Securities Regulation Daily Wrap Up, TOP STORY—SEC adopts Volcker Rule amendments, (Sept. 19, 2019)

Securities Regulation Daily Wrap Up

Click to open document in a browser

By Amy Leisinger, J.D.

The changes are designed to tailor the provisions of the agency's existing regulations to provide banking entities with increased clarity regarding prohibited activities and to improve the supervision and implementation of Section 13 of the Bank Holding Company Act.

Following the Office of the Comptroller of the Currency, the FDIC, and the CFTC, the SEC has adopted, as a seriatim matter, changes to amend its regulations implementing the provisions of Section 13 of the Bank Holding Company Act, commonly referred to as the Volcker Rule. The Volcker Rule generally prohibits banking entities from engaging in proprietary trading and from investing in, sponsoring, or having certain relationships with a hedge fund or private equity fund, referred to as a "covered fund." The SEC originally issued its Volcker Rule regulations in 2013, and the new regulations clarify what activities are prohibited and simplify regulatory requirements, with a focus on compliance program requirements and thresholds and the definition of "proprietary trading," as well as proprietary trading exemptions (*Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds*, Release No. BHCA-7, September 18, 2019).

In a statement, SEC Chairman Jay Clayton noted the importance of working with other regulatory agencies to ensure that jointly issued regulations meet statutory mandates without imposing undue burdens or unnecessary costs. "Experience with the application of the Volcker Rule has shown that the initial implementing regulations can be improved," according to the chairman. "These amendments further the Volcker Rule's statutory objectives, while simplifying, clarifying and better tailoring the application of the rule," he stated.

Compliance programs. The final rules include a tiered approach to the compliance program requirements based on a banking entity's trading assets and liabilities. An entity with total assets and liabilities of at least $20 billion will be considered to have "significant" trading assets and liabilities and will be subject to compliance program, annual CEO attestation, and metrics requirements. The next tier includes entities with consolidated trading assets and liabilities between $1 billion and $20 billion, which will be subject to a simplified compliance program. Banking entities with assets and liabilities of less than $1 billion will be subject to a presumption of compliance.

The final rules also modify the calculation of trading assets and liabilities for the purpose of determining which compliance tier applies to a banking entity by excluding certain financial instruments in which trading is permitted under Section 13. The final rules also align the methodologies for calculating the compliance thresholds for foreign banking organizations by basing the threshold on the trading assets and liabilities of the firm's U.S. operations.

The SEC also modified its rules to eliminate certain metrics and reduce the compliance burdens associated with metrics collection. Filers must submit metrics on a quarterly basis with a reporting schedule of 30 days after the end of each quarter.

Proprietary trading. The final rules also include many of the proposed changes to the proprietary trading restrictions but do not include the proposed accounting prong in the trading account definition. Among the changes to the definition of "proprietary trading," the final rules retain a modified version of the short-term intent prong; eliminate the rebuttable presumption that financial instruments held for fewer than 60 days are within the short-term intent prong of the trading account; and add a rebuttable presumption that financial instruments

held for 60 days or longer are not within the short-term intent prong of the trading account. Further, the final rules provide that a banking entity subject to the market risk capital rule prong of the "trading account" definition is not also subject to the short-term intent prong. A banking entity that is not subject to the market risk capital rule prong could elect to apply the market risk capital rule prong, as an alternative to the short-term intent prong under certain conditions.

The final rules also modify the liquidity management exclusion from the proprietary trading restrictions to permit banking entities to use a broader range of financial instruments to manage liquidity. The changes also add new exclusions for error trades, certain customer-driven swaps, hedges of mortgage servicing rights, and purchases or sales of instruments that do not meet the definition of "trading assets and liabilities" under the applicable reporting form. Further, the final rules revise the "trading desk" definition to provide more flexibility to banking entities to align with other definitions in existing or planned compliance programs.

The final rules also include the proposed changes to the exemptions from the Section 13 prohibition for underwriting and market making-related activities, risk-mitigating hedging, and trading by foreign banking entities solely outside the United States. Regarding exemptions for underwriting and market making-related activities, the SEC adopted a presumption of compliance with the reasonably expected near-term demand requirement for trading within certain internal limits. However, instead of requiring banking entities to promptly report limit breaches or increases, banking entities will be required to maintain and make available upon request records of any such changes and follow certain internal escalation and approval procedures in order to remain qualified for the presumption of compliance.

Effective date and compliance. The final amendments become effective on January 1, 2020, but banking entities will not be required to comply until January 1, 2021. These entities, however, may voluntarily comply in advance, subject to the SEC's and other agencies' completion of technical changes necessary to accept compliant metrics. The agencies will conduct a test run with banking entities of the revised metrics submission format, and banking entities are asked to work with regulators to determine how and when to voluntarily comply and to notify them of an intent to comply prior to the compliance date.

The release is No. BHCA-7.

MainStory: TopStory DoddFrankAct FinancialIntermediaries SECNewsSpeeches