

Reasonably expected near term demands of clients, customers or counterparties

- Are the amount, types and risks of the financial instruments in the trading desk’s market-maker inventory designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers or counterparties (as described on the following slide), based on:
  - The liquidity, maturity and depth of the market for the relevant types of financial instruments; and
  - Demonstrable analysis of specified factors? (See following slide for further detail.)

Market-maker inventory means all of the positions in the financial instruments for which the trading desk stands ready to make a market in accordance with this permitted activity, that are managed by the trading desk, including the trading desk’s open positions or exposures arising from open transactions.

Market making-related hedging conducted or directed by the same market-making trading desk does not need to separately comply with the risk-mitigating hedging permitted activity. Instead, market making-related hedging may be addressed by the market-making compliance program and controls.

Activity is not a permitted market making-related activity

Has the banking entity established, and does it implement, maintain and enforce, an internal compliance program that is reasonably designed to ensure compliance?

- Yes
- No

Activity may be a permitted market making-related activity. Go to Step 3.

Metrics required if trading asset and liability threshold met.

Is the banking entity licensed or registered to engage in market-making activity in accordance with applicable law?

- Yes
- No

Are the compensation arrangements of persons performing the market making-related activities designed not to reward or incentivize prohibited proprietary trading?

- Yes
- No

Activity is not a permitted market making-related activity

To the extent that it has exceeded any limits, has the trading desk taken action to bring itself back into compliance with the limits as promptly as possible thereafter?

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The preamble notes that primary dealer activities and ETF authorized participant activities should be able to rely on the market making-related permitted activity to the extent the underwriting permitted activity is not available.

For the market making-related permitted activity, client, customer or counterparty refers to market participants that make use of the banking entity’s market making-related services by obtaining such services, responding to quotations, or entering into a continuing relationship with respect to such services.

A trading desk may engage in interdealer trading to meet the reasonably expected near term demands of its clients, customers or counterparties, including current demand, unwind or sell positions acquired from clients, customers or counterparties, or engage in risk-mitigating or inventory management transactions. However, a trading desk or other organizational unit of another banking entity is not a client, customer or counterparty of the trading desk if that other entity has trading assets and liabilities of $50 billion or more, unless:

- the trading desk documents how and why a particular trading desk or other organizational unit of the entity should be treated as a client, customer, or counterparty of the trading desk for purposes of market making-related permitted activity;
- or
- the purchase or sale by the trading desk is conducted anonymously on an exchange or similar trading facility that permits trading on behalf of a broad range of market participants.

The preamble states that interdealer trading will bear some scrutiny by the Agencies.

In order to perform market making analysis, a firm must first identify all relevant trading desks that may be ready to engage in permitted market-making activities.

Demonstrable analysis must cover the following factors: historical customer demand, current inventory of financial instruments, and market and other factors regarding the amount, types and risks of or associated with financial instruments in which the trading desk makes a market, including through block trades.

A trading desk would not qualify for the market-making exemption if it is wholly or principally engaged in arbitrage trading or other trading that is not in response to, or driven by, the demands of clients, customers or counterparties.

The preamble notes that primary dealer activities and ETF authorized participant activities should be able to rely on the market making-related permitted activity to the extent the underwriting permitted activity is not available.
Step 2B: Permitted Activities: Underwriting

Is the activity underwriting?

Is the banking entity acting as an underwriter for a distribution of securities and is the trading desk’s underwriting position related to this distribution?

- A person who has agreed with an issuer* or selling security holder to purchase securities, engage in a distribution of securities, or manage a distribution of securities on behalf of the issuer/selling security holder.
- A person who participates or agrees to participate in a distribution for or on behalf of the issuer/selling security holder.

Distribution

- An offering of securities, whether or not subject to registration under the Securities Act of 1933, that is distinguished from ordinary trading transactions by the presence of special selling efforts and selling methods, or
- An offering of securities made pursuant to an effective registration statement under the Securities Act of 1933.

Underwriting position

The long or short positions in one or more securities held by a banking entity or its affiliate, and managed by a particular trading desk, in connection with a particular distribution of securities for which such banking entity or affiliate is acting as an underwriter.

Are the amount and type of the securities in the trading desk’s underwriting position designed not to exceed the reasonably expected near term demands of clients, customers or counterparties?**

The expectation of demand does not require a belief that the securities will be placed immediately, as the time required to carry out a distribution may vary.

Are reasonable efforts 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?

Has the banking entity established, and does it implement, maintain, and enforce, an internal compliance program that is reasonably designed to ensure compliance?

Activity may be a permitted underwriting activity. Go to Step 3.

Activity is not a permitted underwriting activity

Is the banking entity acting as an underwriter for a distribution of securities and is the trading desk’s underwriting position related to this distribution?

Is the banking entity licensed or registered to engage in the underwriting activities in accordance with applicable law?

NO

YES

NO

YES

YES

NO

NO

YES

NO

NO

YES

* Issuer is defined as in Section 2(a)(4) of the Securities Act of 1933.

** Client, customer or counterparty refers to market participants that may transact with the banking entity in connection with a particular distribution for which the banking entity is acting as underwriter.

Underwriting permitted activity may include stabilization, syndicate and aftermarket short covering, holding an unsold allotment due to impracticable market conditions and call-spread transactions. Non-core activity (e.g., purchasing a financial instrument from a customer to facilitate the customer’s ability to purchase in a distribution; purchasing a financial instrument to help determine underwriting pricing) may not rely on the underwriting permitted activity, but in some cases may be permissible under other exceptions.
Step 2C: Permitted Activities: Risk-Mitigating Hedging

**Relationship to Risks**
Risk-mitigating hedging activities are permitted if conducted in connection with and related to individual or aggregated positions, contracts or other holdings of the banking entity and if designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts or other holdings.

Is the hedging activity designed to reduce or otherwise significantly mitigate and demonstrably reduces or otherwise significantly mitigates one or more specific, identifiable risks arising in connection with and related to identified positions, contracts or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity of these positions?

The specific, identified risks may include, among others:
- Market risk
- Counterparty or credit risk
- Currency or foreign exchange risk
- Interest rate risk
- Commodity price risk
- Basis risk
- Any similar risks

This requirement must be met both at the inception of the hedging activity and when any adjustments are made.

**Activity Is Not a Permitted Risk-Mitigating Hedging Activity**

Is the purchase or sale subject to continuing review, monitoring and management by the entity?

The review, monitoring and management must:
- Be consistent with written hedging policies and procedures as required by the final regulations.
- Be designed to and demonstrably reduce or otherwise significantly mitigate specific, identifiable risks that develop over time from the hedging activities undertaken in reliance on this permitted activity and the underlying positions, contracts and other holdings of the banking entity, based upon the relevant facts and circumstances.
- Require ongoing recalibration of the hedging activity by the banking entity to ensure that the hedging activity is not prohibited proprietary trading.

Are the compensation arrangements of persons performing the hedging activity designed not to reward or incentivize proprietary risk-taking?

At the inception of the hedge, does it give rise to significant new or additional risk that is not itself hedged contemporaneously?

**Activity Is Not a Permitted Risk-Mitigating Hedging Activity**

Has the banking entity established, and does it implement, maintain, and enforce, an internal compliance program that is reasonably designed to ensure compliance?

Metrics required if trading asset and liability threshold met.

**Is the Hedging Activity Subject to Additional Documentation Requirements?**
Additional documentation is required for any purchase or sale of a financial instrument made in reliance on this permitted activity if the purchase or sale:
- Is not established by the specific trading desk establishing or responsible for the underlying positions, contracts, or other holdings the risk of which the hedging activity is designed to reduce;
- Is established by the specific trading desk establishing or responsible for the underlying positions, contracts, or other holdings the risks of which the purchases or sales are designed to reduce, but is effected through a financial instrument, exposure, technique or strategy that is not specifically identified in the trading desk’s specific risk mitigating hedging policies and procedures; or
- Is established to hedge aggregated positions across two more trading desks.

**Activity May Be a Permitted Risk-Mitigating Hedging Activity**

Additional documentation required.

Activity may be a permitted risk-mitigating hedging activity. Go to Step 3.
Step 2D-1: Permitted Activities: U.S. Government, Agency and Municipal Obligations

Is the trading in permitted domestic government obligations?

Is the financial instrument an obligation of, or issued or guaranteed by, the United States?

Is the financial instrument an obligation, participation or other instrument of, or issued or guaranteed by, an agency of the United States, Ginnie Mae, Fannie Mae, Freddie Mac, a Federal Home Loan Bank, Farmer Mac or a Farm Credit System institution chartered under and subject to the provisions of the Farm Credit Act of 1971?

Is the financial instrument an obligation of any State or any political subdivision of a State, including any municipal security?

Is the financial instrument an obligation of the FDIC, or any entity formed by or on behalf of the FDIC for purpose of facilitating the disposal of assets acquired or held by the FDIC in its corporate capacity or as conservator or receiver under the Federal Deposit Insurance Act or its Dodd-Frank Act Orderly Liquidation Authority?

Activity may be a permitted domestic government obligations activity. Go to Step 3.

ACTIVITY IS NOT A PERMITTED DOMESTIC GOVERNMENT OBLIGATIONS ACTIVITY

Has the banking entity established, and does it implement, maintain, and enforce, an internal compliance program that is reasonably designed to ensure compliance?

Metrics required if trading asset and liability threshold met.

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Step 2D-2: Permitted Activities:
Foreign Government Obligations

Is the trading in permitted foreign government obligations?

YES

NO

Is the banking entity organized under, or directly or indirectly controlled by, a banking entity that is organized under the laws of a foreign sovereign, and not directly or indirectly controlled by a top-tier banking entity organized under the laws of the United States?

YES

NO

Is the purchase or sale as principal being made by an insured depository institution?

YES

NO

Is the financial instrument traded an obligation of, or issued or guaranteed by, the foreign sovereign under the laws of which the foreign banking entity is organized (including any multinational central bank of which the foreign sovereign is a member) or any agency or political subdivision of that foreign sovereign?

YES

NO

Has the banking entity established, and does it implement, maintain and enforce, an internal compliance program that is reasonably designed to ensure compliance?

YES

NO

ACTIVITY IS NOT A PERMITTED FOREIGN GOVERNMENT OBLIGATIONS ACTIVITY

Metrics required if trading asset and liability threshold met.

Is the banking entity a foreign entity owned or controlled by a banking entity organized or established under the laws of the United States or any State?

YES

NO

Is the banking entity a foreign bank, as defined in the Federal Reserve Board’s Regulation K, or regulated as a securities dealer by the foreign sovereign under whose laws the entity is organized?

YES

NO

Is the banking entity purchasing or selling a financial instrument that is an obligation of, or issued or guaranteed by, the foreign sovereign under whose laws the foreign bank is organized (including any multinational central bank of which the foreign sovereign is a member) or any agency or political subdivision of that foreign sovereign?

YES

NO

Is the financial instrument owned by the foreign entity and not financed by an affiliate that is located in the United States or organized under the laws of the United States or any State?

NO
Step 2E: Permitted Activities: On Behalf of Customers

Is the purchase or sale a permitted activity on behalf of customers?

**Fiduciary Capacity**
Does the banking entity’s purchase or sale of financial instruments meet the following requirements:
- The banking entity is acting as trustee, or in a similar fiduciary capacity for a customer;
- The transaction is conducted for the account of, or on behalf of, a customer; and
- The banking entity does not have or retain beneficial ownership of the financial instruments.

**Riskless Principal**
Is the banking entity acting as riskless principal in a transaction in which the banking entity, after receiving an order to purchase or sell a financial instrument from a customer, purchases or sells the financial instrument for its own account to offset a contemporaneous purchase or sale to or from the customer?

Has the banking entity established, and does it implement, maintain and enforce, an internal compliance program that is reasonably designed to ensure compliance?

Activity may be a permitted activity on behalf of customers. Go to Step 3.

Activity is not a permitted activity on behalf of customers.
Step 2F: Permitted Activities: Regulated Insurance Companies

Is the activity permitted for a regulated insurance company?

- Is the banking entity an insurance company, or an affiliate of an insurance company?
  - YES
  - NO

- Is the insurance company or affiliate purchasing or selling financial instruments solely for the general account of the insurance company or a separate account established by the insurance company?
  - YES
  - NO

- Is the purchase or sale conducted in compliance with, and subject to, the applicable insurance company investment laws, regulations and written guidance of the State or jurisdiction in which the insurance company is domiciled?
  - YES
  - NO

- Have the appropriate federal banking agencies, after consultation with the Financial Stability Oversight Council and the relevant insurance commissioner, jointly determined that a particular insurance legal requirement is insufficient to protect the safety and soundness of the banking entity or the financial stability of the United States?
  - YES
  - NO

Activity may be a permitted activity by a regulated insurance company. Go to Step 3.

ACTIVITY IS NOT A PERMITTED ACTIVITY BY A REGULATED INSURANCE COMPANY

Has the banking entity established, and does it implement, maintain and enforce, an internal compliance program that is reasonably designed to ensure compliance?

- YES
- NO

Metrics not required.

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Step 2G-1:
Permitted Activities: Trading Activities of Foreign Banking Entities Outside the United States

**Is the activity permitted for foreign banking entities?**

- **NO**

**CHARACTERISTICS OF THE FOREIGN BANKING ENTITY**

**Is the entity organized, or directly or indirectly controlled by a banking entity that is organized, under the laws of the United States or of any State?**

- **NO**

**FOREIGN BANKING ORGANIZATIONS (FBOs)**

For a banking entity that is a FBO for purposes of the Federal Reserve Board’s Regulation K, does the entity meet the qualifying foreign banking organization requirements of Regulation K?

- **YES**

**OTHER FOREIGN ORGANIZATIONS**

For a banking entity that is not an FBO for purposes of Regulation K, does the entity meet at least two of the following three requirements?

- Total assets held outside the United States exceed total assets held in the United States.
- Total revenues derived from business outside the United States exceed total revenues derived from business in the United States.
- Total net income derived from business outside the United States exceeds total net income derived from business in the United States.

- **NO**

**U.S. INVOLVEMENT OF THE FOREIGN BANKING ENTITY**

Is the banking entity purchasing or selling as principal located in the United States?

- A U.S. branch, agency or subsidiary of a foreign banking entity is **considered** to be located in the United States.
- However, the foreign bank that operates or controls such a branch, agency or subsidiary is **not considered** to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency or subsidiary.

- **YES**

**LOCATION OF PERSONNEL ARRANGING/NEGOTIATING/EXECUTING**

Are any personnel of the banking entity or its affiliate who arrange, negotiate or execute the purchase or sale located in the United States?

- **YES**

**DECISION-MAKING PERSONNEL**

Are relevant personnel who make the decision to purchase or sell as principal for the banking entity located in the United States?

- **YES**

**TRANSACTION ACCOUNTING**

Is the purchase or sale, including any transaction arising from risk-mitigating hedging related to the instruments purchased or sold, accounted for as principal directly or on a consolidated basis by any branch or affiliate that is located in the United States or organized under United States or State laws?

- **YES**

**SOURCE OF FINANCING OF THE BANKING ENTITY**

Is financing for the banking entity’s purchases or sales provided, directly or indirectly, by any branch or affiliate that is located in the United States or organized under United States or State law?

- **YES**

**ACTIVITY IS NOT A PERMITTED FOREIGN BANK ACTIVITY**

Permitted activity analysis continues on next slide.

**NO TO ALL QUESTIONS**

**VOLCKER RULE FINAL REGULATIONS (RELEASED DECEMBER 10, 2013)**

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Step 2G-2:
Permitted Activities: Trading Activities of Foreign Banking Entities Outside the United States

Potential U.S. involvement of the counterparty

Is the purchase or sale conducted with or through a U.S. entity?
U.S. entity means any entity that is, or is controlled by, or is acting on behalf of, or at the direction of, any other entity that is, located in the United States or organized under U.S. or State law.

IF SO, DO ANY OF THE FOLLOWING APPLY?

Is the purchase or sale with the foreign operations of a U.S. entity, where no personnel of the U.S. entity that are located in the United States are involved in its arrangement, negotiation or execution? Back-office functions such as clearing and settlement of trades do not constitute arrangement, negotiation or execution.

OR

Is it a purchase or sale with an unaffiliated market intermediary acting as principal, where the transaction is promptly cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty?

An unaffiliated market intermediary is an unaffiliated entity acting as an intermediary that is registered as a broker, dealer, swap dealer, security-based swap dealer or FCM, or excluded from regulation as such.

OR

Is it a purchase or sale through an unaffiliated market intermediary acting as agent, where the transaction is conducted anonymously on an exchange or similar trading facility and is promptly cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty?

Has the banking entity established, and does it implement, maintain and enforce, an internal compliance program that is reasonably designed to ensure compliance?

YES TO ANY QUESTION

ACTIVITY IS NOT A PERMITTED FOREIGN BANK ACTIVITY

NO TO ALL QUESTIONS

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Step 3: Is the Activity Precluded by a Backstop Prohibition?

Would the activity otherwise be precluded?

Material Conflicts of Interest
Would the transaction, class of transactions, or activity involve or result in the banking entity’s interests being materially adverse to the interests of its client, customer, or counterparty with respect to such transaction, class of transactions or activity?

Material High-Risk Exposures
Would the transaction, class of transactions or activity result, directly or indirectly, in a material exposure by the covered banking entity to a high-risk asset or a high-risk trading strategy?

High-risk asset means an asset or group of related assets that would, if held by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

High-risk trading strategy means a trading strategy that would, if engaged in by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

Threat to Safety and Soundness
Would the transaction, class of transactions or activity pose a threat to the safety and soundness of the banking entity or the financial stability of the United States?

Activity is permitted

Does either one of the following remedial measures apply?

Exception 1
Timely and Effective Disclosure
Before effecting the specific transaction or class of transactions, or engaging in the specific activity, has the banking entity:
- Made clear, timely and effective disclosure of the conflict of interest, together with other necessary information, in reasonable detail and in a manner sufficient to permit a reasonable client, customer or counterparty to meaningfully understand the conflict of interest; and
- Made such disclosure in a manner that provides the client, customer or counterparty the opportunity to negate, or substantially mitigate, any materially adverse effect on such party created by the conflict of interest?

Activity is permitted

Exception 2
Information Barriers
Has the banking entity established, maintained and enforced information barriers that are memorialized in written policies and procedures, such as physical separation of personnel, or functions, or limitations on types of activity, that are reasonably designed, taking into consideration the nature of the banking entity’s business, to prevent the conflict of interest from involving or resulting in a materially adverse effect on a client, customer or counterparty?

The banking entity may not rely on information barriers if it knows or reasonably should know that notwithstanding, the conflict of interest may involve or result in a materially adverse effect on a client, customer, or counterparty.

Activity is prohibited proprietary trading even if it would otherwise qualify as a permitted activity

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The Volcker Rule contains an extensive compliance program and, for some banking entities, metrics reporting. This section of the document outlines the Volcker Rule’s most important compliance-related provisions.
Standard Compliance Program

**ALL COMPLIANCE PROGRAMS MUST, AT A MINIMUM, INCLUDE:**

**INTERNAL POLICIES AND PROCEDURES**

Written policies and procedures reasonably designed to document, describe, monitor and limit exempted trading activities conducted by the banking entity (including setting, monitoring and managing limits required under the market making-related, underwriting and risk-mitigating hedging permitted activities) to ensure that all activities comply with the Volcker Rule.

**INTERNAL CONTROLS**

A system of internal controls reasonably designed to monitor compliance and to prevent the occurrence of activities that are prohibited by the Volcker Rule.

**MANAGEMENT FRAMEWORK—RESPONSIBILITY AND ACCOUNTABILITY**

A management framework that clearly delineates responsibility and accountability for compliance with the Volcker Rule and that includes appropriate management review of trading limits, strategies, hedging activities, investments, incentive compensation and other matters identified in the Volcker Rule or by management as requiring attention.

**INDEPENDENT TESTING**

Independent testing and audit of the effectiveness of the compliance program conducted periodically by qualified personnel of the banking entity or by a qualified outside party.

**TRAINING**

Training for trading personnel and managers, as well as other appropriate personnel, to effectively implement and enforce the compliance program.

**RECORDKEEPING**

Records sufficient to demonstrate compliance with the Volcker Rule, which a banking entity must promptly provide to regulators upon request and retain for a period of no fewer than 5 years or such longer period as required by regulators. This must include the specified records required to be maintained in connection with the additional document requests for risk-mitigating hedging permitted activity, as applicable.

**BANKING ENTITIES SUBJECT TO THE ENHANCED PROGRAM REQUIREMENT UNDER APPENDIX B OF THE FINAL RULE AND/OR METRICS REPORTING MUST SUPPLEMENT THE STANDARD PROGRAM WITH ADDITIONAL REQUIREMENTS.**
Enhanced Compliance Program for Proprietary Trading

**Enhanced Compliance Programs for Proprietary Trading Must:**

- Identify, document, monitor and report permitted trading activities, and promptly address risks and potential areas of noncompliance and prevent activities prohibited by, or that do not comply with, the Volcker Rule.
- Establish and enforce appropriate limits on covered trading activities, including limits on the size, scope, complexity and risks of the individual activities.
- Provide for periodic independent review and testing and ensure the internal audit, corporate compliance and internal control functions are effective and independent.
- Make senior management and others, as appropriate, accountable and ensure review of the compliance program by the Board and CEO (or equivalent).
- Facilitate supervision and examination by regulators of permitted activities.

**Requirements for Compliance Programs for Proprietary Trading**

A banking entity must establish, maintain and enforce a compliance program that includes written policies and procedures that are appropriate for the types, size, and complexity of, and risks associated with, its permitted trading activities. Adequate resources and knowledgeable personnel must be used, and the program must be updated with a frequency sufficient to account for changes in activities, testing results, identification of weaknesses and legal/regulatory/other changes. Must provide for revision before expanding trading activities.

**Trading Desks:** A banking entity must have written policies governing each trading desk that include descriptions of the financial instruments the desk may purchase and sell, the type of trading activity the desk may conduct, the risks that the desk may take on, and other information relating to the desk’s trading activities.

**Description of Risks and Risk Management Processes:** The compliance program must include a comprehensive description of the entity’s risk management program. This must include a description of the governance, approval, reporting, escalation, review and other extensive procedures used to ensure compliance with the Volcker Rule.

**Authorized Risks, Instruments and Products:** A banking entity must implement and enforce limits and internal controls for each trading desk that are reasonably designed to ensure that trading activity is conducted in compliance with the law and the entity’s policies and procedures. Risk limits must be based on specified criteria.

**Hedging Policies and Procedures:** A banking entity must establish, maintain and enforce written policies and procedures regarding the use of risk-mitigating hedging instruments and strategies.

**Analysis and Quantitative Measurements:** A banking entity must perform robust analysis and quantitative measurement of trading activities reasonably designed to ensure that the trading activity of each trading desk is consistent with the entity’s compliance program. This includes any quantitative metrics specifically tailored to the banking entity’s particular risks, practices and strategies.

**Other Compliance Matters:** Additional requirements apply to identify and monitor permitted trading activities, activities excluded from the definition of proprietary trading, high-risk assets and trading strategies and potential conflicts of interest.

**Remediation of Violations:** The compliance program must describe procedures for identifying violations of the Volcker Rule and require prompt documentation and remediation of any violation and document all proposed and actual remediation efforts. Written policies and procedures must provide for assessment of the extent to which program modifications are needed and implemented, as well as prompt notification of material weaknesses or significant deficiencies in program design or implementation to senior management and the board of directors.

**Independent Testing**

Independent testing of the compliance program, internal controls and management procedures must occur with a frequency appropriate to the size, scope and risk profile of the banking entity’s trading and covered fund activities or investments, at least annually. Testing may be conducted by the banking entity’s internal audit department, compliance personnel or risk managers outside the organizational unit tested, outside auditors/consultants, or other qualified independent parties.

**Training**

A banking entity must provide adequate training to personnel and managers of the banking entity engaged in covered activities and to other appropriate supervisory, risk, independent testing, and audit personnel, to effectively implement and enforce the compliance program. This training should occur with a frequency appropriate to the size and the risk profile of the banking entity’s trading activities.

**Recordkeeping**

A banking entity must create and retain records sufficient to demonstrate compliance and support the operations and effectiveness of the compliance program. A banking entity must retain these records for a period of no fewer than 5 years or such longer period as required by regulators in a form that allows it to promptly produce such records to regulators on request.

**Volcker Rule Final Regulations (Released December 10, 2013)**

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**Summary of Proprietary Trading Metrics**

### Metrics

| Risk Management | ▪ Risk and Position Limits and Usage  
|                 | ▪ Risk Factor Sensitivities  
|                 | ▪ Value at Risk (VaR) and Stress Value at Risk (Stress VaR) |
| Source of Revenue | ▪ Comprehensive Profit and Loss Attribution |
| Customer-Facing Activity | ▪ Inventory Turnover  
|                         | ▪ Inventory Aging  
|                         | ▪ Customer-Facing Trade Ratio – Trade Count Based and Value Based |

### Key Procedures and Logistics

| Certain Reporting Remains Optional | ▪ **Reporting required**: Metrics in respect of trading conducted pursuant to the underwriting-related, market making-related, risk-mitigating hedging and U.S./foreign government obligation permitted activities  
|                                  | ▪ **Reporting optional**: Metrics in respect of trading conducted pursuant to an exclusion from the scope of proprietary trading, or pursuant to the on behalf of customers, regulated insurance company or foreign bank permitted activities |
| Level of Measurement | ▪ Each trading desk, defined 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 of the banking entity. This may span across legal entities. |
| Regulatory Reporting Frequency | ▪ For banking entities with $50 billion or more in trading assets and liabilities: for each calendar month, within 30 days of the end of the relevant month (beginning with information for January 2015, within 10 days of month end)  
|                             | ▪ For other banking entities: for each calendar quarter, within 30 days of quarter end |
| Record Retention | ▪ 5 years; records documenting preparation/content of reports submitted and information necessary to permit regulators to verify accuracy of reports |
Trading Assets and Liabilities: The average gross sum of trading assets and liabilities that the banking entity has, together with its affiliates and subsidiaries, excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States, on a worldwide consolidated basis over the previous consecutive four quarters, as measured as of the last day of each of the four prior calendar quarters.

A foreign banking entity is required to include only total consolidated assets and trading assets and liabilities of the combined U.S. operations of the foreign banking entity (including all subsidiaries, affiliates, branches and agencies of the foreign banking entity operating, located or organized in the United States) over the previous consecutive four quarters, as measured as of the last day of each of the four prior calendar quarters.
CEO must, annually, attest in writing that the banking entity has in place processes reasonably designed to achieve compliance.

Managers with responsibility for one or more trading desks of the banking entity are accountable for the effective implementation and enforcement of the compliance program with respect to those trading desks.

Reliance upon each of these permitted activities requires a banking entity’s compliance program (whether standard or enhanced) to include reasonably designed written policies and procedures, internal controls, analysis and independent testing specific to each permitted activity. These requirements may also include the imposition of limits upon trading activities relying on each permitted activity.
COMPLIANCE PROGRAMS (STANDARD OR ENHANCED) MUST ADDRESS ELEMENTS SPECIFIC TO A BANKING ENTITY’S MARKET MAKING-RELATED, UNDERWRITING AND RISK-MITIGATING HEDGING PERMITTED ACTIVITIES.

MARKET MAKING-RELATED

For its market making-related activities, a banking entity’s compliance program must address:

The financial instruments the trading desk stands ready to purchase and sell.

Risk management elements:
- The actions the trading desk will take to demonstrably reduce or otherwise significantly mitigate promptly the risks of its financial exposure (consistent with the limits set in the desk);
- the products, instruments, and exposures each trading desk may use for risk management purposes;
- the techniques and strategies each trading desk may use to manage the risks of the activities and inventory; and
- the process, strategies, and personnel responsible for ensuring that the actions taken to mitigate these risks are and continue to be effective.

Limits for the trading desk, based on the nature and amount of the trading desk's activities, that address:
- the amount, types, and risks of its market-maker inventory;
- the amount, types, and risks of the products, instruments, and exposures the trading desk may use for risk management purposes;
- the level of exposures to relevant risk factors arising from its financial exposure; and
- the period of time a financial instrument may be held.

Internal controls and ongoing monitoring and analysis of the trading desk’s compliance with its limits.

Authorization procedures, including escalation procedures that require review and approval of any trade that would exceed the trading desk’s limits, demonstrable analysis that the basis for any temporary or permanent increase to the trading desk’s limits is consistent with the requirements of the exemption, and independent review of such demonstrable analysis and approval.

RISK-MITIGATING HEDGING

For its risk-mitigating hedging activities, a banking entity’s compliance program must address:

Reasonably designed written policies and procedures regarding the positions, techniques and strategies that may be used for hedging, including documentation indicating what positions, contracts or other holdings a particular trading desk may use, and position and aging limits with respect to such positions, contracts or other holdings.

Internal controls and ongoing monitoring, management, and authorization and escalation procedures.

The conduct of analysis, including correlation analysis, and independent testing of the policies and procedures.

RISK-MITIGATING HEDGING: ADDITIONAL DOCUMENTATION

For purchases or sales under the risk-mitigation hedging permitted activity that are:
- Not established by the specific trading desk establishing or responsible for the underlying positions being hedged;
- Established by the same trading desk responsible for the underlying positions, but effected through a financial instrument, exposure, technique, or strategy that is not specifically identified in the trading desk’s written policies and procedures; or
- Established to hedge aggregated positions across two or more trading desks.

Contemporaneously, the banking entity must document, at a minimum:
- The specific, identifiable risks of the identified positions, contracts, or other holdings of the banking entity that the hedging transaction is designed to reduce;
- The specific risk-mitigating strategy that the purchase or sale is designed to fulfill; and
- The actions the trading desk will take to demonstrably reduce or otherwise significantly mitigate promptly the risks of its financial exposure (consistent with the limits set in the desk).

The conduct of analysis, including correlation analysis, and independent testing of the policies and procedures.

Limits for each trading desk, based on the nature and amount of the trading desk’s underwriting activities, including the reasonably expected near term demands of clients, customers, or counterparties, on the:
- Amount, types, and risk of its underwriting position;
- Level of exposures to relevant risk factors arising from its underwriting position; and
- Period of time a security may be held.

Internal controls and ongoing monitoring and analysis of each trading desk’s compliance with its limits.

Authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk’s limits, demonstrable analysis of the basis for any temporary or permanent increase to a trading desk’s limits, and independent review of such demonstrable analysis and approval.

UNDERWRITING

For its underwriting activities, a banking entity’s compliance program must address:

The products, instruments or exposures each trading desk may purchase, sell, or manage as part of its underwriting activities.

Limits for each trading desk, based on the nature and amount of the trading desk’s underwriting activities, including the reasonably expected near term demands of clients, customers, or counterparties, on the:
- Amount, types, and risk of its underwriting position;
- Level of exposures to relevant risk factors arising from its underwriting position; and
- Period of time a security may be held.

Internal controls and ongoing monitoring and analysis of each trading desk’s compliance with its limits.

Authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk’s limits, demonstrable analysis of the basis for any temporary or permanent increase to a trading desk’s limits, and independent review of such demonstrable analysis and approval.
CONSULTATION BY THE FEDERAL RESERVE

- The Federal Reserve is responsible for granting extensions for the conformance period, regardless of the primary financial regulatory authority of the banking entity.
- Before granting an extension or imposing any restrictions on activities during any extension period, the Federal Reserve must consult with the FDIC, OCC, SEC or CFTC, if the agency is the banking entity’s primary financial regulatory authority.

BETWEEN JULY 21, 2015
A banking entity must engage in good-faith efforts that will result in conformance by July 21, 2015. This includes:
- Evaluating the extent to which the banking entity is engaged in covered activities
- Implementing a conformance plan that is appropriately specific about how the banking entity will fully conform
- Promptly terminating or divesting stand-alone proprietary trading operations
- Not expanding activities during the conformance period with an expectation that additional time for conformance will be granted

One-year extension does not extend to Appendix A metrics reporting for banking entities with trading assets and liabilities of $50 billion or more.

Blanket one-year extension granted by final rule to all banking entities

JUNE 30, 2014
Metrics reporting requirement effective for banking entities with at least $50 billion in trading assets and liabilities.

APRIL 1, 2014
Effective date of the final regulations.

JULY 21, 2015
Effective date of final regulations following blanket extension. Compliance programs must be ready by this date.

SEPTEMBER 30, 2015
The regulators propose to revisit the metrics and determine, based on a review of the data collected by this date, whether to modify, retain or replace the metrics. The timing or format of any such determination is not discussed.

DECEMBER 31, 2016
Trading assets and liabilities threshold for reporting metrics decreases to $10 billion.

APRIL 30, 2016
Trading assets and liabilities threshold for reporting metrics decreases to $25 billion.

DECEMBER 10, 2013
Final regulations adopted.

JANUARY 22, 2015
Deadline for written applications to request a one-year extension beyond July 21, 2015. Extension on proprietary trading thought to be unusual.

JANUARY 22, 2016
Deadline for written applications to request a third and final one-year extension beyond July 21, 2016. Extension on proprietary trading thought to be unusual.

JULY 21, 2017
Date by which prohibited proprietary trading activities granted all three one-year extensions must be conformed or divested. Extension on proprietary trading thought to be unusual.

SEPTEMBER 30, 2015
The regulators propose to revisit the metrics and determine, based on a review of the data collected by this date, whether to modify, retain or replace the metrics. The timing or format of any such determination is not discussed.

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If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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