Linklaters

December 20, 2013

The Final Volcker Rule and Its Extraterritorial Consequences for Non-U.S. Banks

Introduction

Last week, the Board of Governors of the Federal Reserve System (the "**Fed**") and four other U.S. financial regulators (collectively, the "**Agencies**")[1] approved a long-awaited final rule (the "**Final Rule**") to implement Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**"), commonly known as the "Volcker Rule."[2] While the Final Rule provides some certainty about how the Volcker Rule will be implemented, many provisions of the Final Rule, which comes more than two years after the release of a proposed rule (the "**Proposed Rule**"),[3] have been greeted with disappointment by an industry that has lobbied intensely against it. Although the Final Rule hews closer to the proposal than had been hoped, it does offer some concessions to non-U.S. banking organizations. At the same time, it sweeps them into a U.S.-centric compliance and reporting regime that will inevitably conflict with home country customs and requirements.

Rather than providing a comprehensive summary of the Final Rule, this note highlights those provisions that are likely to be of greatest practical and commercial consequence to our financial institution clients, with a particular focus on the extraterritorial impact of the Final Rule on non-U.S. banks.

---

1 Other than the Fed, the Agencies that have approved the Final Rule are the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation (the "**FDIC**"), the Securities and Exchange Commission (the "**SEC**") and the Commodity Futures Trading Commission (the "**CFTC**").

2 Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds (Dec. 10, 2013). A pre-publication version of the Final Rule text ("**Final Rule Text**") is available at http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20131210a1.pdf. A pre-publication version of the Supplementary Material released by the Agencies in support of the Final Rule ("**Final Rule Supp. Mat.**") is available at http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20131210a2.pdf.

3 Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 68846 (Nov. 7, 2011).

Key takeaways for non-U.S. banks:

> The Volcker Rule will constrain the worldwide activities of virtually all internationally active non-U.S. banks and their affiliates. In the absence of an exception, both proprietary trading in most financial instruments and sponsorship of and investment in alternative funds will be prohibited.

> The worldwide market making, underwriting and hedging activity of affected banks may be exempt from the prohibition on proprietary trading, but these exceptions are narrowly defined. More importantly, any bank with substantial trading activity can only rely on these exceptions if it has implemented an elaborate compliance program and reports a number of detailed "metrics" to U.S. regulators.

> Under the critical "solely outside the United States," or SOTUS, exception, the Final Rule allows non-U.S. banking entities to trade with some U.S. counterparties, subject to certain execution and other requirements that will require trading arrangements to be re-examined and conformed.

> The Final Rule permits any non-U.S. bank to trade in its home country's sovereign debt, without regard to where the trading activity is conducted or booked. It also permits a licensed and regulated non-U.S. subsidiary (but not a foreign branch) of a U.S. bank to trade in the sovereign debt of the country in which the non-U.S. subsidiary is organized.

> The Final Rule continues to bar most investments by non-U.S. banks in "covered funds," but, in an important development, exempts any private fund organized outside of the United States with no U.S. investors from the "covered fund" ban on investments by these banks.

> The Final Rule exempts UCITS and similar public funds, and covered bond vehicles, from the reach of the Volcker Rule.

> The Final Rule imposes time-critical and substantial governance, compliance and reporting burdens on non-U.S. banks that engage in trading activity, with very little deference to the equivalence of home country obligations.

> The Final Rule will not be the last word on the Volcker Rule. Like all regulation, it will be further amplified and interpreted by the regulators in an ongoing dialogue between banks, their legal advisers and the Agencies.

> Although the compliance deadline has been extended to July 21, 2015, institutions with the largest U.S. footprints will need to begin reporting the detailed trading and other metrics required by the Final Rule to the Agencies on June 30, 2014.

Overview of the Volcker Rule

Scope

Broadly speaking, the Volcker Rule bans proprietary trading and the investment in and sponsorship of certain types of private investment funds ("**Covered Funds**") by so-called "banking entities," a term that includes FDIC-insured depository institutions,[4] U.S. bank holding companies, non-U.S. banks with a U.S. branch or agency, and any affiliates of the foregoing around the globe, whether or not they are organized or located in the United States. Because of the reach of the term "banking entity," all of a covered banking organization's operations around the world may be subject to the Volcker Rule's restrictions, even if the organization, or the activities in question, have limited connection with the United States. Both of the Volcker Rule's prohibitions are subject to a number of exceptions.

Proprietary trading ban

Proprietary trading under the Final Rule is defined as trading activity in "financial instruments" (a term that includes securities, options and derivatives (including FX swaps and forwards), but which does not include spot FX and currency transactions) that falls within <u>any of the following</u> buckets:

> trading with the principal purpose of short-term resale, benefiting from short-term price changes, realizing short-term arbitrage profits or hedging any such positions;

> trading in financial instruments that are covered by the U.S. market risk capital rule and booked as trading positions, to the extent that the banking entity is subject to the U.S. market risk capital rule; or

> principal trading in financial instruments by a banking entity that is a securities, swap or security-based swap dealer registered in the United States to the extent that the trading is in connection with dealing activities requiring registration, or is engaged in the business of a foreign dealer to the extent that the trading is connected to its dealing activities.

As to the first prong, a position in a financial instrument held for fewer than 60 days is presumed to be "short term," though a banking entity may rebut that presumption by demonstrating that it did not purchase or sell the financial instrument "principally" for short-term gain. Importantly, there is no such rebuttable presumption available for trading that is subject to the market risk capital rule or trading by a dealer, nor is there a presumption that positions held for longer than 60 days are *not* "short term."

[4] Insured depository institutions include U.S. banks, savings associations and industrial loan companies, the deposits of which are insured by the FDIC.

By including virtually all dealing positions, the Volcker Rule's definition of "proprietary trading" is extraordinarily broad, and the exceptions of critical importance. The exceptions, which are extremely complex and detailed, include:

> market making;

> underwriting activities;

> risk-mitigating hedging;

> transactions conducted in accordance with a "documented liquidity management plan;"

> trading in obligations of the U.S. government;

> trading by a non-U.S. bank in the sovereign obligations of its home country (the "**Foreign Sovereign Exception**"), which is discussed below;

> trading by a U.S. banking entity's non-U.S. banks and non-U.S. regulated securities dealers in the sovereign debt of the country in which they are organized;

> trading on behalf of customers;

> trading by a banking entity that is a regulated insurance company; and

> trading by a non-U.S. banking entity that is conducted "solely outside of the United States" (the "**Proprietary Trading SOTUS Exception**"), discussed below.

As feared, many of the key exceptions – for market making, underwriting, and hedging – are not self-executing. Banking entities, *including non-U.S. banking entities*, are required to implement substantial compliance programs in order to be able to trade in reliance on these very detailed exceptions, and to maintain and report detailed "metrics" with respect to this activity.

For example…
The U.K.-licensed dealer subsidiary of a U.K. bank entering into a 360-day derivative with the branch of a U.S. bank cannot simply conclude that the position is a risk-mitigating hedge. > *Because the position is booked by a dealer, it is a proprietary trade, regardless of term.* > *The U.K. dealer booking the trade can only rely on the "hedging" exception if pursuant to a compliance program and if the "hedging" determination is supported by adequate evidence, including identification of the specific risks and specific positions that the hedge is meant to mitigate.*

While banking entities will face compliance obligations in connection with their use of any of the above exceptions, the compliance burden associated with the market making and underwriting exceptions are especially heavy given the granular focus on the activities and position limits of a banking entity at the level of individual "trading desks," defined as the smallest discrete trading unit of the bank. A banking entity must assess "reasonable near-term customer demand" and establish position limits for each financial instrument it trades under the market making and underwriting exceptions at the individual trading desk level as part of its compliance program, disregarding the banking entity's aggregate or "portfolio" needs for a particular financial instrument. Further, while many banking organizations already compile some of the metrics that must be reported to the Agencies under the Final Rule, it is less likely that they compile the information on a granular trading desk-by-trading desk basis. As such, they will likely face costs associated with adjusting their internal reporting systems to meet the requirements of the Final Rule.

Proprietary Trading SOTUS Exception

For these reasons, non-U.S. banks will probably want to rely where possible on the exception for trading "solely outside the United States," which generally entails less burdensome assessment and reporting of financial metrics.

Under the SOTUS exception, a banking entity may engage in proprietary trading if:

> it is not organized or controlled by a banking entity organized under the laws of the United States, and is a "qualifying foreign banking organization" or satisfies similar criteria establishing that its business is principally outside of the United States; and

> the trading activity occurs "solely outside of the United States."

The key to the exception lies in whether a trade is considered to take place "solely outside of the United States." Under the Proposed Rule trading with a U.S. entity, or even on U.S. exchanges or trading facilities, would have been ineligible for the exception, with the risk that non-U.S. banks would have had to virtually bifurcate their trading between U.S. and non-U.S. counterparties and platforms. Numerous commenters argued that, among other things, it would be difficult for non-U.S. banking entities to track whether their counterparties were non-U.S. entities and that the Proprietary Trading SOTUS Exception should focus on where the risk of a transaction is booked, not on the identity or location of the counterparties or their personnel.[5]

Responding – at least in part – to this criticism, the Final Rule permits a non-U.S. banking entity to rely on the Proprietary Trading SOTUS Exception while transacting with <u>certain</u> U.S. entities where the locus and the risk of the activity is offshore. Specifically, under the Final Rule, a trade will be considered to take place “solely outside of the United States” if:

> the non-U.S. banking entity that is making the purchase or sale as principal (and the personnel involved in the transaction’s arrangement, negotiation or execution) is outside of the United States;

> the decision to purchase or sell is made outside of the United States;

> the transaction is not booked by any U.S. branch or affiliate of the non-U.S. banking entity;

> no financing for the non-U.S. banking entity’s purchase or sale is provided, directly or indirectly, by any branch or affiliate that is located in the United States or organized under U.S. law; and

> the transaction is not conducted “with or through any U.S. entity,” except as provided below. In this context, the term “U.S. entity” is defined to include any entity that is, or is controlled by, acting on behalf or at the direction of, any other entity that is either located in the United States or organized under U.S. law. The U.S. branches, agencies and affiliates of a non-U.S. banking organization are considered U.S. entities, but the home office of such an organization is not. Transactions with the following U.S. entities, however, are permissible:

- the foreign operations of a U.S. entity (including any affiliates or branches of a U.S. entity that are physically located outside of the United States), provided no personnel of the U.S. counterparty located in the United States are involved with the arrangement, negotiation or execution of the transaction;[6]
- an unaffiliated “market intermediary” (e.g., a broker-dealer or security-based swap dealer registered with the SEC (or exempt from such registration) or a swap dealer or futures commission merchant registered with the CFTC (or exempt from such registration)), acting as principal, provided the transaction is promptly cleared and settled through a clearing agency (a “**CA**”) or derivatives clearing organization (a “**DCO**”); and
- an unaffiliated market intermediary acting as agent, provided the transaction is conducted anonymously on an exchange or similar trading facility and promptly cleared and settled through a CA or DCO.

[6] The Agencies noted that back-office personnel engaged in clearing and settlement of a transaction would not be considered to be involved in the “arrangement, negotiation or execution” of the transaction, though any personnel that serve as decision makers would. Final Rule Supp. Mat. at 422 n.1521.

For example…
A U.K. bank could enter into a short-term proprietary trade in reliance on the SOTUS Exception: > *directly with the U.S. broker-dealer affiliate of a U.S. banking organization so long as the trade was promptly settled and cleared* > *with the London trading desk of the same U.S. banking organization* ***only*** *if no U.S.-based personnel of the U.S. banking organization were involved in the negotiation and execution of the trade* > *with another U.K. bank without restriction, provided that the U.K. bank was not itself controlled by or acting for a U.S. entity* > ***but not*** *with a U.S. counterparty if "through" the U.K. bank's own U.S. broker-dealer affiliate.*

SOTUS Concerns left unaddressed

The Final Rule clearly grants non-U.S. banking entities greater leeway to conduct their offshore proprietary trading operations than the Proposed Rule did. There remain, however, a number of critical issues that will complicate proprietary trading by non-U.S. banks with any U.S. counterparty nexus. As illustrated above, a non-U.S. banking entity can, for example, clearly trade with the U.S. broker-dealer subsidiary of a U.S. banking organization, but it is less clear that it can freely trade with the U.K. subsidiary of the same U.S. banking organization without obtaining representations that none of the counterparty's personnel involved in a particular trade are located in the United States. Notwithstanding that the Proprietary Trading SOTUS Exception is meant to permit trading outside of the United States, it may be easier (in some circumstances) for a U.K. bank to trade with the New York-based broker-dealer subsidiary of a U.S. banking organization than with the London desk of the same bank.

Foreign sovereign debt

By statute, the Volcker Rule permits all banking entities to proprietary trade in U.S. treasuries, U.S. agency securities, and securities issued by U.S. states and municipalities.

In response to pressure from banks and governments, the Agencies have created an exception permitting banking entities to execute proprietary trades in obligations issued or guaranteed by a foreign sovereign, or any agency or political subdivision thereof (collectively, "**Foreign Sovereigns**").[7] The Final Rule permits the U.S. operations of a non-U.S. banking organization to trade in the Foreign Sovereigns of its "home country" unless the entity doing the trading is an

[7] Under the Final Rule, the debt securities of a multinational central bank of which a nation is a member would be considered a Foreign Sovereign of that nation. *See* Final Rule Text § __.6(b).

FDIC-insured depository institution.[8] However, it does not permit trading in the debt of multinational development banks.

For example…
The U.S. broker-dealer subsidiary of a German bank would be permitted to trade: > *in German sovereign debt* > ***but not** in U.K. gilts unless in reliance on market making or another exception.*

Covered Fund ban

Complementing the Volcker Rule's ban on proprietary trading is the ban on investing in, sponsoring or having certain relationships with so-called "Covered Funds." Under the Final Rule, a Covered Fund includes:

> a fund that would be an investment company but for Section 3(c)(1) or 3(c)(7)[9] of the Investment Company Act of 1940;

> a commodity pool the investors of which are institutional investors or high-net worth individuals;[10] and

> for U.S. banks only, a non-U.S. private fund organized or established outside of the United States the ownership interests of which are offered or sold solely outside of the United States ("**Foreign Private Funds**")

Foreign Private Fund exception

The Proposed Rule would have included as a Covered Fund any investment vehicle organized or offered outside of the United States that, if it were organized or offered in the United States, would be considered a Covered Fund. This definition would have swept most alternative vehicles, even those with no connection to the United States, into the Volcker Rule's restrictions.

The Final Rule now exempts Foreign Private Funds altogether from the definition of "Covered Fund" *from the perspective of a non-U.S. banking organization*. (A U.S. banking entity must still treat them as Covered Funds.) As such, a non-U.S.

[8] The Final Rule does not offer an exception for the proprietary trading of non-home country, non-U.S. debt by U.S. affiliates. It also does not contain an exception permitting the non-U.S. banking entities of a non-U.S. banking organization to trade in either home country or local sovereign debt (in the event that the banking entity is located in a jurisdiction outside the home country), though the Agencies indicated that such a non-U.S. banking entity could rely on the Proprietary Trading SOTUS Exception for such trading. Final Rule Supp. Mat. at 374.

[9] Generally, Investment Company Act Section 3(c)(1) exempts from the definition of "investment company" a fund the securities of which are owned by fewer than 100 persons. Section 3(c)(7) generally exempts funds owned only by "qualified purchasers."

[10] A commodity pool is only a Covered Fund if (1) its commodity pool operator claims an exception under Section 4.7 of the CFTC's regulations or (2) substantially all of the participation units of the commodity pool are held by "qualified eligible persons" under Section 4.7(a) of the CFTC's regulations and those participation units have not been publicly offered to anyone who is not a "qualified eligible person." Final Rule Text §__.10(b)(ii).

banking entity can sponsor and invest in a Foreign Private Fund without hewing to every requirement of the SOTUS exception, and, as discussed below, may also more freely transact with the fund.

Foreign public fund exception

The Final Rule also carves out funds that are offered to retail investors "predominantly"[11] through public offerings outside of the United States.[12] As such, a variety of retail investment funds offered around the world, such as UCITS in Europe and unit trusts in Australia, are immune from the complications that may arise from being included within the Covered Fund definition.

Covered bonds exception

The Final Rule now also exempts special purpose vehicles that hold a cover pool of assets collateralizing debt instruments issued by a non-U.S. banking organization (i.e., "covered bonds"). However, to qualify, the cover pool must be comprised only of assets permissible under the carve-out for loan securitizations (e.g., loans, servicing rights and assets, certain rate derivatives, and collateral certificates). While the U.S. market for covered bonds is relatively small, the covered bond market outside of the United States is significantly better developed, and thus, the exception for covered bond vehicles will be beneficial for non-U.S. banks.

Permitted sponsorship or investment in Covered Funds

In addition to the important carve-outs added by the Final Rule discussed above, which are of particular importance to non-U.S. banks, the Final Rule retains the statutory exceptions for other Covered Fund activity on which all banks can continue to rely. Among other things, those exceptions allow a banking entity to:

> sponsor, underwrite and make markets in the securities of a Covered Fund in connection with the provision of *bona fide* trust, fiduciary, investment advisory or commodity trading advisory services (the "**Asset Management Exception**");

> make seeding and *de minimis* investments in Covered Funds that it organizes and offers pursuant to the Asset Management Exception;

> purchase interests in a Covered Fund for risk-mitigating hedging purposes; and

> for non-U.S. banks only, make investments in and sponsor Covered Funds if done "solely outside of the United States" (the "**Covered Fund SOTUS Exception**"), discussed in more detail below.

---

[11] The Agencies indicated that an offering would be considered to be predominantly outside of the United States if 85% or more of the fund's interests are sold to investors that are not residents of the United States.

[12] If a U.S. banking organization sponsors a foreign public fund, certain restrictions on the banking organization's ability to invest in the fund apply.

Covered Fund SOTUS Exception

The complete carve-out for Foreign Private Funds will undoubtedly diminish the importance of the Covered Fund SOTUS Exception, although it may still be useful for investments (i) in U.S.-organized funds and (ii) hedge funds or other vehicles engaged in proprietary trading activities. It generally tracks the "solely outside the United States" elements of the Proprietary Trading SOTUS Exception, but additionally requires that the offering of interests in the Covered Fund not "target" residents of the United States. The Final Rule does not define "target," although the preamble suggests that, in order to avoid "targeting" U.S. residents:

> offering materials should include a prominent disclaimer that the offering is not made in the United States or to residents of the United States;

> fund sponsors should use other reasonable procedures to restrict access to offering and subscription materials to persons that are not residents of the United States; and

> non-U.S. banking entities should take care not to send marketing materials into the United States or engage in discussions with persons located in the United States.

The Final Rule fails to distinguish clearly between funds that are sponsored by the foreign bank, where offering and sales are by definition within its control, and those in which the bank has no role other than that of passive investor. Equally, it offers little guidance on a question with which many foreign banks have been wrestling as they structure their private equity activities in anticipation of the Final Rule: under what circumstances can a non-U.S. bank rely on the SOTUS exception for its investment in a non-U.S. fund that accepts no U.S. investors but that participates in an investment strategy shared with a fund that accepts U.S. investors? Put differently, how "parallel" must a parallel vehicle be in order to be respected as a separate Covered Fund?

For example…
A U.K. bank > *can make an investment of any size in an Asian real estate fund that is sponsored and managed by a third-party asset manager so long as it is not offered to U.S. investors;* > ***but cannot*** *make even a 3% investment in the same Asian real estate fund if it is offered to U.S. investors. It cannot rely on the de minimis exception since it is not the manager of the fund, or on the SOTUS exception, given that the fund was offered to U.S. investors.* ***However****, it may be able to structure its investment through a parallel vehicle so that it can rely on the Foreign Private Fund exception.*

Super 23A

In addition to the ban on sponsorship and investment, the Volcker Rule completely prohibits a banking entity from entering into a "covered transaction," as defined in Section 23A of the Federal Reserve Act,[13] with any Covered Fund that it advises or sponsors (the "**Super 23A Restrictions**"). As such, a banking entity may generally not extend credit to a Covered Fund that it (permissibly) advises or sponsors, nor may it generally enter into a swap transaction with such a Covered Fund if the swap would result in a credit exposure to the Covered Fund.[14] The Super 23A Restrictions apply even if a banking entity is able to identify an exception permitting it to sponsor or invest in a Covered Fund. One of the key benefits of the Foreign Private Fund exception may be that a non-U.S. bank will apparently not be constrained by Super 23A in its dealings with a Foreign Private Fund.

For example…
A Swiss bank: > *can sponsor and advise a hedge fund organized in the Cayman Islands and sell interests to its clients globally in reliance on the Asset Management Exception provided the various criteria of that exception are met. However, all transactions with the hedge fund are subject to Super 23A* > *can sponsor and advise a private equity fund organized in the Cayman Islands and sell interests exclusively to non-U.S. residents in reliance on the Foreign Private Fund exception. It can also extend credit to the fund to finance the purchase of portfolio companies.*

[13] 12 U.S.C. § 371c. A "covered transaction" under Section 23A includes (1) loans or extensions of credit by a bank to an affiliate, (2) the purchase by a bank of an affiliate's securities, (3) asset purchases by a bank from an affiliate, (4) the acceptance by a bank of an affiliate's securities as collateral, and (5) the issuance by a bank of a guarantee, acceptance or letter of credit on behalf of an affiliate. The Dodd-Frank Act amended Section 23A to include derivative transactions that create a credit exposure between a member bank and its affiliates. Under the Volcker Rule, a banking entity must treat itself as a member bank and a Covered Fund that it sponsors, advises or is invested in as an affiliate, and is completely barred from any "covered transactions."

[14] Notably, the Agencies made clear that the Volcker Rule's ban on Section 23A "covered transactions" applies *only* to transactions between a banking entity (or its affiliates) and a Covered Fund, not to "covered transactions" between a banking entity and a third party for the benefit of the banking entity. The Agencies explained that Section 23A can, in some circumstances, apply to such third-party transactions, but such an application to a banking entity-third party transaction was inconsistent with the Volcker Rule's statutory language. Thus, for instance, a banking entity can apparently lend moneey to a customer so that the customer could purchase shares in the Covered Fund. Both of these transactions would be covered by Section 23A, but are not subject to the Super 23A Restrictions. Final Rule Supp. Mat. at 756-57.

Compliance program requirements

The Final Rule requires all large banking organizations to adopt a compliance program "designed to ensure and monitor compliance with the prohibitions and restrictions on proprietary trading and covered fund activities and investments" of the Volcker Rule.[15] The compliance program requirement is tiered such that a banking organization with a large book of U.S. assets or which engages in a significant volume of conduct regulated by the Volcker Rule (as detailed in the table below) must establish a more significant compliance program.

The most basic compliance program required under the Final Rule requires the following components (the "**Base Compliance Requirements**"):

> Written policies and procedures;

> Internal controls designed to monitor compliance;

> A management framework that delineates responsibility for compliance;

> Independent testing of the compliance program's effectiveness;

> Training for appropriate personnel; and

> Recordkeeping sufficient to demonstrate compliance.

Enhanced compliance requirements, described in Appendix B of the Final Rule, are imposed on banking entities that meet certain asset thresholds or meet other criteria. Further, banking entities with significant "trading assets" are required to report certain metrics to the Agency that supervises them. The applicability of these requirements is described in the table below:

Applicability of Compliance Requirements		
	U.S. banking entities	Non-U.S. banking entities
Base Compliance Requirements	All banking entities except for (1) banking entities that do not engage in proprietary trading or Covered Fund activities or investments, and (2) banking entities with $10 billion or less in total consolidated assets (though such banking entities must still update their existing compliance programs to reflect the Volcker Rule's requirements). The $10 billion threshold does not distinguish between U.S. and non-U.S. assets.	
Appendix A reporting requirements	Any banking entity that: > engages in proprietary	Any banking entity that: > engages in proprietary

[15] Final Rule Text § __.20(a).

	trading; and > has "trading assets and liabilities"[16] of greater than $50 billion (on June 30, 2014), $25 billion (on April 30, 2016) or $10 billion (on December 31, 2016)	trading; and > has "trading assets and liabilities" in its "combined U.S. operations"[17] of greater than $50 billion (on June 30, 2014), $25 billion (on April 30, 2016) or $10 billion (on December 31, 2016)
Appendix B enhanced compliance	Any banking entity that: > is subject to Appendix A reporting requirements; or > has assets of $50 billion or more	Any banking entity that: > is subject to Appendix A reporting requirements; or > has total assets of $50 billion or more in its combined U.S. operations

In addition to the compliance and documentation requirements laid out in the Appendices, the Agencies included a number of more specific requirements that must be satisfied with respect to individual exceptions from the Volcker Rule's prohibitions. Importantly, all of a non-U.S. bank's activities are subject to the compliance and reporting requirements to the same extent as a U.S. bank. Thus, even though many of the threshold triggers for the enhanced reporting and compliance requirements are on the basis of assets held in a non-U.S. bank's combined U.S. operations, the requirement, once triggered, applies across the global bank.

Effective dates

By the terms of the statute, the Volcker Rule became effective on July 21, 2012. The statute provides a "conformance period" during which banking entities are to bring their activities into line with the Volcker Rule's requirements, which expires on July 21, 2014, just over seven months after the Final Rule's adoption. In recognition of this short time frame, the Fed has granted a blanket one-year extension of the conformance period to July 21, 2015 for all banking entities, granting them additional time to comply with the Final Rule's requirements.[18] The

[16] The phrase "trading assets" is not defined in the Final Rule. In the context of existing Fed reporting requirements, however, "trading assets" include those assets connected with underwriting or dealing in securities or derivatives, positions taken "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 positions taken "as an accommodation to customers or for other trading purposes." Line-Item Instructions for Schedule HC-D (Trading Assets and Liabilities), *available at* http://www.federalreserve.gov/reportforms/forms/FR_Y-9C20130930_i.pdf.

[17] A non-U.S. bank's "combined U.S. operations" includes all of its subsidiaries, affiliates, branches and agencies located, operating or organized in the United States.

[18] Order Approving Extension of Conformance Period, *available at* http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20131210b1.pdf.

Fed is also empowered to further extend the conformance in one-year increments until July 21, 2017. As noted above, however, certain U.S. and non-U.S. banking entities will be required to commence reporting their trading metrics as of June 30, 2014.

Conclusion

While implementing the Volcker Rule will be costly for all banking organizations (and will have knock-on effects in other industries and markets as well), the Final Rule does offer something of a silver lining for non-U.S. banking organizations, at least when compared to the Proposed Rule. The modifications to the Proprietary Trading SOTUS Exception, in particular, promise to give non-U.S. banking organizations somewhat greater flexibility to engage in proprietary trading, particularly with respect to securities and other financial instruments traded with U.S. counterparties or on U.S. markets.

Perhaps the most important aspect of the Agencies' issuance of the Final Rule is that it happened – with the Final Rule now finally published, non-U.S. banking organizations can begin structuring their operations, compliance programs and transactions without the ambiguity that had loomed over them during the pendency of the Proposed Rule. Of course, the costs and limitations imposed by the Final Rule will be substantial – some press reports released before the Final Rule was issued estimated that a strict implementation of the Volcker Rule could cost the eight largest U.S. banking organizations as much as $10 billion.[19] Whether the Volcker Rule ultimately proves to be a boon to U.S. financial stability remains to be seen, and in all likelihood, will be the subject of vigorous debate for years to come.

The next step for banking organizations, both in the United States and abroad, will be to continue the process of reviewing worldwide activities and investments and conforming them to the Volcker Rule's requirements, now guided by the Final Rule's provisions. A key component, and no doubt one of the most costly, will be implementing the compliance and reporting systems required by the Final Rule. Non-U.S. banks should invest the resources necessary to ensure that their systems are sufficient to mitigate the regulatory risk of their activities, even if they intend to rely on the Final Rule's exceptions to continue their operations as they are. Doing so could be the difference between avoiding and facing significant (and costly) regulatory consequences down the road.

[19] Deborah Solomon, *Live Blogging the Volcker Rule*, The Wall Street J. (Dec. 10, 2013), *available at* http://blogs.wsj.com/moneybeat/2013/12/10/live-blogging-the-volcker-rule/.

Linklaters

If you have any questions, please contact the people on the right or your usual Linklaters contacts.

Contacts

For further information please contact:

Robin Maxwell
Partner

(+1) 212 903 9147

robin.maxwell@linklaters.com

Jacques Schillaci
Associate

(+1) 212 903 9341

jacques.schillaci@linklaters.com