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REQUIREMENTS AND HIGHLIGHTS OF THE VOLCKER RULE AND ITS REGULATIONS

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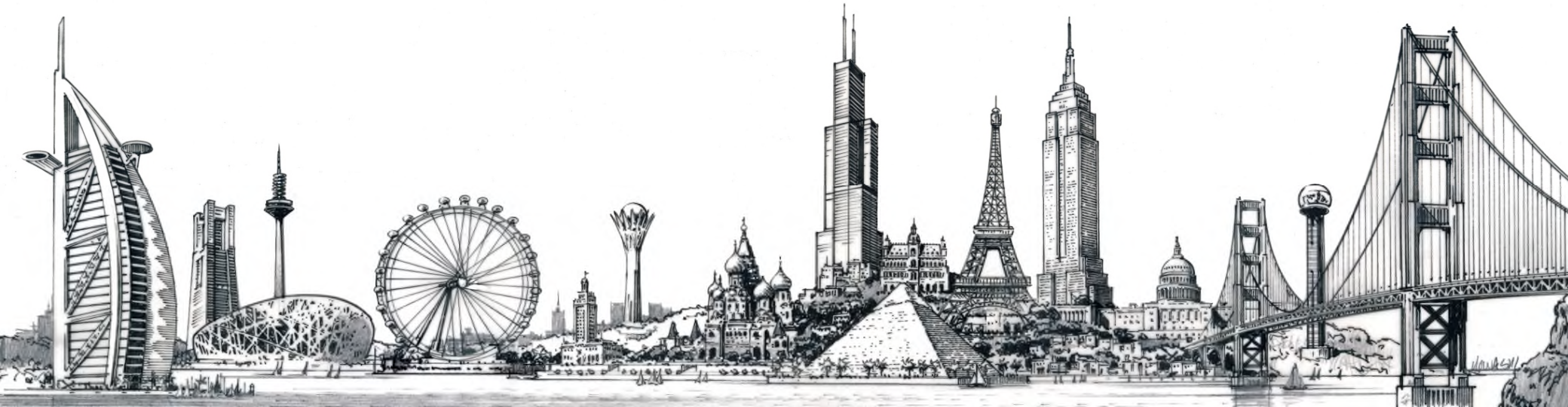


Agenda

- Overview of the covered fund prohibition
- Key definitions
- Exemptions versus exclusions
- Exemptions (organized and offered, foreign (SOTUS) fund)
- Excluded funds
- Foreign public fund exclusion
- Foreign noncovered funds
- Separate accounts and structured separate accounts
- "Super 23A" limits on covered fund relationships
- High risk activities
- Conformance and compliance requirements

OVERVIEW OF THE COVERED FUND PROHIBITION

- A banking entity may not, as principal, directly or indirectly, acquire or retain any ownership interest in or sponsor a covered fund, subject to certain exemptions and exclusions
- Prohibition does not apply if the banking entity acquires or retains the ownership interest on behalf of customers as trustee or in a similar fiduciary capacity for a customer that is not a covered fund, if:
  - the activity is conducted for the account of, or on behalf of, the customer; and
  - the banking entity and its affiliates do not have or retain beneficial ownership of the ownership interest
- A banking entity may sponsor/hold an ownership interest in a covered fund in connection with "organizing and offering" the fund to fiduciary and asset management clients, subject to certain conditions

KEY DEFINITIONS

- Affiliate
  - Cross-references the definition of "affiliate" in the Bank Holding Company Act
  - Any company that controls, is controlled by, or is under common control with another company
  - "Control" means directly or indirectly or acting through one or more other persons owns, controls, or has power to vote 25% or more of any class of voting securities of another company, or controls the election of a majority of the directors of the company, or has the power to exercise, directly or indirectly, a controlling influence over the management or policies of the company

- Covered Fund
  - Hedge fund or private equity fund
  - An issuer that could be an investment company under the Investment Company Act of 1940 but for the exclusions under section 3(c)(1) and 3(c)(7), or such similar funds as the Agencies may, by rule, determine
  - There are enumerated exclusions from the definition of "covered fund," including:
    - foreign public funds
    - wholly owned subsidiaries of banking entities
    - insurance company separate accounts
    - registered investment companies
    - foreign pension or retirement funds

- Banking Entity
  - Insured depository institution
  - Company affiliated with insured depository institutions
  - Foreign bank with US banking operations
  - Covered funds are excluded, unless the covered fund is itself a banking entity
- Sponsor
  - Serves as general partner or managing member, or in a similar capacity
  - Selects or controls, or has officers/directors/employees who constitute, a majority of fund directors, trustees, or similar persons
  - Shares a name/variation of name with a covered fund

- Ownership Interest
  - Equity, partnership, or "similar interest"
    - Similar interest includes GP/GP-equivalent selection and removal rights; right to share in profits; right to distribution of assets; right to excess spread; exposure to losses on underlying assets; pass-through or performance-based income; synthetic rights to any of the foregoing
- Restricted Profit Interest (RPI) (carried interest) is not an ownership interest, subject to four primary conditions:
  - Profit-sharing only as performance compensation
  - Profit distribution/reserve account requirements
  - Investments associated with RPI are subject to applicable limits for banking entity investments in covered funds
  - Strict limits on transferability

EXEMPTIONS VERSUS EXCLUSIONS

- Exempt fund
  - A "covered fund" that may be sponsored by a banking entity or in which a banking entity may invest
  - Subject to restrictions on financial relationships between banking entities and covered funds ("Super 23A," discussed below)
  - Not a "banking entity" and therefore not independently subject to Volcker Rule proprietary trading and covered fund restrictions
- Excluded fund
  - Not a "covered fund"
  - Not subject to Super 23A restrictions
  - If "affiliated" with a banking entity, may be a "banking entity" that is independently subject to Volcker Rule proprietary trading and covered fund restrictions

“ORGANIZED AND OFFERED” FUND EXEMPTION

- A banking entity may sponsor/hold an ownership interest in a covered fund in connection with "organizing and offering" the fund to fiduciary and asset management clients, subject to certain conditions:
  - Must provide "bona fide trust, fiduciary, or advisory services" and may only offer the fund to customers of these trust, fiduciary, or advisory services
  - May establish the customer relationship for these services through or in connection with the organization and offering of the covered fund
  - Must develop a written plan or similar documentation
  - May not directly or indirectly guarantee, assume, or otherwise insure the obligations or performance
  - Must make specified written disclosures to investors
  - May not share or use certain names

- *De minimis* investment exemption for "organized and offered" funds only
  - 3%-per-fund investment limitation
  - 3%-of-capital aggregate investment limitation
- Seeding activities: one year
- Attribution of ownership interests
  - Only to banking organization-controlled entities
  - Co-investments
- Extensions of permitted investment periods
- Permitted hedging activities (limited)

FOREIGN (SOTUS) FUND EXEMPTION

- Exemption from the general prohibition on acquiring or retaining any ownership interest in or sponsoring a covered fund
  - The foreign fund is still a covered fund, but the banking entity's investment in the foreign fund is not prohibited
- Applies if the covered fund is offered "solely outside of the United States" (SOTUS)
  - The banking entity (including relevant personnel) that makes the decision to invest or act as sponsor is not located in the United States;
  - The investment or sponsorship, including any relating hedging transactions, is not accounted for as principal in the United States;
  - The ownership interests in the covered fund are not sold in an offering targeting US residents; and
  - No financing for the banking entity's ownership or sponsorship is provided by a US affiliate of the foreign banking entity
- Fact-based analysis for each covered fund

- FAQ 13 issued in February 2015 clarified the scope of the marketing restriction in the SOTUS exemption
- No ownership interest may be offered for sale or sold to a resident of the United States
- FAQ 13 states that the marketing restriction only applies to activities of the foreign banking entity seeking to rely on the exemption; it does not apply to activities of unaffiliated third parties
- Foreign banking entities that directly or indirectly serve as investment adviser, investment manager, or commodity pool operator/trading advisor to a covered fund are "participating in the offer or sale" of covered fund ownership interests and therefore cannot rely on the SOTUS exemption if the fund offers or sells its interests to US residents

EXCLUDED FUNDS

- Funds that rely on exemptions other than section 3(c)(1) or 3(c)(7) of the Investment Company Act
  - Underwriters and brokers – 3(c)(2)
  - Bank common trust and collective investment funds – 3(c)(3) or 3(c)(11)
  - REITs and other funds primarily engaged in the business of acquiring mortgages and other liens on and interests in real estate – 3(c)(5)
  - Engaged in business other than investing in securities – 3(c)(6)
- Applicability to foreign funds
  - Not a covered fund if, were the fund subject to US securities law, the foreign fund could rely on an exclusion or exemption other than 3(c)(1) or 3(c)(7)

FOREIGN PUBLIC FUND EXCLUSION

- Foreign public fund
  - Organized or established outside of the United States;
  - Authorized to offer and sell ownership interests to retail investors in the issuer's home jurisdiction; and
  - Sells ownership interests predominantly through one or more public offerings outside of the United States
- Exclusion is available to foreign public funds sponsored by US banking entities if ownership interests are sold predominantly:
  - to persons other than the sponsoring banking entity; or
  - to affiliates, employees, or directors of the issuer or the sponsoring banking entity

- FAQ 14 issued in June 2015 clarifies that foreign public funds do not have to be organized and operated identically to US-registered investment companies
- Qualifying foreign public funds will not be treated as banking entity "affiliates" that are subject to the Volcker Rule proprietary trading and covered fund prohibitions
- A foreign public fund qualifies for nonaffiliate treatment if the banking entity:
  - does not own, control, or hold the power to vote 25% or more of the voting shares of the fund after the seeding period; and
  - provides investment advisory, commodity trading advisory, administrative, and other services to the fund in compliance with applicable regulations

FOREIGN NONCOVERED FUNDS

- Foreign private funds that are not covered funds ("foreign noncovered funds")
- The funds do not offer interests to US persons and therefore do not rely on 3(c)(1) or 3(c)(7) (not an "issuer that would be an investment company . . . but for section 3(c)(1) or 3(c)(7) [of the Investment Company Act of 1940]")
- Excluding foreign noncovered funds from the "covered fund" definition intended to limit the extraterritorial impact of the Volcker Rule

- A foreign noncovered fund technically may become a "banking entity"
  - Covered funds are specifically excluded from the definition of "banking entity"
  - No clear exclusion for foreign noncovered funds unless they can rely on another exclusion or exemption
- If the foreign noncovered fund instead relied on the SOTUS exemption, it would not be a banking entity
  - Policy argument that foreign noncovered funds and SOTUS funds should be treated similarly
- No clarification yet from the Agencies regarding whether foreign noncovered funds are banking entities

SEPARATE ACCOUNTS AND STRUCTURED SEPARATE ACCOUNTS

- Structured separate accounts could be covered funds if they rely on 3(c)(1) or 3(c)(7)
- Insurance company separate accounts, including COLI/BOLI separate accounts, are specifically excluded from the definition of "covered fund"
- Family partnerships and LLCs
  - Could be covered funds if they rely on 3(c)(1) or 3(c)(7)
  - May be able to rely on other Investment Company Act exemptions or status exclusions
  - Analysis may depend on the details of the particular office or vehicle
  - The policies behind the Volcker Rule argue strongly against treatment as covered funds

“SUPER 23A” LIMITS ON RELATIONSHIPS

- Applies to a banking entity that, directly or indirectly, serves as investment adviser, investment manager, or sponsor to a covered fund, or that "organizes and offers" a covered fund
- Banking entity is prohibited from entering into a transaction with a covered fund that would be a "covered transaction" as defined in Section 23A of the Federal Reserve Act (bank transactions with affiliates)
  - Extensions of credit and guarantees
  - Purchase of assets or securities (other than permitted "ownership interests")
- Applies only to transactions between the banking entity and a covered fund
  - Transactions between a banking entity and a third party that is not itself a covered fund are not subject to the prohibition
  - E.g., loans to third parties that are collateralized by a covered fund's interests

- Does not apply to transactions with third parties that are covered transactions under the "attribution rule"
- Section 23A's statutory and regulatory exemptions are not incorporated into Super 23A
- Super 23A may present challenges and complications for advisers and managers of private funds that are covered funds
  - May limit credit facilities that can be provided to such funds, even daylight and settlement facilities

HIGH RISK ACTIVITIES

- The Volcker Rule prohibits a banking entity from engaging in a covered activity or making an investment that otherwise is permissible if the activity or investment would
  - pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States, or
  - involve a "material conflict of interest between a banking entity and its clients, customers, or counterparties" or "high-risk assets or trading strategies"
- The Regulations allow certain conflicts to be managed through "timely and effective" disclosure, or information barriers

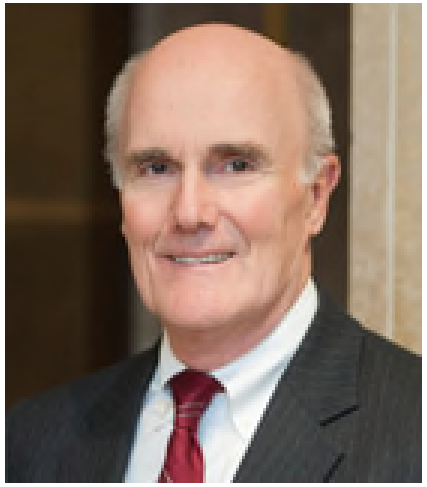
CONFORMANCE AND COMPLIANCE REQUIREMENTS

- Banking organizations generally have until July 21, 2015 to bring proprietary trading and private fund activities into conformance
  - There is a targeted extension of the conformance date (in effect, until July 2017) for covered fund activities and investments occurring prior to January 1, 2014
- Banking organizations are expected to engage in "good-faith efforts" to bring all of their covered activities into compliance by the July 21, 2015 conformance date
- Banking entities that expand activities and make investments during the conformance period should not expect additional time to conform those activities or investments
- Regulators have limited authority to extend the conformance period

- Banking entities engaged in Volcker Rule activities and investments must develop and administer a written compliance program reasonably designed to ensure and monitor compliance with the Volcker Rule and the Regulations, based on a tiered approach calibrated to the size, complexity and activities of a banking organization
  - Larger banking entities are subject to enhanced compliance requirements
- The Regulations specify a variety of data collection and reporting requirements that are applicable primarily to banking entities that are engaged in proprietary trading activities
- Who has to have such a program?
  - Banking entities
  - Bank Holding Company Act "affiliates" of banking entities that are also banking entities (this excludes covered funds)

QUESTIONS?

Biography



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Charles M. Horn counsels US and international banks and other financial institutions on corporate, regulatory, supervisory, enforcement, and compliance matters before all major federal and state financial regulatory agencies. He advises clients on major federal financial services statutes and regulations, as well as on US and international financial reform developments. Charles also counsels banks and other financial services firms on issues affecting their governance, structure, management, and operations.

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Steven W. Stone is a securities lawyer who counsels clients on regulations governing broker-dealers, investment advisers and bank fiduciaries, and pooled investment vehicles. As, head of the firm's financial institutions practice, Steve counsels most of the largest and most prominent US broker-dealers, investment banks, investment advisers, and mutual fund organizations. He regularly represents clients before the US Securities and Exchange Commission (SEC), both in seeking regulatory relief and assisting clients in enforcement or examination matters.

Biography

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Melissa R. H. Hall represents US and overseas banks, nonbank financial services companies, investors in financial services, and technology companies in regulatory and corporate matters. She advises them on a wide range of state and federal financial regulatory laws and regulations. She provides counsel on financial regulatory compliance and enforcement, including state and federal licensing requirements, consumer financial products and compliance, payment systems, corporate and transactional matters, financial institution investment and acquisition, and the development of new financial services products.

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Monique Botkin is a native of the Washington, DC area and joined the IAA in February 2004. Previously, Monique was an associate attorney in the financial services groups of other law firms in Orange County, California and Washington, DC. While in private practice, she represented investment advisers, registered investment companies, private funds, and broker-dealers in corporate, securities, and investment management matters. Monique also served as an attorney in the SEC's Division of Investment Management disclosure review office from 2013 to 2014. Monique is a member of the State Bar of California.

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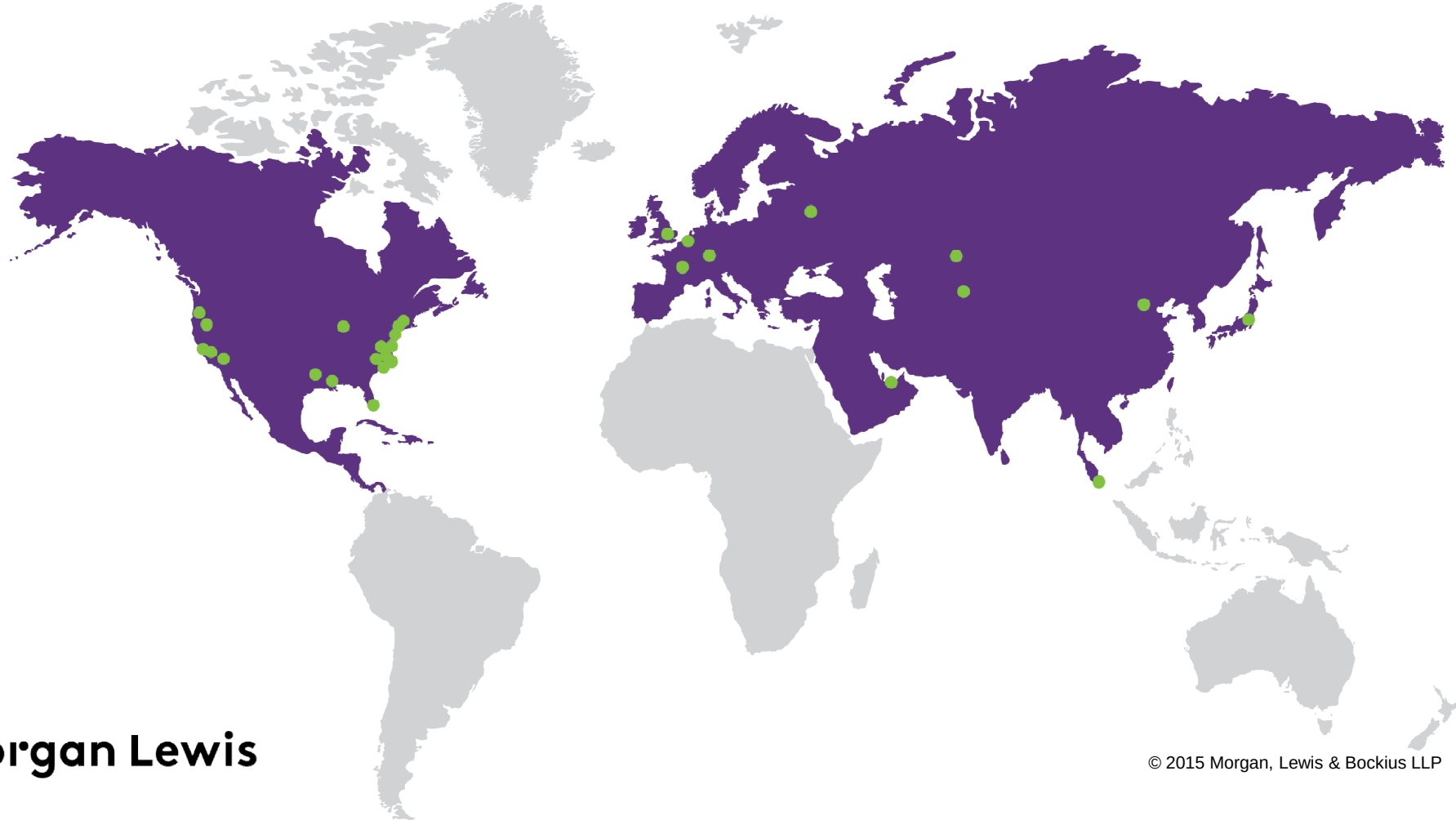

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