ORRICK CLIENT ALERT

Volcker Rule: An Overview and Highlights of Certain Key Provisions

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On December 10, 2013, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation and the Securities and Exchange Commission (collectively, the "Agencies") promulgated the final rule (the "Final Rule") implementing the prohibitions and limitations imposed on banking entities by Section 13 of the Bank Holding Company Act of 1956 (the "BHC Act") added to the BHC Act by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). Section 13 of the BHC generally prohibits banking entities from engaging as principal in "proprietary trading" and from acquiring or retaining an ownership interest in or sponsoring a hedge fund or private equity fund, in each case as defined in and subject to the limitations, exceptions and exemptions set forth in Section 13 of the BHC Act and the Final Rule. A "banking entity" is defined generally in the Final Rule to mean any insured depository institution, any company that controls an insured depository institution, any company treated as a bank holding company under the International Banking Act of 1978 and any affiliate or subsidiary of the foregoing, but does not include a "covered fund" (defined as described below) that is not itself a banking entity, certain portfolio companies and the FDIC as conservator or receiver.

This alert provides a general overview of the Final Rule and highlights certain provisions of the Final Rule we believe to be of particular interest to you. The Final Rule is far-reaching, detailed and highly complex.[1] A number of summaries of the Final Rule are publicly available[2] and more information will become available as the details of the Final Rule are analyzed and perhaps additional guidance provided, and as banking entities and market participants in general seek to execute new transactions and assess holdings in and the terms of existing transactions in light of the Final Rule.

The Final Rule will be effective on April 1, 2014, and full conformance with its provisions is required by July 21, 2015, subject to the Agencies' ability to extend for two additional one-year conformance periods. The Agencies have adopted a tiered approach to compliance and reporting, which are to be phased-in as described in the Final Rule. Banking entities are required to use good faith efforts to fully conform their activities and investments so as to be in full conformance by the full conformance date.

We expect to provide additional information and analysis on one or more specific provisions of the Final Rule in the coming months. Should you have questions, whether general or specific, regarding the Final Rule and its applicability or impact to you or your business, please reach out to any of your contacts at Orrick.

[1] For a copy of the Final Rule, please see: http://federalreserve.gov/newsevents/press/bcreg/bcreg20131210a1.pdf and for a copy of the preamble, please see http://federalreserve.gov/newsevents/press/bcreg/bcreg20131210a2.pdf.

[2] For example, the memorandum from the Staff of the Federal Reserve System to the Board seeking approval of the draft final rule, which can be found at: http://www.federalreserve.gov/aboutthefed/boardmeetings/board-memo-volcker-20131210.pdf .

Proprietary Trading – Subpart B of the Final Rule

General ***(§__.3)***

The Final Rule implements Section 13 of the BHC Act's prohibition on proprietary trading, and provides various exceptions. Proprietary trading is defined as "engaging as principal for the *trading account* of the banking entity in any purchase or sale of one or more *financial instruments*."

A "trading account" is generally any account used by a banking entity to (1) purchase and sell a financial instrument principally for the purpose of (i) short term resale, (ii) benefitting from actual or expected short-term price movements, (iii) realizing short-term arbitrage profits or (iv) hedging one or more positions resulting from any such sales, (2) purchase or sell financial instruments that are both market risk capital rule covered positions and trading positions (or hedges of other market risk capital rule covered positions), if the banking entity, or any affiliate of the banking entity, is an insured depository institution, bank holding company, or savings and loan holding company, and calculates risk-based capital ratios under the market risk capital rule, or (3) purchase or sell a financial instrument for any purpose, if the banking entity is (or is required to be) licensed or registered, to engage in the business of a dealer, swap dealer, or security-based swap dealer, to the extent the instrument is purchased or sold in connection with the activities that require the banking entity to be so licensed or registered or is engaged in the business of a dealer, swap dealer, or security-based swap dealer outside of the United States, to the extent the instrument is purchased or sold in connection with the activities of such business.

The purchase or sale of a financial instrument by a banking entity is presumed to be for the trading account of the banking entity if the banking entity holds the financial instrument for fewer than sixty days or substantially transfers the risk of the financial instrument within sixty days of the purchase or sale of such financial instrument, unless the banking entity can demonstrate, based on all relevant facts and circumstances, that the banking entity did not purchase or sell the financial instrument principally for any of the purposes described above.

A "financial instrument" includes (1) a security or an option on a security, (2) a derivative or an option on a derivative, or (3) a contract of sale or an option on a contract of sale of a commodity for future delivery. A financial instrument does not include (1) a loan, (2) a commodity that is not (i) an excluded commodity (other than foreign exchange or currency), (ii) a derivative, or (iii) a contract of sale or an option on a contract of sale of a commodity for future delivery or (3) foreign exchange or currency.

Exclusions

Under the Final Rule, proprietary trading does not include (1) any purchase or sale of a financial instrument by a banking entity that arises under a repurchase or reverse repurchase agreement or a securities lending agreement, (2) any purchase or sale of a security by a banking entity for the purpose of liquidity management in accordance with a documented liquidity management plan of the banking entity that fulfills certain conditions, (3) any purchase or sale of a financial instrument by a banking entity that is a derivatives clearing organization or a clearing agency in connection with clearing financial instruments, (4) any excluded clearing activities by a banking entity that is a member of a clearing agency, a member of a derivatives clearing organization, or a member of a

designated financial market utility, (5) any purchase or sale of a financial instrument by a banking entity to satisfy (i) an existing delivery obligation of the banking entity or its customers in connection with delivery, clearing, or settlement activity or (ii) an obligation of the banking entity in connection with a judicial, administrative, self-regulatory organization, or arbitration proceeding, (6) any purchase or sale of a financial instrument by a banking entity acting solely as agent, broker, or custodian, (8) any purchase or sale of a financial instrument by a banking entity as trustee for its employees through a deferred compensation, stock-bonus, profit-sharing, or pension plan of the banking entity that is established and administered in accordance with the law of the United States or a foreign sovereign, or (9) any purchase or sale of a financial instrument by a banking entity 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 in any event within any permitted holding period established by the applicable Agency).

Exemptions from Prohibition on Proprietary Trading

The Final Rule exempts certain activities from the prohibition on proprietary trading, as briefly summarized below.

Underwriting Activities (§__.4(a))

The ban on proprietary trading does not prohibit a banking entity from acting as an underwriter for a distribution of securities if the trading desk's underwriting position is related to such distribution and (1) the amount and type of the securities in the trading desk's underwriting position are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, (2) reasonable efforts are made to sell or otherwise reduce the underwriting position within a reasonable period, taking into account the liquidity, maturity, and depth of the market for the relevant type of security, (3) the banking entity has established and implements, maintains, and enforces an internal compliance program that meets certain statutory requirements, (4) the compensation arrangements of the relevant employees are not designed to reward or incentivize prohibited proprietary trading and (5) the banking entity is licensed or registered to engage in the activities described above in accordance with applicable law.

Market Making Activities (§__.4(b))

The ban on proprietary trading does not limit a banking entity's market making-related activities so long as (1) the trading desk that establishes and manages the financial exposure routinely stands ready to purchase and sell one or more types of financial instruments related to its financial exposure and is willing and available to quote, purchase and sell, or otherwise enter into long and short positions in those types of financial instruments for its own account, in commercially reasonable amounts and throughout market cycles on a basis appropriate for the liquidity, maturity, and depth of the market for the relevant types of financial instruments, (2) the amount, types, and risks of the financial instruments in the trading desk's market-maker inventory are designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers, or counterparties, based on (i) liquidity, maturity, and depth of the market for the relevant types of financial instrument(s) and (ii) demonstrable analysis of historical customer demand, current inventory of financial instruments, and market and other factors regarding the amount, types, and risks, of or associated with financial instruments in which the trading desk makes a market, including through block trades, (3) the banking entity has established and

implements, maintains, and enforces an internal compliance program that meets certain statutory requirements, (4) to the extent that any limit identified as part of the banking entity's internal compliance program is exceeded, the trading desk takes action to bring the trading desk into compliance with the limits as promptly as possible after the limit is exceeded, (5) the compensation arrangements of the relevant employees are not designed to reward or incentivize prohibited proprietary trading and (6) the banking entity is licensed or registered to engage in the activities described above in accordance with applicable law.

Risk-Mitigating Hedging (§__.5)

The prohibition on proprietary trading does not apply to risk-mitigating hedging of a banking entity related to individual or aggregated positions if: (1) the banking entity establishes, implements and enforces a compliance program including written policies and procedures regarding the positions, techniques and strategies that may used for hedging, as well as position and aging limits for such hedging, internal controls and authorization procedures and analyses, including correlation analysis, designed to demonstrate that the proposed hedging may reasonably be expected to reduce or mitigate the specific risks being hedged, (2) the risk-mitigating hedging is conducted in accordance with such policies, procedures and controls, (3) the hedging is put on to reduce or mitigate (and demonstrably does so) one or more specific and identifiable risks, including market risk, counterparty or other credit risk, foreign exchange risk, interests rate risk, commodity price risk, basis risk or similar risks arising in connection with identified positions, contracts or other holdings and does not give rise to new or additional risk that is not itself hedged and (4) the compensation arrangements of the applicable employees are not designed to reward or incentivize prohibited proprietary trading.

Domestic Government Obligations (§__.6(a))

The ban on proprietary trading does not apply to a banking entity's purchase or sale of a financial instrument that is (1) an obligation of, or issued or guaranteed by, the United States, (2) an obligation, participation, or other instrument of, or issued or guaranteed by, an agency of the United States, FNMA, GNMA, FHLMC, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation or a Farm Credit System institution chartered under and subject to the provisions of the Farm Credit Act of 1971, (3) an obligation of any State or any political subdivision thereof, including any municipal security or (4) an obligation of the FDIC, or any entity formed by or on behalf of the FDIC for purpose of facilitating the disposal of assets acquired or held by the FDIC in its corporate capacity or as conservator or receiver.

Foreign Government Obligations (§__.6(b))

The ban on proprietary trading does not limit a banking entity's purchase or sale of a financial instrument that is an obligation of, or issued or guaranteed by, a foreign sovereign (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of such foreign sovereign, by a banking entity, so long as (1) the banking entity is organized under or is directly or indirectly controlled by a banking entity that is organized under the laws of a foreign sovereign and is not directly or indirectly controlled by a top-tier banking entity that is organized under the laws of the United States, (2) the financial instrument is an obligation of, or issued or guaranteed by, the foreign sovereign under the laws of which the foreign banking entity referred to in (1) above is organized (including any multinational central bank of

which the foreign sovereign is a member), or any agency or political subdivision of that foreign sovereign and (3) the purchase or sale as principal is not made by an insured depository institution.

Moreover, the ban on proprietary trading does not apply to a banking entity's purchase or sale of a financial instrument that is an obligation of, or issued or guaranteed by, a foreign sovereign (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of that foreign sovereign, by a foreign entity that is owned or controlled by a banking entity organized or established under the laws of the United States or any State, so long as (1) the foreign entity is a foreign bank, as defined in Section 211.2(j) of Regulation K, or is regulated by the foreign sovereign as a securities dealer, (2) the financial instrument is an obligation of, or issued or guaranteed by, the foreign sovereign under the laws of which the foreign entity is organized (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of that foreign sovereign and (3) the financial instrument is owned by the foreign entity and is not financed by an affiliate that is located in the United States or organized under the laws of the United States or of any State.

Trading on Behalf of Customers (§__.6(c))

The ban on proprietary trading does not apply to the purchase or sale of financial instruments by a banking entity: (1) acting as trustee or in a similar fiduciary capacity so long as (i) the transaction is conducted for the account of, or on behalf of, a customer and (ii) the banking entity does not have or retain beneficial ownership of the financial instruments or (2) acting as a riskless principal in a transaction in which the banking entity, after receiving an order to purchase (or sell) a financial instrument from a customer, purchases (or sells) the financial instrument for its own account to offset a contemporaneous sale to (or purchase from) the customer.

Trading By a Regulated Insurance Company (§__.6(d))

The prohibition of proprietary trading generally does not apply to the purchase or sale of financial instruments by a banking entity that is an insurance company or an affiliate of an insurance company if: (1) the insurance company or its affiliate purchases or sells the financial instruments solely for its general account or a separate account established by the insurance company, and (2) the purchase or sale is conducted in compliance with, and subject to, applicable law and regulation.

Trading by Foreign Banking Entities (§__.6(e))

The ban on proprietary trading does not apply to the purchase or sale of financial instruments by a banking entity not organized or directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of any State, if: (1) the purchase or sale by the banking entity is made pursuant to paragraphs (9) or (13) of Section 4(c) of the BHC Act and (2) the purchase or sale meets the requirements of the Final Rule intended to establish that the decision to enter into the trade and the accounting for the trade occur outside of the United States.

Limitations on Permitted Proprietary Trading (§__.7)

The proprietary trading exemptions detailed in the previous sections are not available to the extent a transaction, class of transactions, or activity would: (1) involve or result in a material conflict of interest between the banking entity and its clients, customers, or counterparties, (2) result, directly

or indirectly, in a material exposure by the banking entity to a high-risk asset or a high-risk trading strategy or (3) pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States.

In general, a disabling material conflict of interest between a banking entity and its clients, customers, or counterparties would exist if the banking entity engages in any transaction, class of transactions, or activity that would involve or result in the banking entity's interests being materially adverse to the interests of its client, customer, or counterparty with respect to such transaction, class of transactions, or activity, and the banking entity has not adequately disclosed the conflict in a manner sufficient to permit a reasonable client, customer, or counterparty to meaningfully understand the conflict of interest and to allow such person the opportunity to mitigate any material adverse effect or the banking entity has established, maintained, and enforced information barriers (memorialized in written policies and procedures) reasonably designed, taking into consideration the nature of the banking entity's business, to prevent the conflict of interest from involving or resulting in a materially adverse effect on a client, customer, or counterparty. A banking entity may not rely on such information barriers if, in the case of any specific transaction, class or type of transactions or activity, the banking entity knows or should reasonably know that, notwithstanding the banking entity's establishment of information barriers, the conflict of interest may involve or result in a materially adverse effect on a client, customer, or counterparty.

For purposes of the limitation on permitted proprietary trading, (i) a high-risk asset is an asset or group of related assets that would, if held by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States and (ii) a high-risk trading strategy is a trading strategy that would, if engaged in by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

COVERED FUNDS ACTIVITIES AND INVESTMENTS – SUBPART C OF THE FINAL RULE

General ***(§__.10)***

Section __.10 of the Final Rule provides that a banking entity may not, as principal, directly or indirectly, acquire or retain any "ownership interest" in, or sponsor, a "covered fund." Among a few other exceptions, the rule does not apply to the acquisition or retention of an ownership interest in a covered fund by a banking entity so long as the activity is conducted for the account of, or on behalf of, a customer and the banking entity or its affiliates does not retain a beneficial ownership.

A "covered fund" is defined to mean any of the following: (i) an issuer that would be an investment company as defined in the Investment Company Act of 1940 (the "40 Act") but for the exemptions set forth in Sections 3(c)(1) or 3(c)(7), (ii) registered commodity pools which meet certain requirements set forth in the Final Rule and (iii) certain foreign issuers with ownership interests of which are offered and sold outside of the United States.

An "ownership interest" is any equity, partnership or "other similar interest", which under Section __.10(d)of the Final Rule includes an interest that (either directly or synthetically): (1) has the right

to participate in the selection or removal of a general partner, managing member, member of the board of directors or trustees, investment manager, investment adviser, or commodity trading advisor of the covered fund (excluding the exercise of remedies upon the occurrence of an event of default or an acceleration event); (2) has the right under the terms of the interest to receive a share of the income, gains or profits of the covered fund; (3) has the right to receive the underlying assets of the covered fund after all other interests have been redeemed and/or paid in full (excluding the exercise of remedies upon the occurrence of an event of default or an acceleration event); (4) has the right to receive all or a portion of excess spread; (5) provides that the amounts payable by the covered fund with respect to the interest could be reduced based on losses arising from the underlying assets of the covered fund; or (6) receives income on a pass-through basis from the covered fund, or has a rate of return that is determined by reference to the performance of the underlying assets of the covered fund.

The Final Rule includes a list of 14 exclusions from the definition of covered fund, including certain loan securitizations, qualifying asset-backed commercial paper conduits, qualifying covered bonds, registered investment companies under the 40 Act and issuers formed by or on behalf of the FDIC in connection with its receivership or conservatorship operations. Certain of these exclusions will be described in more detail below.

Loan Securitizations

Section ___.10(c)(8) of subpart C excludes from the definition of covered fund asset-backed securities comprised solely of loans (defined as "any loan, lease, extension of credit or secured or unsecured receivable that is not a security or derivative") and certain other assets and otherwise meeting the requirements specified in paragraph (c)(8).

Under that section, in addition to loans, the assets of the excluded fund may be comprised solely of qualifying servicing rights (rights or other assets designed to assure the servicing or timely distribution of proceeds to holders and related assets), qualifying interest rate or foreign exchange derivatives and certain special units of beneficial interests and collateral certificates (the issuer of which must itself qualify under this section) and which are created by the entity initiating the securitization intended solely to satisfy legal requirements or facilitate the structuring of the securitization. Each loan must be owned directly and not indirectly through a derivative or synthetic, The assets of the excluded fund may not include any other assets, in particular, securities (including asset-backed securities), or an interest in an equity or debt security, any other derivative (including credit default swaps) or any commodity forward contract. The excluded fund may hold cash equivalents related to the permissible assets (high quality, highly liquid short-term investments such as certain "eligible investments" typically included in many transactions) as well as securities received in lieu of debts previously contracted relating to the permitted loan holdings (for example, interests received in a bankruptcy or workout). Interest rate and foreign exchange derivatives held by the excluded fund must relate directly to the loans or other permissible assets or rights held by the fund or securities issued by the fund and must be intended to reduce interest rate and/or foreign exchange risks related to the loans held, securities issued or other permissible assets or rights held by the fund.

As with other aspects of the Final Rule, the impact and efficacy of the exclusion for the loan market generally and the CLO market in particular will not be known for some time as market participants analyze the details of the rule, additional guidance becomes available and new transactions

structured and existing transactions reviewed in the light of that analysis and guidance. For new issues, structuring a transaction which does not permit any investment in bonds is a change from long-established practice. For existing deals, eliminating the bond basket through an amendment or otherwise limiting the use of the bond basket will no doubt be considered. Participants will also be analyzing whether some or all of the debt tranches may have rights which would cause such tranches to be considered "ownership interests" and possibly structuring or restructuring any such rights to ensure that such tranches are not considered ownership interests. To the extent a particular CLO would not fit within the loan securitization exclusion or a class of interests could not be structured so as not to fall within the definition of ownership interests, market participants will also be exploring the use of other Investment Company Act exceptions (such as Rule 3a-7) for a range of transactions for which Sections 3(c)(1) or 3(c)(7) have been traditionally used.

Qualifying Asset-Backed Commercial Paper Conduits

Section ___.10(c)(9) of subpart C excludes from the definition of covered fund asset-backed commercial paper conduits which meet the requirements set forth in the Final Rule.

The Final Rule describes a qualifying asset-backed commercial paper conduit as an asset-backed commercial paper conduit that holds only (1) loans and other assets permissible for a loan securitization described above and (2) asset-backed securities supported solely by assets that are permissible for loan securitizations as described above and which are acquired by the conduit as part of an initial issuance of such asset-backed securities, either directly from the issuer or directly from an underwriter in the distribution of such asset-backed securities. The commercial paper conduit must issue only asset-backed securities comprised of a residual interest and securities with a maturity of 397 days or less. In addition, a "regulated liquidity provider" must provide a legally binding commitment to provide "full and unconditional liquidity coverage" with respect to all commercial paper issued by the conduit in the event funds are required to redeem maturing commercial paper. For this purpose, a regulated liquidity provider means (1) a depository institution under the Federal Deposit Insurance Act; (2) a bank holding company or a subsidiary; (3) a savings and loan holding company (if all or substantially all of the holding company's activities are permissible for a financial holding company under the BHC Act) or a subsidiary; (4) a foreign bank whose home country supervisor has adopted capital standards consistent with the Basel standards, and is subject to such standards or a subsidiary; and (5) the United States or a foreign sovereign.

Qualifying Covered Bonds

Section ___.10(c)(10) of subpart C excludes from the definition of covered fund covered bonds which meet the requirements set forth in the Final Rule.

The Final Rule describes a qualifying covered bond as either: (1) a debt obligation issued by an entity that meets the definition of foreign banking organization under the Final Rule, the payment obligations of which are fully and unconditionally guaranteed by a banking entity which owns or holds a dynamic or fixed pool of loans and other assets, all of which comprise loans assets that are permissible for a loan securitization described above or (2) a debt obligation of a banking entity which owns or holds a dynamic or fixed pool of loans and other assets, all of which comprise loans assets that are permissible for a loan securitization described above, provided that the payment

obligations are fully and unconditionally guaranteed by a foreign banking organization or a wholly-owned subsidiary thereof.

Foreign banking organization, as used in this section, has the same meaning as in Section 211.21(o) of Regulation K (12 CFR 211.21(o)), but does not include a foreign bank, as defined in Section 1(b)(7) of the International Banking Act of 1978, that is organized under the laws of the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, or the Commonwealth of the Northern Mariana Islands.

Wholly-owned subsidiaries are defined as any entity all of whose outstanding ownership interests are owned directly or indirectly by a banking entity or affiliate, except, that (1) up to 5% of the entity's outstanding ownership interests (less any amounts outstanding under clause (2) below) may be held by employees or directors of the banking entity or such affiliate (including former employees or directors if their ownership interest was acquired while employed by or in the service of the banking entity); and (2) up to 0.5% of the entity's outstanding ownership interests may be held by a third party if the ownership interest is acquired or retained by the third party for the purpose of establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns.

Municipal Securities Tender Option Bond Transactions

Municipal securities tender option bond transactions typically rely on the exemption contained in Section 3(c)(1) or Section 3(c)(7) of the 40 Act and, therefore, issuers of tender option bonds fall under the definition of covered fund in the Final Rule. In commenting on the Final Rule in its proposed form (which proposal was issued on November 7, 2011), participants in the tender option bond market argued that tender option bond issuers should be excluded from the definition of covered fund, as these issuers do not have characteristics of the private equity and hedge funds that were the primary focus of the rule, among other reasons. However, tender option bond issuers were among the entities that were identified by the Agencies in the preamble to the Final Rule as *not being specifically excluded* from the definition of covered fund. Participants in the tender option bond market are currently exploring ways in which the tender option bond structure can be modified to be compliant with the Final Rule.

Offering of a Covered Fund; Applicability to Asset-Backed Securities (§__.11)

A securitization which relies on any other exclusion under the 40 Act other than 3(c)(1) and 3(c)(7), such as Rule 3a-7 or Section 3(c)(5), would not be deemed a covered fund under the Final Rule.

The Final Rule indicates that a banking entity is *not prohibited* from acquiring or retaining an ownership interest in, or acting as sponsor to, a covered fund so long as: (1) the banking entity (or an affiliate) provides bona fide trust, fiduciary, investment advisory, or commodity trading advisory services; (2) the covered fund is organized and offered pursuant to a written plan only in connection with the provision of such services and only to persons that are customers of such services of the banking entity (or an affiliate); (3) the banking entity and its affiliates do not acquire or retain an ownership interest in the covered fund except as otherwise permitted under Section __.12 of the Final Rule; (4) the banking entity and its affiliates comply with the requirements of Section __.14 of the Final Rule (limitations on relationships with a covered fund); (5) the banking

entity and its affiliates do not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the covered fund or of any covered fund in which such covered fund invests; (6) the covered fund, for corporate, marketing, promotional, or other purposes does not share the same name or a variation of the same name with the banking entity (or an affiliate) and does not use the word "bank" in its name; (6) no director or employee of the banking entity (or an affiliate) takes or retains an ownership interest in the covered fund, except for any director or employee who is directly engaged in providing investment advisory, commodity trading advisory, or other services at the time the director or employee takes the ownership interest; and (7) the banking entity complies with the disclosure requirements set forth in the Final Rule and any additional rules of the Agencies.

Section __.10 of the Final Rule indicates that an entity will be considered a "sponsor" of a covered fund if it: (1) serves as a general partner, managing member, or trustee of a covered fund, or serves as a registered commodity pool operator with respect to a covered fund; (2) in any manner, selects or controls (or to have employees, officers, or directors, or agents who constitute) a majority of the directors, trustees, or management of a covered fund; or (3) shares with a covered fund, for corporate, marketing, promotional, or other purposes, the same name or a variation of the same name.

To the extent that an issuer of asset-backed securities is a covered fund, the investment limitations described in the Final Rule would also limit the ability of a banking entity to invest in the ownership interests of that issuer. The Final Rule does not prohibit a banking entity from acquiring or retaining an ownership interest in, or acting as sponsor to, a covered fund that is the issuer of asset-backed securities in connection with the direct or indirect organization and offering of such issuing entity, so long as the conditions set forth in the second preceding paragraph above (other than conditions (1) and (2)) are satisfied. In addition, the Final Rule indicates that organizing and offering a covered fund that is an issuer of asset-backed securities means acting as a "securitizer" as that term is used in Section 15G(a)(3) of the Securities Exchange Act of 1934 (the "Exchange Act") and such banking entity would be required to comply with the provisions of Dodd-Frank that apply to securitizers, including, but not limited to, the proposed rules relating to the implementation of the risk retention requirements of Section 941 of Dodd-Frank, proposed on August 28, 2013 (the "Proposed Risk Retention Rules").

Ownership Interests in Securitization Vehicles

To the extent that a securitization vehicle (which is a covered fund) utilizes a collateral manager which is a banking entity, such manager would be required to comply with the provisions of the Final Rule in order to retain an ownership interest in such vehicle. If a debt security or other interest in such fund exhibits characteristics similar to those of equity or other ownership interests (such as providing the holder with the ability to elect or remove an investment manager, to share in the covered fund's profits or losses or to earn a return based on the performance of the covered fund's underlying holdings or investments), then such instrument would be considered an ownership interest under the Final Rule.

Underwriting and Market Making-Related Activities

The Final Rule provides for an exemption for a banking entity's underwriting or market making activities involving a covered fund, so long as: (1) Sections __.4(a) and __.4(b) of the Final Rule are complied with; (2) the banking entity acts as sponsor and acquires and retains an ownership interest in order to comply with the Proposed Risk Retention Rules or directly or indirectly guarantees, assumes or otherwise insures the obligations or performance of the covered fund or of any covered fund in which such fund invests, then such ownership interests must be included in the calculations and limitations described below under "Permitted Investments in Covered Funds;" and (3) the aggregate value of all ownership interests of the banking entity and its affiliates in all covered funds, including those held in connection with underwriting and market making-related activities are included in the calculations and limitations described below under "Permitted Investments in a Covered Funds."

Permitted Investments in Covered Funds (§__.12)

A banking entity may acquire and retain an ownership interest in a covered fund that it or its affiliates organizes and offers for the purposes of establishing the fund and providing it with sufficient initial equity to permit the fund to attract unaffiliated investors. In addition, the banking entity will be allowed to make and retain *de minimis* investments in such covered funds, subject to the limitations described below.

Investment Limits

After the initial seeding period (in general, no later than one year after the date of establishment of the covered fund), the ownership interest of a banking entity and its affiliates in any covered fund may not exceed 3% of the total number or value of the outstanding ownership interests of the fund. If the covered fund is an issuing entity of asset-backed securities, then the ownership interest may not exceed 3% of the total fair market value of the ownership interests of the fund (measured as described below) unless a greater percentage is retained in compliance with the requirements of Section 15G of the Exchange Act and the Proposed Risk Retention Rules, in which case the investment may not exceed the amount, number or value of ownership interests of the fund required under Section 15G of the Exchange Act. The aggregate value of all ownership interests of any banking entity and its affiliates in all covered funds may not exceed 3% of the tier 1 capital of the banking entity.

The calculation of ownership interests for securitizations differs depending on whether the securitization is subject to the Proposed Risk Retention Rules, however, in all cases, the valuation methodology used to calculate the fair market value of the ownership interests must be the same for both the ownership interests held by a banking entity and the ownership interests held by all others in the covered fund.

If a securitization is subject to the Proposed Risk Retention Rules, the calculations shall be made as of the date and according to the valuation methodology applicable pursuant to the requirements of Section 15G of the Exchange Act and the Proposed Risk Retention Rules. If a securitization transaction closed or closes prior to the compliance date of the Proposed Risk Retention Rules (or which is not subject to such rules) (1) the calculations shall be made as of the date on which the assets are initially transferred into the issuing entity or such earlier date on which the transferred

assets have been valued for purposes of transfer to the covered fund (and thereafter only upon the date on which additional securities of the issuing entity are priced for sale to unaffiliated investors); and (2) the aggregate value of the outstanding ownership interests in the covered fund shall be the fair market value of the assets transferred to the issuing entity of the securitization and any other assets otherwise held by the issuing entity at such time, determined in a manner that is consistent with its determination of the fair market value of those assets for financial statement purposes.

***Limitations on Relationships with a Covered Fund* (§__.14)**

The Final Rule provides that no banking entity or affiliate that either (i) serves, directly or indirectly, as the investment manager, investment adviser, commodity trading advisor or sponsor to a covered fund, (ii) organizes and offers a covered fund or (iii) continues to hold an ownership interest in a covered fund may enter into a transaction with a covered fund that would be a covered transaction as deterred in Section 23A of the Federal Reserve Act. There are exceptions for acquisition and retention of ownership interests in compliance with the Final Rule as described above and for prime brokerage transactions.

Conclusion

The preceding discussion was only a summary of certain provisions of the Final Rule. As indicated, the Final Rule is extremely detailed and complex and its application in any particular case may not be clear even after market participants develop a more thorough understanding of the full reach and implications. Please feel free to contact any of us should you wish to discuss any aspect of the Final Rule which affects you or the transactions on which you are working.

Please contact any of the below-listed authors of this Client Alert, any of the members of our Structured Finance Group or other Orrick attorneys with whom you work to discuss any questions you may have with regard to the foregoing.

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