CLIFFORD CHANCE

VOLCKER RULE 2.0: SOME HELPFUL UPGRADES AND BUG FIXES – UPDATE YOUR VOLCKER POLICIES AND PROCEDURES NOW

On October 8, 2019, the Federal Reserve Board approved the interagency final rule (the "**Final Rule**") adopting amendments to the regulations implementing Section 13 of the Bank Holding Company Act of 1956, commonly known as the "Volcker Rule," that provide some much needed regulatory relief from requirements that have proven to be exceedingly complex, burdensome, and challenging to implement for both the regulators and the banking industry. All other US Federal agencies tasked with promulgating regulations implementing the Volcker Rule (collectively, the "**Agencies**"), *i.e.*, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, and the Commodity Futures Trading Commission, have already approved the Final Rule, and it will become effective on January 1, 2020.

Banking entities subject to the Volcker Rule are not required to comply with the Final Rule until January 1, 2021 (the "**Mandatory Compliance Date**")**,** however, banking entities may elect to comply, in whole or in part, with the Final Rule prior to the Mandatory Compliance Date, subject to completion of certain technological changes that the Agencies need to implement in order to accept metrics compliant with the Final Rule. As the Final Rule relaxes the regulatory burden of the existing regulations implementing the Volcker Rule, which were promulgated in 2013 (the "**2013 Rule**"), banking entities would be well advised to take steps towards complying with the Final Rule as of its effective date, including by revising existing Volcker Rule compliance policies and procedures.

The Final Rule adopts, with certain modifications, amendments to the 2013 Rule, which were proposed in a notice of proposed rulemaking issued in July 2018 (the "**Proposed Rule**"). The amendments adopted by the Final Rule focus on the proprietary trading prohibitions of the Volcker Rule. With respect to the Volcker Rule's prohibitions on investing in and certain relationships with "covered funds," the Final Rule adopts only the handful of amendments for which specific text was included in the Proposed Rule. The Agencies have indicated that they are continuing to consider comments and intend to issue a separate proposed rulemaking that would address the covered funds provisions of the Volcker Rule. We address the key amendments made by the Final Rule below.

AMENDED COMPLIANCE PROGRAM REQUIREMENTS

The Final Rule simplifies significantly the Volcker Rule compliance program requirements, particularly for banking entities with "limited" or "moderate" trading assets and liabilities. The Final Rule divides banking entities into three new compliance tiers based on whether they have a "limited," "moderate" or "significant" level of trading assets and liabilities[1] as follows:

> **Banking entities with significant trading assets and liabilities**, *i.e.*, entities that, together with affiliates and subsidiaries, have trading assets and liabilities the average gross sum of which as of the last day of each of the previous consecutive four quarters equals or exceeds $20 billion (or which the responsible Agency has determined should be treated as having significant trading assets and liabilities). Banking entities in this category will generally be subject to the compliance program requirements of the 2013 Rule, including: (i) the six-pillar compliance program requirement; (ii) the metrics reporting requirements; (iii) the covered fund documentation requirements, and (iv) the CEO attestation requirement. The Final Rule incorporates a number of significant amendments reducing reporting burden, however, including, for example, eliminating the "Risk Factor Sensitivities" metric, the "Stressed VaR" metric, the "Inventory Turnover" metric, and the "Inventory Aging" metric.
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> **Banking entities with moderate trading assets and liabilities**, *i.e.*, entities that have less than significant trading assets and liabilities but more than limited trading assets and liabilities. Banking entities in this category may satisfy the compliance program requirements by including in their existing compliance policies and procedures appropriate references to the requirements of the Volcker Rule and related adjustments, as appropriate, given the size, scope and complexity of their activities.
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> **Banking entities with limited trading assets and liabilities**, *i.e.*, entities that, together with affiliates and subsidiaries, have trading assets and liabilities the average gross sum of which as of the last day of each of the

[1] The Agencies have indicated that they expect banking entities to use "trading assets and liabilities" reported on consolidated basis as part of regulatory reports that banking entities are required to prepare under existing law, such as Form FR Y-9C.

previous consecutive four quarters is less than $1 billion. Banking entities in this category will be presumed to be compliant with the requirements of the Volcker Rule and will have no obligation to demonstrate compliance with the Final Rule on an ongoing basis.[2] The Agencies have reserved the authority to rebut this presumption in accordance with notice and response procedures set out in the Final Rule.

For purposes of determining whether their trading assets and liabilities are significant, moderate, or limited, domestic banking organizations must take into account their worldwide trading assets and liabilities. Foreign banking organizations and their subsidiaries, however, are required to take into account only the trading assets and liabilities of their combined US operations.[3]

As a result, under the Final Rule, a number of foreign banking organizations with limited US trading assets and liabilities may no longer be required to maintain a stand-alone Volcker Rule compliance program. While the elimination of the compliance program requirement and the compliance presumption for banking entities with limited trading assets and liabilities is very helpful, such banking entities should carefully evaluate the risks of completely scrapping their existing Volcker Rule compliance programs. The preamble to the Final Rule indicates that a banking entity which has limited trading assets and liabilities, and therefore is presumed to comply with the Volcker Rule, should nonetheless take appropriate actions, tailored to the individual activities in which the banking entity engages, to ensure compliance. Moreover, while the presumption of compliance is helpful, it is not an exemption from the requirements of the Volcker Rule, and the Agencies have indicated that the appropriate consequences for a violation of the Rule would depend on the specific facts and circumstances in any individual case.

PROPRIETARY TRADING PROVISIONS AMENDMENTS

Proprietary Trading Definition

The Volcker Rule generally defines "proprietary trading" to mean engaging as principal for the trading account of the banking entity in any purchase or sale of one or more financial instruments. The Volcker Rule further generally defines the term "trading account" to mean "any account used for acquiring or taking positions in [financial instruments] principally for the purpose of selling in the near term (or otherwise with the intent to resell in order to profit from short-term price movements), and any such other accounts as the [Agencies] may, by rule [as provided under the relevant statutory provisions] determine."

In the 2013 Rule the Agencies adopted a three-pronged test for determining whether an account is a "trading account" containing (i) a short-term intent prong;[4]

2 We also note that, on July 9, 2019, the Agencies adopted amendments to the Volcker Rule implementing regulations pursuant to the Economic Growth, Regulatory Relief, and Consumer Protection Act, under which "insured depository institutions" that have (i) total consolidated assets equal to $10 billion or less and (ii) total trading assets and liabilities equal to 5% or less of total consolidated assets are not “banking entities” and therefore are excluded entirely from the scope the Volcker Rule.

3 Under the Proposed Rule, foreign banking organizations would have had to use the banking entity's worldwide trading assets and liabilities for purposes of classifying them as having limited or moderate trading assets and liabilities.

4 The short-term intent prong largely mirrors the Volcker Rule's statutory trading account definition.

(ii) a market risk capital prong;[5] and (iii) a dealer prong.[6] The 2013 Rule's short-term intent prong also included a rebuttable presumption providing that a banking entity's purchase (or sale) of a financial instrument would be presumed to be for the trading account if the banking entity holds the financial instrument for less than 60 days or substantially transfers the risk associated with the financial instrument within 60 days of the purchase (or sale).

The Final Rule's definition of "trading account" retains a market risk capital prong and a dealer prong that are substantially similar to those set out in the 2013 Rule. The Final Rule provides significant relief and increased certainty, however, by modifying the short-term intent prong. In particular, the Final Rule eliminates the 2013 Rule's rebuttable presumption and replaces it with a rebuttable presumption providing that a banking entity's purchase (or sale) of a financial instrument would be presumed *not* to be for the trading account if the banking entity holds the financial instrument for 60 days or longer and does not transfer substantially all of the risk associated with the financial instrument within 60 days of the purchase (or sale).[7]

The Final Rule also clarifies that a banking entity is subject to either the short-term intent prong or the market risk capital prong, but not both. A banking entity is subject to the market risk capital prong if it, or any affiliate with which the banking entity is consolidated for regulatory reporting purposes, calculates risk-based ratios under the market risk capital rule. The Final Rule also clarifies that a banking entity, including a foreign banking entity, that is not subject to the market risk capital prong may elect to apply that prong instead of the short-term intent prong. Further, the preamble to the Final Rule clarifies that the dealer prong covers only the type of activities of a banking entity registered as a broker-dealer that require the banking entity to be so registered.

Trading Desk Definition

Under the 2013 Rule, the term "trading desk" was defined to mean "the smallest discrete unit of organization of a banking entity that purchases or sells financial instruments for the trading account of the banking entity or an affiliate thereof." In response to concerns raised by commenters, including that the existing trading desk definition is subjective, ambiguous, and has resulted in confusion and duplicative compliance and reporting efforts, the Final Rule adopts a multi-factor definition that would be based on criteria used by banking entities to structure trading desks for other operational, management and compliance purposes. The trading desk definition under the Final Rule covers each unit of a banking entity that purchases or sells financial instruments for the trading account and is: (i) structured to implement a well-defined business strategy; (ii) organized to ensure appropriate setting, monitoring, and management review of the desk's trading and hedging limits, current and potential future loss exposures, and strategies; and (iii) is clearly

5 The market risk capital prong is based on the definition of a trading position in the market risk capital rules earlier promulgated by the Agencies.

6 The dealer prong generally captures financial instruments purchased or sold for any purpose if the banking entity is engaged in a business as a dealer and the instrument is purchased or sold in connection with the activities of such business.

7 After strong commenters' opposition, the Agencies determined not to adopt a proposed accounting prong which was incorporated in the Proposed Rule and would have provided that "trading account" included any account used by a banking entity to purchase or sell one or more financial instruments that is recorded at fair value on a recurring basis under applicable accounting standards. The Agencies also decided not to adopt a proposed trading desk-level presumption of compliance for activities that would have been captured by the proposed accounting prong but did not exceed specified quantitative thresholds.

defined by virtue of engaging in coordinated trading activity, operating subject to a common and calibrated set of risk metrics and trading limits, submitting management and other reports as a unit, and booking its trades together. The amended definition may be useful in aligning internal trading desk designations for operational, management and other compliance purposes with the trading desk definition and related requirements of the Volcker Rule.

Proprietary Trading Exclusions

The Final Rule provides some helpful clarifications to the existing proprietary trading exclusions as well as certain new exclusions as set forth below:

> **Liquidity Management Exclusion** – under the Final Rule the exclusion for liquidity management activities would be amended to permit banking entities to use for liquidity management purposes (in accordance with a documented liquidity management plan) "foreign exchange forwards" and "foreign exchange swaps" as defined under the Commodity Exchange Act, as well as cross-currency swaps.[8] Notably, the Final Rule also removes a requirement for the availability of the exclusion under the 2013 Rule requiring the excluded liquidity management activities to be conducted in accordance with applicable supervisory requirements, guidance and expectations, consistent with changes elsewhere in the Final Rule and with the Agencies' Interagency Statement Clarifying the Role of Supervisory Guidance.[9]

> **New Exclusion for Transactions to Correct Bona Fide Trade Errors** – the Final Rule clarifies that bona fide trade errors and subsequent correcting transactions do not fall within the statutory definition of "proprietary trading" because they lack the requisite short-term trading intent.

> **New Exclusion for Customer-Driven Matched-Book Swap Transactions** – the Final Rule clarifies that a customer-driven swap or security-based swap and a matched swap or security-based swap are excluded from the proprietary trading definition if: (i) the transactions are entered into contemporaneously; (ii) the banking entity retains no more than minimal price risk; and (iii) the banking entity is not a registered dealer, swap dealer, or security-based swap dealer.[10]

> **New Exclusion for Hedges of Mortgage Servicing Rights or Assets** – the Final Rule excludes from the proprietary trading definition purchases or sales of financial instruments used to hedge mortgage servicing rights or mortgage servicing assets in accordance with a documented hedging strategy. Such hedges are generally not captured under the market risk capital prong of the trading account definition and the exclusion is intended

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8 A "cross-currency swap" is defined as "a swap in which one party exchanges with another party principal and interest rate payments in one currency for principal and interest rate payments in another currency, and the exchange of principal occurs on the date the swap is entered into, with a reversal of the exchange of principal at a later date that is agreed upon when the swap is entered into."

9 Interagency Statement Clarifying the Role of Supervisory Guidance (Sept. 11, 2018) (available at: https://www.federalreserve.gov/supervisionreg/srletters/sr1805.htm).

10 This exclusion is not limited to loan-related swaps as was contemplated under the Proposed Rule.

to provide clarity and party for banking entities that are subject to the short-term intent prong.

New Exclusion for Financial Instruments that Are Not Trading Assets or Trading Liabilities – the Final Rule also clarifies that any purchase or sale of a financial instrument that does not meet the definition of "trading asset" or "trading liability" under the "applicable reporting form for a banking entity as of January 1, 2020" is excluded from the proprietary trading definition. The Final Rule does not define "applicable reporting form" but presumably the reference is to US reporting forms applicable under relevant US rules, such as the Call Report and Form FRY-9C. This exclusion is intended to provide greater clarity to banking entities that are subject to the short-term intent prong.

Underwriting and Market Making Exemptions

The Final Rule makes certain amendments to the requirements for the availability of the underwriting and market making exemptions that are intended principally to clarify the circumstances which meet the statutory requirement that permitted underwriting and market making activities are designed not to exceed the reasonably expected near term demand of clients, customers, or counterparties ("**RENTD**"). To that end the Final Rule establishes a presumption that underwriting and market making activities meet the RENTD requirement if such activities are conducted within internally set limits for each trading desk, which limits are designed not to exceed RENTD. A trading desk seeking to rely on the presumption must establish, implement, maintain, and enforce internal limits that are designed not to exceed RENTD taking into account the liquidity, maturity and depth of the market for the relevant types of financial instruments and certain additional specified factors, including: (i) amount, types, and risks of its underwriting and/or market-making positions; (ii) amount, types, and risks of the products, instruments, and exposures the trading desk may use for risk management purposes; (iii) level of exposures to relevant risk factors arising from its financial exposure; and (iv) period of time a financial instrument may be held.

The Proposed Rule would have required prompt reporting to the Agencies of any breaches or increases of the internally set limits but the Final Rule instead requires banking entities to maintain and make available upon request records regarding any such breaches or increases. A breach or increase of a limit would not make the presumption unavailable provided that the banking entity (i) promptly takes action to bring the trading desk into compliance and (ii) follows established written authorization procedures, including escalation procedures that require review and approval of any trade that exceeds a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval. The Agencies have indicated that they may review the internally set limits to assess whether or not such limits are consistent with the statutory RENTD standard and may rebut the presumption in accordance with a notice and response procedures provided for under the Final Rule.

The 2013 Rule also conditioned the availability of the underwriting and market making exemptions on the implementation of a compliance program meeting specific requirements, including reasonably designed written policies and procedures, internal controls, analysis, and independent testing addressing certain specific conditions for the availability of the underwriting and market making exemptions. The Final Rule tailors these compliance program requirements to the nature and risk of the underwriting and market making activities conducted by banking entities by making these compliance program requirements applicable only to banking entities with significant trading assets and liabilities.

Hedging Exemption

Under the 2013 Rule, the availability of the hedging exemption was conditioned on, among other things, a compliance program providing for a correlation analysis designed to ensure that the positions, techniques and strategies that may be used for hedging may reasonably be expected to demonstrably reduce or otherwise significantly mitigate specific identifiable risks being hedged. The 2013 Rule also included a condition that the risk-mitigating hedging activity must demonstrably reduce or otherwise significantly mitigate one or more specific, identifiable, risks.

The Agencies have noted that in practice it may be difficult for banking entities to know with sufficient certainty that a potential hedging activity will demonstrably reduce or significantly mitigate a specific, identifiable risk and that the requirement to show that hedging activity demonstrably reduces or otherwise significantly mitigates a specific, identifiable risk could potentially reduce bona fide risk-mitigating hedging activity. Accordingly, the Final Rule removes from the conditions for the availability of the hedging exemption the "demonstrably reduces or otherwise significantly mitigates" specific risk requirement. The Final Rule also eliminates the requirement that a correlation analysis is used to assess risk-mitigation hedging activities. To be eligible for the exemption, any risk-mitigating hedges must still be designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, but the banking entity would have flexibility to apply a type of analysis that it deems appropriate for the facts and circumstances of the hedge and the underlying targeted risks.

For banking entities with limited and moderate trading assets and liabilities the Final Rule also eliminated: (i) the separate internal compliance program requirements for risk-mitigating hedging; (ii) the requirement that hedging activity is subject to continuing review, monitoring, and management and does not give rise to, at the inception of the hedge, to any significant new or additional risk; (iii) the limits on compensation arrangements for persons engaged in hedging activities; and (iv) documentation requirements for such activities. Under the Final Rule, banking entities with limited or moderate trading assets and liabilities may generally rely on the hedging exemption if the hedging activity is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks and it is subject, as appropriate, to ongoing recalibration to ensure that it satisfies the requirements for the exemption and is not prohibited proprietary trading.

The Final Rule generally retains the enhanced hedging-related documentation requirements for banking entities with significant trading assets and liabilities, but eliminates them for hedging activities that meet certain conditions. In particular, the Final Rule provides that the enhanced documentation requirement does not apply where: (i) the financial instrument used for hedging activity is identified on a written list of financial instruments pre-approved by the banking entity that are commonly used by the trading desk for the specific types of hedging activity for which the financial instrument is being purchased or sold; and (ii) at the time of the purchase or sale of the financial instruments, the related hedging activity complies with written, pre-approved hedging limits for the trading desk purchasing or selling the financial instrument. These hedging limits must be appropriate for: (i) the size, types, and risks of the hedging activities commonly undertaken by the trading desk; (ii) the financial instruments purchased and sold by the trading desk for hedging activities; and (iii) the levels and duration of the risk exposures being hedged.

Exemption for Trading Outside the United States (the "TOTUS Exemption")

For foreign banking organizations, the most significant amendment promulgated by the Final Rule is likely to be the elimination of certain conditions for the availability of the exemption for trading solely outside the United States (commonly referred to as the "**TOTUS Exemption**"). The TOTUS Exemption is available only to qualifying foreign banking entities, *i.e*., banking entities that are not organized in the United States, are not directly or indirectly controlled by a banking entity that is organized in the United States, and meet certain qualifying tests based on assets, revenues, and net income that are designed to ensure that the banking entity conducts activities predominantly outside the United States. In addition, under the 2013 Rule, the TOTUS Exemption is available only if:

> *(i) The banking entity engaging as principal in the purchase or sale (including any personnel of the banking entity or its affiliate that arrange, negotiate or execute such purchase or sale) is not located in the United States or organized under the laws of the United States or of any State [the "**No-US-Personnel-Involvement Prong**"];*
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> *(ii) The banking entity (including relevant personnel) that makes the decision to purchase or sell as principal is not located in the United States or organized under the laws of the United States or of any State;*
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> *(iii) The purchase or sale, including any transaction arising from risk-mitigating hedging related to the instruments purchased or sold, is not accounted for as principal directly or on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State;*
>
> *(iv) No financing for the banking entity's purchases or sales is provided, directly or indirectly, by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State [the "**No-US-Financing Prong**"]; and*
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> *(v) The purchase or sale is not conducted with or through any US entity [the "**No-US-Counterparty Prong**"], other than:*
>
>> *(A) A purchase or sale with the foreign operations of a US entity if no personnel of such US entity that are located in the United States are involved in the arrangement, negotiation, or execution of such purchase or sale;*
>>
>> *(B) A purchase or sale with an unaffiliated market intermediary acting as principal, provided the purchase or sale is promptly*

> *cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty; or*
>
> *(C) A purchase or sale through an unaffiliated market intermediary acting as agent, provided the purchase or sale is conducted anonymously on an exchange or similar trading facility and is promptly cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty.*

The Agencies have acknowledged concerns of foreign banking entities that compliance with the No-US-Personnel-Involvement Prong, the No-US-Financing Prong, and the No-US-Counterparty Prong of the TOTUS Exemption can be overly difficult, complex, restrictive, and costly. To address these concerns, consistent with the Proposed Rule, the Final Rule eliminates the No-US-Financing Prong and the No-US-Counterparty Prong of the TOTUS Exemption and modifies the No-US-Personnel-Involvement Prong to permit some limited involvement by US personnel (*e.g.*, arranging or negotiating) so long as they do not make the decision to purchase or sell as principal.

The Final Rule focuses the conditions of the availability of the TOTUS Exemption on the physical location of a foreign banking entity that is: (i) effecting the trade, (ii) making the decision to trade;[11] and (iii) acts and accounts for the trade as principal. Thus, the Final Rule would generally allow qualifying foreign banking entities to trade on a cross-border basis with US counterparties without regard to the proprietary trading prohibitions of the Volcker Rule,[12] which would largely eliminate the impact of the Volcker Rule's proprietary trading restrictions on such entities. The Agencies have acknowledged that the amendments to the conditions for the TOTUS Exemption would permit qualifying foreign banking entities to trade directly with US counterparties without being subject to the restrictions of the Volcker Rule and that this could give foreign banking entities a competitive advantage over US banking entities. The Agencies have taken the position, however, that any such competitive advantage would be mitigated by the other simplifying and streamlining amendments made in the Final Rule.

COVERED FUND PROVISIONS AMENDMENTS

The covered fund provisions of the regulations implementing the Volcker Rule remain largely unchanged and the resolution of important issues, such as the treatment of so-called "foreign excluded funds"[13] have been deferred. As noted above, the Agencies have indicated that they are continuing to consider potential amendments to the covered funds provisions and intend to publish a separate covered funds proposal. The Final Rule implements only a handful of amendments

[11] The preamble to the Final Rule clarifies that a foreign banking entity may engage a US investment adviser and still be able to rely on the TOTUS Exemption as long as the actions and decisions of the banking entity to trade as principal occur outside the United States.

[12] The preamble to the Final Rule cautions that the modifications to the TOTUS Exemption concerning the meaning of "solely outside the United States" do not affect a foreign banking entity's obligations to comply with additional or different requirements under applicable securities, banking, or other laws.

[13] Foreign excluded funds generally are funds offered and sold outside of the United States that are excluded from the definition of a "covered fund" but that may be captured by the definition of a "banking entity" and, therefore, be subject to the proprietary trading restrictions of the Volcker Rule. The Agencies have issued a policy statement that provides temporary exemptive relief with respect to certain "qualifying foreign excluded funds" until July 21, 2021. *See* Statement Regarding Treatment of Certain Foreign Funds under the Rules Implementing Section 13 of the Bank Holding Company Act (July 17, 2019) (available at: https://www.occ.gov/news-issuances/news-releases/2019/nr-ia-2019-79a.pdf).

to the covered funds provisions for which specific text was included in the Proposed Rule, as outlined below.

Exemption for Underwriting and Market Making with Respect to a Covered Fund

The 2013 Rule provides that the covered fund activity restrictions of the Volcker Rule do not apply to underwriting and market making in ownership interests of a covered fund where certain conditions are met, including, among other things, requiring all covered fund ownership interests acquired by a banking entity in connection with underwriting or market making activities to be included in the calculation of the required capital deduction and aggregate limit for the availability of the "asset management" exemption for investments in covered funds. The Final Rule eliminated the requirement that a banking entity include for purposes of the aggregate fund limit and capital deduction the value of any ownership interests of a third-party covered fund acquired or retained in accordance with the proprietary trading underwriting or market making exemptions.

Exemption for Acquisition of Covered Fund Interests for Hedging Purposes

The Final Rule amends the covered fund hedging exemption to permit acquisition and retention of an ownership interest in a covered fund as a hedge where the banking entity is acting as intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund. The Agencies have indicated that this new exemption is customer-driven, is tailored to permit bona fide customer facilitation activities, and is not available for soliciting customer transactions in order to facilitate the banking entity's own exposure to a covered fund. The Final Rule also removes the condition for the availability of the covered funds hedging exemption that the hedging transaction "demonstrably" reduces or otherwise significantly mitigates the relevant risk.

Exemption for Covered Fund Activities Conducted Solely Outside the United States (the "SOTUS Exemption")

The conditions for the availability of the SOTUS Exemption has been modified in two ways. First, the condition prohibiting financing a permitted SOTUS covered fund sponsorship or investment by a branch or affiliate in the United States has been eliminated.[14] The elimination of the financing condition should address concerns about the difficulty of determining whether a particular financing is tied to a particular activity or investment which is due to the fungibility of financing.

Second, the guidance provided by the Federal Reserve Board staff in FAQ 13 has been codified. The SOTUS Exemption has been amended to state explicitly that an ownership interest in a covered fund is not offered or sold to a resident of the United States if it has not been sold pursuant to an offering that targets residents of the United States in which the banking entity or any affiliate of the banking entity participates. The amendments further clarify that a banking entity will be deemed to

[14] The Agencies have noted, the financing provided by a branch or affiliate in the United States remains subject to other laws and regulations, including, without limitation, Section 23A and 23B of the Federal Reserve Act.

have participated in an offering if the banking entity or its affiliates sponsor or serve, directly or indirectly, as an adviser to the covered fund.

CONCLUSION

The amendments made by the Final Rule are hardly a major rewrite of the 2013 Rule such that the Volcker Rule no longer imposes a meaningful constraint on speculative and proprietary trading by banking entities, as some have argued. The Final Rule does contain more streamlined provisions and provides some meaningful regulatory burden relief to banking entities, however, while still remaining truthful to and carrying out the statutory intent and goals of the Volcker Rule. The Final Rule may also have a positive safety and soundness impact stemming from its overall risk-based approach and removal of impediments to certain trading and hedging activities that could be beneficial for the health of banking entities and the market as a whole.

As the January 1, 2020 effective date of the Final Rule is fast approaching and the Agencies have authorized voluntarily compliance with the Final Rule prior to the Mandatory Compliance Date, banking organizations should consider taking immediate steps to modify their existing Volcker Rule compliance policies, procedures, and practices in line with the amendments. The implementation of appropriate adjustments to policies and procedures in line with the streamlined provisions of the Final Rule would not only reduce regulatory burden, operational inefficiencies, and related costs, but may also further mitigate compliance risk where the amendments have provided clearer guidance.

CONTACTS

Philip Angeloff
Counsel

T +1 202 912 5111
E philip.angeloff@cliffordchance.com

Jeff Berman
Partner

T +1 212 878 3460
E jeffrey.berman@cliffordchance.com

Clifford Cone
Partner

T +1 212 878 3180
E clifford.cone@cliffordchance.com

David Felsenthal
Partner

T +1 212 878 3452
E david.felsenthal@cliffordchance.com

Steven Gatti
Partner

T +1 202 912 5095
E steven.gatti@cliffordchance.com

Gareth Old
Partner

T +1 212 878 8539
E gareth.old@cliffordchance.com

www.cliffordchance.com

Clifford Chance, 2001 K Street NW, Washington, DC 20006-1001, USA

Clifford Chance US LLP

Abu Dhabi • Amsterdam • Barcelona • Beijing • Brussels • Bucharest • Casablanca • Dubai • Düsseldorf • Frankfurt • Hong Kong • Istanbul • London • Luxembourg • Madrid • Milan • Moscow • Munich • Newcastle • New York • Paris • Perth • Prague • Rome • São Paulo • Seoul • Shanghai • Singapore • Sydney • Tokyo • Warsaw • Washington, D.C.

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