

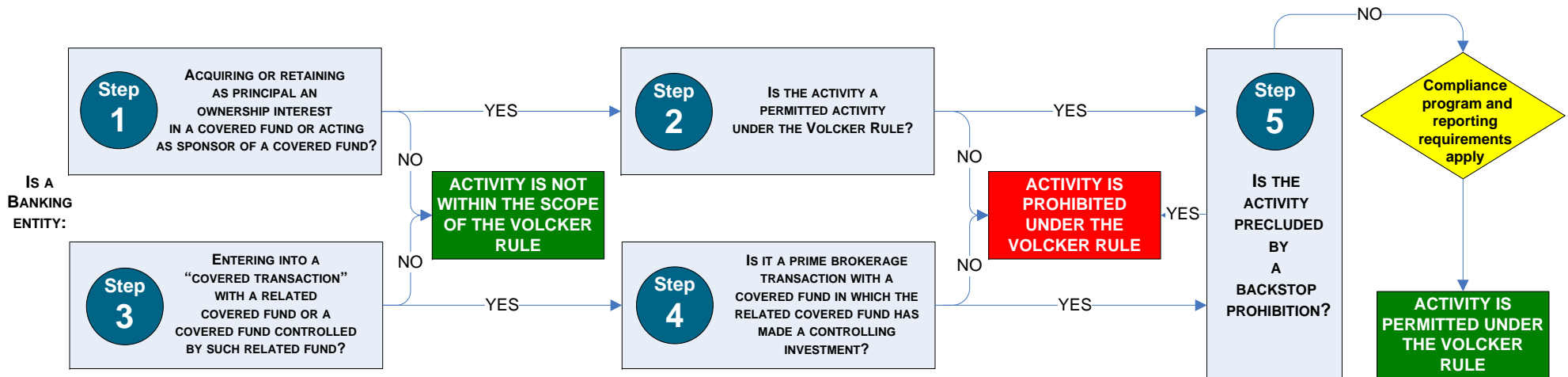


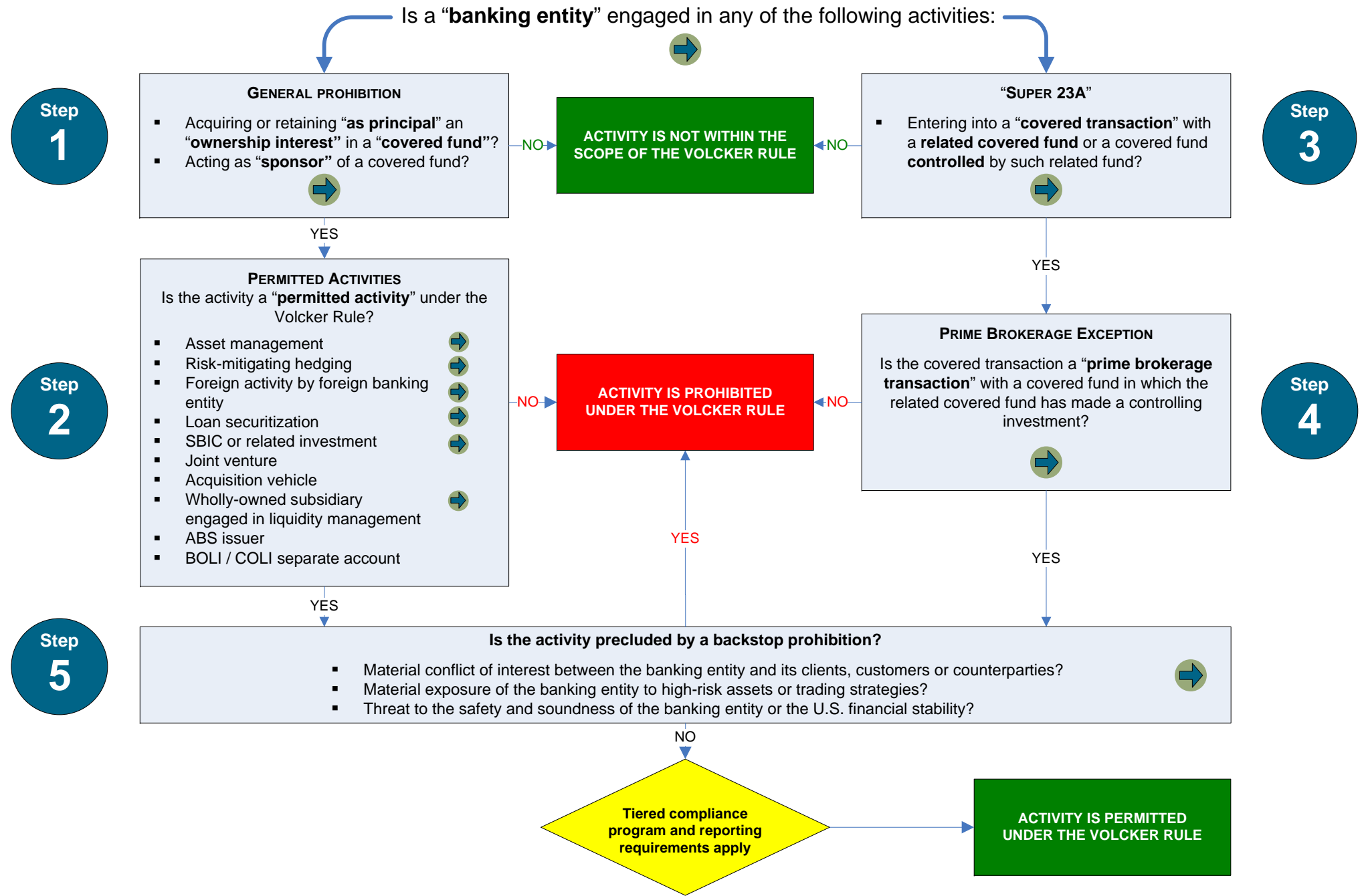
On October 11, 2011, the Federal Reserve, FDIC and OCC released proposed regulations implementing the Volcker Rule. The Dodd-Frank Act requires these three agencies and the SEC and the CFTC to consult and adopt rules restricting the ability of banking entities to invest, sponsor or enter into certain transactions with hedge funds or private equity funds.

Comments on the proposal are due January 13, 2012. The statutory Volcker Rule prohibitions will become effective on July 21, 2012, whether or not regulations are finalized by that date.

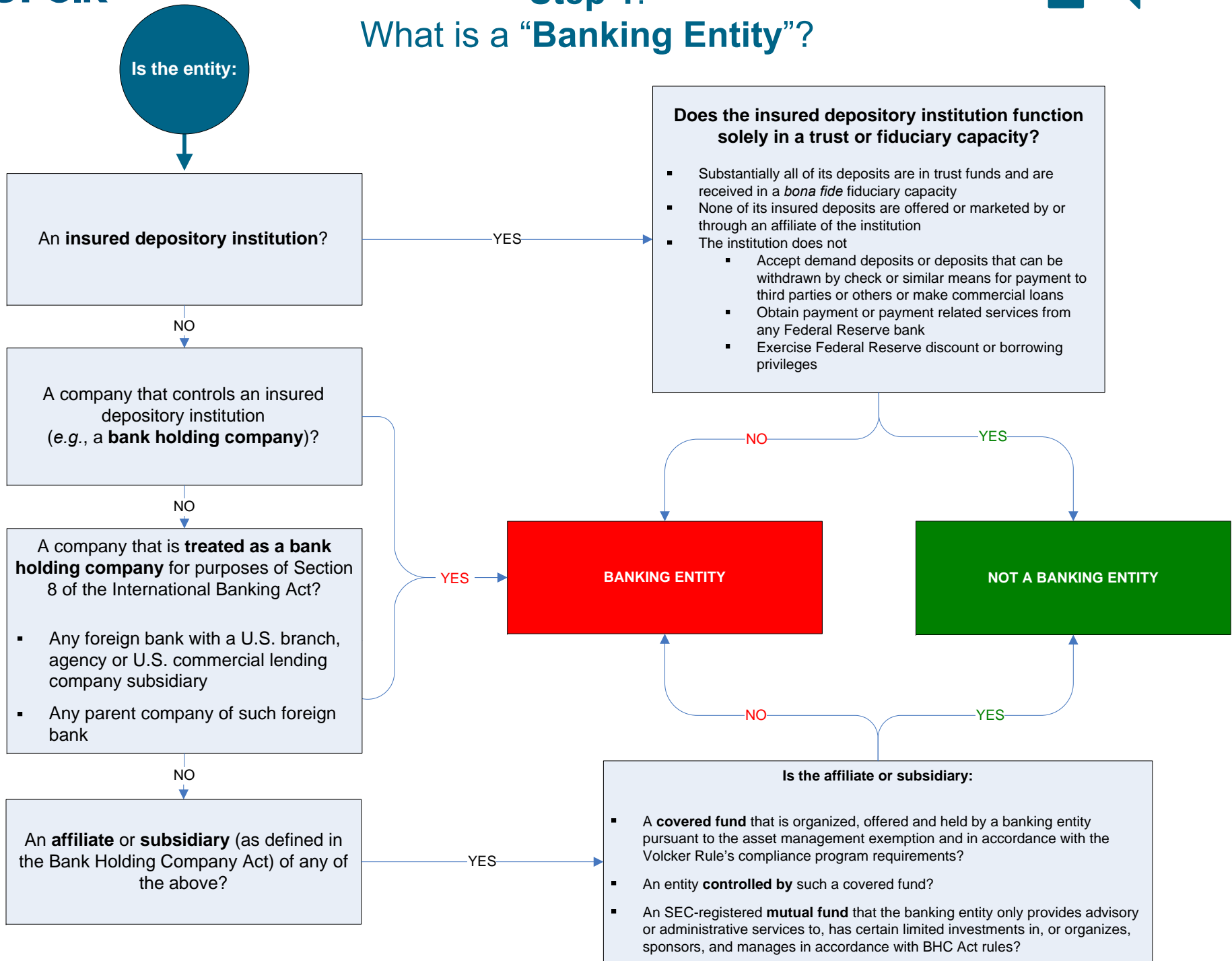
To make our summary and analysis of the proposed regulations more user-friendly, we have prepared a set of flowcharts that graphically maps the key restrictions on covered fund activities in lieu of a traditional law firm memo.

We are also pleased to announce the launch of the Davis Polk Portal, the new online home of our regulatory resources. An interactive version of these flowcharts is available at www.volckerrule.com, which is part of the Davis Polk Portal.

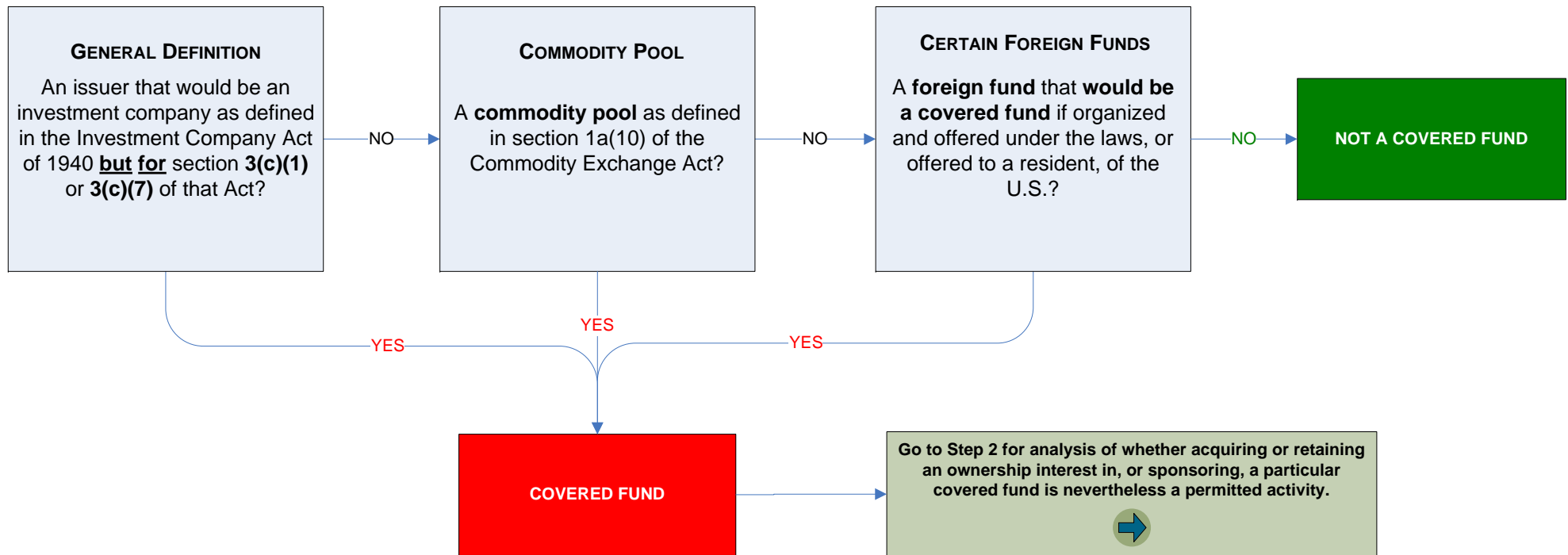




What is a "Banking Entity"?



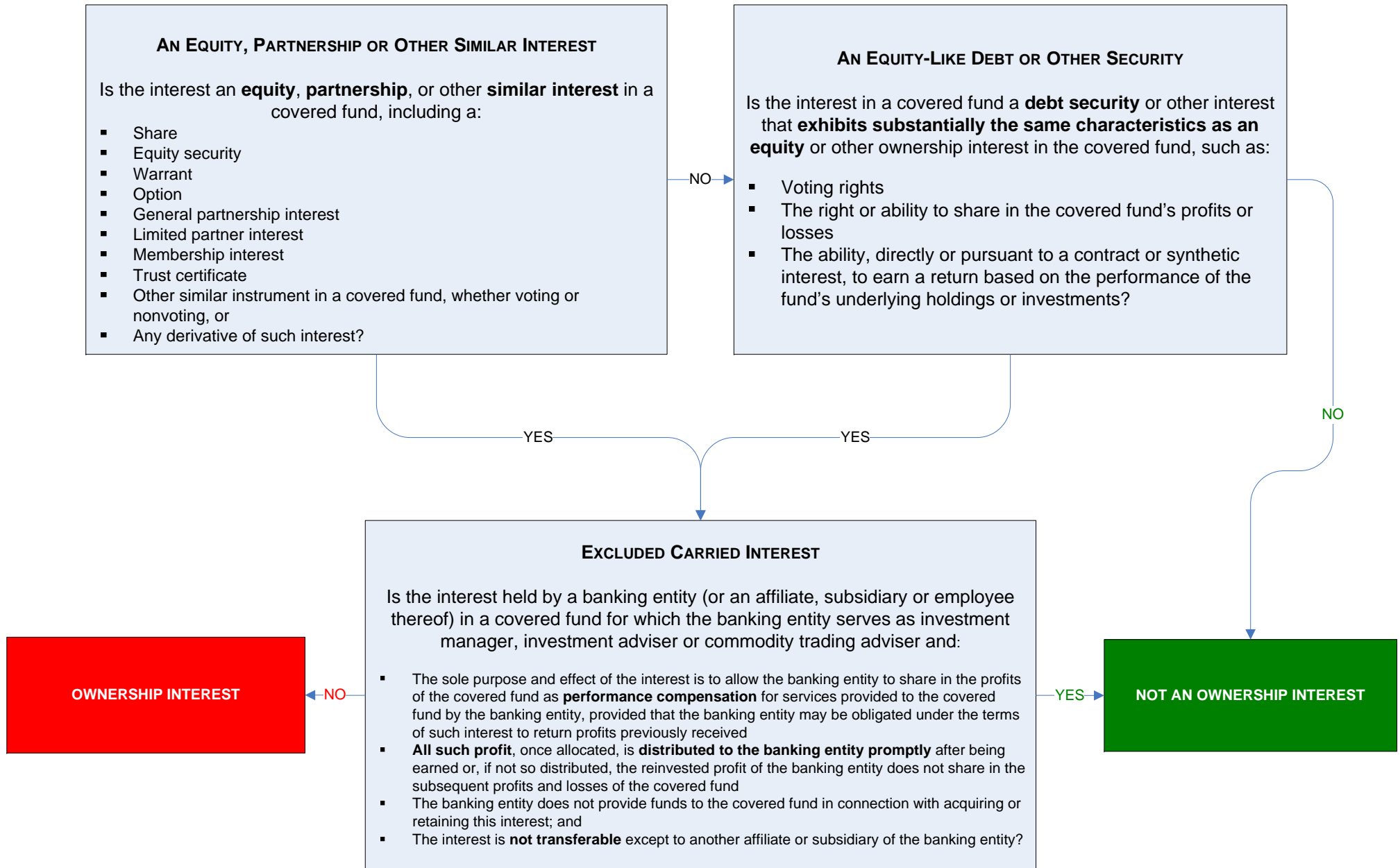
Is an entity:



GENERAL DEFINITION IS A “BUT FOR” TEST

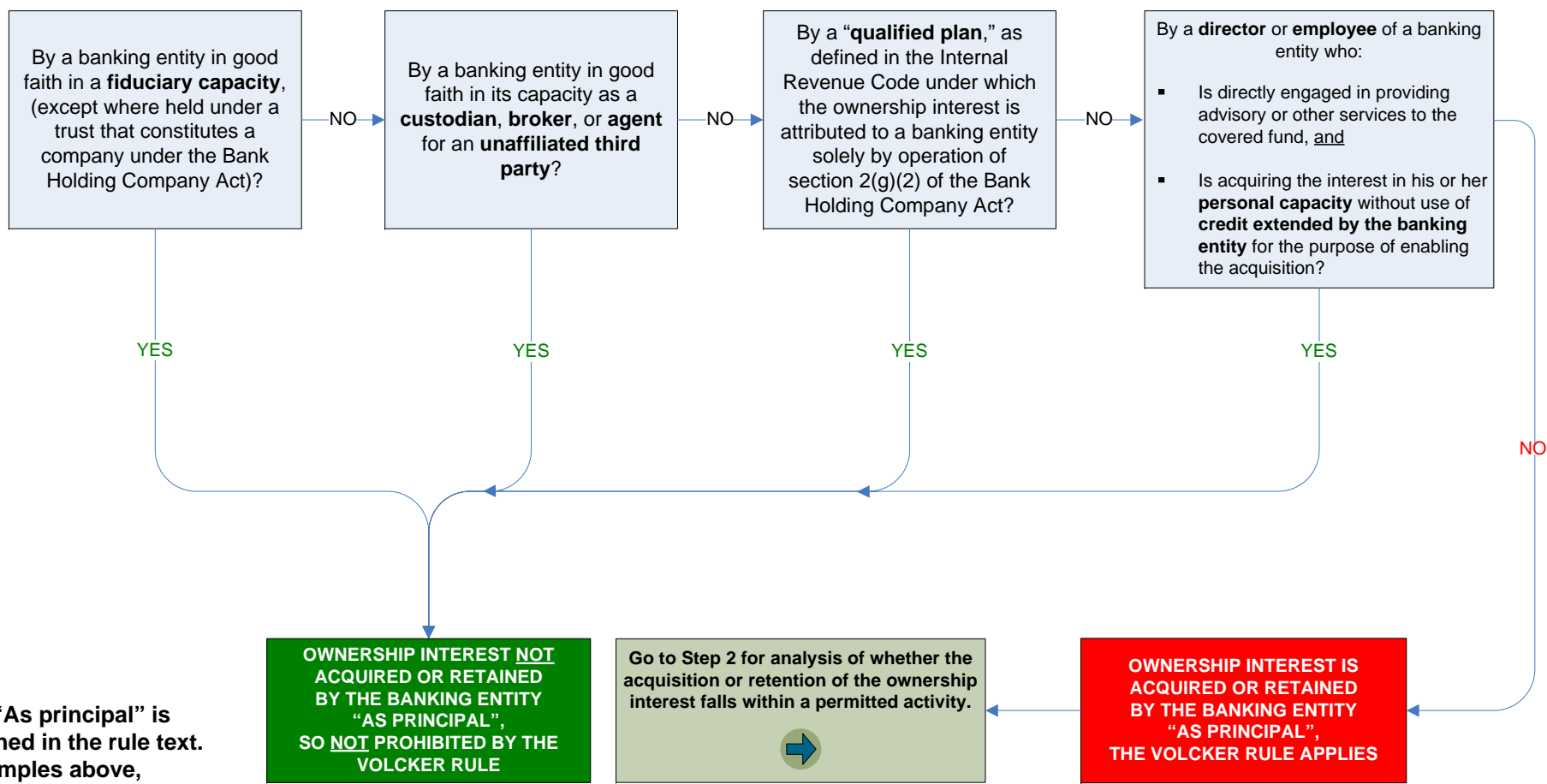
- An entity that may rely on any exemption from the definition of “investment company” under the Investment Company Act other than sections 3(c)(1) or 3(c)(7) is not a covered fund unless it is also a commodity pool or a foreign fund described above
- For example, an entity that may rely on the exemption under section 3(c)(3) of the Investment Company Act for common trust funds maintained by a bank exclusively for the collective investment of qualified assets would not fall within the general definition of covered fund

What is an “Ownership Interest”?



When is the Acquisition or Retention of an Ownership Interest in a Covered Fund Not the Acquisition or Retention of such Interest by a Banking Entity “As Principal”*?

Is the ownership interest in the covered fund being acquired or retained:

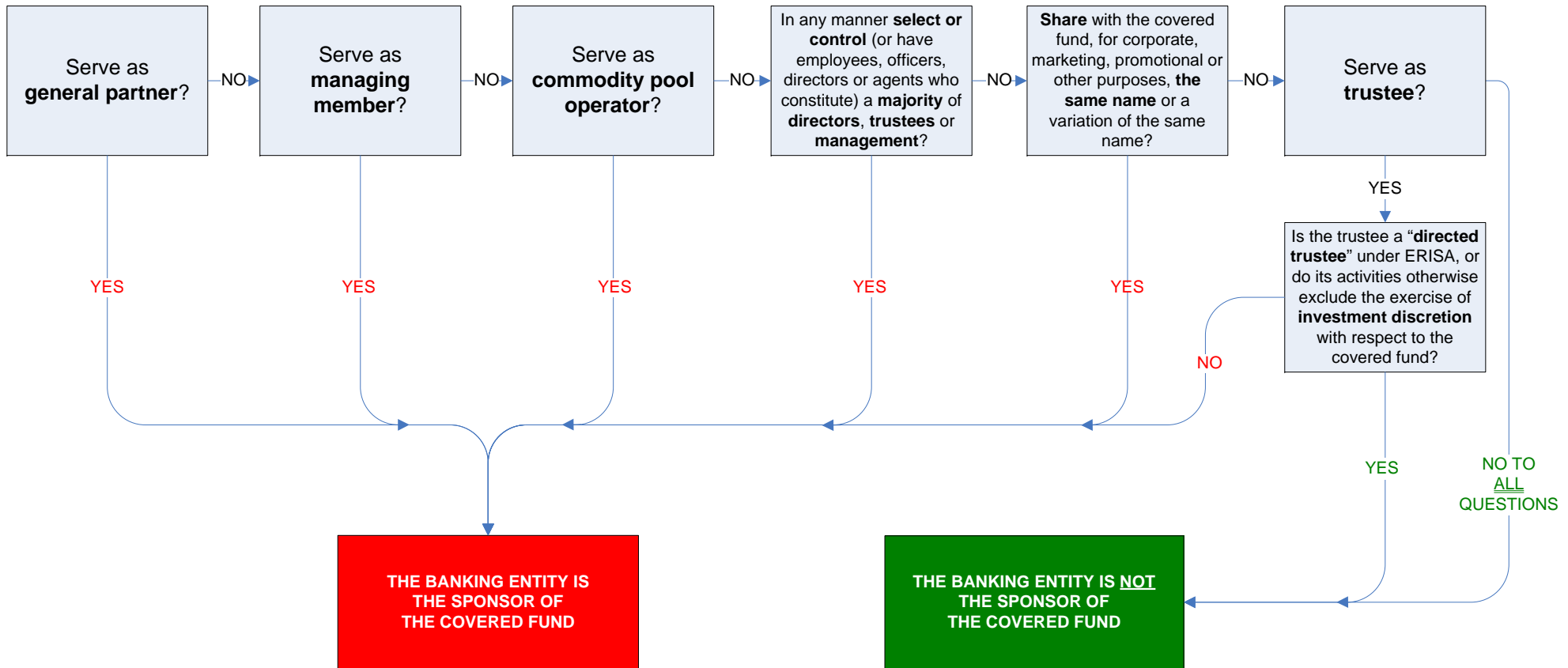


* Note: “As principal” is not defined in the rule text. The examples above, identified in the preamble, are not exclusive.

Step 1: What is a “Sponsor”?

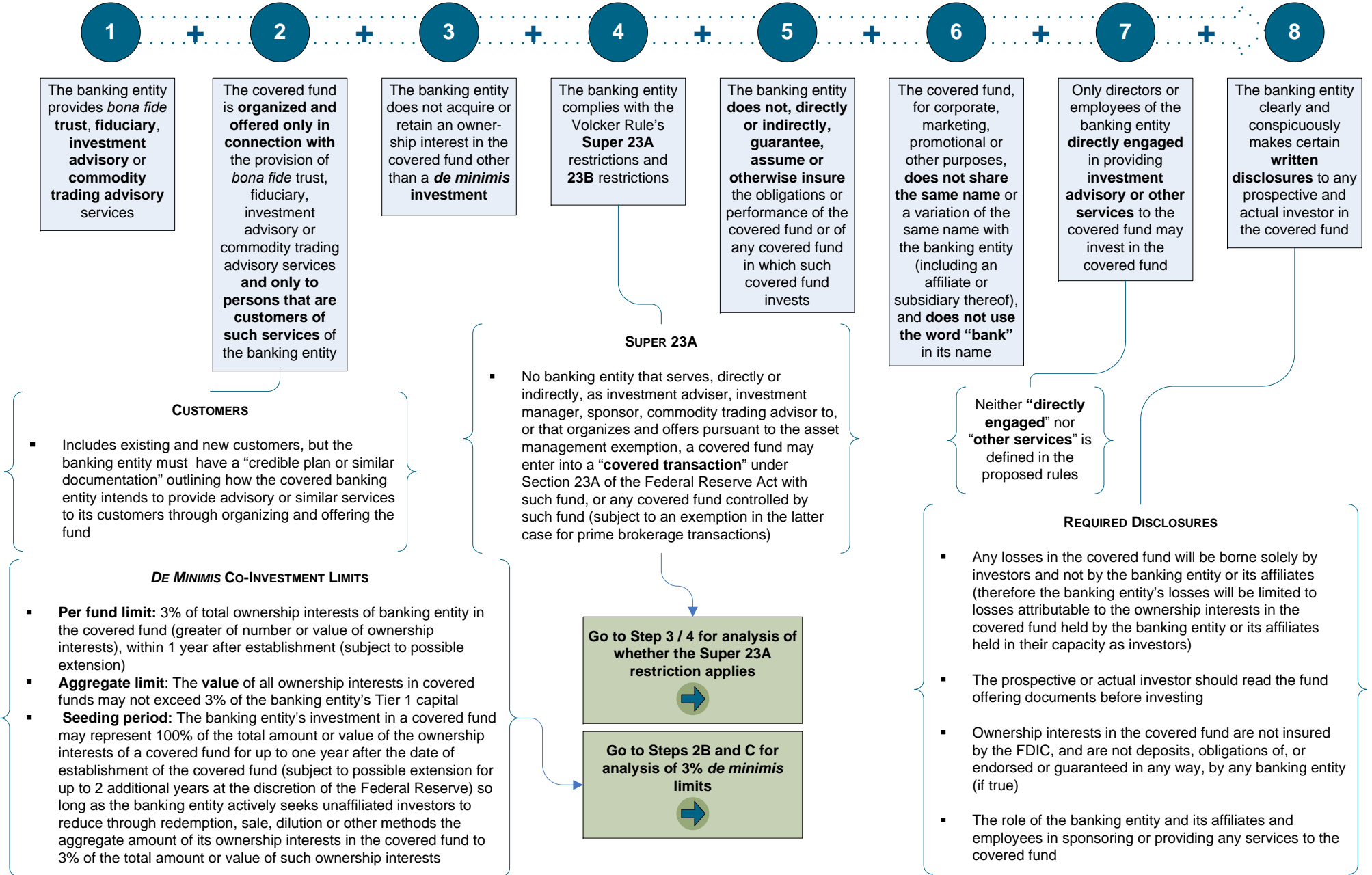


With respect to a covered fund, does the banking entity:

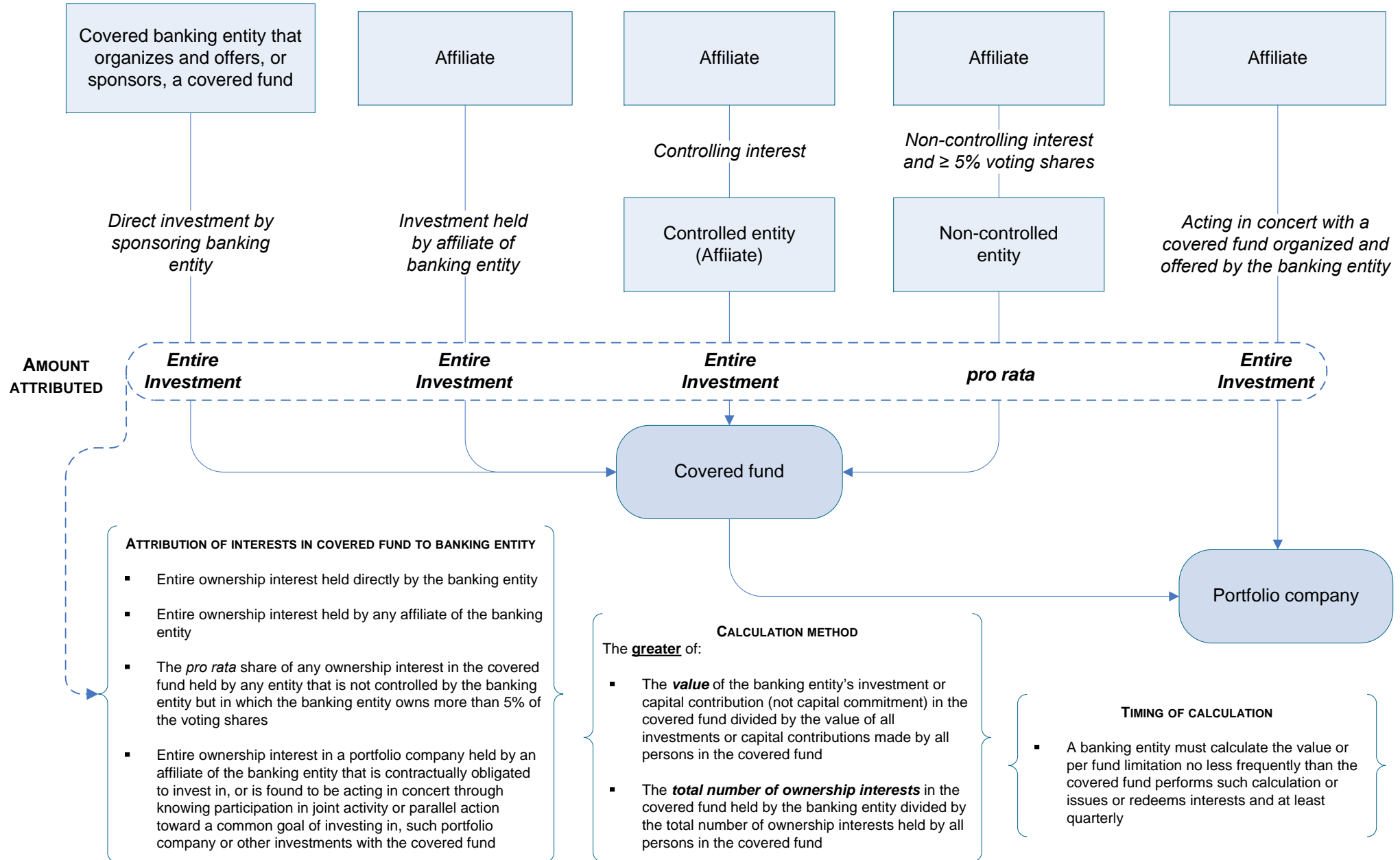


Permitted Activities: Asset Management

A banking entity may organize and offer, including serving as sponsor or commodity pool operator to, a covered fund if:



Permitted Activities: Asset Management (cont.) Calculation of Per Fund 3% *De Minimis* Limit

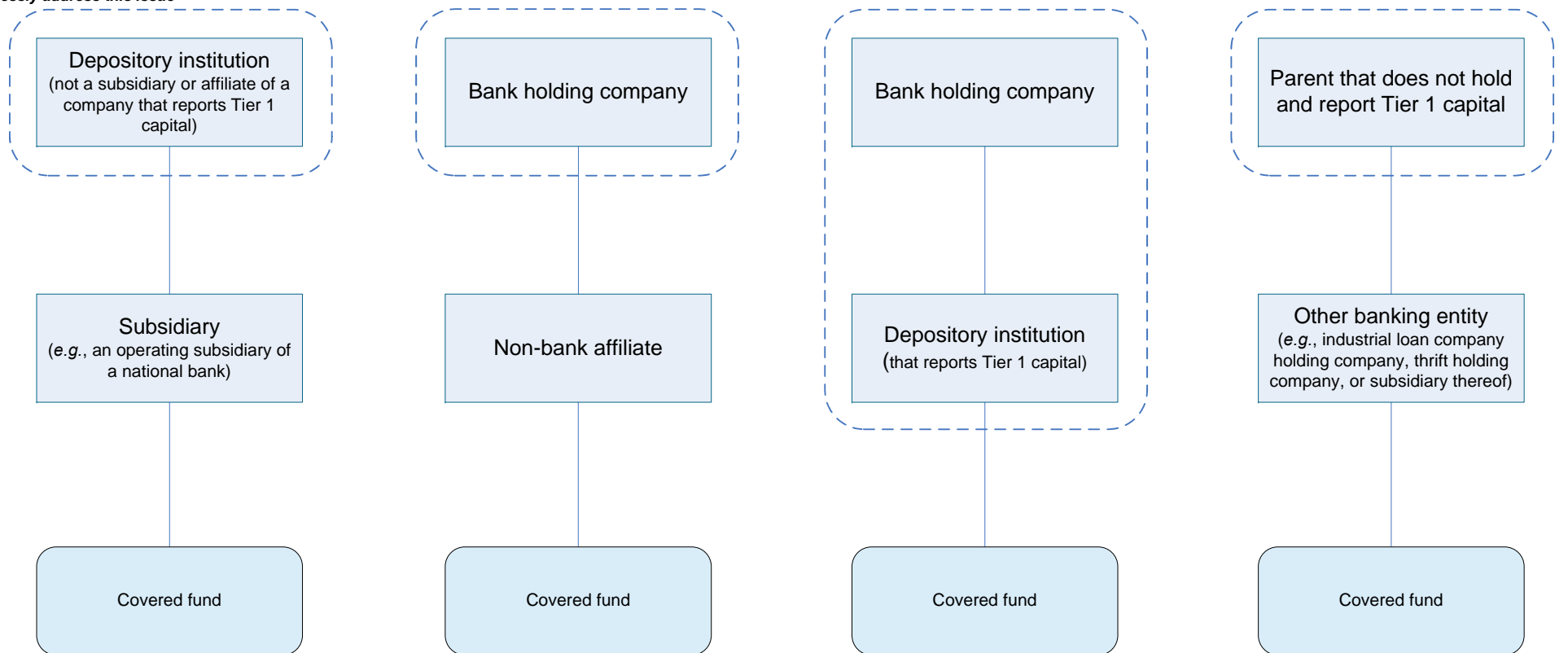


Permitted Activities: Asset Management (cont.)

Calculation of Aggregate 3% of Tier 1 Capital *De Minimis* Limit

Note: all references are to U.S. entities — presumably, any Tier 1 capital calculations required by foreign institutions will be based on home country standards, but the proposed rules do not expressly address this issue

Tier 1 capital for purposes of the 3% aggregate *de minimis* limit calculated at different levels in a banking entity's ownership structure depending on where in the structure Tier 1 capital is calculated and reported



- **Calculation method for aggregate investments in covered funds:** The sum of the *value* of each of the banking entity's investments in covered funds held under the asset management exemption
- **Timing of calculation of aggregate investments in covered funds and Tier 1 capital:** As of the last day of each calendar quarter
- **Deduction from Tier 1 capital:** Aggregate value of all investments in covered funds held under the asset management exemption must be deducted from the banking entity's Tier 1 capital

Depository Institution Controlled by Bank Holding Company

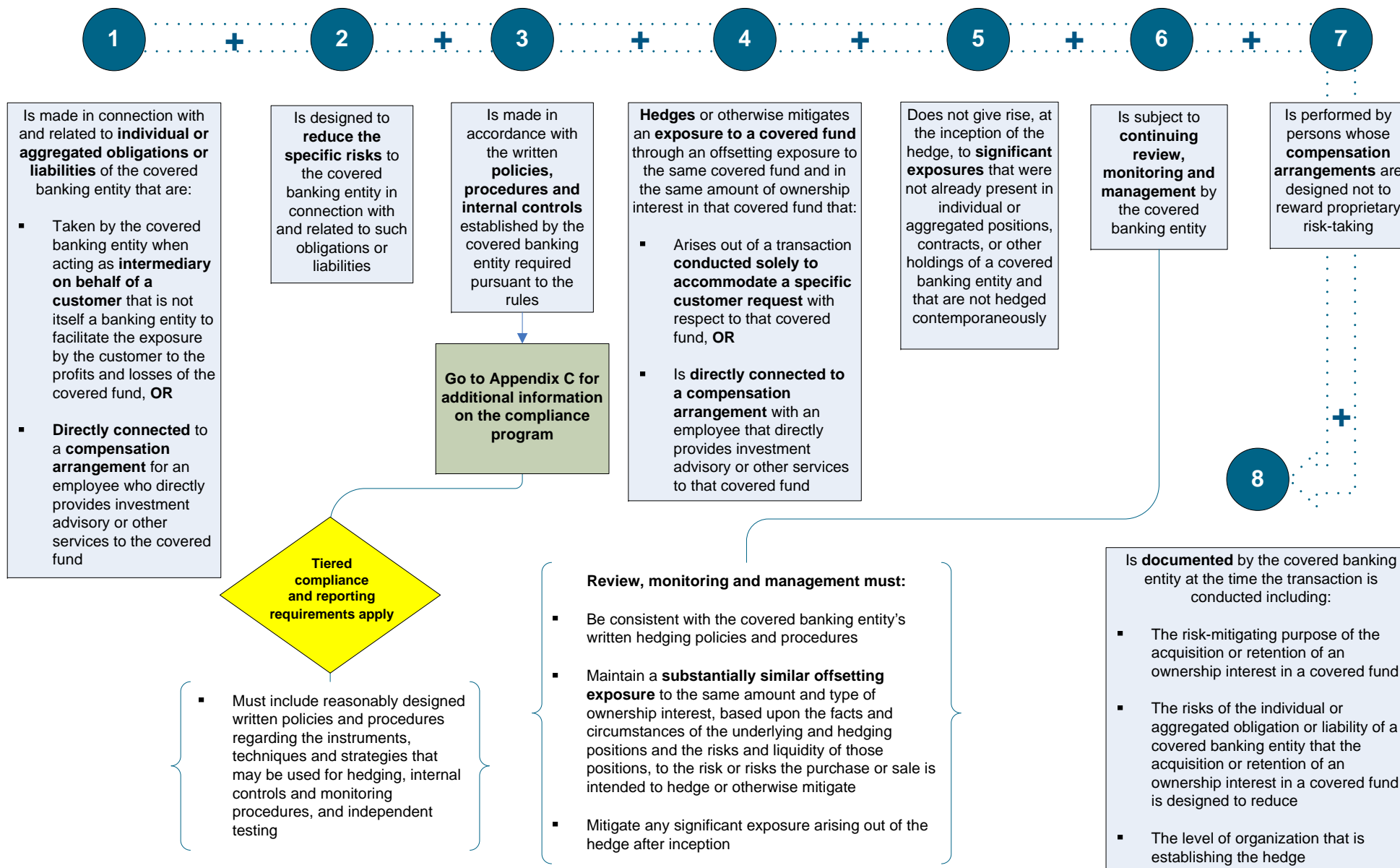
For investments by reporting depository institutions (and their subsidiaries) that are also subsidiaries or affiliates of a bank holding company, the 3% limit is calculated based on the lesser of the Tier 1 capital of the two reporting entities

No Reporting Entity in Control Structure

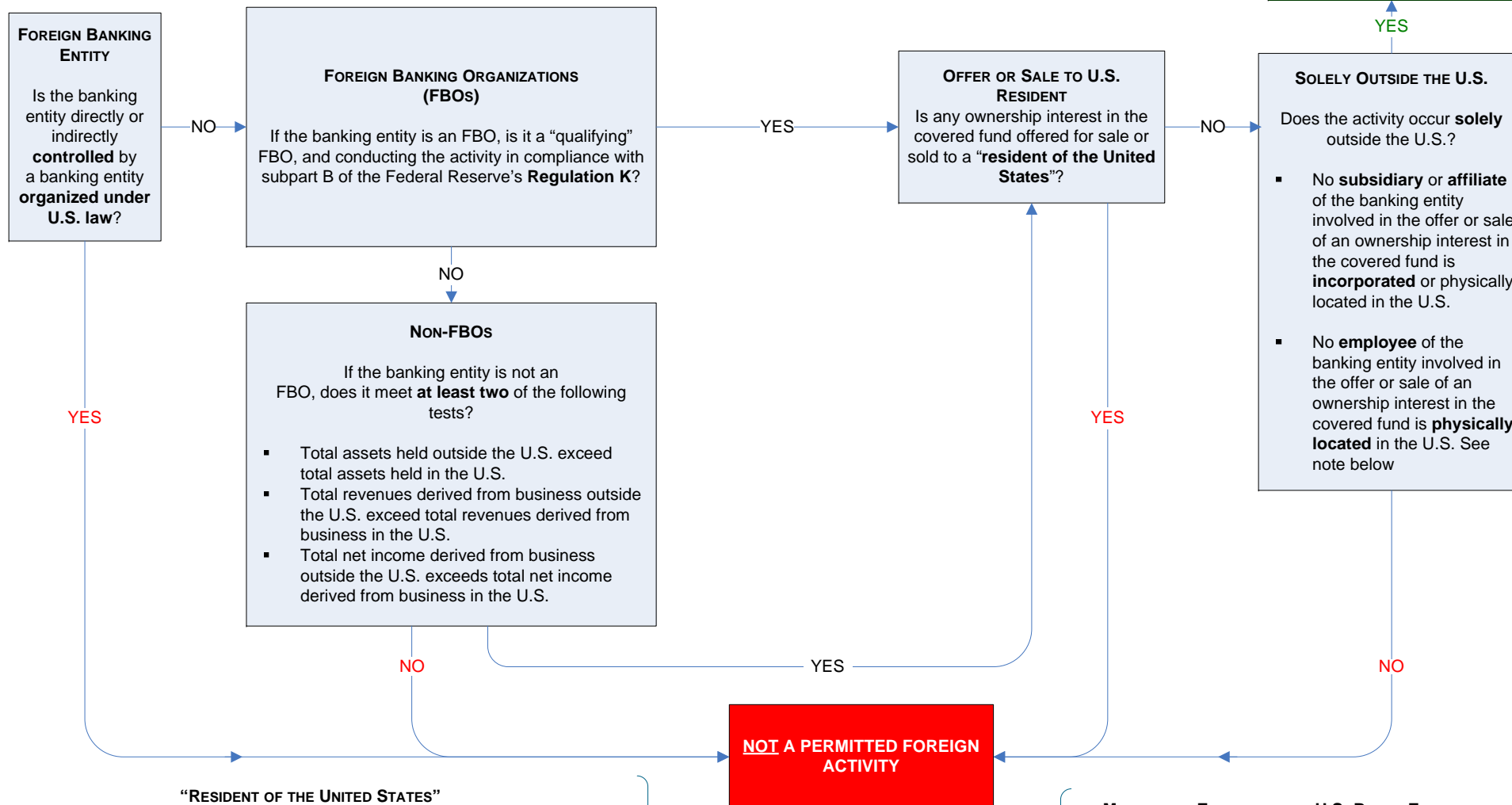
In lieu of Tier 1 capital, 3% limit calculated based on the total amount of the top-tier parent company's shareholders' equity on a consolidated basis

Permitted Activities: Risk-Mitigating Hedging

A banking entity may acquire or retain an ownership interest in a covered fund for risk-mitigating hedging purposes if the acquisition or retention of the ownership interest:



Permitted Activities: Foreign Activities by Foreign Banking Entities

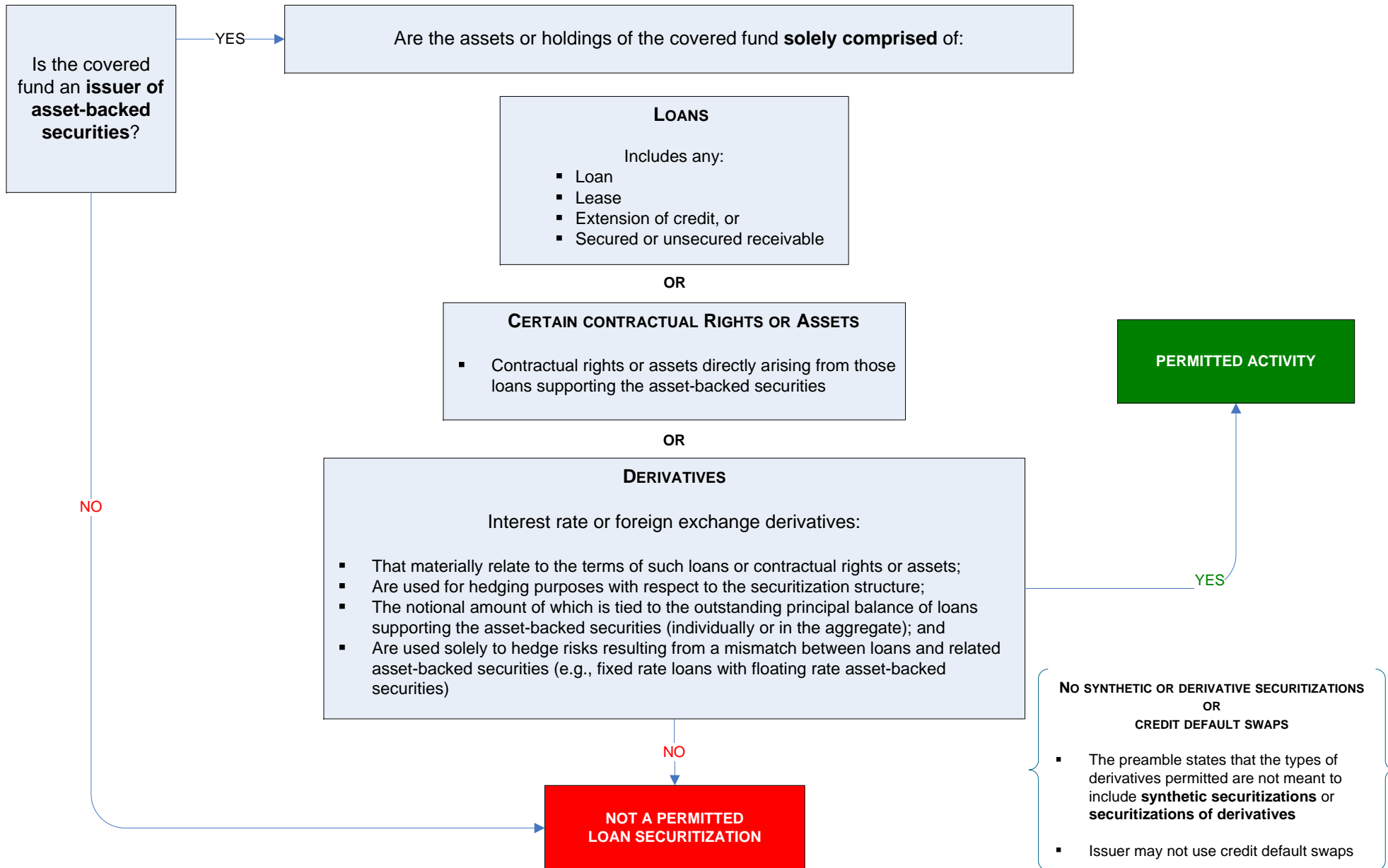


“RESIDENT OF THE UNITED STATES”
Adapts and expands the definition of “U.S. person” in the SEC’s Regulation S:

- Includes discretionary accounts held for a U.S. person by a non-U.S. dealer or fiduciary
- Omits exclusions, including for:
 - Offshore branches or agencies of U.S. entities
 - Discretionary accounts held for a non-U.S. person by a U.S. dealer or fiduciary

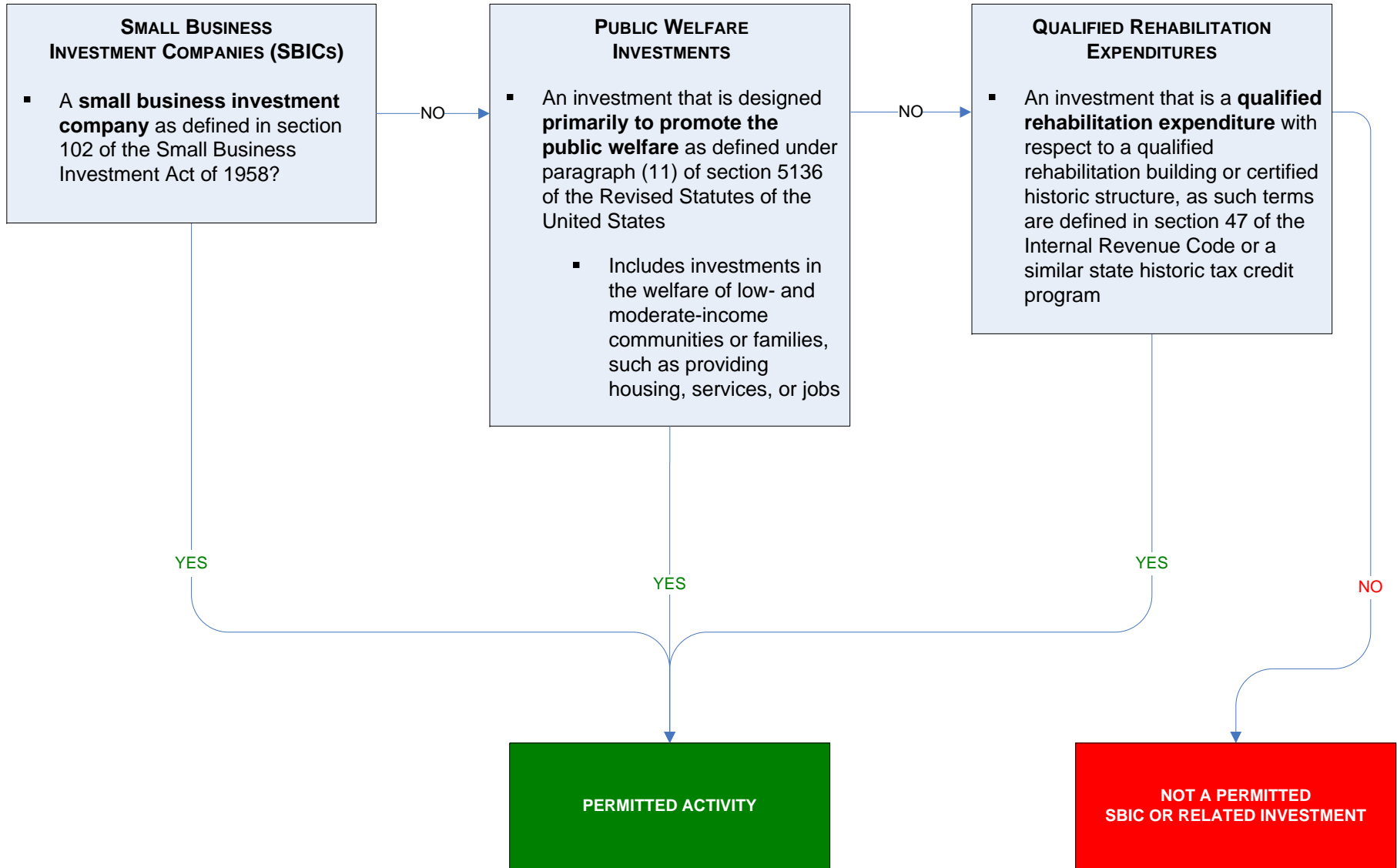
MINISTERIAL EXCEPTION FOR U.S.-BASED EMPLOYEES
The preamble states that an employee or entity with **no customer relationship** and involved solely in providing **administrative services** or “**back office**” functions to the fund incident to activities permitted under the exception, including **clearing and settlement** or maintaining and preserving records of the fund

Step 2F: Permitted Activities: Loan Securitizations

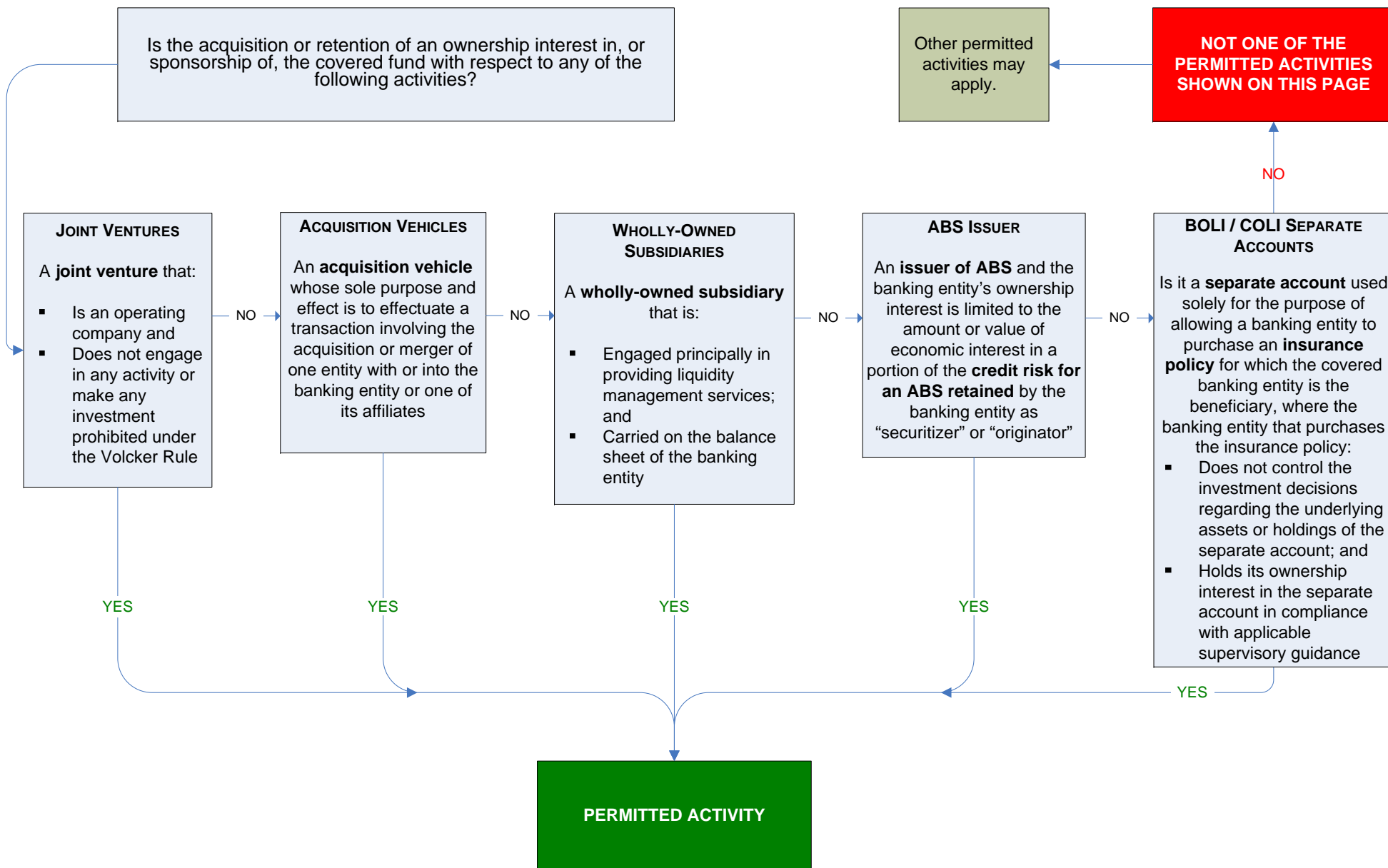


Permitted Activities: SBICs and Related Investments

Is the banking entity acquiring or retaining an ownership interest in, or sponsoring, a covered fund that is also:

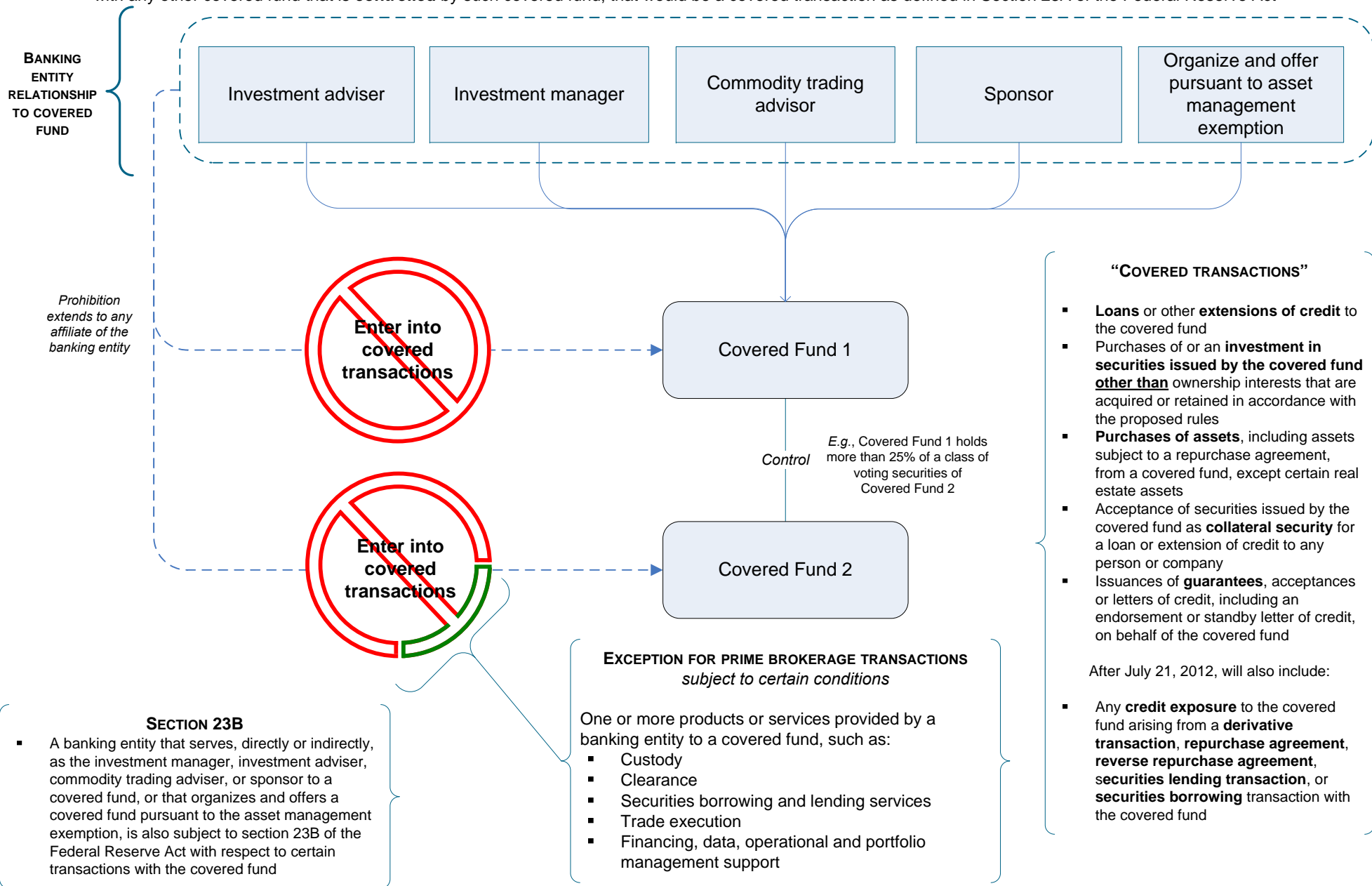


Permitted Activities: Investing in, or Sponsoring of, Certain Types of Vehicles



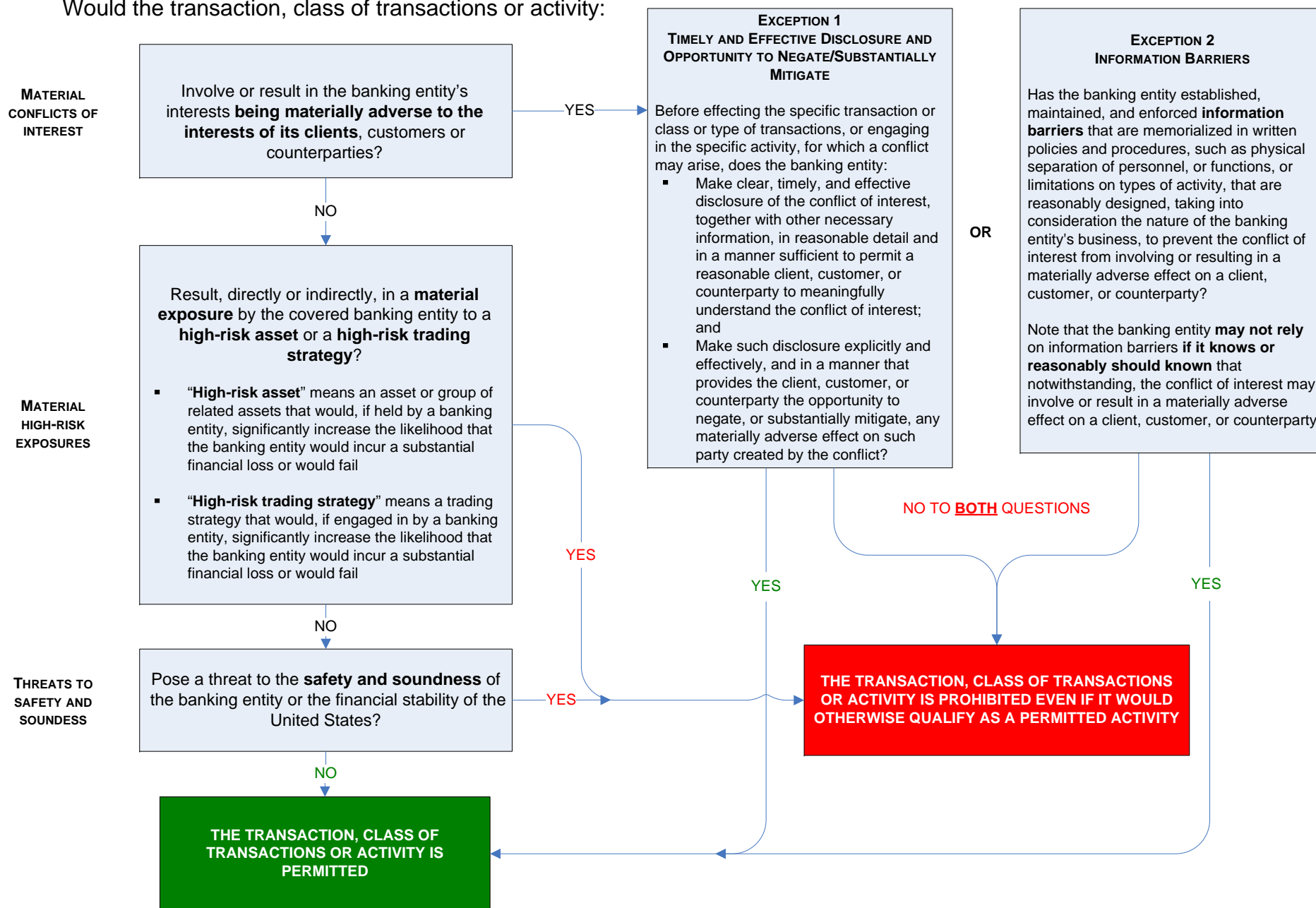
Do the “Super 23A” Restrictions Apply?

No banking entity or its affiliate that serves, directly or indirectly, as the **investment adviser, investment manager, commodity trading advisor, or sponsor** to a covered fund, or that **organizes and offers a covered fund pursuant to the asset management exemption**, may enter into a transaction with the covered fund, or with any other covered fund that is **controlled** by such covered fund, that would be a covered transaction as defined in Section 23A of the Federal Reserve Act



Is the Activity Precluded by a “Backstop” Prohibition?

Would the transaction, class of transactions or activity:



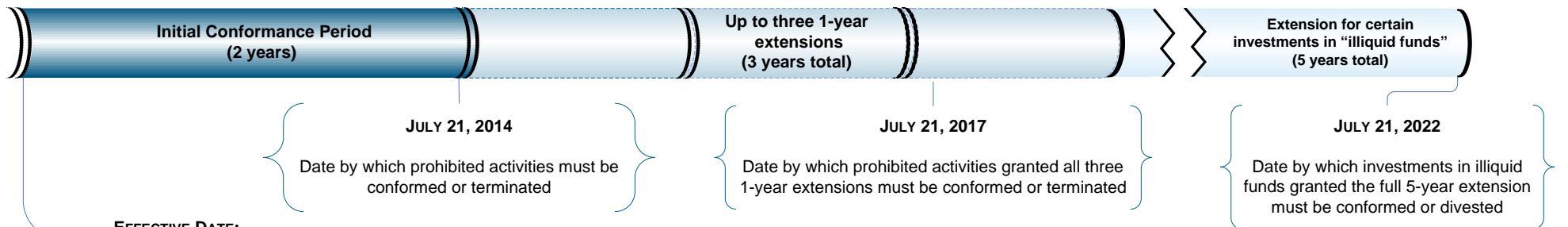


- **Applies to all covered investments and relationships.** Initial 2-year conformance period plus up to three 1-year extensions available for any investment made or relationship (see Super 23A) established with a covered fund prior to July 21, 2012. Up-to-5-year extended conformance period available only for certain investments in “illiquid funds” in existence on May 1, 2010
- **Conformance rules unchanged since final rulemaking.** Proposed rules implementing the Volcker Rule simply incorporate the February, 2011 final conformance rules with non-substantive conforming and technical changes. Proposed rules seek comment on whether the conformance rules should be revised in light of the content of the proposed rules
- **Extensions granted separately, run consecutively.** Banking entities must apply separately for each extension, at least 180 days prior to the expiration of the 2-year initial conformance period or any subsequent extension period

FACTORS FOR GRANTING OF EXTENSIONS BY FEDERAL RESERVE

Applications considered in light of all facts and circumstances, including but not limited to:

- market conditions
- degree of control held by the banking entity over investment decisions of the fund
- whether any assets that were illiquid when first acquired have become liquid
- expected wind-up / liquidation date of fund
- cost to banking entity of divesting or disposing of the activity or investment within the applicable period
- prior efforts to divest or conform the activity or investment
- any other factor the Board believes appropriate



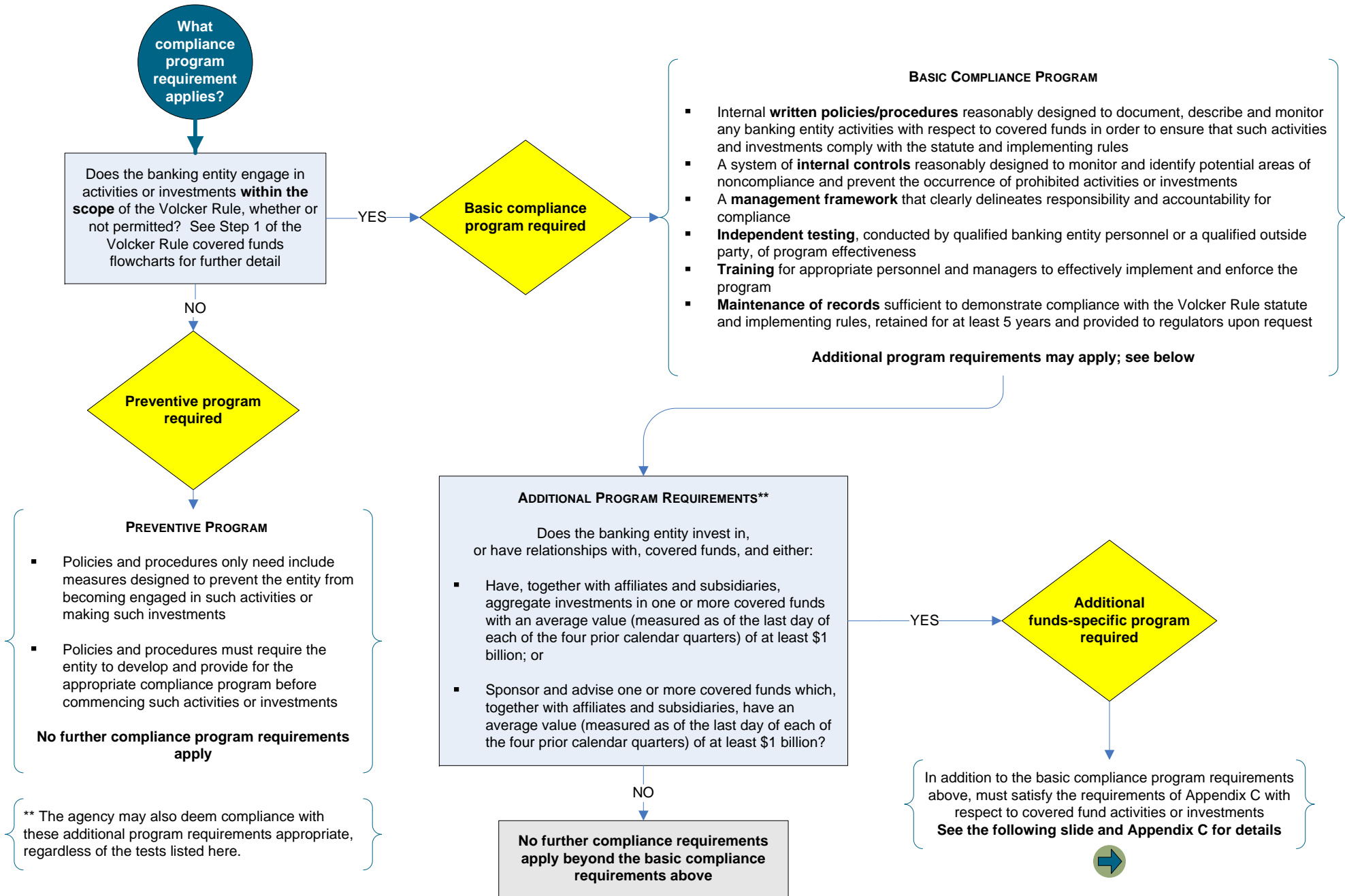
EFFECTIVE DATE:
JULY 21, 2012

UPON EFFECTIVE DATE:

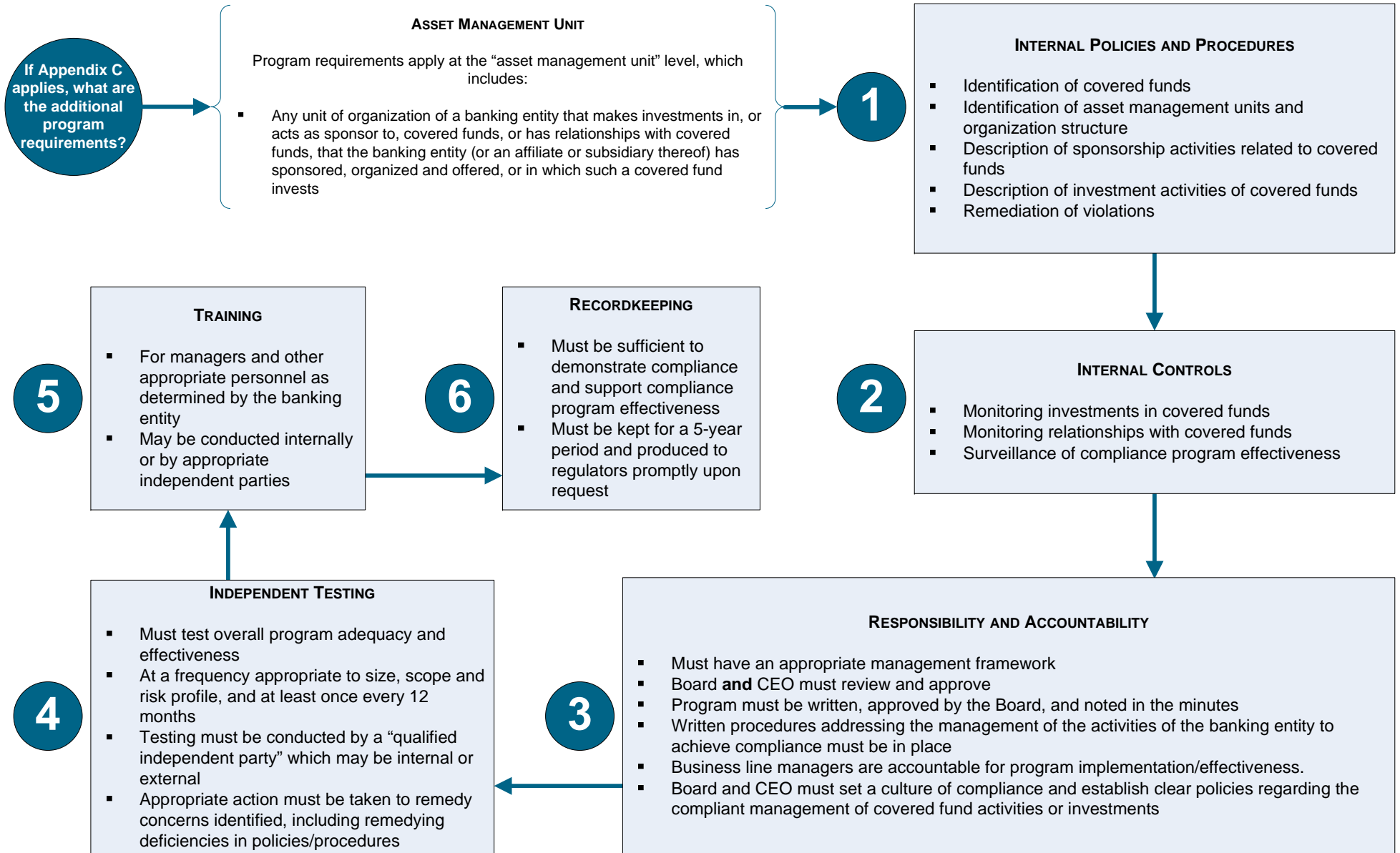
- **New Investments in or Sponsorships of Covered Funds** - A banking entity may not acquire or retain an ownership interest in or be the sponsor of a covered fund established on or after the effective date, except in accordance with the proposed rules, including the final conformance rules for pre-existing covered funds
- **New or Additional Covered Transactions with Related Covered Funds** – A banking entity may not enter into new or additional covered transactions with a related covered fund on or after the effective date
- **Compliance Program Must Be Implemented** - By the effective date, each banking entity would be required to have developed and implemented the required compliance program under Appendix C.

EXTENDED TRANSITION PERIOD FOR CERTAIN INVESTMENTS IN "ILLIQUID FUNDS"

- **Basic eligibility criteria:** In order for a banking entity to be eligible for the extended conformance period to retain or make additional investments in an illiquid fund:
 - The fund must be a covered fund that **as of May 1, 2010** was either **principally invested in illiquid assets** or invested to some degree and contractually committed to principally invest in illiquid assets; and
 - The investment must be **necessary** to fulfill a **contractual obligation** of the banking entity to retain or make additional investments that was in effect on May 1, 2010
- **Illiquid assets.** Any asset that:
 - Is **not** defined as a “liquid” asset, which in turn is defined as cash; assets traded on regulated exchanges or certain other markets with a sufficient volume of bids and offers to permit near instantaneous pricing reasonably related to the last sales price or a current competitive bid; assets traded on recognized inter-dealer quotation or similar systems with competitive bids and offers from multiple dealers; assets with prices routinely quoted in widely disseminated publications; certain short-term debt obligations; and any other asset designated by the Federal Reserve as liquid
 - Cannot be transferred because of statutory, regulatory or contractual restrictions on transfer
- **Principally invested.** A covered fund must have invested at least 75% of its consolidated assets in illiquid assets or risk-mitigating hedges related to such assets
- **Contractual obligation.** A contractual obligation to retain or make additional investments exists if the banking entity is prohibited from redeeming or transferring all ownership interests in a covered fund
- **Necessary.** An investment is deemed to be **necessary** to fulfill a contractual obligation only if the banking entity has no unilateral power to terminate the obligation and, if the consent of a general partner or other third party is needed, has used its reasonable best efforts to obtain such consent and such consent has been denied.



Additional Funds-Specific Compliance Programs, Policies and Procedures





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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