October 31, 2011

Summary of the Proposed Rule Implementing the Volcker Rule

On October 11 and October 12, 2011, the Board of Governors of the Federal Reserve System (the "Board"), the Federal Deposit Insurance Corporation (the "FDIC"), the Office of the Comptroller of the Currency and the Securities and Exchange Commission (the "SEC") issued a notice of proposed rulemaking and request for comments (the "Proposed Rule")[1] implementing Section 619 of the Dodd-Frank Act, also known as the "Volcker Rule." The Dodd-Frank Act requires the above-mentioned agencies and the Commodities Futures Trading Commission (the "CFTC," together with the foregoing agencies collectively, the "Implementing Agencies") to implement the Volcker Rule.[2] Comments on the Proposed Rule are due by January 13, 2012.

The Proposed Rule defines "**covered banking entities**" principally in terms of certain relationships to an "insured depository institution," a bank that receives FDIC deposit insurance. Covered banking entities include insured depository institutions themselves; bank holding companies and entities that control insured depository institutions; and affiliates or subsidiaries of the foregoing banking entities (except for certain private equity and hedge funds, defined as "**covered funds**" below, that are themselves offered and organized by such banking entities, or entities controlled by such covered funds). Thus, the entire corporate organizational structure associated in these ways with an insured depository institution or bank holding company may be subject to the Proposed Rule.

The Proposed Rule prohibits covered banking entities from "**sponsoring**" or acquiring or retaining an "**ownership interest**" in a covered fund, subject to certain exemptions, and prohibits the same banking entities from engaging in "**proprietary trading**."

The Dodd-Frank Act, which added a new Section 13 to the Bank Holding Company Act of 1956, requires that these implementing regulations become effective by July 21, 2012. After that time, covered banking entities will be prohibited from engaging in new activities that are governed by these rules, and will have until July 21, 2014 to bring their preexisting activities into compliance. The Implementing Agencies have the authority to grant certain extensions to these deadlines.

Restrictions on Sponsoring or Investing in Covered Funds

Scope of the Proposed Rule

The Proposed Rule generally prohibits a covered banking entity from "**sponsoring**" a "**covered fund**," or, acquiring or retaining, as principal, directly or indirectly, any "**ownership interest**" in a covered fund, subject to certain exemptions.

[1] For the full text of the Proposed Rule, see http://www.fdic.gov/news/board/2011Octno6.pdf.
[2] The CFTC is expected to issue substantially similar regulations at a later date.

Covered fund. A "**covered fund**" means (i) an issuer that would be an investment company under the Investment Company Act of 1940 (the "Investment Company Act"), but for the exemptions provided by Section 3(c)(1) or 3(c)(7) of that Act; (ii) a commodity pool, as defined in the Commodity Exchange Act; (iii) any issuer organized or offered outside the United States that would be a covered fund if it were organized or offered under the laws, or offered to a resident, of, the United States or one or more States; and (iv) any such similar fund as the Implementing Agencies may by rule determine.

- If an issuer may rely on another exclusion or exemption from the definition of "investment company" under the Investment Company Act other than the exclusions contained in section 3(c)(1) or 3(c)(7) of that Act, it would not be considered a covered fund, as long as it can satisfy all of the conditions of an alternative exclusion or exemption for which it is eligible.

Ownership interest. "**Ownership interest**" means any equity, partnership, or other similar interest (including, without limitation, a share, equity security, warrant, option, general partnership interest, limited partnership interest, membership interest, trust certificate, or other similar instrument) in a covered fund, whether voting or nonvoting, or any derivative of such interest. To the extent that a debt security or other interest in a covered fund provides the holder with voting rights, the right or ability to share in the covered fund's profits or losses, or the ability to earn a return based on the performance of the fund's underlying investments, or exhibits other attributes of an equity or other ownership interest, such debt security or interest can be considered an "other similar instrument."[3]

"Ownership interest" specifically excludes "**carried interest**," held by a covered banking entity (or an affiliate, subsidiary or employee thereof) in a covered fund for which the covered banking entity (or an affiliate, subsidiary or employee thereof) serves as investment manager, investment adviser or commodity trading adviser, provided that: (i) the sole purpose and effect of the carried interest is to allow the recipient to share in the profits of the covered fund as performance compensation for services provided to the covered fund, provided that the recipient may be obligated under the terms of such interest to return profits previously received; (ii) all such profit, once allocated, is distributed to the recipient promptly after being earned or, if not so distributed, the reinvested profit does not share in the subsequent profits and losses of the covered fund; (iii) the recipient does not provide capital to the covered fund in connection with acquiring or retaining this carried interest; and (iv) the interest is not transferable by the recipient except to another affiliate or subsidiary thereof.

Sponsor. A covered banking entity "**sponsors**" a covered fund when it: (i) serves as a general partner, managing member, commodity pool operator or trustee[4] of a covered fund; (ii) selects or controls a majority of the directors, trustees or management of the covered fund; (iii) shares the same name or a variation thereof with the covered fund; or (iv) directs a directed trustee or otherwise manages and controls the assets of the covered fund.

[3] The definition of "ownership interest" does not include the residual interests in a securitization vehicle.
[4] The Proposed Rule provides that "trustee" excludes a trustee that does not exercise investment discretion with respect to a covered fund, including a directed trustee under ERISA.

Permitted Investments in a Covered Fund Organized and Offered by the Covered Banking Entity

General. A covered banking entity may, directly or indirectly, organize and offer a covered fund, including serving as a general partner or commodity pool operator of the covered fund, only if *all* of the following conditions are met:

(i) the covered banking entity provides bona fide trust, fiduciary, *investment advisory*, or commodity trading advisory services; and

(ii) the covered fund is organized and offered only in connection with the provision of such services and only to customers[5] of such services pursuant to a credible documented plan; and

(iii) the covered banking entity does not acquire or retain an ownership interest in the covered fund other than a **de minimis investment** described below; and

(iv) the covered banking entity does not enter into transactions with the covered fund that would be a covered transaction under Section 23A or in violation of 23B of the Federal Reserve Act; and

(v) the covered banking entity does 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; and

(vi) the covered fund does not share the same name or a variation thereof with the banking entity and does not use the word "bank" in its name; and

(vii) only the covered banking entity's directors or employees who are directly engaged in providing investment advisory or other services to the covered fund may invest in the covered fund; and

(viii) the covered banking entity clearly and conspicuously makes the following written disclosures to any prospective and actual investor in the covered fund: (a) that any losses in the covered fund will be borne solely by the investor and not by the covered banking entity; (b) that the ownership interests in the fund are not insured by the FDIC and are not endorsed or guaranteed in any way by any banking entity; (c) that the investor should read the fund offering documents before investing; and (d) the role of the covered banking entity in sponsoring or providing any services to the covered fund.

De minimis investments. The de minimis investments permitted under prong (iii) above are subject to per-fund and aggregate limitations:

(a) *Per-fund limitation*. A covered banking entity may make and retain an investment in a single covered fund organized and offered by the covered banking entity, provided that the investment does not exceed 3% of the total outstanding ownership interests in the covered

[5] The Proposed Rule does not require the customer relationship to be pre-existing.

fund. The Supplementary Information to the Proposed Rule also notes that the covered banking entity's investment may not result in more than 3% of the losses of the covered fund being allocated to the covered banking entity's investments.

- *Seeding exception*. The covered banking entity may make any investment (up to 100%) to establish the covered fund and provide the covered fund with sufficient initial equity for investment to attract unaffiliated investors; provided that the covered banking entity must actively seek unaffiliated investors to reduce its ownership interest to comply with the per-fund limitation within one year of the establishment of the covered fund (which per-fund conformance period may be extended for up to two additional years upon application to the Board);

(b) *Aggregate limitation*. The covered banking entity's aggregate interests in all covered funds that it organizes and offers may not exceed 3% of its Tier 1 capital.

When making ownership interest calculations, the following interests are attributed to the covered banking entity: (i) any ownership interest held by the covered banking entity or through any entity controlled by the covered banking entity; (ii) the pro rata share of any ownership interest held by any covered fund that the covered banking entity does not control but in which the covered banking entity holds more than 5% of the voting shares; and (iii) committed co-investments where the covered banking entity is contractually obligated to directly invest in, or is found to be acting in concert through knowing participation in a joint activity or parallel action toward a common goal of investing in, one or more investments with a covered fund organized and offered by the covered banking entity.

For purposes of complying with the per-fund limitation, the amount of ownership interests of the covered banking entity shall be the greater of: (i) the *value* of any investment or capital contribution (without regard to capital commitment) made with respect to the ownership interests held by the covered banking entity divided by the value of all investments or capital contributions in the covered fund; or (ii) the total *number* of ownership interests held by the covered banking entity divided by the total number of all ownership interests in the covered fund.[6] The covered banking entity must calculate its investments in the same manner and according to the same standards that the covered fund uses for its own internal purposes, and no less frequently than the covered fund performs such calculation or issues or redeems interests and at least quarterly.

For purposes of complying with the aggregate limitation, the value of a covered banking entity's aggregate permitted investments in all covered funds shall be determined in accordance with applicable accounting standards. This calculation is separate from and in addition to the calculation required to comply with the per-fund limitation, and is calculated at the end of each calendar quarter.

Permitted Investments in any Covered Fund

The following exemptions apply to a covered banking entity's investments in any covered fund, regardless of whether the covered fund was organized and offered by the covered

[6] The Proposed Rule does not explain how to determine the "number of ownership interests," particularly in vehicles such as limited partnerships where ownership is not typically delineated in discrete ownership units.

banking entity. Note that the ownership interests permitted by the following exemptions are not subject to the de minimis investment requirement.

Risk-mitigating hedging activities. A covered banking entity may acquire or retain an ownership interest in a covered fund as a hedge in two situations: (i) when the covered banking entity acts as a "riskless principal" on behalf of a customer that is not itself a covered banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund; or (ii) to cover a compensation arrangement with a covered banking entity employee who directly provides investment advisory or other services to the covered fund.

An ownership interest for the limited hedging purposes enumerated above has to meet the following additional requirements: (i) such interest hedges or mitigates a substantially similar offsetting exposure to the same covered fund; (ii) such interest does not, at its inception, give rise to significant new exposures; and (iii) the covered banking entity has established an internal compliance program pursuant to the Proposed Rule and such ownership interest is made in accordance with such program and subject to continuing review and documentation by the covered banking entity.

Foreign activities. An eligible covered banking entity may acquire or retain an ownership interest in or sponsor a covered fund if such activity occurs "**solely outside the United States**."

For the acquisition or retention of an ownership interest to be conducted "solely outside the United States": (i) the covered banking entity may not be organized under the laws of the United States or one or more States; (ii) no such ownership interest may be offered or sold to a resident of the United States[7]; and (iii) no subsidiary, affiliate or employee (excluding back-office personnel) of the banking entity that is involved in the offer or sale of such ownership interest may be incorporated or physically located in the United States or one or more States.

In addition, for a covered banking entity to be eligible: (i) neither the covered banking entity nor any covered banking entity directly or indirectly controlling the covered banking entity may be organized under the laws of the United States or one or more States; (ii) if the covered banking entity is not a foreign banking organization ("FBO"), its business outside the United States must exceed its United States business, as measured by at least two of the following three indices: assets, revenues, or net income; and (iii) if the covered banking entity is an FBO, it is a qualifying FBO under the Board's Regulation K and is conducting the activity in compliance therewith.[8]

[7] The proposed definition of "resident of the United States" is similar but *not* identical to the definition of "U.S. person" under the SEC's Regulation S, and is designed to capture the scope of United States counterparties, decision-makers and personnel that, if involved in a transaction, would preclude the transaction from being considered to have occurred solely outside the United States. A "resident of the United States" includes, among other things, any agency or branch of a foreign entity located in the United States and any discretionary account held for the benefit of a resident of the United States or by a United States dealer or fiduciary.

[8] To be a qualifying FBO, the FBO must demonstrate that: (i) disregarding its United States banking, more than half of its worldwide business is banking; and (ii) more than half of its banking business is outside the United States. Specifically, the FBO's banking business outside the United States must exceed both its worldwide nonbanking business and its banking business in the United States, as measured by at least two of the following three indices: assets, revenues or net income.

Loan securitizations. A covered banking entity may acquire or retain an ownership interest in or sponsor a covered fund that is an issuer of asset-backed securities, if the issuer's assets or holdings are solely comprised of: (i) loans; (ii) contractual rights or assets directly arising from such loans; and (iii) interest rate or foreign exchange derivatives that *materially relate* to the terms of such loans or contractual rights or assets and are used for hedging purposes with respect to the securitization structure. The derivatives permitted under prong (iii) do not include synthetic securitizations, securitizations of derivatives or credit default swaps by an issuer of asset-backed securities.

SBICs. A covered banking entity may acquire or retain an ownership interest in or sponsor a covered fund that is a small business investment company, provided that such ownership interest is a qualified rehabilitation expenditure or designed to promote the "public welfare."

Bank owned life insurance. A covered banking entity may acquire or retain an ownership interest in or sponsor a covered fund that is a separate account used solely for the purpose of purchasing banked owned life insurance ("BOLI") for which the covered banking entity is the beneficiary, provided that the covered banking entity does not control investment decisions regarding the BOLI and the ownership interest complies with applicable BOLI supervisory guidance.

Debt previously contracted. A covered banking entity may acquire or retain an ownership interest in or sponsor a covered fund, if such ownership interest is acquired in the ordinary course of collecting a debt previously contracted in good faith, provided that such interest is divested within periods applicable to such property.

Other covered funds. Although the following entities are not excluded from the definition of a "covered fund," the Proposed Rule nevertheless permits a covered banking entity to acquire or retain an ownership interest in or sponsor them: (i) a joint venture between the covered banking entity and any other person, provided that it is an operating company and otherwise complies with the Proposed Rule; (ii) an acquisition vehicle, provided that its sole purpose and effect is to effectuate a merger or acquisition; and (iii) a wholly-owned subsidiary of the covered banking entity, provided that it is engaged principally in performing bona fide liquidity management activities and is carried on the covered banking entity's balance sheets. In addition, when a covered banking entity is a securitizer or originator of an asset-backed security and is therefore required by the Dodd-Frank Act to retain an economic interest in a portion of the credit risk for the collateralized asset, the covered banking entity may acquire or retain an ownership interest in or sponsor a covered fund with respect to that retained economic interest.

Limitations on Relationships with a Covered Fund

The following applies to transactions between a covered banking entity and a covered fund that it organizes and offers or for which it otherwise serves, directly or indirectly, as investment manager, investment adviser, commodity trading adviser or sponsor.

Prohibited transactions. The covered banking entity (or any affiliate thereof) and such covered fund may not enter into **covered transactions**, as defined in Section 23A of the Federal Reserve Act. "Covered transaction" includes, but is not limited to: (i) a loan or extension of credit to the covered fund; (ii) a purchase of assets from the covered fund; (iii) the acceptance

of securities issued by the covered fund as collateral security for a loan or extension of credit to a third party; and (iv) the issuance of a guarantee, acceptance, or letter of credit, including an endorsement or standby letter of credit, on behalf of the covered fund.

Prime brokerage transactions. The covered banking entity and the covered fund may nevertheless enter into any prime brokerage transaction, which is defined as "one or more products or services provided by a covered banking entity to a covered fund, such as custody, clearance, securities borrowing or lending services, trade execution, or financing, data, operational, and portfolio management support," provided that: (i) the covered banking entity certifies in writing annually that it does not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the covered fund or any covered fund in which such covered fund invests; and (ii) the Board has not determined that such transaction is inconsistent with the safe and sound operation and condition of the covered banking entity.

Market terms requirement. Under Section 23B of the Federal Reserve Act, certain transactions between the covered banking entity and the covered fund must be on terms at least as favorable to the covered banking entity as the prevailing market terms. In the absence of market terms, the transactions must be on terms that in good faith would be offered to nonaffiliated parties. The market terms requirement applies to: (i) any covered transaction; (ii) any prime brokerage transaction; (iii) the sale of securities or other assets to the covered fund; (iv) the payment of money or the furnishing of services to the covered fund; (v) any transaction in which the covered fund acts as an agent or broker for the covered banking entity or receives a fee for services to the covered banking entity or a third party; and (vi) any third-party transaction in which the covered fund is a participant or has an interest in the third party.

Backstop Limitations on Activities Related to Covered Funds

All permitted activities under the Proposed Rule are subject to the limitation that they must not: (i) result in a material exposure by the covered banking entity to a high-risk asset or a high-risk trading strategy; (ii) pose a threat to the safety and soundness of the covered banking entity or the financial system of the United States; or (iii) give rise to material conflicts of interest between the covered banking entity and its clients, customers, or counterparties, unless the covered banking entity, prior to the transaction, (a) makes clear, timely and effective disclosure of the conflict in a manner that provides the relevant parties the opportunity to negate or substantially mitigate any material adverse effect created by the conflict, or (b) has established, maintained and enforced information barriers that are reasonably designed to prevent potential material adverse effects (unless the covered banking entity knows or should reasonably know that the information barriers are ineffective for a particular conflict).

Restrictions on Proprietary Trading

Scope of the Proposed Rule

The Proposed Rule prohibits covered banking entities from engaging in "**proprietary trading**," subject to certain exemptions.

Proprietary trading. The Proposed Rule defines "proprietary trading" as engaging as principal for a covered banking entity's own "**trading account**" in any purchase or sale of a financial position taken with respect to securities, derivatives, or commodities futures, or options on these instruments. Since the Proposed Rule only prohibits acting as principal, a covered banking entity is allowed to be an agent, broker or custodian for an unaffiliated third party.

A covered banking entity's trading account is defined to cover accounts used to acquire or take **financial positions** principally for the purpose of "**short-term**" profit on the position, including short-term resale based on price movements or arbitrage opportunities, or hedging such short-term positions. In addition, the trading account includes market capital risk rule positions (other than foreign exchange and commodity derivatives and commodity futures), if the covered banking entity or its affiliate that is a bank holding company is sufficiently active in trading to be governed by such rules.

Financial position means any type of position, including long, short, and synthetic, in any security, derivative, or commodity future, as well as any option on any of these positions. However, the rule does not prohibit the banking book of loans, commodities themselves, or foreign exchanges or currencies.

The Proposed Rule does not include a bright-line definition of "short-term," but there is a rebuttable presumption that a position held for 60 days or less was made for the covered banking entity's trading account. The Supplementary Information to the Proposed Rule suggests that "short term" involves turnarounds of "minutes or days, not months or years."

Under the Proposed Rule, it is not just the speed of the trade that triggers the rule's prohibition, but the trade's intent. For example, a covered banking entity may take a position, which it initially intends to be a permitted long-term hedge to protect against risks to certain of its assets. If quickly changing conditions make the hedge unworkable, the rule does not prohibit the covered banking entity from selling the position, as long as the intent of the trade was not principally for short-term profit.

Non-trading account positions. Certain financial positions are not considered to be taken for the covered banking entity's trading account. These include positions that more resemble short-term secured loans, such as repurchase agreements and securities lending agreements, or are for the *bona fide* purpose of liquidity management, pursuant to a documented liquidity management plan.

Automatic trading account positions. Certain financial positions are considered to be taken for the covered banking entity's trading account regardless of the trading period or acquisition intent. If a covered banking entity is also a dealer in securities or security-based swaps registered with the SEC, or a swaps dealer registered with the CFTC, or a dealer in government securities registered with the appropriate government agency (or engaged similarly outside the United States), and that entity takes a financial position based upon its registration as a dealer, then the position is deemed to have been taken for the entity's trading account, whatever the timeframe or intent.

Permitted Trading Activities

The Proposed Rule exempts the following categories of activities from the general proprietary trading prohibition.

Underwriting exemption. The rule explicitly allows banking entities to engage in underwriting securities. The exemption requires that an entity act solely in its capacity as an underwriter and establish an internal compliance program to monitor compliance with the Volcker Rule, including reasonably designed written policies and procedures, internal controls and independent testing. The underwriter must only take positions that are designed not to exceed the reasonably expected near term demands of counterparties, and the revenues generated must come primarily from fees and spreads and not from appreciation in the value or hedging of the underwritten positions. Compensation policies of persons involved in the underwriting activity must not be designed to reward proprietary risk-taking.

Market making exemption. There is also an exemption for market making-activities, which must be undertaken under a similar internal compliance program, not exceeding the near term demands of counterparties, and not generating revenues primarily from appreciation of the positions' values.

Hedging exemption. The Proposed Rule permits certain risk-mitigating hedging activities, allowing a covered banking entity, pursuant to an internal compliance program, to take positions to reduce specific risks associated with its other holdings. The position must hedge an identifiable risk of the covered banking entity's assets, and the hedging position must be reasonably correlated with this risk, but must not give rise at the inception of the hedge to significant new exposures. The covered banking entity must continue to review the hedging position for compliance with the rule, and mitigate any developing exposure. The covered banking entity must document, even beyond the previously discussed compliance program, the purpose of each hedging position taken, the specific risk it hedges, and the organizational authority for the position.

Additional exemptions. Additional exemptions include trading in government obligations, as well as trading on behalf of customers in the role of advisor or fiduciary, or as riskless principal offsetting a customer position. In addition, banking entities that are insurance companies are permitted to take positions for an insurance policy account that inure solely to the owner of the policy or, for positions on the insurance company's general account, if certain domestic regulatory bodies have not made a determination that current regulations are insufficient to protect the soundness of the covered banking entity or the financial stability of the United States

Proprietary trading outside the United States. The rule permits certain foreign proprietary trading activities by banking entities. In general, a covered banking entity's proprietary trading is permitted if the covered banking entity is not directly or indirectly organized under the laws of the United States and conducts the greater part of its business outside the United States (by assets or revenue), the covered banking entity has received certain United States regulatory endorsements under the Bank Holding Company Act, and the parties and execution are wholly outside the United States.

Override authority. The Proposed Rule establishes a limitation on the above explicitly granted exemptions. Even if a transaction is otherwise exempted, the transaction is not permissible if it would result in a conflict of interest between the covered banking entity and its counterparties, result in a material exposure by the covered banking entity to a high-risk asset or trading strategy, or pose a threat to the soundness of the covered banking entity or to the financial stability of the United States.

New Reporting and Compliance Requirements

Compliance Programs for All Banking Entities Engaged in Restricted Activities

Covered banking entities that are engaged in permitted proprietary trading or covered fund activities must establish a compliance program, which should include: (i) written policies and procedures to document, describe and monitor the restricted activities; (ii) internal controls to monitor and identify potential areas of noncompliance; (iii) a management framework that clearly delineates responsibility and accountability for compliance; (iv) independent testing for the effectiveness of the compliance program; (v) training of personnel and managers to effectively implement and enforce the compliance program; and (vi) records to be kept for five years to demonstrate compliance. A covered banking entity may establish a compliance program on an enterprise-wide basis that is applicable to all its affiliates and subsidiaries.

The regulating agency of a covered banking entity may impose additional requirements as it deems appropriate. A covered banking entity that violates or evades the Volcker Rule regulations may be ordered to restrict or terminate the offending activity and, as relevant, dispose of the offending investment.

Specific Requirements for Covered Banking Entities with Significant Restricted Activities

The Proposed Rule imposes specific requirements for the compliance programs of covered banking entities with *significant* proprietary trading and covered fund activities. A covered banking entity engages in significant proprietary trading activity if, together with its affiliates and subsidiaries, it has per year trading assets and liabilities equaling at least $1 billion or 10% of its total assets. A covered banking engages in significant covered fund activity if, together with its affiliates and subsidiaries, it sponsors or advises covered funds that average at least $1 billion per year in total assets, or makes investments in covered funds that average at least $1 billion per fund per year. Even if a covered banking entity does not trigger any of the trading volume or covered funds value tests, the entity's regulating agency may nonetheless impose the same specific requirements as it deems appropriate.

A covered banking entity with significant restricted activities must ensure compliance by each of its units that conduct proprietary trading or covered fund activities. Its policies and procedures must identify all of its units and their restricted activities and describe efforts to remedy violations. Its senior management must review and approve the compliance program and is responsible for setting an appropriate culture of compliance. The independent testing must be conducted at least once every year by a qualified independent party, which may include the entity's internal auditing department.

The internal controls for a covered banking entity with significant covered fund activities should monitor the entity's compliance with: (i) all requirements for organizing and offering a

covered fund, including the requisite written disclosures; (ii) the investment limitations; and (iii) Sections 23A and 23B of the Federal Reserve Act.

Required Quantitative Measurements for Covered Banking Entities with Significant Proprietary Trading Activities

The Proposed Rule imposes additional reporting and recordkeeping requirements for a covered banking entity engaged in permitted proprietary trading and with gross trading assets and liabilities of at least $1 billion per year. Such a covered banking entity must issue monthly call reports detailing daily calculations of dozens of factors such as value-at-risk, volatilities of profit and loss on a comprehensive and portfolio basis, and risk and position limits.

Covered Banking Entities not Engaged in any Restricted Activities

Covered banking entities that are not engaged in restricted proprietary trading or covered fund activities must still update their compliance policies and procedures to ensure that they do not become engaged in such restricted activities.

Conformance Period

Initial Conformance Period and Extensions

A covered banking entity must bring itself in conformance with the Volcker Rule's prohibitions against proprietary trading and certain covered fund activities no later than July 21, 2014.

Upon request by a covered banking entity, the Board may grant not more than three separate one-year extensions to the initial conformance period if it deems such extensions to be consistent with the purposes of the Volcker Rule.

Extended Transition Period for Illiquid Funds

If a covered banking entity was contractually obligated, as of May 1, 2010, to acquire or retain an ownership interest in or provide additional capital to a covered fund that is an illiquid fund, the Board may grant one additional extension of up to five years, beyond the three separate one-year extensions and the initial conformance period. This additional extension terminates automatically with the covered banking entity's contractual obligation. When termination of the covered banking entity's contractual obligation requires the consent of an unaffiliated party, such as the general partner or other investors of the covered fund, the covered banking entity must use its *reasonable best efforts* to obtain such consent. The covered banking entity is only contractually obligated if such consent is denied despite such reasonable best efforts.

An illiquid fund is a covered fund that, (i) as of May 1, 2010, was either principally invested in, or invested in and was contractually committed to principally invest in, illiquid assets; and (ii) employs an investment strategy to principally invest in illiquid assets. A covered fund principally invests in illiquid assets if at least 75% of the covered fund's consolidated total assets are illiquid assets or risk-mitigating hedges related to illiquid assets.

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This memorandum is not intended to provide legal advice with respect to any particular situation and no legal or business decision should be based solely on its content. Questions concerning issues addressed in this memorandum should be directed to:

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