Final Volcker Rule Amended Regulations (Volcker 2.0 – Prop)

September 11, 2019
The original regulations implementing Section 13 of the Bank Holding Company Act of 1956 (commonly known as the Volcker Rule) were adopted by the five Volcker Rule agencies—the Federal Reserve, FDIC, OCC, SEC and CFTC (Agencies)—in 2013. The Agencies amended these regulations relating to the proprietary trading portion of the Volcker Rule in 2019 (2019 Amended Regulations or Volcker 2.0 - Prop). The 2019 Amended Regulations have been formally adopted only by the OCC and FDIC as of the date of these Davis Polk flowcharts, but the other Agencies are expected to adopt them in substantially identical form over the next few weeks.

The 2019 Amended Regulations are effective January 1, 2020, with compliance required by January 1, 2021. Banking entities may elect to voluntarily comply, in whole or in part, with the 2019 Amended Regulations after January 1, 2020. These Davis Polk flowcharts are designed to assist firms in determining whether they are banking entities subject to the Volcker Rule and its implementing regulations and, if so, to assist those banking entities in identifying permissible and impermissible proprietary trading activities under the Volcker Rule’s implementing regulations, as modified by the 2019 final amendments and earlier amendments adopted under the Economic Growth, Regulatory Relief and Consumer Protection Act.
**Final Volcker Rule Amended Regulations:**

**Proprietary Trading Overview**

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

- Is there a **banking entity** involved?
- Does the activity or transaction involve a purchase or sale by the banking entity 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 proprietary trading permitted under the Volcker Rule?**

- Market Making and Underwriting Activities
- Risk-Mitigating Hedging Activities
- Trading in US Government Obligations
- Trading in Foreign 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?

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**Tiered compliance program requirements apply for Significant TAL and Moderate TAL Banking Entities. Significant TAL Banking Entities must also report metrics.**

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Step 1A: Is There a Banking Entity Involved?

An insured depository institution (IDI) excluded from the application of the Volcker Rule because it is relatively small and engaged in relatively limited trading activities (an excluded small bank)?

An IDI is an excluded small bank if it, and every company that controls it, has:
- Total consolidated assets of $10 billion or less; and
- Trading assets and liabilities (TAL), on a consolidated basis, that are less than 5% of its total consolidated assets.

Is the IDI function solely in a trust or fiduciary capacity (a non-depository trust company) and is not affiliated with an IDI (other than an excluded small bank or non-depository trust company)?

- 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 IDI 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

Is the entity:
- An insured depository institution (IDI) excluded from the application of the Volcker Rule because it is relatively small and engaged in relatively limited trading activities (an excluded small bank)?

An IDI is an excluded small bank if it, and every company that controls it, has:
- Total consolidated assets of $10 billion or less; and
- Trading assets and liabilities (TAL), on a consolidated basis, that are less than 5% of its total consolidated assets.

A company (e.g., a bank holding company) that controls an IDI (other than an excluded small bank or non-depository trust company)?

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. subsidiary commercial lending company
- A parent company of such foreign bank

An affiliate or subsidiary, as defined in the Bank Holding Company Act, of any of the above (other than an excluded small bank)?

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?
Step 1B:
Does the Activity or Transaction Involve a Purchase or Sale by the Banking Entity of One or More Financial Instruments?

*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.

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

- Futures contracts and options on futures contracts

Activity is Not Proprietary Trading and Is Not Within the Scope of the Volcker Rule

YES

NO
Step 1C: Is the Banking Entity Trading as Principal for a Trading Account?

**DEALER 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.

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.

**SHORT-TERM INTENT 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 purchase or sale of a financial instrument will be presumed not to be for a trading account if the banking entity:

- holds the instrument for 60 days or longer, and
- does not substantially transfer its risk within 60 days.

**MARKET RISK CAPITAL (MRC) TEST**

Is the banking entity, or any affiliate of the banking entity, an insured depository institution, a bank holding company or a savings and loan company that calculates risk-based capital ratios under the U.S. banking agencies’ market risk capital rule?

OR

If the banking entity does not calculate risk-based capital ratios under the U.S. market risk capital rule, has the banking entity made an election to assess its trading account as if it were subject to the U.S. market risk capital rule?

A banking entity must apply this election consistently across itself and all of its wholly-owned subsidiaries.

**NO**

Is the account used to purchase or sell financial instruments that are both covered positions and trading positions (or hedges of such covered positions) under the U.S. market risk capital rule?

**YES**

**NOT TO ALL APPLICABLE TESTS**

**YES TO ANY APPLICABLE TEST**

**NO**

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.

*See slide 6 for further details.
Step 1D-1: Is an Exclusion from Proprietary Trading Available?

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**

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

**REPO AND REVERSE REPO**

Repos or reverse repos pursuant to which the banking entity has simultaneously agreed, in writing, to both purchase and sell a stated asset, at a stated price and on stated dates or on demand with the same counterparty.

**SECURITIES LENDING**

Securities lending transactions 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.

**LIQUIDITY MANAGEMENT PLAN**

Purchase or sale of a security, deliverable foreign exchange forward, deliverable foreign exchange swap or cross-currency swap for the purpose of liquidity management in accordance with a documented liquidity management plan of the banking entity.

**DCO/CLEARING AGENCY TRANSACTIONS**

Made by a banking entity that is a derivatives clearing organization or a clearing agency in connection with clearing financial instruments.

**LIMITED CLEARING MEMBER ACTIVITIES**

Made by a banking entity that is a member of a clearing agency, derivatives clearing organization or designated financial market utility, in specified circumstances.

**SATISFY AN EXISTING DELIVERY OR LEGAL OBLIGATION**

Made by a banking entity 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.
Step 1D-2: Is an Exclusion from Proprietary Trading Available?

Does the purchase or sale meet any of the following criteria?

**ACTING AS AGENT, BROKER OR CUSTODIAN**
Made by the banking entity acting solely as agent, broker or custodian.

**EMPLOYEE COMPENSATION PLANS**
Made 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.

**DEBT PREVIOUSLY CONTRACTED**
Made 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.

**ERROR TRADES**
Made in error by a banking entity in the course of conducting a permitted or excluded activity or a subsequent transaction to correct such an error.

**MATCHED, CUSTOMER-DRIVEN DERIVATIVE TRANSACTIONS**
Made by the banking entity contemporaneously with also entering into a customer-driven swap or security-based swap and a matched swap or security-based swap if:
- The banking entity retains no more than minimal price risk; and
- The banking entity is not a registered broker-dealer, swap dealer or security-based swap dealer.

**HEDGES OF MORTGAGE SERVICING RIGHTS OR ASSETS**
Used by the banking entity to hedge mortgage servicing rights or mortgage servicing assets in accordance with a documented hedging strategy.

**NON-TRADING ASSETS OR LIABILITIES**
Is the purchase or sale of a financial instrument that does not meet the definition of trading asset or trading liability under the applicable reporting form for the banking entity as of January 1, 2020.

The trading activity is not proprietary trading within the scope of the Volcker Rule. Go to Step 2.

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

YES TO ANY QUESTION

NO TO ALL QUESTIONS
Step 2A-1: Permitted Activities: Market Making

Is the activity market making-related?

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?

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 to both

Activity is not a permitted market making-related activity

Is the trading desk’s market making-related activities designed not to exceed, on an ongoing basis, the reasonably expected near term demands (RENTD) of clients, customers or counterparties?**

A trading desk is presumed to be in compliance with this RENTD requirement if it establishes, implements, maintains and enforces internal limits that are designed not to exceed the RENTD of clients, customers or counterparties, as discussed in slide 9.

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.

Significant or Moderate TAL Banking Entity: has the banking entity established, and does it implement, maintain, and enforce, an internal compliance program that is reasonably designed to ensure compliance (including specific market making compliance program requirements for Significant TAL Banking Entities)?

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

 Metrics required for a Significant TAL Banking Entity

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Step 2A-2: Permitted Activities: Underwriting

Is the activity underwriting?

Are the compensation arrangements of persons performing the underwriting activities designed not to reward or incentivize prohibited proprietary trading?

Are the amount and type of the securities in the trading desk’s underwriting position designed not to exceed the RENTD of clients, customers or counterparties, taking into account the liquidity, maturity and depth of the market for the relevant types of securities?

A trading desk is presumed to be in compliance with this RENTD requirement if it establishes, implements, maintains and enforces internal limits that are designed not to exceed the RENTD of clients, customers or counterparties, as discussed in slide 9.

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 types of securities?

Significant or Moderate TAL Banking Entity:
- has the banking entity established, and does it implement, maintain, and enforce, an internal compliance program that is reasonably designed to ensure compliance (including specific market making compliance program requirements for Significant TAL Banking Entities)?

Metrics required for a Significant TAL Banking Entity

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

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

*** See slide 9 for further details.

* See slide 10 for further details.
Step 2A-3: Permitted Activities: Market Making and Underwriting

Key Terms and Concepts

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 RENTD 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.

Banking entities are not permitted to treat affiliated trading desks as clients, customers or counterparties, but certain transactions between affiliated trading desks may still be permitted as market making-related permitted activity if they do not require the expansion of the trading desks’ market-making limits.

For the underwriting permitted activity, 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.

An underwriting trading desk is presumed to comply with the requirement that its market-making related activities are designed not to exceed, on an ongoing basis, RENTD if it establishes, implements, maintains and enforces internal limits that are designed not to exceed RENTD, based on the nature and amount of the trading desk’s market-making related activities, on the:

- amount, types and risks 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.

Banking entities will be required to maintain records regarding any limit that is exceeded and any temporary or permanent increase to any limits and make those records available to Agencies upon request.

An Agency may rebut the presumption of compliance it determines, taking into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments and based on all relevant facts and circumstances, that a trading desk is engaging in activity that is not based on the trading desk’s RENTD.
A unit of organization of a banking entity that purchases and sells financial instruments for the trading account of the banking entity or an affiliate that is:

- Structured by the banking entity to implement a well-defined business strategy; organized to ensure appropriate setting, monitoring and management review of the desk’s trading and hedging limits, current and potential future loss exposures and strategies; and characterized by a clearly-defined unit that typically:
  - engages in coordinated trading activity with a unified approach to its key elements;
  - operates subject to a common and calibrated set of risk metrics, risk levels and joint trading limits;
  - submits compliance reports and other information as a unit for monitoring by management; and
  - books its trades together.

- Or, for a banking entity that calculates risk-based capital ratios under the U.S. market risk capital rule, or a consolidated affiliate for regulatory reporting purposes of a banking entity that calculates risk-based capital ratios under the U.S. market risk capital rule, established by the banking entity or its affiliate for purposes of market risk capital calculations under the U.S. market risk capital rule.
**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 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, identifiable 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.

**Significant TAL Bank Entities**

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

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 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 remains designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks and is not prohibited proprietary trading.

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

**Other Banking Entities**

Is the hedging activity by the banking entity subject to ongoing recalibration to ensure that the hedging activity remains designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks and is not prohibited proprietary trading?

**Additional Documentation Required**

Significant or Moderate TAL Banking Entity: has the banking entity established, and does it implement, maintain, and enforce, an internal compliance program that is reasonably designed to ensure compliance (including specific risk-mitigating hedging compliance program requirements for Significant TAL Banking Entities)?

- Yes
- No

Significant TAL Banking Entities: is the hedging activity subject to additional documentation requirements?

Additional documentation is required for any purchase or sale of a financial instrument by a Significant TAL Banking Entity 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 risks 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 or more trading desks;

Unless the hedging activities involve instruments on a pre-approved list and subject to pre-approved limits appropriate for the particular common hedging activity.

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

- **Is the trading in permitted domestic government obligations?**
  - **NO** → Next step
  - **YES** → Next step

- **Is the financial instrument an obligation of, or issued or guaranteed by, the United States?**
  - **NO** → Next step
  - **YES** → Next step

- **Is the financial instrument an obligation of any State or any political subdivision of a State, including any municipal security?**
  - **NO** → Next step
  - **YES** → Next step

- **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?**
  - **NO** → Next step
  - **YES** → Next step

**Significant or Moderate TAL Banking Entity:**
- has the banking entity established, and does it implement, maintain, and enforce, an internal compliance program that is reasonably designed to ensure compliance?
  - **NO** → Next step
  - **YES** → Next step

**Certain metrics required for a Significant TAL Banking Entity.**

**Activity may be a permitted domestic government obligations activity. Go to Step 3.**
Step 2D: Permitted Activities: Foreign Government Obligations

Is the trading in permitted foreign government obligations?

- **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: Is the purchase or sale as principal being made by an insured depository institution?
    - YES: Activity may be a permitted foreign government obligations activity. Go to Step 3.
    - 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: Significant or Moderate TAL Banking Entity: has the banking entity established, and does it implement, maintain, and enforce an internal compliance program that is reasonably designed to ensure compliance?
        - YES: Certain metrics required for a Significant TAL Banking Entity.
        - NO: ACTIVITY IS NOT A PERMITTED FOREIGN GOVERNMENT OBLIGATIONS ACTIVITY
      - NO: Is the trading in permitted foreign government obligations?
        - YES: 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: 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?
            - YES: ACTIVITY IS NOT A PERMITTED FOREIGN GOVERNMENT OBLIGATIONS ACTIVITY
            - NO: NO
          - NO: NO
        - NO: NO
      - NO: NO
    - NO: NO
  - NO: NO
- **YES**
  - 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: 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: 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?
        - YES: ACTIVITY IS NOT A PERMITTED FOREIGN GOVERNMENT OBLIGATIONS ACTIVITY
        - NO: NO
      - NO: NO
    - NO: NO
Step 2E:
Permitted Activities: 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.

Significant or Moderate TAL Banking Entity: 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 ALL

YES

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

NO TO ANY

ACTIVITY IS NOT A PERMITTED ACTIVITY ON BEHALF OF CUSTOMERS

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?

NO

ACTIVITY IS NOT A PERMITTED ACTIVITY ON BEHALF OF CUSTOMERS

Metrics not required.

YES

Activity is the purchase or sale a permitted activity on behalf of customers.
Step 2F:
Permitted Activities: Regulated Insurance Companies

Is the activity permitted by or for a regulated insurance company?

- YES
  - Is the banking entity an insurance company, or an affiliate of an insurance company?
    - NO
      - ACTIVITY IS NOT A PERMITTED ACTIVITY BY A REGULATED INSURANCE COMPANY
    - YES
      - 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?
        - NO
          - ACTIVITY IS NOT A PERMITTED ACTIVITY BY A REGULATED INSURANCE COMPANY
        - YES
          - 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?
            - NO
              - ACTIVITY IS NOT A PERMITTED ACTIVITY BY A REGULATED INSURANCE COMPANY
            - YES
              - 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
                  - Activity may be a permitted activity by a regulated insurance company. Go to Step 3.
                - NO
                  - ACTIVITY IS NOT A PERMITTED ACTIVITY BY A REGULATED INSURANCE COMPANY

Significant or Moderate TAL Banking Entity:
has the banking entity established, and does it implement, maintain, and enforce, an internal compliance program that is reasonably designed to ensure compliance?

- YES
  - Metrics not required.
- NO
Step 2G:
Permitted Activities: Trading Activities of Foreign Banking Entities Outside the United States

**U.S. Involvement of the Foreign Banking Entity**

Is the banking entity purchasing or selling as principal (including relevant personnel) 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.

**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?

**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?

**Activity is Not a Permitted Foreign Bank Activity**

**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.

**Foreign Banking Organizations (FBOs)**

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

**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

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Metrics not required.

Significant or Moderate TAL Banking Entity: 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 foreign banking activity. Go to Step 3.
**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?

**NO**

**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?

**NO**

**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?

**NO**

**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?

**YES**

**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?

**YES**

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**

**NO**

**ACTIVITY IS PERMITTED**

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The Volcker Rule includes compliance program requirements that vary depending upon whether a banking entity (together with its affiliates) is a Significant TAL Banking Entity, a Moderate TAL Banking Entity or a Limited TAL Banking Entity. Significant TAL Banking Entities are also subject to metrics reporting requirements. This section of the document outlines the Volcker Rule’s most important compliance-related provisions, with a focus on those applicable to Significant TAL Banking Entities.

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Which **Compliance Tier** Applies?

Based on the four-quarter rolling average of the consolidated gross TAL of the banking entity, its affiliates and its subsidiaries, what is the banking entity’s applicable compliance tier?

**Significant TAL Banking Entity**
TAL = $20 billion or more

**Moderate TAL Banking Entity**
TAL = at least $1 billion but less than $20 billion

**Limited TAL Banking Entity**
TAL = less than $1 billion

---

**Consolidated gross TAL** of the banking entity, its affiliates and its subsidiaries

For a given quarter, **Trading Assets and Liabilities (TAL)**

**=**

For an FBO or a subsidiary of an FBO, trading assets and liabilities are measured based on the combined U.S. operations of the top-tier FBO.

**minus**

Obligations of, or guaranteed by, the United States federal government or any agency of the United States (e.g., GSEs).

Do not subtract obligations of U.S. state or local government entities, including municipal securities.

For additional detail on compliance requirements for each tier, see next slide.
TIERED COMPLIANCE REQUIREMENTS BASED ON TAL

SIGNIFICANT TAL BANKING ENTITIES

Significant TAL Banking Entities are subject to six-pillar, Volcker-specific compliance program requirements, including a CEO attestation requirement and metrics reporting requirements.

MODERATE TAL BANKING ENTITIES

Moderate TAL Banking Entities may satisfy their Volcker Rule compliance program obligations by including in their existing compliance policies and procedures appropriate references to the requirements of Section 13 of the BHC Act, and the Volcker Rule regulations, with adjustments as appropriate depending upon their activities, size, scope and complexity.

No CEO attestation or metrics requirements apply.

LIMITED TAL BANKING ENTITIES

Limited TAL Banking Entities do not have an ongoing obligation to demonstrate compliance with the Volcker Rule.

Instead, Limited TAL Banking Entities are presumed to be compliant with the Volcker Rule unless the Agencies rebut the presumption of compliance by determining through examination or audit that the banking entity has engaged in activities that are otherwise prohibited by the Volcker Rule.

The Agencies may rebut the presumption of compliance only in accordance with prescribed notice and response procedures.

If the presumption of compliance is rebutted, the Agencies may require the banking entity to be treated as either a Moderate TAL Banking Entity or a Significant TAL Banking Entity.
COMPLIANCE PROGRAMS FOR SIGNIFICANT TAL BANKING ENTITIES 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 Agencies upon request and retain for a period of no fewer than 5 years or such longer period as required by Agencies. 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.

**CEO ATTESTATION**

The CEO of a Significant TAL Banking Entity must, no later than March 31 of each year, attest in writing that the banking entity has in place processes to establish, maintain, enforce, review, test and modify the six-pillar compliance program in a manner reasonably designed to achieve compliance with Section 13 of the BHC Act and the Volcker Rule regulations.

For banking entities that are U.S. branches or agencies of foreign banking entities, the attestation may be provided by the senior management officer of the U.S. operations the foreign banking entity who is located in the United States.
### Summary of Proprietary Trading Metrics for Significant TAL Banking Entities

<table>
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<tr>
<th>Risk Management</th>
<th>Internal Limits and Usage</th>
<th>These metrics must be reported for all desks engaged in underwriting, market making-related, risk-mitigating hedging and U.S./foreign government obligation permitted activities (covered trading activities)</th>
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<tr>
<td>Source of Revenue</td>
<td>Comprehensive Profit and Loss Attribution</td>
<td>These metrics must be reported for all desks engaged in covered trading activities</td>
</tr>
<tr>
<td>Customer-Facing Activity</td>
<td>Positions Transactions</td>
<td>These metrics must be reported for all desks that rely on the underwriting and market making-related permitted activities to conduct underwriting or market making-related activity, respectively</td>
</tr>
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</table>

### Key Procedures and Logistics

<table>
<thead>
<tr>
<th>Certain Reporting Remains Optional</th>
<th><strong>Reporting Required</strong>: Metrics in respect of covered trading activities or a subset of covered trading activities, as explained above</th>
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<tbody>
<tr>
<td></td>
<td><strong>Reporting Optional</strong>: 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</td>
</tr>
<tr>
<td>Level of Measurement</td>
<td>Each trading desk, as defined in Step 2A-3. This may span across legal entities</td>
</tr>
<tr>
<td>Measurement Frequency</td>
<td>Daily</td>
</tr>
<tr>
<td>Reported Frequency and Method</td>
<td>Within 30 days of each quarter end in accordance with the XML Schema specified and published on the Agency’s website</td>
</tr>
<tr>
<td>Record Retention</td>
<td>Five years</td>
</tr>
</tbody>
</table>
## Summary of Proprietary Trading Metrics for Significant TAL Banking Entities

### INFORMATIONAL REQUIREMENTS

| **Trading Desk Information** | Provide identifying information about each trading desk and the desk’s associated metrics, including: name, identifier, identification of each type of covered trading activity in which the desk is engaged, a description of the desk’s general trading strategy, and a list identifying each Agency receiving the submission of the trading desk. |
| **Level of Measurement** | Provide descriptive information about the desk’s reported quantitative metrics, including:

1. an Internal Limits Information Schedule naming and describing each limit and identifying the corresponding risk factor attribution if the limit type is a limit on a risk factor sensitivity and profit and loss attribution to the same risk factor is reported; and

2. a Risk Factor Attribution Information Schedule providing identifying and descriptive information for each risk factor attribution reported pursuant to the Comprehensive Profit and Loss Attribution metric. |
| **Narrative Statement** | A banking entity may, but is not required to, provide as part of its quarterly reporting a narrative statement discussing any information the banking entity views as relevant for assessing the information it has reported. |
| **Record Retention** | Five years |
Permitted Activity-Specific Compliance Program Elements

**MARKET MAKING-RELATED**

For its market making-related activities, a Significant TAL 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 positions; 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 in accordance with the market making-related presumption of compliance described on Step 2A-3.

Written 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, and independent review of such demonstrable analysis and approval. A significant TAL Banking Entity may comply with the written authorization procedures requirement by complying with the market making-related presumption of compliance described in Step 2A-3.

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

**RISK-MITIGATING HEDGING**

For its risk-mitigating hedging activities, a Significant TAL Banking Entity’s compliance program must include:

- 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.
- Analysis and independent testing designed to ensure that the positions, techniques and strategies that may be used for hedging may be reasonably expected to reduce or otherwise significantly mitigate the specific, identifiable risk(s) being hedged.

**RISK-MITIGATING HEDGING – ADDITIONAL DOCUMENTATION REQUIREMENTS**

Additional documentation is required for any purchase or sale of a financial instrument by a Significant TAL Banking Entity 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 or more trading desks;

Unless the hedging activities are in instruments on a pre-approved list and subject to pre-approved limits appropriate for the particular common hedging activity.

**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, in accordance with the underwriting presumption of compliance described in Step 2A-3.
- Written 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. A Significant TAL Banking Entity may comply with the written authorization procedures requirement by complying with the underwriting presumption of compliance described on Step 2A-3.

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

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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