

Despite FAQs and OCC Interim Examination Procedures, Little Illumination So Far for Volcker Rule Compliance

by Keith R. Fisher

In June 2014, there were two issuances relating to the Volcker Rule (the Rule): (1) Interagency [FAQs](#) and (2) [interim procedures](#) from the Office of the Comptroller of the Currency (OCC) for its examiners to use in assessing progress by national banks and federal thrifts and federal branches and agencies of foreign banks (collectively, Banks) toward compliance with the Rule. Though the latter could logically have been expected to be a harbinger of similar examination procedures from the Federal Reserve and the FDIC, more than two months later nothing of the sort has yet been released by either of those agencies.

Both of the June releases are disappointing in that they provide scant guidance for banking entities subject to the Rule, and with less than a year remaining until the July 21, 2015, compliance deadline, prospects for significant and timely illumination in the near future are rather dim. The FAQs, [as discussed previously](#), addressed only what I called “low hanging fruit” and added relatively little guidance to what was already discernible from a study of the Prologue to the Final Rule released in December 2013. The OCC examination guidelines don’t really address the substance of the Rule but do, at least, provide some insight into what that agency’s examiners will be focusing on during the next 11 months.

Here are the key takeaways from these two issuances:

Just the FAQs – Here are a few points from the FAQs that are worth remembering:

With respect to proprietary trading:

(1) A banking entity must report the full set of metrics for a given trading desk to all agencies with jurisdiction over any entity into which that trading desk book trades.

(2) **REMINDER:** Banking entities with \$50 billion or more in trading assets and liabilities as of June 30, 2014, must record the required metrics since July 1 and report the same on September 2 (the day after Labor Day).

With respect to covered funds:

(1) Excluded loan securitizations may hold servicing assets of “any type,” provided that a servicing asset that is a security must be a cash equivalent or received in lieu of a debt previously contracted consistent with the Rule.

(2) Seeding vehicles for foreign public funds will be treated the same as seeding vehicles for registered investment companies if applicable written plan and other requirements are met. The written plan for a foreign public fund seeding vehicle must

expressly include the banking entity's "plan to operate the seeding vehicle in a manner consistent with the investment strategy, including leverage, of the issuer upon becoming a foreign public fund." If the treatment is identical, we assume that means not being treated during the authorized seeding period as violating the Rule's proprietary trading restrictions.

OCC's Interim Examination Procedures – The overall objective is to help the examiners determine whether individual Banks have business activities or investments that are subject to the Rule and assure that those that do are making progress toward achieving full compliance by the July 21, 2015, deadline. The examiners will focus on:

- Identification of activities subject to the Rule
- Assessment of Banks' progress toward establishing their compliance programs
- Evaluation of Banks' plans for conforming covered fund securitization, asset management, and sponsorship activities
- Banks' progress in being able to report quantitative metrics

A special focus will be on evaluating nascent or evolving compliance programs and assessing plans for avoiding material conflicts of interest and material exposures to high-risk assets and trading strategies.

In the two major categories governed by the Rule, proprietary trading and covered funds, the interim examination procedures will guide the examiners in assessing Banks' progress toward full compliance with respect to the following:

Proprietary Trading

- Timely reporting of proprietary trading metrics
- Using metrics to monitor for impermissible proprietary trading
- Identifying market-making-related activities, market-maker inventory, and reasonably expected near-term demand
- Establishing a compliance program for permitted market-making-related activities
- Establishing a compliance program for underwriting activity
- Establishing a compliance program for risk-mitigating hedging activity and satisfying documentation requirements

Covered Funds

- Conforming asset management and sponsorship activities
- Conforming securitization activities involving a securitization vehicle that is a covered fund

- Conforming underwriting and market-making activities in covered funds
- Ensuring compliance with the *de minimis* ownership limits on investments in covered funds relevant to permissible asset management, securitization, underwriting, and market-making activities
- Conforming hedging activities using covered funds
- Divesting nonconforming investments in covered funds

Overall

- Taking necessary actions to meet the requirements of Volcker Rule regulations within the conformance period
- Readiness for reporting quantitative metrics as required under the Final Rule (national banks with trading assets and liabilities of \$50 billion or more on a worldwide consolidated basis were required to begin collecting quantitative metrics on July 1, 2014, and report these metrics to the OCC on September 2, 2014)

Note that community banks that neither engage in proprietary trading activities covered by the Rule nor make investments subject to its strictures on sponsorship or ownership of interests in covered funds are not subject to the new examination procedures. Should their business plans change, they likely can avail themselves of a simplified compliance program (summarized below) but must ensure that they can comply with the regulations by establishing the requisite compliance protocols *prior to* engaging in activities covered by the Final Rule.

The OCC says it will supplement the interim examination procedures during the conformance period with in-depth procedures designed to enable examiners to test compliance on an ongoing basis. The standards articulated are a helpful synopsis for Banks of various sizes for assessing their own compliance in advance of their next OCC examination:

- **Simplified compliance programs:** Banks (other than the exempted community banks described above) with total consolidated assets of \$10 billion or less may implement a simplified compliance program by including in their existing compliance policies and procedures appropriate references to the requirements of the regulations, and adjustments, as appropriate, given the Banks' activities, size, scope, and complexity.

- **Standard compliance programs:** Banks with total consolidated assets greater than \$10 billion but less than \$50 billion must, unless they report metrics, develop and administer standard compliance programs that include, among other things:
 - Written policies and procedures reasonably designed to document, describe, monitor, and limit permitted trading and covered fund activities
 - A system of internal controls reasonably designed to monitor compliance with and to prevent the occurrence of activities or investments prohibited by the regulations
 - A management framework that clearly delineates responsibility and accountability for compliance with the regulations
 - Independent testing and audit of program effectiveness
- **Enhanced compliance programs:** Banks with total consolidated assets of \$50 billion or more, or that report metrics, must establish, maintain, and enforce enhanced compliance programs, which are more prescriptive than standard programs and require considerable additional documentation. Importantly, an enhanced compliance program must include annual independent testing by qualified personnel.