

**Final Volcker Rule Amended Regulations  
(Volcker 2.0 – Prop)**

September 11, 2019



The original regulations implementing Section 13 of the Bank Holding Company Act of 1956 (commonly known as the Volcker Rule) were adopted by the five Volcker Rule agencies—the Federal Reserve, FDIC, OCC, SEC and CFTC (**Agencies**)—in 2013. The Agencies amended these regulations relating to the proprietary trading portion of the Volcker Rule in 2019 (**2019 Amended Regulations** or **Volcker 2.0 - Prop**). The 2019 Amended Regulations have been formally adopted only by the OCC and FDIC as of the date of these Davis Polk flowcharts, but the other Agencies are expected to adopt them in substantially identical form over the next few weeks.

The 2019 Amended Regulations are effective January 1, 2020, with compliance required by January 1, 2021. Banking entities may elect to voluntarily comply, in whole or in part, with the 2019 Amended Regulations after January 1, 2020.

These Davis Polk flowcharts are designed to assist firms in determining whether they are banking entities subject to the Volcker Rule and its implementing regulations and, if so, to assist those banking entities in identifying permissible and impermissible proprietary trading activities under the Volcker Rule’s implementing regulations, as modified by the 2019 final amendments and earlier amendments adopted under the Economic Growth, Regulatory Relief and Consumer Protection Act.

**Step 1**  
**1** IS THE BANKING ENTITY ENGAGED IN PROPRIETARY TRADING UNDER THE VOLCKER RULE?

IS THERE A BANKING ENTITY INVOLVED?	2
DOES THE ACTIVITY OR TRANSACTION INVOLVE A PURCHASE OR SALE BY THE BANKING ENTITY OF ONE OR MORE FINANCIAL INSTRUMENTS?	3
IS THE BANKING ENTITY TRADING AS PRINCIPAL FOR A TRADING ACCOUNT?	4
IS AN EXCLUSION FROM PROPRIETARY TRADING AVAILABLE?	5 – 6

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**2** IS THE PROPRIETARY TRADING PERMITTED UNDER THE VOLCKER RULE?

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Step 1

SLIDES 2 TO 6

**IS A BANKING ENTITY ENGAGED IN PROPRIETARY TRADING UNDER THE VOLCKER RULE?**

- Is there a **banking entity** involved?
- Does the activity or transaction involve a purchase or sale by the banking entity of one or more **financial instruments**?
- Is the entity trading as principal for a **trading account**?
- Is an **exclusion** from proprietary trading available?

ACTIVITY IS NOT PROPRIETARY TRADING AND IS NOT WITHIN THE SCOPE OF THE VOLCKER RULE

NO (OR IF AN EXCLUSION IS AVAILABLE)

YES (OR IF NO EXCLUSION IS AVAILABLE)

Step 2

SLIDES 7 TO 16

**IS THE PROPRIETARY TRADING PERMITTED UNDER THE VOLCKER RULE?**

- Market Making and Underwriting Activities
- Risk-Mitigating Hedging Activities
- Trading in US Government Obligations
- Trading in Foreign Government Obligations
- Trading on Behalf of Customers
- Trading by a Regulated Insurance Company
- Trading Activities of Foreign Banking Entities Outside the United States

NO

ACTIVITY IS IMPERMISSIBLE PROPRIETARY TRADING

YES

Step 3

SLIDE 17

**IS THE ACTIVITY PRECLUDED BY A BACKSTOP PROHIBITION?**

Does the activity:

- Involve or result in a material conflict of interest between the banking entity and its clients, customers or counterparties?
- Result in a material exposure by the banking entity to high-risk assets or trading strategies?
- Pose a threat to the safety and soundness of the banking entity or U.S. financial stability?

YES

Tiered compliance program requirements apply for Significant TAL and Moderate TAL Banking Entities. Significant TAL Banking Entities must also report metrics.

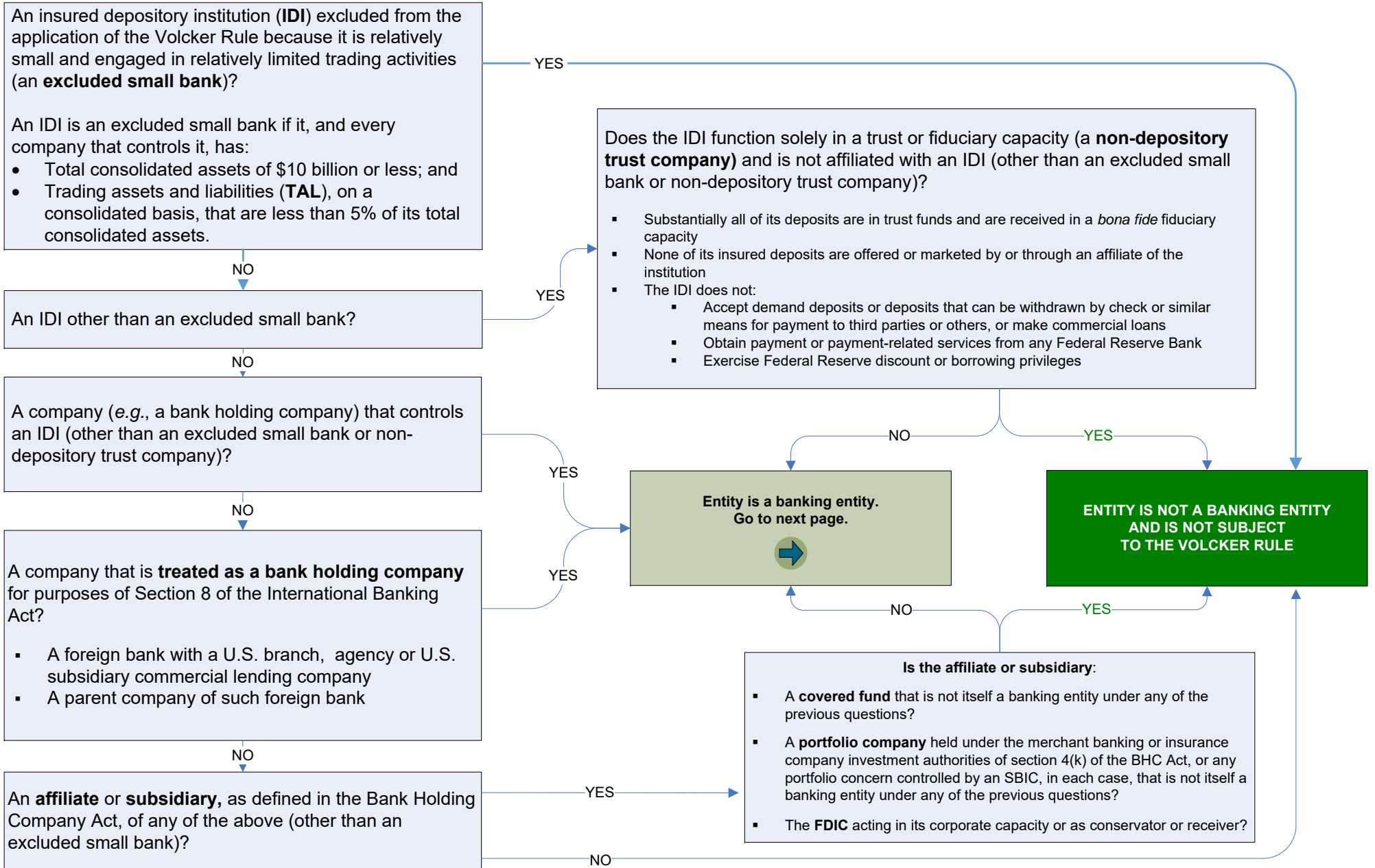
NO

SLIDES 19 TO 24

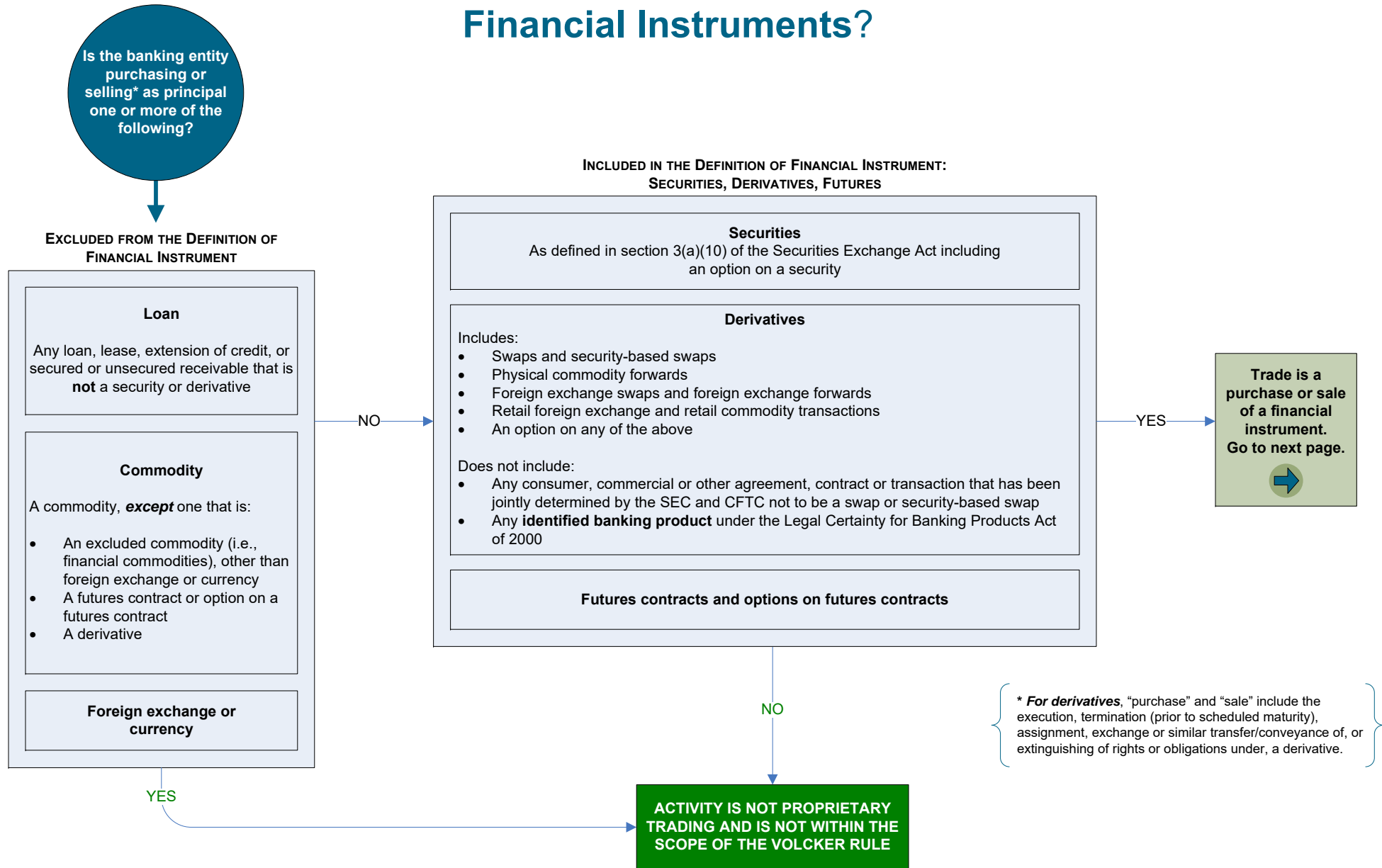
ACTIVITY IS PERMITTED PROPRIETARY TRADING



Is the entity:



# Does the Activity or Transaction Involve a Purchase or Sale by the Banking Entity of One or More Financial Instruments?



# Step 1C: Is the Banking Entity Trading as Principal for a Trading Account?

\***Account** does not refer to an account in the normal business or accounting sense. The preamble notes that trading account is nomenclature for the set of transactions that are subject to the restrictions on proprietary trading.

Are the following tests satisfied?

### DEALER TEST

Regardless of purpose, does the banking entity meet either of the following descriptions?

- The banking entity is **licensed or registered** to engage in the business of a **dealer**, a **swap dealer**, or a **security-based swap dealer** (or required to be).
- The banking entity **engages in the business** of a dealer, swap dealer or security-based swap dealer **outside of the United States**.

**AND**

The financial instrument is purchased or sold in connection with the activities that require the banking entity to be licensed/registered as a dealer or are in connection with the activities of such business outside the United States, as relevant.

### SHORT-TERM INTENT TEST

Is the **account**\* used to purchase or sell one or more financial instruments **principally for the purpose of any** of the following?

- Short-term resale
- Benefitting from **actual or expected** short-term price movements
- Realizing **short-term arbitrage** profits
- Hedging** one or more such positions

A purchase or sale of a financial instrument will be **presumed not** to be for a trading account if the banking entity:

- holds the instrument for **60 days or longer**, and
- does not **substantially transfer its risk** within 60 days.

### MARKET RISK CAPITAL (MRC) TEST

Is the banking entity, or any affiliate of the banking entity, an insured depository institution, a bank holding company or a savings and loan company that calculates risk-based capital ratios under the U.S. banking agencies' market risk capital rule?

OR

If the banking entity does not calculate risk-based capital ratios under the U.S. market risk capital rule, has the banking entity made an election to assess its trading account as if it were subject to the U.S. market risk capital rule?

A banking entity must apply this election **consistently across itself and all of its wholly-owned subsidiaries**.

YES

Is the account used to purchase or sell financial instruments that are both covered positions and trading positions (or hedges of such covered positions) under the U.S. market risk capital rule?

\*\*If a banking entity is or elects to be subject to the MRC Test, then it is not subject to the Short-Term Intent Test.

\*See slide 6 for further details. ➡

**ACTIVITY IS NOT PROPRIETARY TRADING AND IS NOT WITHIN THE SCOPE OF THE VOLCKER RULE**

NO TO ALL APPLICABLE TESTS

YES TO ANY APPLICABLE TEST

Entity is trading as principal for a trading account. Go to the next page. ➡



Does the purchase or sale meet any of the following criteria?

**REPO AND REVERSE REPO**

**Repo** or **reverse repo** pursuant to which the banking entity has simultaneously agreed, in writing, to both purchase and sell a stated asset, at a stated price and on stated dates or on demand with the same counterparty.

**SECURITIES LENDING**

**Securities lending transaction** in which the banking entity lends or borrows a security temporarily to or from another party pursuant to a written securities lending agreement under which the lender retains the economic interests of an owner of such security, and has the right to terminate the transaction and to recall the loaned security on terms agreed by the parties.

**LIQUIDITY MANAGEMENT PLAN**

Purchase or sale of a security, deliverable foreign exchange forward, deliverable foreign exchange swap or cross-currency swap for the purpose of **liquidity management** in accordance with a documented liquidity management plan of the banking entity.

**DCO/CLEARING AGENCY TRANSACTIONS**

Made by a banking entity that is a **derivatives clearing organization** or a **clearing agency** in connection with clearing financial instruments.

**LIMITED CLEARING MEMBER ACTIVITIES**

Made by a banking entity that is a member of a **clearing agency, derivatives clearing organization** or **designated financial market utility**, in specified circumstances.

**SATISFY AN EXISTING DELIVERY OR LEGAL OBLIGATION**

Made by a banking entity to satisfy:

- an **existing delivery obligation** of the banking entity or its customers, including to prevent or close out a failure to deliver.
- an obligation of the banking entity in connection with a **judicial, administrative, self-regulatory organization or arbitration proceeding**.

Is the banking entity trading in accordance with a documented liquidity management plan that meets specified requirements?

These circumstances include any purchase or sale:

- necessary to correct trading errors made by or on behalf of a customer;
- in connection with and related to the management of a default or threatened imminent default of a customer;
- in connection with and related to the management of a default or threatened default of the clearinghouse or financial market utility;
- in connection with and related to the management of a default or threatened default of another member of the clearinghouse or financial market utility; or
- required by the rules of the clearinghouse or financial market utility to mitigate the risk resulting from the clearing by a member of security-based swaps that reference the member or an affiliate of the member.

YES TO ANY QUESTION

ACTIVITY IS NOT PROPRIETARY TRADING AND IS NOT WITHIN THE SCOPE OF THE VOLCKER RULE

Go to the next page.



NO TO ALL QUESTIONS



Does the purchase or sale meet any of the following criteria?

**ACTING AS AGENT, BROKER OR CUSTODIAN**

Made by the banking entity acting solely as **agent, broker or custodian**.

**EMPLOYEE COMPENSATION PLANS**

Made through a **deferred compensation, stock-bonus, profit-sharing or pension plan of the banking entity** that is established in accordance with the law of the United States or a foreign sovereign, if the purchase or sale is made directly or indirectly by the banking entity **as trustee** for the benefit of persons who are or were employees of the banking entity.

**DEBT PREVIOUSLY CONTRACTED**

Made in the ordinary course of collecting a debt previously contracted in good faith, provided that the banking entity divests the financial instrument as soon as practicable, and does not retain such investment for longer than the period permitted by its primary regulatory agency.

**ERROR TRADES**

Made in error by a banking entity in the course of conducting a permitted or excluded activity or a subsequent transaction to correct such an error.

**MATCHED, CUSTOMER-DRIVEN DERIVATIVE TRANSACTIONS**

Made by the banking entity contemporaneously with also entering into a customer-driven swap or security-based swap and a matched swap or security-based swap if:

- The banking entity retains no more than minimal price risk; and
- The banking entity is not a registered broker-dealer, swap dealer or security-based swap dealer.

**HEDGES OF MORTGAGE SERVICING RIGHTS OR ASSETS**

Used by the banking entity to hedge mortgage servicing rights or mortgage servicing assets in accordance with a documented hedging strategy.

**NON-TRADING ASSETS OR LIABILITIES**

Is the 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 the banking entity as of January 1, 2020.

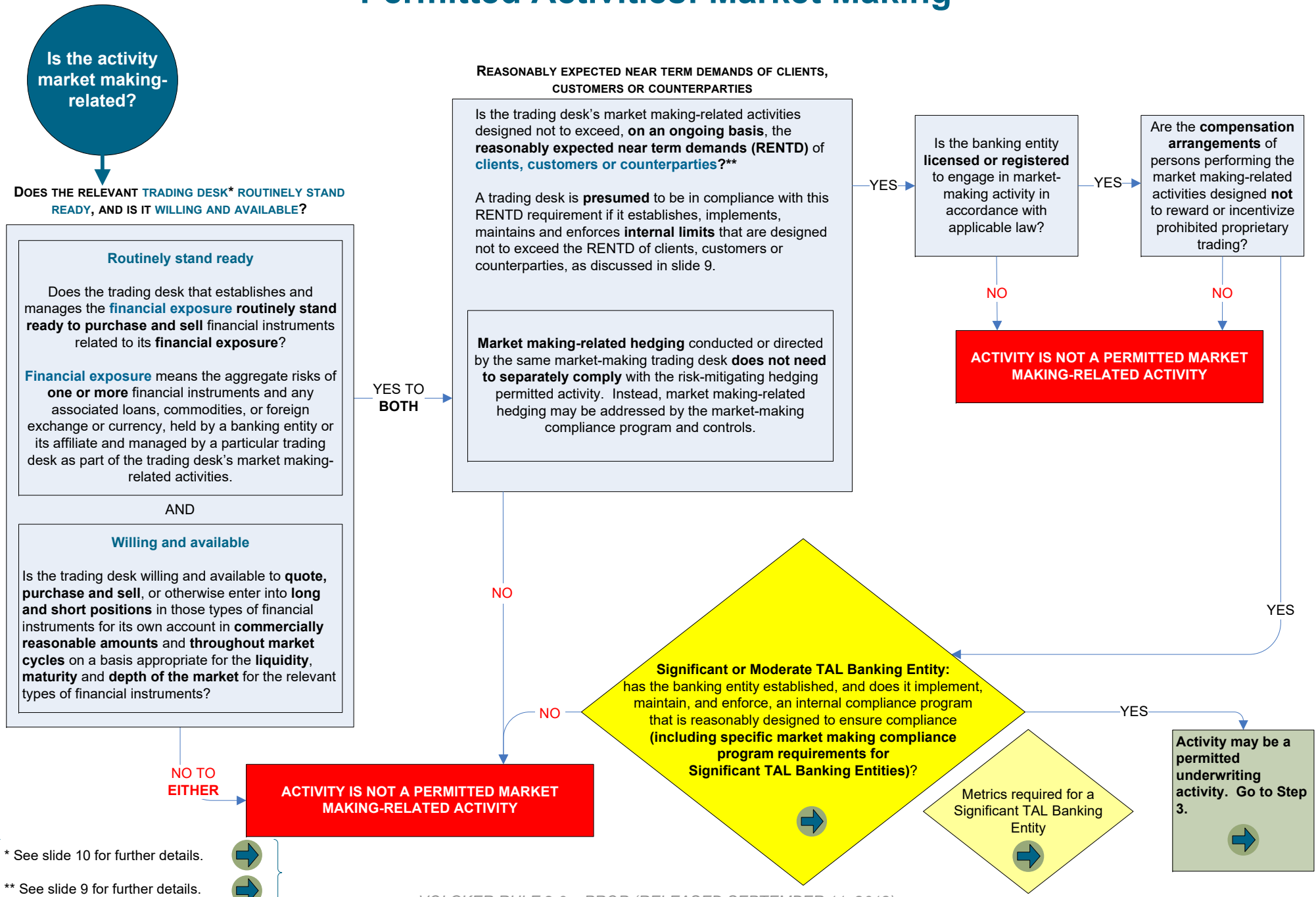
YES TO ANY QUESTION

**ACTIVITY IS NOT PROPRIETARY TRADING AND IS NOT WITHIN THE SCOPE OF THE VOLCKER RULE**

NO TO ALL QUESTIONS

The trading activity is proprietary trading within the scope of the Volcker Rule. Go to Step 2.

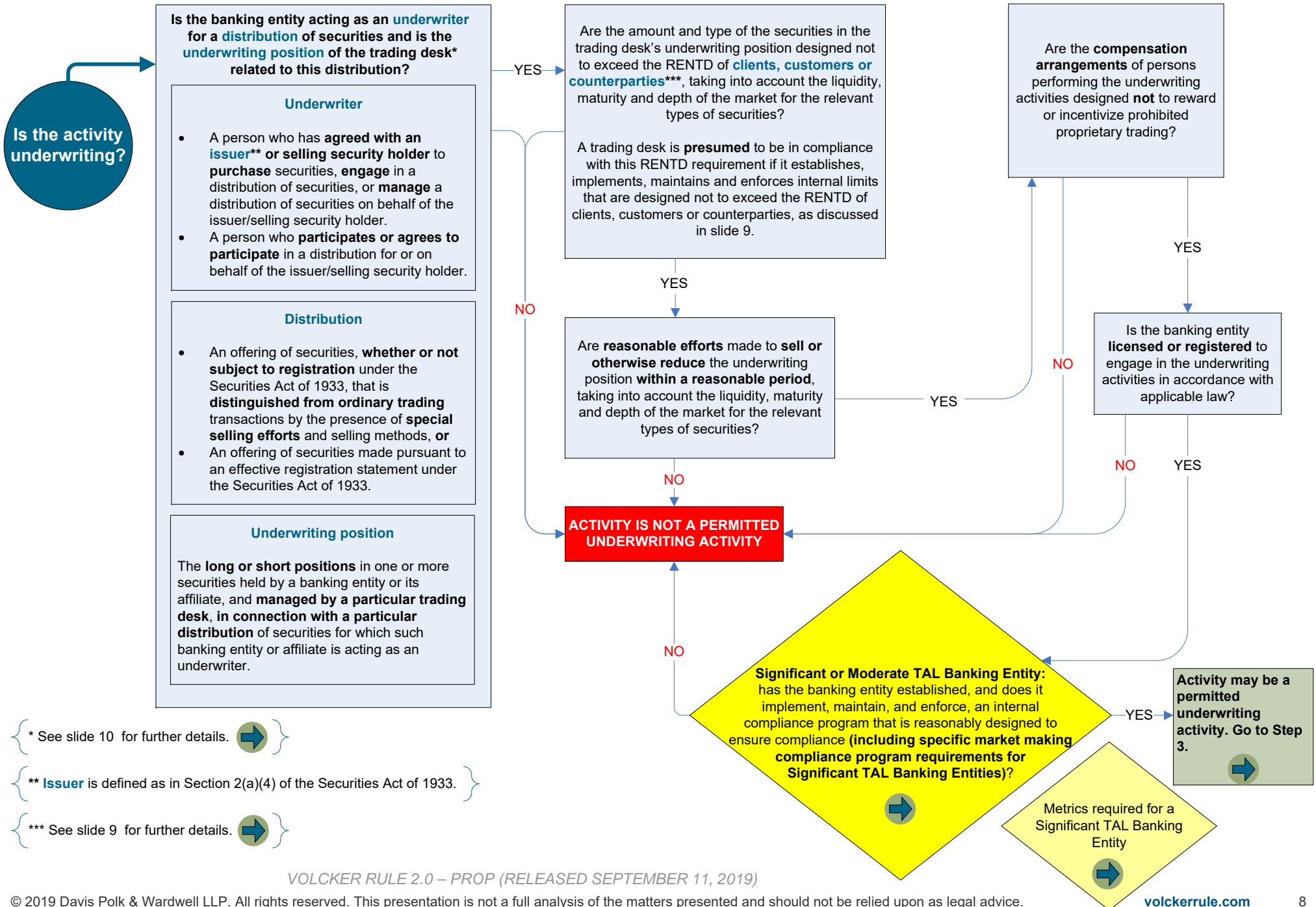




\* See slide 10 for further details.

\*\* See slide 9 for further details.

# Step 2A-2: Permitted Activities: Underwriting



{ \* See slide 10 for further details. → }

{ \*\* Issuer is defined as in Section 2(a)(4) of the Securities Act of 1933. }

{ \*\*\* See slide 9 for further details. → }



# Permitted Activities: Market Making and Underwriting

## Key Terms and Concepts

**CLIENT, CUSTOMER OR COUNTERPARTY**

For the market making-related permitted activity, **client, customer or counterparty** refers to market participants that make use of the banking entity's market making-related services by obtaining such services, responding to quotations, or entering into a continuing relationship with respect to such services.

A trading desk may engage in **interdealer trading** to meet the RENTD of its clients, customers or counterparties, including current demand, unwind or sell positions acquired from clients, customers or counterparties, or engage in risk-mitigating or inventory management transactions. However, a trading desk or other organizational unit of another banking entity is not a client, customer or counterparty of the trading desk if that other entity has **trading assets and liabilities of \$50 billion or more**, unless:

- the trading desk **documents how and why** a particular trading desk or other organizational unit of the entity should be treated as a client, customer, or counterparty of the trading desk for purposes of market making-related permitted activity; **or**
- the purchase or sale by the trading desk is conducted **anonymously** on an **exchange or similar** trading facility that permits trading on behalf of a broad range of market participants.

**INTERDEALER TRADING**

Banking entities are not permitted to treat **affiliated trading desks** as clients, customers or counterparties, but certain transactions between affiliated trading desks may still be permitted as market making-related permitted activity if they do not require the expansion of the trading desks' market-making limits.

For the underwriting permitted activity, **client, customer or counterparty** refers to market participants that may transact with the banking entity in connection with a particular distribution for which the banking entity is acting as underwriter.

**PRESUMPTION OF COMPLIANCE**

A **market making** trading desk is **presumed to comply** with the requirement that its market-making related activities are designed not to exceed, on an ongoing basis, RENTD if it establishes, implements, maintains and enforces **internal limits** that are designed not to exceed RENTD, based on the nature and amount of the trading desk's market-making related activities, on the:

- amount, types and risks of its market-maker positions;
- amount, types and risks of the products, instruments and exposures the trading desk may use for risk management purposes;
- level of exposures to relevant risk factors arising from its financial exposure; and
- period of time a financial instrument may be held.

An **underwriting** trading desk is **presumed to comply** with the requirement that its market-making related activities are designed not to exceed RENTD if it establishes, implements, maintains and enforces **internal limits** that are designed not to exceed RENTD, based on the nature and amount of the trading desk's underwriting activities, on the:

- amount, types and risk of its underwriting position;
- level of exposures to relevant risk factors arising from its underwriting position; and
- period of time a security may be held.

Banking entities will be required to maintain records regarding any limit that is exceeded and any temporary or permanent increase to any limits and make those records available to Agencies upon request.

The presumption of compliance will continue to be available if an internal risk limit is exceeded or if the banking entity increases an internal risk limit if the banking entity takes action as promptly as possible after the breach to bring the trading desk into compliance and follows established written authorization procedures, including escalation procedures.

An Agency may **rebut the presumption** of compliance it determines, taking into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments and based on all relevant facts and circumstances, that a trading desk is engaging in activity that is not based on the trading desk's RENTD.



## Permitted Activities: Market Making and Underwriting

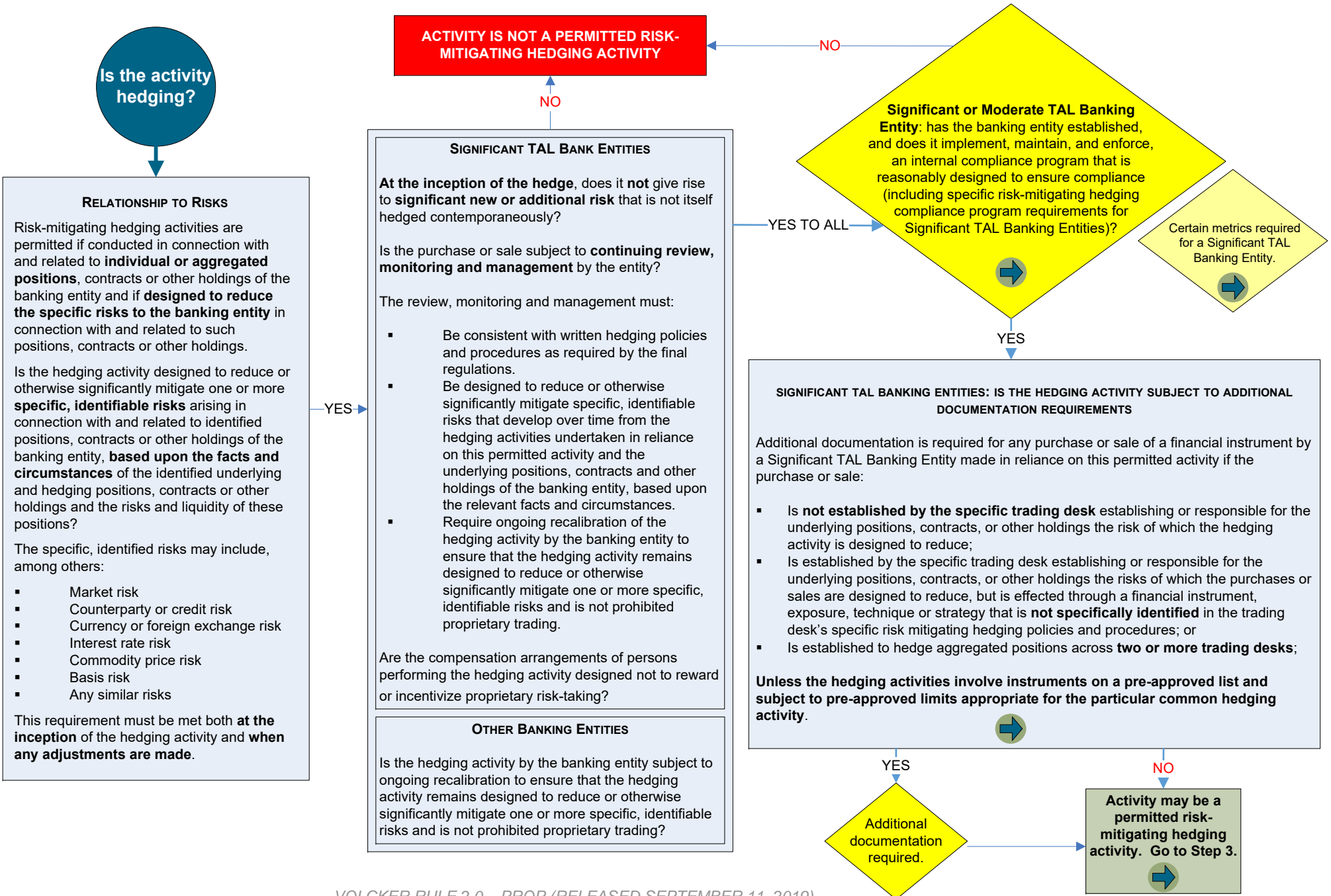
### Key Terms and Concepts

#### TRADING DESK

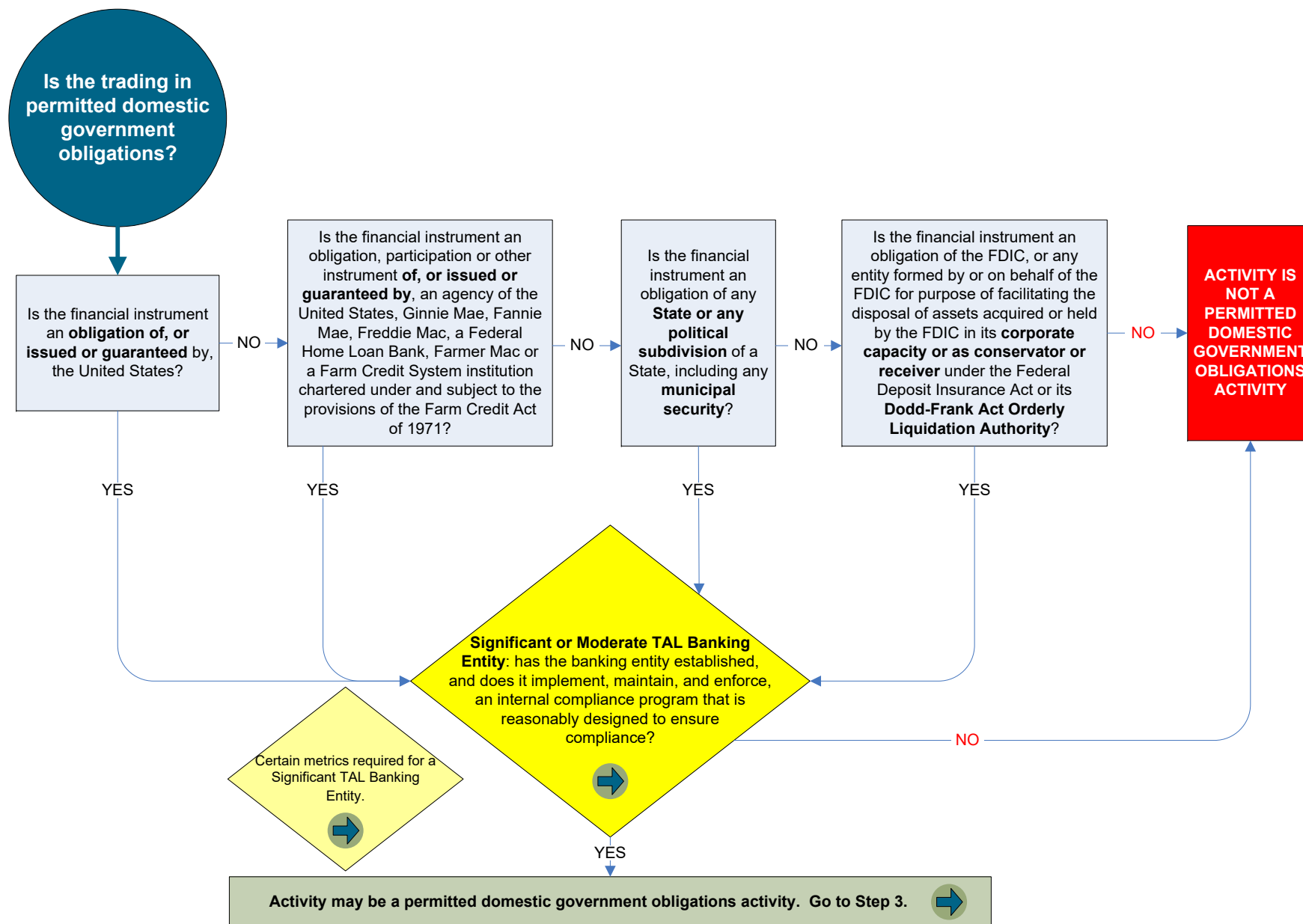
A unit of organization of a banking entity that purchases and sells financial instruments for the trading account of the banking entity or an affiliate that is:

- Structured by the banking entity to implement a well-defined business strategy; 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 characterized by a clearly-defined unit that typically:
  - engages in coordinated trading activity with a unified approach to its key elements;
  - operates subject to a common and calibrated set of risk metrics, risk levels and joint trading limits;
  - submits compliance reports and other information as a unit for monitoring by management; **and**
  - books its trades together.
- **Or**, for a banking entity that calculates risk-based capital ratios under the U.S. market risk capital rule, or a consolidated affiliate for regulatory reporting purposes of a banking entity that calculates risk-based capital ratios under the U.S. market risk capital rule, established by the banking entity or its affiliate for purposes of market risk capital calculations under the U.S. market risk capital rule.

# Permitted Activities: Risk-Mitigating Hedging

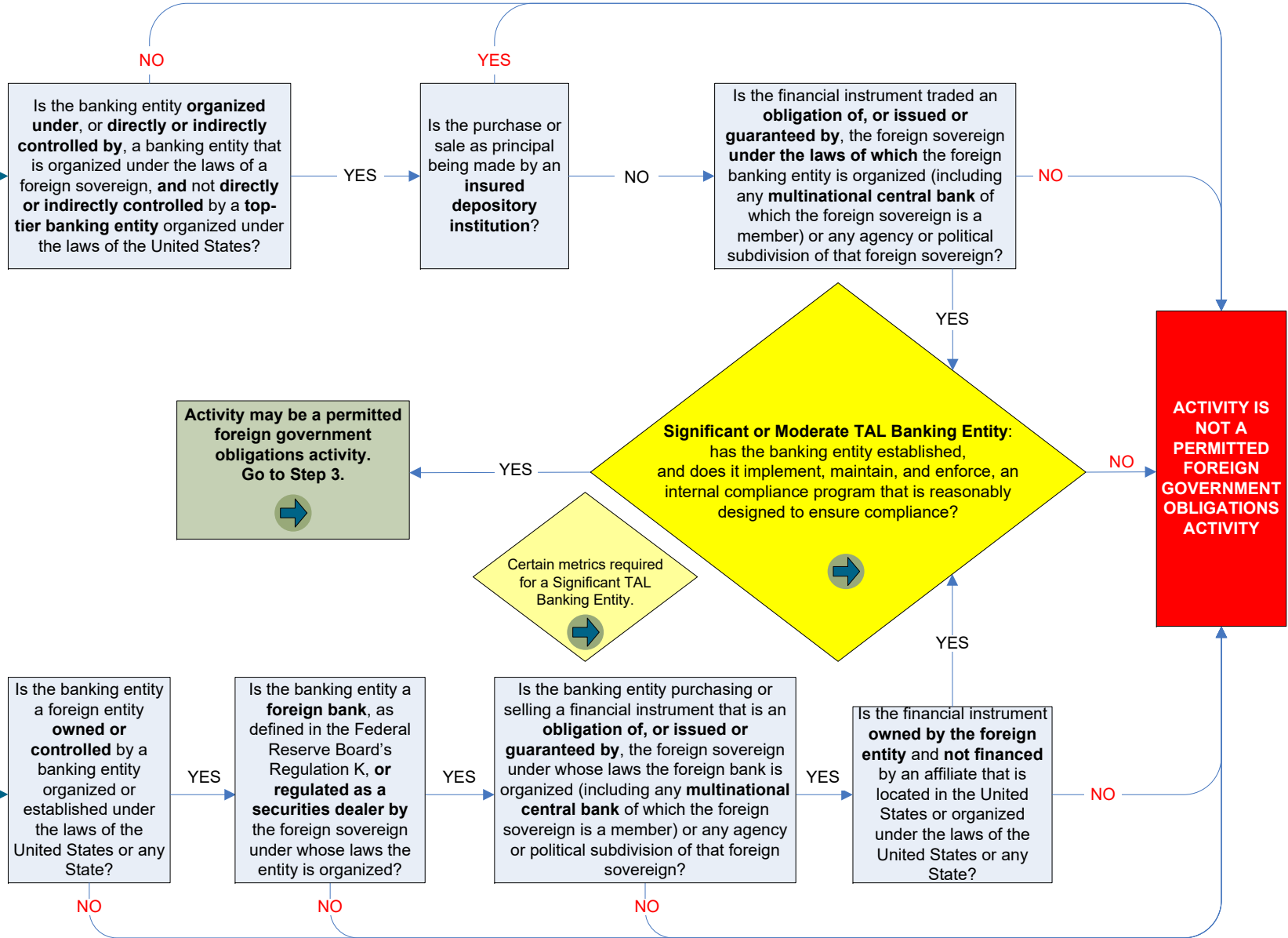


U.S. Government, Agency and Municipal Obligations

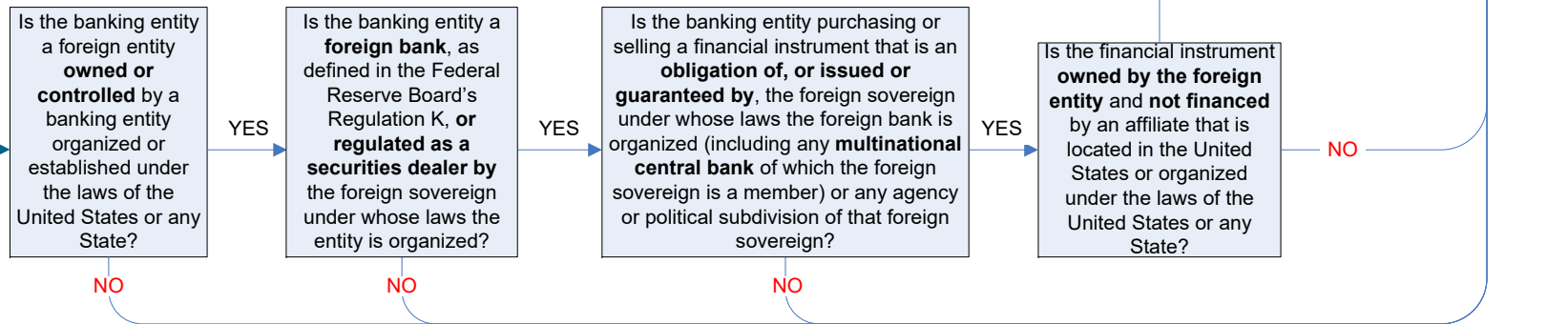


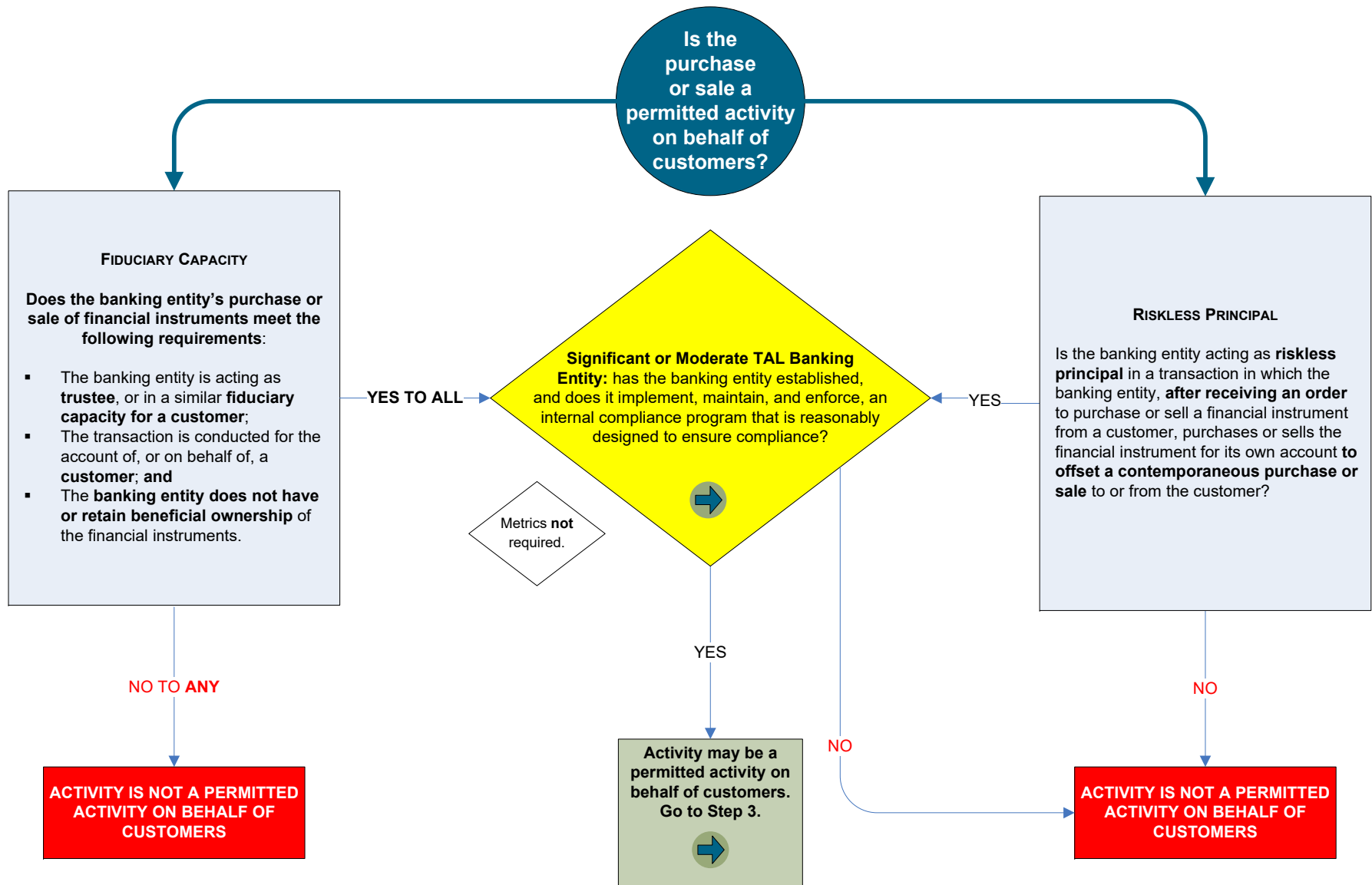


U.S. AFFILIATES OF FOREIGN BANKING ENTITIES (AND FOREIGN BANKING ENTITIES)

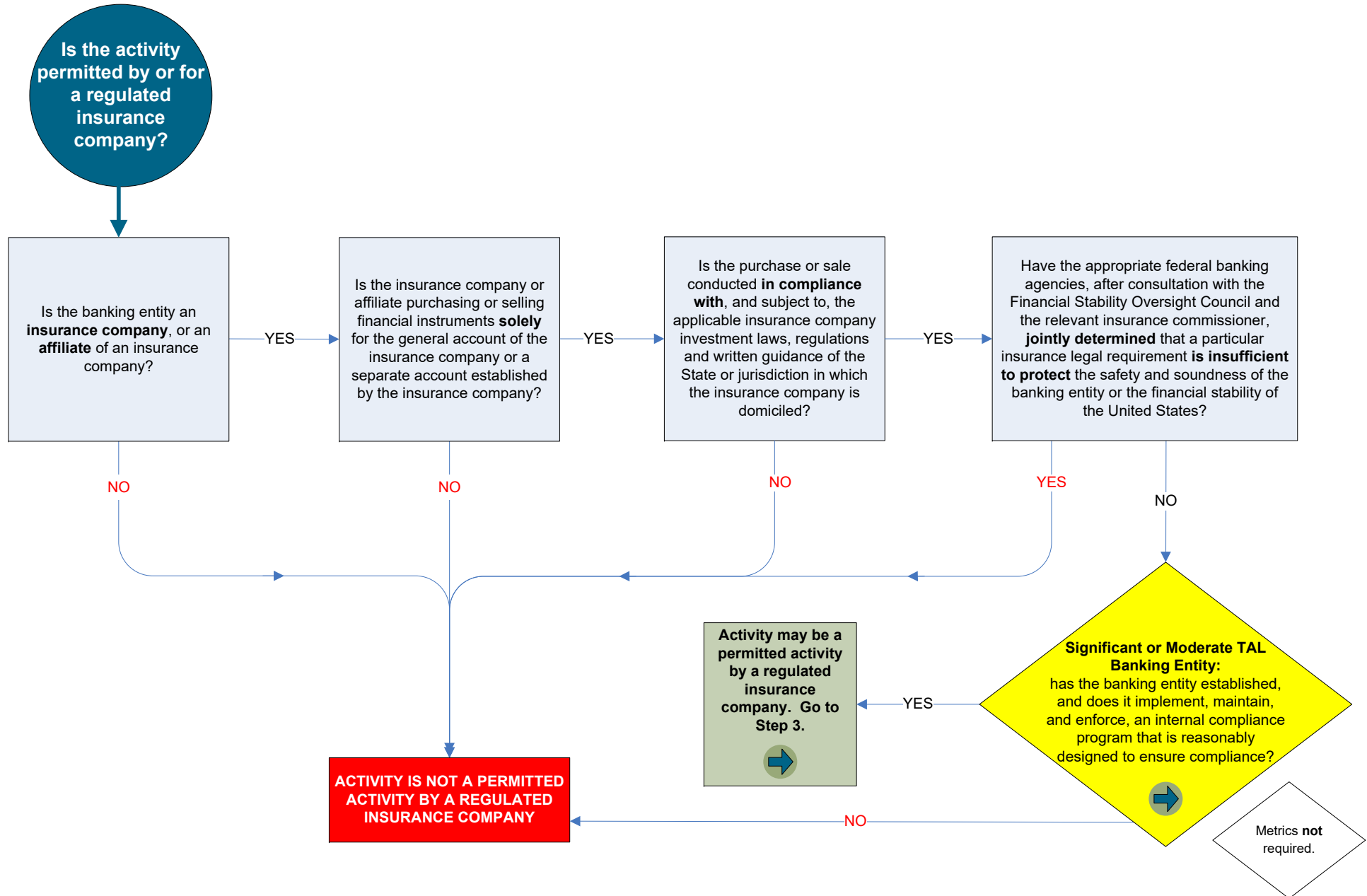


FOREIGN AFFILIATES OF A U.S. BANKING ENTITY (BUT NOT FOREIGN BRANCHES OF U.S. BANKING ENTITIES)

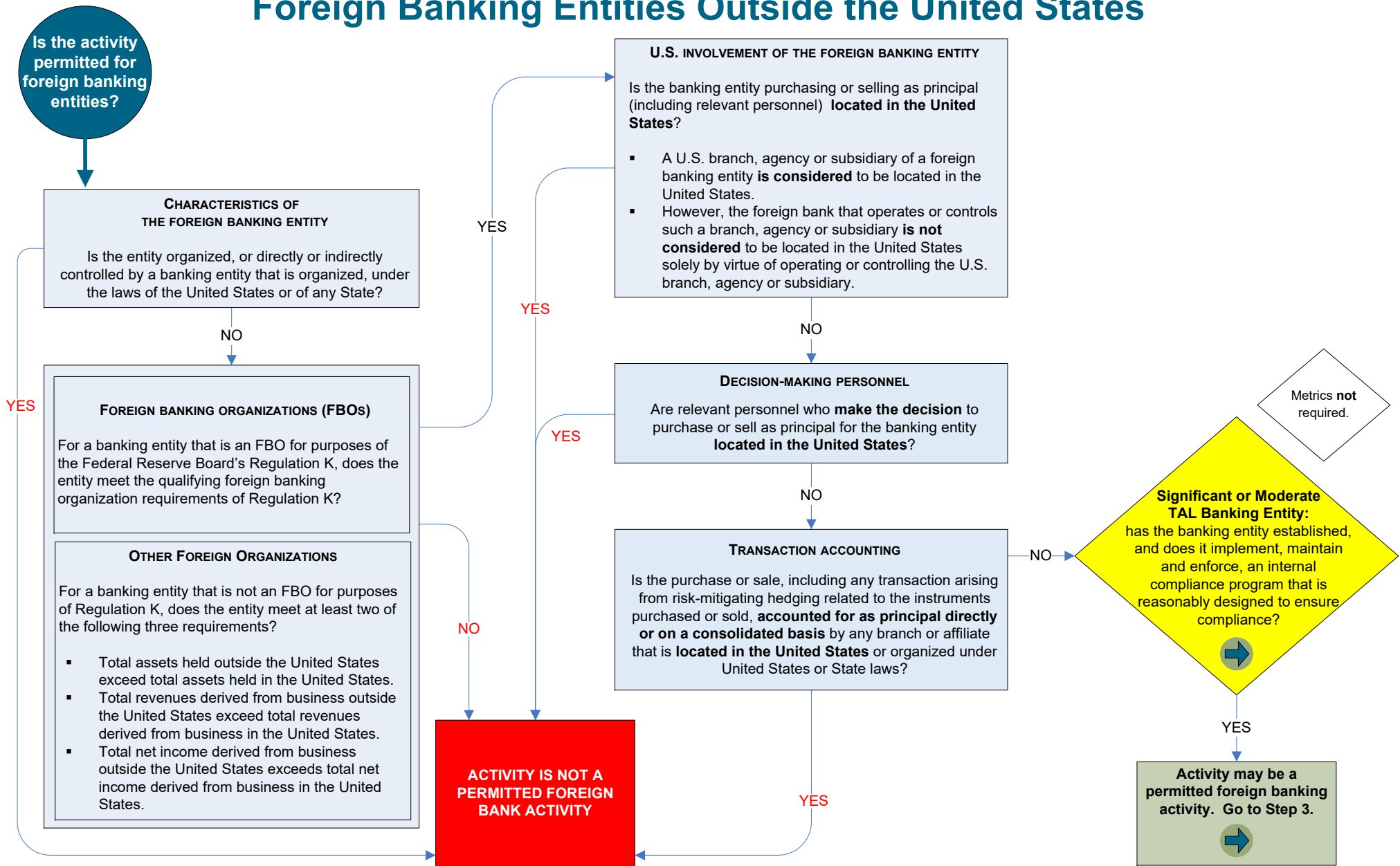




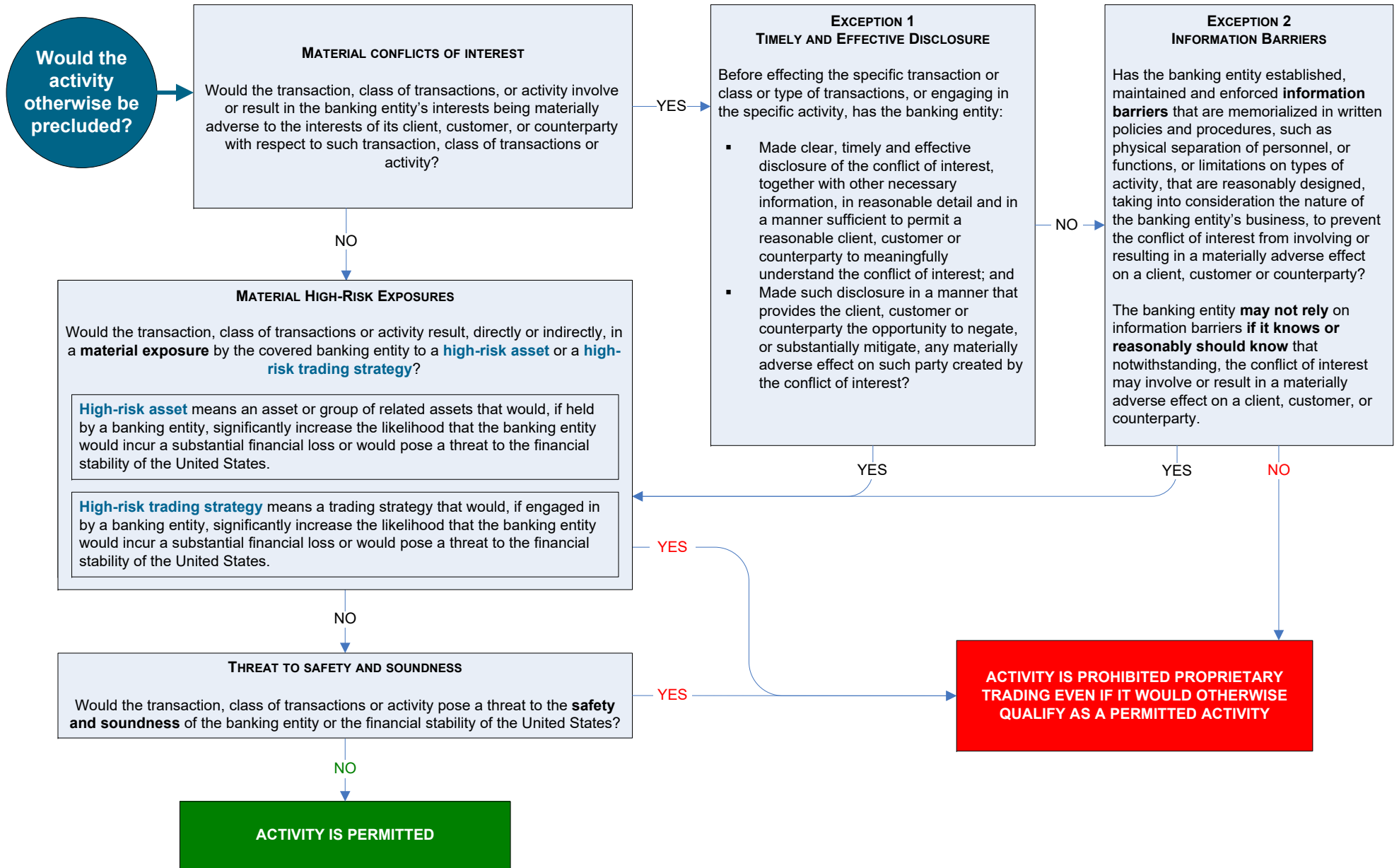




# Permitted Activities: Trading Activities of Foreign Banking Entities Outside the United States



# Is the Activity Precluded by a Backstop Prohibition?

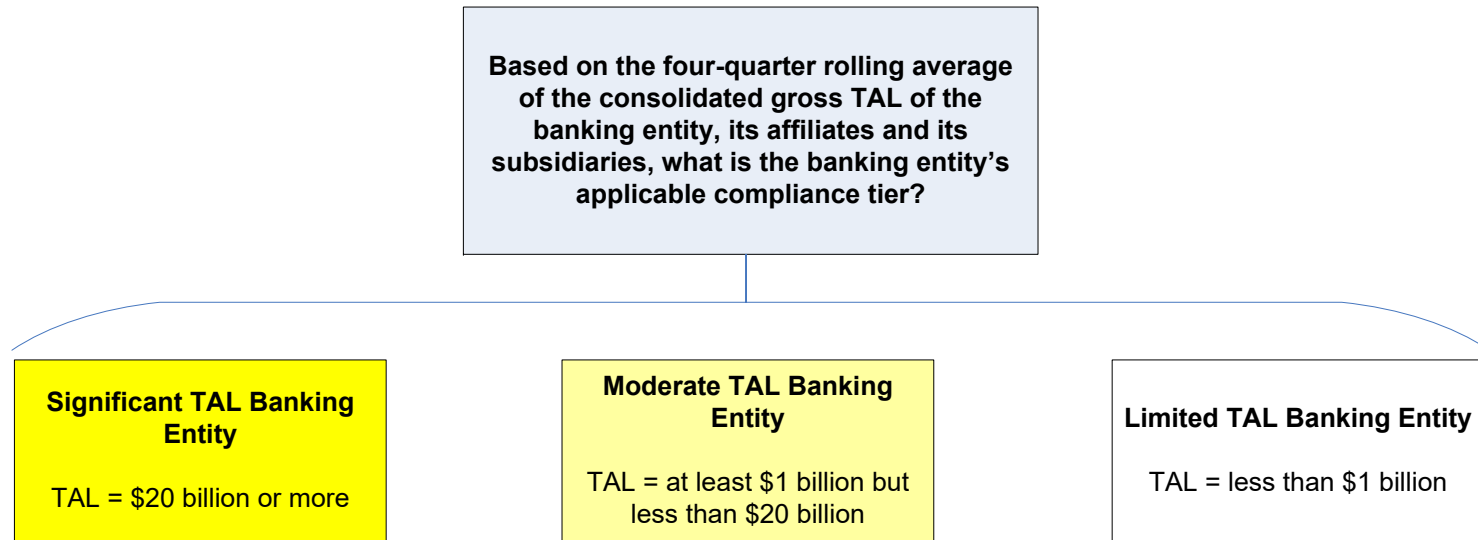




The Volcker Rule includes compliance program requirements that vary depending upon whether a banking entity (together with its affiliates) is a Significant TAL Banking Entity, a Moderate TAL Banking Entity or a Limited TAL Banking Entity.

Significant TAL Banking Entities are also subject to metrics reporting requirements. This section of the document outlines the Volcker Rule's most important compliance-related provisions, with a focus on those applicable to Significant TAL Banking Entities.

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**For a given quarter, Trading Assets and Liabilities (TAL)**

=

**Consolidated gross** TAL of the banking entity, its affiliates and its subsidiaries

For an FBO or a subsidiary of an FBO, trading assets and liabilities are measured based on the combined U.S. operations of the top-tier FBO.

minus

Obligations of, or guaranteed by, the United States federal government or any agency of the United States (e.g., GSEs).

Do not subtract obligations of U.S. state or local government entities, including municipal securities.

For additional detail on compliance requirements for each tier, see next slide.



### SIGNIFICANT TAL BANKING ENTITIES

Significant TAL Banking Entities are subject to **six-pillar, Volcker-specific compliance program** requirements, including a **CEO attestation** requirement and **metrics reporting** requirements.

### MODERATE TAL BANKING ENTITIES

Moderate TAL Banking Entities may satisfy their Volcker Rule compliance program obligations by including in their **existing compliance policies and procedures** appropriate references to the requirements of Section 13 of the BHC Act, and the Volcker Rule regulations, with adjustments as appropriate depending upon their activities, size, scope and complexity.

No CEO attestation or metrics requirements apply.

### LIMITED TAL BANKING ENTITIES

Limited TAL Banking Entities do not have an ongoing obligation to demonstrate compliance with the Volcker Rule.

Instead, Limited TAL Banking Entities are **presumed to be compliant** with the Volcker Rule unless the Agencies rebut the presumption of compliance by determining through examination or audit that the banking entity has engaged in activities that are otherwise prohibited by the Volcker Rule.

The Agencies may rebut the presumption of compliance only in accordance with prescribed notice and response procedures.

If the presumption of compliance is rebutted, the Agencies may require the banking entity to be treated as either a Moderate TAL Banking Entity or a Significant TAL Banking Entity.

**COMPLIANCE PROGRAMS FOR SIGNIFICANT TAL BANKING ENTITIES MUST, AT A MINIMUM, INCLUDE:**

**INTERNAL POLICIES AND PROCEDURES**

**Written policies and procedures reasonably designed** to document, describe, monitor and limit exempted trading activities conducted by the banking entity (including setting, monitoring and managing **limits** required under the market making-related, underwriting and risk-mitigating hedging permitted activities) to ensure that all activities comply with the Volcker Rule.

**INTERNAL CONTROLS**

A **system of internal controls reasonably designed** to monitor compliance and to prevent the occurrence of activities that are prohibited by the Volcker Rule.

**MANAGEMENT FRAMEWORK—RESPONSIBILITY AND ACCOUNTABILITY**

A **management framework that clearly delineates responsibility and accountability** for compliance with the Volcker Rule and that includes appropriate management review of trading limits, strategies, hedging activities, investments, incentive compensation and other matters identified in the Volcker Rule or by management as requiring attention.

**INDEPENDENT TESTING**

**Independent testing and audit** of the effectiveness of the compliance program conducted periodically by **qualified personnel** of the banking entity **or by a qualified outside party**.

**TRAINING**

**Training for trading personnel and managers**, as well as **other appropriate personnel**, to effectively implement and enforce the compliance program.

**RECORDKEEPING**

**Records sufficient to demonstrate compliance** with the Volcker Rule, which a banking entity must promptly provide to Agencies upon request and retain for a period of **no fewer than 5 years** or such longer period as required by Agencies. This must include the specified records required to be maintained in connection with the additional document requests for risk-mitigating hedging permitted activity, as applicable.

**CEO ATTESTATION**

The CEO of a Significant TAL Banking Entity must, no later than March 31 of each year, **attest in writing** that the banking entity has in place processes to establish, maintain, enforce, review, test and modify the six-pillar compliance program in a manner reasonably designed to achieve compliance with Section 13 of the BHC Act and the Volcker Rule regulations.

For banking entities that are U.S. branches or agencies of foreign banking entities, the attestation may be provided by the senior management officer of the U.S. operations the foreign banking entity who is located in the United States.

The terms, scope and detail of the compliance program must be **appropriate for the types, size, scope and complexity of the activities and business structure** of the banking entity.

**METRICS**

<b>Risk Management</b>	<ul style="list-style-type: none"> <li>Internal Limits and Usage</li> <li>Value at Risk (VaR)</li> </ul>	These metrics must be reported for all desks engaged in underwriting, market making-related, risk-mitigating hedging and U.S./foreign government obligation permitted activities ( <b>covered trading activities</b> )
<b>Source of Revenue</b>	<ul style="list-style-type: none"> <li>Comprehensive Profit and Loss Attribution</li> </ul>	These metrics must be reported for all desks engaged in covered trading activities
<b>Customer-Facing Activity</b>	<ul style="list-style-type: none"> <li>Positions</li> <li>Transactions</li> </ul>	These metrics must be reported for all desks that rely on the underwriting and market making-related permitted activities to conduct underwriting or market making-related activity, respectively

**KEY PROCEDURES AND LOGISTICS**

<b>Certain Reporting Remains Optional</b>	<ul style="list-style-type: none"> <li><b>Reporting Required:</b> Metrics in respect of covered trading activities or a subset of covered trading activities, as explained above</li> <li><b>Reporting Optional:</b> Metrics in respect of trading conducted pursuant to an exclusion from the scope of proprietary trading, or pursuant to the on behalf of customers, regulated insurance company or foreign bank permitted activities</li> </ul>
<b>Level of Measurement</b>	<ul style="list-style-type: none"> <li>Each <b>trading desk</b>, as defined in Step 2A-3. This may span across legal entities</li> </ul>
<b>Measurement Frequency</b>	<ul style="list-style-type: none"> <li>Daily</li> </ul>
<b>Reported Frequency and Method</b>	<ul style="list-style-type: none"> <li>Within 30 days of each quarter end in accordance with the XML Schema specified and published on the Agency’s website</li> </ul>
<b>Record Retention</b>	<ul style="list-style-type: none"> <li>Five years</li> </ul>



# Summary of Proprietary Trading Metrics for Significant TAL Banking Entities



## INFORMATIONAL REQUIREMENTS

<p><b>Trading Desk Information</b></p>	<ul style="list-style-type: none"> <li>▪ Provide identifying information about each trading desk and the desk’s associated metrics, including: name, identifier, identification of each type of covered trading activity in which the desk is engaged, a description of the desk’s general trading strategy, and a list identifying each Agency receiving the submission of the trading desk.</li> </ul>
<p><b>Level of Measurement</b></p>	<ul style="list-style-type: none"> <li>▪ Provide descriptive information about the desk’s reported quantitative metrics, including:             <ul style="list-style-type: none"> <li>(1) an Internal Limits Information Schedule naming and describing each limit and identifying the corresponding risk factor attribution if the limit type is a limit on a risk factor sensitivity and profit and loss attribution to the same risk factor is reported; and</li> <li>(2) a Risk Factor Attribution Information Schedule providing identifying and descriptive information for each risk factor attribution reported pursuant to the Comprehensive Profit and Loss Attribution metric.</li> </ul> </li> </ul>
<p><b>Narrative Statement</b></p>	<ul style="list-style-type: none"> <li>▪ A banking entity may, but is not required to, provide as part of its quarterly reporting a narrative statement discussing any information the banking entity views as relevant for assessing the information it has reported.</li> </ul>
<p><b>Record Retention</b></p>	<ul style="list-style-type: none"> <li>▪ Five years</li> </ul>



**COMPLIANCE PROGRAMS FOR SIGNIFICANT TAL BANKING ENTITIES MUST ADDRESS ELEMENTS SPECIFIC TO A BANKING ENTITY'S MARKET MAKING-RELATED, UNDERWRITING AND RISK-MITIGATING HEDGING PERMITTED ACTIVITIES.**

## MARKET MAKING-RELATED

For its market making-related activities, a Significant TAL Banking Entity's compliance program must address:

The financial instruments the trading desk stands ready to purchase and sell.

Risk management elements:

- the **actions the trading desk** will take to demonstrably reduce or otherwise significantly mitigate promptly the risks of its financial exposure (consistent with the limits set in the desk);
- the **products, instruments, and exposures** each trading desk may use for risk management purposes;
- the **techniques and strategies** each trading desk may use to manage the risks of the activities and positions; and
- the **process, strategies, and personnel** responsible for ensuring that the actions taken to mitigate these risks **are and continue to be effective**.

**Limits for the trading desk** in accordance with the market making-related presumption of compliance described on Step 2A-3.

**Written authorization procedures**, including **escalation procedures** that require review and approval of any trade that would exceed the trading desk's limits, demonstrable analysis that the basis for any temporary or permanent increase to the trading desk's limits, and independent review of such demonstrable analysis and approval. A significant TAL Banking Entity may comply with the written authorization procedures requirement by complying with the market making-related presumption of compliance described in Step 2A-3.

**Internal controls and ongoing monitoring and analysis** of the trading desk's compliance with its limits.

## RISK-MITIGATING HEDGING

For its risk-mitigating hedging activities, a Significant TAL Banking Entity's compliance program must include:

**Reasonably designed written policies and procedures** regarding the positions, techniques and strategies that may be used for hedging, including documentation indicating what positions, contracts or other holdings a particular trading desk may use, and position and aging limits with respect to such positions, contracts or other holdings.

**Internal controls** and ongoing monitoring, management, and authorization and escalation procedures.

**Analysis and independent testing** designed to ensure that the positions, techniques and strategies that may be used for hedging may be reasonably expected to reduce or otherwise significantly mitigate the specific, identifiable risk(s) being hedged.

## RISK-MITIGATING HEDGING – ADDITIONAL DOCUMENTATION REQUIREMENTS

Additional documentation is required for any purchase or sale of a financial instrument by a Significant TAL Banking Entity made in reliance on this permitted activity if the purchase or sale:

- Is **not established by the specific trading desk** establishing or responsible for the underlying positions, contracts, or other holdings the risk of which the hedging activity is designed to reduce;
- Is established by the specific trading desk establishing or responsible for the underlying positions, contracts, or other holdings the risks of which the purchases or sales are designed to reduce, but is effected through a financial instrument, exposure, technique or strategy that is **not specifically identified** in the trading desk's specific risk mitigating hedging policies and procedures; or
- Is established to hedge aggregated positions across **two or more trading desks**;

**Unless the hedging activities are in instruments on a pre-approved list and subject to pre-approved limits appropriate for the particular common hedging activity.**

## UNDERWRITING

For its underwriting activities, a banking entity's compliance program must address:

**The products, instruments or exposures** each trading desk may purchase, sell, or manage as part of its underwriting activities.

**Limits for each trading desk**, in accordance with the underwriting presumption of compliance described in Step 2A-3.

**Written authorization procedures**, including **escalation procedures** that require review and approval of any trade that would exceed a trading desk's limits, demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limits, and independent review of such demonstrable analysis and approval. A Significant TAL Banking Entity may comply with the written authorization procedures requirement by complying with the underwriting presumption of compliance described on Step 2A-3.

**Internal controls and ongoing monitoring and analysis** of each trading desk's compliance with its limits.



If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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