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Clients&FriendsMemo

Regulation of Systemically Significant NonBanks Under the Dodd-Frank Wall Street Reform and Consumer Protection Act*

July 20, 2010

The focus of this Memorandum is the potential regulation by the Board of Governors of the Federal Reserve System, pursuant to the newly-passed Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Act**" or the "**Dodd-Frank Act**"), of **nonbank financial companies designated as** "**systemically significant**" as provided by Titles I and VI of the Act, including the Volcker Rule.[1]

Supervision of Systemically Significant NonBanks

Title I of the Dodd-Frank Act contains sweeping provisions that authorize the Board of Governors of the Federal Reserve System (the "**Federal Reserve**") to supervise previously unregulated (or under-regulated) firms--including firms that are neither banks nor affiliated with banks--engaged in various financial activities where those firms' activities are deemed systemically significant with respect to the U.S. financial system. Firms so designated (the Act refers to them as "Nonbank financial companies supervised by the Board of Governors"[2] – we refer to them as "systemically significant nonbank financial firms," or "**SSNFs**" – would be subjected to heightened supervision and prudential regulation by the Federal Reserve, as explained below.

The organization of the memorandum is as follows:

> Section I describes the procedure for designating a nonbank as an SSNF.
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> The principal requirements imposed on SSNFs are described in Section II.

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* Cadwalader has prepared a short summary of the Act and a series of memoranda focused on the Act's application to specific industries, entities and transactions. To see these other memoranda please see a *Summary of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Appendix A links to the various topic-focused memoranda) or visit our website at http://www.cadwalader.com/list_client_friend.php.

[1] Reflects those portions of Titles I and VI of the Act as passed by the House of Representatives and the Senate pertaining to certain nonbank companies that may become subject to regulation by the Federal Reserve pursuant to Section 113 of that Act.

[2] *See* Dodd-Frank Act § 102(a)(4)(D).

Section III sets out the shift in authority over certain investment bank holding companies from the SEC to the Federal Reserve.

Section IV describes the application of "Growth Limits" to SSNFs.

Finally, Section V describes the application of "Volcker Rule" to SSNFs.

I. Creation of the FSOC; Procedure and Criteria for Designation of a Nonbank as an SSNF

Creation of the FSOC. Title I of the Act establishes the Financial Stability Oversight Council ("**FSOC**"), whose voting members include each of the heads of the Federal Reserve, OCC, Bureau of Consumer Financial Protection ("**BCFP**"), CFTC, SEC, FDIC, Federal Housing Finance Agency ("**FHFA**"), and National Credit Union Administration ("**NCUA**"), as well as an independent member appointed by the President.[3] The FSOC has general authority to issue recommendations to the "primary financial regulatory agencies"[4] regarding heightened standards and safeguards as to the conduct of financial activities that "create or increase the risk of significant liquidity, credit, or other problems spreading among bank holding companies ("**BHCs**") and nonbank financial companies, financial markets of the United States, or low-income, minority, or underserved communities."[5] The primary regulatory agencies are generally obligated to implement an FSOC recommendation by rule within ninety days.[6]

Process for Designation as Systemically Significant. The most significant power that the FSOC will exercise directly, rather than through "recommendations," is to designate a nonbank firm an "SSNF." The FSOC is empowered to impose such a designation if it finds that (i) the nonbank firm is "predominantly engaged" in activities that are "financial in nature" under Section 4(k) of the Bank Holding Company Act (the "**BHC Act**"); and (ii) "material financial distress at the nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the

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3 *See* Dodd-Frank Act § 111. Title I also establishes the Office of Financial Research ("**OFiR**"), which is generally tasked with facilitating the management of data that the FSOC collects in connection with FSOC reporting requirements imposed on SSNFs under Section 116. *See* Dodd-Frank Act § 152.

4 Note that "primary financial regulatory agency" is a defined term referring, generally, to the federal or state regulatory authority having "primary" supervisory jurisdiction over an entity. *See* Dodd-Frank Act § 2(12). Note also that the various titles of the legislation contain variations on this defined term, and each variation operates to confer jurisdiction with respect to certain activities on one or another "primary" regulatory agency.

5 *See* Dodd-Frank Act § 120.

6 *See* Dodd-Frank Act § 120(c)(2).

activities of the nonbank financial company, could pose a threat to the financial stability of the United States."[7]

A nonbank firm is deemed "predominantly engaged" in activities that are "financial in nature"[8] if such activities (i) contribute 85% or more of annual gross revenues of the firm, or (ii) account for 85% or more of the firm's total consolidated assets.[9] SSNF designation can be applied to foreign firms if such firm's US operations are deemed significant.[10] Further, a subsidiary may be designated a SSNF even if the parent company is not, which means that the calculation of the 85% test is not required to be made at the ultimate parent level. Thus, the population of entities that could potentially be designated as SSNFs is extremely large.[11]

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7 *See* Dodd-Frank Act § 113; *see also Some Concerns with the Regulation of Large Nonbank Holding Companies* (Cadwalader, June 3, 2010), *available at* http://www.cadwalader.com/assets/client_friend/060310RegLargeNonBankHoldingCos.pdf.

8 *See* Dodd-Frank Act § 163(b). The Gramm-Leach-Bliley Act of 1999 established the category of activities that are "financial in nature." *See* BHC Act Section 4(k) (12 U.S.C. § 1843(k)). Generally, "financial in nature" activities include such additional activities that are permissible for a bank holding company ("**BHC**") that qualifies as and has elected to become a "financial holding company" ("**FHC**"). "Financial in nature" encompasses a fairly sweeping list of activities, some of which would seem unlikely to be fundamental to the financial stability of the United States, including:

- lending
- trust and safekeeping activities
- securitization of assets
- merchant banking
- underwriting and dealing in securities
- mutual fund activities
- check cashing and money transmitting
- insurance agency and underwriting
- investment advisory services
- "finder" activities
- activities permissible for a BHC outside of the United States and which the Federal Reserve has determined is "usual in connection with the transaction of banking" abroad (such as management consulting, general data processing, and travel agency), and
- activities that are "closely related to banking" under Section 4(c)(8) of the BHC Act, including: servicing loans; real estate and personal property appraising; arranging commercial real estate equity financing; real estate settlement servicing; leasing personal or real property; check guaranty services; credit bureau services; collection agency services; acquiring debt in default; asset management, servicing, and collection activities; management consulting and counseling activities; employee benefits consulting services; career counseling services; courier services; printing and selling certain encoded items; and data processing services.

9 *See* Dodd-Frank Act § 102(a)(6).

10 *See* Dodd-Frank Act §113(i). The FSOC must consult with the appropriate foreign regulatory authorities when designating foreign firms SSNFs.

11 Note that an insurer may be designated an SSNF. For a discussion of the provisions of Title V specifically applicable to insurers, see the Memorandum entitled *Insurance Reforms under the Dodd-Frank Wall Street Reform and Consumer Protection Act.*

SSNF Criteria. When deciding whether to designate a firm as an SSNF, the FSOC must consider a series of factors, including:

- leverage;
- off-balance-sheet exposures;
- transactions and relationships with other significant firms;
- the importance of the firm as a source of credit and liquidity for the United States financial system;
- the importance of the firm as a source of credit for low-income, minority, or underserved communities in the United States;
- whether the firm is a manager rather than owner of assets;
- the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company;
- whether the firm is subject to prudential standards on a consolidated basis in its home country; or already regulated by a U.S. financial regulatory agency;
- the amount and nature of the firm's U.S. financial assets;
- how the firm funds its operations.

The FSOC must notify a firm of its determination and provide the firm an opportunity for a hearing to contest its findings.[12] In the event of an unsuccessful contest (we assume most firms will contest designation as an SSNF given the substantial burdens that will follow from it), the judicial recourse afforded the designated firm is limited. The firm may appeal the determination in federal district court, but the court may only overturn the FSOC's determination if it finds the determination

[12] *See* Dodd-Frank Act § 113(e).

"arbitrary and capricious."[13] Designated firms must register with the Federal Reserve within 180 days after receiving a final FSOC determination.[14]

II. Requirements Imposed on Nonbanks Designated as SSNFs

Mandatory Heightened Prudential Standards. SSNFs will be required to comply with "prudential standards" that would be stricter than those imposed on existing banks and BHCs. Certain "prudential standards" *must* be adopted by rule, including:

- **Risk-based capital and leverage requirements**;[15]
- **Liquidity requirements**;[16]
- **Risk management requirements**, including the establishment of board-level "risk committees";[17]

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[13] *See* Dodd-Frank Act § 113(h). Note that the Act requires the Federal Reserve to issue regulations that provide a "safe harbor" from designation as an SSNF for certain "types or classes" of nonbank financial companies. *See* Dodd-Frank Act § 170.

[14] *See* Dodd-Frank Act § 114.

[15] Although the leverage ratio requirement is to be defined in the Federal Reserve rulemaking, the Federal Reserve is required to apply a debt-to-equity ratio limit of 15-to-1 for SSNFs that are found to pose a "grave" threat to U.S. financial stability. In addition, any leverage or risk-based capital provisions adopted by the Federal Reserve must require that certain "off-balance-sheet activities" must be included in the capital computations. "Off-balance-sheet activity" means an existing liability of a company that is not currently a balance sheet liability, but may become one upon the happening of some future event, including the following transactions, to the extent that they may create a liability:

- Direct credit substitutes in which a bank substitutes its own credit for a third party, including standby letters of credit.
- Irrevocable letters of credit that guarantee repayment of commercial paper or tax-exempt securities.
- Risk participations in bankers' acceptances.
- Sale and repurchase agreements.
- Asset sales with recourse against the seller.
- Interest rate swaps.
- Credit swaps.
- Commodities contracts.
- Forward contracts.
- Securities contracts.
- Such other activities or transactions as the Federal Reserve may, by rule, define.

Dodd-Frank Act § 165(j), (k).

[16] Dodd-Frank Act § 165(b)(1)(A)(ii).

[17] Dodd-Frank Act § 165(b)(1)(A)(iii). The Dodd-Frank Act states that publicly traded SSNFs *must* establish a risk committee within one year after becoming an SSNF. Dodd-Frank Act § 165(h).

- **Resolution plan (or "living will") requirements**, including the obligation of the SSNF to report periodically to the Federal Reserve, the FSOC, and the FDIC its plan for its own "rapid and orderly resolution in the event of material financial distress or failure";[18]

- **Periodic credit exposure reporting requirements**, including reports of exposures *to or from* other SSNFs or BHCs with assets of $50 billion or more ("**Large BHCs**");[19] and

- **Concentration limits.**[20]

Potential Heightened Prudential Standards. In addition, the Federal Reserve *may*, but is not *required* to, adopt prudential standards relating to:

- **Contingent capital requirements**, including the requirement that SSNFs hold a minimum amount of contingent capital that is convertible into equity in times of financial stress;[21]

- **Short-term debt limits**, to be calculated as a percentage of the SSNF's capital and surplus;[22]

- **Enhanced public disclosures**;[23] and

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[18] *See* Dodd-Frank Act § 165(b)(1)(A)(iv), (d)(1).

[19] Dodd-Frank Act § 165(b)(1)(A)(iv), (d)(2).

[20] Dodd-Frank Act § 165(b)(1)(A)(v). In addition, the Act provides for a hard credit exposure limit of 25% of capital stock and surplus of the SSNF to any "unaffiliated company." "Credit exposure" is defined as:

- all extensions of credit to the company, including loans, deposits, and lines of credit;
- all repurchase agreements and reverse repurchase agreements with the company, and all securities borrowing and lending transactions with the company, to the extent that such transactions create credit exposure for the SSNF;
- all guarantees, acceptances, or letters of credit (including endorsement or standby letters of credit) issued on behalf of the company;
- all purchases of or investment in securities issued by the company;
- counterparty credit exposure to the company in connection with a derivative transaction between the company and the SSNF; and
- any other similar transactions that the Federal Reserve, by regulation, determines to be a credit exposure.

Section 165(e) also contains an "attribution rule" similar to that found in Section 23A of the Federal Reserve Act (12 U.S.C. § 371c), such that transactions with one party in which the proceeds of the transaction are ultimately transferred to, or that benefit, a second party are treated as a transaction directly with the second party for purposes of the credit concentration limits. The credit concentration limits (including the 25% cap) are not effective until three years after enactment.

[21] *See* Dodd-Frank Act § 165(b)(1)(B)(i), (c). However, the Federal Reserve may adopt contingent capital requirements only following the FSOC's completion of its study regarding contingent capital.

[22] *See* Dodd-Frank Act § 165(b)(1)(B)(ii), (g).

[23] *See* Dodd-Frank Act § 165(b)(1)(B)(iii), (f).

- Other prudential standards recommended by the FSOC or deemed appropriate by the Federal Reserve.

Early Remediation Regulations. In addition, the Federal Reserve, after consultation with the FSOC and the FDIC, is required to adopt regulations regarding early remediation requirements, involving a series of specific remedial actions to be taken by a SSNF that is experiencing financial distress.[24]

Reporting. SSNFs must submit certain reports to the Federal Reserve and FSOC, which in some cases may be duplicates of reports already provided to foreign authorities or other U.S. federal or state regulatory authorities.[25] The reports are intended to keep the Federal Reserve and FSOC informed as to the reporting entity's financial condition, risk control systems, transactions with depository institution subsidiaries (in the case of a banking organization), and "activities and operations [that] could, under adverse circumstances, have the potential to disrupt financial markets or affect the overall financial stability of the United States."

Examination and Enforcement. The Act subjects an SSNF and its subsidiaries to Federal Reserve examination authority with respect to (1) the nature of the operations and financial condition of the SSNF and its subsidiaries; (2) the financial, operational, and other risks of the SSNF and its subsidiaries that may pose a threat to the safety and soundness of the SSNF and its subsidiaries or to the financial stability of the United States; (3) the systems for monitoring and controlling such risks; and (4) compliance by the SSNF and its subsidiaries with the requirements of the Act.[26] The Federal Reserve is also granted authority to issue cease-and-desist orders against an SSNF for engaging in unsafe and unsound practices.[27] In addition, if the Federal Reserve determines that the primary financial regulatory agency having supervisory authority over a functionally regulated subsidiary of an SSNF has not done enough to force the subsidiary to cease the unsafe and unsound practice, the Federal Reserve may initiate enforcement action against the subsidiary as if

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[24] *See* Dodd-Frank Act § 166 (mandatory and subject to Federal Reserve rulemaking). Early remediation regulations issued by the Federal Reserve are likely to generally resemble the FDIC's "prompt corrective action" requirements. The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") mandated that banking regulators take "prompt corrective action" ("PCA") when an institution's capitalization rating falls below the top two capitalization categories. *See* 12 U.S.C. § 1831o. PCA may include an increase in the monitoring of the institution, requiring the institution to raise more capital, requiring the institution to merge with a more highly capitalized institution, or closure of the institution. Similarly, the Federal Reserve's early remediation regulations must establish requirements for (i) limits on capital distributions, acquisitions, and asset growth; (ii) capital restoration plan and capital-raising requirements; (iii) limits on transactions with affiliates; (iv) management changes; and (v) asset sales. Dodd-Frank Act § 166(c).

[25] *See* Dodd-Frank Act §§ 116(b); 161(c).

[26] *See* Dodd-Frank Act §161(b) (subjecting SSNFs to Federal Reserve examination).

[27] *See* Dodd-Frank Act §162. The SSNF would be treated as if it were a BHC for purposes of FDIA cease-and-desist authority.

the subsidiary were a BHC subject to Federal Reserve supervision.[28] Finally, the Federal Reserve is required to conduct annual "stress tests" of SSNFs to evaluate whether such entities have capital that is adequate on a total consolidated basis to absorb losses resulting from adverse economic conditions.[29]

Financial Silos for SSNFs. Bank regulation is largely premised on the concept of "the separation of banking and commerce" – that is, banks are confined to a fairly narrow range of activities, and companies that control banks (*i.e.*, in most cases, Federal Reserve – regulated BHCs) and the other nonbank affiliates of banks are also confined to a limited range of activities permitted under the BHC Act.[30] SSNFs (which, by their nature, are not BHCs and therefore typically engage in a broader range of activities permitted to corporations generally) could not comply with the BHC Act's activity restrictions without significant divestitures or changes in their activities.

The Act does not require an SSNF (or its parent) to conform its activities to Section 4 of the BHC Act or otherwise shed any activities not permissible for a BHC.[31] The Act does, however, authorize the Federal Reserve to require the "siloing" of any of the SSNF's BHC-eligible activities from the remainder of its activities. The Federal Reserve is authorized to issue regulations that would require any SSNF to create an intermediate holding company to "silo" all or a part of the activities of the SSNF that are deemed to be "financial in nature" under BHC Act Section 4(k) – potentially compelling a significant restructuring of the SSNF. The Act further states that such "siloing" is mandatory where the Federal Reserve determines that, essentially, it would be difficult to properly supervise the "financial in nature" activities of the SSNF if such an intermediate holding company was not created.[32] The Act carves out from the siloing requirement any "internal financial activities" that are engaged in on behalf of the SSNF or an affiliate (such as the SSNF's internal treasury or accounts payable functions). Further, the Act extends the Federal Reserve's "source of strength"

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28 *See* Dodd-Frank Act § 162(b)(2).

29 *See* Dodd-Frank Act § 165(i). Note that the Act appears to confer very broad discretionary authority on the Federal Reserve to require stress testing of any "nonbank financial company," which as the term is defined in the act would include any U.S. or non-U.S. company that is engaged "predominantly" in activities that are "financial in nature" under BHC Act § 4(k).

30 *See Some Concerns with the Regulation of Large Nonbank Holding Companies* (Cadwalader, June 3, 2010), *available at* http://www.cadwalader.com/assets/client_friend/060310RegLargeNonBankHoldingCos.pdf. This memorandum was published before the Act was adopted and some of the specific concerns raised in the memorandum were addressed in the final version of the Act. Nonetheless, the general policy concern raised by the memorandum; *i.e.,* the absence of a clear policy justification for regulating entities that were neither banks nor controlled banks under a scheme of regulations designed for banks remains an issue.

31 *See* Dodd-Frank Act § 167(a).

32 *See* Dodd-Frank Act § 167(b)(1)(B).

doctrine to the SSNF's parent company, which would require the SSNF's parent company to provide financial support to the intermediate holding company.[33]

Any forced siloing may have significant burdens associated with it, even beyond the need to undergo a corporate reorganization, and the variety of legal, accounting and tax issues that the reorganization itself may raise. For example, personnel, systems, facilities, licenses, documents, intercompany and third party agreements, expenses, etc. may need to be realigned to be consistent with the newly siloed financial activities.

Limitation on Certain Acquisitions. Section 163 of the Act subjects SSNFs to the prior approval requirements of the BHC Act with respect to certain transactions by the SSNF, including acquisition of shares or assets of a bank or BHC.[34] Thus, the Act effectively lowers the maximum ownership interest a SSNF can hold in a bank or thrift, from 24.9% (without filing a Section 3 application under the BHC Act) or 9.9% (without filing a Change-in-Bank Control Act application) to 4.9%. A further limitation that the Act imposes on SSNFs is a requirement that an SSNF give prior notice to the Federal Reserve regarding acquisitions of companies engaged in activities deemed to be "financial in nature," if the company to be acquired has assets in excess of $10 billion. In short, this gives the Federal Reserve the authority to oversee the acquisition by a nonbank SSNF of another large nonbank financial company, a regulatory hurdle that would have to be accounted for in the accomplishment of virtually any strategic acquisition by an SSNF.

Cessation of Activities. The Act grants the Federal Reserve broad authority to require SSNFs to terminate certain activities and divest certain assets if the Federal Reserve determines that the SSNF poses a "grave threat" to U.S. financial stability.[35] Specifically, the Federal Reserve may: (1) limit the ability of the firm to merge with, acquire, consolidate with, or otherwise become affiliated with another company; (2) restrict the ability of the firm to offer a financial product or products; (3) require the company to terminate one or more activities; (4) impose conditions on the manner in which the company conducts one or more activities; or (5) require the company to sell or otherwise transfer assets or off-balance-sheet items to unaffiliated entities. The exercise of such

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[33] The Act states, "A company that directly or indirectly controls an intermediate holding company established under this section shall serve as a source of strength to its subsidiary intermediate holding company." Dodd-Frank Act § 167(b)(3). "Source of strength" is not defined in Section 167. Prior to the enactment of the Dodd-Frank Act, a "source of strength" doctrine was reflected solely in Federal Reserve Board regulations and not in the banking statutes; the regulations provide that "A bank holding company shall serve as a source of financial and managerial strength to its subsidiary banks ...." 12 C.F.R. § 225.4(a)(1). A separate provision of the Dodd-Frank Act codifies source of strength doctrine with respect to traditional bank holding companies, savings and loan holding companies, and holding companies for nonbank banks, but explicitly limits the obligation to serving as a "source of *financial* strength" to its depository institution subsidiaries. Dodd-Frank Act § 616(d).

[34] *See* Dodd-Frank Act § 163(a).

[35] *See* Dodd-Frank Act § 121.

powers with respect to nonbank financial companies does not have a precedent and there is no way to know how the procedure by which they may be exercised, how frequently, or the criteria to be used in deciding to exercise the authority.

III. Securities Holding Companies

Investment Bank Holding Company vs. Securities Holding Company. Section 617 would eliminate the ability of a foreign entity to become an "investment bank holding company" subject to supervision by the SEC. Instead, Section 618 would create an elective "securities holding company" that would be supervised by the Federal Reserve. The purpose of these provisions is to create a framework for foreign securities companies operating in the U.S. to satisfy non-U.S. legal obligations that the foreign securities companies be subject to comprehensive consolidated supervision within the U.S.

To qualify as a "securities holding company," the entity must control one or more broker-dealers registered with the SEC, and must not otherwise be subject to supervision by the Federal Reserve or another federal banking agency. Section 618 directs the Federal Reserve to establish record keeping, reporting, examination, capital, and risk management requirements applicable to securities holding companies. Section 618 further subjects a securities holding company to the provisions of the BHC Act as if it were a BHC, with the exclusion of the activity and ownership restrictions of Section 4 of the BHC Act.[36]

This provision does not constitute a major change in law. Effectively, this provision shifts an authority that would previously have been exercised by the SEC (with respect to regulated broker-dealers that are intended to be subject to consolidated supervision but that are not part of BHCs) to the Federal Reserve, which is better staffed in regard to the supervision of holding companies. This provision does not apply to the regulation of any existing broker-dealers; *i.e.,* all of the existing broker-dealers that are subject to consolidated supervision are part of BHCs that are already regulated by the Federal Reserve and not by the SEC.

IV. Growth Limits

The Dodd-Frank Act expands the nationwide "concentration limits" first introduced upon the enactment of the Riegle-Neal Interstate Banking and Branching Act of 1994. That Act instituted a "nationwide deposit cap," precluding the Federal Reserve from approving any interstate acquisition of a bank or BHC if the resulting bank or BHC would hold more than 10% of nationwide deposits.[37]

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[36] 12 U.S.C. § 1843.

[37] *See* 12 U.S.C. § 1842(d)(2).

New Nationwide Liability-Based Cap Applicable to SSNFs. Section 622 creates an entirely new concentration limit cap, calculated based on total liabilities and imposed on any acquisition (whether or not interstate) and applicable not only to BHCs but also to companies that control a nonbank bank and to SSNFs. Section 622 prohibits such a financial company (including an SSNF) from acquiring, acquiring substantially all the assets of, or merging or consolidating with, *any* other company (financial or otherwise) if, as a result of the transaction, the surviving financial company's total consolidated liabilities will exceed 10% of all of the consolidated liabilities of all financial companies. "Liabilities" is defined as the difference between the entity's risk-weighted assets and its total regulatory capital, and includes all consolidated liabilities of U.S.-based financial companies (including liabilities abroad) and all consolidated liabilities of foreign-based financial companies' U.S. operations. Within six months following enactment of the Dodd-Frank Act, the FSOC is required to conduct a study and render recommendations regarding any modifications to the liability-based concentration limit. The Federal Reserve is required to promulgate regulations implementing the new concentration limit within nine months thereafter.

V. The Volcker Rule

Section 619 of the Dodd-Frank Act enacts the so-called "Volcker Rule." The Volcker Rule has two prongs: (i) prohibiting "banking entities" from engaging in proprietary trading in certain securities (the "**Prop Trading Restriction**"); and (ii) prohibiting "banking entities" from sponsoring or investing in a hedge fund or private equity fund (the "**Sponsoring and Investing Restriction**"). These two prohibitions apply to "Banking Entities," which includes insured depository institutions, BHCs, entities treated as BHCs for purposes of the Act (such as foreign banks with a U.S. banking presence), holding companies of nonbank banks, and any affiliates of the preceding entities.

SSNFs not Subject to Bar but Subject to Prudential Limits. An SSNF that is not otherwise a banking entity generally is not subject to the two prohibitions of the Volcker Rule because SSNFs are not deemed to be within the definition of "Banking Entity." However, the Federal Reserve is required to adopt rules regarding capital requirements and quantitative limits with respect to the proprietary trading and fund investment activities of SSNFs. If any divestitures are required in accordance with such rules, an SSNF would have a two-year phase-in period for disposal of the investments (with extensions of up to three years) from the date the firm is designated an SSNF.

Study, Rules and Effectiveness. Within six months after the Act's enactment, the FSOC is required to conduct a study regarding the limits imposed by the Volcker Rule and provide recommendations on implementing the Volcker Rule's provisions. Within nine months after the FSOC study, the federal banking agencies, the SEC, and the CFTC would be required to adopt coordinated final regulations implementing the Volcker Rule, consistent with the recommendations and modifications of the FSOC. The provisions of the Volcker Rule become effective twelve months after the adoption of these coordinated final regulations, but in no case later than two years after enactment of the Dodd-Frank Act.

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We hope you find this helpful. Please feel free to contact any of the following Cadwalader attorneys if you have any questions about this memorandum.

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