The Volcker Rule was enacted in 2010, as part of the Dodd-Frank Act, as Section 13 of the Bank Holding Company Act of 1956. The original regulations implementing the Volcker Rule were adopted by the five Volcker Rule agencies—the Federal Reserve, FDIC, OCC, SEC and CFTC (Agencies)—in 2013 (2013 Final Rule). The Economic Growth, Regulatory Relief, and Consumer Protection Act amended the Volcker Rule in 2018 to exempt small banking entities that are not significantly engaged in trading activities, and regulations were adopted to implement those amendments in 2019. The Agencies amended the regulations relating primarily to the proprietary trading portion of the Volcker Rule in 2019 (2019 Final Rule).

The Agencies amended the regulations relating primarily to the covered funds portion of the Volcker Rule in 2020 (2020 Final Rule).

These Davis Polk flowcharts visually depict permissible and impermissible covered fund activities, investments and relationships under the Volcker Rule and its implementing regulations.

Davis Polk’s proprietary trading flowcharts are available at www.volckerrule.com

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**SAMPLE GRAPHIC**

1. **Is a banking entity acquiring or retaining as principal an ownership interest in a covered fund or acting as sponsor of a covered fund?**
   - **Yes:** Is the activity a permitted activity under the Volcker Rule?
   - **No:** Activity is not within the scope of the Volcker Rule.

2. **Do one of the exclusions from the definition of covered fund apply?**
   - **Yes:** Activity is prohibited under the Volcker Rule.
   - **No:** Is the activity precluded by a backstop prohibition?

3. **Is the activity a permitted activity under the Volcker Rule?**
   - **Yes:** Activity is permitted under the Volcker Rule.
   - **No:** Activity is not within the scope of the Volcker Rule.

4. **Is the transaction any one of the following: an exempt covered transaction under Section 23A of the Federal Reserve Act or Section 223.42 of the Federal Reserve’s Regulation W? A riskless principal transaction? A transaction in the ordinary course of business in connection with payment, settlement or clearing activities that ends within five days? A prime brokerage transaction with a covered fund in which the related covered fund has made an investment?**
   - **Yes:** Activity is prohibited under the Volcker Rule.
   - **No:** Activity is permitted under the Volcker Rule.
VOLCKER RULE — COVERED FUNDS

July 14, 2020

VOLCKER RULE — COVERED FUNDS OVERVIEW

WHAT IS A BANKING ENTITY?

WHAT IS A U.S. ORGANIZED OR LOCATED BANKING ENTITY?
  ■ Banking Entities with a U.S. Top Tier Parent
  ■ Banking Entities with a Foreign Top Tier Parent

WHAT IS A COVERED FUND?
  ■ Definition of a Covered Fund
  ■ Exclusions from the Definition of Covered Fund

WHAT IS AN OWNERSHIP INTEREST?
  ■ Definition of an Ownership Interest
  ■ Exclusion for Restricted Profit Interest (Carried Interest)
  ■ Exclusion for Senior Loan or Senior Debt Interest

WHEN IS AN OWNERSHIP INTEREST NOT HELD AS PRINCIPAL?

WHAT IS A SPONSOR OF A COVERED FUND?

EXCLUSIONS FROM THE DEFINITION OF COVERED FUND
  ■ RIC or BDC
  ■ Investment Company Act Excluded Fund (U.S. or Foreign)
  ■ Foreign Public Fund
  ■ Foreign Pension Fund
  ■ Wholly Owned Subsidiary
  ■ Joint Venture
  ■ Acquisition Vehicle
  ■ Loan Securitization
  ■ Qualifying ABCP Conduit
  ■ Qualifying Covered Bond Entity
  ■ SBIC or Public Welfare Investment Fund
  ■ Insurance Company Separate Account
  ■ Bank Owned Life Insurance
  ■ Credit Fund
  ■ Qualifying Venture Capital Fund
  ■ Family Wealth Management Vehicle
  ■ Customer Facilitation Vehicle

PERMITTED ACTIVITIES
  ■ Asset Management Exemption
  ■ ABS Issuer Exemption
  ■ Underwriting and Market Making Exemptions
  ■ Investment Limits
    ▪ 3% Per Fund Limit
      ■ Asset Management Exemption
      ■ ABS Issuer Exemption
      ■ Aggregate 3% of Tier 1 Capital Limit (and Capital Deduction)
    ▪ Attribution Rules
      ■ Generally
      ■ Multi-Tier Funds and Parallel Investments
  ■ Seeding
  ■ Risk-Mitigating Hedging Exemption
  ■ Offshore Exemption
  ■ Regulated Insurance Companies Exemption
  ■ Qualifying Foreign Excluded Funds

DO THE SUPER 23A RESTRICTIONS APPLY?

IS AN OTHERWISE PERMITTED ACTIVITY PRECLUDED BY A “BACKSTOP” PROHIBITION?

DAVIS POLK CONTACTS
Is a banking entity engaged in any of the following activities:

**GENERAL PROHIBITION**
- Acquiring or retaining as principal an ownership interest in a covered fund?
- Acting as sponsor of a covered fund?

**EXCLUSIONS**
- Does one of the exclusions from the definition of covered fund apply?

**PERMITTED ACTIVITIES**
- Is the activity a permitted activity under the Volcker Rule?

**ACTIVITY IS NOT WITHIN THE SCOPE OF THE VOLCKER RULE**

**ACTIVITY IS PROHIBITED UNDER THE VOLCKER RULE**

**SUPER 23A**
- Entering into a covered transaction with a related covered fund or a covered fund controlled by such related covered fund?

**EXCEPTIONS**
- Is the transaction any one of the following:
  - An exempt covered transaction under Section 23A of the Federal Reserve Act or Section 223.42 of the Federal Reserve’s Regulation W?
  - A riskless principal transaction?
  - A transaction in the ordinary course of business in connection with payment, settlement or clearing activities that ends within five days?
  - A prime brokerage transaction with a covered fund in which the related covered fund has made an investment?

**IS THE ACTIVITY PRECLUDED BY A BACKSTOP PROHIBITION?**
- Material conflict of interest between the banking entity and its clients, customers or counterparties?
- Material exposure of the banking entity to high-risk assets or trading strategies?
- Threat to the safety and soundness of the banking entity or to U.S. financial stability?

**ACTIVITY IS PERMITTED UNDER THE VOLCKER RULE**
An insured depository institution 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 insured depository institution 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, on a consolidated basis, that are less than 5% of its total consolidated assets.

A company that controls an insured depository institution (other than an excluded small bank) (e.g., a bank holding company)?

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

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

Is the affiliate or subsidiary any of the following:

- A covered fund that is not itself a core banking entity?
- 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, that is not itself a core banking entity?
- The FDIC acting in its corporate capacity or as conservator or receiver?

What is a banking entity?

FAQs 14 and 16 state that a foreign public fund would not be considered a banking entity so long as no banking entity owns 25% or more of the voting shares of the fund after its seeding period and that a RIC, BDC or FPF would not be treated as a banking entity solely on the basis of the level of ownership of the fund by a banking entity during its seeding period.

Core Banking Entity

- A “core banking entity” means a banking entity as defined in boxes 2, 3 or 4.
WHAT IS A U.S. ORGANIZED OR LOCATED BANKING ENTITY?

BANKING ENTITIES WITH A U.S. TOP TIER PARENT
(INCL. ALL SUBSIDIARIES WORLDWIDE)

U.S. TOP TIER PARENT

U.S. BANK

MADRID BRANCH

JAPAN SUBSIDIARY

AUSTRALIA INDIRECT SUBSIDIARY

SEE WHAT IS A COVERED FUND? AND FOREIGN PUBLIC FUND, SLIDES 5 AND 14

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WHAT IS A U.S. ORGANIZED OR LOCATED BANKING ENTITY?

Banking Entities with a Foreign Top Tier Parent
(Incl. All Subsidiaries Worldwide)

U.S. Organized or Located Banking Entities
(Incl. Their Subsidiaries Worldwide)

- U.S. Bank
- U.S. Subsidiary
- U.S. Branch

European Top Tier Parent

- E.U. Bank

Foreign Organized or Located Banking Entities

- Mumbai Branch
- Indonesia Subsidiary

See What Is a Covered Fund?, Foreign Public Fund and Offshore Exemption, Slides 5, 14 and 39

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WHAT IS A COVERED FUND?

3(c)(1) OR 3(c)(7) ISSUER

- An issuer that would be an investment company as defined in the Investment Company Act of 1940 but for sections 3(c)(1) or 3(c)(7) of that Act

   An issuer that may rely on an exemption from the definition of “investment company” under the 1940 Act other than sections 3(c)(1) or 3(c)(7) is not a covered fund under this test.

   SEE INVESTMENT COMPANY ACT EXCLUDED FUND (U.S. OR FOREIGN), SLIDE 13

   NO

COVERED COMMODITY POOL

- A commodity pool that satisfies either of the following tests:
  - Exempt Pool Test: The commodity pool’s registered CPO has claimed exempt pool status under CFTC Rule 4.7(a)(1)(iii)
  - Alternative Test: The commodity pool has a registered CPO, substantially all units in the pool are owned by qualified eligible persons (QEPs) and no units in the pool have been publicly offered to persons other than QEPs

   YES

   NO

COVERED FOREIGN FUND

- A fund organized or established outside the United States that offers or sells interests inside the United States in reliance on section 3(c)(1) or 3(c)(7) of the 1940 Act

   OR

   With respect to a U.S. Organized or Located Banking Entity only that sponsors or owns an ownership interest in it, a fund that fulfills all of the following criteria:
   - The fund is organized or established outside the United States.
   - The ownership interests of the fund are offered and sold solely outside the United States.
   - The fund is, or holds itself out as being, an issuer or arrangement that raises money from investors primarily for the purpose of investing in securities for resale or other disposition or otherwise trading in securities.

   SEE WHAT IS A U.S. ORGANIZED OR LOCATED BANKING ENTITY?, SLIDES 3 AND 4

   NO
EXCLUSIONS FROM THE DEFINITION OF COVERED FUND

3(c)(1) OR 3(c)(7) ISSUER

NO

COVERED COMMODITY POOL

NO

YES

YES

COVERED FOREIGN FUND

IS THE ISSUER EXCLUDED FROM THE DEFINITION OF COVERED FUND?

RIC OR BDC

INVESTMENT COMPANY ACT EXCLUDED FUND

FOREIGN PUBLIC FUND

FOREIGN PENSION FUND

WHOLLY OWNED SUBSIDIARY

JOINT VENTURE

ACQUISITION VEHICLE

LOAN SECURITIZATION

QUALIFYING ABCP CONDUIT

QUALIFYING COVERED BOND ENTITY

SBIC OR PUBLIC WELFARE INVESTMENT FUND

INSURANCE COMPANY SEPARATE ACCOUNT

BANK OWNED LIFE INSURANCE

CREDIT FUND

QUALIFYING VENTURE CAPITAL FUND

FAMILY WEALTH MANAGEMENT VEHICLE

CUSTOMER FACILITATION VEHICLE

COVERED FUND

NO

NOT A COVERED FUND
What Is an Ownership Interest?

Other than a restricted profit interest (carried interest) or a senior loan or senior debt interest that qualifies for the safe harbor, is the interest in the covered fund acquired or retained by the banking entity:

Yes

- An equity or partnership interest?

Ownership Interest

No

- An other similar interest?

Not an Ownership Interest

Specified Characteristics of an “Other Similar Interest”

An “other similar interest” includes any interest in or security issued by a covered fund that exhibits any of the following characteristics on a current, future or contingent basis:

- Selection or removal of manager. The right to participate in the selection or removal of a general partner, managing member, member of the board of directors or trustees, investment manager, investment adviser or commodity trading advisor of the covered fund (excluding the rights to exercise remedies upon the occurrence of an event of default or acceleration event, to participate in the removal of an investment manager for cause for removal, or to participate in the selection of a replacement manager upon an investment manager’s resignation or removal)

- Share in income, gains or profits. The right under the terms of the interest to receive a share of the income, gains or profits of the covered fund, whether or not pro rata with other owners or holders of interests

- Residual interest in assets. The right to receive the underlying assets of the covered fund after all other interests have been redeemed or paid in full (excluding the rights of a creditor upon an event of default or acceleration)

- Excess spread. The right to receive all or a portion of excess spread (i.e., the positive difference, if any, between the aggregate interest payments received from the underlying assets of the covered fund and the aggregate interest paid to the holders of other outstanding interests)

- Write-down of amounts payable due to losses. Provides that, under the terms of the interest, the amounts payable by the covered fund with respect to the interest could be reduced based on losses arising from the underlying assets of the covered fund, such as allocation of losses, write-downs or charge-offs of the outstanding principal balance, or reductions in the amount of interest due and payable on the interest

- Return based on performance of assets. Receives income on a pass-through basis or has a rate of return that is determined by reference to the performance of the underlying assets of the covered fund

- Synthetic rights. Synthetic right to have, receive or be allocated any of the rights above

Cause for removal of an investment manager means one or more of the following events:

- bankruptcy, insolvency, conservatorship or receivership of the investment manager;
- breach by the investment manager of any material provisions of the covered fund’s transaction agreements applicable to the investment manager, or breach by the investment manager of material representations or warranties
- fraud or criminal activity in the performance of investment manager’s obligations
- indictment of the investment manager for a criminal offense, including in some cases the indictment of any officer, member, partner or other principal of the investment manager
- change in control with respect to the investment manager
- loss, separation or incapacitation of an individual critical to the operation of the investment manager or primarily responsible for the management of the covered fund’s assets
- other similar events that constitute “cause” for removal of an investment manager not solely related to the performance of the covered fund or the investment manager’s exercise of investment discretion

See Exclusion for Restricted Profit Interest (Carried Interest), Slide 8

See Exclusion for Senior Loan or Senior Debt Interest, Slide 9
EXCLUSION FOR **RESTRICTED PROFIT INTEREST**
(Carried Interest)

**GENERAL**
Is the interest in the covered fund held by an entity, or an employee or former employee thereof, for which the entity or employee serves as any of the following:
- investment manager
- investment adviser
- commodity trading advisor
- other services provider — e.g., sub-adviser or placement agent?

**PERFORMANCE COMPENSATION**
Is the sole purpose and effect of the interest to allow the entity (or employee or former employee) to share in the profits of the covered fund as performance compensation for services provided to the covered fund, even if the entity (or employee or former employee) is obligated to return profits previously received?

**DISTRIBUTED PROMPTLY OR HELD IN RESERVE SOLELY FOR CLAWBACK OBLIGATIONS**
- Is all such profit, once allocated:
  - distributed promptly to the entity (or employee or former employee) after being earned or
  - if not so distributed, retained by the covered fund for the sole purpose of establishing a reserve amount to satisfy contractual obligations with respect to subsequent losses of the covered fund?
- In addition, is the undistributed profit held in the covered fund held so as not to share in the subsequent investment gains of the covered fund?

**RELATED AMOUNTS INVESTED ATTRIBUTED TO BANKING ENTITY FOR 3% DE MINIMIS LIMITS, CAPITAL DEDUCTION**
Are any amounts invested in the covered fund, including any amounts paid by the entity in connection with obtaining the carried interest included within the banking entity’s calculation of its 3% per fund limit, aggregate 3% of Tier 1 capital limit and capital deduction?

**NON-TRANSFERABLE**
Is the interest not transferable by the entity (or employee or former employee) except to:
- an affiliate thereof (or an employee of the banking entity or affiliate)
- immediate family members
- through intestacy, or
- in connection with a sale of the business that gave rise to the carried interest by the entity (or employee or former employee) to an unaffiliated party that provides services to the covered fund?

**OWNERSHIP INTEREST**

**NOT AN OWNERSHIP INTEREST**

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Under the terms of the interest, do holders of the interest have no right to receive a share of the income, gains, or profits of the covered fund, but are entitled to receive only:

- interest and commitment or other fees not tied to the performance of the underlying assets of the covered fund; and
- repayment of a fixed principal amount on or before a maturity date, in a contractually determined manner (which may include prepayment premiums intended solely to reflect, and compensate holders of the interest for, forgone income resulting from an early prepayment)?

Are entitlement to payments absolute and not able to be reduced based on losses arising from the underlying assets of the covered fund (e.g., allocation of losses, write-downs or charge-offs of the outstanding principal balance, or reductions in the amount of interest due and payable on the interest)?

Are holders not entitled to receive the underlying assets of the covered fund after all other interests have been redeemed or paid in full (excluding rights of a creditor to exercise remedies upon an event of default or an acceleration event)?

Is the interest a senior loan or senior debt interest?
Is the ownership interest in the covered fund acquired or retained by the banking entity:

**Agent, Broker or Custodian**
Acting solely as agent, broker or custodian for the account of, or on behalf of, a customer and the banking entity and its affiliates do not have or retain beneficial ownership of such ownership interest?

**Employee Benefit Plans**
Through a:
- deferred compensation
- stock-bonus
- profit-sharing or
- pension plan
of the banking entity (or any of its affiliates) that is established and administered in accordance with US or foreign law, if the ownership interest is held or controlled directly or indirectly by the banking entity as trustee for the benefit of persons who are or were employees of the banking entity (or any of its affiliates)?

**DPC**
In the ordinary course of collecting a debt previously contracted in good faith, provided that the banking entity divests the ownership interest as soon as practicable, and in no event later than the maximum period permitted by the relevant Volcker Rule agency?

**Trustee or Fiduciary**
On behalf of customers as trustee or in a similar fiduciary capacity for a customer that is not a covered fund, so long as the activity is conducted:
- for the account of or on behalf of the customer and
- the banking entity and its affiliates do not have or retain beneficial ownership of such ownership interest?

**Other Non-Principal Capacity**
In another non-principal capacity?

NOT PROHIBITED BY THE VOLCKER RULE

INVESTMENT PROHIBITED UNLESS COVERED FUND IS AN EXCLUDED FUND OR INVESTMENT IS PERMITTED ACTIVITY

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

- Serve as a general partner of the covered fund?
- Serve as a managing member of the covered fund?
- Serve as a commodity pool operator of the covered fund?
- In any manner select or control (or have employees, officers, directors or agents who constitute) a majority of directors, trustees or management of the covered fund?
- Share with the covered fund, for corporate, marketing, promotional or other purposes, the same name or a variation of the same name, except as permitted by the name-sharing exception, or does the name of the covered fund include the word “bank”?
- Serve as a trustee of the covered fund, other than:
  - An entity will be a trustee within the meaning of the definition of sponsor if it directs a person serving as a trustee as described immediately above or possesses authority and discretion to manage and control the investment decisions of a covered fund for which such person serves as trustee
  - A trustee that is subject to fiduciary standards imposed under foreign law that are substantially equivalent to the ERISA standards described above

**Initial Selection of Directors, Trustees or Management — Terminating Control**

Initial selection of the board, trustees or management is an action characteristic of a sponsor. However, a banking entity that does not continue to select or control a majority of the board of directors would not be considered to be a sponsor on the basis of the initial selection of a majority of directors once the effect of such action or control terminates.

- In the case of a covered fund that will have a self-perpetuating board of directors or a board selected by the fund’s shareholders, such effect or control would be considered to have terminated when:
  - The board has held its first re-selection of directors or
  - First shareholder vote on directors occurs without selection or control by the banking entity

**Name-Sharing Exception**

A covered fund may share the same name or a variation of the same name with a banking entity that is an investment adviser to the covered fund if:

- The investment adviser is not a Core Banking Entity and
- The investment adviser does not share the same name or a variation of the same name as a Core Banking Entity

SEE WHAT IS A BANKING ENTITY?, SLIDE 2, FOR THE DEFINITION OF CORE BANKING ENTITY

**Excluded Trustees, Custodians and Administrators**

In addition to US directed trustees and their foreign equivalents, the following trustees would not cause sponsorship to the extent that they do not exercise investment discretion with respect to a covered fund:

- A trustee that is required to ensure that underlying assets are appropriately segregated for the benefit of the trust
- A trustee that is authorized to replace an investment adviser when the investment adviser resigns
- Generally, a trustee that executes decision-making, including investment of funds prior to the occurrence of an event of default, solely according to the provisions of a written contract or at the written direction of an unaffiliated party
- A trustee that irrevocably delegates all of its investment discretion to an unaffiliated third party

In addition, a custodian or administrator of a covered fund is not included within the definition of sponsor unless the definitional qualifications in the statute and final regulations are otherwise met.

**THE BANKING ENTITY IS THE SPONSOR OF THE COVERED FUND**

**THE BANKING ENTITY IS NOT THE SPONSOR OF THE COVERED FUND**
EXCLUSIONS FROM DEFINITION OF COVERED FUND
Investment Company Act Excluded Fund (U.S. or Foreign)

U.S. ISSUER
Can the issuer rely on an exclusion or exemption from the definition of investment company in the 1940 Act other than 3(c)(1) or 3(c)(7)?

NO

FOREIGN ISSUER
If the issuer were subject to US securities laws, would it be an investment company that could rely on an exclusion or exemption from the definition of investment company other than 3(c)(1) or 3(c)(7) of the 1940 Act?

NO

EXAMPLES OF OTHER 1940 ACT EXEMPTIONS
- Section 3(c)(5): Exempts certain types of REITs and other funds primarily engaged in the business of acquiring mortgages and other liens on and interests in real estate.
- Section 3(c)(3): Exempts common trust funds maintained by a bank exclusively for the collective investment of funds contributed by the bank in its capacity as a trustee or administrator.
- SEC Rule 3a-7: Exempts issuers of asset-backed securities the payments on which depend primarily on cash flows from a largely static pool of eligible assets that are not bought and sold for the primary purpose of recognizing gains or losses resulting from market changes.

YES

NOT A COVERED FUND

YES

NO

IS THE ISSUER OTHERWISE EXCLUDED FROM THE DEFINITION OF COVERED FUND?

NO

IS THE ISSUER ORGANIZED UNDER U.S. LAW?

YES

COVERED FUND
EXCLUSIONS FROM DEFINITION OF COVERED FUND

Foreign Public Fund (FPF)

**Non-US Issuer**
Is the issuer organized or established outside of the United States?

**Yes**  
**No**

**Retail Investors**
Retail investors can be construed to refer to members of the general public who do not possess the level of sophistication and investment experience typically found among institutional investors, professional investors or high net worth investors who may be permitted to invest in complex investments or private placements in various jurisdictions.

**Authorization and Public Offering**
Is the issuer authorized to offer and sell ownership interests, and such interests are offered and sold, through one or more public offerings?

**Yes**  
**No**

**Public Offering Requirements**
A public offering means a distribution of securities in any jurisdiction outside the United States to investors, including retail investors, that satisfies all of the following conditions:

- The distribution is subject to substantive disclosure and retail investor protection laws or regulations
- With respect to an issuer for which the banking entity serves as the investment manager, investment adviser, commodity trading advisor, commodity pool operator or sponsor, the distribution complies with all applicable requirements in the jurisdiction in which the distribution is made
- The distribution does not restrict availability to investors based on minimum net worth or net investment assets
- The issuer has filed or submitted offering disclosure documents with the appropriate regulatory authority in that jurisdiction that are publicly available

**Additional Condition for US Organized or Located Banking Entity Sponsors Only**
Are more than 75% of the foreign public fund’s ownership interests sold to persons other than:

- The sponsoring US Organized or Located Banking Entity
- The FPF itself
- Affiliates of the sponsoring US Organized or Located Banking Entity or the FPF
- Directors and senior executive officers (as defined in the Federal Reserve’s Regulation Y) of such entities?

**Yes**  
**No**

**Covered Fund**

**Is the issuer otherwise excluded from the definition of Covered Fund?**

**Yes**  
**No**

**Not a Covered Fund**
EXCLUSIONS FROM THE DEFINITION OF COVERED FUND

Foreign Pension Fund

Is the plan, fund or program providing pension, retirement or similar benefits:

Organized and administered outside of the United States?

YES

A broad-based plan for employees or citizens that is subject to regulation as a pension, retirement, or similar plan under the laws of the jurisdiction in which it is organized and administered?

YES

Established for the benefit of citizens and residents of one or more foreign sovereigns or any political subdivision thereof?

YES

NOT A COVERED FUND

NO

IS THE ISSUER OTHERWISE EXCLUDED FROM THE DEFINITION OF COVERED FUND?

YES

NO

COVERED FUND

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EXCLUSIONS FROM THE DEFINITION OF COVERED FUND

Wholly Owned Subsidiary

1. Are all of the ownership interests of the issuer owned directly or indirectly by the banking entity or its affiliate?
   - NO

2. Are the other ownership interests of the issuer permitted minority interests?
   - NO
   - YES

   PERMITTED MINORITY OWNERSHIP INTERESTS
   - Up to 5% of the entity's outstanding ownership interests (less permitted third-party interests) may be held by employees or directors of the banking entity or affiliate (or any former employee or director that acquired them while an employee or director)
   - Up to 0.5% may be held by a third party if acquired or retained for the purpose of establishing corporate separateness or addressing bankruptcy, insolvency or similar concerns

3. IS THE ISSUER OTHERWISE EXCLUDED FROM THE DEFINITION OF COVERED FUND?
   - NO
   - YES

   NOT A COVERED FUND

   COVERED FUND
EXCLUSIONS FROM THE DEFINITION OF COVERED FUND

**Joint Venture**

**UNAFFILIATED CO-VENTURERS**
Is ownership of the issuer divided between a banking entity (and any of its affiliates) and one or more unaffiliated persons?

**YES**

**MAXIMUM OF 10 CO-VENTURERS**
Is the ownership of the issuer divided among no more than 10 unaffiliated co-venturers?

**YES**

**ENGAGED IN A PERMITTED ACTIVITY OTHER THAN MERCHANT BANKING OR INSURANCE CO. INVESTMENT ACTIVITIES**
Is the issuer in the business of engaging in activities that are permissible for the banking entity or affiliate, other than investing in securities for resale or other disposition (i.e., merchant banking or insurance company investment activities)?

**YES**

**NOT AN INVESTMENT VEHICLE**
Is the issuer, or does it hold itself out as being, an issuer or arrangement that raises money from investors primarily for the purposes of investing in securities for resale or other disposition or otherwise trading in securities (i.e., merchant banking or insurance company investment activities or hedge fund activities)?

**NO**

**IS THE ISSUER OTHERWISE EXCLUDED FROM THE DEFINITION OF COVERED FUND?**

**YES**

**NOT A COVERED FUND**

**NO**

**COVERED FUND**

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* FAQ 15 states that an entity engaged in securities investment activities, regardless of the holding period for the securities, would not be eligible to rely upon this exclusion.
LIMITED TIME
Does the issuer exist only for such period as necessary to effectuate the transaction?

LIMITED PURPOSE
Is the issuer formed solely for the purpose of engaging in a *bona fide* merger or acquisition transaction?

**IS THE ISSUER OTHERWISE EXCLUDED FROM THE DEFINITION OF COVERED FUND?**

**NOT A COVERED FUND**

**COVERED FUND**
EXCLUSIONS FROM THE DEFINITION OF COVERED FUND

Loan Securitization

Is the issuer an issuer of ABS, as defined in Section 3(a)(79) of the Securities Exchange Act of 1934?

YES

NO

Asset-Backed Security (ABS)

An ABS means a fixed income or other security collateralized by any type of self-liquidating financial asset (including a loan, a lease, a mortgage, or a secured or unsecured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from the asset, including CDOs and CLOs, but does not include a security issued by a finance subsidiary if none of its securities are held by an unaffiliated party

Loans

The agencies indicated in the 2013 Final Rule preamble that loans must be held directly — no synthetic exposure, e.g., through a CDS or tranche of another loan securitization, specifically identified as an impermissible asset in the rule text, is not a loan

Permitted Securities

Cash equivalents. High quality, highly liquid short term investments (other than debt securities) whose maturity corresponds to the securitization’s expected or potential need for funds and whose currency corresponds either to the underlying loans or the ABS

DPC securities. Securities received in lieu of debts previously contracted with respect to the loans supporting the ABS

Permitted Debt Securities

Debt securities (other than asset-backed securities and convertible securities), provided that the aggregate value of such debt securities is 5% or less of the aggregate value of the vehicle’s loans, cash and cash equivalents, and debt securities

The aggregate value is calculated at par value at the most recent time any debt security is acquired, except that the vehicle may instead use fair market value (FMV) if the vehicle is required to use FMV for purpose of calculating compliance with concentration limitations (or other similar limits) and the vehicle’s valuation methodology treats similarly situated assets consistently

Are the assets and holdings of the issuer comprised solely of the following: loans, permitted derivatives, permitted securities, permitted debt securities, permitted servicing and contractual rights, and SUBIs and collateral certificates?

YES

NO

Is the issuer otherwise excluded from definition of Covered Fund?

YES

NO

Covered Fund

Permitted Derivatives

Limited to interest rate derivatives or FX derivatives that:

- By their written terms, directly relate to the loans, the ABS or the permitted servicing and permitted contractual rights, permitted securities or permitted debt securities
- Reduce the interest rate or FX risks related thereto

The agencies indicated in the 2013 Final Rule preamble that the total notional amount of permitted interest rate derivatives or FX derivatives are expected not to exceed the greater of either the outstanding principal balance of the loans supporting the ABS or the principal balance of the ABS

E.g., a $100 million securitization cannot be hedged using an interest rate derivative with a notional amount of $200 million

SUBIs and Collateral Certificates

Special units of beneficial interest and collateral certificates issued by an SPV, if all of the following are true:

- The SUBI / collateral certificate SPV issuer meets the requirements of the loan securitization exemption (e.g., holds only loan securitization-permissible assets)
- The SUBI or collateral certificate is used for the sole purpose of transferring the economic risks and benefits of permissible assets — no transfer of other economic or financial exposures
- The SUBI or collateral certificate is created solely to satisfy legal requirements or otherwise facilitate the structuring of the loan securitization
- The SUBI / collateral certificate SPV issuer is established under the direction of the same entity that initiated the loan securitization

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EXCLUSIONS FROM THE DEFINITION OF COVERED FUND
Qualifying ABPC Conduit

Does the conduit issue only ABS, comprised of a residual interest and ABS with a term of 397 days or less?

- **NO**
- **YES**

Does the conduit hold only permitted assets?

- **NO**
- **YES**

Has a regulated liquidity provider entered into a legally binding commitment to provide full and unconditional liquidity coverage with respect to all of the outstanding ABS issued by the conduit (other than the residual interest) in the event that funds are required to redeem maturing ABS?

- **NO**
- **YES**

### PERMITTED ASSETS
Assets permissible for a loan securitization
- Loans
- Permitted servicing and contractual rights
- Permitted securities
- Permitted derivatives
- SUBIs and collateral certificates

**ABS** supported solely by assets permissible for a loan securitization
- See above

**SEE LOAN SECURITIZATION, SLIDE 19**

### INITIAL ISSUANCE
Permitted ABS must have been acquired by the ABPC conduit as part of an initial issuance either directly from the issuing entity of the asset-backed securities or an underwriter in the distribution of such securities.

- i.e. no secondary market purchases

### REGULATED LIQUIDITY PROVIDER
A regulated liquidity provider is any of the following:
- Insured depository institution
- Bank holding company or any of its subsidiaries
- Savings and loan holding company provided that all or substantially all of its activities are permissible for a financial holding company under Section 4(k) of the BHC Act
- Foreign bank whose home country supervisor has adopted capital standards consistent with Basel III and that is subject to such standards, or any of its subsidiaries
- The United States or a foreign sovereign

### FULL AND UNCONDITIONAL LIQUIDITY COVERAGE
Full and unconditional liquidity coverage means that:
- in the event the conduit is unable for any reason to repay maturing asset-backed securities issued by the conduit, the total amount for which the regulated liquidity provider may be obligated is equal to 100 percent of the amount of **ABS** outstanding plus accrued and unpaid interest

### PERMISSIBLE FORMS OF LIQUIDITY COVERAGE
- Lending facility
- Asset purchase agreement
- Repurchase agreement or
- Similar arrangement
A covered bond means either:
- A debt obligation issued by a foreign banking organization provided that its payment obligations are fully and unconditionally guaranteed by an eligible covered bond entity
- A debt obligation of an eligible covered bond entity that is a wholly-owned subsidiary of a foreign banking organization provided that the issuer’s payment obligations are fully and unconditionally guaranteed by the foreign banking organization parent
**SMALL BUSINESS INVESTMENT COMPANY (SBIC)**

An issuer:
- That is an SBIC as defined in the Small Business Investment Act or
- That has received a notice to proceed or license from the Small Business Administration; and whose notice or license has not been revoked or
- That has voluntarily surrendered its license to operate as an SBIC and does not make any new investments (other than cash equivalents) after such voluntary surrender?

**PUBLIC WELFARE INVESTMENT FUNDS**

An issuer, the business of which is to make investments that are:
- Designed primarily to promote the public welfare of the type permitted under 12 USC 24, including the welfare of low- and moderate-income communities or families (such as providing housing, services or jobs) and including investments that qualify for consideration under the regulations implementing the Community Reinvestment Act (CRA)?

**QUALIFIED REHABILITATION EXPENDITURES**

An issuer, the business of which is to make investments that are:
- Qualified rehabilitation expenditures with respect to a qualified rehabilitation building or certified historic structure, as defined in section 47 of the Internal Revenue Code, or a similar state historic tax credit program?

**RURAL BUSINESS INVESTMENT COMPANY (RBIC)**

An issuer:
- That has elected to be or is regulated as an RBIC under the Investment Advisers Act of 1940 or
- That has terminated its participation as an RBIC and does not make any new investments (other than cash equivalents) after such termination?

**QUALIFIED OPPORTUNITY FUND**

An issuer that is a qualified opportunity fund under Section 1400Z-2(d) of the Internal Revenue Code?

**IS THE ISSUER OTHERWISE EXCLUDED FROM THE DEFINITION OF COVERED FUND?**

- **YES**
  - **COVERED FUND**
  - **NOT A COVERED FUND**

**CASH EQUIVALENTS**

High quality, highly liquid investments whose maturity corresponds to the issuer’s expected or potential need for funds and whose currency corresponds to the issuer’s assets.
For a **separate account** established by a banking entity that is an insurance company:

Does a banking entity other than the insurance company that established the separate account participate in the account’s profits and losses?

- **NO**: **NOT A COVERED FUND**
- **YES**
  - **IS THE ENTITY OTHERWISE EXCLUDED FROM THE DEFINITION OF COVERED FUND?**
    - **NO**: **COVERED FUND**
    - **YES**: **NOT A COVERED FUND**

**SEPARATE ACCOUNT**

An account established and maintained by an insurance company in connection with one or more insurance contracts to hold assets that are legally segregated from the insurance company’s other assets, under which income, gains and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company.
EXCLUSIONS FROM THE DEFINITION OF COVERED FUND

Bank Owned Life Insurance

For a separate account held by an insurance company:

- Is the separate account used solely for the purpose of allowing one or more banking entities to purchase a life insurance policy for which the banking entities are beneficiaries? **NO**

  - **Purchases from Affiliated Insurance Company**
    - This requirement does not preclude a banking entity from purchasing a life insurance policy from an affiliated insurance company.

- Does a banking entity that purchases the policy control the investment decisions regarding the underlying assets or holdings of the separate account? **YES**

- Does a banking entity that purchases the policy participate in the profits and losses of the separate account other than in compliance with applicable requirements regarding bank owned life insurance? **NO**

- IS THE SEPARATE ACCOUNT OTHERWISE EXCLUDED FROM THE DEFINITION OF COVERED FUND? **NO**

  - COVERED FUND

  - NOT A COVERED FUND
**EXCLUSIONS FROM DEFINITION OF COVERED FUND**

**Credit Fund**

- **Asset Requirement:** Are the assets of the issuer composed of permissible assets?
  - **YES**
  - **Activity Requirement:** Does the issuer (1) engage in proprietary trading under the purpose test or (2) issue ABS?
    - **NO**
    - **Banking Entity Eligibility:** Is the banking entity eligible to rely on the exclusion?
      - **YES**

**Permissible Assets**
The assets of the issuer must consist solely of:
- loans;
- debt instruments, including debt securities;
- rights and other assets that are related or incidental to acquiring, holding, servicing, or selling such loans or debt instruments, provided that (1) each such right or asset that is a security is also a cash equivalent, a security received in lieu of debts previously contracted, or an equity security (or right to acquire an equity security) received on customary terms in connection with such loans or debt instruments and (2) these assets or rights do not include commodity forward contracts or any derivative; and
- certain interest rate or foreign exchange derivatives.

**Eligibility for a Banking Entity to Rely on Exclusion**
A banking entity acting as a sponsor, investment adviser, or commodity trading advisor of the issuer must:
- provide in writing to any prospective and actual investor in the issuer the disclosures required under the asset management exemption;
- ensure that the activities of the issuer are consistent with safety and soundness standards that are substantially similar to those that would apply if the banking entity engaged in the activities directly; and
- comply with the requirements of Super 23A, except the banking entity may acquire and retain any ownership interest in the issuer.

In addition:
- the banking entity must not directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the issuer or of any entity to which such issuer extends credit or in which such issuer invests; and
- any debt instruments or equity securities the issuer holds must be permissible for the banking entity to acquire and hold directly under applicable federal banking laws and regulations.

See Asset Management Exemption, Slide 29
See Do the “Super 23A” Restrictions Apply?, Slide 42

**Investment and Relationship Limits**
(1) Does the banking entity’s investment in, and relationship with, the issuer comply with the covered funds backstop provisions; and
(2) is it conducted in compliance with, and subject to, applicable banking laws and regulations, including applicable safety and soundness standards?

**Covered Fund**
- **No**

**Is the Issuer Otherwise Excluded from the Definition of Covered Fund?**
- **Yes**

**Not a Covered Fund**
EXCLUSIONS FROM THE DEFINITION OF COVERED FUND

Qualifying Venture Capital Fund

VENTURE CAPITAL FUND

Venture capital fund is defined by reference to Rule 203(l)-1 under the Investment Advisers Act of 1940 to include an issuer that:
- represents to investors and potential investors that it pursues a venture capital strategy;
- immediately after the acquisition of any asset, other than a “qualifying investment,” as defined in Rule 203(l)-1(c)(3), or short-term holdings, holds no more than 20% of the amount of the fund’s aggregate capital contributions and uncalled committed capital in assets (other than short-term holdings) that are not qualifying investments, valued at cost or fair value, consistently applied by the fund;
- does not borrow, issue debt obligations, provide guarantees or otherwise incur leverage, in excess of 15% of the fund’s aggregate capital contributions and uncalled committed capital, and any such borrowing, indebtedness, guarantee or leverage is for a non-renewable term of no longer than 120 calendar days, except that any guarantee by the fund of obligations of a qualifying portfolio company, as defined in Rule 203(l)-1(c)(4), up to the amount of the value of the fund’s investment in the qualifying portfolio company is not subject to the 120 calendar day limit;
- only issues securities the terms of which do not provide a holder with any right, except in extraordinary circumstances, to withdraw, redeem or require the repurchase of such securities but may entitle holders to receive distributions made to all holders pro rata; and
- is not registered under section 8 of the Investment Company Act of 1940, and has not elected to be treated as a business development company pursuant to section 54 of that Act.

ELIGIBILITY FOR A BANKING ENTITY TO RELY ON EXCLUSION

A banking entity acting as a sponsor, investment adviser, or commodity trading advisor of the issuer must:
- provide in writing to any prospective and actual investors in the issuer the disclosures required under the asset management exemption;
- ensure that the activities of the issuer are consistent with safety and soundness standards that are substantially similar to those that would apply if the banking entity engaged in the activities directly; and
- comply with the requirements of Super 23A, except the banking entity may acquire and retain any ownership interest in the issuer.

In addition:
- the banking entity must not directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the venture capital fund.

A banking entity’s ownership interest in or relationship with a qualifying venture capital fund must:
- comply with the covered funds backstop provisions; and
- be conducted in compliance with, and subject to, applicable banking laws and regulations, including applicable safety and soundness standards.

See Asset Management Exemption, Slide 29
See Do the “Super 23A” Restrictions Apply?, Slide 42
See Is an Otherwise Permitted Activity Precluded by a “Backstop” Prohibition?, Slide 43
EXCLUSIONS FROM DEFINITION OF COVERED FUND

Family Wealth Management Vehicle

Is the entity, or does it hold itself out as being, an entity or arrangement that raises money from investors primarily for the purpose of investing in securities for resale or other disposition or otherwise trading in securities?

NO

Trust
Is the entity a trust?

YES

OWNERSHIP
Subject to the de minimis exception, are all grantors of the entity family customers?

NO

OWNERSHIP
Subject to the de minimis exception,

- Are a majority of the voting interests in the entity owned (directly or indirectly) by family customers?

- Are a majority of the interests in the entity owned (directly or indirectly) by family customers?

- Is the entity owned only by family customers and up to 5 closely related persons of the family customers?

YES

ADDITIONAL CONDITIONS
Does the banking entity (or an affiliate) relying on the exclusion:

- Provide bona fide trust, fiduciary, investment advisory, or commodity trading advisory services to the entity;

- Not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of such entity;

- Comply with the disclosure requirement of the asset management exemption, provided that the content may be modified to prevent the disclosure from being misleading and the manner of disclosure may be modified to accommodate the specific circumstances of the entity;

- Not acquire or retain, as principal, an ownership interest in the entity, other than as permitted under the de minimis exception;

- Comply with the Section 23B requirement (but compliance with Super 23A is not required) and the covered funds backstop provisions; and

- Except for riskless principal transactions, comply with the requirements of 12 CFR 223.15(a), as if such banking entity and its affiliates were a member bank and the entity were an affiliate thereof?

See Asset Management Exemption, Slide 29
See Do the “Super 23A” Restrictions Apply?, Slide 42
See Is an Otherwise Permitted Activity Precluded by a “Backstop” Prohibition?, Slide 43

NO

FAMILY CUSTOMER
A family customer means:
- A family client, as defined in Rule 202(a)(11)(G)-1(d)(4) of the Investment Advisers Act of 1940; or
- Any natural person who is a father-in-law, mother-in-law, brother-in-law, sister-in-law, son-in-law or daughter-in-law of a family client, or a spouse or a spousal equivalent of any of the foregoing.

YES

CLOSely RELATED PERSON
A closely related person means a natural person (including the estate and estate planning vehicles of such person) who has longstanding business or personal relationships with any family customer.

CLOSELY RELATED PERSON
Are a majority of the voting interests in the entity owned (directly or indirectly) by family customers?

NO

RISKLESS PRINCIPal TRANSACTION
Riskless principal transaction means a transaction in which a banking entity, after receiving an order from a customer to buy (or sell) a security, purchases (or sells) the security in the secondary market for its own account to offset a contemporaneous sale to (or purchase from) the customer.

NO

EXCLUSIONS FROM DEFINITION OF COVERED FUND

IS THE ENTITY OTHERWISE EXCLUDED FROM THE DEFINITION OF COVERED FUND?

NO

COVERED FUND

YES

NOT A COVERED FUND

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EXCLUSIONS FROM DEFINITION OF COVERED FUND

Customer Facilitation Vehicle

Is the issuer formed by or at the request of a customer (which may include one or more affiliates of such customer) of the banking entity for the purpose of providing such customer with exposure to a transaction, investment strategy, or other service provided by the banking entity?

- **YES**
  - Subject to the *de minimis exception*, are all of the ownership interests of the issuer owned by the customer (which may include one or more of its affiliates) for whom the issuer was created?

- **NO**
  - **DE MINIMIS EXCEPTION**
    - Up to an aggregate 0.5 percent of the issuer’s outstanding ownership interests may be acquired or retained by one or more entities (whether or not banking entities) that are not customers if the ownership interest is acquired or retained by such parties for the purpose of and to the extent necessary for establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns.

- **RISKLESS PRINCIPAL TRANSACTION**
  - Riskless principal transaction means a transaction in which a banking entity, after receiving an order from a customer to buy (or sell) a security, purchases (or sells) the security in the secondary market for its own account to offset a contemporaneous sale to (or purchase from) the customer.

Do the banking entity and its affiliates relying on the exclusion:

- Maintain documentation outlining how the banking entity intends to facilitate the customer’s exposure to such transaction, investment strategy, or service;
- Not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of such entity;
- Comply with the disclosure requirement of the asset management exemption, provided that the content may be modified to prevent the disclosure from being misleading and the manner of disclosure may be modified to accommodate the specific circumstances of the issuer;
- Not acquire or retain, as principal, an ownership interest in the issuer, other than as permitted under the *de minimis exception*;
- Comply with the Section 23B requirement (but compliance with Super 23A is not required) and the covered funds backstop provisions; and
- Except for riskless principal transactions, comply with the requirements of 12 CFR 223.15(a), as if such banking entity and its affiliates were a member bank and the issuer were an affiliate thereof?

**SEE ASSET MANAGEMENT EXEMPTION, SLIDE 29**

**SEE DO THE “SUPER 23A” RESTRICTIONS APPLY?, SLIDE 42**

**SEE IS AN OTHERWISE PERMITTED ACTIVITY PRECLUDED BY A “BACKSTOP” PROHIBITION?, SLIDE 43**

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**PERMITTED ACTIVITIES**

**Asset Management Exemption**

A banking entity may acquire or retain an ownership interest in, or act as a sponsor to, a covered fund, in connection with directly or indirectly organizing and offering the covered fund if:

1. The banking entity or an affiliate provides bona fide trust, fiduciary, investment advisory or commodity trading advisory services.

2. The covered fund is organized and offered only in connection with the provision of bona fide trust, fiduciary, investment advisory or commodity trading advisory services and only to persons that are customers of such services of the banking entity or an affiliate.

3. The banking entity and its affiliates do not acquire or retain an ownership interest in the covered fund other than a de minimis investment in compliance with investment limits.

4. The banking entity and its affiliates comply with the Volcker Rule’s Super 23A restrictions and 23B restrictions.

5. The banking entity and its affiliates do not, directly or indirectly, guarantee, assume or otherwise insure the obligations or performance of the covered fund or of any covered fund in which such covered fund invests.

6. The covered fund, for corporate, marketing, promotional or other purposes, does not share the same name or a variation of the same name with the banking entity or its affiliates, except as permitted by the name-sharing exception, and the name of the covered fund does not include the word “bank.”

7. Only directors or employees of the banking entity or an affiliate directly engaged in providing investment advisory, commodity trading advisory or other services to the covered fund at the time the director or employee takes the ownership interest may invest in the covered fund.

8. The banking entity clearly and conspicuously makes certain required written disclosures to any prospective and actual investor in the covered fund.

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**Other Services**

Directors and employees who provide any of the following examples of “other services” to a covered fund that enable the provision of investment advice or investment management — including any former director or employee who provided such services to the covered fund at the time of investment — may invest in or retain an investment in the covered fund:

- Oversight
- Risk Management
- Deal Origination
- Due Diligence
- Administrative
- Other Services

**Customers**

Includes existing and new customers, but the banking entity must have a “written plan or similar documentation” outlining how the banking entity intends to provide advisory or similar services to its customers through organizing and offering the covered fund.

**Name-Sharing Exception**

A covered fund may share the same name or a variation of the same name with a banking entity that is an investment adviser to the covered fund if:

- The investment adviser is not a Core Banking Entity and
- The investment adviser does not share the same name or a variation of the same name as a Core Banking Entity.

SEE WHAT IS A BANKING ENTITY?, SLIDE 2, FOR THE DEFINITION OF CORE BANKING ENTITY

**Super 23A, 23B**

SEE DO THE “SUPER 23A” RESTRICTIONS APPLY?, SLIDE 42

**Investment Limits and Capital Deduction**

SEE INVESTMENT LIMITS, SLIDES 32-36

SEE SEEDING, SLIDE 37

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PERMITTED ACTIVITIES
ABS Issuer Exemption

A banking entity may acquire or retain an ownership interest in, or act as a sponsor to, a covered fund that issues ABS in connection with directly or indirectly organizing and offering* the covered fund, if:

1. Compliance with Investment Limits
   - The banking entity and its affiliates do not acquire or retain an ownership interest in the covered fund other than in compliance with investment limits

2. Super 23A
   - The banking entity and its affiliates comply with the Volcker Rule’s Super 23A restrictions and 23B restrictions

3. No Guarantees
   - The banking entity and its affiliates do not, directly or indirectly, guarantee, assume or otherwise insure the obligations or performance of the covered fund or of any covered fund in which such covered fund invests

4. No Name Sharing
   - The covered fund, for corporate, marketing, promotional or other purposes, does not share the same name or a variation of the same name with the banking entity or its affiliates, except as permitted by the name-sharing exception, and the name of the covered fund does not include the word “bank”

5. Restrictions on Investments by Directors and Employees
   - Only directors or employees of the banking entity or an affiliate directly engaged in providing investment advisory, commodity trading advisory or other services to the covered fund at the time the director or employee takes the ownership interest may invest in the covered fund

6. Written Disclosures
   - The banking entity clearly and conspicuously makes certain written disclosures to any prospective and actual investor in the covered fund

**Organizing and offering** a covered fund that issues asset-backed securities means:
- Acting as the securitizer for the issuer, as defined in the Securities Exchange Act; or
- Acquiring or retaining an ownership interest in the issuing entity as required by the credit risk retention requirements of Section 15G of the Securities Exchange Act and its implementing regulations

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**Securitizer**

The term securitizer is defined in the Securities Exchange Act to mean:
- An issuer of an asset-backed security; or
- A person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer.

**Risk Retention Requirements**

- Section 15G of the Exchange Act requires certain parties to a securitization transaction to retain and maintain a minimum of 5% of the risk of the securitization, which is permitted under the 3% per fund investment limits
- The regulations do not contemplate this requirement being satisfied by compliance with risk retention requirements imposed under foreign law

**See 3% Per Fund Limit, Slide 33**

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**Name-Sharing Exception**

A covered fund may share the same name or a variation of the same name with a banking entity that is an investment adviser to the covered fund if:
- The investment adviser is not a Core Banking Entity
- The investment adviser does not share the same name or a variation of the same name as a Core Banking Entity

**See What is a Banking Entity?, Slide 2, for the definition of Core Banking Entity**

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**Super 23A, 23B**

**See Do the “Super 23A” Restrictions Apply?, Slide 42**

**Required Disclosures**

**See Asset Management Exemption, Slide 29**

**Other Services**

**See Asset Management Exemption, Slide 29**

**Investment Limits and Capital Deduction**

**See Investment Limits, Slides 32-36**

**See Seeding, Slide 37**
PERMITTED ACTIVITIES
Underwriting and Market Making Exemptions

A banking entity may acquire or retain ownership interests in a covered fund as underwriter or market maker if:

1. CONDUCTED IN ACCORDANCE WITH REQUIREMENTS APPLICABLE TO THE RELEVANT PROP TRADING PERMITTED ACTIVITY

The underwriting or market making-related activities are conducted in accordance with the requirements for permitted underwriting or market making-related activities in the proprietary trading provisions of the final regulations.

2. THIRD PARTY COVERED FUNDS

The underwriting and market making exemptions apply to ownership interests in any covered fund, including covered funds organized, offered, sponsored, advised or controlled by an unaffiliated third party.

3. SUBJECT TO INVESTMENT LIMITS, AS APPLICABLE

Ownership interests acquired or retained by a banking entity are subject to the 3% per fund limits if they are or were issued by a covered fund:

- Asset management or ABS issuer exemptions. For which the banking entity is a sponsor or in which the banking entity acquires and retains an ownership interest pursuant to the asset management or ABS issuer exemptions, or
- Other related covered funds. For which the banking entity is otherwise a sponsor, investment adviser or commodity trading advisor

The 3% per fund limit does not apply to ownership interests acquired or retained pursuant to the underwriting or market making exemptions in any covered fund organized and offered by the banking entity pursuant to the asset management or ABS exemptions during the seeding period for such fund.

The 3% per fund limit does not apply to ownership interests acquired or retained pursuant to the underwriting or market making exemptions in third-party covered funds or covered funds guaranteed by the banking entity.

The 3% per fund limit is calculated as of the end of each quarter, but if a banking entity becomes aware that it has exceeded the 3% limit for a given fund at any time, the agencies expect the banking entity to take steps to ensure that it complies promptly with the 3% per fund limit.

3% PER FUND LIMITS

Ownership interests acquired or retained by a banking entity are subject to the 3% per fund limits if they are or were issued by a covered fund:

- Asset management or ABS issuer exemptions. For which the banking entity is a sponsor or in which the banking entity acquires and retains an ownership interest pursuant to the asset management or ABS issuer exemptions, or
- Other related covered funds. For which the banking entity is otherwise a sponsor, investment adviser or commodity trading advisor

The 3% per fund limit does not apply to ownership interests acquired or retained pursuant to the underwriting or market making exemptions in any covered fund organized and offered by the banking entity pursuant to the asset management or ABS exemptions during the seeding period for such fund.

The 3% per fund limit does not apply to ownership interests acquired or retained pursuant to the underwriting or market making exemptions in third-party covered funds or covered funds guaranteed by the banking entity.

The 3% per fund limit is calculated as of the end of each quarter, but if a banking entity becomes aware that it has exceeded the 3% limit for a given fund at any time, the agencies expect the banking entity to take steps to ensure that it complies promptly with the 3% per fund limit.

AGGREGATE 3% OF TIER 1 CAPITAL LIMIT AND CAPITAL DEDUCTIONS

Ownership interests in any covered fund, other than a third-party covered fund or a fund guaranteed by the banking entity, which are acquired and retained by a banking entity pursuant to the underwriting or market making exemptions are subject to the aggregate 3% of Tier 1 capital limits and capital deductions.

The aggregate 3% of Tier 1 capital limit is calculated as of the end of each quarter, but banking entities should monitor their investments in covered funds regularly and remain in compliance with the aggregate 3% of Tier 1 capital limit throughout the quarter.

SEE INVESTMENT LIMITS, AND SEEDING SLIDES 32–37

SEE DAVIS POLK PROPRIETARY TRADING FLOWCHARTS, SLIDES 7-10 FOR DETAILS ON THESE PERMITTED ACTIVITIES

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PERMITTED ACTIVITIES

3% Per Fund Limit:
Asset Management Exemption

Except as permitted during the seeding period and for multi-tier fund investments, the following rules apply for calculating a banking entity's ownership interests in a single covered fund that the banking entity organizes and offers or sponsors under the asset management exemption, including ownership interests acquired or retained under the underwriting or market making exemptions.

3% PER FUND BY NUMBER AND VALUE

3% of Total Number or Value. The maximum permissible investment or other holding by a banking entity and its affiliates in a single covered fund under the asset management exemption, when aggregated with any ownership interests acquired or retained under the underwriting or market making exemptions, is 3% of the total number or value of the outstanding ownership interests of the covered fund (all measured without regard to funds committed but not yet called for investment):

- Total number: The total number of outstanding ownership interests held by the banking entity under the asset management, underwriting, or market making exemptions divided by the total ownership interests held by all investors or other holders in that fund
- Total fair market value. The aggregate fair market value of all investments or other holdings in and capital contributions made to the covered fund by the banking entity under the asset management, underwriting, or market making exemptions divided by the value of all investments or other holdings in and capital contributions made to the covered fund by all investors

  - If fair market value cannot be determined, then the value will be the historical cost basis of the investments or other holdings and capital contributions

CONSISTENCY OF CALCULATION

- Consistent with financial statements and regulatory reports. A banking entity should use the same methodology for valuing its investments and capital contributions as the banking entity uses to prepare its financial statements and regulatory reports
- Same manner and standards. Once a valuation methodology is chosen, the banking entity must calculate the value of its investment or other holding and the investments or other holdings of all others in the covered fund in the same manner and according to the same standards

TIMING

Quarterly. The 3% per fund limit is calculated as of the last day of each calendar quarter.

- 3% limit applies at all times. The 3% per fund limitations apply to investments or other holdings in covered funds under the asset management, underwriting, or market making exemptions at all times following the end of the seeding period
- Prompt compliance expected if 3% per fund limit exceeded. If a banking entity becomes aware that it has exceeded the 3% limit for a given fund at any time, the agencies expect the banking entity to take steps to ensure that it complies promptly with the 3% per fund limit

ATTRIBUTION *

See Attribution Rules, Slides 35-36

OTHER 3% PER FUND LIMITS

See 3% Per Fund Limit: ABS Issuer Exemption, Slide 33
See Underwriting and Market Making Exemptions (3% Per Fund Limits — Other Related Covered Funds), Slide 31

SEEDING PERIOD

See Seeding, Slide 37

AGGREGATE 3% OF TIER 1 CAPITAL LIMIT**

See Aggregate 3% of Tier 1 Capital Limit, Slide 34

* Includes Multi-Tier Investments
** Includes Deductions from Capital
PERMITTED ACTIVITIES
3% Per Fund Limit:
ABS Issuer Exemption

Except as permitted during the seeding period and for multi-tier fund investments, the following rules apply for calculating a banking entity’s ownership interests in a single covered fund that the banking entity organizes and offers or sponsors under the ABS issuer exemption, including ownership interests acquired or retained under the underwriting or market making exemptions:

### 3% De Minimis or 5% Risk Retention

The maximum permissible investment or other holding by a banking entity and its affiliates in a single covered fund organized and offered under the ABS issuer exemption, when aggregated with any ownership interests acquired or retained under the underwriting or market making exemptions, is:

- 3% of the total fair market value of the outstanding ownership interests in the fund

  **unless**

- The banking entity and its affiliates are required to retain a greater percentage in compliance with the credit risk retention requirements of Section 15G of the Securities Exchange Act and its implementing regulations, in which case the investment by the banking entity and its affiliates in the covered fund may not exceed the amount, number, or value of ownership interests of the fund required thereunder.

  - **Risk retention requirements.** Section 15G requires certain parties to a securitization transaction to retain and maintain a minimum of 5% of the risk of the securitization
  - **No accommodation for foreign risk retention requirements.** The regulations do not contemplate this requirement being satisfied by compliance with any risk retention requirements imposed under foreign law

### Valuation

- **Fair market value of assets.** The aggregate value of the outstanding ownership interests in the covered fund will be the fair market value of the assets transferred to the issuing entity of the securitization and any other assets otherwise held by the issuing entity at such time, determined in a manner that is consistent with its determination of the fair market value of those assets for financial statement purposes
- **Not calculated by class or tranche.** The 3% per fund limit for ownership interests in ABS issuers is calculated based only on the value of the ownership interest in relation to the value of all ownership interests in the issuing entity of the asset-backed security and are not calculated on a class by class, or tranche by tranche, basis
- **Date of establishment.** As of the date on which the assets were initially transferred into the ABS issuing entity or such earlier date on which the transferred assets have been valued for purposes of transfer to the covered fund
- **Valuation consistency.** The valuation methodology used to calculate the fair market value of the ownership interests must be the same for both the ownership interests held by the banking entity and the ownership interests held by all others in the covered fund in the same manner and according to the same standards

### Timing of 3% Per Fund Limit Calculation:

- **NOT SUBJECT TO RISK RETENTION REQUIREMENTS OR COMPLETED PRIOR TO RISK RETENTION COMPLIANCE DATE**
  - As of the date on which the assets were initially transferred into the ABS issuing entity
  - Such earlier date on which the transferred assets have been valued for purposes of transfer to the covered fund

- **SUBJECT TO RISK RETENTION REQUIREMENTS AND COMPLETED PRIOR TO RISK RETENTION COMPLIANCE DATE**
  - As of the date and pursuant to the methodology applicable pursuant to the risk retention requirements of section 15G of the Exchange Act and its implementing regulations

### Other 3% Per Fund Limits

- **See 3% Per Fund Limit: Asset Management Exemption, Slide 32**
- **See Underwriting and Market Making Exemptions (3% Per Fund Limits — Other Related Covered Funds), Slide 31**

### Attribution

- **See Attribution Rules, Slides 35-36**

### Seeding Period

- **See Seeding, Slide 37**

### Aggregate 3% of Tier 1 Capital Limit

- **Includes Multi-Tier Investments**
- **Includes Deductions from Capital**

### Aggregate 3% of Tier 1 Capital Limit**

- **See Aggregate 3% of Tier 1 Capital Limit, Slide 34**

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PERMITTED ACTIVITIES
Aggregate 3% of Tier 1 Capital Limit/Capital Deductions

The aggregate value of all ownership interests in covered funds acquired and retained by a banking entity under the asset management and ABS issuer exemptions, and in related covered funds from the underwriting and market making exemptions will be the sum of all amounts paid or contributed by the banking entity in connection with acquiring or retaining an ownership interest in covered funds (together with any amounts of investments made by the entity, or any of its employees, in connection with obtaining a restricted profit or carried interest).

**Valuation Method.** The investments or holdings are valued at historical cost.

**Monitoring.** Banking entities are expected to monitor investments in covered funds regularly and remain in compliance with the limitations on covered fund investments throughout the quarter and that the agencies intend, through their respective supervisory processes, to monitor covered fund investment activity to ensure that a banking entity is not attempting to evade the requirements of the Volcker Rule.

**Interaction with Basel III.** The agencies issued guidance stating that any investment in a covered fund that is deducted from a banking entity’s Tier 1 capital under Basel III because the covered fund is an unconsolidated financial institution is not required to also be deducted under the Volcker Rule, and that any amounts deducted are also excluded from the denominators of applicable risk-based capital and leverage ratios.

**Timing.** The aggregate funds limitation and capital deduction must be calculated at the end of each calendar quarter or at such other time as the appropriate Federal banking agency may request such a calculation.
**General Approach to Attribution**

- The agencies described their general approach to the attribution of ownership interests for purposes of the investment limits as follows:

  "Under the final rule, a banking entity must account for an investment in a covered fund for purposes of the per-fund and aggregate funds limitations only if the investment is made by the banking entity or another entity controlled by that banking entity. Accordingly, the final rule does not generally require that a banking entity include the pro rata share of any ownership interest held by any entity that is not controlled by the banking entity, and thus reduces the potential compliance costs of the final rule. The Agencies believe that this concept of attribution is more consistent with how the [Federal Reserve] has historically applied the concept of 'control' under the BHC Act for purposes of determining whether a company subject to that Act is engaged in an activity or whether to attribute an investment to that company."

  79 Fed. Reg. at 5732

**Covered Funds**

- A covered fund that is not itself a core banking entity is excluded from the term banking entity for the purposes of the Volcker Rule. Consequently:
  - A covered fund that is not a core banking entity is not itself subject to the prohibitions or restrictions of the Volcker Rule, including the limits on acquiring or retaining ownership interests in another covered fund.
  - Subject to the special attribution rules for master-feeder funds and funds-of-funds, ownership interests acquired or retained by a covered fund that is not a core banking entity in another covered fund are not attributable to a banking entity that sponsors, advises or controls the covered fund.

**RICs, BDCs and Foreign Public Funds**

- For purposes of the investment limits, a registered investment company, business development company or foreign public fund is not treated as an affiliate of a banking entity, as long as the other banking entity satisfies both of the following conditions:
  - Does not own, control or hold with the power to vote 25% or more of the voting shares of the company or fund; and
  - Any investment advisory, commodity trading advisory, administrative and other services provided by the banking entity or an affiliate to the RIC, BDC or foreign public fund is provided in compliance with any limitations under applicable regulation, order or other authority.

Consequently, subject to the special attribution rules for master-feeder funds and funds-of-funds, ownership interests acquired or retained in a covered fund by a RIC, BDC or foreign public fund are not attributable to a banking entity for purposes of the investment limits, if the banking entity satisfies both of the conditions set forth above with respect to the RIC, BDC or foreign public fund.

**Employees and Directors**

- For purposes of the investment limits, ownership interests acquired or retained by a director or employee of a banking entity in a covered fund sponsored by the banking entity, other than ownership interests acquired and retained in connection with obtaining a restricted profit interest (carried interest), will not be attributed to the banking entity as long as both of the following conditions are satisfied:
  - The director or employee acquires such ownership interests in his or her personal capacity.
  - The banking entity does not, directly or indirectly, extend financing for the purpose of enabling the director or employee to acquire the ownership interest in the fund or the financing is not used to acquire the ownership interests.

In the 2013 Final Rule preamble, the agencies:

- Clarified that a guarantee by the banking entity of the director or employee’s obligations on financing obtained from a third party constitutes indirect financing by the banking entity.
- Explained that so long as the investments are truly made with personal resources, and are not funded by the banking entity, they would not expose the banking entity to loss.
- Stated that ownership interests acquired and retained by a director or employee of a banking entity in a covered fund sponsored by the banking entity in connection with obtaining a restricted profit interest (carried interest) will be attributed to the banking entity, regardless of whether the banking entity finances the acquisition or retention of such ownership interests.
- Stated that they intend to monitor investments by directors and employees of banking entities to ensure that investments by directors or employees are not used by banking entities to circumvent the investment limits, and that they will consider the following factors in evaluating whether any evasion is taking place:
  - Whether the benefits of the acquisition and retention, such as dividends, inure to the benefit of the director or employee and not the banking entity.
  - Whether the voting or control of the ownership interests is subject to the direction of, or otherwise controlled by, the banking entity.
  - Whether the director or employee, rather than the banking entity, determines whether the director or employee should make the investment.

For investments by employees of a banking entity in a covered fund organized or offered or sponsored by the banking entity, the 2020 Final Rule aligns the manner in which a banking entity calculates its aggregate investment limit and Volcker Rule-specific capital deduction consistent with the manner in which a banking entity calculates its per fund investment limit.

- The 2020 Final Rule preamble states that the Agencies would not expect that a direct investment by a director or employee of a banking entity in a portfolio company alongside a covered fund’s investment in the same portfolio company would be treated as an investment by the director or employee in the covered fund, even if the banking entity arranged the transaction on behalf of the director or employee or provided financing for the investment or the director or employee provided no services to the covered fund. This would be true so long as the investment by the director or employee complies with applicable laws and regulations, including applicable safety and soundness standards.
- In contrast, the 2020 Final Rule attributes to a banking entity amounts paid by an employee or director to acquire a restricted profit interest in a covered fund that is organized and offered or sponsored by the banking entity when the banking entity has financed the acquisition of the interest.
PERMITTED ACTIVITIES
Attribution Rules — Multi-Tier Funds and Parallel Investments

PERMITTED ACTIVITIES
Attribution Rules — Multi-Tier Funds and Parallel Investments

FUND OF FUNDS INVESTMENTS
- If a banking entity organizes and offers a covered fund for the purpose of investing in other covered funds (a fund of funds), and the fund of funds invests in another covered fund that the banking entity is permitted to own, then the banking entity’s permitted investment in the underlying fund shall include both:
  - Any investment by the banking entity in the underlying fund, plus
  - The banking entity’s pro-rata share of any ownership interest in the underlying fund that is held through the fund of funds.
- A banking entity’s investment in the fund of funds must “also meet the investment limitations contained in §... of the rule text.”

AFFILIATE INVESTMENT

MASTER-FEEDER INVESTMENTS
- If the principal investment strategy of a covered fund (the feeder fund) organized and offered by a banking entity is to invest substantially all of its assets in another single covered fund (the master fund), then for purposes of the per-fund investment limitations, the banking entity’s permitted investment in such funds shall be measured only by reference to the value of the master fund.
- The banking entity’s permitted investment in the master fund shall include both:
  - Any investment by the banking entity in the master fund, plus
  - The banking entity’s pro-rata share of any ownership interest of the master fund that is held through the feeder fund.
- Although this attribution rule only applies by its terms to the per fund limit, it seems logical that it would also apply to the aggregate limit as a practical matter.

PARALLEL INVESTMENTS
Banking entities are not required to treat investments alongside covered funds as investments in covered funds if certain conditions are met. Specifically:
- A banking entity is not required to include in the calculation of the limits applicable to investments in covered funds pursuant to the asset management exemption any investment that the banking entity makes alongside a covered fund, so long as the investment is made in compliance with otherwise applicable laws and regulations, including applicable safety and soundness standards.
- A banking entity is not restricted by any such investment limits in the amount of any investment that the banking entity makes alongside the covered fund as long as the investment is made in compliance with otherwise applicable laws and regulations, including applicable safety and soundness standards.

Therefore, as explained in the 2020 Final Rule preamble:
- “The Volcker Rule ‘will not prohibit a banking entity from having investment policies, arrangements or agreements to invest alongside a covered fund in all or substantially all of the investments made by the covered fund or to fund all or any portion of the investment opportunities made available by the covered fund to other investors’” and
- “[A] banking entity could market a covered fund it organizes and offers pursuant to [the asset management exemption] on the basis of the banking entity’s expectation that it would invest in parallel with the covered fund in some or all of the same investments, or the expectation that the banking entity would fund one or more co-investment opportunities made available by the covered fund,”

Provided that “any such investment policies, arrangements or agreements would ensure that the banking entity has the ability to evaluate each investment on a case-by-case basis to confirm that the banking entity does not make any investment unless the investment complies with applicable laws and regulations, including any applicable safety and soundness standards.”
# PERMITTED ACTIVITIES

## Seeding

A banking entity is permitted to establish and seed a covered fund with sufficient initial capital to permit the covered fund to attract unaffiliated investors, subject to certain conditions, notwithstanding the general prohibition on investing in ownership interests in covered funds or the 3% per fund investment limits.

<table>
<thead>
<tr>
<th>Date of Establishment</th>
<th>End of 1-Year General Seeding Period</th>
<th>Maximum 3-Year Seeding Period</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>General Seeding Period</strong> (1 Year)</td>
<td><strong>Potential Extension for up to 2 Additional Years</strong> (up to 2 years total)</td>
<td></td>
</tr>
</tbody>
</table>

### Seeding Period for Covered Funds

A banking entity may provide a covered fund that it organizes and offers pursuant to the asset management or ABS issuer exemptions with seed capital if it:

- Actively seeks to reduce ownership by actively seeking unaffiliated investors to conform its investment to the 3% per fund limits
- Conforms its investment to the 3% per fund limits within 1 year after the date of establishment of the covered fund, or such longer period as the Federal Reserve may allow

### Date of Establishment

- In general, the date on which the investment adviser or similar entity to the covered fund begins making investments pursuant to the written strategy for the fund
- For a fund organized and offered under the ABS issuer exemption, the date on which the assets were initially transferred into the ABS issuing entity

### Applicable Limits During the Seeding Period

- A banking entity must comply with the aggregate 3% of Tier 1 capital limit during the seeding period
- No strict dollar limit on the amount capital a banking entity may use to seed, organize and offer a covered fund

### Extension of Seeding Period

Upon application by a banking entity, the Federal Reserve may extend the seeding period for up to two additional years if it finds that an extension of time would be consistent with the safety and soundness of the banking entity and not detrimental to the public interest.

- An application must:
  - Be submitted at least 90 days prior to the expiration of the seeding period
  - Provide the reasons for the application
  - Explain the banking entity’s plan for reducing the permitted investment in the covered fund as required by the seeding period investment limits

### Factors in the Review of the Extension of Seeding Period

In deciding whether to grant an extension, the Federal Reserve may consider all the facts and circumstances, including all of the following:

- High-risk assets or trading strategies
- Contractual terms
- Projected compliance timing
- Risks to the banking entity or financial stability
- Cost to the banking entity of divesting or disposing of the investment within the applicable period
- Conflict of interest
- Prior efforts to reduce its ownership interests in the covered fund
- Market conditions

### Seeding Vehicles for RICs, BDCs and FPFs

A seeding vehicle that is formed and operated pursuant to a written plan to become a RIC, a BDC, or an FPF, developed in accordance with the banking entity’s compliance program, that reflects the banking entity’s determination that the vehicle will become a RIC, BDC or FPF within the seeding period and complies with the limitations on leverage under Section 18 and Section 61 of the 1940 Act that apply to RICs and BDCs, respectively (or in the case of an FPF, with respect to leverage, the banking entity would be expected to have in place a written plan to operate the seeding vehicle in a manner consistent with the investment strategy of the issuer upon becoming a FPF) is excluded from the definition of covered fund.

A **Significant TAL Banking Entity** must maintain records with respect to such issuers that include all of the following:

- A written plan documenting the banking entity’s determination that the seeding vehicle will become a RIC, BDC or FPF
- The period of time during which the vehicle will operate as a seeding vehicle
- The banking entity’s plan to market the vehicle to third-party investors and convert it into a RIC, BDC or FPF
The hedge is designed to reduce or otherwise significantly mitigate the specific, identifiable risks to the banking entity in connection with:

- A compensation agreement with an employee or former employee of the banking entity or an affiliate thereof that directly provides or provided investment advisory, commodity trading advisory or other services to the covered fund; or
- A position taken by the banking entity when acting as intermediary on behalf of a customer that is not a banking entity to facilitate exposure by the customer to profits and losses of the covered fund.

The hedge is acquired or retained in accordance with the written policies, procedures and internal controls required pursuant to the risk-mitigating hedging permitted activity. At the inception of the hedge, the hedge is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks arising out of a transaction conducted solely to accommodate a specific customer request or in connection with the compensation arrangement with the employee or former employee that directly provides or provided investment advisory, commodity trading advisory or other services to the covered fund.

The banking entity has established and implements, maintains and enforces an internal compliance program that is reasonably designed to ensure compliance with the requirements of the risk-mitigating hedging permitted activity, including:

- Reasonably designed written policies and procedures
- Internal controls and ongoing monitoring, management and authorization procedures, including relevant escalation procedures.

The hedge is subject to continuing review, monitoring and management by the banking entity.

Exposures to Price and Other Fund Performance Risks
A banking entity may hedge its exposures to price and other risks based on fund performance that arise from restricted profit interest (carried interest) and other performance based compensation arrangements with its investment managers.

Commentary on High-Risk Strategies
In the 2013 Final Rule preamble, the agencies described concerns relating to hedging of fund-linked products. The agencies have reconsidered this commentary, and in the 2019 Final Rule preamble, indicated that a banking entity’s customer facilitation activities and related hedging activities involving ownership interests in a covered fund would not necessarily constitute high-risk trading strategies that could threaten the safety and soundness of the banking entity.

The compensation arrangement relates solely to the covered fund in which the banking entity has acquired an ownership interest pursuant to the risk-mitigating hedging permitted activity and such compensation arrangement provides that any losses incurred by the banking entity on such ownership interest will be offset by corresponding decreases in amounts payable under such compensation arrangement.
PERMITTED ACTIVITIES

Solely Outside the U.S. Exemption: Sponsorship of or Investments in a Covered Fund by a Foreign Organized or Located Banking Entity with a Foreign Top Tier Parent

HOW TO COMPLY WITH SECTION 4(c)(9) OF THE BHC ACT FOR PURPOSES OF OFFSHORE EXEMPTION

The activity or investment is deemed to comply with the offshore exemption in the BHC Act if:

- FBOs. If the banking entity is an FBO, it meets the qualifying foreign banking organization requirements of section 211.23(a), (c) or (e) of the Federal Reserve's Regulation K.
- Non-FBOs. If the banking entity is not an FBO, then the banking entity is not organized under U.S. law and it meets at least two of the following tests on a fully consolidated basis:
  - Total assets held outside the U.S. exceed total assets held in the U.S.
  - Total revenues derived from the business of the banking entity outside the U.S. exceed total revenues derived from business in the U.S.
  - Total net income derived from the business of the banking entity outside the U.S. exceeds total net income derived from business in the U.S.
- The activity or investment is conducted in accordance with the requirements of the Volcker Rule regulations.

TARGET RESIDENTS OF THE U.S.

The sponsor of a foreign fund would not be viewed as “targeting” residents of the U.S. if all of the following are true:

- It conducts an offering directed to residents of one or more countries other than the U.S.
- It includes in the offering materials a prominent disclaimer that the securities are not being offered in the U.S. or to residents of the U.S.
- It includes other reasonable procedures to restrict access to offering and subscription materials to persons that are not residents of the U.S.

U.S. PERSONNEL

The personnel of any U.S. Organized or Located Banking Entities with a foreign top tier parent are permitted to act as investment adviser to a covered fund in certain circumstances.

- For instance, such personnel may provide investment advice and recommend investment selections to the manager or general partner of a covered fund so long as that investment advisory activity in the U.S. does not result in such personnel participating in the control of the covered fund or offering or selling an ownership interest to a resident of the U.S.

Such personnel may engage in “back office” activities in connection with one or more covered funds.

- This allows administrative services or similar functions to be provided by such personnel to a covered fund as an incident to activity conducted under the offshore exemption (such as clearing and settlement, maintaining and preserving records of the fund, furnishing statistical and research data, or providing clerical support for the fund).

OFFER OR SALE TO U.S. RESIDENT

Is any ownership interest in a covered fund sold pursuant to an offering that targets “residents of the United States” in which the banking entity or an affiliate participates?

If the banking entity or an affiliate sponsors or serves, directly or indirectly, as investment manager, investment adviser, commodity pool operator or commodity trading advisor to the covered fund, the banking entity or affiliate will be deemed to participate in the offer or sale.

SOLELY OUTSIDE THE U.S.

Is any sponsorship of a covered fund performed or is an ownership interest in a covered fund acquired or retained solely by a foreign organized or located banking entity with a foreign top tier parent?

- The banking entity acting as sponsor, or engaging as principal in the acquisition or retention of an ownership interest in the covered fund, must not be a U.S. Organized or Located Banking Entity or controlled directly or indirectly by a banking entity organized under U.S. law.
- The banking entity (including relevant personnel) that makes the decision to acquire or retain the ownership interest or act as sponsor to the covered fund must not be a U.S. Organized or Located Banking Entity.
- The investment or sponsorship, including any transaction arising from risk-mitigating hedging related to an ownership interest, must not be accounted for as principal directly or indirectly on a consolidated basis by any U.S. Organized or Located Banking Entity.

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PERMITTED ACTIVITIES
Regulated Insurance Companies Exemption

An insurance company or its affiliate is permitted to acquire or retain an ownership interest in or sponsor a covered fund if the activity satisfies the following conditions:

FOR A GENERAL OR SEPARATE ACCOUNT
Did the insurance company or its affiliate acquire or retain the ownership interest solely for the general account of the insurance company or for one or more separate accounts established by the insurance company?

SUBJECT TO INSURANCE REGULATION
Was the acquisition and retention of the ownership interest conducted in compliance with, and subject to, the insurance company investment laws and regulations of the jurisdiction in which the insurance company is domiciled?

INSURANCE REGULATION NOT DEEMED INSUFFICIENT
Have the Federal banking agencies, after consultation with the FSOC and the relevant insurance commissioners, jointly determined, after notice and comment, that a particular insurance company investment, law or regulation with respect to which the acquisition or retention of the ownership interest is in compliance and subject, was insufficient to protect the safety and soundness of the banking entity or the financial stability of the United States?

GENERAL ACCOUNT
All of the assets of an insurance company except those allocated to one or more separate accounts.

SEPARATE ACCOUNT
An account established and maintained by an insurance company in connection with one or more insurance contracts to hold assets that are legally segregated from the insurance company's other assets, under which income, gains and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company.
PERMITTED ACTIVITIES
Qualifying Foreign Excluded Funds

For an investment vehicle that is a banking entity:

Is the entity organized or established outside the U.S.?

**YES**

Are the ownership interests offered and sold solely outside the U.S.?

**YES**

Would the entity be a covered fund if it were organized or established in the U.S.?

- **NO**
- **YES**

Is the entity, or does it hold itself out as being, an entity that raises money from investors primarily for the purpose of investing in financial instruments for resale or other disposition or otherwise trading in financial instruments?

**YES**

Would the entity not otherwise be a banking entity except by virtue of a relationship with another banking entity (whether ownership, sponsorship, or other relationship)?

**NO**

**YES**

PROHIBITIONS ON PROPRIETARY TRADING AND PROHIBITIONS ON OWNERSHIP OR SPONSORSHIP OF COVERED FUNDS APPLY

Is the banking entity with which the entity has a relationship not organized in the U.S. or directly or indirectly controlled by a banking entity organized in the U.S.?

- **NO**
- **YES**

Does that banking entity’s ownership interest or sponsorship of the entity meet the requirements for permitted covered fund activities and investments solely outside the U.S.?

**YES**

**NOT SUBJECT TO COMPLIANCE PROGRAM REQUIREMENTS**

A qualifying foreign excluded fund is not subject to the Volcker Rule compliance program requirements that are otherwise applicable to a banking entity

**THE ENTITY IS A QUALIFYING FOREIGN EXCLUDED FUND AND IS NOT SUBJECT TO PROHIBITIONS ON PROPRIETARY TRADING OR PROHIBITIONS ON OWNERSHIP OR SPONSORSHIP OF COVERED FUNDS**

Is the entity established as part of a *bona fide* asset management business?

**YES**

Is the entity not operated in a manner that enables the banking entity that sponsors or controls it, or any of its affiliates, to evade the requirements of the Volcker Rule?

**NO**

**YES**

**YES**

**YES**

**YES**

**YES**

**YES**

**YES**

**YES**

**YES**
DO THE “SUPER 23A” AND 23B 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 under the asset management or ABS issuer exemption, or that retains an ownership interest under the ABS issuer exemption, may enter into a transaction with the covered fund, or with any other covered fund controlled by such covered fund, that would be a covered transaction as defined in Section 23A of the Federal Reserve Act as if the banking entity were a member bank and the related covered fund were its affiliate. Any banking entity subject to this prohibition is also subject to Section 23B of the Federal Reserve Act with respect to certain transactions as if the banking entity were a member bank and the related covered fund were its affiliate.

**Exception for Prime Brokerage Transactions with Any Covered Fund in Which a Related Covered Fund Has Taken an Ownership Interest**

One or more products or services provided by a banking entity to a second-tier covered fund in connection with:
- Custody
- Clearance and settlement
- Securities borrowing and lending services
- Trade execution
- Financing
- Data, operational and portfolio management support

**Exception for Payment, Clearing and Settlement Transactions**

Extend credit to or purchase assets from a related covered fund, provided:
- The transaction is in the ordinary course of business in connection with payment transactions; settlement services; or futures, derivatives and securities clearing, and
- Each extension of credit is repaid, sold or terminated by the end of five business days, and
- The banking entity making the extension of credit satisfies the requirements of Section 223.42 of Regulation W for intraday extensions of credit, except that the extension of credit may extend beyond the banking entity’s business day.

**“Covered Transactions”**

- Loans or other extensions of credit to the covered fund
- Purchases of or an investment in securities issued by the covered fund, other than ownership interests that are acquired or retained in accordance with the final rules implementing the Volcker Rule
- Acceptance of securities or other debt obligations issued by the related covered fund as collateral security for a loan or extension of credit to any person or company, except as provided by the agencies in the 2013 Final Rule preamble
- Purchases of assets, including assets subject to a repurchase agreement, from a covered fund, except certain real estate assets
- Issuances of guarantees, acceptances or letters of credit, including an endorsement or standby letter of credit, on behalf of the covered fund
- Any credit exposure to the covered fund arising from a derivative transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction with the covered fund

**Exempt Covered Transactions for Purposes of Super 23A**

- Any transaction that would be an exempt covered transaction under Section 23A of the Federal Reserve Act or Section 223.42 of the Federal Reserve’s Regulation W.
- A riskless principal transaction, in which a banking entity, after receiving a customer order, buys or sells a security in the secondary market for its own account to offset a contemporaneous sale or purchase from the customer (including where the covered fund is not a securities affiliate).
- An extension of credit to a third party secured by ownership interests in a related covered fund is not a covered transaction under Super 23A, unless the third party is a related covered fund.

**Section 23B**

- Any banking entity that would be prohibited from entering into a covered transaction with a related covered fund pursuant to Super 23A is subject to Section 23B of the Federal Reserve Act with respect to any of the following transactions as if the banking entity were a member bank and the related covered fund were its affiliate:
  - Sale of securities or other assets to a related covered fund, including assets subject to an agreement to repurchase
  - Payment of money or the furnishing of services to a related covered fund under contract, lease or otherwise
  - Any transaction in which a related covered fund acts as an agent or broker or receives a fee for its services to the banking entity or any other person
  - Any transaction or series of transactions with a third party if a related covered fund has an interest in the third party or if a related covered fund is a participant in such transaction or series of transactions

- Any transaction that would be subject to Super 23A but for the exception for prime brokerage transactions is also subject to the requirements in Section 23B of the Federal Reserve Act as if the banking entity were a member bank and the related covered fund were its affiliate.
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 clients, customers or counterparties?
  - NO

- 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.
  - NO

- Pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States?
  - NO

- THE TRANSACTION, CLASS OF TRANSACTIONS OR ACTIVITY IS PERMITTED

---

**Exception 1**

Timely and Effective Disclosure and Opportunity to Negate/Substantially Mitigate

Before effecting the specific transaction or class of transactions, or engaging in the specific activity, does the banking entity:

- Make 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
- Make such disclosure explicitly and effectively, and 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?

- YES
- NO

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**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?

- Note that the banking entity may not rely on information barriers if it knows or reasonably should have known that notwithstanding these barriers, the conflict of interest may involve or result in a materially adverse effect on a client, customer, or counterparty

- YES
- NO
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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