GUIDE TO BANK UNDERWRITING, DEALING AND BROKERAGE ACTIVITIES

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The authors thank their colleagues
for assistance in preparing this Guide.

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Dedication

We are proud to dedicate this edition of the Guide to its original author, our colleague and friend, Robert (Bob) L. Tortoriello. Bob has been a thought leader in the area of bank capital markets activities for decades, and this publication has been one of his many contributions to this practice area.

Bob is known universally for the many hats he has worn in his professional life – as an advocate, an advisor, a scholar, a counselor, a mentor, a confidante, a writer, a speaker, a teacher, a colleague and a friend. Not one of these roles was carried out by Bob with anything less than all his energy and intellect, coupled with efficiency, insight and always positivity. In the area of financial services transactional and regulatory law, he has combined an unrivaled ability to provide effective and novel solutions across a variety of issues with the courage and skill to affect the overall direction of new law and interpretive guidance.

Bob originally compiled the early versions of this Guide as both a mentoring tool and a repository for the guidance he had offered and the changes that he had effected in financial services regulation. And it became more than that. The Guide offers history as well as insight into new emerging legal conundrums; and outlines considerations and solutions to issues as well as a foreshadowing of open questions with answers yet to be crafted.

Bob retired from the daily practice of law on December 31, 2015, and was elected a Senior Counsel of our firm. Bob continues to advise both clients and colleagues, and we continue to receive his wisdom in the preparation of the Guide. Bob has also launched a new academic career, with plans to teach part-time at Columbia University next year. His energy and vitality will still fill the halls of Cleary Gottlieb, and he will continue his roles as advisor, mentor, colleague and friend.

As we hold the pen to continue the legacy of the Guide, we do so with humility as we try to emulate all of the great qualities that Bob so effortlessly exhibited, and we do so with a sense of gratefulness for the opportunities that Bob has given us in relation not only to the Guide but also our careers.

With deep gratitude,

Derek M. Bush
Hugh C. Conroy Jr.

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PREFACE

This Guide is about the capital markets activities of U.S. and foreign banks and bank holding companies in the United States. It describes the U.S. regulatory regime applicable to these activities and tries to highlight recent developments respecting the conduct of securities-related and other business under applicable banking and securities laws, including the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Gramm-Leach-Bliley Act, the Bank Holding Company Act, the Glass-Steagall Act and the International Banking Act. This Twenty-first Edition speaks as of September 15, 2016 and reflects a substantial re-writing and update from the 2015 edition.

This Guide devotes significant attention to the dramatic re-focusing of banking and securities regulation that the Dodd-Frank Act requires. Dodd-Frank analysis is set out in Part I (Dodd-Frank summary, impact on Gramm-Leach-Bliley Act empowerments and preemption issues), Part II (risk management, capital and liquidity requirements, "Volcker Rule" implications for proprietary trading and fund investment, hedge fund operations and derivatives), Part III (enhanced restrictions on a bank's covered transactions with its affiliates), Part V (loan trading), Part VII (private equity investments), Part VIII (investment advisory/management and related developments), Part IX (enhanced broker-dealer requirements), Part X (securitization developments), and Part XI (international linkages).

This Guide consists of 12 Parts, and is supplemented by a detailed Table of Contents and Index of Defined Terms to make it easier to locate (and cross refer to) specific issues and areas of interest.

Part I discusses the framework, scope, implementation and evaluation of regulatory policies for the integration of investment and commercial banking activities. It provides an overview of U.S. and foreign bank and holding company securities-related activities, and outlines the applicable regulatory framework, and legislative/administrative measures for financial services convergence.

Part I addresses the Dodd-Frank Act and its attendant rulemakings, including its implications for reshaping the provision of financial services in the United States. Since Dodd-Frank's scope and rulemakings have evolved in the past year, Part I includes a significantly more detailed discussion of Dodd-Frank-related regulatory and market developments.

Dodd-Frank notwithstanding, the "bank charter" remains an enormously powerful and comprehensive organizational framework for the conduct of capital markets activities. Accordingly, Part I analyzes the "business of banking" and the various powers given to different types of entities engaged in U.S. banking, insurance and capital markets operations. It also discusses "preemption issues" applicable to bank capital markets activities (including in the context of Dodd-Frank).

In addition, Part I includes a detailed, issue-oriented analysis of the Gramm-Leach-Bliley Act, including the scope of the powers of financial holding companies, the scope of "complementary activities" which financial holding companies are permitted to conduct (particularly in respect of commodities businesses), and other significant recent legislative, regulatory and market developments related to Gramm-Leach's operation and implementation. Appendix A provides a current list of financial holding companies (domestic and foreign), as well as of financial subsidiaries of national banks.

In addition to Part I's summary, a more detailed substantive discussion of various provisions of the Dodd-Frank Act and the Gramm-Leach-Bliley Act has been organized topically and included in the various subsequent Parts of the Guide, all of which have been substantively revised.

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Part II goes to the heart of many of the most significant and far-reaching Dodd-Frank initiatives, including increased capital and liquidity requirements, the Volcker Rule and U.S. derivatives markets.

Part II also discusses permissible trading and investment activities, ranging from U.S. federal, state, municipal and other "eligible" instruments, to "investment securities", specialized equity securities and "identified banking products". It analyzes investment, trading and dealing powers at the financial holding company, bank holding company and bank levels, and addresses the Gramm-Leach-Bliley Act "push-out" provisions relating to bank dealer activities. It includes an enhanced discussion of bank/bank holding company capital-related developments, as well as of the expanding regulatory framework applicable to state and municipal securities markets.

Part II includes an updated and expanded discussion of the Volcker Rule relating to bank/bank holding company/financial holding company "proprietary trading" and "private equity and hedge fund" sponsorship and investment.

In addition, Part II discusses recent market and regulatory developments with respect to legal, compliance and "operational risk"-related aspects of bank capital markets activities, as well as bank participation in "complex structured finance transactions". Part II also includes an expanded discussion of enforcement-related issues and developments.

Moreover, given the critical importance of derivatives activities to banking organizations, Part II updates the statutory, regulatory and market developments and initiatives respecting the legal structure for the issuance, trading and clearance of derivative products (including energy, equity, emissions, credit, commodity, "event" and other derivatives). Dodd-Frank Act requirements applicable to "swap dealers" and "major swap participants" are given special attention.

Finally, the discussion of foreign exchange, precious metals and bullion activities -- including especially in the enforcement context -- has been expanded as well.

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Part III addresses securities underwriting and dealing empowerments relevant to bank/financial holding companies, and includes a detailed analysis of anti-tying considerations in the capital markets context, reflecting regulatory and industry evaluation of the Anti-tying Statute.

Moreover, Part III contains an updated discussion of Sections 23A and 23B of the Federal Reserve Act and the Board's Regulation W, including the applicable Dodd-Frank provisions and the most recent regulatory precedents.

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Parts IV and V focus on those instruments which are not themselves "securities" for most banking and securities law purposes.

Part IV discusses developments respecting certificates of deposit (CDs) and similar money market instruments -- including with respect to CD characterization as "non-securities" under securities and banking law, and SEC proceedings respecting "deposit-like" corporate/"prime" debt obligations.

Recognizing the increased focus on liquidity management and contingent funding, Part IV also addresses the marketing of different types of CD products, as well as ongoing issues with respect to equity- and commodity-linked CDs (both "interest-only at risk" and "principal at risk").

Part V addresses loan trading markets and highlights a number of significant recent regulatory and industry developments. It discusses accounting and securitization issues, increased regulatory focus on leveraged lending, and precedents and guidance with respect to the use or misuse of "inside information" in loan, loan participation and other credit-related transactions in the United States.

Part V also analyzes recent statutory, regulatory and judicial precedents as to the status of loan "notes" and "participations" under Dodd-Frank and other federal banking and securities laws, as well as various grounds for assessing liability of a loan seller to a loan purchaser. It includes a checklist of suggested steps to increase the likelihood that a loan note/participation sale program will not be characterized as involving the trading or disposition of "securities".

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Parts VI through IX focus on an "activity analysis" of bank capital markets activities (i.e., an analysis of activities which fall short of "underwriting" or "dealing").

Part VI discusses "agency placement" and related activities. It reflects recent market and statutory/regulatory/administrative developments respecting private placement services (including under the "JOBS Act", and with respect to disclosure obligations and diligence responsibilities), and discusses the nature and type of these services provided by financial holding companies, bank holding companies and banks.

Part VII addresses merchant banking/private equity developments and empowerments in a number of different contexts. It discusses the Federal Reserve Board's Merchant Banking Rules, and includes a detailed and contextual analysis of other private equity, venture capital and investment empowerments available to financial holding companies, bank holding companies and banks (U.S. and foreign) under the Bank Holding Company Act and other federal banking laws.

Part VII includes a detailed discussion of private equity investments in regulated industries generally, and of concepts of "control" and "controlling influence" for regulatory purposes (including in the context of foreign bank investments in U.S. "critical infrastructure" that might trigger application of the Exon-Florio provisions of the Foreign Investment Act as administered by the Committee on Foreign Investment in the United States (CFIUS)).

Part VII analyzes in detail the manner, scope and structuring of "control" and "non-control" investments in U.S. and foreign banking organizations and other depository institutions. It addresses Federal Reserve Board and FDIC guidance concerning private equity investments in U.S. banks and bank holding companies.

Part VII also discusses SBIC, community/business development and other equity-related investments (in both the domestic and the international context), and covers regulatory empowerments and market developments for real estate investment, management and brokerage.

Significant recent bank regulatory and securities law requirements in the M&A advisory, "finder" and corporate finance context are given special attention, and their presentation has been enhanced.

Part VIII recognizes the enormous importance of compliance with the anti-money laundering and anti-terrorist financing provisions of the Bank Secrecy Act (BSA) and the USA PATRIOT Act, and with the economic sanctions/embargoes administered by the U.S. Office of Foreign Assets Control (OFAC). Part VIII has been streamlined and reorganized, and key regulatory issues are addressed through descriptions of "red flags" and "best practices" regarding BSA/PATRIOT Act/OFAC compliance requirements. The continuing and aggressive nature of securities/bank regulatory/Department of Justice enforcement actions, as well as issues with respect to "virtual currencies", are given particular attention.

In addition, Part VIII includes an expanded discussion of the Foreign Corrupt Practices Act (FCPA) and other anti-corruption/anti-bribery initiatives, and their implications for the provision of global financial services.

Part VIII also covers a broad range of private banking, fiduciary, mutual fund and asset management issues, and emphasizes the most recent developments respecting funds management and collective investment vehicles, including legislative and regulatory enhancements (under the Dodd-Frank Act and otherwise), enforcement actions (including in respect of "Ponzi schemes", and their impact on asset management, supervisory and control issues), and enhanced disclosure, code of ethics, director responsibility and conflict-of-interest considerations.

Appendix B enumerates the administrative services addressed by the Federal Reserve Board in various approvals respecting mutual fund-related operations, as well as the interrelationship between these approvals and other statutory and regulatory overlays.

Part IX discusses all types of agency (or agency-equivalent) intermediation by banking organizations in financial markets. It includes significant recent developments concerning "brokerage" and "riskless principal" activities, securities lending/repo services, "outsourcing" and "offshoring" developments, bank holding company/bank involvement in physically-settled commodity and energy-related transactions and other transactional activities. Special attention is given to the Dodd-Frank Act, as well as to Gramm-Leach-Bliley "push-out" provisions relating to bank broker activities.

In addition, as enforcement efforts -- by the SEC, FINRA and state securities regulators – and private actions have increased in number and intensity, Part IX discusses current statutory, regulatory, compliance and examination issues relating to broker-dealer, analyst and other securities operations.

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Part X discusses ongoing developments from a bank capital markets perspective with respect to asset securitization. It includes an analysis of securitization issues under the Dodd-Frank Act, as well as information on ongoing regulatory and industry efforts with respect to securitization markets.

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Part XI discusses international securities linkages, focusing on significant recent developments with respect to the scope of capital markets activities permitted to U.S. and foreign financial institutions which involve cross-border transactions. Special attention is given to statutory and regulatory issues with respect to the relationship between a U.S. broker-dealer/investment adviser/asset manager/investment company and its foreign bank/securities dealer affiliates (including under the Federal Reserve Board's Regulation K, the SEC's Rule 15a-6, and the CFTC's/SEC's cross-border initiatives related to swaps, enhanced with reference to no-action letters and other regulatory precedents).

Part XI includes an expanded discussion of significant enforcement actions relating to cross-border securities, tax, funds management and banking-related linkages (including issues and recent judicial developments with respect to the extraterritorial reach and scope of U.S. statutory schemes). It also addresses the continuing globalization of securities, asset management and derivatives markets, as well as concepts of "mutual recognition" of foreign regulatory regimes.

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Part XII reflects the increased importance of alternative ways in which banking organizations intersect and interrelate in the provision of capital markets services. It discusses various considerations (including under the Hart-Scott-Rodino Antitrust Improvements Act) relevant to the acquisition of investment banking firms by banking organizations, and highlights initiatives and developments with respect to joint ventures, "networking", "strategic alliance" and other "controlling" and "non-controlling" arrangements between and among banking organizations, securities firms and other business operations.

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This Guide would not have been possible without the extensive participation of a number of our colleagues, including Patrick Fuller (Part I), Brian Kesten (Parts I and II), Robert McNamee (Part II), Allison Breault (Parts II and III), Meredith Leigh Mann (Parts II

and VII), Nathan Brownback (Parts II and X), Christopher Robins (Part IV), Robert Parisot (Part V), Alex Young-Anglim (Part VI), Tabitha Edgens (Parts VII and XII), James Corsiglia, Melissa Ruth, Sarah Crandall and Katie Cragg (Part VIII), Daniel Por, Brandon Hammer and Guru Singh (Part IX), and Daniel Bregman (Part XI).

We are extremely grateful to all of our colleagues, as well as to all of our other unnamed current and former partners, counsel and associates who have supported our efforts to keep this Guide accurate and current. We also owe a special thanks to knowledge management specialists Barbara Gaffney, Ashton LeBourgeois, Heidi Rasciner and Karen Simpson, without whose organizational and other skills and infinite patience this Guide would not have been completed.

While we gladly acknowledge the efforts and insights of all of our colleagues, responsibility for shortcomings in this Guide is, of course, ours alone.

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About the Author

Robert L. Tortoriello

Robert L. Tortoriello is Senior Counsel to Cleary Gottlieb Steen & Hamilton LLP based in the New York office.

Mr. Tortoriello's practice focused on domestic and foreign bank expansion into all types of non-bank services and securities-related businesses, and on cross-border transactions and initiatives. It included extensive counseling with respect to bank capital markets activities, regulatory and compliance issues, internal investigation and enforcement matters, financial institution acquisitions, dispositions and restructurings, private equity and derivative product transactions, and domestic and international securities offerings.

A significant portion of Mr. Tortoriello's practice was devoted to advice concerning the Dodd-Frank Act (including the Volcker Rule), the Gramm-Leach-Bliley Act, the Bank Holding Company Act, the Glass-Steagall Act and the International Banking Act, including in the context of matters involving the Federal Reserve Board, the Office of the Comptroller of the Currency and other federal and state banking regulators.

Mr. Tortoriello advised some of the largest and most sophisticated global financial institutions, U.S. and non-U.S., in their business and operational planning efforts with respect to their investment, trading, dealing, hedge fund, commodities and private equity fund businesses. He has also provided advice on numerous acquisitions (both with and without FDIC assistance), divestitures, joint ventures, strategic alliances and restructurings.

Mr. Tortoriello was involved in a number of internal investigations for domestic and foreign financial institutions, as well as in administrative, regulatory and related enforcement proceedings. He also counseled major financial institutions with respect to Congressional inquiries related to a range of banking practices, and with respect to non-public regulatory investigations by the banking regulators, the Financial Crimes Enforcement Network (FinCEN), OFAC and federal and state enforcement agencies regarding compliance with anti-money laundering requirements and other U.S. banking laws, and U.S. sanctions programs.

Mr. Tortoriello is distinguished as a "star individual" in *Chambers Global* and *Chambers USA* and is ranked in the top tier of leading individuals in financial services regulation by *The Legal 500 U.S.* Mr. Tortoriello is a part of a small, distinguished group that was honored by *The Best Lawyers in America* for at least 10 consecutive years and the publication also named him "2011 New York Banking Lawyer of the Year." Mr. Tortoriello is recognized as one of the five "most highly regarded" banking lawyers in North America in *Law Business Research's (LBR) Who's Who Legal Banking 2015*, and as one of the ten "most highly regarded" banking lawyers in the world by LBR's *The International Who's Who of Banking Lawyers 2014*. *The International Who's Who of Business Lawyers*, *Legal Media Group's The Guide to the World's Leading Banking Lawyers*, *The Best of the Best*, *Euromoney's Expert Guides* and *IFLR 1000: The Guide to the World's Leading Law Firms*, regularly cite Mr. Tortoriello as one of the best financial institutions lawyers in the United States

Mr. Tortoriello lectures and is widely published on bank acquisitions, securities-related activities and bank regulatory developments. He has contributed to numerous professional and scholarly texts and publications, including the *University of Illinois Law Review*, the *Connecticut Journal of International Law*, the *Banking Expansion Reporter,* the *Banking Law Journal,* the *Banking Policy Report, the Banking Report, Insights*, the *International Law Review*, the *Journal of International Financial Markets,* the *Review of Financial Services Regulation* and other journals.

Mr. Tortoriello has served as a member of the New York City Financial Services Advisory Committee, created to monitor and discuss developments within the financial services industry (including regulatory issues) and track the ongoing value and effectiveness of initiatives to promote the support and growth of New York's financial services sector.

Mr. Tortoriello joined Cleary Gottlieb Steen & Hamilton LLP in 1974, was a partner from 1982 through 2015, and currently serves as senior counsel. He received a J.D. degree, *magna cum laude*, from Harvard Law School in 1974 and an undergraduate degree, *summa cum laude*, from St. Peters College, New Jersey in 1971.

Mr. Tortoriello twice served on the Banking Law Committee of the Association of the Bar of the City of New York, and is the principal author of the *Report of the New York City Bar Association Banking Law Committee* on "Non-Voting Equity Investments by Bank Holding Companies in Non-Banking Companies." He is a member of the Bars in New York and New Jersey, and is admitted to practice before the U.S. Supreme Court, the U.S. Court of Appeals for the Second Circuit, and the U.S. District Courts for the Southern and Eastern Districts of New York and the District of New Jersey.

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Mr. Bush's practice focuses on advising domestic and international financial institutions and foreign sovereigns regarding U.S. bank regulatory matters and legislation. His advisory practice spans a wide range of matters, including expansion of powers and activities, geographic expansion, restructurings, compliance with anti-money laundering laws, corporate governance and investments by and in banking organizations. Mr. Bush's practice also includes representing financial institutions in connection with corporate transactions, including mergers and acquisitions, asset sales, privatizations, capital markets transactions, joint ventures and strategic alliances. Mr. Bush also advises financial institutions and their boards of directors, employees and shareholders in internal investigations and in enforcement proceedings involving the U.S. federal banking agencies. In his advisory, corporate and enforcement practices, Mr. Bush represents clients before the Federal Reserve Board, Federal Reserve Banks, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the New York Banking Department. He is distinguished as one of the leading financial services regulation lawyers by Chambers USA and The Legal 500 U.S. and recognized in Law Business Research's The International Who's Who of Banking Lawyers.

Mr. Bush is a frequent speaker on regulatory and corporate matters affecting banks and other financial institutions. His recent publications include *"U.S. Regulation of International Activities of U.S. Banking Organizations" in Regulation of Foreign Banks* (2013), *"Resolution Planning and the Volcker Rule" in The Banker's How to Run a Bank* (2012) and *"Suspicious Activity Reporting: Recent Developments and Guidance on Key Issues" in The Review of Banking and Financial Services* (Nov. 2005).

Mr. Bush joined the firm in 1995 and became a partner in 2003. He received a J.D. degree, with honors, from the University of Chicago, where he was an editor of the Law Review. He received an undergraduate degree, *cum laude*, from Princeton University in 1989. From 1994 to 1995, Mr. Bush served as law clerk to the Honorable Emilio M. Garza of the U.S. Court of Appeals for the Fifth Circuit.

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Hugh C. Conroy Jr. is a counsel at Cleary Gottlieb Steen & Hamilton LLP based in the New York office. He is distinguished as one of the leading financial services regulation lawyers by IFLR 1000: The Guide to the World's Leading Law Firms.

Mr. Conroy's practice focuses on bank and bank holding company regulatory issues. Mr. Conroy currently devotes a significant portion of his practice to advice and advocacy regarding the Dodd-Frank Act and rules promulgated thereunder, including rules related to capital, liquidity, the Volcker Rule and banking regulation of derivatives and securities financing transactions. In addition, he has extensive experience advising on bank regulatory issues arising out of complex structured finance transactions; derivative and structured derivative products; equities, fixed income and commodities derivative and cash trading; new products and activities; mergers and acquisitions; private equity investments; and internal corporate reorganizations.

Mr. Conroy has presented on bank regulatory issues and current events in the banking industry at conferences sponsored by the American Bar Association, the American Bankers Association, the Financial Markets Association, and the Securities Industry and Financial Markets Association, and has been a guest lecturer on bank regulatory matters at Columbia University School of Law and New York University School of Law. Mr. Conroy also teaches on various topics at the "Fundamentals of Banking Law" intensive program sponsored by Boston University School of Law and University of California-Berkeley School of Law.

Mr. Conroy is currently a vice-chairman of the American Bar Association Banking Law Committee, and was formerly chairman of the Securities, Capital Markets and Derivatives Subcommittee (2010 - 2013) and vice-chairman of the same Subcommittee (2007-2010). Mr. Conroy co-authored (with Derek M. Bush) a chapter entitled "U.S. Regulation of International Activities of U.S. Banking Organizations" (*Regulation of Foreign Banks & Affiliates in the United States, Sixth Edition*, 2014), and co-authored (with Katherine Mooney Carroll) an article entitled "Spotlight on Fed's Stance On Chinese Control of U.S. Banks" (*Law 360*, June 2012).

From 2004 to 2011, Mr. Conroy served as associate general counsel, becoming a managing director in 2010, in Citigroup's Bank Regulatory Office. He was responsible primarily for U.S. bank and bank holding company regulatory advice to Citigroup's global corporate and investment bank (particularly its sales and trading desks), and provided advice globally to Citigroup's widespread operations. From 1996 to 2004, he was an associate in Sullivan & Cromwell LLP's Banking Group practice.

Mr. Conroy joined Cleary Gottlieb Steen & Hamilton LLP as counsel in 2011. He received a J.D. degree from Columbia University School of Law in 1996, where he was a James L. Kent Scholar and a Harlan Fiske Stone Scholar; and an undergraduate degree, *summa cum laude*, from the College of William and Mary in 1992. From 1992 to 1993, Mr. Conroy was a Fulbright Scholar researching international economic issues at Kanazawa University in Japan. He is a member of the Bar of the State of New York.

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APPENDIX B

I. U.S. LEGAL FRAMEWORK FOR THE CONDUCT AND STRUCTURE OF FINANCIAL HOLDING COMPANY, BANK HOLDING COMPANY AND BANK SECURITIES ACTIVITIES

A. OVERVIEW OF FEDERAL REGULATORY STRUCTURE

1. General

a. The U.S. legal framework for securities activities of banking organizations has evolved significantly. Both the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203 (2010) ("Dodd-Frank", the "Dodd-Frank Act" or the "DFA"), and the Gramm-Leach-Bliley Act, Pub. L. 106-102 (1999) ("Gramm-Leach", the "GLB Act" or "GLBA"), significantly affect U.S. bank and bank holding company ("BHC") capital markets activities.

b. Gramm-Leach permits BHCs that qualify as financial holding companies ("FHCs") to affiliate broadly with financial services firms (including investment banks and insurance companies), and, correlatively, permits investment banks and insurance companies to affiliate with U.S. banks. See Part I.C below.

(i) Gramm-Leach repealed Glass-Steagall Act ("Glass-Steagall") restrictions on affiliations between commercial and investment banks but kept some restrictions on the intermingling of banking and commerce set out in the Bank Holding Company Act of 1956 (the "BHCA"). See Part I.A.2 and Part I.A.3 below.

(ii) Gramm-Leach left in place most of Glass-Steagall's restrictions on securities activities conducted directly by banks and deposit-taking conducted directly by securities firms. Although Gramm-Leach is reputed to have "repealed Glass-Steagall", two Glass-Steagall provisions -- Sections 16 and 21 -- were largely unaffected. See Part I.A.2 below.

c. Dodd-Frank makes the most sweeping changes to the regulation of the U.S. financial services industry since the Great Depression. The impact of Dodd-Frank is discussed in Part I.B. below and throughout this Guide.

2. Glass-Steagall Act and Related Legislation

a. Glass-Steagall (officially, the Banking Act of 1933) was adopted in the wake of the 1929 stock market collapse and subsequent banking crisis. Glass-Steagall reflected concerns about the risks of the securities business, as well as the "more subtle hazards" that were thought to arise when investment banking activities conflict with the "institutional" role of commercial banks.

b. Glass-Steagall has two provisions aimed at preventing direct combinations of commercial and investment banking.

(i) Section 16 (12 U.S.C. §§ 24(7) and 335): National banks and state-chartered banks that are members of the Federal Reserve System ("member banks" or "state member banks") are barred from "dealing in, underwriting and purchasing" securities except:

A) A bank may purchase and sell securities "without recourse", solely upon the order and for the account of customers.

B) A bank may underwrite, deal in, purchase and sell certain U.S. and Canadian federal, provincial, state and municipal government securities without limitation (referred to as "Type I" securities in regulations (the "Investment Securities Regulations"), 12 C.F.R. Part 1, promulgated by the Office of the Comptroller of the Currency (the "Comptroller" or "OCC")).

C) A bank may underwrite, deal in, purchase and sell securities of federal agencies and international and multilateral development banks and organizations and certain other state and municipal securities ("Type II" securities, and together with Type I securities, "eligible" securities), within limits set out in the Investment Securities Regulations.

D) A bank may purchase and sell (but not underwrite or deal in) certain readily marketable "investment securities" ("Type III" securities, comprising essentially "non-speculative" marketable debt securities, including corporate debt) as prescribed by the Comptroller, within limits set out in the Investment Securities Regulations.

E) A bank may purchase and sell (but not underwrite or deal in) certain small business- and mortgage-related securities ("Type IV" securities).

F) A bank may purchase and sell (but not underwrite or deal in) certain readily marketable securities backed by pools of loans in which a bank could invest directly ("Type V" securities), within limits set out in the Investment Securities Regulations.

G) A bank may purchase and sell (but not underwrite or deal in) shares of a registered investment company (or, as determined by the Comptroller on a case-specific basis, another form of investment vehicle), within limitations set out in the Investment Securities Regulations, if the portfolio of the investment company or other vehicle consists of assets that a bank could purchase and sell directly.

Regulation H, 12 C.F.R. Part 208 ("Regulation H"), which establishes standards for membership in the Federal Reserve System ("FRS"), provides that state member banks may look to the Investment Securities Regulations for requirements with respect to the purchase of investment securities, and that a member bank may consult the Board of Governors of the Federal Reserve System (the "Board" or "FRB") regarding issues not addressed in such Regulations. See 63 Fed. Reg. 37630 (July 13, 1998) (effective Oct. 1, 1998) (the "Regulation H 1998 Revisions").

(ii) Section 21 (12 U.S.C. § 378): No person or organization engaged in the business of "issuing, underwriting, selling, or distributing" securities (except to the extent permitted under Section 16) may engage "at the same time to any extent whatever" in deposit-taking. Section 21 reaches all banks (state or federal, FRS-member or not). It approaches the separation of commercial and investment banking from the investment banking side, drawing the same line as Section 16. A proviso to Section 21 preserves "such right as any bank . . . may otherwise possess to sell, without recourse or agreement to repurchase, obligations evidencing loans on real estate" (the "Section 21 Proviso").

(iii) Dodd-Frank § 619, which added a new BHCA § 13 (the "Volcker Rule"), also limits bank trading and investment activities.

See Part II below.

c. Gramm-Leach repealed two Glass-Steagall provisions which had restricted affiliations between banks and securities firms.

(i) Section 20 (12 U.S.C. § 377) (repealed) provided that no state member bank (or national bank) could be "affiliated" with an organization "engaged principally" in the "issue, flotation, underwriting, public sale or distribution" of any "stocks, bonds, debentures, notes, or other securities".

(ii) Section 32 (12 U.S.C. § 78) (repealed) barred personnel interlocks between state member banks (or national banks) and entities "primarily engaged" in the issuance, underwriting, public sale or distribution of securities, except as permitted by Board regulation.

d. It is not clear whether a private right of action exists under Glass-Steagall. Compare, e.g., Russell v. Continental Illinois National Bank, 479 F.2d 131 (7th Cir.), cert. denied, 414 U.S. 1040 (1973), and Golar v. Daniels & Bell, Inc., 533 F. Supp. 1021 (SDNY 1982) (appearing to deny such a right), with New York Stock Exchange ["NYSE"] v. Bloom, 562 F.2d 736 (D.C. Cir. 1977), cert. denied, 435 U.S. 942 (1978) (appearing to recognize such a right).

e. Glass-Steagall does not prohibit a bank from engaging in the "business of banking", including that part of the business of banking derived from a bank's ability to exercise "incidental powers" necessary to carry on such business. See 12 U.S.C. § 24(7). See also Part I.D.4 below.

(i) The inapplicability of Glass-Steagall to "banking" is well settled. See, e.g., Securities Industry Association ["SIA"] v. Comptroller and Security Pacific National Bank ["SecPac Bank"], 885 F.2d 1034 (2d Cir. 1989) (the "Second Circuit Mortgage Securities Decision") (upholding Comptroller Interpretive Letter No. 388 (June 16, 1987) ("Letter No. 388"), CCH Fed. Banking L. Rep. ¶ 85,612), rev'g 703 F. Supp. 256 (DCNY 1988) (the "Duffy Decision"), cert. denied, 493 U.S. 1070 (1990).

(ii) Furthermore, decisions of the Comptroller -- including as to the scope of the "business of banking" and the interrelationship between such "business" and securities-related activities -- are entitled to "controlling weight". See NationsBank v. Variable Annuity Life Insurance Co., 513 U.S. 251 (1995) ("VALIC") (brokerage of annuities); Investment Company Institute ["ICI"] v. Ludwig, 884 F. Supp. 4 (D.D.C. 1995) (the "Chase CD Decision") (upholding the Comptroller Chase CD Decision discussed in Part IV below).

(iii) The ability of banks to engage in securities activities directly in the bank (as opposed to indirectly through a broker-dealer subsidiary) is constrained by (A) those provisions of Title II of Gramm-Leach (the "GLBA

Push-out Provisions") which affect the scope of "broker" and "dealer" exceptions under the Securities Exchange Act of 1934 (the "1934 Act") insofar as they apply to banks, and (B) those provisions of Title VII of Dodd-Frank which affect the ability of banks to engage in certain "swaps" activities. See Part I.C.2, Part II and Part IX below.

(iv) In Conditional Approval No. 351 (Jan. 28, 2000) ("Approval No. 351"), the Comptroller determined that underwriting and dealing in equity securities -- activities prohibited under Section 16 -- were part of or incidental to the business of banking. A precedent with little practical effect, Approval No. 351 challenged traditional Glass-Steagall doctrine. See Part I.D.4.c below.

f. Each of the federal banking agencies has implemented procedures to facilitate the supervision of securities-related activities.

(i) The Board addresses merchant and investment banking in its Commercial Bank Examination Manual and its [BHC] Supervision Manual, and also has a Trading and Capital-Markets Activities Manual to assist examiners.

Board examination procedures for retail sales of nondeposit investment products are reflected in the Board's Commercial Bank Examination Manual and [BHC] Supervision Manual. See also Board Supervision and Regulation Letter ("Board SR Letter") SR 94-34 (FIS) (May 26, 1994) ("Board SR Letter 94-34"), CCH Fed. Banking L. Rep. ¶ 70-115.

(ii) The Comptroller has a "supervision by risk" program intended to focus examiners on credit, interest rate, liquidity, price, operational, compliance, strategic and reputation risk. See, e.g., Comptroller's Handbooks: Large Bank Supervision and Bank Supervision Process; Comptroller Bulletin No. 13-12 (May 6, 2013).

The Comptroller has also issued guidelines for monitoring the activities of national bank subsidiaries with respect to uninsured investment products, such as mutual funds and annuities. See Comptroller's Handbook: Retail Nondeposit Investment Products.

(iii) The Federal Deposit Insurance Corporation (the "FDIC") has a unit focused on large, complex financial institutions, and has issued examination procedures for retail nondeposit investment product sales, as well as for participation in the examination of any insured bank. See, e.g., 70 Fed. Reg. 2633 (Jan. 14, 2005) (approved Jan. 18, 2005); FDIC Compliance Examination Manual.

(iv) Interagency Standards for Safety and Soundness, adopted under the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), address internal controls, information systems, internal audit, interest expense, asset growth and other matters relevant to securities activities. See 60 Fed. Reg. 35674 (July 10, 1995), amended, 61 Fed. Reg. 43948 (Aug. 27, 1996). The federal banking agencies issued an Interagency Statement on Retail Sales of Nondeposit Investment Products to harmonize their guidance in that area (the "Interagency Statement"). See, e.g., Board SR Letter 94-11 (FIS) (Feb. 17, 1994), CCH Fed. Banking L. Rep. ¶ 49-333.

See also Part II below.

3. Bank Holding Company Act of 1956 and Related Legislation

a. General

The BHCA, as amended by Dodd-Frank and Gramm-Leach, regulates FHC/BHC securities activities. The Volcker Rule imposes limits on the proprietary trading activities of FHCs, BHCs and their subsidiary banks and other affiliates, and limits the investments such entities may make in private equity funds and hedge funds. See Part I.B, Part I.C.1 and Part II below.

b. Financial Holding Companies

Under BHCA § 4(k), added by Gramm-Leach and discussed in Part I.C.1.c below, FHCs may engage in activities that are "financial in nature", "incidental" to financial activities and "complementary" to financial activities. Gramm-Leach authorizes a broad range of securities underwriting, dealing and market-making activities. FHCs may also engage in non-banking activities permitted to BHCs.

c. Bank Holding Companies

BHCA § 4 generally prohibits a BHC from owning or controlling shares of any company that is not a bank, with several exceptions. Among the most important are:

(i) Section 4(c)(8). This permits a BHC to invest in any company engaged in activities which the Board had determined as of November 11, 1999 (the day before enactment of Gramm-Leach), to be "so closely related to banking or managing or controlling banks as to be a proper incident thereto" and which is implemented in the Board's Regulation Y, 12 C.F.R. Part 225 ("Regulation Y"). Gramm-Leach ended the Board's ability to approve new non-banking activities under § 4(c)(8). See Part I.C.1.c and Part I.D.2.a.iii below.

The "Economic Growth and Regulatory Paperwork Reduction Act", Pub. L. 104-208 (1996) ("EGRPRA"), established expedited notification procedures for "well capitalized" and "well managed" BHCs to engage in permissible activities. In 1997, the Board revised Regulation Y (the "Regulation Y 1997 Revisions") to implement the streamlined procedures of this Act. See 62 Fed. Reg. 9290 (Feb. 28, 1997) (the "1997 Regulation Y Release"). See also Board SR Letter 97-13 (APP) (Apr. 24, 1997), CCH Fed. Banking L. Rep. ¶ 59-311.

The Regulation Y 1997 Revisions also expanded the scope of permissible non-banking activities under

Section 4(c)(8). These Revisions (A) put the Regulation Y list of permissible non-banking activities into 14 categories of functionally related activities; and (B) removed restrictions on the conduct of non-banking activities that had been superseded by Board Order, were unnecessary or would not apply to a bank's conduct of the same activity.

(ii) Section 4(c)(6). This permits a BHC to invest in "shares of any company which do not include more than 5% of the outstanding voting shares of such company". It also provides a basis for investments in a company's non-voting securities. The Board requires investments under § 4(c)(6) to be "passive" and "non-controlling".

A corollary provision, Section 4(c)(7), permits a BHC to invest in "shares of an investment company . . . which is not engaged in any business other than investing in securities, which securities do not include more than 5% of the outstanding voting shares of any company".

See Part II, Part VII and Part VIII below.

(iii) Section 4(c)(9) (and § 2(h)(2)). These permit a foreign bank which is subject to the non-banking activity restrictions of the BHCA (see Part I.A.11 below) to engage in activities the Board determines would be consistent with the purposes of the BHCA and in the public interest. As implemented in the Board's Regulation K, 12 C.F.R. Part 211 ("Regulation K"), these Sections permit a foreign bank to engage in activities in the U.S. which are "incidental" to its non-U.S. activities. The Volcker Rule includes exemptions from the limits on proprietary trading and hedge fund and private equity fund investments for foreign banks that engage in such activities "solely" outside the U.S. See Part II.A.7 below.

A more limited corollary provision, Section 4(c)(13), empowers the Board to permit a U.S. BHC, and Federal Reserve Act ("FRA") § 25A permits Edge Act corporations (which may be subsidiaries of BHCs or banks (domestic or foreign)), to engage in a range of activities (including securities activities) outside the U.S., as well as activities in the U.S. which are "incidental" to international or foreign business. See Part I.A.10 and Part XI below.

(iv) As of the fourth quarter of 2015, U.S. BHCs controlled $17.9 trillion in total assets, an increase of over 500% since 1991. During that time, the number of BHCs has declined from 5,860 to 4,266. In 2016, six large BHCs each had more than 1,000 subsidiaries and three had more than 2,000, whereas, in 1990, only one had more than 500 subsidiaries, reflecting the dramatically increased complexity of the largest U.S. financial institutions. See Board Annual Report 2015; Organizational Complexity and Balance Sheet Management in Global Banks (FRBNY, Mar. 2016); "Measures of Global Bank Complexity", Federal Reserve Bank of New York ("FRBNY") Economic Policy Review (Dec. 2014).

d. Banks

(i) Bank subsidiaries of FHCs and BHCs may engage directly or through subsidiaries in many securities activities under the National Bank Act (the "NBA") or (for state-chartered banks) applicable state law, subject to Glass-Steagall §§ 16 and 21 (but not necessarily to BHCA restrictions, other than the Volcker Rule), as well as to the requirement of FDICIA that, without prior FDIC approval, no state bank may engage as principal in any activity that is not permissible for a national bank. See Part I.D.4.b.ii below.

(ii) Banks are also subject to restrictions on transactions with their affiliates under FRA §§ 23A and 23B, 12 U.S.C. §§ 371c ("Section 23A") and 371c-1 ("Section 23B"), respectively. See Part III.A.5 below.

e. Financial Services Regulatory Relief Act of 2006

Among those provisions of the Financial Services Regulatory Relief Act, Pub. L. 109-351 (2006) (the "Relief Act"), most relevant to capital markets activities are:

(i) Section 101, which required the Securities and Exchange Commission (the "SEC") and the FRB to consult and seek the concurrence of the federal banking agencies in issuing joint regulations which implement GLBA Push-out Provisions. See Part I.C.2, Part II.D.3.b and Part IX below.

(ii) Section 305, which increases the authority of banks to make community development investments from 10% to 15% of capital. See Part VII.B.9.f below.

(iii) Section 611, which relaxes cross-marketing restrictions for FHC depository institution subsidiaries in the merchant banking context. See Part VII.A below.

(iv) Section 706, which permits the Board to waive the "attribution rule" of BHCA § 2(g)(2) that a company is deemed in all circumstances to own or control shares that are held by a trust (such as an employee benefit plan) for the benefit of the company or its shareholders or employees. See Part VII.A.3.d below.

(v) Section 711, which improves coordination of examination authority for home and host state supervisors of interstate banks. See Part I.D below.

See generally Financial Services Regulatory Relief (Congressional Research Service ("CRS"), Jan. 25, 2007).

4. Section 106 of the BHCA Amendments of 1970: the Anti-tying Statute

a. Section 106 of the BHCA Amendments of 1970, 12 U.S.C. § 1972 (the "Anti-tying Statute"), prohibits banks from engaging in certain tying arrangements. The Anti-tying Statute, as implemented in Regulation Y, 12 C.F.R. § 225.7, provides that a bank may not condition the availability or pricing of a product or service (the "tying product") on its customer obtaining another product or service (a "tied product") from the bank or one of its affiliates, unless the tied product falls within a "traditional products exemption" -- a loan, discount, deposit or trust service.

The Anti-tying Statute also applies to "reciprocity arrangements" in which the pricing of a product or service for a customer is conditioned on the customer providing a product or service in return, as well as to "exclusive dealing arrangements" under which the availability or price for a product or service is conditioned on a customer agreeing not to use the products or services of a competitor.

b. The Regulation Y 1997 Revisions eliminated the Board's former regulatory extension of the Anti-tying Statute to BHCs and their non-bank subsidiaries. Instead, BHCs and such subsidiaries are subject to the general antitrust laws. Such Revisions also created exceptions from the statutory restriction on bank tying arrangements, including to allow banks greater flexibility to package products with their affiliates.

The Anti-tying Statute is discussed in Part III.A.4 below. See also Part VIII.C.1 and Part IX.E below.

5. Background to Financial "Reform" and Related Issues

Gramm-Leach dramatically reformed the U.S. legal framework for banking organizations engaged in securities and related activities. Market, policy and regulatory developments facilitated this process.

a. Questions on the Separation of Commercial and Investment Banking

Throughout the 1990's, questions as to whether the safety, soundness and viability of banking organizations were truly furthered by an attempt to separate commercial from investment banking became increasingly strident. See, e.g., Commercial Banks in the Securities Business: A Review (Bank for International Settlements ("BIS"), June 1998); Glass-Steagall

Overdue for Repeal (JPMorgan & Co. ("JPMorgan Chase", "JPMorgan" or "Morgan"), Apr. 1995); "Bank Powers and the Separation of Banking from Commerce -- An Historical Perspective", FDIC Banking Review (Spring/Summer, 1994).

b. Market Forces for Regulatory Restructuring

In 2015, financial services accounted for 7.2% of gross state product (ranging from 2% in Alaska to 17% in New York ("NY") and 28% in Delaware), and approximately one-quarter of U.S. banks offered investment products. Employment in the financial services industry accounts for approximately 5% of U.S. total private nonfarm payrolls.

Competitive pressures on banks continue to mount, and significant structural changes affect financial markets more broadly, including (i) the systemic importance of large bank-centered financial institutions; (ii) the operation of government-sponsored enterprises ("GSEs"); (iii) the growth of capital accumulation through less-regulated entities in the "shadow banking" system (such as private equity/hedge/sovereign wealth funds); (iv) the increasing role of financial and information technology ("IT") for banks and alternative service providers; (v) greater operational demands on clearing/settlement systems; (vi) more complex risk management/compliance challenges; (vii) global financial integration; (viii) financial and market implications of developments respecting different financial service providers; and (ix) the impact of widespread economic challenges (including volatility of capital markets–related revenues and earnings).

See generally, e.g., Investment Company Fact Book (ICI, 2016); Wholesale Banks & Asset Managers: Learning to Live with Less Liquidity (Morgan Stanley/Oliver Wyman, 2016); Insurers on the Brink: Disrupt or be Disrupted and Forward Look: Top Regulatory Trends for 2016 in Insurance (Deloitte, 2016); Department of Commerce, Bureau of Economic Analysis (the "BEA") News Releases (June 14, Mar. 2, 2016); Department of Labor, Bureau of Labor Statistics News Release (June 3, 2016); The Hamilton Financial Index (Hamilton Place Strategies, Feb. 2013); Financial Services Fact Book (Financial Services Roundtable, 2013); Securities Industry & Financial Markets Assoc. ("SIFMA") Research Reports.

c. "Cultural" Issues

Banking organizations have faced significant challenges in conducting securities, insurance and asset management operations. "Cultural" issues are significant; questions have been raised as to the success of the model of a large, integrated "full service" financial firm, and training and adaptation of bank personnel to operate successfully in a capital markets context have proven difficult. Insurance underwriting also involves significant risks, as well as different regulatory and capital requirements. See Part III below.

d. "De-banking"

(i) Several foreign banks "de-banked"; i.e., dropped their U.S. bank charters or re-oriented their business from traditional commercial banking to engage in a broader range of U.S. securities and insurance activities unencumbered by Board regulation. See, e.g., Board Letters, Apr. 23, 1999, Dec. 21, 1998, Dec. 16, 1997 and Feb. 23, 1995, re de-banking of Internationale Nederlanden Bank ("ING"), ING Letter to the Board, Nov. 8, 1995, ING, 85 Fed. Res. Bull. 448 (1999) (permitting ING representative office); Board Letters re Fortis, Nov. 16, 1998, June 11, 1997, Oct. 17, 1994 (granting BHCA § 4(c)(9) exemption with respect to Fortis, ASLK-Bank/CGER-Banque, and MeesPierson), and Fortis (approved Feb. 22, 1999) (permitting Fortis to establish subsidiaries under BHCA § 4(c)(8) to facilitate de-banking); Board Letter re Generale Bank, Jan. 19, 1996, Banque Indosuez and Compagnie de Suez; Board Letter re Bank Brussels Lambert ("BBL"), Dec. 14, 1994; Int'l Banking Regulator, Oct. 23, 1995 (State Bank of New South Wales to downgrade branch to representative office; see Board Letter, Dec. 1, 1994 (BHCA § 4(c)(9) exemption to permit Colonial Mutual Life Assurance Society to acquire the Bank)).

De-banking involves a cessation of deposit-taking activities. See, e.g., Banque Worms (Board Order of Assessment and Written Agreement, Mar. 19, 1996).

(ii) It has been reported that a number of current FHCs are undertaking or contemplating de-banking as a means of avoiding certain DFA regulatory requirements. See, e.g., Form 10-K for Franklin Resources (Nov. 12, 2014) (reporting that Franklin Resources deregistered as a BHC in September 2014); SNL Financial, June 30, 2014; Investment News, July 21, 2011.

e. Formation of Citigroup

In 1998, the Board approved an Application by Travelers Group ("Travelers") to become a BHC ("Citigroup") in connection with its acquisition of Citicorp (the "Citicorp/Travelers Acquisition"). See Travelers, 84 Fed. Res. Bull. 985 (1998) (the "Citigroup Order"). Citigroup committed to divest or terminate impermissible non-bank activities -- such as insurance underwriting -- within two years of becoming a BHC, subject to up to three one-year extensions by the Board. Given the scope of its impermissible activities, the formation of Citigroup was a "bet" on Congressional action.

(i) The Board provided some relief from Citigroup commitments reflected in the Citigroup Order. Board Letters, Oct. 5, 2000 (the "Citigroup Extension Letter"), July 1, Mar. 30, Jan. 20, 1999.

(ii) The Independent Community Bankers of America ("ICBA") lost its challenge to the Citigroup Order in ICBA v. Board, 195 F.3d 28 (D.C. Cir. 1999). The ICBA had contended that the Citigroup Order was unlawful under the BHCA and Glass-Steagall. See Part III.B below.

f. Conglomerate Supervision

(i) Coordinated supervision of banking organizations is increasingly important, including in such areas as

(A) capital, governance and risk management (see Part II.A below), (B) consumer protection (see Part I.B below), (C) vendor risk (see Part IX.B below), (D) recovery and resolution planning (see Part I.B below), (E) trading, investment and derivatives activities (see Part II below), (F) data quality, (G) credit quality, (H) cyber threats (see Part IX.F below), (I) liquidity, and (J) anti-money laundering ("AML") (see Part VIII.A below).

See, e.g., Forward Look: Top Regulatory Trends for 2016 in Banking (Deloitte, 2016); Supervising Large, Complex Financial Companies: What Do Supervisors Do? (FRBNY, May 2015); "The Brave New Era of Comprehensively Regulated Banks", BCG Perspectives (Dec. 2, 2014); Report on Supervisory Colleges for Financial Conglomerates (Joint Forum on Financial Conglomerates ("Joint Forum" -- consisting of the Basel Committee on Banking Supervision ("Basel" or the "Basel Committee"), the International Organization of Securities Commissions ("IOSCO") and the International Association of Insurance Supervisors ("IAIS")), Sept. 2014); Principles for the Supervision of Financial Conglomerates (Joint Forum, Sept. 2012); Core Principles for Effective Banking Supervision (Basel, Sept. 2012); Good Practice Principles on Supervisory Colleges (Basel, Oct. 2010); Review of the Differentiated Nature and Scope of Finance Regulation: Key Issues and Recommendations (Joint Forum, Jan. 2010). See also, e.g., Interagency Memorandum of Understanding [("MOU")] for the Implementation of the FDIC's Special Examination Authority (July 12, 2010); Joint Commodity Futures Trading Commission ("CFTC")-SEC Advisory Committee on Emerging Regulatory Issues, 75 Fed. Reg. 27028 (May 13, 2010) (regulatory issues of mutual concern) and [MOU] between [SEC] and [CFTC] Regarding Coordination in Areas of Common Regulatory Interest, Mar. 11, 2008 (the "SEC/CFTC MOU"); International Monetary Fund ("IMF") Financial Sector Assessment Program, U.S. (May 2010): (A) Basel Core Principles for Effective

Banking Supervision, (B) IAIS Insurance Core Principles, (C) IOSCO Objectives and Principles of Securities Regulation, (D) Basel II Implementation Preparedness in the U.S., and (E) Crisis Management Arrangements; Board SR Letter 08-9 (Oct. 16, 2008), CCH Fed. Banking L. Rep. ¶ 59-538 (Consolidated Supervision of [BHCs] and the Combined U.S. Operations of Foreign Banking Organizations) ("Board SR Letter 08-09"); [MOU] between [Board] and [SEC] Regarding Coordination and Information Sharing in Areas of Common Regulatory and Supervisory Interest, July 7, 2008 (the "FRB-SEC MOU").

(ii) Dodd-Frank includes provisions regarding international coordination and financial sector supervision. For example, Dodd-Frank § 929k provides protections from disclosure for information provided to the SEC by foreign securities or law enforcement authorities if such authorities represent that the information is privileged, and Dodd-Frank § 989E established a Council of Inspectors General consisting of Inspectors General of the Board, the FDIC, the CFTC, the SEC and other agencies to address concerns that may apply to the financial sector generally and to consider ways to improve financial oversight.

(iii) With respect to conglomerate supervision issues globally, see, e.g., International Banking and the Cross-Border Effects of Regulation: Lessons from the [U.S.] (FRBNY, Sept. 6, 2016); Remarks of Board Governor Tarullo, Nov. 5, 2015 (Shared Responsibility for the Regulation of International Banks); Opinion and Report on Cooperation with Third Countries (European Banking Authority ("EBA"), Dec. 10, 2015); Implementation and Effects of the G20 Financial Regulatory Reforms (Financial Stability Board ("FSB"), Nov. 9, 2015); Financial Reforms -- Finishing the Post-Crisis Agenda and Moving Forward (FSB, Feb. 4, 2015); Overview of Progress in the Implementation of the G20 Recommendations for Strengthening Financial Stability (FSB, Nov. 14, 2014, Sept. 5, Feb. 16, 2013, Nov. 5, June 19, 2012, Apr. 29, Feb. 15, 2011, Nov. 8, 2010); Global Survey: Regulatory and Market Developments -- Banking, Securities, Insurance (Institute of International Bankers ("IIB"), Oct. 2014); Tarullo, "International Cooperation in Central Banking", Cornell Int'l L.J. (Winter 2014); Remarks of Board Governor Tarullo, Mar. 27, 2014 (Regulating Large Foreign Banking Organizations); Organization for Economic Cooperation and Development ("OECD") Policy Framework for Effective and Efficient Financial Regulation (Dec. 2009); Committee of European Banking Supervisors ("CEBS") Advice on Information Required to be Exchanged (June 3, 2009) (sharing of information between home and host countries); Convergence of Insurance and Capital Markets (World Economic Forum, Oct. 2008); Comptroller Letter to the China Banking Regulatory Commission, Dec. 8, 2003 (cooperative supervision of cross-border establishment of banks); European Union ("EU") Financial Conglomerates Directive 2002/87/EC (prudential requirements on Joint/Forum/banking/investment services/ insurance groups); Board/Comptroller/European Commission ("EC") Statement of Cooperation on the Exchange of Information for the Purposes of Consolidated Supervision (1999).

See also Part I.C.2, Part II.A, Part VIII.C, Part IX.B.3 and Part XI.A below.

6. Impact of the 2007-2009 Economic Crisis on the Supervision of Banking Organizations and the Provision of Financial Services

   a. Statutory and Regulatory Responses to the Economic Crisis

      (i) Background

         A) The financial and economic crisis of 2007-2009 profoundly affected the provision of banking and financial services globally, and prompted federal agencies to implement emergency programs to provide liquidity to stressed markets and capital to stressed financial institutions. Escalating defaults in the U.S. subprime mortgage market commencing in mid-2007 served as the catalyst for credit market turbulence and system-wide shocks. Uncertainties associated with the valuation of structured products caused investor demand for complex financial instruments to fall precipitously.

Risk aversion sapped market liquidity at a time when financial institutions were faced with funding needs due to their build-up of exposures to illiquid assets. Faced with the need to conserve cash, financial institutions scaled back their lending, and the resulting "credit crunch" forced originators and ABS issuers to liquidate assets and to draw on backup lines of credit. Under these circumstances, the degree of collateral support provided by initial and maintenance margin requirements was insufficient to protect against price shocks, haircuts on asset valuations, collateral ratings downgrades and price declines due to asset liquidations. The burden of additional collateral requirements and increasing concern over counterparty credit risk led to continued deterioration in market liquidity.

B) The Board initially provided financial assistance in reliance on its emergency lending authority under FRA § 13(3), 12 U.S.C. § 343 (as in effect prior to its amendment by the DFA). These programs were followed closely by legislation that added new programs or enhanced existing ones (most of which have been terminated). See generally Stigma in Financial Markets: Evidence from Liquidity Auctions and Discount Window Borrowing during the Crisis (FRBNY, Jan. 2011); The Federal Reserve's § 13(3) Lending Facilities to Support Overall Market Liquidity: Function, Status and Risk Management (Board Office of the Inspector General ("OIG"), Nov. 2010). See also Bloomberg, Aug. 21, 2011 (largest borrowers under liquidity programs).

C) Actions taken by the Board in connection with its provision of financial assistance to American International Group ("AIG") have been the subject of lawsuits alleging constitutional and state fiduciary law violations. See Starr Int'l Co., Inc. v. [U.S.], 121 Fed. Cl. 428 (2015) (holding that the government takeover of AIG was an illegal exaction but awarding no damages) (appeal pending); Starr Int'l. Co., Inc. v. FRBNY, 906 F. Supp. 2d 202 (SDNY 2012) (granting in full FRBNY motion to dismiss), aff'd, 742 F.3d 37 (2d Cir. 2014), cert. denied, 134 S. Ct. 2884 (2014). See also, e.g., In re [AIG] 2008 Securities Litigation, Case No. 08-cv-4772, (SDNY Mar. 20, 2015) (order approving settlement of shareholder class action claims against AIG regarding subprime mortgage exposures); People v. Greenberg, No. 401720-2005 (N.Y., June 2, 2016) (affirming denial of motion for summary judgment in case alleging responsibility for sham reinsurance transactions); Law360, June 2, 2016, Aug. 12, 2015; Bloomberg, Apr. 12, 2015; NY Times, Mar. 21, 2015.

See generally FRBNY Actions Related to AIG, at http://www.newyorkfed.org/aboutthefed/aig/index.html; Troubled Asset Relief Program ("TARP") -- Government's Exposure to AIG Lessens as Equity Investments are Sold (Government Accounting Office (the "GAO"), May 2012); [TARP] -- The Government's Exposure to AIG Following the Company's Recapitalization (GAO, July 2011); Updates of Government Assistance Provided to AIG (GAO, Jan. 2011, Apr. 2010); Public Disclosure as a Last Resort -- How the [FRB] Fought to Cover Up the Details of the AIG Counterparties Bailout from the American People (House Committee on Oversight and Government Reform, Jan. 25, 2010); [TARP] -- Status of Government Assistance Provided to AIG (GAO, Sept. 2009) and Preliminary Observations on Assistance Provided to AIG (GAO, Mar. 2009).

D) The FDIC was authorized to provide financial assistance under the authority of the "systemic risk exception" to the "least cost resolution" requirements of the Federal Deposit Insurance Act (the "FDIA"). The systemic risk exception was invoked to provide assistance under the Temporary Liquidity Guarantee Program ("TLGP"). See [FDIA] – Regulators' Use of Systemic Risk Exception Raises Moral Hazard Concerns and Opportunities Exist to Clarify the Provision (GAO, Apr. 2010).

E) See, e.g., The Impact of the Recent Financial Crisis on the Capital Positions of Large U.S. Financial Institutions: An Empirical Analysis (Federal Reserve Bank of Boston ("FRBB"), July 16, 2013); "The Fed's Emergency Liquidity Facilities During the Financial Crisis: The [Primary Dealer Credit Facility] PDCF", Liberty Street Economics (FRBNY, Aug. 22, 2012); Board Letter to House Committee on Banking, Housing and Urban Affairs, Dec. 6, 2011; Board Letter to Senate Committee on Financial Services, Dec. 6, 2011. See also, e.g., Federal Reserve Liquidity Provision During the Financial Crisis of 2007-2009 (FRBNY, July 2012); SEC Enforcement Actions Addressing Misconduct That Led to or Arose from the Financial Crisis, https://www.sec.gov/spotlight/enf-actions-fc.shtml; Final Notice of Public Censure against Bank of Scotland in respect of failings within its Corporate Division between January 2006 and December 2008 (Financial Services Authority ("FSA"), Mar. 9, 2012); Report: The Failure of The Royal Bank of Scotland [("RBS")] (FSA, Dec. 2011); "Federal Reserve Policy Responses to the Financial Crisis" (FRBNY, May 2011); Federal Reserve Policies and Financial Market Conditions During the Crisis (Federal Reserve Bank of Chicago ("FRBC"), May 2011); Remarks of FRBC President Evans, Apr. 2011 (Four Lessons from the Financial Crisis); Senate Permanent Subcommittee on Investigation

("PSI") Staff Report – Wall Street and the Financial Crisis: Anatomy of a Financial Collapse (Apr. 13, 2011); Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the [U.S.] (Financial Crisis Inquiry Commission ("FCIC"), Jan. 2011); Financial Sector Assessment Program – U.S.: Financial System Stability Assessment (IMF, July 2010) and [DFA] Supplement (July 22, 2010); Debt Management: Treasury Was Able to Fund Economic Stabilization and Recovery Expenditures in a Short Period of Time, but Debt Management Challenges Remain (GAO, May 2010); Report of Bankruptcy Examiner In re Lehman Brothers Holdings (Mar. 11, 2010); The Changing Nature of Financial Intermediation and the Financial Crisis of 2007-09 (FRBNY, Mar. 2010); Too Much Right Can Make a Wrong: Setting the Stage for the Financial Crisis (FRBC, Nov. 2009).

(ii) Legislative Responses

Dodd-Frank (See Part I.B below) represents the principal legislative response to the financial crisis. In addition to Dodd-Frank, the following should be noted:

A) Emergency Economic Stabilization Act

The Emergency Economic Stabilization Act, Division A of Pub. L. 110-343 (2008) ("EESA"), provided authority for the TARP, the umbrella program of the Department of the Treasury ("Treasury") that served as the cornerstone of the federal government's efforts to address the crisis.

B) American Recovery and Reinvestment Act

The American Recovery and Reinvestment Act, Pub. L. 111-5 (2009) ("ARRA"), enacted fiscal stimulus provisions, and limited bonus payments to senior executive officers and other highly paid employees of recipients of TARP funding. See ARRA: Summary and Legislative History (CRS, Apr. 20, 2009); Fact Sheet: ARRA, Preliminary Overview (Office of Speaker Pelosi, Feb. 11, 2009).

C) Other Enactments

The Helping Families Save Their Home Act, Division A of Pub. L. 111-22 (2009) (the "Helping Families Act"), adopted a number of provisions regarding mortgage foreclosure. See Preserving Homeownership: Foreclosure Prevention Initiatives (CRS, Aug. 28, 2009).

The Housing and Economic Recovery Act, Pub. L. 110-289 (2008) ("HERA"), created a new regulatory regime for GSEs (Federal National Mortgage Association ("Fannie Mae" or "FNMA") and Federal Home Loan Mortgage Corporation ("FHLMC" or "Freddie Mac")), expanded their mission, updated and expanded the scope of Federal Housing Administration ("FHA") lending programs, and enhanced mortgage disclosure requirements. See [HERA] (CRS, Dec. 5, 2008).

D) Initial TARP Plan

The original plan to purchase troubled assets from banking institutions evolved into 13 different programs. TARP injected over $400 billion into the U.S. economy. Although many of the TARP programs have closed, a number of TARP investments are still outstanding and certain of its housing support programs are scheduled to last until 2023. As of May 31, 2016, TARP had investments in 70 institutions. In March 2016, the Congressional Budget Office ("CBO") estimated the cost of TARP to taxpayers at $30 billion, up $2 billion from its previous estimate in Mar. 2015. See Reports to Congress, Office of the Special Inspector General for the TARP ("SIGTARP"), Treasury and

Congressional Oversight Panel ("COP"). See also [TARP]: Capital Purchase Program Largely Has Wound Down (GAO, May 2016); Report on [TARP] (CBO, Mar. 2016); [TARP]: Treasury Should Estimate Future Expenditures for the Making Home Affordable Program (GAO, Mar. 2016); [TARP]: Status of Housing Programs (GAO, Jan. 8, 2016); [TARP]: Status of Remaining Investment Programs (GAO, Nov. 3, 2015); [TARP]: Treasury Continues to Wind Down Most Programs, but Housing Programs Remain Active (GAO, Jan. 2015); [TARP]: Status of Treasury's Investments in [GM] and Ally Financial (GAO, Oct. 29, 2013); [TARP]: Treasury's Use of Auctions to Exit the Capital Purchase Program (GAO, July 2013); [TARP]: Status of GAO Recommendations to Treasury (GAO, Mar. 2013); [TARP]: Treasury Sees Some Returns as it Exits Programs and Continues to Fund Mortgage Programs (GAO, Jan. 2013); Board Letter to Treasury, (Dec. 7, 2012) (discussing treatment of TARP securities sold in auctions under Board control doctrines) (the "Board TARP Letter"); [TARP] (GAO Reports, Feb. 2012, Jan. 2012, June 2011, June 2010, July, June, Mar. 2009); Summary Response to GAO Recommendations (Updated) (Treasury, Oct. 8, 2009).

E) Capital Purchase Program

Under a Capital Purchase Program ("CPP"), Treasury invested in the senior non-voting preferred stock (and warrants) of banking institutions. Nine large banking institutions received the initial investments totaling $125 billion, and almost 700 regional and local banks also received funding. CPP guidelines excluded U.S. subsidiaries and branches of foreign banks. See Treasury Press Releases, Oct. 31, 14, 2008.

i) The Board outlined the criteria it would apply to evaluate applications to redeem U.S. Treasury capital received under the CPP from the 19 BHCs that participated in "stress tests" under the Supervisory Capital Assessment Program ("SCAP"). See Board Press Release, June 1, 2009.

ii) Treasury established standards for the repurchase of warrants received in connection with investments made under the CPP. See Treasury Press Release, June 26, 2009.

iii) The CPP has been closed to new investments.

See generally [TARP]: Capital Purchase Program Largely Has Wound Down (GAO, May 2016).

F) Supervisory Capital Assessment Program and Stress Tests

i) The SCAP was mandatory for institutions with assets in excess of $100 billion and required stress tests of a bank's equity (assuming an adverse macroeconomic scenario). See [SCAP]: Design and Implementation (Apr. 24, 2009). The Board has continued and expanded its stress testing regime in connection with its "Capital Plan Rule" and Dodd-Frank mandated stress testing. See Part I.B.1.b.v and Part II.A.2 below.

ii) For institutions in need of additional capital, a Capital Assistance Program ("CAP") provided for investments in convertible preferred shares issued by publicly traded banks or holding companies. See Treasury White Paper: The [CAP] and its Role in the Financial Stability Program, related terms and conditions and Frequently Asked Questions [("FAQs")].

The CAP has been closed.

G) Asset Guarantee Program

Treasury was authorized to provide guarantees of certain troubled assets held by systemically significant U.S. financial institutions. Treasury used this Asset Guarantee Program in connection with assistance provided to Citigroup and Bank of America.

This Program has been closed.

H) Systemically Significant Failing Institution Program/Targeted Investment Program

Targeting systemically significant institutions in danger of failure, Treasury was authorized to purchase assets directly from, and securities or obligations issued by, such a financial institution.

These Programs were used to provide assistance to three institutions and are otherwise closed.

(iii) Other Assistance Programs

Several assistance programs were announced or begun prior to the enactment of EESA and did not exclusively rely on authority under the TARP. These include:

A) Asset-Backed Commercial Paper ("ABCP") Money Market Mutual Fund Liquidity Facility ("AMLF"): The FRBB lent to eligible borrowers (U.S. depository institutions, BHC and broker-dealer affiliates, and U.S. branches of foreign banks) on a non-recourse basis to enable the borrower to purchase eligible ABCP from a money market mutual fund under certain conditions. See Board FAQ: [ABCP AMLF].

The AMLF was closed in 2010.

B) Term Asset-Backed Securities Loan Facility ("TALF"): The FRB was authorized to make up to $200 billion of non-recourse loans secured by CMBS and ABS backed by eligible consumer and small business loans to U.S.-domiciled obligors. The program was closed to new lending in 2010.

For additional information regarding the TALF, see, e.g., Final Report Pursuant to Section 129(b) of the [EESA] of 2008: Update on Outstanding Lending Facilities Authorized by the Board Under Section 13(3) of the [FRA], (Board, Nov. 21, 2014); Securitization Markets and Central Banking: An Evaluation of the [TALF], Board Staff Report 2011-16 (Mar. 2011); FRBNY [TALF-FAQ] and Terms and Conditions; [TALF] (avail. Aug. 21, Feb. 17, 2009) (SEC exemption under 1934 Act § 11(d)(i)); Joint Board/Treasury Press Release, Mar. 3, 2009 (launch of TALF).

C) TLGP: The TLGP provided an FDIC guarantee of debt obligations of certain insured depository institutions and their holding companies. The TLGP consisted of two components, the "Debt Guarantee Program" and the "Transaction Account Guarantee Program".

i) Under the Debt Guarantee Program, the FDIC guaranteed (for a fee), through the earlier of December 31, 2012 or maturity, certain senior unsecured debt (including certain mandatory convertible debt) of participating institutions with a maturity greater than 30 days issued on or prior to October 31, 2009.

For additional background on FDIC regulations governing the Debt Guarantee Program, see 74 Fed. Reg. 26941 (June 5, 2009); 74 Fed. Reg. 26521 (June 3, 2009).

ii) Under the Transaction Account Guarantee Program, the FDIC provided unlimited insurance for non-interest bearing transaction accounts and certain NOW accounts. FDIC-insured U.S. subsidiaries and the 10 grandfathered, FDIC-insured U.S. branches of foreign banks were eligible for the guarantee.

iii) Effective December 31, 2010, DFA § 343 provided for unlimited deposit insurance until January 1, 2013 for non-interest bearing demand transaction accounts.

See generally [TLGP FAQ] (FDIC); FDIC Letter to Rep. Capitol, July 29, 2012 (responding to queries regarding the potential risks and consequences of extending TAG coverage or letting it expire). See also Part IV below.

D) Public-Private Investment Program ("PPIP"): The PPIP consisted of two programs: the "Legacy Loans Program" and the "Legacy Securities Program".

i) Under the Legacy Loans Program, Treasury could make up to a 50% equity investment in Public-Private Investment Funds ("PPIFs") that purchased "legacy assets" of participating banking institutions, and the FDIC guaranteed the debt of a PPIF.

ii) Under the Legacy Securities Program, Treasury could make up to a 50% equity investment in PPIFs that purchased certain non-agency residential mortgage-backed securities ("MBS"), commercial mortgage-backed securities ("CMBS") and ABS. The remainder of the equity in a PPIF came from private sources. See, e.g., Legacy Securities Public-Private Investment Funds, Additional [FAQ], Update to FAQ Released on March 23, 2009 (Treasury, Apr. 6, 2009).

iii) Treasury's authority to make investments under PPIP has expired.

E) <u>Commercial Paper ("CP") Funding Facility</u>: The FRB lent to a special purpose vehicle ("<u>SPV</u>") that purchased highly rated three-month unsecured CP and ABCP of eligible U.S. issuers (including U.S. issuers with a foreign parent and U.S. branches of a foreign bank). <u>See</u> "The Federal Reserve's [CP] Funding Facility", FRBNY <u>Economic Policy Review</u> (2011). The CP Funding Facility has been closed.

F) <u>Money Market Funds Guarantee Program</u> ("<u>MMFGP</u>"): Treasury provided a guarantee to holders of certain money market funds for the amount held on September 19, 2008. The MMFGP has expired.

G) <u>Money Market Investor Funding Facility</u> ("<u>MMIFF</u>"): The FRB provided financing to private sector SPVs to fund their purchases of eligible money market instruments from certain U.S. money market investors. <u>See</u> Board Press Release, Oct. 21, 2008; FRBNY <u>MMIFF: Program Terms and Conditions</u> and <u>MMIFF: [FAQ]</u>. The MMIFF has expired.

H) <u>Emergency Lending Facilities</u>: The FRB established emergency lending facilities to facilitate the acquisition of Bear Stearns by JPMorgan Chase, and for AIG. The FRB also established facilities to provide liquidity to the markets, including the "<u>Term Securities Lending Facility</u>" (the "<u>TSLF</u>"), the "<u>Term Auction Facility</u>" and the "<u>Primary Dealer Credit Facility</u>".

I) For additional information regarding these programs, <u>see generally</u>, <u>e.g.</u>, <u>Dealer Financial Conditions and Lender-of-last-resort Facilities</u> (FRBNY, May 2014); <u>Review of [FRB] Financial Assistance to</u>

[AIG] (GAO, Sept. 2011); Preliminary Staff Report: Governmental Rescues of "Too-big-to-fail" [("TBTF")] Financial Institutions (FCIC, Aug. 31, 2010); August Oversight Report: The Global Context and International Effects of the TARP (COP, Aug. 12, 2010); The Unique Treatment of GMAC Under the TARP -- (Mar. 10, 2010); Timelines of Policy Responses to the Global Financial Crisis (FRBNY, 2010); The Next Phase of Government Financial Stabilization and Rehabilitation Policies (Treasury, Sept. 2009); "The Federal Reserve's [PDCF]", Current Issues in Economics and Finance (FRBNY, Aug. 2009); Financial Turmoil: Federal Reserve Policy Responses (CRS, July 10, 2009); Board/FRBNY Letter to the COP, Apr. 1, 2009 (responding to questions regarding TALF); [TARP]: Legislation and Treasury Implementation (CRS, Mar. 24, 2009); Fact Sheet: Financial Stability Plan (Treasury, Feb. 10, 2009); "[TSLF]: Origin, Design, and Effects", Current Issues in Economics and Finance (FRBNY, Feb. 2009).

(iv) Section 23A Exemptions

The Board issued exemptions under Section 23A to facilitate certain funding arrangements, including an exemption (which expired on October 30, 2009) permitting insured depository institutions to provide liquidity to their affiliates for assets typically funded in the triparty repurchase/reverse repurchase ("repo") market. See Board Press Release, Oct. 30, 2009; Part III.A.5 below.

(v) Executive Compensation

Executive compensation issues were prominent as a result of the size of the federal assistance programs, the perceived role of compensation as an incentive for risk-taking, and ongoing actual or proposed bonus payments to employees of recipients of government assistance. These considerations resulted in compensation limits on certain executives and highly compensated employees under EESA, AARA and related regulations. See 74 Fed. Reg. 28394 (June 15, 2009) (the "TARP Compensation Release") (Treasury interim rule).

FRB/OCC/FDIC guidelines on incentive compensation aimed to help insure that compensation policies do not encourage imprudent risk-taking and are consistent with safe and sound banking practices. The agencies noted that the key principles underlying the guidance are: (A) incentive compensation arrangements should balance risk and financial results and not encourage employees to expose their organizations to imprudent risk; (B) the arrangements should be compatible with effective controls and risk management; and (C) the arrangements should be supported by strong corporate governance, including active board of directors oversight. See 75 Fed. Reg. 36395 (June 25, 2010) (final guidance); 74 Fed. Reg. 55227 (Oct. 27, 2009) (solicitation of public comment).

Dodd-Frank mandates new regulations limiting incentive-based compensation at financial institutions. See Part I.B.9.f below.

See generally Treasury Significantly Loosened Executive Pay Limits Resulting in Excessive Pay for Top 25 Employees at GM and Ally (GMAC) When the Companies Were Not Repaying TARP in Full and Taxpayers Were Suffering Billions of Dollars in Losses (SIGTARP, Sept. 24, 2014); Treasury Continues Approving Excessive Pay for Top Executives at Bailed-out Companies (SIGTARP, Jan. 28, 2013).

(vi) Deposit Insurance

EESA raised the basic limit on federal deposit insurance coverage to $250,000 through December 31, 2009. The Helping Families Act extended the temporary increase to

December 31, 2013, and the Dodd-Frank Act made the increase permanent.

The FDIC adopted regulations regarding insurance coverage for custodial and fiduciary mortgage servicing accounts that hold payments of principal and interest to provide that the funds in such accounts will be insured up to the applicable limit for each underlying mortgagor. See 74 Fed. Reg. 47711 (Sept. 17, 2009) (final rule); 73 Fed. Reg. 61658 (Oct. 17, 2008) (interim rule with solicitation of public comment).

See also Part IV below.

(vii) Special Inspector General for the Troubled Asset Relief Program and Related Matters

EESA established the SIGTARP and the COP. SIGTARP is responsible for monitoring federal assistance programs to prevent waste, fraud and abuse. The various TARP and other federal assistance programs were the subject of numerous evaluations. See, e.g., SIGTARP Quarterly Reports to Congress; Treasury's HHF Blight Elimination Program Lacks Important Federal Protections Against Fraud, Waste, and Abuse (SIGTARP, June 16, 2016); Hardest Hit Fund: State Pension Obligations (SIGTARP, Dec. 17, 2015); [TARP]: Status of GAO Recommendations (GAO, Sept. 4, 2015); [TARP]: GAO's Oversight of [TARP] Activities (GAO, Sept. 6, 2013); Emergency Capital Injections Provided to Support the Viability of Bank of America, Other Major Banks and the U.S. Financial System (SIGTARP, Oct. 5, 2009); [TARP]: GAO's Oversight Role (GAO, Oct. 1, 2009); [TARP]: Status of Efforts to Address Transparency and Accountability Issues (GAO, June 2009); [SIGTARP] (CRS, Mar. 10, 2009); Initial Report to Congress (SIGTARP, Feb. 6, 2009); TARP: Status of Efforts to Address Transparency and Accountability Issues (GAO, Jan. 2009); [TARP]: Additional Actions Needed to

Better Ensure Integrity, Accountability and Transparency (GAO, Dec. 2008).

b. Proposals for a Revised U.S. Regulatory Structure

(i) General

The international financial crisis generated reports and studies on its causes and potential "reforms". Many of these assessments highlight inadequate liquidity planning, excessive leverage, the housing bubble, unsound loan underwriting standards, credit rating agency failures, unregulated derivatives markets, flawed incentive compensation practices, and economic factors.

(ii) Treasury Blueprint and Related Proposals

A) Prior to the full onset of the financial crisis, revisions to the U.S. financial regulatory structure had been under active consideration, and were the subject of a Blueprint for a Modernized Financial Regulatory Structure (Treasury, 2008) (the "Treasury Blueprint"). The Treasury Blueprint received extensive media coverage and political attention, but did not lead to consensus on future action. See, e.g., The Blueprint for U.S. Financial Competitiveness (Financial Services Roundtable, 2008); Policy Statement on Financial Market Developments (President's Working Group on Financial Markets ("PWG"), Mar. 2008).

B) Relief Act § 1002 required the GAO to study the overall banking and financial services sector. Compare Financial Regulation: Industry Changes Prompt Need to Reconsider U.S. Regulatory Structure (GAO, Oct. 2004), with "The Future of Banking in America", FDIC Banking Review (2004). See also, e.g., Financial Regulation: Complex and Fragmented Structure Could Be Streamlined to Improve Effectiveness (GAO, Feb. 2016); Who Regulates Whom and How? An

Overview of U.S. Financial Regulatory Policy for Banking and Securities Markets (CRS, Jan. 30, 2015); Federal Financial Services Regulatory Consolidation: An Overview (CRS, July 10, 2008); Financial Services Regulatory Policy for the 21st Century: Applying a Statement of Principles to Specific Regulatory Issues (Conference of State Bank Supervisors (the "CSBS")/Ely & Co, 2003) (arguing that the state banking system should be preserved "as a laboratory for innovation, experimentation and evolution").

(iii) The Administration White Paper

In 2009, the Obama Administration published Financial Regulatory Reform -- A New Foundation: Rebuilding Financial Supervision and Regulation (the "Administration White Paper"). The five key components of the Paper are:

A) Enhanced supervision and regulation.

B) Comprehensive supervision of financial markets.

C) Increased consumer and investor protection.

D) Increased government resolution authority to manage financial crises.

E) Improved international regulatory standards and cooperation.

(iv) Periodic Regulatory Review

A) Executive Order 13563 (Jan. 18, 2011) seeks to improve the U.S. regulatory system by requiring that agencies (A) only propose a regulation whose benefits justify its costs and which is tailored to minimize the burden on society; (B) in choosing among alternatives, seek to maximize net public benefits; (C) adopt regulations that specify performance objectives; and (D) assess alternatives to direct regulation (such as economic incentives to induce desired behavior).

B) In June 2014, the OCC, the Board and the FDIC announced they were initiating a review of existing regulations for insured depository institutions pursuant to EGRPRA and invited the public to identify regulations that are "outdated, unnecessary or unduly burdensome." See 79 Fed. Reg. 32172 (June 4, 2014). See also 80 Fed. Reg. 79724 (Dec. 23, 2015); 80 Fed. Reg. 32046 (June 5, 2015); 80 Fed. Reg. 7980 (Feb. 13, 2015) (the "2015 EGRPRA Review"). The OCC has proposed amendments to certain regulations in response to comments received in the 2015 EGRPRA Review. See 81 Fed. Reg. 13608 (Mar. 14, 2016).

(v) Ongoing Reform Proposals

Years after the passage of Dodd-Frank proposals for reform of the financial regulatory system continue to be put forward. See, e.g., Reshaping the Financial Regulatory System (Volcker Alliance, Apr. 2015); Dodd-Frank's Missed Opportunity: A Road Map for a More Effective Regulatory Architecture (Bipartisan Policy Center, Apr. 2014).

7. Anti-money Laundering Laws and Related Legislation

a. Banks and their affiliates are subject to criminal money laundering laws and to the AML provisions of the Bank Secrecy Act (the "BSA"). Treasury administers and enforces the BSA -- including through its Financial Crimes Enforcement Network ("FinCEN" or "FIN").

b. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act, Pub. L. 107-56 (2001) (the "PATRIOT Act"), followed the terrorist attacks of September 11, 2001. PATRIOT Act Title III -- the International Money Laundering

Abatement and Anti-terrorist Financing Act ("IMLA") -- represented a major expansion of U.S. AML and anti-terrorist financing laws.

See Part VIII.A below.

8. Securities and Commodities Laws and Related Legislation

   a. General

   In conducting securities-related activities, banking organizations are subject to U.S. securities and commodities laws, state and federal.

   See generally Cleary Gottlieb Steen & Hamilton LLP ("Cleary Gottlieb"), U.S. Regulation of the International Securities and Derivatives Markets (11th ed. 2015) ("U.S. Regulation of the International Securities Markets"). See also SEC Strategic Plan: Fiscal Years 2014-2018.

   Among the principal relevant federal securities and commodities laws are:

   (i) Securities Act of 1933

   A) This Act (the "1933 Act") provides that a "public offering" of "securities" involving "U.S. jurisdictional means" must be registered by filing a disclosure document with the SEC. There are exemptions under the 1933 Act for certain transactions (e.g., offers and sales not involving a "public offering") and for certain securities (e.g., CP and certificates of deposit ("CDs")).

   B) In 2005, the SEC adopted significant changes to 1933 Act rules, reflecting the evolution of the securities offering process and capital markets, and the Sarbanes-Oxley Act, Pub. L. 107-204 (2002) ("Sarbanes-Oxley" or "SOX"). See SEC Releases No. 33-8591 (July 19, 2005) (final rules), No. 33-8501 (Nov. 3, 2004) (solicitation of public comments).

(ii) Securities Exchange Act of 1934

A) The 1934 Act (together with the 1933 Act, the "Securities Acts") regulates activities and participants in U.S. securities markets. Subject to certain exceptions -- including one for "banks" that the GLBA Push-out Provisions narrowed (as discussed in Part I.C.2, Part II and Part IX below) -- it provides for SEC registration, supervision and regulation of "brokers" and "dealers", as well as clearing agents, information processors, securities depositories and securities exchanges. It also bars manipulative market conduct, including insider trading.

B) 1934 Act rules provide for the registration of entities that engage in over-the-counter ("OTC") derivative activities, but not the full range of activities typically associated with brokers and dealers -- so-called "broker-dealer lite". SEC Release No. 34-40594 (Oct. 23, 1998) (the "OTC Derivatives Dealer Rules"). See Part II.E.2 below.

C) SEC Concept Release No. 34-61358 (Jan. 14, 2010) set out a broad review of the structure of equity markets, addressing matters such as market quality metrics, fairness of market structure, high frequency trading, co-location and dark pools. The SEC withdrew the release on Nov. 1, 2013.

D) As part of the Jumpstart Our Business Startups Act, Pub. L. 112-106 (2012) (the "JOBS Act"), Congress increased the long-standing 500 shareholder threshold for SEC registration purposes, which was established in 1964, to 2,000 shareholders. However, the threshold remains 500 if the shareholders are not "accredited investors". See also SEC Report on Review of Disclosure Requirements in Regulation S-K as Required by [JOBS Act] Section 108 (Dec. 2013).

(iii) Investment Company Act of 1940

The Investment Company Act of 1940 (the "1940 Act") is the principal source of U.S. regulation of collective investment vehicles. It sets out requirements for "investment companies" -- including unit investment trusts ("UITs"), closed-end investment companies and open-end investment companies ("mutual funds"). The 1940 Act also includes certain exemptions, including one for certain common trust funds (as discussed in Part VIII.B below) and pooled pension asset vehicles maintained by "banks".

(iv) Investment Advisers Act of 1940

A) The Investment Advisers Act of 1940 (the "Advisers Act") provides (subject to certain exceptions, including one for "banks") for the registration, supervision and regulation by the SEC of certain "investment advisers" that provide securities advisory services.

B) The GLB Act requires that a bank (or a "separately identifiable department or division") register under the Advisers Act if it advises SEC-registered investment companies. See Part VIII below.

(v) Commodity Exchange Act

A) The Commodity Exchange Act (the "CEA") regulates transactions in "futures contracts" and "commodity options" in the U.S. and provides for the registration, supervision and regulation by the CFTC of U.S. introducing brokers ("IBs"), futures commission merchants ("FCMs"), commodity trading advisors ("CTAs") and commodity pool operators ("CPOs").

B) The Commodities Futures Modernization Act (the "CFMA"), Pub. L. 106-554 (2000), had liberalized the so-called "Treasury Amendment" (CEA § 2(a)(1)(A)(ii)) to exclude from CEA regulation transactions involving certain financial products, and excluded certain qualifying OTC derivatives and hybrid instruments from CEA regulation ("Legal Certainty for Bank Products Act" (the "Bank Products Act"), CFMA Title IV). See generally, e.g., Rosen et al., "The [CFMA]", Futures & Derivatives Law Rep., Dec. 2000.

C) As called for in the Administration White Paper, the SEC and the CFTC issued A Joint Report on Harmonization of Regulation (Oct. 16, 2009), which identified areas where the agencies' regulatory schemes differ.

D) Dodd-Frank affected many aspects of commodities regulation, and repealed certain provisions of the CFMA. Dodd-Frank and other CFTC-related issues are discussed in Part II, Part IV and Part IX below.

b. Functional Regulation

(i) Gramm-Leach's supervisory approach was based on a policy of "functional regulation", and Gramm-Leach affirmed the SEC's role as primary supervisor of broker-dealer affiliates of banks. In addition to the GLBA Push-out Provisions, Gramm-Leach limited the Board's authority over BHC subsidiaries, including broker-dealers, regulated by other federal or state authorities in respect of examinations, reports and capital ("functionally regulated subsidiaries"), and restricted the Board's ability to require that funds from functionally regulated subsidiaries be used to support a BHC depository institution subsidiary.

(ii) The DFA enhanced the FRB's authority over all BHC subsidiaries without changing the basic policy of functional regulation.

c. National Securities Markets Improvement Act

The "National Securities Markets Improvement Act", Pub. L. 104-290 (1996) ("NSMIA"), preempts certain state "blue sky" laws, expands exemptions under the Advisers Act, and coordinates federal and state regulation of investment advisers. See Part VIII below.

d. Sarbanes-Oxley Act and Related Developments

(i) Sarbanes-Oxley sets out standards of corporate governance, practices and disclosure applicable to companies with U.S.-registered securities.

Sarbanes-Oxley (A) provided for the establishment of the Public Company Accounting Oversight Board (the "PCAOB"); (B) prohibits many corporate loans to company executives; (C) imposes rules regarding a company's audit committee; (D) establishes standards of auditor independence; (E) increases insider trading requirements; (F) establishes standards of corporate responsibility with respect to audits and financial reports; (G) imposes enhanced financial disclosure requirements; and (H) addresses analyst conflicts of interest, and corporate and criminal fraud. The Supreme Court rejected a broad constitutional challenge to the PCAOB. See U.S. Supreme Court Upholds Sarbanes-Oxley and [PCAOB], Severing Unconstitutional Removal Restrictions (Cleary Gottlieb, June 30, 2010).

Dodd-Frank exempts certain smaller issuers from SOX § 404(b) (reporting on the effectiveness of internal controls) and requires the GAO to study and report on the impact of this exemption.

See also Part I.B.9.g and Part IX.E below.

(ii) Although a broad consensus emerged in favor of the standards and practices required by Sarbanes-Oxley, their implementation contributed to a perceived decline in the competitiveness of U.S. public capital markets. See, e.g., Letter from Rep. Issa to SEC, Mar. 22, 2011; Committee on Capital Markets Regulation Summary of Competitiveness Measures (Mar. 22, 2011); Treasury Press Release, June 27, 2007; Commission on the Regulation of U.S. Capital Markets in the 21st Century Report and Recommendations (Mar. 2007); Sustaining New York's and the U.S.'s Global Financial Services Leadership (Jan. 22, 2007).

(iii) With respect to Sarbanes-Oxley issues and related developments, see generally, e.g., Corporate Governance: Interpretative Material (Nasdaq, Apr. 15, 2004); Cleary Gottlieb, The Sarbanes-Oxley Act: Analysis and Practice (Aspen Publishers, 2003) ("Sarbanes-Oxley: Analysis and Practice"); Greene & Boury, "Post-Sarbanes-Oxley Corporate Governance in Europe and the [U.S.]: Americanization or Convergence?", Int'l Journal of Disclosure and Governance (2003).

9. Hart-Scott-Rodino Antitrust Improvements Act

a. The Hart-Scott-Rodino Antitrust Improvements Act ("Hart-Scott") established procedures for the review by the Federal Trade Commission ("FTC") or the Antitrust Division (the "Antitrust Division") of the Department of Justice (the "DOJ") of merger and acquisition ("M&A") transactions that exceed certain thresholds. Parties to a reportable transaction must file notifications, and are subject to a waiting period pending review. See 15 U.S.C. § 18a; 16 C.F.R §§ 801 - 803.

b. Hart-Scott and its implementing regulations contain several significant exemptions for transactions which are reviewed by the federal banking agencies under BHCA § 3 or 4 or the Bank Merger Act, 12 U.S.C. § 1828(c). See 15 U.S.C. § 18a(c)(7) - (8); 16 C.F.R. § 802.8.

c. As a result of Gramm-Leach, which exempts from prior approval under BHCA § 4 acquisitions of companies engaged in financial activities, as well as merchant banking investments, FHCs are subject to Hart-Scott notification requirements for such transactions. See Part I.B.1.d below. See also 16 C.F.R. § 802.2.6(b) (reportability of "mixed transactions"); FTC Formal Interpretation 17, 65 Fed. Reg. 17880 (Apr. 3, 2000) ("mixed transactions").

d. An FHC may file a Notification with the Board pursuant to BHCA § 4(c)(8) to acquire a subsidiary and thereby qualify for the Hart-Scott exemption for transactions reviewed by the Board.

e. DFA § 163 requires large BHCs and FHCs (as well as non-bank financial companies supervised by the Board) to obtain prior Board approval for the acquisition of certain companies with total assets of more than $10 billion, making such acquisitions subject to review under both Hart-Scott and the BHCA.

10. Overseas Securities Activities

Glass-Steagall generally does not apply to activities conducted outside the U.S. See, e.g., 12 U.S.C. § 615, BHCA § 4(c)(13) (powers of Edge Act corporations -- which engage in business pursuant to FRA § 25A -- and U.S. FHC/BHC subsidiaries outside of the U.S. to be determined by the Board); Board Staff Opinion (May 14, 1973), 1973 Fed. Res. Interp. Ltr. LEXIS 42.

a. FHCs/BHCs conduct extensive securities activities overseas. Foreign securities affiliates of U.S. FHCs may operate under Gramm-Leach; foreign securities affiliates of BHCs, national banks and state member banks are subject to limitations on overseas equity securities underwriting and dealing under Regulation K. See 66 Fed. Reg. 54346, 58655 (Oct. 26, Nov. 23, 2001) (final rule) (the "2001 Regulation K Revision"); 62 Fed. Reg. 68424 (Dec. 31, 1997) (solicitation of public comments) (the "Proposed 1997 Regulation K Revision").

b. Comptroller rules also govern national bank activities abroad. 12 C.F.R. §§ 28.1 - 28.5. See also 68 Fed. Reg. 70691 (Dec. 19, 2003) (revisions to 12 C.F.R. Part 28 streamlining procedures for national bank foreign operations) (the "Comptroller 2003 International Revision").

Foreign subsidiaries of national banks that are Gramm-Leach "financial subsidiaries" (see Part I.C.1.d below) are not subject to Regulation K. See Comptroller's Handbook: Related Organizations.

The Comptroller has also approved the establishment by national banks of non-U.S. operating subsidiaries (which do not depend on Regulation K for their operation). See Part I.D.4.c.iii.B below.

c. FDIC rules govern the overseas activities of state-chartered banks that are not members of the FRS but that accept FDIC-insured deposits ("non-member banks" or "state non-member banks"), 12 C.F.R. Part 347 ("Part 347"). See also 70 Fed. Reg. 17550 (Apr. 6, 2005) (revision of Parts 303 and 347) and 70 Fed. Reg. 20704 (Apr. 21, 2005) (technical correction); 63 Fed. Reg. 17056 (Apr. 8, 1998) (the "FDIC 1998 Foreign Activities Revisions") and 68 Fed. Reg. 50457 (Aug. 21, 2003) (technical corrections).

d. Under Regulation K, the securities activities of most foreign banks outside the U.S. are not subject to Glass-Steagall or to any limitations under the BHCA, so long as such activities are conducted "outside" the U.S. See generally, e.g., 12 C.F.R. § 225.124 (offshore activities of foreign-based BHCs).

See also Part VII.A.6 and Part XI below. See generally U.S. Regulation of the International Securities Markets, Chapter 19.

11. Securities Activities of Foreign Banks in the United States

Under International Banking Act of 1978 ("IBA") § 8, 12 U.S.C. § 3106, a foreign bank that controls a U.S. bank or commercial lending company ("CLC") or that operates a U.S. branch or agency (sometimes, collectively, "branches") is subject to BHCA restrictions on U.S. non-banking activities. See generally Foreign Banks in the U.S.: A Primer (FRB, Nov. 2012).

a. Regulation K governs activities of foreign banks in the U.S. conducted through offices or subsidiaries, and a Board interpretation -- 12 C.F.R. § 211.605 (the "Foreign Bank

Underwriting Interpretation") -- affects the ability of foreign banks that are not FHCs to underwrite securities that are distributed in the U.S. See Part XI.D.6 below.

b. Foreign banks or BHCs that seek to establish or acquire securities operations in the U.S. (other than those engaged exclusively in Permissible Incidental Activities referred to in Part XI.B below) must satisfy requirements similar to those applicable to U.S. banks and BHCs.

(i) In order to become an FHC, a foreign bank is required to meet "well capitalized" and "well managed" criteria that are "comparable" to the criteria applicable to U.S. BHCs. See Part I.C.1.b.ii below.

(ii) Foreign banks are significant contributors to nationwide employment, job creation, employee earnings and economic expenditures, provide credit to businesses and local governments throughout the U.S., and enhance the depth and liquidity of U.S. wholesale financial markets. See, e.g., IIB Comment Letter to the Board (Apr. 30, 2013); Enhanced Prudential Standards for Foreign Banking Organizations; An Impact Assessment (Oliver Wyman, Apr. 30, 2013).

c. IBA § 4, 12 U.S.C. § 3102, provides that the operation of a U.S. federally-licensed branch or agency of a foreign bank "shall be conducted with the same rights and privileges as a national bank". See 12 C.F.R. Part 28. See also Comptroller's Handbook: Federal Branches and Agencies Supervision; Comptroller Bulletin No. 2014-57 (Sept. 2014) (Examination Process Booklet for Federal Branches and Agencies); Comptroller 2003 International Revision (permitting well capitalized, well managed federal branches of foreign banks to make non-controlling equity investments); 66 Fed. Reg. 49093 (Sept. 26, 2001) (the "Federal Branch Op Sub Rule") (Comptroller amendment to 12 C.F.R. § 5.34 (the "Op Sub Rule") to permit federal branches to establish operating subsidiaries). See generally Board Letter to OCC, June 27, 2003 (opposing proposal adopted in Comptroller 2003 International

Revision), Feb. 5, 2001 (opposing proposal for Federal Branch Op Sub Rule).

Under the Foreign Bank Supervision Enhancement Act of 1991, 12 U.S.C. § 3105(h), operations of state-licensed branches of foreign banks are restricted to those permitted to national banks unless (i) the Board determines that the activity is consistent with sound banking practice; and (ii) in the case of an insured branch, the FDIC determines that the activity would pose no significant risk to the insurance fund. See Board Examination Manual for U.S. Branches and Agencies of Foreign Banking Organizations.

See also Part I.C.l.d.i.G, Part I.D.4.c.iii and Part I.D.4.g below.

d. U.S. regulators are attempting to coordinate more effectively, both among themselves and with home country supervisors of foreign banks. See, e.g., Board SR Letter 08-9; Essential Elements of a Statement of Cooperation Between Banking Supervisors (Basel, May 2001); Board SR Letter 00-14 (SUP) (Oct. 23, 2000), CCH Fed. Banking L. Rep ¶ 57-233 (Enhancements to the Interagency Program for Supervising the U.S. Operations of Foreign Banking Organizations); "Nationwide Foreign Banking Organization Supervision and Examination Coordination Agreement" (1998) (federal and state supervisory coordination).

See Part I.A.5.f above and Part XI.A below.

e. Regulatory actions against foreign banks evidence the seriousness with which regulators and law enforcement officials treat foreign bank violations of U.S. banking and securities laws.

(i) A prominent administrative action arose from Daiwa Bank's cover-up of securities trading losses at its NY branch, and resulted in a $340 million fine and the closure of all U.S. operations. See U.S. v. Iguchi, No. 1:95 CR00914-001 (judgment) (SDNY Dec. 16, 1996), aff'd, No. 97-1056 (2d Cir., Sept. 22, 1997), U.S. Attorney (SDNY) Press Release Feb. 28, 1996, Daiwa Bank Plea Agreement Feb. 27, 1996 and related Indictment (SDNY Nov. 2, 1995), and U.S. v. Tsuda, 95

Mag. 2124 (complaint) (SDNY, Nov. 2, 1995); Sumitomo Bank ["Sumitomo"], 82 Fed. Res. Bull. 369, 365 (1996) (acquisition of Daiwa U.S. operations); Board, FDIC, NY Banking Department ("NYBD", now the New York Department of Financial Services ("NYDFS")) and Other State Regulator Termination Order (Docket No. 95-028-T-FB), as amended (Feb. 9, 1996, Nov. 1, 1995), FDIC Order of Termination of Insured Status of Daiwa Trust Co. (FDIC-95-155a), Nov. 1, 1995, Board/NYBD Joint Enforcement Order against Daiwa Bank (Docket Nos. 95-028-C-FB, 95-028-C-FBR), Oct. 2, 1995, and FDIC/NYBD Joint Enforcement Order against Daiwa Trust Co. (Docket No. FDIC-95-135c & b), Oct. 2, 1995; Assessment and Recommendation Regarding the [Board]'s Supervision of [Daiwa Bank] (Board, Apr. 12, 1996); "Investigation and Oversight of Daiwa Bank and Daiwa Trust Co.", Hearings before Senate Banking Committee, Nov. 27, 1995.

(ii) Crédit Lyonnais, its parent, Crédit Agricole, and certain of its subsidiaries and officers, were involved in what was at the time one of the largest civil and criminal settlements in history, principally relating to Crédit Lyonnais' participation in the rehabilitation of Executive Life Insurance Company of California, which was declared insolvent in 1991. It was alleged that Crédit Lyonnais violated the BHCA by acquiring a company that assumed Executive Life's insurance underwriting business through secret portage agreements, and that Crédit Lyonnais misrepresented its ownership interests. Crédit Lyonnais settled the proceedings for $772 million, and became subject to orders and agreements with federal and state banking regulators.

See Board Order to Cease and Desist, 92 Fed. Res. Bull. C139 (2006), and Notice of Assessment of Civil Money Penalty, Dec. 18, 2003, re Jean Peyrelevade; Board Order to Cease and Desist, Feb. 9, 2004, re Dominique Bazy; Board and Commission Bancaire Combined Order Issued Upon

Consent, Jan. 8, 2004 (Crédit Lyonnais/Crédit Agricole) (terminated, July 22, 2011); Board Order to Cease and Desist and Order of Assessment of Civil Money Penalty Issued Upon Consent against Crédit Lyonnais, Dec. 18, 2003; Written Agreement between Crédit Agricole and the FRBNY, Dec. 16, 2003; U.S. v. Crédit Lyonnais, No. CR 03-760 et al. (First Superseding Information/Indictment and Plea Agreements) (C.D. Cal., Dec. 15, 2003). See also Board/NYBD Combined Order to Cease and Desist and Assessment of a Civil Money Penalty, Mar. 9, 2004 (deficiencies in operational controls of Crédit Agricole Indosuez ("CAI") NY branch) (terminated, Sept. 21, 2006); Board Written Agreement with Crédit Agricole and CAI, Dec. 1, 2000.

(iii) Other foreign banks have also been hurt by failure to comply with applicable law or operating standards in the conduct of securities and related activities. See, e.g., Banco Industrial de Venezuela (Board/NYBD/Fla. Office of Financial Regulation, Written Agreement, Apr. 21, 2005 (management, compliance and operational control failures)); Skandinaviska Enskilda Banken ("SEB"), Board/NYBD Consent Orders and Civil Money Penalty, Sept. 17, 1997 (unsound practices and violations of law) (terminated, 85 Fed. Res. Bull. 707 (1999)); Postipankki, Board Order of Assessment of a Civil Money Penalty, July 11, 1997 (unsound trading practices at NY branch); Long-Term Credit Bank of Japan ("LTCB")/LTCB Trust Company, FDIC/NYBD Consent Orders, Aug. 2, 1996 (securities lending without proper controls and supervision) (the "LTCB Consent Order") (see also Part IX below).

(iv) Orders and related undertakings with respect to money laundering, sanctions and related violations are described in Part VIII.A below.

f. IBA § 8 permits a foreign bank to engage in non-banking activities in the U.S. in which, directly or through an affiliate, it was lawfully engaged on July 26, 1978. In general, these "grandfather rights" do not extend to acquisitions or to the commencement of new activities.

(i) Grandfather rights can terminate under several circumstances.

A) Grandfather rights terminate automatically two years after a grandfathered foreign bank acquires a U.S. bank and becomes a BHC (subject to Board extension for up to three additional years). See IBA § 8(c)(2). See also, e.g., Banque Nationale de Paris ["BNP"], 86 Fed. Res. Bull. 118 (2000) (the "BNP-Paribas Order"), and Board Letter, Aug. 14, 2001; Commerzbank AG ("Commerzbank"), 85 Fed. Res. Bull. 336 (1999), and Board Letters, July 27, 1998, July 17, 2000, July 27, 2001 and July 26, 2002.

B) Grandfather rights in respect of financial activities -- but not non-financial activities -- terminate automatically if the grandfathered bank becomes an FHC. See Part I.C.1.g.iii below.

C) A foreign bank also loses its grandfather rights if it is acquired by, or merges into, a non-grandfathered bank. See, e.g., Board Letters, Feb. 7, 2003 (Crédit Agricole acquisition of Crédit Lyonnais) and June 17, 2005 (one-year extension of temporary authority); Union Bank of Switzerland ["UBS"], 84 Fed. Res. Bull. 684 (1998) (merger with Swiss Bank Corp. ("SBC")).

D) Some foreign banks terminated grandfather rights prior to the enactment of the GLB Act in connection with acquisitions, or in connection with the integration of an existing grandfathered subsidiary with an acquired securities firm. See, e.g., Société Générale ("SocGen"), 84 Fed. Res. Bull. 680 (1998) (the "SG-Cowen Order"); SBC, 81 Fed. Res. Bull. 185 (1995) (the "SBC 1995

Order"), and Board Letter, Mar. 28, 1995; Deutsche Bank, 79 Fed. Res. Bull. 133 (1993) (the "Deutsche Bank - CJ Lawrence Order"), and Board Letter, Sept. 30, 1993 (acquisition of CJ Lawrence).

E) Although no foreign banks operate IBA-grandfathered securities affiliates any longer, some foreign banks have grandfather rights in respect of non-financial (e.g., real estate) activities (including Crédit Suisse Group ("CSG")).

(ii) In evaluating a request of a foreign bank with a grandfathered subsidiary to acquire another securities firm or to expand U.S. activities, the Board focused on the maintenance of separateness between the grandfathered subsidiary and the acquired firm. See, e.g., CSG, 64 Fed. Reg. 19363 (Apr. 20, 1999) (solicitation of public comments) (approved June 30, 1999) (the "CSG-Warburg Pincus Approval"), 81 Fed. Res. Bull. 803, 46 (1995) and FRBNY Letter, Dec. 19, 1990, and 73 Fed. Res. Bull. 160 (1987); SocGen (approved Jan. 29, 1998); Bayerische Vereinsbank, 63 Fed. Reg. 20410 (Apr. 24, 1998) (solicitation of public comments) (approved May 18, 1998) (leasing activities), Board Letter, Sept. 16, 1997 (the "BV/Hypo Bank Approval"), 61 Fed. Reg. 64087 (Dec. 3, 1996) (solicitation of public comments) (approved Jan. 17, 1997) (swap-related activities) (the "BV Derivatives Approval"), and 73 Fed. Res. Bull. 155 (1987) (advisory activities); Commerzbank, 83 Fed. Res. Bull. 678 (1997) (the "Commerzbank - Montgomery Order"), FRBNY Letter, May 30, 1997 (advisory activities), and 79 Fed. Res. Bull. 961 (1993) (FCM activities), Board Letters, June 9, 2003 (termination of separation commitments upon expiration of grandfather rights), Mar. 30, 1999, Sept. 12, 1997 (commitment modification); Dresdner Bank, 82 Fed. Res. Bull. 850 (1996) (acquisition of Kleinwort Benson Group ("KB")) (the "Dresdner-KB Order"), 82 Fed. Res. Bull. 676 (1996) (the "Dresdner-RCM Order"), 75 Fed. Res. Bull. 642 (1989), and Board Letter, July 31, 1989 (together, the "Dresdner-Oeschle Order"); UBS, 60 Fed. Reg. 2601 (Jan. 10, 1995) (approved Feb. 13, 1995) (the "UBS Letter"); Crédit Commercial de France ["CCF"] and Berliner Handels-und Frankfurter Bank ["BHF"], 81 Fed. Res. Bull. 390 (1995) (the "CCF/BHF Order"); SBC, 60 Fed. Reg. 10084 (Feb. 23, 1995) (solicitation of public comments) (approved Mar. 28, 1995).

g. De-banking by foreign banks is discussed in Part I.A.5.d above.

12. Other Federal Legislative and Related Developments

If enacted, pending legislative proposals could affect the activities of banking organizations in the U.S. Among the initiatives not discussed elsewhere in this Guide are the following:

a. Amendments relating to Dodd-Frank: Congress has held numerous hearings to examine the implementation of Dodd-Frank and to review legislative proposals repealing sections of the Act, delaying implementation of certain provisions, or otherwise amending the Act. These proposals include:

(i) The "Financial CHOICE Act" (H.R. 5983), a bill proposed by House Republicans as an alternative to Dodd-Frank, would, among other things: (1) reduce regulation for strongly capitalized, well-managed financial institutions; (2) retroactively repeal the authority of the Financial Stability Oversight Council ("FSOC") to designate firms as systemically important financial institutions ("SIFIs"); (3) repeal Title II of Dodd-Frank and replace it with a new chapter of the Bankruptcy Code designed to govern the liquidation, reorganization or recapitalization of a large, complex financial institution; (4) repeal Title VIII of Dodd-Frank and retroactively repeal all previous financial market utility designations; (5) restrict the Fed's discount window lending; (6) restructure and retool the Consumer Financial Protection Bureau ("CFPB") as the Consumer Financial Opportunity Commission, replace its director with a five-member commission and make it subject to congressional oversight and appropriations; (7) restructure other financial regulatory agencies as bi-partisan commissions subject to congressional oversight and appropriations, with an exception protecting the Fed's independence in conducting monetary policy; (8) require all financial regulators to conduct a detailed cost-benefit analysis of all proposed regulations; (9) abolish the Office of Financial Research ("OFR"); (10) repeal the so-called Chevron deference doctrine; (11) enhance penalties for certain financial crimes; (12) increase the maximum criminal fines for individuals and firms that engage in insider trading and other corrupt practices; (13) repeal the Volcker Rule; (14) enact a number of statutory and regulatory changes to facilitate capital formation; and (15) provide regulatory relief for community financial institutions.

The "Financial Regulatory Improvement Act" (S. 1484) would amend Dodd-Frank with provisions intended to improve the oversight of the FSOC, the regulation of insurance and the FRS, as well as provisions to improve access to capital. Among other things, the legislation would change the procedures for designating SIFIs. The bill would continue to require BHCs with more than $500 billion in assets to be designated automatically as SIFIs but would allow regulators discretion in designating BHCs with consolidated assets totaling between $50 billion and $500 billion as SIFIs based on size, interconnectedness, substitutability, cross-border activity and complexity. See The Financial CHOICE Act: Policy Issues (CRS, Sept. 14, 2016); "Regulatory Relief" for Banking: Selected Legislation in the 114th Congress (CRS, May 2, 2016). See Part I.B.1.b below.

(ii) Volcker Rule: The "Volcker Rule Relief Act" (H.R. 4049) would exempt from the Volcker Rule banks with less than $10 billion in assets and certain nonfinancial companies; the "Investor Clarity and Bank Parity Act" (H.R. 4096) would allow an investment adviser affiliated with a bank or BHC to share its name with a hedge fund or a private equity fund it manages under certain circumstances; the "Promoting Job Creation and Reducing Small Business Burdens Act" (H.R. 37) and the "Restoring Proven Financing for American Employers Act" (H.R. 1841) would allow banks with investments in certain collateralized loan obligations ("CLOs") an additional two years to comply with the Volcker Rule.

(iii) Derivatives: The "Commodity End User Relief Act" (H.R. 2289, S. 2917) would, among other things, reauthorize and reform certain operations of the CFTC, codify certain regulatory changes already implemented by the National Futures Association ("NFA") and the CFTC, and make numerous changes to Dodd-Frank intended to better protect futures customers, provide end-users with market certainty, and help farmers, ranchers and end-users manage risks. Other bills would make changes to the regulation of derivatives. See, e.g., the "Derivatives Oversight and Taxpayer Protection Act" (H.R. 5592, S. 3118); a bill "To amend the [CEA] and the [1934 Act] to specify how clearing requirements apply to certain affiliate transactions, and for other purposes" (H.R. 1317); the "Public Power Risk Management Act" (H.R. 2041, S. 1111); a bill "To extend the exemption of small banks and savings associations from classification as a financial entity for purposes of the swaps clearing requirements of the [CEA] to their holding companies" (H.R. 4353); the "Swap Data Repository and Clearinghouse Indemnification Correction Act" (H.R. 1847); "Promoting Job Creation and Reducing Small Business Burdens Act" (H.R. 37). See also, e.g., Derivatives: Introduction and Legislation in the 114th Congress (CRS, July 1, 2016); [CFTC]: Proposed Reauthorization in the 114th Congress (CRS, Oct. 19, 2015).

(iv) Consumer Financial Protection Bureau: Legislation has been introduced to modify the structure, oversight and operations of the CFPB. See, e.g., the "[CFPB] Accountability Act" (S. 3318); the "[CFPB] Act"

(S. 3196); the "Financial Services and General Government Appropriations Act, 2017" (H.R. 5485); "An Act Making Appropriations to Stop Regulatory Excess and for Other Purposes, 2016" (S. 2132); the "[CFPB] Advisory Boards Act" (H.R. 1195); the "Bureau Advisory Commission Transparency Act" (H.R. 1265). The "[CFPB] Examination and Reporting Threshold Act" (H.R. 4099) would increase from $10 billion to $50 billion the threshold at which regulated depository institutions would be subject to direct examination and reporting requirements of the CFPB. See also, e.g., Financial Regulation: Complex and Fragmented Structure Could Be Streamlined to Improve Effectiveness (GAO, Feb 25, 2016); Unsafe at Any Bureaucracy: How the [CFPB] Removed Anti-Fraud Safeguards to Achieve Political Goals (Republican Staff of House Financial Services Committee, Jan. 20, 2016); Unsafe at Any Bureaucracy: CFPB Junk Science and Indirect Auto Lending (Republican Staff of House Financial Services Committee, Nov. 24, 2015).

Legislative proposals with respect to the insurance industry are referenced in Part I.B.5 below.

Legislative proposals to address the issue of TBTF financial institutions are referenced at Part I.B.1.e below.

b. Financial Institution Bankruptcy: Congress is considering proposals to resolve insolvent financial institutions with assets exceeding $50 billion while maintaining stability in the financial markets. The "Financial Institution Bankruptcy Act" (H.R. 2947) would amend the Bankruptcy Code by adding a new "Subchapter V" to Chapter 11 of the Bankruptcy Code that would establish procedures for the liquidation, reorganization or recapitalization of covered financial corporations. The legislation would, among other things: (1) allow financial regulators to raise, appear and be heard on any issue in any case or proceeding involving a covered financial corporation; (2) allow the bankruptcy judge to consider the effect of any decision on the financial stability of the U.S.; (3) designate ten or more bankruptcy judges to oversee bankruptcies of covered financial corporations; and (4) establish procedures for the treatment of qualified financial contracts. See also, e.g., the "Financial CHOICE Act" (H.R. 5983); "Financial Services and General Government Appropriations Act, 2017" (H.R. 5485). See generally Systemically Important or "[TBTF]" Financial Institutions (CRS, June 30, 2015); Financial Company Bankruptcies: Information on Legislative Proposals and International Coordination (GAO, Mar. 19, 2015).

c. GSE Reform/Housing Finance: Legislative proposals relating to the mortgage finance system and to improve GSE oversight and accountability, reduce costs to taxpayers or amend the charters of the GSEs include the "Mortgage Finance Act" (S. 495) and the "Partnership to Strengthen Homeownership Act" (H.R. 1491). The "Jumpstart GSE Reform Act" (S. 2038) would prohibit the use of guarantee fees charged by GSEs to offset other government spending and would limit the Treasury's ability to sell, transfer, relinquish, liquidate, divest or otherwise dispose of any outstanding shares of senior preferred stock in the GSEs. The "Housing Finance Restructuring Act" (H.R. 4913) would allow the GSEs to retain their profits to ensure sufficient capitalization in order to prevent future government bailouts of the GSEs.

Other pending bills relate to housing finance. See, e.g., the "Community Mortgage Lender Regulatory Act" (H.R. 5907); the "Home Mortgage Disclosure Adjustment Act" (H.R. 4997, S. 3215); the "HMDA Repeal Act" (H.R. 3567).

The "Housing Opportunity Through Modernization Act", P.L. 114-201, 130 Stat. 782, was enacted on July 29, 2016. The Act makes numerous changes to the Housing and Urban Development programs providing direct rental assistance through the Section 8 Housing Choice Voucher program and the public housing programs, as well as changes to Federal Housing Administration and Rural Housing Service programs providing mortgage insurance for homes and condominiums.

Legislation has been introduced to address portfolio lending and qualified mortgages. The "Portfolio Lending and Mortgage

Access Act" (H.R. 2995, S. 1210) would create a safe harbor from certain requirements related to qualified mortgages for residential mortgage loans held on an originating depository institution's portfolio and also create a safe harbor for mortgage originators for steering a consumer to a residential mortgage loan. See also, e.g., the "Financial Regulatory Improvement Act of 2015" (S. 1484); the "Community Lender Regulatory Relief and Consumer Protection Act" (H.R. 2642, S. 1491).

See generally [DFA] Stress Tests Severely Adverse Scenario (Federal Housing Finance Agency ("FHFA"), Aug. 8, 2016); FHFA's Administrative Reform of Fannie Mae, Freddie Mac, and the Housing Finance System (CRS, July 7, 2016); Fannie Mae and Freddie Mac in Conservatorship: Frequently Asked Questions (CRS, June 15, 2016); The Housing Trust Fund: Background and Issues (CRS, May 24, 2016); Nonbank Mortgage Servicers: Existing Regulatory Oversight Could Be Strengthened (GAO, Mar. 10, 2016); Housing Issues in the 114th Congress (CRS, Mar. 3, 2016); An Analysis of Portfolio Lending and Qualified Mortgages (CRS, Jan. 21, 2016); Mortgage Reforms: Actions Needed to Help Assess Effects of New Regulations (GAO, June 25, 2015); An Overview of the Housing Finance System in the [U.S.] (CRS, Feb. 19, 2015).

d. Regulatory Burden Relief: In addition to proposals to amend Dodd-Frank, legislation has been introduced to reduce the regulatory burden placed on financial institutions. See, e.g., "Community Mortgage Lender Regulatory Act" (H.R. 5907); the "Traditional Banking Regulatory Relief Act" (H.R. 4647); the "Community Bank Capital Clarification Act" (H.R. 2987); the "Taking Account of Institutions with Low Operational Risk Act" (H.R. 2896); the "SAFE Transitional Licensing Act" (H.R. 2121); the "Financial Institutions Examination Fairness and Reform Act" (H.R. 1941); the "Portfolio Lending and Mortgage Access Act" (H.R. 1210); the "Financial Institution Customer Protection Act" (H.R. 766); the "Financial Regulatory Improvement Act" (S. 1484).

   A number of recent legislative proposals would require cost-benefit analysis for new regulations, including, e.g., the "CFPB Rule Accountability Act" (H.R. 5527), which would require congressional review of rulemaking of the CFPB; the "SEC Regulatory Accountability Act" (H.R. 5429), which would require the SEC to conduct a cost-benefit analysis before issuing any regulation under the securities laws; the "Federal Agency Complete Transparency Act" (H.R. 5328) and the "Regulatory Accountability Act" (S. 2006), which would require a general notice of proposed rulemaking for a "major rule" to include a cost-benefit analysis of the proposed rule; the "Article I Regulatory Budget Act" (H.R. 5319, S. 2982), which would require each agency that prepares an initial regulatory flexibility analysis under the Regulatory Flexibility Act to provide the Congress, the CBO, and Office of Management and Budget a cost estimate and cost-benefit analysis of any new proposed regulations, rules, or statements that would have a Federal regulatory cost of at least $100,000,000 for any fiscal year; the "Fed Oversight Reform and Modernization Act" (H. R 3189), which would require the Fed to assess the costs and benefits for proposed regulations and of available regulatory alternatives.

See also "Regulatory Relief" for Banking: Selected Legislation in the 114th Congress (CRS, May 2, 2016); An Analysis of the Regulatory Burden on Small Banks (CRS, Apr. 22, 2015).

e. Capital Formation: Congress has considered numerous proposals to enhance capital formation by removing the burden of certain securities regulations on smaller public and private companies. See, e.g., the "Financial CHOICE Act" (H.R. 5983); the "Financial Regulatory Improvement Act" (S. 1484); the "Micro Offering Safe Harbor Act" (H.R. 4850); the "Private Placement Improvement Act" (H.R. 4852); the "Supporting America's Innovators Act" (H.R. 4854); the "Fix Crowdfunding Act" (H.R. 4855); the "Helping Angels Lead Our Startups Act" (H.R. 4498); the "Small Business Capital Formation Enhancement Act" (H.R. 4168); the "Fostering Innovation Act" (H.R. 4138); "SEC Small Business Advocate Act" (H.R. 3784, S. 2867); the "Improving Access to Capital for Emerging Growth Companies Act" (H.R. 2064); the "Small Company Disclosure Simplification Act" (H.R. 1965); the "Disclosure Modernization and Simplification Act" (H.R. 1525); the "Holding Company Registration Threshold Equalization Act" (H.R. 1334); the "Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act"

(H.R. 686); the "Small Business Investment Company ("SBIC") Advisers Relief Act" (H.R. 432); the "Promoting Job Creation and Reducing Small Business Burdens Act" (H.R. 37). See generally Small Business: Access to Capital and Job Creation (CRS, Aug. 26, 2016); "Regulatory Relief" for Banking: Selected Legislation in the 114th Congress (CRS, May 2, 2016); Selected Securities Legislation in the 114th Congress (CRS, Dec. 4, 2015).

f. Regulatory Agencies: Legislation has been introduced to alter the structure and congressional oversight of the various financial regulatory agencies. See, e.g., the "Financial Services and General Government Appropriations Act, 2017" (H.R. 5485); the "Fed Oversight Reform and Modernization Act" (H.R. 3189); "Centennial Monetary Commission Act" (H.R. 2912); the "Bureau Advisory Commission Transparency Act" (H.R. 1265); the "Federal Reserve Transparency Act" (H.R. 24, S. 264, S. 2232); the "Financial CHOICE Act" (H.R. 5983); the "[CFPB] Act" (S. 3196); "An Act Making Appropriations to Stop Regulatory Excess and for Other Purposes, 2016" (S. 2132); the "Financial Regulatory Improvement Act" (S. 1484); the "[CFPB] Advisory Boards Act" (H.R. 1195). See generally Federal Reserve: Oversight and Disclosure Issues (CRS, May 24, 2016); Federal Reserve: Legislation in the 114th Congress (CRS, May 19, 2016); Financial Regulation: Complex and Fragmented Structure Could Be Streamlined to Improve Effectiveness (GAO, Feb. 25, 2016);

g. Privacy/Data Protection/Cybersecurity: Congress has considered numerous proposals relating to the protection of personal consumer information including, e.g., the "Homeowner Information Privacy Protection Act" (H.R. 4993); the "Safeguarding Social Security Numbers Act" (H.R. 4546); the "Senior$afe Act" (H.R. 4538, S. 2216); the "Secure and Protect Americans' Data" (H.R. 4187); the "Identity Theft and Tax Fraud Prevention Act" (H.R. 3981); the "Defense Against Digital Theft Act" (H.R. 3360); the "Consumer Privacy Protection Act" (H.R. 2977, S. 1158); the "Data Security Act" (H.R. 2205); the "Consumer Right to Financial Privacy Act" (H.R. 1262); the "Commercial Privacy Bill of Rights Act" (H.R. 1053, S. 547); the "Secure Data Act" (H.R. 726, S. 135); the

"Protecting Rights Online To Ensure Consumers' Trust" (H.R. 633); the "Data Accountability and Trust Act" (H.R. 580); the "Cyber Privacy Fortification Act" (H.R. 104); the "Identity Theft and Tax Fraud Prevention Act" (S. 676). See generally Financial Services and Cybersecurity: The Federal Role (CRS, Mar. 23, 2016); Privacy Protection for Customer Financial Information (CRS, July 14, 2016).

On December 18, 2015, the President signed into law the "Consolidated Appropriations Act, 2016", Pub. L. 114-113, 129 Stat. 2242, which included the "Cybersecurity Act of 2015". The legislation called for the Department of Homeland Security ("DHS") to establish a portal for cyber threat information sharing. The Director of National Intelligence, the Department of Defense and the DOJ will work with DHS to jointly develop and issue procedures to facilitate and promote the timely sharing of cyber threat indicators and defensive measures both within the government and between private sector entities and the government. The bill authorizes and provides liability protection for private sector entities to share information about cyber threat indicators and defensive cyber measures with other companies as well as with the federal government. Private sector entities would be required to remove extraneous personal information prior to sharing cyber threat data. DHS would then perform a review to ensure personal information had been removed in accordance with privacy and civil liberties guidelines.

Several bills have been introduced to address additional cybersecurity issues including, e.g., the "National Cybersecurity Preparedness Consortium Act" (H.R. 4743); the "Digital Security Commission Act" (H.R. 4651, S. 2604); the "Strengthening Cybersecurity Information Sharing and Coordination in Our Ports Act" (H.R. 3878); the "[DHS] Cybersecurity Strategy Act" (H.R. 3510); the "National Cybersecurity Protection Advancement Act" (H.R. 1731); the "Protecting Cyber Networks Act" (H.R. 1560); the "Critical Infrastructure Protection Act" (H.R. 1073).

See also Cybersecurity: Legislation, Hearings, and Executive Branch Documents (CRS, July 26, 2016); Encryption and the "Going Dark" Debate (CRS, July 20, 2016); U.S.-EU Data

Privacy: From Safe Harbor to Privacy Shield (CRS, May 19, 2016); Cybersecurity and Information Sharing: Comparison of H.R. 1560 (PCNA and NCPAA) and S. 754 (CISA) (CRS, Nov. 6, 2015); Encryption and Evolving Technology: Implications for U.S. Law Enforcement Investigations (CRS, Sept. 8, 2015); Cybersecurity: Data, Statistics, and Glossaries (CRS, Sept. 8, 2015).

Legislation has been introduced to amend the Gramm-Leach privacy provisions discussed in Part I.C.5 below. See, e.g., the "Community Lender Regulatory Relief and Consumer Protection Act" (H.R. 2642, S. 1491); the "Data Security Act" (H.R. 2205); the "Eliminate Privacy Notice Confusion Act" (H.R. 601); the "Financial Regulatory Improvement Act" (S. 1484); the "Privacy Notice Modernization Act" (S. 423).

Recent disclosures of classified information have prompted Congress to consider proposals to limit authorities under the Foreign Intelligence Surveillance Act ("FISA"). The "USA FREEDOM Act", Pub. L. 114-23 (2015) imposed certain new limitations on foreign intelligence surveillance activities and extended the expiring FISA provisions until December 15, 2019. Several additional proposals have been introduced to limit FISA's authority and increase transparency. See, e.g., the "F.A.I.R. Surveillance Act" (H.R. 5154); the "FISA COURT Act" (H.R. 5153); "A Bill to provide for the public disclosure of information regarding surveillance activities under [FISA]" (H.R.2454); the "Strengthening Privacy, Oversight, and Transparency Act" (H.R. 2305, S. 1337); the "End Warrantless Surveillance of Americans Act" (H.R. 2233); the "Privacy and Civil Liberties Oversight Enhancement Act" (H.R. 2108); the "Surveillance State Repeal Act" (H.R. 1466); the "Surveillance Order Reporting Act" (H.R. 689); the "FISA Reform Act" (S. 1469). See also Surveillance of Foreigners Outside the United States Under Section 702 of [FISA] (CRS, Apr. 13, 2016); Amendments to [FISA] Expiring on December 15, 2019 (CRS, Apr. 11, 2016);

Congress is also considering legislation to impose limits on the use of national security letters ("NSLs"), which were authorized under the PATRIOT Act to allow the FBI to require institutions to provide customer information without court approval. See the "Surveillance Order Reporting Act of 2015" (H.R. 689); the "FISA Reform Act" (S. 1469). See also, e.g., [NSLs] in Foreign Intelligence Investigations: A Glimpse at the Legal Background (CRS, July 31, 2015); [NSLs] in Foreign Intelligence Investigations: Legal Background (CRS, July 30, 2015); [NSLs]: Proposals in the 113th Congress (CRS, Jan. 22, 2015).

The "Commerce, Justice, Science, and Related Agencies Appropriations Act, 2017" (H.R. 5393, S. 2837) includes provisions prohibiting the authorization or issuance of NSLs by the FBI in contravention of the Right to Financial Privacy Act; the Electronic Communications Privacy Act; the Fair Credit Reporting Act ("FCRA"); the National Security Act of 1947; the PATRIOT Act; the USA FREEDOM Act; and the laws amended by these Acts.

See Part I.C and Part VIII.A below.

h. Economic Sanctions:

On July 14, 2015, the P5+1 countries (the U.S., United Kingdom, Germany, France, Russia and China) reached the Joint Comprehensive Plan of Action agreement (the "JCPOA") providing certain sanctions relief for Iran after Iran certifiably completes several steps to constrain its nuclear activities. On January 16, 2016, following a favorable report from the International Atomic Energy Agency, the P5+1 countries and Iran declared that "Implementation Day" had occurred under the JCPOA, bringing into force agreed relief from sanctions against Iran. The majority of U.S. secondary sanctions against Iran were lifted, as were most EU and UN sanctions. In particular, dealings with the Iranian energy sector and most (but not all) Iranian financial institutions are now unrestricted, so long as the dealings have no connection to the U.S. See Implementation of Sanctions Relief for Iran (Cleary Gottlieb, Jan. 18, 2016).

Congress is considering numerous pieces of legislation that would reverse implementation of sanctions relief for Iran under the JCPOA, impose new sanctions on Iran or impose additional restrictions and reporting requirements at the federal level for investments in Iran. See, e.g., the "Determination of Russia-Iran Weapons Transfer Act" (H.R. 5827); the "Preventing Iranian Destabilization of Iraq Act" (H.R. 5727); the "Iran Accountability Act" (H.R. 5631); the "No Impunity for Iranian Aggression at Sea Act" (H.R. 5333, S. 2984); the "Iran Cyber Sanctions Act" (H.R. 5222, S. 2756); the "Preventing Iran's Access to United States Dollars Act" (H.R. 4995, S. 2752); the "United States Financial System Protection Act" (H.R. 4992); the "United States Financial System Protection Act" (H.R. 4898); the "Iran Ballistic Missile Sanctions Act" (H.R. 4815, S. 2725); the "Sanctioned Iranian Entities Oversight Act" (H.R. 4633); the "State Sanctions Against Iranian Terrorism Act" (H.R. 4448); the "Ending Iran's Nuclear Weapon Program Before Sanctions Relief Act" (H.R. 4344, S. 2429); the "Iran Ballistic Missile Prevention and Sanctions Act" (H.R. 4342); the "Iran's Revolutionary Guard Corps Sanctions Implementation and Review Act" (H.R. 4312); the "IRGC Sanctions Act" (H.R. 4257); the "IRGC Terrorist Sanctions Act" (H.R. 3693); the "Iran Terror Finance Transparency Act" (H.R. 3662; the "Keeping Aircraft Away from Terrorists Act" (S. 3286); "A Bill to extend the Iran Sanctions Act of 1996" (S. 3281); the "Countering Iranian Threats Act" (S. 3267); "A bill to extend the sunset of the Iran Sanctions Act of 1996 in order to effectuate the Joint Comprehensive Plan of Action in guaranteeing that all nuclear material in Iran remains in peaceful activities" (S. 2988); the "Iran Financial System Access Limitation Act" (S. 2757); the "Iran Terrorism and Human Rights Sanctions Act" (S. 2726); the "North Korea and Iran Sanctions Act" (S. 2485).

See generally, e.g., Iran's Foreign Policy (CRS, Aug. 24, 2016); Iran: Politics, Gulf Security, and U.S. Policy (CRS, Aug. 19, 2016); Iran Nuclear Agreement (CRS, Aug. 2, 2016); Iran Sanctions (CRS, July 27, 2016); Iran's Nuclear Program: Status (CRS, June 13, 2016); Iran: U.S. Economic Sanctions and the Authority to Lift Restrictions (CRS, Jan. 22, 2016).

In light of North Korea's continuing nuclear and ballistic missile activities, Congress passed and the President signed into law the "North Korea Sanctions and Policy Enhancement Act", Pub. L. 114-122 (2016). The Act provides for secondary sanctions targeting persons who knowingly engage in certain activities with the Government of North Korea, including, among other things: (1) engaging in activities that materially contribute to the proliferation of weapons of mass destruction and the means to deliver them; (2) trading in arms or luxury goods; (3) engaging in censorship or serious human rights abuses; (4) engaging in money laundering in support of North Korea; and (5) selling to North Korea a significant amount of metal or software related to weapons proliferation, military, intelligence or political repression. In addition, the Act imposes a comprehensive ban on North Korea and requires the President to determine whether North Korea is a jurisdiction of primary money laundering concern. On March 16, 2016, President Obama issued Executive Order 13722, further expanding on the Act. See [U.S.] Ratchets Up North Korean Sanctions while Continuing to Ease Cuban Sanctions (Cleary Gottlieb, Apr. 5, 2016).

See generally Iran-North Korea-Syria Ballistic Missile and Nuclear Cooperation (CRS, July 14, 2016); Iran-North Korea-Syria Ballistic Missile and Nuclear Cooperation (CRS, Jan. 15, 2016); North Korea: U.S. Relations, Nuclear Diplomacy, and Internal Situation (CRS, Jan. 15, 2016); North Korea: Legislative Basis for U.S. Economic Sanctions (CRS, Jan. 14, 2016).

Recent changes in economic sanctions and export controls administered by the U.S. Department of the Treasury's Office of Foreign Assets Control ("OFAC") and BIS provide for the incremental easing of sanctions in support of the President's rapprochement with Cuba. Primary sanctions on Cuba remain in place and are expected to do so over the medium term, in large part because congressional action would be required for more sweeping and permanent changes. See, e.g., [U.S.] Ratchets Up North Korean Sanctions while Continuing to Ease Cuban Sanctions (Cleary Gottlieb, Apr. 5, 2016); U.S. Continues Incremental Easing of Cuban Sanctions (Cleary Gottlieb, Jan. 28, 2016). See also Cuba: U.S. Restrictions on Travel and Remittances: (CRS, Aug. 24, 2016); Cuba: Issues for the 114th Congress (CRS, Aug. 1, 2016).

See Part VIII.A below.

i. AML/Counter Terrorism Financing:

(i) On March 25, 2015, the House Financial Services Committee established the bipartisan House Financial Services Task Force to Investigate Terrorism Financing ("Task Force"). Following a series of eleven hearings, the Task Force recommended action and introduced five bills on June 29, 2016.

A) The "Enhancing Treasury's Anti-Terror Tools Act" (H.R. 5607) would, among other things, examine Treasury's counter-terror financing role at U.S. embassies and improve Treasury's anti-terror finance monitoring of cross-border fund transfers.

B) The "Anti-terrorism Information Sharing Is Strength Act" (H.R. 5606) would improve the sharing of information about terrorist activities, money laundering activities, and other specified unlawful activities among financial institutions and government agencies.

C) "A Bill to amend title 31, United States Code, to authorize the Secretary of the Treasury to include all funds when issuing certain geographic targeting orders, and for other purposes" (H.R. 5602) would revise Treasury's authority to issue an order imposing recordkeeping and reporting requirements.

D) The "Kleptocracy Asset Recovery Rewards Act" (H.R. 5603) would authorize Treasury to pay rewards under an asset recovery rewards program to help identify and recover stolen assets linked to foreign government corruption and the proceeds of such corruption hidden behind complex financial structures in the U.S. and abroad.

E) The "National Strategy for Combating Terrorist, Underground, and Other Illicit Financing Act" (H.R. 5594) would direct the President, acting through Treasury, to develop a national strategy for combating the financing of terrorism and related forms of illicit finance.

(ii) On May 5, 2016, Treasury and the DOJ announced legislative proposals to combat money laundering and corruption. The Treasury proposal would require companies formed within the U.S. to file beneficial ownership information with Treasury and face penalties for failure to comply. The DOJ proposal targets illegal proceeds of transnational corruption and substantive corruption offenses. The DOJ proposal would (A) expand foreign money laundering predicates to include any violation for foreign law that would be a money laundering predicate if committed in the U.S.; (B) allow administrative subpoenas for money laundering investigations; (C) enhance authority to access foreign bank or business records by serving branches in the U.S.; (D) create a mechanism to use and protect classified information in civil asset recovery cases; and (E) extend from 30 days to 90 days the period in which the U.S. can restrain property based on a request from a foreign country and extend the procedures to authenticate records of regularly conducted activity in criminal cases to civil asset property cases. Neither proposal has been introduced in Congress.

(iii) Other bills relating to anti-money laundering initiatives and efforts to curb terror finance include, e.g., "A Bill to require the Secretary of the Treasury to direct the United States Executive Director at the International Monetary Fund to support the capacity of the International Monetary Fund to prevent money laundering and financing of terrorism" (H.R. 5469); the "Terrorist Asset Seizure Reform Act" (H.R. 5308); the "Holding Individuals Accountable and Deterring Money Laundering Act" (H.R. 4242); the "Closing Loopholes Against Money-Laundering Practices Act" (S. 3268); the "Stop Terrorist Operational Resources and Money Act" (S. 3125).

See generally Trade-Based Money Laundering: Overview and Policy Issues (CRS, June 22, 2016); Remittances: Background and Issues for Congress (CRS, May 9, 2016); Financial Institutions: Fines, Penalties, and Forfeitures for Violations of Financial Crimes and Sanctions Requirements (GAO, Mar. 22, 2016); International Remittances: Money Laundering Risks and Views on Enhanced Customer Verification and Recordkeeping Requirements (GAO, Jan. 15, 2016).

(iv) On February 9, 2016, the White House released its Fiscal Year 2017 Budget Request. Among other things, the Budget included a proposal to provide authority to readily share information about beneficial ownership information of U.S. companies with law enforcement. Legislation to enhance requirements relating to the identification, verification, or disclosure of the beneficial owners of entities includes, e.g., the "Incorporation Transparency and Law Enforcement Assistance Act" (H.R. 4450, S. 2489); the "Hedge Fund Sunshine Act" (H.R. 3921); the "Combating Global Corruption and Ensuring Accountability Act" (S. 3210); the "Brokaw Act" (S. 2729). See also [FinCEN]: Customer Due Diligence Requirements for Financial Institutions (GAO, May 26, 2016).

(v) The "Stop Tax Haven Abuse Act" (H.R. 297 and S. 174) would mandate that Treasury require unregistered investment companies (including hedge funds and private equity funds) to implement AML programs and submit suspicious activity reports ("SARs"). See also, e.g., Corporate Expatriation, Inversions, and Mergers: Tax Issues (CRS, Apr. 27, 2016); Tax Reform in the 114th Congress: An Overview of Proposals (CRS, Mar. 18, 2016); Tax Havens: International Tax Avoidance and Evasion (CRS, Jan. 15, 2015).

See Part VIII.A below.

j. Virtual Currency: Congress continues to review issues relating to virtual currencies, including the potential for use in illegal money transfers, their effect on monetary policy and financial stability, and related consumer and investor protection issues. See generally Bitcoin: Questions, Answers, and Analysis of Legal Issues (CRS, Oct. 13, 2015); Dark Web (CRS, July 7, 2015); Virtual Currencies Key Definitions and Potential AML/CFT Risks (FATF, June 2014); Virtual Currencies: Emerging Regulatory, Law Enforcement, and Consumer Protection Challenges (GAO, May 2014).

k. Financial Technology ("FinTech"): Congress is reviewing FinTech firms that use technology to provide financial services and financial products. See, e.g., "A Resolution expressing the sense of the House of Representatives that the United States should adopt a national policy for technology to promote consumers' access to financial tools and online commerce to promote economic growth and consumer empowerment" (H. Res. 835). See also, e.g., "Examining the Opportunities and Challenges with [FinTech]: The Development of Online Marketplace Lending", Hearing before House Financial Services Subcommittee, July 12, 2016.

l. Physical Commodities: Congress has examined the investments and activities of banks and BHCs in physical commodities markets and their related businesses. Following a two-year investigation, the PSI held hearings and released its report focused on the activities of Goldman Sachs, JPMorgan Chase, and Morgan Stanley. The activities reviewed by the PSI included "trading uranium, operating coal mines, running warehouses that store metal, stockpiling aluminum and copper, operating oil and gas pipelines, planning to build a compressed natural gas facility, acquiring a natural gas pipeline company, selling jet fuel to airlines, and operating power plants." See "Wall Street Bank Involvement With Physical Commodities", Hearings before Senate PSI, Nov. 20 and 21, 2014. See also Wall Street Bank Involvement With Physical Commodities (PSI, Nov. 2014). Following the hearings, PSI Chairman Carl Levin (D-MI) introduced legislation to prevent large financial institutions from trading in specific physical commodities and commodity-related financial instruments while simultaneously in possession of privileged information based on ownership of commodity infrastructure enterprises such as those used to store, ship or use a product. See "Ending Insider Trading in Commodities Act" (S. 3013).

The Board has recommended that Congress repeal certain commodities-related FHC empowerments. See Report to the Congress and the FSOC Pursuant to Section 620 of the [DFA] (Board, FDIC, OCC, Sept. 8, 2016) (the "Section 620 Report"). See also Part I.B.6 below.

See Part I.C.1.c below.

m. Investment Management: The "Promoting Job Creation and Reducing Small Business Burdens Act" (H.R. 37) and the "[SBIC] Advisers Relief Act" (H.R. 432 and S. 1978) would exempt advisers of SBICs from certain registration and reporting requirements. The "RISE After Disaster Act" (S. 1470) would give priority to SBIC applications for licenses to operate in a declared major disaster area. See also Small Business: Access to Capital and Job Creation (CRS, Apr. 12, 2016); [SBICs]: Characteristics and Investment Performance of Single and Multiple Licensees (GAO, Jan. 27, 2016); Selected Securities Legislation in the 114th Congress (CRS, Dec. 4, 2015).

   Legislation has been introduced to delay or prohibit the implementation of the fiduciary rule promulgated by the Department of Labor (the "DOL") and to create a best interest standard for advice fiduciaries. See, e.g., the "[DOL], Health and Human Services, and Education, and Related Agencies Appropriations Act, 2017" (H.R. 5926); the "Retirement Choice Protection Act" (H.R. 3922); the "Retail Investor Protection Act" (H.R. 1090). See also [DOL's] 2015 Proposed Fiduciary Rule: Background and Issues (CRS, Nov. 27, 2015); The [DFA]: Standards of Conduct of Brokers, Dealers, and Investment Advisers (CRS, Apr. 6, 2015).

   See Part VIII below.

n. Insurance: Congress has continued to review legislation relating to the capital requirements for insurance companies. See, e.g., the "Transparent Insurance Standards Act" (H.R. 5143); the "International Insurance Standards Transparency and

Policyholder Protection Act" (H.R. 2121); the "Financial Regulatory Improvement Act" (S. 1484); the "International Insurance Capital Standards Accountability Act" (S. 1086). See also Insurance Regulation: Background, Overview, and Legislation in the 114th Congress (CRS, Sept. 16, 2015); International Insurance Capital Standards: Collaboration among U.S. Stakeholders Has Improved but Could Be Enhanced (GAO, June 25, 2015); Insurance Agent Licensing: Overview and Background on Federal 'NARAB' Legislation (CRS, Jan, 20, 2015).

See also Part I.B.5 below.

o. Securities Transaction Tax: Legislative proposals to impose a securities transaction tax ("STT") or a financial transaction tax ("FTT") on non-consumer transactions involving stocks, bonds, futures, options, swaps and credit default swaps ("CDS") include the "Inclusive Prosperity Act" (H.R. 1464, S. 1371); the "American Health Security Act" (H.R. 1200); the "Humphrey-Hawkins 21st Century Full Employment and Training Act" (H.R. 1000); the "College for All Act" (S. 1373). See generally, e.g., High-Frequency Trading: Background, Concerns, and Regulatory Developments (CRS, Apr. 4, 2016); Tax Reform in the 114th Congress: An Overview of Proposals (CRS, Mar. 18, 2016); [FTTs]: In Brief (CRS, Oct. 22, 2015).

p. Financial Crisis Responsibility Fee: On February 9, 2016, the White House released the President's Budget for Fiscal Year 2017. Among other things, the Budget included a proposal to impose a "Financial Fee" of seven basis points on banks (both U.S. and foreign), and on "BHCs" and "nonbanks", such as insurance companies, savings and loan holding companies, exchanges, asset managers, broker-dealers, specialty finance corporations and financial affiliates with assets in excess of $50 billion. If enacted, the fee is projected to raise approximately $111 billion over ten years and would be effective on January 1, 2017.

B. DODD-FRANK ACT AND "REFORM" GENERALLY

Dodd-Frank is the most sweeping legislation regulating the U.S. financial services industry since the Great Depression. The final Dodd-Frank Act emerged from a Conference Committee following passage in the House of the "Wall Street Reform and Consumer Protection Act", H.R. 4173, on December 11, 2009, and passage in the Senate of the "Restoring American Financial Stability Act" ("RAFSA"), S. 3217, on May 20, 2010. See Dodd-Frank at Five Years: Reforming Wall Street and Protecting Main Street (Treasury, July 2015).

Some of Dodd-Frank's provisions became effective immediately upon enactment on July 21, 2010. Most provisions, however, have had a delayed effectiveness and/or required rulemaking by various U.S. federal regulators. Although much of that rulemaking has been finalized or is underway, there continue to be delays in implementation. In addition, the scope and meaning of many of Dodd-Frank's provisions, including the potential extraterritorial applicability of such provisions, are unclear, and some provisions are being challenged in court.

Implementation of certain regulations is subject to challenge on cost-benefit grounds, and there has been a significant increase in compliance costs for large U.S. banks since the beginning of the crisis. See, e.g., MetLife, Inc. v. [FSOC], 2016 U.S. Dist. LEXIS 46897 (D.D.C., Mar. 30, 2016) rescinding FSOC's designation of MetLife as a SIFI in part due to inadequate consideration of the costs of designation) (appeal pending); How Dodd-Frank Affects Small Bank Costs (Federal Reserve Bank of Philadelphia ("FRB-Philadelphia"), 2016); Dodd-Frank Regulations: Impacts on Community Banks, Credit Unions and Systemically Important Institutions (GAO, Dec. 2015); The Most Expensive Dodd-Frank Rule Adds to Law's Burden (American Action Forum, Nov. 10, 2015); Community Banking in the 21st Century: 2015 National Survey (Federal Reserve and CSBS, Sept. 30, 2015); Dodd-Frank at 5: Higher Costs, Uncertain Benefits (American Action Forum, July 14, 2015); The Growth Consequences of Dodd-Frank (American Action Forum, May 6, 2015); AFR Response to American Action Forum Study on Costs of Dodd-Frank (Americans for Financial Reform, May 6, 2015); "Dodd-Frank Fails at Measuring Costs and

Benefits", Insights (American Action Forum, Feb. 19, 2015); Dodd-Frank Regulations: Regulators' Analytical and Coordination Effects (GAO, Dec. 2014); The Regulatory Price-Tag: Cost Implications of Post-Crisis Regulatory Reform (Federal Financial Analytics, July 2014); Peirce, Robinson and Stratman, "How Are Small Banks Faring under Dodd-Frank", Mercatus Center Working Paper 14-05 (Feb. 2014); The Importance of Cost-benefit Analysis in Financial Regulation (Center for Capital Markets Competitiveness, Mar. 2013); Dodd-Frank Burden Tracker (House Financial Services Committee, Apr. 17, 2012); Business Roundtable and Chamber of Commerce v. SEC, 647 F.3d 1144 (D.C. Cir. 2011) (SEC failed to conduct required cost-benefit analysis in connection with its proxy access rule); Regulation and Independent Regulatory Agencies (White House Memorandum, July 11, 2011) (urging the independent agencies to consider costs and benefits in connection with agency regulations); A Review of Cost-benefit Analyses Performed by the [CFTC] in Connection with Rulemakings Undertaken Pursuant to the Dodd-Frank Act (CFTC OIG, June 13, 2011); Report of Review of Economic Analysis Performed by the [SEC] in Connection with Dodd-Frank Act Rulemakings (SEC OIG, June 13, 2011); Response to Congressional Request Regarding the Economic Analysis Associated with Specified Rulemakings (Board OIG, June 2011).

Dodd-Frank commissions numerous studies on various aspects of financial services regulation, and administrative rulemaking over a long time period is playing a critical role in establishing the rules for the U.S. financial services marketplace. It is therefore difficult to predict with confidence the potential impact of Dodd-Frank on participants in the U.S. financial markets, including whether Dodd-Frank in fact addressed adequately the key causes of the banking crisis. See, e.g., Dodd-Frank Five Years Later: Accomplishments, Threats, and Next Steps (Democratic Staff of the House Financial Services Committee, July 21, 2015); Testimony of SEC Chairman White Before the Senate Banking Committee, Sept. 9, 2014; Responding to Systemic Risk: Restoring the Balance (Bipartisan Policy Center, Sept. 2014); Failing to End "[TBTF]": An Assessment of the Dodd-Frank Act Four Years Later (Republican Staff of the House Committee on Financial Services, July 2014).

With respect to expectations as to banking and capital markets developments and rulemakings post-Dodd-Frank, see, e.g., Banking

Reimagined: How Disruptive Forces Will Radically Transform the Industry in the Decade Ahead (Deloitte, 2016); 2016 Banking Industry Outlook Survey: The Need for Speed (KPMG, 2016); FDIC 2015–2019 Strategic Plan; The Street, The Bull and The Crisis: A Survey of the U.S. and UK Financial Services Industry (U. of Notre Dame and Labaton Sucharow, May 2015); Supervisory Intensity and Effectiveness (FSB, Apr. 7, 2014); Dodd-Frank Regulations: Agencies Conducted Regulatory Analyses and Coordinated but Could Benefit from Additional Guidance on Major Rules (GAO, Dec. 2013); The Real Financial Crisis: Why Financial Intermediation is Failing – The State of the Financial Services Industry (Oliver Wyman, 2012); What's In Dodd-Frank: Title-by-title Overview (ICBA, Jan. 2012); Cumulative Weight of Regulatory Reform FSOC, July 7, 2011); Review of CBO's Cost Estimate for [Dodd-Frank] (Mar. 30, 2011); Wholesale & Investment Banking Outlook: Reshaping the Model (Morgan Stanley/Oliver Wyman, Mar. 23, 2011); Greene, "Dodd-Frank: A Lesson in Decision Avoidance", Capital Markets L.J. (Jan. 2011).

Eleven states joined a lawsuit filed by a Texas state bank and two advocacy groups challenging the constitutionality of several sections of Dodd-Frank, including the Title II authority to place financial companies into an orderly liquidation if their default would pose a systemic risk to U.S. financial stability. See Part I.B.2 and Part I.B.10 below.

A title-by-title summary of Dodd-Frank is set forth below. Various provisions of Dodd-Frank are described in more detail throughout this Guide.

1. Title I – Financial Stability

   a. The Financial Stability Oversight Council and Office of Financial Research

   Dodd-Frank creates a new framework for overseeing systemic risk. Effective July 21, 2010, the FSOC was established, consisting of 10 voting members and five non-voting members. The FSOC is charged with identifying and managing systemic risks in the financial system, and with serving as a coordinating body to promote consistency and comprehensiveness in federal regulation of systemic risk. See generally FSOC Annual Reports; Dodd-Frank Integrated Implementation Roadmap (FSOC, Oct. 2010); Transparency Policy (FSOC, Oct. 2010).

Dodd-Frank also established the OFR within Treasury. The OFR's mandate is to support the FSOC and its member agencies by (i) collecting data and providing such data to the FSOC and member agencies; (ii) standardizing the types and formats of data reported and collected; (iii) conducting research; (iv) developing risk measurement and monitoring tools; (v) making the results of the activities of the OFR available to financial regulatory agencies; and (vi) assisting such agencies in determining the types and formats of data to be collected. See 75 Fed. Reg. 74146 (Nov. 30, 2010) (OFR Statement of Policy). The OFR is funded by fees assessed on certain systemically significant institutions. See 77 Fed. Reg. 29884 (May 21, 2012). See generally, e.g., OFR Annual Reports; OFR Financial Stability Monitor; FSOC and OFR Data Requests Are Not Duplicative (Treasury OIG, Aug. 26, 2015).

b. Regulation of Systemically Important Financial Institutions

One of the principal conclusions of regulators coming out of the financial crisis was the need for enhanced regulation and supervision of SIFIs. Under Dodd-Frank, the Board has front-line responsibility for supervising and regulating SIFIs. Systemically significant non-bank financial companies ("Non-bank SIFIs") and large interconnected BHCs ("Bank SIFIs" and, together with Non-bank SIFIs, "Covered SIFIs") are now subject to heightened capital, liquidity and other prudential standards, including risk management requirements, resolution plans (so-called "living wills") and stress tests. In applying enhanced standards to non-U.S. Covered SIFIs, the Board is directed to take into account the principle of national treatment and equality of competitive opportunity and the extent to which an institution is subject to comparable home country standards. Dodd-Frank also gave regulators additional tools to restrict the size, growth and activities of these companies, including the power in some circumstances to order the divestiture of activities or operations, and Dodd-Frank restricts the ability of Covered SIFIs to grow by acquisition. U.S. regulators have finalized many rules implementing the provisions of Title I of the Dodd-Frank Act.

(i) Systemically Important Banks

U.S. and foreign regulators have developed indicators to identify systemically important banks ("SIBs"), and the FSB leads the global effort to review and coordinate supervision of SIBs, with a particular focus on globally systemically important banks ("G-SIBs") whose failure could pose a threat to the international financial system. In 2011, the FSB adopted standards originally promulgated by the Basel Committee for determining which banks should be designated as G-SIBs, using indicators that consider a bank's systemic importance across five categories: size, interconnectedness, substitutability, complexity and cross-jurisdictional activity. The list of G-SIBs was first published in November 2011 and has been updated annually. The most recent list of G-SIBs included 30 banks, eight of which were U.S.-based. 2015 Update of List of [G-SIBs] (FSB, Nov. 3, 2015). See also, e.g., Assessment of Basel III G-SIB Framework and Review of D-SIB Frameworks -- China, European Union, Japan, Switzerland and United States (Basel, June 16, 2016); Systemic Importance Data Shed Light on Global Banking Risks (OFR, Apr. 13, 2016); The FSB Agenda for 2015 (Institute of International Finance ("IIF"), 2015); Thematic Review on Supervisory Frameworks and Approaches for SIBs (FSB, May 26, 2015); A Comparison of U.S. and International [G-SIBs] (OFR, Aug. 4. 2015); Systemic Importance Indicators for 33 U.S. [BHCs] (OFR, Feb. 12, 2015); Large and Complex Banks, FRBNY Economic Policy Review (Dec. 2014) (11 research papers on large and complex banks); Progress and Next Steps Towards Ending [TBTF] (FSB, Sept. 2, 2013); [G-SIBs]: Updated Assessment Methodology and the Higher Loss Absorbency Requirement (BIS, July 2013); Reducing the Moral Hazard Posed by [SIFIs] (FSB, Oct. 20, 2010).

In November 2015, the FSB issued final standards requiring G-SIBs to maintain specified levels of equity capital and debt as Total Loss-Absorbing Capacity ("TLAC"); the standards would require G-SIBs to hold debt and equity capital totaling approximately double the level of equity capital required under the Basel III minimum capital standards. The Board has proposed regulations to implement the TLAC requirement in the U.S. The proposal would require covered BHCs and IHCs to issue a minimum level of TLAC in accordance with the FSB's standards, which must include a minimum level of long-term debt, restrict the ability for covered BHCs and IHCs to incur non-TLAC liabilities of the holding company level, and impose a regulatory capital deduction for investments in the unsecured debt of covered BHCs. See 80 Fed. Reg. 74926 (Nov. 30, 2015); Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution and [TLAC] Term Sheet (FSB, Nov. 9, 2015). See also Comparison of FSB TLAC Standards to Federal Reserve TLAC Proposal (Cleary Gottlieb, Nov. 20, 2015).

In the U.S., any BHC with $50 billion or more in total consolidated assets is subject to enhanced prudential standards under Dodd-Frank. See Part I.B.1.b.iii below. See also, e.g., Consequences of Systemic Regulation for U.S. Regional Banks (Federal Financial Analytics, Aug. 6, 2015).

(ii) Designation of Non-bank Financial Companies as Systemically Important

A) In 2012, the FSOC finalized rules for the designation of non-bank financial companies as systemically important. See 77 Fed. Reg. 21637 (Apr. 11, 2012) (final rule and interpretive guidance). It subsequently voted to designate four firms -- AIG, General Electric Capital Corp. ("GE Capital"), Prudential Financial and MetLife -- as Non-bank SIFIs. See FSOC Final Determination Regarding MetLife (Dec. 18, 2014); FSOC Designation of

Prudential Financial (Sept. 19, 2013); FSOC Designation of AIG (July 8, 2013); FSOC Designation of GE Capital (July 8, 2013). See also, e.g., [FSOC] Further Actions Could Improve the Nonbank Designation Process (GAO, Nov. 2014); Bush & Chang, "FSOC Reproposes the Non-bank SIFI Designation Rule: A Revised Procedure but no Greater Clarity Regarding Who Will be Designated or When", Sec. Reg. L. Rep. (Dec. 19, 2011).

A federal district court rescinded MetLife's designation, finding that the FSOC failed to follow its own procedures or consider the costs of designation. The FSOC appealed in June 2016. See MetLife, Inc. v. [FSOC], 2016 U.S. Dist. LEXIS 46897 (D.D.C., Mar. 30, 2016) (appeal pending); Law360, June 16, Apr. 7, 2016.

In June 2016, FSOC rescinded its designation of GE Capital as a Non-bank SIFI after the company exited most of its lending operations and substantially reduced its systemic footprint. See Basis for the [FSOC's] Rescission of its Determination Regarding GE Capital Holdings, LLC (FSOC, June 28, 2016); See also Goldman Sachs Bank USA, 102(3) Fed. Res. Bull.1 (2016) (acquiring deposit liabilities of GE Capital); Securities Law Daily, Apr. 14, 2015.

B) The Board has issued regulations relevant to the designation of Non-bank SIFIs. See 78 Fed. Reg. 20756 (Apr. 5, 2013) (definitions of "predominantly engaged in financial activities", "significant [BHC]" and "significant non-bank financial company").

C) The FSOC has sought comment on the systemic risks posed by the asset management industry. See 79 Fed. Reg. 77488 (Dec. 24, 2014). See also Update on Review of Asset Management Products and Activities (FSOC, Apr. 18, 2016); Global Financial Stability Report (IMF, Apr. 8, 2015) (discussing financial stability risks of asset management companies); Securities Law Daily, Apr. 8, 2015; ICI and SIFMA/Investment Adviser Association Comment Letters to the FSOC, dated Mar. 25, 2015; Asset Management and Financial Stability (OFR, Sept. 30, 2013).

D) Internationally, the FSB has taken the lead in identifying Non-bank SIFIs and making recommendations for their regulation and supervision. See, e.g., Consultative Document: Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities (FSB, June 22, 2016); Developing Effective Resolution Strategies and Plans for Systematically Important Insurers (FSB, June 6, 2016); 2015 Update of List of Globally Systematically Important Insurers [("GSIIs")] (FSB, Nov. 3, 2015) (identifying nine large insurance companies as GSIIs); FSB Press Release, July 30, 2015; Consultative Document (2nd): Assessment Methodologies for Identifying Non-bank Non-Insurer Global [SIFIs] (FSB, Mar. 4, 2015); Consultative Document: Recovery and Resolution Planning for GSIIs (FSB, Oct. 16, 2014); GSIIs and the Policy Measures That Will Apply to Them (FSB, July 18, 2013).

E) Covered SIFIs are subject to annual assessments to cover the Board's expenses incurred in their regulation. See 78 Fed. Reg. 52391 (Aug. 23, 2013).

(iii) Enhanced Prudential Standards

A) In March 2014, the Board issued rules to implement the enhanced prudential standards for Covered SIFIs required under Dodd-Frank § 165. See 12 C.F.R. Part 252 ("Regulation YY"); 79 Fed. Reg. 17240 (Mar. 27, 2014). These include a rule for U.S. Covered SIFIs (the "Domestic SIFI Rule") and a rule for non-U.S. Covered SIFIs (the "Foreign SIFI

Rule" and, together with the Domestic SIFI Rule, the "SIFI Rules").

B) The Domestic SIFI Rule implements enhanced standards, including risk-based capital and leverage requirements, liquidity standards, requirements for overall risk management, stress test requirements and a debt-to-equity limit in certain instances. The Rule also sets forth an early remediation framework that is intended to complement the existing "prompt corrective action" ("PCA") regulations that apply to FDIC-insured institutions. See, e.g., Final Look: A Practical Guide to the Federal Reserve's Enhanced Prudential Standards for Domestic Banks (Deloitte, 2014). The Rule does not include the single-counterparty credit limits mandated under DFA § 165, which the Board has reproposed for public comment after completing a quantitative impact study. 81 Fed. Reg. 14328 (Mar. 16, 2016).

   In July 2015, the Board adopted a final rule imposing additional capital requirements on the largest and most systemically important U.S. BHCs. The rule specifies criteria for identifying G-SIBs subject to the enhanced requirements and provides two methodologies for calculating the risk-based capital surcharge. 80 Fed Reg. 49082 (Aug. 14, 2015).

C) The Foreign SIFI Rule makes dramatic changes to the way non-U.S. banking organizations are regulated in the U.S. It requires a non-U.S. Covered SIFI with U.S. non-branch assets of $50 billion or more to place all of its U.S. subsidiaries into an "intermediate holding company" ("IHC") subject to capital and liquidity requirements and other enhanced standards. U.S. branches and agencies will remain outside of the IHC, but will be subject to separate liquidity and other enhanced standards. See e.g., Enhanced Prudential Standards for Foreign Banks (Deloitte, 2015); Regulatory Brief: Foreign

Banks: U.S. Admission Price Rising (PriceWaterhouse Coopers ("PWC"), July 2014); FAQs: Implementation of Regulation YY Enhanced Prudential Standards for Foreign Banking Organizations (Board, June 26, 2014); Final Look: A Practical Guide to the Federal Reserve's Enhanced Prudential Standards for Foreign Banks (Deloitte, 2014). See also Part I.B.1.f below.

D) The Board has indicated that it may modify or adapt the SIFI Rules and other bank regulatory requirements (in particular, bank regulatory capital requirements) for application to Non-bank SIFIs. In June 2016, the Board release an Advanced Notice of Proposed Rulemaking soliciting comment on two proposed approaches to imposing regulatory capital requirements on a consolidated basis to Board-Supervised entities that are significantly engaged in insurance activities. In addition, the Board proposed enhanced prudential standards for insurance companies that are designated as Non-bank SIFIs (e.g., (Prudential and AIG), tailoring those standards to the particular risk profiles of insurance activities and companies. 81 Fed. Reg. 38610 (June 14, 2016); 81 Fed. Reg. 38631 (June 14, 2016). See also 80 Fed. Reg. 44111 (July 24, 2015) (final order establishing tailored enhanced prudential standards for GE Capital prior to June 2016 rescission of GE's SIFI designation).

E) The Board has indicated that it may act to limit short-term wholesale funding risks by increasing capital requirements and applying other prudential standards to firms that depend on short-term funding, including repos, reverse repos, securities borrowing/lending and securities margin lending. See Testimony of Board Governor Tarullo Before the Senate Banking Committee, Sept. 9, 2014; Governor Tarullo Outlines Anticipated Proposals to Limit Short-term Wholesale Funding Risks (Cleary Gottlieb, Nov. 27, 2013).

F) In order to enhance its supervision of the largest financial institutions, the Board created the Large Institution Supervision Coordinating Committee ("LISCC") and has published a framework for supervision of large financial institutions. The LISCC is a Federal Reserve-wide committee, chaired by the director of the Board's Division of Banking Supervision and Regulation, that oversees supervision of the largest and most systemically important financial institutions. See, e.g., Governance Structure of the [LISCC] Supervisory Program, Board SR Letter 15-7 (Apr. 17, 2015); Consolidated Supervision Framework for Large Financial Institutions, Board SR Letter 12-17 (Dec. 17, 2012) CCH Fed. Banking L. Rep. ¶ 37-749; (the "2012 Supervision Guidance"); Testimony of Board General Counsel Alvarez Before the House Committee on Financial Services, June 19, 2012. See also Part II.A.4 below.

G) In September 2014, the OCC adopted formal guidelines for its "heightened expectations" for large national banks and federal savings associations, establishing minimum standards for the design, implementation and oversight of internal risk governance frameworks. See 79 Fed. Reg. 54518 (Sept. 11, 2014); 76 Fed. Reg. 74595 (Dec. 16, 2014) (correction).

(iv) Recovery and Resolution Plans

A) Board/FDIC regulations require Covered SIFIs to prepare resolution plans pursuant to Dodd-Frank § 165(d). See 12 C.F.R. Parts 243 and 381; 76 Fed. Reg. 67323 (Nov. 1, 2011) (final rule). Resolution plans are required to be updated and refiled annually, and the Board and FDIC continue to release new guidance related to resolution planning. The public portions of the filed plans are available on the Board and FDIC websites.

B) Board and FDIC regulations divide Covered SIFIs into three categories based on assets held outside of insured depository institution subsidiaries: institutions with $250 billion or more in non-bank assets, institutions with $100 billion or more in non-bank assets and institutions with less than $100 billion in non-bank assets. For non-U.S. Covered SIFIs, the asset thresholds are calculated with respect to U.S. non-bank assets only.

C) The largest institutions, with $250 billion or more in non-bank assets, were required to file their initial plans by July 2, 2012. Nine Bank SIFIs, including four non-U.S. banks, filed in the first round, and two other "first-round filers" filed on a delayed basis in October 2012. In April 2016, the Board and the FDIC released joint determinations regarding the eight domestic first-round filers' 2015 plans and provided individual feedback to each filer. The Board and the FDIC jointly determined that the 2015 resolution plans of five of the domestic first-round filers were not credible or would not facilitate an orderly resolution under the Bankruptcy Code, and issued joint notices of deficiencies to these five filers detailing the deficiencies in their plans and the actions the filers must take by October 1, 2016. The Board and the FDIC each identified weaknesses in the 2015 resolution plans of the remaining three domestic first-round filers that those filers must address in their 2017 plans, but did not make a joint determination of deficiencies for these plans. The deadline for the next full plan submission for all eight domestic first-round filers is July 1, 2017. Simultaneously with the April 2016 joint determinations, the Board and the FDIC released further guidance on the resolution planning requirement that provides further information on the determinations and the Board's and the FDIC's process for reviewing the plans and additional guidance for the domestic first-round filers' 2017 plans. See Joint Board/FDIC Press Release, Apr.

13, 2016. Guidance for 2017 § 165(d) Annual Resolution Plan Submissions by Domestic Covered Companies that Submitted Resolution Plans in July 2015 (Board/FDIC, Apr. 29, 2016); Resolution Plan Assessment Framework and Firm Determinations (Board/FDIC, Apr. 13, 2016). See also Judgment on 2015 Domestic First Wave Resolution Plans: Five Deemed "Not Credible", and along with Mixed Progress Comes a More Prescriptive Process (Cleary Gottlieb, Apr. 29, 2016).

In June 2016, the Board and the FDIC announced that the four foreign first-round filers will not be required to submit plans until July 1, 2017. Previously these filers had been required to submit their next plans on July 1, 2016. The Board and the FDIC announced that they expect to provide feedback to these four filers based on their 2015 plans as well as provide additional guidance for their 2017 plans. See Joint Board/FDIC Press Release, June 8, 2016. See also First Wave FBO Filers Not Required to File 2016 Resolution Plans, But Feedback and Guidance "to Come" (Cleary Gottlieb, June 8, 2016).

D) Four "second round filers" with U.S. non-bank assets between $100 billion and $250 billion made their first filings in July 2013. In March 2015, the Board and the FDIC released a joint statement on the resolution plans of the three non-U.S. banks that filed in the second-round and provided those filers with individual feedback on their plans. See Joint Board/FDIC Press Release, Mar. 23, 2015.

E) The vast majority of institutions required to file resolution plans fall into the group of Covered SIFIs with less than $100 billion in non-bank assets. Most of these "third-round filers" are non-U.S banks. In recognition of the limited risks many of these institutions present to U.S. financial stability, the final rule permits many to file "tailored" plans with reduced information requirements. In July 2015, the Board and the FDIC issued additional guidance for third-round filers, providing that less complex third-round filers may limit their future filings to updates that focus on material changes to their previously filed plans. In June 2016, the Board and the FDIC announced that non-U.S. bank third-round filers would be permitted to file reduced content resolution plans for their next three resolution plans. See Joint Board/FDIC Press Releases, June 10, 2016; July 28, 2015.

F) In August 2016, the Board and the FDIC issued a joint press release announcing that specified filers, including three non-U.S. second round filers and many third-round filers, would not be required to submit their next plans until December 31, 2017. Previously these filers had been required to submit their next plans on December 31, 2016. Other third-round filers must submit plans by December 31, 2016 as previously required. The Board and the FDIC expect to provide feedback and guidance based on filers' 2015 plans for use in their 2017 plan submissions. See Joint Board/FDIC Press Release, Aug. 2, 2016.

G) The final rule promulgated by the Board and the FDIC also applies to any Non-bank SIFI designated by the FSOC. Three Non-bank SIFIs filed their initial plans in July 2014. MetLife, which was designated in December 2014, and which has had its designation rescinded by a federal district court, would have been required to file its first plan in December 2016. In July 2015, the Board and FDIC issued guidance to the three Non-bank SIFIs that filed in July 2014 identifying common areas for improvement, and provided each firm with individual guidance tailored to its business, structure and operations. See Joint Board/FDIC Press Release, July 28, 2015.

H) In January 2012, the FDIC issued a final rule requiring insured depository institutions with $50 billion or more in total assets to file resolution plans. See 12 C.F.R. § 360.10; 77 Fed. Reg. 3075 (Jan. 23, 2012) (final rule). See also Guidance for Covered Insured Depository Institution Resolution Plan Submissions (FDIC, Dec. 17, 2014).

I) The FDIC has published a notice describing the "single point of entry" ("SPOE"), strategy for resolving SIFIs, which focuses on resolving the banking group at the level of its ultimate parent, rather than the operating company level. See Resolution of [SIFIs]: The [SPOE] Strategy, 78 Fed. Reg. 76614 (Dec. 18, 2013) (the "FDIC SPOE Notice"). See also Part I.B.2 below.

J) Supervisors also expect SIFIs to engage in "recovery planning" designed to assist the institutions in responding to stress and avoiding a failure and resolution scenario. See, e.g., 80 Fed. Reg. 78681 (Dec. 17, 2015) (proposed OCC rule on guidelines for establishing standards for recovery planning by certain large insured national banks, insured federal savings associations and insured federal branches); Board SR Letter 14-8 (Sept. 25, 2014), CCH Federal Banking L. Rep. ¶ 37-749B.

K) The FSB coordinates supervisory policy and monitors and reports on recovery and resolution planning for global SIFIs. See, e.g., Developing Effective Resolution Strategies and Plans for Systemically Important Insurers (FSB, June 6, 2016); Second Thematic Review on Resolution Regimes: Peer Review Report (FSB, Mar. 18, 2016); Principles for Cross-border Effectiveness of Resolution Actions (FSB, Nov. 3, 2015).

See also Bush, "Resolution Planning and the Volcker Rule", The Banker: How to Run a Bank (2012); Part I.B.2 below.

(v) Stress Testing

A) The Board, FDIC and OCC have issued rules requiring annual company-run stress tests by insured depository institutions under their supervision with greater than $10 billion in total consolidated assets. See 12 C.F.R. Part 46, Part 252, Subpart H and Part 325, Subpart C; 77 Fed. Reg. 62417 (Oct. 15, 2012); 77 Fed. Reg. 62396 (Oct. 12, 2012); 77 Fed. Reg. 61238 (Oct. 9, 2012).

B) The Board also issued a final rule implementing supervisory and company-run stress testing for Covered SIFIs. See 12 C.F.R. Part 252, Subpart G; 77 Fed. Reg. 62378 (Oct. 12, 2012).

C) These rules require covered institutions to conduct annual stress tests that assess their capital adequacy under at least three projected macroeconomic scenarios -- baseline, adverse and severely adverse -- published by the Board, FDIC and OCC each year. Covered SIFIs are also required to conduct mid-year stress tests using internally developed scenarios based on their particular operations and risks, and are subject to annual supervisory stress testing conducted by the Board using proprietary models and assumptions.

D) Summary results of supervisory and company-run stress tests are required to be published on a delayed basis; institutions with less than $50 billion in total consolidated assets began publishing their results in 2015 (with respect to their annual 2014 stress test). See, e.g., Dodd-Frank Act Stress Test 2016: Supervisory Stress Test Methodology and Results (Board, June 2016); Board/FDIC/OCC Press Release, June 2, 2015; SNL Financial, June 24, 2015.

E) Results from company-run and supervisory stress tests help to inform the Board's evaluation of a

Covered SIFI's capital adequacy and capital planning under the Board's Capital Plan Rule, including whether a Covered SIFI may pay dividends or make other capital distributions. See 12 C.F.R. § 225.8. The Capital Plan Rule builds on the SCAP stress tests conducted in 2009 during the financial crisis, and requires Covered SIFIs to submit capital plans detailing their expected sources and uses of capital over a nine quarter planning horizon. Failure to demonstrate the ability to maintain minimum levels of capital under stressed scenarios may result in prohibitions on capital distributions. See, e.g., Comprehensive Capital Analysis and Review[("CCAR")] 2016: Assessment Framework and Results (Board, June 2016), [CCAR] 2016 Summary Instructions (Board, Jan. 2016); Part I.A.6.a.ii.F above and Part II.A.2 below.

F) The Board, FDIC and OCC regularly issue updated guidance regarding the conduct and reporting of stress test results. See, e.g., 2016 Supervisory Scenarios for Annual Stress Tests Required under the Dodd-Frank Act Stress Testing Rules and the Capital Plan Rule (Board, Jan. 2016); Board SR Letters 15-18 and 15-19 (Dec. 18, 2015) CCH Fed. Banking L. Rep. ¶ 47-680 and ¶ 47-681; Policy Statement on Scenario Design Framework for Stress Testing (Board, Nov. 2013). See also, e.g., 80 Fed. Reg. 75419 (Dec. 2, 2015); 79 Fed. Reg. 71630 (Dec. 3, 2014); 79 Fed. Reg. 69365 (Nov. 21, 2014); 79 Fed. Reg. 64026 (Oct. 27, 2014).

See generally Incorporating Liquidity Shocks and Feedbacks in Bank Stress Tests (OFR, July 22, 2015); Credibility and Crisis Stress Testing (IMF Working Paper, Aug. 2013); The Need for "Un-consolidating" Consolidated Banks' Stress Tests (IMF Working Paper, Dec. 2012). For discussion of stress testing in Europe, see European Bank Stress Tests: Cathartic First Step in a Longer Process (Morgan Stanley, Oct. 27, 2014).

(vi) Divestment of Depository Institutions

A) A number of large insurers with bank or thrift affiliates have sought to divest their depository institutions or limit their activities in order to deregister as BHCs or thrift holding companies and avoid consolidated supervision by the Board or certain DFA regulatory requirements. One or more of these companies could still come under Board supervision if the FSOC were to designate them as Non-bank SIFIs. See MetLife Press Release, Feb. 14, 2013. See also Form 10-K for Franklin Resources, Inc. (Nov. 12, 2014) (reporting that Franklin Resources, Inc. deregistered as a BHC in September 2014); Part I.B.1.b.ii above and Part I.B.3.a below.

B) Dodd-Frank § 117 provides that a company that was a BHC with assets of $50 billion or more as of January 1, 2010 and that received assistance under TARP will presumptively be treated as a Non-bank SIFI if it ceases to be a BHC.

c. The Collins Amendment

(i) Title I includes other provisions regarding bank regulatory capital, including the Collins Amendment, which establishes a floor for the capital levels of depository institution holding companies and Non-bank SIFIs. It requires the leverage and risk-weighted capital ratios for these institutions to be no lower than the leverage and risk-based capital requirements applicable to insured depository institutions under generally applicable PCA regulations then in effect (based on the Basel I/Basel II standardized approach). See Part II below.

(ii) The "Insurance Capital Standards Clarification Act" Pub. L. 113-279 (2014) amended the Collins Amendment to clarify that the Fed has the authority to treat regulated insurance companies differently than

BHCs when establishing and applying minimum leverage and risk-based capital requirements. The Board has released an advanced notice of proposed rulemaking soliciting comment on possible approaches. See 81 Fed. Reg. 38631 (June 14, 2016). See also Quantitative Impact Study for Firms Substantially Engaged in Insurance Underwriting Activities (Board, Sept. 30, 2014) (collecting information to evaluate the potential effects of bank/BHC regulatory capital rules on companies engaged in insurance underwriting).

(iii) The non-U.S. parents of U.S. banks will not be subject to the requirements of the Collins Amendment, but their U.S. intermediate BHCs were required to comply as of July 2015. For some international banks, this represents a reversal of a long-standing FRB supervisory policy toward intermediate BHCs. See, e.g., Bank Capital Requirements: Potential Effects of New Changes on Foreign Holding Companies and U.S. Banks Abroad (GAO, Jan. 2012). See also Part I.B.1.f and Part II.A.2.l below.

(iv) The DFA mandated studies regarding contingent capital, hybrid capital instruments and access to capital by smaller financial institutions. See, e.g., Report to Congress on Study of a Contingent Capital Requirement for Certain Non-bank Financial Companies and [BHCs] (FSOC, July 2012); Dodd-Frank Act: Hybrid Capital Instruments and Small Institution Access Capital (GAO, Jan. 2012).

d. Financial Stability Considerations for Bank and Large Non-bank Acquisitions

The DFA (i) requires BHCs with total consolidated assets of \$50 billion or more, as well as Non-bank SIFIs, to obtain the prior approval of the Board for acquisitions of entities with more than \$10 billion in assets that are engaged in certain activities described in BHCA § 4(k), and (ii) requires the Board to consider financial stability factors when evaluating numerous types of transactions under the BHCA. When considering the impact of proposed transactions on the financial stability of the U.S. financial system, the Board takes into account factors (individually and in combination) such as the size of the institutions involved, substitutability as to activities critical to the U.S. financial system, and the interconnectedness, complexity and cross-border activity of the relevant entities. See, e.g., Board Letter to Morgan Stanley, June 20, 2013; Mitsubishi UFJ Financial Group, 99(1) Fed. Res. Bull. 1 (2013); Capital One Financial Corp., 98(5) Fed. Res. Bull. 7 (2012); PNC, 98(3) Fed. Res. Bull. 16 (2012); Board Letter to Mizuho Corporate Bank, Aug. 25, 2011; Mitsubishi UFJ Financial Group, 97(4) Fed. Res. Bull. 10 (2011) (the "Mitsubishi MS 2011 Order"); Board Letter to MetLife, Oct. 29, 2010.

Similar requirements apply to transactions requiring approval under the Bank Merger Act. See Comptroller Letter, Mar. 9, 2012, re: Capital One (the "Comptroller Capital One Letter").

e. Too Big to Fail

(i) Concerns regarding whether certain financial institutions are TBTF due to their size and importance to the financial system continue to provoke controversy and debate. Although no consensus over the definition or scope of the problem or the appropriate solution has emerged, the debate has several common themes: (i) whether TBTF institutions receive a subsidy in the form of lower borrowing costs because lenders view TBTF institutions as carrying an implicit governmental guarantee, and how large the subsidy is; (ii) whether TBTF institutions could be resolved in an orderly fashion under the U.S. Bankruptcy Code (the "Bankruptcy Code") or only through the use of special resolution powers or strategies; (iii) whether banks over a certain size create economies of scale in their provision of financial services; and (iv) whether Dodd-Frank and other U.S., foreign and international initiatives have addressed the TBTF problem. See, e.g., Ending [TBTF]: Lessons from Continental Illinois (Federal Reserve Bank Atlanta, Apr. 2016); Federal Reserve Bank of Minneapolis ("FRB-Minneapolis") Symposia on Ending

[TBTF] (June 20, May 16, Apr. 4, 2016); Remarks of FRB-Minneapolis President Neel Kashkari, Apr. 18, 2016 (Update on Minneapolis Fed Ending [TBTF]); Remarks of FRB-Minneapolis President Neel Kashkari, Feb. 16, 2016 (Lessons from the Crisis: Ending [TBTF]); Remarks of FRBB President Eric Rosengren, Feb. 4, 2016 (Progress on Addressing [TBTF]); Remarks of FRBNY President William Dudley, Nov. 18, 2015; "What Do Bond Markets Think about [TBTF] Since Dodd-Frank", Liberty Street Economics (FRBNY, July 1, 2015); "What Do Rating Agencies Think About "[TBTF]" Since Dodd-Frank?", Liberty Street Economics (FRBNY, June 29, 2015); Financial Company Bankruptcies: Information on Legislative Proposals and International Coordination (GAO, Mar. 2015); "Living Wills": The Legal Regime for Constructing Resolution Plans for Certain Financial Institutions (CRS, Dec. 4, 2014); Large [BHCs]: Expectations of Government Support (GAO, July 2014); Government Support for [BHCs]: Statutory Changes to Limit Future Support Are Not Yet Fully Implemented (GAO, Nov. 2013) and related Testimony of GAO Financial Markets and Community Investments Director Evans before Subcommittee of Senate Banking Committee, Jan. 8, 2014.

Congress continues to hold hearings and debate proposals regarding TBTF institutions. See, e.g., "Oversight of the [FSOC]", Hearing before House Financial Services Committee, Dec. 8, 2015; "Oversight of the [FSOC]: Due Process and Transparency in Non-Bank SIFI Designations", Hearing before House Financial Services Subcommittee, Nov. 19, 2015.

(ii) Recent legislative proposals regarding TBTF institutions include "Financial CHOICE Act" (H.R. 5983), a bill proposed by House Republicans as an alternative to Dodd-Frank, which would, among other things, (1) retroactively repeal FSOC's authority to designate firms as SIFIs; (2) repeal Title II of Dodd-Frank and replace it with a new chapter of the Bankruptcy Code to govern the liquidation, reorganization or recapitalization of large, complex financial institutions; (3) repeal systemic risk determination in resolutions; (4) repeal Title VIII of Dodd-Frank and retroactively repeal all previous financial market utility designations; (5) restrict the Fed's discount window lending; and (6) prohibit the use of the Exchange Stabilization Fund for the establishment of a guaranty program for any nongovernmental entity; the "Financial Services and General Government Appropriations Act, 2017" (H.R. 5485), which would prohibit the use of funds to designate any non-bank financial company as TBTF or as a SIFI or make a determination that material financial distress at a non-bank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of such company, could pose a threat to the financial stability of the United States.

(iii) Activist investor groups have sought, and been denied, access to the proxy statements of several large U.S. banks in order to include proposals that would require the banks to appoint independent committees to explore extraordinary transactions that could enhance shareholder value, potentially including the separation of one or more businesses. See Bank of America, Citigroup, JPMorgan and Morgan Stanley (avail. Mar. 12, 2013) (SEC no-action relief permitting banks to exclude the shareholder proposals from their proxy statements); M&A L. Rep., Mar. 18, 2013.

(iv) In October 2014, the SEC granted UBS AG an exemption from Regulation M Rules 101 and 102, permitting UBS to continue certain transactions, including U.S. and non-U.S. market-making activities, during a reorganization of UBS by means of an exchange offer designed to improve the resolveability of UBS in compliance with Swiss TBTF laws. See UBS AG (avail. Oct. 7, 2014).

(v) The Board and FDIC have sought to address TBTF through prudential supervision, resolution planning, stress testing and the FDIC's SPOE resolution strategy. At the international level, the Basel Committee has welcomed proactive measures to strengthen banks, but has also argued that national governments should remain ready to bail out struggling banks in extreme cases. See Supervisory Guidelines for Identifying and Dealing with Weak Banks (Basel Committee, June 2014).

(vi) The FSOC rescinded its designation of GE Capital as a Non-bank SIFI after the company substantially reduced its systemic footprint. See Part I.B.1.b.ii above.

(vii) For reports and analysis of TBTF issues, see generally, e.g., Overview of the Prudential Regulatory Framework for U.S. Banks: Basel III and the Dodd-Frank Act (CRS, July 27, 2016); The Glass-Steagall Act: A Legal and Policy Analysis (CRS, Jan. 19, 2016); Systemically Important or [TBTF] Financial Institutions (CRS, June 30, 2015); The Big Bank Theory: Breaking Down the Breakup Arguments (Bipartisan Policy Center, Oct. 2014); Progress and Next Steps Towards Ending [TBTF] (FSB, Sept. 2, 2013); [FSOC:] A Framework to Mitigate Systemic Risk (CRS, May 21, 2013); [TBTF]: The Path to a Solution (Bipartisan Policy Center, May 2013); Financial Services Forum, SIFMA, The Clearing House Assoc. ("TCH") , ABA and Financial Services Roundtable Policy Brief (Mar. 11, 2013) (disputing assertions that large banks benefit from taxpayer subsidies); Banking on our Future: The Value of Big Banks in a Global Economy (Hamilton Place Strategies, Feb. 2013); Report To Congress (SIGTARP, Jan. 30, 2013) (warning of financial institutions that are "too interconnected to fail"); Ending [TBTF]: Title II of the Dodd-Frank Act and the Approach of "Single Point of Entry" Private Sector Recapitalization of a Failed Financial Company (TCH, Jan. 2013); Financial Stability: Traditional Banks Pave the Way (Federal Reserve Bank of Dallas ("FRB-Dallas"), Jan. 2013); [GSIBs]: Assessment Methodology and the Additional Loss Absorbency Requirement (BIS, July 2011); The Too-important-to-fail Conundrum: Impossible to Ignore and Difficult to Resolve (IMF Staff Discussion Note, May 27, 2011); Remarks of Federal Reserve Bank of Kansas City ("FRBKC") President Hoenig, May 24, 2011 (Back to the Business of Banking); SIFI Surcharges: Fundamental Issues and Empirical Estimates (IIF, Apr. 20, 2011); Study of the Effect of Size and Complexity of Financial Institutions on Capital Market Efficiency and Economic Growth (FSOC, Jan. 2011); Why "[TBTF]" is Too Short-sighted to Succeed: Problems with Reliance on Firm Size for Systemic Risk Determination (Property Casualty Insurers Association of America and NERA Economic Consulting, Jan. 18, 2010).

f. Intermediate Holding Companies

(i) The Board's Foreign SIFI Rule requires any foreign banking organization with $50 billion or more in global consolidated assets and combined U.S. assets of $50 billion or more (excluding branch and agency assets) to form an IHC to hold all of the foreign bank's U.S. bank and non-bank subsidiaries. Foreign banks subject to the IHC requirement were required to file implementation plans with the Board by January 1, 2015, and to form or designate an IHC holding most of their U.S. non-branch/agency assets and subsidiaries by July 1, 2016. IHCs will generally be subject to stand-alone capital adequacy standards (but not necessarily the advanced approaches capital rules) as if they were independent BHCs and will be subject to enhanced prudential standards very similar to those applicable to U.S. Covered SIFIs under the Domestic SIFI Rule. See, e.g., Board Letters to HSBC North America Holdings, MUFG Americas Holding Corp., and TD Bank US Holding Company, Dec. 11, 2014 (approving elections by U.S. intermediate BHCs to opt out of compliance with the advanced approaches capital rules). See also Part I.B.1.b.iii above and Part II.A.2 below.

(ii) The Foreign SIFI Rule permits institutions to request exemptions or variances from certain provisions of the

IHC requirement. See, e.g., Board Letter to BNP Paribas, Feb. 18, 2016 (granting request to exclude six minority-owned and indirectly controlled U.S. asset management subsidiaries from BNP's IHC); Board Letter to Mizuho Financial Group, Feb. 18, 2016 (granting request for variance to U.S. risk committee requirement); Board Letter to Toronto-Dominion Bank, Dec. 11, 2014 (denying request to exclude TD Ameritrade, a minority-owned subsidiary of Toronto-Dominion, from its IHC); Board Letter to RBS Americas, Dec. 11, 2014 (granting temporary relief from IHC requirement for RBS in light of RBS's ongoing efforts to divest Citizens Financial Group). See also Board Letters to SocGen, Banco Bilbao Vizcaya Argentaria, July 6, 2016; Board Letters to BMO Financial Group, Credit Suisse, Deutsche Bank, The Norinchukin Bank, Royal Bank of Canada ("RBC"), Banco Santander ("Santander"), Feb. 18, 2016.

(iii) In part, the IHC requirement reflects a growing focus by the Board on the consolidated supervision of foreign banks' U.S. operations, including with respect to capital adequacy, liquidity, risk management, governance and resolveability. See, e.g., Santander Holdings USA (Board Written Agreement, July 2, 2015) (requiring improvements to governance, risk management, capital planning and liquidity risk management at a U.S. intermediate BHC). The IHC requirement is also intended to facilitate orderly liquidation of a foreign bank's U.S. operations using the SPOE strategy. See Part I.B.2 below.

However, the IHC requirement has been highly controversial, as it represents a fundamental change to U.S. policies regarding the structure and regulation of foreign banking organizations operating in the U.S., and could trigger reciprocal actions by other countries that could further fragment the financial system. In addition, there is no express authority in Dodd-Frank granting the Board discretion to require foreign banking organizations generally, or non-U.S. Covered SIFIs in particular, to form IHCs, in contrast to other provisions of Dodd-Frank that explicitly provide the Board discretion to require the creation of IHCs for Non-bank SIFIs and for certain thrift holding companies. See, e.g., Bush, "A Dramatic Departure? National Treatment of Foreign Banks", Banking Perspective (TCH, 2015); IIB Comment Letter to the Board, dated Apr. 30, 2013; The [FRB]'s Proposed Framework for Regulation of Foreign Banks: Issues for Comment and Consideration (Cleary Gottlieb, Jan. 2, 2013).

g. Shadow Banking

(i) The so-called "shadow banking system" generally refers to non-bank entities that perform credit intermediation or other traditional banking functions without being subject to corresponding prudential supervision. Attempts to define and measure the size of the shadow banking system have evolved, but estimates and definitions continue to be imprecise and sometimes inconsistent. Still, estimates have placed the amount of net credit provided by the shadow banking system in the U.S. as near or even above the amount of credit provided by regulated banks, and in 2015 a "broad measure" of non-bank financial intermediation estimated the sector at $137 trillion across 20 major economic jurisdictions and the euro area ($80 trillion when excluding pension funds and insurance companies). A major regulatory concern is that financial intermediation functions will increasingly migrate towards the lightly regulated shadow banking system as the regulatory burden on traditional banks increases.

(ii) In the U.S., the FSOC and the OFR are tasked with monitoring developments in the shadow banking system; the Board also plays an active monitoring role. One of the objectives of the FSOC in designating Non-bank SIFIs for regulation by the Board is to address risks arising from the shadow banking system. In addition, regulators have singled out specific industries, such as asset management and money market mutual funds, for further study with regard to threats they may pose to U.S. financial stability. See, e.g., Update on Review of Asset Management Products and Activities (FSOC, Apr. 18, 2016); Asset Management and Financial Stability (OFR, Sept. 2013); Proposed Recommendations Regarding Money Market Mutual Fund Reform (FSOC, Nov. 2012). See also Parts VIII.C and VIII.D below.

(iii) At the international level, the FSB has taken a more sector-based approach, monitoring entities that engage in certain designated types of financial transactions, rather than focusing on the largest non-bank financial institutions; commentators have pointed to the need for coordination between these approaches. See Greene & Broomfield, "Dividing (and Conquering?) Shadows: FSB and US Approaches to Shadow Banking at the Dawn of 2014," J. of Banking and Finance (forthcoming) (Jan. 2014).

(iv) See generally Consultative Document: Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities (FSB, June 22, 2016); Thematic Review on the Implementation of the FSB Policy Framework for Shadow Banking Entities (FSB, May 25, 2016); Shadow Banking in the Euro Area: Risks and Vulnerabilities in the Investment Fund Sector (European Central Bank, June 2016); Remarks of FRB Vice Chairman Stanley Fischer, Dec. 3, 2015 (Financial Stability and Shadow Banks: What We Don't Know Could Hurt Us); Transforming Shadow Banking into Resilient Market-based Finance (FSB, Nov. 12, 2015); Global Shadow Banking Monitoring Report 2015 (FSB, Nov. 12, 2015); Transforming Shadow Banking into Resilient Market-based Financing (FSB, Nov. 14, 2014); Global Financial Stability Report (IMF, Oct. 1, 2014); The Not-so Normal New: The Assault on Bank Franchise Value and Its Policy Impact (Federal Financial Analytics, May 8, 2014); "The Growth of Murky Finance", Liberty Street Economics (FRBNY, Mar. 27, 2014); What is Shadow Banking? (IMF, Feb. 2014); "Shadow Banking", FRBNY Economic Policy Review

(2013); Communication on Shadow Banking: [FAQs] and New Rules on Money Market Funds Proposed: [FAQs] (EC, Sept. 4, 2013); Shadow Bank Monitoring (FRBNY, Sept. 2013); Strengthening Oversight and Regulation of Shadow Banking (FSB, Aug. 29, 2013); Economics and Policy (IMF, Dec. 4, 2012); Greene & Broomfield, "Promoting Risk Mitigation, not Migration: A Comparative Analysis of Shadow Banking Reforms by the FSB, USA and EU", Capital Markets L.J. (Dec. 2012); Understanding the Risks Inherent in Shadow Banking: A Primer and Practical Lessons Learned (FRB-Dallas Staff Paper, Nov. 2012); Shadow Banking: A Review of the Literature (FRBNY, Oct. 2012); "Shadow Banking": A Forward-looking Framework for Effective Policy (IIF, June 2012); U.S. Hedge Fund Industry Submits White Paper on Shadow Banking to European Commission (CCH International Securities and Financial Reporting, June 21, 2012); Managed Funds Association Letter to the EU, dated June 1, 2012; Shadow Banking Regulation (FRBNY, Apr. 2012); Shadow Banking: Strengthening Oversight and Regulation, (FSB, Oct. 27, 2011); Shadow Banking (FRBNY, July 2010); Unregulated Financial Markets and Products (IOSCO, Sept. 2009).

For additional background on financial stability considerations, see generally, e.g., Implementation and Effects of the G20 Financial Regulatory Reforms (FSB, Nov. 9, 2015); Peer Review of the [U.S.] (FSB, Aug. 2013); A Global Legal Entity Identifier for Financial Markets (FSB, June 8, 2012); Greene, "International Regulation of Global [SIFIs]", Rev. of Banking & Fin. Serv. (2011); The Cumulative Impact on the Global Economy of Changes in the Financial Regulatory Framework (IIF, Sept. 2011); "Global SIFIs, Derivatives and Financial Stability", OECD Journal: Financial Market Trends (June 2011); Bank Competition and Financial Stability (OECD, 2011); Systemic Risk Information Study (SIFMA/Deloitte & Touche, June 2010); Board Letter, Jan. 13, 2010 (regarding how the Board's role in banking supervision allows it to better perform its critical functions as a central bank).

See also Part II below.

2. Title II – Orderly Liquidation Authority

   a. Title II of Dodd-Frank established a new special resolution regime known as "orderly liquidation authority" ("OLA") for systemically significant financial companies, effective July 22, 2010.

   b. OLA applies only to certain "financial companies" currently subject to the Bankruptcy Code: BHCs, Non-bank SIFIs, companies predominantly engaged in activities that are financial in nature or incidental thereto, and subsidiaries of any such entities. Insured banks remain subject to the bank insolvency provisions of the FDIA.

   c. Upon a determination by the Treasury Secretary that a financial company is in "default or in danger of default" and that such default presents a systemic risk to U.S. financial stability, and the recommendation of certain other regulators and consultation with the President, the "covered financial company" is placed into orderly liquidation proceedings administered by the FDIC as receiver.

   d. The new OLA regime is closely modeled on the bank receivership provisions of the FDIA. The FDIC as receiver has the power to charter a bridge financial company, transfer assets and liabilities to the bridge financial company or to another acquirer, enforce or repudiate contracts of the covered financial company, and, if necessary, provide liquidity support to the covered financial company (although all such liquidity must be repaid from the proceeds of the receivership or through assessments on industry).

      (i) As a general matter, creditors in OLA proceedings are required to receive at least what they would have received had the covered financial company been liquidated under Chapter 7 of the Bankruptcy Code rather than OLA -- the so-called "minimum recovery" or "no creditor worse off" provision.

e. As part of its dialogue with market participants on how best to create an effective and credible means for addressing the failure of a SIFI, the FDIC has published for public comment a notice in which it detailed the SPOE strategy for resolving a SIFI under OLA. Although the FDIC has been careful not to publicly describe the SPOE strategy as the preferred or assumed strategy under OLA, it is the only strategy under OLA that the FDIC has described publicly, and it is widely viewed as the FDIC's preferred strategy.

(i) The SPOE strategy focuses on resolving a SIFI group at the level of its ultimate parent while keeping operating companies and other subsidiaries out of insolvency or resolution proceedings to preserve the going-concern value of the group and ensure continued provision of critical services and operations.

(ii) In an SPOE resolution, the FDIC would be appointed as receiver under OLA for only the top-tier holding company of a SIFI (the SPOE). The FDIC would exercise authority under OLA to organize a bridge financial company and transfer assets from the receivership to the bridge, including the equity in the SIFI's operating subsidiaries. Claims of creditors and shareholders of the covered financial company would be satisfied with debt or equity securities of the bridge financial company. Losses of the group would be imposed on the equity holders and unsecured creditors of the top-tier holding company according to their order of priority.

(iii) The FDIC described the intended effect of the SPOE strategy as promoting market discipline by imposing losses on the shareholders and creditors of the ultimate parent while also maintaining market stability by allowing operating subsidiaries to remain intact and continue to provide critical services and operations to the financial system.

(iv) <u>See</u> FDIC SPOE Notice. <u>See also</u> <u>Resolving Globally Active, [SIFIs]</u> (FDIC and Bank of England, Dec. 10,

2012) and Resolution of [G-SIBs] (FINMA, Aug. 7, 2012), both addressing the SPOE resolution strategy.

(v) One purpose of the FSB's TLAC requirement is to ensure an SPOE resolution strategy can be successfully executed, by requiring U.S. G-SIBs to maintain sufficient loss absorbing capacity at the parent level that can be "bailed in" during resolution. See Part I.B.1.b above.

f. Under OLA, as under the FDIA, the FDIC would have the power to transfer, within one business day of its appointment as receiver, "qualified financial contracts" ("QFCs") to a third party (e.g., the bridge financial company in an SPOE strategy). As implemented in FDIC regulations, the "resolution stay" powers contained in §§ 210(c)(10) and 210(c)(16) of the DFA are critical to facilitation of the SPOE resolution strategy.

(i) Section 210(c)(10) provides that the FDIC, as receiver for a covered financial company, can suspend the ability of a counterparty to exercise certain termination rights under QFCs with the covered financial company for a period of one business day, and permanently thereafter if the FDIC transfers all QFCs between the covered financial company and the counterparty (and between the covered financial company and all affiliates of the counterparty) to a third party. Any counterparty whose QFCs were not transferred by the end of the one business day stay period would be permitted to exercise its contractual termination rights.

(ii) Section 210(c)(16) grants the FDIC, as receiver, the power to override "cross defaults" -- to enforce contracts entered into with subsidiaries and affiliates of a covered financial company in OLA proceedings, notwithstanding any provision of such contracts that allows counterparties to terminate the contract based on the financial condition of the covered financial company or the FDIC becoming receiver for the covered financial company. Pursuant to § 210(c)(16) and the FDIC's implementing regulations, any contracts (i.e., not just

QFCs) that are "linked to" the covered financial company can be enforced without condition, and contracts that are guaranteed or otherwise "supported by" the covered financial company can be enforced under certain conditions, including if the guarantee or support is transferred to a bridge financial company or other transferee, or if the FDIC otherwise provides "adequate protection" to the beneficiary of the guarantee or support. See 77 Fed. Reg. 63205 (Oct. 16, 2012).

(iii) These provisions are aimed at stabilizing a financial group during resolution by overriding the ability of counterparties of subsidiaries and affiliates to exercise direct and cross-default provisions under QFCs, such as swaps and repurchase agreements, thereby preventing a cascade of failures at potentially viable subsidiaries.

(iv) Similar restrictions on the ability to exercise termination rights exist in resolution regimes implemented in other jurisdictions, but the enforceability of such statutory provisions, and the stays under OLA, with respect to contracts not governed by the law of the jurisdiction where the failed financial institution is resolved is not always certain. To address these concerns, measures have been adopted in different jurisdictions, including the U.S., to require counterparties to agree to opt in to resolution regimes on a cross-border basis.

A) The Board and OCC have issued proposed rules that would prohibit U.S. G-SIBs and the U.S. operations of non-U.S. G-SIBs from becoming a party to a QFC unless (i) the QFC contains a contractual opt-in by the other party to stays of termination rights pursuant to OLA and the FDIA and (ii) the counterparty is prohibited from exercising cross default rights if such rights are triggered by an affiliate of the G-SIB entity entering insolvency or resolution proceedings (other than OLA or the FDIA), subject to certain conditions. The proposed rule would also require G-SIB entities to conform existing QFCs with a counterparty to these requirements if the G-SIB continues to trade with the counterparty. These restrictions are intended to facilitate cross border resolution and enhance the resolvability of G-SIBs under the Bankruptcy Code. See 81 Fed. Reg. 55381 (Aug. 19, 2016) (OCC); 81 Fed. Reg. 29169 (May 11, 2016) (Board).

B) Similar measures have been adopted in the UK, Germany, Switzerland and Japan and would apply to certain subsidiaries of U.S. institutions located in these jurisdictions. The International Swaps and Derivatives Association ("ISDA") has developed the ISDA Resolution Stay Jurisdictional Modular Protocol as a means of compliance with such measures in applicable jurisdictions. See ISDA Resolution Stay Jurisdictional Modular Protocol, available at https://www2.isda.org/functional-areas/protocol-management/protocol/24.

(v) These regulations follow an effort by financial regulators and ISDA to develop the ISDA 2015 Universal Resolution Stay Protocol ("ISDA 2015 Universal Protocol"). Counterparties that adhere to the ISDA 2015 Universal Protocol contractually "opt in" to the resolution regimes applicable to all other adhering parties and consent to the application of stays of termination rights. The ISDA 2015 Universal Protocol was signed by all current G-SIBs. See ISDA 2015 Universal Resolution Stay Protocol, available at https://www2.isda.org/functional-areas/protocol-management/protocol/22. See also Geen et al., "A Step Closer to Ending [TBTF]: The ISDA 2014 Resolution Stay Protocol and Contractual Recognition of Cross-border Resolution", Futures & Derivatives L. Rep. (Apr. 2015).

g. The FDIC has issued final regulations that address other provisions of OLA, including the treatment of insurance company subsidiaries, the recoupment of compensation from senior executives and directors, fraudulent and preferential transfers, the priority of expenses and unsecured claims, claims in respect of impaired rights of setoff, obligations of bridge financial companies, and the payment of "additional amounts" to certain similarly situated creditors. FDIC regulations also address the receivership claims process, the treatment of contingent and secured claims, and define when a company would be considered to be a financial company because it is "predominantly engaged in activities that are financial in nature or incidental thereto", and therefore is eligible for OLA. See 12 C.F.R. Part 380; 78 Fed. Reg. 34712 (June 10, 2013); 76 Fed. Reg. 41626 (July 15, 2011) (final rule). See generally Bankruptcy: Agencies Continue Rulemakings for Clarifying Specific Provisions of Orderly Liquidation Authority (GAO, July 2012).

h. The FDIC and the SEC jointly proposed rules to implement the provisions of OLA that govern the resolution of a broker or dealer under OLA. The proposed rules clarify the roles of the FDIC and SIPC in such a resolution and the administration of claims of customers. 81 Fed. Reg. 10798 (Mar. 2, 2016).

i. To facilitate the orderly resolution of cross-border financial institutions, the FDIC has entered into MOUs with British, Canadian and Chinese regulators. See FDIC/People's Bank of China MOU, Oct. 24, 2013; FDIC/Canadian Deposit Insurance Corporation MOU, June 11, 2013; FDIC/Bank of England MOU, Jan. 10, 2010.

j. In January 2015, the Secretary of the Treasury issued a notice of proposed rulemaking to implement the QFC recordkeeping requirements of the DFA designed to assist the FDIC as receiver in the event of failure. These rules would require certain financial companies to maintain detailed records of their QFCs in a form that can be provided to the companies' primary financial regulators within 24 hours of a request, in order to assist the FDIC in the event of a resolution under OLA. 80 Fed. Reg. 966 (Jan. 7, 2015).

k. For additional background on resolution authority matters, see generally, e.g., Resilience Through Resolvability -- Moving from Policy Design to Implementation (FSB, Aug. 18, 2016); Guiding Principles on the Temporary Funding Needed to Support the

Orderly Resolution of a [G-SIB] (FSB, Aug. 18, 2016); Guidance on Arrangements to Support Operational Continuity in Resolution (FSB, Aug. 18, 2016); Resolution Plans: Regulators Have Refined Their Review Processes but Could Improve Transparency and Timeliness (GAO, Apr. 2016); Second Thematic Review on Resolution Regimes (FSB, Mar. 18, 2016); Removing Remaining Obstacles to Resolvability (FSB, Nov. 9, 2015); Principles for Cross-Border Effectiveness of Resolution Actions (FSB, Nov. 3, 2015); Consultative Document: Guidance on Arrangements to Support Operational Continuity in Resolution (FSB, Nov. 3, 2015); Guidance on Cooperation and Information Sharing with Host Authorities of Jurisdictions where a G-SIFI has a Systemic Presence that are Not Represented on its CMG (FSB, Nov. 3, 2015); Consultative Document: Guiding Principles on the Temporary Funding Needed to Support the Orderly Resolution of a [G-SIB] (FSB, Nov. 3, 2015); Financial Company Bankruptcies: Information on Legislative Proposals and International Coordination (GAO, Mar. 2015); Key Attributes of Effective Resolution Regimes for Financial Institutions (FSB, Oct. 15, 2014) (updated); Achieving Bank Resolution in Practice: Are We Nearly There Yet? (IIF, Sept. 2014); The FDIC's Progress in Implementing Systemic Resolution Authorities under the Dodd-Frank Act (FDIC OIG, Nov. 2013); Guidance on Developing Effective Resolution Strategies, Guidance on Identification of Critical Functions and Critical Shared Services, and Guidance on Recovery Triggers and Stress Scenarios (FSB, July 16, 2013); Financial Company Bankruptcies: Need to Further Consider Proposals' Impact on Systemic Risk (GAO, July 2013); Making Resolution Robust: Completing the Legal and Institutional Frameworks for Effective Cross-border Resolution of Financial Institutions (IIF, June 2012); Complex Financial Institutions and International Coordination Pose Challenges (GAO, July 2011); Effective Resolution of [SIFIs] (FSB, July 19, 2011); Study on International Coordination Relating to Bankruptcy Process for Non-bank Financial Institutions (Board, July 2011); Study on the Resolution of Financial Companies under the Bankruptcy Code (Board, July 2011); Addressing Priority Issues in Cross-border Resolution (IIF, May 2011); Resolving Troubled Cross-border [SIFIs]: Is a New Corporate Organizational Form Required? (FRBNY, July 2010); A Global Approach to Resolving Failing

Financial Firms: An Industry Perspective (IIF, May 2010); Insolvencies of [SIFIs] (CRS, Apr. 20, 2009); Insolvency of [SIFIs]: Bankruptcy vs. Conservatorship/Receivership (CRS, Apr. 20, 2009). See also Creditors' Rights Handbook (Cleary Gottlieb, 2012).

3. Title III – Transfer of Powers to the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Federal Reserve Board

Title III of Dodd-Frank contains several provisions pertaining generally to bank regulatory matters. These include:

a. Elimination of the Office of Thrift Supervision

(i) Dodd-Frank abolished the Office of Thrift Supervision (the "OTS") and transferred its supervisory responsibilities to the OCC (for federally chartered thrifts), the FDIC (for state-chartered thrifts) and the Board (for thrift holding companies). The transfer of authority occurred on July 21, 2011.

See generally Board Letters to GE Capital, H&R Block and AIG, May 8, Feb. 22, 2013 (granting partial temporary relief from new thrift regulatory reporting requirements imposed by the Board); Board SR Letter 13-8 (Apr. 11, 2013), CCH Fed. Banking L. Rep. ¶ 37-777A; Status of the Transfer of [OTS] Functions (Treasury/FDIC/Board/CFPB OIGs, Mar. 27, 2013); 76 Fed. Reg. 43549 (July 21, 2011) (amendment to OCC regulations to incorporate transfer of certain functions of the OTS to the OCC); Board SR Letter 11-11 (July 21, 2011), CCH Fed. Banking L. Rep. ¶ 37-777.

(ii) A number of insurance companies and other financial institutions have sought to divest or surrender their thrift charters and deregister as thrift holding companies in order to avoid the consolidated supervision and regulation, including consolidated bank regulatory capital standards, that the Board has begun to apply to thrift holding companies after the transfer of authority.

Many chose to take advantage of an exemption in the BHCA, added to the Home Owners' Loan Act by Dodd-Frank, exempting companies that control limited purpose "trust-only" companies from regulation as a BHC or thrift holding company. See, e.g., 78 Fed. Reg. 62018 (Oct 11, 2013) (final rule) (applying risk-based and leveraged capital standards to thrift holding companies); Board Letter to Ameriprise Financial, Jan. 30, 2012 (accepting deregistration as a thrift holding company contingent upon commitments to limit subsidiary thrift's activities to trust and advisory activities); Board Letter to Northwestern Mutual Life Insurance Company, Sept. 26, 2012 (same); SNL Financial, Oct. 10, 2012.

b. FDIC Insurance

Dodd-Frank makes a number of changes to the system of deposit insurance, as discussed in detail in Part IV below.

c. Interstate Branching

Effective July 22, 2010, Dodd-Frank virtually eliminated the remaining restrictions on interstate branching by permitting a bank to establish de novo branch offices in a state outside its home state to the extent that a state-chartered bank in that state could establish a branch at the proposed location.

d. Annual Assessments

Dodd-Frank requires the Board to assess Covered SIFIs (and thrift holding companies with more than $50 billion in total assets) an amount equal to the total amount the Board estimates are necessary and appropriate to carrying out its supervisory and regulatory responsibilities with respect to such companies. In 2013 the Board published a final rule with its formula for calculating assessments. See 78 Fed. Reg. 52391 (Aug. 23, 2013).

4. Title IV – Regulation of Advisers to Hedge Funds and Others

   a. Dodd-Frank requires advisers to hedge funds and private equity funds to register as investment advisers under the Advisers Act. (For non-U.S. based advisers, the Advisers Act in general will apply only to relationships with the adviser's U.S. clients.)

   b. The DFA exempts advisers to "venture capital funds" (as defined by the SEC) from registration under the Advisers Act. See SEC Release No. IA-3222 (June 22, 2011).

   c. The definition of "accredited investor" with respect to natural persons is amended by excluding the investor's personal residence from the calculation of the $1 million threshold.

   d. The DFA establishes new reporting and custody requirements for investment advisers.

   In general, all provisions of Title IV became effective July 21, 2011.

   See generally, Evolution Revolution 2016: A Profile of the Investment Adviser Profession (Investment Adviser Assoc./National Regulatory Services, 2016). See also Part VIII below.

5. Title V – Insurance

   Dodd-Frank establishes a Federal Insurance Office (the "FIO") within Treasury. This is the first office in the federal government focused on insurance.

   a. The FIO has the authority to (i) monitor (and gather information about) the insurance industry, and (ii) recommend to the FSOC that it designate an insurer as a Non-bank SIFI.

   b. The DFA streamlines regulation of surplus lines insurance and reinsurance through state-based reforms.

   c. Dodd-Frank does not include an optional federal insurance charter.

d. In December 2013, the FIO released a DFA-mandated Report on modernizing the insurance industry, which (i) recommended the adoption of a hybrid model including both state and federal regulation, and (ii) suggested improvements to state regulation in the areas of capital adequacy and marketplace regulation. The FIO is also directed to report annually on the state of the insurance industry. The first such report was issued in 2013. See FIO Annual Reports. See also, e.g., Report on the Overall Effectiveness of the Terrorism Risk Insurance Program (FIO, June 2016); The Process of Certifying an "Act of Terrorism" under the Terrorism Risk Insurance Act of 2002 (Treasury, Oct. 2015); Report Providing an Assessment of the Current State of the Market for Natural Catastrophe Insurance in the United States (FIO, Sept. 2015); FIO's Consultation Process with State Insurance Regulators Could Be Improved (Treasury OIG, May 15, 2015); Breadth and Scope of the Global Reinsurance Market and the Critical Role Such Market Plays in Supporting Insurance in the [U.S.] (FIO, Dec. 2014); Treasury Made Progress to Stand Up the [FIO], but Missed Reporting Deadlines (Treasury OIG, May 14, 2014); How to Modernize and Improve the System of Insurance Regulation in the [U.S.] (FIO, Dec. 2013). See also Part I.C.3 below.

e. Insurance regulation has been an ongoing topic of debate, and proposals have been made to replace the state-based insurance system with a uniform set of federal standards in such areas as market conduct, producer and insurer licensing, insurance product modernization, reinsurance, antifraud, financial surveillance and state-national coordination. See e.g., "The Impact of International Regulatory Standards on the Competitiveness of U.S. Insurers", Hearings before House Financial Services Subcommittee, Apr. 29, 2015 and Nov. 18, 2014; "The State of the Insurance Industry and Insurance Regulation", Hearing before Senate Banking Committee, Apr. 28, 2015. See also Insurance Regulation: Background, Overview, and Legislation in the 114th Congress (CRS, Sept. 16, 2015); 2015 Report on the Impact of Part II of the Nonadmitted and Reinsurance Reform Act (FIO, May 2015); [U.S.] Financial Sector Assessment Program: Detailed Assessment of Observance of the Insurance Core Principles (IMF, Apr. 2015); Insurance Markets: Impacts of and Regulatory Response to the 2007-2009

Financial Crisis (GAO, June 2013); The Implications of Financial Regulatory Reform for the Insurance Industry (IIF & Oliver Wyman, Aug. 2011); Insurance Regulation: Federal Charter Legislation (CRS, Feb. 3, 2011); The Impact of the Financial Crisis on the Insurance Sector and Policy Responses (OECD, Apr. 2010).

See also Part 1.A.12.k above and Part I.C.3.i below.

6. Title VI – Improvements to Regulation of Bank Holding Companies, Thrift Holding Companies and Depository Institutions

Title VI of Dodd-Frank includes numerous safety and soundness provisions applicable to banks and thrifts and their holding companies.

a. "Non-bank Bank" Moratorium and Required Study

Title VI imposed a three-year moratorium on approvals for deposit insurance or changes in control of non-bank insured depository institutions (i.e., industrial banks/industrial loan companies ("ILCs"), credit card banks and limited-purpose trust companies), which expired on July 21, 2013. Title VI also required the GAO to study the regulation of such institutions and the implications of removing the BHCA exemptions currently applicable to them. The GAO identified 1,002 such institutions and reported that the Board and the Treasury favored the removal of exemptions for these institutions, while the FDIC and OCC, which currently have supervisory oversight of these institutions, viewed current oversight as sufficient. Regulators had differing views as to whether the elimination of the exemptions would improve safety and soundness and financial stability. Commercial owners of such institutions indicated that they would likely divest their ownership if the exemption is eliminated. See Section 620 Report (Board recommendation that Congress repeal the BHCA exemption for corporate owners of ILCs); [BHCA]: Characteristics and Regulation of Exempt Institutions and the Implications of Removing the Exemptions (GAO, Jan. 2012); [ILCs]: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority (GAO, Sept. 2005); Letter from FDIC Chairman

Powell to the GAO, Aug. 29, 2005 (FDIC position on supervision of ILCs and their corporate parents).

Prior to the Dodd-Frank moratorium, ILCs had generated controversy. Wal-Mart's 2005 application to the FDIC to provide federal insurance of deposits for a subsidiary ILC provoked significant public comment and criticism. The FDIC imposed a moratorium on acquisition of ILCs by non-financial companies until January 31, 2008 and invited Congressional action on the issue. Wal-Mart withdrew its application in March 2007. The FDIC proposed conditions and regulations for ILC ownership by companies involved solely in financial activities (72 Fed. Reg. 5217 (Feb. 5, 2007) (solicitation of public comments)). Following the expiration of its moratorium and pending implementation of a final rule, the FDIC conditioned ILC approval on applicants agreeing to conditions similar to those included in the proposed regulations. See, e.g., FDIC Letter re: Capital Source Bank, June 17, 2008; FDIC Letters re: Arcus Financial Bank, May 19, 2008, Sept. 11, 2007.

b. Enhanced Examinations

Title VI provides for examination of non-bank subsidiaries engaged in activities permissible for depository institutions.

c. Interstate Mergers

Title VI establishes heightened supervisory standards for interstate mergers.

d. Section 23A

Title VI expands or alters the coverage of Section 23A in several ways, as described in Part III.A below.

e. Lending Limits

Title VI amends national bank lending limits to include credit exposure arising from derivative transactions and effectively requires state law to take such credit exposure into account for purposes applying state-law lending limits on derivative transactions involving state-chartered banks. See 78 Fed. Reg. 37930 (June 25, 2013) (final rule). See also Part II.E.2.b.v below.

f. Securities Holding Companies

Title VI eliminated the elective "investment bank holding company" ("IBHC") framework administered by the SEC and replaced it with a securities holding company framework administered by the Board. See 78 Fed. Reg. 42863 (July 18, 2013) (rescission of SEC IBHC framework); 77 Fed. Reg. 32881 (June 4, 2012) (Board implementing rule). See also Part I.C.2 below.

g. Source of Strength

Title VI amends the FDIA to codify the "source-of-strength" doctrine (i.e., that a holding company must serve as a source of financial strength to its subsidiary depository institutions). Dodd-Frank requires the federal banking agencies to issue regulations to implement this provision by July 21, 2012. No such regulation has been issued for comment.

h. Volcker Rule

The Volcker Rule prohibits banking entities from engaging in "proprietary trading" and imposes limits on sponsoring or investing in "hedge funds" or "private equity funds". The "banking entities" covered by the Rule include all insured depository institutions, their holding companies (including FHCs), internationally headquartered banking organizations with U.S. banking operations (including those without insured deposits), and the affiliates and subsidiaries (such as broker-dealers) of each. See Part II.A.7 below.

i. Concentration Limits

Title VI imposes concentration limits on large financial firms by prohibiting a financial company from merging with another company if the total consolidated liabilities of the combined company would exceed 10% of the total consolidated liabilities of all financial companies. In November 2014, the Board adopted a final rule implementing the concentration limit and certain exemptions thereto. See 79 Fed. Reg. 68095 (Nov. 14, 2014). In July 2016, the Board released its second annual determination of aggregate consolidated liabilities of all financial companies pursuant to its final implementing rule. See 81 Fed. Reg. 45288 (July 13, 2016). See also Study & Recommendations Regarding Concentration Limits on Large Financial Companies (FSOC, Jan. 2011); Comptroller Capital One Letter.

j. Interest on Demand Deposits

In one of the DFA's few deregulatory measures, the DFA authorizes the payment of interest on demand deposit accounts. See Part IV.A below.

k. Bank Activities Study

Section 620 of Dodd-Frank required the Board, OCC and FDIC to conduct a study and report to Congress and the FSOC on the types of activities and investments permissible for banking entities, the associated risks of those activities, and how banking entities mitigate those risks, and to make recommendations regarding, among other things, the appropriateness of the conduct of each activity by a banking institution and whether additional restrictions may be necessary to address risks to safety and soundness arising from such activities. On September 8, 2016, the three agencies released the Section 620 Report. Each agency prepared the section of the Report describing the activities of the banking entities that it supervises.

(i) The Board's portion of the Report included several recommendations for statutory changes to the powers of banking institutions and their affiliates, including recommendations that Congress (A) repeal the authority of FHCs to engage in merchant banking activities (citing general concerns regarding potential "substantial legal and environmental risk" from merchant banking investments), (B) repeal the grandfather authority for certain FHCs to engage in commodities activities under

GLBA § 103, 12 U.S.C. § 1843(o), (C) repeal the exemption that permits corporate owners of ILCs to operate outside of the regulatory and supervisory framework applicable to BHCs more generally, and (D) repeal the exemption for so-called grandfathered unitary thrift holding companies from the activities restrictions applicable to other thrift holding companies. Although the Board cannot accomplish any of these changes without congressional action, the Report also notes that the Board is considering what further prudential restrictions or limitations on the ability of FHCs to engage in commodities-related activities and merchant banking may be warranted to mitigate risks associated with these activities. The Board may seek to impose higher capital charges or other restrictions on these activities through regulation in the interim.

(ii) The OCC's section of the Report indicated, among other things, that the OCC would consider (A) limiting national banks' authority to deal and invest in copper and other industrial metals, (B) reduce the scope of national bank and federal thrift empowerments to invest in certain ABS and structured products, (C) provide further guidance or rulemaking on concentrations of mark-to-model assets and liabilities, (D) clarify regulatory limits on physical hedging and (E) clarify minimum prudential standards for certain national bank swap dealing activities. See also 81 Fed. Reg. 63428 (Sept. 15, 2016) (proposed rule to prohibit national banks and federal savings associations from dealing and investing in industrial and commercial metals).

(iii) The FDIC's section of the Report indicated that it plans to (A) review FDIC regulations related to investments in other financial institutions and other equity investments and (B) consider clarifying the prudential conditions and standards under which the FDIC evaluates a bank's applications to engage in activities related to mineral rights, commodities or other non-traditional activities.

See Part I.C below.

7. Title VII – Wall Street Transparency and Accountability

   The DFA creates an extensive framework for the regulation of OTC derivatives and a broad range of swap market participants and facilities, as discussed in Part II below.

8. Title VIII – Payment, Clearing and Settlement Supervision

   Title VIII of Dodd-Frank establishes a framework for ensuring the stability of payment, clearing and settlement systems by defining operators of multilateral clearing or settlement involving securities or other financial transactions as "financial market utilities" ("FMUs") and subjecting such entities to enhanced supervision. The FSOC has designated eight FMUs as systemically important. See 76 Fed. Reg. 44763 (July 27, 2011). See also Part IX.G below.

9. Title IX – Investor Protections and Improvements to the Regulation of Securities

   Title IX of Dodd-Frank includes the following:

   a. Fiduciary Standard for Brokers and Advisers

      Dodd-Frank required the SEC to conduct a study evaluating existing standards of care with respect to brokers, dealers and investment advisers providing personalized investment advice and recommendations to retail customers about securities, and granted the SEC discretionary rulemaking authority to establish new standards. The SEC is also authorized to collect data through various means (including focus groups and investor testing). Although the SEC has yet to propose a fiduciary standard for broker-dealers, the DOL has issued a final rule imposing a fiduciary standard of conduct on brokers and advisors who provide investment advice or recommendations for a fee with respect to assets of an employee benefit plan or individual retirement account. 81 Fed. Reg. 20946 (Apr. 8, 2016). See Part IX below.

      See also Remarks of SEC Chair Mary Jo White, June 4, 2015; The [Dodd-Frank Act]: Standards of Conduct of Brokers, Dealers, and Investment Advisers (CRS, Apr. 1, 2015);

78 Fed. Reg. 14848 (Mar. 7, 2013) (request for data and information on the duties of brokers, dealers and investment advisors); Study on Enhancing Investment Adviser Examinations (SEC, Jan. 2011) (mandated by Dodd-Frank § 914); Study and Recommendations on Improved Investor Access to Registration Information About Investment Advisers and Broker-dealers (SEC, Jan. 2011).

b. Financial Literacy

The DFA required the SEC to conduct a study on financial literacy among investors, and the SEC solicited public comment and issued a study on ways to improve investor financial literacy. See Study Regarding Financial Literacy Among Investors (SEC, Aug. 2012) (study mandated by Dodd-Frank § 917); SEC Release No. 34-66164 (Jan. 19, 2012) (request for public comment).

c. "Whistleblower" and Enforcement Provisions

(i) The DFA amends existing securities laws regarding aiding and abetting liability (see Part IX below) and regarding enforcement authority related to violations of antifraud provisions of various securities laws for certain conduct within the U.S. even if the securities transaction occurs outside the U.S., or for conduct occurring outside the U.S. that has a foreseeable substantial effect within the U.S. (see Part XI below). In July 2015, the Court of Appeals for the D.C. Circuit held that certain of Dodd-Frank's enforcement provisions may not be applied retroactively to misconduct that occurred before the passage of the DFA. Koch v. SEC, 793 F.3d 147 (D.C. Cir. 2015) (vacating SEC application of DFA authority to bar individuals from associating with municipal advisors and credit rating agencies) cert. denied, 136 S. Ct. 1492 (2016).

(ii) The SEC adopted final regulations (76 Fed. Reg. 34300 (June 13, 2011)) to pay awards to whistleblowers who provide the SEC with information about a violation of federal securities laws leading to a successful enforcement action.

A) The DFA is arguably inconsistent as to whether, in order to be considered a whistleblower, a person must have reported the allegedly illegal activity to the SEC. The SEC rule implementing the relevant provisions of the DFA intentionally omitted such a requirement, but courts have divided on the question.

B) In one of the first cases brought under the anti-retaliation provisions of this rule, a District Court judge held that the provision does not protect extraterritorial whistleblower activity. On appeal, however, the Court of Appeals did not reach the question of extraterritoriality, holding that the plaintiff did not meet the statutory definition of "whistleblower" because he did not report the allegedly illegal activity to the SEC. See Asadi v. G.E. Energy (USA), CCH Fed. Sec. L. Rep. ¶ 96,929 (S.D. Tex. 2012), aff'd on other grounds, 720 F.3d 620 (5th Cir. 2013). See also, e.g., Verble v. Morgan Stanley, 148 F. Supp. 3d 644 (E.D. Tenn. 2015).

C) In contrast, a number of other courts have followed the SEC's interpretation and have given the term "whistleblower" its ordinary meaning, finding that an employee who had reported misconduct internally was entitled to the anti-retaliation protections of the DFA. See Berman v. Neo@Ogilvy LLC, 801 F.3d 145 (2d Cir. 2015); Peters v. LifeLock Inc., No. CV-14-00576 (D. Ariz. Sept. 19, 2014); Bussing v. COR Clearing, 20 F. Supp. 3d 719 (D. Neb. 2014).

D) In August 2015, the SEC issued interpretive guidance clarifying its view that an individual does not need to report activity to the SEC in order to qualify as a whistleblower eligible for the protections of the DFA's anti-retaliation provisions. See 80 Fed. Reg. 47829 (Aug. 10, 2015).

E) Whistleblower complaints must allege federal securities law violations to qualify for protection under the DFA. See Diaz v. Transatlantic Reinsurance Co., 2016 U.S. Dist. LEXIS 83215 (S.D.N.Y. 2016).

F) The SEC has taken enforcement actions against companies for the use of confidentiality agreements that allegedly impede whistleblowing activity. See Health Net, Inc., SEC Release No. 34-78590 (Aug. 16, 2016); BlueLinx Holdings SEC Release No. 34-78528 (Aug. 10, 2016); In re KBR, SEC Release No. 34-74619 (Apr. 1, 2015). See also How to Update Employee Confidentiality Provisions in Light of Recent SEC Enforcement Action (Cleary Gottlieb, Apr. 20, 2015).

G) See generally SEC Annual Reports to Congress on the Dodd-Frank Whistleblower Program; Evaluation of the SEC's Whistleblower Program (SEC OIG, Jan. 18, 2013). For award announcements and final orders, see http://www.sec.gov/whistleblower.

(iii) Congress repealed the Dodd-Frank prohibition on compelling the SEC to disclose records obtained from certain persons subject to SEC regulation, and confirmed the general exemption under the Freedom of Information Act ("FOIA") for financial institution reports prepared by or for the use of the SEC.

d. Credit Ratings and Rating Agencies

(i) Dodd-Frank establishes an Office of Credit Ratings within the SEC charged with examining each nationally recognized statistical rating organization ("NRSRO") at least annually (and making the results of the examinations available publicly), and increases the extent to which NRSROs face liability under the securities laws.

The DFA also strikes references to credit rating agencies and investment grade ratings in various federal statutes, and required each federal agency to review the use of credit ratings in its rules and to remove those references and replace them with standards of creditworthiness determined by the agency. See, e.g., 81 Fed. Reg. 41877 (June 28, 2016) (amending FDIC regulations related to foreign and domestic branches to remove credit rating references); Sound Practices at Large Intermediaries Relating to the Assessment of Creditworthiness and the Use of External Credit Ratings (IOSCO, Dec. 2015); Annual Report on [NRSROs] (SEC, Dec. 2015); Summary Report of [SEC] Staff's Examinations of Each [NRSRO] (SEC, Dec. 2015); Good Practices on Reducing Reliance on CRAs in Asset Management (IOSCO, June 2015); Thematic Review on FSB Principles for Reducing Reliance on Credit Rating Agency Ratings (FSB, May 12, 2014); Board/FDIC/OCC Uniform Agreement on the Classification and Appraisal of Securities Held by Depository Institutions (Oct. 29, 2013); Credit Rating Standardization Study (SEC, Sept. 2012); SEC Release No. 34-67448 (July 12, 2012); 77 Fed. Reg. 35253 (June 13, 2012) (Comptroller amendments to replace references to credit ratings with alternative standards of creditworthiness); Credit Rating Agencies: Alternative Compensation Models for [NRSROs] (GAO, Jan. 2012); SEC Release No. 34-64975 (July 27, 2011) (SEC amendments to replace rule and form requirements that rely on security ratings eligibility criteria); 76 Fed. Reg. 44262 (July 25, 2011) (CFTC amendments to regulations regarding credit ratings); Report on Review of Reliance on Credit Ratings (SEC, July 2011); Report to the Congress on Credit Ratings (Board, July 2011); 75 Fed. Reg. 52283 (Aug. 25, 2010) (Interagency Advance Notice of Proposed Rulemaking regarding alternatives to the use of credit ratings in risk-based capital regulations).

(ii) Dodd-Frank (A) required the SEC to conduct a study on (1) conflicts of interest in NRSRO compensation models for rating structured finance products, (2) the feasibility of establishing a public utility or SRO to assign NRSROs to give ratings to structured finance products, and (3) alternative NRSRO compensation models; and (B) empowers the SEC to issue rules to respond to the study's findings. See 79 Fed. Reg. 55078 (Sept. 15, 2014) (SEC NRSRO rules); Credit Rating Agency Independence Study (SEC, Nov. 2013); Report to Congress on Assigned Credit Ratings (SEC, Dec. 2012).

(iii) S&P has settled lawsuits and administrative actions brought by the DOJ, the SEC and multiple states alleging fraud or misconduct in its ratings of structured finance products both before and after the financial crisis. See DOJ Press Release, Feb. 3, 2015; NY Attorney General Press Release, Jan. 21, 2015; S&P Ratings Services, SEC Admin. Proc. Nos. 3-16346, 3-16347, 3-16348 (Jan. 21, 2015); Barbara Duka, SEC Admin. Proc. No. 3-16349 (Jan. 21, 2015); In re S&P Rating Agency Litigation, 23 F. Supp. 3d 378 (SDNY June 3, 2014); U.S. v. McGraw-Hill Co., No. Cv 13-779 (C.D. Cal., Feb. 4, 2013) (stipulation for dismissal). In July 2012, Moody's Investors Services ("Moody's"), in the settlement of a shareholder derivative suit, agreed to adopt certain corporate governance practices aimed at producing independent ratings. See generally American Lawyer, July 20, 2012.

e. Risk Retention for Securitizations

DFA includes several provisions related to the asset-backed securitization process, including a provision that required federal regulators to adopt rules requiring "securitizers" to retain an economic interest (usually 5%) in the credit risk of any assets they securitize, subject to various exceptions. The regulations issued pursuant to these provisions have a delayed effective date of 1 year (for securities backed by residential mortgages) or two years (for other ABS) after publication in the Federal Register.

The agencies adopted a final risk retention rule in October 2014. See 79 Fed. Reg. 77602 (Dec. 24, 2014). See also 80 Fed. Reg. 73087 (Nov. 24, 2015) (conforming revisions to the safe harbor granted to certain securitizations from the FDIC's authority to repudiate contracts and reclaim assets in its capacity as conservator or receiver of an insured depository institution).

See Part X below.

f. Executive Compensation

Dodd-Frank mandates federal regulation of compensation paid by "covered financial institutions" (including depository institutions and their holding companies, broker-dealers, investment advisers and (potentially) foreign institutions), and prohibits arrangements that encourage inappropriate risks by providing excessive compensation or that could lead to material financial loss. It also implements certain corporate governance and executive compensation disclosure reforms that would apply to all listed U.S. companies, not just financial institutions.

The SEC has several rulemakings outstanding regarding DFA executive compensation provisions. These include (i) disclosure rules regarding pay-versus-performance, (ii) compensation clawbacks for executive officers, (iii) disclosure rules regarding employee and director hedging, and (iv) rules (to be published with other federal regulators) regarding incentive compensation arrangements at financial institutions. See 80 Fed. Reg. 41144 (July 14, 2015) (proposed rule on executive compensation clawbacks); 80 Fed. Reg. 26330 (May 7, 2015) (proposed rule on pay-versus-performance); 80 Fed. Reg. 8486 (Feb. 17, 2015) (proposed rule on disclosure of hedging by employees, officers and directors).

In June 2016, the SEC, with other federal regulators, re-proposed rules restricting incentive-based compensation arrangements at certain financial institutions, including registered broker-dealers. 81 Fed. Reg. 37670 (June 10, 2016). See also The Dodd-Frank Act: An Overview of the 2016 Incentive-Based Compensation Proposal (CRS, Sept. 14, 2016); 76 Fed. Reg. 21170 (Apr. 14,

2011) (initial interagency proposed rule on incentive-based compensation).

The SEC has finalized regulations to implement provisions of Dodd-Frank § 953(b) relating to the disclosure of CEO to median employee pay ratios and Dodd-Frank § 952 relating to the independence of compensation committees and their advisers. See 80 Fed. Reg. 50104 (Aug. 18, 2015); 77 Fed. Reg. 38422 (June 27, 2012).

See also Some Observations Concerning the SEC's Proposed Pay-Versus-Performance Disclosure Rules (Cleary Gottlieb, May 29, 2015); Dodd-Frank Act Two-year Anniversary: Seven Takeaways on Dodd-Frank's Impact on Compensation (Deloitte, June 2012); Incentive Compensation Practices: A Report on the Horizontal Review of Practices at Large Banking Organizations (Board, Oct. 2011).

g. Small Issuer Auditor Attestation Requirements

The SEC published a study pursuant to Dodd-Frank § 989G regarding the auditor attestation requirement with respect to an issuer's internal control over financial reporting pursuant to SOX § 404(b). Study and Recommendations on § 404(b) of [SOX] for Issuers with Public Float Between $75 million and $250 million (SEC, Apr. 2011).

h. Electronic Fund Transfer Act Amendments

The Board has issued regulations and taken other actions implementing the provisions of Dodd-Frank related to debit cards and electronic debit transactions, including interchange fees. See 2013 Interchange Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions (Board, Sept. 18, 2014); Debit Card Interchange Fees and Routing—A Small Entity Compliance Guide (Board, Aug. 2, 2013); 77 Fed. Reg. 46258 (Aug. 3, 2012) (amendment to permit fraud prevention charges); 76 Fed. Reg. 43394 (July 20, 2011) (final rule).

i. Investor Advocate

The DFA requires the SEC to appoint an Investor Advocate, who is tasked with reporting on and making recommendations to improve the responsiveness of the SEC and SROs to investor concerns. See Office of the Investor Advocate Report on Objectives: Fiscal Year 2017 (SEC, June 30, 2016); Office of the Investor Advocate Report on Activities: Fiscal Year 2015 (SEC, Dec. 23, 2015).

10. Title X – Bureau of Consumer Financial Protection

a. The DFA establishes an independent CFPB to develop consumer protection rules for both bank and non-bank companies that offer consumer financial products and services and to enforce compliance with such rules by large banks and their affiliates as well as by non-bank financial companies. Dodd-Frank transferred rulemaking authority over most federal consumer financial protection laws to the CFPB. The CFPB is required to consider the views of other prudential regulators when proposing a rule or regulation, but is not required to follow the suggestions of such regulators. However, the FSOC may stay any rule or regulation proposed by the CFPB if two-thirds of the members of the FSOC determine that the proposed rule or regulation would put the safety and soundness or the stability of the U.S. financial system at risk.

(i) The CFPB issued a Supervision and Examination Manual which (A) describes the CFPB supervision and examination process, (B) contains examination procedures, and (C) presents templates for documenting information about supervised entities and the examination process.

(ii) While this Guide is not intended to identify or address all CFPB actions and rulemakings, the following developments are worthy of special note:

A) In 2013, the CFPB completed final rules setting out significant new regulations relating to mortgage lending to implement several Dodd-Frank provisions, including requirements that mortgage lenders show that they verified a borrower's ability to repay the mortgage and that provide for potential safe harbors from the "ability to repay" rule for certain "qualified mortgages". These and other CFPB mortgage rulemakings are likely to have a profound effect on the U.S. residential mortgage finance and housing market. See 79 Fed. Reg. 41631 (July 17, 2014) (application of ability-to-pay rule to successors in interest); 78 Fed. Reg. 62993 (Oct. 23, 2013); 78 Fed. Reg. 35430 (June 12, 2013) (amendment and official interpretation of ability-to-repay and qualified mortgage standards under the Truth in Lending Act); 78 Fed. Reg. 25638 (May 2, 2013) (proposed amendments to mortgage rules); 78 Fed. Reg. 6408 (Jan. 30, 2013) (final "ability-to-pay" and "qualified mortgage" rules). See also, e.g., 81 Fed. Reg. 16074 (Mar. 25, 2016) (interim final rule amending mortgage rules for lending in rural areas); 80 Fed Reg. 59943 (Oct. 2, 2015) (amending mortgage rule definitions for small creditors and rural areas); 80 Fed. Reg. 22091 (Apr. 21, 2015) (homeownership and mortgage counseling); 80 Fed. Reg. 8767 (Feb. 19, 2015) (amendments to the 2013 integrated mortgage disclosure rule and 2013 loan origination rule); 79 Fed. Reg. 65300 (Nov. 3, 2014) (amendments to the 2013 mortgage rules); 78 Fed. Reg. 79730 (Dec. 31, 2013) (integrated mortgage disclosure); 78 Fed. Reg. 11280 (Feb. 15, 2013) (loan originator compensation); 78 Fed. Reg. 10696 (Feb. 14, 2013) (mortgage servicing); 78 Fed. Reg. 10368 (Feb. 13, 2013) (appraisals for higher-priced mortgages); 78 Fed. Reg. 6856 (Jan. 31, 2013) (high cost mortgages); 78 Fed. Reg. 4726 (Jan. 22, 2013) (escrow accounts).

B) CFPB rules define the types of non-bank companies the CFPB will supervise for compliance with consumer protection laws and set forth the procedures the CFPB will follow to assert authority over other non-bank consumer financial market participants. See, e.g., 80 Fed. Reg. 37496 (June 30, 2015); 79 Fed. Reg. 56631 (Sept. 23, 2014); 79 Fed. Reg. 5302 (Jan. 31, 2014); 78 Fed. Reg. 40352 (July 3, 2013); 77 Fed. Reg. 65775 (Oct. 31, 2012); 77 Fed. Reg. 42874 (July 20, 2012).

C) The CFPB announced that it was considering proposals that would restrict debt collector contact with consumers and require debt collectors to possess adequate information before attempting to collect debts. The current proposals would apply only to third party debt collectors, although the CFPB has suggested it will address first-party debt collectors on a separate track. If implemented, the proposals would be the first substantive rules promulgated under the Fair Debt Collection Practices Act of 1977. See Small Business Review Panel for Debt Collector and Debt Buyer Rulemaking (CFPB, July 28, 2016); Study of Third-Party Debt Collection Operations (CFPB, July 2016); 78 Fed. Reg. 67848 (Nov. 12, 2013) (advanced notice of proposed rulemaking).

D) The CFPB has proposed a rule governing aspects of consumer finance dispute resolution. The rule would prohibit certain financial product providers from enforcing binding arbitration clauses that bar the consumer from filing or joining a class action lawsuit. The rule would also require certain financial product providers to submit specified arbitral records to the CFPB. See 81 Fed. Reg. 32830 (May 24, 2016). See also Final Report of the Small Business Review Panel on the CFPB's Potential Rulemaking on Pre-Dispute Arbitration Agreements (CFPB, Dec. 11, 2015); Arbitration Study: Report to Congress, pursuant to [DFA] § 1028(a) (CFPB, Mar. 2015); Blackman et al., "Cleary Gottlieb discusses CFPB Rulemaking on Arbitration Agreements in Financial Products and Services Contracts," CLS Blue Sky Blog (June 22, 2016).

E) The CFPB has established a Consumer Financial Civil Penalty Fund to receive the proceeds of civil penalties the CFPB obtains in judicial or administrative actions. Collected funds may be used to make payments to victims of consumer law violations, or for the purpose of consumer education and financial literacy. See 78 Fed. Reg. 26489 (May 7, 2013).

F) The CFPB has participated in enforcement actions, both on its own and jointly with the FDIC, OCC, Board and state regulators, and has referred cases to the DOJ for criminal prosecution. See, e.g., Hudson City Savings Bank (CFPB and DOJ Consent Order, Nov. 4, 2015); CFPB v. Pension Funding, LLC, 8:15-cv-1329 (C.D. Cal., Aug. 20, 2015) (complaint) (CFPB and NYDFS joint action); CFPB v. Mission Settlement Agency, 1:13-cv-03064 (SDNY Dec. 4, 2014) (stipulation and final order); U.S. Attorney (SDNY) Press Release, Apr. 8, 2014 (guilty plea in U.S. v. Mission Settlement Agency); American Express (Board, CFPB, FDIC, OCC and Utah Department of Financial Institutions Consent Orders, Oct. 1, 2012); Discover Bank (CFPB & FDIC Consent Order, Sept. 24, 2012); Capital One Bank (CFPB & OCC Consent Orders, July 18, 2012); Wall St. Lawyer, July 2013.

G) The CFPB continues to develop its relationships and cooperation with other federal and state regulators through MOUs, statements of intent and joint supervisory frameworks. See, e.g., The CFPB Can Enhance Its Process for Notifying Prudential Regulators of Potential Material Violations (OIG, June 29, 2015); Letter from James Reilley Dolan (FTC) to Paul Sandford (CFPB), May 29, 2015; Memorandum of Understanding Between the [CFPB] and the [FTC] (Mar. 6, 2015); State Coordinating Committee Report to State Regulators (CSBS, 2014); Supervisory Coordination Framework (CFPB/CSBS, May 7, 2013); Statement of Intent for Sharing Information with State Banking and Financial Services Regulators (CFPB, Dec. 6, 2012); Board/CFPB/FDIC/OCC/National Credit Union Administration ("NCUA") MOU (May 16, 2012).

H) The constitutionality of the CFPB has been challenged in federal court. See PHH Corp. v. CFPB, Case No. 15-1177 (D.C. Cir., June 19, 2015) (petition challenging final CFPB order and disgorgement under RESPA on constitutional and other grounds); State Nat'l Bank of Big Spring v. Lew, 795 F.3d 48 (D.C. Cir. 2015) (holding that a Texas bank has standing to pursue constitutional claims against the CFPB). See also Bloomberg, Aug. 5, 2016; Law360, July 13, 2016, Nov. 19, 2014; Reuters, July 24, 2015.

I) The CFPB has assumed most rulemaking authority under the GLBA's privacy provisions. See Part I.C.5 below.

(iii) Dodd-Frank provides that Title X preempts state laws if the state law is "inconsistent" with Title X and that such preemption applies "only to the extent of the inconsistency". State laws are not considered inconsistent if they provide greater protection than Title X. The CFPB is empowered to make inconsistency determinations on its own motion or in response to nonfrivolous petitions by interested persons. See, e.g., 78 Fed. Reg. 24386 (Apr. 25, 2013) (notice of preemption determinations regarding Maine and Tennessee unclaimed gift card laws).

b. Title X also addresses the issue of federal preemption of state law with respect to laws and agencies outside the scope of Title X. See Part I.D.4.b.ii below.

c. For additional background on CFPB initiatives and developments, see, e.g., Annual and Semiannual CFPB Reports, Regulatory Agendas and Supervisory Highlights; Management

Report: Improvements Needed in CFPB's Internal Controls and Accounting Procedures (GAO, June 13, 2016); CFPB: Additional Actions Needed to Support Fair and Inclusive Workplace (GAO, May 2016); Consumer Response Annual Report (CFPB, Mar. 2016); The CFPB Strategic Plan, Budget, and Performance Plan and Report (CFPB, Feb. 2016); 2015 List of Major Management Challenges for the CFPB (Board OIG, Sept. 30, 2015); Opportunities Exist to Enhance Management Controls Over the CFPB's Consumer Complaint Database (Board OIG, Sept. 10, 2015); Some Privacy and Security Procedures for Data Collections Should Continue Being Enhanced (GAO, Sept. 2014); Management Report: Improvements Needed in CFPB's Internal Controls and Accounting Procedures (GAO, May 2, 2014); The CFPB Can Improve the Efficiency and Effectiveness of Its Supervisory Activities (Board OIG, Mar. 27, 2014); The CFPB Should Reassess Its Approach to Integrating Enforcement Attorneys Into Examinations and Enhance Associated Safeguards (Board OIG, Dec. 16, 2013); Supervisory Statement: Determination of Depository Institution and Credit Union Asset Size for Purposes of [Dodd-Frank] (CFPB/FDIC/Board/OCC/NCUA, Nov. 17, 2011); CFPB Press Release, July 12, 2011 (CFPB approach to supervising large depository institutions); Joint Statement of Principles (CFPB and the Presidential Initiative Working Group of the National Association of Attorneys General, Apr. 11, 2011) (cooperative measures to advance shared goals regarding consumer protection); [MOU] on the Sharing of Information for Consumer Protection Purposes (CFPB, CSBS and certain state banking regulators, Jan. 5, 2011); [Dodd-Frank]: Regulations to be Issued by the [CFPB] (CRS, Aug. 25, 2010).

11. Title XI – Federal Reserve System Provisions

    a. Title XI limits the use of the emergency authority available under FRA § 13(3) by requiring that any such lending programs and facilities must have broad-based eligibility and must be approved by the Treasury Secretary. The FRB has adopted rules specifying its procedures for lending under FRA § 13(3), as amended by the DFA. 80 Fed. Reg. 78959 (Dec. 18, 2015).

b. In addition, the FRB must now disclose certain information about discount window borrowing, including the identity of the borrower and certain terms of the loans approximately two years after a discount window loan is extended. See, e.g., No Changes Recommended to [FOIA] Exemption Included in the Amended [FRA] (Board OIG, Jan. 18, 2013).

12. Title XII – Improving Access to Mainstream Financial Institutions

Title XII of Dodd-Frank includes provisions generally intended to make low-cost alternatives to payday loans available from traditional financial institutions.

13. Title XIII – Pay it Back Act

Title XIII of Dodd-Frank amends EESA to limit the scope of TARP authority.

14. Title XIV – Mortgage Reform and Anti-predatory Lending Act

Title XIV of Dodd-Frank addresses the residential mortgage loan market by (a) providing for the registration of loan originators; (b) establishing minimum underwriting standards; and (c) addressing creditor liability, appraisal standards, servicing procedures with regard to escrows and arbitration provisions. See generally Part V below.

15. Titles XV and XVI – Miscellaneous Provisions

Titles XV and XVI of Dodd-Frank require the FDIC to conduct various studies, including on the implications of potential changes to the definitions of "core deposits" and "brokered deposits". See also Part IV below.

16. "Reform" Proposals Internationally

Revision of the U.S. financial services regulatory system is taking place in the context of efforts globally. See, e.g., Consultation Document: Directive 2002/87/EC on the Supplementary Supervision of Credit Institutions, Insurance Undertakings and Investment Firms in a Financial Conglomerate (EC, June 9, 2016); Remarks of BIS

General Manager Jamie Caruana, May 10, 2016 (Financial Regulation: Cementing the Gains of Post-crisis Reforms); [FAQs] for the IAIS Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame) (IAIS, Apr. 26, 2016); Global Financial Stability Report (IMF, Apr. 2016); U.S. Insurance Regulator's Views: IAIS Common Framework for the Supervision of Internationally Active Insurance Groups "ComFrame" (IAIS, Apr. 2016); Benefits and Costs of Bank Capital (IMF, Mar. 2016); Response to European Commission's Call for Evidence on EU Regulatory Framework for Financial Services (Financial Markets Law Committee, Jan. 2016); Implementation and Effects of the G20 Financial Regulatory Reforms (FSB, Nov. 9, 2015); Call for Evidence: EU Regulatory Framework for Financial Services (EC, Sept. 30, 2015); Working Paper: "But we are different!": 12 Common Weaknesses in Banking Laws, and What to Do about Them (IMF, Sept. 2015); European Council Press Release, June 19, 2015 (Restructuring Risky Banks: Council Agrees its Negotiating Stance); Thematic Review on Supervisory Frameworks and Approaches for SIBs (FSB, May 26, 2015); Common Framework for the Supervision of Internationally Active Insurance Groups: Revised DRAFT (IAIS, Sept. 2014); Bank Size and Systemic Risk (IMF, May 2014); A Reformed Financial Sector for Europe and Economic Review of the Financial Regulation Agenda (EC, May 15, 2014); International Financial Reforms: U.S. and Other Jurisdictions' Efforts to Develop and Implement Reforms (GAO, Apr. 2014); Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation (IOSCO, Aug. 2013); Promoting Greater International Regulatory Consistency (IIF, June 2013); Structural Bank Regulation Initiatives: Approaches and Implications (BIS, Apr. 2013); Global Regulatory Reform Proposals (Global Financial Markets Association, Mar. 31, 2013) (side-by-side comparisons and timelines of regulatory initiatives); High-level Expert Group on Reforming the Structure of the EU Banking Sector (Liikanen Report, Oct. 2, 2012); Assessing the Cost of Financial Regulation (IMF, Sept. 2012); IAIS Press Release, July 2, 2012 (IAIS Releases 2012 Draft of Common Framework for Supervision of Internationally Active Insurance Groups (ComFrame)); From Bail-out to Bail-In: Mandatory Debt Restructuring of Systemic Financial Institutions (IMF, Apr. 24, 2012); Global Regulatory Reform Proposals (SIFMA, Mar. 31, 2012); Policy Measures to Address [SIFIs] (FSB, Nov. 4, 2011); The

Multilateral Aspects of Policies Affecting Capital Flows (IMF, Oct. 13, 2011); Final Report – Recommendations (UK Independent Commission on Banking, Sept. 2011) (the "Vickers Report"); Achieving Effective Supervision: An Industry Perspective (IIF, July 2011); Greene, McIlwain & Scott, "A Closer Look at '[TBTF]': National and International Approaches to Addressing the Risks of Large, Interconnected Financial Institutions", Capital Markets L.J. (2010); Impact of Regulatory Reforms on Large and Complex Financial Institutions (IMF, Nov. 3, 2010); Impact of Regulatory Reforms on Large and Complex Financial Institutions (IMF, Nov. 3, 2010); Objectives and Principles of Securities Regulation, (IOSCO, June 2010) (the "IOSCO 2010 Objectives and Principles"); Corporate Governance in Financial Institutions and Remuneration Policies (EC, COM(2010)284/3); Corporate Governance in Financial Institutions: Lessons to be Drawn from the Current Financial Crisis -- Best Practices (EC, SEC(2010)669); Global Financial Stability Report: Systemic Risk and the Redesign of Financial Regulation (IMF, Apr. 2010); Report and Recommendations of the Cross-border Resolutions Group (Basel, Mar. 2010); Lessons and Policy: Global Financial Crisis (IMF, Feb. 2010); Comprehensive Strategy to Address the Lessons of the Banking Crisis Announced by [Basel] (BIS, Nov. 20, 2008).

C. GRAMM-LEACH-BLILEY ACT

1. Facilitating Affiliation Among Banks, Securities Firms and Insurance Companies

a. Scope and Coverage

(i) Gramm-Leach repealed Sections 20 and 32 of Glass-Steagall (GLB Act § 101) and eliminated barriers to affiliations among banks, securities firms and insurance companies. See generally Permissible Securities Activities of Commercial Banks Under [Glass-Steagall] and [Gramm-Leach] (CRS, Apr. 12, 2010).

As of September 15, 2016, 460 U.S. domestic and 41 foreign institutions had become FHCs, representing approximately 10.5% of all top-tier BHCs. A list of these FHCs, as well as of national bank "financial subsidiaries" approved to engage in expanded activities under Gramm-Leach, appears at Appendix A.

See also Part I.A.5 above.

(ii) Gramm-Leach preserves the role of the Board as the "umbrella supervisor" for FHCs/BHCs, but incorporates a system of "functional regulation" to use federal and state financial supervisors -- particularly the SEC, the CFTC and state insurance regulators -- and to ensure that similarly-situated entities are subject to consistent requirements. Various provisions of Dodd-Frank enhance the FRB's authority as umbrella supervisor while retaining the basic policy of functional regulation.

(iii) The policy issues that shaped financial modernization legislation continue to inform debate over Gramm-Leach (and Dodd-Frank) implementation. These issues include the separation of banking and commerce, the nature and scope of Board umbrella supervision and of functional regulation of FHC subsidiaries, consumer privacy rights, the system of federal/state financial regulation, and the competitive interests of "Wall Street" financial firms and "Main Street" financial organizations.

A) Gramm-Leach has had a pronounced impact on the financial services marketplace.

i) Virtually every major financial institution -- including investment banks (e.g., Goldman Sachs, Merrill Lynch, Morgan Stanley), large insurance companies (e.g., Prudential), commercial finance vehicles (e.g., CIT Group, GMAC) and financial service vehicles (e.g., American Express, Discover Financial Services) -- became, or became part of, FHCs. More recently some large insurers and asset managers (e.g., Franklin Resources) have divested depository institution subsidiaries or limited their activities to avoid

Board supervision as BHCs. <u>See, e.g.</u>, <u>SNL Financial</u>, June 30, 2014; <u>Part I.A.5.d</u> and <u>Part I.B.1.b.vi above</u>.

ii) Among the factors that inhibit FHC expansion are (a) the DFA; (b) fear of Board umbrella supervision, including with respect to the review of FHC businesses and capital management; (c) the requirement that a Board approval process be followed for an FHC to expand its products and services beyond those previously approved; and (d) restrictions on (i) full physical commodity activities; (ii) conduct of certain commercial and industrial activities related to financial activities (such as ownership of power generation facilities, pipelines, barges and storage facilities); (iii) merchant banking investments (including in respect of the length of time such investments may be held, and restrictions on the ability of an FHC to engage in routine operation or management of portfolio companies); and (iv) other financially-related activities (such as real estate brokerage, management and development and the operation of mutual funds not treated as merchant banking investments). <u>See</u> <u>Part VII</u> and <u>Part VIII below</u>.

B) Some securities and insurance firms used bank-like entities -- such as ILCs -- to conduct retail banking operations. These developments presented unique policy questions. <u>See</u> <u>Part I.B.6.a above</u>.

(iv) With respect to recent developments and interpretations regarding the GLB Act, as well as banking/FHC-related developments generally, <u>see</u> <u>Financial Services Factbook</u> (Financial Services Roundtable, 2013); <u>Expanding into Banking? Considerations for Non-banks</u> (Deloitte, 2009). <u>See also</u> <u>Part I.A.5</u> and <u>Part I.A.6 above.</u>

b. Eligibility Requirements

(i) Bank Holding Companies

To become an FHC, a BHC must meet the criteria set forth in BHCA §§ 4(k) and 4(l). See 66 Fed. Reg. 400 (Jan. 3, 2001) (the "Board FHC Release"), codified at 12 C.F.R. § 225.81 et seq. (the "FHC Regulations"):

A) FHC Election: A BHC must file a declaration with the Board that includes information about the location and capital position of each depository institution controlled by the BHC and a certification that each such institution is well capitalized and well managed. Under Dodd-Frank, the BHC must also certify that it is well capitalized and well managed. The declaration is deemed effective on the 31st day after filing unless the Board notifies the BHC that the election is ineffective.

A non-BHC may file a declaration simultaneously with its application to become a BHC under BHCA § 3(a)(1).

In many instances, every BHC in a chain of ownership over a bank may need to file an FHC election if the parent BHC does so.

B) Capital: A BHC, and all insured depository institution subsidiaries of the BHC, must be well capitalized.

i) This standard essentially means that a bank/BHC must be well capitalized under the PCA standards of FDIA § 38, 12 U.S.C. § 1831o.

ii) The Board discussed possible deconsolidation of functionally regulated insurance underwriting companies from the FHC for purposes of applying the Board's capital adequacy guidelines. See 66 Fed. Reg. 3784 (Jan. 25, 2002) (final rule) (the "Merchant Banking Capital Rule"); 66 Fed. Reg. 1021 (Feb. 14, 2001) (solicitation of public comments) (the "Merchant Banking Capital Proposal"); 65 Fed. Reg. 16480 (Mar. 28, 2000) (solicitation of public comments) (the "Initial Merchant Banking Capital Proposal"). See generally Part I.C.1.i.iii and Part VII below.

C) Management: A BHC, and all insured depository institution subsidiaries of the BHC, must be well managed. Thus, a bank/BHC must have (1) at least a satisfactory ("2") composite rating, and (2) at least a satisfactory ("2") rating for management.

D) Community Reinvestment Act: 12 U.S.C. § 2901 ("CRA"). All insured depository institution subsidiaries of the BHC must have achieved at least a "satisfactory record of meeting community credit needs" at their most recent CRA examination.

E) Controlled Foreign Banks: If a BHC controls a foreign bank that operates a branch or agency or controls a CLC in the U.S., the foreign bank must meet the criteria for foreign bank qualification as an FHC in order for the parent BHC to so qualify. See 12 C.F.R. § 225.81(c)(2). This requirement is not mandated by Gramm-Leach.

See also, e.g., 78 Fed. Reg. 50055 (Aug. 16, 2013) (announcing approval and extension of Board FHC information collection forms).

(ii) Foreign Banks

Gramm-Leach requires the Board to apply "comparable" capital and management standards to foreign banks, giving due regard to national treatment and equality of competitive opportunity.

A) FHC Election: The FHC declaration process for foreign banks is similar to the process for BHCs, except that a "pre-clearance" procedure applies for foreign banks that do not meet relevant criteria or are not domiciled in a jurisdiction that has been subject to a comprehensive consolidated supervision determination by the Board. The pre-clearance process has also been used, especially recently, by foreign banks looking to establish that their capital levels are comparable to the capital required for a U.S. bank owned by an FHC. See Part I.C.1.b.ii.B below.

B) Capital: Under the FHC Regulations, a foreign bank will be considered well capitalized if either:

i) The following criteria are met: (A) the foreign bank's home country supervisor has adopted risk-based capital standards consistent with the Basel Accord; (B) the foreign bank maintains a Tier 1 capital to total risk-based assets ratio of 6% and a total capital to total risk-based assets ratio of 10%, as calculated under home country standards; and (C) the foreign bank's capital is comparable to the capital required for a U.S. bank owned by an FHC; or

ii) The foreign bank has obtained a Board determination that its capital is otherwise comparable to the capital that would be required of a U.S. bank owned by an FHC.

In making a comparability determination, the Board will take into account the foreign bank's capital components, ratio of Tier 1 capital to total assets (or "leverage ratio"), accounting standards, nature and extent of governmental ownership or assistance, and long-term debt ratings.

Where a foreign bank qualifies as an FHC, in general U.S. capital standards had not been applied to a U.S. BHC controlled by the foreign bank absent a special supervisory determination. See Board SR Letter 01-1 (SUP) (Jan. 5, 2001), CCH Fed. Banking L. Rep. ¶ 47-796. The DFA reverses this long-standing Board precedent by subjecting U.S. "intermediate" BHCs to the requirements of the Collins Amendment.

The Board is expected to revise the FHC Regulations to clarify the "well capitalized" criterion for foreign bank FHC status following Dodd-Frank.

C) Management: A foreign bank will be considered well managed if:

i) The foreign bank has received at least a satisfactory ("2") composite rating of its U.S. branch, agency and CLC operations at its most recent assessment;

ii) The foreign bank's home country supervisor consents to the bank's expansion into activities permissible for an FHC; and

iii) The management of the foreign bank meets standards comparable to those required of a U.S. bank owned by an FHC.

Although the FHC Regulations have not yet been amended to this effect, Board staff appear to take the view that a foreign bank's combined U.S. operations rating must also be at least a "2", apparently based on the requirement under DFA § 606 that a BHC, and not just its subsidiary banks, must be well managed.

D) Controlled U.S. Depository Institutions and Foreign Banks: The FHC Regulations impose a requirement, not specified in Gramm-Leach, that the well capitalized and well managed tests apply to each U.S. depository institution subsidiary of the foreign bank and to each foreign bank that has U.S. operations in the form of a branch, agency or CLC subsidiary that is controlled by the top-tier foreign bank seeking FHC certification.

Although the Board FHC Release indicated a willingness to be flexible in applying applicable "control" standards in the context of foreign bank investments in other foreign banks, concerns have been expressed as to the manner in which these standards are being applied. See, e.g., IIB Letter to the Board, Aug. 2, 2001.

E) CRA: Only FDIC-insured branches and U.S. depository institution subsidiaries of a foreign bank are required to have a "satisfactory" CRA rating. No CRA standard applies to uninsured U.S. branches.

F) Grandfather Rights: Grandfather rights in respect of financial activities -- but not non-financial activities -- terminate automatically if a grandfathered foreign bank becomes an FHC. See also Part I.A.11.f above.

c. Expanded Powers/Activities: "Financial", "Incidental" and "Complementary" Activities

(i) Scope

An FHC may engage in the following activities under Gramm-Leach (BHCA § 4(k)):

A) Activities that are "financial in nature", including any activities previously permitted under BHCA § 4(c)(8) or § 4(c)(13), and any new activities enumerated under this broader standard;

B) Activities determined to be "incidental" to financial activities; and

C) Activities determined to be "complementary" to financial activities and not to pose a substantial risk to the safety and soundness of depository institutions or the financial system.

See e.g., Section 620 Report.

(ii) Statutory Financial Activities

BHCA § 4(k)(4) lists activities that are defined as a matter of statute to be "financial in nature" ("Statutory Financial Activities"), including:

A) Securities underwriting, dealing and market-making without regard to virtually any limitations imposed by the Board on BHC subsidiaries that engage in securities activities under BHCA § 4(c)(8) and what was formerly Glass-Steagall § 20 (so-called "Section 20 Subsidiaries"), including limitations on "ineligible revenues" and most of the Board's Operating Standards applicable to Section 20 Subsidiaries, 12 C.F.R. § 225.200 (the "Operating Standards"). However, securities activities that constitute proprietary trading are subject to the Volcker Rule as enacted in Dodd-Frank. See Part II.A.7 and Part III below.

B) Insurance underwriting, agency and brokerage activities. See Part I.C.1.c.vii below.

C) Merchant banking activities, including investing as principal or agent in securities in any type of company engaged in non-financial activities (a "portfolio company"). However, investments in hedge funds and private equity funds are subject to the Volcker Rule. See Part II.A.7 and Part VII below.

D) Activities previously approved by the Board by regulation or order for BHCs under the "closely related to banking" standard of BHCA § 4(c)(8). See Part I.C.1.c.iv below.

E) Activities previously approved by the Board for BHCs to conduct abroad under the "usual in connection with the transaction of banking or other financial operations" standard of BHCA § 4(c)(13). See Part I.C.1.c.v below.

The FHC Regulations list permissible financial and incidental activities in Regulation Y and establish procedures for requesting a determination that an activity is "financial" or "incidental". See also 66 Fed. Reg. 19081 (Apr. 13, 2001) (technical amendments to list of permissible activities); 65 Fed. Reg. 14433 (Mar. 17, 2000) (the "Financial Activities Release") (interim rule amending Regulation Y in respect of financial activities, with solicitation of public comments).

(iii) Approved and Proposed Financial and Incidental Activities

A) BHCA § 4(k)(2) authorizes the Board, in consultation with Treasury, to approve new activities as financial or incidental. Each agency may veto approvals by the other to expand the scope of approved financial or incidental activities. See also Procedures for Board/Treasury Consultation on New Financial Activities (Dec. 7, 2000) (the "Board/Treasury MOU"). In considering whether an activity is financial or incidental, the Board and Treasury must take into account:

i) Changes or reasonably expected changes in the marketplace in which FHCs compete;

ii) Changes or reasonably expected changes in the technology for delivering financial services; and

iii) Whether the activity is "necessary or appropriate" to (a) allow an FHC to compete effectively, (b) deliver efficiently information and services that are financial in nature through the use of technological means, and (c) offer customers technological means for using financial services.

B) Under this standard, the Board has approved acting as "finder" as an "incidental" activity. See 65 Fed. Reg. 80735 (Dec. 22, 2000), codified at 12 C.F.R. § 225.86(d)(1) (the "Board Finder Rule"). See Part VII.C below.

In addition to traditional finder activities (i.e., bringing together buyers and sellers of goods and services and related activities), the Board Finder Rule authorizes Internet-based services, such as hosting an electronic marketplace website, merchant websites and Internet auction websites.

C) In Citigroup, 94 Fed. Res. Bull. C16 (2007), the Board approved as "financial" the acquisition, management, and operation in the UK of defined benefit pension plans established by unaffiliated third parties under circumstances where (1) the plan is "hard-frozen" and fully funded (i.e., no additional beneficiaries may be added, and existing beneficiaries may not accrue additional benefits); (2) Citigroup would assume the rights and obligations of the sponsor of the plan and would do so in transactions that do not represent the acquisition of a going concern or ongoing business operations; and (3) the assets and liabilities of an acquired plan (unlike assets held by an FHC as trustee for third parties or assets held by pension plans maintained for Citigroup's employees) would be consolidated with Citigroup's assets and liabilities.

The Board determined that such activity involves investment advisory and investment management skills that banking organizations routinely exercise and the types of operational and investment risks that banking organizations routinely incur and manage.

The Board noted that, under UK law, the subsidiary established by Citigroup to acquire a third-party UK pension plan will bear sole responsibility for making additional contributions to the plan if the plan assets are not sufficient to meet the plan's liabilities, but that UK law also permits the UK Pensions Regulator in certain circumstances to commence proceedings to hold an affiliate of a plan sponsor (including a depository institution affiliate) responsible for the sponsor's obligations. The Board said that it generally has taken the position that, when a depository institution is secondarily liable for a financial obligation of an affiliate, the institution has issued a guarantee on behalf of an affiliate for purposes of Section 23A (see Part III.A.5 below).

To address potential Section 23A issues, Citigroup obtained assurances from the UK Pensions Regulator that it will not seek to hold any of Citigroup's depository institution subsidiaries that are subject to Section 23A responsible for any shortfalls that may occur in the pension plan acquired by Citigroup.

D) In 2001, the Board and Treasury sought comment on whether to approve real estate brokerage and management as financial activities. See 66 Fed. Reg. 307 (Jan. 3, 2001) (the "FHC Real Estate Proposal"). See generally Part VII.B below.

i) The Proposal sparked significant opposition from the National Association of Realtors ("NAR"). See, e.g., The Consequences of Mixing Banking and Commerce (May 2001);

NAR Press Releases, May 17, 14, 1, Mar. 27, 2001.

Opposition to the Proposal was <u>not</u> unanimous among realtor industry groups (<u>see</u>, <u>e.g.</u>, Realty Alliance Letter to NAR, Feb. 8, 2002). Issues have also been raised with respect to (A) the purported lack of price competition among real estate brokers (<u>see</u>, <u>e.g.</u>, <u>Real Estate Brokerage: Factors that May Affect Price Competition</u> (GAO, Aug. 2005) (the "<u>GAO 2005 Real Estate Brokerage Report</u>")); and (B) the fact that many realtors are already affiliated with non-bank mortgage lenders that operate outside of Board jurisdiction (<u>see</u>, <u>e.g.</u>, Financial Services Roundtable Letters to Congress, May 14, 2002, Dec. 10, 2001).

ABA Letters, June 28, 2008, and June 4, 2007, criticized the NAR position as "anti-competitive and anti-consumer".

ii) In 2009, Congress passed a permanent moratorium on the use of Treasury funds to finalize the FHC Real Estate Proposal.

E) Whether the Board approves an activity as "financial" or "incidental" should not affect an FHC's ability to engage in the activity as a substantive or procedural matter. Approving an activity as "complementary" means that (1) FHC-specific prior Board approval is required, and (2) the activity cannot be conducted in a financial subsidiary of a bank.

(iv) <u>BHCA § 4(c)(8) Activities</u>

Statutory Financial Activities include those activities that the Board had determined to be "closely related to banking" under the BHCA prior to November 12, 1999.

A) The FHC Regulations cross-refer to the "laundry list" in Regulation Y of activities approved for BHCs under the "closely related to banking" standard (12 C.F.R. § 225.28), including credit/loan, advisory, derivatives, data processing, financial leasing, trust, fiduciary, financial intermediation and other activities.

B) The FHC Regulations list some "closely related to banking" activities previously approved by Board Order that are not included in the list of Statutory Financial Activities. Such activities include providing administrative services to mutual funds and owning a securities exchange.

C) The FHC Regulations subject the conduct of previously approved "closely related to banking" activities to the conditions contained in Regulation Y and authorizing Orders.

D) Although the Board may not expand the range of activities that are "closely related to banking" for purposes of BHCA § 4(c)(8), it may modify conditions with respect to such activities.

i) The Board has concluded that aircraft title abstracting falls within the scope of approved real estate title abstracting activities. Board Letter, Oct. 7, 2002, CCH Fed. Banking L. Rep. ¶ 80-306. See also 12 C.F.R. § 225.86(a)(2)(vii); First National Co., 81 Fed. Res. Bull. 805 (1995).

ii) The Board has modified the conditions applicable to certain BHCA trading activities under 12 C.F.R. § 225.28(b)(8)(ii) to confirm that a BHC may conduct transactions, as principal, in forward contracts, options and similar OTC contracts in the natural gas and power markets that physically settle in certain circumstances. See Part II.E.3 below.

iii) The Board has liberalized Regulation Y limitations on BHC data processing activities and increased the prior 30% limit on the non-financial data processing component of BHC total data processing revenues to 49%. See 68 Fed. Reg. 68493 (Dec. 9, 2003) (the "Board IT Rule"); 65 Fed. Reg. 80384 (Dec. 21, 2000) (solicitation of public comments) (the "Board IT Proposal"); Board Letter, June 5, 2001 (software programs that assist with workflow automation and document management). See also Part I.C.1.c.iv below.

The Board IT Rule tracks powers that the Comptroller has approved for national banks. See, e.g., 12 C.F.R. § 7.1019; Comptroller Conditional Approvals No. 479 (July 27, 2001) (document storage, retrieval and collaboration system for personal and business information); No. 409 (Aug. 10, 2000); Comptroller Interpretive Letters No. 889 (Apr. 24, 2000) ("Letter No. 889"), CCH Fed. Banking L. Rep. ¶ 81-408 (securities trading); No. 888 (Mar. 14, 2000) ("Letter No. 888"), CCH Fed. Banking L. Rep. ¶ 81-407 (document storage and retrieval); Comptroller Corporate Decision No. 2000-01 (Jan. 29, 2000) (software); Comptroller Conditional Approvals No. 313 (July 9, 1999); No. 253 (Aug. 20, 1997); Comptroller Interpretive Letters No. 754 (Nov. 6, 1996) ("Letter No. 754"), CCH Fed. Banking L. Rep. ¶ 81-118 (hardware); No. 742 (Aug. 19, 1996), CCH Fed. Banking L. Rep. ¶ 81-106.

See also Part I.D.4.b.i below.

E) Board Letter re UBS, May 15, 2006, (the "UBS VPP Letter") confirms that volumetric production payment ("VPP") transactions involving physical commodities -- i.e., royalty interests (which are considered real property in most states) that entitle the holder, in exchange for an upfront payment, to receive specified quantities of hydrocarbons on a regular basis during the life of the transaction -- are extensions of credit permissible for a BHC under Regulation Y. See also Part I.C.1.c.iv.E, Part II.D.2.d.xi (commodity purchase and forward transactions) and Part VII.B below.

(v) BHCA § 4(c)(13) Activities

Statutory Financial Activities include activities that the Board had determined to be "usual in connection with the transaction of banking or other financial operations abroad" prior to November 12, 1999.

A) The FHC Regulations list three activities which the Board previously approved in Regulation K that were not permissible for a BHC under Regulation Y:

i) Management consulting services (subject to a non-control limitation);

ii) Operating a travel agency in connection with financial services; and

iii) Organizing, sponsoring and managing a mutual fund, so long as (a) the fund does not exercise managerial control over the companies in which it invests; and (b) the FHC reduces its ownership in the fund to less than 25% of the equity of the fund within one year of sponsorship.

The Merchant Banking Regulations permit an FHC to invest in a mutual fund which it manages in excess of the 25% limit. See, e.g., Board Letter to SocGen, May 17, 2001. See also Part VII below.

B) The FHC Regulations do not list commercial banking activities as permissible activities abroad. As a result, a proposal by a U.S. BHC to acquire a foreign bank is subject to the requirements of Regulation K. (See, e.g., 12 C.F.R. § 211.602.) This limitation is not mandated by the GLB Act.

C) The FHC Regulations also do not list activities approved by order for BHCs to conduct abroad, and do not list some activities approved by order under Regulation Y (see, e.g., Board Orders cited in Part II.D.2 below). Compare GLB Act § 4(k)(4)(G) (authorizing as financial activities those that the Board approved by regulation or interpretation under BHCA § 4(c)(13)).

(vi) BHCA § 4(k)(5) Activities

BHCA § 4(k)(5) requires the Board and Treasury to define, by regulation or order, certain specified activities as financial in nature. These activities are:

A) Lending, exchanging, transferring, investing for others, or safeguarding financial assets other than money or securities;

B) Providing any device or other instrumentality for transferring money or other financial assets; and

C) Arranging, effecting or facilitating financial transactions for the account of third parties.

See 66 Fed. Reg. 257 (Jan. 3, 2001). See also Part IX.D below.

(vii) Insurance Activities

Non-bank subsidiaries of an FHC may act as principal, agent or broker for the purpose of (A) "insuring, guaranteeing or indemnifying" against "loss, harm, damage, illness, disability, or death", and (B) providing and issuing annuities.

A) The Financial Activities Release clarifies that reinsurance activities fall within the insurance empowerment.

B) The reference to "insuring against illness" includes activities commonly thought of as health insurance, but is apparently not meant to include providing health care other than to the extent that it may be incidental to the business of insurance.

C) Board Letter, July 10, 2002, re: Hancock Holding Company (the "Board TPA Letter") confirms that an FHC may act as a third party administrator for an insurance company because it is "directly related to the provision and sale of insurance . . . and constitute[s] an integral part of . . . regulated insurance activities" (emphasis added).

D) Board Letter to Karol Sparks, July 10, 2002 (the "Board Insurance Services Letter"), confirms that an insurance company owned by an FHC may engage in claims administration activities (which generally require a state insurance license), and provide insurance risk management services (which generally do not) in connection with insurance sales activities.

   The Comptroller agrees with the Board Insurance Services Letter. See Comptroller Interpretive Letter No. 967 (June 6, 2003), CCH Fed. Banking L. Rep. ¶ 81-490. See also Part I.D.4.d below.

E) Board Letter re Wachovia, Oct. 31, 2005, permitted a BHC to deconsolidate, for risk-based capital purposes, its equity investment in a financial guarantee reinsurance subsidiary that was consolidated under generally accepted accounting principles ("GAAP") where:

i) The risk-based capital requirements imposed on the financial guarantee reinsurance transactions of the subsidiary exceed their economic capital requirements.

ii) The subsidiary's financial condition and operations would be subject to review by Moody's and S&P, the subsidiary has a Aa3/AA stand-alone financial strength rating, and Wachovia committed that the subsidiary's stand-alone financial strength rating will always be at least A.

iii) The subsidiary would be subject to governmental supervision in Bermuda, its licensing jurisdiction.

iv) Wachovia would not make available any additional financial support to the subsidiary without Board approval.

v) The subsidiary would be separated from the rest of Wachovia in that (A) it would not be branded with the Wachovia name; (B) three members of the subsidiary's nine-member board of directors would not have any positions with Wachovia; (C) although the subsidiary and Wachovia would have some dual employees, the subsidiary's chief executive officer, president and chief underwriting officer would not hold any positions with Wachovia; and (D) when they interface with customers or other third parties, subsidiary employees would be identified with, and would act only on behalf of, the subsidiary.

The Board permitted Wachovia to deconsolidate the subsidiary for risk-based capital purposes and deduct its equity investment in the subsidiary 50% from Tier 1 capital and 50% from Tier 2 capital.

The Board noted that this approach may not be available under U.S. implementation of future revisions to the Basel Capital Framework

Indeed, under the agencies' rules implementing the Basel III Capital Framework, this deconsolidate-and-deduct approach is no longer available for functionally regulated subsidiaries. Rather, banking organizations must deduct an amount equal to the regulatory capital requirement for insurance underwriting risks established by the regulator of any insurance underwriting activities of the consolidated company 50% from tier 1 capital and 50% from tier 2 capital and may no longer deconsolidate their insurance underwriting subsidies. See 12 C.F.R. § 217.22(b)(3).

(viii) International Activities

The Board retains authority to grant exemptions for foreign banks and for foreign investments by U.S. BHCs (since BHCA §§ 4(c)(9)/4(c)(13) remain unchanged).

(ix) Complementary Activities

The "complementary" activity standard gives the Board discretion to approve non-financial, commercial activities for FHCs.

A) Under the FHC Regulations, in acting on a proposal to engage in a complementary activity, the Board will consider:

i) Whether the activity is complementary to an identified financial activity;

ii) Whether the activity would pose a substantial risk to the safety and soundness of depository institutions or the financial system; and

iii) Whether the proposal could be expected to produce public benefits that outweigh possible adverse effects.

B) Neither the GLB Act nor the FHC Regulations subject Board consideration of complementary financial activities to public hearing or notice or require Board consultation with Treasury regarding proposed complementary activities.

C) Neither the GLB Act nor the FHC Regulations require that complementary activities "remain small" (as did other legislative proposals). Rather, the FHC Regulations require that a proposal to engage in a complementary activity describe "the scope and relative size of the proposed activity, as measured by the percentage of the projected [FHC] revenues expected to be derived from and assets associated with conducting the activity".

D) While the Board IT Proposal would have approved, as a complementary activity, investment of up to an aggregate of 5% of an FHC's Tier 1 capital in data storage, general data processing and transmission and electronic information portal services, the Board declined to authorize such investment; instead, it stated that it will continue to review FHC proposals to engage in, or acquire a company engaged in, such a complementary activity on a case-by-case basis. Compare New York Clearing House ("NYCH") Letter to the Board, Apr. 24, 2000 (requesting a determination that a range of e-commerce activities "are financial in nature, incidental to a financial activity or complementary to a financial activity").

E) Regulation Y authorizes BHCs to engage in commodity derivative activities subject to restrictions that limit the BHC's activity to trading and investing in financial instruments (rather than dealing directly in physical commodities). See 12 C.F.R. § 225.25(b)(8).

In Citigroup, 89 Fed. Res. Bull. 508 (2003), and subsequent orders, the Board approved notices under BHCA § 4(k) for physical commodity trading activities as "complementary" to the financial activity of engaging as principal in commodity derivative activities.

i) Citigroup requested an expansion of an FHC's authority to purchase and sell non-financial commodities in the spot market and to take and make delivery of physical commodities to settle commodity derivatives ("Commodity Trading Activities").

(a) In order to limit the potential risks of Commodity Trading Activities, the Board conditioned its Order:

i. The market value of commodities held by Citigroup as a result of Commodity Trading Activities may not exceed 5% of Citigroup's consolidated Tier 1 capital (the "5% Commodity Capital Limit"). Citigroup must notify the FRBNY if the market value of commodities held as a result of such Activities exceeds 4% of its Tier 1 capital.

(The UBS VPP Letter confirms that any physical commodities delivered under VPP transactions would not count against the 5% Commodity Capital Limit. See also Board CPFS Letter described in Part II.E.3.c.ii.E below (commodity purchase and forward sale transactions).)

ii. Citigroup may take and make delivery only of physical commodities for which derivative contracts have been approved by the CFTC for trading on a U.S. futures exchange or which have been approved by the Board.

(b) The Board acknowledged that Commodity Trading Activities would expose Citigroup to additional risks. To minimize these risks, Citigroup would (i) not own, operate or invest in facilities for the extraction, transportation, storage or distribution of commodities as part of the complementary activity (although Board staff has informally advised that this commitment does not affect an FHC's ability to make merchant banking investments as described in Part VII below); (ii) not process, refine or alter commodities; (iii) use appropriate third-party storage and transportation facilities; and (iv) adopt additional standards and storage policies for such Activities that involve environmentally sensitive products such as oil or natural gas.

See also Bank of Nova Scotia ("BNS") (Board Letter, Feb. 17, 2011); Wells Fargo (Board Letter, Apr. 10, 2008); BNP Paribas (Board Letter, Aug. 31, 2007); Bank of America (Board Letter, Apr. 24, 2007); Credit Suisse (Board Letter, Mar. 27, 2007); Fortis (Board Letter, Sept. 29, 2006, with respect to the acquisition of Cinergy Marketing & Trading from Duke Energy); Wachovia (Board Letter, Apr. 13, 2006); SocGen, 92 Fed. Res. Bull. C113 (2006) ("SocGen

Complementary Order") (noting permissibility of certain commodity trading activities under Regulation K; see Part XI below); JPMorgan Chase, 92 Fed. Res. Bull. C57 (2006); Deutsche Bank, 92 Fed. Res. Bull. C54 (2006); Barclays, 90 Fed. Res. Bull. 511 (2004); UBS, 90 Fed. Res. Bull. 215 (2004).

ii) In Fortis, 94 Fed. Res. Bull. C20 (2008) (the "Fortis Energy Management Order"), the Board approved energy management services to owners of power generation facilities.

(a) Energy management services generally entail (i) acting as a financial intermediary for a power plant owner to facilitate transactions relating to the acquisition of fuel and the sale of power; (ii) providing advice to assist the owner in risk management; (iii) assuming responsibility for administrative tasks related to fuel and power transactions; and (iv) providing market and risk information to assist the owner in developing its risk management policies, and market information that the owner, in consultation with the operator of the power facility, uses to determine the amount of power the facility should generate.

(b) To limit the size, scope and risks of energy management services, the Board (i) determined that the revenues attributable to such services should not exceed 5% of the FHC's total consolidated operating revenues; (ii) required that the relevant energy management agreement provide that (A) the owner retains the right to market and sell power to third parties; (B) the owner retains the right to determine the level at which the facility will operate; (C) neither the energy manager nor its affiliates guarantee the financial performance of the facility; and (D) neither the energy manager nor its affiliates bear risk of loss if the facility is not profitable; and (iii) did not approve the provision of day-to-day operational services.

See also BNP Paribas (Board Letter, Sept. 21, 2010); Fortis (Board Letter, Feb. 16, 2007) (relief from commitment not to participate in energy management agreements pursuant to which a Fortis subsidiary would act as an energy manager with respect to third party power generation facilities).

iii) RBS, 94 Fed. Res. Bull. C60 (2008) (the "RBS Complementary Order"), approved RBS's request to (A) engage in physically settled energy tolling by entering into tolling agreements with power plant owners as an activity "complementary" to the financial activity of engaging as principal in commodity derivatives transactions; (B) enter into long-term power supply contracts with large commercial and industrial end-users; (C) engage in physical trading in commodities for which derivatives contracts have not been approved by the CFTC for trading on a U.S. exchange but which have viable markets that satisfy fungibility and liquidity concerns (e.g., nickel, natural gas liquids (such as butane, ethane and natural gasoline), oil products (such as asphalt, condensate, boiler cutter, residual fuel oil no. 6, kerosene, straight run, marine diesel and naphtha), and petrochemicals (such as ethylene, paraxylene, styrene, propylene and toluene)); and (D) enter into <u>contracts with third parties to process, refine or otherwise alter commodities</u> for which it is permitted to take or make physical delivery.

(a) Under energy tolling agreements, the toller would pay the plant owner a fixed periodic payment that compensates the owner for its fixed costs in exchange for the right to all or part of the plant's power output (although the plant owner retains control over day-to-day operations).

(b) The primary risk to a toller is that the plant proves to be uneconomical. To limit the potential risk, RBS committed to limit the amount of its energy tolling activities by including the present value of its future committed capacity payments under an energy tolling agreement in calculating the value of commodities held by RBS under its physical commodity trading authority to determine compliance with the 5% Commodity Capital Limit.

iv) Orders comparable or related to the <u>Fortis Energy Management Order</u> or the <u>RBS Complementary Order</u> include Board Letter to JPMorgan Chase, June 30, 2010; Board Letter re Deutsche Bank, Jan. 29, 2010; Board Letter re Barclays, July 2, 2009; Board Letter re Fortis, May 21, 2008.

The Board Letter to JPMorgan Chase concerned its acquisition of RBS Sempra Commodities, and reflected JPMorgan Chase's commitment not to expand, and to divest if necessary to conform to the BHCA, the activities of (i) owning, investing in, or operating storage facilities for commodities; and (ii) making and taking physical delivery of commodities that are not physical commodities for which the Board has authorized JP Morgan to take and make physical delivery.

v) In April 2012, Board staff provided informal guidance confirming that asset management and sub-chartering for transportation of commodities are permissible activities for an FHC when conducted ancillary to an FHC's permissible commodities business.

vi) Under GLBA § 103, 12 U.S.C. § 1843(o), an FHC that was not a BHC or foreign bank at the time of the enactment of the GLBA (e.g., Goldman Sachs, Morgan Stanley) is "grandfathered" with respect to the trading, sale or investment in commodities and underlying physical properties up to 5% of total consolidated assets if the "new" FHC was engaged in any of such activities in the U.S. as of September 30, 1997.

vii) In 2014, the PSI investigated whether expanded commodity activities by banks increased risk to the economy. See Wall Street Bank Involvement with Physical Commodities (Senate PSI Staff Report, Dec. 5, 2014); NY Times, Nov. 20, 2014.

viii) In January 2014, the Board released an Advance Notice of Proposed Rulemaking as part of a review of FHC commodity activities under their "complementary", merchant banking and grandfathered authorities. 79 Fed. Reg. 3329 (Jan. 21, 2014). The Section 620 Report made several recommendations for statutory changes to limit FHC's physical commodities activities, and suggests the Board is considering further regulatory limits; Board Governor Tarullo has also publicly stated that the Board is considering imposing higher capital standards on certain FHC commodities activities. See The Deal, July 6, 2016. See also, e.g., Senate PSI Chairman Levin Letter to the Board, Dec. 17, 2014 (transmitting the PSI Staff Report, Wall Street Bank Involvement with Physical Commodities, for the Board's administrative record); SIFMA/ABA/Financial Services Forum/IIB and Goldman Sachs Comment Letters to the Board, Apr. 16, 2014.

ix) Several antitrust lawsuits have been filed against Goldman Sachs, JP Morgan Chase, The London Metals Exchange (the "LME") and other defendants alleging that they conspired to use their control of aluminum storage companies to restrict the supply of aluminum. See, e.g., In re Aluminum Warehousing Antitrust Litigation, 2016 WL 4191132 (2d Cir. Aug. 9, 2016) (denying standing to secondary purchasers of aluminum); 95 F. Supp. 3d 419 (SDNY 2015); 2015 WL 1344429 (SDNY Mar. 23, 2015), 2014 WL 4277510 (SDNY Aug. 29, 2014), 2014 WL 4743425 (SDNY Sept. 15, 2014); Reynolds Consumer Products v. Glencore, No. 1:16-cv-05955 (SDNY July 26, 2016) (complaint) (alleging the defendants conspired to increase price of aluminum used for consumer foil); Law360, Aug. 9, July 27, 2016, May 15, May 1, Mar. 26, 2015; Reuters, Sept. 4, 2014 and July 20, 2013; Banking Daily, Aug. 26, 2014; Wall St. J., Sept. 10, 2013; NY Times, July 20, 2013. Senators Brown, Baldwin and Warren have urged the CFTC to examine aluminum markets in connection with a pending application by the

LME for approval as a foreign board of trade. See Letter, dated Sept. 26, 2014.

See also Part II.E.2.d and Part II.E.3.c.ii below.

x) Press reports indicate that a number of large FHCs have begun divesting all or portions of their investments in the physical commodities space. See, e.g., The Deal, July 6, 2016; Financial Times, Dec. 22, May 20, Feb. 25, 2014; Reuters, May 16, 2014; NY Times, Mar. 19, 2014.

xi) See generally Comptroller's Handbook: Oil and Gas Exploration and Production Lending; The Impact of Storage and Delivery Infrastructure on Commodity Derivatives Market Pricing (IOSCO, May 9, 2016); Price Formation in Commodities Markets: Financialisation and Beyond (Centre for European Policy Studies 2013); The Economics of Commodity Trading Firms (Trafigura, 2013); The Role of Banks in Physical Commodities (IHS Global, Sept. 2013); Reuters, Mar. 2, 2012 (commodity trading developments); Financial Investment in Commodities Markets: Potential Impact on Commodity Prices & Volatility (IIF, Sept. 2011); Wall St. J., June 2, 2011.

F) The Board Order Determining that Certain Activities Are Complementary to the Financial Activity of Underwriting and Selling Health Insurance, 93 Fed. Res. Bull. C133 (2007), responded favorably to a request by the FDIC for a determination of whether disease management and mail-order pharmacy activities are "complementary" to the GLB Act-permitted activities of underwriting and selling health insurance as principal, agent or broker and, thus, activities permissible for FHCs.

i) To assure that the conduct of the activities does not pose a substantial risk to depository institutions or the financial system, the Board conditioned its determination on the requirement that the activities, in the aggregate, not account for more than 2% of an insurer's consolidated assets or 5% of its consolidated annual revenues, and that the total assets of subsidiaries engaged in pharmacy activities in the aggregate not exceed 5% of the total capital of all regulated insurance subsidiaries and health plans within the insurance group. The Board noted that the risks to which an insurance company could be exposed by conducting these activities would be mitigated by the maintenance of liability insurance and the provision of employee training to ensure compliance with applicable laws and by the fact that mail-order pharmacy units and pharmacists, as well as doctors and nurses employed by subsidiaries engaged in disease management services, are licensed and regulated by state licensing boards.

ii) Because the Order was issued in response to a request from the FDIC, the Board has not determined whether conduct of the proposed activities "can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices" and did not review the financial and managerial resources of the insurance company in question.

G) On September 10, 2013, American Express announced that it was selling its publishing business to Time Inc., in a sale apparently motivated at least partially by the expiration of the up to 5-year transition period for new BHCs to conform their non-banking activities to the requirements of the BHCA. The timing of the sale suggests that the Board was not willing to consider American Express's publishing activities as "complementary" to financial activities. See, e.g., NY Times, Sept. 10, 2013; Wall St. J., Sept. 10, 9, 2013.

H) It is possible that other financially-related activities -- personal property rental and leasing (e.g., automobile or equipment leasing) on an "operating" basis; accounting, auditing and bookkeeping services; health maintenance organization (HMO) administration; etc. -- could be characterized as "complementary" to financial activities. See, e.g., Part I.C.1.c.ix above; FleetBoston Letter to the Board, Apr. 17, 2000 (requesting a determination that certain personal property leasing activities are complementary to financial activities).

(x) Acquisition or Commencement of Financial Activities

A) An FHC is not required to obtain prior Board approval to engage in financial activities, or to acquire a company (other than a thrift institution) engaged in financial activities. See, e.g., JPMorgan Chase, 94 Fed. Res. Bull. C78 (2008) (approval of JPMorgan Chase acquisition of Bear Stearns Bank & Trust (a "grandfathered" non-bank bank) and affirmation that Board prior approval was not required under the BHCA). (Whether the Board would require prior approval of an acquisition involving an ILC remains less clear.)

Instead, an FHC may provide notice to the Board describing the activity commenced, or conducted by a company acquired, not later than 30 days after commencing the activity or consummating the acquisition.

However, "complementary" financial activities must be approved by the Board in advance.

In addition, under the BHCA as amended by Dodd-Frank, an FHC is required to provide prior notice to the Board and obtain prior approval before acquiring shares of a company engaged in financial activities if the company's assets exceed $10 billion. See Part I.B.1.d above.

B) The FHC Regulations provide for (1) after-the-fact notice to the Board of the commencement of a financial activity (12 C.F.R. § 225.87), (2) requesting a determination that an activity is "financial" or "incidental" (12 C.F.R. § 225.88), and (3) obtaining approval to engage in a "complementary" activity (12 C.F.R. § 225.89).

i) No after-the-fact notice is required to acquire shares of a company engaged in a financial activity if the FHC does not "control" the company. 12 C.F.R. § 225.87(b).

ii) The Board expects to receive notice from an FHC if a subsidiary bank acquires an interest in a company pursuant to Gramm-Leach. See Board Letter to Chase Manhattan Bank ("Chase Bank" or "JPMorgan Chase Bank"), Aug. 16, 2000 (the "Board Chase 2000 Letter"). See also Part I.D below.

C) The FHC Regulations provide that an FHC may control or acquire more than 5% of the voting shares of a company that is "substantially engaged" in financial and incidental activities, provided that the FHC either (i) complies with the relevant approval requirements that govern the other activities, or

(ii) commits to divest impermissible activities within two years of the acquisition.

i) "Substantially engaged" is defined as at least 85% of the company's consolidated total assets and annual gross revenues.

ii) The Board has granted extensions of the two year conformance period in certain circumstances. See, e.g., Board Letters, Dec. 22, 2011, Dec. 30, 2010 (extension of period related to Bank of America's acquisition of Merrill Lynch); Board Letters to Deutsche Bank, Apr. 20, 2006, Apr. 22, 2005, Apr. 21, 2004 (extension of period related to Deutsche Bank's acquisition of RREEF Real Estate Investment Managers; see Part VII.B below). See also Citigroup Extension Letter.

iii) The Comptroller has not implemented a similar "basket" approach for limited non-financial activities conducted by financial or other subsidiaries (see Part I.D.4 below), although transactions have been addressed on a case-by-case basis. Compare, e.g., Comptroller Interpretive Letter No. 677 (June 28, 1995), CCH Fed. Banking L. Rep. ¶ 83,625 (computer games insignificant part of business of company acquired, would not be developed further, and would be terminated over time).

D) Since prior Board approval of the acquisition by an FHC of a company engaged in financial activities is not required, notification procedures under Hart-Scott will apply to many acquisitions. See Part I.A.9 above and Part XII.D below.

E) On the other hand, Hart-Scott procedures should not apply if an FHC seeks Board approval under BHCA § 4(c)(8) for an acquisition of a company engaged in

BHC-permissible financial activities. See generally Wells Fargo (approved Dec. 23, 2002) (acquisition of finance and investment advisory unit).

(xi) Acquisitions of Banks

A) Gramm-Leach does not affect BHCA § 3, or Board requirements for the acquisition of a bank (and the supervision and regulation of a BHC).

B) The Board FHC Release provides that a company which seeks to acquire a bank or BHC may file a BHC Application and a declaration to be an FHC at the same time. See Part I.C.1.b above.

d. Financial Subsidiary of an Insured U.S. Bank

A bank may conduct expanded financial activities through a "financial subsidiary". GLB Act § 121 authorizes financial subsidiaries for national banks and creates authority as a federal law matter for comparable subsidiaries of state banks (although state bank authority will also be determined under state law).

(i) National Bank Financial Subsidiaries

A) For a national bank to acquire or establish a financial subsidiary:

i) The bank and all affiliated banks must be well capitalized (after deducting assets of, and investments in, all financial subsidiaries) and well managed;

ii) The bank must meet certain securities issuance requirements if it is one of the 100 largest insured banks (the "Eligible Debt Requirement");

iii) The financial subsidiaries must not exceed 45% of the assets of the bank or $50 billion, whichever is less; and

iv) The bank and its bank affiliates must have "satisfactory" or better CRA ratings.

B) A financial subsidiary must be "controlled" by the bank, but the bank's investment may be a minority (i.e., 50% or less) investment.

C) A financial subsidiary may engage in any activity permissible for a national bank plus most financial activities permissible for FHCs. However, a financial subsidiary may not engage in (1) real estate investment or development ("unless otherwise expressly authorized by law" (see, e.g., 12 U.S.C. § 29)); (2) insurance or annuity underwriting; (3) merchant banking investments (compare Comptroller Conditional Approval No. 819 (Sept. 7, 2007) ("Approval No. 819") (financial subsidiary may serve as general partner of investment fund and hold interests in funds for which it or an affiliate serves as investment manager)); or (4) "complementary" activities.

D) A financial subsidiary is treated as an "affiliate" of its parent bank for almost all purposes under Sections 23A/23B. See generally Part III.A.5 below.

i) If the Board determines that it would be necessary to prevent evasion of law: (a) any purchase of, or investment in, the securities of a financial subsidiary of a bank by an affiliate of the bank will be considered to be a purchase of or investment in such securities by the bank, and (b) any extension of credit by an affiliate of a bank to a financial subsidiary of the bank will be considered to be an extension of credit by the bank.

ii) Financial subsidiaries of an insured U.S. bank are treated as subsidiaries of a holding company, rather than a bank, for purposes of the Anti-tying Statute.

E) A national bank that establishes or maintains a financial subsidiary must comply with the conditions set out in the Comptroller's regulations implementing Gramm-Leach's financial subsidiary provisions. See 65 Fed. Reg. 12905 (Mar. 10, 2000) (final rule, 12 C.F.R. § 5.39) (the "Comptroller GLBA Regulation").

i) For purposes of Sections 23A/23B, (a) the financial subsidiary must be treated as an "affiliate" (and not a subsidiary) of the bank; and (b) the bank's investment in the financial subsidiary will not include retained earnings of the financial subsidiary.

ii) Dodd-Frank repealed the GLB Act provision that exempted covered transactions between a bank and any individual financial subsidiary of the bank from Section 23A's 10% quantitative limit.

F) A majority of national bank financial subsidiaries are insurance agencies that, prior to Gramm-Leach, were limited to towns of less than 5,000. See Appendix A. See also Comptroller Corporate Decision No. 2000-14 (Aug. 17, 2000) (title insurance agency).

G) The Federal Branch Op Sub Rule allows federal branches of foreign banks to establish operating subsidiaries but does not address financial subsidiaries. See Part I.A.11 above and Part I.D.4.g below.

H) The Comptroller GLBA Regulations do not require that a financial subsidiary be organized under U.S. law. See Part I.A.10 above and Part I.D.4.c.iii below.

(ii) State Member Bank Financial Subsidiaries

The Board's regulation implementing the financial subsidiary provisions of the GLB Act for state member banks is comparable to the Comptroller GLBA Regulation. See 66 Fed. Reg. 42929 (Aug. 16, 2001) (12 C.F.R. §§ 208.71 et seq.) (the "Board GLBA Regulation").

(iii) State Non-member Bank Financial Subsidiaries

FDIC regulations implement the financial subsidiary provisions of Gramm-Leach for state non-member banks. See 66 Fed. Reg. 1018 (Jan. 5, 2001) (final rule, 12 C.F.R. §§ 362.16 et seq.) (the "FDIC GLBA Regulation"). See also 65 Fed. Reg. 15526 (Mar. 23, 2000) (interim rule with solicitation of public comments) (the "FDIC Interim GLBA Rule"). See generally "Division of Supervision Implementation of [GLB] Act Provisions", FDIC Audit Report No. 02-025 (July 31, 2002).

A) The FDIC GLBA Regulation is substantially similar to the Comptroller GLBA Regulation and the Board GLBA Regulation.

B) The GLB Act does not supersede the FDIC's ability under FDIA § 24 to authorize non-member banks to engage in activities not permitted to a national bank. See Part I.D.4.b.i below. However, FDIA § 24 generally prohibits subsidiaries of FDIC-insured state banks from engaging in insurance underwriting.

C) Proposals to engage in financial activities will be reviewed under the FDIC GLBA Regulation, and not the FDIC's regulations pertaining to investments under FDIA § 24 (12 C.F.R. Part 362 ("Part 362" or the "FDIC Activities Regulations")).

(iv) Eligible Debt Requirement

The Eligible Debt Requirement applicable to national banks and state member banks that acquire or establish financial subsidiaries required that the bank, if it is among the 100 largest insured banks, have at least one issue of outstanding eligible debt that is rated in one of the three highest rating categories by an NRSRO.

A) The Board GLBA Regulation specifies alternative criteria that are available to the second 50 of the 100 largest insured banks. See also Comptroller Interpretive Letter No. 981 (Aug. 14, 2003), CCH Fed. Banking L. Rep. ¶ 81-507 (bank may use its investment grade-rated CD to meet the Eligible Debt Requirement).

B) Dodd-Frank, however, replaces the reference to credit ratings from an NRSRO with a reference to standards that Treasury and the Board develop, and eliminates the distinction for the second 50 of the 100 largest insured banks. These provisions became effective in 2012. See Part I.B.9.d above.

(v) Merchant Banking and Related Issues

A) A financial subsidiary's ability to control a mutual fund (whether as a general partner or through the provision of "seed capital" or other ownership of shares) is unclear, although it would appear to be subsumed within the GLB Act's authorization to engage in sponsorship, advisory and distribution activities respecting mutual fund shares.

B) Although national bank and state member bank financial subsidiaries have not received merchant banking authority under the GLB Act, nothing in the GLB Act affects adversely the ability of banks to make equity-participating loans and/or to accept warrants incident to the making of a loan or to the conduct of other banking activities. See Part VII below.

e. Failure to Continue Eligibility as a Financial Holding Company

Under BHCA § 4(m), an FHC that fails to continue to meet the capital and management eligibility requirements must correct such non-compliance within 180 days of notice thereof or divest either its bank or its expanded financial activities.

(i) Under the FHC Regulations:

A) Within 45 days (plus any additional time that the Board may grant) after receiving a notice of non-compliance from the Board, an FHC must execute an agreement to comply with applicable capital and management requirements.

B) Until the Board determines that all deficiencies have been corrected, an FHC may not engage in any additional activity or acquire control or shares of any company as authorized by Gramm-Leach (BHCA § 4(k)) without prior Board approval.

(ii) As of September 15, 2016, approximately 457 FHCs have been decertified, in most cases voluntarily.

(iii) If an FHC fails to meet CRA eligibility requirements (i.e., if an insured depository institution controlled by the FHC receives a CRA rating of less than "satisfactory"), it may not commence any additional activity or acquire control of a company under Gramm-Leach until each such insured depository institution has received at least a satisfactory CRA rating. There is no special cure period for failing to maintain CRA eligibility.

However, this prohibition does not prevent an FHC from (A) making additional investments as part of merchant banking, investment banking or insurance company investment activities if the FHC was lawfully engaged in such activity prior to the time that it fell into CRA non-compliance, or (B) making acquisitions or engaging in activities that meet the BHCA § 4(c)(8) "closely related to banking" standard. (However, an FHC that seeks to engage in activities or make acquisitions pursuant to § 4(c)(8) must comply with applicable BHCA notice and approval requirements.)

(iv) A foreign bank that fails to continue to meet FHC eligibility requirements will be subject to notice and "cure" procedures similar to those applicable to U.S. FHCs, and, if it fails to correct non-compliance, will have to close its U.S. banking operations or divest its expanded financial activities.

In this regard, Dexia S.A.'s failure to notify the Board regarding its non-compliance with FHC standards led to a Board enforcement action. See Board Order of Assessment of a Civil Money Penalty, Jan. 14, 2002; Board Letters, Nov. 20, Aug. 30, 2001.

f. Non-qualifying Bank Holding Company

A BHC that does not qualify as an FHC may, upon compliance with applicable BHCA procedures and requirements, nonetheless engage in activities that were approved by the Board "by regulation or order" prior to enactment of Gramm-Leach, but may not engage in new financial activities permitted to an FHC.

(i) Financial activities of non-qualifying BHCs are essentially "frozen" to those permitted to a BHC prior to November 12, 1999. See Part I.C.1.c.iv above.

(ii) After Gramm-Leach's enactment, BHCA § 4(c)(8) no longer includes a "public benefit" requirement, nor a specific requirement that a BHC provide the Board with prior notice before acquiring a non-banking company. However, the Board has not to date amended Regulation Y in either respect.

g. Non-financial Powers

(i) Commercial Activities/Investments

The GLB Act does not include any general "basket" authority for commercial activities/investments (other than the 15% basket for non-financial activities of an acquired subsidiary that is "substantially engaged" in financial activities). See Part I.C.1.c.x above.

(ii) Investments Under Bank Holding Company Act Section 2(h)

Gramm-Leach does not change BHCA § 2(h)(2) for foreign banks (thus permitting investments in predominantly non-U.S. companies that meet certain requirements). See Part VII.A.6.c below.

(iii) Non-Bank Holding Company Grandfathering

Under BHCA §§ 4(n) and (o), a company that was not a BHC or a foreign bank on the date of enactment of Gramm-Leach but subsequently becomes an FHC (a "non-BHC") -- e.g., investment banking operations like Goldman Sachs and Morgan Stanley -- may continue activities and investments engaged in on September 30, 1999 if it is "predominantly engaged in financial activities" (i.e., its consolidated gross revenues from financial activities (not including "complementary" activities) represent at least 85% of its consolidated gross revenues, excluding revenues from subsidiary depository institutions).

A) A non-BHC's grandfathered activities cannot be expanded through acquisition and cannot exceed 15% of consolidated revenues (excluding revenues from subsidiary depository institutions).

B) In general, grandfathering sunset 10 years after Gramm-Leach's enactment; however, if a non-BHC was engaged in activities related to the trading, sale or investment in commodities and physical properties that were not permissible for BHCs as of September 30, 1997, grandfathering of such activities is permanent, for up to 5% of the total consolidated assets of the non-BHC (or such higher percentage as the Board considers appropriate), subject to cross-marketing restrictions.

C) The Section 620 Report includes a recommendation by the Board that Congress repeal BHCA § 4(o) and thereby eliminate the grandfather rights of Goldman Sachs and Morgan Stanley.

h. State Regulation and Preemption Issues

(i) Gramm-Leach §§ 104 and 301 reaffirm the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-15 ("McCarran-Ferguson") -- which preserves to the states the primary regulation of insurance. See Part I.C.3 below.

A) While Gramm-Leach preserves the requirement that no person may engage in the business of insurance in a state as principal or agent unless such person is licensed as required by state law, states may not prevent or significantly interfere with the activities of depository institutions or their affiliates with respect to insurance sales, solicitation and cross-marketing.

B) GLB Act § 104 establishes rules as to federal preemption of state laws, including state insurance laws. The Comptroller has made federal preemption determinations with respect to laws of two states -- Massachusetts and West Virginia -- relating to insurance sales practices. See, e.g., (1) 67 Fed. Reg. 13405 (Mar. 22, 2002) (Mass. law), 65 Fed. Reg. 43827 (July 14, 2000) (solicitation of public comments); see also Mass. Bankers Assoc. v. Bowler, 392 F. Supp. 2d 24 (D. Mass. 2005) (preemption of Mass. restrictions on the right to sell, solicit and cross-market insurance products); Bowler vs. Hawke, 320 F.3d 59 (1st Cir. 2003) (dismissal of suit by Mass. Commissioner of Insurance relating to federal preemption on grounds that there was no justiciable "regulatory conflict"); and (2) 66 Fed. Reg. 51502 (Oct. 9, 2001) (W. Va. law), 65 Fed. Reg. 35420 (June 2, 2000) (solicitation of public comments); Independent Insurance Agents of America ["IIAA"] vs. Hawke, Civ. No. 02-2356 (D.D.C., May 25, 2004) (dismissal of suit relating to preemption of W. Va. statute); see also Cline vs. Hawke, 51 F. App'x 392 (4th Cir. 2002) (the Comptroller has authority to interpret Gramm-Leach and issue preemption decisions with regard to insurance regulation), cert. denied, 540 U.S. 813 (2003).

C) While generally supported by the banking industry, the Comptroller's preemption determinations generated substantial controversy. See generally CSBS Comment Letter, dated Apr. 26, 2004; Treasury Secretary O'Neill Letter to the Comptroller, dated June 13, 2002 (requesting the Comptroller's views on preemption standards) and Rep. Oxley Letter to Treasury Secretary O'Neill, dated Apr. 22, 2002 (contending that Comptroller preemption determination conflicts with Congressional intent); [Gramm-Leach] Preemption of State Insurance Laws Applicable to Banks (American Bankers Insurance Assoc. ("ABIA"), June 4, 2002).

See also Part I.C.3 and Part I.D.4 below.

(ii) Under GLB Act § 104, state regulation of activities other than insurance or securities activities is not prohibited, so long as such regulation does not discriminate against depository institutions or their affiliates or conflict with the intent of Gramm-Leach to permit affiliations.

(iii) Dodd-Frank Title X provides for preemption of state insurance laws on certain matters in the international insurance context and revises the system of federal preemption as it applies to national banks and their subsidiaries. See Part I.D.4 below.

i. Supervision of Financial Holding Companies and Bank Holding Companies

Gramm-Leach adheres to the dual principles of "umbrella supervision" by the Board and "functional regulation" (i.e., similar activities should be regulated by the same regulator, regardless of the nature of the entity in which the activities are conducted).

Dodd-Frank preserves these basic principles while expanding the Board's powers as umbrella supervisor.

(i) Federal Reserve Board Umbrella Supervision

The FHC Regulations affirm that the Board may, in the exercise of its supervisory authority, restrict or limit the commencement or conduct of activities or acquisitions by an FHC, or take other appropriate action, if the Board finds that the FHC does not have the requisite financial or managerial resources (including capital).

A) Charles Schwab ("Schwab"), 87 Fed. Res. Bull. 233 (2001) stated that, because a large majority of Schwab's activities were conducted in functionally regulated subsidiaries supervised by the SEC, the Board expected, "in carrying out its responsibilities as umbrella supervisor, to rely heavily on the SEC for examination and other supervisory information".

B) See also "Historical Review of 'Umbrella Supervision' by the [Board]", Federal Reserve Bank of Cleveland Working Paper 08-07 (Oct. 2008); "Framework for [FHC] Supervision", Board SR Letter 00-13 (SUP) (Aug. 15, 2000), CCH Fed. Banking L. Rep. ¶ 59-423.

(ii) Reports and Examinations

Under BHCA § 5(c), as amended by Gramm-Leach, the Board's authority to prescribe regulations, issue or seek orders, impose restrictions, require reports and conduct examinations was reduced, especially for functionally regulated subsidiaries (e.g., broker-dealers and companies engaged in commodities and insurance activities).

Consistent with its policy objectives, however, Dodd-Frank Title VI grants the Board enhanced authority to require reports from, and to examine, non-bank subsidiaries of BHCs.

A) In keeping with its role as an umbrella supervisor, the Board may require any holding company or subsidiary to submit reports regarding its financial condition, systems for monitoring and controlling financial and operating risks, transactions with depository institutions, and compliance with the BHCA and other federal laws that the Board has jurisdiction to enforce. The Board is directed to use existing examination reports prepared by other regulators, publicly reported information, and reports filed with other supervisory authorities to the extent possible.

Under Dodd-Frank, when the Board seeks information from a functionally regulated subsidiary that is not otherwise prepared for another regulator, the Board is not required to seek such information from such regulator, but may instead seek such information directly from the BHC or functionally regulated subsidiary.

B) The Board is also authorized to examine each holding company and its subsidiaries.

i) Under the GLBA, the Board was only permitted to examine a functionally regulated subsidiary under limited circumstances. The Board was directed, to the fullest extent possible, to make use of examinations by federal and state regulators.

ii) As amended by Dodd-Frank, however, the Board's examination authority was expanded to include not only the financial and operational risks of the holding company and its subsidiaries but also the risks within the holding company that may pose a threat to U.S. financial stability. With regard to functionally regulated subsidiaries, the Board is no longer required to have reasonable cause to believe that the subsidiary is engaged in activities that pose a material risk to an affiliate depository institution. While the Board is still directed, to the fullest extent possible, to rely on examinations by other federal and state regulators, it is no longer directed to rely on such examinations in lieu of examining a functionally regulated subsidiary, and is instead directed to coordinate with the functional regulator of such subsidiary and avoid duplication in examination, reporting, and requests for information to the extent possible.

iii) With regard to non-depository subsidiaries of a depository institution holding company (other than a functionally regulated subsidiary), Dodd-Frank directs the Board to examine the activities of such subsidiary that are permissible for a depository institution in the same manner as an examination would be carried out if such activities were conducted in the holding company's lead depository institution subsidiary.

(iii) Capital Requirements

Under GLB Act § 111 (BHCA § 5(c)(3)) the Board may not apply any capital standard to any functionally regulated subsidiary that is subject to (and meets) the capital requirements of another federal regulator or state insurance authority. In addition, the Board may not impose capital requirements on registered investment advisers or insurance agents.

A) In assessing BHC capital, the Board may not take into account the activities, operations or investments of an affiliated 1940 Act-registered investment company unless the investment company is either (1) a BHC, or (2) controlled by a BHC by reason of ownership by the BHC (including through its affiliates) of 25% or more of the shares of the investment company, and the shares owned by the BHC have a market value of more than $1 million.

B) Under the so-called "suck-out" provision of Gramm-Leach § 112 (BHCA § 5(g)), the Board is limited in its ability to require a BHC to act as a "source of strength" to its depository institution subsidiaries (i.e., to provide funds to support such a subsidiary) if the funds are to be provided by a regulated insurance company, broker-dealer, investment company or investment adviser. The regulator of the relevant entity essentially has a veto if it determines that action by the Board would have a material adverse effect on the financial condition of the entity. If the regulator exercises this veto, the Board may require the BHC to divest its depository institution subsidiary.

C) Gramm-Leach does not address (1) capital standards applicable to BHCs; or (2) how the Board is expected to take into account the capital standards applicable to functionally regulated subsidiaries in determining the capital of a BHC (i.e., on what basis the assets, capital and risks of a functionally regulated subsidiary are to be consolidated into the holding company, and what capital standards should be applied at the holding company level).

D) The FHC Regulations reserve the Board's authority to restrict activities or acquisitions of an FHC if the Board finds that the FHC lacks the financial or managerial strength to engage in new activities, make new acquisitions, or retain ownership of companies engaged in financial activities.

E) In the preambles to the Initial Merchant Banking Capital Proposal, the Merchant Banking Capital Proposal and the Merchant Banking Capital Rule, the Board stated that it expected to seek comments on a proposal to deconsolidate functionally regulated insurance underwriting companies from FHCs for purposes of applying the Board's consolidated capital rules. See Part I.C.1.b.i and Part I.C.1.c.vii.E above. Although the Board has not issued such a proposal for public comment, in the preamble to the 2001 Regulation K Revision the Board noted that, although FHCs "currently may consolidate their insurance companies for purposes of their capital ratios, for supervisory purposes their capital ratios also are analyzed after deconsolidation".

However, in their final rules implementing the Basel III Capital Framework, the agencies rejected commenters' requests to permit the deconsolidation of functionally regulated subsidiaries. Rather, the agencies' Basel III capital rules provide that banking organizations may not deconsolidate their insurance underwriting subsidiaries and also must deduct an amount equal to the regulatory capital requirement for insurance underwriting risks established by the regulator of any insurance underwriting activities of the consolidated company 50 percent from tier 1 capital and 50 percent from tier 2 capital. See 12 C.F.R. § 217.22(b)(3). See also 78 Fed. Reg. 62018, 62128 (Oct 11, 2013).

In June 2016, the Board released an Advance Notice of Proposed Rulemaking requesting comment on conceptual frameworks for consolidated capital standards that could apply to Board-supervised entities that are significantly engaged in insurance activities. 81 Fed. Reg. 38610 (June 14, 2016). See also Part I.B.5.

F) Dodd-Frank includes several provisions relating to BHC capital requirements. See also Part I.B above.

i) Title I provides for heightened prudential and capital standards for all BHCs with total assets of $50 billion or more, and provides the Board with authority to distinguish between BHCs on the basis of their perceived riskiness, complexity, activities, size and other factors. In establishing such standards with respect to foreign non-bank financial companies or foreign-based BHCs, the Board is directed to take into account the principle of national treatment and equality of competitive opportunity, and the extent to which an institution is subject to comparable home country standards.

ii) The Collins Amendment discussed in Part I.B.1.c above sets floors for the risk-based and leverage capital levels of depository institution holding companies (and Non-bank SIFIs).

iii) Dodd-Frank provides that, in establishing capital requirements, the Board should seek to make such requirements countercyclical (i.e., that the amount of capital required increases in times of economic expansion and decreases in times of economic contraction).

iv) Dodd-Frank amends the FDIA to include a statutory source-of-strength doctrine under which a BHC is required to serve as a source of financial strength to its depository institution subsidiaries. As adopted in Dodd-Frank, the doctrine applies to all companies controlling IDIs (i.e., not just BHCs).

(iv) Regulations and Related Requirements

A) Dodd-Frank repealed BHCA § 10A, under which the Board may not promulgate rules, adopt restrictions or impose other requirements affecting a functionally regulated subsidiary unless the action is necessary to address a "material risk" to the safety and soundness of an affiliated depository institution or the domestic or international payments system.

B) A Board rule (the "Prudential Safeguards Regulation") provides that two of the Operating Standards imposed on Section 20 Subsidiaries -- (1) intra-day extensions of credit by a bank or thrift, or U.S. branch of a foreign bank, to a securities affiliate engaged in securities underwriting, dealing or market-making must be on market terms consistent with Section 23B; and (2) extensions of credit and purchases of securities (and, presumably, other financial assets) by a foreign bank's U.S. branches to or from an FHC securities affiliate are subject to the requirements of Sections 23A/23B -- apply to the relationships between depository institutions and their FHC securities affiliates. See 12 C.F.R. § 225.4(g); 65 Fed. Reg. 14440 (Mar. 17, 2000) (interim rule with solicitation of public comments). See also Part III.A.5 below.

C) In the Preamble to the Prudential Safeguards Regulation, the Board noted that it was not imposing customer disclosure requirements, although it expects FHCs to ensure that customers are not confused about the nature of investment products that they are purchasing.

(v) Acquisitions of Depository Institutions

The GLB Act does not affect Board jurisdiction over applications to acquire control of depository institutions.

A) Board staff takes the view that U.S. FHCs may not acquire non-U.S. banks under the authority of BHCA § 4(k), but must instead rely on Regulation K.

B) Acquisitions of depository institutions and non-bank companies could, under some circumstances, require compliance with both the BHCA and Hart-Scott insofar as prior approvals and antitrust review is concerned. See generally Part I.C.1.c.xi above and Part XII.D below.

(vi) Foreign Bank Supervision

Gramm-Leach does not reduce the Board's examination authority under the IBA, does not give deference to home country supervisory reports, and grants the Board examination authority over foreign bank affiliates that conduct business in the U.S.

(vii) FDIC Back-up Examination Authority

Dodd-Frank Article II provides the FDIC with back-up examination authority over BHCs with $50 billion or more in total assets (as well as non-bank financial companies supervised by the Board) in connection with the FDIC's implementation of OLA.

j. Prudential Safeguards

Gramm-Leach authorizes federal banking regulators to impose restrictions on transactions between depository institutions and their non-bank subsidiaries and affiliates.

(i) Cross-marketing

Cross-marketing restrictions apply between a depository institution subsidiary of an FHC and any portfolio company whose shares are held under Gramm-Leach's merchant banking or insurance company investment provisions. Cross-marketing restrictions also apply between a depository institution and any company owned or controlled under the GLB Act non-BHC grandfathering authority. See BHCA §§ 4(n)(5), 4(o)(3). See also Part VII.A below.

A) Cross-marketing restrictions do not prohibit an arrangement between a depository institution and a portfolio company held under Gramm-Leach's merchant banking authority or insurance company investment provisions for the marketing of products or services through statement inserts or Internet websites.

B) Although cross-marketing restrictions apply between a depository institution controlled by a non-BHC and any affiliate owned or controlled by such non-BHC under the non-BHC grandfathering authority, such restrictions do not apply between such non-BHC and merchant banking or insurance company investments.

(ii) Risk Management

An FHC must have procedures to monitor and control financial and operational risks and insulate insured depository institutions from affiliate risks. See BHCA § 5(c).

(iii) Sections 23A/23B

Under GLB Act §§ 103, 121 and 738:

A) Depository institutions (including insured branches of foreign banks) are prohibited from engaging in any "covered transactions" under Section 23A with any portfolio company affiliate owned or controlled under Gramm-Leach's non-BHC grandfathering provisions. See Part I.C.1.g.iii above.

B) In addition to the amendments to Section 23A relating to financial subsidiaries (see Part I.C.1.d above), and to merchant banking portfolio companies (see Part VII below), Gramm-Leach required the Board to adopt rules under Section 23A to address as "covered transactions" credit exposure arising out of derivative transactions between banks and their affiliates, as well as intra-day extensions of credit by banks to their affiliates.

Dodd-Frank provides that such credit exposures are to be treated as covered transactions that are subject to the quantitative and qualitative limits of Section 23A.

C) Gramm-Leach liberalizes Section 23B to permit a majority of a bank's entire board of directors (as opposed to a majority of a bank's independent directors) to authorize the purchase by a bank of securities from an affiliate where the bank acts as an underwriter of the securities. (Such purchases would also be subject to Section 23A.)

D) For a discussion of Sections 23A/23B and related Board rulemakings, see Part III.A.5 below.

k. Mandatory Subordinated Debt

GLB Act § 108 mandated a Board/Treasury study of possible mandatory subordinated debt requirements for large banks and BHCs. See The Feasibility and Desirability of Mandatory Subordinated Debt (Dec. 2000). See generally Markets for Bank Subordinated Debt and Equity in [Basel] Member Countries (Basel, Aug. 2003). See also Part II.A below.

2. Functional Regulation /"Investment Bank Holding Companies"

    a. The GLBA Push-out Provisions (i) amended the 1934 Act so as to narrow the "bank" exemption from the definition of "broker" and "dealer", (ii) set up a regime for determining the circumstances under which banks may engage in transactions in Identified Banking Products and Hybrid Products (as discussed in Part II below), (iii) subject a bank (or a "separately identifiable department or division") that advises a registered investment company to Advisers Act registration, and (iv) narrowed the 1940 Act exemption for bank common trust funds. See Part II.D.3.b, Part VII and Part IX below.

    b. GLB Act § 231 (1934 Act § 17(a)) provided for the creation of IBHCs -- entities which are not affiliated with a U.S. or foreign bank but which elect to become supervised by the SEC. Dodd-Frank repealed the GLBA IBHC provisions, which had little practical significance.

    c. Dodd-Frank Article I establishes a framework for the supervision of Non-bank SIFIs designated by the FSOC similar to the prudential supervisory framework applicable to BHCs, but without the activity limits of BHCA § 4 or the Volcker Rule. However, such firms are subject to the Dodd-Frank limit on acquisitions in which the liabilities of the resulting firm may not constitute more than 10% of the aggregate consolidated liabilities of all financial companies, and such a firm must obtain prior Board approval for acquisitions of certain financial companies with $10 billion or more in total assets. See also Part I.B.1 above.

3. Insurance

    a. General

        (i) Gramm-Leach § 301 reaffirms that states are the principal regulators for insurance activities. States supervise a large and diverse industry, with over 4,300 domestic property/casualty and life/health insurers operating in the U.S. and $5 trillion in total assets. In 2014, 655 BHCs were engaged in insurance activities, generating over $9 billion in insurance fee income. See, e.g., Insurance Fact Book (Insurance Information Institute, 2016).

(ii) Dodd-Frank Title V established the FIO, which will monitor the insurance industry, and the regulatory framework for insurance activities remains under review. See Part I.B.5 above. See also Part I.D.4.d below.

(iii) In April 2015, the IMF published a review of the U.S. insurance regulatory system as part of the IMF's Financial Sector Assessment Program. See Financial Sector Assessment Program: Detailed Assessment of Observance of Insurance Core Principles (IMF, Apr. 2015).

b. Bank Underwriting of Insurance

Under Gramm-Leach §§ 302 and 303, national banks and their subsidiaries are prohibited from underwriting insurance, except for products authorized by the Comptroller as of January 1, 1999 (but not including title insurance (unless state law would permit state banks to do so) or annuities). See, e.g., Comptroller Interpretive Letter No. 886 (Mar. 27, 2000), CCH Fed. Banking L. Rep. ¶ 81-405 (permitting a subsidiary to continue to underwrite credit-related insurance because such activity was authorized prior to January 1, 1999).

c. Reinsurance

Gramm-Leach § 302 clarifies that providing insurance (including reinsurance) outside of the U.S. to indemnify an insurance product or company in a state will be deemed provision of insurance as principal.

d. Conflict Resolution

Gramm-Leach § 304 establishes an expedited and equalized ("without unequal deference") dispute resolution mechanism to guide the courts in deciding conflicts between federal and state regulators regarding insurance issues (the so-called "jump ball provision").

(i) While one reading of the jump ball provision could be that state views about the proper classification of a product as insurance or banking should be weighed equally with those of the Comptroller, the Comptroller can be expected to argue that courts should defer to state interpretations in matters that arise under state law and to Comptroller interpretations in matters that arise under federal law, with the result that, since insurance-banking disputes typically arise in challenges under the NBA, courts should continue to defer to the Comptroller's construction of that statute.

(ii) With respect to certain requests for Comptroller preemption determinations, see Part I.C.1.h above; with respect to bank-permissible insurance-related activities, see Part I.D.4.d below.

e. Consumer Protection Regulations

As required by GLB Act § 305, the federal banking agencies adopted consumer protection regulations to provide additional safeguards for the sale of insurance by any depository institution. See 65 Fed. Reg. 75822 (Dec. 4, 2000) (12 C.F.R. §§ 14.10 et seq. (Comptroller), 208.81 et seq. (Board), 343.10 et seq. (FDIC) (the "Insurance Consumer Protection Rules").

The Insurance Consumer Protection Rules address:

(i) Tying -- Tying and coercive practices are prohibited.

(ii) Disclosures -- Customers must be informed that insurance products are not FDIC-insured and may carry investment risk.

(iii) Customer Acknowledgment -- Sales personnel must obtain the consumer's acknowledgment that disclosures were given.

(iv) Setting -- Insurance sales activities must be separated from teller windows.

(v) Referrals -- Tellers may refer customers to insurance sales personnel, and may receive a one-time, nominal fee for such referrals, as long as the fee is not linked to a sale.

(vi) Domestic Violence -- A customer's status as a victim of domestic violence may not be used as a criterion in the underwriting, pricing, renewal, scope of coverage or payment of claims related to insurance.

See also Board/Comptroller/FDIC/OTS Press Release, Feb. 28, 2003 (disclosure requirements of GLB Act § 305 do not apply to renewals of insurance products sold prior to Oct. 1, 2001); Board/Comptroller/FDIC/OTS Letter to ABA/ABIA, Aug. 17, 2001 (responding to questions in ABA/ABIA Letter, Apr. 3, 2001, relating to the Insurance Consumer Protection Rules).

The Treasury Inspector General issued a Report critical of the Comptroller's preparedness to supervise national bank insurance activities under Gramm-Leach. See [Comptroller] Supervision of Banks Selling Insurance (June 27, 2000). Comptroller Hawke countered that this Report relied on dated fieldwork, an earlier legal framework for insurance activities, and irrelevant past supervisory initiatives. See Comptroller Letter to the Assistant Inspector General for Audit, Apr. 20, 2000. See also Testimony of Comptroller Chief Counsel Williams before Subcommittee of House Commerce Committee, July 20, 2000 (discussing Comptroller implementation of Gramm-Leach through supervisory policies developed with state insurance regulators).

f. State Law Preemption

(i) Gramm-Leach § 306 preempts state laws which (A) prevent or significantly interfere with the ability of insurers to affiliate, become FHCs or demutualize; or (B) limit the investment of an insurer's assets in a depository institution.

(ii) Dodd-Frank does not significantly alter the primacy of state law over the insurance industry, but Title V does provide for preemption of state law in connection with (A) certain internationally related matters, and (B) establishing which state law governs certain matters involving non-admitted insurance.

g. Supervisory Coordination

(i) Gramm-Leach § 307 directs federal banking agencies and state insurance regulators to coordinate efforts to supervise companies that control both depository institutions and insurance companies, and to share information. See generally, e.g., FDIC Staff Memorandum: Proposed Information Sharing and Confidentiality Agreement with State Departments of Insurance (2001).

(ii) The National Association of Insurance Commissioners ("NAIC") has endorsed a Model MOU designed to facilitate information-sharing between U.S. and European insurance supervisors. See NAIC News Release, Mar. 21, 2006; Roadmap for a Common Structure and Common Standards for the Assessment of Insurer Solvency (IAIS, Feb. 16, 2006).

The U.S. and EU have begun bilateral negotiations to reach a covered agreement that could align collateral requirements, enabling access across insurance and reinsurance markets. U.S. federal negotiations for such a covered agreement were authorized by the Dodd-Frank Act to streamline some state insurance rules. Treasury Press Release, July 28, 2016; Law360, Feb. 24, 2016; NAIC Press Release, Nov. 20, 2015. See also Part I.B.5 above.

(iii) The IAIS has proposed a "common framework" for supervision of internationally active insurers, which would include a risk-based global capital standard. See Public Consultation Document: Risk-based Global Insurance Capital Standard (IAIS, July 19, 2016);

[GSIIs] Updated Assessment Methodology (IAIS, June 16, 2016); Capital Requirements for [GSIIs]. Basic Capital Requirements (BCR) and Higher Loss Absorbency (HLA) (IAIS, Oct. 5, 2015); Common Framework for the Supervision of Internationally Active Insurance Groups: Revised Draft (IAIS, Sept. 2014). See also U.S. Insurance Regulators' Views: IAIS Common Framework for the Supervision of Internationally Active Insurance Groups "ComFrame" (NAIC, Apr. 2015). Several states, including Florida, Connecticut and California, have joined IAIS's Multilateral Memorandum of Understanding promoting international cooperation and information sharing among insurance supervisors. IAIS Press Release, Nov. 10, 2015.

(iv) Under Dodd-Frank Article V, the FIO is responsible for monitoring the insurance industry and for recommending to the FSOC that it designate an insurer, including its affiliates, as a Non-bank SIFI.

See generally, e.g., White Paper on High-level Corporate Governance Principles for Use in U.S. Insurance Regulation (NAIC, June 2011).

See also Part I.C.3.i below.

h. Redomestication of Mutual Insurers

Gramm-Leach § 312 allows mutual insurance companies to redomesticate to another state and reorganize into a mutual holding company or stock company facilitating the conversion of mutual insurance companies into stock form.

i. Multistate Licensing Reform and Prospects of a Federal Insurance Charter

(i) Gramm-Leach § 321 required that unless at least a majority of the states enacted uniform or reciprocal laws and regulations governing licensing of insurance agents by November 11, 2002, a National Association of

Registered Agents and Brokers would be established to provide a mechanism through which uniform licensing, appointment, continuing education and other sales qualifications requirements can be adopted on a multistate basis.

In its News Release, Sept. 10, 2002, the NAIC recommended that 35 states be certified as meeting the Gramm-Leach reciprocity requirement.

(ii) With respect to the possibility of an optional federal insurance charter:

A) While supportive of Dodd-Frank's establishment of the FIO, a broad coalition, including the American Council of Life Insurers ("ACLI"), the American Insurance Association (the "AIA") and the ABIA, continues to back proposals for an optional federal insurance charter.

B) The Alliance of American Insurers ("AAI"), the National Association of Mutual Insurance Companies ("NAMIC") and the National Association of Independent Insurers have opposed federal charter proposals.

See also Part I.B.5 above.

(iii) In Definitions of Insurance and Related Information (Feb. 23, 2006), the GAO reported on issues relating to a universal definition of "insurance", including (A) elements that are commonly part of definitions of "insurance"; (B) products that are not universally defined as "insurance"; (C) regulatory implications of separate definitions; (D) statutory/accounting developments in measuring risk transfer in reinsurance contracts; and (E) "finite risk contracts" (which involve interaction between insurers and reinsurers).

(iv) With respect to insurance licensing initiatives, charter issues, and FHC involvement in insurance activities, see generally, e.g., Interstate Insurance Product Regulation Commission ("IIPRC") website at www.insurancecompact.org (as of June 13, 2016, 44 states and Puerto Rico have joined the Interstate Insurance Product Regulation Compact); NAIC Update: Spring 2016 (Deloitte, 2016); Financial Sector Assessment Program: Detailed Assessment of Observance of Insurance Core Principles (IMF, Apr. 2015); Annual Report (IIPRC, 2015); Insurance Regulation: Issues, Background and Legislation in the 114th Congress (CRS, Sept. 16, 2015); Self-Assessment of Observance with Insurance Core Principles (FIO/NAIC/Board, Aug. 2014); Interstate Compact Survey Report (Milliman Research, Nov. 2011); Financial Sector Assessment Program: NAIC Self-assessment (Aug. 26, 2009); Impact of the Abolition of McCarran-Ferguson Antitrust Exemption for the "Business of Insurance" (CRS, Feb 4, 2009); Financial Oversight Failure Highlights Effectiveness of Insurance Regulation (NAMIC, Jan. 2009); The Effects of an Optional Federal Charter on Competition in the Life Insurance Industry (ACLI, 2007); Modernizing Insurance Regulation: Optional Federal Charter Regulation (CRS, Dec. 14, 2007); NAIC Producer Licensing Model Act, Sept. 14, 2003 (joint resolution of National Conference of State Legislatures ("NCSL"), National Conference of Insurance Legislators and NAIC to maintain regulatory authority at the state level); Principles for Federal Insurance Regulation (Financial Services Coordinating Council, 2002); Framework for Insurance Holding Company Analysis (NAIC, Dec. 11, 2001).

4. Foreign Bank Offices

a. Interstate Branches

(i) Gramm-Leach § 732 amends the IBA to allow a foreign bank to upgrade limited branches and agencies outside its home state to full branches, subject to minimum age requirements, if authorized by the relevant state (and the Comptroller, as appropriate) and the Board.

(ii) Dodd-Frank's expanded authority for de novo interstate branching should facilitate foreign banks' establishment of full branches in multiple states. See IBA § 5(a)(7) and DFA § 613.

b. Representative Offices

Gramm-Leach § 142 imposes a Board prior approval requirement for the establishment of representative offices which are subsidiaries of foreign banks. The 2001 Regulation K Revision clarifies that existing subsidiaries and affiliates engaged in representative functions would be "grandfathered" and not required to be "re-established" as representative offices.

5. Privacy

a. General

Title V of Gramm-Leach ("GLBA Title V") -- GLB Act §§ 501-527 -- relates to the privacy of non-public personal information of "consumers" and "customers" of a financial institution.

See generally Tortoriello, "Securities Activities of Banks in the [Gramm-Leach] Era: Privacy Issues" (SIA Compliance and Legal Division Annual Seminar, Mar. 12, 2002).

b. Scope

GLBA Title V applies to all "financial institutions", a term defined to include all entities engaged in activities permissible for FHCs under BHCA § 4(k). This includes banks and many non-bank financial service providers.

(i) Dodd-Frank transferred most rulemaking authority for the GLB Act's privacy provisions to the CFPB, and vested primary enforcement authority over insured depository institutions whose assets exceed $10 billion in the CFPB. See 12 C.F.R. Part 1016 ("Regulation P"); 76 Fed. Reg. 79025 (Dec. 21, 2011). See also, e.g., 79 Fed Reg. 30708 (May 29, 2014) (repeal of the Board's "Regulation P", formerly 12 C.F.R. Part 216). The remaining enforcement authority under GLBA Title V is vested in:

A) The Board, for state member banks, state branches and agencies of foreign banks, CLCs, Edge Act and Agreement corporations and BHCs and their non-bank subsidiaries or affiliates (other than broker-dealers, insurers, investment companies and investment advisers).

B) The Comptroller, for national banks, FDIC-insured federally-chartered thrifts and federal branches and agencies of foreign banks. See, e.g., Comptroller's Handbook: Privacy of Consumer Financial Information; OCC Press Release NR 2003-27 (Apr. 7, 2003) (attaching Stipulation and Consent Orders relating to compromise of confidential customer information); Comptroller Bulletin No. 2000-25 (Sept. 8, 2000), CCH Fed. Banking L. Rep. ¶ 67-651 (privacy laws and regulations).

C) The FDIC, for state non-member banks, FDIC-insured state-chartered thrifts and FDIC-insured state branches of foreign banks. See, e.g., FDIC Privacy Rule Handbook.

D) The NCUA, for federally insured credit unions.

E) The SEC, for broker-dealers, 1940 Act-investment companies and investment advisers regulated under the Advisers Act. See 17 C.F.R. Part 248 ("Regulation S-P"); SEC Letter and Staff Responses to ICI Questions about Regulation S-P, June 14, Apr. 9, 2001; Certified Financial Planner Board of Standards [("CFPBS")] (avail. Mar. 11, 2011) (SEC no-action relief permitting broker-dealers or investment advisers to provide copies of customer complaints and related documentation to the CFPBS in connection with its certification process); LPL Financial Corp., SEC Admin. Proc. No. 3-13181 (Sept. 11, 2008) (insufficient security controls); NEXT Financial Group, SEC Admin. Proc. No. 3-12738 (July 21, 2008) (failure to tell customers that departing employees were allowed to share non-public personal customer information); UNCI, SEC Litigation Release No. 20386 (Dec. 6, 2007) (alleged violation of Regulation S-P through sale of customer information to insurance agents as "sales leads"); ICI (avail. Aug. 21, 2007) (funds may not market using shareholder identity and trading information received from intermediaries).

F) State insurance authorities, for insurance providers. See generally NAIC Preliminary Report on the Status of Insurance Industry Procedures to Protect the Privacy of Customer Information (Sept. 2005) and Report on Improving Privacy Notices (Mar. 10, 2003).

G) The CFTC (under CEA § 5g) for FCMs, CTAs, CPOs (and hedge funds operated by CPOs) and IBs subject to CFTC jurisdiction. See 17 C.F.R. Part 160 (the "CFTC Privacy Rules"). See also, e.g., CFTC Staff Advisory No. 14-21, CCH Comm. Fut. L. Rep. ¶ 32,980 (Feb. 26, 2014) ([GLBA] Security Safeguards); Financial Privacy Requirements -- What Futures Industry Intermediaries Need to Know (CFTC, Feb. 7, 2002).

The CFTC Privacy Rules were amended in 2011 pursuant to Dodd-Frank, to apply to "swap dealers" and "major swap participants" ("MSPs"). See 76 Fed. Reg. 43874 (July 22, 2011). See also Part II.E below.

H) The FTC, for all other institutions subject to GLBA Title V. See 16 C.F.R. Part 313 (the "FTC Privacy Rules"). See also FTC "Financial Institutions and

Customer Data: Complying with the Safeguards Rule" (Oct. 2002). See generally Individual Reference Services Group v. FTC, 145 F. Supp. 2d 6 (D.D.C. 2001) (upholding FTC Privacy Rules).

(ii) The Federal Financial Institutions Examination Council (the "FFIEC") developed interagency examination procedures regarding privacy of consumer financial information. See Board SR Letter 01-15 (SUP) (May 31, 2001) ("Board SR Letter 01-15"), CCH Fed. Banking L. Rep. ¶ 67-515; Comptroller Bulletin No. 2001-26 (May 25, 2001), CCH Fed. Banking L. Rep. ¶ 67-660. These examinations procedures were most recently revised in 2016. See, e.g., Board Consumer Affairs ("CA") Letter 16-3 (June 8, 2016) (revised interagency examination procedures for Regulation P).

See generally Personal Information: Key Federal Privacy Laws Do Not Require Information Resellers to Safeguard All Sensitive Data (GAO, June 2006); Privacy: Key Challenges Facing Federal Agencies (GAO, May 2006); Star Systems, Financial Privacy: Beyond Title V of [the GLB Act], Nov. 2001.

(iii) The term "financial institution" to which GLBA Title V applies indisputably covers each of the entities mentioned in Part I.C.5.b.i above. However, a number of other institutions may need to comply with privacy regulations under certain circumstances.

A) To the extent that the Board approves broad e-commerce or other activities as complementary FHC activities (see Part I.C.1.c above), additional companies could become "financial institutions" for purposes of GLBA Title V.

B) Questions have been raised as to whether a hedge fund or other investment vehicle that is not subject to SEC regulation under the 1940 Act is a "financial institution" (and, if so, whether investors are "customers" of the fund). The SEC has said that Regulation S-P does not apply to such hedge funds. (See SEC Staff Letter, June 14, 2001.) Moreover, from the FTC perspective, of the various activities in which financial institutions engage, none clearly applies to an investment fund, and it is not clear that a fund investor should be viewed as a "customer" of the fund (on the theory that the investor is an equity or debt owner, not the recipient of a service).

C) A provider of trust services should not have to provide privacy notices because a trustee has a relationship with a trust, which is not an individual. In addition, grantors and beneficiaries are not generally considered "customers" of the trustee.

D) Since tax planning is an activity that the Board had determined in 12 C.F.R. § 225.28(b)(6) to be "closely related to banking" under BHCA § 4(c)(8) (and, therefore, permissible for BHCs and FHCs under BHCA § 4(k)(4)(F)), law firms that provide tax advice to individual clients are potentially subject to the FTC Privacy Rules.

American Bar Association ("Am. Bar Assoc.") v. FTC and NY State Bar Association ("NYSBA") v. FTC, CCH Trade Cases ¶ 74,383 (D.D.C. 2004), aff'd, 430 F.3d 457 (D.C. Cir. 2005), found that Congress did not intend that Title V apply to lawyers generally.

E) Trans Union, a credit reporting agency, unsuccessfully challenged the applicability of the GLB Act's privacy provisions to credit reporting agencies. See Trans Union v. FTC, 295 F.3d 42 (D.C. Cir. 2002).

F) Under Relief Act § 609, certified public accountants are not subject to privacy policy disclosure requirements.

(iv) Other related federal sources of privacy protection include:

A) The Right to Financial Privacy Act ("RFPA"), 15 U.S.C. § 1602 et seq., which applies to banks and relates to the disclosure to the U.S. government of customer records. With some exceptions, it requires the government to disclose the request to the customer. See, e.g., CFTC v. Worth Bullion Group, 717 F.3d 545 (7th Cir. 2013) (holding that precious metal dealers that regularly provide financing for customers to purchase their products are not "financial institutions" under the RFPA).

B) The FCRA, 15 U.S.C. § 1681 et seq., which relates to the use of information regarding consumers collected by a "credit reporting agency" (i.e., an entity that regularly sells information bearing on a consumer's creditworthiness (a "consumer report") to third parties). Banks generally tailor their practices to avoid being characterized as a credit reporting agency. See generally Forty Years of Experience with the [FCRA] (FTC, July 2011).

i) Federal regulators have adopted rules to implement the affiliate marketing provision of the Fair and Accurate Credit Transactions Act of 2003 (the "FACT Act"), 15 U.S.C. §§ 1601 et seq., which generally prohibits a person from using information received from an affiliate to make a solicitation for marketing purposes unless the customer has an opportunity to opt out. See 12 C.F.R. Part 1022, Subpart C (CFPB affiliate marketing rule); SEC Release No. 34-60423 (Aug. 4, 2009) (Regulation S-AM, 17 C.F.R. Part 248); Interagency Final Rules: Fair Credit Reporting Affiliate Marketing Regulations, 72 Fed. Reg. 62910 (Nov. 7, 2007); 72 Fed. Reg. 61424 (Oct. 30, 2007) (FTC affiliate marketing rule). See also Part I.C.5.c.viii below.

Federal regulators have also adopted rules regarding the accuracy of information in consumer reports. See Interagency Rule: Procedures to Enhance the Accuracy and Integrity of Information Furnished to Consumer Reporting Agencies Under Section 312 of the [FACT Act], 74 Fed. Reg. 31484 (July 1, 2009). See also Board CA Letter 10-5 (Mar. 29, 2010) CCH Fed. Banking L. Rep. ¶ 64-660 (Interagency Examination Procedures Regarding the Duties of Furnishers of Information); Proposed Guidelines for Furnishers of Information to Consumer Reporting Agencies, 74 Fed. Reg. 31529 (July 1, 2009) (solicitation of public comments).

Regulators have also adopted rules regarding identify theft in connection with the use of customer information. Interagency Joint Final Rules: Identity Theft Red Flags and Address Discrepancies Under the [FACT Act], 72 Fed. Reg. 63718 (Nov. 9, 2007). The Am. Bar Assoc. sued the FTC to enjoin enforcement of the rule against attorneys, and the FTC appealed the District's Court's ruling in favor of the Assoc. See Am. Bar Assoc. v. FTC, 671 F. Supp. 2d 64 (D.D.C. 2009). Am. Bar Assoc. v. FTC, 636 F.3d 641 (D.C. Cir. 2011), ruled that the case challenging FTC rules applying identity theft prevention program to lawyers was moot in light of the Red Flag Program Clarification Act, Pub. L. 111-139 (2010).

See generally 69 Fed. Reg. 69776 (Nov. 30, 2004) (summaries of identity theft and consumer rights under the FCRA and of the duties of users of information obtained from credit reporting agencies); Part IX.F.2 below.

c. Privacy Requirement

(i) Under GLBA Title V, each financial institution has an obligation to respect the privacy of its "customers" (essentially, individuals (not business organizations) who obtain financial products primarily for personal, family or household purposes), to protect the security and confidentiality of non-public personal information -- a term defined in the GLB Act to include "personally identifiable financial information" and to exclude "publicly available information" -- and to disclose to customers its policies with respect to the disclosure of non-public personal information to affiliates and non-affiliated third parties.

(ii) GLBA Title V imposes three basic requirements:

A) A financial institution must provide an initial notice to customers about its privacy policies, describing the conditions under which it may disclose non-public personal information to affiliated and non-affiliated third parties, and must provide this notice before disclosing the information to non-affiliated third parties.

B) A financial institution must provide annual notices of its privacy policies to consumers with whom it establishes a customer relationship, subject to certain exceptions introduced by Section 75001 of the Fixing America's Surface Transportation Act of 2015 (the "FAST Act"), Pub. L 114-94 (2015). See Board CA Letter 16-3 (June 8, 2016) (revised interagency examination procedures for Regulation P)

C) A financial institution must provide a method for consumers to opt out of disclosures to non-affiliated third parties (so-called "opt-out rights"). GLBA opt-out rights do not apply to information-sharing among affiliates, although the FACT Act's provisions requiring an opt-out notice when information from an affiliate is used for marketing solicitations continue to apply. See Part I.C.5.b.iv above.

(iii) A financial institution may not, directly or through any affiliate, disclose to a non-affiliated third party any non-public personal information, unless (A) such financial institution provides notice to the consumer that makes a "clear and conspicuous" disclosure that such information may be disclosed to such third party; (B) the consumer is given the opportunity, before disclosure, to exercise opt-out rights and direct that such information not be disclosed; and (C) the consumer is given an explanation of how to exercise opt-out rights.

(iv) A financial institution may provide non-public personal information to (A) a non-affiliated third party to perform services or functions on behalf of the financial institution (e.g., marketing); or (B) another financial institution subject to the privacy provisions of the GLB Act in connection with financial products or services being offered jointly, in each case if the financial institution discloses that it provides such information to third parties and requires the third party to maintain the confidentiality of such information.

GLBA Title V exempts a financial institution from many of its requirements when the institution discloses personal information:

A) As necessary to effect, administer or enforce a transaction that a consumer requests or authorizes.

B) In connection with (1) servicing or processing a financial product or service that a consumer requests or authorizes; (2) maintaining or servicing the consumer's account; or (3) a proposed or actual securitization, secondary market sale or similar transaction.

C) With the consent or at the direction of the consumer.

D) To protect the confidentiality or security of the institution's records pertaining to the consumer, service, product or transaction.

E) To protect against or prevent fraud, unauthorized transactions, claims or other liability.

F) For institutional risk control or for resolving consumer disputes or inquiries.

G) To persons holding a legal or beneficial interest relating to the consumer.

H) To persons acting in a fiduciary or representative capacity on behalf of the consumer.

I) To provide information to insurance rate advisory organizations, guaranty funds, agencies that are rating the institution, persons that are assessing its compliance with industry standards, attorneys, accountants and auditors.

J) To the extent specifically permitted or required under other provisions of law, to law enforcement agencies or self-regulatory organizations.

K) To a consumer reporting agency.

L) From a consumer report reported by a consumer reporting agency.

M) In connection with a proposed or actual sale or merger of all or a portion of a business or operating unit if the disclosure of personal information concerns solely consumers of such business or unit.

N) To comply with legal requirements.

O) To comply with a civil, criminal or regulatory investigation, or subpoena or summons by federal, state or local authorities.

P) To respond to judicial process or government regulatory authorities for examination, compliance or other purposes as authorized by law.

(v) GLBA Title V includes provisions dealing with the disclosure of specific types of non-public customer information under certain circumstances, as well as the specific exceptions to the non-disclosure policy. See also, e.g., Interagency Interpretive Letter No. 917, CCH Fed. Banking L. Rep. ¶ 81-440 (Sept. 4, 2001) (lender permitted to place borrower's loan account number on mortgages and related publicly-recorded documents).

(vi) GLBA Title V prohibits a financial institution from disclosing, other than to a consumer reporting agency, an account number or similar form of access number for a credit card deposit or transaction account to any non-affiliated third party for use in telemarketing, direct mail marketing or e-mail marketing. See also Interagency Interpretive Letter No. 910 (May 25, 2001), CCH Fed. Banking L. Rep. ¶ 81-435 (declining to permit such disclosures even with a customer's consent).

(vii) Regulation P and Regulation S-P:

A) Take a broad approach to the concept of "financial" information, as well as to whether such information would include the fact that a consumer has a customer relationship with a financial institution.

B) Deem information to be "publicly available" (and, thus, excluded from dissemination restrictions) if the financial institution has a reasonable basis to believe that the information is available to the general public (regardless of whether it was obtained through non-public sources, such as a customer application).

C) Distinguish between "consumers" and "customers". A "consumer" is an individual who obtains or applies to obtain financial products or services from a financial institution that are to be used primarily for personal, family or household purposes, while a "customer" is a "consumer" who has a "continuing relationship" with a financial institution. A financial institution need not provide privacy notices to a non-customer unless it discloses non-public personal information about such non-customer to non-affiliated third parties.

D) Detail the information that must be contained in privacy notices, as well as the manner in which such information should be presented.

   i) Such notices must be "clear and conspicuous" -- reasonably understandable and designed to call attention to the information contained in them (e.g., plain-English, everyday words, easy-to-read type size and spacing, short explanatory sentences and bullet tabs, avoidance of legal boilerplate, etc.).

   ii) Such notices must include information with regard to such matters as (a) the categories of non-public personal information that a financial institution may collect and disclose, (b) the categories of affiliates, non-affiliated third parties and service providers to which a financial institution may disclose information, (c) how the financial institution treats information about former customers, (d) how opt-out rights can be exercised, and (e) the financial institution's policies with respect to protecting personal information.

iii) In 2009, a final interagency model consumer privacy notice was adopted. 12 C.F.R. Part 1016 (Appendix); 74 Fed. Reg. 62890 (Dec. 1, 2009). In addition, the agencies have made available an "Online Form Builder" that institutions may use to develop and print customized versions of the model privacy notice. See Interagency Press Release, Apr. 15, 2010.

iv) The CFPB has amended Regulation P to permit annual privacy notices to be delivered online under certain circumstances. 79 Fed. Reg. 64057 (Oct. 28, 2014).

v) The FAST Act amended section 504 of GLBA to establish an exception to the annual privacy notice requirements for financial institutions that meet certain criteria. Because there are fewer requirements to qualify for the annual privacy notice exception under the FAST Act GLBA amendments than there are to qualify to use the CFPB's alternative online delivery method, institutions that meet the requirements for using the alternative delivery method are effectively exempted from delivering an annual privacy notice. Under the FAST Act, a financial institution does not need to provide annual privacy notices if (A) it does not share non-public personal information with nonaffiliated third-parties in a way that triggers the GLBA opt-out right and (B) it has not changed its policies and procedures regarding disclosure of non-public personal information from the policies and procedures that were last disclosed to its customers. See 81 Fed. Reg. 44801 (July 11, 2016); Board CA Letter 16-3 (June 8, 2016) (revised interagency examination procedures for Regulation P).

E) Do not (1) prohibit affiliated institutions from using a common notice; (2) prohibit a financial institution from establishing different privacy policies and practices for different customers; (3) prohibit a financial institution from taking customer information, stripping it of personal identifiers and using it for statistical purposes (such as credit scoring); or (4) apply to non-U.S. financial institutions that solicit business in the U.S.

(viii) Under FCRA and the FACT Act, financial institutions are required to provide opt-out notices to consumers before sharing certain types of information among affiliates for marketing purposes. This can lead to practical difficulties for institutions attempting to comply with both FCRA and GLBA Title V. See also Part I.C.5.b.iv above and Part I.C.5.d below.

(ix) With respect to the adequacy of privacy disclosures under GLBA Title V, the most effective notices have been those used by institutions that approach them as a marketing tool, or institutions that have recognized a correlation between customer loyalty and perception of the institution's commitment to privacy protection.

d. Information-sharing Among Financial Institutions and Their Affiliates

The GLB Act does not restrict a financial institution from sharing non-public consumer personal information with its affiliates, although it does require a financial institution to disclose its policies with respect to the disclosure of such information. The FACT Act requires opt-out notices to be provided only when information from an affiliate will be used for marketing purposes. See Part I.C.5.b.iv above.

e. PATRIOT Act Implementation

Under PATRIOT Act § 314(b), financial institutions may share financial information with each other as a method of preventing money laundering and terrorist financing. See

67 Fed. Reg. 60579 (Sept. 26, 2002) (31 C.F.R. §§ 1010.505 et seq.). See also Part VIII.A below.

f. Information Safeguards; Identity Theft; "Outsourcing" Issues

(i) Interagency Rules require financial institutions to establish information security programs, and set out the responsibilities of directors and management in overseeing the protection of customer information. See, e.g., 66 Fed. Reg. 8616 (Feb. 1, 2001) (final rule; 12 C.F.R. Part 30 (Appendix B) (Comptroller); Part 208 (Appendix D 2), 12 C.F.R. §§ 211.5(k)(1), 211.24, Part 225 (Appendix F) (Board); Part 364 (Appendix B) (FDIC); Part 570 (Appendix B) (OTS)). See also Comptroller Bulletin No. 2001-35 (July 18, 2001), CCH Fed. Banking L. Rep. ¶ 67-516 (examination procedures); Board SR 01-15; Comptroller Bulletin No. 2001-12 (Feb. 28, 2001), CCH Fed. Banking L. Rep. ¶ 60-587 (account aggregation services); "Privacy Regulation Compliance" (Comptroller Seminar, Feb. 13, 2001). See also IT Examination Handbook: Information Security (FFIEC, July 2006).

In March 2016, the CFPB ordered Dwolla, an online payment system, to pay a penalty and correct its security practices after misrepresenting the company's ability to protect consumer information. In the Matter of Dwolla, Inc., 2016-CFPB-0007 (Mar. 2, 2016) (Consent Order).

See generally Part I.C.5.b.iv above.

(ii) GLBA Title V criminalizes "pretexting"; i.e., attempting to obtain customer information by making a false statement to a financial institution, or to a customer of a financial institution. (Insurance companies and state-licensed private investigators, however, are given greater license.)

(iii) Identity theft and cybersecurity threats have become significant problems, as discussed generally in Part IX.F below.

(iv) Offshore Outsourcing of Data Services by Insured Institutions and Associated Consumer Privacy Risks (FDIC, June 2004) (the "2004 FDIC Outsourcing Study") discusses the risks of offshore outsourcing by financial institutions from a safety and soundness perspective. See also Part IX.B.2 below.

g. State Privacy Laws

(i) GLBA Title V does not preempt state laws that are consistent with, or stricter than, GLBA Title V. However, FCRA preempts certain state or local restrictions on information-sharing, and the FACT Act made permanent a provision of FCRA (15 U.S.C. § 1681t) that prohibits states from enacting financial privacy laws stricter than federal law in certain respects.

A) Insofar as state privacy laws are concerned:

i) Among financial institutions, depository institutions are most likely to be restricted from disclosing customer financial information.

ii) State fair credit reporting acts are an important source of privacy law.

iii) Financial privacy protection may be limited to certain types of transactions under state law (e.g., electronic fund transfers).

iv) Common law, interpreted by state courts, also protects consumer financial privacy.

v) Violations of state privacy laws are typically subject to private rights of action.

B) Bank of America v. Daly City, 279 F. Supp. 2d 1118 (N.D. Cal. 2003), held that FCRA supersedes municipal ordinances that restrict disclosure of information among affiliates, but that federal laws do not preempt ordinances which prohibit bank information-sharing with third parties.

ABA v. Gould, 412 F.3d 1081 (9th Cir. 2005) ("ABA v. Gould"), held that FCRA preempts some parts of California law which include opt-out requirements with respect to bank information-sharing with affiliates (i.e., those parts which would affect how banks share consumer reports with affiliates, not those parts which relate to how banks may share other personal information with affiliates). Ordered to determine whether any portion of the California law would survive preemption, the lower court wrote that it lacked the power to rewrite the law to remove the preempted portions. ABA v. Lockyer, 2005 U.S. Dist. LEXIS 22437 (E.D. Cal. 2005). The Ninth Circuit disagreed, holding that only the preempted portion of California law would be stricken from the statute. 541 F.3d 1214 (9th Cir. 2008), cert. denied sub. nom. ABA v. Brown, 557 U.S. 935 (2009).

However, King v. Retailers National Bank, 388 F. Supp. 2d 913 (N.D. Ill. 2005), held that FCRA does not replace all state law claims or provide for exclusive federal jurisdiction of claims under its provisions; rather, FCRA provides for concurrent state and federal jurisdiction.

C) Some states have adopted privacy requirements stricter than GLBA Title V. Among these initiatives:

i) A number of states require consumer opt-in before an institution may share personal information (in some instances, even with affiliates). Institutions are generally required to tell consumers how their information will be used and shared. Some institutions may deal with the "opt-in problem" by simply not doing business in the relevant states.

ii) California has a hybrid privacy system, requiring opt-in from consumers before institutions may share information with non-affiliated third parties, and opt-out for sharing among affiliates. Institutions may share information among affiliates without notifying consumers or getting their permission (a "no-opt") if they meet certain criteria regarding corporate structure and lines of business. See ABA v. Gould (affiliate sharing restrictions partially preempted).

iii) See generally, e.g., 2007 Enacted Financial Privacy Legislation (NCSL, Feb. 26, 2008); FTC Letters to Ill. and Vt., Aug. 25, 2004 (finding no "inconsistency" of state privacy requirements with GLBA Title V); Insurance Privacy Protection in Response to Gramm-Leach (NAIC, 2002); State Registered Investment Adviser Privacy Guidance (NASAA, 2002).

(ii) If a financial institution announces a privacy policy that goes beyond legal requirements, it will generally be required to comply with its announced standards.

A) Chase Bank entered into a Settlement, Jan. 25, 2000, with the NY Attorney General (in the context of a claim that the Bank had violated its own privacy policy) -- under which the Bank agreed that it would not share its customers' account and credit information with non-affiliated third party vendors, and that customers could require the Bank not to disclose even non-financial information. See also, e.g., Hatch v. U.S. Bank, Civ. No. 99-872 (D. Minn., Sept. 25, 22, 2000). But see, e.g., Smith v. Chase Bank, 741 N.Y.S.2d 100 (N.Y. App. Div. 2d Dept. 2002) (alleged violation of commitment to protect consumer privacy and confidentiality and not to share customer information with unrelated third parties would not result in "actual injury").

B) Minnesota v. Fleet Mortgage Co., 181 F. Supp. 2d 995 (D. Minn. 2001), held that national bank operating subsidiaries may be sued by states under an FTC rule implementing the Telemarketing and Consumer Fraud and Abuse Prevention Act (the "Telemarketing Act"). (See Part IX.F below.) The Court concluded that an operating subsidiary is not a "bank" for purposes of GLB Act § 133 (which preserves the FTC's jurisdiction over non-bank affiliates of banks). The Comptroller took the opposite view.

h. Developments with Respect to International Coordination

(i) The EU and other countries have enacted stringent privacy restrictions. See, e.g., EU General Data Protection Regulation 2016/679/EU (Apr. 27, 2016) (the "General Data Protection Regulation") (replacing the EU Privacy Directive 95/46/EU (Oct. 24, 1995) (the "EU Privacy Directive")).

(ii) The EU General Data Protection Regulation expands the coverage of the EU Privacy Directive and seeks to harmonize the approach to data protection in the EU. It applies to both online and offline processing of "personal data" (i.e., information relating to a natural person in both personal and business capacities (e.g., personal political information, business employment information)), and applies substantive statutory obligations on (A) "processors" and "controllers" of such data that have an establishment in the EU and (B) on controllers of data of EU subjects, even if the controller has no establishment in the EU. Thus, businesses established outside of the EU must consider whether they are involved in processing of personal data of EU individuals that might implicate the EU General Data Protection Regulation. The Regulation provides for a two-year transition period, ending May 25, 2018. See, e.g., The General Data Protection Regulation: Key Changes and Implications (Cleary Gottlieb, May 13, 2016); MLex, Aug. 10, 2016, Apr. 26, 2016.

(iii) In 2010, privacy enforcement agencies from 13 countries launched the Global Privacy Enforcement Network ("GPEN") to facilitate cross border cooperation in privacy law enforcement. By the end of 2015, GPEN included 59 member authorities based in 43 jurisdictions. See GPEN Press Releases, Mar. 21, 2016, Apr. 1, 2015, Sept. 21, 2010.

(iv) The EU Privacy Directive created tension between the U.S. and the EU, which questioned the adequacy of U.S. privacy laws and practices to protect the personal data of EU citizens.

A) The EU and U.S. have negotiated an "Umbrella" data protection agreement to protect personal data exchanged in international criminal justice matters. See Agreement between the [EU] and the U.S. on the Protection of Personal Data when Transferred and Processed for the Purpose of Preventing, Investigating, Detecting or Prosecuting Criminal Offences, Including Terrorism (June 2, 2016) (the "Umbrella Agreement"); EC Press Release, June 2, 2016 (announcing signing of the Umbrella Agreement); Factsheet: [Q&A] on the EU-U.S. Data Protection "Umbrella Agreement" (EC, Sept. 8, 2015).

B) The U.S. and the EU also negotiated "safe harbor" principles that allowed EU entities sharing data with the U.S. to conclude that U.S. entities that have adopted these principles provide adequate protection for personal data transferred from the EU. See EC Safe Harbor Decision 2000/520/EC (July 26, 2000) (the "Safe Harbor Decision"). In October 2015, the Court of Justice of the European Union ("CJEU") in Schrems v. Data Protection Commissioner, C-362/14 (EU Oct. 6, 2015), invalidated the Safe Harbor Decision. See, e.g., [CJEU] Declares EU Commission's U.S. Safe Harbor Decision Invalid (Cleary Gottlieb, Oct. 6, 2015)

C) In February 2016, U.S. and EU officials announced the "EU-U.S. Privacy Shield" as a replacement for the Safe Harbor Decision. The EU-U.S. Privacy Shield, which became operational on August 1, 2016, provides significantly stronger privacy protections and oversight mechanisms, multiple redress possibilities and new safeguards related to U.S. government access to personal data. Nevertheless, questions exist about whether the EU-U.S. Privacy Shield will go far enough in addressing EU data privacy and protection concerns, and whether it will survive expected future legal challenges in the EU. See, e.g., EU-U.S. Privacy Shield at www.privacyshield.gov; 81 Fed. Reg. 51042 (Aug. 2, 2016) (announcing availability of EU-U.S. Privacy Shield framework documents); The EU-U.S. Privacy Shield: Practicalities for U.S. Businesses (Cleary Gottlieb, Aug. 2, 2016); EC Press Releases, Aug. 1, 2016, July 12, 2016; 81 Fed. Reg. 47752 (July 22, 2016) (establishing fees to cover U.S. administration of the EU-U.S. Privacy Shield); Fact Sheet: Overview of EU-US Privacy Shield Framework (Department of Commerce, July 12, 2016); MLex, July 26, 2016.

D) An agreement between Treasury and the Brussels-based Society for Worldwide Interbank Financial Telecommunications ("SWIFT") shortly after the September 11, 2001 terrorist attacks was criticized for infringing EU data protection laws. In response to Treasury subpoenas, SWIFT had allowed access to its records in certain international investigations. SWIFT subsequently joined the U.S. Department of Commerce's program implementing the Safe Harbor Decision (with respect to the protection of personal data), effective July 16, 2007. SWIFT has announced measures to protect the privacy of intra EU transfers, and the EU appointed an investigating judge to confirm that Treasury subpoena access to SWIFT records reflects the controls and safeguards described in Treasury representations. In 2010, the

EU and the U.S. reached an "Agreement on the Processing and Transfer of Financial Messaging Data from the EU to the U.S. for Purposes of the EU U.S. Terrorist Finance Tracking Program." See generally Part VIII.A below.

E) Unless companies decide to adopt the most restrictive rules across the board, keeping the U.S. system alive for multinational companies means having at least two systems for handling personal information and tagging all data so that the appropriate rules are applied.

F) Where foreign privacy law prohibits providing government-issued identification numbers without a customer's affirmative consent, the SEC has taken a no action position to permit foreign intermediaries to supply transaction information linked to unique identification numbers generated by a financial intermediary rather than to the government-issued identification numbers required by 1940 Act Rule 22c 2, with respect to shareholder accounts established before January 1, 2008. See ICI & IIB (avail. Feb. 1, 2007).

See generally U.S.-EU Data Privacy: From Safe Harbor to Privacy Shield (CRS, May 19, 2016); 2015 GPEN: Annual Report (GPEN, Mar. 2016); 2004 FDIC Outsourcing Study; Safe Harbor Decision Implementation Study (EC, Apr. 19, 2004); Safe Harbor Privacy Principles, 65 Fed. Reg. 45666 (July 24, 2000).

D. Permissible Securities and Related Activities by Type of Entity

1. Background

a. Prior to the GLB Act, the scope of permissible securities activities for banking organizations was defined principally by whether a BHC or a bank proposed to engage in the activities. Gramm-Leach supplements the existing framework by adding two new categories of entities with enhanced securities powers: FHCs and financial subsidiaries.

b. Even before Gramm-Leach, Glass-Steagall's separation of investment and commercial banking was not complete. Some securities activities are integrally connected to commercial banking, and Glass-Steagall permits "agency" activities and certain types of underwriting and dealing.

c. In determining the securities activities which Glass-Steagall permits, the words of the statute are the starting point. Glass-Steagall does not define the key terms which provide the basis for either a prohibition (e.g., "underwriting", "dealing", "distribution", "securities") or an exemption (e.g., "agent", "without recourse").

d. Glass-Steagall's parameters evolved through regulations, interpretations and rulings -- as well as through the creativity of market participants -- with respect to both products and activities. A "product analysis" focuses on what instruments banks or BHCs may underwrite, issue and deal in either because they are Glass-Steagall-exempt or because they are not Glass-Steagall "securities"; an "activity analysis" focuses on those instruments which are Glass-Steagall "securities" but where bank/BHC activities fall short of prohibited "underwriting" or "dealing". In some instances (e.g., securitization of bank-originated loan assets and distribution of the related ABS), the particular product or service involves both parts of this analysis.

e. The various prohibitions, limitations, restrictions and requirements that Dodd-Frank imposes on banking organizations overlay the existing FHC/BHC/bank/financial subsidiary framework. See Part II.A.6 below.

See generally U.S. Regulation of International Securities Markets, Chapter 19.

2. Financial Holding Companies

   a. Securities Activities

      (i) FHCs may engage in "underwriting, dealing in or making a market in securities". The Board has taken the position that certain activities in relation to mutual funds are not included within this empowerment (but are nevertheless included under other provisions of the BHCA applicable to FHCs). See Part I.C.1.c above and Part II.A.6 and Part VIII below.

      (ii) FHCs may engage in merchant banking activities subject to the Merchant Banking Regulations. See Part VII.A below.

      (iii) FHCs may engage in any activity approved by the Board under BHCA §§ 4(c)(8) and 4(c)(13) as of November 11, 1999. Board interpretations of the scope of activities it had deemed to be "closely related to banking" under BHCA § 4(c)(8) and Regulation Y, or "usual in connection with the transaction of banking or other financial operations abroad" under BHCA § 4(c)(13) and Regulation K, remain relevant to FHCs. See Part I.D.3 below.

      (iv) The securities activities of FHCs are also subject to the Volcker Rule. See Part II.A.7 below.

   b. Insurance Activities

      (i) FHCs are authorized to act as principal, agent or broker for the purpose of insuring, guaranteeing or indemnifying against "loss, harm, damage, illness, disability or death", and providing and issuing annuities. See Part I.C.1.c.vii above.

      (ii) An insurance underwriting or annuity company affiliate of an FHC may exercise merchant banking-like investment authority (subject to applicable state law, but not subject to the Board's Merchant Banking Regulations). See Part VII.A below.

3. Bank Holding Companies

a. Securities Activities

Among the securities-related activities permitted to BHCs (subject, where applicable, to the Volcker Rule discussed in Part II.A.7 below):

(i) U.S. and Canadian Government Securities: BHCs may underwrite and deal in U.S. government and agency securities. See Part II.B below.

BHCs are also permitted to underwrite and deal in Canadian federal and provincial "full faith and credit" obligations. U.S.-Canada Free-Trade Agreement Implementation Act, Pub. L. 100-449, § 308 (1988).

(ii) State and Municipal General Obligation Securities and Revenue Bonds: BHCs may underwrite and deal in general obligation state and municipal securities, as well as housing, university, dormitory and municipal revenue bonds and other eligible securities. See Part II.B below.

(iii) Investment Securities: BHCs may purchase and sell (but not deal in) debt (and debt-like) securities and certain investment company shares. Purchasing and selling (but not dealing in) corporate equity securities and a broader range of investment company shares are also permitted to BHCs under BHCA §§ 4(c)(6), 4(c)(7) and 4(c)(13). See Part II, Part VII and Part XI below.

(iv) Derivative Products, including Interest Rate, Currency, Equity, Commodity, Energy, Credit-based and Other Products; Foreign Exchange ("FX"), Bullion and Precious Metals; and Futures, Options and Options on Futures: BHCs may originate, issue, deal, trade, broker and advise on these instruments. See Part II and Part IX below.

(v) Corporate and Other Debt and Equity Securities: Underwriting and dealing in corporate and other debt and equity securities (other than mutual fund shares) which are not eligible securities (all of the foregoing, "ineligible securities") are permitted to a Section 20 Subsidiary subject to significant limitations. See Part III below.

(vi) CDs and Bankers Acceptances ("BAs"): BHCs may broker, underwrite and deal in these instruments because they are not Glass-Steagall "securities". See Part IV below.

(vii) Loan Syndications; Loan Participations; Loan Trading: BHCs may engage in these activities because they do not involve Glass-Steagall "securities". See Part V below.

(viii) Agency Placement and Related Services: BHC placement services are part of permissible agency activities. See Part VI below.

(ix) Corporate Finance (including M&A), Real Estate, Merchant Banking and Related Services: BHCs provide these services in both the domestic and the international context. See Part VII and Part XI below.

(x) Mutual Fund and Other Investment Company Activities; Trust/Advisory/Money Management/Private Banking Services: BHCs engage in all aspects of these services, which include (A) fiduciary, trust and investment management services; (B) advisory and administrative services; (C) sponsorship and control of closed-end investment companies; (D) management of common trust funds and collective investment funds; (E) automatic investment services and "sweep" arrangements involving customer-directed investments from deposit accounts; (F) commingling IRA and similar funds; (G) portfolio investment advice; (H) economic information and advice and economic and statistical forecasting services and industry studies; and (I) financial advice to governmental units (such as with respect to the issuance of securities). See Part VII.D, Part VIII and Part IX below.

(xi) Brokerage and Related Services: BHCs provide brokerage services both as a stand-alone activity and as part of "full-service brokerage" (i.e., in conjunction with investment advice and research).

Permissible brokerage includes (A) securities execution and clearance, (B) "riskless principal" activities, (C) shareholder services, and (D) FCM/IB/CTA/CPO activities respecting all types of derivative instruments (financial and "non-financial").

See Part VIII, Part IX and Part XI below.

(xii) Non-U.S. Underwriting and Related Activities: Underwriting and dealing in debt and (to a limited extent) equity securities are permitted outside the U.S. and are governed by Regulation K. See Part XI below.

b. Insurance Activities

(i) Under the BHCA, BHCs have very limited insurance powers, whether as principal, agent or broker. See BHCA § 4(c)(8); 12 C.F.R. § 225.28(b)(11); Joint Report to Congress (FFIEC, July 31, 2007).

(ii) BHC non-bank subsidiaries have greater insurance authority outside the U.S. See 12 C.F.R. § 211.10; Part XI below.

4. Banks and Their Subsidiaries

Banks remain a powerful vehicle for engaging in securities and related activities (subject to the Volcker Rule and the swap push-out provision of Dodd-Frank discussed in Part II below). See generally The Business of Banking: What Every Policy Maker Needs to Know (ABA, Sept. 2012).

a. Gramm-Leach-Bliley Limitations

While Gramm-Leach broadens the scope of securities and related activities in which banks may engage through subsidiaries, Gramm-Leach's policy of "functional regulation" imposes limitations on such activities. See Part I.C.2 above and Part II and Part IX below.

b. Statutory Framework for the "Business of Banking"

(i) General

Under Section 24(7), national banks may engage in the "business of banking", including all "incidental powers" necessary to carry on that business. State bank empowerments are determined in the first instance by the law of the chartering state. However, FRA § 9, 12 U.S.C. § 335, subjects state member banks to "the same limitations and conditions with respect to the purchasing, selling, underwriting, and holding of investment securities and stock as are applicable in the case of national banks". In addition, FDIA § 24, 12 U.S.C. § 1831a, restricts activities of FDIC-insured state-chartered banks and their subsidiaries to those permitted to national banks, unless prior FDIC approval is obtained. Under FRA § 9(13), 12 U.S.C. § 330, the Board may limit the activities of state member banks and their subsidiaries "in a manner consistent" with FDIA § 24.

A) The scope of the "business of banking" continues to develop and expand as the financial services industry evolves, and banks broaden their activities in an effort to enhance revenue, diversify lines of business, and better accommodate client needs. See, e.g., 81 Fed. Reg. 63428 (Sept. 15, 2016) (OCC proposal to prohibit national banks from dealing and investing in copper and other industrial and commercial metals); 81 Fed. Reg. 62836 (Sept. 13, 2016) (OCC proposal for a receivership framework for uninsured national banks, which could include special purpose "financial technology" charters); Section 620 Report; Rethinking the Business of Banking (IBM, June 2016); Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective (OCC, Mar. 2016); The 2015 EGRPRA Review, 80 Fed. Reg. 32049 (June 5, 2015) (including review of regulations regarding consumer protection in sales of insurance); The Public Benefit of State Financial Services Regulation (CSBS, Jan. 2015); The Business of Banking (ABA, 2014); Activities Permissible for a National Bank 2011 (OCC, Apr. 2012); Significant Legal, Licensing and Community Development Precedents for National Banks (OCC, Apr. 2010); Williams & Gillespie, "The Impact of Technology on Banking: The Effect and Implication of 'Deconstruction' of Banking Functions", 5 N.C. Banking Institute 135 (2001); Comptroller Corporate Decision No. 97-92 (Oct. 17, 1997) ("Corporate Decision No. 97-92") (principles used to determine whether an activity is part of the "business of banking"); Williams & Gillespie, "The Business of Banking: Looking to the Future - Part II", 52 Bus. Law. 1279 (1997); Williams & Jacobsen, "The Business of Banking: Looking to the Future", 50 Bus. Law. 783 (1995).

B) Comptroller regulations facilitate national banks' ability to conduct business using electronic technologies. See 67 Fed. Reg. 34992 (May 17, 2002). See also 66 Fed. Reg. 34784 (July 2, 2001) ("OCC 2001 Part 1 Revisions").

(ii) Preemption and "Exclusive Federal Regulation"

A) Prior to the enactment of Dodd-Frank, the Comptroller had amended 12 C.F.R. Part 7 ("Part 7") and 12 C.F.R. Part 34 ("Part 34") to clarify the applicability of state law to national banks and their operating subsidiaries. 69 Fed. Reg. 1895 (Jan. 13, 2004) (final rule) (the "2004 Preemption Release"), 68 Fed. Reg. 46119 (Aug. 5, 2003) (solicitation of public comments) (the "2003 Preemption Proposal"). See also OCC Preemption Rules: OCC Should Further Clarify the Applicability of State Consumer Protection Laws to National Banks (GAO, Apr. 2006); OCC Preemption Rulemaking: Opportunities Existed to Enhance the Consultative Efforts and Better Document the Rulemaking Process (GAO, Oct. 2005); Preemption Final Rule: Questions and Answers (OCC, Jan. 7, 2004).

The Comptroller identified types of state laws that are preempted -- as well as types of state laws that generally are not preempted -- in the context of national bank lending, deposit-taking, and other authorized activities. The 2003 Preemption Proposal described inquiries that the Comptroller had received concerning the applicability of state law to national banks, the principles of preemption, and litigation that addressed the extent to which state law applies to a national bank's exercise of powers. (For preemption determinations concerning national bank securities/broker-dealer activities, see Part IX.B.3 below.)

B) The debate over the Comptroller's preemption authority that arose in response to the 2003 Preemption Proposal and the 2004 Preemption Release ultimately reached the Supreme Court -- which considered Michigan's efforts to subject to state supervision an operating subsidiary of a national bank engaged in mortgage lending. The Court held that a national bank's mortgage business, whether conducted by the bank itself or by an operating subsidiary, was subject to Comptroller supervision and not to the licensing, reporting and visitorial regimes of the states in which the subsidiary operates. See Wachovia Bank v. Watters, 550 U.S. 1 (2007) ("Wachovia-Watters").

C) Dodd-Frank Title X (see Part I.B.10 above) introduced the "federal floor principle" under which states can promulgate consumer financial protection laws that are more protective of consumers than the analogous federal standard. Nonetheless, the Comptroller may, pursuant to the standard set forth in Barnett Bank v. Nelson, 517 U.S. 25 (1996) ("Barnett"), preempt any state consumer financial protection law that "prevents or significantly interferes with the exercise" by a national bank of any power granted under federal law. See 76 Fed. Reg. 43549 (July 21, 2011) (final rule) (the "2011 Preemption Release"), 76 Fed. Reg. 30557 (May 26, 2011) (solicitation of public comments) (the "2011 Preemption Proposal").

i) Federal preemption will not apply to a subsidiary or affiliate of a national bank if such subsidiary or affiliate is not itself a bank or thrift. This provision overturns Wachovia-Watters, and is significant because many banks conduct consumer lending businesses through non-bank subsidiaries.

ii) The overall significance of the preemption changes set out in Dodd-Frank is not clear. The Comptroller has asserted that Dodd-Frank did not change the Barnett conflict standard. Letter from Acting Comptroller Walsh to Sen. Carper, May 12, 2011. See also, e.g., Letter from Financial Services Roundtable to the OCC, June 27, 2011 (supporting the "clarity and certainty" of the legal standard for preemption for national banks).

The Treasury and certain state banking regulators have objected to the preemption standard set forth in the 2011 Preemption Proposal (and finalized in the 2011 Preemption Release) on the grounds that the

OCC (A) interprets the Barnett standard too broadly, as embodying the whole of conflict preemption law rather than a narrower formulation that would preempt state consumer financial laws only when they "prevent or significantly interfere" with the exercise of a national bank's powers; (B) purports to retain prior preemption determinations made under the OCC's "obstruct, impair or condition" standard; and (C) provides for the preemption of a broad category of state consumer financial laws based on existing precedent as opposed to determining preemption on a "case-by-case" basis. See, e.g., Letter from NY Superintendent of Banks Lawsky to Comptroller Walsh, June 27, 2011; American Banker, May 19, 2011.

iii) The preemptive effects of the NBA and the OCC's preemption standards post-Dodd-Frank have been subject to a number of challenges. See, e.g., Wiersum v. U.S. Bank, 785 F.3d 483 (11th Cir. 2015) (claim under Florida Whistleblower Act preempted by NBA); Madden v. Midland Funding, 786 F.3d 246 (2d Cir. 2015) (NY usury laws applied for purposes of a Fair Debt Collection Practices Act claim preempted by NBA) cert. denied 136 S. Ct. 2505 (2016); FNMA v. Sundquist, 311 P.3d 1004 (Utah 2013) (no preemption of Utah laws governing which persons or entities may act as trustees in a nonjudicial foreclosure); Gutierrez v. Wells Fargo Bank, 704 F.3d 712 (9th Cir. 2012) (preemption of state laws governing posting order of debit card transactions, but no preemption of state law fraud and misrepresentation claims), Case No. C 07-05923 (N.D. Cal., May 14, 2013) ($203 million judgment on the basis of state law fraud claims); DeCohen v. Capital One, 703 F.3d 216 (4th Cir. 2012) (no preemption for loan national bank acquired by assignment from a lender that was not a national bank); Levin v. HSBC Bank USA, 2012 NY Misc. LEXIS 6062 (NY Sup. Ct., June 2012) (no preemption of state law claims regarding overdraft fees); Epps v. JPMorgan Chase Bank, 675 F.3d 315 (4th Cir. 2012) (no preemption of Md. debt collection law); Meluzio v. Capital One Bank (USA), 469 B.R. 250 (N.D. W. Va. 2012) (no preemption of W.Va. debt collection law); W.Va. v. JPMorgan Chase & Co., 842 F. Supp. 2d 984 (S.D. W.Va. 2012) (no preemption of W.Va. consumer protection law applicable to debt cancellation and debt suspension plans); Cline v. Bank of America, 823 F. Supp. 2d 387 (S.D. W.Va. 2011) (no preemption of W.Va. debt collection practices law); Williams v. Wells Fargo Bank, 2011 WL 4901346 (S.D. Fla. 2011) (dismissal of Real Estate Settlement Procedures Act claim regarding charges related to force-placed insurance because Dodd-Frank amendment was not yet effective); U.S. Bank v. Schipper, 812 F. Supp. 2d 963 (S.D. Iowa 2011) (Dodd-Frank did not materially change preemption standards). See generally, e.g., American Banker, May 19, 16, Mar. 15, 2011; Banking Daily, Feb. 14, 2011.

D) With respect to other administrative, judicial and related developments and precedents respecting preemptions:

i) Federal and state courts had generally upheld the Comptroller's preemption authority. See generally, e.g., The New York Bankers Association, Inc. v. The City of New York, 119 F. Supp. 3d 158 (SDNY 2015) (preemption of NY law requiring disclosure of operations in low-income neighborhoods); Pereira v. Regions Bank, 752 F.3d 1354 (11th Cir. 2014) (preemption of Fla. law limiting check-cashing fees); Terrazas v. Wells Fargo, 2013 WL 5774120 (S.D. Cal. 2013) (preemption of state law claims related to assignment of mortgage); Jaldin v. ReconTrust Co., N.A., 539 Fed. Appx. 97 (4th Cir. 2013) (preemption of statute limiting national banks' trustee powers); Parks v. MBNA America Bank, 54 Cal. 4th 376 (Cal. Sup. Ct. 2012); Purcell v. Bank of America, 659 F.3d 622 (7th Cir. 2011) (preemption of state law claim of false credit reports by FCRA); Taft v. Wells Fargo Bank, 828 F. Supp. 2d 1031 (D. Minn. 2011) (preemption of state law definition of "interest" on reverse mortgages); Baptista v. JPMorgan Chase Bank, 640 F.3d 1194 (11th Cir. 2011) (preemption of Fla. law limiting check-cashing fees by OCC regulations authorizing national banks to charge fees to non-account-holders); Pacific Capital Bank v. Connecticut, 542 F.3d 341 (2d Cir. 2008) (Conn. law that regulates tax refund anticipation loans cannot be applied to tax preparation firms or third parties that help national banks make these loans); Rose v. Chase Bank, 396 F. Supp. 2d 1116 (C.D. Cal. 2005) (preemption of required Cal. credit card disclosures for "convenience checks"), aff'd, 513 F.3d 1032 (9th Cir. 2008); OCC v. Cuomo, 510 F.3d 105 (2d Cir. 2007) (preemption of/injunction against NY Attorney General investigation of lending practices of national banks and their operating subsidiaries), aff'd in part, rev'd in part, sub nom. Cuomo v. [NYCH], 557 U.S. 519 (2009) ("Cuomo v. NYCH"); SPGGC v. Ayotte, 488 F.3d 525 (1st Cir. 2007), cert. denied, 552 U.S. 1185 (2008) (preemption of N.H.

laws regulating gift cards issued by national bank, but marketed and sold by non-bank third party); Nat'l City Bank of Indiana v. Turnbaugh, 367 F. Supp. 2d 805 (D. Md. 2005), aff'd, 463 F.3d 325 (4th Cir. 2006), cert. denied, 550 U.S. 913 (2007) (preemption of Md. restrictions on national bank subsidiary charging prepayment fees); Wells Fargo v. Boutris, 419 F.3d 949 (9th Cir. 2005) (preemption of Cal. exercise of investigative/licensing authority over national bank operating subsidiaries, but Depository Institutions Deregulation and Monetary Control Act, 12 U.S.C. § 1735f-7a, does not preempt Cal. per diem loan-interest statute); Wachovia v. Burke, 414 F.3d 305 (2d Cir. 2005), cert. denied, 550 U.S. 913 (2007) (preemption extends to national bank subsidiaries) (reversed in Dodd-Frank Title X); Pacific Capital Bank v. Milgram, 2008 U.S. Dist. LEXIS 19639 (D.N.J. 2008) (preemption of N.J. limitation on national bank offer, facilitation and making of tax refund anticipation loans); Glukowsky v. Equity One, 848 A. 2d 747 (N.J. 2004) (upholding federal regulation permitting state-chartered housing lenders to charge prepayment fees despite state law ban); Fuchs v. Wachovia Mortgage Corp., 9 Misc. 3d 1129(A) (NY Sup. Ct. Nassau Co. 2005) (preemption of NY prohibition of document preparation fees).

But see, e.g., Aguayo v. U.S. Bank, 653 F.3d 912 (9th Cir. 2011) (no preemption of debt collection notice provision of Cal. statute protecting motor vehicle purchasers, where national bank unsuccessfully claimed that its notices were related to "credit-related documents"); Sheinkin v. Simon Property Group, 33 Misc. 3d 287 (Sup. Ct., Nass. Co., NY 2011) (no preemption of deceptive practices statute with respect to gift cards issued by a national bank, since the OCC has no regulations regarding required disclosures); In re Checking Account Overdraft Litigation, 694 F. Supp. 2d 1302 (S.D. Fla. 2010) (no preemption of state contract law where claimants allege that national banks manipulated the processing of debit overdrafts in order to generate fees).

ii) In Cuomo v. NYCH, the Supreme Court limited the preemptive scope of the Comptroller's regulation on visitorial powers by ruling that the regulation did not prevent state governments from bringing lawsuits against national banks to enforce applicable state laws. The Court did rule, however, that the "request letters" issued by the NY Attorney General constituted prohibited visitation rather than permissible litigation, which requires satisfaction of established procedural requirements. Cuomo v. NYCH does not permit states to exercise supervisory authority over national banks, and federal law may preempt the substance of a state (or local) law because the law conflicts with the exercise of a national bank's powers. See Comptroller's Amicus Curiae Memorandum in City of Cleveland v. Ameriquest Mortgage Securities, 621 F. Supp. 2d 513 (N.D. Ohio 2009), aff'd, 615 F.3d 496 (6th Cir. 2010) (in a case dismissed on other grounds, the Comptroller argued that Cleveland's public nuisance action was preempted both because it interfered with a national bank's lending authority and because the Comptroller had exclusive visitorial powers over national banks).

See also, e.g., HSBC Bank USA v. NYC Commission on Human Rights, 673 F. Supp. 2d 210 (SDNY 2009) (NBA § 24 (authority to hire and dismiss officers) and FDIA § 19 (prohibition on the employment of certain personnel) do not preempt NY law prohibiting adverse action against a person arrested or accused of a crime followed by a termination of the action in favor of such person); Capital One Bank v. McGraw, 563 F. Supp. 2d 613 (S.D. W.Va. 2008) (no preemption of state investigation into activities of third party corporations which act on behalf of national banks); SPGGC v. Blumenthal, 505 F.3d 183 (2d Cir. 2007) (Conn. law banning use of dormancy fees on gift cards not preempted with respect to third party carrying out the business of a national bank).

iii) Courts have held that the preemption authority extends to agents who engage in an activity on behalf of a federal savings association, concluding that it is the activity being regulated, rather than the actor who is being regulated, that matters for preemption purposes. See, e.g., State Farm Bank v. Reardon, 539 F.3d 336 (6th Cir. 2008) (preemption of Ohio law requiring state licensing of exclusive agents); State Farm Bank v. Burke, 445 F. Supp. 2d 207 (D. Conn. 2006) (preemption of Conn. law with respect to the licensing, registration and mortgage lending and deposit-related activities of plaintiff's agents; see OTS Letter No. P-2004-7 (Oct. 25, 2004)); Banking Daily, Aug. 26, 2008. See also Silvas v. E*Trade Mortgage Corp., 514 F.3d 1001 (9th Cir. 2008) (preemption of Cal. uniform advertising/competition law).

iv) President Obama directed federal agencies to include preemption provisions in federal regulations only when justified by applicable legal principles. See Memorandum for the Heads of Executive Departments and Agencies re: Preemption, May 20, 2009.

v) With respect to preemption issues generally, see, e.g., Comptroller Letter to COP, Feb. 12, 2009 (responding to recommendations set forth in the COP's Special Report on Regulatory Reform (regarding federal preemption)); Mason & Singer, The Economic Impact of Eliminating Preemption of State Consumer Protection Laws (2009); Interim Briefing Paper from the National Association of Attorneys General for President-elect Obama Transition Team (Jan. 2009) (calling for resistance to federal preemption of state law); Letter from OTS Chief Counsel Bowman to S&P, Feb. 20, 2008 (principles of federal preemption); Williams, "Federal Preemption and Federal Banking Agency Responses to Predatory Lending", Bus. Law. (May 2004); Comptroller Hawke Letter to Sen. Sarbanes, Dec. 9, 2003 (rationale behind OCC preemption); Banking Daily, May 10, 2004 (Comptroller Hawke suggesting that operating subsidiaries could be chartered as limited purpose banks so as to maintain federal preemption).

E) Among the types of laws which the 2004 Preemption Release indicated have been preempted are (i) licensing laws, (ii) filing requirements, (iii) laws specifying required terms of real estate loans, (iv) advertising restrictions, (v) laws restricting rates of interest, (vi) laws restricting fees and non-interest charges, (vii) laws restricting the manner in which a bank communicates with borrowers or otherwise manages credit accounts,

(viii) laws restricting due-on-sale clauses, (ix) laws governing covenants and restrictions required in a lease to qualify the leasehold as acceptable security for a real estate loan, and (x) laws mandating specific statements and disclosures.

i) Under the 2004 Preemption Release:

(a) 12 C.F.R. § 7.4007 (1) affirms the authority of a national bank to receive deposits and engage in any related incidental activity; (2) preempts state laws concerning abandoned and dormant accounts (<u>other than</u> state escheat laws), checking accounts, statement/disclosure requirements, funds availability, savings account orders of withdrawal, licensing/registration, and special purpose savings services; and (3) provides that, to the extent that they only incidentally affect deposit-taking, state laws dealing with contracts, torts, criminal law, debt collection, acquisition and transfer of property, taxation and zoning ("<u>Non-Preempted Matters</u>") are <u>not</u> preempted.

(b) 12 C.F.R. § 7.4008 (1) affirms the authority of a national bank to make, sell, purchase, participate in, or otherwise deal in <u>non-real estate loans</u>; (2) preempts state laws concerning (a) licensing, registration, filings or reports by creditors; (b) the ability of a creditor to require or obtain insurance for collateral or other credit enhancements or risk mitigants; (c) loan-to-value ratios; (d) the terms of credit; (e) escrow, impound and similar accounts; (f) security property (including leaseholds); (g) access to, and use of, credit reports; (h) mandated statements, disclosure and advertising; (i) disbursement and repayment; and (j) rates of interest (collectively, "Preempted Lending Requirements"); and (3) provides that state laws dealing with Non-Preempted Matters would not be preempted.

(c) 12 C.F.R. § 7.4009 (1) affirms the authority of a national bank to exercise all powers authorized under federal law, including conducting any activity that is part of, or incidental to, the business of banking; and (2) provides that, except for state laws dealing with Non-Preempted Matters or otherwise made applicable by federal law, state laws that obstruct or condition a bank's exercise of powers granted under federal law do not apply to national banks.

(d) 12 C.F.R. § 34.4 provides that a national bank may make real estate loans without regard to state law limitations concerning Preempted Lending Requirements or such other matters as (1) the aggregate amount of funds that may be loaned upon the security of real estate; (2) processing, origination, servicing, sale or purchase of, or investment or participation in, mortgages; (3) due-on-sale clauses; and (4) covenants and restrictions required in a lease to qualify the leasehold as security for a real estate loan.

ii) Comptroller Interpretive Letter No. 998 (Mar. 9, 2004), CCH Fed. Banking L. Rep. ¶ 81-527, confirms that (A) state anti-discrimination laws are not preempted; and (B) the relative roles of the Comptroller and the states with regard to the enforcement of such laws will depend on the particular type of law at issue. See also, e.g., Comptroller Interpretive Letter No. 1082 (May 17, 2007), CCH Fed. Banking L. Rep. ¶ 81-614 (laws that form the legal infrastructure that supports the conduct of commercial business operations, including the business of banking, apply to national banks, unless they curtail or hamper the exercise of a bank's powers); Charter One Mortgage Corp. v. Condra, 847 N.E.2d 207 (Ind. Ct. App. 2006) (federal law does not preempt suit alleging that bank's charge for non-lawyer employee preparation of mortgage documents violates prohibition on unauthorized practice of law); Comptroller Letters to Mass. Attorney General, Jan. 5, 2005 (concluding in respect of Mass. v. Simon Property Group, Civ. Act. No. 04-12422-RCL (D. Mass.), that provisions of Mass. gift certificate statute are not preempted); Comptroller Interpretive Letters No. 1006 (Aug. 19, 2004), CCH Fed. Banking L. Rep. ¶ 81-635 (state escheat laws not preempted); No. 1005 (June 10, 2004), CCH Fed. Banking L. Rep. ¶ 81-534 (UCC not preempted); No. 999 (Mar. 9, 2004) ("Letter No. 999"), CCH Fed. Banking L. Rep. ¶ 81-528 (implications of the 2004 Preemption Release).

F) The Comptroller amended Part 7 to clarify where he has exclusive authority to exercise "visitorial powers" over national banks. This action was prompted by state efforts to enact consumer protection laws and seek enforcement against national banks, particularly with regard to mortgage lending. See 68 Fed. Reg. 70122 (Dec. 17, 2003) (final rule: 12 C.F.R. § 7.4000), 68 Fed. Reg. 6363

(Feb. 7, 2003) (solicitation of public comments); Visitorial Powers Final Rule: Questions and Answers (OCC, Jan. 7, 2004); Comptroller Advisory Letter No. 2002-9 (Nov. 25, 2002), CCH Fed. Banking L. Rep ¶ 35-122 (preemption principles). See also, e.g., Letter No. 999; Comptroller Interpretive Letter No. 971 (Jan. 16, 2003), CCH Fed. Banking L. Rep. ¶ 81-497; Remarks of Acting Comptroller Williams, July 14, 2005, May 14, Mar. 17, 2003 (history of national banks and federal preemption); GAO Letter to Rep. Leach, Feb. 7, 2000 (role of Comptroller in state law preemption). See generally Part I.C.1.h above.

In 2005, the Comptroller obtained an injunction against efforts by the NY Attorney General to obtain information about the mortgage lending businesses of national banks doing business in NY, arguing that such efforts constitute an unauthorized exercise of visitorial authority over a national bank. See OCC v. Spitzer, 396 F. Supp. 2d 383 (SDNY 2005), aff'd, 510 F.3d 105 (2d Cir. 2007). However, the Supreme Court reversed this decision (in part) in OCC v. NYCH to allow states to bring lawsuits against national banks to enforce applicable state law.

Comptroller Advisory Letter No. 2004-2 (Feb. 26, 2004), sets out supplemental guidelines concerning how national banks should handle complaints forwarded by state authorities. See generally OCC-NY MOU, Nov. 30, 2006 (mechanism for sharing consumer complaint information); OCC-CSBS Model MOU on Consumer Complaint Information Sharing Plan (Nov. 20, 2006).

Dodd-Frank Title X confirms the basic framework on visitorial powers established in OCC v. NYCH by providing that federal banking laws do not preclude states from bringing actions against national banks to enforce non-preempted laws. Dodd-Frank also authorizes state attorneys general to bring actions against national banks to enforce CFPB regulations. See Part I.B.10 above.

G) The Comptroller issued (or sought public comment on requests for) preemption determinations respecting state lending/deposit laws and mortgage and broker-dealer licensing requirements. See, e.g., Comptroller Interpretive Letters No. 1106 (Oct. 10, 2008) ("Letter No. 1106"), CCH Fed. Banking L. Rep. ¶ 81-638 (national bank authority to act as a fiduciary in Ga. and S.C. notwithstanding state laws that purport to limit its ability to do); No. 1080 (Apr. 4, 2007) ("Letter No. 1080"), CCH Fed. Banking L. Rep. ¶ 81-612 (requirement for an out-of-state national bank to obtain a reciprocity certificate under Miss. law prior to acting in a fiduciary capacity preempted); No. 1055 (Aug. 2, 2005), CCH Fed. Banking L. Rep. ¶ 81-584 (preemption of Conn. prohibition of "on-us" check cashing fees); No. 1054 (July 27, 2005), CCH Fed. Banking L. Rep. ¶ 81-583 (preemption of Ind. prohibition of "on-us" check cashing fees); 68 Fed. Reg. 46264 (Aug. 5, 2003) (preemption of Ga. law; see also, e.g., Comptroller Interpretive Letters No. 1016 (Jan. 14, 2005) ("Letter No. 1016"), CCH Fed. Banking L. Rep. ¶ 81-542 (N.J. consumer fraud law not preempted in respect of loans "simply because they were purchased and held by national banks acting as trustees in connection with the issuance of [MBS]")); No. 1015 (Sept. 20, 2004), CCH Fed. Banking L. Rep. ¶ 81-545 (preemption of Ind. law on balloon payment loans); No. 1002 (May 13, 2004), CCH Fed. Banking L. Rep. ¶ 81-531 (preemption relating to Ga. loans arranged by mortgage brokers); No. 1000 (Apr. 2, 2004), CCH Fed. Banking L. Rep. ¶ 81-530 (listing preempted sections of Ga. law and discussing preemption with respect to credit life insurance and the involvement of mortgage brokers in particular transactions); OCC Questions and Answers [on] Preemption Definition and Order

Concerning the [Ga.] Fair Lending Act (July 31, 2003); Comptroller Interpretive Letters No. 958 (Jan. 27, 2003), CCH Fed. Banking L. Rep. ¶ 81-483 (preemption of multiple state laws), No. 957 (Jan. 27, 2003), CCH Fed. Banking L. Rep. ¶ 81-482 (preemption of Cal. law); No. 628 (July 19, 1993), CCH Fed. Banking L. Rep. ¶ 83,511 (preemption of Tx. law); Comptroller Unpublished Letters (Nov. 4, 1999) (preemption of state restrictions on prepayment fees), (Feb. 1, 1993) (preemption of Neb. broker-dealer registration), (Dec. 7, 1992) (preemption of Iowa broker-dealer registration).

See generally, e.g., Comptroller Interpretive Letter No. 1155 (Sept. 17, 2015), CCH Fed. Banking L. Rep. ¶ 81-684 (preempting Ohio financial institutions tax); Letter No. 1106 (national bank fiduciary powers); Comptroller Interpretive Letters No. 1103 (Sept. 18, 2008), CCH Fed. Banking L. Rep. ¶ 81-635 (same); No. 995 (June 22, 2004) ("Letter No. 995"), CCH Fed. Banking L. Rep. ¶ 81-521 (same); No. 973 (Aug. 12, 2003) ("Letter No. 973") (same); Comptroller Advisory Letters No. 2003-3 (Feb. 21, 2003), CCH Fed. Banking L. Rep. ¶ 64-126 (guidance on avoiding predatory and abusive lending practices in brokered and purchased loans); No. 2003-2 (Feb. 21, 2003), CCH Fed. Banking L. Rep. ¶ 64-125 (to similar effect). See also Part I.C.5.g above (preemption of certain state privacy laws).

H) Relief Act § 711 clarifies the supervisory authority of home and host state regulators of state-chartered banks, recognizing the primacy of the home state regulator. The FDIC had proposed rules to preserve parity between FDIC-regulated state-chartered banks (and branches of foreign banks) and national banks by providing that a state bank's home state laws should govern its interstate activities (and thus preempt the laws of other states in which the bank operates) to the same extent that the NBA governs a national bank's interstate activities. 70 Fed. Reg. 60019 (Oct. 14, 2005) (solicitation of public comments). The FDIC withdrew its proposed rulemaking in 2010.

c. Securities Activities

(i) General

As the "business of banking" has evolved through Comptroller interpretation, it includes the following securities-related activities (although certain activities may need to be "pushed out" to a broker-dealer or other affiliate under the GLBA Push-out Provisions or Dodd-Frank swap push-out provisions or terminated if the activity is impermissible under the Volcker Rule (see Part II, Part VII and Part IX below)):

A) U.S. and Canadian Government Securities: Banks may underwrite and deal in U.S. and Canadian government and agency securities. See Part II.B below.

B) State and Municipal General Obligation Securities and Revenue Bonds: Banks may underwrite and deal in general obligation state and municipal securities, as well as housing, university and dormitory and municipal revenue bonds and other eligible securities. See Part II.B below.

C) Investment Securities: Banks may purchase and sell (but not deal in) marketable investment-grade debt (and debt-like) securities and certain investment company shares. See Part I.A.2.b.i above and Part II and Part VII below.

D) Derivative Products, including Interest Rate, Currency, Equity, Commodity, Energy, Credit-based and Other Products; FX, Bullion and Precious Metals; and Futures, Options and Options on Futures: Subject to Dodd-Frank limitations, banks may originate, issue, deal, trade, broker and advise on these instruments as part of the business of banking. See Part II and Part IX below.

E) CDs and BAs: Banks may broker, underwrite and deal in these instruments because they are not Glass-Steagall "securities". See Part IV below.

F) Loan Syndications; Loan Participations; Loan Trading: Banks may engage in these activities as part of the business of banking. See Part V below. The GLBA Push-out Provisions affect certain loan participation trading. See Part II below.

G) Agency Placement and Related Services: As discussed in Part VI below, the GLBA Push-out Provisions significantly limit banks' ability to engage in agency placement activities.

H) Corporate Finance (including M&A), Real Estate, Merchant Banking and Related Services: Banks provide these services in both the domestic and the international context. See Part VII and Part XI below.

I) Mutual Fund and Other Investment Company Activities: Trust/Advisory/Money Management/ Private Banking Services: Banks engage in all aspects of services described in Part I.D.3 above. The GLBA Push-out Provisions narrow the exemption from the 1940 Act for bank common trust funds and from the Advisers Act for certain fund-related advisory services. See Part I.C.2 above and Part VII.D, Part VIII and Part IX below.

J) Brokerage and Related Services: Banks provide brokerage services both as a stand-alone activity and as part of full service brokerage described in Part I.D.3 above. The GLBA Push-out Provisions require certain bank brokerage activities to be "pushed out" to a broker-dealer affiliate. See Part II, Part VIII and Part IX below.

K) Non-U.S. Underwriting and Related Activities: Underwriting and dealing in debt and (to a limited extent) equity securities are permitted outside the U.S. and are governed by Regulation K. See Part XI below.

(ii) Direct "Principal" Activities

Under FDIA § 24, 12 U.S.C. § 1831a, an insured state bank and its subsidiaries may not engage as principal in any type of activity that is not permissible for a national bank unless (A) the FDIC determines that the activity would pose no significant risk to the deposit insurance fund, and (B) the bank is in compliance with applicable federal capital standards.

A) The FDIC's regulations implementing FDIA § 24 -- Part 362 -- establish procedures for obtaining FDIC consent to engage in non-banking activities (but not insurance activities) as principal.

B) Activities that the FDIC has approved include equity investment activities, real estate development, travel agency activities, issuance of guarantees, fixed-rate annuity underwriting and short-term vehicle rental. See FDIC Decisions on Bank Applications: Investments & Activities (website: fdic.gov/regulations/laws/bankdecisions/Invest/Activity/index.html). See also, e.g., FDIC Private Equity Investment Orders referred to in Part VII.A.4.a below; Part VII.B below (real estate-related activities).

C) In 1999 the FDIC revised Part 362 with respect to principal activities not permitted to national banks. See 63 Fed. Reg. 66276 (Dec. 1, 1998) (the "1999 Part 362 Revisions"). In 2000, the FDIC adopted the FDIC GLBA Regulation, which made further revisions to Part 362 to implement the financial subsidiary provisions of Gramm-Leach. See Part I.C.1.d.iii above. The FDIC GLBA Regulation supersedes most of the substantive and procedural changes of the 1999 Part 362 Revisions as they relate to securities activities of non-member banks.

D) The FDIC Activities Regulations apply only to activities as principal, and not to activities "as agent for a customer, conducted in a brokerage, custodial, advisory or administrative capacity, or conducted as trustee, or in any substantially similar capacity". See also, e.g., FDIC Advisory Opinion No. 97-12 (Oct. 20, 1997) ("Opinion No. 97-12"), CCH Fed. Banking L. Rep. ¶ 82-234 (analysis of whether an activity is conducted as principal or agent).

E) The FDIC Activities Regulations provide that state banks may conduct activities authorized by statute or in Comptroller regulations, circulars, bulletins, orders or interpretations. See FDIC Financial Institution Letter ("FIL") FIL-54-2014 (Nov. 19, 2014) CCH Fed. Banking L. Rep. ¶ 38-200B (Filing and Documentation Procedures for State Banks Engaging, Directly or Indirectly, in Activities or Investments that are Permissible for National Banks). See also Part I.D.4.b.i above.

From time to time the Comptroller is asked to rule on the permissibility of activities for a national bank in response to a request to the FDIC by a state non-member bank to engage in such activities. See, e.g., Comptroller Interpretive Letter No. 741 (Aug. 19, 1996), CCH Fed. Banking L. Rep. ¶ 81-105 (finder's service involving provision of automobile inventory information to potential purchasers).

(iii) Activities of Subsidiaries of Banks

A) Financial Subsidiaries

i) Gramm-Leach creates the financial subsidiary structure for national banks, 12 U.S.C. § 24a, and contains authority under federal law for state banks, 12 U.S.C. § 46.

ii) Financial subsidiaries may engage in any activity permissible for a national bank to conduct directly, plus most financial activities authorized for FHCs.

Financial subsidiaries may not engage in insurance underwriting (except certain credit-related insurance), writing annuities, real estate investment or development (unless otherwise expressly authorized by law) and merchant banking.

iii) See generally Part I.C.1.d above regarding financial subsidiaries.

B) National Bank Operating Subsidiaries and Minority Investments

Under the Op Sub Rule (see 61 Fed. Reg. 60342 (Nov. 27, 1996)), a national bank may own a majority interest in an operating subsidiary which engages in activities permissible for the bank. See also Comptroller's Licensing Manual: Investment in Subsidiaries and Equities; Comptroller Conditional Approval No. 642 (June 15, 2004). The Comptroller has clarified the type of entity that may qualify as an operating subsidiary. See 12 C.F.R, § 5.34; 73 Fed. Reg. 22216 (Apr. 24, 2008) (final rule) (the "2008 Op Sub Revision"); 72 Fed. Reg. 36550 (July 3, 2007) (solicitation of public comments); see also Comptroller Conditional Approval No. 895 (Mar. 31, 2009) (operating subsidiary structures).

i) The Comptroller has issued letters and regulations that address whether a particular entity is an operating subsidiary. For example:

(a) The Comptroller has authorized a national bank to convert an existing subsidiary corporation into an LLC. See, e.g., 12 C.F.R. § 5.34(e)(2); Comptroller Unpublished Letter (Mar. 16, 1995). See also Part I.D.4.c.iii.B.vii below (investments in LLCs which were not operating subsidiaries at the time of the investment).

(b) Although previously the OCC had determined that an entity could be an "operating subsidiary" even though the bank may own only non-voting shares or may own less than a majority of the entity's voting shares (see, e.g., Comptroller Conditional Approvals No. 646) (June 28, 2004) ("Approval No. 646"); No. 595 (June 5, 2003) ("Approval No. 595"); No. 134 (June 28, 1994); Comptroller Interpretive Letter No. 650 (May 18, 1994), CCH Fed. Banking L. Rep. ¶ 83,559), since the 2008 Op Sub Revision appears to contemplate a stronger, more active showing of "control" for operating subsidiary purposes (in addition to looking at percentage ownership and accounting treatment), it is not clear that the OCC would reach the same conclusion today.

(c) A national bank may conduct permissible activities through a Delaware business trust. See, e.g., Comptroller Interpretive Letter No. 745 (Aug. 26, 1996), CCH Fed. Banking L. Rep. ¶ 81-110. See also, e.g., Comptroller Corporate Decision 96-52 (Sept. 20, 1996) ("Corporate Decision No. 96-52") (operating subsidiary may sponsor trusts to invest in municipal bonds).

(d) A national bank's 99.99% ownership interest in an LLC that made loans that qualify for New Market Tax Credits ("NMTCs") did not cause the LLC to become an operating subsidiary where the bank did not have control over the management and operations of the LLC (but such an interest could be a permissible non-controlling equity investment under 12 C.F.R. § 5.36). See, e.g., Comptroller Corporate Decision 2011-08 (Apr. 19, 2011). See also, e.g., Comptroller Interpretive Letter No. 996 (July 6, 2004), CCH Fed. Banking L. Rep. ¶ 81-522.

(e) A national bank may conduct permissible activities through an operating subsidiary organized as a partnership. See Part I.D.4.c.iii.B.viii below.

ii) Under the Op Sub Rule a national bank that is "well capitalized" and "well managed" may acquire or establish an operating subsidiary, or perform a new activity in an existing subsidiary, by providing notice to the Comptroller within 10 days after acquiring or establishing the subsidiary or commencing the activity, so long as the activity is enumerated in 12 C.F.R. § 5.34(e)(5)(v) (an "Op Sub Notice Activity"). Op Sub Notice Activities include the following securities-related services:

(a) Financial advisory and consulting services to the parent bank and its affiliates.

(b) Acting as investment adviser (including with discretion), advising investment companies and mortgage or real estate investment trusts ("REITs"), furnishing economic forecasts and information, providing investment advice related to futures, and providing consumer financial counseling.

(c) Providing financial and transactional advice and assistance regarding mergers, acquisitions, divestitures, joint ventures, leveraged buyouts, swaps, FX/ derivative/coin/bullion transactions, and capital restructurings.

(d) Making, purchasing, selling, servicing and warehousing loans.

(e) Providing securities brokerage and acting as an FCM.

(f) Underwriting, dealing and making a market in eligible securities and purchasing ABS as principal.

iii) The Comptroller has approved securities-related services, as well as combinations of services, in operating subsidiaries, including:

(a) Comptroller Conditional Approval No. 1013 (Nov 8. 2011) ("Approval No. 1013"): owning loan participations and loans secured by real estate and investment grade real-estate backed securities in a REIT; holding preferred equity certificates through an agreement corporation in an offshore subsidiary that owns investment grade ABS and investment grade debt securities.

(b) Comptroller Conditional Approval No. 864 (June 30, 2008): derivative transactions; mortgage lending; FX and precious metals trading.

(c) Comptroller Conditional Approval No. 767 (Oct. 18, 2006): cash management, including money order processing; and purchasing, selling, servicing and warehousing loans or other extensions of credit.

(d) Comptroller Interpretive Letter No. 1048 (Dec. 21, 2005) ("Letter No. 1048"), CCH Fed. Banking L. Rep. ¶ 81-577: funding of wind energy project through acquisition of 70% ownership interest; first OCC application of a "federal definition of 'real estate'". See also Part VII.B below.

(e) Comptroller Interpretive Letter No. 1047 (Dec. 20, 2005) ("Letter No. 1047"), CCH Fed. Banking L. Rep. ¶ 81-576: sponsorship of, and investment in, closed-end investment company that invests in non-voting preferred shares of Cayman Islands companies engaged in CDS and related activities.

(f) Comptroller Conditional Approval No. 303 (Feb. 16, 1999) ("Approval No. 303"): agency sale of insurance, annuities and securities, insurance and planning services, and advisory services.

(g) Comptroller Conditional Approval No. 233 (Feb. 26, 1997) ("Approval No. 233"): brokerage, investment advisory, annuities sales and training and promotional activities. See also Approval No. 1013; Comptroller Conditional Approval No. 208 (June 28, 1996) ("Approval No. 208").

(h) Letter No. 754: investment portfolio management and computer networking packages for financial institutions.

(i) Comptroller Conditional Approval No. 190 (Dec. 18, 1995) ("Approval No. 190"): investment advisory services, mutual fund administrative services, CTA activities, securities lending, employee benefit and consulting services.

(j) Comptroller Interpretive Letter No. 658 (Apr. 27, 1995) ("Letter No. 658"), CCH Fed. Banking L. Rep. ¶ 83,606: brokerage, underwriting, cash management and financial and advisory services. See also Comptroller Letters (Feb. 18, 1992, Apr. 26, 1988) re Society National Bank.

(k) Comptroller Conditional Approval No. 164 (Dec. 9, 1994) ("Approval No. 164"): brokerage, private placement services, organization of investment companies, advisory services, mutual fund administrative services, advertising and marketing services.

(l) Comptroller Letter (Sept. 30, 1992) re NatWest USA (the "Comptroller NatWest Letter"): derivative, money market and asset-liability management activities.

(m) Comptroller Letter (Aug. 10, 1992) re Fleet National Bank (the "Comptroller Fleet Letter"): full-service brokerage, dealing, underwriting, purchasing and selling securities.

(n) Comptroller Unpublished Letter (May 12, 1992) (the "Comptroller 1992 Letter"): summarizing permissible securities activities.

(o) Comptroller Letter (Jan. 30, 1992) re Chase Bank (the "Comptroller Chase-CPO Letter"): buying and selling municipal securities, financial advice to municipal debt issuers, underwriting and dealing in eligible securities, arranging loans, project financing, leasing and lending, financial/ investment advice, assistance in arranging acquisitions/ divestitures/ private placements, and full-service brokerage.

(p) Comptroller Interpretive Letter No. 492 (Oct. 20, 1989) ("Letter No. 492"), CCH Fed. Banking L. Rep. ¶ 83,075: purchasing, selling, dealing and underwriting, private placement and full-service brokerage.

(q) Comptroller Letter (Apr. 12, 1988) re American National Bank (the "Comptroller American National Letter"): advisory activities, investment management (including common trust funds), securities brokerage, administrative services for employee benefit plans and accounting for commingled funds.

(r) Comptroller Unpublished Letter (Mar. 9, 1988) (the "Comptroller 1988 Letter"): financial consulting, advisory and private placement services.

(s) Comptroller Interpretive Letter No. 415 (Feb. 12, 1988) ("Letter No. 415"), CCH Fed. Banking L. Rep. ¶ 85,639: denial of "sweeping request" for subsidiary to engage in "all securities-related activities that have been or will be authorized" by the Comptroller, but granting approval for 13 activities.

iv) Prior to Gramm-Leach, the Comptroller had amended the Op Sub Rule to establish a framework for evaluating proposals for national bank operating subsidiaries to engage in activities that were not permissible for the bank. See Comptroller News Releases NR 96-129 (Nov. 20, 1996); NR 96-128 (Nov. 20, 1996); Comptroller Conditional Approval No. 262 (Dec. 11, 1997) ("Approval No. 262") (underwriting and dealing in municipal revenue bonds); Comptroller Corporate Decision No. 98-48 (Oct. 20, 1998) ("Corporate Decision No. 98-48") (to similar effect), Comptroller Conditional Approval No. 297 (Dec. 9, 1998) ("Approval No. 297") (to similar effect); Comptroller Conditional Approval No. 309 (Apr. 12, 1999) ("Approval No. 309"; and together with Approvals No. 262 and No. 297 and Corporate Decision No. 98-48, the "Municipal Underwriting Approvals") (to similar effect); and Approval No. 351 (underwriting debt and equity securities).

v) Dodd-Frank § 1044 reverses the position of the Comptroller (12 C.F.R. § 7.4006) that operating subsidiaries of national banks benefit from the same preemption of state licensing and related requirements as would be applicable to the bank itself. See also Part I.D.4.b.ii above and Part I.D.4.d below.

vi) The Comptroller has approved the establishment by national banks of non-U.S. operating subsidiaries and of minority investments in non-U.S. entities (or U.S. entities with non-U.S. operations).

(a) Comptroller Conditional Approval No. 790 (Feb. 27, 2007) approved a bank's establishment of an operating subsidiary with a Cayman Islands office, to engage in investment activities, on condition that books and records be located in the U.S.

(b) Comptroller Conditional Approval No. 726 (Dec. 21, 2005) approved a bank's acquisition of limited partnership interests in Cayman Islands and Luxembourg entities that were formed with an unaffiliated financial services company as part of a mechanism to provide bank funding.

(c) Letter No. 1047 approved bank sponsorship of a closed–end investment company that in turn invested in non-voting preferred shares of Cayman Islands companies engaged in CDS activities.

(d) Comptroller Conditional Approval No. 724 (Dec. 16, 2005) approved establishment of a Delaware LLC operating subsidiary with its principal office in Bermuda to acquire, hold and sell interests in loans and debt securities.

(e) Comptroller Interpretive Letter No. 1027 (May 3, 2005) ("Letter No. 1027"), CCH Fed. Banking L. Rep. ¶ 81-556, approved a bank's acquisition of the preferred securities of Australian special purpose entities ("SPEs") which held interests in Australian mortgage loans.

(f) Comptroller Conditional Approval No. 686 (Apr. 14, 2005) approved the acquisition of an interest in a Cayman Islands limited partnership to hold and liquidate foreign assets acquired in satisfaction of debts previously contracted ("DPC").

(g) Approvals No. 595 and No. 646 approved a U.S. operating subsidiary which would have two offices, one in the U.S. and one in the UK, all of whose activities would be conducted in the UK.

(h) Comptroller Interpretive Letter No. 965 (Feb. 24, 2003) ("Letter No. 965"), CCH Fed. Banking L. Rep. ¶ 81-488, approved a minority investment in a Bermuda reinsurance company to provide professional liability insurance to the bank's insurance agency/broker.

(i) Comptroller Conditional Approval No. 536 (June 21, 2002) ("Approval No. 536") approved a non-U.S. operating subsidiary that does not conduct business in the U.S., provided that the subsidiary is limited to bank-permissible activities.

(j) Comptroller Conditional Approval No. 413 (Sept. 22, 2000) approved as an operating subsidiary a non-U.S. entity that conducts all of its business in the U.S.

(k) Under Regulation K (12 C.F.R. § 211.3(a)(3)), Board approval can be obtained for a bank operating subsidiary to establish a foreign branch if that branch conducts activities permissible for the parent bank's non-U.S. branch.

See also Part I.A.10 above and Part XI.B below.

vii) The Comptroller has permitted national banks, directly or through operating subsidiaries, to invest in LLCs, corporations and partnerships, even though the investments do not meet the ownership standards for an operating subsidiary, subject to compliance with the following "Minority Investment Criteria":

(a) The activities of the entity must be part of, or incidental to, the business of banking.

(b) The bank must be able to prevent the entity from engaging in activities that do not meet the foregoing standard or the bank must be able to terminate its investment.

(c) The bank's loss exposure must be limited, as a legal and accounting matter, and the bank must not have open-ended liability for the obligations of the entity.

(d) The investment must be convenient or useful to the bank in carrying out its business and not a passive investment.

Comptroller rules regarding non-controlling equity investments, 12 C.F.R. § 5.36, allow national banks to use a 10-day after-the-fact notice procedure for minority investments, so long as the entity in which the national bank is investing engages in an Op Sub Notice Activity (unless the OCC otherwise requires a pre-investment notice). See Part I.D.4.c.iii.B.ii above. Previously, all minority investments required prior Comptroller approval. See, e.g., Comptroller Conditional Approval No. 300 (Jan. 13, 1999) ("Approval No. 300").

For examples of Comptroller minority investment approvals relating to securities, derivatives, fiduciary, insurance or advisory activities, see, e.g., Comptroller Interpretive Letters No. 1077 (Jan. 11, 2007), CCH Fed. Banking L. Rep. ¶ 81-609 (fraud prevention, identity verification, credential validation, and payment/deposit risk services to financial institutions, credit card issuers, check acceptance companies, broker-dealers, mutual fund companies, retailers, government agencies and others); No. 1046 (Dec. 14, 2005) ("Letter No. 1046"), CCH Fed. Banking L. Rep. ¶ 81-575 (financing venture capital fund of funds); Approval No. 646 (complex structured finance activities); Comptroller Interpretive Letters No. 996 (July 6, 2004), CCH Fed Banking L. Rep. ¶ 81-522 (loans that qualify for certain tax credits); No. 994 (June 14, 2004) CCH Fed Banking L. Rep. ¶ 81-520 (employee benefit plans for affiliates); No. 985 (Jan. 14, 2004), CCH Fed. Banking L. Rep. ¶ 81-511 (mortgage reinsurance); No. 970 (June 25, 2003), CCH Fed. Banking L. Rep. ¶ 81-495 (limited purpose "banker's bank"); Comptroller Conditional Approval No. 574 (Jan. 27, 2003) (title insurance agency); Letter No. 965 (reinsurance/professional liability insurance); Comptroller Conditional Approval No. 436 (Dec. 20, 2000) (trade finance); Comptroller Interpretive Letters No. 898 (July 14, 1998) ("Letter No. 898"), CCH Fed. Banking L. Rep. ¶ 81-417 (auto loan origination/purchase/securitization); No. 897 (Oct. 23, 2000) ("Letter No. 897"), CCH Fed. Banking L. Rep. ¶ 81-416 (investment advisory services); No. 890 (May 15, 2000), CCH Fed. Banking L. Rep. ¶ 81-409 (less than 1% interest in a BHC); No. 889 (online securities trading); No. 875 (Internet-related merchant services); No. 871 (Oct. 14, 1999), CCH Fed. Banking L. Rep. ¶ 81-365 (commercial finance); Comptroller Conditional Approval No. 327 (Sept. 14, 1999) (title insurance agency and real estate loan closing services); Comptroller Interpretive Letter No. 868 (Aug. 16, 1999) ("Letter No. 868"), CCH Fed. Banking L. Rep. ¶ 81-362 (minority interest to be obtained through the exercise of warrants issued by provider of Internet payment services); Comptroller Conditional Approvals No. 322 (July 30, 1999) ("Approval No. 322") (title insurance agency, appraisal, loan closing and real estate-related activities); No. 321 (July 28, 1999) ("Approval No. 321") (Internet automobile financing; warrants to purchase shares of co-venturer); No. 319 (July 26, 1999) ("Approval No. 319"), No. 289 (Oct. 2, 1998), No. 273 (Feb. 26, 1998), No. 271 (Jan. 28, 1998), and No. 221 (Dec. 4, 1996) ("Approval No. 221") (collectively, the "Comptroller Integrion Approvals") (interests in Integrion Financial Network ("Integrion"), see Part XII.A.4.e below); Approval No. 303 (agent in sale of insurance, annuities and securities); Approval No. 300 (investment advisory activities); Comptroller Interpretive Letter No. 851 (Dec. 8, 1998), CCH Fed. Banking L. Rep. ¶ 81-308 (same); Comptroller Conditional Approval No. 284 (Aug. 14, 1998) (same); Comptroller Interpretive Letter No. 831 (June 8, 1998) ("Letter No. 831"), CCH Fed. Banking L. Rep. ¶ 81-285 (limited purpose national bank; trust, asset management, agency and custody services); Comptroller Conditional Approval No. 270 (Jan. 21, 1998) (investment advice); Comptroller Interpretive Letter No. 815 (Dec. 2, 1997) ("Letter No. 815"), CCH Fed. Banking L. Rep. ¶ 81-263 (state-chartered trust company); Comptroller Conditional Approval No. 243 (May 9, 1997) (mortgage loan origination, processing, servicing and sale); No. 241 (May 1, 1997) ("Approval No. 241") (mortgage banking); Comptroller Corporate Decision No. 2004-12 (Apr. 3, 1997) ("Corporate Decision No. 2004-12") (insurance agency); Comptroller Interpretive Letters No. 779 (Apr. 3, 1997) ("Letter No. 779"), CCH Fed. Banking L. Rep. ¶ 81-206 (loan fund); No. 778 (Mar. 20, 1997) ("Letter No. 778"), CCH Fed. Banking L. Rep. ¶ 81-205 (LLC to place customer funds in foreign bank deposits); Comptroller Unpublished Letter (Dec. 20, 1996) (the "Comptroller ING Letter") (minority investment by federal branch of foreign bank in open-end limited partnership which invests in loans and notes); Comptroller Conditional Approval No. 225 (Nov. 27, 1996) (origination and servicing of mortgage loans); Comptroller Interpretive Letter No. 756 (Nov. 5, 1996), CCH Fed. Banking L. Rep. ¶ 81-120 (cash management computer software development, distribution and maintenance); Comptroller Conditional Approval No. 216 (Sept. 11, 1996) (student loan marketing and financing); Comptroller Interpretive Letter No. 735 (July 15, 1996), CCH Fed. Banking L. Rep. ¶ 81-052 (acquisition, management and sale of real property acquired through DPC); Comptroller Conditional Approval No. 202 (Apr. 25, 1996) (mortgage origination and servicing) and related Comptroller Interpretive Letter No. 711 (Feb. 23, 1996), CCH Fed. Banking L. Rep. ¶ 81-026; Comptroller Conditional Approval No. 189 (Dec. 15, 1995) (mortgage services); Comptroller Interpretive Letters No. 694 (Dec. 13, 1995), CCH Fed. Banking L. Rep. ¶ 81-009 (home improvement loans); No. 692 (Nov. 1, 1995) ("Letter No. 692"), CCH Fed. Banking L. Rep. ¶ 81-007 (education financing advisory services); No. 677 (stock of MECA Software ("MECA") to develop and market computer software, including financial management programs); Comptroller Unpublished Letter (Jan. 30, 1995) (acquisition/liquidation of real estate); Comptroller Interpretive Letter No. 668

(Oct. 14, 1994), CCH Fed. Banking L. Rep. ¶ 83,616 (mortgage banking).

viii) National banks may act as limited partners and establish operating subsidiaries to act as limited or general partners, so long as the partnership only engages in bank-permissible activities. For examples of Comptroller partnership approvals relating to securities, fiduciary or advisory activities, in addition to those set out in Part I.D.4.c.iii.B above and Part XII.B.5 below, see, e.g., Comptroller Corporate Decision No. 2004-16 (Sept. 10, 2004); Comptroller Conditional Approvals No. 276 (May 8, 1998) ("Approval No. 276") (real estate-related activities); No. 275 (Apr. 22, 1998) (title insurance activities); Comptroller Interpretive Letter No. 687 (Sept. 5, 1995) ("Letter No. 687"), CCH Fed. Banking L. Rep. ¶ 81,002 (investment in fixed income securities); Comptroller Letter (July 7, 1988) re Chase Bank (government securities/derivative transactions); Comptroller Interpretive Letters No. 346 (July 31, 1985) ("Letter No. 346"), CCH Fed. Banking L. Rep. ¶ 85,516 (electronic information/transaction services); No. 265 (July 14, 1983), CCH Fed. Banking L. Rep. ¶ 85,429 (real estate activities).

Corporate Decision No. 2000-07 (May 10, 2000) ("Corporate Decision No. 2000-07") approved a bank acquisition of an LLC to act as general partner to a private equity fund which could include ineligible securities.

With respect to bank/subsidiary-permitted investments, see Part II.D.3.a.ii below.

C) State Member Bank Operating Subsidiaries and Minority Investments

i) A member bank may acquire shares of a company that (A) would be a subsidiary of the bank, and (B) engages only in activities in which the bank may engage, at locations at which the bank may engage in the activities, and subject to the same limitations as if the bank were engaging in the activities directly. If the bank is an FHC subsidiary and acquires less than 100% of the voting shares of such a company, the bank should notify the Board within 30 days in accordance with 12 C.F.R. § 225.87(a). If the bank is a BHC subsidiary and acquires less than 100% of the voting shares of such a company, Board approval under BHCA § 4(c)(8) may be required. See, e.g., Board Chase 2000 Letter; 12 C.F.R. § 250.141. See also Part I.D.6 below.

ii) Member banks may make minority investments, subject to the Minority Investment Criteria. See, e.g., Board Letter, Dec. 11, 1997 (interest in REIT holding mortgage portfolio); Board Letter, Jan. 31, 1997 (the "Board 1997 AmSouth Letter"), CCH Fed. Banking L. Rep. ¶ 80-122 (investment advisory activities); Board Letter, Dec. 19, 1996 (the "1996 DTC Approval Letter"), CCH Fed. Banking L. Rep. ¶ 80-226 (research/marketing services to securities clearing organizations); Board Letter, Nov. 4, 1996, CCH Fed. Banking L. Rep. ¶ 80-222 (electronic data interchange services); Board Memorandum re Member Bank Investments, Oct. 10, 1996 (the "Board Investment Memorandum"); Board Letter, July 11, 1996, CCH Fed. Banking L. Rep. ¶ 80-212 (credit card payment services and residential mortgage origination). See generally Board

Staff Opinions (July 11, 1996, June 13, 1995), Fed. Res. Reg. Serv. ¶ 3-447.14 (minority investment criteria); Board Chase 2000 Letter.

iii) Member banks may act as limited partners and establish operating subsidiaries to act as limited or general partners, so long as the partnership only engages in bank-permissible activities. See, e.g., Board Investment Memorandum; Board Letter, July 11, 1996, CCH Fed. Banking L. Rep. ¶ 80-213 (mortgage banking).

D) State Non-member Bank Subsidiaries and Minority Investments

i) As noted above in Part I.D.4.c.ii, subsidiaries of non-member banks which engage in activities not permissible for a national bank are generally governed by the FDIC Activities Regulations.

ii) The FDIC GLBA Regulation added a new Subpart E to Part 362 which sets forth procedures for establishing a Gramm-Leach financial subsidiary. The Regulation clarified that proposals to engage in securities (and other financial) activities permissible for a national bank to conduct only through financial subsidiaries would be considered under Subpart E of Part 362 (i.e., not under Subpart B of Part 362).

d. Insurance Activities

With respect to banking organizations' entry into insurance (other than through financial subsidiaries discussed in Part I.C above) and related issues, see, e.g., Comptroller's Handbook: Insurance Activities; Banks in Insurance: A Comprehensive Look at the State of the Bank Insurance Industry (Marsh-Berry, 2006); Catalyst for Change: Next Steps in Bridging the Cultural

Divide Between Banks and Life Insurers (ACLI, 2005). See generally Insurance Fact Book (Insurance Information Institute, 2016); Financial Services Fact Book (Financial Services Roundtable, 2013); Title Insurance: Preliminary Views and Issues for Further Study (GAO, Apr. 2006).

(i) In general, insurance is subject to state, rather than federal, regulation under McCarran-Ferguson. Gramm-Leach addresses the relationship between state and federal law in the area of insurance regulation. See Part I.C.3 above.

(ii) National banks engage in insurance activities directly and through subsidiaries.

A) As discussed in Part I.C above, under Gramm-Leach, insurance agency sales are permissible for a financial subsidiary.

B) Gramm-Leach does not limit the Comptroller's authority to define the business of banking as it relates to insurance-related products. However, the jump ball provision of Gramm-Leach § 304 may lead to litigation challenging the Comptroller's determinations. Furthermore, under Gramm-Leach, national banks and their subsidiaries (including financial subsidiaries) are prohibited from underwriting insurance, except for products authorized by the Comptroller as of January 1, 1999 (but not including title insurance (unless state law would permit state banks to do so) or annuities). See Part I.C.3.d above.

C) The Comptroller has interpreted 12 U.S.C. § 92 ("Section 92") to permit national banks with branches in "places" with a population of 5,000 or fewer ("small towns") to engage in insurance agency activities, an interpretation which the Supreme Court has upheld. Section 92 permits national bank-owned insurance agencies with a main office in a small town to sell insurance in the same market range as non-bank insurance agencies, including through branch offices outside of the small town. Marketing, training and consulting services to insurance agencies are also permitted. See, e.g., Barnett Bank; IIAA v. Ludwig, 997 F.2d 958 (D.C. Cir. 1993). See also, e.g., Comptroller's Handbook: Insurance Activities; Decision No. 2004-12 (non-controlling investment); Comptroller Conditional Approval No. 574 (Jan. 27, 2003) (non-controlling investment); Comptroller Interpretive Letters No. 882 (Feb. 22, 2000), CCH Fed. Banking L. Rep. ¶ 81-401; No. 877 (Dec. 13, 1999), CCH Fed. Banking L. Rep. ¶ 81-371; No. 874 (Dec. 1, 1999), CCH Fed. Banking L. Rep. ¶ 81-368; No. 873 (Dec. 1, 1999), CCH Fed. Banking L. Rep. ¶ 81-367; Comptroller Conditional Approval No. 334 (Oct. 30, 1999); Comptroller Corporate Decision No. 99-33 (Sept. 28, 1999); Comptroller Conditional Approval No. 327 (Sept. 14, 1999); Comptroller Corporate Decision No. 99-44 (Sept. 10, 1999); Comptroller Conditional Approval No. 320 (July 28, 1999) ("Approval No. 320"); Comptroller Interpretive Letter No. 864 (May 19, 1999), CCH Fed. Banking L. Rep. ¶ 81-358; Comptroller Unpublished Letter (May 19, 1999); Approval No. 303; Comptroller Conditional Approval No. 302 (Jan. 21, 1999); Comptroller Interpretive Letters No. 844 (Oct. 20, 1998), CCH Fed. Banking L. Rep. ¶ 81-299; No. 842 (Sept. 28, 1998) ("Letter No. 842"), CCH Fed. Banking L. Rep. ¶ 81-297; No. 823 (Feb. 27, 1998), CCH Fed. Banking L. Rep. ¶ 81-272; No. 753 (Nov. 4, 1996) ("Letter No. 753"), CCH Fed. Banking L. Rep. ¶ 81-107; Comptroller Interpretive Letter No. 366 (Aug. 18, 1986) ("Letter No. 366"), CCH Fed. Banking L. Rep. ¶ 85,526.

Approval No. 320 granted a national bank two years to establish the legal permissibility of acquired insurance agencies or to restructure the activities. See also, e.g., Approvals No. 223; No. 208.

D) The Comptroller has approved, as part of the "business of banking", various forms of debt cancellation contracts and debt suspension agreements, credit-related and credit-equivalent insurance and reinsurance (including financial guaranty/municipal bond insurance), as well as bank involvement in the sale of certain products -- such as title insurance (under certain circumstances) and fixed and variable annuities (see also Part IX below) -- that are regulated as "insurance" under state laws, but are not "insurance" for purposes of the NBA. The Comptroller also permits a bank to act as guarantor or surety, provided that the customer's obligation, and the guaranty or surety, are financial in nature, reasonably ascertainable in amount, and otherwise consistent with applicable law. See 12 C.F.R. § 7.1017; 73 Fed. Reg. 22216 (Apr. 24, 2008) (final rule); 72 Fed. Reg. 36550 (July 3, 2007) (solicitation of public comments).

See also, e.g., 12 C.F.R. § 7.1006 (independent undertakings to pay against documents), Part 37 (Debt Cancellation Contracts and Debt Suspension Agreements); Comptroller Interpretive Letters No. 1095 (Feb. 27, 2008), CCH Fed. Banking L. Rep. ¶ 81-627 (interpretation of 12 C.F.R. Part 37); No. 1093 (Oct. 29, 2007), CCH Fed. Banking L. Rep. ¶ 81-625 (interpretation of 12 C.F.R. Part 37); No. 1032 (June 16, 2005), CCH Fed. Banking L. Rep. ¶ 81-561 ("GAP Addendum" -- agreement to protect a borrower on a vehicle loan if the vehicle is declared a loss after an accident and the borrower is unable to pay the difference between insurance proceeds and the loan balance -- is subject to the OCC's rules on debt cancellation contracts); No. 1028 (May 9, 2005), CCH Fed. Banking L. Rep. ¶ 81-557 (debt cancellation feature of auto loan); No. 1010 (Sept. 7,

2004) ("Letter No. 1010"), CCH Fed. Banking L. Rep. ¶ 81-539 (financial warranties with respect to principal-protected investment funds); No. 886 (Mar. 27, 2000), CCH Fed. Banking L. Rep. ¶ 81-405; Comptroller Corporate Decision No. 2000-04 (Mar. 23, 2000); Comptroller Conditional Approval No. 371 (Mar. 20, 2000); Comptroller Interpretive Letter No. 845 (Oct. 20, 1998) ("Letter No. 845"), CCH Fed. Banking L. Rep. ¶ 81-300; Letter No. 842; Approval No. 276; Comptroller Interpretive Letter No. 827 (Apr. 3, 1998), CCH Fed. Banking L. Rep. ¶ 81-276; Comptroller Interpretive Letter No. 338 (May 2, 1985) ("Letter No. 338"), CCH Fed. Banking L. Rep. ¶ 85,508, aff'd, AIA v. Clarke, 865 F.2d 278 (D.C. Cir. 1989) ("AIA v. Clarke"). See also Comptroller Corporate Decision No. 99-38 (Oct. 29, 1999) ("Corporate Decision No. 99-38") (national bank acquisition of insurance agency that would limit its activities to those of a finder under 12 C.F.R. § 7.1002).

E) The Comptroller has approved the establishment by a national bank of a captive insurer or reinsurer with respect to loans serviced, originated or purchased by the bank or its subsidiaries or affiliates, as well as with respect to bank safe deposit boxes. See, e.g., Letters No. 985, No. 965, Comptroller Corporate Decisions No. 2001-10 (Apr. 23, 2001), No. 2000-16 (Aug. 29, 2000) ("Corporate Decision No. 2000-16"), No. 99-37 (Oct. 29, 1999), No. 99-36 (Oct. 29, 1999), No. 99-32 (Sept. 20, 1999); No. 99-26 (Sept. 2, 1999), Comptroller Interpretive Letter No. 862 (June 7, 1999), CCH Fed. Banking L. Rep. ¶ 81-356, Comptroller Corporate Decisions No. 99-05 (Dec. 28, 1998), No. 99-04 (Dec. 23, 1998), No. 99-03 (Dec. 21, 1998), No. 99-02 (Dec. 11, 1998); Letter No. 845, Comptroller Corporate Decisions No. 98-43 (Sept. 11, 1998), No. 98-40 (Aug. 18, 1998), No. 98-22 (Apr. 22, 1998), Comptroller Interpretive

Letters No. 835 (July 31, 1998), CCH Fed. Banking L. Rep. ¶ 81-289, No. 828 (Apr. 6, 1998), CCH Fed. Banking L. Rep. ¶ 81-277, Comptroller Corporate Decisions No. 98-15 (Feb. 19, 1998), No. 98-10 (Jan. 28, 1998), No. 97-97 (Nov. 10, 1997), No. 97-93 (Oct. 20, 1997), No. 97-92 (Oct. 17, 1997), No. 97-89 (Sept. 26, 1997), No. 97-27 (May 2, 1997), No. 97-06 (Jan. 22, 1997), Comptroller Interpretive Letter No. 743 (Oct. 17, 1996), CCH Fed. Banking L. Rep. ¶ 81-108, Comptroller Unpublished Letter (Mar. 31, 1995), Comptroller Interpretive Letters No. 377 (Feb. 6, 1987), CCH Fed. Banking L. Rep. ¶ 85,601, No. 277 (Dec. 13, 1983), CCH Fed. Banking L. Rep. ¶ 85,441 (collectively, the "Comptroller Reinsurance Approvals"). See also Comptroller Interpretive Letter No. 1022 (Feb. 15, 2005), CCH Fed. Banking L. Rep. ¶ 81-551 (authorizing national banks to participate in trade association of banks/ BHCs that provides workers' compensation self-insurance).

F) Several insurance activities qualify as Op Sub Notice Activities (see Part I.D.4.c.iii.B.ii above), including underwriting credit-related insurance, acting as insurance agent or broker, mortgage reinsurance, acting as agent or broker for fixed or variable annuities and offering debt cancellation agreements. See 12 C.F.R. § 5.34(e)(5)(v). See also Corporate Decision No. 2000-16.

G) Comptroller Interpretive Letter No. 1021 (Feb. 17, 2005) ("Letter No. 1021"), CCH Fed. Banking L. Rep. ¶ 81-550, set out conditions for a bank to purchase, for its own account, fixed rate annuities, and Comptroller Interpretive Letter No. 878 (Dec. 22, 1999) ("Letter No. 878"), CCH Fed. Banking L. Rep. ¶ 81-375, approved the purchase by a bank of insurance products and investments funds for hedging purposes.

H) National banks may engage in insurance-related activities, including referral, "kiosking", administrative and finder services, that do not rise to the level of insurance agency sales. See, e.g., 12 C.F.R. § 7.1002; Comptroller Conditional Approval No. 435 (Dec. 18, 2000) (administrative services); Comptroller Corporate Decision No. 99-38; Comptroller Interpretive Letters No. 824 (Feb. 27, 1998), CCH Fed. Banking L. Rep. ¶ 81-273 (referral services); No. 653 (Dec. 22, 1994), CCH Fed. Banking L. Rep. ¶ 83,601 (informational and payments interface between insurance underwriters and insurance agencies); Comptroller Unpublished Letter (May 18, 1989) (referral services); Comptroller Interpretive Letter No. 472 (Mar. 2, 1989) ("Letter No. 472"), CCH Fed. Banking L. Rep. ¶ 83,008 (referral services). See also Part VII.C below.

I) The Comptroller permitted Magna Bank, a national bank formed when two state-chartered banks converted to national charters and merged, to retain as "non-conforming assets" interests in an insurance agency subsidiary and real estate joint venture under 12 U.S.C. § 35. See Comptroller Corporate Decisions No. 95-56, No. 95-55 (Nov. 15, 1995). But see Comptroller Corporate Decision No. 97-05 (Jan. 3, 1997) (requiring converting national bank to divest travel agency within two years after conversion).

(iii) The Comptroller's interpretations of the insurance powers of national banks have been subject to significant litigation.

A) The Comptroller withstood numerous legal challenges by insurance industry organizations and state efforts to regulate or prohibit national bank insurance activities. See, e.g., Barnett Bank; VALIC; Association of Banks in Insurance v. Duryee, 55 F. Supp. 2d 799 (S.D. Ohio 1999), aff'd, 270 F.3d 397 (6th Cir. 2001); Deposit Guaranty National Bank v. Dale, 28 F. Supp. 2d 395 (S.D. Miss. 1998); ACLI v. Ludwig, 1 F. Supp. 2d 24 (D.D.C. 1998); NYSBA v. Levin, 999 F. Supp. 716 (WDNY 1998).

B) Nevertheless, the Comptroller's discretion to interpret the insurance powers of national banks is not unlimited. See, e.g., IIAA v. Hawke, 211 F.3d 638 (D.C. Cir. 2000) (affirming 43 F. Supp. 2d 21 (D. Fla. 1999), which overturned Comptroller Unpublished Letter (Dec. 29, 1997), to the effect that national bank could sell crop insurance as part of the "business of banking" (i.e. without reference to the small town limitation of Section 92)); Blackfeet National Bank ["Blackfeet"] v. Nelson, 171 F.3d 1237 (11th Cir. 1999) (the "Blackfeet Appeal") (upholding state regulation of national bank sales of "Retirement CDs" -- an annuity-like product -- and invalidating Comptroller Interpretive Letter No. 649 (May 12, 1994) ("Letter No. 649"), CCH Fed. Banking L. Rep. ¶ 83,556, with respect to the Blackfeet Retirement CD discussed in Part IV.C.5.b below), cert. denied, 528 U.S. 1004 (1999); American Deposit Corp. v. Schacht, 84 F.3d 834 (7th Cir.), cert. denied, 519 U.S. 870 (1996) (upholding state regulation of national bank sales of Retirement CDs); American Land Title Association v. Clarke, 968 F.2d 150 (2d Cir. 1992) ("ALTA"), cert. denied, 508 U.S. 971 (1993) (reversing Comptroller Unpublished Letter (June 20, 1989) which approved title insurance activities; Gramm-Leach codifies ALTA and prohibits national banks from underwriting title insurance except to the extent permitted to state banks). See Part I.C above.

(iv) As discussed in Part I.C.3.g above, the Comptroller and state insurance regulators are cooperating with respect to insurance sales issues and consumer complaint procedures.

(v) Many state banks have insurance-related powers.

A) Because FDIA § 24 applies only to activities as principal, see Part I.D.4.c.ii above, insurance agency subsidiaries of state banks are not generally confined to national bank limitations. See Advisory Opinion 97-12. Proposals by a non-member bank to engage in an insurance activity as principal that is not permissible for a national bank are reviewed under the FDIC Activities Regulations. See Part I.D.4.c.ii and Part I.D.4.c.iii.D above.

B) In 2003 a federal court dismissed a complaint alleging that Tennessee had improperly granted banks licenses to sell title insurance. The Tennessee Attorney General had opined that Gramm-Leach preempted Tennessee law that prohibited Tennessee banks from owning or controlling a title insurance agent. As a result of the state's "wild card statute", Tennessee state banks could therefore own title insurance agencies. See Tennessee Land Title Assoc. v. Pope, No. 3:03-004 (M.D. Tenn.); Tenn. Attorney General Opinion No. 02-013 (Feb. 1, 2002).

(vi) Certain insurance activities permitted outside the U.S. are discussed in Part XI below.

e. Equity Investments

Under FDICIA, a state bank may not acquire or retain an equity investment that is not permissible for a national bank, except for investments in majority-owned subsidiaries and certain investments related to low-income housing. Additional FDICIA provisions relate to state bank investments in common or preferred stock.

In 1992, the FDIC adopted its rule with respect to non-member bank equity investment restrictions. 57 Fed. Reg. 53213 (Nov. 9, 1992) (included in 12 C.F.R. Part 362). See also FDIC Activities/Investment List; FDIC Advisory Opinion No. 93-12

(Feb. 12, 1993), CCH Fed. Banking L. Rep. ¶ 81,626; FDIC Advisory Opinion No. 92-28 (May 11, 1992), CCH Fed. Banking L. Rep. ¶ 81,515 (investment in a limited partnership to invest in corporate enterprises is impermissible).

See also Part I.D.4.c above concerning national and state bank "investments" permitted as part of a banking business.

f. Capital Requirements for Non-traditional Activities

FDICIA § 305, 12 U.S.C. § 1828, requires each federal banking agency to take account of the risks of non-traditional activities in its risk-based capital rules. The Board/Comptroller/FDIC have implemented this provision. See 59 Fed. Reg. 64561 (Dec. 15, 1994). See also Part II below.

g. Ability of U.S. Branches of Foreign Banks to Engage in Impermissible Activities

(i) Under IBA § 4, 12 U.S.C. § 3102, a federal branch of a foreign bank may engage only in activities permissible for a national bank. See Part I.A.11 above.

A) In 2001, the Comptroller adopted the Federal Branch Op Sub Rule, which overrules Comptroller Interpretive Letter No. 476 (Mar. 20, 1989), CCH Fed. Banking L. Rep. ¶ 83,013, and permits federal branches of foreign banks to establish operating subsidiaries.

B) Even though an operating subsidiary of a federal branch would be operated as part of the conduct of the "business of banking" under the Comptroller analysis set out in the precedents cited in Part I.D.4.c above, such activities are essentially treated as governed by the BHCA. See Board Letter to the Comptroller, Feb. 5, 2001.

C) As described above in Part I.D.4.c, the Comptroller has permitted national banks to invest in LLCs and hold stock interests, subject to the Minority

Investment Criteria. The Comptroller granted similar authority to federal branches of foreign banks (see, e.g., Comptroller ING Letter), and the Comptroller 2003 International Revision permits well capitalized, well managed federal branches of foreign banks to make non-controlling equity investments on the same terms as national banks.

(ii) Part 347 governs state-licensed insured branches of foreign banks, and Regulation K (12 C.F.R. § 211.29) implements IBA § 7(h), 12 U.S.C. § 3105(h), which provides that a state-licensed branch of a foreign bank may not engage in "any type of activity" that is not permissible for a federal branch unless the Board has determined that such activity is consistent with "sound banking practice" and, in the case of an insured branch, the FDIC "has determined that the activities would pose no significant risk to the deposit insurance fund".

5. Selected State Legislative Developments

a. A 2010 state survey (including Puerto Rico and the District of Columbia) indicates that 42 states permit banks to engage in municipal bond underwriting, 49 permit securities brokerage, 28 permit real estate brokerage, 33 permit real estate development, 19 permit insurance underwriting, 52 permit insurance brokerage, 38 permit real estate equity participation and 19 permit merchant banking. See A Profile of State Chartered Banking (CSBS, 2011). See also CSBS Real Estate Letter referred to in Part VII.B.3 below.

b. Conduct by state banks of principal activities broader than those permitted to national banks is limited by FDICIA, as implemented by the FDIC Activities Regulations. See Part I.D.4.c above.

6. Federal Reserve Board Jurisdiction Over Activities of Banks and their Subsidiaries in a Holding Company Structure

   a. Activities of Banks which are Subsidiaries of Bank Holding Companies

      Activities of a national or state bank held by a BHC are not governed by BHCA § 4, which restricts the non-banking activities of BHC subsidiaries. See Independent Insurance Agents v. Board, 890 F.2d 1275 (2d Cir. 1989), cert. denied, 498 U.S. 810 (1990), upholding Merchants National Corp., 75 Fed. Res. Bull. 388 (1989), 73 Fed. Res. Bull. 876 (1987). See also, e.g., BankAmerica, 76 Fed. Res. Bull. 248, 244 (1990); Norwest, 76 Fed. Res. Bull. 79 (1990) (the "Norwest 1990 Order") (reaffirming Board Letter, Mar. 8, 1974, CCH Fed. Banking L. Rep. ¶ 96,202, that 12 C.F.R. § 225.125 ("Section 225.125") (investment advisory activities of BHC subsidiaries) does not govern brokerage by bank subsidiaries of a BHC); Board Letter, Jan. 7, 1998, re Affiliated Community Bancorp.

      (i) However, the Board has reserved the right to restrict the activities of state banks to prevent "evasion" of the BHCA. See, e.g., Citicorp (American State Bank of Rapid City), 71 Fed. Res. Bull. 789 (1985) ("Citicorp (South Dakota)") (denial of application to acquire a bank that proposed to engage in insurance underwriting and brokerage, but would conduct insignificant banking activities).

      (ii) The Board could restrict the activities of state member banks under Regulation H, which authorizes the Board to prevent unsafe and unsound practices. The Board may require prior approval for any state member bank to engage in any activity or make any acquisition which changes the general character of the bank's business. See also Part I.D.4 above.

b. Activities of Subsidiaries of Banks

Regulation Y provides that, without the Board's approval, (i) a national bank or its subsidiary may acquire or retain shares in accordance with Comptroller regulations, and (ii) a state-chartered bank or its subsidiary may acquire or retain all of the shares of a company that engages solely in activities in which the parent bank may engage, at such locations and subject to the same limitations that would apply if the bank were engaging in the activity. 12 C.F.R. § 225.22(e).

(i) National Bank Subsidiaries

In AIA v. Clarke, the District of Columbia Circuit vacated that portion of its prior decision (Aug. 23, 1988) which had held that Citibank's acquisition of American Municipal Bond Assurance Corp. ("AMBAC"), which had been approved by the Comptroller in Letter No. 338, also required Board approval under the BHCA. See also National Association of Life Underwriters v. Clarke, 736 F. Supp. 1162 (D.D.C. 1990) (upholding Letter No. 366 and finding that the Comptroller lacked jurisdiction to decide BHCA issues), aff'd, 508 U.S. 439 (1993), aff'd on remand, 997 F.2d 958 (D.C. Cir. 1993).

See generally Fleet, 76 Fed. Res. Bull. 459 (1990) (Section 225.125 does not apply to brokerage by a BHC subsidiary of securities of investment companies advised by subsidiaries of national bank subsidiaries of the BHC). See also Part VIII below.

(ii) State Bank Subsidiaries

A) The Second Circuit held that once the BHCA has been construed to leave the regulation of a BHC's subsidiary banks to their chartering authorities, it "cannot sensibly be interpreted to reimpose the authority of the Board on a generation-skipping basis to regulate the subsidiary's subsidiary". Citicorp v. Board, 936 F.2d 66 (2d Cir.) (the

"Citicorp Decision"), cert. denied, 502 U.S. 1031 (1992), rev'g 76 Fed. Res. Bull. 977 (1990).

B) How the Board interprets the Citicorp Decision insofar as BHC state bank subsidiaries and investments are concerned is unclear. At different times, Board staff have stated informally that the Citicorp Decision is limited to its facts, or limited to state bank subsidiaries of BHCs located in the Second Circuit, or limited to state bank subsidiaries (as opposed to less-than-subsidiary investments). See FRBC Letter, May 30, 2001 (approval under BHCA for subsidiary of BHC's subsidiary bank to make mortgage banking joint venture investment); Board 2000 Chase Letter.

C) The Board has been flexible in interpreting the powers of subsidiaries of banks, and the powers of banks to organize such subsidiaries. For example:

i) In connection with its approval of a BHC's acquisition of a real/personal property appraisal company, the Board noted that the BHC would conform the activities of the company to the BHCA within two years, and that the stock of the company would be contributed to a non-member bank subsidiary of the BHC. The Board also noted that the bank may engage in the activities conducted by the appraisal company, both directly and through a subsidiary, under applicable state law. Board Letter, Dec. 4, 1998.

ii) The Board 1997 AmSouth Letter stated that a BHC bank subsidiary's indirect 50% interest in an LLC met the requirements of 12 C.F.R. § 225.22(d)(2), including the 100% ownership requirement, because the remaining shares of the LLC would be owned by an employee of the LLC and therefore be attributable to the bank.

iii) The Board approved the acquisition by a BHC's non-member bank subsidiary of a company that provides administrative services to investment companies. Board Letter, July 19, 1996.

iv) The Board relieved Union Planters Corp. of commitments which limited the ability of a subsidiary of a bank subsidiary of the BHC to advertise insurance products, permitting the subsidiary to expand its activities beyond those permitted to BHCs. Board Letter, Apr. 30, 1996.

v) In an FDIC Letter, Sept. 2, 1992, to Wilmington Trust Company with respect to the establishment by Wilmington Trust of a subsidiary to act as distributor, adviser and administrator of mutual funds (the "Wilmington Trust Letter"), the FDIC stated that the Board "had no objections to the transfer of mutual fund distribution activities" to the subsidiary. See Part VIII below.

See also Part I.D.4.c above.

II. TRADING AND RELATED ACTIVITIES: SECURITIES, "IDENTIFIED BANKING PRODUCTS" AND DERIVATIVES TRANSACTIONS

A. FRAMEWORK FOR TRADING ACTIVITIES: THE REGULATORY FOCUS

1. Background

FHCs, financial subsidiaries, BHCs and banks engage in principal trading and underwriting activities with respect to government securities, investment securities, derivatives and currencies. Bank participation in these markets is significant: overall commercial bank holdings of securities in investment and trading accounts in 2016 represented more than 20% of total bank assets. Bank trading activities generated $5.8 billion of revenue in the first quarter of 2016, 35.3% higher than fourth quarter 2015 revenues of $4.3 billion. The total notional amount of derivative contracts booked by the top 25 banks in the U.S. approached $193 trillion as of March 31, 2016, with the top 4 commercial banks holding over $168 trillion of derivatives in their trading accounts. See, e.g., Assets and Liabilities of Commercial Banks in the United States (Board, Sept. 2, 2016); Quarterly Report on Bank Trading and Derivatives Activities (OCC, June 2016). See also SwapsInfo First Quarter 2016 Review (ISDA, June 2016).

Dodd-Frank § 620 required the federal banking agencies to complete a study by January 2012 of the permissible activities and investments of banking entities, including recommendations to Congress and the newly created FSOC as to (a) the appropriateness of such activities, (b) the negative effects they could have on the safety and soundness of banking entities or the U.S. financial system, and (c) restrictions that might be necessary to address such negative effects. The Board, the OCC and the FDIC issued the Section 620 Report on September 8, 2016.

In the Section 620 Report, the Board recommends that Congress (i) repeal the authority of FHCs to engage in merchant banking activities; (ii) repeal the grandfather authority under § 4(o) of the BHCA for certain FHCs to engage in certain commodities activities; (iii) repeal the exemption that permits corporate owners of industrial loan companies to operate outside of the regulatory and supervisory framework applicable to other corporate owners of insured depository institutions ("IDIs"); and (iv) repeal the exemption for grandfathered unitary savings and loan holding companies from the activities restrictions applicable to all other savings and loan holding companies. The Board indicated that it may engage in a rule-making to address risks it sees in certain commodity and merchant banking activities.

The OCC plans to (i) issue a proposed rule to restrict federal banking entities holdings of asset-backed securities that hold bank-impermissible assets; (ii) address concentrations of mark-to-model assets and liabilities with a rulemaking or guidance; (iii) clarify minimum prudential standards for certain national bank swap dealing activities (presumably those that may not meet the swap dealer registration thresholds established by CFTC); (iv) consider providing guidance on risks of clearinghouse memberships; (v) clarify regulatory limits on physical commodity hedging; (vi) address national banks' authority to hold and trade copper; and (vii) incorporate the Volcker Rule into the OCC's investment securities regulations.

The FDIC plans to (i) review activities related to investments to evaluate the interaction of existing FDIC regulations and supervisory approvals and conditions under Part 362 in order to determine whether changes are needed; and (ii) determine whether the prudential conditions and standards under which the FDIC evaluates Part 362 filings with respect to mineral rights, commodities, or other non-traditional activities need to be clarified.

See Report to the Congress and the Financial Stability Oversight Council Pursuant to Section 620 of the Dodd-Frank Act (Board/FDIC/OCC, Sept. 2016). See also NY Times Dealbook, Sept. 13, 2016 ("little risk" in merchant banking); Bloomberg, Sept. 8, 2016; Wall St. J., Sept. 8, 2016; Reuters, Sept. 8, 2016; SIFMA, TCH, ABA, FSR and FSF Joint Press Release, Sept. 8, 2016 (opposing recommendations to repeal merchant banking and related authorities); 79 Fed. Reg. 3329 (Jan. 21, 2014) (Board advance notice of proposed rulemaking requesting comments on risks related to commodities and merchant banking activities).

See also Part III, Part IV, Part V, Part VI, Part VII.A, Part IX, Part X and Part XI below, each of which discusses the ability of FHCs, financial subsidiaries, BHCs and banks to purchase and sell securities and other financial instruments.

2. Capital Requirements

Capital regulation is the basic component of prudential regulation and a significant factor in a banking organization's securities and derivative activities. Banking organizations are expected to demonstrate (i) the effectiveness of internal capital adequacy assessments and strategies; (ii) the ability to monitor and ensure compliance with regulatory capital requirements; and (iii) the effectiveness of a process for assessing overall capital adequacy in relation to risk, including (A) board and senior management oversight; (B) policies and procedures to identify, manage and report risks, relate capital to the level of risk, set capital adequacy goals with respect to risk, and incorporate controls and audits to insure the integrity of the risk management process; (C) comprehensive risk assessment; (D) a system for monitoring and reporting risk exposures; and (E) an internal control review structure. See generally Benefits and Costs of Bank Capital (IMF Staff Discussion Note, Mar. 2016); Remarks of Board Governor Tarullo, Sept. 28, 2015 (Capital Regulation Across Financial Intermediaries); Remarks of FDIC Vice-chairman Hoenig, May 23, 2016 (A Capital Conflict); Statement of FDIC Vice-chairman Hoenig, Apr. 12, 2016 (Update of the Global Capital Index).

a. The Board/Comptroller/FDIC capital guidelines (collectively the "Capital Guidelines") provide a critical framework within which bank/BHC/FHC trading activities take place. In 2012, the Board/Comptroller/FDIC issued three related proposals to completely revise the overall structure of their capital adequacy rules to implement both the post-crisis international agreements on capital and the requirements imposed by Dodd-Frank. See Notices of Proposed Rulemakings, 77 Fed. Reg. 52792 (Aug. 30,

2012) (implementation of Basel III, minimum regulatory capital ratios, capital adequacy, transition provisions, and prompt corrective action) (solicitation of public comments), 77 Fed. Reg. 52888 (Aug. 30, 2012) (standardized approach for risk-weighted assets, market discipline and disclosure requirements) (solicitation of public comments), 77 Fed. Reg. 52978 (Aug. 30, 2012) (advanced approaches risk-based capital) (solicitation of public comments) (collectively, the "Proposed Revised Capital Guidelines"); 77 Fed. Reg. 63763 (Oct. 17, 2012) (FDIC initial regulatory flexibility analysis).

In 2013, the Board/Comptroller/FDIC issued a final regulation that consolidates and largely adopts unchanged the Proposed Revised Capital Guidelines (the "Revised Capital Guidelines"). The Revised Capital Guidelines became effective for "advanced approaches" banking organizations on January 1, 2014, and became effective for banking organizations applying the "standardized approach" on January 1, 2015, although many requirements have phase-in or transition periods. See 79 Fed. Reg. 20754 (Apr. 14, 2014) (FDIC final rule); 78 Fed. Reg. 62018 (Oct. 11, 2013) (Board and OCC final rule); 78 Fed. Reg. 55340 (Sept. 10, 2013) (FDIC interim final rule). See also 78 Fed. Reg. 76973 (Dec. 20, 2013) (Board modifications to clarify the criteria for subordinated debt instruments that may be counted as tier 2 capital); 79 Fed. Reg. 44120 (July 30, 2014) (Board, OCC and FDIC final rule revising the definition of eligible guarantee in the agencies' advanced approaches risk-based capital rule); 79 Fed. Reg. 75417 (Dec. 18, 2014) (OCC interim final rule making Basel III conforming amendments to OCC rules governing subordinated debt issuance); 79 Fed. Reg. 78287 (Dec. 30, 2014) (OCC/FRB interim final revisions to the definition of qualifying master netting agreement in the capital and LCR rules); Interagency [FAQs] on the Regulatory Capital Rule, Board SR Letter 15-6 (Apr. 6, 2015), CCH Fed. Banking L. Rep. ¶ 47-182; OCC Bulletin No. 2015-23 (Apr. 6, 2015), CCH Fed. Banking L. Rep. ¶ 47-182; 80 Fed. Reg. 41409 (July 15, 2015) (FRB/OCC/FDIC final rule revising the risk weights for cleared transactions and derivatives for advanced approaches banking organizations and correcting certain technical errors); 80 Fed. Reg. 76374 (Dec. 9, 2015) (Board final rule to apply common equity Tier 1 ("CET 1") eligibility criteria to non-common-stock instruments such as partnership interests); 81 Fed. Reg. 29169 (May 11, 2016) (FRB proposal to modify definition of qualifying master netting agreement in the Revised Capital Guidelines and related definitions); 81 Fed. Reg. 55381 (Aug. 19, 2016) (OCC proposal to modify definition of qualifying master netting agreement in the Revised Capital Guidelines and related definitions).

b. Before implementation of the Revised Capital Guidelines, the Capital Guidelines were based upon the Basel Committee 1988 accord, commonly known as "Basel I". See International Convergence of Capital Measurement and Capital Standards (BIS, July 1988).

In 2006, the Basel Committee released a comprehensive new accord to enhance the risk sensitivity of Basel I ("Basel II"). Basel II includes a standardized approach, an advanced internal ratings-based approach ("AIRB") and an advanced measurement approach ("AMA") for determining a banking organization's risk weighted asset amounts for credit and operational risk. The AIRB and AMA are collectively referred to as the "advanced approaches." In the U.S., prior to the adoption of the Revised Capital Guidelines, the federal banking agencies had adopted only the advanced approaches and applied them only to large, complex, international banks with assets equal to or exceeding $250 billion or foreign exposures equal to or exceeding $10 billion -- the so-called "core banks". Other U.S. banking organizations remained subject to Basel I-based capital standards.

With respect to implementation of the Basel II capital framework in the U.S., see generally, Board/Comptroller Press Release, dated Feb. 21, 2014 (approving advanced approaches for certain BHCs and banks); Supervisory Guidance: Supervisory Review Process of Capital Adequacy (Pillar 2) Related to the Implementation of [Basel II], 73 Fed. Reg. 44620 (July 31, 2008); Interagency Statement: U.S. Implementation of Basel II Advanced Approaches Framework – Qualification Process, 73 Fed. Reg. 44620 (July 31, 2008); 73 Fed. Reg. 43982 (July 29, 2008) (proposed standardized approach to Basel II) (solicitation of public comments); 72 Fed. Reg. 69288 (Dec. 7, 2007) (advanced approach to Basel II) (final rule).

In addition, the Board has issued examination guidance related to the implementation of the advanced approaches and related issues. See, e.g., Board Basel Coordination Committee ("BCC") Bulletin 16-1 (Apr. 6, 2016) (guidance pertaining to the Basel Committee's consultation paper on the standardised measurement approach for operational risk); BCC Bulletin 14-3 (Oct. 23, 2014) (guidance on referenced data periods and data deficiencies); BCC Bulletin 14-2 (Oct. 10, 2014) (guidance regarding notifications of material changes to advanced systems and modeling changes); BCC Bulletin 14-1 (June 30, 2014) (guidance regarding supervisory expectations for data, modeling, and model risk management under the advanced approaches to calculate operational risk); Board SR Letter 12-17 (Dec. 20, 2013), CCH Fed. Banking L. Rep. ¶ 33-749 (Consolidated Supervision Framework for Large Financial Institutions) (guidance on how certain risk transfer transactions affect assessments of capital adequacy at large financial institutions covered by the Board's Consolidated Supervision Framework for Large Financial Institutions); OCC GAA 2013-01 (Oct. 28, 2013) (Implementing the Supervisory Formula Approach for Securitization Exposures); BCC Bulletin 13-3 (May 2, 2013) (guidance for independent verification of advanced approaches systems); BCC Bulletin 13-4 (May 2, 2013) (guidance on implied support under the advanced approaches); BCC Bulletin 13-5 (May 2, 2013) (applying the requirement for conservatism to the parameters in the advanced approaches); BCC Bulletin 13-6 (May 2, 2013) (guidance for internal audit under the advanced approaches).

c. Basel's capital framework has three principal elements or "Pillars":

(i) Pillar 1: minimum risk-based capital requirements to achieve a more risk-sensitive treatment of credit risk and to cover other risks (e.g., operational risk) explicitly.

(ii) Pillar 2: supervisory review of an institution's capital adequacy and internal assessment processes (with a focus on liquidity risk, interest rate risk and concentration risk).

(iii) Pillar 3: use of more robust disclosure to impose market discipline and encourage safety and soundness.

d. In 2008, the federal banking agencies initially proposed rules to implement the Basel II standardized approach as an optional alternative to the Basel I rules for non-core banks and were on the cusp of finalizing these rules before the enactment of Dodd-Frank. See 73 Fed. Reg. 43982 (July 29, 2008). However, Dodd-Frank § 939A required further revisions to the Basel II standardized approach to eliminate reliance on the use of external credit ratings. As discussed in Part II.A.2.g below, these revisions are reflected in the Revised Capital Guidelines.

e. In July 2009, the Basel Committee released Enhancements to the Basel II Framework to strengthen Basel II in light of weaknesses revealed by the 2007-2009 financial crisis. Modifications to (i) Pillar 1 include tightening the regulatory capital treatment of those exposures and activities which performed adversely or posed heightened risks during the market stress; (ii) Pillar 2 include more rigorous supervision of risk management, off-balance sheet exposures, securitizations and related reputational risks; and (iii) Pillar 3 include increasing disclosure related to securitization positions and capital charges. See also, e.g., BIS Press Release, June 18, 2010 (adjustments to the Basel II market risk framework); Financial Markets Regulation - Financial Crisis Highlights Need to Improve Oversight of Leverage at Financial Institutions and Across System (GAO, July 2009); Assessment of Banks' Pillar 3 Disclosures (CEBS, June 24, 2009); Basel II's Proposed Enhancements - Focus on Concentration Risk (Fitch, Apr. 16, 2009).

f. In December 2009, Basel Committee proposed to increase capital requirements for banking organizations, narrow the definition of capital and introduce new liquidity requirements ("Basel III").

The Basel Committee released the Basel III rules text in December 2010, indicating that many of the new standards would be phased in over time to become fully effective January 1, 2019. See Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems (BIS, Dec. 2010, revised June 2011). See also Frequently Asked Questions on the Revised Pillar 3 Disclosure Requirements (BIS, Aug. 2016); Revisions to the Securitization Framework (BIS, July 2016); Tenth Progress Report on Adoption of the Basel Regulatory Framework (BIS, Apr. 2016); Consultative Document on Capital Treatment for Simple, Transparent and Comparable Securitizations (BIS, Nov. 2015); Revised Pillar 3 Disclosure Requirements (BIS, Jan. 2015); [FAQs] on the Basel III Leverage Ratio Framework (BIS, Oct. 2014, updated July 2015); Review of the Pillar 3 Disclosure Requirements (BIS, June 2014); Progress Report on Implementation of the Basel Regulatory Framework (BIS, Apr. 2014); A Sound Capital Planning Process: Fundamental Elements (BIS, Jan. 2014); Basel III Leverage Ratio Framework and Disclosure Requirements (BIS, Jan. 2014); Regulatory Consistency Assessment Programme ("RCAP") -- Second Report on Risk-weighted Assets for Market Risk in the Trading Book (BIS, Dec. 2013); Revisions to the Securitization Framework (BIS, Dec. 2013); Basel III Monitoring Report (BIS, Sept. 2013); [RCAP]: Analysis of Risk-weighted Assets for Credit Risk in the Banking Book (BIS, July 2013) and Analysis of Risk-weighted Assets for Market Risk (BIS, Jan. 2013); Basel III Counterparty Credit Risk and Exposure to Central Counterparties: [FAQ] (BIS, Dec. 2012); Basel III [RCAP] (BIS, Apr. 2012).

g. The Revised Capital Guidelines implement Basel III in the U.S. In addition, the Revised Capital Guidelines harmonize the Basel capital framework with the capital provisions of Dodd-Frank and specifically, implement the phase-out of certain hybrid securities from the Tier 1 capital of BHCs and establish a floor for core banks applying the advanced approaches as required under the Collins Amendment. Furthermore, the Revised Capital Guidelines adopt alternatives to the use of external credit ratings as required by Dodd-Frank § 939A.

(i) Under the Revised Capital Guidelines, the standardized approach is mandatory for all banking organizations (other than small BHCs) not subject to the advanced approaches. As discussed in greater detail in Part II.A.2.i below, core banks must calculate their capital requirements using both the advanced approaches and the standardized approach, with the latter serving as a floor.

(ii) Consistent with Basel III, the Revised Capital Guidelines increase the minimum requirement for CET1 from 2% (prior to the application of regulatory deductions) to 4.5% (after the application of stricter adjustments) and increase the minimum requirement for a Tier 1 capital ratio from 4% to 6%. The Revised Capital Guidelines also disqualify certain innovative and hybrid capital instruments from Tier 1 capital.

(iii) Consistent with Basel III, the Revised Capital Guidelines require all banking organizations to maintain a capital conservation buffer of 2.5% of common equity above their minimum risk-based requirements. Under the Revised Capital Guidelines, if a banking organization's capital levels dip into the buffer range, it would be required to conserve a percentage of its eligible retained income, with only the remainder available for distribution in the form of dividends or other "discretionary" capital expenditures (such as executive bonuses).

The Revised Capital Guidelines also provide for an additional countercyclical buffer ("CCyB") of 0% to 2.5% of common equity that may be applied to core banks if the federal banking agencies determine such a buffer is necessary to protect the banking system from disorderly downturns following expansionary periods. The capital buffer requirements will be phased in between January 2016 and January 2019.

A) The Board issued a policy statement on the framework for setting the amount of the U.S. CCyB for core banks. In accordance with the Revised Capital Guidelines, the amount of the applicable CCyB is equal to the weighted average of CCyB amounts established by the Board for the national jurisdictions where core banks have private sector credit exposures. As a result, the CCyB may differ for each core bank. The Board's proposed framework for setting the U.S. CCyB encompasses a number of financial-system vulnerabilities, as well as a wide range of financial and macroeconomic quantitative indicators. However, given that no single indicator or fixed set of indicators can adequately capture all key vulnerabilities, the types of indicators and models considered in assessments of the appropriate level of the CCyB are likely to change over time. The Board expects to consider the applicable level of the U.S. CCyB at least once per year. An increase in the amount of the CCyB for U.S.-based credit exposures would generally have an effective date 12 months after such determination, while a decrease in the amount of the CCyB would generally become effective the day after such determination. As of September 15, 2016, the U.S. CCyB remained zero, although several regulators outside the U.S. have imposed a CCyB in their jurisdictions. See 81 Fed. Reg. 63682 (Sept. 16, 2016) (final policy statement); 81 Fed. Reg. 5661 (Feb. 3, 2016) (solicitation of public comments). See also [FAQs] on the [CCyB] (BIS, Oct. 2015).

(iv) In a key divergence from the Basel III framework, the federal banking agencies have imposed two distinct leverage ratios on core banks. The Revised Capital Guidelines preserve for all banking organizations the Capital Guidelines' leverage requirement and calculation methodology (Tier 1 capital, as determined under the Revised Capital Guidelines, divided by average consolidated assets net of deductions from Tier 1 capital). In addition, the Revised Capital Guidelines introduce a new leverage requirement, referred to as the "supplementary leverage ratio", based broadly on Basel III's 3% leverage requirement (which includes off-balance sheet exposures in the denominator) (the "Basel Leverage Ratio"), but make this requirement applicable only to core banks. Under the Revised Capital Guidelines, core banks must calculate and report their supplementary leverage ratio, and, as of January 1, 2018, will be required to satisfy the 3% minimum requirement.

Soon after finalizing the Revised Capital Guidelines, the federal banking agencies adopted an "enhanced supplementary leverage ratio" standard for U.S. top-tier BHCs with at least $700 billion in total consolidated assets or at least $10 trillion in assets under custody. Covered BHCs must maintain a leverage buffer greater than 200 basis points above the minimum supplementary leverage ratio requirement of 3%, for a total of more than 5%, to avoid restrictions on capital distributions and discretionary bonus payments. Insured depository institution subsidiaries of covered BHCs must maintain at least a 6% supplementary leverage ratio to be considered "well capitalized" under the agencies' PCA framework. The final rule, which has an effective date of January 1, 2018, currently applies to eight large U.S. banking organizations that meet the size thresholds and their insured depository institution subsidiaries. See 79 Fed. Reg. 57725 (Sept. 26, 2014) (final rule); 79 Fed. Reg. 24528 (May 1, 2014) (solicitation of public comments); "Enhanced" Supplementary Leverage Ratio to Drive Further Capital Build at Largest U.S. Banking Organizations (Cleary Gottlieb, Apr. 21, 2014). See also Shortcomings of Leverage Ratio Requirements (TCH, Aug. 2016); Report on the Leverage Ratio Requirements Under Article 511 of the CRR (EBA, Aug. 3, 2016) (concluding that the main leverage ratio requirement should remain at 3%, but willing to continue international discussions on higher requirements for G-SIBs); Reuters, Jan. 11, 2016 (global top 30 banks should be required to meet higher leverage ratio).

Together with this rule, the federal banking agencies also adopted a final rule modifying the definition of the denominator of the supplementary leverage ratio to address, among other items, the exposure calculations for repo, securities lending and derivative transactions. See 79 Fed. Reg. 57725 (Sept. 26, 2014) (final rule); 79 Fed. Reg. 24596 (May 1, 2014) (solicitation of public comments). See also U.S. Regulatory Capital: Basel III Supplementary Leverage Ratio Final Rule (Deloitte, 2014).

The introduction of different types of exposures in the denominator of the Basel Leverage Ratio has been the topic of considerable concern for banks. In particular, lobbying efforts urge global regulators to exclude cash held in central bank deposits, as well as to modify the treatment of collateral received and posted in cleared transactions. See, e.g., Risk, Aug. 4, 2016 (UBS use of "settlement" approach, rather than margining, at LCH); PRA Statement on the Leverage Ratio (PRA, Aug. 4, 2016) (allowing banks to apply to exclude claims on central banks matched with deposits from the denominator of the leverage ratio); Securities Lending Times, July 8, 2016; Financial Times, July 5, 2016 (Bank of England urges Basel Committee to review "unintended effects"); Letter to Basel Committee (SIFMA, June 30, 2016); Banking Daily, Apr. 4, 2016; Risk, Feb. 3, 2016 (discussing "daily settlement" rather than collateral posting); Risk, Feb. 8, 2016 (possible spin-offs of swap clearing functions to reduce capital hit); Risk, Feb. 11, 2016 (higher clearing charges resulting from leverage ratio); Financial Times, Sept. 29, 2015 (CFTC Chairman Massad calls for modification in context of clearing).

(v) In April 2016, the Basel Committee proposed revisions to the Basel Leverage Ratio that would replace the method of calculating derivatives exposure using the current exposure methodology ("CEM") with the standardized approach for counterparty credit risk ("SA-CCR"). The CEM has long been criticized as insufficiently risk-sensitive and unlike the SA-CCR does not permit exposure netting. The proposed incorporation of the CA-CCR into the Basel Leverage Ratio was largely welcomed but concerns remain that the proposed revisions would not permit banking organizations to recognize initial margin received to reduce their exposure. See Consultative Document: Revisions to the Basel III Leverage Ratio Framework (BIS, Apr. 25, 2016). See also e.g., Letter to William Coen (SIFMA, June 30, 2016); Financial Times, July 5, 2016; SNL Financial, Apr. 18, 2016; American Banker, Apr. 7, 2016; Risk, Feb. 9, 2016; Wall St. J., Dec. 7, 2015.

(vi) In November 2014, the GAO published a report to Congress examining the potential effects of the Revised Capital Guidelines on credit availability, capital levels and international competitiveness of U.S. banking organizations. The report suggests that the higher regulatory capital requirements will have a modest effect on the cost and availability of credit and estimates that fewer than 10% of BHCs will need to raise less than $5 billion in total additional capital to cover their anticipated shortfall under the Revised Capital Guidelines. The report notes that the impact of the reforms on the competitiveness of internationally active banks is unclear due to the ongoing implementation of Basel III internationally. See Bank Capital Reforms: Initial Effects of Basel III on Capital, Credit and International Competitiveness (GAO, Nov. 2014).

See also Final Capital Rules Adopted: Relief for Community Banks, Increased Burden for Large Internationally Active Banks (Cleary Gottlieb, July 10, 2013); U.S. Regulatory Capital Basel III Final Rules: Key Takeaways and Highlights for U.S. Banks (Deloitte, July 2013); Federal Banking Agencies' Basel III Capital Proposals Would Increase Complexity and Burden of Regulatory Capital Requirements for All U.S. Banking Organizations (Cleary Gottlieb, Sept. 10, 2012); [FRB] Issues Long-Awaited Capital Rules (Cleary Gottlieb, June 11, 2012).

h. In 2013, the Basel Committee updated its rules with respect to the methodology for assessing the systemic importance of banks, which would impose a capital surcharge on banking organizations designated as G-SIBs ranging from 1% to 2.5% (with a possible incremental surcharge of 1% on the largest G-SIBs if they continue to grow). The so-called "G-SIB surcharge" would be phased in over three years beginning in January 2016. See [G-SIBs]: Updated Assessment Methodology and the Higher Loss Absorbency Requirement (BIS, July 2013). See also 2015 Update of List of [G-SIBs] (FSB, Nov. 3, 2015) (listing 30 G-SIBs); Systemic Importance Data Shed Light on Global Banking Risks (OFR, Apr. 13, 2016).

In July 2015, the Board issue a final rule implementing the G-SIB surcharge for U.S. G-SIBs ("G-SIB Surcharge Rule"). The G-SIB Surcharge Rule "gold plates" the Basel G-SIB framework by requiring that U.S. G-SIBs calculate their applicable surcharge using two methods. Method 1 is the approach established by the Basel Committee. Method 2, which is expected to result consistently in a higher surcharge, takes into account the G-SIB's reliance on short-term wholesale funding. The G-SIB Surcharge Rule is accordingly expected to result in significantly higher surcharges for the US G-SIBs (ranging from 1 to 4.5%) than their international peers. Consistent with the Basel G-SIB framework, the surcharge must be met with common equity, will function as an extension of the capital conservation buffer and will be fully phased-in by January 2019. See 80 Fed. Reg. 49082 (Aug. 14, 2015) (final rule); 79 Fed. Reg. 75473 (Dec. 18, 2014) (solicitation of public comments). See also 81 Fed. Reg. 20579 (Apr. 8, 2016) (proposal to clarify timing of Method 1 and Method 2 calculations); GAO Report on the [G-SIB Surcharge Rule] (GAO, Sept. 30, 2015) (finding that the Board complied with necessary procedural requirements in promulgating the rule); Overview and Assessment of the Methodology Used to Calibrate the U.S. GSIB Capital Surcharge (TCH, May 2016).

(i) In 2012, the Basel Committee issued its framework for domestic systemically important banks ("D-SIBs"). The D-SIB framework is intended to supplement the G-SIB framework by imposing a capital buffer on certain banks that may not be significant from an international perspective, but nevertheless have an important impact on a jurisdiction's individual economies. The D-SIB framework has not been implemented in the U.S. See A Framework for Dealing with [D-SIBs] (BIS, Oct. 2012).

i. In 2016, the Basel Committee issued for comment a proposal to revise the calculation methods for credit-risk weighted assets. The Basel Committee indicated that the proposal is intended to reduce the complexity of the regulatory framework, improve comparability and address excessive variability in the capital requirements for credit risk. The proposal would (i) remove the option to use the AIRB approaches for certain exposures, where it is judged that the model parameters cannot be estimated; (ii) adopt model-parameter floors to ensure a minimum level of conservatism for portfolios where the AIRB approaches remain available; and (iii) provide greater specification of parameter estimation practices to reduce variability in risk-weighted assets for portfolios where the AIRB approaches remain available. See Reducing Variation in Credit Risk-weighted Assets – Constraints on the Use of Internal Model Approaches (BIS, Mar. 2016). Significant criticism has been leveled at this proposal, including by non-U.S. governments and regulators who have signaled that they may not adhere to a final form of this proposal if it raises capital requirements too significantly. See, e.g., Bloomberg, July 26, 2016 (indicating opposition from European, Japanese and Indian regulators).

   In addition, the Basel Committee also warned institutions "not [to] engage in transactions that have the aim of offsetting regulatory adjustments", indicating that "[a]ny such transactions will be subject to careful supervisory scrutiny". Statement on Capital Arbitrage Transactions (BIS, June 2016). Cf. Banking Daily, Aug. 11, 2016 (reporting on Nordea swaps designed as synthetic securitizations to counter risk and offset capital charges), Aug. 22, 2016 (reporting on Sweden regulatory scrutiny of Nordea swaps).

j. The Basel capital framework also includes a market risk capital requirement. The Basel Committee adopted the market risk capital requirement in 1996 as an amendment to Basel I. The market risk amendment introduced the use of value-at-risk ("VAR") models to measure the market risk of FX and commodity positions, as well as positions in the trading account, and to determine the amount of additional capital banks must hold to cover their exposure to market risk. These VAR-based models are developed internally by each banking organization and are subject to review and approval by regulators. In addition to the VAR-based measurement of market risk, the market risk framework includes additional specific risk requirements for debt and equity positions held in the trading book.

The Basel Committee adopted revisions to the market risk capital requirements, commonly known as "Basel II.5", in various issuances in 2005, 2009 and 2010. The Basel II.5 revisions introduced specific risk requirements for securitization and correlation trading positions and included a new incremental default risk capital requirement intended to capture the price risk arising from significant changes in the underlying credit quality of a trading book position. The Basel II.5 revisions also placed additional prudential requirements on bank's internal models for measuring market risk and required enhanced disclosures. With respect to market risk generally, see, e.g., Interpretive Issues with respect to the Revisions to the Market Risk Framework (BIS, Nov. 2011); Findings on the Interaction of Market and Credit Risk (BIS, May 2009).

With respect to implementation of Basel II.5 in the U.S. (including alternatives to the use of credit ratings for debt and securitization positions in accordance with Dodd-Frank § 939A), see 78 Fed. Reg. 76521 (Dec. 18, 2013) (final rule to conform to the Revised Capital Guidelines); 77 Fed. Reg. 53060 (Aug. 30, 2012) (final rule); 76 Fed. Reg. 79380 (Dec. 21, 2011) (amendment to notice of proposed rulemaking); 76 Fed. Reg. 1890 (Jan. 11, 2011) (solicitation of public comments).

The Basel Committee published revised requirements for market risk in January 2016. The final standard, also known as the Fundamental Review of the Trading Book, is expected to result in higher global capital requirements for banks subject to the regime. The final standard establishes a revised boundary between the trading book and banking book which, in part, provides more prescriptive guidance as to qualifying trading book positions as well as imposes heightened restrictions and, in certain instances, additional capital charges, on the transfer of positions between the trading book and banking book. With regard to the internal models approach, the final standard introduces a more comprehensive model to measure market risk, provides for a more granular model approval process and reduces the regulatory capital benefits of hedging activities and portfolio diversification. The final standard revises the standardized approach, in part, by calibrating it more closely to the internal models approach by increasing reliance on risk sensitivity inputs in the calculation of market risk capital requirements. The Basel Committee has established an implementation deadline of January 2019 and a compliance deadline of December 2019 for these revised requirements. See Minimum Capital Requirements for Market Risk (BIS, Jan. 2016); Fundamental Review of the Trading Book: Outstanding Issues (BIS, Dec. 2014); Fundamental Review of the Trading Book: A Revised Market Risk Framework (BIS, Oct. 2013). See also First Take: Ten Key Points from Basel's Fundamental Review of the Trading Book (PWC, Jan. 19, 2016); Internal Trading Book Models Under Threat (Oliver Wyman, Jan. 2016); International Financing Review, Apr. 16, 2016; Banking Daily, Apr. 15, 2016.

k. The Basel Committee considered but ultimately rejected the adoption of a Pillar 1 capital requirement for interest rate risk in the banking book. Its final standards for risk management and supervision of interest rate risk in the banking book adopt a supervisory approach that includes quantitative calculation and disclosure but do not impose a minimum capital requirement for interest rate risk in the banking book. See Standards: Interest Rate Risk in the Banking Book (BIS, Apr. 2016); Consultative Document on Interest Rate Risk in the Banking Book (BIS, June 2015). See also IFLR, June 2016; Risk, Jan. 12, 2016.

l. Dodd-Frank § 171, or the "Collins Amendment", has had a significant impact on the federal banking agencies' capital regulation in three important respects.

(i) The Collins Amendment establishes a floor for the capital levels of banks that calculate their capital requirements under the Revised Capital Guidelines' advanced approaches. It requires the minimum required leverage and risk-weighted capital ratios for these institutions to be no lower than the leverage and risk-based capital requirements applicable to insured depository institutions under banking regulators' generally applicable regulations.

A) The federal banking agencies' implementation of the Collins Amendment floor requires core banks to calculate indefinitely their capital requirements using both the standardized approach and the advanced approaches under the Revised Capital Guidelines. See 76 Fed. Reg. 37620 (June 28, 2011) (final rule implementing the Collins Amendment); 75 Fed. Reg. 82317 (Dec. 30, 2010) (solicitation of public comments). See also American Banker, Aug. 31, 2016 (banks question the value of developing advanced models, given the standardized floor).

B) While the Collins Amendment floor does not, by its terms, apply to foreign banking organizations, the federal banking agencies have said that, with respect to making capital equivalency determinations in the context of various applications by foreign banks, including capital comparability in the context of FHC elections by such banks, the agencies will continue to evaluate such equivalency issues on a case-by-case basis.

(ii) The Collins Amendment requires a phase-out of trust preferred securities and cumulative preferred securities from the Tier 1 capital of U.S. BHCs with total assets of at least $15 billion. Although Basel III also requires the elimination of such hybrid capital instruments from a banking organization's Tier 1 capital, the Collins Amendment requires the federal banking agencies to accelerate Basel III's 10-year phase-out by requiring U.S. banking organizations with total assets equal to or greater than $15 billion to eliminate such instruments from their Tier 1 capital calculations by January 1, 2016.

This phase-out is included as part of the Revised Capital Guidelines.

Dodd-Frank § 174 directed the GAO to study the use and benefits of hybrid capital instruments, the risks to banking institutions and the economy of excluding hybrid capital from Tier 1 capital, and alternative means for small banks (those with less than $10 billion in assets) to access capital. The GAO Report determined that, while hybrid capital is an important source of Tier 1 capital for BHCs, it does not absorb losses as well as common stock and its exclusion from regulatory capital will have a limited impact on credit availability and pricing. See Dodd-Frank Act: Hybrid Capital Instruments and Small Institution Access to Capital (GAO, Jan. 2012).

(iii) The Collins Amendment required the U.S. intermediate BHCs of internationally headquartered BHCs to comply with the capital adequacy requirements applicable to BHCs by July 21, 2015. This represented a reversal of a long-standing Board supervisory policy toward intermediate BHCs. See Board SR Letter 01-01 (Jan. 5, 2001), CCH Fed. Banking L. Rep. ¶ 47-796.

A) In 2012, the GAO published its Dodd-Frank-mandated Report to Congress examining regulation of foreign bank-owned BHCs in the U.S., potential effects of changes in U.S. capital requirements on foreign bank-owned BHCs, and banks' views on the potential effects of changes in U.S. capital requirements on U.S. banks operating abroad. The Report primarily observes that market participants expressed uncertainty about how changes in capital requirements applicable to U.S. BHCs owned by foreign banking organizations might affect the competitiveness of U.S. banks operating abroad. See Dodd-Frank Act: Potential Effects of New Changes on Foreign Holding Companies and U.S. Banks Abroad (GAO, Jan. 2012).

B) The Final Foreign SIFI Rule will require certain large foreign banking organizations to hold their U.S. bank and non-bank subsidiaries under a single IHC that would be subject to the Revised Capital Guidelines and the Collins Amendment.

m. In 2011, the Board published its final Capital Plan Rule requiring U.S. BHCs with $50 billion or more of total consolidated assets (including those that are foreign owned) to submit annual capital plans to the Board and such BHCs' respective Federal Reserve Banks. Subject BHCs are required to collect and report certain related data on a quarterly basis to allow the Board to monitor the companies' progress against their annual capital plans. See 79 Fed. Reg. 64026 (Oct. 27, 2014); 76 Fed. Reg. 74631 (Dec. 1, 2011) (12 C.F.R. § 225.8 (Capital Planning)) (final rule); 76 Fed. Reg. 35351 (June 17, 2011) (solicitation of public comments); 76 Fed. Reg. 73634 (Nov. 29, 2011) (agency information collection, FR Y-14A and FR Y-14Q). See also Federal Reserve Supervisory Assessment for Capital Planning and Positions for LISCC Firms and Large Complex Firms, Board SR Letter 15-18 (Dec. 18, 2015), CCH Fed. Banking L. Rep. ¶ 47-681; Federal Reserve Supervisory Assessment of Capital Planning and Positions for Large and Noncomplex Firms, Board SR Letter 15-19 (Dec. 18, 2015); Capital Plan Review: Summary Instructions and Guidance (Board, Nov. 22, 2011). The OCC has issued capital planning guidance applicable to national banks. See Guidance for Evaluating Capital Planning and Adequacy (OCC, June 7, 2012);

n. The Board's review of BHC capital plans is conducted as part of its CCAR program. The Board completed its fifth CCAR review in June 2016. CCAR assesses the ability of a BHC to maintain sufficient capital levels and continue lending in stressed economic environments in light of regulatory expectations, substantive capital policies and capital planning processes. BHCs with large trading operations (currently six firms) are required to include a global market shock "add-on" as part of their supervisory adverse and severely adverse scenarios, and to conduct a stress test of their trading books, private-equity positions, and counterparty exposures. Eight BHCs with substantial trading or custodial operations are further required to incorporate a counterparty default scenario component into their supervisory adverse and severely adverse stress scenarios. Like the global market shock add-on, this component is only applied to the largest and most complex BHCs. As part of the counterparty default scenario component, these BHCs are required to estimate and report the potential losses and related effects on capital associated with the instantaneous and unexpected default of the counterparty that would generate the largest losses across their derivatives and securities financing activities, including securities lending and repo agreement activities.

Each firm received detailed assessments of its capital planning processes, and some were permitted to increase or restart dividend payments, buy back shares, or repay government capital as a result of the CCAR. See [CCAR] 2016: Assessment Framework and Results (Board, June 2016); [CCAR] 2016 Summary Instructions and Guidance (Board, Jan. 2016); Capital Planning at Large [BHCs]: Supervisory Expectations and Range of Current Practice (Board, Aug. 2013); [CCAR:] Objectives and Overview (Board, Mar. 18, 2011).

See also The Administrative Procedure Act and Federal Reserve Stress Tests (Committee on Capital Markets Regulation, Sept. 2016) (suggesting that the process by which the Board's models and stress test reviews are conducted "has likely failed to comply with the APA's procedural requirements"); American Banker, Mar. 10, 2016; Enhancements to [Board] Models Used to Estimate Operational Risk and Capital (Board, Feb. 2016); The Board Identified Areas of Improvement for Its Supervisory Stress Testing Model Validation Activities, and Opportunities Exist for Further Enhancement (OIG, Oct. 29, 2015); Stress Testing Banks: Whence and Wither? (FDIC and Center for Financial Research Working Paper, Nov. 2015); Revised Temporary Addendum to [Board] SR Letter 09-4: Dividend Increases and Other Capital Distributions for the 19 Supervisory Capital Assessment Program [BHCs] (Board, Nov. 17, 2010).

o. In 2012, the OCC, the Board and the FDIC issued joint final supervisory guidance regarding stress testing for banking organizations with more than $10 billion in total consolidated assets. See 77 Fed. Reg. 29458 (May 17, 2012) (final guidance); 76 Fed. Reg. 35072 (June 15, 2011) (solicitation of public comments). See also "Stress Testing and Bank Capital Supervision", Federal Reserve Bank of San Francisco ("FRBSF") Economic Letter (June 27, 2011). The Board, OCC and FDIC have also each issued regulations requiring insured depository institutions with total consolidated assets of more than $10 billion to conduct an annual stress test. See 77 Fed. Reg. 62396 (Oct. 12, 2012) (Board final rule); 77 Fed. Reg. 62417 (Oct. 15, 2012) (FDIC final rule); 77 Fed. Reg. 61238 (Oct. 9, 2012) (OCC final rule).

In 2014, the federal banking agencies shifted the start date for annual stress testing to align with the calendar year. See 79 Fed. Reg. 64026 (Oct. 27, 2014) (Board); 79 Fed. Reg. 69365 (Nov. 21, 2014) (FDIC); 79 Fed. Reg. 71630 (Dec. 3, 2014) (OCC).

With respect to disclosure, supervisory and related issues, see also Part I.A.6.a.ii.F and Part I.B above and Part II.E.2.d.i below.

p. With respect to Basel capital-related matters generally, see, e.g., Report to Congress on the Effect of Capital Rules on Mortgage Servicing Assets (Board, FDIC, OCC and NCUA, June 2016); Prudential Data Report: EU G-SIBs Capital and Liquidity (AFME, Dec. 2015); Report to G20 Leaders on Implementation of the Basel III Regulatory Reforms (BIS, Nov. 2015); Basel III Monitoring Report (BIS, Sept. 2015); Basel Capital Framework National Discretions (BIS, Nov. 2014); Implementation of Basel Standards (BIS, Nov. 2014); Reducing Excessive Variability in Bank's Regulatory Capital Ratios (BIS, Nov. 2014); Brei and Gambacorta, "The Leverage Ratio over the Cycle", BIS Working Paper No. 471 (BIS, Nov. 2014); Seventh Progress Report on Adoption of the Basel Regulatory Framework (BIS, Oct. 2014); 79 Fed. Reg. 56856 (Sept. 23, 2014) (OCC/Board/FDIC Joint Report: Differences in Accounting and Capital Standards Among the Federal Banking Agencies; Report to Congressional Committees); Capital Requirements for Banks' Equity Investments in Funds (BIS, Jan. 2014 and July 2013); Follow-up Review of Banks' Transparency in Their 2012 Pillar 3 Reports (EBA, Dec. 9, 2013); Report to G20 Leaders on Monitoring Implementation of Basel III Regulatory Reforms (BIS, Aug.

2013); The Regulatory Framework: Balancing Risk Sensitivity, Simplicity and Comparability (BIS, July 2013); Revised Basel III Leverage Ratio Framework and Disclosure Requirements (BIS, June 2013); Capital Treatment of Bank Exposures to Central Counterparties (BIS, June 2013); Progress Report on Implementation of the Basel Regulatory Framework (BIS, Apr. 2013); Analyzing the Impact of Bank Capital and Liquidity Regulations on U.S. Economic Growth (Oxford Economics, Apr. 2013); High Capital Requirements Have Consequences (ABA, Apr. 2013); 77 Fed. Reg. 75259 (Dec. 19, 2012) (OCC, Board, FDIC Joint Report: Differences in Accounting and Capital Standards Among the Federal Banking Agencies; Report to Congressional Committees); Financial Stability Institute Survey: Basel II, II.5 and III Implementation (BIS, July 2012); Composition of Capital Disclosure Requirements (BIS, June 2012); Revisiting Risk-Weighted Assets (IMF, Mar. 2012); Basel III Definition of Capital: [FAQ] (BIS, Dec. 2011); Definition of Capital Disclosure Requirements (BIS, Dec. 2011); [G-SIBs]: Assessment Methodology and the Additional Loss Absorbency Requirement (BIS, Nov. 2011); Basel III Counterparty Credit Risk-[FAQ] (BIS, Nov. 2011, updated July 2012); Assessment of the Macroeconomic Impact of Higher Loss Absorbency for [G-SIBs] (BIS, Oct. 10, 2011); Stress Testing and Bank Capital Supervision (FSB, June 27, 2011); Thematic Review on Risk Disclosure Practices (FSB, Mar. 18, 2011); Contingent Capital: Economic Rationale and Design Features (IMF, Jan. 25, 2011); Minimum Requirements to Ensure Loss Absorbency at the Point of Non-viability (BIS, Jan. 13, 2011); Guidance for National Authorities Operating the Countercyclical Capital Buffer (BIS, Dec. 2010); Assessing the Macroeconomic Impact of the Transition to Stronger Capital and Liquidity Investments (BIS, Dec. 2010); Home-host Information-sharing for Effective Basel II Implementation (BIS, June 2006).

See also, e.g., Capital Requirements for Supervised Institutions Significantly Engaged in Insurance, 81 Fed. Reg. 38631 (June 14, 2016) (advanced notice of proposed rulemaking); Enhanced Prudential Standards for Systemically Important Insurance Companies, 81 Fed. Reg. 38610 (June 14, 2016) (notice of proposed rulemaking); Consultation on Risk-based Global Insurance Capital Standard (ICS): Ultimate and Interim Goals, Principles for Development and Delivery Process (IAIS, July 19, 2016); International Insurance Capital Standards: Collaboration Among U.S. Stakeholders Has Improved But Could Be Enhanced (GAO, June 2015); The Cumulative Impact on the Global Economy of Changes in the Financial Regulatory Framework (IIF, Sept. 2011); Measuring the Cumulative Economic Impact of Basel III (IIF, Sept. 19, 2011); Capital Management in Banking: The Way Forward (Pricewaterhouse Coopers, Dec. 2010); Basel II Capital Ratios: A Field Guide for Assessing Risk-based Capital (Fitch, Mar. 11, 2010).

3. Total Loss Absorbing Capacity and Long Term Debt Requirements

In response to the 2007-2009 financial crisis, the FSB developed TLAC standard for G-SIBs that it finalized in November 2015. Similar to capital, banks will need to assess the effect of holding additional assets on their requirements for also having TLAC outstanding.

The FSB's objective in designing the TLAC standard was to ensure that failing G-SIBs will have sufficient loss-absorbing and recapitalization capacity available for regulators to implement an orderly resolution with minimal impact on financial stability and no loss to public funds. The TLAC standard defines a minimum requirement for the instruments and liabilities that should be readily available to "bail in" as part of such resolution. See Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-absorbing Capacity (TLAC) Term Sheet (FSB, Nov. 9, 2015). The FSB standard effectively establishes an additional "gone concern" capital requirement for GSIBs to supplement the Basel capital framework which establishes "going concern" capital requirements for banking organizations generally.

a. The Board has issued a proposal to implement the FSB's TLAC standard that would also introduce a separate minimum eligible long-term debt ("LTD") requirement (the "TLAC Proposal"). See Notice of Proposed Rulemaking, 80 Fed. Reg. 74926 (Nov. 30, 2015). The TLAC Proposal would establish TLAC and LTD requirements for top-tier U.S. bank holding companies identified by the Board as G-SIBs ("G-SIB BHCs") and U.S. intermediate holding companies of global systemically important foreign banking organizations with at least $50 billion in U.S. non-branch assets ("Covered IHCs"). The TLAC Proposal also would impose "clean holding company" requirements on G-SIB BHCs and Covered IHCs that restrict the ability of the top-tier holding company to incur non-TLAC-related liabilities. These clean holding company and the minimum LTD requirements are more stringent than the FSB TLAC standard. The clean holding company restrictions, in particular, will significantly limit G-SIB BHCs' and Covered IHC's ability to engage in securities and derivative activities using their top-tier holding company. See The Federal Reserve Proposes TLAC and Related Requirements for U.S.G-SIBs and U.S. Intermediate Holding Companies of Foreign G-SIBs (Cleary Gottlieb, Oct. 31, 2015). See also Comparing the Federal Reserve's TLAC Proposal to the FSB TLAC Final Standards (Cleary Gottlieb, Nov. 20, 2015).

(i) The TLAC Proposal would require G-SIB BHCs to maintain minimum ratios of external TLAC and external LTD, each as a percentage of both risk-weighted assets (risk-based ratio requirements) and total leverage exposure (supplementary leverage ratio, or SLR, requirements).

A) Under the TLAC Proposal, a G-SIB BHC would be required to maintain external TLAC greater or equal to 18% of its total risk-weighted assets ("RWA") and 9.5% of its total leverage exposure.

B) In addition, G-SIB BHCs would be required to maintain an external TLAC buffer, composed solely of CET1, on top of the minimum external TLAC risk-based ratio, in order to avoid restrictions on distributions and discretionary bonus payments. The proposed buffer would be 2.5% of total RWA plus the countercyclical buffer (when in effect) and the G-SIB BHC's Method 1 G-SIB surcharge.

C) Under the TLAC Proposal, a G-SIB BHC would be required to maintain external LTD equal to at least 6% of its total RWA and 4.5% of its total leverage exposure. As a percentage of total TLAC, the proposed external LTD requirement would significantly exceed the supervisory expectation set forth in the FSB TLAC standard that 33% of a G-SIB's TLAC consist of debt instruments.

D) The TLAC Proposal would require G-SIB BHCs to meet their external LTD requirement through the issuance of eligible debt securities to third-parties. Eligible debt securities would need to have a maturity of at least one year from the date of issuance and would not be able to provide the holder with acceleration rights outside of insolvency or payment default, among other requirements. The TLAC Proposal would also prohibit all "structured notes" from eligible long term debt, which would disqualify most instruments that have embedded derivatives or similar features.

E) TLAC would include all Tier 1 regulatory capital (excluding minority interests in consolidated subsidiaries) and eligible LTD.

(ii) Covered IHCs would be subject to similar but more complex internal TLAC and LTD requirements. The requirements are referred to as "internal" because the regulatory capital and eligible debt instruments issued to satisfy these requirements would need to be issued to the Covered IHC's parent or an intermediate non-U.S. holding company that directly or indirectly controls the Covered IHC and may not be issued "externally" to third parties.

A) Covered IHCs would be required to maintain internal TLAC greater or equal to 18% of its total RWAs, 6.75% of its total leverage exposure and 9% of its average total consolidated assets (the denominator of the generally applicable Tier 1 leverage ratio under the Revised Capital Rules).

B) Covered IHCs would also be required to maintain an internal TLAC buffer of CET1 equal to 2.5% of total

RWA plus the countercyclical buffer (when in effect). Unlike the external TLAC buffer for G-SIB BHCs, the internal TLAC buffer would not include a G-SIB surcharge component (unless the covered IHC were itself a G-SIB BHC).

C) Covered IHCs would also be required to maintain internal LTD equal to at least 7% of total RWA, 3% of total leverage exposure, and 4% of average total consolidated assets.

D) The TLAC Proposal would require Covered IHCs to meet their internal LTD requirement through the issuance of eligible internal debt securities to a foreign parent. These internal debt securities would need to satisfy eligibility criteria similar to external debt securities issued by G-SIB BHCs, with additional requirements that the debt securities include a contractual provision that provides for the immediate conversion or exchange of the instrument into CET1 of the Covered IHC or the cancellation of the instrument upon the Board's issuance of an internal debt conversion order, which can only be issued if certain strict conditions are satisfied. In addition, eligible internal debt securities would need to be the most subordinated claim in a resolution proceeding of the Covered IHC and may not provide the holder with a contractual right to acceleration based on any event (not even on nonpayment or insolvency).

(iii) The proposed rule would establish a clean holding company framework that imposes certain restrictions on the types of liabilities that may be held at the level of the G-SIB BHC and Covered IHCs.

A) G-SIB BHCs would be prohibited from issuing short-term debt (including commercial paper and short-term deposits); creating setoff rights against subsidiaries; entering qualified financial contracts with third parties; issuing guarantees with certain prohibited cross-defaults or benefiting from upstream guarantees ("Prohibited Liabilities"). The Proposal would also impose a 5% cap on the aggregate amount of certain non-contingent liabilities (including structured notes and operating liabilities such as rent and employee obligations) owed to third parties ("Capped Liabilities"). Certain liabilities that would not qualify as eligible external LTD, Prohibited Liabilities or Capped Liabilities would be permitted to remain pari passu or junior to eligible external LTD and would not count toward the 5% cap. Such permissible liabilities would include debt instruments that would otherwise qualify as TLAC except that they have a remaining maturity of less than one year and liabilities to subsidiaries, including short-term debt and qualified financial contracts.

B) The clean holding company requirements for Covered IHCs would be similar to those for G-SIB BHCs, except that certain requirements would apply with respect to affiliates instead of subsidiaries and there would be no 5% cap on unrelated liabilities.

(iv) The TLAC Proposal would also amend the Revised Capital Guidelines applicable to Board-regulated institutions to require deductions from regulatory capital for certain investments in unsecured debt securities issued by G-SIB BHCs that do not qualify as Tier 2 capital. A Board-regulated institution is any BHC or savings and loan holding company ("SLHC"), other than one subject to the Board's Small Holding Company Policy Statement, 12 C.F.R. Part 225, Appendix C (generally, BHCs and SLHCs with total consolidated assets of less than $1 billion that do not engage in significant nonbanking activities) and certain other categories of SLHCs; any state member bank or any U.S. IHC. Investments held as underwriting positions for five or fewer business days would be excluded from covered debt instruments for this purpose.

b. The anticipated cost of compliance with the TLAC Proposal and the rules implementing the FSB TLAC standard in other jurisdictions is significant. The Board estimates that its proposed rule would impose an aggregate eligible external LTD requirement on the G-SIB BHCs of $680 billion, compared to at least $590 billion in outstanding LTD, for a shortfall of $90 billion in required new eligible LTD. The Board's estimate assumes that existing external LTD will qualify as eligible LTD or be grandfathered, even though significant amounts of currently outstanding external LTD would appear not to qualify as eligible LTD and the proposed rule does not currently include a grandfathering provision. See Board Memorandum re TLAC Proposal, Oct. 22, 2015. European G-SIBs have been estimated to have a €210 billion shortfall. See SNL Financial, Apr. 19, 2016.

c. The TLAC Proposal has been controversial and has drawn criticism from other regulators as well as the banking industry. See Remarks of FDIC Vice Chairman Thomas Hoenig, Jan. 20, 2016 (The Relative Role of Debt in Bank Resiliency and Resolvability) (criticizing the Board's TLAC Proposal as potentially undermining financial stability by incentivizing debt funding over deposit funding and thereby increasing leverage in the banking system). See generally IFLR, May 2016 (banking industry poll reflecting concerns about the proposal's impact on bond markets and their operations).

4. Liquidity Requirements

a. Basel III introduces liquidity requirements, including a liquidity coverage ratio ("LCR") in January 2015 and a net stable funding ratio ("NSFR") by January 2018. See Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems (BIS, Dec. 2010, revised June 2011). See also Guidance for Supervisors on Market-based Indicators of Liquidity (BIS, Jan. 2014).

b. The Basel Committee finalized the LCR framework in 2013. Generally, banking organizations are required to calculate net liquidity outflows over a rolling 30-day period, based on a variety of inflow and outflow assumptions set forth in the guidance, and are required to hold a sufficient amount of "high quality liquid assets" to cover the net liquidity outflows over this period. According to the Basel Committee, banking organizations could phase in compliance with the minimum LCR requirement between 2015 and 2019, with a requirement for holding 100% of the liquidity coverage amount by January 1, 2019. See Basel III: The [LCR] and Liquidity Risk Monitoring Tools (BIS, Jan. 2013). See also [FAQ] on Basel III's January 2013 [LCR] Framework (BIS, Apr. 2014); [LCR] Disclosure Standards (BIS, Jan. 2014).

c. The federal banking agencies adopted regulations implementing the LCR in September 2014. As implemented, the LCR applies only to core banks and to their subsidiary IDIs with assets of $10 billion or more. The final rule also applies a less stringent, modified LCR to non-core BHCs with $50 billion or more in total assets. See 79 Fed. Reg. 61440 (Oct. 10, 2014) (final rule). See also 78 Fed. Reg. 71818 (Nov. 29, 2013) (solicitation of public comments); 79 Fed. Reg. 78287 (Dec. 30, 2014) (OCC and Board interim final revisions to the definition of qualifying master netting agreement in the capital and LCR rules); 80 Fed. Reg. 75010 (Dec. 1, 2015) (Board proposal to implement LCR public disclosure requirements); 81 Fed. Reg. 21233 (Apr. 11, 2016) (Board final rule to include certain municipal securities as high quality liquid assets); 81 Fed. Reg. 29169 (May 11, 2016) (Board proposal to revise the definition of qualifying master netting agreement in the capital and LCR rules); 81 Fed. Reg. 55381 (Aug. 19, 2016) (OCC proposal to revise the definition of qualifying master netting agreement in the capital and LCR rules). See generally The U.S. [LCR] Final Rule: Highlights and Impact (Deloitte, 2014); The Difficult Business of Measuring Banks' Liquidity: Understanding the [LCR], Working Paper 15-20 (OFR, Oct. 7, 2015); Securities Law Daily, Apr. 4, 2016.

The LCR rule has driven up liquidity requirements significantly for custody banks because custody deposits are considered short term wholesale funding rather than operational deposits which are subject to lower liquidity requirements under the rule. This punitive treatment of custody deposits has led many large banks with significant asset management activities to charge customers for large dollar deposits or refuse them entirely. See Risk, Nov. 17, 2015; Wall St. J., Oct. 18, 2015.

d. Due in part to its novelty and potential for unintended consequences, the NSFR has taken longer to be developed and implemented. The Basel Committee finalized the NSFR framework in October 2014. While the LCR focuses on short-term liquidity management over a 30-day time horizon, the NSFR focuses on medium- and long-term funding of a banking organization's assets. The NSFR compares a banking organization's available stable funding ("ASF") to its required stable funding ("RSF") , requiring the ASF to be at least 100% of RSF. ASF is calculated by multiplying the banking organization's liabilities and capital by the factors assigned to them depending on their perceived stability, and then summing the results. Liabilities and capital with higher perceived stability have higher multiplication factors. RSF is calculated by multiplying a banking organization's assets by factors assigned based on their maturity, quality and liquidity value, then adding the weighted amounts. The Basel Committee provides that the NSFR will become a minimum standard by January 1, 2018. See Basel III: The [NSFR] (BIS, Oct. 2014) and (BIS, Jan. 2014). See also Basel III – The [NSFR]: [FAQs] (BIS, July 2016).

e. The federal banking agencies proposed regulations to implement the NSFR in May 2016. The proposal would apply to the same set of banking organizations subject to the LCR Rule, and would follow the same tiered approach -- with the "full" NSFR requirement applied only to core banks and their subsidiary IDIs with total assets of $10 billion or more, and a "modified" NSFR applied to non-core BHCs with $50 billion or more in total assets. The proposal, which is largely consistent with the Basel NSFR framework, would take effect on January 1, 2018, consistent with the Basel Committee's timetable for implementation. See 81 Fed. Reg. 35123 (June 1, 2016).

The Proposal's treatment of derivative assets and liabilities generally parallels the Basel NSFR framework, including incorporation of an add-on to a covered company's total RSF amount equal to 20% of its gross derivatives liabilities. This add-on has been sharply criticized as a blunt mechanism, with no empirical basis, that will drive up costs for derivatives end users without commensurate benefits in risk reduction or financial stability. The agencies requested comment on alternative approaches to determining the add-on, including an approach based on historical changes in the value of a covered company's aggregate derivative position and an approach that would use modeled estimates of potential future exposure (each of which would improve the risk-sensitivity of this additional requirement and allow firms more options to manage compliance with the requirement beyond simply shrinking their derivatives book, but at the cost of increased complexity in calculation). The European Commission has also questioned the appropriateness of the 20% add-on, directing the European Banking Authority to provide more background and evidence on the empirical basis and prudential justification of this element, and to suggest possible alternative, more risk-sensitive policy options. See Letter, dated Apr. 12, 2016, from Director General Guersent to EBA Chairman Enria. See also The Net Stable Funding Ratio: Neither Necessary or Harmless (TCH, July 2016); Risk, June 22, 2016.

f. In the Domestic SIFI Rule, the Board required Covered SIFIs to comply with enhanced risk-management and liquidity risk-management standards, conduct liquidity stress tests, and hold a buffer of highly liquid assets based on projected funding needs during a 30-day stress event. See 79 Fed. Reg. 17240 (Mar. 27, 2014). These provisions are intended to be broader than, and to supplement, the LCR, with the Domestic SIFI Rule permitting a Covered SIFI's own estimates and models for calculating required liquidity and conducting stress testing.

g. To complement the LCR and NSFR, the Federal Reserve launched the Comprehensive Liquidity Assessment and Review ("CLAR") in 2012 for firms in the LISCC portfolio. Like CCAR, CLAR is an annual horizontal assessment, with quantitative and qualitative elements administered by the Board. Unlike CCAR, CLAR does not include a specific quantitative post-stress minimum, and results are not publicly disclosed. Firms with weak liquidity positions under CLAR's liquidity metrics are directed to improve their practices and, as warranted, their liquidity positions, through supervisory direction, ratings downgrades, or enforcement actions. See Governance Structure for the [LISCC] Supervisory Program, Board SR Letter 15-7 (Apr. 17, 2015). See also American Banker, June 1, 2016.

h. With respect to the Basel III liquidity framework and related liquidity guidance, see generally e.g., Crises and Rescues: Liquidity Transmission through International Banks (BIS, Aug. 2016); Interagency Guidance on Funds Transfer Pricing Related to Funding and Contingent Liquidity Risks, Board SR Letter 16-3 (Mar. 1, 2016); Making Supervisory Stress Tests More Macroprudential: Considering Liquidity and Solvency Interactions and Systemic Risk (BIS Working Paper No. 29, Nov. 2015); Global Financial Markets Liquidity Study (PWC, Aug. 2015); [NSFR] Disclosure Standards (BIS, Dec. 2014); Monitoring Tools for Intraday Liquidity Management (BIS, Apr. 2013); U.S. Banking Industry Liquidity Update (TCH, Dec. 14, 2012); Monitoring Indicators for Intraday Liquidity Management (BIS, July 2012); Comptroller's Handbook: Liquidity; Liquidity: A Bigger Challenge than Capital (KPMG, May 2012); Basel III Framework for Liquidity: [FAQ] (BIS, July 2011); Basel III: International Framework for Liquidity Risk, Measurement, Standards and Monitoring (BIS, Dec. 2010); Assessing the Macroeconomic Impact of the Transition to Stronger Capital and Liquidity Investments (BIS, Dec. 2010); Interagency Policy Statement on Funding and Liquidity Risk Management (Board/OCC/FDIC/OTS, Mar. 17, 2010).

5. Risk-based Supervision

a. Bank trading activities have spurred regulators to develop a supervisory approach intended to achieve a more effective risk-based examination process focused on (i) internal environment ("tone" of the organization); (ii) setting of objectives; (iii) identifying and measuring internal and external events that could affect achievement of objectives; (iv) risk assessment; (v) responses to risk; (vi) policies, procedures and controls; (vii) identification, capture and communication of relevant information; and (viii) monitoring of the risk management process. In addition to the policies, procedures and guidance set out in Part I.A.5.f above, see, e.g., FDIC Supervisory Insights

(Summer 2015, Winter 2014); OCC Semiannual Risk Perspective (Summer 2015); 2015 Annual Report (OFR); Board Letter from General Counsel Alvarez and BS&R Director Gibson to Board Inspector General Bialek (Nov. 17, 2014); Comptroller's Handbooks: Bank Supervision Process, Internal Control, Liquidity and Large Bank Supervision; OCC Bulletin No. 2004-20 (May 10, 2004), CCH Fed. Banking L. Rep. ¶ 93-985 ("OCC Bulletin No. 2004-20") (Risk Management of New, Expanded or Modified Bank Products and Services); Board Trading and Capital Markets Activities Manual; Risk-focused Bank Examinations: Regulators of Large Banking Organizations Face Challenges (GAO, Jan. 2000).

See also, e.g., Securities Markets Risk Outlook 2016 (IOSCO, Mar. 2, 2016); "Fixed income market liquidity", BIS CGFS Papers No 55 (Jan. 21, 2016); Whitehead, "Size Matters: Commercial Banks and the Capital Markets," Ohio St. L.J. (Nov. 2015); Bank Regulation: Lessons Learned and a Framework for Monitoring Emerging Risks and Regulatory Response (GAO, June 25, 2015); Capital Markets 2020, Will It Change For Good? (PWC, 2015); Global Risk Management Survey (9th Edition) (Deloitte 2015); 2015 Banking Outlook (Deloitte, 2014); Risk Appetite in the Financial Services Industry: A Requisite for Risk Management Today (Deloitte, 2014); A Survey of Securities Markets Risk Trends 2014 (IOSCO, June 2014); Guidance on Supervisory Interaction with Financial Institutions on Risk Culture (FSB, Apr. 7, 2014); Increasing the Intensity and Effectiveness of Supervision (FSB, Nov. 18, 2013); Principles for an Effective Risk Appetite Framework (FSB, Nov. 18, 2013); Board SR Letter 13-13 (Nov. 18, 2013), CCH Fed. Banking L. Rep. ¶ 37-781; OCC Guidance (2012): "Characterization of a Strong Risk Management Function", "Establishing and Communicating Risk Appetite", and "Sanctity of the Charter"; Interagency Advisory on Interest Rate Risk Management: [FAQ] (Jan. 12, 2012); Disclosures about Liquidity and Interest Rate Risk (FASB, June 2012) (Topic 825); Risks in Financial Group Structures (OECD, Feb. 2011); The Prudential Regime for Trading Activities: A Fundamental Review (FSA, Aug. 2010); Correspondent Concentration Risks, 75 Fed. Reg. 23764 (May 4, 2010); Interagency Policy Statement on Funding and Liquidity Risk Management, 75 Fed. Reg. 3656 (Mar. 22, 2010);

Board Advisory on Interest Rate Risk Management (Jan. 6, 2010); Comptroller Bulletin 2009-15 (May 22, 2009), CCH Fed. Banking L. Rep. ¶ 62-096, (Investment Securities: Risk Management and Lessons Learned); "Governing the Financial or Bank Holding Company: How Legal Infrastructure Can Facilitate Consolidated Risk Management", Current Issues (FRBNY, Mar. 2003).

See generally, e.g., Beyond the Horizon: A White Paper to the Industry on Systemic Risk (Depository Trust & Clearing Corporation ("DTCC"), Aug. 2013); Remaking Financial Services: Risk Management Five Years After the Crisis (IIF/Ernst &Young, 2013); Strength Training for Banks (Deloitte, 2013); 2013 Global Risk Management Survey: Setting a Higher Bar (Deloitte, 2013); Macroprudential Oversight: An Industry Perspective (IIF, July 2011); Implementing Robust Risk Appetite Frameworks to Strengthen Financial Institutions (IIF, June 2011); Risk IT and Operations: Strengthening Capabilities (IIF/McKinsey & Co, June 17, 2011); Making Strides in Financial Services Risk Management (IIF/Ernst & Young, 2011).

See Part I.A.5.f, Part II.A.2 and Part II.A.3 above and Part II.A.6 and Part II.E.2 below.

b. In 2008 and 2012, the Board (i) refined and clarified its programs for the consolidated supervision of BHCs and the combined U.S. operations of foreign banking organizations, and (ii) clarified supervisory expectations with respect to firmwide compliance risk management. See also Part I.B.1 above.

(i) Compliance Risk Management Programs and Oversight at Large Banking Organizations with Complex Compliance Profiles, Board SR Letter 08-08 (Oct. 16, 2008) (the "2008 Compliance Guidance"), CCH Fed. Banking L. Rep. ¶ 37-774, reflects the determination that BHCs and foreign banks have expanded the scope, complexity and global nature of their business activities, and compliance requirements associated with these activities have become more complex. As a result, risk management and corporate governance challenges have arisen, particularly with respect to compliance risks that transcend business lines, legal entities and jurisdictions.

A) The 2008 Compliance Guidance states that, while the guiding principles of sound risk management are the same for compliance as for other types of risk, compliance risk does not lend itself to traditional processes for establishing and allocating risk tolerance.

B) The 2008 Compliance Guidance clarifies that:

   i) Large, complex banking organizations require a firmwide, corporate approach to compliance risk management.

   ii) FRB supervisory findings reinforce the need for compliance staff to be independent of the business lines for which they have responsibilities.

      (a) If compliance staff within a business line has a reporting line into the management of the business, compliance staff should also have a reporting line to the corporate function with compliance responsibilities.

      (b) The corporate compliance function should play a key role in determining how compliance matters are handled and in personnel decisions and actions (including remuneration) which affect business line and local compliance staff.

      (c) Compensation and incentives should avoid undermining the independence of compliance staff.

      (d) Controls and enhanced corporate oversight should identify and address issues that may arise from conflicts of interest affecting compliance staff within the business lines.

iii) Robust compliance monitoring and testing play a key role in identifying weaknesses in compliance risk management controls and are critical components of an effective risk management program.

iv) While the primary responsibility for complying with applicable rules and standards must rest with the individuals within the organization as they conduct their business and support activities, the board of directors, senior management and the corporate compliance function are responsible for working together to establish and implement a risk management program and oversight framework designed to prevent and detect compliance issues.

(ii) Board SR Letter 08-09 (Oct. 16, 2008), CCH Fed. Banking L. Rep. ¶ 59-538, specifies the principal areas of focus for consolidated supervision, highlights the supervisory attention that should be paid to risk management systems and internal controls, and reiterates the importance of FRB coordination with (and reliance on) the work of the relevant primary supervisors and functional regulators.

(iii) <u>Consolidated Supervision Framework for Large Financial Institutions</u>, 2012 Supervision Guidance, establishes a framework for the supervision of large financial institutions, including: (A) LISCC firms; (B) large U.S. banking organizations with consolidated assets of $50 billion or more that are not included in the LISCC portfolio; and (C) large foreign banking organizations with combined assets of U.S. operations of $50 billion or more that are not included in the LISCC portfolio. The 2012 Supervision Guidance has two primary objectives: enhancing resiliency of a firm to lower the probability of its failure or inability to serve as a financial intermediary, and reducing the impact on the financial system and the broader economy in the event of a firm's failure or material weakness.

A) In order to enhance a firm's resilience, the 2012 Supervision Guidance states that a firm should (1) actively monitor and maintain capital and liquidity positions; (2) establish a culture and incentive structure that promotes compliance with applicable laws and regulations; (3) engage in recovery planning to identify and correct potential weaknesses; and (4) ensure there is effective management of core business lines.

B) With respect to reducing the impact of a firm's failure on the financial system and broader economy, the 2012 Supervision Guidance recommends that a firm (1) manage critical operations in a manner similar to core business lines to ensure that such operations are sufficiently resilient, (2) assure that its parent company and non-depository institution subsidiaries do not pose material risks to affiliated banking offices, (3) develop and maintain plans for rapid and orderly resolution in the event of material financial distress or failure, and (4) in conjunction with the FRB, work to detect and address emerging threats to financial stability that arise across many firms.

C) The 2012 Supervision Guidance supersedes Board SR Letter 08-09 for the relevant organizations.

See also, e.g., Supervisory Guidance for Assessing Risk Management at Supervised Institutions with Total Consolidated Assets Less than $50 Billion, Board SR Letter 16-11 (June 8, 2016); Board Review of Federal Reserve Bank's [LISCC] Information Flows and Communication Channels (Board, Nov. 2015); As Risks Rise, Boards Respond: A Global View of Risk

Committees (Deloitte, 2014); Remarks of OCC Deputy Chief Counsel Stipano, May 23, 2011 (Policymakers' Perspectives on Regulatory and Enforcement Developments Affecting Internationally Active Banks); Financial Regulation: Review of Regulators' Oversight of Risk Management Systems at a Limited Number of Large, Complex Financial Institutions (GAO, Mar. 18, 2009); PNC, 91 Fed. Res. Bull. 424 (2005) (enterprise-wide risk management); Citigroup, 91 Fed. Res. Bull. 262 (2005) (risk management focus on (i) board and senior management oversight; (ii) adequacy of internal policies and procedures (including accounting and disclosure); (iii) risk monitoring and measurement systems; and (iv) adequacy and independence of controls and audit procedures).

c. In 2014, the Comptroller published a set of "heightened standards" requiring the design and implementation of a risk governance framework for large insured national banks, insured Federal savings associations, and insured Federal branches of foreign banks with average total consolidated assets of $50 billion or more, as well as minimum standards for a board of directors in overseeing this design and implementation. 12 C.F.R. Part 30, Appendix D; 79 Fed. Reg. 54518 (Sept. 11, 2014) (final); 79 Fed. Reg. 4282 (Jan. 27, 2014) (proposal). The heightened standards require:

(i) A written risk governance framework that is designed by independent risk management and approved by the board of directors or the board's risk committee. The framework should address credit risk, interest rate risk, liquidity risk, price risk, concentration risk, operational risk, compliance risk, strategic risk, and reputation risk. The framework should have well defined roles and responsibilities for the "three lines of defense": (A) front-line units, (B) independent risk management and (C) internal audit;

(ii) A strategic plan that assesses the risks that confront the bank, as well as a risk appetite statement for the bank;

(iii) Risk data aggregation, reporting and communication;

(iv) Talent management, performance monitoring/management and compensation policies and procedures; and

(v) Heightened standards for the board of directors, including (A) oversight of the risk management framework, (B) active oversight of management, (C) exercise of independent judgment, (D) employment of independent directors, (E) ongoing training for directors, and (F) an annual self-assessment.

See also Comptroller's Handbook: Corporate and Risk Governance.

d. Bank regulators also focus on the importance of corporate governance practices in order to assure that the interests of directors and senior management are aligned with those of shareholders, creditors and taxpayers. See, e.g., Corporate Governance Principles for Banks (BIS, July 2015).

(i) Regulators do not appear to apply legal standards to director performance that go beyond traditional corporate standards regarding duties of loyalty, care and "business judgment". But see Remarks of Board Governor Tarullo, June 9, 2014 (Corporate Governance and Prudential Regulation) (raising the question whether the fiduciary duties of boards of regulated financial firms should be expanded because of the systemic risk embedded in the banking sector).

(ii) Regulators generally appear to focus on:

A) Director expertise.

B) The role of "non-experts" on the board.

C) Evidence of "engagement" by directors, including the time and energy a director devotes and the propensity of the board to "challenge" management.

D) The independence of the board.

E) The presence of an appropriate mix of inside and outside directors.

(iii) Regulators also look to "best practices", including:

A) The role, stature and importance of a chief risk officer ("CRO").

B) Independent access of the board to the CRO (and the CRO to the board) and board engagement with the CRO.

C) Board access to independent resources.

D) Maintenance of "healthy tension" between board and management.

E) Careful definition of "risk management" and clarity in determining "risk appetite".

F) Evaluation of enterprise-wide risk from multiple perspectives.

G) Attention to capital and liquidity risks at each legal entity in a group.

H) Evaluation of risk across business silos.

I) "Cultural and operational agreement" within a firm.

J) Compensation strategies that correlate to lower levels of risk and higher levels of capital.

e. Various governmental and industry groups analyzed the factors precipitating and contributing to the credit market turmoil of 2007-2009 and recommended remedial measures. See Part I.A above.

(i) The turmoil in credit markets highlighted the linkages among risk exposures previously believed to be independent (i.e., market risk, credit risk, funding risk, liquidity risk and basis risk). It also demonstrated the importance of (A) analyzing risk exposures on a firm-wide basis and implementing holistic risk management systems and contingency funding plans; (B) stress-testing and reviewing the assumptions underlying models and valuation methodologies (particularly those based on limited historical data); and (C) acknowledging the risks associated with off-balance sheet entities and contingent liquidity commitments.

(ii) Market supervisors recognized several areas in need of enhanced regulatory focus, including (A) strengthening incentives for prudent oversight of capital, liquidity and risk management processes; (B) increasing transparency through enhanced disclosure requirements, particularly with respect to valuation metrics and securitization markets; (C) strengthening regulators' responsiveness to excessive risk concentrations through improved internal and cross-border information exchanges and policy development; (D) establishing robust policy frameworks for handling financial market stresses, including through the provision of continued liquidity support; and (E) regulatory reporting requirements. See, e.g., OCC Semiannual Risk Perspective (June 30, 2015); Compliance and Ethics Program Environment Report (Society of Corporate Compliance and Ethics and NYSE Governance Services, Sept. 2014); Wall St. J., July 22, 2014 (reporting on leaked FRBNY examination findings criticizing Deutsche Bank regulatory reporting); Managing Risk Better in 2013: Is What's Old, New Again (Intelligize, June 2013); Global Risk Management Survey (Deloitte, 2013); Observations on Developments in Risk Appetite Frameworks and IT Infrastructure (Senior Supervisors Group, Dec. 23, 2010); Risk Management Lessons from the Global Banking Crisis of 2008 (Senior Supervisors Group, Oct. 21, 2009); Observations on Risk Management Practices During the Recent Market Turbulence (Senior Supervisors Group, Mar. 6, 2008).

6. Governance Issues and Operational and Related Risks

   a. "Operational risk" has generally been defined as the risk of unexpected, direct or indirect loss resulting from inadequate or failed internal processes, people or systems, or from external events. The definition includes legal risk (i.e., the risk of loss resulting from failure to comply with laws, ethical standards and contractual obligations). It also includes exposure to litigation. While the definition does not necessarily include strategic or reputational risks, these risks are typically significant factors in risk management programs.

      (i) Operational risk losses are characterized by event factors associated with: (A) internal fraud; (B) external fraud; (C) employment practices; (D) clients, products and business practices (including fiduciary and suitability requirements); (E) damage to physical assets; (F) business disruption and system failures; or (G) failed execution, delivery and process management.

      An "operational risk event" can involve (A) direct charges to income and write-downs; (B) external costs incurred as a consequence of the event; (C) specific provisions required to be taken; and (D) opportunity costs/lost revenue. A key fear is that of the "fat tail" result: the occurrence of a rare event with disproportionately damaging effects.

      (ii) Operational risk management involves the legal and compliance functions in facilitating the creation of firm-wide values, evaluating firm-wide business practices, and constructing firm-specific "best practice" models. See, e.g., Predicting Operational Loss Exposure Using Past Losses (Federal Reserve Bank of Richmond ("FRBR") and Board, Apr. 8, 2016); Reforming Culture and Behavior in the Financial Services Industry: Workshop on Progress and Challenges (FRBNY, Nov. 19, 2015); Corporate Counsel, July 2, 2015; Moving Beyond the Baseline: Leveraging the Compliance Function to Gain a Competitive Edge (PWC, 2015); Banking Conduct and Culture: A Call for Sustained and

Comprehensive Reform (Group of 30, July 2015); FRBNY General Counsel Baxter, Compliance – Some Thoughts About Reaching the Next Level (Feb. 9, 2015); Law360, Feb. 25, 2015; Comptroller's Handbook: Litigation and Other Legal Matters; Workshop on Reforming Culture and Behavior in the Financial Services Industry (FRBNY, Oct. 28, 2014); FRBNY President Dudley, Enhancing Financial Stability by Improving Culture in the Financial Services Industry (Oct. 20, 2014); Board Governor Tarullo, Good Compliance, Not Mere Compliance (Oct. 20, 2014); Diermeier, Heroes, Villains, and Victims: Understanding and Managing Reputational Risk (TCH Banking Perspective, Qtr. 3, 2014); Principles for the Sound Management of Operational Risk (Basel, June 2011); Sound Practices for the Management and Supervision of Operational Risk (Basel, Feb. 25, 2011). See also Part II.A.5 above.

(iii) U.S. banking organizations appear to be under regulatory pressure to increase their reported "operational risk"-weighted assets, which are subject to increased capital charges. For example (insofar as the largest U.S. FHCs are concerned):

A) JPMorgan Chase's "operational risk"-weighted assets totaled $400 billion in 2015, amounting to 27% of JPMorgan Chase's consolidated total assets, up from 6% in 2010.

B) Citigroup reported an increase of approximately 4% in such assets in 2015 to $325 billion, representing 27% of Citigroup's consolidated total assets. In 2014, Citi's operational risk RWA were substantially increased in conjunction with permission by the Board to exit parallel run and commence the Basel III Advanced Approaches framework. See Citigroup Inc., Form 10-K (Feb. 25, 2015).

(iv) For additional operational risk-related capital issues, see Risk, June 29, 2016; Supervisory Guidance Pertaining to the Issuance of the [Basel Committee]'s Second Consultative Paper, "Standardised Measurement Approach for Operational Risk" (Board, Apr. 6, 2016); ABA Letter to BIS, Mar. 17, 2016 (regarding step-in risk); Ten Key Points from Basel's Standardized Measurement Approach for Operational Risk (PWC, Mar. 11, 2016); Consultative Document: Standardised Measurement Approach for Operational Risk (BIS, Mar. 4, 2016); Consultative Document: Identification and Measurement of Step-in Risk (BIS, Dec. 2015); Operational Risk – Revisions to the Simpler Approaches (BIS, Oct. 2014); Operational Risk – Supervisory Guidelines for the [AMA] (BIS, June 2011); Interagency Guidance on the [AMA] for Operational Risk (June 3, 2011); Observed Range of Practice in Key Elements of [AMA] (BIS, July 2009).

See also Bloomberg, Apr. 22, 2016 (reporting on Credit Suisse structuring of catastrophe bonds intended to offset operational losses and provide capital relief); Risk, Aug. 26, 2016 (reporting that Credit Suisse transaction unlikely to be repeated by other banks).

(v) Progress in Financial Services Risk Management: A Survey of Major Financial Institutions (Ernst & Young 2012) finds that risk management practices at the largest financial institutions significantly changed since the 2008 crisis. For instance:

A) The board of directors role in risk management has increased substantially and board risk committees are almost universal.

B) CROs have more seniority and are more involved in risk management decisions.

C) The size and skill level of risk management teams have increased substantially.

D) The models used to identify risks have been upgraded.

E) Financial institutions have improved their liquidity management.

F) There have been improvements in stress testing capabilities.

G) There has been a heightened and continued focus on improving the risk-taking cultures.

(vi) Reconciliation of Regulatory Overlap for the Management and Supervision of Operational Risk in U.S. Financial Institutions (Financial Services Roundtable, 2005) concludes that banking and securities laws reveal certain common principles, including:

A) Emphasis on internal control systems and processes, and their impact on operational risk.

B) Requirements for risk control assessment documentation and supporting evidence of control systems.

C) Need for clarity around roles and responsibilities regarding board of directors and senior management oversight of internal controls.

D) Concern for the accuracy and transparency of financial reporting (market discipline).

E) Need for operational risk data collection and quantitative processes.

F) Better alignment of minimum regulatory capital requirements and risk profiles.

(vii) Some estimates put the total legal costs arising out of bank conduct (i.e., legal and regulatory risk events) at over 186 billion GBP (around $247 billion) since 2011 for the largest global banks. Conduct Costs Project Report 2015 (CCP Research Foundation, June 2016).

(viii) In 2008, SocGen announced a loss of €4.9 billion on equity positions linked to fraudulent activity by one of its traders, Jerome Kerviel (who was ultimately convicted for criminal violations). Kerviel took unauthorized directional positions on European stock futures, offset by fictitious transactions that masked the size of the position and SocGen's net exposures. The trader was positioned to carry out unauthorized transactions because he had previously worked in the middle office units responsible for risk monitoring and had an understanding of control procedures. See, e.g., FT. com, Oct. 5, 2010; NY Times, Aug. 2, 2008; Wall St. J., July 5, Jan. 28, 25, 2008.

A) The SocGen Board of Directors established a Special Committee to identify the control malfunctions that allowed Kerviel to conceal his trading losses. The Report of the Board of Directors to the General Shareholders Meeting (May 25, 2008) (including PricewaterhouseCoopers Summary of Diagnostic Review and Analysis of the Action Plan (May 23, 2008)), General Inspection Department Mission Green Summary Report (May 20, 2008), and Progress Report of the Special Committee of the Board of Directors (Feb. 20, 2008), highlighted 5 principal reasons that SocGen failed to detect the trading: (i) ineffective supervision, (ii) insufficient senior management support to Kerviel's manager, (iii) insufficient attention to front office alerts, (iv) an overly tolerant managerial attitude towards intraday trading, and (v) a chaotic operations environment.

B) French Economy, Finance and Employment Minister Lagarde's Report to the Prime Minister on Lessons to be Learned from Recent Events at [SocGen] (Feb. 4, 2008) highlighted control points that financial institutions should examine to reduce the risk of "rogue" trading, including:

i) Monitoring of gross notional exposures held by the institution.

ii) Maintenance of an audit trail for each transaction.

iii) Recordation and analysis of anomalies and errors in transaction handling.

iv) Prompt confirmation of trades through effective reconciliation procedures.

v) Detailed documentation of transaction terms and conditions.

(ix) In 2012, JPMorgan Chase announced a loss of over $6 billion as the result of an ill-fated hedging strategy of one of its traders, Bruno Iksil, who was known as the "London Whale" (the "JPMC London Whale").

A) The JPMorgan Chase Board of Directors established a Task Force to investigate and analyze the circumstances that resulted in the JPMC London Whale trading losses. The Report of JPMorgan Chase Management Task Force Regarding 2012 CIO Losses (Jan. 16, 2013) recommended remedial measures to address the identified deficiencies: (1) replacing the individuals responsible for the losses; (2) appointing a new, experienced leadership team; (3) adopting governance measures to improve oversight and ensure that the Chief Investment Office ("CIO") is better integrated into the firm; (4) overhauling the appropriate Risk Committee and enhancing independence of the CIO risk function; (5) creating or restructuring risk limits; and (6) conducting a comprehensive self-assessment of the entire Risk organization.

B) The PSI issued a Report entitled JPMorgan Chase Whale Trades: A Case History of Derivatives Risks and Abuses (Mar. 15, 2013). The Report found that JPMorgan Chase's CIO used its synthetic credit portfolio to engage in high risk trading, hid hundreds of millions of dollars of losses, disregarded multiple internal indicators of increasing risk, manipulated models, and misinformed investors, regulators and the public about the nature of its high-risk derivatives trading.

C) The SEC charged two former JPMorgan Chase traders with committing fraud to hide losses in one of the trading portfolios in the firm's CIO. See SEC v. Martin-Artajo, SEC Litigation Release No. 22779 (Aug. 14, 2013) (complaint). The DOJ brought criminal charges against Martin-Artajo and Grout for wire fraud and conspiracy to falsify books and records related to the trading losses. See U.S. v. Grout, 13 MAG 1976 (Aug. 9, 2013) (complaint); U.S. v. Martin-Artajo, 13 MAG 1975 (Aug. 9, 2013) (complaint). Both defendants remain in Europe. Grout resides in France, which does not extradite its own citizens, and a Spanish court rejected the United States' extradition request for Martin-Artajo. See Reuters, Oct. 21, 2015; Bloomberg Business, Mar. 9, 2015.

D) The OCC and the Board imposed civil money penalties against JPMorgan Chase Bank, N.A. and JPMorgan Chase & Co., respectively. See In the Matter of JPMorgan Chase Bank, N.A., Docket No. AA-EC-2013-75 (OCC, Sept. 18, 2013); In the Matter of JPMorgan Chase & Co., Docket No. 13-0331-CMP-HC (Board, Sept. 18, 2013).

E) The OCC also issued a Cease and Desist Order against JPMorgan Chase Bank, and the Board issued a Cease and Desist Order against JPMorgan Chase & Co. See In the Matter of JPMorgan Chase Bank, Docket No. AA-EC-13-01 (OCC, Jan. 14, 2013) and In the Matter of JPMorgan Chase & Co., Docket No. 13-001-B-HC (Board, Jan. 14, 2013). The orders require JPMorgan to supply reports to the applicable regulators with steps for improving oversight, risk management, valuation of trades, development and implementation of models and internal audit processes.

F) The SEC charged JPMorgan Chase with misstating financial results and lacking effective internal controls to detect and prevent its traders from fraudulently overvaluing investments to conceal trading losses. JPMorgan Chase agreed to settle the SEC's charges by paying a $200 million penalty, admitting the facts underlying the SEC's charges, and publicly acknowledging that it violated the federal securities laws. See In the Matter of JPMorgan Chase & Co., SEC Admin. Proc. No. 3-15507 (Sept. 19, 2013). JPMorgan Chase also reached a $150 million settlement with investors who claimed that the bank hid as much as $6.2 billion in losses caused by the JPMC London Whale. In re JPMorgan Chase & Co. Securities Litigation, No. 12-cv-03852 (SDNY Dec. 18, 2015) (settlement), (SDNY May 10, 2016) (approval of settlement). See also Banking Daily, Dec. 22, 2015.

G) The UK Financial Conduct Authority ("FCA") fined JPMorgan Chase £137 million ($220 million) for serious failings relating to its CIO. See FCA Final Notice to JPMorgan Chase Bank, N.A., FRN 124491 (Sept. 18, 2013). In February 2016, the FCA fined the then-former CIO £792,900 for failing to be open and cooperative with the FCA. See FCA Final Notice to Macris, FRN AOM01001 (Feb. 9, 2016).

H) In connection with the government settlements described above, JPMorgan Chase Chairman Dimon announced:

i) JPMorgan Chase "increased the number of employees dedicated to [its] control efforts (Risk, Compliance, Legal, Finance, Technology, Oversight & Control and Audit) across the entire firm by 4,000 employees since the beginning of 2012 (including adding 3,000 in 2013 alone)."

ii) JPMorgan Chase "increased [its] total spend on controls by about $1 billion this year [and] . . . provided approximately 750,000 hours of Regulatory and Control-related training to employees across [its] franchise, on topics ranging from how to understand new regulations such as Dodd-Frank to [AML] training for Operations employees."

iii) JPMorgan Chase "increased spending on technology in the Regulatory and Control space by 27% since 2011. [It] built a state-of-the-art control room in [its] corporate headquarters to provide streamlined data analysis and reporting capabilities of control and operational risk data across the firm."

Dimon Letter to J.P. Morgan Employees (Wall St. J., Sept. 17, 2013).

I) The CFTC settled charges against JPMorgan Chase for recklessly employing a manipulative device in connection with executing a large volume of CDS in a concentrated period, in violation of Dodd-Frank's prohibition against manipulative conduct. See In the Matter of JPMorgan Chase Bank, N.A., CFTC Docket No. 14-01 (Oct. 16, 2013).

J) The OIG issued an Audit Report: OCC Needs to Strengthen Supervision of Trading Activities in Light of the JPMorgan Chase Losses (OIG-14-35, May 14, 2014). The Report found that the OCC had many opportunities to address weaknesses in the

CIO's risk management of trading activities, but did not act strongly or timely enough to address those weaknesses. The OIG also issued an Evaluation Report: The Board Should Enhance its Supervisory Processes as a Result of Lessons Learned From the Federal Reserve's Supervision of JPMorgan Chase & Company's [CIO] (OIG 2014-SR-B-017, Oct. 17, 2014), finding that the FRBNY should have engaged with the OCC as to how to employ collective resources more effectively, and resource constraints contributed to a vulnerability to loss of institutional knowledge about the firm subject to examination.

(x) Episodes similar to the SocGen and JPMorgan Chase incidents have occurred and involved trading exposures and unusual market positions that exceeded internal limits or otherwise raised risk management, legal or compliance issues. For example:

A) The German BaFin severely criticized Deutsche Bank's management oversight and culture in a strongly worded special audit report. See BaFin Letter, May 11, 2015; Wall St. J., July 16, 2015. Criticism was leveled at Deutsche Bank's leadership and culture for alleged failure to supervise, inaccurate and misleading disclosures to regulators, and hiding or ignoring problems, particularly in relation to LIBOR manipulation investigations and remediation. The letter warns of the potential imposition of supervisory measures. Deutsche Bank co-CEOs Anshu Jain and Jurgen Fitschen announced their resignation in June 2015, although bank officials indicated that the resignations were not the result of regulatory pressure. Following the Board's CCAR review completed in June 2016, the Board objected to Deutsche Bank's capital plans on qualitative grounds, based on material unresolved supervisory issues that critically undermined its capital planning process. See [CCAR] 2016: Assessment Framework and Results (Board, June 2016). See also Wall St. J., June 30, 2016 (reporting that the IMF identified Deutsche Bank as the riskiest financial institution in the world as a potential source of external shocks to the financial system).

B) UBS AG, FSA Final Notice (Nov. 25, 2012) (fining UBS for ineffective risk controls), Financial Times, Nov. 26, 2012, FSA News Release, Sept. 16, 2011 (investigation of $2 billion loss at UBS "Delta 1" trading desk in the UK), Wall St. J., Sept. 16, 2011, Financial Times, Sept. 15, 2011, NY Times Dealbook, Sept. 15, 2011; but see C.D.T.S. v. UBS AG, 2013 WL 6576031 (SDNY 2013) (dismissing a would-be class securities fraud lawsuit against UBS related to its employment of a "rogue trader").

C) Calyon Press Release, Sept. 18, 2007 (€250 million loss resulting from a large, unauthorized position on its proprietary trading desk).

D) Morgan Stanley, SEC Admin. Proc. No. 3-14407 (May 31, 2011) ($25 million loss arising from fraudulent conduct by trader concealing extent of risk associated with proprietary trading).

(xi) Loss events have emphasized the need to develop new strategies to combat fraudulent activities, strengthen internal supervisory methods and ensure management involvement in risk monitoring.

A) Sound Practices for Preventing and Detecting Unauthorized Proprietary Trading (Financial Institution Regulatory Authority ("FINRA") Regulatory Notice 08-18, Apr. 2008) lists practices to assist financial firms in establishing effective internal controls. This list includes:

i) Mandatory vacation policies for employees in sensitive positions.

ii) Heightened scrutiny of (a) trading limit breaches; (b) unrealized profit-and-loss

("P&L") on unsettled transactions; (c) unusual patterns of cancellations and corrections; (d) untimely confirmation and settlement; (e) reports of aged unresolved reconciling items and outstanding confirmations; (f) P&L reports that exceed an expected amount; (g) details underlying a trader's VAR; (h) repeated requests by a trader to relax position/P&L limits or other internal controls; (i) trading in products outside of a trader's expertise; (j) unusual differences between a trader's account positions and account activity; and (k) a pattern of aged fails to deliver.

iii) Heightened systems security.

iv) Effective allocation of supervisory roles and responsibilities.

v) Regular reconciliation and control of affiliate transactions.

vi) Ensuring that mid- and back-office personnel have sufficient internal clout to perform their responsibilities and effectively convey the importance of a "compliance culture".

See also Market Watch No. 25 (FSA, Mar. 2008).

B) There has been an increasing focus on the integration of ethics and compliance programs. These programs frequently exhibit:

i) Coordination between the compliance and ethics specialists and individual business units.

ii) Consistent implementation of the program throughout the organization's business lines.

iii) Clear and effective division of roles and responsibilities among the ethics office, compliance, legal and other relevant units.

iv) Periodic evaluation by the board of directors and management of the effectiveness and design of the program.

C) There has also been an increasing focus on the potential use of internal communication systems to evade supervision and encourage fraudulent activity. In 2015, Senator Warren requested information on compliance and enforcement concerns raised by financial institutions' use of new communication tools advertised to provide data encryption and permanent deletion functions. See Letters from Senator Warren to CFPB Director Cordray, CFTC Chairman Massad, Attorney General Lynch, FDIC Chairman Gruenberg, FINRA Chairman Ketchum and SEC Chair White, dated Aug. 10, 2015. See also Business Insider, June 5, 2016 (noting European politician's calls for tighter regulation of encrypted financial messaging platforms).

(xii) The SEC has published for public comment a proposed national market system plan for a "consolidated audit trail" (CAT) that would create a single, comprehensive database to enable regulators to efficiently track all trading activity in the U.S. equity and options market. Key goals of the proposed CAT plan include increasing the ability of regulators to conduct research, reconstruct market events, monitor market behavior, and identify and investigate misconduct. See SEC Release No. 34-77724 (Apr. 27, 2016); SEC Press Release 2016-77, (Apr. 27, 2016).

b. The role of the legal and compliance function in respect of operational risk has received increased attention.

(i) Regulators expect that the legal and compliance function will be vigilant and proactive in assisting in risk identification, monitoring and mitigation.

(ii) There is a key relationship between risks and controls. Corporate reporting systems, documenting appropriate policies and procedures, and training and advising front, middle and back office personnel on risk management requirements continue to be critical components of satisfying supervisory objectives.

(iii) A financial institution should implement:

A) An appropriate "tone-at-the-top" to recognize the importance of board/senior management oversight.

B) Policies to address legal, operational, compliance and reputational risks, including regular senior management assessments of risk tolerance, and procedures for escalating risk concerns to senior levels.

C) Consistent risk definitions, policies, measurement, reporting, accountability and audit.

D) Compliance programs relating to legal, regulatory and supervisory requirements (laws/regulations with respect to banking, securities, commodities, real estate, insurance, etc.).

E) Policies and procedures for satisfying securities law disclosure requirements.

F) A robust internal audit process focused on independence, planning, risk assessment, exception tracking and resolution.

(iv) Among the key areas focused on to build a "culture of compliance" are:

A) Attention from the board and senior management (see generally Key Bank (OCC Consent Order No. 2005-141 (Oct. 17, 2005) (citing board responsibilities in context of BSA and related compliance 35 times)).

B) Employee training and self-assessment.

C) Policies to identify, measure, assess, monitor, test and minimize compliance/legal/reputational risk, backed by a well-resourced, independent compliance staff.

D) Policies governing the accumulation, retention, use and dissemination of data, including customer data.

E) Attention to the sources of risk management guidance and statements of risk management concerns (including regulatory orders, staff opinions, speeches and presentations, etc.).

F) Procedures for prompt redress of reporting problems.

G) Cooperation with regulators (recognizing the increasing globalization of regulatory focus, communication, coordination and enforcement).

H) Close integration of the governance, risk management and compliance functions.

I) Limitations on outsourcing the compliance function.

J) Clear identification and response to "red flags" given the nature of its business and the nature and scope of its cooperation with regulatory inquiries.

See, e.g., Law360, Feb. 25, 2015; Remarks of Board Governor Tarullo, June 9, 2014 (Corporate Governance and Prudential Regulation); Remarks of SEC Office of Compliance Inspections and

Examinations ("OCIE") Director di Florio, Oct. 17, 2011 (Role of Compliance and Ethics in Risk Management); Implementation of the Compliance Principles: A Survey (BIS, Aug. 2008); Compliance and the Compliance Function in Banks (BIS, Apr. 2005); National Association of Securities Dealers ("NASD") Notice to Members 05-29 (Apr. 2005) (NASD supervisory controls); Remarks of Board Governor Bies, Aug. 10, 2003 (Effective Corporate Governance and the Role of Counsel).

c. Key current issues from a legal and compliance perspective in the context of BHC/bank capital markets activities include:

(i) Responsibility for building a "culture of compliance", assuring compliance with "best" operational, ethical and business practices, and implementing effective codes of conduct. See Behavioral Risk Management in the Financial Services Industry: The Role of Culture, Governance and Financial Reporting (FRBNY, Aug. 2016).

(ii) Recognition of the principal areas which generate reputational risk, including those arising from (A) participation in "complex structured finance transactions" ("CSFTs") motivated by tax, accounting or regulatory avoidance (see Part II.E.2.e below), or novel, complex or unusually profitable transactions that may raise "appropriateness" or "suitability" considerations insofar as marketing to, or selection of, counterparties is concerned; (B) transactions where the likelihood of customer confusion is enhanced (e.g., sale of non-deposit investment products through a bank); (C) transactions involving controversial public associations (political figures, etc.) or unnamed counterparties; and (D) large but non-controlling investments, especially in companies in high risk economic (environmental, "sub-prime", gaming, power, etc.), political or geographic areas.

(iii) Identification and resolution of conflicts of interest that arise (A) between the financial institution and its customers, (B) among the financial institution's customers, and (C) among different business units of the same financial institution. Conflicts of interest which arise from multiple relationships with a customer (e.g., acting as an underwriter and as an adviser to the issuer, acting as market-maker/lender/derivatives counterparty, acting as adviser on M&A transactions coupled with the issuance of fairness opinions, holding positions in debt and equity securities, having a director representative on a client's board, etc.) may require special attention to address potentially increased risk of equitable subordination, incurring fiduciary obligations, restrictions on information-sharing, etc.

Conflicts of interest may be addressed in a number of ways, including (A) determining at the business line level not to proceed in a particular situation; (B) using structural mitigation tools (e.g., information barriers, restricted/watch lists, training and surveillance); (C) elevating issues for senior management resolution and mitigation; and (D) implementing procedures for disclosure/consent/waiver. See generally FSA Letter to Chief Executives of Financial Institutions, Nov. 10, 2005 (the "FSA 2005 Letter") (characteristics of a "well-managed firm" in respect of conflict of interest concerns). See also Part IX.E below.

The Dodd-Frank Act enacts 1934 Act § 27B to require the SEC to implement rules that will prohibit an underwriter, placement agent, initial purchaser or sponsor of an ABS from engaging in any transactions (other than in the context of certain hedging activities) that would involve a conflict of interest with respect to an investor in a transaction arising out of such activity. The prohibition becomes effective upon implementation of rules by the SEC, which have been proposed. See 76 Fed. Reg. 60320 (Sept. 28, 2011) (proposed rule). See also Part X below.

(iv) Restrictions on transactions with affiliates (see Part III.A.5 below).

(v) Anti-tying requirements (see Part III.A.4 below).

(vi) Focus on compliance with equity investment limitations and on monitoring processes, documentation, approval and due diligence procedures (see Part VII below).

(vii) Identification and monitoring of key risk indicators with respect to derivative transactions and trading activities (see Part II.E below).

(viii) Recognition of responsibilities with respect to participation in trading activities, including standards of fair practice, and policies, procedures and controls to guard against manipulative behavior (see Part II.B and Part II.D below).

(ix) Evaluation of issues with respect to the identification and treatment of material non-public information in the context of loan, credit derivative and related markets, as well as in the context of "traditional" securities trading (see Part II.E.l.c and Part V.A.3.d below).

(x) Review/evaluation of outsourcing contracts (see Part I.C.5.f above and Part IX.B.2 below).

(xi) Focus on compliance with banking and securities law licensing/supervisory requirements in connection with international securities transactions/linkages, and access of home jurisdiction supervisors to information in foreign branches and subsidiaries (see Part XI below).

(xii) Evaluation of relationships between banks/broker-dealers and hedge funds, including in respect of space leasing, service arrangements, brokerage compensation, disclosures, and treatment of hedge fund clients in comparison with other clients (see Part VII.D below).

(xiii) Compliance with the PATRIOT Act/BSA/ OFAC/Foreign Corrupt Practices Act ("FCPA") requirements, including in respect of (A) AML and related policies, (B) suspicious activities report ("SAR") tracking/monitoring/filing, (C) customer identification/ know-your-customer ("KYC") procedures, (D) trade finance, (E) foreign correspondent account review, and (F) diligence in respect of U.S. and non-U.S. shell companies and tax havens (see Part VIII.A below).

(xiv) Sensitivity to special concerns relating to broker-dealer/investment adviser and related compliance responsibilities (see Part VIII.C and Part IX.E below).

(xv) Preservation, provision and review of mobile messages or social media records.

d. For additional regulatory and other background and discussion of operational and related risks, see, e.g., Letters, dated May 22, 2014, from Rep. Hensarling to Board/OCC/FDIC (requesting clarification as to evaluation of "reputational risk"); Remarks of Deputy Comptroller for Operational Risk DuChene, Mar. 27, 2014; Accenture 2014 Compliance Risk Survey; Developing an Effective Governance Operating Model: A Guide for Financial Services Boards and Management Teams (Deloitte, 2013); Salz Review: An Independent Review of Barclays' Business Practices (Apr. 2013); Wall Street/Fleet Street/Main Street: Corporate Integrity at a Crossroads (July 2012); Guiding Principles for Enhancing Banking Organization Corporate Governance (TCH, Mar. 13, 2012); Toward Effective Corporate Governance of Financial Institutions (Group of 30, 2012); Growth, Risk and Compliance: The Case for a Strategic Approach to Managing Reference Data (Deloitte/SWIFT, 2012); Too Good to Fail? New Challenges for Risk Management in Financial Services (Economist Intelligence Unit, 2011); The Internal Audit Function in Banks (BIS, Dec. 2011); Guidelines on Internal Governance (EBA, Sept. 27, 2011); Corporate Governance and Banks: What Have We Learned From the Financial Crisis? (FRBNY, June 2011); Guidelines on the Management of Operational Risks in Market-related Activities (CEBS, Oct. 12, 2010); Principles for Enhancing Corporate

Governance (BIS, Oct. 2010); Recognizing the Risk-mitigating Impact of Insurance in Operational Risk Modeling (BIS, Oct. 2010); Global Emerging Risks Survey: Steering the Course, Seizing the Opportunity (Financial Times/Oliver Wyman, Aug. 2010); Guidelines on Operational Risk Mitigation Techniques (CEBS, Dec. 22, 2009); Compendium of Supplementary Guidelines on Implementation Issues of Operational Risk (CEBS, Sept. 2009); Getting Bank Governance Right: The Bank Board Member's Guide to Risk Management Oversight (Deloitte, Aug. 2009); Risk Intelligent Governance: A Practical Guide for Boards (Deloitte, 2009); "Operational Risk Under Basel II: A Model for Extreme Risk Evaluation", Banking & Fin. Serv. Policy Rept. (Oct. 2008); "Operational Risk", FDIC Supervisory Insights (Summer, 2006); Sound Practices for Managing Legal Risk: Principles for Legal Departments in Financial Institutions (FRBNY, 2006); FDIC FIL-105-2005 (Oct. 21, 2005), CCH Fed. Banking L. Rep. ¶ 38-195 (guidance on ethics program); Towards Greater Financial Stability: A Private Sector Perspective (Counterparty Risk Management Policy Group "CRMPG", July 2005) (the "CRMPG II 2005 Report"); Basel II -- A Closer Look: Managing Operational Risk (KPMG, 2003); Sources of Legal Risk for Financial Institutions (Int'l Bar Assoc. Working Party on Legal Risk (Aug. 2003)) (draft); Banking Daily, Aug. 14, June 20, 2012, May 3, 2011; Compliance Reporter, June 6, 2011.

See also Part VIII and Part IX.F below.

7. Volcker Rule

   a. Section 619 of the Dodd-Frank Act ("DFA § 619"), commonly known as the "Volcker Rule" (implementing certain recommendations of former Board Chairman Volcker), amends the BHCA to prohibit banking entities from engaging in certain types of proprietary trading and imposes limits on sponsoring or investing in hedge funds or private equity funds. The federal agencies responsible for implementing the Volcker Rule adopted final regulations in 2013. See 79 Fed. Reg. 5536 (Jan. 31, 2014) (FRB, FDIC, OCC and SEC); 70 Fed. Reg. 5508 (Jan. 31, 2014) (CFTC) (the "Volcker Rule Regulation"), codified at 12 C.F.R. Part 44 (OCC); 12 C.F.R. Part 248 (Board); 12 C.F.R. Part 351

(FDIC); 17 C.F.R. Part 75 (CFTC); 17 C.F.R. Part 255 (SEC). See also Responses to [FAQ] Regarding the Volcker Rule (FRB, OCC, FDIC, SEC and CFTC) ("Volcker Rule FAQs") (last updated Mar. 4, 2016).

See also Study and Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds (FSOC, Jan. 2011).

b. Banking entities covered by the Volcker Rule include all insured depository institutions, FHCs, BHCs, foreign banks treated as BHCs under IBA § 8 (including those without insured deposits), and the affiliates and subsidiaries (such as broker-dealers) of each. See BHCA § 13(h)(1).

While systemically significant non-bank financial companies are not subject to the Volcker Rule's prohibitions, they will be subject to additional capital and quantitative limits on such activities. See BHCA §§ 13(a)(2), 13(f)(4). The Board has not yet issued a proposal for such limits.

Certain types of affiliates and subsidiaries are excluded from the definition of "banking entity" and application of the Volcker Rule, including (i) covered funds (see Part II.A.7.h below); (ii) portfolio companies and concerns held under merchant banking authority or controlled by a small business investment company; and (iii) U.S. registered investment companies and foreign public funds provided that, following a reasonable seeding period, the affiliated banking entity owns less than 25% of the fund's outstanding voting shares. See Volcker Rule FAQ Nos. 5 (June 10, 2014), 14 (June 12, 2015) and 16 (July 16, 2015). See generally Agencies Release Volcker Rule FAQ on Seeding Periods for Registered Investment Companies and Foreign Public Funds (Cleary Gottlieb, July 16, 2015); Law360, June 24, 2015; Agencies Release FAQs on Foreign Public Funds and Joint Ventures (Cleary Gottlieb, June 12, 2015).

The definition of "proprietary trading" is limited to buying and selling securities, derivatives and other "financial instruments" as principal for the banking entity's "trading account".

c. A "trading account" is defined as any account used to take positions principally for the purpose of selling in the near term or otherwise with the intent to resell in order to profit from short-term price movements. Regulators also have discretion to adopt rules treating other accounts as "trading accounts" for this purpose. See BHCA §§ 13(h)(4), 13(h)(6). The Volcker Rule Regulation defines "trading account" by reference to three tests: a purpose test, a market risk capital rule test and a dealer registration test. The Volcker Rule Regulation also establishes a rebuttable presumption that a purchase or sale of a financial instrument that the banking entity holds for less than 60 days is within a trading account. See Final Volcker Rule Highlights – Proprietary Trading (Cleary Gottlieb, Dec. 11, 2013). Based on these three tests and the 60-day presumption, banking entities should still be able to determine that a transaction(s), even involving financial instruments, may be "outside the trading account" and therefore out of scope for the Volcker Rule prohibitions.

   The Volcker Rule Regulation contains several exclusions from the definition of "financial instruments", and transactions in such instruments are outside the scope of the Volcker Rule's ban on proprietary trading, including: (i) loans, (ii) physical commodities; (iii) FX and currency; and (iv) identified banking products, such as deposit accounts, savings accounts and CDs.

d. The Volcker Rule Regulation also excludes certain arrangements and transactions from the scope of the proprietary trading prohibition, including: (i) agency, brokerage and custodial transactions where a banking entity is not taking a position as principal; (ii) repo arrangements and securities lending transactions; (iii) positions taken for bona fide liquidity management; (iv) positions held by a registered derivatives clearing organization or clearing agency acting as a central counterparty; (v) positions taken through certain compensation plans; (vi) positions taken in satisfaction of DPC; (vii) certain limited transactions undertaken by a member of a clearing organization to facilitate functioning of the clearing organizations; (viii) positions taken to satisfy an existing delivery obligation of the banking entity or customer; and

(ix) positions taken in connection with satisfying a judicial, administrative, self-regulatory or arbitration proceeding.

e. Compliance with the prohibition on proprietary trading is demanding and requires significant investments in infrastructure. The Volcker Rule requires implementation of a detailed compliance program and record-keeping requirements, including a series of quantitative metrics. See generally, e.g., Volcker Rule FAQ No. 17 (Sept. 25, 2015); Volcker Rule Interim Examination Procedures (OCC, June 2014); SNL Financial, May 27, 2014; Economic Impact Analysis of the Final Volcker Rule (OCC, Mar. 20, 2014); Bloomberg, Jan. 15, 2014; The Volcker Rule: Compliance Monitoring Program (Deloitte, 2014); The Volcker Rule: 13 Considerations for Calculating and Reporting Quantitative Measures (Deloitte, 2014); SNL Financial, Dec. 17, 2013; The Volcker Rule: Community Bank Applicability (FRB/FDIC/OCC, Dec. 10, 2013); Final Volcker Rule Highlights -- Conformance Plan and Compliance Program (Cleary Gottlieb, Dec. 12, 2013); The Volcker Rule, Impact Assessment on the U.S. Energy Industry and Economy (IHS, 2012); The Economic Consequences of the Volcker Rule (Center for Capital Markets Competitiveness, Summer 2012); The Volcker Rule: Implications for the U.S. Corporate Bond Market (SIFMA/Oliver Wyman, Dec. 14, 2011); Impact Analysis of Proposed Rule to Implement the Volcker Rule (OCC, Sept. 7, 2011); Regulator Will Need More Comprehensive Information to Fully Monitor Compliance with New Restrictions When Implemented (GAO, July 2011).

f. The following categories of proprietary trading are permitted:

(i) Trading in certain expressly permitted securities, including U.S. Treasury securities, obligations of GNMA, the Federal Home Loan Banks (the "FHLB"), Fannie Mae and FHLMC, and obligations of any State or political subdivision thereof. See BHCA § 13(d)(1)(A). The Volcker Rule Regulation also permits certain types of trading in home country foreign sovereign obligations by foreign banks and foreign affiliates of U.S. banking entities, subject to certain conditions. The limited scope of the exemption for trading in foreign sovereign debt compared with the general exemption for U.S. Treasury securities has caused controversy. See Reuters, May 13, 2015.

(ii) Trading in connection with underwriting or market-making-related activities, to the extent designed not to exceed the reasonably expected near term demands of clients, customers and counterparties. See BHCA § 13(d)(1)(B). See generally Law360, Apr. 17, 2015 (underwriting exception); Market-making and Proprietary Trading: Industry Trends Drivers and Policy Implications (BIS Committee on the Global Financial System, Nov. 2014).

The Volcker Rule Regulation identifies indicia of whether a banking entity's activities are legitimately market-making related, but acknowledges that variations in liquidity, trade size, infrastructure, trading volume and frequency, and even geographic location will influence a market maker's activities. The principal requirements, conditions and restrictions of the market-making exemption include the following:

A) A trading desk must (i) routinely stand ready to purchase and sell one or more types of financial instruments, and (ii) be 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.

B) The amount, types and risks of the financial instruments in the trading desk's market-maker inventory must be designed not to exceed the reasonably expected near-term demands of clients, customers or counterparties, based on: (i) the liquidity, maturity and depth of the market for the relevant types of financial instruments; 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.

C) The banking entity must establish and enforce an internal compliance program meeting specified requirements.

D) To the extent that any risk, position or other limit in the internal compliance program is exceeded, the trading desk must take action to bring itself into compliance with the limit as promptly as possible.

E) Compensation of persons performing the banking entity's market-making-related activities must be designed not to reward or incentivize prohibited proprietary trading.

F) The banking entity must be licensed or registered to engage in market-making-related activity if and to the extent required by applicable law.

(iii) Risk-mitigating hedging activities designed to reduce the specific risks to a banking entity in connection with and related to individual or aggregated positions, contracts or other holdings. <u>See</u> BHCA § 13(d)(1)(C). The Volcker Rule Regulation requires that hedging activities satisfy a set of detailed correlation, compliance and documentation requirements. <u>See also</u> <u>Volcker Rule FAQ</u> No. 19 (Nov. 20, 2015) (regarding the treatment of residual market making positions).

(iv) Trading on behalf of customers. <u>See</u> BHCA § 13(d)(1)(D). The Volcker Rule Regulation limits the scope of this permissible activity to fiduciary and riskless principal transactions.

(v) Trading by regulated insurance companies and their affiliates for the general account of the insurance company. See BHCA § 13(d)(1)(F).

(vi) Trading solely outside of the U.S. by the non-U.S. affiliates and personnel of foreign banking organizations. See BHCA § 13(d)(1)(H). The Volcker Rule Regulation permits foreign banking entities to use U.S. infrastructure and trade with U.S. counterparties, but only in certain circumstances.

g. The Volcker Rule generally prohibits banking entities from sponsoring, and acquiring an ownership interest in, private equity and hedge funds.

(i) Sponsorship is defined to include:

A) Serving as general partner, managing member, trustee or CPO of a fund (unless the trustee does not have investment discretion);

B) Selecting or controlling (or having employees, officers, directors or agents who constitute) a majority of the board of directors, trustees or management of the fund; or

C) Sharing the same name or a variation of the same name with a fund for corporate, marketing, promotional or other purposes.

(ii) Ownership interest is defined broadly to include "any equity, partnership or similar interest", which the Volcker Rule Regulation further defines to include any interest that meets one of seven separate tests. Most of these tests focus on economic characteristics, but the Volcker Rule Regulation added one prong based on voting rights that has generated significant controversy. In particular, an interest in a covered fund (which as noted below, will include a variety of securitization vehicles) will be considered an ownership interest if it gives the holder the right to participate in the selection or removal of a fund's general partner, board of directors or trustees, investment adviser or equivalent. Thus, even an interest which is otherwise denominated as a debt security could be treated as an ownership interest if it conveys such voting rights, some of which were customary in certain CLO issues and similar structures.

(iii) Private equity and hedge funds, the term used in Dodd-Frank § 619, was defined principally based on 1940 Act §§ 3(c)(1) and 3(c)(7), creating an extremely broad definition of "covered funds" that included a wide range of vehicles and entities that bore no relation to private equity and hedge funds. This presented a challenge for the agencies charged with implementing the Volcker Rule, which recognized the overbreadth of the definition while at the same time had concerns about creating exceptions that could become "loopholes". In addition, other policy considerations soon captured the Volcker Rule and introduced distinctions that Congress did not envision at the time of Dodd-Frank, such as views concerning the viability of products such as CDOs and CLOs.

A) This distinction not only led to the first court challenge to the Volcker Rule Regulation (as applied to TruPS CDOs) but has since led to guidance and expected extensions of the conformance period for CLOs. See ABA v. FDIC, No. 13-02050 (D.D.C., Feb. 12, 2014) (notice of voluntary dismissal); ABA v. FDIC, No. 13-02050 (D.D.C., Dec. 24, 2013) (complaint). See also Volcker Rule FAQ, No. 21 (Mar. 4, 2016) (capital treatment for permitted TruPS CDOs); Summary of Meeting Between Representatives of LSTA and the Volcker Rule Interagency Working Group (LSTA, Feb. 25, 2014); 79 Fed. Reg. 5223 (Jan. 31, 2014) (interim final rule addressing TruPS CDOs); Agencies Release Non-exclusive List of Qualified [CDOs] Backed Primarily by Trust Preferred Securities [("TruPS")] (Board, FDIC, OCC, Jan. 14, 2014); Statement Regarding Treatment of Certain CDOs Backed by

TruPS under the Rules Implementing § 619 of the Dodd-Frank Act (Board, FDIC, OCC and SEC, Dec. 27, 2013); FAQ Regarding [CDOs] Backed by Trust Preferred Securities under the Final Volcker Rule (Board, FDIC, OCC, Dec. 19, 2013).

For a discussion of conformance period issues, see Part II.A.7.i below.

B) Because the baseline definition of "covered fund" is linked to 1940 Act §§ 3(c)(1) and 3(c)(7), 1940 Act definition and exemption issues play a prominent role in Volcker Rule interpretive issues.

C) While the agencies narrowed the definition of "covered funds" from the baseline definition in several respects, they also expanded the scope of covered funds to include certain commodity pools and certain foreign funds sponsored by U.S. banking entities.

(iv) The main exemption permitting banking entities to sponsor and invest in covered funds is the so-called "asset management exemption". Under this exemption, banking entities will be able to sponsor and invest in covered funds if they meet a number of criteria, including:

A) Bringing any seed capital investment down to 3% within a 1-year seeding period (unless extended by the Board for up to two additional years).

B) 3% per-fund and aggregate quantitative limits on the banking entity's investments in the fund.

C) Restrictions on sharing a name with the sponsor banking entity or any affiliate.

D) Restrictions on the types of employees who can invest in the fund (cf. Managed Funds Assoc. (avail.

Feb. 6, 2014) (no-action relief with respect to 1940 Act § 7 and SEC Rule 3c-5)).

E) A prohibition on any transaction with the covered fund that would be a "covered transaction" under Section 23A (see Part III.A.5 below), commonly referred to as "Super 23A". See also Volcker Rule FAQ Nos. 18 (Sept. 25, 2015) (timing of CEO certifications with respect to certain prime brokerage relationships permitted under Super 23A) and 20 (Nov. 20, 2015) (timing of applicability of Super 23A).

(v) An important exemption (the so-called "SOTUS exemption") permits foreign banks to sponsor and invest in covered funds solely outside the U.S. Among other limitations, this exemption contains a prohibition on marketing to U.S. residents by the banking entity seeking to rely on the exemption. Subsequent guidance clarifies that this restriction does not apply to U.S. marketing undertaken by unaffiliated third parties, provided that the banking entity seeking to rely on the exemption is neither the sponsor nor adviser of the fund. See Volcker Rule FAQ No. 13 (Feb. 27, 2015). As a result, foreign banks may rely on the SOTUS exemption to invest in third party funds that have been marketed to U.S. investors so long as the foreign bank does not participate in the U.S. marketing activities. See New Volcker Rule Interpretation Clarifies that Foreign Banks are Permitted to Invest in Third-Party Funds with U.S. Investors (Cleary Gottlieb, Mar. 2, 2015).

(vi) The Volcker Rule Regulation contains a number of specific exemptions from the definition of "covered fund", some of which represent clarifications of the scope of "covered funds" and many of which have detailed criteria set out in the Volcker Rule Regulation. Key exemptions include:

A) Foreign public funds (subject to a number of restrictions, particularly for U.S. banking entities).

B) Foreign pension and retirement funds.

C) Wholly-owned subsidiaries.

D) Joint ventures, subject to certain limitations. See Volcker Rule FAQ No. 15 (June 12, 2015).

E) Loan securitizations and ABCP conduits.

F) Insurance company separate accounts.

G) Business development companies ("BDCs") and SBICs. See American Banker, Oct. 1, 2015; IFLR, Sept. 2014 (uptick in SBIC licenses).

H) Investment companies registered under the 1940 Act.

I) Entities that rely on a 1940 Act exemption from registration other than 1940 Act §§ 3(c)(1) and 3(c)(7).

(vii) Banking entities retain the ability to serve as investment manager or investment adviser to covered funds, subject to certain restrictions on transactions with the fund (including Super 23A). See BHCA §13(f). See also Part III.A.5 below.

(viii) Banking entities retain the ability to make noncontrolling investments in asset managers. See, e.g., Securities and Investments M&A, Oct. 2010 (Credit Suisse investment in York Capital Management).

(ix) The Volcker Rule Regulation permits a banking entity to engage in underwriting and market-making activities involving the acquisition of covered fund interests, provided that the activities are conducted in accordance with the underwriting and market-making provisions of the Rule's proprietary trading provisions and adhere to certain quantitive limitations. See Volcker Rule FAQ No. 17 (Sept. 25, 2015) (a reasonably designed compliance program for a trading desk engaged in market making may include objective factors to determine whether a security is issued by a covered fund).

h. The Volcker Rule does not preclude FHCs from continuing merchant banking investments, so long as the investments do not constitute proprietary trading and are not in covered funds.

i. The effective date of the Volcker Rule Regulation was April 1, 2014. Section 619 took effect in July 2012, with a conformance period that was initially scheduled to end on July 21, 2014. The Board granted a blanket one-year extension for all banking entities to July 21, 2015, in an order issued the same day that the Volcker Rule Regulation was released. See Order Approving Extension of Conformance Period (Board, Dec. 10, 2013). During the extended conformance period, banking entities were expected to continue to engage in good faith efforts to achieve conformance by the end of the period and to promptly terminate or divest stand-alone proprietary trading operations. See Final Volcker Rule Highlights -- Conformance Period (Cleary Gottlieb, Dec. 10, 2013).

In an order issued on December 18, 2014, the Board granted a limited one-year extension of the conformance period to give banking entities until July 21, 2016 to conform investments in and relationships with covered funds and foreign funds that were in place prior to December 31, 2013 ("legacy funds"). See Order Approving Extension of Conformance Period (Board, Dec. 18, 2014) (the "First Order"). The Board subsequently granted a second one-year extension, giving banking entities until July 21, 2017 to conform legacy fund investments and relationships. See Order Approving Extension of Conformance Period Under Section 13 of the [BHCA] (Board, July 6, 2016) (the "Second Order"). The Second Order is the final of the three one-year extensions that the Board is authorized to grant. Neither the First nor Second Order extended the conformance period for the Volcker Rule's proprietary trading provisions or the date on which banks were expected to have a compliance program in place. See Federal Reserve Extends Volcker Rule Conformance Period for Legacy Funds (Cleary Gottlieb, Dec. 19, 2014); see also Statement Regarding the Treatment of [CLOs] Under Section 13 of the [BHCA] (Board, Apr. 7, 2014) (indicating that Board intended to grant two additional one-year extensions of the conformance period for banking entities with respect to their ownership interests in, and sponsorship of, certain CLOs that were in place as of December 31, 2013).

(i) The Board's final rules regarding the conformance period issued in 2011 (12 C.F.R. §§ 225.180-182) provide for an additional five-year transition period, upon application, for qualifying "illiquid fund" investments that were in place prior to May 1, 2010. See 76 Fed. Reg. 8265 (Feb. 14, 2011); Statement of Policy Regarding the Conformance Period for Entities Engaged in Prohibited Proprietary Trading or Private Equity Fund or Hedge Fund Activities, Fed. Res. Reg. Serv. ¶ 4-102 (Apr. 19, 2012); 77 Fed. Reg. 33949 (June 8, 2012). See also Volcker Rule Conformance Period Clarified (Joint Press Release of the Board/CFTC/FDIC/OCC/SEC, Apr. 19, 2012).

The Board's 2011 definition of "illiquid fund" is quite restrictive and Board legal staff informally indicated in 2014 that staff was preparing a revised proposal of the definition. On March 1, 2016, SIFMA and the ABA submitted a letter to the Board asking that the Board broaden the definition of illiquid fund to better align with the Volcker Rule's statutory language and congressional intent. See SIFMA and ABA Letter to Board, Mar. 1, 2016; see also Securities Law Daily, July 18, 2016 (regarding banks' attempts to unwind illiquid legacy positions). More recently, in connection with the Second Order the Board stated that it "expects to provide more information in the near term" regarding how the Board will address applications for illiquid fund extensions. To date, no such action has been taken and yet it is relatively clear that banking entities are already planning illiquid fund extension applications.

B. ELIGIBLE SECURITIES

FHCs, financial subsidiaries, BHCs and banks may underwrite, deal in, make a market in and broker "eligible securities", and GLB Act § 151 empowers well capitalized national banks to underwrite and deal in municipal revenue bonds. See, e.g., the following precedents (collectively, the "Eligible Securities Precedents"): 12 U.S.C. § 24(7); Investment Securities Regulations; Comptroller Interpretive Letters No. 915 (Aug. 15, 2001), CCH Fed. Banking L. Reg. ¶ 81-440; No. 512 (July 9, 1990), CCH Fed. Banking L. Rep. ¶ 83,214; Comptroller Unpublished Letter (May 21, 1986); 12 C.F.R. §§ 201.108, 225.28(b)(8); Citicorp Government Securities, 68 Fed. Res. Bull. 249 (1982) (the "CGS Order").

See Part I.A.2 above and Part II.D and Part X.C below.

1. Instruments Which Constitute Eligible Securities

a. As reflected in the Eligible Securities Precedents, "eligible securities" include:

(i) Obligations issued by or backed by the full faith and credit of the U.S.

(ii) General obligations of U.S. states (including Puerto Rico) and political subdivisions (including municipalities) which possess general powers of taxation, including certain "indirect" general obligations supported by state/municipal lease/rental agreements, service/purchase agreements, refillable reserve funds, other grants or support, tax anticipation notes, bond anticipation notes and similar arrangements (collectively, "municipal securities").

(iii) Limited obligation bonds, revenue bonds and similar instruments of U.S. states (including Puerto Rico) and political subdivisions (including municipalities), provided that a bank proposing to underwrite or deal in the instruments is well capitalized.

(iv) Obligations issued by any U.S. state (including Puerto Rico) or political subdivision, or agency thereof, for housing, university or dormitory purposes.

(v) Obligations backed by Canada, or any province or political subdivision, and certain obligations of any "agent" of Canada, any province or any political subdivision if the jurisdiction on whose behalf the agent is acting is ultimately unconditionally liable for the obligation.

(vi) Certain obligations issued by governmental and international organizations, including the International Bank for Reconstruction and Development, European Bank for Reconstruction and Development, Inter-American Development Bank for Economic Cooperation and Development in the Middle East and North Africa, North American Development Bank, African Development Bank, Asian Development Bank, Inter-American Investment Corporation, International Finance Corporation, Tennessee Valley Authority, U.S. Postal Service, Federal Financing Bank, Environmental Financing Authority, Federal Intermediate Credit Bank, Merchant Marine, Export-Import Bank, Federal Housing Administration, Commodity Credit Corporation, and Farmers Home Administration.

(vii) CDs and BAs issued by U.S. and non-U.S. banks.

(viii) Obligations of Fannie Mae, GNMA and FHLMC. (Until the enactment of the Reorganization Act of 1996, 20 U.S.C. § 1087-3, which privatized the Student Loan Marketing Association, its obligations were also eligible securities.)

(ix) Obligations of the Washington, D.C. Metropolitan Area Transit Authority (if such obligations are guaranteed by the U.S. Secretary of Transportation under the National Capital Transportation Act of 1969) and D.C. Armory Board bonds.

(x) Obligations issued (A) under authority of the U.S. Federal Farm Loan Act/Farm Credit Act of 1971 (including certain securities guaranteed by the Federal Agricultural Mortgage Corp. ("Farmer Mac")); (B) by any of the 13 Banks for Cooperatives; or (C) by the FHLBs or Federal Land Banks.

(xi) Certain obligations of a "local public agency" (as defined in the Housing Act of 1949) that are secured by an agreement between the local public agency and the U.S. Secretary of Housing and Urban Development.

(xii) Certain obligations of a "public housing agency" (as defined in the U.S. Housing Act of 1937) that are secured by an agreement between the public housing agency and the U.S. Secretary of Housing and Urban Development.

(xiii) Certain obligations guaranteed by the Overseas Private Investment Corp. or the Small Business Administration (the "SBA").

(xiv) Participation certificates in purchase contracts entered into by the General Services Administration.

b. Issues are sometimes raised as to whether a particular instrument is an eligible security.

(i) The Comptroller determined that a bank may treat as Type I securities debt securities that qualify for the FDIC's TLGP so long as the tenor of such securities does not exceed the term of the FDIC guarantee. Comptroller Interpretive Letter No. 1109 (Jan. 8, 2009), CCH Fed. Banking L. Rep. ¶ 81-641. See also SEC Letter to FDIC, July 12, 2010 (confirming that FDIC-guaranteed Senior Certificates issued by a mortgage trust would be exempt from registration requirements under the 1933 Act).

(ii) Comptroller Interpretive Letter No. 1001 (May 3, 2004), CCH Fed. Banking L. Rep. ¶ 81-530, determined that a bank may treat as Type I securities certificates of participation representing undivided fractional interests in a stream of principal and interest payments due under a loan it made to a third party where the principal and interest have been guaranteed under the Foreign Assistance Act (22 U.S.C. § 2197(c)).

(iii) The Comptroller has determined that state and local government securities, as well as securities issued by state development authorities, in each case whose payment is subject to an "appropriations clause", could nonetheless constitute Type I securities where a bank determines that, on the basis of past actions by voters involving similar projects, it is "reasonably probable" that the obligor will obtain all necessary appropriations. See, e.g., Comptroller Interpretive Letters No. 858 (Mar. 17, 1999), CCH Fed. Banking L. Rep. ¶ 81-352; No. 791 (July 10, 1997), CCH Fed. Banking L. Rep. ¶ 81-218; No. 675 (Mar. 15, 1995), CCH Fed. Banking L. Rep. ¶ 83,623; Comptroller Unpublished Letter (Aug. 16, 1988). See also Comptroller Interpretive Letter No. 907 (Feb. 1, 2001), CCH Fed. Banking L. Rep. ¶ 81-432 (housing authority bonds would constitute Type I securities where state had committed to maintain a reserve fund supporting the bonds).

(iv) Comptroller Interpretive Letter No. 767 (Jan. 9, 1997) ("Letter No. 767"), CCH Fed. Banking L. Rep. ¶ 81-131, determined that a variable rate security -- created with such terms as to permit a bank to participate indirectly in commodities markets -- with the principal amount, a minimum return and a portion of the variable return secured by Type I securities, constitutes a Type I security even though all of the variable return was not so secured, so long as the bank evaluates the payment and collateral mechanisms and concludes that they are reasonable to assure coverage of principal and interest, and determines that the proposed arrangement is consistent with safe and sound banking practices.

(v) In the context of the operation by a bank of a "tender option", remarketing and placement arrangement, Corporate Decision No. 96-52 stated that certificates issued by bank-affiliated trusts that own eligible securities are themselves eligible securities.

(vi) Board Staff Opinion (Jan. 10, 1994), Fed. Res. Reg. Serv. ¶ 4-655.5, concluded that custodial receipts which entitle the holder to an interest or principal payment on a U.S. Treasury security, are eligible securities.

(vii) Comptroller Interpretive Letter No. 579 (Mar. 24, 1992) ("Letter No. 579"), CCH Fed. Banking L. Rep. ¶ 83,349, concluded that certificates representing participation interests in pools of 90% FHA-insured Title I property improvement loans may not be purchased by national banks as Type I securities, but may be purchased and booked as "loans". See Part II.D.3.a.iii below.

(viii) The Comptroller has traditionally held that options on U.S. government securities are not "securities" for Glass-Steagall purposes. See, e.g., Comptroller No-Objection Letter No. 86-19 (Oct. 30, 1986) ("Letter No. 86-19"), CCH Fed. Banking L. Rep. ¶ 84,025.

(ix) The Comptroller amended the Investment Securities Regulations in 1999 by removing a statement that national banks may deal in Type IV securities secured by Type I securities and reiterated that ABS secured by Type I securities are Type I securities. See 64 Fed. Reg. 60092 (Nov. 4, 1999).

See also Part X.C.3 below.

c. Some, but not all, types of eligible securities are included in the exemption for permitted trading in domestic government obligations in the Volcker Rule Regulation. See Part II.A.7 above.

2. Treasury Securities Market

U.S. Treasury marketable public debt outstanding was over $13.5 trillion in 2016, and Federal agencies had outstanding debt of $2 trillion in 2016. U.S. government and agency obligations are an important component of domestic and foreign FHC, BHC and bank operations. See, e.g., Bureau of the Fiscal Service Monthly Statement of the Public Debt of the [U.S.] (Aug. 31, 2016); US Agency Debt Outstanding (SIFMA, Aug. 9, 2016).

A number of issues with respect to U.S. government securities dealing and trading activities merit attention:

a. Under the Government Securities Act of 1986 (the "GSA"), 15 U.S.C. § 78o et seq., government securities dealers must register with the SEC under 1934 Act § 15C and are subject to capital, customer protection, recordkeeping and other requirements.

(i) Federal bank regulators have adopted sales practice rules respecting government securities operations comparable to FINRA broker-dealer rules. See 12 C.F.R. Parts 13, 208, 368; 17 C.F.R. Parts 404, 405, 420. See also Comptroller's Handbook: [GSA].

(ii) Following the issuance of the Board/SEC/Treasury Joint Report on the Government Securities Markets (1992) (the "Government Securities Joint Report"), in 1993 the Treasury issued the "uniform offering circular" rule, which sets forth terms and conditions for the issue and sale of U.S. government securities. See 39 C.F.R. Parts 349, 356.

(iii) Pursuant to Dodd-Frank § 939A, the Treasury amended regulations issued under the GSA to replace references to credit ratings in the regulations with alternative requirements. See 79 Fed. Reg. 38451 (July 8, 2014).

See also Part IX below.

b. The GSA is not applicable to institutions which purchase and sell, but do not "deal in", government securities; i.e., to firms which trade government securities as principal with major brokerage firms and banks, or pool loans under government programs and sell such loans through broker-dealers. See, e.g., Bankers Guarantee Title & Trust Co. (avail. Jan. 22, 1991), Bank of America Canada (avail. May 1, 1988), Fairfield Trading Corp. (avail. Jan. 10, 1988), Continental Grain (avail. Nov. 6, 1987), Citicorp Homeowners (avail. Oct. 7, 1987), Fireman's Fund Mortgage Corp. (avail. July 30, 1987), Louis Dreyfus Corp. (avail. July 23, 1987), Meridian Mortgage Corp. (avail. Apr. 7, 1987), United Savings Association of Texas (avail. Apr. 2, 1987). See also, e.g., Fenchurch Paget Fund (avail. Aug. 3, 1987) (registration not required of a company organized to facilitate execution of government securities transactions); Int'l Investment Group (avail. July 23, 1987) (registration not required of investment adviser that provides government securities advisory and agency services and effects trades for its own account with securities dealers). See also Part II.B.3.b, Part II.D.3.b and Part IX.A below.

c. The Treasury's regulations issued under the GSA include certain exemptions from government securities dealer registration for financial institutions whose activities are limited to (i) sales or purchases in a fiduciary capacity and (ii) repos and reverse repos. See 17 C.F.R. § 401.4. Financial institutions may also qualify for an exemption from registration if engaged in only limited government securities brokerage activities. See 17 C.F.R. § 401.3.

d. "Primary dealers" recognized by the FRBNY perform a key role in the operation of the U.S. government securities market. These firms buy and sell government securities in direct dealings with the FRBNY. Primary dealers are expected to comply with FRBNY capital, reporting, personnel and auction participation requirements and to make markets in U.S. government securities, participate in Treasury auctions, facilitate the Board's open market operations, provide the Board with market information, and evidence a long-term commitment as a market-maker. See New York Fed Publishes Revised Policy for Administration of Primary Dealer Relationships (FRBNY, updated Mar. 24, 2016);

Government Securities Joint Report. See generally The Early Years of the Primary Dealer System (FRBNY, June 2016); "Primary Dealer Participation in the Secondary U.S. Treasury Market", Liberty Street Economics (FRBNY, Feb. 12, 2016); Primary Dealers Waning Role in Treasury Auctions (FRBNY, Feb. 2013); "Who Buys Treasury Securities at Auction", Current Issues (FRBNY, 2007).

(i) Under the Primary Dealers Act of 1988, 22 U.S.C. §§ 5341-42, the FRBNY may confer primary dealer status on a foreign institution only if such institution's home country grants U.S. persons similar opportunities in its government debt markets. The Board completed comprehensive studies on France, Germany, Japan, the Netherlands, Switzerland and the UK prior to favorable determinations in respect of such jurisdictions. See 84 Fed. Res. Bull. 1058 (1998).

(ii) Underwriting, dealing, trading and brokering U.S. government securities are intensely competitive. While a number of primary dealers have left the business or been acquired by other primary dealers in the past several years, additional broker-dealers have now been named as primary dealers; 23 primary dealers exist as of August 2016, 21 of which are broker-dealers and 2 of which are U.S. branches or agencies of foreign banks.

(iii) Primary dealers and other significant participants in U.S. government securities markets are held to high standards of market practice.

For example, allegations of abusive squeezes in the Treasury and Treasury repo markets led to increased market scrutiny. Regulatory attention to these markets resulted in the publication in 2007 (and update in 2009) of Treasury Market Best Practices by the Treasury Market Practices Group (the "TMPG"), chaired by the FRBNY, and the publication in 2010 of the Best Practices for Treasury, Agency Debt and Agency [MBS] Markets (and update in Feb. 2016).

On the heels of market benchmark investigations, U.S. authorities have also begun to explore trading practices in the U.S. Treasuries markets. See Use of Financial Benchmarks in TMPG-Covered Markets: Three Sample Case Studies (TMPG, Feb. 2016); Proposed Best Practice Guidance on the Use of Financial Benchmarks (TMPG, Dec. 3, 2015); Banking Report, Nov. 16, 2015 (describing government inquiries into U.S. Treasury "when-issued" trading); Bloomberg, June 10, 2015 (DOJ examining potential collusion in U.S. Treasury trading). See also Torus Capital v. Bank of Nova Scotia, No. 16-cv-05437 (SDNY July 7, 2016) (class action complaint against 25 banks alleging conspiracy in U.S. Treasury markets); CP Stone Fort Holdings v. Does, No. 16-cv-4991 (N.D. Ill., May 5, 2016) (company sues "John Does" for alleged manipulation of market because trading in U.S. Treasury secondary market is anonymous); Banking Report, Nov. 16, 2015; State-Boston Retirement System v. Bank of Nova Scotia, No. 15-cv-05794 (SDNY July 23, 2015) (class action complaint filed against all 22 primary dealers alleging collusive action in U.S. Treasury markets and related derivative products).

See also SEC Press Release 2016-90 (May 16, 2016) (announcing collaboration of SEC and Treasury to consider methods of collecting U.S. Treasury market transaction data); HSBC Brokerage, NASD News Release, May 29, 2007 (fine for failure to have adequate systems in place to assure "best execution" in government securities transactions); FRBNY News Releases, Nov. 13, 2006 (announcing 35% per-issue holding limit to be applied to Treasury securities), Nov. 6, 2006; Remarks of Deputy Assistant Treasury Secretary for Federal Finance Clouse, Sept. 27, 2006 (certain trading practices raised questions as to whether firms have sought to gain control over Treasury issues, distorting prices in the cash, repo and futures markets); Goldman Sachs, SEC Litigation Release No. 18322 (Sept. 4, 2003) (allegations of use of inside information learned at a Treasury press conference and tipped to

Goldman Sachs and others before Treasury's news embargo was lifted); Remarks of FRBNY Executive Vice President Kos, Dec. 6, 2001; Remarks of FRBNY Executive Vice President Fisher, Jan. 16, 1997, Oct. 8, 1996 (standards of market manipulation in respect of Treasury repo markets). Compare Fenchurch Capital Management, SEC Litigation Release No. 14977 (July 10, 1996), CFTC Release No. 3922-96 (July 10, 2006) (charges related to Treasury market repo and futures trading).

(iv) Banks also perform primary dealer roles in non-U.S. government bond markets and are regulated with respect to their non-U.S. primary dealer activities under applicable foreign laws and regulations. Increased costs and lower margins have caused some banks to exit the primary dealer market in Europe. See Reuters, Jan. 21, 2016. See also Amstad, Remolona and Shek, "How do global investors differentiate between sovereign risks? The new normal versus the old", BIS Working Paper No. 541 (BIS, Jan. 2016).

e. Market structure, settlement fails, volatility and liquidity in relation to government securities have received increased attention, particularly in light of the concentration of clearing functions for government securities in two banks and related operational and other considerations following the terrorist attacks of September 11, 2001.

On July 21, 2016, JPMorgan Chase announced that it would exit the U.S. Treasuries clearing and settling business, leaving BNYM as the sole provider of such services. JPMorgan Chase would not, however, exit its tri-party repo business in U.S. Treasuries. See Wall St. J., July 21, 31, 2016.

See, e.g., Securities Law Daily, Aug. 30, 2016 (discussing difficulties in entering market given large bank dominance); SEC Letter to FINRA, Aug. 19, 2016 (requesting review of FINRA rules to identify gaps in regulations applicable to U.S. Treasuries market); Statement Regarding Progress on the Review of the U.S. Treasury Market Structure since the July 2015 Joint Staff

Report (Treasury/Board/FRBNY/SEC/CFTC, Aug. 2, 2016); 81 Fed. Reg. 48465 (July 25, 2016) (notice of proposed FINRA rule change to apply TRACE reporting to U.S. Treasury transactions); "A Deeper Look at Liquidity Conditions in the Treasury Market", Treasury Notes (Treasury, May 6, 2016); Emerging Issues in the Functioning of the US Treasury Market (Promontory Financial Group, Apr. 2016); SIFMA Letter to Treasury Re: Notice Seeking Public Comment on the Evolution of the Treasury Market Structure (Apr. 22, 2016); SIFMA/ABA Letter to Treasury re: Request for Information on Evolving Treasury Market Structure (Apr. 22, 2016); ABA/ABASA Letter to Treasury re: Request for Information on Evolving Treasury Market Structure (Apr. 22, 2016); Banking Report, Feb. 22, 2016 (describing high frequency algorithmic or arbitrage trading in Treasuries markets); Notice Seeking Public Comment on the Evolution of the Treasury Market Structure, 81 Fed. Reg. 3928 (Jan. 22, 2016); Wall St. J., Dec. 2, 2015 (describing shift in bond trading from banks to funds and electronic trading specialists); Sec. Reg. & L. Report, Nov. 2., 2015 (same); Remarks of SEC Chair Mary Jo White, Oct. 20, 2015 (Taking Stock of Treasury Market Regulation); Remarks of Board Governor Jerome Powell, Oct. 20, 2015 (The Evolving Structure of U.S. Treasury Markets); Remarks of Counselor to the Secretary of the Treasury Antonio Weiss, Oct. 20, 2015; Risk, Oct. 1, 2015 (use of high frequency trading in U.S. Treasury markets); Financial Times, July 29, 2015 (liquidity issues in Treasury market); Joint Staff Report: The U.S. Treasury Market on October 15, 2014 (Treasury/Board/FRBNY/SEC/CFTC, July 13, 2015) (analyzing significant volatility in U.S. Treasury market on that date); Automated Trading in Treasury Markets (TMPG, Apr. 9, 2015) (best practices to promote integrity of market); "Measuring Settlement Fails" Liberty Street Economics (FRBNY, Sept. 19, 2014); Report to the [FRB] by the Working Group on NewBank Implementation (Dec. 2005) (concept of dormant bank to be available to clear and settle U.S. government securities and facilitate tri-party repos); "Explaining Settlement Fails", FRBNY Current Issues in Economics and Finance (Sept. 2005); Policy Statement on Payments System Risk, 69 Fed. Reg. 22512 (Apr. 26, 2004); Report to the Board by the Working Group on Government Securities Clearance and Settlement (Dec. 2003) (steps to mitigate risks to the financial system from the interruption or termination of the services of a clearing bank); Interagency White Paper on Structural Change in the Settlement of Government Securities: Issues and Options, 67 Fed. Reg. 32043 (May 13, 2002).

The TMPG and SIFMA recommended charges for failed settlements in U.S. Treasuries in order to improve efficiency and reduce overall risk. See U.S. Treasury Securities Fails Charge Trading Practice (TMPG, updated July 13, 2016). The TMPG also recommended fails charge trading practices for the agency debt and MBS markets in order to reduce the incidence of delivery failures. See, e.g., Agency Debt and Agency MBS Fails Charge Trading Practice (TMPG, updated July 13, 2016); Agency Debt Securities Fails Charge Trading Practice Summary (TMPG, June 28, 2011); Agency [MBS] Fails Charge Trading Practice Summary (TMPG, June 28, 2011); [TMPG] Proposes Fails Charge Recommendations for Agency Debt and Agency MBS Markets and Seeks Public Comments (TMPG, Apr. 29, 2011); Understanding Settlement Fails in Agency [MBS] (TMPG, Apr. 29, 2011). See generally [FAQ]s: TMPG Fails Charges (TMPG, updated July 13, 2016).

See generally Part II.D.3.a.vii below.

f. In 2010, the FRBNY announced a program to expand its eligible counterparties for conducting reverse repos beyond its primary dealers, and simultaneously issued eligibility criteria for money market funds to participate in reverse repos with the FRBNY. See Statement Regarding Reverse Repurchase Transaction Counterparts (FRBNY, Mar. 9, 2015) (adding new eligible repo counterparties to FRBNY approved list); "Statement Regarding Reverse [Repos]", FRBNY Operating Policy (Feb. 28, 2012); "RRP Eligibility Criteria -- Banks and Savings Associations", FRBNY, July 28, 2011; "Statement Regarding Counterparties for Reverse [Repos]", FRBNY Operating Policy (Mar. 8, 2010).

g. In 2011, S&P downgraded the U.S. government's long-term sovereign credit rating from AAA to AA+ and has not changed that rating as of September 2016. The downgrade appears to have had minimal regulatory impact, whether in terms of the risk-weighting for capital purposes of U.S. government or agency securities or the ability of broker-dealers to use U.S. Treasury securities to meet net capital requirements. The impact of the downgrade on trading and banking markets led various SEC registrants to discuss the operating and business risks related to this downgrade as well as further downgrades in the future. See, e.g., SEC Filings Insight, Sept. 8, 2011.

h. In 2016, FINRA amended its margin requirements under FINRA Rule 4210 to establish margin requirements for covered agency transactions in the "to-be-announced" market. See FINRA Rule 4210; 81 Fed. Reg. 40364 (June 21, 2016).

3. Municipal Securities Markets

While much smaller than the Treasury market, the municipal securities market is substantial, with over $3.7 trillion in municipal securities and issuances in 2013. See, e.g., Municipal Bond Credit Report (SIFMA, 2Q 2016); Report on Secondary Market Trading in the Municipal Securities Market (Municipal Securities Rulemaking Board (the "MSRB"), July 2014); Municipal Securities: Overview of Market Structure, Pricing and Regulation (GAO, Jan. 2012); Reuters, Mar. 10, 2011; see also SIFMA Press Release, June 8, 2016 (launch of state-by-state capital markets database).

a. The MSRB is a self-regulatory organization of dealers of municipal securities and their municipal securities transactions. Dodd-Frank § 975 et seq. expand the MSRB's authority, extend the MSRB's jurisdiction to municipal advisers, and amend the MSRB's composition such that a majority of its members are investor, municipal entity and other public representatives rather than registered dealer representatives. See generally MSRB Press Release, Sept. 15, 2010. See also Comptroller's Handbook: [MSRB Rules].

b. While the Securities Acts have broad exemptions for municipal securities, regulation of the market has expanded significantly.

(i) 1934 Act Rule 15c2-12 sets out information and notice requirements respecting many municipal securities offerings. See, e.g., MSRB Letter to SEC, Jan. 20, 2015 (suggestions by MSRB as to possible changes to Rule

15c2-12); SEC Release No. 34-62184 (May 26, 2010); SEC Release No. 34-59062 (Dec. 5, 2008) (single centralized electronic repository for municipal securities information); SEC Release No. 34-34961 (Nov. 10, 1994); Rule 15c2-12 (avail. Mar. 15, 1996, June 23, 1995); Public Securities Association Rule 15c2-12 Model Language (June 1995); SEC Release No. 33-2049 (Mar. 9, 1994) (disclosure obligations).

(ii) MSRB Regulatory Notice 2013-18 (Aug. 12, 2013) provides guidance for continuing disclosures by issuers with respect to municipal securities under continuing disclosure agreements entered into pursuant to Rule 15c2-12. The guidance outlines the types of financial disclosures called for and the manner in which such disclosures should be provided.

In 2012, the SEC released a comprehensive report on the municipal securities market and made legislative and regulatory recommendations, including legislation authorizing the SEC to set disclosure standards and requiring audited financial statements. Report on the Municipal Securities Market (SEC, July 31, 2012). See also 2014 Annual Report (MSRB); 2014 Fact Book (MSRB); Final Report (State Budget Crisis Task Force, Jan. 2014); Municipal Securities: Options for Improving Continuing Disclosure (GAO, July 2012); Estimating Municipal Securities Continuing Disclosure Compliance (DPC Data, 2008); SEC White Paper: Disclosure and Accounting Practices in the Municipal Securities Market (July 2007).

(iii) On March 10, 2014, the SEC Enforcement Division announced a new cooperation initiative, and on July 31, 2014 modified the initiative, to encourage issuers and underwriters of municipal securities to self-report violations of the federal securities laws rather than wait for their violations to be detected. See SEC Press Release 2014-156 (July 31, 2014); SEC Press Release 2014-46 (Mar. 10, 2014). The "Municipalities Continuing Disclosure Cooperation Initiative"

("MCDC") is intended to address violations of the federal securities laws by municipal issuers and underwriters of municipal securities in connection with continuing disclosures in bond offering documents, and is designed to offer favorable or reduced settlements in connection with voluntary self-reporting. In the first enforcement action against underwriters under the MCDC, 36 municipal underwriting firms settled with the SEC in 2015 for a combined total of about $9 million, based on charges that municipal bond offering documents contained materially false statements or omissions about the issuers' compliance with continuing disclosure obligations, as well as failure by the underwriters to conduct due diligence. See SEC Press Release 2015-125 (June 18, 2015). See generally SEC Press Release 2016-166 (Aug. 24, 2016) (announcing enforcement actions against municipal issuers and other obligated persons); SEC Press Release 2016-18 (Feb. 2, 2016) (announcing enforcement actions against municipal underwriting firms); SEC Press Release 2015-220 (Sept. 30, 2015) (announcing enforcement action against municipal underwriting firms); Wall St. J., June 18, 2015. See also, e.g., BOKF, NA, SEC Admin. Proc. No. 3-17533 (Sept. 9, 2016) (enforcement action against indenture trustee and dissemination agent for failure to notify bondholders of issuer's failure to replenish reserves and to make issuer financial filings); Kings Canyon Joint Unified School District, SEC Release No. 33-9610 (July 8, 2014) (cease and desist order against California school district for false or misleading statements in municipal bond offering).

FINRA and MSRB have coordinated efforts in requiring additional disclosure of price information in retail customer confirmations for certain principal transactions. See FINRA Regulatory Notice 15-36 (Oct. 2015) (seeking comment on a proposed rule that would require member firms to disclose additional information in customer confirmations); MSRB Regulatory Notice No. 2015-16 (Sept. 24, 2015) (seeking comment on draft rule amendments to require disclosure of mark-ups on retail customer confirmations).

In the wake of the MCDC program, SIFMA has proposed to the SEC and the MSRB that, in competitive bids, the municipal adviser assisting the municipality on the offering documents should be responsible for disclosure, rather than the underwriters who are given little due diligence time. See Rule 15c2-12 Whitepaper (SIFMA, Apr. 2016); Securities Law Daily, Apr. 12, 2016.

(iv) MSRB Advisory on the Potential Applicability of MSRB Rules to Certain Bank Loans and Direct Purchases, Sept. 12, 2011 (the "MSRB 2011 Loan/Note Advisory"), alerted market participants as to the potential applicability of MSRB rules to certain municipal finance transactions that may entail securities transactions triggering regulatory requirements. The Advisory covers "bank loans" that could, depending on the nature of the transactions, be placements of municipal securities, as well as certain "direct purchases" by banks of issuers' securities that are subsequently restructured so significantly that they may constitute primary offerings of securities.

The MSRB is also working to improve public disclosure of bank loans received by state and local government entities that issue municipal securities. The existence of a new bank loan is not typically disclosed until the release of an issuer's financial statements. As a result, holders of an issuer's outstanding debt, potential investors and other market participants usually do not become aware, on a timely basis, of the loan's impact on the issuer's outstanding debt. To improve the timeliness of public disclosure, the MSRB released a notice to encourage government entities to post information about their bank loan financings to the Electronic Municipal Market Access ("EMMA") website. Notice Concerning Voluntary Disclosure of Bank Loans to EMMA (MSRB, Apr. 3, 2012). In 2013, the Bank Loan

Disclosure Task Force, made up of industry trade groups, prepared a report to assist issuers and their financial advisors and legal counsel in determining whether to disclose the incurrence of a loan and the extent of such disclosure. Considerations Regarding Voluntary Secondary Market Disclosure About Bank Loans (Bank Loan Disclosure Task Force, Mar. 6, 2013). See also Sec. Reg. & L. Rep., June 20, 2016 (SEC considering municipal bank loan disclosure requirements); The Bond Buyer, May 31, 2016; ABA Letter to MSRB, May 27, 2016 (re: MSRB Regulatory Notice 2016-11); Securities Law Daily, Apr. 12, 2016; MSRB Regulatory Notice 2016-12 (Apr. 4, 2016) (warning banks regarding due diligence, status of loan as a security, status of bank as broker-dealer or municipal advisor); FINRA Regulatory Notice 16-10 (Apr. 2016) (joint notice with MSRB); Banking Daily, Apr. 4, 2016; MSRB Regulatory Notice No. 2016-11 (Mar. 28, 2016) (seeking comment on proposal regarding bank loan disclosure); Securities Law Daily, Oct. 26, 2015 (indicating MSRB requests to SEC regarding whether certain bank loans are "securities"); MSRB Regulatory Notice 2015-03 (Jan. 29, 2015) (alerting municipal market participants of the importance of voluntary disclosure of bank loans). See also Part V.B below (analysis of securities status of loans and notes).

(v) The MSRB, the SEC and FINRA regulate sales activities with respect to "529 Plan" college savings vehicles which are classified in general as municipal securities because they are administered by state governments. 529 Plans typically invest primarily in registered mutual funds. See MSRB Regulatory Notice 2006-03 (Feb. 22, 2006) (joint MSRB-NASD statement regarding cooperation in harmonizing 529 Plan and mutual fund regulations). At year end 2015, more than $253 billion was invested in 529 Plans, and more than 12.5 million 529 Plan accounts were open nationally, according to the College Savings Plan Network website.

A) MSRB Rules G-21 and G-27, which were updated and harmonized with analogous SEC/FINRA rules by SEC Release No. 34-55830 (May 30, 2007), govern the basis and content of 529 Plan advertisements. See also MSRB Regulatory Notice 2006-23 (Aug. 7, 2006) (disclosure requirements for customers of out-of-state 529 Plans); MSRB Regulatory Notice 2006-13 (May 15, 2006) (advertisements); SEC Release No. 34-53715 (Apr. 25, 2006) (suitability analysis municipal securities dealers must conduct in selling out-of-state 529 Plans).

B) With respect to the characterization of 529 Plans for securities law purposes, see generally, e.g., Securities Law Daily, Apr. 1, 2016 (SEC advising MSRB that 529(A) ABLE Act accounts could be securities); Missouri Higher Education Savings Program (avail. Oct. 25, 1999); MSRB (avail. Feb. 26, 1999); NY State College Choice Tuition Savings Program (avail. Sept. 10, 1998); NH Higher Education Savings Plan Trust (avail. June 30, 1998); College Assurance Plan (avail. Sept. 8, 1989).

C) SEC and FINRA supervision of 529 Plan sales have resulted in enforcement actions concerning suitability policies. See, e.g., 1st Global Capital, SEC Admin. Proc. No. 3-12479 (Nov. 15, 2006); NASD News Release, Nov. 6, 2006 (Chase Investment Services and Metlife Securities).

D) In Missouri Bankers Assoc. (avail. Aug. 18, 2008), the SEC denied a no-action request regarding the offer and sale of bank deposit instruments under a 529 Plan, and concluded that Plan participants would not purchase interests issued by public instrumentalities of a state within the meaning of 1933 Act § 3(a)(2). In addition, no assurances were provided that the Plan was not a 1940 Act investment company, or that the administrator/trust under the Plan and participating banks would not be required to register as broker-dealers. See also Part IV.A.5 and Part IX.E below.

(vi) SEC Investor Alert on State of California IOUs (July 9, 2009) stated that California "registered warrants" (IOUs) likely qualify as "municipal securities" and that intermediaries which deal in such warrants likely must register with the MSRB as a municipal securities dealer. See also MSRB Regulatory Notice 2009-41 (July 10, 2009).

(vii) The SEC, FINRA, the MSRB and the CFTC have expressed concern as to the integrity of municipal securities markets and sought to limit so-called "pay-to-play" practices.

A) MSRB Rule G-37 prohibits municipal securities dealers and municipal advisors from doing business with issuers for two years if political contributions above a de minimis level are made to officials of such issuers, and imposes public disclosure requirements on contributions to bond ballot campaigns by dealers, certain of their professionals and related political action committees. See Summary of Ban on Business Provisions Under MSRB Rule G-37 (MSRB, Aug. 17, 2016); MSRB Regulatory Notice 2016-18 (Aug. 4, 2016) (clarification of look-back provisions related to application of rule to municipal advisors); SEC Release No. IA-4512 (Aug. 25, 2016) (SEC notice of intent to issue order to approve change to Rule G-37); MSRB Regulatory Notice 2016-06 (Feb. 17, 2016) (extending the application of Rule G-37 to municipal advisers); National Examination Risk Alert: Pay-to-play Prohibitions for Brokers, Dealers and Municipal Securities Dealers under MSRB Rules (OCIE, Aug. 31, 2012); MSRB Regulatory Notice 2011-04 (Jan. 14, 2011) (proposing conforming changes to Rule G-37 and restating Rule G-37 Interpretative Notice in light of proposed Rule G-42); MSRB Regulatory Notice 2010-45 (Oct. 21,

2010) (guidance on factors that may result in a political action committee formed by or maintaining a relationship with a dealer being viewed as controlled by the dealer); SEC Releases No. 34-61381 (Jan. 20, 2010) (amendments to Rule G-37), No. 34-53961, No. 34-53960 (June 8, 2006) (guidance relating to "solicitations" subject to Rule G-37); MSRB Regulatory Notice 2005-11 (June 8, 2005); MSRB Regulatory Notice 2004-8 (Feb. 25, 2004); MSRB Regulatory Notice 2003-41 (Oct. 30, 2003); SEC Release No. 34-47814 (May 8, 2003); MSRB Review of Rule G-37 (June 4, 2001); SEC Release No. 34-36857 (Feb. 16, 1996) (interpretation of Rule G-37); SEC Release No. 34-33868 (Apr. 7, 1994) (approval of Rule G-37).

See also MSRB Rule G-20 ("gifts and gratuities rule"); SEC Release No. 34-65234 (Aug. 31, 2011) (MSRB proposed rule to extend Rule G-20 to municipal advisers).

B) Rule G-37's prohibitions on municipal securities dealers' political contributions and solicitations include political parties and political action committees in areas where a municipal securities dealer engages in municipal securities business. SEC Release No. 34-52235 (Aug. 10, 2005). Rule G-38 prohibits payments to persons that are not "affiliated" with the dealer in connection with the solicitation of issuers' business. SEC Release No. 34-52278 (Aug. 17, 2005). See also, e.g., SIA Letter to MSRB, Apr. 5, 2005; Bond Market Association ("BMA") Letters to MSRB, Apr. 1, 2005, Dec. 15, 2004.

C) MSRB Rule G-37 was upheld against constitutional challenge. Blount v. SEC, 61 F.3d 938 (D.C. Cir. 1995), cert. denied, 517 U.S. 1119 (1996). Additionally, the Supreme Court's ruling in Citizens United v. Federal Election Commission, 558 U.S. 310 (2010), does not appear to have implications for Rule G-37. See Investment Dealers' Digest, Jan. 22, 2010. Several groups have threatened to challenge the constitutionality of Rule G-37's 2016 application to municipal advisers. See The Bond Buyer, Feb. 18, 2016.

D) The SEC has indicated that Rule G-37 applies to financial professionals of affiliate companies, not just employees of the dealer entity. See, e.g., SEC Releases No. 34-44291 (Mar. 18, 2010); No. 33-9078 (Nov. 4, 2009).

E) SEC Release No. IA-3043 (June 30, 2010) adopted rules to prohibit investment advisers from (i) providing advisory services for compensation for two years if political contributions are made to an elected official that can influence the selection of the adviser, (ii) soliciting and coordinating campaign contributions for such an elected official or soliciting payments to a political party in any jurisdiction where the adviser is seeking business, and (iii) paying a third party that is not a registered investment adviser to solicit a government client on behalf of the investment adviser. See also ICI (avail. Sept. 14, 2011); MSRB Regulatory Notice 2011-04 (Jan. 14, 2011).

F) CFTC Rule 23.451 prohibits a swap dealer from offering or entering into a swap or a trading strategy involving a swap with a governmental entity for two years following the swap dealer (or one of its covered associates) contributing to an official of that governmental entity.

G) In December 2015, FINRA proposed FINRA Rules 2030 and 4580 to establish "pay-to-play" rules and regulate the activities of member firms that engage in distribution or solicitation activities for compensation with government entities on behalf of investment advisers. See SEC Release No. IA-4511

(Aug. 25, 2016) (notice of intent to issue order to approve change to FINRA Rule 2030 and noting FINRA's change to FINRA Rule 4580); 81 Fed. Reg. 19260 (Apr. 4, 2016) (SEC order instituting proceedings to determine whether to approve proposal); SEC Release No. 34-76767 (Dec. 24, 2015) (FINRA proposal).

H) "Pay-to-play" allegations and proceedings have arisen with respect to numerous banking organizations and municipal securities underwritings. See, e.g., State Street Bank and Trust Company, SEC Releases No. 34-76905 (Jan. 14, 2016) (cease and desist order); 34-76904 (Jan. 14, 2016) (cease and desist order against SVP of State Street Bank); SEC v. Robert Crowe, No. 16-cv-00036 (S.D. Ohio Jan. 14, 2016) (complaint against State Street Bank lobbyist); Recent SEC Order Finds Employee's Use of Company Resources Violates Pay-to-play Rules (Cleary Gottlieb, Oct. 10, 2012); Goldman Sachs, SEC Admin. Proc. Nos. 3-15048, 3-15049 (Sept. 27, 2012); Fifth Third Securities, SEC Release No. 34-46087 (June 18, 2002); SEC Releases No. 34-40376 (Aug. 27, 1998) (undisclosed lobbyist "contingency fee" in municipal bond underwriting); No. 34-36694 (Jan. 9, 1996) (payments to secure municipal business).

(viii) The SEC, Treasury, the DOJ and FINRA have focused on "yield burning", in which a securities dealer inflates the price it charges a municipality for Treasury securities in a bond refinancing. See, e.g., SEC Press Release 2000-45 (Apr. 6, 2000).

A number of securities firms settled charges alleging a failure to obtain a fair price for customers selling municipal bonds and agreed to pay fines and restitution to customers. NASD Press Release, June 29, 2004.

(ix) In the wake of severe illiquidity in the market for "auction rate securities" ("ARS") -- municipal bonds and other securities which bear interest at a rate reset periodically in a Dutch auction -- securities firms have come under scrutiny for their marketing and sales practices.

A) Dealers must submit to the MSRB for public dissemination information on auction procedures, interest rate setting mechanisms for ARS and liquidity facilities for variable rate demand obligations. MSRB Regulatory Notices 2010-31 (Aug. 26, 2010), 2010-06 (Mar. 10, 2010).

B) SEC Admin. Proc. No. 3-12310 (May 31, 2006) reports fines and a Consent Order affecting 15 commercial/investment bank-affiliated broker-dealers with respect to manipulative practices, including (i) allowing customers to place open or market orders in auctions; (ii) intervening in auctions by bidding for a firm's proprietary account or asking customers to make or change orders in order to prevent failed auctions, to set a "market" rate, or to prevent all-hold auctions; (iii) submitting or changing orders, or allowing customers to submit or change orders, after auction deadlines; (iv) not requiring certain customers to purchase partially-filled orders even though the orders were supposed to be irrevocable; (v) providing certain customers with higher returns than the auction clearing rate; and (vi) providing certain customers with information that gave them a bidding advantage. See also First Southwest Co., SEC Admin. Proc. No. 3-13046 (May 27, 2008).

C) The SEC, FINRA, state securities regulators and private litigants have brought actions (not all successful), or reached settlements, with respect to allegations that financial institutions engaged in bid-rigging, securities registration violations and deceptive marketing and sales practices with respect to ARS. See, e.g., DOJ Press Release, Feb. 10, 2014 (guilty plea of former Bank of America managing director); In re: Municipal Derivatives Antitrust Litigation, MDL No. 1950, Master Docket No. 08-02516 (Dec. 4, 2013) (Bank of America Corp. agreed to pay $20 million to settle part of a multidistrict litigation accusing it and other financial institutions of bid-rigging in the municipal bond derivatives market); Anschutz Corp. v. Merrill Lynch, 2012 WL 3289832 (2d Cir. 2012) (affirming dismissal of plaintiff's market manipulation claims); Wilson v. Merrill Lynch, 671 F.3d 120 (2d Cir. 2011) (dismissal of In re Merrill Lynch [ARS] Litigation, 2010 U.S. Dist. LEXIS 33532 (SDNY Mar. 31, 2010)); E*TRADE Securities, NASAA Press Release (Oct. 19, 2011) (settlement); Wachovia and Raymond James, NJ Division of Consumer Affairs Press Release, Oct. 4, 2011 (settlement); SunTrust/Robinson Humphrey, FINRA Letter of Acceptance, Waiver and Consent Nos. 2008-01-3864101, 2008-01-6036101 (June 29, 2011); Raymond James, SEC Admin. Proc. No. 3-14445 (June 29, 2011); Nuveen Investments, FINRA Letter of Acceptance, Waiver and Consent No. 2008-01-3056701 (May 20, 2011); Wells Fargo Investments, CRD # 10582 (NJ Consent Order, May 6, 2011); Morgan Stanley, CRD # 8209 (NJ Consent Order, May 4, 2011); TD Ameritrade, CRD # 7870 (NJ Consent Order, Apr. 20, 2011); UBS, SEC Litigation Release No. 21658 (Sept. 21, 2010) (Review of Performance under ARS Settlement); SEC Litigation Release No. 21585 (June 30, 2010) (Citigroup, RBC, Wachovia); W. Va. Attorney General, June 22, 2010 (24 banks and insurance companies); Mich. Office of Financial and Ins. Reg. Settlements, May 26, 2010 (UBS), Jan. 26, 2010 (Deutsche Bank, Morgan Stanley, RBC), Oct. 8, 2009 (JPMorgan Chase); FINRA News Release, Apr. 22, 2010 (HSBC, US Bancorp); Merrill Lynch, Mass. Securities Division (Apr. 7, 2010); Tex. State Securities Bd. Order No. IC10-CDO-07 (Mar. 4, 2010) (UBS); Oppenheimer & Co., NY Assurance of Discontinuance (Feb. 24, 2010); California v.

Wells Fargo, CGC-09-487641 (Jan. 4, 2010) (settlement); NASAA Releases, Dec. 29, 2009 (Stifel, Nicolaus), Nov. 18, 2009 (Wells Fargo), July 20, 2009 (TD Ameritrade), Aug. 21, 2008 (Deutsche Bank, Goldman Sachs, Merrill Lynch), Aug. 15, 2008 (Wachovia), Aug. 14, 2008 (JPMorgan Chase and Morgan Stanley), Aug. 11, 2008 (UBS), Aug. 7, 2008 (Citigroup); Col. ARS Settlements, Nov. 24, 2009 (Credit Suisse), Nov. 19, 2009 (JPMorgan Chase); Morgan Keegan, SEC Litigation Release No. 21143 (July 21, 2009) (complaint, Civ. Action. No. 1: 09-cv-1965-WSD dismissed (N.D. Ga., Aug. 5, 2011), dismissal vacated and remanded (11th Cir., May 2, 2012)); TD Ameritrade, SEC Admin. Proc. No. 3-13557 (July 20, 2009) (settlement); NY Attorney General Assurances of Discontinuance, July 7, 2009 (Credit Suisse, Merrill Lynch), June 3, 2009 (Bank of America, Deutsche Bank, Goldman Sachs, JP Morgan Chase, Morgan Stanley, RBC), Feb. 5, 2009 (Wachovia), Dec. 11, 2008 (Citigroup, UBS); Western Digital Corp. v. Lehman Brothers, Case No. 08-013555 (JMP) (SDNY June 9, 2009) (complaint); Bank of America, RBC, Deutsche Bank, SEC Release No. 2009-127 (June 3, 2009) (settlement); FINRA News Releases, May 7, 2009 (Janney Montgomery Scott, M&I Financial Advisors, M&T Securities, NatCity Investments), Oct. 23, 2008 (BNY Mellon Capital Markets, City National Securities, Harris Investor Services), Sept. 18, 2008 (Comerica Securities, First Southwest, SunTrust, WaMu Investments); Citigroup, SEC Litigation Release No. 20824 (Dec. 11, 2008); Merrill Lynch, SEC Release No. 2008-181 (Aug. 22, 2008) (settlement); Wall St. J., July 17, 2008 (10 state investigations concerning Wachovia sales and marketing practices). See also Dealer Practice and Procedure Guidelines Regarding Disclosures Suitability and Pricing of Municipal Securities Transactions on the Secondary Market (Bond Dealers of America, June 6, 2011).

(x) The DOJ has investigated alleged "bid-rigging" in the market for management of municipal security proceeds between the issuance of the securities and the use of funds on municipal projects. An industry-wide investigation focused on whether financial institutions have acted improperly in providing high-fee contracts to municipalities. See, e.g., NY Times, July 23, 2013 (three former UBS bankers receive prison sentences and fines for bid-rigging); JPMorgan Chase SEC Form 10-Q Quarterly Report (Mar. 2010).

(xi) The SEC and IRS have formed a joint committee to share information and identify issues relating to tax-exempt bonds in the municipal securities industry and to develop strategies to enhance performance of their respective regulatory responsibilities. SEC Release 2010-30 (Mar. 2, 2010).

(xii) Other enforcement actions in the municipal securities context include:

A) The SEC, in its first action under the rule, censured and fined 13 firms for violating MSRB Rule G-15 requiring minimum denominations in municipal bond offerings, primarily in relation to the offer of Puerto Rico bonds. See Charles Schwab & Co., SEC Admin. Proc. No. 3-16232 (Nov. 3, 2014); Hapoalim Securities, SEC Admin. Proc. No. 3-16233 (Nov. 3, 2014); Interactive Brokers, SEC Admin. Proc. No. 3-16234 (Nov. 3, 2014); Investment Professionals, SEC Admin. Proc. No. 3-16235 (Nov. 3, 2014); J.P. Morgan Securities ("JPMS"), SEC Admin. Proc. No. 3-16236 (Nov. 3, 2014); Lebenthal & Co., SEC Admin. Proc. No. 3-16241 (Nov. 3, 2014); National Securities Corp., SEC Admin. Proc. No. 3-16242 (Nov. 3, 2014); Oppenheimer & Co., SEC Admin. Proc. No. 3-16243 (Nov. 3, 2014); Riedl First Securities Co. of Kansas, SEC Admin. Proc. No. 3-16244 (Nov. 3, 2014); Stifel Nicolaus & Co., SEC Admin. Proc. No. 3-16237 (Nov. 3, 2014); TD Ameritrade, SEC

Admin. Proc. No. 3-16238 (Nov. 3, 2014); UBS Financial Services, SEC Admin. Proc. No. 3-16239 (Nov. 3, 2014); Wedbush Securities, SEC Admin. Proc. No. 3-16240 (Nov. 3, 2014).

B) First Southwest Company, SEC Release No. 34-77300 (Mar. 7, 2016) (cease and desist order charging municipal advisor for rendering services without a written financial advisory agreement); SEC v. Rhode Island Commerce Corp., 16-cv-00107 (D.R.I. Mar. 7, 2016) (charging fraud in offering municipal securities); Santander Securities LLC, FINRA Letter of Acceptance, Waiver and Consent No. 2014041355501 (Oct. 13, 2015) (ordering Santander Securities to pay restitution to customers who were solicited to purchase Puerto Rican Municipal Bonds); West Clark Community Schools, SEC Press Release 2013-136 (July 29, 2013) (settlement regarding fraudulent practices and misrepresentations in bond offerings); GE Funding Capital Market Services, SEC Press Release 2011-276 (Dec. 23, 2011) (settlement regarding fraudulent practices and misrepresentations in municipal bond reinvestment transactions); Wachovia Bank, DOJ Press Release, Dec. 8, 2011 (settlement with the DOJ, SEC, IRS, OCC, and 26 state attorneys general regarding bids on municipal investments); Wells Fargo Bank (OCC, Dec. 6, 2011); JPMS, SEC Press Release 2011-143 (July 7, 2011) (settlement regarding rigging municipal bond reinvestment transactions in 31 states); UBS Financial Services, SEC Litigation Release No. 21956 (May 4, 2011) (settlement regarding fraudulent misrepresentations affecting prices paid by municipalities for investment of proceeds of municipal securities sale); NY Attorney General News Release, May 4, 2011 (settlement with UBS for fraudulent and anticompetitive conduct in municipal bond derivative transactions with governments and non-profits); Banc of America Securities, SEC Press Release 2010-239 (Dec. 7, 2010) (settlement regarding bid rigging in connection with the investment of municipal security proceeds).

C) UBS Financial Services, FINRA Report (Nov. 2011) (failure to supervise the cross-trading of municipal bonds); BNY Mellon ("BNYM") Capital Markets, FINRA Report (Mar. 2011) (failure to report information properly to real time reporting system); Merrill Lynch, FINRA Report (Mar. 2011) (firm purchase and sale of municipal securities at prices that were not fair and reasonable); JPMS, FINRA Release (Dec. 13, 2007) (failure to disclose payments to consultants to obtain 70 municipal securities offerings); State Street Global Markets, NASD Press Release, Nov. 22, 2005 (municipal bond trade reporting violations); Edward D. Jones & Co., NASD Press Release, Sept. 29, 2005 and Morgan Stanley, NASD Press Release, Dec. 6, 2004 (deficiencies in municipal securities disclosure); Oppenheimer & Co. and 20 other brokerage firms, NASD Press Releases, (June 29, May 5, 2005) (inaccurate or late reporting or violation of document retention rule).

See also Part IX.E below.

c. An entity that underwrites and deals in municipal securities (but is not registered with the SEC as a broker-dealer) is subject to registration with the SEC or the appropriate federal banking regulator as a "municipal securities dealer" under 1934 Act § 15B.

(i) The MSRB is empowered to adopt rules regarding municipal securities dealers and transactions, and federal bank regulators generally defer to MSRB requirements. See generally, e.g., 2016 Compliance Advisory for Brokers, Dealers and Municipal Securities Dealers (MSRB, 2016); Implementation Guidance on MSRB Rule G-18, on Best Execution (MSRB, Nov. 20, 2015); MSRB Regulatory Notice 2014-22 (Dec. 8, 2014) (MSRB Rule G-18 establishes best execution obligations for transactions in municipal securities); MSRB Regulatory Notice 2011-62 (Nov. 7, 2011) (MSRB Rule G-3 requires non-ministerial associated persons of brokers, dealers and municipal securities dealers to register with the MSRB and take a qualification exam); MSRB Regulatory Notice 2010-37 (Sept. 20, 2010) (reminding dealers of MSRB requirements arising out of dealers' disclosure, suitability and pricing obligations); SEC Release No. 34-55792 (May 22, 2007) (MSRB rules governing the supervision by municipal securities dealers of their employees).

The MSRB has also amended, consolidated, and streamlined its registration rules and process for brokers, dealers, municipal securities dealers and municipal advisers. The MSRB established a single MSRB registration rule, Rule A-12, and Form A-12, updating certain key information pertaining to categories of registration, types of business and contact personnel. The changes require all MSRB regulated entities to verify and augment their existing registration information with the MSRB. See MSRB Regulatory Notice 2014-05 (Feb. 27, 2014). See also MSRB Regulatory Notice 2014-11 (May 12, 2014) (consolidating various rules and interpretive guidance on fair-pricing obligations into MSRB Rule G-30); SEC Release No. 34-71616 (Feb. 26, 2014).

(ii) The MSRB made a "ground-breaking" request to the SEC to approve detailed guidance regarding the treatment of issuer clients by underwriters. The approved guidance relates to representations made to issuers, required disclosures, new issue pricing and compensation, conflicts of interest, retail order periods, and dealer payments to issuers. See Guidance on Implementation of Interpretive Notice Concerning the Application of MSRB Rule G-17 to Underwriters of Municipal Securities (MSRB, Aug. 2, 2012); MSRB Regulatory Notice 2012-38 (July 18, 2012) (guidance to underwriters of municipal securities applicable primarily to negotiated offerings about the fair practice duties owed to state and local governments under MSRB Rule G-17, including the disclosure of potential conflicts of interest); SEC Release No. 34-66927 (May 10, 2012); MSRB Regulatory Notice 2011-36 (Aug. 2, 2011).

(iii) Conflict of interest concerns have been raised respecting participation in municipal markets. See, e.g., SEC Release No. 34-67238 (June 22, 2012), 77 Fed. Reg. 386 84 (June 28, 2012) (approval of an MSRB rule change governing the conduct of broker's brokers, who act as intermediaries between municipal securities dealers); MSRB Regulatory Notice 2011-29 (May 31, 2011) (dealer that serves as financial adviser to an issuer prohibited from switching roles and underwriting the same issue); MSRB Regulatory Notice 2008-34 (Aug. 14, 2008) (tying concerns; see also Part I.A.4 above and Part III.A.4 below); California v. Bank of America, Case No. 968484 (Cal. Super. Ct., May 14, 1999) (settlement) (alleged misperformance of municipal securities and trust services, including by improperly retaining unclaimed bond proceeds). See generally The Bond Buyer, Aug. 27, 1997 (report as to 1983-1997 OCC enforcement actions related to national bank municipal securities activities). See also Part II.B.3.c.ii above and Part III.B.5 below.

(iv) The SEC has not required 1934 Act § 15B registration where a bank maintains both an investment and a trading account and uses its trading account to buy and sell as principal (consistent with its investment, liquidity and financial objectives), under circumstances where the transactions are conducted solely with registered broker-dealers or municipal securities dealers. See, e.g., SEC Release No. 34-11742 (Oct. 15, 1975) (defining "municipal securities dealer"); United Mercantile Bank (avail. Dec. 4, 1986).

(v) The MSRB amended Rules G-12 and G-15 to shorten the settlement cycle for municipal securities transactions to two days, and the SEC has approved the changes. SEC Release No. 34-77744 (Apr. 29, 2016) (SEC approval of

MSRB rule shortening settlement cycle); SIFMA Letter to SEC, Apr. 8, 2016 (commenting on MSRB proposal to shorten settlement cycle); 81 Fed. Reg. 14906 (Mar. 18, 2016) (notice of MSRB proposal to shorten settlement cycle).

See also Part II.D and Part IX.B below.

d. The Dodd-Frank Act adopts 1934 Act § 15B(a)-(c) to require entities that solicit or provide advice to municipal entities with respect to municipal financial products (including municipal derivatives, guaranteed investment contracts and investment strategies) or the issuance of municipal securities to register under the 1934 Act as "municipal advisers". Municipal advisers are subject to antifraud provisions and owe their clients a fiduciary duty.

The SEC has since adopted rules with respect to municipal adviser registration. See 78 Fed. Reg. 67468 (Nov. 12, 2013). See also SEC Office of Municipal Securities, Registration of Municipal Advisors FAQs (May 19, 2014); Letter to Senior Executive or Principal of a Newly Registered Municipal Advisor (SEC, Aug. 19, 2014).

(i) The MSRB recently updated its rules to impose additional requirements and provide for enhanced supervision of municipal advisors. MSRB Rule G-44 requires municipal advisors to establish, implement and maintain a supervisory system and written compliance policies and procedures, and to designate a chief compliance officer. See MSRB Regulatory Notice 2014-19 (Oct. 24, 2014). The MSRB also amended its professional qualification and examination rules to cover municipal advisor representatives and municipal advisor principals as separate registration categories. See MSRB Regulatory Notice 2015-04 (Mar. 2, 2015) (amendments to MSRB Rule G-3).

(ii) The SEC approved new MSRB Rule G-42, which establishes fiduciary duties, standards of conduct and other duties of non-solicitor municipal advisors, including conflicts disclosures, documentation requirements, suitability obligations and compensation requirements. See Municipal Advisors: Understanding Standards of Conduct (MSRB, Apr. 2016); Underwriters: Understanding Duties of Municipal Advisors (MSRB, Apr. 2016); MSRB Regulatory Notice No. 2016-03 (Jan. 13, 2016); SEC Release No. 34-76753 (Dec. 23, 2015) (order granting approval to proposed rule G-42);); SEC Release No. 34-75628 (Aug. 6, 2015) (SEC solicitation of further comments); MSRB Form 19b-4 (Apr. 24, 2015); 80 Fed. Reg. 26752 (May 8, 2015) (original SEC solicitation of comments). See also SIFMA Press Release, May 21, 2016 (announcing SIFMA model compliance documents for G-42).

(iii) The MSRB amended Rule G-17 in 2010 by applying its restrictions to municipal advisers. See MSRB Regulatory Notice 2010-59 (Dec. 23, 2010) (change approved by SEC); MSRB Regulatory Notice 2010-47 (Nov. 1, 2010) (proposed rule change). After the amendment, the MSRB issued interpretive guidance regarding the duty of a municipal adviser to deal fairly with all persons. See MSRB Regulatory Notice 2012-38 (July 18, 2012) (notice as adopted); MSRB Regulatory Notice 2011-61 (Nov. 3, 2011) (amended proposal); MSRB Regulatory Notice 2011-36 (Aug. 2, 2011) (proposed interpretive notice); MSRB Regulatory Notice 2011-13 (Feb. 14, 2011) (draft interpretive notice). The MSRB also issued a draft interpretive notice in 2011 regarding advertising and marketing communications. See MSRB Regulatory Notice 2011-12 (Feb. 17, 2011) (draft notice concerning advertising and fair dealing in communications). Additionally, the MSRB answered FAQs regarding the obligations of municipal securities dealers to customers under Rule G-17. See MSRB Regulatory Notice 2011-67 (Nov. 30, 2011). See also MSRB Requests Comment on Municipal Adviser Rules on Written Communications and Disclosures (MSRB, Aug. 10, 2011).

The SEC has brought enforcement proceedings charging violations of MSRB Rule G-17. See School Business Consulting, Inc. and Terrance Bradley, SEC Release No. 34-78054 (June 13, 2016) (breach of fiduciary duty by sharing confidential client information); Central States Capital Markets, SEC Release No. 34-77369 (Mar. 15, 2016) (breach of fiduciary duty by acting as both municipal adviser and underwriter). See also SEC Press Release 2016-54 (Mar. 15, 2016); Reuters, Mar. 15, 2016.

See also Part II.B.3.b. above.

e. The OCC 2001 Part 1 Revisions incorporate the authority (provided by GLB Act § 151) of well-capitalized national banks to underwrite, deal in and purchase certain municipal revenue bonds. See also Statement Regarding Bank Investment in the Municipal Securities Market, OCC News Release No. 2015-37, Mar. 18, 2015; Board SR Letter 01-13 (SUP) (May 14, 2001), CCH Fed. Banking L. Rep. ¶ 69-592 (state member bank underwriting, dealing and investing in municipal revenue bonds).

f. In the context of a final rule on the LCR (see Part II.A.4 above), the bank regulatory agencies had excluded municipal securities from use as "high quality liquid assets" that could be a permissible store of liquidity, citing potential inability to quickly monetize municipal securities during a period of stress. See 79 Fed. Reg. 61440, 61462-4 (Oct. 10, 2014) ("the liquidity characteristics of municipal securities range significantly and many of these assets do not exhibit the characteristics for inclusion as" high quality liquid assets). However, the Board issued an amendment to the LCR that included, in limited amounts and as level 2B liquid assets, municipal securities that are (i) general obligations of the issuing entity, not revenue obligations, (ii) investment grade, (iii) demonstrated to "have a proven record as a reliable source of liquidity … during a period of significant stress", and (iv) not issued by a financial sector entity or guaranteed by a financial sector entity unless they would meet the other three criteria without such a guarantee. 81 Fed. Reg. 21223 (Apr. 11, 2016) (final rule); 80 Fed. Reg. 30383 (May 28, 2015) (proposed rule).

C. OTHER IDENTIFIED BANKING PRODUCTS AND HYBRID PRODUCTS

1. Identified Banking Products

Notwithstanding the GLB Act Push-out Provisions discussed in Part I.C.2 above and Part II.D and Part IX.B below, pursuant to amendments to the 1934 Act made by GLB Act §§ 201 and 202, banks may engage in securities activities to the extent otherwise permissible under applicable banking laws with respect to Identified Banking Products without becoming a "broker" or a "dealer" under the 1934 Act.

a. As defined in GLB Act § 206, "Identified Banking Products" are:

(i) Deposit accounts, savings accounts, CDs and other bank deposit instruments. (See Part IV below.)

(ii) BAs. (See Part IV below.)

(iii) Bank letters of credit and loans. (See Part V below.)

(iv) Bank credit card and debit accounts. (See Part V and Part X below.)

(v) Loan participations which the bank or an affiliate (other than a broker-dealer) funds, participates in, or owns and sells to Qualified Investors (as defined in Part II.C.1.d below) or other sophisticated investors. (See Part V below.)

(vi) Any "swap agreement", including credit and equity swaps (but only if equity swaps are not directly sold by the bank to any person other than a Qualified Investor). For this purpose, "swap agreements" include any individually negotiated contract, agreement, warrant, note or option based in whole or in part on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodities, securities, currencies, rates, indices or other assets. (See Part II.E below.) This definition differs in scope from the "swap" and "security-based swap" definitions applicable under Title VII of Dodd-Frank.

b. Under the GLB Act, the classification of a particular product as an Identified Banking Product may not be construed as a finding that such product is or is not a "security" for purposes of the securities laws, or is or is not a transaction subject to the CEA. (But see Part II.E and Part IV.C.6 below.) The GLB Act did not amend the CEA, and Gramm-Leach did not exempt from CFTC requirements any transaction or person otherwise subject to CFTC jurisdiction. However, under the Legal Certainty for Bank Products Act of 2000, as amended by Title VII of Dodd-Frank, identified banking products other than swap agreements are excluded from regulation by the CFTC, subject to certain anti-evasion exceptions.

c. Although the definition of Identified Banking Products does not include equity swaps that are sold directly by a bank to a person other than a Qualified Investor, subject to Dodd-Frank provisions discussed in Part II.E below, banks should still be able to act as counterparty on such swaps. If such swaps are "securities", however, a broker-dealer would be required to act as intermediary in such swap transactions.

d. "Qualified Investors" are:

(i) Any 1940 Act-registered investment company.

(ii) Any entity exempt from the 1940 Act under § 3(c)(7) (investment company owned exclusively by "qualified purchasers").

(iii) Any bank (including, generally, any U.S. branch of a foreign bank), savings association, broker, dealer, insurance company or business development company.

(iv) Any SBIC.

(v) Any Employee Retirement Income Security Act of 1974 ("ERISA") employee benefit plan (other than an individual retirement account ("IRA")) if investment decisions are made by a plan fiduciary that is a bank, savings association, insurance company or investment adviser.

(vi) Any trust whose purchases are directed by one of the above.

(vii) Any market intermediary in financial contracts.

(viii) Any associated person of a broker-dealer (other than a natural person).

(ix) Any foreign bank.

(x) Any foreign government.

(xi) Any natural person, company, partnership or corporation that owns and invests with discretion at least $25 million (or, in certain cases, $10 million).

(xii) Any governmental entity that owns and invests with discretion at least $50 million.

(xiii) Any multinational or supranational entity.

The SEC may by rule expand the definition to include other persons. See also SEC Dealer Release (interpreting "Qualified Investor" definition and stating that the SEC would consider adopting a "reasonable belief" standard for determining whether a counterparty is a Qualified Investor).

See Part II.D, Part II.E, Part IV, Part V and Part X below.

2. Hybrid Products

Under Gramm-Leach § 205, the SEC may determine that "new hybrid products" are "securities" (and, accordingly, that a bank may not engage in any transactions in, or buy or sell, a new hybrid product without registering as a broker-dealer or without an exemption from registration). However:

a. Under Gramm-Leach § 205, the SEC must consult with the Board before seeking to regulate bank transactions in new hybrid products.

b. The Board or any "aggrieved party" may seek judicial review of any such determination, without judicial deference to the SEC or the Board.

c. "New hybrid product" excludes (i) any product regulated by the SEC as a "security" prior to enactment of the GLB Act, (ii) any Identified Banking Product, and (iii) any equity swap.

D. OTHER SECURITIES

1. Financial Holding Company and Financial Subsidiary Empowerments

a. Full-scope securities underwriting, dealing and market-making activities are permitted to non-bank subsidiaries of an FHC, and to financial subsidiaries. See Part III below.

b. An FHC may invest as principal in stock, assets or ownership interests (including debt and equity securities) -- whether or not controlling -- in any type of company, subject (in the case of investments in non-financial companies) to the GLB Act's merchant banking requirements set out in Part VII.A below.

c. The GLB Act's merchant banking empowerment is in addition to those set out in BHCA §§ 4(c)(6), 4(c)(7), 4(c)(9) and 4(c)(13) and applicable to BHCs as discussed in Part I.A above and Part II.D.2, Part VII.A and Part XI below.

d. Dodd-Frank and the Volcker Rule affect some empowerments. See Part I.B and Part II.A.7 above.

2. Bank Holding Company Empowerments

a. A BHC may invest in (i) debt and equity securities under BHCA §§ 4(c)(6) and 4(c)(7); and (ii) debt and equity securities of non-U.S. issuers subject to the requirements of BHCA § 4(c)(13) -- or, in the case of a foreign bank, BHCA

§§ 2(h)(2)/4(c)(9) -- and Regulation K. In general, the scope of BHC empowerment to invest in debt securities tracks that of FHCs. See Part VII below.

b. BHC subsidiaries may engage in activities under BHCA § 4(c)(8) that involve derivative transactions (see Part II.E below). The Regulation Y 1997 Revisions (12 C.F.R. § 225.28(b)(2)(vii)) also permit a BHC to acquire debt in default subject to various conditions (see Part V below).

c. Dodd-Frank and the Volcker Rule affect certain empowerments. See Part I.B and Part II.A.7 above.

d. Board Orders under BHCA § 4(c)(8) clarified BHC investment authority in various contexts:

(i) Meridian, 80 Fed. Res. Bull. 736 (1994) (the "Meridian Order"), permitted a BHC to sponsor, organize and manage, and privately place interests in, closed-end investment companies and unregistered limited partnerships that invest in securities. See Meridian Lists of Commitments, June 23, 21, 1994. See also 12 C.F.R. §§ 228.28(b)(6), 225.125.

(ii) Norwest, 81 Fed. Res. Bull. 1128 (1995) (the "Norwest 1995 Order"), permitted a BHC to engage in lending and asset management as the general partner in partnerships that make, service and invest in bank loans and other debt securities where the partnerships would restructure the debt acquired. Since some of the acquired debt may be in default at the time of acquisition and may be secured by shares or other assets, and since the partnership would have the right in some cases to take title immediately to shares or assets securing defaulted debt, the partnerships must treat this collateral, and any other assets acquired in renegotiating debt, as assets acquired in satisfaction of a DPC. See also Board Letters, July 22, 1998 (the "Norwest Modification Letter"), Apr. 28, 1998, Dec. 18, 1995; BNCCORP, 82 Fed. Res. Bull. 673 (1996).

(iii) Bessemer Group ["Bessemer"], 82 Fed. Res. Bull. 569 (1996) (the "Bessemer Order"), permitted a BHC subsidiary to act as the general partner of commodity pools holding distressed debt, loan participations, FX, money market instruments, and palladium, platinum, gold and silver coin and bullion. Bessemer would also provide administrative services, and would privately place partnership interests. Because the BHC subsidiary would be the general partner of the partnerships and because the partnerships would be leveraged, the Board required Bessemer to consolidate the partnerships' assets and liabilities with its own for capital purposes, rejecting Bessemer's proposal that it deduct its investment in the general partner in calculating capital ratios. See also Board Letter, July 22, 1998 (the "Bessemer Modification Letter").

(iv) Crédit Agricole, 61 Fed. Reg. 47128 (Sept. 6, 1996) (solicitation of public comments) (approved Sept. 26, 1996) (the "Crédit Agricole-Breen Approval"), approved Crédit Agricole's retention of Daniel Breen & Co. and indicated that all funds controlled by Breen must be invested in securities eligible for investment by Crédit Agricole under BHCA § 4(c)(6) (taking into account securities held by Crédit Agricole and its other subsidiaries) except (A) as permitted by Regulation K, and (B) for securities held in a fiduciary capacity. In calculating the percentage of voting shares and equity held by such funds (A) convertible securities or other rights to acquire equity held by such funds are treated as if converted or exercised, (B) convertible securities or other rights held by all other persons are treated as if none have been converted or exercised, and (C) subordinated debt is treated as part of total equity.

(v) Dresdner Bank, 84 Fed. Res. Bull. 361 (1998) (the "Dresdner CPO Order"), stated that (A) if a BHC reports its investment in a partnership on other than a consolidated basis, when calculating its consolidated capital ratios the BHC must include an amount of assets in the denominator equal to all liabilities reported by the partnership; (B) a BHC may not guarantee the obligations of a subsidiary which acts as general partner to the partnership, or enter into any guarantee, indemnity, loss-sharing or similar arrangement to protect an investor; and (C) partnerships controlled by BHCs should not offer interests more than 4 times a year. See also Part VIII.C below. The Board has informally indicated that a private investment fund for which an FHC acts as CPO, general partner or managing member and holds its interest in such fund pursuant to its merchant banking authority (see Part VII.A below) may offer interests more than 4 times per year, an expansion of the relief granted for BHCs as described in the Dresdner CPO Order.

(vi) In HSH Nordbank/WestLB (approved May 5, 2005) (the "HSH Nordbank Approval"), the Board permitted a joint venture to originate, hold and sell junior and senior debt and serve as investment adviser with respect to assets other than securities.

(vii) The Board noted that a number of past BHC commitments are addressed by applicable statutes and regulations, such as Sections 23A/23B and Regulation Y. See also, e.g., Fleet (approved Aug. 31, 1998) (the "Fleet-Oeschle Approval"), FRBNY Letter re Morgan, July 24, 1998 (the "Morgan CPO Approval"), Board Letter re PNC, July 22, 1998 (the "PNC Modification Letter"), and Bessemer and Norwest Modification Letters (collectively, the "Private Fund Modification Letters"). See generally Part IX.B below.

(viii) For other Board approvals in this area, see, e.g., Westpac Banking Corp., 76 Fed. Reg. 46808 (Aug. 3, 2011) (solicitation of public comments) (approved Oct. 24, 2011); Banco Bilbao Vizcaya Argentaria, 73 Fed. Reg. 16859 (Mar. 31, 2008) (solicitation of public comments) (approved June 18, 2008 (including modification of certain commitments)); Boston Private Financial Holdings (approved July 2, 2012) (acquisition of an additional interest in Anchor Capital Advisors LLC to engage in advisory activities); 68 Fed. Reg. 65071 (Nov. 18, 2003) (solicitation of public comments) (approved Feb. 2, 2004) (acquisition of an interest in Bingham, Osborn & Scarborough to engage in advisory activities), (approved Oct. 1, July 17, 2007, July 18, 2006) (acquisition of additional interests in Bingham, Osborn & Scarborough); 68 Fed. Reg. 69406 (Dec. 12, 2003) (solicitation of public comments) (approved Feb. 2, 2004) (acquisition of an interest in Dalton, Grenier, Hartman, Maher & Co. to engage in advisory activities); (approved Dec. 16, 2002) (acquisition of interests in Coldstream Holdings to engage in advisory and CPO activities); Commerzbank, 68 Fed. Reg. 27565 (May 20, 2003) (solicitation of public comments) (approved June 6, 2003); Bank One Corp. (approved Oct. 6, 2000); National Bank of Greece, 65 Fed. Reg. 32099 (May 22, 2000) (solicitation of public comments) (approved June 20, 2000); Deutsche Bank, 64 Fed. Reg. 63321 (Nov. 19, 1999) (solicitation of public comments) (approved Dec. 1, 1999); UBS, 64 Fed. Reg. 55936 (Oct. 15, 1999) (solicitation of public comments) (approved Nov. 29, 1999); U.S. Trust Corp., 64 Fed. Reg. 40007 (July 23, 1999) (solicitation of public comments) (approved Aug. 24, 1999); Wachovia Corp., 64 Fed. Reg. 35159 (June 30, 1999) (solicitation of public comments) (approved Aug. 20, 1999); Rabobank, 84 Fed. Res. Bull. 852 (1998) and 62 Fed. Reg. 34453, 30330 (June 26, 3, 1997) (solicitation of public comments) (approved July 21, 1997); CSG-Warburg Pincus Approval; Comerica (approved Nov. 23, 1998); Dresdner Bank, 63 Fed. Reg. 51578 (Sept. 28, 1998) (solicitation of public comments) (approved Oct. 19, 1998); RBC (approved Sept. 29, 1998); Bank of Montreal (approved May 15, 1998); Allied Irish Banks (approved May 11, 1998) (the "Allied Irish 1998 Approval"); Canadian Imperial Bank of Commerce ["CIBC"], 83 Fed. Res. Bull. 1008 (1997); Suez Lyonnaise des Eaux, 62 Fed. Reg. 42253 (Aug. 6, 1997) (approved Sept. 26, 1997); PNC, 62 Fed. Reg. 11895 (Mar. 13, 1997) (solicitation of public comments) (approved Apr.

17, 1997), PNC Modification Letter, and Board Letter, July 15, 1997 (the "PNC 1997 Approval").

(ix) The Board has permitted BHC subsidiaries that engage in broker-dealer and other activities to invest in securities where such investments are not an integral part of the proposed activities. See, e.g., Commitments, Nov. 30, 1994, in connection with Industrial Bank of Japan ("IBJ"), 81 Fed. Res. Bull. 731 (1995); NationsBank, 80 Fed. Res. Bull. 154 (1994); FRBSF Letter, Feb. 9, 1995, to Bank of Tokyo; Bank of Tokyo, 76 Fed. Res. Bull. 654 (1990), 54 Fed. Reg. 32394 (Aug. 7, 1989) (solicitation of public comments) (approved Aug. 23, 1989).

(x) Board Letter to Bankers Trust Company ("BTCo"), Jan. 5, 1998, permitted a Bankers Trust New York Corp. ("BTNY") subsidiary to purchase investment grade CMBS without obtaining the appraisal required by 12 C.F.R. § 225.63(a) under circumstances where (A) the loans supporting the CMBS would have appraisals and property assessments and inspections by a licensed engineer or consultant; and (B) BTCo would conduct due diligence, including with respect to prepayment risk and secondary market trading activity, large assets and portfolio concentrations, available reports by appraisers, loan servicers and other consultants, and other offering and supporting documents.

3. Bank Empowerments

a. Federal Banking Law Issues

Glass-Steagall § 16 permits banks to "purchase and sell" (but not "deal in") "investment securities" in accordance with, and subject to the "quality" and "marketability" standards set forth in, the Comptroller's Investment Securities Regulations. See, e.g., 12 U.S.C. § 24(7); Comptroller's Handbook: Investment Securities; Comptroller Interpretive Letter No. 629 (July 2,

1993) ("Letter No. 629"), CCH Fed. Banking L. Rep. ¶ 83,512; Board Trading and Capital Markets Activities Manual.

Dodd-Frank and the Volcker Rule affect some empowerments. See Part I.B and Part II.A.7 above.

(i) Commercial Paper

As discussed in Part VI below, CP is a "security", for Glass-Steagall purposes, notwithstanding that, depending upon certain attributes of the CP, it may not be a "security" for 1933 Act or 1934 Act purposes. Nonetheless, SIA v. Board, 468 U.S. 137 (1984) ("Bankers Trust I"), makes clear that, under its authority to "discount[] and negotiat[e] promissory notes, drafts, bills of exchange and other evidences of debt", a bank may purchase and sell CP as part of the "business of banking".

A) Bankers Trust I left open the question of whether CP is an "investment security" for purposes of Glass-Steagall § 16 (and, accordingly, whether a bank's ability to buy and sell CP is limited to CP which meets the quality and marketability standards referred to in Part II.D.3.a.ii below).

B) The Comptroller has historically considered CP to be a loan, not an "investment security", and "loans" purchased, held or sold by a national bank need not satisfy "investment security" requirements. Furthermore, the Comptroller has recognized that banks "actively trade" CP as principal. See, e.g., Comptroller Examiner's Guide to Investment Products and Practices; Comptroller's Handbook: Investment Securities; Letter No. 629; Comptroller Interpretive Letter No. 548 (Mar. 27, 1991), CCH Fed. Banking L. Rep. ¶ 83,264; Comptroller Investment Securities Letter No. 15 (Feb. 11, 1987), CCH Fed. Banking L. Rep. ¶ 85,885; Comptroller Interpretive Letter No. 329 (Mar. 4, 1985) ("Letter No. 329"), CCH Fed. Banking L. Rep. ¶ 85,499;

Board Study: The Economics of the Private Placement Market (Dec. 1993) (the "Board Private Placement Study"). See also Part II.D.3.a.iii below. See generally American Banker, May 27, 2010.

C) The power to purchase and sell CP does not encompass "dealing" in CP. See Part II.D.3.a.iv below.

(ii) Other Securities and Financial Instruments

A) "Investment Securities"

Bank purchases and sales of "investment securities" (so-called Type III securities) must comply with the "quality" and "marketability" standards set forth in the Investment Securities Regulations.

i) Under the Investment Securities Regulations an "investment security" means a marketable debt security that is not "predominantly speculative in nature"; i.e., is determined by the bank to be "investment grade": (a) the security has a low risk of default by the obligor, and (b) the full and timely repayment of principal is expected over the anticipated life of the investment.

Dodd-Frank § 939A directed all federal agencies to remove any requirements of reliance on credit ratings and substitute an alternative standard of creditworthiness. The OCC's definition of "investment grade" reflects this requirement. See 77 Fed. Reg. 35253 (June 13, 2012) (final rule).

The OCC released guidance regarding the due diligence banks should undertake to determine whether a security meets the investment grade standard. See 77 Fed. Reg. 35259 (June 13,

2012) (final guidance). The FDIC adopted similar requirements. See 77 Fed. Reg. 43151, 43155 (July 24, 2012). See also FDIC FIL-48-2012 (Nov. 16, 2012), CCH Fed. Banking L. Rep. ¶ 38-198.

ii) Under the Investment Securities Regulations, (a) securities registered under the 1933 Act, (b) municipal revenue bonds exempt from 1933 Act registration, (c) investment grade securities offered and sold under 1933 Act Rule 144A ("Rule 144A"), and (d) any other security which may "be sold with reasonable promptness at a price which corresponds reasonably to its fair value", meet the marketability standard of an investment security. The Regulations as revised in 1996 reverse Comptroller Interpretive Letter No. 600 (July 31, 1992), CCH Fed. Banking L. Rep. ¶ 83,427, which had concluded that Rule 144A securities did not meet this standard. However, other privately placed securities have not generally been thought to meet such standard. See generally, e.g., Morgan, 76 Fed. Res. Bull. 26, 28 n.10 (1990) (the "Morgan Placement Order"); Comptrollers' Handbook: Investment Securities. Cf. Comptroller Banking Circular No. 216 (Sept. 11, 1986) (guidelines for investment in foreign currency-denominated securities).

iii) In general, a bank may purchase investment (Type III) securities of one obligor up to 10% of the bank's capital and surplus. However, subject to a limit of 5% of capital and surplus, notwithstanding the otherwise applicable "investment grade" standard, a bank may treat a debt security as an investment security if the bank concludes, on the basis of estimates that it reasonably believes are reliable, that the obligor will be able to satisfy its obligations under that security, and the bank believes that the security may be sold with reasonable promptness at a price that corresponds reasonably to fair value.

iv) In addition to Type I, Type II and Type III securities (see Parts I.A.2.b.i and II.B above), the Investment Securities Regulations include two additional types of securities: certain mortgage- and small business-related securities (Type IV) and certain investment grade securities secured by loans in which a bank may invest (Type V). See Part I.A above.

v) The Investment Securities Regulations permit banks to invest in the equity of certain mutual funds, investment companies, limited partnerships and other vehicles whose portfolios consist of securities and other instruments that a bank may purchase directly.

Investments in non-registered investment companies are considered on a case-by-case basis. See, e.g., Comptroller Interpretive Letters No. 912 (July 3, 2001) ("Letter No. 912"), CCH Fed. Banking L. Rep. ¶ 81-437 (fund that holds general obligations and municipal revenue bonds); No. 911 (June 4, 2001) ("Letter No. 911"), CCH Fed. Banking L. Rep. ¶ 81-436 (fund that invests in loans, cash and cash equivalents); No. 826 (Mar. 17, 1998), CCH Fed. Banking L. Rep. ¶ 81-275 (insurance company "separate account" that invests in eligible securities); Comptroller Unpublished Letter (Apr. 11, 1991) ("hub and spoke" funds); Comptroller Banking Circular No. 220 (Nov. 21, 1986) ("Circular No. 220"), CCH Fed. Banking L. Rep. ¶ 62-083 (investment companies that invest in securities, futures and options); Part I.D.4 above and Part II.D.3.a.iii and Part X.C below. See also "Bank Investment in Securitizations: The New Regulatory Landscape in Brief", Supervisory Insights (FDIC, Summer 2015) (survey of FDIC/OCC post-crisis regulations).

vi) Comptroller Interpretive Letter No. 1070 (Sept. 6, 2006) ("Letter No. 1070"), CCH Fed. Banking L. Rep. ¶ 81-602, permits a bank to acquire and hold certificates issued as a part of a "tender option" municipal bond trust structure under which (a) a trust purchases tax-exempt long-term fixed rate municipal bonds that are eligible bank investments and funds the purchase of the bonds through the issuance and sale under Rule 144A of two classes of certificates: (i) Class A certificates, which are floating rate investment grade interests that pay a rate of interest linked to a short-term pricing mechanism, and (ii) Class B certificates, which are inverse floating rate interests, pay the difference between the long-term rate earned on the bonds and the short-term rate paid on the Class A certificates, could be subordinate to the Class A certificates in liquidation, fluctuate in value (based on the inverse floating rate), and are entitled to most of the gains upon the liquidation of the bonds; and (b) the bank enters into a reimbursement agreement with the liquidity provider under the tender option structure.

The OCC concluded that (a) the Class A certificates satisfy the marketability and credit quality requirements for investment securities; and (b) the Class B certificates qualify as investment securities if the bank can demonstrate that the certificates are marketable debt obligations and are the credit equivalent of investment grade.

B) "Preferred Securities" and Other "Equity" Instruments

i) Banks may purchase auction rate preferred securities ("ARP"), "non-cumulative preferred securities" and "money market preferred stock" (which possess debt-like characteristics) as Type III investments, as well as certain "TruPS" (which are hybrid debt/equity instruments). See, e.g., Comptroller Interpretive Letters No. 1135 (Jan. 20, 2012), CCH Fed. Banking L. Rep. ¶ 81-664 (ARP), No. 1126 (Mar. 8, 2010), CCH Fed. Banking L. Rep. ¶ 81-658 (ARP), No. 1124 (Nov. 3, 2009), CCH Fed. Banking L. Rep. ¶ 81-656 (ARP), No. 1115 (Apr. 3, 2009), CCH Fed. Banking L. Rep. ¶ 81-647 (ARP), No. 1086 (Aug. 23, 2007), CCH Fed. Banking L. Rep. ¶ 81-618 (fixed rate, cumulative, convertible preferred securities), Letter No. 1027, Comptroller Interpretive Letter No. 908 (Apr. 23, 2001), CCH Fed. Banking L. Rep. ¶ 81-433, Comptroller Unpublished Letter (May 25, 1999) to Robert Tortoriello, Comptroller Interpretive Letter No. 781 (Apr. 9, 1997), CCH Fed. Banking L. Rep. ¶ 81-208, No. 777 (Apr. 8, 1997), CCH Fed. Banking L. Rep. ¶ 81-204 (collectively, the "Comptroller Preferred Securities Precedents"). See also Comptroller Interpretive Letter No. 941 (June 11, 2002) ("Letter No. 941"), CCH Fed. Banking L. Rep. ¶ 81-466; FDIC FIL-16-99 (Feb. 19, 1999), CCH Fed. Banking L. Rep. ¶ 62-288 (authority of state banks to invest in TruPS).

ii) A national bank may not, in general, purchase equity securities (see Part I.D above), and may not invest through a trust in securities in which it could not invest directly. Comptroller Interpretive Letter No. 426 (Apr. 27, 1988) ("Letter No. 426"), CCH Fed. Banking L. Rep. ¶ 85,650. Cf. also Comptroller Interpretive Letter No. 435 (June 30, 1988), CCH Fed. Banking L. Rep. ¶ 85,659 (bank may not invest in entity formed to own, operate and renovate real estate; enumeration of instances in which national bank has been permitted to acquire stock); Comptroller Investment Securities Letter No. 34 (Jan. 30, 1989) ("Letter No. 34"), CCH Fed. Banking L. Rep. ¶ 83,040 (bank may not purchase U.S. Agriculture Department Commodity Credit Corporation payment-in-kind certificates representing right to specified commodities).

iii) However, a bank may acquire equity securities as a by-product of otherwise permissible activities. See, e.g., Comptroller Interpretive Letters No. 1118 (July 2, 2009), CCH Fed. Banking L. Rep. ¶ 81-650 (bank may obtain equity interests in an LLC that manages, markets and sells certain real property that the bank had acquired in exchange for DPC); No. 1075 (Nov. 14, 2006), CCH Fed. Banking L. Rep. ¶ 81-607 (bank may retain stock of MasterCard after its initial public offering ("IPO") where such stock was originally acquired as a condition to participation in credit/debit card issuance and payment programs); No. 1047 (Dec. 20, 2005), CCH Fed. Banking L. Rep. ¶ 81-576 (bank may sponsor and invest in investment company which invests in non-voting preferred shares of Cayman Islands companies engaged in CDS activities; investment company interests characterized as an "indirect investment in a credit strategy", and preferred shares characterized as "the substantial equivalent of debt"); No.1030 (May 26, 2005) ("Letter No. 1030"), CCH Fed. Banking L. Rep. ¶ 81-559 (bank may hold insurance company products, including those with equity characteristics, for purposes incidental to banking, such as to hedge obligations under an employee benefit plan); Letter No. 941 (bank may acquire preferred stock as partial consideration for loan portfolio sale); Comptroller Interpretive Letters No. 926 (Mar. 2002), CCH Fed. Banking L. Rep. ¶ 81-451 (to similar effect as Letter No. 1030); No. 905 (Jan. 29, 2001) ("Letter No. 905"), CCH Fed. Banking L. Rep. ¶ 81-424 (receipt of insurance company stock as a result of conversion from mutual to stock form where bank was owner of "key person" life insurance policy); No. 901 (to similar effect as Letter No. 905).

See also Part I.D above with respect to bank investments in operating subsidiaries and other entities, Part II.E below with respect to bank hedging customer-driven equity derivative transactions with equity securities, Part VII.A and Part VIII.C below with respect to real estate, venture capital-related, investment management-related and other "equity" investment activities, and Part X below with respect to acquisitions of interests in REMIC resecuritizations.

C) Selected Other Financial Instruments

i) A national bank may purchase transferable state tax credits for its own use (or for resale as a financial intermediation activity), as well as real estate tax lien certificates (as "evidences of debt"). See, e.g., Comptroller Corporate Decision No. 2006-06 (July 12, 2006); Comptroller Interpretive Letters No. 948 (Oct. 23, 2002), CCH Fed. Banking L. Rep. ¶ 81-473; No. 717 (Mar. 22, 1996) ("Letter No. 717"), CCH Fed. Banking L. Rep. ¶ 81-032. See also Comptroller Bulletin No. 2004-39 (Aug. 31, 2004) (bank risk management practices when purchasing tax lien certificates).

ii) A national bank's power to invest in debt-like instruments extends to fixed rate annuities. Such investments must be general obligations of the issuer and not tied to the performance of any other investment, and the bank must retain the option to terminate the annuity at any time. See, e.g., Letter No. 1021.

(iii) "Loans" v. "Investments"

It is sometimes difficult to characterize products as "loans" or "investments." Banks must exercise care when acquiring "securities" -- particularly lower quality/higher yield, privately placed securitized instruments (i.e., "securities" that may not be "investment securities") -- and classifying them as "loans". See Part II.C above and Part II.D.3.b, Part II.D.4, Part V.B.5, Part V.C and Part VI.B.3 below.

Compare, e.g., Comptroller's Handbook: Investment Securities; Letter No. 1070 (permitting bank to purchase municipal securities either as investment securities or as loans); Comptroller Bank Accounting Advisory Series (Sept. 2003) (loans held for sale); Comptroller Interpretive Letter No. 930 (Mar. 11, 2002) ("Letter No. 930"), CCH Fed. Banking L. Rep. ¶ 81-455 (permitting bank to purchase bonds convertible into equity either as investment securities or as loans); Letter No. 911 (permitting bank to acquire interests in investment funds that invest in loans, cash and/or cash equivalents); Comptroller Interpretive Letters No. 834 (July 8, 1998) ("Letter No. 834"), CCH Fed. Banking L. Rep. ¶ 81-288 (permitting bank to invest in "performance loan notes" and non-marketable debt securities as loans); No. 833 (July 8, 1998) ("Letter No. 833"), CCH Fed. Banking L. Rep. ¶ 81-287 (permitting bank to invest in "variable rate subordinated notes" tied to mortgage loan performance as loans); No. 798 (Sept. 3, 1997), CCH Fed. Banking L. Rep. ¶ 81-225 (permitting bank to invest in unrated community development securities as loans); No. 779 (Apr. 3, 1997), CCH Fed. Banking L. Rep. ¶ 81-206 (permitting bank to acquire interests in privately offered fund that would invest in loans either as investment securities or as loan participations); Comptroller ING Letter; Letter No. 717 (permitting bank to purchase real estate tax lien certificates as "evidences of debt"); Comptroller Interpretive Letters No. 703 (Jan. 25, 1996), CCH Fed. Banking L. Rep. ¶ 81-018 (permitting bank to treat unrated municipal bonds as investment securities or loans); No. 663 (June 8, 1995), CCH Fed. Banking L. Rep. ¶ 83,611 (permitting bank to acquire Farmer Mac subordinated securities as loans); Letter No. 579; Comptroller Unpublished Letter (Dec. 5, 1990) (permitting bank to treat Venezuelan Brady bonds as loans or investment securities); Comptroller Interpretive Letter No. 506 (Oct. 31, 1989), CCH Fed. Banking L. Rep. ¶ 83,204 (to similar effect with respect to Mexican Brady bonds); Comptroller Unpublished Letter (May 31, 1989) (permitting bank to participate in equipment lease investment program pursuant to loan power); Comptroller Interpretive Letter No. 262 (June 27, 1983), CCH Fed. Banking L. Rep. ¶ 85,426; Comptroller Letter No. 182 (Mar. 10, 1981), CCH Fed. Banking L. Rep. ¶ 85,263; with, e.g., Comptroller Unpublished Letters (Feb. 23, 1990), (Mar. 28, 1989) (refusing to accept loan characterization under circumstances at issue); Comptroller Investment Securities Letter No. 10 (Nov. 3, 1986), CCH Fed. Banking L. Rep. ¶ 85,880 (security may not be reported as a loan because it is "convenient to do so"); Comptroller Banking Bulletin 85-12 (May 31, 1985), CCH Fed. Banking L. Rep. ¶ 62-089 (junk bonds viewed as impermissible "investment securities"); Comptroller Investment Securities Letter No. 3 (July 17, 1976), CCH Fed. Banking L. Rep. ¶ 85,873.

The Comptroller's staff had at one time been preparing guidelines for "Differentiating Loans from Investments" (Sept. 23, 1988 (draft)).

See generally MSRB 2011 Loan/Note Advisory; see also Part II.B.3.b.iv.

(iv) "Trading" v. "Dealing"

The line between permitted "purchasing and selling" (or "trading") and prohibited "dealing" and "underwriting" for banking law purposes can be unclear; for example, if a bank purchases a block of securities from an issuer or underwriter with no clear intention to retain or resell them but in fact sells them shortly after acquisition ("underwriting"?), or if purchases and sales are effected on a regular basis ("dealing"?). See also Part II.D.3.b below.

A) A regular course of purchases and sales may not constitute "dealing", so long as the bank does not (i) maintain an inventory from which it is prepared to quote prices regularly, (ii) hold itself out as a dealer, (iii) engage in trading for the benefit of customers (rather than consistent with its own investment and liquidity objectives), or (iv) engage in "market-making". See, e.g., Comptroller's Handbook: Investment Securities; Comptroller Interpretive Letter No. 393 (July 5, 1987), CCH Fed. Banking L. Rep. ¶ 85,617; Comptroller Investment Securities Division Information Notice No. 12 (Nov. 7, 1985). See also Letter No. 912.

i) The Board has said that a dealer in securities normally maintains an inventory of securities and holds itself out to the public as willing to purchase and sell securities for its own account. See, e.g., Board Trading and Capital Markets Activities Manual; Merchant and Investment Bank Examination Manual, Section E; 1987 Order, 73 Fed. Res. Bull. at 481; BankAmerica, 69 Fed. Res. Bull. 105, 114 n.41 (1983) (the "Schwab Order").

ii) The distinction between purchases/sales and dealing seems to relate primarily to the purpose for which the trading is done (i.e., for the benefit of customers -- a function of a "dealer" -- or in furtherance of a bank's own investment and liquidity objectives), as well as to how a bank holds itself out to the public.

iii) The SEC has provided guidance on its interpretation of the dealer/trader distinction through various no-action letters. See, e.g., Louis Dreyfus Corporation (avail. July 23, 1987); International Investment Group Inc. (avail. July 23, 1987); United Saving Association of Texas (avail. Apr. 2, 1987); Burton Securities (avail. Nov. 4, 1977).

B) Regulatory guidance on country risk management issues respecting trading of loans, bonds (Brady and other), euronotes, CDs, CP and other instruments addresses country exposure limits, the need to monitor "stale" or non-liquid inventory and legal risk. See Comptroller's Handbook: Financial Derivatives and Trading Activities; Comptroller News Release No. NR 95-139 (Dec. 20, 1995). See also Interagency Statement on Country Risk: Sound Risk Management Practices (Mar. 11, 2002), Fed. Res. Reg. Serv. ¶ 3-1510.1.

(v) "Fair Value Reporting" Requirements

A) A bank may need to mark-to-market investment securities -- and other financial assets -- depending on the intent underlying its acquisition of the security and its ability to hold the security to maturity. See FASB Accounting Standards Codification Topic 825 (valuation of certain financial instruments by reference to the price that would be obtained in an orderly transaction between market participants); Topic 820 (fair value measurement, including in the absence of relevant market data); Topic 320 ("three tier approach" to securities categorization: (i) debt securities "held to maturity" (i.e., for investment), reported at amortized cost; (ii) "trading securities" (i.e., debt and equity securities held for current resale), reported at fair value, with unrealized gains and losses included in earnings; and (iii) securities "available for sale" (i.e., all other debt and equity securities), with unrealized gains and losses reported as a component of equity); Topic 321 (detailed guidance for investments in equity securities and other ownership interests); Topic 326 (measurement of credit losses on financial instruments).

In 2009, FASB issued three Final Staff Positions to provide guidance and enhance disclosures regarding fair value measurements and impairments of securities: (i) FSP FAS 157-4 (Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly); (ii) FSP FAS 107-1 and APB 28-1 (Interim Disclosures about Fair Value of Financial Instruments); and (iii) FSP FAS 115-2 and FAS 124-2 (Recognition and Presentation of Other-than-temporary Impairments).

FASB has updated its guidance on fair value measurement and disclosure in financial statements prepared in accordance with both U.S. GAAP and "International Financial Reporting Standards" ("IFRS"). See FASB Accounting Standards Update No. 2016-01 (Topic 820-10) (Jan. 2016); FASB

Accounting Standards Update (Topic 820) (May 2011).

With respect to issues regarding fair value accounting, see generally, e.g., "Available for Sale? Understanding Bank Securities Portfolios", Liberty Street Economics (FRBNY, Feb. 11, 2015); Comptroller, Bank Accounting Advisory Series (Oct. 2014); Wall St. J., Nov. 10, 2011 (discussing deliberations by Goldman Sachs and Morgan Stanley over whether to decrease their use of mark-to-market accounting); Classification and Measurement of Financial Assets and Liabilities (ABA, Aug. 31, 2010); Fair Value Accounting: Villain or Innocent Victim – Exploring the Links between Fair Value Accounting, Bank Regulatory Capital and the Recent Financial Crisis (FRBB, Jan. 31, 2010); Report and Recommendations Pursuant to [EESA § 133]: Study on Mark-to-market Accounting (SEC, 2009); Supervisory Guidance for Assessing Banks' Financial Instrument Fair Value Practices (Basel, Apr. 2009); Using Judgment to Measure the Fair Value of Financial Instruments When Markets Are No Longer Active (International Accounting Standards Board, Oct. 2008); ABA Letter to the Board, May 12, 2008 (noting that "fair value" valuation metric would override price inputs from reasoned estimates and models, and that the resultant downward impact on asset valuations in times of strained liquidity can contribute to financial turmoil), and Interagency Response, July 3, 2008 (reporting that the banking regulators "share some of [the ABA's] concerns").

See also Part III.A.5 and Part V.A.3 below.

B) Consistent with FDICIA § 121, 12 U.S.C. § 1831n, bank regulators have adopted Statement No. 115 (now codified and superseded by Topic 320) for reporting purposes. See 59 Fed. Reg. 66662 (Dec. 28, 1994) (FDIC); 59 Fed. Reg. 63241

(Dec. 8, 1994) (Board); 59 Fed. Reg. 60552 (Nov. 25, 1994) (Comptroller).

Mark-to-market accounting adjustments with respect to available-for-sale debt securities must be taken into account by certain banking organizations for purposes of capital calculations under the Basel III. See Part II.A.2 above. See also SNL Financial, July 6, 2015.

C) Comptroller Bank Accounting Advisory Series (Feb. 2004, Sept. 2003, Nov. 2002) discusses the classification of securities and loans as "available for sale", "held to maturity" or "trading" in accordance with Statement No. 115 (now codified and superseded by Topic 320), as well as the circumstances under which securities may be transferred between categories. Comptroller Investment Securities Letter No. 23 (Oct. 16, 1987), CCH Fed. Banking L. Rep. ¶ 85,893, states that if a bank transfers securities from its trading account to its investment portfolio to avoid recognizing losses, such transactions would "certainly" violate GAAP. See also Testimony of Deputy Comptroller Bailey before Subcommittee of House Financial Services Committee, Mar. 12, 2009; Comptroller Bank Accounting Letter No. 95-41 (Oct. 16, 1995) (discussing ability of a bank to sell securities which are designated "held to maturity" to improve its interest rate risk position); Instructions for Preparation of Consolidated Reports of Condition and Income (FFIEC, last update Mar. 2016) (distinguishing "held-for trading," "available-for-sale" and "held-to-maturity" securities).

D) Comptroller's Handbook: Unique and Hard-to-value Assets (Aug. 2012) provides guidance on assessing the management of hard-to-value assets.

E) Citigroup, SEC Admin. Proc. No. 3-13070 (June 16, 2008), settled charges that the accounting treatment of certain Argentinian assets during Argentina's economic and political crisis in 2001-02 violated 1934 Act reporting, record-keeping and internal controls provisions.

(vi) Supervisory Guidance on Investment and Trading Practices

A) Comptroller Bulletin No. 2002-19 (May 22, 2002), CCH Fed. Banking L. Rep. ¶ 62-092, relates to the risk of "yield chasing" in a low interest rate environment, including by investment in ABS, structured securities, trust preferred securities and equity-linked CDs.

B) FFIEC Supervisory Policy Statement on Investment Securities and End-User Derivatives Activities (the "1998 FFIEC Supervisory Policy"), 63 Fed. Reg. 20191 (Apr. 23, 1998), covers securities "held to maturity" and "available for sale", CDs held for investment, and end-user derivative contracts not held in trading accounts. See also, e.g., FDIC FIL-88-2000 (Dec. 20, 2000) (examiner guidance regarding credit-linked notes with speculative characteristics).

C) Board/Comptroller/FDIC guidance relates to investments in structured notes (i.e., debt securities whose cash flows are dependent on one or more indices in ways that incorporate risk characteristics of such indices). See, e.g., FDIC FIL-20-2009 (Apr. 30, 2009), CCH Fed. Banking L. Rep. ¶ 42-552; FDIC FIL-59-04 (May 18, 2004); FDIC FIL-45-98 (Apr. 28, 1998), CCH Fed. Banking L. Rep. ¶ 42-527; FDIC FIL-61-94 (Aug. 31, 1994), CCH Fed. Banking L. Rep. ¶ 62-153; FDIC Memorandum No. 94-130 (Aug. 26, 1994). See also, e.g., Report on [SPEs] (Joint Forum, Sept. 2009); Good Practices in Relation to Investment Managers' Due Diligence when Investing in Structured Finance Instruments

(IOSCO, July 2009); Risk Management in the Age of Structured Products: Lessons Learned for Improving Risk Intelligence (Deloitte, 2008).

D) The Comptroller has alerted banks to credit risks arising from arrangements with third parties (agents, dealers, brokers, marketers, etc.), including those which arise when investment assets are held with third parties for safekeeping. See, e.g., Comptroller Bulletin Nos. 2013-29 (Oct. 30, 2013) (Third-Party Relationships: Risk Management Guidance); 2002-39 (Sept. 5, 2002) (Investment Portfolio Credit Risks: Safekeeping Arrangements) ("Bulletin No. 2002-39"). See also, e.g., Comptroller Interpretive Letter No. 492 (Oct. 20, 1989), CCH Fed. Banking L. Rep. ¶ 83,075 (conditioning approval of a securities subsidiary on adequate bank managerial resources and compliance program); Comptroller Investment Securities Letter No. 29 (Aug. 3, 1988), CCH Fed. Banking L. Rep. ¶ 85,899 (banks should avoid excessive reliance on any single ABS issuer, underwriter, credit-enhancer, servicer or trustee).

E) SIFMA Amended and Restated Money Market Trading Practice Guidelines (Oct. 26, 2009) are designed to further the efficient trading of money market securities.

F) A bank's board may delegate investment authority to a subsidiary, or within guidelines established by the board and subject to appropriate board oversight. See, e.g., Corporate Decision No. 2004-12; 1998 FFIEC Supervisory Policy; Comptroller Conditional Approval No. 236 (Apr. 3, 1997); Letters No. 754; No. 745; Comptroller Interpretive Letter No. 469 (Jan. 30, 1989), CCH Fed. Banking L. Rep. ¶ 85,693; Comptroller Investment Securities Information Notice No. 23 (June 2, 1988), CCH Fed. Banking L. Rep. ¶ 85,893.

(vii) Repurchase/Reverse Repurchase Agreements

A) The average daily volume of total outstanding repo and reverse repo contracts involving government securities dealers alone totals approximately $5.6 trillion in the first half of 2015.

With respect to repo markets, see, e.g., "Borrowing, Lending and Swapping Collateral in GCF [General Collateral Finance] Repo", Liberty Street Economics (FRBNY, May 5, 2016); "Why Dealers Trade in GCF Repo", Liberty Street Economics (FRBNY, May 4, 2016); "Understanding the Interbank GCF Repo Market", Liberty Street Economics (FRBNY, May 3, 2016); "What's Up with GCF Repo?", Liberty Street Economics (FRBNY, May 2, 2016); Securities Law Daily, Apr. 19, 2016 (Treasury Dept. survey of primary dealers' repo activity); International Financing Review, Mar. 5, 2016; The U.S. Bilateral Repo Market: Lessons from a New Survey (OFR, Jan. 13, 2016); A New Survey of the U.S. Bilateral Repo Market: A Snapshot of Broker-Dealer Activity (FRBNY, Jan. 2016); U.S Repo Market Fact Sheet (SIFMA, 2016); "An Empirical Analysis of the GCF Repo Service", Economic Policy Review (FRBNY, Dec. 2015); "The Financial Plumbing of the GCF Repo Service", Economic Policy Review (FRBNY, Dec. 2015); "A Primer on the GCF Repo Service: Introduction" Economic Policy Review (FRBNY, Dec. 2015); Regulatory Arbitrage in Repo Markets (OFR, Oct. 19, 2015) (describing "window dressing" by non-U.S. banks in relation to termination of repo trades at each quarter-end to de-lever); Reference Guide to U.S. Repo and Securities Lending Markets (OFR, Sept. 9, 2015); Repo and Securities Lending: Improving Transparency with Better Data (OFR, Apr. 23, 2015); DTCC GCF Repo Index (listing average interest rate paid each day for the most-traded general collateral repos involving U.S. Treasury Securities, federal agency securities, and MBS issued by Fannie Mae and Freddie Mac); Update on Tri-party Repo Infrastructure Reform (FRBNY, Feb. 13, 2014); "The Risk of Fire Sales in the Tri-party Repo Market", Staff Report (FRBNY, May 2013); "Key Mechanics of the U.S. Tri-party Repo Market", Economic Policy Review (FRBNY, Oct. 1, 2012); Securities Lending and Repos: Market Overview and Financial Stability Issues (FSB, Apr. 27, 2012); Strengthening Repo Clearing and Settlement Arrangements (BIS, Sept. 2010); FFIEC Policy Statement: [Repo] Agreements of Depository Institutions with Securities Dealers and Others (the "FFIEC Repo Policy Statement"), Fed. Res. Reg. Serv. ¶ 3-1579.1. See also Restated Repo Trading Product Guidelines (Nov. 30, 2004); "The [Repo] Agreement Refined: GCF Repo", Current Issues (FRBNY, June 2003); FFIEC Policy Statement: Issuance of [Repos] (Apr. 13, 1982), Fed. Res. Reg. Serv. ¶ 3-1579. See generally The (Sizeable) Role of Rehypothecation in the Shadow Banking System (IMF, July 2010).

B) A number of post-Dodd Frank regulations have directly or indirectly targeted the risks and the leverage of the repo market, including the NSFR, LCR, G-SIB surcharge, the supplementary leverage ratio, lending and large exposure limits, among others. Regulatory constraints on bank and broker-dealer use of the repo market has caused significant change to the market. See, e.g., Wall St. J., July 20, 2016 (increase in "direct" repo between market participants, such as insurance companies and funds, without bank or broker-dealer intermediation); Wall St. J., Dec. 9, 2015 (regulatory pressure on DTCC to shore up credit backstop to repo clearinghouse); Risk, Nov. 25, 2015 (increase in price and decrease in liquidity because of DTCC credit backstop); FSB Press Release, Nov. 12, 2015 (release of reports, including details of regime for haircuts for non-centrally cleared repo); IFLR, Sept. 2015;

Bloomberg, Sept. 29, 2015 (decrease in size and limited growth of European repo market).

C) Comptroller Interpretive Letter No. 1088 (Sept. 11, 2007) ("Letter No. 1088"), CCH Fed. Banking L. Rep. ¶ 81-620, discusses the proper calculation of the legal lending limit under 12 U.S.C. §§ 32, 84 in the context of a bank's participation in a centralized clearing and netting facility for participants in repo markets for European government securities. See also 78 Fed. Reg. 37930 (June 23, 2013) (OCC final rule amending lending limits rules to include certain derivatives, repos and reverse repos, and securities lending and borrowing transactions).

D) The FRBNY established the "Tri-party [Repo] Agreement Infrastructure Reform Task Force" to recommend improvements related to the tri-party repo infrastructure, including with respect to operational improvements, collateral margining practices, liquidity risk management, transparency, and contingency planning in the event of a dealer default. See "Recent Developments in Tri-party Repo Reform", (FRBNY, Dec. 20, 2012) FRBNY Statement (Dec. 2012); Update on Tri-party Repo Infrastructure Reform (Feb 13, 2014); Task Force on Tri-party Repo Infrastructure Final Report (Feb. 15, 2012); Repo and Securities Lending (FRBNY Staff Report, Dec. 2011); FRBNY White Paper: Tri-party Repo Infrastructure Reform (May 17, 2010); FRBNY Press Release, Dec. 22, 2009.

E) The SEC issued a release encouraging money market funds to make advance preparations for handling the default of a tri-party repo transaction held in the fund's portfolio. Counterparty Risk Management Practices with Respect to Tri-party Repos (SEC Division of Investment Management, July 2013).

F) In a Release, Mar. 30, 2010, the SEC announced its inquiry into banks' repo accounting practices, prompted by a Bankruptcy Court Examiner's Report that alleged that Lehman had used improper repo accounting to make itself look healthier prior to its collapse ("REPO 105"). In response to the inquiry, Citigroup and Bank of America acknowledged accounting errors that misclassified certain short-term trades as "sales" when they should have been classified as borrowings. See Letters to SEC, May 13, 2010 (Bank of America), Apr. 14, 2010 (Bank of America), Apr. 13, 2010 (Citigroup, Morgan Stanley, AIG), Apr. 12, 2010 (Goldman Sachs, JP Morgan, State Street Boston Corp. ("State Street")), Apr. 2, 2010 (Wells Fargo); Bloomberg News, May 9, 2011; Wall St. J., Aug. 11, 2010. See also Wall St. J., Oct. 1, 2015 (judge rules for JPMorgan in $8.6 billion Lehman lawsuit over repo advances).

NY Attorney General Cuomo sued Ernst & Young, Lehman's accountants, for securities fraud for approving and supporting Lehman's use of such repo accounting. See Cuomo v. Ernst & Young, 1:11-cv-00384-LAK (SDNY Jan. 19, 2011 (complaint). Ernst & Young agreed to pay $99 million to settle claims in an investor class action against former Lehman officials and auditors, ending long-running multidistrict litigation over the bankrupt company's securities offerings. Law360, Oct. 16, 2013.

In response to REPO 105, FASB amended the accounting standards that determine whether repos qualify for sale accounting. That determination continues to be based, in part, on whether the entity has maintained effective control over the transferred financial assets. See FASB Accounting Standards Update No. 2011-03, Transfers and Servicing (Topic 860) (Apr. 2011). FASB has issued new standards to improve the financial reporting of repos and other similar transactions. The new standards change the accounting for repurchase-to-maturity transactions and repo financing arrangements and require enhanced disclosures. See FASB Accounting Standards Update No. 2014-11, Transfers and Servicing (Topic 860) (June 2014).

G) Dodd-Frank amends 1934 Act § 10(c) to the effect that the SEC may prescribe rules with respect to transactions involving securities lending/borrowing. Dodd-Frank § 984(b) also requires rulemaking that would improve the transparency of information available to brokers, dealers and investors with respect to securities lending or borrowing. See generally NY Times, Oct. 17, 2010.

H) See also discussion of (i) market risk issues in Part II.A above, (ii) GLBA Push-out Provisions in Part II.D.3.b below, and (iii) securities lending activities in Part IX.A.1.b.ii below.

b. Gramm-Leach-Bliley Act "Push-out" Issues

(i) Banks no longer have a general exemption from the definition of "dealer" in the 1934 Act. Instead, the GLB Act, together with SEC regulations implementing the GLBA Push-out Provisions, provide for several transactional exemptions.

(ii) The GLBA Push-out Provisions and implementing SEC Rules for dealer activities became effective on October 1, 2003. See SEC Release No. 34-47364 (Feb. 13, 2003) (the "SEC Dealer Release"); SEC Staff Compliance Guide to Banks on Dealer Statutory Exceptions and Rules (Sept. 2003). The SEC and the Board in 2007 adopted the jointly drafted provisions of Regulation R, 12 C.F.R. Part 218 and 17 C.F.R. Part 247 (see 72 Fed. Reg. 56514 (Oct. 3, 2007)) ("Regulation R"), to implement the GLBA Push-out Provision for brokerage activities. (See also Part I.C above and Part IX.B below.) SEC Release No. 34-56502 (Sept. 24, 2007) conformed certain of the 2003 rules for dealer activities to the provisions of Regulation R.

(iii) The term "dealer" under the 1934 Act means any person engaged in the business of buying and selling securities (excluding security-based swaps ("SBS") with or for persons who are eligible contract participants ("ECP")) for its own account, through a broker or otherwise, but does not include a person that buys or sells such securities for its own account, either individually or in a fiduciary capacity, but not as a part of a regular business.

A bank (or a U.S. branch of a foreign bank) is not considered to be a dealer (the "Dealer Exemption") if it:

A) Buys or sells CP, BAs, commercial bills, government, municipal and other 1934 Act "exempted" securities, qualifying Canadian government obligations, North American Development Bank obligations or "Brady bonds" (collectively, "Push-out Exempt Securities").

B) Buys or sells securities for investment, trust or fiduciary purposes (the "Investment Purposes Exemption").

C) Engages in the issuance or sale of ABS, if the underlying assets are "predominantly originated" by (i) the bank; (ii) an affiliate that is not a broker-dealer; or (iii) in the case of mortgage- or consumer-related ABS, a syndicate of banks of which the bank is a member (the "Asset-backed Exemption"). (1934 Act Rule 3b-18(g) uses 85% of value as the test for "predominantly originated".) See Part X below.

D) Buys, sells or otherwise transacts in Identified Banking Products. (See Part II.C.1 above.)

(iv) The SEC Dealer Release (A) clarifies that riskless principal transactions, as well as brokerage transactions, are eligible for the 500-transaction de minimis exemption from the definition of "broker" discussed in Part IX.B below (with the "buy" and "sell" components of a riskless principal transaction counting as a single transaction); (B) defines certain terms for purposes of the Asset-backed Exemption; and (C) exempts from the definitions of "dealer" and "broker" banks that act as agent or conduit lender for qualifying securities lending transactions with "qualified investors" or certain employee benefit plans (1934 Act Rule 3a5-3).

(v) Transactions which fall within the SEC No-dealer Government or Municipal Securities Precedents -- or other SEC precedents which define the scope of trading or related activities which do not require broker-dealer registration -- should not require broker-dealer registration if conducted by a bank. See, e.g., Acqua Wellington North American Equities Fund (avail. Oct. 11, 2001) (investor in equity line of credit not required to register as a broker-dealer), Davenport Management (avail. Apr. 3, 1993) (denial of no-action request with respect to entity involved in negotiating or providing advice with respect to securities transactions, and in receiving compensation tied to securities transactions), National Council of Savings Institutions (avail. June 26, 1986) (distinction between "dealers" and "traders"), Burton Securities (avail. Nov. 4, 1977) (distinction between "dealers" and "traders") (together with the SEC No-dealer Government and Municipal Securities Precedents, the "SEC No-dealer Precedents").

The SEC No-dealer Precedents stand generally for the proposition that a person need not register as a broker-dealer if such person acts as an investor or trader for its own account and does not (A) underwrite or participate in a syndicate for the sale of securities; (B) purchase or sell securities as principal for the benefit of or at the instruction of a customer, issuer or dealer; (C) advertise or otherwise hold itself out as a dealer or as willing to buy or sell securities for its own account on a continuous basis; (D) carry a dealing inventory; (E) quote a market;

(F) provide investment advice; (G) extend or arrange for the extension of credit in connection with securities transactions; (H) run a repo/reverse repo book; (I) use an interdealer broker for securities transactions; or (J) guarantee contract performances or indemnify counterparties for losses or liabilities from the failure of securities transactions. See Part II.B.2.b and Part II.B.3.b above and Part IX.B below.

(vi) Open questions with respect to the Dealer Exemption relate to (A) how repo transactions on securities which are not Push-out Exempt Securities or Identified Banking Products should be treated for purposes of the Exemption (see, e.g., American Bankers Association Securities Association ("ABASA") Letters to SEC/FRB, Sept. 8, 2008, Mar. 26, 2007); (B) under what circumstances cash/physically settled forward transactions should be characterized as Identified Banking Products; (C) the scope of the Investment Purposes Exemption (or other exemptions) in the context of hedges of equity/credit derivative transactions; and (D) the treatment of loan participations within the scope of Identified Banking Products.

E. DERIVATIVE AND RELATED PRODUCTS

1. Background

a. Derivatives Markets

The market for "derivatives" (financial contracts -- such as options, futures, swaps, forwards and related products (e.g., caps, collars, floors and swaptions) -- whose value depends on the values of one or more underlying assets or indices) has become a multi-trillion dollar industry as financial institutions seek new ways to restructure risk and generate trading/intermediation profits. The notional amount of outstanding contracts held by U.S. banks amounted to more than $192 trillion at March 31, 2016.

Derivative contracts shift risks that arise from the particular attributes of the underlying instrument, the market for that instrument or both. Derivative instruments are typically some form of interest rate, FX, commodity, equity or credit contract. 76% of the notional amount of bank derivatives at March 31, 2016 comprised interest rate contracts, compared with 18% for FX contracts and 6% for equity, commodity and credit contracts. See OCC Quarterly Report on Bank Trading and Derivatives Activities (June 2016).

Derivatives are traded both on organized exchanges (where the contracts have standardized terms, including with respect to size of contract, maturity and delivery) and OTC (where products are customized). OTC derivatives dwarf exchange-traded derivatives. While contracts are typically based on a "notional" principal amount, the actual amount at risk is usually measured by replacement cost, which studies have suggested typically ranges between 2% and 3% of the notional amount. Increasingly, executed swaps are subject to central clearing. For example, over 75% of interest rate swaps and 65% of CDS index swaps were cleared as of August 2016. Trading in OTC interest rate derivatives averaged $2.7 trillion per day in April 2016. See OTC Derivatives Statistics at End-December 2015 (BIS, May 2016); Weekly Swaps Report (CFTC, Aug. 19, 2016); Triennial Central Bank Survey: OTC Interest Rate Derivatives Turnover in April 2016: Preliminary Global Results (BIS, Sept. 2016) (the "BIS Triennial Survey").

b. Bank/Bank Holding Company Involvement in Derivatives Markets

Bank/BHC participation in the market for derivative products has taken a number of forms -- as end-user, intermediary and dealer (see Part II.E.2.a below).

The bank derivatives market continues to be heavily concentrated: the largest 4 commercial bank participants accounted for 91% of the total banking industry notional amounts as of March 31, 2016. The credit exposure-to-capital ratio of these 4 banks averaged together amount to 242%.

Exposure would have been substantially higher without bilateral netting arrangements.

During the first quarter of 2014, the fair value of contracts past due 30 days amounted to only \$8.4 million or 0.01% of the net current credit exposure from derivatives contracts. Banks with derivative contracts reported \$13 million in charge-offs from derivative receivables during the first quarter of 2016.

c. The Market for Credit Derivatives, Insurance Derivatives, Energy Derivatives and Other Novel Derivative Products

Credit derivatives can decouple credit relationships and credit risks, and cover investment grade, high yield, distressed, secured bond, secured loan and emerging market credit exposures. Banks and other derivatives dealers are constantly developing new products and variations on existing products.

(i) The notional amount of credit derivatives -- transactions designed to manage credit exposure by permitting one party to transfer certain aspects of that exposure to the other -- entered into by U.S. banks amounted to \$7.4 trillion as of March 31, 2016 (down from \$16.4 trillion at year-end 2008). OCC Quarterly Report on Bank Trading and Derivatives Activities (June 2016).

Credit derivatives exposures are highly concentrated, with the top 25 global banks and broker- dealers holding over 99% of total positions. Hedge funds, insurers and financial guarantors are also heavily involved in the sale of credit protection. See also Part II.E.3.c.iii below.

A) The primary objectives of banks for credit derivatives have been to transfer credit risk (as an alternative to traditional forms of selling down credit risk, such as loan participations, assignments, novations, etc.), to facilitate portfolio management, reduce or hedge risk concentrations, and increase liquidity. Credit derivatives can also be used for risk enhancement in securitizations and project finance.

B) Investors use credit derivatives for credit protection, to obtain synthetic access to different credit markets (e.g., loans, high yield debt and emerging markets exposures), and for the capacity to trade credit risk attributes.

C) Credit derivatives achieve these ends by transferring credit risk or customizing risk profiles. These effects can be achieved by:

i) Modifying the type, term and concentration of credit risk.

ii) Facilitating trading opportunities in less liquid instruments.

iii) Differentiating relative default risk on different classes of obligations.

D) Credit derivative structures include:

i) CDS/options -- which transfer credit risk between two parties without transferring ownership of the underlying asset or portfolio of underlying assets (although in some cases ownership of the underlying assets may be transferred following certain "credit events").

ii) Index and tranche CDS -- which transfer (A) exposure to a class of credit risk (e.g., a basket or index of high yield bonds, first lien loans or emerging market sovereign debt), and (B) credit risk with respect to portions of the aggregate credit risk from baskets of reference credits. Variations include first-to-default and nth-to-default CDS. In a first-to-default CDS, the protection seller pays and the CDS terminates upon the first default of an entity or other exposure in the reference basket. In a nth-to-default CDS, the protection seller pays and the CDS terminates when the nth default occurs in the reference basket, where n is a defined number of defaulted entities or exposures.

iii) Credit Spread -- which relate to the difference in "yield" between an agreed reference rate and the rate on a specified underlying asset; this credit spread generally reflects perceptions of the credit quality of the underlying asset compared to a market benchmark.

iv) TRS -- which transfer credit risks by swapping an underlying asset's total return; instead of a payment in the event of a default, the TRS provides the risk seller a specified economic value for the reference credit but entitles the risk buyer to any increase in the economic value of the reference credit as well as the return on that credit.

v) Credit-linked notes -- under which the payment of principal and/or interest depends on the credit performance of one or more third parties.

See, e.g., Interconnectedness in the CDS Market (SEC Staff Report, Apr. 2014); The [CDS] Market (IOSCO, June 2012); ISDA Bullet Syndicated Secured Loan [CDS] Standard Terms Supplement (Apr. 2010); Collateral Netting and Systemic Risk in the OTC Derivatives Market (IMF, 2010); Nijenhuis, "[CDS] in the New Regulatory Environment", Taxation of Financial Products and Transactions (PLI, 2010); Credit Derivatives: Systemic Risks and Policy Options (IMF, 2009); Credit Derivatives and Risk Management (Board Discussion Series 2007-47, May 2, 2007; ISDA Credit Derivatives Definitions).

E) From 2005, the Board convened meetings with major credit derivatives dealers (including banks and BHCs) to address backlogs in credit derivatives confirmations, procedures for novating transactions and cash settlement of credit derivatives on a market-wide basis. As a result, dealers have significantly reduced the number of confirmations outstanding largely through the use of electronic confirmation services, as a result of which many OTC market participants view the CDS market as the most automated among OTC derivatives markets. Formalized procedures for novating credit derivatives trades set forth in the 2005 ISDA Novation Protocol (to which 2,000 market participants adhere) and the ISDA Novation Protocol II (to which 567 market participants adhere) have also increased the speed and efficiency of trade documentation. In connection with these efforts to improve the market infrastructure, the industry has moved towards adoption of centralized, rather than bilateral, settlement mechanisms. See ISDA Operations Benchmarking Survey (May 27, 2011); ISDA Letter to Congress, Apr. 23, 2010; FRBNY News Releases, Mar. 1, Jan. 14, 7, 2010, Sept. 24, 8, July 13, June 2, 2009, Oct. 31, July 31, June 9, Mar. 27, 2008; Industry Letters to Board/FRBNY, June 30, 2, 2009, Dec. 15, Mar. 27, 2008; Board/SEC/CFTC [MOU] Regarding Central Counterparties for [CDS] (Nov. 2008); Credit Derivatives: Confirmation Backlogs Increased Dealers' Operational Risks, But Were Successfully Addressed After Joint Regulatory Action (GAO, June 2007).

F) CDS market participants have sought to develop electronic systems to facilitate trading and back-office processing, to develop exchange-traded credit derivative products, and to implement systems for determining credit spreads and other relevant variables in valuing credit derivatives. The FRBNY and the NYBD approved applications submitted by

Warehouse Trust Company, a wholly-owned subsidiary of DTCC, to act as a central trade information repository for CDS transactions. See 96 Fed. Res. Bull. B13 (2010); NYBD Press Release, Nov. 6, 2009. See also, e.g., Creditex/MarKit News Releases, Oct. 31, 16, Sept. 8, July 2, 2008.

Dodd-Frank also imposes reporting requirements on parties to swap and SBS transactions, including CDS, which require participants to report swap or SBS transaction and pricing data to a swap or SBS data repository. See Part II.E.2.b.vi.E below.

G) Comptroller interpretations as to the treatment of specific credit derivative structures under historical capital guidelines include Comptroller Interpretive Letters No. 1091 (Aug. 17, 2006), CCH Fed. Banking L. Rep. ¶ 81-623; No. 946 (Sept. 27, 2001), CCH Fed. Banking L. Rep. ¶ 81-471; No. 945 (June 30, 2000), CCH Fed. Banking L. Rep. ¶ 81-470. See also Part II.A.2 above.

H) Some market participants have raised concerns that banks and other parties that hedge in the credit derivatives market may improperly use non-public information obtained in connection with their lending business. In response to these concerns, a group of financial market trade associations prepared a Statement of Principles and Recommendations Regarding the Handling of Material Non-public Information by Credit Market Participants (Joint Market Practices Forum, Oct. 2003) (the "JMPF Statement of Principles on Non-public Information").

The SEC has reaffirmed its authority to bring enforcement proceedings in situations involving derivatives if there has been insider trading or other securities law violations. Compliance Reporter, Nov. 26, 2007. See also Part V.A.3.d below.

I) Credit derivative products may have aspects similar to financial guarantee insurance, causing certain states to discuss the possibility of regulating such contracts as insurance (see, e.g., NY Insurance Dept. Circular Letter No. 19 (Sept. 22, 2008); Remarks of NY Superintendent of Insurance Dinallo, Nov. 20, May 12, 2008). However, the Dodd-Frank Act amends CEA § 12(h) and 1934 Act § 38(a) to prohibit states from regulating swaps and SBS as insurance.

J) An exchange effecting transactions in single-name CDS and other SBS must register under the 1934 Act or structure itself as an alternative trading system (an "ATS") required under applicable regulation to be registered as a broker-dealer. See SEC Releases No. 34-64795 (July 1, 2011), No. 34-61662 (Mar. 5, 2010), No. 34-61119 (Dec. 4, 2009), No. 34-60373 (July 23, 2009), No. 34-60372 (July 23, 2009), No. 34-59955 (May 22, 2009), No. 34-59578 (Mar. 13, 2009) and No. 34-59527 (Mar. 6, 2009).

Under the SEC's proposed rules for SBS execution facilities ("SB SEFs"), an SB SEF, unlike an exchange or ATS, would not be required to register as an exchange or a broker-dealer. See SEC Release No. 34-63825 (Feb. 2, 2011) (proposed rule: Registration and Regulation of SB SEFs).

(ii) The market for insurance derivatives, including bonds backed by pools of insurance policies as well as application of swaps, options and other derivative transactions to insurance markets, continues to expand. "Catastrophe bonds" and other "risk-linked securities" enable insurance companies to shift risk to the capital markets. Approximately $23 billion in risk-linked securities were outstanding at year-end 2013, principally covering perils such as earthquakes, hurricanes, typhoons and windstorms in the U.S., Japan and Western

Europe. See Insurance-Linked Securities (ILS): Market Review 2014 and Outlook 2015 (Munich RE 2015).

(iii) Energy derivatives have become increasingly common. These products, typically linked to the price of oil or natural gas, are traded on exchanges and OTC. Energy derivatives are used both for hedging purposes by entities with exposure to such commodities in their normal course of business and investment purposes by entities which wish to acquire exposure to energy markets synthetically. Other energy-related derivatives can include emissions derivatives and electricity/power derivatives (which may or may not result in actual delivery of power). See generally Regulation of Energy Derivatives (CRS, Apr. 21, 2006). See also Part II.E.3.c.ii below.

(iv) Since the first contract was written in 1997, the notional value of weather derivatives -- designed generally to shift the risk of temperature or weather variability -- has varied considerably. The market for weather derivatives was estimated at approximately $12 billion as of March 31, 2011. See Institutional Investor, Jan. 23, 2014.

The NAIC "tabled" its Draft White Paper, Weather Financial Instruments (Temperature): Insurance or Capital Markets Products? (Sept. 2003), which had concluded that weather derivatives should be subject to regulation as insurance. Market participants and trade associations strongly opposed this view. See, e.g., BMA Comment Letter, Mar. 2, 2004; ISDA Comment Letter, Feb. 23, 2004.

(v) The market for inflation-linked derivatives, such as OTC swaps, options and notes linked to, e.g., the U.S. consumer price index, is expanding, particularly in Europe.

(vi) Property derivatives, which are typically based on commercial real estate and reference an index of property prices, are being used to obtain or hedge exposure to real estate. ISDA has published the 2007 ISDA Property Index Derivatives Definitions (intended to standardize trades and promote liquidity), and a Real Estate Derivative Special Interest Group has been established to offer insight and perspectives to the market.

(vii) In its Concept Release on the Appropriate Regulatory Treatment of Event Contracts, 73 Fed. Reg. 25669 (May 7, 2008), the CFTC solicited comments on issues raised by "event contracts" (financial arrangements offered in "event prediction" or "information" markets linked to eventualities or measures that neither derive from, nor correlate with, market prices or broad economic or commercial measures).

Dodd-Frank amended CEA § 5c to provide for heightened CFTC review of event contracts to determine whether a contract involves activity contrary to the public interest. Pursuant to this provision, the CFTC has prohibited the listing of certain political event contracts. See CFTC Press Release, Apr. 2, 2012.

(viii) Other areas of derivative product development include "exotic" derivatives relating to FX and other assets, volatility derivatives, complex options, longevity swaps, telecommunications bandwidth derivatives, economic derivatives (linked to an economic variable, such as GDP growth or the national unemployment rate), and catastrophe derivatives.

d. Selected Sources

For selected additional general background and recent discussion on derivatives markets and current issues generally, see The Future of Derivatives Processing and Market Infrastructure (ISDA, Sept. 2016); "Bank Counterparties and Collateral Usage" Economic Letter 2014-21 (FRBSF, July 14, 2014); BIS Triennial Surveys; BIS Quarterly Reviews and Reports of Derivatives Market Activity; OCC Quarterly Reports on Bank Derivatives Activities; FDIC Quarterly Banking Profiles; SIFMA Research

Quarterly; ISDA Counterparty Credit Risk Management in the U.S. OTC Derivatives Markets, OTC Derivatives Market Analysis, Margin Survey and Operations Benchmarking Surveys; "Trading Activity and Price Transparency in the Inflation Swap Market", Economic Policy Review (FRBNY, 2013); "Global SIFIs, Derivatives and Financial Stability", OECD Journal (June 2011); Derivatives and U.S. Corporations (Fitch, June 7, 2012); OTC Markets and Derivatives Trading in Emerging Markets (IOSCO, July 2010); Overview on Derivatives (FCIC, June 2010); Derivatives Protection Without Suffocation: Thriving in a New Era of Regulatory and Market Transformation (BNY Mellon, May 2010); Use of OTC Derivatives by American Companies (SIFMA, 2009); Weather Risk Management Assoc. Release, June 28, 2006; CRMPG II 2005 Report; Catastrophe Insurance Risks: The Role of Risk-linked Securities and Factors Affecting Their Use (GAO, Sept. 2002); Wall St. J., Apr 23, 2014, June 2, 2011, Oct. 24, 2010. See also Part II.E.3 below.

2. Implications of the Expansion of Derivative Markets on Banking Organizations

   a. General Scope and Range of Bank Derivatives-related Activities

   Banking organizations act as issuers, dealers and end-users of derivatives contracts and provide related brokerage and advisory services. For example:

   (i) Banking organizations act as originator, issuer and/or principal with respect to cash-settled (and many physically-settled) exchange-traded and OTC derivative products based on, among other things (A) interest rate indices; (B) currencies; (C) physical commodity indices, prices and related measures of value; (D) equity and bond indices; (E) single equity and debt securities; (F) energy prices; (G) credit default risk; and (H) emissions allowances. Banking organizations also trade FX and related derivatives, both on exchanges and OTC, in spot, forward, futures and options markets. These activities may involve market-making.

(ii) Banking organizations act as derivatives dealers (marketing derivative products to customers), or as end-users (either "limited" end-users or "active position-takers") for investment, risk management or other purposes. In conducting "dealer bank" activities, banks enter into transactions:

A) On a "perfectly matched" basis (i.e., where a bank enters into a transaction only after arranging a "mirror transaction" which offsets the risk of the first transaction "perfectly" with respect to notional amount, maturity, physical delivery and underlying exposure); and/or

B) On a "portfolio" or "aggregate" hedging basis (i.e., where a bank does not "perfectly match" particular transactions, but rather complies with safe and sound banking practices in identifying, limiting and controlling (rather than eliminating) risk; risk limitation is effected cross-security, cross-index and cross-commodity).

(iii) Banking organizations trade derivatives (including on exchanges) based on instruments or indices which they are permitted to hold. An FHC (and, upon receipt of Board approval, a BHC) may also trade for its own account derivatives based on commodities or securities, or on stock, bond or commodity indices, that banks are not generally permitted to hold. Generally, however, a bank may trade such instruments only for the purpose of hedging risks arising from, or engaging in, otherwise permissible banking activities. All of these empowerments are subject to Dodd-Frank restrictions. See Part II.A.7 above.

(iv) Banking organizations hedge risks of derivatives, lending, securities, deposit and other activities, among other things, in:

A) Cash- and (under certain circumstances) physically-settled exchange-traded and OTC swaps, futures and related derivatives products.

B) Physical commodities (with specific regulatory clearance) and, under some circumstances, equity securities. See Part II.E.3 below.

(v) Banking organizations provide advisory services, and act as broker or agent, with respect to all types of exchange-traded and OTC derivatives transactions. See Part IX below.

(vi) U.S. banks and U.S. branches of foreign banks issue securities and other instruments -- including CDs, structured notes and warrants -- linked to various securities, currencies, commodities or indices. These transactions include the issuance of securities and other instruments where (A) only the interest varies, and (B) the principal varies. Putting all or a portion of the principal of a security or other instrument at risk can raise securities law and other issues. See Part IV below.

(vii) Banking organizations engage in lending activities where the interest on (or, less frequently, the principal amount of) loans is pegged to particular indices or the prices of particular securities or commodities. Moreover, even if bank loans are not pegged to indices or securities, borrowers are commonly required to hedge their exposures.

(viii) Banking organizations engage in equity derivative transactions with the issuers of the underlying securities, such as put options written by issuers and forward contracts with issuers in connection with stock repurchase programs. Banking organizations also enter into equity derivatives transactions with private banking clients, including with clients who wish to reduce their exposure to changes in the market price of a particular security.

(ix) Banking organizations have entered into strategic alliances with derivatives specialists to facilitate the provision of equity-linked or other customized derivatives products. See Part XII below.

(x) U.S. banking organizations engage in derivatives-related business both in the U.S. and outside the U.S. (in the latter case, in reliance on the GLB Act and/or Regulation K (see 12 C.F.R. § 211.10 and Part XI below)).

b. Congressional Initiatives: Dodd-Frank and Other Enactments

(i) The Commodity Futures Modernization Act

The CFMA became law in 2000. It excluded or exempted from the CEA a range of OTC derivatives (including equity swaps) and hybrid instruments. The CFMA also clarified the treatment of swap agreements under the Securities Acts. See also Part I.A.8 above and Part II.E.2.c below. The CFMA expanded on recommendations of the report of the PWG, [OTC] Derivatives and the [CEA] (Nov. 1999).

See Rosen, et al., "The [CFMA]", Futures & Derivatives Law Report (Dec. 2000). See also Part I.A.8 above.

(ii) Pre-Dodd-Frank Concerns with Derivative Markets

Congressional and regulatory concern with the risks posed by the derivatives markets was evident in certain provisions of FDICIA, and resulted in many hearings and studies, including the Report of the House Banking Committee Minority Staff, Financial Derivatives (Nov. 1993) (30 recommendations for strengthening regulation) (the "Minority Staff Report"); CFTC OTC Derivatives Study; Derivatives Product Activities of Commercial Banks (Board/Comptroller/FDIC, Jan. 27, 1993). See also Energy Derivatives: Preliminary Views on Energy Derivatives Trading and CFTC Oversight (GAO, July 2007).

(iii) 2008 Expansion of CFTC Authority

The CFTC Reauthorization Act, Title XIII of Pub. L. 110-246 (2008), expanded the CFTC's authority with respect to off-exchange retail FX markets, and increased the regulation of exempt commercial markets. See generally, Policy Perspectives on OTC Derivatives Market Infrastructure (FRBNY, Jan. 2010).

(iv) Section 23A

Title VI of Dodd-Frank expands or alters the coverage of Section 23A in several ways, including with respect to credit exposures arising from derivatives transactions, as described in Part III.A.5 below.

(v) Lending Limits

Title VI of Dodd-Frank amended national bank lending limits to include credit exposure arising from derivatives transactions and effectively requires state law to take such credit exposure into account for purposes of applying state-law lending limits on derivatives transactions involving state-chartered banks. The OCC has issued final rules on such lending limits. Those rules provide banks with the flexibility to use internal models for calculating credit exposures and permit banks to reduce their exposure, for lending limit purposes, from loans and other non-derivatives extensions of credit through the purchase of credit protection in the form of eligible credit derivatives. Despite industry protest, the OCC rejected suggestions that the final rules exempt or provide special treatment for exposures to central counterparties, thereby stoking concerns that the application of traditional exposure limits to central counterparty exposures could significantly constrain derivatives activities as exposures become more concentrated at a limited number of central counterparties. See 78 Fed. Reg. 37930 (June 25, 2013) (final rule); 77 Fed. Reg. 76841 (Dec. 31, 2012) (final rule extending the rule's temporary exception for credit exposures arising from derivatives transactions or securities financing transactions); 77 Fed. Reg. 37265 (June 21, 2012) (interim final rule). See also Part I.B.6.e above.

(vi) Title VII of Dodd-Frank

Dodd-Frank §§ 701-774 repealed restrictions on the substantive regulation of OTC derivatives in the CEA and the Securities Acts and instead established a regime of substantially parallel regulation of SBSs -- to be administered by the SEC -- and swaps -- to be administered by the CFTC.

See generally Navigating Key Dodd-Frank Rules Related to the Use of Swaps by End Users (Cleary Gottlieb, Jan. 12, 2016); Dispelling Myths: End-user Activity in OTC Derivatives (ISDA, Aug. 2014); CFTC Letter to Sen. Johnson, May 14, 2012 (CFTC regulatory approach in implementation of Dodd-Frank); Notice of Renewal of Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues, 77 Fed. Reg. 27444 (May 10, 2012); Ready or Not? Here It Comes: OTC Derivatives in the Post-Dodd-Frank Landscape – Implications for Investment Managers (Citibank, 2011).

A) Covered and Excluded Products

i) Swaps. A swap generally includes OTC derivatives products based on rates, currencies, commodities, exempt securities, two or more loans, broad-based security indices, quantitative measures, or other financial or economic interests or property of any kind as well as the occurrence of events associated with potential financial, economic or commercial consequences of certain issuers. See CEA § 1a(47); 77 Fed. Reg. 48207 (Aug. 13, 2012) (Joint CFTC/SEC Final Rule: Further Definition of "Swap," "[SBS]", and "[SBS Agreement]";

Mixed Swaps; [SBS] Agreement Recordkeeping) (the "Product Definition Final Rules").

ii) SBS. An SBS generally includes OTC derivatives products that are based on a single non-exempt security or loan, narrow-based security indices and the occurrence of events associated with potential financial, economic or commercial consequences of certain issuers. See 1934 Act § 3(a)(68); Product Definition Final Rules.

Dodd-Frank amended the Securities Acts to include SBS in the statutory definitions of "security". In order to avoid unintended consequences, the SEC issued a temporary exemption clarifying that a number of the 1934 Act provisions applicable to securities will not apply to SBS pending further SEC rulemakings under the Dodd-Frank Act, although federal securities laws prohibiting fraud and manipulation continue to apply. SEC Release No. 34-71435 (Feb. 5, 2014) (order extending temporary exemption of SBS from the definition of "security" under the 1934 Act until February 11, 2017).

iii) Mixed Swaps. Mixed swaps are a narrow category of products that fall within both the SBS and the swap definition. CEA § 1a(47); 1934 Act § 3(a)(68). To avoid duplicative and conflicting regulations, the SEC and the CFTC provide for an alternative regulatory structure in certain situations. See Product Definition Final Rules.

iv) Excluded Products. Products excluded from being regulated as a swap, SBS or mixed swap include (a) futures contracts or options on futures contracts, (b) options on securities or securities indices, (c) certain "identified banking products", (d) non-financial commodity forwards, (e) commodity trade options, (f) retail commodity and FX transactions, (g) insurance products, (h) certain loan participations, and (i) certain consumer and commercial transactions. See CEA § 1a(47)(B); 1934 Act § 3(a)(68)(c); Product Definition Final Rules. See also 81 Fed. Reg. 20583 (Apr. 8, 2016) (CFTC and SEC proposed joint guidance to exclude certain contracts related to electric power and natural gas from definition of swap), CFTC and SEC, Forward Contracts with Embedded Volumetric Optionality, 80 Fed. Reg. 28239 (May 18, 2015) (final interpretation), 79 Fed. Reg. 69073 (Nov. 20, 2014) (proposed interpretation); 77 Fed. Reg. 25320 (Apr. 27, 2012) (final rule and interim final rule: Commodity Options), 76 Fed. Reg. 6095 (Feb. 3, 2011) (proposed rule: Commodity Options and Agricultural Swaps).

Additionally, the Secretary of the Treasury has exempted certain FX forwards and FX swaps from certain swap regulations. See 77 Fed. Reg. 69694 (Nov. 20, 2012) (notice of final determination).

B) Swap and SBS Dealers and Major Swap and SBS Participants

Title VII of Dodd-Frank subjects swap dealers ("Swap Dealers") and MSPs, as well as SBS dealers ("SBS Dealers") and major SBS participants ("Major SBS Participants") (collectively, "Swap Entities") to new regulatory requirements applicable to their swap or SBS activities. See CEA § 4s; 1934 Act §15F.

i) <u>Definitions</u>

(a) <u>Dealers</u>. A Swap Dealer or SBS Dealer is an entity that -- subject to limited exceptions, such as a <u>de minimis</u> exception and an exception for any "insured depository institution" that offers to enter into a swap with a customer in connection with originating a loan with that customer -- (i) holds itself out as a dealer in swaps or SBS; (ii) makes a market in swaps or SBS; (iii) regularly enters into swaps or SBS in the ordinary course of business for its own account; or (iv) engages in an activity causing the person to be commonly known in the trade as a dealer or market-maker in swaps or SBS. <u>See</u> § 1a(49); 1934 Act § 3(a)(71). <u>See also</u> 77 Fed. Reg. 30596 (May 23, 2012) (Joint CFTC/SEC Final Rule: Further Definition of "Swap Dealer," ["SBS Dealer"]," ["MSP"], ["Major SBS Participant"], and ["ECP"]), 77 Fed. Reg. 39626 (July 5, 2012) (Correction) ("<u>Joint Entity Definitions</u>"); 75 Fed. Reg. 80174 (Dec. 21, 2010) (proposed rule). <u>See also</u> <u>Order of a Limited Purpose Designation for State Street Bank</u> (CFTC, Dec. 19, 2013); <u>Order of a Limited Purpose Designation for Cargill, Inc. and an Affiliate</u> (CFTC, Oct. 29, 2013); "Cost-Benefit Analysis of the CFTC's Proposed Swap Dealer Definition Proposed for the Working Group of Commercial Energy Firms" (NERA Economic Consulting, Dec. 20, 2011).

The de minimis exceptions are subject to a phase-in period, after which the de minimis thresholds will automatically be reduced if the agencies do not take further action. See Swap Dealer De Minimis Exception Final Staff Report (CFTC, Aug. 15, 2016); Sec. Reg. & Law Rep., Jan. 25, 2016 (ISDA, SIFMA and others asked the CFTC to keep de minimis exception at $8 billion).

(b) Major Participants. A MSP or Major SBS Participant is defined as any person that is not a Swap Dealer or SBS Dealer, and (i) maintains a substantial position in swaps or SBS for any of the major categories as determined by the CFTC or the SEC (excluding positions held for hedging or mitigating commercial risk or risks directly associated with the operation of certain employee benefit plans); (ii) whose outstanding swaps or SBS create substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets; or (iii) is a "financial entity" that is highly leveraged relative to the amount of capital it holds, is not subject to capital requirements established by a federal banking agency (each a "Prudential Regulator"), and maintains a substantial position in outstanding swaps or SBS in any major category of transaction as determined by the CFTC or the SEC. See CEA § 1a(33); 1934 Act § 3(a)(67). The relevant threshold definitions and computations are further specified in the Joint Entity Definitions.

ii) Registration. Swap Entities are required to register with the SEC or the CFTC, and there are no exemptions from registration as a Swap Entity for foreign banks or other entities subject to comparable regulation. See 80 Fed. Reg. 48964 (Aug. 14, 2015) (final rule: Registration Process for SBS Dealers and Major SBS Participants) ("SEC Registration Rule"); 77 Fed. Reg. 2613 (Jan. 19, 2012) (final rule: Registration of Swap Dealers and MSPs); SEC Release No. 34-65543 (Oct. 12, 2011) (proposed rule); 75 Fed. Reg. 71379 (Nov. 23, 2010) (proposed rule). See also 80 Fed. Reg. 55022 (Sept. 14, 2015) (final rule requiring registered introducing brokers, CPOs and CTAs to become members of the NFA); SEC Release No. 34-75612 (Aug. 5, 2015) (proposed rule: Applications by SBS Dealers or Major SBS Participants for statutory disqualified associated persons to effect or be involved in effecting SBSs).

iii) External Business Conduct Standards. Swap Entities are subject to extensive sales practice or "external business conduct" standards, including requirements relating to: (a) know-your-counterparty; (b) prohibitions on fraud and other abusive practices, including restrictions on the disclosure or misuse of confidential counterparty information; (c) verification of counterparty eligibility; (d) disclosure of material risks, contract characteristics, material incentives and conflicts of interest, pre- and post-trade marks and counterparty clearing rights; (e) fair and balanced communications; (f) institutional suitability; (g) heightened obligations when trading with, or acting as an advisor for, "Special Entities" (i.e., certain pension plans, municipal unions and endowments); and (h) restrictions on political contributions in connection with swap/SBS business. See CEA § 4s(h); 1934 Act § 15F(h); 77 Fed. Reg. 9734 (Feb. 17, 2012) (CFTC final rule: Business Conduct Standards for Swap Dealers and MSPs with Counterparties), 75 Fed. Reg. 80638 (Dec. 22, 2010) (CFTC proposed rule); 81 Fed. Reg. 29960 (May 13, 2016) (SEC final rule: Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants); 76 Fed. Reg. 42396 (July 18, 2011) (SEC proposed rule). See also 81 Fed. Reg. 39809 (June 17, 2016) (SEC final rule on SBS trade acknowledgment and verification); CFTC Adopts External Business Conduct Standards (Cleary Gottlieb, Apr. 12, 2012).

Formalized procedures set forth in the ISDA August 2012 [DFA] Protocol have increased the speed and efficiency of amending swap documentation to bring it into compliance with these rules.

The CFTC has provided no-action relief from certain of the external business conduct standards to Swap Entities in a variety of circumstances. See, e.g., CFTC No-Action Letter No. 15-21 (Mar. 31, 2015), CCH Comm. Fut. L. Rep. ¶ 33,445 (remedial actions taken with respect to certain "legacy SPV swaps"); CFTC No-Action Letter No. 13-70 (Nov. 15, 2013), CCH Comm. Fut. L. Rep. ¶ 32,859 (certain "intended-to-be-cleared" swaps); CFTC No-Action Letter No. 13-12 (May 1, 2013), CCH Comm. Fut. L. Rep. ¶ 32,610 (obligation to provide pre-trade mid-market mark); CFTC No-Action Letter No. 13-11 (Apr. 30, 2013), CCH Comm. Fut. L. Rep. ¶ 32,609 (allowing prime brokers and executing dealers that are both Swap Entities to allocate external requirements between one another); CFTC No-Action Letter No. 12-58 (Dec. 18, 2012), CCH Comm. Fut. L. Rep. ¶ 32,480 (obligation to provide pre-trade mid-market mark); CFTC No-Action Letter No. 12-42 (Dec. 6, 2012), CCH Comm. Fut. L. Rep. ¶ 32,457 (pre-trade mid-market marks with respect to certain FX transactions); CFTC No-Action Letter No. 12-33 (Nov. 29, 2012), CCH Comm. Fut. L. Rep. ¶ 33,441 (providing that Swap Dealers that comply with the "pay-to-play" rules of the SEC and/or MSRB in dealings with "governmental plans" under ERISA will be deemed to have complied with the analogous CFTC rules).

iv) Internal Business Conduct Standards. Swap Entities are subject to extensive internal business conduct standards, including requirements relating to: (a) mitigation of internal conflicts of interest; (b) chief compliance officers; (c) risk management programs; (d) reporting, recordkeeping and daily trading records; (e) monitoring of position limits; (f) diligent supervision; (g) business continuity and disaster recovery; (h) antitrust considerations; (i) swap/SBS confirmations; (j) portfolio reconciliation; (k) portfolio compressions; and (l) trading relationship and clearing documentation. See CEA §§ 4s(h) and (j); 1934 Act §§ 15F(h) and (j); 81 Fed. Reg. 53343 (Aug. 12, 2016) (proposed rule: codification of CFTC No-Action Letter No. 15-15 permitting submission of chief compliance officer annual reports 90 days after fiscal year-end); SEC Release No. 34-78011 (June 8, 2016) (final rule: Trade Acknowledgment and Verification of Security-Based Swap Transactions); SEC Release No. 34-77617 (Apr. 14, 2016) (final rule: Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants); 81 Fed. Reg. 27309 (May 6, 2016) (final rule: Definitions of "Portfolio Reconciliation" and "Material Terms" for Purposes of Swap Portfolio Reconciliation); 77 Fed. Reg. 55904 (Sept. 11, 2012) (final rule: Confirmation, Portfolio Reconciliation Portfolio Compression and Swap Trading Relationship Documentation for Swap Dealers and MSPs); 77 Fed. Reg. 21278 (Apr. 9, 2012) (final rule: Customer Clearing Documentation, Timing of Acceptance for Clearing and Clearing Member Risk Management); 77 Fed. Reg. 20128 (Apr. 3, 2012) (final rule: Swap Dealer and MSP Recordkeeping, Reporting and Duties Rules; FCM and IB Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, MSPs and FCMs); SEC Release No. 34-63737 (Jan. 14, 2011) (proposed rule: Trade Acknowledgment and Verification of SBS Transactions).

Formalized procedures set forth in the ISDA March 2013 [DFA] Protocol have increased the speed and efficiency of amending swap documentation to bring it into compliance with these rules.

The CFTC has provided no-action relief from certain of the internal business conduct standards to Swap Entities in certain circumstances. See, e.g., CFTC Staff Advisory No. 16-62 (July 25, 2016) (clarifying reporting lines for chief compliance officer); CFTC No-Action Letter No. 15-15 (Mar. 27, 2015), CCH Comm. Fut. L. Rep. ¶ 33,437 (permitting submission of chief compliance officer annual reports 90 days, rather than 60 days, after fiscal year-end); CFTC No-Action Letter. No. 14-158 (Nov. 25, 2014), CCH

Comm. Fut. L. Rep. ¶ 33,393 (permitting chief compliance officer to report to a governing body instead of a board of directors or senior officer, subject to certain conditions); CFTC No-Action Letter 13-70 (Nov. 15, 2013), CCH Comm. Fut. L. Rep. ¶ 32,859 (certain regulatory obligations of Swap Dealers and MSPs in the context of an "Intended-To-Be-Cleared Swap"); CFTC No-Action Letter No. 13-45 (July 11, 2013), CCH Comm. Fut. L. Rep. ¶ 32,674 (allowing Swap Entities to comply with either CFTC or EU regulations with respect to swap confirmation, swap portfolio reconciliation, swap portfolio compression and swap trading relationship documentation).

See also International Standards for Derivatives Market Intermediary Regulation (IOSCO, June 2012); CFTC Adopts Internal Business Conduct Standards (Cleary Gottlieb, Apr. 17, 2012).

v) Capital Requirements. Swap Entities are subject to risk-based capital requirements. Generally, the Prudential Regulators prescribe these requirements for Swap Entities that are banks, and the CFTC and the SEC prescribe them for other Swap Entities. See 80 Fed. Reg. 74840 (Nov. 30, 2015) (Prudential Regulator final rule) (Margin and Capital Requirements for Covered Swap Entities); 79 Fed. Reg. 57348 (Sept. 24, 2014) (Prudential Regulator re-proposal of margin and capital requirements for covered swap entities); 77 Fed. Reg. 70214 (Nov. 23, 2012) (SEC proposed rule) (Capital, Margin, and Segregation Requirements for Swap Entities and Capital Requirements for Broker-dealers); 76 Fed. Reg. 27802 (May 12, 2011) (CFTC Notice of Proposed Rulemaking: Capital

Requirements of Swap Dealers and MSPs) (proposing different capital regimes for swap dealers and MSPs that are (A) subsidiaries of BHCs, (B) commercial and other firms that are not part of BHCs, and (C) FCMs); 76 Fed. Reg. 27564 (May 11, 2011) (Prudential Regulator proposed rule) (Margin and Capital Requirements for Swap Entities). In the case of foreign banks whose home country supervisor has adopted capital standards consistent with the Basel Accord, the home country's capital standards would apply. CEA § 4s(e); 1934 Act § 15F(e).

vi) <u>Margin Requirements for Uncleared Swaps and SBS</u>. Dodd-Frank requires regulators to impose both initial and variation margin requirements for Swap Entities on all swaps and SBS that are not cleared by a registered clearinghouse. Generally, the Prudential Regulators prescribe these requirements for a Swap Entity that is a bank, and the CFTC and the SEC prescribe them for other Swap Entities. <u>See</u> CEA § 4s(e); 1934 Act § 15F(e); 81 Fed. Reg. 34818 (May 31, 2016) (CFTC final rule: Cross-Border Application of the Margin Requirements); 81 Fed. Reg. 636 (Jan. 6, 2016) (CFTC final rule: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants); 80 Fed. Reg. 74840 (Nov. 30, 2015) (Prudential Regulator final rule: Margin and Capital Requirements for Covered Swap Entities); 79 Fed. Reg. 59898 (Oct. 3, 2014) (CFTC re-proposed rule); 79 Fed. Reg. 57348 (Sept. 24, 2014) (Prudential Regulators re-proposed rule); 77 Fed. Reg. 70214 (Nov. 23, 2012) (SEC proposed rule) (Capital, Margin, and Segregation Requirements for Swap Entities and Capital Requirements for Broker-dealers); 76 Fed. Reg. 27564 (May 11, 2011)

(Prudential Regulators proposed rule); 76 Fed. Reg. 23732 (Apr. 28, 2011) (CFTC proposed rule). See generally Risk Mitigation Standards for Non-centrally Cleared OTC Derivatives (IOSCO, Jan. 28, 2015); Margin Requirements for Non-centrally-cleared Derivatives (BIS/IOSCO, Mar. 2015); Second Consultative Document: Margin Requirements for Non-centrally-cleared Derivatives (BIS/IOSCO, Mar. 2013); Consultative Document: Margin Requirements for Non-centrally-cleared Derivatives (BIS/IOSCO, July 2012).

The Prudential Regulators and the CFTC adopted a phased implementation. Variation margin requirements were effective September 1, 2016 for the most active market participants and will apply March 1, 2017 for all other market participants. Initial margin requirements are phased in from September 1, 2016 through September 1, 2020 depending on the level of a market participant's uncleared swap and uncleared security-based swap market exposure. While there have been substantial efforts toward the international harmonization of margin requirements for uncleared derivatives, the EU has delayed the implementation of its margin requirements to allow more time to approve final technical standards. Japanese margin requirements track the U.S. implementation schedule.

See CFTC No-Action Letter No. 16-70 (Sept. 1, 2016) (providing relief on compliance date for initial margin not initially segregated at an unaffiliated custodian); Sec. Reg. & Law Rep., Mar. 14, 2016 (requirements under new EU rules would require billions in additional collateral); Implications of Collateral Settlement Fails (PWC/DTCC, Feb. 2016);

Agencies Finalize Margin Rules for Non-Cleared Swaps and Security-Based Swaps (Cleary Gottlieb, Jan. 28, 2016); Letter from Senator Warren and Rep. Cummings to CFTC Chairman Massad and SEC Chair White, Nov. 10, 2015 (urging stronger margin rules after repeal of swaps push-out); ISDA Margin Survey 2015 (ISDA, Aug. 2015); OCC Memorandum (Aug. 28, 2014) (economic impact analysis of swaps margin proposed rule); OTC Derivatives Reform Collateral Management: New Game, New Rules -- Ready to Play (Deloitte, 2011).

vii) Segregation Requirements for Uncleared Swaps and SBS. In addition to the mandatory segregation of initial margin required under the margin rules described above, Dodd-Frank requires the CFTC and SEC to impose requirements for Swap Entities to notify their swap and SBS counterparties of the right to elect to have other initial margin collected by the Swap Entity segregated at an independent third party custodian. See 78 Fed. Reg. 66621 (Nov. 6, 2013) (CFTC final rule) (Protection of Collateral of Counterparties to Uncleared Swaps); 77 Fed. Reg. 70214 (Nov. 23, 2012) (SEC proposed rule) (Capital, Margin, and Segregation Requirements for Swap Entities and Capital Requirements for Broker-dealers); see also CFTC Letter No. 14-132 (Oct. 31, 2014), CCH Comm. Fut. L. Rep. ¶ 33,326 (CFTC interpretive guidance regarding initial margin segregation requirements).

viii) Swaps "Push Out" Issues. Dodd-Frank § 716 originally included a swaps "push-out" provision that prohibited Swap Entities from receiving certain forms of federal assistance, including programs such as the Board's discount window and FDIC deposit insurance.

This prohibition took effect on July 16, 2013, subject to a potential extension for up to an additional three years in the case of an insured depository institution. See 78 Fed. Reg. 1306 (Jan. 8, 2013) (Notice of Guidance: Transition Period Under § 716 of Dodd-Frank); 77 Fed. Reg. 27456 (May 10, 2012) (Notice of Joint Guidance: Guidance on the Effective Date of § 716 of Dodd-Frank). The OCC and the Board granted numerous extensions under § 716.

The Consolidated and Further Continuing Appropriations Act of 2015, Pub. L. 113-235, effected two significant amendments to the "swaps push-out" provision. First, it codified the eligibility of U.S. branches and agencies of foreign banks for the exception to the Federal assistance prohibition available only to IDIs under the original provision. Second, it limited the prohibition for qualifying "covered depository institutions" to certain "structured finance swaps" that are not entered into for hedging or risk management purposes. Although the Act did not repeal § 716, its amendments will permit both IDIs and the uninsured U.S. branches and agencies of foreign banks to continue to engage in a broader scope of swaps activities than was originally permitted. See Amendments to Dodd-Frank Swaps Push-Out Provision Passed in Omnibus Spending Bill (Cleary Gottlieb, Dec. 17, 2014). See also Letter from Senator Warren and Rep. Cummings to GAO, Nov. 10, 2015 (urging study of effects of repeal of portion of § 716); Letter from Comptroller of Currency Thomas Curry to Senator Warren, Aug. 13, 2015.

C) Mandatory Clearing and Trading Requirements

i) Mandatory Clearing. Dodd-Frank gives the CFTC and the SEC the authority, either upon application by a derivatives clearing organization (a "DCO") or clearing agency or upon their own initiative, to require designated swaps and SBS to be cleared. See CEA § 2(h); 1934 Act §§ 3B, 17A(g)-(m); 77 Fed. Reg. 74284 (Dec. 13, 2012) (final rule) (Clearing Requirement Determination Under Section 2(h) of the CEA); 77 Fed. Reg. 41602 (July 13, 2012) (final rule) (Process for Submissions for Review of SBS for Mandatory Clearing and Notice Filing Requirements for Clearing Agencies); 76 Fed. Reg. 44464 (July 26, 2011) (final rule) (Process for Review of Swaps for Mandatory Clearing). See also CFTC Press Release, June 23, 2016 (requesting comment on submissions from DCOs regarding additional swaps to become subject to mandatory clearing requirement); 81 Fed. Reg. 39506 (June 16, 2016) (proposed rule) (proposing additional clearing determinations for interest rate swaps in certain additional foreign currencies); Clearing of deliverable FX instruments (BIS/IOSCO, Feb. 5, 2016); Clearing – Balancing CCP and Member Contributions with Exposures (CME, Jan. 2015); "Clearing [OTC] Derivatives", Economic Perspectives (FRBC, 4Q 2011).

(a) Limited exceptions to the mandatory clearing requirement apply to swaps entered into by certain commercial end-users. Exemptions have also been adopted for swaps by small bank/thrift holding companies, cooperatives, capital finance entities and for certain affiliate transactions. See CFTC

No-Action Letter No. 16-05 (Feb. 1, 2016), CCH Comm. Fut. L. Rep. ¶ 33,635 (relief to Eurex Clearing for documents with, and placement of clearing funds at, Bundesbank); CFTC No-Action Letter No. 16-04 (Feb. 1, 2016), CCH Comm. Fut. L. Rep. ¶ 33,634 (relief to Eurex AG from straight-through processing requirements during pendency of EU rulemakings); CFTC No-Action Letter No. 16-01 (Jan. 8, 2016), CCH Comm. Fut. L. Rep. ¶ 33,630 (relief for small bank and savings and loan holding companies); CFTC No-Action Letter No. 16-02 (Jan. 8, 2016), CCH Comm. Fut. L. Rep. ¶ 33,631 (relief for community development financial institutions); CFTC No-Action Letter No. 15-63 (Nov. 17, 2015), CCH Comm. Fut. L. Rep. ¶ 33,591 (extending time-limited relief permitting compliance with alternative conditions to inter-affiliate clearing exemption); CFTC No-Action Letter No. 14-144 (Nov. 26, 2014), CCH Comm. Fut. L. Rep. ¶ 33,359 (eligible treasury affiliates); 78 Fed. Reg. 52286 (Aug. 22, 2013) (final rule) (Clearing Exemption for Certain Swaps Entered Into by Cooperatives); 78 Fed. Reg. 21750 (Apr. 11, 2013) (final rule) (Clearing Exemption for Swaps Between Certain Affiliated Entities); 77 Fed. Reg. 42560 (July 19, 2012) (final rule) (End-user Exception to the Clearing Requirement for Swaps); SEC Release No. 34-63556 (Dec. 15, 2010) (proposed rule) (End-user Exemption to Mandatory Clearing of SBS). <u>See also</u> CFTC No-Action Letter No. 15-27 (May 4, 2015), CCH

Comm. Fut. L. Rep. ¶ 33,461 (clarifying that certain securitization special purpose vehicles qualify as captive finance companies); CFTC Letter No. 15-51 (Sept. 18, 2015), CCH Comm. Fut. L. Rep. ¶ 33,543 (interpretation regarding "firm or forced trades"); CFTC No-Action Letter No. 13-02 (Mar. 20, 2013), CCH Comm. Fut. L. Rep. ¶ 32,560 (relief for certain partially novated or terminated swaps); CFTC No-Action Letter No. 13-01 (Mar. 18, 2013), CCH Comm. Fut. L. Rep. ¶ 32,559 (relief for multilateral portfolio compression exercises).

(b) The mandatory clearing requirement does not apply to swaps entered into by foreign governments, foreign central banks and certain multinational financial institutions. This exclusion does not extend to sovereign wealth funds ("SWFs") and similar entities whose activities are predominantly commercial in nature. 77 Fed. Reg. 42560, 42562 (July 19, 2012). See also CFTC No-Action Letter No. 13-25 (June 10, 2013), CCH Comm. Fut. Rep. L. ¶ 32,645 (Corporacion Andina de Fomento).

(c) Margin accepted for cleared swaps is subject to certain segregation requirements, and investment of the margin is restricted. 78 Fed. Reg. 68506 (Nov. 14, 2013) (final rule) (Enhancing Protections Afforded Customers and Customer Funds Held by FCMs and DCOs). See also Morgan Stanley, CFTC Docket No. 15-26 (Aug. 6, 2015) (penalty for violations of customer protection rule for cleared swaps and related supervision failures); 77 Fed. Reg. 6336 (Feb. 7, 2012) (final rule) (Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions).

(d) DCOs and clearing agencies themselves are subject to enhanced risk-management and other standards established by the CFTC or the SEC. See 81 Fed. Reg. 64322 (Sept. 19, 2016) (system safeguard final rule for DCOs); CFTC Memorandum No. 15-50 (Sept. 18, 2015) (CFTC staff interpretation regarding consistency between DCO core principles and the Principles for Financial Market Infrastructures); 78 Fed. Reg. 72476 (Dec. 2, 2013) (final rule) (DCOs and International Standards); 78 Fed. Reg. 49663 (Aug. 15, 2013) (final rule) (Enhanced Risk Management Standards for Systemically Important DCOs); 77 Fed. Reg. 66220 (Nov. 2, 2012) (final rule) (Clearing Agency Standards); 76 Fed. Reg. 69334 (Nov. 8, 2011) (final rule) (DCO General Provisions and Core Principles). See also Part IX.G below; Risk Management Supervision of Designated Clearing Entities (Board/SEC/CFTC, July 2011).

ii) Swaps and SBS subject to the mandatory clearing requirement are also required to be traded on an exchange or swap execution facility ("SEF")/SB SEF, unless no exchange or SEF/SB SEF makes the swap or SBS available to trade. CEA § 2(h)(8); 1934 Act

§ 3C(h). SEFs/SB SEF and exchanges are themselves subject to registration and other SEC or CFTC supervisory requirements. See 81 Fed. Reg. 64272 (Sept. 19, 2016) (system safeguard final rule for DCMs, SEFs, and swap data repositories); CFTC Press Release No. 6853-14 (Feb. 10, 2014) (measures to promote trading on SEFs and support an orderly transition to mandatory trading); 78 Fed. Reg. 33476 (June 4, 2013) (final rule) (Core Principles and Other Requirements for SEFs); 78 Fed. Reg. 33606 (June 4, 2013) (final rule) (Process for a Designated Contract Market ("DCM") or SEF to Make a Swap Available to Trade); 77 Fed. Reg. 36612 (June 19, 2012) (final rule) (Core Principles and Other Requirements for DCMs); SEC Release No. 34-63825 (Feb. 2, 2011) (proposed rule) (Proposed Interpretation: Registration and Regulation of SBS Execution Facilities). See also CFTC No-Action Letter No. 16-58 (June 10, 2016), CCH Comm. Fut. L. Rep. ¶ 33,775 (temporary relief for correction of trades rejected from clearing due to clerical or operational errors); CFTC No-Action Letter No. 16-25 (Mar. 14, 2016), CCH Comm. Fut. L. Rep. ¶ 33,690 (temporary relief from certain SEF recordkeeping requirements in connection with SEF-executed uncleared swaps); CFTC Letter No. 15-67 (Dec. 21, 2015), CCH Comm. Fut. L. Rep. ¶ 33,618 (interpretive guidance regarding straight through processing and affirmation requirements of SEF cleared swaps); CFTC Letter No. 15-62 (Nov. 17, 2015), CCH Comm. Fut. L. Rep. ¶ 33,590 (extending time-limited no-action relief from trade execution requirement for swaps between certain affiliated entities); CFTC No-Action Letter No. 15-60 (Nov. 2, 2015), CCH Comm. Fut. L. Rep. ¶ 33,584 (extending no-action relief for SEFs from certain block trade requirements); CFTC No-Action Letter No. 15-55 (Oct. 14, 2015), CCH Comm. Fut. L. Rep. ¶ 33,568 (temporary relief from trade execution required for certain "package transactions").

See also Centralized Trading, Transparency and Interest Rate Swap Market Liquidity: Evidence from the Implementation of the Dodd-Frank Act (Bank of England, Jan. 2016); CFTC Commissioner Giancarlo Pro-Reform Reconsideration of the CFTC Swaps Trading Rules: Return to Dodd-Frank (Jan. 29, 2015); Follow-on Analysis to the Report on Trading of OTC Derivatives (IOSCO, Jan. 2012).

iii) Dodd-Frank requires the CFTC and the SEC to adopt rules to mitigate conflicts of interest posed by the control of DCOs/clearing agencies, exchanges and SEFs/SB SEFs by Swap Entities and a wide range of other industry participants. See SEC Release No. 34-64018 (Mar. 3, 2011) (reopening of comment period); 76 Fed. Reg. 722 (Jan. 6, 2011) (proposed rule) (Governance Requirements for DCOs, DCMs and SEFs; Additional Requirements Regarding the Mitigation of Conflicts of Interest); 75 Fed. Reg. 63732 (Oct. 18, 2010) (proposed rule) (Requirements for DCOs, DCMs and SEFs Regarding the Mitigation of Conflicts of Interest); SEC Release No. 34-63107 (Oct. 14, 2010) (proposed rule) (Ownership Limitations and Governance Requirements for SBS Clearing Agencies, SEFs and National Securities Exchanges with Respect to SBS).

iv) As of September 2016, the following DCOs had registered with the CFTC: Cantor

Clearinghouse, L.P.; CME; Eurex Clearing AG; ICE Clear Credit LLC; ICE Clear Europe Limited; ICE Clear US; LCH.Clearnet LLC; LCH.Clearnet Ltd.; LCH.Clearnet SA; Minneapolis Grain Exchange; Natural Gas Exchange; Nodal Clear, LLC; North American Derivatives Exchange; Options Clearing Corporation; Singapore Exchange Derivatives Clearing Limited. One DCO, CME Clearing Europe Limited, had its registration application pending with the CFTC. The following DCOs received exemptions from DCO registration: ASX Clear (Futures) PTY Limited, Japan Securities Clearing Corporation, Korea Exchange and OTC Clearing Hong Kong Limited.

The following SEFs had registered with the CFTC: 360 Trading Networks; BGC Derivatives Markets, L.P.; Bloomberg SEF LLC; CME; Clear Markets North America; DW SEF LLC; FTSEF LLC; GFI Swaps Exchange LLC; GTX SEF LLC; ICAP Global Derivatives Limited; ICAP SEF (US) LLC; ICE Swap Trade LLC; Javelin SEF, LLC; LatAm SEF, LLC; MarketAxess SEF Corporation; Seed SEF LLC; SwapEx LLC; TeraExchange, LLC; Thomson Reuters (SEF) LLC; tpSEF; Tradition SEF; trueEX LLC; and TW SEF LLC. One SEF, EBS Global Facility Ltd, had its registration pending with the CFTC. See also CFTC No-Action Letter No. 16-72 (Sept. 14, 2016), CCH Comm. Fut. L. Rep. ¶ 33,855 (relief under No-Action Letter No. 15-29 to Yieldbroker Pty Limited); CFTC No-Action Letter No. 15-60 (Nov. 2, 2015), CCH Comm. Fut. L. Rep. ¶ 33,589 (conditional relief for SEFs from certain requirements in definition of "block trade"); CFTC No-Action Letter No. 15-29 (May 15, 2015), CCH Comm. Fut. L. Rep. ¶ 33,471 (providing conditional no-action relief for swaps trading on certain Australian financial markets).

v) Banks and BHCs that are, or that own, clearing members of central counterparties are subject to favorable capital requirements with respect to such exposures. See 12 C.F.R. §§ 3.35 and 3.133 (OCC), 217.35 and 217.133 (Board), and 324.34 and 324.133 (FDIC). See also Capital Requirements for Bank Exposures to Central Counterparties (BIS, Apr. 2014); Consultative Document: Capital Treatment of Bank Exposures to Central Counterparties (BIS, Sept. 2013); Capital Requirements for Bank Exposures to Central Counterparties (BIS, July 2012).

D) Position Limits

i) Dodd-Frank amended the CEA to extend position limits beyond listed futures and option contracts to swaps that are economically equivalent to such contracts. See 81 Fed. Reg. 38458 (June 13, 2016) (proposed rule) (Position Limits for Derivatives: Certain Exemptions and Guidance); 80 Fed. Reg. 58365 (Sept. 29, 2015) (proposed rule) (Aggregation of Positions); 78 Fed. Reg. 75680 (Dec. 12, 2013) (proposed rule) (Position Limits for Derivatives); 78 Fed. Reg. 68946 (Nov. 14, 2013) (proposed rule) (Aggregation of Positions); ISDA v. CFTC, 887 F.Supp.2d 259 (D.D.C. 2012) (vacating CFTC rules related to position limits); 76 Fed. Reg. 71626 (Nov. 18, 2011) (final rule and interim final rule) (Position Limits for Futures and Swaps).

ii) The CFTC has also adopted requirements for reporting positions on physical commodity swaps subject to position limits. See Large Trader Reporting for Physical Commodity Swaps: Division of Market Oversight Guidebook for Part 20 Reports (CFTC, June 22, 2015); CFTC Staff Advisory No. 15-14 (Mar. 23, 2015), CCH Comm. Fut. L. Rep ¶ 33,433 (reminding FCMs, clearing members, foreign brokers, SDs, and certain reporting markets of their reporting obligations pursuant to the ownership and control final rule); 78 Fed. Reg. 69178 (Nov. 18, 2013) (final rule) (Ownership and Control Reports, Forms 102/102S, 40/40S, and 71); 76 Fed. Reg. 43851 (July 22, 2011) (final rule) (Large Trader Reporting for Physical Commodity Swaps). The CFTC has brought several enforcement actions against swap dealers for filing inaccurate large trader reports. See, e.g., In the Matter of Barclays Bank PLC, CFTC Docket No. 16-20 (July 6, 2016); In the Matter of JP Morgan Ventures Energy Corp. and JP Morgan Chase Bank N.A., CFTC Docket No. 16-11 (Mar. 23, 2016); In the Matter of Australia and New Zealand Banking Group Ltd., CFTC Docket No. 15-31 (Sept. 17, 2015).

E) Reporting Requirements

i) Dodd-Frank imposes real-time public reporting, regulatory reporting and recordkeeping requirements on parties to a swap or SBS transaction. The real-time public reporting rules require market participants to report swap or SBS transaction and pricing data to a swap or SBS data repository as soon as technologically practicable after execution. See, e.g., 81 Fed. Reg. 53546 (Aug. 12, 2016) (SEC final rule on reporting requirements of clearing agencies and SEFs); SEC Release No. 34-74244 (Feb. 11, 2015) (final rule)

(Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information); SEC Release No. 34-74245 (Feb. 11, 2015) (proposed rule and guidance) (Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information); 77 Fed. Reg. 1182 (Jan. 9, 2012) (final rule) (Real-time Public Reporting of Swap Transaction Data). The information reported to a swap or SBS data repository is made available to the public, without counterparty identifying information. See also, e.g., CFTC v. Deutsche Bank AG, No. 16-cv-06544 (SDNY Aug. 18, 2016) (complaint alleging repeated failure to report swaps data and data integrity issues, many in violation of 2015 settlement); In the Matter of Deutsche Bank AG, CFTC Docket No. 15-40 (Sept. 30, 2015) (settlement of CFTC enforcement case for swaps reporting violations and related supervision failures); Post-Trade Transparency in the Credit Default Swaps Market (IOSCO, Aug. 2015) (analysis of impact of post-trade transparency through public dissemination of price and volume information for individual transactions in the credit default swaps market).

ii) The CFTC and the SEC are required to prescribe rules for delayed reporting of large notional swap transactions (i.e., block trades). See 78 Fed. Reg. 32866 (May 31, 2013) (final rule) (Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-facility Swaps and Block Trades).

iii) Market participants are also required to report a more detailed set of swap/SBS transaction data to a registered swap/SBS data repository or, if a swap/SBS data repository is not available for the swap or SBS, to the CFTC or the SEC. See 81 Fed. Reg. 41736 (June 27, 2016) (final rule) (CFTC Amendments to Swap Data Recordkeeping and Reporting Requirements for Cleared Swaps); 81 Fed. Reg. 14966 (Mar. 21, 2016) (CFTC final rule removing certain reporting and recordkeeping requirements for end users); 80 Fed. Reg. 14564 (Mar. 19, 2015) (final SBS reporting rules); 80 Fed. Reg. 14740 (Mar. 19, 2015) (proposed amendments to SBS reporting rules); 77 Fed. Reg. 35200 (June 12, 2012) (final rule) (Swap Data Recordkeeping and Reporting Requirements: Pre-enactment and Transition Swaps); 77 Fed. Reg. 2136 (Jan. 13, 2012) (final rule) (Swap Data Recordkeeping and Reporting Requirements). See also SEC Adopts Rules Regarding Reporting and Dissemination of Security-Based Swap Information and Proposes Further Amendments to the Reporting Rules (Cleary Gottlieb, Apr. 20, 2015); Draft Technical Specifications for Certain Data Elements (CFTC, Dec. 22, 2015) (request for comment); 79 Fed. Reg. 16689 (Mar. 26, 2014) (request for comment) (Review of Swap Data Recordkeeping and Reporting Requirements).

The CFTC has provided time-limited conditional no-action relief from certain aspects of the reporting requirements. See, e.g., CFTC No-Action Letter No. 16-03 (Jan. 15, 2016), CCH Comm. Fut. L. Rep. ¶ 33,632 (extending no-action relief from reporting certain counterparty identifying information for specified jurisdictions due to conflicting privacy, blocking and secrecy laws); CFTC No-Action Letter No. 15-61 (Nov. 9, 2015), CCH Comm. Fut. L. Rep. ¶ 33,588 (extending no-action relief from reporting certain non-U.S. swaps for certain non-U.S. swap entities); CFTC No-Action Letter No. 15-60 (Nov. 2, 2015), CCH Comm. Fut. L. Rep. ¶ 33,584 (temporary relief from the "occurs away" requirement for certain block trades).

This information will be used by various regulators to fulfill their regulatory mandates, including analyzing systemic risk, market abuse and market trends. See 81 Fed. Reg. 60585 (Sept. 2, 2016) (SEC rule requiring swap data repositories to make data available to regulators and other authorities); Report on FSB Members' Plans to Address Legal Barriers to Reporting and Accessing OTC Derivatives Transaction Data (FSB, Aug. 26, 2016).

iv) Swap/SBS data repositories are themselves subject to various registration and compliance requirements under the CEA and the 1934 Act. See CEA § 21(d); 81 Fed. Reg. 64272 (Sept. 19, 2016) (CFTC final rule on systems safeguards for DCMs, SEFs and swap data repositories); SEC Release No. 34-78716 (Aug. 29, 2016) (final rule) (Access to Data Obtained by SBS Data Repositories); 80 Fed. Reg. 14438 (Mar. 19, 2015) (final rule regarding SBS Data Repository Registration, Duties and Core Principles); 77 Fed. Reg. 65177 (Oct. 25, 2012) (Final Interpretative Statement: Swap Data Repositories: Interpretative Statement Regarding the Confidentiality and Indemnification Provisions of CEA § 21(d)); 76 Fed. Reg. 54538 (Sept. 1, 2011) (final rule) (Swap Data Repositories: Registration Standards, Duties and Core Principles). See also SEC Release No. 34-78216 (June 30, 2016) (DTCC Data Repository (U.S.) LLC Notice of Filing of Application for Registration as an SBS Data Repository); SEC Release No. 34-78215A (June 30, 2016) (order extending temporary exemption from SBS data repository registration until October 5, 2016); SEC Release No. 34-77699 (Apr. 22, 2016) (ICE Trade Vault, LLC Notice of Filing of Application for Registration as an SBS Data Repository); BDSR LLC, Order of Provisional Registration (CFTC, Jan. 17, 2014); CME, Order of Provisional Registration (CFTC, Nov. 20, 2012); DTC Data Repository, Order of Provisional Registration (CFTC, Sept. 19, 2012); ICE Trade Vault, Order of Provisional Registration (CFTC, June 27, 2012).

F) Enforcement

i) Dodd-Frank expands the power of the CFTC and the SEC to address disruptive, manipulative, fraudulent and deceptive practices. See 78 Fed. Reg. 31890 (May 28, 2013) (Final Interpretive Guidance and Policy Statement Regarding Antidisruptive Practices Authority). The CFTC has also adopted rules interpreting the statutory mandate to prohibit fraudulent or manipulative behavior largely similar to SEC Rule 10b-5 ("Rule 10b-5") and expanding the regulation of manipulative behavior to cover misconduct affecting ongoing payments or deliveries through the lifetime of a swap. See CEA § 6(c); 1934 Act § 9(j); 76 Fed. Reg. 41398 (July 14, 2011) (final rule) (Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation). The SEC has proposed similar rules. See SEC Release No. 34-63236 (Nov. 3, 2010) (proposed rule): (Prohibition Against Fraud, Manipulation and Deception in Connection with SBS). See also Law360, Mar. 1, 2016 (comparison of SEC and CFTC market abuse regimes); NFA Notice to

Members 1-15-01 (Jan. 5, 2015) (extending NFA Compliance Rule 2-4, which requires members to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their commodity futures business, to a member's swaps business).

ii) The CFTC has brought several enforcement actions alleging "spoofing" activity, i.e. bidding or offering with the intent to cancel the bid or offer before execution. See, e.g., CFTC v. Khara, No. 15-cv-03497 (SDNY Mar. 31, 2016) (consent order); CFTC v. Oystacher, No. 15-cv-09196 (E.D. Ill., Oct. 19, 2015) (complaint); CFTC v. Nav Sarao Futures Limited plc, No. 15-cv-03398 (N.D. Ill., Apr. 17, 2015) (complaint); In the Matter of Panther Energy Trading LLC, CFTC Docket No. 13-26 (July 22, 2013).

iii) Dodd-Frank also amended the CEA and the 1934 Act to provide incentives and protections to a whistleblower who provides information leading to a successful enforcement action relating to a violation of the CEA or securities laws. CEA § 26; 1934 Act § 21F. See also 81 Fed. Reg. 59551 (Aug. 30, 2016) (CFTC proposing modifications to the whistleblower awards process and clarification of enforcement authority over retaliation claims); 76 Fed. Reg. 53172 (Aug. 25, 2011) (final rule) (Whistleblower Incentives and Protection); SEC Releases No. 34-64545 (May 25, 2011) (final rule) (Implementation of the Whistleblower Provisions of 1934 Act § 21F), No. 34-63237 (Nov. 3, 2010) (proposed rule).

G) Effective Dates

i) Dodd-Frank's swap and SBS provisions were initially expected to take effect on July 16, 2011. However, the CFTC and the SEC took steps to clarify or otherwise defer these effective dates.

ii) Most of the CFTC's rules implementing Dodd-Frank's swap rules are now in effect, with the major exception of the Swap Dealer and MSP capital rules. The CFTC and Prudential Regulator margin requirements for uncleared swaps and SBS will be phased in from 2016 to 2020, as described above.

iii) The SEC's relief generally defers the effective dates for relevant rules until after the rules defining SBS, SBS Dealer, Major SBS Participant and ECP take effect. See 79 Fed. Reg. 7731 (Feb. 10, 2014) (Exemptive Order: Temporary Exemptions Under the 1934 Act in Connection with the Revision of the Definition of "Security" to Encompass [SBS], and Request for Comment until 2017); SEC Releases No. 34-71485 (Feb. 5, 2014), No. 34-67166 (June 8, 2012) (Statement of General Policy on the Sequencing of the Compliance Dates for Final Rules Applicable to SBSs Adopted Pursuant to the 1934 Act and Dodd-Frank), No. 34-64800 (July 1, 2011) (Final Temporary Rules Regarding Extension of Temporary Exemptions for Eligible CDS to Facilitate Operation of Central Counterparties to Clear and Settle CDS), No. 34-64678 (June 15, 2011) (Exemptive Order: Temporary Exemptions Together with Information on Compliance Dates for New Provisions of the 1934 Act Applicable to SBS).

The compliance date for the SBS Dealer and Major SBS Participant registration requirement is deferred until the later of: (i) six months after the publication of the final SEC capital, margin and segregation rule; (ii) the compliance date of the final recordkeeping and reporting rule for SBS Dealers and Major SBS Participants; (iii) the compliance date of the business conduct rules for SBS Dealers and Major SBS Participants; and (iv) the compliance date for final rules establishing a process for a registered SBS Dealer or Major SBS Participant to make an application to the SEC to permit an associated person who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on its behalf. See SEC Registration Rule.

iv) With regard to implementation and implications of derivative reforms generally, see, e.g., OTC Derivatives Market Reforms: Eleventh Progress Report on Implementation (FSB, Aug. 26, 2016).

c. Regulatory Oversight

(i) In overseeing derivatives activities, bank regulators focus on (A) board and senior management supervision; (B) internal control, audit, approval, supervisory and reporting systems; and (C) identification, quantification, evaluation, measurement, limitation and control of market (or "price") risk, interest rate and FX risk, credit risk, settlement risk, liquidity risk, transaction risk, operating systems risk, capital (or "strategic") risk, aggregation (or "interconnection") risk (resulting from the manner in which positions in one derivative instrument are tied to other positions), operational risk, legal (or "compliance") risk and reputational risk. See, e.g., Interagency Risk Management Guidance;

Interagency Responses to Minority Staff Report, Attachments A, C, D & E (Sept./Oct. 1993).

See also Part II.A above and Part II.E.3 below.

(ii) The Board framework regarding derivative functions is reflected in, e.g.; Board Trading and Capital Markets Activities Manual; 87 Fed. Res. Bull. 47 (2001); SBC 1995 Order; FRBNY Letter, Apr. 28, 1994 (credit/trading agreements with institutional customers); Board SR Letter 93-69 (FIS) (Dec. 20, 1993), CCH Fed. Banking L. Rep. ¶ 62-152; Derivatives Product Activities of Commercial Banks (Board/Comptroller/FDIC, Jan. 27, 1993).

See also Part II.E.1.c above and Part II.E.3.c.iii below concerning credit derivatives.

(iii) The Comptroller's Handbooks: Financial Derivatives and Trading Activities and Risk Management of Financial Derivatives provide guidance for evaluating derivatives activities. See also Comptroller Banking Circular BC 277 (Oct. 27, 1993), CCH Fed. Banking L. Rep. ¶ 62-152 ("BC 277"), and Comptroller Bulletins updating BC 277, including Bulletins No. 94-31 (May 10, 1994), CCH Fed. Banking L. Rep. ¶ 62-152 (Questions and Answers re BC 277), No. 1999-2 (Jan. 25, 1999), No. 2014-8 (Mar. 24, 2014) and No. 2015-35 (Aug. 4, 2015); Comptroller News Release NR 95-58 (June 7, 1995) (Review of the Sales Practices of the Largest National Bank Derivatives Dealers) (the "Comptroller Sales Practices Review"); Comptroller Unpublished Letter (Oct. 12, 1995); Comptroller News Release NR 95-129 (Nov. 20, 1995) (sales practices and compensation policies).

(iv) FDIC guidance to bank examiners regarding derivatives risk-assessment and management focuses on seven types of risk: market, credit, liquidity, operating, legal, settlement and interconnection risk. See, e.g., FDIC

FIL-60-94 (Aug. 26, 1994); FDIC FIL-34-94 (May 18, 1994), CCH Fed. Banking L. Rep. ¶ 62-286.

d. Disclosure, Litigation and Other Risks

The growth of derivatives markets, along with well-publicized losses and accounting scandals, focused the attention of regulators and market participants on several key areas, including (i) accounting and disclosure, (ii) litigation and enforcement issues, and (iii) individual participation in derivatives markets.

(i) Accounting and Disclosure Issues

A) Sarbanes-Oxley and SEC rules impose a number of disclosure requirements. See generally Sarbanes-Oxley: Analysis and Practice; Disclosures about Derivative Instruments and Hedging Activities (Ernst & Young, Sept. 2008); Disclosures about Credit Derivatives (FASB Staff Paper, Apr. 2008); SEC Release No. 34-45321 (Jan. 22, 2002) (disclosure of liquidity and capital resources and exposures, including off-balance sheet arrangements, trading activities in OTC derivatives, and related party transactions).

See also Part I.A.8.d above and Part V.A.3 and Part XI below.

B) Governmental and industry reviews focused on disclosure regarding market, liquidity, operational and legal risk, fair/market values, asset composition and structured finance. See, e.g., Progress Reports on Implementation of Disclosure Recommendations (FSB Enhanced Disclosure Task Force, Sept. 2014 and July 2013); Improving Bank Disclosure (Oliver Wyman, Apr. 2012); Summary of Key Themes that Arose During an FSB Roundtable on Risk Disclosure (FSB, Mar. 20, 2012); An Analysis of CDS Transactions: Implications for Public

Reporting (FRBNY, Sept. 2011); See generally Part II.A above.

See also, e.g., Deutsche Bank, SEC Admin. Proc. No. 3-16557 (May 26, 2015) (charging Deutsche Bank with misstating "gap risk" on synthetic CDOs and related derivatives); JPMorgan Chase (avail. Mar. 19, 2010) (SEC denial of no-action request to omit from proxy materials shareholder proposal requesting disclosure of information concerning initial and variation margin policies); Bank of America (avail. Feb. 24, 2010) (to similar effect); Citigroup (avail. Feb. 23, 2010) (to similar effect); [PNC] Securities Litigation, Civ. Act. No. 94-1961 (W.D. Pa., June 18, 1998) (settlement) (shareholder suit based on alleged misrepresentations relating to interest rate swap position); Merrill Lynch (avail. Dec. 15, 1994) (SEC denial of no-action request to omit from proxy materials shareholder proposal requesting disclosure of information concerning derivatives activities).

C) In 2013, the SEC's Division of Corporate Finance began to ask banks that sell structured notes to make certain changes to their disclosures in offering prospectuses. In April 2012 and February 2013, the SEC sent letters to Bank of America, Barclays, Goldman Sachs, JPMorgan Chase and Morgan Stanley requesting that the banks disclose how certain structured notes are priced, traded and named in their offering prospectuses, and to address additional risk factors such as the possibility that the structured notes may be worth less in the secondary market than they were originally priced, or the extent to which investors may be exposed to the bank's creditworthiness. In response to the SEC's letters, the banks agreed to make the recommended changes to their prospectuses. See Wall St. J., Apr. 11, 2013. See also Regulation of Retail Structured Products (IOSCO, Apr. 2013).

(ii) Litigation and Enforcement Issues

Derivatives-related losses led to litigation against derivatives dealers and corporate directors, as well as to enforcement actions by U.S. regulators. Cases over the last several years include those relating to: (A) formation and existence of the contract; (B) power and authority; (C) legality (under foreign law, commodities regulation and state gaming and bucket-shop laws); (D) choice of law and jurisdiction; (E) shareholder derivative suits against directors; (F) duties of advisers, brokers and dealers (including as to whether dealers owe "customers", "counterparties", other "dealers" or "end-users" a duty to propose or carry out only "suitable" transactions); (G) implied duties of principals in derivative transactions; (H) alleged conflicts of interest and market manipulation; and (I) disclosure. See generally Part I.C.1.c.ix and Part VII.D below.

A) As a defense against payment of derivatives losses, and in actions for damages, counterparties have claimed that derivatives dealers breached a fiduciary duty, or have alleged common law fraud, negligent misrepresentation and/or fraud under federal commodities laws and/or federal or state securities laws. See, e.g., Securities Law Daily, July 5, 2016 (reporting settlement that could exceed $1 billion between four to six Dutch banks and small and mid-sized Dutch businesses over the suitability of interest-rate swaps); NY Times, June 4, 2013 (reporting significant concessions by JPM on swaps payments in bankruptcy settlement of Jefferson County, AL); HSH Nordbank v. UBS, 95 A.D. 3d 185 (NY App. Div. 1st Dept. 2012) (allegations of fraud against UBS in a CDS transaction dismissed due in part to lack of justifiable reliance by HSH Nordbank); Biola Univ. v. Bank of America and BNP Paribas, No. 07-0917 (C.D. Cal., July 31, 2007) (complaint) (allegations of "excessive profits" in interest rate derivatives transactions), dismissed as to BNP Paribas (Oct. 29, 2007); Ciaola v. Citibank, 295 F.3d 312 (2d Cir. 2002); Lehman Brothers v. Minmetals International Non-ferrous Metals Trading Co., 179 F. Supp. 2d. 118 (SDNY 2000) (since settled); Ozawa Denki Koji Co. v. Republic NY Securities Corp., No. 00-04443 (SDNY, filed June 16, 2000) (since settled); NY Times, June 3, 1998 (reporting Merrill Lynch $400 million settlement in relation to sale of derivatives to Orange County, CA investment pool); Morgan Guaranty Trust Company ["Morgan Bank"] v. SK Securities, Civ. Act. No. 98-01041 (SDNY Feb. 13, 1998) (complaint; since settled); Procter & Gamble ["P&G"] v. BTCo, 925 F. Supp. 1270 (S.D. Ohio 1996); Carlton Financial Services Corp. v. BTCo, No. 94-07172 (SDNY, filed Oct. 3, 1994) (since settled); Gibson Greetings v. BTCo, No. 94-00620 (S.D. Ohio, filed Sept. 12, 1994) (since settled). See also, e.g., Comptroller Sales Practices Review.

i) In asserting that a derivatives dealer owes a fiduciary duty, counterparties have relied on allegations as to the dealer's experience and access to data and financial technology, the counterparty's sharing of confidential information with the dealer, and the counterparty's reliance on the dealer's advice. If a fiduciary duty exists, the dealer's responsibilities could expand significantly. In addition, claims have been made against dealers alleging unauthorized or illegal trading, ultra vires activities, and suitability and disclosure violations. See generally, e.g., OTC Derivatives: Lawsuits Involving Sales Practice Concerns (GAO, Dec. 19, 1997).

ii) The insertion of "non-reliance" clauses in derivatives documentation and the use of generic risk disclosure statements could reduce the risk to derivatives dealers of fiduciary duty and other suitability-type claims.

iii) Hinds County v. Wells Fargo, 700 F. Supp. 2d 378 (SDNY 2010), upheld against a motion to dismiss certain claims brought by local governments alleging that Wells Fargo and 15 other banks and broker-dealers conspired to rig bids and fix prices of guaranteed investment and derivative contracts in the municipal market. In 2010, the California State Treasurer launched a probe into six banks' trading activities in the municipal CDS market and the impact of such activities on borrowing costs. See Cal. State Treasurer Letters, Mar. 29, 2010 (Bank of America, Barclays, Citigroup, Goldman Sachs, JP Morgan, Morgan Stanley); LA Times, Apr. 23, 2010. Similarly, see Merced Irrigation District v. Barclays Bank PLC, No. 15-04878 (SDNY Feb. 29, 2016) (denying motion to dismiss in lawsuit relating to manipulation of electricity prices).

iv) Administrative proceedings/prosecutions involving bank participants in derivative transactions include: FERC v. Barclays Bank Plc, No. 13-cv-02093 (E.D. Cal. Mar. 1, 2015) (denying Barclay's stay motion in lawsuit for manipulation of electricity markets); CFTC v. RBC, No. 12 Civ. 2497 (SDNY Dec. 18, 2014) (consent order for permanent injunction and civil monetary penalty for unlawful wash sale scheme in connection with futures trades); Morgan Stanley, CFTC Order No. 14-10 (Mar. 24, 2014), CCH Comm. Fut. L. Rep. ¶ 33,004 (net long positions in soybean meal contract in excess of all-months speculative position); JP Morgan Ventures Energy, 144 FERC ¶ 61,068 (July 30, 2013) (stipulation and consent agreement for alleged energy market manipulation in California and the Midwest); Barclays Bank PLC, 144 FERC ¶ 61,041 (July 16, 2013) (order in connection with manipulation of energy markets in California and other western markets); Deutsche Bank Energy Trading, 142 FERC ¶ 61,056 (Jan. 22, 2013) (stipulation and consent agreement for alleged energy market manipulation in California); Morgan Stanley, CFTC Order No. 12-22 (June 5, 2012), CCH Comm. Fut. L. Rep. ¶ 32-218 (unlawfully executed, processed and reported off-exchange futures trades); U.S. v. Morgan Stanley, 881 F. Supp.2d 563 (SDNY 2012) (settlement of antitrust claims related to the use of swaps to manipulate energy prices); JPMorganChase, Agreement with NY Attorney General and Attorneys-General of 24 additional states (July 7, 2011) (alleged fraudulent and anti-competitive conduct in municipal bond derivative transactions), SEC Admin. Proc. No. 3-14455 (July 7, 2011), OCC Consent Order AA-EC-11-63 (July 6, 2011), Board/FRBNY Written Agreement (July 6, 2011) (agreement to strengthen compliance risk management program and provide notice prior to re-engaging in the marketing or sale of derivatives to U.S. municipalities); Bank of America Securities, SEC Admin. Proc. No. 3-14153 (Dec. 7, 2010), Bank of America, Board/FRBR/OCC Written Agreements (Dec. 6, 2010) (alleged anti-competitive activities in sale of derivatives to municipalities and non-profit organizations); UBS, CFTC Order No. 10-11 (Apr. 29, 2010); Morgan Stanley, CFTC Order No. 10-10 (Apr. 29, 2010), CCH Comm. Fut. L. Rep. ¶ 31,564 (concealing large block oil trades); UBS, CFTC Order No. 10-07 (Feb. 24, 2010), CCH Comm. Fut. L. Rep. ¶ 31,528 (exceeding position limits on natural gas, heating oil and platinum futures contracts); CFTC v. Lee, No. 08-09962 (SDNY Nov. 18, 2008) (complaint/consent judgments: 2009/2010); SEC Litigation Release No. 20811 (Nov. 18, 2008) (mismarking and misvaluing Bank of Montreal natural gas options); CIBC, SEC Admin. Proc. No. 3-11987 (July 20, 2005) (allegation that TRS entered into to finance hedge fund customer late trading were "sham loans"); CFTC v. Commercial Hedge Services, Sherman County Bank, CFTC News Releases No. 5030-04 (Dec. 4, 2004), No. 4924-04 (May 5, 2004) (charges of fraud and unauthorized trading with regard to managed commodity hedge accounts) (settled, Dec. 3, 2007); Citigroup Global Markets, NASD News Release, Dec. 7, 2004 (unsuitable recommendations, failed recordkeeping and inadequate risk disclosure respecting sales of proprietary futures funds); SEC v. Masferrer, SEC Litigation Release No. 18772 (June 30, 2004), No. 03-22524 (S.D. Fla.) (complaint, Sept. 25, 2003; injunction, Jan. 9, 2006); 2006 U.S. Dist. LEXIS 76387 (S.D. Fla. 2006) (conviction), aff'd, 514 F. 3d. 1158 (11th Cir. 2008), cert. denied, 555 U.S. 1136 (2009) (proceedings against former officers and directors of Hamilton Bancorp based on allegations that "ratio swap" transactions were used to conceal non-performing loans); NationsBank, Comptroller News Release 98-49 (May 4, 1998), SEC Release No. 33-7532 (May 4, 1998), NASD Press Release, May 4, 1998 (charges of inadequate disclosure to purchasers of bond funds that included mortgage-backed derivatives); BTSecurities Corp. ("BTSC"), SEC Release No. 34-35136 (Dec. 22, 1994), CFTC Release No. 3806-04 (Dec. 22, 1994), Executive Summary and Recommendations of the

Report on the OTC Derivatives Business of Bankers Trust During 1991-1994 (June 30, 1996), Board Agreement, Dec. 4, 1994 (amended July 18, 1995), with BTNY, BTCo and BTSC (terminated Dec. 9, 1996).

See generally SNL Financial, Oct. 10, 2013. See also Part II.E.3.c.ii.D, Part VIII.C.1.c and Part IX.E below.

B) Counterparties have brought actions against numerous banks for conspiring to manipulate LIBOR and other pricing benchmarks. Some have alleged manipulation in violation of the 1934 Act, violations of U.S. antitrust laws and unjust enrichment. Banks have settled numerous actions with regulatory authorities. See, e.g., NYAG Press Release, Aug. 8, 2016 (44-state settlement by Barclays Bank and Barclays Capital related to LIBOR and other benchmark manipulation); In the Matter of Matthew Gardiner (Board Prohibition Order, July 19, 2016) (prohibiting former trader from banking industry); BNA Banking Report, July 11, 2016 (three Barclays traders found guilty in jury trial of manipulating LIBOR); DOJ Press Release, July 7, 2016 (former Rabobank trader pleads guilty for scheme to manipulate LIBOR); Wall St. J., July 4, 2016 (three former Barclays traders convicted in London of LIBOR manipulation); In re: LIBOR-Based Financial Instruments Antitrust Litigation, No. 13-3565 (2d Cir., May 23, 2016); County of Montgomery, Pennsylvania v. ICAP PLC, No. 14-cv-8576, Alaska Electrical Pension Fund v. Bank of America, No. 14-cv-07126, The County of Beaver v. Bank of America, No. 14-cv-7907, Magnolia Regional Health Center v. Bank of America, No. 14-cv-8342, Genesee County Employees' Retirement System v. Bank of America, No. 14-cv-8365 (SDNY May 3, 2016) (seven banks settle rate fixing claims, several banks remain in litigation), (SDNY Nov. 3, 2014) (consolidated complaint); Sonterra Capital v. UBS AG, No. 15-cv-05844 (SDNY Apr. 7, 2016) (approving $23 million settlement in investor suit against 21 banks for benchmark yen LIBOR manipulation); U.S. v. Robson, No. 14-cr-00272 (SDNY Mar. 10, 2016) (two former Rabobank traders convicted and sentenced for alleged manipulation of LIBOR for U.S. dollar and Japanese Yen); In re: LIBOR-Based Financial Instruments Antitrust Litigation, No. 11-md-02262 (SDNY Aug. 4, 2015) (dismissing certain claims against banks for late filing or lack of jurisdiction over defendants); Barclays Bank plc, CFTC Docket No. 15-25 (May 20, 2015) (settlement related to charges of manipulation of ISDAFIX USD benchmark); BaFin Letter to Deutsche Bank, May 11, 2015 (critical of Deutsche Bank management response to LIBOR investigations); U.S. v. DB Group Services UK Limited, No. 15-cr-62 (D.C. Conn. Apr. 23, 2015) (plea agreement under which Deutsche Bank's UK subsidiary paid $150 million to settle wire fraud charges in connection with LIBOR manipulation); Deutsche Bank AG and Deutsche Bank AG, NY Branch, NYDFS Consent Order (Apr. 23, 2015) (settlement of LIBOR, EURIBOR and TIBOR manipulation charges with NYDFS for $600 million penalty); FCA Final Notice to Deutsche Bank (#150018) (Apr. 23, 2015) (fining Deutsche Bank £227 million for LIBOR and EURIBOR failings and for misleading regulators); Deutsche Bank AG, CFTC Docket No. 15-20 (Apr. 23, 2015) ($800 million CFTC penalty to settle charges that Deutsche Bank routinely engaged in acts of false reporting and manipulation of LIBOR and EURIBOR); Lloyds Bank, CFTC Docket No 14-18 (July 28, 2014) (settlement); DOJ Press Release, July 28, 2014 (Lloyds admits wrongdoing in LIBOR investigation and agrees to pay $86 million criminal penalty); DOJ Press Release, June 10, 2014 (former Rabobank trader pleads guilty in scheme to manipulate yen LIBOR); Statement on the Euro Interest Rate Derivatives Case (EC, May 20, 2014)

(Statement of objections to Crédit Agricole, HSBC and JPMorgan for suspected participation in euro interest rate derivatives cartel); RP Martin Holdings Limited, CFTC Docket No. 14-16 (May 15, 2014) (settlement); Carpenters Pension Trust Fund v. Barclays, 750 F.3d 227 (2d Cir. 2014) (reinstating plaintiff's claims); [FDIC] as Receiver for Hillcrest Bank v. Bank of America, No. 14-01757 (SDNY Mar. 14, 2014) (complaint); EC Press Release (Dec. 4, 2013) (EC fines eight international financial institutions a total of €1.71 billion for participating in cartels in the interest rate derivatives industry); Rabobank, CFTC Docket No. 14-02 (Oct. 29, 2013) (settlement); ICAP Europe, CFTC Docket No. 13-38 (Sept. 25, 2013); NCUA Board v. Credit Suisse (D. Kansas, Sept. 23, 2013); U.S. v. UBS Securities Japan Co., No. 3:12-00268 (D. Conn., Sept. 12, 2013) (joint sentencing memorandum); City of Philadelphia v. Bank of America (SDNY July 26, 2013) (complaint); County of Sonoma v. Bank of America, No. 13-00602, No. 13-02979 (N.D. Cal., June 28, 2013) (complaint); San Diego Ass'n of Gov'ts v. Bank of America, No. 13-1466L (S.D. Cal., June 25, 2013) (complaint); Regents of the University of California v. Bank of America, No. 13-cv-0586 (SDNY June 25, 2013) (complaint); Gusinksy v. Barclays, No. 12 Civ. 5329 (SDNY May 13, 2013) (dismissing investor class action); In re LIBOR-based Financial Instrument Antitrust Litigation, No. 11 MD 2262 (Mar. 29, 2013) (dismissing private plaintiff claims of antitrust and RICO violations); DOJ Press Release, Feb. 6, 2013 (RBS Securities Japan guilty plea); RBS, CFTC Docket No. 13-14 (Feb. 6, 2013) (proceeding brought against RBS and RBS Securities Japan); East Bay Municipal Utility District v. Bank of America, No. 13-00626 (SDNY Jan. 9, 2013); City of Richmond v. Bank of America, No. 13-00627 (SDNY Jan. 9, 2013); County of San Mateo v. Bank of America, No. 13-00625 (SDNY Jan. 9, 2013); City of Riverside v. Bank of America, No. 13-00062

(C.D. Cal., Jan. 9, 2013) (complaint); UBS, CFTC Docket No. 13-09 (Dec. 19, 2012) (order bringing and settling charges of LIBOR manipulation against UBS and UBS Securities Japan); Barclays, CFTC Docket No. 12-25 (order), CCH Comm. Fut. L. Rep. ¶ 32,234 (June 27, 2012); UBS Fined $160 Million for Significant Failings in Relation to LIBOR and EURIBOR (FSA, 2012); FTC Capital v. Credit Suisse Group, Bank of America, JPMorganChase, HSBC, Barclays Bank, Lloyds Banking Group, WestLB, UBS, RBS, Deutsche Bank, Norinchukin Bank and Citibank, No. 11-02613 (SDNY Apr. 15, 2011).

With regard to non-LIBOR benchmarks, see also, e.g., Dennis v. JPMorgan Chase & Co., No. 16-cv-06496 (SDNY Aug. 16, 2016) (class action complaint against 16 banks claiming fixing of the Australian bank bill swap rate); Frontpoint Asian Event Driven Fund v. Citibank NA, No. 16-cv-05263 (SDNY July 1, 2016) (class action complaint alleging "massive conspiracy" to manipulate SIBOR and other rates); In the Matter of Citibank, N.A., CFTC Docket No. 16-16 (May 25, 2016) (order instituting proceedings with settlement including $250 million civil penalty alleging manipulation and false reporting concerning ISDAFIX USD); In the Matter of Citibank, N.A., Citibank Japan Ltd. and Citigroup Global Markets Japan Inc., CFTC Docket No. 16-17 (May 25, 2016) (order instituting proceedings with settlement including $175 million civil penalty for attempted manipulation of Yen LIBOR and Euroyen TIBOR and false reporting of Euroyen TIBOR and U.S. dollar LIBOR); In re Foreign Exchange Benchmark Rates Antitrust Litigation, No. 13-cv-07789 (SDNY Mar. 31, 2016) (order dismissing investor class-action suit alleging foreign banks conspired to fix foreign exchange prices for lack of personal jurisdiction with respect to one defendant and denying with respect to two others).

See generally Wall St. J., May 21, 2016 (reporting a group of banks, clearing houses and U.S. regulators considering two possible replacements for the LIBOR rate); IFLR, Apr. 2015 (discussing LIBOR and related manipulation claims generally).

The UK has undertaken a review of the structure and governance of LIBOR. See The Wheatley Review of LIBOR Initial Discussion Paper (HM Treasury, Aug. and Sept. 2012). See also Reforming Major Interest Rate Benchmarks: Progress Report on Implementation of July 2014 FSB Recommendations (FSB, July 19, 2016); Progress in Reforming Major Interest Rate Benchmarks: Interim Report on Implementation of July 2014 FSB Recommendations (FSB, July 9, 2015); Reforming Major Interest Rate Benchmarks (FSB, July 22, 2014); Principles for Financial Benchmarks (IOSCO, July 2013); Recommendations for Enhancing the Credibility of LIBOR (FRBNY, May 27, 2008) .

C) Counterparties have brought class antitrust claims against numerous banks, ISDA and Markit claiming they conspired to restrict services, pricing information and competition in the trading and clearing market for CDS. The plaintiffs have alleged various violations of the Sherman Act, including conspiring to fix spreads for CDS transactions at artificially inflated levels and attempting to monopolize the market for CDS. Other suits have been brought alleging collusion in interest rate swap and other derivative markets. See, e.g., In re: [CDS] Antitrust Litigation, No. 13-02476 (SDNY July 25, 2016) (dismissing all claims against remaining defendants, others received settlement); City of Philadelphia v. Bank of America Corp., No. 16-cv-05409 (N.D. Ill. May 23, 2016) (class action complaint alleging collusion to block exchange trading on the interest rate swap market); Pub. School Teachers' Pension and Retirement Fund of

Chicago v. Bank of America, No. 15-cv-09319 (SDNY Nov. 15, 2015) (complaint alleging collusion to block fund managers from entering interest-rate swap market); Securities Law Daily, Nov. 25, 2015; Wall St. J., Oct. 1, 2015 (reporting $1.86 billion credit default swaps settlement by defendant banks and industry groups ISDA and Markit under which 9,000 to 12,000 investing institutions can file claims); Magnolia Regional Health Center v. Bank of America, No. 14-cv-08576 (SDNY May 11, 2016) (settling class action complaint alleging manipulation of reference rates); MF Global Capital v. Bank of America, No. 13-cv-07647 (SDNY Apr. 18, 2016) (settlement); Sheet Metal Workers Local No. 33 Cleveland Dist. Plan v. Bank of America No. 13-cv-0745 (SDNY Apr. 18, 2016 (settlement). See also Part II.E.4.f below.

In 2013, the EC notified numerous banks that it had reached the preliminary conclusion that the banks, along with ISDA and Markit, engaged in anti-competitive behavior in violation of Article 101 of the Treaty on the Functioning of the EU. See Banking Report, July 9, 2013; EC Memo, July 1, 2013. In 2016, ISDA and Markit reached a settlement with the EU, pledging to license intellectual property including data and indices used to price swaps. See Securities Law Daily, July 21, 2016; EC Press Release, Apr. 28, 2016; Bloomberg, Apr. 28, 2016. Cf. Wall St. J., Dec. 4, 2015 (EC dropped investigation into 13 banks for alleged collusion in the credit derivatives market).

D) The SEC and the CFTC have focused on uncovering parties that offer and sell derivatives products by means of interstate commerce without complying with applicable regulatory regimes.

i) The SEC and the CFTC issued a joint alert warning investors about certain "binary options" that are sold on Internet trading platforms that are not registered as exchanges or DCMs subject to oversight by the SEC and the CFTC. See SEC Investor Alert (June 2013).

ii) Each of the SEC and the CFTC brought actions against Banc de Binary, Ltd. for failure to register in the appropriate capacities with the applicable regulators. See CFTC v. Banc de Binary, No. 13-cv-00992 (D. Nev., Feb. 29, 2016 (consent order); SEC v. Banc de Binary, No. 13-cv-00993 (D. Nev. Mar. 9, 2016) (consent order).

iii) The CFTC brought an action against Intrade The Prediction Market Limited ("Intrade") and Trade Exchange Network Limited ("TEN") for violating the CFTC's ban on off-exchange options trading. Intrade and TEN operated an online prediction market through which customers could buy or sell binary options that allowed them to predict whether a specific future event would occur. See CFTC v. TEN, (D.D.C., Nov. 26, 2012) (complaint), (D.D.C., July 31, 2015) (order granting partial summary judgment in favor of CFTC).

(iii) Individual Participation in Derivative Markets

A) Based on the GLB Act § 206 definition of Identified Banking Product, banks not registered as broker-dealers are not permitted to sell equity swaps directly to any individual who is not a Qualified Investor. Banks may issue or originate such swaps as principal, but if such swaps are "securities", a broker-dealer must act as intermediary in sales and other transactions.

B) IOSCO outlined regulatory options that IOSCO members may find useful in their regulation of retail structured products. The toolkit is intended to allow for a wide range of application and adaptation in different jurisdictions. See Final Report: Regulation of Retail Structured Products (IOSCO, Dec. 2013).

C) A number of trade associations (including ISDA and SIFMA) have released guidance on best practices for the sale of structured products to retail investors. See Joint Associations Committee Combined Principles for Retail Structured Products (May 23, 2011); Structured Products: Principles for Managing the Distributor-Individual Investor Relationship (July 2008); Retail Structured Products: Principles for Managing the Provider-Distributor Relationship (July 2007). Compare How Safe Are Your Savings? How Complex Derivatives Products Imperil Seniors' Retirement Security (Demos, 2011).

D) The SEC Summary Report on Issues Identified in Examinations of Certain Structured Securities Products Sold to Retail Investors (2011) identified potential supervisory deficiencies, and observed that broker-dealers might have recommended unsuitable products to retail investors, traded at disadvantageous prices, omitted material facts about structured products offered to retail investors, and engaged in questionable sales practices. See also National Examination Risk Alert: Broker-Dealer Controls Regarding Retail Sales of Structured Securities Products (OCIE, Aug. 24, 2015). Compare Joint Report on Retail Swaps (Board/Treasury/CFTC/SEC, Dec. 2001).

E) CEA § 2(e) and 1934 Act § 6(l), as added by the Dodd-Frank Act, prohibit transactions in swaps or SBS with a person that does not qualify as an eligible ECP, unless effected on an exchange.

F) Dodd-Frank amended the CEA to require the SEC and the federal banking agencies to adopt rules for the regulation of retail FX activities by broker-dealers and banks. See CEA § 2(C)(2)(B) and (E). See also Part II.E.4.b below.

See also Part II.D.3.b above and Part IV below.

e. Complex Structured Finance Transactions

Courts and regulators have held financial institutions responsible for participating in CSFTs that may be deceptive or improperly reported. See generally In re Enron Corp., No. 01-16034 (Bankr. Nov. 4, 2003) (final examiner's report), (Bankr. SDNY July 28, 2003); Investment Banks: The Role of Firms and Their Analysts with Enron and Global Crossing (GAO, Mar. 2003); Fishtail, Bacchus, Sundance and Slapshot: Four Enron Transactions Funded and Facilitated by U.S. Financial Institutions (Senate PSI, Jan. 2, 2003). See also SEC Conduit Disclosure Letter; Report of Senate Homeland Security Committee Investigations Subcommittee, Tax Haven Abuses: The Enablers, the Tools and Secrecy (Aug. 1, 2006); Report and Recommendations Pursuant to [Sarbanes-Oxley §401(c)] on Arrangements with Off-balance Sheet Implications, [SPEs], and Transparency of Filings by Issuers (SEC, June 2005); CRMPG II 2005 Report; Corporate Fraud Task Force: First Year Report to the President (July 2003).

(i) Suitability Requirements with respect to the Distribution of Complex Financial Products Consultation Report (IOSCO, Jan. 2013) recommends suitability and disclosure obligations for intermediaries that distribute complex financial products to retail and non-retail customers, with an emphasis on enhanced consumer protection.

(ii) The Interagency Statement on Sound Practices Concerning Elevated Risk Complex Structured Finance Activities (the "Final Interagency Statement on CSFTs"), 72 Fed. Reg. 1372 (Jan. 11, 2007) (the "Interagency Statement Release") -- adopted by the Board, the OCC, the FDIC and the SEC -- offers principles-based guidance with respect to CSFTs.

A) The process that led to the issuance of the Final Interagency Statement on CSFTs began with a Proposed Interagency Statement on Sound Practices Concerning Complex Structured Finance Activities, 69 Fed. Reg. 28980 (May 19, 2004) (the "Initial Proposed Interagency Statement on CSFTs"), and was carried forward in a Revised Interagency Statement on Sound Practices Concerning Elevated Risk Complex Structured Finance Activities, 71 Fed. Reg. 28386 (May 16, 2006) (the "Revised Proposed Interagency Statement on CSFTs"). See also Board CPFS Letter (discussing responsibilities in connection with CPFS transactions); Approval No. 646 (CSFT procedures).

B) The Final Interagency Statement on CSFTs focuses on the identification and management of elevated risk CSFTs based on the following principles and recommendations:

i) Identification of elevated risk CSFTs

(a) The Final Interagency Statement on CSFTs requires financial institutions to establish and maintain policies, procedures and systems to identify elevated risk CSFTs, such as CSFTs that appear to:

i. Lack economic or business purpose.

ii. Reflect questionable accounting, regulatory or tax objectives (particularly at the end of a reporting period).

iii. Raise concerns that the customer will disclose or report in a misleading manner.

iv. Involve circular transfers of risk.

v. Involve oral or undocumented agreements.

vi. Have material economic terms that are inconsistent with market norms (e.g., deep "in the money" options or historic rate rollovers).

vii. Provide compensation disproportionate to services, or to the credit, market or operational risk assumed.

(b) A financial institution may find it helpful to incorporate the review of new CSFTs into its new product policies, and may consider a number of factors in determining whether a CSFT is "new", including (1) structural or pricing variations; (2) whether the product targets a new class of customers or a new customer need; (3) whether the CSFT raises new compliance, legal or regulatory issues; and (4) whether the CSFT would be offered in a manner that would deviate from standard market practice. See also OCC Bulletin No. 2004-20.

(c) A financial institution operating in non-U.S. jurisdictions may tailor its policies and procedures to account for the laws, regulations and standards of those jurisdictions. The Final Interagency Statement on CSFTs clarifies that a U.S. branch of a foreign bank is not expected to establish separate U.S.-based risk management structures or policies for its CSFT activities; a U.S. branch should have sufficient flexibility to develop controls, risk management and reporting structures and lines of authority that are consistent with its internal management structure. <u>However</u>, the risk management structure and policies used by a U.S. branch -- whether group-wide or stand-alone -- should be effective in managing the risks of the branch's activities.

(d) In terms of the type of transactions that should be characterized as elevated risk CSFTs:

i. The hallmarks of a non-complex transaction are that it has a well-established track record and is familiar to participants in the financial markets.

ii. Some commenters contended that the examples of elevated risk CSFTs contained in the <u>Final Interagency Statement on CSFTs</u> have characteristics that signal fraudulent activity and recommended that financial institutions be informed that transactions or products with <u>any</u> of those characteristics should be prohibited. <u>However</u>, the <u>Final Statement</u> reflects the view that, while CSFTs that initially appear to have one or more of the identified characteristics should generally be identified as an elevated risk CSFT, all transactions identified as potentially creating elevated risks should not be presumptively prohibited.

iii. The Final Interagency Statement on CSFTs does not prevent a financial institution from proceeding with a CSFT simply because there may be ambiguity in how the transaction might be viewed under applicable law or accounting principles. A financial institution should maintain processes and controls designed to determine whether any such ambiguities may create legal or reputational risks, and to manage and address those risks.

ii) Due diligence

The Final Interagency Statement on CSFTs requires a financial institution to implement policies and procedures for heightened due diligence of elevated risk CSFTs.

iii) Approval process

(a) A financial institution should have policies to ensure review and approval of elevated risk CSFTs by appropriate levels of control and management personnel with experience and training, including representatives of appropriate control areas that are independent of the business lines.

(b) An institution should take steps to address legal or reputational risks, which may include declining to participate in the transaction, modifying the transaction or conditioning participation upon receipt of representations from the customer that reasonably address heightened risks. An institution should decline to participate if it determines that the transaction presents unacceptable risk or would result in a violation of law, regulation or accounting principles.

iv) Documentation

(a) A financial institution should create and collect documentation sufficient to:

i. Document the material terms of the CSFT.

ii. Enforce the material obligations of counterparties.

iii. Confirm that customers have received any required disclosures.

iv. Verify that policies are being followed and allow internal audit to monitor compliance.

(b) Where a financial institution's policies require senior management approval of an elevated risk CSFT, the institution should maintain documentation presented to management, and documentation reflecting approval or disapproval, any conditions imposed by senior management and the reasons for such action.

v) Other risk management principles

(a) General business ethics: The board and senior management should establish a "tone at the top" to create firm-wide culture sensitive to ethical and legal issues. The Final Interagency Statement on CSFTs notes that a financial institution may need to consider mechanisms to protect personnel by permitting confidential disclosure of concerns.

(b) Reporting: A financial institution's policies should provide for appropriate levels of management and the board to receive information concerning elevated risk CSFTs.

(c) Monitoring: a financial institution should conduct periodic independent reviews of CSFT activities to verify that procedures and controls are implemented effectively and that elevated risk CSFTs are identified and receive proper approvals.

(d) Audit: Internal audit or compliance should review the financial institution's compliance with its policies (and the adequacy of such policies). Periodic validations should include transaction testing.

(e) Training: Relevant personnel involved in CSFTs should be familiar with the financial institution's policies, including processes for the identification, escalation and approval of elevated risk and new CSFTs.

C) The Final Interagency Statement on CSFTs shortened, narrowed and revised the Initial Proposed Interagency Statement on CSFTs.

i) Among the concerns raised by industry commenters with respect to the Initial Proposed Interagency Statement on CSFTs were (A) "prescriptiveness"; (B) the potential that vagueness would generate compliance obligations or legal risk beyond the Statement's purpose; and (C) the need to distinguish among the roles that financial institutions play in CSFTs (ranging from adviser to arm's-length provider of services). In response, the Revised and Final Interagency Statements on CSFTs set out principles-based guidance that enunciates the goals that banks' internal policies should achieve.

ii) In response to industry comments on the Revised Proposed Interagency Statement on CSFTs requesting that the Statement clarify operational, compliance and documentation requirements and the legal standards governing the potential liability of financial institutions in respect of CSFTs (see, e.g., ABA/BMA/ISDA/SIFMA, Bank of America and Clearing House Association Comment Letters, June 15, 2006), the Interagency Release indicates that the Final Interagency Statement on CSFTs does not (A) establish legally enforceable obligations, (B) create private rights of action, or (C) alter or expand the obligations that a financial institution may have to a customer, its shareholders or other parties under applicable law.

iii) Some commenters were critical of the scope of the Revised Proposed Interagency Statement on CSFTs and questioned whether the Revised Statement provided sufficient prescriptive guidance, or created the potential for financial institutions to aid and abet securities fraud. (See, e.g., Comment Letter of

Professors Cohen, Dana, Koniak and Ross, June 2, 2006.)

D) The FSA 2005 Letter sets out senior management responsibilities to implement processes and procedures for the effective management of risks arising from non-standard CSFTs.

See also Part IX.E.3 below.

E) FINRA Conduct Rules apply to the sale and trading of structured finance products. NASD Notice to Members 05-59 (Sept. 2005) provides that members are obliged to (i) provide balanced disclosure, (ii) ascertain whether CSFTs are appropriate for the relevant accounts, (iii) deal fairly with customers when making recommendations or accepting orders, (iv) perform suitability determinations, (v) maintain a supervisory control system, and (vi) implement adequate training.

F) The CFTC is reported to have requested information from certain large banks regarding complex dividend-arbitrage trades through which banks allegedly help clients avoid paying withholding taxes on stock dividends. The CFTC's examination reportedly focused on mechanics of the transactions, how the trades might affect U.S. trading or exchange operations, and whether the trades reflect arms'-length terms. See Wall St. J., Feb. 27, 2015.

(iii) The Enron bankruptcy estate pursued claims against 11 banks for the avoidance of "fraudulent transfers", return of "preferential payments", equitable subordination and damages in connection with the banks' alleged participation in a scheme with Enron officers to misrepresent Enron's financial condition (the so-called "megaclaims" litigation). The megaclaims litigation concluded in 2008, with the Enron bankruptcy estate able to return over $5 billion to Enron's creditors. See In re Enron ("In re Enron"), No. 01-16034 (Bankr.

SDNY Jan. 10, 2005) (amended complaint), (Bankr. SDNY Nov. 28, 2005) (subordination order), 340 B.R. 180 (Bankr. SDNY 2006) (disallowance order), 2007 U.S. Dist. LEXIS 63129 (SDNY 2007).

Regents of the University of California v. Credit Suisse First Boston, et al., 482 F.3d 372 (5th Cir. 2007), cert. denied, 552 U.S. 1170 (2008), reversed a District Court class action certification (529 F. Supp. 2d 644 (S.D. Tex. 2006)) and held that an allegation that investment banks entered into partnerships and transactions that allowed Enron to take liabilities off of its books and to book revenue from the transactions when it was actually incurring debt was not sufficient to ground a class action under 1934 Act § 10(b) and Rule 10b-5 in the absence of an allegation that the investment banks were fiduciaries which owed a duty of disclosure to the plaintiffs, that they improperly filed financial reports on Enron's behalf, or that they engaged in manipulative activities in the market for Enron securities.

(iv) Enforcement actions in connection with financial institution participation in CSFTs include the following:

A) CIBC (i) entered into a Deferred Prosecution Agreement with the DOJ in connection with alleged crimes with respect to Enron off-balance sheet financings, (ii) agreed to pay $80 million in settlement of an SEC civil action alleging that it had facilitated transactions which had improperly transferred assets off Enron's balance sheets, and (iii) entered into an agreement with the Ontario Superintendent of Financial Institutions and the FRBNY (a) not to engage in structured finance transactions for three years, (b) not to engage in any transaction where it knows or believes that an objective of a third party is to achieve a misleading earnings, revenue or balance sheet effect, (c) not to engage in quarter-end or year-end transactions intended by a third party to achieve accounting objectives without specific internal approvals, and

(d) to improve legal and reputational risk management. See Agreement, Dec. 22, 2003, between the DOJ Enron Task Force and CIBC; Written Agreement, Dec. 22, 2003, among CIBC, the Ontario Superintendent of Financial Institutions and the FRBNY; SEC Litigation Release No. 18517 (Dec. 22, 2003). See also SEC v. CIBC, Civil Action No. H-03-5785 (S.D. Tex. June 25, 2004) (final judgment against Ian Schottlaender).

B) Merrill Lynch entered into a Deferred Prosecution Agreement with the DOJ in connection with certain Enron transactions. Merrill Lynch agreed not to engage in transactions where it knows or believes that an objective of a third party is to achieve a misleading earnings, revenue or balance sheet effect, and to implement certain procedures with respect to structured finance transactions. Agreement, Sept. 17, 2003, between the DOJ Enron Task Force and Merrill Lynch. See also NY Times, Nov. 20, 2005 (criminal conviction of 4 Merrill Lynch executives).

C) Without admitting or denying any allegations, JPMorgan Chase (i) agreed to pay $135 million in settlement of a civil action brought by the SEC alleging that it had helped Enron structure and execute CSFTs that misled investors by disguising Enron debt; (ii) agreed with the District Attorney for New York County ("DANY") to pay $25 million and change policies relating to CSFTs; and (iii) entered into a Written Agreement with the FRBNY and the NYBD to improve credit, legal and reputational risk management. See SEC Release No. 2003-87 (July 28, 2003); SEC Litigation Release No. 18252 (July 28, 2003); DANY News Release, July 28, 2003; Written Agreement, July 28, 2003, among JPMorgan Chase, the FRBNY and the NYBD.

JPMorgan Chase Bank settled disputes with insurance companies that had refused to pay under guarantees made against certain Enron defaults. See, e.g., Washington Post, Jan. 3, 2003. See also Rabobank v RBC, No. 602303/02 (NY Sup. Ct. NY Co., Feb. 16, 2004) (settlement of Enron-related swap dispute); Unicredito Italiano v. JPMorgan Chase, No. H-04-0324 (N.D. Tex., Mar. 8, 2004) (claims of aiding and abetting fraud and civil conspiracy against JPMorgan and Citigroup (co-administrative agents for Enron credit facilities) (settled)).

JPMorgan Chase won dismissal of a suit by investors claiming that they would not have invested in JPMorgan Chase if they had known the details of its involvement with Enron. In re JP Morgan Chase Securities Litigation, 2007 U.S. Dist. LEXIS 22948 (SDNY 2007), aff'd, 553 F.3d 187 (2d Cir. 2009), concluded that such allegations failed to show "in a particularized fashion" that JPMorgan Chase intended to deceive its own shareholders or in fact did deceive them.

D) Without admitting or denying any allegations, Citigroup (i) agreed to pay $120 million to settle SEC proceedings with respect to structured finance transactions with Enron and Dynegy, (ii) entered into a settlement agreement with the DANY, and (iii) entered into a Written Agreement with the FRBNY, and Citibank entered into a Written Agreement with the Comptroller, pursuant to which they agreed to improve credit, legal and reputational CSFT risk management. See SEC Release No. 2003-87 (July 28, 2003); Citigroup, SEC Admin. Proc. No. 3-11192 (July 28, 2003); DANY News Release, July 28, 2003; Written Agreement, July 28, 2003, between Citigroup and the FRBNY (terminated Dec. 21, 2006); Written Agreement No. 2003-77 (July 28, 2003), between Citibank and the Comptroller.

E) Bayerische Hypo-und Vereinsbank ("HVB") entered into a DOJ Deferred Prosecution Agreement, Feb. 13, 2006, with respect to alleged assistance in the evasion of taxes on $1.8 billion in income by implementing tax shelters through transactions purporting to be "loans" (but which were not bona fide loans), participating in trading activity on instructions from promoters that was intended to create the appearance of investment activity, and participating in documentation that allegedly contained false representations concerning the purpose and design of the transactions.

i) In addition to paying a $29 million fine, HVB agreed to (a) prohibit participation in any transaction or strategy that has a significant tax component, unless such transaction or strategy is accompanied by an opinion that the transaction "should" be upheld by the courts; (b) adopt a "transaction approval" process that involves review and approval by its Tax Director of any transaction that has a significant tax component; (c) prevent account officers from controlling banking transactions after the closing of the transactions; and (d) maintain an effective compliance and ethics program. See U.S. Attorney SDNY Press Release, Feb. 14, 2006.

ii) The law firm of Sidley Austin Brown & Wood was sued by clients who made use of HVB tax shelter transactions with respect to which the firm offered tax advice. In part on the basis of HVB's related Deferred Prosecution Agreement, the suit survived a motion to dismiss and later settled. Williams v. Sidley Austin, 816 NYS 2d 702 (Sup. Ct. NY Co. 2006), aff'd, 832 NYS 2d 9 (App. Div. 1st. Dept. 2007) ("Williams v. Sidley Austin").

F) BB&T claimed foreign tax credits in connection with structured trust advantaged repackaged securities transactions. After the IRS disallowed the credits, BB&T sued, seeking a refund of taxes and penalties. A federal appeals court ruled that BB&T was not entitled to most of the credits, remarking that the transactions were "simply a money machine" with no economic purpose. See Salem Financial, Inc. v. U.S., 786 F. 3d 932 (Fed. Cir., 2015).

G) Plaintiffs that bought "Strategic Return Notes" survived a motion to dismiss by adequately pleading that Bank of America had made material omissions about the decay of a proprietary index (the "Investable Volatility Index") over time, and the predominance of higher futures prices and their effect on the index. See Flinn v. Bank of America Corp., No. 5:15-cv-193 (D. Vt., Mar. 30, 2016).

(v) "Non-traditional insurance products", particularly reinsurance contracts with offshore reinsurers, have come under scrutiny.

A) AIG entered into a Settlement Agreement with the SEC and NY Attorney General, paid $800 million (consisting of disgorgement of $700 million and a penalty of $100 million) and undertook corporate reforms following a complaint alleging that AIG's reinsurance transactions with General Reinsurance ("GenRe") were designed to inflate AIG's loss reserves. The complaint also identified transactions in which AIG allegedly misstated its financial results. See SEC Litigation Release No. 19560 (Feb. 9, 2006); NY v. AIG, No. 401720/05 (Sup. Ct. NY Co., Sept. 7, 2006) (amended complaint).

GenRe also entered into a Settlement Agreement with the SEC for its involvement in the scheme. See SEC Litigation Release No. 21384 (Jan. 10, 2010).

AIG settled SEC suits alleging that AIG arranged fraudulent reinsurance transactions for PNC and Brightpoint. See SEC Litigation Releases No. 18985 (Nov. 30, 2004); No. 18340 (Sept. 11, 2003).

See generally NY Times, Mar. 9, Jan. 20, 2010.

B) SEC Litigation Release No. 19989 (Feb. 6, 2007) reflects a Settlement Agreement with RenaissanceRe Holdings, a property/casualty insurer, in respect of allegedly fraudulent reinsurance transactions. RenaissanceRe settled charges that it created "sham" insurance transactions to smooth earnings.

C) SEC Litigation Release No. 20670 (Aug. 6, 2008) reflects settlement of financial reporting and related charges against Prudential Financial based on "finite reinsurance contracts" with GenRe that allegedly had no economic substance and no purpose other than to build up and then draw down an off-balance sheet asset that GenRe held for Prudential. According to the SEC, the contracts were shams, written to look like they met the requirements to qualify for reinsurance accounting (resulting in an overstatement of Prudential's net income) but, in fact, were subject to an oral side agreement that eliminated risk to either party and made such accounting improper.

(vii) With respect to issues relating to cross-border transactions, some of which involved derivatives, that were allegedly designed to facilitate U.S. tax evasion, see Part XI.H below.

(viii) A number of principles arise from the Final Interagency Statement on CSFTs and other administrative and judicial proceedings.

A) "Is it ethical?" is a critical starting point to any analysis of a CSFT. It is also important to think about how a disinterested observer would apply the relevant legal principles: "How would it look in The NY Times?" is a reasonable proxy for this test.

B) No bank or broker should (i) engage in any CSFT where it knows or believes that an objective of its counterparty is to achieve a misleading earnings, revenue or balance sheet effect; (ii) enter into any undocumented agreement; or (iii) use some perceived "market practice" -- the "everybody is doing it" test -- as a benchmark.

C) A financial intermediary should:

i) Establish policies and a process for review of any unusual transaction where a purpose is to achieve a particular economic, accounting, tax, legal or regulatory objective (including an objective to obtain off-balance sheet treatment, to counteract or delay the failure of another transaction, to replace debt with funds not characterized as debt, or to characterize as something other than a financing what is, in fact, a loan).

ii) Be attentive to CSFTs that could create legal or reputational risks (including CSFTs the only purpose of which is to have a financial statement impact).

iii) Conduct its diligence in respect of elevated risk CSFTs through well-qualified accounting, legal, compliance and operational personnel.

iv) Assure that sufficient information is provided to the appropriate committee or senior management.

v) Identify "red flags" for further review once a CSFT has been approved and consummated (e.g., early un-winds).

vi) Establish appropriate committees to review CSFT activity.

vii) Implement training and review procedures.

D) Although the Final Interagency Statement on CSFTs appears to move away from the implications in the Initial Proposed Interagency Statement on CSFTs that a financial intermediary may need to be its "brother's keeper" in the context of CSFTs, it nonetheless remains the case that:

i) It is not sufficient for a financial institution to assume that a counterparty will disclose and account for a CSFT properly, particularly if the CSFT has been structured in a way that could mask its economic effect and if the financial institution has reason to believe that the CSFT could result in misleading financial statements.

In order to minimize this risk, a financial intermediary should ascertain how its counterparty intends to report a CSFT, and obtain appropriate assurance that the CSFT has a legitimate business purpose and that its counterparty will comply with applicable law insofar as the CSFT's legal, regulatory, tax, financial and accounting characterizations and disclosures are concerned.

ii) Recording a CSFT in accordance with GAAP does not fully answer the question as to the propriety of the applicable disclosures.

iii) Lawyers who advise on, or assist financial institutions in structuring, a CSFT may have an obligation to satisfy themselves as to the bona fides of the CSFT. The "mere scrivener" standard will not apply, nor will it satisfy appropriate standards to be a "slave to a checklist". Senior legal and compliance personnel (or senior management not involved in the implementation of the CSFT or supervision of the relevant business unit) should approve the CSFT. It will be important to focus on what a CSFT is trying to accomplish in evaluating its propriety.

E) A CSFT financial intermediary may be liable for legal violations by counterparties or for losses which such counterparties incur on two bases: an intermediary (i) can become secondarily liable by taking actions which "aid and abet" the violation, or (ii) can be so involved that it becomes primarily liable as a principal. See, e.g., Board SR Letter 04-7 (May 14, 2004), CCH Fed. Banking L. Rep. ¶ 62-164 (SEC Guidance on the Potential Liability of Financial Institutions for Securities Law Violations Arising from Deceptive Structured Finance Products and Transactions). But see, e.g., In re Enron, 388 F. Supp. 2d 780 (S.D. Tex. 2005) (dismissing claims against JPMorgan for allegedly aiding and abetting Enron-related fraud); Howard v. SEC, 376 F.3d 1136 (D.C. Cir. 2004) (standard for liability not met).

i) In general, there is no private right of action under the Securities Acts based on "aiding and abetting" theories. This does not preclude SEC action, however, where there is (a) a violation by another party, (b) a general awareness, knowledge or recklessness in the face of "red flags" that the actions of the aider and abettor are part of an improper course of conduct, and (c) substantial assistance by the aider and abettor. See SEC v. Apuzzo, 689 F.3d 204 (2d Cir. 2012) (holding that proximate cause is not an element of aiding and abetting liability).

ii) Cases against financial institutions for primary liability can occur if the conduct of the intermediary -- including structuring, packaging or execution -- goes beyond general awareness and assistance to the primary violator.

iii) If a financial intermediary is a public company and an attorney representing the company becomes aware of potential liability like that described, the SEC "reporting up" rules under Sarbanes-Oxley § 307 could apply. (See generally Sarbanes-Oxley: Analysis and Practice.)

iv) Stoneridge Investment Partners v. Scientific-Atlanta, 552 U.S. 148 (2008), rejected the theory of "scheme liability" (i.e., that third parties -- e.g., financial institutions, advisers or vendors -- could be liable for alleged securities law violations by principal actors) and held that third parties who enter into transactions with a company which allegedly allow the company to deceive its auditor and issue misleading financial statements are not liable to the company's investors for violations of federal securities laws.

f. AAA-Rated Derivative Programs

A number of banks created AAA-rated derivative programs and vehicles to expand the potential customer base to include credit-sensitive counterparties, improve portfolio credit quality, increase higher-margin transactions, enhance marketability of other bank activities (including structured finance, leveraged leasing and bond underwriting) and improve liquidity. Many have terminated AAA structures.

(i) In 1993, Banque Paribas became the first bank to establish a separately capitalized, special purpose non-U.S. derivatives vehicle rated AAA by S&P. While

Sumitomo set up a similar AAA-rated offshore vehicle, Crédit Lyonnais was the first bank to establish a U.S. program whereby derivatives transactions entered into by its NY branch could benefit from a AAA-rated guaranty of a special purpose vehicle.

(ii) In 1996, NationsBank (now Bank of America) became the first U.S. bank to establish a AAA-rated derivatives subsidiary, and the Comptroller agreed that the subsidiary's capital could be included for purposes of calculating the Bank's capital ratios. See Comptroller Conditional Approval No. 203 (June 1996).

(iii) With respect to AAA structures historically, see, e.g., Derivative Ratings (S&P, Feb. 2000); "Risk Management by Structured Derivatives Product Companies", FRBNY Economic Policy Review (Apr. 1996); American Banker, June 3, 2002; Swaps Monitor, Sept. 6, 1999, Aug. 24, 1998 (structural comparisons).

3. Certain Regulatory Precedents Concerning Financial Holding Company, Financial Subsidiary, Bank Holding Company and Bank Principal Activities in Derivative Instruments

a. General Powers

(i) Financial Holding Companies and Financial Subsidiaries

A) An FHC or a financial subsidiary has plenary powers with respect to principal activities in all types of derivative instruments linked to interest rates, currencies, credit and securities, as part of its securities or (in the case of an FHC) merchant banking power.

B) While the Board had historically limited trading of derivative instruments linked to physical commodities under Regulation Y, it has permitted an FHC to engage in broader physical commodity and commodity derivative trading under complementary authority. See Part I.C.1.c above.

(ii) Bank Holding Companies and Banks

Banks and BHC subsidiaries may engage as principal in transactions in a wide variety of futures, options, options on futures, swaps, and derivative products, and may issue securities and other instruments linked to interest rates, securities, currencies, commodities and equity-, currency-, commodity-, energy-, credit-related and other indices. See, e.g., 12 C.F.R. § 225.28(b)(8); definition of Identified Banking Product (Gramm-Leach § 206).

Dodd-Frank affects the ability of banks to engage in certain derivatives transactions as principal. See Part II.A.7 above.

b. Derivatives as "Securities"

(i) Generally, futures (other than security futures) and options on futures (as opposed to options on securities) are not "securities" for federal securities law purposes. See CEA §§ 2, 2a. In addition, in general, swaps and similar instruments are not "securities" for federal securities law purposes unless they are based on securities or, in some cases, loans. While qualifying swap agreements had been excluded from the definition of "security" for purposes of the Securities Acts, Dodd-Frank explicitly included SBS in these definitions. See 1933 Act § 2A; 1934 Act § 3A; Part II.E.2 above.

(ii) In general, swaps and futures should not be "securities" for Glass-Steagall purposes. See, e.g., SBC, 82 Fed. Res. Bull. 685 (1996); SBC 1995 Order; Comptroller Chase CD Decision referred to in Part IV below; Letter No. 86-19; Comptroller Interpretive Letters No. 357 (Feb. 26, 1986), CCH Fed. Banking L. Rep. ¶ 85,527; No. 356 (Jan. 7, 1986), CCH Fed. Banking L. Rep. ¶ 85,526.

(iii) Certain derivatives referencing securities may constitute "derivative securities" warranting special treatment under Section 16 of the 1934 Act. See SEC Rule 16a-1.

The application of these rules to complex derivatives transactions has presented interpretive challenges for the courts. See, e.g., Chechele v. Sperling, 758 F.3d 463 (2d Cir. 2014) (holding that a prepaid variable forward contract should be viewed as two fixed-price derivatives -- a purchase of a put option and sale of a call option -- and that retention of a portion of pledged shares at commencement does not constitute a "purchase" of stock at time of settlement for purposes of the short-swing profit disgorgement rules); Second Circuit Decision Clarifies Framework for Treatment of Prepaid Variable Forward Contracts Under Section 16 (Cleary Gottlieb, Jan. 23, 2015).

c. Swaps and Related Derivative Products

Subject to Volcker Rule requirements (see Part II.A.7 above):

(i) Interest Rate and Currency Swaps and Related Derivative Products

A) In 12 C.F.R. §§ 208.128 (rescinded) and 211.603 the Board stated that state member banks (and non-U.S. subsidiaries of U.S. banks and BHCs) may engage in transactions in interest rate and currency swaps and other derivative products as principal -- whether or not perfectly matched. In addition, consistent with prior Board Orders, Regulation Y permits BHC subsidiaries to act as intermediary (including as principal), broker, agent and adviser with respect to interest rate and currency swaps and other derivative products, but unless such activities are conducted in an FHC or a financial subsidiary, a BHC may not engage in securities "dealing", activities as principal in ineligible securities or activities involving certain physically-settled derivatives. See 12 C.F.R. §§ 225.28(b)(6), (7), (8), 211.10(a)(18). See generally, e.g., BV Derivatives Approval; National Westminster Bank ["NatWest"], 82 Fed. Res. Bull. 1044 (1996); Rabobank, 60 Fed. Reg. 28613 (June 1, 1995) (solicitation of public comments) (approved July 3, 1995); First of America Bank Corp., 80 Fed. Res. Bull. 1120 (1994); Toronto-Dominion, 58 Fed. Reg. 47458 (Sept. 9, 1993) (solicitation of public comments) (approved Oct. 15, 1993); LTCB, 79 Fed. Res. Bull. 345 (1993) (the "LTCB Order"); Sumitomo, 78 Fed. Res. Bull. 101 (1992), 75 Fed. Res. Bull. 582 (1989); Dai-Ichi Kangyo Bank ("DKB"), 77 Fed. Res. Bull. 670 (1991); Mitsubishi Bank, 77 Fed. Res. Bull. 337 (1991); Mitsui Taiyo Kobe Bank, 77 Fed. Res. Bull. 116 (1991); Sanwa, 77 Fed. Res. Bull. 84 (1991) (the "Sanwa Order"); Fuji Bank ("Fuji"), 76 Fed. Res. Bull. 768 (1990).

B) A national bank may act as originator or principal in interest rate and currency swaps and other derivative products, whether or not perfectly matched. See 12 C.F.R. § 5.34(e)(3)(ii)(E). See also, e.g., Comptroller No-Objection Letter No. 90-1 (Feb. 16, 1990) ("Letter No. 90-1"), CCH Fed. Banking L. Rep. ¶ 83,095; Comptroller Interpretive Letter No. 462 (Dec. 19, 1988), CCH Fed. Banking L. Rep. ¶ 85,686; Comptroller No-Objection Letter No. 87-5 (July 20, 1987) ("Letter No. 87-5"), CCH Fed. Banking L. Rep. ¶ 84,034.

(ii) Equity, Commodity and Energy Swaps and Other Derivative Products

A) In its Regulation H 1998 Revisions, the Board eliminated its requirement in former 12 C.F.R. § 208.128 that Board approval be obtained before a state member bank engages in commodity and equity swaps and other derivative products that are not perfectly matched. See also 62 Fed. Reg. 15272 (Mar. 31, 1997) (solicitation of public comments) (discussing proposed elimination of 12 C.F.R. § 208.128).

Under its prior regulations, a state member bank (or a non-U.S. subsidiary of a U.S. bank or BHC) could, without prior Board approval, engage in perfectly-matched cash-settled commodity and equity swaps and other derivative products and offer loan or deposit contracts in which only the interest portion of the return was linked to commodity or security prices or indices. A state member bank was required to receive prior Board approval to engage in transactions involving equity and commodity derivatives that were not perfectly matched. See 56 Fed. Reg. 63406 (Dec. 4, 1991).

Under Regulation Y, a BHC subsidiary may act as principal, broker, agent or adviser with respect to equity, commodity and other swap and other derivative products. However, such a subsidiary may not engage as principal in transactions which are themselves ineligible securities, nor in transactions on an index of ineligible securities where the derivative does not require cash settlement. See 12 C.F.R. § 225.28(b)(6), (7), (8); SBC 1995 Order. See also Part II.E.3.e below.

B) A national bank may engage in customer-driven transactions in cash-settled swaps, options, forwards and other derivative products based on bank-ineligible commodity and equity security prices and indices whether or not perfectly matched. The Comptroller has analyzed such activity as a form of funds intermediation incidental to the business of banking. A national bank may also engage in transactions in swaps and other derivative products which require or permit physical settlement under appropriate circumstances. See, e.g., Comptroller Conditional Approval No. 864 (June 30, 2008); Comptroller Interpretive Letters No. 1040 (Sept. 15, 2005) ("Letter No. 1040") (physical settlement), CCH Fed. Banking L. Rep. ¶ 81-569; No. 949 (Sept. 19, 2002), CCH Fed. Banking L. Rep. ¶ 81-474; No. 937 (June 7, 2002) ("Letter No. 937"), CCH Fed. Banking L. Rep. ¶ 81-462; No. 935 (May 14, 2002) ("Letter No. 935") (physical settlement), CCH Fed. Banking L. Rep. ¶ 81-460; No. 896 (Aug. 21, 2000) ("Letter No. 896"), CCH Fed. Banking L. Rep. ¶ 81-415; No. 892 (Sept. 13, 2000) ("Letter No. 892"), CCH Fed. Banking L. Rep. ¶ 81-411; Comptroller Unpublished Letter to FDIC (Oct. 28, 1998); Comptroller Interpretive Letter No. 684 (Aug. 4, 1995), CCH Fed. Banking L. Rep. ¶ 83,632; Comptroller Unpublished Letter (Oct. 4, 1994) (the "Comptroller 1994 Letter"); Comptroller Interpretive Letters No. 652 (Sept. 13, 1994), CCH Fed. Banking. L. Rep. ¶ 83,600 (the "1994 Citibank Letter"); No. 632 (June 30, 1993) ("Letter No. 632"), CCH Fed. Banking L. Rep. "¶ 83,515; Comptroller Letter re Citibank (May 13, 1992) (the Comptroller Letter re First National Bank of Chicago (Mar. 2, 1992) (management of swaps on a portfolio basis); Letter No. 90-1 (unmatched commodity price index swaps); Letter No. 87-5 (matched commodity price index swaps). See also Comptroller Examiner's Guide to Investment Products and Practices.

i) Comptroller Interpretive Letter No. 1018 (Feb. 10, 2005) ("Letter No. 1018"), CCH Fed. Banking L. Rep. ¶ 81-547, permits a bank to enter into back-to-back "mirror" transactions with affiliates and subsidiaries to match transactions those affiliates and subsidiaries enter into with their customers.

ii) Comptroller Interpretive Letter No. 1039 (Sept. 13, 2005) ("Letter No. 1039"), CCH Fed. Banking L. Rep. ¶ 81-568, permits a bank to enter into customer-driven, perfectly matched, cash-settled derivative transactions with an affiliate on certain commodities and related indices (including crude oil, natural gas, heating oil, natural gasoline, gasoline, unleaded gas, gasoil, diesel, jet fuel, jet kerosene, residual fuel oil, naphtha, ethane, propane, butane, isobutene, crack spreads, lightends, liquefied petroleum gases, natural gas liquids, distillates, oil products, coal, emissions allowances, benzene, dairy, cattle, wheat, corn, soybeans, soybean meal, soybean oil, cocoa, coffee, cotton, orange juice, sugar, paper, rubber, steel, aluminum, zinc, lead, nickel, tin, cobalt, iridium, rhodium, freight, high density polyethylene (plastic), ethanol, methanol, newsprint, paper (linerboard), pulp (kraft), and recovered paper (old newsprint)). The Comptroller determined that the bank's use of an affiliate for one leg of the transaction and the expansive list of commodities and related indices that the bank may use as reference assets do not alter the nature of the proposed activities, and that a bank may engage in derivative transactions on <u>any</u> commodity where the use of the commodity will not result in a substantive change in the type or nature of the intermediation.

The Comptroller has re-affirmed that banks may enter into perfectly-matched cash-settled customer-driven commodity transactions in respect of petroleum products, agricultural oils, grains and grain derivatives, seeds, fibers, foodstuffs, livestock/meat products, metals, wood products, plastics and fertilizer. Comptroller Interpretive Letter No. 1065 (July 24, 2006), CCH Fed. Banking L. Rep. ¶ 81-594.

iii) OCC staff has advised that the Comptroller would expect to review bank participation in commodity derivatives transactions (including with respect to hedging policies) on a <u>commodity-by-commodity basis</u>. <u>Cf.</u> Comptroller Interpretive Letters No. 1063 (June 1, 2006), CCH Fed Banking L. Rep.

¶ 81-592 (hogs (including lean hogs and pork bellies), lumber, corrugated cardboard (new and recycled) and polystyrene); No. 1059 (Apr. 13, 2006), CCH Fed. Banking L. Rep. ¶ 81-580 (polypropylene, corrugated cardboard, Dow Jones AIG Commodity Index); No. 1056 (Mar. 29, 2006), CCH Fed. Banking L. Rep. ¶ 81-585 (frozen concentrate orange juice).

In addition, Letter No. 1039 and its progeny generally require that, even if the OCC approves an underlying commodity as a legal matter, a national bank must still obtain the approval of its examiner-in-charge, after review of the banks' risk management policies and procedures, with respect to each commodity to be added to a bank's derivative product list.

iv) Comptroller Interpretive Letter No. 1073 (Oct. 19, 2006), CCH Fed. Banking L. Rep. ¶ 81-605, permits a bank, including its non-U.S. branches, to engage in customer-driven retail derivative transactions that settle in cash or by transitory title transfer, and that are hedged on a portfolio basis with derivatives that settle in cash or by transitory title transfer.

C) The Comptroller has permitted banks to engage in customer-driven derivative transactions based on the price of <u>electricity</u>, both in <u>cash-settled</u> transactions and transactions that contemplate the possibility of <u>physical settlement</u>. <u>See</u> Comptroller Interpretive Letters No. 1025 (Apr. 6, 2005), CCH Fed. Banking L. Rep. ¶ 81-554; No. 962 (Apr. 21, 2003) ("<u>Letter No. 962</u>"), CCH Fed. Banking L. Rep. ¶ 81-487; Letter No. 937. The Comptroller limited physically-settled transactions to those in which a bank had "transitory" title to the electricity, and the bank represented that it did not intend to be in a position where it is required to deliver or receive actual power. The same authority has been extended to derivatives relating to coal. Comptroller Interpretive Letter No. 1060 (Apr. 26, 2006), CCH Fed. Banking L. Rep. ¶ 81-589.

i) Under Comptroller Interpretive Letter No. 1071 (Sept. 6, 2006), CCH Fed. Banking L. Rep. ¶ 81-603, a bank may become a member of "independent system operators" ("ISOs") and "regional transmission organizations" ("RTOs") in order to execute electricity derivative transactions. The Comptroller determined that the "mutualized default risk" among ISO and RTO members (i.e., that a bank, as ISO member, could be allocated a portion of the losses arising from the default of another member) constitutes a permissible guarantee under 12 C.F.R. § 7.1017, and that the steps taken by ISOs to mitigate the risk of a default allocation assessment (including credit, collateral and netting requirements, credit monitoring and analysis, shortened settlement periods, and FERC regulatory controls), address safety and soundness concerns.

ii) Bank of America, UBS, Barclays Bank, JPMorgan Chase and SocGen obtained permission from the FERC to engage in wholesale electric power and energy transactions as marketers and brokers. The FERC also granted limited waivers from restrictions under the Federal Power Act involving the purchase of securities of public utilities, provided that a bank does not hold as principal (i.e., other than in connection with certain lending, fiduciary, underwriting, dealing, trading or derivatives activities) more than 5% of any class of voting securities of a public utility and that the securities acquired confer no right to control the management or operation of the public utility. See JPMorgan Chase, 123 FERC ¶ 61,088 (Apr. 21, 2008) (acquisition of Bear Stearns), 110 FERC ¶ 61,292 (Mar. 18, 2005); SocGen, 112 FERC ¶ 61,248 (Sept. 2, 2005); Barclays Bank, FERC Unpublished Letter, June 2, 2004 (rev. June 4, 2004), 69 Fed. Reg. 38889 (June 29, 2004); Bank of America/UBS, 105 FERC ¶ 61,078 (Oct. 22, 2003) (modification to conditions); Bank of America, 101 FERC ¶ 61,098 (Oct. 30, 2002); UBS, 98 FERC ¶ 61,255 (Mar. 7, 2002). See also Tortoriello, Schotland & Bidstrup, "FERC Regulation of Banks Proposing to Qualify as Power Marketers", Banking Report, Sept. 17, 2007.

Compare Morgan Stanley, 114 FERC ¶ 61,119 (Feb. 7, 2006) (acquisition of certain utility securities); Goldman Sachs, 114 FERC ¶ 61,118 (Feb. 7, 2006) (to similar effect; Goldman Sachs request to exclude ownership of securities in a fiduciary capacity denied). See also, e.g., Woolsey v. J.P. Morgan Ventures Energy Corp., No. 15-cv-00530 (Oct. 26, 2015) (FERC has exclusive authority under Federal Power Act and is provided deference under settlement; consumer allegations of price manipulation dismissed); Electric Power Supply Association Petition for [FERC] Guidance Regarding "Control" and "Affiliation" (Sept. 2, 2008); Order on Rehearing, Repeal of the Public Utility Holding Company Act of 1935 and Enactment of the Public Utility Holding Company Act of 2005, 115 FERC ¶ 61,096 (Apr. 24, 2006); ICI Memorandum, Additional Information Concerning Filings Under the Public Utility Holding Company Act of 1935 (May 30, 2006).

See Part II.E.2.d.above with respect to certain enforcement actions.

D) The UBS VPP Letter confirmed that VPP transactions involving physical commodities -- i.e., royalty interests (which are considered real property in most states) that entitle the holder, in exchange for an upfront payment, to receive specified quantities of hydrocarbons on a regular basis during the life of the transaction -- are extensions of credit permissible for a BHC, provided that the BHC does not retain title to the underlying physical commodity. (In order to hold the underlying commodity, a BHC must obtain approval as an FHC to engage in physical commodity trading as a "complementary activity" under BHCA § 4(k)(1)(B); see Part I.C above.) See also Part II.D.3.a above.

E) Board Letter, May 15, 2006 (the "Board CPFS Letter"), confirmed that "commodity purchase and forward sale" ("CPFS") transactions -- i.e., transactions where a BHC either (A) purchases a commodity from its customer and simultaneously enters into a forward sale agreement under which the customer would be obligated to repurchase the commodity from the BHC at a predetermined price and on a predetermined future date, or (B) engages in a similar transaction involving a third party which acts either as the initial seller of the commodity to the BHC or as the ultimate purchaser of the commodity from the BHC -- are the functional equivalent of extensions of credit, and the acquisition of title to the underlying commodity in a CPFS transaction should be considered to be incident to the financing.

The BHC was required to have in place policies and procedures to identify (A) whether a CPFS transaction would create heightened legal or reputational risk; and (B) whether a particular CPFS transaction (i) lacks economic substance or business purpose; (ii) may have been designed by the counterparty for a questionable accounting, regulatory or tax purpose; or (iii) may be accounted for or disclosed by the counterparty in a way that is misleading or inconsistent with the substance of the transaction or regulatory or accounting requirements.

F) A national bank may enter into VPP transactions involving physical commodities as permissible extensions of credit. Comptroller Interpretive Letter No. 1117 (May 19, 2009), CCH Fed. Banking L. Rep. ¶ 81-649. See also Comptroller Unpublished Letter, Oct. 4, 1994 Letter (permitting a bank to purchase "production payments" (which entitle the owner to a share of minerals produced from a specific property and which are considered real estate interests under some state laws) where such purchase is related to a bank's credit extension).

G) Comptroller Interpretive Letter No. 1019 (Feb. 10, 2005) ("Letter No. 1019"), CCH Fed. Banking L. Rep. ¶81-548, indicates that hybrid lending with embedded derivatives should be permissible and that a national bank may make loans to agricultural borrowers the repayment of which is tied to the value of the borrower's crops which secure the loan. The Comptroller likened the transaction to a permissible collar combined with a loan. See Part VII.A.4.a below.

H) Letter No. 1040 permits a bank to (1) engage in customer-driven, physically settled, derivative transactions in emissions allowances (i.e., authorizations or licenses subject to the U.S. Environmental Protection Agency (or comparable EU) regulatory scheme, that give affected entities the right to emit certain pollutants) linked to emission allowance markets (the U.S. SO2 (sulfur dioxide), NOx (nitrogen oxide) and EU CO2 (carbon dioxide) markets); and (2) enter into physical transactions in emissions allowances to manage the risks of the derivatives transactions. In Letter No. 1040 the OCC also noted that "[t]here is nothing in the GLBA's definition of 'swap agreement' that requires cash settlement. Thus, physically settled emissions derivatives transactions would qualify as swap agreements and therefore would be regarded as 'identified banking products' under GLBA."

I) Comptroller Interpretive Letter No. 1079 (Apr. 19, 2007) ("Letter No. 1079"), CCH Fed. Banking L. Rep. ¶ 81-611, permits a bank to engage in customer-driven, perfectly matched, cash-settled transactions in inflation derivatives.

J) Comptroller Interpretive Letter No. 1081 (May 15, 2007), CCH Fed. Banking Rep. ¶ 81-613, permits a bank to engage in customer-driven, perfectly matched, cash-settled transactions in U.S. and UK property indices. See also Comptroller Interpretive Letter No. 1089 (Oct. 15, 2007), CCH Fed. Banking L. Rep. ¶ 81-621 (U.S., UK and European property indices).

K) Comptroller Interpretive Letter No. 1101 (July 7, 2008), CCH Fed. Banking L. Rep. ¶ 81-633 permits a national bank to engage in customer-driven, perfectly matched, cash-settled derivative transactions referencing risk indices associated with natural events and catastrophes.

L) Comptroller Interpretive Letter No. 1110 (Jan. 30, 2009), CCH Fed. Banking L. Rep. ¶ 81-642 permits a national bank to engage in customer-driven, perfectly matched, cash-settled derivative transactions referencing risk indices associated with longevity (life expectancy).

(iii) Credit Swaps and Related Derivative Products

A) Bank regulatory guidance on credit derivatives stresses the importance of effective management and focuses on credit risk (which may relate to the counterparty or the reference credit, depending on whether the bank is buying or selling protection), transaction risk (including in respect of the confirmation and documentation of trades), liquidity risk, compliance risk, specific risk (i.e., risk arising from changes in the reference asset's value due to factors other than broad market movements), strategic risk, price risk and reputation risk. See, e.g., Board SR Letters 97-21 (SUP) (July 11, 1997), CCH Fed. Banking L. Rep. ¶ 37-048; 97-18 (GEN) (June 13, 1997), CCH Fed. Banking L. Rep. ¶ 47-672B; Comptroller Bulletin 96-43 (Aug. 12, 1996); FDIC Manual of Examination Policies: "Securities and Derivatives". See also Part II.E.1.c above.

B) National banks may enter into contingent CDS and hold below investment grade bonds in connection with their derivatives activities. This authority relates to the use of such CDS and assets as hedges for counterparty credit risks and liability exposures arising out of such derivatives activities. Comptroller Interpretive Letter No. 1051 (Feb. 15, 2006), CCH Fed. Banking L. Rep. ¶ 81-580. See also Letter No. 935 (below investment grade bonds as hedge).

C) Banks' authority to enter into "structured finance swaps" on ABS or ABS indices may also be limited by Dodd-Frank's Swaps "push-out" provision. See Part II.E.2.b above.

(iv) Combined Principal and Advisory Activities

Regulation Y permits BHCs to engage in any combination of permissible non-banking activities, including principal and advisory activities, without the commitments contained in prior Board Orders (compare, e.g., SBC 1995 Order; LTCB Order).

Neither the Comptroller nor the FDIC prohibit the combination of principal and advisory activities in appropriate circumstances.

d. Futures, Options, Options on Futures and Related Derivatives

Subject to Volcker Rule considerations (see Part II.A.7 above):

(i) "Financial" Futures and Options on "Financial" Futures

The Board and the Comptroller have authorized banks and BHC subsidiaries to trade for their own account futures, options and options on futures based on eligible securities and money market instruments, but such trading should not be for "speculative purposes"; rather, it should reduce risk exposure, assist in asset-liability management, or fall within the scope of permissible "trading activities" in accordance with safe and sound banking practices.

A) Selected Federal Reserve Board Precedents: 12 C.F.R. §§ 225.28(b)(8), 225.142 (Board policy statement); CIBC, 83 Fed. Res. Bull. 324 (1997); SBC 1995 and 1991 Orders; IBJ, 81 Fed. Res. Bull. 731 (1995) (the "IBJ Order"); First Chicago Corp., 60 Fed. Reg. 7059 (Feb. 6, 1995) (solicitation of public comments) (approved Apr. 12, 1995), 53 Fed. Reg. 24499 (June 29, 1988) (solicitation of public comments) (approved Aug. 4, 1988); DKB, 80 Fed. Res. Bull. 148 (1994); Citicorp, 68 Fed. Res. Bull. 776 (1982).

B) Selected Comptroller of the Currency Precedents: Comptroller Chase CPO Letter (subsidiary may form (and serve as general partner/CPO of) commodity pools which invest in FX, U.S. and foreign government obligations, precious metals and related derivative products) (supplementing Comptroller Interpretive Letter No. 496 (Dec. 18, 1989) ("Letter No. 496"), CCH Fed. Banking L. Rep. ¶ 83,087); Comptroller Letters (Mar. 26,

1991) re Citibank; (Apr. 23, 1990) re Chase Bank; Letter No. 496; Comptroller Interpretive Letters No. 494 (Dec. 20, 1989) ("Letter No. 494"), CCH Fed. Banking L. Rep. ¶ 83,083; No. 433 (June 3, 1988) ("Letter No. 433"), CCH Fed. Banking L. Rep ¶ 85,657; No. 422 (Apr. 11, 1988) ("Letter No. 422"), CCH Fed. Banking L. Rep. ¶ 85,646; No. 384 (May 19, 1987) ("Letter No. 384"); Comptroller No-Objection Letter No. 86-13 (Aug. 8, 1986), CCH Fed. Banking L. Rep. ¶ 84,019; Comptroller Investment Securities Letter No. 5 (Aug. 5, 1986), CCH Fed. Banking L. Rep. ¶ 85,875 (trading "covered calls" on U.S. Treasury notes); Comptroller Interpretive Letter No. 260 (June 27, 1983), CCH Fed. Banking L. Rep. ¶ 85,424 (bank may trade financial options on fixed-income securities that are permissible bank investments).

With respect to certain related areas, see generally, e.g., Comptroller's Handbook: Interest Rate Risk; Part II.D.3.a.ii above.

(ii) Equity, Commodity and Other Futures and Options on Such Futures

A) Regulation Y permits BHCs to trade for their own account in futures, options and options on futures (other than instruments that are ineligible securities) based on financial and non-financial commodities if (i) the underlying asset is a bank-permissible investment; (ii) the derivative contract requires cash settlement; or (iii) the derivative contract allows for assignment, termination or offset prior to expiration and the BHC makes every reasonable effort to avoid delivery. A BHC is permitted to invest or trade in such transactions based on an index of bank-ineligible securities if the derivative requires cash settlement. 12 C.F.R. § 225.28(b)(8). See also SBC 1995 Order.

B) A bank may engage in transactions in stock index futures and every other type of future to hedge risks arising from, or otherwise engage in, permissible banking functions (e.g., for financial intermediation or customer accommodation purposes), at least so long as such instruments are cash-settled. See, e.g., Letter No. 896; 1994 Citibank Letter; Letter No. 90-1; Comptroller Chase CD Decision and Comptroller Chase CD Letter referred to in Part IV below; "The Pricing and Hedging of Market Index Deposits", Quarterly Review (FRBNY, Summer 1987). Cf. Letters No. 1040, 935 (physical settlement).

(iii) Options on Securities

Under many circumstances, as reflected in Board and Comptroller precedents set out in Part II.E.3.c, Part II.E.3.d.i and Part II.E.3.d.ii above, banks and BHCs may engage in transactions in options on securities, although, depending on the nature of the activity, authority as an FHC or a financial subsidiary may be required, given that options on securities are often themselves "securities". See also Part I.D above and Part II.E.3.f and Part III below.

e. Hedging and Related Transactions in Bank Ineligible Commodities and Securities

(i) Physical Commodities

A) Regulation Y permits BHCs to take title to non-financial commodities underlying physically-settled derivative contracts on an instantaneous, pass-through basis. See Part IX.D.2.b below and Part I.C.1.c.iv above.

See also Part I.C.1.c.ix.E above (complementary authority for FHCs to engage in physical Commodity Trading Activities). But see 79 Fed. Reg. 3329 (Jan. 21, 2014) (Board ANPR requesting comment on possible restrictions on physical Commodity Trading Activities and merchant banking activities).

B) State member banks may hedge in bank ineligible physical commodities with specific approval. See, e.g., FRBNY Letters to BTCo, Chemical Bank and Morgan Bank, June 30, 1994.

Bank of Montreal, 79 Fed. Res. Bull. 1049 (1993) (the "Bank of Montreal Order") authorized an FCM to trade in underlying physical commodities to assist in the orderly resolution of an account where offsets are entered into as soon as practicable.

Export trading companies may enter into contracts to buy and sell commodities at a fixed price to hedge a customer's exposure in commodities in international trade. Board Letter to Citicorp, July 21, 1987.

C) Under Letter No. 632, a national bank may hedge the financial exposure arising from otherwise permissible banking activities with the physical delivery of commodities so long as such activity (i) supplements hedging activities, (ii) constitutes only a nominal percentage of such activities, (iii) is used only to reduce risks, and (iv) is customer-driven and not for speculative purposes. A bank must specifically apply to engage in such activities. See also, e.g., OCC Bulletin 2015-35 (Aug. 4, 2015) (holding of physical commodities as a hedge is permitted under BC 277 if it is a "nominal portion of risk management activities", defined as "no more than 5 percent of the notional value of derivatives contracts in that commodity that allow for settlement through physical delivery within 30 days."); BC 277.

The Comptroller approved a bank plan to hedge in physical commodities -- including aluminum, copper, lead, nickel, tin, zinc, cobalt, iridium, palladium and rhodium -- and take delivery by warehouse receipts or simultaneous pass-through delivery to another party (rather than by actual receipt of physical metals). Comptroller Interpretive Letter No. 684 (Aug. 4, 1995), CCH Fed. Banking L. Rep. ¶ 83,632.

(ii) Below Investment Grade Bonds

National banks may engage in physical hedging activities using below-investment grade bonds in connection with customer-driven transactions involving credit derivatives on high yield or emerging market bonds. Comptroller Interpretive Letter No. 1064 (July 13, 2006), CCH Fed. Banking L. Rep. ¶ 81-593. See also Letter No. 935.

(iii) Equity Securities and Related Instruments

A) Commencing with Letter No. 892, the Comptroller determined that a national bank may engage in physical hedging activities using equity securities in connection with customer-driven equity derivatives transactions, subject to the conditions that (i) the bank hold securities solely to hedge risks arising from such transactions; (ii) the bank not take anticipatory, or maintain residual, positions in securities except as necessary for the orderly establishment or unwinding of a hedge; and (iii) the bank not acquire equity securities for hedging purposes that constitute more than 5% of a class of securities. A bank with an approved program may (i) hedge equity derivatives through long and short positions in equity securities; (ii) settle such derivatives in cash or by delivery of the relevant securities; and (iii) "cross-hedge" (hedge in securities different from, but related to, a derivative transaction involving a particular security). See also Letter No. 935. A bank must dispose of an equity hedge if the related customer derivative terminates, unless necessary for the orderly unwinding of the hedge.

Comptroller Interpretive Letter No. 1090 (Oct. 25, 2007), CCH Fed. Banking L. Rep.¶ 81-622, concluded that a bank may hedge equity derivative transactions with physical hedges on common and preferred stock, convertible and exchangeable securities, master limited partnership, LP and LLC interests, American/global depository receipts, closed-end/mutual funds, exchange-traded funds ("ETFs") and REITs.

See also Comptroller Interpretive Letters No. 1033 (June 14, 2005), CCH Fed. Banking L. Rep. ¶ 81-562 (bank may use baskets of securities to hedge exposures arising from equity index derivatives where the baskets do not exactly match the underlying index but are designed to replicate sector and industry weightings and general index risks); Letter No. 935; No. 924 (Jan. 2, 2002) ("Letter No. 924"), CCH Fed. Banking L. Rep. ¶ 81-449 (not applying 5% limitation to securities held by an Edge corporation subsidiary; see Part XI.B below); Equity Hedging: Comptroller Needs to Establish Policy on Publishing Interpretive Decisions (GAO, Aug. 2001); Statement of the Comptroller on Bank Holdings of Securities for Hedge Purposes, Dec. 18, 2000; Memorandum of House Banking Committee Staff, Dec. 18, 2000; Letters from Rep. Leach to the GAO and the Treasury Inspector General, Dec. 18, 2000; Letters from Rep. Leach to the Comptroller, Dec. 18, Sept. 12, 8, 2000.

B) In light of Letter No. 892, the Board concluded that a state member bank may acquire equity securities in order to hedge its exposure under customer-driven equity derivatives transactions. This authority is subject to the same restrictions as for national banks, and the state member bank must obtain permission prior to commencing such activities. See Board Statement Concerning the Acquisition of Stock by State Member Banks to Hedge Equity Derivative

Transactions (Feb. 21, 2002); Board Letter to BNY, Apr. 25, 2003; Board Letter to SunTrust Bank, May 4, 2007;

The Board's 2001 Regulation K Revision acknowledged the Comptroller's position as set out in Letter No. 892, and took such position into account in addressing equity securities-related provisions of Regulation K. See Part XI.B below.

C) Comptroller Interpretive Letter No. 961 (Mar. 17, 2003), CCH Fed. Banking L. Rep. ¶ 81-486, concludes that a bank may buy and sell options on the shares of a company in order to hedge the market risk associated with shares of that company acquired by the bank in satisfaction of DPC.

D) Comptroller Interpretive Letter No. 1037 (Aug. 9, 2005), CCH Banking L. Rep. ¶ 81-566, concludes that a bank may use cash-settled derivatives linked to the performance of the S&P 500 to hedge the market risk associated with the fees it receives from its investment advisory activities.

E) Goldman Sachs (avail. Oct. 9, 2003) provides interpretive guidance with respect to 1933 Act - registered hedging transactions in connection with derivative transactions entered into with the issuer of the underlying stock. The guidance permits a financial institution to engage in registered short sales as an initial hedge, and once the financial institution has delivered a prospectus with respect to sales of the maximum number of shares underlying the derivative transaction, it may, without further delivery of a prospectus (i) adjust its hedge (i.e., "dynamic" or "delta" hedging) through further sales and purchases, and (ii) deliver shares received from the issuer in settlement of the transaction or borrowed from the issuer in a stock loan or rehypothecated out of a pledge by the issuer in connection with the transaction to stock lenders to close out short positions. See Dayan, et al., "Raising Capital Through OTC Equity Derivatives: The [Goldman Sachs] Interpretive Letter", Futures & Derivatives L. Rep. (Jan. 2004, Oct. 2007). See also SEC Letter to Bank of America Merrill Lynch (Dec. 1, 2011) (Rule 144 safe harbor permits affiliates and holders of restricted securities to enter into forward or option-based derivative contracts without registering the transaction or initial hedge under the Securities Act).

F) JPMS (avail. June 5, 2007) permits JPMS, as part of a "program trading" service that trades "baskets" of stocks which comprise the actual securities that track the relevant index, to sell, without 1933 Act registration, JPMorgan Chase common stock in connection with facilitating JPMS's customer trades of the actual basket of the stocks comprising the S&P 500 if (i) JPMS's transactions in the JPMorgan Chase common stock occur as part of an integrated set of transactions based on the S&P 500 index and are executed through computerized trading facilities; (ii) orders to sell JPMorgan Chase common stock related to the S&P basket are entered simultaneously along with orders to sell the other component stocks; (iii) JPMS does not solicit customer transactions in JPMorgan Chase common stock or the S&P 500 basket of securities; and (iv) stock issued by JPMorgan Chase or an affiliate in an S&P basket is 5% or less of the class. Bank of America (avail. June 11, 2009) provided similar relief.

f. Issuance of Commodity- and Equity-based Derivative Products

(i) As reflected in this Part II and in Part IV below, banks may issue commodity- and equity-based derivatives and structured products.

(ii) In 12 C.F.R. § 208.128 (rescinded) the Board indicated that prior approval would not be required for a bank to offer deposit contracts in which only the interest portion of the return is linked to a commodity or security, and that approval could be requested for the issuance of other types of deposit instruments. With the rescission of § 208.128, specific prior Board approval is not required.

(iii) BTNY issued put warrants based on the Nikkei Stock Average. BTNY stated that the proceeds of the warrants could be used in trading and other activities, including the purchase and sale of futures and securities underlying the Nikkei in order to hedge its obligations on the warrants. Prospectus Feb. 1, 1990. The Board warned that such transactions would constitute an "activity" under the BHCA. See Board Letter to BTNY, Feb. 8, 1990. See also Part II.E.4.c.i below.

BHCs may have greater latitude under Regulation K in derivative product issuance outside of the U.S. See Part XI.B below.

(iv) BHC issuance of debt or preferred equity securities with an embedded derivative (even related to exchange-traded equities) should be permissible. See, e.g., JPMorgan Chase Amended and Restated Pricing Supplement (Sept. 24, 2014) (notes linked to the common stock of Tesoro Corporation); Pricing Supplement (Sept. 22, 2014) (notes linked to common stock of FireEye, Inc.); Bank of America Prospectus (Sept. 8, 2014) (notes linked to the performance of a basket of three financial stocks versus the iShares 20+ year Treasury Bond ETF).

(v) A foreign bank should be able to issue equity warrants directly (whether through a U.S. or a foreign branch), or indirectly through a non-U.S. subsidiary (at least so long as the foreign bank's U.S. branches are not involved (including through the issuance of a guarantee), since such involvement could lead the Board to characterize the activity as taking place in the U.S. and thus potentially requiring approval under the BHCA).

(vi) Morgan Stanley (avail. June 24, 1996) addresses disclosure issues relating to registered offerings of securities that are exchangeable for the equity securities of another issuer (or their cash value). Since an investor's return on exchangeable securities depends materially on the market performance of the underlying securities, holders of the exchangeable securities should be provided with disclosure about the issuer of the underlying securities in addition to that provided with respect to the issuer of the exchangeable securities, but this disclosure need not be set forth in the filings of the issuer of the exchangeable securities where there is sufficient market interest and publicly available information regarding the issuer of the underlying securities, and abbreviated disclosure concerning the issuer is included in SEC filings with respect to the exchangeable securities.

4. Currencies, Coin, Bullion, Metals and Related Derivative Products

a. Background

In 2016, average daily FX turnover exceeded \$6.5 trillion. BIS Triennial Central Bank Survey: Turnover of OTC Foreign Exchange Derivatives (BIS, Sept. 2016). As of September 2012, FX trading in North America accounts for more than \$970 billion in average daily turnover, and FX trading of emerging market currencies is expanding at a faster rate than trading in other currencies. Banking organizations derive significant revenues from trading FX and currency options, as well as gold, silver and platinum bullion, rounds, bars and coins. An increasing fraction of FX trading is electronic, with more than 40% currently estimated to take place over either proprietary single-bank electronic platforms or multibank trading portals. FX settlement risk is gaining increasing attention.

Banks are also significant participants in markets for base metals, with trading activities linked to either their commodity or currency/FX business. The London Metals Exchange, the leading non-ferrous metals market with annual volume in excess of \$12 trillion in 2015, counts 13 banks among 32 Associate Broker Clearing ("category two") members (participants in inter-dealer markets and the London Clearing House system).

With respect to FX-related issues and developments, see, e.g., Continued Evolution: 2016 Global Foreign Exchange Survey (Deloitte, 2016); Securities Law Daily, Jan. 28, 2015 (currency trading platforms); Global Financial Markets Association Letter re the FSB Consultative Document on [FX] Benchmarks (Aug. 12, 2014); Consultative Document on [FX] Benchmarks (FSB, July 15, 2014); NY Times, Mar. 14, 2014; Supervisory Guidance for Managing Risks Associated with the Settlement of [FX] Transactions (BIS, Feb. 2013); BIS Triennial Central Bank Surveys; High-frequency Trading in the [FX] Market (BIS, Sept. 2011); From Turmoil to Crisis: Dislocations in the FX Swap Market Before and After the Failure of Lehman Brothers (BIS, July 2009); Wall St. J., Aug. 31, 2010; Dow Jones Newswire, June 1, 2011; See also Part IX.D.

b. Certain Regulatory Precedents Respecting Currencies and Related Derivative Products

FHCs, BHCs, banks and their subsidiaries may trade FX and FX warrants, options, futures and options on futures.

(i) Selected Federal Reserve Board Precedents

A) Regulation Y -- 12 C.F.R. § 225.28(b)(8)(ii)(A) -- retains BHC authority to trade FX and removes the prohibitions included in certain Orders on BHCs engaging in the same subsidiary in trading activities as principal and advising customers.

Principal Orders in this area (in addition to those referred to in Part II.E.4.c below) include, e.g.:

i) Board Letter, Jan. 19, 2010 (the "CLSAS Letter") (FX aggregation services); Board Letter to CLS Services ("CLS"), Feb. 5, 2002 (acquisition of CLS Bank by CLS Group); Board Policy Statement on Privately Operated Multilateral Settlement Systems, 63 Fed. Reg. 34888 (June 26, 1998); Board Letter, Dec. 2, 1997 (CLS acquisition of Multinet and Exchange Clearing House

(London)). Bank of Montreal et al., 83 Fed. Res. Bull. 127 (1997) (the "Multinet Order") (clearinghouse for multilateral netting of FX transactions for participant banks; Board action taken in context of earlier version of Policy Statement on Privately Operated Large-Dollar Multilateral Netting Systems, 59 Fed. Reg. 67534 (Dec. 29, 1994); see also Part I.D above). See also, e.g., Board Letters, Dec. 2, 2004, Aug. 20, 2003 (expanding currencies eligible for CLS settlement); CLS, 64 Fed. Reg. 45969 (Aug. 23, 1999) (solicitation of public comments) (approved Nov. 1, 1999) (service to reduce FX settlement risk).

ii) PNC 1997 Approval (managed investment partnership FX contracts to hedge investments in foreign currency-denominated securities).

iii) ABN AMRO, 83 Fed. Res. Bull. 138 (1997) (trading, transactional and advisory services). See also, e.g., NatWest, 82 Fed. Res. Bull. 1044 (1996) (Greenwich Capital Markets); SocGen, 81 Fed. Res. Bull. 880 (1995); Sumitomo, 80 Fed. Res. Bull. 157 (1994); IBJ Order; NationsBank, 79 Fed. Res. Bull. 892 (1993); LTCB, 79 Fed. Res. Bull. 347 (1993); Sanwa Order; Midland Bank, 76 Fed. Res. Bull. 860 (1990) (the "Midland Order"), 74 Fed. Res. Bull. 577 (1988); Bank of Tokyo, 76 Fed. Res. Bull. 654 (1990); Nippon Credit Bank, 75 Fed. Res. Bull. 308 (1989).

iv) HSBC, 75 Fed. Res. Bull. 217 (1989), 69 Fed. Res. Bull. 221 (1983) (trading and transactional services pursuant to Regulations K and Y).

B) Under Dodd-Frank § 742(c)'s amendments to the CEA, retail FX transactions are prohibited unless made pursuant to a rule of a federal regulatory agency that prescribes disclosure, recordkeeping, capital, margin, reporting, business conduct and documentation requirements.

i) The Board has adopted rules to address retail FX transactions. See 78 Fed. Reg. 21019 (Apr. 9, 2013) (final rule: Retail Foreign Exchange Transactions (Regulation NN)).

ii) The CFTC has also adopted rules governing off-exchange retail FX transactions. See 76 Fed. Reg. 56103 (Sept. 12, 2011) (amendments to final rule); 75 Fed. Reg. 55410 (Sept. 10, 2010) (final rule). See also CFTC v. Forex Capital Markets, No. 16-cv-06551 (SDNY Aug. 18, 2016) (complaint filed against retail FX dealer for violation of prohibition on guaranteeing customer losses); CFTC v. IB Capital FX, No. 15-cv-01022 (W.D. Tex., Nov. 9, 2015) (alleging sales of FX contracts to retail customers who were not eligible contract participants without registration); CFTC Press Release No. 7219-15 (Aug. 27, 2015) (CFTC approval of NFA amendments to retail FX rules).

iii) The SEC adopted an interim final rule permitting broker-dealers to continue to enter into retail FX transactions, but the interim final rule expired on July 31, 2016. See SEC Release 33-77874 (May 26, 2016) (notice of expiration of interim final rule). See also Part II.E.4.b.ii and Part II.E.4.d below.

(ii) Selected Comptroller of the Currency and FDIC Precedents

Banks have broad powers respecting FX and related derivatives. See, e.g., 12 U.S.C. § 24(7). See also, e.g.:

A) OCC rules for national banks, federal branches and agencies of foreign banks, federal savings associations and their respective operating subsidiaries, address Dodd-Frank § 742(c)'s requirements with respect to retail FX transactions. 77 Fed. Reg. 62177 (Oct. 12, 2012), 76 Fed. Reg. 56094 (Sept. 12, 2011), 76 Fed. Reg. 41375 (July 14, 2011) (12 C.F.R. Part 48).

   Similarly, the FDIC has adopted rules for insured depository institutions. 76 Fed. Reg. 40779 (July 12, 2011) (12 C.F.R. Part 349).

   See also Part II.E.4.b.i above and Part II.E.4.d below.

B) Comptroller Interpretive Letter No. 624 (June 30, 1993), CCH Fed. Banking L. Rep. ¶ 83,506 (bank subsidiary may acquire equity in a partnership which trades FX options and futures).

C) Letters No. 541 and No. 496 (bank subsidiary may act as general partner and CPO of partnerships which trade, invest and hold FX spot, forward, futures and options contracts).

D) Letter No. 433 (trading FX options on the Philadelphia Stock Exchange (the "PSX") as a Registered Options Trader).

E) Comptroller Interpretive Letter No. 414 (Feb. 11, 1988) ("Letter No. 414"), CCH Fed. Banking L. Rep. ¶ 85,638 (trading OTC FX options to hedge market-maker/arbitrage activities in exchange-traded options).

c. Certain Regulatory Precedents Respecting Market-making and Specialist Activities

(i) Selected Federal Reserve Board Precedents

The Board approved Applications for a BHC subsidiary to act as a specialist in options on currencies traded on the PSX. Accordingly, FHCs and financial subsidiaries may act as specialists in FX options. See, e.g., BNP, 81 Fed. Res. Bull. 386 (1995) (the "BNP/Cooper-Neff Order"); SBC, 77 Fed. Res. Bull. 126 (1991) (the "SBC 1991 Order"), and FRBNY Letter, Sept. 24, 1991; SocGen, 76 Fed. Res. Bull. 776 (1990), 75 Fed. Res. Bull. 580 (1989), and Board Letter, June 14, 1994. Compare Banque Indosuez, 72 Fed. Res. Bull. 141 (1986) (denial of Application to act as a specialist in French franc options).

(ii) Selected Comptroller of the Currency Precedents

See, e.g., Letter No. 422 (FX option market-making on the PSX); Comptroller Unpublished Letter (June 3, 1988); Letter No. 414; Comptroller Letter (May 19, 1987) re Marine Midland Bank; Letter No. 384; Comptroller Interpretive Letter No. 372 (Nov. 7, 1986), CCH Fed. Banking L. Rep. ¶ 85,542; Comptroller Letter (Jan. 11, 1984) re Bank of America; Comptroller News Release No. 83-36 (May 13, 1983), CCH Fed. Banking L. Rep. ¶ 99,554.

d. Certain Regulatory Precedents Respecting Other Currency-related Activities

(i) The issuance and sale by a BHC of currency warrants "would appear to be an activity" subject to the BHCA. Board Letter to BankAmerica, Nov. 2, 1990. BankAmerica Letter to the Board, Nov. 8, 1990, opposed such position, arguing that warrant issuance is connected to fundraising operations pursuant to BHCA § 4(a)(2)(A).

(ii) If it is an activity subject to the BHCA, issuance of currency warrants would appear to be a "financial activity" within the meaning of the GLB Act and thus permissible for an FHC and a financial subsidiary.

(iii) Banks should be able to issue currency warrants as incident to the business of banking.

e. Certain Regulatory Precedents Respecting Metals Trading

(i) Selected Federal Reserve Board Precedents

Regulation Y -- 12 C.F.R. § 225.28(b)(8)(ii)(B) -- authorizes BHCs to buy, sell and store gold, silver, platinum, palladium, copper and any other metal that the Board may approve. Accordingly, FHCs and financial subsidiaries may engage in such activities.

A) The Board has permitted BHCs to deal in, finance the production of, arbitrage, and provide incidental services for customers (such as arranging for safe custody, assaying and shipment) with respect to, gold, silver, platinum and palladium. See, e.g., ABN AMRO, 93 Fed. Res. Bull 138 (1997) (the "ABN AMRO-ChiCorp Order"); Bessemer Order; Deutsche Bank, 82 Fed. Res. Bull. 161 (1996) (see also commitments to the Board in letters May 31, 1994, Sept. 15, 1995) and Deutsche Bank - CJ Lawrence Order; SBC 1995 Order; National City Corp. ("NatCity"), 80 Fed. Res. Bull. 346 (1994); Midland Order; Standard Chartered, 76 Fed. Res. Bull. 681 (1990); LTCB, 76 Fed. Res. Bull. 554 (1990); Westpac, 73 Fed. Res. Bull. 61 (1987).

B) A BHC may trade platinum and palladium for customers outside the U.S. under Regulation K and may deal in both for its own account. See, e.g., Republic, 80 Fed. Res. Bull. 177 (1994); Morgan, 76 Fed. Res. Bull. 552 (1990); United Mizrahi Overseas Holding Company, 71 Fed. Res. Bull. 63 (1985).

C) Questions have been raised about the continued permissibility of BHC's holding or trading in copper, particularly as the OCC has proposed that many industrial/commercial forms of copper should not be permissible for national banks. See the Industrial/Commercial Metals NPR discussed in Part II.E.4.e.ii below.

(ii) Selected Comptroller of the Currency Precedents

A) National banks may trade gold, silver, platinum, palladium and copper under 12 U.S.C. § 24(7). See, e.g., Comptroller Banking Circular No. 58 (Rev.) (Nov. 3, 1981), as supplemented Dec. 28, 1983; Comptroller Unpublished Letter (July 11, 1975) (spot and futures contracts for the purchase and sale of gold bullion and U.S. silver coins).

The OCC has proposed a rule that would prohibit national banks and federal savings associations from dealing and investing in industrial and commercial metal, even if the metal were gold, silver, platinum, palladium or copper. The proposal would define the prohibited commodities as metal (including an alloy) in a physical form primarily suited to industrial or commercial use, for example, copper cathodes or gold jewelry. See 81 Fed. Reg. 63428 (Sept. 15, 2016) (the "Industrial/Commercial Metals NPR").

B) A national bank may sell gold and silver coins to customers for their metallurgic value (not for their numismatic value) and may engage in promotional activities (such as selling merchandise) to market such coins, but may not make more than a nominal profit from such sales. Comptroller No-Objection Letter No. 88-8 (May 26, 1988), CCH Fed. Banking

L. Rep. ¶ 84,048. See also Comptroller Interpretive Letters No. 975 (Oct. 14, 2003), CCH Fed. Banking L. Rep. ¶ 81-504 (bank may dispose of old coins found in vault for their numismatic value); No. 840 (Sept. 21, 1998), CCH Fed. Banking L. ¶ 81,295 (purchase and sale of commemorative coins which have not been issued by the U.S. mint); Comptroller Unpublished Letter (Mar. 31, 1989) (gold coin "deposit accounts").

However, a national bank may not invest in rare coins and currency not used as a medium of exchange. Comptroller Legal Advisory Letter No. 252 (Oct. 26, 1982), CCH Fed. Banking L. Rep. ¶ 85,416.

C) A bank may trade platinum and palladium as part of its power to buy and sell bullion, or as functionally equivalent to trading in platinum or palladium coins and thus incidental to a bank's power to trade in coins. See, e.g., Comptroller Interpretive Letters No. 685 (Aug. 4, 1995), CCH Fed. Banking L. Rep. ¶ 83,999; No. 683 (July 28, 1995), CCH Fed. Banking L. Rep. ¶ 83,631; No. 553 (May 2, 1991), CCH Fed. Banking L. Rep. ¶ 83,244; Comptroller Unpublished Letters (Dec. 7, 1988), (July 29, 1987).

D) A bank may buy and sell copper and conduct financial derivatives activities regarding copper as part of its power to buy and sell coin and bullion. Comptroller Interpretive Letter No. 693 (Nov. 14, 1995), CCH Fed. Banking L. Rep. ¶ 81-008. See generally Wall St. J., Dec. 7, 2010 (JPMorgan Chase copper positions). But see Industrial/Commercial Metals NPR.

E) A bank's ability to buy and sell metals for its own account or for its customers extends to securities that track those metals, such as exchange-traded "gold shares" which are backed by and exchangeable for gold bullion. Comptroller Interpretive Letter No.

1013 (Jan. 7, 2005), CCH Fed. Banking L. Rep. ¶ 81-543.

f. Risk Management, Trading and Related Considerations

(i) Care must be taken to comply with all legal requirements, and appropriate internal controls should be implemented that address issues such as settlement risk (so-called "Herstatt risk") and activity limits. See generally, e.g., Supervisory Guidance for Managing Risks Associated with the Settlement of [FX] Transactions (BIS, Feb. 2013); Guidelines for [FX] Trading Activities (FX Committee, Oct. 2002); SWIFT News Release, June 11, 1998 (recommendations for FX market practices); Int'l Banking Regulator, Mar. 11, 1996 (NYBD recommendations for FX policies).

Trading Principles, Feb. 22, 2001 (published by 16 major commercial and investment banks), sets out commercial/investment bank good practice guidelines for FX trading. See Progress in Implementing the Recommendations of the Working Group on [HLTs] (FSF, Mar. 2001).

FRBNY Guidelines for [FX] Trading Activities (May 2008) address risk management practices in respect of trading, sales activities, operational risk, ethics and standards, and supervisory control functions, including market risk management limits (which could include gross or net aggregate limits, maximum allowable loss (stop loss) limits, VAR limits, maturity gap limits, option limits for each of the "Greek" risks (delta (price), gamma (change in an option's delta as underlying prices change), vega (volatility), theta (time) and rho (interest rate)), and liquidity limits) and credit risk management (including collateral arrangements, netting agreements, close-out contracts, cash settlement techniques and "material change" triggers). See also, e.g., Bloomberg, Aug. 14, 2014; Wall St. J, Aug. 13, 2014; Board SR Letter 13-24 (Dec. 23, 2013).

See also FX Global Code: May 2016 Update (BIS, May 2016) (articulating a single set of best practices for market participants and counterparties in the global FX market); FX Global Code Public Update on Adherence: May 2016 (BIS, May 2016) (description of mechanisms to promote adherence to best practices); BIS Press Releases, May 26, 2016, July 24, 2015 (announcing establishment of the Foreign Exchange Working Group to strengthen code of conduct standards and principles in FX markets); Global Preamble: Codes of Best Market Practice and Shared Global Principles (BIS FX Committees, Mar. 30, 2015); [FX] Benchmarks Final Report (FSB, Sep. 30, 2014).

See generally Part II.E.4.a above.

(ii) Allied Irish Banks ("AIB"), Allfirst Financial and Allfirst Bank entered into a Written Agreement with the Board and other regulators following the discovery of $700 million in FX trading losses resulting from unauthorized FX option transactions and other fraudulent trading activities by an Allfirst trader. AIB and Allfirst agreed to improve internal auditing and risk management controls. See Written Agreement among the Board, Maryland Commissioner of Financial Regulation, Central Bank of Ireland, AIB, Allfirst Financial and Allfirst Bank, May 16, 2002 (terminated Feb. 24, 2003); Promontory Financial Group Report to the Boards of AIB, Allfirst Financial and Allfirst Bank (Mar. 12, 2002).

Two AIB executives with supervisory responsibility at the time of the losses agreed to Board Consent Orders. David Cronin, Order of Prohibition (Apr. 20, 2006); Robert Ray, Order of Prohibition (Apr. 20, 2006). See also U.S. v. Rusnak, No. 02-CR-280 (D. Md., Oct. 24, 2002) (trader guilty plea).

AIB sued Bank of America and Citibank based on theories of fraudulent concealment and unjust enrichment alleging that, in their capacities as prime brokers, they aided and abetted unauthorized and/or fictitious trading, and had collaborated to create fake forward and option trades (which were allegedly credit extensions). See AIB v. Bank of America, 2006 U.S. Dist. LEXIS 4270 (SDNY 2006); AIB v. Bank of America, 875 F. Supp. 2d 352 (SDNY 2012) (granting motion to strike AIB's demand for jury trial); AIB v. Bank of America, No. 03-cv-03748 (SDNY Jan. 14, 2016) (dismissed all claims and counter claims).

(iii) Regulators reprimanded JPMorgan in respect of management and controls in its metals business after an investigation into its relationship with Sumitomo Corp., and related significant losses in copper trading. Sumitomo settled for $125 million its claim against Morgan alleging that it had improperly facilitated a rogue trader's fraud. Sumitomo also reached a settlement with UBS arising out of the same litigation. See Sumitomo Corp. v. Chase, No. 99 Civ. 4004 (SDNY Apr. 19, 2002) (stipulation of dismissal). See also In re Sumitomo Copper Litigation, 262 F.3d 134 (2d Cir. 2001) (suit by copper futures contract traders against Sumitomo Corp., broker-dealers and banks alleging a conspiracy to manipulate prices).

g. Certain Securities, Enforcement and Related Considerations

(i) Neither coin, bullion nor FX are 1933 Act "securities", although FX warrants or options which are traded on a national securities exchange are "securities". 15 U.S.C. § 77(b)(1).

A) Subject to limited exceptions (e.g., warrants or options that are traded on a national securities exchange), non-spot FX transactions are generally subject to regulation under the regimes applicable to listed futures and options, OTC swaps or retail FX.

B) Dodd-Frank (7 U.S.C. § 1B) granted the Treasury Secretary authority to exempt certain physically-settled FX swaps and forwards from substantive regulations that would otherwise apply to them as swaps under the Dodd-Frank amendments to the CEA. The Secretary issued a Final Determination that exempts such transactions from central clearing and exchange trading requirements, but applies new trade reporting requirements and business conduct standards. See 77 Fed. Reg. 69694 (Nov. 20, 2012) (Final Determination of FX Swaps and FX Forwards Under the CEA). See also Part II.E.4.b.i and ii above.

C) SEC staff has stated that it would not recommend enforcement action for failure to register under the 1933 Act programs where gold and silver bullion or coins were sold to a customer and non-negotiable certificates signifying ownership were issued if the customer declined to take physical possession of the bullion or coins. See, e.g., SEC Release No. 33-5552 (Dec. 26, 1974); Security Pacific Corp. ("SecPac") (avail. Jan. 11, 1980); Deak & Co. (avail. Nov. 3, 1975); Pan American Gold Corp. (avail. Sept. 18, 1975); Canadian Bank of Commerce Trust Company (avail. May 12, 1975); Dreyfus Gold Deposits (avail. Mar. 12, 1975); Mocatta Metals Corp. (avail. Jan. 2, 1975); E.F. Hutton (avail. Dec. 31, 1974). See also SEC v. Belmont Reid & Co., 794 F.2d 1388 (9th Cir. 1986) (prepayment plan relating to sale of gold did not constitute an "investment contract").

A combination of such a program with other features may lead to the conclusion that a 1933 Act "security" exists. See, e.g., SEC v. R.G. Reynolds Enterprises, 952 F.2d 1125 (9th Cir. 1991) (combination of gold sales contract, refining contract and security agreement amounted to an investment contract and thus a 1933 Act "security"); Samuel Weiss & Co. (avail. Mar. 26, 1975).

D) The SEC has published risk factors individual investors trading FX may wish to consider. See

SEC Investor Bulletin: [FX] Exchange (Forex) Trading for Individual Investors (July 2011).

E) The SEC has for some time refused to express a view concerning whether particular gold sale programs require 1933 Act registration based on "unique and unusual circumstances". See, e.g., SEC Release No. 33-6253 (Oct. 28, 1980); MTB Banking Corp. (avail. Mar. 1, 1991).

F) Regardless of whether an FX transaction involves a 1933 Act "security", it could involve a "security" for purposes of state law. See, e.g., Integrated Research Services v. Ill. Secretary of State, 765 N.E. 2d 130 (Ill. App. Ct. 2002) (FX transaction made through discretionary trading account was "investment contract" under Ill. law).

G) FINRA has issued an Investor Alert regarding scams involving gold stocks: "Gold" Stocks – Some Investments Mine Your Pocketbook (Aug. 24, 2011)

(ii) Banks have faced litigation and enforcement actions in relation to their FX and metals activities.

A) A number of banks have been subject to criminal, regulatory and civil actions in connection with alleged manipulation of FX benchmark rates and related practices. See, e.g., Board Press Release, Aug. 29, 2016 (announcing filing of notice of intent to seek fine and industry ban against Barclays trader using chat rooms to coordinate FX trading, facilitating manipulation of FX benchmarks, disclosing confidential customer information and engaging in unsafe and unsound practices); U.S. v. Mark Johnson, No. 16-cr-004570 (SDNY Aug. 16, 2016) (charging HSBC executives with front running fraud in FX market); DOJ Press Release, July 20, 2016; In the Matter of Christopher Ashton, Docket Nos. 16-015-E-1, 16-015-CMP-1 (Board Notice of Intent to Prohibit and Notice of

Assessment of Civil Money Penalty, June 30, 2016); In re [FX] Benchmark Rates Antitrust Litigation, No. 13-cv-07789 (SDNY Oct. 22, 2015) (nine banks agree to settle FX manipulation claims); In re [FX] Benchmark Rates Antitrust Litigation, No 13-cv-07789 (SDNY Aug. 13, 2015) (settlements by 5 banks); Wall St. J., June 17, 2015; Client Letter Regarding Spot FX Sales and Trading Practices (J.P. Morgan, May 26, 2015); BNYM, Form 8-K (May 21, 2015) (settlement of FX-related class action for $180 million); DOJ Press Release, May 20, 2015 (guilty pleas for manipulation of U.S. dollar and euro exchange rates and criminal fines totaling more than $2.5 billion); In the Matter of UBS AG and UBS AG Stamford Branch, Nos. 15-005-B-FB, 15-005-B-FBR, 15-005-CMP-FB (Board, May 20, 2015); In the Matter of Barclays Bank plc and Barclays Bank plc NY Branch, Nos. 15-006-B-FB, 15-006-B-FBR, 15-006-CMP-FB (Board, May 20, 2015); In the Matter of Citigroup, Nos. 15-008-B-HC, 15-008-CMP-HC (Board, May 20, 2015); In the Matter of JPMorgan Chase & Co., Nos. 15-009-B-HC, 15-009-CMP-HC (Board, May 20, 2015); In the Matter of [RBS] plc and RBS Securities Inc., Nos. 15-007-B-FB, 15-007-CMP-FB (Board, May 20, 2015); In the Matter of Bank of America, Nos. 15-010-B-HC, 15-010-CMP-HC (Board, May 20, 2015); In the Matter of Barclays Bank, Barclays Bank, NY Branch (NYDFS, May 20, 2015); In the Matter of Barclays Bank, CFTC Docket No. 15-24 (May 20, 2015); FCA Final Notice to Barclays Bank PLC (#122702) (May 20, 2015); Securities Law Daily, Apr. 29, 2015; Banking Report, Apr. 21, 2015; U.S. v. BNYM and David Nichols, 11 Civ. 06969 (SDNY Mar. 19, 2015); Banking Daily, Feb. 17, Jan. 30, 2015; In re: [FX] Benchmark Rates Antitrust Litigation, 74 F. Supp. 3d 581 (SDNY 2015) (dismissal of claims by foreign defendants under antitrust jurisdictional principles); Banking Daily, Jan. 6, 2015; FCA Press Release, Nov. 12, 2014; FINMA Press Release, Nov. 12, 2014; In the

Matter of Bank of America, AA-EC-14-99 (OCC, Nov. 11, 2014); In the Matter of Citibank, AA-EC-14-101 (OCC, Nov. 11, 2014); In the Matter of JPMorgan Chase Bank, AA-EC-14-100 (OCC, Nov. 11, 2014); In the Matter of Citibank, CFTC Docket No. 15-03 (Nov. 11, 2014); In the Matter of JPMorgan Chase Bank, CFTC Docket No. 15-04 (Nov. 11, 2014); In the Matter of [RBS], CFTC Docket No. 15-05 (Nov. 11, 2014); In the Matter of UBS AG, CFTC Docket No. 15-06 (Nov. 11, 2014); In the Matter of HSBC Bank plc, CFTC Docket No. 15-07 (Nov. 11, 2014).

See generally Wall St. J., June 17, 2015 (fines have reached almost $2 billion); Banking Daily, Sept. 17, 2014 (banks overhauling manner of trading FX).

B) Custody banks such as State Street and BNYM faced increasing scrutiny regarding their FX trading from clients and state Attorneys General.

State Street settled several enforcement actions and private lawsuits regarding its practices related to "indirect" FX transactions designed to assist custody customers in acquiring currencies needed to settle their transactions in foreign securities. State Street admitted that it had misled customers by informing them it guaranteed competitive rates and provided "best execution", when actual prices charged customers were determined by an internal mark-up formula. See SEC Press Release 2016-152 (July 26, 2016); DOJ Press Release, July 26, 2016 (describing DOJ settlement of claims under the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA") and DOL settlement of claims under ERISA); Arkansas Teacher Retirement System v. State Street Bank and Trust Company, No. 11-cv-10230 (D. Mass. July 26, 2016).

The California Attorney General filed a lawsuit seeking $200 million in damages against State

Street, alleging that it illegally overcharged California pension funds for the costs of executing FX trades over an eight year period. See California v. State Street, No. 08-08457 (Cal. Super. Ct., Oct. 20, 2009) (complaint), (Dec. 7, 2015) (settled).

See also, e.g., Bloomberg, Sept. 16, June 19, 2014; Hill v. State Street Corporation, No. 1:09-12146 (D. Mass. July 21, 2014) (settlement); Florida Attorney General Press Release ($28 Million Settlement with BNYM) (Nov. 1, 2013); Wall St. J., Apr. 19, Feb. 4, 2011.

Cases brought in the federal courts and NY State courts have alleged that BNYM defrauded custodial clients by representing that BNYM provided "best execution" when pricing FX trades under its "standing instructions" program. In a question of first impression, one court held that a federally insured institution harmed by its own alleged fraud can be held liable for civil penalties under the FIRREA. U.S. v. BNYM, 941 F. Supp.2d 438 (SDNY 2013). Cf. U.S. v. Wells Fargo Bank, 12 Civ. 7527 (SDNY 2013) (FIRREA claim in the mortgage activity context).

See also In re BNYM, SEC. Admin. Proc. No. 3-17286 (June 13, 2016) (settlement); Normand v. BNYM, No. 16-cv-00212 (SDNY Jan. 11, 2016) (complaint alleging excessive charges for customer ADR transactions); Carver v. BNYM, No. 15-cv-10180 (SDNY Dec. 31, 2015) (complaint related to BNYM's foreign exchange transactions' impact on employee pension plans); In re BNYM Forex Transactions Litigation, No. 12-md-02335 (SDNY Sept. 24, 2015) (approving settlement); U.S. v. BNYM, No. 11-06969 (SDNY Jan. 17, 2012) (partial settlement), (SDNY Apr. 23, 2015) (final settlement) (settling civil fraud lawsuit brought by the DOJ for allegedly misrepresenting the FX rates clients would receive and agreeing to revise representations it makes to clients); NY v. BNYM, 2013 NY Slip Op. 51394(U) (NY Sup. Ct. 2013); NY v. BNYM, Index No. 09-114735 (NY Sup. Ct., Dec. 12, 2011) (complaint); In re BNYM, Case No. 2011-0044 (Oct. 26, 2011) (Mass. administrative complaint).

C) The SDNY dismissed would-be class claims that JPMorgan Chase breached a series of legal duties by charging custodial clients markups on FX transactions on the basis that the custody agreement "imported no requirement that the rate be the best available market rate, the rate at which the Bank had originally procured the currency that it bought or sold to the customer, or any other particular measure." Bloomberg, July 3, 2013. See also Louisiana Municipal Police Employees' Retirement System v. JPMorgan Chase, No. 11-cv-09175 (SDNY Oct. 20, 2015) (settling claims of manipulating FX transactions because markups were disclosed); "Trading Matching and 'Last Look' in the Wholesale Electronic Spot FX Market" (J.P. Morgan, May 31, 2016).

D) See also Axiom Investment Advisors LLC v. Barclays Bank PLC, No. 15-cv-09323 (Feb. 18, 2016) (settling claims that Barclays misused a system intended to block stale foreign exchange prices by putting holds on foreign exchange orders); In the Matter of Barclays Bank PLC, NYDFS Consent Order (Nov. 18, 2015) (additional $150 million penalty and termination agreement for use of "Last Look" system to manipulate FX market).

E) A number of banks have been subject to class action lawsuits surrounding FX rate manipulation alleging financial damage to traders in South Korea. See, e.g., Simmtech Co. v. Barclays Bank, No. 13-7953 (SDNY Nov. 8, 2013) (complaint). See also Wall St. J., Mar. 31, 2014 (investors sue 12 banks to alleging rigging of FX markets); Bloomberg, June 13, Oct. 16, 2013.

F) De Kwiatkowski v. Bear Stearns, 306 F.3d 1293 (2d Cir. 2002), reversed a $165 million judgment against Bear Stearns in favor of an FX trader who had lost money trading FX contracts through a non-discretionary account. The Court held that Bear Stearns had no duty to monitor the account or to give ongoing advice and that Bear Stearns had not undertaken an advisory role that would give rise to additional duties.

G) In SEC v. Unique Financial Concepts, 119 F. Supp. 2d 1332 (S.D. Fla. 1998), aff'd, 196 F.3d 1195 (11th Cir. 1999), the SEC obtained relief against Unique for offering unregistered securities in the form of interests in an FX option trading program.

H) UBS was the subject of a suit (subsequently dismissed on the grounds of forum non conveniens since related litigation was already pending in the Isle of Jersey) alleging that a non-U.S. subsidiary churned currency trading accounts and ignored contractual loss limitations. Mayo Associates v. UBS, Civ. Action No. 97-8835, dismissed, 1998 U.S. Dist. LEXIS 7791 (SDNY 1998), dismissal aff'd, 1999 U.S. App. LEXIS 8747 (2d Cir. 1999).

I) Banks have come under fire for alleged actions in relation to both precious and base metals. See e.g., In re Aluminum Warehousing Antitrust Litigation, No. 12-3574 (2d Cir. Aug. 9, 2016) (dismissing complaints against Goldman Sachs, JPMorgan Chase and Glencore for lack of antitrust standing and lack of antitrust injury); Modern Settings v. BASF Metals, No. 14-cv-09391 (SDNY Nov. 25, 2014) (complaint against Goldman Sachs, HSBC and others over alleged manipulation of platinum and palladium pricing).

J) A number of banks have been accused in lawsuits of rigging silver and other precious metals prices. See, e.g., Shak v. JP Morgan Chase, No. 15-cv-00992 (June 29, 2016) (dismissing allegations JP Morgan manipulated the silver futures market); Bloomberg, Sept. 28, 2015 (reporting Switzerland's competition regulator investigating banks in Europe, the U.S. and Japan for precious metal price manipulation); Banking Report, Mar. 31, 2015, Nov. 26, 2014; Barrett v. BNS, 14-cv-9112 (SDNY Nov. 17, 2014) (class action complaint alleging manipulation of silver and silver derivative prices); Nicholson v. BNS, No. 14-5682 (SDNY July 25, 2014) (class action complaint). See also Bloomberg, July 26, 2014.

K) A number of banks have been subject to a putative antitrust class action alleging they have conspired to manipulate the London gold fix, which is used as a benchmark to determine the prices of gold and gold derivatives. See, e.g., Maher v. BNS, No. 14-1459 (SDNY Mar. 4, 2014) (complaint). See also, e.g., Wall St. J., Sept. 5, 2014 (CME and Thomson Reuters manage London Gold Fix); Bloomberg, July 11, 2014 (CME/Thomson Reuters run silver fixing replacement).

(iii) The CFTC has undertaken a number of enforcement, interpretive and other actions relating to its oversight of FX and precious metals markets.

A) CFTC Advisory, Feb. 8, 2001, relates to fraud in retail FX futures and options trading, and CFTC Release No. 4833-03 (Aug. 26, 2003) approved several NFA rules designed to protect retail FX futures and options investors. See also, e.g., CFTC Release 4513-01 (May 2, 2001); NFA Letter to the CFTC, Sept. 8, 2004 (change to NFA's interpretive notice regarding FX transactions to require "bid-ask" spread disclosure).

CFTC actions which allege fraudulent FX transactions and the sale of illegal off-exchange FX futures include, e.g., CFTC v. Paramount Management, No. 13-04636 (SDNY Sept. 9, 2013) (consent order); CFTC v. The Borrowing Station, No. 12-01225 (D. Md., Aug. 23, 2013) (settlement order); CFTC v. Madison Dean, Inc., No. 12-02235 (EDNY, June 27, 2013) (consent order); CFTC v. Prestige Capital Advisors, No. 18-00431 (W.D.N.C. Jan. 25, 2013) (consent order); CFTC v. Alcocer, No. 12-23459 (S.D. Fla., Apr. 5, 2013) (order); CFTC v. Yu, No. 12-cv-3921, No. 12-03921 (N.D. Cal., Mar. 26, 2013) (judgment); CFTC v. Trimble, No. 11-02827 (D. Colo., Mar. 14, 2013) (injunction) CFTC v. MXBK Group, No. 10-01172 (D. Utah, Mar. 7, 2013) (default judgment); CFTC v. Liskov, No. 11-11577 (D. Mass. Feb. 19, 2013) (injunction); CFTC v. MXBK Group, No. 10-01172 (D.VI., Dec. 1, 2010) (complaint); CFTC v. Sterling Trading Group, No. 04021346 (S.D. Fla., June 8, 2009) (order); CFTC v. Ovsepyan, No. 01-06907 (C.D. Cal., Sept. 2, 2004) (order); CFTC v. Offshore Financial Consultants, No. 02-60769 (S.D. Fla., Aug. 14, 2003) (order); CFTC v. Infinite Trading Group, No. 01-01107 (N.D. Ga., June 24, Mar. 27, 2003) (orders); CFTC v. Int'l Currency Strategies, Civ. No. 01-08350 (S.D. Fla., July 15, 2002) (order); CFTC v. Garbe, No. 01-08329 (S.D. Fla., Nov. 27, 2001) (order). See also Maximum Financial Investments Group, FINRA News Release, Aug. 18, 2009; CFTC Advisory 06-01 (Feb. 5, 2001) (post-CFMA regulation of OTC FX transactions); CFTC v. Baragosh, 278 F.3d 319 (4th Cir.), cert. denied, 537 U.S. 950 (2002) (CFTC authority over retail FX transactions under pre-CFMA version of Treasury Amendment).

B) The CFTC declared Bitcoin and other virtual currencies to be within the definition of commodities that are regulated under the CEA in a settlement with an unregistered trading platform. In re Coinflip

Inc., CFTC Docket No. 15-29 (Sept. 17, 2015). See also Financial Times, Aug. 23, 2016 (banks team up to create digital cash to settle financial trades).

C) CFTC v. Zelener, 373 F.3d 861, rehearing denied, 387 F.3d 624 (7th Cir. 2004), held that the CFTC lacks jurisdiction over fraud in connection with FX spot contracts that are rolled forward and not settled by physical delivery. The CFTC had argued that such contracts were futures subject to its jurisdiction. See also 78 Fed. Reg. 52426 (Aug. 23, 2013) (Interpretation: Retail Commodity Transactions under [CEA]), 76 Fed. Reg. 77670 (Dec. 14, 2011) (request for comment).

D) CFTC Advisory, Jan. 31, 2012, warns consumers about fraudulent sales practices in gold, silver and other precious metals.

E) The CFTC received numerous communications from silver investors alleging manipulation of the price of silver futures on NYMEX. In its Open Letter, May 14, 2004, the CFTC concluded that the existence of a long-term manipulation was not plausible and that an analysis of activity in the market did not support a conclusion of manipulation.

In 2008, silver commentators and investors reasserted their allegations. The CFTC Report on Large Short Trader Activity in the Silver Futures Market concluded that there is no evidence of manipulation in the market. In 2011, the CFTC released a statement that the investigation was ongoing but the CFTC has not revised its conclusion. CFTC Press Release, Nov. 4, 2011. See CFTC v. Southern Trust Metals, Inc., No. 14-22739 (S.D. Fl. July 23, 2014) (complaint as to a scheme to defraud retail customers in connection with illegal, off-exchange, financed precious metals transactions), No. 14-22739 (S.D.Fl., June 23, 2015) (referral to magistrate of motion to compel document requests).

(iv) In July 2014, the UK's Financial Conduct Authority referred allegations of fraudulent conduct in the FX market to the Serious Fraud Office (SFO). The SFO concluded its investigation in March 2016 without bringing any prosecutions. See SFO Press Release, Mar. 15, 2016.

III. UNDERWRITING AND DEALING ACTIVITIES

This Part primarily explores the powers of FHCs and financial subsidiaries in relation to full service underwriting, and to a lesser extent dealing (see Part IX) activities, followed by a brief foray into considerations related to BHC "Section 20" subsidiaries and the securities distribution powers of banks. Along the way, this Part also explores two legal frameworks -- anti-tying and interaffiliate transaction restrictions -- that affect the interaction between FHC/BHC subsidiaries and bank subsidiaries.

A. FINANCIAL HOLDING COMPANIES AND FINANCIAL SUBSIDIARIES: STRATEGIC AND COMPLIANCE ISSUES

Part III.A addresses (1) FHC and financial subsidiary empowerments, (2) anti-tying requirements, (3) interaffiliate transaction restrictions of Sections 23A/23B, and (4) other compliance-related requirements.

1. Empowerments

a. Under Gramm-Leach, FHCs and financial subsidiaries may engage in securities underwriting, dealing and market-making, as well as mutual fund sponsorship, advisory, management, administrative and distribution activities, without any "ineligible revenue" limitation and free from most of the Operating Standards. See 65 Fed. Reg. 14440 (Mar. 17, 2000). See also Part I.C.1.c.ii above.

b. Although Gramm-Leach empowerments should encompass all transactions, as principal or intermediary, involving securities of any type, the Financial Activities Release indicates that an FHC's authority to engage in securities activities under Gramm-Leach (BHCA § 4(k)(4)(E)) includes "underwriting or distributing shares of" mutual funds, but not "organizing, sponsoring or managing a mutual fund."

However, the Board determined that BHCs may engage in the latter activities under Regulation K (and, thus, such activities are permissible U.S. activities for FHCs). In addition, such Release suggests that the Board does not view "providing administrative and other services to mutual funds" as within the scope of the BHCA § 4(k)(4)(E) securities authorization, but rather that such activities are permissible because they have been approved by Board order as "closely related to banking" under BHCA § 4(c)(8).

2. Certain Issues Respecting a Financial Holding Company's Establishment/Operation of a Securities Firm

   a. Careful evaluation of the acquisition-related considerations discussed in Part XII.D below will be critical in determining how a securities firm will fit within an FHC's business plan.

   b. The ability to cross-market/sell and otherwise integrate product offerings between a securities firm and an affiliated bank has become increasingly important, as banking organizations have striven to provide a full range of services -- e.g., adviser, underwriter, dealer manager/consent solicitation agent, lender, loan syndicator, placement agent, investor, hedge provider, etc. -- through the combined efforts of their bank and securities operations.

      On the other hand, some FHCs have moved away from the "financial supermarket" concept to concentrate on those areas where their strengths are more pronounced. Moreover, extensive involvement with a customer through multiple product and service offerings can significantly increase the regulatory risk of the combined organization, and anti-tying and similar compliance-related concerns are receiving serious attention.

      See also Part VII.A.2.b.vi and Part IX.A.1.b.i below. See generally Euromoney, Feb. 2012; American Banker, June 1, 2010.

      (i) The volume of business cross-referrals between a bank and its affiliated securities firm has become an important indicator of the success of integration.

      (ii) Bank/securities firm cross-marketing raises a number of issues, including:

         A) Compliance with the GLB Push-out Provisions. See Part I.C.2 and Part II.D.3.b above and Part IX.B.3 below.

B) Bank powers.

C) Compliance with the Anti-tying Statute. See Part III.A.4 below.

D) Compliance with Sections 23A/23B. See Part III.A.5 below.

E) Compliance with GLB Act privacy provisions. See Part I.C.5 above.

c. Since the onset of the financial crisis in 2007, corporate bond markets have begun to fill an emerging gap in bank lending and long-term financing and are showing potential for servicing the credit needs of small-and medium-sized enterprises. In the U.S. and Europe, there is evidence that, in some sectors, bank loans to nonfinancial firms have declined while corporate bond issuances of these firms have grown substantially. Therefore, an imperative exists for banking institutions to engage in the underwriting and dealing of debt securities, in addition to and perhaps even in lieu of traditional bank lending. See Corporate Bond Markets: A Global Perspective (IOSCO, Apr. 2014).

3. Operating Standards and Other Compliance-related Concerns

a. A Board rule -- 12 C.F.R. § 225.4(g) -- imposes two Operating Standards on FHCs that engage in securities underwriting and dealing:

(i) Intra-day extensions of credit to a securities firm from an affiliated bank or thrift or U.S. branch of a foreign bank must be on market terms. See the discussion of Operating Standard 5 in Part III.B.5.c below. See also Part III.A.5 below.

(ii) Sections 23A/23B apply to loans and other "covered transactions" between a U.S. branch of a foreign bank and a securities affiliate. See Part III.A.5 below.

The concerns addressed by the balance of the Operating Standards are generally addressed by the "well capitalized" and "well managed" criteria which Gramm-Leach imposes on FHCs. See Part I.C above.

b. See Part II.A.7 above for a discussion of the Volcker Rule prohibitions on "proprietary trading" (including that Rule's underwriting exemption) and investments in a "hedge fund or private equity fund" by a "banking entity".

c. See Part I.C.1.j.(i) above for a discussion of cross-marketing restrictions applicable to certain FHC operations.

d. As a broker-dealer, a subsidiary of an FHC/BHC which engages in securities underwriting and dealing must comply with all securities law requirements. While this Guide is not intended to set out all issues relating to the conduct of a securities business from a U.S. federal or state securities law perspective, a number of the operational issues relevant to a broker-dealer that relate most directly to an FHC's/BHC's/bank's capital markets activities are discussed in various Parts of this Guide.

e. With respect to supervision and examination of broker-dealer subsidiaries of an FHC/BHC, Gramm-Leach had previously restricted the Board's access to, as well as the Board's ability to impose regulations or standards on, such "functionally regulated" subsidiaries, thus reserving plenary authority to the SEC in the case of broker-dealers. See Gramm-Leach §§ 111 and 113 (amending BHCA § 5(c), and adding BHCA §§ 5(g) and 10A). Dodd-Frank § 604 significantly modified these restrictions on the Board's authority, permitting direct access and examination of "functionally regulated" subsidiaries (BHCA § 5(c)) and repealing BHCA § 10A's restrictions on the Board's ability to impose regulations or standards on such subsidiaries. However, the Board is still prohibited from directly applying capital requirements to broker-dealer subsidiaries. See BHCA § 5(c)(3), 12 U.S.C. § 1844(c)(3).

f. The interaction between securities firms and other affiliates within an FHC/BHC organization can often be the subject of alleged conflicts or unfair dealing claims. For example, a customer's claim against a securities subsidiary for recommending that such customer invest in CP without disclosing that the securities subsidiary's parent corporation, a

BHC, had provided a credit facility for, and was the underwriter/dealer of, the recommended CP, withstood a motion to dismiss. However a claim against the BHC was dismissed since the BHC had no duty to disclose its involvement. See Abbell Credit Corp. v. Banc of America Securities, CCH Fed. Sec. L. Rep. ¶ 91,734 (N.D. Ill. 2002).

4. Anti-tying Requirements

a. Background

(i) As described in Part I.A.4 above, the Anti-tying Statute provides that a bank may not condition the availability of a product or service, or vary the consideration of a product or service, on its customer obtaining another product or service from the bank or one of its affiliates, unless the tied product falls within a "traditional products exception" -- a loan, discount, deposit or trust service -- or another exception applies.

(ii) The Anti-tying Statute also applies to "reciprocity arrangements" and "exclusive dealing arrangements" described in Part III.A.4.b below.

(iii) The Regulation Y 1997 Revisions (see 12 C.F.R. § 225.7) eliminated the regulatory extension of the Anti-tying Statute to BHCs and their non-bank subsidiaries, leaving restrictions on anti-competitive behavior by BHCs and such subsidiaries to the general antitrust laws. The Revisions also created exceptions from the statutory restriction on bank tying arrangements.

(iv) The Anti-tying Statute reflects 1970-era concerns about dominance of bank credit in the economy, as well as a concern as to a bank's ability to impose conditions at a retail level. Congress perceived tying transactions involving credit as "inherently anti-competitive, operating to the detriment of banking and non-banking competitors". See S. Rep. No. 1084, 91st Cong., 2d Sess. 16 (1971). Courts have adopted the view that the Statute imposes restrictions on banks that are stricter than antitrust limitations, and that violation of the Statute does not require proof of market power or anti-competitive effect. See, e.g., Highland Capital v. Franklin National Bank, 350 F.3d 558 (6th Cir. 2003) ("Highland Capital"); Oak Rubber Co. v. Bank One, N.A., 214 F. Supp. 2d 820 (N.D. Ohio 2002). See generally "Tie-in Sales and Banks", FRBR Quarterly Review (Spring 1996).

(v) In 2003, the Board issued a proposed interpretation of the Anti-tying Statute. See 68 Fed. Reg. 52024 (Aug. 29, 2003) (solicitation of public comments) (the "Proposed Anti-tying Interpretation"). See also Today's Credit Markets, Relationship Banking and Tying (OCC, Sept. 2003) (the "OCC 2003 Anti-tying Report"); OCC Statement, dated Aug. 25, 2003 (endorsing the Proposed Anti-tying Interpretation); Tortoriello et al., "The [Board's] Proposed Interpretation of the Anti-tying Provisions of the [BHCA] Amendments of 1970", Banking Law J. (Nov./Dec. 2003).

In addition, the Board proposed an exception under the Anti-tying Statute for financial subsidiaries of state non-member banks. 68 Fed. Reg. 51938 (Aug. 29, 2003) (solicitation of public comments) (the "Proposed Financial Subsidiary Anti-tying Exception").

(vi) Timothy Naegele, author of the Anti-tying Statute, criticized the Proposed Anti-tying Interpretation, and concluded that it is debatable whether the Statute has been an effective tool for preventing bank misconduct. He surmised that the lack of many "plaintiff-friendly" decisions is the result of (A) the lack of written documentary evidence (e.g., particularly in the context of orally-imposed tying arrangements), (B) uncertainty as to what constitutes impermissible conduct, (C) perceived adverse consequences in suing a bank, and (D) judicial/regulatory bias. See Naegele, "The [BHCA's] Anti-tying Provision: 35 Years Later", Banking L. J. (Mar. 2005).

(vii) The Centre for European Policy Studies Report to the EC: Tying and Other Potentially Unfair Commercial Practices in the Retail Financial Service Sector (Nov. 24, 2009) focuses on the identification and assessment of those practices in Europe that restrict customer mobility and increase customer switching costs in retail financial services, and examines aggressive commercial practices as well as practices that may result from informational asymmetry between financial advisers and their customers.

See also Part I.A.4 above and Part IX.E below.

b. Conduct Prohibited by the Anti-tying Statute

(i) A bank is prohibited from extending credit, leasing or selling property, furnishing any service, or fixing or varying the consideration for any of the foregoing, on the condition or requirement that the customer:

A) Enter into a "tie-in arrangement"; i.e., obtain an additional credit, property or service from such bank or its affiliates, other than a "loan, discount, deposit or trust service" ("traditional bank products");

B) Enter into a "reciprocity arrangement"; i.e., provide an additional credit, property or service to the bank or its affiliates, other than those related to and usually provided in connection with a traditional bank product; or

C) Enter into an "exclusive dealing arrangement"; i.e., not obtain some other credit, property or service from a competitor of the bank other than a condition or requirement that the bank reasonably imposes in a credit transaction to assure the soundness of the credit.

(ii) According to examples described in the Proposed Anti-tying Interpretation, the Anti-tying Statute prohibits a bank from imposing a condition on a prospective borrower that requires the borrower to do any of the following in order to obtain a loan from the bank:

A) Purchase an insurance product from the bank or an affiliate of the bank (a prohibited tie);

B) Obtain securities underwriting services from an affiliate of the bank (a prohibited tie);

C) Sell the bank or an affiliate of the bank an asset unrelated to the requested loan (a prohibited reciprocity arrangement); or

D) Refrain from obtaining insurance products or securities underwriting services from a competitor of the bank or from a competitor of an affiliate of the bank (a prohibited exclusive dealing arrangement).

Comptroller Bulletin No. 95-20 (Apr. 14, 1995) sets out examples of arrangements allowed under the Anti-tying Statute. See also OCC 2003 Anti-tying Report; "Legality of Relationship Banking Under Bank Anti-tying Restrictions" (ABA/ABASA, May 28, 2003) (tying is legal when (A) a customer seeks multiple products to obtain favorable terms; (B) a customer initiates the tie; (C) a bank refuses to renew a line of credit because its overall relationship with the customer is not profitable enough; (D) a non-bank unit of a BHC conditions a loan on a customer obtaining a service from another non-bank unit; (E) a lender links traditional bank products; or (F) a bank grants a loan if the borrower selects another, more profitable service from a menu of traditional bank products and other products).

(iii) Among the general points raised by, or relevant to, the Proposed Anti-tying Interpretation:

A) The determination of whether a violation of the Anti-tying Statute has occurred is fact specific.

B) The Anti-tying Statute does not require a bank to extend credit or provide any other product to any customer; <u>i.e.</u>, the Statute does <u>not</u> prohibit a bank from declining to provide credit to a customer so long as the bank's decision is not based on the customer's failure to satisfy a condition or requirement prohibited by the Statute.

C) The Anti-tying Statute applies only to tying arrangements that are imposed by a <u>bank</u>. The Statute does not apply to tying arrangements imposed by a <u>non-bank affiliate</u> of a bank. <u>However</u>, if a non-bank affiliate acts on behalf of a bank in implementing a tying arrangement, the Statute's prohibitions may be implicated. <u>See Morales v. UBS Bank USA</u>, No. 2:14-cv-888 (D. Utah, July 8, 2016) ("<u>Morales</u>") (alleged tying through oral communications by employee of affiliate when bank allegedly "authorized the loan program to be implemented and managed through" affiliate). <u>See also</u> <u>Part III.A.4.e below</u>.

D) The question of whether "<u>coercion</u>" or force is required when imposing a condition continues to be debated. The Proposed Anti-tying Interpretation concluded that the Anti-tying Statute "is intended to prevent banks from using their ability to offer bank products, credit in particular, in a coercive manner to gain a competitive advantage." The Board also "recognize[d] that some courts have held that a tying arrangement may violate [the Anti-tying Statute] without a showing that the arrangement resulted from any type of coercion by the bank. . . . After carefully reviewing the language, legislative history and purposes of the statute, the Board believes the better interpretation of [the Anti-tying Statute] is that a violation may exist only if a bank forces or coerces a customer to obtain (or provide) the tied product as a condition to obtaining the customer's desired product."

Nevertheless, as the Proposed Anti-tying Interpretation was never formally adopted by the Board, courts have not given the Board's views significant weight. See Morales (tying claim survived motion to dismiss because "the BHCA does not require proof of force or coercion"; citing other cases and stating that "since the proposed interpretation was issued, no circuit court has held that a BHCA claim requires proof of coercion"); Highland Capital. Compare 2004 Bank Submission (described in Part III.A.4.b.v below).

E) The Anti-tying Statute covers some activities that are not included in the conventional notion of tying. For example, the Statute prohibits banks from granting certain types of price discounts on the condition that the customer purchase one or more other products from the bank or an affiliate. Yet, price discounts (including rebates) on bundled products are the subject of much discussion of their permissibility.

i) There is no "perfect price" for any product or service when multiple products or services are offered. A bank's risk profile and financial and cost structures, applicable capital requirements, the interrelationships between -- and, thus, cost savings and efficiencies on -- different products and services (e.g., a lower cost of services if due diligence needed for a credit facility duplicates that needed for a securities offering), and bona fide customer relationships, could all be important components in pricing decisions.

ii) Banks may take into account a customer's overall relationship when pricing a product in much the same way a bank would evaluate a customer's credit history. See Remarks by Board General Counsel Mattingly, May 23, 1993.

iii) Assistant Secretary of the Treasury Abernathy cautioned against confusing illegal "tying" with legal discounts banks give to good customers who buy additional services (even if the services are securities services, and even if the customer relationship was established through lending). See American Banker, Nov. 10, 2003.

(iv) While the vast majority of comments on the Proposed Anti-tying Interpretation commend the Board on its approach (and suggest clarifications and modifications), the comments run the range from those which request that the Board limit the application of the Anti-tying Statute only to those arrangements which would violate the antitrust laws, or which suggest a "wholesale" exception to the Statute's applicability, to those which criticize the Board for purportedly undercutting Congressional intent.

A) Compare, e.g., "Economic Power and the Bank Tying Provisions" (Sept. 2003) and related Letters of Bank of America, Citigroup, Deutsche Bank, JPMorgan Chase and UBS (the "Bank Anti-tying Group") to the Board, dated Aug. 2, 2005, Mar. 30, 2004, Sept. 30, 2003, ABASA Comment Letter, dated Sept. 30, 2003 (the "ABASA Comment Letter"), Financial Services Roundtable Comment Letter, dated Sept. 30, 2003 (the "FSR Comment Letter"), and NYC Bar Comment Letter, dated Sept. 30, 2003 (the "NYC Bar Comment Letter"), with, e.g., Lazard Frères Comment Letter, dated Sept. 30, 2003.

B) The Antitrust Division Comment Letter, dated Nov. 7, 2003, stated:

"[T]he prohibitions on tying within [the Anti-tying Statute] are much broader than those found in the federal antitrust laws. While the [Proposed Anti-tying Interpretation] brings [the Statute] closer to the scope of the federal antitrust laws by stating that it pertains only to coercive, not voluntary, tying, the Division is still concerned that the [Proposed Anti-tying Interpretation's] interpretation of [the

Statute] may continue to prohibit some pro-competitive practices, particularly multi-product discounting. Additionally, the Division is concerned that the [Statute] disadvantages banks as competitors in markets in which banks and non-banks compete, thus lessening competition and harming consumers. The Division, therefore, recommends that the [Board] interpret [the Statute] to be consistent with, and not broader than, the federal antitrust laws. In the event the Board determines that court precedent precludes such an interpretation, the Division recommends that the Board exercise its statutory right to expand the range of exemptions to [the Statute] . . . [A]t a minimum, . . . the [Statute] should be limited to ties involving small businesses and individual consumers." (Emphasis added.)

(v) The Bank Anti-tying Group made a Joint Submission to the Board in 2004 (the "2004 Bank Submission") proposing (A) a safe-harbor exemption to the Anti-tying Statute for transactions which involve large, sophisticated customers (the "Proposed Large Customer Safe-harbor Exemption"), and (B) a complementary interpretation with respect to the standard of bank "coercion" required for a violation of the Anti-tying Statute. (See also NYC Bar Comment Letter; NYC Bar Letter to the Board, dated May 8, 2001.)

A) The 2004 Bank Submission included an extensive analysis of the competitiveness of credit markets in order to provide support for the adoption of the Proposed Large Customer Safe-harbor Exemption.

See also, e.g., Bank of America Letter to the Board, dated Feb. 22, 2005 (borrowing needs of "large customers" are not so large that only a few banks could effectively perform the role of lead arranger). Compare Association of Financial Professionals Credit Access Survey: Linking Corporate Credit to the Awarding of Other Financial Services (June 2004) (stating that (i) 96% of the companies with revenue of $1 billion or more which responded said that they had been pressured by lenders to buy other services in exchange for loans, and (ii) nearly two-thirds of such companies said that a bank had denied credit or raised loan prices because the companies did not buy other services).

B) A study on the tying of lending and equity underwriting supports the notion that tying arrangements may benefit banks and customers, that tying lowers issuers' financing costs through lower underwriting fees and loan yield spreads, and that banks can realize cost savings from efficiencies (e.g., informational economies of scale attributable to using the same client-specific information for multiple purposes) resulting from combining lending and underwriting. The study also indicates that both commercial and investment banks tie lending and underwriting and offer price discounts. See Drucker & Puri, The Tying of Lending and Equity Underwriting (Apr. 2004). See also Tying and Subsidized Loans: A Doubtful Problem (ABA, May 2003).

(vi) Allegations had been made that banking organizations violated the Anti-tying Statute by, e.g., tying credit extensions or enhancements to use of the bank or its affiliate as underwriter.

A) Letters from Rep. Dingell to the Board and the Comptroller, dated Sept. 12, July 11, 2002, stated that tying is widespread. Notwithstanding the Board/Comptroller Letter to him, dated Aug. 13, 2002, which reported limited evidence of bank tying, Rep. Dingell expressed doubt as to whether the Anti-tying Statute has been vigorously enforced. For other allegations of tying violations or expressions of concern as to enforcement of the Anti-tying Statute, see, e.g., Letters from Reps. Dingell/Markey to the Board/Comptroller/GAO, dated Sept. 12, Aug. 8, 1994, and responses of the Board, dated Aug. 23, 1994, and Comptroller, dated Sept. 6, 1994; Board Memorandum to Federal

Reserve Banks, dated Nov. 6, 1992 (Supervisory Policy Regarding Prohibitions Against Tying Arrangements); SEC Division of Market Regulation Memorandum, Tie-in Arrangements in Municipal Securities Underwriting (Oct. 8, 1992). See also Wall St. J., Feb. 23, 2012 (noting that bank credit providers are often later named as underwriters in a company's IPO); American Banker, Oct. 28, 2003 (tying and small businesses).

B) In a Letter to Rep. Dingell, dated Oct. 16, 2002, Board Chairman Greenspan/Comptroller Hawke reaffirmed supervisory efforts to enforce the Anti-tying Statute.

i) The Board/Comptroller stated that they had not uncovered evidence that credit facilities or loan commitments were being "mispriced", and stated that "up-front fees received by the initial lender, the ability of 'relationship lenders' to more effectively monitor the credit quality of a borrower on an ongoing basis, and the different objectives, risk profiles and financial structures of 'relationship and non-relationship lenders' are just a few of the factors that might result in institutional investors requiring different returns on a given credit than originating banking organizations."

ii) The Board/Comptroller also stated that examiners would interview bank officials concerning pricing practices, including to what extent a bank may vary the pricing of its products or services "based on the customer's entire relationship with the bank (keeping in mind that not all such variations are prohibited . . .)".

C) In a Letter to the GAO, dated Nov. 4, 2002, Rep. Dingell challenged the Board/Comptroller conclusion that bank credit has not been "mispriced" as part of tying violations. He also acknowledged confusion over what activity is and is not illegal, and asked that the GAO update its Report Bank Oversight: Few Cases of Tying Have Been Detected (May 1997).

D) Bank Tying: Additional Steps Needed to Ensure Effective Enforcement of Tying Prohibitions (GAO, 2003) (the "GAO 2003 Tying Report") concluded that the application of the Anti-tying Statute depends on the facts and circumstances of specific transactions, and that there was little evidence of bank violations of the Statute. See generally OCC Press Release NR 2004-23 (Mar. 23, 2004) (OCC contact information for questions concerning tying); Highland Capital (discussing the ability of a claimant to use circumstantial evidence to prove violation of the Statute; violation not found).

E) In In re WestLB, Docket No. 03-030-B-FB (Aug. 27, 2003) (Board Order to Cease and Desist and Assessment of a Civil Money Penalty), without admitting any allegations, WestLB consented to the issuance of the Order for violations of the Anti-tying Statute relating to the alleged conditioning of the availability or price of credit to corporate customers on the appointment of WestLB as a securities underwriter.

F) As set out in his Letter to the Board and the OCC, dated Oct. 20, 2003, Congressman Dingell was not satisfied with the GAO 2003 Tying Report. See also Letter from Rep. Dingell to Board/Comptroller/SEC, dated Oct. 14, 2003 (regarding allegations of violation of the Anti-tying Statute); Rep. Dingell Letter to GAO, dated Oct. 2, 2003.

(vii) In general, any customer of a bank should have standing to raise a violation of the Anti-tying Statute, and non-customers should be able to bring suit if they have suffered direct injury as a result of the bank's actions. See, e.g., Amerifirst Properties v. FDIC, 880 F.2d 821 (5th Cir. 1989); Campbell v. Wells Fargo Bank, 781

F.2d 440 (5th Cir. 1986) (direct injury not found in respect of investors who advanced funds to borrower which had allegedly been harmed by bank tie), rehearing denied, 784 F.2d 1113 (5th Cir. 1986), cert. denied, 476 U.S. 1159 (1986); Swerdloff v. Miami Nat'l Bank, 584 F.2d 54 (5th Cir. 1978).

Former employees, however, generally do not have standing to bring suit under the Anti-tying Statute for injuries suffered as a result of a bank's alleged tying because the purpose of the Anti-tying Statute is to protect the bank's competitors, customers and persons closely related to such customers. See e.g., Bray v. Bank of America N.A, 2014 WL 5783039 (E.D. Mo., Nov. 6, 2014), rev'd and remanded, 611 Fed. App'x 888 (8th Cir. 2015), aff'd on reconsideration, 2016 WL 687818 (E.D. Mo., Feb. 19, 2016).

(viii) See Wall St. J., Mar. 1, 2015, for a discussion of reciprocal business granting practices among international banking institutions, and investigations and allegations of anti-competitive behavior.

c. Essential Elements of an Impermissible Tying Arrangement

(i) The Arrangement Must Involve Two Products -- a Desired Product and a Tied Product

A) A "tying arrangement" under the Anti-tying Statute must involve two or more products. A bank does not violate the Statute by requiring a customer to obtain two or more aspects of a single product from the bank, or by conditioning the availability or varying the price of a product on the basis of the characteristics or terms of that product. For example, a bank does not violate the Statute by requiring:

i) A borrower to provide the bank specified collateral in order to obtain a loan or to obtain a loan at a favorable interest rate; or

ii) A borrower to post additional collateral, accept a higher interest rate, or provide updated or additional financial information as a condition to loan renewal.

B) According to the Proposed Anti-tying Interpretation, two products will be separate for purposes of the Anti-tying Statute only if there is such demand for each of the products individually that it would be efficient for a firm to provide the products separately.

C) The ABASA Comment Letter suggested that the standard set forth in the Proposed Anti-tying Interpretation should be broad enough to permit banks to consider as a single product two or more <u>interrelated products</u> that, if offered together, could be offered at a lower price than if offered separately (<u>e.g.</u>, a loan that requires an interest rate swap, a loan secured with stock with an equity collar, or derivatives offered in conjunction with lending transactions).

D) A Board Letter, Feb. 2, 2004, addresses the permissibility under the Anti-tying Statute of a secured lending program offered by Merrill Lynch Bank and its affiliate, Merrill Lynch Private Finance ("<u>MLPF</u>"). Under the program, the Bank and MLPF offer loans subject to the requirement that the securities collateralizing the loans be kept in collateral accounts with a broker-dealer affiliate of the Bank/MLPF under circumstances where (i) the lender has a security interest in all securities in the account, (ii) the customer is not required to place any securities in the account beyond those necessary to satisfy the collateral requirement, and (iii) the customer is not required to pay a fee to establish or maintain the account.

The Letter concluded that (i) by requiring collateral for a securities-based loan, Bank/MLPF do not require that the customer obtain a product separate from the loan; and (ii) the fact that the lenders require the pledged securities to be held in an account at an affiliate does not make the collateral, or the account, a product separate from the loan that the collateral secures. See also Board Letter to NatCity, Aug. 18, 2003 (exception from the Anti-tying Statute to permit banks to require borrowers whose loans are secured with publicly traded securities to keep those securities in accounts at a broker-dealer affiliate).

(ii) Bank-imposed Condition or Requirement

A) Existence of a Condition or Requirement

i) In order to prove a violation of the Anti-tying Statute, a claimant must prove that the purchase of a tied product was a "condition or requirement" of obtaining the tying product. Banks are also prohibited from conditioning their services on a requirement that the customer not obtain services from competitors of the bank and its affiliates. See, e.g., Akiki v. Bank of America 632 F. App'x 695 (11th Cir. 2015) ("Akiki") (dismissal of claim for failure to allege loan was conditioned on establishment of other accounts); Highland Capital; Comptroller Interpretive Letter No. 991 (Mar. 11, 2004), CCH Fed. Banking L. Rep. ¶ 81-517 (no prohibited tie resulted from discount offered on homeowners insurance premiums by a bank's insurance affiliate; discount was not conditioned on customer obtaining another product). But see, e.g., McCune v. National City Bank, 701 F. Supp. 2d 797 (E.D. Va. 2010) (bank's agreement to maintain subordination of credit line improperly "tied" to restrictions on refinancing original mortgage with competing lender).

ii) This standard does not prohibit:

(a) A customer from deciding to award some of its business to a bank as a reward for previously providing credit or other services.

(b) A bank from granting credit to a customer based on a desire or hope that the customer will obtain additional products, even if the bank conveys this desire or hope to the customer.

(c) Cross-marketing products offered by the bank or its affiliates, encouraging an existing customer to purchase additional products, or cross-selling multiple products ("whether suggestive or aggressive").

(d) Offering multiple products as a package if the bank offers the customer the opportunity to obtain the customer's desired product separately from other products in the package.

B) Condition or Requirement Imposed by the Bank

i) A violation of the Anti-tying Statute may occur only if a condition or requirement is imposed by the bank.

ii) This does not include "voluntary" (or "reverse") customer-initiated ties, including when a customer believes that it stands a better chance of securing a scarce commodity (such as credit) by "volunteering" to accept other products or services from the bank or its affiliates.

iii) It should be possible for a bank to respond to a request for a particular "voluntary tie" with a counter-offer suggesting a modified or different "tie" so long as the counter-offer is reasonably related to the nature and scope of the voluntary tie requested.

C) Practice was Unusual in the Banking Industry and Benefitted the Bank

Some courts have required evidence that the contested practice was unusual in the banking industry and benefitted the bank, where "unusual" practices are defined as practices not normally taken to protect a bank's investment. See, e.g., Mamot Feed Lot and Trucking v. Hobson, 539 F.3d 898 (8th Cir. 2008); Ticket Center v. Banco Popular, 613 F. Supp. 2d 162 (D.P.R. 2008); K3C Inc. v. Bank of America, 204 Fed. Appx. 455 (5th Cir. 2006); Highland Capital.

D) Factual Inquiry Required

i) The facts and circumstances surrounding the bank-customer relationship often will be critical in determining whether a prohibited condition or requirement was imposed by the bank or volunteered or sought by the customer.

ii) The timing and sequence of the offers, purchases or other transactions between the customer and the bank or its affiliates that form the basis of the alleged tying arrangement, and the nature of the condition or requirement, may be relevant in determining whether the customer was required to obtain a tied product in order to obtain the desired product.

Other information that may be useful in determining whether a condition or requirement exists (and, if so, whether the bank coerced the customer into accepting the condition or requirement) includes (a) correspondence and conversations (see

Morales (alleged oral tie by employee of affiliate)), (b) marketing or other materials, (c) the bank's course of dealings with the customer and similarly situated customers, (d) bank policies and procedures, (e) the customer's course of dealings with the bank and other financial institutions, (f) the customer's financial resources and sophistication, and (g) whether the customer was represented by counsel or other advisers.

d. Exceptions to the Anti-tying Prohibitions

(i) Tying Arrangements Involving Traditional Bank Products

A) Statutory and Regulatory Exceptions

i) The Anti-tying Statute allows a bank to condition the availability and price of any product on the requirement that the customer obtain a traditional bank product from the bank.

Board regulation (12 C.F.R. § 225.7(b)(1)) provides that the traditional bank product exception also applies to products obtained from affiliates of a bank.

ii) The exception is available only if the tied product is a traditional bank product. The availability of the exception, however, does not depend on the type of desired (i.e., tying) product involved. See, e.g., Comptroller Interpretive Letter No. 982 (Sept. 29, 2003), CCH Fed. Banking Law Rep. ¶ 81-508 (bank may offer to provide underwriting services (a non-traditional product) to a customer on the condition that the customer obtain a bank letter of credit (a traditional product)).

iii) The exception applies only if the tied product is a <u>defined</u> traditional bank product. The Proposed Anti-tying Interpretation indicated that products that fall within the scope of the exception include, <u>among others</u>:

(a) Extensions of credit, including loans, lines of credit, and backup lines of credit. (An "extension of credit" does <u>not</u> include underwriting, privately placing or brokering debt securities.)

(b) Letters of credit/guarantees.

(c) Lease transactions that are the functional equivalent of an extension of credit.

(d) Credit derivatives where the bank or affiliate is the seller of credit protection.

(e) Acquiring, brokering, arranging, syndicating and servicing loans or other extensions of credit.

(f) Deposit accounts.

(g) Safe deposit box services.

(h) Escrow services (<u>see</u> <u>Akiki</u>).

(i) Payment and settlement services.

(j) Payroll services.

(k) Traveler's check and money order services.

(l) Cash management services.

(m) Trust services.

(n) Asset management/fiduciary services.

(o) Custody/securities lending.

(p) Paying agent, transfer agent and registrar services.

iv) The traditional bank product exception is arguably broad enough to cover (a) all bank-permissible derivative products; (b) all services provided in a "fiduciary capacity" (see, e.g., 12 C.F.R. § 9.2(e)); (c) discretionary account management services (and related deposit-mutual fund "sweeps"); (d) investment/corporate finance advisory services; (e) packages of settlement services and mortgage loans; and (f) FX and related services. See, e.g., FSR Comment Letter; ABASA Comment Letter.

B) "Mixed-product Arrangements"

i) A bank may permit a customer to choose whether to satisfy a condition imposed by the bank through the purchase of traditional or "non-traditional" products (a "mixed-product arrangement").

ii) Where a bank offers a mixed-product arrangement, if the customer has a meaningful option to satisfy the bank's condition through the purchase of traditional bank products, then the bank's offer would not be viewed as requiring the customer to purchase any non-traditional product in violation of the Statute.

iii) According to the Proposed Anti-tying Interpretation, whether a mixed-product arrangement comports with the Anti-tying Statute often will depend on the nature and characteristics of the arrangement and the customers to which the arrangement is offered.

iv) "Relationship banking" should be permissible under the Anti-tying Statute. The Proposed Anti-tying Interpretation indicated that if:

(a) a bank and its affiliates periodically review the overall profitability of their business relationships with a customer to determine whether the bank's internal profitability threshold ("hurdle rate") is satisfied;

(b) in accordance with this policy, the bank determines that the profitability of existing relationships does not meet the hurdle rate; and

(c) in light of this review, the bank informs the customer that the bank will not renew the customer's transaction with the bank (such as a credit facility) unless the customer commits to provide the bank or its affiliates sufficient additional business to allow the customer's overall relationships to meet the hurdle rate (but under circumstances where the bank does not tie renewal to the purchase by the customer of specific products from the bank or its affiliates but rather offers a "wide" variety of traditional and non-traditional products);

the bank's actions would be permissible if the customer could reasonably obtain sufficient traditional bank products to meet the hurdle rate.

The Proposed Anti-tying Interpretation indicated that a bank would provide a customer a meaningful option even though the customer had a long-standing arrangement with another financial institution, so long as the customer may legally transfer traditional bank product business to the bank and the bank would be able to satisfy the customer's need for such a product.

v) While authorizing mixed product arrangements essentially validates the principles of relationship banking, the Board was asked, through comment letters on the Proposed Anti-tying Interpretation, to confirm that:

(a) It would be permissible for the "traditional bank product" component of a mixed product arrangement to involve "traditional bank products" provided by affiliates of banks.

(b) A bank should be able to vary the price of a "desired product" as part of the structure of a mixed product arrangement, or otherwise offer bundled products at "all-in" prices.

(c) If a bank does not offer a "wide" variety of traditional bank products as a general matter, it should nonetheless be possible for the bank to offer a mixed product arrangement so long as the customer has a meaningful option to satisfy the bank's return requirements either through a variation in the price of the tying product (coupled with a more limited choice of one or more traditional bank products) or through the choice of a non-traditional product.

(d) A bank may price traditional bank products included in a mixed-product arrangement in whatever manner the bank believes in good faith is appropriate (including at a price higher than the price that a competitor might charge).

(ii) Reciprocity Exception

A) The reciprocity restrictions of the Anti-tying Statute generally prohibit a bank from conditioning the availability or price of a product on a requirement that the customer provide another product to the bank or an affiliate, subject to an exception for situations where the tied product is to be provided to the bank and is related to and usually provided in connection with a traditional bank product (a "usually-connected product"). The Board extended this exception in 12 C.F.R. § 225.7(b)(l)(ii) to include situations where a bank requires the customer to provide a usually-connected product to an affiliate of the bank.

B) Facts that may be relevant in determining whether a bank's demand that a customer provide an additional product is appropriate include (i) the relationship between the tied product and the additional product, (ii) whether the practice protects the value of the bank's credit or other exposures, (iii) whether the practice is usual in the banking industry, and (iv) whether the condition was imposed by the bank principally to reduce competition or to allow it to compete unfairly in the market for the tied product.

C) However, the Proposed Anti-tying Interpretation noted that a reciprocity arrangement involving a particular product does not violate the Anti-tying Statute simply because the arrangement is not usual in banking transactions, since contractual agreements between banks and their customers can be tailored to individual characteristics.

D) Examples of permissible usually-connected products include:

i) A bank conditions the availability of secured credit on a requirement that the customer obtain insurance, for the benefit of the bank, that protects the bank's security interest in collateral.

ii) A bank requires affiliated parties of a troubled borrower to pay down their loans with the bank prior to renewing or advancing additional credit to the borrower, or requires the borrower's owners to guaranty the borrower's debt.

(iii) <u>Exclusive Dealing Exception</u>

A) The Anti-tying Statute generally prohibits a bank from conditioning the availability or price of a bank product on a requirement that the customer not obtain another product from a competitor.

B) <u>However</u>, the Anti-tying Statute contains an exception to this restriction where the condition is "reasonably imposed by the bank in a credit transaction to ensure the soundness of the credit." This exception permits a bank, when consistent with banking standards, to condition the availability of a loan on the requirement that the customer not borrow, or increase its borrowing, from other sources (and not pledge collateral securing the loan to other entities).

(iv) <u>Regulatory Safe Harbors</u>

A) <u>Combined-balance Discount Safe Harbor</u>

i) In 12 C.F.R. § 225.7(b)(2), the Board granted a safe harbor for combined-balance discount packages if they do not obligate customers to purchase non-traditional products in order to obtain the discount. The conditions for this safe harbor are that (a) the bank must offer deposits; (b) all deposits must be eligible to be counted toward the minimum balance; and (c) deposits must count at least as much as non-deposit products.

ii) For a selection of Board interpretations and orders with respect to combined-balance discounts, see, e.g., Board Letters, Nov. 26, 2002 (defining all members of a household or family to be a "customer" for purposes of the "safe harbor"), May 16, 2001 (insurance products), June 2, 2000 (private label credit cards), Dec. 6, 1996 (combined-balanced discount program excluding retirement plan deposits, private banking deposits, deposits held in branches of the same institution located in different states, and certain CDs); Huntington Bancshares, 82 Fed. Res. Bull. 688 (1996) (floorplan financing and two- and three-party paper); Capital One, 82 Fed. Res. Bull. 584 (1996) (secured credit cards); Fleet, 80 Fed. Res. Bull. 1134 (1994) (combined minimum balance); First Union, 80 Fed. Res. Bull. 166 (1994) (brokerage services); Norwest, 76 Fed. Res. Bull. 702 (1990) (credit cards).

B) Foreign Transactions Safe Harbor

i) In 12 C.F.R. § 225.7(b)(3), the Board granted a safe harbor from the Anti-tying Statute for transactions between a bank and a customer if (a) the customer is a company that is organized outside the U.S. and has its principal place of business outside the U.S.; or (b) the customer is an individual who is a citizen of a country other than the U.S. and is not a U.S. resident.

ii) While this safe harbor would generally be available for a loan by a bank to a foreign company even if (a) the loan is partially guaranteed by a U.S. affiliate of the foreign company, or (b) the foreign company directs the bank to disburse a portion of the loan to a U.S. affiliate, such a loan would not qualify for the safe harbor if (i) the borrower, in substance, is the U.S. affiliate and not the foreign company, or (ii) the customer is a U.S. subsidiary of a foreign company.

C) Transactions Outside a Safe Harbor

The Proposed Anti-tying Interpretation made clear that transactions that fall outside of the combined-balance discount or foreign transaction safe harbors may nonetheless be permissible if they qualify for another exemption, or (in the case of the foreign transaction safe harbor) the transactions are so foreign in nature that they do not raise the competitive concerns that the Anti-tying Statute was designed to address. These transactions would require a customer-by-customer evaluation.

(v) Exceptions in Connection with Corporate Reorganizations

In connection with their conversion from industrial banks into banks, Goldman Sachs Bank and Morgan Stanley Bank received exemptions from the Anti-tying Statute for the acquisition from their respective parent companies and other non-bank affiliates of loans that might contain conditions that would have violated the Statute had the loans originally been extended by a bank. However, the Board required the banks and their subsidiaries not to extend or renew any loans on terms that would violate the Statute. See Board Letter to Goldman Sachs Bank, Apr. 22, 2009 (the "GS Reg W Letter"); Board Letter re Morgan Stanley Bank, Apr. 22, 2009 (the "MS Reg W Letter").

e. Application of the Anti-tying Statute to "Banks"

(i) A "bank" for purposes of the Anti-tying Statute includes not only commercial banks but also other U.S.

depository institutions (including savings banks, "non-bank banks", limited-purpose trust companies, credit card banks, Edge Act and Agreement corporations, industrial banks and similar institutions (collectively "non-bank depository institutions")). See 12 U.S.C. § 1841. See also Adelphia Recovery Trust v. Bank of America, 390 B.R. 64 (SDNY 2008) (defendant investment banks (each a non-depository institution) do not come within the term "bank" for purposes of the Statute) and 646 F. Supp. 2d 489 (SDNY 2009) (finance company not considered a "bank" merely because it is affiliated with entities that accept deposits or maintain FDIC insurance).

(ii) The Anti-tying Statute also applies to any U.S. branch, agency or commercial lending subsidiary of a foreign bank. See 12 U.S.C. § 3106; 12 C.F.R. § 225.7.

A) The term "bank" does not include foreign banks as such, even if the bank maintains one or more U.S. banking offices. Accordingly, the Anti-tying Statute does not apply to non-U.S. branches of foreign banks.

B) Although the Board has not made a formal statement on the matter, it would appear that a foreign bank's offshore booking center (see 12 C.F.R. § 211.24(g)) should be treated as a non-U.S. branch for this purpose even if it is managed by a U.S. branch.

(iii) Although affiliates of a bank generally are not subject to the Anti-tying Statute, an affiliate of a non-bank bank or a non-bank depository institution is subject to the Statute in connection with any transaction involving the products of both the affiliate and the non-bank as if the affiliate were the bank and the institution were an affiliate. See 12 U.S.C. §§ 1843(f)(9)(B) and (h)(2).

(iv) The Proposed Anti-tying Interpretation states that the Anti-tying Statute also applies to all subsidiaries of a bank -- other than a "financial subsidiary" under Gramm-Leach -- in the same manner as it applies to the bank itself. (A "financial subsidiary" of a bank is treated as an affiliate of the bank, and not as a subsidiary of the bank, for purposes of the Statute.) The Proposed Financial Subsidiary Anti-tying Exception would provide that a financial subsidiary of a state non-member bank would likewise be treated as an affiliate of the bank, and not as a subsidiary, for purposes of the Anti-tying Statute. See 12 U.S.C. § 1971 (national bank); 12 C.F.R. § 208.73(e) (state member bank). Although no formal statement has been made by the Board, it is not clear whether the Anti-tying Statute would apply to subsidiaries of an Edge Act or Agreement corporation, whether or not the Edge Act or Agreement corporation is a subsidiary of a bank.

(v) Under 12 C.F.R. § 225.7, the Anti-tying Statute does not apply to tying arrangements entered into by any FHC/BHC non-bank subsidiary.

f. Definition of "Affiliate" for Purposes of the Anti-tying Statute

(i) The term "affiliate" with respect to a bank under the Anti-tying Statute generally means any company or natural person that controls the bank, and any company that is controlled by such company or person (other than the bank itself).

A) Certain companies with a bank subsidiary that are not considered BHCs are considered "affiliates" of such bank for purposes of the Anti-tying Statute. Moreover, companies that are not considered "BHCs" with respect to such a bank subsidiary are also subject to the Anti-tying Statute in connection with any transaction involving the products of both the company and a subsidiary bank as if the company were the bank and the bank were an affiliate.

B) The Board has reserved judgment on whether a bank-advised fund is "affiliated" with its adviser for purposes of the Anti-tying Statute. Compare Fleet, 80 Fed. Res. Bull. 1134 (1994) (silent on the matter) with 59 Fed. Reg. 9216 (Feb. 25, 1994) (solicitation of public comments), 59 Fed. Reg. 39667 (Aug. 4, 1994). See also Part VIII.C.1.c.vii below.

(ii) While the Anti-tying Statute generally does not apply to tying arrangements imposed by an affiliate of a bank, a bank may not participate in a transaction in which an affiliate has nominally imposed a condition on a customer that the bank is prohibited from imposing under the Statute if the affiliate was acting on behalf of, as agent for, or in conjunction with, the bank. See Morales (affiliate acting as agent of bank).

A) A bank should not have an arrangement with an affiliate to fund a loan for which the affiliate acts as syndicate manager if the affiliate has conditioned the availability (or price) of its syndication on a requirement that the customer obtain underwriting services from the affiliate.

B) If an affiliate of a bank has conditioned the availability (or price) of a bridge loan on a requirement that the customer hire the bank's securities affiliate as an underwriter for the company's follow-on bond offering, the bank should not have an arrangement with the affiliate at the time the bridge loan is made to purchase the loan or a participation in the loan from, or write a credit-related derivative referencing the loan to, the affiliate. Compare GS Reg W Letter and MS Reg W Letter (exemption from the Anti-tying Statute for acquisition of loans from affiliates that might contain conditions that would have violated the Statute had the loans originally been extended by the bank).

g. Internal Controls

(i) Anti-tying Policies, Procedures and Systems

A) Scope of Policies

i) A bank's anti-tying policies should describe the scope of the Anti-tying Statute and prohibited tying arrangements. A bank should ensure that its policies (including those concerning credit approval, new product approval, pricing and marketing) reflect the Statute's prohibitions and:

(a) Permit personnel with questions concerning the Statute or its application to discuss the issue with the bank's compliance or legal department.

(b) Address the receipt, handling and resolution of customer complaints.

(c) Prohibit any employee from taking adverse action against a customer because the customer submitted a complaint to the bank or a federal banking agency.

ii) While the policies, procedures and systems appropriate for a particular bank depend on the size of the bank and the nature, scope and complexity of the bank's activities (including activities conducted in conjunction with affiliates), in general the following principles/strategies should be considered:

(a) Oral statements (in addition to any written documents or correspondence) may give rise to a violation of the Anti-tying Statute.

(b) Preparation of internal documents (such as minutes of meetings with clients) may be helpful in monitoring compliance.

(c) Written acknowledgments by a client as to the voluntary nature of a request for a "cross-sale" or "packaged offering" may be helpful for a bank to conclude that a "package" proposal constitutes a permissible "voluntary tie".

(d) Separate agreements between the same (or affiliated) parties may be viewed together under the Anti-tying Statute.

iii) An important predicate to any anti-tying policy -- particularly in the context of mixed product offerings -- is to assure ongoing compliance with the "affiliate transaction" requirements of Section 23B (i.e., assuring that, as between a bank and its affiliate, the bank is fully and properly compensated for any service it provides and that bank credit is not "mis(under)-priced", even if any "keep whole" payment comes from the affiliate rather than, e.g., directly from the borrower). Section 23B applies even in situations where a bank may benefit from a safe harbor or exception to the Anti-tying Statute.

B) Customer Complaints

Customer complaints alleging tying should be investigated and resolved.

i) Regulatory action could be taken by federal bank regulatory agencies, by the DOJ or, if a bank's broker-dealer affiliate is purportedly involved in the alleged tying, by FINRA, the MSRB and/or the SEC. See also Part III.A.4.h below.

ii) Regulatory enforcement could involve civil penalties and could affect the "well managed" status of a bank or FHC.

iii) The Anti-tying Statute provides for treble damages in the event of a successful demonstration by a customer of a statutory violation, together with the cost of suit, "including a reasonable attorney's fee". 12 U.S.C. § 1975.

iv) Risk to a bank's reputation, as well as to other aspects of its operational risk management, cannot be ignored.

C) Education and Training

i) Education and training should focus on providing personnel with a framework to identify and address anti-tying compliance issues (not on providing "hints" on how to tie without getting caught).

ii) The scope and frequency of training should be tailored to the person's or department's functions, with greater resources devoted to those positions or departments that present the greatest legal or reputational risk (e.g., corporate relationship managers, syndicated lending personnel, persons with authority to approve credit extensions or establish pricing policies, and personnel who market bank products).

iii) A bank should review its compensation programs to ensure that they do not provide inappropriate incentives to tie products.

D) Compliance Function

i) A bank's compliance function should take a lead in monitoring compliance with the Anti-tying Statute, including periodic review of:

(a) The bank's policies -- to ensure that they are updated to reflect changes in business or applicable laws, regulations or supervisory guidance, and to provide appropriate training.

(b) The bank's marketing materials.

(c) Individual transactions -- to test bank compliance.

ii) Compliance and internal audit programs should be designed and evaluated periodically to test adherence to legal requirements and policies, focusing on areas that may pose a higher risk (e.g., extensions of credit by a bank to support or "bridge" a securities offering where the bank's affiliate is acting as underwriter, syndicated loans and fee-sharing arrangements).

(ii) Requirements for Banks Offering Mixed-product Arrangements Outside a Regulatory Safe Harbor

A) The Proposed Anti-tying Interpretation requires a bank to evaluate mixed-product arrangements on a customer-by-customer basis, but, at some point, it is hoped that the Board will permit such evaluation to be done on the basis of classes of customers.

B) The cost and compliance burden of a fact-specific customer-by-customer analysis could be significant. See, e.g., Bank Anti-tying Group Letter to the Board, dated Mar. 30, 2004.

C) According to the Proposed Anti-tying Interpretation, a bank's policies should address:

i) The factors and types of information that the bank will review in forming a good faith belief that a customer offered a mixed-product arrangement has a meaningful option to satisfy the bank's condition <u>solely</u> through the purchase of traditional bank products, including such information as:

(a) The range and types of traditional bank products that the bank and its affiliates offer and include in the arrangement.

(b) The manner in which traditional bank products and non-traditional products are treated for purposes of determining whether a customer would meet the condition.

(c) The types and amounts of traditional bank products typically required or obtained by companies that are comparable to the customer in size, credit quality and business operation.

(d) Information provided by the customer concerning the types and amounts of traditional bank products needed or desired and the customer's ability to obtain those products from the bank or its affiliates.

ii) The bank personnel authorized to make the analysis described above for individual customers and the training and guidelines provided these personnel.

iii) The internal processes and controls, including approval and documentation requirements, the bank uses to ensure that analysis is

(a) performed for a customer before the customer is offered a mixed-product arrangement; and (b) adequately reflected in the bank's records.

D) In mixed-product arrangements, a bank may not weight, discourage the use of, or otherwise treat, traditional bank products in a manner designed to deprive customers of a meaningful choice.

E) The bank's policies should ensure that any material information relied on in analyzing the traditional bank products likely required by a customer is current and reliable, recognizing that the types and amount of information and level of analysis necessary for a bank to establish a good faith belief that a customer has a meaningful choice under a mixed-product arrangement may vary depending on the nature and characteristics of the arrangement and type of customers (large, complex organizations as opposed to small businesses, longstanding customers as opposed to new customers, etc.).

(iii) Mixed-product Arrangements to Individuals

A) Individuals may be more susceptible to subtle pressure by a bank to purchase a non-traditional product. It is likely to be more difficult for a bank to establish a good faith belief that a mixed-product arrangement offered to an individual provides a meaningful option to satisfy the condition associated with the arrangement solely through the purchase of traditional bank products without a detailed analysis of the customer's needs and capabilities.

B) The safe-harbor discussed in Part III.A.4.d.iv.A above allows a bank to offer certain combined-balance discount programs to individuals without making a specific determination in respect of a particular customer.

h. Securities-related Developments

(i) NASD Notice to Members No. 02-64 (Sept. 2002) expressed concern about tying commercial credit to investment banking, and noted that tying issues usually arise in three contexts: (A) bridge loans in which the loan is intended to be repaid out of the proceeds of a bond offering; (B) backup CP credit facilities; and (C) syndicated loans. The NASD cautioned that aiding and abetting a violation of the BHCA by an affiliated bank would violate "just and equitable principles of trade". See also MSRB Regulatory Notice No. 2008-34 (Aug. 14, 2008) (reminding members that aiding and abetting a tying violation also would violate MSRB Rule G-17 on fair dealing).

(ii) The NASD concluded that a threat by a broker-dealer to discontinue research coverage of, and stop making a market in, stock of an issuer if the issuer did not select the broker-dealer for investment banking services was "inconsistent with high standards of commercial honor and just and equitable principles of trade" required by FINRA Rule 2110. See U.S. Bancorp Piper Jaffray, FINRA Letter of Acceptance No. CAF 020020 (July 2002).

(iii) Other FINRA Rules could have implications in the tying context. See, e.g.:

A) Rule 2020: "No member shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance".

B) Rule 2111.01: "Implicit in all member and registered representative relationships with customers and others is the fundamental responsibility for fair dealing".

C) Rule 5110(c)(1): "No member or person associated with a member shall participate in any manner in any public offering of securities in which the underwriting or other terms or arrangements in connection with or relating to the distribution of the securities, or the terms and conditions related thereto, are unfair or unreasonable". Among the arrangements considered to be per se "unfair or unreasonable" is any right of first refusal to underwrite or participate in future public offerings, private placements or other financings which (i) has a duration of more than three years; or (ii) provides more than one opportunity to waive or terminate the right of first refusal in consideration of a payment or fee. See FINRA Rule 5110(f)(2)(F).

5. Implications of Federal Reserve Act Sections 23A and 23B

Sections 23A/23B affect the ability of an FHC's or BHC's depository institution to engage in transactions with a securities affiliate or a financial subsidiary.

a. Scope and Purpose of Sections 23A and 23B

Sections 23A/23B are the main constraint on transactions between FHC/BHC securities firms and their bank affiliates. Form FR Y-8 enables the Board to monitor compliance with Section 23A. See 65 Fed. Reg. 31912 (May 19, 2000).

The financial crisis of 2007-2009 put increased pressure on Section 23A compliance and led to requests for numerous transactional exemptions. See Part III.A.5.g.i below.

Dodd-Frank § 608 made Sections 23A/23B even more restrictive, effective July 21, 2012, by:

(i) expanding the definition of "covered transactions" (including defining reverse repo as an extension of credit and adding credit exposure arising from securities borrowing/lending and derivatives transactions);

(ii) clarifying that accepting "debt obligations" (and not only "securities") of an affiliate as collateral for a loan to any party is a "covered transaction";

(iii) expanding the definition of "affiliate" to include any investment fund advised by the bank or an affiliate of the bank;

(iv) authorizing the Board to issue regulations or interpretations defining the term "credit exposure" and outlining how it will treat netting arrangements in determining the amount of, and collateral required for, a covered transaction;

(v) clarifying that a credit extension or guarantee is subject to the collateral requirements of Section 23A so long as it is outstanding;

(vi) expanding the collateral requirements for extensions of credit to apply to the credit exposure on derivative transactions as well as securities lending or borrowing transactions with an affiliate;

(vii) eliminating the provision that permitted a bank to engage in covered transactions with a financial subsidiary in an amount greater than 10% of the bank's capital and surplus; and

(viii) establishing new procedures for Section 23A exemptions.

As of September 15, 2016, the Board had not yet issued a proposal to implement these provisions of Dodd-Frank.

b. <u>Implementing Regulations</u>

(i) Board <u>Regulation W</u> implements Sections 23A/23B. When it promulgated Regulation W in 2002, the Board also adopted certain exemptions from Sections 23A/23B and made one proposal with respect to the application of the so-called "<u>250.250 Exemption</u>". <u>See</u> 12 C.F.R. Part 223; 67 Fed. Reg. 76560 (Dec. 12, 2002) (the "<u>Regulation W Release</u>"); 67 Fed. Reg. 76618 (Dec. 12, 2002) (proposal on 250.250 Exemption); 67 Fed. Reg. 76620 (Dec. 12, 2002) (rescission of Board interpretations of Section 23A). <u>Compare</u>

66 Fed. Reg. 24186 (May 11, 2001) (solicitation of public comments), 33649 (June 25, 2001) (correction) (collectively, the "Regulation W Proposal"). See also Comptroller's Handbook: Related Organizations; Comptroller Comment Letter, dated Oct. 1, 2001.

As of September 15, 2016, the Board had not yet proposed revisions to Regulation W to implement Dodd-Frank's amendments to Sections 23A/23B, notwithstanding the July 21, 2012 effective date of such amendments.

(ii) In 2004, the FDIC proposed 12 C.F.R. Part 324 to clarify the application of Section 23A, and to affirm that the FDIC (and not the Board) administers (and may grant exemptions from) the restrictions of Section 23A, for state non-member banks. See 69 Fed. Reg. 12571 (Mar. 17, 2004) (solicitation of public comments); FDIC Division of Supervision and Consumer Protection Memorandum to the FDIC Board of Directors, dated Mar. 10, 2004.

A) Under the FDIC proposal, certain bank-subsidiary relationships that the FDIC did not consider to be subject to Sections 23A/23B prior to December 12, 2002 (i.e., the subsidiary was not considered to be an "affiliate" for purposes of Sections 23A/23B as it was interpreted and applied by the FDIC), but that are considered to be affiliate relationships under Regulation W, would have been exempted from Sections 23A/23B. The exemption was intended to cover certain subsidiaries approved by the FDIC under FDIA § 24 that engage in activities approved by the FDIC but not authorized for national banks or state member banks.

B) The Board supported the FDIC proposal to the extent that it clarified that state non-member banks are subject to Regulation W as if they were member banks, but disagreed with those elements of the proposal that do not conform to Regulation W, or that purport to provide the FDIC with authority that the Board believes has been statutorily conferred on the Board. See Board Letter to FDIC, May 3, 2004. See also Board Letter to FDIC, Feb. 6, 2004.

C) Pursuant to Dodd-Frank § 608, all exemptions under Section 23A, whether by order or regulation, are subject to the prior non-objection, in writing, by the FDIC based on a finding that the exemption does not present an unacceptable risk to the FDIC deposit insurance fund (the "DIF").

c. General Scope of Section 23A

This Part III.A.5.c describes generally the statutory provisions of Section 23A, including as they have been amended by Dodd-Frank effective July 21, 2012. The impact of these general provisions on Regulation W as an implementing regulation and on certain regulatory interpretations is described more fully in Parts III.A.5.e through g below.

Section 23A limits a bank's "covered transactions" with any single "affiliate" to 10%, and with all affiliates combined to no more than 20% (the "20% 23A Limit"), of the bank's capital stock and surplus. It also requires that any extension of credit to an affiliate by a bank be secured by collateral with a specified market value. See, e.g., 12 C.F.R. § 223.3(y); 12 C.F.R. § 201.108(b) (representative list of government obligations entitled to 100% collateral weight).

(i) Subject to certain exceptions (including for most subsidiaries of banks -- e.g., operating subsidiaries, Edge Act corporations and Regulation K subsidiaries), Section 23A, as amended by Dodd-Frank, defines an "affiliate" of a bank to include any company controlled by, controlling or under common control with such bank, as well as any investment fund with respect to which a bank or any affiliate is an investment adviser.

A) With respect to investment funds that may be affiliates, prior to Dodd-Frank, Section 23A had defined an affiliate to include (i) any 1940 Act-registered investment company with respect to which a bank or any affiliate was an investment adviser, and (ii) any other company that was sponsored and advised on a contractual basis by a bank or any of its affiliates. Certain issues related to the Board's pre-Dodd-Frank view of investment funds are set forth in Part III.A.5.g.iii.B below. As of September 15, 2016, the Board had not yet issued a proposal to implement the Dodd-Frank modifications to the definition of affiliate, including particularly a definition of "investment fund."

B) A company has "control" over another company if the first company (i) directly or indirectly owns, controls or has power to vote 25% or more of any class of voting securities of the other company, (ii) controls in any manner the election of a majority of directors or trustees of the other company, or (iii) exercises a controlling influence over the management or policies of the other company. 12 U.S.C. § 371c(b)(3).

C) Section 23A(b)(11), implemented in 12 C.F.R. § 225.176, creates a rebuttable presumption of control of a portfolio company held in reliance on Gramm-Leach's merchant banking or insurance company investment empowerments if an FHC owns 15% or more of the equity capital of the portfolio company. See also Part I.C above and Part III.A.5.g.iii.C and Part VII.A.2 below.

D) A "securities affiliate" of a bank is defined to include (i) a U.S.-registered broker-dealer affiliate, and (ii) any other (e.g., foreign) broker-dealer affiliate approved by the Board on a case-by-case basis. 12 C.F.R. § 223.3(gg).

(ii) "Covered transactions" under Section 23A, as amended by Dodd-Frank, include (A) a loan or extension of credit to an affiliate, including a reverse repo of assets by the bank; (B) a purchase of, or investment in, securities issued by an affiliate; (C) a purchase of assets from an affiliate; (D) acceptance of securities or other debt obligations issued by an affiliate as collateral for a loan or extension of credit to any person (the "Affiliate Collateral Provision"); (E) a transaction with an affiliate involving the borrowing or lending of securities to the extent that the transaction causes the bank to have credit exposure to the affiliate; (F) a derivative transaction with an affiliate to the extent that the transaction causes the bank to have credit exposure to the affiliate; and (G) issuance of a guarantee or letter of credit on behalf of an affiliate. See, e.g., Rose & Talley, "The 'New' Section 23A", CCH Fed. Banking L. Rep. ¶ 59-781 (Jan. 1983); Board Staff Memorandum (Sept. 1981) (amendments to Section 23A).

Loans and extensions of credit, purchase of or investment in debt securities of an affiliate, the issuance of a guarantee on behalf of an affiliate and any credit exposure arising from securities borrows/loans, reverse repos or derivatives are all considered "credit transactions" subject to Section 23A collateral requirements and quantitative limits. Before Dodd-Frank, purchases of assets subject to a repo were treated as a purchase of assets and not subject to collateral requirements.

(iii) Certain transactions are exempt from Section 23A's restrictions, most significantly (A) deposits in an affiliated bank/foreign bank in the ordinary course of correspondent business; (B) giving immediate credit to an affiliate on uncollected items in the ordinary course of business; (C) purchases of assets having a "readily identifiable and publicly available market quotation" (the "Market Quotation Exemption"); (D) credit transactions that are secured by obligations issued or guaranteed as to principal and interest by the U.S. government or its agencies, or by a segregated, earmarked deposit account (see, e.g., Board Letter, Nov. 21, 2001 (SBA-guaranteed interest certificates ("SBA-GICs") entitled to government agency exemption)); (E) purchases from an affiliate of a loan or extension of credit that the bank originated and sold to the affiliate subject to a repo or with recourse; (F) investments in certain subsidiaries of a parent BHC that engage in bank servicing and other activities under BHCA § 4(c)(1); and (G) transactions by a bank with a subsidiary of such bank or with an 80% commonly owned U.S. bank (a "sister bank") (but see Part III.A.5.g.v.J below).

Among the other types of transactions that generally are not subject to Section 23A are dividends paid by a bank to its parent, sales of assets by a bank to its affiliate, the purchase by an affiliate of securities issued by a bank, and service contracts between a bank and an affiliate.

Dodd-Frank replaced the Board's authority to grant exemptions from Section 23A by order with a procedure under which the OCC or FDIC may grant the exemption if (A) together with the Board, the OCC or the FDIC finds that the exemption is in the public interest and consistent with the purposes of Section 23A; and (B) the FDIC does not object to the exemption as presenting an unacceptable risk to the DIF. The Board may still create exemptions by regulation, subject to the objection of the FDIC. The Board continues to retain sole jurisdiction over regulations and orders that provide definitions for terms used in Section 23A or that "may be necessary or appropriate to prevent evasions of" Section 23A.

(iv) Section 23A contains the so-called "Attribution Rule", i.e., a transaction by a bank with any person is deemed to be a transaction with an affiliate "to the extent that the proceeds of the transaction are used for the benefit of, or transferred to that affiliate".

d. General Scope of Section 23B

This Part III.A.5.d describes generally the statutory provisions of Section 23B. The impact of Regulation W as an implementing regulation and of certain regulatory interpretations is described more fully in Parts III.A.5.e through g below.

Section 23B provides that a bank may (i) engage in a covered transaction with an affiliate, (ii) sell securities or other assets to an affiliate (including assets subject to a repo), (iii) pay money or furnish services to an affiliate, (iv) engage in any transaction where an affiliate acts as an agent or broker or receives a fee for its services to the bank, or (v) engage in any transaction with a third party if an affiliate has a financial interest in the third party or if an affiliate is a participant in such transaction, in each case only if the terms of the transaction are at least as favorable to the bank as those prevailing at the time for comparable transactions involving non-affiliated companies (the "Market Terms Requirement").

Furthermore, under Section 23B:

(i) No bank (or subsidiary or affiliate of a bank) may publish any advertisement or enter into any agreement stating or suggesting that the bank is responsible for the obligations of its affiliates (the "No Responsibility Standard").

(ii) A bank may not purchase as fiduciary any securities or other assets from an affiliate unless such purchase is permitted under the instrument creating the fiduciary relationship, by court order or by the law governing the fiduciary relationship.

(iii) A bank may not, whether acting as principal or fiduciary, knowingly purchase or otherwise acquire, during the existence of any underwriting or selling syndicate, any security if an affiliate of the bank is an underwriter of that security, unless, before the security is initially offered to the public, a majority of the directors of the bank approve such purchase based on a determination that the purchase is a sound investment for the bank irrespective of the fact that an affiliate of the bank is an underwriter (the "Director Approval Standard").

e. Application of Sections 23A and 23B to U.S. Branches of Foreign Banks

Although Sections 23A/23B by their terms do not apply to U.S. branches of foreign banks because such entities are not insured U.S. banks, Gramm-Leach § 114(b)(4) authorizes the Board to impose restrictions on transactions between a U.S. branch of a foreign bank and any U.S. affiliate that the Board finds is appropriate to prevent decreased or unfair competition or a significant risk to the safety and soundness of U.S. banks.

(i) Regulation W (12 C.F.R. § 223.61) applies Sections 23A/23B to transactions between a U.S. branch of a foreign bank and any affiliate (or a subsidiary of such affiliate) directly engaged in the U.S. in the following "Covered Activities":

A) Non-credit-related insurance underwriting.

B) Securities underwriting, dealing and market-making.

C) Merchant banking (but only to the extent that the proceeds of the transaction are used for the purpose of funding the affiliate's merchant banking activities).

D) Insurance company investment activities.

See also 12 C.F.R. § 225.176(b)(6); 12 C.F.R. § 225.200.

These Covered Activities would generally be permissible in the United States for non-bank subsidiaries of a foreign banking organization under section 4(k) of the BHCA only if the foreign bank has elected FHC status. Subsidiaries of a foreign bank that engage only in activities permissible under section 4(c) of the BHCA would not be considered affiliates of the foreign bank's U.S. branches and agencies and thus would not be subject to Sections 23A/23B or Regulation W. Accordingly, non-bank subsidiaries of a foreign bank that has not elected FHC status would not be subject to Sections 23A/23B or Regulation W with respect to the foreign bank's U.S. branches and agencies (other than Section 20 Subsidiaries discussed in Part III.B.5.c.i.H below).

(ii) In the context of the application of Sections 23A/23B to U.S. branches of foreign banks, the Board stated in the

Regulation W Proposal that Regulation W was drafted to cover subsidiaries of affiliates directly engaged in Covered Activities in order to prevent evasion. See 66 Fed. Reg. 24186, 24202 n.80 (May 11, 2001).

(iii) Regulation W does not apply Sections 23A/23B to transactions between a U.S. branch and any other type of affiliate, or to transactions between a foreign bank's non-U.S. offices and its U.S. affiliates. Regulation W should not apply Sections 23A/23B to transactions between a U.S. branch and a non-U.S. affiliate held under authorities other than those granted in Gramm-Leach (e.g., 12 C.F.R. §211.23(f)), even if the non-U.S. affiliate engages in Covered Activities outside the U.S.

(iv) An offshore booking center of a foreign bank (see 12 C.F.R. § 211.24(g)) should not be treated as a U.S. branch of the foreign bank for purposes of Section 23A, even if it is managed by a U.S. branch. Although the Board has not made any formal statement on the matter, certain Board staff have informally indicated in the past that such a booking center should not be treated as a U.S. branch at least so long as it derives at least 50% of its funding offshore.

It is not clear, however, that, even if an offshore booking center does not meet this "50% standard", it should be treated as a U.S. branch.

In addition, certain Board staff have also informally indicated that transactions that exhibit "matching" (e.g., funds directed to non-U.S. branches by U.S. branches for purposes of conducting transactions with affiliates engaged in Covered Activities) may be a concern under Section 23A.

(v) Since foreign banks do not separately capitalize their U.S. branches, Regulation W (12 C.F.R. § 223.61(c)) defines the capital stock and surplus of such branches for purposes of the quantitative limits of Section 23A by reference to the capital of the foreign bank calculated under its home country capital standards.

(vi) Regulation W (12 C.F.R. § 223.42(j)) exempts any merger or acquisition between a bank and a U.S. branch of a foreign bank that has been approved under the Bank Merger Act.

(vii) With respect to certain issues under Section 23B particularly relevant to U.S. branches of foreign banks, see Part III.A.5.g.xv below.

f. Federal Reserve Board Rules Mandated by the Gramm-Leach-Bliley Act

(i) Bank Intraday Extensions of Credit to Affiliates

A) An "intraday extension of credit" under Regulation W (12 C.F.R. § 223.42(l)(2)) means an extension of credit by a bank to an affiliate which the bank expects to be repaid, sold or terminated, or to otherwise qualify for an exemption under Regulation W, by the end of its U.S. business day.

B) Regulation W (12 C.F.R. § 223.42(l)) provides that an intraday extension of credit by a bank to an affiliate is exempt from Section 23A if the bank (i) maintains procedures to manage the credit exposure arising from such credit extensions in a safe and sound manner (including procedures for (a) monitoring and controlling the credit exposure from the bank's intraday extensions of credit to each affiliate and all affiliates in the aggregate, and (b) ensuring that any intraday extension of credit to an affiliate complies with the Market Terms Requirement); (ii) has no reason to believe that the affiliate will have difficulty repaying the extension of credit in accordance with its terms; and (iii) ceases to treat such extension of credit as an intraday extension of credit at the end of the bank's U.S. business day. See also 66 Fed. Reg. 24233 (May 11, 2001).

C) Regulation W reflects the Board's determination that (i) the potential risk reduction benefits afforded by application of Section 23A to intraday credit exposures would not justify the costs to banking organizations of complying with such requirement, (ii) there is only a remote risk that intraday credit extensions could become overnight funding, (iii) intraday credit generally is not used as a means of funding an affiliate, (iv) mandating that banks collateralize intraday exposures would require banks not only to measure exposures across multiple accounts, offices and systems on a global basis but also to adjust collateral holdings in real time throughout the day, and (v) there is no evidence that banks have suffered losses from intraday extensions of credit to affiliates.

(ii) Credit Exposure on Derivative Transactions

A) Pursuant to Gramm-Leach, the Board was to "address as covered transactions credit exposure arising out of derivative transactions between" banks and their affiliates. In the Regulation W Release, the Board determined that such derivative transactions would not be deemed covered transactions and should be subject generally to policies and procedures designed to preserve the safety and soundness of the bank and to apply the Market Terms Requirements.

B) However, Dodd-Frank provides that a derivative transaction with an affiliate is a covered transaction to the extent that it causes the bank to have credit exposure to the affiliate. "Derivative transaction" is defined to include any transaction that is a contract, agreement, swap, warrant, note or option that is based, in whole or in part, on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodities, securities, currencies, interest or other rates, indices or other assets. As of September 15, 2016, the Board had not yet issued a proposed regulation or any guidance providing a methodology for determining the amount of credit exposure associated with a bank's derivative transactions with its affiliates. See Part III.A.5.f.ii.C below.

Furthermore, as discussed in Part III.A.5.g.vi.D below, the Board clarified that novations to a bank from an affiliate of derivative transactions with third parties are not exempt transactions and provided a methodology for valuing novations for purposes of a bank's Section 23A quantitative limit.

C) In the context of third party transactions, several different methodologies for determining a bank's credit exposure to a derivative counterparty have been proposed or adopted by the Board and other agencies in other contexts.

i) Under Basel I risk-based capital adequacy guidelines, a banking organization's credit exposure to a derivative is determined using a CEM based on the mark-to-market of the derivative and including a potential future exposure add-on (expressed as a percentage of the notional amount of the contract) based on the type and maturity date of the derivative. See, e.g., 12 C.F.R. Part 225 Appendix A, Section III.E. Large internationally active banking organizations are permitted under the advanced approaches capital rules to use internal models to determine the capital requirements for their derivative exposures. See, e.g., 12 C.F.R. § 217.32(d).

ii) In April 2016, the Board re-proposed rules to establish single-counterparty credit limits for large BHCs, foreign banks with $50 billion or more of total consolidated assets and their IHCs (See Part I.B.1.b.iii above). In contrast to the original proposals which would have required use of CEM to calculate credit exposure from derivative transactions, under the re-proposal, the Board would permit the use of any methodology for determining derivative credit exposure that may be used under the Board's risk-based capital rules, including the CEM or internal models for banking organizations subject to the U.S. advanced approaches risk-based capital rules. See 81 Fed. Reg. 14328 (Mar. 16, 2016) (re-proposal) (the "SCCL Reproposal"); 77 Fed. Reg. 76, 628 (Dec. 28, 2012) and 77 Fed. Reg. 594 (Jan. 5, 2012) (original proposals).

This change is responsive to a number of commenters that argued that CEM was insufficiently risk-sensitive and overstated the realistic exposure of derivatives transactions. It is also responsive to the industry push to make the exposure calculations for complex financial instruments consistent across various regulatory regimes, such as the capital rules and other exposure-dependent rules. This change is also consistent with the approach taken to calculating derivatives exposure under the OCC's lending limits applicable to national banks, although the OCC had also included a matrix look-up method primarily designed for smaller national banks. The Board noted, however, that it will consider incorporating the Basel Committee's "standardized approach to counterparty credit risk", when finalized, into both its risk-based capital rules and the single counterparty credit limits. See The Standardized Approach for Measuring Counterparty Credit Risk Exposures (Basel Committee, Apr. 2014).

iii) The OCC permitted banks to choose from a range of methodologies for determining credit exposure in its revised lending limit rule. See 77 Fed. Reg. 37265 (June 21, 2012) (interim final rule); 78 Fed. Reg. 37930 (June 25, 2013) (final rule) (the "OCC Lending Limit Rule"). The OCC expanded the range of transactions subject to its Lending Limit Rule to include credit exposures arising from derivative transactions as well as repo/reverse repo and securities borrowing/lending transactions as required under Dodd-Frank § 610. Under the OCC Lending Limit Rule, banks may choose among (a) internally developed models approved for use by the appropriate federal regulator, (b) the CEM, or (c) simpler, alternative methods that use look-up tables, for calculating derivative credit exposure.

iv) In an Interagency final rule related to margin requirements for non-cleared swaps (see 80 Fed. Reg. 74840 (Nov. 30, 2015), the Board and other regulators require that "initial margin" that must be collected from and posted to certain financial and dealer counterparties must be calculated using either (a) regulator-approved models that determine a one-tailed 99th percentile price move of the derivative over a 10-day liquidation horizon, calibrated using data from an equally weighted historical observation period of one to five years that incorporates a period of significant financial stress; or (b) a look-up table that contains standardized initial margin amounts based on the risk category and tenor of the derivative. The Board issued its final rule for non-cleared swaps together with the other prudential regulators (including the OCC and FDIC) (the "Bank Non-cleared Swap Rules"), while the CFTC separately issued a similar rule for registered swaps dealers and major swap participants that do not have a prudential regulator (the "CFTC Non-cleared Swap Rules").

The Bank Non-cleared Swap Rules impose margin requirements for swaps between a bank and its affiliates as well as all such swaps between a bank and its subsidiaries. Under the Bank Non-cleared Swap Rules, banks are not obligated to post initial margin with respect to inter-affiliate swaps, but they do have an obligation to collect initial margin. The preamble to the Bank Non-cleared Swap Rules stated that compliance with the Bank Final Rules would not ensure compliance with regulatory requirements under Sections 23A and 23B. See 80 Fed. Reg. 74840, 74889 (Nov. 30, 2015). The preamble did not, however, state that compliance with the Bank Non-cleared Swap Rules' inter-affiliate provisions would be inconsistent with Sections 23A and 23B. In addition, the Bank Non-cleared Swap Rules will require banks to collect initial margin from affiliates even in circumstances where Sections 23A and 23B do not apply (e.g., in the case of non-cleared swaps between a bank and its subsidiary).

v) In contrast to the Bank Non-cleared Swap Rules, the CFTC Non-cleared Swap Rules do not require nonbank swap entities to collect or post initial margin in respect of non-cleared swaps entered into with affiliates so long as the entity is subject to a centralized risk management program that is reasonably designed to monitor and to manage the risks associated with inter-affiliate swaps. See 81 Fed. Reg. 636 (Jan. 6, 2016).

D) Although the Board is expected to revise Regulation W to define credit exposure to affiliates arising from derivative transactions as covered transactions subject to collateral requirements, as of September 15, 2016, Regulation W (12 C.F.R. § 223.33) provides only that a bank must maintain procedures to manage the credit exposure arising from its derivative transactions with affiliates in a safe and sound manner. These procedures must at a minimum provide for (i) monitoring and controlling the credit exposure arising from such transactions with each affiliate and with all affiliates in the aggregate (including credit limits, mark-to-market requirements and collateral requirements), and (ii) ensuring that derivative transactions with affiliates comply with the Market Terms Requirement.

E) The Board stated in the preamble to the Regulation W Release that a bank should (i) have in place credit limits on its derivative exposure to affiliates that are at least as strict as the limits the bank imposes on comparable unaffiliated companies, (ii) monitor derivatives exposure to affiliates in a manner that is at least as rigorous as it uses to monitor derivative exposures to comparable unaffiliated counterparties, and (iii) price (and require collateral in) derivative transactions with affiliates in a way that is at least as favorable to the bank as the way the bank would price (or require collateral in) a derivative transaction with a comparable unaffiliated counterparty. The Board stated that typical market terms among major financial institutions generally include daily marks-to-market and two-way collateralization above a relatively small exposure threshold.

   Bank examiners will particularly scrutinize unique derivative structures that a bank only uses with affiliates.

F) Section 223.33 of Regulation W requires that a credit derivative between a bank and a non-affiliate in which the bank provides credit protection to the non-affiliate with respect to an obligation of an affiliate of the bank be treated as a "guarantee" by the bank on behalf of an affiliate and, accordingly, a Section 23A covered transaction. Such derivatives would include (i) an agreement under which a bank agrees to compensate a non-affiliate for a default on an affiliate's obligation; and (ii) an agreement under which a bank, in exchange for payments based on the total return of an underlying affiliate obligation, agrees to pay a non-affiliate a spread over funding costs plus any depreciation in the value of the underlying obligation.

In the case of such credit derivatives, the bank should (i) count as the covered transaction amount the notional principal amount of the derivative or, if lower, the maximum bank loss on the transaction, or, for guarantee-equivalent derivatives that include both non-affiliate and affiliate credits as reference assets, the pro rata portion of the notional principal amount or maximum loss on the transaction; and (ii) obtain collateral on the derivative.

Board staff has interpreted Section 223.33 so as to treat such a derivative as a covered transaction only to the extent that the derivative provides credit protection with respect to obligations of an affiliate, and informally advised that a credit derivative in which affiliate obligations represent less than 1% of the reference assets underlying the derivative would not be treated as a covered transaction.

G) Board Form FR Y-8 collects quarterly aggregate information from each BHC about bank-affiliate derivatives, including (i) the mark-to-market value of such derivatives, (ii) the amount of collateral pledged to secure such derivatives, and (iii) the notional amount of such derivatives.

H) Letter No. 1018 approved a national bank's proposal to enter into equity derivatives transactions with subsidiaries and affiliates, and to hold physical equity hedges, in order to manage risk arising out of such affiliates/subsidiaries' derivatives transactions with customers. The bank -- which represented to the Comptroller that the proposed transactions would accomplish a cost effective centralization of derivatives risk management -- was previously authorized to enter into and hedge similar derivatives transactions directly with its own customers. The Comptroller conditioned its approval on the bank's having appropriate risk management procedures and safety and soundness practices designed to ensure compliance with Section 23B, and a commitment that the affiliates would post collateral to cover the mark-to-market amount owed to the bank under such transactions.

g. Certain Special Interpretive and Policy Issues

(i) Exemptions from Section 23A in Response to 2007-2009 Credit Crisis

A) Board Letters to Bank of America, Citigroup and JPMorgan Chase, Aug. 20, 2007, to Deutsche Bank, Sept. 12, 2007, to Barclays, Oct. 11, 2007, and to RBS, Oct. 12, 2007, granted exemptions to allow the applicable bank to engage in reverse repo and securities borrowing transactions with its affiliated broker-dealer in conjunction with actions the Board took simultaneously to provide insured depository institutions with access to term loans at the discount window.

The Board terminated the temporary exemptions by Letters, dated Mar. 18, 2010.

B) Board Letter to Citibank, Oct. 23, 2007, granted a similar exemption to cover securities financing transactions with Citibank's European broker-dealer affiliate (in addition to its U.S. broker-dealer affiliate).

C) In 2008, the Board granted JPMorgan Chase Bank temporary relief from Section 23A in order to facilitate JPMorgan Chase's acquisition of Bear Stearns and the orderly integration of Bear Stearns with and into JPMorgan Chase. Board Letter, Apr. 1, 2008. See also Board Letters, June 26 and July 1, 2008.

D) Regulation W (12 C.F.R. § 223.42(n)) provided a temporary exemption (see Board Press Release, Sept. 14, 2008) extended through October 30, 2009 (see 74 Fed. Reg. 6225 (Feb. 6, 2009)) -- but not beyond that (see Board Press Release, Oct. 30, 2009) -- to allow insured depository institutions to provide liquidity to their affiliates for securities or other assets that the affiliates typically would have funded in the tri-party repo market. This exemption allowed a bank to engage with an affiliate in reverse repo transactions, collateralized securities borrowing transactions and secured extensions of credit, exempt from quantitative limits, collateral requirements and low-quality asset prohibitions.

E) The AMLF was adopted in September 2008 in order to provide liquidity to money market mutual funds. See Part I.A.6.iii above. On January 30, 2009, the Board provided an exemption from Sections 23A and 23B for a bank's AMLF-financed purchases of ABCP from an affiliated money market mutual fund. 12 C.F.R. § 223.42(o); 74 Fed. Reg. 6226 (Feb. 6, 2009).

F) Board Letter to Wells Fargo Bank, Nov. 20, 2008, granted an exemption from Section 23A for loans of up to $17 billion to affiliate Wachovia Bank (constituting nearly 40% of Wells Fargo Bank's capital stock and surplus) to meet Wachovia Bank's anticipated funding needs during the transition period prior to the completion of Wells Fargo's acquisition of Wachovia. At the time of the issuance of the Letter, Wachovia Bank had become an affiliate of Wells Fargo Bank for purposes of Section 23A by virtue of Wells Fargo's acquisition of 39.9% of the voting stock of Wachovia's parent. The Board noted that, upon completion of the acquisition, the banks would become "sister banks" (more than 80% commonly owned), and transactions between them would be exempt from Section 23A requirements.

G) GAO's Report on Government Support for [BHCs]: Statutory Changes to Limit Future Support are Not

Yet Implemented (GAO, Nov. 14, 2013) details these Section 23A exemptions, noting they were granted to allow financial institutions to provide liquidity support to the nonbanking sector during the 2008-2009 financial crisis.

(ii) Application of the Attribution Rule

A) Federal banking regulators have broadly interpreted the Attribution Rule (12 C.F.R. § 223.16(a)). These interpretations raise issues as to the ability of a bank to participate in credit-related transactions which involve an affiliate, or in transactions involving the purchase by a bank of securities underwritten or dealt in by an affiliated securities firm.

i) A Board Letter to Morgan Stanley Bank, N.A., Nov. 5, 2012 (the "2012 Section 23A Interpretation") , analyzed novations from an affiliate to a bank of derivatives with third parties as purchases of assets, and therefore covered transactions. Alternatively, the Board stated that such novations would also be covered transactions pursuant to the Attribution Rule because "[t]he assumption by the bank of the obligation to make payments to the counterparty under the novated derivative contract benefits the bank's affiliate by relieving the affiliate of the obligation to make those payments." This conclusion could have ramifications for the application of the Attribution Rule to other scenarios where the bank may be deemed to have "taken over" an obligation or commitment of an affiliate, even if no money or "proceeds" are paid.

ii) Compare, e.g., Board Letter re Ally Bank (formerly GMAC Bank), May 21, 2009 (the "Ally Letter") (exemption for certain bank loans to consumers to finance the purchase of vehicles, as well as floor plan financings to independent dealerships for the purchase of vehicles, from affiliated GM), with FDIC Advisory Opinion 04-9 (June 9, 2004), CCH Fed. Banking L. Rep. ¶ 82-270 (where floor plan financing arrangements exist between a bank affiliate and independent dealerships, auto loans to customers that result in the repayment of floor plan financings constitute covered transactions).

iii) See also, e.g., Board Letters re Fifth Third Bank, Jan. 30, 2009, and BB&T, Jan. 9, 2009 (exemption for certain purchases of variable rate demand notes ("VRDNs") from third-party holders considered covered transactions to the extent that proceeds from a liquidity facility provided by the affiliated bank to the VRDN-issuing trusts would be transferred to the securities affiliate holding the VRDNs through interest and other payments on the notes); Board Letter to Iberville Bank, Aug. 10, 2001 (loan to unaffiliated borrower is a covered transaction where borrower uses loan proceeds to purchase real estate developed and sold as principal by an affiliate); Board Letter to American State Bank, Aug. 26, 1996 (loan to unaffiliated borrower is a covered transaction where borrower leases land from an affiliate); FDIC Advisory Opinion 96-2 (Jan. 22, 1996), CCH Fed. Banking L. Rep. ¶ 82-102 (bank purchase of assets of affiliate bank whose stock was being sold by its BHC parent is a covered transaction because the cash payment by the purchaser benefited the BHC); OTS Unpublished Letter (Oct. 4, 1995) (purchases of loans from an affiliated real estate developer are not exempt under Section 23A because the Board has not authorized the 250.250 Exemption for situations where the affiliate is both the loan originator and the seller of the underlying property being financed; direct loans to unaffiliated borrowers who use proceeds to purchase homes from the developer are covered transactions because the developer was an indirect recipient of the proceeds); Board Staff Opinion, dated Mar. 4, 1994, Fed. Res. Reg. Serv. ¶ 3-1188.1, and FDIC Advisory Opinion 94-16 (Mar. 23, 1994), CCH Fed. Banking L. Rep. ¶ 81,736 (bank loan to finance the purchase of preferred stock issued by an affiliate is a covered transaction unless the proceeds of the loan are not transferred to the affiliate); OTS Letter (Dec. 22, 1992), CCH Fed. Banking L. Rep. ¶ 82,644 (bank loan to unaffiliated borrower to purchase property from a developer subsidiary of the bank's BHC is a covered transaction); Comptroller Unpublished Letter (Oct. 18, 1989) (bank loan to a third party Employee Stock Ownership Plan for the purpose of purchasing shares of a bank affiliate is a covered transaction); Board Letter re First City, Mar. 3, 1988 (bank loan to an unaffiliated borrower that had borrowed money from an affiliate of the bank is a covered transaction even if none of the proceeds of the bank loan would be used to service the loan from the bank's affiliate, because the loan proceeds would be "commingled" with the borrower's other assets and could be used indirectly to service debt to the affiliate).

iv) Compare, e.g., Comptroller Interpretive Letters No. 730 (May 29, 1996) ("Letter No. 730"), CCH Fed. Banking L. Rep. ¶ 81-047, and No. 656 (Mar. 13, 1995), CCH Fed. Banking L. Rep. ¶ 83,604 (loans to distributors of mutual funds to finance commissions to selling brokers not treated as "for the benefit" of "affiliated" funds); Comptroller Interpretive Letters No. 565 (Nov. 27, 1991), CCH Fed. Banking L. Rep. ¶ 83,319 ("Letter No. 565") (bank affiliate settlement services on credit cards issued by the bank and receipt from merchants of fee for clearinghouse services did not cause credit card loans to be covered transactions since the affiliate's participation in the transactions was limited to the ministerial advance of money to merchants on behalf of the bank); No. 529 (Sept. 20, 1990), CCH Fed. Banking L. Rep. ¶ 83,240 (bank purchase of BAs created by unaffiliated banks pursuant to letters of credit issued by affiliates of the purchasing bank are not covered transactions since the proceeds of the purchase go to the person discounting the BA, not to an affiliate); No. 266 (July 28, 1983), CCH Fed. Banking L. Rep. ¶ 85,430 ("Letter No. 266") (bank guarantee of loans to a third party made by an affiliate not a covered transaction where the bank conducted an independent credit evaluation of the borrower).

v) In circumstances where some portion of the proceeds of a loan to a non-affiliate will be transferred to or used for the benefit of an affiliate, Board staff has generally taken the position that the Attribution Rule only applies to the pro rata portion of the proceeds to be transferred/used.

B) Regulation W (12 C.F.R. § 223.16(b)) carries forward the approach taken in 2001 when the Board issued 12 C.F.R. §§ 250.243, 250.244 and 250.245 (each of which has since been removed). See 66 Fed. Reg. 24226 et seq. (May 11, 2001). Essentially:

i) A bank extension of credit to a customer is not treated as an extension of credit to an affiliate if (a) the proceeds of the extension of credit are used to purchase an asset through an affiliate and the affiliate is acting as an agent or broker, and (b) the asset purchased by the customer is not issued, underwritten or sold by an affiliate.

However, a different analysis is required when an affiliate retains a portion of the bank's loan to a third party as a brokerage or agency fee. The Board granted an exemption from Section 23A for such a fee if it is substantially the same as, or lower than, that prevailing for comparable transactions involving non-affiliates (12 C.F.R. § 223.16(c)(2)).

Transactions that are the subject of the exemption (including the terms of a loan to a third-party borrower and any fee paid to an affiliate of the lending bank out of loan proceeds) would be subject to Section 23B's Market Terms Requirement.

ii) A customer's use of a bank extension of credit to purchase securities in a riskless principal transaction from an affiliate was granted an exemption for the affiliate's retention of loan proceeds for a moment in time. (12 C.F.R. § 223.16(c)(1)). However, the Board limited this exemption to "securities affiliates" (a term defined in 12 C.F.R. § 223.3(gg)).

Similar to the exemption for brokerage and agency fees, the Board also granted an exemption for any riskless principal mark-up or other compensation received by the securities affiliate from the proceeds of the bank loan, provided such mark-up or compensation is consistent with the Market Terms Requirement (12 C.F.R. § 223.16(c)(1)(iii)).

However, the exemption for riskless principal transactions does not apply if the security purchased by the non-affiliate is issued, underwritten or sold as principal (other than as riskless principal) by any affiliate of the bank.

See also Part III.A.5.g.viii.C and Part III.A.5.g.xiii below.

iii) The Board also granted an exemption (12 C.F.R. § 223.16(c)(3)) for an extension of credit by a bank to a non-affiliate, if (a) the proceeds of the extension of credit are used to purchase a security from or through a securities affiliate of the bank; and (b) the extension of credit is made pursuant to a pre-existing line of credit that was not established in contemplation of the purchase of securities from or through an affiliate.

The Board clarified that the "pre-existing line of credit" exemption may not be used in circumstances in which a line of credit has only been pre-approved.

iv) When it adopted 12 C.F.R § 250.245 in 2001 (since removed), the Board noted that the Attribution Rule does not distinguish between eligible and ineligible securities. Accordingly, a bank loan used by the borrower to buy securities underwritten or held as principal by the bank's affiliate would be covered by Section 23A (unless some other exemption applies) regardless of the type of securities purchased.

C) Regulation W (12 C.F.R. § 223.16(c)(4)) exempts from Section 23A extensions of credit by a bank under a general purpose credit card where the borrower uses the credit to purchase goods or services from an affiliate, so long as less than 25% of the aggregate amount of purchases with the card are purchases from affiliates.

The Board also noted that most special purpose credit card banks generally comply with Section 23A by selling their receivables or establishing a segregated, earmarked deposit account to collateralize receivables at the end of the day.

D) In submissions to the Board on Nov. 4, 2003 and Mar. 12, 2004, the New York Clearing House Association ("NY Clearing House") requested an exemption from the Attribution Rule for transactions where the bank does not have knowledge (actual or constructive) that the proceeds of the transactions are transferred to, or otherwise benefit, its affiliate. See also NY Clearing House Letter to the Board, dated May 4, 2004 (withdrawing two proposals).

E) Provision of credit support to an issuer of debt securities underwritten by an affiliate, or for which an affiliate serves as dealer, should not generally be a covered transaction. See Part III.A.5.g.x.E below.

(iii) Definition of "Affiliate"

Regulation W clarifies and expands the definition of "affiliate" for purposes of Section 23A.

A) Financial Subsidiaries

i) Regulation W (12 C.F.R. § 223.3(p)) provides that a financial subsidiary of a bank -- defined to include any subsidiary of a national or state bank that engages in an activity not permissible for a national bank (such as securities underwriting and dealing) or that is conducted under terms and conditions that differ from those that govern the conduct of such activity by a national bank -- is an affiliate of the bank for purposes of Sections 23A/23B. However, the Board exempts from the definition of financial subsidiary (a) any insurance agency subsidiary of a bank (but not a subsidiary that engages in other agency activities not otherwise permissible for a national bank), and (b) any subsidiary of a state bank that engages solely in (i) activities permissible for the state bank under federal and state law; or (ii) activities that such subsidiary was lawfully conducting before issuance of Regulation W.

The Board refused to accept the comments of the FDIC and others that a state bank subsidiary approved by the FDIC under FDIA § 24 should be exempt from the definition of affiliate in Section 23A even if the subsidiary engages in an activity that the parent bank may not conduct directly so long as (a) the FDIC has made a determination that the activity would pose no significant risk to the DIF, and (b) the state bank remains in compliance with applicable capital guidelines.

ii) Gramm-Leach provides that any investment in the securities of a financial subsidiary of a bank by an affiliate of the bank will be treated as an investment in such securities by the bank. Gramm-Leach also provides that any extension of credit to a financial subsidiary of a bank by an affiliate of the bank will be treated as an extension of credit by the bank if the Board so determines. Regulation W (12 C.F.R. § 223.32(c)) states that any extension of credit to a financial subsidiary of a bank by an affiliate would be treated as an extension of credit by the bank if the extension of credit is treated as regulatory capital of the subsidiary.

iii) Regulation W (12 C.F.R. §§ 223.11, 223.32(a)) reflects Gramm-Leach's determination that covered transactions with a financial subsidiary are not subject to the 10% limit. However, effective July 21, 2012, Dodd-Frank eliminated this exception for financial subsidiaries. As of September 15, 2016, the Board had not yet proposed revisions to Regulation W to implement Dodd-Frank's changes.

B) Investment Funds

i) Prior to Dodd-Frank, Section 23A limited the definition of "affiliate" in the investment fund context to an entity that is "sponsored and advised on a contractual basis" by a bank or an affiliate, or an investment company registered under the 1940 Act for which the bank or an affiliate serves as an investment adviser. See generally OTS Letter 94/CC-03 (June 14, 1994). Regulation W (12 C.F.R. § 223.2(a)(6)) defines "affiliate" to also include any unregistered investment fund if the bank or any affiliate (a) serves as investment adviser to the fund, and (b) owns more than 5% of any class of voting shares or of the equity capital of the fund.

However, Dodd-Frank, effective July 21, 2012, provides that any investment fund that is advised by the bank or an affiliate of the bank is an "affiliate" for purposes of Section 23A. The Board is expected to propose revisions to Regulation W to incorporate this change and to clarify the types of "investment funds" that may be deemed affiliates.

See also Part VIII.C.2.k below.

ii) An investment fund could also be an "affiliate" of a bank if an FHC that controls the bank owns more than 15% of the equity capital of the fund -- or has a general partnership interest in the fund -- in reliance on Gramm-Leach's merchant banking authority (regardless of whether the bank or an affiliate serves as investment adviser). See Part III.A.5.g.iii.C below.

iii) Under 12 C.F.R. § 223.2(a)(11), subsidiaries of investment fund affiliates of a bank are affiliates of the bank for purposes of Section 23A.

iv) However, under 12 C.F.R. § 223.2(a)(9), an FHC will not be deemed to own or control the equity capital of a company solely by virtue of an investment made by the FHC under the Merchant Banking Regulations in a private equity fund that owns or controls the equity capital of the company unless the FHC "controls" the private equity fund.

C) Merchant Banking

Regulation W's rebuttable presumption in 12 C.F.R. § 223.2(a)(9) that a portfolio company is an "affiliate" of a bank if an FHC that controls the bank owns or controls 15% or more of the equity capital of the portfolio company under Gramm-Leach's merchant banking authority or insurance company investment authority tracks the Merchant Banking Regulations and includes three safe harbors from this presumption:

i) Where no representative of the FHC serves as a director, trustee or general partner of the portfolio company (or in a similar capacity);

ii) Where a third party owns a greater percentage of the equity capital of the portfolio company than does the FHC and no more than one representative of the FHC serves as a director or trustee of the portfolio company (or in a similar capacity); or

iii) Where a third party owns more than 50% of the voting shares of the portfolio company and representatives of the FHC do not constitute a majority of the directors or trustees of the portfolio company.

D) Jointly Held Companies

Although Section 23A excludes from the definition of "affiliate" most subsidiaries of a bank, Regulation W (12 C.F.R. § 223.2(b)(1)(iii)) defines "affiliate" to include any subsidiary of a bank if an affiliate of the bank (other than a "sister bank") "directly controls" the subsidiary.

Given the Regulation W definition of "control" (12 C.F.R. § 223.3(g)), "direct control" could be found at the 25% ownership level.

E) Convertible Securities

i) Regulation W (12 C.F.R. § 223.3(g)(4)) provides that a shareholder that owns or controls securities (including options and warrants) that are convertible, at the option of the holder, into other securities will be deemed to control the other securities (unless the shareholder presents information to the Board that demonstrates that the shareholder should not be deemed to control the securities).

ii) Unlike the comparable provision of Regulation Y (12 C.F.R. § 225.31(d)(1)(i)), which treats as a rebuttable presumption of control the ownership of convertible securities which are immediately convertible into underlying securities, Regulation W includes no such qualification. Moreover, it is not clear how flexible Board staff would be with respect to the "unless" clause, since there is little evidence of control-related flexibility when Board staff interprets comparable provisions of Regulation Y.

F) Definition of "Control"

i) Regulation W (12 C.F.R. § 223.3(g)(5)) contains a rebuttable presumption that a company will be deemed to "control" another company if the first company owns or controls more than 25% of the "equity capital" of the second company. See, e.g., Board Letter re Marshall & Ilsley Corp. ("M&I"), July 23, 2008 (following the spin-off of 75% of Metavante Technologies to M&I's shareholders and a sale of the remaining 25% of Metavante to an unaffiliated private equity fund, Metavante no longer considered an "affiliate" of M&I).

ii) The 2008 Board Control Guidance indicates that an investment in less than one-third of the total equity of a banking organization will generally be deemed non-controlling in the context of determining whether an application or notice will be required under BHCA §§ 3 and 4, provided that the investor does not control more than 14.9% of any class of voting securities. However, there is no indication whether the Board would apply this control standard in the face of the Regulation W rebuttable presumption on equity capital ownership. See Board Control Guidance, 12 C.F.R. § 225.144.

iii) In the 2009 Ally Letter, the Board deemed GM to be an affiliate of Ally Bank (formerly GMAC Bank) despite the fact that GM controlled less than 10% of the total voting stock and total equity of Ally Bank's parent, GMAC, and GM had not been deemed to control GMAC for purposes of BHCA § 3 in the Board Order approving GMAC's application to become a BHC. Compare Ally Letter, with GMAC, 95 Fed. Res. Bull. B29 (2009).

(iv) Asset Securitization Issues

A) The purchase of ABS issued by an affiliate may be regarded as the purchase of assets rather than affiliate securities for purposes of Section 23A if such securities are functionally equivalent to the underlying assets. See, e.g., Board Letter, May 6, 1986 (the "Board 1986 23A Letter"); Comptroller No-Objection Letter No. 88-4 (Feb. 5, 1988) ("Letter No. 88-4"), CCH Fed Banking L. Rep. ¶ 84,044. See also Part III.A.5.g.viii below.

Regulation W does not disturb this conclusion.

B) It is possible that an asset securitization vehicle might be an "affiliate" of a bank for purposes of Section 23A depending on how the relationships (e.g., directors, ownership, sponsorship, operational/managerial advice/involvement) between the bank (or the bank's affiliate) and such vehicle are structured. If such vehicle is an affiliate, a bank's ability to provide credit or liquidity enhancement would be greatly reduced.

(v) Restriction on Bank Purchases of Assets from Affiliates: The 250.250 Exemption and Other Issues

A) The restriction on bank purchases of assets from affiliates has been interpreted broadly. See, e.g., FDIC Advisory Opinion 94-1(a) (Jan. 4, 1994), CCH Fed. Banking L. Rep. ¶ 81,721 (bank purchase of credit card receivables from its credit card affiliate); Board Staff Opinion (May 2, 1990), Fed. Res. Reg. Serv. ¶ 3-1188 (bank purchase of a loan made to an unaffiliated borrower from a non-bank affiliate (i) if on a non-recourse basis, would be a purchase of assets from the affiliate, and (ii) if on a recourse basis, would be an extension of credit to the affiliate; bank purchase of a loan made to an affiliate would be an extension of credit to that affiliate and must be collateralized regardless of whether the bank purchases the loan from a third party).

B) <u>But see</u> 12 C.F.R. § 223.41(c) (exempting purchases, on a nonrecourse basis, of loans from an affiliated depository institution that does not meet the "sister bank" exemption) and § 223.42(h) (exempting purchases back from an affiliate of extensions of credit originated by the bank and sold under a repo agreement or with recourse).

C) In 1979, the Board issued the 250.250 Exemption to exempt from Section 23A a bank's purchase of a loan from an affiliate if the bank's commitment to purchase is (i) obtained by the affiliate within the context of each proposed loan (<u>i.e.</u>, is not a "blanket" advance commitment to purchase loans); (ii) obtained <u>prior</u> to the affiliate's commitment to make such loan; and (iii) based on the bank's independent evaluation of the creditworthiness of each borrower conducted <u>prior</u> to the affiliate's commitment to make such loan. A Board Staff Opinion (Apr. 24, 1995) (the "<u>1995 Staff Opinion</u>") indicated that the 250.250 Exemption would <u>not</u> be available if the dollar amount of the bank's purchase from its affiliate represented more than 50% of the dollar amount of loans made by the affiliate over the preceding 12 months.

<u>See also</u>, <u>e.g.</u>, <u>Amplicon, Inc.</u>, 87 Fed. Res. Bull. 421 (2001) (to similar effect as the 1995 Staff Opinion); Board Letter to Bank One, Jan. 17, 1996 (method of reporting loans acquired pursuant to 250.250 Exemption); Comptroller Unpublished Letter (Apr. 20, 1993); OTS Letter No. 92/CC-58 (Dec. 22, 1992); Letter No. 565; Board Letters re Marine Midland Bank, Jan. 7, 1987 and Dec. 24, 1985, and related Board Legal Division Memorandum, dated Dec. 17, 1985 (250.250 Exemption does not apply to acquisition of a business where the bank's participation is necessary to fund such acquisition); Letter No. 266.

D) Regulation W (12 C.F.R. § 223.42(k)) includes the 250.250 Exemption, as supplemented by the 1995

Staff Opinion but qualified by a provision allowing a bank's primary regulator to reduce the 50% test to protect the safety and soundness of the bank.

E) The Board sought comment on whether to limit the amount of assets that a bank may purchase from an affiliate pursuant to the 250.250 Exemption to not more than 100% of the bank's capital stock and surplus. See 67 Fed. Reg. 76618 (Dec. 12, 2002) (solicitation of public comments). See also OTS Comment Letter, dated Jan. 13, 2003 (a specific limit on 250.250 Exemption transactions is unnecessary); Financial Services Roundtable Comment Letter, dated Jan. 13, 2003 (additional restriction is unnecessary and could undermine longstanding bank practices).

F) Regulation W limits the assets purchased through an affiliate that could fall within the 250.250 Exemption to loans and other extensions of credit as set out in 12 C.F.R. § 223.3(o) (including CP and other debt securities, as well as "[a]ny other similar transaction as a result of which an affiliate becomes obligated to pay money").

G) The Regulation W Proposal indicated that the Board does not believe that a bank may satisfy a requirement that it independently review the creditworthiness of each obligor prior to committing to purchase a loan by having its affiliates use the bank's underwriting standards or the underwriting standards of a government agency.

H) Regulation W (12 C.F.R. § 223.3(dd)) provides that (i) a bank is deemed to purchase an asset from an affiliate if it acquires the asset in exchange for cash or any other consideration (including an assumption of liabilities), and (ii) the merger of an affiliate into a bank is a purchase of assets if the bank assumes any liabilities of the affiliate or pays any other form of consideration in the transaction.

I) The Board has granted exemptions under Section 23A for purchases of real property/improvements and other operating properties from an affiliate because Section 23A is not designed to cover such transactions. See, e.g., Board Letters re First Command Bank, Mar. 14, 2011 (office building); re FirsTier Bank, Nov. 22, 2005 (bank premises); re Omni National Bank, Apr. 8, 2005 (aircraft); re Bank of Wausau, Nov. 19, 2003 (bank premises).

J) Board Letter re Minnwest/Metro Banks, Mar. 25, 2008, clarifies that where (i) a bank (Bank A) purchases assets from a non-bank affiliate, and (ii) a "sister bank" (Bank B) purchases those assets from Bank A, this is the functional equivalent of Bank B purchasing the assets from the affiliate directly. This interpretation prevents banks from using the "sister bank" exemption (discussed in Part III.A.5.c.iii.G above) to circumvent the quantitative limitations by using a larger bank to purchase assets from an affiliate and then having those assets purchased by a smaller bank in quantities that the smaller bank could not buy directly from the affiliate.

(vi) Valuation of Transactions

A) Regulation W (12 C.F.R. § 223.21) values credit transactions between a bank and an affiliate as the greatest of (i) the principal amount of the credit transaction, (ii) the amount owed by the affiliate to the bank under the transaction, or (iii) any amount lent to an affiliate plus any amount that the bank could be required to provide to the affiliate under the transaction. (Thus, if a bank provides a revolving credit facility to an affiliate, the amount of the covered transaction would include not only drawings under such facility but also the maximum undrawn amount.)

Regulation W (12 C.F.R. § 223.22(a)(2)(iv)) applies similar principles to the valuation of a bank's purchase from an affiliate of a line of credit, revolving credit facility or similar credit arrangement for a non-affiliate (i.e., such a transaction is valued at the total amount of consideration given by the bank in exchange for the asset plus any additional amount that the bank could be required to provide to the non-affiliate borrower).

B) Regulation W (12 C.F.R. § 223.23) values a purchase of, or investment in, securities issued by an affiliate at the greater of (i) the total consideration given (including liabilities assumed) by the bank, or (ii) the "carrying value" of such securities.

i) Thus, a bank that pays no consideration for affiliate securities must nevertheless value the covered transaction at no less than the bank's carrying value.

ii) This valuation method means that an increase in the carrying value of affiliate securities could use quantitative limit capacity for covered transactions under Section 23A.

C) With respect to transactions subject to the Affiliate Collateral Provision:

i) In a relaxation of Board staff's traditional position, Regulation W (12 C.F.R. § 223.24(a)) values such transactions where the only collateral for the loan is affiliate securities at the lesser of (a) the total amount of the extension of credit, and (b) the fair market value of the affiliate's securities that are pledged as collateral (but only if such securities are traded in a ready market). Compare, e.g., OTS Letters 94/CC-05 (June 14, 1994); 92/CC-60 (Dec. 24, 1992).

ii) Consistent with the position taken in Board Letter, Jan. 21, 1999 (the "1999 Section 23A Interpretation"), Regulation W

(12 C.F.R. § 223.24(b)) values transactions where the collateral for a loan includes both affiliate securities and other collateral at the lesser of (a) the total amount of the extension of credit minus the fair market value of the non-affiliate collateral, and (b) the fair market value of the affiliate's securities that are pledged as collateral (but only if such securities are traded in a ready market). Compare 73 Fed. Reg. 22216, 22233 (Apr. 24, 2008) (OCC removal of more liberal interpretation to conform to Regulation W); OTS Letter 94/CC-05 (June 14, 1994) (reserving the question whether using the cash value of life insurance policies issued by an affiliate is subject to Section 23A).

iii) Regulation W does not include an implicit condition of the 1999 Section 23A Interpretation that only a small amount of total collateral for a loan may be affiliate securities.

D) Although the Board has not yet proposed regulations to implement Dodd-Frank's expansion of "covered transactions" to include derivative transactions between a bank and its affiliates, the 2012 Section 23A Interpretation clarifies that a novation to a bank from its affiliate of derivative transactions with third parties is to be treated as a purchase of assets from the affiliate and must be counted against a bank's Section 23A quantitative limits. See also Board Letter re JPMorgan Chase, July 1, 2008 (transfer of derivative transactions and associated hedges constitutes purchase of assets for which Board granted waiver to facilitate Bear Stearns acquisition).

Specifically, a bank should value a novation at the sum of: (i) the aggregate amount of all payments made by the bank to or for the benefit of the affiliate in connection with the novation; (ii) the aggregate absolute value of the negative current exposure of all novated derivative contracts or novated "derivative netting sets" that have negative current exposure at the time of novation; (iii) a "counterparty credit risk measure" determined under the Board's capital rules; and (iv) a "market risk measure" determined under the Board's market risk capital rule. The covered transaction amount must be recalculated daily.

The covered transaction amount for all derivatives that are novated from an affiliate may be reduced by the sum of: (i) the aggregate amount of all payments made from the affiliate to the bank in connection with any novation; (ii) the aggregate amount of cash or U.S. government securities collateral held by the bank; and (iii) the aggregate amount of any cash or U.S. government securities collateral previously posted by the affiliate to a counterparty with respect to a novated derivative contract or derivative netting set so long as the affiliate transfers to the bank all current and future rights to the collateral.

The Board has not yet provided guidance on collateral requirements with respect to derivatives transactions between a bank and its affiliates under Section 23A, or on what levels of collateral are required to make such derivatives "exempt" from Section 23A. The 2012 Section 23A Interpretation appears to suggest, however, that collateral in addition to variation margin would be required to achieve "exempt" status (e.g., independent amounts for credit or market risk, beyond variation margin). See Part III.A.5.f.ii. above.

(vii) Corporate Acquisition and Reorganization Transactions

Regulation W (12 C.F.R. § 223.31) provides that when a BHC contributes the shares of an affiliate to a subsidiary bank, thereby making the contributed company a subsidiary of the bank, the transaction should be viewed as a purchase of assets of an affiliate by the bank (and, therefore, a covered transaction), with the value of the transaction based on the total amount of liabilities owed by the contributed affiliate to any person plus the total consideration given by the bank for the shares.

A) Regulation W's approach is more onerous than the approach that the Board had taken in the past. Historically, the Board only required a bank to treat a contribution as a covered transaction if the contributed company had liabilities to another affiliate. The Regulation W approach is also contrary to the position that other bank regulators took. See, e.g., Comptroller Interpretive Letter No. 389 (July 7, 1987), CCH Fed. Banking L. Rep. ¶ 85,613; Comptroller No-Objection Letter No. 86-8 (May 1, 1986), CCH Fed. Banking L. Rep. ¶ 84,014.

B) The Board rejected a proposal that a covered transaction should be deemed to occur in connection with a share contribution only if there is a net transfer of value from the bank to the affiliate (i.e., if the liabilities of the transferred company exceed the value of the company's assets).

C) Based on Section 23A's provisions which give special treatment to transactions secured by cash (see Section 23A(d)(4)), if, as part of the transfer of a company from an affiliate to a bank, the amount of cash contributed (whether in the company, or by the affiliate) exceeds the company's total liabilities, such transaction should be valued at "zero" for Section 23A purposes. Cf., e.g. Board Letter re Citigroup, Feb. 27, 2003.

D) Regulation W (12 C.F.R. § 223.31(d)) exempts a bank's acquisition of an affiliate conducted as a "step transaction", involving (i) an initial acquisition by an affiliate of a third-party company and, shortly thereafter, (ii) the transfer of ownership of such company to the bank. The exemption is available if:

i) The bank acquires the securities issued by the transferred company within one business day (or such longer period, up to three months, as may be permitted by the bank's federal banking agency) after the company becomes an affiliate of the bank.

ii) The bank acquires all the securities of the transferred company that were transferred in connection with the transaction that made the company an affiliate.

iii) The business and financial condition (including the asset quality and liabilities) of the transferred company do not materially change from the time the company becomes an affiliate of the bank and the time the bank acquires the company.

iv) At or before the time that the transferred company becomes an affiliate of the bank, the bank notifies its federal banking agency and the Board of the bank's intent.

See, e.g., PNC Notice to Board to acquire HW Holdings, dated Sept. 9, 2005.

E) Regulation W (12 C.F.R. § 223.41(d)) exempts certain internal corporate reorganizations. This approach is consistent with numerous Section 23A exemptions which the Board has granted. Section 223.41(d) exempts the purchase of assets by a bank from an affiliate if:

i) The asset purchase is part of a corporate reorganization of a BHC and involves the transfer of all or substantially all the shares or assets of an affiliate or of a division or department of an affiliate.

ii) The bank provides its federal banking agency and the Board written notice of the transaction <u>before</u> consummation.

iii) The bank's top-tier BHC commits to its federal banking agency and the Board before consummation either: (a) to make quarterly cash contributions to the bank, for a two-year period following the bank's purchase, equal to the book value plus any write-downs taken by the bank, of any transferred assets that become low-quality during the quarter; or (b) to repurchase, on a quarterly basis for a two-year period following the bank's purchase, at a price equal to the book value plus any write-downs taken by the bank, any transferred assets that become low-quality during the quarter.

iv) A majority of the bank's directors approves the transaction before consummation.

v) The value of the covered transaction when aggregated with the value of any other covered transactions under this exemption during the preceding 12 months, represents less than 10% of the bank's capital stock and surplus (or such higher amount, up to 25%, as may be permitted by the bank's federal banking agency).

vi) The BHC and all of its subsidiary depository institutions are well capitalized and well managed and would remain well capitalized upon consummation of the transaction.

<u>See</u>, <u>e.g.</u>, Comptroller Conditional Approval No. 1002 (June 17, 2011) (merger of uninsured trust company and national bank affiliate within Morgan Stanley corporate group); Comptroller Interpretive Letter No. 1130 (Mar. 10, 2011), CCH Fed. Banking L. Rep. ¶ 81-660 (transfer of mortgage servicing

business); Comptroller Conditional Approval No. 859 (June 13, 2008) (intrastate mergers within BNYM corporate group).

F) The Board admits that the foregoing criteria are stricter than what the Board traditionally approved in case-by-case exemptions.

i) On the other hand, the Board has continued to grant exemptions under Section 23A for one-time inter-affiliate corporate transactions subject to commitments that (a) none of the assets purchased by the bank are low-quality; (b) before purchasing assets of an affiliate, the bank reviews the assets to ensure that the transaction is consistent with safe and sound banking practices; (c) at the end of each calendar quarter for a designated period (generally two years) after the date of transfer, the affiliate repurchases, at the then current book value plus any write-downs taken by the bank, any transferred assets that are low-quality; (d) before any purchase, a majority of the bank's directors who are not affiliated with the bank approve the purchase; and (e) the bank is well capitalized. Compare, e.g., Board Letter re R&G Premier Bank, Apr. 29, 2010 (bank granted exemption to acquire assets and liabilities of its affiliate mortgage company without being subject to standard conditions and commitments relating to the transfer of low quality assets).

ii) The Board issued a number of exemptions triggered by the crisis of 2007-2009. See, e.g., GS Reg. W Letter and MS Reg. W Letter (acquisition of assets of the parent and other affiliates to expand the banks' deposits and investment portfolio; financing transactions with affiliates in the transition period prior to the transfer of the assets; full-term repurchase commitment); Board Letter re GS Reg. W

Letter, Dec. 17, 2014 (relief from commitment to maintain minimum capital ratios as condition to exemption).

See also, e.g., Board Letters re CIT Bank, Apr. 13, 2009 (acquisition of non-bank affiliates holding government-guaranteed student loans; 5 year repurchase commitment); re ING Bank, Mar. 31, 2009 (participation in portfolio of troubled MBS by affiliate in exchange for deferred payments originating from Dutch government and guaranteed by parent); re Fifth Third Bank, Jan. 30, 2009, and re BB&T Company, Jan. 9, 2009 (purchase of VRDNs and tender option bonds from securities affiliate; limited to securities rated A and higher); re HSBC Bank USA, Jan. 14, 2009 (credit card receivables (5 year repurchase commitment) and subprime and near-prime auto loans (full-term repurchase commitment)); re GE Money Bank, Jan. 12, 2009 (consumer loan receivables and related loan loss reserves; 5 year repurchase commitment); re Northern Trust, Jan. 9, 2009, and re Wachovia Bank, Dec. 29, 2008 (purchase at fair market value of ARS acquired from customers by parent at par as an accommodation due to illiquidity in the ARS market; full-term repurchase commitment); re Wachovia Bank, Dec. 1, Oct. 6, 2008 (purchase of A-1/P-1 rated assets from affiliated money market funds to facilitate meeting redemption requests without having to sell assets into illiquid markets; monthly reimbursement for losses); re Union Bank, Nov. 24, 2008 (student loans; full-term repurchase commitment and escrow account for unguaranteed portion of the assets); re Wells Fargo Bank, Oct. 29, 2008 (acquisition of non-bank affiliates; full-term repurchase commitment); re JPMorgan Chase, July 1, 2008 (purchase of derivative transactions and associated hedges related to Bear Stearns acquisition), June 26, 2008 (swap transactions with parent and SPE formed in connection with Maiden Lane Arrangement; cash collateral for mark-to-market exposure), and Apr. 1, 2008 (temporary relief for loans and guarantees to affiliates to ensure funding and liquidity of Bear Stearns and facilitate its acquisition by JPMorgan Chase; collateralization subject to daily mark-to-market and remargining, and parent guarantee).

iii) See also, e.g., Board Letter re Bank of America, Sept. 3, 2010 (exemption for purchase of two affiliate credit facilities to allow the bank to preserve all of its capacity within the 20% 23A Limit; holding company committed to transfer additional capital to support assets that become low-quality); Board Letter re First Farmers & Merchant State Bank, June 23, 2009 (purchase of premises from parent); Comptroller Interpretive Letter No. 1114 (Apr. 9, 2009), CCH Fed. Banking L. Rep. ¶ 81-646 (airplane leased to parent; property leased counts toward collateral requirements); Board Letters re Minnwest/Metro Banks, Mar. 25, 2008 (finance leasing operation; bank subsidiaries permitted to hold transferred assets that become low-quality so long as the BHC transfers funds to its bank subsidiaries equal to the book value of any such assets plus any write-downs and any such funds provide a cushion of capital); re Capital One Financial Corp., dated Dec. 21, 2007 (auto finance); re E*TRADE Bank, Oct. 24, 2006 (transfer of SEC-regulated broker-dealer ("E*TRADE Clearing") to OTS-regulated E*Trade Bank) (the "E*TRADE Reg W Letter"); re RBS/Charter One Bank, N.A., Nov. 22, 2005 (asset-finance affiliate); re Klein Financial, Apr. 1, 2005 (mortgage banking affiliate); re HSBC Bank USA, Dec. 22, 2004 (affiliate credit card loans), Dec. 29, 2003 (mortgage loans); re GMAC Commercial Holding Corp., July 7, 2004 (commercial construction credit facilities); re Citicorp Trust Bank, FSB, May 14, 2004 (subprime mortgage lending affiliate); re Merrill Lynch Bank USA, Feb. 10, 2004 (securities-based lender affiliate); re First Alliance Bank, dated Dec. 22, 2003 (lending affiliate); re Valley Independent Bank, Aug. 14, 2003 (assets of NY branch of foreign bank parent); re Citigroup, Feb. 27, 2003 (transfer of mortgage subsidiary of national bank to federal savings bank; national bank permitted to leave low quality assets in mortgage subsidiary since, at the time of transfer, the BHC would make a cash contribution to the acquiring bank equal to the book value of any low quality assets).

iv) In evaluating whether to grant exemptions under Section 23A for inter-affiliate corporate transactions, Board staff has informally advised that the Board may take into account such factors as the dollar size of the covered transaction and, more importantly, the covered transaction's percentage of the bank's pre-reorganization capital. On the other hand, there does not appear to be a specific upper limit in terms of the size (in either dollars or percent-of-capital) of an exempted corporate reorganization, particularly under circumstances where the bank's primary regulator does not object, and the request contains appropriate commitments. The Board has previously granted approval of very substantial corporate reorganizations (e.g., with a covered transaction dollar size as much as 300% of the bank's pre-reorganization capital).

v) Section 23A-related issues may arise in the context of an internal corporate reorganization involving the transfer of an operating subsidiary of a bank to the bank's BHC (i.e., under circumstances where the entity being transferred would no longer be a subsidiary of the bank, and, thus, would become an "affiliate" of the bank for purposes of Section 23A upon the reorganization).

For example, in Board Letter re Merrill Lynch Bank FSB, May 19, 2008, the Board granted a Section 23A exemption to facilitate a transfer of a Bank mortgage lender subsidiary to an affiliate outside of the "bank chain". Prior to the transaction, the Bank had guaranteed the subsidiary's loan repurchase obligations. As a result of the reorganization, the guarantees became guarantees by the Bank on behalf of an affiliate (and, thus, Section 23A covered transactions). In granting the exemption, the Board noted that (a) the guarantees were not covered transactions at the time they were entered into and the Bank did not issue the guarantees in contemplation of the mortgage lender becoming an affiliate of the Bank, and (b) the proposed reorganization reduced the risk exposure of the Bank and raised the Bank's regulatory capital ratios.

See also Part III.A.5.g.vii above.

vi) Transactions approved following Regulation W's adoption are generally consistent with approvals granted prior to Regulation W. See, e.g., Board Letters re Marquette Financial, Oct. 11, 2002 (BHC subsidiaries engaged in residential construction lending and asset-based lending); re Bank Leumi (USA), June 19, 2002 (U.S. agency of foreign bank parent); re RBC Centura Bank, May 3, 2002 (BHC mortgage banking and commercial finance subsidiaries); re Grand National, Mar. 1, 2002 (assets of U.S. branch of foreign bank parent); re Israel Discount Bank of NY, Feb. 14, 2002 (U.S. agency of foreign bank parent); re Citibank, Aug. 28, 2001 (BHC commercial finance and credit card subsidiaries); re Wells Fargo, July 27, 2001 (BHC equipment leasing subsidiary), Jan. 8, 2001 (BHC student loan servicing subsidiary); re HSBC Bank USA, Nov. 21, 2000 (U.S. branch of foreign bank parent); re Chase, Aug. 18, 2000 (the "Board Chase-Fleming Letter") ((A) exempting purchase by Chase Bank of certain businesses previously acquired by Chase and (B) exempting from collateral requirements, for 6 months, outstanding lines of credit from such businesses to investment funds sponsored and advised by acquired company).

(viii) Purchase of Commercial Paper or Other Debt Securities Issued by an Affiliate

A) Regulation W (12 C.F.R. § 223.3(o)(4)) provides that a bank's purchase of a debt security (including CP) issued by an affiliate is considered both an investment by the bank in securities issued by an affiliate and an extension of credit by the bank to the affiliate (and, thus, subject to Section 23A's collateral requirements).

i) This approach is inconsistent with what appears to have been prior market practice pursuant to which banks purchased CP of their BHCs or other affiliates without collateralizing the purchase on the theory that the purchase of CP is a purchase of securities issued by an affiliate, which is not subject to a collateral requirement.

ii) Regulation W (12 C.F.R. § 223.14(f)(3)) provides that a bank's investment in the debt securities (including CP) of an affiliate is not subject to Section 23A collateral requirements if the bank purchases the debt securities from a non-affiliate in a bona fide secondary market transaction. However, the Board did not exempt from Section 23A collateral requirements a bank's purchase of affiliate debt securities pursuant to a public offering or a private placement even if there is significant participation by third parties.

B) The purchase of ABS issued by an affiliate may be regarded as the purchase of assets rather than affiliate securities for the purposes of Section 23A if such securities are functionally equivalent to the underlying assets. See, e.g., Board 1986 23A Letter; Letter No. 88-4.

C) Bank purchases from a non-affiliate on an agency or riskless principal basis of securities issued by an affiliate should not be covered transactions. See, e.g., OTS Unpublished Letter (June 30, 1993); accord Board Staff Opinion (Sept. 21, 1977), Fed. Res. Reg. Serv. ¶ 3-1190. See also Part III.A.5.g.xiii below.

(ix) Timing Principles; No "Unwind" Requirement

A) Regulation W (12 C.F.R. § 223.21(b)(1)) provides that a bank will be deemed to have made an extension of credit under Section 23A at the time that the bank becomes legally obligated to make the extension of credit.

B) Like Section 23A, Regulation W (12 C.F.R. §§ 223.11, 223.12) only prohibits a bank from engaging in a new covered transaction if the bank would be in excess of the applicable percentage limits after consummation of the transaction.

C) Regulation W would not require a bank to unwind existing covered transactions if the bank exceeds these limits because, e.g., the bank's capital declines or because an entity which was not an affiliate at the time that a loan was made becomes an affiliate, even though the ability to engage in future transactions would be affected. In relation to future transactions, note that Regulation W (12 C.F.R. § 223.3(o)) treats as an extension of credit any increase in the amount of, extension of the maturity of, or adjustment in the interest rate or other material term of, an existing extension of credit. However, if a bank makes a loan to a non-affiliate which becomes an affiliate less than one year after the loan, Regulation W (12 C.F.R. § 223.21(b)(2)(i)) requires that the loan be brought into compliance with applicable collateral requirements "promptly".

In contrast, where a bank enters into a credit transaction with a non-affiliate "in contemplation" (see 12 C.F.R. § 223.3(t)) of the non-affiliate becoming an affiliate, Regulation W (12 C.F.R. § 223.21(b)(2)(ii)) provides that the bank must, at or prior to the time the non-affiliate becomes an affiliate, (i) reduce the aggregate amount of its covered transactions with affiliates, if necessary, so as not to exceed Section 23A quantitative limits, and (ii) bring the credit transaction into compliance with applicable collateral requirements.

(x) Scope of "Covered Transactions", Securities Lending Exemptions and Related Issues

A) Dodd-Frank provides that a bank transaction with an affiliate involving the borrowing or lending of securities is a covered transaction to the extent that the transaction causes the bank to have credit exposure to the affiliate. Dodd-Frank also clarifies that a purchase of assets subject to a repo is an extension of credit and therefore subject to both Section 23A quantitative limits and collateral requirements. (Repo transactions had been "covered transactions" under Section 23A prior to

Dodd-Frank, but as asset purchase transactions not subject to collateral requirements.) Dodd-Frank seems to require, however, that only purchases of assets subject to repurchase (a "reverse repo") by the bank are deemed to be extensions of credit. There is no mention in Dodd-Frank as to how to treat a sale by the bank subject to repurchase (a "repo").

B) Prior to Dodd-Frank, Board staff had informally advised that a repo to an affiliate (i.e., where the affiliate buys securities from the bank subject to an obligation to resell to the bank) is not generally a Section 23A "covered transaction". Compare, e.g., 12 C.F.R. § 215.3(a)(1) (while a bank's purchase under a reverse repo is an extension of credit for purposes of Regulation O (12 C.F.R. Part 215), Regulation O is silent regarding a sale by the bank under repo). See also 12 C.F.R. § 223.42(h) (purchase by a bank from an affiliate of an extension of credit that was originated by the bank and sold to the affiliate subject to a repo or with recourse is exempt from quantitative limits, collateral requirements and low-quality asset prohibitions). But see SCCL Reproposal (Board proposed that the credit exposure of both repos and reverse repos would be included in the single counterparty credit limits) and OCC Lending Limit Rule (same).

C) Board staff have informally advised that a bank's repurchase or redemption of equity securities issued to its parent BHC should not be treated as a covered transaction for purposes of Section 23A.

D) Board staff have informally advised that finance leases, but not necessarily operating leases, would be Section 23A covered transactions.

E) With respect to a bank's issuance of credit support (e.g., a letter of credit) on the debt securities of a corporate issuer:

i) It should not be a covered transaction under Regulation W if an affiliate acts as an underwriter or dealer of those securities.

ii) However, the Board could treat such credit support as a covered transaction if an affiliate purchases such securities, as principal, as an investment. (See Part III.A.5.g.ii above.)

F) A bank's purchase of a CD from, or placement of a deposit with, an affiliate is considered a "covered transaction" for purposes of Regulation W, even though such a transaction is not considered an extension of credit under the OCC's Lending Limit Rule. See OCC Unpublished Interpretive Letters (Dec. 15, 1982) (deposits outside the coverage of lending limits), (Mar. 4, 1983) and (Dec. 22, 1983).

G) Dodd-Frank amended Section 23A to include the credit exposure to an affiliate arising from securities borrowing/lending transactions as "covered transactions." In contrast to the treatment of repos and reverse repos, Dodd-Frank states that both securities borrow and securities loan transactions are covered to the extent that they cause a bank to have credit exposure to an affiliate. It will be important to observe whether, and to what extent, the precedents related to securities borrowing/lending transactions described below will be incorporated into proposed revisions to Regulation W pursuant to those Dodd-Frank changes. As of September 15, 2016, the Board had not yet proposed such revisions.

i) In a Letter to JPMorgan Chase, Oct. 31, 2001 (the "Securities Lending 23A Letter"), the Board granted a limited exemption from Section 23A for a program in which JPMorgan Chase Bank acts as agent in lending customer securities held in custody and trust accounts to a broker-dealer affiliate (as well as other unaffiliated broker-dealers) in exchange for cash or securities collateral and the Bank

(a) indemnifies its customer for the borrower's failure to return the securities, (b) agrees to credit the customer with any distributions payable by the issuer of the borrowed securities regardless of whether the borrower has furnished the distribution to the Bank for the account of the customer, and (c) may advance fees to the borrower on behalf of a customer or advance the return of collateral to the borrower.

The Board determined that granting an exemption from Section 23A was appropriate because:

(a) In the case of the indemnity given by the Bank to its customers on behalf of its affiliated broker-dealer, the risk of loss was not substantial -- the Bank's exposure on the indemnity would be limited to the amount by which the market value of borrowed securities exceeds the amount of collateral posted by the borrower. The Board noted that, so long as the Bank employed mark-to-market collateralization, the Bank should rarely be exposed to any substantial borrower credit risk. The Board concluded that (i) credit risk generated by cash-collateralized securities lending transactions is minimal; (ii) the case for exempting securities lending transactions secured by U.S. government securities is strong given the special treatment that Section 23A affords such collateral; and (iii) it would be appropriate to grant a limited exemption for transactions secured by property other than cash or U.S. government securities to the extent that the market value of borrowed securities lent by the Bank's customer to an affiliated broker-dealer against such collateral did not exceed the lesser of 5% of the Bank's capital stock and surplus or 5% of the market value of borrowed securities lent by the Bank's customers.

(b) Any affiliate credit exposure that the Bank would face arising from advances to customers of funds (such as interest payments or dividends) that are distributed by the issuer of the borrowed securities to the affiliate borrower are short-term and generally are repaid on an intraday basis.

(c) Fee advances and collateral return advances by the Bank to the borrower on behalf of the Bank's customers are generally short-term and are secured by investment securities in the customer's account.

<u>See also</u> Board Letters re Wachovia, Sept. 29, 2006, and re BNY, May 5, 2005 (to same general effect).

ii) In a Letter to Bank of America, June 7, 2005 (the "<u>Bank of America Section 23A Letter</u>"), the Board granted a limited exemption from Section 23A for a program where the Bank enters into <u>securities borrowing transactions</u> with affiliated broker-dealers to cover short positions which the Bank enters to hedge derivatives transactions with customers.

Under the Bank's program:

(a) The Bank borrows securities from affiliated broker-dealers under an agreement pursuant to which the Bank must post collateral to secure the Bank's obligation to return the securities.

(b) The affiliated broker-dealer usually repledges the collateral to secure a contemporaneous and parallel borrowing of the borrowed securities from a non-affiliate, although the collateral could be available to meet the broker-dealer's funding needs.

(c) During the term of the securities borrowing, the Bank marks the borrowed securities and any collateral to market daily and calls daily for the return of collateral to the extent that the value of the collateral exceeds the agreed-on margin percentage.

The Board determined that securities borrowing transactions are Section 23A covered transactions, since the transactions result in an affiliate receiving money from the Bank and incurring an obligation to pay the money back at termination under circumstances where the Bank stands to lose the difference between the amount of cash transferred to the affiliated broker-dealer and the liquidation value of the securities transferred to the Bank if the broker-dealer defaults.

The Board granted a Section 23A exemption because:

(a) In the Securities Lending 23A Letter, the Board previously granted an exemption from Section 23A for transactions in which a bank indemnifies a customer's <u>loan</u> of securities <u>to</u> an affiliate.

(b) The Bank's exposure on a borrow from an affiliated broker-dealer would be limited to (i) the amount by which the value of the collateral exceeds the value of the borrowed securities, plus (ii) the amount by which the value of the collateral further exceeds the value of the borrowed securities between the last remargining event and the time when the Bank is able to liquidate borrowed securities after a default by an affiliated broker-dealer.

(c) In order to enhance the ability of the Bank to determine the mark-to-market value of the borrowed securities and to facilitate any efforts by the Bank to liquidate the securities if the affiliated broker-dealer defaults, the exemption would be available only for borrowed securities that have a "ready market".

(d) The Bank would be required to treat a portion of each securities borrowing transaction with an affiliate as non-exempt. The non-exempt amount would equal (i) the Bank's current exposure, i.e., the difference between the cash which the Bank posts as collateral and the market value of the borrowed securities, and (ii) the Bank's potential future exposure, fixed at 6% of the current market value of the borrowed securities (but the Bank may use an internal model to measure such exposure with Board and OCC staff approval).

(e) To address the potential that the exemption might facilitate the Bank's structuring loans to affiliates in the form of securities borrowing transactions, the exemption would be available only if the affiliated broker-dealer executes a securities borrowing transaction with an unaffiliated counterparty that is substantially contemporaneous with (and on the same basic terms as) the Bank's transaction with the affiliated broker-dealer.

See also Board Letter to Wachovia Corp., June 12, 2007 (to similar effect); Part IX.A.1.b.ii below.

iii) In a Letter to Bank of America, dated Jan. 23, 2007, the Board granted an exemption from Section 23A for a securities lending program under which Bank of America would lend securities to an affiliated broker-dealer. As part of the program, the Bank would lend securities in either a principal or an agency capacity.

Under the Bank's program:

(a) The Bank's broker-dealer affiliate may use the borrowed securities for its own purposes but must return the securities on demand by the Bank (or the Bank's customer, where the Bank is acting as agent).

(b) The Bank's broker-dealer affiliate would provide collateral to the Bank in the form of cash or U.S. government securities.

(c) The Bank would ensure that the value of the collateral exceeds the value of the borrowed securities.

The Board determined that when a bank, acting as principal, lends securities to an affiliate, the bank is making a "loan or extension of credit" to the affiliate.

The Board concluded that an exemption from Section 23A would be appropriate because:

(a) The risk of loss to the Bank did not appear to be substantial due to the daily mark-to-market and remargining procedures employed and the proposed use of cash and U.S. government securities as collateral to mitigate the Bank's exposure to its broker-dealer affiliate.

(b) The Market Terms Requirement would apply.

(c) The exemption would enable the Bank's customers to obtain additional securities lending opportunities and diversify the risks of securities lending.

The Board noted that securities lending transactions between the Bank and its broker-dealer affiliate that are secured by property <u>other</u> <u>than</u> cash or U.S. government securities should be exempt from Section 23A to the extent that the total market value of the securities lent to the broker-dealer affiliate by the Bank against such collateral does not in the aggregate exceed the lesser of: (a) 5% of the Bank's capital stock and surplus, or (b) 5% of the total market value of the securities lent to the broker-dealer affiliate by the Bank.

H) Board Letter to Citigroup, Oct. 25, 2005, granted an exemption from Section 23A for a tax-sharing arrangement among certain Australian operating <u>subsidiaries</u> of Citibank (or "bank chain" companies) and certain Australian <u>affiliates</u> of Citibank (or "non-bank chain" companies).

Under the arrangement, a "bank chain" subsidiary serves as the "head" company of Citigroup's Australian tax group, and could be deemed to "guarantee" the payments on behalf of its affiliates in the tax group. Because such guarantee was effectively unlimited in amount, the value of the covered transaction exceeds Section 23A quantitative limits.

In granting an exemption, the Board noted:

i) Each "non-bank chain" company is required to make any required Australian tax payment to the "head" company before the head company is required to pay the "non-bank chain" company's tax liability.

ii) Citigroup guarantees the tax-payment obligations of the "non-bank chain" companies to the "head" company.

iii) The arrangement provides for more benefits to the "bank chain" companies than to the "non-bank chain" companies (e.g., while the "bank chain" companies may use tax losses of the "non-bank chain" companies without compensating the "non-bank chain" companies, the "non-bank chain" companies are only able to use tax losses of the "bank chain" companies if Citigroup compensates the "bank chain" companies for the value of such losses).

I) The federal banking agencies have determined that both (i) a bank's tax payments to its non-bank parent made in advance of the date on which the bank would have been obligated to pay the taxing authority if it had filed as a separate entity, and (ii) a bank's refund, determined as if it had filed as a separate entity, to the extent that it is held by its parent tax filer beyond a reasonable period within which the bank would have received the refund if it had been a separate filer, may be considered extensions of credit and therefore subject to Sections 23A and 23B. See Interagency Policy Statement on Income Tax Allocation in a Holding Company Structure, 63 Fed. Reg. 64757 (Nov. 23, 1998).

The federal banking agencies expanded this Interagency Statement to require that tax allocation agreements between a bank and its holding company acknowledge that any tax refunds paid to the parent for the account of the bank are held by parent as agent, so as to avoid situations that had arisen in failed bank cases where courts determined the refund was an asset of the parent. Tax allocation agreements that fail to acknowledge such agency relationship, and/or do not require the parent to remit tax refunds to a bank, may be deemed to be inconsistent with Section 23B and may be deemed extensions of credit under Section 23A. See Addendum to the Interagency Policy Statement on Income Tax Allocation in a Holding Company Structure, 79 Fed. Reg. 35228 (June 9, 2014).

J) In the E*TRADE Reg W Letter, the Board granted (i) an exemption from Section 23A to permit an internal reorganization involving the transfer of E*TRADE Clearing by E*TRADE Bank's parent company to the Bank, and (ii) an ongoing exemption from Section 23A to permit E*TRADE Clearing (as a wholly owned subsidiary of the Bank) to continue to make margin loans to customers -- the proceeds of which would be transferred to the Bank's broker-dealer affiliates. In addition to providing margin loans, E*TRADE Clearing would perform traditional clearing, settlement and related functions for the brokerage customers of affiliated introducing brokers.

i) The principal objectives of the reorganization were to (a) generate cost savings and financial benefits at the holding company level by reducing E*TRADE Bank's interest rate risk (and associated hedging costs), (b) lower E*TRADE Clearing's funding costs, and (c) integrate the balance sheets of E*TRADE Clearing and the Bank for bank regulatory capital purposes.

Without the exemption, the reorganization would have been a covered transaction (which would have greatly exceeded Section 23A's quantitative limits) because (a) E*TRADE Clearing would become an operating subsidiary of E*TRADE Bank, and (b) E*TRADE Clearing would have liabilities at the time of the transaction.

Although the Board noted that the reorganization would expose the Bank to credit, market and operational risks associated with securities clearing:

(a) The parent holding company committed its affiliated introducing broker affiliates to indemnify E*TRADE Clearing perpetually for all losses on margin loans made to customers.

(b) E*TRADE Clearing committed to refrain from clearing securities transactions for other broker-dealers trading for their own accounts.

(c) E*TRADE Bank committed to remain well-capitalized on both (i) consolidation of E*TRADE Clearing, and (ii) deconsolidation of E*TRADE Clearing and deduction of the Bank's investment in E*TRADE Clearing.

(d) E*TRADE Clearing was required to inform its customers that customer funds are not covered by FDIC insurance.

ii) Without an exemption, margin loans extended by E*TRADE Clearing -- as a subsidiary of E*Trade Bank -- would have constituted Section 23A covered transactions under circumstances where a customer uses the loan proceeds to purchase securities from an affiliate, or to purchase common stock of E*TRADE Clearing's parent company in the secondary market.

Although the Board noted that the margin-loan covered transactions would present risks to E*TRADE Bank, the Board determined that granting the exemption was appropriate in light of the following:

(a) Margin lending is a low-risk, collateralized form of lending.

(b) E*TRADE Clearing's credit exposure would be to unaffiliated investors.

(c) E*TRADE Clearing must abide by the best-execution rule under federal securities laws, which would help prevent E*TRADE Clearing from routing customer trades to an affiliated market-maker unless such routing produces the highest quality transaction for the customer.

(d) The affiliated market-makers deal in highly liquid securities and rarely maintain overnight positions.

(e) The affiliated introducing broker is required to maintain an escrow deposit account with E*TRADE Clearing to ensure payment for E*TRADE Clearing's services.

(f) The clearing agreement provides that E*TRADE Clearing may net margin loan losses from the amounts E*TRADE Clearing owes the introducing broker.

(g) E*TRADE Clearing would have an unsecured claim against the affiliated introducing broker for any residual margin-loan losses.

The Board also noted that while the Section 23A exemption for assets that have a readily identifiable and publicly available market quotation would <u>not</u> apply to margin-loan covered transactions (because E*TRADE Bank would be making a loan to fund a <u>third party's</u> purchase of an asset from an affiliate rather than directly purchasing an asset from an affiliate), the exemption nevertheless evidences Congressional intent not to impede bank-affiliate transactions involving liquid assets.

iii) In 2015, E*TRADE Bank announced that it would transfer its two broker-dealer subsidiaries, E*TRADE Clearing and E*TRADE Securities, back to its holding company. <u>See</u> E*TRADE Fin. Corp. Press Release (Jan. 22, 2015).

(xi) <u>Collateral Requirements</u>

Section 23A generally requires that bank extensions of credit to (or guarantees, letters of credit and acceptances issued by a bank on behalf of) an affiliate be secured by collateral, ranging from 100% to 130% of the transaction amount.

A) Regulation W (12 C.F.R. § 223.14(c)) clarifies that intangible assets (including mortgage servicing rights), guarantees, letters of credit, equity securities issued by the bank (and debt securities issued by the bank that constitute regulatory capital), low quality assets and securities issued by an affiliate may not be used as collateral.

Dodd-Frank expanded this exclusion to prohibit a bank's acceptance as collateral for a covered transaction any debt obligation of an affiliate -- such as a loan or receivable -- rather than simply debt securities. However, as of September 15, 2016, the Board had not yet proposed revisions to Regulation W to implement this expanded prohibition on ineligible collateral.

B) Regulation W (12 C.F.R. § 223.14(d)) provides that a bank must have a first priority, perfected security interest in any required collateral, or must deduct from the amount of collateral obtained the lesser of (1) the amount of any security interest in the collateral senior to that obtained by the bank, or (2) the amount of any credit secured by the collateral that is senior to that of the bank.

C) Regulation W (12 C.F.R. § 223.24(c)) provides that a bank's extensions of credit to a third party secured by shares of an affiliated mutual fund are exempt from Section 23A if (i) the fund is 1940 Act-registered, (ii) the fund shares serving as collateral have a publicly available market price, (iii) the bank and its affiliates do not own more than 5% of the fund shares (excluding certain shares held in a fiduciary capacity), and (iv) the proceeds of the extension of credit are not used to purchase the fund shares and are not otherwise used for the benefit of (or transferred to) an affiliate.

D) Board Letter to Banco Popular, Oct. 3, 2005, granted an exemption from Section 23A for a bank extension of credit to unaffiliated customers secured by shares of investment fund affiliates. A specific Board exemption was required because the funds were <u>not</u> registered under the 1940 Act.

The Board granted the exemption in light of the following:

i) Banco Popular served as investment adviser, transfer agent, custodian and administrative agent for each fund.

ii) Banco Popular's affiliate, Popular Securities, served as the distributor of each fund.

iii) Although the funds were not 1940 Act-registered, they met the other criteria to qualify for an exemption under 12 C.F.R. § 223.24(c).

iv) The funds were open-end investment companies registered with Puerto Rico and were subject to restrictions and requirements similar to those imposed on 1940 Act-registered funds.

v) The aggregate amount of the extensions of credit would not exceed 25% of the aggregate net assets of each fund, and the maximum loan-to-value ratio for the credits would be 50% for loans secured by an equity-based fund and 70% for loans secured by a fixed-income fund.

E) <u>Reversing</u> Board staff's prior position on the matter (which required a bank that provided a line of credit to an affiliate to obtain collateral for the <u>full amount</u> of the credit facility), Regulation W (12 C.F.R. § 223.14(f)(2)) provides that Section 23A collateral requirements do <u>not</u> apply to the undrawn portion of an extension of credit to an affiliate so long as the bank has no legal obligation to advance additional funds until the affiliate posts any required collateral.

F) Dodd-Frank also modified the Section 23A collateral requirements to provide that the appropriate collateral amount must be maintained "at all times" -- replacing the prior formulation of "at the time of the transaction".

(xii) Cross-guarantee Agreements, Cross-affiliate Netting Arrangements and Keepwells

A) Dodd-Frank authorizes the Board to take into account a netting arrangement (1) in determining the amount of a Section 23A covered transaction between a bank and an affiliate, and (2) for purposes of the exemption from Section 23A for certain covered transactions (including credit exposure on derivatives or securities financing transactions) that are secured by U.S. government securities or a segregated deposit account.

The Act provides that the Board may issue a regulation regarding netting. However, if it plans to issue an interpretation of these provisions with regard to a specific bank or affiliate, it must issue the interpretation together with the appropriate federal banking agency for the bank or affiliate. As of September 15, 2016, the Board had not issued either an interpretation or a regulation relating to netting arrangements.

B) Regulation W (12 C.F.R. §§ 223.3(h)(5) and 223.3(j)) provide that each of (i) a cross-guarantee agreement among a bank, an affiliate and a non-affiliate in which the non-affiliate may require the bank to satisfy the obligations of a defaulting affiliate, or otherwise add an affiliate's obligations to those of the bank when calculating the bank's obligations, and (ii) a cross-affiliate netting arrangement among a bank, one or more affiliates, and one or more non-affiliates in which a non-affiliate is permitted to net (offset) obligations of an affiliate of the bank owed to the non-affiliate when settling the non-affiliate's obligations owed to the bank, is a covered transaction.

C) The Regulation W Proposal also indicated that a keepwell agreement between a bank and an affiliate whereby the bank commits to maintain the capital levels or solvency of the affiliate should be treated as a guarantee and, if unlimited in amount, would be prohibited by Section 23A's quantitative limits.

(xiii) Riskless Principal Transactions

Regulation W (12 C.F.R. § 223.42(m)) exempts the purchase of securities and other assets by a bank from its "securities affiliate" from Section 23A if the bank or the affiliate acts in a riskless principal capacity and the instrument purchased is not issued, underwritten or sold as principal (other than as riskless principal) by any affiliate. See also Part III.A.5.g.viii.C and Part III.A.5.g.ii.B above.

(xiv) Expansion of "Market Quotation Exemption"

A) Regulation W (12 C.F.R. § 223.42(e)) does not interfere with the ability of a bank to purchase securities and other assets from affiliates pursuant to the Market Quotation Exemption -- e.g., FX and precious metals -- so long as the prices of such assets are recorded in a widely disseminated publication that is readily available to the public.

i) Regulation W clarifies that the Market Quotation Exemption is only available if the asset in question is purchased at or below the asset's current market quotation.

ii) For purposes of the Market Quotation Exemption, a "widely disseminated publication" would include a newspaper with a national circulation. See Regulation W Release.

iii) Regulation W treats U.S. Government obligations the same as any other assets in terms of eligibility for the Market Quotation Exemption (i.e., U.S. government obligations only qualify for the Exemption if the obligations are quoted routinely in a widely disseminated publication that is readily available to the public). See Regulation W Release. In contrast, the Regulation W Proposal would have automatically qualified all such obligations for the Market Quotation Exemption.

iv) A notice accompanying the Regulation W Release clarified that the Market Quotation Exemption could potentially apply to a purchase of assets that are not traded on an exchange (e.g., gold and silver, OTC securities, loans and derivative contracts), but that otherwise meet the criteria for the Exemption.

v) Board Letter, Nov. 21, 2001, clarified that SBA-GICs would not qualify under the Market Quotation Exemption since the GICs in question were not actively traded, and prices for the certificates were not available in widely disseminated publications.

vi) If a bank purchases from one affiliate securities issued by another affiliate, the bank has engaged in two types of covered transactions. The Regulation W Release indicates that the Market Quotation Exemption could exempt the one-time asset purchase from the first affiliate, but that such Exemption would not exempt the ongoing investment in securities issued by the second affiliate. See 12 C.F.R. § 223.71.

B) Regulation W (12 C.F.R. § 223.42(f) (replacing 12 C.F.R. § 250.246)) exempts a bank's purchase of securities from a "securities affiliate" from Section 23A if the following apply:

i) The security has a "ready market" (i.e., the security is traded in a recognized established securities market in which (a) there exists independent bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations may be determined almost instantaneously; and (b) a payment will be received in settlement of a sale at such price within a relatively short time, conforming to trade custom).

In letters to FINRA, dated Nov. 28, 2012 and February 9, 2016, the SEC indicated its willingness to expand the types of foreign securities that would be treated as having a "ready market", if the following conditions are met: (a) the security is listed for trading on a foreign securities exchange located in a country that is recognized on the FTSE World Index, where the security has been trading for at least 90 days; (b) daily quotations for both bid and ask or last sale prices for the security are continuously available in the U.S. through an electronic quotation system; (c) the median daily trading volume is at least 100,000 shares or $500,000 based on bona fide transactions; and (d) the aggregate unrestricted market capitalization in shares of such security exceeds $500 million over each of the preceding 10 days. See also SEC Letter to SIA, dated Aug. 13, 1993 (foreign equity securities listed on the FT-Actuaries World Indices).

ii) The security is eligible for a bank to purchase directly (e.g., generally an investment grade corporate, governmental debt security or ABS, but even including equity securities that are used for bank-permissible hedging purposes) and the bank records the transaction as a purchase of a security.

iii) The security is not a "low-quality asset" (a term defined in 12 C.F.R. § 223.3(v)).

iv) The security is not purchased during an underwriting, or within 30 days of an underwriting, if an affiliate is an underwriter (unless the security is purchased as part of an issue of obligations of, or obligations guaranteed as to principal and interest by, the U.S. or its agencies).

v) The security's price is quoted routinely on an unaffiliated electronic service that provides indicative data from real-time financial networks.

vi) The bank maintains records and supporting information to enable the appropriate federal banking agency to ensure the bank's compliance with this exemption.

C) Regulation W (12 C.F.R. § 223.42(g)) includes a broader exemption for a bank's purchase of municipal securities from a securities affiliate.

D) For prior regulatory guidance, see, e.g., OTS Letter 93/CC/22 (Sept. 9, 1993) (exemption would not apply to purchases of MBS from affiliate at prices set out in an automated quotation service); OTS Unpublished Letter (Dec. 6, 1989) (exemption would not apply to purchases of mortgages at prices quoted by FNMA or FHLMC in the secondary market); Letter No. 88-4 (exemption would not apply to bank purchase of MBS issued by its affiliate where the MBS would be priced based on "competitive bidding"); Comptroller Unpublished

Letter (June 3, 1986) (exemption would apply to quotations and trades on one of six French stock exchanges).

(xv) Certain Issues under Section 23B

A) Regulation W (12 C.F.R. § 223.53(b)(3)) clarifies that a bank may satisfy the Director Approval Standard by having a majority of the bank's directors:

i) Approve in advance standards for the bank's acquisition of securities; and

ii) Periodically review such acquisitions to ensure that they meet the standards, and periodically review the standards to ensure that they meet Section 23B's "sound investment" criterion.

The Regulation W Release stated that the appropriate period of time between reviews would vary depending on the scope and nature of a bank's program, but that such reviews should be conducted at least annually.

B) Regulation W (12 C.F.R. § 223.54) clarifies that the No Responsibility Standard does not prohibit a bank from issuing a guarantee or letter of credit on behalf of an affiliate, so long as the guarantee or letter of credit complies with Section 23A.

C) Regulation W (12 C.F.R. § 223.53(b)(4)) sets out a standard for compliance with the Director Approval Standard for U.S. branches of foreign banks that is stricter than the informal interpretation that Board staff historically took in the context of the Operating Standards (where Board staff had concluded that a U.S. branch could purchase securities from an affiliate if such purchase was approved by two senior executive officers of the bank outside of the U.S.). Regulation W provides, however, that, a U.S.

branch must obtain the approval of either a majority of the directors, or a majority of the senior executive officers, of the foreign bank.

D) Comptroller Letter (Dec. 22, 1994) concluded that a national bank may, consistent with Section 23B, purchase as fiduciary securities underwritten by syndicates of which a securities affiliate is a member from third party members of that syndicate, subject to compliance with Section 23B standards, as well as guidelines that (i) the securities must be investment grade; (ii) when the affiliate's participation in a syndication is 10% or less, the bank may purchase from third parties without having to rebut a presumption of self-dealing; and (iii) when the affiliate's participation in a syndication is 75% or more, no fiduciary purchases are permitted (see also, e.g., Comptroller Interpretive Letter No. 766 (Jan. 6, 1997), CCH Fed. Banking L. Rep. ¶ 81-130).

However, the Board concluded that the 10% test described in (ii) above would not relieve a bank from its obligations to comply with Section 23B procedures. See Board Letter, Mar. 5, 1997, CCH Fed. Banking L. Rep. ¶ 80-227.

B. BANK HOLDING COMPANIES: THE "SECTION 20 FRAMEWORK"

Prior to Gramm-Leach, the Board approved Applications and Notifications ("Section 20 Applications") under BHCA §4(c)(8) allowing Section 20 Subsidiaries to underwrite and deal in ineligible securities subject to restrictions originally intended to assure that such Subsidiaries were not "engaged principally" in such activities, (see Part III.B.5.a below) and thus that their affiliation with banks was not proscribed by Glass-Steagall § 20 ("Section 20 Approvals").

As of September 15, 2016, only one Section 20 Subsidiary still remained in operation under the BHCA -- BBVA Securities (a subsidiary of Banco Bilbao Vizcaya Argentaria, a foreign bank which has not become an FHC).

1. Certain Pre-1987 and Related Developments

   a. In 1984, Citicorp filed an Application to engage in underwriting and dealing in debt securities, subject to a limit that not more than 20% of its subsidiary's business would be generated from ineligible securities. Citicorp withdrew its Application in 1985, and the Board stated at that time that such Application would be inconsistent with Glass-Steagall. 71 Fed. Res. Bull. 225 (1985).

   b. In BTNY, 73 Fed. Res. Bull. 138 (1987) (the "BTNY Section 20 Order"), the Board determined that a non-bank subsidiary engaged in commercial lending activities may also engage in private placement of CP. The Board discussed the scope of the "engaged principally" language of Glass-Steagall § 20.

   c. In 1988, Chase Manhattan Corp ("Chase"). filed, then withdrew, an Application to sponsor and distribute mutual funds. See Part VIII.C.1.b.ii below.

2. The 1987 Order and Related Developments

   a. In Citicorp, 73 Fed. Res. Bull. 473 (1987) (the "1987 Order"), by a three-to-two vote, the Board approved Section 20 Applications relating to underwriting and dealing in CP, municipal revenue bonds ("MRBs") and MBSs. The Board subsequently authorized underwriting and dealing in consumer receivable-related securities ("CRRs"). Chemical Banking Corp. ("Chemical"), 73 Fed. Res. Bull. 731 (1987).

      (i) In construing the "engaged principally" language, the Board limited each Section 20 Subsidiary's ineligible securities activities to 5% of the total domestic market in such securities (the "Market Share Limit") and 5% of such Subsidiary's gross revenues (the "Gross Revenue Limit").

      (ii) The Board imposed firewalls to mitigate the possible adverse effects of the 1987 Order; such firewalls have since been rescinded and replaced by the Operating Standards.

b. The Board eliminated the Market Share Limit in BankBoston Corp., 74 Fed. Res. Bull. 699 (1988), in light of the Section 20 Decision discussed in Part III.B.4 below.

c. In (i) the Norwest 1995 Order, the Board authorized a Section 20 Subsidiary to underwrite and deal in certain unrated investment-grade MRBs, (ii) Bank South Corp., 81 Fed. Res. Bull. 1116 (1995), the Board authorized a Section 20 Subsidiary to underwrite and deal in "private ownership" MRBs, and (iii) BOK Financial Corp., 83 Fed. Res. Bull. 510 (1997), the Board removed the single issue dollar limitation on underwriting unrated MRBs.

3. Underwriting and Dealing in Debt and Equity Securities

In 1989, the Board approved Applications pursuant to BHCA § 4(c)(8) to underwrite and deal in debt and equity securities to a limited extent. Morgan et al., 75 Fed. Res. Bull. 192 (1989) (the "1989 Order").

a. Debt securities approved for underwriting and dealing included all corporate and other debt. The 1989 Order also authorized underwriting and dealing in convertible debt securities with an initial conversion price of at least 115% of the market price of the underlying equity.

b. Equity securities approved for underwriting and dealing did not include mutual fund shares.

c. The 1989 Order imposed new firewalls designed to reduce risks perceived to arise from broader underwriting and dealing. Although the firewalls have been rescinded and replaced with the Operating Standards. See also Part III.B.3.c.ii below.

d. In order to assure that BHCA "control" issues do not arise as a result of underwriting and dealing in equity securities, the Board (i) stated that it would not view an acquisition of voting shares by a Section 20 Subsidiary pursuant to an underwriting as an acquisition of voting shares in violation of BHCA § 4 as long as such Subsidiary disposed of the shares within 30 days of acquisition and did not vote them in the interim; and (ii) prohibited such Subsidiary from acquiring or retaining voting shares of a company -- whether as part of a market-maker or dealer function, for hedging purposes or otherwise -- which, together with voting shares of the company held by all affiliates, exceeded 5% of the outstanding shares of any class of voting shares of the company (unless another exemption to such ownership limitation otherwise applies).

The exception from the voting share limits for underwriting by a Section 20 Subsidiary should encompass stabilization and other purchase and sale transactions during the "underwriting period" when such transactions facilitate the overall underwriting.

e. Section 20 Subsidiaries could engage in all aspects of underwriting and dealing, including acting as stock exchange specialists, floor brokers, block traders and Nasdaq market-makers. See, e.g., Chase (approved Dec. 2, 1999); BNY, 63 Fed. Reg. 68768 (Dec. 14, 1998) (approved Feb. 5, 1999); Fleet, 63 Fed. Reg. 64089 (Nov. 18, 1998), (approved Dec. 17, 1998, 84 Fed. Res. Bull. 227 (1998)); Citigroup Order.

f. The 1989 Order required a Board "infrastructure" review covering: (i) internal controls/compliance procedures, (ii) risk management, (iii) accounting systems, (iv) computer systems, and (v) audit programs. See, e.g., RBS, 86 Fed. Res. Bull. 655 (2000); Wachovia Corp. 85 Fed. Res. Bull. 340 (1999); PNC BankCorp., 85 Fed. Res. Bull. 66 (1999); First Security Corp. 85 Fed. Res. Bull. 207 (1999); KeyCorp, 84 Fed. Res. Bull. 1075 (1998); BankBoston Corp., 84 Fed. Res. Bull. 849 (1998); SG-Cowen Order; Fifth Third Bancorp, 84 Fed. Res. Bull. 677 (1998); Norwest, 84 Fed. Res. Bull. 552 (1998); U.S. Bancorp, 84 Fed. Res. Bull. 483 (1998) (the "U.S. Bancorp-Piper Jaffray Order"); Banco Bilbao Vizcaya, 84 Fed. Res. Bull. 356 (1998) (acquisition of LatInvest Securities); BankAmerica, 83 Fed. Res. Bull. 913 (1997); BB&T Corp., 83 Fed. Res. Bull. 919 (1997); SBC, 83 Fed. Res. Bull. 786 (1997); BancOne Corp., 83 Fed. Res. Bull. 439 (1997); BNY, 83 Fed. Res. Bull. 323 (1997); HSBC, 82 Fed. Res. Bull. 356 (1996); NatCity, 81 Fed. Res. Bull. 807 (1995); Santander, 81 Fed. Res. Bull. 501 (1995) (the "Santander Order"); SBC 1995 Order; ABN AMRO, 81 Fed. Res. Bull. 182 (1995); First Chicago Corp., 80 Fed. Res. Bull. 449 (1994); Republic, 80 Fed. Res. Bull. 249 (1994) (the "Republic Section 20 Order");

Chemical, 79 Fed. Res. Bull. 719 (1993); Dauphin Deposit Corp., 77 Fed. Res. Bull. 672 (1991).

g. Board Form FR Y-20 collects quarterly information allowing the Board to monitor a Section 20 Subsidiary's compliance with the Gross Revenue Limit. See Board Staff Memo, dated Mar. 25, 2008.

4. Section 20 Litigation

a. The SIA sued the Board challenging the 1987 Order (the "Section 20 Litigation"). Although the Second Circuit stayed the effectiveness of the 1987 Order in response to the potential effects of BHC subsidiaries entering markets and the danger of market disruptions should they be required to leave, the Court dismissed the SIA's petition, upheld the Gross Revenue Limit and rejected the Market Share Limit. SIA v. Board, 839 F.2d 47 (2d Cir.), cert. denied, 486 U.S. 1059 (1988) (the "Section 20 Decision").

b. The SIA sued the Board in the D.C. Circuit challenging Chase, 73 Fed. Res. Bull. 367 (1987) (the "Chase CP Order"), making many of the same arguments as in the Section 20 Litigation. The Court upheld the Chase CP Order. SIA v. Board, 847 F.2d 890 (D.C. Cir. 1988).

c. The SIA unsuccessfully sought to overturn the 1989 Order in the D.C. Circuit. SIA v. Board, 900 F.2d 360 (D.C. Cir. 1990).

d. An action had been brought challenging the increase in the Gross Revenue Limit from 10% to 25%, but was subsequently dismissed. Cunningham v. Board, 1997 WL 255072 (D.C. Cir., Apr. 30, 1997) (dismissed), cert. denied, 522 U.S. 874 (1997).

e. ICBAA v. Board challenged the Citigroup Order on the grounds that (i) the BHCA prohibited a BHC from owning insurance underwriters where such BHC had no present intention to divest such underwriters; (ii) Glass-Steagall did not permit a BHC to own securities affiliates the size of Citigroup's; and (iii) the Order encroached on Congress' prerogative. The D.C. Circuit upheld the Order. 195 F.3d 28 (D.C. Cir. 1999).

5. Certain Issues

   a. Definition of "Engaged Principally"

      (i) In 1989, the Board raised the Gross Revenue Limit from 5% to 10%. 75 Fed. Res. Bull. 751 (1989).

      (ii) Requests to increase the Gross Revenue Limit had been made repeatedly, and the Comptroller stated that a 25%-of-business test would be an appropriate "safe harbor" and that the Board could adopt even a 50% interpretation. See Comptroller Interpretive Letter No. 383 (Jan. 29, 1987), CCH Fed. Banking L. Rep. ¶ 85,607. See also, e.g., Comptroller Letter to the Board, dated July 24, 1989 (the "Second Comptroller Comment Letter").

      (iii) In response to concerns that low short-term interest rates and a steep yield curve were distorting the Gross Revenue Limit, in 1993 the Board approved the use of an alternative method (the "Indexed Revenue Test") to calculate revenues for compliance with such limit, based on adjustments that varied according to the average duration of the securities portfolio of the Section 20 Subsidiary. Order Approving Modifications to Section 20 Orders, 79 Fed. Res. Bull. 226 (1993).

      (iv) In 1996, the Board approved an increase in the Gross Revenue Limit from 10% to 25%. 61 Fed. Reg. 68750 (Dec. 30, 1996) (the "Gross Revenue Limit Order"). This Order also repealed the Indexed Revenue Test.

      (v) As reflected in the Board FHC Release, the Board declined to remove the 25% Gross Revenue Limit after the enactment of Gramm-Leach and the repeal of Glass-Steagall § 20 because it believed that it would not be appropriate to allow a BHC that does not meet FHC standards to engage in expanded securities activities.

      (vi) The Gross Revenue Limit must be tested at the level of each Section 20 Subsidiary (i.e., not on the basis of a combination of multiple Section 20 Subsidiaries).

b. Components of "Eligible Revenue"

Section 20 Subsidiaries conducted a broad range of eligible activities. However, the SEC's Net Capital Rule (1934 Act Rule 15c3-1) made it cost-prohibitive for a Section 20 Subsidiary to conduct most non-securities related activities.

(i) In CIBC, et al., 76 Fed. Res. Bull. 158 (1990) (the "Foreign Bank Section 20 Order"), the Board provided that all Section 20 Subsidiaries may engage in transactions involving Canadian government securities to the same extent as those involving U.S. government securities. See Part I.D above.

(ii) Revenues derived from a Section 20 Subsidiary acting in a servicing (agent) capacity for affiliates under BHCA § 4(c)(1) were treated as eligible. FRBNY Letter, dated June 11, 1996.

(iii) Interest earned on debt securities that a member bank may hold for its own account is eligible revenue. 61 Fed. Reg. 48953 (Sept. 17, 1996), reversing 57 Fed. Reg. 33507, 33961 (July 29, 31, 1992).

(iv) As discussed in Part VI.B.2.a below, Santander's application in connection with the Santander Order included commitments with respect to the treatment of revenues derived from Rule 144A transactions. See also ABN AMRO-ChiCorp Order.

(v) A Section 20 Subsidiary's revenues from underwriting and dealing in obligations that represent interests in a pool of bank loans where the loans were originated or purchased by an affiliated bank should be counted as neither eligible nor ineligible. See General Instructions to Form FR Y-20. See also Letter from Board General Counsel Mattingly to Comptroller Chief Counsel Bowden, dated Mar. 16, 1994, and response, dated June 21, 1994 (the "Bowden 1994 Letter").

(vi) Board SR Letter 97-2 (SPE) (Feb. 21, 1997), CCH Fed. Banking L. Rep ¶ 69-645B, clarified that (A) rebate income earned on cash pledged as collateral to support borrowings of ineligible securities by a Section 20 Subsidiary may be treated as eligible revenue, and (B) interest revenue derived from any reverse repo with collateral that a member bank could hold for its own account may be treated as eligible revenue.

c. Operating Standards

In 1997, the Board reexamined the firewalls, eliminated those which had proven unnecessary, and consolidated the remaining firewalls into eight Operating Standards. 62 Fed. Reg. 45295 (Aug. 27, 1997) (the "1997 Firewall Revision"). See 12 C.F.R. § 225.200, Fed. Res. Reg. Serv. ¶ 4-655.4.

(i) Regulatory Requirements

A) Operating Standard 1: the "Capital Requirement Operating Standard": A BHC must maintain strong capital on a consolidated basis. If a bank or thrift affiliate of a Section 20 Subsidiary becomes less than well capitalized and the BHC fails to restore it promptly to the well-capitalized level, the Board may reimpose firewalls or order the BHC to divest such Subsidiary.

A foreign bank that operates a U.S. branch must maintain strong capital on a consolidated basis at levels above the minimum required by the Basel Accord. If the bank's capital falls below these levels and the bank fails to restore its capital position promptly, the Board may reimpose firewalls or order the bank to divest its Section 20 Subsidiary.

B) Operating Standard 2: the "Internal Control Operating Standard": Each bank and thrift affiliate of a Section 20 Subsidiary, and each U.S. branch of an affiliated foreign bank, must (1) adopt policies to govern their participation in transactions underwritten or arranged by a Section 20 Subsidiary, (2) ensure that an independent credit evaluation has been undertaken in connection with participation in such transactions, and (3) maintain documentation of such evaluation.

C) Operating Standard 3: the "Interlocks Operating Standard": Directors, officers or employees of a BHC's or foreign bank's bank or thrift subsidiaries or U.S. branches may not serve as a majority of the board of directors or the chief executive officer of an affiliated Section 20 Subsidiary, and vice versa, except that the manager of a branch (who will generally be the chief executive officer of the branch) may act as a director of the Subsidiary. Operating Standard 3 does not apply to subsidiaries of banks. See, e.g., BTNY, 83 Fed. Res. Bull. 780 (1997).

D) Operating Standard 4: the "Customer Disclosure Operating Standard": As modified in 63 Fed. Reg. 14803 (Mar. 27, 1998), a Section 20 Subsidiary must provide each of its retail customers with the disclosure, and obtain the acknowledgment, required by the Interagency Statement. A director, officer or employee of an affiliated bank, thrift or U.S. branch may not express an opinion on the value or advisability of the purchase or sale of ineligible securities that he or she knows are being underwritten or dealt in by an affiliated Section 20 Subsidiary unless he or she notifies the customer of the Subsidiary's role.

E) Operating Standard 5: the "Credit Operating Standard": Any intra-day extension of credit to a Section 20 Subsidiary from an affiliated bank, thrift or U.S. branch must be on market terms consistent with Section 23B.

F) Operating Standard 6: the "Securities Purchase Operating Standard": No bank, thrift or U.S. branch may extend credit to a customer secured by, or for the purpose of purchasing, any ineligible security that an affiliated Section 20 Subsidiary is underwriting or has underwritten within the past

30 days, unless (i) the extension of credit is made under a preexisting line of credit that was not established in contemplation of the underwriting; or (ii) the bank, thrift or branch is clearing transactions for the Section 20 Subsidiary.

The Board recognized that Section 23A would apply to both types of transactions exempted from Operating Standard 6 to the extent that the Attribution Rule applied. See also Part III.A.5 above.

G) Operating Standard 7: the "Reporting Requirement Operating Standard": Each BHC or foreign bank must submit FOCUS reports quarterly to the appropriate Federal Reserve Bank.

H) Operating Standard 8: the "23A/23B Operating Standard": A foreign bank must ensure that (i) all transactions between a U.S. branch and a Section 20 Subsidiary conform to Sections 23A/23B, and (ii) its branches do not advertise or suggest that they are responsible for the obligations of such Subsidiary.

Although the Board's Regulation Y appears to limit the 23A/23B Operating Standard to extensions of credit and certain securities purchases, in practice the Board has required all transactions between the U.S. branch of a foreign bank and a Section 20 subsidiary to comply with Sections 23A/23B. See, e.g., 62 Fed. Reg. 45295, 45304 (Aug. 27, 1997) and Board SR Letter 98-6 (SPE) (Mar. 27, 1998), CCH Fed. Banking L. Rep. ¶ 69-667.

Interpretations under Sections 23A/23B are discussed in Part III.A.5 above.

(ii) Selected Firewall Interpretations

Board interpretations of some of the firewalls of the 1987, 1989 and Foreign Bank Section 20 Orders are relevant to interpreting and applying the Operating Standards, which are based on firewalls as follows:

Capital Requirement Operating Standard	(1)	Firewalls 1, 3, 4
Internal Control Operating Standard	(2)	Firewall 11
Interlocks Operating Standard	(3)	Firewall 13
Customer Disclosure Operating Standard	(4)	Firewalls 14, 17
Credit Operating Standard	(5)	Firewalls 21(a), 21(b)
Securities Purchase Operating Standard	(6)	Firewall 6
Reporting Requirement Operating Standard	(7)	Firewalls 4, 24
23A/23B Operating Standard	(8)	Firewall 21(a)

Among the more important interpretations:

A) Firewall 5 (Credit Enhancements)

i) Firewall 5 (the "Credit Enhancement Firewall") had covered activities that placed the bank's credit behind securities being underwritten, but did not prohibit the bank from entering into derivative arrangements with a customer of the Section 20 Subsidiary. See, e.g., Board Staff Opinion (Oct. 3, 1989), Fed. Res. Reg. Serv. ¶ 4-655.4.

ii) The Board repealed the Credit Enhancement Firewall in the 1997 Firewall Revision. The Board noted that Operating Standard 2 requires that a bank conduct a credit evaluation before offering any credit enhancement in tandem with an affiliated Section 20 Subsidiary.

B) Firewall 6 (Restriction on Funding Securities Purchases)

The Board generally retained Firewall 6 as Operating Standard 6. The Board removed Firewall 6, however, to the extent that it restricted lending for purchases of securities in which a Section 20 Subsidiary makes a market.

C) Firewall 13 (Interlocks)

i) Firewall 13 in the 1989 Order prohibited director, officer or employee interlocks between a Section 20 Subsidiary and its affiliated banks.

The Board scaled back Firewall 13 in 1996 (61 Fed. Reg. 57679 (Nov. 7, 1996) (the "1996 Firewall Amendment")) to prohibit directors, officers or employees of a bank from serving as a majority of the board of directors or the chief executive officer of a Section 20 Subsidiary, and to prohibit directors, officers and employees of a Section 20 Subsidiary from serving as a majority of the board of directors or the chief executive officer of an affiliate bank.

See also discussion of Firewall 16 below.

ii) The manager of a U.S. branch of a foreign bank normally will be considered to be the chief executive officer of the branch.

This standard should not preclude a senior country officer of a foreign bank with broad responsibility for overall U.S. operations from also serving as chief executive officer of a Section 20 Subsidiary. See IIB Letter, dated Mar. 10, 1997.

iii) Section 20 Subsidiaries may enter into joint employee arrangements with bank affiliates and third party insurance agents to permit the sale of annuities and insurance products from bank premises. See, e.g., Board Letter re SouthTrust Corp., May 15, 1998; Board Letter, Nov. 24, 1997; CoreStates, 83 Fed. Res. Bull. 838 (1997); Board Letter, Apr. 10, 1997, CCH Fed. Banking L. Rep. ¶ 80-234; Board Letter, Nov. 15, 1996; Board

Letter, Sept. 30, 1996, CCH Fed. Banking L. Rep. ¶ 80-115; Board Letter, Apr. 1, 1996, CCH Fed. Banking L. Rep. ¶ 80-105; Board Letter, Mar. 8, 1996, CCH Fed. Banking L. Rep. ¶ 80-102; Board Letter, Dec. 6, 1995 (collectively, the "Section 20 Insurance & Annuity Letters").

iv) Firewall 13 required a Section 20 Subsidiary to maintain separate offices from its bank affiliates. The Board repealed this restriction in the 1997 Firewall Revision.

D) Firewall 14 (Customer Disclosures)

The Board amended Firewall 14 in the 1997 Firewall Revision to limit its applicability only to retail customers and, as modified, retained it in Operating Standard 4.

E) Firewall 16 (Cross-marketing)

The Board repealed Firewall 16, which prohibited a bank from acting as agent for, or engaging in marketing activities on behalf of, an affiliated Section 20 Subsidiary. See also discussion of Firewall 13 above.

F) Firewall 19 (Purchases of Ineligible Securities Underwritten by a Section 20 Subsidiary)

i) The Board took the position that since selling group members (i.e., broker-dealers that have signed a selected dealer agreement but are not members of the underwriting syndicate) "are part of the underwriting or distribution process", firewalls applied with respect to ineligible securities sold by a Section 20 Subsidiary pursuant to a selected dealer agreement. If, however, no securities were allocated to the Subsidiary in an offering, the firewalls did not apply with respect to such offering. Board BHC Supervision Manual § 2185.0 (since repealed).

ii) In the Foreign Bank Section 20 Order, the Board modified Firewall 19 to permit purchases and sales of securities underwritten by an affiliated Section 20 Subsidiary between affiliates that are participating in simultaneous underwritings in more than one market.

iii) The Board repealed Firewall 19 as part of the 1997 Firewall Revision as superfluous given the requirements of Section 23B.

G) Firewall 21 (Affiliate Bank Credit Extensions to a Section 20 Subsidiary)

The Board determined that:

i) A Section 20 Subsidiary may engage in repos and reverse repos in Treasury securities with foreign subsidiaries of an affiliate bank "to accommodate the operational needs of those foreign subsidiaries." Such Subsidiary may also engage in interest rate and FX swaps and FX spot, forward and futures contracts with an affiliate bank for hedging purposes. The Board's approval was contingent on the BHC guaranteeing the bank against any losses from such Subsidiary's non-performance.

ii) A Section 20 Subsidiary may engage in swap and options transactions with an affiliate bank to hedge the exposure of the Subsidiary. Exposure arising from such transactions must be marked-to-market daily, 100% of the risk must be collateralized with Treasury securities, and the BHC must guarantee the bank against losses from non-payment.

Board Letter to Morgan, dated June 19, 1989, Fed. Res. Reg. Serv. ¶ 4-655.2. See also Board Letter to

First Chicago, Apr. 21, 1995 (clearing services to Section 20 Subsidiary).

(iii) Firewalls Applicable to Foreign Bank Section 20 Subsidiaries

The Foreign Bank Section 20 Order set out the basic framework for ownership of Section 20 Subsidiaries by foreign banks. See, e.g., Toronto-Dominion, 76 Fed. Res. Bull. 573 (1990) (the "Toronto-Dominion Order"); Sanwa Bank, 76 Fed. Res. Bull. 568 (1990).

The primary responsibility for foreign bank firewall compliance was placed on the Section 20 Subsidiaries. While only foreign bank U.S. offices were required to establish policies regulating exposure to the customers of a Section 20 Subsidiary, the SBC 1995 Order allowed SBC to establish these policies worldwide on a consolidated basis.

See also 12 C.F.R. §211.605 and related discussion in Part XI.B.4.c below.

C. BANK SECURITIES DISTRIBUTION POWERS

1. As discussed in Part I and Part III.A. above, bank financial subsidiaries may engage in securities underwriting and dealing.

2. As discussed in Part X below, banks may participate to a limited extent in the public distribution of securities representing interests in, or backed by, loans originated or acquired by the bank.

3. As discussed in Part XI below, subsidiaries of banks which operate under Regulation K (including Edge Act corporations under FRA § 25A and foreign bank subsidiaries of U.S. banks), as well as U.S. bank non-U.S. branches have certain underwriting and dealing authority.

4. FDIC regulations discussed in Part I above and Part XI below contemplate that subsidiaries of non-member banks may participate in securities distribution under appropriate circumstances.

IV. CERTIFICATES OF DEPOSIT AND SIMILAR INSTRUMENTS

A. SECURITIES LAW STATUS AND RELATED ISSUES

1. Domestic Deposits

a. Securities Law Implications

(i) Marine Bank v. Weaver, 455 U.S. 551 (1982) ("Weaver"), held that a CD issued by an FDIC-insured bank was not a "security" under the Securities Acts. The Court emphasized that, because a purchaser of such a CD is "virtually guaranteed" payment under federal banking laws, it is unnecessary to subject bank CD issuers to securities law regulation.

Weaver indicates that each transaction must be evaluated on its own facts, and a number of lower courts have considered the federal securities status of CDs:

A) Tafflin v. Levitt, 865 F.2d 595 (4th Cir. 1989), aff'd on an unrelated issue, 493 U.S. 455 (1990) ("Tafflin"), held that thrift CDs were not "securities" because the issuer was subject to comprehensive state regulation. The Court rejected the argument that Weaver depended upon the effectiveness of a U.S. regulatory scheme.

B) In Holloway v. Peat Marwick, 900 F.2d 1485 (10th Cir.) ("Holloway"), cert. denied, 498 U.S. 958 (1990), the Tenth Circuit affirmed its earlier decision, 879 F.2d 772 (10th Cir. 1989), that "thrift certificates" and "passbook savings accounts" issued by a state-regulated trust company were "securities".

Following the Supreme Court's order to reconsider its decision in light of Reves v. Ernst & Young, 494 U.S. 56 (1990) ("Reves") (see Part V.B.3 below), the Tenth Circuit in Holloway concluded that non-FDIC-insured instruments were "securities". Contrary to Tafflin, the Court found that state regulation should not be a factor in the application of federal securities laws.

The Court also affirmed the District Court's ruling that debt obligations issued by a finance company were "securities".

C) Sanderson v. Roethenmund, 682 F. Supp. 205 (SDNY 1988), held that the "international CDs" at issue were "securities". The Court adopted the reasoning of the SEC, which had filed an amicus brief arguing that the issuer, Deak-Perera International Banking Corp., was not subject to banking regulation, nor were the instruments FDIC-insured. See also, e.g., SEC v. First American Bank & Trust Co., 481 F.2d 673 (8th Cir. 1973) (uninsured CDs of a state-chartered trust company were "securities"); Bradford v. Moench, 809 F. Supp. 1473 (D. Utah 1992) ("Bradford") (industrial bank thrift certificates were "securities").

D) Dubach v. Weitzel, 135 F.3d 590 (8th Cir. 1998), held that a credit union CD was not a "security" because credit unions are subject to regulation and the issuance of the CD was a "conventional commercial transaction".

(ii) U.S. banks may offer CDs denominated in foreign currencies. See 12 C.F.R. § 330.3(c), 54 Fed. Reg. 27735 (June 30, 1989); Comptroller Unpublished Letter (Mar. 21, 1989). Foreign-currency denominated CDs should be analyzed under Weaver and Reves to determine whether they are "securities", but if issued by

U.S. banks, they are almost certainly not "securities" under the Securities Acts.

(iii) With respect to CDs, the interest on which is based on stock market performance or other indices, see Part IV.C below.

b. FDIC Insurance Issues

(i) The Federal Deposit Insurance Reform Act, Pub. L. 109-171 (2006), and the Federal Deposit Insurance Reform Conforming Amendments Act, Pub. L. 109-173 (2006) (collectively, the "FDI Reform Act"), reformed the deposit insurance system, restructured deposit insurance funds, and provided for increases in insurance coverage. See generally Federal Deposit Insurance Reform Legislation (Including Budgetary Implications) (CRS, Jan. 27, 2006). See also Part I.A above.

A) As part of the FDI Reform Act, the FDIC merged the Bank Insurance Fund and Savings Association Insurance Fund into the Deposit Insurance Fund and determined to provide coverage to employee benefit plan accounts on a pass-through basis (i.e., maximum insurance coverage for each individually identifiable person included in an employee benefit plan).

B) In an effort to better price deposit insurance for risk, the FDIC created different risk differentiation frameworks for insured institutions. To help prevent sharp swings in assessment rates, the FDI Reform Act granted the FDIC flexibility to manage the Deposit Insurance Fund's designated reserve ratio within a range. See 72 Fed. Reg. 27122 (May 14, 2007) (assessment rate adjustment guidelines), 71 Fed. Reg. 69323 (reserve ratio), 69282 (risk differentiation system), 69270 (assessment standards) (Nov. 30, 2006).

The FDIC adopted rules to make the assessment system more sensitive to risk. See 74 Fed.

Reg. 9525 (Mar. 4, 2009) (final rule); 73 Fed. Reg. 61560 (Oct. 16, 2008) (solicitation of public comments).

C) The FDIC revised the assessment system for deposit insurance applicable to large institutions that pose unique challenges and risks in the case of failure. The assessment system scores large institutions both on their likely performance during a period of stress and on the level of potential losses in the case of a failure. See FDIC Assessment Rate Adjustment Guidelines for Large and Highly Complex Institutions, FDIC FIL-64-2011 (Sept. 14, 2011), CCH Fed. Banking L. Rep. ¶ 55-261; 76 Fed. Reg. 10672 (Feb. 25, 2011) (final rule), 75 Fed. Reg. 72612 (Nov. 24, 2010) (solicitation of public comments), 75 Fed. Reg. 23516 (May 3, 2010) (solicitation of public comments).

The FDIC also adopted guidelines in respect of upward and downward adjustments to assessment scores based upon material risks or risk-mitigating factors. See 76 Fed. Reg. 57992 (Sept. 19, 2011) (final guidelines); 76 Fed. Reg. 21256 (Apr. 15, 2011) (solicitation of public comments).

D) In 2016, the FDIC adopted a rule that imposes a surcharge on the quarterly assessments of insured depository institutions with total consolidated assets of $10 billion or more. See 12 C.F.R. § 327.11; 81 Fed. Reg. 16059 (Mar. 25, 2016). The FDIC also adopted a rule that revises the pricing system for established small institutions by eliminating existing risk categories and instead using a revised financial ratio method to determine assessment rates, with supervisory ratings operating to set floors and ceilings on the resulting assessments. See 12 C.F.R. Part 327; 81 Fed. Reg. 32180 (May 20, 2016).

E) In order to harmonize its risk-based deposit assessment system with changes to its regulatory capital rules (some of which went into effect on January 1, 2015 and others come into effect on January 1, 2018), the FDIC conformed the ratios and ratio thresholds to be used in the risk-based deposit assessment system to the recently revised PCA ratios and ratio thresholds, modified the assessment base calculation for custodial banks and now requires highly complex institutions to measure counterparty exposures under the standardized approach of the regulatory capital rules. See Assessments, FDIC FIL-57-2014 (Nov. 24. 2014), CCH Fed. Banking L. Rep. ¶ 153,469; 79 Fed. Reg. 70427 (Nov. 26, 2014) (final rule); 79 Fed. Reg. 42698 (July 23, 2014) (solicitation of public comments).

F) FDIC FIL-33-2012 (July 9, 2012), CCH Fed. Banking L. Rep. ¶ 55-262, expresses FDIC's concerns regarding insured institutions passing deposit insurance assessment fees to their customers and instructs that, in the process, confidential supervisory information (such as supervisory ratings or deposit insurance assessment risk assignments) not be revealed and customers not be misled or misinformed.

G) In an effort to modernize the FDIC's deposit insurance determination process for large banks, the FDIC requires covered institutions to adopt mechanisms that, in the event of a bank failure, allow automatic posting of provisional holds on liability accounts (including deposit accounts) in any percentage requested by the FDIC. See 12 C.F.R. § 360.9 and Appendices, 73 Fed. Reg. 41180 (July 17, 2008).

(ii) Policymakers' responses to the credit crisis of 2007-2009 included several measures related to bank deposits and funding. Key developments included the following:

A) The maximum limit on FDIC deposit insurance was increased to $250,000. See EESA § 136, 12 U.S.C. § 5420; 74 Fed. Reg. 47711 (Sept. 17, 2009) (final rule); Helping Families Act.

B) As part of its TLGP, the FDIC implemented (1) the Transaction Account Guarantee Program (the "TAGP"), under which non-interest-bearing transaction accounts at participating depository institutions were insured without limit; and (2) the Debt Guarantee Program (the "DGP"), which allowed depository institutions and certain holding companies to issue senior unsecured debt guaranteed by the FDIC. See FDIC: [TLGP] (http://www.fdic.gov/regulations/resources/tlgp/); Dodd-Frank § 343. See generally SEC Letter to the FDIC, dated Nov. 24, 2008 (debt guaranteed under the DGP is exempt from registration under 1933 Act § 3(a)(2)). The programs expired by 2012.

C) Effective July 21, 2011, Dodd-Frank § 627 repealed the prohibition on paying interest on demand deposit accounts. In response, the Board repealed Regulation Q (12 C.F.R. Part 217), and the FDIC repealed its regulations prohibiting the payment of interest on demand deposit accounts. See 76 Fed. Reg. 42015 (July 18, 2011) (final rule), 76 Fed. Reg. 41392 (July 14, 2011) (final rule), 76 Fed. Reg. 20892 (Apr. 14, 2011) (solicitation of public comments).

D) In 2011, the FDIC issued a proposed rule that would provide depositors with improved access to information about FDIC insurance coverage. Under the proposed rule, (1) customer-facing depository institution personnel would be required to complete FDIC-provided computer-based training on the fundamentals of deposit insurance coverage; (2) in connection with the opening of new accounts, a depository institution would be required to inquire as to a customer's ownership interests in other accounts at the institution to determine whether the customer's aggregate interest in deposit accounts at the institution exceeds the FDIC's maximum deposit insurance coverage (and, if so, provide the customer with FDIC deposit insurance literature); and (3) a depository institution would be required to provide a link to the FDIC's Electronic Deposit Insurance Estimator on any customer-facing website. While the computer-based training module was made available to institutions in 2012, its use remains optional. As of September 2016, the FDIC had neither finalized the rule nor withdrawn the proposed rule. FDIC FIL-40-2012 (Sept. 19, 2012), CCH Fed. Banking L. Rep. ¶ 151-752; 76 Fed. Reg. 7740 (Feb. 11, 2011) (solicitation of public comments).

(iii) Dodd-Frank §§ 331-334 made significant changes to the FDIC deposit insurance scheme, directing the FDIC to risk-adjust insurance assessments based on an institution's total liabilities (instead of total deposits), increasing the minimum reserve ratio from 1.15% to 1.35%, and eliminating the FDIC's statutory obligation to dividend back assessments when the reserve ratio reaches 1.5%.

(iv) Insurance companies frequently place <u>life insurance proceeds</u> into an interest-bearing "<u>retained asset account</u>" in the name of a death beneficiary in lieu of immediate payment. FDIC FIL-48-2010 (Aug. 11, 2010), CCH Fed. Banking L. Rep. ¶ 54-732, calls for disclosure that these accounts are not FDIC-insured. The FDIC also noted that banks or their affiliates may provide administrative services in connection with the accounts, and should ensure that their role is properly disclosed.

(v) In 2013, with the stated objective of protecting the DIF from potential global liability that could result if U.S. insured depository institutions made deposits held at their foreign branches payable both in the U.S. and abroad in order to avoid foreign depositor subordination, the FDIC adopted a rule that revises its deposit insurance regulations to provide that deposits held at foreign branches, including "dually payable" deposits, are not insured deposits. Previously, the consensus view had been that "dually payable" deposits would be insured. The FDIC's preamble to the rule makes clear that such "dually payable" deposits would be afforded the benefit of "depositor preference" as a "deposit liability" in the liquidation of the insured depository institution. See 78 Fed. Reg. 56583 (Sept. 13, 2013) (final rule); 78 Fed. Reg. 11604 (Feb. 19, 2013) (solicitation of public comments).

The adoption of the foregoing rule has been controversial, and it was not the only means to address international developments related to the U.S. depositor preference. See Memoranda from Cleary Gottlieb, Davis Polk and Sullivan & Cromwell to FDIC Staff, dated Feb. 4 and Jan. 2, 2013. See also Part IV.A.3.C below.

c. "Brokered Deposits" and Similar Arrangements

(i) FDICIA § 301, 12 U.S.C. § 1831f, as implemented by the FDIC in 12 C.F.R. § 337.6, links the ability of a federally-insured depository institution to accept and pay interest on brokered deposits (i.e., deposits obtained with the assistance of a "deposit broker") to prescribed capital levels and regulatory status. Deposits paying a "significantly" (i.e., more than 75 basis points) higher interest rate than the rate paid in the relevant market area generally are deemed to be brokered deposits. See generally FDIC-93-31 (June 17, 1993) ("FDIC-93-31"), CCH Fed. Banking L. Rep. ¶ 81,645 (respecting variable rate instruments).

A) Brokered deposits amounted to approximately \$827 billion, or 6.6% of deposits, in the second quarter of 2016. Banking organizations are actively involved in CD distribution, and CD Internet auction sites are proliferating. See Part IV.B below; FDIC Statistics on Depository Institutions Report (2nd Q 2016).

i) Federal regulatory agencies have reminded banks to ensure proper risk management of brokered deposits. See, e.g., FDIC FIL-84-2008 (Aug. 26, 2008), CCH Fed. Banking L. Rep. ¶ 57-234; Joint Agency Advisory on Brokered and Rate-sensitive Deposits (May 11, 2001), Fed. Res. Reg. Serv. ¶ 3-1579.37.

FDIC FIL-32-2009 (June 19, 2009) ("FDIC FIL-32-2009"), CCH Fed. Banking L. Rep. ¶ 57-235, warned banks about third-party referrals which promise above-market CD rates; the actual rate offered by the bank may be lower than the advertised rate. In addition, even if unsolicited, these deposits are "brokered" and must be treated as such. Banks are responsible for managing third party relationships, regardless of a formal agreement, and for ensuring that they comply with all laws and guidance.

Investors have been reminded of the potential risks associated with purchasing CDs through brokers. See FDIC Consumer News (Fall 2000).

ii) After the $2 billion-asset ANB Financial of Arkansas failed in 2008, in part due to its reliance on brokered deposits (which constituted 86% of its deposit base), the FDIC said that it would scrutinize new deposit applications from institutions that rely heavily on brokered deposits. In 2009, the use of brokered deposits was implicated in the failure of several more banks, including IndyMac Bank of California, Columbian Bank & Trust of Kansas, First Bank of Beverly Hills of California and MagnetBank of Utah.

In addition, bank call reports require banks to report the estimated amount of deposits obtained through the use of deposit listing services (services that list CD rates at the request of a bank and that are compensated by either the bank or by the persons viewing those rates by means of flat subscription fees, but that do not actually facilitate the placement of CDs) on the theory that these deposits are potentially volatile. See 76 Fed. Reg. 5253 (Jan. 28, 2011), 75 Fed. Reg. 60497 (Sept. 30, 2010) (solicitation of public comments). See also, e.g., FDIC FIL-13-2009 (Mar. 3, 2009), CCH Fed. Banking L. Rep. ¶ 47-986 (cautioning against the use of volatile or special funding sources by financial institutions in a weakened condition). However, the FDIC does not consider listing service deposits to be brokered deposits and hence does not subject them to the restrictions applicable to brokered deposits. See FDIC FIL-2-2015 (Jan. 5, 2015), CCH Fed. Banking L. Rep. ¶57,238 ("FDIC FIL-2-2015"); SNL Financial (Aug. 25, 2015) (noting different regulatory approaches to deposits placed through a deposit broker and deposits placed through listing service).

iii) Dodd-Frank § 1506 required the FDIC to report to Congress on the differences between core and brokered deposits (and their role in the economy and banking sector), the possible effects of revising the definitions of core and brokered deposits, and the competitive parity between large institutions and community banks that could result from such redefinition.

In response to the FDIC's solicitation of comments, several third party reports supported the position that the demand for brokered deposits is often driven by a financial institution's increased risk appetite, but that brokered deposits nevertheless can be, and are used as, an important funding source for financial institutions regardless of their risk profile. The reports conclude that it would be more prudent to manage risk at the source rather than indirectly managing risk by limiting the use of brokered deposits as a funding input for all financial institutions. See, e.g., Farin & Associates and Promontory Interfinancial Network Letters to FDIC, dated May 1, 2011; Revisiting Core and Brokered Deposits: Contribution to Bank Stability and Value (Oliver Wyman, Apr. 29, 2011); Decomposing the Impact of Brokered Deposits on Bank Failure: Theory and Practice (Anthony T. Cliff Fund, Sept. 9, 2010).

Notwithstanding the reports, the FDIC Study on Core Deposits and Brokered Deposits (July 8, 2011) concluded that the current brokered deposit statutory regime continues to serve an essential function, and recommended that the brokered deposit statute not be amended or repealed. The FDIC stated that, in general, as brokered deposit levels increase, the probability that a bank will fail also increases, and that banks with higher levels of brokered deposits are more costly when they do fail.

B) 12 C.F.R. § 337.6 limits the ability of insured depository institutions that are not well capitalized to pay interest rates more than 75 basis points above a "national rate" published on the FDIC's Web site. See 74 Fed. Reg. 27679 (June 11, 2009) (final rule), 74 Fed. Reg. 5904 (Feb. 3, 2009) (solicitation of public comments).

The national rate is a simple average of the rates paid by all insured depository institutions and branches for which data are available. A less than well capitalized institution may seek a determination from the FDIC that it operates in a high-rate area, permitting the institution to pay the prevailing rate in that area. See FDIC FIL-62-2009 (Nov. 3, 2009), CCH Fed. Banking L. Rep. ¶ 96-399; ABA Letter to FDIC, dated Aug. 20, 2009 (questions on rule).

FDICIA does not affect the availability of insurance in respect of brokered deposits, and the acceptance of brokered deposits by an undercapitalized bank in violation of FIRREA will not affect insurance coverage. FDIC Letter to Cleary Gottlieb, dated Dec. 8, 1989.

C) A brokered deposit is one obtained with the assistance of a "deposit broker".

i) The term "deposit broker" encompasses any person engaged in the business of placing or facilitating the placement of deposits. Virtually every form of intermediation -- including as underwriter, selected dealer, agent, investment manager, adviser, financial planner, finder, listing service (under certain circumstances), and advertiser (except for "passive marketing"), insurance agent, lawyer, accountant, or dual, contract or affiliate employee of the depository institution -- constitutes deposit brokerage. In addition, the FDIC has determined that companies that issue general purpose prepaid cards also qualify as deposit brokers. See, e.g., FDIC FIL-42-2016 (June 30, 2016) ("FDIC FIL-42-2016"), FDIC FIL-2-2015, FDIC

FIL-32-2009; FDIC-04-04 (July 28, 2004), CCH Fed. Banking L. Rep. ¶ 82-265; FDIC-00-8 (Oct. 30, 2000), CCH Fed. Banking L. Rep. ¶ 82-248; FDIC-95-9 (June 29, 1993), CCH Fed. Banking L. Rep. ¶ 82-002; FDIC-94-41 (Aug. 29, 1994), CCH Fed. Banking L. Rep. ¶ 81,761; FDIC-94-15 (Mar. 16, 1994), CCH Fed. Banking L. Rep. ¶ 81,735; FDIC-94-11 (Mar. 2, 1994), CCH Fed. Banking L. Rep. ¶ 81,731; FDIC-93-71 (Oct. 1, 1993), CCH Fed. Banking L. Rep. ¶ 81,709; FDIC-93-46 (July 21, 1993) ("FDIC-93-46"), CCH Fed. Banking L. Rep. ¶ 81,660; FDIC-93-44 (July 19, 1993) ("FDIC-93-44"), CCH Fed. Banking L. Rep. ¶ 81,658; FDIC-93-34 (June 24, 1993), CCH Fed. Banking L. Rep. ¶ 81,648; FDIC-93-31; FDIC-93-14 (Feb. 24, 1993), CCH Fed. Banking L. Rep. ¶ 81,628; FDIC-92-92 (Dec. 15, 1992), CCH Fed. Banking L. Rep. ¶ 81,608; FDIC-92-88 (Dec. 10, 1992), CCH Fed. Banking L. Rep. ¶ 81,604; FDIC-92-87 (Dec. 9, 1992), CCH Fed. Banking L. Rep. ¶ 81,603; FDIC-92-86 (Dec. 7, 1992), CCH Fed. Banking L. Rep. ¶ 81,602; FDIC-92-71 (Oct. 26, 1992), CCH Fed. Banking L. Rep. ¶ 81,559; FDIC-92-56 (Aug. 6, 1992), CCH Fed. Banking L. Rep. ¶ 81,544; FDIC-92-53 (Aug. 3, 1992), CCH Fed. Banking L. Rep. ¶ 81,541; FDIC-92-52 (Aug. 3, 1992), CCH Fed. Banking L. Rep. ¶ 81,540; FDIC-92-51 (Aug. 3, 1992) ("FDIC-92-51"), CCH Fed. Banking L. Rep. ¶ 81,539. See also TCH Letter, dated Aug. 11, 2015 (expressing concern of the characterization of deposits resulting from client servicing activities performed by dual, contract or affiliate employees as brokered deposits); SNL Financial (Mar. 17, 2015) (noting that, in light of FDIC FIL-2-2015, many banks and thrifts reclassified billions of deposits as brokered);

FDIC Letter, dated Feb. 15, 2002 (no opinion expressed as to whether Internet payment processing service is a deposit broker).

ii) The FDIC has acknowledged exceptions to the definition of "deposit broker", including a person whose primary purpose is not the placement of funds with depository institutions (see 12 U.S.C. § 1831f(g)(2)(l)); 12 C.F.R. § 337.6(a)(5)(ii)(l)). The FDIC has indicated that this "primary purpose exception" is not measured by the proportion of a person's activity represented by the placement, but by his or its intent in making the placement and whether there is a substantial purpose other than obtaining deposit insurance or providing a deposit-placement service. See, e.g., FDIC FIL-42-2016; FDIC FIL-2-2015; FDIC-05-02 (Feb. 3, 2005); FDIC-94-39 (Aug. 17, 1994), CCH Fed. Banking L. Rep. ¶ 81-759; FDIC-94-13 (Mar. 11, 1994), CCH Fed. Banking L. Rep. ¶ 81-733; FDIC 90-21 (May 29, 1990), CCH Fed. Banking L. Rep. ¶ 81-309. But see FDIC FIL-2-2015 (noting that general purposes prepaid cards do not qualify for the "primary purpose exception").

The FDIC has recognized a few other exceptions. See, e.g., FDIC FIL-42-2016; FDIC FIL-2-2015; FDIC Letter, dated Apr. 21, 2004 (the "FDIC 2004 Listing Service Letter"); FDIC-02-04 (Nov. 13, 2002), CCH Fed. Banking L. Rep. ¶ 82-254 (listing service); FDIC-96-4 (Feb. 5, 1996), CCH Fed. Banking L. Rep. ¶ 82-104 (foreign bank not subject to deposit broker requirements with respect to deposit solicitation for U.S. bank outside of the U.S.); FDIC-94-13 (Mar. 11, 1994), CCH Fed. Banking L. Rep. ¶ 81,733 (bank loan secured by deposits in another bank); FDIC-93-44 (July 19, 1993) CCH Fed. Banking L. Rep. ¶ 81,658 (listing service); FDIC-93-31 (states, colleges and universities in connection with college tuition-linked CDs; see Part IV.C.5.c.ii below); FDIC-92-54 (Aug. 3, 1992), CCH Fed. Banking L. Rep. ¶ 81,542 (company which publishes information on availability and terms of deposit accounts); FDIC-92-50 (July 24, 1992), CCH Fed. Banking L. Rep. ¶ 81,537; FDIC-90-24 (June 12, 1990), CCH Fed. Banking L. Rep. ¶ 81,312 (listing service, including an Internet website; however, the listing service would be a deposit broker if it attempted to steer funds toward particular institutions); FDIC-94-37 (July 19, 1994), CCH Fed. Banking L. Rep. ¶ 81,757 (deposit referral program); FDIC-93-63 (Sept. 1, 1993), CCH Fed. Banking L. Rep. ¶ 81,701 (bank "deposit support services" and "customer service" facilities to affiliates; however, if the bank transfers funds to an affiliate at the request of a customer, then it would be a "deposit broker"); FDIC-92-51 (trust department).

iii) In the past, deposit brokers were required to notify the FDIC that they were acting, or that they had stopped acting, as deposit brokers. While this registration requirement was repealed (see Financial Regulatory Relief and Economic Efficiency Act, Pub. L. 106-569 (2000), Title XII, §1203; 64 Fed. Reg. 17621 (Apr. 3, 2001)), deposit brokers remain subject to FDIC reporting processes. See FDIC Deposit Brokers Processing Guide.

iv) OCC Bulletin No. 2002-39 (Sept. 5, 2002) discusses losses incurred by financial institutions following the insolvency of two deposit brokers.

(ii) In an effort to address the need of community banks to attract deposits, Promontory Interfinancial Network developed the Certificate of Deposit Account Registry System ("CDARS"), which permits banks to sell FDIC-insured CDs in amounts above the FDIC limit. CDARS permits each member to put a customer's funds in excess of that limit with other FDIC-insured banks in exchange for which it is entitled to receive an equivalent amount of funds from such other banks; the customer deals with one bank and receives the same interest rate for the entire CD. See, e.g., American Banker, Sept. 11, 2015, Feb. 13, 2006, June 9, 2005, July 22, June 24, Feb. 11, Jan. 21, 2003. See also St. Louis Bus. J., Sept. 12, 2006 (A.G. Edwards & Sons bank deposit program offering up to $1 million in FDIC coverage through brokerage accounts). Historically, the FDIC calculated deposit insurance assessments by using a brokered deposit adjustment, in which reciprocal deposits were categorized as brokered deposits. For small institutions, the FDIC no longer treats reciprocal deposits as brokered deposits in its assessments for deposit insurance, if the institution is well capitalized and well rated. See 81 Fed. Reg. 32184 (May 20, 2016).

(iii) In 2015, the FDIC issued guidance in the form of FAQs, FDIC FIL-2-2015, to promote consistency among depository institutions in identifying, accepting and reporting brokered deposits. The guidance clarified previously issued interpretations and broadened the universe of deposits that qualify as brokered to encompass general purpose prepaid cards, deposits placed by agents, lawyers, or accountants who refer a client to a bank, deposits placed by third parties that do not receive fees in exchange, and deposits placed by dual, contract or affiliate employees of the depository institution. See FDIC FIL-2-2015. The guidance created significant controversy, and in January 2015, the FDIC indicated that it did not expect banks to apply FDIC FIL-2-2015 to their current activities and noted that the guidance would be clarified or added to over the following months. The FDIC revised the guidance in June 2016. See FDIC FIL-42-2016. While the revised FAQs provide additional direction regarding how despository institutions should identify, accept, and report brokered deposits, the revised FAQs have generated significant new interpretive questions.

d. Deposit Advance Products

(i) The CFPB and banking agencies have expressed concerns regarding "deposit advance products", short-term loans offered by depository institutions to account holders who have recurring direct deposits to their accounts. The loans are typically automatically repaid upon the funding of the next direct deposit; in the event an outstanding advance is not fully repaid by direct deposits within 35 days of origination, the depositor's account will typically be debited for the outstanding loan balance, whether or not there are sufficient funds in the account to repay the loan. Fees are typically charged as a percentage of the amount advanced, regardless of the length of time the loan is outstanding.

(ii) In 2013, the CFPB issued a White Paper, Payday Loans and Deposit Advance Products (Apr. 24, 2013), that concluded that it is unclear whether consumers understand the costs, benefits and risks associated with deposit advance products and that the products may become particularly harmful if used on a recurring basis as a long-term source of liquidity.

(iii) The Board issued Consumer Advisory Letter CA 13-7 (Apr. 25, 2013), CCH Fed. Banking L. Rep. ¶ 64-130, emphasizing the risks associated with the products and reminding member banks that they must comply with all applicable federal and state laws and regulations in connection with the design and offer of these products, including the Truth in Lending Act, the Electronic Fund Transfer Act, the Truth in Savings Act, the Equal Credit Opportunity Act, FTC Act § 5 and Dodd-Frank § 1036.

(iv) The FDIC and the OCC issued guidance detailing the principles that they expect their respective supervised financial institutions to follow to address potential reputational, compliance, operational and credit risks that are associated with offering deposit advance products, and encouraged the institutions to offer properly managed small-dollar loan products (other than deposit advance products) with reasonable terms, at a reasonable cost and consistent with safety and soundness and other supervisory considerations. See 78 Fed. Reg. 70552 (FDIC), 70624 (OCC) (Nov. 26, 2013) (final guidance); 78 Fed. Reg. 25268 (FDIC), 25353 (OCC) (Apr. 30, 2013) (proposed guidance).

e. Overdraft Protection

(i) The CFPB has expressed its commitment to ensure that protections are in place to limit the use of overdraft fees. In a 2013 white paper on overdraft programs, the CFPB noted the difficulty in assessing the volume of revenue generated from overdraft and non-sufficient funds ("NSF") fees. See CFPB Study of Overdraft Programs: A White Paper of Initial Data Findings (June 2013). In 2015, the FFIEC modified its call report form to require all banks with over $1 billion in assets that offer consumer deposit accounts to report overdraft and NSF fees earned on consumer accounts separately from other deposit service charges, and in 2016 the CFPB published an analysis of the reported data. See Variation in Bank Overdraft Revenues and Contribution (CFPB, Feb. 2016).

(ii) Director Cordray sent letters to the CEOs of the largest U.S. retail banks encouraging them to offer customers lower-risk accounts that are specifically designed to prevent authorization of overdrafts and that do not charge overdraft fees. See Letter from CFPB Director Cordray to Financial Institution CEOs, Feb. 3, 2016. See also Remarks of CFPB Director Cordray, Feb. 3, 2016. The CFPB is currently engaged in pre-rule making activities to consider the potential regulation of overdraft services on checking accounts. See CFPB Semiannual Regulatory Agenda, 81 Fed. Reg. 37412 (June 9, 2016).

f. Advertising and Disclosure

(i) The Board's Regulation DD requires that depository institutions that offer CDs provide consumers with written disclosures related to fees, annual percentage yield ("APY"), interest rates, and other terms for the deposit account. These disclosures are required before an account is opened, in advance of a change in the terms of the CD, and periodically, if the depository institution provides periodic statements. See generally 12 U.S.C. § 4301-13; 12 C.F.R. § 1030 and Appendices; 57 Fed. Reg. 43337 (Sept. 21, 1992).

(ii) In addition, Regulation DD requires that depository institutions take measures to ensure that their advertisements are not misleading or inaccurate. For example, if an advertisement states a rate of return, it must state the rate as an annual percentage yield, using the term "annual percentage yield" or APY. See 12 C.F.R. § 1030.8.

g. Guidance on the Offer and Sale of Structured Notes, CDs and Similar Instruments

(i) Consistent with the SEC's increased focus on sales of structured products to retail investors, the Office of Investor Education and Advocacy released Investor Bulletin: Structured Notes (Jan. 12, 2015) to highlight potential risks for retail investors of investing in structured notes. The bulletin urges investors to inquire about the cost, fees, estimated value, liquidity, tax implications and potential limits on return before investing in structured notes. The OCIE Risk Alert: Broker-Dealer Controls Regarding Retail Sales of Structured Securities Products (Aug. 24, 2015) identified deficiencies in the controls that broker-dealers had in place to determine the suitability of recommending structured notes (and other structured securities products) to retail brokerage customers and the supervisory procedures for review of such suitability determinations.

(ii) UBS AG agreed to pay $19.5 million to settle charges with the SEC that it made false or misleading statements and omissions in offering materials provided to U.S. investors in structured notes linked to a proprietary FX index. The case was the SEC's first involving misstatements and omissions by an issuer of structured notes. See SEC Press Release No. 2015-238 (Oct. 13, 2015).

(iii) In June 2016, Merrill Lynch agreed to pay $10 million to settle charges that it made misleading statements in offering materials provided to retail investors for structured notes linked to a proprietary volatility index. See SEC Press Release No. 2016-129 (June 23, 2016).

(iv) FINRA Investor Alert: High-yield CDs: Red Flags That Signal a Scam (May 28, 2014) cautions against unsolicited promotions of CDs promising outsized returns in the current low-interest rate environment and describes six red flags that indicate that a CD offer may be fraudulent.

(v) The European Securities and Markets Authority ("ESMA") and IOSCO have published reports analyzing trends and developments in the retail structured product market and related regulatory issues and proposing good practices in respect of retail structured products. See Structured Retail Products: Good Practices for Product Governance Arrangements (ESMA, Mar. 2014); Regulation of Retail Structured Products Consultation Report (IOSCO, Apr. 2013).

(vi) FINRA Investor Alert: Exchange-traded Notes -- Avoid Unpleasant Surprises (July 10, 2012) explains differences between exchange-traded notes and ETFs and describes risks associated with investments in exchange-traded notes (including credit risk, market risk, liquidity risk, price-tracking risk, holding-period risk, call, early redemption and acceleration risk and risks associated with conflicts of interest).

(vii) In 2012, the SEC sent letters to banks asking for additional information about structured notes issued by the banks and asking the banks to include in their offering documents certain information concerning the risk that investors could lose their principal. In 2013, the SEC sent letters to banks asking them to comply with a series of guidelines concerning structured note offering documents, including guidelines recommending the inclusion of disclosure about the banks' valuation of the notes and other fees, costs and other amounts included in the original issue price of the notes, as well as the inclusion of risk factors related to the pricing and valuation of the notes. See SEC Sample Letters Sent to Financial Institutions Regarding Their Structured Note Offerings Disclosure (Feb. 2013 and Apr. 2012). See also Wall St. J., Apr. 11, 2013.

(viii) In Zions Direct, FINRA Press Release, dated Aug. 25, 2010, FINRA imposed a fine for failing to disclose the potential conflict of interest created by the participation of an affiliate in online CD auctions. FINRA concluded that the yields in the auctions in which the affiliate participated might have been higher had the affiliate not participated, that the participation of the affiliate was a potential conflict of interest and that this information was material to Zions' customers. FINRA also found that Zions' advertisements to customers included misleading statements and claims.

(ix) FDIC FIL-29-2010 (June 7, 2010), CCH Fed. Banking L. Rep. ¶ 57-237, provided guidance regarding deposit insurance and customer disclosure issues that arise when deposits are placed at insured depository institutions by trade associations or affinity groups. The FDIC notes the heightened risk for customer confusion regarding FDIC-insurance coverage of such deposits, and cautions that the deposit insurance only "passes through" the entity placing the funds to the actual owner if (A) the institution's records disclose the fiduciary relationship (e.g., "XYZ Broker for its clients"); (B) the records of the depository institution, the fiduciary or an authorized third party identify the owner of the funds in the account; and (C) the funds are owned by the customer and not the placing entity -- this includes a requirement that the interest rate and maturity date offered to the customer match those of the CD purchased by the placing entity. The FDIC reminds depository institutions that such placed deposits are brokered deposits. See also Part IV.A.1.c above.

(x) FINRA Regulatory Notice 10-09 (Feb. 2010) expressed the concern that reverse convertible market-linked structured products (including CDs) could have complex payout structures that can make it difficult to assess their risks, costs and benefits. In addition to advising customers about market risk and liquidity risk, FINRA advised that customers should be advised of (A) how the product works, including its payout structure, relevant information about the reference asset and, if applicable, that the customer will not participate in any appreciation in the value of the reference asset; and (B) if applicable, the fact that the broker has published its own research reports regarding the reference asset, the content of that research and how the research is or is not relevant to a recommendation to purchase or sell the reverse convertible.

(xi) NYSE Information Memo No. 06-12 (Mar. 17, 2006) raised concerns that investors may not fully understand market-indexed or linked CDs and therefore such CDs could be mistaken for traditional CDs. Customers should be advised (A) that, if liquidated prior to maturity, the CD may be worth less than the purchase amount (market risk); (B) that a secondary market may not exist in the CDs (liquidity risk); (C) that, if the CDs are called, their return may be less than would have otherwise been realized and the customer may not be able to reinvest the proceeds in a similar instrument (call risk); (D) of tax implications; (E) of valuation methods; and (F) where practicable, of the actual market value of the instrument.

(xii) NYSE Panel Decision 03-98 (June 4, 2003) entered a Stipulation of Facts and Consent to Penalty in respect of UBS PaineWebber, which was alleged to have recommended and sold long-term "Callable CDs" and "Stepdown Callable CDs" which were unsuitable for certain customers in view of their ages, investment objectives, financial resources and accounts, and without adequate risk disclosure.

Claims in respect of Callable CDs may also be brought under state law. See, e.g., Lippitt v. Raymond James Financial Services, 340 F.3d 1033 (9th Cir. 2003) (holding that 1934 Act does not create exclusive jurisdiction for actions against broker-dealers accused of false advertising and deceptive practices in CD sales).

(xiii) NASD Notice to Members No. 02-69 (Oct. 2002) stated that, although brokered deposits may have certain features that traditional CDs do not (such as longer maturities, interest rates linked to market indices, and step-rate and call features), they are generally considered bank products, not securities. However, the NASD warned that a brokered deposit could be a "security" where a deposit broker (A) materially alters the terms and features of a deposit (e.g., changes the interest rate); (B) buys a large denomination CD and fractionalizes it; or (C) offers to customers, as an incentive to purchase a deposit, expertise and skills that go beyond the sale of such deposit, such as marketing the ability to identify attractive CDs or to maintain a secondary market. See also Part IV.A.5 and Part IV.A.6 below.

The Notice recommends that NASD members provide disclosures as to (A) possible loss of principal in the event of a sale prior to maturity, (B) the illiquid secondary market for brokered deposits, (C) call features, (D) step-rate features, (E) the difficulty of accurately determining market value, and (F) differences between the actual value of such deposits and their purchase price.

(xiv) Investing in [CDs]: The Basics (BMA/SIA, Nov. 2001) outlines CD features, redemption procedures and investment considerations. See also NASAA Checklist, dated Aug. 30, 2001 (investment implications of "callable" CDs).

(xv) NYSE Information Memo No. 01-5 (Mar. 7, 2001) expressed the concern that the manner in which long-term CDs are represented to customers could be misleading. The NYSE focused on the absence of risk-factor disclosure (e.g., market risk, interest rate sensitivity, term/call provisions/reinvestment risk, step-rate risk and liquidity risk) as well as the inadequacy of secondary market price disclosure.

2. Foreign Bank Deposits

The general focus of a court's inquiry in determining whether a foreign bank CD is a "security" for purposes of the Securities Acts is whether the foreign regulatory scheme reduces the risk of the CD to the extent that the protection of the U.S. securities laws is unnecessary. The most important criteria in this regard -- with respect to both domicile of the issuing bank and (where applicable) of the issuing branch -- include (a) the history of bank failures and losses to depositors; (b) whether the issuing bank is subject to comprehensive consolidated supervision; (c) reporting, examination, audit, operational, capital adequacy, reserve and similar requirements to which the issuing bank is subject; and (d) the ranking of, or insurance on, CDs vis-à-vis other debt obligations (see generally, e.g., FDIC International Directory of Deposit Insurers).

a. Federal Securities Law

(i) Prior to Reves, the Ninth Circuit held that CDs issued by a foreign bank subject to regulation similar to that of a

U.S. bank were not 1933 Act "securities". Wolf v. Banco Nacional de México, 739 F.2d 1458 (9th Cir. 1984) ("Banamex"), cert. denied, 469 U.S. 1108 (1985).

The Ninth Circuit interpreted Weaver broadly, ruling that its regulatory scheme/risk-of-loss approach was not limited to U.S. regulation, although defendants had to prove the adequacy of Mexico's regulatory structure and insolvency protection. Mexican bank regulations were found to be comprehensive enough to "virtually guarantee" depositors against the risk of insolvency.

(ii) West v. Multibanco Comermex, 807 F.2d 820 (9th Cir.), cert. denied, 482 U.S. 906 (1987), relied on the Banamex rationale to find that CDs issued by Mexican banks were not "securities". The Court stated that as a matter of comity it may not examine the actual operation (as opposed to the existence and adequacy) of a foreign regulatory system and must presume that foreign officials act in a manner consistent with their laws.

(iii) Most courts have agreed with Banamex. See, e.g., Grass v. Crédito Mexicano, 797 F.2d 220 (5th Cir. 1986), cert. denied, 480 U.S. 934 (1987); Riedel v. Bancam, 792 F.2d 587 (6th Cir. 1986); Callejo v. Bancomer, 764 F.2d 1101 (5th Cir. 1985).

(iv) "Bearer certificates" (denominated in U.S. dollars and other currencies) which the State Bank of Pakistan proposed to sell in the U.S. (see, e.g., Wall St. J., Mar. 16, 1992) were characterized as "securities" subject to 1933 Act registration. See SEC Release No. 33-6937 (May 6, 1992); Jeffrey Feldman, SEC Admin. Proc. No. 3-8063 (Sept. 20, May 27, 1993).

(v) State Bank of India announced the sale of "Resurgent India Bonds" which it apparently characterized as deposit obligations and, thus, not 1933 Act "securities". See, e.g., Offer Document dated Aug. 5, 1998; NY Times, Aug. 19, 1998.

The SEC ruled that these instruments were "securities", requiring the filing of a registration statement. State Bank of India's marketing materials referred to the "Resurgent India Bonds" as "five year foreign currency denominated bonds" and "investments", and used terms commonly associated with securities offerings. Marketing materials also touted characteristics of the "Resurgent India Bonds" that were similar to government bonds. See State Bank of India, SEC Admin. Proc. No. 3-10643 (Nov. 19, 2001). See also State Bank of India Regulatory Order discussed in Part XI.D.5 below.

(vi) At one point, UniCredito (Italy) was considering the sale of principal-protected CDs linked to equity, commodity and interest rate indices through midsize and small U.S. regional banks, which would use their own names on the CDs through a "private label" arrangement. See, e.g., American Banker, Feb. 26, 2004.

(vii) ADRs -- contractual interests in foreign securities held by a depository -- are not "deposits" covered by FDIC insurance. FDIC-94-23 (June 13, 1994), CCH Fed. Banking L. Rep. ¶ 81,743.

b. State Securities Laws

CDs which are not "securities" under the Securities Acts may nonetheless be "securities" under state law, subject to registration and/or antifraud provisions.

c. Foreign Bank U.S. Deposits

(i) The Foreign Bank Supervision Enhancement Act, 12 U.S.C. § 3104(d), as amended by the FDI Reform Act, provides that foreign banks may accept or maintain domestic retail deposit accounts (including CDs) having balances of less than the standard maximum FDIC deposit insurance amount only through FDIC-insured U.S. banking subsidiaries (or U.S. branches that were

FDIC-insured on December 19, 1991 and remain FDIC-insured) unless the depositor falls within a list of exempt depositors. See 12 C.F.R. § 347.206 et seq., 61 Fed. Reg. 5671 (Feb. 14, 1996); 12 C.F.R. Part 28.16, 67 Fed. Reg. 41619 (June 19, 2002).

(ii) As part of its response to the increase of the standard maximum FDIC insurance amount from $100,000 to $250,000 in Dodd-Frank, the FDIC replaced "$100,000" with references to the "standard maximum amount" in 12 C.F.R. Part 347.

(iii) 12 U.S.C. § 3104(d) should not bar U.S. retail deposits with foreign bank non-U.S. branches. See generally, e.g., Letter No. 778 (national bank subsidiary may act as agent for customers in placing funds in FX time deposits with foreign banks).

(iv) The SEC determined that U.S. federal or state branches or agencies of foreign banks should have the same right to issue or guarantee a security as U.S. banks, therefore allowing them to rely on the exemption from registration in Section 3(a)(2) of the Securities Act. See 51 Fed. Reg. 34462 (Sept. 29, 1986). Recently, SEC staff have indicated that they are re-examining certain aspects of the availability of Section 3(a)(2) exemption, including for offerings guaranteed by U.S. branches of foreign banks. The SEC has expressed particular concern with respect to offerings to retail investors of structured notes issued by foreign banks and guaranteed by their U.S. branches.

3. "Jumbo" Certificates of Deposit, Bank Notes and Other Issues

a. Weaver and Banamex suggest that a CD in a denomination larger than the FDIC insurance limit is not necessarily a 1933 Act "security". In Weaver, only $40,000 of the $50,000 CD at issue was insured, and the Banamex CDs did not benefit from any FDIC insurance.

b. Brockton Savings Bank v. Peat Marwick, 577 F. Supp. 1281 (D. Mass. 1983), concluded that Weaver relied on evidence that, since the advent of deposit insurance, "nearly all" depositors in failing banks had received payment in full even when their deposits were in excess of the insurance ceiling. (The FDIC may be prohibited from covering uninsured portions of deposits as part of the "least-cost resolution" measures adopted in FDICIA § 141, 12 U.S.C. § 1823(c).)

c. The 1993 Budget Reconciliation Act included "depositor preference" provisions that altered the priorities governing the distribution of proceeds from receiverships of FDIC-insured institutions. See 12 U.S.C. § 1821(d)(11). Prior to this Act, all senior creditors of a failed depository institution (e.g., depositors, holders of general obligation bank notes and trade creditors) shared equally in the proceeds of a liquidation. Under the "depositor preference" provisions, bank deposits -- whether or not insured -- rank senior to other obligations.

(i) The depositor preference does not apply to deposits payable only outside the U.S. See, e.g., Consultation Paper CP12/23 (FSA, Sept. 2012); "The Consequences of National Depositor Preference", FDIC Banking Review (1999); FDIC-94-1 (Feb. 28, 1994), CCH Fed. Banking L. Rep. ¶ 81,700.

(ii) The FDIA liquidation priorities could affect whether general obligation bank notes should be characterized as "securities". However, the shift in the manner in which the FDIC calculates deposit insurance premiums (i.e., based on liabilities, rather than deposits) may reduce the importance of the distinction between deposits and uninsured bank notes for bank issuers. See Part IV.A.1.b.iii above. See also Part IV.C below.

(iii) "Deposit notes" which are stated to "evidence[] a deposit that is insured" by the FDIC should be characterizable as deposits. See, e.g., FDIC-90-19, ("FDIC-90-19"), CCH Fed. Banking L. Rep. ¶ 81,307. See also, e.g., FDIC-90-20 (Apr. 25, 1990) ("FDIC-90-20"), CCH Fed. Banking L. Rep. ¶ 81,308 (FDIC insurance on "deposit notes").

"Deposit notes" are not "securities" as defined in the Comptroller's securities offering regulations at 12 C.F.R. Part 16 ("Part 16"). See Comptroller Interpretive Letter No. 922 (Dec. 13, 2001) ("Letter No. 922"), CCH Fed. Banking L. Rep. ¶ 81-447.

(iv) Liabilities arising under "depository institution investment contracts" are not insured deposits. See 12 C.F.R. § 327.5(a)(2)(v).

d. Publicly-offered participations in a pool of jumbo CDs are likely to be characterized as "securities" if the arrangement presents a risk of loss separate from that of the underlying investment. See, e.g., NEA-N.H. Payroll Investment Plan (avail. Apr. 29, 1983); Merrill Lynch (avail. Oct. 28, 1982); Management Corp. of America (avail. Apr. 8, 1982); Bank of Oregon (avail. Dec. 20, 1979); Arthur E. Fox (avail. Dec. 12, 1974). See also, e.g., Rappaport and Segal (avail. May 24, 1988) (participation interests in single CD deemed a 1940 Act "security").

(i) However, the SEC took a no-action position where the institution issuing the CD recognized holders of CD participations as beneficial owners of the CD and where such participations were FDIC-insured. See, e.g., E.F. Hutton & Co. (avail. Mar. 28, 1985); Lincoln Federal Savings & Loan (avail. Jan. 8, 1985).

(ii) Comptroller Interpretive Letter No. 385 (June 19, 1987) ("Letter No. 385"), CCH Fed. Banking L. Rep. ¶ 85,609, suggests, pursuant to Weaver, that participations issued by a bank in CDs purchased by that bank from another bank would not be subject to the Securities Acts.

e. Part 16 covers virtually all non-deposit indebtedness of national banks and federal branches and agencies of foreign banks. Similarly, the FDIC Statement of Policy on the Use of Offering Circulars, 61 Fed. Reg. 46807 (Sept. 5, 1996), discusses the antifraud provisions of the securities laws and sets out the information that should be furnished when a state non-member bank offers and sells equity or debt securities in a public offering.

National banks and state non-member banks are required to make available to the public annual financial disclosure statements. 12 C.F.R. § 18.4 (Comptroller), Part 350 (FDIC). See also 62 Fed. Reg. 10199 (Mar. 6, 1997) (revision of 12 C.F.R. Part 350). The Board repealed such a requirement for state member banks. 59 Fed. Reg. 55987 (Nov. 10, 1994).

f. Depending on how a broker-dealer structures a sweep arrangement into FDIC-insured deposit bank accounts, the SEC/FINRA could take the position that the broker-dealer did not, for regulatory purposes, effectively move client balances to bank accounts established in the clients' names, resulting in a regulatory net capital deficiency for the broker-dealer. See, e.g., Ameritrade Holding Corp. 2004 Form 10-K.

4. Non-bank Issuances and "Prime Bank" Instruments

a. In Ford Motor Credit, SEC Admin. Proc. No. 3-11950 (June 14, 2005), the SEC issued a cease-and-desist order with respect to the "Ford Money Market Account" and required implementation of a name change and improved disclosures. The SEC found that sales materials soliciting investment in the "Ford Money Market Account" did not satisfy 1933 Act requirements.

Ford Credit had promoted the Account as comparable to a traditional money market investment, emphasized that the Account paid a guaranteed interest rate higher than the average rate paid by money market accounts, and highlighted features of the investment typically present in checking and money market accounts offered by banks or mutual funds. However, sales materials failed to explain that (i) the Account was not a bank account or a money market mutual fund, and that investors were purchasing unsecured Ford Credit corporate debt; and (ii) investors' accounts, unlike bank checking or money market accounts or money market mutual funds, were not insured by the FDIC or subject to 1940 Act standards.

The SEC's action resulted from its investigation of the $28 billion market for corporate money market debt offerings in an effort to ensure that investors understand the risks associated with these financial instruments. See SEC Press Release 2005-89 (June 14, 2005).

b. Regulatory authorities have issued warnings about so-called "prime bank" notes, "Federal Reserve notes", guarantees, letters of credit and similar financial instruments involving promoters which use the names of domestic and foreign banks, the World Bank and central banks. The Board has cautioned that it is aware of no legitimate "prime bank" financial instrument, and that it does not license or register traders of such instruments. See, e.g., Board SR Letters 03-14 (July 16, 2003), CCH Fed. Banking L. Rep.¶ 51-923; SR 02-13 (May 20, 2002), CCH Fed. Banking L. Rep. ¶ 51-922; NASAA Releases, dated Jan. 17, 2002, July 19, 1999, Dec. 29, 1998; Comptroller Consumer News No. 62-97 (Oct. 13, 1997); Comptroller Alerts No. 97-12 (May 20, 1997), CCH Fed. Banking L. Rep. ¶ 90-835; No. 97-11 (May 15, 1997), CCH Fed. Banking L. Rep. ¶ 90-834; Board Investment Scheme Advisory (June 11, 1996), Fed. Res. Reg. Serv. ¶ 3-1535.6; "Prime Bank" Interagency Warning (Oct. 21, 1993), Fed. Res. Reg. Serv. ¶ 3-1535.5. See also Stark & Vietmeyer, "The SEC and Prime Bank Securities Frauds: Past, Present and Future", 31 Sec. Reg. L.J. 4 (Spring 2003); International Chamber of Commerce ("ICC") Commercial Crime Bureau Special Report, Prime Bank Instrument Frauds (Feb. 22, 1996, Jan. 10, 1994).

(i) Section 2603 of NSMIA, 18 U.S.C. § 474/§ 474A, makes it a crime to produce, possess or sell fictitious financial instruments which purport to be financial instruments of the U.S., a foreign country or a private organization. The SEC has taken numerous actions against participants in "prime bank" and similar frauds. See, e.g., SEC Warning to All Investors About Bogus "Prime Bank" and Other Banking-Related Investment Schemes, How Prime Bank Frauds Work, and Announcements of Selected SEC Enforcement Actions Related to Prime Bank Fraud (http://www.sec.gov/divisions/enforce/primebank.shtml).

(ii) For selected recent actions, see, e.g., SEC v. Malom Group, No. 2:13-cv-2280 (D. Nev., Dec. 16, 2013) (Dec. 16, 2013) (complaint) (prime bank transactions and overseas debt instruments); SEC v. Coddington, Case No. 1:13-cv-03363 (D. Co., Dec. 12, 2013) (complaint) (alleged prime bank fund); SEC v. Global Funding, Case No. 1:13-cv-05781 (D. N.J., Sept. 27, 2013) (complaint) (prime bank fraud); SEC v. Butts, SEC Press Release 2013-175 (Sept. 9, 2013) (complaint) (alleged fraudulent, high-yield "prime bank" investment scheme through Worldwide Funding III); SEC v. Kegley, Case No. 1:12-CV-1605 (N.D. Ga., May 8, 2012) (complaint) (alleged misrepresentations regarding the existence of fictitious bank guarantees), final judgment (Feb. 20, 2013); SEC v. DeMaria, SEC Litigation Release No. 22380 (May 30, 2012) (complaint) (alleged fictitious investment program involving the purchase of interests in financial instruments), final judgment (N.D. Ill 2013); SEC v. Milan Group, Case No. 1:11-CV-02132 (D.D.C., Nov. 30, 2011) (complaint) (alleged fictitious investment scheme involving foreign bank instruments), final judgment (D.D.C. 2013); U.S. v. Morgan, Case No. 8:09-cv-00585 (M.D. Fla. 2011) (plea agreement) (criminal fraud and money laundering charges related to "prime bank" scheme); SEC v. Peterson, SEC Litigation Release No. 21843 (Feb. 8, 2011) (complaint) (alleged fraudulent, high-yield "prime bank" investment scheme through Express International), final judgment (C.D. Ca. 2012); SEC v. Dodge, SEC Litigation Release No. 21759 (Dec. 1, 2010) (alleged unregistered sales of high-yield interests in "prime bank" scheme through Quantum Funding Strategies), final judgment (W.D. Tx. 2011); SEC v. Morgan European Holdings (M.D. Fla. 2010) (judgment), SEC Litigation Release No. 21082 (June 12, 2009) (fictitious investment program involving the trading of financial instruments) (complaint and emergency order); SEC v. Millennium Bank, Case No. 07:09-cv-050 (N.D. Tx., Sept. 23, 2010) (permanent injunction), SEC Litigation Release No. 20974 (Mar. 26, 2009) (bogus CDs through offshore institutions) (complaint); SEC v. RUSA Corp., SEC Litigation Release No. 20928 (Mar. 5, 2009) (judgment), SEC

Litigation Release No. 20111 (May 10, 2007) (complaint), final judgment (N.D. Ga. 2010); SEC v. Stanford Int'l Bank, SEC Litigation Release No. 20901 (Feb. 17, 2009) (CDs "promising improbable and unsubstantiated high interest rates, supposedly earned through [a] unique investment strategy [and sold through] misrepresent[ations] to CD purchasers that their deposits are safe, [and] false[] claim[s] that the Bank reinvests client funds primarily in 'liquid' financial instruments"); SEC v. EFS (N.D. Tex. 2008) (order), SEC Litigation Release No. 19689 (May 5, 2006) (fraudulent "prime bank" scheme) (complaint), final judgment (N.D. Tex. 2012).

5. The Gary Plastic Decision and its Progeny

   a. Gary Plastic Packaging Corp. v. Merrill Lynch, 756 F.2d 230 (2d Cir. 1985) ("Gary Plastic"), held that CDs sold through a Merrill Lynch Money Markets ("MLMM") program constituted 1933 Act "securities" and were outside of the scope of Weaver which, in the Court's view, dealt only with "conventional" CDs.

      MLMM purported to offer $100,000, FDIC-insured negotiable CDs issued by a number of institutions. MLMM purported to obtain "competitive yields", but the interest rates on the CDs were lower than those paid to direct customers. From this differential, MLMM received an undisclosed commission for its services, which included providing a secondary market.

      The Court concluded that, because customers relied on MLMM (i) to create and maintain a secondary market, (ii) for an implicit promise of marketing efforts to assure a secondary market, and (iii) for monitoring the issuing banks' creditworthiness and solvency, the program represented a joint effort between the CD issuers and MLMM.

   b. Gary Plastic is consistent with cases where courts concluded that certain arrangements involving CDs were "securities". These cases involved brokers that offered bonuses of additional interest to be paid on the CDs' maturity. The "package" of the CDs and bonus, which was dependent on the continued solvency of the broker, was held to be an "investment contract" constituting a "security".

(i) Precedents in this regard include, e.g., Safeway Portland Employees' Federal Credit Union v. C.H. Wagner & Co., 501 F.2d 1120 (9th Cir. 1974), and the related cases of SEC v. C.H. Wagner & Co., 373 F. Supp. 1214 (D. Mass. 1974), and Swank Federal Credit Union v. C.H. Wagner & Co., 405 F. Supp. 385 (D. Mass. 1975). But see, e.g., Resolution Trust Corp. ["RTC"] v. Stone, 998 F.2d 1534 (10th Cir. 1993) ("Stone") ("enhanced automobile receivables" are not "securities" since packaging, enhancements and secondary marketing do not eliminate the instruments' resemblance to consumer receivables).

(ii) FDIC FIL-32-2009 warned that FDIC-insured banks should be aware of any unsolicited deposits received through third-party referrals, since certain firms have advertised above-market rate CDs to attract customers under circumstances where, when a customer buys the advertised CD, the customer is referred to the bank's Web site, with the third party "making up" the difference between the bank's actual rate and the advertised rate. This practice may cause a contradiction with the terms in the bank's Truth-in-Savings disclosures. Banks prohibited from accepting brokered deposits under 12 C.F.R. § 337.6 cannot accept these third-party referral deposits. Deposits received by a bank from such a third-party referral also may expose the bank to reputation risk, since customers may be misled. See also Part IV.A.1.c above.

c. SEC v. U.S. Reservation Bank & Trust [("USRBT")], 289 Fed. Appx. 228 (9th Cir. 2008), affirmed that a hybrid instrument consisting of a CD and a leveraged profit-sharing agreement was a "security" under the Securities Acts because (i) its purpose was to raise funds for investment, (ii) a reasonable investor would likely regard it as an investment because it offered the greater of a fixed rate of return and a percentage of the profits gained by

USRBT's investing the funds, and (iii) the investment was not insured, guaranteed or regulated in such a way as to reduce its risk. The Court did not reach the question of whether USRBT was a "bank" within the meaning of 1933 Act § 3(a)(2), a public instrumentality of a U.S. territory or a "tribal entity".

d. Missouri Bankers Assoc. (avail. Aug. 18, 2008) denied a no-action request regarding the proposed offer and sale of bank deposit instruments under a 529 Plan, concluding that 529 Plans involve rights and obligations different from bank deposits, and that the offer and sale of bank deposits under such Plan did not fall within 1933 Act § 3(a)(2). See also Part II.B.3 and Part II.C above and Part IX.B below.

In Goldman Sachs (avail. Oct. 19, 1989), the SEC denied a no-action request for a broker-dealer to make conditional undertakings to repurchase certain instruments, including CDs, from institutional holders without having to register the undertakings under the 1933 Act.

e. The SEC has taken the position that Weaver and Gary Plastic do not automatically exclude an instrument labeled a "deposit" from the Securities Acts, although the Memorandum of the Office of General Counsel Concerning the Application of the Federal Securities Laws to Bank Obligations Defined as Deposits (Apr. 14, 1989) and SEC General Counsel Letter, dated Apr. 14, 1989, recognize that FDIC insurance of bank instruments "substantially increases" the likelihood that courts will find that the instruments are not "securities".

(i) The SEC has refused to issue no-action letters for certain investment or marketing programs involving CDs. See, e.g., Anderson & Strudwick (avail. Jan. 11, 1989); Kemper Financial Services (avail. Nov. 29, 1985).

(ii) CDs purchased by a broker on behalf of fiduciary accounts were held to be "securities" under the Securities Acts where they were actively traded in the context of alleged "churning". Olson v. E.F. Hutton & Co., 957 F.2d 622 (8th Cir. 1992).

(iii) However, the SEC granted no-action requests regarding "investment strategies" in which a broker solicits investors to buy CDs and shares of mutual funds, where the CDs and shares are sold as independent investments and there is no promise to maintain a secondary market in the CDs or otherwise enhance the purchaser's investment. See, e.g., Old Stone Bank (avail. Sept. 21, 1988); Union Planters National Bank (avail. Aug. 10, 1987). Compare, e.g., Lincoln Federal Savings & Loan (avail. Jan. 8, 1985); Piette & Assoc. (avail. Sept. 17, 1981); Prudential American Securities (avail. Jan. 26, 1975). See also Part IV.A.3 above.

f. Under Gary Plastic and related SEC interpretations, the context of a CD sale is important. To avoid a "securities" characterization, it would be helpful if (i) the CDs sold are not specially created and issued for the broker's customers, and do not have interest rates higher or lower than those of comparable CDs of the issuer (although this may be the least important factor), (ii) the broker does not take undisclosed commissions, (iii) the broker does not undertake to create a secondary market or to repurchase CDs, and (iv) the broker does not induce CD purchasers to rely on the broker's managerial or financial expertise in the selection of CD issuers. See generally, e.g., Letter No. 922 (deposit note program found unlike that in Gary Plastic).

6. Bankers' Acceptances

BAs (drafts drawn on a bank that the bank agrees to pay) are apparently "securities" under the 1933 Act (albeit "exempt securities" under § 3(a)(2)), but, if they have a maturity of 9 months or less, not under the 1934 Act. Mishkin v. Peat Marwick, 744 F. Supp. 531 (SDNY 1990) ("Mishkin"), held that participations in such BAs were not "securities" for purposes of the 1934 Act because participations had no identity separate from that of the underlying BAs. See also Part X.C.3 below.

For an overview of BA issues and regulation, see, e.g., Comptroller's Handbook: Trade Finance.

B. EMPOWERMENTS

1. Financial Holding Companies and Financial Subsidiaries

a. FHCs and financial subsidiaries may engage under Gramm-Leach in underwriting, dealing, market-making, brokerage and agency placement activities respecting CDs of every type and nature, as well as in the structuring and marketing of such CDs (and Dodd-Frank should not, in general, affect these powers). See Part I, Part II and Part III above.

b. Depending on the nature of the arrangements respecting the offer and sale of CDs, as well as the nature of the issuer (e.g., an affiliated bank, a U.S. or non-U.S. bank, etc.), issues could arise as to whether the FHC or financial subsidiary is acting in a "representational" capacity on behalf of the issuing bank, requiring compliance with federal (see, e.g., 12 C.F.R. §§ 211.21(x), 211.24; Part I.C.4.b above) or state law relating to the licensing of "representative offices".

2. Bank Holding Companies and Banks

a. CDs and BAs are not Glass-Steagall "securities"; accordingly, BHCs and banks may underwrite and deal in such instruments (and Dodd-Frank should not, in general, affect these powers). See Part I, Part II and Part III above.

(i) Selected Board precedents: 12 C.F.R. § 225.28(b)(8)(ii); CGS Order; Board General Counsel Letter, dated Feb. 12, 1986 (the "Board CD Letter").

(ii) Selected Comptroller precedents: Comptroller's Handbook: Risk Management of Financial Derivatives; Letters No. 922 (deposit notes); No. 778 (placement of funds, as agent, in FX time deposits in foreign banks); Comptroller Interpretive Letter No. 497 (Dec. 20, 1989), CCH Fed. Bank L. Rep. ¶ 83,088; Comptroller Investment Securities Letter No. 32 (Dec. 2, 1988) ("Letter No. 32(88)"), CCH Fed. Banking L. Rep. ¶ 83,038; Decision of the Comptroller on the Request to Offer the Chase Market Index Investment Deposit Account [the "Chase CD"] (Aug. 8, 1988) (the

"Comptroller Chase CD Decision"); Letter No. 385; Comptroller Interpretive Letter No. 272 (Aug. 4, 1983) ("Letter No. 272"), CCH Fed. Banking L. Rep. ¶ 85,436; Comptroller Letter, dated Dec. 29, 1971.

b. In none of the Orders or Letters relating to CDs has the Board or Comptroller articulated a distinction for Glass-Steagall purposes between long-term or short-term CDs, between CDs of U.S. or non-U.S. banks, or between "traditional" and equity- or commodity-linked CDs, nor does Regulation Y contain any statement concerning the nature or nationality of the CD or CD issuer.

c. BHC/bank CD brokering and agency placement is also permissible. See, e.g., 12 C.F.R. § 228.28(b)(7); Board CD Letter; Letter No. 32; FDIC-99-6 (Aug. 18, 1999) ("FDIC-99-6"), CCH Fed. Banking L. Rep. ¶ 82-240 (transactions in CDs with maturities less than 9 months exempt from 12 C.F.R. Part 344 FDIC securities transaction rules). See also Part VI and Part IX.A below.

d. The GLBA Push-out Provisions do not affect the ability of banks to broker or deal in CDs. See generally Part II.C and Part II.D.3 above and Part IX.B.3 below.

e. With respect to possible "representative office" issues, see Part IV.B.1.b above.

C. NON-STANDARD CDS

1. The Chase CD and Similar Products with Interest or Principal at Risk

a. In 1987, Chase Bank introduced the Chase CD, a deposit account paying interest based on gains in the S&P 500®-stock index (the "S&P Index"): Chase Introduces: An Investment Breakthrough! (Bank pamphlet). The Bank stated that it would hedge its liabilities under the CDs primarily with S&P Index futures and options. See Part II above.

b. Bank equity-linked CDs and related notes (whether issued or guaranteed by a bank) include those where the principal could vary with stock market results. See, e.g., NYBD Letters, Jan. 12, 2005 (SPV notes, both with and without principal protection, guaranteed by the NY branch of a foreign bank), Dec. 24, 2004 (equity-linked deposits and notes that have a portion of principal at risk may be sold to institutional investors and high net worth individuals); "The Banker's Guide to Equity-Linked [CDs]", Journal of Derivatives (Winter 1993); Bloomberg, Feb. 14, 2012.

c. Many banks issue equity-linked and other structured CDs. See, e.g., Morgan Stanley Bank Disclosure Statement dated October 2015 (return linked to the performance of the S&P 500 Daily Risk Control 10% Index); Goldman Sachs Bank USA Disclosure Statement Supplement dated May 2015 (return linked to the performance of an index tracking a basket of equity, debt, commodity, real estate and other exchange-traded fund components, and a money market position.); JPMorgan Chase Bank, N.A. Disclosure Supplement dated May 31, 2016 (return linked to the performance of an index tracking a basket of equity, debt, commodity, real estate and other exchange traded fund components); BMO Harris Bank N.A. Marketing Materials dated February 2016 (return linked to a basket of 10 large-cap stocks); Wells Fargo Bank, N.A. Final Terms Supplement dated Mar. 5, 2015 (return linked to the performance of the S&P Index); HSBC Bank USA, N.A. Indicative Terms and Conditions, dated Jan. 14, 2015 (return linked to basket of emerging market equity indices); Bloomberg, June 22, 2010.

d. Debt instruments linked to an equity index are sometimes referred to as "hybrid instruments". Due to this hybrid nature, investors in equity-linked instruments do not earn a fixed rate of interest on their investment and, unless the instrument is principal-protected, may lose some or all of the amount they invested. See also Part IV.C.5 and Part IV.C.6 below.

e. Issues with respect to the marketing of equity-linked and other structured CDs are discussed in Part IV.A above.

2. Political Concerns and Agency Responses

a. Rep. Dingell's Letter to the Board/SEC/FDIC/Comptroller, dated Apr. 7, 1987, asked for views as to (i) whether the Chase CD was a 1933 Act "security", (ii) what part of the Chase CD was

FDIC-insured, and (iii) how Chase Bank's investment in stock index futures and options as a hedge met "safety and soundness" concerns.

b. FDIC Letter, dated May 8, 1987 (the "FDIC Chase CD Letter"), stated that the principal and the guaranteed portion of the interest accrued on the Chase CD would be covered by deposit insurance, and that hedging by means of S&P Index futures and options is consistent with bank safety and soundness.

c. Comptroller Letter, dated May 12, 1987 (the "Comptroller Chase CD Letter"), stated that (i) Chase Bank was not required to obtain the Comptroller's approval before offering the Chase CD, (ii) the acceptance of a deposit contract calling for the payment of interest determined by a market index is a legitimate banking practice, (iii) the Bank's hedging program was a "logical" means of managing exposure, and (iv) the CD was "probably" not a security. See also Comptroller Letter to FDIC, dated Oct. 20, 1998.

d. Board Letter, dated June 16, 1987, concluded that the Chase CD did not violate any statutes or regulations administered by the Board.

e. SEC Letter, dated July 2, 1987 (the "SEC Chase CD Letter"), said that the Chase CD program need not be registered under the 1933 Act. The Letter analyzed the Chase CD in the context of Weaver and Gary Plastic, although it did observe that the Chase CD could be viewed as a vehicle for participation in stock market values which could be a separate security for 1933 Act purposes. Even if the Chase CD were a "security", however, in the SEC's view it was exempt from registration by reason of 1933 Act § 3(a)(2).

3. Litigation Against the Chase CD

a. The ICI sued Chase Bank and the Comptroller challenging the Chase CD program and contending that the CD violated Glass-Steagall because it functions more like a mutual fund than a "conventional" CD. The ICI also challenged the Bank's hedging with S&P Index futures and options. ICI v. Chase Bank, No. 87-1093 (D.D.C. 1987) (the "ICI CD Action ").

b. Following a District Court holding (D.D.C., Mar. 30, 1988) that the Comptroller had not taken "final agency action" on the Chase CD, the Comptroller issued the Comptroller Chase CD Decision, which concluded that (i) the offering of the CD was a permissible banking activity; (ii) the CD was an FDIC-insured "deposit" as to which the method of calculating interest was irrelevant; (iii) the purchase and sale of S&P Index futures to hedge exposure on the CD was an "integral adjunct" to deposit-taking, consistent with safe and sound banking practices and Glass-Steagall; and (iv) neither the CD nor the futures used for hedging were Glass-Steagall "securities", and even if they were "securities", the offering of the CD did not constitute prohibited "underwriting" or "dealing".

c. In 1995, the D.C. District Court granted summary judgment to the Comptroller. 884 F. Supp. 4 (D.D.C. 1995).

4. FDIC Insurance for Non-standard CDs

a. Prior to the Chase CD, the FDIC found that "Indexed Deposit Accounts" bearing interest based in part on the S&P Index were insured deposits within FDIA limits. The method by which interest on a deposit is calculated has no bearing on whether an obligation is a "deposit". FDIC-86-40 (Dec. 24, 1986), CCH Fed. Banking L. Rep. ¶ 81,049. See also, e.g., FDIC-04-05 (Aug. 13, 2004), CCH Fed. Banking L. Rep. ¶ 82,266 (CDs the interest on which varies based on the consumer price index); FDIC-93-31; FDIC Chase CD Letter; FDIC-86-26 (Sept. 9, 1986), CCH Fed. Banking L. Rep. ¶ 81,146.

b. "Deposit notes" (negotiable, fixed-rate instruments issued in minimum denominations of $250,000) and CDs indexed to a stock index, the price of gold or FX prices, are "deposits" for insurance purposes. FDIC-90-20; FDIC-90-19; FDIC-87-15 (Sept. 18, 1987).

c. In its Letter to Rep. Barnard, dated July 22, 1992 (the "FDIC 1992 CD Letter"), the FDIC suggested that if a bank issued an indexed deposit, putting the principal at risk "could affect whether the obligation is treated as an insurable deposit and whether it is a security subject to the federal securities laws".

d. Where the proceeds of an annuity contract between an insurance company and a plan participant are deposited with an FDIC-insured depository institution, the insurance company, not the plan participant, is the owner and insured depositor; however, the interests of the individual plan participants are entitled to separate insurance coverage. FDIC-02-01 (Feb. 19, 2002), CCH Fed. Banking L. Rep. ¶ 82-251.

5. Other Non-standard CDs

a. Banks have structured and issued many types of deposit instruments whose principal or interest depends on stock market returns or which are linked to particular credit risks or the performance of specific securities. See Part II.E.3.f above.

It is not clear whether a CD, the principal of which is based on such factors, should be characterized as a "security" for securities law purposes. See, e.g., FDIC 1992 CD Letter. See also Part IV.C.5.c.iv below.

b. In Letter No. 649, the Comptroller permitted Blackfeet to offer a Retirement CD as part of the business of banking. See also Part I.D.4 above.

(i) In the Blackfeet Appeal, however, the U.S. Court of Appeals for the Eleventh Circuit invalidated Letter No. 649, distinguishing VALIC as involving the ability of a national bank to broker annuities, an activity which the Court viewed as different from the ability of a national bank to underwrite a Retirement CD. The Court of Appeals concluded that the "risk shifting" and "use of actuarial tables" which the CD entails "necessitates the exclusion of the Retirement CD from the business of banking and its inclusion in the business of insurance". The Supreme Court denied Blackfeet's petition for certiorari. 528 U.S. 1004 (1999).

(ii) The FDIC confirmed that the Retirement CD's principal and accrued interest would be an FDIA insured "deposit"; however, FDIC insurance would not extend to the bank's commitment to make annuity-like payments. FDIC Letter No. 94-31 (May 12, 1994), CCH Fed. Banking L. Rep. ¶ 81,751.

NSMIA § 2614 amended 12 U.S.C. § 1813(l)(5)(c)to provide that tax-deferred annuity contracts issued after enactment are not "deposits" under the FDIA and, therefore, are not insured.

(iii) IRS regulations eliminated tax-deferred treatment of the Retirement CDs' interest accumulation. 63 Fed. Reg. 1054 (Jan. 8, 1998). Blackfeet sued to set aside the IRS notice of proposed rulemaking, but the Court refused to do so. Blackfeet v. Rubin, 890 F. Supp. 48 (D.D.C.), aff'd, 67 F.3d 972 (D.D.C. 1995).

c. Other non-standard CDs have been offered. Some are similar to the Chase CD and all raise banking, commodities, tax and securities law issues. See also Part IV.C.6 below.

(i) Some banks offer "inflation-protected" CDs, called "CDIPs", for which the principal amount of the deposit is adjusted periodically to reflect changes in inflation, as well as "Inflation Floater" CDs called "IFCDs" which pay a monthly coupon that changes periodically based on the rate of inflation. Interest and principal on CDIPs/IFCDs are considered insured deposits; however, because any additional interest paid at maturity (in the case of CDIPs) or on an interest payment date (in the case of IFCDs) is considered contingent, it may not be eligible for FDIC insurance if the issuing bank fails before the payment due date. See, e.g., Letter No. 1079.

(ii) College Savings Bank of Princeton offered a "College-Sure" CD pegged to the Independent College 500 Index, based on the average tuition, room and board at the 500 most expensive U.S. colleges. The Bank obtained patents (U.S. Patent No. 4.722.055, "Methods and Apparatus for Funding Liability of Uncertain

Costs") to protect the algorithms and methodologies used.

In 1996, College Savings Bank sued Florida's Prepaid Postsecondary Education Expense Program for allegedly infringing the Bank's patent under the Patent Act, 35 U.S.C. §§ 271(h), 296(a), and violating the Lanham Act, 15 U.S.C. § 1125(a), through "false and misleading claims" in its promotional materials. The District Court dismissed the Lanham Act claims, but not the Patent Act claim. Although the Court of Appeals affirmed the District Court's decision not to dismiss the Patent Act claim, the Supreme Court reversed in a 5-4 decision, declaring the Patent Act's abrogation of state sovereign immunity invalid. College Savings Bank v. Prepaid Postsecondary Education Expense Program, 948 F. Supp. 400 (D. N.J. 1996), aff'd, 131 F.3d 353 (3d Cir. 1997), rev'd, 527 U.S. 627 (1999).

(iii) Financial firms were at increased risk of patent infringement lawsuits after State Street Bank v. Signature Financial Group, 149 F. 3d 1368 (Fed. Cir. 1998), cert. denied, 525 U.S. 1093 (1999) (data processing system for pooling mutual funds in a partnership characterized as a product that could be patented, and not a "method of doing business", which could not). However, the American Inventor Protection Act, Pub. L. 106-113, Appendix I, Title IV (1999), reduced such legal exposure. The Act shields from patent infringement suits any bank, securities firm or other company that has commercially used a product or process for at least a year before another company applies for a patent on it.

(iv) Although national banks may link the principal amount of a federally insured deposit to a general price index, the Comptroller expressed a number of "supervisory concerns" that banks should address (e.g., avoiding significant mismatches of indexed assets and liabilities, developing risk-management techniques and improving disclosure). Letter to Rep. Barnard, dated July 13, 1992.

(v) Banks have also issued CDs with the interest rates dependent on "non-traditional" variables, such as the value of silver or sports results. See, e.g., Derivatives Week, July 23, 2007.

6. CFTC Regulation

a. The CFTC's Advance Notice of Proposed Rulemaking Respecting Hybrid Instruments, 52 Fed. Reg. 47022 (Dec. 11, 1987), asserted that the CFTC has jurisdiction over a broad range of hybrid instruments, including CDs and bank loans, with more than de minimis commodity elements.

The CFTC solicited the comments of the Board and the Comptroller as to their practices in connection with bank sales of hybrid instruments. The bank regulators described their authority and practices as to financial integrity, advertising, disclosure and consumer protection. See Comptroller Letter to the CFTC, dated Dec. 14, 1988; Board Letter to the CFTC, dated Nov. 21, 1988.

b. The CFTC subsequently adopted administrative interpretations and exemptions that permitted hybrid debt and depository instruments to be sold without being subject to CEA regulation. See 54 Fed. Reg. 1139 (Jan. 11, 1989), 55 Fed. Reg. 13582 (Apr. 11, 1990) (the "Statutory Interpretation"); 17 C.F.R. Part 34 (the "Hybrid Exemption"). These precedents imposed significant constraints on the economic terms of hybrid instruments.

c. The CFMA excluded qualifying hybrid instruments from CEA regulation, superseding the Statutory Interpretation and the Hybrid Exemption.

Under the CFMA, a "hybrid instrument" that is "predominantly" a banking product or security is excluded from CEA regulation.

(i) A "hybrid instrument" is (A) an Identified Banking Product under the GLB Act (see Part II.C above) (without regard to the "swap agreement" clause of that definition) offered by a "bank", or (B) a security, in either case, that has "one or more payments indexed to the value, level or rate of, or providing for the delivery of, one or more commodities". ("Bank" includes a U.S. depository institution, foreign bank, trust company, federal or state credit union, Edge Act or Agreement corporation, and any subsidiary of any such entity regulated as if it were part of such entity but not registered as a broker-dealer or FCM.)

(ii) A hybrid instrument is "predominantly" a banking product or security if (A) the issuer receives the full purchase price of the instrument at issuance, (B) the holder of the instrument is not required to make any additional payments to the issuer, (C) the issuer is not subject to mark-to-market margining requirements, and (D) the instrument is not marketed as a futures contract or commodity option.

d. Under the Bank Products Act, the CFTC may not regulate a hybrid banking product unless it determines that (i) such action is in the public interest and consistent with the CEA, and (ii) the hybrid product does not satisfy the "predominantly" test described in Part IV.C.6.c.ii above. The CFTC must consult with the Board before commencing any such rulemaking.

e. The Bank Products Act also "grandfathers" from CEA regulation any banking product that (i) an appropriate banking agency certifies was commonly offered in the U.S. by any bank on or before December 5, 2000, and (ii) was not prohibited by the CEA and was not regulated by the CFTC as a futures contract or commodity option on or before such date.

f. Dodd-Frank § 725(g) exempts all Identified Banking Products from regulation by the CFTC under the CEA, but permits the appropriate federal banking agency to except from this exemption any Identified Banking Product issued by a bank under its regulatory jurisdiction if the agency determines (in consultation with the CFTC and the SEC) that the product

(i) meets the definition of a "swap" in the CEA or an "SBS" in the Securities Acts, and (ii) has become known to the trade as a swap or SBS or has been structured as an Identified Banking Product for the purpose of evading the CEA or the Securities Acts. Dodd-Frank defines "Identified Banking Product" based on the GLB Act definition without regard to the "swap agreement" prong of that definition. Pursuant to its more general anti-evasion authority under Dodd-Frank § 721(c), the CFTC has proposed to regard any agreement, contract or transaction that is willfully structured to evade any regulation under Dodd-Frank Title VII.A as a "swap". See Part II.E above.

V. LOAN NOTES AND LOAN PARTICIPATIONS

A. THE LOAN SALES MARKET

1. Introduction

a. Banks sell loan notes and loan participations to diversify risk, improve liquidity and comply with capital requirements or lending limits. The origination of loans for sale and the trading of loan instruments are important activities. In the past two decades, U.S. banks have shifted their corporate lending from loans originated-to-hold to loans originated-to-distribute. See generally, e.g., The Rise of the Originate-to-distribute Model and the Role of Banks in Financial Intermediation (FRBNY, July 17, 2012); A Guide to the U.S. Loan Market (S&P, Sept. 2013).

b. Following the onset of the global credit crisis in 2008, syndicated loan origination declined dramatically, with global origination in 2008 nearly 50% lower than in 2007, and declining an additional 42% to a 2009 low of $1.5 trillion. At that time, issuers showed a preference for high-yield bonds over institutional loans, and the size of the secondary loan market decreased as high-yield bond issuances were used to pay down outstanding loans. Since 2009, origination has recovered and surpassed pre-crisis levels. Global origination of syndicated loans in 2015 totaled $4.7 trillion, approximately half of which was U.S. issuance.

After a slow start to 2015 relative to record-setting 2014, the global syndicated loan market recovered in the second half of 2015 and gross issuance proceeds declined by only 3% relative to 2014 levels. As in 2015, the global syndicated loan market lagged in the first half of 2016. Gross issuance proceeds of $2.0 trillion in the first half of 2016 were 9% lower than proceeds for the first half of 2015.

Syndicated lending origination in the U.S. declined by approximately 6% in 2015, driven in part by a decline in U.S. leveraged lending of approximately 17%. Net new issuance in the U.S. leveraged loan market has continued to lag in the first half of 2016, though opportunistic institutional refinancing drove up gross issuances in the second quarter. Since early 2014, regulators have stepped up efforts to curb leveraged loan origination by banks, which may restrict supply. In addition to regulatory constraints, uncertainty over the timing of Federal Reserve rate hikes, market volatility due to sinking oil prices, European political uncertainty and credit concerns have motivated the leveraged lending decline. See Part V.A.4.e below.

Secondary trading of loans, including through Internet auction websites, continues to evolve, with insurers, hedge funds, mutual funds and other institutional investors fueling demand. Total syndicated loan trading volume declined significantly from 2009 to a low of $396 billion in 2012, returning to a new record $628 billion in 2014. Global syndicated loan trading volume in 2015 totaled $591 billion and maintained a similar pace in the first quarter of 2016 with a volume of $146.5 billion. The significant jump in trading in recent years has been fueled, in part, by a revival in demand for CLOs.

The third quarter of 2008 marked the beginning of a period of unprecedented volatility for the secondary market, with loan prices dropping rapidly and significantly, reflecting the turmoil in the credit markets. Mean trade prices were below 70% of par in December 2008. Relative stability returned in the second half of 2009, and trade prices relative to par rose steadily thereafter. While prices have not returned to crisis levels, the second half of 2014 saw a significant decline in prices from approximately 99% mid-year to 95.9% at year-end, and prices remained depressed in 2015 and the first half of 2016. Stress in the oil and gas sector and the expectation of rising interest rates were factors in this decline.

In January 2016, U.S. benchmark crude prices dropped below $27 for the first time since 2003 and remained below half of the July 2014 price of $100 during the first half of 2016. Low energy prices have in turn produced a sharp increase in noncurrent loans to oil and gas producers. In the first quarter of 2016, the aggregate net income reported by FDIC insured commercial banks and savings institutions declined by 1.9% relative to the first quarter of 2015, in large part due to the sharp increase in reserves taken to recognize potential losses from oil and gas sector loans. Both domestic and foreign banks expect charge-off rates on loans to the oil and gas sector to deteriorate somewhat through the end of 2016 and, in addition to expanding loss reserves, have taken a variety of measures to mitigate potential losses, including restructuring outstanding loans, requiring additional collateral, requiring minimum liquidity covenants, and otherwise tightening lending policies on new loans and lines of credit.

In addition to market forces, U.S. regulatory scrutiny has played a role in forcing banks to boost loss reserves and downgrade ratings of energy sector loans. In 2015, regulatory reviews found many loans to leveraged energy companies to be improperly rated. Regulatory reviews and guidance in late 2015 and early 2016 have emphasized more stringent standards for revolving credit facilities backed by the value of oil and gas reserves. See Prudent Risk Management of Oil and Gas Exposures, FDIC FIL-49-2016 (July 27, 2016); Comptroller's Handbook: Oil and Gas Exploration and Production Lending (Mar. 2016).

Corporate bond and commercial loan markets are converging. In particular, the secondary market for commercial loans has assumed many of the characteristics of the corporate bond market as depository institutions have moved to originating loans and collecting fees for structuring, distributing and servicing loan assets. The increased participation of institutional investors in the loan market makes the pricing of syndicated loan instruments more market-based, and "covenant-lite" loan issuances have nearly quadrupled since 2007 (to more than $380 billion in 2013). Loan and bond markets for distressed debt have, in particular, become closely integrated.

See, e.g., Loan Syndications and Trading Association ("LSTA") Newsletter, July 8, 2016; Reuters, June 30, 2016; American Banker, June 30, Apr. 22, 2016; International Financing Review, June 4, Apr. 16, 2016, Oct. 10, 2015; Banking Daily, June 2, 2016; LSTA News Release, Apr. 29, 2016; Senior Loan Officer Opinion Survey on Bank Lending Practices (Board, Apr. 2016); Corporate Financing Week, Feb. 8, 2016; Comptroller's Handbook: Oil and Gas Exploration and Production Lending (Mar. 2016); Global Syndicated Loans Review (Thomson Reuters, First Half 2016, 2015, 2Q 2015, 2014); LSTA, 2016 Loan Market Chronicle; Financial Times, Nov. 30, 2015; LSTA Secondary Trading & Settlement Study, 2Q 2015 (the "LSTA Trade Data Study"); Leveraged Finance News, Apr. 14, 2014; 2013 Survey of Credit Underwriting Practices (Comptroller, Jan. 2014); Leveraged Finance News, Nov. 18, 2013; "The Integration of Corporate Bond and Commercial Loan Markets", OECD Financial Market Trends (Oct. 2003).

2. Market Structure

a. Major purchasers of loans include U.S. and foreign banks, insurance companies, thrift institutions, pension funds, corporations, money market and other mutual funds, hedge funds, institutional investors and, increasingly (particularly in respect of leveraged loans), investment banks and loan funds. There is evidence that, even sophisticated individuals purchase loan participations.

The Shared National Credit Program -- pursuant to which the Board, OCC and FDIC review loans or loan commitments of at least $20 million that are shared by three or more unaffiliated, federally supervised financial institutions (such loans or loan commitments, "SNC Commitments") -- has been shifted to a twice-a-year schedule starting in 2016. The 1st quarter 2016 review indicated that non-banks continue to participate disproportionately in classified and stressed credits. Although non-banks owned approximately 21.6% of the $4.1 trillion of all SNC Commitments (a share that has increased considerably since 2004 when they owned approximately 12%), they owned 60.8% of all special mention and classified SNC Commitments. The 1st quarter 2016 review also focused on leveraged lending exposure and oil and gas lending. Shared National Credits Program, 1st Quarter 2016 Review (July 2016).

Due to the recent decline in oil markets and pressure from regulators in SNC examinations, there is evidence that many bank lenders are retreating from SNC Commitments, potentially allowing non-banks to increase their market share. See, e.g., American Banker, June 30, 2016; Financial Times, Nov. 13, 2015; Wall St. J. Mar 18, 2015. See also Direct Lending in Europe: Recent Developments (Cleary Gottlieb, Feb. 22, 2016) (recent regulatory reforms permitting alternative investment funds to make direct loans, in competition with banks); "A Look at Bank Loan Performance", Liberty Street Economics (FRBNY, Oct. 16, 2013).

See generally Part V.A.1 above and Part V.A.4.e below.

b. Large commercial banks are major loan sellers. Banks may sell loans for many reasons, including to mitigate credit risk and to generate liquidity. See, e.g., Irani and Meisenzahl, "Loan Sales and Bank Liquidity Risk Management: Evidence from the U.S. Credit Register", Finance and Economic Discussion Series 2015-001 (Board, Oct. 28, 2014).

c. Investment banks act as middlemen in the market -- trading loans for their own accounts, serving as brokers, and providing research -- and play an increasing role as originators and sellers of commercial loans. Investment banks established bridge loan funds in connection with LBOs and M&A engagements and became increasingly active as arrangers and administrative, syndication and documentation agents for syndicated loans. Foreign banks, non-bank affiliates of commercial banks and finance companies are also significant market participants.

d. Commercial and investment banks strive to create, package and trade instruments designed to obtain broad market acceptance.

(i) Through such organizations as the LSTA and electronic trading platforms, these efforts have changed the structure of the loan market and important aspects of the product itself, particularly as originators create loans that are standardized in form and content (including through the use of derivative instruments to re-configure cash flows). The LSTA publishes standard terms and conditions for secondary market trading: in April 2014 it released a number of updated standard documents (purchase and sale agreements, collateral annexes and trading confirms) for both par/near par trading and distressed trading.

(ii) Rating agencies rate loans -- in some cases regardless of whether they are asked to do so by a borrower or a bank -- and bank loan indices have been created to improve secondary market liquidity.

(iii) Banks also use Internet technology to facilitate communication among lead banks, participants, borrowers and other parties to loan syndications. Dealer-based systems provide daily "mark-to-market" pricing information for loans, fostering secondary loan trading.

e. Loan participations account for 10% of cash loan trading in the U.S., and a higher percentage in Europe. See, e.g., Leveraged Finance News, July 23, 2012.

f. In 2008, the LSTA revised and republished its Code of Conduct to promote integrity, fairness, efficiency and liquidity in the syndicated loan market, and followed in 2009 with its Conflict of Interest and Confidentiality Policy. See also Bank Letter 1999 Survey. See generally Part V.A.4.d.viii below.

g. Hedge funds that invest in loans aggressively enforce covenants and other loan terms, often as a means of extracting additional profits from the loans in their portfolio. Borrowers have responded to this trend by obtaining agreements with loan agents not to sell or transfer loans to such investors.

h. Since 2008, banks have increased issuance of loans with interest rates tied to the borrower's CDS spread. This market-based pricing appears to result in lower interest rates, perhaps because reliance on an independent market indicator -- CDS spreads -- reduces monitoring costs for the issuing bank. See Ivanov, The Transformation of Banking: Tying Loan Interest Rates to Borrowers' CDS Spreads, July 11, 2014.

i. As discussed in Part VII.A below, warrants and equity-based consideration are used in connection with certain types of loan transactions. See also Part V.B.5.b below.

3. Loans and Loan Participations: Regulatory Considerations

a. Comptroller guidelines for the purchase and sale of loan participations (Comptroller's Handbook: Loan Portfolio Management) require:

(i) Written policies and procedures.

(ii) Independent credit analysis by the purchaser.

(iii) Disclosure by the seller to the purchaser of credit information on the borrower during the term of the loan. (Information is required regardless of whether the borrower is subject to SEC filing requirements. Comptroller Unpublished Letter (Dec. 18, 1985).)

(iv) Written documentation of parties' rights and obligations to buy back loans or participations.

The FDIC has also issued safety and soundness guidance in the context of the purchase of loan participations, including with regard to documentation and accounting. See, e.g., FDIC FIL-49-2015 (Nov. 6, 2015); FDIC NY Region Regulatory Teleconference: Regulatory Expectations for Loan Participations (Apr. 4, 2013); FDIC FIL-38-2012 (Sept. 12, 2012), CCH Fed. Banking L. Rep. ¶ 62-294.

See also Comptroller's Handbook: Agricultural Lending, Asset-Based Lending, Commercial Real Estate Lending, Concentrations of Credit, Credit Card Lending, Deposit-Related Credit, Floor Plan Lending, Installment Lending, Lease Financing, Mortgage Banking, Oil and Gas Exploration and Production Lending, Residential Real Estate Lending, Student Lending, Trade Finance and Services, Allowance for Loan and Lease Losses, Commercial Loans, Interest Rate Risk, Leveraged Lending, and Loan Portfolio Management.

b. The Interagency Statement on 100% Loan participations (Apr. 10, 1997) (the "Loan Participation Statement") relates to "100% participation programs" in which an institution sells 100% of a loan that it has originated.

A bank should (i) require written agreements which state the rights and limitations of originators and participants, and which state that participants are participating in loans and are not investing in a business enterprise; (ii) not target the general public through marketing efforts (and limit participants to sophisticated entities and individuals with experience in dealing with participations); (iii) structure its program only for borrowers which meet appropriate credit requirements; and (iv) allow potential loan participants to obtain and review information on the borrower to enable informed credit decisions, and state in promotional materials that the participants, and not the originator, are responsible for making the ultimate credit decision.

c. Board SR Letter 97-21 (SUP) (July 11, 1997) ("Board SR 97-21"), CCH Fed. Banking L. Rep. ¶ 37-048, concerns risk management and capital adequacy issues in secondary market credit activities, including loan participations, loan sales/purchases and asset securitizations.

d. Loan Participation Agreements: ABA/Robert Morris Assoc. Industry Guidelines include the following:

(i) Originating banks should (A) provide participants with complete, current credit information, and (B) keep bank examiners' loan classifications confidential unless the regulator approves disclosure. However, the facts underlying an examiner's loan criticisms and the originating bank's internal classifications may be furnished.

(ii) Participants should (A) exercise diligence regarding the originating bank, including as to its reputation and expertise; (B) perform their own credit analysis; (C) maintain complete, current credit information on the borrower; (D) have counsel review relevant documents;

and (E) require the originating bank to provide credit information throughout the life of the loan.

(iii) Participation agreements should (A) be structured as non-recourse sales of a share in the underlying loan, (B) limit the power of the originating bank to modify material provisions without a participant's consent, (C) provide that the insolvency of the originating bank terminates its agency and results in the assignment of all loan documents to the participants, (D) address the consequences of a participant's default, and (E) require the approval of the originating bank and all participants for any sub-participations.

See also Master Participation Agreement for Trade Transactions (Banker's Assoc. for Finance and Trade, Jan. 2008 (English Law) and Sept. 2010 (NY Law)); IFLR, Apr. 2016 (English law participations do not transfer an interest in payments under that loan, but rather give the purchaser a contractual claim for loan payments against the participation seller; by contrast, NY law participations result in a transfer of the seller's interest in the future payments).

e. For financial reporting purposes, loans held by banks can be characterized and treated as either "held for sale" or as "held for investment". See Part II.D.3.a.iii above and Part V.A.4.a below.

f. Issues with respect to disclosures relating to loans to state and local governments are discussed in Part II.B.3 above.

g. Internationally-related credit devices include note issuance facilities ("NIF"), revolving underwriting facilities ("RUF") and various derivative arrangements. See, e.g., Board BHC Supervision Manual § 2220.3.

(i) In a NIF, the borrower and its investment bank formalize procedures for the issuance of notes during the facility's duration. Bank "tender panels" may bid for notes when an issuer proposes to borrow. A variant of this structure is the "variable funding note" which is generally a revolving credit facility in note form.

(ii) In a RUF -- essentially a NIF with a firm commitment backup -- banks agree to provide the borrower with revolving credit for funds which the investment bank is unable to raise through securities sales.

h. The Board, the FDIC and the OCC released a joint statement on prudent risk management practices for commercial real estate lending activity and continue to monitor risks associated with such lending in 2016. See Statement on Prudent Risk Management for Commercial Real Estate Lending (Dec 18, 2015).

4. Selected Current Issues Respecting Loan Trading

a. Accounting Issues

(i) As part of a broader joint project, the FASB and the International Accounting Standards Board (the "IASB") released proposals on the classification of financial instruments. In July 2014, the IASB completed its project and published the final version of IFRS 9: Financial Instruments (July 24, 2014) ("IFRS 9"). IFRS 9 will be effective for accounting periods after January 1, 2018.

FASB issued its final version of Recognition and Measurement of Financial Assets and Financial Liabilities, Accounting Standards Update ("ASU") No. 2016-01 (Jan. 5, 2016) ("ASU 2016-01"). FASB did not adopt the IASB approach described below and thus FASB standards will not converge with IFRS 9. See also Accounting For Financial Instruments: Classification and Measurement: Tentative Board Decisions to Date During Redeliberation (FASB, Jan. 14, 2015); Recognition and Measurement of Financial Assets and Financial Liabilities (FASB, Feb. 14, 2013) (exposure draft).

IFRS 9 will abolish the "held for sale" and "held for investment" categories currently used, and require that loans and debt securities be categorized at the time of issuance or acquisition into one of three measurement categories: "amortized cost" (primary objective is to hold for contractual cash flows, and all cash flows are payments of principal and interest), "fair value through other comprehensive income" (primary objective is to hold for contractual cash flows and to realize changes in fair value through sale, and all cash flows are payments of principal and interest), or "fair value through net income" (all other business models and contractual terms). Early proposals from 2010 would have expanded the use of fair value accounting to nearly all loans and debt securities.

Under U.S. GAAP, loans are generally accounted for as "held for sale" or "held for investment" pursuant to Accounting Standards Codification ("ASC") 310: Receivables. Loans held for investment are accounted for at amortized cost; loans held for sale are accounted for at lower of cost or fair value. A bank may elect the "fair value option" on a loan under ASC Subtopic 825-10, and thereby account for such loan at fair value, with changes to fair value running through earnings. While earlier proposals by FASB would have required greater convergence with IFRS 9 and greater use of fair value accounting for loans, ASU 2016-01 largely left the current U.S. GAAP standards intact.

The principles updated in ASU 2016-01 are effective December 15, 2017 for fiscal years beginning thereafter for all public business entities; for all other entities, the effective date is December 15, 2018.

(ii) The FASB/IASB joint project also includes revisions to the standards for accounting for credit impairment of financial assets.

IFRS 9 will require "12-month expected loss" to be recognized in net income at the time of origination or purchase. Subsequently, "lifetime expected loss" would be recognized if credit risk increases significantly from the time of origination or purchase. Measurement of expected credit losses is to be based on reasonable and supportable information that is available without undue cost or effort, including historical, current and forecasted information.

FASB also departed from the "incurred loss" standard (i.e., recognition of credit losses when loss became probable) in favor of a forward-looking "current expected credit loss" ("CECL") model that applies to all instruments not accounted for at fair value through net income (which would generally include loans).

FASB issued its updated principles in Measurement of Credit Losses on Financial Instruments, ASU No. 2016-13 (June 16, 2016), which established the CECL concept. With regard to financial assets measured at amortized cost basis, CECL requires the asset to be valued at the amount expected to be collected over the life of the asset, thereby differing from the IFRS 9 12-month expected loss approach. This results in the recognition of expected credit losses on newly originated loans. In determining the expected credit loss, supportable forecasts regarding expected collection of the asset must be used. CECL's replacement of the incurred loss model is expected to impact banks' allowance for loan and lease losses ("ALLL") and, in the event of a large impact on ALLL, potentially bank capital adequacy. Early projections posited that aggregate ALLL could increase 30-50% while more recent projections estimate as little as 3%. The Board has indicated that it would study the issue of whether to adjust capital standards in light of CECL.

The ABA has described CECL as "the most sweeping change to bank accounting ever" and has assessed it as "pos[ing] significant compliance and operational challenges for banks." The CECL amendments are effective for public business entities that are SEC filers for fiscal years beginning after December 15, 2019. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2020. Early adoption is available in the fiscal year beginning after December 15, 2018.

See, generally, e.g., SNL, Aug. 29, 2016; Risk, Aug. 15, 2016; Banking Daily, July 22, May 6, 2016; New Credit Loss Rules Manageable for US Banks (Fitch, July 20, 2016); Joint Statement on the New Accounting Standard on Financial Instruments -- Credit Losses (Board/FDIC/NCUA/OCC, June 17, 2016); "CECL Implementation Challenges: The Life of Loan Concept" (ABA, June 2016); "CECL Highlights and Challenges" (ABA, June 2016); FASB's Current Expected Credit Loss Model for Credit Loss Accounting (CECL): Background and FAQ's for Bankers (ABA, June 2016); FASB Issues Final Standard on Accounting for Credit Losses (Deloitte, June 17, 2016); Risk, June 15, 2016 (IFRS 9 may have greater impact than new capital rules); ABA Letter to OCC/Board/FDIC, Apr. 20, 2016; ABA Letters to FASB, April 15, Jan. 13, 2016; EBA Press Release, Jan. 27, 2016 (EBA launching impact assessment of IFRS 9 on regulatory capital); ABA Letters to FASB, Jan. 13, 2015, Jan. 24, 2014; American Banker, Dec. 31, 29, Nov. 12, 9, Sept. 29, 2015; Guidance On Credit Risk and Accounting for Expected Credit Losses (Basel Committee, Dec. 2015); ICBA Letters to FASB, Dec. 15, 2015, May 30, 2013; "Impact of Expected Credit Loss Approaches on Bank Risk Disclosures" (Enhanced Disclosure Task Force, Nov. 30, 2015); "CECL – What You Can Do Now" (FRB Richmond, Nov. 9, 2015); Banking Report, Nov. 9, 2015.

(iii) There has been increased regulatory scrutiny of the accounting treatment afforded to SPEs created to shift loan assets off of a bank's balance sheet. In reviewing accounting involving SPEs, regulators consider the underlying facts to determine whether risks are really transferred to an SPE or whether such transactions mask risks which a bank retains. In general, a bank that retains a sufficient economic interest with respect to assets transferred to an SPE must consolidate such SPE's assets in its regulatory reports and financial statements.

A) Each of the Board and the SEC investigated PNC's accounting treatment of three SPEs. Private lawsuits were also filed alleging that accounting treatment of the SPEs affected the accuracy of PNC's reported financial results. See generally, e.g., Business Week, June 10, 2002; American Banker, May 9, Jan. 30, 2002; Banking Daily, Feb. 15, 2002; Wall St. J., Feb. 14, Jan. 30, 2002.

   i) The SEC issued a Cease and Desist Order finding accounting improprieties which concerned PNC's retention of a "substantial interest" in SPEs -- which were designed to buy and sell $760 million of PNC's volatile, troubled or under-performing loans and assets. The PNC SPEs failed to meet the GAAP requirements for non-consolidation. Failure to consolidate resulted in PNC overstating its earnings and misrepresenting balance sheet information related to non-performing loans. SEC Release No. 34-46225 (July 18, 2002). See also Part VIII.D below (Bank of America settlement of SEC enforcement action in respect of Bank accounting for its alliance with D.E. Shaw & Co.).

   ii) The Federal Reserve Bank of Cleveland and the Comptroller entered into Written Agreements with PNC and PNC Bank with respect to risk management, corporate governance, internal controls, credit administration and credit risk and financial safeguards (the "PNC Regulatory Agreements") (terminated Sept. 2003). PNC also entered into a Deferred Prosecution Agreement with the DOJ. See PNC SEC Forms 8-K, dated June 23, 2004, June 2, 2003. See also Part I.C.1.e above.

iii) The SEC issued a Cease and Desist Order against Ernst & Young in connection with its provision of accounting advice to PNC regarding the PNC SPEs. See SEC Release No. 34-55523 (Mar. 26, 2007).

B) Accounting standards require an entity to include subsidiaries in which it has a controlling financial interest in its consolidated financial statements. That requirement usually had been applied to subsidiaries in which an enterprise had a majority voting interest. In 2003, the FASB approved FASB Interpretation No. 46, "Consolidation of Variable Interest Entities [("VIEs")]" ("FIN 46"). See revisions to FIN 46 in FASB Statement of Financial Accounting Standards No. 167 ("FAS 167") and Accounting Standards Update No. 2015-02 ("ASU 2015-2"). ASU 2015-2 revised the FASB standards for determining whether a fee is an "insignificant interest" in a VIE and the analysis of variable interests held by two or more related parties. ASU 2015-2 also provided a separate analysis for evaluating the decision rights of equity holders in limited partnerships and similar vehicles (including member-managed limited liability companies). See, e.g., In Depth (PWC, Apr. 29, 2015).

A VIE is an SPE created for a specified purpose (e.g., to facilitate securitization, leasing, real estate development or operation, hedging, reinsurance or other transactions) which has (i) insufficient equity to finance its activities without additional financial support, (ii) equity owners as a group that are not able to make decisions about its activities, or (iii) equity that does not absorb its losses or receive its residual returns. The VIE consolidation standards apply to any public or private enterprise that has an ownership interest or contractual or other business relationship with an SPE, and were designed to prevent circumvention of accounting consolidation by a company deemed to be the VIE's "primary beneficiary". Under the FASB standards, determination of the "primary beneficiary" is a two-step process. In general, the primary beneficiary is the party determined to have (i) the power to direct the activities of the VIE that most significantly affect its economic performance, and (ii) the possibility of (A) receiving significant VIE benefits, or (B) absorbing significant VIE losses. FASB abandoned its 2011 proposal to adopt a principal and agency model for determining a VIE's primary beneficiary. See Proposed Accounting Standards Update, Consolidation (Topic 810) - Principal versus Agent Analysis (FASB 2011).

These FASB standards impact the accounting and regulatory (including risk-based capital) treatment of ABCP conduits and other off-balance sheet vehicles. See Interagency Guidance on the Eligibility of [ABCP] Liquidity Facilities and the Resulting Risk-Based Capital Treatment (Aug. 4, 2005); 69 Fed. Reg. 44908 (July 28, 2004) (final rule); 69 Fed. Reg. 22382 (Apr. 26, 2004) (interim final rule); 68 Fed. Reg. 56530 (Oct. 1, 2003) (solicitation of public comments); Comptroller Interpretive Letters No. 1099 (May 11, 2007), CCH Fed. Banking L. Rep. ¶ 81-631; No. 1098 (2007), CCH Fed. Banking L. Rep. ¶ 81-630.

i) Common approaches to conduit restructurings in response to FIN 46 included (A) consolidation of conduits on-balance sheet, (B) sale of "expected loss tranches" to avoid consolidation, and (C) forming a joint venture so that no single entity would have to consolidate the conduit.

The 2009 amendments to FIN 46 and FASB Statement of Financial Accounting Standards No. 140 ("FAS 140") contained in FAS 166 and FAS 167 (codified in FASB Accounting

Standards Updates 2009-16 and 2009-17) resulted in increased consolidation by sponsors of entities that had not previously been consolidated. The federal banking agencies addressed the capital adequacy framework in response to FAS 166 and FAS 167. See 75 Fed. Reg. 4636 (Jan. 28, 2010) (final rule). See also Securitization Accounting: The Ins and Outs (and Some Do's and Don'ts) of FAS 166, [FAS] 167, and Counting (Deloitte, Jan. 2010); Hot Topic No. 2009-21 (Ernst & Young, June 12, 2009).

ii) Board Letter, dated Jan. 26, 2004, confirms that bringing ABCP conduit liabilities onto the balance sheet of a depository institution under FIN 46 does not in and of itself make such liabilities either reservable liabilities or "demand deposits" of the institution for purposes of the Board's Regulation D (12 C.F.R. Part 204). Such Letter emphasized, however, that it should not serve as a basis for arrangements whose sole purpose is to evade reserve requirements.

(iv) Sales of loan assets are subject to FAS 140, which provides that a transfer of financial assets may not be accounted for as a sale unless certain criteria are met. In the loan participation context, a seller will want to remove the loan from its balance sheet, and the buyer will wish to ensure that in the event of the insolvency of the seller, the buyer's share of the proceeds of the underlying loan will not be viewed as property of the seller (and will not be available to the seller's creditors in the event of the seller's bankruptcy). Sellers and buyers of loan participations structure and document these transactions as sales of loan interests, rather than as financing to the seller secured by pledges of payments due on the underlying loans.

A) Amendments to FAS 140 contained in FAS 166 affected the accounting treatment of loan participations. Under FAS 166, in order for the transfer of portions of financial assets (such as loan participations) to qualify for sale accounting treatment, the transferred portion must qualify under the definition of "participating interest" and the transfer must satisfy an "isolation requirement".

i) FAS 166 defines "participating interest" to encompass the following characteristics: (a) the interest represents a proportionate ownership interest in a financial asset, (b) cash flows from the asset are divided among the participating interests in proportion to ownership, (c) the interest meets recourse and subordination limitations, and (d) neither the transferor nor any participating interest holder has the right to pledge or exchange the entire asset in which it owns a participating interest unless all holders agree.

ii) A transfer of financial assets satisfies the "isolation requirement" and may be accounted for as a sale only if: (a) the transferee has the right to pledge or exchange the transferred assets; and (b) the transferor does not maintain effective control over the transferred assets, including through (1) an agreement that entitles and obligates the transferor to repurchase or redeem the assets before maturity, (2) the ability to cause the holder to return specific assets, or (3) a repo exercisable at the transferee's option upon terms so favorable as to make exercise of the option probable.

iii) Auditing standards require "persuasive evidence" that FAS 140's isolation standard has been met. This often takes the form of a "true sale opinion" (i.e., a legal opinion that, in the event of the transferor's bankruptcy, the transfer of the financial assets would be considered to be a sale of the assets, and not a loan and, accordingly, that the assets would not be deemed property of the transferor's bankruptcy estate).

B) A number of Enron-related issues arose with respect to FAS 140. (See also Part II.E.2.e above.)

i) In re Enron, Case No. 01-16034 (SDNY Sept. 21, 2002) (First Interim Report of Examiner) (the "First Enron Examiner Report"), discussed whether Enron misused the principles of FAS 140 in transactions involving off-balance sheet SPEs. It found that a number of purported sale transactions contained features that more closely resembled a loan from the SPE to Enron than a sale of an asset from Enron to the SPE:

(a) Enron appeared to continue to exercise control over the asset.

(b) Enron appeared to continue to have the true economic benefits of the asset through various arrangements (including swaps).

(c) The principal credit basis for most of these financings appeared to be Enron's creditworthiness and not the value or anticipated cash flow of the asset. In most of the transactions, lenders did not take a security interest nor did they require delivery of legal opinions on true sale and non-consolidation.

(d) The interest rate on the debt financing was based on Enron's credit.

(e) Enron viewed the transactions as something less than sales, and treated some of the transactions as loans for tax purposes.

ii) In re Enron, Case No. 01-16034 (SDNY Jan. 21, 2003) (Second Interim Report of Examiner), reinforced the conclusions set out in the First Enron Examiner Report.

iii) In re Enron, Case No. 01-16034 (SDNY Nov. 4, 2003) (Final Report of Examiner), summarized conclusions and outlined the participation of outside institutions (including law firms, banks and an accounting firm) in Enron's FAS 140 violations.

C) First BanCorp, SEC Litigation Release No. 20227 (Aug. 7, 2007), reports a settled SEC action for the purported purchase of non-conforming mortgages from Doral Financial in transactions that were not true sales because Doral agreed to extend recourse. See also Doral Financial, SEC Litigation Release No. 19837 (Sept. 19, 2006).

D) Chinese regulators reportedly issued regulations prohibiting (i) banks from entering into repurchase agreements and other structured products that attempt to transfer bad loans, but leave the assets on the books of the bank, and (ii) asset management companies from entering into agreements with banks to temporarily warehouse loans in an effort to remove bad loans from bank balance sheets. Reuters, May 3, 2016.

(v) The Interagency Guidance on Certain Loans Held for Sale (Mar. 26, 2001) is directed towards loans that have declined in credit quality and applies when an institution decides to sell loans that were not originated or otherwise acquired with the intent to sell, and the fair value of those loans has declined for any reason other than a change in the general market level of interest or FX rates. The Guidance instructs financial institutions:

A) To report loans that are held-for-sale at the lower of cost or fair value.

B) To report reductions in the value of loans transferred to the held-for-sale portfolio through a write-down of the loan to fair value upon transfer and, at the same time, to make a charge to the institution's allowance for loan losses.

C) To recognize any decline in value of a loan after it is determined to be held-for-sale through an increase in the valuation allowance for held-for-sale loans.

D) To give loans transferred to the held-for-sale account the same past due and non-accrual treatment as other loans.

See also Part II.D.3.a.iv above.

(vi) The OCC has confirmed that lending limit analysis is independent of a transaction's accounting treatment. The sale of a participation that meets the requirements for lending limit relief under the OCC's lending limit rules qualifies for such relief even if not characterized as a sale under accounting standards. Comptroller Interpretive Letter No. 1134 (Aug. 2, 2011), CCH Fed. Banking Law Rep. ¶ 81-663.

The OCC plans to update annually its Bank Accounting Advisory Series to promote consistency in application of accounting standards among national banks and federal savings associations. Recent amendments have been related to troubled debt restructurings, contingencies, fair value accounting, loans held for sale and OREO. Comptroller Bank Accounting Advisory Series (Aug. 2016).

(vii) FASB'S ASU No. 2016-02 (Feb. 25, 2016) requires lessees to change their accounting for operating leases (formerly off-balance sheet) by recognizing assets and liabilities on balance sheet for leases with terms of more than 12 months. The ABA estimates that the standard could add billions in assets and liabilities to bank balance sheets and could impact bank regulatory capital and leverage ratios. See ABA Banking Journal, Nov. 12, 2015.

(viii) In April 2016, the Treasury and IRS proposed regulations under section 385 of the Internal Revenue Code (the "IRC") that would classify certain intragroup loans as equity for U.S. tax purposes. The proposed regulations include four key components. First, the "Basic Rule" would treat an intragroup loan as equity if the borrower does not receive cash proceeds from the lender. Second, as a means of preventing circumvention of the Basic Rule, the "Funding Rule" would provide that a related-party loan will be treated as equity to the extent the borrower has made a distribution (or purchased stock of a group member or acquired assets in an asset reorganization) during the 36 months preceding the date of the loan, and will become equity if, when and to the extent the borrower makes a distribution (or purchases stock of a group member or acquires assets in an asset reorganization) during the 36 months following the date of the loan. The Basic Rule and the Funding Rule may affect any transaction occurring on or after April 4, 2016. Third, the "Documentation Rule" would impose detailed new requirements to be satisfied as a precondition to classifying a related-party loan as debt. The Documentation Rule is by its terms effective only for debt issued after the regulations are issued in final form. Fourth, under the "Bifurcation Rule," the IRS would have the authority to bifurcate a related-party loan and treat part of it as equity if it is reasonable to believe only part of the debt could be repaid. Like the Documentation Rule, the Bifurcation Rule will take effect generally only for debt issued after the regulations are issued in final form.

Commenters have argued that the proposed regulations would interfere with the ability of banks and broker-dealers to perform core financing functions in the ordinary course of business. Intercompany debts allow banks and broker-dealer to satisfy financing demands of customers at lower cost and reduced risk. The regulatory regimes applicable to banks and broker-dealers already constrain the use of related-party debt and also require banks and broker-dealers to include intercompany debt in their capital structures to meet supervisory objectives. Consequently, commenters have proposed an exception for regulated banks and broker-dealers and that the Documentation Rule be modified to ease the burden on banks and broker-dealers. See, e.g., Letter from Citigroup Inc., Bank of America Corp., and JPMorgan Chase & Co., July 7, 2016; Banking Daily, May 31, 2016; Not Just Inversions: Proposed Changes in the Tax Treatment of Related-Party Debt Will Affect M&A Transactions, Restructurings and Financings (Cleary Gottlieb, Apr. 11, 2016); 81 Fed. Reg. 20912 (Apr. 8, 2016).

(ix) Selected Enforcement Actions Related to Accounting

A) Fifth Third Bancorp, SEC Press Release 2013-255 (Dec. 4, 2013), reports a settled SEC action relating to the accounting treatment of commercial real estate loans held by Fifth Third. The settlement order included findings that Fifth Third continued to classify certain pools of non-performing CRE loans as "held for investment" after deciding to sell them and that proper classification of these loans as "held for sale" would have resulted in marking the loans to fair value and increasing Fifth Third's pretax losses for that quarter.

B) In 2014, the SEC imposed a fine and remedial sanctions on Wilmington Trust for failure to report matured construction loans as "past due" in accordance with accounting rules, and for internally approving extensions of troubled loans without updated underwriting criteria and despite difficulties in extension negotiations with borrowers. Wilmington Trust, SEC Admin. Proc. No. 3-16098 (Sept. 11, 2014). Nevertheless, Wilmington Trust was also subjected to a criminal indictment in connection with the indictment of former senior bank executives for concealing from the Board, the SEC and the public the total quantity of past due loans, and failing to report past due loans as required in its Call Reports, Form 10-Ks and Form 10-Qs. The indictment also alleges that Wilmington Trust engaged in further concealment in connection with Board examinations. See United States v. Gibson et al., No. 15-23-RGA (D. Del. Jan. 6, 2016) (second superseding indictment).

C) See also In the Matter of Thomas Nelly, Jr., Board Docket Nos. 14-020-E-1, 14-020-CMP-1 (Oct. 16, 2015) (fine and banking industry prohibition imposed on former Regions Bank executive for involvement in reporting nonaccrual loans as performing loans and knowingly misleading bank examiners); Trinity Capital Corp., SEC Admin. Proc. No. 3-16837 (Sept. 28, 2015) (fine imposed for materially misstating ALLL and understating OREO in financial reports filed with the SEC due to failure to properly grade, identify and measure impaired loans); Hampton Roads Bankshares, SEC Admin. Proc. No. 3-16296 (Dec. 5, 2014) (continued deterioration, and expected deterioration, of loan portfolio should have resulted in reduction of deferred tax asset); Mercantile Bancorp, SEC Press Release 2013-196 (Sept. 24, 2013) (settlement of charges that bank executives knew of a decline in borrower financial condition and collateral value in a large loan and failed to recognize a loss).

b. LDC Debt Market and Other Distressed Credits

Banks are major traders in debt of less developed countries ("LDC Debt"), including loans, loan participations, Brady bonds and securities backed by such loans. This relatively unstructured and unregulated market is quite substantial. See, e.g., Comptroller's Handbook: Emerging Market Country Products and Trading Activities (discussing unique aspects of emerging markets; board and senior management oversight; strategic, credit, liquidity, price, FX, transaction and compliance risk; accounting principles; examination objectives and procedures); Emerging Markets Traders Association ["EMTA"] Trading Volume Survey Reports.

(i) LDC Debt trading had been tainted by allegations of bribery, market manipulation, "front-running", trading on inside information and other wrongdoing (including violations of state law). See, e.g., SEC v. Barclays Bank (SDNY June 4, 2007) (final judgment), and Barclays Bank, SEC Litigation Release No. 20132 (May 30, 2007) (together, "SEC v. Barclays Bank") (alleged insider trading in distressed debt); Government's Sentencing Memorandum, dated Jan. 10, 1997, in U.S. v. Gomez (SDNY 96 Cr. 169 (MBM)); New York v. Young (NY Sup. Ct., Aug. 25, 1994); In re Young, Docket No. 93-032 (Board Order filed Nov. 17, 1994).

(ii) The EMTA Code of Conduct respecting LDC Debt trading includes standards relating to (A) disclosure of the identity of the trader and the capacity in which it is acting; (B) policies respecting training, supervision, documentation, recordkeeping, risk management, disclosure, confidentiality, internal controls and employee transactions; (C) establishment, maintenance and enforcement of procedures to prevent the misuse of inside information; and (D) avoidance of price manipulation and conflicts of interest. See also Board Letter, dated Sept. 29, 1995 (EMTA joint-trade confirmation and matching system (Match-EM) under Regulation H) (the "Board Match-EM Letter").

(iii) To address inconsistencies across jurisdictions, the Basel Committee proposed guidelines for common definitions of "non-performing exposures" and "forbearance". The definition of non-performing exposures offers criteria for categorizing loans and debt securities that are centered around delinquency status (90 days past due) and the likelihood of repayment. The definition of forbearance provides a harmonized view on bank concessions, modifications or refinancings of loans and debt securities resulting from a borrower's financial difficulty. Guidelines: Prudential Treatment of Problem Assets – Definitions of Non-performing Exposures and Forbearance (Basel Committee, July 15, 2016). See also Draft Guidance to Banks on Non-Performing Loans (ECB, Sept. 2016); Report on the Dynamics and Drivers of Non-Performing Exposures in the EU Banking Sector (EBA, July 22, 2016).

(iv) The LSTA has issued Model Purchase and Sale Agreements for distressed loans (including original assignments and secondary assignments). The LSTA has also approved a Form of Distressed Trade Confirmation and Standard Terms and Conditions for Distressed Trade Confirmations. See also SIFMA Distressed Debt Committee Practice Guidelines for Trading in Distressed Bonds.

(v) The Board has recognized the potential for balance sheet improvement through transactions where a bank disposes of problem assets by exchanging them for performing assets. The Board has, however, expressed safety and soundness concerns regarding these transactions and issued guidance that directs banks and examiners to consider a number of factors, including (A) up front due diligence and valuation of the assets being acquired; (B) due diligence of the parties involved, including any relationships or cross-ownership; (C) appropriate accounting treatment of both the assets being disposed and those being acquired; and (D) whether the bank has the servicing and other expertise to manage the new assets, particularly if they are in a geographic area or business segment that the bank does not traditionally service. Board SR Letter 11-15 (Dec. 21, 2011), CCH Fed. Banking L. Rep. ¶ 62-080A.

(vi) The purchase or assignment of distressed credits may constitute "champertous" conduct under state law if such purchase or assignment is made with the intent and for the purpose of bringing an action or proceeding, and the applicable state law does not exempt purchasers of bonds from champerty prosecutions.

(vii) Bankruptcy proceedings of distressed debt obligors can add uncertainty and complexity to investments in distressed debt and bankruptcy courts often disfavor purchasers of distressed debt. Many borrowers negotiate contract provisions intended to prevent assignments of their debt to distressed debt traders. Bankruptcy courts may subordinate or disallow claims because of conduct of the original creditor or the purchaser of the distressed credit. See, e.g., In re KB Toys Inc., 736 F.3d 247 (3d Cir. 2013) (assigned claims disallowed because of preferential transfer by original creditor; sophisticated purchasers should have known of possibility of disallowance); Lightsquared LP v. SP Special Opportunities LLC, 511 B.R. 253 (Bankr. SDNY 2014) (purchases of debt by competitor structured through anonymous SPV violated competitor's duty of good faith in bankruptcy proceedings and under contract; intentional delays violated good faith duty of competitor as bankruptcy proceeding participant; equitable subordination ordered).

c. Loan Pooling and Related Securitization Issues

(i) Bank efforts to securitize commercial loan pools had limited success. Since major impediments to securitization of commercial loans are a lack of information to allow investors to assess the credit risk of such loans and the fact that commercial loans are frequently evaluated on a case-by-case basis, the greatest likelihood of successful pooling relates to commercial real estate loans or commercial loans with standard contractual provisions and collateral (such as leases and trade receivables). See also Part X below.

A) With the passage of Dodd-Frank, loan pooling and securitizations, including CLOs, are subject to risk retention requirements applicable to ABS. See Part X below.

B) Bank ABCP programs peaked at approximately \$1.2 trillion in 2007, representing approximately 53% of total CP outstanding. However, the amount of ABCP outstanding fell precipitously to \$450 billion in 2009 and has generally continued to decline, to \$240 billion in June 2016, representing approximately 23% of total CP outstanding. See [CP] Rates and Outstanding (Board Statistical Release, July 7, 2016); ABCP Outstanding Economic Data (FRB St. Louis, July 6, 2016); "[ABCP] Programs", 78 Fed. Res. Bull. 107 (1992).

C) Comptroller's Handbook: Asset-Based Lending (Mar. 2014) sets forth guidance regarding asset-based lending (i.e., fully collateralized credit facilities often backed by pools of receivables). The Handbook:

   i) Identifies credit risk as the most significant risk associated with asset-based lending, in part because characteristics such as erratic cash flows, rapid growth or high leverage are common among asset-based borrowers.

   ii) States that there is a heightened risk of loss due to operational failure as compared to other forms of lending, in part due to the reliance on collateral and the need to understand a borrower's operating cycle.

   iii) Discusses strategic risk and the need to invest in the systems and personnel necessary to maintain a sound and profitable lending operation, noting that banks that purchase participations in asset-based lending transactions should perform the same analysis as though the bank had originated the loans.

iv) Describes requirements and suggested practices for asset-based lending policies, borrower analysis, establishing the borrowing base (i.e., the collateral value against which the bank is lending), controls (e.g., collateral appraisals and field audits), evaluating third-party guarantees or insurance, administering asset-based loans, and problem loan management.

v) Discusses credit risk rating considerations for examiners.

D) Pools of "high yield securities" (or "junk bonds"), particularly those issued in highly leveraged transactions ("HLTs"), may be securitized through the creation of "collateralized bond obligations" ("CBOs"), and large, high-yield corporate loans may be securitized to create CLOs. The success of loan pooling/securitization efforts depends in part on the creation of a mechanism to address HLT loan covenants and irregular payment structures. See also Part V.A.4.e below.

E) In 2014, CLO issuance set a new record of $115 billion and issuance for the first half of 2015 was slightly below the first half of 2014. This resurgence prompted some concern about the complexity of these securitizations and their similarity to the CDOs at the heart of the 2007 financial crisis. For example, effective April 2013, the FDIC deposit insurance assessment for a bank treats interests in securitizations of "higher risk" assets the same as direct interests in those higher risk assets, notwithstanding the credit protection benefit of holding a senior tranche in such a securitization. This change in assessment appears to have reduced significantly bank appetite for the senior-most CLO tranches. The sale of new CLOs declined sharply in the first quarter of 2016 to $8.2 billion, the slowest stretch since 2012, in the face of regulatory uncertainty (e.g., the risk retention rules) and credit market volatility. See Bloomberg, Apr. 13, 2016; Research Quarterly (SIFMA, 2Q 2015); Reuters, Dec. 18, 2014; 77 Fed. Reg. 66000 (Oct. 31, 2012). See also, e.g., Bloomberg, Aug. 28, 2014; Business Insider, Aug. 21, 2013.

F) Harder to securitize commercial loans may make their way into "private" CLOs, characterized by proprietary structures, lack of public or even Rule 144A distribution, few participants, and at times the right of participants (rather than an asset manager) to approve the loans in the pool. See, e.g., American Banker, Mar. 5, 2012.

G) Commercial loan securitization can come under criticism from corporate treasurers on the grounds that such a securitization alters the relationship between a bank and its customers and that, if banks simply securitize their loans, borrowers might as well go directly to the capital markets (or, at least, receive some portion of the securitization profits). In addition, unrated or non-public corporate borrowers fear that their confidential information will be disclosed to rating agencies and investors.

(ii) The "Small Business Loan Securitization and Secondary Market Enhancement Act", Pub. L. 103-325 (1994), permits banks to invest in securities backed by small business loan pools. The ARRA contains two programs designed to stimulate the secondary market for small business loans: (A) a lending facility for "systemically important SBA secondary market broker-dealers", to provide inventory financing for government-guaranteed small business loan pools; and (B) an "SBA secondary market guarantee authority" to provide a federal guarantee for previously unguaranteed loans that are sold on the secondary market. See also, e.g., Board Report to the Congress on the Availability of Credit to Small Businesses (Sept. 2002) (including small business loan securitization) (the "Board 2002 Small Business Loan Report"); Board/SEC Report to the Congress on Markets for Small Business- and Commercial Mortgage-related Securities (Sept. 2000) (the "Board/SEC 2000 Small Business Loan Report"); Reuters, Apr. 11, 2014 (first French issuance of notes backed by loans to small and medium enterprises). See also Part X below.

(iii) The securitization of "non-prime" or "sub-prime" loans (i.e., loans to borrowers with weak credit histories) was not common until the mid-1990s. By 2006, however, an estimated 73% of sub-prime loans, worth approximately $450 billion, were securitized and sold on the secondary market. Origination and securitization of sub-prime loans came to a complete halt after the first quarter of 2008 and has not returned since, as investor demand dried up amid serious problems with these assets. The turmoil in the credit markets in 2007-2009 that began with the rising default levels in the sub-prime mortgage market exposed a number of weaknesses in the loan origination process.

Loan purchasers and investors in securities backed by sub-prime loans focused increasingly on the issues and concerns associated with "predatory lending" and "assignee liability". These concerns also contributed to the virtual elimination of the market for "private label" (non-GSE issued) securitizations of residential mortgages, although there has been some issuance in recent years. See, e.g., Wall St. J., Jan. 18, 2016; SIFMA, The US Private Label [MBS] Market in 2015, July 1, 2015; Financial Times, Sept. 22, 2014, Feb. 22, 2013; Securitization and Mortgage Default, FRB Philadelphia, Working Paper No. 09-21 (Sept. 2009). See also Part X below.

A) "Predatory lending" refers to abusive lending practices involving fraud, deception or unfairness. While sub-prime loans can serve a social and economic function, since such loans frequently carry high interest rates or fees as compensation to the lender for assuming greater risk of default (and since sub-prime borrowers tend to be the target of abusive lending practices), the line between "sub-prime" and "predatory" loans is not always clear.

B) Federal and state laws address predatory lending. The Home Ownership Equity Protection Act, 15 U.S.C. § 1641(c) ("HOEPA"), imposes disclosure requirements and substantive limitations on home equity loans which bear rates or fees above a certain amount. HOEPA and state predatory lending laws impose liability to varying degrees on assignees of loans that were originated in violation of such laws. Borrowers may also seek to assert a claim against loan assignees on the basis of common law theories (such as "aiding and abetting" violations of law, and civil conspiracy). See, e.g., 12 C.F.R. § 226.34 and adopting release (66 Fed. Reg. 65604 (Dec. 20, 2001)) (with limited exceptions, assignees are subject to "all claims and defenses" with respect to a mortgage that the borrower could assert against originating lenders under HOEPA).

C) The Helping Families Save Their Homes Act, 15 U.S.C. § 1641(g), requires any person that acquires a consumer mortgage loan or home equity loan to notify the borrower of the transfer within 30 days. Acquirors are exempt from the notification requirement if they transfer the loan within 30 days. See 12 C.F.R. § 226.39 and adopting release (74 Fed. Reg. 60143 (Nov. 20, 2009)).

D) Risk has increased for loan purchasers (including in a securitization) due to the growing number of states with laws providing for "assignee liability". See, e.g., In re Enron, 379 B.R. 425 (SDNY 2007) (opinion and order) (equitable subordination may be applied to claims held by transferees, based on the misconduct of their transferors); Associates Home Equity Services v. Troup, 778 A.2d 529 (N.J. Super. Ct. App. Div. 2001) (borrower may raise a defense against a loan purchaser in respect of payment on a loan under the doctrine of "equitable recoupment" based on "predatory lending" by the loan seller); BTCo v. Payne, 188 Misc. 2d 726 (NY Sup. Ct. 2001) (plaintiff trustee for a trust holding a loan is not entitled to judgment in a mortgage foreclosure action where loan fraud and HOEPA violations by the loan originator and seller are alleged); Lopez v. Delta Funding, 1998 U.S. Dist. LEXIS 23318 (EDNY 1998) (defendants -- including the trustee for the trust holding loans in a securitization -- enjoined from proceeding with foreclosure sales because borrower-plaintiffs demonstrated a likelihood that they can prove that their mortgage loans, originated and sold by Delta Funding, violated HOEPA).

E) The 2nd Circuit, in Madden v. Midland Funding, 786 F.3d. 246 (2d Cir. 2015), reh. denied, No. 14-2131 (2d. Cir. Aug. 12, 2015), cert. denied, 136 S. Ct. 2505 (2016) ("Madden") held that the NBA does not preempt the application of state usury laws to a non-bank purchaser of a debt originated by a national bank. The 2nd Circuit held that debt collector Midland, which had purchased charged-off credit card accounts originated by a national bank, could not rely on federal preemption under the NBA to avoid the application of state usury laws, notwithstanding that Midland was attempting to collect at the same rate that applied when the bank held the accounts. The court opined that applying state usury law to the loans purchased by Midland would not prevent or significantly interfere with any national bank's exercise of its powers under the NBA, and therefore that Madden's claims against Midland under such law are not preempted.

In petitions for a rehearing en banc and for certiorari (both of which were denied), Midland and the many amici briefs filed by industry participants characterized the decision as inconsistent with decisions in other circuits and the longstanding "cardinal rule" of usury law that the determination of whether a loan is usurious occurs at the time of origination (the "valid when made" doctrine). The Supreme Court denied Midland's request for certiorari, following recommendation of denial in an amicus brief filed by the U.S. Solicitor General at the Supreme Court's request. The brief indicated that the 2nd Circuit had decided the case incorrectly and failed to understand that "a national bank's Section 85 authority to charge interest up to the maximum permitted by its home State encompasses the power to convey to an assignee the right to enforce the interest-rate term of the agreement." However, the Solicitor General recommended denial of certiorari because of lack of a circuit split, key aspects of the preemption analysis were not initially presented to the 2nd Circuit and Midland may prevail on remand. Thus, until there is binding precedent overturning the 2nd Circuit's decision, the secondary market for bank originated debt will remain in a state of uncertainty, though the view expressed by the brief of the Solicitor General should provide some comfort. See Midland Funding, LLC v. Madden, No. 15-610 (US May 24, 2016) (Brief for the United States as Amicus Curiae).

See also, e.g., Comptroller Interpretive Letter No. 1016 (Jan. 14, 2005), CCH Fed. Banking L. Rep. ¶ 81-542 (neither 12 C.F.R. § 34.4 nor the NBA preempts application of state consumer fraud laws to loans simply because they were purchased and held by national banks acting as trustees for MBS); Krispin v. May Department Stores Co., 218 F.3d 919 (8th Cir. 2000) (the NBA preempted state law prohibitions on interest on department store credit accounts that were assigned by a store to a national bank); FDIC v. Lattimore Land Corp., 656 F.2d 139 (5th Cir. 1981) (interest rates prohibited by the NBA, but permitted under state usury law, could continue to be charged when loans were assigned to a national bank).

F) In response to Madden, some loan sellers and securitizers have modified their sale arrangements. See, e.g., Banking Daily, Feb. 29, 2016 and American Banker, Mar. 1, 2016 (WebBank, loan originator for marketplace lender, LendingClub, reportedly modified sale agreements to retain ongoing economic interest in loans).

G) Credit rating agencies maintained that statutory assignee liability provisions can make it difficult to measure the risk associated with loan pools. They have sometimes required such steps as (i) a representation from the seller attesting to the fact that the loans sold were originated in compliance with applicable law, (ii) provision of credit support by the seller to cover the exposure associated with violating anti-predatory lending laws, and/or (iii) exclusion from rated pools of loans governed by state laws that may pose an "unquantifiable" risk. See, e.g., "Fitch Comments on Indiana Predatory Lending Legislation" (Fitch Ratings, Jan. 5, 2005); S&P Implements Credit Enhancement Criteria and Revises Representation and Warranty Criteria for Including Anti-predatory Lending Law Loans in U.S. Rated Structured Finance Transactions (May 13, 2004).

(iv) Investment banks that provide financing by, e.g., assisting in the packaging and sale of loan pools and underwriting loan securitizations, may incur potential liability where the underlying loans were originated in violation of law. See, e.g., Austin v. Chisick, 2003 U.S. Dist. LEXIS 25925 (jury verdict) (C. D. Cal., June 16, 2003) (Lehman Brothers found to have assisted First

Alliance in committing fraud by providing First Alliance with financial backing -- through the underwriting of $400 million in MBS and the provision of a $150 million line of credit -- after Lehman had become aware of accusations that First Alliance employed high-pressure sales tactics and concealed fees), partial summary judgment in favor of Lehman on issue of punitive damages (C.D. Cal., June 17, 2004), partial remand on issue of calculation of damages, 471 F.3d 977 (9th Cir. 2006). See also Dep't of Legal Affairs v. Lehman [CP], No. 0310116 (complaint) (Fla. Cir. Ct., June 11, 2003), dismissed without prejudice (Feb. 3, 2005).

Compare, e.g., Lone Star Fund v. Barclays Bank, 594 F.3d 383 (5th Cir. 2010) (while certain statements in MBS prospectus to the effect that no payment required under any mortgage in the pool backing the securities would be more than 30 days delinquent, could, if viewed in isolation, be interpreted as a representation that the pool was free of any mortgage in default, these statements had to be interpreted in accordance with the agreement as whole, in which the parties agreed that, if any mortgages in the pool were delinquent, then the seller would either repurchase them or substitute conforming mortgages).

(v) A group of hedge funds that purchased Le-Nature syndicated debt sued Wachovia Bank, claiming that Wachovia, which originated and sold the debt, ignored warning signs during its diligence of Le-Nature and should thus bear some responsibility for the investors' losses. Wachovia obtained a temporary restraining order from a NC state court barring the group from suing, claiming that the hedge funds' purchase of the debt after the company had filed for bankruptcy violated champerty laws (prohibiting certain transfers of litigation rights). The hedge funds (and others) nevertheless sued Wachovia in NY federal court and, after that case was dismissed as unripe, sued in NY state court. The NY court refused to dismiss the fraud charges against Wachovia, finding that there were questions of fact regarding the alleged fraud. See Harbinger Capital Partners Master Fund I v. Wachovia Capital Markets, 27 Misc. 3d 1236A (NY Sup. Ct. 2010). Compare, e.g., Part V.A.4.b. v above.

d. Issues Relating to the Use or Misuse of "Material Non-public Information"

(i) Industry efforts such as the EMTA Code of Conduct, the ABA/RMA Industry Guidelines, the ABA Guide and guidance from the LSTA address issues that arise when loan traders possess material non-public ("inside") information, particularly under circumstances where such traders buy and sell "securities" (to which the 1934 Act and the SEC's anti-manipulation rules apply) as well as "non-security" loan instruments and credit derivatives.

A) Financial institutions may receive material non-public information from borrowers, both in connection with the origination or acquisition of loans and at subsequent times, pursuant to reporting covenants in loan agreements, in accordance with due diligence and related lending practices or in connection with service on creditors' committees. If such information is communicated under circumstances that would create a duty under the 1934 Act's antifraud provisions -- most notably § 10(b) and Rule 10b-5 -- credit market participants would be prohibited from engaging in security-based transactions on the basis of such information, absent appropriate disclosures. See also Part V.B.7.b below.

B) Information could be "material" if there is a "substantial likelihood" that a reasonable investor would view disclosure of such information as significantly altering the "total mix" of information available. Accordingly, an analysis of whether a fact is important enough to be "material" should involve an inquiry into whether the fact is likely to affect significantly the market price for a financial instrument; i.e., if there is a substantial likelihood that a reasonable investor would consider it important in deciding whether (and on what terms) to buy, sell or hold the instrument in question. The Supreme Court rejected a bright-line test of materiality based on quantitative criteria. Matrixx Initiatives v. Siracusano, 563 U.S. 27 (2011).

C) In general, information is "non-public" if it has not been disseminated in a manner making it available to investors generally, and has not been specifically made available to a counterparty in respect of a particular trade. Information is considered to have become available generally to the public only after it has been released through appropriate channels (typically, a press release) and only after enough time has elapsed to permit the market to absorb and evaluate the information.

See, e.g., Board Policy Statement on Use of Inside Information (Mar. 17, 1978), Fed. Res. Reg. Serv. ¶ 3-1550. See also Part V.B and Part IX.E below.

(ii) "Information wall" procedures may prevent material inside information obtained in the course of an investment banking or lending arrangement from flowing to trading units.

A) Such procedures include the physical segregation of trading units and the placement of financial instruments on a "restricted list" (a list of instruments or issuers as to which a firm has determined to restrict proprietary, employee and solicited customer transactions) and/or "watch list" (a list of financial instruments or issuers where trading is not prohibited but is subject to scrutiny by the firm's compliance department) when the bank has inside information with respect to the issuer. In the case of high yield instruments, the need for adequate information-blocking devices is especially acute. See, e.g., Wolverine Trading, LLC and Wolverine Asset Management, LLC, SEC Admin. Proc. No. 3-16890 (Oct. 8, 2015) (sanctioning broker-dealer and asset manager affiliates for sharing inside information and failing to enforce information wall procedures); Citigroup Global Markets, SEC Admin. Proc. No. 3-16764 (Aug. 19, 2015) (description of Citigroup's information barriers; despite creation of a "loan watch list" for traders that had accessed non-public information when trading loans, internally generated trade reports failed to include securities trades conducted by such traders); Tuch, Financial Conglomerates and Chinese Walls (2014); Broker-dealer Internal Control Procedures for High-yield Securities (SEC, Oct. 1993); Securities Markets: Clearly Defined "Chinese Wall" Standards Have Been Issued (GAO, Aug. 1991); Report by the [SEC] Division of Market Regulation on Transparency in the Market for High-yield Debt Securities (Sept. 6, 1991); Broker-dealer Policies and Procedures Designed to Segment the Flow and Prevent the Misuse of Material Non-public Information (SEC, Mar. 1990).

B) The SEC has provided safe harbor protections for institutions that establish appropriate information controls. 1934 Act Rule 10b5-1 provides that a firm may demonstrate that a purchase or sale of securities was not made "on the basis of" material non-public information, even if the firm is in possession of such information, if the firm can show that:

i) The individual making the decision on behalf of the firm to purchase or sell the securities was not aware of such information; and

ii) The firm had implemented reasonable policies and procedures to ensure that individuals making investment decisions would not violate laws prohibiting trading on the basis of such information.

In December 2012, the Council of Institutional Investors submitted a letter to the SEC requesting guidance regarding Rule 10b5-1 trading plans. Specifically, the Council advocates (i) that insiders be permitted to adopt trading plans only when direct purchases and sales would be permitted (i.e., during windows after the release of quarterly financial data), (ii) that multiple, overlapping plans be impermissible, (iii) for a delay between the adoption of any plan and the execution of the first trade thereunder and (iv) for restrictions on the frequency of modifications to, and cancellation of, plans. The Council again urged these changes in follow-up letters submitted in May 2013 and March 2014.

(iii) There is a trend towards separating loan origination and advice from credit hedging/management. If personnel responsible for credit portfolio management activities are located on the "public side" of an information wall (i.e., do not have access to material non-public information), such persons should generally be permitted to execute hedging transactions without the need to determine, on a case-by-case basis, whether they or the firm are in possession of material non-public information with respect to a particular transaction.

(iv) Other firms rely on self-certification or self-reporting procedures that require traders to make an affirmative statement that they do not have material non-public information with respect to an issuer prior to trading in respect of such issuer and/or make a self-evaluation whether information might be material non-public information and, if so, report the matter to a compliance officer and refrain from trading. The efficacy of such procedures must be evaluated in light of the individuals involved and their overall responsibilities. See generally, e.g., Gintel Asset Management, SEC Admin. Proc. No. 3-10930 (Nov. 8, 2002) (investment adviser's owner and chairman traded on the basis of material non-public information; the firm was found not to have adequate procedures because the chairman was the person most likely to have such information; given the chairman's central position in the firm, individual self-evaluation and self-reporting were found not reasonably designed to prevent the misuse of such information).

(v) Other approaches to addressing issues in the loan trading context with respect to material non-public information exist.

A) "Big boy letters" -- contractual disclaimers of reliance -- disclose to trading counterparties that an institution has, or may have, material non-public information regarding a borrower that it is not disclosing to its counterparty, and obtain the counterparty's consent to the transaction in question. Since reliance by the counterparty and a deceptive act or omission by the trader are essential components of a private cause of action under Rule 10b-5 (see, e.g., Basic v. Levinson, 485 U.S. 224 (1988)), a big boy letter could weaken the ability of a counterparty to establish those elements. This argument finds support in such decisions as Pharos Capital Partners v. Deloitte & Touche, 535 Fed. Appx. 522 (Mem.) (6th Cir. 2013); In re Capco Energy, 669 F.3d 274, 284 (5th Cir. 2012); Harborview Master Fund v. Lightpath Technologies, 601 F. Supp. 2d 537 (SDNY 2009); Extra Equipamentos e Exportação Ltda. v. Case Corp., 541 F.3d 719, 724 (7th Cir. 2008); AES v. Dow Chemical, 325 F.3d 174 (3d Cir. 2003); DynCorp v. GTE Corp., 215 F. Supp. 2d 308 (SDNY 2002); McCormick v. Fund American Companies, 26 F.3d 869 (9th Cir. 1994); and Jensen v. Kimble, 1 F.3d 1073 (10th Cir. 1993).

i) SEC v. Barclays Bank demonstrates that, while a big boy letter could provide some defense in private litigation, it may not be useful in the context of a government enforcement action. Since the development of insider trading law in the 1960s, the standard rule declared by the SEC and adopted by the courts has consistently been that a corporate insider must abstain from trading unless he has first disclosed all known material inside information. See, e.g., Chiarella v. U.S., 445 U.S. 222 (1980) (citing Cady, Roberts & Co., 40 S.E.C. 907 (1961)); SEC v. Texas Gulf Sulphur, 401 F.2d 833 (2d Cir. 1968).

ii) Big boy letters also raise questions about downstream trades with counterparties which may be unaware of the upstream existence of a letter (and thus are unaware that material non-public information played a role in the sale of securities into the market). A Texas hedge fund sued Jefferies Group after Jefferies purchased World Access bonds pursuant to a big boy letter and then resold them to the hedge fund, without disclosing the existence of the letter, just before World Access announced severe financial problems and its value fell precipitously. The case was reportedly settled. See, e.g., HedgeWorld Daily News, May 22, 2008; Insights, June 2007; NY Times, May 22, 2007.

iii) Barclays Bank settled an SEC enforcement action alleging that a trader, with the authorization of Barclays management, had traded on material non-public information obtained through his service on bankruptcy committees. The SEC noted that the trader used big boy letters in connection with some of these trades, but "in no instance did Barclays or [the trader] disclose the material non-public information received from creditors committees to their bond trading counterparties". Since the Barclays proceeding involved dozens of insider trades, with only a handful using big boy letters, the

SEC did not express an opinion on the practice, and found that the conduct violated 1933 Act § 17(a), 1934 Act § 10(b) and Rule 10b-5. See also, e.g., NY Times, May 22, 2007.

iv) Issues to be considered in the context of loan trading involving big boy letters include: (A) the articulation of a clear policy; (B) the terms and scope of the letter, and the counterparties with which the letter is exchanged; (C) whether trading when in possession of inside information may violate any duty of non-use (legal or contractual) with respect to the issuer to which the inside information relates; (D) whether each party explicitly acknowledges that each counterparty may have knowledge not available to such party; and (E) state law (fraud, etc.) considerations, and FINRA considerations (involving broker-dealers) relating to "just and equitable principles of trade".

B) Institutions sometimes enter into transactions based on a "written trading plan" or formula for hedging loan exposures at a time when the institution is not aware of material non-public information (thereby effectively eliminating discretion as to whether to execute the transaction at a particular time).

(vi) In 2003, the Joint Market Practices Forum, a collaborative effort of the BMA, the International Association of Credit Portfolio Managers, ISDA and the LSTA, released the JMPF Statement of Principles on Non-public Information, which sets out ways to prevent the dissemination of material non-public information from the "private side" of banking organizations to the "public side" responsible for trading decisions.

A) The Statement of Principles recommends that credit market participants have policies, procedures and controls appropriate to their business activities and organizational structures to control, limit and monitor the dissemination and use of material non-public information. Such controls may include (i) information barriers (e.g., functional and physical separation -- such as separate employees, lines of authority, databases, recordkeeping and support groups -- to prevent access to material non-public information by persons having responsibility for transaction execution); (ii) "need-to-know" policies for communication across information barriers; and (iii) restricted lists, watch lists and trading reviews to restrict, monitor and control transactions when the firm possesses material non-public information. Firms should consider subjecting such information controls to approval and review by management senior to (or independent of) the business units engaged in credit portfolio management.

B) The Statement of Principles recommends involvement of an independent internal compliance function in: (i) providing training; (ii) reviewing, monitoring and controlling interdepartmental communications and personnel transfers over information barriers; (iii) maintaining restricted/watch lists and monitoring and reviewing transactions involving securities on such lists; and (iv) creating or maintaining records relating to the firm's activities and compliance with its policies.

C) The Statement of Principles counsels employee education and training regarding the structure and purpose of a firm's information controls. Such education and training may be useful, particularly for employees in sensitive areas, at the time an employee joins the firm, when an employee changes departments, upon changes in law, and after any significant modification or violation of the firm's policies.

Topics to consider in an education program include describing (i) the prohibition on entering into transactions on the basis of material non-public information; (ii) reputational and client-relations consequences of the misuse of such information; (iii) the consequences for employees of policy violations; (iv) procedures that restrict the time and manner of entering into transactions and that control the flow of such information; (v) the importance of consulting qualified personnel when uncertain as to how procedures apply; and (vi) the contact person/department responsible for implementing information controls, answering questions and approving exceptions.

D) The Statement of Principles recommends that the following be considered in evaluating controls:

i) A firm may find it useful to implement a "wall within a wall"; i.e., procedures to "wall off" specific individuals on the private side responsible for credit portfolio management activities from certain categories of material non-public information. These individuals then could be presumed not to be trading on the basis of that information even when such information is available to other individuals on the private side. A firm establishing "wall within a wall" procedures should consider what information barriers would be appropriate, including physical segregation of the covered individuals, and procedures to control or limit the flow of information between these areas of the firm.

ii) Credit market participants should consider the handling of communications between private and public sides, such as those that might occur if private side employees seek pricing or other market information from public side employees to assist in determining transaction timing and strategy. Similarly, procedures might address how orders will be communicated and executed, particularly if the execution desk is on the public side. In order to protect against communications that include or signal material non-public information, firms should consider whether the compliance department should review, monitor or control these or other communications or trading.

iii) While a firm may determine that certain categories of non-public information -- such as the amount of the exposures being managed -- should normally be transferable to the public side, a firm might need to consider a procedure for addressing situations in which the existence or amount of the exposure is itself material non-public information. Harder issues could arise if a firm proposes to transfer information regarding internal ratings (or other information derived from such ratings, such as exposure limits) established or modified on the private side. The difficulty is determining when, or under what circumstances, communications to the public side could signal the existence of material non-public information. Possible approaches for addressing the transfer of rating information might include: (a) reviews of rating changes by compliance personnel to determine whether they are based on material non-public information; (b) if a change in ratings was based on such information, controls, limits or delays on the communication of that change to the public side or on the execution of any transactions in the relevant securities; or (c) procedures designed to prohibit trading on the basis of such information. Alternatively, a firm may prepare internal ratings on the public side, so that the establishment of (or changes to) the ratings would not be based on material non-public information.

See also Part V.B.7.b below.

(vii) In 2006, a group of 12 industry associations issued the Industry Associations Joint Statement Regarding the Communication and Use of Material Non-public Information (Dec. 2006) reaffirming their rejection of the "inappropriate" use of material non-public information in trading. See also FSA Market Watch (July 2007) (review of controls over inside information in the M&A context).

(viii) In 2008, the LSTA published a Confidential Information Supplement to its Code of Conduct, which sets forth standards for the use and disclosure of confidential information in connection with transactions in the loan market. The Confidential Information Supplement describes (A) types of information in the loan market; (B) the circumstances under which a market participant may trade on such information; (C) pre-transaction due diligence recommendations; and (D) internal procedure recommendations (such as information barriers and trading restrictions) to ensure that the market participant follows high standards of professional integrity, fair dealing and legal requirements. In 2013, the LSTA published a form of Master Confidentiality Agreement for Claims Trading. See also LSTA Statement of Principles for the Communication and Use of Confidential Information by Loan Market Participants (Dec. 2006); Dealing with Confidential and Price Sensitive Information (Loan Market Assoc., 2006).

(ix) SEC staff released a Report on Examination of Information Barriers (Sept. 27, 2012) discussing broker-dealers' compliance with their obligation to have policies and procedures reasonably designed to prevent the misuse of inside information. See 1934 Act § 15(g). The Report discusses areas of concern regarding

(A) sources of inside information at broker-dealers, including less often recognized sources such as derivatives sales and customers who are themselves insiders; (B) control structures, where areas of concern include executives "above the wall" who may not be monitored appropriately, and the failure to monitor and document immateriality determinations; and (C) specific controls, particularly with regard to informal interactions among broker-dealer staff and between the broker-dealer's "public side" employees and third parties with inside information. The Report emphasizes appropriate documentation in all aspects of information barrier programs and expresses discomfort with "categorical" rules for monitoring and controlling access to inside information (e.g., the removal of all items from monitoring lists after a fixed period of time or the exclusion of IT personnel from barriers and monitoring).

e. Highly Leveraged Transactions

(i) Following a drop from historic highs in the 1990's, HLT new issues rose to nearly $500 billion in 2006. Investment banks were active in the high-yield loan market, and the LSTA and S&P published the Leveraged Loan Index, a performance benchmark for the syndicated leveraged loan industry. In 2006, more than 74% of the average leveraged loan was funded by institutional investors, insurance companies, finance companies and securities firms. The demand for leveraged loans collapsed as a result of the global credit crisis, and new leveraged loan issuance declined from $130 billion in the fourth quarter of 2007 to less than $30 billion in the first quarter of 2009. Activity has recovered and surpassed 2006 levels, as increased M&A and equity sponsor activity drive growth, along with significant refinancing activity and the recovery of LBO activity. While U.S. leveraged loan issuance (including refinancings) reached a record high of approximately $1.21 trillion in 2013, issuance has declined since, totaling $865.4 billion in 2015, a 29% decline relative to 2013, and $425.2 billion in the first half of 2016, a 6.2%

decline relative to the first half of 2015. Total U.S. syndicated loan volume has been much more stable, increasing 3% in 2014 and decreasing 6% in 2015. See, e.g., Global Syndicated Loans (Thomson Reuters, 2Q 2016, 2015, 2014); LSTA, 2016 Loan Market Chronicle; Bloomberg, Global Syndicated Loans 2014 (Dec. 2014) and First Half 2015 (July 2015); Bloomberg, Dec. 23, Aug. 20, 2013; Leveraged Loan Enhancements: Leveraged Finance U.S. Special Report (Mar. 14, 2008); Private Equity and Leveraged Finance Markets (BIS, July 2008). See also Part V.A.4.c above.

As leveraged lending has rebounded following the financial crisis, covenant-lite loans have become a majority of leveraged lending. Covenant-lite loans lack covenants favorable to lenders, such as restrictions on new debt issuance, total leverage limits and loan-to-value maintenance requirements. Covenant-lite loan issuances quadrupled since 2007 to more than \$250 billion in 2013. In 2014 and 2015, covenant-lite loans continued to make up the majority of U.S. leveraged loan issuance, reaching a record share of 56% of issuances in 2015. The portion of European leveraged loans that are covenant-lite is also rising, representing 48% of issuances in the first quarter of 2014 and sustaining a similar share in 2015. Nevertheless, there is evidence in the 2015-16 market that leveraged loan investors are requiring concessions on covenants in order to agree to buy into certain loan deals. See, e.g., Bloomberg, Mar. 8, 2016; International Financing Review, Feb. 6, 2016; Financial Times, Nov. 4, 2015; Wall St. J., May 11, 2015; American Banker, Aug. 11, 2014; Forbes, Aug. 1, 2014.

(ii) Federal guidelines highlight the need for sound risk management respecting leveraged financing, including credit analysis, frequent monitoring, and reports to enable lending institutions to better understand and manage HLT risk. See, e.g., Interagency Guidance on Leveraged Lending, 78 Fed. Reg. 17766 (Mar. 22, 2013) (the "Leveraged Lending Guidance"); Comptroller's Handbook: Leveraged Lending.

A) The Leveraged Lending Guidance describes concerns regarding growth in leveraged lending and the increased popularity of debtor-friendly terms (e.g., a payment-in-kind provision that allows the borrower to elect to capitalize interest rather than pay it). The Guidance underscores the need for (1) soundly structured transactions with supportable performance projections; (2) well defined risk management and underwriting standards that include leverage limits (indicating that a total-debt-to-EBITDA ratio of 6x "raises concerns in most industries") and credit/concentration limits; (3) stress testing; and (4) management information systems that allow identification, aggregation and monitoring of exposures across all lines of business.

B) The federal banking agencies released Frequently Asked Questions for Implementing [the Leveraged Lending Guidance] (Nov. 7, 2014) (the "Guidance FAQs"). The Guidance FAQs (1) address how an institution should define a leveraged loan, including clarifying that a purpose test to identify such loans is not sufficient; (2) confirm that refinancings, modifications and renewals of existing loans that address structural or credit-related concerns are not new loans subject to the Guidance; (3) clarify whether certain criteria in the Guidance are bright-line rules or examples; and (4) clarify whether and how the Guidance applies to certain assets (including convenant-lite loans), activities and institutions. In the release accompanying the Guidance FAQs, the agencies indicated that they would increase the frequency of leveraged lending reviews.

C) The effect and effectiveness of the Leveraged Lending Guidance and the Guidance FAQs have been the subject of significant industry and supervisory attention. Leading up to the release of the Guidance FAQs, the Board and Comptroller indicated that they expected greater compliance with the Guidance. After the release of the Guidance FAQs, the Board indicated that it has begun "intensive supervision". There is evidence that the Leveraged Lending Guidance has decreased leveraged lending by banks, but perhaps not achieved equivalent risk reduction, as non-bank lenders not subject to the Guidance have increased borrowing from banks to finance their own growing leveraged lending activity. See "Did the Supervisory Guidance on Leveraged Lending Work?", Liberty Street Economics (FRBNY, May 16, 2016); 2015 Annual Report to Congress (OFR, Jan. 27, 2016) (more than two-thirds of highest-risk leveraged loans in hands of non-banks); Bloomberg, July 14 (asset managers and direct-lending funds), July 8, 2015; NY Times, July 7, 2015 (independent investment banks, business development companies); Financial Times, June 29, 2015 (independent investment banks, such as Jefferies, and non-U.S. banks and investment banks not subject to the Guidance, such as Nomura and Macquarie).

See generally, e.g., Banking Daily, July 29, 2016 (regulators questioning loans that are "on the line"); American Banker, June 15, May 27, 2016, May 24, 2013; M&A L. Rep., Apr. 13, 2015; Bloomberg, May 22, 2015; Board Gov. Powell, Financial Institutions, Financial Markets, and Financial Stability (Feb. 18, 2015); Wall St. J., Dec. 2, 2015 (pressure from regulators to raise leveraged lending underwriting standards), Nov. 19, Sept. 16, June 25, May 20, 13, 2014, Mar. 21, 2013; Banking Daily, Sept. 23, Aug. 8, July 21, May 2, 2014; FRB – Dallas Economic Letter (Sept. 2014); Securities Law Daily, June 24, 2014; Reuters, June 10, 4, 2014; International Financing Review, June 9, 2014; Leveraged Finance News, June 9, 2014; Bloomberg, May 28, 2014; Financial Times, Apr. 29, 2014. See also generally Semiannual Risk Perspective (OCC, Spring 2016) ("key risk themes" include risk management, weak underwriting, and erosion of covenant protection in leveraged lending); 2015 Survey of Credit Underwriting Practices (OCC, Dec. 2015); Remarks of Comptroller Curry, Nov. 2, 2015, Before the RMA Annual Risk Management Conference, (concerns regarding relaxed credit underwriting and increased loan concentrations); Interagency Supervisory Guidance Addressing Certain Issues Related to Troubled Debt Restructurings (Oct. 24, 2013).

(iii) One area of concern with respect to HLT loan trading is the impact of state and federal fraudulent conveyance laws on the ranking of these loans in bankruptcy. Such laws -- including the Uniform Fraudulent Conveyance Act, the Uniform Fraudulent Transfer Act and the federal Bankruptcy Code -- can enable creditors of companies acquired in an HLT to challenge the validity of HLT financing arrangements and of collateral security granted to HLT lenders.

A) Fraudulent conveyance laws apply to transfers of interests in property of a borrower where (i) the borrower fails to receive fair consideration or reasonably equivalent value for the loan; and (ii) after giving effect to the loan, the borrower is insolvent, has unreasonably small capital or has incurred or expects to incur debts beyond its ability to repay. Under these circumstances, a court could invalidate the loan (and any related security interest) or subordinate the loan to existing or future creditors.

B) A safe harbor in Bankruptcy Code § 546(e) exempts certain payments to or for the benefit of a financial institution in connection with a securities contract from "avoidance" (i.e., clawback) by an entity that is in bankruptcy. However, Weisfelner v. Fund 1 (In re Lyondell Chemical Co.), 503 B.R. 348 (SDNY 2014) held that this safe harbor did not preclude or protect against claims under state fraudulent conveyance laws where unsecured creditors sought to recover payments to shareholders made in an LBO. See also In re Tribune Co. Fraudulent Conveyance Litigation, 499 B.R. 310 (SDNY 2013). Cf. Whyte v. Barclays Bank, 494 B.R. 196 (SDNY 2013).

C) Other cases which discuss fraudulent conveyance issues in the HLT context include, e.g., In re Sabine Oil and Gas Corp., 547 B.R. 503 (Bankr. SDNY 2016) (no fraudulent conveyance because analysis must consider merger-related transactions as an integrated plan); Moody v. Security Pacific Business Credit, 971 F.2d 1056 (3d Cir. 1992), affirming 127 B.R. 958 (W.D. Pa. 1991) (no fraudulent conveyance); Mellon Bank v. Metro Communications, 945 F.2d 635 (3d Cir. 1991), cert. denied, 503 U.S. 937 (1992) (no fraudulent conveyance); MFS/SunLife Trust-High Yield Service v. Van Dusen Airport Services, 910 F. Supp. 913 (SDNY 1995) (no fraudulent conveyance); Bay Plastics v. BT Commercial Corp., 187 B.R. 315 (Bankr. C.D. Cal. 1995) (fraudulent conveyance); In re Best Products Co., 168 B.R. 35 (Bankr. SDNY 1994), aff'd, 68 F.3d 26 (2d Cir. 1995) (discussing fraudulent conveyance claim); In re Buckhead America Corp., 178 B.R. 956 (D. Del. 1994) (denying motion to dismiss fraudulent conveyance claim); Kendall v. Sorani, 151 B.R. 1012 (Bankr. N.D. Cal. 1993), aff'd, 195 B.R. 455 (Bankr. N.D. Cal. 1996) (fraudulent conveyance); In re Aluminum Mills Corp., 132 B.R. 869 (Bankr. N.D. Ill. 1991) (fraudulent conveyance claims sufficient to withstand motion to dismiss); Crowthers McCall Pattern v. Lewis, 129 B.R. 992 (Bankr. SDNY 1991) (permitting fraudulent conveyance claim to proceed); In re O'Day Corp., 126 B.R. 370 (Bankr. D. Mass. 1991) (fraudulent conveyance).

D) Any LBO carries a risk that the loans in question would be characterized as "constructively fraudulent" under the first prong of the fraudulent conveyance test. To best protect itself from a claim under the second prong of the test, a lender/loan purchaser should (i) investigate the borrower's financial condition, (ii) obtain a solvency certificate, (iii) establish and memorialize the borrower's business motivations for the LBO, and (iv) see if it is possible for the LBO loan to provide consideration to the borrower over and above that which is designed to be paid out to shareholders.

(iv) "<u>Equitable subordination</u>" issues -- <u>i.e.</u>, the treatment in bankruptcy of purportedly senior debt claims as subordinated to <u>pari</u> <u>passu</u> (or junior) debt and/or equity claims -- can be important. In general, a claim could be equitably subordinated to other claims if (A) the claimant engaged in inequitable conduct, (B) the misconduct resulted in injury to creditors or conferred an unfair advantage on the claimant, and (C) subordination would not be inconsistent with the Bankruptcy Code. <u>See</u>, <u>e.g.</u>, <u>U.S. v. Noland</u>, 517 U.S. 535 (1996); <u>Benjamin v. Diamond</u>, 563 F.2d 692 (5th Cir. 1977).

<u>SI Restructuring v. Faulkner</u>, 532 F.3d 355 (5th Cir. 2008), rejected an attempt to apply the "deepening insolvency" doctrine to a loan by an insider so long as the loan proceeds were used for legitimate purposes (such as paying employees, secured creditors and vendors).

<u>See also</u> <u>Part V.A.4.c above</u> and <u>Part VII.A.3.f below</u>.

f. <u>Issues Relating to Board of Directors Representation</u>

(i) Directors of portfolio companies (particularly financially troubled companies) may face special issues and conflicts, such as (A) an obligation to put the interests of creditors ahead of the interests of stockholders once a company nears insolvency; or (B) holding officer positions at the investor or lender (or at other, similar portfolio companies) that may give rise to antitrust concerns, corporate opportunity issues, information-sharing duties or actual or perceived conflicts in decisions requiring board approval (e.g., mergers and acquisitions).

(ii) Equitable subordination issues can also arise. See Part V.A.4.e above. For example, Citicorp Venture Capital ["CVC"] v. Committee of Creditors, 160 F.3d 982 (3d Cir. 1998), subsequent decision, 323 F.3d 228 (3d Cir.), cert. denied, 540 U.S. 825 (2003), concluded that CVC's purchase of Papercraft debt at a time when CVC was a "fiduciary" of Papercraft as a result of CVC's representation on the Papercraft board of directors, and receipt of information about Papercraft's financial stability and assets that was not shared with Papercraft's other creditors, established conduct supporting equitable subordination of the purchased claims. See also Part VII.A below.

(iii) Questions under 1934 Act § 10A(m), as well as under NYSE/FINRA corporate accountability standards, relate to whether director representatives of lenders or venture capital firms on the boards of directors of borrowers/portfolio companies meet applicable requirements of "independence" to serve on board audit committees. See NYSE Listed Company Manual § 303A (as approved Aug. 1, 2002) and related Commentary; Nasdaq Corporate Governance Proposals (2002).

B. SECURITIES LAW STATUS

Although the weight of precedent is decidedly in favor of the view that loan notes and participations are not "securities" under federal or state securities laws, the issue remains in light of market developments, including increases in (1) the volume of loan sales and secondary market loan trading (2) the level of investment bank participation in the market, (3) the degree of standardization of instruments, (4) the extent to which loans are rated by rating agencies, (5) the extent of repackaging and securitization in the market, and (6) the level of participation of non-bank purchasers. See Part V.A above. See generally Investment Dealers' Digest, Dec. 6, 2004 (former SEC Chairman Pitt's concern that loan notes could be characterized as "securities").

1. Statutory Definitions

The definitions of "security" in each of the Securities Acts are functionally equivalent and are interpreted similarly. See, e.g., Landreth Timber Co. v. Landreth, 471 U.S. 681 (1985) ("Landreth"); Tcherepnin v. Knight, 389 U.S. 332 (1967).

Under such Acts, "unless the context otherwise requires", a note is a "security", and a participation in a security is a "security"; the 1934 Act definition excludes notes with maturities of less than nine months.

2. Pre-1990 Case Law

Courts had been nearly unanimous in holding that a loan note or participation sold by one bank or financial institution to another was not a "security" for purposes of the Securities Acts. The legal analyses used include:

a. "Family Resemblance" Approach

Exchange National Bank of Chicago v. Touche Ross & Co., 544 F.2d 1126 (2d Cir. 1976) ("Exchange National"), modified, Chemical Bank v. Arthur Andersen & Co., 726 F.2d 930 (2d Cir. 1984), cert. denied, 469 U.S. 884 (1984), stated a presumption that all notes are "securities" unless they bear a "strong family resemblance" to consumer/mortgage loans, secured commercial loans and bank loans for current operations. See also, e.g., Equitable Life Assurance Society v. Arthur Andersen & Co., 655 F. Supp. 1225 (SDNY 1987); Commercial Discount Corp. v. Lincoln First Commercial Corp., 445 F. Supp. 1263 (SDNY 1978) ("Commercial Discount Corp.").

b. "Investment/Commercial" Approach

Some courts attempted to distinguish "commercial" from "investment" transactions based on such factors as whether sales were to a large class of investors, the characterization of the instruments in the business community and by the parties, the use of proceeds, the extent of reliance on efforts of others, collateral, the number of notes issued, the dollar amount of the transaction and the instrument's term. They concluded that "commercial" loan notes or participations are not "securities". See, e.g., Futura Development Corp. v. Centex Corp., 761 F.2d 33 (1st Cir. 1985), cert. denied, 474 U.S. 850 (1985) ("Futura"); American Fletcher Mortgage Co. v. U.S. Steel Credit Corp., 635 F. 2d 1247 (7th Cir. 1980), cert. denied, 451 U.S. 911 (1981); Bellah v. First National Bank of Hereford, 495 F.2d 1109 (5th Cir. 1974); Lino v. City Investing Co., 487 F.2d 689 (3d Cir. 1973).

c. Howey or "Risk Capital" Approach

Some courts, relying principally on United Housing Foundation v. Forman, 421 U.S. 837 (1975), and SEC v. W.J. Howey Co., 328 U.S. 293 (1946) ("Howey"), attempted (i) to draw a line between conventional loans and those representing "risk capital" by looking at such factors as the duration of the transaction, collateral, the relation between the amount borrowed and the size of the borrower's enterprise, the terms of the transaction, the form of the obligation, the use of proceeds, the nature of the contractual arrangements, and the bargaining position and intent of the parties; and/or (ii) to determine whether the transaction constituted an investment in a common venture with a reasonable expectation of profits to be derived from the efforts of others. See, e.g., SEC v. Shavers, No. 4:13-CV-416 (E.D. Tex., Aug. 26, 2014) (finding that loans of Bitcoins with expectation of interest rate return constituted consideration of value, thus rendering the loans "investment contracts" and therefore securities under the Howey test; court declined to reach question of whether the loans were "notes"); McVay v. Western Plains Service Corp., 823 F.2d 1395 (10th Cir. 1987); Union National Bank of Little Rock v. Farmers Bank, 786 F.2d 881 (8th Cir. 1986); American Bank and Trust Co. v. Wallace, 702 F.2d 93

(6th Cir. 1983); Amfac Mortgage Corp. v. Arizona Mall of Tempe, 583 F.2d 426 (9th Cir. 1978).

Cf. Steinhardt Group v. Citicorp, 126 F.3d 144 (3d Cir. 1997) ("Steinhardt") (investment in limited partnership involving the securitization of delinquent residential mortgage loans and real estate owned by a bank as a result of foreclosure is not a "security" because the investor had pervasive control and it could not be said that any profits were to come from the efforts of others); SEC v. Life Partners, 87 F.3d 536 (D.C. Cir.) ("Life Partners"), reh. denied, 102 F.3d 587 (D.C. Cir. 1996), on remand, 986 F. Supp. 644 (D.D.C. 1997) (viatical settlements are not "securities" because the profits from their purchase do not derive from the efforts of others). But see, e.g., SEC v. Mutual Benefits Corp., 408 F.3d 737 (11th Cir. 2005), cert. denied, 511 U.S. 1180 (2007) (viatical settlements meet the criteria for an investment contract because profits from their purchase derive from the efforts of promoters in evaluating life expectancies); SEC v. Tyler, 2002 U.S. Dist. LEXIS 2952 (N.D. Tex. 2002) (viatical settlement notes sold to 480 investors constituted "securities").

3. The Reves Decision

a. In the 1990 Reves decision, the Supreme Court adopted the analysis set out in Exchange National for determining whether a note is a "security". Reves also approved the "investment/commercial" test as another method of "formulating the same general approach". However, Reves rejected the Howey analysis, stating that such analysis was applicable to a determination of whether an investment contract is a "security", not to whether a note is a "security".

b. Reves held that publicly distributed, unsecured, demand notes are "securities" and that demand notes do not fall within the 1934 Act exception for "any note . . . which has a maturity at the time of issuance of less than nine months".

In analyzing whether a note is a "security", Reves stated that (i) the starting point is the "presumption" that every note is a "security"; (ii) exceptions to this presumption are notes "for which the context otherwise requires", such as notes delivered in consumer financing, home mortgage notes, short-term notes secured by a lien on a small business or some of its assets (a characteristic analyzed in Prochaska & Assoc. v. Merrill Lynch, 798 F. Supp. 1427 (D. Neb. 1992)), bank loans to individuals, short-term notes secured by an assignment of accounts, notes formalizing open-account debt and notes evidencing bank loans for current operations; and (iii) any note bearing a "family resemblance" to the foregoing was also excepted from this presumption. Reves set out four factors a court should examine in determining whether a note is a "security":

(i) Motivation for the Transaction: If the seller of a note does so to finance the purchase of a minor asset or consumer good, to correct cash-flow, or "to advance some other commercial or consumer purpose", the note is less likely to be considered a "security" than if the seller's purpose is to raise money for general business use or to finance substantial investment and the buyer is interested primarily "in the profit the note is expected to generate". "Profit" includes "a valuable return on an investment" and is said to include interest.

(ii) Plan of Distribution: Notes in which there is "common trading for speculation or investment", or that are sold to a "broad segment of the public" are more likely to be considered "securities".

(iii) Expectations of Purchasers: If the "investing public" has "reasonable expectations" that a note is a security, a court could consider it to be a "security".

(iv) Alternative Regulation or Government Guarantee: If there is a governmental scheme that significantly "reduces the risk of the instrument" such that application of the Securities Acts is not necessary, the note is less likely to be considered a "security".

4. Application of Reves Factors to Loan Notes and Loan Participations

Commercial loan notes and participations bear a "family resemblance" to notes evidencing loans by banks for current operations. Building on that analysis, Banco Espanol de Credito v. SecPac Bank, 973 F.2d 51 (2d Cir. 1992) (the "Banco Espanol Appeal"), cert. denied, 509 U.S. 903 (1993), affirmed Judge Pollack's "well reasoned opinion" in 763 F. Supp. 36 (SDNY 1991) ("Banco Espanol"), that participations in short-term (less than six months) working capital loans sold by a U.S. bank to domestic and foreign commercial banks, pension funds and corporations pursuant to master participation agreements were not "securities". These agreements stated that the participations were "loans" and were not readily transferable and that the purchaser was to make its own credit analysis of the issuer of the note underlying the participation. Compare, e.g., Pollack v. Laidlaw Holdings, 27 F.3d 808 (2d Cir.) ("Pollack"), cert. denied, 513 U.S. 963 (1994) (participations in mortgage notes are "securities" where notes are issued in "broad-based, unrestricted sales to the general investing public"); Prosper Marketplace, SEC Admin. Proc. No. 3-13296 (Nov. 24, 2008) (notes sold to the public through an online lending platform that anonymously connected lenders and borrowers are "securities").

The determination of whether a "note" is a "security" under a Reves analysis can involve significant questions of fact as well as questions of law. U.S. v. McKye, 734 F.3d 1104 (10th Cir. 2013), overturned a securities fraud conviction, holding that the District Court erred in instructing the jury that all notes are "securities". The Tenth Circuit held that a necessary element of securities fraud is a determination of whether the notes in question were securities, and that the Government was required to prove that they were. In SEC v. Thompson, 732 F.3d 1151 (10th Cir. 2013) ("Thompson"), the Tenth Circuit stated that in civil cases, "the ultimate determination of whether the note is a security is one of law", requiring resolution of factual disputes only in the rare instances where necessary to make a proper balancing of the Reves factors. See, e.g., Zhang-Kirkpatrick v. Layer Saver, 84 F.Supp. 3d 757 (N.D. Ill. 2015) ("Zhang-Kirkpatrick").

a. Motivation for the Transaction

Courts will likely look to the motivation of both the underlying borrower and of the bank that sells the instrument.

(i) An argument can be made that any borrowing from a financial institution is for a "commercial purpose" (and, thus, that the related note would not be a "security"), and that any participation in such a borrowing is in furtherance of that purpose. Cf. Banco Espanol ("the loan participation did not have an identity separate from the underlying loan"); Mishkin (participation in a BA is not separate from the BA). However, some courts have found that notes issued to a broad range of "lenders" are securities when used by the borrower for its general use or for substantial, long-term investments. See, e.g., SEC v. Novus Technologies, 2010 U.S. Dist. LEXIS 111851 (D. Utah 2010); SEC v. Wallenbrock Associates, 313 F.3d 532 (9th Cir. 2002) ("Wallenbrock"); McNabb v. SEC, 298 F.3d 1126 (9th Cir. 2002).

(ii) In the context of loan sales, the motivation of the seller could also be relevant. See, e.g., Banco Espanol Appeal ("even if an underlying instrument is not a security, the manner in which participations … are used, pooled, or marketed might establish that such participations are securities"); Commercial Discount Corp. (a participation in a loan may be a security, even though the underlying loan is not).

Banco Espanol found the motivation of the selling bank -- to enable it to increase its lines of credit to the borrower and to diversify its risk -- consistent with commercial characterization. However, Pollack held that the funding company's sales of participations in mortgage notes had an investment motivation because the seller "was raising funds for its general business activities".

(iii) With respect to secondary market transactions, one court concluded that there is "nothing anomalous" in finding that a note is not a "security" when originally sold, but may become a "security" if publicly sold in a later transaction. Mercer v. Jaffe, Snider, Raitt and Heuer, 736 F. Supp. 764 (W.D. Mich. 1990) ("Mercer"), aff'd sub nom. Schreimer v. Greenburg, 931 F.2d 893 (6th Cir. 1991).

(iv) The motivations of purchasers of loan notes/participations are as complex as those of sellers. While a purchaser is presumably motivated by the income to be derived from the instrument, it is hard to distinguish that interest from the motivation that would exist if the buyer had made a loan directly to the borrower, rather than indirectly through the purchase of a note/participation.

(v) Intelligent Digital System v. Visual Management Systems, 683 F. Supp. 2d 278 (EDNY 2010) ("VMS"), determined that a convertible note issued in connection with a technology sale was not a security because the motivation of the seller was in receiving a lump sum payment, not to invest in the buyer. Fletcher Int'l v. ION Geophysical Corp, 2010 WL 2173838 (Del. Ch. 2010) ("Fletcher I"), determined, however, that a note convertible into common stock and issued already in-the-money under a credit facility to further the formation of a joint venture was an "investment" under Reves.

(vi) Applying the analysis in Fletcher I and in Reves to a different set of notes, Fletcher Int'l v. ION Geophysical Corp., 2012 WL 1883040 (Del. Ch. 2012), held that a transferrable note with a term of more than four years issued to a substantial stockholder of the issuer in connection with the sale of a business to the issuer by that stockholder was a security. The stockholder sold a business to the issuer in exchange for common stock and two short-term notes. The issuer was subsequently unable to complete an anticipated bond issuance to finance repayment of the short-term notes. In lieu of cash, the stockholder accepted a long-term note to retire the two short-term notes. The court held that the two short-term notes were not securities because they were short-term bridge financing in a commercial context, but that the final note was a security because it was a more permanent source of funds, was accepted by the stockholder in part to protect its equity investment, had its value tied to the fate of the issuer, was freely transferable, had the characteristics of commonly traded debt instruments, and bore a legend referring to securities laws.

(vii) The absence of any profit motive on the part of the lender or borrower may also be considered. In Poplogix (avail. Nov. 5, 2010), SEC staff granted a no-action request of a company created to facilitate interest-free loans by members of the public to artists to fund specific art projects, where the company would collect origination and servicing fees from the artists. See also, e.g., CanAccord Capital Corp. (avail. Jan. 18, 2002) (lender created by Canadian government agency to facilitate interest-free investments by non-Canadians to secure immigration benefits); Service Centers Corp. (avail. May 21, 1992) (borrower created to operate service centers for credit unions without profit).

b. Plan of Distribution

The second factor of the Reves analysis is also ambiguous in the loan note/participation context. For example, a broad-based institutional sale of loan notes could result in "common trading for speculation or investment", especially if the lead bank makes the instruments attractive to purchasers by providing assurances as to the creation of a secondary market. Further, if a loan note has been rated by a rating agency and the selling bank hires a broker-dealer to locate potential purchasers, the distinction between the plan of distribution for a loan and for a "security" becomes less clear.

Reves states that the plan of distribution for a note most resembles that for a "security" when the note is offered to a "broad segment of the public", a factor which the Court characterized as "necessary to establish the requisite 'common trading' in an instrument" (emphasis added). Thus, courts should look primarily to the type and sophistication of loan purchasers in evaluating this factor. Assuming that there is no public sale, a selling bank's technique of institutional distribution should not be determinative.

(i) Focusing on the type of purchaser is consistent with the purposes of the Securities Acts, which are intended to protect investors, not lenders. See, e.g., Hunssinger v. Rockford Business Credits, 745 F.2d 484 (7th Cir. 1984) ("Hunssinger").

(ii) In Banco Espanol, the selling bank had limited its solicitation to "sophisticated financial or commercial institutions and not the general public", and the participations were not freely negotiable. See also, e.g., SEC v. Zada, 787 F.3d 375 (6th Cir. 2015) (notes sold to "a variety of laypersons" are "securities") ("Zada"); Wallenbrock (sale of notes to 1,000 investors "strongly" indicates that the notes were "securities"); Stoiber v. SEC, 161 F.3d 745 (D.C. Cir. 1998), cert. denied, 526 U.S. 1069 (1999) ("Stoiber") (solicitation of individuals for loan note transaction suggests "common trading"); Pollack (distinguishing "broad-based, unrestricted sales" to the general public from the "marketing scheme in Banco Espanol [which] was more analogous to a group of highly sophisticated commercial entities engaging in short-term commercial financing"); Holloway (most important factor in determination that note is a "security" is that the issuer solicited the general public); Bank of Louisiana v. D&A Funding Corp., 1997 U.S. Dist. LEXIS 16407 (E.D. La. 1997) ("Bank of Louisiana") (sale of credit card receivables to bank did not involve "securities"); Realtek Industries v. Nomura Securities, 939 F. Supp. 572 (N.D. Oh. 1996) ("Realtek") (since the parties intended to repackage mortgage loans and issue certificates to the general public, such certificates were "securities"); TAB Partnership v. Grantland Financial Corp., 866 F. Supp. 807 (SDNY 1994) (one-on-one negotiation with no expectation of public trading or prospectus distribution consistent with conclusion that an instrument is not a "security"); Stone ("enhanced automobile receivables" sold "to a very specialized and sophisticated secondary market" of financial institutions were not "securities").

(iii) Some courts have focused on the number of purchasers in determining whether a note is a "security". See, e.g., Thompson (scheme with one "borrower" and many individual "lenders" involved "securities" and closely resembled the activity of a company selling its own stock on an exchange; interested investors were sought through website, shopping mall seminars and conference calls); Developer's Mortgage Co. v. TransOhio Savings Bank, 706 F. Supp. 570 (S.D. Ohio 1989) (loan participation sold to only one purchaser was not a "security"); Crocker National Bank v. Rockwell Int'l Corp., 555 F. Supp. 47 (N.D. Cal. 1982) (use of investment bank to approach financial institutions through marketing channels designed for sale of securities is indicative that note is a "security"). Compare, e.g., Delgado v. Center on Children, 2012 WL 2878622 (E.D. La. 2012) (the Center's note is a "security" based on the other three Reves factors, notwithstanding that advertising in the Center's newsletter and other publications was not a distribution to a broad segment of the public).

(iv) Under some circumstances, however, the sale of a note to only a single purchaser -- even a bank -- could be consistent with characterizing that note as a "security". See, e.g., Trust Company of Louisiana v. NNP, Inc., 104 F.3d 1478 (5th Cir. 1997); National Bank of Yugoslavia v. Drexel Burnham, 768 F. Supp. 1010 (SDNY 1991).

(v) For a discussion of issues related to "crowdfunding", see Part VI.A.2.a below.

c. Expectations of Purchasers

The third factor of the Reves analysis is to a certain extent a restatement of the "investment/commercial test".

(i) Each case that Reves approved which had followed the investment/commercial approach focused on the character of the underlying transactions to determine whether the instruments involved were "securities". See, e.g., Futura (seller of property held to have received note from purchaser in "commercial" context); McClure v. First National Bank of Lubbock, 497 F.2d 490 (5th Cir. 1974), cert. denied, 420 U.S. 930 (1975) (bank loan notes which were neither offered to investors nor acquired for speculation are not "securities"); Hunssinger (Securities Acts are intended to protect investors, not lenders).

(ii) Reves described the investment/commercial test as one made "on the basis of all the circumstances", and did not recommend consideration of such characteristics of a note as its duration or whether it is collateralized. Thus, the Court may have implicitly rejected cases such as Great Western Bank v. Kotz, 532 F.2d 1252 (9th Cir. 1976), that analyzed notes in terms of such characteristics.

(iii) One factor that may be important in determining the expectations of a loan purchaser is whether the purchaser relied on the seller to evaluate the notes or to enhance their value by, for example, promising to buy them back or make a market. Compare, e.g., Asset Protection Plans v. Oppenheimer & Co., 2011WL 2533839 (M.D. Fla. 2011) (loans to prospective NFL players anticipating signing bonuses were not securities; Oppenheimer employee arranged loans but lender investigated borrowers independently), Stone ("enhanced automobile receivables" were not "securities" despite a buy-back guarantee for receivables more than 90 days past due, insurance and reserves), First Financial Federal Savings & Loan v. E.F. Hutton Mortgage, 834 F.2d 685 (8th Cir.

1987) (purchaser of mortgage loans "as is" that acknowledged that it was a sophisticated institution and had access to information concerning the loans, and where no person employed by the seller had been authorized to give any information concerning the loans, could not claim protection of Securities Acts), Union Planters National Bank v. Commercial Credit Business Loans, 651 F.2d 1174 (6th Cir.), cert. denied, 454 U.S. 1124 (1981) (when bank perceived loan participation as a commercial loan and its officers who purchased the participation were the same officers who normally passed on direct loans, bank could not claim protection of Securities Acts), and United American Bank v. Gunter, 620 F.2d 1108 (5th Cir. 1980) (bank that acknowledged that it evaluated purchase of loan participation in same manner as it evaluated loan application and that treated participation as a loan on its books could not claim protection of Securities Acts), with, e.g., Gary Plastic (although FDIC-insured CDs were not "securities", they became "securities" when distributed by investment bank under circumstances where the investor relied on the investment bank to maintain a liquid market, find issuers offering the best price and monitor issuer solvency).

(iv) Many loan sale documents state that the loan interest transferred is not a "security". This should make it more difficult for a purchaser to show that it reasonably expected that the instrument was a "security". See, e.g., Banco Espanol.

On the other hand, Wallenbrock concluded that the fact that the note issuer did not use the term "investment" to describe the notes "is of little import, given the nature of the transactions". Stoiber held that, even though the investing public may not have viewed notes as "securities", this conclusion "d[id] not . . . add much to the inquiry into whether the . . . notes are securities" since the Court considered this factor to be a "one-way ratchet. . . . It allows notes that would not be deemed securities under a balancing of the other three factors nonetheless to be treated as securities if the public has been led to believe they are. It does not, however, allow notes which under the other factors would be deemed securities to escape the reach of regulatory laws." Zada indicates that the nature of the business of the borrower may also be a factor ("a reasonable person who gave Zada money to invest in oil markets would expect that securities laws apply to the transaction").

(v) The nature and reasonableness of a purchaser's expectations in a loan note context will vary depending on the nature of the purchaser. Compare, e.g., Pollack ("unsophisticated, passive investors" have reasonable expectation that they are protected by the Securities Acts); Bradford (characterization of deposit notes as "investment" in promotional materials sufficient to satisfy the third prong of the Reves test); Mercer (in context of offering circular for mortgage notes, it was reasonable for purchaser to believe notes were "securities").

d. Alternative Regulation

Reves likely intended the final factor of its analysis in the loan context to allow the presence of "risk-reducing factors" to result in a determination that a note otherwise appearing to be a "security" is not a "security". See, e.g., Bradford; Holloway.

Since banks are regulated in the manner in which they evaluate and acquire loans, it is arguable that the fourth Reves factor would treat loans purchased by banks as non-securities under the Securities Acts. See, e.g., Banco Espanol (focusing on the Comptroller Loan Participation Guidelines). See also, e.g., Stone (collateral is a risk-reducing factor); Zhang-Kirkpatrick (same); Bank of Louisiana (UCC financing statement filings constitute "another regulatory scheme" consistent with finding that credit card receivables are not "securities"); Singer v. Livoti, O'Grady & O'Hare, 741 F. Supp. 1040 (SDNY 1990) ("Singer") (state regulatory scheme surrounding the recordation of mortgages is relevant under this factor). But see, e.g., Wallenbrock ("the existence of limited alternative regulatory enforcement . . . does not obviate the need for the protection of the Securities Acts"); Pollack (disagreeing with Singer, but reserving question of whether state law can be a source of alternative protection); Bradford (even a comprehensive state regulatory scheme is insufficient to render the protection of the Securities Acts unnecessary).

5. Implications of Reves and Post-Reves Case Law

   a. Whether a loan note or participation is a "security" is likely to depend less on what is distributed (in terms of the purpose of the underlying credit) than to whom and how it is distributed. Courts will focus on the context of a transaction.

      Following Reves -- as before it -- a public distribution of loan notes or participations is very likely to be found to be subject to the Securities Acts.

      On the other hand, a placement of loan notes or participations with sophisticated institutional investors (and, possibly, with sophisticated individuals) is not likely to be characterized as an offering of "securities" if the purchasers have the expertise to evaluate the instruments, and if the purchasers acknowledge that the instruments sold were "loans" and not "securities".

      (i) Reves does not set out the relative weights to be accorded the four factors in its analysis. Banks should be careful respecting sales to purchasers that are not involved in direct credit extension. They should determine in each case that the purchaser has sufficient sophistication to evaluate borrower creditworthiness and has no expectation that it will benefit from the Securities Acts.

      (ii) A selling bank should provide sufficient credit information for the purchaser to evaluate the loan, and should not allow the purchaser to rely on the seller's expertise. It may be useful for the seller to obtain certification from the purchaser that it has not relied on the seller's credit evaluation, and that (if the purchaser is a bank) it has evaluated the instrument and will treat the instrument on its books for regulatory and other purposes as a "loan".

(iii) Capital markets developments are compressing the distinction between "loans" and "securities". See Part V.A above. See generally Part II.D.3 above.

A) Large lending transactions often pressure loan sellers to find new purchasers and to provide liquidity in the instruments acquired. Care will be needed to minimize the risk that purchasers will rely on the selling bank to repurchase or make a market in the instruments sold.

B) Some loan notes and participations "look" more like "securities" in form and structure and are traded more like securities through electronic or exchange-like facilities. This is consistent with investment bank movement into the loan syndication area, as well as with expanded institutional trading of privately-placed securities (see Part VI.A below). As discussed in Part II.D above and Part V.C below, banks may justify their acquisition of securities under certain circumstances by classifying them as "loans" for banking law purposes.

C) Although Banco Espanol did not treat this factor as particularly important, assigning ratings to commercial loans could be significant from a securities law perspective, as it could imply that the purchaser of the loan is not relying on its own credit analysis.

(iv) The SEC appears to disagree in some respects with the weight of judicial precedent concerning the treatment of loan notes/participations under the Securities Acts.

A) The SEC filed a brief in support of the complaining purchasers in the appeal of Banco Espanol, arguing that only "traditional" loan notes or participations fall outside the definition of "security". The SEC distinguished the loan participation program in Banco Espanol on the basis of (i) the number and type of participants; (ii) the sales approach ("cold calls" from trading desk rather than loan department referrals); and (iii) the availability of information regarding the borrower (withholding of non-public information). See also, e.g., Remarks of SEC Commissioner Roberts, Sept. 27, 1994 ("mass marketing" of loan participations to institutions that are not in the lending business or to individuals should subject such transactions to the Securities Acts).

B) SEC staff is reported to have taken the position in its review of certain MBS registration statements that loan participations in the MBS collateral pools would be treated as "securities" without regard to a Reves analysis and, unless registered under the 1933 Act or otherwise eligible for sale under SEC Rule 144, would need to be registered. See also Part X.B below.

C) Pursuant to Dodd-Frank §§ 761 and 768, certain SBS are incorporated into the definition of "securities" under the Securities Acts and subject to the full range of securities laws and SEC regulations applicable to "securities". SBS can include a swap on a loan or a credit derivative referencing a single issuer. Under final rules defining the terms "swap" and SBS, the SEC/CFTC clarified that certain loan participations will not be considered swaps or SBS. To qualify for the exclusion, a participation must meet specified criteria for being a current or future direct or indirect ownership interest in the loan or commitment that is the subject of the participation, including that (i) the grantor of the participation is a lender or participant in the loan or commitment; (ii) the participation does not represent a greater interest in the loan or commitment than the grantor owns, nor in the aggregate a greater amount than the principal of the loan or commitment; (iii) the purchase price for the participation is paid in full at the time of acquisition and not financed by the grantor; and (iv) the participation provides the participant with the economic benefits and risks of the whole or part of the loan or commitment that is the subject of the participation. See 77 Fed. Reg. 48208 (Aug. 13, 2012); American Banker, July 26, 2012. See also Part II above.

(v) The Solicitor General filed a brief in opposition to Banco Espanol's certiorari petition on grounds that the decision was limited and did not create a split among the Circuits. However, the Solicitor General viewed Banco Espanol as "flawed" and "open to serious question" since, in his view, the lower courts had (A) focused on the nature of the purchasers and failed to examine their ability to obtain and evaluate borrower credit information; (B) failed to account for marketing materials comparing the notes to CP and other "investments"; and (C) "misunderstood" the fourth prong of Reves in stating that such factor was satisfied by "the existence of another regulatory scheme", and, hence, failed to determine whether regulatory guidelines "significantly reduced the risk" associated with the notes. Brief for the U.S. as Amicus Curiae, Banco Espanol, No. 92-913 (1993).

(vi) In the 2011 Loan/Note Advisory, the MSRB stated that certain municipal finance transactions that have become popularly known as bank products, may in fact entail securities transactions. The Advisory covers certain financings called "bank loans" that could, depending on the nature of the transactions, be placements of municipal securities, as well as certain "direct purchases" by banks of issuers' securities that are subsequently restructured so significantly that they may constitute primary offerings of securities.

See generally Financial Security Assurance v. Stephens, 500 F.3d 1276 (11th Cir. 2007) (municipal bond is not a "security" under Reves when it is acquired by a municipal bond insurer after the issuer's default).

See also Part II.B.3 and Part II.D above.

b. Bass v. Janney Montgomery Scott, 210 F.3d 577 (6th Cir. 2000) ("Janney Montgomery Scott"), analyzed whether notes and stock warrants received by an investor in exchange for "bridge loans" qualify as "securities". While the Court determined that the notes were not "securities", it concluded that the warrants were "securities" and, accordingly, that the entire loan sale transaction was subject to the securities laws.

The Court rejected arguments that warrants issued as part of the underlying loan transaction are not "securities", and instead adopted a per se rule that the securities laws apply to any exchange of warrants regardless of context. The Court noted that (i) the Securities Acts define warrants as "securities", and (ii) the Supreme Court decided in Landreth that stock is a "security" per se regardless of the circumstances in which it changes hands. Compare, e.g., Rispo v. Spring Lake Mews, 485 F. Supp. 462 (E.D. Pa. 1980) (in the context at issue, a promise to deliver stock coupled with a short-term loan did not involve the issuance of a "security").

c. Leemon v. Burns, 175 F. Supp. 2d 551 (SDNY 2001), analyzed whether a note, issued in exchange for an investment convertible into common stock of a publicly traded company, was a 1934 Act "security". The Court found that the fact that the note's principal could be converted into common stock was a "strong factor" for holding that it was a security, while the fact that the note was never intended to be distributed publicly was not, in the context of the transaction, a strong counter-argument. See also Simmons Investments v. Conversational Computing, 2011 U.S. Dist. LEXIS 15962 (D. Kan. 2011); Fletcher I. But compare VMS.

d. Following Reves, a variety of factors could be significant to a securities law analysis of loan note/participation trading: An instrument should be treated as a "loan" where (i) the instrument is identified in the transaction documents as such; (ii) the purchaser of the instrument is a sophisticated institution (or, possibly, a sophisticated individual) of a type that/who regularly makes loans or purchases loan notes or similar instruments; (iii) the seller is a bank (particularly the originating bank) or other financial institution that regularly makes or purchases loan notes or similar instruments (although the involvement of a broker-dealer in the sale should not be dispositive of the appropriate characterization); (iv) the information provided to the purchaser is of the type ordinarily provided to bank lenders, and the purchaser has the sophistication to evaluate such information and to seek more information if required; (v) the instrument is not unusually small for a commercial loan (e.g., is not less than $250,000); (vi) the instrument is of a type that a bank or other financial institution would ordinarily be prepared to keep on its books; (vii) the seller does not agree that it will assist the purchaser in reselling the instrument; (viii) the number of purchasers is not so large as to connote a widespread distribution; and (ix) the purchaser is involved in the administration of the loan (e.g., in the case of a loan participation, the seller does not, in general, have the power to modify material provisions of the loan documents without the purchaser's consent). It would also be helpful to a "loan" characterization if (A) the seller retains a portion of the instrument; (B) the sale agreement is negotiated rather than a "form" document; and/or (C) the note is not accompanied by an instrument (e.g., warrant, option) which is itself a security, and the note does not have equity conversion rights.

6. Gramm-Leach-Bliley Act

a. As described more fully in Part I.C and Part II above and Part IX below, the GLBA Push-out Provisions affect the ability of banks to engage in "broker" or "dealer" activities respecting securities unless their activities conform to product and/or transaction-specific exemptions.

One such exemption permits banks to broker or deal in Identified Banking Products, a term which includes (i) any loan made by a bank (the "Bank Loan Exemption"), and (ii) any participation in a loan which a bank or an affiliate (other than a broker-dealer) funds, participates in, or owns that is sold to a Qualified Investor or certain other sophisticated investors who have the opportunity to review and assess material information concerning the loan participation, and (based on factors such as financial sophistication, net worth and experience in financial matters) have the capability to evaluate such information, as determined under generally applicable standards or guidelines (together with the Bank Loan Exemption, the "Push-out Loan Exemption"). "Qualified Investors" include registered (and certain exempt) investment companies, banks and other financial institutions, certain employee benefit plans/trusts, and corporations and natural persons who own and invest on a discretionary basis not less than $10 million. (Other exemptions (including the Investment Purposes Exemption) could also apply, even if the Push-out Loan Exemption does not.)

The Push-out Loan Exemption would appear to permit banks to broker or deal in any loan or loan participation that qualifies as an Identified Banking Product regardless of whether the loan/participation is a 1934 Act "security". The legislative history of Gramm-Leach creates some ambiguity, however, as to whether such Exemption was intended to apply under circumstances where the loans/participations at issue are 1934 Act "securities." See House Report 106-74, Part 3 (Commerce Committee, June 15, 1999) (Report which accompanied a bill that was a precursor to Gramm-Leach suggesting that the Bank Loan Exemption might only be available for loans that are not 1934 Act "securities").

In any event, if particular loan notes or participations are not 1934 Act securities (even if all of the factors set out in the Push-out Loan Exemption are not present), the GLBA Push-out Provisions should not be applicable.

See also Part V.B.7.b below.

b. The fact that Gramm-Leach may require that, in the particular context, a transaction in a particular loan note or participation be effected by a broker-dealer, or that a bank may not deal in (as opposed to invest in, purchase and sell) a particular instrument, should not mean that, for other purposes of the Securities Act, such note or participation must necessarily be characterized as a "security".

7. Consequences under Securities Laws

   a. 1933 Act

      (i) If a loan note is a "security", its sale would invoke the registration and prospectus delivery requirements of the 1933 Act, unless an exemption is applicable.

      (ii) The 1933 Act § 4(a)(2) private placement exemption and the so-called "§ 4(a) (1-1/2)" exemption for institutional resale -- discussed in Part VI below -- would likely apply to most sales of loan notes, given the level of sophistication (and limited number) of purchasers, and the size of the instruments ordinarily employed. See, e.g., SEC Release No. 33-4552 (Nov. 6, 1962); Equibank Corp. (avail. July 9, 1983) (sales of loan participations to depository institutions and other accredited investors are not subject to 1933 Act registration). See also, e.g., Bradford Homes (avail. Dec. 11, 1997) (short-term construction loan notes secured by loans to be sold to "accredited investors" are 1933 Act "securities"); Security Federal Savings & Loan (avail. Aug. 17, 1990) (participations in short-term construction loan notes are 1933 Act "securities"); Bankers Mortgage Funding Corp. (avail. May 8, 1990) (sale by a non-bank financial institution of secured real estate loans to institutions and individual investors may require registration of loans under the 1933 Act and registration of seller as a broker-dealer).

      (iii) The "issuer" of a loan participation would be the selling bank, not the original borrower. However, the SEC would not likely concur that, if the bank is the "issuer" and the participation is a "security", the "security" is an "exempt security" under 1933 Act § 3(a)(2) (which exempts from registration securities "issued or guaranteed by any bank"). See, e.g., SEC Letter to Rep. Dingell, dated July 2, 1987; Buffalo Savings Bank (avail. Oct. 25, 1982); Bank of America (avail. May 19, 1977); First State Bank of Dodge City (avail. Nov. 21, 1975).

b. 1934 Act

(i) The 1934 Act's antifraud provisions, most notably Section 10(b) and Rule 10b-5, prohibit the use of any device, scheme or artifice to defraud, the making of any untrue statement of a material fact or the omission of a material fact necessary to make the statements made not misleading, or any act, practice or course of business which would operate to deceive any person in connection with the purchase or sale of a "security".

(ii) Rule 10b-5 is the source of the prohibition on "insider" trading. While a prerequisite to Rule 10b-5 liability is that the trader has breached an obligation to keep the information confidential and not to use such information for its private purposes, this obligation can arise from a variety of sources, including, potentially, by reason of a confidential borrower-lender relationship. See generally Part V.A.4.d above and Part V.B.8 below.

(iii) If a loan note or participation is a 1934 Act "security", unless such note or participation falls within the Push-out Loan Exemption, a bank may not engage in brokerage or trading activities respecting such notes or participations without registering as a broker-dealer or relying on another exemption from the GLBA Push-out Provisions. See Part I.C.2, Part II and Part V.B.6 above and Part IX.B.3 below.

c. 1940 Act

Loan participations held by an investment company are "securities" under the 1940 Act because they possess risk attributes similar to debt securities. Putnam Diversified Premium Income Trust (avail. July 10, 1989).

d. State Law

State law offering circular, antifraud and similar provisions could all be relevant if a loan note or participation is a state law "security".

e. MSRB

The MSRB has recently focused on the increasing use of bank loans as municipal financing, and both the MSRB and FINRA have highlighted to market participants that labeling financings evidenced by notes as "loans" is not dispositive of whether such instruments would be viewed as securities under the Reves family resemblance test. The loan/securities distinction is particularly important in determing applicability of a variety of MSRB rules, as it is in relation to other securities regulation. The MSRB is also concerned that due to deficiencies in the current disclosure requirements investors in direct purchases (private placements to a single purchaser) and bank loans may not have access to accurate information about the total indebtedness of municipal issuers. See MSRB Regulatory Notice 2016-12 (Apr. 4, 2016); FINRA Regulatory Notice 16-10 (Apr. 2016); MSRB Regulatory Notice 2016-11 (Mar. 28, 2016).

8. Other Bases for Liability of a Loan Seller to a Loan Purchaser

Claims could be raised against selling banks for violating purported standards of disclosure, contractual obligations or fiduciary responsibility. In other words, courts may conclude that loan sellers have obligations to loan purchasers -- in terms of disclosure of material non-public information, a duty to update or correct prior representations, fiduciary responsibilities and the like -- wholly apart from those arising under federal or state securities laws.

a. Under California law, for example, a fiduciary duty could arise from the contractual identification of one bank as "agent" for another. Chemical Bank v. SecPac Bank, 20 F.3d 375 (9th Cir. 1994).

b. Fiduciary duties could also arise by virtue of an agent bank's "superior knowledge". Banque Arabe et Internationale d'Investissement v. Maryland National Bank, 819 F. Supp. 1282 (SDNY 1993), subsequent decision, 850 F. Supp. 1199 (SDNY 1994), aff'd., 57 F.3d 146 (2d Cir. 1995), found that a lead bank has a duty under NY law to disclose "material" information "not readily available" to a participation purchaser, and that the duty could apply even in the face of contractual "no-reliance" provisions if the information is "peculiarly within the knowledge of the lead bank". See also, e.g., In re Colocotronis Tanker Securities Litigation, 420 F. Supp. 998 (J.P.M.L. 1976) (cases which alleged breach by a lead bank of "common law fiduciary duties" to third-party lenders by failing to disclose material information concerning the borrower). Compare Part II.E.2.e above.

c. Other courts have found that such fiduciary duties do not exist as a matter of law or where contractual arrangements are to the contrary. See, e.g., Bank of the West v. Valley National Bank, 41 F.3d 471 (9th Cir. 1994) (under Cal. law, reliance on lead bank not justified for purposes of fraud claim where contract states participant was relying on its own credit judgment); Banco Totta e Acores v. Fleet National Bank, 768 F. Supp. 943 (D.R.I. 1991) (to similar effect under RI law); Banco Espanol (lead bank and third party lenders are not in a fiduciary relationship); First Citizens Federal Savings & Loan v. Worthen Bank, 919 F.2d 510 (9th Cir. 1990) (under AZ law, "fiduciary relationships should not be inferred" in loan participation agreements among financial institutions "absent unequivocal contractual language"); Aaron Ferer & Sons v. Chase Bank, 731 F.2d 112 (2d Cir. 1984) (under NY law correspondent banking does not create a fiduciary relationship); Northern Trust Co. v. FDIC, 619 F. Supp. 1340 (W.D. Okla. 1985) (no fiduciary duty found where contractual language did not express an intention that the lead lender have such obligation).

d. Some courts have held that a claim for constructive fraud (i.e., a claim that a materially false statement was made and relied on, although there may not have been an intent to mislead) can be established even where there is an express disclaimer of reliance on representations of a loan seller. See, e.g., CoreStates Bank v. Signet Bank, 1997 U.S. Dist. LEXIS 2686 (E.D. Pa. 1997) (although CoreStates disclaimed reliance on representations regarding the financial risks of the loan discernible from the loan documents, under VA law CoreStates did not disclaim reliance on any assurance that Signet had independently verified borrower representations, under circumstances where Signet's assurances were an inducement to CoreStates). See also, e.g., Bank of Montreal v. Signet Bank, 193 F.3d 818 (4th Cir. 1999) (same underlying loan transaction; conclusion that VA law required deliberate non-disclosure to ground an action in fraud); Hitachi Credit America v. Signet Bank, 166 F.3d 614 (4th Cir. 1999) (same underlying loan transaction).

C. Permissibility of Loan Note and Loan Participation Sales and Related Activities under Federal Banking Law

1. The Volcker Rule

The statutory Volcker Rule explicitly exempts loan sales and loan securitizations from its restrictions on proprietary trading, although its legislative history suggests that loan products could be covered by the restrictions if they become financial instruments traded to capture changes in market value. 156 Cong. Rec. S5895 (daily ed., July 15, 2010).

However, under the final Volcker Rule regulations, loans are not "financial instruments" subject to proprietary trading restrictions; the final regulations define a "loan" to include any loan, lease, receivable or extension of credit "that is not a security or derivative." No exemption from the proprietary trading restrictions was made for securities issued in a loan securitization. Although derivatives are also financial instruments, the final regulations define "derivative", in part, by reference to the terms "swap" and "SBS" in the SEC's and CFTC's rules under Title VII of Dodd-Frank. As noted in Part V.B.5.a.iv above, the SEC and the CFTC determined that loan participations are generally not "swaps" or "SBS".

For purposes of the Volcker Rule restrictions on investments in hedge funds and private equity funds, "loan securitizations" are excluded from such restrictions if the assets or holdings of the issuer are solely comprised of (a) loans; (b) rights or other assets designed to assure the servicing or timely distribution of proceeds to holders of the issuer's ABS and rights or other assets that are related or incidental to purchasing or otherwise acquiring and holding loans; (c) interest rate or FX derivatives that reduce interest rate or FX risks related to the loans (or other permissible assets) or the ABS, the terms of which derivatives directly relate to the loans (or other permissible assets) or the ABS; and (d) certain special units of beneficial interest and collateral certificates representing interests in assets the issuer is otherwise permitted to hold under the exclusion. Further, excluded loan securitizations are permitted to hold securities if such securities are cash equivalents or received in lieu of DPC (e.g., in a workout of a loan owned by the issuer). Certain covered bond structures and qualifying ABCP conduits are also exempt from coverage under the Volcker Rule fund investment restrictions.

See Part II.A above.

2. Financial Holding Companies and Financial Subsidiaries

Whether or not loan notes or participations are "securities" under the Securities Acts, FHCs and financial subsidiaries have the power as a federal banking law matter to act as originator, seller, distributor or agent with respect to such notes or participations, and to engage in asset management and other activities permissible to BHCs or banks, as "financial activities" under Gramm-Leach. See Part I above.

3. Bank Holding Companies and Banks

Although the factors that enter into a determination as to whether particular loan notes or participations are "securities" under the Securities Acts (see Part V.B above) could be relevant for Glass-Steagall purposes, loan notes and participations should not be characterized as Glass-Steagall "securities", and the sale of such instruments to financial and institutional purchasers should not be found to violate Glass-Steagall.

a. Glass-Steagall § 16 authorizes national banks to "discount . . . and negotiat[e] promissory notes", and banks have traditionally bought and sold loan notes and participations. However, a broad-based or "retail" sale of loan notes is arguably similar to a corporate debt underwriting and could pose some of the financial risks and conflicts of interest at which Glass-Steagall is directed.

(i) Bankers Trust I held that CP is a Glass-Steagall "security". Given the Supreme Court's broad interpretation of "notes" and "securities" and the Court's focus on both the nature of the instrument and the role of the bank in the transactions at issue, the possibility of Glass-Steagall coverage of some transactions in loan notes and participations cannot be ignored. SEC staff stated at one time that sales of loan participations may raise questions under Glass-Steagall. SEC General Counsel Letter to Board General Counsel, dated June 26, 1979.

(ii) The Board's Legal Division has stated that "the business of commercial banking" includes "sales of loan participations . . . to other commercial banks and other institutional purchasers". [CP] Activities of Commercial Banks: A Legal Analysis (June 28, 1979) (emphasis added). See also, e.g., Board SR 97-21; 1989 Order.

A) Purchases and sales (as principal or broker) of loan notes, loan participations and other extensions of credit, as well as loan marketing and advisory services, are permissible for BHCs. 12 C.F.R. § 225.28(b)(1). See generally, e.g., Standard Chartered, 60 Fed. Reg. 44347 (Aug. 25, 1995) (trade finance activities) (approved Sept. 15, 1995).

B) The Board authorized a BHC to engage in electronic consumer and mortgage loan origination and brokerage (including automobile dealer paper) through a computer database matching borrowers and lenders and locating loan purchasers. U.S. Bancorp, 57 Fed. Reg. 29511 (July 2, 1992) (solicitation of public comments) (approved Sept. 8, 1992).

C) Regulation Y permits BHCs to provide asset management, servicing and collection services respecting loan assets (including acting as agent in the liquidation or sale of loans and loan collateral, so long as the BHC does not engage in real property management or real estate brokerage). 12 C.F.R. § 225.28(b)(2)(vi). See also, e.g., Sumitomo Trust, 59 Fed. Reg. 15732 (Apr. 4, 1994) (solicitation of public comments) (approved May 13, 1994); Fleet, 59 Fed. Reg. 25660 (May 17, 1994) (solicitation of public comments) (approved Apr. 15, 1994), 57 Fed. Reg. 45810 (Oct. 5, 1992) (solicitation of public comments) (approved Nov. 3, 1992); PNC, 58 Fed. Reg. 31962 (June 7, 1993) (solicitation of public comments) (approved July 26, 1993); Continental Bank Corp., 79 Fed. Res. Bull. 888 (1993); DKB, 79 Fed. Res. Bull. 131 (1993); Michigan National Corp., 78 Fed. Res. Bull. 65 (1992); First Interstate Bancorp, 77 Fed. Res. Bull. 334 (1991); Banc One Corp., 77 Fed. Res. Bull. 331 (1991), modified by Board Letter, dated May 19, 1993; NCNB Corp., 77 Fed. Res. Bull. 124 (1991); First Florida Banks, 74 Fed. Res. Bull. 771 (1988) (collectively, the "Asset Management Orders").

D) A BHC may acquire debt that is in default at the time of acquisition, if the BHC (i) divests shares or assets securing debt in default that are not permissible investments for BHCs within the time period (calculated beginning on the date that the debt is acquired) required for divestiture of property acquired DPC under 12 C.F.R. § 225.12(b); (ii) stands in the position of a creditor and does not purchase equity of obligors of debt in default (other than equity that may be collateral for such debt); and (iii) does not acquire debt in default secured by shares of a bank or BHC. This reflects Board Orders referred to in Part II.D.2 above. See also, e.g., Bayerische Vereinsbank, 61 Fed. Reg. 43764 (Aug. 26, 1996) (solicitation of public comments) (approved Sept. 12, 1996).

(iii) The Comptroller has stated that banks "engage every day in the sale of . . . loan participations, . . . which can be considered securities in certain contexts" but which are not Glass-Steagall "securities". Letter, dated Mar. 30, 1977, CCH Fed. Banking L. Rep. ¶ 97,093.

A) Letter No. 388 reaffirmed that instruments representing bank mortgage loans are not Glass-Steagall "securities" in the context of even the public sale of those instruments. While Letter No. 388 was upheld in the Second Circuit Mortgage Securities Decision discussed below in Part X.C.3.a, the Second Circuit did not resolve the question of whether loans are ever Glass-Steagall "securities".

B) The Comptroller has approved national bank participation in all aspects of loan sales and asset management services. See, e.g., Comptroller's Handbook: Asset Management; Comptroller Unpublished Letter (Dec. 20, 1996); Comptroller Interpretive Letters No. 736 (July 25, 1996), CCH Fed. Banking L. Rep. ¶ 81-053 (bank sale of loan participations to non-banks); No. 646 (May 1994), CCH Fed. Banking L. Rep. ¶ 83,555 (asset management services); No. 539 (Jan. 15, 1991), CCH Fed. Banking L. Rep. ¶ 83,251 (asset management services); No. 387 (June 22, 1987) ("Letter No. 387"), CCH Fed. Banking L. Rep. ¶ 85,611 (brokerage of mortgage loans) (collectively, the "Comptroller Asset Management Precedents").

C) Comptroller Interpretive Letter No. 953 (Dec. 4, 2002), CCH Fed. Banking L. Rep. ¶ 81-478, stated that it is the functional equivalent and a logical outgrowth of a recognized banking activity -- originating or purchasing loans (specifically, loans with balloon payments where the bank assumes the necessity of disposing of the collateral if, at the time of the final payment, the borrower chooses to return the collateral to the bank in lieu of the balloon payment) -- for a national bank to enter into residual purchase agreements with third party equipment lessors under which the bank agrees to purchase equipment from lessors at the end of the lease term at pre-determined prices (or to act as agent of the lessor in the sale of the equipment, but where the lessor will receive the pre-determined price regardless of the actual sale price). The Comptroller stated that the risk management that a bank would undertake in estimating the residual value, assigning a purchase price, and selling off-lease equipment is identical to the risk management that a bank would undertake in connection with its own finance lease transactions.

b. As noted in Part II.D above, it is not always easy to determine whether a particular instrument is a "loan" or a "security". However, at least where (i) a bank characterizes an instrument as a "loan" for all purposes (including internal classification and monitoring, credit review, reporting, lending policy compliance, allowance and provision for loan losses, lending limits, etc.); (ii) the bank performs a credit review of (and maintains a credit file on) the issuer comparable to that for a "loan" under similar circumstances (e.g., where the instrument is acquired as a long-term bank asset, or where it is acquired as part of a loan trading function); and (iii) the instrument is, in general, not publicly traded on an exchange or the like, the bank should have the authority to hold, purchase and sell (but not necessarily underwrite or deal in) an instrument which is a "security" or an "investment" for purposes of the Securities Acts in reliance on its power to make, buy and sell loans and other extensions of credit. See also Part V.B.6 above (GLBA Push-out Provisions) and Part VI.B below.

c. If loan instruments are Glass-Steagall "securities", transactions in such instruments could constitute prohibited "underwriting", "dealing" or "selling". Nonetheless, there seems to be little risk that a loan/loan participation sale program would violate Glass-Steagall, at least where (i) an appropriate credit review is made; (ii) the instrument is of the type that a bank would, in general, be prepared to keep on its books; (iii) the purchasers are all sophisticated; and (iv) the bank does not use a broker-dealer to effect widespread sales to entities which do not ordinarily purchase loan notes or participations or similar instruments.

d. With respect to NIF and RUF obligations, a number of steps can be taken which would strengthen the argument that Glass-Steagall "securities" are not involved.

(i) Participating banks could resell such obligations only to institutions which normally purchase loan participations. NIF/RUF certificates could bear a legend restricting subsequent resale in this regard.

(ii) Bank-owned NIF/RUF certificates could be physically distinguishable from notes sold by an investment bank. It may be helpful if the NIF/RUF agreement provides that, in lieu of purchasing notes, a bank may make an advance (a "loan") equal to the principal amount of the notes that it is otherwise obligated to purchase.

(iii) Transfers of bank-owned NIF/RUF certificates should be accompanied by such documentation and credit information as is typically provided in loan sales.

VI. Agency Placement and Related Activities

A. <u>Private Placement Markets</u>

1. <u>General</u>

   a. In recent years, U.S. traditional private placement have been in excess of $50 billion. <u>U.S. Private Placement Reviews</u> (Thomson Reuters, 2014 and 2015); <u>Private Placement Monitor</u> (2016).

      For recent general background on private placement markets, <u>see</u>, <u>e.g.</u>, <u>U.S. Regulation of International Securities Markets</u>, Chapter 7.

   b. To generate fee income and offer corporate customers a broad array of financial services, banking organizations typically look to combine their placement role with advisory, "bridge loan" and other activities. <u>See generally</u> <u>Part III.A.2.b. above</u>.

   c. With respect to alternatives to conventional SEC-registered offerings, <u>see</u> Fleisher, Hur & Brush, "Alternatives to Traditional Securities Offerings", <u>Financial Products Fundamentals</u> (PLI, 2013); <u>Corporate Counsel</u>, May/June 2013.

2. <u>SEC and Related Developments</u>

   a. <u>Private Placement Procedures</u>

      Any offer or sale of a security in the U.S. must be registered with the SEC under the 1933 Act unless an exemption is available. 1933 Act § 4(a)(2) exempts from registration "[t]ransactions by an issuer not involving any public offering". The securities law guidelines within which private placements are conducted are derived from both § 4(a)(2) and SEC rules, and from principles developed by the private securities bar.

(i) The SEC's Regulation D under the 1933 Act, 17 C.F.R. §§ 501-508 ("Regulation D"), sets forth non-exclusive "safe-harbors" from registration for offers and sales of securities, including for certain small offerings. The private placement "safe-harbor" (based on 1933 Act § 4(a)(2) and set forth in Rule 506) is available to an issuer if (A) the securities are not offered or sold through general solicitation or advertising; (B) the securities are essentially sold only to "accredited investors" (a term which includes most banks, insurance companies and investment companies); (C) investors receive information comparable to that required in an SEC-registered offering; (D) the issuer exercises "reasonable care" to ensure that the purchasers are not "underwriters" (i.e., that they are not purchasing securities with a view to public distribution); and (E) a notice of the offering (Form D) is filed with the SEC. See generally Capital Raising in the U.S.: The Significance of Unregistered Offerings Using the Regulation D Exemption (SEC, Feb. 2012).

On August 6, 2015, the SEC staff issued guidance on what constitutes "general solicitation and general advertising." See SEC Compliance and Disclosure Interpretations (Aug. 6, 2015); see also, New SEC Staff Guidance on General Solicitation (Cleary Gottlieb, Sept. 2, 2015).

In practice, most private placements do not comply with Regulation D, largely because of the obligation to file a Form D, which requires information regarding the issuer and the offering that many issuers -- especially foreign issuers -- are reluctant to provide.

(ii) Regulation D guidelines for conducting "traditional" private placements include (A) prohibition against general solicitation or advertising; (B) limitation on offers and sales to sophisticated investors; (C) use of "investment" or "non-distribution" letters with representations to the effect that the purchaser (i) is an accredited investor with such knowledge and experience in financial and business matters that it is capable of evaluating the merits and risks of the investment, and (ii) is not purchasing the securities with a view to their distribution; (D) sale of securities only in large denominations (e.g., $250,000 or more); (E) legending of securities to the effect that they have not been registered under the 1933 Act; and (F) transfer restrictions.

Private placements also involve the use of a placement memorandum, the distribution of which is controlled to ensure that the securities are offered and sold only to a limited number of investors. The level of disclosure in placement memoranda varies, although typically less than in a 1933 Act registration statement.

(iii) Dodd-Frank § 413(b) authorizes the SEC to undertake an initial review of the definition of "accredited investor" and then requires the SEC to undertake subsequent reviews not earlier than July 21, 2014 and not less frequently than every four years thereafter (the "SEC AI Review").

[SEC]: Alternative Criteria for Qualifying as an Accredited Investor Should Be Considered (GAO, July 18, 2013), mandated by Dodd-Frank § 415, recommended that the SEC consider alternative criteria for the accredited investor standard. Though net worth was agreed to be the most important criterion, market participants suggested other criteria (e.g., related to an investor's liquid investments and the use of an investment adviser). The study was meant to provide a starting point for the SEC AI Review.

(iv) SIFMA has issued guidance offering two different methods for broker-dealers and investment advisers to verify that prospective purchasers qualify as accredited investors under Regulation D Rule 506 ("Rule 506").

See SIFMA, Guidance on Rule 506(c) Verification (June 23, 2014).

A) Under the Account Balance Method, the client must have been with the firm for at least six months, have at least $2 million in cash and marketable securities and have made certain purchaser representations (including that the purchaser is an accredited investor, is not borrowing money to make the investment and is making the investment for his or her own account) and the firm must not be aware of facts indicating that the client is not an accredited investor.

B) Under the Investment Amount Method, the client must have been with the firm for at least six months, have invested or committed to invest at least $250,000 and have provided the appropriate purchaser representations described in the Account Balance Method, and the firm must not be aware of facts indicating that the client is not an accredited investor.

(v) In 2011, in order to reflect Dodd-Frank § 413(a), the SEC adopted definitional amendments to exclude the value of a person's primary residence for purposes of determining whether the person qualifies as an "accredited investor" on the basis of having a net worth in excess of $1 million. See SEC Release No. 33-9287 (Dec. 21, 2011).

(vi) In 2013, the SEC adopted amendments to implement Dodd-Frank § 926, which requires the SEC to adopt rules that disqualify certain "felons and other 'bad actors'" from reliance on the Rule 506 safe harbor from 1933 Act registration. Rule 506(d) disqualifies certain issuers, underwriters, placement agents, directors, officers and significant shareholders from participating in exempt securities offerings if they have been convicted of, or are subject to court or administrative sanctions for, securities fraud or similar scienter-based violations. However, the Rule includes a "reasonable care" exception under which an issuer would not lose the benefit of Rule 506 despite the existence of a disqualifying event if it can show that it did not know and, in the exercise of reasonable care could not have known, of the disqualification. See 78 Fed. Reg. 44730 (July 24, 2013). See also Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings and Related Disclosure Requirements: A Small Entity Compliance Guide (SEC, Sept. 19, 2013).

The SEC's Compliance and Disclosure Interpretations (Nov. 13, Dec. 4, 2013, Jan. 3 and 23, 2014) have clarified certain aspects of Rule 506(d), including the following:

A) Issuers must determine whether they are subject to this "bad actor" disqualification whenever they offer or sell securities pursuant to Rule 506.

B) Rule 506(d) applies to all persons who are compensated for soliciting purchasers.

C) In determining whether it is subject to disqualification, an issuer may reasonably rely on a covered person's agreement to notify it of an event triggering disqualification. If the offering is continuous, delayed or long-lived, however, the issuer must renew its factual inquiry periodically (e.g., by obtaining bring-down representations and negative consent letters, searching public databases and taking "other steps depending on the circumstances").

D) If a placement agent becomes disqualified under Rule 506(d) while an offering is ongoing, the issuer may continue relying on the Rule if it terminates the placement agent and the placement agent receives no compensation for future sales. If only a covered control person -- such as an executive director or a non-managing member -- becomes disqualified, the issuer may continue relying on Rule 506 if the relevant person is terminated or ceases to perform any role for the placement agent causing such person to be a covered person for purposes of Rule 506(d).

E) An "affiliated issuer" under Rule 506(d) is an affiliate of the issuer (as defined in Regulation D Rule 501(b)) that issues securities in the same offering (including offerings subject to integration pursuant to Regulation D Rule 502(a)).

F) The term "participating" does not include persons whose sole involvement with the offering is to approve a solicitor's participation in the offering (i.e., the members of a compensated solicitor's committee). However, officers of a compensated solicitor may be "participating" if they are involved in due diligence activities, prepare offering materials, provide advice related to the offering or communicate with the issuer, prospective investors or other participants about the offering. Transitory, incidental and administrative functions (such as opening accounts, bookkeeping and wiring funds) generally would not be considered participating in the offering.

G) The definition of "beneficial owner" of an issuer should be given the same meaning as the term in the SEC's Rule 13d-3 under the 1934 Act (which includes holders of voting and/or investment power), including concepts regarding direct and indirect ownership, status as a "group", etc.

The SEC has granted waivers of 506(d) disqualifications to banking organizations that have been subject to judgments or have pled guilty to legal violations. Waivers may be granted by order of the Commission or by letter under delegated authority by the Division of Corporation Finance, Office of Small Business Policy. See, e.g., Moloney Securities Co., Inc. (SEC Letter, Sept. 30, 2016); SG Americas Securities, LLC (SEC Order, Sept. 28, 2016); Feltl & Company, Inc. (SEC Letter, June 21, 2016); Canaccord Genuity Inc. (SEC Letter, Mar. 24, 2016); Royal Alliance Associates, Inc., SagePoint Financial, Inc. and FSC Securities Corporation (SEC Letter, Mar. 14, 2016); Certain Underwriters Participating in the Municipalities Continuing Disclosure Cooperation Initiative (SEC Orders, Feb. 2, 2016 and Sept. 30, June 18, 2015); Barclays Capital Inc. (SEC Order, Jan. 31, 2016); In the Matter of Steven A. Cohen (SEC Letter, Jan. 8, 2016); JPMorgan Chase Bank, N.A. (SEC Order, Dec. 18, 2015); National Asset Management, Inc. (SEC Letter, Oct. 26, 2015); Aegis Capital Corp. (SEC Letter, Sept. 14, 2015); Citigroup Global Markets, Inc. (SEC Order, Aug. 19, 2015); Guggenheim Partners Investment Management, LLC (SEC Order, Aug. 10, 2015); Piper Jaffray & Co. (SEC Letter, July 20, 2015); Macquarie Capital (USA) Inc. (SEC Letters, July 6, May 15, 2015); Merrill Lynch, Pierce, Fenner & Smith Inc. (SEC Letter, June 1, 2015); Barclays PLC, Barclays Bank PLC and Barclays Capital Inc. (SEC Order, May 20, 2015); UBS AG (SEC Order, May 20, 2015); BlackRock Advisors, LLC (SEC Letter, Apr. 20, 2015); H.D. Vest Investment Services, Inc. (SEC Letter, Mar. 4, 2015); Oppenheimer & Co. Inc. (SEC Order, Jan. 27, 2015); Bank of America, N.A. and Merrill Lynch, Pierce, Fenner & Smith Inc. (SEC Order, Nov. 25, 2014); Citigroup Global Markets, Inc. (SEC Order, Sept. 26, 2014). In response to criticism over the granting of such waivers (see, e.g., Law360, Feb. 21, 2015; Remarks of SEC Commissioner Stein, Feb. 20, 2015), the SEC's Division of Corporation Finance issued guidance clarifying how it processes waiver requests, including a description of the factors considered, among other facts and circumstances, when evaluating waiver requests. See Waivers of Disqualification under Regulation A and Rules 505 and 506 of Regulation D (SEC, March 13, 2015). See also Process for Requesting Waivers of "Bad Actor" Disqualification under Rule 262 of Regulation A and Rules 505 and 506 of Regulation D (SEC, Mar. 13, 2015). However, controversy surrounding the Rule 506(d) waiver process has continued. See, e.g., Remarks of Commissioner Aguilar, Aug. 27, 2015; Law360, May 18, 2015.

(vii) The JOBS Act (see Part I.A.8.a.ii above) includes provisions intended to facilitate capital formation by making it easier for smaller companies to raise public and private capital in the U.S. financial markets. See generally JOBS Act FAQs (SEC, Feb. 3, 2013, Sept. 28, Aug. 22, May 3, Apr. 16, 2012). Studies of the effects of the JOBS Act on costs of going public and the volume of IPOs have reached conflicting conclusions, recognizing that it can be difficult to control for market factors. See, e.g., The JOBS Act: 2015 Mid-year Update (Ernst & Young, Sept. 2015); Dambra, Field and Gustafson, "The JOBS Act and IPO Volume: Evidence That Disclosure Costs Affect the IPO Decision", Journal of Financial Economics (2015); Chaplinsky, Weiss, Hanley & Moon, The JOBS Act and the Costs of Going Public (Aug. 14, 2014, revised Sept. 16, 2014).

A) JOBS Act § 201(a) directs the SEC to revise its rules to remove the prohibition on general solicitation or general advertising for offerings under Rule 506 in which all purchasers are accredited investors and the issuer takes reasonable steps to confirm purchasers' accredited investor status. The SEC finalized a Rule adding a new Section 506(c) to Rule 506 on July 10, 2013, which became effective on September 23, 2013. See 78 Fed. Reg. 44771 (July 24, 2013) (final rule) (the "SEC JOBS Act Rule"); 77 Fed. Reg. 54464 (Sept. 5, 2012) (solicitation of public comments).

i) The SEC JOBS Act Rule leaves the existing safe harbor under Rule 506 unchanged, but adds a new Rule 506(c) providing for offerings under the Rule that use general solicitation and general advertising and stating the conditions that must be met for those offerings.

ii) The conditions for Rule 506(c) differ from the general Rule 506 safe harbor in four respects:

(a) All purchasers must be accredited investors.

(b) The issuer "shall take reasonable steps to verify" that the purchasers are accredited investors.

(c) The limitation on manner of offering in Regulation D Rule 502(c) -- which requires that there be no general solicitation or general advertising -- does not apply.

(d) The information requirement in Regulation D Rule 502(b) does not apply.

iii) If an issuer commences an offering intending to rely on Rule 506(c) but ultimately does not engage in any form of general solicitation, it may subsequently decide to rely on Rule 506(b) instead, provided that all of the conditions of Rule 506(b) have been satisfied. If the issuer has already submitted a Form D indicating reliance on Rule 506(c), it must file an amendment to the form. Conversely, if an issuer intends to rely on Rule 506(b) but subsequently decides to rely on Rule 506(c), it may do so as long as the conditions to Rule 506(c) have been satisfied and the issuer amends its Form D. If the issuer has engaged in general solicitation, it may not subsequently decide to rely on the exemption for private offerings in 1933 Act § 4(a)(2), and "[t]he use of general solicitation continues to be incompatible with a claim of exemption under § 4(a)(2)." SEC Compliance and Disclosure Interpretations (Nov. 13, 2013).

iv) At the same time as it adopted the SEC JOBS Act Rule, the SEC proposed additional Rule amendments and changes to Form D to enhance the SEC's understanding of market changes arising from the SEC JOBS Act Rule. The changes would expand the information requirements of Form D and require, on a temporary basis, submission to the SEC of written general solicitation materials used in offerings under Rule 506(c). See 78 Fed. Reg. 44806 (July 24, 2013) (solicitation of public comments).

B) JOBS Act § 201(a) also directs the SEC to permit securities sold under Rule 144A to be offered to persons other than qualified institutional buyers ("QIBs"), including by means of general solicitation or general advertising, provided that only QIBs (or persons the seller, or any person acting on the seller's behalf, reasonably believes to be QIBs) purchase the securities. The SEC implemented these changes in the SEC JOBS Act Rule. The SEC's amendments to Rule 144A did not change how directed selling efforts under Regulation S, 17 C.F.R. Part 230.901 ("Regulation S") -- which relates to offerings outside of the U.S. -- are analyzed in concurrent Rule 144A and Regulation S offerings. See SEC Compliance and Disclosure Interpretations (Nov. 13, 2013). See also Part VI.A.2.c below.

C) The issuer and other participants will remain subject to potential federal securities law antifraud liability for whatever is communicated in the general solicitation or general advertising that is relevant to the offering. Concerns in this area may lead some market participants to continue to observe conventional publicity restrictions, but without the concern that inadvertent general solicitation and general advertising will make Rule 506 (or Rule 144A) unavailable.

D) JOBS Act Title III exempts certain "crowdfunding" transactions from the 1933 Act registration requirements. "Crowdfunding" is a method of capital formation in which groups of individuals or entities pool money, typically composed of small individual contributions, and often via Internet platforms, to invest in or lend to a company or otherwise support an effort by others to accomplish a specific goal. See generally NASAA Press Release, Dec. 5, 2012.

   i) To the extent that certain types of crowdfunding may have implicated the U.S. securities laws, the JOBS Act amended 1933 Act § 4 to exempt offerings in which the aggregate amount of securities of an issuer sold within the previous 12-month period is $1 million or less.

   ii) The amount that may be sold to any one investor in reliance on the exemption within a 12-month period is limited to (a) the greater of $2,000 or 5% of the investor's annual income or net worth, if the investor's annual income or net worth is less than $100,000; and (b) 10% of the investor's annual income or net worth, not to exceed a maximum aggregate amount sold to the investor of $100,000, if the investor's annual income or net worth is equal to or more than $100,000.

iii) Only U.S. companies may take advantage of the crowdfunding exemption. In addition, issuers may not be reporting companies under the 1934 Act and may not be 1940 Act investment companies or be excluded from the definition of investment company by 1940 Act § 3(b) or (c).

iv) Companies would be permitted to issue crowdfunding securities without filing a registration statement with the SEC, provided that issuers, brokers and funding portals conduct such transactions as set forth in the JOBS Act.

v) The JOBS Act calls for the SEC to issue crowdfunding rules and to define criteria for the disqualification of issuers, brokers and funding portals from making use of the crowdfunding exemption. In 2015, the SEC adopted final rules implementing the crowdfunding provisions of the Act. <u>See</u> 80 Fed. Reg. 71388 (Nov. 16, 2015) (final rule); 78 Fed. Reg. 66428 (Nov. 5, 2013) (solicitation of public comments).

(a) New 1934 Act § 3(h) requires the SEC to exempt an intermediary that operates a funding portal from the requirement to register with the SEC as a broker.

(b) The funding portal would need to register as such with the SEC and would be subject to SEC examination, enforcement and rulemaking. It would also need to become a member of FINRA.

(c) FINRA has adopted funding portal rules and related forms for SEC-registered funding portals that become FINRA members. See FINRA Regulatory Notice 16-06 (Jan. 2016).

vi) Purchasers of securities sold in crowdfunding transactions may not transfer such securities within one year unless transferred (A) to the issuer, (B) to an accredited investor, (C) as part of an SEC-registered offering, or (D) to a family member or in connection with the death or divorce of the purchaser or other similar circumstance.

vii) The JOBS Act will create liability for issuers that offer or sell securities in crowdfunding transactions through oral or written communications containing material misstatements or omissions that the issuer cannot prove it did not know about or could not have known about if reasonable care had been exercised. Securities offered in crowdfunding transactions will be exempt from state regulation of the offering process, but the JOBS Act preserves state jurisdiction over fraud, deceit or the unlawful conduct of brokers, dealers, funding portals and issuers.

E) JOBS Act Title IV requires the SEC to enact rules expanding the exemption from registration under Regulation A, 17 C.F.R. § 251 et seq. ("Regulation A"), for small offerings of securities. The Act provides that the SEC must allow offerings of up to $50 million of securities in a 12-month period under

Regulation A and must require companies to file audited financial statements annually with the SEC. The SEC has adopted rules implementing these provisions. See 80 Fed. Reg. 21806 (Apr. 20, 2015) (final rule) ("SEC Regulation A Amendments"); SEC Press Release 2015-49 (Mar. 25, 2015); 79 Fed. Reg. 3926 (Jan. 23, 2014) (solicitation of public comments).

F) JOBS Act Titles V and VI amend the thresholds for registration, termination of registration and suspension of reporting under the 1934 Act. With regard to registration, the JOBS Act requires an issuer that has total assets exceeding $10 million to register a class of securities if that class of securities is held of record by 2,000 persons or, with respect to issuers that are not banks or bank holding companies, 500 persons who are not accredited investors. Additionally, under the JOBS Act, issuers that are banks or bank holding companies are able to terminate registration of a class of securities or suspend 1934 Act reporting if the class of securities is held of record by less than 1,200 persons. For other issuers, the threshold for the termination of registration or the suspension of reporting remains 300 persons. Further, the JOBS act amended Section 12(g)(5) of the 1934 Act to exclude from the definition of "held of record" securities that are held by persons who received them pursuant to an employee compensation plan in transactions exempted from the registration requirements of Section 5 of the Securities Act, and instructed the SEC to create a safe harbor for issuers when determining compliance with this provision. In December 2014, the SEC proposed rules that would implement these provisions and would allow savings and loan holding companies to register, terminate registration and suspend reporting using the same thresholds that apply to banks and bank holding companies under the JOBS Act. See 79 Fed.

Reg. 78343 (Dec. 30, 2014) (proposed rule); SEC Press Release 2014-288 (Dec. 18, 2014).

(viii) Except in unusual cases (see, e.g., United Mexican States (avail. Mar. 28, 1990)), the SEC does not issue no-action letters regarding the availability of the private placement exemption.

A) A U.S. private placement may be combined with a concurrent offering outside the U.S. under Regulation S. See Part XI.D.2 below.

B) The SEC's views about computer and other investor matching services within the context of the "general solicitation" restriction of Regulation D, as well as issues with respect to Internet-based solicitation, qualification and offer acceptance, are reflected in precedents set out in Part IX.F below.

(ix) Securities that are privately placed are "restricted securities", which cannot be resold except pursuant to a registration statement or an exemption from 1933 Act registration requirements.

A) Rule 144 under the 1933 Act ("Rule 144") permits resale without registration after expiration of a prescribed holding period.

B) To increase the liquidity of privately-sold securities and to decrease the cost of capital for reporting companies, SEC Release No. 33-8869 (Dec. 6, 2007) reduced the holding period under Rule 144. See, e.g., Silverman et al., "SEC Adopts Amendments to Rules 144 and 145", Sec. & Comm. Reg., May 7, 2008.

As a result of these amendments, many initial purchasers of private placements (particularly purchasers of convertible notes) appear willing to rely on their ability to resell under Rule 144 in lieu of requiring the issuer to enter into registration rights agreements. Investors continue to prefer these agreements in some circumstances, including where (i) securities are required for inclusion in a securities index and such inclusion is important to the investor, (ii) the investor is subject to internal or regulatory restrictions that favor registered securities, or (iii) the issuer is a non-reporting company and the investor seeks to impose the disciplined reporting requirements that accompany registration. See Fleisher & Ju, "Revised Rule 144 and Registration Rights", Practical L.J. (Feb. 2010).

C) The securities-bar-developed "§ 4(1-1/2) exemption" allows restricted securities to be resold (without any holding period requirement) if the sale would have qualified as a private placement had the purchaser acquired the securities from the issuer.

(x) Some offerings are structured and documented as registered public offerings but are pre-marketed on a confidential basis to a number of accredited investors before being converted into a public offering. See Fleisher, Hur & Brush, "Alternatives to Traditional Securities Offerings", Financial Products Fundamentals (PLI, 2013).

(xi) The FAST Act added a new Section 4(a)(7) of the 1933 Act, exempting from registration certain resales of securities to accredited investors. This new nonexclusive safe harbor from registration came into effect in December 2015. While Section 4(a)(7) appears designed to codify existing market use of the § 4(1-1/2) exemption, it contains several significant limitations that will not allow sellers to rely on it as they have relied on the § 4(1-1/2) exemption in the past. See generally Grabar, "FAST Act Amendments to the U.S. Securities Laws", Harvard Law School

Forum on Corporate Governance and Financial Regulation (Jan. 16, 2016).

b. Liability Risk for Placement Agents

(i) Gustafson v. Alloyd Co., 513 U.S. 561 (1995) ("Gustafson"), affected the standards for agents' liability in private placements.

A) Prior to Gustafson, market participants generally understood that a purchaser in a private placement could take advantage of the remedies afforded by 1933 Act § 12(a)(2), which imposes liability on a "seller" of securities (e.g., an underwriter or a private placement agent) if a prospectus or other communication used in the offer or sale contained a material misstatement or omission. The seller's liability under § 12(a)(2) was subject only to the affirmative defense that the seller "did not know, and in the exercise of reasonable care [i.e., 'due diligence'] could not have known", of the misstatement or omission.

B) Gustafson held, however, that 1933 Act § 12(a)(2) liability is limited to public offerings (i.e., is inapplicable to private placements or secondary market transactions). As a result, a purchaser of securities in a private placement has to pursue claims for misstatements or omissions in offering documents under the more rigorous standards of Rule 10b-5, which requires proof that the seller acted with "scienter" (i.e., intentionally or recklessly) and that the purchaser relied on the misstatement or omission in making the purchase.

C) Gustafson seems to have had a limited impact on U.S. private placements. Diligence and disclosure practices do not appear to have changed significantly, in part because of the difficulty of defining the minimum steps that a placement agent must take to ensure that it is not found to be "reckless" for purposes of Rule 10b-5, the risk of SEC action against a placement agent based on the negligence standards imposed in connection with sales of securities under 1933 Act § 17, the risk of actions under state securities laws, reputational concerns and investor expectations.

D) Gustafson seems to have influenced an increase in the number of offerings that do not use a prospectus ("undocumented offerings").

i) Particularly in Europe and Asia, securities offerings are sometimes made without a formal offering document. These offerings are marketed to institutional investors, are often timed to coincide with (or follow closely on) a substantive press release by the issuer, and may be undertaken in conjunction with a roadshow or other presentation at which investors may ask questions. Salespeople typically use a "selling script" or "fact sheet", and research reports are often distributed. A purchaser in such an offering is often asked to acknowledge that it has not received a prospectus or relied on any information relating to the issuer other than that provided by the issuer. Typically a purchase agreement between the issuer and the placement agent contains "bare-bones" representations.

Undocumented offerings can provide flexibility and efficiency, although the risk of U.S. liability for material misstatements or omissions under Rule 10b-5 is increased because oral statements by salespeople, research reports by distribution participants and press releases by the issuer take on added significance, and each can be a source of liability. In part because of the perceived reduction of liability risk following Gustafson, some non-U.S. financial houses have, to a limited extent, included U.S. investors in undocumented Rule 144A offerings.

Undocumented U.S. offerings can be classified along a risk spectrum: the risk is likely to be lowest for block trades on behalf of shareholders unaffiliated with the issuer, and highest in the case of significant capital-raising exercises by issuers and affiliates that involve roadshows and marketing efforts. Key factors to consider include (a) the identity of the seller, (b) contractual arrangements with the seller, (c) the placement agent's relationship with the issuer, (d) the nature of the market for the issuer's securities and the amount of publicly available information, and (e) the nature of the selling efforts.

ii) Private placements may be made in the U.S. either pursuant to Rule 144A or in traditional offerings. There is no mandatory disclosure, and offering materials (e.g., prospectuses, press releases and research reports) may be furnished to investors but must not be distributed to the general public.

The investment banking community generally seems reluctant to distribute research reports in the U.S. during a sale of securities because of concerns about potential liability if a court were to find that the reports constitute "prospectuses". While underwriters or placement agents might be willing to bear the potential liability associated with distributing a research report to a U.S. investor if they are indemnified by an issuer with respect to such liability, many issuers are reluctant to do so as they might be viewed as having adopted the research as their own. SEC Release No. 33-8591 (July 19, 2005) defined "research report" for purposes of 1933 Act Rules 138 and 139 and clarified that, in connection with a Rule 144A offering, the research report that conforms to such Rules does not constitute "general solicitation" or "general advertising".

E) A purchaser of securities may assert a claim under Rule 10b-5 for a misstatement or omission in a private placement offering document, even if it disclaims reliance on information provided. Courts asked to consider the effect of a non-reliance provision in the context of an agreement to purchase stock have determined that enforcing such a provision would be inconsistent with 1934 Act § 29(a), which forecloses anticipatory waivers of the duties imposed by Rule 10b-5. A non-reliance provision, however, may be one factor in determining whether a purchaser "reasonably relied" on the accuracy of information provided, which is required for liability under Rule 10b-5. See, e.g., AES Corp. v. Dow Chemical, 325 F.3d 174 (3d Cir.), cert. denied, 540 U.S. 1068 (2003). Whether reliance by the purchaser was "reasonable" could be based on such factors as (i) whether a fiduciary relationship existed between the parties, (ii) the plaintiff's sophistication, (iii) the existence of business or personal relationships, and (iv) the plaintiff's access to the information. See, e.g., Straub v. Vaisman and Co., 540 F. 2d 591 (3d Cir. 1976).

F) In light of Gustafson, courts asked to consider whether an investor has a right of action under 1933 Act §§ 12(a)(1)/12(a)(2) have examined whether the purchase of securities in question was made pursuant to a private placement or a public offering.

i) Although Gustafson was brought under 1933 Act § 12(a)(2) and not § 12(a)(1), courts have interpreted the decision to encompass § 12(a)(1), which imposes liability or rescission for the offer or sale of a security in violation of 1933 Act § 5.

ii) Lewis v. Fresne, 252 F.3d 352 (5th Cir. 2001), held that a plaintiff who acquired a note and a pledge of 29% of the issuer's stock as consideration for making a 90-day "bridge" loan may not invoke 1933 Act § 12(a)(1)/(2). Lewis highlighted several aspects of the transaction -- including the fact that it involved a major stake in the issuer -- as evidence that the securities offering was "private". Compare, e.g., Fisk v. Superannuities, Inc., 927 F. Supp. 718 (SDNY 1996) (plaintiff, who purchased stock pursuant to a "private placement" memorandum, allowed to sue under § 12 where there was evidence that the transaction was not a bona fide private placement).

G) Gustafson did not affect the ability of FINRA to bring actions against broker-dealers for failure to include complete disclosure in private placement offering documents and marketing material. See, e.g., Pacific Cornerstone Capital, FINRA Press Release, Dec. 21, 2009.

H) In Abu Dhabi Commercial Bank v. Morgan Stanley, 910 F. Supp.2d 543 (SDNY 2012), the Court refused to dismiss state law negligent misrepresentation claims over Morgan Stanley's role as placement agent in sales of interests in a structured investment vehicle. Abu Dhabi Commercial Bank claimed that Morgan Stanley was negligent in conveying ratings that it should have known were inaccurate.

(ii) FINRA Rule 5123 ("Rule 5123") requires FINRA member firms involved in a private placement to file any offering documents with FINRA within 15 days after the first sale (or indicate that no offering documents were used). See SEC Release No. 34-67157 (June 7, 2012); FINRA Regulatory Notice 12-40 (Dec. 2012); Broker/Dealer Compliance, Dec. 12, 2012.

In 2013, the SEC changed Rule 5123 to require electronic filing of offering documents in connection with certain private placements via FINRA Firm Gateway. See 78 Fed. Reg. 39367 (July 1, 2013) (notice of immediate effectiveness of proposed rule change); SEC Release 34-69843 (June 25, 2013) (solicitation of public comments).

(iii) FINRA Regulatory Notice 10-22 (Apr. 2010) ("FINRA Notice 10-22") reminds broker-dealers of their duty to conduct reasonable investigations when recommending private placement offerings to their clients.

A) Inherent in the recommendation of a security by a broker-dealer is a representation that a reasonable investigation has been made and that the recommendation rests on the conclusions based on such investigation. Violation of this duty may expose the broker-dealer to liability under the antifraud provisions of the 1933 Act and may constitute a violation of FINRA rules regarding both fraud and the suitability of the security for the customer.

B) The scope of the investigation required will be affected by the broker-dealer's (i) affiliation with the issuer, which raises potential conflict of interest issues and may cause customers to expect that the broker-dealer has special expertise; (ii) preparation of the private placement memorandum; (iii) awareness of any "red flags" on which the broker-dealer may be obligated to conduct an independent investigation; and (iv) reliance on counsel and other experts, which requires the broker-dealer to assess their competence, ensure that their investigation covers all relevant areas, and follow up on any issues or concerns. Broker-dealers should have supervisory procedures to ensure that investigations conducted satisfy the broker-dealer's duty, and should document the process and results of the investigation.

C) For examples of FINRA enforcement proceedings involving alleged unsuitable private placement offerings and failure to conduct a "reasonable investigation", see, e.g., Sunset Financial Services, FINRA Letter of Acceptance, Waiver of Consent No. 20110269157 (July 17, 2013); FINRA News Releases, Nov. 29, Apr. 7, 2011. See also Part IX.E.3.a below.

D) FINRA Notice 10-22 includes a survey of industry practices designed to help broker-dealers meet their reasonable investigation obligations.

(iv) In order to facilitate the capital formation process, NSMIA provides for the preemption of state-level registration requirements and review of transactions involving certain classes of securities, including those sold to "qualified purchasers". In the SEC Regulation A Amendments, the SEC adopted a definition of "qualified purchaser" to include "any person to whom securities are offered or sold pursuant to a [Regulation A] Tier 2 offering". See 12 C.F.R. 230.256; 80 Fed. Reg. 21858. On two prior occasions (first in 2001 and then in 2007), the SEC proposed but did not adopt a definition of "qualified purchaser" that would preempt state securities regulation in connection with offers and sales to "accredited investors" and "large accredited investors", respectively, each as defined in Regulation D. See SEC Release No. 33-8041

(Dec. 19, 2001); SEC Release No. 33-8828 (Aug. 3, 2007) (withdrawn Oct. 1, 2009).

c. Rule 144A

Rule 144A provides a non-exclusive safe harbor from 1933 Act registration requirements for resales of eligible securities to QIBs. See SEC Release No. 33-6862 (Apr. 23, 1990) (adopting Rule 144A) (the "Rule 144A Release"). See also SEC Releases No. 33-6806 (Oct. 25, 1988) (Rule 144A proposed), No. 33-6839 (July 11, 1989) (Rule 144A reproposed), No. 33-6963 (Oct. 23, 1992) (Rule 144A amendments).

(i) Rule 144A permits private placements to be conducted in a manner that resembles underwritten public offerings in some respects; i.e., the issuer sells securities to one or more financial intermediaries that immediately resell them to QIBs. The Rule does not limit the number of QIBs to which securities may be reoffered or sold, nor does it require legends or other procedures used in traditional private placements. It does, however, contain information and transfer requirements.

(ii) Rule 144A is available only for resales of securities that are not "fungible" with securities listed on a U.S. securities exchange or quoted in an automated inter-dealer quotation system.

(iii) QIBs include institutions (such as insurance companies, investment companies, employee benefit plans, investment advisers, securities dealers, banks and other institutions) that, at the end of their most recent fiscal year, owned or invested on a discretionary basis at least $100 million in securities. For a broker-dealer to qualify as a QIB, it either must own or invest on a discretionary basis at least $10 million in securities, or act as riskless principal on behalf of a QIB. A U.S. or foreign bank is required to have net worth of at least $25 million in addition to meeting the general $100 million-in-securities requirement.

(iv) JOBS Act § 201(a) directs the SEC to permit securities sold under Rule 144A to be offered to persons other than QIBs, including by means of general solicitation or general advertising, provided that only QIBs (or persons the seller, or any person acting on the seller's behalf, reasonably believes to be QIBs) purchase the securities. Under the SEC JOBS Act Rule, a seller may rely on Rule 144A even if the securities are offered to non-QIBs and even if there has been general solicitation or general advertising.

(v) In 2014, in connection with the SEC lifting the prohibition on general solicitation in Rule 144A offerings, FINRA began disseminating Rule 144A transaction data in corporate debt securities through the Trade Reporting and Compliance Engine ("TRACE"). See FINRA Press Release, June 30, 2014, SEC Release No. 34-70009 (July 19, 2013); FINRA Regulatory Notice 12-39 (Sept. 2012); Broker/Dealer Compliance, July 31, 2013.

(vi) A group of major firms joined Nasdaq in creating the "PORTAL Alliance", a single platform for trading unregistered securities, which launched in 2009. See Nasdaq Press Release (Sept. 8, 2009).

(vii) Securities offered and sold pursuant to Rule 144A may be considered "marketable" for purposes of the Comptroller's definition of "investment security" in 12 C.F.R. § 1.2(e). See 12 C.F.R. § 1.2(f) (definition of "marketable"). See also Part II.D.3 above.

(viii) Financial intermediaries that sell unregistered securities in reliance on Rule 144A may be liable for violations of state and federal securities laws if they do not verify whether buyers are QIBs. In 2010, JPMorgan Securities entered into a Settlement Agreement in which it paid $25 million to the Florida State Board of Administration for selling unregistered securities to funds managed by the State Board and for failure to establish adequate procedures to verify whether the managed funds were QIBs.

d. Gramm-Leach-Bliley Act

(i) As described in Part I.C.2.a above and Part IX.B.3 below, the GLBA Push-out Provisions eliminated the general exemption for "banks" from the definitions of "broker" and "dealer" under the 1934 Act and replaced it with a number of transactional exemptions.

(ii) Insofar as bank participation in private placements is concerned, as a federal securities law matter:

A) A bank may broker sales in a primary offering of securities not involving a "public offering", provided that (i) the bank is not affiliated with any "broker" or "dealer" that (a) is registered under the 1934 Act, and (b) engages in dealing, market-making or underwriting activities with respect to securities (other than Push-out Exempt Securities), and (ii) if the bank is not affiliated with a "broker" or "dealer", the aggregate dollar amount of any private offering (excluding government or municipal securities) does not exceed 25% of the bank's capital (the "Private Placement Exemption"). See Part VI.C.1.a.iv, Part VI.C.1.c and Part IX.B below.

B) A bank may act as agent in the private placement of traditional banking products (including CP, BAs, municipal securities and other Push-out Exempt Securities) and Identified Banking Products. See Part II.B and C above.

C) A bank may effect, as agent for its customers, up to 500 otherwise impermissible securities transactions per year, excluding transactions that qualify for another exemption from the GLBA Push-out Provisions (the "De Minimis Exemption"), subject to limitations discussed in Part IX.B.3.d.x below.

(iii) Notwithstanding the Private Placement Exemption, the De Minimis Exemption and the product-specific exemptions described in Part VI.A.2.d.ii above, the GLBA Push-out Provisions effectively require banks to conduct their private placement activities through broker-dealers.

(iv) To implement Gramm-Leach § 203 (which requires that registered securities associations establish a registration category for broker-dealer personnel engaged solely in private securities offerings), FINRA Rule 1032 established a new registration category. See SEC Release No. 34-44281 (May 8, 2001).

B. EMPOWERMENTS

1. Financial Holding Companies and Financial Subsidiaries

a. Under Gramm-Leach's empowerment to engage in underwriting, dealing and market-making in securities, as well as in other financial activities approved for BHCs, an FHC or financial subsidiary should be able to act as agent and adviser for, or initial purchaser of, private placements of all types, including those as to which the FHC or financial subsidiary (or, subject to other legal requirements -- such as the FRA -- an affiliate) provides credit enhancement.

b. Private placement agents typically make recommendations concerning the terms and timing of an issue, help prepare the offering documents, search the market for accredited investors or QIBs, and participate in negotiations, generally for a fee based on a percentage of the amount placed.

2. Bank Holding Companies

Regulation Y (12 C.F.R. § 225.28(b)(7)(iii)) authorizes a BHC to act as agent in the private placement of securities in accordance with the 1933 Act and the SEC's rules, if the BHC does not purchase or repurchase the securities being placed for its own account or hold in inventory unsold securities being placed (the "Regulation Y Placement Restrictions").

a. The Regulation Y Placement Restrictions prevent a BHC from classifying securities underwriting activities as private placement activities.

   In this regard, in connection with the Santander Order, Santander committed that, with respect to Rule 144A transactions to be conducted by a Section 20 Subsidiary: (i) whenever such Subsidiary acted as a dealer or market-maker with respect to a Rule 144A transaction, it would treat revenue attributable to such activities as "ineligible"; (ii) whenever such Subsidiary resold as agent securities it originally placed as agent, it would treat all revenue attributable to such activity as "eligible"; (iii) if such Subsidiary purchased ineligible securities as principal that it was unable to place as agent, it would treat the entire transaction as a dealing transaction and all revenue attributable to such transaction as "ineligible"; and (iv) if such Subsidiary acted as agent for one portion of a Rule 144A issue and, at the same time, acted as dealer with respect to another portion, it would treat its activities with respect to both portions as dealer activities and all revenue attributable to such activities as "ineligible". See also Part III.B.3.f and Part II.B.5.b.iv above.

b. The Regulation Y 1997 Revisions removed some restrictions on private placement activities, including prohibitions on (i) extending credit that enhances the marketability of securities being placed, (ii) lending to an issuer for the purpose of covering the unsold portion of such securities, (iii) lending to an issuer for the purpose of repurchasing such securities, (iv) acquiring such securities for an account for which the BHC has fiduciary authority, (v) providing advice to a purchaser regarding securities being placed, and (vi) placing such securities with non-institutional investors. The Board noted that none of the deleted restrictions are imposed on national banks. See Part VI.B.2.d below.

c. The Regulation Y 1997 Revisions state that a BHC may act as agent in the (i) private resale by third parties of privately placed securities, and (ii) private placement of securities issued by investment companies.

d. The Regulation Y 1997 Revisions reflect a culmination of the reasoning set out in numerous Board Orders. However, except for the Regulation Y Placement Restrictions, the restrictions on private placement activities included in such Orders have effectively been removed. See, e.g., BTNY Section 20 Order, petitions for review dismissed, SIA v. Board, No. 87-1030 (D.C. Cir., filed Jan. 21, 1987, dismissed Nov. 25, 1987), BTNY v. Board, No. 87-1035 (D.C. Cir., filed Feb. 23, 1987, dismissed, Oct. 30, 1987); Bank of Montreal, 74 Fed. Res. Bull. 500 (1988); BTNY, 75 Fed. Res. Bull. 829 (1989) (the "BTNY Placement Order"); Morgan Placement Order (Morgan and its bank and non-bank subsidiaries permitted to extend credit to issuers for the payment of principal or interest on placed securities; Morgan and its non-bank subsidiaries permitted to purchase up to 50% of such securities); Norwest 1990 Order (placement of ineligible affiliate securities); Toronto-Dominion Order (subject to the 50%-of-issue limitation of the Morgan Placement Order, permitting the placement of securities with Toronto-Dominion non-U.S. offices); Chase, 76 Fed. Res. Bull. 658 (1990) (placement of securities in minimum denominations of $100,000); Deutsche Bank-C.J. Lawrence Order; First Eastern Corp., 76 Fed. Res. Bull. 764 (1990) (the "First Eastern Order"); Meridian Order (securities placement in amounts less than $100,000 to investors that initially invested at least $100,000).

3. Banks

a. Legal Framework

(i) The Board Staff Study Commercial Bank Private Placement Activities (June 1977) (the "1977 Private Placement Study") and Comptroller Interpretive Letter No. 32 (Dec. 9, 1977) ("Letter No. 32"), CCH Fed. Banking L. Rep. ¶ 85,107, concluded that private placement activities do not violate Glass-Steagall because they do not represent public underwriting or distribution, but are rather the agency placement of securities "upon the order" of the issuer.

(ii) After Bankers Trust I concluded that CP was a Glass-Steagall "security", in a letter to BTCo, dated Dec. 3, 1984, the Board advised that it had reason to believe that BTCo's CP activities -- particularly BTCo's extensions of credit to issuers to cover unsold portions of an issue -- constituted Glass-Steagall "selling" and "underwriting".

BTCo responded by letter dated Jan. 17, 1985, in which it described changes in its CP placement program. In its Statement Concerning Applicability of the Glass-Steagall Act to the [CP] Placement Activities of [BTCo] (June 1985) (the "BT Statement"), the Board concluded that agency placement activities did not constitute prohibited "selling", "distributing" or "underwriting".

(iii) In 1986, the District Court to which Bankers Trust I had been remanded issued an order "invalidating" the BT Statement. SIA v. Board, 627 F. Supp. 695 (D.D.C. 1986). The District Court interpreted Glass-Steagall's "agency" exception to include only secondary market brokerage.

(iv) The U.S. Court of Appeals reversed the District Court and reinstated the BT Statement. SIA v. Board, 807 F.2d 1052 (D.C. Cir. 1986) ("Bankers Trust II"), cert. denied, 483 U.S. 1005 (1987).

A) The Court determined that BTCo's program could be interpreted as a placement "upon the order" of the issuer (and thus not impermissible "selling"), and that private placements do not involve Glass-Steagall "underwriting".

B) The Court rejected the view that "underwriting" does not include securities placed on an agency basis (as in "best efforts" underwriting). Compare SIA v. Board, 716 F.2d 92 (2d Cir. 1983), upholding the

Schwab Order, aff'd, 468 U.S. 207 (1984) (the "Schwab Decision"), which, in the context of permitting BankAmerica to acquire Schwab, concluded that "underwriting" and "distribution" refer to "the widespread marketing of specific issues of new securities in which the dealer trades as principal", suggesting that best efforts underwriting is not Glass-Steagall "underwriting".

The Board treats "best efforts" and "firm commitment" as two types of "underwriting" for purposes of Glass-Steagall and the BHCA. 1989 Order, 75 Fed. Res. Bull. at 198 n.20. The Supreme Court in the Schwab Decision did not reach this question. See also Part VI.C.1.d.i below.

C) Bankers Trust II distinguished passive advice to a CP issuer that wants to raise money from an investment bank that "initiates discussions with its customer" where "the initiative of the investment banker itself creates . . . demand".

Neither banks nor bank regulators have placed weight on this distinction.

b. Typical Bank Private Placement Activities

(i) Banks have been private placement agents and advisers with respect to many kinds of securities. See, e.g., Comptroller Conditional Approval Letters No. 309 (Apr. 12, 1999) (corporate debt securities, trust preferred securities and leases); No. 164 (Dec. 9, 1994) (closed-end investment company shares); Comptroller Interpretive Letter No. 627 (July 13, 1993), CCH Fed. Banking L. Rep. ¶ 83,510 (affiliate CP); Letter No. 541 (commodity pool interests); Comptroller Investment Securities Letter No. 49 (July 25, 1991), CCH Fed. Banking L. Rep. ¶ 83,308 (agent fees for CP sales); Comptroller Trust Interpretation No. 256 (July 9, 1990) ("Letter No. 256"), CCH Fed. Banking L. Rep. ¶ 83,227 (partnership interests); Comptroller Interpretive Letter No. 499 (Feb. 12, 1990) ("Letter No. 499") CCH Fed. Banking L. Rep. ¶ 83,090 (annuity contracts); Comptroller Interpretive Letter No. 463 (Dec. 27, 1988), CCH Fed. Banking L. Rep. ¶ 85,687 (loans); Comptroller Interpretive Letter No. 436 (July 19, 1988) ("Letter No. 436"), CCH Fed. Banking L. Rep. ¶ 85,660 (mutual fund shares); Comptroller Investment Securities Letter No. 19 (July 23, 1987), CCH Fed. Banking L. Rep. ¶ 85,889 (CP); Letter No. 387 (commercial mortgage loans); Comptroller No-Objection Letter No. 87-4 (May 19, 1987), CCH Fed. Banking L. Rep. ¶ 84,033 (real estate mortgage investment conduit ("REMIC") certificates); Board Private Placement Study.

(ii) Because Rule 144A is available only to a person acting as principal, a U.S. bank is generally not eligible to participate in Rule 144A primary markets. The Comptroller's 1996 Investment Securities Regulation permits banks to purchase certain securities under Rule 144A. See Part II.D.3.a.ii above.

(iii) The GLBA Push-out Provisions affect the ability of a bank to participate as agent or principal in private placement markets. See Part I.C, Part II.D.3.b and Part VI.A.2.d above, and Part IX.B.3 below.

C. CERTAIN GLASS-STEAGALL AND SECURITIES LAW ISSUES

1. Definition of a "Private Placement"

a. The BT Statement concluded that compliance with the SEC's Regulation D is not determinative of whether a private placement occurs, but noted that the activities at issue met most of the Regulation D requirements, and that the areas of noncompliance (relating to notice to the SEC and resale restrictions) "do not appear to be germane to the core concerns" of Glass-Steagall.

(i) Bankers Trust II did not require BTCo's placement activities to comply with Regulation D.

(ii) The Regulation Y 1997 Revisions adopted the private placement definition used in the 1933 Act and SEC regulations.

(iii) The Comptroller's staff noted that "the boundary between public and private offerings under securities laws, while relevant for purposes of guidance, is not necessarily the same as that applicable under. . . Glass-Steagall". Comptroller No-Objection Letter No. 87-9 (Dec. 16, 1987) ("Letter No. 87-9"), CCH Fed. Banking L. Rep. ¶ 84,038.

(iv) For purposes of the GLBA Push-out Provisions, the term "private placement" almost certainly refers to the concept of private placement as set out in the 1933 Act and SEC regulations. See Part VI.A.2.d above and Part VI.C.1.c below.

b. The BT Statement indicated that advertising of BTCo's placement services (as opposed to advertising relating to a particular placement) should not raise a Glass-Steagall problem, and Bankers Trust II concurred. SEC letters as to the scope of solicitation permitted in 1933 Act private offerings may provide some guidance as to the scope of permissible advertising under Bankers Trust II. See also Part VI.A.2.a above.

(i) General Electric Capital Corp. (avail. July 13, 1994) permitted a placement agent to advertise CP through advertisements in The Wall Street Journal and financial industry publications if the agent took steps to ensure that it did not market to the general public, including that: (A) the advertisements state that the CP is not 1933 Act-registered and is offered only to institutional investors, (B) information memoranda state that the CP is offered only to institutional investors, (C) the placement agent meets with prospective CP purchasers to determine whether they possess the requisite degree of sophistication, (D) sales of CP are not made to unsophisticated institutions, and (E) the CP is sold in large minimum denominations. Gerald F. Gerstenfeld (avail. Dec. 3, 1985) permitted newspaper advertising regarding the services of a syndicator of limited partnerships if the syndicator was neither offering nor selling a particular partnership and did not intend to do so "in the near future".

(ii) A "general solicitation" is not involved when a seller offers securities to a person with which it has a preexisting business relationship. See, e.g., SEC Compliance and Disclosure Interpretations (Aug. 6, 2015) (clarifying certain aspects of the general solicitation prohibition under Regulation D, including the type of preexisting relationships that may demonstrate the absence of a general solicitation). Information regarding the sophistication and financial circumstances of a potential customer may be sought initially through general solicitation, but enough time must elapse between such a solicitation and any offer to the customer so that the offer will not be made by general solicitation. See, e.g., Royce Exchange Fund (avail. Aug. 28, 1996); IPONET (avail. July 26, 1996); H.B. Shaine & Co. (avail. May 1, 1987); E.F. Hutton & Co. (avail. Dec. 3, 1985); Bateman Eichler, Hill Richards, Inc. (avail. Dec. 3, 1985). But see, e.g., Circle Creek AquaCulture (avail. Mar. 26, 1993).

(iii) Webster Management Assured Return Equity Management Group Trust (avail. Feb. 7, 1987) declined to take a no-action position with respect to an investment trust which proposed that its broker-dealer affiliate make potential customers aware of the trust. The staff was unable to conclude that there would be no "general solicitation" because (A) the broker-dealer would have no preexisting relationship with the customers solicited, (B) some customers would not be "accredited investors", and (C) no limitation had been proposed on the manner of contacting customers. See also, e.g., Agristar Global

Networks (avail. Feb. 9, 2004) (declining no-action position respecting accredited investor database); Mobile Biopsy (avail. Aug. 11, 1999) (declining no-action position respecting contact of all physicians in a state); Robert T. Willis (avail. Jan. 18, 1988) (declining no-action position respecting referral arrangements); J.D. Manning (avail. Feb. 27, 1986) (declining no-action position respecting newsletter containing list of closely held businesses likely to raise capital); SEC Release No. 34-21962 (Apr. 19, 1985) (lists of "thousands of persons" to identify potential offerees does not comply with Regulation D).

c. Bank private placement powers (including powers of broker-dealer subsidiaries of banks) should extend to securities registered for public sale under the 1933 Act under appropriate circumstances (although to the extent that direct bank agency activity would depend on the GLBA Push-out Provisions Private Placement Exemption, such activity would not likely include registered securities). See Part VI.A.2.d above.

(i) The question of how different the term "public offering" is for banking and securities law purposes was raised in connection with the sale by BTCo of registered debt securities issued by Louisiana Land and Exploration Company.

BTCo acted as placement agent for holders of Louisiana Land notes, which were registered under the 1933 Act. The SIA challenged the offering as an impermissible underwriting; BTCo responded that the transaction was a "private placement" in which it acted as agent, and that 1933 Act registration alone does not convert a private placement into a public offering.

In 1984, Board legal staff requested SEC comments on the SIA/BTCo correspondence. SEC staff replied that the transaction was not a non-public offering under 1933 Act § 4(a)(2) because it was made pursuant to an SEC registration statement, which constituted an offer to the public and a general solicitation of investors. BTCo thus acted as a 1933 Act "underwriter". Undated Letter from Division Director Huber.

(ii) See Part VI.A.2.a.x above regarding registered securities that are confidentially marketed to accredited investors in an initial phase.

(iii) Regulation Y permits BHCs to act as agent in the private placement of securities in accordance with the 1933 Act and the SEC's rules.

(iv) The Comptroller has approved national bank participation in the institutional agency placement of 1933 Act-registered securities. See, e.g., Comptroller Letter (Jan. 11, 1990) re Sovran Bank (the "Comptroller Sovran Letter"); Comptroller Interpretive Letter No. 417 (Feb. 17, 1988) ("Letter No. 417"), CCH Fed. Banking L. Rep. ¶ 85,641; Letter No. 87-9; Comptroller No-Objection Letter No. 87-3 (Mar. 24, 1987), CCH Fed. Banking L. Rep. ¶ 84,032.

See also, e.g., Comptroller Letter, dated Jan. 19, 1993, re Continental Bank (the "Comptroller 1993 Continental Letter") (bank may act as agent for its customers in the purchase of 1933 Act-registered notes); Comptroller Interpretive Letter No. 420 (Mar. 14, 1988) ("Letter No. 420"), CCH Fed. Banking L. Rep. ¶ 85,644 (bank may act as agent for its customers in the purchase and sale of publicly offered limited partnership interests). See generally Prospectus of Chase Mortgage Finance Corp. dated Dec. 20, 1988, and Prospectus Supplement dated Mar. 31, 1989 (respecting Chase Bank acting as "placement agent" selling institutionally 1933 Act-registered pass-through certificates backed by mortgages originated by the Bank and two affiliates).

(v) FDIC Advisory Opinion No. 86-5 (Mar. 11, 1986), CCH Fed. Banking L. Rep. ¶ 81,145, stated that a bank's purchase of capital notes from its affiliates and subsequent resale of the notes to the general public violates Glass-Steagall.

(vi) "Best efforts" underwriting (involving "agency" placement efforts on a retail basis) would not necessarily violate Glass-Steagall. The Supreme Court left this question open in the Schwab Decision, although the Second Circuit appeared to exclude such underwriting from Glass-Steagall prohibitions. Bankers Trust II, however, in dictum, asserts that Section 16's prohibition of "underwriting" applies to "best efforts" underwriting. The Board treated "best efforts" underwriting as an ineligible activity for purposes of its Section 20 Approvals discussed in Part III above. Moreover, the GLBA Push-out Provisions affect the ability of a bank to participate in such an underwriting.

d. The issue of whether bank private placement powers extend to 1933 Act-registered securities may be sidestepped to a degree by virtue of no-action positions taken by the SEC staff.

(i) In, e.g., Exxon Capital Holdings Corp. (avail. May 13, 1988) ("Exxon Capital"), Mary Kay Cosmetics (avail. June 5, 1991), Morgan Stanley & Co. (avail. June 5, 1991), Warnaco (avail. Oct. 11, 1991), Epic Properties (avail. Oct. 21, 1991), Vitro (avail. Nov. 19, 1991), Transportación Maritima Mexicana (avail. June 8, 1992), Corimon (avail. Mar. 22, 1993), K III Communications Corp. (avail. May 14, 1993), Shearman & Sterling (avail. July 2, 1993), Grupo Financiero InverMexico (avail. Apr. 4, 1995), Brown & Wood (avail. Feb. 5, 1997) and related letters, SEC staff permitted arrangements whereby securities would be privately placed, with the issuers agreeing to register new securities similar to those issued in the private placement. Following the effectiveness of the registration, the issuer would exchange the registered securities for those that had been privately placed. The SEC has permitted foreign issuers that are not 1934 Act reporting companies even greater latitude.

The SEC affirmed that Exxon Capital arrangements should not be viewed as impermissible evasion of 1933 Act registration requirements. See SEC Letter to Judge Bowdre (N.D. Al.), dated Nov. 28, 2006.

(ii) As part of the SEC's proposed, but later withdrawn, so-called "Aircraft Carrier Release" (suggesting change in the regulatory framework for securities offerings), the SEC proposed the repeal of Exxon Capital, reflecting the concern that investors exchanging privately-placed securities for registered securities would resell such securities without complying with 1933 Act registration or prospectus delivery requirements. See SEC Releases No. 33-7606, No. 33-7606A (Nov. 13, 1998) (withdrawn, 65 Fed. Reg. 23942 (Apr. 24, 2000)). These releases generated voluminous public comment. See, e.g., Cleary Gottlieb Comment Letter, dated June 30, 1999.

(iii) PIPE (private investment in public equity) transactions have attracted considerable attention. SEC analysis of capital-raising techniques that involve private financing of a public company called into question the availability of a resale registration statement for certain issuers if a disproportionately large number of securities was sold in that private financing. The concern is whether the purported secondary offering is an issuer's "primary offering". See, e.g., IFLR, May 2007.

2. Combination of Private Placement and Credit Support Activities"

Under appropriate circumstances, a bank or BHC should be able to act as placement agent with respect to an issuer's securities while also providing credit enhancement (e.g., with a letter of credit) or otherwise supporting the instruments placed (e.g., with back up "liquidity facilities" or lines of credit).

a. The Regulation Y 1997 Revisions reverse the position taken in the BT Statement, but are consistent with the position taken in the 1977 Private Placement Study. See also

Board/Comptroller/FDIC Study, Commercial Bank Private Placement Activities (June 1, 1978). The Board recognized that the position taken in the BT Statement is not required by Glass-Steagall or the BHCA where a credit arrangement in connection with a private placement is arm's-length, subject to the extender's normal review process, and consistent with arrangements with persons that do not use the private placement services.

b. A national bank may provide private placement services and issue a letter of credit to support the security being placed. The Comptroller reasoned that the credit risk inherent in a letter of credit is the kind that banks are equipped to evaluate, and that a letter of credit does not require the bank to assume market risk on the underlying securities. See Comptroller Trust Interpretation No. 182 (Oct. 24, 1988) ("Trust Letter No. 182"), CCH Fed. Banking L. Rep. ¶ 84,949; Comptroller Interpretive Letter No. 212 (July 2, 1981), CCH Fed. Banking L. Rep. ¶ 85,293. Cf. Letter No. 329; Letter No. 271.

   The Comptroller has also, however, "strongly advised" against a bank's acting as trustee with respect to securities bearing its letter of credit. See, e.g., Trust Letter No. 182.

c. Issues with respect to the Anti-tying Statute and Sections 23A and 23B which could be implicated where a bank provides credit support in respect of securities as to which its affiliate acts as placement agent are discussed in Part III.A above.

VII. MERCHANT BANKING, CORPORATE FINANCE AND RELATED ACTIVITIES

A. MERCHANT BANKING, VENTURE CAPITAL AND M&A FINANCING; "PRIVATE EQUITY" INVESTMENTS

1. Background

a. U.S. banking organizations are actively engaged in the "private equity" market -- an umbrella term that encompasses elements of merchant banking and venture capital as well as traditional direct investment.

b. Private equity markets have undergone dramatic growth from under $5 billion of assets under management in 1980 to approximately 2.4 trillion as of June 2015.

Private equity firms globally had raised but not invested $818 billion in June 2016.

Private equity/venture capital has been a major vehicle for economic growth, and U.S. private equity and deal volumes have recovered somewhat from post-global credit crisis lows. For example, quarterly fundraising in the second quarter of 2016 exceeded $100 billion for the fourth time since the beginning of 2008. Aggregate deal value in the second quarter of 2016 was $89 billion.

Private equity and venture capital investors have remained active in U.S. and global markets. North America-focused funds represent nearly half the number of funds in the market and account for approximately 45 percent of aggregate capital targeted. The Q2 2016 Preqin Quarterly Update: Private Equity (Preqin, 2016). As of the end of the third quarter of 2016, venture capital investors deployed approximately $15 billion to nearly 1,800 companies in the United States, and total venture capital fundraising for the year was approximately $32 billion, putting 2016 on pace to be one of the best U.S. venture capital fundraising years since before the financial crisis. Venture Monitor 3Q 2016 (NVCA & Pitchbook, Oct. 2016). The software, commercial services, life sciences (biotechnology and medical devices) and media/entertainment sectors were all significant recipients of venture capital investments in 2015.

During the financial crisis, private equity became a major source of bank capital, providing as much as 40% of the money raised in 2009 by U.S. and European banks seeking to offset losses and meet capital requirements. See Part VII.A.7 below.

Community banks have started merchant banking businesses aimed at small and midsized companies to maintain banking relationships and boost regional expansion.

For background on private equity/venture capital markets generally, see, e.g., Venture Monitor 3Q 2016 (NVCA & Pitchbook, Oct. 2016); Disruption: A Seismic Shift in the Private Equity Industry (Ernst & Young, 2016); Alternative Asset Management 2020 Fast Forward to Centre Stage (PWC, June 2015); Top 10 Private Equity Trends for 2016 (Private Equity Growth Capital Council, Jan. 22, 2016); 2015 Preqin Global Private Equity and Venture Capital Report (Preqin, 2015); Yearbook 2016 (NVCA, Mar. 8, 2016); Back to Reality: EY Global Venture Capital Trends 2015 (Ernst & Young, 2016); Preqin Investor Outlook: Private Equity H1 2015 (Preqin, 2015); Private Equity Secondary Market (Preqin Special Report, May 2014); American Banker, Aug. 10, 2012; Reuters Buyouts, June 28, 2011; Hedgeweek, Jan. 21, 2011; Globalization of Alternative Investments: The Global Economic Impact of Private Equity (World Economic Forum, Dec. 2009); Venture Impact: The Economic Importance of Venture Capital-Backed Companies in the U.S. Economy (NVCA, 2009); Updated U.S. Private Equity Valuation Guidelines (Private Equity Industry Guidelines Group, Mar. 2007).

c. While some banking organizations have tried to combine capital markets services (such as underwriting, securities placement, lending and loan syndication and corporate finance advisory services) with private equity investments to provide a "full service" to corporate customers, some have concluded that the inherent conflicts of interest are such that private equity should be separated from other capital markets operations. See, e.g., Private Equity Conflicts of Interest (IOSCO, Nov. 2010).

Combinations of lending and equity investments could raise corporate issues. See, e.g., Part V.A.3.e(iii) and (iv) above (fraudulent conveyance/equitable subordination matters).

d. Motivated by the growth in private equity activity, investment banks and the Nasdaq have sought to develop private markets and trading systems for the securities of privately-held companies. See Part VI.A.2 above and Part IX.F below.

e. A BHC files Board Form FR Y-10 to report certain large merchant banking investments, and Board Form FR Y-12 with respect to merchant banking investments approaching the end of their applicable holding period (see Part VII.A.2.b below), reporting such matters as the type of investment (public or non-public entity; reliance on GLBA merchant banking authority or not), and the type of security (common stock, preferred stock/convertible debt, other).

f. The Volcker Rule restricts the ability of banking organizations to sponsor or make investments in private equity or hedge funds, as described in detail in Part II.A.7 above, but does not restrict direct investments in non-financial companies.

(i) Dodd-Frank § 620 required the federal banking agencies to prepare a joint report on the activities and investments in which a banking organization may engage under federal and state law, taking into consideration (A) the type of activities or investments; (B) financial, operational, managerial or reputational risks; and (C) risk mitigation activities.

(ii) Within two months of completing their report, the federal banking agencies are required to submit the results to the FSOC and to Congress, as well as recommendations regarding (A) the actual or potential negative effect of each activity or investment on the "safety and soundness" of the banking organization or the U.S. financial system, (B) the appropriateness of banking organizations engaging in such activities or investments, and (C) additional restrictions that may be necessary to address "safety and soundness" risks.

(iii) On September 8, 2016, almost five years after the January 2012 statutory deadline, the agencies issued the Section 620 Report. The Report included recommendations from the Board, OCC and FDIC related to banking organizations' authority to make investments in non-financial companies, including the FHC merchant banking authority. In particular, the Board recommended that Congress repeal FHCs' authority to make merchant banking investments, citing concerns about risks associated with environmental and other events that may occur at the portfolio company and that may expose the FHC to alter ego liability if it has temporarily operated the portfolio company in accordance with the Merchant Banking Regulations. See Part VII.A.1.h.iv below. The Board also indicated that it may seek to impose higher capital charges or other restrictions on merchant banking activities. See also Part I.B.6.k above.

g. Other laws also apply to private equity/merchant banking activities. These include:

(i) U.S. securities laws relating to large shareholder reporting. See generally U.S. Regulation of International Securities Markets, Chapter 9; CSX (and note that, irrespective of the extent to which CSX is followed by other courts, some companies have amended their "poison pills" to include cash-settled derivatives for purposes of computing "beneficial ownership" levels that would trigger the pills; see, e.g., Wall St. J., June 18, 2008). See also Part II.B.3 above and Part VII.A.2.b below.

(ii) Hart-Scott, which applies to transactions that exceed applicable size thresholds, including reporting requirements aimed at private equity and other investment firms and requiring extensive information about an acquiring firm's "associates," such as a fund manager and other firms managed by the same manager. See FTC Press Release, July 7, 2011. See Part I.A.9 above. See also, e.g., Financial Times (Aug. 7, 2014);

FTC Release, May 21, 2007 (ultimate parent entity of hedge fund fined for failure to comply twice with Hart-Scott rules despite representations following the first violations that procedures would be put in place to ensure that Hart-Scott violations would not occur).

(iii) Laws against price fixing, bid rigging and other forms of collusion. See, e.g., U.S. v. Value Act Partners, DOJ Release, Apr. 4, 2016; U.S. v. ESL Partners L.P. and ZAM Holdings, L.P., 2008 U.S. Dist. Lexis 106213 (D.D.C. 2008); Wall St. J., Nov. 6, Oct. 10, 2006; NY Times, Oct. 22, 2006 (DOJ letters issued to several private equity firms inquiring about so-called "club" deals).

(iv) Reporting requirements of the BEA of the Commerce Department potentially applicable to acquisitions of U.S. companies by non-U.S. companies. See Part VI.A.5 below.

(v) Notification procedures or "change in control" approval requirements with respect to investments in regulated entities, including:

A) Financial services, such as:

i) Banks.

ii) Savings and loan associations and other thrifts.

iii) BHCs (including non-U.S. banks with U.S. subsidiary banks).

iv) Thrift holding companies.

v) Edge Act/Agreement corporations.

vi) Commercial lending companies.

vii) Non-U.S. banks with U.S. branches, agencies or commercial lending company subsidiaries.

viii) Broker-dealers.

ix) Investment advisers/asset managers.

x) FCMs, CTAs, CPOs.

xi) Securities and commodities exchanges.

xii) Credit unions.

xiii) Industrial banks/industrial loan companies.

xiv) Mortgage/consumer "licensed lenders".

xv) Insurance companies.

xvi) Check-cashers, money transmitters, FX brokers.

xvii) Other ancillary financial services companies.

B) Entities which hold broadcast and other Federal Communications Commission ("FCC") licenses or which are subject to FCC cross-ownership restrictions on acquisitions of newspapers and other media.

C) Common carriers, including:

i) Airlines.

ii) Railroads.

iii) Water carriers.

iv) Trucking companies.

D) Nuclear power companies.

E) Electric/gas (and other public) utilities and public service companies, and Federal Power Act-regulated holding companies and operating entities.

F) REITs.

G) SBICs.

H) Casinos and gaming companies.

I) Mining and other companies engaged in mineral extraction.

(vi) Potential reporting requirements in respect of the beneficial ownership of private companies is discussed in Part I.A above and Part VII.A.2 below.

(vii) With respect to foreign investment in the U.S., the ("Exon-Florio Provision") (§ 721 of the Defense Production Act of 1950, 50 U.S.C. § 4565) empowers the President to suspend or prohibit non-U.S. acquisitions, mergers or control of U.S. businesses -- including U.S. operations of non-U.S. companies -- that threaten to impair U.S. national security. The Committee on Foreign Investment in the U.S. ("CFIUS") has the authority to conduct investigations pursuant to the Exon-Florio Provision.

A) The CFIUS review process ordinarily begins with the filing of a voluntary notification, which triggers a 30-day initial review period. While CFIUS notification is optional, a foreign acquiror may choose to make such a notification because CFIUS is authorized to initiate its own review, 50 U.S.C. § 4565(b)(1)(D), which may not coincide with the desired or contractually agreed transaction timeline and may pose reputational risk for the transaction parties, particularly in a public deal. Further, if the transaction is not voluntarily notified and cleared, the government retains the power to order that the transaction be unwound. See, e.g., Order Regarding the Acquisition of Four U.S. Wind Farm Project Companies by Ralls Corp. (Sept. 28, 2012) (requiring divesture of four Oregon wind farms following a post-closing investigation into a 2012 acquisition by a Chinese company) ("Ralls Presidential Order"); Nevada Gold Holdings Current Report (Form 8-K) (June 11, 2012) (requiring divestiture of a Nevada mining operation after a post-closing investigation into a 2010 acquisition by a Chinese company) ("Nevada Gold").

See 31 C.F.R. § 800.402 (contents of voluntary notification).

B) CFIUS decisions made to block a transaction are subject to only limited, judicial review. See 50 U.S.C. § 4565(e); see also Ralls Corp. v. [CFIUS], 758 F.3d 296 (D.C. Cir. 2014).

i) On September 12, 2012, Ralls Corporation ("Ralls"), a Chinese-owned wind-farm developer connected to a Chinese manufacturer of wind turbines, brought the first, and to date only, direct challenge to the validity of a CFIUS order. The developer's suit in federal court challenged temporary mitigation orders issued by CFIUS requiring it to halt development of wind farm projects ("Ralls CFIUS Orders"), claiming that the orders violated the Administrative Procedure Act, exceeded CFIUS' statutory authority, and constituted an unconstitutional deprivation of property without due process. See Ralls Corp. v. [CFIUS], 12-cv-01513 (D.D.C., Sept. 12, 2012) (complaint). The Ralls Presidential Order subsequently reaffirmed the Ralls CFIUS Orders. See Order Regarding the Acquisition of Four U.S. Wind Farm Project Companies by Ralls Corp. (Sept. 28, 2012). The District Court dismissed the challenges to the Ralls CFIUS Orders and Ralls Corp.'s claim that the Ralls Presidential Order violated the Due Process Clause of the Fifth Amendment of the U.S. Constitution by depriving Ralls Corp. of property without providing adequate opportunity to be heard or an adequate explanation of the reason for the decision. Ralls Corp. appealed the decisions, and the Court of Appeals reversed the District Court's decision, holding that (1) the Ralls Presidential Order deprived Ralls Corp. of its constitutionally protected property interests without due process of law, and (2) the Ralls CFIUS Orders were not rendered moot by the Ralls Presidential Order. It remanded the case to the District Court with instructions that (1) Ralls Corp. be provided with appropriate process, including that Ralls Corp. be given access to the unclassified evidence on which the President relied and an opportunity to respond, and (2) the District Court address the merits of Ralls Corp.'s claims relating to the CFIUS Order. See Ralls Corp. v. [CFIUS], 758 F.3d 296 (D.C. Cir. 2014); Ralls Corp. v. [CFIUS], 926 F. Supp. 2d 71 (D.D.C. 2013); Ralls Corp. v. [CFIUS], 987 F. Supp. 2d 18 (D.D.C. 2013). See also M&A Law Report, Mar. 24, 2014; Law360, Feb. 25, 2013. On November 6, 2014, while hearing the case on remand, the District Court ordered (i) that the Ralls Presidential Order remain in place while Ralls Corp. receives the process it is due and (ii) that CFIUS provide Ralls Corp. with access to all unclassified material contained in the record compiled by CFIUS and all unclassified factual finding or evidence underlying CFIUS's recommendation to the President. See Ralls Corp. v. [CFIUS], No. 12-1513 (D.D.C. Nov. 6, 2014). On November 21, 2014, CFIUS provided Ralls the unclassified record (with the exception of two documents withheld under an assertion of executive privilege, portions of which eventually were made available for review by Ralls' counsel. The parties ultimately reached a settlement and, on November 4, 2015, stipulated to dismissal with prejudice of the case. Ralls Corp. v. [CFIUS], No. 12-1513 (D.D.C. Nov. 4, 2015) (stipulation of dismissal). Although, the exact terms of the settlement were never disclosed, various press accounts, relying solely on accounts from Ralls, suggest that Ralls ultimately was permitted to sell the wind farms on favorable terms. See, e.g., WSJ Risk & Compliance Journal (Nov. 4, 2015).

C) The "Foreign Investment and National Security Act", Pub. L. 110-49 (2007) (the "Foreign Investment Act"), amended the laws governing the review processes for foreign investment in the U.S., including the Exon-Florio Provision. The Act updated and expanded the processes used by CFIUS for reviewing foreign acquisitions of U.S. businesses that raise national security concerns, enhanced the oversight of transactions involving companies controlled by foreign governments, and enhanced Congressional oversight. See generally, e.g., [CFIUS] (CRS, Aug. 12, 2016); Trade Concepts, Performance, and Policy FAQs (CRS, Nov. 17, 2014); [CFIUS] (CRS, Mar. 6, 2014); Foreign Direct Investment in the United States: An Economic Analysis (CRS, Dec. 11, 2013); Foreign Investment in the [U.S.]: Major Federal Statutory Restrictions (CRS, June 17, 2013); Foreign Investment and National Security: Economic Considerations (CRS, Apr. 4, 2013); The Exon-Florio National Security Test for Foreign Investment (CRS, Mar. 29, 2013); Foreign Investment, CFIUS and Homeland Security: An Overview (CRS, Mar. 30, 2011); Foreign Direct Investment: Current Issues (CRS, Feb. 11, 2010).

The Foreign Investment Act:

i) Requires, in certain cases, an additional 45-day investigation following the 30-day initial review period. (Such cases include situations where any CFIUS Member advises that the acquisition threatens to impair U.S. national security and that threat has not been mitigated.)

ii) Provides statutory authority for CFIUS to enter into mitigation agreements with parties to the acquisition or impose conditions on the transaction to address such concerns.

iii) Unless high-level approvals are received, requires full CFIUS investigations of proposed acquisitions of "critical infrastructure" (defined broadly as physical or virtual systems or assets so vital to the U.S. that their incapacity or destruction would have a debilitating impact on national security) by parties controlled by foreign governments.

D) In 2008, Treasury regulations to implement the Foreign Investment Act and revise existing regulations implementing the Exon-Florio Provision took effect.

Treasury rules -- see 31 C.F.R. Part 800, (the "Final CFIUS Rules"); see also Guidance Concerning the National Security Review Conducted by CFIUS, 73 Fed. Reg. 74567 (Dec. 8, 2008) (CFIUS national security factors) -- make explicit CFIUS's practice of encouraging parties to contact and engage with CFIUS before filing a notification, clarify the scope of transactions subject to review, incorporate certain informal practices into the review process, and expand the information required to be included in notifications. See also CFIUS Annual Reports to Congress.

Under the Final CFIUS Rules:

i) National Security: CFIUS review extends beyond the defense industry to sectors such as aerospace, chemicals, information technology, energy, telecommunications, transportation, U.S. businesses that could "significantly and directly affect the U.S. financial system" and similar businesses. The Final CFIUS Rules clarify that the concepts of "critical infrastructure" and "critical technologies" are the subject of increased scrutiny, and involve a system or asset (physical or virtual) so vital to the U.S. that its incapacity or destruction "would have a debilitating impact on national security". See generally, e.g., Critical Technologies: Agency Initiatives Address Some Weaknesses, but Additional Interagency Collaboration Is Needed (GAO, 2015) (describing role of CFIUS and various CFIUS members in the overall U.S. framework for identifying and protecting critical technologies); Letter from Reps. Murphy and Visclosky to Treasury Secretary Geithner, July 2, 2010 (urging investigation of Anchor Iron & Steel Group (China) joint venture with Steel Development Co.); Nevada Gold (requiring divestiture of mining operations due to their proximity to sensitive U.S. government facilities); Letter from Rep. Westmoreland to Board Chairman Bernanke, May 18, 2012 (requesting information on the approvals of three government-controlled Chinese banks to operate in the U.S. -- in one case through a U.S. bank subsidiary -- including whether the applications had been subject to CFIUS review).

ii) Control: Only those transactions involving the acquisition of "control" of a U.S. business are subject to CFIUS review. "Control" is not defined in terms of a specified percentage of shares or numbers of board seats. Instead, all relevant factors are generally considered together in light of their potential impact on a foreign acquiror's ability to "determine, direct, or decide important matters affecting" the target company.

Under the Final CFIUS Rules, "control" includes the power (formal or practical) to <u>block</u> key corporate decisions as well as the power to determine the matters in question. Key matters that are considered to affect an entity for purposes of determining control include the following:

(a) The sale, lease, mortgage, pledge, or other transfer of any of the tangible or intangible principal assets of the entity, whether or not in the ordinary course of business.

(b) The reorganization, merger or dissolution of the entity.

(c) The closing, relocation or alteration of the production, operational or research and development facilities of the entity.

(d) Major expenditures or investments, issuances of equity or debt, or dividend payments by the entity, or approval of the operating budget of the entity.

(e) The selection of new business lines or ventures that the entity will pursue.

(f) The entry into, termination, or non-fulfillment by the entity of significant contracts.

(g) The policies or procedures of the entity governing the treatment of non-public technical, financial or other proprietary information.

(h) The appointment or dismissal of officers or senior managers.

(i) The appointment or dismissal of employees with access to sensitive technology or classified U.S. Government information.

(j) The amendment of the organizational documents of the entity with respect to the matters described above.

The Final CFIUS Rules identify minority protection rights that do not necessarily confer control over an entity. Such list includes the power to: (i) prevent the sale or pledge of all or substantially all of the entity's assets or a voluntary filing for bankruptcy or liquidation; (ii) prevent the entity's entry into contracts with majority investors or their affiliates; (iii) prevent the entity from guaranteeing the obligations of majority investors or their affiliates; (iv) purchase additional shares to prevent dilution of the investor's pro rata interest; (v) prevent the change of existing legal rights or preferences of the particular class of stock held by minority investors; and (vi) prevent amendment of the entity's corporate documents regarding the foregoing.

The Final CFIUS Rules include a safe harbor from the definition of "control" under circumstances where the foreign acquiror holds 10% or less of the voting interest in an entity and holds that interest "solely for the purpose of passive investment". The Rules emphasize that the safe harbor does not apply when any governance rights (e.g., a directorship) are obtained with the investment or when the acquiror has an intent to acquire "control" at a later time.

The Final CFIUS Rules reaffirm that a loan is generally not a covered transaction for purposes of the Exon-Florio Amendment and further provides that standard loan covenants will not be considered to result in control of the borrower "so long as the foreign person does not acquire economic or governance rights in the U.S. business characteristic of an equity investment". Rights acquired by a lender upon default (e.g., a security interest in the shares of a borrower) would be subject to CFIUS jurisdiction if a default has occurred or is imminent. The Final CFIUS Rules give the foreign lender time to dispose of collateral in cases raising national security concerns, provided there are arrangements to transfer management decisions or day-to-day control over the U.S. business to U.S. nationals.

iii) Foreign Person: Only acquisitions by "foreign persons" -- a term which includes any foreign national, foreign government or foreign entity or any entity over which control is exercised or exercisable by a foreign national, foreign government or foreign entity -- are subject to CFIUS review. The Final CFIUS Rules clarify the definition of "foreign entity" to include any entity organized under the laws of a foreign jurisdiction if either its principal place of business is outside of the U.S. or its equity securities are primarily traded on foreign exchanges. Such an entity, however, is not a "foreign entity" if "a majority of the equity interest in such entity is ultimately owned by U.S. nationals". Any entity that is, or is controlled by, a foreign national, foreign government or foreign entity is a "foreign person" whose acquisitions are subject to review.

See generally [CFIUS] (CRS, Aug. 12, 2016); CFIUS Annual Report to Congress (Feb. 2016); Foreign Investment in the United States: Major Federal Statutory Restrictions (CRS, June 17, 2013); The Exon-Florio National Security Test for Foreign Investment (CRS, Mar. 29, 2013).

E) The GAO accepted a bipartisan request from members of Congress to review how the current statutory and administrative authorities of CFIUS have kept pace with the growing scope of foreign acquisitions in important economic sectors in the United States. Specifically, the legislators noted the increased role of Chinese foreign direct investment, the extent of state subsidies provided to foreign acquirers, and the potential need to expand the membership of CFIUS and scope of CFIUS review. The GAO review is expected to commence in early 2017.

F) Foreign purchasers planning acquisitions of U.S. companies must navigate U.S. federal securities laws and state corporation laws. See, e.g., Manual of Foreign Investment in the United States (3d ed., 2004 and 2013-2014 Supp.) ("Manual of Foreign Investment"), Chapter 6: "Corporate and Securities Law Considerations for a Foreign Purchaser Planning an Acquisition in the [U.S.]".

h. Merchant banks/private equity investors face increasing scrutiny and potential liability arising from (i) litigation relating to their investments, primarily arising from the disclosure obligations of their portfolio companies, and for alleged insider trading of such portfolio companies' securities; (ii) conflicts of interest between fund managers and their investors; and (iii) potential "alter ego" liability for the actions of their portfolio companies (as private plaintiffs seek to pierce the corporate veil between portfolio company and investor).

(i) For <u>disclosure-based liability</u>, private equity funds are often accused of violating federal and state securities laws by participating in material misrepresentations or omissions by their portfolio companies.

(ii) <u>Insider trading claims</u> are often targeted at private equity funds and their managers who serve as directors of public portfolio companies. Measures to minimize the risk of liability include avoiding daily portfolio company management, implementing insider trading policies, maintaining "information walls", and assuring insurance coverage and indemnification.

(iii) Private equity firms seek to minimize <u>conflicts of interest</u> between fund managers and their investors by (A) conditioning receipt of performance-related compensation on fund investors receiving a full return on investment plus a cost of money hurdle, (B) negotiating key investor protections in investor contracts, (C) regular disclosure of key fund performance information to investors, and (D) establishment of (and consultation with) investor advisory committees. One area of current scrutiny lies in the valuation of portfolio investments, particularly when used to demonstrate fund performance.

(iv) Plaintiffs may seek to <u>pierce the corporate veil</u> and impose liability on a private equity firm for the actions of its portfolio companies if they can demonstrate that the private equity firm had domination and control of the portfolio company and engaged in fraud, inequitable conduct or misuse of that control in a way that caused foreseeable harm. Steps to maintain the separate corporate existence of portfolio companies and avoid <u>alter ego</u> liability include observing corporate formalities, maintaining arm's-length relationships, maintaining separate operations and accounts, ensuring that dual officers and directors who act on behalf of the portfolio company are acting in the portfolio company's interest, and avoiding intermingling of funds and assets. Alter ego liability was one of the main concerns identified by the Board in the Section 620 Report, in which it recommended that Congress repeal FHCs' merchant banking authority. In particular, the Board raised concerns that an FHC could become exposed to legal risks through its involvement in the operations of a portfolio company that subsequently experiences an environmental event that causes significant losses. Section 620 Report (Sept. 2016). See also Part I.B.6.k above.

(v) Dodd-Frank Title IV revised the exemptions from registration available under the Advisers Act, resulting in a significant increase in registrations by advisers to hedge funds and private equity funds. See Part I.B.4 above and Part VIII.C.2.a.iv below.

See generally, e.g., Remarks of SEC OCIE Director Bowden, May 6, 2014 (Spreading Sunshine in Private Equity); Remarks of SEC OCIE Director di Florio, May 2, 2012 (SEC approach to supervision and examination of private equity fund advisers); Wall St. J., Feb. 24, 2012 (investigation by SEC and the Mass. Attorney General into a fund's valuation of its portfolio companies while marketing to investors), Feb. 11, 2012 (SEC private equity inquiry); SEC Letter, Dec. 2011 (requesting information from private equity advisers); SEC Release No. 34-65217 (Aug. 29, 2011) (order alleging conflicts of interest by a partner at an investment adviser who misappropriated an investment opportunity from his advised funds); Private Equity Conflicts of Interest (IOSCO, Nov. 2010).

(vi) The SEC has increased its scrutiny of private equity funds and their advisers. In 2010, the SEC formed a specialized enforcement unit focused on asset management issues, and in late 2011 the SEC launched an inquiry into private equity firms, sending information requests to a number of firms. Among the issues the SEC was reported to be examining are compliance and risk management, disclosure of fees and expenses, and conflicts of interest that may arise throughout the life cycle of a private equity fund (e.g., the fund raising, investment, management and exit stages).

(vii) Invested private equity funds could be held jointly and severally liable for pension obligations of bankrupt portfolio companies if the funds are deemed "trades or businesses" under "common control" with the portfolio companies under ERISA. The First Circuit held that Sun Capital Partners IV, LP was a "trade or business" because it exercised a significant management influence over the relevant portfolio company and "derived direct economic benefit" that was different than what a passive investor would derive. The Court also concluded that the actions of the fund's general partner and management company could be attributed to the fund. See Sun Capital Partners III v. New England Teamsters & Trucking Industry Pension Fund, 724 F.3d 129 (1st Cir. 2013). The Supreme Court declined to review the First Circuit's conclusions, and the case was remanded to the District Court to determine whether the fund was under "common control" with the relevant portfolio company.

Since that time, the SEC has brought several enforcement actions related to private equity advisers, especially with respect to the fees and expenses they charge. In these cases, the SEC has alleged that advisers did not adequately disclose fees and expenses, misallocated and impermissibly shifted fees and expenses, and failed to disclose conflicts of interest. See generally Remarks of SEC Director of Division of Enforcement Andrew Ceresney, May 12, 2016. See also Cherokee Investment Partners, LLC and Cherokee Advisers, LLC, SEC Release No. IA-4258 (Nov. 5, 2015); Fenway Partners, LLC et al., SEC Release No. IA-4253 (Nov. 3, 2015); Blackstone Management Partners, L.L.C., et al., SEC Release No. IA-4219 (Oct. 7, 2015); Kohlberg Kravis Roberts & Co., L.P., SEC Release No. IA-4131 (June 29, 2015); Lincolnshire Management, Inc., SEC Release No. IA-3927 (Sept. 22, 2014).

The SEC has also brought an enforcement action against a private equity firm and its principal for failing to register as a broker-dealer. See Part VII.C.7.b.iii below.

2. Financial Holding Companies and Financial Subsidiaries: Gramm-Leach-Bliley Merchant Banking Considerations

   a. Scope of Authority

      (i) FHCs (but not financial subsidiaries) may engage in merchant banking activities both in accordance with the Merchant Banking Regulations discussed in Part VII.A.2.b below and to the extent permitted for BHCs and banks as discussed in Part VII.A.3 and Part VII.A.4 below.

      (ii) Under BHCA § 4(k)(4)(H), an FHC may invest in stock, assets or ownership interests (including debt and equity securities) -- whether or not controlling -- in any portfolio company engaged in non-financial activities if the stock, assets or ownership interests are:

         A) Acquired and held by a "securities affiliate" (or an affiliate thereof), or an affiliate of an insurance company registered as an investment adviser (or an affiliate thereof), as part of a bona fide underwriting or investment or merchant banking activity, including investment activities for the purpose of appreciation and ultimate resale or disposition of the investment.

         B) Held for a period of time to enable their sale or disposition on a reasonable basis.

         C) Not held under circumstances where the FHC routinely manages or operates a portfolio company except as necessary to obtain a reasonable return on investment.

         D) Not acquired or held by a U.S. depository institution (or a U.S. branch of a non-U.S. bank).

(iii) In terms of the scope of the Gramm-Leach merchant banking authority:

A) The Merchant Banking Regulations discussed in Part VII.A.2.b below apply to investments in non-financial firms made in reliance on the GLBA merchant banking authority. (The term "non-financial firm" should encompass any portfolio company engaged to a meaningful extent in non-financial activities.) Investments in financial firms, if made for the purposes of appreciation and ultimate resale, might be subject to the restrictions set forth in the Regulations depending on the investor's business focus and intent. See Part VII.A.2.b.v below (private equity fund empowerments).

B) FHCs need not rely on the Gramm-Leach merchant banking authority -- and should not be subject to any restrictions on investments made pursuant to other BHCA empowerments (e.g., BHCA § 4(c)(6)) -- with respect to their underwriting, dealing and market-making operations. Issues can arise relating to the appropriate characterization of hedging positions, which may in some circumstances be acquired as a dealing activity or pursuant to BHCA § 4(c)(6) or Gramm-Leach merchant banking authority.

b. Federal Reserve Board Merchant Banking Regulations

12 C.F.R. §§ 225.170 et seq. (the "Merchant Banking Regulations") interpret and implement Gramm-Leach's merchant banking provisions. The final form of such Regulations -- set out at 66 Fed. Reg. 8466 (Jan. 31, 2001) -- reflected a significant liberalization of the regulations initially announced (see 65 Fed. Reg. 16460 (Mar. 24, 2000) (solicitation of public comments) (the "Interim Merchant Banking Regulations")).

(i) Investment Limits

Prior to 2002, merchant banking investments were in general subject to an aggregate cap equal to 30% of the FHC's Tier 1 capital.

The quantitative limits were eliminated in 2002 when the Board adopted the Merchant Banking Capital Rule (discussed in <u>Part VII.A.2.c below</u>).

(ii) <u>Holding Period</u>

Merchant banking investments may be held for up to 10 years generally, and up to 15 years if held by a <u>private equity fund</u> as described in <u>Part VII.A.2.b.v below</u>. The holding periods can be extended with Board approval, but other restrictions may apply.

A) An FHC must file a Board Form FR Y-12A report for a merchant banking investment if, as of December 31 of the relevant calendar year, the FHC has owned, controlled or held such investment for more than 8 years generally or more than 13 years through a private equity fund.

B) In 2009, the Board granted the first extension of a merchant banking holding period. <u>See</u> Board Letter to Cleary Gottlieb, May 28, 2009, and further extensions, Sept. 9, 2013, Nov. 7, 2012, Aug. 24, 2011 and Sept. 21, 2010. <u>See also</u>, <u>e.g.</u>, Board Letters to JPMorgan Chase, Aug. 11, 2014, July 17, 2013; Board Letter to KeyCorp, June 23, 2014; Board Letter to RBC, June 26, 2014; Board Letter to Wells Fargo, Sept. 4, 2013; Board Letter to Bank of America, Feb. 14, 2013; Board Letter to Wells Fargo, Dec. 20, 2012.

C) In some cases, the end of an applicable holding period for a private equity fund could coincide with the Volcker Rule conformance period, giving rise to a need to consider an extension request under both regimes. <u>See</u> <u>Part II.A.7 above</u>.

(iii) Ownership of "Assets"

"Assets" other than debt or equity securities or other ownership interests (e.g. real estate or commodities) must be put into a portfolio company, subject to corporate separateness requirements.

(iv) No "Routine Management or Operation"

An FHC may not engage in "routine management or operation" of a portfolio company. However:

A) An FHC is permitted to have any number of representatives on a portfolio company's board of directors and may select a portfolio company's partners (including the general partner). With respect to certain issues which arise from representation on the boards of directors of portfolio companies, see Part VII.A.1.h above.

B) Although "executive officer" interlocks between an FHC and a portfolio company would constitute "routine management or operation", officer and employee interlocks, and certain managerial, supervisory and reporting relationships, between an FHC and a portfolio company below the level of "executive officers" would only create a "rebuttable presumption" of "routine management or operation".

While the Board has not set out a list of factors that could be used to rebut this presumption, these factors could include such matters as (1) the purpose of the interlock, its intended length, and the proportion of time the interlocking employee would expect to devote to the portfolio company; (2) the nature of the operating function as to which the interlock exists; (3) the rank and function of the FHC non-executive officer who interlocks with the portfolio company; (4) whether there are other factors -- including business covenants -- which could lead to the conclusion that the FHC is or is not participating in the "routine management or operation" of the portfolio company; and (5) whether the interlock is consistent with interlocks generally provided by other FHCs or merchant banking investors given the nature of the portfolio company or the nature of the interlock.

C) An FHC may enter into an agreement with a portfolio company that includes covenants that restrict conduct outside of the ordinary course of business.

i) The Merchant Banking Regulations set out a <u>non-exclusive</u> list of actions which are considered to be outside the ordinary course of business, including:

(a) The acquisition of significant assets or control of another company.

(b) Removal or selection of an independent accountant, auditor or investment banker.

(c) Significant changes to business plans or accounting policies.

(d) Removal or replacement of executive officers.

(e) Redemption, authorization or issuance of equity or debt securities, or borrowing outside of the ordinary course of business.

(f) Amendment of governing documents.

(g) Sale, merger, consolidation, spin-off, recapitalization, liquidation, dissolution or sale of substantially all of the assets of the portfolio company or any of its significant subsidiaries.

ii) The provision of financial, investment or management consulting advisory services, or securities underwriting/placement services, to or for a portfolio company should <u>not</u> constitute "routine management" so long as the FHC does not exercise decision-making authority on behalf of the portfolio company.

iii) Board Letter to CSFB, Dec. 21, 2001 (the "<u>CSFB Letter</u>"), gave <u>additional examples of covenants</u> that would be permissible, including covenants that restrict the ability of the portfolio company to:

(a) Alter its capital structure through the issuance, redemption, authorization or sale of equity or debt securities (including options, warrants, obligations or other instruments that give the holder the right to acquire securities).

(b) Establish the general purpose for funds sought to be raised through the issuance or sale of equity or debt securities (<u>e.g.</u>, retirement of existing debt, acquisition of another company, general corporate use).

(c) Amend the terms of equity or debt securities.

(d) Declare a dividend on any class of securities or change the dividend rate.

(e) Publicly offer securities.

(f) Register a class of securities under federal or state securities laws.

(g) List (or de-list) securities on a securities exchange.

(h) Create, incur, assume, guarantee, refinance or prepay indebtedness outside the ordinary course of business.

(i) File for bankruptcy, or consent to the appointment of a receiver, liquidator, assignee, custodian or trustee.

(j) Significantly alter regulatory, tax or liability status.

(k) Make capital expenditures outside the ordinary course of business.

(l) Engage in any purchase, sale, lease, transfer or other transaction outside the ordinary course of business (e.g., (i) a contract (including a lease or consulting agreement) that imposes significant financial obligations, (ii) sale of a significant asset, (iii) establishment of a significant new subsidiary, (iv) transfer of significant assets to a subsidiary or to a person affiliated with the portfolio company, or (v) establishment of a significant joint venture).

(m) Hire, remove or replace executive officers.

(n) Establish, accept or modify an executive officer employment agreement or employee benefit plan.

(o) Adopt or significantly modify policies or budget concerning salary, compensation or employment.

(p) Alter significantly business strategy or operations (e.g., by entering or discontinuing a significant line of business, or altering significantly tax, cash management, dividend or hedging policies).

(q) Establish, dissolve or materially alter the duties of a committee of the board of directors.

iv) The CSFB Letter noted that some actions by their very nature are outside the ordinary course of business and, thus, may be subject to a covenant with the portfolio company (e.g., restricting the ability of a company to issue or redeem equity or debt securities or hire or fire its executive officers), but that covenants concerning other types of actions may, or may not, involve the FHC in routine business decisions depending on the actions covered by the covenant and the characteristics of the portfolio company. Whether an action would be "significant" would depend on the size, capital, condition, business and other characteristics of the particular company.

One rule of thumb would be that any action that would, under ordinary business practices, be presented to the board of directors for approval or consideration could also be subject to a covenant that requires review and approval by the FHC investor.

D) An FHC has the authority to manage or operate a portfolio company on a temporary basis when necessary to obtain a reasonable return, such as to avoid a significant operating loss or in connection with a loss of senior management. Written notice must be given to the Board if an FHC routinely manages or operates a portfolio company for more than <u>nine months</u>.

i) The notice should identify the portfolio company, the date on which the FHC first became involved in its management or operation, the reasons for the involvement, the actions that the FHC has taken to address the circumstances giving rise to the intervention, and an estimate of when the FHC anticipates ceasing such intervention.

ii) An FHC is also required to document each intervention in the operations of a portfolio company so that such intervention can be reviewed in the examination process.

iii) This ability to manage portfolio companies on a temporary basis gave rise to the concerns about alter ego liability that the Board described in the Section 620 Report. The Board provided this as the primary rationale for its recommendation for Congress to repeal the merchant banking authority. <u>See also</u> <u>Part VII.A.1.h.iv above</u>.

(v) <u>Private Equity Funds</u>

A "private equity fund" for purposes of the Merchant Banking Rules is an investment vehicle that represents a pool of resources from both an FHC and outside investors. It may invest in both <u>financial</u> and <u>non-financial</u> companies.

A) A fund may qualify as a private equity fund if:

i) The fund has a fixed duration (including all potential extensions) of 15 years or less; <u>and</u>

ii) The FHC and its officers, directors, employees and principal shareholders own 25% or less of the total equity of the fund.

B) The Board may extend the 15-year maximum term upon request, which must be filed 90 days before expiration of the holding period. Extended investments will become subject to a capital charge and discretionary Board restrictions.

C) The general prohibition on routine management or operation of a portfolio company would apply only to a fund controlled by an FHC. An FHC may invest in a fund that manages or controls a portfolio company so long as the FHC does not "control", and does not routinely manage or operate, the fund in which the FHC invests.

D) An FHC would be deemed to "control" a fund if the FHC or a director, officer, employee or principal shareholder of the FHC:

i) Serves as general partner, managing member or trustee of the fund;

ii) Owns or controls 25% or more of any class of voting shares of the fund;

iii) Selects, controls or constitutes a majority of the directors, trustees or management of the fund; or

iv) Owns more than 5% of any class of voting shares of the fund and serves as the fund's investment adviser.

E) An FHC may own more than 25% of the equity of a fund -- which, then, by definition, would not be a "private equity fund" -- so long as the fund does not hold investments in portfolio companies for more than a 10-year holding period and the fund complies with the "no routine management" and other restrictions generally applicable to the FHC's merchant banking investments. Alternatively, so long as the FHC does not otherwise "control" a fund within the standards described, the fund should not be subject to such restrictions -- even if the FHC's investment exceeds 25% (e.g., of non-voting securities) -- so long as the FHC treats its investment in the fund as subject to the Board's 10-year holding period and complies with the other Board requirements that apply to investments in a portfolio company.

F) As discussed in Part II.A.7 above, the Volcker Rule restricts the ability of an FHC to invest in investment funds which constitute "private equity funds" or "hedge funds" for Volcker Rule purposes, and for some bank-sponsored private equity funds, the potential need for an extension of the applicable 15– or 10–year maximum term will coincide with a requirement for an extension of the conformance period under the Volcker Rule.

(vi) Cross-marketing and Affiliate Transaction Restrictions

The Merchant Banking Regulations implement Gramm-Leach's cross-marketing and affiliate transactions restrictions which relate to an FHC's depository institution subsidiaries and portfolio company investments.

A) Under the Merchant Banking Regulations:

i) An FHC's depository institution subsidiaries may not (A) market any product or service of any portfolio company in which the FHC owns more than a 5% voting interest, or (B) allow any product or service of such depository institution to be marketed by such a company.

ii) Cross-marketing restrictions apply to U.S. branches of non-U.S. banks that conduct merchant banking activities through a U.S. company.

iii) Cross-marketing restrictions do <u>not</u> apply to (A) portfolio companies held by a private equity fund which the FHC does <u>not</u> <u>control</u>, or (B) the sale or marketing of any investment in a private equity fund, whether or not controlled by the FHC.

iv) Under Relief Act § 611, cross-marketing restrictions do <u>not</u> apply to arrangements between companies held pursuant to the merchant banking authority and affiliated depository institutions for the marketing of products or services through "statement stuffers" or Internet websites so long as: (A) the arrangement does not violate the Anti-tying Statute; and (B) the Board determines that the arrangement is in the public interest, does not undermine the separation of banking and commerce, and is consistent with the safety and soundness of depository institutions. <u>See</u> <u>Part III.A.4 above</u>.

B) Gramm-Leach provides that a portfolio company is rebuttably presumed to be an "affiliate" of a bank for purposes of Sections 23A/23B if such bank's FHC owns 15% or more of the stock of the portfolio company. Under the Merchant Banking Regulations:

i) A company controlled by a private equity fund in which an FHC invests will <u>not</u> be presumed to be an affiliate of a bank controlled by the FHC <u>unless</u> the FHC (A) controls the fund, or (B) has sponsored and advised the fund.

ii) Sections 23A/23B apply to a covered transaction between a U.S. branch of a non-U.S. bank and (A) any portfolio company controlled by the non-U.S. bank or an affiliate, and (B) any company controlled by the non-U.S. bank or affiliate that makes merchant banking investments if the proceeds of the covered transaction are used to fund merchant banking activities.

(vii) Recordkeeping and Reporting

A) The Merchant Banking Regulations specify required policies, systems and recordkeeping. See also Board SR Letter 00-9 (SPE) (June 22, 2000), CCH Fed. Banking L. Rep. ¶ 62-014.

B) Board requirements for merchant banking activities include (i) board of directors oversight, (ii) investment and exposure limits, (iii) diversification, (iv) holding period policies, (v) investment approval processes, (vi) investment reviews and compliance analysis, and (vii) post-transaction notice for large merchant banking investments (investments that exceed 5% of the shares of a portfolio company and the lesser of $200 million and 5% of the FHC's Tier 1 capital).

C) Under Dodd-Frank § 604(e), prior Board approval is required for merchant banking investments which exceed $10 billion.

c. Capital Rules for Non-financial Equity Investments

Prior to the banking agencies' adoption of the Revised Capital Guidelines, FHCs were required under the Merchant Banking Capital Rule to make specific deductions from Tier 1 capital for merchant banking investments. However, these requirements have been revised as part of the Revised Capital Guidelines' treatment of equity exposures generally. See Part II.A.2 above.

d. Insurance Company Investment Authority

Under BHCA § 4(k)(4)(I), an insurance underwriting or annuity company (but not an insurance agency) may make investments for any length of time if such investments are made in the ordinary course of business in accordance with relevant state law, and the insurance company does not routinely manage or operate the portfolio company except as may be necessary to obtain a reasonable return on investment.

The Merchant Banking Regulations do not apply to investments made under this authority.

3. Bank Holding Companies: Considerations under the Bank Holding Company Act of 1956

a. General

(i) BHC subsidiaries may make equity investments pursuant to BHCA §§ 4(c)(6)/(7). In general, this means that a BHC is subject to the following ("Regulation Y Investment Limits"):

A) Limitations restricting equity investments to "passive", "non-control" investments:

i) Which amount to not more than 5% of any class of "voting securities" of any issuer (the "5% test"); and

ii) represent less than one-third of the total equity.

In the past, Board staff had looked to whether the dollar amount of the investment (if made directly in an issuer) represented as much as 25% of the total equity of the issuer; more recently, this principle has not been an explicit part of Board control evaluations, and other methodologies would appear more appropriate in some contexts, such as investments in start-up companies that may not be profitable in early years.

The one-third total equity test is grounded in the Board's Policy Statement on Equity Investments in Banks and Bank Holding Companies ("Board Control Guidance"), but the Section 620 Report did not mention this test and instead described §§ 4(c)(6)/(7) only in terms of the 25% test. It described §§4(c)(6)/(7) as permitting investments in any company "provided the investment does not exceed 5 percent of the outstanding voting shares, and up to 25 percent of the total equity, of the target company."

B) Restrictions on the number of BHC representatives who may serve as a director of any issuer.

See also Part VII.A.7.d below.

(ii) Other available empowerments with respect to a BHC's ownership of interests in non-financial companies include BHCA §§ 4(c)(2) (shares held in the context of DPC), 4(c)(5) (e.g., SBICs, as discussed in Part VII.A.5 below), and 4(c)(9)/(13) (investments in foreign companies, as discussed in Part VII.A.6 below).

b. "Voting Securities"

In general, shares or interests are voting securities for purposes of BHCA § 4(c)(6) if they (i) vote generally for the election of directors, general partners or similar persons, or (ii) have the right to vote on any other matter (unless such voting rights are limited to the type customarily provided by statute with regard to matters that would "significantly and adversely" affect the rights or preferences of the shares or other interests (the "4(c)(6) permitted voting rights")). See 12 C.F.R. § 225.2(q); 49 Fed. Reg. 794 (Jan. 5, 1984) (the "1984 Release") (BHCA concept of "voting security").

(i) All general partnership interests are treated as "voting securities" (although it is arguable that, if a general partnership interest is subject to appropriate voting constraints, it should be treated as a "non-voting security").

(ii) If a security entitles the holders to vote for directors, such security generally is treated as a voting security.

A) However, the Board traditionally regards preferred stock as "non-voting" even if the holder has the right to designate directors in the event dividends are in arrears. See, e.g., Board Letter to Joseph J. Samonas, Esq., Office of Financial Stability, Department of the Treasury, Dec. 7, 2012; Board Letter to Bank of America, Aug. 22, 2007 (the "BofA-CFC Letter"). Such a security would be regarded as a "voting security" when the right to vote arises.

B) In general, the Board would treat a security that permits the holder to vote separately as a class to elect even a single director as a separate "class" of voting securities. See, e.g., Board Letter to Michigan National Corp., Mar. 9, 1999. By contrast, a "separate class" should not arise if the right to board representation is contractual (rather than pursuant to the terms of the securities), especially if such right is non-transferable.

(iii) Provisions that raise the risk of a security being treated as a "voting security" include those that give the holder:

A) The right to remove a director or partner.

B) The right to vote on the approval of new shareholders or partners, or to nominate persons to be elected as partner or serve as directors or officers.

C) The right to vote for members of an "advisory board" with significant veto powers over the actions of the directors or general partners. (However, the right to select members of a consultative board should not ordinarily raise issues of the same magnitude, nor should the presence of "non-voting observers" at board meetings.)

D) The right to vote on changes in business policy or other corporate developments whether or not they have a "significant and adverse" impact on the rights or preferences of such security.

(iv) Whether a particular class or series of voting shares will be considered a separate class, or will be aggregated with another class for purposes of determining compliance with the 5% test, will depend on whether the classes/series vote together as a single class (regardless of differences in dividend rights or liquidation preferences) on all matters for which the classes/series have voting rights (other than those matters which are the subject of 4(c)(6) permitted voting rights). See 12 C.F.R. § 225.2(q)(3).

If a particular class votes with another class on all matters for which the classes have voting rights but casts a different number of votes per share, this should not adversely affect the ability to aggregate the two classes for calculation purposes, but would affect the manner of calculation.

(v) Securities that are non-voting in the hands of a BHC, but could become voting (or could be convertible into voting shares) at the election of the holder of the shares or on transfer, or that mandatorily convert after the passage of time, are often treated as "voting" at the outset. See generally, e.g. 12 C.F.R. § 225.143 (the "Board Stake-out Guidelines"); Board Control Guidance.

In general, however, such treatment should not be triggered if the BHC may only transfer its securities (A) with the approval of the issuer; (B) as part of a widespread public or private offering where no ultimate purchaser acquires more than a small amount (e.g., 2%) of any class of the portfolio company's voting securities; (C) to an underwriter for the purpose of underwriting a widely distributed public or private offering; (D) in one or more open market transactions effected on a stock exchange, ECN or similar execution system, or in the OTC market (which may include a sale to one or more broker-dealers acting as market-makers or otherwise intending to resell the securities in accordance with normal business practices); (E) to a transferee that already has "control" of the issuer; or (F) with the approval of the Board.

(vi) Although there are a number of precedents in which the Board accepted the proposition that an investor may, by agreement, convert voting into non-voting shares under certain circumstances (see, e.g., Santander, 81 Fed. Res. Bull. 1139 (1995); Board Letter, Sept. 29, 1995, re American Financial Group (the "AFG Letter"); Letter, dated Nov. 25, 1986 (the "Sumitomo Letter"), Board staff have taken the position that no such agreement would be effective for purposes of BHCA § 4(c)(6). See, e.g., Board Ruling, Aug. 30, 1974, Fed. Res. Reg. Serv. ¶ 4-550.

(vii) Whether a particular corporate change would "significantly and adversely" affect the rights or preferences of a security is a question of fact.

A) Board staff have indicated on occasion that, in defining the type of vote that would not make a security a "voting security", the Board did not have in mind changes which affect the economic return or safety of such security, but only actual alterations in such security's preferences or legal terms. Thus, while voting rights as to such matters as the term of any security and the amount and business terms of such security (e.g., interest or dividend rate, voting, liquidation or winding up of the issuing entity, redemption or repayment rights, etc.) would appear to relate to "significant" matters, other types of votes are less clear.

B) In its discussion of the concept of "voting security" in the 1984 Release Y, the Board stated:

"[P]referred stock would not be viewed as a voting security if it may vote on a merger that would adversely affect its rights or preference or that involves the issuance of additional amounts or classes of senior securities, or the alteration of charter or by-laws that would adversely affect the preferred stock. On the other hand, preferred stock that may vote on any merger regardless of whether its preferred status would be affected, could [sic: not 'would'] be viewed as a voting security". (Emphasis added.)

See also Board Letter, Sept. 24, 1999.

C) Inclusion of significant "business related provisions" as part of such company's organization documents (as to which provision is made for amendment only by a "super-majority" vote) or in the investment agreement itself could emphasize the critical importance of these particular provisions to the BHC and support the proposition that change in these provisions would be viewed as "significantly and adversely" affecting the investment.

As a general matter, it should be consistent with a security's "non-voting" characterization for organizational documents to (i) define with specificity corporate governance or permitted business and operations, and to provide that any modification of such provision will require securityholder consent; and/or (ii) require securityholder consent for the creation, acquisition or disposition of subsidiaries in any manner which dilutes the rights or preferences of the security in question (such as by reducing par value, or changing the nature, rights or ranking of the security), or which results in the issuance of securities or other financial instruments senior to such security.

D) Other examples of voting rights that, in general, should be consistent with a "non-voting" characterization for BHCA purposes would include the right to vote on such matters as:

i) Dissolution, liquidation or winding up of the issuing equity.

ii) Consolidation or sale of all or substantially all of the assets of the issuing entity (in each case to the extent that such transaction or amendment would significantly and adversely affect the rights or preferences of the investor's securities).

iii) Payment of dividends by the issuing entity when dividend or other payments in respect of the investor's securities are in arrears.

E) With respect to debt covenants, the Board traditionally has permitted a broader range of restrictions in the form of redemption or trigger rights because the ability to redeem the interests allows the target company to avoid any controlling influence. See, e.g., Board Letter, Mar. 21, 2012 ("Moneygram Letter"); Board Letter, Aug. 24, 2005; Board Letter re Mercantile Texas Corp., July 8, 1983.

c. Convertible Securities and Other Rights to Acquire Equity

In calculating the percentage ownership that a BHC has in a portfolio company based on a BHC's ownership of convertible securities and other rights to acquire equity, the Board "rebuttably presumes" that securities "immediately convertible" into underlying equity represent the underlying equity. 12 C.F.R. § 225.31(d)(1)(i).

(i) In computing the denominator for this purpose, the BHC may only include securities of the underlying class actually outstanding and those additional shares which would be outstanding assuming conversion by the BHC, but not any additional shares which would be outstanding assuming conversion by third persons, even if the rights are immediately exercisable on both a legal and an economic basis. See, e.g., Crédit Agricole-Breen Approval; Board Letter to Fleet, Dec. 4, 1998.

(ii) Although the Regulation Y presumption uses the words "immediately convertible", Board staff have advised informally that even conversion rights which are not "immediately" exercisable could affect the Board's control-related determinations. The Board Control Guidance articulates the principle as follows: "The Board continues to believe that non-voting shares that may be converted into voting shares at the election of the holder of the shares, or that mandatorily convert after the passage of time, should be considered voting shares at all times for purposes of the BHC Act". Board Control Guidance § 225.144(c)(2).

(iii) In general, a security could be deemed to be "immediately convertible" into an underlying security even if early conversion would be subject to prior Board approval, if the holder of the security has the legal authority to apply to the Board for such approval. See, e.g., Board Staff Opinions, Aug. 12, 1988; May 14, 1984, Fed. Res. Reg. Serv. ¶ 4-397.2. But see BofA-CFC Letter (Board staff treated preferred stock convertible at the option of the holder as non-voting under circumstances where conversion into more than 4.9% of a class of voting securities would be subject to Board approval). However, securities which become convertible into an underlying security in the hands of a transferee would not necessarily be so treated (or the "rebuttable presumption" of immediate convertibility would not necessarily be triggered) if steps are taken to address control-related concerns (e.g., as set out in Part VII.A.3.b.v above). See, e.g., BofA-CFC Letter; AFG Letter; Board Approval under the Change in Bank Control Act (12 U.S.C. § 1817(j)) (the "CBCA"), July 12, 1991, Fed. Res. Reg. Serv. ¶ 4-397.3; Board Letter, Apr. 7, 1987, concerning Citicorp participation in the purchase of 34% of Reliance Electric common stock (the "Citicorp Reliance Letter"). See generally FDIC Opinion No. 03-02 (June 13, 2003), CCH Fed. Banking L. Rep. ¶ 82-258 (in context of the CBCA, immediately exercisable option treated as representing underlying equity securities).

(iv) In rebutting the "presumption" of "immediate convertibility", although Board staff would resist the analysis, it should be possible to make a presentation that the relevant securities are not "immediately convertible" as an economic matter.

(v) In evaluating control-related issues (see Part VII.A.3.e below), the Board can be expected to consider (A) the proportion of any class of voting shares in a portfolio company that a BHC could hold upon the exchange of warrants or similar securities held (even warrants which are not "immediately convertible"), particularly if such proportion would equal or exceed one-third; and (B) the nature of any restriction (or lack thereof) applicable to the transfer of such warrant or similar securities.

(vi) If a BHC enters into an agreement or understanding under which the rights of a holder of voting securities of a portfolio company are restricted, the Board "rebuttably presumes" that the BHC controls such voting securities except under circumstances where such agreement or understanding is (A) a mutual right of first refusal among shareholders, or (B) incident to a bona fide loan. 12 C.F.R. § 225.31(d)(1)(ii).

(vii) As a general matter, convertible securities should not be deemed to be "immediately convertible" into an underlying equity security if such securities only become exercisable in connection with an event that the security holders do not have the ability to bring about (e.g., a widespread distribution of the underlying equity securities of the entity in question.)

d. "Side-by-side" Employee Investments

Issues sometimes arise as to whether a BHC's investment in a portfolio company should be aggregated with side-by-side (or other) investments by its officers or employees.

(i) The Board "rebuttably presumes" that a BHC would control a portfolio company if the BHC, together with its management officials (directors, officers, etc.) and members of their immediate families, own 25% or more of any class of a portfolio company's voting securities and the BHC owns more than 5% of any class of the portfolio company's voting securities. 12 C.F.R. § 225.31(d)(2)(ii). See generally Board 1997 AmSouth Letter.

(ii) The Board "rebuttably presumes" that a BHC controls a portfolio company if the BHC shares one or more management officials with the company and owns more than 5% of any of the company's voting securities, and there is no other holder of at least 5% of any class of the company's voting securities. 12 C.F.R. § 225.31(d)(2)(iii).

(iii) Prior to enactment of Relief Act § 706, BHCA § 2(g)(2) provided that securities held by a fiduciary for the benefit of a company, its shareholders, members or employees, are deemed to be controlled by the company (and, accordingly, would be aggregated with the company's proprietary ownership). The Relief Act permits the Board to determine that such treatment is not appropriate "in light of the facts and circumstances of the case and the purposes of [the BHCA]".

e. “Control” and “Passivity”

(i) The Board’s analysis of “control” and “passivity” issues evidences a very cautious approach. Under the BHCA and Board interpretations, a BHC “controls” a portfolio company if it (A) owns 25% or more of any class of “voting shares”, or (although not statutorily mandated) one-third or more of the total equity of the company; (B) controls in any way the election of a majority of the company’s directors or similar officials; or (C) exercises a “controlling influence” over the company’s management or policies.

Moreover, although the statutory and policy basis for the conclusion is not entirely clear, the Board also requires that an investment under BHCA § 4(c)(6) be “passive” -- a standard that restricts certain business interrelationships, cross-referrals, joint marketing and the like between the BHC and the portfolio company.

See 12 C.F.R. § 225.2(e); 12 C.F.R. § 225.137; Board Control Guidance; Board Policy Statement on Non-voting Equity Investments; Board Stake-out Guidelines. Board Letter Aug. 24, 2005 (deconsolidation/preferred stock consent rights); BNP-Neuberger Order/BNP-Neuberger & Berman, L.P. (“N&B”) Board Letter, dated May 12, 1994, to Robert Tortoriello (the “BNP-N&B Letter”); U.S. Trust Corp., 58 Fed. Reg. 31390 (June 2, 1993) (solicitation of public comments) (approved July 7, 1993) (including commitments); Board Staff Opinion (Nov. 5, 1984) (the “Board Non-voting Investment Staff Opinion”), Fed. Res. Reg. Serv. ¶ 4-305.1

For a discussion of the background and framework of certain Board “control” and “passivity” precedents, see The Record of the Association of the Bar of the City of New York, Non-voting Equity Investments by [BHCs] in Non-banking Companies (Banking Law Committee, Nov. 1992).

For a discussion of the Board's analysis of "control" and "passivity" as they relate to the interrelationships between investment banks and commercial banks, see Part XII.C below.

For a discussion of bank-related "control" and "passivity" precedents, see Part VII.A.4 below.

(ii) In connection with BHC Applications to provide "mezzanine" financing for recapitalizations and similar transactions and to take equity positions in the companies financed, the Board stated that the acquisition of options, warrants or preferred or common equity would be subject to compliance with the Board's Stake-out Guidelines. For Board Orders in this area, see, e.g., Crédit Agricole-Breen Approval; Wells Fargo, 82 Fed. Res. Bull. 165 (1996); NationsBank, 80 Fed. Res. Bull. 154 (1994); Creditanstalt Bankverein, 59 Fed. Reg. 11605 (Mar. 11, 1994) (solicitation of public comments) (approved Apr. 8, 1994); NatWest, 54 Fed. Reg. 5677 (Feb. 6, 1989) (solicitation of public comments) (approved Mar. 24, 1989); Banc One Corp., 54 Fed. Reg. 8597 (Mar. 1, 1989) (solicitation of public comments) (approved Mar. 6, 1989); Matewan Bancshares, 54 Fed. Reg. 66 (Jan. 3, 1989) (solicitation of public comments) (approved Jan. 14, 1989); CB&T Financial Corp., 53 Fed. Reg. 51586 (Dec. 22, 1988) (solicitation of public comments) (approved Jan. 13, 1989); Signet Banking Corp. ["Signet"] 53 Fed. Reg. 15734 (May 3, 1988) (solicitation of public comments) (approved June 22, 1988); Fleet, 53 Fed. Reg. 3456 (Feb. 5, 1988) (solicitation of public comments) (approved Feb. 18, 1988); First National Boston Corp., 47 Fed. Reg. 40236 (Sept. 13, 1982) (solicitation of public comments) (approved Oct. 7, 1982).

(iii) The Board has taken a similar position in connection with BHC investments in acquisition funds, limited partnerships and similar vehicles. See, e.g., 12 C.F.R. § 225.125; Board Orders and Approvals referred to in Part II.D.2 above and FRBNY Letter to Swiss Bank Corp., Mar. 28, 1995 (compare Mellon-Dreyfus Order, Part VIII.C.1.b.ii.C.i.b below); Board Ruling (Dec. 7, 1989), Fed. Res. Reg. Serv. ¶ 4-271.2; Citicorp Reliance Letter; Board Letter to Shea & Gould (undated) (BHC acquisition of up to 4.9% of the voting shares of a fund).

(iv) For purposes of Board Form FR Y-10, a BHC "controls" a non-banking company if the BHC (A) controls 25% or more of any class of voting securities of the company; (B) elects a majority of the company's board of directors, trustees, general partners or similar persons; (C) is a general partner, managing member or trustee of the company; or (D) in certain situations, acquires all or substantially all of the company's assets.

In addition, a BHC is rebuttably deemed to "control" a non-banking company if the BHC (A) enters into a management agreement with the company under which the BHC exercises significant influence over the company's management or operations; (B) controls more than 5% of a class of voting securities of the company, one or more individuals serve as director or officer of both the company and the BHC, and no person unaffiliated with the BHC controls 5% or more of the company; (C) controls more than 5% of a class of voting securities of the company and together with directors or officers of the BHC controls more than 25% of a class of voting securities of the company; or (D) controls 10% or more of a class of voting securities of the company and an individual serves as both a director or officer of both the company and the BHC. See Instructions for Preparation of Report of Changes in Organizational Structure, Reporting Form FR Y-10.

Especially because this last presumption does not align with current Board policy as set out in the Board Control Guidance, it is sometimes appropriate to rebut the presumption for purposes of Form FR Y-10 reporting.

(v) Whether an investment is passive or involves a "controlling influence" over a portfolio company is determined in light of the overall circumstances. Board staff has generally interpreted the "controlling influence" language broadly to include a wide array of arrangements and appears to support the notion that a BHC does not necessarily need actual operational control of a company in order to be deemed to have a "controlling influence" over such company.

In addition to the factors mentioned in Part VII.A.3.a-e above, "control-related" facts and circumstances may include:

A) How the investment compares in size with those of other equityholders (in particular, whether there is at least one equityholder with a voting investment of 5% or more).

B) Whether the BHC has other financial exposure to, or rights with respect to, the portfolio company (including whether the BHC extends credit to the portfolio company, particularly loans which are not on arm's length terms).

C) Whether investment covenants limit the portfolio company's management (and, if so whether (i) such covenants are more onerous than a good faith lender would impose; and (ii) the portfolio company has a right (and, if so, at what premium and on what other terms) to "call" the BHC's investment so as to release such covenants).

D) Whether the BHC acts as an entrepreneur in organizing or operating, or enters into agreements to acquire, the portfolio company.

E) Whether there are significant business relationships between the BHC and the portfolio company, such as profit-sharing, business cross-referral, joint marketing, joint venture or similar arrangements.

The Board can be expected to look not only at whether the relationships are on arm's length terms and non-exclusive, but also at the overall materiality of such relationships to both the BHC and the portfolio company.

F) Whether (and to what extent) the BHC and the portfolio company have common employees, officers or directors, and whether (and to what extent) the BHC has a representative on policy-making board committees.

G) Whether the BHC is a party to any shareholder or other agreement regarding management, control, voting or transfer of shares or seeks to influence the election of directors or the approval/disapproval of shareholder proposals (such as through the solicitation of proxies).

H) Whether the BHC seeks to dispose, or threatens to dispose, of its investment so as to obtain any specific action or non-action.

I) Whether the BHC holds shares of a portfolio company in a fiduciary capacity, particularly if the BHC has sole discretionary voting authority.

(vi) Under 12 C.F.R. § 225.31(e)(1), an investor is presumed not to control a portfolio company if the investor acquires less than 5% of any class of the portfolio company's voting securities.

(vii) When a company seeks to divest control of a previously controlled company, the Board has applied additional scrutiny on the theory that a controlling influence may continue despite the divestiture of a controlling equity interest. See, e.g., 12 C.F.R. § 225.138(b)(6). The Board's general position has been that divestiture down to less than 5% of the voting shares of a bank is regarded as an effective divestment of control, a position supported by the statutory presumption of non-control under Section 2(a)(4) of the BHCA. See, e.g., Board Staff Opinion, June 25, 1974 ("The Board has previously indicated its general position that divestiture down to less than 5 percent of the voting shares of a bank is regarded as an effective and preferable means to terminate bank holding company status."). In some cases, the Board has required the party seeking to divest BHCA control to reduce its voting interest to less than 5% of any class of voting shares. In other cases, the Board has not required divestiture down to 5% or less of a class of voting securities in an effective divestiture of control. Id. ("However, in the particular circumstances of a given case, the Board has accepted something less than divestiture down to 5 percent or less of the voting shares as effective divestiture of control under the [BHCA].") In these cases, the Board considers in particular whether the company has divested to well below a 25% voting interest and whether there are any common directors and officers between the divesting and divested firms. The Board's precedents explicitly affirm that the required level of divestiture depends on the overall facts and circumstances of a particular case, and that the scope, nature and complexity of a matrix of relationships between and among relevant entities could constitute important factors in the overall analysis.

Board Letter, dated Jan. 28, 2016, regarding RBS's sale of its equity interest in Citizens Financial Group, Inc. ("CFG") confirmed that RBS would no longer control CFG following the sale of its entire equity interest and termination of its director representation. The Board Letter describes several business relationships between RBS and CFG that would continue, including (i) certain transactions, service and referral arrangements and office sharing agreements, which were described as de minimis and "non-exclusive, ordinary course transactions that were entered into on an arms-length basis and on market terms, are terminable at will by either party, and do not provide RBS with the ability or incentive to exercise a controlling influence over CFG"; (ii) agreements facilitating orderly separation of the two companies during the divestiture period, including related to technology, human resources, back office operations, web services, trading services, and risk modeling, that generally would terminate by December 31, 2016 and that RBS represented were negotiated on an arms-length basis, were typical in divestiture situations, and represented a de minimis amount of CFG's expenditures and RBS's revenues; and (iii) a trademark agreement allowing CFG to continue using the RBS "daisywheel" logo for up to ten years. The Letter concluded that RBS would not be found to control CFG "in light of the continued winding down and eventual termination of the transition services and certain business relationships, and the limited continuing business relationships that will exist between RBS and CFG." See also, Board Letter to Robert Tortoriello regarding BlackRock, Dec. 30, 2011 (described further at Part XII.C.6.b below); Part VII.A.7.d.ii.C.vi.h below (divestiture of control by GM of GMAC).

(viii) Hedge funds and other sophisticated investors have employed derivatives to "unbundle" or "decouple" the economic and voting aspects of securities of a company. The specific circumstances of any particular arrangement would need to be assessed in order to determine whether such arrangement provides an investor with a "controlling influence" over the management or policies of a company.

"Decoupling" is frequently accomplished through "swap agreements" between an investor and a counterparty. Investors may engage in such transactions for a variety of purposes, including to influence the outcomes of mergers and proxy fights (e.g., by acquiring a voting stake in a company without actually holding the same economic interests) or to accumulate stakes in companies without triggering rules requiring disclosure of share ownership (e.g., by acquiring an economic stake in a company without technically owning the shares).

Particularly in view of the fact that "decoupling" arrangements can take different and complex forms, such arrangements can raise novel issues (e.g., from U.S. banking, securities, corporate and/or antitrust law perspectives) that courts and policymakers have addressed in a variety of contexts. See, e.g., CSX. See also, e.g., Hu & Black, "Debt, Equity and Hybrid Decoupling: Governance and Systematic Risk Implications", U. Tex. Law and Economics Working Paper No. 120 (June 2008).

(ix) See also Part VII.A.7 below and Part XII below for a discussion of Board precedents concerning investments consistent with BHCA "passivity" and "non-control" standards.

f. Investment Fund Issues

(i) As discussed in Part II.A.7 above, the Volcker Rule restricts the ability of a BHC to invest in investment funds which constitute "private equity funds" or "hedge funds" for Volcker Rule purposes. However, a BHC should be able to structure its advisory/management relationship with, and investment in, an investment fund or similar vehicle that does not fall within the scope of the Volcker Rule (or is otherwise exempt from the Rule) either in such a manner that the fund's investments comply with BHCA § 4(c)(6) or other applicable standards or in such a manner that the fund can invest in other companies essentially without limit.

(ii) Structuring issues relevant to the characterization of a fund for which a BHC acts as adviser/manager and/or in which a BHC invests (i.e., as "§ 4(c)(6) complying" or "not § 4(c)(6) complying") would include such factors as (A) the proportion of equity owned by the BHC and whether some or all of the equity owned is voting or non-voting; (B) whether the BHC acts as, or controls, the general partner (or other control person) of such fund; (C) whether the BHC acts as "adviser" to, or has a more substantial role with respect to, such fund (see generally 12 C.F.R. § 225.31(d)(2)(i)); (D) other relationships which the BHC and/or its current or former employees have with such fund; and (E) whether, and to what extent, such fund has operational control of any portfolio company.

(iii) As amended by Dodd-Frank § 608(a), Section 23A deems a fund for which a bank or BHC serves as investment adviser to be a Section 23A "affiliate" of the bank. See Part III.A.5 above.

(iv) With respect to BHCA § 4(c)(7), see Part VIII.C.1.b below.

4. Banks

a. Although Glass-Steagall § 16 generally precludes banks from acquiring equity securities, banks may participate in private equity/merchant banking activities. See Part I.A above. See also Part II.D.3 and Part XII below.

(i) National banks may take as consideration for a loan -- or as compensation for other banking services -- a share in the profit, income or earnings from a borrower, and may also take warrants issued by a borrower (so long as the bank (A) does not exercise the warrants; or (B) exercises the warrants only under circumstances where there is no readily-identifiable market for such warrants, and only after entering into an agreement to deliver and sell the resulting stock immediately after conversion).

The profit share or warrants may be taken in addition to, or in lieu of, interest or other compensation, but the borrower's obligation to repay principal may not be conditioned on the value of the profit, income or earnings of the borrower, or on the value of any warrant received.

The Comptroller has interpreted this power to include as an element of return a percentage of property appreciation and a percentage of revenues. In some circumstances, this power may even extend to debt securities or loan instruments which are convertible into equity securities at the option of the issuer or on a mandatory basis, but does not encompass the power to accept bonus stock.

See, e.g., 12 C.F.R. §§ 1.10, 7.1006; Letter No. 1046 (investment in fund formed for the purpose of financing venture capital fund-of-funds); Comptroller Interpretive Letters No. 992 (May 10, 2004), CCH Fed. Banking L. Rep. ¶ 81-518; No. 956 (Jan. 31, 2003), CCH Fed. Banking L. Rep. ¶ 81-481; Letter No. 930 (convertible bonds); Comptroller Corporate Decision No. 2000-02 (Feb. 25, 2000) (performance-linked compensation/warrants for private placement, advisory and other services); Letter No. 868; Approvals No. 321; No. 319; Letter No. 834; Letter No. 833; Comptroller Interpretive Letter No. 785 (June 3, 1997), CCH Fed. Banking L. Rep. ¶ 81-212; Comptroller Unpublished Letter to the Board, Jan. 29, 1996; Comptroller Interpretive Letter No. 620 (July 5, 1992), CCH Fed. Banking L. Rep. ¶ 83,502; Comptroller Investment Securities Letter No. 55 (Aug. 5, 1991), CCH Fed. Banking L. Rep. ¶ 83,328; Comptroller Interpretive Letter No. 517 (Aug. 16, 1990) ("Letter No. 517"); CCH Fed. Banking L. Rep. ¶ 83,228; Comptroller Unpublished Letter to Robert Tortoriello, Cleary Gottlieb (Apr. 22, 1986) (mandatory convertible securities); Comptroller Unpublished Letters (June 14, May 4, 1983); Comptroller Interpretive Letter No. 244 (Jan. 26, 1982), CCH Fed. Banking L. Rep. ¶ 85,408; Comptroller Unpublished Letter (May 12, 1982); Comptroller Interpretive Letter No. 204 (June 17, 1981), CCH Fed. Banking L. Rep. ¶ 85,285; Comptroller Unpublished Letter (Feb. 8, 1980) (prohibition on receipt of "bonus stock"); Comptroller Unpublished Letters (Jan. 13, 1976), (June 26, 1974), (Oct. 16, 1970), (July 11, 1969).

(ii) Comptroller Interpretive Letter No. 1075 (Nov. 14, 2006), CCH Fed. Banking L. Rep. ¶ 81-607 ("Letter

No. 1075”), permitted a bank to retain shares of stock of MasterCard, Inc., which it acquired in connection with MasterCard’s IPO. Prior to the offering, the bank -- like other financial institution members of the MasterCard system -- was required to own MasterCard shares in order to be a member of the system and receive its services. The bank automatically acquired the MasterCard shares in the offering in exchange for the shares that it had held prior to the IPO.

The Comptroller approved such acquisition, finding that (A) the bank’s ownership of MasterCard stock prior to the offering fell within Comptroller precedents that a national bank may make equity investments for the purpose of facilitating the bank’s participation in an otherwise permissible activity, or to enable the bank to receive services; and (B) the bank received MasterCard shares in the offering automatically.

However, Letter No. 1075 did not address whether a member of the MasterCard system could acquire additional MasterCard shares to supplement its current holdings or whether MasterCard shares may be acquired by national banks that become members of MasterCard in the future.

(iii) Letter No. 1019 permitted a bank to engage in a loan program with agricultural customers designed to finance certain crops. Under this program, the bank would (A) make the loan at a rate at or below the generally prevailing market rate, (B) forgive a portion of the principal at maturity to reflect declines in the value of crops resulting from decreases in commodity prices, (C) share in increases in the value of the crops resulting from any increases in commodity prices, and (D) hedge the risks it assumes through swap transactions that mirror the risks in the transactions between the bank and its borrowers.

Although, in general, a borrower’s obligation to repay principal may not be conditioned on the value of the profit, income or earnings of the borrower, the Comptroller deemed that restriction inapplicable because any increase or decrease in the principal of the loan would be in reaction to a change in the market price of the collateral underlying the loan, rather than in reaction to the profit or earnings of the borrower.

(iv) Letter No. 897 permitted a bank to acquire a 24.9% non-controlling interest in an investment adviser which, as part of its business, owned limited equity interests in private investment funds containing bank-ineligible assets for which the investment adviser served as investment manager where (A) the maximum investment by the adviser in any one fund containing bank-ineligible assets does not exceed (i) 5% of a class of voting securities of the fund, (ii) 24.99% of the total equity of the fund, or (iii) 1% of the equity of the bank at the time the investment is initially made; and (B) the aggregate investment in all such funds does not exceed 10% of the bank's capital.

Comptroller Interpretive Letter No. 940 (May 24, 2002) ("Letter No. 940"), CCH Fed. Banking L. Rep. ¶ 81-465, permitted a bank to hold limited, non-controlling interests in advised funds for which it served as investment manager so as to structure the bank's performance-based compensation as a share of profits, rather than as a fee. Even though the funds were permitted to hold bank-ineligible assets, the Comptroller found that such holding was in furtherance of the bank's permissible advisory business. Under Letter No. 940, the bank (A) may not hold interests in funds that own real estate or tangible personal property, (B) must account for its fund interests under the equity method of accounting, and (C) may hold an interest in a fund only for as long as it provides investment management services to such fund.

See also, e.g., Comptroller Conditional Approvals No. 1018 (Dec. 23, 2011); No. 842 (Mar. 13, 2008); No. 804 (May 1, 2007); No. 755 (Aug. 25, 2006)

("Approval No. 755"), No. 643 (June 16, 2004) ("Approval No. 643"), No. 578 (Feb. 27, 2003) ("Approval No. 578"); Corporate Decision No. 2000-07; Comptroller Unpublished Letter re PNC Bank (Oct. 1, 1999) (all to same general effect). See generally Comptroller Conditional Approval No. 819 (Sept. 7, 2007) (permitting financial subsidiary of national bank to hold for limited periods of time interests in funds for which subsidiary or its parent serve as investment manager). (Letter No. 940 and all Letters, Approvals and Corporate Decisions set out in this paragraph, collectively, the ("Comptroller Fund Investment Precedents").

See also Part VIII.B below.

(v) FDIC Orders permit state banks to acquire non-controlling interests in corporations and other business entities, including venture capital investment funds and public or private investment companies that invest in debt or equity securities, real estate or other assets. See, e.g., In re S&T Bank (Sept. 30, 2002); In re Androscoggin Savings Bank (Mar. 25, 2002); In re First Republic Bank (Oct. 17, 2000); In re Dedham Institute for Savings (July 12, 2000); In re First Savings Bank of Perkasie (Nov. 8, 1999); In re Institution for Savings in Newburyport (Aug. 10, 1999); In re Hamlin Bank and Trust Co. (Dec. 23, 1997); In re Firstrust Savings Bank (Nov. 25, 1997); In re Bank of Agriculture & Commerce (Jan. 23, 1997); In re PFC Bank (Nov. 26, 1996) (the "FDIC Private Equity Investment Orders"). See also Part I.D.4.e above with respect to state bank equity investment authority under FDICIA and FDIC precedent.

b. Debt securities could be deemed to be equity securities for certain purposes. For example, In re Ruff Financial Services, 166 F.3d 348 (10th Cir. 1998), considered the situation where a bankruptcy trustee sued holders of Ruff promissory notes, alleging that the notes constituted shares and that payments under the notes made at a time when Ruff was insolvent represented redemption of the shares, in violation of Utah law. Although the Bankruptcy Court found in favor of the trustee, both the District Court and the Court of Appeals determined that the notes constituted debt because the holders did not have voting rights and were not subordinated to general creditors and the maturity date and interest rate of the notes were fixed. See also Part V.A.3.e above.

c. The inclusion of stock warrants as partial consideration for a loan can subject the transaction to federal and state securities laws. Janney Montgomery Scott determined that a bridge financing that included warrants as partial consideration for the loan was subject to securities laws, and an investor who made bridge loans could sue the issuer and the underwriters for securities law violations. See Part V.B.5 above.

5. Small Business Investment Companies and Business Development Companies

Banks (as well as FHC/BHC subsidiaries) may own SBICs, which are licensed and regulated by the SBA under the Small Business Investment Act, 15 U.S.C. § 631 et seq. (the "SBIA"). See BHCA § 4(c)(5); 12 C.F.R. §§ 7.1015, 225.107, 225.111; 13 C.F.R. Parts 107 (SBICs) and 121 (Small Business Size Regulations). See also, e.g., 13 C.F.R. Part 108 (New Markets Venture Capital Program).

a. An SBIC provides investment flexibility to an FHC since (i) SBICs may be held under banks as well as under BHCs, (ii) the Volcker Rule does not apply to investments in SBICs, (iii) Sections 23A/23B should not generally apply to portfolio companies which are subsidiaries of an SBIC which is in turn a subsidiary of a bank, and (iv) it might be possible to obtain CRA credit for some SBIC investments.

b. Reflecting amendments to the SBIA set out in the Small Business Investment Corrections Act, Pub. L. 106-554 (2000), an SBIC may assume control over small businesses in which it invests without notice to the SBA, and may retain such control for up to seven years without SBA approval (or longer with SBA approval). An SBIC may also sell its interests in a company in which it invests to a competitor of that company. See

67 Fed. Reg. 64789 (Oct. 22, 2002) (amendment to 13 C.F.R. § 107.865) (the "2002 SBA Release").

c. The 2002 SBA Release reaffirms that, while FHCs which take controlling (e.g., more than 50%) positions in a portfolio company may not manage or operate that company, SBICs are not subject to the same restriction. SBICs may provide both debt and equity to portfolio companies.

d. As of December 31, 2014, bank-owned and specialty SBICs reported $195.7 million of financing. As of Dec. 31, 2014, six of 30 new SBIC licenses in 2014 were granted to bank-owned SBICs, following five out of 34 in 2013, three out of 30 in 2012 and four of 22 in 2011, illustrating that bank-owned SBIC's remain a significant segment of the SBIC program. See, e.g., SBIC Program Overview (SBA, Dec. 31, 2014); Small Business Investor Alliance Comment Letter to the Board, FDIC, OCC and SEC, Feb. 13, 2012. The steady increase in the number of bank-owned SBICs may be due in part to the Volcker Rule's exclusion for SBICs. The Volcker Rule excludes any fund "[t]hat is a [SBIC], as defined in section 103(3) of the [SBIA] (15 U.S.C. 662), or that has received from the [SBA] notice to proceed to qualify for a license as a small business investment company, which notice or license has not been revoked" from its prohibition on investing in and sponsoring certain private equity and hedge funds. See Volcker Rule § __.10(c)(11); BHCA § 13(d)(1)(D). See also Part II.A.7 above.

e. Comptroller Interpretive Letter No. 832 (June 18, 1998), CCH Fed. Banking L. Rep. ¶ 81-286, reversed the position taken in Comptroller Interpretive Letter No. 617 (Mar. 4, 1993), CCH Fed. Banking L. Rep. ¶ 83,457, and concluded that a national bank may invest in an SBIC that is in the process of organization.

f. Sometimes issues can arise as to the appropriate use of SBICs in the venture capital context. See, e.g., American Banker, Sept. 2, 1989 (report of Board objection to purchase of a unit of RJR Nabisco by Citicorp's SBIC).

g. BHCs can also make investments in BDCs under BHCA § 4. BDCs are registered investment companies under the 1940 Act, but they are not subject to all of the 1940 Act's provisions. See 1940 Act §§ 54-65. The U.S. BDC industry has grown since the financial crisis in 2007 and the around 40 U.S. BDCs function as closed-end funds. BDCs tend to be riskier than other registered investment companies because they focus on smaller enterprises, but investor confidence in BDCs has remained high, in part because of the industry's performance during the financial crisis, and because BDCs often have investment-grade ratings and are subject to leverage limits. See Banking Daily, Oct. 16, 2013.

Because BDCs do not need to rely on §§ 3(c)(1) or 3(c)(7) under the 1940 Act, they have access to a retail investor base and are not subject to the Volcker Rule as covered funds.

6. International Investments

a. Under BHCA § 4(c)(13) and the Edge Act, 12 U.S.C. § 25A, as implemented in Regulation K, BHCs and subsidiaries of national banks and state member banks may make equity investments in non-U.S. companies. See 12 C.F.R. § 211.8 et seq.

(i) Subject to certain aggregate dollar limits and compliance with notice/approval procedures, Regulation K permits U.S. banking organizations to make the following investments in non-U.S. companies that do not have U.S. operations, or where U.S. operations satisfy the Reg. K Revenue Limit referred to in Part VII.A.6.a.ii below:

A) "Portfolio investments" -- Passive, non-controlling investments of not more than 19.9% of the voting shares and not more than 40% of the total equity (including subordinated debt, if more than 5% of the equity of the issuer is held) of the company invested in. In general, the holder of a portfolio investment may have representation on the board of directors of the portfolio company proportionate to its voting interest, but not to its economic interest.

Subject to netting and certain exclusions, an overall aggregate equity limit applies to all shares held under Regulation K's portfolio investment and dealing authorities: 25% of a BHC's Tier 1 capital where the investor is a BHC; 20% of the investor's Tier 1 capital where the investor is a bank or a direct subsidiary of a bank; and the lesser of 20% of any parent bank's Tier 1 capital or 100% of the investor's Tier 1 capital, where any other investor is involved. The aggregate Regulation K investment limits for portfolio investments and those for dealing positions are calculated separately (but virtually all equity shares held in a single company are combined for purposes of determining compliance with BHCA § 4(c)(6) and the voting and total equity limits for portfolio investments).

In light of the enactment of the GLB Act, which expanded merchant banking authority for FHC non-bank subsidiaries, the Board determined not to act favorably on those aspects of the Proposed 1997 Regulation K Revisions Proposal which would have increased portfolio investment limits and permitted investors to make non-controlling portfolio investments in up to 24.9% of a company's voting shares.

B) "Joint venture" investments -- Non-controlling investments equal to 20% or more, but less than 50%, of the shares of the company invested in, but not more than 10% of the assets of such company may be derived from activities impermissible for a "subsidiary" investment referred to in Part VII.A.6.a.i.C below. A joint venture may engage in financial activities as permitted under Regulation K or otherwise approved by the Board.

C) "Subsidiary" investments -- Investments of 50% or more of any class of voting shares, or 50% or more of the total equity, of the company invested in, or any general partnership interest (regardless of size), or other forms of "control". Subject to a 5% exception, a foreign subsidiary generally must engage only in banking and financial activities set out in Regulation K (12 C.F.R. § 211.10).

(ii) In general, investments by U.S. BHCs in non-U.S. companies with U.S. operations would be subject to Regulation Y Investment Limits (or, for FHCs, the Merchant Banking Regulations).

An investment made under Regulation K must be divested (or, if possible, recharacterized) "promptly" if the entity invested in (A) engages in activities which are not permissible for that category of investment; (B) engages in the business of buying or selling goods, wares, merchandise or commodities in the U.S.; or (C) engages directly or indirectly in any other business in the U.S., other than certain trade- and internationally-related activities, except that an investor may (i) hold up to 5% of the shares of a foreign company that engages directly or indirectly in business in the U.S., and (ii) retain portfolio investments in companies that derive no more than 10% of their total revenue from activities in the U.S. (the "Reg. K Revenue Limit").

The 2001 Regulation K Revision reaffirmed that revenue derived from U.S. activities includes all revenue derived from activities performed in U.S. offices, but not business that may originate from the U.S. but is performed offshore. See also 56 Fed. Reg. 19549 (Apr. 29, 1991) (the "1991 Regulation K Revision") at 19563 (repealing Board Letter to American International Bank, Nov. 13, 1970, which treated certain loans from a non-U.S. bank to a U.S. person as a U.S. activity). But see Part XI.D.6 below.

For trading and dealing positions, it would seem reasonable in general to treat as "prompt" a divestiture effected within 90 days of the event or knowledge that triggers a divestiture requirement (although a longer period could be appropriate depending on the circumstances). With respect to other investments, a somewhat longer time for divestiture may be appropriate.

(iii) The Board adopted (A) a preclearance program to assess an investor's proposal to exceed investment limits on a case–by–case basis; and (B) a procedure for advisory opinions on the scope of Regulation K-permitted activities. See also Board SR Letter 02-2 (SR) (Feb. 7, 2002), CCH Fed. Banking L. Rep. ¶ 61-582 (guidance on compliance and recordkeeping).

b. Part 347-permitted subsidiaries of state non-member banks are subject to FDIC limitations generally similar to those in Regulation K.

c. BHCA §§ 2(h)(2)/4(c)(9) and Regulation K permit non-U.S. bank QFBOs with U.S. banking operations to engage in investment activities respecting non-U.S. companies. See generally Manual of Foreign Investment, Chapter 14: "Foreign Investment in [U.S.] Banking".

Regulation K addresses four types of situations in this context:

(i) Activities conducted outside of the U.S. and shareholdings in companies that do not engage in activities in the U.S. These are all permissible for QFBOs.

(ii) Activities and shareholdings having U.S. contacts that are only "incidental" to foreign operations. These are permissible for QFBOs, but are limited to U.S. activities that would be permissible for U.S. banking organizations under 12 C.F.R. § 211.6. See, e.g., Lloyds Bank, 60 Fed. Res. Bull. 139 (1974) (the "Lloyds Order").

(iii) U.S.-related operations involving non-U.S. companies which are not subsidiaries of the foreign bank. These are, in general, permitted so long as the foreign company invested in (A) is not, and does not own more than 10%

of any class of voting shares of, a securities firm with U.S. operations; and (B) is primarily engaged in non-U.S. activities (i.e., more than 50% of the foreign company's consolidated assets and revenues are non-U.S.).

(iv) U.S.-related operations involving non-U.S. subsidiaries of the foreign bank. These are, in general, permitted so long as the foreign company invested in (A) is not, and does not own more than 10% of any class of voting shares of, a securities firm with U.S. operations; (B) is primarily engaged in non-U.S. activities; (C) is only engaged in the U.S. in the same activities as are conducted abroad (based on an evaluation of U.S. Department of Commerce classification codes); and (D) without prior Board approval, does not engage in banking or financially-related activities in the U.S. -- a term which includes insurance and real estate activities, credit reporting services, rental and leasing activities, accounting, auditing and bookkeeping services, courier services and travel agency activities.

d. Although an FHC should be able to use its Gramm-Leach merchant banking authority to invest in non-U.S. (as well as U.S.) non-financial companies, (i) such authority does not enable an FHC's subsidiary banks (under which many FHCs hold their Regulation K-permitted investments) to make expanded investments; and (ii) an FHC is not permitted to acquire a non-U.S. bank pursuant to Gramm-Leach's merchant banking authority, but rather any such acquisition must be made under Regulation K.

7. Investments in U.S. and Non-U.S. Banks and Other Depository Institutions

a. Historically, many private equity firms and hedge funds had been reluctant to make significant investments in financial institutions given concerns over regulation/supervision. In the aftermath of the credit crisis, however, private equity firms and other investor groups raised close to $15 billion to invest in distressed or failed banks, and it became more common for financial institutions (including banks and other depository institutions) to be the targets of private equity investments. Since then, private equity interest in bank investments has waned in the face of significant regulatory hurdles and a dearth of attractive deals. See, e.g., Wall St. J., Aug. 6, 2013; American Banker, Aug. 10, 2012; SNL Financial Apr. 3, Jan. 17, 2012. See generally, Bush, "Easy Way to Get Private Equity to Banks". See also Part VII.A.1 above.

U.S. federal legislation of particular relevance to acquisitions of interests in U.S. and non-U.S. banks and other depository institutions includes:

(i) The (A) BHCA (as implemented by Board regulations (in particular, Regulation Y)), and (B) CBCA (as implemented by (i) Board regulations (in particular, Regulation Y), applicable to investments in U.S. BHCs and state member banks; (ii) Comptroller regulations (12 C.F.R. § 5.50), applicable to investments in national banks; and (iii) FDIC regulations (12 C.F.R. Part 303), applicable to investments in state non-member banks), regulate the acquisition of interests in U.S. banks and BHCs.

(ii) The Savings and Loan Holding Company Act (part of HOLA) and the CBCA regulate the acquisition of interests in thrift institutions and their holding companies. Until July 21, 2011, these statutes were implemented by OTS regulations (12 C.F.R. Part 574 ("Part 574")). With the elimination of the OTS pursuant to Dodd-Frank and the transfer of OTS authority to the Board, FDIC and OCC, Part 574 has been modified and redesignated in each agency's regulations. See 79 Fed. Reg. 33260 (June 10, 2014) (OCC final rule modifying and redesignating portions of Part 574 as 12 C.F.R. Part 174); 80 Fed. Reg. 28346 (May 18, 2015) (integrating rules regarding national banks and Federal savings associations and removing 12 C.F.R. Part 174); 76 Fed. Reg. 47652 (Aug. 5, 2011) (FDIC final rule redesignating portions of Part 574 as 12 C.F.R. Parts 390 and 391); 76 Fed. Reg. 56508 (Sept. 13, 2011) (Board interim final rule modifying and redesignating portions of Part 574 as 12 C.F.R. Part 238). See also OCC Bulletins 2014-49 (Oct. 1, 2014) (Application of Guidance to FSAs and Rescission of OTS Documents); 2013-34 (Nov. 20, 2013) (Recission of OTS Compliance Documents); 2012-15 (May 17, 2012) (Rescission of OTS Documents); 2012-3 (Jan. 6, 2012) (Recission of OTS Transmittal Letters); 2012-2 (Jan. 6, 2012) (Recission of OTS Documents); and 2011-47 (Dec. 8, 2011) (Supervisory Policy Integration Process); Board SR Letter 14-9 (Nov. 7, 2014) (identifying Board SR Letters issued prior to July 21, 2011 that are applicable to SLHCs). Since re-designating parts of Part 574 as Parts 390 and 391, the FDIC has conformed and removed Subparts A through E, H, K, L, N, U, V and X of Part 390 and Subparts B, C and D of Parts 391 through a series of rulemakings. See 80 Fed. Reg. 65889 (Oct. 28. 2015) (removing Subpart E from Part 391); 80 Fed. Reg. 65903 (Oct. 28, 2015) (removing Subpart B of Part 391); 80 Fed. Reg. 65913 (Oct. 28, 2015) (removing Subpart C of Part 391); 79 Fed. Reg. 2014 (Dec. 19, 2014) (removing Subpart D of Part 391); 79 Fed. Reg. 42181 (July 21, 2014) (removing Subpart A of Part 390); 80 Fed. Reg. 5009 (Jan. 30, 2015) (removing Subparts B-E of Part 390); 79 Fed. Reg. 42183 (July 21, 2014) (removing Subpart H of Part 390); 78 Fed. Reg. 76721 (Dec. 19, 2013) (removing Subpart K of Part 390); 80 Fed. Reg. 65612 (Oct. 27, 2015) (removing Subpart L of Part 390); 80 Fed. Reg. 5015 (Jan. 30, 2015) (removing Subpart N of Part 390); 79 Fed. Reg. 63498 (Oct. 24, 2014) (removing Subpart U of Part 390); 80 Fed. Reg. 32658 (June 9, 2015) (removing Subpart X from Part 390); 80 Fed. Reg. 79250 (Dec. 21, 2015) (removing Subpart V from Part 390).

(iii) The IBA (as implemented by Board regulations (in particular, Regulations Y and K)) regulates the acquisition of interests in non-U.S. banks with U.S. banking operations (e.g., a U.S. branch or agency).

State banking law -- in combination with one or more U.S. federal banking laws -- would generally also regulate acquisitions of state chartered or licensed banking institutions.

b. In 2009, the FDIC adopted a final statement of policy on the "Qualifications for Failed Bank Acquisitions" (the "FDIC Failed Bank Policy Statement"), which sets forth the conditions under which the FDIC will evaluate transactions by private investors seeking to acquire failed depository institutions (or their deposit liabilities) from the FDIC. See 74 Fed. Reg. 45440 (Sept. 2, 2009). The FDIC issued a Q&A in January 2010 and another in April 2010 (collectively, the "Q&As"), clarifying certain aspects of the Policy Statement. See FDIC Jan. 6, 2010 Q&A; FDIC Apr. 23, 2010 Q&A.

(i) The FDIC Failed Bank Policy Statement was released after substantial public and industry comment on a proposed policy statement that the FDIC issued in July 2009 (74 Fed. Reg. 32931 (July 9, 2009) (solicitation of public comments)).

(ii) The FDIC Failed Bank Policy Statement makes clear that it will not apply to investors that acquire 5% or less of the total voting power of an acquired institution, and that it is not intended to interfere with or supplant the preexisting regulation of BHCs. While the FDIC will not consider contemporaneous investments by multiple investors which each holds 5% or less of the total voting power in an acquired institution as "concerted action" when such investors, in the aggregate, hold less than two-thirds of the total voting power, if they hold more than two-thirds of the total voting power, the FDIC may consider such purchase to be "concerted action". Therefore, an "anchor group" of investors which, in aggregate, hold a minimum of either one-third of the total voting power or one-third of the total equity must be bound by the Policy Statement in order for the remaining investors to be exempted. Investors which hold 5% or less of the total voting power may elect to form and contribute to such "anchor group", and this "one-third test" only needs to be met at the time of the acquisition. An investor will also be subject to the Policy Statement if it has the right to designate a board member.

(iii) The FDIC Failed Bank Policy Statement and the Q&As sets forth the following conditions for the acquisition of failed depository institutions:

A) Capital Commitment: The resulting depository institution must maintain a ratio of Tier 1 common equity to total assets of at least 10% for three years from the time of acquisition. Thereafter, the depository institution must remain "well-capitalized" during the remaining period of ownership by the investors.

B) Cross Support: If one or more investors owns at least 80% of two or more banks or thrifts, the stock of the banks or thrifts commonly owned by these investors must be pledged to the FDIC. If any one of those depository institutions fails, the FDIC may exercise such pledges to recoup any losses incurred by the FDIC as a result of the bank or thrift failure. The FDIC may waive this requirement if the exercise of the pledge would not reduce the cost of bank/thrift failure to the Deposit Insurance Fund.

C) Transactions with Affiliates: All extensions of credit to investors, their investment funds (if any), and any affiliates of either, by an insured depository institution acquired by investors are prohibited. However, existing extensions of credit by an insured depository institution acquired by such investors are not included in this prohibition.

For purposes of the FDIC Failed Bank Policy Statement, the term (i) "extension of credit" has the meaning set out in Regulation W, and (ii) "affiliate" means any company in which the investor owns, directly or indirectly, at least 10% of the equity and has maintained such ownership for at least 30 days.

Investors must provide regular reports to the insured depository institution identifying affiliates.

D) Strong Majority Interest: An investor which invests directly in an existing institution that has a "strong majority interest" in a failed institution and has an established record for successful operation of insured institutions is exempt from the FDIC Failed Bank Policy Statement, so long as it owns less than one-third of the voting or total equity of the existing institution. There is no minimum holding requirement for the pre-existing shareholders in the existing institution prior to the recapitalization, although the FDIC will take such holding period into consideration if a "significant portion" of the total voting power or equity is involved.

E) Recapitalization: Recapitalization of an existing institution is not subject to the FDIC Failed Bank Policy Statement, unless such institution thereafter acquires a failed institution. If a recapitalized institution seeks to acquire a failed institution, the FDIC will review whether the additional capital was contingent on such acquisition. The Policy Statement will apply if the recapitalized institution acquires a failed institution within 18 months of its recapitalization and the acquired assets exceed 100% of the recapitalized institution's pre-acquisition total assets.

F) Secrecy Law Jurisdictions: Investors ("Offshore Investors") which employ ownership structures utilizing entities that are domiciled in "Secrecy Law Jurisdictions" are not eligible to own a direct interest in an insured depository institution unless the Offshore Investors (i) are subsidiaries of companies that are subject to comprehensive consolidated supervision as recognized by the Board; (ii) execute agreements regarding the provision of information to the primary federal regulator about the Offshore Investors' operations; (iii) maintain books and records in the U.S.; (iv) consent to the disclosure of information that might be covered by confidentiality or privacy laws and agree to cooperate with FDIC in obtaining information maintained by foreign government entities; (v) consent to jurisdiction and designation of an agent for service of process; and (vi) consent to be bound by the laws and regulations administered by the appropriate U.S. federal banking agencies.

A "Secrecy Law Jurisdiction" is a country that (i) limits U.S. bank regulators from determining compliance with U.S. laws or prevents them from obtaining information on the competence, experience and financial condition of applicants and related parties; (ii) lacks authorization for exchange of information with U.S. regulatory authorities; (iii) does not provide for a minimum standard of transparency for financial activities; or (iv) permits offshore companies to operate shell companies without substantial activities within the host country.

An investor subject to the FDIC Failed Bank Policy Statement may utilize an Offshore Investor as long as such Investor invests through a wholly-owned U.S. subsidiary, provided that the Offshore Investor and its domestic subsidiary agree to (i) maintain books and records in the U.S. (including a list of investors in the Offshore Investor); and (ii) make such books and records available to the FDIC.

G) Continuity of Ownership: Absent the FDIC's prior approval, investors are prohibited from selling or otherwise transferring their securities for three years following an acquisition. Such approval will not be unreasonably withheld for transfers to affiliates, provided that the affiliate agrees to be subject to the FDIC Failed Bank Policy Statement. (However, this requirement does not apply to mutual funds registered under the 1940 Act.)

H) Prohibited Structures: Complex and functionally opaque ownership structures in which (i) the beneficial ownership is difficult to ascertain, (ii) the responsible parties for making decisions are not identified, and (iii) ownership and control are separated, will not be approved.

I) Special Owner Bid Limitation: Investors that directly or indirectly hold 10% or more of the equity of a bank or thrift in receivership are not eligible to bid or to become an investor in either the deposit liabilities or the assets of such failed depository institution.

J) Disclosure: Investors subject to the FDIC Failed Bank Policy Statement are expected to provide the FDIC information about the investors and all entities in the ownership chain (including information regarding the size of the capital fund, its diversification, the return profile, the marketing documents, the management team and the business model). Investors and all entities in the ownership chain may be required to provide the FDIC other information necessary to assure compliance with the Policy Statement.

While investors which hold 5% or less of voting equity are not subject to detailed questionnaires, they are subject to being included in the "List of Investors" provided to the FDIC which discloses (i) name of investor; (ii) type of investor; (iii) domicile; (iv) number of voting shares and total equity held; (v) derivatives, convertible stock and rights to control voting shares; and (vi) shares held by affiliates or immediate family members.

c. Acquisition of "control" (for purposes of the BHCA, CBCA, IBA and/or applicable regulations thereunder) of a U.S. depository institution and/or non-U.S. bank with U.S. banking operations has several implications:

(i) As a general matter, a "control" investment may not be completed unless and until prior U.S. regulatory approval has been obtained.

(ii) Following successful completion of a "control" investment, the investor would generally be subject to:

A) Regulatory reporting requirements.

B) U.S. federal supervision and examination.

C) U.S. federal administrative enforcement authority.

D) Restrictions governing permissible activities (which may be problematic for investors with substantial interests outside of financial services). Such restrictions, however, would not apply to acquisitions of certain U.S. depository institutions that are not considered "banks" for purposes of the BHCA (e.g., credit card banks, certain trust companies, industrial banks).

E) Capital constraints and/or consolidated minimum capital requirements.

d. Several approaches exist to structuring investments in U.S. depository institutions and non-U.S. banks with U.S. banking operations (and/or related holding companies) in order to avoid the implications of making a "control" investment.

These approaches include (i) acquiring a line of business "spun off" from the target; (ii) making a "passive", "non-control" acquisition in the target representing less than one-third of the total equity, and less than 25% (or, in some cases, 5%, 10% or 15%) of any class of the target's voting securities; (iii) creating a separate "bank fund" to invest in the target; (iv) dispersing ownership interests in the target among several unaffiliated and independent entities or trusts; and (v) "debanking" the target.

(i) Acquire a line of business "spun off" from the target.

An acquisition of a business line (other than businesses that necessitate a banking license, such as deposit-taking) should not generally trigger U.S. bank supervisory review requirements, particularly if the line of business does not represent all or substantially all of the assets of the target.

(ii) Make a "passive", "non-control" acquisition of the target's ownership interests representing less than one-third of the total equity, and less than 25% (or, in some cases, 5% or 10%) of any class of the target's voting securities. See Part VII.A.3.e above.

A) In 2008, the Board released the Board Control Guidance regarding non-controlling equity investments in banking organizations. The Guidance provides investors with increased flexibility to make investments in banks and BHCs without being regarded as BHCs themselves (while at the same time reaffirming that the "facts and circumstances" approach historically taken by the Board with respect to "controlling influence" issues will remain).

While an investment of greater than 25% of a class of voting securities represents a controlling investment by statute (and, thus, the Board does not have any flexibility to relax that control threshold), the Board does have the ability to redefine the standard for control in terms of overall size of a total equity investment (since the BHCA does not impose an express limit on ownership of non-voting shares).

The Board Control Guidance increased the overall maximum possible size of total equity investments deemed to be non-controlling from less than 25% to less than one-third, and investors now have greater ability to have representation on the board of directors of a bank or BHC without being deemed to possess a controlling influence over the bank/BHC.

B) Whether an investor is deemed to have acquired a "controlling influence over the management or policies" of a target (i.e., as opposed to having only a "passive", "non-control" investment) depends upon the size and nature of the equity investment, combined with the business relationships between the investor and the target.

  i) Investments equal to or greater than 25% of any class of voting securities, or one-third of the total equity of the target, would conclusively represent a "controlling" investment regardless of the relevant facts and circumstances.

  ii) On the other hand, investments below these thresholds, but 10% or greater of any class of voting securities, may trigger rebuttable presumptions of "control". In this situation, the burden is on the investor to demonstrate that it does not exercise a "controlling influence over the management or policies" of the target. For investments above 5% but below 10% of any class of voting securities, "control" is generally avoidable, but the specific facts and circumstances of the investment could alter that result. Investments below 5% of any class of voting securities and below 5% of the total equity are generally presumed to represent a non-controlling investment.

C) With respect to investments of less than 25% of a class of voting securities and less than one-third of total equity:

  i) Unlike other investors, BHCs (and non-U.S. banks with U.S. banking operations) are, in every case, required to obtain Board approval pursuant to BHCA § 3 (as implemented in Regulation Y) prior to acquiring more than

5% of any class of voting securities of a U.S. bank or BHC (even under circumstances where the acquisition is "passive" and "non-controlling"). See generally Part VII.A.3 above and Part XII.C below.

ii) Under the Board Control Guidance, a non-controlling investor that holds up to 24.9% of any class of a banking organization's voting securities is permitted to appoint one director, and may appoint two directors if (a) the investor's board representation is proportional to the greater of its voting or total equity interest in the banking organization, (b) the investor holds no more than 25% of the board seats, and (c) there is a larger controlling shareholder that is regulated as a BHC. A non-controlling investor may also communicate with the target's management about, and advocate for changes in, the banking organization's policies and operations. However, an investor is not permitted veto rights with respect to such issues, and an investor may not explicitly or implicitly threaten to dispose of its shares in the banking organization in connection with its advocacy.

iii) Under the Board Control Guidance, a non-controlling investor may own up to one-third of the total equity of a banking organization (and have director rights as described above) if the investor would hold (A) less than one-third of any class of voting securities when counting all convertible non-voting shares held by the investor as if converted, and (B) no more than 14.9% of any class of voting securities.

iv) Even where a statutory "presumption of control" is not triggered, individual investments of more than 9.9% (or even less where investors are entitled to appoint directors or are granted certain other oversight/business relationship rights) frequently require the investor to make (a) "passivity" commitments to the appropriate U.S. federal banking agency, and/or (b) a formal or informal submission to demonstrate that the investment will not be controlling for CBCA and/or BHCA purposes.

v) Overall facts and circumstances of the investment (e.g., director/officer interlocks, agreements, etc.) are important to U.S. federal banking agency control determinations. A finding of operational control, however, is not required in order for a U.S. federal banking agency to determine that an investor possesses statutory control over a U.S. bank/BHC.

vi) Private equity firms have structured and made "passive", "non-control" investments in U.S. banks and BHCs below the 25% threshold.

Often passivity commitments were used to effectuate these investments, and many of the transactions involved investments in contingent convertible preferred stock and/or warrants of the target BHCs.

(a) In Sumitomo Mitsui Banking Corp, 101, Fed. Res. Bull. 47 (2015), the Board approved an application on behalf of Sumitomo Mitsui Financial Group, Inc. and Sumitomo Mitsui Banking Corporation, both foreign FHCs, to increase their ownership interest from 9.7% to 19.9% of the voting shares of The Bank of East Asia, Limited, a foreign BHC, (and, indirectly, Industrial and Commercial Bank of China (USA), National Association), subject to passivity commitments. See also Sumitomo, 99 Fed. Res. Bull. 24 (2013) (approval to increase investment from a 4.7% voting interest up to a 9.9% voting interest without acquiring control, subject to passivity commitments).

(b) Board Letter re BankUnited, Inc., dated Apr. 17, 2014, concluded that five private equity groups were no longer presumed to control BankUnited because their ownership interests had been completely divested. The Board granted the private equity groups relief from commitments made in connection with the private equity group's investment in BankUnited. See also, e.g., Board Letter re BankCap Equity Fund, LLC, Dec. 21, 2015 (relief from commitments to purchase limited amount of loan participations from Silvergate Bank); Board Letters to EJF Capital LLC ("EJF"), dated Jan. 29, 2015, July 16, May 2, Mar. 27, Mar. 13, 2014 (relief from commitments made in connection with EJF's purchase of TARP preferred shares); Board Letters to Jacobs Asset Management ("JAM"), dated Jan. 29, 2015, Aug. 11, 2014, Dec. 23 and Nov. 25, 2013 (relief from commitments made in connection with purchase of TARP preferred shares); Board Letter re WL Ross & Co., dated Oct. 8, 2014 (relief from commitments in connection with investment in Bank of Ireland); Board Letter to Virginia Community Capital, Inc. ("VCC"), dated May 2, 2014 (relief from VCC's commitment not to engage in business relationships with VCC's former members); Board Letter to JMAC, Inc., dated Oct. 21, 2013 (partial relief from the commitment not to engage in business relationships with the Delaware County Bank and Trust Company).

See also, e.g., Board Letter to Freestone Capital Management, LLC, dated Apr. 1, 2015 (relief from commitments made in connection with investment in Cordia Bancorp, Inc.); Board Letter to WL Ross & Co. LLC, dated Oct. 8, 2014 (relief from commitments made in connection with investment in Bank of Ireland); Board Letter to GI Partners, dated Aug. 7, 2014 (relief from commitments made in connection with investment in First Republic Bank); Board Letters to Kensico Capital Management, Paulson & Co. and Sageview Capital, dated July 17, 2014 (relief from commitments made in connection with investment in State Bank Financial Corporation); Board Letter, Feb. 5, 2014 (allowing Carpenter Bank Partners to acquire shares of Heritage Oaks Bancorp and thereby indirectly acquire Heritage Oaks Bank); Board Letter, Apr. 2, 2013 (relief from commitment to permit bank to guarantee on arm's-length terms a loan made by foundation that controls 17.21% of the bank's voting stock); Board Letter, Mar. 28, 2013 (relief from commitment to permit a foreign bank to enter into a Chinese auto finance joint venture with a foreign BHC in which the foreign bank has a non-controlling investment); Board Letter, Nov. 6, 2012 (relief from commitment to permit fund adviser to appoint one director to serve on the boards of each of three BHCs in which the fund adviser and its funds had non-controlling investments of up to 9.9% voting and 16.98% total equity); National Penn BancShares SEC Form 8-K, Jan. 7, 2011 ($150 million investment by Warburg Pincus, representing 16.4% of National Penn's common stock); City Holding Company, 96 Fed. Res. Bull. B21 (2010) (7.5% voting interest of a BHC in another BHC determined to be non-controlling subject to passivity commitments); Board Letters re Three Shores Bancorp, dated Mar. 2, 2010 ("no control" determinations under the BHCA based on passivity commitments as well as "non-association" commitments affirming independent action by three investors); Warburg Pincus, 74 Fed. Reg. 40596 (Aug. 12, 2009) (solicitation of public comments) (approved Oct. 13, Aug. 26, 2009) (investment in Webster Financial), and Board Letters, Jan. 13, 2014, Aug. 3, 2012 (relief from commitments in connection with Warburg Pincus investment in Webster Financial); Comptroller Conditional Approval No. 893 (Mar. 4, 2009) (no objection to the retention of ownership of voting shares by Capital Group Companies ("CGC") in Target Corp. aggregating 10% or more but less than 25%, and determination that CGC would not indirectly control Target National Bank as long as CGC adheres to a Passivity Agreement); Boston Private Financial Holdings ("Boston Private") SEC Form 8-K, July 22, 2008 ($75 million investment structured by the Carlyle Group in up to 24.99% economic interest), and Board Letter, Nov. 15, 2013 (relief from commitments in connection with Carlyle Group investment in Boston Private); National City Corp. SEC Form 8-K, June 30, 2008 ($785 million investment by Corsair Capital); First National Bank Group, 94 Fed. Res. Bull. C31 (2008) ("control" permitted at 9.9% ownership level and release of passivity commitments set out in 92 Fed. Res. Bull. C164 (2006)); Washington Mutual SEC Form 8-K, Apr. 7, 2008 ($2 billion investment by TPG Capital as anchor investor in Washington Mutual, a thrift holding company); BNS, 93 Fed. Res. Bull. C136 (2007); Doral Financial Corp. ("Doral"), FRBNY Letter, dated July 13, 2007, and Board Letters, July 18, 2007 (investments involving private equity investors and Bear Stearns; see Part VII.A.7 below) (the "Doral Precedents"); Passumpsic Bancorp, 92 Fed. Res. Bull. C175 (2006); Sky Financial Group, 92 Fed. Res. Bull. C92 (2006); Penn Bancshares, 92 Fed. Res. Bull. C37 (2006) (but see NJ Dept. Banking & Ins. Order (Mar. 21, 2006) (disagreeing with FRB "no control" conclusion)); C-B-G, 91 Fed. Res. Bull. 421 (2005); S&T Bancorp, 91 Fed. Res. Bull. 74 (2005); 90 Fed. Res. Bull. 79, 82 (2004); Letter from Board General Counsel Mattingly, dated Aug. 1, 2000 (investments in minority-owned and women-owned banks); FleetBoston, 86 Fed. Res. Bull. 751 (2000);

Brookline Bancorp, 86 Fed. Res. Bull. 52 (2000); Board Letter re Imperial Bancorp spin-off of Imperial Financial Group, Aug. 19, 1998; North Fork Bancorp, 84 Fed. Res. Bull. 477 (1998); Board Letter re Boston Bank of Commerce, dated Oct. 21, 1997 (insurance company investment in convertible non-voting preferred stock representing 32% of the equity of a minority bank); Amboy Bancorp, 83 Fed. Res. Bull. 507 (1997) ("control" found at 9.9% ownership level given other business relationships between investor and target); GB Bancorp, 83 Fed. Res. Bull. 115, 117 (1997); Emigrant Bancorp, 82 Fed. Res. Bull. 555 (1996); BOK Financial Corp., 81 Fed. Res. Bull. 1052 (1995); Board Letter, Dec. 7, 1994 (the "Board 1994 Control Letter"); Mansura Bancshares, 79 Fed. Res. Bull. 37 (1993); First Community Bancshares, 77 Fed. Res. Bull. 50 (1991); SunTrust Banks, 76 Fed. Res. Bull. 542 (1990); First State Corp., 76 Fed. Res. Bull. 376 (1990); Sun Banks, 71 Fed. Res. Bull. 243 (1985); Board "Crown X" Letter, dated May 28, 1985 (Board precedents characterizing investments as "passive" and "non-controlling" for BHCA purposes); Board Release S-2173 (Sept. 17, 1971) (the "Board Control Release"), Fed. Res. Reg. Serv. ¶ 4-191.1.

(c) Board Letter, Mar. 12, 2012, confirmed that Goldman Sachs would not control Moneygram International ("Moneygram") for purposes of the BHCA for (i) owning (A) non-voting stock of Moneygram representing 19.9% of Moneygram's total equity, which was convertible to voting common stock of Moneygram in the hands of any holder other than Goldman Sachs only if such shares were transferred as part of (1) a widespread public distribution, (2) a transfer to an underwriter for the purpose of conducting a widespread public distribution, (3) a transfer in which no transferee (or group of associated transferees) would receive 2% or more of any class of voting securities, or (4) a transfer to a transferee that would control more than 50% of the voting securities without any transfer from Goldman Sachs; (B) approximately 0.05% of Moneygram voting common stock in proprietary trading accounts; and (C) approximately 34% of Moneygram's consolidated debt that did not have the characteristics of regulatory capital instruments and could be redeemed by Moneygram at any time; and (ii) having the right to have a non-voting observer attend meetings of Moneygram's board of directors. The Board also relied on passivity commitments similar to those the Board had previously relied on in making non-control determinations as well as the fact that the Moneygram debt held by Goldman Sachs contained standard covenants and did not limit in any material way the discretion of Moneygram's management over major policies and decisions or provide Goldman Sachs with a means to control Moneygram.

(d) Board Letter, Feb. 14, 2012, confirmed that ING Group N.V. would not control Capital One Financial Corporation ("Capital One") for purposes of the BHCA upon the sale of ING Bank, fsb to Capital One as a result of ING Group (i) acquiring up to 9.9% of the voting common shares of Capital One; (ii) having one director representative on Capital One's board for a limited time; and (iii) having certain business relationships with Capital One's use of certain ING Group trademarks for up to sixteen months, and a transition services agreement. The Board also relied on passivity commitments similar to those the Board has previously relied on in making non-control determination as well as certain restrictions on ING Group's ownership of Capital One shares set forth in a shareholders' agreement between the parties.

Upon the sale of ING Group's interest in Capital One and the resignation of ING Group's director on Capital One's board, Board Letter, Dec. 20, 2012, released ING Group from its passivity commitments with respect to Capital One. The Board also noted that the sole relationships remaining between ING Group and Capital One would be business relationships relating to the purchase and sale of ING Bank, fsb and limited relationships that predated the purchase and sale of ING Bank, fsb.

(e) Board Letter, Dec. 30, 2011, concluded that Triodos Bank NV would not control New Resource Bank ("NRB") for purposes of the BHCA upon making an investment in NRB of no more than 24.9% of any class of the voting common stock or total equity of NRB under circumstances where Triodos would have no representative on the board of, and no employee interlocks or business relationships with, NRB.

(f) Board Letter re Alostar Bank of Commerce, dated Apr. 4, 2011, concluded that four independent private equity groups could each acquire up to 24.9% of the voting securities of a de novo bank, formed to bid on a failing bank, without forming an association that would be treated as a single company with control of the bank. In reaching its conclusion, the Board relied on passivity and anti-association commitments made by each investor.

(g) Franklin Resources (Letter, dated Jan. 22, 2010) approved an application on behalf of Franklin Resources and its mutual funds to acquire 9.9% of the voting shares of Bond Street Holdings (and, indirectly, Bond Street Bank), subject to passivity commitments. See also Franklin Resources (Letters, dated Dec. 14, 2010 (First Chicago Bank & Trust); July 15, 2010 (NAFH National Bank); Apr. 2, 2010 (West Coast Bank)).

(h) The Board issued a series of Letters from Mar. 24, 2009 to Feb. 18, 2015, relating to the reorganization or divestiture of controlling positions in GMAC, which became a BHC in Dec. 2008.

In the first letter, the Board addressed the ownership of GMAC by an individual (Stephen Feinburg), and certain investment funds ("Cerberus Funds") and other entities the individual controlled or advised ("Cerberus"), which owned 51% of the voting shares of GMAC through three investment companies (the "Cerberus Companies") and had five director representatives on GMAC's board. The Board determined that Cerberus would no longer control GMAC provided that: (i) the Cerberus Companies distributed their shares of GMAC to the Cerberus Funds unaffiliated with Cerberus such that the Cerberus Funds would own 22.02% of the voting equity and no non-voting equity of GMAC and no co-investor would own more than 5% of the voting or total equity of GMAC; (ii) any "blocker" corporations (established to facilitate payment of U.S. taxes) owned by the Cerberus Funds would be separate from any blocker corporation that holds a co-investor's interests in GMAC, and any co-investor blocker corporation would own no more than 4.9% of GMAC's voting equity and would be independent of Cerberus and the individual who controls Cerberus; (iii) the co-investors would be free to vote or dispose of their respective interests in GMAC without restriction; (iv) there would be no shareholder agreements regarding the ownership or voting of GMAC shares or management of the companies; (v) neither any Cerberus-controlled entity nor the individual who controls Cerberus would advise the co-investors regarding their shares or regarding the management of GMAC; (vi) Cerberus would have only one director representative on the GMAC board; (vii) Cerberus would eliminate employee interlocks and advisory agreements between Cerberus and GMAC; and (viii) business relationships and transactions between GMAC and Cerberus-controlled entities or affiliates of Cerberus would be limited to their existing scope and terms, and no new business relations between GMAC or any Cerberus-controlled entity would be permitted.

Board Letter, Feb. 22, 2013, addressed the divestiture of GMAC by GM, which owned 49% of the voting shares of GMAC and had controlled it since its formation. (GMAC provides financing for the vast majority of purchases of GM vehicles, and GM automobiles constitute approximately 80% of GMAC's business.) The Board determined that GM would no longer control GMAC based on the following considerations: (i) GM reduced its direct ownership interest in GMAC to less than 10% of the voting and total equity of GMAC by transferring its interest in excess of that amount to a trust with an independent trustee, who would be independent of GM and have sole discretion to vote and dispose of the ownership interests and would be required to dispose of the shares held in trust within three years of the Board's approval of GMAC's application to become a BHC (Dec. 24, 2008); (ii) GM would have no director representative on the GMAC board, although it would be permitted to have one non-voting observer attend board meetings; (iii) GM and GMAC agreed to modify their business relationships to remove economic and legal incentives for GMAC to do business primarily with GM; (iv) GM would continue to be treated as an affiliate of GMAC Bank for purposes of Section 23A until GM owns less than 10% of the voting or total equity of GMAC; and (v) GM made other passivity commitments similar to those relied on by the Board in the past for non-controlling investments. In making its non-control determination (including the determination to permit GM to own up to 10% of the voting shares of GMAC), the Board noted that when one company has controlled another company for a significant period, the Board has generally required the controlling company to divest to below 5% of the other company and has permitted only minimal ongoing business relationships between the companies. In this case, the Board noted that GM's commitments to limit its ongoing relationship with GMAC should prevent GM from using its historical control position to continue to exert a controlling influence over GMAC. The Board subsequently issued a letter authorizing Cerberus to bid to purchase mortgage servicing rights from GMAC.

Board Letter, Dec. 20, 2011, extended the deadline for GMAC Common Equity Trust I ("GM Trust") to divest its approximately 39% interest in Ally Financial ("Ally", previously operating as GMAC) by two years, until

December 24, 2012. This interest in Ally was held by GM Trust after GM reduced its direct ownership in Ally to 9.9% in 2009, and transferred its remaining interest to the Trust, which was managed by an independent trustee. In granting the extension, the Board found that extending the deadline would benefit the public, since the financial and structural reforms taken by Ally since 2008 had made Ally profitable again, and would enable a planned IPO of Ally in 2012. This IPO would also eliminate the capital support received by Ally from the U.S. government. The Board also noted that GM and the trustee of GM Trust had been diligent in exploring divestiture options and GM did not have voting control over the Ally shares held by GM Trust.

Board Letter, Nov. 1, 2013, approved Cerberus's request for relief from its commitment to not acquire any voting securities of Ally in addition to the voting securities it already owned. The Board's approval was based on the following considerations: (i) Cerberus's equity interest had been reduced to less than 10% of the outstanding voting stock of Ally; and (ii) Cerberus had no other relationships with Ally besides its investment, a director/observer interlock, and a limited advisory relationship.

Board Letter, Feb. 18, 2015, approved Cerberus's request for relief from a commitment that restricts banking and nonbanking relationships with Ally to permit Cerberus to bid on and purchase a portfolio of mortgage loans designated as troubled-debt restructuring loans held by Ally Bank, Midvale, Utah. The Board considered the following, among other things, in granting approval: (i) Cerberus's equity interest in Ally had been significantly reduced to approximately 8.65%; (ii) the proposed business relationship with Ally would be a one-time transaction of limited size and scope for both Cerberus and Ally; and (iii) the auction process would be on market terms and involve additional bidders.

(i) In Board Letters, Mar. 24, 23, 2009, the Board made a relatively rare combination of determinations by: (i) concluding that the GIC Private Ltd. (then known as Government of Singapore Investment Corporation ("GIC")) would not control Citigroup for purposes of the BHCA, and (ii) not disapproving GIC's notice under the CBCA for the acquisition of up to 19.9% of the voting shares of Citigroup as part of an exchange offer initiated by Citigroup. GIC made passivity commitments similar to those relied on by the Board in the past for non-controlling investments. GIC's commitments permit it to have one representative on the Citigroup board and to own up to 25% of Citigroup's total equity if GIC owns 15% or more of Citigroup's voting shares, or to own up to 33% of Citigroup's total equity capital if GIC owns less than 15% of Citigroup's voting shares.

(j) In an FDIC Letter, dated Nov. 21, 2006, to Aozora Bank Limited ("Aozora") with respect to Aozora's proposed acquisition of a 6.25% indirect ownership interest through GMAC in GMAC Automotive Bank, an FDIC-insured Utah industrial bank, the FDIC had determined that it would not deem Aozora to be in control of GMAC or its subsidiaries within the meaning of § 3(w)(5) of FDIA. The FDIC appears to have issued similar letters to Citigroup and PNC with respect to their indirect investments in GMAC. These determinations were based in part on passivity commitments made by Aozora and the other investors.

D) The Board Control Release provides that, among other circumstances, ownership by a single entity of at least 10% of each of two banks or at least 5% of each of three or more banks can be an indicator of control.

E) With respect to investments of less than 5% of a class of voting securities (i.e., presumptively non-controlling investments):

i) In general, material control issues should not be presented in the context of a proposed investment that is both (a) less than 5% of any class of voting securities of a U.S. bank/BHC, and (b) less than 5% of the total equity (including subordinated debt) of the bank/BHC, unless (in each case) the investor obtains the right to elect a majority of the target's directors (or enters into an agreement to manage its affairs).

ii) However, control issues may arise where there are substantial business relationships, board of directors representation, and/or concurrent co-investments made by advisory clients or related investors, etc. In such cases, it may be necessary for investors to make a formal or informal submission to the applicable U.S. federal banking agency to demonstrate that the investment will not create a control relationship.

(iii) Create a separate "bank fund" to invest in the target.

A) Some private equity/management firms (e.g., Belvedere Capital Partners, Castle Creek, CBCR Partners, Community Bank Investors of America, Crescent Capital, FA Capital, JLL Partners, Oaktree Capital Group, Patriot Financial Partners, PIMCO and Warburg Pincus) have operated funds that register as BHCs and make controlling investments in U.S. banks and BHCs.

B) Comptroller Conditional Approval No. 872 (Aug. 27, 2008) (the "Flowers-FNBC Approval Letter") approved a change of control involving First National Bank of Cainsville, which was acquired by J. Christopher Flowers in his individual capacity.

C) Several private equity/management firms have structured "bank funds":

i) The firm establishes a special purpose fund for the sole purpose of acquiring and holding the stock of one or more BHCs.

ii) The firm as well as unaffiliated investors advised by such firm make non-controlling investments in the "bank fund".

iii) The fund (which is advised by the private equity/management firm) makes a controlling investment in the target BHC. As a result, the fund becomes a BHC itself and becomes subject to regulation as a BHC.

iv) On the other hand, given their status as non-controlling investors in the fund, neither the private equity/management firm nor its co-investors are considered BHCs or regulated as such. (Accordingly, private equity activities of the private equity/management firm outside the fund are unaffected by the structure.)

D) In 2009, the OTS granted preliminary clearance for an investment consortium led by Steven Mnuchin to acquire the operations of Indymac Federal Bank from the FDIC. See OTS News Release 09-11 (Jan. 2, 2009). Final OTS approval was granted on Mar. 4, 2009, when the OTS approved an application to organize OneWest Bank FSB ("OneWest Bank") in connection with OneWest's acquisition of IndyMac assets and liabilities from the FDIC. See OTS Director's Order No. 2009-13 (Mar. 4, 2009). By Letter to Steven Mnuchin, Mar. 5, 2009, the FDIC approved the application of OneWest Bank for federal deposit insurance.

Approval of these applications was subject to both of the two largest shareholders of the holding company (J.C. Flowers III L.P. and Paulson & Co., each owning a 24.9% interest) executing a Rebuttal of Control Agreement and the OTS's acceptance of these Agreements. See also, e.g., OTS Director's Order No. 2009-31 (May 21, 2009) (approval for investment consortium including Wilbur Ross, Carlyle Group and Blackstone Capital Partners to form a de novo thrift to acquire certain assets and liabilities of BankUnited, FSB from the FDIC).

E) In 2007, as reflected in the Doral Precedents, a "bank fund" structure was used in a transaction arranged by Bear Stearns to provide Doral, a registered BHC, with equity financing. The transaction involved a contribution of more than $600 million to Doral in return for 90% of Doral's voting shares (which were acquired and held by a new entity established for such purpose). Bear Stearns acquired less than 5% of the shares (and unaffiliated investors advised by Bear Stearns, as well as other institutional investors, acquired the balance).

Bear Stearns was required to make passivity commitments to the Board in light of Bear Stearns' role in arranging the transaction, the existence of co-investors advised by Bear Stearns, Bear Stearns' intention to enter into an advisory agreement with Doral, and Bear Stearns' representation on the boards of directors of Doral and affiliated companies. Bear Stearns committed not to (i) take any action that may cause Doral to become a subsidiary of Bear Stearns, (ii) acquire or retain shares of Doral that would cause Bear Stearns to own 5% or more of the outstanding shares of Doral, (iii) exercise or attempt to exercise a controlling influence over the management or policies of Doral, (iv) have or seek to have more than one representative serve as a director of Doral, or (v) have or seek to have any representative serve as an officer, agent or employee of Doral. None of Bear Stearns' co-investors (many of which were investors in other Bear Stearns funds) held more than 9.9% of the equity or the voting securities of Doral (through their investments in the "bank fund"). See Part VII.A.7.d.iv below (regarding "acting in concert" issues).

F) For the "bank fund" approach to be respected and for the BHC status of the bank fund not to cause other funds advised by the same firm to also be treated as BHCs, the Board has focused on the following facts:

i) No common portfolio investments by the funds.

ii) No cross-investment or lending among the funds.

iii) No asset transfers among the funds.

iv) No material economic linkages among the funds (e.g., no cross-fund carried interest clawback).

Under current law, the so-called "silo structure" is the only way a private equity firm that also controls non-financial companies could acquire control of a bank. In a silo structure, a private equity firm sets up a separate entity to invest in and take control of a target bank, which keeps the firm's main fund from being regulated as a BHC. Board staff has expressed skepticism regarding silo structures. In contrast, the OTS allowed private equity firms to make controlling investments through the use of a silo structure, as noted in its approval of MP Thrift Investments' purchase of Flagstar Bank, FSB. (See OTS Director's Order No. 2009-06 (Jan. 29, 2009)). In connection with the elimination of the OTS under Dodd-Frank and the transfer of supervisory responsibility over thrift holding companies, the Board has indicated that it expects to analyze thrift control determinations and relationships using Board policies and precedents, calling into question the continued viability of the use of silo structures with thrifts, although the Board does not expect to revisit ownership structures previously approved by the OTS. See 76 Fed. Reg. 43953 (July 22, 2011).

G) In Conditional Approval No. 901 (Nov. 17, 2008), the Comptroller granted preliminary approval for the first time of the use of a so-called "shelf charter", designed to enable private equity investors to be "pre-cleared" to assume the deposit liabilities and purchase the assets of a failed bank. This Conditional Approval signaled that the Comptroller was willing to ease the bidding process for non-bank investors and allow private equity investors interested in acquiring a bank to begin the charter approval process before they have identified a target. However, the Conditional Approval does not obviate the need for filings with other regulators (such as the FDIC for deposit insurance, and the Board if the acquisition involves the establishment of a BHC) and remains subject to significant conditions. Updated information must be provided to the Comptroller once a potential acquisition transaction is identified and investors must adhere to an Operating Agreement with the Comptroller that will require the bank to submit a comprehensive business plan. The Comptroller must also approve the bank's initial board and management along with any proposed changes to either in its first two years of operation. See, e.g., Comptroller Conditional Approvals No. 960 (July 15, 2010); No. 950 (Mar. 25, 2010); No. 945 (Jan. 29, 2010); No. 936 (Oct. 23, 2009); No. 922 (Aug. 28, 2009); No. 917 (July 31, 2009).

H) Alliance Data Systems v. Blackstone Capital Partners, 963 A.2d 746, aff'd, 976 A.2d 170 (Del. Ch. 2009), dealt with a circumstance where Blackstone, a private equity group, created a holding company to acquire indirect control of World Financial Network National Bank (a subsidiary of Alliance Data Systems). As part of the regulatory process, the OCC insisted that Blackstone, as well as the holding company, take responsibility for certain regulatory assurances in connection with the proposed acquisition. When Blackstone refused, and Alliance sued claiming that the holding company had an obligation to cause Blackstone (which had not signed the acquisition agreement) to accommodate the OCC's demand, the Court concluded that Blackstone's refusal to accept such obligations did not violate the agreement since Blackstone was not a party to that agreement, and there was no specific requirement in the agreement that the holding company must cause Blackstone to enter into any agreements with regulatory authorities.

I) The Board's Written Agreement with Belvedere Capital Partners, dated Mar. 10, 2010, sets out principles that the Board applies with respect to private equity positions in U.S. banks, and requires Belvedere to utilize its "financial and managerial resources" to be a "source of strength" for its subsidiary banks. As part of the Agreement, without prior written approval from the Board, Belvedere's subsidiary banks will not pay dividends or make any other payments to Belvedere, and Belvedere may not incur, increase or guarantee any debt. See also L.A. Business Journal, July 12, 2010.

(iv) Disperse ownership interests in the target among unaffiliated and independent entities or trusts.

A) In 2006, a group led by private-equity firm JC Flowers & Co. acquired approximately 27% in HSH Nordbank -- a German bank with a U.S. branch. The goal of the structure -- to ensure that Nordbank would not be regarded as a "subsidiary" of Flowers or (individually or collectively) any of the investors advised by Flowers -- was achieved by splitting investment stakes among 5 independent trusts controlled by limited partners in Flowers' funds. Each trust acquired a less than 9.9% interest in Nordbank -- keeping below the threshold that would have triggered increased Board scrutiny. See, e.g., Wall St. J., May 9, 2007.

Subsequently, Nordbank failed, and in 2010, six of nine partnerships overseen by JC Flowers which held the Nordbank stock on behalf of the independent trusts filed for bankruptcy. See, e.g., Reuters, Jan. 21, 2010.

B) Formal U.S. federal banking agency approval/confirmation of acquisition structures involving a number of private equity investors may be required. See, e.g., "Private Equity Investments in Banks", Practical L.J. (Apr. 2011); SNL Financial, Apr. 27, 7, 2011; Article IV of Appendix B to the Flowers-FNBC Approval Letter.

C) In general, for structures involving multiple investment vehicles to be respected from a BHCA/CBCA perspective, the various investment vehicles must, in fact, be independent from one another, and the owners of interests in the investment vehicles may not act as a single group. If unaffiliated equity holders are found to be acting in concert with one another, the U.S. federal banking agencies can aggregate the combined holdings of the group and treat such holders as a single entity for purposes of analyzing "control" issues. By adding the holdings together, an acquiror which would otherwise be below a control threshold based on its own holdings can be pushed over a control limit. See, e.g., Doral Precedents (in determining not to aggregate Bear Stearns's investment in Doral with investments made by investors unaffiliated with, but advised by, Bear Stearns, the Board noted that such investors (i) made independent decisions to invest in Doral, (ii) provided representations indicating their independence from the other investors, (iii) would not make their investments through any Bear Stearns entity, and (iv) would not have agreements or understandings with Bear Stearns regarding the voting or transfer of their interests); OTS Director's Order No. 2008-18 (June 13, 2008) (determining that Goldman Sachs Group rebutted a presumption of concerted action with respect to investment in a thrift holding company (derived from the presumption that equity securities of the holding company's outside directors should be aggregated with positions held by the Group)).

(v) "Debank" the target entity (e.g., divest the U.S. banking operations of a non-U.S. bank). See also Part I A.5.d above.

A) In the case of a non-U.S. bank with U.S. banking operations, this approach involves shutting down the non-U.S. bank's U.S. banking operations so that neither it nor any company that controls it is treated as a BHC or otherwise subject to the BHCA. Following the divestiture of the U.S. banking operations (e.g., a U.S. depository institution or the U.S. offices of a non-U.S. bank) of a larger entity (e.g., a non-U.S. bank), investors would no longer need to consider the U.S. bank regulatory implications of making a "control" investment in the target.

B) In certain cases, a divestiture may be accomplished or facilitated through the use of a voting trust structure. Generally, such an arrangement could provide an unaffiliated trustee with (typically, temporary) authority to vote the shares of a U.S. depository institution subsidiary of the target.

C) In 2005, Cerberus Capital Management and Gabriel Capital had won an auction for (i) 9.9% of Bank Leumi, an Israeli bank with a U.S. bank subsidiary, and (ii) rights to purchase an additional 10.01% of the stock of Bank Leumi. The investment group's plan to exercise its rights to purchase the additional shares was ultimately frustrated due to its inability to cause Bank Leumi to divest its U.S. bank subsidiary -- a necessary step in order for the investment group to avoid BHC status upon consummation of the transaction. The investment group had intended to use an independent trustee to hold the shares of the U.S. bank pending its final divestment. See, e.g., Investment Dealers' Digest, May 28, 2007.

e. SWFs have made significant investments in U.S. banking organizations and other financial service companies.

(i) Broadly speaking, an SWF is an investment vehicle established and controlled by a sovereign political entity (e.g., a foreign government or a U.S. state government) that seeks to generate financial returns in direct competition with market institutions. The profile of SWFs has increased in recent years due to their significant growth and investments in important sectors, which in turn has brought more scrutiny on SWFs. While SWFs share certain attributes, they have a range of investment goals, structures and financial, economic and political objectives.

A) Purpose and strategies: May be multiple and overlapping (e.g., to stabilize revenues from the sale of a commodity (such as oil), promote socio-economic projects and/or increase return on FX reserves/fiscal surpluses/pension contributions/receipts from privatizations).

B) Organizational structures: Either legal entities separate from the state or central bank, or pools of assets not legally separate from the state.

C) Investment policies, management and operational decisions: Typically centralized within the SWF or a government's central bank; parliaments can exercise varying levels of scrutiny.

D) Other common attributes: (i) high FX exposure, (ii) no explicit liabilities/low leverage, (iii) high risk tolerance, and (iv) long investment horizons.

See, e.g., The Sky Did Not Fall: [SWF] Annual Report 2015; The Santiago Principles: What's Next? (Mar. 2016); Int'l. Forum of [SWFs]: Santiago Principles: 15

Case Studies (Nov. 2014), Members' Experiences in the Application of the Santiago Principles [for SWF Investment Practices and Objectives] (July 7, 2011), "Kuwait Declaration": Establishment of the International Forum of [SWFs] (Apr. 6, 2009), [SWFs]: Generally Accepted Principles and Practices -- "Santiago Principles" (Oct. 14, 2008), [SWFs]: Current Institutional and Operational Practices (Sept. 15, 2008).

(ii) SWFs are spread across the world. In 2016, SWF assets under management amounted to approximately $7.4 trillion.

A) According to some estimates there are at least 78 SWFs in operation.

B) The largest SWFs include: (i) Government Pension Fund-Global (Norway), (ii) Abu Dhabi Investment Authority ("ADIA") (iii) SAMA Foreign Holdings (Saudi Arabia), (iv) China Investment Corporation ("CIC"), (v) SAFE Investment Company (China), (vi) Kuwait Investment Authority ("KIA"), (vii) Hong Kong Monetary Authority Investment Portfolio, and (viii) GIC. See [SWF] Rankings (SWF Institute, June 2016); M&A Law Report, Apr. 30, 2012; Economist, Jan. 1, 2012; Institutional Investor, 2016 SWF Ranking.

C) According to certain estimates, SWFs could reach $15 trillion by 2020.

D) SWF investments in private equity have increased in 2016, with over half of SWFs having known investments in private equity. See Sovereign Wealth Funds and Their Investments in Private Equity (Preqin, 2016).

(iii) Foreign SWFs have a long track record of investing in U.S. corporations and have been an important source of capital for U.S. financial institutions.

A) Globally, SWFs are one of the largest investors in the financial sector, with almost 270 deals from 2006 to 2014, over one-third of SWF direct investments during that period. See Sovereign Wealth Funds (Esade, KPMG and Investin Spain 2014).

B) Significant investments which SWFs made in U.S. financial institutions during the financial crisis include:

   i) Citigroup: $12.5 billion from an investor group including GIC and KIA (Mar. 2009, Jan. 2008; see Board Letter, Mar. 24, 2009); $7.5 billion from ADIA (Nov. 2007).

   ii) Merrill Lynch: $6.2 billion from an investor group including Temasek Holdings (Dec. 2007), followed by an additional $3.4 billion (Aug. 2008); $6.6 billion from an investor group including KIA and Korean Investment Fund (Jan. 2008).

   iii) Morgan Stanley: $5 billion from CIC (Dec. 2007) followed by an additional investment transaction (Aug. 2010).

C) The Board has issued a number of exceptions under BHCA § 4(c)(9) from (i) BHCA non-banking restrictions, and (ii) the regular reporting, filing and capital requirements of the BHCA with respect to SWF investments in non-U.S. banking organizations with U.S. banking activities. See, e.g., Board Letters, July 30, 2009 (French government owned Société de Prise de Participation de l'Etat investment in BPCE), Nov. 26, 2008 (UK government owned Financial Investment Ltd. investment in RBS), Aug. 5, 2008 (CIC and Central SAFE Investments Ltd. investment in Chinese banks with existing and prospective U.S. operations), July 28, 2008

(Temasek Holdings investment in Merrill Lynch) (the "Board SWF Letters").

(iv) Most SWFs (like many other investors, including U.S. investment banking firms, hedge funds and private equity pools) have structured their investments in U.S. banking organizations so as not to trigger the thresholds for U.S. federal bank agency review and approval under either the BHCA or the CBCA.

A) As reflected in the Board SWF Letters, the Board has held that the provisions of the BHCA -- including those requiring Board approval before a company may acquire control of a bank or BHC -- (i) do not apply to direct investments made by the U.S. government or by any state or foreign government, but (ii) generally do apply to SWFs structured as government-owned investment vehicles. See also CIC, 96 Fed. Res. Bull. B31 (2010).

B) While foreign governments to date have primarily invested in U.S. banks and BHCs through government-owned investment vehicles, SWF investments in U.S. banks and BHCs have generally been structured as non-controlling -- below 10% (and often below 5%) of voting equity -- and passive, with no officer, director or business interlocks (so as not to trigger prior approval and other requirements under the BHCA or the CBCA).

C) When the Board approved CIC's acquisition of up to 10% of the voting shares of Morgan Stanley as a passive, non-controlling investment, it determined that CIC is subject to comprehensive supervision on a consolidated basis as required by BHCA § 3. See 96 Fed. Res. Bull. B31 (2010).

(v) Because the Board SWF Letters did not by their terms extend to the Volcker Rule, see, e.g., Preqin, Jan. 20, 2014, those SWFs that are subject to the Volcker Rule have sought to structure their investments in private equity funds in particular to conform to the Volcker Rule. For example, SWFs may make investments in funds pursuant to the "SOTUS" exemption and the Volcker agencies' FAQ 13, which was a benefit to SWFs because it clarified that they may make investments pursuant to the SOTUS exemption even if the issuer has U.S. investors, as long as the SWF itself does not participate in the offer or sale of interests to investors in the United States or sponsor the fund. See Part II.A.7.g.v.

(vi) Concerns raised regarding the rapid growth of non-U.S. SWFs -- especially those based in Asia or the Middle East -- generally fall into the following categories:

A) As a group, SWFs have less transparency (regarding activities, holdings, governance and other matters) than more regulated institutional investors (although a growing number of SWFs now provide information on the objectives, investment strategies, and results of their management of these entities).

B) Potential for mismanagement of investments by SWFs (including corruption) is believed to be greater than for more regulated institutional investors.

C) SWF investments could be affected by political objectives.

D) Foreign government owners of SWFs could come into conflict with the U.S. government (or other "host country" governments).

E) The legal authority (and/or practical ability) of the U.S. (or other "host country") government to sanction an SWF for any unlawful activity could be problematic.

(vii) Foreign SWFs have been encouraged to take certain steps -- including the development of best practices -- intended to mitigate concerns raised by their investment activities.

A) The IMF and the International Working Group of SWFs (composed of several of the most significant SWFs) have formulated Best Practices for SWFs.

B) Certain SWFs (e.g., ADIA) increased the amount of information that they disclose and/or announced that their investments would be made with no political goals. See, e.g., Treasury Press Release, Mar. 20, 2008.

(viii) The SEC has investigated the dealings between financial institutions and SWFs for possible violations of the FCPA. See, e.g., SEC Letter, Jan. 5, 2011 (information request to bank regarding certain advisory services provided to SWFs); Wall St. J., Jan. 14, 2011; NY Times Dealbook, Jan. 13, 2011. See also Part VIII.A.

(ix) Selected SWF materials include: Sovereign Wealth Fund Review (Preqin, 2016); Sovereign Investors 2020: A Growing Force (PWC, 2016); The Rise of Asian [SWFs] (FRBSF, Mar. 2015); [SWFs] (KPMG, 2014); [SWFs] (Preqin Special Report, 2013); The Deal, May 4, 2012; [SWFs] (TheCityUK, Feb. 2012); Economist, Jan. 21, 2012; FT.com, Mar. 8, 2011; Investment Objectives of [SWFs] -- A Shifting Paradigm (IMF, Jan. 2011); "The Regulation of [SWF] Investments in the [U.S.]", Banking & Fin. Serv. Policy Rpt. (Oct. 2010); Corporate Financing Week, Mar. 15, 2010; [SWFs]: Laws Limiting Foreign Investment Affect Certain U.S. Assets and Agencies Have Various Enforcement Processes (GAO, May 2009); [SWFs]: Real Estate Partners in Growth? (Deloitte, 2009); Rose, "Sovereigns as Shareholders", 87 N. C. Law Review 101 (Fall 2008); Sovereign Wealth and Sovereign Power: The Strategic Consequences of American Indebtedness (Council on Foreign Relations, Sept. 2008); Testimony of SEC

Office of International Affairs Director Tafara before Senate Banking Committee, Apr. 24, Mar. 24, 5, 2008; Testimony of Board General Counsel Alvarez before Senate Banking Committee, Apr. 24, 2008; Testimony of Treasury Under Secretary for International Affairs McCormick before House Financial Services Committee, Mar. 5, 2008; [SWFs]: A Working Agenda (IMF, Feb. 29, 2008); Remarks by Treasury Assistant Secretary for International Affairs Lowery, Feb. 25, 2008; Kimmitt, "Public Footprints in Private Markets: Testimony of Federal Financial Analytics Managing Partner Petrou, and of SEC Division of Enforcement Director Thomsen, before U.S. China Economic and Security Review Commission, Feb. 7, 2008; Sovereign Wealth Funds and the World Economy", Foreign Affairs, Jan./Feb. 2008.

f. Other issues frequently arise in connection with investments in U.S. and non-U.S. banks and other depository institutions.

(i) Large amounts of borrowing required to acquire a financial institution may raise safety and soundness concerns. Accordingly, use of highly leveraged vehicles to acquire U.S. banking institutions may not be practicable.

(ii) It is contrary to Board regulation and policy for a bank/BHC to enter into an agreement that (A) restricts the bank/BHC from providing information to Board supervisory staff; (B) requires or permits disclosure to a counterparty of any information that will be or was provided to Board supervisory staff; or (C) requires or permits the bank/BHC to inform a counterparty of a current or upcoming Board examination or any non-public Board supervisory initiative or action.

A) Board staff has taken the position that identification of any information requested by, or provided to, supervisory staff (including the fact that an examination has taken place or that Board staff has requested information covered by an agreement) is related to an examination and, as such, constitutes confidential supervisory information that may not be released without Board approval.

B) The Global Documentation Steering Committee --comprised of representatives of financial institutions, financial market trade associations and the FRBNY -- has published confidentiality terms to promote prompt negotiation of confidentiality agreements.

See Board SR Letter 07-19 (Dec. 13, 2007), CCH Fed. Banking L. Rep. ¶ 37-772.

(iii) Certain U.S. banking institutions have considered implementing a "good bank/bad bank" approach as a strategy to shore up confidence in the institution. Under the approach, the institution forms a "bad bank" (e.g., a newly established national or state bank) to purchase, and eventually liquidate, troubled assets held by the existing or "good bank". The objectives of the approach are generally to improve the earnings power and capital-raising ability of the institution, realize potential efficiencies from management specialization, and better capture different investor risk appetites.

g. With respect to investments in banking organizations as fiduciary, as well as with respect to the aggregation of multiple funds with the same investment manager, see Part VIII.C below.

B. REAL ESTATE-RELATED SERVICES

1. Banks engage in real estate-related loan placements, term loans and construction loans, have relationships with REITs, and are active in commercial real estate securitization and real estate-related services generally, as well as in the origination and sale of derivatives based on real property. See generally Part X below. The bank share of the real estate lending market has been growing. Between 1986 and 2014, for example, the bank share of credits secured by real estate grew from 18% to 31%. In addition, by 4Q 2014 over 50% of total loans of the entire commercial banking system (76% of the total

loans of banks whose assets are less than $1 billion) were real estate loans. Since the financial crisis, however, banks have decreased their exposure to real estate-backed loans. After reaching a height of 48.6% in 2006, real estate-backed loans made up only 26.8% of U.S. bank assets in 2014. See Wall. St. J., June 8, 2014. However, for Banks with less than $1 billion in assets, real estate–backed loans made up almost 50% of their assets in 2014. Banks may also acquire, develop and hold real estate where such property will be used in, or as an accommodation for, their business. See, e.g., Board Statistical Release, Mortgage Debt Outstanding, (Mar. 2015); Statistics on Depository Institutions (FDIC, Dec. 31, 2014); American Banker, Mar. 3, 2010.

2. FHCs and (to a certain extent) financial subsidiaries may provide a range of real estate-related services at least as broad as those permitted for BHCs and banks as discussed below, but also including title insurance and related services (as principal, agent or broker), and investments in real estate projects (subject to compliance with the Merchant Banking Regulations). See Part VII.A.2.b above.

3. The FHC Real Estate Proposal would have amended the Financial Activities Regulations to add real estate brokerage and real estate management to the list of FHC-permissible activities. See Part I.C.1.c.iii above.

   a. Under the Proposal:

      (i) Real estate brokerage activities would include: acting as an agent for a buyer, seller, lessor or lessee; providing advice in connection with a real estate purchase, sale, exchange, lease or rental; bringing together parties interested in consummating a transaction; and negotiating a contract relating to a transaction on behalf of such parties.

      (ii) Real estate management activities would include: procuring tenants; negotiating leases; maintaining security deposits; billing, collecting and accounting for rent; making principal, interest, insurance, tax and utility payments; and generally overseeing inspection, maintenance and upkeep.

b. At stake in the debate over the FHC Real Estate Proposal was more than $50 billion in annual real estate commissions. The Board received 44,000 public comments concerning the Proposal, and Treasury received 35,000.

See, e.g., Competition in the Real Estate Brokerage Industry (FTC/DOJ, Apr. 2007); Real Estate Brokerage: Various Factors May Affect Price Competition (GAO, July 25, 2006); Consumer Federation of America Report, How the Real Estate Cartel Harms Consumers and How Consumers Can Protect Themselves (June 2006); Should Banking Powers Expand Into Real Estate Brokerage and Management (CRS, May 25, 2006); GAO 2005 Real Estate Brokerage Report; Realty Alliance Letter to NAR, Feb. 8, 2002; Letter from Rep. Tauzin to Treasury Secretary O'Neill and Board Chairman Greenspan, Dec. 21, 2001 (requesting information as to applicability of GLB Act privacy requirements (see Part I.C.5 above) to real estate brokers if FHC Real Estate Proposal were adopted); CSBS Letter to Board/Treasury, May 1, 2001 (the "CSBS Real Estate Letter") (identifying 25 states which permit banks to engage in real estate brokerage); NAR White Paper, May 14, 2001; SIA Letter to the Board, May 1, 2001; Financial Services Roundtable Letters to the Board, Mar. 16, 2001, and to Rep. Oxley, Mar. 15, 2001; ABA/ACB/Consumer Bankers Association/Financial Services Roundtable Letter to the Senate and the House, Feb. 16, 2001.

c. Through the annual appropriations process, Congress prevented Treasury from finalizing regulations declaring real estate brokerage and management to be "financial in nature or incidental to a financial activity" or "complementary to a financial activity". See Part I.C.1.c above.

4. In general, BHC and/or bank real estate-related services include:

a. Providing financial, investment and economic advisory, asset management, brokerage/intermediation and relocation services to investors (e.g., individuals, investment companies, private fund vehicles, REITs) and corporate customers with respect to the purchase, sale or financing of real estate.

b. Lending, appraisal, advice and arranging equity financing (including by arranging for the transfer of the title, control and risk of a real estate project to investors).

c. Providing flood zone determination services.

d. Providing investment advice concerning income-producing property (including the provision of Murabaha (Islamic) financing products).

e. Publishing reports on market conditions and investment trends.

f. Informing clients about potential real estate investments.

g. Acting as agent in the purchase and sale of securities representing debt or equity interests in real estate.

h. Acting as a finder in bringing together parties wishing to finance the purchase, construction, development, operation or placement of real estate, and equity interests and securities related to real estate (see Part VII.C below).

i. Identifying and engaging a real estate broker.

j. Assisting in the structure, negotiation and facilitation of "like-kind exchanges" under Internal Revenue Code § 1031 (see also Part VII.B.9 below).

k. Assisting in negotiating and closing purchase and sale transactions and providing real estate settlement, closing and escrow services.

l. Assisting in real estate-related loan restructurings, workouts and bankruptcies.

m. Monitoring and making recommendations concerning the financial and technical aspects of property management.

n. Inspecting investment properties to assess their condition and compliance by contractors, managers and other service providers with applicable contracts, and to obtain information with respect to purchase, sale, financing or related decisions.

o. Furnishing administrative, management and consulting services to real estate construction lenders and investors (e.g., project feasibility, cost, contract, environmental and seismic reviews and appraisals).

In addition, a state non-member bank may receive FDIC approval under the FDIA to engage in real estate-related activities. See, e.g., SunTrust Bank (2004); Citybank (Dec. 10, 2001).

5. In general, a BHC or a bank may not:

   a. Acquire fee simple interests in real estate as principal.

   b. Solicit properties to be sold.

   c. List or advertise properties for sale.

   d. Hold itself out as a real estate broker.

   e. Assist clients in finding tenants and negotiating leases.

   f. Provide real estate advisory services to clients when the property is intended to be used in a trade or business (except as part of a permissible management consulting activity which does not involve the performance of tasks or operations or the provision of services on a daily or continuous basis).

   g. Have an interest in (or participate in managing, developing or syndicating) a real estate project for which it arranges equity financing, or promote or sponsor property development.

   h. Participate in real property operation or management.

   But see CSBS Real Estate Letter; Board Letter, Apr. 20, 2006 (Board staff to analyze whether real estate management activities of an FHC subsidiary may be permissible if such activities are incidental or complementary to real estate investment advisory activities).

6. A bank's ability to engage in real estate activities which might require registration as a real estate broker is unclear (see, e.g., NAR Letter to the Comptroller, Feb. 13, 2004 (raising issues as to how preemption principles (see Part I.C.1.h above) would apply "in the

event that the Comptroller authorizes national banks . . . to engage in real estate brokerage activities"), and Comptroller Letter to the NAR, Feb. 24, 2004 (confirming that "as a general matter, national banks are not permitted to engage in real estate brokerage"). Regulation Y specifically provides that BHC-permissible activities do not include engaging in real estate property management or brokerage, or providing title insurance as principal, agent or broker.

7. Many of the prohibitions described above in this Part VII.B should not apply to a BHC/bank's ability to engage in real estate-related activities on behalf of customers under its authority to provide fiduciary, investment or financial advisory and related services. See generally 12 U.S.C. § 92a; 12 C.F.R. Part 9 ("Part 9"); 12 C.F.R. § 225.28; Letter No. 831; Comptroller Interpretive Letter No. 508 (Apr. 6, 1990) ("Letter No. 508"), CCH Fed. Banking L. Rep. ¶ 83,206; Comptroller Unpublished Letter (Sept. 13, 1984); Comptroller Interpretive Letters No. 265 (July 14, 1983), CCH Fed. Banking L. Rep. ¶ 85,429; No. 238 (Feb. 9, 1982) ("Letter No. 238"), CCH Fed. Banking L. Rep. ¶ 85,402. See also Board Staff Opinion (Nov. 24, 2004), Fed. Res. Reg. Serv. ¶ 3-744.13.

8. With respect to real estate-related powers generally, see, e.g., 12 U.S.C. § 29; 12 C.F.R. §§ 5.34(e)(5)(v)(I) (national banks), 211.6(a)(6)(v) (Edge Act and Agreement corporations), 225.28(b)(2)(i), (ii), (viii), (3), (6), (9) (BHCs), 362.4 (state non-member banks); Comptroller's Handbook: Residential Real Estate Lending; HSH Nordbank Approval; Board Letter re Commerzbank, Nov. 24, 2004 (the "Commerzbank Real Estate Letter"); Board Letter, July 9, 2002; Allegiant Capital Corp. (approved May 6, 2002); LTCB, 57 Fed. Reg. 2098 (Jan. 17, 1992) (solicitation of public comments) (approved Feb. 19, 1993); RBS, 76 Fed. Res. Bull. 866 (1990) (the "Royal Scotland Order"); Illinois Regional Bancorp, 52 Fed. Reg. 10931 (Apr. 6, 1987) (solicitation of public comments) (approved Apr. 24, 1987); Standard Chartered Bank ("SCB"), 71 Fed. Res. Bull. 470 (1985) (the "Standard Chartered Order"); Bancorp Hawaii, 71 Fed. Res. Bull. 168 (1985); Comptroller Interpretive Letters No. 1041 (Sept. 28, 2005), CCH Fed. Banking L. Rep.¶ 81-574 (escrow agent activities); No. 966 (May 12, 2003) ("Letter No. 966"), CCH Fed. Banking L. Rep. ¶ 81-489 (short-term title to residential

real estate held as part of relocation services); Comptroller Corporate Decisions No. 2001-30 (Oct. 10, 2001) ("Corporate Decision No. 2001-30"); No. 2001-27 (Sept. 13, 2001); Comptroller Interpretive Letters No. 880 (Dec. 16, 1999) ("Letter No. 880"), CCH Fed. Banking L. Rep. ¶ 81-373; No. 867 (June 1, 1999) ("Letter No. 867"), CCH Fed. Banking L. Rep. ¶ 81-361; Corporate Decision No. 99-33; Approvals No. 338; No. 327; No. 322; Letter No. 842; Approvals No. 276; No. 265; No. 241; Comptroller Unpublished Letter (Jan. 30, 1995); Comptroller Asset Management Precedents; Letters No. 508; No. 435; No. 420; Comptroller Interpretive Letter No. 389 (July 7, 1987), CCH Fed. Banking L. Rep. ¶ 85,613; Letter No. 387; Comptroller Interpretive Letter No. 271 (Sept. 21, 1983) ("Letter No. 271"), CCH Fed. Banking L. Rep. ¶ 85,435; Letter No. 238; CSBC Real Estate Letter. See also Part VII.C.3.d below.

9. Under some circumstances, BHCs and banks are authorized to own real estate or interests in real estate as part of, or incidental to, the business of banking or as an extension of a lending function.

   a. Acquisition of production payments, options to purchase real estate or technical title to real estate could be incident to permissible banking activities. See, e.g., Board UBS VPP Letter; Chemical, 59 Fed. Res. Bull. 698 (1973) (coal and other natural resource financing); Comptroller Conditional Approval No. 295 (Dec. 3, 1998); Comptroller Corporate Decision No. 98-17 (Mar. 23, 1998); Comptroller Unpublished Letters (Nov. 4, 1994), (Oct. 4, 1994); Comptroller Interpretive Letter No. 603 (Aug. 3, 1992), CCH Fed. Banking L. Rep. ¶ 83,437; Comptroller Unpublished Letter (May 18, 1989); Comptroller No-Objection Letter No. 86-2 (Feb. 25, 1986), CCH Fed. Banking L. Rep. ¶ 84,008; Letter No. 238. See also Part II.D.3 above. But see American Banker, Mar. 8, 2006 (JPMorgan Chase Bank withdrawal of Application to the Comptroller for permission to own royalty streams generated by oil and natural gas reserves).

   b. Under Board Letter, Feb. 9, 2006, a BHC may act as a qualified intermediary in "forward exchange transactions" under Internal Revenue Code § 1031, including (i) providing its customer/property seller with documents relating to the exchange; (ii) accepting responsibility from the customer for the sale of property and the receipt of sales proceeds in order to ensure that the customer does not "constructively receive" the proceeds of the initial property sale; (iii) taking "transitory title" to the initial property and the replacement property as they are transferred from seller to buyer; and (iv) investing the proceeds of the sale of the initial property on behalf of the customer until the customer acquires replacement property. The Board characterizes these services as real estate settlement services, trust company functions, financial advisory services, and tax planning/tax preparation services. <u>See also</u> Comptroller Conditional Approval No. 869 (July 22, 2008) ("qualified intermediary" for like-kind exchanges and "exchange accommodation titleholder" in "reverse like-kind exchanges"); Corporate Decision No. 2001-30 ("exchange accommodation titleholder" in "reverse like-kind exchanges"); Comptroller Interpretive Letter No. 706 (Oct. 6, 2005), CCH Fed. Banking L. Rep. ¶ 81-021 (to similar effect, including holding of replacement property pending sale).

c. Since it would be an "integral part of an authorized activity", a bank may acquire a 70% ownership interest in a wind energy project as part of a funding mechanism to take advantage of renewable electricity production tax credit programs. Letter No. 1048 (first Comptroller application of a "federal definition of 'real estate'" to address potentially inconsistent state law characterizations). <u>See also</u> Comptroller Interpretive Letter No. 1141, CCH Fed. Banking L. Rep. ¶ 81-670 (Apr. 22, 2014) (project financing for renewable energy wind facility using equity-based investment structure); Comptroller Interpretive Letter No. 1139, CCH Fed. Banking L. Rep. ¶ 81-668 (Nov. 13, 2013) (similar non-objection); Comptroller Corporate Decision No. 2012-06 (Feb. 28, 2012) (bank may lease wind turbines and ancillary equipment acquired through a sale-and-leaseback transaction where bank expects to realize return of its investment through lease payments and tax benefits); Comptroller Interpretive Letter No. 1074 (Nov. 21, 2006), CCH Fed. Banking L. Rep. ¶ 81-606 (applicability of lending limit to different wind tower lending programs); Comptroller Letter to Union Bank of California, Feb. 27, 2006 (explaining Letter No. 1048); Comptroller Corporate Decision

No. 98-17 (Mar. 23, 1998) (bank may hold working natural gas interest in connection with a loan, and receive tax credits as partial repayment of the loan).

d. Comptroller Interpretive Letter No. 1045 (Dec. 5, 2005) ("Letter No. 1045"), CCH Fed. Banking L. Rep. ¶ 81-573, held that, pursuant to its authority under 12 U.S.C. § 29 to purchase and hold real estate to accommodate the transaction of its business, a bank may develop a hotel to house visiting employees, directors and other visitors and make rooms not used by the bank available to third parties in order to maximize the utility of its premises. On the same reasoning, Comptroller Interpretive Letter No. 1044 (Dec. 5, 2005) ("Letter No. 1044"), CCH Fed. Banking L. Rep. ¶ 81-572, held that a bank may develop a mixed-use building adjacent to its existing headquarters, including space for retail and office space, a hotel and condominia, partly for its own use (including providing hotel lodging to its employees, directors, officers and customers), and may lease excess office and hotel space to third parties.

The Comptroller emphasized that Letters No. 1045 and No. 1044 dealt with limited situations where banks had long been allowed to hold an interest in real estate and did not permit banks to engage in broad-based real estate investment, development or commercial activities, nor did they erode the separation of banking and commerce. See, e.g., Testimony of Comptroller Chief Counsel Williams before Subcommittee of House Committee on Government Reform, Sept. 27, 2006; Comptroller Letter to Rep. Frank, May 4, 2006; House Financial Services Committee Press Release, Mar. 29, 2006; Comptroller Letter to Sen. Shelby, Jan. 31, 2006; Comptroller Interpretive Letter No. 1053 (Jan. 31, 2006), CCH Fed. Banking L. Rep. ¶ 81-582.

See also, e.g., Comptroller Interpretive Letters No. 1072 (Sept. 15, 2006), CCH Fed. Banking L. Rep. ¶ 81-604 (lease of excess bank premises); No. 1043 (July 8, 1993), CCH Fed. Banking L. Rep. ¶ 81-571; No. 1042 (Jan. 21, 1993), CCH Fed. Bank L. Rep. ¶ 81-570 (residential condominium to be used for lodging bank's auditors, consultants and customers); No. 1034 (Apr. 1, 2005), CCH Fed. Bank. L. Rep. ¶ 81-563 (multi-building complex of which bank would use 22%); No. 758 (Apr. 5, 1996), CCH Fed. Bank L. Rep. ¶ 81-122 (picnic ground for use by bank employees and customer groups); Unpublished Letters (Aug. 8, 1984) (management of excess space in bank building), (Jan. 29, 1981) (construction and lease of commercial space in office building where bank's initial use of the building would amount to 15%), (Aug. 27, 1973) (day care center for children of employees).

e. Banks and BHCs are permitted to hold and manage interests in real property as other real estate owned ("OREO") acquired in satisfaction of DPC interests. BHCs and banks are expected to make good faith efforts to dispose of OREO in a prudent and reasonable manner, and have flexibility to manage property in a manner that preserves value, including, e.g., by completing construction or by renting the property. OREO must be divested within two years (for BHCs) or five years (for national banks) from acquisition, although in each case extensions are available to permit holdings for up to ten years. See, e.g., 12 U.S.C. § 29; BHCA § 4(c)(2); 12 C.F.R. §§ 34.81 et seq., § 225.22(d)(1); Comptroller's Handbook: [OREO] (updated Sept. 13, 2013); Questions & Answers for [Board]-Regulated Institutions Related to the Management of [OREO] Assets (June 28, 2012).

(i) Comptroller Interpretive Letter No. 1097 (Apr. 3, 2008) ("Letter No. 1097"), CCH Fed. Banking L. Rep. ¶ 81-573, held that, in order to facilitate a permissible purchase of loans out of commercial real estate mortgage-backed securitization trusts, a national bank may acquire real estate in exchange for DPC, for a moment in time, as "incidental" to such purchase. The Comptroller emphasized that (A) in order to acquire the loans, the bank had no choice but to also acquire the real estate; and (B) the bank would acquire the real estate only with an agreement in place to sell the real estate to an unrelated third party at the same price.

(ii) Comptroller Interpretive Letters No. 1123 (Sept. 18, 2009), CCH Fed. Banking L. Rep. ¶ 81-655 ("Letter No. 1123"), and No. 1118 (July 2, 2009), CCH Fed. Banking L. Rep. ¶ 81-650, held that a bank may exchange its interest in OREO acquired in satisfaction of DPC for an ownership interest in an LLC which would manage, market and sell the exchanged DPC property (along with adjacent, related DPC properties acquired from other banks) subject to the conditions that (A) prior to the exchange, the bank's directors must determine that the exchange is in the best interests of the bank and would improve its ability to limit its loan loss; (B) the bank must receive non-objection from its OCC examiner; (C) the bank may not further exchange the LLC interests for an interest in any other real or personal property; (D) the bank must ensure that the LLC complies with 12 C.F.R. Part 34; and (E) the bank must dispose of its interests in the LLC no later than 5 years from the date it acquired the DPC interests.

(iii) Comptroller's Handbook: [OREO] (as updated on Sept. 13, 2013) warns banks to use caution before entering into any such program, and clarifies that approvals under Letter No. 1123 are only available where participants in a loan form an SPE as a means to hold, manage, and dispose of the OREO collateral acquired for DPC, and would not permit a bank to exchange OREO for equity in an entity that aggregates unrelated OREO parcels from multiple banks.

(iv) Comptroller Interpretive Letter No. 1131 (Apr. 15, 2011), CCH Fed. Banking L. Rep. ¶ 81-661 ("Letter No. 1131"), held that a bank could dispose of a Low-Income Housing Tax Credit development project acquired as DPC by transferring the project to the bank's wholly-owned CDC affiliate.

f. Pursuant to the general public welfare investment authority in 12 U.S.C. § 24(11) and 12 C.F.R. Part 24, national banks may make community development investments directly or through an entity primarily engaged in making qualifying investments (e.g., a CDC). The federal bank regulators provide interagency guidance on qualifying investments in a Q&A on Community Development. See 79 Fed. Reg. 53838 (Sept. 10, 2014); 78 Fed.

Reg. 69671 (Nov. 20, 2013); 75 Fed. Reg. 11642 (Mar. 11, 2010).

(i) Relief Act § 305, enacted in 2006, narrowed national bank authority "to make investments designed primarily to promote the public welfare, including the welfare of low-and moderate-income communities or families" (emphasis added) to limit the authorization to "investments . . . each of which promotes the public welfare by benefiting primarily low-and moderate-income communities or families". As a result, the Relief Act narrowed Comptroller flexibility in the area. Compare, e.g., Comptroller Interpretive Letter No. 837 (Sept. 4, 1998), Fed. Banking L. Rep. ¶ 81-291 (bank to engage in low-income tax credit projects, act as a finder and financial intermediary between investors and low- and moderate-income housing developers, and engage in similar activities with respect to state historic rehabilitation tax credit projects which were not technically covered by CDC-related statutory provisions).

In 2008, however, the pre-Relief Act wording of the public-welfare test was essentially reinstated by HERA § 2503. The Comptroller issued final rules under 12 C.F.R. Part 24 to conform to the statutory changes brought about by HERA. See 74 Fed. Reg. 15657 (Apr. 7, 2009).

(ii) The Relief Act raised the maximum aggregate outstanding investment limit for public welfare investments from 10% to 15% of a national bank's capital and surplus. As a result, a bank may make public welfare investments up to 5% of capital and surplus without Comptroller approval, and a bank now may invest an additional 10% (15% total) if the Comptroller determines that such additional investment will not pose a risk to the deposit insurance fund and that the investing bank is not undercapitalized.

(iii) The investment authority contained in 12 U.S.C. § 24(11) is separate from the lending limits contained in 12 U.S.C. § 84; however, other considerations (such as avoidance of unsafe or unsound concentrations) may limit a bank's aggregate investments in, and loans to, a given entity, regardless of the source of the authority relied upon. See Comptroller Interpretive Letter No. 1076 (Nov. 14, 2006), CCH Fed. Banking L. Rep. ¶ 81-608.

(iv) The federal bank regulators released interagency guidance on how certain qualifying community development investments are considered as part of an institution's CRA performance test. Among other things this guidance clarified that (A) examiners will consider community development activities that are conducted in the broader statewide or regional area that includes the institution's assessment area(s), so long as "the institution has been responsive to community development needs and opportunities in its assessment area(s)"; (B) investments in nationwide funds will be considered if the fund's investment is generally consistent with the institution's geographic focus in the CRA regulations and investment goals, but an institution's performance within its assessment area(s) is the primary focus of CRA performance tests; (C) serving on the board of directors of a community development organization and providing other services reflecting the expertise of an institution's employees are examples of technical assistance activities that could be provided to community development organizations; and (D) community development lending performance is always a factor considered in an institution's lending test rating. See 79 Fed. Reg. 69671 (Nov. 20, 2013).

(v) On September 8, 2014, the federal bank regulators requested comment on proposed revisions to their final interagency guidance. These revisions, among other things, clarify the guidance on economic development and how community development services are evaluated, provide additional guidance on how an institution's loans, qualified investments and community development services are evaluated, and add examples of community development activities and loans that revitalize or stabilize an underserved nonmetropolitan middle-income area and innovative or flexible lending practices. See 79 Fed. Reg. 53838 (Sept. 10, 2014).

(vi) On October 16, 2014, the OCC published guidance on how banks can collaborate with Community Development Loan Funds (CDLFs) to facilitate reaching low and moderate-income and underserved populations. CDLFs are generally nonprofit organizations that provide loans and development services to customers that banks normally would not be able to reach. Bank partnerships with CDLFs may take many forms, including referrals, participation lending, lending consortiums and providing institutional support for CDLFs. Banks invest in CDLFs under their general public welfare investment authority, as investments in CDLFs usually meet the criteria for such investments set forth in 12 C.F.R. Part 24. Such investments may receive consideration as a part of a bank's CRA performance test if the CDLF primarily lends or facilitates lending to promote community development. Community Development Loan Funds: Partnership Opportunities for Banks (OCC, Oct. 16, 2014).

(vii) Comptroller approvals in the CDC context include, e.g., Letter No. 1131; Community Development Investment Letters No. 2009-5 (June 17, 2009) (investment in fund to construct a rent-to-own affordable housing complex); No. 2009-4 (June 17, 2009) (investment in fund to renovate and lease a residential drug and alcohol treatment center); No. 2009-3 (Mar. 9, 2009) (investment in fund which will create employment by constructing an industrial facility); No. 2009-2 (Jan. 6, 2009) (investment in fund which invests in construction of agricultural product bins); No. 2008-1 (Aug. 2008) (investment in fund which invests in limited liability entities to develop, acquire, install and maintain solar energy-producing facilities and provide electricity);

[NMTCs]: Unlocking Investment Potential (Comptroller, Feb. 2007); Community Development Investment Letter No. 2006-1 (Feb. 8, 2006) (investment in fund which invests in the federally guaranteed portion of SBA loans); Comptroller Interpretive Letter No. 984 (Dec. 17, 2003), CCH Fed. Banking L. Rep. ¶ 81-510 (investment under NMTC program); Comptroller Community Development Investment Letters No. 2002-7 (Nov. 27, 2002) (minimum capital requirements for equity investments in non-financial companies do not apply to investments in CDCs and community development projects); No. 1999-1 (Feb. 25, 1999) (community development company operated as a REIT). See also OCC, Community Developments/Investments: Investing in Solar Energy Using the Public Welfare Investment Authority (July 2011) (banks may use the public welfare investment authority to invest directly in solar facilities or indirectly through a fund backed by interests in solar facilities if the investment meets the OCC's public welfare requirements); Significant Legal, Licensing, and Community Development Precedents for National Banks (Comptroller, Apr. 2010).

See also Board Letters re Goldman Sachs Bank USA, dated Feb. 9, Jan. 16, 2015, Dec. 22, Aug. 15, 13, 1, June 25, 19, 13, 2014; June 19, Dec. 20, Feb. 20, 2013 (approval of investment in a federal low-income-housing tax credits project qualifying as a permissible public welfare investment); Board Letters re Manufacturers and Traders Trust Company, dated Dec. 31, July 31, 2014; Board Letter to Fulton Financial Corp., dated Dec. 23, 2014; Board Letter to Regions Bank, dated July 29, 2014; Board Letter to East West Bank, dated July 29, 2014.

(viii) The CRA was enacted to encourage banks to lend to their local communities, by periodically examining banks to evaluate the extent to which they serve their communities. The FCIC Preliminary Staff Report:

[CRA] and the Mortgage Crisis (Apr. 7, 2010) addresses the impact of the CRA on the 2007-2009 financial crisis.

g. A bank may acquire property as a means of providing lease financing of public facilities. See, e.g., 12 C.F.R. § 7.1000(d)(i); Comptroller Interpretive Letter No. 847 (Oct. 28, 1998), CCH Fed. Banking L. Rep. ¶ 81-302.

h. A U.S. bank (as well as certain other U.S. financial institutions) that has as its primary mission promoting community development may apply to become certified by the Treasury as a "community development financial institution". Such an institution is eligible to receive assistance and grants from the Treasury's Community Development Financial Institutions Fund. See Community Development Financial Institutions Fund, CDFI Certification (May 2008).

10. An Edge Act corporation may engage in real estate brokerage outside of the U.S. (including identifying and locating properties for buyers, locating and introducing potential buyers to owners of properties, acting as intermediary in negotiations, and providing ancillary services to buyers and sellers). Citibank Overseas Investment Corp., 72 Fed. Res. Bull. 156 (1986).

C. CORPORATE FINANCE AND FINDER SERVICES

1. Background

M&A activity with U.S. involvement rose to $1.9 trillion in deals announced in 2014, a 54% increase from 2013. See M&A Review: Legal Advisors, Full Year 2014 (Thomson Reuters).

Smaller banks are gaining a larger share of the total M&A advisory fees. In 2013, boutiques and independent banks earned $5.73 billion in M&A advisory fees, representing 30% of total fees globally. See NY Times Dealbook Jan. 8, 2014.

2. Financial Holding Companies and Financial Subsidiaries

a. FHCs and financial subsidiaries may provide a full range of corporate finance and related services to the extent permitted for BHCs as described in Part VII.C.3 below.

b. Under the Financial Activities Regulations (see 66 Fed. Reg. 19081 (Apr. 13, 2001), 65 Fed. Reg. 80735 (Dec. 22, 2000)), FHCs and financial subsidiaries may engage in finder activities, which may include:

   (i) Identifying potential parties, making inquiries as to interest, introducing and referring potential parties to each other, and arranging contacts and meetings between interested parties;

   (ii) Conveying expressions of interest, bids, offers, orders and confirmations between interested parties; and

   (iii) Transmitting information concerning products and services.

c. Permissible finder activities include hosting an electronic marketplace on an FHC's Internet website by providing hypertext or similar links to the websites of third party buyers or sellers ("weblinking"), operating a website that allows buyers and sellers to exchange information, and operating a telephone call center. Such activities do not include any activity that would require registration as a real estate agent or broker.

3. Bank Holding Companies

Regulation Y (12 C.F.R. § 225.28(b)(6)(iii)) permits BHCs to provide advice in connection with mergers, acquisitions, divestitures, joint ventures, LBOs, recapitalizations, capital structurings, financing and other similar transactions, and to conduct financial feasibility studies (the "Regulation Y Corporate Finance Authorization"). See, e.g., PNC, 70 Fed. Reg. 55131 (Sept. 20, 2005), 70 Fed. Reg. 56468 (Sept. 27, 2005) (solicitation of public comments) (approved Sept. 27, 2005).

a. Advisory services with respect to specific industries -- as distinguished from "transactional" advisory services -- are also permissible. See, e.g., UBS Letter.

b. Under the Regulation Y Corporate Finance Authorization, BHC subsidiaries may serve as dealer-managers in cash tender offers (as an "advisory" service) and may provide bridge financing in connection with tender offers. See Part VII.D below.

c. The Board had previously permitted the activities covered by the Regulation Y Corporate Finance Authorization in Orders under BHCA § 4(c)(8). See, e.g., SecPac, 71 Fed. Res. Bull. 118 (1985); AMRO, 73 Fed. Res. Bull. 726 (1987); Signet 73 Fed. Res. Bull. 59 (1987); Sovran Financial Corp., 73 Fed. Res. Bull. 744 (1987); SunTrust Banks, 74 Fed. Res. Bull. 256 (1988); SBG M&A Order; BancOne Corp., 76 Fed. Res. Bull. 756 (1990); Fuji, 75 Fed. Res. Bull. 577 (1989) (the "Fuji M&A Order"); Creditanstalt Bankverein, 76 Fed. Res. Bull. 761 (1990); HSBC, 76 Fed. Res. Bull. 770 (1990); First Regional Bancorp, 76 Fed. Res. Bull. 766 (1990); ("First Regional Order"); Royal Scotland Order. See also 57 Fed. Reg. 41381 (Sept. 10, 1992) (Board initial Regulation Y revisions with respect to corporate finance activities).

d. The Regulation Y Corporate Finance Authorization provides that advisory activities do not include assisting management with planning or marketing a given project or providing general operational or management advice. However, the Regulation Y 1997 Revisions permit a BHC to provide appraisal services respecting real estate and personal property (12 C.F.R. § 225.28(b)(2)(i)), and management consulting services regarding financial, economic, accounting or audit matters (12 C.F.R. § 225.28(b)(9)), including under circumstances where the BHC derives up to 30% of its management consulting revenue from services to any customer on any matter. See, e.g., Compass Bancshares (approved Dec. 4, 1998) (appraisal of oil and gas property, leasehold interests in such property, and property rights to oil and gas reserves, and advisory services in connection with the sale of energy-related property).

Board Orders (and the provisions of Regulation Y prior to the Regulation Y 1997 Revisions) relating to the provision of corporate finance services included conditions which are <u>not</u> included in Regulation Y (although, to the extent that one or more of such conditions reflect a requirement that a BHC comply with applicable law -- or otherwise receive an authorization to engage in management consulting under Regulation Y -- they would continue to be relevant):

(i) The BHC subsidiary will act solely as agent in providing such services.

(ii) The BHC subsidiary will not make available to its affiliates confidential information obtained in the course of providing such services.

(iii) The BHC subsidiary will disclose its affiliation with the BHC to each potential client.

(iv) The BHC will comply with the Anti-tying Statute.

(v) The BHC will not perform routine tasks or operations for a customer on a daily or continuous basis.

(vi) Corporate finance advice will be rendered on a fee basis only, without regard to correspondent balances at any of the BHC's bank affiliates.

4. <u>Banks</u>

A national bank may offer corporate finance advice and related services "as a power incidental to the business of banking". <u>See</u>, <u>e.g.</u>, Comptroller Letter (Feb. 17, 1987) <u>re</u> Chase Bank (the "<u>Comptroller Chase M&A Letter</u>"); Comptroller Unpublished Letters (June 14, 1982), (May 25, 1982). <u>See also</u>, <u>e.g.</u>, <u>Norwest Bank v. Sween Corp.</u>, 916 F. Supp. 1494 (D. Minn. 1996), <u>aff'd</u>, 118 F.3d 1255 (8th Cir. 1997) (national bank's activities as an adviser to locate suitable buyers and initiate negotiations for the sale of a corporation).

a. A national bank may act as a "finder" in bringing together buyers and sellers for a fee, and perform related services including: (i) conveying information about product and service providers, prices and terms; (ii) informing a seller of an offer to purchase a product or service; (iii) arranging for third parties to offer lower rates for customers that banks refer; (iv) administrative, clerical and record keeping operations; (v) relaying information between buyers and sellers about bids, offers, orders and transaction confirmations; and (vi) conducting communications between buyers, sellers and interested parties.

<u>See</u>, <u>e.g.</u>, 12 C.F.R. § 7.1002 ("<u>Section 7.1002</u>"), as revised in 67 Fed. Reg. 34992 (May 17, 2002) (the "<u>Comptroller Electronic Activities Release</u>"); Comptroller Conditional Approvals No. 773 (Nov. 30, 2006) (merchant credit card account relationships); No. 612 (Nov. 21, 2003) (phone connections and long-distance service); Comptroller Corporate Decision No. 2003-10 (July 2003) (redeeming credit card reward points); Letter No. 966 (real estate corporate relocation services); Comptroller Bulletin No. 2003-15 (Apr. 23, 2005) ("weblinking"); Comptroller Conditional Approval No. 535 (June 21, 2002) (automotive roadside assistance and credit card programs); Comptroller Interpretive Letter No. 904 (Jan. 18, 2001), CCH Fed. Banking L. Rep. ¶ 81-423 (purchase of non-financial products by credit card customers); Comptroller Corporate Decisions No. 2000-11 (June 24, 2000) (matching welfare-to-work program participants with potential employers); No. 2000-08 (commercial merchant websites, registering merchants with search engines and obtaining universal resource locators (URLs)); Comptroller Conditional Approval No. 369 (Feb. 25, 2000) (Internet websites, providing a "collective purchasing resource", developing systems for web-based communications and payment systems, and tracking and storing financial and transactional information); Comptroller Interpretive Letter No. 883 (Mar. 3, 2000), CCH Fed. Banking L. Rep. ¶ 81-402 (merchant processing); Comptroller Conditional Approvals No. 361 (Mar. 3, 2000) (government agency websites); No. 347 (Jan. 29, 2000) (financial and non-financial products); Comptroller Corporate Decision No. 99-50 (Dec. 23, 1999) (merchant websites); Letter

No. 880 (real estate transactions); Comptroller Corporate Decision No. 99-43 (Nov. 29, 1999) (employee relocation services); Comptroller Interpretive Letter No. 875 (Oct. 31, 1999), CCH Fed. Banking L. Rep. ¶ 81-369 (commercial websites); Comptroller Corporate Decisions No. 99-38 (Oct. 29, 1999) (finance company loans); No. 99-35 (Oct. 20, 1999) (third party vendors); Comptroller Unpublished Letter (Sept. 13, 1999) (investment advisory arrangement); Approval No. 322 (commercial real estate transactions); Comptroller Interpretive Letters No. 856 (Mar. 5, 1999) (small business Internet and payment services and information on products and services), CCH Fed. Banking L. Rep. ¶ 81-313; No. 850 (Jan. 27, 1999) ("Letter No. 850") (investment advisory services), CCH Fed. Banking L. Rep. ¶ 81-307; No. 824 (insurance agency); No. 741 (new/used car inventories); Comptroller Corporate Decisions No. 98-13 (Feb. 9, 1998) (health insurance); No. 97-60 (July 1, 1997) (used car inventories); Approval No. 241 (purchase, construction, development, operation and placement of real estate interests); Approval No. 221 (Internet online services); Letters No. 653 (insurance agency); No. 630 (securities broker); No. 607 (trust business); Comptroller Interpretive Letter No. 593 (July 1, 1992) (securities broker), CCH Fed. Banking L. Rep. ¶ 83,418; Comptroller Trust Interpretation No. 249 (May 23, 1990) ("Letter No. 249") (fiduciary services), CCH Fed. Banking L. Rep. ¶ 83,210; Comptroller Interpretive Letter No. 504 (trust services), CCH Fed. Banking L. Rep. ¶ 83,202; Comptroller Unpublished Letter (May 18, 1989) ("Letter No. 504") (insurance/real estate broker/agents); Letter No. 472 (homeowner's insurance); Comptroller Unpublished Letter (Mar. 9, 1988) (M&A context); Comptroller Trust Interpretive Letter No. 78 (Mar. 4, 1987) ("Letter No. 78") (trust business); Comptroller Unpublished Letter (May 25, 1984) (M&A); Letter No. 238 (real estate transactions).

Although a national bank acting as a finder may not engage in brokerage activities that have not been found to be permissible, such limitation does not restrict a bank's authority to act as a broker where permitted by law. 61 Fed. Reg. 4849 (Feb. 9, 1996).

See also Weblinking: Identifying Risks and Risk Management Techniques (Comptroller/FDIC/OTS/NCUA, Apr. 23, 2003).

b. Assistance in negotiations is an increasingly standard element of bank M&A services, and it does not appear that the Comptroller would interpret M&A advisory authorizations to prohibit such assistance. 12 C.F.R. § 5.34(e)(2)(ii)(J) permits national banks to provide financial and transactional advice and to assist in structuring, arranging and executing financial transactions (including mergers, acquisitions, divestitures, joint ventures, LBOs, recapitalizations, capital structurings, private and public financings and loan syndications). Moreover, as part of its proposal which led to the revision of 12 C.F.R. Part 5, the Comptroller referred to "financial and transactional advice to customers and [assistance to] customers in structuring, arranging and executing various financial transactions". See 59 Fed. Reg. 61057 (Nov. 20, 1994) (solicitation of public comments). See also, e.g., Letter No. 880 ("negotiations with the buyer" of real property interests); Comptroller Unpublished Letter (Feb. 17, 1987) ("assist[ance] . . . in arranging acquisitions and divestitures").

c. Neither the Board nor the FDIC appears to have taken a formal position concerning the ability of banks to provide corporate finance services.

d. If a bank's activities as a finder were viewed as requiring registration as a broker, see Part VII.C.7.b below, and did not fall within the SEC's limited no-action assurance with respect to "M&A Brokers," see Part VII.C.7.b.iii below, then the activities could require registration as a broker with the SEC and would be subject to the GLBA push-out requirement (absent any other applicable safe harbor or exemption). See Part IX.B.3 below.

5. Edge Act Corporations

Regulation K permits Edge Act corporations (and other internationally-related U.S. operations of U.S. and non-U.S. banks) to provide (including in the U.S.) "advice on mergers and acquisitions, provided such services for U.S. persons are with respect to foreign assets only". 12 C.F.R. § 211.6(a)(6)(v); Lloyds Order. See Part XI.B.3 below.

6. Conflict-of-interest and Related Issues

   Banking organizations have expanded the number and type of roles they play in M&A transactions. See also Part III above.

   a. The extent of bank participation in acquisition transactions -- including (i) the number and nature of the roles which the bank performs (dealer-manager, adviser, lender, placement agent, equity participant); (ii) the extent of bank involvement in transaction planning and implementation; (iii) whether the transaction is hostile or contested; (iv) the amount and type of financing; (v) the scope and type of covenants relating to financing insofar as "control" of the acquiror or the acquisition vehicle is concerned; (vi) the historic and current relationships between the bank and the acquiror; and (vii) the extent, nature and amount of fees to be received and/or equity participation taken in connection with the transaction -- can raise risks of regulatory/judicial scrutiny.

   b. An important question with respect to bank/BHC involvement in M&A transactions is whether the bank/BHC has acquired impermissible "control" over a non-banking entity as a result of a combination of lending, equity and advisory services.

      (i) A bona fide lending and security arrangement on commercial terms that is not accompanied by a direct equity investment does not raise a BHCA "control" issue. Board Letter, Sept. 24, 1987 (Barclays Bank financing of Hugh Culverhouse tender offer for Florida Commercial Banks). Compare 12 C.F.R. § 225.31(d)(1)(ii) (agreement by a holder of voting securities in favor of another company restricting the holder's rights with respect to the securities does not constitute "control" if the agreement "is incident to a bona fide loan") with Board Control Release (discussing circumstances -- including availability of credit terms which are more favorable to the borrower than for comparable loans -- which could indicate BHCA "control").

(ii) Koppers Co. v. American Express, 689 F. Supp. 1371 (W.D. Pa. 1988) ("Koppers"), held that the involvement by NatWest (through multiple affiliates) in the acquisition of Koppers by Beazer PLC as (A) tender offer dealer-manager and financial adviser, (B) 5% equity participant, and (C) lender, and the relationship between NatWest and the ultimate acquiror through (i) equity ownership, (ii) a NatWest employee serving as director, and (iii) NatWest serving as adviser to the acquiror, did not give NatWest a "controlling influence" over the acquisition vehicle. The Board apparently reached the same conclusion.

(iii) In its letter to the FRBNY, Apr. 12, 1991, Square D Company, in fending off a tender offer by Schneider S.A., requested a Board determination that the role of Paribas and SocGen in the proposed acquisition would violate the BHCA. Square D alleged that the two banks, through minority equity stakes in Schneider's parent company (10%, in the case of SocGen; 10% plus 20% of a company which controlled 21%, in the case of Paribas), "controlled" Schneider. Square D also objected to the banks' financing role. Board Letter, Apr. 26, 1991, informed Square D that the facts presented were insufficient to demonstrate that either bank controlled Schneider, although the Board requested information on the nature of the relationship among the various shareholders of Schneider's parent. See also Board Letter to Sen. Bentsen, May 30, 1991.

c. Potential conflicts of interest may arise from multiple bank roles as lender, investor and adviser. See Part II.A.6 above and Part IX.E.3.d below.

(i) Banks use a variety of approaches to avoid or mitigate potential conflicts, including (A) proactively identifying potential conflicts; (B) clearly specifying the scope of services to be provided; (C) disclosure combined with written consent; (D) involving co-advisers or co-financiers; (E) use of information walls; and (F) establishing standards and limitations for areas of frequent conflict.

A) Buy-side financing provided by a bank which also serves as adviser to the seller is one frequent area of conflict, since the bank will earn fee income from both buyer and seller. Except in the context of "stapled financing", where the bank offers acquisition financing to all potential buyers as part of the sale process, banks serving as advisers to sellers generally should offer buy-side financing only after price and key terms have been agreed. Use of a second, independent adviser is also advisable.

B) The implications of buy-side financing offered by a seller's financial adviser can vary depending on a variety of factors, including: (i) the mix of potential bidders (strategic vs. financial sponsors); (ii) whether all, or only some, of the bidders need financing; (iii) whether any bidders have pre-existing relationships with the seller's financial adviser; (iv) the availability of alternative financing; (v) use of stapled financing to create a benchmark for financing terms before bidders can contact other potential lenders; (vi) the timing of the financing offer (e.g., before or after price and key terms agreed); and (vii) the existence of any "go-shop" or "window-shop" period. See generally, e.g., In Re Toys "R" Us Shareholder Litigation, 877 A.2d 975 (2005) (discussing concerns as to an "appearance of impropriety" with respect to adviser/financing arrangements).

(ii) FINRA Rule 5150 imposes disclosure requirements on broker-dealer fairness opinions when these opinions will be included in proxy statements or other communications with shareholders, including whether the opining broker-dealer has, or anticipates developing, a "material relationship" with any of the parties in the transaction. See also Part VII.C.8.b below.

(iii) Several recent Delaware Chancery Court decisions have considered alleged financial adviser conflicts of interest.

A) Corwin v. KKR Financial Holdings, No. 629 (Del. Ch. 2015) held that transactions approved by a fully-informed, uncoerced stockholder vote will be viewed under the business judgment rule when not subject to the entire fairness standard of review. Corwin has implications not only for potential claims against directors for breach of fiduciary duties but also for potential aiding and abetting claims against financial advisers. See also Singh v. Attenborough, No. 9388 (Del. Ch. 2016); In re Zale Corp, No. 9388 (Del. Ch. 2015).

B) In re PLX Technology Inc. Stockholders Litigation, No. 9880-VCL (Del. Ch. 2015), denied Deutsche Bank Securities' motion to dismiss the claim of the stockholders of PLX Technology Inc. ("PLX") that Deutsche Bank Securities aided and abetted PLX's board of directors in breaching their fiduciary duties in the context of Avago Technologies Ltd.'s ("Avago's") acquisition of PLX. The PLX board of directors hired Deutsche Bank Securities as its financial advisor with respect to the sale of PLX. At the time, Avago was, perhaps, the most likely potential acquirer of PLX. The Delaware Chancery Court concluded that, based on the allegations in the compliant, the stockholders of PLX have a claim against Deutsche Bank Securities for aiding and abetting PLX's board of directors because Deutsche Bank Securities failed to disclose at the time it was hired that it had significant relationships with Avago, including the fact that one of the Deutsche Bank Securities bankers who was on the fairness committee for the PLX acquisition was also working for Avago on another acquisition. Deutsche Bank Securities did not inform the PLX board of directors of its relationships with Avago until a few days before it presented its fairness opinion on the proposed sale of PLX to Avago.

C) Assad v. World Energy Solutions, CA 1032 (Del. Ch. 2014), granted expedited discovery on the plaintiff's claim that the disclosures relating to the alleged conflicts of interest of the World Energy Solutions special committee's financial advisor were inadequate. The alleged conflicts of interest stemmed from (i) the financial advisor's prior relationships with the buyer and (ii) the buyer's request that the financial advisor participate in buyer financing.

D) In re Rural Metro Corporation Stockholders Litigation, 88 A.3d 54 (Del. Ch. 2014), clarified on reargument, 2014 WL 1094173 (Del. Ch. 2014), held RBC Capital Markets liable for aiding and abetting breaches of fiduciary duty by Rural Metro's board of directors in connection with Warburg Pincus's acquisition of Rural Metro. According to the court, RBC was motivated by multiple undisclosed conflicts of interest, most importantly its effort to secure the buy-side financing role from Warburg Pincus while serving as financial advisor to Rural Metro during the sale process. The court found that these conflicts of interest caused RBC to manipulate the valuation it provided to Rural Metro's board to make Warburg Pincus's offer appear more favorable.

The court's ruling has led to increased emphasis on banker-related proxy disclosures, engagement letter protections and processes surrounding valuations and client communications.

See also RBC Capital Markets, SEC Admin. Proc. No. 3-17520 (Aug. 31, 2016).

E) In re Atheros Communications Shareholder Litigation, No. 6124-VCN, 2011 WL 768835 (Del. Ch. 2011), enjoined a stockholder vote to approve a sale transaction based on a failure to disclose adequately in the proxy statement fee arrangements with the financial adviser which provided the fairness opinion. 98% of the financial adviser's fee was contingent on the closing of a sale. However, Atheros made a curative disclosure three days after the court's order and made a motion for the order to be vacated. The court granted this motion and the Atheros stockholders ultimately approved the sale. 2011 WL 885931 (Del. Ch. 2011).

F) In re Del Monte Foods Shareholders Litigation, 25 A.3d 813 (Del. Ch. 2011), enjoined a stockholder vote to approve a sale transaction in a preliminary ruling, finding that the Del Monte board had failed to fulfill its fiduciary duties in the sale process because it was misled by its financial adviser regarding conflicts of interest. Del Monte's adviser had allegedly failed to disclose to Del Monte's board that it (i) had been shopping an acquisition of Del Monte to potential buyers before Del Monte retained the adviser; (ii) was seeking to provide buy-side financing; (iii) had continued to solicit certain bidders after the original sale process was terminated, and had suggested that two such bidders join their efforts; (iv) had arranged to provide buy-side financing prior to obtaining Del Monte's permission; and (v) had intentionally concealed the involvement of one of the two joint bidders.

G) In re El Paso Corporation Shareholder Litigation, 41 A.3d 432 (Del. Ch. 2012) ("El Paso"), expressed concerns regarding potential conflicts of interest where private equity funds affiliated with the seller's adviser had a $4 billion investment in the buyer (approximately 19% of the buyer's equity) and two seats on the buyer's board, despite the fact that the adviser had disclosed the equity interest, had advised the seller's board to retain an independent adviser for the potential sale, had stepped down from representing the seller on the sale, had recused its directors on the buyer's board, and had established firewalls between the team that was advising the seller on an alternative spin-off transaction and the team responsible for the investment in the buyer. The court noted that the adviser continued to advise the seller on the alternative potential spin-off transaction and had not disclosed that the lead investment banker advising the seller on the spin-off transaction and other options had a $340,000 investment in the buyer; in addition, the second, independent adviser would only have received compensation if the sale (rather than the alternative spin-off transaction) had been completed. Compare In re Micromet Shareholders Litigation, 2012 WL 681785 (Del. Ch. 2012) (finding no material conflict or failure to disclose where the seller's financial adviser held a $336 million stake in the buyer's stock, mostly on behalf of clients). See also M&A Lawyer, Apr. 2012 (discussing implications of El Paso for investment banker sell-side conflicts); Wall St. J., Mar. 16, 2012 (major investment bank reviews of conflict of interest policies for M&A financial advisers); NY Times, Mar. 6, 2012.

(iv) Dodd-Frank included several provisions targeting conflicts of interest. The Volcker Rule (see Part II.A.7 above) requires the federal financial regulators to prohibit certain trading and fund investment and sponsorship activities in which banking entities would otherwise be permitted to engage, if the activities would involve or result in a material conflict of interest between the banking entity and its customers, clients or counterparties. A related provision, codified at 15 U.S.C. § 77z-2a, prohibits material conflicts of interest in securitizations. Dodd-Frank § 919A required the GAO to study conflicts of interest between the staff and analyst functions at investment banks. See Additional Actions Could Improve Regulatory Oversight of Analyst Conflicts of Interest (GAO, Jan. 2012).

(v) Conflict issues relating to board of directors representation are discussed in Part V.A.4.f above.

7. Securities Law Requirements

Providers of corporate finance advisory services must also comply with applicable securities requirements.

a. The extent to which the GLBA Push-out Provisions affect the ability of banks to provide corporate finance services is not entirely clear, particularly given SEC positions set out in Part VII.C.7.b below (although, at a minimum, the De Minimis Exemption should be available). See Part IX.B.3 below.

b. An entity which acts only as a finder, and does not participate in the distribution of securities or share in profits, is not a "broker" or "dealer". Thus, under certain circumstances, the operator of an investor/entrepreneur matching program need not register as a broker-dealer. Whether a person is functioning as a broker (and, therefore, is required to register as such with the SEC), or is functioning as a finder (and, therefore, is not required to so register), is an analysis that must be made based on the facts of each situation.

(i) The 1934 Act defines a "broker" as any person that is "engaged in the business of effecting transactions in securities for the account of others." A person effects transactions if it participates in securities transactions "at key points in the chain of distribution". Such participation includes selecting the market to which a securities transaction will be sent, assisting an issuer to structure securities transactions, helping an issuer identify purchasers, soliciting securities transactions (including advertising), and participating in the order-taking or order-routing process. Factors indicating that a person is "engaged in the business of effecting transactions" include: receiving transaction-related compensation, holding oneself out as a broker, as executing trades, or as assisting others in completing securities transactions, and participating in the securities business with regularity. See, e.g., Social Finance Inc. (avail. Nov. 13, 2014); AngelList LLC (avail. Mar 28, 2013); SEC v. Benger, 697 F. Supp. 2d 932 (N.D. Ill. 2010); DeHuff v. Digital Ally, 2009 WL 4908581 (S.D. Miss. 2009); SEC v. Bravata, 2009 WL 2245649 (E.D. Mich. 2009); Cornhusker Energy Lexington v. Prospect Street Ventures, 2006 WL 2620985 (D. Nev. 2006); SEC v. Martino, 255 F. Supp. 2d 268 (SDNY 2003); Brumberg, Mackey & Wall (avail. May 17, 2010); SEC v. Kenton Capital, 69 F. Supp. 2d 1 (D.D.C. 1998); Environmental Capital Network (avail. Dec. 28, 1995); Mid-Atlantic Investment Network (avail. May 18, 1993); Ruth Quigley (avail. June 13, 1973). See also Part IX below.

(ii) Very generally, entities which are characterized as "finders" occasionally (but not as a regular activity) attempt to bring together buyers and sellers of securities, but do not otherwise engage in securities brokerage activities. After introducing parties to a potential transaction, a finder usually steps away from the transaction and is not otherwise involved.

(iii) "Business brokers" or "M&A brokers" -- a subset of finders -- attempt to initiate or arrange transactions between prospective buyers and sellers of a business. The SEC has granted limited no-action assurance to a subset of brokers "engaged in the business of effecting securities transactions solely in connection with the transfer of ownership and control of a privately-held company…to a buyer that will actively operate the company or the business conducted with the assets of the company." See M&A Brokers (avail. Jan. 31, 2014, revised Feb. 4, 2014) ("M&A Brokers Letter"). However, the debate about M&A Brokers may have been reopened by a 2016 SEC enforcement action against a private equity firm and its principal for failing to register as a broker in connection with acquiring and disposing of portfolio companies. In its press release announcing the action, the SEC stated that it brought the action against the firm for "performing in-house brokerage services rather than using investment banks or broker-dealers to handle the acquisition and disposition of portfolio companies for a pair of private equity funds they advise". The SEC's action focused on the facts that (i) the firm received transaction-based compensation; (ii) disclosed to its investors that it would provide brokerage services for a fee and (iii) solicited deals, identified buyers or sellers, negotiated and structured transactions, arranged financing, and executed transactions in-house. Blackstreet Capital Mgmt., LLC et al. SEC Admin. Proc. No. 3-17267 (June 1, 2016).

Activities which do not require broker-dealer registration are generally limited to circumstances where (A) the broker assumes a limited role in negotiations between the seller and purchaser, without the power to bind either party; (B) the business represented by the broker is a going concern; (C) the company being sold is a "small business" under SBA regulations; (D) if the transaction involves a group of buyers, the broker was not involved in forming the group; (E) the broker never has custody, control or possession or otherwise handles the assets exchanged or securities issued in connection with the transaction; (F) only assets are advertised or offered for sale (even if the transaction ends up involving a sale of securities); (G) if securities rather than assets end up being sold, the transaction does not involve a public offering but involves a conveyance to a single purchaser or group of purchasers formed without the assistance of the broker; (H) the broker does not advise the seller or the purchaser whether to issue securities or otherwise to effect the transfer by means of a securities transaction or assess the value of any securities sold (other than by valuing the underlying assets); (I) the broker's manner of compensation (e.g., hourly or fixed fee, commission or a combination) is determined prior to the decision on how to effect the sale of the business and does not vary depending on the form of the transaction; (J) the broker does not provide financing, either directly or indirectly through any of its affiliates, for the transaction or assist purchasers in obtaining financing other than providing uncompensated introductions to unaffiliated lenders or help with loan-related paperwork; (K) if the broker represents both the buyer and the seller, the broker provides written disclosures to and obtains the written consent of both parties; and (L) the buyers actively operate and control the business upon completion of the transaction. See M&A Brokers Letter; Country Business (avail. Nov. 8, 2006).

(iv) The SEC granted no-action assurance with respect to broker-dealer registration to certain online "funding portals" that perform limited functions for angel investor fundraising and crowdfunding offerings where (A) the platform and its officers, directors and employees do not receive transaction-based compensation for raising investments (though compensation as "carried interest" is permitted), (B) specific terms of any compensation paid to the platform are disclosed to the investors, and (C) the platform generally does not handle customer funds or securities. See, e.g., AngelList LLC (avail. Mar. 28, 2013); FundersClub and FundersClub Management (avail. Mar. 26, 2013). See also Remarks of Chief Counsel, SEC Division of Trading and Markets Blass, Apr. 5, 2013.

(v) In Nemzoff & Co. (avail. Nov. 30, 2010), the SEC declined no-action assurance that a consultant/business broker that receives transaction-based compensation need not register as a broker in connection with providing financial consulting services and assistance to not-for-profit hospitals engaged in joint ventures, mergers and sales, including assisting in the purchase and sale of membership interests and participation in negotiations. See also, e.g., Hallmark Capital (avail. June 11, 2007) (declining no-action assurance that a financial consultant/finder which receives transaction-based compensation need not register as a broker in connection with consulting services and assistance to small business clients with raising capital to meet debt and equity needs (including by identifying broker-dealers) and facilitating mergers and acquisitions); Loofbourrow Assoc. (avail. June 29, 2006) (declining no-action assurance that finder which receives transaction-based compensation need not register as a broker-dealer if its role in securities transactions is limited to the introduction of investment-banking clients to a broker-dealer); BD Advantage (avail. Oct. 11, 2000) (declining no-action assurance that company which would receive transaction-based compensation for (A) soliciting and referring introducing brokers to a clearing broker, and (B) playing a role in selecting the market to which a securities transaction will be sent, need not register as a broker); Oil-N-Gas (avail. June 8, 2000) (declining no-action assurance that operator of website providing investors with information about mining and oil and gas companies need not register as a broker); Transfer Online (avail. May 13, 2000) (declining no-action assurance that online service provider need not register as a broker); MuniAuction (avail. Mar. 13, 2000) (declining no-action assurance that website operator that runs a securities auction site, assists in structuring transactions, identifies potential purchasers, and solicits transactions (including by advertising and participating in order-taking or order-routing) need not register as a broker); Dominion Resources (avail. Mar. 7, 2000) (withdrawing no-action letter that exempted from broker-dealer registration a finder which assisted issuers in structuring and issuing securities); Davenport Management (avail. Apr. 13, 1993) (declining no-action assurance for finder which would (A) act as an intermediary in securities transactions, (B) negotiate or provide advice, (C) receive compensation tied to securities transactions, (D) provide "investment banking services" to an affiliated entity, and (E) have direct contact in finding co-investors and purchasers, need not register as a broker-dealer). But see, e.g. Paul Anka (avail. July 24, 1991) (no-action assurance with respect to limited finder activities); John DiMeno (avail. Apr. 1, 1979) (to similar effect);

Moana/Kauai Corp. (avail Aug. 10, 1974) (to similar effect).

(vi) Courts have identified a limited finder's exception for broker-dealer registration that permits a person or entity to perform a narrow scope of activities without triggering broker registration requirements, even if the person or entity receives transaction-based compensation for its activities. See, e.g., SEC v. Kramer, 778 F. Supp. 2d 1320 (M.D. Fla. 2011) (a person who received transaction-based compensation for (A) introducing a potential investor to a company, and (B) reporting on purchases of the company's stock by other investors, was not acting as a broker); SEC v. M&A West, 2005 WL 1514101 (N.D. Cal. 2005) (a person who facilitated reverse mergers by identifying public shell companies, coordinating the parties and preparing the necessary documents, was not engaged in broker activities even though he facilitated securities transactions and received transaction-based compensation), aff'd on other grounds, 538 F.3d 1043 (9th Cir. 2008). See also, e.g., Apex Global Partners v. Kaye/Bassman Intern. Corp., 2009 WL 2777869 (N.D. Tex. 2009); Salamon v. Teleplus Enterprises, 2008 WL 2277094 (D.N.J. 2008); Salamon v. CirTran Corp., 2005 WL 3132343 (D. Utah 2005).

(vii) FINRA has re-proposed a special rule set for firms that meet the definition of "capital acquisition broker" ("CAB") -- i.e., firms that engage in a limited range of activities advising companies and private equity funds on capital raising and corporate restructuring, and acting as placement agents for sales of unregistered securities to institutional investors in limited circumstances. 80 Fed. Reg. 79969 (Dec. 23, 2015). Under the proposed rule, firms that meet the definition could elect to change their status and become subject to the proposed rule set. To qualify as a CAB a firm must engage only in the following activities: (A) advising an issuer, including a private fund, concerning its securities offerings or other capital raising activities; (B) advising a company regarding its selection of an investment banker or its purchase or sale of a business or assets or regarding its corporate restructuring, including a going-private transaction, divestiture or merger; (C) advising a company regarding its selection of an investment banker; (D) assisting in the preparation of offering materials on behalf of an issuer; (E) providing fairness opinions, valuation services, negotiation and structuring services, etc.; (F) qualifying, identifying or soliciting potential institutional investors; and (G) effecting M&A transactions only in accordance with the M&A Brokers letter. A firm that (A) carries or maintains customer accounts; (B) holds or handles customers' funds or securities; (C) accepts orders from customers to purchase or sell securities either as principal or as agent for the customer; (D) possesses investment discretion on behalf of any customer; (E) engages in proprietary trading of securities or market-making activities or (F) participates in or maintains an online platform in connection with offerings of unregistered securities pursuant to Regulation Crowdfunding (17 CFR Parts 200, 227, 232, et al.) or Regulation A under the 1933 Act would not qualify as a CAB.

c. In general, absent an applicable exemption or no-action assurance, a non-bank may not, without registering as a broker: (i) assist in the preparation of transaction documents; (ii) advise a purchaser as to the value of securities (or otherwise recommend securities purchases or sales); (iii) participate in negotiations; (iv) assist in the formulation of offers; (v) receive contingency fees; or (vi) receive transaction-based compensation for fund-sourcing. See, e.g., Remarks of SEC Chief Counsel, Division of Trading and Markets, David W. Blass, April 5, 2013 (suggesting private fund advisers that receive transaction-based compensation could be required to register as brokers); Brumberg, Mackey & Wall PLC (avail. May 17, 2010); Victoria Bancroft (avail. Aug. 9, 1987); Int'l Business Exchange Corp. (avail. Dec. 12, 1986); Russell R. Miller & Co., Inc. (avail. June 17, 1977); M. Bantuveris (avail. Oct. 23, 1975); May-Pac Management Co. (avail. Dec. 20, 1973); Fulham & Co. (avail. Dec. 20, 1972).

d. A bank's involvement in M&A transactions could also raise a question as to whether the bank may have special responsibilities under the 1934 Act. The SEC's Division of Corporation Finance stated that the role played by a bank in initiating, structuring and negotiating a tender offer (in particular, the provision of financing or the assumption of a primary role in obtaining financing) may result in the bank being deemed a "bidder". See Current Issues and Rulemaking Projects (SEC, Nov. 14, 2000). See also, e.g., MAI Basic Four v. Prime Computer, 871 F.2d 212 (1st Cir. 1989) (adviser-broker-financer-participant that owns a significant minority interest in the surviving entity is a "bidder" where there has been a history of association between the acquiror and the adviser, the transaction involves equity sharing and adviser board representation, and the adviser has been involved in the offer and may become a major creditor in connection with the offer); Koppers (multiple roles of investment bank in the Beazer/Koppers transaction (adviser, underwriter, 46% equity partner, financier, broker-dealer) and investment bank representation on the board of directors of the surviving company led to the conclusion that the investment bank was a tender offer bidder, "central to the offer", a "major equity participant", and "one of the entities on whose behalf the . . . offer was made"). But see, e.g., City Capital Associates v. Interco, 860 F.2d 60 (3d Cir. 1988) (minority shareholders/financial advisers of acquisition vehicle were not 1934 Act "bidders").

8. Fairness Opinions and Related Disclosure Issues

Care must be taken as to how the role of the investment banker is characterized (e.g., "exclusive financial adviser", etc.), and whether any implicit duties arising from an investment banking engagement are specifically negated (e.g., that the investment bank is not a "fiduciary" or an "agent"; that its duties are only those specifically set out).

a. The SEC Division of Corporation Finance objected to financial adviser disclaimers in proxy statements and other SEC filings regarding the right of shareholders to rely on a fairness opinion that the adviser has furnished to the board of directors, a special committee of the board or the issuer. See, e.g., Current Issues and Rulemaking Projects (SEC, Nov. 14, 2000). To address these concerns, an adviser sometimes inserts a disclaimer to the effect that (i) its advisory services are provided to the board for its evaluation of a proposed transaction, and are not intended to constitute a recommendation to shareholders; (ii) it has assumed the accuracy of management's projections and financial statements; and (iii) it may have potential conflicts of interest relating to a fairness opinion assignment (e.g., the success fee structure of the M&A transaction and the performance by the adviser of work for one company and/or work for the other company involved in the M&A transaction). See, e.g., Duff & Phelps, Fairness Opinion Insight (Feb. 2009): Klingsberg, "How Fair Are Fairness Opinions?", M&A Journal, Dec. 2004.

b. FINRA Rule 5150 addresses disclosures and procedures concerning the issuance of fairness opinions. The Rule requires broker-dealers to (i) include certain disclosures in fairness opinions to the extent the broker-dealer knows or has reason to know that the opinion will be provided to the company's shareholders, and (ii) establish and follow certain procedures in issuing fairness opinions. The Rule is intended to strengthen disclosure about potential conflicts of interest between the firm rendering the opinion and the issuer, including fees that the firm will receive upon the successful completion of the transaction and other material relationships. See FINRA Regulatory Notices 08-57 (Dec. 2008); 07-54 (Nov. 2007). In March 2012, the International Valuation Standards Council Professional Board published draft guidelines for preparing fairness opinions. See International Valuation Standards Council, Exposure Draft: Procedural Guidelines for Fairness Opinions (Mar. 2012). After reviewing the comments on the draft guidelines, the Professional Board concluded that any guidelines would have minimal benefit in practice, as they would be frequently overridden by local law, and agreed to suspend the project. See Minutes of the International Valuation Standards Council Professional Board, dated Mar. 6, 2013. See also, e.g., Letter from Rep. Markey to SEC Chairman Donaldson, June 6, 2005 (requesting information about fairness opinion conflicts of interest); SEC Response Letter, June 30, 2005 (noting that the SEC has not taken a formal position with respect to the conflicts of interest inherent in such arrangements).

c. Herskowitz v. Nutri/System, 857 F.2d 179 (3d Cir. 1988), cert. denied, 489 U.S. 1054 (1989), held that a bank could be liable to a company's shareholder for a negligently-issued fairness opinion. See also, e.g., Schneider v. Lazard Frères, No. 06905/89 Slip Op. (N.Y. Sup. Ct., Aug. 16, 1989), modified on other grounds, 552 N.Y.S. 2d 571 (1st Dept. 1990) ("Schneider") (former RJR Nabisco shareholders, in alleging that Lazard had negligently advised a special committee of RJR's board of directors on the fairness of a bid, had stated a claim for negligence against Lazard based on the theory that the special committee acts as an agent for the shareholders). Compare, e.g., Young v. Goldman Sachs, No. 08 CH 28542 (Ill. Ch., Jan. 13, 2009) (applying NY law to limit Schneider to situations where an adviser has been engaged by a special committee established to advise shareholders); Collins v. Morgan Stanley, 224 F.3d 496 (5th Cir. 2000), affirming 60 F. Supp. 2d 614 (S.D. Tx. 1999) (dismissing claims by optionholders for breach of contract, negligence, fraud and breach of fiduciary duty against investment bank which had given an opinion on merger with a company that later disclosed financial reporting irregularities; "[s]imply put, [the optionholders] were not in privity of contract" with the investment bank); Stuchen v. Duty Free International, 1996 Del. Super. LEXIS 187 (Apr. 22, 1996) (shareholders of two companies which had separately retained Goldman Sachs to search for purchasers (and which eventually merged) were not third-party beneficiaries of the agreement with Goldman Sachs and lacked standing to allege negligent performance; claims of statutory and common law fraud dismissed; misrepresentation claims based on alleged Goldman Sachs representations to shareholders retained); Meyer v. Goldman Sachs, No. 95/101735 Slip Op. (N.Y. Sup. Ct., Oct. 26, 1995), aff'd, 651 N.Y.S. 2d 304 (1st Dept. 1996), (rejecting Centel shareholder claim that Goldman Sachs had negligently advised Centel's non-management directors to conduct an auction and had conducted the auction negligently; shareholder claims limited to where a special committee was formed to advise shareholders); In re Shoe-Town Stockholders Litigation, 1990 Del. Ch. LEXIS 14 (Feb. 12, 1990) (investment bank retained by management in connection with "freeze out" transaction owed no duty to minority shareholders, but could be held liable for aiding and abetting directors' breach of fiduciary duty); Kitchens v. U.S.

Shelter, CCH Fed. Sec. L. Rep. ¶ 93-920 (D.S.C. 1988) (investment bank sued by shareholders of merging company, who were not shareholders of the investment bank's client, alleging that they had been fraudulently induced to accept an exchange offer; investment bank which issued fairness opinion found to be an expert under the 1933 Act, but only with respect to any material misstatement in the opinion).

d. Court decisions have held that investment banks may rely on the language of their engagement letters and explicit disclaimers in their fairness opinions when providing advisory services and rendering fairness opinions to boards of directors. Investment banks have no duty to update fairness opinions nor must they verify the financial projections provided by management that were relied upon in rendering a fairness opinion. An investment bank does not owe a seller's shareholders any extra-contractual fiduciary duties. See, e.g., Joyce v. Morgan Stanley, 538 F.3d 797 (7th Cir. 2008) (due to disclaimer in the fairness opinion, investment bank did not owe a fiduciary duty to the company's shareholders (including to advise them as to potential hedging strategies) and could not be liable to them for its services as the board's financial adviser); HA2003 Liquidating Trust v. Credit Suisse Securities 517 F.3d 454 (7th Cir. 2008) (rejecting the creditor Liquidating Trust's claim that defendant Credit Suisse was grossly negligent for (i) failing to withdraw or update its fairness opinion after the market began to decline, and (ii) relying on financial projections provided by management as opposed to projections prepared by an independent auditor which had told management that its projections were unrealistic).

e. Investment banks and their clients should consider the following points when negotiating fairness opinion language:

(i) Explicitly identify the services being provided.

(ii) Specifically identify to whom the services are being provided as well as any other intended beneficiaries of the services, and also specifically state who are not beneficiaries of the services.

(iii) State the relationship between the investment bank and client and disclaim any fiduciary duties to the client or any of its constituents.

(iv) Set forth any potential conflicts of interests and waivers of those conflicts.

(v) Identify and agree on the materials on which the investment bank will rely and the material assumptions to be used in preparing a fairness opinion (including whether the financial adviser agrees with management's projections).

(vi) Explicitly provide that the fairness opinion is not a valuation or appraisal and is not a solvency opinion.

9. <u>Duties and Potential Liability</u>

Claims have also been made against investment banks alleging that they have breached a duty to their clients.

a. <u>Baker v. Goldman Sachs</u>, No. 13-2173 (1st Cir. 2014), affirmed the decision by the district court that Goldman Sachs could not be held liable under the Massachusetts Unfair Trade Practices Act in connection with advice Goldman Sachs provided to its client Dragon Systems Inc. ("<u>Dragon</u>") with respect to its merger with Lernout & Hauspie Speech Products N.V. ("<u>L&H</u>") because Goldman Sachs did not engage in unfair or deceptive conduct. Shortly after the merger, it emerged that L&H had misstated its earnings, and L&H went into bankruptcy. Dragon's name and technology were ultimately sold from L&H's bankruptcy estate. According to the district court, Goldman Sachs may have provided negligent advice by (1) failing to disclose that no one at Goldman Sachs was covering L&H at the time of the merger; (2) failing to reiterate Goldman Sachs's due diligence concerns more than once; and (3) not adequately analyzing L&H's revenues. However, the court held that the conduct was not egregious enough to warrant relief under the Massachusetts Unfair Trade Practices Act.

b. Ha-Lo Industries v. Credit Suisse, 2005 U.S. Dist. LEXIS 23505 (N.D. Ill. 2005), held that, under NY law, a company may bring a claim against its M&A adviser for grossly negligent performance of a service contract or breach of the common law duty (independent of the contract itself) that the adviser exercise reasonable care and skill; notwithstanding a disclaimer in the engagement letter that the adviser has no fiduciary duty to the company, such a duty may arise out of a long-term relationship. See also, e.g., In re Daisy Systems, 1994 U.S. Dist. LEXIS 11679 (N.D. Cal. 1998) (jury verdict against Bear Stearns for negligent advice; verdict followed decision (97 F.3d 1171 (9th Cir. 1996)) to the effect that an adviser's duties may go beyond the terms of an engagement letter and could be fiduciary in nature); Lennon v. First Boston Corp., NYSE Docket No. 1993-003434 (July 25, 1994) (damages with respect to merger fairness opinion); Wall St. J., Feb. 12, 1999 (allegations of potential conflicts of interest in respect of multiple Chase advisory/lending/syndication roles). See generally, e.g., Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261 (Del. 1989).

c. EBC v. Goldman Sachs, 5 N.Y.3d 11 (N.Y. 2005), held that the relationship between an issuer and an underwriter could be more than an arm's-length commercial purchase/sale relationship; rather, if the underwriter acts as adviser to an issuer with respect to the pricing of an offering, and the underwriter's practice is to act as an expert on market conditions, a fiduciary duty may exist, which could require the underwriter to disclose to the issuer any material conflicts of interest (in the IPO at issue, alleged undisclosed profit-sharing arrangements between the underwriter and customers in connection with customer resale of securities). The Court left open the question of whether an adviser or underwriter may be treated as a "professional" for purposes of a claim of "professional malpractice" (i.e., negligently failing to exercise a particular level of skill). After discovery, Goldman Sachs obtained summary judgment from the state trial court, which dismissed the case in 2010; on appeal, the Appellate Division affirmed the dismissal, holding that Goldman Sachs had not assumed a fiduciary duty to the issuer. EBC v. Goldman Sachs, 936 N.Y.S.2d 92 (N.Y. App. Div. 2011).

An underwriter may seek to protect itself against an issuer's claim of breach of fiduciary duty by (i) affirming the arm's-length commercial nature of the transaction (including the determination of the public offering price and related discounts and commissions); (ii) disclaiming any fiduciary duties to the issuer, the issuer's creditors, employees or any other person; and (iii) disclosing that the underwriter and its affiliates may be engaged in other transactions involving conflicts of interest. If these provisions are only contained in the underwriting agreement, however, they might not immunize the underwriter from a claim that the fiduciary duty arose outside the agreement, or from an argument that the disclaimer is ineffective because it was secured by breach of an existing fiduciary duty. Accordingly, consideration should be given to including these provisions in an engagement letter that is signed at the outset and governs the full range of the parties' relationship, making clear prospectively that the underwriter will not assume fiduciary duties.

d. Deutsche Asset Management, SEC Admin. Proc. No. 3-11226 (Aug. 19, 2003) ("Deutsche AM"), charged Deutsche Asset Management for failing to disclose a material conflict of interest in voting client proxies for the 2002 Hewlett-Packard-Compaq Computer merger. The SEC found that advisory clients did not know that Deutsche Bank's investment banking division was working for Hewlett-Packard and had intervened in Deutsche Asset Management's proxy voting process. This created a conflict of interest for Deutsche Asset Management, which had a fiduciary duty to act solely in the best interests of its clients; Deutsche Asset Management violated this duty by voting Hewlett-Packard proxies without first disclosing the conflict.

e. FleetBoston v. Innovex, 172 F. Supp. 2d 1190 (D. Minn. 2001), held that a merged company must pay the investment banking fee that its acquisition target agreed to because claims that the fee was exorbitant and that the investment bank did not introduce the buyer to the seller did not override the contract's terms.

f. Dime Bancorp v. Smith Barney, 2000 N.Y. Misc. LEXIS 94 (Sup. Ct. N.Y. Apr. 6, 2000), enjoined Smith Barney from acting as financial adviser to North Fork Bancorp in its hostile bid for

Dime and held that a pre-existing confidentiality agreement barred Smith Barney from acting as North Fork's adviser. (Smith Barney's appeal was rendered moot by North Fork's decision to engage another adviser.)

g. In a suit against a subsidiary of Citigroup, HBO alleged breach of a duty to maintain the confidentiality of a proposed merger between HBO and McKesson Corp. which "directly caused the decline in value of HBO stock price, and killed the merger." See HBO v. Smith Barney, 98-VS-0148206 (Fulton Co., Ga., filed Oct. 7, 1998) (dismissed without prejudice, June 7, 1999).

h. ADT v. Chase Bank, 662 N.Y.S. 2d 190 (1st Dept. 1997), held that a fiduciary relationship is not created by the "mere communication of confidential information from a customer to the bank" and that the Bank did not violate fiduciary and contractual obligations to ADT (a borrower) in advising Western Resources on Western's hostile bid for ADT and in offering to fund such offer; however, communication of confidential information to the bidder could constitute a breach of fiduciary duty. Compare generally, e.g., Wiener v. Lazard Frères, 672 N.Y.S. 2d 8 (1st Dept. 1998) (investment bank could have fiduciary duty to client based on written commitment to provide financing, which could be breached by delivery of confidential information to a third party).

i. Chase Bank v. Remington Products, 865 F. Supp. 194 (SDNY 1994), aff'd, 71 F.3d 407 (2d Cir. 1995), held that the Bank, which agreed to help Remington obtain refinancing, was entitled to its fee once it provided contracted-for advisory services; no fiduciary duty arose from agreement, and even if the Bank violated the Anti-tying Statute by allegedly conditioning personal loan to Remington's principal on Remington obtaining services of Bank's M&A department, BHCA would not be defense to claim for fees). See also, e.g., Brandt v. Hicks, Muse & Co., 213 Bankr. 784 (D. Mass. 1997) (rejecting bankruptcy trustee's allegations that Lazard Frères, as the "exclusive financial adviser" of Healthco, had aided and abetted a breach of duty by Healthco's directors, had been grossly negligent, had acted in bad faith and had breached its contract with Healthco; Lazard did not have fiduciary duties and it was only obligated to perform services contracted for); Lama Holding v. Shearman & Sterling, 758 F. Supp. 159 (SDNY 1991) (BTCo, which had been retained as "exclusive agent, financial adviser and sales representative" for disposition of investment, was not liable for negligent misrepresentation, breach of fiduciary duty or breach of contract based on its alleged failure to alert investors to change in tax law; investors had negotiated and committed to sale and had not consulted BTCo until transaction was complete).

D. DEALER-MANAGER ACTIVITIES

1. FHCs and financial subsidiaries may act as dealer-manager in any type of tender or exchange offer.

2. A bank/BHC should be able to serve as a dealer-manager for all-cash stock tender offers in connection with acquisitions of public companies ("Stock Tenders") as well as in connection with debt tender offers and solicitations of consents with respect to debt covenant modification ("Debt Tenders") -- subject (in the case of a bank) to compliance as applicable with the GLBA Push-out Provisions (see Part IX.B.3 below). See, e.g., Chemical, 80 Fed. Res. Bull 49 (1994); Republic Section 20 Order; Fuji M&A Order (approving Application which stated that "dealer-manager services in connection with tender offer transactions [are] incident to its financial advisory function"); Royal Scotland Order (approving Application to similar effect).

   However, the Board has stated that dealer-manager activities in connection with Stock Tenders (and, presumably, Debt Tenders) which are exchange offers are only permitted for entities with underwriting authority, since exchange offers may entail the public sale of securities. See, e.g., Chemical 80 Fed. Res. Bull 49 (1994); Republic Section 20 Order. It is not clear whether such a conclusion is mandated by Glass-Steagall, nor whether the Comptroller would reach the same conclusion.

VIII. ANTI-MONEY LAUNDERING; FUND MANAGEMENT, MUTUAL FUND AND RELATED SERVICES

A. ANTI-MONEY LAUNDERING, ANTI-TERRORIST FINANCING, FOREIGN CORRUPT PRACTICES AND ECONOMIC SANCTIONS

1. Money Laundering - Background

a. Money laundering is the criminal practice of disguising illegal gains through a series of transactions so that they appear to be proceeds from legal activities. It involves (i) "placement" (i.e., introduction of unlawful proceeds into the financial system, such as by structuring currency deposits in amounts to evade reporting requirements or commingling currency deposits of legal and illegal enterprises); (ii) "layering" (i.e., moving funds around the financial system to conceal the origin of the funds, often through multiple accounts and jurisdictions); and (iii) "integration" (i.e., return of the funds to the money launderer as what appear to be legitimate funds).

AML issues pervade banking operations, and have a particular impact on private banking, asset management and related activities.

b. Estimates suggest that more than $1.5 trillion is laundered worldwide annually by drug dealers, arms traffickers and other criminals, and that money laundering comprises between 2% and 4% of global Gross Domestic Product. See, e.g., "Trade-based Money Laundering: Ever-increasing Threat with Little Regulation", 29 J. Int'l Banking L. & Reg. 665 (2014); How to Clean up the Dirty Business of Money Laundering (European Parliament, Nov. 14, 2012); Estimating Illicit Financial Flows Resulting From Drug Trafficking and Other Transnational Organized Crimes (UN Office on Drugs and Crime, Oct. 2011).

c. The introduction of large amounts of illicit funds into a financial system contributes to public corruption, economic destabilization and weakening of the rule of law. See generally, e.g. National Laundering Risk Assessment (Treasury, June 2015); Kroll 2013/2014 Global Fraud Report; Specific Risk Factors in Laundering the Proceeds of Corruption (FATF, June 2012); International Narcotics Control Strategy Report: Money Laundering and Financial Crimes (Dept. of State, Mar. 2012).

d. The cost to banks of detecting and preventing money laundering, and complying with AML program and SAR and other requirements, continues to rise. See, e.g., FIN-2014-A007 (Aug. 11, 2014) (Advisory to U.S. Financial Institutions on Promoting a Culture of Compliance); What's New in the World of AML? (Association of Certified [AML] Specialists, May 15, 2012); Practical Suggestions and Tips for an Effective BSA/AML Compliance Function -- Risk Assessment and Transaction Monitoring (Deloitte, May 15, 2012); Global [AML] Survey: How Banks Are Facing up to the Challenge (KPMG, 2011) (the "KPMG 2011 AML Survey").

2. U.S. Regulatory Framework

In addition to criminal AML statutes (see 18 U.S.C. §§ 1956, 1957), U.S. financial institutions are subject to a highly developed AML regulatory regime.

a. Bank Secrecy Act

The BSA, codified at 12 U.S.C. §§ 1829b, 1951-1959 and 31 U.S.C. §§ 5311-5322, was adopted in 1970 as a framework for detecting and preventing money laundering. The BSA is intended to prevent financial institutions from being used as intermediaries for the transfer or deposit of money derived from criminal activity and to provide a paper trail for law enforcement agencies in their investigations.

b. Administration and Supervision

(i) The BSA and the PATRIOT Act are administered and enforced by Treasury through FinCEN and by federal functional regulators, including the banking agencies and the SEC. See 75 Fed. Reg. 65806 (Oct. 26, 2010) (transferring the BSA regulations administered by FinCEN from 31 C.F.R. Part 103 to 31 C.F.R. Chapter X).

(ii) FinCEN is a bureau of Treasury with the mission of safeguarding the U.S. financial system from financial crime. See generally FinCEN Strategic Plan (2012-2016); FinCEN Annual Reports. See also Mutual Evaluation Report on [AML] and Combating the Financing of Terrorism: [U.S.] (FATF, June 23, 2006) (the "FATF U.S. Evaluation").

(iii) FinCEN has entered into information-sharing agreements with numerous federal and state supervisory agencies that examine for AML compliance. See, e.g., Better Communication Could Enhance the Support FinCEN Provides to Law Enforcement (GAO, Apr. 2010); FinCEN/SEC MOU, dated Dec. 21, 2006; FinCEN/Board/OCC/FDIC/OTS/NCUA MOU, dated Oct. 1, 2004. See generally CFTC Press Release, Jan. 16, 2009 (CFTC/FinCEN information-sharing agreement); [BSA]: Federal Agencies Should Take Action to Further Improve Coordination and Information-sharing Efforts (GAO, Feb. 2009) ("2009 GAO BSA Report"); CSBS Model Information-sharing Agreement.

(iv) The Board/SEC 2008 MOU enhances information-sharing and cooperation in a number of areas, including AML.

(v) The IRS has signed MOUs with state banking agencies to share information concerning money services businesses ("MSBs") and other non-bank financial institutions. See generally [BSA]: FinCEN and IRS Need to Improve and Better Coordinate Compliance and Data Management Efforts (GAO, Dec. 2006).

(vi) The first interagency [BSA/AML] Examination Manual (the "BSA Exam Manual") was released in 2005 and updated most recently in 2014. The BSA Exam Manual:

Provides guidance regarding (A) BSA/AML compliance program assessments, (B) customer identification programs ("CIPs"), (C) due diligence, (D) SARs, (E) CTRs, (F) information sharing, (G) purchase and sale of monetary instruments recordkeeping, (H) funds transfers recordkeeping, (I) foreign correspondent account recordkeeping and reporting, (J) foreign bank and financial accounts reporting, (K) reporting of international transportation of currency and monetary instruments, and (L) OFAC compliance. It also addresses "red flags" for SARs and enforcement guidance. See generally BSA Exam Manual (FFIEC, Dec. 2, 2014). See also American Banker, May 4, 2015.

A) Provides specific guidance regarding certain products and services, including: private banking and trust/asset management services.

B) Identifies the customers and entities banks must focus on, particularly:

i) Foreign financial institutions, including banks and foreign money service providers (e.g., casas de cambio, exchange houses, money transmitters and bureaux de change).

ii) Non-bank financial institutions and non-traditional financial entities, including MSBs, casinos, broker-dealers and dealers in precious metals and jewels.

iii) Senior foreign political figures and their family members and associates (including embassy and foreign consulate personnel).

iv) Non-resident aliens and foreign individuals.

v) Foreign corporations (particularly if from high-risk geographic locations).

vi) Deposit brokers (particularly foreign).

vii) Cash-intensive businesses.

viii) Non-governmental organizations and charities (foreign and domestic).

ix) Professional service providers (e.g., attorneys, accountants, doctors, real estate brokers).

C) Identifies high risk geographic areas banks must focus on.

c. Adoption of the USA PATRIOT Act

(i) Title III of the PATRIOT Act, the IMLA, expanded AML and anti-terrorist financing laws and extended their scope to many non-bank financial institutions. It also expanded the extraterritorial reach of U.S. AML laws. See Parts VIII.A.2.g,l and m below.

(ii) On June 2, 2015, President Obama signed the USA FREEDOM Act, Pub. L. 114-23 (2015), which extended for four years certain expiring provisions.

d. AML Program Requirements

(i) PATRIOT Act § 352 amended the BSA (31 U.S.C. § 5318(h)) to require all "financial institutions" to establish AML programs. The BSA defines "financial institution" broadly to include not only banks but also other businesses that might be potential vehicles for money laundering, such as broker-dealers, insurance companies, FCMs, CTAs, CPOs, money transmitters, finance companies, currency exchangers, travel agencies, casinos, and automobile, plane and boat dealers. See 31 U.S.C. § 5312.

(ii) AML programs must be approved by an institution's board of directors and include (A) internal policies, procedures (including testing procedures) and controls at all levels (including corporate, compliance, internal audit and business unit); (B) designation of a compliance officer; (C) employee training program; and (D) independent audit. See 12 C.F.R. §§ 21.21 (OCC), 208.63 (Board), 326.8 (FDIC).

See generally BSA Exam Manual; Sound Management of Risks Related to Money Laundering and Financing of Terrorism (Basel, Jan. 2014); Wolfsberg [AML] Questionnaire (2014); Wolfsberg Guidance on Mobile and Internet Payment Services (2014); The Buck Stops Here: Improving U.S. [AML] Practices (Senate Caucus on Int'l Narcotics Control, Apr. 2013); FDIC FIL-38-2008 (May 16, 2008) (Provision for Independent Testing for BSA/AML Compliance); FinCEN Answers to Frequently Asked [BSA] Questions; Guide to U.S. [AML] Requirements (Protiviti, 2010).

(iii) Board rules require Edge Act and Agreement corporations and U.S. branches, agencies and representative offices of foreign banks to have AML programs. 71 Fed. Reg. 13934 (Mar. 20, 2006) (12 C.F.R. §§ 211.5(m)(1), 211.24(j)(1)).

(iv) U.S. banks, U.S. offices of non-U.S. banks, and their U.S. affiliates have long maintained AML programs. For banking organizations, the PATRIOT Act requirement codified existing practice. See 67 Fed. Reg. 21110 (Apr. 29, 2002) (31 C.F.R. § 1020.210).

(v) Non-banks historically had less developed AML controls and compliance programs. The PATRIOT Act granted the Treasury Secretary authority to issue regulations and exempt institutions. See PATRIOT Act § 313, 31 U.S.C. § 5318(j).

A) Non-bank financial institutions currently required (31 C.F.R. § 1010.200) to have AML programs include:

i) Mutual funds. See 67 Fed. Reg. 21117 (Apr. 29, 2002) (31 C.F.R. § 1024.210). See [AML] Source Tool for Mutual Funds (SEC, July 2, 2012). See also 75 Fed. Reg. 19241 (Apr. 14, 2010) (adding mutual funds to the definition of "financial institution" in BSA rules (31 C.F.R. § 1010.100(t)); Mutual Funds: Assessing the Impact of Amendments to the Regulations Defining Mutual Funds as Financial Institutions (FinCEN, Dec. 2011).

ii) SEC-registered broker-dealers, CFTC-registered FCMs and certain IBs. See 67 Fed. Reg. 21110 (Apr. 29, 2002); 68 Fed. Reg. 25148 (May 9, 2003); SEC Releases No. 34-60645 (Sept. 15, 2009) (adopting FINRA Rule 3310); No. 34-48169 (July 11, 2003) (MSRB Rule G-41 establishing AML requirements for municipal securities dealers).

The most common AML deficiencies at broker-dealers include inadequate policies and procedures and internal controls, independent testing, suspicious activity reporting, and CIP procedures. AML examinations have recently focused on: (a) how a firm considers its enterprise-wide functions and risks, including branch offices and foreign business relationships; (b) the impact of new business acquisitions and outsourced activities on AML compliance; (c) relationships with foreign financial institutions; (d) firms offering foreign customers direct access to U.S. markets; (e) broker-dealer reliance on investment advisers' CIPs; and (f) AML training. See, e.g., Remarks of SEC OCIE

Associate National Director Goodman, June 18, 2015; Remarks of SEC OCIE Director di Flori, Mar. 3, 2011; 2009 GAO BSA Report.

See also, e.g., CFTC Docket No. 14-25 (Sept. 15, 2014) (settlement for improper supervision and records violations related to CIP procedures), Broker/Dealer Compliance Report, Aug. 7, 2013; [AML] Source Tool for Broker-dealers (SEC, June 20, 2012) (compilation of AML laws, rules and guidance applicable to broker-dealers); [AML FAQs] (FINRA, 2011); 2008 Guidance for Deterring Money Laundering and Terrorist Financing Activity (SIFMA, Feb. 2008); NASD Notice to Members 02-21 (Apr. 2002) (AML Guidance); CFTC Press Release No. 4712-02 (Oct. 10, 2002) ("CFTC Release No. 4712-02") (addition to CFTC Internet website to assist in BSA compliance).

In 2016, FinCEN proposed to amend the definition of broker-dealer for purposes of the AML program requirement to include funding portals, in line with changes made by the JOBS Act. See 81 Fed. Reg. 19086 (Apr. 4, 2016).

iii) Operators of credit card systems. See 67 Fed. Reg. 21121 (Apr. 29, 2002) (31 C.F.R. Part 1028).

iv) MSBs; e.g., money transmitters, check cashers, issuers or redeemers of travelers' checks or money orders, and currency exchanges. See 76 Fed. Reg. 45403 (July 29, 2011) (final rule regarding stored value and prepaid access cards) (31 C.F.R. Parts 1020 and 1022); 76 Fed. Reg. 43585 (July 21, 2011) (final rule clarifying definition of MSB re non-U.S. MSBs doing business in the U.S.) (31 C.F.R. Parts 1010, 1021 and 1022); 67 Fed. Reg. 21114 (Apr. 29, 2002) (31 C.F.R. § 1022.210); [BSA/AML] Examination Manual for [MSBs] (2008) and [BSA/AML] Examination Work Program for [MSBs] (2008). See also FIN-2016-G001 (Mar. 11, 2016) (Guidance on Existing AML Program Rule Compliance Obligations for MSP Principals with Respect to Agent Monitoring); FIN-2014-R010 (Sept. 24, 2014) (Administrative Ruling on the Application of FinCEN Regulations to Currency Transporters, Including Armored Car Services, and Exemptive Relief).

v) Non-bank residential mortgage lenders and originators. See 77 Fed. Reg. 8148 (Feb. 14, 2012). See also FIN-2012-R005 (Aug. 13, 2012) (Compliance Obligations of Certain Loan or Finance Company Subsidiaries of Federally Regulated Banks and Other Financial Institutions).

vi) Dealers in precious stones or jewels. See 70 Fed. Reg. 33702 (June 9, 2005) (interim final rule (31 C.F.R. §§ 1027.100, 1027.210) and FAQs; solicitation of public comments). See also FIN-2015-R001 (Aug. 14, 2015) (Application of FinCEN's Regulations to Persons Issuing Physical or Digital Negotiable Certificates of Ownership of Precious Metals); FIN-2012-R002 (May 25, 2011) (Definition of Precious Metals in the Interim Final Rule Requiring [AML] Programs for Dealers in Precious Metals, Stones, or Jewels); FIN-2008-G003 (Mar. 10, 2008) (Guidance for Dealers, Including Certain Retailers, of Precious Metals, Precious Stones, or Jewels, on Conducting a Risk Assessment of Their Foreign Suppliers).

vii) Insurance companies. See 70 Fed. Reg. 66754 (Nov. 3, 2005) (31 C.F.R. §§ 1025.100, 1025.210); FIN-2008-G004 (Mar. 20, 2008), FIN-2006-G010 (May 31, 2006) (AML Program and SAR Reporting Requirements for Insurance Companies); 67 Fed. Reg. 60625 (Sept. 26, 2002) (initial proposal/solicitation of public comments) (identifying "red flags" that could make an insurance transaction suspicious).

viii) Casinos. See 67 Fed Reg. 21110 (Apr. 29, 2002).

ix) Fannie Mae, Freddie Mac and the FHLBs. (see 79 Fed. Reg. 10365 (Feb. 25, 2014)).

B) Treasury has issued (and in some cases withdrawn) proposals to require the following institutions to develop and implement AML programs:

i) CTAs (see 68 Fed. Reg. 23640 (May 5, 2003) (solicitation of public comments), withdrawn 73 Fed. Reg. 65567 (Nov. 4, 2008), and CFTC Release No. 4712-02 (Oct. 10, 2002)).

ii) Investment advisers (see 80 Fed. Reg. 52680 (Sept. 1, 2015) (notice of proposed rulemaking)).

iii) Persons involved in real estate closings and settlements (see 68 Fed. Reg. 17569 (Apr. 10, 2003) (solicitation of public comments)).

iv) Travel agencies (see 68 Fed. Reg. 8571 (Feb. 24, 2003) (solicitation of public comments)).

v) Automobile/airplane/ boat sellers (see 68 Fed. Reg. 8568 (Feb. 24, 2003) (solicitation of public comments)).

vi) Unregistered investment companies (hedge funds), REITs and commodity pools (including non-U.S. entities that are organized, operated or sponsored by a U.S. person, or that sell ownership interests to U.S. persons) (see 67 Fed. Reg. 60617 (Sept. 26, 2002) (solicitation of public comments), withdrawn 73 Fed. Reg. 65569 (Nov. 4, 2008)). See generally [AML] and Financial Crimes Committee [AML] Suggested Due Diligence Practices for Hedge Funds (SIFMA, Feb. 26, 2009).

C) Treasury has deferred the issuance of AML program rules with respect to: (i) pawnbrokers; (ii) loan or finance companies; (iii) private bankers; and (iv) CPOs. See 67 Fed. Reg. 67547 (Nov. 6, 2002); 67 Fed. Reg. 21110 (Apr. 29, 2002).

D) Virtual Currency

i) Regulatory concerns about the development and risks posed by "virtual currencies" such as Bitcoin led the Senate Committee on Homeland Security and Governmental Affairs, FinCEN, the SEC, the CFTC and NYDFS to research and open investigations on virtual currencies to assess the appropriate regulatory framework for the industry. See, e.g., NYLJ, Sept. 4, 2014; Bloomberg, June 25, 6, Apr. 23, 2014; Statement of FinCEN Director Shasky Calvery, Nov. 19, 2013; Statement of Bitpay CEO Gallippi, Nov. 19, 2013; NY Times Dealbook, Aug. 13, 2013. See also Bitcoin: Technical Background and Data Analysis (Board, Oct. 2014); Risks to Consumers Posed by Virtual Currencies (CFPB, Aug. 2014); Virtual Currencies Key Definitions and Potential AML/CFT Risks (FATF, June 2014); Virtual Currencies: Emerging Regulatory, Law Enforcement, and Consumer

Protection Challenges (GAO, May 2014); Investor Alert: Bitcoin and Other Virtual Currency-related Investments (SEC, May 2014); Model State Consumer and Investor Guidance on Virtual Currency (CSBS and NASAA, Apr. 2014); Bitcoin: More than a Bit Risky (FINRA News Release, Mar. 2014); The Bitcoin Question: Currency vs. Trust-less Transfer Technology (OECD Working Paper, 2014); The Way Forward for Digital Currencies (Promontory, Sept. 2013).

ii) In 2013, FinCEN issued FIN-2013-G001 (Mar. 18, 2013) to clarify the virtual currency activities that constitute money transmission under BSA regulations. Under this guidance, a user who obtains virtual currency to purchase goods or services for the user's own behalf is not a money transmitter, but a person engaged as a business in the exchange or issuance of virtual currency may be a money transmitter.

FinCEN expanded on this guidance with several administrative rulings that explained the application of AML/BSA obligations to specific virtual currency activities. See FIN-2015-R001 (Aug. 14, 2015) (Application of FinCEN's Regulations to Persons Issuing Physical or Digital Negotiable Certificates of Ownership of Precious Metals); FIN-2014-R012 (Oct. 27, 2014) (Request for Administrative Ruling on the Application of FinCEN's Regulations to a Virtual Currency Payment System); FIN-2014-R011 (Oct. 27, 2014) (Request for Administrative Ruling on the Application of FinCEN's Regulations to a Virtual Currency Trading Platform); FIN-2014-R007 (Apr. 29, 2014) (Application of [MSB] Regulations to the Rental of Computer Systems for Mining Virtual Currency); FIN-

2014-R002 (Jan. 30, 2014) (Application of FinCEN's Regulations to Virtual Currency Software Development and Certain Investment Activity); FIN-2014-R001 (Jan. 30, 2014) (Application of FinCEN's Regulations to Virtual Currency Mining Operations).

iii) On September 15, 2015, the CSBS issued a model regulatory framework for state regulation of virtual currency activities that applies to activities that facilitate the exchange, storage, and transmission of virtual currency conducted on behalf of another person or entity. State Regulatory Requirements for Virtual Currency Activities (CSBS, Sept. 15, 2015)

iv) On June 2, 2015, NYDFS adopted the "Bitlicense" regulatory framework for virtual currency businesses in NY. The Bitlicense framework includes consumer protection obligations, required AML compliance and cybersecurity programs, capital requirements, and reporting and recordkeeping obligations. See NY Codes Rules & Regulations, Title 23, Part 200; Superintendent Benjamin Lawsky's Remarks at the BITS Emerging Payments Forum, June 3, 2015. See also NYDFS Press Release, July 17, 2014; NYDFS, Order Pursuant to NY Banking Law §§ 2-b, 24, 32, 102-a, and 4001-b and Financial Services Law §§ 301(c) and 302(a) (Mar. 11, 2014).

v) FinCEN, the SEC, DOJ and other authorities have brought charges against several individuals and entities in connection with activities related to virtual currency. See DOJ Press Release, Sept. 21, 2015 (Texas Man Pleads Guilty in Manhattan Federal Court to Operating Bitcoin Ponzi Scheme) and SEC v.

Shavers, No. 13-CV-416 (E.D. Tex., Sept. 21, 2014) (ordered to pay $40 million in fines for operating Ponzi scheme involving Bitcoin); DOJ Press Release, July 21, 2015 (Manhattan U.S. Attorney Announces Charges Against Two Florida Men For Operating An Underground Bitcoin Exchange); U.S. v. Lebeder, No. 15-mj-02501 (SDNY July 17, 2015) (complaint); U.S. v. Murgio, No. 15-mj-02508 (SDNY July 17, 2015) (complaint); Ripple Labs Inc. (FinCEN Assessment of Civil Money Penalty; May 5, 2015); DOJ Press Release, May 5, 2015 (Ripple Labs Resolves Criminal Investigation); SEC Admin. Proc. No. 3-16307 (Dec. 8, 2014) (operator of Bitcoin-related exchanges sanctioned for failure to register exchanges as broker-dealers or stock exchanges); DOJ Press Release, Sept. 23, 2014 (Liberty Reserve Technology Manager Pleads Guilty); FTC v. Butterfly Labs, No. 14-cv-00815-BCW (W.D. Mo. 2014) (complaint filed against Missouri-based company alleging that it deceptively marketed specialized computers designed to produce Bitcoins); DOJ Press Release, Sept. 4, 2014 (Bitcoin Exchangers Plead Guilty in Manhattan Federal Court in Connection with the Sale of Approximately $1 Million in Bitcoins for Use on the Silk Road Website); DOJ Press Release, Aug. 14, 2014 (Deputy to Liberty Reserve Founder Pleads Guilty to Money Laundering in Manhattan Federal Court); Erik T. Voorhees, SEC Admin. Proc. No. 3-15902 (June 3, 2014) (Bitcoin entrepreneur charged with failing to register an offering of stock denominated in bitcoin); Banking Daily, Apr. 14, 2014; DOJ Press Release, Jan. 27, 2014 (Manhattan U.S. Attorney Announces Charges Against Bitcoin Exchangers, Including CEO of Bitcoin

Exchange Company, For Scheme to Sell and Launder over $1 Million in Bitcoins Related to Silk Road Drug Trafficking); U.S. v. Faiella, et. al., No. 14-mj-00164 (SDNY Jan. 24, 2014) (complaint filed against Bitcoin exchangers in connection with Silk Road); DOJ Press Release, Jan. 16, 2014 (Manhattan U.S. Attorney Announces Forfeiture of $28 Million Worth of Bitcoins Belonging to Silk Road); U.S. v. Ulbricht, No. 13 civ. 6919 (SDNY Jan. 15, 2014) (order of forfeiture); DOJ Press Release, Dec. 20, 2013 (Manhattan U.S. Attorney Announces Charges Against Three Individuals in Virginia, Ireland and Australia for Their Roles in Running Silk Road website); U.S. v. Jones, et. al, 1517 Cr. 950 (SDNY Dec. 20, 2013).

E) Marijuana-Related Businesses

i) Since several states enacted laws to legalize certain marijuana-related activities, the DOJ issued guidance advising federal prosecutors that enforcement of marijuana cases under the Controlled Substances Act ("CSA") should focus on the degree to which the marijuana-related activity threatens federal enforcement priorities. Such enforcement priorities include preventing proceeds from the sale of marijuana from going to criminal enterprises, gangs and cartels and preventing state-authorized marijuana activity from being used as a cover or pretext for trafficking of other illegal drugs or other illegal activity. See DOJ, Memorandum for All [U.S.] Attorneys: Guidance Regarding Marijuana Enforcement (Feb. 14, 2014, Aug. 29, 2013) (the "Cole Memos").

ii) In 2014, FinCEN issued guidance to clarify BSA expectations for financial institutions providing services to marijuana-related businesses. This guidance clarified when a bank should report currency transactions and file SARs in the context of marijuana-related businesses and explained that customer due diligence on marijuana-related businesses should consider whether the business is in compliance with state law or implicates any of the federal enforcement priorities mentioned in the Cole Memos. See FIN-2014-G001 (Feb. 14, 2014).

F) See also, e.g., Voluntary Good Practices Guidance for Lawyers to Detect and Combat Money Laundering and Terrorist Financing (Am. Bar Assoc., 2010).

e. Customer Identification Program Requirements

(i) PATRIOT Act § 326, 31 U.S.C. § 5318(l) ("Section 326"), directs the Treasury Secretary to require financial institutions to implement "reasonable procedures" to verify the identity of persons who seek to open accounts, to maintain records of this information, and to consult governmental lists of known or suspected terrorists or terrorist organizations.

(ii) The Treasury Secretary, in concert with other federal functional regulators, has issued CIP rules implementing Section 326. See generally BSA Exam Manual; Interagency [FAQs]: Final CIP Rule (Apr. 28, 2005); Treasury Fact Sheet: Final Regulations Implementing Customer Identification Verification Requirements Under Section 326 (Apr. 30, 2003).

A) Financial institutions subject to the CIP requirements include:

i) Banks, trust companies, savings associations and credit unions that have a federal functional regulator (Treasury (Comptroller and OTS), Board, FDIC, NCUA). See 68 Fed. Reg. 25090 (May 9, 2003) (31 C.F.R. § 1020.220). See also 12 C.F.R. § 21.21(b)(2) (OCC); 12 C.F.R. §§ 208.63(b)(2), 211.5(m)(2), 211.24(j) (Board); 12 C.F.R. § 326.8(b)(2) (FDIC); 12 C.F.R. § 563.177(b)(2) (OTS); 12 C.F.R. § 748.2(b)(2) (NCUA).

ii) Banks, private banks, credit unions and trust companies that do not have a federal functional regulator (Treasury). See 68 Fed. Reg. 25090 (May 9, 2003) (31 C.F.R. § 1020.100(b)). See also 81 Fed. Reg. 58425 (Aug. 25, 2016) (proposed rule for other state banks without a federal regulator); 68 Fed. Reg. 25163 (May 9, 2003) (earlier proposal, never adopted). See generally Interagency [FAQs]: Final CIP Rules (Apr. 28, 2005).

iii) Broker-dealers (Treasury and SEC). See 68 Fed. Reg. 25113 (May 9, 2003) (31 C.F.R. § 1023.220). See also NASD Notice to Members 03-34 (June 2003). See generally SIFMA (avail. Jan. 9, 2015) (ability of broker-dealer to rely on investment adviser in respect of certain CIP functions); FIN-2008-R008 (June 3, 2008) ([BSA] Obligation of a U.S. Clearing Broker-dealer Establishing a Fully Disclosed Clearing Relationship with a Foreign Financial Institution); FIN-2006-G007 (Apr. 25, 2006) (SEC/FinCEN Question and Answer Regarding Broker-dealer [CIP] Responsibilities Under the Agency Lending Disclosure Initiative); Suggested Practices for [CIPs] (SIA, 2005).

iv) Mutual funds (Treasury and SEC). See 68 Fed. Reg. 25131 (May 9, 2003) (17 C.F.R. § 270.0-11 (SEC), 31 C.F.R. § 1024.220

(Treasury)); SEC Questions and Answers Regarding the Mutual Fund [CIP] Rule (31 C.F.R. § 103.131) (Aug. 11, 2003).

v) FCMs and IBs (Treasury and CFTC). See 68 Fed. Reg. 25149 (May 9, 2003) (17 C.F.R. § 42.2 (CFTC), 31 C.F.R. § 1026.220 (Treasury)). See also FIN-2007-G001 (Apr. 20, 2007) (CFTC/FinCEN Application of the [CIP] Rule to [FCMs] Operating as Executing and Clearing Brokers in Give-Up Arrangements); FIN-2006-G004 (Feb. 14, 2006) (CFTC/FinCEN Questions and Answers Regarding the [CIP] Rule for [FCMs] and [IBs]).

B) Insurance companies are not currently subject to a CIP requirement. See FIN-2006-G010 (May 31, 2006).

C) See generally General Guide to Account Opening (Basel, July 2015); Wolfsberg Statement on AML Screening, Monitoring and Searching (Wolfsberg Group, Nov. 2009); Consolidated KYC Risk Management (Basel, Oct. 2004); 68 Fed. Reg. 55335 (Sept. 25, 2003) (termination of FinCEN inquiry with respect to reliance on the matrícula consular, a Mexican consular identification document); 68 Fed. Reg. 39039 (July 1, 2003) (solicitation of public comments); Reducing Money Laundering Risk: [KYC] and [AML] Monitoring (FSA, Aug. 2003); A Report to Congress in Accordance with [Section 326(b)] (Treasury, Oct. 21, 2002) (recommendations to enhance the ability of financial institutions to verify the identity of foreign nationals).

(iii) The FDIC, the OCC and FinCEN have issued guidance to advise financial institutions to assess the risk of individual customers on a case-by-case basis (as opposed to applying the same treatment to entire categories of customers). See FDIC FIL-5-2015 (Jan. 28, 2015) (Statement on Providing Banking Services); OCC Bulletin 2014-58 (Nov. 19, 2014) (Banking [MSBs]); Statement on Providing Banking Services to [MSBs], (FinCEN, Nov. 10, 2014). See generally NY Times, June 9, 2016; Remarks of FinCEN Deputy Director El-Hindi, May 26, 2016.

(iv) The banking agencies have issued guidance regarding the application of CIP requirements to bank issuers of prepaid cards. See, e.g., Board SR Letter 16-7 (Mar. 21, 2016).

f. Customer Due Diligence and Beneficial Ownership

(i) After a lengthy rulemaking process, FinCEN adopted a final rule expanding CIP requirements to increase customer due diligence ("CDD") obligations and include specific requirements to identify the beneficial owners of certain accounts. The rule significantly expands the specific expectations of financial institutions in relation to beneficial ownership information, with a compliance deadline of May 11, 2018. See 81 Fed. Reg. 29398 (May 11, 2016) (final rule); 79 Fed. Reg. 45151 (Aug. 4, 2014) (notice of proposed rulemaking); 77 Fed. Reg. 13046 (Mar. 5, 2012) (advance notice of proposed rulemaking); 77 Fed. Reg. 27381 (May 10, 2012) (extension of comment period); 77 Fed. Reg. 41334 (July 13, 2012) (announcement of public hearing). See also FIN-2016-G003 (FAQs Regarding [CDD] Requirements for Financial Institutions); Wall St. J., May 9, 2016.; FIN-2010-G001 (Mar. 5, 2010) (Guidance on Obtaining and Retaining Beneficial Ownership Information).

(ii) FATF had criticized the absence of a beneficial ownership regime in the U.S. as inconsistent with international standards. See Parts VIII.A.2.g and 7 below. See also Transparency and Beneficial Ownership (FATF, Oct. 2014) (providing guidance on the implementation of the FATF transparency and beneficial ownership recommendations); Wolfsberg Group Press Release, June 15, 2012 (announcing revisions to AML principles for private banking and related FAQs on beneficial ownership); Customer Due Diligence for Banks (Basel, Oct. 2001).

(iii) The U.S. announced a National Action Plan on Preventing the Misuse of Companies and Legal Arrangements (White House, June 18, 2013) to assist U.S. authorities in identifying beneficial owners of legal entities.

g. Special Considerations for "Foreign Shell Banks" and "Shell Companies"

(i) PATRIOT Act § 313, 31 U.S.C. § 5318(j), prohibits "covered financial institutions" from establishing, maintaining, administering or managing a correspondent account for a foreign bank that does not have a physical presence (a "foreign shell bank").

(ii) A covered financial institution is required to take "reasonable steps" to ensure that correspondent accounts maintained for foreign banks are not used to provide banking services to a foreign shell bank indirectly. See 67 Fed. Reg. 60562 (Sept. 26, 2002) (31 C.F.R. § 1010.630); 31 C.F.R. Subpart I, Appendix A (form of certification). See also BSA Exam Manual; FIN-2006-G003 (Feb. 3, 2006) ([FAQs] -- Foreign Bank Recertifications under 31 C.F.R. § 103.177); FinCEN Ruling No. 2003-2 (Apr. 3, 2003) (offshore bank with two employees not a foreign shell bank); Shell Banks and Booking Offices (Basel, Jan. 2003).

(iii) Law enforcement and Treasury officials and Congress have increased their focus on the use of U.S. shell companies by criminals and tax evaders. See, e.g., BSA Exam Manual; Economist, Feb. 16, 2013; NASS [National Association of Secretaries of State] Company Formation Task Force Report & Recommendations (July 18, 2007); "Failure to Identify Company Owners

Impedes Law Enforcement", Hearing of the Senate PSI (Nov. 11, 2006); FIN-2006-G014 (Nov. 9, 2006) (Potential Money Laundering Risks Related to Shell Companies); The Role of Domestic Shell Companies in Financial Crime and Money Laundering: [LLCs] (FinCEN, Nov. 2006); Company Formations -- Minimal Ownership Information Is Collected and Available (GAO, Apr. 2006); Senate Tax Haven Abuse Report.

(iv) FATF has highlighted the potential misuse of shell companies. See The Misuse of Corporate Vehicles, Including Trust and Company Service Providers (FATF, Oct. 13, 2006); Mutual Evaluation Report on [AML] and Combating the Financing of Terrorism: [U.S.] (FATF, June 23, 2006).

(v) As described in Part VIII.A.2.f above, FinCEN's final CDD rule is designed in part to address concerns regarding shell companies. See generally Export Insight into The World of Offshore Company Incorporation (Appleby Global Group Services Ltd., 2014); Nat'l L. J., Jan. 11, 2010.

(vi) In 2016, a leak by the International Consortium of Investigative Journalists of information from a Panamanian law firm (Mossack Fonseca) listing 200,000 shell companies prompted widespread news coverage and law enforcement and regulatory scrutiny. See generally Financial Times, Apr. 20, 2016; Bloomberg, May 10, 2016

h. Special Considerations for Foreign Correspondent Accounts and Concentration Accounts

The risk that U.S. correspondent accounts may be used as a conduit for illicit funds to enter the U.S. financial system has been an issue of particular concern.

(i) Due Diligence and "Enhanced Due Diligence"

PATRIOT Act § 312, 31 U.S.C. § 5318(i) ("Section 312"), requires covered financial institutions to establish due diligence (and, where necessary, enhanced due diligence) policies, procedures and controls reasonably designed to detect and report money laundering through correspondent accounts maintained for non-U.S. persons (including foreign branches of U.S. banks). See 71 Fed. Reg. 496 (Jan. 4, 2006) (now 31 C.F.R. §§ 1010.605, 1010.610 and 1010.620) (the "Section 312 Rule").

A) Since covered financial institutions include broker-dealers, FCMs, IBs and mutual funds as well as banking institutions, the definition of "correspondent account" is broader than the conventional understanding of the term. Different definitions of the term "account" applicable to non-bank financial institutions for purposes of the Section 312 Rule are provided in 31 C.F.R. §§ 1010.605(c)(2)(ii) – (iv).

See also FIN-2008-R008 (June 3, 2008) ([BSA] Obligations of a U.S. Clearing Broker-dealer Establishing a Fully Disclosed Clearing Relationship with a Foreign Financial Institution); FIN-2008-G001 (Jan. 30, 2008) (Application of Correspondent Account Rules to the Presentation of Negotiable Instruments Received by a Covered Financial Institution); FIN-2007-G004 (Sept. 5, 2007) (Application of the Correspondent Account Rule to Executing Dealers Operating in [OTC FX] and Derivatives Markets Pursuant to Prime Brokerage Arrangements); FIN-2006-G011 (June 7, 2006) (Application of the Regulations Requiring Special Due Diligence Programs for Certain Foreign Accounts to Certain Introduced Accounts and Give-up Arrangements in the Futures Industry); FIN-2006-G009 (May 10, 2006) (Application of Regulations Requiring Special Due Diligence

Programs for Certain Foreign Accounts to the Securities and Futures Industries); NYCH Guidelines for Counter Money Laundering Policies and Procedures in Correspondent Banking (Mar. 2002).

B) The Section 312 Rule adopted a risk-based approach that requires a financial institution to:

i) Determine whether an account is subject to Section 312's enhanced due diligence requirements.

ii) Assess the money-laundering risk posed by the account based on a consideration of all relevant factors, including, "as appropriate":

(a) The nature of the non-U.S. financial institution's business and the markets it serves.

(b) The type, purpose and anticipated activity of the account.

(c) The nature and duration of the covered financial institution's relationship with the non-U.S. financial institution and its affiliates.

(d) The AML and supervisory regime of the jurisdiction of the non-U.S. financial institution, and, "to the extent that information . . . is reasonably available," of the jurisdiction of any company that is an owner of the non-U.S. financial institution.

(e) The non-U.S. financial institution's AML record.

iii) Apply risk-based policies, procedures and controls reasonably designed to detect and report money laundering, including a periodic review of account activity.

C) Section 312 requires "enhanced due diligence" for correspondent accounts maintained for certain non-U.S. banks, including those (i) operating under an offshore banking license, (ii) licensed by a country designated as being non-cooperative with international AML principles by an intergovernmental group, or (iii) licensed by a country designated by the Treasury Secretary as warranting special AML measures. See 72 Fed. Reg. 44768 (Aug. 9, 2007) (final rule).

See generally BSA Exam Manual; Wolfsberg [AML] Principles for Correspondent Banking (2014); Special Due Diligence Programs for Certain Foreign Accounts (FinCEN, Mar. 2009).

D) In response to concerns that U.S. respondent banks may be "de-risking" and exiting correspondent banking relationships with banks in jurisdictions such as Mexico, the banking agencies and Treasury issued a "Joint Fact Sheet on Foreign Correspondent Banking: Approach to BSA/AML and OFAC Sanctions Supervision and Enforcement" (Aug. 30, 2016). The Joint Fact Sheet, as well as other public statements on the topic, have tended to perpetuate the dual message that, on the one hand, U.S. financial institutions should not exit business lines categorically without a risk assessment, but, on the other hand, U.S. financial institutions should have policies and procedures to address the heightened risks of foreign correspondent banking. See generally Wall St. J., Aug. 30, 2016; American Banker, July 22, 2016. "De-risking" has also been a concern in the context of banks providing services to MSBs. See Part VIII.A.2.e.ii above. See generally ABA Banking Journal, July 5, 2016; BIS Committee on Payments and Market Infrastructure, "Correspondent Banking" (July 2016); IMF Staff Discussion Note, "The Withdrawal of Correspondent Banking Relationships: A Case for Policy Action" (June 2016); Guiding Principles for [AML] Policies and Procedures in Correspondent Banking (TCH, Feb. 2016).

(ii) Recordkeeping and Agents for Service of Process

Pursuant to PATRIOT Act § 319, 31 U.S.C. § 5318(k) ("Section 319"), a covered financial institution must maintain records identifying the "owners" of a non-U.S. respondent bank and the name and address of a U.S. resident designated by the foreign bank to accept service of process for records regarding the correspondent account. A covered financial institution may rely on a certification obtained from a non-U.S. respondent bank to satisfy its recordkeeping obligation. See 31 C.F.R. Chapter X.

(iii) Penalties for Failing to Monitor Foreign Correspondent Bank Accounts

A) Several banks have received substantial civil money penalties for failing to monitor foreign correspondent bank accounts. See, e.g., Pacific National Bank, NR 2011-32 (Joint Release of FinCEN/OCC, Mar. 24, 2011); Zions First National Bank, FinCEN Press Release, Feb. 11, 2011; Wachovia Bank, FinCEN Press Release, Mar. 17, 2010.

B) Heightened compliance expectations have reportedly led some U.S. correspondent banks to reduce their activities in the area. See, e.g., Economist, June 14, 2014; Wall St. J., Aug. 23, 2013.

(iv) Concentration Accounts

PATRIOT Act § 325, 31 U.S.C. § 5318(h)(3), authorizes the Treasury Secretary to issue regulations regarding "concentration accounts" (i.e., in-house accounts established to facilitate processing and settlement of multiple individual customer transactions within the bank), to ensure that such accounts are not used to hide the identity of a customer.

(v) U.S. Correspondent Accounts with Iranian Connections

CISADA § 104 seeks to restrict or prohibit U.S. financial institutions from maintaining correspondent accounts for non-U.S. financial institutions that maintain correspondent accounts for, or have relationships with, Iranian entities that are subject to international or U.S. sanctions. OFAC has promulgated the Iranian Financial Sanctions Regulations (the "IFSR"), which restrict or prohibit U.S. financial institutions from maintaining a correspondent account in the U.S. for any non-U.S. financial institution that facilitates transactions of entities designated under U.S. or UN sanctions linked to Iran's Revolutionary Guard Corps ("IRGC") or weapons of mass destruction ("WMD") or terror-related activities. 75 Fed. Reg. 49836 (Aug. 16, 2010) (31 C.F.R. Part 561); 76 Fed. Reg. 62607 (Oct. 11, 2011) (31 C.F.R. Part 1060).

i. Special Considerations for Private Banking Accounts

(i) Section 312 imposes due diligence requirements with respect to "private banking accounts." See generally BSA Exam Manual; Keeping Foreign Corruption out of the [U.S.]: Four Case Histories (Majority and Minority Staff Report for the Senate PSI, Feb. 4, 2010) (examining how "politically exposed persons" ("PEPs") have used U.S. financial institutions to bring suspect funds into the U.S. and circumvent U.S. AML and anti-corruption safeguards); Minority Staff Report for PSI Hearing on Private Banking and Money Laundering

(Nov. 9, 1999); Private Banking: Information on Private Banking and its Vulnerability to Money Laundering (GAO, Oct. 30, 1997). See also Global Private Banking/Wealth Management Survey 2007 (PricewaterhouseCoopers) (compliance risks).

(ii) "Best practices" in these areas include: (A) risk-focused assessments to identify customers whose transactions are routine and those that pose a heightened risk of illegal activities; (B) keeping current "KYC profiles" that describe account activity and may be used as a basis for assessing whether customers require enhanced due diligence; (C) keeping information on customer identity and business activities; and (D) monitoring for customer accounts and transactions potentially involving the proceeds of foreign official corruption. See, e.g., Wolfsberg [AML] Principles (revised June 15, 2012); Wolfsberg Anti-Corruption Guidance (Aug. 2011); Wolfsberg [FAQs] on [PEPs] (2008); Board Guidance on Enhanced Scrutiny for Transactions that May Involve the Proceeds of Foreign Official Corruption (Jan. 2001).

j. Suspicious Activity Reports

(i) Patterns of Suspicious Activity Report Filings

For a discussion of trends in SAR reporting, see FinCEN SAR Stats, SAR Activity Reviews: Trends, Tips & Issues and By the Numbers. See generally FIN-2014-A008 (Sept. 11, 2014) (Guidance on Recognizing Activity that May be Associated with Human Smuggling and Human Trafficking -- Financial Red Flags); FinCEN Mortgage Loan Fraud Update (Aug. 2013); [SARs] and Analytics: Staying Ahead of the Compliance Curve (Deloitte, 2013); FinCEN Reports: Mortgage Loan Fraud (Apr. 2013); FIN-2012-A010 (Oct. 22, 2012) (Advisory on Risk Associated with Third-party Payment Processors); FIN-2012-A009 (Aug. 16, 2012) (Advisory on Suspicious Activity Related to Mortgage Loan Fraud); Mortgage Loan Fraud (Apr. 2012), Commercial Real Estate Tenancy Financing Fraud (Mar. 2011) and

Mortgage Loan Fraud (Mar. 2011); FIN-2011-A007 (Mar. 30, 2011) (Advisory on Activities Potentially Related to Commercial Real Estate Fraud); FIN-2010-A006 (June 17, 2010) (Updated Advisory to Financial Institutions on Filing SARs Regarding Loan Modification/Foreclosure Rescue Scams); FIN-2010-A005 (Apr. 27, 2010) (Advisory to Financial Institutions on Filing SARs Regarding Home Equity Conversion Mortgage Fraud Schemes); Bush & Carroll, "Suspicious Activity Reporting: Recent Developments and Guidance on Key Issues", Review of Banking & Financial Services (Nov. 2005).

(ii) Institutions Required to File Suspicious Activity Reports

A) Banks were required to file SARs under the BSA prior to the passage of the PATRIOT Act. See, e.g., 61 Fed. Reg. 4332 (Feb. 5, 1996) (OCC final rule).

B) Suspicious activity reporting requirements have been extended by regulation to:

i) Broker-dealers: See 31 C.F.R. § 1023.320. See also 67 Fed. Reg. 44048 (July 1, 2002); Reuters, Feb. 25, 2015 (report of broker-dealer failures to file SARs); [AML] Efforts in the Securities Industry (GAO, Oct. 2001); Money Laundering: Oversight of Suspicious Activity Reporting at Bank-affiliated Broker-dealers (GAO, Mar. 2001).

ii) MSBs: See 31 C.F.R. § 1022.320. See also 70 Fed. Reg. 20204 (Apr. 18, 2005); 68 Fed. Reg. 6613 (Feb. 10, 2003); 67 Fed. Reg. 48704 (July 25, 2002); 65 Fed. Reg. 13683 (Mar. 14, 2000).

iii) Casinos: See 31 C.F.R. § 1021.320. See also 68 Fed. Reg. 60722 (Sept. 26, 2002).

iv) FCMs and IBs: See 31 C.F.R. § 1026.320. See also 68 Fed. Reg. 65392 (Nov. 20, 2003) (final rule); 69 Fed. Reg. 4236 (Jan. 29, 2004) (correction to final rule).

v) Insurance companies: See 31 C.F.R. § 1025.320. See also 70 Fed. Reg. 66761 (Nov. 3, 2005); 67 Fed. Reg. 60625 (Sept. 26, 2002) (AML program proposal including "red flags" that could make an insurance transaction suspicious); FIN-2006-G010 (May 31, 2006) ([FAQs]: [AML] and [SAR] Requirements for Insurance Companies).

vi) Mutual funds: See 31 C.F.R. § 1024.320. See also 71 Fed. Reg. 26213 (May 4, 2006); FIN-2006-G013 (Oct. 4, 2006) ([FAQs]: SAR Requirements for Mutual Funds).

vii) Non-bank residential mortgage lenders and originators. See 77 Fed. Reg. 8148 (Feb. 14, 2012).

C) Most recently, FinCEN has defined Fannie Mae, Freddie Mac and the FHLBs as financial institutions for BSA purposes, subjecting them to SAR requirements and requiring them to develop AML programs. See 79 Fed. Reg. 10365 (Feb. 25, 2014).

(iii) When a Suspicious Activity Report Must Be Filed

A) Filing requirements vary slightly by type of financial institution, but generally a financial institution must file a SAR when it knows, suspects or has reason to suspect that a transaction of $5,000 or more:

i) Involves proceeds of illegal activity, or is intended to hide funds or assets derived from illegal activity;

ii) Is designed to evade BSA regulations;

iii) Has no business or apparent lawful purpose or is not the sort in which the customer would normally be expected to engage, and the institution knows of no reasonable explanation for the transaction; or

iv) Involves use of the institution to facilitate criminal activity.

See generally Comptroller Interpretive Letter No. 1003 (July 21, 2004), CCH Fed. Banking L. Rep ¶ 81-532 (whether a bank must file a SAR upon receipt of an NSL); Board SR Letter 03-20 (Nov. 19, 2003), CCH Fed. Banking L. Rep. ¶ 52-001; Interagency Guidance Package on the Preparation of SARs by Financial Institutions (Nov. 2003).

B) A banking institution must also file a SAR if it discovers that it has been an actual or potential victim of a crime or was used to facilitate a criminal transaction if (i) the transaction involved insider abuse, (ii) transactions aggregated $5,000 or more and a suspect could be identified, or (iii) transactions aggregated $25,000 or more and there was no specific suspect.

C) Common "red flags" which could trigger SAR filing include (i) customers who provide insufficient or suspicious information; (ii) customer efforts to avoid reporting/recordkeeping requirements; (iii) wire transfer activity to/from a high-risk geographic location without an apparent business reason; (iv) unusual movements of funds; (v) many incoming wire transfers which are wired out almost immediately, or other repetitive wire transfer patterns; (vi) activity inconsistent with the customer's business; and (vii) transactions conducted in bursts of activity, especially in previously dormant accounts. See BSA Exam Manual, Appendix F.

D) A report of "blocked transactions" filed with OFAC is sufficient to fulfill a financial institution's requirement to file a SAR on the same transaction unless the transaction would be reportable under FinCEN's SAR rules even if there were no OFAC match. See 69 Fed. Reg. 76847 (Dec. 23, 2004).

(iv) Content of a Suspicious Activity Report

A) In general, a SAR's narrative should (i) describe (a) who is conducting the criminal or suspicious activity, (b) what instruments or mechanisms facilitate the activity, (c) when the activity occurred, (d) where the activity took place, and (e) why the institution thinks the activity is suspicious; (ii) avoid conclusory statements, but rather provide supporting information and reasoning; (iii) not insert tables or pre-formatted spreadsheets; and (iv) not attach supporting documentation. See generally Suggestions for Addressing Common Errors Noted in Suspicious Activity Reporting (FinCEN, Oct. 10, 2007), CCH Fed. Banking L. Rep ¶ 52-004.

B) FIN-2008-G005 (Apr. 17, 2008) (Guidance to Financial Institutions in Filing [SARs] Regarding the Proceeds of Foreign Corruption) requests that SARs relating to potential foreign corruption include the term "foreign corruption" in the narrative.

(v) Account Closing

In general, a financial institution is not required to close an account with respect to which a SAR has been filed. In some cases, law enforcement may request an institution to keep an account open for investigative purposes. See FIN-2007-G002 (June 13, 2007) (Requests by Law Enforcement for Financial Institutions to Maintain Accounts).

(vi) Key Program Elements

Effective SAR programs include (A) understanding the normal and expected transactions of each customer, and periodically reviewing account activity to update parameters of “normal” activity; (B) establishing a methodology to assign risk levels to different types of customers and products; (C) requiring enhanced due diligence for customers, products and geographic areas that pose higher risks; (D) establishing internal procedures for reporting information about potentially suspicious transactions; (E) engaging senior management in the process of identifying, reviewing and reporting potentially suspicious activity; and (F) ensuring that information received from subpoenas and other law enforcement inquiries is included in risk assessments.

(vii) Confidentiality and Safe Harbor

A) The BSA (31 U.S.C. § 5318(g)(2)) prohibits disclosing to any person involved in activity that is the subject of a SAR that the activity has been reported. In 2010, FinCEN and other supervisory agencies issued final rules clarifying that SARs, and any information that would reveal the existence of a SAR, are confidential and may not be disclosed except as specifically authorized.

i) Provided no person involved in the transaction is notified of a SAR filing, a depository institution may disclose a SAR to: (a) FinCEN, (b) any federal, state or local law enforcement agency, (c) any federal regulatory agency that examines the depository institution for BSA compliance, or (d) any state regulatory authority that examines the depository institution for adherence to state laws requiring BSA compliance.

ii) The disclosure prohibition does not apply to the disclosure of the underlying facts, transactions and documents upon which a SAR is based.

iii) Given civil and criminal penalties that could result from failure to maintain the confidentiality of SARs, financial institutions should address SAR confidentiality in ongoing employee training and use other risk-based measures to ensure SAR confidentiality, such as limiting access to SARs on a "need to know" basis, restricting areas for reviewing SARs, logging any access to SARs, and highlighting the confidentiality of SARs and any supporting documentation that indicates the filing of a SAR.

iv) FinCEN issued a reminder to counsel to financial institutions regarding the importance of maintaining SAR confidentiality in the context of civil litigation. See FIN-2012-A002 (Mar. 2, 2012) (SAR Confidentiality Reminder for Internal and External Counsel of Financial Institutions).

See 75 Fed. Reg. 75593 (Dec. 3, 2010) (FinCEN rule); 75 Fed. Reg. 75576 (Dec. 3, 2010) (OCC rule); Letter to FINRA, dated Jan. 26, 2012 (requiring broker-dealers to make SARs available to their SROs); Mendoza (FinCEN Assessment of Civil Money Penalty, Dec. 15, 2011) (bank employee unlawfully revealed existence of SAR to subject of the report). OCC Standards Governing the Release of a [SAR], 75 Fed. Reg. 75574 (Dec. 3, 2010). See also FinCEN, Answers to Frequently Asked BSA Questions; FinCEN Chief Counsel Opinion No. 2005-1 (Apr. 8, 2005); FinCEN Announcement: Unauthorized Disclosure of [SARs] (Aug. 18, 2004).

B) Interagency Guidance on Sharing [SARs] with Head Offices and Controlling Companies (Jan. 20, 2006), Fed. Res. Reg. Serv. ¶ 3-1873.2, provides that U.S. branches of non-U.S. banks may share SARs with their head offices, and U.S. financial institutions may share SARs with their controlling companies.

C) FinCEN has confirmed that depository institutions and certain other financial institutions may share SARs horizontally with affiliates that are themselves subject to a SAR regulation. The guidance does not permit sharing a SAR with non-U.S. branches of U.S. banks because such branches are not subject to SAR regulation. See Notice of Availability of Final Interpretive Guidance: Sharing [SARs] by Depository Institutions and Securities Broker-dealers, Mutual Funds, [FCMs], or [IBs] in Commodities with Certain U.S. Affiliates, 75 Fed. Reg. 75607 (Dec. 3, 2010); FIN-2010-A014 (Nov. 23, 2010) (Maintaining the Confidentiality of [SARs]); FIN-2010-G006 (Nov. 23, 2010) (Sharing [SARs] by Depository Institutions with Certain U.S. Affiliates).

See also TCH letter to FinCEN, dated Mar. 13, 2015 (requesting guidance to enable banks to share SARs within their international organization for AML compliance purposes); Enterprise-wide [SAR] Sharing: Issues and Approaches (Egmont Group of Financial Intelligence Units, Feb. 2011); FIN-2009-G002 (June 16, 2009) (Guidance on the Scope of Permissible Information Sharing Covered by Section 314(b) Safe Harbor of the [PATRIOT Act]); FIN-2006-G013 (Oct. 4, 2006) (FAQs: SAR Requirements for Mutual Funds); Guidance on Sharing of [SARs] by Securities Broker-dealers, [FCMs] and [IBs] in Commodities (FinCEN, Jan. 20, 2006). Note also Relief Act § 709 (protection of confidential information received by federal banking regulators from foreign banking supervisors).

D) Part VIII.A.2.n below discusses permissible information-sharing with unaffiliated financial institutions and law enforcement.

E) Financial institutions subpoenaed or otherwise requested to provide copies of SARs are required to decline to turn over SARs or any information that would disclose that a SAR has been filed, and to inform their federal regulator of the subpoena. See, e.g., 12 C.F.R. § 208.62(j). See generally FIN-2012-A0002 (Mar. 2, 2012).

F) Courts have generally upheld the refusal of financial institutions to produce SARs in civil litigation. See, e.g., Monte Hasie v. OCC, 633 F.3d 361 (5th Cir. 2011); FDIC v. Flagship Auto Center, 2005 U.S. Dist. LEXIS 9468 (N.D. Ohio 2005); Wuliger v. OCC, 394 F. Supp. 2d 1009 (N.D. Ohio 2005); Interagency Advisory, dated May 24, 2004 (reporting on Whitney National Bank v. Karam, 306 F. Supp. 2d 678 (S.D. Tex. 2004) ("unqualified protection" to financial institutions in respect of SAR filings)); Union Bank of California N.A. v. Superior Court of Alameda County, 29 Cal. Rptr. 3d 894 (Cal. Ct. App. 1st App. Dist. 2005) (in-house form that the Bank used to prepare a possible SAR is protected from disclosure in private litigation); Int'l Bank of Miami v. Shinitzky, 849 So. 2d 1188 (Fla. 2003); Comptroller Interpretive Letter No. 978 (Dec. 4, 2003), CCH Fed. Banking L. Rep. ¶ 81-501 (rejecting request for SAR in context of litigation). But see, e.g., In re JPMorgan Chase Bank, No. 14-8015, 2015 WL497954 (1st Cir. Aug. 21, 2015); First American Title Insurance Co. v. Westbury Bank, 2014 WL4267450 (E.D. Wis., 2014) (compelling disclosure of internal alerts but not information on whether a SAR was filed); Wultz v. Bank of China, 2014 WL 5690342 (SDNY 2014) (documents not privileged simply because they arose from bank's policies governing filing SARs), 2013 WL 1453258 (SDNY 2013) (compelling production of materials related to SAR filing practices).

G) The BSA provides financial institutions a "safe harbor" from liability (e.g., defamation liability) for filing a SAR. See 12 U.S.C. § 5318(g)(2); see also, e.g., 12 C.F.R. § 21.11(l). Voluntary filing of SARs is also accorded safe harbor protection, and a report to law enforcement authorities of activity already reported on an SAR should not cause a financial institution to lose this protection. See, e.g., FinCEN Chief Counsel Opinion No. 2005-1 (Apr. 8, 2005).

(viii) In 2016, in an initiative to gather information regarding potentially suspicious real estate transactions, FinCEN issued Geographic Targeting Orders requiring title insurance companies to report information to FinCEN concerning high-end real estate transactions completed without bank financing (paid by cash, check, etc.). Together, the Orders cover areas located in New York, Florida, California and Texas. See FinCEN Geographic Targeting Orders (Jan. 13, July 27, 2016); FinCEN FAQs: Geographic Targeting Orders Involving Certain Real Estate Transactions (Feb. 1, 2016). See also Remarks of FinCEN Director Shasky Calvery, Apr. 12, 2016; Wall St. J., Jan. 13, 2016; NY Times, Jan. 13, 2016.

(ix) As a complement to the New York SAR rule, the NYDFS adopted a transaction monitoring program rule as Part 504 of the Superintendent's Regulations, including an annual certification requirement, effective January 1, 2017. DFS Press Release, June 30, 2016.

k. Currency Reporting and Related Requirements

Financial institutions must file a CTR regarding any cash transaction of more than $10,000, subject to certain exemptions. Multiple transactions in a business day, including those conducted at different branch offices, must be treated as a single transaction if the institution knows that they are by or on behalf of a single person. See 31 U.S.C. § 5312, 31 C.F.R. § 1010.313 (financial institutions); 75 Fed. Reg. 19241 (Apr. 14, 2010) (final rule), 31 C.F.R. § 1024.313 (mutual funds); 31 U.S.C. § 5331, 31 C.F.R. § 1010.330(b), 66 Fed. Reg. 67680 (Dec. 31, 2001) (interim rule) (non-financial businesses). See also Remarks of FinCEN Director Shasky Calvery, Dec. 9, 2015; FIN-2012-A006 (July 18, 2012) (Update on U.S. Currency Restrictions in Mexico); Commerzbank (Board Written Agreement, June 8, 2012); FIN-2012-G001 (Mar. 16, 2012) ([CTR] Aggregation for Businesses with Common Ownership); FIN-2011-A009 (Apr. 21, 2011) (Advisory Information on Narcotics and Bulk Currency Corridors); FinCEN Ruling 2009-R002 (July 2, 2009) (aggregation of certain armored car deposits with other transactions); FIN-2008-R001 (Jan. 25, 2008) (Reporting of Certain Currency Transactions for Sole Proprietorships and Legal Entities Operating Under a "Doing Business As" ('DBA') Name); FinCEN Ruling 2003-1 (Oct. 3, 2002). For a discussion of recent enforcement actions that include CTR issues, see Part VIII.A.6.c.ii (Commerzbank) and Part VIII.A.6.c.v (Western Union) below.

(i) CTR requirements apply to the physical transfer of coins or paper currency, including foreign currency, and to "any monetary instrument (whether or not in bearer form) with a face amount of not more than $10,000."

(ii) An institution's AML program should be designed to detect and report "structuring" transactions (breaking transactions into smaller transactions, including on multiple days or at multiple branches, in an effort to evade reporting requirements). Financial institutions should report suspected structuring in a SAR. See FinCEN Ruling No. 2005-6 (July 15, 2005).

(iii) With respect to CTR exemptions, see 73 Fed. Reg. 74010 (Dec. 5, 2008) (final FinCEN rule). See also FIN-2012-G003 (June 11, 2012) (Guidance on Determining Eligibility for Exemption from [CTR] Requirements); Designation of Exempt Person (DOEP) & Currency Transaction Reporting (CTR): Assessing the Impact of Amendments to the CTR

Exemption Rules Implemented on January 5, 2009 (FinCEN, July 2010); FIN-2009-G003 (Aug. 31, 2009) (Guidance on Determining Eligibility for Exemption from [CTR] Requirements); FIN-2009-G001 (Apr. 27, 2009) (Guidance on Supporting Information Suitable for Determining the Portion of a Business Customer's Annual Gross Revenues that is Derived from Activities Ineligible for Exemption from [CTR] Requirements); FIN-2008-R013 (Dec. 18, 2008) (Whether a Non-listed Insurance Company May Be Exempted from [CTR] Reporting); [BSA]: Increased Use of Exemption Provisions Could Reduce Currency Transaction Reporting While Maintaining Usefulness to Law Enforcement Efforts (GAO, Feb. 2008).

(iv) FinCEN requires a financial institution to verify a customer's identity and retain records of certain information before issuing or selling bank checks and drafts, cashier's checks, money orders and traveler's checks worth between $3,000 and $10,000 that are purchased with cash. See 31 C.F.R. § 1010.415; Guidance on Interpreting Financial Institution Policies in Relation to Recordkeeping Requirements under 31 C.F.R. § 103.29 (FinCEN, Nov. 2002).

(v) On March 11, 2014, FinCEN issued a ruling that requires dealers in FX to retain a record of each FX transaction exceeding $1,000, which should include the name and address of the customer, the customer's passport number or taxpayer identification number, the date and amount of the transaction and the currency name, country and total amount of each foreign currency. See FIN-2014-R003 (Mar. 11, 2014) (Records to be Made and Maintained by Dealers in [FX]).

(vi) Transactions entirely outside the U.S. are exempt from the reporting requirements.

(vii) Concern that drug proceeds are being smuggled out of the U.S. and then repatriated through bulk currency shipments has increased scrutiny of AML controls in this area. See, e.g., BSA Exam Manual; FIN-2014-A005 (May 28, 2014) (Update on U.S. Currency Restrictions in Mexico: Funnel Accounts and TBML); FIN-2013-A007 (Sept. 27, 2013) (Supplement on U.S. Currency Restrictions on Banks in Mexico); FIN-2010-A007 (June 21, 2010) (Newly Released Mexican Regulations Imposing Restrictions on Mexican Banks for Transactions in U.S. Currency). See also Geographic Targeting Order (FinCEN, Aug. 7, 2015) (requiring enhanced cash reporting by armored car services and other common carriers of currency at certain points of entry on the Mexico-California and Mexico-Texas borders); FIN-2014-G002 (Aug. 1, 2014) (CMIR Guidance for Common Carriers of Currency, including Armored Car Services).

l. Funds Transfers and the "Travel Rule"

(i) Recordkeeping Requirements

A) Banks and non-bank financial institutions are required to collect and retain information on funds transfers and transmittals of funds in amounts of $3,000 and more. (31 C.F.R. §§ 1020.410(a), 1010.410(e)).

B) In addition, the "travel rule" (31 C.F.R. § 1010.410(f)) requires banks and non-bank financial institutions to include certain information in transmittal orders for transfers over $3,000, including the sender's name and address and, if received, information regarding the beneficiary (causing the information to "travel" with the funds).

(ii) International Funds Transfers and Remittances

International funds transfers are an important area of Treasury focus.

A) SWIFT provides a messaging system for international funds transfer instructions and processes over two billion payment messages per year. SWIFT messages direct the transfer of nearly $6 trillion worldwide each day.

B) Dodd-Frank § 1076 Act requires the Board to provide biennial reports to Congress for 10 years covering (i) the status of the automated clearinghouse ("ACH") system for remittances to foreign countries, (ii) adoption rates of international ACH transfer rules and formats, (iii) the efficacy of increasing such adoption rates, and (iv) recommendations to increase adoption. See Board Reports to Congress on the Use of the [ACH] System for Remittance Transfers to Foreign Countries (Apr. 2013 and July 2011).

C) In 2012, the CFPB issued a remittance rule implementing Dodd-Frank § 1073 (amendments to the Electronic Fund Transfer Act, 15 U.S.C. §§ 1693-1693r, to establish protections for consumers who send remittances from the U.S.).

D) Intelligence Reform and Terrorism Prevention Act § 6302, 31 U.S.C. § 5318A, required Treasury to produce a report examining the feasibility and effectiveness of requiring financial institutions to report to FinCEN data concerning cross-border wire transfers.

   i) Feasibility of a Cross-border Electronic Funds Transfer Reporting System Under the [BSA] (FinCEN, Oct. 2006) concluded that such reporting is "technically feasible" and "may be valuable to the government's efforts to combat money laundering and terrorist financing."

   ii) In 2010, FinCEN issued a proposed rule that would implement an electronic reporting system for cross-border wire transfers. 75 Fed. Reg. 60377 (Sept. 30, 2010) (solicitation of public comments).

iii) SWIFT message formats (MT 202COV) designed to improve transparency of "cover payments" (bank transfers in "cover" of underlying customer transactions) in accordance with principles announced by the Wolfsberg Group and the TCH were implemented in 2009. The Board and TCH enhanced the message formats for their U.S. dollar wire transfer systems (Fedwire and CHIPS) in 2011 to enable them to carry remittance information. See Extended Remittance Information Now Available Via the Fedwire Funds Service (Fedwire, Apr. 15, 2012); CHIPS Extended Remittance Information and Payment Notification (TCH, July 2011); TCH News Release, Apr. 26, 2010; Transparency and Compliance for U.S. Banking Organizations Conducting Cross-border Funds Transfers (Interagency Release, Dec. 2009); Due Diligence and Transparency Regarding Cover Payment Messages Related to Cross-border Wire Transfers (Basel, May 2009); [FAQs] (OFAC, Feb. 24, 2009; TCH News Release, Oct. 20, 2008 (Specifications for New Cover Payments Message Format); Statement on Payment Message Standards (Wolfsberg Group and TCH, Apr. 19, 2007).

E) For recent GAO reports on international remittances, see International Remittances: Money Laundering Risks and Views on Enhanced Customer Verification and Recordkeeping Requirements (GAO, Jan. 2016); International Remittances: Actions Needed to Address Unreliable Official U.S. Estimate (GAO, Feb. 2016).

F) See Part VIII.A.2.n.iv below regarding U.S.-EU sharing of cross-border payment information.

m. Special Measures for High-Risk Jurisdictions and Entities

PATRIOT Act § 311, 31 U.S.C. § 5318A, authorizes the Treasury Secretary to require U.S. financial institutions to take "Special Measures" when the Secretary determines that any non-U.S. financial institution or jurisdiction, or class of transactions or accounts, is of "primary money laundering concern" ("Primary ML Concern").

(i) Special Measures imposed to date are summarized at http://www.fincen.gov/statutes_regs/patriot/Section311.html. By far the most significant Special Measures to date relate to Iran. See Part VIII.A.2.h above.

(ii) On May 28, 2013, the U.S. Attorney for the SDNY unsealed an indictment charging Liberty Reserve SA ("Liberty Reserve") and seven of its principals with money laundering and operating an unlicensed money transmitting business. See U.S. v. [Liberty Reserve], Cr. No. 13-368 (SDNY May 28, 2013). In addition, Treasury named Liberty Reserve as a financial institution of primary money laundering concern under PATRIOT Act § 311, the first such use by Treasury of such authority against a web-based virtual currency. See 78 Fed. Reg. 34169 (June 6, 2013) (notice of finding). After Liberty Reserve ceased to function as a financial institution, Treasury withdrew its finding. See 81 Fed. Reg. 9139 (Feb. 24, 2016).

See Part VIII.A.2.d.v.D above for a discussion of issues related to virtual currencies.

n. Information-sharing

(i) Pursuant to FinCEN rules under PATRIOT Act § 314(a), federal, state, local and certain non-U.S. law enforcement agencies, through FinCEN, may request information regarding suspected terrorists or money launderers from any financial institution subject to the BSA. See 67 Fed. Reg. 60579 (Sept. 26, 2002) (final rule). In 2010, FinCEN significantly expanded the program under § 314(a), and enabled EU member states to submit information requests to U.S. financial institutions, thereby securing reciprocal rights for the U.S. 75 Fed. Reg. 6560 (Feb. 10, 2010) (31 C.F.R. § 1010.520). See generally 314(a) Fact Sheet (FinCEN, Aug. 23, 2011); [AML]: Improved Communication Could Enhance the Support FinCEN Provides to Law Enforcement (GAO, Dec. 2009).

(ii) PATRIOT Act § 314(b) provides a safe harbor for financial institutions that share information, following notice to Treasury, for purposes of identifying and reporting activities suspected to involve money laundering or terrorist financing. See 67 Fed. Reg. 60579 (Sept. 26, 2002) (31 C.F.R. § 1010.540) (procedures for safe harbor); FinCEN Section 314(b) Fact Sheet (Oct. 2013); FIN-2009-G002 (June 16, 2009) (scope of safe harbor).

A financial institution must file a SAR if, as a result of information shared by other financial institutions, it knows, suspects or has reason to suspect that a person is or may be involved in money laundering or terrorist financing.

(iii) Pursuant to PATRIOT Act § 314(d), 31 U.S.C. § 5313(d), the Treasury Secretary must prepare and distribute reports to financial institutions concerning patterns of suspicious activity and other investigative insights derived from SARs. See, e.g., Identity Theft: Trends, Patterns, and Typologies Based on [SARs] Filed by the Securities and Futures Industries (FinCEN, Sept. 2011).

(iv) After the attacks of September 11, 2001, U.S. law enforcement authorities used subpoenas to obtain access to information on millions of transactions stored on a U.S.-based SWIFT server for use in terrorism investigations.

A) When SWIFT's compliance with the subpoena became public, it was highly controversial. EU and Belgian authorities accused SWIFT of violating EU data protection rules.

B) In 2007, the EU and the U.S. reached an Agreement on a process for U.S. authorities to access SWIFT data for anti-terror investigations. That Agreement was replaced in 2010 by a new U.S.-EU Agreement that permits the bulk transfer of financial messaging data stored in the EU to the Treasury for purposes of targeted searches by the U.S. Terrorist Finance Tracking Program ("TFTP").

C) Plaintiffs have unsuccessfully alleged that SWIFT's disclosure of transaction information violated constitutional and statutory rights. See, e.g., Amidax Trading Group v. SWIFT, 607 F. Supp. 2d 500 (SDNY 2009) (dismissing complaint), aff'd, 671 F.3d 140 (2d Cir. 2011); Walker v. SWIFT, 517 F. Supp. 2d 801 (E.D. Va. 2007) (dismissing without prejudice, with leave to amend complaint).

D) See Report on the Joint Review of the Implementation of the Agreement between the [EU] and the [U.S.] on the Processing and Transfer of Financial Messaging Data from the [EU] to the [U.S.] for the Purposes of the [TFTP] (EC, Mar. 2011); Signature of EU-U.S. Agreement on Financial Messaging Data for Purposes of the U.S. [TFTP] (EU Council, June 28, 2010); 72 Fed. Reg. 60054 (Oct. 23, 2007) (OFAC Notice: Publication of U.S./EU Exchange of Letters and [TFTP] Representations of [Treasury]).

3. Terrorist Financing

a. Since the attacks of September 11, 2001, there has been an increased focus on using AML systems to detect and prevent the financing of terrorism. The use of AML tools has enabled the U.S. and its international partners to limit terrorist organizations' use of the formal financial sector. However, terrorist organizations continue to use charitable organizations and the largely unregulated hawala network to funnel money. In addition, new technology provides conduits that terrorist organizations can use. See, e.g., G7 Action Plan on Combatting the Financing of Terrorism (May 2016); Terrorist Assets Report: Twenty-fourth Annual Report to Congress on Assets in the [U.S.] Relating to Terrorist Countries and International Terrorism Program Designees (OFAC, June 2015) ("2015 Terrorist Assets Report"); Fact Sheet: National Strategy for Counterterrorism (White House, June 2011); EU-U.S. and Member States 2010 Declaration on Counterterrorism (EU Council, June 2010); Final Report of the UN Working Group on Tackling the Financing of Terrorism (Jan. 2009).

b. Because of the small amounts of funds typically involved and changes in technology, terrorist financing is difficult to detect with traditional AML tools. Potential "red flags" for terrorist financing include (i) stated occupation of the customer is not commensurate with the type or level of activity; (ii) persons involved in currency transactions share an address or phone number, particularly when the address is also a business location; (iii) non-profit or charitable organizations are engaged in transactions that appear inconsistent with their mission, particularly with respect to high-risk jurisdictions; (iv) large numbers of funds transfers through an account with no apparent purpose; and (v) FX exchanges followed within a short time by funds transfers to high-risk locations. See Testimony of Deputy Assistant Secretary of State Keller, June 9, 2016; Testimony of FinCEN Director Shasky Calvery, May 24, 2016; BSA Exam Manual, Appendix F; 2014 Terrorist Assets Report; National Commission on Terrorist Attacks upon the [U.S.]: Monograph on Terrorist Financing (SEC Staff Report, 2004); Guidance for Financial Institutions in Detecting Terrorist Financing (FATF, Apr. 24, 2002).

c. Class actions against banks which assert that the banks knowingly provided financial services related to terrorism have raised questions about the extent of banks' diligence obligations and potential liability. A U.S. District Court sanctioned Arab Bank for failing to obey a court order to produce bank records to the plaintiff, and instructed the jury that it may infer from the refusal to produce that the Bank knowingly and purposefully worked on behalf of terrorist organizations. Arab Bank argued that release of the records would violate foreign bank secrecy laws. See Linde v. Arab Bank, 269 F.R.D. 186 (EDNY 2010), petition for writ of mandamus denied, No. 10-4519 (2d Cir., Jan. 18, 2013), cert. denied, 134 S. Ct. 2869 (2014). The case went to trial, and a jury found Arab Bank liable in September 2014. After Arab Bank's request for an immediate appeal was rejected, Arab Bank settled in August 2015 prior to the damages trial. See Linde, No. 04-cv-02799 (EDNY, May 24, 2016) (final judgment); Banking Daily, Apr. 8, 2015; Wall St. J., Sept. 22, 2014; Law360, Sept. 22, 2014; Wall St. J., Aug. 14, 2014.

More than a dozen suits have been filed in New York, including one against a group of six banks, three against Crédit Lyonnais, two against National Westminster Bank, and nine against Arab Bank. See, e.g., Freeman v. HSBC, No. 14-cv-06601 (EDNY Nov. 10, 2014) (complaint filed by victims of Iran-sponsored attacks during the Iraq war alleging that HSBC, Barclays, SCB, Credit Suisse, RBS and Commerzbank conspired with Iran and Iranian banks to evade U.S. sanctions which enabled the transfer of funds to Iranian-backed militias and terrorist groups); Rothstein v. UBS, 708 F.3d 82 (2d Cir. 2013) (affirming District Court’s dismissal for lack of standing and failure to state a cognizable claim); Strauss v. Crédit Lyonnais, 2013 WL 751283 (EDNY, 2013) (denying in part Crédit Lyonnais summary judgment motion on the grounds that a genuine issue of material fact existed as to whether Crédit Lyonnais knew about or deliberately disregarded a French charity’s purported support of Hamas or Hamas front groups); Licci v. Lebanese Canadian Bank, 984 N.E. 2d 893 (NY 2012) (non-U.S. bank’s maintenance and use of a correspondent banking account to effect dozens of wire transfers worth millions of dollars was sufficient to form the basis for personal jurisdiction under NY long-arm statute); 2013 WL 566360 (2d Cir. 2013) (exercise of personal jurisdiction over foreign bank using NY correspondent account is consistent with due process); Goldberg v. UBS, 690 F. Supp. 2d 92 (EDNY 2010) (denying UBS motions to reconsider denial of dismissal on forum non conveniens grounds where plaintiffs alleged UBS aided terrorist acts by transmitting funds on behalf of Hamas-linked charities) (settlement approved June 25, 2012); Weiss v. National Westminster Bank, 453 F. Supp. 2d 609 (EDNY 2006) (granting motion to dismiss with respect to allegation of aiding and abetting murder, but denying motion with respect to allegations of knowingly providing material support to a terrorist organization and unlawfully and willfully providing or collecting funds with the intention or knowledge that such funds would be used for terrorist purposes); 768 F. 3d 202 (2d Cir. 2014) (vacating and remanding summary judgment based on triable issue of fact existing as to whether National Westminster Bank had actual knowledge or was deliberately indifferent to material support its correspondent account provided to terrorist organization). See also Bennett v. Islamic Republic of Iran, 2015 WL 5024070 (9th Cir. 2015) (affirming order holding Bank Melli responsible for Iran's liability under a statute that allows victims of terrorism to collect from instrumentalities of the state sponsoring the attack); Holder v. Humanitarian Law Project, 561 U.S. 1, (2010) (upholding the constitutionality of the criminal prohibition against providing material support to a foreign terrorist organization).

d. In Peterson v. Iran, Consol. Civ. Act. 01-2094 (RCL), 01-2684 (RCL) (D.D.C., Dec. 18, 2002), family members of U.S. Marines killed in the 1983 bombing of the Beirut Marine barracks won a default judgment against Iran for $2.6 billion. In 2008, plaintiffs sought to enforce their judgment by filing a motion to compel international financial institutions with operations in California to assign to the plaintiffs any funds and other rights of Iran held at any locations of the financial institutions worldwide. The Court found that it lacked jurisdiction over the financial institutions and denied the motion. 563 F. Supp. 2d 268 (D.D.C. 2008). Plaintiffs also sought to enforce their judgment against Iran's blocked assets at NY financial institutions. In March 2013, a District Court granted summary judgment to the plaintiffs and ordered that such assets be turned over to the plaintiffs. 2013 WL 1155576 (SDNY 2013), affirmed, 758 F.3d 185 (2d Cir. 2014), affirmed, 578 U.S. ___ (2016).

e. In Villoldo v. BNP Paribas, plaintiffs with a $2.9 billion default judgment against Cuba for torturing their relatives unsuccessfully sought to enforce their judgment against Cuban electronic fund transfers held by BNP Paribas. See Villoldo v. BNP Paribas, No. 15-2375-cv (2d Cir., Apr. 29, 2016) (summary order).

4. Foreign Corrupt Practices Act

The FCPA prohibits the bribery of foreign officials and requires companies to keep accurate books and records and to maintain a system of internal accounting controls. The FCPA is enforced by the DOJ and the SEC. 15 U.S.C. §§ 78m(b)(2)-(7), 78dd-1, 78dd-2, 78dd-3, 78ff. SEC Rules 13b2-1 and 13b2-2(a) implement the FCPA's accounting provisions. In 2012, the DOJ and the SEC issued guidance on the FCPA, providing analysis of key provisions and describing the Government's enforcement approach and priorities. A Resource Guide to the U.S. [FCPA] (DOJ and SEC, Nov. 2012) (the "FCPA Resource Guide"). (U.S. authorities subsequently made minor technical changes to the Guide, primarily correcting statements on an issuer's potential FCPA exposure for minority investments and the calculation of FCPA fines. FCPA Resource Guide; National Law Review, Aug. 5, 2015.

Growing international efforts to fight corruption, combined with aggressive enforcement of the FCPA in the U.S., have put the FCPA at the top of many financial institutions' compliance agendas. FCPA risk may also influence where financial institutions conduct business. FCPA bribery enforcement had a slower pace in 2015, but increased significantly in 2016. Law360, May 18, 2016; American Lawyer, May 9, 2016. In 2015, FCPA fines dropped significantly compared to the year prior. DOJ fines dropped from $1.25 billion in 2014 to $24.2 million in 2015. Corporate Counsel, Feb. 2, 2016. The largest enforcement action of the year was BHP Billiton's $25 million settlement with the SEC. "The 2015 FCPA Enforcement Index", The FCPA Blog, (Jan. 4, 2016). The SEC's Director of its Enforcement Division stated that enforcement of FCPA violations "won't slow down" in 2016. Securities Law Daily, Mar. 10, 2016. One recent poll found that 36% of the companies surveyed had pulled out of acquisition deals due to a target's links to corrupt activity. AlixPartners Annual Global Anticorruption Survey 2016 (Apr. 2016). See also Corruption Perceptions Index 2015 (Transparency International, 2016) (Denmark, Finland, Sweden, New Zealand, Netherlands, Norway perceived as least corrupt; Somalia, North Korea, Afghanistan, Sudan, South Sudan perceived as most corrupt). According to the most recent TRACE report, in 2015, non-U.S. enforcement actions involving bribery of foreign officials dropped 73% from 2014. In 2015, there were 251 investigations concerning bribery of foreign officials, of which 126 were U.S. enforcement actions and 125 were non-U.S. enforcement actions. Global Enforcement Report 2015 (TRACE, Mar. 2016).

While challenges remain, corporations have made significant strides in implementing anticorruption compliance programs. See 2016 Anti-bribery and Corruption Benchmarking Report (Kroll, 2016) (83% of companies perform diligence on third parties); Kroll, 2015 Anti-bribery and Corruption Benchmarking Report (2015) (69% of companies rated their policies for domestic employees as effective); Anti-corruption Survey Results 2016 (Dow Jones, 2016) (97% of anticorruption programs have internal conduct codes, 94% have training, 63% of companies have confidence in their diligence processes); International Business Attitudes to Corruption, Survey 2015/2016 (Control Risks, 2016) (64% of respondents have an anti-corruption training program for employees).

In its report on transnational bribery, the OECD found that most international bribes are paid by large corporations, usually with the knowledge of senior-level executives. Foreign Bribery Report (OECD, 2014) (study of 427 transnational bribery cases between 1999 and 2014 found that management-level employees paid or authorized the bribes in 41% of cases, while CEOs were involved in 12% of cases). Small to mid-sized firms may face increased FCPA risk when expanding operations overseas due to the limited resources they may have available for anticorruption compliance programs. Securities Law Daily, Nov. 9, 2015.

a. Bribery Prohibition

The FCPA bars any act in furtherance of a corrupt payment, offer or promise to pay, or authorization of any payment of money or anything of value to, a "foreign official" to obtain or retain business or to secure an improper advantage. In addition, these corrupt payments cannot be made, offered, promised or authorized to or for a third party while "knowing" that any portion of the payment will be passed on to a foreign official.

(i) The FCPA's "knowledge" element goes beyond actual knowledge. If a person is aware of a high probability that an improper payment is going to take place, a defendant cannot escape FCPA liability by consciously ignoring "red flags" which provide evidence of possible bribery. See U.S. v. Kozeny, 664 F. Supp. 2d 369 (SDNY), aff'd, 667 F.3d 122 (2d Cir. 2011); Third Party Payments: Lay-person's Guide to the FCPA (DOJ, 2001).

(ii) FCPA enforcement actions frequently focus on the payment of bribes by third parties, including agents and distributors. See, e.g., Diago plc, SEC Admin. Proc. No. 3-14490 (July 27, 2011); DOJ Press Release, Dec. 6, 2004 (InVision Technologies Enters Into Agreement with the [U.S.]); GE InVision, SEC Litigation Release No. 19078 (Feb. 14, 2005). Third-party diligence, anticorruption contract terms, and careful monitoring of third parties can help decrease the risk that a company will be viewed as having intentionally ignored warning signs of bribery by business partners.

(iii) The term "foreign official" is defined broadly and covers (A) an officer, employee or official adviser of a non-U.S. government, any department, agency or instrumentality of a non-U.S. government, or a public international organization (e.g., World Bank); (B) a political party or party official; and (C) a candidate for political office. 15 U.S.C. §§ 78dd-1(f)(1), 78dd-2(h)(2), 78dd-3(f)(2). See generally, e.g., Bloomberg, June 29, 2011; Nat'l. L. J., May 16, 2011; Wall St. J., Feb. 22, 2011.

A) Employees of previously private financial institutions that have been nationalized may become "foreign officials" for FCPA purposes.

B) Employees of SWFs are likely to be treated as "foreign officials".

C) On the other hand, purely passive, minority investments by a government (capital infusions, loan guarantees, etc.) into a financial institution may not result in the institution's employees being deemed to be "foreign officials".

D) A person's membership in the royal family of a foreign country, by itself, does not automatically qualify that person as a "foreign official", but a royal family member who exercises government power can be a "foreign official". DOJ Opinion Procedure Release No. 12-01 (Sept. 18, 2012). See also New FCPA Guidelines on When Foreign Royalty is Considered a "Foreign Official" under the U.S. FCPA (Cleary Gottlieb, Oct. 10, 2012).

E) Defining "foreign official" is a fact-intensive process that requires an analysis of multiple factors that may include the purported official's past and present positions in government, the manner in which the relevant government is structured and power is distributed, and the individual's ability to influence governmental decision-making. "What You Should Know About 'Foreign Officials' Under the Foreign Corrupt Practices Act" (TRACE International, May 2016).

(iv) The FCPA's "anything of value" element takes many forms, including cash, gifts, travel and entertainment expenses, regardless of size. The payment of reasonable travel and entertainment expenses, however, has not been the focus of DOJ and SEC enforcement efforts. Rather, the DOJ and the SEC have generally brought cases when payments of travel and entertainment occurred in conjunction with other conduct reflecting bribery. See, e.g., FCPA Resource Guide; DOJ Opinion Procedure Release No. 12-02, Oct. 18, 2012. The SEC recently confirmed that its interpretation of "items of value" reaches benefits such as the provision of internships to relatives of foreign officials. Securities Law Daily, Nov. 23, 2015.

(v) The prohibition on foreign bribes does not apply to a "facilitating or expediting payment" to foreign officials if the purpose of the payments is "to expedite or to secure the performance of a routine governmental action" by a foreign official (e.g., a payment to speed the processing of a visa). "Routine governmental action" does not include (A) a decision by a non-U.S. official to award new business or to continue business with a particular company, or (B) government approvals involving the exercise of discretion by an official. See generally Corporate Counsel, Feb. 5, 2013.

(vi) There are affirmative defenses to a foreign bribery charge, if:

A) The payment to a foreign official was a "reasonable and bona fide expenditure, such as travel and lodging expenses" and was "directly related" to "the promotion, demonstration or explanation of products or services;" or "the execution or performance of a contract with a foreign government or agency" (see, e.g., DOJ FCPA Opinion Releases 11-01 (2011), 07-02 (2007), 07-01 (2007));

B) The payment to a foreign official was "lawful under the written laws and regulations" (emphasis added) of the foreign official's nation; or

C) The applicable statute of limitations has expired. There is no express statute of limitations provision in the text of the FCPA. As a result, the general five-year statutes of limitations for criminal cases and civil penalties apply.

If the defendant is not physically present in the U.S., the five-year limitations period may be delayed. See SEC v. Straub, CCH Fed. Sec. L. Rep. ¶ 97,295 (N.D. Ill., Feb. 8, 2013) ("SEC v. Straub"). See generally Corporate Counsel, Apr. 17, 2013; Peace et al., "The FCPA Statute of Limitations -- A Way Out for Wal-Mart?", Sec. Reg. & L. Rep., Oct. 1, 2012.

(vii) The anti-bribery provision applies to several types of entities and persons:

A) "Issuers," defined as companies subject to 1934 Act registration or reporting requirements, are covered if an act in furtherance of a bribe makes use of U.S. interstate commerce.

B) "Domestic concerns," defined to include any citizen, national or resident of the U.S. or any corporation, partnership, association or other business entity which has its principal place of business in the U.S. or which is organized under the law of any U.S. state, are covered regardless of whether an act in furtherance of a bribe makes use of U.S. interstate commerce.

C) Foreign entities or natural persons (other than "issuers" and "domestic concerns") are covered if they act in furtherance of a bribe within U.S. territory.

D) Foreign subsidiaries of U.S. companies generally are not covered, but they could be liable as agents of the parent company or as "persons" acting in furtherance of a bribe within the U.S. Similarly, U.S. parents may be liable if they use their foreign subsidiaries to engage in bribery. See H.R. Conf. Rep. No. 95-831 (1977); FCPA Resource Guide, 27-28; Diagnostic Products, SEC Admin. Proc. No. 3-11933 (May 20, 2005); DOJ Press Release, May 20, 2005 (DPC (Tianjin) Ltd.); DOJ Press Release, Dec. 10, 2002 (Syncor Taiwan), U.S. v. Syncor Taiwan (C.D. Cal., Dec. 9, 2002) (plea agreement), Syncor Int'l Corp., SEC Admin. Proc. No. 3-10969 (Dec. 10, 2002).

E) Foreign subsidiaries of foreign "issuers" may also be liable as "agents" of the parent company. Snamprogetti, a non-issuer Dutch corporation, was charged by the SEC with violating the FCPA by acting as an agent for its parent company, the Italian oil company ENI. The SEC's complaint included little specific evidence of an agent relationship beyond Snamprogetti's status as a subsidiary of ENI. ENI, SEC Litigation Release No. 21588 (July 7, 2010).

F) Even if all the elements of an FCPA anti-bribery violation are not present, payments to foreign government officials and intermediaries may violate the Travel Act. See 18 U.S.C. § 1952. The Travel Act prohibits the use of the facilities of interstate or foreign commerce (such as mail, fax or email) in the commission of any unlawful activity, including the FCPA and state commercial bribery laws. See FCPA Resource Guide.

b. Accounting Provision

The FCPA accounting provision relates to (i) books and records, and (ii) internal controls.

(i) Under the books and records section, a company must "keep books, records, and accounts" that in "reasonable detail, accurately and fairly reflect" the company's transactions and assets. See 15 U.S.C. § 78m(b)(2)(A). No person may "directly or indirectly, falsify or cause to by falsified, any book, record or account". See 1934 Act Rule 13b2-1.

(ii) Under the internal controls section, every "issuer" must maintain a "system of internal accounting controls" to provide "reasonable assurances" that:

A) Transactions are only made with "management's general or specific authorization";

B) Transactions are recorded in a manner that allows (1) preparation of GAAP financial statements, and (2) accountability of corporate assets;

C) Access to assets is permitted only in accordance with management's directions; and

D) Actual corporate assets are compared with recorded assets at "reasonable intervals" and "appropriate action" is taken if there are discrepancies.

(iii) 1934 Act Rule 13b2-2 makes it illegal for directors, officers and persons acting under their direction to mislead auditors.

(iv) The accounting provision applies to "issuers," but an individual may be criminally liable if the person "knowingly" circumvents or fails to implement the required internal accounting control system or "knowingly" falsifies any book, record or account.

(v) "Issuers" must ensure that subsidiaries have accurate books and records and required internal controls. If, however, the issuer holds 50% or less of the voting power of subsidiary, the issuer must "proceed in good faith to use its influence, to the extent reasonable under the issuer's circumstances, to cause" the subsidiary to create an internal control system.

(vi) Diligence in acquisition transactions increasingly includes an FCPA component, particularly if the business involved engages in operations in emerging markets. See, e.g., Compliance Week.com, Feb. 3, 2015; Corporate Counsel, Jan. 14, 2015; ACFE.com, Mar./Apr. 2012; CFD.com, Feb. 15, 2011.

(vii) More generally, the SEC will consider the "reasonable assurances" standard to have been met if a company's internal controls are robust enough to demonstrate that no bribery or corruption had occurred. See FCPA Compliance & Ethics, May 13, 2016. The SEC has brought FCPA actions under the internal controls section even where no illicit activity has occurred based on violations that create a risk of corruption. "Revisiting the FCPA's Internal Accounting Controls Provision:

Addressing Common Misconceptions and Challenges" (TRACE, Apr. 13, 2016).

c. Jurisdiction

The FCPA anti-bribery and accounting provisions apply to conduct both inside and outside the U.S. When a defendant plays a role in falsifying or manipulating SEC filings relied on by U.S. investors, there is personal jurisdiction in FCPA actions. When, however, a defendant's role in a bribery scheme could only have an attenuated impact on SEC filings, there is no personal jurisdiction. See SEC v. Straub; SEC v. Sharef, CCH Fed. Sec. L. Rep. ¶ 97,292 (SDNY 2013).

d. Compliance

(i) As a component of various FCPA settlements, the DOJ has required companies to implement compliance programs designed to deter and detect foreign bribery activity, and it is now common for multinational companies, especially those operating in high-risk industries or countries, to implement an FCPA compliance program. See, e.g., U.S. v. Metcalf & Eddy, C.A. No. 99CV-12566 N6 (D. Mass., Dec. 14, 1999) (consent and undertaking); U.S. v. Siemens, Cr. No. 08 367 RVC (D.D.C., Dec. 15, 2008) (statement of offense). See generally Securities Law Daily, Nov. 4, 2015. Aftermarket Business, May 23, 2011 ("Basic FCPA Compliance Principles"); OECD Good Practice Guidance on Internal Controls, Ethics, and Compliance (Feb. 18, 2010); Business Finance, May 2, 2011.

U.S. enforcement authorities may launch a broad investigation into a particular industry or type of business. The financial industry and private equity firms in particular have been an area of increasing focus for U.S. authorities. See Securities Law Daily, Oct. 26, 2015; Corporate Counsel, Dec. 13, 2013. The SEC recently created a private fund unit dedicated to investigating the operations of private equity funds. See National Law Review, July 1, 2016.

Pre-acquisition due diligence is an important tool for avoiding FCPA liability. Once buyers learn of possible FCPA problems they can pressure targets to institute appropriate compliance programs and/or take corrective actions regarding specific incidents or practices, including possible self-disclosure to law enforcement agencies. See, e.g., DOJ Opinion Procedure Release No. 14-02 (Nov. 7, 2014) (providing detail about what DOJ would like to see companies do to address potential acquirer liability for corrupt activities of a target); DOJ Opinion Procedure Release No. 08-02 (June 13, 2008). See generally Corporate Counsel, Jan. 14 2015; Complianceweek.com, Feb. 8, 2015. Failure to address these problems can result in liability under the FCPA and has given rise to a malpractice claim against buyer's counsel whose diligence allegedly failed to detect a target's bribery. See, e.g., Watts Water Technologies, SEC Admin. Proc. No. 3-14585 (July 27, 2011).

(ii) U.S. authorities will weigh the existence or absence of a reasonable compliance program in assessing penalties. Federal Sentencing Guidelines Manual, § 8C2.5(g)(1) (2009); Memorandum from Deputy Attorney General McNulty, Principles of Federal Prosecution of Business Organizations (2010). See also NACDonline.org, May/June 2016; DOJ Advisory Opinion 04-02 (2004).

The SEC and DOJ's decision not to bring an action against Morgan Stanley in the wake of the Garth Peterson prosecution (discussed below in Part VIII. A.4.g.i.T) has been taken as an illustration of what the SEC and DOJ consider an internal control system sufficient to provide "reasonable assurances that [a company's] employees were not bribing government officials." Morgan Stanley employed over 500 dedicated compliance officers, conducted training on anti-corruption policies and the FCPA seven times in six years, and frequently distributed materials and a code of conduct to employees. Morgan Stanley also implemented a system to detect improper payments, conducted random audits, operated a toll-free compliance hotline, and regularly updated its policies and systems. See U.S. v. Peterson, Cr. No. 12-224 (JBW) (EDNY, May 3, 2012) (final judgment).

(iii) FINRA Regulatory Notice 11-12 (Mar. 2011) reminded broker-dealers of their FCPA obligations, advised firms to review their business practices to ensure they comply with their FCPA obligations, and indicated that a firm's failure to comply with such obligations will be considered conduct inconsistent with high standards of commercial honor and just and equitable principles of trade in violation of FINRA Rule 2010.

FINRA clarified that the FCPA's anti-bribery prohibitions apply to every broker-dealer (and its officers, directors, employees, agents, and any stockholders acting on its behalf). Specifically:

A) A broker-dealer that is considered an "issuer" pursuant to the FCPA must comply with both the FCPA's anti-bribery provisions for issuers and the 1934 Act accounting provisions.

B) A broker-dealer that meets the definition of "domestic concern" and that is not considered an "issuer" must comply with the FCPA's anti-bribery provisions for domestic concerns.

C) A foreign broker-dealer registered with the SEC may be considered a foreign business that must comply with the FCPA anti-bribery provisions for foreign businesses.

D) The FCPA's anti-bribery prohibitions apply to broker-dealers that are considered either "domestic concerns" or "foreign businesses" even though those statutory provisions are not incorporated into the 1934 Act.

(iv) The SEC circulated a "sweep letter" to investment advisers requesting information about their use of third parties to obtain investments from SWFs, and their FCPA compliance. See, e.g., Wall St. J., Jan. 14. 2011; NY Times, Jan. 13, 2011.

In 2011, the SEC opened an investigation, in cooperation with the UK Serious Fraud Office, into whether banks, hedge funds and private-equity firms violated the FCPA by paying bribes to SWF officials in order to secure investments or sell securities. See Bloomberg, June 29, 2011. In 2012, the FSA launched a formal investigation into the activities of Barclays' employees in connection with fundraising activities involving the Qatari SWF. As part of the investigation, the FSA and the Serious Fraud Office are probing an allegation that Barclays agreed to make cash payments to Qatari investors in order to secure investments at the height of the financial crisis without proper disclosure. The U.S. and UK investigations are ongoing, see Reuters, June 17, 2016. Financial Times, Sept. 16, 2013; Wall St. J., July 30, 2012, and there have been reports that the Serious Fraud Office approached Barclays with a potential settlement involving a Deferred Prosecution Agreement. See International Business Times, July 22, 2015.

(v) A majority of the respondents in the Deloitte 2011 Anti-corruption Survey addressed the following activities in their anti-corruption policies: (A) bribes, (B) gifts and travel/lodging expenses for government officials, (C) expenses for government business/relations, (D) "facilitating" payments, (E) political contributions, (F) due diligence on third parties, (G) charitable contributions/donations, and (H) employment of government officials or their relatives.

Identifying and managing third-party relationships, and managing cultural norms in different countries were viewed as the biggest challenges for anti-corruption efforts.

(vi) Steps that a company can take to minimize FCPA risk could include the following:

A) A system of internal accounting controls that would detect unauthorized or illegal transactions; in particular, such a system should require that (i) cash disbursements and other asset transfers be recorded promptly, (ii) employees have access to corporate assets only pursuant to authorization from senior management, and (iii) the recorded accountability for assets be compared with existing assets at reasonable intervals and appropriate action be taken to address disparities.

B) A "tone at the top" and "culture of compliance" and a written code of conduct forbidding corrupt payments to non-U.S. government officials, and a compliance policy that includes both a recitation of the law and real-world examples that are relevant to the industry and business.

C) Clearly articulated FCPA compliance policies.

D) Oversight by senior executives with responsibility for compliance policy implementation and review, and reporting responsibility to a board of directors or board committee.

E) Monitoring programs for review of policies, procedures and upward reporting so a company can take ameliorative action.

F) Employee anti-bribery and recordkeeping training programs (with more intensive training for key employees, such as those in sales and marketing, those who operate abroad, finance employees, and supervisory personnel).

G) A requirement that a company's subsidiaries include FCPA compliance provisions in appropriate contracts.

H) Application of uniform standards for all divisions and countries of operation.

I) An international compliance function to review and advise on compliance with company policy.

J) Procedures for entering into third-party business relationships.

K) A requirement that a company's subsidiaries conduct background investigations ("due diligence") of consultants and agents, including:

   i) Determining whether any person receiving payments is considered a foreign official or may be a foreign government entity.

   ii) Providing due diligence questionnaires to potential third-party firms and appropriate employees inquiring about current and former relationships with government entities or foreign officials, ownership structures, prior sanctions and violations of the law.

   iii) Examining references and conducting background investigations.

   iv) Reviewing relevant compliance policies and resources of the third party.

L) Preparation of procedures for dealing with foreign agents, distributors and joint venture partners (including model FCPA provisions and procedures for performing due diligence that can be tailored to meet individual situations).

M) A requirement that relevant company officials periodically certify that they have not made improper payments.

N) Procedures to ensure control over the distribution and tracking of expenditures.

O) Procedures for confidential reporting of suspected problems.

P) Investigation of "red flags" and establishment of a structure for deciding whether a potential FCPA violation exists by people who are independent of the transaction.

Q) A reporting system (including an anonymous hotline) to ensure that violations can be detected and remedied.

R) Independent audits conducted by outside legal counsel or auditors.

S) Disciplinary procedures.

See FCPA Resource Guide, 59-60.

(vii) Recognizing that insurance products may become an important part of multinational companies' risk management programs, insurance companies have developed products to provide coverage for legal, accounting, auditing and consulting expenses incurred as part of an FCPA investigation. See, e.g., Marsh USA FCPA Corporate Response (2011).

(viii) The ICC has developed rules and guidance relating to anti-corruption. See, e.g., ICC Anti-corruption Clause (2012); ICC Rules on Combatting Corruption (2011).

(ix) The LSTA issued new guidance in December 2014 relating primarily to issues that arise under the FCPA, and explains how lenders can mitigate their FCPA-related risks and protect themselves when making and documenting their credit arrangements. LSTA Guidance on Anti-Corruption Issues in Lending Transactions (2014).

e. Penalties

The FCPA carries harsh criminal penalties.

(i) With respect to the anti-bribery provision, convicted individuals may be sentenced to up to five years' imprisonment and up to a $250,000 fine for each violation. The company employing the individual may not pay this fine on the employee's behalf. Convicted companies may be fined $2 million for each violation (or twice the applicable gross gain or loss, whichever is greater). In addition, the DOJ and the SEC are authorized to bring civil actions.

(ii) With respect to the recordkeeping and accounting provisions, if convicted of knowing violations, an individual may be sentenced to up to 20 years' imprisonment and fined up to $5 million for each violation, while a company may be fined up to $25 million for each violation.

(iii) When settling FCPA cases in recent years, the DOJ has frequently required companies to hire an FCPA compliance monitor who reports to the government on a company's efforts to improve its anticorruption policies.

f. Voluntary Reporting and Cooperation

(i) Corporations and individuals who voluntarily report FCPA violations and who cooperate in any investigation are eligible to receive reduced sentences and penalties. According to a DOJ official, one defendant received a penalty "67 to 84% less than it what it otherwise could have faced had it not provided extraordinary cooperation and carried out such extensive remediation". Remarks of Assistant Attorney General Breuer, May 26, 2010. See also, e.g., Washington Post, May 22, 2011.

(ii) Enforcement agencies rely heavily on voluntary reporting when instituting FCPA enforcement actions. In 2011, approximately 99% of the money collected by the DOJ and 97% of the money collected by the SEC came from FCPA enforcement actions resulting from voluntary disclosures. "Special Report: 2011 Foreign Corrupt Practices Act Year in Review", World Sec. L. Rep., Feb. 2012.

(iii) On April 5, 2016, the DOJ's Criminal Division announced the launch of a one-year FCPA pilot program. This new guidance states that a company that voluntarily self-discloses FCPA misconduct, fully cooperates with the investigation, and engages in remediation efforts may receive up to a 50% reduction from the bottom end of the Sentencing Guidelines fine range. However, a company that forgoes voluntary disclosure, but fully cooperates and appropriately remediates, may receive only limited credit – at most a 25% reduction from the bottom end of the Sentencing Guidelines fine range. The Fraud Section's Foreign Corrupt Practices Act Enforcement Plan and Guidance (DOJ, Apr. 5, 2016). See also Inside Counsel, June 17, 2016; PLI SmartBrief, June 14, 2016; DOJ Launches Foreign Corrupt Practices Act Pilot Program (Cleary Gottlieb, Apr. 15, 2016); NACDonline.org, May/June 2016. The program has been criticized for the lack of certainty about the treatment of self-disclosures under the program. See Law360, May 5, 2016; Wall St. J., Apr. 13, 2016; Corporate Crime Reporter, Apr. 5, 2016.

(iv) The first cases under the Pilot Program resulted in declinations of enforcement by the DOJ and Non-prosecutions Agreements with the SEC for the companies, Akamai Technologies, and Nortek, who both self-reported their unrelated cases involving bribery of Chinese officials. In a letter to the companies' counsel, the DOJ cited a number of factors influencing its decision to decline to press charges, including identification of the misconduct, prompt voluntary self-disclosure, a thorough investigation, and full cooperation. DOJ Letter, June 6, 2016; DOJ Letter, June 3, 2016. Under the SEC Non-prosecution Agreements, Akamai agreed to pay $672,000 and Nortek agreed to pay $322,000 to settle the cases. See Corporate Counsel, June 13, 2016; Wall St. J., June 7, 2016; Reuters, June 7, 2016; SEC Press Release 2016-109 (June 7, 2016).

g. Significant New Developments

In 2016, the DOJ announced that it was dedicating increased personnel resources to the pursuit of FCPA violations by both individuals and corporations. Securities Law Daily, June 15, May 27, 2016. The SEC also announced that it would consider monetary penalties paid to foreign jurisdictions when calculating monetary penalties for its own settlement agreements. Securities Law Daily, May 3, 2016. The SEC has continued to investigate hiring practices as potential FCPA violations. It settled cases with BNY Mellon and Qualcomm over the hiring of relatives of foreign government officials as a means to seek improper business advantages. BNY Mellon agreed to pay $14.8 million, and Qualcomm agreed to pay $7.5 million to the SEC to settle those charges. Securities Law Daily, July 12, 2016. An SEC official affirmed that it viewed an internship as an item of value that could constitute a bribe payment. Remarks of SEC Enforcement Division Director Andrew Ceresney, Nov. 17, 2015. Increasingly, the DOJ and SEC have resolved FCPA enforcement actions independently so that the SEC can enjoy a "home court advantage" before an administrative judge and utilize a "preponderance of the evidence" standard. Law360, Mar. 23, 2016.

A Siemens settlement involving a fine of $800 million in 2008 introduced a new era of extremely large FCPA penalties. In total, Siemens paid over $1.6 billion in penalties to U.S. and German authorities, and also incurred legal, accounting and restructuring costs of over $1 billion. DOJ Press Release, Dec. 15, 2008; U.S. v. Siemens, Cr. No. 08 367 (DDC, Dec. 15, 2008) (statement of offense). See generally NY Times, Sept. 3, 2012. As part of its settlement with the DOJ, Siemens retained a corporate monitor. Efforts by private parties to obtain copies of the monitors' reports have thus far failed. Corporate Crime Reporter, Aug. 24, 2016.

(i) Focus on Individuals

In 2015, in connection with FCPA cases, 16 individuals faced civil or criminal charges, pled guilty in criminal cases, were sentenced, or otherwise settled civil or criminal FCPA claims. 2015 FCPA Enforcement Index; The FCPA Blog, Jan. 4, 2016. The prosecution of individuals "continues to be a high priority" for the DOJ. Remarks of Assistant Attorney General Caldwell, Oct. 1, 2014.

In late 2015, the DOJ published the "Yates Memorandum," which states that the DOJ would give greater focus to holding individuals accountable under the FCPA. See generally "What You Should Know About Individual Liability Under the Foreign Corrupt Practices Act" (TRACE, 2016).

The increased focus on individual prosecutions has been accompanied by aggressive law enforcement tactics such as "sting" operations and wiretaps. In 2010, after a multi-year undercover investigation involving 150 FBI agents, the DOJ brought FCPA charges against 22 executives and employees of 16 different military and law enforcement products companies. The DOJ indictments allege that the defendants agreed to pay bribes to an FBI agent posing as an African minister of defense in order to receive a $15 million contract. DOJ Press Release, Jan. 19, 2010.

The following cases represent heightened efforts to target individuals:

A) Jun Ping Zhang, the former Chairman and CEO of Harris Corporation's China subsidiary, agreed to pay a $46,000 civil penalty for engaging in a scheme to bribe Chinese government officials in order to secure business. SEC Admin. Proc. No. 3-17535 (Sept. 13, 2016).

B) Abraham Jose Shiera Bastidas and Roberto Enrique Rincon Fernandez, the owners of several U.S.-based energy companies, pled guilty to FCPA charges for their role in a scheme to bribe officials from Venezuela's state-owned energy company Petróleos de Venezuela S.A. (PDVSA) in order to secure lucrative energy contracts. A former employee of Shiera and Rincon as well as three former PDVSA officials also pled guilty for their roles in the scheme. DOJ Press Releases, June 16, 2016; Mar. 23, 2016.

C) Dmitrij Harder, the former owner and president of the Chestnut Group, pled guilty to violating the FCPA for a scheme in which he paid approximately $3.5 million to an official at the European Bank for Reconstruction and Development (EBRD) in an effort to influence the official to approve the Chestnut Group's clients' financing requests and to direct further business to the Chestnut Group. The EBRD official and his sister were charged by the UK's Crown Prosecution Service in a related action. DOJ Press Release, Apr. 20, 2016. See also Wall St. J., Apr. 15, 2016.

D) Mikhail Gourevitch, a former employee of the health science company Nordion, agreed to pay $179,000 to settle SEC charges that he arranged bribes by Nordion to Russian government officials to approve distribution of a liver cancer treatment. Nordion also agreed to pay a $375,000 penalty to the SEC to settle charges that it failed to conduct basic FCPA diligence to prevent the scheme. SEC Admin. Proc. No. 3-17153 (Mar. 3, 2016).

E) Ignacio Cueto Plaza, the CEO of the South American-based LAN Airlines, agreed to a $75,000 penalty to settle SEC charges that he authorized improper payments to a consultant while knowing that a portion of the funds could be used to pay union officials in Argentina to influence the settlement of a labor dispute. SEC Admin. Proc. No. 3-1710 (Feb. 4, 2016).

F) Daren Condrey pled guilty to FCPA conspiracy charges for his role in arranging over $2 million in corrupt payments to influence the awarding of contracts with TENEX, a subsidiary of Russia's State Atomic Energy Corporation. DOJ Press Release, Aug. 31, 2015.

G) Vicente Garcia, a former vice president at SAP SE, a software manufacturer headquartered in Germany, agreed to pay $92,395 to settle SEC allegations that he bribed Panamanian government officials through an intermediary to procure software license sales. SEC Press Release 2015-165 (Aug. 12, 2015). He also pled guilty to DOJ charges that he conspired to violate the FCPA. DOJ Press Release, Aug. 12, 2015.

H) Richard Hirsch and James McClung, both former executives of Louis Berger International, a New Jersey-based construction management company, pled guilty in connection with the company's scheme to bribe foreign officials in India, Indonesia, Vietnam and Kuwait to secure government construction management contracts. DOJ Press Release, July 17, 2015.

I) James Rama, the former vice president of IAP Worldwide Services, a Florida defense and government contracting company, pled guilty for his involvement in the company's conspiracy to bribe Kuwaiti officials in order to secure a government contract. DOJ Press Release, June 16, 2015.

J) Joseph Sigelman, the former CEO of PetroTiger, a British Virgin Islands oil and gas company with operations in Colombia, pled guilty to conspiring to pay bribes to foreign officials in exchange for assistance in securing a $45 million oil services contract for PetroTiger. DOJ Press Release, June 15, 2015.

K) Walid Hatoum, a former executive at PBSJ, a Florida-based engineering and construction firm, agreed to settle SEC charges that he offered to funnel funds to a local company owned and controlled by a foreign official in order to secure two multi-million dollar Qatari government contracts for PBSJ. Hatoum agreed to pay a penalty of $50,000. SEC Press Release 2015-13 (Jan. 22, 2015).

L) Dmitrij Harder, the former owner and president of Chestnut Consulting, was indicted for his alleged participation in a scheme to pay bribes to a senior official at a multilateral development bank in exchange for influencing the official's actions on applications for financing submitted by Chestnut Consulting's clients and for directing business to Chestnut Consulting. DOJ Press Release, Jan. 6, 2015.

M) Stephen Timms and Yasser Ramahi, who worked in sales at FLIR Systems, an Oregon-based defense contractor, consented to the entry of an SEC order arising out of allegations that Timms and Ramahi provided Saudi Arabian officials, whose business they were seeking, expensive luxury watches and sent them on a "world tour" of personal travel before they visited FLIR's Boston facilities. Timms and Ramahi agreed to pay penalties of $50,000 and $20,000 respectively. SEC Press Release 2014-257 (Nov. 17, 2014).

N) A French citizen was sentenced to two years in prison for obstructing a criminal investigation into alleged bribes to obtain a mining concessions in the Republic of Guinea. The defendant allegedly tried to bribe a witness in the FCPA investigation. DOJ Press Release, July 25, 2014.

O) A former president and CEO of a U.S. aircraft services company pled guilty to participating in a scheme to bribe Mexican and Panamanian government officials to obtain contracts. Certain of the bribes were paid though a company that laundered money related to the scheme. DOJ Press Release, July 24, 2014.

P) Executives of French power and transportation company Alstom and its U.S. subsidiary pled guilty to conspiring to violate the FCPA in a scheme to pay bribes to foreign government officials. DOJ Press Release, July 17, 2014.

Q) The former CEO of a British Virgin Islands oil and gas company with operations in Colombia pled guilty in connection with a scheme to bribe a Colombian official in return for a contract. DOJ Press Release, Feb. 18, 2014.

R) Several employees of a U.S. broker-dealer and a senior official in Venezuela's state economic development bank were charged with and ultimately pled guilty to participating in an international scheme involving bribes to senior officials in Venezuela's state economic development bank. The bribes allegedly included payments to a bank official in exchange for directing the bank's trading business to the broker-dealer. The employees pled guilty to FCPA and related charges. DOJ Press Releases, Mar. 27, 2015; Aug. 30, June 12, 2013; SEC Press Release 2013-109 (June 12, 2013); DOJ Press Release, May 7, 2013; SEC Press Release 2013-84 (May 6, 2013); DOJ Press Release, Apr. 14, 2014. See generally Banking Daily, June 13, 2013; Law360 May 17, 2013; NY Times Dealbook, May 8, 2013. The Venezuelan banking officials who received the bribes also pled guilty to related charges. DOJ Press Release, Nov. 18, 2013.

S) Four former executives of a U.S.-based subsidiary of Lufthansa Technik AG were charged with participating in a scheme to pay bribes to government officials in Latin America. DOJ Press Release, Apr. 5, 2013.

T) Garth Peterson, former managing director of Chinese real estate for Morgan Stanley, pled guilty to engaging in a conspiracy to evade Morgan Stanley's internal accounting controls. In his plea allocution, Peterson admitted to evading Morgan Stanley's controls in order to direct $1.8 million to himself and a Chinese government official. DOJ Press Release, Apr. 25, 2012; SEC Press Release 2012-78 (Apr. 25, 2012).

U) Two oil company executives settled SEC civil actions by accepting liability for their involvement in alleged bribes to Nigerian natural gas customs officials to process false paperwork. The bribes were paid through a customs agent with the executives' approval. SEC Litigation Release No. 23038 (July 7, 2014); SEC Litigation Release No. 22290 (Mar. 14, 2012).

V) Albert Stanley, former chairman and CEO of Kellogg, Brown & Root ("<u>KBR</u>"), was sentenced to 30 months in prison for his participation in the TSKJ joint venture, which allegedly paid, over the course of nine years, $182 million in bribes to Nigerian governmental officials in exchange for engineering, procurement and construction contracts. Stanley was also ordered to pay $10.8 million in restitution. Two of Stanley's co-conspirators were also sentenced in connection with the scheme. DOJ Press Release, Feb. 23, 2012.

W) Jean Rene Duperval, former director of international relations for Telecommunications d'Haiti, Haiti's state-owned telecommunications company, was sentenced to nine years in prison for taking and laundering bribes from two Miami-based telecommunications companies. Duperval was also ordered to forfeit nearly $500,000. DOJ Press Release, May 21, 2012.

X) Seven former executives of Siemens were charged in connection with Siemens' alleged bribery scheme in Argentina. The officials were charged with acting as intermediaries between the company and Argentine officials and falsifying documents to cover up the bribe payments. SEC Litigation Release No. 22190 (Dec. 13, 2011).

Y) Former Terra Telecommunications Corp. president Joel Esquenazi was sentenced to 15 years in prison for his role in a bribery scheme involving Telecommunications d'Haiti. This sentence was the longest imposed in an FCPA case. Four other individuals have been sentenced, with sentences ranging from 84 months to six months, in related cases. DOJ Press Release, Oct. 25, 2011.

Z) LatinNode CEO Jorge Granados pled guilty to conspiring to pay bribes to government officials in Honduras in connection with the establishment of a U.S.-Honduras long distance telecommunications link. Granados was sentenced to 46 months in prison. DOJ Press Release, Sept. 8, 2011.

AA) Control Components executive Flavio Ricotti pled guilty for his participation in a conspiracy to secure contracts by paying bribes to officials of foreign state-owned companies (as well as officers and employees of foreign and domestic private companies) in several countries, including Qatar and Saudi Arabia. Ricotti had been arrested in Germany, and subsequently extradited to the U.S. DOJ Press Release, Apr. 29, 2011.

BB) Wojciech Chodan, a commercial vice president and consultant to a UK subsidiary of KBR, pled guilty for his role in a decade-long scheme to bribe Nigerian officials to obtain contracts connected to a Nigerian oil development project. DOJ Press Release, Dec. 6, 2010. The former CEO of KBR and a UK agent also pled guilty to violating the FCPA for actions related to the same matter. See DOJ Press Release, Mar. 11, 2011.

CC) Paul Jennings, the CEO of Innospec, was charged with approving bribery payments made by his company in Iraq and Indonesia. Without admitting guilt, Jennings agreed to disgorgements and penalties. SEC Press Release 2011-21 (Jan. 24, 2011).

DD) Antonio Perez, Controller of a U.S. telecommunications company, was sentenced to two years in prison for participation in a conspiracy to pay and conceal bribes to former Haitian government officials. Other participants in the conspiracy had also been sentenced to prison following "substantial assistance" by the government of Haiti. DOJ Press Release, Jan. 21, 2011.

EE) Charles Jumet, a former executive with Ports Engineering Consultants who allegedly made improper payments to Panamanian government officials, was sentenced to 87 months in prison. See U.S. v. Jumet, Cr. No. 3:09-CR-00397-HEH (E.D. Va., Apr. 22, 2010) (criminal judgment).

FF) Nature's Sunshine Products, SEC Litigation Release No. 21162 (July 31, 2009), involved an FCPA enforcement action against both the chief executive officer and the former chief financial officer; the two were charged with "control person liability", even though the SEC complaint does not allege that either was involved with the foreign briber. This is the first time that the SEC brought an FCPA action based on "control person" liability.

(ii) Proposals for FCPA Reform

A) After publication of the FCPA Resource Guide, the Manhattan Institute for Policy Research called for amendments to the FCPA in the following areas: (1) jurisdiction, (2) the definition of "foreign officials", and (3) the definition of "facilitating payments." Corporate Counsel, Jan. 17, 2013.

B) Former U.S. Attorney General Mukasey, acting on behalf of an affiliate of the U.S. Chamber of Commerce, has advocated for reform of the FCPA that would provide an acquiring company with a safe-harbor from liability for actions undertaken by a subsidiary prior to acquisition. Under the Chamber's proposal, an acquiring company would be immune from such liability so long as it conducted reasonable due diligence prior to the acquisition. Testimony of Former U.S. Attorney General Mukasey before Subcommittee of House Judiciary Committee, June 14, 2011; Testimony of Chamber of Commerce Representative Weissmann before Subcommittee of Senate Judiciary Committee, Nov. 30, 2010.

C) The Chamber of Commerce has also asked Congress to reform the FCPA by (1) adding an affirmative defense for companies with robust compliance programs, (2) adding a "willfulness" requirement for a finding of corporate criminal liability, (3) clarifying the definition of "foreign official", (4) limiting a company's liability for acts of its foreign subsidiaries, and (5) improving procedures for DOJ guidance and advisory opinions. See generally Washington Post, July 22, 2011; Trust Law, June 1, 2011. Compare generally Corporate Counsel, Jan. 17, 2013; Busting Bribery: Sustaining the Global Momentum of the [FCPA] (Open Society Foundation, Sept., 2011) (arguing that proposed amendments to the FCPA would alter the FCPA's effectiveness in combating bribery and adversely affect worldwide adoption and enforcement of anti-bribery measures); Reuters, June 14, 2011.

D) The NYC Bar issued The FCPA and its Impact on International Business Transactions (Dec. 2011), a report calling for a "reassessment" of the FCPA. The report finds that the U.S. approach to foreign corruption places significant costs on companies subject to the FCPA, which makes it difficult for them to compete with companies that are not covered.

(iii) State-owned Enterprises

A) Recent decisions have held that the definition of "instrumentality" in the FCPA includes state-owned enterprises with certain attributes. The leading case described an "instrumentality" as an entity that (i) is "controlled by a foreign government," and (ii) "performs a function the controlling government treats as its own." Factors relevant to the question of government control include: (1) whether the government formally designates the entity as a state company; (2) whether the government has a majority interest in the entity; (3) the government's ability to hire and fire the entity's principals; (4) the extent to which the entity's profits go to the government; (5) the extent to which the government funds the entity if it loses money; and (6) how long these indicia have existed. Factors relevant to whether "the government treats [the company's function] as its own," include: (1) whether the entity is a monopoly; (2) whether the government subsidizes the entity; (3) whether the entity provides services to the public at large; and (4) whether the public and the government perceive the entity to be performing a governmental function. U.S. v. Esquenazi, 752 F.3d 912 (11th Cir. 2014), cert. denied, 135 S. Ct. 293 (2014); See also 11th Circuit Confirms that Bribes Paid to Employees of State-owned or Controlled Companies Violate the U.S. [FCPA]

(Cleary Gottlieb, June 6, 2014). Lower courts reached similar results. See, e.g., U.S. v. Lindsey, 783 F. Supp. 2d 1108 (C.D. Cal. 2011); U.S. v. Carson, No. 09-cr-00077 (C.D. Cal. 2011). See generally Wall St. J., Aug. 10, June 10, 2011 (SEC investigation of Goldman Sachs dealings with Libyan Investment Authority). See generally Securities Law Daily, May 23, 2016.

B) The FCPA Resource Guide clarifies that, as a practical matter, an entity is unlikely to qualify as an "instrumentality" if the government does not own or control a majority of its shares.

(iv) Joint Ventures

The DOJ may seek to hold joint venture partners liable for the acts of joint venturers. In 2010, RAE Systems entered into a Non-prosecution Agreement and settlement with the DOJ in which liability was based on the actions of a joint venture in which the company was a partner. This case suggests that U.S. authorities will seek to hold joint venture partners liable for actions of a joint venture when they do not take appropriate anti-corruption measures. DOJ Press Release, Dec. 10, 2010.

(v) Successor Liability

Generally, the DOJ and SEC only take action against buyers in limited circumstances: in cases of egregious and sustained violations or where the successor company participated in the violations or failed to stop the misconduct from continuing after the acquisition. More often, the DOJ and SEC bring actions, if any, against the target itself for any pre-closing FCPA violations. See FCPA Resource Guide.

(vi) Forfeiture Actions

The DOJ filed a complaint seeking civil forfeiture of approximately $34 million, which represents the cash value of shares in Griffiths Energy International, which were used to bribe Chad's former Ambassador to the United States and Canada for the purpose of influencing the award of oil development rights in Chad to Griffiths Energy, a Canadian energy company. In 2013, Griffiths Energy pled guilty in Canadian court to bribing the former Ambassador. DOJ Press Release, June 30, 2015.

(vii) Permitted Payments to Government Officials

In March 2014, the DOJ issued an opinion in which it approved a payment by a company to a minority shareholder, also a government official, for the official's shares. The shares were valued by a global accounting firm, and the transaction was disclosed to the official's government agency. DOJ Opinion Procedures Release No. 14-01 (Mar. 17, 2014).

(viii) Targeting Bribe Recipients

Although the FCPA applies only to bribe payers, rather than recipients, the DOJ has announced its intention to prosecute government official recipients as well, and has prosecuted those officials under other applicable laws. In 2010, Robert Antoine, a former Haitian government official, pled guilty to money laundering charges based on bribes paid to him in violation of the FCPA. See U.S. v. Antoine, No. 1:09-21010-CR-Martinez-3 (S.D. Fla., June 9, 2010) (judgment); U.S. v. Siriwan, Cr. No. 09-00081 (C.D. Cal., Jan. 28, 2009) (criminal indictment). See generally Wall St. J., Aug. 22, 2011.

(ix) Whistleblower Laws and Dodd-Frank

A) In 2011, the SEC adopted final rules governing a whistleblower program pursuant to Dodd-Frank § 922. (See Part IX.B.1.c.iv.B below.) This creates an incentive for employees to report perceived FCPA violations directly to U.S. law enforcement authorities, rather than internally.

B) Dodd-Frank § 1504 requires any business that files an annual report with the SEC to disclose in annual filings certain payments made to foreign governments -- including legitimate and legal payments -- related to the development of oil, natural gas and minerals. The District Court for the District of Columbia vacated the SEC's rule implementing Dodd-Frank § 1504. See Am. Petroleum Inst. v. SEC, No. 12-1668 (D.D.C., July 2, 2013); 77 Fed. Reg. 56365 (Sept. 12, 2012) (final rule). The SEC was scheduled to propose a new § 1504 rule by March 2015, see Wall St. J., May 28, 2014, but has not yet done so.

C) Following passage of Dodd-Frank, the SEC reportedly received, on average, one FCPA-related whistleblower tip per day. NYLJ, Nov. 7, 2011.

D) The extraterritorial reach of the Dodd-Frank whistleblower protections was limited by a U.S. court, which dismissed a lawsuit against Siemens brought by a Taiwanese citizen and resident working for a Chinese subsidiary of Siemens. The court held that there was "simply no indication that Congress intended the anti-retaliation provisions to apply extraterritorially." Liu v. Siemens, 978 F. Supp. 2d 325 (SDNY 2013), aff'd, 763 F.3d 175 (2d Cir. 2014).

E) According to news reports, the SEC awarded more than $3.75 million to a whistleblower in connection with the BHP Billiton FCPA case. See, e.g., Reuters, Aug. 28, 2016.

(x) Civil Lawsuits

FCPA law enforcement actions or investigations frequently trigger shareholder class actions and derivative lawsuits. The FCPA itself does not provide for a private right of action, see Republic of Iraq v. ABB, 768 F.3d 145 (2d Cir. 2014), but plaintiffs bring claims based on theories that directors or officers have breached their duties or that a company has failed to disclose material information related to a bribery matter. Recent civil claims have been filed against the following companies and/or their officers and directors: Och-Ziff Capital Management, Hewlett Packard, Archer-Daniels Midland and Wal-Mart. Sec. Reg. & L. Rep., May 19, 2014.

(xi) International Anti-bribery Efforts

A) The OECD Anti-Bribery Convention came into effect in 1999. While the U.S. remains the nation most likely to prosecute foreign bribery crimes, other nations have increased their foreign bribery prosecutions and convictions. According to Transparency International, four countries have "active enforcement" of anti-corruption laws and another six have "moderate enforcement". See "Exporting Corruption, Progress Report 2015: Assessing Enforcement of the OECD Convention on Combatting Foreign Bribery" (Transparency International, May 2015). See also, e.g., "Anti-Bribery and Corruption: Rising to the Challenge in the Age of Globalization" (KPMG, 2015); Global Fraud Survey 2016 (Ernst & Young 2016); OECD Working Group on Bribery: Annual Report 2014 and 2014 Data on Enforcement of the Anti-Bribery Convention (Nov. 2015).

Transparency International's 2015 assessment on the implementation of the OECD Anti-bribery Convention found that four countries with 23% of the world's exports had "active enforcement" of the

Convention (U.S., Germany, U.K. and Switzerland); six countries with 9% of the world's exports had "moderate enforcement" of the Convention (Italy, Australia, Austria, Finland, Canada and Norway); nine countries with 13% of the world's exports had "limited enforcement" of the Convention (France, Sweden, Hungary, South Africa, Portugal, Greece, The Netherlands, New Zealand and South Korea); and the remaining signatories to the Convention with 21% of the world's exports had "little or no enforcement". Exporting Corruption: Progress Report 2015: Assessing Enforcement of the OECD Convention on Combating Foreign Bribery (OECD, 2015).

B) In 2016, France proposed legislation that would significantly strengthen its anti-corruption laws. The draft bill gives companies an affirmative obligation to implement effective anti-corruption compliance programs. It also creates an anti-corruption authority dedicated to monitoring and enforcing compliance with France's anti-corruption laws. France Introduces Sweeping Anti-Corruption Reform (Cleary Gottlieb, Apr. 20, 2016).

C) In 2013, Canada expanded criminal liability for companies and individuals. Under new amendments to Canada's Corruption of Foreign Public Officials Act ("CFPOA"), Canadian companies and individuals involved in bribery of foreign public officials are subject to the law regardless of where the bribery actually took place and even if the only connection with Canada is the nationality of the company or individual. The CFPOA bars bribery to obtain an advantage "in the course of business," and the amendments modified the definition of "business" to include not-for-profit endeavors. The amendments also increase the maximum penalty for individuals from five to 14 years of imprisonment. Under the amendments, there is an additional "books and records" offense for misrepresenting or concealing the bribery of foreign public officials. The revised CFPOA phases out the exception allowing facilitation payments. See generally Compliance Week, July 18, 2013.

D) The UK Bribery Act came into force on July 1, 2011. See thebriberyact.com, Apr. 24, 2013. See also United Kingdom: Follow-up to the Phase 3 Report & Recommendations (OECD, Sept. 2014); Phase 3 Report on Implementing OECD Anti-bribery Convention in the UK (OECD, Mar. 2012).

The Bribery Act makes a commercial organization (companies and partnerships) liable for bribery committed by any person associated with the organization, whether or not anyone within the company was aware of the bribery. The only defense is for the commercial organization to show it had "adequate procedures" in place to prevent bribes. The practical effect is to require companies to develop anti-corruption programs to avoid liability.

The Bribery Act is broader in scope than the FCPA. The Bribery Act applies to improper payments to private, as well as public, officials and does not contain a safe-harbor for facilitation payments. The head of the UK Serious Fraud Office ("SFO") has indicated that, in deciding whether to prosecute companies that make facilitation payments, the SFO will consider whether companies are implementing procedures designed to control, record and curtail such payments. See The Bribery Act 2010: Guidance About Procedures which Relevant Commercial Organizations Can Put Into Place to Prevent Persons Associated with Them from Bribing (UK Ministry of Justice, Mar. 2011); Facilitation Payments: SFO & thebriberyact.com Six Step Solution (June 21, 2011).

The UK Serious Fraud Office has increased enforcement of the Bribery Act in recent years. Wall St. J., July 1, 2016. The office entered into its first Deferred Prosecution Agreement, against Standard Bank in 2015. (Standard Bank simultaneously settled with the SEC on related but non-FCPA charges.) SEC Press Release 2015-268 (Nov. 30, 2015). See also NY Times, Nov. 30, 2015; Corporate Crime Reporter, Nov. 30, 2015; Corporate Counsel, Nov. 30, 2015. It entered into a second Deferred Prosecution Agreement, with an unnamed company, to resolve foreign bribery offenses in 2016. "SFO Settles Overseas Bribery Case With Second DPA", The FCPA Blog, (July 12, 2016).

New corporate sentencing guidelines for England and Wales came into effect on October 1, 2014. The new guidelines allow judges to consider the harm done to the victim and are generally expected to result in higher financial penalties than those previously imposed. Circumstances that would put a company at risk for the highest penalty bracket include bribing a public official. See Financial Times, May 22, 2014.

In 2012, the FSA released the results of a survey that found that the majority of firms surveyed "did not have robust anti-bribery systems and controls in place", and that some financial services firms fell far short of regulatory requirements. In response, the FSA proposed updates to its publication Financial Crime: A Guide for Firms, with new guidance and examples of good as well as poor practices. Proposed Guidance and Amendments to 'Financial Crime: a Guide for Firms' (FSA, Mar. 2012). The updates took effect in April 2015. FG15/7: Guidance on Financial Crime Systems and Controls (FSA, Aug. 2015).

E) The OECD has published a study of challenges that arise in obtaining mutual legal assistance in foreign bribery cases. See Typology on Mutual Legal Assistance in Foreign Bribery Cases (OECD, 2012).

F) In 2010, the OECD issued a Report focused on U.S. compliance with respect to the Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 2009 Revised Recommendation on Combating Bribery in International Business Transactions.

i) The Report describes "good practices" developed within the U.S. legal and policy framework that have helped achieve a significant enforcement level, including (a) investigation and prosecution of cases involving various business sectors and various modes of bribing foreign public officials; (b) proactive investigations; (c) innovative methods of resolution of open issues (like plea agreements, deferred prosecution agreements, non-prosecution agreements and the appointment of corporate monitors); (d) application of the FCPA to employees of state-owned enterprises (as "foreign officials"); and (e) record penalties.

ii) The Report does, however, recommend that the U.S. (a) focus on a clearer approach to "facilitation payments" (including a definition of "facilitation payments" – financial service companies were said to be especially interested in further guidance); (b) consider the views of the private sector; and (c) consolidate and manage better publicly available information on the application of the FCPA (including information regarding the affirmative defense for reasonable and bona fide expenses).

G) In 2014, the Asia-Pacific Economic Cooperation forum met and agreed to enhance cross-border cooperation in combatting corruption and created a new network of law enforcement authorities dedicated to fighting corruption. White House, Nov. 11, 2014.

H) In 2014, the U.S. announced that it will develop a National Action Plan to promote and incentivize responsible business conduct. White House, Sept. 24, 2014.

I) FATF and the G20 Anti-corruption Working Group held an Experts Meeting on Corruption on October 18, 2014. FATF's standards requiring countries to implement measures ensuring that accurate information on the beneficial ownership of companies is available to legal authorities "received strong support from the participants". The G20 Working Group agreed on High Level Principles on Beneficial Ownership Transparency, which also focus on ensuring that countries know who owns or controls companies. <u>President's Summary of Outcomes from the Experts' Meeting on Corruption</u> (FATF, Oct. 18, 2014). <u>See also</u> <u>Part VIII.A.2 above</u>.

(xii) <u>Difficulties in FCPA Prosecutions</u>

A) On August 13, 2015, a U.S. court ruled that a former executive of a non-U.S. Alstom subsidiary could not be held criminally liable for conspiring to violate the FCPA. The court explained that the FCPA has three jurisdictional bases: (i) domestic concerns or issuers operating in the U.S.; (ii) U.S. citizens, nationals or residents; and (iii) persons or entities engaging in corruption within the territory of the U.S. The court concluded that Congress did not intend to impose accomplice liability (<u>i.e.</u>, aiding and abetting, conspiracy) on non-resident foreign nationals who are not subject to direct liability. <u>See</u> <u>U.S. v. Hoskins</u>, 3:12cr238 (JBA) (D. Conn. Aug. 13, 2015); <u>Law360</u>, Aug. 14, 2015.

B) On February 21, 2012, the DOJ moved to dismiss the indictments of all the defendants awaiting trial in connection with their arrests as part of the sting operation discussed above in Part VIII.A.4.g.i. The move was prompted by a series of acquittals and mistrials, which resulted in the non-conviction of nine defendants. On March 27, 2012, the DOJ moved to dismiss with prejudice the indictments of the defendants who had previously pled guilty. See The FCPA Blog, Feb. 9, 2012; TRACE International, The TRACE Compendium: FCPA Sting Operation.

C) On January 17, 2012, U.S. District Judge Hughes granted a motion for the acquittal of John O'Shea. O'Shea was indicted for allegedly bribing Mexican officials in order to secure contracts for the maintenance of country's electrical system. In granting the acquittal, Judge Hughes remarked that "[t]he problem [with the case] is that the principal witness against Mr. O'Shea . . . knows almost nothing". Judge Hughes then described the evidence missing from the Government's case and found it reasonable to conclude that O'Shea's alleged activities were lawfully motivated. On February 9, 2012, the DOJ moved unopposed to dismiss the remaining counts against O'Shea. See The FCPA Blog, Feb. 9, 2012.

D) On May 10, 2011, Lindsey Manufacturing and its executives were found guilty by a jury after a five-week trial. On December 1, 2011, however, U.S. District Judge Matz dismissed with prejudice the indictments against the three defendants. Judge Matz found the prosecution allowed an FBI witness to offer false testimony to the jury, made false statements in affidavits used to obtain search warrants, conducted unlawful searches of attorney-client documents, "recklessly failed" to comply with discovery obligations, defied the Court's rulings during witness questioning and made misrepresentations to the Court during the course of the trial. U.S. v. Aguilar, 831 F. Supp. 2d 1180 (C.D. Cal. 2011).

(xiii) High-profile and High-penalty FCPA Cases

In addition to the other proceedings discussed in this Part VIII.A.4, other key recent proceedings include:

A) AstraZeneca, a U.K.-based biopharmaceutical company, paid \$5 million to settle charges that its China and Russia subsidiaries paid bribes to officials of healthcare providers to induce them to prescribe AstraZeneca products. The SEC found that the bribery scheme continued over the course of several years. SEC Admin. Proc. 3-17517 (Aug. 30, 2016).

B) Key Energy Services, a Houston-based company, agreed to pay \$5 million to settle charges that its Mexican subsidiary, Key Mexico, made improper payments through a consultant to an employee of Petróleos Mexicanos (PEMEX), Mexico's state-owned oil company. In limiting its sanction to the disgorgement of profits, the SEC considered Key Energy's cooperation and remediation and the company's financial condition. SEC Admin. Proc. No. 3-17379 (Aug. 11, 2016).

C) LATAM Airlines Group (LATAM), a Chilean-based airline company, entered into a Deferred Prosecution Agreement pursuant to which it paid \$12.8 million for bribing Argentine union officials via a fictitious consulting agreement with an advisor to the Secretary of Argentina's Ministry of Transportation. DOJ Press Release, July 25, 2016.

D) Olympus Latin America, a distributor of endoscopes and related equipment, entered into a Deferred Prosecution Agreement in which it agreed to pay \$22.8 million for making improper payments to health officials in a scheme to increase medical equipment sales. DOJ Press Release, Mar. 1, 2016; SEC Press Release 2016-151 (July 25, 2016).

E) Johnson Controls, a Wisconsin-based provider of HVAC systems, agreed to pay over $14 million to settle charges that its wholly-owned Chinese subsidiary engaged in a scheme to make improper payments via sham vendors to ship-owners and employees of Chinese government owned shipyards to secure business. SEC Admin. Proc. 3-17337 (July 11, 2016). See DOJ Letter, June 21, 2016.

F) BK Medical, a subsidiary of the Massachusetts technology company Analogic Corporation, agreed to pay $3.4 million under a Non-prosecution Agreement to resolve claims that it used fictitious invoices to falsely book improper payments made in Russia and five other countries. Analogic agreed to pay $11.5 million to settle a parallel SEC proceeding, and its former Chief Financial Officer also agreed to pay a $20,000 penalty to settle SEC charges. DOJ Press Release, June 21, 2016; SEC Press Release 2016-126 (June 21, 2016).

G) Akamai Technologies, a Massachusetts-based internet services company, entered into Non-prosecution Agreements with the SEC after self-reporting improper payments and gifts made by its subsidiary to officials at Chinese government-owned entities to induce them to purchase Akamai services. Akamai agreed to pay $652,000 to settle the matter. SEC Press Release 2016-109 (June 7, 2016).

See Part VIII.A.4.f .iv above.

H) Nortek, a Rhode Island-based building products manufacturer, entered into a Nonprosecution Agreement with the SEC after self-reporting improper payments and gifts made by its China subsidiary to officials at Chinese government-owned entities to receive relaxed regulatory oversight and reduced customs duties, taxes and fees. Nortek agreed to pay $291,000 to settle the matter. SEC Press Release 2016-109 (June 7, 2016).

<u>See</u> <u>Part VIII.A.4.f .iv above</u>.

I) Las Vegas Sands agreed to pay $9 million to settle SEC charges that it failed to properly authorize or document millions of dollars in payments to a consultant facilitating certain business transactions in China and Macao. SEC Press Release 2016-64 (Apr. 7, 2016).

J) Novartis agreed to pay $25 million to settle SEC charges that its China-based subsidiaries made improper payments to health care professionals to increase sales of pharmaceutical products to China's state health institutions. SEC Press Release (Mar. 23, 2016).

K) Qualcomm agreed to pay $7.5 million to settle SEC charges that it hired relatives of Chinese government officials and made improper expenditures for the benefit of Chinese government officials to gain a business advantage for Qualcomm's products in China. SEC Press Release 2016-36 (Mar. 1, 2016).

L) VimpelCom, a telecommunications company based in Amsterdam, and its wholly-owned Uzbek subsidiary, Unitel LLC, entered into settlements with the DOJ in which they admitted to conspiring to make over $114 million in bribery payments between 2006 and 2012 to an Uzbek government official in order to enter and operate in the Uzbek market. VimpelCom settled related proceedings with the SEC and the Public Prosecution Service of the Netherlands, resulting in global criminal and civil penalties in excess of $795 million. DOJ Press Release, Feb. 18, 2016; SEC Press Release 2016-34 (Feb. 18, 2016).

M) Two subsidiaries of the Massachusetts software company PTC entered into a Non-prosecution Agreement and agreed to pay the DOJ $14.5 million to resolve allegations that the companies improperly provided Chinese government officials with recreational travel within the United States in order to obtain business contracts with Chinese state-owned entities. PTC reached a related settlement with the SEC, and the SEC also entered into a Deferred Prosecution Agreement with Yu Kai Yuan, a former employee of a PTC China subsidiary. DOJ Press Release, Feb. 16, 2016; SEC Press Release 2016-29 (Feb. 16, 2016).

N) SciClone Pharmaceuticals, a California-based company, agreed to pay more than $12 million to resolve SEC charges that its China-based subsidiaries made improper payments to health care professionals at state institutions in China in order to increase their pharmaceutical sales to those institutions. SEC Admin. Proc. No. 3-17101 (Feb. 4, 2016).

O) SAP, a software manufacturer, agreed to disgorge $3.7 million in profits to settle SEC charges that the company's deficient internal controls allowed a former SAP executive to pay $145,000 in bribes to a Panamanian government official and offer bribes to two other officials in exchange for lucrative sales contracts in Panama. The former executive, Vicente Garcia, was sentenced to 22 months in prison in a parallel criminal action. SEC Press Release 2016-17 (Feb. 1, 2016).

P) Bristol-Myers Squibb agreed to pay $14 million to settle SEC charges that it failed to respond to red flags indicating that personnel at its majority-owned joint-venture in China provided bribes and other benefits to health care providers in China in exchange for prescription sales. SEC Press Release 2015-229 (Oct. 5, 2015).

Q) Hitachi agreed to pay $19 million to settle SEC charges that a subsidiary paid millions of dollars to a front company connected to South Africa's ruling political party in order to obtain contracts to build two multi-billion dollar power plants. SEC Press Release 2015-212 (Sept. 28, 2015).

R) BNYM agreed to pay $14.8 million to settle SEC charges that it provided valuable student internships to family members of foreign government officials affiliated with a Middle Eastern sovereign wealth fund. The SEC found that BNYM hired interns that did not meet the criteria of its internship program in order to influence foreign officials and to win or retain contracts to manage and service the assets of the sovereign wealth fund. SEC Press Release 2015-170 (Aug. 18, 2015).

S) Mead Johnson Nutrition agreed to pay $12 million to settle SEC charges that its Chinese subsidiary made improper payments to health care professionals at government-owned hospitals to recommend the company's infant formula to new or expectant mothers. SEC Press Release 2015-154 (July 28, 2015).

T) Louis Berger International, a New Jersey-based construction management company, entered into a Deferred Prosecution Agreement and agreed to pay $17 million to resolve DOJ charges that it bribed foreign officials in India, Indonesia, Vietnam and Kuwait to secure government construction management contracts. DOJ Press Release, July 17, 2015.

U) IAP Worldwide Services, a Florida defense and government contracting company, entered into a Non-prosecution Agreement and agreed to pay the DOJ $7.1 million to resolve allegations the company conspired to bribe Kuwaiti officials in order to secure a government contract. The Non-prosecution

Agreement identifies what the DOJ considers the "minimum elements" of an effective anti-bribery compliance program, and includes ten separate elements. DOJ Press Release, June 16, 2015.

V) BHP Billiton, an Australian global resources company, agreed to pay $25 million to settle SEC charges that it sponsored the attendance of foreign government officials at the 2008 Summer Olympics in Beijing. The company invited employees of state-owned enterprises to attend the Games at the company's expense, treating them to hospitality packages that included event tickets, luxury hotel accommodations and sightseeing excursions. SEC Press Release 2015-93 (May 20, 2015). The SEC criticized BHP Billiton's compliance program as an example of "check-the-box" compliance that is insufficient to comply with the FCPA. NACDonline.org, May/June 2016.

W) FLIR Systems, an Oregon-based defense contractor, agreed to pay $9.5 million to settle SEC charges that it made illicit payments for travel and other gifts for Middle East government officials. SEC Press Release 2015-62 (Apr. 8, 2015).

X) Goodyear Tire & Rubber agreed to pay over $16 million to settle SEC charges that its subsidiaries paid $3.2 million in bribes to land tire sales in Kenya and Angola. SEC Press Release 2015-38 (Feb. 24, 2015).

Y) PBSJ, a Florida-based engineering and construction firm, entered into a Deferred Prosecution Agreement with the SEC and paid $3.4 to settle charges one of its executives offered to funnel funds to a local company owned and controlled by a foreign official in order to secure two multi-million Qatari government contracts for PBSJ. SEC Press Release 2015-13 (Jan. 22, 2015).

Z) Alstom, a French power and transportation company, pled guilty and agreed to pay $772 million in connection with a widespread scheme sustained over a decade and involving tens of millions of dollars in bribes to government officials in countries around the world, including Indonesia, Saudi Arabia, Egypt and the Bahamas. In addition, a Swiss Alstom subsidiary pled guilty, and two U.S. Alstom subsidiaries entered into Deferred Prosecution Agreements. DOJ Press Release, Dec. 22, 2014.

AA) Avon Products, a global beauty products manufacturer and seller, settled SEC charges and entered into a Deferred Prosecution Agreement with the DOJ, agreeing to pay a total of $134 million. The charges arose from payments made to Chinese government officials by employees and consultants at an Avon Chinese subsidiary. SEC Press Release 2014-285 (Dec. 17, 2014); DOJ Press Release, Dec. 17, 2014.

BB) Bruker Corporation, a global manufacturer of scientific instruments, agreed to pay $2.4 million to resolve charges in connection with $230,000 in improper payments by its China-based offices that were falsely recorded as legitimate business and marketing expenses. The payments enabled Bruker to realize approximately $1.7 million in profits from sales contracts with state-owned entities in China. SEC Press Release 2014-280 (Dec. 15, 2014).

CC) Dallas Airmotive, a provider of aircraft engine maintenance, repair and overhaul services based in Texas, entered into a Non-prosecution Agreement, agreeing to pay $14 million to resolve DOJ charges that it bribed Latin American government officials in order to secure government contracts. DOJ Press Release, Dec. 10, 2014.

DD) Bio-Rad Laboratories, a clinical diagnostic and life science research company based in California, entered into a Non-prosecution Agreement and agreed to pay $55 million to settle SEC and DOJ charges that its subsidiaries made improper payments to foreign officials in Russia, Vietnam and Thailand in order to win business. Bio-Rad made payments disguised as commissions to foreign agents with false Moscow addresses and off-shore bank accounts. SEC Press Release 2014-245 (Nov. 3, 2014); DOJ Press Release, Nov. 3, 2014.

EE) Layne Christensen, a global water management, construction and drilling company headquartered in Texas, paid $5 million to settle SEC charges that it made improper payments to foreign officials in several African countries to obtain beneficial treatment and reduce its tax liability. SEC Press Release 2014-240 (Oct. 27, 2014).

FF) Hewlett-Packard agreed to pay more than $108 million to settle SEC and DOJ charges related to making illegal payments to government officials in Russia, Poland, and Mexico to obtain technology contracts. DOJ Press Release, Sept. 11, 2014; SEC Press Release 2014-73 (Apr. 9, 2014).

GG) Marubeni, a Japanese trading company, pled guilty to FCPA charges and later agreed to pay an $88 million fine in connection with a scheme to pay bribes to high-ranking Indonesian officials to secure a power project. DOJ Press Release, May 15, 2014; DOJ Press Release, Mar. 19, 2014.

HH) Smith & Wesson agreed to pay $2 million to settle SEC charges related to making illegal payments to government officials in Pakistan, Indonesia and other foreign countries to win contracts to supply firearm products to military and law enforcement forces. SEC Press Release 2014-148 (July 28, 2014). This was the first case in which the SEC tied the internal controls violations to the company's failure to have an adequate anticorruption program. Securities Law Daily, Feb. 27, 2014.

II) Alcoa agreed to pay a total of $384 million to settle SEC and DOJ charges related to illegal payments to a London-based consultant with ties to Bahrain's royal family in exchange for aluminum contracts. SEC Press Release 2014-3 (Jan. 9, 2014); DOJ Press Release, Jan. 9, 2014.

JJ) Archer-Daniels Midland agreed to pay more than $54 million to settle SEC charges related to illegal payments to Ukrainian government officials to secure the release of value-added tax refunds. SEC Press Release 2013-271 (Dec. 20, 2013); DOJ Press Release, Dec. 20, 2013.

KK) The German engineering firm Bilfinger agreed to pay a $32 million penalty to resolve charges that it and others paid bribes of $6 million to Nigerian officials to obtain and retain contracts related to a gas development project. DOJ Press Release, Dec. 11, 2013.

LL) Weatherford, a Swiss-based oilfield services company, agreed to pay $154 million to settle SEC and DOJ charges that the company and its subsidiaries authorized bribes and improper travel and entertainment for foreign officials in the Middle East and Africa. SEC Press Release 2013-252 (Nov. 26, 2013); DOJ Press Release, Nov. 26, 2013.

MM) U.S.-based Stryker settled SEC claims that its subsidiaries in Argentina, Greece, Mexico, Poland and Romania paid $2 million in bribes to obtain $8 million in illicit profits. Stryker agreed to pay $13 million to settle the charges. SEC Press Release 2103-229 (Oct. 24, 2013).

NN) U.S.-based Diebold settled SEC claims that its subsidiaries in China and Indonesia spent $2 million on travel, entertainment and gifts, and in Russia paid $1 million in cash bribes, to induce the purchase of Diebold ATMs and bank security systems. Payments were made to officials employed at state-owned banks. Diebold settled the claims by paying $48 million. SEC Press Release 2013-225 (Oct. 22, 2013).

OO) Total agreed to pay $398 million to settle SEC and DOJ charges related to making payments to an Iranian government official to obtain gas contracts awarded in the 1990s. DOJ Press Release, May 29, 2013; SEC Press Release 2013-94 (May 29, 2013).

PP) Rino International and two of its executives settled with the SEC and agreed to pay penalties of $250,000 and disgorge $3.5 million for FCPA books and records offenses. SEC Press Release 2013-87 (May 15, 2013).

QQ) Ralph Lauren Corp. agreed to pay $1.5 million to resolve allegations that it bribed government officials in Argentina in order to obtain customs clearance. DOJ Press Release, Apr. 22, 2013; SEC Press Release 2013-65 (Apr. 22, 2013).

RR) Parker Drilling agreed to pay $15.9 million to resolve charges that it authorized payments to an intermediary, knowing that the payments would be used to bribe Nigerian government officials. DOJ Press Release, Apr. 16, 2013; SEC Litigation Release No. 22672 (Apr. 16, 2013).

SS) Koninklijke Philips Electronics agreed to pay $4.5 million to settle charges related to improper payments made to health care officials in Poland. SEC Admin. Proc. No. 3-15265 (Apr. 5, 2013).

TT) Keyuan Petrochemicals and its CEO settled with the SEC over alleged FCPA books and records and internal controls offenses. They paid $1 million in penalties. SEC Press Release 2013-30 (Feb. 28, 2013).

UU) Germany-based insurance and asset management company Allianz agreed to pay $12.3 million to settle SEC's charges for FCPA books and records offenses. SEC Press Release 2012-266 (Dec. 17, 2012).

VV) Tyco International agreed to pay more than $26 million for payments to government officials in various countries. DOJ Press Release, Sept. 24, 2012; SEC Press Release 2012-196 (Sept. 24, 2012).

WW) Oracle consented to a $2 million penalty for failing to prevent a subsidiary from secretly setting aside money off the company's books that was eventually used to make unauthorized payments to phony vendors in India. SEC Press Release 2012-158 (Aug. 16, 2012).

XX) Pfizer and certain of its affiliates entered into a Deferred Prosecution Agreement and agreed to pay $60 million to settle charges relating to payments to publicly-employed regulators and health care professionals in Eastern Europe. DOJ Press Release, Aug. 7, 2012; SEC Press Release 2012-152 (Aug. 7, 2012).

YY) Orthofix International entered into a Deferred Prosecution Agreement and agreed to pay $5.2 million to settle SEC charges that Orthofix's Mexican subsidiary allegedly bribed government officials in order to obtain sales contracts and falsified its records to obscure the payments. Orthofix launched an investigation into the expenditures and self-reported the violations. SEC Press Release 2012-133, (July 10, 2012); DOJ Deferred Prosecution Agreement, July 10, 2012. The DOJ and Orthofix agreed to an extension of the Agreement to allow the DOJ additional time to

(i) assess Orthofix's compliance with the Agreement and (ii) investigate potential misconduct disclosed by Orthofix pursuant to the Agreement. Securities Law Daily, Mar. 2, 2016.

ZZ) Data Systems & Solutions ("DS&S") agreed to pay $8.8 million in criminal penalties for bribes to Lithuanian officials in order to secure contracts at a state-owned nuclear power plant. DOJ Press Release, June 18, 2012.

AAA) Biomet agreed to pay $17.3 million in criminal penalties and $5.4 million in disgorgement to settle charges by the DOJ and SEC. The SEC charged Biomet and its subsidiaries with engaging in a scheme from 2000 to 2008 to pay bribes to publicly-employed doctors in Argentina. The SEC also alleged that Biomet's internal audit system failed to catch the scheme and that Biomet failed to stop the bribes when it learned of them. SEC Press Release (Mar. 26, 2012); DOJ Press Release, Mar. 26, 2012.

BBB) BizJet International Sales & Support agreed to pay $11.8 million in criminal penalties in order to resolve charges that it paid bribes to Mexican government officials. As part of the agreement with DOJ, BizJet also agreed to cooperate with ongoing investigations, as well as to implement a stricter internal controls system. DOJ Press Release, Mar. 14, 2012.

CCC) Smith & Nephew, a London-based company, and its subsidiaries agreed to pay more than $22 million to resolve an FCPA action. The SEC alleged that, beginning in 1997, the subsidiaries created a "slush fund" to bribe publicly-employed Greek doctors. The SEC asserted that Smith & Nephew ignored several indicators of bribery, and that employees at both the parent and subsidiaries were aware of the activity. SEC Press Release 2012-25 (Feb. 6, 2012).

DDD) Magyar Telekom and Deutsche Telekom agreed to pay $95 million to resolve parallel enforcement actions by the SEC/DOJ. Magyar was accused of bribing Macedonian officials and attempting to hide the bribes in official company records. Deutsche, as majority owner of Magyar, was implicated because it was a U.S. issuer and reported Magyar's accounting in its consolidated financial statements. DOJ Press Release, Dec. 29, 2011; SEC Press Release 2011-279 (Dec. 29, 2011).

EEE) The SEC charged Aon with violations of the FCPA books and records and internal controls provisions. The SEC alleged that Aon's subsidiaries made over $3.6 million in improper payments in order to gain or retain business. Aon settled the matter by paying $14.5 million in disgorgement, and also settled a related DOJ matter by paying a $1.8 million criminal fine. SEC Litigation Release No. 22203 (Dec. 20, 2011); DOJ Press Release, Dec. 20, 2011.

FFF) WWT settled charges of improper payments to the Chinese government by paying a total penalty of $3.7 million and disgorging $2.75 million in profits. SEC Administrative Proc. No. 3-14585, Oct. 13, 2011.

GGG) Diageo plc agreed to pay $16 million to settle charges related to allegedly improper payments to government officials in India, Thailand and South Korea to obtain sales and tax benefits related to product sales. The SEC concluded that Diageo's books and records did not accurately reflect illicit payments, and that such payments were disguised as vendor expenses. Diageo plc, SEC Admin. Proc. No. 3-14490 (July 27, 2011).

HHH) Armor Holdings (a subsidiary of BAE Systems) agreed to pay $16 million to settle charges related to "commissions" paid to a sales agent, a portion of which was passed on to a UN procurement official to induce the award of UN contracts. Armor acknowledged that it falsely recorded the commission payments on its books and records, and admitted that it kept off its books and records approximately $4 million in additional payments to agents and other intermediaries used to assist it in obtaining business from foreign government customers. SEC v. Armor Holdings, Case 11-cv-01271 (D.D.C., July 13, 2011); SEC Press Release 2011-146 (July 13, 2011); DOJ Press Release, July 13, 2011.

III) Tenaris S.A., a publicly traded corporation headquartered in Luxembourg, agreed to pay a $8.9 million penalty for violations of the FCPA relating to improper payments to officials of an Uzbekistan state-controlled oil and gas production company in connection with four bids to provide oilfield pipe and related services for energy extraction and transportation projects. Tenaris retained an agent to obtain competitor bid information, which Tenaris then used to submit revised bids. Tenaris also entered into a Deferred Prosecution Agreement with the SEC. Tenaris-SEC Deferred Prosecution Agreement, dated May 17, 2011; DOJ Press Release, May 17, 2011.

JJJ) Johnson & Johnson agreed to pay $70 million to settle charges related to alleged bribes paid to public doctors and hospital administrators in Greece, Poland and Romania, as well as kickbacks paid to obtain contracts under the UN Oil-for-Food Program. Johnson & Johnson, SEC Litigation Release No. 21922 (Apr. 8, 2011); DOJ Press Release, Apr. 8, 2011.

KKK) Comverse Technology agreed to pay a $1.2 million penalty for violation of the FCPA books and records provisions arising from Converse's failure to record accurately improper payments that were made by employees and an agent to individuals connected to

OTE, a Greek telecommunications provider, in order to obtain purchase orders. The payments were inaccurately characterized as legitimate agent commissions in the books and records of a Converse subsidiary based in Israel. SEC Litigation Release No. 21920 (Apr. 7, 2011); DOJ Press Release, Apr. 7, 2011.

LLL) IBM resolved charges brought by the SEC for violating FCPA books and records and internal control provisions, and paid fines and penalties totaling over $10 million. SEC Litigation Release No. 21889 (Mar. 18, 2011).

MMM) Tyson Foods resolved charges brought by the SEC and DOJ for violating the FCPA by making illicit payments to Mexican government veterinarians responsible for certifying its Mexican subsidiary's products for export sales, and concealing the improper payments by putting the veterinarians' wives on its payroll while they performed no services. It was not until two years after Tyson Foods offices first learned about its subsidiary's illicit payments that its counsel instructed the subsidiary to cease making them. Tyson paid fines and penalties of $5 million. SEC Litigation Release No. 21851 (Feb. 10, 2011); DOJ Press Release, Feb. 10, 2011.

NNN) Maxwell Technologies resolved charges brought by the SEC/DOJ for violating the FCPA by paying bribes through its Swiss subsidiary to government officials in China to obtain business from Chinese state-owned entities. Maxwell accounted for the bribes as commission expenses. It paid fines and penalties of $14 million. SEC Litigation Release No. 21832 (Jan. 31, 2011); DOJ Press Release, Jan. 31, 2011.

OOO) Alcatel-Lucent S.A. and three subsidiaries entered into a plea agreement and agreed to pay

$137 million to the DOJ/SEC to resolve FCPA violations arising from alleged bribes in Costa Rica, Honduras, Malaysia and Taiwan prior to Alcatel's 2006 merger with Lucent Technologies. SEC Litigation Release No. 21795 (Dec. 27, 2010); DOJ Press Release, Dec. 27, 2010.

In a first-of-its kind action, Instituto Costarricense de Electricidad, the Costa Rican power company whose officials were bribed, filed a motion in U.S. v. Alcatel-Lucent, Case No. CR-20907 (S.D. Fla. 2011), objecting to the plea agreement, requesting an order declaring it to be a victim of Alcatel-Lucent's criminal conduct and seeking restitution for damages caused to it. The District Court denied relief. See U.S. v. Alcatel-Lucent, Nos. 11-12716, 11-12802 (11th Cir. Aug. 3, 2012).

PPP) Panalpina World Transport and its subsidiaries agreed to pay more than $80 million to resolve allegations that Panalpina and its subsidiaries paid at least $27 million in bribes to foreign officials in seven countries. SEC Press Release 2010-214 (Nov. 4, 2010); DOJ Press Release, Nov. 4, 2010. The SEC complaint against Panalpina's U.S. subsidiary is notable because the subsidiary is not an "issuer" under the 1934 Act. The SEC asserted jurisdiction by charging the subsidiary as an agent and with aiding and abetting its "issuer" customers. SEC v. Panalpina, SEC Litigation Release No. 21727 (Nov. 4, 2010).

In connection with the same investigation, U.S. authorities announced an FCPA settlement with six other companies in the oil and gas industry. DOJ Press Release, Nov. 4. 2010; SEC Press Release 2010-214 (Nov. 4, 2010).

QQQ) The Swiss company ABB settled charges based on the kickbacks paid in connection with the UN Oil-for-Food Program and payments to Mexican officials. ABB paid a penalty of more than $58 million. SEC Litigation Release No. 21673 (Sept. 29, 2010).

RRR) Alliance One International, a global tobacco leaf merchant, pled guilty to violating the FCPA by making bribes to Thai and Kyrgystan government officials to secure contracts. DOJ Press Release, Aug. 6, 2010.

SSS) The Italian company ENI and its Dutch subsidiary, Snamprogetti, agreed to pay $125 million to settle SEC charges, and Snamprogetti agreed to pay an additional $240 million criminal penalty to settle DOJ charges. The SEC complaint against Snamprogetti is notable because Snamprogetti is not an "issuer" under the 1934 Act. SEC Litigation Release No. 21588 (July 7, 2010); DOJ Press Release, July 7, 2010. See also Part VIII.A.4.a.vii.E above.

TTT) Veraz Networks, a telecommunications company, settled allegations that it violated the FCPA books and records and internal control provisions stemming from payments to foreign officials in China and Vietnam (a "gift scheme") in an attempt to win business. SEC Litigation Release No. 21581 (June 29, 2010).

UUU) Daimler AG and three subsidiaries agreed to pay combined fines and penalties of $185 million to resolve SEC and DOJ charges alleging that Daimler had paid $55 million in bribes to government officials in Eastern Europe, the Middle East, Africa and Asia. DOJ Press Release, Apr. 1, 2010; SEC Press Release 2010-51 (Apr. 1, 2010).

VVV) GE agreed to pay $23 million to settle SEC charges that several GE subsidiaries paid illegal kickbacks to Iraqi officials to gain contracts under the UN Oil-for-Food Program. SEC Press Release 2010-133

(July 27, 2010). See also SEC Litigation Release No. 21615 (Aug. 5, 2010), SEC Form 8-K (Mar. 22, 2010).

WWW) BAE Systems pled guilty to FCPA related charges, agreeing to pay a $400 million criminal fine. BAE was charged with making false statements to U.S. government agencies about its FCPA compliance programs. In response to earlier government inquiries, BAE had represented that it would develop an FCPA compliance program, but then failed to develop the program and took steps to conceal and facilitate FCPA offenses. DOJ Press Release, Mar. 1, 2010.

XXX) UTStarcom settled SEC charges, and agreed with the DOJ to pay a $1.5 million fine for violations of the FCPA by providing travel and other things of value to foreign officials, specifically employees at state-owned telecommunications firms in China. DOJ Press Release, Jan. 5, 2010; SEC Release 2009-277 (Dec. 31, 2009).

YYY) JGC Corp. agreed to pay a $219 million criminal penalty to resolve charges related to its participation in a scheme to bribe Nigerian government officials to obtain engineering, procurement and construction contracts. DOJ Press Release, Apr. 6, 2011. See also Technip, SEC Litigation Release No. 21578 (June 28, 2010), DOJ Press Release, June 28, 2010; Halliburton, SEC Litigation Release No. 20897A (Feb. 11, 2009) ($580 million penalty).

(xiv) Current Important Investigations

As of July 2016, there were 87 companies that had disclosed that they are the subject of an FCPA investigation. FCPA Blog, July 6, 2016. Some of the significant cases under investigation are listed below.

The Brazilian aircraft manufacturer Embraer disclosed in July 2016 that it had reserved $200 million for a loss contingency in connection with allegations of FCPA violations involving sales practices in three countries. FCPA Blog, Aug. 1, 2016.

The Ford Motor Company is being investigated in connection with bribes to Russian customs officials. Reuters, Aug., 18, 2015.

A) Teva Pharmaceutical

Teva Pharmaceutical, the world's largest maker of generic medicines, disclosed in a February 2015 filing that it likely violated the FCPA. The disclosure followed an internal investigation. Law360, Feb. 11, 2015.

B) Wal-Mart

In a filing with the SEC in December 2011, Wal-Mart announced that it had begun an investigation into potential FCPA violations. In April 2012, the NY Times published a story alleging that not only had Wal-Mart been aware of bribery by Wal-Mart de Mexico, Wal-Mart's largest subsidiary, since 2005, but that Wal-Mart's top executives had ordered the investigation to stop after uncovering $24 million in bribes. NY Times, Apr. 21, 2012. In the first day of trading after the article's publication, Wal-Mart lost more than $12 billion in market cap. Reuters, Apr. 23, 2012. The following day, the first of four shareholders' suits was filed against the company and its executives. Reuters, Apr. 25, 2012. Civil suits continue in Arkansas and Delaware, including a suit against Wal-Mart's former CEO. FCPA Professor Blog, Oct. 2, 2014; FCPA Blog, Sept. 29, 2014. Since the 2012 NY Times article was published, Wal-Mart reportedly has spent over $650 million on FCPA-related investigations. See FCPA Blog, Aug. 19, 2015.

C) JPMorgan Chase, Morgan Stanley, Citibank

JPMorgan disclosed an SEC inquiry relating to its hiring of certain former employees with possible ties to Chinese officials. See NY Times Dealbook, Aug. 30, 2013; Int'l. Financing Rev., Aug. 24, 2013; Financial Times, Aug. 18, 2013. U.S. regulators have been investigating the company to determine whether the hiring program, called "Sons and Daughters," constituted bribery under the FCPA. Wall St. J., March 28, 2016. The JPMorgan investigation has also been expanded to include Morgan Stanley and Citibank, each of which reportedly received letters from the SEC in late 2013 concerning possible FCPA violations. See Wall St. J., Nov. 26, 2013. Goldman Sachs reportedly has since been implicated as well. See Reuters, May 9, 2014.

D) Libya Investigation

The DOJ and SEC are reportedly investigating Goldman Sachs, Credit Suisse, JPMorgan Chase, Société Générale, Blackstone Group and Och-Ziff Capital in connection with possible bribes of Libyan investment fund officials. See The Wall St. J., Apr. 11, 2016; Financial Times, Mar. 19, 2014; Law360, Feb. 3, 2014.

E) Other Investigations

Johnson Controls reported that it had disclosed to the SEC and DOJ what Johnson described as "isolated" FCPA violations related to its marine business in China. Securities Law Daily, May 5, 2014. Key Energy disclosed that the SEC is investigating possible FCPA violations related to the Texas-based oil fields services company's operations in Russia. Form 10-Q (May 6, 2014). Key Energy disclosed $18 million in expenses for the first quarter of 2015 related to the FCPA investigation. PR Newswire, April 29, 2015. UK-based Delphi Automotive disclosed that it had identified potential FCPA violations by employees in China. Securities Law Daily, Apr. 28, 2014.

5. Economic Sanctions and the Office of Foreign Assets Control

U.S. sanctions programs derive from presidential wartime and national emergency powers, as well as authority granted by specific legislation, to impose controls on transactions and freeze assets under U.S. jurisdiction. The sanctions programs operate by prohibiting or controlling the activities of U.S. persons in order to restrict economic dealings with and/or block the assets of targeted foreign countries, entities or nationals. Programs are/have been directed against governments, entities or nationals (with programs varying widely in scope by country) in the Balkan States, Belarus, Burundi, Central African Republic, Cuba, Democratic Republic of the Congo, Iran, Iraq, Ivory Coast, Lebanon, Libya, Myanmar, North Korea, Russia/Ukraine, Somalia, Sudan, Syria, Venezuela, Yemen and Zimbabwe (see 31 C.F.R. Parts 510, 515, 535, 537, 538, 541-543, 546-549, 551-54, 560-562, 570, 576, 588-89, 591. Additionally, some programs bear the names of the activities they target or the aims they intend to achieve: Magnitsky (freezing assets of persons responsible for the detention, abuse, and death of Sergei Magnitsky) (see Pub. L. 112-208 (2012) (Sergei Magnitsky Rule of Law Accountability Act)), Counter Narcotics Trafficking, Counter Terrorism, Non-Proliferation, Rough Diamond Trade Controls, Transnational Criminal Organizations and Cyber-related, (see 31 C.F.R. §§ 536, 539, 540, 544, 578, 590, 592, 594-97, 598;).

Sanctions fall under a number of primary legal authorities, including the Trading with the Enemy Act, 50 U.S.C. § 5 ("TWEA"), the International Emergency Economic Powers Act, 50 U.S.C. § 1701 ("IEEPA"), and the Combating Terrorism Financing Act, 50 U.S.C. § 1705.

a. OFAC Sanctions Overview

(i) OFAC is a part of Treasury, and is charged with administering and enforcing economic and trade sanctions based on U.S. foreign policy and national security goals against targeted foreign countries, terrorists, international narcotics traffickers, transnational criminal organizations, and those engaged in activities related to trafficking in conflict diamonds and the proliferation of WMD.

(ii) OFAC regulations generally apply to U.S. persons, including U.S. nationals wherever located, U.S. residents, entities formed under U.S. law, individuals or entities located in the U.S., and, for certain sanctions regimes, foreign subsidiaries of U.S. entities.

(iii) OFAC regulations (A) target direct and indirect relationships; (B) prohibit not only transacting and dealing in assets, but also the provision of services (financial and otherwise) and the facilitation of services provided by others; and (C) relate to relationships, transactions or dealings of any type that could touch, or are supported by, the U.S. financial system.

(iv) OFAC restrictions fall into two general categories: (A) asset controls that affect property in which a sanctioned entity has an interest (and typically require that any such property that comes within the possession or control of a U.S. person be frozen and blocked); and (B) trade controls that may range from a full embargo to more limited import/export controls or restrictions on specific transactions. Trade controls generally restrict the provision of services as well as goods.

(v) Sanctioned parties may include not only a foreign government and its agents, but also corporate entities, nationals or residents of the sanctioned country and nationals living outside the sanctioned country, who may all be designated and placed on OFAC's List of Specially Designated Nationals and Blocked Persons (the "SDN List"). Such individuals and entities may be owned or controlled by the governments of sanctioned countries, or so closely associated with a sanctioned country that OFAC considers them to be "acting for or on behalf of" that country. OFAC maintains the SDN

List on its website at http://www.treas.gov/resource-center/sanctions/SDN-List/Pages/default.aspx. However, OFAC cautions that the SDN List is not exhaustive and a U.S. person is responsible for determining whether a party in a transaction is "acting on behalf of" a sanctioned country.

Compliance with OFAC restrictions requires more than avoiding dealings with parties on the SDN List; e.g., a transaction may be impermissible because it involves persons or activity in a restricted jurisdiction, but not any SDNs.

(vi) OFAC has advised that U.S. persons are not permitted to engage in transactions with an entity that is owned 50% or more in the aggregate by one or more persons whose property is blocked by an Executive Order or OFAC regulation (a "blocked person"), regardless of whether the entity is named on OFAC's SDN List. OFAC has advised that shares held by blocked persons through majority-owned intermediaries should be considered when making the 50% ownership calculation. OFAC also advises U.S. persons to act cautiously in considering transactions with entities in which a blocked person owns a significant stake less than 50%, since such an entity could be the subject of a future OFAC designation. See Revised Guidance on Entities Owned by Persons Whose Property and Interests in Property are Blocked (OFAC, Aug. 13, 2014).

(vii) U.S. persons are generally prohibited from "approving" or "facilitating" transactions by non-U.S. persons that would not be permitted if performed by a U.S. person. See, e.g., 31 C.F.R. §§ 538.206, 538.407 and 538.415.

Facilitation prohibitions vary somewhat by sanction program, but generally the facilitation prohibitions preclude a U.S. financial institution from processing a transaction (including a U.S. dollar-clearing transaction) that relates to activity conducted by a non-U.S. person that would be impermissible if conducted by a U.S. person.

(viii) OFAC has the authority, through a licensing process, to permit certain transactions that would otherwise be prohibited if it determines that the transaction does not undermine U.S. policy objectives, or is otherwise justified by U.S. national security or foreign policy objectives. See generally Biennial Report of Licensing Activities Pursuant to the Trade Sanctions Reform and Report Enhancement Act of 2000 (OFAC, Sept. 2016).

b. Compliance Programs and Enforcement

(i) OFAC's website (see http://www.treas.gov/resource-center/sanctions/pages/default.aspx)provides overviews and guidelines covering active OFAC-administered sanctions programs, as well as detailed guidance on "OFAC Regulations for the Financial Community", which summarizes relevant prohibitions of each sanctions regime. See also, e.g., Facing the Sanctions Challenge in Financial Services: A Global Sanctions Compliance Study (Deloitte, July 30, 2009); Opening Securities and Futures Accounts from an OFAC Perspective (OFAC, Nov. 5, 2008); Bachman et al., "OFAC Compliance for Non-U.S. Financial Institutions", Review of Banking & Financial Services (Oct. 2006).

(ii) The sufficiency of a financial institution's OFAC compliance program is evaluated as part of an institution's examination by its primary federal regulator. A bank is expected to establish and maintain an effective, written OFAC program commensurate with its OFAC risk profile (based on products, services, customers and geographic locations). The program should identify high-risk areas and provide for internal controls for screening and reviewing suspect transactions, complying with OFAC reporting requirements, independent compliance testing, designating a bank employee responsible for OFAC compliance, and training programs. See, e.g., BSA

Exam Manual; "How to Implement Risk-based OFAC Monitoring Practices", ABA Bank Compliance, Sept./Oct. 2007. See also Guidance Paper on the Use of Sanctions Clauses in Trade Finance-related Instruments Subject to ICC Rules (ICC, Dec. 2014); Risk Factors for OFAC Compliance in the Securities Industry (OFAC, Nov. 5, 2008).

(iii) OFAC posts final Penalty Notices and related case reports on its website at http://www.treas.gov/resource-center/sanctions/CivPen/Pages/civpen-index2.aspx. See also Part VIII.A.6 below.

(iv) OFAC has entered into MOUs with state banking agencies for the exchange of information about OFAC's administration and enforcement of economic sanctions, compliance with OFAC requirements by state-licensed banking organizations, and possible OFAC violations. See, e.g., OFAC/NYBD MOU, dated Nov. 29, 2006. See generally Interagency/OFAC MOU on Information Sharing, Apr. 12, 2006.

c. Revised Economic Sanctions Enforcement Guidelines

In 2007, Congress increased the maximum civil penalty for violations of IEEPA, the authorizing legislation for many OFAC-administered sanctions, to the greater of $250,000 or twice the amount of a prohibited transaction. It also amended IEEPA's criminal penalty provisions. OFAC accordingly amended its IEEPA-based regulations and issued revised enforcement guidelines. See Pub. L. 110-96 (2007) (the "Enhancement Act"); 73 Fed. Reg. 32650 (June 10, 2008); Civil Penalties -- Interim Policy (OFAC, Nov. 27, 2007); Enhanced IEEPA Fines for Export Control and Embargoes: What Does It Mean for Your Clients? (Am. Bar Assoc., 2007).

In 2009, OFAC published final economic sanctions enforcement guidelines (the "Guidelines"). See 74 Fed. Reg. 57593 (Nov. 9, 2009).

(i) The Guidelines set forth General Factors that OFAC will consider in determining what type of enforcement action to take (e.g., no action, request for additional information, cautionary letter, finding of violation, civil penalty, criminal referral or other administrative action) and establishing the amount of any civil money penalty.

(ii) The Guidelines provide for the issuance of either cautionary letters or findings of violation under certain circumstances.

(iii) In recognition of OFAC's position that the enhanced maximum civil penalties authorized by the Enhancement Act "should be reserved for the most serious cases", the Guidelines distinguish between egregious and non-egregious cases. Egregious cases are defined as those representing particularly serious violations, based on an analysis of applicable General Factors, with substantial weight given to considerations of willfulness or recklessness, awareness of the conduct giving rise to an apparent violation, harm to sanctions program objectives, and the individual characteristics of the alleged violation.

d. Iranian Sanctions

(i) U.S. Sanctions against Iran and Iranian interests increased over nearly two decades, but 2015 and 2016 marked a critical turning point.

(ii) The Iran and Libya Sanctions Act, Pub. L. 104-172 (1996) ("ILSA"), imposes penalties on persons investing in Iranian oil and gas industries. In 2010, CISADA extended ILSA (now known as the "Iran Sanctions Act" or "ISA") through December 31, 2016, and mandated sanctions against governments or entities that assist Iran's nuclear program and development of WMD. CISADA expanded the activities that may lead to sanctions on U.S. and foreign persons that deal with Iran and the potential severity of those sanctions. Because OFAC regulations separately bar U.S. persons from making forbidden investments, practitioners generally view the ISA, as amended by CISADA, as directed against non-U.S. persons and such sanctions as "secondary sanctions."

CISADA added a number of provisions affecting U.S. and non-U.S. financial institutions, including: (A) potential sanctions for financing investments in the Iranian petroleum or refining sectors or financing the import of refined products; (B) denial of U.S. correspondent accounts to foreign financial institutions who engage in certain activities; (C) requirements for Treasury to adopt regulations imposing due diligence requirements related to correspondent accounts to foreign banks engaged in sanctionable activities; and (D) extension of OFAC compliance requirements with respect to SDNs connected to the IRGC to foreign subsidiaries of U.S. financial institutions.

See generally Iranian Commercial Activities Update: Foreign Firms Reported to Have Engaged in Iran's Energy or Communications Sectors (GAO, Jan. 2015); Combating Terrorism: Strategy to Counter Iran in the Western Hemisphere Has Gaps That State Department Should Address (GAO, Sept. 2014); Iran: State Leads an Interagency Process to Determine Whether to Impose Sanctions Under Section 5(b) of the Iran Sanctions Act (GAO, May 2014); CISADA: The New U.S. Sanctions on Iran (Treasury, 2012); Iran Sanctions (CRS, Sept. 13, 2012); Iran: U.S. Concerns and Policy Responses (CRS, Sept. 5, 2012); Actions to Enforce the [ISA] and Implement Contractor Certification Requirement (GAO, Jan. 24, 2012); Iran Sanctions: New Act Underscores Importance of Comprehensive Assessment of Sanctions' Effectiveness (GAO, July 29, 2010).

(iii) Pursuant to CISADA, FinCEN issued regulations in 2011 to require U.S. banks, upon FinCEN's request, to inquire of foreign banks for which they maintain correspondent accounts and report to FinCEN as to whether the foreign bank has processed funds transfers related to certain designated Iranian entities or maintains a correspondent account at any designated Iranian financial institutions. 76 Fed. Reg. 62607 (Oct. 11, 2011) (31 C.F.R. Part 1060).

(iv) In 2010, OFAC promulgated the IFSR to implement provisions of CISADA that restrict U.S. financial institutions from maintaining correspondent accounts for foreign financial institutions that have facilitated transactions for sanctioned Iranian parties. See 76 Fed. Reg. 62607 (Oct. 11, 2011) (31 C.F.R. Part 1060); 75 Fed. Reg. 49836 (Aug. 16, 2010).

(v) The State Department also issued guidance clarifying certain provisions of CISADA. See, e.g., State Department Release, May 23, 2011 (Guidelines about the Provision of Goods and Services, Including Insurance, to Entities that Ship Refined Petroleum to Iran).

(vi) In 2011, the President issued an Executive Order which effectively expanded CISADA to cover activities in the Iranian petrochemical sector and tightened the existing definitions of sanctionable investment in Iranian oil and gas production. See Presidential Executive Order 13590, dated Nov. 21, 2011 (Authorizing the Imposition of Certain Sanctions With Respect to the Provision of Goods, Services, Technology, or Support for Iran's Energy and Petrochemical Sectors).

(vii) Section 1245 of The National Defense Authorization Act for Fiscal Year 2012 (the "2012 NDAA"), Pub. L. 112-81, further expanded CISADA's threat of sanctions against foreign banks dealing with the Iranian financial sector by providing for a prohibition on U.S. correspondent relationships with any financial institution found to have "knowingly conducted or facilitated any significant financial transaction with the Central Bank of Iran". OFAC amended the IFSR to implement the 2012 NDAA. See 77 Fed. Reg. 11724 (Feb. 27, 2012) (31 C.F.R. Part 561).

(viii) On July 20, 2012, the President issued an Executive Order which effectively expanded the sanctions of the 2012 NDAA to include purchases of petroleum and petroleum products through any channel. It also provided new authority to sanction the purchasers themselves and targeted those who provide material support to key Iranian institutions. See Presidential Executive Order 13622, dated July 30, 2012, (Authorizing Additional Sanctions with Respect to Iran).

(ix) Enacted in 2012, ITRA provided for sanctions on activities related to Iran's energy and financial sectors, and amended the ISA, CISADA and the NDAA, further expanding the scope and severity of U.S. sanctions against Iran. See Iran Sanctions (CRS, Mar. 18, 2014); Iran Sanctions Contained in [ITRA] (State Department Fact Sheet, Sept. 28, 2012); Iran: U.S. Concerns and Policy Responses (CRS Aug. 2, 2012); Unrest in Syria and U.S. Policy (CRS May 24, 2012); and Unrest in Syria and U.S. Sanctions Against the Assad Regime (CRS, Mar. 26, 2012).

(x) ITRA also imposed new reporting requirements on U.S. domestic and foreign companies required to file reports with the SEC pursuant to § 13(r) of the 1934 Act. Annual Reports on Form 10-K, Annual Reports on Form 20-F, and Quarterly Reports on Form 10-Q must include disclosure of contracts, transactions, and "dealings" with Iranian and other entities. See SEC FAQs (Dec. 4, 2012); 1934 Act § 13(r): Disclosure Guidance for Public Companies (Eight Law Firm Consensus Report, Feb. 7, 2013).

(xi) On December 26, 2012, OFAC amended its "Iranian Transactions and Sanctions Regulations" ("ITSR") to implement portions of ITRA as well as certain Iran-related provisions of Executive Orders 13622 and 13628. See 77 Fed. Reg. 75845 (Dec. 26, 2012). These amendments provided additional detail regarding the prohibition against non-U.S. entities owned or controlled by a U.S. person knowingly engaging in transactions with Iran or Iranian entities that would be prohibited to a U.S. person. See U.S. Enacts Additional Iran-related Sanctions; OFAC Amends Iranian Sanctions Regulations to Cover Entities Owned by U.S. Persons (Cleary Gottlieb, Jan. 8, 2013).

(xii) On January 2, 2013, the President signed the "National Defense Authorization Act for Fiscal Year 2013" (the "2013 NDAA"), Pub. L. 112-239, into law. Provisions of the 2013 NDAA, entitled the "Iran Freedom and Counter-Proliferation Act" (the "IFCA"), further expanded Iran-related sanctions to target companies that engage in a variety of activities.

(xiii) Effective March 15, 2013, OFAC adopted a final rule amending the IFSR to implement certain provisions of IRA and related provisions of Executive Order 13622. See 78 Fed. Reg. 16403 (Mar. 15, 2013).

(xiv) On June 3, 2013, the President signed an Executive Order implementing certain sanctions set forth in IFCA and authorizing additional sanctions against Iran, targeting transactions and activities related to the Iranian rail, Iran's automotive sector, and Iranians SDNs. See Executive Order 13645, dated June 3, 2013 (Authorizing the Implementation of Certain Sanctions Set Forth in [IFCA] and Additional Sanctions with Respect to Iran).

(xv) According to U.S. and International Sanctions Have Adversely Affected the Iranian Economy (GAO, Feb. 2013), the Iranian economy consistently underperformed the economies of comparable peer countries since 2010, when increased sanctions were introduced. While Iran tried to adapt to such sanctions through various means, including using alternative payment mechanisms and changing its trading partners, it was unsuccessful in offsetting the impact of sanctions.

(xvi) On July 14, 2015, the U.S., the UK, China, France, Russia and Germany (the "P5+1") and Iran reached the JCPOA, easing sanctions against Iran in return for restrictions on its nuclear program. The most significant EU and UN sanctions against Iran and many of the U.S. secondary sanctions described above were suspended beginning on January 16, 2016, ("Implementation Day") when the International Atomic Energy Agency certified that Iran had implemented certain requirements. U.S. direct OFAC sanctions will remain in force and continue to restrict dealings with Iran within U.S. jurisdiction. Certain U.S. secondary sanctions remain in place, including those targeted at activities supporting human rights abuses, Iranian terrorist activity, WMD-related activity and dealings with designated Iranian persons. See, e.g., Guidance Relating to the Lifting of Certain U.S. Sanctions Pursuant to the [JCPOA] on Implementation Day (OFAC, Jan. 16, 2016); [FAQs] Relating to the Lifting of Certain U.S. Sanctions Under the [JCPOA] on Implementation Day (OFAC, Jan. 16, 2016); General License H: Authorizing Certain Transactions Relating to Foreign Entities Owned or Controlled by a United States Person (OFAC, Jan. 16, 2016); Statement of Licensing Policy for Activities Related to the Export or Re-Export to Iran of Commercial Passenger Aircraft and Related Parts and Services (OFAC, Jan. 16, 2016). See also Bloomberg, June 7, 2016; Remarks of Acting Undersecretary of Treasury Adam Szubin, June 24, 2016, Apr. 13, 2016; Statement of Senator Brown, May 24, 2016; before Senate Committee on Banking, Housing, and Urban Affairs, May 24, 2016; Testimony of Mark Dubowitz, Michael Ellerman, Elizabeth Rosenberg and Juan Zarate before Senate Committee on Banking, Housing, and Urban Affairs, May 24, 2016; Remarks of Senator Richard Shelby, May 24, 2016.

The JCPOA followed negotiations after the P5+1 and Iran reached a preliminary framework agreement on April 2, 2015 and the Joint Plan of Action ("JPOA") interim agreement on November 24, 2013. The limited, targeted sanctions relief provided for under the JPOA was extended until Implementation Day. See JCPOA (July 14, 2015); 79 Fed. Reg. 5025 (Jan. 30, 2014);

JPOA (Nov. 24, 2013). See also Statement on the [JCPOA] Regarding the Islamic Republic of Iran's Nuclear Program (Treasury, July 14, 2015); Parameters for a Joint Comprehensive Plan of Action Regarding the Islamic Republic of Iran's Nuclear Program (State Department, Apr. 2, 2015).

After Implementation Day, OFAC issued a final rule authorizing the importation of certain Iranian foodstuffs and carpets, and related transactions. 81 Fed. Reg. 330 (Jan. 21, 2016). OFAC has also issued guidance reflecting the lifting of nuclear-related secondary sanctions under the JCPOA. See OFAC FAQs: Iran Sanctions (OFAC, Apr. 27, 2016).

(xvii) In March 2016, OFAC sanctioned additional Iranian entities and units of the IRGC for their role in the country's recent ballistic missile tests. Treasury Press Release, Mar. 24, 2016; Wall St. J., Mar. 24, 2016.

(xviii) The disclosure required under Section 13(r) of the Exchange Act regarding certain activities with Iran was unaffected by the JCPOA. Securities Law Daily, Jan. 23, 2016.

e. Russian Sanctions

In 2014, the U.S. imposed sanctions in connection with events in the Crimea region of Ukraine ("Crimea"). Pursuant to these sanctions, all transactions with Crimea within U.S. jurisdiction are prohibited, a number of Russian individuals and entities were designated as SDNs and sanctions were imposed on new debt and equity transactions for targeted entities in the Russian financial, energy and defense sectors. In addition, the "Ukraine Freedom Support Act" Pub. L. 133-212 (2014) imposed secondary sanctions targeted at foreign persons and entities that engage in specified defense and oil production-related transactions. See, e.g., Ukraine-Related Sanctions Regulations, 31 C.F.R. Part 589; Sectoral Sanctions Identifications List (OFAC, Sept. 1, 2016) (designating additional firms in the Russian financial, energy, and defense sectors for restrictions on new debt and new equity); Obfuscation of Critical Information in Financial and Trade Transactions Involving the Crimea Region of Ukraine (OFAC, July 30, 2015); Presidential Executive Order 13685, dated Dec. 19, 2014 (Blocking Property of Certain Persons and Prohibiting Certain Transactions with Respect to the Crimea Region of Ukraine); Presidential Executive Order 13660, dated Mar. 6, 2014 (Blocking Property of Certain Persons Contributing to the Situation in Ukraine); Presidential Executive Order 13661, dated Mar. 17. 2014 (Blocking Property of Additional Persons Contributing to the Situation in Ukraine); Presidential Executive Order 13662, dated Mar. 20, 2014 (Blocking Property of Additional Persons Contributing to the Situation in Ukraine) (authorizing sanctions against persons or entities determined to be part of sectors in the Russian Federation economy that are identified for sanctions); Directives 1 and 2 Pursuant to Executive Order 13662 (OFAC, July 16, 2014); Directive 1 as Amended Under Executive Order 13662 (Sept. 12, 2014); Directive 2 as Amended Under Executive Order 13662 (Sept. 12, 2014); Directive 3 Under Executive Order 13662 (Sept. 12, 2014); Directive 4 Under Executive Order 13662 (Sept. 12, 2014). See also Banking Daily, Dec. 2, 2015; Bloomberg, Nov. 30, 2015; G-7 Leaders Statement on Ukraine (White House, July 30, 2014).

f. Revised Cuba Sanctions

In 2015 and 2016, OFAC released revisions to the Cuba sanctions regulations to ease sanctions against Cuba to implement policy changes announced by the President. The revised regulations relax restrictions on existing categories of authorized travel and expand categories of authorized travel, ease certain restrictions on financial transactions with Cuban persons or in which Cuba or Cuban persons have an interest, permit banks to reject (instead of block) most funds transfers in which a Cuban person has an interest, authorize certain U.S. entities to maintain a physical presence or business presence in Cuba, and expand the categories for which licenses to export goods or services to Cuban consumers can be obtained, among other changes. However, except in circumstances expressly permitted by the regulations or pursuant to specific licenses granted by OFAC, the revised regulations generally do not permit transactions directly with or transactions in Cuba. See, e.g., 31 C.F.R. Part 515; 81 Fed. Reg. 13989 (Mar. 16, 2016); 81 Fed. Reg. 4583 (Jan. 27, 2016); 80 Fed. Reg. 56915 (Sept. 21, 2015); 80 Fed. Reg. 2291-15 (Jan. 16, 2015). See also [FAQs] on Changes to the Cuba Sanctions Program (OFAC, July 23, 2016);

Fact Sheet: Treasury and Commerce Announce Significant Amendments to the Cuba Sanctions Regulations (OFAC, Mar. 15, 2016).

g. North Korea

(i) The North Korean Sanctions and Policy Enhancement Act of 2016, Pub. L. 114-122 (2016) ("NKSPEA") was enacted in February 2016 and expanded sanctions against North Korea. The NKSPEA imposed a comprehensive export ban on North Korea and provided for secondary sanctions against persons who engage in certain activities, including (A) trading in luxury goods with North Korea, (B) engaging in activities related to North Korea's proliferation of WMDs, military, intelligence or political oppression, (C) engaging in human rights abuses, censorship, activities to undermine cybersecurity and (D) money laundering in support of the Government of North Korea. It also authorized the imposition of sanctions against any person who bribes a North Korean government official or facilitates activities of any person designated by the U.N. Security Council in relation to North Korea.

In March 2016, the President issued an Executive Order which further expanded sanctions against North Korea by (A) blocking all property of the Government of North Korea, its agencies and controlled entities and the Worker's Party of Korea, (B) prohibiting the export or re-export of any U.S. goods, services or technology to North Korea, new investment in North Korea or the facilitation of activities that would be illegal if conducted by a U.S. person and (C) authorizing the future designation of any person operating in North Korea's transportation, mining, energy and financial services sectors, participating in the trade of certain metals and software that benefits the Government of North Korea or engaging in certain activities, including human rights abuses, censorship and undermining cybersecurity. Pursuant to this Executive Order, OFAC later designated senior officials in the North Korean government, including leader Kim Jong Un. See Presidential Executive Order 13722, dated Mar. 16, 2016 (Blocking Property of the Government of North Korea and the Workers' Party of Korea, and Prohibiting Certain Transactions With Respect to North Korea). See also, Treasury Press Release, July 6, 2016; Financial Times, July 6, 2016.

Prior to this expansion of sanctions against North Korea, FinCEN advised in 2013 that, given North Korea's record of illicit and deceptive activity, all U.S. financial institutions should take commensurate risk-mitigation measures to diminish threats emanating from North Korea. FinCEN has also encouraged financial institutions to be familiar with customers involved with or transactions related to items identified as prohibited under U.N. Security Council Resolutions relating to North Korea. See FIN 2013-A005 (July 1, 2013) (Update on the Continuing Illicit Finance Threat Emanating from North Korea). See also, North Korea Sanctions: [U.S.] Has Increased Flexibility to Impose Sanctions but United Nations is Impeded by a Lack of Member State Reports (GAO, May 2015).

h. Other Recent Developments

(i) In September 2016, the President announced his intention to terminate the national emergency with respect to Myanmar and revoke the Executive Orders that impose trade and investment restrictions on Myanmar in response to the country's progress toward a democratic transition. All sanctions currently remain in place, but once the President issues a new Executive Order implementing this policy, the restrictions under the Burmese sanctions regulations will no longer be in effect. See, e.g., Remarks by President Obama and State Counselor Aung San Suu Kyi of Burma, Sept. 14, 2016; [FAQs] on Changes to the Burma Sanctions Program (OFAC, Sept. 14, 2016). This follows OFAC easing sanctions on Myanmar in May 2016 by issuing and expanding general licenses to support trade with Myanmar, allow movement of goods within Myanmar, authorize certain transactions related to U.S. individuals residing in Myanmar and allow most transactions involving designated financial institutions. OFAC also removed seven state-owned enterprises and three state-owned banks from the SDN List. See, e.g., 31 C.F.R. 537; 81 Fed. Reg. 31169 (May 18, 2016). See also 81 Fed. Reg. 31169 (May 28, 2016); Treasury Press Release, May 17, 2016.

(ii) In October 2015, OFAC provided temporary sanctions relief to nine Belarusian entities through a general license, which was extended through October 31, 2016. In June 2016, the President extended the national emergency with respect to Belarus for an additional year. See Continuation of the National Emergency With Respect to the Actions and Policies of Certain Members of the Government of Belarus and Other Persons to Undermine Belarus's Democratic Processes or Institutions (White House, June 10, 2016); Treasury Press Release, Apr. 29. 2016, Oct. 29, 2015; General License 2A: General License with Respect to Entities Blocked Pursuant to Executive Order 13405 (OFAC, Apr. 28, 2016).

(iii) In 2010, the Second Circuit ruled that blocked assets of Bank Melli were subject to attachment by relatives of a 1996 Hamas suicide bombing in Israel. The ruling found that the assets could be attached based on the Bank's status as an instrumentality of Iran, regardless of whether it was a party subject to the underlying judgment for the plaintiffs in the case. Hazi v. Bank Melli Iran, 609 F.3d 43 (2d Cir. 2010).

(iv) The SEC established the Office of Global Security Risk to monitor disclosure by U.S.-listed companies about their activities in sanctioned countries, particularly those designated as state sponsors of terrorism. In 2007, the SEC issued a Concept Release on whether it should facilitate greater access to companies' disclosures concerning their business activities in or with countries designated as state sponsors of terrorism. A list of companies doing business in sanctioned countries was removed from the SEC website in 2007 after objections from industry groups about its accuracy. See SEC Release No. 33-8860 (Nov. 11, 2007); SEC Press Release 2007-138 (July 20, 2007).

6. Enforcement Actions

a. Most of the major enforcement actions against financial institutions for BSA violations have involved failure to detect and report suspicious activity, which is then treated as an indication of failure to maintain an effective AML or OFAC program. Enforcement actions reflect such matters as (i) lack of management oversight and accountability, (ii) failure to meet reporting requirements, (iii) failure/absence of key controls, (iv) inadequate risk assessment, (v) inadequate/ineffective monitoring functions, (vi) due diligence failures, (vii) inadequate communication of information, (viii) failure to correct a previously reported problem or to respond to previous criticism, (ix) concealing information from examiners, (x) insufficient resources dedicated to compliance, (xi) inadequate testing of the compliance program, and (xii) compliance personnel lacking experience and/or knowledge. See generally BSA Exam Manual, Appendix R (Interagency BSA Enforcement Guidance); The FDIC's Response to [BSA] and [AML] Concerns Identified at FDIC-supervised Institutions (OIG, Dec. 15, 2014); Comptroller Bulletin No. 2005-45 (Dec. 23, 2005) (Comptroller process for taking administrative actions against banks for BSA violations); [BSA/AML] Supervision (OCC, May 18, 2005).

b. In Use and Review of Independent Consultants ["ICs"] in Enforcement Actions (Nov. 2013), the OCC explained the standards it uses when requiring banks to employ ICs as part of an enforcement action, which include: (i) the severity of the violations or issues; (ii) the criticality of the function needing remediation; (iii) confidence in management's ability to ensure necessary actions are taken to identify violations and take corrective action in a timely manner; (iv) the expertise, staffing and resources of the bank to perform the necessary actions; (v) actions already taken to address the violations or issues; (vi) services to be provided by an IC; and (vii) alternatives to engaging an IC. In cases where an IC is required, the OCC reviews the bank's proposed IC and the engagement contract, monitors the work of the IC throughout the engagement and reviews the IC's final report and findings.

On August 18, 2015, NYDFS announced an Agreement with Promontory Financial Group to resolve findings of its investigation into Promontory's work at SCB, which included a lack of independent judgment and credibility. Under the Agreement, Promontory agreed to: (i) make a $15 million payment to NY; and (ii) abstain for six months from certain new engagements requiring disclosure of confidential NY supervisory information. See NYDFS Agreement, Aug. 18, 2015. See also Report on Investigation of Promontory Financial Group (NYDFS, Aug. 2015).

On June 18, 2013, the State of New York announced an Agreement with Deloitte Financial Advisory Services ("Deloitte FAS") regarding Deloitte FAS' alleged misconduct, violations of law, and lack of autonomy during its consulting work at SCB on AML issues. Under the Agreement, Deloitte FAS agreed to: (i) a one-year suspension from consulting work at financial institutions regulated by the NYDFS; (ii) make a $10 million payment to NY; and (iii) implement reforms designed to help address conflicts of interest in the consulting industry. SCB had retained Deloitte FAS to review AML issues pursuant to a 2004 Agreement with the NYBD that identified risk management deficiencies in the AML and BSA controls at SCB's NY branch. A subsequent NYDFS investigation into Deloitte's conduct found that Deloitte FAS had removed an AML recommendation from a written final report to the NYBD and violated NY law by disclosing confidential information of other Deloitte clients to SCB. See NYDFS Agreement, June 18, 2013.

In August 2014, NYDFS announced an Agreement with Pricewaterhouse Coopers Regulatory Advisory Services ("PwC RAS") regarding alleged misconduct during its consulting work at Bank of Tokyo Mitsubishi-UFJ, Ltd. ("BTMU") on AML and sanctions issues. An investigation by NYDFS found that PwC RAS had improperly altered reports submitted to regulators concerning BTMU's AML and sanctions compliance. Under the Agreement, which was modeled on the NYDFS' agreement with Deloitte FAS, PwC RAS agreed to: (i) a 24-month suspension from providing consulting services; (ii) make a $25 million payment to NY; and (iii) implement reforms designed to reduce conflicts of interest involved in consulting services. See NYDFS Settlement Agreement, Aug. 14, 2014.

For a more extensive discussion of outsourcing issues, see Part IX.B.2 below.

c. Notable BSA/AML and OFAC enforcement actions include the following:

(i) On July 22, 2015, the FDIC and California Department of Business Oversight (the "CA-DBO") announced the assessment of a $140 million joint civil money penalty against Banamex, a subsidiary of Citigroup, for its failure to implement an effective BSA/AML compliance program, to retain qualified AML compliance personnel, to maintain adequate internal controls to detect and report suspicious transactions, and to provide sufficient training to employees. Banamex continues to be under investigation by the DOJ for potential AML violations. See FDIC/ Cal. Dept. of Business Oversight, Joint Order to Pay Civil Money Penalty, July 22, 2015; Banking Daily, July 27, 2015. See also FDIC/Cal. Dept. of Financial Institutions Consent Order, Aug. 2, 2012.

Citigroup and Citibank N.A. have been subject to previous enforcement actions. See Citigroup, OFAC Enforcement Information for Sept. 3, 2014 and Board Consent Order, Mar. 21, 2013; Citibank, OCC Consent Order, Apr. 5, 2012 (for BSA compliance program deficiencies with respect to internal controls, customer due diligence, the audit function, monitoring foreign correspondent banking, and SAR reporting).

(ii) On March 12, 2015, the Board, NYDFS, OFAC, the DOJ and DANY announced a combined $1.71 billion settlement with Commerzbank to settle alleged violations of U.S. sanctions and the BSA that occurred between 2002 and 2013. In addition to the penalty, the settlement required Commerzbank to (A) implement an enhanced AML and sanctions compliance program, (B) install an independent monitor, (C) terminate employees who engaged in misconduct, (D) admit criminal violations of U.S. sanctions, the BSA, and NY books and records requirements, and (E) admit willful failure to maintain an adequate AML program, due diligence for foreign correspondence accounts and reporting suspicious transactions. See Board Cease and Desist Order (Mar. 12, 2015); NYDFS Consent Order (Mar. 12, 2015); DOJ Deferred Prosecution Agreement (Mar. 12, 2015); OFAC Settlement Agreement (Mar. 11, 2015).

U.S. v. Commerzbank, No. 13-cv-08095 (SDNY 2015) represents a False Claims Act suit brought by a former Commerzbank employee that accuses Commerzbank of borrowing $350 million from the FRBNY while unlawfully processing gold trades for the Central Bank of Iran. Commerzbank settled in May 2015. See Law360, May 15, 2015.

Prior enforcement actions have been brought against Commerzbank by the FRBNY, the Board and OFAC. See FRBNY Written Agreement (June 8, 2012) (for deficiencies in its BSA/AML compliance program, CTR reporting procedures, and SAR filing procedures related to its conduct of bulk cash transactions outside the U.S); Board Consent Order (Oct. 16, 2013) (for failure to maintain adequate controls for its correspondent bank business and requiring Commerzbank's NY branch to develop an enhanced BSA/AML compliance program); OFAC Enforcement Information, Nov. 29, 2011.

In addition, prior to Commerzbank's acquisition of Dresdner Bank, the Board issued a Cease and Desist Order against Dresdner relating to BSA/AML compliance at its NY branch. See Board Cease and Desist Order (Nov. 7, 2008) (terminated May 11, 2009).

(iii) On November 18, 2014, the NYDFS issued a Consent Order against BTMU. Under the terms of the Order, BTMU agreed to pay $315 million to the NYDFS for misleading the NYDFS in reaching a settlement in 2013 and violations of NY books and records requirements. See NYDFS Consent Order, Nov. 18, 2014.

This Order follows a Consent Order the NYDFS issued against BTMU in June 2013, under which BTMU agreed to pay $250 million to the NYDFS for violations of NY law in connection with transactions involving countries and entities subject to international sanctions, including the regimes of Iran, Sudan and Myanmar. Specifically, the NYDFS alleged that BTMU had systematically removed information from wire transfer messages that could have been used to identify the involvement of countries and persons subject to international sanctions. Most of the wire transfer messages that were the subject of the Order did not violate OFAC requirements (i.e., requested permissible "U-turns" under the OFAC Iran sanctions regulations). See NYDFS Consent Order, June 20, 2013. BTMU previously entered into a Settlement Agreement with OFAC under which BTMU agreed to pay more than $8.5 million to settle alleged violations of U.S. sanctions. See OFAC Enforcement Information (Dec. 12, 2012).

(iv) On June 30, 2014, OFAC, the Board, the DOJ, DANY and the NYDFS announced a combined $8.9 billion agreement with BNP Paribas to settle alleged violations of U.S. sanctions. According to the Settlement Agreement, BNP Paribas concealed, removed or omitted references to sanctioned parties in payment messages sent to U.S. banks between 2005 and 2012 in violation of U.S. sanctions against Sudan, Iran, Cuba and Burma. In addition to the penalty, the settlement required BNP Paribas to (A) plead guilty to conspiracy to violate the IEEPA and TWEA, (B) suspend certain U.S. dollar clearing by BNP Paribas' NY branch for one year, (C) engage an IC to review the bank's BSA/AML and OFAC compliance programs, (D) establish a sanctions compliance office located in the U.S., and (E) discipline certain employees. See OFAC Settlement Agreement (June 28, 2014); Board Cease and Desist Order (June 29, 2014); DOJ Plea Agreement (June 29, 2014); DOJ Consent Order of Forfeiture/Money Judgment (June 28, 2014); NYDFS Consent Order (June 29, 2014). BNP Paribas was sentenced by the NY State Supreme Court in April 2015 and a U.S. District Court in May 2015. The sentencing of BNP Paribas was postponed until the Department of Labor issued a notice of exemption which allowed BNP Paribas to maintain its qualified asset manager status upon sentencing. See DOJ Press Release, May 1, 2015; DANY Press Release, Apr. 15, 2015; 80 Fed. Reg. 20261 (Apr. 15, 2015).

(v) In February 2014, the State of Arizona and Western Union announced an agreement to extend their $94 million Settlement Agreement in February 2010 regarding alleged money laundering violations to allow Western Union additional time to implement required reforms. Under the extended agreement, Western Union will remain under the supervision of a court-appointed monitor until the end of 2017, must continue to implement compliance reforms, will fund a special financial crimes center and could face additional monetary penalties. See Corporate Counsel (Feb. 7, 2014). Previously, Western Union entered into a settlement with FinCEN in 2003 relating to an alleged failure to comply with CTR and SAR requirements. See FinCEN Assessment of Civil Money Penalty, Mar. 6, 2003.

(vi) On January 23, 2014, OFAC announced a $153 million agreement with Clearstream to settle allegations that its use of an omnibus account at a U.S. financial institution gave the Iranian government substantial and unauthorized access to the U.S. financial system. See OFAC Settlement Agreement (Jan. 23, 2014).

(vii) On December 11, 2013, OFAC, the Board and NYDFS announced an agreement with RBS which required RBS to pay $100 million to settle alleged violations of U.S. sanctions. Among other violations, the authorities alleged that RBS omitted or removed references to sanctioned parties from payment messages sent to U.S. financial institutions in violation of U.S. sanctions against Iran, Sudan, Burma and Cuba. The Board issued a concurrent Cease and Desist Order that required RBS to establish an acceptable OFAC compliance program. See OFAC Settlement Agreement (Dec. 11, 2013); Board Assessment of Civil Monetary Penalty (Dec. 11, 2013); NYDFS Consent Order (Dec. 11, 2013); Board Cease and Desist Order (Dec. 11, 2013). The Board previously issued a Cease and Desist Order against RBS related to BSA/AML and OFAC compliance and risk-management practices at its U.S. branches. See Board Ceases and Desist Order (July 26, 2011).

(viii) On August 13, 2013, OFAC announced the issuance of a Finding of Violation to VISA International Services Association ("VISA") for its failure on three occasions between 2007 and 2011 to file reports required by 31 C.F.R. § 501.603(b) with respect to blocked property in which Iranian and Syrian sanctioned parties had an interest. OFAC determined that a monetary penalty against VISA was not warranted in part because the violations did not result in a sanctioned party receiving an economic benefit. See OFAC Enforcement Information (Aug. 13, 2013).

(ix) On January 14, 2013, the OCC issued a Cease and Desist Order, by consent, in response to alleged deficiencies in AML compliance by JPMorgan Chase and two affiliated banks. The OCC found that the banks were in violation of statutory and regulatory requirements to maintain an adequate BSA compliance program, file SARs, and conduct appropriate due diligence on business and commercial banking customers. See OCC Consent Order, AA-EC-13-04 (Jan. 14, 2013). The Board issued a concurrent Cease and Desist Order to the parent company, JPMorgan Chase & Co. See Board Consent Order, No. 13-002-B-HC (Jan. 14, 2013). In January 2014, JPM entered into a Deferred Prosecution Agreement with the DOJ and agreed to pay civil monetary penalties to the OCC and FinCEN to settle claims related to deficiencies in its AML program. See DOJ Deferred Prosecution Agreement, Jan. 7, 2014; OCC Consent Order, AA-EC-13-109 (Jan. 7, 2014); FinCEN Assessment of Civil Money Penalty, Jan. 7, 2014.

JPMorgan Chase had previously entered into a Settlement Agreement with OFAC in August 2011 to pay $88 million to settle charges that the Bank had violated U.S. sanctions by processing wire transfers involving a Cuban national, making a trade loan that involved an IRISL-affiliated vessel blocked by OFAC, and failing to provide complete information in connection with an OFAC administrative subpoena. See OFAC Settlement Agreement, Aug. 25, 2011.

Louisiana Municipal Police Employee Retirement System v. JPMorgan Chase, No. 11-civ-6231 (SDNY Sept. 6, 2011) (complaint), dismissed without prejudice (Oct. 19, 2011), represents a derivative action naming 11 directors and officers of JPMorgan Chase as defendants, that alleged the defendants "knowingly allowed and rewarded [JPMorgan Chase's] violations of . . . multiple sanctions programs." Among other damages alleged are "the costs to [JPMorgan Chase] associated with the settlement, remedial measures, damage to goodwill and increased regulatory scrutiny."

(x) On December 11, 2012, HSBC entered into a $1.9 billion Deferred Prosecution Agreement with U.S. regulators for violations of the BSA, TWEA and IEEPA.

According to the agreement, HSBC violated the BSA by failing to maintain an effective AML program and to conduct appropriate due diligence on its foreign correspondent account holders, and violated TWEA and IEEPA by illegally conducting transactions on behalf of customers in Cuba, Iran, Libya, Sudan and Burma. Pursuant to the Agreement, HSBC:

A) Committed to undertake enhanced AML and other compliance obligations and to effect structural changes within its entire global operations to prevent a repeat of the conduct that led to its prosecution.

B) Replaced almost all of its senior management, "clawed back" deferred compensation bonuses for senior AML and compliance officers, and agreed to partially defer bonus compensation for its senior executives.

C) Made significant changes in its management structure and AML compliance functions to increase the accountability of its most senior executives.

D) Forfeited $1.256 billion to the DOJ (also satisfying a $375 million settlement agreement with OFAC).

E) Agreed to pay a $500 million civil penalty to the OCC (also satisfying a $500 million FinCEN civil penalty).

F) Agreed to pay a $165 million civil penalty to the Board.

<u>See</u> DOJ Deferred Prosecution Agreement, Dec. 11, 2012; Treasury Settlement Agreement, Dec. 11, 2012; OCC Consent Order, AA-EC-2012-140 (Dec. 11, 2012); FinCEN Assessment of Civil Money Penalty, No. 2012-02 (Dec. 11, 2012); Board Assessment of Civil Money Penalty (Dec. 11, 2012); DOJ Press Release, Dec. 11, 2012; <u>U.S. v. HSBC</u>, No. 12-763 (EDNY, July 1, 2013).

The OCC had previously issued a Cease and Desist Order against HSBC Bank USA and the Board issued a Cease and Desist Order against the Bank's parent company in 2010. Subsequently, AML deficiencies at the Bank became the subject of a report and hearings by the Senate PSI. See Staff Report -- U.S. Vulnerabilities to Money Laundering, Drugs, and Terrorist Financing: HSBC Case History (Senate PSI, July 17, 2012); OCC Press Release 2010-121, Oct. 7, 2010; Board Cease and Desist Order, Oct. 4, 2010. See also OFAC Enforcement Information (Dec. 3, 2013); Board Written Agreement (Apr. 30, 2003) (terminated July 4, 2004).

Press reports suggesting that the court-appointed monitor at HSBC had made findings of continued AML lapses prompted litigation over whether the monitor's report should be made public. A district court ordered the public release of the report, but the federal government and HSBC appealed. See United States v. HSBC Bank USA, No. 16-308 (2d Cir. 2016). See also House Financial Services Committee Staff Report, Too Big to Jail: Internal Treasury Documents Reveal Why Justice Department Did Not Prosecute HSBC, July 11, 2016.

(xi) On December 10, 2012, OFAC, the DOJ, the DANY and the Board announced the resolution of a joint investigation into SCB transactions relating to Iran, Myanmar, Sudan and Libya between 2001 and 2007 that were alleged to have been in violation of OFAC sanctions. Pursuant to the Settlement Agreements, SCB admitted that, in the course of conducting transactions through SCB's NY branch, SCB's non-U.S. branches had routinely altered payment instructions to delete references to certain countries, or deliberately used cover payments to characterize transactions as transfers between non-sanctioned banks, in order to avoid triggering OFAC filters. Further, SCB admitted that when it received evidence that its non-U.S. branches were trying to circumvent OFAC filters, it failed to take action to end the conduct. The Agreements required SCB to make payments totaling $327 million to the DOJ and the Board. See Treasury Settlement Agreement, Dec. 10, 2012; DOJ Deferred Prosecution Agreement, Dec. 10, 2012 (extended for three years Dec. 9, 2014). In August 2012, NYDFS ordered SCB to suspend U.S. dollar clearing through its NY branch for high-end clients in Hong Kong and pay a $300 million penalty for failure to remediate its AML compliance program as required by the Agreements. See NYDFS Consent Order, Aug. 19, 2012.

The joint resolution followed a prior settlement between SCB and the NYDFS, announced on August 14, 2012, under which SCB agreed to pay a civil monetary penalty of $340 million for violations of NY law and OFAC regulations. See NYDFS Consent Order, Sept. 21, 2012. In addition to paying the civil penalty, SCB agreed to install a monitor to evaluate risks and implement corrective measures with regard to AML and sanctions matters.

The settlement provided for the on-site presence of NYDFS examiners at the Bank and required the Bank to retain personnel in its NY branch to oversee and audit all AML and sanctions-related due diligence and monitoring. The settlement followed the release of an Order by the NYDFS on August 6, 2012 alleging that SCB had operated as a "rogue institution" and demanding it appear before the NYDFS on August 15, 2012, to demonstrate why the Bank's license to operate in New York should not be revoked. Pursuant to the settlement, the August 15 hearing was "adjourned". See NYDFS Order, Aug. 6, 2012; NYDFS Press Release, Aug. 14, 2012.

SCB previously entered into a Written Agreement with the Board and NYBD in response to BSA/AML compliance issues at SCB's NY branch. See Board/NYBD Written Agreement, Oct. 7, 2004 (terminated July 10, 2007).

(xii) On November 9, 2012, MoneyGram entered into a Deferred Prosecution Agreement with the DOJ. Pursuant to the Agreement, MoneyGram agreed to forfeit \$100 million and admitted to criminally aiding and abetting wire fraud and failing to maintain an effective AML program. According to DOJ allegations, MoneyGram was involved in mass marketing and consumer fraud phishing schemes that defrauded tens of thousands of victims in the U.S. and failed to maintain an effective AML program in violation of the BSA. See DOJ Deferred Prosecution Agreement, Nov. 9, 2012; DOJ Press Release, Nov. 9, 2012. In addition, MoneyGram's chief compliance officer at the time of the AML violations has been assessed a \$1 million civil money penalty by FinCEN and is the subject of a civil enforcement action brought by the U.S. Attorney for the SDNY for BSA violations. See FinCEN Assessment of Civil Money Penalty, Dec. 18, 2014; U.S. v. Haider, No. 14-cv-9987 (SDNY Dec. 18, 2014) (complaint).

(xiii) In June 2012, ING Bank entered into a settlement with OFAC and with the DOJ and the DANY related to alleged violations of U.S. sanctions on Cuba and Iran. Among other violations of OFAC sanctions, the authorities alleged that an ING affiliate in Cuba engaged in systemic removal of references to Cuba in payment instructions connected to U.S. dollar-denominated transactions. ING settled the allegations for \$619 million. See DOJ Deferred Prosecution Agreement, dated June 12, 2002; OFAC Settlement Agreement, June 2, 2012.

(xiv) In 2010, Barclays Bank entered into a Deferred Prosecution Agreement with the DOJ and the DANY to resolve charges that Barclays violated U.S. sanctions by using U.S. financial institutions to process payments and transactions on behalf of U.S.-sanctioned countries and persons. Barclays agreed to forfeit \$149 million. DOJ/DANY Press Releases, Aug. 18, 2010. See also OFAC Settlement Agreement, Aug. 18, 2010; Board Cease and Desist Order, Aug. 16, 2010.

(xv) On May 4, 2010 ABN AMRO (now part of RBS) entered into a Deferred Prosecution Agreement with the

DOJ, agreeing to forfeit $500 million in connection with criminal charges relating to its dollar-clearing transaction activities and AML programs that violated IEEPA, TWEA and the BSA. See DOJ Press Release, May 10, 2010. See also Order Approving Extension of Deferred Prosecution Agreement (D.D.C. Apr. 6, 2011) (extending agreement until Dec. 31, 2011) (terminated Dec. 20, 2011).

Previously, the Board, FinCEN and OFAC, joined by Dutch regulatory authorities, issued Cease and Desist and other Orders against the head office and the NY and Chicago branches of ABN AMRO, and assessed fines and payments totaling $80 million. See Board/FinCEN/OFAC/Ill. Dep't Financial and Professional Regulation/NYBD Order, Dec. 19, 2005 (terminated Sept. 10, 2008); Board/Ill. Dep't Financial and Professional Regulation/NYBD Written Agreement, July 23, 2004 (terminated Dec. 19, 2005).

(xvi) In 2009, Credit Suisse entered into Deferred Prosecution Agreements with the DOJ and the DANY and a Settlement Agreement with OFAC to resolve charges that it violated U.S. sanctions and NY state law by using U.S. financial institutions to process payments and transactions on behalf of sanctioned parties. Credit Suisse agreed to forfeit $268 million to the U.S. and another $268 million to the State of New York. DOJ/DANY Press Releases, Dec. 16, 2009; OFAC Settlement Agreement, Dec. 16, 2009; Deferred Prosecution Agreements, Dec. 16, 2009 (terminated Dec. 2012). See also Board Cease and Desist Order, Dec. 16, 2009 (terminated Mar. 14, 2012).

(xvii) In 2009, Lloyds TSB Bank entered into a Deferred Prosecution Agreement with the DOJ in connection with transactions Lloyds conducted for customers from Iran, Sudan and other countries subject to U.S. sanctions. Lloyds agreed to pay a $350 million penalty to the U.S. and NY for allegedly removing information from payment messages so that wire transfers would pass undetected through filters at unaffiliated U.S. financial institutions. See DOJ Press Release, Jan. 9, 2009; DOJ Deferred Prosecution Agreement, Jan. 9, 2009 (terminated Mar. 21, 2011); Lloyds TSB Bank (OFAC Settlement Agreement, Dec. 22, 2009).

(xviii) In 2009, Australia and New Zealand Bank Group paid $6 million to settle allegations it had violated U.S. sanctions against Cuba and Sudan by concealing the identities of parties from U.S. correspondent banks. See OFAC Settlement Agreement (Aug. 21, 2009).

(xix) In civil and criminal proceedings involving Riggs Bank:

A) Riggs pled guilty and paid a $16 million fine for its "systematic failure" to report suspicious transactions for accounts owned and controlled by former Chilean President Pinochet and the government of Equatorial Guinea. U.S. v. Riggs Bank (information) (D.D.C., Jan. 26, 2005).

B) The Comptroller and FinCEN issued concurrent $25 million civil money penalties against Riggs for BSA violations. Riggs was cited for (i) inadequacies in its BSA compliance program, (ii) failing to detect and investigate suspicious activities and file SARs, and (iii) failures in risk management procedures and internal controls, primarily with respect to "Embassy banking" (under which Riggs administered accounts for foreign missions and embassies). See Riggs 2006 Report; Testimony of OCC Deputy Chief Counsel Stipano before Subcommittee of House Financial Services Committee, June 2, 2004; Board Cease and Desist Order, May 14, 2004 (modified Jan. 27, 2005, and terminated May 13, 2005); OCC Cease and Desist Order and Assessment of Civil Money Penalty, and FinCEN Assessment of Civil Money Penalty, May 13, 2004 (modified Jan. 27, 2005, and terminated May 13, 2005); OCC Cease and Desist Order, July 16, 2003 (terminated May 13, 2005).

See also Senate PSI Supplemental Staff Report, Money Laundering and Foreign Corruption: Enforcement and Effectiveness of the PATRIOT Act -- Supplemental Staff Report on U.S. Accounts Used by Augusto Pinochet (Mar. 16, 2005), and Minority Staff Report, Money Laundering and Foreign Corruption: Enforcement and Effectiveness of the PATRIOT Act -- Case Study Involving Riggs Bank (July 15, 2004).

Treasury Press Release, June 16, 2004, set out a Statement of Policy on Accepting Accounts From Foreign Governments, Foreign Embassies and Foreign Political Figures and affirmed Treasury's policy that persons residing or working in the U.S. should have access to U.S. banking services, but that this policy is not in conflict with the policy that financial institutions comply with the BSA. See also State Department and Treasury Statement of Policy on Provision of Banking Services to Diplomatic Missions, Jan. 13, 2011; Interagency Guidance on Accepting Accounts from Foreign Governments, Foreign Embassies and Foreign Political Figures, dated Mar. 24, 2011. See generally Wall St. J., Apr. 17, 2012 (State Department request that banks resume doing business with foreign embassies); Washington Post, Jan. 12, 2011 (JPMorgan Chase termination of foreign government services).

C) Comptroller Conditional Approval No. 687 (Apr. 25, 2005), which approved PNC Bank's acquisition of Riggs' assets and liabilities, commented on the development of a comprehensive action plan to address risks in Riggs' customer base, to integrate the PNC/Riggs BSA/AML systems, and to enhance Riggs' BSA/AML compliance. See also PNC, 91 Fed. Res. Bull. 424 (2005) (approval of PNC's acquisition of Riggs).

(xx) Russia's Federal Customs Service sued BNY in Moscow for its alleged role in a 1990s money laundering scandal in which billions of dollars were sent from Russia through BNY to accounts around the world. The lawsuit alleged that Russia was deprived of tax revenues and sought \$22.5 billion based on U.S. racketeering laws permitting treble damages. The parties settled the case in 2009. BNY paid the Customs Service \$14 million in legal fees and opened a trade-finance credit facility for Russian banks worth \$4 billion over five years. Reuters, Oct. 22, 2009.

BNY settled DOJ money laundering investigations in 2005 and paid \$38 million in penalties and restitution; the criminal investigations related to allegations that BNY (A) aided and abetted fraudulent activities of a customer through "sham" escrow agreements that the client presented in support of loan applications; (B) failed to file SARs related to that client; (C) aided and abetted an unlicensed non-U.S. bank money transmitting business; (D) failed to implement an effective AML program, and (E) engaged in money laundering. See Board Written Agreements, Apr. 21, 2006 (terminated June 5, 2009) and Sept. 5, 2000 (terminated June 3, 2002); BNY Non-prosecution Agreement, Nov. 4, 2005 (Agreement with U.S. Attorneys for EDNY and SDNY).

(xxi) For other selected recent AML and OFAC enforcement actions against banks and related coverage, see, e.g., Mega Int'l Commercial Bank (NYDFS Consent Order, Aug. 19, 2016); Liberty Bank (FRBSF Written Agreement, Aug. 5, 2016); CommerceWest Bank (Board/CA-DBO Cease and Desist Order, Apr. 12, 2016); MasterCard International (OFAC Enforcement Information, Mar. 16, 2016); National Bank of Pakistan (FRBNY/NYDFS Written Agreement, Mar. 14, 2016); Industrial Bank of Korea (FRBNY/DFS Written Agreement, Feb. 24, 2016); UBS (OFAC Enforcement Information, Aug. 27, 2015); China Construction Bank Corporation (FRBNY/NYDFS Written Agreement, July 16, 2015); Rabobank (FRBNY/NYDFS Written Agreement, June 30, 2015); Bank of the Orient (Board Cease and Desist Order, June 23, 2015); National Bank of Pakistan (OFAC Enforcement Information, June 18, 2015); Bank of Mingo (FinCEN Assessment of Civil Money Penalty, June 15, 2015; FDIC Order to Pay, June 15, 2015; SDNY Press Release, June 15, 2015); State Street (Board/Mass. Div. of Banks Written Agreement, May 28, 2015); Discover (FRBC Written Agreement, May 26, 2015) and FDIC Consent Order, June 13, 2014); First National Community Bank of Dunmore (FinCEN Assessment of Civil Money Penalty, Feb. 27, 2015; OCC Consent Order No. 2015-016, Feb. 27, 2015); Banco Bradesco (OCC Consent Order No. 2015-003, Feb. 20, 2015); Fulton Financial Corp/Lafayette Ambassador Bank (Board Cease and Desist Order, Sept. 4, 2014); BB&T (OFAC Enforcement Information, Aug. 27, 2014); Bank of America (OFAC Enforcement Information, July 24, 2014; Manhattan District Attorney Press Release, Sept. 27, 2006); Fulton Bank/FNB Bank/Swineford National Bank (OCC Consent Orders, July 14, 2014); AIG (OFAC Enforcement Information, May 8, 2014); Bank of Moscow (OFAC Enforcement Information for Jan. 27, 2014); Compass Bank (OFAC Enforcement Information for Dec. 3, 2013); United Bank Limited (Board Written Agreement, Oct. 28, 2013); Saddle River Valley Bank (OCC Consent Order, AA-EC-2013-70, Sept. 18, 2013; FinCEN Assessment of Civil Money Penalty No. 2013-02, Sept. 24, 2013; OCC Consent Order, Oct. 17, 2011); Deutsche Bank (OFAC Enforcement Information, Sept. 5, 2013); American Express (OFAC Enforcement Information, July 22, 2013); (DOJ Deferred Prosecution Agreement, Aug. 6, 2007) (terminated June 29, 2011); (Board Cease and Desist Order and Civil Money Order Penalty, Aug. 3, 2007); and (FinCEN Assessment of Civil Money Penalty, Aug. 3, 2007); Intesa Sanpaolo (OFAC Enforcement Information, June 28, 2013); Wells Fargo Bank (OFAC Enforcement Information, June 27, 2013); U.S. v. Lebanese Canadian Bank SAL, 11 Civ. 9186

(PAE) (SDNY) (Stipulation and Order of Settlement, June 25, 2013); M&T Bank Corporation and Manufacturers & Traders Trust Company (FRBNY Written Agreement, June 18, 2013); Bank of Montreal and BMO Financial Corp. (FRBC/Illinois Dept. of Financial and Professional Regulation Written Agreement, Apr. 29, 2013); BMO Harris Bank (OCC Agreement, Apr. 29, 2010); HSH Nordbank (FRBNY/NYDFS Written Agreement, Mar. 25, 2013); TCF National Bank (OCC Consent Order, Jan. 25, 2013); National Bank of Abu Dhabi (OFAC Enforcement Information, June 14, 2012); Genesis Asset Managers (OFAC Enforcement Information, May 21, 2012); Serith Meas (FinCEN Assessment of Civil Money Penalty, Dec. 8, 2011); Mohamed Sheikh (FinCEN Assessment of Civil Money Penalty, Sept. 23, 2011); Community One Bank, N.A. (DOJ Deferred Prosecution Agreement, Apr. 27, 2011); Ocean Bank (U.S. Attorney S.D. Fla. Press Release, Aug. 22, 2011; Joint Release of FDIC/FinCEN/Fla., Aug. 22, 2011; FinCEN Assessment of Civil Money Penalty, Aug. 22, 2011); Banco Industrial de Venezuela (Board/NYBD/Fla. Office of Financial Regulation Cease and Desist Order, Apr. 15, 2011, and Written Agreement, July 14, 2006); Pacific National Bank (FinCEN/OCC Assessment of Civil Money Penalty, Mar. 24, 2011); Halal Depot (FinCEN Assessment of Civil Money Penalty, Mar. 2, 2011); Victor Kaganov (FinCEN Assessment of Civil Money Penalty, Mar. 1, 2011); Zions First National Bank (OCC Assessment of Civil Money Penalty, Feb. 11, 2011); Trans Pacific National Bank (OFAC Enforcement Information, Jan. 31, 2011); Baltic Financial Servicer (FinCEN Assessment of Civil Money Penalty, Dec. 16, 2010); Banco Colpatria (OFAC Enforcement Information, Aug. 19, 2010); Pamrapo Savings Bank (DOJ Press Release, Mar. 29, 2010); Wachovia Bank (DOJ Deferred Prosecution Agreement, Mar. 16, 2010) (terminated Apr. 6, 2011); (OCC Cease and Desist Order and Civil Money Penalty, Mar. 12, 2010) and (FinCEN Assessment of Civil Money Penalty, Mar. 12, 2010);

Eurobank (FinCEN Press Release, Mar. 4, 2010); South Suburban Family Bank and Trust (DOJ Press Release, Oct. 26, 2009); Eurobank (FDIC Cease and Desist Order, Oct. 9, 2009); Bank Hapoalim (Board/Florida Written Agreement, July 8, 2009); Amboy Bancorporation (Board/NJ Banking Dept. Written Agreement, June 29, 2009); Philippine National Bank (Board/NYBD Written Agreement, May 20, 2009); Doha Bank (FinCEN/OCC Assessment of Civil Money Penalty, Apr. 20, 2009); Société Générale (Board/NYBD Written Agreement, Mar. 4, 2009); SocGen (Board/NYBD Written Agreement, Mar. 4, 2009); United Bank for Africa (OCC Consent Order, Feb. 28, 2009); Brookline Bank (OTS Order to Cease and Desist, Feb. 20, 2009); University Bank (FDIC/Mich. Cease and Desist Order, Feb. 12, 2009) (terminated Mar. 16, 2010); Brookline Bank (OTS Cease and Desist Order, Feb. 20, 2009) (terminated Aug. 7, 2009); United Bank of Africa (FinCEN/OCC Assessment of Civil Money Penalty, Apr. 28, 2008); Salin Bank (FRBC/Ind. Written Agreement, dated Jan. 23, 2008) (terminated Dec. 1, 2009); Union Bank of California (DOJ Deferred Prosecution Agreement, Sept. 18, 2007) (terminated Oct. 1, 2008); (FinCEN Assessment of Civil Money Penalty, Sept. 14, 2007); and (OCC Cease and Desist Order and Civil Money Penalty (Sept. 14, 2007) (terminated Sept. 25, 2008); First American International Bank (FDIC Cease and Desist Order, Aug. 3, 2007) (terminated Dec. 22, 2008); United Roosevelt Savings Bank (FDIC Order to Cease and Desist, Mar. 7, 2007); Intesa Sanpaolo (Board/NYBD Written Agreement, Mar. 2, 2007); Banco de la Nación Argentina (Board/NYBD Written Agreement, Mar. 2, 2007) (terminated May 19, 2010); Sumitomo Mitsui Banking Corp. (Board/NYBD Written Agreement, Jan. 22, 2007) (terminated May 6, 2010); Beach Bank (FinCEN Assessment of Civil Money Penalty, Dec. 27, 2006, and FDIC/Florida Office of Financial Regulation Order to Pay, Dec. 27, 2006); Habib Bank (Board/NYBD Written Agreement, Dec. 19, 2006); Bank of Tokyo-Mitsubishi UFJ Trust Company

(FDIC/NYBD Cease and Desist Order, Dec. 18, 2006); Mitsubishi UFJ Financial Group (Board/NYBD Written Agreement, Dec. 18, 2006) (terminated Sept. 29, 2008); Foster Bank (FinCEN Assessment of Civil Money Penalty, Dec. 14, 2006); Israel-Discount Bank (FinCEN/FDIC/NYSBD Assessment of Civil Money Penalty, Oct. 31, 2006) and (NYBD Cease and Desist Order/NY Co. District Attorney Settlement and Cooperation Agreement, Dec. 15, 2005) (terminated June 5, 2009); Texas State Bank (Board/Tex. Dept. of Banking Written Agreement, Apr. 25, 2006) (terminated July 2, 2007); Liberty Bank (FinCEN/FDIC/NYBD Assessment of Civil Money Penalty, May 18, 2006); BankAtlantic (FinCEN Assessment of Civil Money Penalty, Apr. 26, 2006); (OTS Order to Cease and Desist Order of Assessment of Civil Money Penalty, Apr. 26, 2006) (terminated Nov. 5, 2007); and (DOJ Deferred Prosecution Agreement, Apr. 26, 2006) (terminated May 18, 2007); Metropolitan Bank (FinCEN Assessment of Civil Money Penalty, Apr. 18, 2006); Sella Holding Banca (Board Written Agreement, Apr. 12, 2006) (terminated Mar. 26, 2008); Key Bank (OCC Cease and Desist Order, Oct. 17, 2005) (terminated June 27, 2007); Deutsche Bank Trust Company Americas (FRBNY/NYBD Written Agreement, Oct. 12, 2005) (terminated June 16, 2008); Banco de Chile (FinCEN Assessment of Civil Money Penalty, Oct. 12, 2005) and (OCC Assessment of Civil Money Penalty, Oct. 11, 2005) (terminated June 27, 2007); North Fork Bank (FDIC/NYBD MOU, Aug. 30, 2005); Arab Bank (OCC Assessment of Civil Money Penalty, Aug. 17, 2005) and (OCC Cease and Desist Order, Feb. 24, 2005); Continental National Bank of Miami (OCC Cease and Desist Order, June 24, 2005) (terminated Dec. 8, 2008); Banco de Chile (Board Cease and Desist Order, Feb. 2, 2005) (terminated June 2, 2008) and (OCC Cease and Desist Order, Feb. 2, 2005) (terminated Jan. 30, 2007); Asian Bank (Board Written Agreement, Jan. 28, 2005) (terminated Mar. 17, 2008); International Bank of Miami (OCC Cease and Desist Order, Oct. 18, 2004) (terminated Jan. 5, 2009);

FDIC: Supervisory Actions Taken for [BSA] Violations (FDIC OIG, Mar. 31, 2004); U.S. v. Delta National Bank, No. JFM-03-0416 (criminal judgment (Oct. 1, 2003) on plea agreement (Sept. 11, 2003) (D. Md.) (failure to file SAR)); United Orient Bank (FDIC Cease and Desist Order, Sept. 30, 2003) (terminated June 19, 2006); Korea Exchange Bank (FinCEN Assessment of Civil Money Penalty, June 24, 2003); Saks Incorporated (OCC Cease and Desist Order, Apr. 11, 2003) and National Bank of the Great Lakes (OCC Cease and Desist Order, Apr. 11, 2003) (terminated Dec. 31, 2003); Banco Popular (Deferred Prosecution Agreement, Jan. 16, 2003) (terminated Jan. 16, 2004); U.S. v. Broadway National Bank, 02 Crim. 1507 (information and waiver of indictment) (SDNY Nov. 27, 2002); Broadway National Bank (OCC Cease and Desist Order, Apr. 13, 1998) (terminated Feb. 27, 2003).

d. Broker-dealers have also become targets for BSA/AML enforcement actions.

(i) In May, 2016, Raymond James agreed to pay \$17 million to settle allegations by FINRA over widespread failures related to its AML program and failures to file SARs. FINRA News Release, May 18, 2016. Raymond James' compliance officer, Linda Busby, also settled with FINRA, agreeing to pay \$25,000 and to be temporarily suspended from associating with any FINRA member firm.

(ii) In January 2015, Oppenheimer settled claims with FinCEN and the SEC and agreed to pay \$20 million for AML and Securities Acts violations related to unregistered sales of penny stocks. Concurrently, the SEC granted Oppenheimer a waiver from automatic disqualification under Rule 506(d) of Regulation D in connection with its violations of the Securities Acts. See FinCEN Assessment of Civil Money Penalty, Jan. 26, 2015; SEC Admin. Proc. No. 3-16361 (Jan. 27, 2015) (cease and desist order; waiver under Regulation D);

Dissenting Statement by Commissioners Aguilar and Stein, Feb. 4, 2015.

Oppenheimer has been the subject of previous enforcement actions. See FINRA News Release, Aug. 5, 2013 (for the sale of unregistered penny stock shares and failure to implement an adequate AML compliance program); NYSE Hearing Panel Decision 05-181 (Dec. 29, 2005) (joint action by FinCEN and the NYSE for failure to implement an effective AML program).

(iii) See, e.g., Albert Fried & Co., SEC Admin. Proc. No. 3-17270 (June 1, 2016); Van Doren, FinRA Default Decision, Apr. 19, 2016; E.S. Financial Services, Inc., SEC Admin. Proc. No. 3-17099 (Feb. 4, 2016); Aegis Capital Corp., FINRA Order Accepting Offer of Settlement, Aug. 3, 2015; Stock USA Execution Services, Inc., FINRA Letter of Acceptance, Waiver and Consent No. 20120310864-02 (Apr. 10, 2015); Wells Fargo Advisers/Financial Network, FINRA Letter of Acceptance, Waiver and Consent No. 2012034123501 (Dec. 18, 2014); Brown Brothers Harriman & Co., FINRA News Release, Feb. 4, 2014; Banorte-Ixe Securities International, FINRA Letter of Acceptance, Waiver and Consent No. 2010025241301 (Jan. 28, 2014); Atlas One Financial Group, FINRA Letter of Acceptance, Waiver and Consent No. 2011025673201 (May 8, 2013); World Trade Financial Corporation, FINRA Letter of Acceptance, Waiver and Consent No. 20120315071-01 (Apr. 24, 2014); Firstrade Securities, FINRA Letter of Acceptance, Waiver and Consent No. 2010021211901 (May 8, 2013); AIS Financial, FINRA News Release, Apr. 4, 2011; Pinnacle Capital Markets, FINRA News Releases, Sept. 1, Feb. 2, 2010, SEC Admin. Proc. No. 3-14026 (Sept. 1, 2010), FinCEN Assessment of Civil Money Penalty, Sept. 1, 2010 (failure to follow CIP procedures with respect to omnibus accounts for foreign customers); Pension Financial Services, FINRA News Release, Feb. 2, 2010 (AML compliance program failures); Scottrade, FINRA News Release, Oct. 26, 2009 (AML deficiencies);

E*Trade, FINRA News Release, Jan. 2, 2009, SEC Admin. Proc. No. 34-58250 (July 30, 2008 (AML/CIP deficiencies)); Franklin Ross, FINRA News Release, Nov. 5, 2007 (repeated AML violations); Crowell, Weeden & Co., SEC Release No. 34-53847 (May 22, 2007) (failure to document CIP program); Park Financial Group, SEC Admin. Proc. No. 3-12614 (Apr. 11, 2007) (failure to comply with SAR filing requirements); RBC Dain Rauscher, NYSE Hearing Board Decision 07-44 (Mar. 23, 2007) (failure to establish SAR filing procedures, to conduct adequate reviews, and to have an adequate monitoring system); NevWest Securities Corp., NASD AWC EO 22OO40112-01, Mar. 21, 2007 (failure to implement procedures to detect suspicious activity and file SARs); Banc of America Investment Services, NASD News Release, Jan. 29, 2007 (failure to obtain customer information on high risk accounts and to satisfy SAR obligations); Hartsfield Capital-Securities, FinCEN Assessment of Civil Money Penalty, Nov. 24, 2003.

See generally Basel Institute on Governance, Basel AML Index 2016 (July 27, 2016); Financial Institutions: Fines, Penalties and Forfeitures for Violations of Financial Crimes and Sanctions Requirements (GAO, Mar. 22, 2016); Investment News, June 3, 2016; Remarks of SEC Chief of Staff Donohue, Oct. 14, 2015; Money Laundering and Terrorist Financing in the Securities Sector (FATF, Oct. 2009); [BSA] Obligations of a U.S. Clearing Broker-dealer Establishing a Fully Disclosed Clearing Relationship with a Foreign Financial Institution, FIN-2008-R008 (FinCEN, June 2, 2008).

e. MSBs have also been the subject of BSA/AML enforcement actions. See, e.g., PayPal, Inc. (OFAC Settlement Agreement, Mar. 25, 2015); BPI (FinCEN Assessment of Civil Monetary Penalty, Aug. 28, 2014); New Millennium Cash Exchange (FinCEN Assessment of Civil Money Penalty, Apr. 23, 2014); Sigue Corp. (DOJ Deferred Prosecution Agreement, Jan. 28, 2008) and (FinCEN Assessment of Civil Money Penalty, Jan. 24, 2008).

f. Recent enforcement orders and other guidance relating to SAR/AML programs emphasize the importance of a financial institution (i) fostering a culture of compliance with a "tone" clearly set "at the top"; (ii) ensuring that the SAR/AML function is adequately led, staffed and supported; (iii) maintaining policies that address the institution's risks; (iv) assuring that policies are followed, that CIPs are robust, that exceptions are kept to a minimum (and are adequately documented), and that documentation (including of any exceptions) is accurate and complete; (v) understanding the normal/expected transactions of each customer and periodically reviewing a customer's account activity to update the parameters of "normal" activity if necessary; (vi) establishing a methodology to assign risk levels to different types of customers and products; (vii) providing enhanced due diligence for customers, products and geographic areas that pose higher risks; (viii) establishing internal procedures for reporting information about potentially suspicious transactions; (ix) engaging senior management in the process of identifying and reviewing significant SAR issues; (x) conducting rigorous independent testing; and (xi) responding quickly and fully to regulatory issues.

   In addition, following an enforcement action, special attention must be given to (i) satisfying enhanced regulatory expectations; (ii) as needed, clarifying or seeking a modification of deadlines for addressing open terms; (iii) fully engaging internal/external auditors/consultants/counsel as necessary; and (iv) developing a clear action plan in terms of implementation, prioritization, exception requests and reporting.

g. In response to industry and bank regulatory agency concerns about criminal prosecutions of banks for BSA violations, DOJ amended Part 9-105.000 of its U.S. Attorney's Manual to provide that U.S. Attorneys must obtain the approval of the DOJ Criminal Division before filing criminal charges against a financial institution for AML failures. DOJ and the banking regulators have also worked to improve their coordination, and DOJ has sought to reassure banks that criminal prosecutions are brought only in extreme cases, not where a bank has made reasonable, good faith efforts to comply.

See Principles of Federal Prosecution of Business Organizations (DOJ, Jan. 20, 2003); Remarks of DOJ Section Chief Weber, May 20, 2008. Compare Part VIII.A.4.d above.

h. "Look-backs" requiring a review (often by an independent party) of past transactions over a certain time period to identify potentially suspicious transactions have become an increasingly common element of enforcement orders.

i. Potential consequences of BSA/AML enforcement actions include (i) criminal prosecutions; (ii) civil money penalties; (iii) potential "death penalty" for non-U.S. banks (arising from IBA § 7(e)(1) (which authorizes the Board to terminate the U.S. activities of a non-U.S. bank based on violations of U.S. law) or § 7(i) (which authorizes the Board to issue a notice of intention to commence termination proceedings if a non-U.S. bank is found guilty of a money laundering offense)); (iv) reputational impact; and (v) potential collateral consequences under other statutes (e.g., an unsatisfactory management or composite rating which could jeopardize FHC status or restrictions on future bank acquisition under the BHCA).

j. In 2016, families of U.S. citizens murdered by drug gangs in Mexico sued HSBC claiming that the bank was responsible for the deaths because it allowed Mexican drug cartels to launder money. See Zapata v. HSBC Holdings plc, No. 16-cv-00030 (S.D. Tex., Feb. 9, 2016) (complaint).

k. Several banks have been investigated after an alleged misappropriation of more than $3.5 billion by officials connected to 1Malaysia Development Bhd. ("iMDB"), a Malaysian SWF. Singapore's central bank is reportedly investigating potential AML deficiencies at banks, and the DOJ has brought enforcement actions to recover the funds. See generally Financial Times, July 25, 2016; Reuters, July 21, 2016; Bloomberg, Aug. 4, July 20, 2016; Remarks of Assistant Attorney General Caldwell, July 20, 2016.

7. Financial Action Task Force and International Considerations

   a. FATF is an inter-governmental body established in 1989 and is the most important international organization in setting international standards and assessing the sufficiency of AML and anti-terrorist finance regimes.

   b. The cornerstone of FATF's standard-setting is a document that is now known as the "FATF Recommendations". See International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation: The FATF Recommendations (FATF, 2012). Before their most recent revision and consolidation in February 2012, the FATF Recommendations consisted of the "FATF 40 Recommendations" relating primarily to money laundering (originally agreed in 1990) and the "Nine Special Recommendations on Terrorist Financing" (originally agreed as eight special recommendations in October 2001 following the terrorist attacks of September 11th). Before they were combined, the FATF Recommendations were sometimes known as the "40 + 9 Recommendations". See also FATF Public Consultation on the Revision of Recommendation 8 (Non-profit Organizations) (Apr. 22, 2016); FATF Guidance for a Risk-based Approach: Banking Sector (Oct. 2014); FATF Guidance: Transparency and Beneficial Ownership (Oct. 2014); FATF Guidance: [PEPs] (Recommendations 12 and 22) (June 2013); Best Practices: Combating the Abuse of Non-profit Organizations (Recommendation 8) (June 2013); FATF Guidance: [AML] and Terrorist Financing Measures and Financial Inclusion (Feb. 2013).

   c. FATF monitors the progress of its member jurisdictions in implementing the FATF Recommendations and makes recommendations regarding AML and terrorist financing threats. See, e.g., FATF Advisories on FATF-identified Jurisdictions with AML/CFT Deficiencies; Improving Global AML/CFT Compliance: On-going Process; High Risks and Non-cooperative Jurisdictions; FATF Actions on Terrorist Finance; Methodology for Assessing Compliance with the FATF 40 Recommendations and the FATF Nine Special Recommendations (Feb. 2008); FATF U.S. Evaluation. See also Advisory Notice on Money Laundering and Terrorist Financing

Controls in Overseas Jurisdictions (HM Treasury, July 2, 2013); Banking Daily, June 24, 2013.

d. FATF, as well as other international bodies, provide guidance on a wide range of specific money laundering and terrorist financing typologies, threats and best practices, which are often further implemented by FinCEN. See, e.g., Consolidated Strategy on Combatting Terrorist Financing (FATF, Apr. 22, 2016); Money or Value Transfer Services (FATF, Feb. 2016); Emerging Terrorist Financing Risks (FATF, Oct. 2015); Effective Supervision and Enforcement by AML/CFT Supervisors of the Financial Sector and Law Enforcement (FATF, Oct. 2015); Financing of the Terrorist Organization Islamic State in Iraq and the Levant (FATF, Feb. 2015); MONEYVAL Report: Strengthening Financial Integrity Through Financial Inclusion (Council of Europe, Nov. 2014); Virtual Currencies: Key Definitions and Potential AML/CFT Risks (FATF, June 2014); Money Laundering and Terrorist Financing through Trade in Diamonds (FATF, Oct. 2013); The Role of "Hawala" and Other Similar Service Providers in Money Laundering and Terrorist Financing (FATF, Oct. 2013); Terrorist Financing in West Africa (Oct. 2013); Sound Management of Risks Related to Money Laundering and Terrorism (BIS, June 2013); Guidance for a Risk-based Approach: Prepaid Cards, Mobile Payments and Internet-based Payment Services (FATF, June 2013); FATF Report: Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals (June 2013); [AML] and Terrorist Financing Measures and Financial Inclusion (FATF, Feb. 2013); Methodology for Assessing Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems (FATF, Feb. 2013); National Money Laundering and Terrorist Financing Risk Assessment (FATF, Feb. 2013); [AML] and Combating the Financing of Terrorism Inclusion in Surveillance and Financial Stability Assessments (IMF, Dec. 14, 2012); Operational Issues: Financial Investigations Guidance (FATF, June 2012); Specific Risk Factors in the Laundering of Proceeds of Corruption-Assistance to Reporting Institutions (FATF, June 2012); FIN-2012-A004 (Mar. 6, 2012), FIN-2012-A003 (Mar. 6, 2012), FIN-2011-A012, (July 13, 2011) (Guidance to Financial Institutions Based on [FATF] Public Statements on [AML] and

[CTF] Financing Risks); Guidance for Legal Professionals (Oct. 23, 2008); Best Practices Paper: Sharing Among Domestic Competent Authorities Information Related to the Financing of Proliferation (Feb. 2012); Laundering the Proceeds of Corruption (FATF, July 2011); Money Laundering Risks Arising from Trafficking in Human Beings and Smuggling of Migrants (FATF, July 2011); Compliance with the AML/CFT International Standard: Lessons from a Cross-country Analysis (IMF, July 2011); [AML] and Terrorist Financing Measures and Financial Inclusion (FATF, June 2011); Money Laundering Using New Payment Methods (FATF, Oct. 2010), Money Laundering Using Trusts and Company Service Providers (FATF, Oct. 2010); Money Laundering Vulnerabilities of Free Trade Zone (FATF, Mar. 2010); Money Laundering through Private Pension Funds and the Insurance Sector – Red Flags and Indicators (Council of Europe Committee of Experts on the Evaluation of [AML] Measures and the Financing of Terrorism, Mar. 18, 2010); Combating Proliferation Financing: A Status Report on Policy Development and Consultation (Feb. 2010); Money Laundering and Terrorist Financing in the Securities Sector (Oct. 2009); Best Practices on Trade Based Money Laundering (June 20, 2008); Money Laundering and Terrorist Financing Vulnerabilities of Commercial Websites and Internet Payment Systems (June 18, 2008); Proliferation Financing Report (June 18, 2008). Special Recommendations [I-VIII] on Terrorist Financing (Oct. 31, 2001).

e. FATF has issued guidance on implementation of UNSCRs related to WMD proliferation, in particular regarding Iran. See Guidance Regarding the Implementation of Financial Provisions of [UNSCRs] to Counter the Proliferation of [WMD] (FATF, June 26, 2013); See also FATF Statements (June 24, 2011, Feb. 25, 2009, Oct. 17, 2008, Oct. 11, 2007); Guidance on the Implementation of the Financial Provisions of [UNSCR] 1803 (Oct. 17, 2008); Guidance Regarding the Implementation of Activity-based Financial Prohibitions of [UNSCR] 1737 (Oct. 12, 2007).

f. In October 2013, FinCEN and Mexico's National Banking and Securities Commission ("CNBV") signed the first-ever MOU among U.S. and Mexican AML/CFT supervisors to exchange financial information to thwart drug crime. See FinCEN Press Release, Oct. 24, 2013 (FinCEN/CNBV MOU); Statement of FinCEN Director Shasky Calvery, Oct. 24, 2013. See also Cal. Attorney General Press Release, Mar. 25, 2014 (announcing letter of intent among five state attorneys general and the CNBV to establish a bi-national working group on money laundering enforcement).

g. The IMF's efforts to respond to money laundering and the financing of terrorism through its AML/CFT program are discussed in [AML] and Combating the Financing of Terrorism (AML/CFT) -- Report on the Review of the Effectiveness of the Program (IMF, May 11, 2011). See also IMF Public Information Notice No. 11/74 (June 27, 2011) (IMF Executive Board Reviews Efforts in [AML] and Combating the Financing of Terrorism).

h. In May 2015, the EU adopted the Fourth Money Laundering Directive and the Second Information Accompanying Transfers of Funds Regulations. The Directive reflects the revised FATF Recommendations, including an increased emphasis on a risk-based approach, the creation of controlled registers of beneficial ownership information and new requirements for the use of simplified due diligence procedures. The Regulations changed the information required for funds transfers to include, among other items, information on payees. See Directive (EU) 2015/849; Regulation (EU) 2015/847. See also Banking Daily, Dec. 4, 2014.

B. SELECT PRIVATE BANKING AND RELATED ISSUES

Important issues respecting a bank's provision of fiduciary services include (1) legal and regulatory compliance, (2) the ability of a bank to delegate trust management functions, and (3) the ability of a bank to establish and manage collective investment funds ("CIFs").

Banks have broad powers of fiduciary management, with banks and their affiliates managing over $20 trillion in wealth management AUM worldwide. Banking organizations receive the principal components of their fiduciary and related services income from (1) custody and safekeeping, (2) personal trust and agency accounts,

(3) retirement-related accounts, (4) investment management accounts, and (5) corporate trust and related accounts.

See, e.g., 12 U.S.C. § 92a; Part 9; Comptroller's Handbook: Personal Fiduciary Activities, Collective Investment Funds, Asset Management and Conflicts of Interest; Letter No. 995 (bank program to market and deliver institutional/individual trust/fiduciary services throughout the U.S.); Letter No. 973 (scope of trust powers); Letter No. 831 (personal trust services, financial and estate planning, investment/real estate/oil and gas property management, agency and custody services); Letter No. 815 (bank interest in state-chartered trust company); Comptroller Unpublished Letters (Jan. 12, 1994), (May 15, 1989) (managing agency services); FDIC Trust Examination Manual.

See generally, e.g., Asset Management and Financial Stability (OFR, Sept. 2013); Global Private Banking and Wealth Management Survey 2013 (PricewaterhouseCoopers, June 2013); 2011 Survey of Trends in the Financial Planning Industry (College for Financial Planning, 2011); Global Wealth 2015: Winning the Growth Game (Boston Consulting Group, June 2015); FDIC Quarterly Banking Profile; Managing Change in Asset Management (SIFMA, Broadridge, Mar. 2015); "In Flux: Private Banking in 2015" (The Banker, Apr. 2015); Scorpio Partnership Global Private Banking Benchmark (Scorpio, July 2015).

1. Supervision of Private Banking Activities

   a. Private banking activities have become an increasingly important aspect of large, internationally active banking organizations. See, e.g., Comptroller's Handbook: Investment Management Services.

   b. While the GLB Act eliminated the blanket exemption for banks from broker-dealer registration (see Part I.C and Part II.D above and Part VIII.B.2.b and Part IX.B below), it preserved the Fiduciary Exemption for bank trust activities.

   c. Federal law generally preempts state requirements applicable to national bank trust activities. See Part I.D above.

2. Delegation of Trust Management Functions, "Referral" and "Private Label" Arrangements

   a. Comptroller of the Currency Developments

      (i) A national bank may "delegate" certain trust management functions to outside advisers. See generally Comptroller's Handbook: Asset Management.

         A) Under Section 9.18(b)(2), a national bank must have "exclusive management" of a trust "except as a prudent person might delegate responsibilities to others". A bank may delegate ministerial functions and may seek adviser recommendations, but may not delegate discretionary powers. See, e.g., Comptroller Trust Interpretations No. 229 (Aug. 10, 1989), CCH Fed. Banking L. Rep. ¶ 83,063; No. 205 (Mar. 10, 1989), CCH Fed. Banking L. Rep. ¶ 83,016; No. 163 (June 8, 1988), CCH Fed. Banking L. Rep. ¶ 84,930.

         B) A bank may employ an affiliated or unaffiliated adviser for a CIF, so long as the bank establishes guidelines, reviews the adviser's activities for compliance with such guidelines and may terminate the advisory relationship at will. See, e.g., Comptroller Interpretive Letter No. 696 (Nov. 28, 1995), CCH Fed. Banking L. Rep. ¶ 81-011; Comptroller Trust Interpretation No. 169 (Aug. 5, 1988), CCH Fed. Banking L. Rep. ¶ 84,936; Comptroller Interpretive Letter No. 447 (Mar. 28, 1988), CCH Fed. Banking L. Rep. ¶ 85,671.

         C) The Part 9 Revision referred to in Part VIII.B.3.g below codified the Comptroller's practice of granting waivers of the "exclusive management" requirement for collective IRAs, Keogh funds or other employee benefit accounts managed in accordance with the 1940 Act.

(ii) The Comptroller permits national banks to enter into "referral" or "private label" arrangements with investment advisers.

A) Under a "referral" arrangement, a bank, for a finder's fee, agrees to refer its customers to another bank or investment adviser for advisory services. The referring bank does not act as fiduciary or retain investment discretion, and makes referrals, distributes literature relating to the trustee/adviser and performs administrative services (such as reviewing customer applications, transmitting documents and arranging appointments). Compliance with the Interagency Statement is required, and the fee arrangement must be disclosed. National banks may also pay finder's fees for trust business referrals made by non-banks (such as insurance agents, lawyers and accountants). See, e.g., Comptroller Unpublished Letter (Sept. 13, 1999); Letters No. 850; No. 607; No. 504; No. 249; No. 78. See also Part VII.C above.

B) Under a "private label" arrangement, a customer enters into an investment management agreement with its bank, and an investment adviser manages the accounts pursuant to a sub-advisory agreement. Because the bank acts as fiduciary, compliance with the Interagency Statement is not required, and the sub-adviser need not be identified to bank customers. See, e.g., Letter No. 850.

(iii) Comptroller Bulletin No. 2001-47 (Nov. 1, 2001), CCH Fed. Banking L. Rep. ¶ 35-522, warns banks of the risks associated with third party relationships, including "franchising" a bank's name or regulatory status to products or services offered by others.

(iv) A national bank may hold limited interests in investment funds for which it serves as investment manager (including to receive compensation in a tax-efficient manner), and may acquire as an operating subsidiary an

LLC that serves as general partner to a limited partnership used as an investment vehicle for clients. The investments and relationships are part of permissible investment management and administrative services. The Volcker Rule also applies in this context. See Part II and Part VII.A.2.b.v above and Part VIII.C.1.b.ii.F.i below.

b. SEC Requirements

The Comptroller's requirement that a national bank have "exclusive management" of a trust or CIF is consistent with the SEC's interpretation of exceptions under the 1933, 1934 and 1940 Acts which relate to common trust (or similar) funds "maintained by a bank". See also Part VIII.B.3 below.

While a bank must have "substantial investment responsibility" over a fund, this does not preclude the use of an investment adviser. See, e.g., SEC Release No. 33-6188 (Feb. 1, 1980); General Motors Investment Management (avail. Feb. 2, 2000); Provident Bank (avail. Sept. 24, 1991); Government Securities Fund, Waukesha State Bank (avail. May 31, 1989); Trust Company of Knoxville (avail. Apr. 20, 1989) ("Knoxville"); Huntington National Bank (avail. Mar. 9, 1988); Citytrust (avail. Feb. 2, 1988); Union Bank & Trust (avail. July 8, 1987); National Bank of Commerce (avail. Oct. 10, 1986); Bank of Delaware Collective Trust Funds (avail. Apr. 4, 1986); Citizens & Southern National Bank (avail. Feb. 10, 1986); Trust Co. Bank (avail. June 17, 1985); Imperial Trust Co. (avail. Mar. 21, 1985); Brown Brothers Harriman (avail. Nov. 29, 1984); First National Bank of Peoria (avail. Nov. 24, 1983); Lincoln First Bank (avail. Oct. 24, 1983); Frank Russell Trust Co. (avail. Aug. 24, 1980).

3. Common Trust Funds, CIFs, Pooled IRAs and Related Issues

As part of its fiduciary services, banks may establish common trust funds and CIFs which are exempt from 1933/1940 Act registration requirements, although they may not establish commingled managed agency accounts which do not have a principal fiduciary purpose. ICI v. Camp, 401 U.S. 617 (1971) ("ICI I").

a. The OCC has established specific rules and regulations with respect to CIFs (including "short-term investment funds" ("STIFs")). See 12 C.F.R. § 9.18 ("Section 9.18"); Comptroller's Handbooks: Collective Investment Funds and Retirement Plan Products and Services; 77 Fed. Reg. 61229 (Oct. 9, 2012) (final rule regarding revised STIF requirements).

b. The parameters of a bank's ability to commingle managed assets are not always clear.

   (i) GLB Act § 221 narrowed the 1940 Act § 3(c)(3) exemption for bank common trust funds to only those funds (A) employed by a bank solely as an aid to the administration of trusts, estates or other accounts maintained for a fiduciary purpose; (B) which are not advertised (except in connection with the bank's fiduciary services) or offered for sale to the public; and (C) where fees and expenses are not in contravention of federal or state fiduciary principles.

   This provision does not affect the ability of banks to advertise employee benefit plan CIFs, but the Comptroller has recommended that any such advertising conform to SEC and FINRA rules. See Comptroller's Handbook: Collective Investment Funds.

   (ii) Banks may establish collective funds involving IRA and related assets. See, e.g., Comptroller's Handbook: Collective Investment Funds; Comptroller Letters (Nov. 25, 1985) re First Union National Bank, (Feb. 7, 1985) re Connecticut Bank & Trust Company, (Jan. 31, 1984) re Bank of California, (Jan. 27, 1984) re Wells Fargo Bank, (Oct. 21, 1982) re Citibank, CCH Fed. Banking L. Rep. ¶ 99,339 (the "Comptroller IRA Approvals").

   A) The IRA market amounted to $7.3 trillion in 2015, and 31% of U.S. households owned IRAs as of year-end 2015. Assets in 401(k) and similar retirement plans in 2015 amounted to an estimated $6.7 trillion. See generally Investment Company Fact Book (ICI, 2016); The IRA Investor Profile: Traditional IRA Investors' Activity, 2007-2013 (ICI, July 2015); The Effects of Conflicted Investment Advice on Retirement Savings (Council of Economic Advisers to the President, Feb. 2015 ("White House Retirement Report")).

B) IRA accounts fall somewhere between classic trust funds and agency accounts, and do not benefit from 1933/1940 Act registration exemptions. See, e.g., SEC Release No. 33-6188 (Feb. 1, 1980); Dunham & Associates Holdings, SEC Admin. Proc. No. 3-12427 (Sept. 22, 2006); Commercial Bank (avail. Feb. 24, 1988); Hibernia National Bank (avail. Sept. 24, 1986); First National Bank (avail. Feb. 10, 1986) ("First National"); First Commerce Trust Co. (avail. Feb. 28, 1983) ("FCTCo"). But see, e.g., Monsanto Co. (avail. July 22, 1987) (under certain circumstances, pooled IRA plan need not be registered under 1940 Act).

C) Collective IRA investment vehicles could benefit from the "intrastate offering" exemption (1933 Act § 3(a)(ii)), but only if the SEC also exempts the vehicles from 1940 Act registration (a doubtful possibility). 1940 Act § 24(d). See also C. Evans Patterson (avail. Mar. 9, 1988); FCTCo.

Such vehicles could also benefit from 1940 Act § 3(c)(1), which excludes from the definition of "investment company" any fund the securities of which are beneficially owned by not more than 100 persons and which does not make a public offering. See, e.g., Continental Bank (avail. Sept. 2, 1982); San Fernando Valley Inv. Co. (avail. June 30, 1972). See also Comptroller Trust Interpretation No. 224 (July 7, 1989), CCH Fed. Banking L. Rep. ¶ 83,055.

D) Three Circuits affirmed the Comptroller IRA Approvals (the "IRA Cases"). ICI v. Clarke, 793 F.2d 220 (9th Cir. 1986); ICI v. Conover, 790 F.2d 925 (D.C. Cir. 1986); ICI v. Clarke, 789 F.2d 175 (2d Cir. 1986) (per curiam). See also ICI v. Clarke, No. C-C-86-32-M (W.D.N.C., Aug. 20, 1986), appeal docketed, No. 86-3725 (4th Cir., Dec. 5, 1986), voluntarily dismissed (Jan. 15, 1987). The U.S. Supreme Court denied all ICI petitions for certiorari. 479 U.S. 939, 940 (1986).

E) Since the Comptroller IRA Approvals, other banks have received Comptroller approval to establish collective IRA and related trusts. See, e.g., Comptroller Interpretive Letters No. 608 (Aug. 27, 1992), CCH Fed. Banking L. Rep. ¶ 83,446 (Canandaigua National Bank); No. 446 (Feb. 25, 1988), CCH Fed. Banking L. Rep. ¶ 85,670 (Seattle First National Bank); No. 425 (Feb. 25, 1988), CCH Fed Banking L. Rep. ¶ 85,649; No. 413 (Dec. 30, 1987), CCH Fed. Banking L. Rep. ¶ 85,637 (Provident National Bank); Comptroller Letters (Jan. 14, 1988) re Texas Commerce Bank, (Mar. 23, 1987) re Ameritrust Company, (Mar. 19, 1987) re First Fidelity National Bank, (Nov. 14, 1986) re Chase Manhattan Bank. See also Comptroller Trust Interpretation No. 132 (Dec. 9, 1987), CCH Fed. Banking L. Rep. ¶ 87,206.

F) The Comptroller has permitted national banks to commingle trust assets in a variety of contexts.

i) A national bank may establish collective investment trusts in which trusts serviced by the bank's affiliates also participate. See, e.g., Letters No. 446, No. 425, No. 413; Comptroller Unpublished Letter (Dec. 30, 1987); Comptroller Trust Interpretation No. 131 (Dec. 1987), CCH Fed. Banking L. Rep. ¶ 87,205.

ii) A national bank may establish and act as trustee for a GIC Fund as a collective IRA investment vehicle. Comptroller Trust

Interpretation No. 173 (Aug. 31, 1988), CCH Fed. Banking L. Rep. ¶ 84,940.

iii) A national bank may establish collective investment pools for public fund customers as trustee. Comptroller Unpublished Letter (Sept. 30, 1988).

iv) A national bank may administer closed-end investment funds as a fiduciary service to qualified employee benefit plans or act as custodian for a group trust arrangement related to employee benefit assets. See, e.g., Comptroller Trust Interpretations No. 208 (Apr. 7, 1989), CCH Fed. Banking L. Rep. ¶ 83,019; No. 138 (Jan. 21, 1988), CCH Fed. Banking L. Rep. ¶ 84,905.

v) A national bank may establish CIFs involving tax exempt employee retirement and pension plan assets for which it or an affiliated bank serves as managing agent. Comptroller Interpretive Letter No. 734 (July 12, 1996), CCH Fed. Banking L. Rep. ¶ 81-051.

vi) A national bank may charge different fund management fees to participants in a CIF commensurate with the amount and types of services the bank provides. However, all participating accounts in a CIF are required to have a proportionate interest in all the fund's assets. 12 CFR 9.18(b)(3); Comptroller Interpretive Letter No. 829 (Apr. 9, 1998), CCH Fed. Banking L. Rep. ¶ 81-278.

vii) A national bank may pool cash collateral held as trustee pursuant to securities lending agreements. Comptroller Interpretive Letter No. 865 (May 26, 1999) ("Letter No. 865"), CCH Fed. Banking L. Rep. ¶ 81-359. See also Part IX.A.1.a.i below.

viii) A national bank may, as non-discretionary custodian, invest the assets of tax-exempt employee benefit plans in CIFs of which it is trustee. See Comptroller Interpretive Letter No. 884 (Jan. 13, 2000), CCH Fed. Banking L. Rep. ¶ 81-403.

G) If bank commingled assets are subject to the 1933 and 1940 Acts, under the GLB Act § 217, the Advisers Act (see §§ 202(a) (11)(A), 202(a)(26)) will apply to the bank (or a "separately identifiable department or division"), and the bank must register as an investment adviser.

c. The SEC has taken a narrow view of the common trust fund exemption under the 1940 Act. See also Part VIII.B.3.a above.

(i) First Jersey National Bank (avail. Nov. 13, 1987) denied a no-action request by a bank that proposed to solicit investment in trust funds through revocable participating trust agreements or "mini-trusts". SEC staff could not conclude that the bank's customers would use the "mini-trusts" primarily to avail themselves of fiduciary services. See also, e.g., United Missouri Bank (avail. Dec. 31, 1981); Howard Savings Bank (avail. May 1, 1980).

Compare, e.g., Knoxville (no-action-request granted with regard to common trust fund; no general advertising would occur and the fund would not be promoted as an investment vehicle).

(ii) Northern Trust Corp. (avail. July 21, Mar. 3, 1989) denied a no-action request by a bank that proposed to maintain a common trust fund in which unaffiliated banks would invest funds received for fiduciary purposes.

On the other hand, SEC staff has issued no-action letters where a BHC proposed to implement interbank trust funds for assets held by affiliated banks in fiduciary capacities without registration under the 1933, 1934 or 1940 Act. See, e.g., Old Kent Financial Corp. (avail. July 25, 1989, Feb. 29, 25, 1988); First Wachovia Corp. (avail. May 18, 1988); United Virginia Bankshares (avail. June 15, 1987); SunTrust Banks (avail. June 18, 1986); InterFirst Corp. (avail. Nov. 24, 1982).

(iii) The SEC has taken the positions that (A) it is not appropriate to commingle common trust fund and employee benefit plan assets (see, e.g., Santa Barbara Bank & Trust (avail. Nov. 1, 1991)); National Boulevard Bank of Chicago (avail. Oct. 18, 1974)); and (B) common trust funds holding "rabbi trust" assets are not exempt from the 1933, 1934 or 1940 Act (see, e.g., Boatmen's Bancshares (avail. Aug. 17, 1994)).

(iv) Comptroller Banking Circular No. 247 (Sept. 12, 1990) apprised national banks of the SEC's position that common trust funds established for investment, or otherwise lacking a fiduciary purpose, must be registered under the 1933 and 1940 Acts. See also, e.g., Comptroller Trust Interpretation No. 247 (May 9, 1990), CCH Fed. Banking L. Rep. ¶ 83,208.

d. A state non-member bank does not need trust powers to act as trustee or custodian of IRA and related accounts so long as the bank does not exercise investment discretion or provide investment advice. 12 C.F.R. § 331.101(b); see also 70 Fed. Reg. 60420 (Oct. 18, 2005). However, FDIC Advisory Opinion No. 83-20 (Nov. 17, 1983), CCH Fed. Banking L. Rep. ¶ 81,194, provides that the establishment of a CIF that allows a bank, acting as technical "trustee", to invest commingled funds would violate Glass-Steagall.

e. State chartered banks must determine what constitutes a common trust fund for state law purposes and in what capacity -- e.g., executor, administrator, guardian, custodian -- a bank must act in order to put fiduciary assets into a common fund.

f. Section 1805 of the "Small Business Job Protection Act", Pub. L. 104-188 (1996), 26 U.S.C. § 584 (the "Common Trust Fund

Legislation”), provides that investors in a common trust fund recognize no gain or loss from the transfer of substantially all of the assets of the common trust fund into mutual funds.

Recognizing that conversion of common trust funds to mutual funds can raise supervisory concerns, the Board issued SR Letter 97-3 (FIS) (Feb. 26, 1997), CCH Fed. Banking L. Rep. ¶ 37-052. See also Kutten v. Bank of America, 530 F.3d 669 (8th Cir. 2008), 2007 U.S. Dist. LEXIS 63897 (E.D. Mo. 2007), cert. denied, 555 U.S. 1031 (2008); Siepel v. Bank of America, 526 F.3d 1122 (8th Cir. 2008), 2007 U.S. Dist. LEXIS 14430 (E.D. Mo. 2007) (dismissing federal claims and finding state claims pre-empted for class action alleging breach of fiduciary duty and self-dealing in conversion of common trust funds to mutual funds); Parsky v. Wachovia Bank, No. 000771 (Phila. Cty. Ct. Comm. Pl., Oct. 24, 2003) (settlement of class action alleging self-interest in investment of trust accounts in proprietary mutual funds).

See Part VIII.C.2 below.

g. In 1996, the Comptroller substantially revised Part 9, which governs the fiduciary activities of national banks. See 61 Fed. Reg. 68543 (Dec. 30, 1996) (the “Part 9 Revision”). In 2001, the Comptroller further revised provisions of Part 9 relating to multi-state trust activities. See 66 Fed. Reg. 34792 (July 2, 2001) (the “Multi-state Trust Revision”). See also OCC Bulletin 2008-10 (Mar. 27, 2008) (Annual Review of Fiduciary Accounts).

(i) The Part 9 Revision retains a general prohibition on advertising common trust funds. See also, e.g., Comptroller Unpublished Letter (Oct. 22, 1992) (CIF advertising standards).

(ii) The Comptroller permits national banks to (A) advertise general trust services, (B) publicize surveys of common trust fund performance, (C) compare fund performance with performance of all funds of a particular type (but not with performance of another institution’s funds), and

(D) publish comparisons of fund performance with national indices.

(iii) Restrictions on advertising common trust funds under Section 9.18(a)(1) were never extended to CIFs comprised of retirement, pension, profit-sharing, stock bonus and other similar tax exempt trusts (see 37 Fed. Reg. 24161 (Nov. 15, 1972)), and the GLB Act does not effect any substantive change in this regard. Nevertheless, the antifraud provisions of the securities laws apply to these CIFs and the Comptroller has recommended that banks conform any such advertisement to SEC and FINRA rules, particularly the rules regarding historical performance data. See Comptroller's Handbook: Collective Investment Funds.

(iv) The Part 9 Revision replaced the terms "fiduciary" and "managing agent" with the term "fiduciary capacity". While the Comptroller added acting as an "investment adviser if the bank receives a fee for its investment advice" to the list of fiduciary capacities, he clarified that if investment advice is "merely incidental to other services" the bank will not be considered to be acting in a fiduciary capacity. Other "incidental" activities include financial advice and counseling, client-directed investment activities, advice incidental to acting as a municipal securities dealer, real estate management and consulting, bridge loan advice, services for homeowners' associations, tax planning and structuring advice, and general investment advisory services. See 12 C.F.R. § 9.101, 63 Fed. Reg. 6472 (Feb. 9, 1998) (adopting release), 62 Fed. Reg. 36746 (July 9, 1997) (solicitation of public comments); Comptroller Bulletin 97-22 (May 15, 1997); Comptroller Interpretive Letter No. 769 (Jan. 28, 1997), CCH Fed. Banking L. Rep. ¶ 81-133.

(v) Federal law preempts state reciprocity and other requirements beyond those imposed by NBA § 92a. See Multi-state Trust Revision (a national bank (A) may act in a fiduciary capacity in any state to the extent permitted for that state's own fiduciaries, and (B) if acting in a fiduciary capacity in any state, may offer its fiduciary services to customers located in any state). See also Letters No. 1080; No. 995.

(vi) Computer model-driven funds (as well as index funds) administered by national banks may allocate transaction costs (e.g., brokers' commissions) to individual fund participants. See Comptroller Interpretive Letters No. 1120 (Feb. 20, 2009) ("Letter No. 1120"), CCH Fed. Banking L. Rep. ¶ 81-652; No. 919 (Nov. 2, 2001), CCH Fed. Banking L. Rep. ¶ 81-444. See also Part VIII.C.2.k below.

h. In 2016, the DOL issued a final rule substantially expanding the scope of persons deemed to be a "fiduciary" of a pension plan or IRA by virtue of providing investment advice to the pension plan or IRA ("Final DOL Fiduciary Rule"). The Final DOL Fiduciary Rule fundamentally changes how the fiduciary responsibility provisions of U.S. pension law apply to financial institutions that deal with retirement assets. See 81 Fed. Reg. 20946 (Apr. 8, 2016).

(i) For financial services providers that will be treated as a fiduciary because of the new scope of the definition of "investment advice" in the Final DOL Fiduciary Rule ("Advice Fiduciaries"), the DOL also adopted two new prohibited transaction class exemptions, including the "Best Interest Contract" exemption ("BIC Exemption"). The BIC Exemption permits Advice Fiduciaries to receive compensation that would otherwise be prohibited, subject to certain conditions including that it acknowledge that it is operating in the best interests of its plan client. See 81 Fed. Reg. 21002 (Apr. 8, 2016). The second exemption permits fiduciaries to enter into principal transactions in certain property with pension plans and IRAs, subject to substantial conditions. See 81 Fed. Reg. 21089 (Apr. 8, 2016).

i. A national bank is not relieved of its responsibility as a fiduciary by delegating responsibility for a bank CIF to a third-party provider. Moreover, before delegating administrative, operational or investment functions of its CIF to a third party, the bank must conduct due diligence and adopt appropriate oversight and monitoring of the vendor. A national bank cannot permit a third party to advertise or market a bank CIF without disclosing that the CIF is managed and offered by the sponsoring bank. See Comptroller Bulletin No. 2011-11 (Mar. 29, 2011).

j. National banks may, under certain circumstances, place funds ("self-deposits") for which a national bank is a fiduciary on deposit in the bank or with a bank affiliate. Because self-deposits of fiduciary funds create conflicts of interest, the bank should demonstrate that appropriate due diligence is being applied to such deposits and that the bank is complying with applicable laws. In addition, a bank should consider the level of credit risk to which the self-deposit fiduciary funds would be exposed. See Comptroller Bulletin 2010-37 (Sept. 20, 2010).

k. A national bank may establish a "rabbi trust" for the benefit of employees or act as trustee for a rabbi trust, even if the trust holds assets beyond those allowed for national banks, since the investment restrictions of Section 24(7) apply only to a bank's investments for its own account. See Comptroller Interpretive Letter No. 1031 (Jan. 19, 1995), CCH Fed. Banking L. Rep. ¶ 81-560. See also, e.g., Letter No. 878.

l. OCC Approvals relating to the establishment or operation of national trust banks ("non-bank banks" for BHCA purposes) indicate that the OCC requires trust banks to hold additional capital as fiduciary assets increase.

(i) In early 2013, the OCC shifted policy to require new national trust banks to be FDIC-insured, requiring a separate FDIC approval to charter a national trust bank. See American Banker, Apr. 22, 2013. More recently, interest in potential use of a national trust bank charter as a platform for FinTech activities has led to renewed interest in the possibility of an uninsured trust bank charter. This could lead the OCC to reconsider chartering uninsured trust banks, especially if owned by a regulated BHC (or FHC), and could lead to the OCC to seek to clarify the resolution regime that would apply to such an institution. See generally, Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective (Mar. 2016).

(ii) Among the more recent national trust bank approvals are, e.g., Comptroller Conditional Approvals No. 1055 (Dec. 20, 2012) (Ameriprise National Trust Bank); No. 962 (July 19, 2010) (Zions First National Bank); No. 942 (Jan. 12, 2010) (Barclays Wealth Trustees (U.S.), N.A.); No. 938 (Dec. 16, 2009) (Brown Brothers Harriman Trust Company of Delaware, National Association); No. 916 (July 31, 2009) (Rockefeller Trust Company) (conversion from state charter); No. 853 (May 8, 2008) (Marshall & Ilsey Trust Company, National Association); No. 834 (Dec. 13, 2007) (UBS Trust Company, National Association); No. 828 (Oct. 15, 2007) (Raymond James Trust, National Association) (conversion from state charter); No. 812 (July 23, 2007) (Goldman Sachs Trust Company (Delaware), N.A.); No. 560 (Dec. 3, 2002) (Glenmede Trust Company); see also No. 455 (Mar. 1, 2001)); No. 804 (May 1, 2007) (VNBTrust, National Association); No. 777 (Dec. 27, 2006) (Brown Brothers Harriman Trust Co., N.A.); No. 696 (June 9, 2005) (Brown Brothers Harriman National Trust Co. LLC); No. 741 (Apr. 21, 2006) (LaSalle National Trust Delaware); No. 708 (Oct. 17, 2005) (Legg Mason Trust Company, National Association); No. 694 (May 3, 2005) (HSBC Trust Company (Delaware); but see Comptroller Community Reinvestment Act Decision No. 137 (Sept. 29, 2006) (expansion of scope of activities to include loans and benefits related to tax refunds)); Comptroller Conditional Approvals No. 689 (Nov. 14, 2003) (Wells Fargo Alaska Trust Company); No. 688 (Mar. 25, 2005) (Riggs National Trust Company); No. 652 (Sept. 27, 2004) (Bessemer Trust Company of Delaware); No. 623 (Feb. 19, 2004) (Commercebank Trust Co.); No. 605 (Oct. 15, 2003) (State Street Bank & Trust Co. of New England); No. 597 (June 13, 2003) (First Financial Trust & Asset Management Co.); No. 587 (Apr. 25,

2003) (Western National Trust Co.); No. 575 (Jan. 27, 2003) (Morgan Stanley Trust, N.A.); No. 566 (Dec. 23, 2002) (Merchants Trust Co.); No. 556 (Oct. 24, 2002), Comptroller Corporate Decision No. 2001-29 (Sept. 28, 2001), Comptroller Conditional Approval No. 439 (Dec. 28, 2000) (Neuberger Berman National Trust Company). See generally Letter No. 436.

C. MUTUAL FUNDS AND OTHER FUND MANAGEMENT SERVICES

1. Growth of the Mutual Fund Industry and Involvement by Banking Organizations

a. Background

(i) Total mutual fund and ETF assets amounted to $18.1 trillion in 2015, in more than 16,860 registered funds. Mutual fund assets have exceeded bank deposits since 1996, and 54.9 million U.S. households (44.1%) owned mutual funds in 2015.

(ii) Bank participation in the mutual fund business is significant, through trust departments and brokerage units, and through de novo efforts and acquisition of mutual fund advisers, managers and administrators. More than 1,600 banks report mutual fund sales, and the larger the bank, the more likely it is to be involved in such sales.

(iii) Banks continue to explore different ways to sell mutual fund services (e.g., cross-sales of funds managed by the bank or its affiliates ("proprietary funds"), sales of principal-protected funds, sales of "no load" funds, creation of fund "supermarkets", offers of mutual funds from different mutual fund companies as to which the bank acts as co-adviser, and provision of back-office services) and to provide customer access to so-called "alternative investments", such as ETFs, hedge funds, venture capital funds, private equity funds and managed futures funds.

A) Mutual funds sold by banks may be third-party funds, "private label funds" sold exclusively through one bank or proprietary funds. Fund shares are offered through many channels: direct advertising, telephone sales, mailings and third parties (such as brokerage firms and banks, including through joint ventures or "kiosking" arrangements).

To lower regulatory costs and increase distribution, some asset managers transfer the distribution rights to their U.S. mutual fund businesses. In such an arrangement, the buyer becomes the investment adviser, distributor and administrator to a mutual fund and engages the seller as a sub-adviser.

B) ETFs are investment companies with shares that trade on an intraday basis at prices that can vary from an ETF's net asset value. By year-end 2015, assets held in ETFs amounted to approximately $2.1 trillion (compared with $100 billion in 2002) in over 1,500 funds (compared with 100 funds in 2002). Most ETFs are "passively managed" as they are designed to track the performance of a specified index. However, the number of actively managed or "non-index-based" ETFs has grown significantly in recent years.

C) With respect to commodity pool and hedge fund-related issues, as well as issues under the Volcker Rule, see Part II.A, Part II.D.2 and Part II.D.4 above, Part VIII.D below and Part IX.C below.

D) With respect to principal-protected funds, see Part VIII.C.1.b.ii.F below.

(iv) Total assets in closed-end funds amounted to $261 billion in 2015, representing a 10% decrease since year-end 2014 and a decline from the peak of $312 billion in 2007.

(v) For discussion of mutual fund and ETF developments, common trust fund conversions, private equity fund/mutual fund conversions, marketing and operating strategies and business trends, see generally, e.g., Money Management Executive (Feb. 2015); "Understanding [ETFs]: How ETFs Work", ICI Research Perspective (Sept. 2014); Profile of Mutual Fund Shareholders (ICI, Feb. 2014); Investment Company Fact Book (ICI, 2015); "Alternative Funds Are Not Your Typical Mutual Funds", FINRA Investor Alert, June 12, 2013; The Closed-End Fund Market (ICI, Mar. 2011).

(vi) For a discussion of issues relating to non-U.S. investment companies and CPOs, see U.S. Regulation of International Securities Markets, Chapters 17 and 18. See also Part XI below.

(vii) The 2008 financial crisis put a spotlight on potential systemic risks posed by money market funds. As described in Part I.A.6.a.iii above, U.S. authorities provided several types of assistance to support money markets during the crisis, including a direct guarantee to holders of certain money market funds. This caused U.S. and international policy makers to focus on methods to curtail perceived systemic risks arising from money market funds, which generally do not otherwise benefit from government or private sector guarantee or insurance programs and therefore are considered vulnerable to a "run".

A) Internationally, the FSB has a work stream devoted to money market funds, led by IOSCO. See Peer Review of Regulation of Money Market Funds (IOSCO, Sept. 2, 2015); Policy Recommendations for Money Market Funds (IOSCO, Oct. 9, 2012) ("IOSCO Money Market Funds Recommendations").

B) In the U.S., reform of money market funds has been controversial.

i) In 2010, the SEC adopted amendments to Rule 2a-7 that required funds to maintain a portion of their portfolios in instruments that can be readily converted to cash, reduced the maximum weighted average maturity of portfolio holdings, required money market funds to report their portfolio holdings monthly to the SEC, and permitted a money market fund that has "broken the buck" (or is at imminent risk of breaking the buck), to suspend redemptions to allow for the orderly liquidation of fund assets. See SEC Release No. IC-29132 (Feb. 23, 2010).

ii) In December 2012, the SEC's Division of Risk, Strategy and Financial Innovation released a Report addressing the effects of the 2010 regulatory changes. See Response to Questions Posed by Commissioners Aguilar, Paredes and Gallagher, Nov. 30, 2012. See generally Broker/Dealer Compliance Report, Jan. 4, 2013.

iii) On June 5, 2013, the SEC proposed two alternatives to address systemic risk issues associated with money market mutual funds: (a) a floating NAV, and/or (b) giving funds discretion to impose a liquidity fee and allowing them to suspend redemptions temporarily (to "gate" funds). See 78 Fed. Reg. 36834 (June 19, 2013).

iv) On July 23, 2014, the SEC approved a final rule adopting both proposals, as well as other diversification, management, disclosure and reporting requirements. See 79 Fed. Reg. 47736 (Aug. 14, 2014). See also SEC Responses to [FAQ] Regarding Money Market Fund Reform (updated Jan. 2016); ICI Research Report (Jan. 2015).

b. Scope of Services Provided by Banking Organizations

(i) Financial Holding Companies and Financial Subsidiaries

FHCs and financial subsidiaries may provide every type of service to mutual funds as discussed in Part VIII.C.1.b.ii below, and may also act as a distributor for such funds.

Subject to the application of Volcker Rule restrictions (see Part II above), FHCs may also hold investments in funds which they manage in reliance on their Merchant Banking Authority. See, e.g., Board Letter to SocGen, May 17, 2001. The Board has recently raised concerns regarding the scope of FHC's Merchant Banking Authority and signaled potential changes, which could affect the types of services FHCs may provide (see Part I and VII).

(ii) Bank Holding Companies and Banks

A) Permissible Roles

i) Banking organizations fill the following roles with respect to mutual funds:

(a) Adviser/portfolio manager.

(b) Custodian.

(c) Broker for fund shares.

(d) Transfer agent.

(e) Administrator/shareholder servicing agent.

See also Part VIII.C.2 and Part IX below.

ii) In general, a BHC or a bank may not act as a fund distributor (or dealer), or "underwrite" mutual fund shares (see Part III above). BHCs and banks may, however, "privately place" fund shares (see Part VI.B above).

In the Wilmington Trust Letter, the FDIC indicated that neither it nor the Board objected to a subsidiary of a state non-member bank acting as a mutual fund distributor. See also FDIC Letter to Rep. Dingell, dated Feb. 25, 1994.

iii) Bank and BHC affiliates also sponsor, manage and control closed-end funds.

B) "Distribution Function"

i) Securities firms fulfill the bank-prohibited roles of sponsor, organizer and manager of open-end funds and underwriter or distributor of shares of all types of funds. Sometimes the role of the firm is essentially nominal, and in other cases, funds do not even have distributors.

Although the services provided by distributors vary, a distributor generally (a) enters into a distribution agreement with a fund to act as agent in selling shares and to serve as the fund's "principal underwriter", (b) enters into selling agreements with broker-dealers or other financial intermediaries, (c) controls the channels through which fund shares are sold, and (d) is responsible for FINRA/SEC filings.

For regulatory precedents which discuss the scope of the distribution function and certain issues arising in connection with "distributorless funds", see, e.g., Rabobank, 84 Fed. Res. Bull. 852 (1998) (the "Rabobank-Weiss, Peck & Greer Order"); Lloyds Bank, 84 Fed. Res. Bull. 116 (1998) (the "Lloyds-IAI Order"); SG-Cowen Order; Investors Financial Services Corp. (approved May 29, 1998) (the "Investors Financial Services Approval"); and Comptroller Interpretive Letter No. 648 (May 4, 1994) ("Letter No. 648"), CCH Fed. Banking L. Rep. ¶ 83,557. See also Part VIII.C.1.b.ii.C below.

ii) Questions arise as to the manner in which a bank can support the distribution function; e.g., whether, to what extent and in what manner a bank may finance back-end loads (sales charges paid by a distributor to banks and broker-dealers on the sale of fund shares, but recovered from investors, if at all, only at the time of the investors' resale) or purchase from the distributor the cash flow streams from the investors' resale load and/or 12b-1 plans (referred to in Part VIII.C.1.b.ii.E below).

(a) A bank may make loans to a fund distributor to finance commissions to selling brokers, including a bank's brokerage subsidiary. If loan proceeds are transferred to an affiliate, the bank must satisfy Sections 23A/23B, but loans of this type are not treated as "for the benefit" of advised ("affiliate") funds, since any benefit arising from such a loan is considered "intangible and impossible to quantify", and therefore not the type of benefit contemplated by Section 23A. See, e.g., Letters No. 730; No. 656. See also Part III.A.5 above.

(b) The Comptroller has permitted a marketing arrangement between a national bank and a distributor of advised funds pursuant to which the bank pays commissions directly to selling brokers (including a brokerage subsidiary of the bank) in respect of fund shares sold under a "back-end load structure" rather than financing the payment of the commissions by the distributor. The bank then pays fees pursuant to 1940 Act Rule 12b-1 ("Rule 12b-1") and contingent deferred sales charges in respect of the sale or redemption of fund shares. In connection with the payment of the back-end loads, the bank provides marketing and advertising services to the selling brokers. See Comptroller Interpretive Letter No. 804 (Sept. 30, 1997), CCH Fed. Banking L. Rep. ¶ 81-251.

(c) In Board Letter to Robert Tortoriello re Barclays, dated Aug. 14, 2001 (the "Barclays 2001 Letter"), modifying Barclays, 82 Fed. Res. Bull. 158 (1996) (the "Barclays Order"), the Board confirmed that a national bank subsidiary could enter into an agreement in which the subsidiary, as investment adviser, pays all or a portion of a fee in exchange for the fund distributor performing administrative services to the fund. See also, e.g., CSG-Warburg Pincus Approval (acquisition of Warburg Pincus Asset Management and 19.9% investment in the private equity business of Warburg, Pincus & Co.; Notification, dated Apr. 6, 1999, discusses "supermarket fees"); Mellon Bank Corp. ["Mellon"], 79 Fed. Res. Bull. 626 (1993) (the "Mellon-TBC Order") (acquisition of The Boston

Company ("TBC"); Notification, dated Nov. 24, 1992, discusses "supermarket fees").

C) "Control" Issues

Historically, neither a bank nor a BHC was permitted to "control" a mutual fund because mutual funds were viewed as "principally engaged" in securities issuance within the meaning of Glass-Steagall § 20 prior to its repeal (see, e.g., Board v. ICI, 450 U.S. 46 (1981) ("ICI II")). Federal banking regulators have not interpreted the GLB Act as overriding this prohibition (although it may be possible to combine other GLB Act authorities, such as merchant banking).

i) Adviser "Control" of Mutual Fund Interests

In evaluating issues which involve "control" of mutual funds, the Board and the Comptroller did not historically take the same approach, although the Board liberalized its analysis over time, as reflected in, e.g., Barclays 2001 Letter, Banc One Corp. (approved Dec. 22, 1999) (the "Bank One Approval"), CSG-Warburg Pincus Approval, Rabobank-Weiss, Peck & Greer, Lloyds-IAI, SG-Cowen, Morgan-American Century, Bank of Ireland and Commerzbank-Montgomery Orders, SunTrust, 84 Fed. Res. Bull. 126 (1998) (the "SunTrust-Equitable Order"), BTNY, 83 Fed. Res. Bull. 780 (1997) (the "BTNY-Alex. Brown Order"), and Mellon-TBC Order. (All of the foregoing are referred to as the "Board Mutual Fund Control Precedents".) See also Part VIII.C.1.b.ii.E below.

Compare, e.g., Janus Capital Group ("JCG" v. First Derivative Traders, 564 U.S. ___, 131 S.

Ct. 2296 (2011) ("JCG v. First Derivative") (for purposes of Rule 10b-5, a mutual fund adviser did not "make" the statements in question because the fund, not the adviser, had "ultimate authority" over the statements). In an administrative case, the SEC attempted to limit the JCG v. First Derivative holding by not applying it to claims other than those brought pursuant to Rule 10b-5. See SEC Admin. Proc. No. 3-14081 (Dec. 15, 2014).

(a) In the 1980s, the Board and the Comptroller considered applications by Dreyfus Corporation and J&W Seligman and Co., mutual fund sponsors/advisers, to establish national banks that would engage solely in fiduciary activities.

i. The Board took the position that such banks would violate Glass-Steagall § 20 because an adviser manages a fund, directs its operations and "controls" the fund. Letter to the Comptroller dated Dec. 14, 1982. See also, e.g., Board Letter, Mar. 20, 1998 (Transamerica treated as affiliate of mutual funds as to which it acts as sponsor, underwriter and distributor); Chase Mutual Fund Application referred to in Part VIII.C.1.b.ii.E below.

ii. The Comptroller stated that (A) the extent to which a sponsor/adviser is engaged in prohibited securities activities should be determined on a consolidated basis, (B) if a bank holds no shares of a mutual fund, it would not be "affiliated" with such fund, and (C) control of a mutual fund lay with its board of directors and not with its adviser. Decision of the Comptroller to Charter Dreyfus National Bank & Trust Company, Quarterly Journal (June 1983); Decision of the Comptroller to Charter J&W Seligman Trust Company, N.A., Quarterly Journal (June 1983). See also, e.g., Letter No. 648; Comptroller Interpretive Letter No. 647 (Apr. 15, 1994), ("Letter No. 647") CCH Fed. Banking L. Rep. ¶ 83,558 (commitments terminated in Comptroller Corporate Decision No. 2002-15 (Oct. 7, 2002)).

Letter No. 730 affirmed that a distributor of proprietary funds is not a Section 23A "affiliate" of the adviser bank.

(b) The Board Mutual Fund Control Precedents held that mutual funds are not controlled by their "administrators", since an administrator performs ministerial duties, while the policy-making functions rest with the fund's board of directors. Moreover, neither limited officer and director interlocks between an adviser/administrator and a fund, nor the performance of promotional or marketing services for an advised fund, should change this result. See also, e.g., Mellon, 80 Fed. Res. Bull. 733 (1994) (the "Mellon-Dreyfus Order") (BHC subsidiary may act as non-managing general partner of mutual fund under certain circumstances).

(c) The Commerzbank-Montgomery Order held that Commerzbank could acquire up to 5% of the shares of funds for which it provides administrative/advisory services, so long as such ownership was not used to market the fund. See also, e.g., BTNY-Alex. Brown Order.

(d) The Lloyds-IAI Order permitted a pension plan for employees of a BHC subsidiary providing advisory and administrative services to acquire up to 5% of the shares of any advised fund -- so long as such ownership interest was not used to market the funds -- even though the funds did not have an independent distributor. In permitting a BHC subsidiary to provide services to "distributorless funds" the Board relied on commitments that such funds would employ a marketing officer independent of the BHC. See also, e.g., Rabobank-Weiss, Peck & Greer Order.

(e) The Board has also permitted a BHC executive officer to serve on the boards of directors of proprietary funds advised by a bank subsidiary of the BHC when the officer does not serve as an officer, director or employee of any bank subsidiary of the BHC or of the distributor of the funds, or serve as an officer or employee (or have any responsibility for the day-to-day operations) of the funds. Board Letter re U.S. Bancorp, Mar. 20, 1998.

(f) In considering MetLife's acquisition of a limited purpose national trust bank, Board Letter, Dec. 19, 1995, said that "MetLife, as the sponsor and provider of numerous major services to the MetLife mutual funds, could be deemed to control the funds". See also Comptroller Conditional Approval No. 191 (Dec. 21, 1995).

ii) Fund Investments in U.S. Banking Organizations

Although regulatory precedents in this Part VIII attest that, in general, the boards of directors of mutual funds are treated as controlling such funds for regulatory purposes (see generally Part VIII.C.2.b below), the Board has blurred this issue in the context of fund ownership of interests in U.S. banking organizations. See also Part VII above and Part XII below.

(a) The Board generally treats advisers to mutual funds as controlling shares of U.S. banks/BHCs held by such funds, requiring that the adviser comply with BHCA/CBCA requirements. It is not clear that the Board treats such "control" as falling within the "fiduciary exception" of 12 C.F.R. § 225.12(a) for purposes of BHCA/CBCA compliance.

In addition, the Board has treated certain mutual fund families as if they were "acting in concert" for BHCA/CBCA purposes (thus requiring an aggregation of all bank/BHC voting securities owned by such funds). However, the Board has determined that a mutual fund complex (i) may acquire as much as 15% of a class of voting securities of a bank/BHC without filing a BHCA/CBCA application, and (ii) would not be deemed to have control over the bank/BHC, if certain conditions are met (e.g., no one entity in the complex would hold more than 10% of any class of bank/BHC voting securities; arrangements are made to vote shares in excess of 10% in the same proportion as all other shares are voted or, failing such arrangements, not voting those excess shares; limited representation on the board of the bank/BHC). See, e.g., Board Letter re Vanguard Group, Apr. 11, 2013; Board Letter re T. Rowe Price Group, Apr. 27, 2016; Board Letter re Wells Fargo, Sept. 3, 2010; Board Letter re Davis Selected Advisers, Dec. 20, 2007; Board Letter re Dodge & Cox, Dec. 19, 2007; Board Letter re Ariel Capital Management, Oct. 31, 2005; Board Letter re Franklin Resources, Nov. 29, 2004; Board Letter re Capital Group, Aug. 13, 2002; Board Letter to ICI, Oct. 25, 2001; Board Letter, Apr. 18, 2000. See also, e.g., NY Times, May 7, 2013; Board 1994 Control Letter.

(b) Issues could also arise under Regulation O with respect to banking (or other) organizations which have investment management or related authority over more than 10% of a class of voting securities of a bank or BHC, since Regulation O (unlike Section 23A and Regulation W) does not include an exemption for ownership of securities in a fiduciary capacity. See, e.g., Board Letter re Barclays, Sept. 29, 2006. The

Relief Act and an implementing Board Rule narrowed the scope of potential problems by eliminating certain Regulation O reporting requirements in respect of correspondent banks. See 71 Fed. Reg. 71472 (Dec. 11, 2006).

(c) Comptroller Conditional Approval No. 893 (Mar. 4, 2009) permitted a family of investment management companies to hold up to 25% of the voting shares of a national bank without finding control of the bank by the family. This was conditioned on the execution of a passivity agreement (including prohibitions on board representation, influencing management, seeking or using non-public information about the bank or its non-bank parent, or otherwise controlling the bank; and arrangements to vote shares in excess of 10% in the same proportion as all other shares are voted or, alternatively, not to vote those excess shares). See also Part VIII.C.2.c.iv below.

iii) Section 23A "Affiliation"

(a) A 1940 Act-registered investment company is a Section 23A "affiliate" of its adviser, and Regulation W expands the definition of "affiliate" to include any unregistered investment company if a bank or its affiliate serves as the fund's adviser and owns more than 5% of any class of voting shares or equity capital of the fund.

(b) Dodd-Frank provisions expanded the scope of "affiliation" in this context, and prohibit certain covered transactions between a bank and private equity and hedge funds that are sponsored, advised, or organized and offered by the bank. See Part II.A.7 and Part III.A above.

iv) Management/Director Interlocks Between Funds and U.S. Banking Organizations

The GLB Act repeal of Glass-Steagall § 32 should have eliminated issues with respect to management and director interlocks between mutual funds and banks/BHCs. Although neither the Board nor the FDIC appear to have confirmed that banks may have management/director interlocks with mutual funds, Comptroller Interpretive Letter No. 885 (Mar. 20, 2000) ("Letter No. 885"), CCH Fed. Banking L. Rep. ¶ 81-404, seems to have reached this conclusion. Moreover, both prior to and after the enactment of the GLB Act, the Board had permitted BHC interlocks with mutual funds. See, e.g., Barclays 2001 Letter, Bank One and CSG-Warburg Pincus Approvals, KeyCorp-McDonald, SG-Cowen, SunTrust-Equitable, Morgan-American Century, Lloyds-IAI (distributorless funds), Bank of Ireland, Commerzbank-Montgomery, BTNY-Alex. Brown and Mellon-TBC Orders (the "Board Interlock Orders").

See generally Comptroller Conditional Approval No. 178 (July 24, 1995) (interlocks permitted with mutual funds such that bank employees could act as ministerial officers of the funds); Approval No. 164 (interlocks permitted with closed-end and offshore investment companies).

D) "Sweeps"

Cash management is an important bank service, and revenues are generated from sweep accounts in various contexts. See also Part IX.A below.

i) Selected Comptroller of the Currency Precedents

Sweep arrangements whereby a customer directs funds from deposit accounts into mutual funds are part of the business of purchasing and selling securities on the order and for the account of customers. Some of these arrangements have involved a bank temporarily purchasing mutual fund shares (but not in excess of 25% of any fund's outstanding shares). See, e.g., Comptroller Interpretive Letter No. 760 (Nov. 14, 1996), CCH Fed. Banking L. Rep. ¶ 81-124; Comptroller Conditional Approvals No. 222 (Oct. 22, 1996); No. 184 (Oct. 6, 1995); No. 183 (Oct. 6, 1995), as amended by Comptroller Letter, dated Nov. 22, 1995 ("Approval No. 183"); Comptroller Interpretive Letter No. 688 (May 31, 1995), CCH Fed. Banking L. Rep. ¶ 81-003; Letters No. 593, No. 591; Comptroller Interpretive Letter No. 326 (Jan. 17, 1985), CCH Fed. Banking L. Rep. ¶ 85,496 (collectively, the "Comptroller Sweep Precedents"). See generally Comptroller Banking Circular No. 218 (Oct. 31, 1986) (caution as to trust department use of "sweep" programs where banks receive supplemental fees). See also Comptroller Conditional Approval No. 899 (Apr. 23, 2009) (Bank of America to hold deposits generated from sweep arrangements with Merrill Lynch following its acquisition by Bank of America; similar arrangements with unaffiliated broker-dealers would require non-objection from the Comptroller).

ii) Selected Federal Reserve Board Precedents

The Schwab Order held that a BHC brokerage subsidiary may sweep customer deposits above a pre-set amount into mutual funds. But see Osterreichische Landesbank, 55 Fed. Reg. 42478 (Oct. 19, 1990) (solicitation of public comments) (approved Dec. 24, 1990) (application to acquire Roley Nichols Capital Group and provide mutual fund shareholder services; FRBNY approval provides that Landesbank would not sweep to a fund advised by Roley Nichols).

iii) Selected Federal Deposit Insurance Corporation Precedents

The FDIC has approved various sweep arrangements.

(a) FDIC Advisory Opinions No. 00-2 (Apr. 4, 2000), CCH Fed. Banking L. Rep. ¶ 82-242, and 98-4 (Jan. 23, 1998), CCH Fed. Banking L. Rep. ¶ 82-235, approved arrangements involving third party money market mutual funds. But see FDIC Advisory Opinion No. 92-27 (Apr. 28, 1992), CCH Fed. Banking L. Rep ¶ 81,514 (impermissible bank payment of interest on a demand deposit where funds would be swept to an investment account administered by the bank and would be accessible by the customer to the same degree as a demand deposit).

(b) A state non-member bank may act as "servicing agent" for a fund sponsor and make fund shares available to its customers as agent. FDIC Advisory Letter No. 89-04 (Jan. 30, 1989), CCH Fed. Banking L. Rep. ¶ 81,212.

E) Multiple Activities

A bank or BHC subsidiary may combine advisory, brokerage and administrative roles respecting mutual funds and other investment companies. See also Part I. D and Part VIII.B above.

i) Selected Comptroller of the Currency Precedents

(a) A national bank may act as investment adviser to investment companies as one of its fiduciary powers under 12 U.S.C. § 92a. See Part 9; Comptroller's Handbook: Personal Fiduciary Services. See also, e.g., Approval No. 190; Comptroller Letter (Jan. 13, 1993) re Zions First National Bank (the "Zions First National Letter"); Comptroller Interpretive Letters No. 525 (Aug. 8, 1990) ("Letter No. 525"), CCH Fed. Banking L. Rep. ¶ 83,236 (framework for fiduciary powers); No. 515 (July 9, 1990), CCH Fed. Banking L. Rep. ¶ 83,219 (bank as co-investment adviser with securities firm); No. 298 (July 23, 1984), CCH Fed. Banking L. Rep. ¶ 85,468.

(b) A national bank may provide combined investment advisory and brokerage services to customers in connection with the purchase and sale of fund securities. See, e.g., Comptroller Interpretive Letter No. 622 (Apr. 9, 1993) ("Letter No. 622"), CCH Fed. Banking L. Rep.

¶ 83,504; Comptroller Unpublished Letters (Aug. 8, 1988), (Jan. 14, 1988); Letter No. 420; Comptroller Interpretive Letters No. 407 (Aug. 4, 1987) ("Letter No. 407"), CCH Fed. Banking L. Rep. ¶ 85,631, No. 406 (Aug. 4, 1987) ("Letter No. 406"), CCH Fed. Banking L. Rep. ¶ 85,630; Letter No. 386; Comptroller Interpretive Letters No. 363 (May 23, 1986) ("Letter No. 363"), CCH Fed. Banking L. Rep. ¶ 85,533 (describing arrangements between banks and investment company sponsors/ underwriters, such as participation in plans pursuant to Rule 12b-1 ("12b-1 plans")); No. 332 (Mar. 8, 1985), CCH Fed. Banking L. Rep. ¶ 85,502 (12b-1 plan compensation does not transform brokerage into underwriting even if such compensation is characterized as for "distribution" for securities law purposes where (A) the customer selects the investment, and (B) the bank does not buy securities for its own account).

(c) A national bank may broker shares of advised funds. See, e.g., Letters No. 625; No. 622; Comptroller Letter re Society National Bank (Apr. 26, 1988); Comptroller Interpretive Letter No. 403 (Dec. 9, 1987) ("Letter No. 403"), CCH Fed. Banking L. Rep. ¶ 85,627.

(d) A national bank may perform fund administrative services. See, e.g., Approvals No. 190; No. 178; Letter No. 363; Letter from First National Bank of Chicago to the Comptroller, dated Sept. 14, 1994 (describing services; Letter relates to what became

Letter No. 688); Letter from Mellon Bank to the Board, dated Mar. 9, 1993 (describing services).

(e) The Comptroller conditioned his approvals of <u>acquisitions of mutual fund companies</u> by Mellon Bank and First Union National Bank (Letters No. 648 (as modified in Comptroller Corporate Decision No. 97-07 (Jan. 29, 1997)) and No. 647) on certain commitments, which the Comptroller significantly reduced in Letter No. 885 and in Comptroller Corporate Decision No. 2002-15 (Oct. 7, 2002).

(f) A national bank may sponsor trusts to hold general obligation municipal bonds to be sold to institutional investors where the trusts would provide a <u>tender option feature</u> for "continuous redemption and remarketing". Comptroller Corporate Decision No. 96-52 (Sept. 20, 1996).

(g) A national bank may (i) provide services to affiliates (including cash management, payroll and other services); (ii) serve as a transfer agent; (iii) provide services ancillary to acting as an investment adviser (such as administrative, accounting and director and corporate secretarial services to mutual funds, hedge funds, private equity funds, retirement plans, separately managed accounts and alternative investments); and (iv) provide financial and consulting services to financial institutions. Comptroller Conditional Approval No. 811 (July 19, 2007) (Citibank acquisition of BISYS Group; insurance distribution services to be divested within one year).

ii) Selected Federal Reserve Board Precedents

(a) Regulation Y permits a BHC subsidiary to provide fiduciary, financial and investment advisory and agency transactional (including brokerage) services, either separately or in combination. Regulation K includes a similar empowerment. See 12 C.F.R. §§ 211.6(a)(6), 225.28(b)(5), (6), (7); ICI II.

i. "Advisory" powers include investment management. See 62 Fed. Reg. 9290, 9306 (Feb. 28, 1997); Board Legal Division Memorandum, Oct. 1, 1971.

ii. The Commerzbank Real Estate Letter clarified that a non-U.S. bank may own and manage investment trusts that invest in U.S. real estate where the assets of the trusts are held in a fiduciary capacity for the benefit of investors. In the conduct of such activities, property management, real estate brokerage and related services would be obtained from unaffiliated parties. Commerzbank, its subsidiaries and pension, and similar plans sponsored by Commerzbank for the benefit of its employees, will not own interests in the trusts. Although Commerzbank's shareholders and employees may purchase interests in the trusts in their individual capacities, these interests would have no voting rights and would not be expected to exceed 5% of any trust's total interests.

iii. The Board approved an application by a Luxembourg affiliate of RBC, RBC Investor Services Bank S.A., to establish a U.S. representative office to support its custody-related activities. RBC Investor Services Bank, S.A., 100 Fed. Res. Bull. 55 (Dec. 17, 2013).

(b) The Board has long held that a mutual fund is engaged principally in issuing securities (see 12 C.F.R. § 250.400; Board Letter, June 24, 1999, re First Union (the "First Union Letter"), Fed. Res. Reg. Serv. ¶ 4-612), and, accordingly, that a BHC may not "control" a mutual fund. However, a BHC subsidiary may sponsor, organize and manage a closed-end investment company. See 12 C.F.R. § 225.28(b)(6)(i); ICI II. See also, e.g., Board Orders referred to in Part II.D.2 above; Creditanstalt-Bankverein, 80 Fed. Res. Bull. 828 (1994); Compagnie Financière de Suez, 55 Fed. Reg. 14862 (Apr. 19, 1990) (solicitation of public comments) (approved May 10, 1990).

An investment company that is open-end for purposes of the 1940 Act may be closed-end for purposes of Regulation Y if it issues shares infrequently. The Board has set a "safe harbor" for closed-end funds if offerings are made not more than 4 times a year. See, e.g., Fleet-Oechsle, Morgan CPO, BOM-HIMCO Approvals; AMRO (approved June 23, 1998) (the "AMRO CPO Approval"); Allied Irish 1998 Approval; Dresdner CPO Order; Private Fund Modification Letters; Bayerische Vereinsbank, 73 Fed. Res. Bull. 155 (1987). See also, e.g., FRBC Crédit Agricole 1996 Letter; Board Staff Opinion (Dec. 15, 1981), Fed. Res. Reg. Serv. ¶ 4-611.

(c) The Board's view of the ability of a BHC subsidiary to broker shares of advised funds has evolved.

i. Board Staff Opinion, dated June 27, 1986 (the "Sovran Letter"), stated that BHC subsidiaries may broker mutual fund shares. Compare Letter, dated Jan. 17, 1986, from Board Associate General Counsel Mattingly (BHC must broker shares of at least 30 funds from at least five different sponsors and receive no compensation from the funds).

Board Legal Division Memorandum, dated Aug. 21, 1996 (the "Sovran Repeal"), stated that the restrictions in the Sovran Letter -- that employees would not receive commissions, the BHC would provide no investment advice regarding the securities brokered, and the BHC would not exercise investment discretion or purchase securities for its own account -- “either have been effectively superseded or no longer appear necessary”.

ii. With respect to BHC subsidiaries providing full service brokerage to customers in respect of shares of an advised fund, the Board’s position moved from (A) prohibition (see, e.g., Bank of New England, 74 Fed. Res. Bull. 700 (1988)), to (B) ambiguity (see, e.g., Letters to First Chicago Corp., dated Apr. 10, 1989, to PNC, dated Mar. 14, 1989, and to CB&T Bancshares, dated Feb. 27, 1989), to (C) permitting BHC subsidiaries to provide brokerage (but not advisory) services to customers in respect of funds advised by bank affiliates (see, e.g., Dauphin Deposit Corp., 77 Fed. Res. Bull. 672 (1991); Fleet, 76 Fed. Res. Bull. 459, 672 (1990); HSBC, 76 Fed. Res. Bull. 770 (1990); Citicorp, 76 Fed. Res. Bull. 666 (1990); Chemical, 76 Fed. Res. Bull. 662 (1990); Bank of Tokyo, 76 Fed. Res. Bull. 654 (1990); Norwest 1990 Order (collectively, the “Board Initial Fund Orders”)).

iii. In 1992, the Board revised Section 225.125 to allow BHCs to provide brokerage and advisory services regarding investment companies for which the BHC or any of its bank or non-bank subsidiaries acts as adviser if: (A) customers are cautioned to read the prospectus before investing; (B) it is disclosed that the shares are not (1) FDIC insured, or (2) deposits or obligations of, or endorsed or guaranteed by, any bank; and (C) the role of the company or an affiliate as fund adviser is disclosed. See 57 Fed. Reg. 30387 (July 9, 1992) (the "Board Mutual Fund Release"). See also Board SR Letter 94-53 (FIS) (Oct. 25, 1994) ("Board SR Letter 94-53"), CCH Fed. Banking L. Rep. ¶ 69-635.

However, the Board Mutual Fund Release states that a BHC that participates in a brokerage/advisory joint venture, and such joint venture, are not relieved of any limitation on their ability to provide services in connection with investment companies sponsored, advised, distributed or controlled by the co-venturer. See also Part I.D.1 above. But see BNP, 80 Fed. Res. Bull. 638 (1994) (the "BNP-Neuberger Order").

In revising Section 225.125(h), the Board did not, as requested in public comments (55 Fed. Reg. 25849 (June 25, 1990)), clarify that a BHC may distribute prospectuses and sales literature in respect of mutual funds, and that sales representatives and fund advisers may receive a portion of the sales commission ("load") upon the sale of fund shares. See Board Staff Memorandum, Apr. 20, 1992.

However, the Interagency Statement, the Sovran Repeal and the Board Administrative Orders referred to in Part VIII.C.1.c.vi below appear to contemplate such powers.

iv. Board Staff Opinion (June 5, 1986), Fed. Res. Reg. Serv. ¶ 4-655.1, sanctioned exclusive arrangements between a BHC subsidiary and a distributor of investment company shares. An SIA suit to block Schwab's participation in the arrangement was dismissed on procedural grounds, and, in light of Bank of America's sale of Schwab, became moot. SIA v. Board, No. 86-2768 (D.D.C., Oct. 27, 1986), appeal docketed, No. 86-5667 (D.C. Cir., Nov. 3, 1986), dismissed as moot, June 25, 1987.

v. Chase had submitted an Application to the Board (the "Chase Mutual Fund Application") to sponsor, distribute and advise mutual funds through a subsidiary. The Board was reportedly of the view that Chase would (by its sponsoring and advising activities) "control" the funds. Chase subsequently withdrew the Application. Letter, dated June 24, 1987. See Part III.B.5 above.

(d) The Mellon-TBC Order approved Mellon's Application under BHCA § 4(c)(8) to acquire TBC, which provided institutional trust and custody, administrative and investment management services. Mellon agreed (i) to discontinue sponsoring mutual funds, (ii) not to acquire TBC subsidiaries engaged in fund distribution, and (iii) to limit investments of any closed-end fund it sponsored, organized or controlled to less than 5% of the voting shares. See also Board Letter to Rep. Dingell, May 19, 1993, responding to Letter, dated May 3, 1993.

The provision of administrative services to mutual funds is a separate "activity" for purposes of BHCA § 4. See, e.g., Banco Latinoamericano de Exportaciones (approved Oct. 4, 2007) (provision of administrative services to a closed-end fund; a separate notice would be required to provide such services to a mutual fund); First Financial Bancorp (approved Apr. 8, 2002); UniCredito Italiano, 86 Fed. Res. Bull. 825 (2000); Board Mutual Fund Control Precedents; First Union, 63 Fed. Reg. 6192 (Feb. 6, 1998) (solicitation of public comments) (approved Mar. 16, 1998); U.S. Bancorp-Piper Jaffray Order; BankAmerica, 84 Fed. Res. Bull. 858 (1998); Dresdner-RCM Order (and see 61 Fed. Reg. 7004 (Feb. 23, 1996) (solicitation of public comments); Board

Letter to Dresdner, Aug. 13, 1999 (relaxing commitments made in the Dresdner-RCM Order)); Barclays Order (as modified by the Barclays 2001 Letter); Chase, 81 Fed. Res. Bull. 883 (1995); Carbon County Holding Co., 81 Fed. Res. Bull. 501 (1995); State Street, 81 Fed. Res. Bull. 297 (1995); Investors Financial Services Approval (all of the foregoing, the "Board Administrative Orders").

Appendix B enumerates the administrative services and related activities approved in the Board Administrative Orders, as well as the interrelationship between such Orders and other statutory and regulatory overlays.

(e) Board Orders discussed in Part II.D.2 above address the combination of services/investments respecting private and other funds.

(f) The Board's approach to "supermarket fees" is described in Part VIII.C.1.b.ii.B above.

(g) A BHC may provide consulting services to funds, performance measurement systems for pension funds, accounting software, targeted market research and industry studies, and investment strategies to pension funds. Deutsche Bank, 65 Fed. Reg. 2414 (Jan. 14, 1999) (approved Feb. 7, 2000) (acquisition of Intersec Development Corp.) (the "Deutsche Bank-Intersec Approval").

(h) Board Letter, Jan. 30, 2003, concludes that mutual fund administration is a financial activity usual in connection with the transaction of the business of banking or other financial operations abroad for purposes of Regulation K. See also U.S. Bank (approved Nov. 6, 2013); Board Letter, Mar. 30, 2007; Part XI.B below. Compare Letter to FRBB re State Street Bank, dated Jan. 29, 2007 (requesting Regulation K approval to engage in fund administration activities).

iii) Selected Federal Deposit Insurance Corporation Precedents

(a) With respect to the provision of full service brokerage respecting mutual fund shares (including bank receipt of Rule 12b-1 and other compensation in connection with the brokerage of UIT and fund shares), see, e.g., FDIC Advisory Opinion No. 94-30 (Feb. 17, 1994), CCH Fed. Banking L. Rep. ¶ 81,753; No. 87-13 (Sept. 15, 1987) ("Letter No. 87-13"), CCH Fed. Banking L. Rep. ¶ 81,104; No. 87-6 (June 16, 1987), CCH Fed. Banking L. Rep ¶ 81,050; No. 86-34 (Nov. 21, 1986), CCH Fed. Banking L. Rep. ¶ 81,090; No. 86-18 (June 12, 1986) ("Letter No. 86-18"); No. 84-20 (Nov. 1, 1984), CCH Fed. Banking L. Rep. ¶ 81,089; No. 83-21 (Dec. 9, 1983) ("Letter No. 83-21"), CCH Fed. Banking L. Rep. ¶ 81,015; No. 83-14 (Oct. 11, 1983), CCH Fed. Banking L. Rep. ¶ 81,159; FDIC General Counsel Opinion No. 6, 48 Fed. Reg. 22989

(May 23, 1983) ("FDIC Opinion No. 6").

(b) Dual employees of the bank and a broker-dealer may sell mutual fund shares on the premises of a state non-member bank. FDIC Advisory Opinion No. 97-74 (Oct. 29, 1992) ("Opinion No. 92-74"), CCH Fed. Banking L. Rep. ¶ 81,562. See also, e.g., FDIC Advisory Opinion No. 92-48 (July 16, 1992) ("Opinion No. 92-48"), CCH Fed. Banking L. Rep. ¶ 81,535

(c) The Wilmington Trust Letter (see Part I.D.6.b.ii.C above) indicated that the FDIC had no objection to a subsidiary of a state non-member bank acting as a distributor of mutual fund shares. See also, e.g., FDIC Advisory Opinion 88-24 (Mar. 16, 1988), CCH Fed. Banking L. Rep. ¶ 81,067.

F) Purchases as Principal or Fiduciary; "Principal-protected Funds"

Federal bank regulators have provided guidance as to whether and under what circumstances a bank/BHC may purchase shares of an advised fund for its own account or on a discretionary basis for trust or other fiduciary accounts, or may guarantee fund performance. See also, e.g., Trust Assets: Investment of Trust Assets in Bank Proprietary Mutual Funds (GAO, Mar. 1995). See generally Part VIII.C.1.c.viii and Part VIII.C.2.k below.

Dodd-Frank affects the ability of FHCs, BHCs and banks to invest in Volcker Rule-defined "covered funds" (but such restrictions do not apply to other funds or collective investment vehicles). See Part II.A.7 above.

i) <u>Selected Comptroller of the Currency Precedents</u>

In connection with investments of national bank <u>proprietary</u> or <u>fiduciary</u> assets in mutual funds, <u>see</u> <u>generally</u> Comptroller's Handbooks: <u>Asset Management</u>, Collective Investment Funds, <u>Conflicts of Interest</u> and <u>Retail Sales of Non-deposit Investment Products</u>.

(a) 12 C.F.R. § 9.12 ("<u>Section 9.12</u>") -- the "no self-dealing rule" -- Comptroller interpretations and Section 23A limit a national bank's <u>investment of fiduciary assets in advised funds</u> to instances where the trust instrument, a court order or state law authorizes the investment. <u>See</u>, <u>e.g.</u>, Letter No. 525; Comptroller Trust Interpretation No. 234 (Sept. 21, 1989), CCH Fed. Banking L. Rep. ¶ 83,072. <u>Compare</u> Letter No. 256 (marketing limited partnership interests to trust customer non-discretionary accounts does not involve a conflict of interest where bank receives no fee from the partnership).

i. Section 9.12 extends to investments of trust assets in mutual funds advised by an <u>unaffiliated</u> entity in which a bank director (who also serves on the bank's trust committee) has a 5.23% interest. Comptroller <u>Report of the Ombudsman 1995-1996</u> at 56.

ii. A bank bears the burden of establishing an exception to the prohibition. Comptroller Trust

Interpretation No. 259 (June 18, 1991), CCH Fed. Banking L. Rep. ¶ 83,303.

(b) A national bank may invest trust assets in mutual funds that pay the bank fees for administrative services without reducing the bank's trust account compensation when the arrangement is authorized by state law and is consistent with the underlying trust instrument, and disclosures required by local law are made. Comptroller Interpretive Letter No. 704 (Oct. 30, 1995), CCH Fed. Banking L. Rep. ¶ 81-019.

(c) A national bank may charge fees in its dual role as trustee of trust assets invested in, and adviser to, an advised fund, subject to compliance with authorization and disclosure requirements. See, e.g., Comptroller Unpublished Letter (Jan. 3, 1992); Comptroller Trust Interpretations No. 270 (Nov. 24, 1989), CCH Fed. Banking L. Rep. ¶ 83,438; No. 242 (Dec. 15, 1989), CCH Fed. Banking L. Rep. ¶ 83,085; No. 235 (Sept. 21, 1989), CCH Fed. Banking L. Rep. ¶ 83,073; No. 217 (May 18, 1989), CCH Fed. Banking L. Rep. ¶ 83,033.

In Packard v. Provident National Bank, 994 F.2d 1039 (3d Cir.) (vacating Upp v. Mellon Bank, 799 F. Supp. 540 (E.D. Pa. 1992)), cert. denied, 510 U.S. 964 (1993), the District Court, applying Pennsylvania law, had ordered the Bank to reimburse trust accounts for "unreasonable sweep fees" in connection with funds in which it had an interest, and awarded punitive damages for "especially egregious" conduct. The Court of Appeals vacated the decision. An action alleging federal law claims for violation of 12 C.F.R. § 9.15 (for excessive fees) and 1934 Act Rule 10b-5 (for failing to make adequate disclosure) was dismissed; the Court held that no private right of action exists under 12 U.S.C. § 92a/93 and that the securities laws were inapplicable. Simpson v. Mellon Bank, CCH Fed. Sec. L. Rep. ¶ 98,027 (E.D. Pa. 1993). See also In re Fidelity Bank Trust Fee Litigation, 839 F. Supp. 318 (E.D. Pa. 1993), aff'd, 43 F.3d 1461 (3d Cir. 1994); In re Corestates Trust Fee Litigation, 39 F.3d 61 (3d Cir. 1994).

(d) A national bank may invest CIFs in proprietary and non-proprietary funds from which it receives servicing fees if such arrangements are permissible under state law, the governing trust instrument and Section 9.18(b)(9). Comptroller Interpretive Letter No. 722 (Mar. 12, 1996), CCH Fed. Banking L. Rep. ¶ 81-037. The Comptroller had previously taken the position that it would be a conflict of interest for a bank to receive fees in connection with investment of trust assets in funds, but that decision was based in part on the fact that the bank maintained "no (or at best, insignificant) additional records", so the fees were considered unearned. Comptroller Trust Interpretation No. 237 (Oct. 30, 1989), CCH Fed. Banking L. Rep. ¶ 83,077.

A national bank may include in a management fee to a CIF which it administers the cost of a publication analyzing investments of a type in which the CIF is designed to invest. Comptroller Investment Securities Letter No. 48 (May 3, 1990), CCH Fed. Banking L. Rep. ¶ 83,261.

A national bank may place funds held in a fiduciary capacity in bank-managed STIFs unless otherwise prohibited by applicable law. Comptroller Interpretive Letter No. 969 (Apr. 28, 2003), CCH Fed. Banking L. Rep. ¶ 81-494.

(e) With respect to the receipt by trustees of ancillary benefits related to the investment of fiduciary moneys in funds, Comptroller Banking Circular No. 233 (Feb. 3, 1989), CCH Fed. Banking L. Rep. ¶ 58,715, reminded national banks of the principles of Section 9.12 (and state fiduciary laws) which prohibit banks from receiving financial benefits for particular investments. Comptroller News Release, Jan. 6, 1990, indicates enforcement of this prohibition in one case by requiring banks which received discounts on computer services in return for fund purchases to reimburse trust customers. However, a national bank trustee is not per se prohibited from accepting a financial benefit from a mutual fund complex. Comptroller Interpretive Letter No. 558 (Apr. 3, 1991), CCH Fed. Banking L. Rep. ¶ 83,309.

The Comptroller disallowed arrangements whereby banks received computer services from fund distributors or sponsors even though the banks had not invested trust assets in the funds. See, e.g., Comptroller Interpretive Letters No. 521 (Jan. 30, 1990), CCH Fed. Banking L. Rep. ¶ 83,232; No. 520 (Jan. 30, 1990), CCH Fed. Banking L. Rep. ¶ 83,231; Comptroller Trust Interpretation No. 214 (May 4, 1989), CCH Fed. Banking L. Rep. ¶ 83,025.

However, Comptroller Unpublished Letter (July 1, 1983) approved the investment of trust assets in funds where the funds' distributor provided an automated order entry system (which included a sweep feature).

The Comptroller might object to a bank receiving credits from a fund sponsor for investment of custodial assets in the fund, even though the credits would not apply to fiduciary funds invested. Comptroller Interpretive Letter No. 519 (Jan. 12, 1990), CCH Fed. Banking L. Rep. ¶ 83,230. See also, e.g., Comptroller Trust Interpretation No. 221 (May 15, 1989), CCH Fed. Banking L. Rep. ¶ 83,052 (advice on a bank trust department receiving benefits based on investment of agency and/or trust cash balances in funds).

The Comptroller has also expressed conflict of interest concerns in related contexts. See, e.g., OCC Bulletin 2007-7 (Feb. 5, 2007), CCH Fed. Banking L. Rep. ¶ 35-562R (use of commission payments by fiduciaries); Comptroller

Report of the Ombudsman 1995-1996 at 60 (objecting to a bank's agreement with an unaffiliated broker to split commissions for non-discretionary accounts where the bank would direct discretionary trust transactions to the broker for a flat fee); Comptroller Trust Interpretation No. 273 (Sept. 25, 1992), CCH Fed. Banking L. Rep. ¶ 83,442 (rescinding policy set out in Comptroller Trust Circular No. 23 (Oct. 4, 1983) which had permitted banks to effect brokerage transactions for trust accounts with affiliated brokers on a non-profit basis); Comptroller Trust Interpretation No. 277 (Aug. 17, 1993), CCH Fed. Banking L. Rep. ¶ 83,515 (conflict of interest for a dividend reinvestment plan administrator to place securities transactions with an affiliated broker); Comptroller Unpublished Letter (Mar. 4, 1992) (conflict of interest where broker that executes transactions for bank fiduciary accounts pays rent to bank based on commissions earned); Comptroller Unpublished Letter (Feb. 25, 1992) (trustee must reimburse trust accounts for amount saved by trustee when trustee received research in exchange for directed brokerage trades); Comptroller Investment Securities Letter No. 33 (Dec. 6, 1988), CCH Fed. Banking L. Rep. ¶ 83,039 (discussing permissibility of trust department directing securities trades to affiliated broker); Comptroller Unpublished Letter (Sept. 22, 1988) (conflict of interest where discretionary accounts pay higher commission because broker provides advice to bank that is used for all bank clients); Comptroller Trust Interpretive

Letter No. 6 (Jan. 2, 1986) (conflict of interest for bank trust department to use broker if bank shares commissions).

(f) A national bank may invest as principal in shares of an advised fund if (i) the bank invests only in securities in which the bank could invest directly, and (ii) the bank's decisions to purchase fund shares are independent of its brokerage/advisory services. Comptroller Interpretive Letter No. 386 (June 10, 1987) ("Letter No. 386"), CCH Fed. Banking L. Rep. ¶ 85,610.

See also, e.g., Comptroller Sweep Precedents; Letter No. 403.

(g) A national bank may provide "seed money" to a closed-end fund if the fund invests in assets that the bank may hold directly. Approval No. 164.

(h) Under the Comptroller Fund Investment Precedents, a national bank may provide seed money to, or acquire non-controlling interests in, funds that hold bank-ineligible securities as part of the bank's fund management function. A national bank may also hedge with equity-linked derivatives the market risk associated with the fees it receives from its investment advisory activities. See Part II.D.3.a.ii.A, Part II.E.3.e.iii and Part VII.A.4 above.

(i) Letter No. 1010 provides that a national bank may issue a "financial warranty" to investors in the context of a principal-protected advised fund; the Comptroller characterized the guarantee as one that investment structuring advice and monitoring services will perform as described. See also Principal-Protected Funds -- Security Has a Price (NASD, Mar. 27, 2003).

(j) Letter No. 1047 provides that a national bank may sponsor a closed-end private investment company advised by an affiliate of the bank. Where the fund's underlying portfolio consists of bank eligible investments, a national bank may purchase shares in the fund up to an aggregate of 1% of the bank's capital and surplus.

ii) Selected Federal Reserve Board Precedents

(a) In Section 225.125(g), the Board originally took the position that a BHC should not (i) purchase for its own account securities of an advised fund, (ii) purchase such securities in its sole discretion in a fiduciary capacity, (iii) lend to an advised fund, or (iv) accept shares of an advised fund as collateral for a loan to a customer for the purpose of purchasing such shares.

(b) In 1996, the Board amended Section 225.125(g) to permit BHCs and their bank and non-bank subsidiaries to purchase, in a fiduciary capacity, securities of an advised fund if authorized by the instrument creating the fiduciary relationship, by court order or by applicable law. 61 Fed. Reg. 45873 (Sept. 6, 1996).

(c) Board SR Letter 99-7 (Mar. 26, 1999), CCH Fed. Banking L. Rep. ¶ 37-053, provides guidance to banks that receive fees or other incentives to place trust/fiduciary assets with particular funds or that place such assets with funds managed by the bank or an affiliate. In determining whether such arrangements constitute a conflict of interest, the Board requires a bank to obtain a legal opinion, to establish policies governing the acceptance of compensation from fund providers and the use of proprietary funds, and to document the basis for investment decisions.

(d) The Regulation Y 1997 Revisions amended Section 225.125 to delete the prohibition on ownership by a BHC of shares of an advised fund, since the Board determined that the investment limitations in BHCA § 4 mitigate potential conflicts of interest. See also, e.g., Investors Financial Services Approval. Compare, e.g., Mellon-Dreyfus Order (rejecting the proposition that a Mellon subsidiary could continue to act as non-managing general partner to two funds so long as the funds limited their investments to those that would comply with § 4(c)(7) (see 59 Fed. Reg. 23066 (May 4, 1994) (solicitation of public comments)) with Board Orders referred to in Part II.D.2 above (permitting BHC subsidiary to act as general partner to investment partnerships, so long as partnership investments comply with the BHCA).

(e) The Regulation Y 1997 Revisions deleted prohibitions on a BHC lending to an advised fund or accepting shares of an advised fund as collateral for a loan to a customer that is for the purpose of purchasing such shares.

(f) The First Union Letter sets out circumstances under which BHCs may provide seed money to advised funds:

i. No such fund would own more than 5% of the voting securities of any company.

ii. A majority of directors of each such fund would be independent.

iii. Each such fund would be part of an established family of funds, and First Union would not hold a significant amount of the voting shares of these other funds.

iv. Because the shares of all funds in each family would be aggregated for purposes of voting for fund directors, the voting shares acquired would always constitute a de minimis percentage of the total shares voted for directors, and First Union's shares would be voted in the same proportion as the shares voted by other shareholders.

v. First Union would reduce its interest in each fund to below 25% of total voting shares within 6 months after the fund begins issuing shares.

vi. First Union's objective in providing seed money would be to facilitate the provision of investment services.

vii. Each fund would have an independent distributor.

(g) Board staff have indicated informally that it is not clear that BHCA § 4(c)(7) -- which permits a BHC to purchase "shares of an investment company which . . . is not engaged in any business other than investing in securities . . ." (emphasis added) -- would permit a BHC to purchase shares of an investment company which invests in financial futures (or other non-securities) even if such futures are purchased as an incident to investment in securities, or only for hedging purposes.

It should be possible, however, in reliance on 12 C.F.R. § 225.123, to combine a BHCA § 4(c)(8) investment authorization (e.g., 12 C.F.R. § 225.28(b)(8)) with an authorization under BHCA § 4(c)(7).

(iii) Selected Federal Deposit Insurance Corporation Precedents

A) Investments by a state non-member bank as principal could be permissible as a federal law matter under circumstances discussed in Part I.D.4 above.

B) A bank trust department may share in commissions paid to an affiliated broker for securities transactions respecting trust accounts if authorized in the trust instrument. FDIC Advisory Opinion No. 83-17 (Nov. 3, 1983), CCH Fed. Banking L. Rep. ¶ 81,014.

Bank trustees may receive "rebates" from 12b-1 funds used as investments for fiduciary accounts if disclosure and other requirements are met. See FDIC Memorandum to Regional Directors, dated Aug. 8, 1984.

Customer authorization alone would not necessarily remove conflicts of interest where a bank employs its brokerage department to effect transactions on behalf of trust accounts and receives a fee. Rather, any self-dealing must be disclosed, authorized by all interested parties and beneficiaries or by court order, and consistent with applicable law. FDIC Advisory Opinion No. 85-10 (May 21, 1985), CCH Fed. Banking L. Rep. ¶ 81,115. See generally Wilmington Trust Letter (bank would not invest administered employee benefit accounts in advised and distributed funds and would invest discretionary personal accounts only with prior approval).

See also, e.g., 12 C.F.R. § 337.4(e); FDIC Trust Examination Manual §§ 3 (Asset Management) and 8 (Conflicts of Interest, Self-dealing and Contingent Liabilities).

c. Disclosure and Related Concerns Respecting Investment Company Operations and Sales of Investment Company Shares by and through Banking Organizations

(i) Customer Confusion and Regulatory Focus

A) Regulators have focused on the potential for consumer confusion regarding mutual fund and other security sales. See, e.g., Wall St. J., July 28, 2014 (OCC inquiry into JP Morgan potentially steering private banking clients to its investment products) NASD/MSRB 2006 Joint Statement; Prudential Securities, SEC Admin. Proc. No. 3-11174 (July 10, 2003) (complaint relating to allegedly inadequate systems to monitor sales of, and disclosures regarding, different classes of mutual fund shares);

Bank Mutual Funds: Improvements in Risk Disclosure Needed (GAO, June 26, 1996); Bank Mutual Funds: Sales Practices and Regulatory Issues (GAO, Sept. 1995); Comptroller Investment Securities Letter No. 61 (Dec. 31, 1991), CCH Fed. Banking L. Rep. ¶ 83,334 (advertising complaint).

B) Issues can arise as to the qualification of bank salespeople with respect to funds, the adequacy of their supervision, the nature of fund advertising, the quality of disclosure about the relationship between the bank and fund products, and the propriety of sales practices relating to "follow up trading".

C) OCC examiners have reportedly scrutinized bank sales practices with respect to proprietary funds. See American Banker, July 8, 2013.

D) Issues with respect to privacy-related issues are discussed in Part I.C.5 above, and with respect to conflicts of interest and related matters are discussed in Part VIII.C.1.b above and Part VIII.C.2 and Part IX.E below.

(ii) Interagency Statement and Related Developments

A) The Interagency Statement covers the retail sale of funds and other investment products by, in or from banks. The Statement requires a bank (or third parties on bank premises) to (i) disclose the uninsured nature of, and the risks of investing in, funds; (ii) obtain a written acknowledgment that the customer understands the disclosures; (iii) sell funds in a location physically distinct from deposit activities; (iv) train sales personnel, including with respect to suitability determinations; (v) ensure that tellers do not engage in sales activities or receive incentive compensation; (vi) structure incentive compensation to minimize the risk that sales personnel would recommend unsuitable investments; and (vii) develop policies that ensure compliance with the Statement. See also Interagency Joint Release, dated Sept. 12, 1995, Fed. Res. Reg. Serv. ¶ 3-1579.52 (interpretations of the Statement); Comptroller's Handbook: Retail Sales of Non-deposit Investment Products; Comptroller News Release No. 94-88 (Sept. 19, 1994); Comptroller News Release No. 93-120 (Nov. 7, 1993); FDIC FIL-64-94 (Sept. 27, 1994), CCH Fed. Banking L. Rep. ¶ 70-117; FDIC FIL-53-94 (July 20, 1994); FDIC Memorandum, dated Apr. 28, 1994 (Examination Procedures for Banks Involved with the Sale of Non-deposit Investment Products).

B) In the Joint Release of the Board/OCC/FDIC/NASD, dated Jan. 3, 1995 (the "Regulatory Coordination Agreement"), the federal banking agencies and FINRA agreed to share information from examinations of bank-affiliated broker-dealers that sell non-deposit investment products on bank premises. In addition, an SEC/Comptroller MOU, dated June 12, 1995, provides for joint examinations of bank-advised funds and of national banks that provide fund investment services.

C) The Joint Forum has issued a consultative document proposing changes to point of sale disclosures, in part to address perceived divergences among the banking, securities and insurance sectors. Point of Sale Disclosure in the Insurance, Banking and Securities Sectors (Joint Forum, Apr. 2014).

See also Part I.D.6 above and Part IX.E below.

(iii) Fund Names

A) The Interagency Statement prohibits non-deposit products from having the same name as the bank and warns against customer confusion where the product has a similar name.

B) The Regulation Y 1997 Revisions removed a prohibition, originally included in Section 225.125, on a BHC acting as investment adviser to a fund which has a name similar to that of the BHC or any of its subsidiary banks, subject to the requirements that (1) the fund name not be identical to that of the BHC or bank; (2) the fund name not include the word "bank"; and (3) the BHC or fund provide written disclosures that shares of the fund are not insured and are not obligations of or guaranteed by any bank, and disclose the role of the BHC as a fund adviser.

The Board previously permitted a BHC to advise a fund which contained the BHC's name. See Board Letter re Firstar Corp., Sept. 2, 1997 (permitting a Firstar non-bank subsidiary to act as investment adviser to "The Firstar Funds").

C) The Comptroller has also permitted similar names. Compare, e.g., Comptroller Interpretive Letter No. 637 (Sept. 17, 1993), CCH Fed. Banking L. Rep. ¶ 83,522 (assuming proper sales activities, similar name acceptable), with Comptroller Interpretive Letter No. 619 (Oct. 14, 1992), CCH Fed. Banking L. Rep. ¶ 83,501 (expressing concern over common name).

D) The Volcker Rule prohibits banks and bank affiliates from sharing a name with "covered funds" that they sponsor or advise. See Part II.A.7 above.

E) NSMIA § 208 grants the SEC authority to identify investment company names or titles, or names or titles of securities that investment companies issue, as materially deceptive. The SEC has said that advertisements by an advised fund using the same or a similar name as that of the adviser bank are presumptively misleading, although the presumption can be rebutted through prominent disclosure. See, e.g., John D. Dingell/Bank Mutual Fund Names (avail. June 2, 1993) (listing funds with a name similar to that of the adviser bank). NASD Notice to Members No. 95-49 (June 1995) reminds members that advertisements or sales literature that uses a non-member's name or logo must make clear the relationship of the entities and not be misleading.

1940 Act Rule 35d-1 relates to the use of fund names to identify the principal focus of certain funds, generally requiring a fund whose name indicates a particular type of investment to invest 80% of its assets in that type of investment. See SEC Release No. IC-24828 (Jan. 17, 2001). See also SEC Division of Investment Management Release: [FAQ] about Rule 35d-1 (Investment Company Names) (Dec. 26, 2001).

F) The SEC has advised mutual funds and other investment companies that expose investors to significant market risks to use a name and advertising terms that lessen the potential for investor misunderstanding. Some terms highlighted as possible sources of misunderstanding include "protected" and "guaranteed," especially when such terms are used without qualifying language. See Division of Investment Management, SEC Guidance Update, No. 2013-12 (Nov. 2013).

(iv) Integration of Commercial Banking and Sales Cultures

Because of differences in compensation structure and views regarding employee autonomy, some banks have difficulty integrating money management, brokerage and mutual fund sales operations with their commercial banking/trust department culture.

See Part I.C and Part III.A.2 above and Part IX.E below.

(v) Personal Trading

Attention has been called to the guidelines and controls applicable to fund managers, including the extent to which ethical codes address insider trading and potential conflicts of interest where investment personnel trade in the same securities as funds. See, e.g., Comptroller Interpretive Letter No. 1062 (Apr. 24, 2006), CCH Fed. Banking L. Rep. ¶ 81-591 (permitting bank officers/employees who make investment recommendations or decisions to report their personal transactions in securities to the bank within 30 days after the end of the calendar quarter (consistent with SEC 1940 Act Rule 17j-1), rather than within 10 business days after the end of the calendar quarter (as provided in 12 C.F.R. § 12.7(a)(4)); SEC Release No. IA-2256 (July 2, 2004) (final rule regarding personal securities transactions by employees of registered investment advisers); SEC Guidance Update No. 2015-03 (June 2015); SEC v. Scott, SEC Litigation Release No. 18428 (Oct. 28, 2003) (personal account trading of managed funds); An Investment Company's Guide to Oversight of Codes of Ethics and Personal Investing (ICI, July 2000); Alliance Capital Management, SEC Admin. Proc. No. 3-9301 (Apr. 28, 1997) (censure and fine for failure to supervise personal trades); Gabelli & Co., SEC Release No. 34-35057 (Dec. 8, 1994) (inadequate insider trading policies); Personal Investment Activities of Investment Company Personnel (SEC Division of Investment Management, Sept. 1994); Report of the Advisory Group on Personal Investing (ICI, May 9, 1994); Drafting Guides for Codes of Ethics and Procedures to Prevent Insider Trading (ICI, Sept. 19, 1993).

See also Part IX.E below.

(vi) Certain Compensation-related Issues

A) Prior guidance on incentive compensation to bank/BHC employees may be useful in considering the application of the Interagency Statement. (See also Part I.A.6.a.v above and Part IX.E below.) Such guidance includes:

i) Comptroller: Letters No. 541; No. 533; No. 499; Comptroller Interpretive Letters No. 441 (Feb. 17, 1988), CCH Fed. Banking L. Rep. ¶ 85,665; Comptroller Interpretive Letters No. 408 (Aug. 4, 1987) ("Letter No. 408"), CCH Fed. Banking L. Rep. ¶ 85,632; No. 407; No. 406; No. 386; No. 85 (Apr. 3, 1979), CCH Fed. Banking L. Rep. ¶ 85,161.

ii) Board: Letter to TransFinancial, dated Oct. 19, 1996; Sovran Repeal.

iii) FDIC: Opinions No. 92-74, No. 92-48; Letters No. 89-02, No. 87-13, No. 86-18, No. 83-21.

B) The NASD requested comment on proposals to amend its Rule 2830 (Investment Company Securities) to (1) prohibit higher payment for the sale of proprietary products; (2) prohibit single security sales contests (i.e., arrangements that offer incentives for a specified level of sales); and (3) require disclosure of accelerated payout arrangements for salespersons who change firms. NASD Notice to Members No. 99-81 (Sept. 1999). In 2011, FINRA proposed to adopt NASD Rule 2830 as FINRA Rule 2341, with significant changes, but FINRA withdrew the proposed rule. See 76 Fed. Reg. 26779 (May 9, 2011).

See also Part VIII.C.2 and Part IX.E below.

(vii) "Tying" Issues

The Board reserved judgment on whether an advised fund is affiliated with its adviser for purposes of the Anti-tying Statute. Compare Fleet, 80 Fed. Res. Bull.

1134 (1994) (silent on the matter) with 59 Fed. Reg. 9216 (Feb. 25, 1994) (solicitation of public comments), 59 Fed. Reg. 29667 (Aug. 4, 1994). See also Part III.A.4 above.

(viii) Derivatives and Fund "Bailouts"; Valuation Issues

A) Dodd-Frank § 619 prohibits banks and their affiliates from assuming the obligations of, or entering into covered transactions with, hedge funds and private equity funds sponsored by the bank or its affiliates, but does not restrict transactions with mutual funds and other registered investment companies. See also Interagency Policy on Banks/Thrifts Providing Financial Support to Funds Advised by Banking Organizations (Jan. 5, 2004); Board SR Letter 94-53; Board Letter to Rep. Gonzalez, Oct. 17, 1994 (accompanied by Board Staff Paper: Financial Support Provided to Proprietary Money Market Funds by [BHCs]), responding to Letter, dated Sept. 29, 1994.

B) In December 2015, the Basel Committee on Banking Supervision issued a consultative document proposing a conceptual framework for identifying, assessing and addressing "step-in" risk (or the risk that banks would provide financial support to certain entities beyond any contractual obligation to do so) potentially embedded in banks' relationships with shadow banking entities, including securitization vehicles, money market and other investment funds and asset managers. The consultative document requests input with respect to indicators of "step-in" risk, including reputational risk, "sponsorship", branding, overall structure of the shadow banking entity and major economic dependence of the entity on the bank. The consultative document does not propose specific capital requirements, but suggests that such a measurement could be included under Pillar 1 or 2 capital requirements. See "Consultative Document: Identification and measurement of step-in risk" (Basel Committee on Banking Supervision, Dec. 2015).

C) The SEC has addressed the propriety of mutual fund advisers purchasing securities from the fund, or otherwise making cash infusions into the fund to maintain the fund's quality and rating. Several no-action letters have permitted such support. See, e.g., Northwestern Mutual Series Fund (avail. Feb. 19, 2009), Hartford Mutual Funds (avail. Feb. 19, 2009), ING (avail. Feb. 19, 2009), Principal Funds (avail. Feb. 19, 2009), Tamarack Funds (avail. Feb. 19, 2009) (in each case, granting no-action relief where money market fund sought to execute a support agreement with an affiliate to avoid "breaking the buck" during economic crisis); Allianz Dresdner Daily Asset Fund (avail. May 5, 2008); SEI Daily Income Trust (avail. Nov. 9, 8, 2007); STI Classic Funds (avail. Oct. 26, 2007). See also Letter from SEC Chairman Levitt to Rep. Markey and Fields, dated Sept. 26, 1994 (accompanied by SEC Staff Study: Mutual Funds and Derivative Instruments), responding to Letter, dated June 14, 1994; SEC Letter, dated Aug. 25, 1994 (listing money market funds that sought assurance that SEC staff would not recommend enforcement action if an affiliate purchased securities from the fund); PaineWebber Capital (avail. Aug. 4, 1994); ICI (avail. June 30, 1994). See generally Report of the Task Force on Investment Company Use of Derivatives and Leverage (Am. Bar Assoc. Section of Business Law Committee on Federal Regulation of Securities, July 6, 2010).

D) The SEC conducted a review of the use of derivatives by mutual funds, ETFs and other investment companies, including an examination of disclosures in fund-related documents. The SEC viewed as inadequate both "highly abbreviated" generic disclosures and lengthy, technical disclosures regarding an array of potential derivatives transactions. See SEC Letter to the ICI, dated July 30, 2010 (Derivatives-related Disclosures by Investment Companies). See also Oppenheimer Funds, SEC Admin. Proc. No. 3-14909 (June 6, 2012) (settlement of allegations that Oppenheimer failed adequately to disclose use of leverage through derivatives); SEC Release No. 2011-175 (Aug. 31, 2011) (seeking public comment on use of derivatives by mutual funds and other investment companies); SEC Release 2010-45 (Mar. 25, 2010).

E) In 2013, the SEC's Division of Investment issued guidance regarding disclosure and compliance matters for investment companies that invest in derivatives. See SEC Division of Investment Management, Guidance Update No. 2013-05 (Aug. 2013).

F) The SEC has also started to change its approach to regulating the use of derivatives and other transactions that give rise to leverage under Section 18 of the 1940 Act. In December 2015, the SEC proposed new Rule 18f-4, which would impose new exposure limits, asset segregation requirements and compliance obligations on registered investment companies and business development companies that enter into derivative transactions. See 80 Fed. Reg. 80884 (Dec. 28, 2015).

G) The Comptroller and the SEC each fined a portfolio manager for causing advised funds to sell derivative securities to common trust funds and a trust department custody account at inflated prices in order to avoid recognizing losses. Michael Traba, SEC Admin. Proc. No. 3-9788 (Aug. 19, 1999); Comptroller Stipulation and Consent Order No. 99-58 (May 1, 1999).

H) Fund valuation and related issues remain a continuing area of regulatory focus.

i) When it adopted 1940 Act Rule 38a-1 (SEC Release No. IC-26299 (Dec. 17, 2003)), the SEC stated that a fund must (a) monitor circumstances that may necessitate the use of fair value pricing (as opposed to market prices); (b) establish criteria for determining when market quotations are not reliable; (c) establish a valuation methodology; and (d) regularly review the appropriateness and accuracy of the methods used. See generally SEC Valuation and Liquidity Guidance for Registered Investment Companies (ICI, 2009); Peer Review of Regulation of Money Market Funds: Final Report (IOSCO, Sept. 2, 2015); An Introduction to Fair Valuation (ICI, Spring 2005).

ii) In Alderman, Blair, et al., SEC Admin. Proc. No. 3-13847 (June 13, 2013), a settled order concluded that fund directors delegated their valuation responsibility to a committee without providing sufficient guidance on how to conduct fair valuations.

iii) In Karpus v. Gerken, Index No. 603984/05 (NY Sup. Ct., May 10, 2006) (order approving settlement), Index No. 05603984 (NY Sup. Ct., Nov. 9, 2005) (complaint), Citigroup closed-end funds and their directors were sued for allegedly breaching fiduciary duties by letting the funds trade at discounts to the value of their underlying assets, despite language in offering documents indicating that the boards would consider actions to reduce or eliminate those discounts.

iv) Springer Investment Management, SEC Admin. Proc. No. 3-12052 (Sept. 21, 2005), represents a settled proceeding for misrepresenting the performance of a hedge fund by inflating the value of privately-held stock in which the fund invested.

v) A BHC subsidiary pleaded guilty to securities fraud and paid restitution to Japanese investors of more than $565 million for inflating the net asset value of a fund. See U.S. v Republic NY Securities Corp., No. 1:01CR 01180-(01) (RCC) (SDNY Jan. 10, 2002) (judgment). The SEC revoked the subsidiary's broker-dealer registration and the CFTC revoked its registration as a CTA and FCM. See SEC Release No. 34-45157 (Dec. 17, 2001); CFTC Docket No. 02-03 (Dec. 17, 2001).

(ix) Divestiture of Asset Management Businesses

A) OCC Bulletin No. 2008-5 (Mar. 6, 2008) provides guidance regarding the potential risks of a national bank's divestiture of asset management businesses.

The OCC identified several issues with divestitures that could result in a bank placing its interests ahead of the interests of fiduciary customers.

i) Transactions that include financial incentives to the bank which sells its adviser or fund assets raise potential conflict of interest issues since they could influence a bank's investment decisions and lead to a potential compromise of fiduciary duties. Examples of terms that raise concerns include:

(a) Payments and ongoing financial incentives to maintain or increase the AUM in successor funds paid both at deal closing and over specified future time periods.

(b) Non-compete clauses and penalties for declines in AUM that result from future mergers or acquisitions by either the bank or its affiliates that include a fund family.

(c) Purchaser payment of transaction costs contingent upon maintenance of specific AUM levels.

(d) Revenue sharing arrangements in which the purchaser pays fund level fees to the seller in order to induce the seller to retain assets in the funds (including 12b-1 fees, shareholder servicing fees, marketing allowances and administrative fees).

ii) Transactions with ineffective planning, due diligence, risk controls and implementation processes raise concerns and could include the following:

(a) Lack of a comprehensive plan to address applicable considerations, including:

i. Engagement of bank counsel too late in the process.

ii. Overreliance by selling banks on advice of counsel from the purchasing adviser and fund complex.

iii. Inadequate or untimely information and disclosures to client-directed accounts that prevent account holders from voting their proxies on an informed basis.

iv. Failure to obtain affirmative consents from clients who exercise sole or shared investment discretion.

(b) Due diligence performed by the bank or the selling affiliate that focuses on a single purchaser rather than soliciting competing offers.

(c) Post-transaction due diligence processes for selecting, maintaining and eliminating investments for fiduciary accounts that appear to be unduly influenced by financial incentives in the transaction.

(d) Failure to provide timely and effective employee training about the divestment and its impact on customers.

iii) The OCC expects national banks that contemplate divestiture of affiliated funds and advisers to evaluate the risks associated with these transactions and to implement controls, both pre-transaction (including independent advice, due diligence, consent solicitation and similar controls) and post-transaction (including ensuring that post-divestiture investment decisions are not compromised by financial incentives to retain fiduciary assets with the successor adviser or funds).

See also Part II.E.2.e above.

B) In ING National Trust, the OCC approved a divestiture by a national bank trust company of its retirement plan services business through a combination of asset transfer, reduction of capital and merger transactions. See Comptroller Conditional Approval No. 1106 (Aug. 11, 2014).

2. Certain Securities Law and Related Considerations Applicable to Asset Management Services

Although it is not a principal purpose of this Guide to address comprehensively securities law-related considerations and requirements applicable to the operation of asset management businesses, among the key securities law considerations applicable to asset management services that raise important strategic and reputational issues (see also Part VIII.B above and Part IX.E below) are the following:

a. Legislative and Regulatory Developments

(i) With respect to the operation and regulation of investment advisers and investment funds, see, e.g., U.S. Regulation of International Securities Markets, Chapters 17 and 18; IA Watch, Sept. 3, 2015, June 23, 2014; Investment Company Fact Book (ICI, 2014); Evolution Revolution – A Profile of the Investment Adviser Profession (National Regulatory Services/Investment Adviser Assoc., 2013). See also Part VIII.C.2.d below (SEC-Rand Corporation study).

(ii) The Volcker Rule restricts the ability of banks and their affiliates to sponsor or invest in private equity funds and hedge funds. In order for a bank to sponsor or invest in such funds pursuant to the de minimis exception in the Rule, the bank must comply with certain restrictions on the bank and the fund sharing a name, bank employee investments in the fund, and material conflicts of interest between the bank and its clients, customers or counterparties. The Volcker Rule also prohibits banks and their affiliates from entering into covered transactions with private equity and hedge funds advised or managed by the bank or its affiliates. See Part II.A.7 above.

(iii) NSMIA:

A) Preempted certain state laws with respect to securities issuances by registered 1940 Act investment companies.

B) Established exemptions for "private investment companies" (whose securities are held by an unlimited number of "qualified purchasers").

C) Granted the SEC rulemaking authority to identify registered investment company names or titles, or names or titles of securities that investment companies issue, as materially deceptive. See Part VIII.C.1.c.iii above.

D) Provided for the coordination of federal and state regulation of investment advisers and divided supervisory responsibility between the SEC and the states.

See, e.g., "Realtime Investor Protection Act", Pub. L. 109-290 (2006) (investors' access to regulatory and disciplinary records of brokers, dealers and investment advisers); GLB Act §§ 211 et seq. (amendments to 1940 Act and the Advisers Act); SEC Letter to NASAA, dated Apr. 8, 2011 (Dodd-Frank's requirement for mid-sized investment advisers to register with states, and repeal of Advisers Act private adviser exemption); Remarks of SEC Director Richards, Feb. 27, 2006 (the "Richards 2006 Remarks").

See also Part VIII.C.2.a.iv.B below.

(iv) Dodd-Frank Title IV:

A) Requires hedge funds and other private funds to register with the SEC, establishes new exemptions from SEC registration and reporting requirements for certain advisers, and reallocates regulatory responsibilities for oversight of advisers between the

SEC and state regulators. See Dodd-Frank §§ 403, 410; CFTC/SEC Release No. IA-3308 (Oct. 31, 2011) (joint final rules for reporting by investment advisers to private funds and certain CPOs and CTAs) ("Private Fund Reporting Rule"); SEC Release No. IA-3221 (June 22, 2011) (final registration rule) ("Private Fund Registration Rule"). See also NASAA Press Release, Nov. 29, 2011 (coordinated review program for investment advisers that switch from federal to state oversight). See generally M&A Law Report, Mar. 18, 2013; SEC FAQs: Form PF (Mar. 8, 2013); IA Week, July 20, 2012; Remarks of SEC OCIE Director di Florio, May 2, 2012.

i) More than 1,500 hedge fund and private fund advisers have registered with the SEC since Dodd-Frank became effective. SEC Press Release 2012-214 (Oct. 19, 2012).

ii) In 2011, the SEC/CFTC issued a joint release adopting new reporting requirements for advisers to hedge funds and other private funds. See Private Fund Reporting Rule; Reporting by Investment Advisers to Private Funds and Certain CPOs and [CTAs] on Form PF: A Small Entity Compliance Guide (SEC, Jan. 5, 2012). In Am. Bar. Assoc. (avail. Jan. 18, 2012), the SEC staff advised that they would not recommend enforcement action against an investment adviser that files (or amends) a single Form ADV (the "filing adviser") on behalf of itself and each other adviser that is controlled by or under common control with the filing adviser that is registering through a single registration with the filing adviser (each, a "relying adviser") where the filing adviser and each relying adviser collectively conduct a single advisory business. A proposed rule regarding umbrella registration for affiliated private fund advisers was released in May 2015. See SEC Release No IA-4091 (May 20, 2015).

B) Exempts from registration advisers to certain privately offered investment funds, including advisers who solely advise venture capital funds and advisers with AUM in the U.S. of less than \$150 million. See Dodd-Frank §§ 407, 408; Private Fund Registration Rule. See also Model Rule for Registration Exemption for Investment Advisers to Private Funds (NASAA, Dec. 16, 2011); IA Week, Dec. 9, 2013.

C) Delegates to the states regulatory responsibility over mid-sized advisers who have between \$25 million and \$100 million AUM. As a result, the number of SEC-registered advisers decreased by more than 2,000 between 2011 and 2012. See 77 Fed. Reg. 65234 (Oct. 25, 2012).

D) Excludes "family offices" from the Advisers Act definition of investment adviser. See Dodd-Frank § 409; 76 Fed. Reg. 37983 (June 29, 2011) (final rule).

See also Part IX.C below.

(v) Dodd-Frank Title VII imposes new requirements on CTAs and amended the definition of CTA in the CEA to include any person who engages in the business of advising others on swaps. See Dodd-Frank §§ 701-774. See generally CFTC Advisory No. 13-79 (Dec. 23, 2013) (guidance on new Dodd-Frank obligations of CTAs).

(vi) Dodd-Frank Title IX:

A) Mandates an SEC study and report evaluating the need for enhanced examination and enforcement resources for investment advisers.

The Study concluded in 2011 and advised that the SEC likely will not have sufficient capacity to conduct effective exams of investment advisers with adequate frequency. It recommended that Congress consider: (i) imposing user fees on SEC-registered advisers; (ii) authorizing one or more SROs to examine SEC-registered advisers (subject to SEC oversight); or (iii) authorizing FINRA to examine dual broker-dealer/investment adviser registrants for compliance with the Advisers Act. See Dodd-Frank § 914; Study on Enhancing Investment Adviser Examinations (SEC, Jan. 2011). See also Investment Adviser Oversight: Economic Analysis of Options (Boston Consulting Group, Dec. 2011) (industry-funded analysis of the three options recommended in the Study). See generally Part I.B above; Economic consequences of the U.S. Dept. of Labor's Proposed New Fiduciary Standard, (Financial Services Institute Report, Aug. 2015).

B) Mandates an SEC study and recommendations evaluating ways to improve investors' access to registration information about registered and previously registered investment advisers (including disciplinary history), and identifying additional information that should be made publicly available. See Dodd-Frank § 919B; Study and Recommendations on Improved Investor Access to Registration Information About Investment Advisers and Broker-dealers (SEC, Jan. 2011). See generally Part IX.B.1.c below.

C) Authorizes the SEC to impose penalties on those who "knowingly or recklessly" aid or abet a violation of the Advisers Act or any rule thereunder. See Dodd-Frank § 929N; see generally Part IX.B.1.c below.

D) Establishes an Office of the Investor Advocate within the SEC, and an associated Ombudsman, to represent the interests of retail investors in matters relating to the SEC and self-regulatory organizations. See Dodd-Frank §§ 915, 919D.

E) Mandates an SEC study and report evaluating financial literacy among retail investors and recommending improvements to financial disclosure timing, content and format, and potential educational strategies to improve financial decision making. See Dodd-Frank § 917; Financial Literacy Among Retail Investors in the United States (Library of Congress / SEC, Dec. 30, 2011).

F) Mandates a Comptroller General study and report evaluating the effectiveness of, and offering recommendations regarding, state and federal regulation of financial planners. See Dodd Frank § 919C; Regulatory Coverage Generally Exists for Financial Planners, but Consumer Protection Issues Remain (GAO, Jan. 2011).

G) Authorizes the SEC to restrict the use of agreements that require customers or clients of an investment adviser to arbitrate any further disputes with the investment adviser arising under federal securities laws, rules thereunder or the rules of an SRO. See Dodd-Frank § 921. To date, no such rules have been proposed or adopted.

See also Part IX.E.3.c below.

(vii) Recent areas of compliance interest with respect to investment advisers/investment companies include (A) protections for retail and retirement investors, with a focus on fee selection, sales practices, and suitability, (B) conflicts of interest related to compensation, and allocation of expenses and investment opportunities, (C) recordkeeping and documentation; (D) personal trading, (E) valuation policies, (F) business continuity planning, (G) compliance policies, (H) due diligence practices, (I) cybersecurity, (J) treatment of whistleblowers, (K) liquidity risk management, and (L) the annual contract review.

See, e.g., IA Watch, Sept. 10, Sept. 3, July 17, Apr. 23, 2015; SEC OCIE Examination Priorities for 2015 (Jan. 13, 2015); Banking Daily, Oct. 21, May 6, 2014; SEC Letter to Senior Executives and Principals of a Registered Investment Adviser, dated Feb. 20, 2014; SEC OCIE (Sept. 15, June 22, 2015, Jan. 28, 2014, Aug. 27, 2013); State News, Oct. 14, 2013; Cutting Through the Confusion (NASAA, July 30, 2013); IA Week, Nov. 25, May 13, 2013, July 2, Mar. 19, 2012; Senior Designations for Financial Advisers (CFPB, Apr. 18, 2013); Compliance Reporter, Oct. 21, Jan. 28, 2013; NASAA Enforcement Report (Oct. 2012); SEC Investment Management Staff Issues of Interest; Securities Research: Additional Actions Could Improve Regulatory Oversight of Analyst Conflicts of Interest (GAO, Jan. 2012); SEC Letter to Chief Compliance Officers, dated Jan. 17, 2012; SEC OCIE National Examination Risk Alert (Jan. 4, 2012); Remarks of SEC OCIE Director di Florio, Mar. 21, Feb. 8, 2011.

See also Coordinated Investment Adviser Examinations (NASAA, 2013); Enforcement Report (NASAA, Oct. 2012); NASAA Offers Best Practices to Enhance Compliance (NASAA, Oct. 3, 2011) (revised) (addressing advisers' compliance procedures: (A) reviewing and updating disclosure (including Form ADV); (B) reviewing and updating customer contracts; (C) maintaining and backing up books and records; (D) maintaining client profiles; (E) maintaining a written compliance manual and privacy policy; (F) calculating and documenting fees; (G) reviewing and revising advertisements; (H) implementing custody safeguards; and (I) reviewing solicitor agreements and procedures); Investment Adviser Association Standards of Practice (Feb. 28, 2006) (including (i) fiduciary duty and professional responsibility; (ii) professional qualifications; (iii) responsible and ethical business practices; (iv) fair, reasonable and fully disclosed compensation; and (v) accurate, balanced communications with clients and the public).

(viii) In 2012, the SEC's Division of Investment Management issued guidance to CFTC-registered advisers about the ability of advisers to private funds to rely on the exemption from SEC registration in Advisers Act § 203(b)(6), as amended by Dodd-Frank. Investment Management Staff Issues of Interest, Nov. 15, 2012.

(ix) Advisers Act Rule 206(4)-7 requires advisers to adopt and implement policies designed to prevent violations of the Act and to review the policies' effectiveness. 1940 Act Rule 38a-1 requires funds to adopt policies to prevent violations of federal securities laws and to annually review the policies' effectiveness. See SEC Division of Investment Management Guidance Update (May 2013).

(x) In 2014, Barclays paid a $15 million penalty for failing to adopt and implement written compliance policies and procedures reasonably designed to prevent violations of the Advisers Act with respect to its wealth management business (acquired from Lehman Brothers). Barclays Capital, SEC Release No. 34-73183 (Sept. 23, 2014).

See also, e.g., SEC Press Release 2013-226 (Oct. 23, 2013) (penalties on three investment firms for repeated failure to improve their compliance programs and heed previous SEC warnings); Feltl & Co., SEC Admin. Proc. No. 3-14645 (Nov. 28, 2011) (failure to implement adequate compliance program); Asset Advisers, SEC Admin. Proc. No. 3-14644 (Nov. 28, 2011) (same); OMNI Investment Advisers, SEC Admin. Proc. No. 3-14643 (Nov. 28, 2011) (same); Assessing the Adequacy and Effectiveness of a Fund's Compliance Policies and Procedures (ICI, Dec. 2005); Remarks of SEC Associate Director Gohlke, May 5, 2005 (duties of chief compliance officer).

(xi) In 2013, the SEC announced that it had entered into supervisory arrangements with 25 EU and three other member-state regulators to improve oversight over cross-border asset management firms. SEC Press Release 2013-131 (July 19, 2013).

b. Director Independence, Codes of Ethics, Compliance Programs and Related Policies and Procedures

(i) The SEC adopted rules aimed at improving investment company governance and investment adviser and investment company compliance programs. See, e.g., SEC Release No. IC-26985 (June 30, 2005) ("Release No. IC-26985"), addressing on remand SEC Release No. IC-26520 (July 27, 2004) (requiring (by a 3-2 vote) certain funds to satisfy governance standards that (A) at least 75% of the directors of the fund be independent, (B) the chairman of the board be independent, (C) the board perform a self-assessment at least annually, (D) independent directors meet at least once a quarter, and (E) independent directors be authorized to hire their own staff (collectively, the "SEC Director Independence Requirement"), and addressing the role of fund directors); SEC Releases No. IC-26492 (July 2, 2004) (investment adviser codes of ethics); No. IA-2204 (Dec. 17, 2003) (compliance programs for investment companies/advisers).

See also, e.g., Corporate Counsel, July 10, 2014; Risk Principles for Fund Directors: Practical Guidance for Fund Directors on Effective Risk Management Oversight (Mutual Fund Directors Forum, Apr. 2010); Board Oversight of Fund Compliance (ICI/Independent Directors Council, Sept. 2009); Overview of Fund Governance Practices (ICI/Independent Directors Council, 2006); Director Oversight of Multiple Funds (ICI/Independent Directors Council, May 2005); Implementing the Independent Chairperson Requirement (ICI/Independent Directors Council, Jan. 2005); Best Practices for Investment Adviser Codes of Ethics (ICAA, July 20, 2004). See generally ICI (avail. Feb.

12, 2002) (clarifying aspects of the independent counsel requirement); SEC Release No. IC-24083 (Oct. 13, 1999) (independent director issues under the 1940 Act).

A) Chamber of Commerce v. SEC, 412 F.3d 133 (D.C. Cir. 2005), had directed the SEC to reconsider the SEC Director Independence Requirement as adopted in 2004 after finding that the SEC violated rule-making procedures by failing to take into account how much the reforms would cost the industry. Release No. IC-26985 followed the Court's decision and was challenged by Chamber of Commerce v. SEC, Civ. Action No. 05-1240 (D.C. Cir., July 7, 2005 (petition for review)). By a 2-2 vote, the SEC refused to stay the SEC Director Independence Requirement pending resolution of the litigation. The Court, however, did grant a stay (D.C. Cir., Aug. 10, 2005).

B) See generally Chamber of Commerce v. SEC, 443 F.3d 890 (D.C. Cir. 2006). See also SEC Release No. IC-27600 (Dec. 21, 2006); SEC Status Report (June 13, 2006).

(ii) With respect to investment company director independence issues and related matters, see, e.g., Board Oversight of Subadvisers (ICI/Independent Directors Council, Jan. 2010); Board Self-assessments: Seeking to Improve Mutual Fund Board Effectiveness (ICI/Independent Directors Council, Feb. 2005); Best Practices and Practical Guidance for Mutual Fund Directors (Mutual Fund Directors Forum, July 2004); Mutual Fund Independent Directors: A Model for Corporate America (ICI, 2003); SEC Release No. 34-48745 (Nov. 4, 2003) (definition of "independence" for directors and increased requirements for board/committee independence); Report of the Advisory Group on Best Practices for Fund Directors: Enhancing a Culture of Independence and Effectiveness (ICI, June 24, 1999; amended Oct. 7, 2003).

The SEC Staff Report Concerning Examinations of Select Pension Consultants (May 16, 2005) describes the results of the SEC's examination of pension consultants who are registered investment advisers relating to the consultants' products and services, method of compensation, disclosures to clients and conflict of interest-related concerns. Under circumstances where U.S. retirement market assets grew to $23 trillion in 2012 (see ICI Fact Book (ICI, 2014)), pension consulting is growing in importance.

c. Special Conflict of Interest Concerns

Conflicts of interest relating to investment company operations raise significant regulatory concerns. They arise (i) among clients, (ii) between clients and the adviser, and (iii) between clients and the adviser's staff. See generally IA Week, Dec. 16, 2013. See also Part VIII.C.1 above and Part IX.E below.

In 2016 there were significant changes to rules governing Advice Fiduciaries in order to reduce potential conflicts of interest in retirement planning. See, e.g., Final DOL Fiduciary Rule; White House Retirement Report; SIFMA-released White Paper on DOL Retirement Regulation (Mar. 16, 2015); Review of the [White House Retirement Report] (NERA, Mar. 15, 2015).

(i) "Pay-to-Play"

The SEC finalized a rule designed to address "pay-to-play" arrangements -- political contributions by investment advisers made to obtain or retain contracts with government entities. The rule is modeled on rules that apply to municipal securities dealers (see Part II.B above). 75 Fed. Reg. 41018 (July 14, 2010).

(ii) "Portfolio Pumping"

Oechsle International Advisers, SEC Admin. Proc. No. 3-10554 (Aug. 10, 2001), and ABN AMRO, SEC Admin. Proc. No. 3-10552 (Aug. 10, 2001), relate to "portfolio pumping"/"window dressing"; i.e., transactions by a money manager near the end of a fiscal period of stocks held in an advised fund in an attempt to improve the fund's performance.

(iii) "Switching"

Norwest Investment Services, SEC Admin. Proc. No. 3-10706 (Feb. 20, 2002), censured "mutual fund switching"; i.e., redemption by money managers of one fund and purchase of shares in another fund in order to impose redemption costs where the benefit does not justify the costs.

(iv) Proxy Voting and Other Disclosure Issues

A) Under NYSE Rule 452, brokers may not vote uninstructed proxies for uncontested elections of directors, but investment companies are exempt. See SEC Release No. 34-60215 (July 1, 2009). See also "Proxy Voting by Registered Investment Companies; Promoting the Interests of Fund Shareholders", ICI Research Perspective (July 2008); Oversight of Fund Proxy Voting (ICI/Independent Directors Council, July 2008); Corporate Shareholder Meetings: Issues Relating to Firms That Advise Institutional Investors on Proxy Voting (GAO, June 2007).

B) The SEC addressed the ability of advisers to follow recommendations of independent third-party proxy advisory firms in two no-action letters in 2004. See Institutional Shareholder Services (avail. Sept. 15. 2004); Egan-Jones Proxy Services (avail. May 27, 2004). Some commentators have recently criticized the ability of investment advisers to "outsource" their voting responsibilities. See, e.g., M&A Law Report, Dec. 17, 2012 (quoting former SEC Chairman Pitt).

C) In Deutsche AM (see Part VII.C.9.d above), the SEC instituted an enforcement proceeding against an investment adviser for failing to divulge a conflict of interest in its voting of client proxies and for intervening in the proxy voting process.

D) The SEC's Divisions of Investment Management and Corporation Finance issued staff guidance addressing investment advisers' responsibilities in voting client proxies and retaining proxy advisory firms. See SEC Staff Legal Bulletin No. 20 (June 30, 2014), CCH Fed. Sec. L. Rep. ¶ 60,020. SEC Commissioner Gallagher has been an outspoken critic of investment adviser reliance on proxy advisory firms. See, e.g., Gallagher, "Outsized Power & Influence: The Role of Proxy Advisers" (Washington Legal Foundation, Aug. 2014). See generally IA Watch, Dec. 9, 2013 (reporting on SEC roundtable on role of proxy advisers).

(v) "Late Trading" and "Market-timing"

A) Regulators and law enforcement agencies focused on "late trading" (i.e., the purchase of mutual fund shares after the market closes, but at the closing price, which allows an investor to take advantage of post-market closing events not reflected in the market closing price) and "market-timing" (i.e., "in and out" trading designed to exploit market inefficiencies when the net asset value of the fund shares does not reflect the value of the fund's assets). Administrative and judicial proceedings have been brought against funds themselves, traders and financial intermediaries. Funds, in turn, have brought private actions against law firms which advised them on trading practices. See generally Best Practices Standards on Anti-market Timing and Associated Issues for CIS [Collective Investment Schemes] (IOSCO, Oct. 2005).

B) With respect to administrative and judicial proceedings:

i) Reaching beyond U.S. borders, Pentagon Asset Management, SEC Litigation Release No. 20516 (Apr. 3, 2008), involved a civil action filed against a UK-based hedge fund adviser alleging a scheme to defraud U.S. mutual funds and their shareholders through late trading and market timing. In 2012, a U.S. District Court ruled that the SEC had failed to establish liability for the fund's market timing because the SEC had failed to adopt specific market timing rules and practices for funds. SEC v. Pentagon Cap. Mgmt., 844 F. Supp. 2d 377 (SDNY 2012), aff'd, No. 12-1680-cv (2d Cir., Aug. 8, 2013). See also Part XI below.

ii) Bank of America/Banc of America Securities Written Agreements, dated Feb. 9, 2005 (terminated Feb. 27, 2007), with the OCC and the Board regarded allegations that favored clients were allowed to engage in market timing and late trading in fund shares. See also Bank of America/Banc of America Capital Management, SEC Admin. Proc. No. 3-11818 (Feb. 9, 2005); NY v. Sihpol, Indictment No. 1710/2004 (Sup. Ct. NY Co., Mar. 20, 2004) (verdict in favor of Sihpol, June 9, 2005); SEC Press Release 2004-33 (Mar. 15, 2004); SEC Admin. Proc. No. 3-11261 (Sept. 16, 2003).

iii) Funds and traders settled SEC and other enforcement actions, and paid significant penalties, with respect to late trading/market timing, and class actions alleged that mutual fund companies violated their duties to shareholders by permitting these transactions. See, e.g., actions with respect to the following firms (and/or their employees): Pritchard Capital Partners (VanCook v. SEC, 653 F.3d 130 (2d Cir. 2011), cert. denied, 132

S. Ct. 1582 (2012)); Southwest Securities (SEC v. Gann, 565 F.3d 932 (5th Cir. 2009)); Simpson Capital Management (SEC v. Simpson Capital Management, 586 F. Supp. 2d 196 (SDNY 2008)); Oppenheimer & Co. (FINRA News Release, Feb. 21, 2008); Ritchie Capital Management (SEC Admin. Proc. No. 3-12947 (Feb. 5, 2008); NY Attorney General Assurance of Discontinuance, Feb. 4, 2008); Chronos Asset Management (SEC Admin. Proc. No. 3-12934 (Jan. 25, 2008)); Morgan Stanley (SEC Admin. Proc. No. 3-12907 (Dec. 18, 2007)); Rafferty Capital Markets (FINRA Press Release, Nov. 29, 2007); Evergreen (SEC Admin. Proc. No. 3-12805 (Sept. 19, 2007)); Haidar Capital Management (SEC Admin. Proc. No. 3-12678 (July 6, 2007)); Putnam Investment Management (SEC Litigation Release No. 20141 (June 4, 2007)); SEC Press Release 2005-26 (Mar. 3, 2005); SEC Admin. Proc. No. 3-11317 (Apr. 8, 2004)); A.G. Edwards (SEC Admin. Proc. No. 3-12624 (May 2, 2007)); Kaplan & Co. Securities (SEC Admin. Proc. No. 3-12509 (Dec. 18, 2006)); Deutsche Bank Securities (NYSE Hearing Board Decision No. 06-157 (Dec. 18, 2006)); Prudential Securities (SEC v. Druffner, Civ. Action No. 03-12154-NMG (D. Mass., Oct. 17, 2006) (final judgment) (D. Mass., July 14, 2004) (complaint)); MetLife Securities (NASD Press Release, Sept. 19, 2006); JB Oxford Holdings/National Clearing Corp. (SEC Litigation Releases No. 19641 (Apr. 5, 2006), No. 18850 (Aug. 25, 2004)); Bear Stearns (SEC Admin. Proc. No. 3-12238 (Mar. 16, 2006)); Security Brokerage (SEC Litigation Release No. 19526 (Jan. 10, 2006)); Veras Investment Partners (SEC Admin. Proc. No. 3-12133 (Dec. 22, 2005)); Ameriprise Financial (SEC Admin. Proc. No. 3-12114

(Dec. 1, 2005)); Millennium Partners (SEC Admin. Proc. No. 3-12116 (Dec. 1, 2005), No. 311292 (Oct. 2, 2003); NY v. Millennium Partners (complaint / assurance of discontinuance, Nov. 29, 2005)); Federated Investment Management (SEC Admin. Proc. No. 3-12111 (Nov. 28, 2005); NY Attorney General Assurance of Discontinuance (Nov. 28, 2005)); First Allied Securities (NASD Press Release, Oct. 3, 2005); Janney Montgomery Scott (NASD Press Release, Oct. 3, 2005); ING (NASD Press Release, Oct. 3, 2005); Ehrenkrantz King Nussbaum (SEC Litigation Release No. 19410 (Sept. 30, 2005)); Legg Mason Wood Walker Inc. (SEC Admin. Proc. No. 3-12048 (Sept. 21, 2005)); Merrill Lynch (NYSE Hearing Panel Decision No. 05-27 (Mar. 7, 2005)); Brean Murray & Co. (SEC Admin. Proc. No. 3-11836 (Feb. 17, 2005)); Columbia Management Advisers/Funds Distributor (SEC Admin. Proc. No. 3-11814, 3-11815, 3-11816, 3-11817 (Feb. 9, 2005)); SEC Litigation Release No. 18590 (Feb. 24, 2004)); Banc One Securities Corp. / Investment Advisers (NASD News Release, Jan. 12, 2005; SEC Admin. Proc. No. 3-11530 (June 29, 2004); NY Attorney General Assurance of Discontinuance, June 29, 2004)); Fremont Investment Advisers (SEC Press Release 2004-153 (Nov. 4, 2004)); Franklin Resources / Franklin Advisers (Mass. Docket No. E 2004-0044 (Oct. 25, 2004), No. E-2004-007 (Sept. 20, 2004); SEC Admin. Proc. No. 3-11572 (Aug. 2, 2004)); Invesco Funds Group/AIM Advisers (SEC Admin. Proc. No. 3-11701 (Oct. 8, 2004)); NY/Colo. Attorney General Press Releases, Sept. 7, 2004; SEC Admin. Proc. No. 3-11619 (Aug. 30, 2004); SEC Litigation Release No. 18482 (Dec. 2, 2003)); TD Waterhouse

Investor Services (SEC Admin. Proc. No. 3-11669 (Sept. 21, 2004)); Schwab (SEC Admin. Proc. No. 3-11648 (Sept. 14, 2004)); PIMCO Advisers Fund Management (SEC Admin. Proc. No. 3-11645 (Sept. 13, 2004)); Harvey v. Allianz Dresdner Asset Management, No. C-54-04 (consent order and final judgment) (Sup. Ct. Essex Co., NJ, June 1, 2004); SEC Press Release 2004-61 (May 6, 2004)); National Securities Corp. (NASD Letter of Acceptance, Waiver and Consent, dated Aug. 2004); Janus Capital Management (SEC Admin. Proc. No. 3-11590 (Aug. 18, 2004); NY/Colo. Attorney General Press Releases, Apr. 27, 2004)); Conseco/Inversia (SEC Admin. Proc. Nos. 3-11578, No. 3-11579 (Aug. 9, 2004)) (market timing in variable annuities)); Pilgrim Baxter & Assoc. (SEC Admin. Proc. No. 3-11524 (June 21, 2004)); Davenport & Co. (NASD News Release No. 04-038, June 1, 2004 (market timing in variable annuities)); Strong Capital Management (SEC Admin. Proc. No. 3-11498 (May 20, 2004)); NY v. Strong Financial (judgment on consent) (Sup. Ct. NY Co., May 20, 2004)); Security Brokerage (SEC v. Calugar, SEC Litigation Release No. 18524 (Dec. 24, 2003)); and Alliance Capital Management (SEC Admin. Proc. No. 3-11350 (Dec. 18, 2003)).

iv) Proceedings have been brought against facilitators of fund trades as well. See, e.g., Zurich Capital Markets (SEC Admin. Proc. No. 3-12628 (May 7, 2007)); Veras Investment Partners v. Akin Gump, No. 07600340 (NY Sup. Ct., Feb. 1, 2007) (complaint alleging that legal advice facilitated market-timing), discontinued with prejudice (NY Sup. Ct., Mar. 29, 2010); Prudential Equity Group (SEC Litigation

Release No. 19813 (Aug. 28, 2006), NY Attorney General Assurance of Discontinuance (Aug. 24, 2006), NYSE Decision of 06-156 (Aug. 18, 2006)); Morgan Keegan & Co. (SEC Admin. Proc. No. 3-12177 (Feb. 8, 2006)); UBS Financial Services (NYSE Decision 06-5 (Jan. 12, 2006)); CIBC (SEC Admin. Proc. No. 3-11987 (July 20, 2005)) (financing customers' late trading and market timing, including through "swap transactions" which the SEC characterized as "sham loans"); NY v. CIBC (Assurance of Discontinuance) (Sup. Ct. NY Co., July 19, 2005)); SEC v. Security Trust Company, N.A. (SEC Litigation Releases No. 18653 (Apr. 1, 2004), No. 18479 (Nov. 25, 2003)); State Street Investment Services (NASD News Release, Feb. 19, 2004).

v) SEC Rule 22c-2 allows funds to impose a redemption fee, not exceeding 2% of the amount redeemed; the fee is intended to allow funds to recoup some of the costs incurred as a result of short-term trading strategies. See SEC Release No. IC-26782 (Mar. 11, 2005).

See generally, e.g., Rule 22c-2 and Information Provided by Certain Financial Intermediaries (avail. Feb. 1, 2007); Model Contractual Clauses for Rule 22c-2 (ICI/SIA, Dec. 2005).

vi) JCG v. First Derivative considered an allegation that JCM, which served as investment adviser to the Janus mutual funds, violated Rule 10b-5 because certain advised funds distributed prospectuses which stated that such funds prohibited market timing when in fact those funds permitted it to certain hedge funds. Shareholders of JCG, JCM's parent, sued, claiming that they lost money after the market timing practices were revealed and JCG was fined $325 million, JCM's assets under management decreased by $14 billion, and JCG's stock price dropped. The Supreme Court held that the fund adviser did not "make" a statement for purposes of Rule 10b-5 by preparing or publishing a statement on behalf of another, because the maker of a statement is the "person or entity with ultimate authority over the statement." In so holding, the Court reversed Wiggins v. JCG, 566 F.3d 111 (4th Cir. 2009), which had held that the plaintiffs' claims (including that JCM and JCG participated in the writing and dissemination of the prospectuses and that investors would have inferred that JCM drafted or at least approved the misleading statements) were sufficient to overcome a motion to dismiss.

(vi) "Breakpoint" Discounts

"Breakpoint discounts" are volume discounts applicable to front-end sales charges on certain mutual fund shares. The SEC/NASD determined that many investors did not receive correct breakpoint discounts on their mutual fund purchases. See, e.g., Wells Fargo Investors, FINRA Letter of Acceptance, Waiver and Consent No. 2008015651901 (Dec. 15, 2011); FINRA News Releases, Mar. 23, 2009 (25 broker-dealers), Feb. 18, 2009 (Robert W. Baird & Co.); NASD Press Release, Dec. 13, 2006 (Edward D. Jones & Co., RBC Dain Rauscher, Royal Alliance, Morgan Stanley); Oppenheimer & Co., NASD News Release, Jan, 9, 2006; SunTrust Securities, SEC Admin. Proc. No. 3-11924 (May 17, 2005); SEC Release No. IC-26464 (June 7, 2004); AXA, NASD News Release, Feb. 26, 2004; Wachovia Securities, SEC Admin. Proc. No. 3-11410 (Feb. 12, 2004); UBS, SEC Admin. Proc. No. 3-11407 (Feb. 12, 2004); Linsco/Private Ledger, SEC Admin.

Proc. No. 3-11401 (Feb. 12, 2004); Legg Mason Wood Walker, SEC Admin. Proc. No. 3-11398 (Feb. 12, 2004); American Express Financial Advisers, SEC Admin. Proc. No. 3-11395 (Feb. 12, 2004); SEC Press Release 2004-17 (Feb. 12, 2004) (SEC/NASD settlements with nine firms; SEC Press Release 2003-14-7 (Nov. 3, 2003); NASD Investor Alert (Nov. 3, 2003); SEC/NASD/NYSE Report of Examinations of Broker-dealers Regarding Discounts on Front-end Sales Charges on Mutual Funds (Mar. 2003).

(vii) Payments for "Preferred Marketing" / "Shelf Space" "Directed Brokerage"/ "Revenue Sharing"

A) The SEC and other regulators have settled enforcement actions against firms for preferred marketing/shelf space arrangements, such as "exclusivity agreements" (in which a fund pays a fee to a broker-dealer to have its funds marketed over other comparable investments), where firms failed to provide appropriate disclosures. Enforcement actions also have been brought against firms which conduct prohibited broker sales contests to promote the sale of selected funds. Arrangements in which a fund "directs trades" to a broker-dealer or financial planner that does not necessarily provide the fund with best execution have also been scrutinized. See, e.g., AmSouth (SEC Admin. Proc. No. 3-13230 (Sept. 23, 2008)); Edward D. Jones & Co. (Cal. Attorney General News Releases, Sept. 10, 2008, Dec. 20, 2004; SEC Admin. Proc. No. 3-11780 (July 13, 2007), No. 3-11769 (Dec. 13, 2004)); American Funds Distributors (FINRA Press Release, Apr. 30, 2008); Securities America (NASD Press Release, July 11, 2007); John Hancock Investment Management Services (SEC Admin. Proc. No. 3-12664 (June 25, 2007)); Deutsche Investment Management Americas (NY Attorney General Assurance of Discontinuance (Dec. 20, 2006), SEC Admin. Proc. No. 3-12442 (Sept. 28, 2006)); Hartford Investment Financial Services (SEC

Admin. Proc. No. 3-12476 (Nov. 8, 2006)); ING American Insurance Holdings (NASD Press Release, Aug. 9, 2006); Financial Network Investments (NASD Press Release, Aug. 9, 2006); American General Securities (NASD Press Release, Apr. 5, 2006); Ameriprise Financial Services (SEC Admin. Proc. No. 3-12115 (Dec. 1, 2005)); IFC Holdings et al. (7 other broker-dealers) (NASD Press Release, Oct. 10, 2005); Oppenheimer funds (SEC Admin. Proc. No. 3-12038 (Sept. 14, 2005)); American Express Financial Advisers (NH Bureau of Securities Regulation Settlement Agreement, July 15, 2005); Advantage Capital (NASD Press Release, June 8, 2005); Advest (NASD Press Release, June 8, 2005); Alliance Bernstein Investment Research (NASD Press Release, June 8, 2005); AXA (NASD Press Release, June 8, 2005); FSC Securities (NASD Press Release, June 8, 2005); H.D. Vest Investment Services (NASD Press Release, June 8, 2005); Linsco/Private Ledger (NASD Press Release, June 8, 2005); McDonald Investments (NASD Press Release, June 8, 2005); RBC Dain Rauscher (NASD Press Release, June 8, 2005); Royal Alliance Associates (NASD Press Release, June 8, 2005); Securities America (NASD Press Release, June 8, 2005); Sentra Securities (NASD Press Release, June 8, 2005); Spelman & Co. (NASD Press Release, June 8, 2005); SunAmerica Securities (NASD Press Release, June 8, 2005); Wells Fargo Investments (NASD Press Release, June 8, 2005); Citigroup Global Markets (SEC Admin. Proc. No. 3-11869 (Mar. 23, 2005)); Putnam Investment Management (SEC Admin. Proc. No. 3-11868 (Mar. 23, 2005)); Piper Jaffray (NASD Press Release, Feb. 22, 2005); American Funds Distributors (NASD Press Release, Feb. 16, 2005); Franklin-Templeton (SEC Admin. Proc. No. 3-11769 (Dec. 13, 2004)); Mass. Financial Services Co. (SEC Admin. Proc. No. 3-11450 (Mar. 31, 2004)); Morgan Stanley (SEC Admin. Proc. No. 3-11335 (Nov. 17, 2003)); NASD Press

Release, Sept. 16, 2003). See also Hamilton & Co. (avail. Apr. 21, 1995) (broker-dealer payments to pension plan trustees/fiduciaries in compensation for "directed brokerage"); Wall St. J., June 17, 2005 (financial planner conflicts of interest), Jan. 25, 2005 (Cerulli Assoc. Report on Impact of Preferred Marketing Arrangements).

B) Ulferts v. Franklin Resources, 567 F. Supp. 2d 678 (D.N.J. 2008), 554 F. Supp. 2d 568 (D.N.J. 2008), found that a fund manager and distributor had no duty to disclose shelf-space arrangements to fund shareholders. See also AIG Group Securities Litigation, 06 CV 1625 (JG) (EDNY, Sept. 20, 2007) (dismissing claims that advisers failed to disclose shelf-space arrangements).

C) SEC Release No. IC-28345 (July 30, 2008) requested comment on guidance to boards of directors of investment companies regarding oversight of the best execution obligations of investment advisers (including the conflicts of interest that may exist when an investment adviser uses an investment company's brokerage commissions to purchase services other than execution). To date, no further action has been taken.

(viii) "Kickbacks" and Gifts

In BISYS Fund Services, SEC Admin. Proc. No. 3-12432 (Sept. 26, 2006), a provider of administrative services settled allegations of kickbacks to mutual funds. See also AmSouth, SEC Admin. Proc. No. 3-13230 (Sept. 23, 2008) (enforcement action for accepting kickbacks in exchange for recommending BISYS' services to mutual fund trustees); Montoya v. ING Life Insurance, NY Civ. Action No. 07 CV 2574 (NRB) (SDNY Apr. 4, 2007) (complaint) (claiming that NY United Teachers Trust accepted payments from ING in exchange for recommending its funds to plan members) (since closed); Fidelity, NASD Press Release, Feb. 5, 2007 (acceptance of gifts by fund equity traders and supervisors).

(ix) Other Conflicts and Violations

Examples of other conflicts and violations include the following:

A) BlackRock Advisors, SEC Release No. IA-4065 (Apr. 20, 2015), settled charges that it failed to disclose a conflict of interest created by the outside business activity of one of its portfolio managers.

B) Wells Fargo Advisors, SEC Release No. 34-73175 (Sept. 22, 2014), settled charges that it failed to maintain adequate controls to prevent one of its employees from insider trading based on a customer's nonpublic information.

C) Focus Point Solutions, SEC Admin. Proc. No. 3-15011 (Sept. 6, 2012), settled charges involving alleged conflicts of interest stemming from an adviser's undisclosed revenue-sharing arrangements with related companies.

D) UBS, SEC Admin. Proc. No. 3-14699 (Jan. 17, 2012), settled charges that it improperly priced securities in three managed mutual funds.

E) Calpers, the California Public Employees' Retirement System, conducted an 18-month internal investigation of payments by money managers to firms that provide placement services, including a placement firm that was headed by a former Calpers board member and employed a former Calpers director and CEO. That firm received more than $50 million in fees for its efforts to secure Calpers business. The investigation concluded that several former top fund officials had acted in ways that were "inconsistent" with their responsibilities. See Wall St. J., Mar. 15, 2011, May 7, 2010.

F) Merrill Lynch, SEC Admin. Proc. No. 3-13357 (Jan. 30, 2009), settled charges that it misrepresented to clients the process by which it recommended individual fund managers and failed to disclose financial incentives.

G) Pax World Management, SEC Admin. Proc. No. 3-13107 (July 30, 2008), settled SEC charges that the adviser violated "socially responsible investing restrictions" in funds it advised.

H) Citigroup paid fines and restitution for supervisory and recordkeeping violations in connection with a ploy by more than 100 of its brokers to obtain waivers of mutual fund sales charges by falsely claiming that their customers were disabled. NASD Press Release, Aug. 10, 2006.

I) Brooks v. Wachovia Bank, No. 06-CV-955 (complaint) (E.D. Pa., June 1, 2006), made claims under the Securities Acts (for inadequate disclosure with respect to alleged conflicts of interest), as well as claims of breach of fiduciary duty and breach of contract, in respect of (1) the Bank's investment of fiduciary assets in proprietary funds, despite the alleged availability of other funds which had lower expenses; and (2) "sweep fees" for computerized transfer of funds within the accounts that are alleged to be unreasonable and to constitute "double dipping".

The claims were settled. 2007 U.S. Dist. LEXIS 68079 (E.D. Pa. 2007), aff'd, 312 Fed. Appx. 494 (3d Cir. 2009).

J) The NASD fined Merrill Lynch, Wells Fargo and Linsco for suitability and supervisory violations for recommending and selling Class B mutual fund shares to their customers without considering or adequately disclosing that an equal investment in Class A shares would have been more advantageous. NASD News Release, Dec. 19, 2005.

K) State Street Research settled charges that it improperly transferred redemption fees collected in connection with short-term trading in a State Street Fund to an affiliated distributor, rather than paying those fees to that fund as required by the fund's prospectus. SEC Release No. IA-2435 (Sept. 23, 2005).

L) Nevis Capital Management, SEC Admin. Proc. No. 3-11201 (Feb. 9, 2004), settled charges that Nevis allocated IPO shares to two of 105 clients. Unlike Nevis' other clients, one of the two recipients paid Nevis a performance-based fee of 20% of profits, and the other was a fund whose enhanced performance attracted new investors, and thus increased Nevis' management fees.

M) Jamison, Eaton & Wood, SEC Release No. IA-2129 (May 15, 2003), addressed an adviser's conflict of interest that arose when the adviser received client referrals from a broker-dealer and then used the broker-dealer to execute trades. Jamison failed to disclose that (1) clients paid higher commissions, (2) Jamison stood to gain by having its accounts execute trades through the broker-dealer, and (3) other brokerage options were available.

See also Part VIII.C.2.j below.

(x) Hedge Funds and Alternative Investments

Hedge funds and other alternative investment vehicles have become an increasingly important area of focus. See, e.g., GLG Partners, SEC Admin. Proc. No. 3-15641 (Dec. 12, 2013) (hedge fund adviser internal control failures that led to over-valuation of assets and inflated fee revenue); Remarks of SEC Enforcement Division Asset Management Unit Chief Karpati, Dec. 18, 2012 (outlining enforcement risks and summarizing recent cases).

See Part VIII.D below.

d. Certain Broker-dealer/Investment Adviser/Hedge Fund Adviser/Investment Company Registration and Related Issues

(i) The GLB Act eliminated the blanket exemption for banks from broker-dealer registration, requires investment adviser registration for advice to an SEC-registered investment company, and narrowed the 1940 Act exemption for common trust funds. See Part I.C, Part II.D, Part VIII.B.3 above and Part IX.B below.

(ii) Dodd-Frank exempted certain private fund advisers, foreign private advisers, mid-sized advisers and venture capital advisers from Advisers Act registration. At the same time, Dodd-Frank repealed the "15-client exemption" previously available to qualifying advisers. See Dodd-Frank §§ 403, 407, 408; SEC Release No. IA-3221 (July 18, 2011) (final rule), SEC Release No. IA-3222 (July 5, 2011) (final rule). See also Part VIII.C.2.a.iv above.

(iii) Issues can arise as to whether non-deposit (or limited deposit) trust companies are "banks" for purposes of the securities law exemptions applicable to banks or funds managed by banks. See, e.g., Reliance Trust Co. (avail. Mar. 29, 2005); Idaho First National Bank (avail. July 8, 1988); Provident Trust Co. (avail. Nov. 4, 1985); Bishop Trust Co. (avail. Apr. 25, 1985); Franklin Trust Co. (avail. Oct. 29, 1984).

(iv) Other registration issues:

A) In Jonathon Hendricks (avail. Jan. 26, 2015), SEC staff declined to issue no-action relief from Advisers

Act registration for a website recommending Lending Club securities, because the request for relief contained insufficient facts.

B) Zenkyoren Asset Management of America (avail. June 30, 2011) stated that SEC staff would not recommend enforcement action against Zenkyoren for failure to register under the Advisers Act where (i) Zenkyoren is a wholly owned subsidiary of a Japanese insurance federation, established and operated for the sole purpose of providing investment advisory services to its parent; (ii) Zenkyoren does not hold itself out to the public as an adviser, and provides investment advice only to its parent; and (iii) funds through which Zenkyoren provides advisory services to its parent are established and operated solely to enable its parent to pool and invest its premium proceeds, and consist solely of parent assets. See also Compliance Reporter, July 11, 2011.

C) BNY-ConvergEx (avail. Sept. 21, 2010) stated that the provision of research by a firm that is a registered broker-dealer to an investment manager would not, by itself, create an adviser/client relationship under the Advisers Act between the broker-dealer and accounts managed by the investment manager on a discretionary basis.

D) Financial Planning Assoc. v. SEC, 482 F.3d 481 (D.C. Cir. 2007) ("FPA"), found that the SEC did not have authority to broaden the exception from the definition of "investment adviser" for broker-dealers under Advisers Act § 202(a)(11)(C) and, thus, vacated Advisers Act Rule 202(a)(11)-1, which provided that fee-based brokerage accounts were not advisory accounts and thus not subject to the Advisers Act. See SEC Release No. IA-2376 (Apr. 12, 2005).

The SEC obtained a stay of the ruling in light of the fact that it affected one million fee-based brokerage accounts. Prior to the stay's expiration, the SEC issued a temporary Rule that established an alternative means for investment advisers which are registered as broker-dealers to meet the requirements of Advisers Act § 206(3) when they act in a principal capacity in transactions with advisory clients. See SEC Release No. IA-2653 (Sept. 28, 2007) (interim final temporary rule; request for comments).

The SEC also proposed rule amendments that would recodify guidance, which had been vacated in FPA, as to when advice is "solely incidental" to the business of brokerage, but no final rule has been adopted. See SEC Release No. IA-2652 (Sept. 24, 2007). See generally SIA (avail. Dec. 16, 2005), Morgan, Lewis & Bockius (avail. Nov. 17, 2005), UBS Financial Services (avail. Sept. 29, 2005) (each interpreting the Rule in various contexts). Compare SEC Release No. IA-2339 (Jan. 6, 2005) (temporary rule); SEC Release No. IA-2340 (Jan. 6, 2005); SEC Release No. IA-2278 (Aug. 18, 2004) (reopening of comment period); SEC Release No. IA-1845 (Nov. 4, 1999) (initial proposal and solicitation of public comments); Investor Knowledge of Stockbrokers and Financial Planners (Opinion Research Corp., Apr. 26, 2007).

E) SIA (avail. Dec. 30, 1997) stated that SEC staff would not recommend enforcement under the 1934 Act if a broker-dealer engages in prime brokerage activities (as described in Prime Broker Committee (avail. Jan. 25, 1994), as extended, Ad-Hoc Prime Brokerage Group (avail. Dec. 23, 1998), and as extended permanently, NYSE (Dec. 30, 1999) (the "Prime Brokerage No-Action Letters")) with certain investment advisers no longer required to be registered under the Advisers Act. See also Part VIII.C.2.c.ii and Part IX.A.1.a below.

F) 1934 Act Rule 3a4-1 provides that certain associated persons of an issuer of securities are not deemed to be brokers solely by reason of their participation in the sale of the securities of such issuer, if certain conditions are met. This Rule provides a basis for fund/investment management employees to participate in the sale of interests in funds without <u>themselves</u> registering as broker-dealers.

(v) <u>National Football League Players Assoc.</u> (avail. Jan. 25, 2002) took the position that if the Association maintains a list of advisers which meet certain basic qualifications it would <u>not</u> be an adviser under the Advisers Act so long as (A) the list does not recommend, or advise on the merits or shortcomings of, any adviser; (B) the eligibility criteria are not highly selective; (C) no eligibility requirements relate to an adviser's financial performance; (D) players choose, hire and fire advisers, and the list is not tailored to particular players; (E) the list is operated on a non-profit basis; and (F) the Association is not affiliated with any adviser. The staff also confirmed that the Association would not be viewed as a "solicitor" of an investment adviser subject to Advisers Act Rule 206(4)-3.

(vi) A financial adviser that provides advice to municipal issuers as to the investment of bond proceeds would not be an adviser under the Advisers Act if it does not advise on a regular basis, receives no compensation separate from that received for advice on structuring bond issues, and does not hold itself out as an adviser. SEC Division of Investment Management Staff Legal Bulletin No. 11 (Sept. 19, 2000), CCH Fed. Sec. L. Rep. ¶ 60,011. <u>See also</u> <u>Part II.B.3 above</u>.

(vii) Financial planners are primarily regulated as investment advisers by the SEC and the states, and they are subject to laws governing broker-dealers and insurance agents when acting in those capacities.

(viii) Each investment adviser must consider whether it must register as a broker-dealer under the 1934 Act. See also Part IX.B below.

A) Although there is no clear test, some combination of the following could require such registration: (i) execution of transactions, (ii) solicitation of customers to enter into transactions, (iii) holding an inventory of securities, (iv) holding itself out as willing to make a market in securities, (v) charging transaction-based fees, (vi) taking possession of client funds or securities, (vii) not effecting client transactions through a registered broker-dealer, (viii) offering self-directed accounts, or (ix) regular provision of research.

B) Activities of advisers to private funds have been an area of SEC focus. See, e.g., Remarks of SEC Chief Counsel Blass, Apr. 5, 2013; Ranieri Partners, SEC Admin. Proc. No. 3-15234 (Mar. 8, 2013) proceedings against consultant who solicited investors in private funds without registering as a broker-dealer).

C) SEC staff has taken a no-action position with respect to an investment adviser's non-registration as a broker-dealer where (i) employees of the adviser sell shares of an advised fund, (ii) the adviser does not receive or hold client funds or securities, (iii) investors purchase shares in the fund by making payment directly to the fund's custodian, and (iv) the adviser's employees do not receive compensation linked to the number of fund shares sold and are supervised in their activities by a broker-dealer affiliate of the adviser. See, e.g., MAS (avail. Jan. 19, 1989). Cf., e.g., Fundamental Advisers (avail. Dec. 4, 1971).

D) SEC staff will not recommend action against research providers not registered as broker-dealers when they receive compensation for research services from credits generated from client commissions set apart in a commission account under 1934 Act § 28(e) and the research provider does not perform other services characteristic of a broker-dealer. Capital Institutional Services (avail. Apr. 13, 2007); Goldman Sachs (avail. Jan. 17, 2007).

E) SEC staff have indicated that examination of dually registered advisers will increase, with a focus on potential conflicts of interest. See Reuters, Jan. 30, 2014; ThinkAdvisor, Mar. 11, 2013; Investment News, Mar. 3, 2013.

(ix) A RAND Corporation study for the SEC examined (A) the marketing and provision of financial products and services to individuals by broker-dealers and advisers; and (B) investors' understanding of the differences between broker-dealers' and advisers' products and services, duties and obligations. See Investor and Industry Perspectives on Investment Advisers and Broker-dealers (RAND 2008); SEC 2008-1 (Jan. 3, 2008); SEC Release No. 34-54077 (June 30, 2006). See also Standard of Care Harmonization: Impact Assessment for SEC (Oliver Wyman, Oct. 2010) (adoption of the Advisers Act for all brokerage activity is likely to have a negative impact on smaller investors).

(x) Dodd-Frank § 913 required the SEC to conduct a study on issues related to the effectiveness of existing standards of care for broker-dealers and investment advisers that provide services to retail customers.

The SEC's Study on Investment Advisers and Broker-dealers (Jan. 2011) recommended that broker-dealers and advisers -- when providing personalized securities advice to retail investors -- be evaluated under a uniform fiduciary standard of conduct that is no less stringent than that applied under the Advisers Act. See also Dodd-Frank § 919 (empowering the SEC to designate disclosure that broker-dealers must provide to retail investors in advance of the purchase of investment products or services). See generally SIFMA Comment Letter to the SEC, dated Aug. 30, 2010.

In March 2013, the SEC requested data and other information relating to the benefits and costs that could result from various approaches regarding the standards of conduct and other obligations of broker-dealers and investment advisers. 78 Fed. Reg. 14848 (Mar. 7, 2013).

(xi) Under the SEC's rules, "family offices" are not investment advisers under the Advisers Act and thus are exempt from its regulation. See SEC Release No. IA-3220 (June 28, 2011).

e. "Ponzi Schemes" and Custody Requirements

(i) The SEC and state agencies have brought charges in connection with several "Ponzi schemes" in which mutual fund or hedge fund managers used client funds to pay fictional returns on other clients' investments and for personal expenditures; some of these charges have been dropped. See, e.g., U.S. v. Madoff, No. 09-00213 (SDNY May 15, 2014); SEC Litigation Releases No. 23090 (Sept. 22, 2014) (Trendon Shavers/Pirateat40) (Bitcoin Ponzi scheme); No. 22406 (June 28. 2012) (Small Business Capital Corp.); No. 21970 (May 16, 2011) (Francisco Illarramendi); No. 21579 (June 28, 2010) (Kenzie Financial Management); No. 21495 (Apr. 21, 2010) (Capitol Investments USA); No. 21184 (Aug. 26, 2009) (Titan Wealth Management and Point West Partners); No. 21124 (July 10, 2009) (Lancelot Management); No. 21101 (June 24, 2009) (Advanced Money Management Business Development & Consulting Co.); No. 21102 (June 24, 2009) (Regan & Company); No. 20983 (Apr. 1, 2009) (Prima Capital Management); No. 20946 (Mar. 12, 2009) (Brian Smart).

(ii) The largest and most infamous Wall Street Ponzi scheme to date is that of Bernard Madoff, who, for at least two decades, attracted investors to his investment advisory firm through false promises of large returns from a proprietary investment strategy. In fact, Madoff did not invest his clients' money, but instead used it for personal expenditures and to fulfill investors' redemption requests. Madoff was arrested in December 2008 and pled guilty in March 2009 to 11 federal crimes (including securities fraud).

Enforcement actions and civil suits have been brought against a number of individuals and entities in connection with the Madoff scheme, including Madoff's second-in-command, managers of Madoff "feeder" funds, Madoff's banks, and a broker-dealer that acted as the marketer for Madoff's firm. See, e.g., Hill v. HSBC Bank PLC (SDNY Dec. 10, 2014); U.S. v. JPMorgan Chase Bank, No. 14 Cr. 00007 (information and complaint) (SDNY Jan. 7, 2014); DOJ Deferred Prosecution Agreement, Jan. 6, 2014; DOJ Press Release, Jan. 7, 2014; JPMorgan Chase Bank (OCC Consent Order, Jan. 7, 2014); FinCEN Assessment of Civil Money Penalty, Jan. 7, 2014; NY v. Ivy Asset Management, Index No. 450489-2010 (NY Sup. Ct., May 11, 2010) (complaint), (stipulation of discontinuance, July 9, 2013); Frank DiPascali, SEC Admin. Proc. No. 3-13639 (Oct. 5, 2009), SEC v. DiPascali, Case No. 09 CV 7085 (SDNY Aug. 11, 2009) (complaint), 907 N.Y.S.2d 439 (Sup. Ct., NY Co., 2010) (denial of motion to dismiss complaint); NY v. Merkin, Index No. 450879-2009 (Sup. Ct., NY Co., Apr. 6, 2009) (complaint); In re Fairfield Greenwich Advisers, Mass. Sec. Div. 2009-0028 (Apr. 1, 2009) (complaint) (consent order approving settlement, Sept. 8, 2009); NYU v. Ariel Fund, Index No. 603803/2008 (NY Sup. Ct., Dec. 23, 2008) (complaint) (stipulation in contemplation of settlement, May 12, 2010). See also Securities Investor Protection Corporation ("SIPC") Customer Outcomes in the Madoff Liquidation Proceeding (GAO, Mar. 2012); SIPC Interim Report on the Madoff Liquidation Proceeding (GAO, Mar. 2012).

(iii) The SEC was criticized for failing to detect Madoff's fraud and mishandling complaints about Madoff and his firm. Report of Investigation/Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme (SEC OIG, Aug. 31, 2009), Program Improvements Needed within the SEC's Division of Enforcement (SEC OIG, Sept. 29, 2009), and Review and Analysis of OCIE Examinations of Bernard L. Madoff Investment Securities (SEC OIG, Sept. 29, 2009), identify SEC failures over a 16-year period to respond to complaints and "red flags" regarding Madoff's operations, and make recommendations for improving SEC operations in response to the Madoff failures.

(iv) Similar criticism was directed at the SEC's handling of an alleged Ponzi scheme by Robert Allen Stanford. See Report of Investigation/Investigation of the SEC's Response to Concerns Regarding Robert Allen Stanford's Alleged Ponzi Scheme (SEC OIG, Mar. 31, 2010). See also Chadbourne & Parke v. Troice, CCH Fed. Sec. L. Rep. ¶ 97,832 (Feb. 26, 2014) (Securities Litigation Uniform Standards Act does not preclude state-law claims against alleged assistants in Stanford Ponzi scheme based on alleged malrepresentations involving Stanford International Bank CDs).

(v) SEC and DOJ enforcement actions against perpetrators of Ponzi schemes have continued, often in a global context. One of the largest has been the prosecution of individuals associated with Long Island-based Agape World, founded by Nicholas Cosmo. See, e.g., DOJ Press Release, Dec. 17, 2013; SEC Press Release 2012-112 (June 12, 2012).

Scott Rothstein's $1.4 billion Ponzi scheme involving fabricated structured settlement led to several enforcement actions. See, e.g., DOJ Press Release, Sept. 19, 2014 (Boden and Pearson), Aug. 29,2014 (Shannon), May 1, 2014 (Bates), June 9, 2010 (Rothstein sentenced to 50 years in prison); see also, e.g., TD Bank (FinCEN Assessment of Civil Money Penalty, Sept. 23, 2013), (OCC Consent Order, Sept. 23, 2013), (SEC Admin. Proc. No. 3-15512 (Sept. 23, 2013)).

Other recent actions include SEC v. Onyx Capital Advisors, CCH Fed. Sec. L. Rep. ¶ 97,804 (E.D. Mich., Jan. 31, 2014) (Ponzi scheme relating to purported oil-related ventures); SEC v. Pedras, No. 13-07932 (C.D. Cal., Oct. 28, 2013) (complaint) (Ponzi scheme involving U.S. and New Zealand–based companies); and SEC v. Fujinaga, No. 13-01658 (D. Nev., Sept. 11, 2013) (Las Vegas-based Ponzi scheme targeted at investors in Japan). But see U.S. v. Simmons, 737 F.3d 319 (4th Cir. 2013) (overturning money laundering conviction connected to alleged Ponzi scheme).

(vi) In response to the Madoff fraud and other Ponzi schemes, the SEC has announced (A) additional training for examiners in fraud detection and complex financial products; (B) focused examinations of firms with high-risk attributes; (C) a program to verify assets held by investment advisers and broker-dealers; and (D) improved surveillance, risk-based targeting and handling of tips and complaints. See Remarks of SEC OCIE Director Richards, June 17, 2009.

In addition, the SEC amended 1940 Act Rule 206(4)-2, which regulates the custodial practices of investment advisers. The amendments (A) impose an annual surprise examination requirement on registered advisers that have custody of client assets, (B) require that such advisers obtain an opinion of an independent accountant regarding the adviser's custody-related controls, (C) impose restrictions on advisers to pooled vehicles, and (D) amend Form ADV to collect more complete information about advisers' custody practices. See SEC Release No. IA-2968 (Dec. 30, 2009) (final rule). See also SEC Division of Investment Management Guidance Update No. 2014-07 (June 2014) (private funds and application of custody rule to SPVs and escrow accounts); SEC Release No. IA-3705-7 (Oct. 27, 2013) (custody rule violations); Recommendations Regarding the Protection of Client Assets (IOSCO, Jan. 29, 2014) SEC Division of Investment Management Guidance Update No. 2013-04 (Aug. 2013); Requirements and Costs Associated with the Custody Rule (GAO, July 2013); SEC OCIE Risk Alert, Significant Deficiencies Involving Adviser Custody and Safety of Client Assets (Mar. 4, 2013); SEC Investor Bulletin, Custody of Your Investment Assets (Mar. 4, 2013); SEC Division of Investment Management Release, Staff Responses to Questions About the Custody Rule (updated as of Apr. 1, 2011); AICPA (avail. Dec. 23, 2010) (denial of no-action request to adviser which sought to engage an independent public accountant not subject to regular inspection by PCAOB); SEC Letter to Investment Adviser Assoc., dated Mar. 9, 2009; Investment Adviser Assoc. Letter to SEC dated Mar. 6, 2009; Part IX.A.1.b.iii below.

f. Fee-related Issues and "Soft Dollar" Practices

(i) Mutual fund fees have decreased significantly in recent years -- in 2015, investors paid an average of 0.68% of fund assets in fees and expenses for stock funds, a decrease of more than 31% from 2000. See Investment Company Fact Book (ICI, 2016), "The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2014," Research Perspectives (ICI, Aug. 2015)

(ii) Mutual fund sales charges are assessed in a number of ways (including upfront loads and contingent deferred sales loads). See generally SEC Release No. IC-26591 (Sept. 2, 2004) (amendment to Rule 12b-1); Investment Company Fact Book (ICI, 2015); Report on Elements of International Regulatory Standards on Fees and Expenses of Investment Funds (IOSCO, June 2015); Mutual Fund Distribution and Shareholder Servicing Practices (SIFMA, June 13, 2007); Best Practices and Practical Guidance for Directors under Rule 12b-1 (Mutual Fund Directors Forum, May 2007).

(iii) The SEC has proposed an overhaul of 12b-1 fees aimed at limiting mutual fund sales charges, improving transparency of fee disclosure, encouraging retail price competition, and revising mutual fund director oversight duties. See SEC Release No. 33-9128 (July 21, 2010) (solicitation of public comments).

(iv) Advisers Act § 205(a)(1) prohibits investment advisers from charging (A) fees based on the performance of an investment, or (B) contingent fees which are waived or refunded if a client's account does not meet a specified level of performance. However, Advisers Act Rule 205-3 permits an adviser to charge performance fees to (1) a "qualified client" with at least $1,000,000 under management or a net worth of more than $2,100,000, (2) a 1940 Act "qualified purchaser", or (3) certain employees. See SEC Release No. IA-3372 (Feb. 15, 2012) (final rule reflecting inflation adjustment to dollar thresholds for "qualified client" status as required by Dodd-Frank § 418). See also SEC Release No. IA-4421 (June 14, 2016) (order approving inflation adjustment for exemption's dollar thresholds).

SEC staff has provided no-action guidance indicating that certain arrangements that an adviser enters into with clients would not be considered prohibited performance fee arrangements. See, e.g., Amerivest Investment Management (avail. Aug. 19, 2014) (fee rebate); Pacific Select Fund (avail. Dec. 23, 2004) (fee reduction); Trainer, Wortham & Co. (avail. Dec. 6, 2004) (fee refund).

(v) "Reverse churning" of fee-based brokerage accounts involves encouraging clients with low transaction volume to enter into fee-based, rather than transaction-based, arrangements. See, e.g., SunTrust Investment Services, FINRA News Release, Oct. 15, 2008 (failing to supervise fee-based brokerage business, including in respect of the appropriateness of fee-based accounts); UBS Financial Services, NY Attorney General Settlement Agreement, dated Dec. 12, 2006; Morgan

Stanley, NASD News Release, Aug. 2, 2005; Raymond James & Assoc., NASD News Release, Apr. 27, 2005; NASD Notice to Members No. 03-68 (Nov. 2003).

See also Part VIII.C.1.c above.

g. Advertising, Disclosure and Suitability-related Issues

Investment company advertising and disclosure and the suitability of recommended fund investments are subject to increasing scrutiny. See, e.g., New England Investment and Retirement Group, SEC Admin. Proc. No. 3-15137 (Dec. 18, 2012) (alleged failure to disclose that a report provided to clients comparing historical performance and risk of the company's equity and fixed income models to benchmarks relied on hypothetical past performance of investments); Aladdin Capital, SEC Admin. Proc. No. 3-15134 (Dec. 17, 2012) (cease and desist order prohibiting an investment adviser from claiming it co-invested alongside investors when it failed to do so with two CDOs in 2006); Oppenheimer Funds, SEC Admin. Proc. No. 3-14909 (June 6, 2012) (failure to disclose use of leverage through derivatives); Northstar Financial Advisers v. Schwab Investments, 615 F. 3d 1106 (9th Cir. 2010) (no implied private right of action under 1940 Act § 13(a) for investors who claim that a mutual fund violated its published policies); In re Mutual Funds Investment Litigation, 566 F.3d 111 (4th Cir. 2009) (reversing a motion to dismiss investors' 1934 Act § 10(b) claim against mutual fund adviser arising from alleged misrepresentations regarding policies on market timing); Evergreen Investment Management, SEC Admin. Proc. No. 3-13507 (June 8, 2009) (overvaluation of fund net assets and selective disclosure about repricing); Centre for Financial Market Integrity Global Investment Performance Standards (2005) ("CFM-GIPs") (voluntary standards for investment managers to present investment performance). See also Part VIII.B.1 above and Part IX.E below.

(i) Recent issues respecting investment company disclosure include the following:

A) Mutual Fund Advertising: Improving How Regulators Communicate New Rule Interpretations to Industry Would Further Protect Investors (GAO, July 2011), prepared pursuant to Dodd-Frank § 917, found that (i) investors use more than just performance information when making investment decisions, and (ii) advertising focusing on performance is generally not common.

B) SEC Release No. 33-8998 (Jan. 13, 2009) permits mutual funds to provide a plain English summary of key facts about a fund and a summary prospectus.

(ii) Interpretive guidance respecting disclosure filings and advertising materials includes, e.g., SEC Division of Investment Management Guidance Update No. 2016-02 (March 2016); No. 2014-08 (June 2014); TCW Group (avail. Nov. 7, 2008); Report of the Mutual Fund Task Force: Mutual Fund Distribution (NASD, Apr. 4, 2005) (recommendations as to point-of-sale disclosure to investors); ICI (avail. Oct. 17, 2003, Oct. 2, May 19, 1998).

(iii) Advisers Act Rule 206(4)-1 relates to investment adviser advertisements. See also, e.g., Investment Advisers Association (avail. Dec. 2, 2005) (third-party ratings that rely in part (and not primarily) on client evaluations are not necessarily testimonials for purposes of Advisers Act Rule 206(4)-1); ICAA (avail. Mar. 1, 2004) (communication by an adviser that responds to an unsolicited request by a client for specific information about the adviser's past recommendations is not an "advertisement"); Dalbar, Inc. (avail. Mar. 24, 1998) (third-party ratings that rely on client evaluations would be testimonials).

(iv) State Street Bank and Trust Co., SEC Admin. Proc. No. 3-13776 (Feb. 4, 2010), settled an administrative proceeding that alleged that State Street misled investors regarding the degree to which certain collective trust funds under its management were exposed to subprime

MBS, subsequently provided more complete information to select investors while continuing to mislead others, and sold the funds' most liquid holdings to meet the redemption demands of the more well-informed investors.

(v) UBS Advisory Firms, SEC Admin. Proc. No 3-16909 (Oct. 16, 2015), settled administrative and cease-and-desist proceedings against UBS Willow Management and UBS Fund Advisor for failing to disclose a material change in the investment strategy of a closed-end fund, which was marketed as a product that invested in distressed debt, but allegedly started purchasing credit default swaps based on the view that debt would decrease in value.

(vi) FINRA settled cases for improper mutual fund sales and supervisory failures, and assessed fines, against Merrill Lynch, Prudential Securities, Pruco and UBS. Wells Fargo was spared a fine due to its proactive remedial measures. See FINRA News Release, Feb. 28, 2008.

Citigroup Global Markets, NASD Press Release, Dec. 7, 2004, related to unsuitable fund recommendations to customers, failure to maintain suitability records regarding investors, and lack of adequate disclosure as to the risks of managed futures investments. See also, e.g., Piper Capital Management, SEC Admin. Proc. No. 3-9657 (Nov. 30, 2000) (fine for misleading investors about a high-risk mutual fund that purported to have conservative investment objectives).

h. "Substantially Identical" Investment Advice: Rule 3a-4, "Wrap Fee" Programs and Related Issues

Advisory arrangements designed to provide substantially identical investment programs to a large number of clients may be subject to regulation as investment companies.

(i) In 1970, the SEC brought an action against Citibank with respect to its Special Investment Advisory Service.

Since customers with similar investment objectives received substantially the same advice, the SEC concluded that the Service constituted a 1940 Act "investment company", and that participations in the Service constituted 1933 Act "securities". SEC v. First National City Bank, CCH Fed. Sec. L. Rep. ¶ 92,592 (Feb. 6, 1970). See also O'Brien Sherwood Associates (avail. Apr. 2, 1973).

(ii) In 1980, the SEC issued proposed 1940 Act Rule 3a-4 (SEC Release No. IC-11391 (Oct. 10, 1980) (solicitation of public comments)). Subsequently, SEC staff granted no-action relief where a proposed investment service substantially addressed the factors in the proposed Rule. See, e.g., Banque Indosuez (avail. Dec. 10, 1996) (investment company may use "cloning technology" (i.e., an automated system which facilitates the management of mirror portfolios) where the funds invested in such portfolios would continue to receive individualized treatment); Benson White & Co. (avail. June 14, 1995); UMB Bank (avail. Jan 23, 1995) (reversing Balliet, Blackstock & Stearns (avail. Aug. 19, 1987)); Benefit Consultant Securities (avail. Dec. 16, 1993); Rauscher Pierce Refsnes (avail. Apr. 10, 1992); Wall Street Preferred Money Managers (avail. Apr. 10, 1992); Westfield Consultants (avail. Dec. 13, 1991); WestAmerica Investment (avail. Nov. 26, 1991); Atlantic Bank of New York (avail. June 7, 1991); Rushmore Investment Advisers (avail. Feb. 1, 1991); Morgan Keegan & Co. (avail. Oct. 2, 1990); Qualivest Capital Management (avail. July 30, 1990); United Missouri Bank (avail. May 11, 1990); Manning & Napier Advisers (avail. Apr. 24, 1990); Jeffries & Co. (avail. June 16, 1989); Fidelity Managed Accounts (avail. Dec. 13, 1988); Strategic Advisers (avail. Dec. 13, 1988); Scudder Fund Management Service (avail. Aug. 17, 1988); National Deferred Compensation (avail. Aug. 31, 1987); AMA Advisers (avail. May 18, 1987); Shearson/American Express (avail. July 13, 1983); Professional Investment Management (avail. Apr. 19, 1984); No Load Timing Service (avail. Nov. 28, 1983); Paley & Ganz (avail. Dec. 6, 1982). But see SEC Release No. IC-21140 (June 16, 1995) (enforcement action); International Asset Management (avail. Oct. 11, 1989) (denial of no-action request); Republic Bank (avail. Aug. 23, 1982) (same).

(iii) In 1997, the SEC adopted 1940 Act Rule 3a-4, which provides that an investment advisory program is not an investment company if each client is provided with individualized treatment and retains ownership of all securities in an account.

(iv) "Wrap fee" arrangements are investment programs which "wrap" asset management, financial planning, brokerage and related services for a single fee.

A) "Wrap fee" arrangements raise registration, disclosure and conflict of interest issues. The "sponsor" of a "wrap fee" arrangement should disclose (i) the fee and the services it covers, (ii) that the arrangement may cost more or less than separately purchased services, and (iii) that persons who recommend the arrangement may have an incentive to do so. Sponsors should also have reasonable grounds for believing that a fee-based program is appropriate for a particular customer. See, e.g., CFM-GIP Wrap Fee/SMA [Separately Managed Account] Performance Presentation and Reporting (2006); NASD Notice to Members 03-68 (Nov. 2003). See also Wunderlich Securities, SEC Admin. Proc. No. 3-14403 (May 27, 2011) (settling charges that Wunderlich charged fees to clients who participated in wrap fee programs that were contrary to the fees disclosed in advisory agreements); Sage Advisory Group, SEC Litigation Release No. 21672 (Sept. 29, 2010) (alleging that company made materially false and misleading statements that wrap fees would be less than prior fee arrangements). See also IA Watch, Aug. 4, 2014 (with link to SEC document request letter relating to wrap fee program sponsors).

B) Assuming that a bank or BHC has powers/regulatory approvals for all activities involved, it should be able to offer "wrap" products. See, e.g., Approval No. 183.

C) SEC staff permitted a wrap-fee sponsor to receive ADV Part 2's from unaffiliated sub-advisers on behalf of its clients. Goldman Sachs (avail. June 20, 2013).

D) Bank of America Investment Services, SEC Admin. Proc. No. 33-8913 (May 1, 2008), represented a settlement for failing to disclose that affiliated funds were favored when mutual funds were selected for wrap fee accounts.

E) The SEC granted exemptions from the trade-by-trade broker-dealer confirmation requirements to permit the issuance of periodic statements to participants in discretionary "wrap-fee" programs. See, e.g., UBS Financial Services (avail. May 24, 2007); Wachovia Securities (avail. Apr. 30, 2007); FSC Securities (avail. Jan. 30, 2007); William Blair & Co. (avail June 10, 2005); Morgan Keegan & Co. (avail. Apr. 21, 2005); Sanford C. Bernstein & Co. (avail. Apr. 18, 2005); Goldman Sachs (avail. Aug. 14, 2003); MMI/SIA (avail. Aug. 23, 1999); Advest (avail. July 19, 1999) Sudden Investor Services (avail. Feb. 11, 1998); DLJ (avail. Aug. 21, 1997).

F) Morgan, Lewis & Bockius (avail. Apr. 16, 1997) stated that a broker-dealer/investment adviser could organize "wrap fee" programs to which securities trades are directed by an unaffiliated portfolio manager.

(v) Online broker-dealers and investment advisers introduced portfolio investment programs that allow investors to purchase customized baskets of stocks. The SEC denied a petition by the ICI to regulate portfolio investment programs (including pre-packaged portfolios) under the 1933 and 1940 Acts. See ICI Letters to the SEC, dated Oct. 17, July 24, Mar. 28, 2001; SEC Letter to ICI, dated Aug. 23, 2001; SIA Letter to the SEC, dated June 14, 2001.

These portfolio programs were not very popular. Several providers ceased operations or filed for bankruptcy, and others partnered with established fund advisers. See, e.g., Money, June 2002; Christian Science Monitor, June 10, 2002; Business Week, May 27, 2002.

i. Networking Issues

For a discussion of SEC issues in connection with "networking" and similar arrangements, see Part VIII.C.1 above and Part IX.A.1.vi and Part IX.E below.

j. Certain Transactional and Corporate Structuring Issues

(i) BHC strategic investments in investment advisers can raise SEC issues regarding a change of control of the adviser. See, e.g., Bank of Ireland Asset Management (avail. Apr. 2, 2009) (no-action relief where emergency government investment in Bank of Ireland resulted in a change of control of investment adviser without shareholder approval); Fortis Group (avail. Jan. 27, 2009) (same, in context of Belgium's nationalization of Fortis' global asset management arm); American Century Companies/Morgan (avail. Dec. 23, 1997) ("strategic alliance" found not to constitute the acquisition by Morgan of 1940 Act "control" of American Century). See also Part I.D.1 above.

(ii) At one point, SEC staff had concluded that the merger of two publicly held companies which provide asset and fund management services through subsidiaries will not result in the "assignment" (and, thus, termination) of investment advisory contracts of either party under the 1940 Act/Advisers Act where, after the merger, the adviser remains wholly owned, directly and indirectly, by a public company with no controlling shareholder. See, e.g., Zurich Insurance (avail. Aug. 31, 1998) (cautioning that SEC staff will not respond to inquiries as to whether a particular transaction falls within such interpretation because the issue is "primarily factual in nature"); Dean Witter & Co.; Morgan Stanley Group (avail. Apr. 18, 1997); SEC Release No. IA-1034 (Sept. 11, 1986). See generally, e.g., Herzog v. Russell, 483 F. Supp. 1346 (EDNY 1979); Central Corporate Reports (avail. Mar. 9, 1981); Smith Barney (avail. Feb. 18, 1976). Compare, e.g., Lowry Management (avail. Mar. 20, 1984), New England Asset Management (avail. Dec. 23, 1973), Finomic Investment Fund (avail. Dec. 19, 1973) ("assignment" may occur when 25% or more of the voting securities of an issuer is transferred).

However, the current SEC staff position in this regard is not clear.

Moreover, in connection with the transfer of certain Citigroup fund operations to Legg Mason, the NYSE proposed that any request for shareholder approval of an investment company's advisory contract with a new adviser (including any assignment of such a contract caused by a change in control of the adviser that is party to the assigned contract) will be deemed to be a significant matter. SEC Release No. 34-52569 (Oct. 6, 2005).

(iii) Under extraordinary circumstances, SEC staff has allowed an investment adviser to continue to act as adviser pursuant to contracts that terminated as a result of a change in control (see JPMorgan Chase/Bear Stearns (avail. July 14, 2008, as of Mar. 16, 2008). SEC staff has also allowed an adviser to continue to rely on existing SEC exemptive orders pending submission of new exemptive applications after a merger with another adviser. See, e.g., Warburg, Pincus Asset Management (avail. May 28, 1999).

(iv) Advisers Act § 205(a)(2) prohibits an adviser from entering, extending or renewing any advisory contract that fails to prohibit assignment without the consent of the client. In some cases, SEC staff has indicated that a "negative consent" approach could be permissible (i.e., customers could be notified of the proposed transaction and if they continue to accept advisory services they will be deemed to have consented to the assignment). See, e.g., Jennison Assoc. Capital (avail. Dec. 2, 1985); Scudder, Stevens & Clark (avail. Mar. 18, 1985); Kephart Communications (avail. Oct. 13, 1976).

(v) SEC staff has granted no-action relief to an investment adviser to appoint its affiliate as a sub-adviser to existing funds without obtaining prior approval of fund shareholders, so long as (A) the services provided to the funds are not reduced and fees are not increased, and (B) existing and prospective fund shareholders are informed. See, e.g., Eaton Vance Special Investment Trust (avail. Mar. 30, 2004); Wells Fargo Bank (avail. Mar. 31, 1998); Principal Preservation Portfolios (avail. Jan. 11, 1996).

SEC staff has not granted such relief, however, where the new sub-adviser is not wholly owned. See, e.g., American Express Financial Corp. (avail. Nov. 17, 1998).

k. Certain Affiliate Transaction Issues

(i) The SEC has granted no-action relief permitting a national bank custodian to act as securities lending agent for certain affiliated funds under certain circumstances. See U.S. Bank (avail. Feb. 13, 2014); Norwest Bank Minn. (avail. May 25, 1995). But see U.S. Bank, SEC Admin. Proc. No. 3-12029 (Sept. 2, 2005) (SEC settled cease-and-desist proceedings against U.S. Bank, which (A) engaged as principal in prohibited FX transactions with 1940 Act-registered investment companies advised by a U.S. Bank subsidiary, and (B) did not have adequate compliance procedures to prevent such affiliated transactions).

(ii) In re Morgan Stanley Info. Fund Sec. Litig., 592 F.3d 347 (2d Cir. 2010), involved a putative class action alleging that Morgan Stanley failed to disclose the fact that two Morgan Stanley broker-dealers, which provided investment research to the funds, had conflicts of interest. The Second Circuit, relying in part on an SEC amicus brief, affirmed the SDNY's dismissal, holding that the mere fact that investment research may be flawed does not create a fund-specific risk meriting disclosure on Form N-1A. The Court shared the SEC's view that the fact that the broker-dealers at issue were affiliates of Morgan Stanley was irrelevant, since there was no evidence that the funds' investment objectives or strategy was altered by their affiliation with the broker-dealers.

(iii) JPMorgan Chase Bank N.A. and J.P. Morgan Securities LLC, SEC Admin. Proc. No 3-17008 (Dec. 18, 2015), settled administrative proceedings regarding the failure of J.P. Morgan Securities and JPMorgan Chase Bank, N.A. to properly disclose conflicts of interests arising from undisclosed preferences for (i) JPMorgan-managed mutual funds and hedge funds; and (ii) third-party managed private hedge funds that shared client fees with affiliates of JPMorgan, resulting in a fine of $267 million.

(iv) Investment Advisers Act Rule 206(3)-3T provides an alternative means for registered broker-dealers to act as principal in transactions with clients with respect to non-discretionary accounts while complying with the provisions of the Advisers Act requiring disclosure and client consent in such circumstances. Rule 206(3)-3T requires (A) prospective disclosure of conflicts arising from trades in which an adviser acts as principal; (B) written, revocable client consents to enter such transactions; (C) disclosures in advance of each transaction; and (D) confirmations and annual reports reflecting such trades. Originally adopted in 2007 on a temporary basis as an interim final rule, Rule 206(3)-3T's "sunset" date has been extended several times, most recently to December 31, 2016. See 77 Fed. Reg. 76854 (Dec. 31, 2012) (final rule); see also 79 Fed. Reg. 76880 (Dec. 23, 2014) (rule to extend the sunset to December 31, 2016).

(v) The acquisition by Barclays, an affiliate at the time of Barclays Global Investors, N.A. ("BGI"), of Lehman Brothers' banking and capital markets business raised a potential violation of the Comptroller's requirement that the benchmark to which an index or model-driven fund is pegged be established and maintained by an independent third party, because many of BGI's index and model-driven funds were benchmarked to Lehman's indices. The Comptroller determined that the Lehman indices could continue to be considered to be outside of BGI's control, citing "substantial information barriers" between BGI and Barclays Capital and the fact that the Lehman indices were tracked throughout the global debt market and were not specifically tailored for BGI's use. Comptroller Letter to BGI, dated Sept. 19, 2008; see also Letter No. 1120 (extending relief on a permanent basis, subject to information barriers and other controls). See Part VIII.B.3.g.vi above.

(vi) The SEC settled fraud charges against two Citigroup subsidiaries that, when recommending to the boards of directors of Citigroup mutual funds that the funds change from third party transfer agent to a Citigroup affiliate, failed to disclose fully that most of the work was to be done under a subcontract with the mutual funds' existing third party transfer agent at discounted rates, and that such discount would not be passed on to the funds. See SEC Press Release 2005-80 (May 31, 2005); SEC Litigation Release No. 19330 (Aug. 8, 2005).

(vii) Bank of America sold the bank loan asset management group of Columbia Management Advisers because of the prohibition against an asset manager purchasing bank loans from an affiliate. American Banker, Apr. 16, 2004.

(viii) Maxim Series Fund (avail. Jan. 15, 2004) permitted an affiliate of an investment adviser to act as custodian where (A) the custodian was not a first- or second-tier affiliate of the adviser or any sub-adviser to the investment portfolios for which the custodian provided custodial services; (B) there were no common officers, employees or directors between the custodian and the sub-advisers or between the custodian and the adviser; and (C) the assets of each investment portfolio receiving custodial services were segregated from the assets of any other investment portfolio. See generally SEC Division of Investment Management Guidance Update No. 2014-06 (June 2014) (guidance regarding affiliate transactions and mutual funds operated as "series companies")

(ix) 1940 Act Rule 17a-10 prohibits funds from engaging in transactions with portfolio companies in which they own more than 5% of the voting securities without first obtaining an exemptive order. The Rule provides that a fund may engage in certain transactions with persons that are technically affiliated with the fund because those persons or their affiliates provide investment advice to an affiliated fund in the same fund complex. See SEC Release No. IC-25888 (Jan. 14, 2003).

(x) SEC Release No. IA-1732 (July 17, 1998) addresses Advisers Act § 206(3), which prohibits an investment adviser from effecting a transaction on behalf of a customer while acting as principal or broker for a person other than the customer, without disclosing the adviser's role and obtaining the customer's consent.

A) CSFB (avail. Aug. 31, 2005) permitted an investment adviser to use global consent forms to provide disclosures to (and obtain consents from) advisory clients, rather than per-transaction consents, with respect to purchases of securities for clients from an affiliated derivatives dealer.

B) Merrill Lynch Trust Co. (avail. July 6, 2000) permitted an investment adviser to invest customer assets in funds sponsored, advised and distributed by its affiliates where fund shares (i) are redeemed at net asset value, and (ii) pass through the affiliates only in satisfaction of a customer order.

(xi) A number of no-action letters permit advised funds to engage in, and receive compensation for, certain transactions with affiliates. See, e.g., PNC Bank (avail. June 10, 1997) (overnight cash balances of advised funds); Norwest Bank Minnesota and Society National Bank (avail. May 25, 1995) (lending of securities owned by advised funds). See also Part IX.A below.

(xii) SEC Release No. IC-21340 (Sept. 7, 1995) permits a fund to engage in purchase and sale transactions in debt securities and repos with a bank or BHC that is an "affiliated person" of the fund by reason of its owning, holding or controlling 5% or more of the fund, except that no fund may engage in such transactions with a bank or BHC that controls, advises or sponsors that fund. See also SEC Release No. IC-21342 (Sept. 8, 1995).

See also Part III.A.7 and Part VIII.C.2.a.ii above regarding Dodd-Frank restrictions on transactions with affiliated private equity and hedge funds.

D. HEDGE FUNDS AND FINANCIAL AND TRADING RISKS

1. Although there is no precise definition of a "hedge fund," the term is commonly used to describe a private pooled investment vehicle, administered by a professional investment manager, that is largely unregulated because the vehicle qualifies for various exemptions under securities and other laws. As of July 2015, there were over 10,100 hedge funds operating globally, with approximately $2.97 trillion in assets under management ("AUM"). Capital Inflows

Drive Hedge Fund Assets Towards Milestone in Q2 (Hedge Fund Research, July 20, 2015).

High net worth individuals were traditionally the main investors in hedge funds; however, institutional investors now represent the majority of AUM. This shift has resulted in hedge funds increasing their due diligence, operational infrastructure and transparency because of institutional investor demands. "the Evolution of an Industry" (Oct. 2012) (the "2012 KPMG/AIMA Global Hedge Fund Survey").

Hedge funds may be, but are not necessarily, leveraged. Generally, they engage in several types of trading strategies: (i) "macro" or "directional" funds take positions based on their view as to the level and direction of fundamental economic indicators; (ii) "relative value" or "arbitrage" funds take offsetting positions in comparable financial instruments, based on their view as to how the relative value of such instruments will change; (iii) event-driven funds invest in securities in connection with events such as bankruptcies, reorganizations and mergers; and (iv) "multi-strategy" funds allocate capital among various hedge fund strategies.

2. Hedge funds frequently seek to limit the disclosure they make to counterparties (which may also be competitors) and investors, although new rules under Dodd-Frank require that investment advisers to private funds make certain reports to regulators. See Annual Staff Report Relating to the Use of Data Collected from Private Fund Systemic Risk Reports (SEC, July 25, 2013). The opacity of disclosure by certain hedge funds, the difficulty of determining the risk profile of hedge funds with changing portfolios, the significant use of leverage by some hedge funds, and the over-reliance on collateral and competitive pressures among banks and other financial institutions in acting as counterparties (and providing financing) to hedge funds were among the factors contributing to highly publicized hedge fund losses. In the wake of these losses, bank investment in, and lending to, hedge funds and other highly leveraged institutions ("HLIs") has received increased attention. See Part II.A.7 above (Volcker Rule).

    a. Long-Term Capital Management ("LTCM") lost most of its capital following Russia's 1998 devaluation of the ruble and declaration of a debt moratorium. Ultimately, after meetings organized by the FRBNY, financial institutions invested $3.6 billion in LTCM's portfolio in exchange for a 90% interest to avoid market disruptions that might have resulted from a forced liquidation. See also Lakonia Management v. Meriwether, 106 F. Supp. 2d 540 (SDNY 2000) (investor claims dismissed).

b. Bank of America announced losses arising from its lending arrangement and strategic alliance with D.E. Shaw & Co. (see Part XII.B.6.b below), which resulted in a class action litigation which Bank of America ultimately settled. See In re Bank of America Securities Litigation, MDL No. 1264 (E.D. Mo.) (Order, Sept. 30, 2002; Stipulation and Agreement of Compromise and Settlement, Mar. 8, 2002).

   Bank of America also settled an SEC administrative proceeding finding that it had improperly accounted for its alliance with D.E. Shaw & Co. as a "loan" and made incomplete disclosures concerning losses arising from the alliance. See SEC Release No. 34-44613 (July 30, 2001) ("Release No. 34-44613").

c. The bankruptcy of Refco, a major trading firm, in 2005 underscored the freedom of hedge funds to conduct business without significant regulatory supervision. Refco's bankruptcy was triggered by a flight of capital after it was disclosed that its former chief executive had received significant loans from Refco. Liberty Corner Capital, a New Jersey hedge fund, was reported to have assisted in concealing the loans through sham transactions designed to "cleanse" Refco's financial statements at the end of each reporting period. PlusFunds Group, a hedge fund adviser with close ties to Refco, also filed for bankruptcy, Refco officers were indicted for a number of fraud and conspiracy charges, and actions were also commenced against Refco's lawyers and advisers. See, e.g., Bloomberg, June 2, 2014 (Former Refco Chief Executive Officer Phillip Bennett and two of his ex-colleagues ordered to pay $672 million for losses stemming from Refco fraud); Law 360, Apr. 22, 2013 (Report of Special Master states that aiding and abetting claims against Mayer Brown should not be summarily dismissed); NYLJ, Nov. 19, 2012 (conviction re: former Mayer Brown partner Joseph Collins); Kirschner v. KPMG, 15 NY 3d 446 (NY, 2010);

Teachers' Retirement System of Louisiana and City of New Orleans Employees Retirement System v. Pricewaterhouse Coopers, No. 152 (NY, Oct. 21, 2010); SEC Litigation Release No. 21555 (June 14, 2010) (settlement re former Mayer Brown Partner Joseph Collins), SEC Litigation Release No. 20402 (Dec. 18, 2007) (complaint); Pacific Investment Management v. Mayer Brown, 603 F.3d 144 (2d Cir. 2010) (dismissal of claims against outside counsel for alleged false statements); Kirschner v. Grant Thornton, Mayer Brown, 2009 U.S. Dist. LEXIS 32581 (SDNY 2009) (decision for defendant in suit by Refco bankruptcy trustee against Refco lawyers, accountants and lenders) (appeal filed, May 18, 2009); In re Refco, Case No. 05-60006 (RDD) (Bankr. SDNY July 11, 2007) (Final Report of Examiner); U.S. v. Bennett, No. 105-CR 1192 (SDNY Oct. 4, 2006) (indictment), June 6, 2008 (sentencing memorandum).

d. Amaranth, a multi-strategy hedge fund that managed more than $9 billion at its peak, collapsed in 2006, losing almost $6 billion in less than one month. Amaranth took substantial leveraged positions in natural gas markets, and adverse price movements forced it to sell those positions at significant losses. See In re: Amaranth Natural Gas Commodities Litigation, 730 F.3d 170 (2d Cir. 2013) (affirming the dismissal of J.P. Morgan Chase and two of its subsidiaries from a suit brought by natural gas futures contracts purchasers that alleged J.P. Morgan aided and abetted the massive price manipulation scheme that led to the 2006 collapse of Amaranth); 135 Federal Energy Regulatory Commission ("FERC") ¶ 61,054 (Apr. 21, 2011) (Order against Amaranth trader), 121 FERC ¶ 61,224 (Nov. 30, 2007) (Order Denying Rehearing), 120 FERC ¶ 61,085 (July 26, 2007) (Order to Show Cause); CFTC v. Amaranth, 07-cv-6682 (SDNY Aug. 12, 2009) (consent order for Amaranth to pay fine for manipulation of natural gas futures prices); Excessive Speculation in the Natural Gas Market (Senate PSI Staff Report, June 25, 2007); Letters from Sen. Bingaman to CFTC/FERC, Feb. 6, 2007, and response, Feb. 22, 2007 (information with respect to volatility in natural gas markets and Amaranth's role); A Review of Recent Hedge Fund Participation in NYMEX Natural Gas and Crude Oil Futures Markets (NYMEX, Mar. 1, 2005). See generally, e.g., Hunter v. FERC, 527 F. Supp. 2d 9 (D.D.C. 2007) (upholding FERC authority to investigate hedge fund trading activity), aff'd, 348 Fed. Appx. 592 (D.C. Cir. 2009).

Amaranth v. JPMorgan Chase, No. 603756/07 (Sup. Ct. NY Co., Oct. 28, 2008), upheld Amaranth's breach of contract claim against a motion to dismiss in connection with JPMorgan Chase's alleged refusal to consent to Amaranth's attempts to transfer its natural gas book to other counterparties in exchange for a concession payment, which refusal allegedly caused Amaranth to lose more than $1 billion due to adverse intervening movements in the natural gas market. The parties subsequently settled the matter.

e. Pension Committee of the University of Montreal Pension Plan v. CITCO Fund Services, 568 F.3d 374 (2d Cir. 2009), reinstated claims by investors in two offshore hedge funds that Banc of America Securities, acting as the funds' prime broker, had aided and abetted a breach of fiduciary duty by the funds' manager by allowing the manager to prepare fraudulent account statements that bore the Banc of America name. The parties subsequently settled the matter.

f. Hedge funds and feeder funds that had invested in accounts managed by Bernard L. Madoff Investment Securities LLC suffered significant losses in the "Ponzi scheme" Madoff perpetrated for 17 years. See Part VIII.C.2.e above.

g. The bankruptcy of MFGlobal highlighted the debilitating effects of liquidity runs and improper use of customers' segregated funds. MFGlobal, a global investment bank, experienced several liquidity events, including increased margin calls and customer withdrawals, in the week leading up to its bankruptcy because of its exposure to the European debt markets. To meet increased liquidity demands, MFGlobal not only drew down its credit facilities but also used customers' segregated funds to pay its own obligations. At the time MFGlobal failed, approximately $1.6 billion of customer funds were missing. This loss resulted in Congressional inquiries, calls for regulatory reform and class action lawsuits. See, e.g., MF Global Holdings as Plan Administrator v. Pricewaterhousecoopers, No. 14-cv-2197 (SDNY Aug. 5, 2016) (decision and order) (denying defendant's motion for summary judgment), (SDNY Mar. 28, 2014) (complaint) (claiming that accounting firm's advice about repurchase-to-maturity financing transactions led MF Global to amass enormous exposure to European debt, contributing to more than $1 billion in losses); In re MF Global Holdings Ltd. Securities Litigation, No. 11-cv-7866 (SDNY July 15, 2016) (approval of settlement with certain underwriters); In re MF Global Holdings Ltd. Investment Litigation, No. 11-cv-7866 (SDNY July 14, 2016) (preliminary approval of final customer settlement with individual defendants); In re MF Global Holdings Ltd. Investment Litigation, No. 11-cv-07866 (SDNY Nov. 25, 2015) (final approval of settlement with individual defendants); In re MF Global Holdings Ltd. Securities Litigation, No. 11-cv-07866 (SDNY July 7, 2015) (preliminary settlement with Corzine and MFGlobal officers), (SDNY June 26, 2015) (final approval of class settlement with underwriters), (SDNY Apr. 20, 2015) (preliminary settlement with PWC); AG Oncon, et al. v. Corzine, et al., No. 14-cv-00396 (SDNY Jan. 5, 2015) (settlement agreement between investors group and underwriters); In re MF Global Inc., No. 11-2790 (Bankr. SDNY 2014) (distribution to unsecured creditors of brokerage MF Global Inc.); In re MF Global Inc., No. 11-2790 (Bankr. SDNY June 4, 2012) (Report of the Trustee's Investigation and Recommendations). See also Staff Report on MF Global for House Subcommittee on Oversight & Investigations (Nov. 15, 2012); In re MF Global Holdings, No. 11-15059 (Bankr. SDNY June 4, 2012) (First Report of Chapter 11 Trustee of MF Global Holdings).

The trustee overseeing MF Global Holdings bankruptcy also sued officers for breaching their fiduciary duties of care and loyalty. Tavakoli v. Corzine, No. 11-15059 (Bankr. SDNY Sept. 17, 2013) (amended complaint); Freeh v. Corzine, No. 11-15059 (Bankr. SDNY Apr. 22, 2013) (complaint); In re MF Global Holdings, No. 11-15059 (Bankr. SDNY Apr. 3, 2013) (Trustee's Report on its investigation of MF Global Holdings).

In a CFTC enforcement action, MF Global admitted liability and agreed to pay more than $1.2 billion in restitution and fines to resolve claims that it misused customer funds. See CFTC v. MF Global, No. 11- Civ-7866 (SDNY Nov. 8, 2013) (consent order with subsidiary), (SDNY Dec. 23, 2014) (consent order with parent holding company); Review of the [CFTC's] Oversight and Regulation of MF Global (CFTC, May 20, 2013).

h. In 2012, the CFTC sued Peregrine Financial Group and its CEO for allegedly failing to maintain adequate customer funds in segregated accounts and making false statements in filings about the segregation of customer funds. The lawsuit came a day after the NFA took enforcement action against Peregrine, prohibiting it from soliciting or accepting additional customer accounts or funds and accepting or placing trades for customers. CFTC v. Peregrine, 12-cv-05383 (N.D. Ill. 2012) (default judgment: Feb. 13, 2013). See also NFA News Release, July 9, 2012 (emergency enforcement action against Peregrine); Wall St. J., July 11, 2012; Forbes July 10, 2012.

   In June 2013, the CFTC filed a complaint against U.S. Bank N.A. for unlawfully using Peregrine's customer segregated funds. The complaint alleges U.S. Bank knew that transfers to Wasendorf were not for the benefit of Peregrine's customers. CFTC v. U.S. Bank, 13-Civ-2041- ESM (N.D. Iowa, ED. 2013) (complaint). The parties subsequently settled the matter.

i. Law suits over hedge fund failures and press commentary have raised the question of whether regulated financial institutions serving as prime brokers to hedge funds have any duty to monitor the activities of such funds. See, e.g., In re Manhattan Investment Fund, 359 B.R. 510 (Bankr. SDNY 2007) (determination that Bear Stearns failed to act on signs of fraudulent activity, and that payments made through accounts at Bear Stearns were recoverable).

3. Market turbulence affecting hedge funds (see Part I.A.6 above) led banking and other regulators to examine how risk management, disclosure and regulatory processes can be improved.

   a. IOSCO Media Release, Mar. 22, 2010, sets out a template for the global collection and exchange of information by regulators relating to hedge fund activities.

b. The PWG established two private sector groups -- the Asset Managers' Committee (major institutional alternative asset managers) and the Investors' Committee (major institutional investors) -- to address systemic risk and investor protection. The Committees made recommendations for asset managers/investors with respect to hedge fund disclosure, valuation, risk management, trading and compliance practices. See Best Practices for the Hedge Fund Industry – Report of the Asset Managers' Committee to the [PWG] (Jan. 15, 2009); Principles and Best Practices for Hedge Fund Investors -- Report of the Investors' Committee to the [PWG] (Jan. 15, 2009); Principles and Guidelines Regarding Private Pools of Capital (PWG, Feb. 22, 2007).

   See also e.g. The Cost of Compliance: Global Hedge Fund Survey (KPMG, 2013); Hedge Funds: Legal Status and Proposals for Regulation (CRS, Aug. 27, 2009); Hedge Funds: Should They Be Regulated? (CRS, July 13, 2009); Hedge Funds Oversight: Final Report (IOSCO, June 22, 2009); Hedge Funds: Overview of Regulatory Oversight, Counterparty Risks, and Investment Challenges (GAO, May 7, 2009); Hedge Fund Activism: Findings and Recommendations for Corporations and Investors (Conference Board Governance Center, Mar. 18, 2008); Some Lessons on the Rescue of [LTCM], Federal Reserve Bank of Cleveland Policy Discussion Paper No. 19 (Apr. 2007); Final Report: The Regulatory Environment for Hedge Funds – A Survey and Comparison (IOSCO, Nov. 2006); Hedge Funds: A Discussion of Risk and Regulatory Engagement (FSA, Mar. 2006 (Feedback), June 2005); Interagency Memorandum on Leveraged Finance: Sound Risk Management Practices (2001) (the "Interagency Risk Management Guidance"); The Costs and Benefits of Moral Suasion: Evidence from the Rescue of [LTCM] (BIS, Aug. 2001); Responses to Questions Concerning [LTCM] and Related Events (GAO, Feb. 23, 2000); Hedge Funds, Leverage, and the Lessons of [LTCM] (PWG, Apr. 1999).

c. Disclosure issues are addressed in Hedge Fund Reporting Survey (EDHEC Risk and Asset Management Research Centre, Nov. 2008); Leading-Practice Disclosures for Selected Exposures (Senior Supervisors Group, Apr. 11, 2008). See also Hedge

Fund Standards: Final Report (Hedge Fund Working Group, Jan. 2008) (best disclosure practices by London's largest hedge funds on (A) investment strategies and risks, (B) fees and withdrawal terms, (C) investor side agreements, (D) valuation, (E) the percentage of the fund comprising assets that are difficult to value, (F) internal risk management, and (G) potential conflicts of interest from service providers); Principles for the Valuation of Hedge Fund Portfolios (IOSCO, Nov. 2007).

d. The Cayman Islands Monetary Authority announced that Cayman-registered hedge funds are required to disclose 31 key data points, including assets managed, key personnel, strategies employed and significant corporate changes.

4. The SEC and other regulators have focused on hedge funds in light of the continued growth of the industry and concerns that hedge funds are being made available to retail investors, including through "funds of funds".

   Regulators identified key areas of concern with respect to hedge funds, including: (A) customer abuses, such as the misappropriation of funds; (B) market abuses, such as disclosure and trading violations; (C) conflicts of interest in the relationship between banks/broker-dealers and funds, such as the creation of "hedge fund hotels" at or near bank/broker-dealer premises; (D) the roles of prime brokers and custodians; (E) supervision of broker-dealer employees physically located at hedge fund clients; (F) crossing large customer orders with hedge fund clients; (G) insider trading by hedge funds, particularly with respect to "private investment in public equity" (PIPE) transactions; (H) portfolio valuation issues; and (I) "retailization" of hedge fund clients. See, e.g., Remarks by Director of SEC OCIE di Florio, May 3, 2011; Wall St. J., May 16, 2011; Wood River Capital Management, SEC Litigation Releases No. 19428 (Oct. 13, 2005) (complaint), No. 20234 (Aug. 9, 2007) (judgment) (alleged fraudulent representations concerning audits and investment diversification when Wood River had not engaged an auditor and had invested up to 65% of its assets in a single security).

5. Dodd-Frank requires certain advisers to hedge funds and private equity funds that were previously exempt from registration to register as investment advisers under the Advisers Act.

a. In a pre-Dodd Frank action, SEC Release No. IA-2333 (Dec. 10, 2004), which would have required hedge fund advisers to register under the Advisers Act, was vacated in Goldstein v. SEC, 451 F.3d 873 (D.C. Cir. 2006).

b. Dodd-Frank eliminates the "private adviser exemption" under the Advisers Act, which most private fund advisers relied upon to avoid registration. However, Dodd-Frank requires the SEC to provide an exemption from registration for advisers that act solely as advisers to private funds (defined as an issuer that would be an investment company but for 1940 Act § 3(c)(1) or § 3(c)(7) that have an aggregate AUM in the U.S. of less than $150 million). Advisers Act §§ 203(b), 407(m)-(n).

c. SEC Releases No. IA-3221/3222 (June 2, 2011) reflect the adoption of (A) rules requiring the registration of private fund and hedge fund advisers (including a requirement that such advisers provide basic organizational and operational information about the funds they manage and identify "gatekeepers" that perform critical roles for advisers and the private funds they manage (e.g., auditors, prime brokers, custodians, administrators)); and (B) rules implementing certain other Dodd-Frank amendments to the Advisers Act (including as to identification of mid-sized advisers that must transition to state registration and as to new exemptions from registration). See also 76 Fed. Reg. 71128 (Nov. 16, 2011) (Joint CFTC/SEC final rule under the CEA and the Advisers Act that requires registered investment advisers and CTAs to file Form PF with the SEC (designed to assist the FSOC in its assessment of systemic risk in the U.S. financial system)). See also Parts VIII.C above and IX.C below.

6. The GAO published a study on the feasibility of an SRO to oversee private funds. See Private Fund Advisers: Although a[n] [SRO] Could Supplement SEC Oversight It Would Present Challenges and Trade-offs (GAO, July 11, 2011).

7. Treasury and FRB reporting requirements are applicable to the cross-border holdings of long-term securities by private equity funds, hedge fund advisers and other financial institutions. See Part XI below.

8. In recommending hedge fund and other "non-conventional" investments, a broker-dealer should have a reasonable basis for believing that the product is suitable for investors generally (through an appropriate due diligence investigation) and must make a customer-specific suitability determination. See, e.g., NASD Notice to Member 03-71 (Nov. 2003); NASD Notice to Members 03-07 (Feb. 2003).

   FINRA also regulates hedge fund sales material. See, e.g., NASD Letter: "Use of Related Performance Information in Sales Material for Private Equity Funds and Other Similar Funds", Dec. 30, 2003.

9. Securities regulators have brought actions against hedge fund managers alleging actionable misconduct. See, e.g., Citigroup Alternative Investments LLC and Citigroup Global Markets Inc., SEC Admin. Proc. No. 3-16757 (Aug. 17, 2015) (two Citigroup affiliates paid $180 million to settle charges of false and misleading disclosures to investors in two failed hedge funds); Westgate Capital Management, SEC Litigation Release No. 20911 (Feb. 25, 2009) (misleading marketing materials and valuations); Quattro Global Capital, SEC Admin. Proc. No. 3-12725 (Aug. 15, 2007) (failure to file Forms 13F reporting securities under management); Beacon Hill Asset Management, SEC Litigation Releases No. 18950 (Oct. 28, 2004) (judgment), No. 17831 (Nov. 7, 2002) (alleged fraud, inflation of prices in underlying securities and improper trading); Citigroup Global Markets, NASD News Release, Oct. 25, 2004 (inappropriate sales literature); NASD Letters of Acceptance, Waiver and Consent No. CAF040051 re UBS (Sept. 2004) (inadequate risk disclosure), No. CAF030015 re Altegris Investments (Apr. 2003) (inadequate risk disclosure).

   In addition, the FTC monitors hedge fund investments for compliance with antitrust laws, and cited one hedge fund manager for failing to make a required Hart-Scott filing. U.S. v. Sacane, Civ. Act. No. 05-1897 (PLF) (D.D.C. 2005).

10. In CSX Corp. v. Children's Investment Fund Management (UK), 562 F. Supp. 2d 511 (SDNY 2008) ("CSX"), activist hedge fund defendants were found to have violated 1934 Act § 13(d) by failing to disclose their "beneficial ownership" of shares established through long positions in TRS, referencing shares that were entered into as

part of a "plan or scheme" to evade § 13(d)'s reporting requirement. On appeal at the Second Circuit, no further guidance was provided on the issue of "long party" beneficial ownership of shares owned by a "short party", despite the centrality of the issue to the case. See CSX, 654 F.3d 296 (2d Cir. 2011). Compare, however, SEC Release No. 34-64628 (June 14, 2011) (final rule with respect to beneficial ownership reporting requirements for SBS that preserves the status quo regarding disclosure of positions in SBS while the SEC develops a proposal to modernize reporting under 1934 Act § 13(a)); SEC Letter to SDNY, June 4, 2008; Disclosure of Contracts for Differences (FSA Consultation Paper, Nov. 2007) (discussion of when disclosure should be required of economic long positions). See also Donoghue v. CSX Corp., 2009 U.S. Dist. LEXIS 97086 (SDNY 2009) (settlement).

See Part VII.A.1 below.

11. For other information on financial institution/hedge fund developments, expansion of hedge fund offerings, and regulatory actions and concerns, see generally, e.g., Opportunities and Challenges for Hedge Funds in the Coming Era of Optimization (Citi Investor Services, 2014); Report on Hedge Fund Survey (IOSCO, Oct. 2013); Remarks of SEC Director of Investment Management Champ, Sept. 12, 2013 (Current SEC Priorities Regarding Hedge Fund Managers); Institutional Investment in Hedge Funds: Evolving Investor Portfolio Construction Drives Product Convergence (Citi Prime Finance, June 2012); Defined Benefit Pension Plans: Recent Developments Highlight Challenges of Hedge Fund and Private Equity Investing (GAO, Feb. 2012); Assessing Possible Sources of Systemic Risk from Hedge Funds (FSA, Feb. 2010); Hedge Funds: How They Serve Investors in U.S. and Global Markets (Coalition of Private Investment Companies, 2009); Elements of International Regulatory Standards on Funds of Hedge Funds Related Issues Based on Best Market Practices (IOSCO, Sept. 2009); Report on Funds of Hedge Funds (IOSCO, June 2008); Update of the [BIS Financial Stability Forum ("FSF") 2000] Report on [HLIs] (2007); Sound Practices for Hedge Fund Managers (Managed Funds Association, 2007); Hedge Fund Failures (CRS, June 21, 2007); Precautions that Pay Off: Risk Management and Valuation Practices in the Global Hedge Fund Industry (Deloitte, 2007); Hedge Fund Operational Risk (BNY, June 2006); Moloney, et al., "Secondary

Liability of Broker-dealers to Hedge Fund Investors", Derivatives Litigation Reporter, Aug. 27, 2001; Wall St. J., Sept. 9, 2013, May 16, Apr. 20, 18, Feb. 3, 2011.

12. Sovereign wealth funds, and their implications for investment in U.S. financial institutions, are discussed in Part VII.A.7.e above.

IX. BROKERAGE AND RELATED ACTIVITIES

A. SCOPE AND PERMISSIBILITY OF SECURITIES BROKERAGE AND RISKLESS PRINCIPAL ACTIVITIES

1. Securities Brokerage Activities

a. Background

(i) Brokerage services encompass a wide range of activities, including (A) execution and clearance of transactions in securities and other financial instruments; (B) services as corporate transfer agent, remarketing agent, registrar, or agent in the operation of dividend reinvestment and similar plans; (C) automatic investment services; and (D) "sweeps" of deposits into various investment options.

In 2011, BHCs recorded nearly $37 billion in securities brokerage income, and 57% of BHCs (and 21% of banks) reported brokerage revenues.

See generally Part VIII above and Part XI below; Financial Services Fact Book (Financial Services Roundtable, 2013).

(ii) As a federal banking law matter, FHCs, BHCs and banks may conduct securities brokerage activities. See BHCA § 4(k) (FHCs); Schwab Decision, 12 C.F.R. § 225.25(b)(7) (BHCs); 12 U.S.C. § 24(7), SIA v. Comptroller, 577 F. Supp. 252 (D.D.C. 1983), aff'd, 758 F.2d 739, reh. denied, 765 F.2d 1196 (D.C. Cir. 1985), cert. denied (on permissibility of brokerage issue), 474 U.S. 1054 (1986) (brokerage offices do not constitute "branches" for purposes of the interstate branching prohibitions of the McFadden Act, 12 U.S.C. § 36) (national banks).

(iii) Prior to the GLBA, banks were generally exempted from registration and regulation as "brokers" or "dealers" under the federal securities laws. Under the GLBA and regulations adopted by the SEC and the Board, however, banks that do not confine their broker-dealer activities to specific functional exemptions are not excluded from broker-dealer registration and regulation, effectively requiring banking organizations to conduct their non-exempt securities activities in a broker-dealer affiliate subject to SEC oversight. See Part IX.B below.

b. Illustrative Brokerage Services

(i) "Full Service" Brokerage

A) BHCs/FHCs: Regulation Y permissible non-banking activities for BHCs and FHCs include full-service brokerage and financial advisory activities. 12 C.F.R. § 225.28(b)(7)(i). See also, e.g., Board SR Letter 94-53 (FIS) (Oct. 24, 1994) (investment adviser activities).

This represents the culmination of a long process, commencing with NatWest, 72 Fed. Res. Bull. 584 (1986) (the "NatWest Order") (non-discretionary full-service brokerage to institutional customers), aff'd, SIA v. Board, 821 F.2d 810 (D.C. Cir. 1987) (the "NatWest Decision"), cert. denied, 484 U.S. 1005 (1988).

Following the NatWest Order, the Board expanded the scope of permitted full service brokerage incrementally, including:

i) Institutional brokerage: See, e.g., Sovran Fin. Corp., 73 Fed. Res. Bull. 744, 225 (1987), 74 Fed. Res. Bull. 504 (1988); Morgan, 73 Fed. Res. Bull. 810 (1987); Shawmut

Corp., 52 Fed. Reg. 38273 (Oct. 15, 1987) (solicitation of public comments) (approved Nov. 12, 1987); BTNY, 74 Fed. Res. Bull. 695 (1988) (the "BTNY Brokerage Order"); ABN AMRO, 76 Fed. Res. Bull. 682 (1990).

ii) Retail brokerage: See, e.g., Bank of New England, 74 Fed. Res. Bull. 700 (1988); First Regional and First Eastern Orders; Banc One Corp., 76 Fed. Res. Bull. 756 (1990); Signet, 75 Fed. Res. Bull. 34 (1989); and PNC Fin. Corp., 75 Fed. Res. Bull. 396 (1989) (the "PNC Order"); 57 Fed. Reg. 41381 (Sept. 10, 1992).

iii) Retail funds management: See, e.g., CoreStates Fin. Corp., 80 Fed. Res. Bull. 644 (1994); CNB, 82 Fed. Res. Bull. 952 (1996); Keystone Fin., 82 Fed. Res. Bull. 84 (1996) and Board Letters, dated June 13, 1996, Apr. 29, 1998; Cambridge Bancorp, 82 Fed. Res. Bull. 1049 (1996).

iv) Non-security funds management: See, e.g., BNP/Cooper-Neff Order (futures and options on futures on exchange-traded financial commodities); Crédit Suisse, 81 Fed. Res. Bull. 803 (1995) (non-financial commodities); AIB, 60 Fed. Reg. 26885 (May 19, 1995) (solicitation of public comments) (approved July 7, 1995) (financial commodities); Commerzbank Letter and Board Letter, Mar. 28, 1995 re: SBC (futures and options on futures).

B) Banks: National bank subsidiaries may provide brokerage and/or advisory services, and may engage in multiple related securities activities. See, e.g., 12 C.F.R. §§ 5.34(e)(5)(v)(I), (K), (N) and (W). See also, e.g., Comptroller Interpretive Letter No. 929 (Feb. 11, 2002) ("Letter No. 929"), CCH Fed. Banking L. Rep. ¶ 81-454; Approvals No. 233; No. 208; No. 190; Letter No. 658; Comptroller Conditional Approval No. 165 (Dec. 15, 1994); Approval No. 164; Comptroller NatWest Letter; Comptroller Fleet Letter; Comptroller 1992 Letter; Comptroller Chase-CPO Letter; Letters No. 562; No. 492; Comptroller Unpublished Letter (Sept. 30, 1992) re NatWest USA; Comptroller Unpublished Letters (Sept. 22, 1988), (Sept. 19, 1988), (July 7, 1988), (May 11, 1988), (June 30, 1987); Comptroller American National Letter; Comptroller 1988 Letter; Letter No. 415; Memorandum to District Deputy Comptroller and District Counsels, dated Nov. 20, 1987; Letter No. 386; Comptroller Interpretive Letters Nos. 371 and 375 (June 13, Sept. 25, 1986) (together, the "Vickers da Costa Letter"), CCH Fed. Banking L. Rep. ¶¶ 85,541, 85,545; Comptroller Letters (Feb. 17, 1987) re Chase Bank, (Feb. 4, 1987) re SecPac Bank; Comptroller Interpretive Letters No. 370 (Apr. 16, 1986) ("Letter No. 370"), CCH Fed. Banking L. Rep. ¶ 85,540; No. 367 (Aug. 19, 1986), CCH Fed. Banking L. Rep. ¶ 85,537; No. 365 (Aug. 11, 1986) ("Letter No. 365"), CCH Fed. Banking L. Rep. ¶ 85,535; No. 360 (Apr. 16, 1986), CCH Fed. Banking L. Rep. ¶ 85,530; Comptroller No-Action Letter No. 85-1 (July 30, 1985), CCH Fed. Banking L. Rep. ¶ 84,001; Comptroller No-Objection Letter No. 85-51 (July 30, 1985), CCH Fed. Banking L. Rep. ¶ 86,482; Comptroller Interpretive Letter No. 353 (July 30, 1985), CCH Fed. Banking L. Rep. ¶ 85,523; Letter No. 346; Comptroller Letters (July 12, 1985) re SecPac Bank, (Aug. 7, 1984) re First National Bank (Fayetteville); Comptroller Unpublished Letter (July 20, 1984); Decision of the Comptroller Concerning an Application by American National Bank of Austin (Sept. 2, 1983), CCH Fed. Banking L. Rep. ¶ 99,732. Compare Part I.D.4.b.ii (preemption discussion).

In general, bank exercise of investment discretion or the provision of investment advice to customers for a fee requires fiduciary powers. See 12 C.F.R. Part 9 and § 5.34(e)(5)(vii).

In FDIC Opinion No. 6, the FDIC had at one point indicated some doubt as to the permissibility of the combination of brokerage and advisory services. The FDIC would not come to the same conclusion today.

(ii) Securities Borrowing/Lending/Repurchase/Financing Activities

A) Securities borrowing/lending/repo/financing activities are well-recognized banking activities. See, e.g., A Pilot Survey of Agent Securities Lending Activity (FRBNY, Aug. 2016); Reference Guide to U.S. Repo and Securities Lending Markets, (OFR Working Paper, Sept. 9, 2015); Securities Lending (FRBNY, Mar. 2012); Bank of America Section 23A Letter; Securities Lending Section 23A Letter; Securities Lending Transactions: Market Developments and Implications (IOSCO/BIS, July 1999); FFIEC Repo Policy Statement; FFIEC Supervisory Policy Statement on Securities Lending, Fed. Res. Reg. Serv. ¶ 3-1579.5 (July 21, 1997); Approval No. 190; Letters No. 629; No. 380; Comptroller Letter No. 376 (Oct. 22, 1986), CCH Fed. Banking L. Rep. ¶ 85,600. See also Securities Lending and Repos: Market Overview and Financial Stability Issues (FSB, Apr. 27, 2012).

But see SEC v. Bello, No. 12-CV-03794 (D.N.J., July 6, 2012) (enjoining individual and his controlled firms from violations of the Securities Acts for acting as unregistered broker in brokering stock-collateralized loans, and for engaging in unregistered sales of restricted shares pledged as collateral for such loans); SEC Admin. Proc. Nos. 3-14924 (June 21, 2012) and 3-14941 (July 9,

2012) (sanctions in same case for acting as unregistered broker in connection with activity with respect to loans secured by securities).

Regulatory guidance with respect to repo activities is set out in Part II.D.3.a.vii above, and issues under Section 23A are discussed in Part III.A.5 above.

B) SEC Rule 3a5-3 exempts a bank acting as a "conduit lender" from regulation under the 1934 Act as a "dealer" to the extent it engages in or effects "securities lending transactions" or provides "securities lending services" in connection with or on behalf of a Qualified Investor or an employee benefit plan that owns and invests at least $25 million.

i) A "conduit lender" is a bank that, as principal for its own account, borrows or loans securities and contemporaneously loans or borrows the same (or substituted) securities.

ii) A "securities lending transaction" is one in which the owner lends securities temporarily pursuant to an agreement under which the lender retains the economic interest in such securities, and has the right to terminate the transaction and to recall the loaned securities on agreed terms.

iii) "Securities lending services" include (A) selecting and negotiating with a securities borrower; (B) executing loans with securities borrowers; (C) receiving or delivering loaned securities or collateral; (D) providing services incidental to the administration of securities lending transactions (e.g., recordkeeping services); (E) investing cash collateral; and (F) indemnifying securities lenders.

C) Republic, 78 Fed. Res. Bull. 955 (1992), permitted a subsidiary of a BHC to act as "conduit" or "intermediary" in securities borrowing/lending.

Although the Board initially treated conduit activities as separate from the brokerage empowerment now codified at 12 C.F.R. § 225.28(b)(7)(i), it appears that the Board now regards conduit activities as subsumed within such empowerment. Compare, e.g., BankBoston Corp., 83 Fed. Res. Bull. 42 (1997), with 61 Fed. Reg. 52946 (Oct. 9, 1996) (solicitation of public comments). See also Securities Lending 23A Letter.

The Republic Section 20 Order permitted Republic's Section 20 Subsidiary to engage in "bonds borrowed transactions", where the Subsidiary would borrow securities from customer custodial accounts at trust departments of bank affiliates.

D) Comptroller Interpretive Letter No. 1026 (Apr. 27, 2005) ("Letter No. 1026"), CCH Fed. Banking L. Rep. ¶ 81 555, authorized securities conduit lending services for national banks, even for bank ineligible securities. See also Letter No. 1105; NYSDFS Memorandum, dated Sept. 29, 2011 (NY banks).

E) Chase Bank (avail. July 24, 2001) granted no-action relief to permit a bank to invest cash collateral received pursuant to securities lending arrangements in short-term instruments through joint accounts. The SEC also permitted banks to lend securities as to which such banks act as custodian for advised funds. See, e.g., Nuveen Investment Funds (avail. Feb. 13, 2014); Norwest Bank Minn. and Society Nat'l Bank (avail. May 25, 1995).

F) The LTCB Consent Order followed NYBD and FDIC enforcement action relating to securities lending activities conducted without proper financial, operational and risk controls and supervision.

See also, e.g., Goldman, Sachs & Co., SEC Admin. Proc. No. 3-17053 (Jan. 14, 2016) (penalty for accepting short sale orders from customers without adequate review to confirm that broker had borrowed, arranged to borrow, or reasonably believed it could borrow the security); Diebold v. Northern Trust Investments, N.A., 2012 WL 4017929 (N.D. Ill. 2012) (denial of motion to dismiss investor claims that investment manager breached fiduciary duty by imprudently managing collateral received from securities borrowers); SEC Litigation Release No. 20526 (Apr. 15, 2008) (allegation that JPMorgan Chase Bank stock loan trader conspired with finders to misappropriate stock loan profits); Janney Montgomery Scott, NYSE Press Release, Aug. 14, 2007 (fine and censure for payments to stock loan finders who performed no legitimate business function); Van der Moolen Specialists, NYSE Hearing Board Decision 06-91 (June 13, 2006) (fine and censure for rule violations in stock loan activities).

G) Letter No. 865 concluded that a national bank may pool in a common trust fund collateral held as trustee pursuant to securities lending agreements. See Part VIII.B.3.b.ii.F.vii above.

(iii) Custody Services

Core custody services include the settlement, safekeeping, and reporting of customer marketable securities and cash. Global custodians, which provide custody services for cross-border securities transactions, typically also execute FX transactions. Bank custodians may also offer securities lending, performance measurement, risk measurement, and compliance monitoring. See, e.g., The Custody Services of Banks (TCH, July 2016); Standards for the Custody of

Collective Investment Schemes' Assets (IOSCO, Nov. 2015); Comptroller's Handbook: Custody Services; Recommendations Regarding the Protection of Client Assets (IOSCO, Feb. 2013); R&M Surveys Global Custody 2009; The Securities Custody Industry (European Central Bank ("ECB") Occasional Paper No. 68, Aug. 2007); M&A Law Report, Feb. 8, 2010.

In response to new regulatory requirements for collateralization of derivatives, some institutions are offering collateral management services for cleared and non-cleared OTC derivatives. See, e.g., Developments in Collateral Management Services (BIS Committee on Payments and Market Infrastructures, Sept. 2014); BNP Paribas Press Release, June 26, 2013 ("Collateral Access" product).

Custody-related regulatory precedents include, e.g., Barclays Bank plc, FCA Final Notice (Sept. 23, 2014) (failing to maintain adequate policies, books and records and failing to ensure safe-keeping of client assets across affiliates and sub-custodians); JP Morgan Securities Ltd., FSA Final Notice (May 25, 2010) (failing to protect client money by segregating it appropriately); BNYM, 93 Fed. Res. Bull. C80 (2007) (using concentration of domestic assets under custody as the measure of the effect on competition for "securities services", including: custody services; clearing, corporate trust and depository receipts services; securities lending; transfer agent services, fund administration and accounting services; and FX); Comptroller Interpretive Letter No. 1078 (Apr. 19, 2007), CCH Fed. Banking L. Rep. ¶ 81-610 (holding and paying interest as custodian on cash deposits from broker-dealers for the benefit of broker-dealer customers); Letter No. 1026 (custodial and securities lending services); Comptroller Interpretive Letter No. 1013 (Jan. 7, 2005), CCH Fed. Banking L. Rep. ¶ 81-543 (custodian of gold bullion and cash); FDIC FIL-38-2002 (Apr. 25, 2002), CCH Fed. Banking L. Rep. ¶ 62-292 (securities and custodial accounts held at broker-dealers). See also Part XI.E.2.b below regarding an IIB request on the ability of non-U.S. banks to provide custody services to U.S. investors.

For broker-dealers, § 15(c)(3) of the 1934 Act and the SEC's Rule 15c3-3 (also known as the ("Customer Protection Rule") requires possession, control and segregation of customer fully-paid securities held in custody by the broker-dealer, as well as a reserve requirement for brokers to set aside net amounts owed to customers. In Merrill Lynch, SEC Admin. Proc. No. 3-17312 (June 23, 2016), the SEC found that Merrill Lynch had (A) held billions of dollars of customer securities in clearing accounts that were subject to liens by its clearing banks, in violation of Rule 15c3-3 and (B) engaged in certain complex options transactions and margin loans that reduced its reserve deposit artificially. Merrill Lynch was fined $415 million. See also William Tirrell, SEC Admin. Proc. No. 3-17313 (June 23, 2016) (head of regulatory reporting and financial/operational principal; cease-and-desist proceedings initiated). Following the Merrill Lynch order, the SEC launched a Customer Protection Rule Initiative under which it (1) provides incentives to broker-dealers to proactively report potential violations of customer protection requirements to the SEC and (2) conducts risk-based examinations of certain broker-dealers to assess compliance with customer protection rules. SEC Press Release 2016-188 (June 23, 2016).

(iv) Administrative, Corporate Trust and Other "Shareholder Services"

Corporate brokerage-related and administrative services include (A) shareholder record maintenance; (B) stock option processing, recordkeeping and account maintenance; (C) restricted securities processing and recordkeeping; (D) stock watch services; (E) dividend payment/reinvestment and employee stock purchase plan administration; (F) shareholder meeting services; (G) reorganization services (e.g., share exchanges, remitting payments, issuing shares in subscription offerings and acting as depository in tender/exchange offers); (H) investor communication services; (I) employee investment program processing services; (J) acting as registrar, transfer agent, paying agent, dividend disbursing agent, stock option administrator, rights agent, reorganization agent, escheat agent and proxy agent or administrator; (K) tender option or remarketing agent services; (L) securities processing; and (M) statistical analyses and reports.

See, e.g., 81 Fed. Reg. 27295 (May 6, 2016) (FDIC rule regarding registration of savings associations as transfer agents); SEC Release No. 34-76743 (Dec. 22, 2015) (advance notice of proposed rulemaking describing new requirements for transfer agents, including reporting requirements and operational safeguards, and a concept release regarding additional issues of interest to SEC); Comptroller Interpretive Letter No. 1111 (Sept. 9, 2008), CCH Fed. Banking L. Rep. ¶ 81-644 (waiver of certain confirmation requirements in respect of transfer agent function for stock purchase and sale plans); Comptroller Bulletin No. 2007-6 (Jan. 25, 2007) (transfer agent registration and reporting); Corporate Decision No. 2005-06 (June 10, 2005) ("Corporate Decision No. 2005-06"); Comptroller Interpretive Letter No. 1029 (May 23, 2005), CCH Fed. Banking L. Rep. ¶ 81-558 (waiving certain requirements of 12 C.F.R. Part 12 as they relate to stock purchase and sale plans); BankOne Corp., 85 Fed. Res. Bull. 65 (1999); 1996 DTC Approval Letter; Corporate Decision No. 96-52; Chase, Mellon, 82 Fed. Res. Bull. 1041 (1996); Chemical, Mellon, 60 Fed. Reg. 13987 (Mar. 15, 1995) (solicitation of public comments) (approved Apr. 18, 1995) (the "Chase-Mellon Approval") (creation of joint venture, ChaseMellon Shareholder Services ("ChaseMellon")); State Street Boston Corp., 81 Fed. Res. Bull. 1049 and 297 (1995) and Letter to FRBB, dated Sept. 22, 1995; Bancorp Hawaii, 71 Fed. Res. Bull. 168 (1985); Comptroller Unpublished Letter (Sept. 15, 1995). See also, e.g., Manufacturers Hanover (avail. Mar. 8, 1990) (without registration under the 1933 Act and compliance with 1934 Act tender offer provisions, trust company permitted to solicit shareholders of companies who receive fewer than 100 shares in a spin-off to have them elect to have the trust company sell the odd-lot shares, to receive stock certificates, or to have the trust company round-up odd-lot shareholdings).

(v) “Reverse Inquiry” Services

In providing these services, a bank acts as agent for its customers in the purchase of securities to be issued by corporate entities and registered under the 1933 Act. See, e.g., Comptroller 1993 Continental Letter. See also Part IX.A.1.d below.

(vi) “Kiosking” and Related Networking Arrangements

These services are described in Part XII.B.6 below.

(vii) “Prime Brokerage” and Related Services

These services involve coordinated clearance, custody, settlement, recordkeeping, short sales and extension of margin credit in respect of securities trades. The main driver of the growth in prime brokerage revenues is the increase in the number of hedge funds and the amount of assets under hedge fund management. In a prime brokerage relationship, a customer may execute securities trades with different broker-dealers (“executing brokers”) and have those trades cleared by a single broker-dealer, the prime broker.

The framework for prime brokerage in the U.S. equities markets is described in the Prime Brokerage No-Action Letters and generally documented using standard SIFMA agreements. FINRA has proposed best practices for U.S. broker-dealers regarding prime brokerage arrangements with non-U.S. broker-dealers. See FINRA Regulatory Notice 07-58 (Nov. 2007).

Prime brokers also provide securities lending, performance reporting (including net asset value calculations), risk management systems and direct market access through electronic trading platforms. Hedge funds account for more than 40% of brokerage revenue at large securities firms, and large hedge funds tend to use multiple prime brokers.

In addition to traditional securities prime brokerage services, many swaps dealers also offer derivatives prime brokerage services in the OTC derivatives market. In a derivatives prime brokerage arrangement, the client negotiates derivatives trades with executing dealers that, upon execution, are "given up" for clearance to its derivatives prime broker. The client faces its derivatives prime broker, and the prime broker faces all of the executing derivatives dealers. These arrangements also allow for significant netting and compression of exposure among derivative dealers that are also prime brokers.

See generally, e.g., American Banker, Nov. 10, 2014; Senior Credit Officer Opinion Survey on Dealer Financing Terms (Board, June 2012); NY Times Dealbook, Apr. 27, 2012; Reuters, Nov. 3, 2010.

Prime brokerage issues are also discussed in Part VIII.D and Part VIII.C.2.d.iv.E above.

(viii) Securities Exchanges

A) FHCs and BHCs may own securities exchanges. See, e.g., 12 C.F.R. § 225.86(a)(ii); J.P. Morgan, 86 Fed. Res. Bull. 61 (2000) ("Tradepoint Order"). See generally M&A L. Rep., Aug. 22, 2005 (Citigroup, CSFB, Morgan Stanley, UBS acquisition of combined 25% interest in the PSX); IFLR, July 2007. See also Part XII.B below.

B) National banks may engage in clearing activities in connection with trades executed on securities exchanges. See, e.g., Comptroller Interpretive Letter No. 1102 (Oct. 14, 2008) ("Letter No. 1102"); CCH Fed. Banking L. Rep. ¶ 81-634; Comptroller Operating Subsidiary Notice Application Control Number: 94-ML-08-0002 (Sept. 21, 1994) (clearing membership in the Singapore International Monetary Exchange); Letters No. 494; No. 422; No. 384; No. 380; Comptroller Interpretive Letter No. 372 (Nov. 7, 1986), CCH Fed. Banking L. Rep. ¶ 85-542. See also, e.g., Letter No. 1113 (OTC CDS clearing house). See generally Market Structure Developments in the Clearing Industry: Implications for Financial Stability (BIS, Sept. 2010).

c. Sweep Programs

"Sweep programs" in which deposits are swept into various investment options, or broker-dealer balances are swept into bank deposits, is a permissible agency activity. See Part VIII.C.1.b.ii.D above.

(i) Particular concerns may exist where the "sweep" is directed by a bank to the securities of an affiliate. See, e.g., Comptroller Investment Securities Letter No. 44 (Oct. 10, 1990) (investigation of CP sweep program following press reports concerning the condition of the bank's parent BHC); Orbanco Financial Services, 68 Fed. Res. Bull. 198 (1982) (denial of application to offer notes of parent BHC to subsidiary bank deposit customers); Board Ruling (Nov. 4, 1982), Fed. Res. Reg. Serv. ¶ 4-318.1 (sweep by bank into parent BHC CP permitted if CP proceeds are only invested in bank CDs). See also Part IX.E.3.d.viii below.

(ii) Securities law issues relating to the investment products made part of the sweep must also be addressed. See, e.g., OCC Bulletin 2016-17 (May 19, 2016) (warning bank deposit sweep programs, as well as bank fiduciaries and bank investors, to monitor risks of, and developments in SEC regulations related to, money market funds); Union Planters National Bank (avail. Oct. 4, 1984) (sweep into U.S. Government securities repo agreements without 1933 Act registration).

(iii) Rule 15c3-3 under the 1934 Act imposes certain obligations on broker-dealers when they transfer free credit balances out of a customer's brokerage account. The requirements applicable depend on whether a transfer is pursuant to a "sweep program" under the rule -- defined as a service by a broker-dealer whereby the customer has the option to have free credit balances swept to either a money market mutual fund or an FDIC-insured deposit account. With respect to "sweep programs", the Rule's requirements include consent, disclosure and notice obligations. See 17 C.F.R. § 240.15c3-3(j). See also SIFMA (avail. Feb. 26, 2014) (time-limited relief allowing broker-dealers to obtain and document a customer's oral consent to a sweep program and implementing a process reasonably designed to obtain written consent within 90 calendar days of account opening).

Transfers of free credit balances not pursuant to a "sweep program" may be made only upon a specific order, authorization or draft from the customer. The staff of the Division of Trading and Markets have provided guidance as to how transfers outside of a "sweep program" may be conducted, including with respect to oral authorizations and transfers from pledged accounts subject to control agreements. SEC Division of Trading and Markets, [FAQs] Concerning the Amendments to Certain Broker-dealer Financial Responsibility Rules (SEC, Mar. 6, 2014).

d. Underwriting v. Brokerage

There is not always a bright line between "underwriting" and brokerage. For example, the mutual fund, UIT and other precedents discussed in Part VIII.C.1.b.ii.E.iii above indicate that brokerage in primary distributions is a permissible agency activity. See also, e.g., Letter No. 778 (placement of customer funds in foreign bank time deposits); Comptroller 1993 Continental Letter.

Building on the same principles, a bank (subject to the GLBA Push-out Provisions; see Part IX.B.3 below), or a broker-dealer subsidiary of a bank, should be able to act as agent for its customers in the purchase of securities as a "selling group member" (whether directly from an issuer or from an underwriter), or receive "designated sales" commissions, without being characterized as a Glass-Steagall "underwriter", at least under circumstances where the banking organization (i) arranges with the underwriter to receive an allocation of securities for placement with customers for which it is acting as agent, but is not party to an underwriting agreement and does not take "underwriting risk"; (ii) receives only a selling concession or commission; and (iii) acts only as agent for its customers. See, e.g., Comptroller Unpublished Letter (Apr. 7, 1987).

See also Part VI.C.1.c above.

e. "Inadvertent Principal"

The risk that a broker may become an "inadvertent principal" due to the failure of a customer does not make the broker's activities impermissible or "with recourse". See, e.g., Schwab Decision; SIA v. Comptroller, 577 F. Supp. 252 (D.D.C. 1983), aff'd, 758 F.2d 739, reh. denied, 765 F.2d 1196 (D.C. Cir. 1985), cert. denied (on permissibility of brokerage issue), 474 U.S. 1054 (1986); Schwab Order; Vickers da Costa Letter. See also Letter No. 494 (commodity futures).

2. Riskless Principal Activities

Unlike dealing or trading (see Part II above), brokerage consists of purchases and sales of financial instruments as agent on the order and for the account of customers. However, Glass-Steagall "brokerage" also includes "riskless principal" transactions -- where the broker, after receiving an order to buy (or sell) a financial instrument from a customer, sells (or buys) the instrument to (or from) the customer in conjunction with an offsetting transaction upon the order of a second customer. Beginning with the BTNY

Placement Order, the Board approved BHC riskless principal activities and, in the Regulation Y 1997 Revisions, the Board added riskless principal activities to the list of permissible non-banking activities. The riskless principal empowerment encompasses securities and other financial instruments.

a. The BTNY Placement Order stated that acting as riskless principal does not constitute Glass-Steagall "underwriting" or "dealing" because the entity acting as riskless principal assumes neither the risk of ownership nor the obligation to buy or sell securities prior to the execution of an offsetting transaction.

   Regulation Y requires that BHC subsidiaries not act as riskless principal (i) in selling securities on the order of a customer that is the issuer of the securities or in any transaction where the subsidiary has a contractual agreement to place the securities as agent of the issuer; or (ii) in any transaction involving an ineligible security for which the subsidiary or any of its affiliates acts as an underwriter (during the period of the underwriting or for 30 days thereafter) or dealer (except that the subsidiary and its affiliates may enter "bid" or "ask" quotations, or publish "offering wanted" or "bid wanted" notices on trading systems other than Nasdaq or an exchange, if the subsidiary or the affiliate does not enter price quotations on different sides of the market for a particular security for two business days). See, e.g., 12 C.F.R. § 225.28(b)(7)(ii).

   Informally, Board staff has indicated that the prohibition on a BHC subsidiary acting as riskless principal in transactions for which the BHC subsidiary or any of its affiliates acts as underwriter or dealer only applies to transactions with BHC affiliates, and not to transactions with third parties.

   (i) For selected Board precedents relating to riskless principal transactions, see, e.g., Order Revising the Limitations Applicable to Riskless Principal Activities, 82 Fed. Res. Bull. 759 (1996); BNY, 82 Fed. Res. Bull. 748 (1996); SocGen, 81 Fed. Res. Bull. 880 (1995) (the "SocGen 1995 Order") (FX); HSBC, 72 Fed. Res. Bull. 345 (1986) (precious metals); Schwab Order, 69 Fed. Res. Bull. at

116 n.55 (municipal securities); FRBR Letter to Crestar Securities, dated Mar. 15, 1988 (same).

(ii) A 1994 Daiwa Bank application sought the Board's concurrence that the requirement of "contemporaneous" purchases and sales in riskless principal transactions is satisfied if the offsetting transaction occurs within seven days of the initial transaction. 59 Fed. Reg. 15730 (Apr. 4, 1994) (solicitation of public comments). The Board approved Daiwa's application only after Daiwa committed to observe the standard conditions. See Daiwa Bank, 80 Fed. Res. Bull. 1014 (1994).

(iii) The analytic principles behind the characterization of riskless principal transactions as permissible bank "brokerage" activities should also apply in other contexts (e.g., with respect to a bank's ability to enter into physically-settled equity or commodity derivatives transactions). See, e.g., Board CPFS Letter; Letter No. 1026 (conduit securities lending approved as analogous to riskless principal activities). See also Part II.D.3.b.iv above and Part IX.D.2.b below.

b. Each of the Comptroller and the FDIC has approved riskless principal transactions as permitted brokerage, although such activities may be subject to the GLBA Push-Out Provisions. See, e.g., Letter No. 1097; FDIC-99-6; Letter No. 867 (Islamic Murabaha real estate, commercial inventory and equipment financing); Comptroller 1994 Letter (hydrocarbon production payments); Vickers da Costa Letter (see Part XI.E.1 below); FDIC Advisory Opinion No. 88-31 (Mar. 28, 1988), CCH Fed. Banking L. Rep. ¶ 81,076. See also, e.g., Comptroller No-Objection Letter No. 97-02 (May 21, 1997) (remuneration disclosure requirements in riskless principal municipal bond transactions); Comptroller Interpretive Letter No. 626 (July 7, 1993), CCH Fed. Banking L. Rep. ¶ 83,508 (remuneration disclosure requirements in riskless principal transactions).

c. The SEC declined to take a no-action position that riskless principal transactions satisfy the requirement of Rule 144 that securities sold in reliance on such Rule be sold in "brokers' transactions" within the meaning of 1933 Act § 4(4). Goldman Sachs (avail. Dec. 16, 1993).

B. SECURITIES REGULATION: REGISTRATION AND RELATED ISSUES

1. General

a. A non-bank subsidiary of a bank, BHC or FHC may be subject to registration and supervision as a broker-dealer and may be subject to state securities or "blue sky" laws. The SEC regulates approximately 4,500 broker-dealers.

See generally Agency and Mission Information (SEC, Nov. 2015); 2015 Agency Financial Report (SEC, Nov. 2015); SEC Division of Trading and Markets Guide to Broker-Dealer Registration (last modified, July 29, 2016); Study on Investment Advisers and Broker-dealers As Required by Section 913 of [Dodd-Frank] (SEC, Jan. 2011); SEC Press Release 2003-114 (Sept. 15, 2003) (SEC/NASAA joint initiative on federal and state cooperation); Final Report: 2003 Conference on Federal-State Securities Regulation (SEC/NASAA, June 2003). See also, e.g., SEC Release No. 34-57820 (May 15, 2008) (approval of FINRA proposed rule change to allow an unnamed bank -- presumably Brown Brothers Harriman & Co. -- to come under its supervision).

See also Part II.D above and Part XII.B.6 below with respect to "networking" and related issues (as well as issues related to whether entities engaged in certain types of activities must register as broker-dealers), Part VII.C above with respect to applicability of registration requirements to finders and corporate finance advisers, Part VIII.C.2 above with respect to the applicability of such requirements to investment advisers, and Part IX.F below with respect to the application of such requirements to certain transaction-matching and similar systems.

b. Generally applicable provisions of the federal securities laws (e.g., Rule 10b-5) also apply to banks.

c. The nature and scope of securities regulation are the subject of intensive review and extensive legislative and regulatory changes. See Part I above.

(i) In 2007, the NASD and the regulatory functions of the NYSE were consolidated to create FINRA. FINRA is responsible for regulating all securities firms that do business with the public and regulates the Nasdaq Stock Market and several other securities exchanges (including the NYSE) by contract. See FINRA-NYSE Agreement for the Allocation of Regulatory Responsibility, June 14, 2010; SEC Release No. 34-56145 (July 26, 2007). See also Retrospective Rule Review Report: Membership Application Rules and Processes (FINRA, Mar. 2016); Securities Regulation: Opportunities Exist to Improve SEC's Oversight of [FINRA] (GAO, May 2012).

(ii) To help identify developing risks and trends in the financial markets, the SEC has created a Division of Economic and Risk Analysis ("DERA") covering risk and economic analysis, strategic research and financial innovation. See SEC Press Release 2009-199 (Sept. 16, 2009); SEC Press Release 2013-104 (June 6, 2013).

DERA, together with the SEC's Office of the General Counsel, issued internal guidance to rule-writing divisions of the SEC on the use of economic analysis in rulemaking. DERA and Office of the General Counsel Memorandum (Mar. 16, 2012). For more on cost-benefit analysis in relation to SEC and CFTC rulemaking, see Part I.B above.

(iii) Dodd-Frank § 911 establishes an Investment Advisory Committee to advise and consult with the SEC on (A) regulatory priorities; (B) issues relating to the regulation of securities products, trading strategies, fee structures, and the effectiveness of disclosure; (C) investor protection initiatives; and (D) securities market integrity. The Committee includes the Investor Advocate, a representative of state securities commissions, a representative of senior citizen interests, individuals who represent the interests of individual debt and equity investors, and individuals who represent the interests of institutional investors.

(iv) The Dodd-Frank Act makes a number of changes relating to the enforcement of the securities laws.

A) Dodd-Frank § 921 authorizes the SEC to restrict the use of arbitration requirements in customer agreements. See generally Part VIII.C.2.a.vi.G above.

B) Pursuant to Dodd-Frank § 922 (1934 Act § 21F), the SEC has adopted a whistleblower program under which the SEC pays an award of 10-30% of the penalties collected in an SEC enforcement or related action to individuals who provide the SEC with original information about a violation of the securities laws that leads to a successful enforcement action involving a monetary sanction exceeding $1,000,000. See SEC Release No. 34-64545 (May 25, 2011) (adopting 1934 Act Rules 21F-1 et seq.). See also Remarks of SEC Director, Division of Enforcement Ceresney, Sept. 14, 2016 (The SEC's Whistleblower Program: The Successful Early Years).

i) The SEC issued its first whistleblower award under Dodd-Frank § 922 in August 2012. See SEC Release Nos. 34-67698 and 34-67699 (Aug. 21, 2012). See also SEC Press Release 2014-68 (Apr. 4, 2014) (increasing first whistleblower award). The SEC issued 10 awards in 2013 and 2014, 7 awards in 2015, and 7 awards in 2016 prior to Sept. 15, 2016.

ii) Dodd-Frank § 922 provides whistleblowers a private right of action against retaliating employers. However, a circuit split has developed over whether the anti-retaliation statute and related SEC regulations require reporting to the SEC (as the award regulations do) in order to benefit from their protection. See Egan v. TradingScreen, 2011 U.S. Dist. LEXIS 47713 (SDNY 2011) (whistleblower who provides information to outside counsel hired by the company's independent directors to investigate satisfies reporting requirement if counsel subsequently reports the allegation to the SEC); Asadi v. GE Energy, 720 F.3d 620 (5th Cir. 2013) (concluding that anti-retaliation provision requires reporting to SEC); Zillges v. Kenney Bank and Trust, 2014 WL 2515403 (E.D. Wis. 2014) (allegations of bank regulatory violations not "securities laws" protected by whistleblower statute; also noting split in courts as to whether disclosure to SEC is required); SEC Release No. 34-75592 (Aug. 4, 2015) (disagreeing with Asadi and concluding that whistleblower need not have followed reporting rules for award and confidentiality provisions in order to benefit from anti-retaliation protection; whistleblower may report internally); Berman v. Neo@Ogilvy, 801 F.3d 145 (2d Cir. 2015) (anti-retaliation provisions are sufficiently ambiguous as to warrant deference to SEC; whistleblower may obtain remedies if report was solely internal to employer and not to the SEC); Wadler v. Bio-Rad Lab., 2015 WL 6438670 (N.D. Cal. 2015) ("Bio-Rad") (anti-retaliation provisions apply irrespective of whether the employee reports information to the SEC); Verble v. Morgan Stanley, No. 15-6397 (6th Cir., Feb. 4, 2016) (SEC amicus brief in support of its position that the anti-retaliation provisions apply irrespective of whether the employee reports information to the SEC).

iii) See also Meng-Lin v. Siemans, 763 F.3d 175 (2d Cir. 2014) (whistleblower statute does not apply extraterritorially to foreign resident employed abroad by foreign company where all events alleged to have occurred outside the U.S.).

iv) A district court recently held that directors could be held individually liable for violations of Dodd-Frank's whistleblower provisions. See Bio-Rad.

v) A number of circuit courts have held that the NBA preempts state whistleblower laws, under the theory that national banks are governed by federal law with regard to management of their staffing needs. Wiersum v. U.S. Bank, 785 F.3d 483 (11th Cir. 2015), cert. denied, 136 S. Ct. 1655 (2016); Schweikert v. Bank of America, 521 F.3d 285 (4th Cir. 2008); Mackey v. Pioneer Nat'l Bank, 867 F.2d 520 (9th Cir. 1989); Wiskotoni v. Michigan Nat'l Bank-West, 716 F.2d 378 (6th Cir. 1983).

vi) The CFTC created an analogous whistleblower program under Section 23 of the CEA. 76 Fed. Reg. 53172 (Aug. 25, 2011). See also 81 Fed. Reg. 59551 (Aug. 30, 2016) (proposed amendments); CFTC Press Release 7312-16 (Jan. 21, 2016).

C) Dodd-Frank § 929L expands the scope of certain 1934 Act antifraud provisions: §§ 9 (market manipulation) and 10(a)(1) (short sales) now cover all securities (other than government securities), not just securities registered on a national securities exchange; § 9(c) (options) now covers all broker-dealers (previously limited to exchange members); and § 15(c)(1)(A) now covers both exchange and OTC transactions (previously limited to OTC transactions). See also Part IX.E.2.e below

(1934 Act § 9(d) relating to manipulative short sales).

D) Dodd-Frank §§ 929M and 929O expand SEC actions for aiding and abetting securities law violations to cover those who "recklessly" assist in connection with such a violation.

E) Dodd-Frank § 929P(a) grants the SEC authority to impose civil money penalties in an administrative proceeding against any person who violates a provision of the federal securities laws (previously the SEC's authority to bring such actions was limited to associated persons of regulated entities).

F) Pursuant to Dodd-Frank § 929W, the SEC has amended 1934 Act Rule 17Ad-17 to (1) extend to broker-dealers the requirement of the rule that transfer agents search for "lost securityholders", and (2) require that "paying agents" provide written notifications to a "missing securityholder". The SEC has also adopted 1934 Act Rule 15b1-6 to ensure that broker-dealers have notice of these obligations. SEC Release No. 34-68668 (Jan. 16, 2013).

G) Pursuant to Dodd-Frank § 929Z, the GAO published a report regarding proposals to create a private right of action against persons who aid or abet violations of the securities laws. <u>Securities Fraud Liability of Secondary Actors</u> (GAO, July 2011).

(v) Pursuant to Dodd-Frank § 939A, the SEC has proposed to replace (and, in some cases, has replaced) references to credit ratings in its regulations with alternative standards of creditworthiness. <u>See</u> 80 Fed. Reg. 58124 (Sept. 25, 2015) (final rule) (Rule 2a-7 under the 1940 Act); 79 Fed. Reg. 57184 (Sept. 24, 2014) (final rule) (Regulation AB under the 1933 Act and the 1934 Act); 79 Fed. Reg. 1522 (Jan. 8, 2014) (final rule) (financial responsibility and confirmation of transactions rules); 79

Fed. Reg. 1316 (Jan. 8, 2014) (final rule) (1940 Act Rule 5b-3); 77 Fed. Reg. 70117 (Nov. 23, 2012) (final rule) (credit risk and liquidity standard for debt securities purchased by 1940 Act registrants under exemption for business and industrial development companies); 77 Fed. Reg. 42980 (July 23, 2012) ("transitional" interpretive guidance on definitions of "mortgage related security" and "small business related security" to provide SEC additional time to seek comment on potential standards of creditworthiness to replace credit ratings); 76 Fed. Reg. 46603 (Aug. 3, 2011) (final rule) (conditions to use short-form registration for the public sale of securities); 76 Fed. Reg. 26550 (May 6, 2011) (solicitation of public comments) (proposing to exempt non-convertible debt and preferred stock and ABS from certain requirements if they satisfy certain conditions verified by an "independent third party"). See also 76 Fed. Reg. 78776 (Dec. 19, 2011) and 76 Fed. Reg. 44262 (July 25, 2011) (final rule) (CFTC replacing references to credit ratings in its regulations pursuant to Dodd-Frank § 939A).

The SEC conducted a study, mandated by Dodd-Frank § 939A, regarding a system for assigning NRSROs to determine credit ratings for structured products. See Report to Congress on Assigned Credit Ratings (SEC, Dec. 2012). In addition to examining the feasibility of such a system (under which a public utility or SRO would assign an NRSRO to rate a particular structured product issue), the Report also examines conflicts of interest inherent in the "issuer-pay" and "subscriber-pay" models, certain measures to mitigate such conflicts (including statutes and SEC rules, and eliminating statutory references to and requirements associated with ratings), as well as alternative means for compensating NRSROs.

See also Part I.B above.

(vi) Issues have been raised as to the respective obligations of broker-dealers and investment advisers. See Part VIII.C above and Part IX.E.3.c below.

(vii) Additional registration issues:

A) Under FINRA Rules 1031 and 1032, any "representative" associated with a FINRA member securities firm must register with FINRA if the person engages in the investment banking or securities business for the member. Such a representative must also register as a "securities trader" if the person is engaged in proprietary trading, agency execution of transactions, or the direct supervision of such activities, with respect to equity, preferred or convertible debt securities transacted other than on a securities exchange. FINRA Rule 1032(f).

In April 2016, the SEC approved changes to FINRA Rule 1032 to require registration as securities traders of associated persons (i) primarily responsible for the design, development or significant modification of "algorithmic trading strategies", or (ii) responsible for the day-to-day supervision or direction of such activities. See SEC Release No. 34-77551 (Apr. 7, 2016).

B) FINRA Rule 1230(b)(6) establishes a registration category and qualification examination requirement for operations personnel who are "operations professionals", comprising (A) senior managers responsible for "covered functions", (B) supervisors or others responsible for approving or authorizing work in direct furtherance of "covered functions", or (C) persons with authority or discretion to commit capital or to commit a member to a material contract in furtherance of "covered functions".

"Covered functions" include (A) client on-boarding; (B) collection, maintenance, re-investment and disbursement of funds; (C) receipt and delivery of securities and funds and account transfers; (D) bank, custody, depository and firm account management and reconciliation; (E) settlement, fail control, buy ins, segregation, possession and control; (F) trade confirmation and account statements; (G) margin; (H) stock loan / securities lending; (I) prime brokerage; (J) approval of valuation pricing models; (K) financial control; (L) preparing and filing financial regulatory reports; (M) defining, approving and validating business requirements for sales and trading systems and any other systems related to the covered functions; (N) defining and approving business security requirements and policies for information technology; (O) defining and approving information entitlement policies in connection with covered functions; and (P) posting entries to books and records to ensure integrity and compliance with securities laws and regulations. SEC Release No. 34-64687 (June 16, 2011).

C) The SEC approved FINRA's proposal for a separate set of rules for "capital acquisition brokers" ("CABs"), defined as firms that engage in a limited range of brokerage activities, including advising companies on mergers and acquisitions, advising issuers on raising debt and equity capital in private placements with institutional investors, and providing advisory services on a consulting basis to companies on strategic and financial alternatives. These firms are often registered as broker-dealers because they receive transaction-based compensation for their role in securities transactions. Nevertheless, these firms do not engage in many of the types of activities typically associated with traditional broker-dealers (e.g., maintaining customer accounts, handling customer funds or securities, accepting orders to purchase or sell securities as principal or agent, exercising investment discretion on behalf of customers, or engaging in proprietary trading, market-making or dealing as principal). While the proposal would provide relief for CABs from a number of FINRA rules, CABs would continue to be subject to all SEC rules and regulations applicable to broker-dealers.

The final rules reflect comments received on FINRA Regulatory Notice 14-09 (Feb. 2014) which proposed a separate rule set applicable to "limited corporate financing brokers". Most of the commentators argued that FINRA's original proposal did not go far enough to relieve firms of their current regulatory burdens. SEC Release No. 34-78617 (Aug. 18, 2016).

See Part VII.C.7.b.iii above for a discussion of relief from SEC registration for certain "M&A Brokers".

(viii) Pursuant to Dodd-Frank § 919B, the SEC completed a study (A) as to ways to improve investor access to broker-dealer registration information (including disciplinary actions, regulatory, judicial and arbitration proceedings, and other information); and (B) identifying additional information that should be made publicly available. See Study and Recommendations on Improved Investor Access to Registration Information About Investment Advisers and Broker-dealers (SEC, Jan. 2011).

FINRA's BrokerCheck website provides access to information about broker-dealers, and the Investment Adviser Public Disclosure website provides access to information about investment advisers. FINRA requires broker-dealers to include on their websites a "readily apparent reference" and hyperlink to BrokerCheck. FINRA Rule 2210; FINRA Regulatory Notice 15-50 (Dec. 2015).

(ix) Other registration-related SEC proceedings and guidance include:

A) In the first enforcement of its kind, the SEC issued a cease-and-desist order and fine against private equity firm, Blackstreet Capital Management, for receiving transaction-based compensation in connection with soliciting, identifying, negotiating, structuring and executing purchases and sales of portfolio companies (including the purchase and sale of securities of such companies) for funds it advised without having registered as a broker-dealer. SEC Admin. Proc. No. 3-17267 (June 1, 2016).

B) International Capital Group, SEC Admin. Proc. No. 3-16366 (Jan. 29, 2015), which settled an administrative action against International Capital Group for failing to register as a broker-dealer and for distributing securities without registering the offerings with the SEC. International Capital Group sold over 9 billion shares of mostly microcap companies in connection with purported stock-based loans, block trades, and other transactions.

C) BTC Trading, SEC Admin. Proc. No. 3-16307 (Dec. 8, 2014), which settled an administrative action against BTC Trading and its founder for offering to buy and sell securities using virtual currencies without registering the offerings, for operating unregistered securities exchanges that allowed users to buy and sell securities of businesses using virtual currencies, and for failing to register as a broker-dealer.

D) Computershare Trust Company of Canada, SEC Admin. Proc. No. 3-12265 (Apr. 18, 2006), which settled an administrative action against Computershare for failing to register as a transfer agent or broker. Computershare acted as transfer agent for 260 companies, and effected securities transactions for U.S. resident investors in connection with its administration of dividend reinvestment, stock purchase and employee stock and options plans on behalf of 100 issuers.

E) CIBC Mellon Trust, SEC Admin. Proc. No. 3-11839 (Mar. 2, 2005), which settled an administrative action against CIBC Mellon for failing to register as a transfer agent or a broker-dealer in connection with its activities as administrator of employee stock plans for issuers for which CIBC Mellon acted as transfer agent. See also SEC v. CIBC Mellon Trust, SEC Litigation Release No. 19081 (Feb. 16, 2005) (charge of employee participation in scheme to promote, sell and distribute stock of non-U.S. company through illegal issuance of stock certificates; CIBC Mellon charged with having failed to train its employees with respect to U.S. securities laws, or create systems to assure compliance with U.S. securities laws, despite providing transfer agent services to U.S. companies; see also Part XI.E.2.a.xi.B below).

CIBC Mellon registered as a transfer agent and the SEC issued an Order exempting it from broker-dealer registration in connection with its administration of dividend reinvestment plans, stock purchase plans, employee stock purchase/option plans and odd-lot programs. CIBC Mellon represented that it will (i) maintain its registration as transfer agent; (ii) only administer plans with U.S. resident investors for issuers for which it acts as transfer agent; (iii) not net customer orders to buy and sell plan securities; (iv) not solicit transactions from, or provide advice to, U.S. investors; (v) direct any transactions for such investors to a U.S. broker-dealer; (vi) restrict its call center activities respecting U.S. investors; and (vii) comply with designated account maintenance and reporting procedures. SEC Release No. 34-60136 (June 18, 2009) (the "CIBC Mellon Order"). See also Canadian Stock Transfer Co. (avail Mar. 4, 2015), which provides time-limited relief from registration as a broker-dealer to Canadian Stock Transfer Co., which purchased CIBC Mellon's transfer agency and employee stock plan administration business, subject to the same conditions contained in the CIBC Mellon Order.

F) Stockback.com (avail. July 28, 2000), which granted relief from the broker-dealer registration requirement to merchants participating in a program operated by a broker-dealer pursuant to which consumers who open accounts through the broker-dealer's website would receive cash rebates for purchases made through the merchants' websites, which rebates would be forwarded to the consumers' accounts at the broker-dealer and could be used to purchase shares of a mutual fund or held in cash. See also Part IX.F.2 below (broker-dealer registration issues related to Internet-based and other electronic services).

(x) As a follow up to President Obama's Executive Orders 13563 (Jan. 18, 2011) and 13579 (July 11, 2011) (regulatory agencies should consider how to promote retrospective analysis of rules that may be "outmoded, ineffective, insufficient or excessively burdensome"), in Release No. 33-9257 (Sept. 6, 2011) the SEC issued a Request for Information inviting public comment to assist the SEC in the development of a plan for the retrospective review of its regulations.

FINRA has also invited public comment on the effectiveness and efficiency of its rules regarding communications with the public, gifts, gratuities and non-cash compensation. FINRA Regulatory Notices 14-14 and 14-15 (Apr. 2014). FINRA subsequently issued two reports summarizing comments received on its communications and gifts rules which suggest that commenters view the rules as effective in protecting investors but the rules could benefit from updates to better align investor protection benefits with economic impacts. See Retrospective Rule Review Report (FINRA, Dec. 2014). In addition, FINRA is conducting a retrospective review of its membership application rules and processes. Retrospective Rule Review Report:

Membership Application Rules and Processes (FINRA, Mar. 2016).

d. Banks are subject to recordkeeping and confirmation requirements for securities transactions and transfer and clearing agency requirements of the (i) Comptroller (12 C.F.R. Part 12); (ii) Board (12 C.F.R. §§ 208.31, 208.34; see also, e.g., Board Match-EM Letter); or (iii) FDIC (12 C.F.R. Parts 341, 344). See also 70 Fed. Reg. 5571 (Feb. 3, 2005) (solicitation of public comments) (Interagency request for comments on ways to reduce the burden in securities rules relating to clearing agencies, transfer agents, government and municipal securities dealers, securities sales practices, recordkeeping and confirmation, reporting requirements and margin lending); Joint Report to Congress on the Economic Growth and Regulatory Paperwork Reduction Act (FFIEC, July 31, 2007), 72 Fed. Reg. 62036 (Nov. 1, 2007) (reporting comments received); ABA/ABASA Letter to the NASD, Aug. 31, 2001 (the "Rule 3040 Letter") (including index of banking laws and regulations applicable to bank securities activities).

e. U.S. branches and agencies of foreign banks that accept deposits or exercise fiduciary powers as a substantial part of their businesses are generally treated as "banks" for purposes of the 1934 Act, the Advisers Act and the CEA to the same extent as U.S. banks. See, e.g., Israel Discount Bank (avail. Mar. 2, 1974).

f. Broker-dealers are subject to state common law claims for securities fraud that, in general, are not preempted by federal securities laws. While NSMIA precludes states from regulating national securities offerings, the statute does not preempt state fraud action. See, e.g., Zuri-Invest v. NatWest Finance, 177 F. Supp. 2d 189 (SDNY 2001).

In light of Dodd-Frank § 1044, GLBA § 104 and NSMIA, broker-dealers and investment advisers that are subsidiaries of national banks generally would not benefit from federal banking law preemption principles. See Part I.D.4.b.ii above and Part IX.B.3.a.i below.

g. Federal securities laws preempt the application of state and federal antitrust laws to underwriting practices. See Credit Suisse Securities v. Billing, 551 U.S. 264 (2007). See also, e.g., "Clear Incompatibility" Between Antitrust and Securities Laws Implies Antitrust Immunity: Credit Suisse Securities v. Billing (CRS, July 18, 2007).

h. A broker-dealer that performs banking functions may be subject to regulation under applicable banking laws. See, e.g., Brooks v. Transamerica Financial Advisors, 57 So.3d 1153 (La. Ct. App. 2d Cir. 2011) (failure of brokerage customer to notify clearing broker that signatures on checks were unauthorized precluded customer's claim against broker because broker provided checking account allowing customer to write checks on the funds contained in customer's brokerage account and therefore was a "bank" for purposes of the Uniform Commercial Code); Travelers v. Wells Fargo Bank, 374 F.3d 521 (7th Cir. 2004) (firm that offers checking services in competition with banks is subject to same common law duty of care as bank to make reasonably sure that a deposit is authorized); Jones v. Mishler, 983 P.2d 1086 (Or. Ct. App. 1999) (broker-dealer considered "bank" because it made checking accounts available to its customers; as a "bank" it was liable for losses for dishonored checks).

i. Issues with respect to the registration of non-U.S. broker-dealers and concepts of "mutual recognition" are discussed in Part XI.G below.

j. The SEC and the Board have entered into an MOU under which they cooperate in a number of areas, including regulatory and supervisory issues (e.g., capital, liquidity and funding) relating to BHCs that own securities firms. See Board Press Release, July 7, 2008. Dodd-Frank §§ 604(b) and (c) (codified at 12 U.S.C. § 1844(c)) provide that the Board may examine each subsidiary of a BHC, including those with a functional regulator such as the SEC, but require the Board to rely upon examination reports by other regulators to the fullest extent possible. Dodd-Frank does not allow separate capital regulation of broker-dealers by the Board. See 12 U.S.C. § 1844(c)(3).

k. The Board has adopted procedures by which securities holding companies may elect to be supervised by the Board pursuant to Dodd-Frank § 618, which permits non-bank companies that own at least one registered broker-dealer and are required by a foreign regulator or provision of foreign law to be subject to comprehensive consolidated supervision to register with the Board and subject themselves to supervision by the Board. 77 Fed. Reg. 32881 (June 4, 2012). See also Part I above.

l. Beginning in 2004, the SEC supervised 5 large U.S. securities firms -- Goldman Sachs, Merrill Lynch, Morgan Stanley, Lehman Brothers and Bear Stearns -- on a consolidated basis (including the U.S. registered broker-dealer, its holding company and all of its affiliates), in a manner designed to be broadly consistent with Board oversight of BHCs. SEC Release No. 34-49830 (June 21, 2004). Following the election of Goldman Sachs and Morgan Stanley to become FHCs under the supervision of the Board, and the liquidation or merger of the remaining consolidated supervised entities with other FHCs, the SEC terminated the program in 2008. See SEC Press Release 2008-230 (Sept. 26, 2008). See also SEC's Oversight of Bear Stearns and Related Entities: Broker-dealer Risk Assessment Program (SEC, Sept. 25, 2008); Dodd-Frank § 617 (eliminating investment bank holding company framework); 78 Fed. Reg. 42863 (July 18, 2013) (SEC rescission of rules related to investment bank holding companies).

m. From March 2014 through early 2015, FINRA conducted a review of the policies and practices related to liquidity risk management at 43 member firms. FINRA focused primarily on firms that hold inventory positions or clear and carry customer transactions. FINRA required the firms to apply a 30-day stress test on funding for (i) inventory positions, (ii) mismatched financing transactions, (iii) operational liquidity drains, (iv) customer withdrawals and (v) forced deleveraging and reserves against trading losses. In addition, FINRA measured qualitative aspects of firms' response to stress, including (A) understanding of issues that arise in stress events, (B) measurement of risk, (C) plans for idiosyncratic stress and (D) contingency funding plans. FINRA then published its observations on effective and ineffective practices and its expectations for stress testing and liquidity risk management. FINRA Regulatory Notice 15-33 (Sept. 2015). See also Part II.A.4 above (BHC and bank liquidity requirements).

n. The SEC has established a "large trader" reporting system to enhance its ability to assess the impact of large trader activity on the securities markets and to detect and deter trading abuses. 1934 Act Rule 13h-1 requires large traders to identify themselves to the SEC and to make certain disclosures on Form 13H. A "large trader" is a person whose transactions in securities equal or exceed 2 million shares or $20 million during any calendar day, or 20 million shares or $200 million during any calendar month. See SEC Release No. 34-64976 (July 1, 2011). See also SEC Release No. 34-70150 (Aug. 8, 2013) (modifying prior phase-in, and adding third phase extending compliance for certain recordkeeping and reporting requirements until November 1, 2015); SEC Release No. 34-76322 (Oct. 30, 2015) (exempting certain equity options market participants from the self-identification requirements and exempting until Nov. 1, 2017 broker-dealers from the recordkeeping and reporting requirements).

2. Outsourcing Issues

a. Outsourcing of internal functions by financial institutions to third-party providers raises supervisory issues, due in part to an increase in "offshoring" of services. U.S. regulators have identified risks that may arise from outsourcing arrangements and that financial institutions must manage, including (i) consumer privacy; (ii) reliance on third parties to perform compliance functions, particularly related to AML, KYC and CIP; (iii) transactions with affiliates; (iv) clarity, completeness and enforceability of contracts; (v) due diligence and monitoring of service providers; and (vi) country risk and home country supervisory oversight. See, e.g., Shifting Toward Maturity: Key Findings from EY's 2016 Financial Services Third-Party Risk Management Survey (Ernst Young, June 2016); Examinations of Advisers and Funds that Outsource Their Chief Compliance Officers (OCIE, Nov. 9, 2015); Managing Third-party Risk in Financial Services: Key Considerations for the Extended Enterprise (Deloitte, 2015); Global Financial Services

Offshoring Report 2007 (Deloitte, 2007); Global Financial Services Offshoring: Scaling the Heights (Deloitte, Nov. 2005); Calling a Change in the Outsourcing Market: The Realities for the World's Largest Organizations (Deloitte, Apr. 2005).

b. Proposed FINRA Rule 3190 (i) reiterates that broker-dealers are not relieved of their obligation to comply with applicable law when outsourcing functions related to their regulated businesses, and that unregistered persons may not engage in activities that require registration; (ii) prohibits firms from delegating responsibility for, or control over, outsourced functions; (iii) requires firms to establish and maintain supervisory systems and procedures for outsourced activities; (iv) imposes restrictions and obligations on clearing and carrying firms; and (v) permits "ministerial activities" to be outsourced pursuant to FINRA-approved carrying agreements. FINRA Regulatory Notice 11-14 (Mar. 2011). See also NASD Notice to Members 05-48 (July 2005) (broker-dealer due diligence and supervisory responsibilities when outsourcing activities to third-party service providers, and prohibiting outsourcing of supervisory or compliance responsibilities or other activities requiring registration or qualification); Principles on Outsourcing of Financial Services for Market Intermediaries (IOSCO, Aug. 2004); NASD Notice to Members 99-45 (June 1999) (broker-dealers should ensure "clear lines of authority, accountability, and responsibility" in supervising the activities of third-party service providers).

c. Bank regulators have recommended risk management steps relating to outsourcing (including risk assessments, due diligence, contractual protections, contingency planning, incentive compensation review, monitoring and oversight, independent reviews, and access to information), and have reminded institutions that they remain responsible for compliance with applicable law and ensuring that activities performed by service providers are consistent with safe and sound banking practices. See, e.g., FFIEC Information Technology Examination Handbook (including Outsourcing Technology Services Booklet, Supervision of Technology Service Providers Booklet, Business Continuity Planning Booklet, and Appendix J, "Strengthening the Resilience of

Outsourced Technology Services", released Feb. 6, 2015); FDIC FIL-50-2016 (July 29, 2016) (seeking comment on Proposed Guidance for Third-Party Lending); Board SR Letter 13-19 (Dec. 5, 2013), CCH Fed. Banking L. Rep. ¶ 37-785 (Guidance on Managing Outsourcing Risk); Comptroller Bulletin 2013-29 (Oct. 30, 2013), CCH Fed. Banking L. Rep. ¶ 35-522 (Risk Management Guidance); Board SR Letter 13-1 (Jan. 23, 2013) (Supplemental Policy Statement on the Internal Audit Function and its Outsourcing); FDIC FIL-44-2008, (June 6, 2008), CCH Fed. Banking L. Rep. ¶ 38-198 (Third-party Risk: Guidance for Managing Third-party Risk); FDIC Supervisory Insights (Summer 2007); FDIC FIL-52-2006, (June 21, 2006), CCH Fed. Banking L. Rep. ¶ 38-197 (Foreign-based Service Providers: Guidance on Managing Risks in These Outsourcing Relationships); Outsourcing in Financial Services (Joint Forum, Feb. 2005); "Outsourcing by Financial Services Firms; the Supervisory Response", FRBSF Economic Letter (Nov. 26, 2004); Comptroller Bulletin 2002-16 (May 15, 2002), CCH Fed. Banking L. Rep. ¶ 35-523 (Bank Use of Foreign-based Third-party Service Providers); Board SR Letter 00-4 (Feb. 29, 2000), CCH Fed. Banking L. Rep. ¶ 60-687 (Outsourcing of Information and Transaction Processing). See also OCC's Review of Banks' Use of Third Party Service Providers Is Not Sufficiently Documented (Treasury OIG, Apr. 21, 2014).

d. Issues related to the oversight and independence of consultants hired by financial institutions at the behest of regulators have also become important.

   (i) In 2011, the OCC, the Board and the OTS entered into Consent Orders against 14 mortgage servicers in relation to enhancing foreclosure practices. See Part X.B.6 below. The Consent Orders originally required the servicers to hire third-party consultants to review loan files and foreclosure practices. In 2013, the GAO found that the regulators should improve oversight of the review and sampling techniques of the third-party consultants. See Foreclosure Review: Lessons Learned Could Enhance Continuing Reviews and Activities under Amended Consent Orders (GAO, Mar. 26, 2013).

(ii) On June 18, 2013, the NYDFS reached an Agreement with Deloitte in connection with consulting services performed for SCB pursuant to an NYDFS Order, dated Aug. 6, 2012, related to alleged weaknesses in SCB's compliance with AML and economic sanctions laws. (See Part VIII.A above.) In order to settle charges of unauthorized disclosure of confidential supervisory information and of removing independent recommendations from a final report to the NYDFS at the request of SCB, Deloitte agreed to pay a $10 million fine, not accept any new engagements that would require NYDFS approval for one year, and adopt procedures to ensure Deloitte's independence as a financial services consultant. The NYDFS appended to the Order a set of "Independent Consultant Practices for Department Engagements" designed to reinforce independence of consultants and to require direct reporting of consultants to the NYDFS in situations where the NYDFS has mandated hiring of consultants. In the Matter of Deloitte (NYDFS, June 18, 2013). See also In the Matter of [BTMU], New York Branch (NYDFS, Nov. 18, 2014) (additional $315 million fine and industry ban on three employees for misleading regulators by pressuring consultants to remove key warnings from report to regulators); In the Matter of PricewaterhouseCoopers (NYDFS, Aug. 14, 2014) ($25 million settlement and two year ban from certain engagements; based on work for BTMU); In the Matter of [BTMU], New York Branch (NYDFS, June 20, 2013) ($250 million settlement of charges of violating international sanctions laws).

(iii) In August 2015, the NYDFS initially suspended indefinitely Promontory Financial Group's access to confidential supervisory information on the grounds that Promontory had exhibited a lack of independent judgment in the preparation and submission of certain reports submitted to the NYDFS in 2010-11 regarding SCB's transactions with sanctioned countries. Promontory had allegedly "softened", "toned down" and "omitted red flags" in its report about SCB. See Report on Investigation of Promontory Financial Group, LLC (NYDFS, Aug. 2015). Shortly thereafter, however, Promontory entered into a settlement agreement with the NYDFS agreeing to pay a $15 million fine and a 6-month voluntary abstention from new consulting engagements that would require the NYDFS to authorize the disclosure of confidential supervisory information. Promontory also agreed to document any changes to pending or future reports that are made at the suggestion of its client or client's counsel. In the Matter of Promontory Financial Group, LLC (NYDFS, Aug. 18, 2015); NYDFS Press Release, Aug. 18, 2015.

(iv) The OCC issued guidance and standards related to situations where the OCC has required employment of consultants as part of an enforcement action to address violations of law, fraud or harm to consumers. The guidance does not apply in situations where banks are required to hire consultants to provide managerial or operational expertise. In providing a supervisory no-objection to a proposed consultant, the OCC will assess a bank's submission of information with regard to its due diligence investigation of the consultant, its assessment of the consultant's independence, and its final work plan and engagement contract. The OCC will also monitor bank/consultant progress and assessments. OCC Bulletin 2013-33 (Nov. 12, 2013), CCH Fed. Banking L. Rep. ¶ 35-653 (Use and Review of Independent Consultants in Enforcement Actions).

3. Gramm-Leach-Bliley Act Push-out Provisions and Related Matters

Gramm-Leach reconfigured the regulatory landscape on the applicability of the 1934 Act and the Advisers Act to banks that act in a broker, dealer or adviser capacity. See also Part II.D.3.b, Part VIII.B.3.b and Part VIII.C.2.d.i above.

a. Prior to Gramm-Leach, a bank was excluded from coverage under each of the 1934 Act, the Advisers Act and (in certain circumstances) the CEA.

(i) The Comptroller also took the position that state laws that purport to impose registration, licensing, examination or similar requirements on the securities activities of national banks are preempted as invalid attempts to "license" the activities of national banks. See, e.g., Comptroller Interpretive Letter No. 628 (July 19, 1993), CCH Fed. Banking L. Rep. ¶ 83,511; Comptroller Interpretive Letter No. 623 (May 10, 1993), CCH Fed. Banking L. Rep. ¶ 83,505; Comptroller Unpublished Letters (Feb. 1, 1993), (Dec. 7, 1992), (Oct. 26, 1990), (Apr. 9, 1990), (Mar. 22, 1989), (Aug. 11, 1986); Guice v. Schwab, 651 N.Y.S.2d 352 (N.Y. 1996), cert. denied, 520 U.S. 1118 (1997). See also Part I.C.1.h above.

(ii) The SEC had previously tried to restrict the "bank" exemption from broker-dealer registration. In 1985, the SEC adopted Rule 3b-9, revoking such exemption, but the Rule was overturned as inconsistent with Congressional intent. ABA v. SEC, 804 F.2d 739 (D.C. Cir. 1986).

b. Under Gramm-Leach, subject to specific functional exemptions described in Part II.D.3.b and Part II.C.1 above and Part IX.B.3.d below, U.S. banks (and U.S. branches of foreign banks) are no longer automatically excluded from the definitions of "broker" and "dealer" under the 1934 Act and instead are required to register as a broker-dealer (which is generally impractical) or conduct their securities activities in a broker-dealer subject to SEC oversight.

(i) Banks became subject to the definition of "dealer" in 2003. See Part II.D.3.b above.

(ii) With the adoption of Regulation R in 2007, a bank became subject to the definition of "broker" on the first day of its first fiscal year to commence after September 30, 2008.

(iii) Banks may not rely on the "bank" exemption from investment adviser registration under the Advisers Act insofar as advice to SEC-registered investment companies is concerned. See Part VIII.B.3.b and Part VIII.C.2.d.i above.

c. Eight years after the enactment of Gramm-Leach, and only after Relief Act § 101 directed the SEC and the Board to adopt jointly a single set of rules to implement the bank exemptions from the definition of "broker" in the 1934 Act, the SEC and the Board adopted Regulation R. See 17 C.F.R. Part 247; 12 C.F.R. Part 218; SEC Releases No. 34-56501 (Sept. 24, 2007) (adopting Regulation R) (the "Regulation R Adopting Release"), No. 34-56501A (Apr. 11, 2008) (technical amendments to Regulation R). See also Board Small Entity Compliance Guide for Regulation R (last updated Aug. 2, 2013). Compare SEC Releases No. 34-54946 (Dec. 18, 2006) (proposing Regulation R) and No. 34-49879 (June 17, 2004) (proposing Regulation B ("Proposed Regulation B"), which preceded Regulation R); SEC Press Release 2004-73 and related Fact Sheet (June 2, 2004) (summarizing Proposed Regulation B).

d. 1934 Act § 3(a)(4) generally defines "broker" as "any person engaged in the business of effecting transactions in securities for the account of others." See 72 Fed. Reg. 56514 (Oct. 3, 2007). Gramm-Leach added certain functional exceptions, under which a bank will not be considered to be a "broker":

(i) Third-Party Brokerage Arrangements: brokerage, "networking" or "kiosking" arrangements with third-party brokers or dealers under which the broker-dealer offers services on or off the premises of the bank, subject to requirements regarding qualification and a separation between the bank and the broker-dealer.

Bank employees who are not "associated persons" of a broker or dealer generally may not receive "incentive compensation" for any brokerage transactions except for a "nominal one-time cash fee of a fixed dollar amount" that is not "contingent on whether the referral results in a transaction". Regulation R Rule 700 allows banks to pay more than nominal fees for referrals of certain institutional customers and high net worth customers.

(ii) Trust Activities: transactions in a trustee or fiduciary capacity in a bank's trust department (or other department that is regularly examined for compliance with fiduciary principles and standards), subject to advertising restrictions and a requirement that the bank be "chiefly compensated" for such transactions on the basis of a periodic fee, a percentage of assets under management, and/or a flat or capped per order processing fee not greater than the bank's execution cost (collectively "relationship compensation").

Regulation R Rules 721-723 determine how a bank is "chiefly compensated" on the basis of a two-year rolling average and allow banks to take either an account-by-account (under which relationship compensation must be greater than 50% of total compensation) or bank-wide approach (under which relationship compensation may not be less than 70% of total compensation). Banks using the account-by-account method are permitted to exclude the lesser of 1% or 500 of their trust accounts and transfer any non-conforming account to a registered broker-dealer or an unaffiliated entity. A bank is also allowed to exclude trust and fiduciary accounts held at foreign branches if it reasonably believes that less than 10% of those accounts are held by or for the benefit of U.S. persons.

(iii) Permissible Securities Transactions: transactions in CP, BAs, municipal securities and other Push-out Exempt Securities.

(iv) Certain Stock Purchase Plans: transactions, as part of transfer agency activities, for employee benefit, dividend reinvestment and shareholder plans, and transactions directly with the transfer agent and solely for the benefit of an employee benefit plan account.

(v) Sweep Account Activities: transactions as part of a program for the investment or reinvestment of deposit funds into SEC-registered no-load money market mutual funds. Under Regulation R Rule 740, a class or series of securities are "no-load" if they are not subject to a sales load or deferred sales load and total per annum charges against net assets of the class or series for sales or promotional expenses or for the maintenance of accounts is not more than 0.25%.

(vi) Affiliate Transactions: transactions for the account of affiliates (other than a U.S. broker-dealer or merchant banking affiliate).

(vii) Private Securities Offerings: private securities offerings by certain banks as discussed in Part VI.A.2.d above.

(viii) Safekeeping and Custody Activities: safekeeping and custody services, including (A) exercise of warrants and other rights on behalf of customers, (B) facilitating the transfer of funds or securities in connection with the clearance and settlement of securities transactions, (C) effecting securities lending or borrowing transactions with or for custodial customers and investing cash collateral, (D) holding securities pledged by a customer or subject to purchase or resale agreements involving a customer and facilitating the pledge or transfer of such securities, and (E) serving as custodian or provider of administrative services to a pension or benefit plan; however, a bank may not act as carrying broker for any broker or dealer except with respect to U.S. government securities.

Regulation R Rule 760 permits a bank to accept orders for securities transactions from accounts for which it acts as a non-fiduciary custodian, subject to advertising limitations and compensation conditions.

(ix) Identified Banking Products: transactions in Identified Banking Products.

(x) De Minimis Exemption: up to 500 otherwise impermissible securities transactions per year, which may not be effected by staff shared with a broker-dealer affiliate.

Brokerage transactions in U.S. publicly traded securities under the exemptions for Trust Activities, Certain Stock Purchase Plans and Safekeeping and Custody Activities must be directed to a broker-dealer for execution unless they involve certain cross-trades between the bank and an affiliate.

e. Regulation R provides additional exemptions for banks that engage in the following activities:

(i) Money Market Funds: transactions on behalf of a customer in securities of SEC-registered no-load money market funds.

(ii) Mutual Funds: transactions in mutual funds neither traded on a securities exchange nor through the facilities of a national securities association or interdealer quotation system, provided that such transactions are conducted through the National Securities Clearing Corp. ("NSCC") or directly with the mutual fund transfer agent and the securities are distributed by a broker-dealer or the sales charge is no more than the amount a broker-dealer may charge.

(iii) Securities Lending: securities lending transactions (and related services, including investing cash collateral and indemnifying the securities lender with respect to various matters) as agent with or on behalf of a Qualified Investor or an employee benefit plan that owns and invests on a discretionary basis not less than $25 million. See also Part IX.A.1.b.ii.B above.

(iv) Regulation S Securities: sales and resales of eligible securities in compliance with Regulation S, principally to or with non-U.S. persons.

f. Regulation R Rule 780 provides exemptions to prevent a bank's contracts from being void or voidable under 1934 Act § 29 due to an inadvertent failure to register as a broker or comply with an exemption from registration. Under this Rule, no bank contract will be void or voidable under § 29 based on the bank's status as a broker when the contract was created if (i) the contract was entered into before March 31, 2009, or (ii) the bank acted in good faith and had reasonable policies and procedures in place to comply with the bank broker rules, and any violation of the registration requirements did not result in any significant harm, financial loss or cost to the person seeking to void the contract.

g. Sales of uninsured securities products through banks raise significant concerns. See generally, e.g., Comptroller's Handbook: Retail Nondeposit Investment Products; Model Rules for Sales of Securities at Financial Institutions (NASAA, Oct. 6, 1998); FDIC Division of Supervision Release: Non-deposit Investment Product Examination Procedures (June 1, 1997); Interagency Statement. See also Part II.E.2.e and Part VIII.C.1.c.ii.B above, and Part IX.E.3 and Part XII.B.6.a.i below.

C. FUTURES COMMISSION MERCHANT/COMMODITY TRADING ADVISER/COMMODITY POOL OPERATOR AND RELATED DERIVATIVES BROKERAGE AND ADVISORY ACTIVITIES

Banking organizations are actively involved in all types of FCM/CTA/CPO activities. As of September 30, 2015, there were 71 FCMs, 1,719 CPOs and 2,377 CTAs registered with the CFTC. CFTC Agency Financial Report (2015). See also Part XI.F below.

As discussed in Part II above, Dodd-Frank affects significantly the conduct of U.S. derivatives markets.

1. Empowerments

a. Financial Holding Companies and Financial Subsidiaries

FHCs and financial subsidiaries may engage in FCM, CTA, CPO and related activities, including as part of their securities, asset management, merchant banking and other financial activities.

b. Bank Holding Companies

Regulation Y and Board Orders authorize FCM, CTA and CPO activities respecting futures, options on futures and related derivative instruments based on financial and non-financial commodities, whether traded on a U.S. or foreign exchange. See 12 C.F.R. §§ 225.28(b)(6)(iv) and (7)(iv); Regulation Y 1997 Revisions.

(i) Examiner Guidance for Futures Commission Merchants

The Board's guidance to examiners focuses on the adequacy of FCM controls with respect to credit, market, liquidity, reputational and operational risks. Examiners are directed to employ a "global line-of-business" supervisory approach. BHC Supervision Manual § 3250.

(ii) Participation in Exchanges and Clearing Systems

In the Regulation Y 1997 Revisions, the Board deleted the requirement that a BHC subsidiary not act as an FCM on any exchange unless the Board has reviewed the rules of the exchange. Hundreds of different contracts on different exchanges had received Board approval. See, e.g., Board List of Approved Exchanges and Contracts, June 3, 1997.

FCM activities must be conducted through a separately incorporated subsidiary, and the parent BHC may not provide a guarantee to the exchange or clearing association other than for proprietary trades. See 12 C.F.R. §§ 225.28(b)(7)(iv)(A), (B). See also 12 C.F.R. § 211.10(a)(18) (international operations). However, the Board deleted a restriction prohibiting a BHC subsidiary from joining an exchange that requires the parent BHC also to become a member.

(iii) Clearance and Execution

Regulation Y authorizes BHC FCM subsidiaries to provide clearing services divorced from execution services, reversing a position that the Board took in ABN AMRO, 77 Fed. Res. Bull. 189 (1991) (the "ABN AMRO 1991 Denial"). See 12 C.F.R. § 225.28(b)(7)(iv).

In the 1997 Regulation Y Release, the Board deleted restrictions (set out in e.g., Northern Trust Corp., 79 Fed. Res. Bull. 723 (1993) (the "Northern Trust Order")) that had (A) prohibited a clearing subsidiary from serving as the customer's primary clearing firm, and (B) required the subsidiary to have a contractual right to decline to clear any trade that the subsidiary believed presented unacceptable risks (a so-called "give-up" agreement).

Regulation Y permits the combination of advisory services with execution and clearance services. See 12 C.F.R. § 225.28(b)(6)(iv). See also, e.g., SocGen 1995 Order; Morgan, 80 Fed. Res. Bull. 151 (1994); Northern Trust Order.

(iv) Futures Commission Merchant and Commodity Trading Adviser Activities Involving Non-financial Commodities

Following Comptroller Interpretive Letter No. 507 (May 5, 1990), CCH Fed. Banking L. Rep. ¶ 83,205, and Letter No. 494, the Regulation Y FCM empowerment encompasses the execution and clearance as agent of transactions in futures and options on futures on non-financial commodities. See 12 C.F.R. § 225.28(b)(7)(iv).

(v) Combination of Futures Commission Merchant and Trading Activities

Noting that the CFTC had not found it necessary to prohibit an FCM from trading for its own account, the

Regulation Y 1997 Revisions delete such a restriction for BHC FCM subsidiaries. See 12 C.F.R. § 225.28(b)(7)(iv)(A). Compare Part II.E above.

(vi) Commodity Pool Operators

A) The Board approved CPO activities for BHCs by Order. See, e.g., CSG-Warburg Pincus Approval Letter; AMRO CPO Approval; Dresdner CPO Order; Bessemer Order. See generally Part II.D.2 above. However, the Board declined to add CPO activities to the Regulation Y laundry list.

As evidenced by the Morgan CPO Approval and Morgan, 83 Fed. Res. Bull. 113 (1998) (the "Morgan American Century Order"), the Board has not yet approved CPO activities for mutual funds or funds that are publicly sold. These restrictions apparently continue to apply to BHCs, although they may not apply to FHCs that rely in part on the GLBA merchant banking authority (see Part I.C.1.c.ix.E and Part VII.A above).

B) Commencing with SocGen, 80 Fed. Res. Bull. 649 (1994), the Board permitted BHC FCM subsidiaries to perform execution, clearance and advisory services for commodity pools owned or sponsored by, or otherwise affiliated with, the BHC, if such pools are organized offshore and owned by non-U.S. persons.

(vii) Customers

The Regulation Y 1997 Revisions deleted a requirement that FCM/CTA activities be provided only to "institutional customers".

(viii) Overseas Activities

Under Regulation Y (see 12 C.F.R. § 225.25(c)(1)), a BHC subsidiary that is authorized to engage in activities under BHCA § 4(c)(8) may open offices outside the U.S. to conduct the same activities unless the approval is limited geographically.

The Board has also permitted the conduct of non-U.S. FCM activities under Regulation K. See, e.g., 12 C.F.R. § 211.10(a)(18); Board Letters, dated Sept. 25, 1996, to each of BTCo, Chase, Citibank and Morgan (membership in London Clearing House). See also Part XI.B below.

(ix) Incidental or Ancillary Activities

A) The 1997 Regulation Y Release confirmed that an FCM subsidiary may provide futures-related financing to customers.

B) Sumitomo received approval to provide back office services (e.g., funds transfers, rate settings, payment notification, cash reconciliation and risk reporting) for others engaged in offering derivative products. 58 Fed. Reg. 46971 (Sept. 3, 1993) (solicitation of public comments) (approved Nov. 19, 1993).

c. Banks

The Comptroller has approved broad FCM activities respecting both financial and non-financial futures, as well as acting as a CPO. See, e.g., 12 C.F.R. § 5.34(e)(5)(v)(N); Comptroller, [FCM] Activities (Nov. 1995); Letters No. 507; No. 496; No. 494; Comptroller Trust Interpretive Letter No. 121 (Oct. 26, 1987); Comptroller Interpretive Letter No. 390 (July 28, 1987), CCH Fed. Banking L. Rep. ¶ 85,614; Letters No. 380; No. 365; Comptroller Letters (Mar. 26, 1991) re Citibank (May 5, 1990), re Continental Bank (Apr. 23, 1990), re Chase Bank (Mar. 21, 1990), re NCNB National Bank (Feb. 22, 1990), re First National Bank of Chicago.

2. Other Regulatory Requirements

   In conducting FCM/CTA/CPO activities, subsidiaries of banks and BHCs must comply with CFTC requirements. See, e.g., 17 C.F.R. Parts 4 and 5.

   a. There are limited exceptions for banks from CFTC registration, but the CFTC takes a narrow view of these exceptions. See, e.g., CFTC Interpretative Letters No. 02-106 (Sept. 30, 2002), CCH Comm. Fut. L. Rep. ¶ 29,198; No. 89-11 (Aug. 15, 1989), CCH Comm. Fut. L. Rep. ¶ 24,516; No. 89-7 (June 22, 1989), CCH Comm. Fut. L. Rep. ¶ 24,479; No. 86-23 (June 16, 1988), CCH Comm. Fut. L. Rep. ¶ 23,281; No. 84-16 (Sept. 7, 1984), CCH Comm. Fut. L. Rep. ¶ 22,347; No. 83-2 (Mar. 18, 1983), CCH Comm. Fut. L. Rep. ¶ 21,788.

   b. CFTC Letter No. 03-13 (Mar. 19, 2003), CCH Comm. L. Rep. ¶ 29,438, took a no-action position with respect to whether a bank was required to register as an IB based on the referral of customers to an affiliated FCM where (i) the bank is subject to U.S. banking regulations, (ii) all bank employees who introduce customers to the FCM are registered as associated persons of the FCM, (iii) each office where futures activities take place is a branch office of the FCM, (iv) a registered manager supervises the futures activities of the bank employees, and (v) the FCM is liable for the FCM-related activities of the bank associated persons.

   c. All persons registered as FCMs, Swap Dealers, MSPs, IBs, CPOs or CTAs are required to also become and remain a member of a registered futures association. 17 C.F.R. §§ 170.15 and 170.16; 80 Fed. Reg. 55022 (Sept. 14, 2015) (promulgating 17 C.F.R. § 170.17 for IBs, CPOs and CTAs; effective Nov. 13, 2015).

   d. 17 C.F.R. § 4.14 exempts from the CEA's registration requirements CTAs that provide standardized advice by means of media such as newsletters, telephone newslines, Internet websites and non-customized computer software, and that do not direct client accounts. See 65 Fed. Reg. 12938 (Mar. 10, 2000).

This exemption was prompted by Taucher v. Born, 53 F. Supp. 2d 464 (D.D.C. 1999), dismissed sub nom. Taucher v. Rainer, 2000 U.S. App. LEXIS 6993 (D.C. Cir. 2000) (requirement that publishers and website operators who provide futures trading information register with the CFTC is unconstitutional restraint on free speech), and Commodity Trend Service v. CFTC, CCH Comm. Fut. L. Rep. ¶ 27,777 (N.D. Ill., Sept. 29, 1999) (CEA registration requirement is unconstitutional restraint on free speech, but the CEA's antifraud provisions apply to "impersonal" CTAs), aff'd, 233 F.3d 981 (7th Cir. 2000). Cf. CFTC v. Mass Media Marketing, 297 F.3d 1321 (11th Cir. 2002) (companies may advertise futures and options trading without liability under the CEA if they do not actually trade for customers); CFTC v. Vartuli, 228 F.3d 94 (2d Cir. 2000) (although the CTA registration requirement is a form of prior restraint on speech, the prior restraint analysis is inapplicable to a vendor of an automatic futures trading system because that system does not generate protected speech; such vendor must register as a CTA and is subject to the CEA's antifraud provisions).

e. The CFTC has determined that "cryptocurrencies" and "virtual currencies", such as "bitcoin", are commodities for purposes of the CEA. See Coinflip, Inc. d/b/a Derivabit, CFTC Docket No. 15-29 (Sept. 17, 2015) (Derivabit conducted options transactions in virtual currencies without complying with swaps regulations, and operated an exchange for virtual currency options without registering as a swap execution facility or a designated contract market); TeraExchange LLC, CFTC Docket No. 15-33 (Sept. 24, 2015) (registered SEF engaged in wash trading and prearranged trading in non-deliverable U.S. dollar/bitcoin forwards). See also BFXNA, Inc., CFTC Docket No. 16-19 (June 2, 2016) (penalty for offering illegal off-exchange financed retail commodity transactions in bitcoin and other cryptocurrencies, and for failing to register as an FCM for receiving orders and accepting funds in retail virtual currency commodity transactions).

f. In fiscal year 2015, the CFTC filed 69 new enforcement actions and imposed over $3.14 billion in sanctions. High profile enforcement actions included a spoofing action against Navinder

Sarao, the imposition of a penalty of $800 million against Deutsche Bank for manipulation of LIBOR, and the bringing and settling of the first cases charging attempted manipulation of forex exchange benchmark rates and the ISDAFix rate. See Part II.E above.

D. OTHER TRANSACTIONAL SERVICES

1. Financial Holding Companies and Financial Subsidiaries

a. Gramm-Leach (BHCA § 4(k)(5)) requires the Board to adopt a regulation or order setting out which transactional activities qualify as financial activities permissible for FHCs, as well as which activities qualify as "incidental" to such financial activities. Such regulation or order should clarify the extent to which the following activities qualify as financial activities:

(i) Lending, exchanging, transferring, investing for others or safeguarding financial assets other than money or securities;

(ii) Providing any device or instrumentality for transferring money or other financial assets; and

(iii) Arranging, effecting or facilitating financial transactions for the account of third parties.

The Board/Treasury joint interim rule regarding these activities reflects uncertainty regarding how best to implement this mandate. See 66 Fed. Reg. 257 (Jan. 3, 2001). Rather than define such activities, the Board and Treasury established a procedure for seeking approval by Order of activities within the described categories and solicited comment regarding what activities, "if any", should be defined by rule to be "financial" or "incidental" for purposes of BHCA § 4(k)(5). See 12 C.F.R. §§ 225.86(e), 225.88.

In any event, FHCs and financial subsidiaries would have all powers currently possessed by BHCs in respect of transactional services.

b. The Financial Activities Regulations do not address the scope of permissible e-commerce activities, although virtually all types of e-commerce are arguably "financial in nature". See, e.g., Board Finder Rule and Board IT Proposal, Part I.C.1.c.iii.B and Part VII.C above.

2. Bank Holding Companies

Under Regulation Y, BHC subsidiaries may provide agency transactional services with respect to virtually any financial instrument.

a. A BHC subsidiary may act as broker or agent with respect to (i) derivative or FX transactions that a BHC or state member bank may conduct for its own account, and (ii) forward contracts based on a financial or non-financial commodity that also serves as the basis for an exchange-traded futures contract (but not, e.g., with respect to commercial products -- such as automobiles, consumer products, etc. -- or real estate). See, e.g., 12 C.F.R. § 225.28(b)(8); ABN AMRO ChiCorp Order; Multinet Order; Bank of Montreal Order. See also Part II.E.4 above.

b. Prior to 2003, a BHC was not permitted to physically settle many commodity derivative contracts.

In 2003, the Board amended Regulation Y, § 225.28(b)(8)(ii)(B), to permit BHCs to (A) make and take delivery of title to non-financial commodities underlying physically-settled derivative contracts on an instantaneous, pass-through basis; and (B) enter into derivative contracts that do not require cash settlement or do not provide for assignment, termination or offset prior to delivery so long as such contracts are based on commodities approved by the CFTC for trading on a U.S. futures exchange and the BHC either reasonably tries to avoid taking or making delivery or receives and instantaneously transfers title to the commodity, by operation of contract and without taking or making physical delivery. See 68 Fed. Reg. 39807 (July 3, 2003). See also Part II.E.3.c.ii and Part IX.A.2 above.

c. In the annuities context, the Board has permitted (i) employees of BHC brokerage subsidiaries to become "dual employees" or "independent contractors" of unaffiliated insurance agents; (ii) such insurance agents to sublease space from the BHC; and (iii) such dual employee/independent contractors, in their capacities as insurance agents, to sell annuities and insurance products. See, e.g., Section 20 Insurance and Annuity Letters; Board Letters, Mar. 8, 1996 (BHC thrift subsidiary arrangements), Mar. 8, 1996 (BHC brokerage subsidiary to act as independent contractor to insurance agent); Summit Bancorp, 60 Fed. Reg. 66802 (Dec. 26, 1995) (solicitation of public comments), approved Feb. 15, 1996 (the "Summit Approval"). See also Part IX.E.2 and Part XII.B.3.s below.

3. Banks

A bank may act as broker/agent with respect to (a) derivative or FX transactions that a bank is permitted to conduct for its own account, (b) forward contracts based on a financial or non-financial commodity that also serves as the basis for an exchange-traded futures contract, and (c) virtually any other type of financial or financially-related instrument. See 12 U.S.C. § 24(7). See also Part II.E above.

a. Banks may provide brokerage/advisory services respecting "investment instruments", including variable and fixed rate annuities. See, e.g., VALIC; Approval No. 303; Letter No. 753; Comptroller Conditional Approval No. 176 (July 19, 1995); Comptroller Unpublished Letters (Mar. 6, 1991), (June 21, 1990), (Apr. 9, 1990), (Feb. 12, 1990), (Mar. 22, 1989); Comptroller Letter (Mar. 21, 1990) re NationsBank; Letter No. 34; Comptroller Unpublished Letters (Sept. 19, 1988) re Valley Bank, (May 11, 1988) re Centerre Bank; Letter No. 499; Comptroller Interpretive Letter No. 331 (Apr. 4, 1985) ("Letter No. 331"), CCH Fed. Banking L. Rep. ¶ 85,501.

b. Banks may engage in certain transactions involving physical commodities of the type that national banks are not permitted to purchase, sell or trade for their own account. See, e.g., Letter No. 962; Comptroller Unpublished Letter (Oct. 4, 1994); BC 277 (Section F.3); Comptroller Investment Securities Letter No. 34 (Jan. 30, 1989), CCH Fed. Banking L. Rep. ¶ 83,040. But see Section 620 Report; Industrial/Commercial Metals NPR.

c. National banks may act as finders with respect to all types of products and services. See Part VII.C above.

E. CERTAIN REGULATORY, ENFORCEMENT AND COMPLIANCE ISSUES RELATING TO BROKER-DEALER OPERATIONS

1. Compliance Systems, Enforcement Focus and Examination Issues

a. The SEC and FINRA have enhanced their respective examination programs and recent releases have highlighted examination priorities and results.

See, e.g., Coming Into Focus: 2015 Securities Litigation Study (PWC, Apr. 2016) (discussing trends in enforcement, including the SEC's increased attention to cybersecurity preparedness and continued focus on accounting, financial reporting and disclosure matters); SEC Press Release 2016-38 (Mar. 8, 2016) (new OCIE office to streamline risk assessment, market surveillance and quantitative analysis and provide organizational risk management and strategy); Remarks of SEC Chair Mary Jo White, Feb. 19, 2016 (SEC's 2016 enforcement priorities to include financial reporting, market structure and the structuring, disclosure and sales of complex financial instruments); Remarks of SEC Commissioner Kara M. Stein, Feb. 19, 2016 (advocating for greater transparency and accountability in respect of exchange traded funds, amendments to proxy rules to facilitate more robust shareholder enfranchisement, completing the remaining rules under Dodd-Frank, completing the Consolidated Audit Trail and shortening the settlement cycle to T+2); OCIE Examination Priorities for 2016 (SEC, Jan. 11, 2016) (discussing OCIE's focus on protecting investors saving for retirement, assessing market-wide risks and examining registrants that may be involved in illegal activity); 2016 Regulatory and Examinations Priorities Letter (FINRA, Jan. 5, 2016) (noting culture, conflicts of interest and ethics; supervision, risk management and controls; and liquidity); SEC 2015 Agency Financial Report (reporting 807 enforcement actions and \$4.2 billion in penalties and disgorgements in FY 2015); FINRA 2015 Year in Review and Annual Financial Report (reporting 1,512 disciplinary actions and \$93.8 million in fines); Top Regulatory Trends for 2016 in Securities (Deloitte, Dec. 2015) (noting the

SEC's increased efforts to obtain admissions of misconduct, greater focus on individual accountability and heightened reliance on data analytics and other advanced technologies); Remarks of SEC Director, Division of Enforcement Andrew Ceresney, Nov. 2, 2015 (focus on market structure, including fairness in trading venues, misuse of confidential customer order information, failures to adopt policies and procedures to guard against the risks of direct market access and high-volume manipulative trading); SEC Press Release 2015-245 (Oct. 16, 2015) (noting a number of first-ever cases brought in FY 2015, including an action involving a "Big Three" credit rating agency, an action against a private equity adviser misusing broken deal expenses, an FCPA proceeding against a financial institution and an action involving an SEC rule disallowing the use of a confidentiality agreement to prevent whistleblowers from contacting the SEC). See also CFTC Press Release 7275-14 (Nov. 6, 2015) (noting 69 CFTC enforcement actions in FY 2015 focusing on manipulation, spoofing and fraud and ensuring market participants meet regulatory requirements).

National and international organizations also weigh in on the development of examination programs and priorities. See, e.g., 2016 Enforcement Report (NASAA, Sept. 13, 2016); Securities Markets Risk Outlook 2016 (IOSCO, Mar. 2016) (focus on cybersecurity, corporate bond market liquidity, use of collateral in financial transactions and harmful conduct related to retail financial products and services); Credible Deterrance in the Enforcement of Securities Regulation (IOSCO, June 2015); A Comparison and Analysis of Prudential Standards in the Securities Sector (IOSCO, Feb. 2015) (international comparative analysis of prudential (including capital adequacy) frameworks for securities firms); Top Investor & Small Business Threats (NASAA, Dec. 2013) (noting private offerings, real estate investment schemes, high yield investment and Ponzi schemes, affinity fraud, scam artists using self-directed IRAs to mask fraud, risky oil and gas drilling programs, proxy trading accounts and digital currency).

b. In 2015, the SEC filed 807 enforcement actions leading to a record $4.2 billion in penalties and profit disgorgement. These included actions against a private equity adviser for misallocating broken deal expenses, an underwriter for pricing-related fraud in the primary market for municipal securities and a "Big Three" credit rating agency; an action involving violations arising from a dark pool's disclosure of order types to its subscribers; an FCPA action against a financial institution; an admissions settlement with an auditing firm; and an action involving an SEC rule prohibiting the use of confidentiality agreements to impede whistleblower communication with the SEC. SEC Press Release 2015-245 (Oct. 22, 2015). In 2015, the DOJ also issued the "Yates Memorandum", which outlines the steps that should be taken to identify and seek accountability from culpable individuals in the event of corporate fraud or other misconduct. See Memorandum for all U.S. Attorneys: Individual Accountability for Corporate Wrongdoing (DOJ, Sept. 9, 2015) (the "Yates Memo").

See also CFTC Press Release No. 7274-15 (Nov. 6, 2015) (reporting 69 enforcement actions in fiscal year 2015; more than $3.14 billion in civil monetary penalties and more than $1.4 billion in restitution and disgorgement).

(i) The SEC's practice of granting certain applicants waivers from regulatory disqualifications has been the subject of debate and criticism. See, e.g., SEC Commissioner Aguilar, Enhancing the Commission's Waiver Process (Aug. 27, 2015) (arguing for greater transparency to the Commissioners and a more flexible approach); Remarks of SEC Chairman White, Mar. 12, 2015 (factors considered by the SEC in determining whether to grant a waiver, including the nature of the violation, the duration of the wrongdoing, the level of seniority of the employees involved and the state of mind of the participants); SEC Commissioner Gallagher, Why is the SEC Wavering on Waivers? (Feb. 13, 2015) (arguing that disqualification should only be a prospective protective measure, not tied to enforcement or used as a form of sanction); Banking Daily, Feb. 5, 2015 (detailing recent disagreements among SEC commissioners regarding the granting of waivers); SEC Commissioners Aguilar and Stein, Dissenting Statement in Matter of Oppenheimer & Co. (Feb. 4, 2015) (dissenting from waiver of Oppenheimer's automatic disqualification from Regulation D provisions that would have resulted from an SEC order censuring and penalizing Oppenheimer for securities laws violations; see SEC Admin. Proc. No. 3-16361 (Jan. 27, 2015)). See also Waivers of Disqualification under Regulation A and Rules 505 and 506 of Regulation D (SEC, last modified Mar. 13, 2015) (discussing factors the SEC Division of Corporate Finance considers in waiver requests); Process for Requesting Waivers of "Bad Actor" Disqualification Under Rule 262 of Regulation A and Rules 505 and 506 of Regulation D (SEC, last modified Mar. 3, 2015).

The conditional waiver granted to JPMorgan following CFTC-imposed sanctions against JPMorgan for failing to disclose certain conflicts of interests suggests a possible compromise. JPMorgan Chase Bank (avail. Dec. 18, 2015). See also Remarks of Commissioner Stein, Dec. 18, 2015 (noting concern about binary nature of approving or denying waiver requests and arguing that the conditional waiver granted to JPMorgan Chase, which included "stringent requirements," such as the hiring of an independent consultant to conduct a comprehensive review of the firm's policies and procedures under Rule 506, provides a more outcome-focused approach).

(ii) A number of guiding principles are applied in determining whether and to what extent to impose penalties in connection with securities violations. See, e.g.:

A) SEC Division of Enforcement, Enforcement Manual (June 4, 2015); SEC Press Release 2006-4 (Jan. 11, 2006) (relevant factors include (i) the presence or absence of a direct benefit as a result of the violation; (ii) the degree to which the penalty will compensate injured investors; (iii) the need to deter a particular offense; (iv) the extent of the injury to innocent parties; (v) whether complicity in the violation is widespread; (vi) the level of intent;

(vii) the degree of difficulty in detecting the particular offense; (viii) the presence or absence of remedial steps; and (ix) cooperation with the SEC and law enforcement agencies).

See also, e.g., HSBC Securities (USA), FINRA Letter of Acceptance, Waiver and Consent No. 2011027202401 (Dec. 28, 2012) (noting that "HSBC has satisfied the criteria necessary to receive credit for extraordinary cooperation"); Putnam Fiduciary Trust Co., SEC Litigation Release No. 19517 (Jan. 3, 2006) (SEC action against former Putnam officers for fraud; SEC would not bring an enforcement action against Putnam "because of its swift, extensive and extraordinary cooperation", including "prompt self-reporting, an independent internal investigation, sharing the results of that investigation with the government (including not asserting any applicable privileges . . .), terminating and otherwise disciplining responsible wrongdoers, providing full restitution to its defrauded clients, paying for the attorneys' and consultants' fees of its defrauded clients, and implementing new controls designed to prevent the occurrence of fraudulent conduct").

B) FINRA Sanction Guidelines (2015) (principal considerations include: (i) disciplinary history; (ii) acceptance of responsibility and self-reporting; (iii) corrective measures; (iv) restitution or other remedial action; (v) existence of reasonable supervisory, operational and/or technical procedures or controls; (vi) adequate training and educational initiatives; (vii) reasonable reliance on competent legal or accounting advice; (viii) numerous acts and/or any pattern of misconduct; (ix) misconduct over an extended period of time; (x) attempts to conceal misconduct, or to mislead a customer, regulatory authority or the firm; (xi) nature and extent of any injury to other parties; (xii) substantial assistance in examination/investigation or attempts to delay, conceal or mislead; (xiii) whether the misconduct resulted from an intentional act, recklessness or negligence; (xiv) prior disciplinary actions or sanctions of other regulators; (xv) prior warnings of misconduct; (xvi) whether conduct was aberrant or not reflective of firm's historical compliance record; (xvii) monetary or other gain; (xviii) number, size and character of transactions; and (xix) sophistication of those affected).

See also FINRA Regulatory Notice 08-70 (Nov. 2008) (guidance regarding "credit for extraordinary cooperation" includes factors such as (1) self-reporting of violations, (2) extraordinary steps to correct deficient procedures and systems, (3) extraordinary remediation to customers and (4) providing substantial assistance to FINRA investigators); NYSE Information Memos No. 05-77 (Oct. 7, 2005) (factors considered in determining sanctions for violations); No. 05-65 (Sept. 14, 2005) (guidance on obligations to cooperate with reviews, examinations and investigations).

See generally FINRA Launches New Disciplinary Actions Database, FINRA News Release, May 16, 2011.

C) CFTC Enforcement Advisory: Cooperation Factors in Enforcement Division Sanction Recommendations (Mar. 1, 2007) (factors considered include (i) cooperation, (ii) the organizational level at which the misconduct occurred, (iii) the length of the misconduct after discovery, (iv) adequacy of staff and resources, (v) actions to mitigate loss, (vi) efforts to uncover and investigate violations, (vii) cooperation with the CFTC and management, and (viii) efforts to prevent future violations).

See generally Part VIII.C above and Part IX.E.3 below.

(iii) See also Performance Audit of the Division of Market Oversight's Rule Enforcement Reviews (CFTC OIG, Aug. 5, 2015) (noting incomplete enforcement of all core principles, need for improvement in selecting DCMs for review, incomplete follow-up on recommendations from prior reviews, and lengthy completion times for reviews); OCIE Regional Offices' Referrals to Enforcement (SEC OIG, Mar. 30, 2011) (noting that OCIE may refer matters to the Division of Enforcement when the "noncompliance or internal control failures are considered serious, such as when OCIE staff believe that investor funds or securities are at risk"); Allegations of Improper Coordination Between the SEC and Other Governmental Entities Concerning the SEC's Enforcement Action Against Goldman Sachs & Co. (SEC OIG, Sept. 30, 2010); Testimony of SEC Division of Enforcement Director Khuzami before Senate Judiciary Committee, Sept. 22, 2010 (Investigating and Prosecuting Fraud after the Fraud Enforcement and Recovery Act) (significant SEC cases, coordination with other law enforcement agencies, fraud-detection and risk-based initiatives, and incorporation of authorities and responsibilities under Dodd-Frank).

c. Broker-dealer supervision is receiving intense focus. See, e.g., 2015 FINRA Regulatory and Examination Priorities Letter; Broker/Dealer Compliance Report, Jan. 6, 2015; FINRA Regulatory Notice 14-10 (Mar. 2014) (SEC approval of FINRA consolidated rules on broker-dealer supervision); SEC Division of Trading and Markets, [FAQ] about Liability of Compliance and Legal Personnel at Broker-dealers under Section 15(b)(4) and 15(b)(6) of the Exchange Act (Sept. 30, 2013) (clarifying liability of broker-dealer compliance and legal personnel); FINRA Regulatory Notices 09-17 (Mar. 2009) (enforcement process) and 08-18 (Apr. 2008) (supervisory and control practices for preventing unauthorized proprietary trading).

d. Top areas of interest for current broker-dealer examinations include:

(i) Corporate governance and enterprise risk management, including analyzing how financial, legal, compliance, operational and reputational risks are controlled and managed.

(ii) Maintenance and implementation of a "culture of compliance", including (A) compliance oversight; (B) codes of conduct; (C) identification and control of compliance risks; (D) implementation of well-resourced compliance and supervisory systems; (E) supervision of employees; (F) communication, education and training; (G) internal processes to monitor and audit compliance; (H) effective reporting and resolution of significant compliance issues; and (I) response to violations and non-compliant actions; in particular, firms will be examined for whether (1) control functions are valued within the firm; (2) policy or control breaches are tolerated; (3) the firm proactively identifies risk and compliance events; (4) supervisors are effective role models; and (E) sub-cultures that may not conform to overall corporate culture are identified and addressed.

(iii) Fraud detection and prevention, and fraudulent activity associated with customer accounts (including affinity fraud and fraud targeting seniors), including microcap fraud (particularly whether firms have engaged in or aided pump-and-dump schemes or market manipulation, whether firms are publishing quotes and trading OTC securities consistently with securities laws and whether firms' conduct appropriate due diligence with respect to deposits of large blocks of microcap securities).

(iv) Trading and pricing practices (e.g., controls and abuses related to high frequency and algorithmic trading, fixed income (including best execution, inter-positioning and fair pricing), sponsored access, direct market access, trading pauses, insider trading, front-running, manipulation of securities prices, order entry controls and order routing practices, misuse of customer trading data or other non-public information, best execution responsibilities (including mark-ups, "bundled" commissions and the pricing of principal and agency trades)).

(v) Short selling and compliance with Regulation SHO (including in connection with ETFs). (See Part IX.E.2 below.)

(vi) Operations and adequacy of disclosure to subscribers of ATS (including handling of order flow, firms' participation as agent or principal, compensation, error handling, and interactions between ATS and affiliates).

(vii) Trading in non-public securities, including related registration, suitability, fair pricing, communications and disclosure requirements.

(viii) Conflicts of interest (including conflict mitigation controls, sufficiency of disclosures, and conflicts arising from hiring and compensation practices), information barriers and other internal controls (including separation of banking from research) and disclosures (including through Forms BD and ADV, performance advertising, marketing, fund prospectuses and other information provided to clients); in particular, firms will be examined for (A) incentives created by compensation plans and receipt of third-party payments; (B) compliance with FINRA's research rules; (C) information leakage; and (D) position valuation. (See Part IX.E.3.c below.)

(ix) Sales practices and new product approval process (including suitability, disclosure of risks, costs and fees, unauthorized trading, cold calling, automated investment advice, churning, switching, misrepresentation of performance results), with special emphasis on private placements and private self-offerings, high yield investments (including business development companies, leveraged loan products, and high yield debt instruments), municipal securities, non-conventional or new products (including the improper supervision and due diligence processes regarding recommendations of those products, and the creation and marketing of structured finance products, commercial MBS, ABS, collateralized mortgage obligations ("CMOs"), non-traded REITs, CDSs and other derivatives or similar instruments), and ETFs (including leveraged and "non-traditional" ETFs), potential layering and spoofing activities, variable annuities, life settlements, reverse convertibles, municipal interest rate swaps, fee-based accounts, separately managed accounts, Section 529 college savings plans, penny stocks, principal-protected notes, illiquid or volatile securities (including ARS), underwritings and distributions, money market funds and hedge funds.

Particular emphasis on protection of retail investors, retirement savers, seniors and other vulnerable investors, including from unsuitable investments or concentrations, fraud, sales practice abuse and financial exploitation., including (A) through the ReTIRE initiative, which examines recommendations made to investors, conflicts of interest, supervision and compliance controls and marketing and disclosure practices, and (B) examinations of the suitability of variable annuities and disclosures regarding such sales. (See also Part II.E.2 above.)

(x) Whether supervisory and compliance procedures are comprehensive, updated, tailored to the broker-dealer's business and being followed, including with respect to electronic communications and social media, master/sub-account relationships (which may implicate CIP, registration, margin, books and records, net capital and reserve requirements), intercompany transactions and the activities of affiliates, customer complaints, communications with the public generally, FCPA requirements (see Part VIII.A above), branch office operations and supervision, independent contractors and outsourcing arrangements (see Part IX.B.2 above); how the broker-dealer identifies and responds to "red flags" given the nature of its business; and the status and function of compliance officers.

(xi) AML compliance, including a focus on firms that have not filed the number of suspicious activity reports consistent with their business models or have filed incomplete or late reports; emphasis on (A) the adequacy of independent testing and (B) the extent to which firms adapt programs to current risks. (See Part VIII.A above; ThinkAdvisor, Apr. 8, 2016; Remarks of Executive Vice President, Enforcement, FINRA, J. Bradley Bennett, Apr. 5, 2016; Reuters, June 18, 2015 (brokers that sell banking products may be at greater risk of AML issues)).

(xii) Operations and firm-wide and systemic risk management with respect to credit, funding, liquidity, operational and legal risk, including governance processes and controls regarding margin lending, customer statements and the use of consolidated account reports, internal audit, reporting (including data integrity), books and records, e-mail retention, and inventory and collateral valuations (especially structured products). (See, e.g., Guidance on Liquidity Risk Management Practices, FINRA Regulatory Notice 15-33 (Sept. 2015)).

(xiii) Policies and procedures for the safeguarding of customer assets from theft, loss, misuse and misappropriation (including existing custodial and prime brokerage arrangements), and other custodial risk issues (particularly as they relate to investment advisers which "self-custody" client assets). (See Part VIII.C above.)

(xiv) Financial issues (including net capital and reserve account deficiencies, inaccuracies in computing net capital or reserve requirements, internal controls of clearing firms for managing intraday liquidity and net capital, identification and accounting for guarantees and contingencies, asset/liability duration mismatches and balance sheet liquidity risk).

(xv) Governance and supervision of information technology, operational capability, market access (including risks of system outages and data integrity compromises).

(xvi) Information security and cybersecurity (including policies, procedures and controls to protect customer information within the firm and in the context of outsourcing arrangements, on-line brokerage account intrusions, compliance with "identity theft" regulations, and "leaking" of information to favored customers). (See Part IX.F.2 below.)

(xvii) Outsourcing, including due diligence, supervision and risk assessment of providers. (See Part IX.B.2 above.)

(xviii) The organization and governance of firms' internal audit frameworks, including the process for identifying and prioritizing risks, the interaction between the audit committee and the board of directors, the involvement of the internal audit in committee and major projects and the execution of the audit plan.

(xix) Policies and controls related to onboarding clients.

(xx) Outside business activities and private securities transactions of registered representatives (including mortgage brokers and sellers of hedge funds and variable insurance products).

(xxi) Business continuity programs.

(xxii) Bank sweep programs. (See Part IX.A.1.c above and Part IX.E.3.d.viii below.)

(xxiii) Securities lending programs, particularly with respect to customer fully paid securities. (See Part IX.A.1.b.ii above.)

(xxiv) Use and abuse of options origin codes (including improper coding of broker-dealer orders as customer orders) and misreporting or nonreporting of large option positions.

(xxv) Compensation or payment arrangements that may be part of revenue sharing or other undisclosed arrangements (including payments to increase fund sales or AUM, misappropriation of adviser/fund/broker-dealer assets through the creation of fictitious expenses, or kick-backs from service providers).

(xxvi) Interaction with credit rating agencies (including the agencies' sources of fee compensation and factors that could change ratings).

(xxvii) Due diligence policies and procedures.

(xxviii) Non-securities and non-traditional activities, particularly FX trading, binary options and virtual currencies. (See Part II.E.4 above.)

(xxix) Regulatory risks related to the development of programs to comply with new rules.

See, e.g., National Exam Program Examination Priorities for 2016 (OCIE, Jan. 11, 2016); 2016 Regulatory and Examination Priorities Letter (FINRA, Jan. 5, 2016); Retirement-Targeted Industry Reviews and Examination Initiative (OCIE, June 22, 2015); National Exam Program Examination Priorities for 2015 (OCIE, Jan. 13, 2015); Unclaimed Property: Compliance Obligations and Challenges for Broker-dealers (SIFMA, Jan. 2015); Report on Activities: Fiscal Year 2014 (SEC Office Of Investor Advocate, Dec. 2014); Broker Dealer Controls Regarding Customer Sales of Microcap Securities (OCIE, Oct. 9, 2014); National Exam Program Examination Priorities for 2014 (OCIE, Jan. 9, 2014); FINRA Letter to Broker-dealers, Jan. 11, 2013; 2012 Broker-Dealer Coordinated Examinations Project (NASAA, Sept. 9, 2012); Examinations by the [SEC's OCIE] (SEC, Feb. 2012); FINRA Regulatory Notice 11-54 (Nov. 2011) (Branch Office Inspections); Examinations by Regulators from the Regulators' Perspective (SIFMA, Mar. 23, 2011); Compliance Reporter, June 6, 2011, June 7, Mar. 15, 2010; Corporate Counsel, Jan./Feb. 2011 (Model Insider Trading Program); Sec. Reg. & L. Rep., May 27, 2013, Oct. 18, 2010; Banking Daily, Mar. 29, 2010. See also Part VIII.C above.

e. Components of a compliance program:

(i) In seeking to assure a quality compliance program, in his remarks of June 21, 2005, NYSE Chief Regulatory Officer Ketchum said that it is critical that firms' legal and compliance officers regularly work through a series of questions, including: (A) whether the access of senior legal and compliance personnel is regular and systematic, or ad hoc and episodic; (B) even if access is regular, whether it involves a full analysis of compliance developments and exposures; (C) whether the firm's commitment to providing technology resources is as great for compliance as for other initiatives; (D) whether the firm has analyzed compliance technology proposals that did not receive approval in prior budgets to see if exposures persist; and (E) whether employees are rewarded for raising compliance issues.

(ii) In an October 19, 2006 speech (The Process of Compliance), SEC OCIE Director Richards identified components of a compliance program, including (A) oversight; (B) a code of ethics/conduct and policies and procedures to implement required standards; (C) due diligence before responsibilities are delegated; (D) communication, education and training; (E) monitoring and auditing; (F) enforcement and discipline; and (G) response to problems, prevention efforts and periodic risk-assessment and evaluation.

(iii) In remarks of October 18, 2007, SEC OCIE Director Richards identified several reasons why compliance programs fail, or are not fully effective:

A) Lack of management support.

B) Valuing risk-taking over all else.

C) Employees who do not understand the value or purpose of compliance programs.

D) Lack of resources or sporadic training.

E) Lack of consistency in response to enforcement actions or new rules.

(iv) SIFMA issued The Evolving Role of Compliance (Mar. 2013) to highlight the changing environment and complexity of securities businesses within which the compliance function must operate and to offer recommendations to management, regulators and the compliance function to define the proper role of compliance. See also SIA White Paper on the Role of Compliance (July 2005).

(v) In November 2015, in connection with the DOJ's hiring of an expert compliance consultant, the DOJ laid out the metrics that it would use to judge companies in criminal matters, including whether (A) directors and managers offer strong support for corporate compliance policies; (B) compliance personnel have stature in the company and get the resources they need; (C) the company maintains written compliance policies that are clear and easily translated; (D) policies are effectively communicated to employees, easily accessible, and are the subject of repeated training; (E) compliance policies are kept current; (F) compliance policies are enforceable, compliance is incentivized, and violators are disciplined; and (G) third parties are informed of compliance expectations. The DOJ articulated additional metrics for financial institutions, including whether an institution can identify its customers, is complying with U.S. laws, and is candid with regulators. See Wall. St. J., Nov. 2, 2015; Corporate Counsel, Nov. 4, 2015.

(vi) In remarks of Nov. 4, 2015, Director Ceresny, SEC Division of Enforcement, listed several factors influencing the likelihood of an enforcement action and surveyed recent actions against compliance officers. Ceresny noted that actions against compliance officers typically are pursued in the following contexts: (A) direct involvement in fraudulent activity or other conduct that harms investors; (B) participation in efforts to obstruct or mislead SEC staff; or (C) "wholesale failure" to carry out responsibilities.

(vii) Recent cases against compliance officers include SFX Financial Advisory Management Enterprises, Inc., SEC Admin. Proc. No. 3-16591 (June 15, 2015) (alleging CCO failed to implement policies and procedures to detect misappropriation of client assets and failed to review compliance programs after the misappropriation had been investigated); BlackRock Advisors, LLC, SEC Admin. Proc. No. 3-16501 (Apr. 20, 2015) (alleging failure to adopt written policies to monitor, and disclose conflicts related to, employees' outside activities, and charging its CCO with "causing" such failures); Wolf, SEC Admin. Proc. No. 3-16195 (Oct. 15, 2014) (alleging that compliance officer aided and abetted insider trading violations by not taking action after a review of trading activity and by altering documentation after broker was charged with insider trading); Delaney, SEC Admin. Proc. No. 3-15873 (May 19, 2014) (allegations against CCO for causing violations of Reg. SHO and related accounting and disclosure failures in connection with margin loans secured by unrated municipal bonds).

See also Pensions & Investments, Jan. 11, 2016; Corporate Counsel, Nov. 9, Aug. 11, 2015; Wall St. Lawyer, Sept. 2015.

f. Deloitte's Global Risk Management Survey (July 2013) estimated that, in response to the 2007-2009 financial crisis and resulting regulatory reforms, 88% of U.S. firms faced increased compliance costs, 65% of firms across jurisdictions faced increased compliance costs (up from 55% in 2010), and 48% of firms across jurisdictions revised product lines and business activities (up from 24% in 2010).

g. Proceedings have been brought against broker-dealers (or their employees) arising from alleged compliance failures or legal violations.

(i) Examples include, e.g., Raymond James & Associates, FINRA Letter of Acceptance, Waiver and Consent No. 2014043592001 (May 5, 2016) (failure to allocate sufficient resources to AML compliance systems to match the firm's growth, failure to implement supervisory systems to ensure compliance with securities laws and failure to maintain supervisory system to review suitability requirements for variable annuities); Cantor Fitzgerald & Co., FINRA Letter of Acceptance, Waiver and Consent No. 20120349643 (Dec. 21, 2015) (failure to maintain supervisory system commensurate with firm's activities, failure to identify red flags of suspicious activity and failure to establish AML program in connection with microcap securities); Fidelity Brokerage Services, FINRA Letter of Acceptance, Waiver and Consent No. 2014041374401 (Dec. 18, 2015) (failure to implement adequate supervisory systems to comply with securities laws and to monitor transfers of funds from customers' accounts); NASAA Press Release, Sept. 23, 2015 (announcing settlement in connection with failure of LPL Financial to implement adequate supervisory systems, or enforce policies, related to sales of non-traded REITs); Citigroup Global Markets, Inc., SEC Admin. Proc. No. 3-16764 (Aug. 19, 2015) (policies to detect and prevent misuse of material non-public information and to prevent certain principal transactions by affiliates); Deutsche Bank Securities, FINRA Letter of Acceptance, Waiver and Consent No. 20100023559301 (Dec. 19, 2013) (financial and operational deficiencies); COR Clearing, FINRA Order Accepting Offers of Settlement No. 2009016239701 (Dec. 16, 2013) (AML, financial reporting and deficiencies in exercise of supervisory responsibilities).

See also, e.g., Press Release, Attorney General Reaches Agreement with TD Ameritrade in Investigation of Retail Securities Brokerage Industry (Office of the Conn. Attorney General, July 6, 2012) and related Commitment Agreement, dated July 5, 2012 (agreement with the Attorneys General of Connecticut, Iowa and Missouri in connection with an investigation of potential violations of antitrust law by retail securities brokers and order execution firms, and requiring creation of an antitrust policy and training program).

(ii) In the first case of its kind, Albert Fried & Company, SEC Admin. Proc. No. 3-17270 (June 1, 2016), imposed a civil money penalty against a broker-dealer based on alleged failures, over a five-year period, to file suspicious activity reports with bank regulators despite "red flags" of fraudulent or unlawful activity.

(iii) The SEC dismissed enforcement proceedings against the general counsel of a registered broker-dealer where it had been alleged that the general counsel had "failed reasonably to supervise" an employee (who was not a member of a department reporting to the general counsel) allegedly engaged in violations of securities laws. An administrative law judge in an earlier proceeding had determined that the general counsel should be deemed a "supervisor" because, as general counsel, his "opinions on legal and compliance issues were viewed as authoritative and his recommendations were generally followed by . . . business units." The SEC was evenly divided on appeal, and SEC rules in such situations dismiss the proceeding and render the administrative law judge decision "of no effect". See In re Theodore Urban, SEC Admin. Proc. No. 3-13655 (Jan. 26, 2012), dismissing SEC Admin. Proc. No. 3-13655 (Sept. 8, 2010).

h. The GAO has studied OCIE's systems for planning, tracking and closing investigations, and risk-based examination focus. See [SEC]: Greater Attention Needed to Enhance Communication and Utilization of Resources in the Division of Enforcement (GAO, Mar. 2009); SEC: Additional Actions Needed to Ensure Planned Improvements Address Limitations in Enforcement Division Operations (GAO, Aug. 2007); SEC: Steps Being Taken to Make Examination Program More Risk-based and Transparent (GAO, Aug. 2007).

i. Dodd-Frank § 982 authorizes the PCAOB to adopt rules for inspections of broker-dealer audit reports. The PCAOB has adopted an interim inspection program for registered public accounting firms' audits of broker-dealers. It has issued five Progress Reports on the program, and is developing a rule proposal to establish a permanent inspection program. In 2015, it inspected 75 firms and covered portions of 115 audits and found deficiency in portions of 80, including deficiencies relating to the SEC's net capital and customer protection rules. Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers (PCAOB, Aug. 18, 2016).

See also Staff Inspection Brief: Information About 2016 Inspection of Auditors of Brokers and Dealers (PCAOB, July 2016); Observations from PCAOB Inspections Covering Five Audits of Brokers and Dealers Required to be Conducted in Accordance with PCAOB Standards (PCAOB, Jan. 28, 2015); SEC Press Release 2014-272 (Dec. 8, 2014) (violations by 8 firms of auditor independence requirements); PCAOB Press Releases, Mar. 15, 2016, July 19, Apr. 1, 2015, Dec. 8, May 7, 2014 (violations of auditor independence requirements); Staff Guidance for Auditors of SEC-Registered Broker-Dealers (PCAOB, June 26, 2014).

j. This Guide addresses a number of additional issues relevant to general broker-dealer compliance concerns.

(i) For a discussion of "tying", see Part I.A.4, Part II.B.3.c.iii and Part III.A.4 above.

(ii) For a discussion of operational risk, see Part II.A.5 above.

(iii) For a discussion of Volcker Rule requirements, see Part II.A.7 above.

(iv) For a discussion of misuse of material non-public information, see Part V.A.4.d above.

(v) For a discussion of asset managers and investment advisors, see Part VIII.C above.

2. Short Sales and Market Manipulation

   a. Short-selling has been regulated since 1938, when the SEC adopted 1934 Act Rule 10a-1 in response to a Congressional directive to "purge the market" of short-selling abuses. Rule 10a-1 (also known as the "uptick rule") generally permitted short sales in exchange-traded securities only at a price above the last sale at a different price. This Rule was designed to prevent short sales from being used to drive down the price of securities. Because Rule 10a-1 applied only to exchange-traded securities, the NASD attempted to provide the same protection to Nasdaq National Market System securities through NASD Rule 3350. SEC Release No. 34-48709 (Oct. 28, 2003). See generally The Effects of Short-selling Public Disclosure Regimes on Equity Markets: A Comparative Analysis of U.S. and European Markets (Oliver Wyman, 2010); "Regulating Short-Sales", Federal Reserve Bank of Philadelphia Business Review (Q2 2009) (background and history). The SEC removed Rule 10a-1 in 2007. SEC Release No. 34-56212 (June 28, 2007). FINRA repealed the successor NASD Rule 3350 shortly thereafter. SEC Release No. 34-56279 (Aug. 24, 2007).

   b. In 2004, the SEC adopted Regulation SHO. SEC Release No. 34-50103 (July 28, 2004). See generally SEC Division of Market Regulation, Responses to [FAQ] Concerning Regulation SHO.

      (i) Regulation SHO attempted to address concerns about failures to deliver securities sold short (including claims that some sellers sold securities "naked short", without any intention of delivering the security they sold) by establishing a uniform "Locate Rule" that generally requires any broker-dealer that executes a short sale in an equity security to have reasonable grounds for believing that it will be able to borrow the security in order to make delivery on the sale. If, despite the Locate Rule, delivery failures in an equity security exceed a certain threshold, Regulation SHO requires (the "Close-out Rule") any broker-dealer that has an aged fail-to-deliver position in such a security to close that position by buying in the security.

(ii) Despite the adoption of Regulation SHO, the SEC found that large and persistent delivery failures continued. The SEC responded by (A) narrowing or eliminating certain exceptions to the Locate and Close-out Rules (see, e.g., SEC Releases No. 34-56212 (Aug. 7, 2007) and No. 34-58775 (Oct. 14, 2008) (interim final temporary Rule 204T), and No. 34-60388 (July 27, 2009) (Final Rule 204)); and (B) adopting a new Rule 10b-21 that defines submitting a sale order and deceiving a broker-dealer about one's intention or ability to deliver on the settlement date to be a violation of the 1934 Act's antifraud provision. SEC Release No. 34-58774 (Oct. 14, 2008) (the "Anti-fraud Rule Adopting Release").

(iii) In the context of public offerings, Rule 105 of Regulation M is intended to protect against short sales that could depress offering prices artificially by prohibiting a person from purchasing securities in a firm commitment equity offering if that person has sold short the same security during a restricted period before pricing (typically, five days). The Rule provides exceptions for "bona fide purchases" (A) if a person has, prior to the offer pricing, already purchased an amount of shares equivalent to the amount sold short during the restricted period (subject to certain timing and reporting requirements); (B) for trading in separate accounts, provided that decisions regarding the accounts were made without coordination; and (C) for registered funds that participate in the offering when another series of the registered fund sold short during the restricted period. The SEC has clarified that Rule 105 does not require intent to engage in the prohibited transaction. The SEC has pursued a "zero-tolerance" policy against violations of Rule 105. See SEC Press Release 2015-239 (Oct. 15, 2015) (announcing settlement of enforcement actions against six firms that violated Rule 105, and of the effectiveness of its "Rule 105 Initiative" over the prior six years). See also Rule 105 of Regulation M: Short Selling in Connection with a Public Offering (SEC, Sept. 17, 2013).

(iv) In Goldman Sachs Execution & Clearing (avail. Oct. 27, 2014), the SEC staff granted no-action relief related to Close-out Rule policies and procedures in a context where the broker-dealer experienced operational burdens because of transactions "away" from the broker-dealer or transactions conducted near market close. The broker-dealer would: (A) identify customers that caused or contributed to a failure to deliver, determine the number of shares attributable to each customer and "buy-in" the next day an amount of shares which, if added to the customer's net trading activity, would have been sufficient to make the customer a "net purchaser"; (B) establish and maintain policies and procedures to monitor trading activities of customers and detect whether a customer has engaged in trading activity that could re-establish a short position and potentially extend the failure to deliver; and (C) reasonably allocate close-out responsibility to customers who are market-maker broker-dealers in situations permitted under Rule 204(d).

c. The SEC and FINRA also stepped up their enforcement of Regulation SHO and Rule 105 of Regulation M, and the SEC and other securities regulators investigated issues with respect to the conduct of short sales operations. See, e.g., Deutsche Bank Securities, FINRA Letter of Acceptance, Waiver and Consent No. 20110273488-01 (Nov, 19, 2015); Merrill Lynch, FINRA Letter of Acceptance, Waiver and Consent No. 20100229712 (Oct. 27, 2014); 19 Broker-dealers, SEC Admin. Proc. No. 16108 et seq. (Sept. 16, 2014); Citigroup Global Markets, FINRA Letter of Acceptance, Waiver and Consent No. 20100227065-01 (Feb. 14, 2014); 21 Broker-dealers, SEC Admin. Proc. No. 15473 et seq. (Sept. 16, 2013); Credit Suisse, FINRA News Release, Dec. 27, 2011 (failure to supervise short sales properly); UBS, SEC Admin. Proc. No. 3-14620 (Nov. 10, 2011), FINRA News Release, Oct. 25, 2011 (short sale mismarkings and other violations); Deutsche Bank Securities/National Financial Services, FINRA News Release, May 13, 2010; Citigroup Global Markets, FINRA News Release, Apr. 6, 2010 (disclosure/supervisory failures); SG Americas Securities, SEC Admin. Proc. No. 3-13372 (Feb. 13, 2009); SEC Press Release 2008-214 (Sept. 19, 2008) (market manipulation investigation); Deutsche Bank Securities, NYSE Hearing Board Decision 08-AE-02 (Aug. 28, 2008); Targeted Examination Request re: False or Misleading Rumors (FINRA, July 2008) (examination sweep regarding firms' processes relating to false or misleading rumors and related procedures and internal controls); SEC Press Release 2008-64 (Apr. 24, 2008) (short-seller charged with securities fraud and market manipulation for spreading false rumors while shorting the target's shares).

d. In 2010 the SEC adopted a circuit breaker price restriction on short sales in stocks that experience a price decline of 10% or more from the prior day's close. Once the circuit breaker is triggered for a stock, short selling in that stock is generally allowed only at prices above the current national best bid for the remainder of the trading day and the next trading day. See 75 Fed. Reg. 11231 (Mar. 10, 2010).

e. Dodd-Frank § 929X makes several changes related to short sales:

(i) It requires the SEC to adopt rules requiring certain institutional investment managers to disclose information about short sales.

(ii) It adds a new antifraud provision (1934 Act § 9(d)) prohibiting the manipulative short sale of any security.

(iii) It requires a broker-dealer to provide notice to its customers that they may elect not to allow their fully paid securities to be used in connection with short sales. If a broker-dealer uses a customer's securities in connection with short sales, the broker-dealer must provide notice to the customer that the broker-dealer may receive compensation for lending the customer's securities.

f. In June 2014, DERA issued a report, required by Dodd-Frank § 417, on the feasibility, benefits and costs of proposals for real-time reporting of short sale positions in publicly listed securities and for a pilot program to add new short sale marks to the consolidated tape. DERA concluded that, when viewed in light of currently available data about short sales and potential data from the prospective "Consolidated Audit Trail", neither the real-time reporting proposal nor the consolidated tape proposal was likely to be cost effective. Short Sale Position and Transaction Reporting (DERA, June 5, 2014).

3. Broker-dealer Sales and Advisory Practices

a. Sales and Suitability Issues

(i) Upon establishing a relationship with a customer, broker-dealers become subject to FINRA Rule 2090 (the "KYC Rule"), which requires broker-dealers to use "reasonable diligence" to ascertain certain "essential facts" concerning that customer. Broker-dealers are also subject to FINRA Rule 2111 (the "Suitability Rule"), which applies to recommended transactions or investment strategies involving securities. The Suitability Rule includes three principal obligations. "Reasonable Basis Suitability" requires that, for each recommended transaction or investment strategy, the broker-dealer must have a reasonable basis to believe, based on reasonable diligence, that it is suitable for at least some investors. "Customer-specific Suitability" requires a broker-dealer to have a reasonable basis to believe that the recommendation is suitable for the customer based on the customer's investment profile. A "Quantitative Suitability" requirement exists where a broker-dealer has control over a customer account and requires a broker-dealer to have a reasonable basis to believe that a series of recommended transactions is not, taken as a whole, excessive for the customer. See also FINRA Regulatory Notices 13-31 (Sept. 2013) (detailing findings from FINRA suitability examinations), 12-55 (Dec. 2012) (additional FAQs), 12-25 (July 2012) (additional FAQs), 11-25 (May 2011) (FAQs regarding the KYC Rule and Suitability Rules), and 11-02 (Jan. 2011) (describing the KYC Rule and Suitability Rule in light of predecessor rules); SEC Release No. 34-63325 (Nov. 17, 2010); FINRA Regulatory Notice 09-31 (June

2009) (reminding firms of their sales practice obligations in connection with leveraged, inverse and inverse-leveraged ETFs).

(ii) With respect to issues relating to the manner in which banking and securities organizations sell investments, see generally, e.g., Oppenheimer & Co., FINRA Letter of Acceptance, Waiver and Consent No. 2013038180801 (June 7, 2016) (failure to implement supervisory systems related to the sales of leveraged, inverse and inverse-leveraged ETFs to retail customers, failure to conduct reasonable diligence, and making unsuitable recommendations of such ETFs); Citizens Securities, Mass. Docket No. E-2015-0103 (Jan. 7, 2016) (alleging supervisory failures and violations of policy leading to the improper recommendation of a robo-adviser that created an unsuitable investment portfolio for a senior investor; detailing customer confusion based on co-location of brokerage services on bank premises); LPL Financial, FINRA Letter of Acceptance, Waiver and Consent No. 2013035109701 (May 6, 2015) (failure to supervise sales of non-traditional ETFs, variable annuities, non-traded REITS and other complex products; failure to monitor and report trades and deliver trade confirmations); RBC Capital Markets, FINRA Letter of Acceptance, Waiver and Consent No. 2010022918701 (Apr. 23, 2015) (failure to supervise sales of unsuitable reverse convertibles); TD Ameritrade, SEC Admin. Proc. No. 3-14225 (Feb. 3, 2011) (failure to supervise; customers misled in money market fund sales); Ferris Baker Watts, FINRA Letter of Acceptance, Waiver and Consent No. 20070091803 (Oct. 19, 2010) (failure to have adequate supervisory procedures governing the sale of reverse convertible notes; see also Part IV above); HSBC Securities, FINRA News Release, Aug. 19, 2010 (unsuitable sales of inverse floating rate CMOs); SunTrust Investment Services, FINRA News Release, July 22, 2010 (unsuitable UIT, closed-end fund and mutual fund transactions); NASD Notice to Member 05-59 (Sept. 2005) (sale of structured products; see also

Part II.E.2.e above); In re Shvarts, Complaint No. CAF980029 (NASD, June 2, 2000) ("broad ethical principles" required of broker-dealers in their conduct of "just and equitable principles of trade").

See also Remarks of SEC Office of Capital Markets Trends Chief Starr, May 14, 2015 (Structured Products – Complexity and Disclosure – Do Retail Investors Really Understand What They are Buying and What the Risks Are); Survey on Anti-Fraud Messaging Final Report (IOSCO, May 2015) (strategies of international regulators to educate investors about fraud); National Senior Investor Initiative (SEC/FINRA, Apr. 2015); Customer Suitability in the Retail Sale of Financial Products and Services (Joint Forum, Apr. 2008).

(iii) The Federal Trade Commission Act (the "FTC Act") prohibition against unfair or deceptive practices, 15 U.S.C. § 45(a), applies to banks, and bank regulators enforce compliance with the FTC Act pursuant to their authority under the FDIA. See, e.g., Board/FDIC Statement: Unfair or Deceptive Acts or Practices by State-chartered Banks (Mar. 11, 2004).

CFPB rulemakings and focus on unfair or deceptive acts or practices are referenced in Part I.B.10 above.

(iv) The collapse in 2008 of the market for ARS and structured products, led to numerous actions against investment banks. See Part II.B.3.b.ix above.

(v) FINRA Rule 2210(d)(1)(F) prohibits broker-dealers from predicting investment results. FINRA Rule 2214 provides a limited exception for certain investment analysis tools and related written reports and communications, provided that the tools, written reports or communications (A) describe the criteria and methodology, including key assumptions; (B) explain that the results may vary with each use and over time; (C) disclose the universe of investments considered; (D) explain how the tool determines which securities to select, disclose if the tool favors certain securities and state that other investments not considered may have characteristics similar or superior to those being analyzed; and (E) display a legend explaining the hypothetical nature of the information generated. See FINRA Regulatory Notice 12-29 (June 2012).

(vi) The NASD reminded firms of their sales practice obligations in respect of debt securities, including obligations to (A) perform a "reasonable-basis" analysis as to whether the product is suitable for investment in general, and a customer-specific suitability analysis; (B) provide balanced disclosure; (C) train sales personnel; and (D) implement adequate supervisory controls. NASD Notice to Members No. 04-30 (Apr. 2004). See also NASD Notices to Members 03-71 (Nov. 2003) (similar obligations in respect of investments in ABS, index or equity-linked notes, distressed debt, derivative products and non-conventional investments); 01-23 (Apr. 2001) (the determination of whether a communication is a "recommendation" requiring a suitability analysis requires examination of the facts and circumstances; an important factor is whether the communication would be viewed as a "call to action" or suggestion that the customer engage in a transaction).

(vii) The SEC and FINRA issue investor alerts to educate investors about the risks of investments. See, e.g., Exchange Traded Notes (ETNs) (Dec. 1, 2015); Bond Liquidity: Factors to Consider and Questions to Ask (July 10, 2015); Beware of Fantasy Stock Trading Websites Offering Real Returns (June 17, 2015); What Are High-Yield Corporate Bonds? (June 2013); Municipal Bonds – Important Considerations for Individual Investors (Apr. 24, 2013); What Are Municipal Bonds? (June 15, 2012); Public Non-traded REITS (Oct. 4, 2011); Notes with Principal Protection: Note the Terms of Your Investment (June 2, 2011).

(viii) Reg. S-AM implements the FACT Act's affiliate marketing provisions and prohibits affiliates of a broker-dealer from using "eligibility information" about a consumer communicated to such affiliate by the broker-dealer unless the broker-dealer has provided a notice that the information may be put to such use and a reasonable opportunity for the consumer to opt out. See SEC Release No. 34-60423 (Aug. 4, 2009). See also Part I.C.5.b.iv.B.i above.

(ix) Initiatives in respect of sales and suitability issues include:

A) A focus on fraud and sales of unsuitable investments to senior citizens. See Dodd-Frank § 989A (grants to states to enhance protection of seniors). See also, e.g., Securities Law Daily, Mar. 31, 2016 (NASAA launching a training program for broker-dealers and investment advisers to identify and report suspected financial abuse of seniors); Recommendations and Report for Financial Institutions On Preventing and Responding to Elder Financial Exploitation (CFPB, Mar. 2016); Advisory for Financial Institutions on Preventing and Responding to Elder Financial Exploitation (CFPB, Mar. 2016); FINRA Regulatory Notice 15-37 (Nov. 30, 2015) (seeking comments on proposed rules to protect seniors and other vulnerable adults, including allowing firms to place temporary holds on disbursements from accounts in connection with suspected financial exploitation); Wall. St. J., Sept. 17, 2015; National Senior Investor Initiative (SEC/FINRA, Apr. 2015); NASAA, Model Rule on the Use of Senior-Specific Certifications and Professional Designations (Mar. 20, 2008); Press Release, Feb. 8, 2008 (SEC/NASAA/FINRA initiative to identify strong supervisory, compliance and other practices when serving seniors); Joint Report, Protecting Senior Investors: Report of Examinations of Securities Firms Providing "Free Lunch" Sales Seminars (OCIE/NASAA/FINRA Sept. 2007); Senior Investor

Alert: Free Meal Seminars – Seminars, Specialists and Abusive Sales Practices (NASAA, Sept. 10, 2007).

B) Suitability standards for direct participation programs are contained in NASAA Guidelines and Statements of Policy as to: Registration of [ABS] (last amended May 6, 2012); Registration of Commodity Pool Programs (last amended May 6, 2012); Registration of Equipment Programs (last amended May 6, 2012); Registration of Oil and Gas Programs (last amended May 6, 2012); Registration of Mortgage Programs Guidelines (last amended May 7, 2007); Statement of Policy Regarding [REITs] (last amended May 7, 2007); and Statement of Policy Regarding Real Estate Programs (last amended May 7, 2007).

C) Addressing investor confusion over fees. See Investor Confusion About Brokerage Service & Maintenance Fees (NASAA, Apr. 2015).

(x) Recent litigation and administrative proceedings against bank-affiliated brokers that allege improper selling practices and supervisory violations include, e.g., Barclays Capital, Inc., FINRA Letter of Acceptance, Waiver and Consent No. 2015044544001 (Dec. 29, 2015) (failure to supervise suitability of, and identify unsuitable, mutual fund transactions; failure to notify customers of costs associated with mutual fund switches; failure to centralize purchases to ensure customers received breakpoint discounts); Santander Securities LLC, FINRA Letter of Acceptance, Waiver and Consent No. 2014041355501 (Oct. 13, 2015) (failure to monitor sales of Puerto Rico Municipal Bonds, and related over-concentrated positions and use of margin); UBS Financial Services Inc. of Puerto Rico, FINRA Letter of Acceptance, Waiver and Consent No. 2013039142101 (Sept. 29, 2015) (failure to monitor leverage and concentration levels in customer accounts resulting in unsuitable transactions in closed-end funds by retail customers); UBS Financial Services Inc. of Puerto Rico, SEC Admin. Proc. No. 3-16846, and Ramiro L. Colon, III, SEC Admin. Proc. 3-16847 (both Sept. 29, 2015) (settlement of complaint alleging failure to supervise a broker whose customers invested in UBS Puerto Rico mutual funds against UBS policy by using prohibited loans from UBS Bank USA); LPL Financial, FINRA Letter of Acceptance, Waiver and Consent No. 2011027170901 (Mar. 24, 2014) (inadequate supervision of suitability requirements in respect of "alternative investments"); Stifel, Nicolaus & Co., FINRA Letter of Acceptance, Waiver and Consent Nos. 2012034576901 and 2011025493401 (Jan. 9, 2014) (unsuitable sales of non-traditional ETFs and inadequate supervision of suitability); Wells Fargo Investments, FINRA News Release, Dec. 15, 2011 (unsuitable sales of reverse convertible securities to elderly customers); Chase Investment Services, FINRA News Release, Nov. 15, 2011 (unsuitable sales of UITs and floating-rate loan funds); Santander Securities, FINRA News Release, Apr. 12, 2011 (unsuitable sales of reverse convertible securities and inadequate supervision of sales of structured products and accounts funded with loans from its affiliated bank; see also Part IV.A.1.g.x above); Citigroup Global Markets, FINRA Dispute Resolution Arbitration No. 09-03297 (Apr. 11, 2011) (claim investors were misled about risks associated with municipal bond hedge funds); UBS Financial Services, FINRA News Release, Apr. 11, 2011 (omissions regarding "principal protection" feature of fixed income security structured products with bond and option components); Banc of America Investment Services, SEC Press Release 2008-72 (May 1, 2008) (favoring affiliated mutual funds in selecting investments for discretionary mutual fund wrap fee accounts); Prudential Securities, UBS, Merrill Lynch, Wells Fargo and Pruco Securities, FINRA News Release, Feb. 28, 2008 (mutual fund sales and supervisory failures); JPMS, FINRA News Release, Dec. 13, 2007 (failure to disclose payments to consultants in connection with municipal securities transactions); Wachovia Securities, NASD

News Release, June 21, 2007 (allowing customers who made few trades to maintain fee-based accounts, and charging sales fees on mutual fund shares to customers with fee-based accounts); Citigroup Global Markets, NASD News Release, June 6, 2007 (misleading documents and inadequate disclosures in retirement seminars); UBS, NY Attorney General Press Release, July 16, 2007 (settlement over steering customers into fee-based accounts).

See also Part II.E.2.d, Part VI.A.2 and Part VIII.C.1.c, Part IX.E.1.g and Part IX.E.2 below.

(xi) AML-related KYC procedures are discussed in Part VIII.A above.

b. Fallout from Crisis-era Sales of ABS, MBS and Other Securities

A sampling of cases arising out of crisis-era sales of securities is described below. Many of these cases and regulatory actions continue in the U.S. courts, even as the financial crisis becomes part of U.S. financial history.

(i) Actions Against Financial Institutions. Investment banks have come under fire for selling CDOs, CMOs, MBS and similar securities in a deceptive manner or to purchasers for whom the securities were unsuitable, or for failing to mark down appropriately (as the market tumbled) the price of these securities on their own books.

See, e.g., U.S. Bank v. UBS Real Estate Securities, No. 12-cv-07322 (SDNY Sept. 9, 2016) (UBS could be required to repurchase or pay damages for breach of contract as to some RMBS; appointment of a lead master to examine individual loans); Morgan Stanley Mtg. Loan Trust 2006-13ARX v. Morgan Stanley Mtg. Capital Holdings, 36 N.Y.S.3d 458 (N.Y. App. Div. 2016) (RMBS seller's failure to provide trustee with notice of material breaches in underlying loans); U.S. Bank v. Federal Home Loan Bank of Boston, No. 652382/2014

(N.Y. Sup. Ct. Aug. 16, 2016) (settlement); IKB Int'l S.A. v. Morgan Stanley, 142 A.D.3d 447 (N.Y. App. Div. 2016) (complaint alleging fraudulent conduct with regard to RMBS survives motion to dismiss); SEC Release No. 78585 (Aug. 16, 2016) (industry bar and penalty for Goldman Sachs trader for misleading customers about RMBS prices and misrepresenting sales from inventory as RMBS trades between customers); Basis Yield Alpha Fund (Master) v. Goldman Sachs Group, No. 652996/2011 (NY Sup. Ct., June 10, 2016) (settling allegations that Goldman Sachs induced a hedge fund to buy CDOs by claiming the market had stabilized); FDIC Settlement and Release Agreement, May 26, 2016 (settlement of claims brought by FDIC, as receiver of five failed banks, against underwriters of 21 Countrywide RMBS); HSBC Bank USA v. Merrill Lynch Mortgage Lending, No. 652793/2016 (NY Sup. Ct. May 24, 2016) (action by MBS trustee against sponsor, servicer and originator of MBS for breach of contract); Citigroup v. AHW Inv. P'ship, 140 A.3d 1125 (Del. May 24, 2016) (shareholders could bring direct, rather than derivative, claims); NECA-IBEW Health & Welfare Fund v. Goldman, Sachs & Co., Nos. 08-cv-10783, 10-Civ.-4429 (SDNY May 2, 2016) (settlement against Goldman Sachs for misleading investors about safety of RMBS); Master Adjustable Rate Mortgages Trust 2006-OA2 v. UBS Real Estate Securities, No. 12-cv-07322 (SDNY 2016) (alleging UBS knowingly sold defective RMBS to investors); DOJ Settlement Agreement, Apr. 11, 2016 (settlement of action by DOJ and other federal and state regulators against Goldman Sachs alleging that it misled investors in the sale and issuance of RMBS); People v. Morgan Stanley, No. 16-551238 (Cal. Super. Ct., Apr. 1, 2016) (complaint under False Claims Act and state law alleging concealment or understatement of risks of investments sold to state pension plan); NCUA v. Credit Suisse Securities USA, No. 16-cv-06736 (SDNY Mar. 24, 2016) (settlement of allegations that Credit Suisse misrepresented quality of MBS); NCUA v. UBS Securities, No. 13-cv-06731 (SDNY Feb. 25, 2016) (notice) (settlement of allegations that UBS made false statements in RMBS offering documents); Bloomberg, Feb. 25, 2016 (DOJ considering suing Moody's for allegedly inflating ratings on MBS in 2008); DOJ Press Release, Feb. 11, 2016 (settlement of actions by DOJ and New York and Illinois regulators alleging that Morgan Stanley misled investors on quality of mortgage loans underlying RMBS); FDIC Settlement and Release Agreement, Jan. 28, 2016 (settlement of claims against Morgan Stanley alleging misrepresentation of the quality of RMBS sold to failed banks); Banking Daily, Feb. 1, 2016 (settlement of claims by Ambac Financial against JPMorgan alleging inducement to insure mortgage bonds backed by poor quality loans); Attorney General of Virginia Press Release, Jan. 22, 2016 (settlement of claims that eleven banks misled Virginia and the Virginia Retirement System through the sale of RMBS); New Jersey Carpenters Health Fund v. DLJ Mortgage Capital, No. 08-cv-5653 (SDNY Jan. 6, 2016) (preliminary settlement of allegations that Credit Suisse provided misleading offering documents to RMBS investors); Basis Yield Alpha Fund Master v. Morgan Stanley, No. 12527 (NY App. Div. Dec. 29, 2015) (investors could justifiably rely on credit ratings that Morgan Stanley knew to be unreliable, even where ratings related to a more senior tranche of securities and offering materials disclosed that investments were highly speculative); In re U.S. Bank, 27 N.Y.S.3d 797 (N.Y. Sup. Ct. 2015) (settlement against seller, sponsor and depositor for RMBS trusts); NCUA Press Release, Dec. 10, 2015 (settlement against Morgan Stanley relating to credit unions' purchases of RMBS); Lorely v. Morgan Stanley, 18 N.Y.S.3d 534 (Nov. 5, 2015) (reversing a lower court's dismissal of claims alleging misrepresentations of underlying MBS collateral); SEC Release No. 76261 (Oct. 26, 2015) (censuring ratings organization, and ordering disgorgement and penalty, for misrepresenting methodology for rating RMBS and Re-REMICs); NCUA Press Release, Oct. 19, 2015 (settlements with Wachovia and Barclays Capital related to purchases of RMBS); U.S. Bank v. DLJ Mortgage Capital, No.

650369/2013 (N.Y. Sup. Ct., Oct. 8, 2015) (RMBS bundler could be required to repurchase all RMBS); Bloomberg, Sep. 24, 2015 (settlement against UBS of claims of misrepresentation of quality of CDO holdings); NCUA v. RBS Securities, No. 13-cv-6726 (SDNY Sept. 15, 2015) (settlement); New Jersey Carpenters Health Fund v. Residential Capital, No. 08-cv-08781 (SDNY July 31, 2015) (settlement against multiple underwriters); FHFA v. Nomura Holdings America, No. 11-cv-6201 (SDNY May 11, 2015) (improperly underwritten and appraised loans backing MBS); In re [BNYM], No. 651786/2011 (NY App. Div., 1st Dept., Mar. 5, 2015) (settlement covering nearly all legacy Countrywide-issued first-lien RMBS; see also Bank of America Press Release, June 29, 2011); NY v. Charles Schwab, No. 453388/2009 (NY Sup. Ct., NY Co., Feb. 13, 2015) (settlement regarding ARS sales); DOJ Press Release, Feb. 3, 2015 (settlement against Standard & Poor's with DOJ, DC and 19 states for allegedly ignoring analyst warnings that securitized products were not performing to level of ratings); U.S. Bank v. Citigroup Global Markets Realty, Nos. 653919 (Dec. 22, 2014), 653929, 653930 (Dec. 23, 2014) (NY Sup. Ct., NY Co.) (trustee claims for breach of contract under loan purchase agreement and servicing agreement); In re Morgan Stanley Mortgage Pass-through Certificates, No. 09-cv-2137 (SDNY Sept. 8, 2014) (preliminary settlement); Morgan Stanley, SEC Admin. Proc. No. 3-15982 (July 24, 2014) (misleading investors with respect to RMBS delinquency rates); Citigroup, DOJ Press Release, July 14, 2014 (Federal and state settlements); FHFA Press Releases, June 19, Apr. 24, Mar. 26, 21, 2014 (settlements of suits, filed as conservator for Fannie Mae and Freddie Mac, against RBS (in respect of certain claims), Barclays, Bank of America/Countrywide/Merrill Lynch and Credit Suisse, alleging inadequate disclosure in MBS sales from 2005-07); Jefferies, SEC Admin. Proc. No. 3-15785 (Mar. 12, 2014) (consent order, disgorgement and penalty for failure to supervise representatives who misled investors as to RMBS prices); RBS, SEC Press Release 2013-239

(Nov. 7, 2013) (settlement of charges of misleading investors as to quality of loans underlying RMBS); Hoffman v. Credit Suisse, No. MER-C-000137 13 (N.J. Super. Ct., Dec. 17, 2013) (complaint) (State of N.J. alleging material misrepresentations and omissions in RMBS sales); SEC Press Release 2013-260 (Dec. 12, 2013) (settlement of charges against NIR Capital Management, as collateral manager, for allowing third party to influence selection of portfolio underlying RMBS, and against Merrill Lynch for structuring and marketing RMBS); RBS Securities, SEC Press Release 2013-239 (Nov. 7, 2013) (settlement of charges that nearly 30% of loans underlying RMBS deviated from underwriting standards); JPMorgan, DOJ Press Release, Nov. 19, 2013 (Federal and state settlements); NCUA Press Release, Aug. 30, 2013 (filing of suit against Morgan Stanley (settled/dismissed, Feb. 18, 2016) alleging violations of securities laws related to MBS sales to credit unions, adding to suits against other financial institutions on similar claims (Barclays, Credit Suisse, Goldman Sachs, JPMS, RBS Securities, UBS Securities, Wachovia, Bear Stearns, Washington Mutual), and noting settlements with Citigroup, Deutsche Bank Securities, HSBC and Bank of America); Maine State Retirement System v. Countrywide Financial, No. 10-cv-00302 (C.D. Cal., Aug. 7, 2013) (settlement related to alleged failure to disclose disregard for origination guidelines for loans backing RMBS); UBS Securities, SEC Admin. Proc. No. 3-15407 (Aug. 6, 2013) (settlement for alleged failure to disclose receipt and retention of upfront payments in connection with the acquisition of collateral for CDOs); SEC v. Bank of America, No. 13-cv-447, and U.S. v. Bank of America, No. 13-cv-446 (W.D.N.C., Aug. 6, 2013) (alleging fraud for failing to disclose deviations from stated underwriting standards, failing to conduct loan due diligence, and concealing information regarding proportion of riskier loans in the pool and decline in loan performance); In re Citigroup Securities Litigation, 965 F.Supp.2d 369 (SDNY 2013) (settlement of shareholder class action suit alleging failure to disclose extent of, and to mark-down appropriately, CDO holdings); FHFA Press Release, July 25, 2013 (settlement of suit, filed as conservator for Fannie Mae and Freddie Mac, against UBS alleging inadequate disclosure in MBS sales from 2005 to 2007); Wells Fargo Advisors, FINRA Letter of Acceptance, Waiver and Consent No. 2008014350501, and Merrill Lynch, FINRA Letter of Acceptance, Waiver and Consent No. 2008014763601 (both June 3, 2013) (unsuitable investment recommendations, and failure to supervise sales of floating rate loan funds); SEC v. JPMS, No. 12-cv-1862 (D.D.C., Jan. 7, 2013) (settlement of charges of material misstatement regarding delinquency of loans supporting RMBS); Credit Suisse Securities, SEC Admin. Proc. No. 3-15098 (Nov. 16, 2012) (settlement of charges of failure to disclose retention of proceeds in bulk settlements with loan originators, and failure to comply with RMBS offering document repurchase provisions); Bayerische Landesbank v. Aladdin Capital Mgt., 692 F.3d 42 (2d Cir. 2012) (reinstating breach of contract, tort and gross negligence claims against CDO portfolio manager because noteholders could be third party beneficiaries to portfolio management agreement), dismissed, No. 11-cv-673 (SDNY Sept. 9, 2013); Mizuho Securities, SEC Litigation Release No. 22417 (July 19, 2012) (settlement of claims that Mizuho submitted a portfolio of "dummy" assets to rating firm to inflate CDO ratings); Bayerische Landesbank v. Barclays Capital, 902 F. Supp. 2d 471 (SDNY 2012) (alleging misrepresentation by structuring bank regarding independence of synthetic CDO collateral manager); Barclays Capital, FINRA Letter of Acceptance, Waiver and Consent No. 2008012808801 (Dec. 22, 2011) (fine with respect to misreported delinquency data from 2007-2010 and inadequate supervision in connection with issuance of subprime residential MBS); Public Employees' Retirement System of MS v. Merrill Lynch, No. 08-cv-1084 (SDNY Dec. 5, 2011) (class settlement with respect to MBS sales); In re Wells Fargo Mortgage-backed Certificates Litigation, No. 09-cv-01376 (N.D. Cal., Nov. 14, 2011) (settlement of allegations that firm misrepresented risks of MBS); Citigroup, SEC Press Release 2011-214 (Oct. 19, 2011) (settlement for misleading investors about CDO characterized internally as "dogsh*t" and "possibly the best short EVER"); Credit Suisse, SEC Admin. Proc. No. 3-14594 (Oct. 19, 2011) (consent order in relation to allegations of violation of Advisers Act for allowing Citigroup to influence selection of CDO collateral); RBC Capital Markets, SEC Admin. Proc. No. 3-14564 (Sept. 27, 2011) (suitability issues in CDO sale); JP Morgan Securities, SEC Press Release 2011-131 (June 21, 2011) (structuring and marketing synthetic CDO without informing investors that hedge fund helped select assets in CDO portfolio and had short position in most of those assets); Wachovia Capital Markets, SEC Press Release 2011-83 (Apr. 5, 2011) (undisclosed excessive markups in sale of CDO equity and misrepresentations to CDO investors); Goldman Sachs, SEC Litigation Release No. 21592 (July 15, 2010) (settlement for failure to disclose that a hedge fund, with economic interests adverse to the investors, played significant role in selection of CDO portfolio); Morgan Stanley, No. 10-2538 (Mass. Sup. Ct., June 21, 2010) (settlement of charges that firm funded subprime loans that it should have known were likely to fail); Pursuit Partners v. UBS, 2009 Conn. Super. LEXIS 2313 (Conn. 2009) (CDOs sold to hedge fund characterized internally as "crap" and "vomit"; settlement reported Sept. 1, 2015 (Banking Daily)).

(ii) Positive Outcomes for Financial Institutions. Not all actions against investment banks have resulted in losses or penalties for the sellers of ABS, MBS and other securities. See, e.g., FHFA v. UBS Real Estate Securities, 2016 NY Slip Op. 31458(U) (N.Y. Sup. Ct. July 27, 2016) (dismissed breach of contract claims because FHFA lacked standing and claim was untimely); Dodona I LLC v. Goldman Sachs & Co., No. 10-cv-7497 (SDNY July 1, 2016) (settlement after court granted Goldman Sachs summary judgment for lack of evidence of failure to disclose risks of investments);

United States ex rel. O'Donnell v. Countrywide Home Loans, Nos. 15-496, 15-499 (2d Cir. May 23, 2016), reh. denied (2016) (overturning awards against Countrywide, Bank of America and the COO of a Countrywide unit under FIRREA for mail and wire fraud because the government did not prove that defendants intended to sell poor quality mortgages at the time of entering into the contracts for such sale, even if the nature of the mortgages was known at closing of sale); Rakuten Bank v. Royal Bank of Canada, 136 A.D.3d 481 (N.Y. App. Div. 2016) (affirming dismissal of MBS claims on grounds of forum non conveniens, where only connection with New York was marketing and design of notes by the only New York-based defendant); Commonwealth of Pa. Public School Emps.' Retirement System v. Morgan Stanley & Co., No. 13-2095-cv (2nd Cir. Feb. 23, 2016) (affirming Commerzbank did not have standing to pursue common law fraud claims stemming from the liquidation of notes issued by a structured investment vehicle); Northern Grp. v. Merrill Lynch, 135 A.D.3d 414 (N.Y. App. Div. 2016) (affirming dismissal of fraud action because alleged misrepresentations were "mere puffery, opinions of value or future expectations, rather than false statements of value" and because sophisticated plaintiffs could not reasonably have relied on them); Flannery v. SEC, Nos. 15-1080, 15-1117 (1st Cir. Dec. 8, 2015) (overturning SEC enforcement action for lack of "substantial evidence"); Sealink Funding Limited v. Morgan Stanley, 133 A.D.3d 458 (N.Y. App. Div. 2015) (lack of standing on grounds that tort claims were not transferred to assignees under English law); Report of Investigation (Federal Housing Finance Agency, Office of Inspector General, Nov. 2, 2015) (finding that, although evidence showed that loans did not meet representations and warranties or in many cases were fraudulent, "there was not enough compelling evidence" to prosecute individuals involved with such activities); Louisiana Pacific v. Merrill Lynch, No. 13-1980-cv (2d Cir., June 24, 2014) (rejecting arguments that ARS market liquidity was misrepresented when prior SEC pronouncements had put investors on notice of such facts); Phoenix Light v. Goldman Sachs, 43 Misc. 3d 1233A (N.Y. Sup. Ct., 2014) (dismissing RMBS claims because investors could have, but did not, undertake more research into loan files); Bank of America v. Bear Stearns, 969 F. Supp. 2d 339 (SDNY Sept. 3, 2013) (claims dismissed because of "unreliable" expert testimony on loss causation); Phoenix Light v. JPMS, No. 651755/2012 (NY Sup. Ct., NY Co., July 16, 2013) (claims dismissed with leave to replead based on failure to particularize and clarify allegations notwithstanding more-than-500-page complaint); In re Deutsche Bank Securities Litigation, No. 09-cv-1714 (SDNY Aug. 9, 2012) (dismissing claims because securities valuations are opinions and plaintiffs must allege that bank did not believe the valuations when made); SEC v. Stoker, No. 11-cv-7388 (SDNY Aug. 6, 2012) (Citigroup employee found not liable by jury, and SEC complaint alleging negligent violation of securities laws and misleading CDO investors dismissed); Oddo Asset Mgt. v. Barclays Bank, 19 N.Y.3d 584 (NY, 2012) (noteholder failed to establish fiduciary duty owed by collateral managers of structured investment vehicle, and failed to state case against structuring bank and credit rating agency for aiding and abetting breach of fiduciary duty); Landesbank Baden-Wurttemberg v. Goldman, Sachs, 478 Fed. Appx. 679 (2d Cir., 2012) (affirming dismissal of claims for common law fraud, negligent misrepresentation and unjust enrichment in connection with marketing and sale of CDO notes); HSH Nordbank v. UBS, 95 A.D.3d 185 (NY App. Div. 1st Dept., 2012) (reversing lower court decision that had refused to dismiss claims of fraud in respect of CDO sales).

(iii) Extender Statutes Benefit Regulatory Actions. Certain claims brought by regulators have benefited from statutes permitting extended filing periods. See, e.g., NCUA v. RBS Securities, No. 13-56620 (9th Cir. Aug. 15, 2016) (FIRREA's "extender statute" permitting NCUA extra time to file actions replaces all preexisting time limitations, whether statute of limitations or statute of repose, in any action by the NCUA as conservator or liquidating agent); FDIC v. First Horizon Asset Securities, Inc., 821 F.3d 372 (2nd Cir. 2016) (holding that Supreme Court decision in CTS Corp. v. Waldburger, 134 S. Ct. 2175 (2014), did not affect circuit holding that "extender statute" permitting the FDIC and FHFA extra time to file actions applies to both statutes of limitations and statutes of repose); FDIC v. Chase Mortgage Finance Corp., No. 14-cv-03648 (2d. Cir. 2016) (reversing a district court holding that FIRREA's extender statute did not alter 1933 Act statute of repose); FDIC v. RBS Securities, No. 14-51055 (5th Cir. Aug. 10, 2015) cert. denied, 136 S. Ct. 1492 (2016) ("extender statute" applies to statutes of repose); NCUA v. Barclays Capital, 785 F.3d 387 (10th Cir. 2015) (although extender statute cannot be tolled by contract, defendants barred by NCUA reliance from raising statute of limitations defense); NCUA v. Nomura Home Equity Loan, 2014 WL 4069137 (10th Cir. 2014), cert. denied, 135 S. Ct. 949 (2015) (holding, on remand from the Supreme Court in light of CTS Corp. v. Waldburger, that FIRREA's "extender statute" supplants three-year repose period for certain federal securities laws claims); FHFA v. UBS Americas, 712 F.3d 136 (2d Cir. 2013) (FIRREA extender statute applied to claims brought by the FHFA as conservator).

(iv) Statute of Limitation / Statutes of Repose. As the financial crisis recedes into the past, courts have found cases to be barred by limitation and repose statutes with greater frequency. See, e.g., FHFA v. Equifirst Corp. 2016 NY Slip Op. 31386(U) (N.Y. Sup. Ct. July 19, 2016) (although claims were filed by FHFA within statute of limitations, trustee did not file action until more than six years after the claims accrued); SRM Global Master Fund LP v. Bear Stearns, No. 14-507-cv (2d Cir. 2016) (class action tolling rule set forth by the Supreme Court does not apply to the statute of repose that limits the time in which plaintiffs may bring fraud actions under the 1934 Act); Stein v. Regions Morgan Keegan Select High Income Fund, Nos. 15-5903, 15-

5905 (6th Cir. 2016) (tolling doctrine did not apply to statutes of repose barring investors from pursuing claims); Wells Fargo v. JPMorgan, 2016 WL 1042020 (2d Cir. Mar. 16, 2016) (affirming dismissal of complaint as barred by New York's six-year contract statute of limitations); Deutsche Bank Nat'l Trust Co. v. Flagstar Capital Markets Corp., 36 N.Y.S.3d 135 (N.Y. App. Div. 2016) (affirming dismissal of breach of contract action against Quicken Loans as time-barred by New York's six-year statute of limitations because breach of contract claim begins to accrue on date the allegedly false representations and warranties were made, notwithstanding parties' assent to a contract provision that would have delayed the cause of action's accrual); Deutsche Bank National Trust v. Quicken Loans, 810 F.3d 861 (2d Cir. 2015) (holding that FIRREA's extender statute does not apply to claims filed by the trustee when FHFA is no longer a party to the action); Ace Securities v. DB Structured Products, 25 N.Y.3d 581 (2015) (representations about the characteristics of loans in the pool were made at the point of contract execution, not at the point of refusal to purchase back loans; thus, claims are barred by NY six-year contract statute of limitations); Varga v. McGraw Hill Financial, No. 652410/2013 (NY Sup. Ct., NY Co., Aug. 4, 2015) (suit against rating agencies dismissed under statute of limitations); Commerzbank v. UBS, No. 654464/2013 (NY Sup. Ct., NY Co., June 17, 2015) ("duty of inquiry . . . unquestionably triggered long prior to [discovery statute window] by the downgrades of the certificates and the publicly available information [concerning] . . . the alleged defectiveness of the loans"); Assured Guaranty v. DLJ Mortgage Capital, No. 652837/2011 (NY Sup. Ct., NY Co., Mar. 5, 2015) (trustee's motion to intervene in private settlement barred as untimely); In re Countrywide Financial Corp. [MBS] Litigation, 966 F. Supp. 2d 1031 (C.D. Cal. 2013) (denying motion for reconsideration and request for interlocutory appeal of decision that FIRREA did not preempt statutes of repose contained in the Texas and Nevada Securities Acts).

(v) Actions Against Securities Trustees. Plaintiffs seeking compensation, or government agencies seeking reimbursement of public funds used in receiverships and liquidations of failed institutions, have also alleged failure by trustees of CDOs, CMOs and MBS to fulfill their fiduciary duties. See, e.g., Commerce Bank v. BNYM, 2016 N.Y. Slip. Op. 05339 (N.Y.S.3d July 5, 2016) (denying motion to dismiss allegations of breach of contract and fiduciary duty, and negligence against BNYM for failing to maintain proper records as RMBS trustee); IKB International v. Wilmington Trust Co., No. 16-Civ.-04917 (SDNY June 24, 2016) (alleging that Wilmington breached its duties as RMBS trustee because it had knowledge of deficiencies in loans and poor servicing practices); Royal Park Investments SA/NV v. BNYM, No. 14-cv-6502 (SDNY Mar. 2, 2016) (denying motion to dismiss breach of contract, breach of trust and certain Trust Indenture Act ("TIA") claims against BNYM where plaintiffs alleged that trustee knew of breaches of representations and events of default); Blackrock Core Bond Portfolio v. U.S. Bank, No. 14-cv-9401 (SDNY Feb. 26, 2016) (denying motion to dismiss claims against U.S. Bank for breach of contract and claims under the TIA related to U.S. Bank's role as MBS indenture trustee, but granting motion to dismiss claims for breach of fiduciary duties); NCUA v. U.S. Bank, No. 14-cv-9928 (SDNY Feb. 25, 2016) (granting motion to dismiss claims against U.S. Bank and Bank of America for breach of fiduciary duty, breach of covenant of good faith and violations of the Streit Act and the TIA); Royal Park Investments SA/NV v. Deutsche Bank Nat'l Trust Co., No. 14-cv-04394 (SDNY Feb. 3, 2016) (denying motion to dismiss claims of breach of contract and breach of trust against Deutsche Bank as MBS trustee); Blackrock Allocation Target Shares: Series S Portfolio v. Deutsche Bank National Trust Co., Nos. 14-cv-09367, 14-cv-09371 (SDNY Jan. 19, 2016) (dismissing bulk of claims brought by multiple plaintiffs against Deutsche Bank and Wells Fargo on the ground that state law claims "substantially predominate[d]" over federal law claims);

Retirement Board of the Policemen's Annuity and Benefit Fund of the City of Chicago v. BNYM, No. 15-314 (U.S., Jan. 11, 2016) (denial of petition for writ of certiorari from Second Circuit decision holding that TIA did not apply to MBS because they were certificates and thus not within TIA scope); Commerzbank v. Wells Fargo Bank, No. 15-cv-10033 (Dec. 24, 2015) (claims against trustee of securitization trusts for breach of contractual and fiduciary duties and duties under the TIA and the Streit Act); Commerzbank v. HSBC Bank USA, No. 15-cv-10032 (Dec. 24, 2015) (same); Commerzbank v. Deutsche Bank National Trust Co., No. 15-cv-10031 (Dec. 23, 2015) (same); Commerzbank v. BNYM, No. 15-cv-10029 (Dec. 23, 2015) (same); Retirement Board of the Policemen's Annuity and Benefit Fund of the City of Chicago v. BNYM, No. 11 Civ. 5459 (SDNY Dec. 18, 2015) (denying motion to dismiss claims against BNYM and Wells Fargo); Fixed Income Shares: Series M v. Citibank, N.A., No. 653891/2015 (N.Y. Sup. Nov. 24, 2015) (class action against Citibank for breach of contract, breach of fiduciary duty, breach of duty to avoid conflicts of interest and violations of the Streit Act relating to role as MBS trustee); GSAA Home Equity Trust 2006-2 v. Wells Fargo Bank, No. 14-cv-4166 (S.S.D. Sept. 30, 2015) (denying motion to dismiss breach of contract claims against servicer, but granting motion in respect of RICO claims); Fixed Income Shares: Series M v. Citibank, 130 F. Supp. 3d 842 (SDNY 2015) (private right of action exists under TIA, permitting claims in relation to three RMBS trusts, but dismissing claims in relation to 24 RMBS trusts that were not covered by the TIA as raising predominantly state law issues); Blackrock Balanced Capital Portfolio v. HSBC Bank USA, No. 14-civ-9366 (SDNY Mar. 31, 2015) (court exercised jurisdiction over both TIA trusts and those not covered by that Act); NCUA v. HSBC Bank USA, No. 15-cv-02144 (SDNY Mar. 20, 2015) (complaint); NCUA v. Wells Fargo Bank, No. 14-cv-10067 (SDNY Dec. 22, 2014) (complaint); NCUA v. Deutsche Bank National Trust Co., No. 14-cv-89119 (SDNY Nov. 7, 2014) (complaint).

c. Fiduciary Duties

(i) The SEC has focused on the issue of broker-dealers' duties to retail customers. In a study mandated by Dodd-Frank § 913 (see Part IX.B.1 above), SEC staff recommended implementation of a uniform fiduciary standard of conduct for broker-dealers and investment advisers when providing personalized investment advice to retail customers. Such a standard would incorporate a duty of loyalty (requiring broker-dealers and advisers to act in the best interests of a retail customer when making investment recommendations, and to eliminate or disclose all material conflicts of interest) as well as a duty of care (including customer suitability obligations, product-specific due diligence and disclosure requirements, and a best execution obligation). SEC staff also recommended harmonization of the regulatory obligations of broker-dealers and advisers with respect to advertising and communications with customers, licensing and registration, continuing education of associated persons, and maintenance of books and records. See SEC Release No. 34-62577 (July 27, 2010) (SEC staff solicitation of comment in preparation for § 913 study); Study on Investment Advisers and Broker-dealers (SEC, Jan. 2011); 78 Fed. Reg. 14848 (Mar. 7, 2013) (requesting data and other information relating to whether the SEC should engage in rulemaking to adopt a uniform fiduciary standard); Recommendation of the Investment Advisory Committee: Broker-dealer Fiduciary Duty (SEC Investment Advisory Committee, 2013).

(ii) NASAA has advocated for the adoption of a uniform fiduciary standard for financial professionals who offer personalized investment advice (arguing that FINRA's Suitability Rule is not sufficient), but has also expressed concern that the SEC's approach could weaken the standard currently applicable to investment advisers. See NASAA Legislative Agenda for the 113th Congress; NASAA Letter, July 5, 2013, Re: Framework for Rulemaking under [Dodd-Frank § 913].

(iii) In April 2016, the DOL finalized regulations (the "Final DOL Regulations") that impose fiduciary standards and potential liability on brokers and investment advisors that render advice to employee benefit plans (including IRAs), plan fiduciaries and plan participants, regarding the management and investment in securities or other property. The Final DOL Regulations expand the type of advice that could give rise to fiduciary status under ERISA, and substantially modify the DOL's prior requirements for investment advice to form the basis of a fiduciary relationship, i.e., that such advice be provided to a plan on a regular basis, be the primary basis for the plan's investment decisions, and be provided by mutual agreement. In addition, the Final DOL Regulations define the term "recommendation," which triggers the application of the new requirements for "investment advice," as communications that would "reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action". See 81 Fed. Reg. 20946 (Apr. 8, 2016).

In May 2016, Congress passed a resolution to repeal the Final DOL Regulations, but President Obama vetoed the resolution in June 2016. The Final DOL Regulations have also come under significant attack from the financial services industry with numerous industry groups filing lawsuits challenging the DOL's authority to promulgate the Final DOL Regulations, including the scope of certain exemptions, and seeking preliminary injunctions to stay the effectiveness of the regulations. See American Council of Life Insurers v. DOL, No. 16-cv-1530 (N.D. Tex., June 8, 2016) (complaint); Market Synergy Group v. DOL, No. 16-cv-04803 (D. Kan., June 8, 2016) (complaint); Indexed Annuity Leadership Counsel v. Perez, No. 16-cv-01537 (N.D. Tex., June 8, 2016) (complaint); NAFA v. Perez, No. 16-cv-1035 (D.D.C., June 2, 2016) (complaint); Chamber of Comm. of U.S. v. Perez, No. 16-cv-1476 (N.D. Tex., June 1, 2016) (complaint). See also ABA Letter to Office of Information and Regulatory Affairs, Office of Management and Budget, Mar. 11, 2016 (expressing concern that DOL failed to consult with OCC and other bank regulators in crafting the Final DOL Regulations, and that the regulations violate the NBA and OCC regulations).

The proposed DOL Regulations were also controversial and were reproposed in April 2015. See 80 Fed. Reg. 21927 (Apr. 20, 2015) (solicitation of comments); 75 Fed. Reg. 65,263 (Oct. 22, 2010) (original proposal, withdrawn in 2011). The reproposal garnered significant attention, including significant criticism, which focused on the potentially high cost of implementation and the potential limitation of investors' access to investment choice and guidance, among other concerns. See, e.g., U.S. Senate Committee on Homeland Security and Governmental Affairs Report, Feb. 24, 2016; U.S. Senate Committee on Finance Letter, Aug. 7, 2015; Senator McCaskill Letter, Aug. 5, 2015; Congresswoman Wagner, et al. Letter, July 29, 2015; Congressman Babin, et al. Letter, July 29, 2015; SEC Commissioner Gallagher Letter, July 21, 2015; Congressman MacArthur, et al. Letter, July 21, 2015; ABA Letter, July 21, 2015; ICI Letter, July 21, 2015; SIFMA Letter to the DOL, July 20, 2015.

(iv) New York State has also considered amending its General Obligation Law to include provisions that would impose a fiduciary obligation on investment advisers, including broker-dealers, not subject to such obligations under existing state or federal law. See also Safeguarding Our Savings: Protecting New Yorkers Through the Fiduciary Standard, (Office of the New York City Comptroller, March 2015).

d. Conflicts of Interest

(i) General

A) Conflicts of interest are inherent in any financial services operation. Increasingly, regulators focus on how banking and securities organizations identify and resolve conflicts as they arise (1) between the financial institution and its customers, (2) among the financial institution's customers, and (3) among different business units of the same financial institution.

See, e.g., OCIE's 2016 Share Class Initiative (SEC, July 13, 2016) (describing OCIE initiative to identify conflicts of interest tied to investment advisers' compensation or financial incentives for recommending mutual fund and 529 Plan share classes that have substantial loads and distribution fees); FINRA Regulatory Notice 16-22 (June 2016) (SEC approving adoption of new FINRA Rule 3210, which requires associated persons obtain prior written consent of their employers when opening accounts at financial institutions other than their employers); Report on Conflicts of Interest (FINRA, Oct. 2013) (outlining approaches to enterprise-level frameworks for conflict identification and management, to handling conflicts relating to the manufacture and distribution of new products and to managing compensation-related conflicts); Remarks of OCIE Director di Florio (Oct. 22, 2012); FINRA Targeted Examination Letter, July 2012; NY Times, Jan. 13, 2010.

B) Key conflicts of interest include (i) disclosure-related issues (e.g., payments by mutual funds to broker-dealers and the use of soft dollars); (ii) misuse of customer trading information or other non-public information; (iii) allocation of limited products, services or opportunities to favored clients or provision of special incentives or payments for use of products or services; (iv) use of products or services of affiliates or favored clients; (v) multiple roles in a transaction or with respect to an issuer or client; (vi) biased research and advice; (vii) accounting, booking or reporting to achieve other interests; (viii) gifts and entertainment to and from clients; and (ix) undisclosed compensation and solicitation agreements.

i) In response to focus on its conduct before and during the financial crisis, Goldman Sachs created a "Business Standards Committee" in 2010 to review business practices. The firm subsequently implemented a series of policy, procedure and operational changes with regard to (a) conflicts of interest (including enhanced mitigation and disclosure standards for conflicts of interest in situations when the firm is acting as an adviser to the client, and preventing "wall crossings" between departments whose interests may conflict with those of the client); (b) suitability standards for clients and products (including segmenting clients in order to demarcate suitability standards, creating a firm-wide suitability committee to approve transactions and products, and adopting enhanced disclosure standards for risk factors); and (c) training and professional development (including updating the firm's code of business conduct and ethics, and updating performance review criteria to include focus on reputational matters). See Goldman Sachs Business Standards Committee Impact Report (May 2013); Goldman Sachs Report of the Business Standards Committee (Jan. 2011).

ii) See generally JPMorgan Chase Bank, CFTC Docket No. 16-05 (Dec. 18, 2015) (failure to disclose to discretionary managed account clients conflicts of interest in connection with commodity pools operated by JPM); JPMorgan Chase Bank/JPMorgan Securities, SEC Admin. Proc. No. 3-17008 (Dec. 18, 2015) (failure to disclose conflicts of interest arising from investments in proprietary and certain third-party funds); SEC v. Weiss, No. 15-cv-13460 (D. Mass., Sept. 29, 2015) (complaint) (alleging fraud against investment advisor for self-dealing and failing to disclose conflicts of interest, use of investor funds and risks of investments); AFTRA Retirement Fund v. JPMorgan Chase Bank, 806 F. Supp. 2d 662 (SDNY 2011) (no conflict of interest/breach of duty of loyalty where bank provided repo financing to investment vehicle while investing client funds in notes issued by the vehicle); Janney Montgomery Scott, SEC Press Release 2011-144 (July 11, 2011) (failure to establish and enforce policies and procedures to prevent the misuse of non-public information); Jefferies & Co., FINRA News Release, Apr. 14, 2011 (failure to disclose additional compensation and conflicts to customers in connection with securities sale); Merrill Lynch, SEC Admin. Proc. No. 3-14204 (Jan. 25, 2011) (alleged misuse of customer order information to place proprietary trades); Guidelines for the Regulation of Conflicts of Interest Facing Market Intermediaries (IOSCO Emerging Markets Committee, Nov. 2010); Barclays Bank, SEC Litigation Release No. 20132 (May 30, 2007) (trading on non-public information received through creditors' committees); CIBC World Markets/Nandra Group, NYSE Hearing Board Decisions, Oct. 5, 2006 (stock loan transaction involving a "sham finder's fee" and below-market rates); CIBC World Markets, NYSE Hearing Board Decision No. 06-140 (July 17, 2006) (improper loan at below market rates).

See also Part II.A, Part II.B.3 and Part VIII.C.2.c above.

C) FINRA released a concept proposal to require broker-dealers to provide each retail customer a written statement describing the types of accounts and services provided at or prior to commencing a business relationship. The written statement would also have been required to describe conflicts of interest. FINRA Regulatory Notice 10-54 (Oct. 2010).

D) FINRA Rule 2210 requires that, when a firm recommends a security to a retail customer, it must disclose (i) if the firm makes a market in the recommended security, or the underlying security if the recommendation is for an option or future, or if the firm will sell or buy the security as a principal in the transaction with the customer; (ii) if the firm or any associated person who was involved in preparing the communication that contained the recommendation has any financial interest in any security issued by the issuer of the recommended security; and (iii) if the firm was a manager or co-manager of a public offering of any securities of the issuer of the recommended security in the prior year. See FINRA Regulatory Notice 12-29 (June 2012).

(ii) Securities Research and Analysis

The SEC/FINRA and other regulators brought actions and adopted regulations addressing research analyst conflicts of interest.

A) Pursuant to Dodd-Frank § 919A, the GAO examined potential conflicts of interest between the investment banking and equity and fixed income securities analyst functions within the same firm and made recommendations to Congress. Securities Research, Additional Actions Could Improve Regulatory Oversight of Analyst Conflicts of Interest (GAO, Jan. 2012) recommends that the SEC assess which terms of the Global Settlement (described below) should be codified in order to ensure a consistent level of investor protection.

B) Analyst research may be compromised where, e.g., analyst compensation is linked to investment banking, the analyst's (or the analyst's firm's) position in a recommended stock is not disclosed, a firm is underwriting an IPO of a company the analyst is researching, recommendations are made without disclosure of potential conflicts, or reports are issued just before or after a "lock-up" period. See also CFA Institute/National Investor Relations Institute Best Practice Guidelines Governing Analysts and Corporate Issuer Relationships (Nov. 2004); Best Practices For Research (SIA, June 2001).

C) FINRA Rule 2241 relating to analyst conflicts of interest in respect of equity securities (1) requires disclosure of conflicts of interest (including securities ownership) in research reports and analyst public appearances; (2) restricts the relationship between analysts and investment bankers; (3) restricts the relationship between analysts and the companies they cover; (4) requires research reports to include the definition of ratings (and the distribution of the analyst's ratings) and graphic depictions of the analyst's past price targets and the security's performance; and (5) requires analysts to provide notice of their intention to terminate research coverage of a company. See FINRA Regulatory Notice 15-30 (Aug. 2015).

See also FINRA Rules (currently NASD Rule 1050 and NYSE Rule 344) relating to qualification and registration of research analysts; NASD Notice to Members No. 05-24 (Apr. 2005) (exemption from analyst qualification requirements for employees of foreign affiliates of broker-dealers in jurisdictions determined to have acceptable qualification standards and conflict of interest rules).

D) FINRA also adopted Rule 2242 to address conflicts of interest related to the publication and distribution of debt research reports including safeguards and disclosure requirements. See SEC Release No. 34-77963 (June 1, 2016) (effective July 16, 2016).

See generally Research Rules [FAQ] (FINRA, last updated May 27, 2015). See also NASD Notice to Members 06-36 (July 2006) (NASD/NYSE joint interpretive guidance on fixed income research); Guiding Principles to Promote the Integrity of Fixed Income Research (BMA, Mar. 2004).

E) The NASD and the NYSE have sanctioned firms for violations relating to analyst conflicts of interest. See, e.g., Wachovia Capital Markets, FINRA News Release, Nov. 28, 2007; Wells Fargo Securities, NASD News Release, June 27, 2007; Deutsche Bank Securities, NYSE Hearing Panel Decision No. 06-217 (Dec. 20, 2006); Citigroup Global Markets, Credit Suisse Securities (USA), and Morgan Stanley, NASD Press Release, July 17, 2006; Bear Stearns, NYSE Hearing Panel Decision No. 05-163 (Dec. 22, 2005); SunTrust Capital, NASD News Release, May 9, 2005.

F) The SEC's Regulation Analyst Certification, 17 C.F.R. § 242.500 et seq. ("Regulation AC"), complements the FINRA actions regarding conflicts of interest, but is broader in scope.

Regulation AC applies to broker-dealers and their affiliates in respect of research reports distributed to U.S. persons. Regulation AC does not apply to those affiliates with respect to which the broker-dealer has established information barriers and other procedures reasonably designed to prevent the broker-dealer from influencing the affiliate or the content of the affiliate's research reports.

Regulation AC exempts (i) distribution of third party research, (ii) offshore appearances by analysts employed outside the U.S. by a non-U.S. entity, (iii) activities of the news media, (iv) activities of advisers not required to register under the Advisers Act, and (v) reports on foreign securities prepared by a foreign broker-dealer that is not affiliated with an SEC-registered broker-dealer and that provides such reports to major U.S. institutional investors in accordance with Rule 15a-6(a)(2) (see generally Part XI below). See SEC Release Nos. 34-47384 (Feb. 20, 2003) (final rule), 34-46301 (Aug. 2, 2002) (solicitation of public comments).

G) In 2003, the SEC, the NYSE, the NASD, the NASAA, the NY Attorney General and state securities regulators entered into a Global Settlement Agreement with 10 investment banking firms regarding charges that the firms engaged in practices that created analyst conflicts of interests that were not adequately disclosed (the "Global Settlement").

As part of the Global Settlement, without admitting or denying the allegations, the firms agreed to pay a total of $1.4 billion, $875 million for civil penalties and disgorgement and the remainder for investor education programs and independent research. The firms agreed to limit the interaction between their investment banking and research departments in respect of equity securities, including (i) physical separation; (ii) separate reporting lines; (iii) separate legal and compliance staffs; (iv) separate budgeting; (v) restrictions regarding methods of determining analyst compensation; (vi) restrictions on investment banking personnel involvement in research and coverage decisions, and on analyst involvement in investment banking pitches and roadshows; (vii) firewalls to prevent communication between investment banking and research personnel (other than so-called "vetting" communications where an investment banker seeks the views of analysts about the merits of a proposed transaction or a potential candidate for a transaction, or about market or industry developments); (viii) enhanced disclosures; and (ix) agreement to contract with independent firms for research. The firms also agreed to restrictions on allocations of securities in "hot IPOs" (see Part IX.E.3.c.iii below).

In 2010, the Global Settlement was modified to remove certain provisions that are now covered by FINRA/NYSE rules.

See, e.g., SEC Fact Sheet on Global Analyst Research Settlements (Apr. 28, 2003); SEC Press Releases 2003-54 (Apr. 28, 2003) and 2002-179, (Dec. 20, 2002); SEC Litigation Releases No. 18109 (Apr. 28, 2003) (Bear Stearns), No. 18110 (Apr. 28, 2003) (CSFB), No. 18111 (Apr. 28, 2003) (Citigroup), No. 18112 (Apr. 28, 2003) (UBS Warburg), No. 18113 (Apr. 28, 2003) (Goldman Sachs), No. 18114 (Apr. 28, 2003) (JPMorgan), No. 18115 (Apr. 28, 2003) (Merrill Lynch), No. 18116 (Apr. 28, 2003) (Lehman), No. 18117 (Apr. 28, 2003) (Morgan Stanley), No. 18118 (Apr. 28, 2003) (U.S. Bancorp Piper Jaffray); SEC Litigation Release No. 18438 (Oct. 31, 2003) (SDNY Order approving Global Settlement); SEC Press Release 2004-40 (Mar. 25, 2004) (SDNY Order approving the SEC Investor Education Plan), rescinded and replaced by funding of NASD Investor Education Foundation (see SEC Litigation Release No. 19359 (Sept. 2, 2005)); SEC Letter to Cleary Gottlieb, Nov. 2, 2004 (responds to questions on the Global Settlement with respect to (i) education and information access, (ii) coverage, (iii) "pitch meetings", (iv) conversations between research and investment banking, (v) requests by investment banking clients, (vi) notice requirements, confirmations and account statements, (vii) participation in conferences, and (viii) compensation); SEC Press Release (Apr. 22,

2005) (SDNY approval of Distribution Plan submitted by court-appointed administrator); SEC Litigation Release No. 21457 (Mar. 19, 2010) (SDNY Order Modifying Global Settlement).

See also, e.g., Deutsche Bank Securities, FINRA Letter of Acceptance, Waiver and Consent No. 2012035003201 (Aug. 8, 2016) (research and trading information disseminated over internal "squawk box" speakers contained confidential, price-sensitive information); Stephens Inc., FINRA Letter of Acceptance, Waiver and Consent No. 2014041823201 (May 11, 2016) (failure to adopt policies related to, and supervise, the content and dissemination of firm-wide "flash" email research insights by the firm's analysts to sales and trading personnel, some of which included material non-public information); Barclays Capital, Citigroup Global Markets, Credit Suisse Securities, Goldman, Sachs & Co., JPMS, Deutsche Bank Securities, Merrill Lynch, Morgan Stanley & Co., Wells Fargo Securities and Needham & Company, FINRA News Release, Dec. 11, 2014 (fines for allowing research analysts to solicit investment banking business and to offer favorable research coverage for planned IPO of Toys "R" Us); Citigroup Global Markets, FINRA Letter of Acceptance, Waiver and Consent No. 2013036054901 (Nov. 20, 2014) (failing to adequately supervise communication between research analysts and clients and permitting analyst to participate in road shows promoting IPOs to investors); Citigroup Global Markets, Mass. Sec. Div. Consent Order No. 2013-0014 (Oct. 2, 2013) (misconduct of Taiwanese affiliate from which hedge fund and institutional clients received confidential unpublished research views); Goldman Sachs, SEC Admin. Proc. No. 3-14845 (Apr. 12, 2012) (deficient policies during research "huddles" where analysts share ideas with traders which are passed on to select clients) (the "GS Huddle Settlement"); Citigroup, FINRA News Release, Jan. 18, 2012 (failure to disclose conflicts of interest in research reports and public appearances); Morgan Stanley, FINRA News Release, Aug. 10, 2010 (deficient conflict of interest disclosures in research reports and public appearances); Credit Suisse, FINRA News Release, Aug. 10, 2009 (failure to make independent research available); Banc of America Securities, SEC Release No. 34-55466 (Mar. 14, 2007) (requirements with respect to the separation of research and investment banking); Wachovia Capital Markets, NASAA Press Release, July 5, 2006 (multistate settlement involving alleged conflicts of interest); NASD News Release, Dec. 9, 2003 (fining and suspending former analyst for issuing research reports contrary to his personal opinion and releasing market sensitive information in advance of public release, and censuring and fining broker-dealers for misleading research reports); SEC Litigation Releases No. 18855 (Aug. 26, 2004) (Thomas Weisel Partners); No. 18854 (Aug. 26, 2004) (Deutsche Bank Securities); SEC Admin. Proc. No. 3-11600 (Aug. 25, 2004) (Morgan Keegan), No. 3-11601 (Aug. 25, 2004) (Prudential Equity Group), No. 3-11602 (Aug. 25, 2004) (S. G. Cowen), No. 3-11603 (Aug. 25, 2004) (Needham & Co.), No. 3-11604 (Aug. 25, 2004) (Janney Montgomery Scott) (failure to disclose receipt of payments for providing research coverage); SEC Litigation Release No. 17922 (Jan. 9, 2003) (conflict of interest-related proceedings which preceded the Global Settlement); Agreement between NY Attorney General and Merrill Lynch, dated May 21, 2002 (predecessor to Global Settlement).

H) In April 2012, Congress enacted the JOBS Act. See Part I.A.8.a.ii.D and Part VI.A.2.a.vii above. With regard to an "emerging growth company" (an "EGC"), defined as an issuer with total annual gross revenues of less than $1 billion, research analysts will no longer be restricted from participating with investment bankers and non-research personnel in communications with an EGC's management, and investment bankers and non-research personnel will no longer be restricted from arranging communications between analysts and EGC investors. Research reports on an EGC will not constitute prospectuses or an offer to sell a security.

In August 2012, the SEC clarified, however, that the greater flexibility for interaction between research analysts and investment bankers under the JOBS Act does <u>not</u> apply to any of the firms that are subject to the Global Settlement unless the firms apply to the court for an amendment of the Global Settlement. <u>See</u> <u>[FAQs] About Research Analysts and Underwriters</u> (SEC, Aug. 22, 2012).

I) The CFTC has adopted rules establishing conflicts of interest requirements for swap dealers, MSPs, FCMs and IBs pursuant to Dodd-Frank §§ 731-732. 17 C.F.R. § 23.605 (regarding swap dealers and MSPs); 17 C.F.R. § 1.71 (regarding FCMs and IBs).

J) A group of research firms obtained an injunction against an Internet subscription news service that aggregates and publishes the firms' research analysts' stock recommendations. The injunction permits the firms a limited period of exclusivity before the news service may disseminate the recommendations. <u>See</u> <u>Barclays Capital v. Theflyonthewall.com</u>, 700 F. Supp. 2d 310 (SDNY 2010).

K) There is reportedly a growing hedge fund practice of disseminating extensive questionnaires to brokerage firm research analysts, which may be used to receive information to determine analyst views of hedge fund portfolio companies' prospects. As the selective release of analysts' views has gained increasing public focus, there is some evidence that this practice is designed to elicit non-public information. Although the SEC has not commented on this practice generally, it fined Goldman Sachs $22 million in the GS Huddle Settlement. See Wall St. J., Sept. 27, 2015; NY Times, Jan. 8, 2014, July 15, 2012.

The NY Attorney General took steps to curb the practice of surveying analysts at investment banks, a practice asserted by the Attorney General to capture non-public analyst sentiment. Eighteen financial institutions reached interim agreements with the NY Attorney General to refrain from cooperating with analyst surveys, and BlackRock agreed to discontinue its analyst survey program. See NY Attorney General Press Release, Feb. 26, 2014; BlackRock, NY Attorney General Assurance of Discontinuance No. 14-007 (Jan. 8, 2014).

(iii) Allocation of IPO Distributions

A) Issues in respect of the allocation of IPO distributions relate to (i) the receipt of allegedly excessive commissions on secondary trades from certain customers that received allocations of shares, (ii) the relationship between the payment of commissions and the receipt of IPO allocations, and (iii) the antitrust, "tie-in" and securities disclosure issues that such practices might raise.

i) A multi-agency investigation focused on whether firms received commission payments in exchange for IPO allocations and whether some firms improperly tied IPO allocations to aftermarket orders ("laddering").

ii) Broker-dealers came under scrutiny for allegations as to "spinning" (allocating shares in underwritings to the personal accounts of corporate executives in hopes of receiving investment banking business). Plaintiffs filed more than 1,000 complaints alleging securities law violations in connection with IPO-related issues. See, e.g., In re [IPO] Securities Litigation, 671 F. Supp. 2d 467 (SDNY 2009) (approving class action settlement of charges that defendants induced the purchase of IPO shares at inflated prices for undisclosed compensation and published misleading research reports). See also, e.g., NY Attorney General Press Release, July 31, 2006 (disgorgement by executives of profits received in IPO spinning practices).

iii) A Congressional investigation found that executives with investment banking business to offer were given special access to hot IPOs, IPO shares were often sold quickly ("flipping"), investment banking relationships led to biased research reports, and companies were brought to market prematurely so that underwriters could collect investment banking fees. House Committee on Financial Services Press Release, dated Oct. 2, 2002.

B) An NYSE/NASD IPO Advisory Committee had proposed 20 steps to enhance public confidence in the integrity of the IPO process. The steps follow four basic themes: (i) the IPO process must promote transparency in pricing and avoid aftermarket distortions; (ii) abusive allocation practices must be eliminated; (iii) regulators must improve the flow of information; and (iv) regulators must encourage underwriters to maintain the highest standards, establish issuer education programs and promote investor education regarding the IPO process and IPO investing. The recommendations include prohibitions on laddering, spinning and flipping. See Report and Recommendations of a Committee Convened by the [NYSE] and NASD at the Request of the [SEC] (May 2003); NASD Notice to Members No. 03-72 (Nov. 2003).

See generally FINRA Rules 5130, 5131.

C) SEC/NASD complaints/settlements in connection with IPO allocation practices include, e.g., Goldman Sachs, SEC Litigation Release No. 19051 (Jan. 25, 2005); Morgan Stanley, SEC Litigation Release No. 19050 (Jan. 25, 2005); Thomas Weisel Partners, NASD News Release, Mar. 30, 2005; U.S. Bancorp Piper Jaffray, NASD News Release, July 12, 2004; Bear Stearns, Deutsche Bank, Morgan Stanley, NASD News Releases, May 18, 2014; JPMorgan Securities, SEC Litigation Release No. 18385 (Oct. 1, 2003); Credit Suisse, SEC Litigation Release No. 17327 (Jan. 22, 2002).

D) Each firm participating in the Global Settlement agreed to implement procedures to ensure that (i) securities in hot IPOs are not allocated to accounts of executive officers of public companies, (ii) any firm that wants to be a lead underwriter in an IPO notifies the company's legal or other executive officers that the firm may have allocated hot IPOs to the company's officers or directors, (iii) the firm does not allocate securities in hot IPOs in exchange for investment banking business, and (iv) investment banking personnel do not influence the firm's allocation of IPO securities to brokerage accounts of individual customers. See SEC Press Release 2003-56 (Apr. 28, 2003).

(iv) Participation in Public Offerings in Which the Underwriter Has an Interest

A) FINRA Rule 5121 generally prohibits a broker-dealer from participating in public offerings with respect to which it has a "conflict of interest" (defined, at a high level, to include situations in which (1) the broker-dealer is the issuer, (2) the issuer controls, is controlled by or is under common control with the broker-dealer or one of its associated persons, (3) at least 5% of the net offering proceeds are directed to the broker-dealer, its affiliates or associated persons; or (4) the public offering or related transactions will result in the broker-dealer becoming an affiliate of the issuer, the broker-dealer becoming publicly owned or the issuer becoming a FINRA member or forming a FINRA-member subsidiary). Notwithstanding the general prohibition, FINRA Rule 5121 provides circumstances under which participation is permissible, including through disclosure of the nature of the conflict combined with other factors (e.g., the presence of a "qualified independent underwriter").

B) FINRA Rule 6130 prohibits a broker-dealer from executing transactions in a security subject to an IPO off-exchange until the security has first opened for trading on the exchange listing the security.

(v) ATS and "Dark Pools"

A) A "dark pool" is defined by FINRA as an ATS that does not display quotations or orders internally or externally. See FINRA Rule 6160. As ATSs, dark pools are operated by broker-dealers and regulated by the SEC.

B) Barclays Capital and Credit Suisse Securities agreed to pay a combined $154 million, and Barclays admitted wrongdoing, to settle claims brought by the SEC and the NYDFS in connection with the operation of the firms' dark pools. The original complaint against Barclays alleged that Barclays misled its clients by representing that it would monitor and suppress predatory trading while also soliciting business from high frequency firms engaged in such trading strategies. Similarly, the original complaint against Credit Suisse Securities alleged, among other things, that Credit Suisse misled clients by representing that its dark pools would allow clients to avoid trading with opportunistic high-speed firms while it categorized some such firms as non-opportunistic and did not block orders from others. See Barclays Capital Inc., SEC Admin. Proc. No. 3-17077 (Jan. 31, 2016); In the Matter of Barclays plc and Barclays Capital Inc., NY Attorney General Settlement Agreement (Jan. 29, 2016); Credit Suisse Securities (USA) LLC, SEC Admin. Proc. No. 3-17078 (Jan. 31, 2016); In the Matter of Credit Suisse Securities (USA) LLC, NY Attorney General Settlement Agreement (Jan. 29, 2016).

See also In re: Barclays Liquidity Cross and High Frequency Trading Litigation, 14-MD-2589 (SDNY Aug. 26, 2015) (dismissing multi-district litigation against Barclays and several exchanges alleging favoritism to high-frequency trading firms through co-location, enhanced data feeds and dark pools); Strougo v. Barclays, No. 14-cv-5797 (SDNY July 28, 2014) (private plaintiff; complaint survived (in part) motion to dismiss, Apr. 24, 2015; motion to certify class, July 17, 2015; order certifying class, Feb. 2, 2016; denial of motion to stay, July 5, 2016).

C) The SEC charged UBS Securities with violating the 1933 and 1934 Acts in its operation of a dark pool for (1) allowing market-makers and high frequency traders to conduct transactions at fractions of a penny, thereby allegedly prioritizing such orders over ATS subscribers that entered lawful orders at whole-penny prices, and (2) selectively allowing certain subscribers to trade against "natural" subscribers and avoid trading against market-makers and high frequency traders, without disclosing to such "non-natural" subscribers their status. UBS Securities, SEC Admin. Proc. No. 3-16338 (Jan. 15, 2015). See also ITG Inc. and Alternet Securities Inc., SEC Admin. Proc. No. 3-16742 (Aug. 12, 2015) (firm operating an "undisclosed proprietary trading desk" by exploiting confidential dark pool customer information); In re Pipeline Trading Systems LLC, SEC Admin. Proc. No. 3-14600 (Oct. 24, 2011) (failure to disclose to customers that most customer orders were filled by an affiliate of the ATS operator).

D) Regulators and SROs have increased focus on dark pool related issues, including market transparency. FINRA pursued an ATS "transparency initiative", which also includes requiring reporting of trading activity outside of ATSs. See FINRA Regulatory Notice 16-28 (Aug. 2016) (SEC approval of FINRA Rule 4554 to require additional information to be reported to OATS in order to facilitate order-based surveillance of ATSs); 80 Fed. Reg. 61246 (Oct. 9, 2015) (approving changes to FINRA Rules 6110 and 6610 to require firms to report certain OTC equity trading volume executed outside ATSs). The SEC proposed rules requiring an NMS stock ATS to disclose certain information about the operation and activities of its broker-dealer operator and its affiliates, including any trading activity on the ATS. See SEC Release No. 34-76474 (Nov. 18, 2015). See also Automated Matching Systems Exchange v. SEC, No. 14-3698 (8th Cir., June 20, 2016) (affirming an SEC order denying an ATS operator application for an exemption from registration as a national securities exchange); Reuters, Jan. 26, 2016; Remarks of SEC Commissioner Stein, Sept. 30, 2015. European regulators and exchanges are also grappling with dark pools. See, e.g., UK Equity Market Dark Pools – Role, Promotion and Oversight in Wholesale Markets (FCA, July 2016); Financial Times, Nov. 29, 2015.

E) See generally The Dark Side of the Pools: What Investors Should Learn From Regulators' Actions (Healthy Markets, 2015).

(vi) Arrangements with Hedge Funds

Regulators expressed concern about the operation of "hedge fund hotels", pursuant to which a banking organization leases space to hedge fund traders with the possibility of using the relationship to entice hedge funds to do business with them, possibly at the expense of hedge fund investors. See e.g., Wall St. J., Jan. 3, 2007; NY Times, Jan. 2, 2007.

(vii) "Privacy" and Use of Confidential Customer Information

See Part I.C.5 above. See also, e.g., Tomlinson v. SEC, 2016 WL 890681 (2d Cir., Mar. 9, 2016) (credit union employee dual-hatted with broker-dealer took customer information to new employer); Marc Ellis, Frederick Kraus and David Levine, SEC Press Release 2011-86 (Apr. 7, 2011) (failure to protect confidential information about customers by transferring customer records from failing broker-dealer employer to another firm in violation of Regulation S-P); Lincoln Financial Securities / Advisors, FINRA Letter of Acceptance, Waiver and Consent No. 2009018720501/ 2009020074601 (Feb. 16, 2011) (failure to protect confidential customer information).

(viii) Cash Sweeps

Automatic transfers (or "sweeps") of cash from customers' brokerage accounts to banks may raise conflicts of interest where the bank is an affiliate of the broker or the broker receives compensation from the bank in connection with the cash sweep. See, e.g., DeBlasio v. Merrill Lynch, 2009 WL 2242605 (SDNY 2009) (dismissing a class action suit against Merrill Lynch, Morgan Stanley, Citigroup, Charles Schwab, Wachovia and affiliated companies and banks accusing them of deceptive and misleading practices with respect to cash sweep programs); NYSE Informed Investor Series: The Cash Sweep Account: What Deal Are You

Getting?; NYSE Information Memo 05-11 (Feb. 15, 2007) (expressing concern about reliance on negative consent to implement or change cash sweep programs and delineating suggested practices). See also Part VIII.C.1.b.ii.D above.

e. "Best Execution", Trade Disclosure and Related Requirements

(i) Broker-dealers are required to observe a duty of "best execution", i.e., that a broker-dealer obtain the most favorable terms reasonably available under the circumstances for a customer's transaction. See FINRA Rule 5310. In addition, both the SEC and FINRA review broker-dealer compliance programs for regular and rigorous examination of execution quality likely to be obtained from different market venues or market makers. See, e.g., FINRA Rule 5310 (supplementary material .09). See also FINRA Regulatory Notice 12-13 (Mar. 2012) (SEC approval of consolidated FINRA Rule 5310 (Best Execution and Interpositioning) and Rule 6438 (Displaying Priced Quotations in Multiple Quotation Mediums)).

(ii) The SEC and FINRA engage in ongoing reviews of best execution issues in order to clarify and expand on guidance to broker-dealers. See, e.g., SEC Release No. 34-78309 (July 13, 2016) (proposed rule to require broker-dealers to disclose to customers information regarding the handling of institutional orders and to expand the information included in existing retail order disclosures); FINRA Regulatory Notice 16-03 (Jan. 2016) (SEC approval of FINRA rule amendments that codify the application of FINRA's rule concerning mark-ups and commissions to exempted securities); Securities Law Daily, Dec. 15, 2015 (describing FINRA guidance related to brokers accessing both proprietary data feeds as well as the consolidated "securities information processor" or SIP, and expressing expectation that such data feeds will be used when meeting best execution requirements); FINRA Regulatory Notice 15-46 (Nov. 2015) (reiterating to members their best execution obligations, particularly in light of technological enhancements to trading); 2015 Regulatory and Examination Priorities Letter (review of firms' order routing practices to ensure compliance with best execution obligations, including in the context of unmarketable orders, options orders and fixed income orders); SEC Release No. 33-73764 (Dec. 5, 2014) (MSRB rule establishing best execution requirements in municipal securities); FINRA Targeted Examination Letter (July 2014) (requesting information regarding diligence efforts of firms to determine the best markets for orders); SEC Release No. 34-52683 (Oct. 26, 2005) (approval of NYSE Rule 123G to prohibit "trade shredding"; i.e., unbundling of customer orders into multiple smaller orders to maximize commissions); SEC Release No. 34-35473 (May 10, 1995) (enhanced disclosure of "payment for order flow"; i.e., payments, services, property, reciprocation or other benefits that result in compensation to a broker-dealer in return for routing customer orders).

See also Robert W. Baird & Co., Important Information about Investment Managers' Placement of Client Trade Orders and their "Trade Away" Practices (Mar. 31, 2014) (disclosing firm's best execution practices); SIFMA White Paper, Best Execution Guidelines for Fixed Income Securities (Jan. 2008, updated Sept. 2008).

(iii) In June 2016, the SEC approved Investors' Exchange LLC ("IEX") as a stock exchange. IEX operates a dark pool, but with national stock exchange status, broker-dealers would be required to route orders to IEX if it shows the best price. IEX incorporates a "speed bump" into its order fulfillment process, delaying orders by 350 microseconds in an effort to reduce the edge that high-frequency traders may obtain on other venues. In connection with the approval, the SEC also issued an interpretation of Rule 600(b)(3) of Regulation NMS to clarify that the term "immediate" as used therein does not prohibit an exchange from implementing an intentional access delay that is de minimis. See SEC Release No. 34-78101 (June 17, 2016) (approval); SEC Release No. 34-78102 (June 17, 2016) (interpretative release); Staff Guidance on Automated Quotations under Regulation NMS (SEC, June 17, 2016) (guidance on length of delay that is likely to meet the de minimis standard; concluding that delays less than one millisecond are "within the current geographic and technological latencies already experienced by market participants"). See also SEC Press Release 2016-123 (June 17, 2016); Securities Law Daily, June 20, 2016 (describing IEX's business model and its "speed bump"). See also Wall St. J., Aug. 4, 2016 (Nasdaq reportedly developing preferential treatment product for customers who agree not to cancel their orders for at least one second).

(iv) JPMorgan Securities (avail. Aug. 4, 2005) confirmed that SEC staff would not recommend enforcement action if the firm confirms its capacity as "agent" when it submits a customer order through Archipelago's electronic trading facilities and the order is executed with an anonymous counterparty that turns out to be the firm or one of its affiliates, so long as (A) the representatives of the firm submitting customer orders to Archipelago do not have knowledge of principal orders submitted by JPMorgan entities, and the representatives of the JPMorgan entities submitting principal orders to Archipelago do not have knowledge of customer orders submitted by the firm; and (B) the firm does not determine or influence the selection of the counterparty against which the customer order will be executed. See also, e.g., BATS Y-Exchange (avail. Oct. 12, 2010); EDGX Exchange (avail. May 26, 2010); BATS Exchange (avail. Feb. 25, 2010, Oct. 23, 2008); Boston Stock Exchange (avail. Dec. 23, 2008); National Stock Exchange (avail. Oct. 13, 2006); Nasdaq (avail. Jan. 26, 2005).

(v) Transparency of pricing and orders in securities markets remains a continuing challenge. In the first ever financial penalty against an exchange, the SEC charged the NYSE with compliance failures in violation of Regulation NMS for improperly sending market data to certain customers before it was more widely disseminated. In re [NYSE] and [NYSE] Euronext, SEC Admin. Proc. No. 3-15023 (Sept. 14, 2012); SEC Press Release 2012-189 (Sept. 14, 2012). Similarly, in 2013, Thomson Reuters, the exclusive distributor of the University of Michigan consumer survey results, discontinued its practice of providing the survey results to certain high-frequency trading subscribers seconds before all Thomson Reuters subscribers generally. See NY Attorney General Press Release, July 8, 2013.

See also, e.g., Braman v. CME Group, No. 14-cv-02646 (N.D. Ill., Dec. 3, 2015) (dismissal of allegations that CME provided high frequency traders with preferential access to real-time market information); Reuters, Feb. 2, 2015 (brokers voluntarily disclosing payments received from market makers to route customer orders); ICAP Securities, SEC Admin. Proc. No. 3-13726 (Dec. 18, 2009) (fine for displaying fictitious trades and disseminating false trade information to attract customer attention and encourage actual trading); TradeStation Securities, E*Trade Securities and CIBC World Markets, FINRA News Release, May 15, 2008 (reporting and supervision violations); State Street Global Markets, NASD Press Release, Nov. 22, 2005 (failure to report thousands of corporate bond trades to NASD's Trade Reporting and Compliance Engine and hundreds of municipal bond trades to the MSRB).

(vi) Enforcement actions and lawsuits have further developed the law and regulation related to the best execution duty. See, e.g., Lewis v. Scottrade, No. 15-cv-01255 (E.D Mo., Aug. 29, 2016) (Securities Litigation Uniform Standards Act pre-empts state law claims of illegal practices, fiduciary duty violation and unjust enrichment based on allegations of violation of duty of best execution); E*TRADE Securities LLC, FINRA Letter of Acceptance, Waiver and Consent

No. 20130368815-01 (June 2, 2016) (failure to conduct an adequate review of the quality of execution of customers' orders and for supervisory deficiencies concerning the protection of customer order information); SEC v. McLellan, No. 16-cv-10874 (D. Mass., May 13, 2016) (complaint) (SEC fraud action against former State Street executive for charging hidden and unauthorized mark-ups on trading in U.S. and European securities); U.S. v. McLellan, No. 16-cr-10094 (D. Mass., Mar. 31, 2016) (indictment) (charging former State Street executives with engaging in a scheme to defraud at least six of the bank's clients through secret commissions); J.P. Morgan Securities LLC, SEC Admin. Proc. No. 3-17036 (Jan. 6, 2016) (false statements on website and in marketing materials that advisors are compensated "based on our clients' performance; no one is paid on commission", when compensation was not based on client performance, but on a salary and a discretionary bonus based on a number of factors); Lim v. Charles Schwab & Co., Nos. 15-Civ.-02074, 15-Civ.-02945 (N.D. Cal., Dec. 7, 2015) (in context of suit against Schwab in relation to agreement by Schwab to direct significant percentage of its "non-directed" orders to UBS, holding that the Securities Litigation Uniform Standards Act preempted state law claims for breach of contract, breach of fiduciary duty, intentional misrepresentation, negligent competition, unfair competition and aiding and abetting); Merrill Lynch, FINRA Letter of Acceptance, Waiver and Consent No. 20100226911 (Dec. 10, 2014) (failure to detect pattern of below-market purchases from customers); ConvergEx, DOJ Press Release, Nov. 19, 2014 (guilty plea related to fraudulent order routing in order to charge hidden fees); Citigroup Global Markets, FINRA Letter of Acceptance, Waiver and Consent No. 20090187389-01 (Aug. 26, 2014) (use of proprietary order execution system, which was alleged to have flawed pricing logic, and use of manual pricing methodology that did not incorporate the National Best Bid and Offer); Morgan Stanley, FINRA Letter of Acceptance, Waiver and Consent No. 20080160235-01 (Aug. 22, 2013) (best execution for corporate/agency bonds and fair and reasonable price for purchases of municipal bonds); A.R. Schmeidler, SEC Admin. Proc. No. 3-15399 (July 31, 2013) (failure to analyze best execution upon renegotiation of contract with third party clearing firm deemed breach of fiduciary duty under Advisers Act); Goelzer Investment Management, SEC Admin. Proc. No. 3-15400 (July 31, 2013) (investment adviser failed to analyze alternatives when directing trading through itself as broker-dealer); Morgan Stanley, SEC Release No. 34-55726 (May 9, 2007) (best execution violations in retail transactions, including embedding undisclosed mark-ups and mark-downs and delaying execution of orders); HSBC Brokerage, NASD News Release, May 29, 2007 (directing government securities orders to an affiliated broker without reviewing to ensure best execution); NASD News Release, July 28, 2004 (Citigroup, Deutsche Bank, Goldman Sachs, et al. fined for excessive markups/markdowns of high yield bonds, inadequate recordkeeping and supervisory violations); Newton v. Merrill Lynch, 135 F.3d 266 (3d Cir.), cert. denied, 525 U.S. 811 (1998) (execution of customer orders for OTC securities at the National Best Bid and Offer price does not fulfill best execution duties if better prices are reasonably available on other systems).

(vii) The SEC has sanctioned broker-dealers and auction agents for undisclosed activities in the ARS market, including intervening to prevent failed or "all hold" auctions or to set a "market" rate, that may have affected the rates paid on the ARS and concealed credit and liquidity risks. See Citigroup Global Markets, SEC Admin. Proc. No. 3-12629 (May 7, 2007); Bear Stearns et al., SEC Admin. Proc. No. 3-12310 (May 31, 2006) and SEC Press Release 2006-83 (May 31, 2006) (15 broker-dealers settle charges); Deutsche Bank Trust Co., BNY and Wilmington Trust Co., SEC Admin. Proc. No. 3-12526 (Jan. 9, 2007). See also Part II.B.3.b.ix and Part IX.E.3.a.iv above.

f. Annuity and Insurance Marketing

(i) The volume of variable annuities sold amounted to \$133 billion in 2015, down from a high of \$184 billion in 2007. See, e.g., LIMRA Secure Retirement Institute U.S. Individual Annuities Survey (2016). Income earned from sales of annuities by BHCs in 2015 was \$3.15 billion. Michael White Associates News Release, Apr. 19, 2016.

(ii) In response to concerns regarding abuses in annuity sales practices, FINRA adopted Rule 2330 (former NASD Rule 2821) imposing suitability, disclosure, principal review, supervisory and training requirements. See SEC Release No. 34-56375 (Sept. 7, 2007) (approving Rule 2821). See also FINRA Regulatory Notice 10-05 (Jan. 2010) (reminding firms of their responsibilities under FINRA Rule 2330).

(iii) SEC Release No. 33-8996 (Jan. 15, 2009) reported the adoption of Rule 151A, which subjected to regulation as a "security" any annuity with a payout calculated in whole or in part by reference to a security (or a group or index of securities) and where the amounts payable by the issuer are more likely than not to exceed the amounts guaranteed under the contract. American Equity Investment Life Ins. Co. v. SEC, 2010 U.S. App. LEXIS 14249 (D.C. Cir., 2010), vacated Rule 151A on the grounds that the SEC's consideration of the effect of the Rule on efficiency, competition and capital formation was arbitrary and capricious. The SEC subsequently withdrew Rule 151A. SEC Release No. 33-9152 (Oct. 14, 2010).

Dodd-Frank § 989J requires the SEC to treat certain indexed annuities as exempt securities for purposes of the 1933 Act.

(iv) Issues with respect to variable annuity marketing are discussed in, e.g., Variable Annuities: Beyond the Hard Sell (FINRA Investor Alert, Apr. 14, 2009); Remarks of

Board Governor Olson, June 10, 2004 (key insurance and annuity sales compliance issues, including (A) preventing conflicts of interest and ensuring that sales are suitable in light of customer needs and that appropriate alternative products are considered; (B) monitoring consumer complaints regarding sales practices, and identifying and addressing trends and issues that may expose the banking organization to potential loss; (C) ensuring appropriate systems to protect the privacy of customer information; (D) monitoring claims and potential exposures from mistakes related to insurance sales and brokerage activities, and identifying and reporting to management adverse trends and potential legal exposures; and (E) reporting to the board of directors and management regarding the risks associated with sales activities and the internal controls used to minimize potential loss).

See also, e.g., Equity-Indexed Annuities—A Complex Choice (FINRA Investor Alert, Apr. 22, 2008); NASD Notices to Members Nos. 06-38 (Aug. 2006), 05-54 (Aug. 2005), 05-50 (Aug. 2005), No. 00-44 (July 2000) (equity-indexed annuity and variable life insurance sales); Should You Exchange Your Variable Annuity? (NASD Investor Alert, 2011; updated 2016); Joint SEC/NASD Staff Report, Examination Findings Regarding Broker-dealer Sales of Variable Insurance Products (June 2004); What's Reasonable for Investor Protection and for Agents Selling Variable Annuities (NASAA, Jan. 10, 2003).

(v) Recent regulatory enforcement actions for compliance failures in the sale of annuities and related products include, e.g., Prudential Annuities Distributors, FINRA Letter of Acceptance, Waiver and Consent, No. 2012034423502 (July 19, 2016) (failure to follow up on red flags related to fraudulent withdrawals from variable annuity); MetLife Securities, Inc., FINRA Letter of Acceptance, Waiver and Consent, No. 2014040870001 (May 3, 2016) (material misrepresentations and omissions on variable annuity replacement applications that made the replacements appear more beneficial to the customers despite higher costs); SEC v. Life Partners Holdings, 71 F. Supp. 3d 615 (W.D. Tx., 2014) (judgment) (company and executives found to have engaged in fraudulent pricing practices, and disclosure and accounting violations, involving life settlements); Fifth Third Securities, FINRA Press Release, Apr. 14, 2009; Morgan Stanley, FINRA Press Release, Mar. 25, 2009; Banc One Securities, FINRA Press Release, Jan. 29, 2008; Raymond James Financial Services, NASD Press Release, Feb. 21, 2007; MetLife, NY Attorney General Press Release, Dec. 29, 2006 (settlement of charges relating to payments to brokers to steer customers to MetLife); Investors Capital Corp., Mass. Commonwealth Secretary Press Release, Dec. 19, 2006; Insurance J., Dec. 19, 2006 (NY, Ill. and Conn. Attorneys General proceedings against Acordia and its parent, Wells Fargo, for steering customers to insurance companies from which they received undisclosed compensation); CCO Investment Services, NASD Press Release, Oct. 16, 2006; Securities America, NASD Press Release, Sept. 14, 2006; Waddell & Reed, NASD News Release, Apr. 29, 2005 ("thousands of variable annuity exchanges made as part of the firm's national switching campaign"); Jefferson Pilot Variable Corp., NASD News Release, Mar. 16, 2005 (market timing in variable universal life insurance sub-accounts); Conseco Services, SEC Admin. Proc. No. 3-11578 (Aug. 9, 2004) (facilitation of market timing of mutual funds through the sale of annuities); Davenport & Co., NASD News Release, June 1, 2004 (deceptive market timing in annuities); Prudential Investment Management, NASD News Release, Jan. 29, 2004.

(vi) With respect to life settlements and related matters:

A) The SEC released a Staff Report recommending that life settlements be defined as securities and issued an investor bulletin regarding investments in life settlements. See Investor Bulletin on Life Settlements (SEC, last modified Jan. 19, 2011);

Report of Life Settlements Task Force (SEC, July 22, 2010). See also, e.g., Seniors Beware: What You Should Know About Life Settlements (NASD Investor Alert, updated 2011).

B) In a ruling that could have a significant impact on the secondary "life-settlement market" (see Wall St. J., Sept. 26, 2011), the Delaware Supreme Court held that insurers can challenge the validity of life insurance policies based on a lack of insurable interest (such as situations where an investor has no interest in the life of the insured), notwithstanding the lapse of the policies' two-year contestability periods. However, the Court found that a person can procure a policy in good faith with the intention of immediately transferring the policy to a third party, provided that the third party cannot use the insured as a means to procure a policy, nor financially induce the insured to procure a policy that, if taken out by the third party, would lack an insurable interest. The ruling targets the practice of investors causing an individual to take out a policy with the intention of purchasing such policy in a "quick flip". PHL Variable Insurance Company v. Price Dawe 2006 Insurance Trust, 28 A.3d 1059 (Del. 2011). But see Kramer v. Phoenix Life Ins. Co., 15 N.Y.3d 539 (Ct. App. 2010) (NY law "permits a person to procure an insurance policy on his or her own life and immediately transfer it to one without an insurable interest in that life, even where the policy was obtained for just such a purpose"). See also The Deal, June 24, 2016 (investigation of Deutsche Bank's practices in the "stranger-originated" life insurance markets).

C) See also In re Life Partners Holdings Inc., No. 15-40289 (Bankr. N.D. Tex., Nov. 28, 2015) (proposed bankruptcy reorganization plan giving life settlement investors the ability to keep or pool their investments); SEC v. Novinger, No. 15-cv-358 (N.D. Tex. May 11, 2015) (complaint) (alleging fraudulent sales of life settlement interests while promising interests were "safe", "guaranteed", "risk free" and "federally insured"); SEC v. Secure Investment Services, SEC Litigation Release No. 20252 (Aug. 23, 2007) (Ponzi scheme victimizing seniors and other investors who purchased fractional interests in life insurance policies); Wall St. J., Feb. 21, 2007 (market for "death bonds" (insurance-linked financial instruments)).

D) FINRA has stepped up review of other types of income stream and settlement sales. See, e.g., FINRA Regulatory Notice 16-12 (Apr. 2016) (providing guidance to members on responsibilities related to sales of pension income stream products); Pension Advance Transactions (GAO, June 2014) (recommending that the CFPB and FTC review certain pension advance practices); FINRA Investor Alert, May 9, 2013 (alert to investors about the risks involved when selling their right to an income stream or investing in another's income stream).

g. Investment Scams

NASAA, Top Investor Threats (2015) include (i) unregistered products/unlicensed salesmen, (ii) promissory notes, (iii) oil/gas investments, (iv) real estate-related investments, and (v) Ponzi schemes (see Part VIII.c.2.e above).

Lists in prior years also included (i) binary options, (ii) marijuana industry investments, (iii) stream-of-income investments, (iv) digital currency and cyber-security risks, (v) fraudulent private placement offerings, (vi) real estate investment schemes, (vii) affinity fraud, (viii) Internet fraud (including social media and crowd funding) (ix) use of self-directed IRAs to hide fraud; (x) inappropriate advice from or practices by investment advisers; (xi) fraud stemming from investments in businesses established through the Immigrant Investor Program; (xii) gold and precious metal investments; (xiii) securities purchase and sale recommendations by unlicensed agents; (xiv) ETFs; (xv) FX trading; (xvi) "green" schemes; (xvii) undisclosed conflicts of interest; (xviii) private or special deals; (xix) "off the books" deals; (xx) unsolicited online pitches; (xxi) churning; (xxii) equity-indexed CDs (see Part IV above); (xxiii) personal information scams; (xxiv) "recovery rooms" where the scam artist promises, in return for an advance fee, to recover money lost in a prior scam; (xxv) securitized life settlement contracts (see Part IX.E.4.e.v above); (xxvi) variable annuities (see Part IX.E.4.e above); (xxvii) senior investment fraud (e.g., scams involving unregistered securities, charitable gift annuities, variable/life settlements; see Part IX.E.4.e above); (xxviii) entertainment investments; (xxix) prime bank schemes (see Part IV above); (xxx) "pump and dump" schemes; (xxxi) sale and leaseback contracts; (xxxii) short-term CP; (xxxiii) speculative investments and options; and (xxxiv) mirror trading. See NASAA, Top Investor Threats (2014), (2013), (2012) and Top Investor Traps and Threats (2011); NASAA News Releases, Aug. 23, 2011, Aug. 3, 2010.

See also Guidance for Financial Institutions on Preventing Elder Financial Exploitation (NYDFS, Feb. 27, 2015); Interagency Guidance on Privacy Laws and Reporting Financial Abuse of Older Adults (Sept. 2013); The Grass Isn't Always Greener -- Chasing Return in a Challenging Investment Environment (FINRA Investor Alert, last updated Nov. 16, 2011) (warnings regarding high-yield bonds, floating-rate loan funds, structured retail products and leveraged products); Stock-based Loan Programs: What Investors Need to Know (FINRA Investor Alert, last updated May 17, 2016); FinCEN FIN-2011-A003 (Feb. 22, 2011) (Advisory to Financial Institutions on Filing [SARs] Regarding Elder Financial Exploitation); SEC/NASAA/FINRA Joint Press Release, Aug. 13, 2010 (update of joint report on practices to protect senior investors).

F. EXCHANGES, ELECTRONIC COMMUNICATIONS NETWORKS AND INTERNET-AND TECHNOLOGY-RELATED ISSUES

1. Trading Systems, Computer Databases and Technology Requirements

a. Online trading platforms have become an integral part of fixed-income trading. Numerous electronic fixed-income trading platforms operate in the U.S. and Europe. Online bond trading platforms have also increased their OTC derivatives trading activities. See, e.g., Electronic Trading in Fixed Income Markets (BIS, Jan. 2016); Automated Trading in Treasury Markets (Treasury Market Practices Group, Apr. 9, 2015); Equity Trading in the 21st Century (Angel/Harris/Spatt, 2010); European Fixed Income e-Trading Survey (SIFMA, Feb. 2009).

Nevertheless, fully electronic fixed-income trading continues to face significant headwinds. As of 2013, single-dealer platforms, such as Morgan Stanley's Bond Pool and Goldman Sachs' GSessions, had experienced significant reductions in volume, while BlackRock discontinued its Aladdin Trading Network platform entirely. See Wall St. J., Aug. 7, 2013. A McKinsey & Co. and Greenwich Associates joint study (Corporate Bond E-Trading: Same Game, New Playing Field (Aug. 5, 2013)) noted that single-dealer platforms were significantly less favored than multi-dealer platforms. For example, a group of 12 banks embarked on an initiative to develop a non-trading platform that would link buyers and sellers of corporate bonds. See Wall. St. J., Oct. 5, 2014.

b. An ATS is an organization or system that satisfies the 1934 Act definition of "exchange" but generally does not regulate the conduct of its members. See 17 C.F.R. § 242.300(a). ATSs are permitted to register as broker-dealers and comply with Regulation ATS instead of registering as exchanges. See also Part IX.E.3.d.v above ("dark pools").

(i) The definition of "exchange" in 1934 Act § 3(a)(1), as interpreted by SEC Rule 3b-16, does not exempt banks, and compliance with Regulation ATS is an alternative to exchange registration only for entities that also register as broker-dealers. See SEC Release No. 34-40760 (Dec. 8, 1998) (adopting Regulation ATS and Rule 3b-16). However, an ATS that is a broker-dealer or a bank and limits its securities activities to government securities (including repos, reverse repos and OTC options on government securities) and CP is exempt from registration as an exchange and also exempt from the substantive requirements of Regulation ATS. See 17 C.F.R. §§ 240.3a1-1, 242.301(a)(4).

(ii) SEC Release No. 34-47351 (Feb. 11, 2003) approved Nasdaq's Primex Auction System, the first fully automated electronic hybrid dealer/auction system for trading Nasdaq and NYSE-listed securities. See also SEC Release Nos. 34-41967 (Sept. 30, 1999) (NASD ATS); 34-39829 (Apr. 6, 1998) ("matching" service that compares securities trade information from a broker-dealer and its customer is a clearing agency function); 34-52514 (Sept. 27, 2005) (Liquinet System); Direct Edge ECN (avail. June 28, 2006, Oct. 21, 2005), Bloomberg Tradebook (avail. June 28, 2006, Jan. 6, 2005), BATS Trading (avail. Feb. 15, 2006); Track Data Securities (avail. Oct. 21, 2005), Inet ATS (avail. Oct. 21, 2005, Jan. 17, 1997), BRUT LLC (avail. Jan. 6, 2005, Nov. 13, 1998) (collectively, "Trading System Letters").

See generally Targeted Examination Letters re: [ATS] (FINRA, May 2013); Impact of High Frequency Trading and Considerations for Regulatory Change (SIFMA, Dec. 13, 2011).

c. SEC Rule 15c3-5 requires broker-dealers with direct access, or that provide customers with access through use of the broker-dealer's market participant identifier or otherwise, to an exchange or ATS to implement risk management controls and supervisory procedures to manage the financial and regulatory risks associated with market access. See 75 Fed. Reg. 69792 (Nov. 15, 2010). See also Morgan Stanley, SEC Admin. Proc. No. 3-16310 (Dec. 10, 2014) (failure to design reasonable controls for customer market access to electronic trading desk, allowing third-party trader to exceed credit threshold and commit fraud); LavaFlow, SEC Admin. Proc. 3-15985 (July 25, 2014) (ATS censured for allowing order routing system to access confidential subscriber information without adequate safeguards). See generally Principles for Direct Electronic Access (IOSCO, Aug. 2010).

d. In S3 Matching Technologies (avail. July 19, 2012) (the "S3 Matching Letter"), SEC staff granted no-action relief from registering as a broker-dealer for S3 Matching's computerized platform. The platform uses an order routing analytical tool that determines to which broker an order is to be routed based on execution quality metrics selected by the sending broker. S3 Matching will not (i) hold, have access to or handle funds or securities; (ii) be involved in the solicitation, execution, settlement, clearance, processing or facilitation of transactions; or (iii) trade for its own account through the platform. See also, e.g., GlobalTec Solutions/CommandTRADE (avail. Dec. 28, 2005) (no-action relief to GlobalTec and its subsidiary, CommandTRADE, with respect to a computerized, user-programmable investment strategy platform to be linked electronically to participating broker-dealers without either entity registering as a broker-dealer); Swiss American Securities/Streetline (avail. May 28, 2002) (the "Swiss American Letter"); Evare (avail. Nov. 30, 1998).

e. High-frequency trading and algorithmic trading has come under increased scrutiny by regulators.

(i) FINRA adopted amendments to NASD Rule 1032(f) that require associated persons primarily responsible for the design, development or significant modification of algorithmic trading strategies for equities, preferred or convertible debt, or supervisors of such persons, to register with FINRA as a Securities Trader. See FINRA Regulatory Notice 16-21 (June 2016); SEC Release 34-77551 (Apr. 7, 2016); NASD Rule 1032(f).

(ii) Following criticism that it failed to detect market abuses that led to the 2008 financial crisis, the SEC started the Center for Risk and Quantitative Analytics in 2013, and has since developed algorithms to monitor segments of the market. See Sec. Reg. & L. Rep., Jan. 4, 2016.

(iii) The CFTC proposed Regulation Automated Trading ("Regulation AT"), which would regulate automated trading and use of algorithmic trading systems on DCMs, including requiring traders to register source code with repositories. See 81 Fed. Reg. 36484 (June 7, 2016); 80 Fed. Reg. 78824 (Dec. 17, 2015). See also Sec. Reg. & L. Rep., June 20, 2016 (Congressional Letter to CFTC urging amendment or removal of provision requiring source code to be stored at repositories for inspection by CFTC).

(iv) High-frequency trading and algorithmic trading has also increasingly become the subject of litigation. See Axiom Investment Advisors v. Deutsche Bank, No. 15-cv-09945 (SDNY Dec. 21, 2015) (complaint) (alleging the bank used its proprietary foreign exchange software platform to profit off of customers' orders); U.S. v. Coscia, No. 14-CR-551 (ND Ill. Nov. 3, 2015) (jury conviction) (first criminal conviction under Dodd-Frank's anti-spoofing provisions); Latour Trading LLC, SEC Admin. Proc. No. 3-16851 (Sept. 30, 2015) (alleging a high-frequency algorithmic trading firm violated the market access rule and Regulation NMS by sending millions of non-compliant trades to U.S. exchanges). But see In re Barclays Liquidity Cross and High Frequency Trading Litigation, 2015 WL 5052538 (SDNY Aug. 26, 2015), and Braman v. The CME Group, 2015 WL 7776871 (N.D. Ill. Dec. 3, 2015) (dismissing fraud and manipulation claims against exchanges in connection with high-frequency trading co-location agreements and data feeds).

f. In response to high-profile technology-related disruptions to markets, the SEC adopted Regulation Systems Compliance and Integrity ("Regulation SCI") to replace the voluntary principles articulated in the SEC's Automation Review Policy and the related Inspection Program. Under Regulation SCI, national securities exchanges and self-regulatory organizations, certain

ATS, clearing agencies and plan processors are required to adopt policies and procedures to ensure the integrity of their systems, conduct systems tests with participation of their members, ensure such systems operate in the manner intended and in compliance with federal securities laws, and notify the SEC and their members of systems issues. See 79 Fed. Reg. 72252 (Dec. 5, 2014). As required by Regulation SCI, FINRA adopted Rule 4380, governing broker-dealers' mandatory participation in business continuity and disaster recovery testing. See FINRA Regulatory Notice 15-43 (Nov. 2015), FINRA Rule 4380.

See also Information Technology Risks in Financial Services: What Board Members Need to Know and Do (Deloitte, 2016), Consultation Report: Technological Challenges to Effective Market Surveillance Issues and Regulatory Tools (IOSCO, Aug. 2012).

2. Internet-related Issues

a. Commercial use of the Internet has become the norm.

(i) In 2015, 53% of smartphone users with a bank account used mobile banking in the prior year but mobile payments are less common with only 28% of smartphone users making mobile payments in 2015. See, e.g., Consumers and Mobile Financial Services 2016 (Board, Mar. 2016).

(ii) Banking organizations are joining alliances with Internet trading networks, attempting to improve their online and mobile capabilities, creating online and mobile product offerings, and seeking to develop financing, investment and advisory units to assist new Internet ventures. See also, generally, Discussion Paper: The Distributed Ledger Technology Applied to Securities Markets (ESMA, June 2, 2016).

(iii) Regulators are striving for an appropriate regulatory framework.

A) The White House issued A Framework for Global Electronic Commerce (Nov. 30, 1998), and securities, banking and other regulators and industry groups issued guidance relating to the use of electronic media. See, e.g., Interagency Guidance (Apr. 23, 2003); SEC Release No. 33-7856 (Apr. 28, 2000) (Use of Electronic Media).

B) Regulatory and trade association focus on Internet-related compliance and regulatory issues is reflected in, e.g., Securities Law Daily, Apr. 1, 2016 (Massachusetts's secretary of state announcing plans to evaluate "robo adviser" registrations on a case-by-case basis over concerns that such advisers may be inherently unable to act as fiduciaries and perform the functions of state-registered investment advisors); Trading in the 21st Century: An Investor Perspective (Managed Funds Association, Oct. 2015); Online Trading Investor Protections Have Improved but Continued Attention Is Needed (GAO, July 2001) (privacy, trade execution, margin risk, trading risk, operations capability, suitability and enforcement); Examinations of Broker-dealers Offering Online Trading: Summary of Findings and Recommendations (OCIE, Jan. 25, 2001).

(iv) Innovative uses of the Internet in the securities context include:

A) Offshore Securities Transactions and Services: SEC Release No. 33-7516 (Mar. 23, 1998) (the "SEC Offshore Website Release") addresses the application of securities law registration requirements to Internet dissemination of offering materials for offshore sales of securities and investment services. The SEC stated that the principles in such Release apply only to websites, and not to other "more targeted" communication methods -- e.g., e-mailing and mass e-mailing ("spamming"). See generally, e.g., LiquidityHub (avail. Nov. 28, 2007) (permitting London-based electronic messaging system to enable institutional investors to access an aggregated pricing stream in fixed income products provided by, and negotiate transactions with, U.S. and non-U.S. broker-dealers, provided that any transactions are effected by a U.S. broker-dealer in accordance with Rule 15a-6(a)(3)); Swiss American Letter (permitting broker-dealer to make website services available to foreign financial institutions in exchange for their agreement to route U.S. securities orders to broker-dealer for execution, where broker-dealer would pay a non-broker-dealer affiliate to develop, customize and host the websites); Report on Securities Activity on the Internet II (IOSCO, June 2001), and Securities Activity on the Internet (IOSCO, Sept. 1998); SEC Release No. 34-39779 (Mar. 23, 1998), as clarified, Merrill Lynch (avail. Jan. 13, 1999) (broker-dealer soliciting business through website cannot rely on Rule 15a-6 unsolicited transaction exemption); LIFFE (avail. July 23, 1998) (electronic trading and order matching system). See also Part XI below.

B) Trading System Letters: A number of such Letters address proposals with respect to computerized proprietary trading systems as well as issuer-based "off the grid" trading systems. See also, e.g., Flamemaster (avail. Oct. 29, 1996) (SEC "no longer will respond to requests for no-action assurance with respect to [issuer-based] systems that are established and maintained in a substantially similar manner, unless they present novel or unusual issues"); PerfectData (avail. Aug. 5, 1996); Real Goods Trading (avail. June 24, 1996).

C) Online Communications Systems: See, e.g., Investment Archive (avail. May 14, 2010) (website that provides calculation of cost-basis of securities need not register as a broker-dealer if it does not advise on, or solicit, securities transactions, participate in negotiations, assist in clearing transactions, or handle funds or securities); Swiss

American Letter (broker-dealer permitted to pay affiliated website services company flat fee and per order service fee without affiliate having to register as a broker-dealer); InvestScape (avail. May 21, 1997) (broker-dealer arrangements with unaffiliated financial research centers which would install communications links between such centers and InvestScape and be compensated by InvestScape with a flat fee per customer use; neither financial centers nor their employees would be required to register as broker-dealers); Schwab (avail. Nov. 27, 1996) (to similar effect as Swiss American Letter). See also, e.g., Evare (avail. Nov. 30, 1998); Trade Point of America (avail. Feb. 18, 1998); Plummer & Plummer (avail. Sept. 7, 1996). See generally Part I.C.1.c.iii.B above.

D) Venture Capital for Small Businesses -- Matching Systems for Entrepreneurs and Investors: See, e.g., AngelList (avail. Mar. 28, 2013) (no-action relief from broker-dealer registration for web-based platform for accredited investors to invest in portfolio companies through investment vehicles formed by AngelList; staff highlighted that AngelList Advisors would be registered as an investment adviser, that the platform would be available only to accredited investors, that investments would be offered and sold pursuant to Rule 506 of Regulation D, that AngelList would not receive transaction-based compensation, that compensation and conflicts of interest would be disclosed and that AngelList would not handle customer funds or securities or solicit investors (other than from the website itself)); FundersClub (avail. Mar. 26, 2013) (no-action relief from broker-dealer registration for venture capital fund adviser and parent corporation with respect to web portal for accredited investors to invest in venture capital funds; staff highlighted that the adviser would be exempt from registration as an investment adviser, that the parent and the adviser would not receive transaction-based compensation, that compensation would be disclosed and that the parent and the adviser would not handle investor funds or securities); Angel Capital Electronic Network (ACE-Net) (avail. Oct. 25, 1996) (Internet listing service that provides information to "angel" accredited investors on small businesses seeking equity financing; ACE-Net is not a matching service and does not serve as an adviser or broker-dealer). See also, e.g., Arizona Capital Network (avail. Apr. 21, 1998); Colorado Capital Alliance (avail. May 4, 1995); Texas Capital Network (avail. Feb. 23, 1994). Compare, e.g., Spring Street Brewing Co. (avail. Apr. 17, 1996) (Wit-Trade, an electronic bulletin board for trading shares of Spring Street, would not negotiate, cross or facilitate the execution of bids and offers; concerns were raised that investors' funds and securities be handled appropriately, that investors understand the risks of purchasing illiquid and speculative securities, that buyers be made aware of last sale prices and that investors be provided with ongoing disclosure about Spring Street).

E) Public Securities Offerings: Issuers use the Internet to assist in the public offering process -- including in connection with IPOs, roadshows, stock purchase plans, and offerings of securities in connection with employee benefit packages -- and online brokers made inroads into IPO underwriting. See, e.g., Wall St. J., Aug. 29, 2013 (Loyal 3 internet broker specializes in providing IPO stocks to small investors commission-free); NetRoadshow (avail. Jan. 29, 2013) (transmission of electronic roadshows for municipal securities offerings to retail investors); Roadshow Broadcast (avail. May 6, 2011) (transmission of pre-recorded public offering road shows on behalf of underwriters); e-Media (avail. Dec. 14, 2000) (transmission of live public offering road shows on behalf of underwriters); Bear Stearns (avail. July 20, 2000) (offering of debt securities by

Dutch auction internet syndication system); Wit Capital (avail. July 20, 2000, July 14, 1999) (offering of equity securities and online IPO distribution); W.R. Hambrecht & Co. (avail. July 12, 2000) (Internet auction of debt securities); Schwab (avail. Feb. 9, 2000, Nov. 15, 1999) (Internet road shows); Activate.net (avail. Sept. 21, 1999) (same); StockPower (avail. Nov. 3, 1998) (access to dividend reinvestment plan prospectuses; order placement); Thomson Financial Services (avail. Sept. 4, 1998) (Internet road shows); Net Roadshow (avail. Jan. 30, 1998, Sept. 8, 1997) (same); Internet Capital (avail. Jan. 13, 1998, Dec. 24, 22, 18, 1997) (Internet bulletin board for prospectus-posting not required to register as a broker-dealer or investment adviser (but no view expressed as to whether Internet Capital would be a 1933 Act "underwriter")); Bloomberg LP (avail. Dec. 1, 1997) (Internet road shows); Private Financial Network (avail. Mar. 12, 1997) (same).

F) IntraLinks/IntraLoan and Related Systems: Internet-based systems used by JPMorgan, Bank of America and others to facilitate the transfer of loan syndication information from agent banks to borrowers. See, e.g., American Banker, Feb. 24, 1998, Sept. 8, 1997; Private Placement Letter, Aug. 18, 1997.

G) Private Securities/CP Offerings: See, e.g., Citizen VC Inc. (avail. Aug. 6, 2015) (prospective investors access to offering materials related to unregistered interests in SPVs on a password-protected website does not constitute general solicitation or advertising within the meaning of Rule 502(c) of Regulation D); Prescient Market (avail. Apr. 2, 2001) (broker-dealer registration not required for Internet-based CP electronic execution platform); Net Roadshow (avail. Jan. 30, 1998) (Internet transmission of Rule 144A road show materials); Lamp Technologies (avail. May 29, 1997) (Internet access to information about private securities offerings). But see SEC Release No. 34-42728 (Apr. 28, 2000) (noting that the activities of a website operator described in Lamp Technologies may require the operator to register as a broker-dealer). See also Part VI.C.1 above.

H) Mutual Fund Information: See, e.g., How Mutual Fund Shareholders Use the Internet (ICI, July 2000); Munder Capital Management (avail. May 17, 1996) (Internet website with fund purchase and sale information).

I) Electronic Messaging and Satisfaction of Confirmation and Document Requirements: See, e.g., Bloomberg L.P. (avail. Nov. 24, 2015); MarketAxess Corp. (avail. Jan. 26, 2015); Omgeo (avail. Nov. 19, 2010, Mar. 12, 2008); SWIFT (avail. May 27, 2010); TradeWeb (avail. July 22, 2003); Brown & Wood (avail. Feb. 17, 1995); Thomson Financial Services (avail. Oct. 8, 1993).

J) Consumer Stock Ownership Program: See, e.g., Stockback.com (avail. July 28, 2000), discussed above in Part IX.B.1.c.ix.F.

K) Broker-dealer Support: See, e.g., S3 Matching Letter; Loffa Interactive (avail. Sept. 26, 2003) (broker-dealer registration not required for communications services designed to facilitate broker-dealer compliance with 1934 Act margin rules); Swiss American Letter (broker-dealer registration not required for websites permitting order delivery and communications between broker-dealer and its customers); Broker-to-Broker Networks (avail. Dec. 1, 2000) (broker-dealer registration not required for order delivery and messaging system enabling broker-dealers to communicate with each other and with settlement agents).

L) Investment Adviser Registration: SEC Release No. IA-2091 (Dec. 12, 2002) permitted an investment adviser that conducts "substantially all" of its advisory business through an interactive website to register with the SEC (instead of with state authorities). See Part VIII.C.2.d above.

M) Shareholder Communications: See, e.g., Swingvote (avail. July 15, 2005) ("passive communications hub" may offer proxy dissemination and vote processing services to broker-dealers/banks in respect of institutional clients).

(v) The SEC denied relief from broker-dealer registration where the services offered by Internet-based systems are functionally similar to those offered by broker-dealers. See, e.g., BondGlobe (avail. Feb. 6, 2001) (Internet-based order routing and matching system); BD Advantage (avail. Oct. 11, 2000) (service whereby introducing broker customers are referred to clearing brokers).

See also Part VII.C.7 above.

(vi) Increased use of the Internet as a means for broker-dealers to communicate with their customers prompted the NASD to issue guidance regarding the application of its "suitability" rule in the electronic environment. FINRA has since issued guidance regarding the review and supervision of electronic communications and the use of social media websites and personal devices for business communications. See NASD Notice to Members No. 01-23 (Apr. 2001) (Policy Statement for determining whether a communication constitutes a "recommendation" (e.g., by analysis of content, context and presentation)); FINRA Regulatory Notice 07-59 (Dec. 2007) (use of risk-based principles to review incoming, outgoing and internal electronic communications); FINRA Regulatory Notice 10-06 (Jan. 2010) (blogs and social networking websites); FINRA Regulatory Notice 11-39 (Aug. 2011) (personal devices and social networking websites).

b. Banks use the Internet as a supplementary channel for delivering traditional products to consumers.

(i) Selected Board precedents include Deutsche Bank-Intersec Approval; Tradepoint Order; RBC, 83 Fed. Res. Bull. 135 (1997) ("Integrion Order") (acquisition by three banking organizations of more than 5% of the voting interests in Integrion, a joint venture electronic gateway for financial services); Toronto Dominion, 83 Fed. Res. Bull. 335 (1997) (the "TD Marketware Order"); Cardinal Bancshares/Huntington Bankshares, 82 Fed. Res. Bull. 674 (1996) (data processing activities related to providing banking and financial services over the Internet).

(ii) The Comptroller published a framework to improve the Comptroller's ability to understand trends and innovations in financial services. See Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective (OCC, Mar. 2016). See also ABA Comment Letter, May 31, 2016.

Published in 2002, the Comptroller Electronic Activities Release (A) codifies letters approving the use of finder powers to engage in activities made possible by technological developments (see Part VII.C.4 above); (B) sets forth factors for determining whether an electronic activity is part of the business of banking; (C) clarifies that a bank may market and sell excess capacity acquired or developed for banking business; (D) codifies letters permitting banks to act as a digital signature certification authority; (E) codifies interpretations that permit banks to collect, process and store data for themselves and their customers; (F) clarifies that a bank will not be "located" in a state simply because it maintains technology there or because customers access products and services from there; and (G) requires that a bank that shares websites with another entity distinguish between products and services offered by the bank and those offered by the other entity.

(iii) Selected additional Comptroller precedents include Letters No. 889; No. 778; No. 754; Comptroller Integrion Approvals; Comptroller Interpretive Letters No. 742 (Aug. 19, 1996), CCH Fed. Banking L. Rep. ¶ 81-106 (Internet-related and home banking services); No. 611 (Nov. 23, 1992), CCH Fed. Banking L. Rep. ¶ 83,449 (permission to use "smart phone" that allows a bank customer to conduct transactions and access information, including with respect to investments and stock market transactions); Comptroller Interpretive Letter No. 516 (July 12, 1990) ("Letter No. 516")), CCH Fed. Banking L. Rep. ¶ 82-220.

(iv) The Interagency Statement on Branch Names was developed to prevent customer confusion when a bank operates its offices, branches or other outlets, including on the Internet, under a trade name. See FDIC Advisory Opinion No. 99-4 (Apr. 15, 1999), CCH Fed. Banking L. Rep. ¶ 82-238.

c. With respect to cybersecurity and related issues:

(i) On February 12, 2013, the President issued Executive Order 13636, "Improving Critical Infrastructure Cybersecurity" calling for the development of a voluntary risk-based Cybersecurity Framework that, through collaboration between government and the private sector, can serve as a set of principles and practices for managing cybersecurity risk. The National Institute of Standards and Technology issued Version 1.0 of a "Framework for Improving Critical Infrastructure Cybersecurity" on February 12, 2014 as a "living document" to assist government and industry in identifying and protecting critical systems and detecting, responding to and recovering from cybersecurity events. See also American Banker, Oct. 8, 2014. Cybersecurity remains a focus of the White House, with the President appointing a former national security advisor to chair a special commission to develop long-term cybersecurity strategy, increasing funding to bolster private and public cybersecurity defenses and creating a new chief information security officer position for the government. See American Banker, Feb. 19, Feb. 10, 2016. The President began implementation of the Cybersecurity National Action Plan, which includes establishing a commission to make recommendations to strengthen cybersecurity, modernize government IT, and encourage citizens to take additional steps to secure their online accounts. See Fact Sheet: Cybersecurity National Action Plan (White House, Feb. 9, 2016); Presidential Policy Directive PPD-41 (July 26, 2016) (United States Cyber Incident Coordination). In addition, the President signed into law the Cybersecurity Act of 2015, which permits cyber threat information sharing between the government and the private sector. See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Div. N, Title I (2015). See also Federal Cybersecurity Workforce Strategy (OMB, July 12, 2016).

(ii) FINRA provided guidance to firms on cybersecurity practices based, in part, on its 2014 examinations of firms. See Report on Cybersecurity Practices (FINRA, Feb. 2015). FINRA examiners are focusing on broker-dealers' approaches to cybersecurity risk management, including governance structures, processes for conducting risk assessments and forms of electronic data storage. See IA Watch (Feb. 19, 2015). Recent FINRA cybersecurity enforcement actions include Sterne, Agee & Leach, Inc., FINRA Letter of Acceptance, Waiver and Consent No. 2014041619501 (May 22, 2015) (failure to encrypt laptops thereby placing customer information at risk); OptionsXpress, FINRA Letter of Acceptance, Waiver and Consent No. 201203190001 (Mar. 17, 2015) (inadequate policies to prevent unauthorized transfers of customer funds); Morgan Keegan & Co., FINRA Letter of Acceptance, Waiver and Consent No. 2010022554701 (Apr. 9, 2012) (failure to adequately maintain safeguards to detect and report breaches of customer information).

(iii) The SEC elevated OCIE's lead coordinator of cybersecurity efforts to be the senior cybersecurity policy advisor to Chair White; this policy advisor will lead cybersecurity initiatives within the SEC, including assessment of market-wide risk. See SEC Release 2016-103 (June 2, 2016). The SEC Division of Investment Management issued guidance to funds and advisers on measures to manage cybersecurity risks, including periodic self-assessments and adopting written policies, procedures and training programs. See IM Guidance Update No. 2015-02 (SEC, Apr. 2015). OCIE has also put cybersecurity high on its examination agenda, including conducting an examination sweep in 2015 and 2016, focusing on, among other areas, customer account protection. See IA Watch, June 7, 2016; Financial Planning, Apr. 20, 2016; National Exam Program Risk Alert: OCIE's 2015 Cybersecurity Examination Initiative (SEC, Sept. 15, 2015).

Recent SEC enforcement actions focused on cybersecurity include Morgan Stanley Smith Barney, SEC Admin. Proc. No. 3-17280 (June 8, 2016) (failure to protect customer information from hackers); Marsh, SEC Admin. Proc. No. 3-17279 (June 8, 2016) (unauthorized access to confidential customer information); R.T. Jones Capital Equities Management, Inc., SEC Admin. Proc. No. 3-16827 (Sept. 22, 2015) (failure to establish cybersecurity policies and procedures in advance of a breach that comprised the personally identifiable information of 100,000 investors); SEC v. Dubovoy and U.S. v. Korchevsky, SEC Litigation Release No. 23610 (Aug. 4, 2016) (describing court cases, administrative actions and guilty pleas in relation to investigations into hacking of newswires to obtain and trade on nonpublic information). See also SEC Investor Alert (Sept. 22, 2015) (advising investors of actions they can take if their financial information is comprised).

(iv) The CFTC proposed enhanced rules requiring all DCOs, DCMs, SEFs, and swap data repositories to conduct

(1) vulnerability testing, (2) penetration testing, (3) controls testing, (4) security incident response plan testing, and (5) enterprise technology risk assessments. See 80 Fed. Reg. 80114, 80140 (Dec. 23, 2015) (proposed rule). See also CFTC Staff Advisory No. 14-21, CCH Comm. Fut. L. Rep. ¶ 32,980 (Feb. 26, 2014). The CFTC has also pursued cybersecurity related enforcement actions. See, e.g., In re Interbank FX, LLC, CFTC Docket No. 09-11 (June 29, 2009) (failure to adopt cybersecurity policies and procedures to protect customer records).

(v) The NFA required FCMs, swap dealers and other NFA members to adopt and enforce written information system security programs to protect against cyber attack. See NFA's Interpretive Notice to NFA Compliance Rules 2-9, 2-36 and 2-49 entitled Information Systems Security Programs (Mar. 1, 2016).

(vi) In light of recent cyber attacks, the FFIEC reminded financial institutions to actively manage risks associated with interbank messaging and wholesale payment networks. See Joint Statement on Cybersecurity of Interbank Messaging and Wholesale Payment Networks (FFIEC, June 7, 2016). The FFIEC has continued to update its FFIEC IT Examination Handbook, increasing its focus on cybersecurity risks. See FFIEC Press Release, Sept. 9, 2016 (Information Security section of Handbook); Appendix E, Retail Payment Systems, FFIEC IT Examination Handbook (Apr. 2016); OCC Bulletin No. 2016-14 (Apr. 29, 2016); FFIEC IT Examination Handbook (Nov. 2015). See also Joint Statement on Cyber Attacks Involving Extortion (FFIEC, Nov. 3, 2015). The FFIEC issued an overview of its cybersecurity priorities, including developing a self-assessment tool; enhancing processes, protocols and information-gathering and use in responding to cyber incidents; developing training programs for members; updating its information technology examination handbook and collaborating with law enforcement and intelligence agencies. FFIEC Press Release, Mar. 17,

2015. See also FFIEC IT Examination Handbook; FFIEC Press Release, June 30, 2015 (announcing the release of cybersecurity assessment tool); FFIEC Cybersecurity Assessment Tool (June 2015); FFIEC Press Release, June 6, 2013 (Formation of Cyber Security and Critical Infrastructure Working Group). Banks are also becoming increasingly focused on securing their networks against cyber-attacks and have created information sharing for a (including the Financial Services Information Sharing and Analysis Center) as well as a cyber-attack alert system with DTC. Financial Times, July 28, 2015. See also Securities Law Daily, June 22, 2015.

(vii) The FDIC published a framework for cybersecurity, outlining cyber risks to financial institutions, specifically, corporate governance, threat intelligence and security awareness training. See Supervisory Insights (FDIC, Winter 2015). See also FDIC FIL-43-2016 (June 30, 2016) (instituting the Information Technology Risk Examination Program); FDIC FIL-55-2015 (Nov. 23, 2015), CCH Fed. Banking L. Rep. ¶ 154-072. With regard to the FDIC's own controls over its systems, see Information Security: FDIC Implemented Controls over Financial Systems, but Further Improvements are Needed (GAO, June 2016).

(viii) The NYDFS proposed cybersecurity regulations requiring covered institutions to implement and maintain written cybersecurity policies and procedures that address cybersecurity, including business continuity, network security and customer data privacy. See NYDFS Press Release, Sept. 13, 2016; Potential New NYDFS Cyber Security Regulation Requirements (NYDFS, Nov. 9, 2015). The NYDFS also adopted cybersecurity regulations applicable to virtual currency business activities. See NYDFS, New York Codes, Rules and Regulations, Part 200 (June 3, 2015). The NYDFS has significantly weighted its examination focus toward cybersecurity efforts of banks. See, e.g., Update on Cyber Security in the Banking Sector: Third Party

Service Providers (NYDFS, Apr. 2015); NYDFS Letter, Mar. 26, 2015 (expanding examination framework to cover cybersecurity and requesting filing of report on IT and cybersecurity policies, procedures and efforts); Report on Cyber Security in the Insurance Sector (NYDFS, Feb. 2015); Report on Cyber Security in the Banking Sector (NYDFS, May 2014); NYDFS Letter, Dec. 10, 2014 (new cybersecurity examination process); NYDFS Letter, Oct. 21, 2014 (information request re: managing cybersecurity in third party relationships).

(ix) The NAIC also issued a set of principles to aid insurance regulators to establish uniform cybersecurity standards within the insurance industry. See Principles for Effective Cybersecurity Insurance Regulatory Guidance (NAIC, April 17, 2015).

(x) U.S. Attorney General Lynch outlined steps taken by the DOJ to prosecute cyber crimes, including coordinating with the EU's cybercrime coordinating body and establishing a framework that permits UK authorities to access electronic communications directly from American companies where the investigation targets accounts not used by U.S. citizens or people within the U.S. See Remarks by U.S. Attorney General Lynch, Mar. 1, 2015. In November 2015, the DOJ announced charges against hackers for organizing computer hacking crimes against U.S. financial institutions, brokerage firms, and financial news publishers, including theft of customer data. DOJ Press Release, Nov. 10, 2015. In the wake of an increase in the number of significant data breaches, the DOJ urged financial companies to report data breaches to law enforcement agencies in order to promote measures to prevent breaches. Securities Law Daily, May 19, 2015. The White House and the DOJ have also identified hedge funds as being particularly at risk of cyber-attack, possibly exposing significant portions of the financial system. Financial Times, May 10, 2015. See also Bloomberg Brief Special Edition, Cybersecurity: The New Threat Landscape (Apr. 21, 2015).

(xi) The U.S. Treasury Office of Inspector General published an audit report concluding that the U.S. Treasury fulfilled its cybersecurity requirements in relation to critical infrastructure. See Cyber Security: Department of the Treasury's Activities to Protect Critical Infrastructure in the Financial Services Sector (Treasury OIG, Apr. 28, 2016). See also Treasury Press Release, July 19, 2016 (update on meetings of the federal-state Financial and Banking Information Infrastructure Committee).

(xii) The CFPB took enforcement action against an online payment platform for deceiving customers about its data security practices and the safety of its online payment system. See Dwolla CFPB Admin. Proc. No. 2016-CFPB-0007 (Feb. 27, 2016).

(xiii) There have been several international developments on cybersecurity issues. The European Parliament approved EU-wide cybersecurity rules (the "NIS Directive") that would require financial firms to bolster their systems to be strong enough to resist cyber attacks. See Directive (EU) 2016/1148 (July 6, 2016). The European Banking Federation ("EBF"), the Global Financial Markets Association ("GFMA"), and ISDA published a paper on cybersecurity, data and technology outlining considerations when a nation or agency creates laws, regulations or standards that affect the technology infrastructure of financial services firms operating globally. See International Cybersecurity, Data and Technology Principles (EBF/GFMA/ISDA, May 9, 2016). See also Cyber Security in Securities Markets – An International Perspective (IOSCO, Apr. 6, 2016); Guidance on Cyber Resilience for Financial Market Infrastructures (CPMI/IOSCO, June 2016).

(xiv) Other cybersecurity developments emerged after major security breaches. In 2016, hackers successfully stole $81 million from the central bank of Bangladesh and another unidentified bank by attacking the banks' connection to the SWIFT network. See NY Times, May 12, 2016. See also Board/OCC/FDIC Letter to Rep. Maloney, Aug. 17, 2016; Joint Statement: FRBNY, Bangladesh Bank and SWIFT (May 10, 2016); FRBNY Letter to Rep. Maloney, Apr. 14, 2016. A consortium of financial service groups released recommendations on risk mitigation to prevent cyber attacks involving SWIFT. See Security of Payment Network Access Points (Financial Services Information Sharing and Analysis Center, July 1, 2016). See also Reuters, Sept. 15, 2016 (reporting on new BIS task force to set cyber security standards for inter-bank transfers).

d. With respect to identity theft, consumer fraud and related issues:

(i) Identity theft and fraud complaints exceeded 2.5 million in 2013. See, e.g., Consumer Sentinel Network Data Book (FTC, Feb. 2015).

The Board, OCC, FDIC, OTS, NCUA and FTC jointly adopted rules implementing sections of the FACT Act relating to identity theft red flags (the "Red Flags Rules"). See 74 Fed. Reg. 22639 (May 14, 2009); 72 Fed. Reg. 63717 (Nov. 9, 2007). Under Dodd-Frank § 1088, authority over parts of the FACT Act that pertain to certain financial institutions was transferred to the CFTC and the SEC from the FTC. Pursuant to the Dodd-Frank Act, the CFTC and SEC jointly issued rules substantially similar to the Red Flags Rules. See 78 Fed. Reg. 23638 (Apr. 19, 2013).

The Red Flags Rules require financial institutions and "creditors" that offer or maintain certain covered accounts to have policies and procedures to identify signs of possible identity theft and to respond appropriately. See also Identity Theft Red Flags Rules: A Small Entity Compliance Guide (SEC, May 17, 2013); Fighting Identity Theft with the Red Flags Rule: A How-To Guide for Business (FTC, May 2013); Joint Agency Release, June 11, 2009 (FAQ on Red Flags Rules); Joint FTC/DOJ Press Release, Oct. 21, 2008 (31 recommendations).

(ii) The FTC had taken the position that the definition of "creditor" covered all entities that permit deferred payments for goods or services, including professionals, merchants or service providers that regularly provide a product or service for which the consumer pays after delivery. Congress subsequently amended the definition of "creditor" to exempt a creditor that "advances funds on behalf of a person for expenses incidental to a service provided by the creditor to that person." See Red Flag Program Clarification Act, Pub. L. 111-319 (2010). See also ABA v. FTC, 636 F.3d 641 (D.C. Cir. 2011), vacated as moot ABA v. FTC, 671 F. Supp. 2d 64 (D.D.C. 2009) (which had applied the Red Flags Rules to attorneys). The FTC and the Board have narrowed the scope of creditors to whom the rules are applicable. 77 Fed. Reg. 72712 (Dec. 6, 2012); 79 Fed. Reg. 30709 (May 29, 2014).

(iii) Other precedents and guidance include, e.g., Identity Theft, Data Breaches and Your Investment Accounts (SEC Investor Alert, Sept. 22, 2015); Top Financial Services Cyber Security Trends for 2014 (Booz Allen, Dec. 2013); Corporation Finance Disclosure Guidance (SEC OCIE, Oct. 13, 2011) (cybersecurity); Cybercrime: Protecting Against the Growing Threat (PricewaterhouseCoopers, Nov. 2011); Identity Theft: Trends, Patterns and Typologies Based on [SARs] Filed by the Securities and Futures Industries January 1, 2005-December 31, 2010 (FinCEN, Sept. 2011); Identity Theft: Trends, Patterns and Typologies Based on [SARs] Filed by Depository Institutions January 1, 2003 – December 31, 2009 (FinCEN, Oct. 2010); The U.S. SAFE WEB Act [Undertaking Spam, Spyware and Fraud Enforcement with Enforcers Beyond Borders Act, Pub. L. 109-455 (2006)]: The First Three Years (FTC, Dec. 2009) (the "SAFE WEB Act 2009 Report"); President's Identity Theft Task Force Report (Sept. 2008); FDIC FIL-32-2007, (Apr. 11, 2007), CCH Fed. Banking L. Rep. ¶ 67-726 (supervisory policy); FDIC FIL-64-2005 (July 18, 2005), CCH Fed. Banking L. Rep. ¶ 60-648 (guidance on "pharming", the process of redirecting Internet domain name requests to false websites to collect personal information used to commit fraud and identity theft); FDIC FIL-39-2001 (May 9, 2001), CCH Fed. Banking L. Rep. ¶ 67-724; Board Supervisory Release SR 01-11 (SUP) (Apr. 26, 2001), CCH Fed. Banking L. Rep.¶ 67-721; CFTC News Release No. 4442-00 (Sept. 7, 2000) (enforcement actions).

See also, e.g., Insights, May 29, 2014 (cybersecurity issues); American Banker, Feb. 1, 2012 (Bank of America anti-"phishing" initiatives); U.S. v. Lucas, No. CR-09-01005 (C.D. Cal., sentencing June 24, 27, 2011) (leader of international "phishing" scheme against U.S. banks); SEC v. Ampudia, SEC Litigation Releases No. 21071 (June 8, 2009) (judgment), No. 20071 (Apr. 6, 2007) (prices of thinly traded stocks manipulated upward by purchases in brokerage accounts opened in the name of identity theft victims); U.S. v. Tran, No. CR-08-00584 (C.D.Cal., filed May 15, 2008) (cross-border Internet-based "phishing" scam) (judgments: June 9, 18, 19, 2009, Oct. 11, 2011); SEC v. McKnight, SEC Litigation Release No. 20563 (May 8, 2008) (asset freeze against alleged perpetrators of international Internet fraud scheme); SEC v. FairPax.com, SEC Litigation Release No. 19431 (Oct. 18, 2005) (fraudulent website that impersonated a mutual fund complex); SEC v. E-Biz Ventures, SEC Litigation Release No. 18722 (May 21, 2004) (Internet Ponzi scheme); SEC v. SG Limited, SEC Litigation Release No. 18181 (June 9, 2003) (settlement with "virtual stock exchange" for violations of securities laws in connection with the sale of "virtual shares" in "virtual companies"); SEC v. St. Heart, SEC Litigation Release No. 16947 (Mar. 29, 2001) (judgment, Apr. 4, 2001) ("cyber smear" posting of false messages on Internet bulletin board); SEC News Digest, Feb. 25, 1997 (settlement with publisher of Internet and print stock newsletters for false statements, and failure to disclose payment from issuers for recommending their securities); SEC Website (SEC Enforcement Complaint Center on the Internet); Banking Report, June 17, 1996 (SEC

Commissioner Wallman concerns about insider use of Internet "chat rooms" to manipulate markets).

See also Part I.C.5 above for related privacy issues.

G. PAYMENT, CLEARING AND SETTLEMENT SUPERVISION ACT

1. Overview

Dodd-Frank Title VIII -- the Payment, Clearing and Settlement Supervision Act -- provides for increased regulation of FMUs and payment, clearing and settlement ("PCS") activities that the FSOC determines are, or are likely to become, systemically important. In particular, Dodd-Frank §§ 805(a)(1)(A) and 806(e) require the Board to promulgate risk-management and operational standards related to the PCS activities of systemically important FMUs. See also U.S. Regulatory Authority over Payment, Clearing and Settlement Systems (FRBC, Sept. 13, 2011); Part I.B.8 above.

a. An "FMU" includes any person that manages or operates a multilateral system for the purpose of transferring, clearing or settling payments, securities or other financial transactions among or between financial institutions and other persons.

b. A "PCS activity" includes an activity carried out by one or more financial institutions to facilitate the completion of financial transactions.

c. A "financial transaction" includes funds transfers, securities contracts, contracts of sale of a commodity for future delivery, forward contracts, repos, swaps, SBS, swap agreements, SBS agreements, FX contracts, financial derivatives contracts, and any similar transaction that the FSOC determines to be a financial transaction.

2. Standards for Designation of Financial Market Utilities and PCS Activities as Systemically Important

In determining whether to designate an FMU or PCS activity as systemically important, the FSOC is to consider:

a. The aggregate value of transactions processed by the FMU or carried out through the PCS activity.

b. The aggregate exposure of the FMU or a financial institution engaged in PCS activities to its counterparties.

c. The relationship, interdependencies or other interactions of the FMU or PCS activity with other FMUs or PCS activities.

d. The effect that the failure of or a disruption to the FMU or PCS activity would have on critical markets, financial institutions or the broader financial system.

e. Any other factors the FSOC deems appropriate.

The FSOC adopted 12 C.F.R. Part 1320 to outline the process by which it will determine whether an FMU is systemically important. See 76 Fed. Reg. 44763 (July 27, 2011).

In 2012, the FSOC designated eight systemically important FMUs: The Clearing House Payments Company, CLS Bank International, the Chicago Mercantile Exchange, Depository Trust Company, Fixed Income Clearing Corporation ("FICC"), ICE Clear Credit, NSCC and the Options Clearing Corporation. See Treasury Press Release, July 18, 2012.

3. Risk Management Standards for Systemically Important Financial Market Utilities and PCS Activities

   a. In 2012, the Board adopted Regulation HH ("Regulation HH"), establishing risk-management standards for systemically important FMUs. See 77 Fed. Reg. 45919 (Aug. 2, 2012) (codified at 12 C.F.R. Part. 234). See also Board's Policy on Payment System Risk (as amended effective Dec. 31, 2014).

      (i) The Board adopted revisions to Regulation HH's risk management standards based on Principles for Financial Market Infrastructures published by the Committee on Payments and Market Infrastructure (the "CPMI" formerly known as the Committee on Payment and

Settlement Systems) and IOSCO (the "PFMIs") (see Part IX.G.4 below). See 79 Fed. Reg. 65543 (Nov. 5, 2014).

(ii) The Board adopted amendments to Regulation HH setting forth conditions and requirements for Federal Reserve Banks to establish and maintain accounts for, and provide services to, FMUs. See 78 Fed. Reg. 76973 (Dec. 20, 2013).

(iii) Regulation HH does not cover entities registered with the SEC as clearing agencies or registered with the CFTC as derivative clearing organizations ("DCOs"). The SEC/CFTC may set standards for those entities for which they are the appropriate regulatory agency, but the Board may challenge those standards if it believes that they are insufficient. The FSOC may require the SEC or CFTC to prescribe such standards as the FSOC determines are necessary. See also Risk Management Supervision of Designated Clearing Entities (Board/SEC/CFTC, July 2011).

b. In 2016, the Board adopted a rating system for designated FMUs under their supervision designed to link supervisory assessments to risk management standards, including Regulation HH and the Board's Policy on Payment System Risk. The rating system, referred to as ("ORSOM"), will measure FMUs across five categories: organization; risk management; settlement; operational risk and information technology; and market support, access, and transparency. See 81 Fed. Reg. 58932 (Aug. 26, 2016).

c. The SEC adopted 1934 Act Rule 17Ad-22, which prescribes minimum risk management practices and operational standards applicable to all clearing agencies under its jurisdiction, some of which may include designated FMUs. The standards are also based in part on the PFMIs (see Part IX.G.4 below). The SEC has proposed Rule 17Ad-22(e), which would establish requirements for risk management, operations and governance of clearing agencies that are "covered clearing agencies", including those designated as systemically important by the FSOC and certain other clearing agencies that have "more complex risk profiles". See 79 Fed. Reg. 29508 (May 22, 2014) (proposed).

(i) In February 2016, the SEC affirmed its prior approval of the Options Clearing Corporation's capital plan, first proposed in 2015, which is intended to facilitate compliance with the SEC's proposed rules and the PFMIs. See SEC Release No. 34-77041 (Feb. 3, 2016). The capital plan requires options exchanges that are stockholders of The Options Clearing Corporation to make additional capital contributions and to commit to replenish capital in certain circumstances. See SEC Release No. 34-74136 (Jan. 26, 2015) (soliciting comments). The SEC issued a no-objection notice to the capital plan and an approval of various by-law and rule changes necessary to effect the capital plan, as being "consistent with the objectives and principles" of Dodd-Frank Title VIII. See SEC Releases No. 34-74387 (Feb. 26, 2015), No. 34-74452 (Mar. 6, 2015). Several stockholder options exchanges petitioned for review of the approvals, and the SEC granted their petition, but did not stay the approval. See SEC Releases Nos. 34-75885, 34-75886 (Sept. 10, 2015).

(ii) The SEC also adopted Regulation SCI, which applies to clearing agencies. See Part IX.F.1.f above. The SEC noted that it will separately consider a tailored framework for clearing agencies that provide post-trade processing services. See 77 Fed. Reg. 66220 (Nov. 2, 2012).

d. The CFTC has promulgated standards applicable to all DCOs under its jurisdiction. See 76 Fed. Reg. 69334 (Nov. 8, 2011). The CFTC has also promulgated enhanced risk management standards for so-called "systemically important" DCOs ("SIDCOs"). See 78 Fed. Reg. 49663 (Aug. 15, 2013). In addition, the CFTC has adopted additional standards to make its requirements for SIDCOs consistent with the PFMIs. See 78 Fed. Reg. 72476 (Dec. 2, 2013). In response to IOSCO publishing its Level 2 assessment reports, the CFTC issued a memorandum stating that its Part 39 regulations are consistent with the PFMIs. See CFTC Memorandum No. 15-50 (Sept. 18, 2015). See also CFTC Letter No. 16-61 (July 21, 2016) (guidance to DCOs on recovery plans and wind-down plans). Also, to facilitate SIDCOs' use of Federal Reserve Banks as depositories for customer funds, the CFTC proposed to exempt Federal Reserve Banks that provide customer accounts and other services to SIDCOs from liability under § 4d and 22 of the CEA. See 81 Fed. Reg. 35337 (June 2, 2016).

e. See generally Considerations for CCP Resolution (ISDA and TCH, May 2016); Central Counterparties: Recommendations to Promote Financial Stability and Resilience (TCH, Dec. 2012).

4. International Approaches to Regulation of Financial Market Utilities

a. In 2012, the CPMI and IOSCO issued the PFMIs. The PFMIs consolidate and modernize prior issuances by CPMI and IOSCO and set forth 24 key standards for the organization and operation of financial market infrastructures.

In 2013, the CPMI and IOSCO began monitoring implementation of the PFMIs. Implementation Monitoring of PFMIs – Level 1 Assessment Report (CPMI/IOSCO, Aug. 2013) indicates that most jurisdictions have started the process of implementing the PFMIs, based on the jurisdictions' self-assessments. Level 2 assessments have also begun, analyzing the completeness of implementation of the PFMIs and the consistency of such implementation with the PFMIs. See Implementation Monitoring of PFMIs – Third Update to Level 1 Assessment Report (CMPI/IOSCO, June 2016); Implementation Monitoring of PFMIs: Level 2 Assessment Report for Central Counterparties and Trade Repositories for Japan, the EU and the US (CPMI/IOSCO, Feb. 2015). In 2015, the CPMI and IOSCO also published an assessment and review of the application of the PFMIs, finding that a majority of jurisdictions achieved a high level of compliance to PFMIs. See Assessment and Review of Application of Responsibilities for Authorities (CPMI/IOSCO, Nov. 2015). Level 3 reviews examine consistency in outcomes of implementation of the PFMIs by CCPs and national regulators. See Implementation Monitoring of PFMI: Level 3 Assessment – Report on the Financial Risk Management and

Recovery Practices of 10 Derivatives CCPs (CPMI/IOSCO, Aug. 2016).

IOSCO, along with other market associations, established a joint study group to analyze interdependencies between CCPs and major clearing members, including any resulting systemic implications. See Progress Report on the CCP Workplan (IOSCO, Sept. 22, 2015). See also CCP Workplan (Apr. 15, 2015); Assessment Methodology for the Oversight Expectations Applicable to Critical Service Providers (CPMI/IOSCO, Dec. 2014).

b. As required by EMIR, ESMA conducted its first stress tests of CCPs and found that EU CCPs were resilient to the stress scenarios used to model extreme but plausible market developments. See EU-wide CCP Stress Test 2015 (ESMA, Apr. 29, 2016.)

Analysis of CCPs' ability to withstand stress continues more broadly at the international level. See Resilience and Recovery of CCPs: Further Guidance on the PFMI (CPMI/IOSCO, Aug. 2016); Essential Aspects of CCP Resolution Planning (FSB, Aug. 16, 2016); Progress Report on the CCP Workplan (BIS/CPMI/IOSCO/FSB, Aug. 16, 2016); Recovery of Financial Market Infrastructures (CPMI/IOSCO, Oct. 2014). See also Considerations for CCP Resolution (TCH/ISDA, May 2016).

X. ASSET SECURITIZATION ISSUES

A. BACKGROUND

1. Financial institutions securitize and sell assets to increase liquidity, earn fees, protect capital, promote asset diversification and spread risk. Banking organizations act as underwriters and issuers of ABS and are also significant investors in ABS. See, e.g., The Role of Banks in Asset Securitization (FRBNY Economic Policy Review, July 2012).

   Prior to the 2007-2009 credit crisis, offerings of ABS involving mortgage loans, home equity loans, manufactured housing loans, automobile, vehicle and boat loans and leases, credit card receivables and student loans were common.

   In addition to the more common underlying assets described above, the following types of assets have been used and/or proposed as underlying assets for ABS:

   a. Commercial and related loans, through loan pooling techniques, ABCP programs and mutual funds, including commercial mortgage loans, construction loans, small business loans, LDC loans, trade finance instruments, corporate leases and lease receivables and large single-asset commercial mortgages. See Part V above. See also, e.g., Board 2002 Small Business Loan Report; Board/SEC 2000 Small Business Loan Report; 64 Fed. Reg. 6503 (Feb. 10, 1999) (SBA rule regarding the financing and securitization of unguaranteed portion of SBA-guaranteed loans, 13 C.F.R. § 120.420). See generally Euromoney, Jan. 2015 (trade finance instruments); Asset Securitization Report, July 2014 (single-asset commercial mortgages); CNBC.com, Apr. 8, 2012 (trade finance instruments); Banking Daily, Aug. 24, 2010 (commercial real estate loans).

   b. "Life settlement" and "death rate" securitizations by insurance companies hedging against mortality risk. See, e.g., Statement of the ACLI Regarding Securitization of Life Settlements, Feb. 3, 2010.

   c. "Esoteric"/non-traditional assets. See, e.g., Sec. & Comm. Reg., Mar. 9, 2016 (intellectual property receivables, cell phone purchase contracts, music royalties, comic strip syndication payments, restaurant franchise fees, and others); Reuters, Jan. 30, 2013 (solar panel bonds); Asset Securitization Report, Oct. 2011.

2. Fueled by low interest rates and the resulting increase in lending, the U.S. market for securitized assets grew considerably in all market sectors through 2007, when ABS outstanding approximated $4.5 trillion. However, the global securitization market experienced a dramatic slowdown commencing in 2008. High default rates in the U.S. on "subprime" mortgage loans, many of which had been packaged and sold to investors as highly rated MBS, led to a rapid loss of confidence in the ratings and valuations of securitization products. As of June 30, 2016, U.S. dollar-denominated ABS outstanding amounted to approximately $1.4 trillion. SIFMA Research Quarterly, Second Quarter 2016. As of June 30, 2016, total MBS issuance totaled $455.7 billion, of which $428.9 billion were agency MBS. SIFMA Research Quarterly, Second Quarter 2016.

3. Attendant on the global credit crisis, U.S. federal programs -- including the TALF and other initiatives described in Part I.A.6 above -- were intended to facilitate the issuance of ABS and improve generally the market conditions for ABS.

   Industry efforts to support the ABS market included the SIFMA, ASF, European Securitisation Forum ("ESF") and Australian Securitisation Forum's Global Joint Initiative, Restoring Confidence in the Securitization Markets (Dec. 3, 2008), which prioritized areas of industry focus -- including (a) improved disclosure regarding underlying assets; (b) enhanced transparency with regard to underwriting and origination practices; (c) efforts to restore the credibility of credit rating agencies; and (d) improved confidence in valuations, methodologies and assumptions. See also Securitization: Lessons Learned and the Road Ahead (IMF, Nov. 2013); Securitization and the Mortgage Crisis (FCIC, Apr. 7, 2010); Study of the Impact of Securitization on Consumers, Investors, Financial Institutions and the Capital Markets (ASF, June 17, 2009).

4. Covered bonds, traditionally European, are an emerging U.S. asset class. These bonds are typically fixed-rate, "dual recourse" obligations (i.e., direct obligations of the issuer -- generally large banks -- which are backed by collateral on the issuer's balance sheet, such as commercial and residential mortgages). In contrast to ABS

(which typically amortize principal and interest during the life of a transaction), covered bonds typically pay a fixed coupon followed by a balloon principal payment at maturity. See, e.g., IFLR Covered Bonds Guide 2013, July 1, 2013; Asset Securitization Report, June 1, 2012, Dec. 6, 2010; Wall St. J., May 30, 2012; Banks Use of Covered Bond Funding on the Rise (Fitch Ratings, Mar. 10, 2011). See generally 2016 ECBL European Covered Bond Fact Book, 11th ed., (European Covered Bond Council, Aug. 2016) EBA Final Draft Regulatory Technical Standards (Sept. 30, 2013) (adopting regulation on covered bonds).

a. In response to the slowdown in ABS markets, Treasury, the Board and the FDIC began working together to encourage increased reliance on covered bonds in the U.S. market. The FDIC published a Statement of Policy providing that holders of covered bonds which meet certain criteria -- including the consent of the institution's primary federal regulator and a limitation to 4% of the institution's total liabilities -- may obtain access to a depository institution's collateral under certain circumstances. See 73 Fed. Reg. 43754 (July 28, 2008). See also, e.g., Best Practices for Residential Covered Bonds (Treasury, July 28, 2008). Additionally, the SEC has taken no-action positions allowing foreign banks to offer and sell covered bonds in the U.S. market on a registered basis under the Securities Act. See, e.g., Bank of Montreal (avail. July 3, 2013); BNS (avail. May 31, 2013); RBC (avail. May 18, 2012).

b. Covered bonds may attract additional interest from U.S. banks in light of Dodd-Frank's risk retention requirements (see Part X.B below). See, e.g., Global Securitization Update 2010 (SIFMA, July 18, 2011); Euromoney, May 4, 2011.

5. Foreign markets for securitized assets are also developing, and banking organizations have been in the forefront of international securitization and trading.

a. Benefiting from historically low interest rates and funding cost levels, the European securitization market grew considerably through 2008, when it approximated €700 billion. However, European securitizations experienced a significant decline during and after the financial crisis; total global European securitization issuances amounted to approximately 214 billion in 2015, down from €217 billion in 2014. See, e.g., AFME Securitisation Data Report Q1: 2016; Global Developments in Securitization Regulation (IOSCO, June 2012). See generally Ten Industry Initiatives to Increase Transparency in the European Securitization Markets (July 2, 2008). The European Union is considering "new regulations concerning securitizations." See, e.g., Proposal for a Regulation of the European Parliament and of the Council laying down common rules on securitisation and creating a European framework for a simple, transparent and standardised securitisation and amending [certain Directives], COM (2015) 472 final (Sept. 30, 2015); EBA Report on Qualifying Securitisation, European Banking Authority, July 2015.

b. Principles for Ongoing Disclosure for [ABS] (IOSCO, Nov. 27, 2012) sets out guidance with respect to the implementation of ongoing ABS disclosure regimes. See also Peer Review of Implementation of Incentive Alignment Recommendations for Securitization (IOSCO, Sept. 3, 2015); Criteria for Identifying Simple, Transparent and Comparable Securitizations (Basel/IOSCO, July 2015); Report on Asset Securitisation Incentives (Joint Forum, July 2011).

c. In 2014, French banks began experimenting with securitizing loans to small and medium-sized enterprises ("SMEs") as a means of reviving lending to the sector. See, e.g., Reuters, Apr. 11, 2014.

d. The Chinese securitization market has grown considerably after being shut down by the China Banking Regulatory Commission and the People's Bank of China during the 2008 credit crisis. Economic growth has led to increasing variety in securitizations as well, including auto loan securitizations driven by a steady increase in car ownership in China. Ford Automotive Finance (China), Toyota Motor Finance (China), BMW Automotive Finance (China), Volkswagen Finance (China) and Dangfeng Nissan Auto Finance all issued auto loan securitizations in China in 2014. Structured Finance News, Dec. 2014. By 2015, China had become Asia's largest securitization market, with issuance of $26.3 billion in the first eight months of 2015, of which $20.9 billion was CLO issuance. Wall St., J., Sept. 24, 2015. In 2016, the Bank of China made the first sale of bonds backed by bad loans in China since 2008. Bloomberg, May 19, 2016.

B. THE DODD-FRANK ACT AND RECENT DEVELOPMENTS

Although this Part X is not intended to address most issues with respect to the structure and implementation of securitization programs -- including the capital, insolvency, risk management, tax, accounting and other substantive issues which these programs implicate -- certain Dodd-Frank and SEC regulatory developments are worthy of special note in the context of bank/BHC/FHC consideration of active participation in securitization markets.

1. In August 2014, the SEC adopted a final ABS rule making significant revisions to Regulation AB and related rules governing the offering process, disclosure requirements and ongoing reporting requirements for ABS. See [ABS] Disclosure and Registration, SEC Release No. 33-9638 (Sept. 4, 2014) (final rule). In December 2014, the SEC also issued interpretive guidance in the form of Compliance and Disclosure Interpretations ("C&DIs"), which cover financial reporting, servicing and other topics, and replace the interpretations previously published in the Regulation AB Manual of Publicly Available Telephone Interpretations. Most of the interpretive provisions were either clarified or updated, including to reflect the change from the use of Form S-3 to Form SF-3. The SEC continues to update the C&DIs on an ongoing basis. See Regulation AB and Related Rules Compliance (SEC, Sept. 6, 2016).

   a. The final ABS rule requires loan-level disclosure for certain assets, including residential and commercial mortgages and automobile loans. For each asset, the rule requires disclosure (both at the offering and in ongoing reports) of data points related to:

      (i) The asset's payment stream (including contractual terms, scheduled payment amounts, etc.).

      (ii) The collateral (including geographic location, property valuation and loan-to-value ratio).

      (iii) The asset's performance over time.

(iv) The servicer's loss mitigation efforts to collect amounts past due.

(v) The extent to which the borrower's income and employment status have been verified.

(vi) Mortgage insurance coverage.

(vii) Lien position.

b. The rule addresses commenters' privacy concerns by omitting or modifying these asset-level disclosures for RMBS and securities backed by automobile loans and leases.

c. The rule revises the process and eligibility criteria for shelf offerings. Under newly-adopted Rule 424(h), ABS issuers using a shelf registration must file a preliminary prospectus containing transaction-specific information at least three days prior to the first sale of securities in the offering. In keeping with Dodd-Frank's requirement that the SEC review and eliminate the use of credit ratings as an assessment of creditworthiness, the eligibility requirements for shelf registration no longer refer to investment-grade ratings. Instead, the transaction must contain:

(i) A certification from the chief executive officer of the depositor concerning the disclosure and structure of the securitization.

(ii) A provision requiring review of compliance with the representations and warranties made with respect to a pool of assets whenever (A) a certain percentage of delinquencies occurs in the pool, and (B) the investors direct review.

(iii) A dispute resolution provision for asset repurchase requests.

(iv) Disclosure in ongoing distribution reports of requests by an investor to communicate with other investors.

2. The SEC has issued a number of additional rules implementing Dodd-Frank provisions related to securitization.

a. The SEC issued a final rule implementing Dodd-Frank § 942(a), which eliminated the automatic suspension of an ABS issuer's reporting obligations under the 1934 Act when the number of holders is below the threshold applicable to other 1934 Act issuers. SEC Release No. 34-65148 (Aug. 17, 2011). The SEC also issued a final rule implementing Dodd-Frank § 942(b), requiring ABS issuers to disclose asset-level data for assets underlying the ABS if necessary for investors to independently perform due diligence. SEC Release No. 33-9638 (Aug. 27, 2014).

b. The SEC issued a final rule implementing Dodd-Frank § 943, which requires issuers, sponsors, underwriters and depositors of ABS to disclose historical information on asset put-backs on an ongoing basis. SEC Release Nos. 33-9175 (Jan. 20, 2011) (final rule), 33-9175A (Aug. 25, 2011) (technical correction). See also PNC (avail. Feb. 1, 2012) (SEC grant of no-action request regarding disclosure provided by issuers of Ginnie Mae MBS relating to repo activity).

c. The SEC issued a final rule implementing Dodd-Frank § 945, which requires issuers of SEC-registered ABS to conduct a review of the underlying assets. In addition, this rule amended Regulation AB to require disclosure of this review as well as of any assets that deviate from the stated underwriting criteria. SEC Release Nos. 33-9176 (Jan. 20, 2011) (final rule), 33-9150 (Oct. 13, 2010) (solicitation of public comments).

d. The SEC proposed a rule implementing Dodd-Frank § 621, which prohibits an underwriter, placement agent, initial purchaser or sponsor (or any affiliate of such entities) of an ABS from engaging in any transaction, within one year of the first closing of the sale of such ABS, that would involve a material conflict of interest with any investor in the ABS. As of 2016, a final rule implementing the conflict of interest prohibition has not yet been adopted. SEC Release Nos. 34-66058 (Dec. 23, 2011) (extension of comment period), 34-65942 (Dec. 13, 2011) (extension of comment period), 34-65355 (Sept. 19, 2011) (solicitation of public comments).

3. The Dodd-Frank § 941 risk retention provisions require an ABS depositor and/or sponsor to retain an economic interest of no less than 5% of the credit risk for assets that it transfers, sells or conveys to a third party.

   a. The banking agencies, the SEC and other regulators issued an Interagency proposed rule in 2011. 76 Fed. Reg. 34010 (June 10, 2011) (extension of comment period); 76 Fed. Reg. 24090 (Apr. 29, 2011) (solicitation of public comments). Following extensive public comments, the agencies re-proposed the rule in September 2013. 78 Fed. Reg. 57928 (Sept. 20, 2013) (solicitation of public comments) (the "Interagency Risk Retention Proposal"). Following further comments, the agencies issued final rules in October 2014 (the "Final Risk Retention Rules"), which revised or clarified certain aspects of the Interagency Risk Retention Proposal but otherwise largely retained the risk retention framework contained in the Interagency Risk Retention Proposal. 79 Fed. Reg. 77602 (Dec. 24, 2014). The Final Risk Retention Rules maintained the options to satisfy the risk retention requirements that were included in the Interagency Risk Retention Proposal, specifically: (i) retention of a 5% "vertical" slice of each class of interests issued in the securitization; (ii) retention of a 5% "horizontal" slice of the first-loss interests in the securitization; or (iii) retention of a combined slice of the interests, which represents a mixture of the vertical and horizontal risk retention options. In addition, the Final Risk Retention Rules provide other retention options for securitizations involving revolving asset master trusts, securities guaranteed by Fannie Mae and Freddie Mac, tender option bonds, open market CLOs, ABCP conduits and commercial MBS. The Final Risk Retention Rules also allow sponsors, originators, originator-sellers and third-party purchasers to hold credit risk through a majority-owned affiliate.

   b. ABS collateralized by certain "qualified residential mortgages" are exempt from Dodd-Frank risk retention requirements. Under the agencies' original proposed rule, the requirements for satisfaction of the "qualified residential mortgage" definition were extensive. One of the more significant changes from the original proposed rule in the Interagency Risk Retention Proposal was to relax these requirements by aligning the definition of exempt "qualified residential mortgages" with that of the term "qualified mortgage" in regulations of the CFPB implementing Dodd-Frank §§ 1411 and 1412. The Final Risk Retention Rules maintained this alignment, but required the agencies to review the definition of "qualified residential mortgage" no later than four years after the effective date of the rule with respect to the securitization of residential mortgages and every five years thereafter, and allow each agency to request a review of the definition at any time.

c. Compliance with the Final Risk Retention Rules is required with respect to residential mortgage-backed securities beginning December 24, 2015, and with respect to all other securitization types beginning December 24, 2016.

d. The Interagency Risk Retention Proposal and the Final Risk Retention Rules follow the Board's Report to the Congress on Risk Retention (Oct. 2010), which was mandated by Dodd-Frank § 941(c) and analyzes the impact of several risk retention options and incentive alignment practices for various asset classes. Compare, e.g., Risk Retention for CLOs: A Square Peg in a Round Hole? (Oliver Wyman, Nov. 2013) (arguing that the Interagency Risk Retention Proposal will reduce the CLO market and urging regulators to take a conservative approach to regulation).

e. The LSTA has challenged the Final Risk Retention Rules in court, but the case has not yet been adjudicated on the merits. See LSTA v. SEC, No. 14-1240 (transferring case to U.S. District Court for the District of Columbia for lack of jurisdiction) (D.C. Cir. Mar. 18, 2016). See also McCarty, Levington, Sterling and Crandall, "U.S. Risk Retention in the CLO Market", Banking & Financial Serv., May 2016.

4. The CFTC issued a final rule rescinding the exemption from CPO registration previously available to certain pools offered only to qualified eligible persons. 77 Fed. Reg. 11252 (Feb. 24, 2012) (final rule). Coupled with the implementation of regulations under Dodd-Frank Title VII, rescinding the exemption implies that any fund, including a securitization structure, that has among its assets a "swap" will potentially be a commodity pool, giving rise to CPO

registration requirements. See 77 Fed. Reg. 48208 (Aug. 13, 2012) (joint final rule).

5. The Volcker Rule provides that nothing in the Rule will limit or restrict the sale or securitization of loans in a manner otherwise permitted by law. However, regulatory implementation of the Volcker Rule as it relates to CLOs and ABS generally has proven complex. See Part I.B.6.h, Part II.A.7 and Part V.C.1 above.

6. Following the 2007-2009 credit crisis, allegations arose of mortgage companies "robo-signing" mortgage documentation without knowledge of their contents. In response, the COP released Examining the Consequences of Mortgage Irregularities for Financial Stability and Foreclosure Mitigation (COP, Nov. 16, 2010). See also Transfer and Assignment of Residential Mortgage Loans in the Secondary Mortgage Market (ASF White Paper, Nov. 16, 2010).

   Between 2011 and 2013, the OCC, the FRB and the OTS issued consent orders against 16 mortgage servicers, requiring the servicers to engage third-party consultants to identify borrowers who had suffered financial harm due to errors, misrepresentations or other deficiencies in foreclosure processing. Civil money penalties have been issued with respect to some of the mortgage servicers, and some of the consent orders have been amended, replaced, and/or terminated. Ally Financial, Residential Capital, GMAC Mortgage and Ally Bank (Board/FDIC Consent Order, Apr. 13, 2011; Board Civil Money Penalty, Feb. 10, 2012; Board amended Order, July 26, 2013; FDIC Order terminated Aug. 5, 2015); Aurora Bank (OTS Consent Order, Apr. 13, 2011; OCC amended Order, Feb. 28, 2013; OCC Order terminated Mar. 28, 2013); Bank of America (Board/OCC Consent Order, Apr. 13, 2011; Board Civil Money Penalty, Feb. 9, 2012; OCC Formal Agreement declining to impose Civil Money Penalty, Feb. 27, 2012; Board/OCC amended Order, Feb. 28, 2013; OCC Order terminated June 16, 2015); Citibank, Citigroup and CitiFinancial Credit (Board/OCC Consent Order, Apr. 13, 2011; Board Civil Money Penalty, Feb. 13, 2012; OCC Formal Agreement declining to impose Civil Money Penalty, Feb. 24, 2012; Board/OCC amended Order, Feb. 28, 2012; OCC Order terminated, June 16, 2015); EverBank (OTS Consent Order, Apr. 13, 2011; OCC amended Order, Oct. 15, 2013; OCC amended Order, June 16, 2015; OCC Civil Money Penalty, Jan. 4, 2016; OCC Order terminated Jan.

4, 2016); EverBank Financial (OTS Consent Order, Apr. 13, 2011; Board amended Order, Oct. 16, 2013); The Goldman Sachs Group, Inc., and Goldman Sachs Bank U.S.A. (Board Consent Order, Sept. 1, 2011; Board amended Order Feb. 28, 2013); HSBC Bank, HSBC North America Holdings and HSBC Finance (Board/OCC Consent Order, Apr. 13, 2011; Board/OCC amended Order Feb. 28, 2013, Board Civil Money Penalty, Feb. 5, 2016; OCC amended Order, June 16, 2015); IMB HoldCo (OTS Consent Order, Apr. 13, 2011; Board Replacement Consent Order, Mar. 21, 2014); JPMorgan Chase, EMC Mortgage and JPMorgan Chase Bank (Board/OCC Consent Order, Apr. 13, 2011; Board Civil Money Penalty, Feb. 9, 2012; OCC Formal Agreement declining to impose Civil Money Penalty, Feb. 22, 2012; Board/OCC amended Order, Feb. 28, 2013; OCC amended Order June 16, 2015; OCC Civil Money Penalty, Jan. 4, 2016; OCC Order terminated Jan. 4, 2016); Lender Processing Services, DocX and LPS Default Solutions (Board/FDIC/OCC/OTS Consent Order, Apr. 13, 2011); MERSCORP and Mortgage Electronic Registration Systems (Board/FDIC/OCC/OTS/FHFA Consent Order, Apr. 13, 2011); MetLife (Board/OCC Consent Order, Apr. 13, 2011; Board Civil Money Penalty, Aug. 6, 2012; OCC amended Order, Feb. 28, 2013); Morgan Stanley (Board Consent Order, Apr. 2, 2012; Board amended Order, Feb. 28, 2013); OneWest Bank (OTS Consent Order, Apr. 13, 2011; OCC Replacement Consent Order, Mar. 11, 2014; OCC/OTS Order terminated July 14, 2015); PNC Bank and PNC Financial Services Group (Board/OCC Consent Order, Apr. 13, 2011; Board amended Order, Feb. 28, 2013; OCC amended Order, Feb 28, 2013; OCC Order terminated June 16, 2015); Sovereign Bank (OTS Consent Order, Apr. 13, 2011; OCC Replacement Order, Jan. 26, 2012; OCC amended Order, Feb. 28, 2013; OCC amended Order against successor Santander Bank, N.A., June 16, 2015; OCC Order terminated Feb. 8, 2016); SunTrust Banks, SunTrust Bank and SunTrust Mortgage (Board Consent Order, Apr. 13, 2011; Board amended Order, Feb. 28, 2013; Board Civil Money Penalty, July 25, 2014); U.S. Bancorp, U.S. Bank and U.S. Bank ND (Board/OCC Consent Order, Apr. 13, 2011; Board/OCC amended Order, Feb. 28, 2013; OCC amended Order June 16, 2015; OCC Civil Money Penalty, Feb. 8, 2016; OCC Order terminated Feb. 8, 2016); Wells Fargo and Wells Fargo Bank, (Board/OCC Consent Order, Apr. 13, 2011; Board Civil Money Penalty, Feb. 9, 2012; OCC Formal

Agreement declining to impose Civil Money Penalty, Feb. 22, 2012; Board/OCC amended Order, Feb. 28, 2013; OCC amended Order June 16, 2015; OCC Civil Money Penalty, May 24, 2016; OCC Order terminated May 24, 2016).

a. A number of banks have faced lawsuits and entered settlements relating to their disclosure of MBS transactions. For examples of these actions, see Part IX.E.3.b.i above.

b. On November 9, 2010, the ABA released a position paper on The Trustee's Role in [ABS].

7. Several lawsuits have been filed against banks that acted as trustees for RMBS trusts alleging breaches of the trustees' duties and remain ongoing. See, e.g., Phoenix Light v. HSBC Bank USA, No. 14-cv-10101 (complaint) (SDNY Dec. 23, 2014); Phoenix Light v. Wells Fargo Bank, No. 14-cv-10102 (complaint) (SDNY Dec. 23, 2014); NCUA v. Wells Fargo Bank, No. 14-cv-10067 (complaint) (SDNY Dec. 22, 2014). See, e.g., Reuters, Aug. 9, 2016. Securities Law Daily, Dec. 29, 2014; Banking Daily, Dec. 23, 2014. Some of these claims have been dismissed. See, e.g., NCUA v. U.S. Bank, 2015 WL 2359295 (SDNY May 18, 2015); Bloomberg, May 18, 2015.

8. For issues related to the treatment by the FDIC as conservator or receiver of financial assets transferred by an insured depository institution in connection with securitizations, see, e.g., 75 Fed. Reg. 60287 (Sept. 30, 2010) (final rule (12 C.F.R. § 360.6) regarding safe harbor protection for certain securitizations), 75 Fed. Reg. 27471 (May 17, 2010) (notice of proposed rulemaking), 75 Fed. Reg. 934 (Jan. 7, 2010) (advance notice of proposed rulemaking). The rule has important implications for disclosure and risk retention requirements for ABS and other securitizations involving insured depository institutions.

9. For supervisory and industry guidance with respect to securitization programs generally, see, e.g., Comptroller's Handbook: Asset Securitization; Board Commercial Bank Examination Manual § 4030.1; Board Examination Manual for U.S. Branches and Agencies of Foreign Banking Organizations § 3020.1; Revisions to the Securitization Framework (Basel, Dec. 11, 2014). See also Part V.A.4.c above.

C. EMPOWERMENTS

1. Financial Holding Companies and Financial Subsidiaries

FHCs and financial subsidiaries should have the power under Gramm-Leach -- as an "underwriting", "dealing" or other "financial activity" -- to participate in the pooling, packaging and securitization of loans and related assets originated or acquired by bank or BHC subsidiaries or affiliates or third parties.

Furthermore, the Volcker Rule specifically provides that nothing in the Rule will limit or restrict the ability of a banking entity to sell or securitize loans in a manner otherwise permitted by law. See Part I.B.6.h, Part II.A.7 and Part X.B.5 above.

2. Bank Holding Companies

a. BHC subsidiaries may conduct a wide range of mortgage banking activities (see 12 C.F.R. § 225.28(b)(1)), including:

(i) Originating consumer finance/home equity loans and securitizing such loans for sale. See, e.g., Barnett Banks, 59 Fed. Reg. 55119 (Nov. 3, 1994) (solicitation of public comments) (approved Dec. 7, 1994).

(ii) Making, acquiring, selling and servicing residential and commercial mortgage loans. See, e.g., First Midwest Bancorp, 58 Fed. Reg. 61912 (Nov. 23, 1993) (solicitation of public comments) (approved Dec. 17, 1993); Central State Bancorp, 57 Fed. Reg. 39686 (Sept. 1, 1992) (solicitation of public comments) (approved Feb. 22, 1993); MHC, 56 Fed. Reg. 46323 (Sept. 11, 1991) (solicitation of public comments) (approved Sept. 27, 1991) (the "MHC Mortgage Approval"); Hudson Valley Holding Co., 53 Fed. Reg. 49924 (Dec. 12, 1988) (solicitation of public comments) (approved Dec. 28, 1988); Midwest Financial Group, 53 Fed. Reg. 5042 (Feb. 19, 1988) (solicitation of public comments) (approved Feb. 20, 1988); Trust Corp., 53 Fed. Reg. 759 (Jan. 12, 1988) (solicitation of public comments) (approved Jan. 30, 1988).

(iii) Providing asset management services, including developing and implementing strategies for the packaging and sale of whole or securitized loan portfolios. See, e.g., Asset Management Orders.

(iv) Making, acquiring or servicing loans or other extensions of credit for its own account or the account of others secured by mortgages or deeds of trust on real property or condominia, and participating in the secondary mortgage market. See, e.g., First Maryland Bancorp, 53 Fed. Reg. 49924 (Dec. 12, 1988) (solicitation of public comments) (approved Dec. 29, 1988).

(v) Negotiating, originating, making, acquiring, buying, selling, pooling and exchanging, for its own account and for the account of others, mortgage loans, notes secured by liens on real property and such extensions of credit as would be made or arranged by a mortgage company; second mortgage financing; and acting as an adviser in mortgage loan transactions. See, e.g., NatWest, 52 Fed. Reg. 42342, 45246 (Nov. 4, 25, 1987) (solicitation of public comments) (approved Dec. 11, 1987); SDNB Financial Corp., 49 Fed. Reg. 45068 (Nov. 14, 1984) (solicitation of public comments) (approved Dec. 5, 1984); Norstar Bancorp, 48 Fed. Reg. 1113 (Jan. 10, 1983) (solicitation of public comments) (approved Feb. 4, 1983).

(vi) Originating, selling and servicing residential mortgages, including selling mortgages to investors in the form of government agency pass-through certificates or certificates evidencing interests in pools of mortgages. See, e.g., Texas Commerce Bancshares, 72 Fed. Res. Bull. 803 (1986); Texas Commerce Letter to Board Legal Division, May 9, 1986; Midlantic Banks, 48 Fed. Reg. 32866 (July 19, 1983) (solicitation of public comments) (approved Aug. 22, 1983).

(vii) Originating and servicing residential mortgage loans, including "participat[ion] in the development of an active secondary market in conventional mortgage-backed pass-through securities with institutional investors". See, e.g., Citicorp, 65 Fed. Res. Bull. 587 (1980).

b. A BHC subsidiary may acquire and hold credit card receivables of an affiliated bank and act as soliciting agent for the bank. See, e.g., Cass Commercial Corp., 60 Fed. Reg. 13157 (Mar. 10, 1995) (approved Mar. 31, 1995).

c. Board Letter to Meridian, dated Jan. 17, 1995 (the "Meridian Letter"), indicates that BHC mortgage banking subsidiaries may securitize mortgage loans. The Board also approved BHC subsidiary involvement in certificating, pooling and securitizing government-guaranteed loans. See, e.g., Hawkeye Bancorp, 59 Fed. Reg. 32432 (June 23, 1994) (approved July 21, 1994) (approval described in Board Form H.2 (Aug. 15-19, 1994)). But see MHC Mortgage Approval, (compare to solicitation of public comments, 56 Fed. Reg. 46323 (Sept. 11, 1991)).

3. Banks

a. Comptroller of the Currency Position and National Bank Developments

Investment Securities Regulation § 1.3(g) provides that a "national bank may securitize and sell assets that it holds, as part of its banking business". A national bank's sale of securitized assets and participation in the public distribution of securities representing (or backed by) interests in such assets do not violate Glass-Steagall either because transactions in originated or acquired assets are part of the "business of banking" (and thus not covered by Glass-Steagall prohibitions), or because the instruments do not represent Glass-Steagall "securities" (or the sale process does not represent Glass-Steagall "underwriting").

The Comptroller's "business of banking" analysis in Letter No. 388 was upheld in the Second Circuit Mortgage Securities Decision. A discussion of the more significant Comptroller interpretations, and the litigation regarding Letter No. 388, follows:

(i) Comptroller Letter, dated Mar. 30, 1977, CCH Fed. Banking L. Rep. ¶ 97,093, stated that a sale of <u>mortgage pool pass-through interests</u> would not violate Glass-Steagall, and that the Section 21 Proviso exempts the sale of "obligations evidencing loans on real estate" from Glass-Steagall's prohibitions. <u>See also</u>, <u>e.g.</u>, Comptroller Interpretive Letters No. 257 (Apr. 12, 1983), CCH Fed. Banking L. Rep. ¶ 85,421; No. 194 (May 29, 1981), CCH Fed. Banking L. Rep. ¶ 85,275; No. 92 (Apr. 20, 1979), CCH Fed. Banking L. Rep. ¶ 85,167; No. 69 (Oct. 17, 1978), CCH Fed. Banking L. Rep. ¶ 85,144; No. 41 (May 18, 1978), CCH Fed. Banking L. Rep. ¶ 85,116; Comptroller Letter No. 25 (Feb. 14, 1978), CCH Fed. Banking L. Rep. ¶ 85,100; Board Letter re Bank of America, June 1, 1976.

(ii) Letter No. 272 approved the sale of <u>retail participations in BAs</u> because the underlying assets are not Glass-Steagall "securities".

(iii) Comptroller No-Objection Letter No. 86-9 (May 22, 1986), CCH Fed. Banking L. Rep. ¶ 84,015 (also indexed as Comptroller Interpretive Letter No. 362 (May 22, 1986), CCH Fed. Banking L. Rep. ¶ 85,532), stated that a subsidiary of a national bank may <u>issue and underwrite CMOs</u> backed by residential real estate loans. <u>See also</u> Comptroller Interpretive Letter No. 378 (Mar. 24, 1987), CCH Fed. Banking L. Rep. ¶ 85,602 (<u>issuance and sale of CMOs</u> by a national bank does not violate Glass-Steagall; Section 21 Proviso relates to <u>commercial</u>, as well as <u>residential</u>, real estate (<u>see</u>, <u>e.g.</u>, H.R. Rep. No. 742, 74th Cong. 1st Sess. 14 (1935), Banking Act of 1935, § 308, Ch. 614, 49 Stat. 684 (1935) (repealed))); Comptroller Letter to Senator D'Amato, June 18, 1986.

(iv) Letter to the Board, Jan. 30, 1987 (the "<u>Comptroller Comment Letter</u>"), noted that a bank may issue and sell

MBSs and CRRs based on its authority to sell assets and borrow funds. The Comptroller reaffirmed this position in the Second Comptroller Comment Letter and the Bowden 1994 Letter.

(v) Letter No. 388 was issued in response to an SIA Letter, dated Apr. 2, 1987, challenging the participation of SecPac Bank in the public sale of pass-through certificates representing interests in residential mortgages originated by SecPac Bank which were "not federally insured". The Comptroller stated that a national bank may "underwrite" pass-through certificates, issued through a grantor trust, representing mortgages originated by the bank.

A) In response to a suit by the SIA, Judge Duffy ruled that Letter No. 388 violated Glass-Steagall. Final Judgment, Jan. 3, 1989 (SDNY).

Focusing on the fact that SecPac Bank had transferred the mortgages to a trust, Judge Duffy reasoned that owning trust certificates is not identical to owning underlying mortgages and held that the certificates were Glass-Steagall "securities" and that SecPac Bank's sale of such certificates constituted "underwriting". Judge Duffy seemed concerned that concluding that the certificates were not "securities" would remove them from the protection of the securities laws.

B) The Second Circuit Mortgage Securities Decision reversed the Duffy Decision.

The Court described the threshold question as whether the sale of pass-through certificates was part of the "business of banking".

First, noting that the sale by a bank of its mortgage loans has historically been considered part of the "business of banking", the Court found that selling loans in securitized form does not alter the substance of the transaction.

Second, the Court stated that since the sale of pass-through certificates was permitted under Glass-Steagall § 16, it would not be prohibited even if such sale constituted the "underwriting" of "securities".

Third, the Court expressed doubt that the sale of pass-through certificates would give rise to "subtle hazards", noting that a bank has a permissible promotional interest in every product it offers and that no special promotional interest arises because a bank chooses to market its loans by means of pass-through certificates rather than by selling them directly.

Finally, the Court found that the Duffy Decision confused banking and securities laws.

C) The Second Circuit Mortgage Securities Decision did not address whether pass-through certificates were "securities" or the sale of such securities constituted Glass-Steagall "underwriting". Citing the IRA Cases, however, the Court noted that the "mere fact" that the loans were packaged into certificates would not transform the sale of the loans into the "underwriting" of "securities".

D) In its petition for a writ of certiorari, the SIA asserted that the Second Circuit Mortgage Securities Decision would permit bank underwriting of "virtually all securities". The SIA petition was denied.

The Comptroller reaffirmed that national banks may securitize mortgage loans in Comptroller Conditional Approval No. 338 (Nov. 10, 1999) ("Approval No. 338").

(vi) Letter No. 87-9 indicated that a national bank may make loans to limited partnership investors and sell the resulting "loan notes" to a trust which would issue to the bank pass-through certificates representing interests in the resulting loan pool. An unaffiliated broker-dealer would privately place the certificates. The Letter indicated that the pooling of loan notes and sale of certificates is derived from a bank's power to sell assets, that the certificates would not be Glass-Steagall "securities", and that the proposed activities would not constitute "dealing" or "underwriting" because the sale of interests in a pool of notes is a <u>banking</u> activity, and because they would be placed by an unaffiliated broker-dealer.

(vii) Comptroller Interpretive Letter No. 416 (Feb. 16, 1988), CCH Fed. Banking L. Rep. ¶ 85,640, authorized a national bank subsidiary to purchase loans, leases, installment sales contracts and other loan assets from the bank and sell them to unaffiliated third parties for securitization.

(viii) Letter No. 417 indicated that a national bank could market ("in the manner of a private placement") 1933 Act-registered certificates representing interests in pools of <u>commercial mortgages</u>.

(ix) Comptroller Interpretive Letter No. 418 (Feb. 17, 1988), CCH Fed. Banking L. Rep. ¶ 85,642, authorized a national bank subsidiary to securitize mortgage assets and issue pass-through certificates and CMOs respecting such assets. It was expected that 50% of the mortgages in the subsidiary's portfolio would be originated by parties <u>unrelated</u> to the bank and that the subsidiary would regularly buy and sell mortgages. An unaffiliated broker-dealer would act as the distributor. <u>See also</u> Comptroller Sovran Letter (following Letter No. 418, except that the bank would participate in the private placement of the subsidiary's MBS, including the "private placement" of 1933 Act-registered MBS); Comptroller Unpublished Letter (Nov. 13, 1986).

(x) In reliance on the Section 21 Proviso and a national bank's power to sell assets, Comptroller Interpretive Letter No. 423 (Apr. 11, 1988) ("Letter No. 423"), CCH Fed. Banking L. Rep. ¶ 85,647, authorized a national bank subsidiary to serve as a general partner in a partnership which would invest in mortgage loans, MBS and participation certificates. An unaffiliated broker-dealer would publicly offer the partnership units.

(xi) Comptroller Interpretive Letter No. 514 (May 5, 1990) ("Letter No. 514"), CCH Fed. Banking L. Rep. ¶ 83,218, authorized a national bank subsidiary to sell debt obligations collateralized by federally-guaranteed mortgage pools where the obligations would be issued either by the subsidiary or by other entities, including non-affiliated financial institutions.

(xii) Comptroller Interpretive Letter No. 540 (Dec. 12, 1990), CCH Fed. Banking L. Rep. ¶ 83,252, authorized a national bank subsidiary to acquire credit card receivables originated by the bank or purchased from others. The subsidiary would issue bonds or certificates backed by the receivables, supported by third party credit enhancement and underwritten by an unaffiliated investment bank. See also Comptroller Interpretive Letter No. 585 (June 8, 1992), CCH Fed. Banking L. Rep. ¶ 83,406 (bank securitization of automobile receivables purchased from automobile dealers).

(xiii) The Bowden 1994 Letter reaffirmed the power of a national bank to sell obligations representing interests in pools of mortgage and non-mortgage loans that are originated by the bank or purchased from others.

(xiv) Letter No. 898 authorized a national bank to acquire and hold a minority interest in a company engaged in the origination, purchase and securitization of auto leases.

(xv) Comptroller Interpretive Letter No. 1035 (July 21, 2005), CCH Fed. Banking L. Rep. ¶ 81-564, authorized a national bank to transfer its home equity lines of credit through affiliated SPEs under circumstances where the bank would take back notes and asset-backed owner trust certificates issued by one of the SPEs through a securitization process.

(xvi) Comptroller Conditional Approval No. 864 (June 30, 2008) authorized JPMorgan Chase Bank to acquire four Bear Stearns operating subsidiaries that engage in derivative and mortgage lending activities, including the origination, sale and securitization of fixed and adjustable rate commercial mortgage loans.

(xvii) Comptroller Interpretive Letter No. 1133 (June 16, 2011) authorized a national bank to securitize non-investment-grade residential MBS held on the bank's balance sheet through a re-REMIC transaction (creating multiple classes of REMIC securities) and hold the resulting investment-grade (and below investment grade) re-REMIC securities. See also Asset Securitization Report, Aug. 2013 (predicting a rise in bank demand for re-REMIC securities related to the Board's Final Rule implementing Basel III requirements).

A) The Comptroller noted that the authority to re-securitize the MBS is based on a national bank's authority to securitize assets as part of the "business of banking", and characterized the re-REMIC transaction as a "modern variation of the type of asset restructuring long recognized as permissible for national banks".

B) The Comptroller also noted that the bank's creation/retention of the non-investment-grade re-REMIC securities in connection with the re-REMIC transaction was a consequence of the benefits achieved through the re-REMIC transaction. By restructuring its assets in the re-REMIC, the bank was said to have enhanced the marketability of the underlying assets, improved its liquidity, and reduced its non-conforming assets (since all of the original MBS were below investment grade, but only part of the re-REMIC securities would be below investment grade).

C) The bank did not plan to change capital treatment or its public disclosures as a result of the re-REMIC transaction (including securities filings and call reports), except as needed to comply with changes in capital rules or applicable disclosure requirements.

b. Federal Reserve Board Position

The Meridian Letter, citing the position of the Comptroller in Letter No. 388, confirmed that a state member bank may underwrite securities backed by pools of residential mortgage loans originated by such bank and its affiliates as well as pools that include loans purchased from other sources (although the bank could not cause mortgages to be securitized and then hold the securities for later sale).

c. "Functional Equivalence" Analysis

Under the Second Circuit Mortgage Securities Decision, a bank may, as part of the "business of banking", issue securities representing an interest in its mortgage assets, and may participate in the private or public sale of such securities. The analysis set forth in the Decision could also apply to other bank assets (although attention must be given to GLBA "push-out" limitations discussed in Part IX.B.3 above).

(i) There is a "continuum of risk" with respect to the participation by a bank (or its broker-dealer subsidiary) in the distribution of ABS, both as to the nature of the distribution mechanism and the nature of the asset being securitized. Dodd-Frank should not materially affect this continuum. See Part X.C.1 above.

A) Mere securitization of assets, where the resulting securities are distributed by an investment bank, should not raise any Glass-Steagall issue. This would certainly be the case if the bank has originated such assets and should also be the case if the bank purchases the underlying assets, especially if the assets are maintained on the books of the bank for some time prior to securitization.

B) Regulators have been less sensitive to bank involvement in <u>private placements</u> than in public distributions.

C) A bank's participation in the <u>public distribution</u> of ABS should be immune to challenge if it is consistent with the <u>Second Circuit Mortgage Securities Decision</u>. Whether a challenge is brought against activities which go beyond such <u>Decision</u> may depend on the type of assets being securitized and whether (or when) such assets were originated or acquired by the bank.

i) The "business of banking" analysis should apply to bank participation in the distribution of securities backed not only by the bank's originated or acquired residential mortgage loans, but also to those backed by any other types of consumer loans, because the sale of such loans is a well-accepted bank activity.

Such analysis should also apply to bank distribution of securities backed by certain types of commercial credit, such as equipment finance leases and installment purchase contracts, where the statistical characteristics of the asset pool (rather than the creditworthiness of any particular borrower) are predominant.

Bank participation in a distribution of securitized commercial mortgage and construction loans is not well established. Pools of such loans are likely to contain fewer loans, and the sale of interests in such pools could begin to look more like a bond offering. However, distribution of securities based on such loans would appear to be protected by the Section 21 Proviso, and Citibank's distribution of commercial MBS went unchallenged. See Prospectus of Mortgage Capital Funding dated Sept. 28, 1993.

ii) The ABS at issue in the Second Circuit Mortgage Securities Decision were backed by mortgage loans originated by SecPac Bank. Under the Court's "business of banking" analysis, however, as attested by precedents discussed in Part X.C.3.a above, it should not matter whether loans securitized and sold by a bank are originated or acquired by the bank, and banks participated in the public distribution of residential and commercial mortgage and consumer receivable ABS based on assets acquired from unaffiliated third parties.

(a) Citibank acquired collateral (government agency certificates) from a third party so as to create and underwrite CMOs. Prospectus Supplement of Cititrust II, Sept. 16, 1987.

(b) Some banks participated in the securitization of loans not originated by the bank, but generated by third parties subject to the bank's credit, appraisal and underwriting standards. If these standards are established prior to loan origination, such loans should be classed as "bank originated" for purposes of a "business of banking" analysis. See generally, e.g., Board 23A Asset Purchase Precedents. Cf. ComFed Savings Bank (avail. Sept. 29, 1988).

(c) As evidenced by some of the Bank ABS Prospectuses referred to below, banks indicated that acquired loans were included in the asset pools securitized and distributed. Banks even securitized pools of acquired loans where such loans, when originated, were not subjected to the bank's underwriting or credit standards. See, e.g., Prospectus of Mortgage Capital Funding, dated Sept. 28, 1993 (Citibank); Prospectus of Hibernia National Bank 1990-A Grantor Trust, Dec. 20, 1990.

iii) Banks took a broad view of their ABS distribution powers, and were named in prospectuses as "underwriters" of "securities" representing interests in, or backed by, mortgage, credit card, automobile or other consumer loans originated or acquired by the bank or affiliated entities. <u>See</u>, <u>e.g.</u>, Prospectuses and Prospectus Supplements of the following "underwriters" (collectively, the "<u>Bank ABS Prospectuses</u>"): (i) <u>Citibank</u> (July 31, 1997, Oct. 6, Jan. 19, 1995); (ii) <u>CoreStates Bank</u> (May 22, 1996); (iii) Fifth Third Bank (Mar. 19, 1996); (iv) Signet Bank (Nov. 30, 1995); (v) <u>Society National Bank</u> (Oct. 26, July 13, 1995); and (vi) Boatmen's National Bank (Sept. 20, 1995).

As evidenced by some of the Bank ABS Prospectuses, banks participated in the distribution of ABS of <u>affiliates</u>, which, although structurally distinct from such banks, carry a reduced risk of challenge.

(a) In Letter No. 88-4, the Comptroller indicated (citing Glass-Steagall precedents) that the <u>purchase of ABS</u> from an affiliate should be regarded as a purchase of assets rather than of affiliate securities under Section 23A because such securities are functionally equivalent to the underlying assets. The context of this Letter makes clear that the bank intended to purchase the ABS for distribution.

The Meridian Letter also contemplated bank involvement in the securitization of affiliate mortgage loans.

(b) Transactions between affiliated banks, in general, are exempt from certain Section 23A/23B restrictions on "covered transactions".

(c) The cross-guarantee provision of FIRREA, 12 U.S.C. § 1815(e), making affiliated banks responsible for each others' obligations under certain circumstances, supports treating ABS of affiliate banks more favorably than ABS of non-affiliates.

(d) The connection between a bank and its affiliates has been recognized in other contexts. See, e.g., Comptroller Reinsurance Approvals.

iv) Letter No. 514 provides a basis for national bank underwriting of certain ABS issued by unaffiliated financial institutions.

v) After-market transactions in ABS which a bank has sold publicly may require "evergreen" registration of such ABS under the 1933 Act if the bank "controls" the ABS issuer for purposes of such Act. Some Bank ABS Prospectuses that named banks as underwriters included a statement that the underwriters intend to make a market in the ABS, presumably justifying such an intention under Glass-Steagall on the grounds that the ability to make a market is an integral part of completing a distribution.

(ii) The Comptroller made a "functional equivalence" analysis in other contexts. See, e.g.:

A) 12 C.F.R. §§ 1.100, 1.110, 1.120; Comptroller Release, 47 Fed. Reg. 5701 (Feb. 8, 1982) (investment securities guidelines with respect to "indirect general obligations" of federal and state issuers); Comptroller Letter No. 90 (Apr. 30, 1979), CCH Fed. Banking L. Rep. ¶ 85,165 (bank purchase, dealing and underwriting certain collateralized hospital bonds). <u>See also</u> <u>Part II.B above</u>.

B) Comptroller Reinsurance Approvals (subsidiary of bank permitted to reinsure mortgage loans originated, purchased or serviced by the bank or its affiliates as "functionally equivalent" to the purchase or underwriting of mortgage loans); Letter No. 867 (bank permitted to offer Murabaha financing products to Islamic customers involving the acquisition and sale of real property as "functionally equivalent" to conventional financing); Corporate Decision No. 97-92 (subsidiary of bank permitted to underwrite safe deposit box liability insurance as the "functional equivalent" of a bank's safe deposit business); Comptroller Interpretive Letter No. 806 (Oct. 17, 1997), CCH Fed. Banking L. Rep. ¶ 81-253 (bank permitted to enter into residential net leases with Islamic customers as "functionally equivalent" to secured real estate lending).

C) Comptroller Preferred Securities Precedents (bank permitted to invest in "preferred securities" where such securities are functionally equivalent to debt securities).

D) Letter No. 779 (bank permitted to invest in investment fund that would invest in loans, either by acquiring such investments as "securities" or as "loan participations"); Comptroller ING Fund Letter (to similar effect). <u>See also</u> <u>Part II.D.3.a.iii above</u>.

E) Letter No. 767 (notes the principal of which, and a portion of the interest on which, are secured by an obligation of Fannie Mae and the remaining interest on which is secured by cash or U.S. obligations, were eligible securities); Comptroller Letter to Nikko Securities ("Nikko"), Mar. 10, 1993 (similar conclusion with respect to yen-denominated bonds issued by a third party where issuer would use proceeds to purchase dollar-denominated U.S. government bonds to pay principal and interest); Comptroller Interpretive Letter No. 583 (Apr. 27, 1992), CCH Fed. Banking L. Rep. ¶ 83,404 (similar conclusion with respect to debt securities collateralized by notes guaranteed as to principal by the U.S. Export-Import Bank (the "Eximbank") and partially guaranteed as to interest, with the remaining interest secured by the pledge of an instrument guaranteed by Eximbank); Comptroller Letter re First Interstate Bank (Dec. 14, 1990) (to similar effect); Comptroller Investment Securities Letters No. 38 (Apr. 7, 1989), CCH Fed. Banking L. Rep. ¶ 83,044 (to similar effect, non-Eximbank collateral); No. 35 (Mar. 2, 1989), CCH Fed. Banking L. Rep. ¶ 83,041 (to similar effect); No. 11 (Nov. 26, 1986), CCH Fed. Banking L. Rep. ¶ 85,881 (insurance company notes secured by government securities).

F) Letter No. 687 (bank may become a limited partner in partnership that invests solely in securities in which banks may invest directly); Comptroller Investment Securities Letter No. 87-16 (Feb. 18, 1987), CCH Fed. Banking L. Rep. ¶ 85,886 (bank may invest in shares of investment companies that invest only in bank-eligible securities); Circular No. 220 (to same general effect). See also Part II.D.3.a.ii above.

G) Comptroller IRA Approvals.

H) Letter No. 426 (use of a "functional equivalence" analysis to prohibit a proposed transaction in which a bank would have invested in a trust holding corporate stock).

I) Letter No. 272 (retail participations in BAs).

(iii) The Board has accepted a "functional equivalence" analysis in certain contexts. See, e.g., 12 C.F.R. §§ 204.124 (repo involving shares of a mutual fund whose portfolio consists of U.S. Treasury and GSE securities treated for reserve purposes as if repo related to underlying securities); Regulation H 1998 Revisions (rescinding 12 C.F.R. § 208.124 (which provided that member banks may invest in shares of investment companies that invest only in eligible securities) but stating that member banks may rely on Comptroller interpretations); Board 1986 23A Letter (certain securities purchases are included within the meaning of "asset purchase" for purposes of Section 23A; according to Letter No. 88-4, Board staff have taken the position that affiliate-issued ABS would be included within the meaning of asset purchase). But cf. Board Staff Opinion (Jan. 27, 1961), 1961 Fed. Res. Interp. Ltr. LEXIS 1 (notes secured by guaranteed mortgages are not U.S. government-guaranteed obligations and thus are not eligible securities; Board Staff Opinion removed from Federal Reserve Regulatory Service).

(iv) The SEC has also used a "functional equivalence" analysis from time to time.

A) The SEC exercised its authority under FIRREA to exempt securities issued by the Resolution Funding Corporation ("Refcorp") from 1933 Act registration requirements on the grounds that the credit and investment risks of Refcorp securities "essentially are equivalent" to those of U.S. government obligations. SEC Release No. 33-6844 (Sept. 8, 1989).

B) In offerings by foreign governments of securities 90% guaranteed as to principal and interest by the U.S. government and 10% collateralized by U.S. government securities ("Military Sales Trusts") -- such as those that were the subject of Letters No. 35 and No. 38 -- the SEC took a no-action position with respect to non-registration of such securities under the 1933 Act, on the grounds that such securities are functionally equivalent to U.S. guaranteed securities. See, e.g., Republic of Tunisia (avail. Dec. 29, Aug. 11, 1988).

The SEC also took no-action positions with respect to non-registration under the 1933 Act of (i) certificates issued by trusts holding U.S.-guaranteed notes; and (ii) notes issued by special purpose issuers secured by lease payments from a U.S. government instrumentality and/or U.S. government obligations. See, e.g., State of Israel; AID Housing Guaranty Program (avail. Mar. 27, 1991); Newman & Associates (avail. Nov. 9, 1987); Military Sealift Command (avail. Sept. 26, 1984); Tennessee Valley Authority Leases (avail. Mar. 14, 1984); Tennessee Valley Authority (avail. Feb. 18, 1983).

Without taking a no-action position with respect to the 1933 Act, SEC no-action letters concluded that securities issuance vehicles relating to military sales programs need not register as 1940 Act investment companies due to the nature of the collateral. See, e.g., Hellenic Republic (Greece) (avail. Jan. 10, 1991); Islamic Republic of Pakistan (avail. Jan. 18, 1989); Kingdom of Jordan (avail. Nov. 21, 1988); Republic of Turkey (avail. Nov. 3, 1988); State of Israel (avail. Aug. 17, 1988).

The SEC has also accepted “functional equivalence” in granting requests for no-action letters (or exemptions) with respect to broker-dealers publishing quotations and effecting transactions in certificates issued by Military Sales Trusts. See, e.g., Lehman Government Securities (avail. Oct. 18, 1991); CRT Government Securities (avail. Aug. 6, 1990); Shearson Lehman Government Securities (avail. Sept. 22, Aug. 22, May 23, 1989); Merrill Lynch Government Securities (avail. Mar. 9, 1989); RMJ Securities Corp. (avail. Dec. 9, 1988); Discount

Corp. (avail. Dec. 9, 1988); Government Trust Certificates (avail. Sept. 22, 1988).

C) Stripped Coupon Municipal Securities (avail. Jan. 19, 1989) concluded that such securities (i.e., instruments representing separate rights to receive payment of interest and principal) should be viewed as 1934 Act "municipal securities" despite the fact that the "sponsor" of the "certificates of accrual" representing such securities is a broker-dealer.

D) Postal Square Limited Partnership (avail. May 24, 1990) took a no-action position with respect to the non-registration of securities issued by a partnership to finance the construction of U.S. government office space, on which payments of principal and interest during construction were guaranteed by the U.S. Postal Service, and payments thereafter were indirectly guaranteed by the General Services Administration's lease payments.

However, SEC staff refused to conclude that notes issued by trusts whose property consisted of obligations issued or guaranteed by the U.S. would be treated as U.S. government and agency securities for purposes of 1940 Act Rule 2a-7 where the trusts entered into swap agreements with a bank secured by U.S. government and agency obligations, since the swap-related risks were viewed as "significantly different" from the underlying obligations. JPMorgan Securities (avail. July 27, 1994). Compare, e.g., T. Rowe Price Tax Free Funds (avail. June 24, 1993) (investment in municipal bonds refunded with borrowed government securities treated as investment in such securities under 1940 Act § 5(b)(1)).

E) Custodial receipt programs do not generally involve securities separate from the underlying securities for purposes of the Securities Acts or represent 1940 Act investment companies. See, e.g., Cantor Fitzgerald (avail. June 16, 2004) (receipt representing an interest in both fixed income and equity securities); Merrill Lynch (avail. Sept. 26, 3, 1999, Sept. 26, 1990); Indosuez Asset Management Asia (avail. Feb. 14, 1997); Commonwealth Bank of Australia (avail. Sept. 23, 1996); Robertson, Stephens & Co. (avail. Mar. 13, 1993); CRT Government Securities (avail. Nov. 24, 1992); Bear Stearns (avail. Jan. 28, 1992); Apfel & Co. (avail. Nov. 15, 1991); Financial Guaranty Insurance Co. (avail. Feb. 15, 1989); FSA (avail. Mar. 30, 1988); Central Utah Rural Impact Capital Corp. (avail. Aug. 29, 1980). Cf. Government Securities Corp. (avail. Oct. 15, 1993) (custodial receipt program for SBA-guaranteed fees would be exempt from 1933 Act registration; SEC warns that material changes in the program could lead to a different result under Gary Plastic and SEC v. American Board of Trade, 751 F.2d 529 (2d Cir. 1984) (violation of securities laws found in U.S. Treasury bill "pooling" and "safekeeping" program)).

F) Epic Mortgage Insurance Litigation, 701 F. Supp. 1192 (E.D. Va. 1988), held that certificates which were sold in private transactions to financial institutions and which represented interests in a trust whose only assets were mortgage loans originated by the issuer, were not 1933 Act "securities". The SEC filed an Amicus Brief urging that the Fourth Circuit overturn that decision, but, in affirming in part and reversing in part, the Fourth Circuit did not address 1933 Act issues. Foremost Guaranty Corp. v. Meritor Savings Bank, 910 F.2d 118 (4th Cir. 1990). See generally, e.g., Steinhardt (investment in partnership involving securitization of delinquent residential mortgage loans and real estate owned by a bank is not a "security" where investor had such control over partnership that it could not be said that profits were to come from the efforts of others); Life Partners (non-recourse notes of trust holding viatical contracts, which are not 1933 Act "securities", are not themselves "securities" based on an analysis of the "substance of the transaction"); Stone ("enhanced automobile receivables" are not "securities" when sold to sophisticated financial institutions); National Mortgage Equity Corp., 723 F. Supp. 497 (C.D. Cal. 1989) (certificates collateralized by federally guaranteed mortgages and sold to institutional investors which could reject individual loans and negotiate terms are not "securities").

But see, e.g., Realtek (mortgage notes and participation certificates are 1933 Act "securities") Zolfaghari v. Sheikholeslami, 943 F.2d 451 (4th Cir. 1991) (participation interests in mortgage-backed mutual fund pool may be 1933 Act "securities"); Security Federal Savings (avail. Aug. 17, 1990) (participation interests in short-term construction loan notes may be 1933 Act "securities").

G) Mishkin deemed participations in an exempt security to be exempt securities under the 1934 Act where the participations share all of the essential attributes (i.e., risk and maturity) of the underlying security.

See also Part V.B above.

(v) Bank underwriting of Private Export Funding Corporation ("PEFCO") notes was justified by a "functional equivalence" analysis, and banks have underwritten PEFCO offerings. See, e.g., Prospectuses of PEFCO dated July 10, Apr. 16, 2, 1997, June 26, 1996, Sept. 28, June 21, 1995. Although the interest on PEFCO notes is guaranteed by the Eximbank, the principal of the notes is secured by government obligations. PEFCO (avail. June 9, 1975) takes a no-action position respecting the registration of PEFCO obligations under the 1933 Act.

d. Gramm-Leach-Bliley Act Push-out Provisions

(i) The GLBA Push-out Provisions include a limited exemption for a bank to issue or sell ABS without being a "dealer" under the 1934 Act, but certain activities described as permissible for banks as a bank regulatory matter (such as the securitization and sale of assets purchased by a bank for securitization) in Part X.C.3.c above may not fit the exemption.

(ii) The GLBA Push-out Provisions provide that a bank may, without registering as a broker-dealer, issue and sell to qualified investors ABS that securitize obligations "predominantly originated" by the bank, by an affiliate of the bank (other than a broker or dealer) or by a syndicate of banks of which the bank is a member. Under such Provisions, and as reflected in the SEC Dealer Release and 1934 Act Rule 3b-18:

A) An obligation will be considered to have been "originated" by a bank if:

i) The bank funds the obligation at the time that it is created; or

ii) The bank approves the underwriting of the obligation, or initially agrees to purchase the obligation, and (a) the obligation conforms to the bank's underwriting standards or is evidenced by the bank's loan documents; and (b) the bank funds the obligation in a timely manner, not to exceed six months after the obligation is created.

B) To be considered "predominantly originated" by a bank, the bank and its non-broker-dealer affiliates participating in any loan syndicate must have "originated" 85% of the obligations in any pool as measured by the value of such obligations.

See also Part II.D.3.b and Part IX.C above.

XI. International Securities Linkages

A. General

1. Capital markets have become increasingly international in terms of trading and securities offerings, relationships among broker-dealers, and linkages among securities exchanges. Firms have built global electronic trading networks. The growth in trading volume within the U.S. and abroad has resulted in efforts to expand operational and settlement capacities, particularly with respect to international offerings and cross-border trading.

    a. U.S. holdings of non-U.S. securities grew from $300 billion in 1990 to $9.74 trillion in 2015. U.S. purchases and sales of non-U.S. securities amounted to approximately $18.2 trillion in 2014, and U.S. private equity investors are an increasing presence in overseas markets.

    Non-U.S. holdings of U.S. securities grew from $1 trillion in 1990 to nearly $17.1 trillion in 2015. Foreign purchases and sales of U.S. securities amounted to approximately $55 trillion in 2014.

    b. The increasing internationalization of the capital markets poses challenges for both market participants and regulators. Market participants must determine how to remain competitive in a global environment and manage the related risks. Traditional banks must also contend with competition from financial technology, or "fintech", firms and other new banking-technology innovators. Regulators, who primarily operate on a national basis, must determine how to supervise multinational institutions without impeding market competitiveness. Rapid regulatory change opens another vector for disparate treatment of financial institutions across borders. See The Fight for the Customer: McKinsey Global Banking Annual Review 2015 (Sept. 2015); The Road Back: McKinsey Global Banking Annual Review 2014 (Dec. 2014).

    In addition, in order to remain competitive, market participants must determine their optimal international structure, while operating within regulatory regimes that may influence that structure. See, e.g., "International Banking and Cross-Border Effects of Regulation: Lessons from the United States", Staff Report (FRBNY, Sept. 6, 2016); Wall St. J., Aug. 3, 2016 (foreign banks "slashing" U.S. brokerage assets as U.S. rules kick in requiring capital regulation to apply to U.S. intermediate holding companies); Newell, "Rethinking the Internationalization of U.S. Bank Regulation", Banking Perspective (TCH, Q2 2016); "U.S. Banks' Changing Footprint at Home and Abroad," Liberty Street Economics (FRBNY, Nov. 30, 2015); "Around the World in 8,379 Foreign Entities," Liberty Street Economics (FRBNY, Aug. 11, 2015); "International Banking after the Crisis: Increasingly Local and Safer?" (IMF, Apr. 2015).

c. For background on general issues and trends with respect to the internationalization of capital markets and financial services, see, e.g., "Highlights of the BIS international statistics," BIS Quarterly Review (June 2016); Remarks of SEC Director Higgins, Jan. 21, 2016 (International Developments – Past, Present and Future); Nieto, Wall, "Cross-Border Banking on the Two Sides of the Atlantic: Does It Have an Impact on Bank Crisis Management?" (Federal Reserve Bank of Atlanta, Nov. 2015); Remarks of Board Governor Tarullo, Nov. 5, 2015 (Shared Responsibility for the Regulation of International Banks); Packer, Shu, "Cross-border Financial Linkages: Challenges for Monetary Policy and Financial Stability" (BIS, Oct. 2015); "IOSCO Task Force on Cross-Border Regulation Final Report" (IOSCO, Sept. 17, 2015); Foreign Activity Report (SIFMA, Feb. 19, 2015, Dec. 3, 2014); Estimating U.S. Cross-Border Securities Positions (Board, Aug. 2014); Financial Services Factbook (Financial Services Roundtable, 2013); Financial Globalization: Retreat or Reset? – Global Capital Markets 2013 (McKinsey Global Institute, Mar. 2013); BEA News Release, U.S. Net International Investment Position (Mar. 26, 2013); World Investment Report 2012: Towards a New Generation of Investment Policies (UNCTAD, July 2012); Assoc. Foreign Investors in Real Estate, 20th Annual Survey (Jan. 2012); "Improving the Measurement of Cross-border Securities Holdings:", 98 Fed. Res. Bull. 1 (2012); The Multilateral Aspects of Policies Affecting Capital Flows (IMF, Oct. 21, 2011); Long-term Issues in International Banking (BIS, July 2010). See generally Part II.D.3.a.iv.B above (bank regulatory guidance on country risk management issues). See also Part XI.A.4 below.

2. UK referendum to exit the European Union

   On June 23, 2016, UK citizens voted in a referendum to exit the EU. From a legal perspective, the referendum was a non-binding advisory vote and thus has no immediate legal impact. However, the UK Government has stated that it will proceed with the actions necessary to withdraw from the EU. The terms of this "Brexit" will have a significant effect on cross-border financial services once the UK and the remaining EU member states negotiate an exit agreement. See generally Brexit: Frequently Asked Questions (Cleary Gottlieb, July 2016).

   a. The so-called "MiFID passport" that permits banks and broker-dealers authorized in an EU member state to conduct certain regulated activities cross-border without establishing a branch or subsidiary, and to establish a branch in another EU member state without requiring separate authorization, may no longer apply to the UK if it leaves the EU. Absent a negotiated solution, UK institutions may retain the right to conduct regulated activities with certain EU counterparties only if the EU Commission deems that the UK has an equivalent financial regulatory and supervisory framework to the EU. U.S. institutions with UK bank or broker-dealer subsidiaries have also benefited from this "passport" concept, and will therefore be affected by any changes to that privilege brought about by Brexit. See Banking Daily, Sept. 1, 2016; International Financing Review, Aug. 6, June 25, 2016.

   b. Currently, UK fund managers registered in the EU and managing alternative investment funds can benefit from a fund manager and marketing passport that allows them to market EU funds into the EU. Upon the withdrawal from the EU, and if the UK does not then become a member of the EEA, UK fund managers may need to comply with EU Member State private placement regimes.

c. The UK currently applies consolidated supervision to UK subsidiaries of non-UK banking groups, which is likely to continue even after the UK exits the EU. Additionally, for banking groups supervised on a consolidated basis whose parent company is a UK company, an EU consolidated supervisor may request the creation of an EU intermediate holding company or other form of consolidated supervision for the EU subsidiaries.

d. The results of the UK referendum led to immediate volatility in markets, resulting in the IMF cutting its forecasts for global economic growth for the remainder of 2016 and 2017. See IMF News, July 19, 2016. See also "Risks Still in Medium Range, But Pushed Higher by U.K. Referendum Result", OFR Financial Stability Monitor (July 2016); Bloomberg, July 7, 2016 (UK property funds shut down redemptions). However, certain banks may have benefited, as trading volatility boosted FX and other trading results, in an otherwise low interest rate environment. See American Banker, July 22, 2016; "United Kingdom Referendum Roils Markets", OFR Markets Monitor (2Q 2016).

e. The future of Eurozone trading, particularly Euro-denominated clearing, within the UK remains uncertain. See Financial Times, July 18, 2016; Reuters, July 18, 2016.

f. Banks may face increased costs in moving operations out of London in the event that restrictions on access to EU financial services markets come to fruition. See Business Times, July 11, 2016. For banks outside of the EU, many are reliant on using their UK licenses as a gateway to the EU financial services markets. As such, banks might have to set up subsidiaries, both in the EU and in the UK, which could lead to increased business costs. See International Financing Review, June 25, 2016.

3. Members of the World Trade Organization (the "WTO"), the EU and regional trade organizations have devoted significant attention to trade in financial services, and regulatory initiatives, studies and commentary have addressed the globalization of financial markets and the resulting need for worldwide regulatory coordination. Recent evaluations include, e.g., "Revisiting the Case for International Policy Coordination", Liberty Street Economics (FRBNY, June 1, 2016) (countering the trend, some emerging

economies have opted to focus on home-country regulation and protectionism to limit foreign capital); Global Survey 2014: Regulatory and Market Developments (IIB, Oct. 2014); U.S.-EC High-Level Regulatory Cooperation Forum Common Understanding on Regulatory Principles and Best Practices (June 8, 2011); Assoc. Financial Markets in Europe/SIFMA Release, Mar. 31, 2011 (Reinvigorating Open Trade in Financial Services); U.S.-EU Transatlantic Economic Council Joint Statement (Dec. 17, 2010).

Cross-border coordination and implementation continues to be a focus of domestic regulators, as well as their foreign and international counterparts. For example, regulators from the U.S. and EU meet periodically under the Financial Markets Regulatory Dialogue (recently renamed the "U.S.-EU Financial Regulatory Forum") to discuss technical and policy matters. See U.S. Department of the Treasury Press Releases, July 25, July 19, Feb. 12, 2016, Sept. 23, Jan. 15, 2015, July 11, 2014 (description of ongoing negotiations).

Representatives from the U.S. and EU continue to work towards and negotiate the Transatlantic Trade and Investment Partnership ("TTIP"). See 78 Fed. Reg. 19566 (Apr. 1, 2013). Efforts to conclude the TTIP agreement before the end of President Obama's term have been thwarted by recent events, including the UK's referendum to leave the EU. U.S. demands have come under protest by key member states of the EU, including France and Germany. While the EU has sought to include enhanced cooperation on financial regulation in the trade talks, the U.S. has only thus far agreed to include financial market access issues and has defended its position to exclude financial regulation from the TTIP negotiations. See Euractiv.com, July 18, 2016; Securities Law Daily, July 6, 2016; Banking Daily, Jan. 27, 2016; Financial Times, July 28, 2016, June 16, 2014; The Hill, June 7, 2016; World Finance, July 17, 2013.

In contrast, twelve nations concluded the Tran-Pacific Partnership ("TPP") in February 2016. The final proposal awaits ratification by the twelve signatories. U.S. ratification could be jeopardized by a provision that exempts financial services from a ban on nations requiring localized data storage. See American Banker, July 8, 2016; Banking Daily, Mar. 10, 2016.

Bilateral Investment Treaties ("BIT") provide another alternative to cross-border coordination. As of June 2016, there were close to 3000 BITs, entered into between two counties to define investor and creditor protections and ensure investor-state arbitration to resolve disputes. See The Deal Pipeline, June 10, 2016.

4. U.S. regulators have addressed the internationalization of financial markets in a number of ways. See also Part XI.D, Part XI.F and Part XI.G below.

   a. U.S. banking regulators have entered into statements of cooperation or MOUs with non-U.S. regulators to share supervisory information, demonstrate a mutual commitment to principles of comprehensive consolidated supervision, and enhance cooperation in resolving troubled cross-border financial institutions. See, e.g., Coordination in the Reform of International Financial Regulation: Addressing the Causes of Legal Uncertainty (Financial Markets Law Committee, Feb. 2015); Interim Feedback Statement on Discussion Paper on Coordination in the Reform of International Financial Regulation (Financial Markets Law Committee, Sept. 2015); FDIC/People's Bank of China MOU, Oct. 24, 2013; FinCEN/Mexico National Banking and Securities Commission MOU, Oct. 24, 2013; FDIC/Bank of England, Resolving Globally Active, Systemically Important, Financial Institutions, Dec. 10, 2012; FDIC/Bank of England MOU, Jan. 10, 2010; FDIC/FSA MOU, June 25, 2008; Board/Comptroller/FDIC/Australian Prudential Regulation Authority Statement of Cooperation, Oct. 19, 2006; Board/Comptroller/FDIC/OTS/EC Statement of Cooperation on the Exchange of Information for the Purposes of Consolidated Supervision, Sept. 17, 1999 (supplemented Sept. 27, 2004, Sept. 20, 2005); Guidance on Information Sharing (IOSCO, Nov. 1997).

   See also Part I.A, Parts II.A.2 through II.A.4, and Part II.A.7 above and Part XI.E.2 below.

b. The general framework of U.S. securities laws applies to non-U.S. as well as U.S. issuers, although U.S. securities regulators have modified restrictions on foreign issuers and purchasers to encourage participation in U.S. markets and, at times, to address concerns about extraterritorial application of U.S. laws.

(i) While Sarbanes-Oxley's focus on improved disclosure, corporate governance and higher professional standards for issuers of securities publicly traded in the U.S. does not distinguish between U.S. and non-U.S. issuers, and while global adoption of Sarbanes-Oxley principles has become increasingly widespread (including in respect of strengthening auditor independence, audit committee requirements and internal controls), in its rulemaking the SEC tried to be responsive to non-U.S. issuer concerns regarding potential conflicts with home country laws. See, e.g., Whoriskey, "Taking Foreign Issuers Private", M&A Lawyer (May 2005). See also Part I.A.8.d.iii and Part II.A above.

A) Dodd-Frank § 989G amends Sarbanes-Oxley to remove certain obligations related to internal controls and related reporting for certain non-U.S. issuers. In 2010, the SEC adopted final rules with respect to the compliance obligations. 75 Fed. Reg. 57385 (Sept. 21, 2010).

B) The SEC revised its rules to make it easier for non-U.S. private issuers to deregister and terminate their SEC registration and reporting obligations. See SEC Release No. 34-55540 (Mar. 27, 2007); Silverman, Galvis & Mejia, "Requirements for Foreign Private Issuers to Terminate U.S. Reporting Obligations", World Securities Law Report, Jan. 2008.

C) In 2011, the SEC announced a policy change with respect to review of registration statements of foreign issuers, and limited the practice of "non-public" review of initial registration statements to circumstances where the registrant is (i) a foreign government registering its debt securities; (ii) a foreign private issuer that has listed or is concurrently listing its securities on a non-U.S. securities exchange; (iii) a foreign private issuer that is being privatized by a foreign government; or (iv) a foreign private issuer that can demonstrate that the public filing of an initial registration statement would conflict with the law of an applicable foreign jurisdiction. See Non-public Submissions from Foreign Private Issuers (SEC, Dec. 8, 2011, updated May 30, 2012).

(ii) With respect to cross-border tender and exchange offers and similar transactions:

A) SEC Release No. 33-7759 (Oct. 22, 1999) (as amended (see SEC Release No. 33-8957 (Sept. 19, 2008), the "Cross-border Release") adopted exemptions under the U.S. securities laws to encourage non-U.S. issuers and bidders to extend tender/exchange offers, rights offerings and offers of securities in connection with business combinations to U.S. security holders. In a number of areas, however, the rules do not go as far as some practitioners believe appropriate. See, e.g., Cleary Gottlieb Comment Letter to the SEC, June 27, 2008.

The Cross-border Release also addressed disclosure over the Internet and advised offerors in non-U.S. tender/exchange offerings and rights offerings to take "special care" that their websites not be used to induce indirect participation by U.S. securities holders.

B) The SEC also revised its rules governing takeover and other M&A transactions so as to reduce restrictions on communications, balance the regulatory treatment of cash and stock tender offers, and integrate disclosure requirements for issuer tender offers, third-party tender offers and going-private transactions (17 C.F.R. §§ 229.1000 et seq. ("Regulation M-A")). See SEC Release No. 33-7760 (Oct. 22, 1999).

C) The SEC exempts financial advisers and their affiliates from certain restrictions applicable to tender offers in the context of cross-border transactions involving equity securities issued by non-U.S. private issuers. See Cleary Gottlieb (avail. Apr. 4, 2007).

D) UBS Group AG (avail. July 22, 2014) granted UBS an exemption from Rule 14e-5 to form a new non-operating group holding company via a share-for-share exchange offer. The exemption permitted (i) the dual U.S./Swiss offer structure, (ii) non-U.S. market activities in UBS shares, and (iii) limited U.S. market activities in UBS shares during the Rule 14e-5 restricted period. See also, e.g., Stork Holdco (avail. Dec. 19, 2014) (no action with regard to timing of consideration payment in bid for UK company and exemption from Rule 14e-5 for purchases outside the offer).

E) See also Mphasis Ltd. (avail. June 28, 2016) (exceptions for partial tender offer under Indian law); Metalink Ltd. (avail. Feb. 16, 2016) (exceptions for partial tender offer under Israeli Law).

(iii) The SEC and FASB have participated in efforts to promote international convergence in financial statement and disclosure requirements.

A) There have been numerous reports and releases regarding a multinational financial reporting framework (including IFRS), and the SEC has accepted financial statements from non-U.S. private issuers prepared in accordance with IFRS without reconciliation to U.S. GAAP. See SEC Releases

No. 33-9109 (Feb. 24, 2010), No. 33-8879 (Dec. 21, 2007).

The SEC issued a "Work Plan for the Consideration of Incorporating [IFRS] into the Financial Reporting System for U.S. Issuers" (the "SEC IFRS Work Plan"), as well as several papers building on the SEC IFRS Work Plan. See, e.g., [SEC IFRS Work Plan]—Progress Report (SEC, Oct. 29, 2010); [SEC IFRS Work Plan]—Exploring a Possible Method of Incorporation (SEC, May 26, 2011); [SEC IFRS Work Plan]—A Comparison of U.S. GAAP and IFRS (SEC, Nov. 16, 2011); [SEC IFRS Work Plan]—An Analysis of IFRS in Practice (SEC, Nov. 16, 2011).

SEC staff published a final Staff Report pursuant to the SEC IFRS Work Plan in 2012. This Report identifies potential challenges to implementing IFRS in the U.S. See [SEC IFRS Work Plan] Final Staff Report (SEC, July 13, 2012). See also IFRS Foundation Staff Analysis of the SEC Final Staff Report (Oct. 22, 2012) (critique of and responses to the SEC Final Staff Report).

In a draft of its Strategic Plan for 2014-2018, the SEC appears to shift away from efforts to converge U.S. accounting standards and IFRS. See Wall St. J., Feb. 4, 2014; SEC Strategic Plan 2014-2018 Draft, SEC Release No. 34-71466 (Feb. 3, 2014). Cf. IFRS Application Around the World, Jurisdictional Profile: [U.S.] (IFRS Foundation, last updated June 16, 2016); Remarks of SEC Chief Accountant Schnurr, June 5, 2015 (although little or no support for full scale adoption of IFRS in U.S., there is continued support for convergence of globally accepted accounting standards).

Nevertheless, the SEC and its staff are reportedly considering allowing U.S. companies to supplement their U.S. financial statements with statements prepared under IFRS. See Wall St. J. Dec. 10, 9, 2015. The SEC has not yet adopted such proposal, however.

B) Since 2003, the FASB and the IASB have collaborated through joint projects to develop common standards (the FASB under U.S. GAAP, and the IASB under IFRS). Over time, the two standards are expected to both improve in quality and become increasingly similar. In early 2013, the IFRS Foundation (which oversees the IASB) created a new Accounting Standards Advisory Forum ("ASAF") to broaden the scope of the IASB's collaborative efforts. The FASB is participating in the ASAF as one of its 12 members. See Bloomberg, Mar. 29, 2013.

Among other recent relevant releases, see, e.g., Report to the FSB Plenary on Accounting Convergence (FASB/IASB Apr. 2012); Accounting Standards Update: Fair Value Measurement – Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS (FASB/IASB, May 2011); Progress Report on Commitment to Convergence of Accounting Standards and a Single Set of High Quality Global Accounting Standards (FASB/IASB, Nov. 29, 2010); FASB/IASB MOU, Feb. 27, 2006 (Roadmap for Convergence between IFRS and U.S. GAAP). See also Handbook on Securities Statistics (IMF/BIS/ECB, May 2015) (international standardization of presentation of securities data); Part V.A.4.a. above.

C) The SEC approved PCAOB rules requiring all accounting firms, both U.S. and non-U.S., to register with the PCAOB under Sarbanes-Oxley. However, PCAOB rules accommodate non-U.S. firms, including through reliance on inspections and sanctions by the accounting firm's home country. See SEC Releases No. 34-61649 (Mar. 4, 2010), No. 34-50291 (Aug. 30, 2004), No. 34-48180 (July 16, 2003). See also PCAOB Updated Information on PCAOB International Inspections (Dec. 31, 2010); (Oct. 7, 2010).

D) Dodd-Frank § 929J requires (i) a foreign public accounting firm, if requested, to produce its audit papers to the SEC and the PCAOB if the firm issues an audit report, performs audit work, conducts interim reviews, or provides material services on which a PCAOB-registered accounting firm relies; and (ii) that any PCAOB-registered accounting firm that relies on the work of a foreign public accounting firm must produce the foreign firm's audit work papers, if asked, and secure the agreement of the foreign firm to cooperate.

i) Dodd-Frank § 981 amends Sarbanes-Oxley to provide for the sharing of information with foreign auditor oversight authorities without waiving confidentiality or privilege.

ii) In the first case of its type, in 2012, the SEC initiated an enforcement action against Shanghai-based Deloitte Touche Tohmatsu CPA Ltd. ("D&T Shanghai"), charging the firm with violating Sarbanes-Oxley (as amended by Dodd-Frank § 929J). D&T Shanghai had refused the SEC's subpoena to produce documents related to its work with a China-based company under investigation for potential accounting fraud. D&T Shanghai claimed that it was prevented from producing the documents by Chinese law. See SEC Admin. Proc. No. 3-14872 (May 9, 2012). The SEC dismissed the subpoena enforcement action after receiving a "substantial volume of documents called for by its subpoena" from the China Securities Regulatory Commission

("CSRC"). See SEC Litigation Release No. 22911 (Jan. 27, 2014).

iii) In BDO China Dahua CPA Co. et al., SEC Admin. Proc. Nos. 3-14872, 3-15116 (Feb. 6, 2015), the SEC imposed sanctions of $500,000 against each of four Chinese subsidiaries of U.S. accounting firms for refusal to provide the SEC with audit workpapers and other materials regarding fraud investigations into Chinese issuers of U.S.-registered securities. See also SEC v. D&T Shanghai, 940 F. Supp. 2d 10 (DDC 2013) (denying D&T Shanghai motion to stay proceedings and clarifying that the D&T Shanghai proceeding seeks compliance with subpoena, whereas the multi-accounting firm proceeding seeks censure and a bar against practice before the SEC).

iv) On May 24, 2013, the PCAOB entered into an MOU with the CSRC and the China Ministry of Finance to establish a cooperative framework governing the production and exchange of documents relating to cross-border investigations of audit firms.

E) SEC Release No. 34-58465 (Sept. 5, 2008) expanded the exemption for certain foreign private issuers from SEC registration if they meet certain conditions and make it easier for U.S. investors to gain access to a foreign issuer's non-U.S. disclosure documents through English-language publication on electronic websites. (This amendment does not include the most controversial eligibility requirement from the SEC's initial proposal, which would have made a foreign company ineligible for the exemption if trading in the U.S. represented more than 20% of the company's worldwide trading volume. U.S. trading must represent no more than 45% of the company's worldwide trading volume.)

(iv) Regulation M under the 1934 Act -- see SEC Release No. 34-38067 (Dec. 20, 1996); 17 C.F.R. Part 242 (SEC Rules 100-105) ("Regulation M") -- restricts certain trading and stabilization activities (including certain non-U.S. securities activities of non-U.S. participants in a distribution into the U.S.).

The SEC has issued exemptions from Regulation M to non-U.S. issuers permitting them to conduct banking, insurance, asset management, brokerage, market-making, derivatives and hedging activities during the restricted period of offerings by the issuers, subject to information barriers, access by the SEC to information about the activities and the requirement that the transactions be conducted in the ordinary course of business. Among the most recent exemptions, see, e.g., National Bank of Greece S.A. (avail. Nov. 13, 2015); Royal Bank of Canada (avail. Apr. 21, 2015); BBVA (avail. Nov. 17, 2014, Oct. 28, 2010); Banco Santander (avail. Sept. 18, 2014); Deutsche Bank (avail. June 4, 2014, Sept. 16, 2010); National Bank of Greece (avail. May 7, 2014); Lloyds (avail. Mar. 25, 2014, Sept. 16, 2013); Barclays (avail. July 31, 2013); Bank of Ireland (avail. June 7, 2011); Bank of Montreal (avail. Apr. 8, 2011); Toronto-Dominion (avail. Aug. 19, 2010); Exemption under Rule 10b-13 for Certain Principal Trading and Market Making Activities (avail. June 29, 1998).

The Offshore Website Release addresses the application of U.S. securities registration requirements to non-U.S. offers and sales of securities and investment services via the Internet. See Part IX.F.2 and Part XI.D.3 below.

(v) Enforcement actions and litigation with respect to international securities and related transactions include the following:

A) In the Matter of Credit Suisse International and Credit Suisse Securities (USA), CFTC Docket No. 16-10 (Mar. 22, 2016), fined and censured Credit

Suisse for exceeding its speculative position limit on wheat futures on multiple occasions, and for submitting materially false and misleading information to the CFTC's Division of Enforcement regarding these futures and related swaps.

B) SEC v. Caledonian Bank Ltd., Litigation Release No. 23195 (Feb. 12, 2016), charged a Cayman Islands bank with allegedly violating §5 of the 1934 Act, claiming investors were swindled out of millions in a pump-and-dump scheme related to stock of shell companies. The SEC's actions to freeze assets, including depositor funds and other client assets, led to a run on a bank and its subsequent failure and filing for bankruptcy. The owner of the bank has sought damages and sanctions against the SEC for actions it claims led to its bankruptcy. See BNA Banking Report, Feb. 22, 2016; IA Watch, Dec. 14, 2015.

C) Monex Securities, FINRA Disciplinary Proc. No. 2011025617702 (Dec. 30, 2014), fined and censured a U.S. broker-dealer and its CEO for failing to register, and for paying transaction-related compensation to, personnel of its parent, a Mexican broker-dealer, who sought non-U.S. customers for Monex and transmitted trade orders to Monex.

D) HSBC Private Bank (Suisse), SEC Admin. Proc. No. 3-16288 (Nov. 25, 2014), fined and censured a Swiss private bank for conducting securities transactions with, and providing investment advice to, U.S. clients from locations in Switzerland, in violation of the registration requirements of both 1934 Act and the Advisers Act.

E) HSBC Bank USA, SEC Admin. Proc. No. 3-12809 (Sept. 19, 2007), involved enforcement proceedings in connection with a fraud by Pension Fund of America, which raised funds from investors in Central and South America. Pension Fund used

HSBC's name and logo in offering and marketing materials that falsely suggested that Pension Fund's "trust plans" were co-developed by HSBC and Pension Fund and that investors' funds would be deposited in a trust account at HSBC (when in fact Pension Fund deposited investors' funds in a checking account in its name at HSBC). HSBC was also found to have participated in the selection of offshore, high fee front-loaded mutual funds to be offered to investors under a negotiated fee arrangement where neither the amount of the funds' sales loads, nor HSBC's role in the funds' selection, were disclosed.

F) Citigroup Global Markets Inc. ("CGMI") v. Abbar, No. 11-ev-6993 (SDNY May 2, 2013), involved a Saudi businessman who invested with various affiliates of Citigroup. The District Court concluded that Abbar was not a CGMI "customer" for FINRA arbitration purposes, since his transactions were with Citigroup's London affiliate, even though CGMI personnel were involved. The Second Circuit affirmed the ruling, holding that "'customer' under FINRA Rule 12200 is one who, while not a broker or dealer, either (1) purchases a good or service from a FINRA member, or (2) has an account with a FINRA member." The Court found that since Abbar had neither purchased a good or service from, nor opened an account with, CGMI's U.S. office, Abbar was not a "customer" of CGMI. CGMI v. Abbar, 761 F.3d 268 (2d Cir. 2014).

G) In SEC v. Malom Group AG, No. 13-cv-2280 (D. Nev., Dec. 16, 2013), the SEC filed fraud charges against Swiss-based Malom Group (apparently an acronym for "Make A Lot of Money") for its advance fee schemes wherein investors were allegedly solicited to make upfront payments before international joint ventures or structured note issuances could be consummated. These foreign trading schemes typically ended with no joint venture, note issuance or other investment being completed. The DOJ announced criminal charges against the same six individuals charged in the SEC's complaint. See also SEC v. James L. Erwin and Joint Venture Solutions, Inc., SEC Litigation Release No. 23383 (Nov. 23, 2015) (default judgment entered against individual and company for violating securities offering and broker-dealer registration provisions by promoting investments in Malom Group AG).

H) In GLG Partners, SEC Release No. 34-71050 (Dec. 12, 2013), the SEC settled charges against a London-based hedge fund adviser and its former U.S.-based holding company for internal control failures that led to the overvaluation of an emerging market fund's assets and inflated fee revenue for the firms. The settlement required the hiring of an independent consultant to recommend and test new valuation procedures.

I) The SEC charged five individuals with ties to a New York City brokerage firm, Direct Access Partners ("DAP"), in a scheme allegedly involving fraudulent trades and excessive fees charged to Banco de Desarrollo Económico y Social de Venezuela ("BANDES"), a state-owned Venezuelan bank. The DAP traders allegedly coordinated with the BANDES Vice President of Finance to defraud BANDES by increasing DAP's fees through the use of significant markups or markdowns, internal wash trades and roundtrip trades. A portion of the inflated fees were returned to the Vice President as kickbacks for authorizing the trades. In a parallel action, criminal charges were brought against three of the DAP traders and the BANDES Vice President. The CEO of DAP and six co-conspirators settled with the SEC for a $42.5 million fine. SEC v. Bethancourt, et al., 13-Cv-3074 (SDNY June 12, 2013 (first amended complaint), Apr. 14, 2014 (second amended complaint), SEC Litigation

Release No. 23513 (Apr. 8, 2016) (settlement)). In August 2013, three defendants pleaded guilty to FCPA, money laundering and similar offenses. See DOJ Press Release, Aug. 30, 2013. In November 2013, the BANDES Vice President pleaded guilty to five charges. See Law360, Jan. 15, 2016. Additional defendants pleaded guilty in December 2014. See DOJ Press Release, Dec. 17, 2014.

J) Regions Bank, SEC Litigation Releases No. 21215 (Sept. 21, 2009) (complaint), No. 21682 (Oct. 4, 2010) (Order), involves enforcement proceedings for Regions' actions in connection with mutual fund offering fraud against Latin American and other investors. As trustee of investment plans offered by U.S. Pension Trust Corp. and U.S. College Trust Corp. (collectively, "USPT"), Regions allowed USPT to use its name in marketing materials, prepared a promotional video posted on USPT's website, and sent representatives to Latin America to meet with sales agents and prospective investors to explain Regions' role as trustee. Regions entered into trust relationships with investors, processed their contributions, and purchased mutual funds for them. However, when it sent them confirming certificates (prepared by USPT but signed by a Regions representative), it failed to disclose the amounts taken out for USPT's fees and commissions. Regions' Trust Agreement and Trust Summary also failed to disclose USPT commissions and fees.

In 2011, a federal appeals court affirmed the aiding-and-abetting liability of three USPT principals. See SEC v. U.S. Pension Trust Corp., 444 Fed. Appx. 435 (11th Cir. 2011).

K) Pentagon Capital Management, SEC Litigation Release No. 20516 (Apr. 3, 2008), charged a UK investment adviser with late trading, market timing and deceptive marketing involving U.S. mutual funds.

L) ING Bank, SEC Admin. Proc. No. 3-11991 (July 26, 2005), represents a cease-and-desist proceeding with respect to the failure of ING (as issuer of securities in the U.S.) to implement policies outside of the U.S. to prevent transactions by ING affiliates in such securities (including as market-maker) and the resale of such securities in the U.S. Such transactions were common in the Netherlands and other European countries, and ING's European traders did not understand that, under the 1933 Act, transactions are registered, not securities.

ING instituted policies that (i) prohibit the trading of ING and ING affiliate securities with U.S. customers, except with prior approval of legal/compliance personnel; (ii) provide for an enhanced restricted list to ensure that ING and ING affiliate securities appear among the restricted securities; (iii) require daily reviews of trading in ING and ING affiliate securities; (iv) require relevant employees to be notified of these procedures; and (v) mandate legal/compliance education regarding U.S. securities laws.

M) Pinker v. Roche Holdings, 292 F.3d 361 (3d Cir. 2002), held that a non-U.S. issuer of sponsored ADRs is subject to personal jurisdiction in the U.S. regardless of whether the ADRs are listed on a U.S. exchange.

(vi) In recent years, the SEC has brought enforcement actions with respect to wrongful conduct related to marketing under the Immigrant Investor Program (or the "EB-5 Program"). Congress created the EB-5 Program in 1990 to promote job creation and capital investment by foreign investors. The program provides EB-5 visas for participants who invest in certain approved commercial enterprises that the U.S. Citizenship and

Immigration Services deems will create jobs and are otherwise appropriate. Multiple enforcement actions have been initiated against persons and law firms that have used the EB-5 Program to launch fraudulent and unregistered securities offerings. See, e.g., SEC v. Hui Feng and Law Offices of Feng & Associates, SEC Litigation Release No. 23420 (Dec. 7, 2015) (complaint) (failure to disclose commissions and acting as unregistered broker); SEC Press Release 2015-274 (Dec. 7, 2015) (lists settlements with individuals, attorneys and law firms of allegations of acting as unregistered brokers); Ireeco, SEC Press Release 2015-127 (June 23, 2015) (unregistered broker for EB-5 investments); Investor Alert: Investment Scams Exploit Immigrant Investor Program (SEC, Oct. 9, 2013); SEC v. Ramirez, No. 13-cv-00531 (S.D. Tex., Sept. 30, 2013) (complaint) (misappropriation of funds); SEC v. A Chicago Convention Center, No. 13-cv-982 (N.D. Ill., Feb. 6, 2013) (complaint) (fraudulent projects and misappropriation of funds).

(vii) In 1997, the SEC issued a concept release requesting comment on cross-border electronic trading and the regulation of non-U.S. market activities in the U.S. The SEC never acted on the various proposals discussed in this release. See SEC Release No. 34-38672 (May 23, 1997) (solicitation of public comments).

(viii) For a detailed analysis of legal issues respecting global offerings of securities and related matters, see U.S. Regulation of International Securities Markets, Chapter 5. See also Fleisher & Castellon, "Regulation S Selling and Transfer Restrictions: A Basic User's Guide", Insights (Aug. 1, 2012) ("Regulation S User's Guide").

c. U.S. securities and commodities regulators have emphasized the need for international cooperation to develop a worldwide market system, including efficient structures for dissemination of information, clearing, settlement and payment procedures, capital adequacy standards, disclosure and fair and honest markets. As of November 2015, 106 of IOSCO's 130 members have signed its Multilateral MOU concerning Consultation, Cooperation and the Exchange of Information (the "IOSCO MMOU"), and a further 20 members have indicated their commitment to becoming signatories.

The SEC/CFTC/FINRA have entered into MOUs or other information-sharing, regulatory cooperation, technical assistance and enforcement arrangements with numerous foreign regulators, including those in Argentina, Australia, Belgium, Brazil, Bulgaria, Canadian provinces, Chile, China, Costa Rica, Denmark, Egypt, the EC, France, Germany, Hong Kong, Hungary, India, Indonesia, Ireland, Isle of Man, Israel, Italy, Japan, Jersey, Korea, Lithuania, Luxembourg, Malaysia, Mexico, the Netherlands, New Zealand, Norway, Peru, Poland, Portugal, Russia, Singapore, South Africa, Spain, Sweden, Switzerland, Taiwan, Turkey and the UK.

MOU-related issues are reflected in, e.g., CFTC/Comisión Nacional Bancaria y de Valores/Banco de Mexico MOU (Sept. 6, 2016); CFTC MOUs with Canadian provinces (Mar. 25, Oct. 21, 2014, Apr. 20, July 27, 2016); Memorandum of Understanding Between CFTC and Hong Kong Securities and Futures Commission (Dec. 21, 2015); CFTC Press Release PR7247-15 (Sept. 25, 2015) (Korea MOU); Statement of [EU] and [U.S.] on Shared Principles for International Investment (Apr. 10, 2012); Declaration on the Cooperation and Supervision of International Futures Exchanges and Clearing Organizations; SEC Cooperative Arrangements with Foreign Regulators (modified June 11, 2010); Principles Regarding Cross-border Supervisory Cooperation (IOSCO, May 2010); SEC Press Release 2009-198 (Sept. 16, 2009) (SEC and UK FSA Discuss Approaches to Global Regulatory Requirements); FSA and CFTC to Enhance Regulatory Cooperation and Cross-border Surveillance of Oil Markets (FSA, Aug. 20, 2009); MOUs (IOSCO, July 2007); CFTC Backgrounder No. 4-92 (Apr. 27, 2005) (The CFTC: An Active Partner in Global Cooperation through Information-sharing with Other Financial Regulators). See also, e.g., Germany (avail. Nov. 16, 1993) (describing SEC authority to request legal assistance from non-U.S. governmental/regulatory bodies).

Dodd-Frank § 929K allows the SEC and domestic and foreign securities and law enforcement authorities to share information without waiving any privilege applicable to that information. It also prevents the SEC from being compelled to disclose privileged information obtained from a foreign authority, if the foreign authority represents that the information is privileged.

d. A U.S. interagency taskforce (involving the Executive Office of the President, the Departments of Commerce and State, the DOJ, Treasury, the FCC and the FTC) issued the Framework for Global Electronic Commerce (July 1, 1997) to guide policy development relating to electronic commerce and provide the basis for international negotiations. The U.S. has signed joint statements on electronic commerce with a number of jurisdictions, including Australia, Chile, Colombia, Egypt, the EU, France, Ireland, Japan, Jordan, Korea, the Netherlands, the Philippines, Singapore and the UK. See also SAFE WEB Act 2009 Report.

e. Dodd-Frank directs U.S. regulators to coordinate with their foreign counterparts and conduct studies relating to international policy issues. See Dodd-Frank §§ 175(b) (matters relating to systemic risk), 175(c) (consultation with foreign regulators and multilateral organizations to encourage prudential regulation and supervision for highly leveraged and interconnected financial companies), 217 (international coordination relating to the resolution of systemically significant financial companies), 719(c) (international swap regulation), 752(a) (regulation of swaps and swap entities), and 752(b) (international standards for the regulation of futures). See generally Part I.B above.

See also Part XI.E below with respect to SEC accommodation to non-U.S. entities under the 1934 and Advisers Acts.

5. With respect to certain aspects of non-U.S. investment in U.S. securities:

a. Pursuant to the International Investment and Trade in Services Survey Act, 22 U.S.C. §§ 3101 et seq., Treasury conducts a survey of non-U.S. portfolio investment in the U.S. once every five years. See Treasury/Board/FRBNY Report on Foreign Holdings of U.S. Securities at End-June 2012 (Apr. 2013). Smaller annual surveys of the largest reporters are also conducted.

   Surveys of U.S. ownership of non-U.S. securities are also conducted. See 76 Fed. Reg. 37403 (June 27, 2011); 75 Fed. Reg. 80294 (Dec. 22, 2010); Treasury/Board/FRBNY Report on U.S. Portfolio Holdings of Foreign Securities (Oct. 2012) and Instructions for Monthly Treasury International Capital Report on Aggregate Holdings of Long-term Securities by U.S. and Foreign Residents (June 2011); 72 Fed. Reg. 54715 (Sept. 26, 2007).

b. The BEA conducts (i) quarterly, annual and benchmark (once every five years) surveys of non-U.S. investment in the U.S. and U.S. investment abroad, and (ii) a benchmark Survey of Financial Services Transactions between U.S. Financial Services Providers and Unaffiliated Foreign Persons. See 15 C.F.R. Parts 801 and 806; Forms BE-12, BE-15, BE-180, BE-577 and BE-605. See also 79 Fed. Reg. 47573 (Aug. 14, 2014) (reinstatement of Form BE-13, Survey of New Foreign Direct Investment in the U.S., to measure the acquisition or establishment of U.S. business enterprises by foreign investors).

See also Part VII above.

B. GRAMM-LEACH-BLILEY ACT, REGULATION K AND RELATED MATTERS

1. Impact of the Dodd-Frank Act and Evolution of the Separate Entity Doctrine

The Dodd-Frank Act imposes a number of new restrictions and requirements on activities of banking organizations. In relation to such restrictions, the Dodd-Frank Act (i) does not, in general, provide broader authority for U.S. FHCs/BHCs/banks to conduct such restricted activities outside of the U.S. (and, thus, cuts back on existing Regulation K empowerments), but (ii) provides exemptions meant to allow non-U.S. banking organizations to conduct such activities outside of the U.S. (though the scope of such exemptions may, in practice, be rather limited). See Part I.B and Part II above.

Because of this distinction, however, an important consideration in structuring international operations is often determining the appropriate legal form of establishment in a particular jurisdiction -- i.e., through a subsidiary organized under local law or, particularly for banks in contrast to other legal entities, through a branch office of the banking organization.

a. The "separate entity doctrine", in its broadest form, stands for the concept that a branch, although part of the same bank legal entity, is a separate and distinct entity for purposes of the applicability of certain statutes and regulations, and the exercise of jurisdiction. For example, in insolvency of a bank, a branch may be "ring-fenced" and liquidated by local country authorities in a manner separate from the bank as a whole. See, e.g., 12 U.S.C. § 3102(j); NY Banking Law § 606 et seq. For background on the separate entity doctrine as applied to U.S. branches of foreign banks in light of the enactment of Dodd-Frank, see, e.g., White Paper on the Separate Entity Doctrine as Applied to the U.S. Branches of Foreign Headquartered (Non-U.S.) Banks (Cleary Gottlieb, Davis Polk, Sullivan & Cromwell, Apr. 19, 2012). The separate entity doctrine has also been significantly associated with attempts by judgment creditors to either attach, or receive payment from, assets of judgment debtors held outside the United States. See, e.g., Cronan v. Schilling, 100 N.Y.S.2d 474 (NY Sup. Ct., NY Co. 1950) (warrant of attachment served on a branch may not reach assets held for, or other accounts of, a person in other branches or in the home office).

b. A series of recent cases have debated the scope and history of the separate entity doctrine, ultimately concluding (at least in New York) that the doctrine remains in effect. See inter alia, Koehler v. Bank of Bermuda, 12 N.Y.3d 533 (Ct. App. 2009) (responding to question certified from Second Circuit with 4-3 vote; New York court with personal jurisdiction over the garnishee bank may order the garnishee to turn over property of a judgment debtor, even if the property is outside the U.S.); Samsun Logix Corp. v. Bank of China, 929 N.Y.S.2d 202 (N.Y. Sup. Ct. 2011) (distinguishing Koehler, stating that the Koehler Court "had not intended to overrule" the separate entity doctrine); Motorola Credit Corp. v. Standard Chartered Bank, 24 N.Y.3d 149 (NY 2014) (NY Court of Appeals responding to question certified from Second Circuit; concluding that the separate entity doctrine "is a firmly established principle of New York law" and that service of a restraint on a garnishee bank's NY branch "is ineffective under the separate entity rule to freeze assets held in the bank's foreign branches"; distinguishing Koehler as a case that did not involve bank branches or assets held in bank accounts); Motorola Credit Corp. v. Standard Chartered Bank, 771 F.3d 160 (2d Cir. 2014) (per curiam) (after certifying question to NY Court of Appeals, vacating restraining order on defendant's assets in non-U.S. branches). Cf. Goodyear Dunlap Tires Operations, S.A. v. Brown, 131 S. Ct. 2846 (2011) (no specific or general personal jurisdiction over a foreign subsidiary of a U.S. corporation where the subsidiary itself lacks "the continuous and systemic general business contacts" with the state notwithstanding contacts of parent).

A threshold question in these cases is whether the court has general jurisdiction over the bank through the activity of its local branch, has only specific jurisdiction related to transactions of the branch in the forum state, or has no jurisdiction at all. See Daimler AG v. Bauman, 134 S.Ct. 746 (2014) (warning against risks to international comity, general jurisdiction should be found only in a state that is the company's formal place of incorporation or its principal place of business, or in a state where the company's contacts are so continuous and systematic as to constitute the company's "home"); Gliklad v. Bank Hapoalim, No. 155195/2014 (NY Sup. Ct., NY Cnty., Aug. 4, 2014) (pursuant to Daimler, but in contrast to Koehler, court does not have general jurisdiction over Bank Hapaolim, therefore requiring that it deny petition to enforce judgment against assets held in non-U.S. branch; bank only consented to specific jurisdiction when applying for branch license from NYDFS; "no reason to believe" that Koehler resulted in abrogation of separate entity rule); Gucci America v. Bank of China, 768 F.3d 122 (2d Cir. 2014) (regardless of personal jurisdiction over bank, personal jurisdiction over account holders by District Court is also required to restrain account holders' assets; reversing, in light of Daimler, finding of general jurisdiction over Bank of China and remanding to District Court to consider, in light of Daimler and in light of international comity considerations, whether court has specific jurisdiction over Bank of China to compel compliance with asset freeze injunction against non-U.S. branches); Gucci America v. Weixing Li, 135 F. Supp. 3d 87 (SDNY 2015) (District Court on remand finding specific jurisdiction over Bank of China based on correspondent banking transactions in-state and subpoena subject matter related to such transactions); Vera v. Cuba, 91 F. Supp.3d 561 (SDNY 2015) (in context of enforcing information subpoena, finding Daimler limited to situations where the parties to the lawsuit have not consented to jurisdiction and holding that a bank is subject to general jurisdiction in NY through consent provided during its branch application process); B&M Kingstone v. Mega International Commercial Bank, 15 N.Y.S.3d 318 (NY App. Div., 1st Dept., Aug. 11, 2015) (holding that Motorola was limited to restraining orders on assets held at non-U.S. branches, and does not bar jurisdiction over a bank to compel a full response to an information subpoena; bank also consented to general personal jurisdiction in context of obtaining branch license from NYDFS); Cortlandt Street Recovery Corp. v. Deutsche Bank AG, London Branch, 2015 WL 5091170 (SDNY Aug. 28, 2015) (court did not have general or specific jurisdiction over Deutsche Bank); Motorola Credit Corp. v. Uzan, 132 F.Supp.3d 518 (SDNY 2015) (in light of Daimler and Gucci, court revisited earlier decision compelling foreign banks to provide non-U.S. information in response to subpoenas; court now held that the banks were not subject to general jurisdiction in New York; establishment of a branch "and satisfaction of any attendant licensing requirements" is not sufficient to establish general jurisdiction); Leibovitch v. Islamic Republic of Iran, No. 08-cv-01939 (N.D. Ill., May 19, 2016) (general jurisdiction not found based on foreign banks' branches in Chicago, regardless of bank's registration to conduct business in the state or appointment of agent for service of process; linkage between discovery sought and banks' U.S. contacts not sufficient for specific jurisdiction; disagreeing with Vera v. Cuba); Brown v. Lockheed Martin Corp., 814 F.3d 319 (2d Cir. 2016) (mere registration to do business in a state is not sufficient to exercise general jurisdiction over a company); Genuine Parts Company v. Cepec, 137 A.3d 123 (Del. 2016) (Del. corporate law requirements for foreign corporation to have agent for service of process and to register to do business are not sufficient for general jurisdiction).

See also NYLJ, Mar. 17, 2016 (questioning whether NY Banking Law requirement to appoint agent for service of process is sufficient to exercise general jurisdiction).

c. Similarly, the concept of "national treatment" has also been an important consideration in statutory and regulatory requirements on the local offices of foreign banks, both affording such offices the benefits of authorities and opportunities available to local banks and restricting those local offices in a manner similar to local banks. See generally Bush, "A Dramatic Departure? National Treatment of Foreign Banks", Banking Perspective (TCH, Q1 2015).

2. Financial Holding Company and Financial Subsidiary Empowerments

Under Gramm-Leach, FHCs and financial subsidiaries may engage in, or acquire companies engaged in, financial activities (including securities underwriting, dealing and market-making activities), whether inside or outside the U.S., without compliance with Regulation K limitations (except for acquisition of a foreign bank).

See generally Part I.A.10 and Part I.C above.

3. General Scope of Regulation K Capital Markets Provisions

Although this Guide is not intended to discuss generally the operation of, and issues under, Regulation K, this Part XI.B addresses certain capital markets-related interpretations and developments. See generally Part I.A.10 and Part I.A.11 above;

Bush & Conroy, "U.S. Regulation of International Activities of U.S. Banking Organizations," Chapter 15, Regulation of Foreign Banks & Affiliates in the United States (7th ed. 2013).

a. Under Regulation K (12 C.F.R. § 211.10), U.S. banking organizations may engage in securities and insurance activities outside of the U.S., including (i) underwriting, distributing and dealing in debt securities and (to a limited extent) equity securities; (ii) investment, financial and economic advisory services; (iii) organizing, sponsoring and managing a mutual fund if the fund's shares are not sold or distributed in the U.S. or to U.S. residents and the fund does not exercise managerial control over its portfolio companies; (iv) FCM services; (v) acting as principal or agent in commodity swap transactions; (vi) underwriting credit life/accident and health insurance; (vii) insurance agency and brokerage services; and (viii) underwriting life, annuity, pension fund-related and other types of insurance approved by the Board as actuarially predictable (such as, e.g., (A) life insurance in the UK, Germany and Australia (Citibank Overseas Investment Corp., 71 Fed. Res. Bull. 267 (1985), 70 Fed. Res. Bull. 168 (1984)); (B) life insurance related to mortgage lending activities in Belgium and Luxembourg (Citicorp, 71 Fed. Res. Bull. 247 (1985)); (C) pension fund-related and disability insurance in Chile (Board Letter to BTCo, Dec. 24, 1985, Fed. Res. Reg. Serv. ¶ 3-767); (D) retirement-related life insurance in Argentina (Board Letter to Citicorp, June 6, 1988); and (E) health insurance in the UK (Board Letter to Citicorp, Oct. 10, 1999); see also Board Staff Memorandum re "Proposed Revisions of Regulation K", July 10, 1990); compare, e.g., Citibank Overseas Investment Corp., 71 Fed. Res. Bull. 267 (1985) (denying application to underwrite property and casualty insurance in Australia)).

b. In addition to their general powers under U.S. banking laws, under Regulation K (12 C.F.R. § 211.4) non-U.S. branches of U.S. banks may conduct insurance agency and brokerage activities and underwrite, distribute, purchase, sell and invest in obligations of foreign governments and their political subdivisions, agencies and instrumentalities. See also Letter

No. 929 (national bank London branch may act as swap clearing member of London Clearing House either under the authority of the NBA or under Regulation K); Letter No. 1102 (national bank Mumbai branch may act as clearing member of India's National Securities Clearing Corp.).

c. Under Regulation K (12 C.F.R. § 211.6), Edge Act or Agreement corporations, which conduct "international or foreign banking or other international or foreign financial operations", may engage in internationally-related securities advisory and agency activities in the U.S. ("Permissible Incidental Activities"), including (i) placing and executing orders for securities transactions (provided such services for U.S. persons are with respect to non-U.S. securities only); (ii) providing portfolio investment advice and management to (A) non-U.S. persons with respect to U.S. financial instruments, real property interests and other investment assets, and (B) U.S. persons and non-U.S. persons with respect to non-U.S. investment assets; (iii) advising (A) U.S. companies on acquisitions of non-U.S. assets; and (B) non-U.S. companies on acquisitions of U.S. and non-U.S. assets; (iv) arranging private placements in the U.S. for non-U.S. companies, and outside the U.S. for U.S. and non-U.S. companies; and (v) acting as insurance agent with respect to insurance on international commercial risks. See generally, e.g., Citibank International, 71 Fed. Res. Bull. 265 (1985); Lloyds Order; Board Letters, Nov. 7, 1984, Aug. 13, 1982.

d. Under Regulation K (12 C.F.R. § 211.23), a qualifying foreign banking organization may engage in activities of any kind outside the U.S., as well as in Permissible Incidental Activities, and the ownership of limited interests in foreign companies with U.S. securities operations. See also Part I.A.11 and Part VII.A.6 above and Part XI.D and Part XI.E below.

e. U.S. and foreign banking organizations that are not FHCs continue to look to Regulation K for authorization to conduct non-U.S. or internationally-related activities, some of which may be broader than those permitted to BHCs generally. Moreover, even an FHC may choose to conduct such activities under its bank subsidiaries, or through entities -- such as Edge Act or Agreement corporations (see, e.g., 12 U.S.C. § 611 et seq.) -- which are not financial subsidiaries under Gramm-Leach (and, thus, operate under Regulation K).

f. FDIC Part 347 (applicable to non-member banks) conforms closely to Regulation K. See 70 Fed. Reg. 20704 (Apr. 21, 2005), 17550 (Apr. 6, 2005); FDIC 1998 Foreign Activities Revisions; Opinion No. 85-22 (FDIC Securities Subsidiary Regulations do not apply to state non-member bank foreign affiliates which engage in securities activities outside of the U.S.).

g. Comptroller Regulations (12 C.F.R. Part 28) apply to non-U.S. activities of national banks, and U.S. activities of federal branches of foreign banks, and the Comptroller has concluded that banks may establish non-U.S. operating subsidiaries that do not operate in reliance on Regulation K. See Part I.A.10, Part I.A.11 and Part I.D.4.c.iii.B above. See also Comptroller's Handbook: Trade Finance and Services.

h. Comptroller Corporate Decision No. 2005-02 (Mar. 24, 2005) authorized JPMorgan Chase Bank to acquire Vastera, a provider of global trade management services. Vastera's U.S. operations would become an operating subsidiary of the Bank and its non-U.S. subsidiaries would be transferred to the Bank's Edge Act subsidiary. Vastera's activities include maintaining a global trade database, preparing financial and trade-related documents, acting as information intermediary for customs services, providing information and advice on trade compliance matters and supplier/shipper performance and managing vendor and custom broker contracts.

4. 2001 Regulation K Revision and Related Developments

a. General

The 2001 Regulation K Revision significantly affected the international operations of U.S. and foreign banking organizations. See generally U.S. Regulation of International Securities Markets, Chapter 19.

(i) Finalization of the Proposed 1997 Regulation K Revision was delayed by Congressional consideration of financial modernization legislation, ultimately passed as the GLB Act. Although more modest than the Proposed Revision, the 2001 Regulation K Revision expands permissible activities abroad for U.S. banks, reduces the regulatory burden on foreign banks operating in the U.S., and streamlines the Regulation K application process.

(ii) The Proposed 1997 Regulation K Revision would have expanded the scope of permissible international activities for U.S. and foreign banking organizations. Because the GLB Act expanded the activities permissible for FHCs, many observers expected the GLB Act to reinforce the Board's willingness to adopt the Proposed Revision. Instead, the 2001 Revision expresses a Board preference that expanded financial activities be conducted pursuant to the GLB Act (<u>i.e.</u>, by FHCs and financial subsidiaries of U.S. banks).

b. <u>Principal Capital Market Revisions: U.S. Banking Organizations</u>

(i) <u>Expanded Permissible Government Bond Trading by Foreign Branches of U.S. Banks</u>

A) Regulation K permits U.S. banks to underwrite and deal through their foreign branches in certain government obligations. <u>See</u> 12 C.F.R. § 211.4(a)(2).

B) The Board <u>retained</u> the existing authority of foreign branches of U.S. banks to underwrite and deal in host government bonds <u>regardless</u> of whether they are investment grade.

C) The Board <u>declined</u> to adopt a similar approach to permissible underwriting with respect to obligations of governments other than the host government, nor an approach that would permit a foreign branch to underwrite such an obligation if it is the credit equivalent of investment grade.

See also Part I.A.10 above.

D) Dodd-Frank § 939A requires the Board to remove all references to or requirements of reliance on credit ratings and substitute alternative standards of creditworthiness in its regulations. The OCC and FDIC have released corresponding guidance for meeting the investment grade standard. See Part II.D.3.a.ii.A.i.

E) Although the SEC has not to date issued formal guidance on the matter, it would not appear that the GLBA Push-out Provisions should adversely affect the ability of non-U.S. branches of U.S. banks to engage in otherwise permissible securities brokerage and trading transactions in non-U.S. securities (and, possibly, U.S. securities) outside the U.S. with non-U.S. persons. See Part II.D.3.b and Part IX.B.3 above.

(ii) Expanded Equity Underwriting and Dealing Activities

A) Equity Underwriting

i) Under the 2001 Regulation K Revision, limits applicable to equity underwriting activities are determined by reference to the Tier 1 capital of the parent bank, as well as to the Tier 1 capital of the investor subsidiary, in the case of well capitalized and well managed investors. Limits for underwriting exposure to a single company are set at (a) 15% of Tier 1 capital where the investor is a BHC, (b) 3% of Tier 1 capital where the investor is a bank, and (c) the lesser of 3% of Tier 1 capital of a parent bank or 15% of the Tier 1 capital of the investor, in the case of any other investor. See 12 C.F.R. § 211.10(a)(14)(i).

The Board retained existing dollar limits for companies that are not well capitalized and well managed. See 12 C.F.R. § 211.10(a)(14)(ii).

ii) Prior notice to the Board is required to engage in equity underwriting, or to take advantage of increased limits. See Board SR Letter 02-3 (Feb. 7, 2002), CCH Fed. Banking L. Rep. ¶ 61-583. See also, e.g., Citibank Prior Notice to Underwrite Equity Securities Through Citibank Overseas Investment Corp. (approved Jan. 29, 2003); Bank of America Prior Notice to Engage in Expanded Underwriting Authority Pursuant to Regulation K (approved Jan. 10, 2002).

B) Equity Dealing

i) The Board made only a "small incremental" increase in equity dealing limits -- which could in some cases require prior notice to the Board -- from \$30 million to the lesser of \$40 million and 10% of the investor's Tier 1 capital. See 12 C.F.R. § 211.10(a)(15).

ii) The Board noted the equity hedging authority granted to national banks under Letter No. 892 (supplemented in respect of Edge Act corporations in Letter No. 924; see Part II.E.3.e above), and concluded that the value of any residual equity positions that remain after netting and offset of equity securities against derivatives must be included in the dealing limit.

iii) The Board clarified that convertible debt prior to conversion, and equity-participating loans, are not subject to the Regulation K equity dealing limit.

iv) Given the provisions of Regulation K permitting the use of hedges (up to 75% of the net long position) and the netting of short positions as a means of reducing long positions in physical securities for purposes of compliance with the equity dealing limits (see 12 C.F.R. § 211.10(a)(15)(iv)), the Board noted that the increase in the dealing limit to $40 million will result in an overall cap on net long positions in physical securities of $160 million where the positions are fully hedged.

(a) This constraint will apply only to net long positions in securities held under Regulation K dealing authority, not to securities acquired under Letter No. 892 (except for any residual positions).

(b) The equity dealing limit will apply to net positions across legal vehicles held, directly or indirectly, by the entity to which the limit is applicable.

(c) With prior Board approval, a U.S. banking organization may use internal models to calculate the value of derivative positions used to offset exposures and net dealing positions in individual stocks, as well as the value of total net equity holdings in the trading account. Internal models must use current market value (rather than historical cost) in determining compliance with the dealing limits. See also Board Chase-Fleming Letter; Board Letter to BTCo, Aug. 25, 1994.

(iii) Limited Expansion of Equity Investment Authority

A) In light of the GLB Act, which expanded merchant banking authority for FHC non-bank subsidiaries, the Board determined not to act favorably on those aspects of the Proposed 1997 Regulation K Revision which would have increased portfolio investment limits to in excess of $25 million and permitted investors to make non-controlling portfolio investments in up to 24.9% of a company's voting shares.

B) The Board also determined that Regulation K investments will no longer be determined on an historical cost basis, but rather will equal the balance sheet carrying value of such investments, reduced by any unrealized gains that are reflected in carrying value but are excluded from the investor's Tier 1 capital.

C) The Board did respond favorably, however, to the proposition that portfolio investments should not be combined with dealing positions for purposes of calculating applicable dollar limits under each authority. Accordingly, the Board determined that such limits will be separately calculated. However, the Board noted that all equity shares held in a company, including those held in connection with dealing activity (but excluding underwriting commitments and shares held for up to 90 days pursuant to an underwriting), must be combined for purposes of determining compliance with (i) the equity investment limitations of BHCA § 4(c)(6) with respect to U.S. companies; and (ii) the voting and total equity percentage limits for portfolio investments under Regulation K with respect to foreign companies.

D) The Board imposed an overall aggregate equity limit on all shares held under Regulation K's portfolio investment and dealing authorities: (1) 25% of a

BHC's Tier 1 capital, where the investor is a BHC; (2) 20% of the investor's Tier 1 capital, where the investor is a bank or a direct subsidiary of a bank; and (3) the lesser of 20% of a parent bank's Tier 1 capital or 100% of the investor's Tier 1 capital, for any other investor.

i) In each case, (A) long and short positions in the same security may be netted; and (B) underwriting commitments, shares held pursuant to an underwriting commitment for up to 90 days, and equity securities held pursuant to permissible hedging of equity derivatives transactions, would be excluded for purposes of such calculation.

ii) The Board declined to adopt a preclearance program for additional investment authority.

E) The Board expanded the general consent authority for investments in a company, particularly for well capitalized and well managed investors. See 12 C.F.R. §§ 211.9(b), (c).

F) The Board noted that Regulation K portfolio investments (not more than 19.9% of the voting shares or 40% of total equity) are permissible only if the investor otherwise does not control the company in which the investment is made. See Part VII.A.6 above.

(iv) No Expanded Insurance Authority

The Board declined to act on that part of the Proposed 1997 Regulation K Revision which would have expanded Regulation K-permitted insurance activities (see Part XI.B.3.a above).

(v) Other Capital Markets-related Provisions and Developments

A) While the Board eliminated any Regulation K requirement that commodity swaps must require cash settlement (see 12 C.F.R. § 211.10(a)(19)), it rejected requests that the commodity swaps provision be expanded to include activities relating to the trading, sale or investment in commodities and underlying physical properties (see also Part II.E above). The Board concluded that such a change would be inconsistent with FRA § 25A, which prohibits Edge Act corporations from engaging in commerce or trading in commodities.

B) The Board eliminated the requirement that an investor seek Board approval before acting as an FCM for financial instruments, and on exchanges, not previously approved by the Board. The Board also eliminated the requirement that investors obtain prior Board approval for FCM activities conducted on any exchange or clearinghouse that requires members to guarantee or otherwise to contract to cover losses suffered by other members (i.e., a mutual exchange) provided that (i) the activity is conducted through a separate subsidiary, and (ii) if the company conducting the activity is a subsidiary of a bank, the parent bank does not provide a guarantee or otherwise become liable to the exchange or clearinghouse for an amount in excess of Regulation K's general consent limit for investments. 12 C.F.R. § 211.10 (a)(18). Compare 12 C.F.R. § 225.28(b)(7)(iv) (Regulation Y provision).

C) In a Letter of Oct. 22, 2004, the Board determined that Zions First National Bank's Edge Act subsidiary could acquire Weather Xchange Limited to engage in brokerage and riskless principal activities related to weather derivatives and provide data and consulting services in connection with weather risk management derivative instruments.

D) In a Letter of Jan. 30, 2003, the Board determined that State Street Bank's Edge Act subsidiary could engage in mutual fund administration under Regulation K to the extent permitted under Regulation Y. See also Board Letters, Nov. 6, 2013 (re: U.S. Bank N.A. agreement corporation), Mar. 30, 2007.

E) In Letter No. 1088, the Comptroller determined that a national bank member of the RepoClear System -- a centralized clearing and netting facility for European government security repo markets -- may use the aggregate daily net repayment obligation to determine lending limit compliance.

F) In the CLAS Letter, the Board approved CLS Bank International's application to acquire 51% of the shares of CLS Aggregation Service LLC under Regulation K to engage in matching and compressing FX trades.

c. Principal Capital Markets Revisions: Foreign Banking Organizations

(i) A qualifying foreign banking organization may engage in any activity outside the U.S., including underwriting, dealing, brokerage, insurance and other activities. See also Part XI.D below.

(ii) Prior to the 2001 Regulation K Revision, a foreign bank could not rely on Regulation K to acquire more than 5% of a class of voting shares of a foreign company that underwrites, sells or distributes -- or that owns or controls more than 5% of the shares of a company that underwrites, sells or distributes -- securities in the U.S., except to the extent permitted to U.S. BHCs. In 12 C.F.R. § 211.23(f)(5)(ii), the Board increased the 5% limit to 10%.

(iii) With respect to qualifying foreign banking organization investments in U.S. and foreign companies, <u>see Part VII.A.7 above</u>.

(iv) The Board noted a trend by foreign banks to conduct activities abroad through foreign subsidiaries of U.S. companies operating under BHCA § 4(c)(8). While the Board did not prevent the practice, it reserved the right to review these situations and require a change if such practice results in competitive inequality.

(v) Dodd-Frank § 173 amended IBA §§ 7(d)(3) and 7(e)(i) so that, in approving the establishment or termination of a foreign bank office in the U.S., the Board may, for a foreign bank that presents a risk to the stability of the U.S. financial system, take into account whether the bank's home country has adopted, or is making progress toward adopting, an appropriate system of financial regulation to mitigate such risk. <u>See</u>, <u>e.g.</u>, <u>Agricultural Bank of China</u>, Board Order No. 2012-5 (May 9, 2012) and <u>Bank of China</u>, Board Order No. 2012-6 (May 9, 2012). <u>Compare</u> <u>Industrial and Commercial Bank of China</u>, Board Order No. 2012-4 (May 9, 2012) (applying Dodd-Frank § 604(d) to acquisition of U.S. bank).

Dodd-Frank § 173 provides the SEC with similar authority under the 1934 Act with respect to broker-dealers.

C. <u>ACQUISITION OF SECURITIES FIRMS WITH INTERNATIONAL LINKAGES</u>

The Board accommodated international transactions involving foreign banks and non-U.S. securities/insurance firms with U.S. operations. <u>See</u>, <u>e.g.</u>, <u>Manulife Financial</u>, 90 Fed. Res. Bull. 373 (2004) (BHC/FHC approval, including special exemption under Regulation K); Crédit Agricole-Lazard Letter.

<u>See also</u> Board "temporary" approvals under BHCA § 4(c)(9) for a foreign bank to continue U.S. securities activities of the acquired firm pending processing of a § 4(c)(8) Notification and/or any

required restructuring of U.S. operations, including, e.g., Banco Financiero y de Ahorros/Caja de Ahorros y Monte de Piedad de Madrid (approved Dec. 16, 2010, two-year extension granted Mar. 11, 2013 in relation to nationalization by Spain and divestiture of U.S. banking assets); Julius Baer Holding/GAM Holding (approved Nov. 8, 2005); SAS Rue la Boétie (Crédit Agricole)/Crédit Lyonnais (approved Feb. 7, 2003); Bank of Tokyo-Mitsubishi/KOKUSAI Securities (approved Nov. 27, 2000); Bayerische Vereinsbank/Hypo Securities (approved Jan. 15, 1998) and BV-HypoBank Approval; BBVA/LatInvest Securities, 84 Fed. Res. Bull. 356 (1998), and Board Letter, Oct. 15, 1996; Unibank/Aros Securities, 83 Fed. Res. Bull. 146 (1997), and Board Letter to Cleary Gottlieb, Aug. 14, 1996 (merger of Unibank and Aros operations); Board Letters, July 21, Jan. 31, 1997 (Rabobank/RGNV); Dresdner-KB Order and FRBNY Letter, July 13, 1995; ABN AMRO/Alfred Berg, 81 Fed. Res. Bull. 1135 (1995), and Board Letter, Sept. 5, 1995; CCF/BHF Order and Board Letter, Sept. 7, 1993, Fed. Res. Reg. Serv. ¶ 3-774.12; SBC 1995 Order and Board Letter, June 26, 1995; Daiwa Bank/Cosmo Securities, 80 Fed. Res. Bull. 1014 (1994), and Board Letter, Sept. 1, 1993; CIBC/Wood Gundy, 74 Fed. Res. Bull. 571 (1988); RBC/Dominion Securities, 74 Fed. Res. Bull. 334 (1988); BNS/McLeod, 74 Fed. Res. Bull. 249 (1988), and Board Letter, Apr. 28, 1988; JCT Trust Co./Leumi Securities, 67 Fed. Res. Bull. 362 (1981); Bank of Montreal/Burns Fry Holding Corp. ("BFH") U.S. Subsidiaries (approved Aug. 18, 1994); BNS/Montreal Trustco (approved Apr. 7, 1994); RBC/McNeil, Mantha, Inc. (approved Oct. 15, 1991); BNP/BAII Banking Corp. (approved June 29, 1990); Deutsche Bank/Morgan Grenfell (approved Nov. 24, 1989); Crédit Lyonnais/Alexanders Laing and Cruickshank Holdings (approved Oct. 30, 1987).

For Board approvals under BHCA § 4(c)(9) -- some permanent and some temporary -- with respect to foreign bank non-control investments in non-U.S. investment banks or other firms with U.S. securities operations, see, e.g., Board Letter to Cleary Gottlieb, July 29, 1999 (BNP acquisition of Paribas and, indirectly, Paribas' 23% (14% voting) interest in Finaxa, which in turn controlled AXA, an entity which indirectly controlled DLJ; permanent exemption); Board Letter to Cleary Gottlieb, June 11, 1999 (Commerzbank acquisition of up to 10% interest in Crédit Lyonnais, which owned Crédit Lyonnais Securities, a grandfathered subsidiary; permanent exemption), and related Board Letters, June 11, 1999 (Paribas and Crédit Agricole acquisitions); Board Letter to Cleary Gottlieb, Jan. 21, 1997 (BNP 7.7% interest in AXA; permanent exemption); Board Letters, Sept. 12, 1997, Oct. 28, 1996, Sept. 22, 1994 (Banca Monte dei Paschi di Siena, Cariplo-Casa de Risparmio delle Provincie Lombarde and Istituto Bancario San Paolo di Torino respective 9.9% interests in Istituto Mobiliare Italiano, which indirectly owned Mabon Securities; 3-year exemption); Board Letters, May 19, 1997, Mar. 27, 1992, Dec. 6, July 16, 1991 (Paribas 20-28% interest in Finaxa; permanent exemption). See also Part I.A.11 above.

Acquisitions, joint venture and "alliance" proposals with respect to non-U.S. securities, Internet-trading, mutual fund distribution and related matters are also increasing in scope. See, e.g., NY Times Dealbook, Jan. 7, 2011.

See generally Part XII below.

D. GLOBAL PUBLIC AND PRIVATE OFFERINGS

Simultaneous U.S. private placements and non-U.S. public offerings, as well as "global" public offerings, are increasing, and U.S. banking organizations act in the U.S. while their offshore affiliates act as underwriters or placement agents outside the U.S. See Part III and Part VI above. See also "What Does It Take to List Abroad? The Role of Global Underwriters" (Board, 2016).

1. Regulation S clarifies the application of 1933 Act registration requirements to international securities offerings. See SEC Release No. 33-6863 (Apr. 24, 1990); Regulation S User's Guide.

    a. Regulation S takes a territorial approach, providing that such requirements do not apply to offers and sales of securities outside the U.S. It includes two "safe harbors", one applicable to initial securities sales and one to resales. To take advantage of either safe harbor an offering must be an "offshore transaction" and there must be no "directed selling efforts" in the U.S. See U.S. Regulation of International Securities Markets, Chapter 6.

b. Regulation S sets out restrictions on non-U.S. equity placements by U.S. issuers. A proposal which would have applied the same restrictions to equity placements by non-U.S. issuers where the principal market for the securities was in the U.S. was not adopted. See SEC Release No. 33-7505 (Feb. 17, 1998). See also SEC Release No. 33-7516 (Mar. 23, 1998) (offerings through the Internet).

c. Regulation S Rule 904 sets forth a safe harbor for offers and sales to be deemed to have occurred outside the U.S. Among the conditions of Rule 904 is a requirement that the offer or sale occur in an "offshore transaction" executed in, on or through the facilities of a "designated offshore securities market". In addition to numerous non-U.S. securities exchanges and markets listed in Rule 902(b)(1), the SEC may "designate" an offshore securities market. See, e.g., The Bahamas International Securities Exchange (avail. Oct. 20, 2011); Bursa Malaysia (avail. Sept. 10, 2010); Euronext Paris/Eurolist/Alternext Market (avail. Mar. 16, 2007); Korea Exchange (avail. Feb. 28, 2007); Panama Stock Exchange (avail. June 21, 2006); Vienna Stock Exchange (avail. Dec. 14, 2004); Euronext Brussels (avail. Nov. 10, 2004); Cairo and Alexandria Stock Exchanges (avail. Apr. 16, 2003); Barcelona Stock Exchange (avail. Mar. 11, 2003); Berlin Stock Exchange (avail. Sept. 26, 2000); Channel Islands Stock Exchange (avail. Sept. 6, 2000); Tel-Aviv Stock Exchange (avail. May 12, 1999); Bolsa de Valores de Lima (avail. May 14, 1998).

2. Offerings under Rule 144A and Regulation S are not "integrated" and securities sold in accordance with each exemption from registration may be resold in accordance with the other. See also ING Bank (avail. July 8, 2002) (CP conduits need not register as investment companies if they offer and sell short-term paper in the U.S. in reliance on 1933 Act § 4(2) and outside the U.S. in reliance on Regulation S). See Part VI above.

3. For SEC steps to address the use of the Internet, e-mail and other forms of electronic media in connection with offerings of securities

in the U.S., see, e.g., SEC Offshore WebSite Release, SEC Releases No. 33-7856 (Apr. 28, 2000), 33-7288 (May 9, 1996) and 33-7233 (Oct. 6, 1995), and the Swiss American Letter. See also Part IX.F above.

4. In an administrative proceeding against E.on, a German company whose ADRs trade on the NYSE, the SEC confirmed that the antifraud provisions of the U.S. securities laws apply to home country communications by a foreign company whose securities trade in the U.S. public market, regardless of whether U.S.-style disclosure standards are the home country norm. SEC Release No. 34-43372 (Sept. 28, 2000).

5. The SEC has charged a number of foreign-based banking institutions with violations of the U.S. securities laws in connection with offering and selling securities to U.S. residents.

   a. In SEC v. Banc De Binary, SEC Litigation Release No. 22718 (June 7, 2013), the SEC charged a Cyprus-based company with sales of "binary options" to U.S. customers without first registering the securities and registering as a broker-dealer. The company solicited U.S. customers by phone, email, instant messenger chats, YouTube videos and other internet-based advertising. The company settled the charges for an $11 million fine. See SEC Press Release 2016-42 (Mar. 9, 2016). The SEC and the CFTC have warned investors about the risks of investing in binary options – instruments that provide a payout based on the occurrence of a contingent event, but pay nothing if that event does not occur. See SEC Press Release 2013-103 (June 6, 2013); Investor Alert: Binary Options and Fraud (SEC/CFTC, June 2013).

   b. The SEC issued an Order against Banco Espírito Santo ("BES"), a Portugal-based banking conglomerate, finding that BES acted as an unregistered broker-dealer and investment adviser by offering and selling unregistered securities to U.S. customers through direct mailings to U.S. residents, the use of a third-party call center located in Portugal dedicated to servicing U.S. customers, and twice annual visits to the U.S. by dedicated relationship managers. SEC Admin. Proc. No. 3-14599 (Oct. 24, 2011); NY AG Press Release, Oct. 24, 2011 (BES settlement with NY for failure to register as broker-dealer or investment adviser). See also In the Matter of [BES] and Espirito Santo e Commercial de Lisboa, Docket Nos. 12-016-CMP-FBH and 12-017-CMP-DEO (Board, Apr. 2, 2012) (cease and desist order and civil money penalty against BES for operating customer liaison offices and offering money transmission services without prior Board approval as representative offices under Regulation K).

c. The SEC issued an Order against State Bank of India and Citibank finding that they violated federal securities laws by selling \$500 million of "Resurgent India Bonds" in the U.S. without filing a registration statement. The marketing campaign featured the name "RESURGENT INDIA BOND", repeatedly referred to the Bonds as "bonds" and "investments", and used terms associated with securities offerings. Some of the marketing documents also described the Bonds as "5-year fixed return deposit[s]". SEC Release No. 33-8036 (Nov. 19, 2001). See also Part IV.A.2.a above.

6. U.S. banking organizations that are not FHCs may underwrite securities outside of the U.S. (Regulation K), act as agent in the private placement of securities inside the U.S. (see Part VI above) and act as broker or agent for customers in the purchase of securities inside the U.S. (see Part IX above). Foreign banking organizations have essentially unlimited securities underwriting powers abroad (see Part I.A.10 above).

a. Historically the Board had not raised any BHCA or Glass-Steagall issues in respect of the combination of these powers, and numerous transactions reflect this approach. See, e.g., Prospectuses July 19, 10, June 24, 22, 2002, Dec. 13, 2001; Wall St. J., Dec. 19, 11, Nov. 20, Sept. 25, Aug. 20, 6, July 24, 8, June 26, May 15, 7, Apr. 2, Mar. 18, 13, Feb. 26, 25, Jan. 15, 1997, Dec. 4, Nov. 7, 6, Oct. 22, 15, 3, Sept. 23, 11, 10, Aug. 27, 21, 8, 1, July 30, 24, 11, 10, 9, 2, June 18, 12, 11, 5, May 30, 22, 21, 16, 9, 8, Apr. 16, 11, 10, Mar. 14, 12, 7, Feb. 29, 28, 27, 22, 1996 (U.S. tombstones/prospectuses involving Bank of Tokyo-Mitsubishi, Barclays, BNP, Mizuho, NatWest and Westdeutsche Landesbank affiliates as to underwriting of securities of U.S. issuers (or securities of non-U.S. issuers offered in the U.S.) by non-U.S. entity); Investment Dealers' Digest, Apr. 7, 1997.

b. The Board's Foreign Bank Underwriting Interpretation provides that, unless a foreign bank is either an FHC or has the authority to engage in underwriting through a Section 20 Subsidiary, the foreign bank may not become a member of an underwriting syndicate for securities that are registered under the 1933 Act and are intended to be publicly distributed in the U.S. See 68 Fed. Reg. 7898 (Feb. 19, 2003).

(i) Although the Interpretation is not entirely clear, an industry consensus developed that:

A) The Interpretation should not apply to dealing or trading activities conducted by a foreign bank outside the U.S. even if a U.S. broker-dealer subsidiary of the foreign bank acts as agent for the bank in effecting purchase and sale transactions between the bank and U.S. investors. (See precedents cited in Part XI.E below.)

B) The Interpretation should apply only to the underwriting of securities, and not (i) where a foreign bank or any of its U.S. offices or affiliates acts as an agent for customers in accordance with applicable law in respect of the purchase of securities which are the subject of a U.S. underwriting, or (ii) to any other business (e.g., lending, reinsurance, etc.) conducted by the bank from outside the U.S. consistent with Board interpretations (see, e.g., 66 Fed. Reg. 54346, 54357 (Oct. 26, 2001); 56 Fed. Reg. 19549, 19563 (Apr. 29, 1991)).

C) Although by its terms, the Interpretation would only appear to apply to securities that are registered under the 1933 Act and are intended for distribution in the U.S., Board staff take the position that the Interpretation also applies to transactions under Rule 144A (see Part VI above) where a foreign bank's non-U.S. office or affiliate acts as initial purchaser. Compare, e.g., Comptroller Interpretive Letter No. 876 (Dec. 8, 1999), CCH Fed. Banking L. Rep. ¶ 81-370 (federal branch of foreign bank may serve as agent for an offshore office or affiliate which acts as initial purchaser of foreign securities in resales to U.S. institutional investors under Rule 144A (see Part VI above)).

D) Although Board staff have questioned the conclusion, the Interpretation should only relate to those offerings where a foreign bank's U.S. offices or affiliates act as liaison with the issuer and the lead underwriter in the U.S., prepare documentation and/or provide other services in connection with the underwriting.

E) The Interpretation should apply only to the underwriting of bank-ineligible securities.

F) The Interpretation should not apply to securities underwritten by a foreign bank outside of the U.S. which are part of a global offering of securities to be publicly distributed both inside and outside the U.S. where bona fide selling efforts are conducted outside of the U.S.

(ii) In re West LB, Docket No. 03-030-B-FB (Board, Aug. 27, 2003), requires WestLB to establish an internal controls program "for ensuring ongoing compliance with the limitations on WestLB's activities relating to underwriting and dealing securities with respect to the [U.S.], including activities of its home office, branches outside the [U.S.], and of its affiliates."

7. Exemptions from the broker-dealer registration requirements of the GLBA Push-out Provisions have been adopted for a bank located in the U.S. (a) to effect transactions in securities with non-U.S. persons on an agency or riskless principal basis that are covered by Regulation S, and (b) to resell Regulation S securities after their initial issuance by or on behalf of a non-U.S. person or to a non-U.S.

person if the bank continues to comply with Regulation S's requirements. See Part IX.B.3 above.

E. U.S. BROKERAGE AND OTHER TRANSACTIONS INVOLVING FOREIGN AFFILIATES: SEC RULE 15A-6 AND RELATED MATTERS

The use of a BHC or foreign bank U.S. subsidiary to engage in brokerage transactions in the U.S. between an unaffiliated U.S. person and a non-U.S. dealer affiliate is common. Such arrangements call for analysis under (1) the BHCA, as to what restrictions are necessary on the activity of the U.S. subsidiary; (2) Regulation K, as to whether the BHC's (or foreign bank's) non-U.S. affiliates are properly conducting business "outside" of the U.S.; and (3) the 1934 Act, as to whether the non-U.S. affiliates that broker or deal in securities must register with the SEC.

1. Bank Regulatory Analysis

a. The Comptroller concluded that Citibank, whose parent, Citicorp, controlled Scrimgeour Vickers Securities Ltd. ("Vickers UK"), a London-based dealer, could acquire Vickers da Costa Securities ("Vickers NY"), a NASDAQ market-maker whose principal business was brokering securities of foreign issuers traded in U.S. and foreign markets. Vickers da Costa Letter. The SEC issued a Letter, Aug. 13, 1986 (the "Vickers SEC Letter"), exempting Vickers UK from U.S. broker-dealer registration.

(i) As a subsidiary of Citibank, Vickers NY would have been prohibited by Glass-Steagall from dealing in securities. However, the Comptroller would have permitted Vickers NY to act as riskless principal with its foreign affiliates and to provide investment advice and research.

(ii) The Board never made a direct public statement concerning the Vickers proposal. However, while Regulation K indicates that a non-U.S. entity is only deemed to be "engaged in business" in the U.S. if it has an office or subsidiary in the U.S., the Board has taken the position in certain contexts that no part of a prohibited securities activity may take place in the U.S. and that the prohibition on the activity does not depend on it being conducted through a U.S. office or subsidiary. 49 Fed. Reg. 26002, 26005 (June 25, 1984). Accordingly, the Board, relying on its jurisdiction to determine compliance with Regulation K, reportedly required abandonment of Vickers NY's proposal.

b. As part of SecPac's acquisition (the "BF Acquisition") of an interest in BFH/BF Ltd., SecPac Bank proposed to acquire 100% of BF Ltd.'s U.S. subsidiary, Burns Fry & Timmins (renamed "Burns Fry Hoare Govett Inc." ("BFHG")), the principal activities of which consisted of trading, as principal or as agent for BF Ltd., in multiple-listed Canadian and U.S. securities.

(i) SecPac proposed that, following the BF Acquisition, BFHG's activities would include executing orders (as agent or riskless principal) for purchases and sales of securities placed by SecPac's foreign dealer subsidiaries, as well as BF Ltd. (collectively, the "BFHG Foreign Customers"). The BFHG Foreign Customers would place orders with BFHG which could be specific as to price and volume or could set price and volume parameters.

(ii) SEC Letter to Robert Tortoriello, Apr. 1, 1988, concluded that a no-action position (rather than an exemptive order, as in the Vickers SEC Letter) was appropriate so long as the BFHG Foreign Customers effected transactions through BFHG as a registered broker-dealer (together with Bank of Montreal (avail. June 20, 1989), NatWest (avail. July 7, 1988), and Chase Bank (avail. July 28, 1987), the "SEC Pre-15a-6 Letters").

(iii) Board Letter, Apr. 18, 1988 (the "SecPac-BF Letter"), stated that the fact that BFHG would act as broker on behalf of foreign securities affiliates would not be inconsistent with Glass-Steagall. See also, e.g., Crédit Lyonnais, 53 Fed. Reg. 15463 (Apr. 29, 1988) (solicitation of public comments) (approved Sept. 2,

1988) (U.S. affiliate of Crédit Lyonnais may transmit orders in non-financial futures for foreign affiliate to floor of exchange for clearance by unaffiliated FCM); NatWest Order, 72 Fed. Res. Bull. at 590 n.25; NatWest Decision, 821 F.2d at 819 n.9; FRBNY Letter, Jan. 31, 1989, concerning activities of Discount Brokers International Holdings (in which ABN AMRO had an investment interest); International Joint Arbitrage Incidental to Securities Business Abroad, 59 Fed. Res. Bull. 179 (1973).

However, the Board also stated that, "in acting as a principal, whether or not such activity is characterized as 'riskless,' [BFHG] would hold itself out to other dealers as a buyer and seller of securities for its own account, and thus would be considered to be engaging in a dealing activity. . . ."

Board Letter to SecPac, June 4, 1991, reaffirmed the permissibility of brokerage for foreign affiliates.

c. FRBNY Letter, Oct. 29, 1999, approved KBC Bank's acquisition of assets and liabilities of D.E. Shaw & Co. and its conduct of advisory, agency (including brokerage) and investment transactions. KBC's Notification contemplated that the business to be acquired would include dealing in convertible securities issued by U.S. companies and that persons who deal in such securities would be relocated to a London affiliate of KBC and remain there until KBC obtained a Section 20 Approval.

   KBC received a Section 20 Approval on January 14, 2000, and is currently qualified as an FHC.

d. The 2001 Regulation K Revision reaffirmed that revenue derived from activities in the U.S. would include all revenue derived from activities performed in U.S. offices, but not business that may originate in the U.S. but is performed offshore. See also Lloyds TSB Bank (approved June 29, 2006) (authorizing Lloyds to engage through a U.S. subsidiary in personal property leasing and related lending; Lloyds letter, May 24, 2006, in connection with Application discusses permissibility of conducting leasing activities, including in respect of U.S. personality, from outside the U.S.); SocGen Complementary Order (referencing SocGen conduct of U.S. physical commodity trading activities pursuant to Regulation K); 1991 Regulation K Revision (repealing Board Letter to American International Bank, Nov. 13, 1970, which treated certain loans from a non-U.S. bank to U.S. persons as a U.S. activity); Board Letter, May 20, 1997 (offshore subsidiary of a BHC may reinsure annuities sold in the U.S. to U.S. residents). But see Part XI.D.6.b above.

2. Securities Regulatory Analysis

   a. Rule 15a-6 and Related Considerations

   Building on the Vickers SEC Letter and SEC Pre-15a-6 Letters, in 1989 the SEC adopted Rule 15a-6, which permits foreign broker-dealers -- including U.S. and foreign bank-affiliated broker-dealers -- to have certain "non-direct contacts" and "direct contacts" with U.S. investors without having to register with the SEC. SEC Release No. 34-27017 (July 11, 1989) (the "Broker-dealer Release"). See generally U.S. Regulation of International Securities Markets, Chapter 14. In 2008, the SEC proposed to update and expand Rule 15a-6 to reflect increasing internationalization in securities markets, and noted that approximately 700 non-U.S. broker-dealers engaged in business with U.S. customers under the Rule. See SEC Release No. 34-58047 (June 27, 2008) (the "Proposed 15a-6 Amendments").

   (i) Permissible "non-direct contacts" under Rule 15a-6 include:

      A) Execution of "unsolicited" securities transactions.

      B) Provision of research reports to "major" U.S. institutional investors with more than $100 million in assets or under management if: (i) the reports do not recommend use of the foreign broker-dealer to effect trades and the foreign broker-dealer does not follow up on the reports or otherwise induce securities transactions by the recipient; (ii) a foreign broker-dealer that has a relationship with a 15a-6 broker-dealer (defined below) effects all trades resulting from such reports through the 15a-6 broker-dealer; and (iii) the reports are not provided pursuant to a "soft-dollar" arrangement with respect to brokerage commissions charged by the foreign broker-dealer.

C) Provision of research reports to <u>any</u> U.S. person if: (i) they are distributed by a registered broker-dealer; (ii) the registered broker-dealer accepts responsibility for their contents; (iii) any U.S. person receiving the reports and wishing to effect security transactions is directed to do so with the registered broker-dealer; (iv) any transactions with U.S. recipients of the reports are effected with the registered broker-dealer; and (v) the reports are not provided pursuant to a "soft dollar" arrangement with respect to brokerage commissions charged by the foreign broker-dealer.

(ii) Permissible "<u>direct contacts</u>" under Rule 15a-6 include:

A) Solicitation of certain U.S. institutional investors, subject to the following: (i) the foreign broker-dealer acts from outside the U.S. (except that the foreign broker-dealer may conduct visits to certain institutional customers if "chaperoned" by a registered broker-dealer that accepts responsibility for the foreign broker-dealer's activities and that effects resulting transactions (a "<u>15a-6 broker-dealer</u>")); (ii) the 15a-6 broker-dealer "chaperones" oral communications by the foreign broker-dealer with U.S. institutional investors which are not "major" U.S. institutional investors; (iii) any transaction order resulting from such solicitation (a) may be taken by the foreign broker-dealer, <u>but</u> (b) must be booked, cleared and settled, and any credit in connection with such transaction must be arranged or extended, by the 15a-6 broker-dealer; (iv) the 15a-6 broker-dealer obtains information regarding the foreign broker-dealer's personnel having contact with U.S. customers, and concerning trades executed with such customers, and such information is available for inspection by the SEC and self-regulatory organizations; (v) the foreign broker-dealer's personnel having contact with U.S. customers are not subject to a disqualification under U.S. or foreign law and consent to U.S. service of process; and (vi) the foreign broker-dealer agrees to provide documents, testimony and other assistance that the SEC requests in connection with the U.S. transactions.

B) Effecting transactions with registered broker-dealers, U.S. banks acting in a broker or dealer capacity, certain international organizations, certain foreign persons temporarily present in the U.S., foreign branches and agencies of U.S. persons and U.S. citizens resident abroad.

The SEC adopted amendments to Rule 15a-6 that permit foreign broker-dealers to effect transactions in securities with a bank that meets one of the GLBA exceptions from broker-dealer registration with respect to its securities activities. See 72 Fed. Reg. 56562 (Oct. 3, 2007) and Part II.D.3.b above. The term "solicitation" is not defined in Rule 15a-6. SEC precedents (discussed in SEC Release No. 34-25801 (June 14, 1988)) indicate that "solicitation" includes any effort by a broker-dealer to induce transactional business, including telephone calls, advertising in newspapers or periodicals of general circulation in the U.S. or any radio or television station broadcasting into the U.S., conducting investment seminars for U.S. investors, recommending the purchase or sale of securities with the expectation that the investor will execute the recommended trade through the broker-dealer, and providing research.

C) A U.S. broker-dealer may not conduct a seminar on non-U.S. securities and pass potential investors' names to a foreign bank for follow-up, for which the broker-dealer would receive a commission, unless the foreign bank is itself a registered broker-dealer. Private Ledger (avail. Sept. 5, 1990). Compare Part XI.E.2.a.vii below.

D) The SEC Offshore Website Release provides that a foreign broker-dealer that advertises services via an Internet website would not be viewed as attempting to induce securities transactions with U.S. persons if it takes measures "reasonably designed" to ensure that it does not effect securities transactions with U.S. persons. Such measures might include (i) posting a disclaimer on the website stating that the services are not available to U.S. persons, and (ii) refusing to provide brokerage services to any potential customer that the broker-dealer has reason to believe is a U.S. person. A foreign broker-dealer that solicits business through its website but wishes to rely on the Rule 15a-6 exemption for "unsolicited" transactions with U.S. investors must ensure that any transaction with an "unsolicited" U.S. investor is not in fact solicited through its website. See also Merrill Lynch (avail. Jan. 13, 1999). See Part VII.C.7 and Part IX.F above.

(iii) Rule 15a-6 does not define the term "U.S. person", but SEC staff has indicated that, for purposes of the Rule and 1934 Act registration requirements, it will not apply the Regulation S definition of such term. See, e.g., Cleary Gottlieb (avail. Feb. 22, 1994) (U.S. investment adviser acting for the account of a non-U.S. investor is "non-U.S. person" for purposes of Regulation S, but a "U.S. person" for purposes of Rule 15a-6).

However, SEC staff has indicated that it would not recommend enforcement action against a foreign broker-dealer that effects transactions in foreign securities directly with a U.S. resident fiduciary acting on behalf of a non-U.S. client. Cleary Gottlieb (avail. Jan. 30, 1996) (the "Cleary Gottlieb 1996 15a-6 Letter") (superseding and replacing a letter to such firm Nov. 22, 1995).

(iv) Cleary Gottlieb (avail. Apr. 9, 1997, as clarified by letter Apr. 25, 1997) (the "Cleary Gottlieb 1997 15a-6 Letter"):

A) Expands the definition of "major" U.S. institutional investor to include any entity (including corporations, partnerships and registered or unregistered investment advisers) that owns or has under management at least $100 million in financial assets.

B) Permits direct transfers of funds and securities between U.S. investors and foreign dealers in connection with foreign securities transactions.

C) Permits unchaperoned communications between employees of the foreign dealer and U.S. institutional investors that are not "major" U.S. institutional investors, so long as (i) such communications take place outside NYSE trading hours, and (ii) foreign broker-dealer employees only accept orders to effect transactions in foreign securities.

D) Permits unchaperoned in-person visits to major U.S. institutional investors by employees of the foreign broker-dealer, so long as the number of days on which such unchaperoned visits occur does not exceed 30 per year per employee and the employee does not accept orders to effect securities transactions (whether U.S. or foreign) while in the U.S.

E) Clarifies that foreign broker-dealers may input quotes, prices and other trade-reporting directly into (i) third-party screen-based systems (whether or not such systems are primarily directed to foreign markets) without such activity constituting "solicitation" for purposes of Rule 15a-6, and (ii) proprietary systems, so long as any transactions between the foreign broker-dealer and the U.S. investor are intermediated in accordance with Rule 15a-6.

(v) The Proposed 15a-6 Amendments would expand the categories of U.S. investors with which foreign broker-dealers may interact, reduce the role that U.S. broker-dealers are required to assume in intermediating transactions between foreign broker-dealers and U.S. investors, and streamline some of Rule 15a-6's requirements.

(vi) Morgan Stanley India Securities ("MSIS") (avail. Dec. 20, 1996), concluded that MSIS could effect transactions in Indian securities in India for U.S. institutional customers without registering as a broker-dealer, under circumstances where Indian law requires MSIS or an Indian custodian (and not its U.S. broker-dealer affiliate) to hold funds and securities on behalf of U.S. customers where transactions are executed through MSIS.

(vii) In Dinosaur Securities (avail. June 23, 2006), the SEC declined to provide no-action relief from broker-dealer registration to foreign companies that receive transaction-based compensation from an SEC-registered broker-dealer for referring non-U.S. persons to the broker-dealer.

(viii) LiquidityHub (avail. Nov. 28, 2007) permitted an arranger based in London to operate an electronic messaging system to enable major U.S. institutional investors to access an indicative pricing system without registering with the SEC, provided that transactions were effected in accordance with Rule 15a-6.

(ix) Ernst & Young Corporate Finance (Canada) ("E&Y Canada") (avail. July 12, 2012) permitted non-U.S. advisers to treat non-financial U.S. persons with $100 million in total assets (as opposed to $100 million in financial assets) as "major U.S. institutional investors" for the purposes of Rule 15a-6 in the context of certain cross-border M&A transactions (i.e., a private placement in the context of a transaction that would result in the transfer of control of an entire company or business unit).

(x) In 2013, SEC staff addressed and clarified a number of interpretive issues regarding Rule 15a-6. See [FAQ] Regarding Rule 15a-6 and Foreign Broker-dealers (SEC, Mar. 21, 2013, last updated Apr. 14, 2014). The SEC guidance:

A) Clarifies that a foreign person in the U.S. with whom a foreign broker-dealer has a pre-existing relationship before the foreign person entered the U.S. will generally be deemed "temporarily present" in the U.S. for purposes of Rule 15a-6(a)(4)(iii), provided such person is not a U.S. citizen or otherwise a permanent resident.

B) Permits a foreign broker-dealer chosen by a foreign issuer to administer a global employee stock option plan to rely on Rule 15a-6(a)(1) to deliver communications regarding such plan to, and effect transactions in the foreign issuer's securities (including ADRs) for, U.S. employees of the foreign issuer or its U.S. subsidiary.

C) Clarifies that a foreign broker-dealer that effects an unsolicited transaction on behalf of a U.S. investor in reliance on Rule 15a-6 may provide such investor with a confirmation of the transaction, periodic account statements, and other documents related to the transaction that are required under foreign law, provided that these documents do not include material intended to induce transactional business.

D) Confirms that a foreign broker-dealer may send confirmation and account statements directly to U.S. counterparties to the extent required by foreign law or as required by a firm's internal policies (although the "chaperoning" 15a-6 broker-dealer must ensure that these documents comply with all applicable U.S. requirements).

E) Reiterates that a foreign broker-dealer may distribute research directly to major U.S. institutional investors without involvement of a registered broker-dealer.

F) Affirms that the relief contained in the Cleary Gottlieb 1996 15a-6 Letter and Cleary Gottlieb 1997 15a-6 Letter is available to all foreign broker-dealers, including those not affiliated with a registered broker-dealer.

G) Addresses minimum net capital requirements and other obligations applicable to a registered broker-dealer acting as a 15a-6 broker-dealer for a foreign broker-dealer.

(xi) A number of administrative and private proceedings relate to international broker-dealer regulatory issues.

A) Direct solicitation of U.S. investors outside the parameters of Rule 15a-6 may lead to private actions in the U.S. against foreign broker-dealers. See, e.g., UBS Asset Management (NY) v. Wood Gundy, 914 F. Supp. 66 (SDNY 1996); MTC Electronic Technologies v. Leung, 889 F. Supp. 396 (C.D. Cal. 1995); Trafton v. Deacon Barclays de Zoete Wedd Limited, 1994 WL746199 (N.D. Cal. 1994).

B) SEC v. CIBC Mellon Trust Co., SEC Litigation Release No. 19081 (Feb. 16, 2005), settled SEC charges that CIBC Mellon, a Canadian company, acted as broker and transfer agent without registration. The SEC alleged that CIBC Mellon had acted as a transfer agent for 113 companies whose securities were SEC-registered, and acted as a broker-dealer for 45 of these companies in administering dividend reinvestment and stock purchase plans, ESOPs, employee stock option plans and odd-lot programs. See CIBC Mellon Trust Co., SEC Admin. Proc. No. 3-11839 (June 15, 2009 and Mar. 2, 2005).

CIBC Mellon subsequently received exemptions from broker-dealer registration to the extent it acts as a broker in connection with such programs with U.S. resident investors for issuers for which it acts as registered transfer agent, but CIBC Mellon was not permitted to net customer orders to buy and sell issuer plan securities, nor to solicit transactions or provide investment advice to U.S. investors. SEC Release Nos. 34-60136 (June 18, 2009) and 34-51253 (Feb. 25, 2005).

C) In CSFB, SEC Admin. Proc. No. 3-11936 (May 31, 2005), the SEC charged CSFB with failing to supervise an employee who traded on behalf of a non-U.S. subsidiary which CSFB failed to detect since the employee's only supervisor was an employee of the non-U.S. subsidiary located outside of the U.S. The SEC concluded that (i) CSFB failed to implement supervisory procedures because its business arrangement with its non-U.S. subsidiary led to relaxed "back office" monitoring, (ii) CSFB's systems were inadequate to ensure that all registered representatives in the U.S. were assigned to a proper licensed supervisor, and (iii) CSFB's procedures allowed traders to obtain pro forma approval from supervisors.

D) In CentreInvest, SEC Admin. Proc. No. 3-13304 (Dec. 8, 2008), the SEC charged a Moscow-based unregistered broker-dealer and an associated individual with soliciting institutional investors in the U.S. without registering as a broker-dealer or complying with an exemption from registration. It also charged the NY affiliate of the Moscow broker-dealer and associated individuals with aiding and abetting the violations.

E) In Glenn Manterfield and Lydia Capital, SEC Litigation Release No. 20872 (Jan. 28, 2009), the SEC announced that a UK appellate court upheld an earlier order that the SEC obtained from a UK court freezing assets held in the UK by a UK citizen who was a defendant in an SEC enforcement action. See also SEC Litigation Release No. 21528 (May 21, 2010) (final judgment).

F) In Compania Internacional Financiera, SEC Litigation Release No. 22049 (July 20, 2011), the SEC announced that it obtained asset freezes and other emergency relief against three Swiss-based entities it charged with insider trading.

G) In Hold Brothers On-line Investment Services, SEC Admin. Proc. No. 3-15046 (Sept. 25, 2012), the SEC fined a broker-dealer for failing to investigate manipulative trading through accounts at the broker-dealer held by overseas firms under common control with the broker-dealer. The overseas traders engaged in "spoofing" or "layering" strategies in which non-bona fide orders were sent to the market to induce market participants to move the price of a security artificially. In related actions, FINRA and numerous securities exchanges censured and fined the broker-dealer for manipulative trading activities and failure to have proper policies, procedures and controls. See FINRA Press Release, Sept. 25, 2012; FINRA Letter of Acceptance, Waiver and Consent No. 2010023771001, Sept. 24, 2012; NYSE Arca Hearing Board Decision, 12-ARCA-9, Sept. 24, 2012; NASDAQ Stock Market Letter of Acceptance, Waiver and Consent No. 20100233513-01, Sept. 24, 2012; NASDAQ OMX BX Letter of Acceptance, Waiver and Consent No. 20100233513-02, Sept. 24, 2012; and BATS Exchange Letter of Acceptance, Waiver and Consent No. 20100248992, Sept. 24, 2012.

H) SEC Press Release 2012-241 (Nov. 27, 2012) describes an SEC action against four firms based in India that agreed to settle charges of failing to register as broker-dealers. The firms had interacted with U.S. investors in a variety of ways, including sponsoring conferences in the U.S., having employees regularly travel to the U.S. to meet investors, trading securities of India-based issuers on behalf of U.S. investors, and participating in offerings of India-based issuers to U.S. investors. The firms' remedial measures included entering into 15a-6 chaperoning agreements with U.S. broker-dealers. See SEC Admin. Proc. Nos. 3-15105 (Ambit Capital), 3-15106 (Motilal Oswal Securities), 3-15107 (JM Financial) and 3-15108 (Edelweiss Financing Services) (Nov. 27, 2012).

I) In Biremis, SEC Admin. Proc. No. 3-15136 (Dec. 18, 2012), a Toronto-based broker-dealer agreed to revocation of its registration and two executives agreed to be barred from the industry after the SEC alleged they failed to supervise overseas traders who engaged in manipulative trading strategies. The SEC also alleged that the broker-dealer failed to file SARs and failed to preserve instant message communications related to its business. In a parallel action, FINRA expelled Biremis and barred its president and CEO from associating with any FINRA member firm in any capacity. FINRA Letter of Acceptance, Waiver and Consent No. 2010021162202 (July 30, 2012).

J) In Banco Comercial Portugues, SEC Release No. 33-9393 (Mar. 18, 2013), the SEC censured and fined Banco for buying and selling securities for U.S. resident customers through accounts in

Portugal without registration as a broker-dealer or as an investment adviser.

K) In SEC v. Benger, 934 F. Supp. 2d 1008 (N.D. Ill. 2013), the court held that, in light of Morrison (see Part XI.H.1 below), the broker-dealer registration requirements of 1934 Act § 15(a) would not apply to U.S. persons and companies that were acting in connection with foreign sales of non-U.S. securities not effected on a U.S. exchange. The court rejected the SEC's argument that Rule 15a-6 provides that all broker-dealers physically operating in the U.S. are required to register with the SEC, stating that Rule 15a-6 does not control the requirements of § 15(a), Rule 15a-6 was promulgated before Morrison was decided and, therefore, Rule 15a-6's requirements "beg the very question to be decided".

L) In ABN AMRO, SEC Admin. Proc. No. 3-15401 (July 31, 2013), ABN AMRO settled claims that, since 2004, it and its affiliates had solicited, effected securities transactions on behalf of, and provided investment advice to, U.S. persons without registering as a broker-dealer or an investment adviser. Many of the accounts were allegedly existing clients who continued to receive services after moving to the U.S. on a non-temporary basis.

M) In UBS Securities, FINRA Letter of Acceptance, Waiver and Consent No. 2012033156201 (Sept. 9, 2013), UBS Securities was fined for failing to send 1934 Act Rules 15a-6- and 10b-10-compliant trade confirmations and account statements, and failing to disclose required transaction information to institutional customers who executed trades in non-U.S. securities through UBS Securities' non-registered foreign affiliates.

N) In Deutsche Bank Securities, FINRA Letter of Acceptance, Waiver and Consent No. 2010023559301 (Dec. 19, 2013), Deutsche

Bank Securities was fined for violations arising from the way in which it had recorded transactions with its London bank affiliate, Deutsche Bank AG London -- in particular, securities lending transactions in connection with its arranged financing activities.

O) In SEC v. Lax, No. 15-cv-01079 (D. N.J., Feb. 10, 2015), the SEC charged the former CEO of G-Trade Services, a U.S. broker-dealer, and its affiliate, ConvergEx Global Markets Limited, a Bermuda broker-dealer, with violations of Rule 10b-5 for failing to disclose mark-ups and related profits on international securities purchases conducted with local brokers in the relevant market. See also G-Trade Services, SEC Admin. Proc. No. 3-15654 (Dec. 18, 2013) (settlement of claims that G-Trade and ConvergEx were involved in fraudulent scheme to "unnecessarily" route customer orders through offshore affiliates in order to conceal mark-ups and mark-downs in relation to local broker prices).

P) In SEC v. Gibraltar Global Securities, No. 13-Civ.-2575 (SDNY Jan. 12, 2016), disgorgement and civil penalties were ordered against an unregistered Bahamas-based broker-dealer and its owner for soliciting U.S. customers through its website and offering services that would allow U.S. customers to trade anonymously and avoid taxes. The SEC also alleged that the broker-dealer participated in the unregistered offer and sale of securities of U.S. issuers. See also Oppenheimer & Co., SEC Admin. Proc. No. 3-16361 (Jan. 27, 2015) (Oppenheimer held Gibraltar account, knew that Gibraltar was executing trades through the account for U.S. customers, and knew Gibraltar declared trades as proprietary trades so that customers could avoid taxes; Oppenheimer willfully aided and abetted Gibraltar's violations of broker-dealer registration rules); SEC v. Gibraltar Global Securities, 2015 WL 1514746 (SDNY Apr. 1, 2015) (Gibraltar must produce documents related to U.S. customers even if located in Bahamas).

Q) Certain internationally-linked FCPA issues involving banks' capital markets and asset management activities are discussed in <u>Part VIII.A.4 above</u>.

b. <u>Custody Issues</u>

The IIB filed a request with the SEC, Nov. 8, 2007, for a no-action position or an exemption with respect to the ability of non-U.S. banks to act as securities custodian for U.S. investors, and to engage in ancillary transactions (such as income and dividend collection, securities lending and borrowing, etc.), including under circumstances where a U.S. entity (such as a broker-dealer, investment adviser or U.S. bank) apprises customers of the custodial capabilities of the bank and facilitates the establishment of the custodial relationship. The request goes beyond the current ability of foreign banks to serve as subcustodian or "satisfactory control location" for U.S. broker-dealers (<u>see</u> 1934 Act Rule 15c3-3), and would clarify that direct custodian-client relationships are permitted.

The proposition is that acting as a custodian does not constitute "effecting transactions" in securities for purposes of the 1934 Act and that foreign institutions are acceptable custodians for U.S. investors. <u>Compare</u> 1940 Act Rules 17f-5, 17f-7 (permitting foreign banks to act as custodian for certain assets owned by U.S. investment companies); Advisers Act Rule 206(4)-2 (custody of funds or securities by investment advisers); 68 Fed. Reg. 56692 (Oct. 1, 2003).

<u>See also</u> SEC Release No. 34-70072 (July 30, 2013) (in context of amending "financial responsibility rules" for broker-dealers, SEC effectively precluded U.S. branches of foreign banks from being able to serve as depositories for Rule 15c3-3 reserve account funds primarily because "branches of foreign banks generally are not FDIC-insured"; indicating willingness to consider requests for exemptions); Credit Suisse Comment Letter, Sept. 12, 2008.

<u>See generally</u> <u>Part IX.A.1.b.iii above</u>.

c. <u>Other Regulatory Provisions Similar to Rule 15a-6</u>

(i) Treasury adopted 17 C.F.R. § 401.9, an exemptive rule for foreign dealers in U.S. government securities that generally parallels Rule 15a-6, and has confirmed that the relief afforded by the <u>Cleary Gottlieb 1997 15a-6 Letter</u> will apply with respect to entities subject to § 401.9. Unlike Rule 15a-6, § 401.9 permits a foreign government securities broker-dealer to engage in direct contacts with institutional investors in conjunction with a <u>bank</u> that is a government securities broker or dealer, as well as in conjunction with an SEC-registered broker-dealer.

(ii) The CFTC exempts foreign commodities brokers from registering as FCMs if they only have customers outside the U.S. and they submit transactions on U.S. exchanges for clearing on an omnibus basis through a registered FCM. <u>See</u> 72 Fed. Reg. 63976 (Nov. 14, 2007); 77 Fed. Reg. 51898 (Aug. 28, 2012) (technical amendments). A CFTC exemption allows non-U.S. affiliates of registered FCMs to act as intermediaries for U.S. institutional investors without registering with the CFTC as introducing brokers. <u>See</u> 73 Fed. Reg. 54069 (Sept. 18, 2008). The exemptions reflect earlier CFTC staff positions. <u>See</u>, <u>e.g.</u>, CFTC Interpretative Letters No. 01-106 (Sept. 30, 2002), CCH Comm. Fut. L. Rep. ¶ 29,198 (foreign bank U.S. branch may refer customers to non-U.S. FCM on an unsolicited basis); No. 89-11 (Aug. 15, 1989), CCH Comm. Fut. L. Rep. ¶ 24,516 (foreign bank U.S. branch may refer customers to registered FCM on an unsolicited basis); No. 87-7 (Nov. 17, 1987), CCH Comm. Fut. L. Rep. ¶ 23,972. <u>See also</u> <u>Part XI.F.1 below</u>.

A) Under 17 C.F.R § 30.12 ("<u>CFTC Rule 30.12</u>"), an unregistered "foreign futures and options broker" (an "<u>FFOB</u>") may accept orders directly from sophisticated U.S. "authorized customers" <u>via</u>

telephone, facsimile, e-mail or automated order routing system.

As noted in <u>Part XI.F.1 below</u>, a non-U.S. firm operating pursuant to a CFTC Rule 30.10 exemption may enter into transactions directly with U.S. customers without intermediation by a U.S. FCM. <u>But see</u> <u>Otkritie Capital International</u>, CFTC Docket No. 16-06 (Jan. 13, 2016) (enforcement against UK-based firm for failing to seek Rule 30.10 exemption, and failure to register as FCM, while allowing two U.S.-based customers to open accounts and trade in foreign markets).

B) CFTC staff has permitted U.S. FCMs to "pass the book" to their foreign affiliates in certain circumstances. <u>See</u>, <u>e.g.</u>, CFTC Interpretative Letter No. 93-83 (Aug. 9, 1993), CCH Comm. Fut. L. Rep. ¶ 25,849 (orders for U.S. exchange-traded contracts received on behalf of U.S. customers of U.S. FCM may be directed to personnel at the U.S. FCM's foreign affiliate for entry into terminals outside regular U.S. trading hours without requiring the foreign affiliate to register as a U.S. FCM).

C) The SEC adopted conditional exemptions permitting certain persons to effect transactions in foreign security futures traded on, or subject to the rules of, a foreign board of trade. <u>See</u> SEC Release No. 34-60194 (June 30, 2009). <u>See also</u> <u>CFTC Advisory Concerning the Offer and Sale of Foreign Security Futures Products to Customers Located in the U.S.</u> (June 9, 2010).

D) On January 22, 2010, the CFTC granted ICE Clear Europe registration as a DCO. ICE Clear Europe, which had operated within the U.S. as a multilateral clearing organization pursuant to a CFTC Order issued on July 23, 2009, clears energy-based contracts and CDS on European reference entities.

As a DCO, ICE Clear Europe is authorized to clear futures contracts, options on futures contracts, commodity options and OTC derivatives contracts.

d. Investment Advisers Act Considerations

The SEC staff's position on registration requirements imposed under the Advisers Act -- see generally Part VIII above -- reflects an attempt to grapple with issues raised by global securities markets. See, e.g., InTouch Global (avail. Nov. 14, 1995); Canadian Consulate General (avail. Mar. 18, 1993) (summarizing U.S. rules). See also U.S. Regulation of International Securities Markets, Chapter 18.

(i) Unless another exemption is available, a U.S. resident adviser that provides investment advisory services exclusively to foreign customers must still register with the SEC; however, a foreign adviser to foreign customers may, without registering with the SEC, acquire information regarding U.S. securities, give advice abroad concerning those securities and effect transactions in U.S. securities through U.S. broker-dealers. Gim-Seong Seow (avail. Nov. 30, 1987). See also, e.g., Industrial Alliance Investment Management (avail. Mar. 14, 2012); Vocor International Holding (avail. Apr. 9, 1990); Securities International (avail. Mar. 14, 1989); Pajolo AG (avail. Oct. 14, 1988); BOH Investment Management Co. (Hong Kong) (avail. Jan. 12, 1987); Double D Management (avail. Jan. 31, 1983).

Compare Credit Agricole Asset Management Alternative Investments (avail. Aug. 7, 2006) (U.S. limited purpose investment adviser subsidiary of non-U.S. bank prohibited from registering with the SEC where such subsidiary provides limited non-discretionary services to its affiliates which, in turn, provide advice only to non-U.S. funds-of-funds and other vehicles in which only non-U.S. persons invest).

(ii) SEC no-action letters regarding exemptions from registration under the Advisers Act by non-U.S. dealers that comply with the research dissemination standards of Rule 15a-6 and/or the Broker-Dealer Release include, e.g., Charterhouse Tilney (avail. July 15, 1993); Barclays (avail. Feb. 14, 1991); Dean Witter Reynolds (Canada) (avail. Mar. 1, 1990); James Capel & Co. (avail. Dec. 6, 1989).

(iii) In Uniao de Bancos de Brasileiros ("UBB") (avail. July 28, 1992) ("Unibanco"), SEC staff did not object if UBB did not register under the Advisers Act notwithstanding the fact that a wholly owned subsidiary, Unibanco Consultoria de Investmentos ("UC"), a registered investment adviser, provides advisory services to non-U.S. customers without complying with the Advisers Act. This reverses the Division's previous position that, once registered, an adviser is subject to the substantive provisions of the Advisers Act with respect to both U.S. and non-U.S. customers, and that a non-U.S. adviser could avoid subjecting all of its operations to the Advisers Act only by forming a subsidiary, which met strict standards of separateness, to provide advice to U.S. customers (see, e.g., Richard Ellis (avail. Sept. 17, 1981) ("Richard Ellis")).

Under Unibanco, the Advisers Act would not apply with respect to a non-U.S. registered adviser's non-U.S. customers. Non-U.S. advisers have greater flexibility than permitted under Richard Ellis in organizing U.S.-registered subsidiaries, and separateness will be recognized if (A) the affiliated companies are separately organized; (B) the registered entity has qualified personnel; (C) all persons involved in U.S. activities are deemed "associated persons" of the registered entity; and (D) the SEC has access to trading and other records of each affiliate involved in U.S. advisory activities, and to its personnel.

For related precedents, see also, e.g., Am. Bar Assoc. Subcommittee on Private Investment Entities (avail.

Aug. 10, 2006); Mercury Asset Management (avail. Apr. 16, 1993) ("MAM"); National Mutual Group (avail. Mar. 8, 1993) ("NMG"). Cf. generally John W. Henry & Co. (avail. Sept. 20, 1996); Thomson Advisory Group (avail. Sept. 26, 1995).

(iv) In Kleinwort Benson Investment Management Limited (avail. Dec. 15, 1993) ("KBIML"), the SEC granted an exemption from registration under the Advisers Act to various non-U.S. affiliates (the "KB Affiliates") of Kleinwort Benson Investment Management Americas ("KBIMA"), a UK investment adviser registered under the Advisers Act, despite the fact that the KB Affiliates would share certain personnel with KBIMA. KBIML sets out parameters regarding KBIMA's access to research from non-U.S. affiliates that would not consent to U.S. jurisdiction or afford the SEC access to personnel and records.

(v) SEC staff reaffirmed Unibanco and KBIML in Murray Johnstone Group (avail. Oct. 7, 1994), which stated that non-U.S. entities did not need to register under the Advisers Act, and the Group's registered U.S. investment adviser did not need to comply with certain provisions of the Advisers Act in connection with advice to non-U.S. clients. See also, e.g., RBC (avail. June 3, 1998) (the "RBC Letter"), which noted that all prior no-action letters were superseded to the extent that such letters excluded clerical and ministerial personnel from the undertaking made by the registered adviser to make its personnel available to SEC staff.

(vi) ABN AMRO (avail. July 1, 1997) stated that ABN AMRO and its affiliates could (A) share certain personnel with, and provide certain services to, ABN AMRO Asset Management (USA), a registered investment adviser; and (B) provide investment advisory services to clients who are not U.S. residents in accordance with non-U.S. law without complying with all of the provisions of the Advisers Act. ABN AMRO was unable under Dutch law to make certain of the representations that had been made in KBIML, MAM, NMG and Unibanco with respect to the availability to the SEC of certain records and personnel, but it did include alternative representations.

(vii) M&G Investment Management (avail. Mar. 1, 2007) permitted M&G, a UK-based registered investment adviser, to exclude from its code of ethics a requirement that certain of its access persons report transactions in specified UK securities that are similar to instruments (e.g., U.S. government securities and certain investment company interests) that are not "reportable securities" for purposes of Advisers Act Rule 204A-1(e)(10), the Rule intended to aid investment advisers and SEC staff in identifying conflict of interest situations involving personal securities transactions.

(viii) Dodd-Frank amended the Advisers Act to require certain advisers to hedge funds, private equity funds and other private pools of capital to register as investment advisers. Dodd-Frank eliminated the so-called "private adviser exemption" under Advisers Act § 203(b)(3) relied upon by many non-U.S. advisers to operate without SEC registration, and replaced it with a more limited "foreign private adviser exemption" for advisers with no place of business in the U.S. In 2011, the SEC adopted final rules implementing these Dodd-Frank amendments and confirmed that it did not intend to overturn any prior statement of the SEC or the view of the staff in Unibanco and related precedents. See SEC Releases No. IA-3221, IA-3222 (June 22, 2011). See also Part XI.E.2.d.iii above.

(ix) Allianz of America (avail. May 25, 2012) involved a wholly-owned subsidiary of a German financial services firm that did not hold itself out to the public as an investment adviser and had previously relied on the "private adviser exemption" which Dodd-Frank eliminated. The staff permitted Allianz of America to continue to provide asset management and advisory services to wholly owned U.S.-based and foreign insurance company affiliates without registering. See also MEAG MUNICH ERGO (avail. Feb. 14, 2014) (German advisory company providing advice only to affiliated companies, including those in the U.S.).

(x) TACT Asset Management (avail. Oct. 24, 2012) involved a wholly-owned U.S. subsidiary of a Japanese asset manager. TACT's parent was not registered as a U.S. investment adviser and TACT's only client was a Japanese insurance company for which it provided advice and assisted, through its parent, with the management of proprietary investments in U.S. securities. Advisers Act § 203(b)(2) provides that the registration requirement does not apply to investment advisers whose only clients are insurance companies. Finding the meaning of "insurance company" to be unclear, but plausibly to include foreign insurance companies, the staff permitted TACT to provide asset management and advisory services to the Japanese insurance company without registering.

(xi) There were 636 foreign investment advisors registered with the SEC in 2014. Those that have a foreign registration totaled 932 in 2014. In coordination with home country regulators, the SEC inspects practices of registered advisers located outside of the U.S. with respect to U.S. customers. Similarly, the NYSE sends examiners to inspect overseas branches of U.S.-based broker-dealers.

e. 1940 Act Considerations

(i) A private investment fund that is not publicly offered and either has fewer than 100 beneficial holders, or has an unlimited number of holders all of whom are qualified purchasers (including a broad range of institutional investors and wealthy individuals -- generally with investments above the $5 million level), is excluded from the definition of investment company under 1940 Act §§ 3(c)(1)/(7). See generally Managed Funds Assoc. (avail. Feb. 6, 2014) (reviewing Rule 3c-5 on certain "knowledgeable employee" investors); Amer. Bar Assoc. (avail. Apr. 22, 1999).

(ii) 1940 Act §7(d) prohibits a non-U.S. investment company from publicly offering any security in the U.S. in the absence of SEC permission to register under the 1940 Act. The SEC's main concern in granting such permission is assuring that the requirements of the 1940 Act would be enforceable against such non-U.S. company. However, while a non-U.S. investment company may make a private offering to U.S. investors without violating § 7(d), it may only do so if such investment company meets the requirements of § 3(c)(1) or (7). See France Growth Fund (avail. July 15, 2003).

In 2008, a group of law firms authored a set of procedures (the "2008 Procedures") designed to assist non-U.S. fund issuers in establishing an appropriate compliance mechanism for determining whether their investors are "qualified purchasers" for purposes of relying on the § 3(c)(7) exemption for a private offering in the U.S. See Bergen, Lincer (Cleary Gottlieb), et al., "Book Entry Deposit Procedures for Certain Offerings by Non-U.S. Issuers under Section 3(c)(7) of the [1940] Act," Investment Lawyer (July 2008). In 2012, the group updated the 2008 Procedures with additional commentary based on market practice and subsequent legislation and regulatory events. See Bergen, Lincer (Cleary Gottlieb), et al., "[1940] Act Status of Non-U.S. Issuers: Updated Commentary on Book-entry Deposit Procedures under § 3(c)(7) of the [1940] Act", Investment Lawyer (Mar. 2012).

(iii) The SEC has provided guidance as to 1940 Act provisions in the non-U.S. fund context:

A) Touche Remnant & Co. (avail. Aug. 27, 1984) concluded that a non-U.S. fund could privately offer its securities in the U.S. without violating 1940 Act registration requirements only if, after such offering, there were no more than 100 U.S. beneficial holders of its securities. See also, e.g., Goodwin Proctor & Hoar (avail. Feb. 28, 1997); Fiduciary Trust Global Fund (avail. Aug. 2, 1995).

The SEC Offshore Website Release addressed how a non-U.S. fund may use the Internet in connection with an unregistered offshore offering without being deemed to have conducted a U.S. public offering. See Part IX.F and Part XI.D.3 above.

B) Investment Funds Institute of Canada (avail. Mar. 4, 1996) permitted a non-U.S. fund to exceed the 100 U.S. holder limit by reason of the relocation to the U.S. of "non-U.S. holders" (including U.S. residents who make offshore purchases of the fund's securities in the secondary market). This position was conditioned on there being no activities to facilitate U.S. secondary market trading or to condition the U.S. market with respect to the fund's securities. See also, e.g., Indosuez Asset Management Asia Ltd. (avail. Feb. 14, 1997).

C) Goodwin, Proctor & Hoar (avail. Oct. 5, 1998) addressed the ability of non-U.S. private funds to conduct operational and marketing activities inside the U.S. Following the adoption of § 1162 of the Taxpayer Relief Act, Pub. L. 105-34 (1997), non-U.S. funds desiring to avoid U.S. taxation may perform certain activities in the U.S. (including solicitation or sale of fund shares and communications with shareholders or the public) that previously were required to be performed outside the U.S. under the IRS's so-called "Ten Commandments". A non-U.S. fund may conduct these activities in the U.S. without otherwise being treated as a U.S. fund for 1940 Act purposes.

D) Wilmer, Cutler & Pickering (avail. Oct. 5, 1998) indicated that the manager of a non-U.S. fund that conducts a global private offering may meet with non-U.S. investors who are temporarily present in the U.S., and sell securities to such investors, without deeming the fund to be making a U.S. public offering, and without having to count the non-U.S. investors as U.S. persons under the 1940 Act.

E) ING Bank (avail. July 8, 2002) permitted unregistered CP conduits to conduct U.S. CP offerings exempt from 1933 Act registration requirements, while simultaneously offering and selling notes in non-U.S. offerings under Regulation S. This position was conditioned on a representation that each conduit would issue only short-term paper, or that it would limit to 100 the number of beneficial owners of conduit-issued paper that was not short-term.

F) Metropolitan Insurance (avail. June 6, 2003) allowed a Separate Account of a U.S. company to issue publicly flexible-premium variable life insurance policies in Taiwan through such company's Taiwan branch without registration under the 1940 Act, provided that (i) the policies would not be offered or sold to any U.S. citizen residing in Taiwan or to any person resident in the U.S., and that all offers and sales of the policies would occur in Taiwan; (ii) the Separate Account would invest solely in offshore funds; (iii) the Taiwan branch's administration of the policies would entail only limited contact with the company's U.S. operations; and (iv) the sales period would be limited to 5 to 12 months (after which the Taiwan branch would be spun off to a separate Taiwan insurance company).

G) Alternative Investment Partners Absolute Return (avail. July 10, 2006) concluded that it would not violate the 1940 Act if an investment company group established a three tier investment structure whereby (i) a top-tier registered U.S. fund advised by a registered U.S. investment adviser, (ii) invested solely in (and controlled) an unregistered Cayman fund which sold shares to non-U.S. investors, (iii) where the Cayman fund in turn only invested in an underlying registered U.S. closed-end investment company. See also, e.g., Man-Glenwood Lexington (avail. Apr. 30, 2004).

H) Doughty Hanson (avail. Sept. 15, 2006) provided U.S. broker-dealers that participate in a global offering of securities of a non-U.S. fund with a "staged investment" feature a conditional exemption from restrictions in 1934 Act § 11(d)(1) on arranging credit, permitting them to participate in the offer and sale of the securities to U.S. qualified institutional buyers.

I) ASA (Bermuda) (avail. Dec. 13, 2006) concluded that a non-U.S. fund could continue to rely on an SEC order issued in 2004 (1940 Act Releases No. 26602 (Sept. 20, 2004), No. 26582 (Aug. 27, 2004)) that permitted the fund to register under the 1940 Act, when its custodian enters into an agreement with a new South African sub-custodian.

J) Dechert LLP (avail. Aug. 4, 2009) permitted a non-U.S. fund to invest in a U.S. registered investment company in excess of the 1940 Act's restrictions on acquisitions by an investment company of more than 5% of the total assets of an investment company, and investments by an investment company of more than 10% of its total assets in other investment companies. This position was conditioned on (i) the non-U.S. fund complying with the 1940 Act's prohibition on an investment company purchasing more than 3% of the voting shares of a U.S. investment company, (ii) each acquired U.S. investment company complying with the 1940 Act's prohibition on sales of more than 10% of its voting shares to other investment companies, (iii) the non-U.S. fund not offering or selling securities in the U.S. to any U.S. person, and (iv) the non-U.S. fund conducting transactions with its shareholders consistent with the definition of "offshore transactions" in Regulation S.

K) With respect to considerations that the SEC takes into account in determining whether subsidiaries of a non-U.S. BHC are "engaged substantially in commercial banking" (and, thus, are "foreign banks") for purposes of 1940 Act Rule 3a-6 (which provides that "foreign banks" are not 1940 Act "investment companies"), see, e.g., Seward & Kissell (avail. Oct. 12, 2005) (listing as factors in determining whether a foreign bank derives a substantial portion of its business from extending credit and accepting deposits (i) whether the bank is authorized to accept deposits and extend credit, (ii) whether the bank holds itself out as doing so, (iii) whether the bank's deposit-taking and credit extensions are sufficiently large that they require separate identification in public reports and regulatory filings, and (iv) whether deposit-taking and credit extension are among the bank's principal activities; SEC staff did not conclude that the "engaged substantially" test would necessarily be satisfied if the average of the separate percentages obtained by computing an entity's (a) credit extension revenues as a percentage of total revenues, (b) receivables from credit activities as a percentage of assets, and (c) aggregate deposits as a percentage of liabilities, exceeds 10%). See also, e.g., Safra Republic Holdings, S.A. (avail. Apr. 21, 1998).

L) ICI/IIB (avail. Feb. 1, 2007) provides that where foreign law prohibits the sharing of a shareholder's government-issued identifier without the affirmative consent of the shareholder, a foreign financial intermediary may comply with the identifier disclosure requirement in 1940 Act Rule 22c-2 by supplying transaction information that is linked to identification numbers generated by the financial intermediary.

F. REGULATION OF INTERNATIONAL FUTURES, OPTIONS AND SWAPS TRANSACTIONS

In 2009, leaders from the G20 nations met to discuss responses to the 2007-2009 global financial crisis. One of the primary goals enunciated by the G20 leaders was to improve the global OTC derivatives markets through standardization of contracts, clearing through central counterparties, requiring trading of derivatives on exchanges or electronic trading platforms, mandating reporting of derivatives trades to trade repositories and subjecting non-cleared contracts to higher capital requirements. See G20 Leaders' Statement: The Pittsburgh Summit (Sept. 2009).

Dodd-Frank Title VII implements the U.S. approach to the regulation of swaps markets. See generally Part II.E above. This Guide describes below certain international applications of the CEA to the futures and options markets, as well as the international impact and "extraterritorial application" of Dodd-Frank Title VII to swaps markets.

Compare generally the Rule 15a-6 provisions described in Part XI.E.2.a and Part XI.E.2.c above.

1. Futures and Options

The CFTC took a number of steps to facilitate U.S. investment in foreign futures and option contracts.

a. In 1996, the CFTC allowed Deutsche Terminbörse to place trading terminals in the U.S. See, e.g., CFTC Interpretative Letters No. 99-8 (Dec. 22, 1998), CCH Comm. Fut. L. Rep. ¶ 27,546; No. 98-42 (June 3, 1998), CCH Comm. Fut. L. Rep. ¶ 27,365; No. 96-28 (Feb. 29, 1996), CCH Comm. Fut. L. Rep. ¶ 26,669.

   The CFTC subsequently issued a Concept Release and proposed rules regarding U.S. access to non-U.S. futures exchanges. See 64 Fed. Reg. 14159 (Mar. 24, 1999) (solicitation of public comments); 63 Fed. Reg. 39779 (July 24, 1998). After substantial negative comment, the CFTC withdrew the proposal. See 64 Fed. Reg. 32829 (June 18, 1999).

CFTC Release No. 5252-06 (Oct. 31, 2006) sets out a Statement of Policy Regarding the Processing of No-action Requests by Foreign Boards of Trade to Provide Direct Electronic Access to Their U.S. Members or Authorized Participants. Among the no-action requests to which CFTC staff has responded are, e.g., Osaka Securities Exchange, CFTC No-Action Letter 11-02 (June 1, 2011), CCH Comm. Fut. L. Rep. ¶ 31,981; International Petroleum (now ICE Futures Europe), CFTC No-Action Letter 09-37 (Aug. 20, 2009), CCH Comm. Fut. L. Rep. ¶ 31,478; Hong Kong Futures Exchange, CFTC No-Action Letters 09-01 (Jan. 16, 2009), CCH Comm. Fut. L. Rep. ¶ 31,305, 01-74 (July 30, 2001), CCH Comm. Fut. L. Rep. ¶ 28,612 and 00-75 (June 9, 2000), CCH Comm. Fut. L. Rep. ¶ 28,180; Nord Pool ASA, CFTC No-Action Letter 08-14 (Aug. 20, 2008), CCH Comm. Fut. L. Rep.¶ 31,305; Eurex Deutschland, CFTC No-Action Letters 08-13 (Aug. 18, 2008), CCH Comm. Fut. L. Rep. ¶ 30,897, 08-05 (Mar. 6, 2008), CCH Comm. Fut. L. Rep. ¶ 30,801, 08-03 (Feb. 6, 2008), CCH Comm. Fut. L. Rep. ¶ 30,797), 07-11 (June 18, 2007), Comm. Fut. L. Rep. ¶ 30,579, 06-08 (Apr. 21, 2006), CCH Comm. Fut. L. Rep. ¶ 30,227, and 99-48 (Aug. 10, 1999), CCH Comm. Fut. L. Rep. ¶ 27,917; Tokyo Financial Exchange, CFTC No-Action Letter 07-02 (Mar. 6, 2007), CCH Comm. Fut. L. Rep. ¶ 30,456; LIFFE Administration and Management, CFTC No-Action Letters 06-25 (Sept. 29, 2006), CCH Comm. Fut. L. Rep. ¶ 30,395, and 00-41 (Mar. 14, 2000), CCH Comm. Fut. L. Rep. ¶ 28,074, CFTC No-Action Letter 99-31 (July 23, 1999), CCH Comm. Fut. L. Rep. ¶ 27,744; Euronet Paris, CFTC No-Action Letters 06-24 (Sept. 29, 2006), CCH Comm. Fut. L. Rep. ¶ 30,394, and 99-33 (Aug. 10, 1999), CCH Comm. Fut. L. Rep. ¶ 27,746; Singapore International Monetary Exchange, CFTC No-Action Letters 06-21 (Sept. 22, 2006), CCH Comm. Fut. L. Rep. ¶ 30,365, and 99-63 (Dec. 17, 1999), CCH Comm. Fut. L. Rep. ¶ 27,966; Euronext Amsterdam, CFTC No-Action Letter 05-16 (Aug. 26, 2005), CCH Comm. Fut. L. Rep. ¶ 30,127; Winnipeg Commodity Exchange, CFTC No-Action Letter 04-35 (Dec. 15, 2004), CCH

Comm. Fut. L. Rep. ¶ 29,938; European Energy Exchange, CFTC No-Action Letter 04-33 (Oct. 25, 2004), CCH Com. Fut. L. Rep. ¶ 29,915; MEFF Sociedad Holding de Productos Financieros Derivados, CFTC No-Action Letter 02-29 (Mar. 8, 2002), CCH Comm. Fut. L. Rep. ¶ 28,990; Bourse de Montréal, CFTC No-Action Letter 02-24 (Feb. 27, 2002), CCH Comm. Fut. L. Rep. ¶ 28,957; SFE Corp., CFTC No-Action Letter 01-75 (July 30, 2001), CCH Comm. Fut. L. Rep. ¶ 28,613; London Metal Exchange, CFTC No-Action Letter 01-11 (Mar. 12, 2001), CCH Comm. Fut. L. Rep. ¶ 28,488; Sydney Futures Exchange/New Zealand Futures and Options Exchange, CFTC No-Action Letter 99-37 (Aug. 10, 1999), CCH Comm. Fut. L. Rep. ¶ 27,757.

b. The Statement of Policy of CFTC Regarding the Listing of New Futures and Option Contracts by Foreign Boards of Trade that Have Received Staff No-action Relief to Place Electronic Trading Devices in the [U.S.], 65 Fed. Reg. 41641 (July 6, 2000), permits non-U.S. exchanges that have received no-action relief to list additional contracts for trading without obtaining supplemental no-action relief or other CFTC approval (other than in the case of stock index futures contracts, which require no-action relief). In 2013, CFTC staff expanded existing relief to allow foreign boards of trade to list certain swaps for trading by direct access, in addition to the futures and option contracts already permitted. CFTC Letter No. 13-46 (July 11, 2013), CCH Fed. Comm. Fut. L. Rep. ¶ 32,675. See also, e.g., CFTC Letter No.11-06 (Aug. 31, 2011), CCH Fed. Comm. Fut. L. Rep. ¶ 32,027 (Euronext Brussels (EB) offer and sale of EB futures contract based on the BEL 20 Stock Index).

c. Dodd-Frank § 738 amended the CEA such that, consistent with the CFTC's prior no-action approach, a non-U.S. exchange (or foreign board of trade) providing its U.S. members or participants with direct access to its trading and order matching system may be required to register with the CFTC, with consideration given to the extent to which the non-U.S. exchange is subject to comparable, comprehensive supervision and regulation. Section 738 also expands CFTC authority over non-U.S. exchanges which list contracts linked to U.S. futures exchanges.

In 2011, the CFTC published final rules to implement § 738 and impose a registration requirement on non-U.S. exchanges that wish to provide direct access to U.S. persons. See 76 Fed. Reg. 80674 (Dec. 23, 2011). See also, e.g., CFTC Press Release No. 7218-15 (Aug. 26, 2015) (indicating registration replaces need to operate under prior no-action letters); BM&F BOVESPA, CFTC Order of Registration (June 1, 2016); Cleartrade Exchange Pte. Ltd., CFTC Order of Registration (June 1, 2016); ICE Futures Canada, CFTC Order of Registration (Aug. 25, 2015); Montreal Exchange, CFTC Order of Registration (Aug. 25, 2015); Singapore Exchange Derivatives Trading Ltd., CFTC Order of Registration (Jan. 22, 2015); Bursa Malaysia Derivatives Berhad, CFTC Order of Registration (Jan. 22, 2015).

d. The CFMA reduced the regulatory burden applicable to U.S. futures exchanges (or "contract markets"), and replaced many of the rules governing futures exchanges with a set of "core principles", which Dodd-Frank subsequently expanded. See CEA § 5(d); 17 C.F.R. Part 38; 66 Fed. Reg. 42256 (Aug. 10, 2001). In 2012, the CFTC published final rules under this authority, providing more detailed and prescriptive guidance regarding how contract markets are required to apply these "core principles". See 77 Fed. Reg. 36612 (June 19, 2012). Contract markets may also generally list new contracts and amend their rules without prior CFTC approval, although Dodd-Frank gave the CFTC authority to review rule submissions and stay their effectiveness. See CEA § 5c(c); 17 C.F.R. Part 40. The CFTC has adopted new rules providing a process for contract markets and other registered entities to list new contracts.

e. 17 C.F.R. Part 30 establishes the CFTC regulatory structure governing the offer and sale of non-U.S. futures and options contracts to U.S. persons. See CFTC Rule 30.12; 65 Fed. Reg. 47275 (Aug. 2, 2000).

Special restrictions apply to the offer or sale of futures on securities, including a non-U.S. government debt obligation or a non-U.S. stock index. The SEC must designate non-U.S. government debt as exempt under 1934 Act Rule 3a12-8 before a futures contract or option thereon may be offered or sold in the U.S. Non-U.S. futures contracts on a stock index that is not a CEA-defined "narrow-based security index" may be offered or sold in the U.S. only following the issuance of CFTC no-action relief. See CEA § 1a(25) ("narrow-based security index" definition). SEC/CFTC regulations clarify the operation of the definition. See 66 Fed. Reg. 44489 (Aug. 23, 2001). CFTC staff has granted no-action relief for non-U.S. futures contracts on numerous stock indices. See CFTC website: Foreign Instrument Approvals and Exemptions; Foreign Commodity Options, 61 Fed. Reg. 10891 (Mar. 18, 1996). See also, e.g., CFTC Letter, July 20, 2012 (certifying that Eurex Deutschland's Euro STOXX 50 Volatility Index Mini futures contract may be offered or sold to persons in the U.S.); CFTC No-Action Letter No. 11-07 (Oct. 24, 2011) (permitting the offer and sale in the U.S. of the Taiwan Futures Exchange's futures contract on the Gretai Securities Market Capitalized Weighted Stock Index).

Non-U.S. futures contracts (or options thereon) on an individual security (other than certain securities exempt under the 1934 Act) or a narrow-based securities index are defined as both "securities" and "futures" and are subject to dual SEC/CFTC regulation. See 1934 Act § 6(k); CEA § 2(a)(1)(E). See also Part II.E.3.b above.

f. The CFTC publishes a "RED List" (Registration Deficient List) of those "foreign entities that have been identified as acting in a capacity that appears to require registration but are not appropriately registered with the [CFTC]." CFTC Press Release No. 7224-15 (Sept. 9, 2015). There are now over 40 foreign entities on the list. See Securities Law Daily, Apr. 19, 2016. See also 80 Fed. Reg. 55098 (Sept. 14, 2015) (request for comment).

g. Pursuant to 17 C.F.R. § 30.10 ("CFTC Rule 30.10"), the CFTC has granted exemptive relief to non-U.S. persons which are subject to comparable regulation in their home jurisdiction. See 17 C.F.R. Part 30, Appendix A (process to petition for such an exemption); CFTC website: Foreign Part 30 Exemptions; CFTC No-Action Letter 16-08 (Feb. 12, 2016), CCH Comm. Fut. L. Rep. ¶ 33,639 (non-U.S. exempt IBs, CTAs or CPOs not required to submit swaps with non-U.S.-person for clearing through registered FCM if swap not subject to CFTC clearing requirement); 81 Fed. Reg. 7204 (Feb. 11, 2016) (relief for firms designated by the Korea Exchange); 80 Fed. Reg. 15680 (Mar. 25, 2015) (relief for firms designated by the Hong Kong Securities and Futures Commission); CFTC No-Action Letter 00-94 (Sept. 27, 2000), CCH Comm. Fut. L. Rep. ¶ 28,279 (permitting a non-U.S. bank with a NY branch to obtain Rule 30.10 relief for its London branch); Notice of Office of Management and Budget Action (July 16, 2010) (approval of questionnaire to be sent to Rule 30.10 exemption recipients inquiring as to changes that could impact the fundamentals for which exemptive relief was granted). See also CFTC Report: Futures Exchange and Contract Authorization Standards and Procedures in Selected Countries (Aug. 1999); 64 Fed. Reg. 30489 (June 8, 1999) (NFA functions with respect to Rule 30.10 exemptions).

h. CFTC regulation 17 C.F.R. § 3.10 sets forth the manner in which intermediaries, including FCMs, IBs, CPOs and CTAs, must apply for registration with the CFTC. Sections 3.10(c)(2)(i) and (c)(3)(i) provide exemptions from registration for intermediaries located outside the U.S. that act solely on behalf of persons located outside the U.S., even if such transaction may occur across a DCM or SEF, provided the transactions are cleared through a registered FCM. The CFTC has proposed to remove the condition requiring clearing of the transaction. See 81 Fed. Reg. 51824 (Aug. 5, 2016) (proposed rule).

i. In 2002, the CFTC granted no-action relief allowing an SEC-registered broker-dealer affiliate of a UK investment firm that operates an electronic system for trading foreign debt securities to pass the futures leg of certain transactions entered into by its U.S. bank and broker-dealer customers to the foreign firm for execution on Eurex Deutschland and LIFFE. In granting the relief, the CFTC noted that both Eurex and LIFFE operate under CFTC no-action letters with respect to access to U.S. customers via trading terminals and automated order routing systems. See CFTC No-Action Letter 02-92 (Aug. 2, 2002), CCH Comm. Fut. L. Rep. ¶ 29,134. See also Part XI.F.1 above.

j. CFTC Order Regarding Treatment of Funds Held in Connection with the Clearing by The Clearing Corporation of Euro-denominated Contracts Executed on Eurex Deutschland, CFTC Release No. 5014-04 (Oct. 21, 2004), permitted the establishment of "Euro Link" which, through participating U.S. FCMs, provides clearing services to U.S. and non-U.S. futures customers for European commodity futures and option contracts.

k. The CFTC has published final rules that govern the investment of customer funds held in an account for foreign futures and options transactions to reflect Dodd-Frank amendments to the CEA. See 76 Fed. Reg. 78776 (Dec. 19, 2011). The CFTC also issued rules enhancing the protection for FCMs' holdings of customer funds. 78 Fed. Reg. 68506 (Nov. 14, 2013). Pursuant to 17 C.F.R. § 30.7, the CFTC restricted the amount of funds related to foreign futures and options that may be held in accounts outside the U.S., and restricted the manner and location for holding these funds. See ICE Clear Europe Ltd., Amended Order (Mar. 26, 2015) (allowing ICE Clear Europe, its clearing member FCMs and other FCMs that clear through its clearing member FCMs to commingle customer property related to foreign futures with customer property related to U.S. futures); CFTC Letter No. 14-138 (Nov. 13, 2014), CCH Comm. Fut. L. Rep. ¶ 33,341 (subject to conditions, FCM may (1) exclude funds held at a foreign bank or trust company from certain limits, (2) net offsetting transfers of customer funds between the FCM and the foreign depository instead of executing multiple transfers, and (3) withdraw foreign currency from a customer account without being subject to withdrawal limitations, if the withdrawal is related to an exchange of margin currency into U.S. dollars); CFTC Letter No. 14-110 (Aug. 28, 2014), CCH Comm. Fut. L. Rep. ¶ 33,232 (allowing foreign option and future customer funds to be held at UK investment banks that hold funds on deposit rather than in trust); CFTC Letter No. 14-08 (Jan. 10, 2014), CCH Comm. Fut. L. Rep. ¶ 32,962 (time limited no-action relief for purpose of providing time to assess customer protection rules in UK and Hong Kong); CFTC Letter No. 14-03

(Jan. 10, 2014), CCH Comm. Fut. L. Rep. ¶ 32,932 (no-action relief for potential delays in transmitting funds back to U.S. accounts).

l. The CFTC enforces the CEA and its related rules extraterritorially. For example:

(i) In 2011, the CFTC issued an order settling charges against Enskilda Futures ("EFL"), a London-based FCM, and its Swedish parent company, SEB, for failing to supervise commodity interest accounts carried by EFL. The CFTC found SEB liable even though EFL was the registered FCM because EFL limited its FCM services to SEB and SEB's clients and SEB controlled "every aspect" of EFL's FCM activities. See CFTC Press Release, Nov. 28, 2011; In the Matter of Enskilda Futures, Docket No. 12-04 (CFTC, Nov. 28, 2011).

(ii) CFTC v. MXBK Group, No. 10-CV-01172 (D. Utah, Mar. 7, 2013), decided a CFTC enforcement action against MXBK Group (a Mexican financial services holding company) and its FX trading division on charges of issuing false customer statements and misrepresenting trading results on a website.

(iii) In the Matter of Zulutrade, Docket No. 14-24 (CFTC, Sept. 9, 2014), sanctioned a Greece-based, CFTC-registered IB and CTA for failure to adhere to its OFAC screening policies and to oversee third party consultants that assisted in reviewing potential customer accounts under those screening procedures.

(iv) The CFTC has enforced the CEA against foreign nationals engaged in "layering" and "spoofing" tactics designed to drive participants into one side of the market. For example, in CFTC v. Khara and Salim, No. 15-cv-03497 (SDNY May 5, 2016) (consent order), the CFTC imposed a permanent injunction against two UAE nationals who had used accounts at registered FCMs to engage in false trades on the CME and the COMEX. In CFTC v. Nav Sarao Futures Ltd., No.

15-cv-3398 (N.D. Ill. Apr. 17, 2015) (complaint), the CFTC alleged that a UK national and his UK company, acting through accounts at four registered FCMs, engaged in large size spoofing and layering using algorithms and an automated system to manipulate the CME's "E-mini S&P 500" futures contract.

2. International Swaps Regulation

The global nature of the swaps and derivatives markets has required a greater degree of international coordination and harmonization of regulations related to both participation in such markets and the infrastructure supporting such markets.

Significant issues have emerged concerning international coordination and the extraterritorial application of new swap regulations. While this Guide is not intended to set out all of the issues related to international regulation of swaps markets and market participants, this Guide discusses below several of the issues related to coordination and application of U.S. swaps rules internationally.

See generally Part II.E above; Cross-Border Fragmentation of Global Derivatives (ISDA, Oct. 2015) (European dealers prefer trades with non-U.S. dealers to avoid being subject to U.S. rules); OTC Derivatives Markets Reforms: Ninth Progress Report on Implementation (FSB, July 24, 2015); Consultation Report [on Cross-Border Regulation] (IOSCO, Nov. 25, 2014); Jurisdictions' Ability to Defer to Each Other's OTC Derivatives Market Regulatory Regimes (FSB, Sept. 18, 2014); Greene & Potiha, "Examining the Extraterritorial Reach of Dodd-Frank's Volcker Rule and Margin Rules for Uncleared Swaps -- A Call for Regulatory Coordination and Cooperation," Cap. Mkts. Law J., Vol. 7, No. 3 (June 2012).

a. The CFTC and Committee of European Securities Regulators ("CESR") (now known as ESMA) announced a Common Work Program to Facilitate Trans-Atlantic Derivatives Business. See CFTC Release No. 5090-05 (June 28, 2005). In 2006, the CFTC and CESR published a series of guides for conducting derivatives business in the U.S. and EU. See CFTC Release No. 5182-06 (May 15, 2006).

In September 2014, the CFTC announced the re-establishment of the Global Markets Advisory Committee for a two-year period. The Committee will assess the ways in which initiatives by the CFTC and foreign regulators impact U.S. firms and markets. It will work to improve the domestic and international regulatory structure, while preserving protections for customers and market participants and ensuring that U.S. markets and firms remain competitive globally. See 79 Fed. Reg. 21411 (Sept. 9, 2014).

b. In 2012, the CFTC and SEC issued the Joint Report on International Swap Regulation ("Joint Report") mandated by Dodd-Frank § 719(c). See also 76 Fed. Reg. 44508 (July 26, 2011) (solicitation of information).

The Joint Report noted that Dodd-Frank is the only legislation across jurisdictions that seeks to register and regulate entities that undertake swaps activities, in contrast to applying swaps regulation to transactions (and clearing, trading, reporting of such transactions). The Joint Report did observe, however, that entities that engage in swaps activity in other jurisdictions may be subject to regulatory oversight under other regulatory regimes, such as bank or broker-dealer regulation.

c. Dodd-Frank § 752 (i) requires that, in order to promote effective and consistent global regulation of swaps and SBS, the CFTC, the SEC and prudential bank regulators consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards; and (ii) states that U.S./foreign authorities may agree to appropriate information-sharing arrangements.

d. From 2011 through 2015, senior representatives of OTC derivatives regulators from jurisdictions including the U.S., EU, Australia, Brazil, Canada, Japan, Hong Kong, Singapore and Switzerland met in regulatory dialogues to address cross-border issues related to implementation of OTC derivatives reforms, including Dodd-Frank in the U.S. See, e.g., OTC Derivatives Regulators Group, Reports on Cross-Border Implementation

Issues (Nov. 2014, Mar. 2014), Report on Agreed Understandings to Resolving Cross-border Conflicts, Inconsistencies, Gaps and Duplicative Requirements (Aug. 30, 2013) and Report to the G-20 Meeting (Apr. 16, 2013).

e. Dodd-Frank §§ 722(d) and 772(b) describe the scope of CFTC/SEC authority in relation to international swaps activities. However, the wording of each section is slightly different.

(i) Section 722(d) states that neither the CEA swaps provisions enacted by Dodd-Frank Title VII, nor any rule promulgated under those provisions, shall "apply to activities outside the [U.S.] unless those activities (1) have a direct and significant connection with activities in, or effect on, commerce of the [U.S.]; or (2) contravene such rules or regulations as the [CFTC] may prescribe or promulgate as are necessary or appropriate to prevent . . . evasion."

(ii) Section 772(b) states that neither the 1934 Act swaps provisions enacted by Dodd-Frank Title VII, nor any SEC rule promulgated under those provisions, "shall apply to any person insofar as such person transacts a business in [SBS] without the jurisdiction of the [U.S.], unless such person transacts such business in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate to prevent evasion."

f. In 2013, the CFTC issued interpretive guidance addressing the cross-border application of the swaps provisions of Dodd-Frank Title VII. See 78 Fed. Reg. 45292 (July 26, 2013) (the "CFTC Cross-border Guidance"). See also 78 Fed. Reg. 909 (Jan. 7, 2013) (further proposal and solicitation of public comments); 77 Fed. Reg. 41214 (July 12, 2012) (solicitation of public comments).

(i) The CFTC Cross-border Guidance addresses a number of key issues relevant to the regulation of cross-border swaps activity, including: (A) the definition of "U.S. person" for the purposes of defining the scope of such regulation; (B) the circumstances under which both U.S. and non-U.S. persons are required to register as a Swap Dealer or MSP; (C) the interpretation of the terms "foreign branch" of a U.S. bank, "guaranteed affiliate" and "conduit affiliate"; (D) the classification of certain Title VII requirements as either "entity-level" or "transaction-level" requirements; and (E) the process for registered Swap Dealers or MSPs, when eligible, to seek recognition of "substituted compliance" with comparable entity- or transaction-level requirements imposed by foreign regulators instead of those imposed by the CFTC.

(ii) The CFTC Cross-border Guidance includes a broad definition of "U.S. person" for the purposes of determining whether a person is, or a person's counterparties cause a person to be, subject to Title VII and the CFTC's swap regulations. The definition of "U.S. person" includes, but is not limited to:

A) Any natural person who is a U.S. resident.

B) Any estate of a decedent who was a resident of the U.S. at the time of death.

C) Any corporation, partnership, LLC, business or other trust, association, joint-stock company, fund or any similar form of enterprise, in each case that is organized or incorporated under U.S. law or has its principal place of business in the U.S.

D) Any pension plan for the employees, officers or principals of a legal entity, unless the pension plan is primarily for foreign employees of such entity.

E) Any trust governed by U.S law.

F) Any commodity pool, pooled account, investment fund or other collective investment vehicle that is majority-owned by one or more persons described above, except any vehicle that is publicly offered only to non-U.S. persons and not offered to U.S. persons.

G) Any legal entity (other than a LLC, limited liability partnership or similar entity where all of the owners of the entity have limited liability) that is directly or indirectly majority-owned by one or more persons described above and in which such persons bear unlimited responsibility for the obligations and liabilities of the legal entity.

H) Any individual account (discretionary or not) where the beneficial owner is a U.S. person.

(iii) Under the CFTC Cross-border Guidance, a U.S. person would be required to register as a Swap Dealer if its swap dealing activities with all counterparties, when aggregated with certain U.S. and non-U.S. affiliates' swap dealing activities, exceed a de minimis threshold. A non-U.S. person may be treated as a U.S. person for purposes of determining whether it must register if it is either:

A) An affiliate of and guaranteed by a U.S. person (a "guaranteed affiliate"); or

B) An "affiliate conduit" of a U.S. person -- the CFTC will weigh multiple factors to determine whether a non-U.S. person is an "affiliate conduit," including: (i) majority ownership by a U.S. person; (ii) controlling, being controlled by or being under common control with a U.S. person; (iii) consolidated financial results with a U.S. person; and (iv) the engagement in (a) swaps with non-U.S. third parties, in the regular course of business, to hedge risks faced by, or take positions on behalf of, its U.S. affiliates; and (b) offsetting swaps or other arrangements with its U.S. affiliates to transfer the risks and benefits of such swaps with non-U.S. third parties to its U.S. affiliates. The term "affiliate conduit" does not include affiliates of Swap Dealers.

(iv) In contrast, a non-U.S. person that is not a guaranteed affiliate or an affiliate conduit must register as a Swap Dealer only if its swap dealing activities with U.S. persons and certain guaranteed affiliates, when aggregated with certain U.S. and non-U.S. affiliates' swap dealing activities, exceed a de minimis threshold. Such non-U.S. persons are permitted to exclude certain swaps when calculating compliance with the thresholds, including swaps with foreign branches of U.S. persons that are registered Swap Dealers.

Because the Swap Dealer registration requirements for non-U.S. persons is based, in part, on transactions facing guaranteed affiliates of U.S. persons, various U.S. banking organizations reportedly began to remove guarantees from their overseas affiliates. These actions reportedly caused the CFTC to commence a review into whether U.S. Swap Dealers might be evading Title VII. See, e.g., Banking Daily, May 16, 2014. In June 2015, CFTC Chairman Massad, in the context of issuance of the cross-border margin rules (discussed in Parts XI.F.2.i and XI.F.2.j below), stated: "I have also considered the practice of what has been loosely termed 'de-guaranteeing.' . . . The line I would propose is this: if the financial results and position of the non-U.S. [S]wap [D]ealer are consolidated in the financial statements of the U.S. parent, then we should take that into account, whether or not there is an explicit guarantee. . . . [T]ransactions by a non-U.S. [S]wap [D]ealer would be excluded from the rule only if both the [S]wap [D]ealer and its counterparty are neither guaranteed by a U.S. person nor consolidated in the financial statements of a U.S. person. The limited exclusion available – which applies only if neither party is guaranteed or consolidated with a U.S. person – helps address the concern that there is risk to the U.S. even if there is no explicit guarantee." Remarks of CFTC Chairman Massad June 9, 2015.

(v) For purposes of the de minimis test, all entities, whether U.S. or non-U.S., are required to aggregate the swap dealing activities of their affiliates (to the extent those activities count toward those affiliates' own de minimis thresholds), subject to exceptions in the CFTC Cross-border Guidance for swap dealing activities by a registered Swap Dealer affiliate.

(vi) The CFTC Cross-border Guidance separately describes the types of activities and transactions that must be included in calculating whether both U.S. or non-U.S. persons must register as MSPs.

(vii) A foreign branch, agency or office of a U.S. person is considered to be a part of the U.S. person under the CFTC Cross-border Guidance. However, for Swap Dealer and MSP registration purposes, the Guidance permits a non-U.S. person that is not a guaranteed affiliate or affiliate conduit to exclude transactions with foreign branches of U.S. Swap Dealers in certain instances. In addition, foreign branches of U.S. Swap Dealers also receive different treatment when applying transaction-level rules.

A) For purposes of the Guidance, a "foreign branch" of a U.S. swap dealer or MSP is any foreign branch designated as such under Regulation K or by the U.S. bank's primary regulator that maintains accounts for profit and loss independently of the home office and other foreign branches and that is subject to substantive banking regulation in the jurisdiction where it is located.

B) A swap is considered to be "with a foreign branch" when (i) employees negotiating and agreeing to the terms of the swap are located in the foreign branch or in another foreign branch of the U.S. bank; (ii) payments and deliveries under the swap are made and received by the foreign branch or another foreign branch; (iii) the documentation of the swap specifies that the office for the U.S. bank is the foreign branch; (iv) the swap is entered into by the foreign branch in its normal course of business; (v) the swap is treated as a swap of the foreign branch for tax purposes; and (vi) the swap is reflected in the local accounts of the foreign branch.

(viii) As a general matter, entities registering as Swap Dealers or MSPs are subject to regulatory requirements under Title VII regardless of whether the entity is a U.S. person or non-U.S. person. <u>See</u> <u>Part II.E above</u>. The CFTC Cross-border Guidance categorizes regulatory requirements as either "<u>transaction-level requirements</u>" (<u>e.g.</u>, clearing and swap processing, margin for uncleared swaps, trade execution, daily trading records, real-time public reporting, external business conduct standards) or "<u>entity-level requirements</u>" (<u>e.g.</u>, capital, risk management, internal conflicts, swap data recordkeeping).

A) <u>U.S. Swap Dealers or MSPs</u> are subject to all entity-level and transaction-level requirements across all of their swap transactions.

B) <u>Foreign branches of U.S. Swap Dealers or MSPs</u> are subject to all entity-level requirements as part of the registered entity. Such branches must apply transaction-level requirements to all swap transactions, except that (i) external business conduct standards do not apply to transactions with non-U.S. persons or other foreign branches of U.S. Swap Dealers; (ii) transactions with non-U.S. persons (including guaranteed affiliates or affiliate conduits) and other foreign branches of U.S. Swap Dealers may be eligible for "substituted compliance" by following comparable local rules; and (iii) certain branches that represent a small amount of the transactions of all foreign branches of the U.S. Swap Dealer or MSP may be able to apply local swaps regulation (without needing a substituted compliance determination) if the branch is in a jurisdiction other than Australia, Canada, the EU, Hong Kong, Japan or Switzerland.

C) Non-U.S. Swap Dealers or MSPs (whether or not affiliated with, guaranteed by or a subsidiary of a U.S. person) are eligible to apply for "substituted compliance" for most of the entity-level requirements, except for certain reporting requirements in connection with swaps with U.S. persons, guaranteed affiliates and affiliate conduits. Such entities are subject to all transaction-level requirements for swaps with U.S. persons and guaranteed affiliates, unless the swap is (i) executed anonymously on a DCM, SEF or foreign board of trade and cleared; or (ii) subject to "essentially identical" home country requirements, as determined by the CFTC. Such entities are eligible to apply for "substituted compliance" for transaction-level rules applicable to transactions with foreign branches of U.S. Swap Dealers and with guaranteed affiliates. (See CFTC No-Action Letter No. 15-64 (Nov. 20, 2015), CCH Comm. Fut. L. Rep. ¶ 33,595 (certain non-U.S. counterparties of Wells Fargo Bank's London branch granted relief based on compliance with local swap rules, even though CFTC has not yet issued a substituted compliance determination for counterparties' jurisdictions).) No U.S. transaction-level rules apply to swaps between a non-U.S. Swap Dealer or MSP that is not a guaranteed affiliate or an affiliate conduit and another non-U.S. person that is not a guaranteed affiliate or an affiliate conduit. A non-U.S. Swap Dealer or MSP that is a guaranteed affiliate is subject to transaction-level rules for its swaps with other non-U.S. swap dealers and MSPs, but is eligible for substituted compliance. Certain transaction-level rules also apply to swaps between a non-U.S. swap dealer or MSP and an affiliate conduit.

D) Notwithstanding the CFTC's view that a U.S. branch of a non-U.S. Swap Dealer or MSP is part of such non-U.S. person, the CFTC indicated in a footnote to the CFTC Cross-border Guidance ("footnote 513") that it would expect such U.S. branches to apply transaction-level requirements to swap transactions with all customers without the opportunity for substituted compliance.

Furthermore, the CFTC also concluded that even if a non-U.S. Swap Dealer were facing a non-U.S. person, transaction-level rules should apply in situations where the swap is arranged, negotiated or executed by personnel or agents of the non-U.S. Swap Dealer located in the United States. CFTC Staff Advisory No. 13-69 (Nov. 14, 2013) ("CFTC Letter 13-69"), CCH Comm. Fut. L. Rep. ¶ 32,585. The CFTC requested comment on CFTC Letter 13-69, 79 Fed. Reg. 1347 (Jan. 8, 2014), and has repeatedly delayed its implementation, in part based on industry objection to the CFTC's position. See CFTC Staff Letters Nos. 13-71 (Nov. 26, 2013), CCH Comm. Fut. L. Rep. ¶ 32,882, 14-01 (Jan. 3, 2014), CCH Comm. Fut. L. Rep. ¶ 32,932, 14-74 (June 4, 2014), CCH Comm. Fut. L. Rep. ¶ 33,170, 14-140 (Nov. 14, 2014), CCH Comm. Fut. L. Rep. ¶ 33,344, 15-48 (Aug. 13, 2015), CCH Comm. Fut. L. Rep. ¶ 33,522, and 16-64 (Aug. 4, 2016), CCH Comm. Fut. L. Rep. ¶ 33,819 (delay until Sept. 30, 2017).

(ix) The CFTC Cross-border Guidance subjects applications for "substituted compliance" for either entity-level or transaction-level requirements to an individual category-by-category determination as to whether local swap rules are comparable to, and as comprehensive as, those promulgated by the CFTCF; this determination would not depend on an evaluation of the jurisdiction's swap regulatory regime as a whole.

g. On December 4, 2013, SIFMA, ISDA and the IIB sued the CFTC to halt implementation of the CFTC Cross-border Guidance for alleged failure to comply with the Administrative Procedure Act and failure to conduct cost-benefit analysis. On cross motions for summary judgment, the Court ruled that (A) the CFTC Cross-Border Guidance is a non-binding statement of policy not yet ripe for adjudication, (B) Title VII of the Dodd-Frank Act does apply extraterritorially when the appropriate nexus is present, and (C) Congress' decision to apply Title VII rules extraterritorially did not relieve the CFTC from its duty to consider the cost and benefits of the choices it made in the rules it promulgated. SIFMA et al. v. CFTC, 67 F. Supp. 3d 373 (D.D.C. 2014) (final opinion). The CFTC sought further comment on the costs and benefits of the extraterritorial application of its Title VII rules. In its "final response" to the District Court's order, the CFTC addressed comments received, acknowledged that it currently employs three potential methods of mitigating regulatory arbitrage and/or overlapping or inconsistent rulemaking (promulgating rules specifically delineating geographic reach, altering the substance of regulation to address special issues in non-U.S. regulation, and/or offering substituted compliance or similar relief) and it concluded that no substantive changes are currently needed in its Cross-Border Guidance. See 81 Fed. Reg. 54478 (Aug. 16, 2016) (final response); 80 Fed. Reg. 12555 (Mar. 10, 2015) (initial response).

h. Regulators in non-U.S. jurisdictions criticized the CFTC's approach to cross-border swap activity, and expressed concern over the breadth of the "U.S. person" definition, the potential for conflicting U.S. and foreign regulatory requirements, the short timetable for the implementation of Title VII requirements, and other issues. See, e.g., Letter to Treasury Secretary Jack Lew, Apr. 18, 2013 (from Brazil, EC, France, Germany, Italy, Japan, Russia, South Africa, Switzerland and UK); Letter from the UK FSA, Aug. 24, 2012; Letter from the EC, Aug. 24, 2012; Letter from Financial Services Agency of Japan and the Bank of Japan, Aug. 13, 2012. See also, e.g., Financial Times, Sept. 6, Aug. 29, 2012; Compliance Week, Aug. 31, 2012.

i. On October 22 and 30, 2015, the Prudential Regulators adopted final rules establishing margin requirements for non-cleared swaps and SBS. 80 Fed. Reg. 74840 (Nov. 30, 2015) (the "Bank Final Margin Rules"). The Bank Final Margin Rules apply to non-cleared swaps and SBS entered into by SDs, MSPs, SBSDs and MSBSPs that are banks or are otherwise subject to oversight by the Prudential Regulators ("Bank Swap Entities"). Furthermore, with respect to cross-border swaps, U.S. margin requirements for Bank Swap Entities will apply extraterritorially to U.S.-based firms' foreign branches and foreign subsidiaries, with limited opportunity for substituted compliance. Among other provisions, with respect to cross-border swaps, the Bank Final Margin Rules address the following:

(i) A U.S. Bank Swap Entity is subject to all requirements of the Bank Final Margin Rules for all non-cleared swaps and SBS (regardless of a counterparty's U.S. or non-U.S. status) and are eligible for substituted compliance only in connection with obligations to post initial margin ("IM") to financial end users with a material swap exposure that are not guaranteed by a U.S. person and that are required to collect IM pursuant to a foreign regulatory framework, for which the Prudential Regulators have made a comparability determination.

(ii) A foreign branch of a U.S. Bank Swap Entity is treated in the same manner as the U.S. head office; substituted compliance is only available in connection with obligations to post IM to financial end users with material swaps exposure that are not guaranteed by a U.S. person.

(iii) A non-U.S. Bank Swap Entity that is, with respect to the uncleared swap or SBS in question, guaranteed by a U.S. person is treated the same as a U.S. Bank Swap Entity.

(iv) A non-U.S. Bank Swap Entity that is a subsidiary of a U.S. person but, with respect to the uncleared swap or SBS in question, is not guaranteed by a U.S. person is subject to all the requirements under the Bank Final Margin Rules, but is eligible for substituted compliance, if it is a subsidiary of a U.S. depository institution, Edge corporation or agreement corporation.

(v) A Bank Swap Entity that is a U.S. branch or agency of a foreign bank is subject to all requirements of the Bank Final Margin Rules for all non-cleared swaps and SBS (regardless of a counterparty's U.S. or non-U.S. status), but is also eligible for substituted compliance for all requirements of the Bank Final Rules (including in respect of its U.S.-facing transactions).

(vi) The Bank Final Margin Rules include an exemption from the requirement to post and segregate margin under certain circumstances, typically with respect to transactions in emerging markets.

(vii) A non-U.S. Bank Swap Entity that is not guaranteed by, nor consolidated with, a U.S. person may avail itself of an exemption from the Bank Final Margin Rules in transactions with a non-U.S. counterparty that is not guaranteed by a U.S. person.

(viii) The Bank Final Margin Rules also include a process for requesting substituted compliance comparability determinations.

j. On May 24, 2016, the CFTC adopted final rules governing margin requirements for non-cleared swaps in the context of cross-border transactions. 81 Fed. Reg. 34817 (May 31, 2016) (the "CFTC Cross-border Margin Rules"). See also CFTC Press Release 7370-16, May 24, 2016; Fact Sheet – Final Rule Regarding the Cross-Border Application of the Margin Requirements (CFTC, May 24, 2016); Wall St. J., May 24, 2016. The rule applies to CFTC-registered SDs and MSPs that are not subject to the margin requirements of the prudential regulators (covered swaps entities or "CSEs"). Nevertheless, the CFTC Cross-border Margin Rules are closely aligned with the Bank Final Margin Rules and are generally consistent with the CFTC proposed rule published in 2015. 80 Fed. Reg. 4137 (July 14, 2015). Among other provisions, the CFTC Cross-border Margin Rules address the following:

(i) Generally, U.S. CSEs must follow the CFTC margin rules with regard to all of their non-cleared swaps. Such

CSEs may benefit from substituted compliance for the posting (but not collection) of initial margin with a non-U.S. counterparty whose obligations are not guaranteed by a U.S. person.

(ii) A non-U.S. CSE whose swaps are guaranteed by a U.S. person must follow the margin rules as if it were a U.S. CSE.

(iii) A non-U.S. CSE that is consolidated with a U.S. ultimate parent may avail itself of substituted compliance in a manner broader than a U.S. CSE, but does not benefit from the exemption described below.

(iv) A non-U.S. CSE that is not guaranteed by, nor consolidated with, a U.S. person may avail itself of an exemption from the CFTC margin rules in transactions with a non-U.S. counterparty.

(v) The CFTC Cross-border Margin Rules also include a process for requesting substituted compliance comparability determinations.

See also 81 Fed. Reg. 63376 (Sept. 15, 2016) (CFTC determination of comparability of Japan's margin requirements for non-cleared swaps); Risk, Sept. 9, 2016 (practical issues related to inter-affiliate margining).

k. On June 25, 2014, the SEC adopted final rules governing certain aspects of cross-border activities in SBS. See SEC Release No. 34-72472; 79 Fed. Reg. 39068 (July 9, 2014) (the "Final SEC Cross-border Rules"). The final rules are broadly consistent with the approach taken by the CFTC in its Cross-border Guidance. The small size of the SBS market in comparison to swaps subject to CFTC jurisdiction, however, is likely to result in the CFTC Cross-border Guidance driving the international compliance programs of swaps dealers. Nevertheless, the Final SEC Cross-border Rules differ in a number of key respects from the CFTC Cross-border Guidance.

(i) The Final SEC Cross-border Rules address a number of issues relevant to the regulation of cross-border SBS activity, including: (A) a "territorial approach" to defining the scope of such regulation to include only SBS activities involving a "U.S. person" or involving "transactions conducted within the [U.S.]"; (B) the circumstances under which both U.S. and non-U.S. persons would be required to register as SBS Dealers or MSBSPs; (C) the procedures for foreign regulators and market participants to apply for "substituted compliance"; and (D) the scope of the SEC's cross-border antifraud enforcement authority.

(ii) The Final SEC Cross-border Rules take a territorial approach to the SEC's jurisdiction such that the SEC's regulations generally would apply to SBS activities involving a "<u>U.S. person</u>," or involving a "<u>transaction conducted within the [U.S.]</u>".

(iii) The final rule definition of "<u>U.S. person</u>" includes:

A) Any natural person who is a U.S. resident.

B) Any corporation, partnership, trust or other legal person that is organized or incorporated under U.S. laws or has its principal place of business in the U.S.

C) Any account (whether discretionary or non-discretionary) of a U.S. person.

D) Any estate of a decedent who was a resident of the U.S. at the time of death.

(iv) An SBS transaction conducted "<u>through" a foreign branch</u> of a U.S. bank would <u>not</u> be a transaction conducted within the U.S. so long as:

A) The branch (i) is located outside the U.S., (ii) operates for valid business reasons, (iii) is engaged in the business of banking, and (iv) is subject to banking regulation; and

B) The SBS is not solicited, negotiated or executed by a person within the U.S. on behalf of the branch or its counterparty.

(v) Under the Final SEC Cross-border Rules, a "U.S. person" is required to register as a SBS Dealer if the level of SBS dealing activity by it and its affiliates with all counterparties, including transactions conducted through a foreign branch, exceeds a de minimis threshold.

(vi) In contrast, a non-U.S. person is required to register as a SBS Dealer if the following activities exceed a de minimis threshold: (A) SBS dealing transactions with a U.S. person counterparty (other than transactions with majority-owned affiliates and transactions conducted through the foreign branch of a registered SBS Dealer); (B) SBS dealing transactions with a non-U.S. person counterparty (other than a majority-owned affiliate) if such counterparty has legally enforceable rights of recourse against a U.S. affiliate of the foreign dealer in connection with the foreign dealer's obligations under the SBS; and (C) all SBS dealing activity (other than transactions with a majority-owned affiliate) if the foreign dealer acts as a "conduit affiliate."

(vii) The Final SEC Cross-border Rules include guidance on the aggregation of the SBS positions across affiliates for the purposes of calculating toward the de minimis threshold, as well as the activities and transactions that would count toward either a U.S. or a non-U.S. person having to register as a MSBSP.

(viii) The Final SEC Cross-border Rules adopt procedures for parties to apply for substituted compliance, which would permit market participants to comply with U.S. requirements by complying with foreign requirements.

(ix) The Final SEC Cross-border Rules also include an anti-fraud rule that addresses the scope of the SEC's cross-border antifraud civil enforcement authority under the Dodd-Frank Act.

l. On February 10, 2016, the SEC adopted final amendments to the Final SEC Cross-border Rules related to the application of SBS regulatory requirements to a non-U.S. person's dealing activity in the U.S. 81 Fed. Reg. 8598 (Feb. 19, 2016) (the "Revised SEC Cross-border Rules"). See also 81 Fed. Reg. 12821 (Mar. 11, 2016) (corrections); 80 Fed. Reg. 27444 (May 13, 2015) (re-proposal); 78 Fed. Reg. 30968 (May 23, 2013) (original proposal).

Specifically, under the Revised SEC Cross-border Rules:

(i) For purposes of determining whether a non-U.S. person has exceeded its de minimis trade threshold and is required to register as a SBS Dealer, in addition to other transactions described above, a non-U.S. person would also be required to include transactions with non-U.S. counterparties if personnel of the non-U.S. person or its agent located in a U.S. branch or office "arrange, negotiate or execute" a SBS transaction (even if such transactions are executed anonymously on an execution facility or exchange and cleared through a clearing agency).

(ii) The rule text itself does not provide a definition of "arrange, negotiate or execute", but the preamble to the Revised SEC Cross-border Rules provides some interpretive guidance indicating that

A) Arrangement or negotiation is considered the market-facing activity of sales or trading personnel in connection with a particular SBS transaction, including interactions with counterparties or their agents;

B) Execution of a transaction is considered the market-facing act that, in connection with a particular SBS transaction, causes the person to become irrevocably bound under the SBS under applicable law; and

C) The terms include "direction" of the market-facing activities of a non-U.S. person.

The preamble also provides examples of activities that are not covered by these terms.

(iii) Additionally, the Revised SEC Cross-border Rules excepts international organizations that are excluded from the definition of U.S. person under the Exchange Act.

G. MUTUAL RECOGNITION INITIATIVES

1. In light of the increasing internationalization of the securities markets, proposals have been put forth for the SEC to consider mutual recognition of foreign regulation.

   a. Under mutual recognition, foreign exchanges and broker-dealers would be permitted to provide services to U.S. investors under an abbreviated registration system if they are supervised in a foreign jurisdiction under a securities regulatory regime substantially comparable to that in the U.S. A G7 Finance Ministers Statement (Feb. 9/10, 2007) agreed "to explore within the G7 free trade in securities based on mutual recognition of regulatory regimes".

   b. In 2008, the SEC announced steps for implementation of mutual recognition. These steps include (i) exploring initial agreements with foreign regulatory counterparts, which would be based on a comparability assessment by the SEC and by the foreign authority of one another's regulatory regimes; (ii) considering adoption of a formal process for engaging other national regulators; (iii) developing a framework for mutual recognition discussions with jurisdictions comprising multiple securities regulators tied together by a common legal framework (including Canada (which has no national securities regulator, but rather provincial regulators) and the EU (where national securities regulators are subject to supranational legislation and directives)); and (iv) proposing reforms to Rule 15a-6 in order to improve the process by which U.S. investors have access to foreign broker-dealers (see Part XI.E.2 above).

c. On August 25, 2008, the SEC signed a Mutual Recognition Arrangement with the Australian Securities and Investments Commission (the "ASIC") and the Australian Minister for Superannuation and Corporate Law, representing the SEC's first ever mutual recognition arrangement.

An integral component of the Mutual Recognition Arrangement is an MOU Concerning Consultation, Cooperation and the Exchange of Information Related to the Enforcement of Securities Laws and an MOU Concerning Consultation, Cooperation and the Exchange of Information Related to Market Oversight and the Supervision of Financial Services Firms, each of which will allow for greater regulatory and enforcement cooperation and coordination between the SEC and ASIC. These MOUs will apply broadly to all U.S. and Australian market activity.

But see Risk.net, Oct. 5, 2015 (ASIC Commissioner notes that national financial markets are too diverse to ever fully harmonize).

d. For background on mutual recognition issues, see, e.g. SEC Press Releases 2008-49 (Mar. 24, 2008), 2008-9 (Feb. 1, 2008), 2007-111 (June 8, 2007); Call for Evidence on Mutual Recognition with Non-EU Jurisdictions (CESR, June 8, 2009); Greene & Oztan, "The Attack on National Regulation: Why We Need a Global Framework for Domestic Regulation", Capital Markets L.J. (Jan. 2009); Tafara & Peterson, "A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework", Harvard Int'l L.J. (Winter 2007); Greene, "Beyond Borders: Time To Tear Down the Barriers to Global Investing", Harvard Int'l L.J. (Winter 2007).

2. Industry groups have urged U.S. and EU securities regulators to work toward regulatory convergence of transatlantic markets. An EU-U.S. Coalition on Financial Regulation Report -- The Transatlantic Dialogue in Financial Services: The Case for Regulatory Simplification and Trading Efficiency (2005) -- details the contrasting licensing and business conduct rules in respect of equity securities and equity derivatives of the EU with those of the

U.S., highlights instances of duplication and regulatory conflict, and argues for (a) a common set of customer definitions; (b) a common approach to investor protection; (c) common examination and registration requirements; (d) a consensual regulatory approach to outsourcing arrangements; (e) regulatory simplification (including as to best execution, trade allocation procedures and research distribution); and (f) consensual U.S./EU principles of regulation and a common approach to regulatory impact assessments. See also ISDA Press Release, Apr. 13, 2016; Improving Derivatives Transparency: The Merits of an Entity-Based Reporting Framework (ISDA, Apr. 2016); Principles for US/EU Trading Platform Recognition (ISDA, Feb. 2016); Risk.net, Oct.14, 2015 (IOSCO, ASIFMA urge further cooperation); EU-US Coalition on Financial Regulation, Transatlantic Trade Associations Call for Urgent Re-Engagement on the Pre-Crisis Dialogue on Regulatory Recognition and Accreditation (June 19, 2012).

3. The NYSE developed, and the NASD approved, a modified version of the general securities representative examination ("Series 7") to facilitate the qualification of representatives of UK firms. The UK Securities and Futures Authority (now part of the UK Financial Conduct Authority) reciprocated by permitting Series 7-qualified personnel to satisfy UK's requirements by either passing the UK's equivalent examination or meeting experience criteria. NYSE Information Memos No. 93-36 (Aug. 31, 1993), No. 93-3 (June 15, 1993) and No. 91-9 (July 12, 1991); NASD Notices to Members No. 91-28 (May 1991) and No. 90-69 (Oct. 1990); SEC Releases No. 34-27967 (May 1, 1990), No. 34-27168 (Aug. 22, 1989). See also FINRA Rule 1032.

   In addition to the UK version of the Series 7, the SEC has approved the use of modified Series 7s for qualified representatives in good standing with Canadian and Japanese securities regulators. See SEC Releases No. 34-38921 (Aug. 11, 1997); No. 34-38274 (Feb. 12, 1997); No. 34-37112 (Apr. 12, 1996); No. 34-36825 (Feb. 9, 1996); No. 34-36708 (Jan. 11, 1996); No. 34-36629A (Jan. 4, 1996); No. 34-36629 (Dec. 21, 1995). See also FINRA Rule 1032.

4. FINRA Regulatory Notice 08-15 (Apr. 2008) sets out an exemption from the Research Analyst Qualification Examination for research

analysts who are employed by a FINRA member's foreign affiliate, reside outside the U.S. and contribute to the preparation of "globally branded" or foreign affiliate research reports, provided the member firm complies with supervisory review, disclosure and recordkeeping requirements.

5. SEC staff has taken no-action positions with respect to broker-dealer, exchange and clearing agency registration for non-U.S. exchanges that familiarize broker-dealers and large financial institutions in the U.S. with equity, index and ETF options, subject to disclosure, supervisory and transactional requirements (including compliance with Rule 15a-6). See, e.g., Taiwan Futures Exchange (avail. Feb. 2, 2016); LIFFE (avail. July 1, 2013, July 29, 2009, Mar. 6, 1996, May 1, 1992); ASX Limited/Australian Clearing House (avail. Aug. 13, 2007); Tokyo Stock Exchange (avail. Nov. 20, 2006, Nov. 15, 2002, July 27, 1999); Cleary Gottlieb (avail. July 27, 2005) (Eurex system); Eurex Deutschland (avail. May 3, 2006); Borsa Italiana (avail. Sept. 24, 2004, Sept. 1, 1998); EDX London (avail. Oct. 29, 2003); Paris Bourse (avail. Dec. 6, 1999); Osaka Securities Exchange (avail. July 23, 1999); MONEP (avail. Oct. 26, 1998); Mercato Italiano dei Derivati (avail. Sept. 1, 1998); Société de Compensation des Marchés Conditionnels (avail. June 17, 1996); Hong Kong Futures Exchange (avail. Sept. 26, 1995); London Traded Options Market ["LTOM"] (avail. Sept. 4, 1990).

6. Dodd-Frank § 725(b) permits the CFTC to exempt a DCO (e.g., a clearing house) from registration requirements if the CFTC "determines that the [DCO] is subject to comparable, comprehensive supervision and regulation by the . . . appropriate government authorities in the home country of the [DCO]." Dodd-Frank § 733 provides the same authority to the CFTC in the context of SEFs (e.g., trading venues), and § 763(b) provides the same authority to the SEC in the context of clearing agencies.

   See OTC Clearing Hong Kong Ltd., CFTC Order of Exemption (Dec. 21, 2015); Japan Securities Clearing Corp., CFTC Order of Exemption (Oct. 26, 2015); Korea Exchange, CFTC Order of Exemption (Oct. 26, 2015); ASX Clear (Futures) Pty Ltd., CFTC Order of Exemption (Aug. 18, 2015); Risk, Aug. 20, 2015 (ASX order was first exemption under new laws; CFTC has not issued regulations on topic).

Some non-U.S. clearinghouses register, or have maintained their historical registration, with the CFTC as DCOs in lieu of seeking an exemption. See, e.g., Eurex AG (Feb. 1, 2016); Eurex AG, CFTC No-Action Letter Nos. 16-04, CCH Comm. Fut. L. Rep. ¶ 33,634, 16-05 CCH Comm. Fut. L. Rep. ¶ 33,635 (Feb. 1, 2016) (relief from conditions pending MiFID II implementation and based on Deutsche Bundesbank changes to templates; exemption for holding customer funds at Bundesbank); Singapore Exchange Derivatives Clearing Limited (Dec. 27, 2013); LCH.Clearnet (Dec. 16, 2014, Jan. 23, 2013).

With regard to Dodd-Frank's registration requirements for foreign boards of trade, including consideration of comparability of regulatory requirements, see Part XI.F.1 above.

7. Dodd-Frank § 723(a)(3) provides that swap market participants are subject to mandatory clearing requirements for those swaps determined by the CFTC to warrant clearing. The CFTC provided temporary relief to foreign clearing houses that have not yet registered (or been exempted from registering) as DCOs, but that may be clearing swaps for persons subject to the CEA mandatory clearing requirement. See, e.g., Shanghai Clearing House, CFTC No-Action Letter No. 16-56 (Mar. 31, 2016) CCH Comm. Fut. L. Rep ¶ 33,763; Clearing Corporation of India Ltd., CFTC No-Action Letters No. 14-149 (Dec. 18, 2014), CCH Comm. Fut. L. Rep. ¶ 33,374, 14-107 (Aug. 18, 2014), CCH Comm. Fut. L. Rep. ¶ 33,222; Eurex AG, CFTC No-Action Letter Nos. 15-54 (Sept. 30, 2015) CCH Comm. Fut. L. Rep. ¶ 33,562, 14-156 (Dec. 23, 2014) CCH Comm. Fut. L. Rep. ¶ 33,389, 13-44 (July 11, 2013) CCH Comm. Fut. L. Rep. ¶ 32,673 (pending application for DCO registration); LCH.Clearnet SA, CFTC No-Action Letter No. 13-43 (July 11, 2013), CCH Comm. Fut. L. Rep. ¶ 32,672 (French subsidiary of LCH.Clearnet); Singapore Exchange Derivatives Clearing, CFTC No-Action-Letter No. 12-63 (Dec. 21, 2012), CCH Comm. Fut. L. Rep. ¶ 32,497; Japan Securities Clearing Corp., CFTC No-Action Letter No. 12-56 (Dec. 17, 2012), CCH Comm. Fut. L. Rep. ¶ 32,478.

8. CEA § 5(h)(a)(1) requires registration of multilateral trading facilities ("MTFs"), but on April 9, 2014, the CTFC issued a

no-action letter for MTFs overseen by competent authorities designated by EU member states. CFTC No-Action Letter 14-46 (Apr. 9, 2014), CCH Comm. Fut. L. Rep. ¶ 33,023. See also CFTC No-Action Letter 14-16 (Feb 12. 2014), CCH Comm. Fut. L. Rep. ¶ 32,970. The CFTC provided similar relief to certain swaps trading platforms in Australia. See CFTC No-Action Letter Nos. 15-56 (Oct. 15, 2015), CCH Comm. Fut. L. Rep. ¶ 33,569, 15-29 (May 15, 2015), CCH Comm. Fut. L. Rep. ¶ 33,471, 14-117 (Sept. 15, 2014), CCH Comm. Fut. L. Rep. ¶ 33,255.

9. After determining that the legal and supervisory arrangements of the relevant non-EU country impose legally binding requirements which are equivalent to those contained in Title IV of European Market Infrastructure Regulation ("EMIR"), ESMA has approved a number of institutions ("central counterparties", or "CCPs") to offer clearing services to EU customers: ASX Clear (Futures) Pty Limited (Australia); ASX Clear Pty Limited (Australia); Hong Kong Securities Clearing Company Limited (Hong Kong); HKFE Clearing Corporation Limited (Hong Kong); OTC Clearing Hong Kong Limited (Hong Kong); The SEHK Options Clearing House Limited (Hong Kong); Japan Securities Clearing Corporation (Japan); Tokyo Financial Exchange (Japan); Central Depository (Pte) Limited (Singapore); Singapore Exchange Derivatives Clearing (Singapore); ICE Clear Singapore (Singapore); JSE Clear (South Africa); ICE Clear Canada (Canada); Natural Gas Exchange Inc. (Canada); Canadian Derivatives Clearing Corporation (Canada); Asigna Compensacion y Liquidacion (Mexico); SIC x-clear AG (Switzerland); Korea Exchange, Inc. (South Korea); Chicago Mercantile Exchange, Inc. (U.S.). See List of Third-Country Central Counterparties Recognised to Offer Services and Activities in the Union (ESMA, last updated June 17, 2016).

   The path toward recognizing equivalence of U.S. CCPs, however, was littered with roadblocks. See Wall St. J., Mar. 26, 2015. Without recognition of U.S. CCPs, EU banks would have had to hold more capital against trades cleared through such CCPs. In February 2016, the CFTC reached an agreement with the EC regarding recognition of CCPs in each jurisdiction. The agreement included taking steps to make comparability/equivalency findings for each jurisdiction's respective regulations over CCPs, thus enabling CCPs to continue to provide services to customers from the other. See EC

Press Release, Feb. 10, 2016; CFTC Press Release, Feb. 10, 2016; Common Approach for Transatlantic CCPs (CFTC/EC, Feb. 10, 2016); EC Press Release, Mar. 15, 2016 (official determination of CCP equivalence); CFTC Press Release PR 7342-16 (Mar. 16, 2016) (CFTC approval of substituted compliance for dually registered CCPs located in the EU); 81 Fed. Reg. 15260 (Mar. 22, 2016) (CFTC comparability determination for certain EMIR rules); CFTC No-Action Letter No. 16-26 (Mar. 16, 2016), CCH Comm. Fut. L. Rep. ¶ 33,682 (relief under certain CCP rules, provided that the EU CCP is registered with the CFTC as a DCO); ESMA/CFTC Memorandum of Understanding (June 2, 2016) (regulatory cooperation with respect to supervision of U.S. DCOs); Equivalence of Designated Contract Markets in the United States, EC Implementing Decision (EU) 2016/1073 (July 1, 2016).

The SEC and the EC continue to negotiate with regard to mutual recognition of clearing agencies within their respective jurisdictions. In the wake of growing fear that the transition period deadline for recognition (and for maintenance of capital against CCP exposures) of June 15, 2016 would arrive without agreement, the EC extended the transition period for 6 months. EC Press Release, June 4, 2015. EU banks would have to maintain significantly more capital against clearing agencies, such as the U.S. Options Clearing Corporation and divisions of the DTCC, if an agreement were not reached.

10. In 2013, the CFTC and the EC announced a "Path Forward" to a common approach to regulating cross-border derivatives transactions. Through exemptions and accords, the Path Forward creates a framework for EU and U.S. authorities to recognize rules in the counterpart jurisdiction in lieu of enforcing their own rules abroad.

    In conjunction with the Path Forward announcement, CFTC staff released relevant no-action relief, and expect to issue more in the future. For certain swaps, the CFTC will permit U.S. and EU Swap Dealers and MSPs registered with the CFTC to satisfy swap confirmation, portfolio reconciliation, portfolio compression and swap trading relationship documentation requirements by complying with either the relevant CFTC rule or EMIR provision. CFTC Letter No. 13-45 (July 11, 2013), CCH Comm. Fut. L. Rep. ¶ 32,674. See also CFTC Letter No. 13-50 (Aug. 23, 2013), CCH Comm. Fut. L. Rep. ¶ 32,709 (clarifying certain compliance dates to coincide with EMIR).

The CFTC-EC Path Forward announcement also contemplates relief from the CFTC in connection with trading on certain EU-registered facilities that have not yet registered with the CFTC as SEFs.

11. Pursuant to the CFTC Cross-border Guidance, the CFTC issued several comparability determinations related to the swaps regulations of non-U.S. jurisdictions for those institutions relying on "substituted compliance". See Australia: Certain Entity-level Requirements, 78 Fed. Reg. 78864 (Dec. 27, 2013); Canada: Certain Entity-level Requirements, 78 Fed. Reg. 78839 (Dec. 27, 2013); [EU]: Certain Entity-level Requirements, 78 Fed. Reg. 78923 (Dec. 27, 2013); [EU]: Certain Transaction-level Requirements, 78 Fed. Reg. 78878 (Dec. 27, 2013); Hong Kong: Certain Entity-level Requirements, 78 Fed. Reg. 78852 (Dec. 27, 2013); Japan: Certain Entity-level Requirements, 78 Fed. Reg. 78910 (Dec. 27, 2013); Japan: Certain Transaction-level Requirements, 78 Fed. Reg. 78890 (Dec. 27, 2013); Switzerland: Certain Entity-level Requirements, 78 Fed. Reg. 78899 (Dec. 27, 2013). See also CFTC Business Conduct Rules for Swap Dealers and [MSPs]: Summary of Entity-level Comparability Determinations (Dec. 2013). Nevertheless, as the CFTC has not yet issued comparability determinations on swap data reporting rules, it has provided temporary no-action relief to certain non-U.S. swap parties. See CFTC No-Action Letter Nos. 13-75 (Dec. 20, 2013), CCH Comm. Fut. L. Rep. ¶ 32,895, 14-141 (Nov. 24, 2014), CCH Comm. Fut. L. Rep. ¶ 33,352 and 15-61 (Nov. 9, 2015), CCH Comm. Fut. L. Rep. ¶ 33,440. See also Wells Fargo Bank, N.A., CFTC No-Action Letter 15-64 (Nov. 20, 2015), CCH Comm. Fut. L. Rep. ¶ 33,595 (relief from enforcement if Wells Fargo London Branch complies with transaction-level requirements of certain jurisdictions outside of Australia, Canada, EU, Hong Kong, Japan, and Switzerland, for transactions with counterparties located outside those jurisdictions).

    For additional perspectives on substituted compliance or regulatory equivalence generally, see also ESMA Press Release, Sept. 3, 2013 (advising EC on equivalence to EMIR's requirements of regulatory regimes of Australia, Hong Kong, Japan, Singapore, Switzerland and the U.S.); ISDA, Methodology for Regulatory Comparisons (Aug. 2013); ISDA, Common Principles – Examples (Aug. 2013); CFTC and EU OTC Derivatives Regulation: An Outcomes-based Comparison (Deloitte, July 2013). But see Alternative Investment Management Association, Addressing Overlaps Between EMIR and CFTC OTC Derivatives Regulation (May 2013) (noting potential for conflict and overlap between certain regulations "notwithstanding the shared objectives of promoting central clearing, increasing transparency and overall financial stability"). See also Part XI.F.2.f above (CFTC Cross-border Guidance allowing for substituted compliance in certain circumstances through application of local jurisdiction swaps rules) and Parts XI.F.2.k and XI.F.2.l above (SEC final rule and proposal on SBS substituted compliance).

12. Dodd-Frank § 715 allows the CFTC or the SEC to prohibit a foreign-domiciled entity from participating in swaps or SBS activities in the U.S. if the CFTC/SEC makes a determination that the regulation of swaps or SBS markets by the entity's home country "undermines the stability of the [U.S.] financial system".

H. CERTAIN OTHER INTER-MARKET, REGULATORY AND RELATED LINKAGES AND CONSIDERATIONS

1. Morrison v. National Australia Bank and its Progeny

   a. Prior to 2010, courts had followed long-standing precedents which had applied an analysis based on "conduct" (i.e., whether the fraud occurred in the U.S.) and "effect" (i.e., whether the fraud had a substantial effect in the U.S.) in determining whether to assert jurisdiction over securities law claims. The Supreme Court essentially reversed that approach in Morrison v. National Australia Bank, 561 U.S. 247 (2010) ("Morrison"), which involved so-called "foreign cubed" claims of fraud by non-U.S. purchasers of securities of a non-U.S. issuer on a non-U.S. exchange where some of the alleged fraudulent conduct took place in the U.S.

      The Supreme Court held that 1934 Act § 10(b) and Rule 10b-5 only provide a cause of action for fraud in connection with (i) the purchase or sale of a security listed on a U.S. stock exchange, or

(ii) the purchase or sale of any security in the U.S. Morrison explained that, since the 1934 Act's focus is not on the place where a deceptive act took place, but on U.S. purchases and sales of securities, 1934 Act § 10(b) does not provide a cause of action to foreign plaintiffs suing foreign or U.S. defendants for misconduct in connection with securities traded on foreign exchanges.

b. Lower courts have applied Morrison's transaction test strictly, yet ambiguities remain. See generally, e.g., Greene & Patel, "Consequences of Morrison v. NAB, Securities Litigation and Beyond", Cap. Mkts. L. J (Apr. 2016); Bernstein, Dugan & Addison, "Closing Time: You Don't Have to Go Home, But You Can't Stay Here", 67 Business Lawyer 957 (Aug. 2012); 45 Rev. Sec. & Comm. Reg. 157 (July 2012); Rasmussen & Tonkovic, "Courts, SEC Explore Scope of Morrison Decision", CCH Fed. Sec. L. Rep. Report Letter 2524 (Apr. 18, 2012) ("Rasmussen & Tonkovic"); NYLJ, May 19, 2011; 33 Sec. & Fed. Corp. L. Rep. (Mar./Apr. 2011). See also Parkcentral Global Hub v. Porsche Auto. Holdings, 763 F.3d 198 (2d Cir. 2014) ("Parkcentral v. Porsche") (concurring opinion adding that Morrison should not be read to command that "only bright-line, single-factor tests may be used to determine whether a 10(b) claim would be impermissibly extraterritorial").

(i) Federal courts have dismissed actions by U.S. plaintiffs who bought the stocks of non-U.S. defendants abroad. See, e.g., In re Petrobras Securities Litigation, 150 F. Supp. 3d 337 (SDNY 2015) (certain non-U.S. plaintiffs ruled unable to show that securities were listed on U.S. stock exchange or that sale occurred in U.S.); Wu v. Stomber, 883 F. Supp. 2d 233 (D.D.C. 2012) ("Wu v. Stomber") (dismissing claims under 1934 Act §§ 10(b) and 20(a) with regard to purchases by U.S. investors on Euronext exchange of shares of Guernsey investment fund); Plumbers' Union Local #12 Pension Fund v. Swiss Reinsurance Co., 753 F. Supp. 2d 166 (SDNY 2010) (dismissing fraud class action involving placement of order in U.S., but purchase of shares of non-U.S. issuer on Swiss Stock Exchange).

(ii) Courts have also had to address the impact of Morrison where securities listed and purchased on non-U.S. exchanges are also listed in the U.S. directly or as American Depository Receipts ("ADRs") or American Depository Shares ("ADSs"). See, e.g., Stoyas v. Toshiba Corp., 2016 WL 3563084 (C.D. Cal., May 20, 2016) (finding the OTC market for ADS not to be a "national exchange"; when analyzing whether the transactions were nevertheless purchases of securities in the U.S., court makes distinction between sponsored and unsponsored ADS programs, holding that even though the ADS were purchased in the U.S., defendant corporation was not alleged to have taken any "affirmative action in connection with securities sales in the United States" in relation to an unsponsored ADS program); City of Pontiac Policemen's and Firemen's Retirement System v. UBS, 752 F.3d 173 (2d Cir. 2014) (purchases by non-U.S. plaintiffs of securities in a non-U.S. company (UBS) that were cross-listed on a U.S. exchange, were executed outside the U.S. on a foreign exchange; actions dismissed because the location of the transaction, and not the location of the exchange or the fact of listing on a U.S. exchange, was the predominant factor; buy orders by U.S. plaintiff were placed in U.S. but executed on foreign exchange; actions dismissed because buy orders not sufficient to create irrevocable liability in U.S. and U.S. nationality of plaintiff was non-factor); In re Vivendi Universal Securities Litigation, 284 F.R.D. 144 (SDNY 2012) ("Vivendi") (dismissing fraud claims brought by individual non-U.S. purchasers of shares listed on the Paris Bourse and not on any U.S. exchange while acknowledging that plaintiffs' claims with regard to ADSs sold on the NYSE were still valid); Clal Finance Batucha Investment Management v. Perrigo Co., 2011 WL 5331648 (SDNY 2011) (dismissing claims by lead plaintiffs of a class action who purchased their shares on the Tel Aviv Stock Exchange, but allowing the complaint to be amended to substitute lead plaintiffs who purchased their shares on NASDAQ); In re UBS

Securities Litigation, 2011 WL 4059356 (SDNY 2011) (dismissing claims by both "foreign squared" investors (U.S. investors who bought stock in a foreign company on a foreign exchange) and "foreign cubed" investors (non-U.S. investors in a similar circumstance) even if the foreign transactions had an effect in the U.S.); In re RBS Securities Litigation, 765 F. Supp. 2d 327 (SDNY 2011) (the "RBS Litigation") (dismissing fraud claims based on transactions in ordinary and preferred shares listed on foreign exchanges, even though some of the securities were also listed on U.S. exchanges as ADRs); In re Alstom Securities Litigation, 741 F. Supp. 2d 469 (SDNY 2010) (dismissing claims by U.S. investors who purchased securities of a non-U.S. issuer on Euronext where the issuer also had U.S.-listed ADRs); Sgalambo v. McKenzie, 739 F. Supp. 2d 453 (SDNY 2010) (dismissing claims where plaintiff purchased defendant's shares on the Toronto Stock Exchange, despite defendant's shares also being sold on the American Stock Exchange); Cornwell v. Credit Suisse, 729 F. Supp. 2d 620 (SDNY 2010) ("Cornwell") (dismissing claims by U.S. residents who purchased securities traded on the Swiss Stock Exchange from their offices in the U.S. where the issuer also had U.S.-listed ADRs).

(iii) The case law involving the purchase of ADRs or ADSs in the U.S. has in many instances focused on whether the ADRs or ADSs were purchased on a U.S. exchange. For example, an earlier holding in Vivendi dismissed fraud claims brought by a class of U.S. and foreign purchasers of ordinary shares that traded overseas, allowing only claims for purchases of ADSs that were listed on a U.S. exchange (thereby reducing potential damages claimed by more than 80%). 765 F. Supp. 2d 512 (SDNY 2011).

In U.S. v. Martoma, 962 F. Supp. 2d 602 (SDNY 2013), the Court refused to dismiss insider trading charges against a U.S. defendant that allegedly traded ADRs listed on a U.S. exchange where the ordinary shares were deposited in Ireland. See also, e.g., Cornwell; Wu v.

<u>Stomber</u> (refusing to dismiss §§ 10(b) and 20(a) claims with respect to "restricted depository shares", similar to ADRs, purchased in the U.S.); <u>Stackhouse v. Toyota Motor Co.</u>, 2010 WL 3377409 (C.D. Cal. 2010) (appointing plaintiff with largest ADR loss as lead plaintiff in class action). <u>But see</u>, <u>e.g.</u>, <u>In re SocGen Securities Litigation</u>, 2010 WL 3910286 (SDNY 2010) (dismissing fraud claims by investors who purchased ordinary shares listed on a foreign exchange, <u>and</u> by those who purchased ADRs on an OTC market in the U.S.).

(iv) Cross-border transactions not executed on a U.S. exchange present complicated issues given the lack of a clear situs of the "purchase or sale" of the security.

For instance, in the SEC's case against Goldman Sachs trader Fabrice Tourre for improper sales practices involving subprime securities, <u>SEC v. Goldman Sachs</u>, 790 F. Supp. 2d 147 (SDNY 2011) ("<u>SEC v. Goldman Sachs</u>"), the court rejected the SEC's argument that it should take an expansive view of the <u>entire selling process</u>, not just the consummation of the transaction, to determine the applicability of 1934 Act § 10(b). Instead, the court adopted a narrow view of § 10(b) liability that requires a purchaser to incur "irrevocable liability" in the U.S. The court dismissed several charges against Tourre under § 10(b), but allowed a § 10(b) charge relating to a transaction with a U.S. counterparty to stand, as well as charges under 1933 Act § 17(a) to the extent they were based on "domestic offers". The court defined "domestic offers" as (A) an "attempt or offer" in the U.S. to dispose of securities or SBSs, or (B) "solicit[ation]" in the U.S. of "an offer to buy" securities or SBSs. Tourre's alleged calls and e-mails to foreign institutions from NY satisfied this test. The court later denied Tourre's motion to certify the § 17(a) question for interlocutory appeal. <u>SEC v. Goldman Sachs</u>, 2011 WL 4940908 (SDNY 2011).

The Second Circuit adopted a similar approach, ruling that plaintiffs may sustain a § 10(b) claim if they demonstrate that they incurred irrevocable liability within the U.S., but added that a transaction could also be deemed domestic where the title to the security was transferred in the U.S. See Absolute Activist Value Master Fund v. Ficeto, 677 F.3d 60 (2d Cir. 2012) ("Absolute Activist") (facts in the complaint should lead "to the plausible inference that either irrevocable liability was incurred or that title passed" in the U.S.; other proposed tests for determining the location of the purchase or sale (including the location of the broker-dealer, identity of the buyer or seller, and identity of the security) expressly rejected).

Subsequent to Absolute Activist, the SEC sought reconsideration of SEC v. Goldman Sachs under an amended complaint that attempted to connect the ultimate alleged fraud to the transfer of title to CDO notes to Goldman Sachs in NY at the closing of the deal. The Court rejected this claim, finding that the transfer from the CDO trustee to Goldman Sachs at the NY closing did not support the application of § 10(b) to the subsequent transfer -- the transfer to which the alleged fraud was linked -- of the security from Goldman Sachs, through Euroclear accounts, to foreign investors. SEC v. Tourre, 2012 WL 5838794 (SDNY 2012). The parties later moved for summary judgment on the surviving §§ 10(b) and 17(a) domestic counts, with Tourre arguing that, even if § 17(a) applies to "domestic offers", a subsequent foreign sale of a security pursuant to such offer should attach the fraud claim to the sale only, and therefore such claims would also be barred by Morrison. The Court rejected such argument, finding that § 17(a) "does not distinguish between consummated and unconsummated offers", and therefore Morrison requires only that the "offer" be performed domestically. SEC v. Tourre, 2013 WL 2407172 (SDNY 2013). A federal jury found Tourre liable on six of seven remaining SEC claims of securities law violations. Wall St. J., Aug. 2,

2013. Tourre's requests for a new trial were denied. SEC v. Tourre, 2014 WL 61864 (SDNY Jan. 7, 2014). Tourre was subsequently ordered to pay more than $825,000 and he released a statement that he would not appeal the judgment. Securities Daily, May 12, 2014; NY Times Dealbook, May 27, 2014.

See also SEC v. Brown, 2015 WL 1010510 (N.D. Ill. Mar. 4, 2015) ("SEC v. Brown") (denying Bahamian broker's motion to dismiss as SEC sufficiently alleged irrevocable liability in the U.S. when transaction documents were executed in the U.S. and funds were wired from U.S. bank accounts); U.S. v. Georgiou, 777 F.3d 125 (3d. Cir. 2015) ("US v. Georgiou") (OTC Bulletin Board and Pink Sheets are not "national securities exchanges" within scope of Morrison; however, securities were issued by U.S. companies and were executed (establishing irrevocable liability) by U.S. market makers, thus constituting domestic transactions under Morrison); SEC v. Spencer Pharmaceutical, 57 F. Supp. 3d 127 (D. Mass. 2014) (rejected defendant's claims that Morrison required dismissal because securities were traded only OTC and not on an "exchange"; Morrison relates to subject matter jurisdiction, and cannot be used as a defense to personal jurisdiction); Starr Investments Cayman II v. China MediaExpress Holdings, 2014 WL 4180331 (D. Del. 2014) (Morrison does not bar a securities fraud claim against a U.S. corporation shares of which were listed only on a U.S. exchange even though the shares were bought in a private sale rather than on the exchange); SEC v. Ficeto, 2013 WL 1196356 (C.D. Cal. 2013) (Morrison does not bar application of § 10(b) claims against manipulative trading in domestic OTC markets (OTC Bulletin Board and Pink Sheets) even where the trading occurs between foreign persons located solely outside the U.S.); U.S. v. Isaacson, 752 F.3d 1291 (11th Cir. 2013) (OTC Bulletin Board and Pink Sheets meet requirements for U.S. nexus); Arco Capital v. Deutsche Bank, 949 F. Supp. 2d 532 (SDNY

2013) (irrevocable liability of Cayman purchaser attached under Cayman CLO's subscription agreement when funds were delivered to trustee in NY); Bayerische Landesbank v. Barclays Capital, 902 F. Supp. 2d 471 (SDNY 2012) (denying a motion to dismiss § 10(b) claims involving securities not listed on a U.S. exchange where the plaintiff had made "at least a plausible showing" that the plaintiff purchased the securities in NY); Pope Investments v. Deheng Law Firm, 2012 WL 3526621 (SDNY 2012) (dismissing securities fraud claims for failure to "create a plausible inference that title was transferred in the U.S." where the plaintiffs alleged that a Chinese law firm had "drafted the Securities Purchase Agreement, presumably in China, and they [did] not allege where the agreement was negotiated or signed"); In re Vivendi Universal Securities Litigation, 284 F.R.D. 144 (SDNY 2012) (rejecting expansion of class because of failure to support any inference that title of shares was passed in the U.S. or that potential class participants incurred irrevocable liability in the U.S.); SEC v. ICP Asset Management, 2012 WL 2359830 (SDNY 2012) ("SEC v. ICP") (denying motion to dismiss because facts presented by the SEC were "sufficient to at least permit the inference that the trades complained of were domestic transactions").

For additional precedent in this area, see, e.g., SEC v. Graulich, 2013 WL 3146862 (D.N.J. 2013) (although "securities at issue were a sham", summary judgment granted to the SEC under § 10(b), even with regard to alleged fraud on foreign investor because defendants "consummated every sale in the [U.S.] by receiving investor funds in [their] New Jersey bank accounts"); SEC v. Benger, 934 F. Supp. 2d 1008 (N.D. Ill. 2013) (rejecting arguments concerning the locus of the fraudulent conduct and granting partial summary judgment to defendants on § 10(b) charges by finding "the sale's only connection with the [U.S.] was the fact that [the non-U.S. issuer] employed escrow agents in the

[U.S.] as intermediaries between it and [non-U.S.] investors"); MVP Asset Mgmt. v. Vestbirk, 2012 WL 2873371 (E.D. Cal. 2012) (finding plaintiffs' allegations that "certain funds were transferred in between New York-based banking institutions . . . insufficient to establish the existence of a domestic transaction"); Cascade Fund v. Absolute Capital Management Holdings, 2011 U.S. Dist. LEXIS 34748 (D. Colo. 2011) (dismissing securities fraud class action by a U.S. investor in offshore funds where investments were solicited in the U.S. and money for the purchase of fund shares was wired to NY, but the orders were accepted in the fund's Cayman Islands office); Quail Cruises Ship Management v. Agencia de Viagens CVC Tur Limitada, 732 F. Supp. 2d 1345 (S.D. Fla. 2010) (dismissing securities fraud claims involving non-U.S. securities where only alleged connection to the U.S. was intended location for closing), vacated and remanded, 645 F. 3d 1307 (11th Cir. 2011) (closing of transaction in U.S. was potential basis for territorial application of § 10(b)); In re Banco Santander Securities-Optimal Litigation, 732 F. Supp. 2d 1305 (S.D. Fla. 2010) (dismissing securities fraud claims where non-U.S. investors purchased securities in offshore investment funds that were closed to U.S. investors); Terra Securities Konkursbo v. Citigroup, 740 F. Supp. 2d 441 (SDNY 2010) (no jurisdiction over a securities fraud suit by seven Norwegian municipalities claiming that Citigroup and three of its U.S. subsidiaries defrauded them in securities listed on European stock exchanges and TRS sold in Europe). But see In re Optimal Litigation, 813 F.Supp.2d 351 (SDNY 2011) (denying motion to dismiss where court believed factual record should be developed on where shares were "issued", where payments were wired, where subscription was accepted and the meaning of certain contractual statements), claims later dismissed, 865 F.Supp.2d 451 (SDNY 2012).

(v) In a case decided before the effective date of Dodd-Frank, Elliot Associates v. Porsche Automobil Holding, 759 F. Supp. 2d 469 (SDNY 2010) ("Elliot Associates"), ruled that swaps referencing foreign securities fall outside 1934 Act § 10(b). The Court viewed swaps as the "functional equivalent" of trading the underlying shares, which were traded on a foreign exchange, and therefore, under Morrison, were not within the jurisdiction of the 1934 Act even if the swaps were conducted in the U.S.

To the extent that the Court's ruling was based on the pre-Dodd-Frank treatment of SBS agreements under the antifraud provisions of the securities laws, additional questions for judicial consideration are likely to arise under Morrison given the Dodd-Frank amendment to these provisions to define SBS to be "securities", including questions of whether the locus of sale of SBS, rather than the location of trading of the underlying securities, is important. Elliot Associates was decided on appeal in Parkcentral v. Porsche. The Second Circuit stated that although the statutes had been amended, "if applicable to the case at the bar [they] would not, so far as we can tell, affect the analysis here[; however], they are unlikely to be applicable because the facts in issue occurred before the amendments became effective". The Court concluded that, although the consummation of the swaps in the U.S. was "necessary" to state a claim, it was not "sufficient" as a privately negotiated contract executed in the U.S. on foreign securities "would subject to U.S. securities laws conduct that occurred in a foreign country, concerning securities in a foreign company, traded entirely on foreign exchanges" – an outcome not permitted by Morrison.

Cf. SEC v. Goldman Sachs (without discussing definition of securities or SBSs, Court dismisses certain SEC claims under 1934 Act § 10(b) related to CDS sales for failure to allege a domestic transaction under Morrison; Court allows claim under § 10(b) for sale of notes and SBS to U.S. person, and claim under 1933 Act

§ 17(a) for "offer" of securities and SBSs to both U.S. and non-U.S. persons); Valentini v. Citigroup, 837 F. Supp. 2d 304 (SDNY 2011) (under a Morrison analysis, finding that, even though equity-linked securities at issue were neither purchased in the U.S. nor listed on a U.S. exchange, they "were all linked to securities listed on a domestic exchange"; finding that convertible securities constitute the equivalent of a put option on the underlying securities; therefore rejecting motion to dismiss § 10(b) claims with regard to "convertible products" (emphasis in original)); In re Optimal Litigation, 865 F. Supp. 2d 451 (SDNY 2012) (in context of investments in fund that then invested with Madoff, dismissing claims that investment in fund was "in connection with" purported underlying trades in the U.S. and investment in fund was the "economic reality" of investing in purported trades in the U.S.; refusing to expand Elliot Associates to the "reverse situation, where private parties with little relation to the [U.S.] can enter into agreements referencing U.S. securities and take advantage of the benefit of U.S. laws"; criticizing Valentini); Wu v. Stomber (criticizing Elliot Associates "functional equivalence" and "economic reality" tests).

c. Courts have also considered Morrison's applicability beyond the 1934 Act § 10(b) context to claims under other provisions of the federal securities or commodities laws. See, e.g., Choi v. Tower Research Capital, 2016 WL 796849 (SDNY Feb. 24, 2016) (Morrison applies to CEA; failure to state sufficient facts that (i) CME Globex was domestic exchange in relation to futures contracts on a Korean stock index entered initially through a Korean exchange and later matched on CME Globex, and (ii) "meeting of the minds" on the transaction took place in US); Lay v. U.S., 623 Fed. Appx. 790 (6th Cir. 2015) (Advisers Act regulates a different aspect of securities transactions, and business of advising, as well as related fiduciary duties, attach to a person or entity; even if Morrison applied, parties and fraudulent conduct took place primarily in U.S. and only non-domestic component was domicile of fund); Loginovskaya v. Batratchenko, 764 F.3d 266 (2d Cir. 2014) (private right of action under the CEA is "limited to claims alleging a commodities transaction within the [U.S.]"); Starshinova v. Batratchenko, 931 F. Supp. 2d 478 (SDNY 2013) (finding no clear indication of extraterritoriality in the CEA); SEC v. Benger, 934 F. Supp. 2d 1008 (N.D. Ill. 2013) (holding that 1934 Act § 15(a) registration requirement for broker-dealers is, in light of Morrison, intended to "regulate those brokers and dealers utilizing American exchange facilities" and granting defendants' motion to dismiss in context of foreign sale of non-U.S. security); SEC v. Gruss, 859 F. Supp. 2d 653 (SDNY 2012) ("Gruss") (rejecting defendant motion that Morrison requires that the Advisers Act only apply to actions directed at domestic clients, by determining that Advisers Act is focused on investment adviser and its actions and not on location of client; even if Morrison applies there were enough contacts with the U.S., including exchanges of money in or from the U.S., to deny defendant's motion to dismiss); SEC v. ICP (applying Morrison to 1933 Act and 1934 Act claims; rejecting defendant motion to dismiss Advisers Act claims for same reasons as Gruss); SEC v. Goldman Sachs (applying Morrison to 1933 Act § 17(a)); RBS Litigation (applying Morrison to 1933 Act §§ 11, 12 and 15); SEC v. Illarramendi, 2011 WL 2457734 (D. Conn. 2011) (Morrison does not limit the SEC's authority to seek equitable relief under 1934 Act § 21 extraterritorially where the alleged fraudulent conduct occurred in the U.S.). See also Sec. Reg. & L. Rep., Feb. 14, 2011 (discussing SEC General Counsel Becker's remarks regarding the application of Morrison to federal securities laws).

d. Courts have grappled with the application of Morrison in criminal contexts. In U.S. v. Vilar, 729 F.3d 62 (2d Cir. 2013), cert. denied, 134 S. Ct. 2684 (2014), the Second Circuit determined that a number of the transactions in question on appeal were, in fact, domestic transactions, and upheld the conviction for securities and mail fraud and money laundering. Nevertheless, the court also addressed the applicability of Morrison to the sentences received, and determined that transactions that occurred abroad may not have been relevant to sentencing because "Morrison's holding applies equally to criminal actions brought under § 10(b)". The U.S. government had argued that "Morrison's geographic limit on the reach of § 10(b) and Rule 10b-5 applies only in the civil context". See also Amerindo Investment Advisors v. SEC, 639 Fed. Appx. 752 (2d Cir., 2016), cert. denied, 136 S. Ct. 2429 (2016) (after Vilar found guilty in criminal case, 2d Circuit entered summary judgment for SEC in civil case against Vilar and related persons); U.S. v. Georgiou; Butler v. U.S., 992 F. Supp. 2d 165 (EDNY 2014) (refusing to vacate securities fraud conviction where the defendant purchased and sold securities in the U.S. on behalf of foreign clients and created irrevocable liability in the U.S. through such actions).

e. The Supreme Court relied on Morrison's formulation of the presumption against extraterritorial application in other contexts. See, e.g., RJR Nabisco, Inc. v. European Community, 136 S. Ct. 2090 (2016) (holding that certain substantive provisions of the Racketeer Influenced and Corrupt Organizations Act ("RICO") have extraterritorial application, but that Congress did not provide a clear indication that a private right of action was to apply extraterritorially, and therefore Morrison's presumption is not overcome); Kiobel v. Royal Dutch Petroleum, 133 S.Ct. 1659 (2013) (Alien Tort Statute).

   Some lower courts have also applied Morrison outside the context of federal securities laws. See, e.g., Liu v. Siemens, 763 F. 3d 175 (2d Cir. 2014) (applying Morrison's presumption against extraterritorial application to the "whistleblower anti-retaliation provision" of Dodd-Frank); Norex Petroleum v. Access Indus., 631 F. 3d 29 (2d Cir. 2010) (applying Morrison's presumption against extraterritorial application to RICO); accord Cedeno v. Castillo, 457 Fed. Appx. 35 (2012).

   But see Aluminum Bahrain v. Alcoa, 2012 WL 2093997 (W.D. Pa. 2012) (allegations of significant U.S. conduct were sufficient to deny motion to dismiss RICO claims); U.S. v. Coffman, 771 F. Supp. 2d 735 (E.D. Ky. 2011), aff'd 574 Fed. Appx. 541 (6th Cir. 2014), cert. denied, 135 S.Ct. 1568 (2015) (motion by defendant claiming that Morrison required dismissal of wire and mail fraud charges related to foreign transactions was rejected by court because defendant did, in fact, use U.S. mail and interstate wires).

f. Post-Morrison some courts have dismissed claims based on alternative theories other than Morrison. See, e.g., Rentokil-Initial Pension Scheme v. Citigroup (In re Citigroup Securities Litigation), 2014 WL 2580992 (SDNY 2014), aff'd 614 Fed. Appx. 27 (2d Cir. 2015) (granting U.S.-based defendants' motion to dismiss a class action suit brought by UK-based plaintiffs on the grounds of forum non conveniens because the defendants consented to jurisdiction in the UK); Desyatnikov v. Credit Suisse, 2012 WL 1019990 (EDNY 2012) (dismissing for lack of personal jurisdiction claims of fraud by dual U.S./Russian citizen against Swiss company in situation where plaintiff had made all communications from Russia, plaintiff had established account at Singapore office of Swiss company, and all alleged acts took place in Singapore with regard to foreign securities); In re Herald, Primeo and Thema Securities Litigation, 2011 WL 5928952 (SDNY 2011) (dismissing on forum non conveniens grounds claims by foreign investors in foreign funds that were closed to U.S. investors).

g. Attempts to bring international fraud cases in state court under common law claims of fraud or misrepresentation have also met with difficulties. See, e.g., Viking Global Equities v. Porsche Automobil Holding, 101 A.D.3d 640 (NY App. Div., 1st Dept., 2012) (dismissing claims for fraud and unjust enrichment on basis of forum non conveniens where neither defendant nor most plaintiffs were residents of NY, only alleged connections with NY were phone calls between NY and Germany and emails sent to NY (but also generally disseminated to parties elsewhere), and securities in question were traded only on foreign exchanges).

h. Dodd-Frank § 929P(b) amended the 1933 Act, the 1934 Act and the Advisers Act to grant federal district courts jurisdiction over actions brought by the SEC or the DOJ with respect to violations of the antifraud provisions of those statutes if "significant steps in furtherance of the violation" took place in the U.S., or foreign conduct had "a foreseeable substantial effect within the [U.S.]". These amendments arguably overturn Morrison with respect to claims by the SEC and the DOJ. See, e.g., Gruss (§ 929P(b) "may have . . . revived" the conduct and effects test for claims by the SEC); Rasmussen & Tonkovic (discussing § 929P's impact on ability of the SEC to bring actions under Rule 10b-5); Painter, "The Dodd-Frank Exterritorial Jurisdiction Provision: Was it Effective, Needed or Sufficient?", 1 Harv. Bus. L. Rev. 195 (Spring 2011) (discussing Congressional intent and impact of § 929P); Sec. Reg. & L. Rep., Jan. 10, 2011 (discussing the SEC's assertion that Dodd-Frank has restored the "conduct and effects" test with respect to enforcement actions).

But see SEC v. Brown ("construing the Dodd-Frank Act to supersede Morrison may be problematic . . . [and a] difficult question"); SEC v. Chicago Convention Center, 961 F. Supp. 2d 905 (N.D. Ill. 2013) (summarizing case law dicta on § 929P; noting that plain meaning of § 929P provides courts with jurisdiction but does not provide the SEC with substantive power even if Congressional intent may have been to overturn Morrison with respect to claims brought by the SEC; but holding that SEC's complaint survived motion to dismiss under either Morrison or a "conduct and effects" test); Conway, Extraterritoriality After Dodd-Frank (Aug. 5, 2010) (arguing that § 929P "addresses only the jurisdiction of the district courts of the U.S. to hear cases involving extraterritorial elements…[and thus] does not expand the geographic scope of any substantive regulatory provision…[or] the territorial scope of the government's enforcement powers").

i. As required by Dodd-Frank § 929Y, the SEC conducted a study considering the extent to which private rights of action under the 1934 Act antifraud provision should apply to the conduct covered by Dodd-Frank § 929P(b). The SEC's Study on the Cross-border Scope of the Private Right of Action Under [1934 Act § 10(b)] (Apr. 2012) generally supported pre-Morrison jurisprudence and advanced options for Congress to consider, ranging from taking no action and letting Morrison stand, to enactment of a "conduct and effects" test similar to that applicable to SEC and DOJ enforcement actions, to a version of the Morrison transactional test which would clarify that an off-exchange transaction takes place within the U.S. if either party makes an offer to sell or purchase, or accepts an offer to sell or purchase, while in the U.S. The SEC advocated a version of the "conduct" test that would require a private plaintiff to demonstrate that its injury resulted directly from conduct within the U.S.

2. International Tax Enforcement

Activities of foreign banks and broker-dealers in the U.S. have been subject to extensive scrutiny, as well as to administrative and judicial proceedings, arising out of alleged involvement in tax evasion schemes.

a. A significant number of administrative and judicial proceedings have involved UBS.

(i) In June 2008, former UBS banker Bradley Birkenfeld pleaded guilty to conspiring with a U.S. taxpayer to hide assets in Switzerland and Liechtenstein to evade U.S. taxes and in August 2009 was sentenced to 40 months incarceration. See U.S. v. Birkenfeld, No. 08-CR-60099 (S.D. Fla., June 19, 2008) (Statement of Facts); US Attorney S.D. Fla. Press Release, Aug. 21, 2009.

Birkenfeld has since been awarded a $104 million whistleblower award by the IRS and is likely to seek a presidential pardon. Banking Daily, Sept. 12, 2012.

(ii) In November 2008, Raoul Weil, who was responsible for overseeing UBS's global wealth management business, and the highest ranking UBS official charged by U.S. authorities in a multi-year probe, was charged with conspiring to defraud the U.S. for his alleged role in assisting U.S. clients in concealing their identities and offshore assets. See U.S. v. Weil, No. 08-cr-60322 (S.D. Fla., Nov. 12, 2008) (indictment). Mr. Weil was acquitted in a jury trial. U.S. v. Weil, No. 08-cr-60322 (S.D. Fla., Nov. 3, 2014).

(iii) In February 2009 in UBS, SEC Litigation Release No. 20905 (Feb. 18, 2009), UBS settled charges that it acted as an unregistered broker-dealer and investment adviser to thousands of U.S. persons and offshore entities with U.S. citizens as beneficial owners. The SEC charged that UBS's conduct facilitated the ability of certain U.S. clients to maintain undisclosed accounts, enabling such clients to avoid paying taxes related to assets in the accounts.

(iv) In February 2009, UBS also entered into a DOJ Deferred Prosecution Agreement on charges of conspiring to defraud the U.S. by impeding the IRS. U.S. v. UBS, Case No. 09-60033-CR (S.D. Fla., Feb. 18, 2009). As part of the Agreement, UBS agreed that:

A) UBS will provide the U.S. with detailed records concerning accounts held directly or through beneficial arrangements by U.S. persons.

B) UBS will cooperate with the criminal investigation and any resulting prosecutions, and search for and turn over any additional records found concerning such accounts. (The specific criteria for account records disclosed, and the number of accounts whose records have been disclosed, were set forth in a document that the Court ordered sealed.)

C) UBS will terminate its U.S. cross-border business. Accounts of U.S. customers covered by the Agreement will be closed and assets liquidated, with proceeds distributed to the U.S. owners in dollar-denominated instruments.

D) UBS will pay to the U.S. $780 million.

E) UBS's challenge to the DOJ's motion to enforce a "John Doe" Summons (which sought information on thousands of U.S. taxpayers), including the filing of an appeal from an adverse ruling, will not be considered a breach of the Agreement. However, upon completion of that litigation, if the Court were to order UBS to produce the documents sought and hold UBS in contempt for failure to do so, UBS's non-compliance may be determined to be a material breach of the Agreement.

F) UBS's failure to comply with a term of the Agreement may, in the sole discretion of the U.S., be deemed a material breach, permitting the U.S. to proceed with a criminal prosecution.

G) The Agreement only applies and provides protection for UBS as to the specific conduct set forth in the Agreement.

(v) On February 19, 2009, the DOJ filed a petition for an order authorizing the IRS to obtain information from UBS about U.S. taxpayers who may be using Swiss bank accounts to evade federal income taxes (see DOJ Press Release, July 1, 2008); that petition was dismissed on August 19, 2009, after the U.S. and Switzerland reached an Agreement under which the IRS is to submit a treaty request describing the accounts for which it is seeking information, and Switzerland is to direct UBS to initiate procedures that could result in turning over information on thousands of accounts. Following a successful challenge in Swiss Court to the Agreement on January 27, 2010, the U.S. and Switzerland signed a protocol on March 31, 2010 amending the Agreement, and, on June 17, 2010, the Swiss Parliament approved. See, e.g., U.S. v. UBS, Case No. 09-20423-CIV (S.D. Fla., Feb. 19, 2009) (petition to enforce "John Doe" summons); (S.D. Fla., Aug. 19, 2009) (dismissal); DOJ Press Release, Aug. 19, 2009 (terms of Agreement with Switzerland regarding UBS); IRS Release IR-2009-75 (Aug. 19, 2009); Swiss Federal Department of Justice and Police Releases, June 17, 2010, Aug. 19, 2009; Report of the Control Committee of the Swiss Federal Assembly: The Swiss Authorities under the Pressure of the Financial Crisis and the Disclosure of UBS Customer Data to the USA (May 31, 2010). See also DOJ Press Releases, June 20, May 24, 23, Mar. 14, 8, 4, 2011, Apr. 15, 2010.

On January 12, 2010, UBS released its Code of Business Conduct and Ethics, which provides that UBS will not "provide assistance to clients or colleagues in acts aimed at deceiving tax authorities nor . . . support transactions where the tax efficacy relies on assumptions that are inconsistent with the commercial facts or on non-disclosure of material facts". The Code also calls for safeguarding client confidentiality "except when disclosure is authorized by them or required by applicable laws, rules or regulations".

(vi) On September 16, 2008, Igor Olenicoff, who had pleaded guilty in 2007 to evading taxes on $700 million held offshore with UBS, sued UBS claiming that UBS had defrauded him and breached its fiduciary duty by secretly reporting him to the IRS for tax evasion while advising him that his investments were properly reported for tax purposes. On March 16, 2010, the District Court ruled in favor of Olenicoff on a motion to dismiss. See Olenicoff v. UBS, 2010 WL 8530286 (C.D. Cal. 2010). On March 14, 2011, the District Court dismissed all claims against UBS pursuant to a settlement agreement. See Olenicoff v. UBS, No. 08-CV-1029 (C.D. Cal. 2011).

(vii) On October 22, 2010, the DOJ dropped criminal charges against UBS after concluding that UBS had fully complied with its obligations under its Deferred Prosecution Agreement. See NY Times, Oct. 22, 2010.

(viii) In 2011 and 2012, the DOJ prosecuted a number of individuals for failure to report foreign bank accounts held at UBS, as well as income associated with such accounts. See, e.g., DOJ Press Releases, Jan. 30, 2012, June 20, May 24, 23, 19, Mar. 14, 8, 4, 2011; Banking Daily, Apr. 25, 2011.

(ix) UBS confirmed that it is subject to further U.S. probes related to U.S. customers' purchases and sales of bearer bonds which can be transferred without registering and, therefore, may enable secreting of assets. See BBC News, Feb. 10, 2015.

(x) Reportedly, a Belgian court has launched a probe into UBS over allegations that it helped Belgian clients evade the taxes. In addition, French authorities have also required that UBS post a €1.1 billion bond in relation to a similar investigation. In relation to these and similar investigations, UBS has been subject to increasing demands for customer account data, at times challenging such demands. See Wall St. J., July 5, Feb. 26, 2016; NY Times, July 5, 2016; Financial Times, July 5, 2016; Banking Daily, Feb. 26, 2016.

(xi) With regard to the UBS situation and related concerns, see, e.g., PSI Offshore Tax Evasion: The Effort to Collect Unpaid Taxes on Billions in Hidden Offshore Accounts (Feb. 26, 2014); Tax Havens: International Tax Avoidance and Evasion (CRS, July 2009); Senate Permanent Subcommittee on Investigations, Exhibits to Hearing on Tax Haven Banks and U.S. Tax Compliance -- Obtaining the Names of U.S. Clients With Swiss Accounts (Mar. 4, 2009), and Staff Reports, Dividend Tax Abuse: How Offshore Entities Dodge Taxes on U.S. Stock Dividends (Sept. 11, 2008), and Tax Haven Banks and U.S. Tax Compliance (July 17, 2008); EKB Investigation of the Cross-border Business of UBS A.G. With Private Clients in the [U.S.] (Swiss Financial Market Supervisory Authority, Feb. 18, 2009); Cayman Islands: Business and Tax Advantages Attract U.S. Persons but Enforcement Challenges Exist (GAO, July 2008); Banking Daily, June 24, Jan. 18, 2011, July 6, Apr. 19, 2010.

b. Credit Suisse.

(i) In February 2011, the DOJ's investigation of Credit Suisse resulted in charges against a number of Credit Suisse bankers for conspiring to help U.S. citizens evade federal income taxes. See DOJ Press Release, Feb. 23, 2011 (indictment) (the "February Indictment"); NY

Times, Feb. 21, 2011 (Credit Suisse banker held in offshore inquiry).

(ii) On July 14, 2011, the DOJ notified Credit Suisse that it is a target of the DOJ's broader investigation into the provision of cross-border private banking services to U.S. persons. See Credit Suisse Media Release, July 15, 2011.

(iii) On July 21, 2011, the DOJ charged additional former Credit Suisse bankers in a superseding indictment, together with the defendants charged in the February Indictment. See DOJ Press Release, July 21, 2011.

(iv) In November 2011, Credit Suisse confirmed that it had disclosed the names of some of its U.S. clients to U.S. tax authorities following a formal U.S. request under the U.S.-Swiss double taxation treaty. See Financial Times, Nov. 8, 2011.

(v) In December 2011, press reports indicated that U.S. officials had offered 11 Swiss banks (including Credit Suisse) immunity from criminal prosecution on tax evasion charges in exchange for full details of their U.S. offshore business. See Reuters, Dec. 18, 2011.

(vi) In February 2014, Credit Suisse settled charges by the SEC for violations of federal securities laws, including for providing cross-border brokerage and investment advisory services to U.S. clients without registering with the SEC. The settlement included an admission of wrongdoing, payment of $196 million to the SEC, and agreement to retain an independent consultant. In the Matter of Credit Suisse Group, SEC Admin. Proc. No. 3-15763 (Feb. 21, 2014).

(vii) Also in February 2014, the PSI released a Report detailing a number of findings of fact with regard to Credit Suisse, including active recruitment of U.S. clients, facilitation of secrecy and tax evasion for U.S. clients, weak oversight of its own policies and compliance, and inadequate efforts to begin curtailing and closing accounts for U.S. customers. The Report also criticized U.S. enforcement efforts as well as efforts by Swiss officials to preserve bank secrecy. The Report recommended (A) increased prosecution of tax haven banks and hidden offshore account holders, (B) increased transparency and reporting by tax haven banks, (C) streamlining the use of "John Doe" summons to uncover names of taxpayers that use offshore accounts, (D) closing FATCA loopholes, and (E) ratification of the revised U.S.-Switzerland tax treaty which provides for improved disclosure standards. Offshore Tax Evasion: The Effort to Collect Unpaid Taxes on Billions in Hidden Offshore Accounts (Feb. 26, 2014).

(viii) In May 2014, Credit Suisse pleaded guilty to one count of conspiring to aid tax evasion and settled civil enforcement actions, paying $2.6 billion to the SEC, the Board, and other regulators. As part of the settlement, Credit Suisse agreed to (A) make complete disclosure of its cross-border activities, (B) cooperate in treaty requests for account information, (C) provide information about other banks that sent or received secret funds, (D) close accounts of account holders who fail to come into compliance with U.S. reporting obligations, (E) be monitored by an independent investigator selected by the NYDFS for two years, and (F) terminate certain employees who had participated in illegal conduct and are under investigation. See U.S. v. Credit Suisse AG, No. 1:14-CR-188-RBS (E.D. VA May 19, 2014) (information, statement of facts, financial disclosure statement and plea agreement); In the Matter of Credit Suisse AG, Docket No. 14-009-B-FP (Board, May 19, 2014) (cease and desist order and civil money penalty); In the Matter of Credit Suisse AG (NYDFS, May 18, 2014) (consent order). See also DOJ Press Release, June 22, 2016 (detailing guilty pleas of relationship managers who assisted U.S. citizens in evading U.S. income taxes); In the Matter of Institution-

Affiliated Parties of Credit Suisse, Docket No. 15-012-G-I (Board, May 4, 2015) (barring five individuals from participating in affairs of U.S. or foreign banks or BHCs); DOJ Press Release, Nov. 21, 2014 (sentencing); NY Times, May 19, 2014.

(ix) The issue of collateral consequences to a guilty plea became important and Credit Suisse sought waivers of various negative consequences that had been triggered. For example, the SEC granted Credit Suisse a waiver to avoid designation as a "bad actor." Such designation would have prevented Credit Suisse and any affiliate from relying on the Regulation D exemption from securities registration. See SEC Release No. 33-9589 (May 19, 2014). Credit Suisse was also permitted to remain a counterparty to the FRBNY in its primary dealer capacity after the criminal conviction. See Banking Daily, May 21, 2014. However, as part of the plea and settlement, Credit Suisse agreed to close its NY representative office. Furthermore, Credit Suisse was granted an exemption by the Department of Labor from disqualification as a "qualified professional asset manager" in relation to ERISA-covered benefit plans and IRAs until November 2019 for certain affiliated entities and November 2024 for others. See 79 Fed. Reg. 52365 (Sept. 3, 2014) (notice of proposed exemption); 79 Fed. Reg. 68711 (Nov. 18, 2014) (notice of hearing); 80 Fed. Reg. 8689 (Feb. 18, 2015) (extension of comment period); 80 Fed. Reg. 59817 (Oct. 2, 2015).

c. The DOJ has also investigated the offshore private banking activities of other foreign banks. See generally Bloomberg, Oct. 9, 2015.

(i) On January 26, 2011, the DOJ indicted Vaibhav Dahake, a naturalized U.S. citizen of Indian origin, on charges of conspiracy to defraud the U.S. by failing to report offshore bank accounts in India and the British Virgin Islands. The DOJ also brought charges against HSBC bankers as co-conspirators. See NY Times, Jan. 26, 2011.

On April 7, 2011, the U.S. District Court for the Northern District of California granted the IRS leave to request account information from HSBC Bank USA regarding U.S. residents who may have used offshore accounts at HSBC India to evade U.S. tax obligations. The DOJ alleged that in 2002 HSBC opened a "representative office" at an HSBC Bank USA office in New York to enable Indians living in the U.S. to open accounts in India. In 2007, HSBC allegedly opened a second representative office at an HSBC Bank USA office in California. Although HSBC purportedly closed those offices in June 2010, the DOJ alleged that HSBC clients could still access their accounts at HSBC India from the U.S. According to the DOJ petition, HSBC clients told IRS investigators that HSBC representatives in the U.S. assured the clients that they could invest in accounts at HSBC India without paying U.S. income tax on interest earned on the accounts and that HSBC would not report the income earned on the HSBC India accounts to the IRS. See DOJ Press Release, Apr. 7, 2011; DOJ Memorandum in Support of Ex Parte Petition for Leave to Serve "John Doe" Summons, No. CV11-1686 (N.D. Cal., Mar. 30, 2011); Banking Daily, Apr. 14, 2011.

The DOJ has also pursued criminal charges against a number of other U.S. residents in connection with its investigation into the activities of HSBC India. See DOJ Press Release, June 28, 2011; Banking Daily, Apr. 14, 2011.

In July 2011, HSBC announced that it will no longer offer wealth-management services to U.S. resident private clients from locations outside the U.S. See Wall St. J., July 20, 2011.

(ii) On August 22, 2011, a federal judge formalized the DOJ's rights to more than $400 million transferred in connection with a December 2010 settlement with Deutsche Bank. Under this settlement, Deutsche Bank agreed to forfeit $554 million to the U.S. and admitted criminal wrongdoing for its participation in financial transactions that furthered fraudulent tax shelters. See U.S. v. $403,794,150, No. 11 CIV 4045 (SDNY Aug. 22, 2011).

(iii) Israeli Bank Leumi, Bank Hapoalim and Mizrahi-Tefahot Bank are under investigation by the IRS and the DOJ in connection with offshore private banking services that may have enabled wealthy Americans to evade taxes. See Bloomberg, Oct. 9, 2015; Reuters, Sept. 16, 2011.

On December 22, 2014, Bank Leumi entered into a Deferred Prosecution Agreement with the DOJ. Bank Leumi agreed to pay $270 million for assisting U.S. taxpayers in hiding assets in offshore bank accounts and agreed to disclose more than 1500 U.S. account holders. DOJ Press Release, Dec. 22, 2014.

On December 22, 2014, the NYDFS entered into a Consent Order with Bank Leumi and Bank Leumi USA with respect to Leumi's "knowing and willful" assistance to U.S. clients in opening and maintaining undeclared accounts, concealing offshore client assets and income from the IRS and other federal and state authorities, and filing false tax returns and other documents. Under the terms of the Consent Order, Leumi will (A) pay $130 million to the NYDFS, (B) move to terminate and ban individual senior employees who engaged in misconduct, (C) admit its violations of law for conducting an illegal cross-border scheme to assist U.S. clients in evading federal and state taxes, and (D) install an independent monitor, selected by the NYDFS, to conduct a comprehensive review of compliance programs, policies and procedures.

In a February 2013 guilty plea, Zvi Sperling admitted to conspiring with Bank Leumi and Mizrahi-Tefahot bankers to open and fund accounts in Israel that were not reported to the IRS. According to the plea agreement, the Israeli branches entered into back-to-back loans with their U.S. branches and Sperling to repatriate offshore, undeclared assets. See Bloomberg, Feb. 19, 2013. The DOJ has obtained guilty pleas from additional persons who utilized the back-to-back loan structure through Israeli bank accounts. See DOJ Press Release, Aug. 29, 2013. See also DOJ Press Releases, Aug. 10, Feb. 2, 2015; Banking Daily, July 19, 2013.

(iv) On January 19. 2016, two Swiss bankers working for Julius Baer pleaded guilty to conspiring with U.S. clients to hide offshore accounts and to evade U.S. taxes on those accounts. See DOJ Press Release, Feb. 4, 2016.

(v) Julius Baer also entered into a deferred prosecution agreement with the DOJ, in which the company admitted that it knowingly assisted many of its U.S. taxpayer clients in evading U.S. tax obligations. The bank will pay a total of $547 million as part of the deferred prosecution agreement. See Bank Julius Baer & Co Deferred Prosecution Agreement, Feb. 2, 2016; DOJ Press Release, Feb. 4, 2016. United States of America v. $219,250,000, No. 16-cv-00886 (SDNY Feb 4. 2016); U.S. v. Bank Julius Baer & Co., 11-cr-866 (SDNY Feb. 4, 2016).

(vi) In January 2012, the DOJ indicted three client advisers for the Zurich branch of Switzerland's oldest bank, Wegelin & Co., for conspiring with U.S. taxpayers and others to hide more than $1.2 billion in assets from U.S. tax authorities. The client advisers also allegedly tried to capture business lost by other Swiss banks after those banks came under U.S. investigation. On February 2, 2012, the U.S. Attorney for SDNY announced a superseding indictment that also included Wegelin & Co. for its participation in this alleged U.S. tax evasion, the first time such charges have been brought against a bank itself. Wegelin & Co. did not have branches outside of Switzerland, but it accessed U.S. customers through correspondent accounts at UBS. See Wall St. J., Feb. 3, 2012; U.S. v. Wegelin & Co., No. S1-12-Cr.-02 (SDNY Feb. 2, 2012) (indictment). See also U.S. v. Funds on Deposit at UBS, No. 12-Civ-0836 (SDNY Apr. 24, 2012) (forfeiture of funds at UBS held in the name of Wegelin & Co. as property involved in the allegedly fraudulent transaction); SDNY Press Release, Jan. 3, 2012; U.S. v. Berlinka, Frei and Keller, Case No. 12-Crim-002 (SDNY Jan. 3, 2012).

On January 3, 2013, Wegelin & Co. pleaded guilty to conspiracy to defraud the IRS, file false federal income tax returns and evade federal income taxes. The plea was accompanied by an agreement to pay $20 million in restitution to the IRS, a $22.05 million fine, and a civil forfeiture of $15.8 million, as well as an agreement not to contest the prior forfeiture of $16.2 million from its UBS correspondent account. See SDNY Press Release, Jan. 3, 2013. See also SDNY Press Release, Mar. 4, 2013 (confirming sentencing, fines and forfeiture). After the guilty plea, Wegelin & Co. announced that it would cease to operate as a bank pending final resolution of the charges. Wegelin has sold its non-U.S. assets to Raiffersen Gruppe. See Reuters, Jan. 4, 2013.

(vii) On December 19, 2012, three former client advisers at an unnamed Swiss bank were indicted for conspiring with U.S. taxpayer-clients and others to hide more than $420 million in offshore accounts from the IRS. U.S. v. Fellman, Huppi and Reist, No. 12-Cr-962 (SDNY Dec. 19, 2012) (indictment). It was later reported that the three were current or former employees of Zuercher Kantonalbank, the largest Swiss cantonal (regional) bank, which itself is reportedly negotiating a Deferred Prosecution Agreement with U.S. authorities. Another cantonal bank, Basler Kantonalbank, is also reportedly under scrutiny by U.S. authorities. See NY Times, May 28, 2013; Banking Daily, May 21, 2013, Dec. 20, 2012.

(viii) On April 16, 2013, a partner at a Swiss law firm and the head of private banking at a Swiss bank were indicted for conspiring with U.S. taxpayers to hide millions of dollars in offshore accounts from the IRS. U.S. v. Paltzer and Buck, No. 13-Cr-282 (SDNY Apr. 16, 2013) (indictment). Paltzer was arrested while traveling through NY and on August 16, 2013 pled guilty to conspiracy to evade federal taxes and to file false tax returns. Buck has been indicted by a U.S. court but refuses to go to the U.S. to face the charges. See SDNY Press Release, Aug. 16, 2013; Bloomberg, Apr. 16, 2015. An alleged co-conspirator of Paltzer's has also been indicted. See DOJ Press Release, Nov. 13, 2014 (Swiss banker Martin Dunki accused of moving assets to different banks and jurisdictions to avoid various investigations (including of UBS) and treaties (including Liechtenstein - U.S. treaty)).

(ix) On May 9, 2013, the IRS, the Australian Tax Office and UK HM Revenue & Customs announced a plan to share tax information from trusts and companies organized in a number of jurisdictions, including Singapore, British Virgin Islands, Cayman Islands and Cook Islands. The shared data contains both the identities of individual owners of the entities and the advisers who assisted in establishing the entity structure. See IRS Press Release, May 9, 2013.

(x) On July 26, 2013, Liechtensteinische Landesbank, a bank based in Liechtenstein, entered into a Non-Prosecution Agreement with the DOJ for allegedly opening and maintaining undeclared bank accounts for U.S. taxpayers from 2001 through 2011, assisting U.S. taxpayers in evading U.S. tax obligations and filing false federal tax returns. Landesbank agreed to forfeit revenues of $16 million and pay restitution for lost tax revenue of $7.5 million. The U.S. authorities noted Landesbank's "extraordinary cooperation in the form of its support and assistance in 2012 to obtain a change in law by the Liechtenstein Parliament that permitted the [DOJ] to request and obtain the bank files of non-compliant U.S. taxpayers from Liechtenstein without having to identify the taxpayers by name." See SDNY Press Release, July 30, 2013. See also DOJ Press Release, Nov. 10, 2015, (U.S. citizen pleads guilty to willfully failing to file government reports and intending to conceal an offshore bank account at Liechtensteinische Landesbanke).

(xi) On February 6, 2014, an asset manager at a Swiss asset management firm was indicted for conspiring with U.S. taxpayers to hide millions of dollars in Swiss bank accounts. U.S. v. Amrein, No. 13-Cr-972 (SDNY Feb. 6, 2014) (indictment). He has since pleaded guilty to these charges and now faces a maximum sentence of five years in prison. DOJ Press Release, Mar. 31, 2015.

(xii) On March 12, 2014, Andreas Bachmann, a former Swiss banker, entered a guilty plea to the charge of helping U.S. citizens evade taxes. U.S. v. Bachmann, No. 11-CR-95 (E.D. Va. Mar. 12, 2014).

(xiii) A Kentucky resident was indicted and arrested in connection with the maintenance of a sham foundation in Liechtenstein and undeclared accounts in Switzerland (including accounts at Wegelin and accounts opened through use of the services of client advisors at UBS and other Swiss financial advisory and asset management firms). U.S. v. Canale, No. 14-Crim.-713 (SDNY 2014) (sealed indictment). On August 5, 2015, Canale pleaded guilty to the charges. See DOJ Press Release, Aug. 5, 2015.

(xiv) On March 9, 2016, Cayman National Securities Ltd. and Cayman National Trust Co. Ltd., two affiliates of Cayman National Corporation, pleaded guilty to charges of conspiring with U.S. taxpayer-clients to hide more than $130 million in offshore accounts from the IRS. Pursuant to their plea, the two companies are required to provide information of non-compliant U.S. taxpayers who maintained accounts with the banks and pay $6 million in penalties. See Banking Daily, Mar. 9, 2016; DOJ Press Release, Mar. 9, 2016.

(xv) The DOJ/IRS practice of obtaining information through a "John Doe Summons" has expanded in the context of international tax enforcement. The John Doe Summons is used to obtain information about possible violations of tax laws by individuals whose identities are unknown. In addition, the IRS has used such summons as a tool to access records related to foreign banks with no U.S. operations but that maintain correspondent accounts at banks in the U.S.

A) Following Wegelin & Co.'s guilty plea, the U.S. District Court SDNY authorized the IRS to issue a John Doe Summons requiring UBS to produce records of U.S. taxpayers who may hold accounts at Wegelin & Co. or other Swiss banks through Wegelin & Co.'s UBS correspondent account. Order Granting Ex Parte Petition for Leave to Serve "John Doe" Summons, No. 13-MC-21 (SDNY Jan. 25, 2013).

B) On April 29, 2013, the District Court for the Northern District of California authorized the IRS to serve a John Doe Summons seeking records for the CIBC FirstCarribean International Bank ("FCIB") correspondent account at Wells Fargo, N.A., intended to enable the IRS to identify U.S. taxpayers who hold or held interests in financial accounts at FCIB and other financial institutions that used FCIB's correspondent account. IRS Acting Commissioner Miller noted that the IRS would "pursue these cases in all parts of the world, regardless of whether the person hiding money overseas chooses a bank with no offices on U.S. soil." See DOJ Press Release, Apr. 30, 2013; Order Granting Ex Parte Petition for Leave to Serve John Doe Summons, No. 13-cv-01938 (N.D. Cal., Apr. 29, 2013).

C) John McDougal, Special Trial Attorney at the IRS, and Daniel Levy, Assistant U.S. Attorney SDNY, noted that the U.S. is investigating foreign bank transactions processed through U.S. correspondent accounts for evidence of assets hidden overseas. Levy also indicated that the activity of tax lawyers and advisers who help clients hide assets overseas is under examination. See Banking Daily, June 10, 2013. See also IRS Announcement 2008-98 (Nov. 3, 2008) (proposing amendments to the IRS Qualified Intermediary Program that would require banks that act as qualified intermediaries to provide the IRS early notification of material failure of internal controls, to improve evaluation of risk of circumvention of U.S. taxation by U.S. persons, and to include audit oversight by a U.S. auditor).

D) On September 16, 2015, the District Court for the Southern District of Florida authorized the IRS to serve John Doe Summons on Citibank and Bank of America for records identifying U.S. taxpayers with accounts at Belize Bank International Limited and Belize Bank Limited, or their affiliates, as well as correspondent accounts for Belize Corporate Services. DOJ Press Release, Sept. 16, 2015; In the Matter of Tax Liabilities of John Does, No. 15-mc-23475 (S.D. Fla., Sept. 16, 2015)

E) See also, e.g., In re the Tax Liabilities of John Does, No. 14-Misc.-00417 (SDNY Dec. 19, 2014) (Summons requiring Federal Express Corporation and subsidiaries, DHL Express, United Parcel Service, Western Union Financial Services, FRBNY, The Clearing House, and HSBC Bank USA to produce U.S. taxpayer records with regard to use of services of Sovereign Management & Legal Ltd., a multijurisdictional provider of corporate/foundation formation, mail forwarding, virtual office and separate entity director services); In re the Tax Liabilities of John Does, No. 13-MC-00377 (SDNY Nov. 12, 2013) (Summons requiring

BNYM, Citibank, JPMorgan Chase Bank, HSBC Bank USA and Bank of America to produce U.S. taxpayer records with regard to accounts at The Bank of NT Butterfield & Son Ltd., a Bermuda bank); In re the Tax Liabilities of John Does, No. 13-MC-00378 (SDNY Nov. 7, 2013) (Summons requiring BNYM and Citibank to produce U.S. taxpayer records with regard to accounts at Zurchers Kantonalbank, a Swiss bank). In re Tax Liabilities of John Does, No. 08-21864 (S.D. Fla. 2008) (summons sought production by UBS of the identity of and certain related documents of accounts of U.S. taxpayers having accounts maintained at, monitored by or managed though any office in UBS Switzerland); In re Tax Liabilities of John Does, No. 09-CV-2290-N (N.D. Tex. 2009) (summons on receiver of the Stanford Group Cos. for assets and records related to clients that may not have reported income).

d. On January 27, 2016, the DOJ ended a three year joint program (the "Program") between the DOJ and the Swiss Department of Finance, originally announced in 2013, that allowed Swiss banks to cooperate with DOJ investigations into the use of foreign bank accounts to commit tax evasion. The Program, which was not available to individuals, banks that were already under investigation or certain other financial institutions, allowed 78 Swiss banks to resolve potential criminal liabilities by entering into Non-Prosecution Agreements after coming forward, agreeing to pay "substantial penalties" (20% of the maximum aggregate dollar value of all non-disclosed accounts of U.S. taxpayers that were held by the bank on August 1, 2008, with increases for accounts opened after those dates) and disclosing "detailed" information about activities, methods of evading U.S. tax liabilities and accounts of U.S. taxpayers as well as about other banks to which funds may have been transferred. The Program resulted in $1.37 billion in penalties. See DOJ Website, Swiss Bank Program (last updated Jan. 27, 2016); DOJ Press Release, Aug. 29, 2013; Joint Statement [on the Program] between the [DOJ] and the Swiss Federal Department of Finance

(Aug. 29, 2013); Tax Division's Comments about the Program for Non-Prosecution Agreements or Non-Target letters for Swiss Banks (DOJ, Nov. 5, 2013); DOJ Press Release, June 5, 2014; Tax Division's Further Comments about the Program for Non-Prosecution Agreements or Non-Target letters for Swiss Banks (June 5, 2014). See also Wall St. J., June 30, 2016, Oct. 22, 2015 (authorities' use of data provided by Swiss Banks under the Program); DOJ Press Release, Oct. 6, 2015 (Finacor SA, which was not eligible for the Program due to its structure as an asset management firm, agreed with the DOJ to participate in Program, comply with Program's obligations, provide required disclosure and pay a penalty).

e. Similar to the program for Swiss banks, in 2009, the IRS began an Offshore Voluntary Disclosure Program ("OVDP") for U.S. taxpayers. Under the OVDP, the IRS agreed to reduce financial penalties and not prosecute taxpayers who disclose their offshore accounts and pay delinquent taxes and penalties. The greatest number of individual participants in the 2009 OVDP appear to be from California and New York with the majority of accounts being held in Switzerland and the United Kingdom (42% and 8% of accounts, respectively). See IRS's Offshore Voluntary Disclosure Program: 2009 Participation by State and Location of Foreign Bank Accounts (GAO, Jan. 6, 2014). The IRS went on to announce a 2011 OVDP that net an equivalent number of disclosures (approximately 15,000) as the 2009 OVDP. In January 2012, the OVDP was made permanent. Under the 2012 permanent program, participants pay a penalty of 27.5% of the highest aggregate balance or value of offshore assets during the prior eight years. Each year of the program the penalty against the aggregate value of unreported accounts (as well as the coverage years for unreported accounts) has increased, although lower penalties can be applied in certain instances and higher penalties apply to customers of banks that are under investigation or have already agreed to a Non-Prosecution Agreement with the DOJ. As of June 2014, the 2009, 2011 and permanent programs have resulted in more than 45,000 voluntary disclosures and payments of $6.5 billion in taxes and penalties. In June 2014, the IRS announced streamlined processes intended to make disclosure easier and to make the program available to a wider pool of taxpayers. The modifications also included an increase in penalty if the individual filed only after it became public that a financial institution in which the individual had accounts had come under investigation. See IRS Press Release No. IR-2014-73 (June 18, 2014); IRS Release Nos. FS-2014-7 and FS-2014-6 (June 2014). See also DOJ Press Release, Feb. 3, 2016 (harsher penalties for U.S. citizen who did not self-report under the program).

f. On March 18, 2010, President Obama signed into law the Hiring Incentives to Restore Employment Act, Pub. L. 111-147 ("HIRE Act"), which contains key provisions of the FATCA, including requirements that (i) foreign financial institutions ("FFIs") report U.S. accounts or pay a 30% withholding tax on any withholdable payments made to the institutions or their affiliates, and (ii) U.S. persons with an interest in any "specified foreign financial asset" file a report with the IRS relating to the asset in any year in which the asset exceeds $50,000.

(i) In 2013, the IRS finalized regulations to implement FATCA. See 78 Fed. Reg. 5874 (Jan. 28, 2013); 78 Fed. Reg. 55202 (Sept. 10, 2013) (correcting amendments). The final regulations generally (A) introduce a phased implementation schedule for an FFI's registration, account due diligence, withholding and reporting requirements; (B) define a number of terms used in FATCA (including defining "FFI" to include banks, custodians and other financial institutions, as well as investment funds, securitization vehicles and other SPVs); (C) define the due diligence requirements applicable to FFIs and other withholding agents to identify U.S. account holders; and (D) explain reporting requirements for FFIs and other required policies and procedures. In July 2013, the Treasury and the IRS delayed certain grandfather dates and the implementation of withholding and due diligence requirements from Jan. 1, 2014 until July 1, 2014 to allow more time to complete intergovernmental information sharing agreements ("IGAs") with foreign jurisdictions. See IRS Notice 2013-43 (July 12, 2013). In August 2013, the IRS launched its online registration system for FFIs and provided draft forms for FFI reporting. See Banking Daily, Aug. 20, 16, 2013. On February 12, 2014, the Treasury and the IRS released the remaining regulations necessary to implement FATCA. 79 Fed. Reg. 12726 (Mar. 6, 2014); 79 Fed. Reg. 12812 (Mar. 6, 2014). See also Treasury Press Release and Fact Sheet, Feb. 20, 2014. In 2015, the IRS extended certain FATCA transitional rules and provided guidance to jurisdictions for the exchange of information for tax year 2014. See Treasury and IRS Notice 2015-66 (Sept. 18, 2015). The IRS also announced it was successful in sharing information with certain foreign authorities by its Sept. 30, 2015 deadline. See IRS Press Release 2015-111 (Oct. 2, 2015). See also IRS Notice 2016-8 (Jan. 19, 2016) (various clarifications).

(ii) In April 2012, despite concerns that had been raised with respect to the initial IRS proposal that it would represent an unnecessary burden on U.S. banks and potentially reduce foreign funds flows and investments in the U.S., the IRS adopted final regulations to require U.S. banks and U.S. branches of foreign banks to collect and report information on interest paid to non-resident aliens who deposit funds in U.S. financial institutions. The regulations require reporting only in the case of interest paid to a non-resident alien individual who is resident in a country with which the U.S. has in effect an information exchange agreement. See 77 Fed. Reg. 23391 (Apr. 19, 2012). See also 76 Fed. Reg. 1105 (Jan. 7, 2011) (solicitation of comments).

(iii) HIRE Act § 541 enacted Internal Revenue Code § 871(m), which would apply the 30% withholding tax on dividends paid by U.S. corporations to foreign persons also to “dividend equivalent” or “substantially similar” payments to foreign persons made under certain swap contracts. The IRS issued temporary regulations to delay such application until after December 31, 2013. See 77 Fed. Reg. 53141 (Aug. 31, 2012). On September 17, 2015, the IRS and the Treasury Department issued final regulations under § 871(m) that impose withholding tax on amounts paid to a non-U.S. person for certain notional principal contracts, derivatives and other "equity-linked instruments" that reference dividends on U.S. equity securities. The rules generally follow the proposed regulations issued in 2013, as supplemented and amended, but apply to a smaller class of derivatives by raising the "delta" to 0.80 or more (up from 0.70) and limiting the testing of delta to only the original issuance or a material modification of the instrument. The new regulations still require withholding on "price return only" derivatives that do not provide for payments that reference dividends. Additionally, the new rules imposed withholding only on equity derivatives entered into after 2016 and on payments made after 2017 related to derivatives entered into in 2016. The release also includes temporary (and proposed) regulations for determining whether certain complex derivatives are subject to § 871(m) and for payments by certain dealers. See 80 Fed. Reg. 56866 (Sept. 18, 2015) (final regulation); 80 Fed. Reg. 56415 (Sept. 18, 2015) (notice of temporary/proposed regulations); 78 Fed. Reg. 73128 (Dec. 5, 2013) (notice of proposed rulemaking); 78 Fed. Reg. 73079 (Dec. 5, 2013) (certain final regulations); 77 Fed. Reg. 53141 (Aug. 31, 2012) (corrections); 77 Fed. Reg. 13969 (Mar. 8, 2012) (corrections); 77 Fed. Reg. 5700 (Feb. 6, 2012) (corrections); 77 Fed. Reg. 3108 (Jan. 23, 2012) (temporary regulations); 77 Fed. Reg. 3202 (Jan. 23, 2012) (notice of proposed regulations).

(iv) During 2012, the U.S. signed joint statements on intergovernmental cooperation to facilitate the implementation of FATCA with several jurisdictions, including France, Germany, Italy, Spain, the UK, Japan, and Switzerland. As a result of such cooperation, on July 26, 2012, Treasury released a model IGA. Generally, the IGAs permit foreign institutions that would otherwise have to report information to the IRS under FATCA instead to report such information to their home government, and the home government would in turn agree to transfer the information to the IRS. Two forms of IGA were created -- a "reciprocal" agreement wherein the U.S. would also agree to provide information about accounts at U.S. institutions to the foreign government, and a "non-reciprocal" version wherein the U.S. only receives information from the foreign government. The model IGA is intended to reduce concerns about foreign institutions supplying information to the IRS in potential contravention of local bank secrecy, data protection or privacy laws. See Treasury Press Release, July 26, 2012. See also Banking Daily, July 27, 2012.

On November 14, 2012, the Treasury Department published a second model IGA, which generally requires direct reporting from an FFI to the IRS, rather than through the FFI's home government.

(v) On December 26, 2014, together with related guidance, the Treasury and the IRS published a final FFI Agreement for Participating FFIs. IRS Rev. Proc. 2014-10. See also IRS Rev. Proc. 2014-38 (June 24, 2014) (updates); IRS Notice 2013-69 (Oct. 29, 2013) (proposal). On June 2, 2014, the Treasury released the first list of close to 77,000 financial institutions that had registered. Banking Report, June 10, 2014. In addition, the IRS has issued FAQs on its website (and reportedly will continue to update such FAQs) covering registration and definitional issues, as well as interpretive guidance. One such interpretation requires a branch to be included in a bank's registration rather than register separately. See Banking Daily, Aug. 25, 2015. The IRS has also implemented the "International Data Exchange Service" to allow registrants and governments with IGAs to submit electronically FATCA reports on accounts of U.S. taxpayers. IRS Press Release No. IR-2015-01 (Jan. 12, 2015).

(vi) In the wake of implementation of FATCA, studies of its early effects have concluded that many U.S. citizens, including those that live overseas, have been affected by closure of accounts by foreign banks or brokerages. See Democrats Abroad, 2014 FATCA Research Project: FATCA Affecting Everyday Americans Every Day (Sept. 2014).

g. In April 2016, over 11.5 million files (the "Panama Papers") from the database of Mossack Fonseca, the world's fourth largest offshore law firm, were obtained by the International Consortium of Investigative Journalists and released publicly. The documents reveal offshore activities by individuals, banks and other institutions potentially and allegedly used to hide funds and avoid tax obligations. The Panama Papers detail the use of offshore entities and tax havens to potentially defraud tax authorities around the world. Regulators in the U.S. and Europe are probing the banks they regulate based on information obtained from the Panama Papers, many of which indicated that banks helped their customers in creating the offshore structures. In addition, over 500 banks used the services of Mossack Fonseca and its predecessor to create shell companies for themselves, in addition to their clients, between 1977 and 2015. HSBC reportedly accounted for more than 14% of the total number of shell companies formed during that time. See e.g., Wall Street on Parade (May 16, 2016) (Citi affiliate in Miami houses dozens of offshore companies); Bloomberg, Apr. 20, 2016 (NYDFS orders 13 foreign banks to turn over information about contacts with Mossack Fonseca and related shell companies; DOJ opens potential criminal investigation); Wall St. J., Apr. 5, 2016 (France places Panama on noncooperative list), Apr. 5, 2016 (identifying Credit Suisse, UBS and HSBC as heaviest users of Mossack Fonseca services; Credit Suisse CEO states Credit Suisse "only encourage[s] the use of structures when they have a legitimate economic purpose"); Banking Daily, Apr. 4, 2016 (HSBC among the most active in registering shell companies), Apr. 4, 2016 (describing potential involvement of banks and regulatory inquiries into such banks); Reuters, Apr. 4, 2016 (Nordea Bank), Apr. 4, 2016 (RBC).

See also 81 Fed. Reg. 29398 (May 11, 2016) (final FinCEN rules on customer due diligence requirements under the Bank Secrecy Act; rules apply to banks, brokers or dealers in securities, mutual funds, FCMs and IBs; rules include a new requirement to identify and verify the identity of beneficial owners of legal entity customers, subject to certain exclusions and exemptions).

h. The Global Forum on Transparency and Exchange of Information for Tax Purposes, a multilateral framework established under the auspices of the OECD and the G-20, includes a peer review process to remove obstacles to information exchange on tax matters in participating jurisdictions. Phase 1 reviews by the Forum examine the legal and regulatory framework of a jurisdiction for transparency and information exchange, and offer recommendations for improvements. Phase 2 reviews look to the effectiveness of transparency and information exchange rules in practice. The Global Forum continues to review jurisdictions with plans to review more over the next few years. The majority of jurisdictions have at least partially complied with the recommendations suggested by the Global Forum.

   As of September 2016, the Global Forum had 135 members, had completed 215 peer reviews and assigned "compliance" ratings to 85 jurisdictions that have undergone Phase 2 reviews. See Tax Transparency 2015 – Report on Progress (OECD, Oct. 30, 2015).

   Switzerland announced that it plans to phase out its bank secrecy laws and to be able to fully exchange tax information with other countries by 2018. Banking Daily, Feb. 11, 2015.

i. Estimates of lost revenue from "round-tripping", the practice of moving funds to offshore tax havens and reinvesting those funds in U.S. securities, range from $8 to $27 billion. A recent study found that in jurisdictions where the U.S. maintains a tax information exchange agreement, round-tripping occurs much less frequently. See Banking Daily, Apr. 15, 2014; Hanlon, et al., "Taking the Long Way Home: U.S. Tax Evasion and Offshore Investments in U.S. Equity and Debt Markets", Journal of Finance (Sept. 2014).

3. Correspondent Banking

Correspondent banking relationships permit banks to access financial services in different jurisdictions and provide cross-border payment services to their customers, supporting international trade and financial inclusion. A recent trend, however, has seen banks entering into fewer new correspondent relationships and reducing the number of existing relationships, particularly with banks in emerging markets and developing economies. Nearly half the banks in such jurisdictions have seen a decline in correspondent relationships, threatening fragmentation of cross-border payment networks.

The decline has been attributed to rising oversight costs and uncertainty over counterpart banks' due diligence of customers, particularly where concerns over money laundering and terrorism financing exist. Banks have sought to avoid potential penalties or other damages related to the risks associated with correspondent banking, leading to this decline.

There have been multiple attempts by international banking organizations and even regulators to reverse the trend and assist banks without access to correspondent banking services to gain such access.

See generally Joint Fact Sheet On Foreign Correspondent Banking: Approach to BSA/AML and OFAC Sanctions Supervision and Enforcement (Board/FDIC/NCUA/OCC/Treasury, Aug. 30, 2016); Report to the G20 on Actions Taken to Assess and Address the Decline in Correspondent Banking (FSB, Aug. 25, 2016, Nov. 6, 2015); Correspondent Banking (CPMI, July 2016); The Withdrawal of Correspondent Banking Relationships: A Case for Policy Action (IMF, June 2016); Treasury Press Release, Nov. 6, 2015 (U.S. officials met with representatives from Middle East banking community to discuss increasing correspondent relationships); FSB Press Release, Nov. 6, 2015; Correspondent Banking-Consultative Report (CPMI, Oct. 2015). See also, e.g., 81 Fed. Reg. 18480 (Mar. 31, 2016) (final FinCEN rule imposing a prohibition on U.S. financial institutions from opening or maintaining a correspondent account for, or on behalf of FBME Bank Ltd. (formerly known as Federal Bank of the Middle East) because of international money laundering and terrorist financing risks posted to the U.S. financial system); 80 Fed. Reg. 74064 (Nov. 27, 2015) (proposed rule);

FinCEN Press Release, July 28, 2016 (Court ordered stay of final rule).

4. International Prime Brokerage

FINRA Regulatory Notice 07-58 (Nov. 2007) (solicitation of public comments) proposes guidance on international prime brokerage practices. It defines international prime brokerage as the practice where a foreign domiciled customer executes transactions through a FINRA member that are settled and carried by another FINRA member on behalf of its affiliated foreign broker-dealer, and sets out proposed best practices with respect to account arrangements, delivery instructions, affirmation of trades, books and records and confirmation of trades.

5. Internet Issues

The Internet provides access to information worldwide, and securities exchanges, banks, brokerage firms, mutual funds, investment advisers and other institutions have developed their own websites, providing users with market data, company-specific descriptions, prospectuses, research reports and other information. SEC Release No. 34-58288 (Aug. 1, 2008) provides guidance on the use of company websites, and solicits comment on the use of technology to provide information to investors. See also Part IX.F, Part XI.A and Part XI.D.3 above.

6. International Clearance and Settlement

Initiatives to improve international securities and derivatives clearance and settlement linkages are also expanding.

a. The SEC granted exemptions permitting ICE Clear Europe, Eurex Clearing AG, LIFFE Administration and Management and LCH.Clearnet to perform clearing agency functions for certain CDS. See SEC Releases No 34-60372 (July 23, 2009); 34-60373 (July 23, 2009); 34-59164 (Dec. 24, 2008). The SEC approved agreements between U.S. and non-U.S. securities exchanges that permit the transfer of orders between the exchanges, and a number of such trading links connect, or have connected, NASDAQ and the SGX; the Boston Stock Exchange and the Montreal Stock Exchange; the AMEX and the Amsterdam Stock Exchange, the Toronto Stock Exchange and the European Options Exchange; the Chicago Stock Exchange and the Toronto Stock Exchange; and the CBOT and LIFFE. See, e.g., SEC Releases No. 34-35116 (Dec. 19, 1994), No. 34-34021 (May 6, 1994), No. 34-33061 (Oct. 15, 1993), No. 34-25457 (Mar. 14, 1988); No. 34-27080 (July 31, 1989), No. 34-24869 (Sept. 2, 1987), No. 34-23075 (Mar. 28, 1986), No. 34-22442 (Sept. 20, 1985), No. 34-21925 (Apr. 8, 1985) and No. 34-21449 (Nov. 19, 1984); SGX (avail. Aug. 16, 1990).

b. The SEC permitted London-based Tradepoint -- a screen-based electronic market -- to operate in the U.S. without registering as a U.S. exchange, marking the first time that the SEC granted such approval to a non-U.S. exchange. The SEC's order imposed volume limitations and other conditions on Tradepoint that would likely be unworkable for large foreign exchanges. In 2001, the SEC extended the Tradepoint order to virt-x, an arrangement between Tradepoint and the Swiss Stock Exchange. See Tradepoint/virt-x (avail. June 21, 2001); Tradepoint (avail. July 3, 2000); SEC Release No. 34-4119 (Mar. 22, 1999).

c. FICC (formerly Government Securities Clearing Corporation, "GSCC") joined with LCH and JPMorgan Chase, as operator of Euroclear, to form the European Securities Clearing Corporation, a facility for netting European government debt repo and cash transactions. See GSCC Important Notices, May 11, 2000, Nov. 5, Mar. 15, 1999.

d. The SEC approved linkages between Deutsche Börse Clearing, DTC, SIS SegaInterSettle and The Canadian Depository for Securities, permitting book-entry movements of securities from a participant's account in one system to its counterparty's account in another system. DTC has additional central securities depository link operations with other non-U.S. clearing entities, including Euroclear and entities in Argentina, Brazil, Hong Kong, Japan, Peru and Singapore. See, e.g., SEC Releases No. 34-42782 (May 15, 2000), No. 34-40660 (Nov. 10, 1998), No. 34-40523 (Oct. 6, 1998); DTC Press Release, Nov. 16, 1998. See also SEC Releases No. 34-39643 (Feb. 11, 1998) (exemption from registration as a clearing agency granted to Euroclear) and No. 34-38328 (Feb. 24, 1997) (exemption from registration as a clearing agency granted to predecessor to Clearstream).

e. A study commissioned by the Group of 30 recommended a 20-point "action plan" for global clearing and settlement, focusing on (i) technical and business practice standards intended to strengthen the connections across borders and systems, (ii) stronger risk management, and (iii) improved governance. See Global Clearing and Settlement: Final Report (Group of 30, 2006); Global Clearing and Settlement: A Plan of Action (Group of 30, 2003). See also Fact Sheet on Potential Cross-border Exchange Mergers, Press Release No. 2006-96 (June 16, 2006).

XII. ACQUISITIONS, JOINT VENTURES AND STRATEGIC RELATIONSHIPS

A. CRISIS-ERA ACQUISITIONS

The 2008 credit crisis led to a number of large financial sector acquisitions, several of which were quickly consummated and involved unprecedented government support and participation. The acquisition of Bear Stearns by JPMorgan Chase, of Merrill Lynch by Bank of America and of Lehman by Barclays were all driven by the 2008 credit crisis.

1. Bear Stearns

a. In mid-March 2008, Bear Stearns faced a decision between filing for bankruptcy or concluding an acquisition with a more financially secure partner. Under intense time pressure, the Board of Directors of Bear Stearns unanimously agreed to a takeover by JPMorgan Chase -- an institution that had been working in tandem with the FRBNY at the time to try to alleviate Bear Stearn's liquidity problems.

b. The acquisition was ultimately completed in May 2008. Key elements of the transaction include the following:

   (i) JPMorgan Chase purchased nearly half of the shares of Bear Stearns common stock shortly prior to the completion of the merger (purchases were made both in the open market and pursuant to a stock exchange agreement with Bear Stearns), virtually guaranteeing Bear Stearns shareholder approval of the merger.

   (ii) In connection with the merger and as an integral part of the rescue plan, JPMorgan Chase guaranteed certain liabilities of Bear Stearns in order to strengthen Bear Stearns' liquidity. In addition, JPMorgan Chase guaranteed the borrowings of Bear Stearns from the FRBNY's discount window.

c. The U.S. government took certain steps to facilitate JPMorgan Chase's acquisition of Bear Stearns. For example:

   (i) The FRBNY provided $29 billion in credit support to JPMorgan Chase in connection with the transaction.

Under the arrangement (the "Maiden Lane Arrangement"), JPMorgan Chase bore the first $1 billion of any losses associated with the portfolio of Bear Stearns assets securing the loan; any realized gains accrue to the FRBNY. See FRBNY Press Release, Mar. 24, 2008. See also FRBNY Press Release, June 14, 2012 (FRBNY credit support repaid).

(ii) In addition, the FRBNY provided liquidity to Bear Stearns through its discount window. Bear Stearns' inability to borrow against even high-quality securities had prompted the FRBNY's action to open the discount window to major securities firms for the first time since the Great Depression.

(iii) Several U.S. regulatory agencies granted exemptions to facilitate the transaction and/or granted required approvals on an expedited basis. For example, the Comptroller issued an emergency rule granting national banks temporary authority to increase certain loans beyond normal lending limits (e.g., so as to allow JPMorgan Chase Bank to assist in funding Bear Stearns' operations). See also, e.g., Board Letters, July 1, 2008 (Section 23A exemption to allow JPMorgan Chase Bank to acquire from its parent a portfolio of derivative transactions and associated hedges that were acquired in connection with the acquisition of Bear Stearns), June 26, 2008 (Section 23A exemption to facilitate Maiden Lane Arrangement), Apr. 1, 2008 (temporary relief from application of Section 23A and BHC capital guidelines); 94 Fed. Res. Bull. C78 (2008) (Board approval of JPMorgan Chase's indirect acquisition of Bear Stearns Bank & Trust); FERC Order re: approval of JPMorgan Chase acquisition of Bear Stearns public utility subsidiaries, 123 FERC ¶ 61,088 (Apr. 28, 2008). For letters clarifying the SEC staff's position on certain matters, see JPMorgan Chase (avail. Mar. 19, 17, 16, 2008).

2. Merrill Lynch

   a. On September 15, 2008, following a tumultuous weekend of due diligence and negotiations, Bank of America agreed to acquire Merrill Lynch for common and preferred shares worth roughly $50 billion at the time (a value that dropped considerably by the time the transaction was consummated).

   b. On January 1, 2009, Bank of America completed its acquisition of Merrill Lynch. The merger created the then-largest brokerage in the world and enhanced Bank of America's wealth management, investment banking and international capabilities. See, e.g., NY Times, Sept. 15, 2008; Wall St. J., Sept. 15, 2008; American Banker, Sept. 14, 2008.

   c. On January 16, 2009, Treasury, the FDIC and the Board announced financial assistance to Bank of America in the form of an additional $20 billion equity investment from TARP, and a loss-protection arrangement for a pool of assets valued at $118 billion. In light of subsequent market improvements, the loss-protection arrangement was never consummated. See Report Pursuant to Section 129 of the EESA (Board, Aug. 27, 2009); Testimony of Board Chairman Bernanke before House Committee on Oversight and Reform, June 25, 2009; NY Attorney General Letter to Senate, House, SEC and COP, dated Apr. 23, 2009 (investigation relating to TARP investment in Bank of America).

   d. U.S. regulatory approvals for the Merrill Lynch acquisition include Bank of America, 95 Fed. Res. Bull. B13 (2009) (indirect acquisition of Merrill Lynch Bank & Trust); 125 FERC ¶ 61,181 (Nov. 17, 2008).

   e. The SEC conducted an investigation of Bank of America focusing on whether it adequately disclosed to shareholders Merrill Lynch's losses or executive bonus payments. Under the terms of its Settlement Agreement with the SEC, Bank of America agreed to pay $150 million. See SEC v. Bank of America, CCH Fed. Sec. L. Rep. ¶ 95,614 (SDNY 2010), SEC Litigation Release No. 21377 (Jan. 12, 2010). A shareholder class action suit alleging false and misleading statements by

Bank of America in connection with the acquisition of Merrill Lynch was also settled by Bank of America for $2.425 billion. See In re Bank of America, No. 09 MDL 2058 (PKC) (SDNY Apr. 9, 2013).

f. On March 26, 2014, the NY Attorney General announced a settlement with Bank of America and former CEO Kenneth Lewis for allegedly concealing and misrepresenting material financial forecasts while seeking shareholder approval of the merger with Merrill Lynch. Under the Settlement Agreement, Mr. Lewis is barred from serving as an officer or director of a public company for three years and is required to pay a $10 million fine. Bank of America agreed to various corporate governance reforms, including the retention of independent disclosure counsel, and to a fine of $15 million. NY Attorney General's Office Press Release, Mar. 26, 2014 (attaching Stipulation of Settlement).

3. Lehman

a. On September 15, 2008, faced with liabilities exceeding the reported value of its assets, Lehman filed for Chapter 11 bankruptcy. Prior to the filing, the Treasury and the Board had been actively trying to help Lehman put itself up for sale, but declined to commit public funds to support Lehman.

b. On September 16, 2008, Barclays, through its U.S. broker-dealer subsidiary, agreed to purchase out of bankruptcy substantially all of the assets, businesses and personnel of the U.S. capital markets unit of Lehman. By waiting until Lehman had filed for bankruptcy, Barclays was able to purchase only the parts of Lehman that it wanted, leaving behind the holding company and its troubled balance sheet.

c. The Bankruptcy Court overseeing the Lehman proceedings approved the purchase over various objections. Case No. 08-13555 (JMP) (Order) (Sept. 19, 2008). The Court indicated that the transaction, in which Lehman's core assets were sold in less than a week, should not be viewed as a precedent for other Chapter 11 bankruptcy cases. However, Lehman, the SEC, the Board, and SIPC all supported expedited review of the transaction, which was intended to minimize the loss in value of Lehman's operations, save jobs and stabilize market confidence.

d. U.S. regulatory approvals for the transaction include <u>Lehman Brothers Commodity Service</u>, 125 FERC ¶ 61,122 (Oct. 30, 2008); SEC Release No. 34-58612 (Sept. 22, 2008) (conditional relief from net capital rule relating to acquisition).

B. <u>LINKAGES BETWEEN BANKING ORGANIZATIONS AND SECURITIES FIRMS: JOINT VENTURES, "STRATEGIC ALLIANCES", AND OTHER ARRANGEMENTS</u>

1. <u>Joint Ventures Involving Financial Holding Companies and Financial Subsidiaries</u>

a. FHCs and financial subsidiaries generally have authority to engage indirectly in any "financial" or "incidental" activity without prior bank regulatory approval, including through a joint venture or controlling or non-controlling investment. <u>See</u> <u>Part I.C above</u>. Furthermore, the Board's Merchant Banking Regulations generally do <u>not</u> apply to investments in financial firms. <u>See</u> <u>Part VII.A above</u>. Consequently, an FHC/financial subsidiary investment in a joint venture engaged in a financial activity should generally be subject only to compliance with other laws (<u>e.g.</u>, Hart-Scott) and with after-the-fact notice requirements relating to control investments (and to the approval requirements of Dodd-Frank for certain large acquisitions).

(i) An example of a permissible alliance between FHCs is the retail brokerage joint venture between Citigroup and Morgan Stanley known as Morgan Stanley Smith Barney, in which Morgan Stanley paid $2.75 billion for a 51% interest in the joint venture, which employed approximately 18,500 financial advisers. <u>See</u> Citigroup SEC Form 8-K, dated June 3, 2009; <u>NY Times</u>, June 1, 2009.

In 2012, Morgan Stanley agreed to purchase Citigroup's remaining 49% interest in Smith Barney, which was valued at $13.5 billion, over the next three years.

Morgan Stanley purchased an additional 14% interest in Smith Barney in 2012 and completed its acquisition of the remaining 35% interest in 2013. See Board Letters, June 20, 2013 and May 24, 2012 (granting approval for the exercise of Morgan Stanley's options to purchase Smith Barney interests); Morgan Stanley Notice to Board (Dec. 19, 2012) (seeking approval to acquire remaining shares of Smith Barney under DFA § 163(b)'s financial stability standard for large non-bank acquisitions); Morgan Stanley SEC Form 10-Q Quarterly Report (June 2013).

(ii) Joint ventures can also be consistent with non-controlling equity investments between the co-venturers. For example, Morgan Stanley and Mitsubishi UFJ entered into a joint venture for U.S. loan marketing and other relationships, including an employee secondment agreement. Mitsubishi UFJ obtained Board approval to make a non-controlling investment in Morgan Stanley, which was subject to "passivity commitments" that imposed limits on business transactions between the two firms. See Part XII.C.5 below. See also NY Times, June 17, 2008 (private banking alliance in which SocGen bought 37% of Rockefeller Financial Services); see also RBS Complementary Order (joint venture with Sempra Energy).

(iii) If an investment is made in an entity which engages in "complementary" activities, prior Board approval would be required.

b. Nothing in Gramm-Leach would appear to limit an FHC's or financial subsidiary's authority to engage in joint ventures with an entity engaged in non-financial activities. However, it is unclear whether the federal banking agencies will impose cross-marketing or other restrictions to prevent a "matrix of relationships" between the co-venturers similar to the Board's practice regarding pre-Gramm-Leach proposals by BHCs. See Part XII.B.2 below.

2. Joint Ventures Involving Bank Holding Company Subsidiaries and Securities Firms Engaged Generally in Activities Impermissible to the Bank Holding Company

   The Board has approved joint ventures between BHC subsidiaries and securities firms to engage in permissible activities, although the Board has expressed concern that joint ventures could lead to a "matrix of relationships" between co-venturers that could erode the separation of banking and commerce, create conflicts of interest, or impair the ability of the BHC to function as an impartial credit provider. Joint ventures are also analyzed for possible adverse effects on competition and on the financial condition of the BHC.

   Board Supervisory Release SR 96-39 (APP) (Dec. 26, 1996) ("Board SR 96-39"), CCH Fed. Banking L. Rep. ¶ 59-177, discusses issues raised by joint venture proposals. As a condition to delegation of approval authority to Federal Reserve Banks, the BHC must (a) agree not to solicit business on behalf of its co-venturer and represent that it does not currently have or expect to have any other significant relationships with its co-venturer that would cause the BHC to be engaged in the activities of the co-venturer; and (b) commit that the joint venture will be treated as an affiliate for purposes of Sections 23A/23B, and as a "subsidiary" of the BHC for purposes of the BHCA. See also FRBNY Letter, June 11, 1999 (interpreting "no solicitation of business" commitment).

   Board SR 96-39 provides that joint ventures to engage in securities-related activities -- including brokerage and advisory activities -- or joint ventures where the co-venturer is engaged in securities-related activities, will not be processed by Federal Reserve Banks under delegated authority and may be subject to additional commitments. Board Orders which provide context in this area include:

   a. AMRO, 70 Fed. Res. Bull. 835 (1984) (the "AMRO Order"), approved an application under BHCA § 4(c)(8) to acquire a 50% interest in a joint venture (the "AMRO Joint Venture"), the other 50% of which would be owned by a company whose subsidiaries were engaged in mutual fund distribution. The AMRO Joint Venture proposed to engage in investment advisory and portfolio management services.

The AMRO Order was the Board's first approval of a joint venture between a banking organization and a securities firm in which the securities firm's interest was not passive. Compare Maybaco Co., 69 Fed. Res. Bull. 375 (1983) (mortgage banking joint venture between BHC and securities firm).

Subsequently, the FRBNY approved AMRO's application under BHCA § 4(c)(8) to acquire the remaining 50% of the AMRO Joint Venture. Letter, dated Dec. 29, 1987.

b. Fuji Bank, 75 Fed. Res. Bull. 94 (1989), approved an application under BHCA § 4(c)(8) to acquire 24.9% of the voting shares of Kleinwort Benson Government Securities ("KB-GSI") from KB. Fuji also proposed to hold subordinated debt of KB-GSI, provide it with capital support, acquire an option to purchase up to 80% of its voting shares and be represented on its board of directors and executive committee.

   Fuji subsequently exercised its option to acquire the remaining interest in KB-GSI. 54 Fed. Reg. 41871 (Oct. 12, 1989) (solicitation of public comments) (approved Dec. 8, 1989).

c. Wells Fargo, 76 Fed. Res. Bull 465 (1990), approved an application under BHCA § 4(c)(8) to form a joint venture (the "Wells-Nikko Joint Venture") with Nikko through Wells Fargo Bank, N.A., to engage in trust company and investment advisory activities through a 50.05% interest in Wells Fargo Institutional Trust Company, N.A., a limited-purpose national bank trust company, a 50% investment in Wells Fargo-Nikko Investment Advisors, and a 66.7% interest in Wells Fargo Funds Advisors.

   Wells Fargo and Nikko subsequently sold their interests in the Wells-Nikko Joint Venture. Barclays, 82 Fed. Res. Bull. 158 (1996).

d. SBC 1991 Order approved an application under BHCA § 4(c)(8) to form a joint venture (the "SBC-OCA Joint Venture") with O'Connor and Associates ("OCA"), whose principal activities were dealing in derivative instruments and other activities not permissible for BHCs, to (i) provide investment advice to SBC, its affiliates and OCA on futures; (ii) provide execution and advisory services to an SBC subsidiary for FX and derivative transactions; and (iii) trade for its own account as a specialist in Swiss franc options on the PSX and as a registered FX options trader.

SBC made an 80% equity investment in the SBC-OCA Joint Venture. Although SBC made commitments designed to separate the venture from OCA, OCA was to pay for investment advice based upon a percentage of OCA's profits, thus providing indirect linkage between the venture and otherwise impermissible activities.

Subsequently, SBC acquired the assets and liabilities of OCA. SBC 1995 Order.

e. Chuo Trust and Banking Company, 78 Fed. Res. Bull. 446 (1992), approved an application under BHCA § 4(c)(8) to form an investment advisory joint venture (the "Chuo-Seligman Joint Venture") with J. & W. Seligman & Co., a firm engaged in mutual fund activities.

Chuo acquired 51% of the Chuo-Seligman Joint Venture. Chuo had proposed that the name of the venture reflect its connection with Seligman, but the Board refused, citing a concern that common names would create the perception that the BHC had acquired a company engaged in impermissible activities. The name ultimately chosen was "Chuo Trust-JWS Advisors, Inc."

f. BNP-Neuberger Order, approved an application under BHCA § 4(c)(8) to engage with N&B, an entity engaged in mutual fund activities, in a joint venture (the "BNP-N&B Joint Venture") to provide investment and FX advisory and transactional services.

BNP acquired 50% of the BNP-N&B Joint Venture, which the Board permitted to provide investment advice with respect to mutual funds advised by the joint venture partners, subject to operating restrictions and to Section 225.125. Previously, the Board had concluded that a BHC non-bank subsidiary may act as an agent for the account of a customer respecting shares of an advised fund, but had refused to grant automatic relief to BHC joint ventures with respect to any mutual fund sponsored, advised, distributed or controlled by a joint venture partner. Board Mutual Fund Release. <u>See also</u> <u>Part VIII.C above</u>.

BNP also acquired a 10% to 13% non-voting, non-controlling special limited partnership interest in N&B under BHCA § 4(c)(6). BNP-N&B Letter.

g. <u>Pinnacle Bancorp</u>, 80 Fed. Res. Bull. 1023 (1994), approved an application under BHCA § 4(c)(8) for a joint venture with Gilbert Marshall & Co., a securities firm, to provide full-service brokerage.

h. <u>Crédit Agricole</u>, 82 Fed. Res. Bull. 754 (1996), approved an application under BHCA § 4(c)(8) to engage with Lazard Frères, an investment bank, in a joint venture to provide brokerage, advisory and related services. <u>See also</u> Letter to the Board, dated June 5, 1996.

i. <u>Bank of Ireland</u> [“<u>BOI</u>”], 82 Fed. Res. Bull. 1129 (1996), approved an application under BHCA § 4(c)(8) for a joint venture with Berger Associates to provide investment advisory and administrative services to Berger mutual funds. The Board allowed the mutual funds to bear the name “Berger/BIAM”.

j. <u>Morgan-American Century Order</u>, approved an application under BHCA § 4(c)(8) to acquire 45% of American Century Companies, which provide mutual fund advisory, brokerage and administrative services. Morgan committed that American Century’s broker-dealer subsidiary would cease to act as a fund distributor. The Board permitted limited director, officer and employee interlocks between Morgan and its subsidiaries (including American Century) and the American Century funds.

The SEC concluded that the Morgan/American Century “strategic alliance” would not constitute the acquisition by Morgan of “control” of American Century under the 1940 Act. <u>American Century Companies/Morgan</u> (avail. Dec. 23, 1997).

k. <u>HVB</u>, 64 Fed. Reg. 62204 (Nov. 16, 1999) (approved Jan. 7, 2000), approved an application under BHCA § 4(c)(8) to acquire a 20% interest in Babcock & Brown entities engaged in lending and equity financing, leasing, advisory services, brokerage, private placement and agency transactional services, and management consulting.

l. IBJ, 65 Fed. Reg. 19899 (Apr. 13, 2000) (solicitation of public comments) (approved Sept. 6, 2000), approved a joint venture with Nomura Securities to engage in investment advisory activities.

m. Board Letter re Northern Trust Corp., May 15, 2001, approved a minority interest in Equilend, an electronic securities lending platform, where other investors included Bear Stearns, Goldman Sachs, Lehman Brothers, Merrill Lynch, Morgan Stanley and four banking organizations.

See also Part VIII above.

3. Joint Ventures Involving Bank Holding Company Subsidiaries and Other Firms Engaged in Securities-related Activities

The Board has considered applications/notifications under BHCA § 4(c)(8) for BHCs to engage in joint ventures with securities firms that are not engaged (or are only minimally engaged) in Glass-Steagall impermissible activities. In these cases, the BHC ordinarily makes commitments regarding the venture's operation, but the Board has not generally required the same type of separation commitments as it required where one venturer is a full-service securities firm. See, e.g.:

a. NHB Holdings (approved Dec. 20, 2007) (joint venture with NRI Relocation to engage in mortgage banking).

b. HSH Nordbank (approved Oct. 5, 2007) (50% limited partnership interest in Estein & Associates USA to provide advisory and fund administrative services).

c. Boston Private Financial Holdings (approved July 2, 2012) (acquisition of an additional interest in Anchor Capital Advisors LLC to engage in advisory activities); 68 Fed. Reg. 65071 (Nov. 18, 2003) (solicitation of public comments) (approved Feb. 2, 2004) (acquisition of an interest in Bingham, Osborn &

Scarborough to engage in advisory activities), (approved Oct. 1, July 17, 2007, July 18, 2006) (acquisition of additional interests in Bingham, Osborn & Scarborough); 68 Fed. Reg. 69406 (Dec. 12, 2003) (solicitation of public comments) (approved Feb. 2, 2004) (acquisition of an interest in Dalton, Grenier, Hartman, Maher & Co. to engage in advisory activities); (approved Dec. 16, 2002) (acquisition of interests in Coldstream Holdings to engage in advisory and CPO activities).

d. Bankers Bancorp (approved June 19, 2007) (50% equity interest in Municipal Investment Management to provide advisory services to municipal clients), (approved Nov. 24, 2006) (25% interest in Bankers' Bank Investment Services to engage in securities brokerage, private placement services, and bank-eligible underwriting and dealing).

e. Legacy Integrity Group (approved May 17, 2006) (51% interest in Berry-Shino Securities to engage in advisory activities, brokerage and private placement services).

f. CenterState Banks of Florida (approved Sept. 7, 2004) (joint venture with Pinnacle Financial Corp. to originate, process, close, and sell real estate loans).

g. Northrim BanCorp (approved Apr. 27, 2004) (48% interest in Elliot Love Capital Management to engage in advisory activities).

h. Bank of Hawaii Corp. (approved Aug. 21, 2003) (joint venture with Chicago Equity Partners to engage in advisory activities).

i. Enterbank Holdings, 63 Fed. Reg. 63318 (Nov. 12, 1998) (solicitation of public comments) (approved Dec. 22, 1998) (8% interest in Argent Capital Management LLC to engage in advisory activities).

j. Bank One Corp., 85 Fed. Res. Bull. 65 (1999) (the "Bank One-EquiServe Order") (50% interest in EquiServe to engage in shareholder servicing; see Part IX.A above). See also Comptroller Corporate Decision No. 2005-06 (CBCA approval of acquisition of control of EquiServe's national bank subsidiary by Computershare Ltd.).

k. ANB Corp., 63 Fed. Reg. 49696 (Sept. 17, 1998) (solicitation of public comments) (approved Oct. 8, 1998) (15% interest in Indiana Trust & Investment Management Co. to engage in trust functions).

l. Norwest (approved Nov. 18, 1997) (20% interest in Smith Asset Management Group to engage in advisory activities).

m. Crédit Agricole, 62 Fed. Reg. 37058 (July 10, 1997) (solicitation of public comments) (approved Aug. 1, 1997) (retention by Crédit Agricole of an indirect 50% interest in Indosuez Investment Management Services); 55 Fed. Reg. 43218 (Oct. 26, 1990) (solicitation of public comments) (approved Nov. 23, 1990) (49.9% voting interest in Locasuez America to engage in making and servicing loans, advisory activities and leasing); Compagnie Financière de Suez, 75 Fed. Res. Bull. 717 (1989) (general partnership interest in Daniel Breen & Co. to engage in advisory activities) (see also FRBC Letter, dated Sept. 26, 1996, re: retention of such venture).

n. Rabobank, 62 Fed. Reg. 34453 (June 26, 1997) (solicitation of public comments) (approved July 21, 1997) (one-third (and up to 100%) interest in AEA Global Advisors, to engage in advisory activities, act as general partner and provide administrative services to investment partnerships and mutual funds (and place interests in such partnerships), and act as a CPO), 61 Fed. Reg. 41415 (Aug. 8, 1996) (solicitation of public comments) (approved Sept. 27, 1996) (51% interest in Agricredit Acceptance to engage in receivables financing).

o. TD Marketware Order (50% interest in Marketware International to develop and sell Internet brokerage computer software).

p. Mitsubishi Trust and Banking Corp., 61 Fed. Reg. 58070 (Nov. 12, 1996) (solicitation of public comments) (approved Dec. 16, 1996) (75% interest in Spectrum Capital to engage in lending and personal property leasing).

q. Greater Community Bancorp, 61 Fed. Reg. 34435 (July 2, 1996) (solicitation of public comments) (approved Aug. 2, 1996) (joint venture to engage in brokerage activities).

r. Woodforest Bancshares, 82 Fed. Res. Bull. 573 (1996) (up to 80% voting interest in Mutual Money Investments to provide brokerage services, underwrite and deal in eligible securities, provide data processing services and purchase and sell securities as riskless principal).

s. Summit Approval (joint venture with U.S. Clearing Corp. to engage in advisory and brokerage activities and maintain a dual employee arrangement with a third party insurance agent for the sale of annuities).

t. Commerzbank, 60 Fed. Reg. 38998 (July 31, 1995) (solicitation of public comments) (approved Aug. 28, 1995) ("Commerzbank Letter") (general partnership interest of at least 60% in Martingale Asset Management to engage in advisory activities).

u. Banco de Sabadell, 60 Fed. Reg. 17798 (Apr. 7, 1995) (solicitation of public comments) (approved May 15, 1995) (50% voting interest in PRS International Investment Advisory Services and PRS International Brokerage to engage in advisory, brokerage and FCM activities).

v. Creditanstalt-Bankverein, 80 Fed. Res. Bull. 828 (1994) (25% interest in Gulfstream Global Investors to engage in advisory/asset management activities), 80 Fed. Res. Bull. 143 (1994) (joint venture with Steinberg Asset Management to engage in advisory activities).

w. Cardinal Bankshares, 80 Fed. Res. Bull. 447 (1994) (joint venture with Compulife Investor Services to engage in brokerage and riskless principal activities through joint employees).

x. BWC Financial Corp., 59 Fed. Reg. 28106 (May 31, 1994) (solicitation of public comments) (approved July 18, 1994) (joint venture with Simonich Corporation to engage in mortgage brokerage).

y. Sakura Bank, 79 Fed. Res. Bull. 728 (1993) (60% interest in Dellsher Investment Company to engage in FCM and advisory activities).

z. LTCB, 79 Fed. Res. Bull. 371 (1993) (95.5% voting equity of Peers Holdings to engage in financial and real estate-related advisory activities), 75 Fed. Res. Bull. 719 (1989) (60% voting equity in LTCB-MAS Investment Management, Inc.; joint venture with Miller, Anderson & Sherrerd ("MAS") (see Part XII.C.7 below) to engage in advisory activities).

aa. Kredietbank, 58 Fed. Reg. 3281 (Jan. 8, 1993) (solicitation of public comments) (approved May 24, 1993) (joint venture with Darien Asset Management to engage in advisory and portfolio management activities).

bb. Meridian, 78 Fed. Res. Bull. 570 (1992) (acquisition of 50% of C.A.S.E. Management to engage in advisory activities), Board Letter, May 18, 1992 (commitments).

cc. NatCity, 78 Fed. Res. Bull. 552 (1992) (limited partnership interest in Reserve Capital Group to engage in private placement, advisory, management consulting and real estate-related activities).

dd. Michigan National Corp., 78 Fed. Res. Bull. 65 (1992) (75% general partnership interest in Independence One/Graimark; joint venture with Graimark Realty Advisors to engage in asset management, servicing and collection activities).

ee. CCF, 56 Fed. Reg. 46793 (Sept. 16, 1991) (solicitation of public comments) (approved Dec. 18, 1992) (up to 80% interest in Pilgrim Baxter Grieg Framlington & Associates to manage institutional equity portfolios).

ff. Matewan Bancshares, 57 Fed. Reg. 4882 (Feb. 10, 1992) (solicitation of public comments) (approved Apr. 10, 1992) (49% ownership interest in Hampden Venture Limited Partnership to make and service commercial loans).

gg. Mitsui Taiyo Kobe Bank, 77 Fed. Res. Bull. 116 (1991) (67% equity interest in Mitsui Taiyo Kobe Global Capital to engage in swap activities).

hh. Royal Scotland Order (50% interest in Continental Partners to engage in research/advisory activities).

ii. ABN AMRO, 76 Fed. Res. Bull. 29 (1990) (42% voting interest in DBI Holdings to engage in advisory, brokerage and riskless principal activities).

jj. Dresdner-Oeschle Order (49% limited partnership interest in Oechsle International Advisors to engage in advisory activities); investment subsequently sold to Fleet (approved Aug. 31, 1998) (see Part II.D.2.d above).

kk. Fuji M&A Order, 75 Fed. Res. Bull. 577 (1989) (general partnership interest in Fuji-Wolfensohn International to engage in M&A advisory activities). See also BTNY, 61 Fed. Reg. 31116 (June 19, 1996) (solicitation of public comments) (approved July 19, 1996) (BTNY acquisition of Wolfensohn & Co. and continuation of joint venture).

ll. Scandinavian Bank Group, 75 Fed. Res. Bull. 311 (1989) (50.5% ownership interest in Cambridge International Partners to engage in M&A activities).

mm. Yasuda Trust & Banking Co., 54 Fed. Reg. 51938 (Dec. 19, 1989) (solicitation of public comments) (approved Jan. 22, 1990) (50% voting interest in MASI, Ltd. to engage in M&A activities).

nn. SecPac, 54 Fed. Reg. 34552 (Aug. 21, 1989) (solicitation of public comments) (approved Nov. 14, 1989) (50% voting interest in Sumisei SecPac Investment Advisors).

oo. Independent Bankers Financial Corp. ["IBF"], 71 Fed. Res. Bull. 651 (1985) (the "IBF Order") (49% interest in joint venture to engage in municipal securities brokerage, the other 51% of which would be owned indirectly by Mills & Allen, a UK company engaged in securities and insurance brokerage). IBF committed to provide notice to the Board of any expansion in Mills & Allen's U.S. securities activities. One day after the IBF Order, Mills & Allen acquired Gintelco, a securities dealer, and IBF filed an application to retain its interest. The Board commented that the timing of the acquisition suggested that Mills & Allen had misrepresented its plans, but, in IBF, 72 Fed. Res. Bull. 664 (1986), approved the application.

pp. Bank of New York, 72 Fed. Res. Bull. 336 (1986) (50.1% interest in joint venture to engage in brokerage activities).

qq. Standard Chartered Order (50% interest in joint venture to engage in real estate and leasing-related advisory activities; see Part VII.B above).

See generally Board SR Letter 96-39 (Dec. 26, 1996).

4. Joint Ventures Involving Bank Holding Company Subsidiaries and/or Foreign Banks

The Board has also considered Applications/Notifications under BHCA § 4(c)(8) for BHCs or foreign banks to engage in joint ventures with other BHCs or foreign banks. The Board has not generally imposed the same type of restrictions on the interrelationships between the joint venturers, or between either joint venturer and the joint venture, as it does where one joint venturer is a securities firm. See, e.g.:

a. HSH Nordbank/West LB (approved Oct. 18, 2005) (joint venture to extend credit/service loans); HSH Nordbank Approval (joint venture to extend credit, service loans and act as an investment/financial adviser).

b. Tradepoint Order (investment by Morgan and UBS in 17% and 11%, respectively, of Tradepoint Financial Networks plc, which operated Tradepoint Stock Exchange (collectively, "Tradepoint")), and Deutsche Bank, 65 Fed. Reg. 7017 (Feb. 11, 2000) (solicitation of public comments) (collectively, the "Tradepoint Precedents"). See generally Securities Industry News, June 26, 2006 (Bank of America, Bear Stearns, E*Trade Financial Corp., Goldman Sachs purchase minority stakes in

CHX Holdings, parent company of the Chicago Stock Exchange); Securities Industry News, Apr. 10, 2006 (Goldman Sachs and UBS "strategic investments" in high-tech broker UNX); Sec. Reg. & L. Rep., Aug. 22, 2005 (Citigroup, CSFB, Morgan Stanley, UBS acquisition of 25% interest in the PSX).

c. HVB, Deutsche Bank, ABN AMRO, 86 Fed. Res. Bull. 56 (2000) (creation of Indentrus, a joint venture to coordinate certification authorities in connection with financial and non-financial transactions). See also HVB, 68 Fed. Reg. 66436 (Nov. 26, 2003) (solicitation of public comments) (acquisition by Indentrus of eFinance Corp. (credit bureau services)).

d. SBC, CSG, 62 Fed. Reg. 15711 (Apr. 2, 1997) (solicitation of public comments) (approved Apr. 18, 1997 (SBC), Apr. 18, 1997 (CSG)) (minority ownership interests in TradeWeb to engage in data processing activities).

e. RBC, 83 Fed. Res. Bull. 135 (1997) (the "Integrion Orders") (acquisition by three banking organizations of more than 5% of the voting interests in Integrion, a joint venture including banks and others for an electronic gateway for financial services); and see RBC, 63 Fed. Reg. 6760 (Feb. 10, 1998) (solicitation of public comments) (approved Mar. 27, 1998), and ABN AMRO, 63 Fed. Reg. 11447 (Mar. 9, 1998) (solicitation of public comments) (approved Apr. 10, 1998) (re: acquisition through Integrion of warrants to acquire 15% of CheckFree and engage in data processing/transmission); RBC, 61 Fed. Reg. 54441 (Oct. 18, 1996) (solicitation of public comments) (approved Aug. 14, 1997), and ABN AMRO, 62 Fed. Reg. 40528 (July 29, 1997) (solicitation of public comments) (approved Aug. 14, 1997) (acquisition by Integrion of data processing/transmission services of VISA Interactive); Comptroller Integrion Approvals. See also Part IX.F above.

f. Multinet Order (creation of Multinet International Bank ("Multinet") as a joint venture among banking organizations to act as an FX clearinghouse); and Board Letter, Dec. 2, 1997 (the "Board CLSSL-Multinet Letter") (acquisition of Multinet by CLS in conjunction with acquisition of Exchange Clearing House (London), as part of an FX settlement system

("CLS Bank"); because owners of Multinet would each own less than 5% of the voting securities of CLS, no BHCA § 4(c)(8) application would be required by reason of BHCA § 4(c)(6)). Multinet was ultimately dissolved (see NYBD Weekly Bulletin (May 12, 2000); Multinet, No. 98-122980 (dissolution order) (NY Sup. Ct., Apr. 18, 2000)).

g. RBC, 82 Fed. Res. Bull. 363 (1996) (acquisition of 20% of voting shares of MECA, a joint venture with U.S. banks with respect to financial management computer software). See Letter No. 677.

h. Chase-Mellon Approval; Mellon, Chase, 82 Fed. Res. Bull. 1041 (1996) (acquisition by ChaseMellon of Wells Fargo Bank's shareholder services business). See also Part IX.A above.

i. State Street, 81 Fed. Res. Bull. 1049 (1995) (joint venture with The First National Bank of Boston, N.A. to create BancBoston State Street Investor Services and engage in trust-related and data processing activities) (commitments set out in Letter to FRBB, dated Sept. 22, 1995).

j. CCF/BHF Order (jointly-owned Charterhouse North America to provide private placement and advisory services).

k. CCF, 57 Fed. Reg. 34779 (Aug. 6, 1992) (solicitation of public comments) (approved Dec. 18, 1992), Mellon, 57 Fed. Reg. 34569 (Aug. 5, 1992) (solicitation of public comments) (approved Dec. 11, 1992) (joint venture, CCF-Mellon Partners, to engage in advisory and money management activities).

l. SecPac, 73 Fed. Res. Bull. 749 (1987) (joint venture with Sumitomo to create Sumitrust Security Pacific Investment Managers).

See also Board SR Letter 96-39 (Dec. 26, 1996).

5. Joint Ventures and Other Arrangements Involving Banks and Non-banking Firms

   a. The Comptroller has approved joint ventures and related arrangements involving subsidiaries of national banks and non-banking firms, subject to the requirements that (i) the venture only engage in activities that are permissible for the bank, (ii) the bank have effective veto power over the venture's decisions, and (iii) the venture be subject to Comptroller supervision and examination. See Part I.D.4 above.

   b. Among the more significant Comptroller Letters and Approvals in the joint venture context with respect to securities-related activities are the following:

      (i) Approval No. 338 (mortgage banking, mortgage loan securitization, real estate loan closings, escrow services, appraisal, property inspection, real estate tax verification and payment and real estate mortgage foreclosure).

      (ii) Comptroller Conditional Approval No. 264 (Dec. 29, 1997) (origination, servicing and securitization of home mortgage loans/home equity lines of credit).

      (iii) Comptroller Conditional Approval No. 215 (Sept. 11, 1996) (origination/sale of commercial real estate loans).

      (iv) Comptroller Interpretive Letter No. 697 (Nov. 15, 1995), CCH Fed. Banking L. Rep. ¶ 81-012 (partnership that owns a trust company).

      (v) Comptroller Conditional Approval No. 165 (Dec. 30, 1994) (partnership to offer advisory and portfolio management services to high net worth U.S. citizens who wish to invest offshore).

      (vi) Comptroller 1994 Letter (joint venture with marketer of hydrocarbon products to facilitate financing, including through production payment rights).

(vii) Letter No. 630 (program with a securities firm to offer brokerage services through dual employees with the bank; bank would receive "finder's fees" for referrals to investment advisory affiliate of the securities firm).

(viii) Comptroller Interpretive Letter No. 625 (July 1, 1993), CCH Fed. Banking L. Rep. ¶ 83,507 (partnership with insurance company for retail sale of investment products, including securities and annuities).

(ix) Letter No. 622 (joint venture to broker securities, including shares of NationsBank-, Dean Witter- and third party- advised funds, annuities and UITs; describes framework for selling uninsured investment products).

Letter No. 622 also authorized NationsSecurities to enter into arrangements with unaffiliated depository institutions to operate securities and annuities programs. See also Part IX.E above.

(x) Zions First National Letter (partnership between a national bank and an investment adviser to provide advisory services to mutual funds).

(xi) Letter No. 517 (limited partnerships (in which a subsidiary of a securities firm would act as general partner) to make commercial loans and receive "equity kickers" in the form of warrants and stock appreciation and net profit participation rights). See also Comptroller Interpretive Letter No. 411 (Jan. 20, 1988), CCH Fed. Banking L. Rep. ¶ 85,635 (partnership with an affiliate of a securities firm to make merchant banking bridge loans).

(xii) Letter No. 516 (partnership with securities firms to engage in information analysis and execution services).

(xiii) Comptroller Unpublished Letter, dated Mar. 26, 1990, re: Wells Fargo Bank, N.A. (Wells-Nikko Joint Venture).

(xiv) Letter No. 496 (national bank subsidiary to act as general partner and CPO of financial products partnership to be offered to accredited investors), as modified in Comptroller Interpretive Letter No. 541 (Feb. 6, 1991) ("Letter No. 541"), CCH Fed. Banking L. Rep. ¶ 83,253.

(xv) Letter No. 423 (national bank subsidiary to act as managing general partner with an unaffiliated adviser in partnership that would invest in mortgage loans, MBS and participation certificates, and whose partnership units would be distributed to investors).

6. "Networking", Cooperation, "Strategic Alliance" and Other Arrangements

a. Arrangements with Broker-dealers and Other Service Providers

Banks may generate fees through "networking" or "kiosking" arrangements, whereby independent firms provide securities (and other) services to bank customers.

The GLBA Push-out Provisions permit banks that engage in "third-party brokerage arrangements" to maintain their exemption from 1934 Act broker-dealer registration requirements. Permissible arrangements encompass "contractual or other written arrangements" with SEC-registered broker-dealers under which the broker-dealer offers brokerage services on or off the premises of the bank. See Part IX.B above.

Banks have sought to develop client referral programs with respect to the offering of securities, advisory, financial planning, annuity, and insurance-related products. On the other hand, concerns have been expressed about ceding responsibility for programs to third party servicers.

Regulatory precedents in "networking" and related contexts include the following:

(i) Selected Federal Reserve Board Precedents

Banks may enter into arrangements under which broker-dealers provide uninsured products on bank premises. See Board Staff Opinion (July 12, 1994), Fed. Res. Reg. Serv. ¶ 3-447.12.

See generally Chestatee Bancshares (approved Nov. 17, 2005) (agreement with insurance/investment securities firms; fee-sharing).

(ii) Selected Comptroller of the Currency Precedents

A) Broker-dealers and investment advisers may provide brokerage and advisory services from leased space on bank premises, including through the use of dual employees, "percentage leases" (where the rental varies with the amount of business) and "commission splitting". See 12 C.F.R. § 7.3001. See also, e.g., Comptroller Interpretive Letter No. 680 (July 26, 1995), CCH Fed. Banking L. Rep. ¶ 83,628; Letters No. 630; No. 622; Comptroller Interpretive Letters No. 607 (Aug. 24, 1992), CCH Fed. Banking L. Rep. ¶ 83,445; No. 562 (Aug. 26, 1991), CCH Fed. Banking L. Rep. ¶ 83,313; No. 533 (Oct. 5, 1990), CCH Fed. Banking L. Rep. ¶ 83,244; Letter No. 499; Comptroller Interpretive Letters No. 441 (Feb. 17, 1988), CCH Fed. Banking L. Rep. ¶ 85,665; No. 406, No. 407 and No. 408 (Aug. 4, 1987), CCH Fed. Banking L. Rep. ¶¶ 85,630, 85,631, 85,632; Letter No. 370; Chief Counsel Letter, dated June 4, 1985; Comptroller Unpublished Letters (June 24, 1992), (Feb. 10, 1988). Compare Comptroller Unpublished Letter (Aug. 24, 1988) (lease arrangement with broker-dealer "was accomplished without regard to safety and soundness and in derogation of the national banking laws").

B) Comptroller Interpretive Letter No. 591 (June 18, 1992), CCH Fed. Banking L. Rep. ¶ 83,416, approved an arrangement pursuant to which funds deposited by a bank's corporate customers are swept daily into accounts held by an unaffiliated broker-dealer to be used either to pay creditors or to purchase shares of mutual funds. The bank advertises the availability of the service and receives a percentage fee. The Comptroller permitted this service to be introduced to customers of an unaffiliated bank which acts as a "finder". Comptroller Interpretive Letter No. 593 (July 1, 1992), CCH Fed. Banking L. Rep. ¶ 83,418. <u>See also Part VII.C above</u>.

(iii) <u>Selected Federal Deposit Insurance Corporation Precedents</u>

The FDIC has not objected to arrangements whereby broker-dealers provide brokerage services on the premises of non-member banks. <u>See</u>, <u>e.g.</u>, FDIC Financial Institutions Letter FIL-80-98 (July 16, 1998); FDIC Advisory Opinions No. 94-33 (July 28, 1994), CCH Fed. Banking L. Rep. ¶ 81,753; (Oct. 29, 1992) Opinion No. 92-74, Opinion No. 92-48; Letter No. 89-02; Letter No. 87-13; Letter No. 86-18; Letter No. 83-21. <u>See also</u> FDIC Activities Regulations (state bank may contract with broker-dealers for securities services on the bank's premises on the same terms and conditions as a national bank).

(iv) <u>Selected Securities and Exchange Commission and Other Federal and State Securities Regulatory Precedents</u>

Under circumstances described in Regulation R, banks and their employees need not register as broker-dealers under the 1934 Act. <u>See</u> <u>Part IX.B above</u>.

A) In 1997, NASD issued Rule 2350 regulating broker-dealer services on bank premises (the "<u>NASD Bank Premises Rule</u>"). <u>See</u> NASD

Notice to Members 97-89 (Dec. 1997); SEC Release No. 34-39294 (Nov. 4, 1997).

As part of the development of a consolidated rulebook, FINRA adopted NASD Rule 2350 in an amended form as FINRA Rule 3160. The amendments incorporate provisions of the GLBA and Regulation R. See 75 Fed. Reg. 13632 (Mar. 22, 2010).

B) The federal banking agencies and the NASD entered into an agreement to regulate broker-dealers affiliated with banks that sell non-deposit investment products on bank premises. See Regulatory Coordination Agreement.

C) SEC staff has indicated that, while transaction-related compensation is permitted for dual employees of a broker-dealer/bank, commission payments permitted for bank employees are not appropriate for employees of entities which are not depository institutions (e.g., affiliated corporations, BHCs, financial planners, consultants, money managers, etc.). Principal SEC no-action letters of the past several years with respect to such arrangements (which could be relevant to interpretations of Regulation R) include:

i) Insurance Networking Arrangements (avail. Apr. 23, 2013) (no-action relief for insurance agencies to (a) enter into insurance networking arrangements with broker-dealers for the offer and sale of insurance securities products, and (b) pay commissions and other transaction-based payments to dual registered representatives based on the sale of insurance securities products). See also M Financial Holdings (avail. May 8, 2006); First of America Brokerage Service (avail. Sept. 28, 1995).

ii) AngelList LLC (avail. Mar. 28, 2013) (investment adviser and lead "angel" investor may receive carried interest from investment vehicles formed for other "angel" investors in particular portfolio companies).

iii) Social Finance Inc. (avail. Nov. 13, 2014) (non-profit could receive non-transaction-based compensation for assisting other not-for-profit social providers in obtaining funding through the offer and sale of "social impact bonds" without registering as a broker-dealer).

iv) Capital Institutional Services (avail. Apr. 13, 2007) (vendors may receive non-transaction-based compensation for "research services").

v) Welton Street Investments (avail. June 27, 2006) (real estate agents may be associated with broker-dealer and receive fees as independent contractors).

See also, e.g., Attkisson Carter & Akers (avail. June 23, 1998); Somerset Group (avail. Dec. 20, 1996); Standard Federal Bank (avail. Aug. 18, 1995); Chubb Securities Corp. (avail. Nov. 24, 1993); INVEST Financial Corp. (avail. Aug. 27, 1993); Financial Network Investment Corp. (avail. Aug. 16, 1993); Bekhor Securities Corp. (avail. Aug. 12, 1993); Independent Financial Securities (avail. July 21, 1993); Mid-Hudson Savings Bank (avail. May 28, 1993); Bankers Financial Partners (avail. May 14, 1993); Coast Federal Bank (avail. May 13, 1993); Independence One Bank of California (avail. Apr. 6, 1993); Capital Securities Investment Corp. (avail. Feb. 3, 1993); UVEST Financial Services Group (avail. Nov. 24, 1992); Liberty Securities Corp. (avail. Oct. 21, 1992); MidAmerica Management Corp. (avail. July

16, 1992, June 12, 1988); Dime Savings Bank (avail. June 30, 1992); Retirement System Distributors (avail. Feb. 7, 1992) ("affinity" relationships between a broker-dealer and trade associations and networking relationships with financial institution members of such associations). See also NASD Letter, dated Dec. 16, 1998 ("asset-gathering" point system for dual bank/broker-dealer employees permissible so long as no part of compensation paid was "directly" attributable to securities commissions).

D) Other SEC no-action letters relate to alternative business arrangements involving unregistered entities as employers of broker-dealer securities personnel, or as service providers to the broker-dealer. See, e.g., Investment Archive (avail. May 14, 2010); ADP TotalSource (avail. Dec. 4, 2007) (stating that the SEC "will no longer respond to letters in this area unless they present novel or unusual issues"); eEmployers Solutions (avail. Dec. 3, 2007); TriNet Group (avail. Feb. 17, 2006); R & H Management (avail. Apr. 25, 2005); Investacorp Group (avail. Sept. 26, 2003); Headway Corporate Staff Administration (avail. Aug. 14, 2002); EPIX Holdings (avail. Mar. 12, 2001); Staff Management (avail. Apr. 27, 2000); EMPOWER (avail. Feb. 1, 1994).

E) For examples of SEC denials of requested no-action positions in the networking or "employee leasing" context (principally concerning arrangements that failed to assure adequate supervision, with entities other than depository institutions, or where compensation or employee-sharing arrangements were considered inappropriate), see, e.g., Brumberg, Mackey & Wall (avail. May 17, 2010); Herbruck, Alder & Co. (avail. May 3, 2002); Century Business Services (avail. Apr. 1, 2002); First Global (avail. May 7, 2001) (partial denial); Lincoln Financial

Advisors Corp. (avail. Feb. 20, 1998); BCS Financial Corp. (avail. Oct. 3, 1996); G.R. Phelps & Co. (avail. Dec. 12, 1991); Landmark Savings Association (avail. Feb. 14, 1990); First Federal Savings & Loan (avail. Jan. 19, 1989); Arkansas Federal Savings Bank (avail. June 2, 1988).

F) The SEC expressed particular concern over kiosking and lobby sales where the institution sells its own securities or those of its parent. See generally, e.g., USLICO Securities Corp. (avail. Apr. 17, 1990); Letter, dated Dec. 13, 1989, from SEC Associate Director Zipoy to depository institutions; St. Paul Federal Bank for Savings (avail. Oct. 13, 1988); Naples Federal Savings & Loan (avail. Sept. 9, 1988).

G) NASAA Model Rules for Sales of Securities at Financial Institutions track the NASD Bank Premises Rule in most respects, incorporate provisions from the Interagency Statement, and include an exception for broker-dealer services to "non-retail customers".

See also Part VIII above.

b. "Strategic Alliances" and Similar Arrangements

Not every relationship or "strategic alliance" between a bank and a non-banking entity takes the form of a corporation, LLC, joint venture, partnership or other legal entity structure. Past examples include: (i) Citizens Bank strategic alliance with Hub International to provide insurance products and services; (ii) Commerzbank alliances with Compass Partners to provide cross-border M&A advisory services, and with Key Bank to provide international banking services; (iii) Deutsche Bank "joint marketing venture" with Ameritrade to allow U.S. investors access to European securities; and (iv) Bank of America "strategic alliance" with D.E. Shaw & Co. to provide Bank of America customers access to D.E. Shaw & Co.'s financial strategies (see also Release No. 34-44613) (SEC administrative action against Bank of America relating to accounting treatment of loan to D.E. Shaw & Co.; Part VIII.D above). See, e.g., Insurance Journal, Mar. 1, 2006; American Banker, Nov. 20, 1998; Euromoney, Apr. 1997; Risk, Apr. 1997; Investment Dealers' Digest, Mar. 17, 1997.

Cf. also Letter No. 504, (national bank to pay finders for marketing bank trust services; existence of joint venture depends on state law); Comptroller Interpretive Letter No. 434 (June 27, 1988), CCH Fed. Banking L. Rep. ¶ 85,658 (bank to acquire subordinated note of adviser to issuers of tax-exempt debt convertible into 18% of the issuer's capital, as well as option to acquire substantially all of the issuer's assets; for a fee, the issuer would refer to bank opportunities to privately place municipal and corporate obligations and to underwrite eligible municipal obligations); Comptroller Trust Interpretive Letter No. 78 (Mar. 4, 1987) (to similar effect as Letter No. 504).

7. Investments in Specialized Entities Engaged in Securities Activities

Federal bank regulators have approved joint arrangements between banking and securities organizations effected through investments in brokerage, clearing and related entities.

a. The Board and the Comptroller approved BHC/national bank investment in clearing/settlement organizations. See, e.g., CLSAS Letter (acquisition by CLS Bank of CLS Aggregation Services to provide FX aggregation services), and Board CLSSL-Multinet Letter (see also Part XI above); Board Letters, July 21, 1997 (Emerging Markets Clearing Corporation), Apr. 18, 1988 (GSCC) (BHCs may each acquire up to 5% of shares without filing an application under BHCA § 4(c)(8) by reason of BHCA § 4(c)(6)); Comptroller Interpretive Letter No. 993 (May 16, 1997); Integrion Orders; Comptroller Interpretive Letter No. 421 (Mar. 14, 1988), CCH Fed. Banking L. Rep. ¶ 85,645 (national bank may acquire shares in GSCC as an incident to participation in the clearing system). See also, e.g., Comptroller Interpretive Letter No. 543 (Feb. 13, 1991), CCH Fed. Banking L. Rep. ¶ 83,255 (national bank may acquire shares of corporation to furnish trading data collection services).

The OCC has also authorized national banks to become members of various payment, settlement and clearing organizations without making an equity investment in the organization. See, e.g., Comptroller Interpretive Letters No. 1140 (Jan. 13, 2014), CCH Fed. Banking L. Rep. ¶ 81-669(RMB CHATS, a provider of interbank payment services in Renminbi), No. 1122 (ICE Clear Europe, a clearinghouse for OTC credit derivatives); No. 1113 (ICE Trust U.S. LLC, a clearinghouse for OTC credit derivatives); Letter No. 1102 (Mumbai branch of a national bank may offer clearing and settlement services in India as a custodial clearing member of the National Securities Clearing Corporation Limited subject to limits on the bank's exposure to the clearing organization for defaults of other members).

b. The Board approved BHC and foreign bank applications under BHCA § 4(c)(8) to acquire interests in Government Pricing Information System ("GovPx") and thereby engage in data processing and transmission services respecting government securities prices. See, e.g., IBJ, 61 Fed. Reg. 15946 (Apr. 10, 1996) (solicitation of public comments) (approved May 1, 1996); SBC, 60 Fed. Reg. 26726 (May 18, 1995) (solicitation of public comments) (approved June 30, 1995); UBS, 60 Fed. Reg. 10588 (Feb. 27, 1995) (solicitation of public comments) (approved Mar. 17, 1995); Bank of Montreal, 59 Fed. Reg. 28859 (June 3, 1994) (solicitation of public comments) (approved July 20, 1994); BTNY et al., 58 Fed. Reg. 6639 (Feb. 1, 1993) (solicitation of public comments) (approved May 4, 1993).

c. The Board approved the application under BHCA § 4(c)(8) of 14 BHCs to acquire interests in Liberty Brokerage, an interdealer broker in U.S. government securities, through a joint venture with 16 securities firms. BankAmerica, 73 Fed. Res. Bull. 361 (1987).

The Board also approved the acquisition by 4 BHCs of non-voting shares of TGB Corporation, a broker for primary dealers in government securities, concluding that no Application under BHCA § 4(c)(8) was required by reason of BHCA § 4(c)(6). Board Letter, May 15, 1989 (approval granted on condition that aggregate investment by all BHCs not exceed 25% of TGB's capitalization and that there be no shared employees between TGB and investing BHCs).

See also, e.g., Tradepoint Precedents.

d. The Board and the Comptroller approved BHC/national bank investment in various specialized depositories and related entities. See, e.g., Comptroller Unpublished Letter (Feb. 16, 1989) (Participants Trust Company); Comptroller Interpretive Letter No. 380 (Dec. 29, 1986), CCH Fed. Banking L. Rep. ¶ 85,604 (Chicago Board of Trade Clearing Corp.); Comptroller Unpublished Letter (Aug. 18, 1980) (corporations performing permissible banking activities); Comptroller Unpublished Letter (Dec. 19, 1975), and Letter, dated Dec. 20, 1973 (Depository Trust Company; see also 1996 DTC Approval Letter); Board Letter, Jan. 31, 1974 (Student Loan Marketing Corp.).

e. The Board, Comptroller and FDIC concluded that banks may acquire stock of Farmer Mac as an incident to participation in the secondary market for agricultural real estate. See Regulation H 1998 Revisions (12 C.F.R. § 208.101); Board Letter, July 26, 1988; Comptroller Interpretive Letter No. 427 (May 9, 1988), CCH Fed. Banking L. Rep. ¶ 85,651; FDIC Advisory Opinion No. 93-51 (July 30, 1993), CCH Fed. Banking L. Rep. ¶ 81,665.

f. National banks may invest in preferred stock of Freddie Mac, and in certain circumstances in FHLB stock in excess of the minimum amount required for FHLB membership. See Comptroller Interpretive Letters No. 931 (Mar. 15, 2002), CCH Fed. Banking L. Rep. ¶ 81-456; No. 755 (Oct. 3, 1996), CCH Fed. Banking L. Rep. ¶ 81-119; No. 577 (Apr. 6, 1992), CCH Fed. Banking L. Rep. ¶ 83,347.

g. Letter No. 692 concluded that national banks may purchase units in an LLC organized by the state of North Carolina to implement a program of higher education financing. The Board approved BHC participation pursuant to BHCA § 4(c)(8). First Union Corp., 81 Fed. Res. Bull. 1042 (1995).

C. <u>NON-CONTROL INVESTMENTS</u>

1. Numerous banking organizations have made non-controlling investments in other entities engaged in securities, asset management and other capital markets-related activities, and vice versa. See also Part VII above for additional precedents relating to "control" issues.

   The relationship between Goldman Sachs and Sumitomo was the subject of significant Board analysis.

   a. In 1986, the Board approved the investment by Sumitomo of $500 million in a limited partnership interest and subordinated debt in Goldman Sachs under BHCA § 4(c)(6). See Sumitomo Letter, Proposed Investment by Sumitomo Bank Deemed Consistent with [BHCA], 73 Fed. Res. Bull. 24 (1987).

      (i) The Board determined that Sumitomo's original proposed investment would not have been passive and non-controlling for BHCA purposes since (A) Sumitomo's total investment, including subordinated debt, would have exceeded 25% of Goldman Sachs' total equity; (B) Sumitomo would have had representation on the boards of directors of Goldman Sachs subsidiaries in Tokyo and London and the name of the London subsidiary would have reflected an affiliation with Sumitomo; (C) Sumitomo and Goldman Sachs would have operated foreign joint ventures; (D) the investment was expected to result in increased business relationships, in part through referrals; and (E) Sumitomo employees could have been transferred to Goldman Sachs as trainees and could have been used to solicit business from Japanese companies. The Board was concerned that this combination of equity investment and business relationships would give Sumitomo the economic incentive and means to exercise a controlling influence over Goldman Sachs' management or policies.

      (ii) The Board approved the investment as a "truly passive non-controlling investment" (Board Release, Nov. 19, 1986) after Sumitomo made the following changes:

A) Sumitomo's total investment in Goldman Sachs, including both partnership interests and subordinated debt, would not exceed 24.9% of Goldman Sachs' total capital.

B) Sumitomo's name would not be used by any Goldman Sachs affiliate or vice versa; Sumitomo would not acquire any stock in, or have any directors on the board of, any Goldman Sachs affiliate (although Sumitomo later received relief for an investment in a real estate fund sponsored by Goldman Sachs; see Board Letter, Oct. 2, 1997).

C) No Sumitomo employees would be trainees of Goldman Sachs (although Sumitomo later received relief for 2, and then 3, lower level employees, as well as the visit (for a 1-month period) of junior staff personnel who would visit four financial institutions, including Goldman Sachs (Board Letters, Nov. 22, Aug. 11, 1993, Oct. 27, 1988)).

D) Sumitomo would not solicit any business for Goldman Sachs or vice versa, nor would Sumitomo introduce Goldman Sachs to customers, or vice versa, unless in response to a specific customer request, and any such introduced business would not exceed 2.5% of the annual consolidated gross revenues of the recipient of the introduction.

E) Business relationships would be maintained on an arm's-length, non-exclusive basis, and there would be no advertising or marketing of each other's services.

F) Sumitomo would enhance its capital by an amount that would substantially offset the funds invested in Goldman Sachs.

G) Sumitomo would waive any right to select Goldman Sachs' general partners under New York law, and would not have the right to participate in the selection of Goldman Sachs' general partners or management.

H) Sumitomo's investment would be terminated if the Board found that Sumitomo had the power to exercise a controlling influence over Goldman Sachs.

(iii) In connection with Goldman Sachs' IPO Sumitomo exchanged its limited partnership interests for shares of common stock, reducing its investment to 6.3%. In connection with a secondary offering by Goldman Sachs, Sumitomo sold additional shares, reducing its stake to 3.6%, and in 2002 Sumitomo sold the last of its shares in Goldman Sachs. See Board Letter, Feb. 6, 2003 (the "2003 Goldman-Sumitomo Letter").

b. In the 2003 Goldman-Sumitomo Letter, the Board considered whether Goldman Sachs would control Sumitomo for purposes of the BHCA or the CBCA as a result of Goldman Sachs' investment in, and business relationships with, Sumitomo.

(i) Goldman Sachs' relationship with Sumitomo involved three components:

A) Goldman Sachs invested approximately $1.3 billion in Sumitomo non-voting convertible preferred stock, representing approximately 5% of Sumitomo's total equity. Commencing two years after issuance, the preferred stock initially would be convertible into 7.4% of Sumitomo's common stock but would convert into a greater percentage (up to a maximum of 19.4%) if the market price of the common stock fell.

In connection with the preferred stock conversion feature, Goldman Sachs committed to limit its ability to hold, vote or transfer any shares of Sumitomo's common stock that it received in excess of 10%. In particular, Goldman Sachs committed that, in the event of a decline in the market price of

Sumitomo's common stock such that the preferred stock would represent, on a pro forma basis, 10% or more of Sumitomo's outstanding common stock (i) Goldman Sachs would not convert preferred stock such that Goldman Sachs would hold more than 9.9% of Sumitomo's common stock (Goldman Sachs could hold more than 9.9% on a temporary basis in order to sell the common stock, but would not vote more than 9.9%); and (ii) sales by Goldman Sachs of shares of Sumitomo's common stock that exceed 10% would be made only (a) in a widely dispersed public offering, (b) in private sales in which no purchaser or group of related purchasers would acquire from Goldman Sachs more than 2% of Sumitomo's common stock, (c) to a purchaser acquiring majority control of Sumitomo, or (d) as approved by the Board.

B) As a condition to Goldman Sachs' investment, Sumitomo agreed to issue letters of credit for the benefit of Goldman Sachs that would allow Goldman Sachs to hedge the credit risk arising from a lending program (the "Sumitomo L/Cs"). Under the program, a Goldman Sachs affiliate would extend approximately $55 billion in credit facilities.

The credit arrangements allow Sumitomo to participate in selecting eligible borrowers, and prohibit Sumitomo from entering into similar credit arrangements with Goldman Sachs' competitors.

The Board stated that "there are no comparable transactions in the market".

C) Goldman Sachs and Sumitomo also entered into a five-year cooperation agreement relating to Japan-based financial transactions. The agreement gave Goldman Sachs a priority in (i) selling certain investment products to Sumitomo's retail customers, (ii) providing investment banking services to Sumitomo, (iii) purchasing certain Japan-based assets from Sumitomo, and (iv) co-investing with Sumitomo in Japan-based merchant banking investments. The agreement also obligates Goldman Sachs to include Sumitomo in certain Japan-related loan syndications and to encourage Goldman Sachs' customers to use Sumitomo for Japanese banking services.

Sumitomo would be prevented from entering into similar arrangements with Goldman Sachs' competitors.

(ii) The Board noted that the size and nature of Goldman Sachs' equity investment, when combined with the unique nature of the Sumitomo L/Cs, raise the issue of whether Goldman Sachs has a significant influence over the policies and management of Sumitomo, and stated that "[t]he Board typically has been concerned that a company has acquired control of a [BHC] for [BHCA] purposes if the company (A) acquires more than 10% (or instruments convertible into more than 10%) of a class of voting securities of the bank holding company; <u>and</u> (B) has significant business relationships or off-market business relationships with the [BHC]" (emphasis in original).

To address concerns that Goldman Sachs might have the ability to exercise a controlling influence over Sumitomo:

A) Goldman Sachs' investment would represent less than 5% of Sumitomo's total equity.

B) Goldman Sachs' investment, if converted at the initial conversion price, would represent only 7.4% of Sumitomo's common stock and would not under any circumstances be convertible into more than 19.4% of Sumitomo's common stock.

C) Goldman Sachs would not hold or vote more than 9.9% of Sumitomo's common stock.

D) Any sales of shares of Sumitomo's common stock beyond 10% would be made in a widely dispersed manner.

E) No director, officer, employee or representative of Goldman Sachs would serve as a director, officer or employee of Sumitomo.

F) Goldman Sachs would not be the largest shareholder of Sumitomo. (The largest shareholder would be the Japanese government.)

G) The transactions would not involve the U.S. subsidiary bank (or any other U.S. offices) of Sumitomo.

H) Goldman Sachs would provide "passivity commitments". Although such commitments would permit Goldman Sachs and Sumitomo to maintain business relationships, Goldman Sachs (i) indicated that the proposed Sumitomo L/C arrangements and the business cooperation agreement were expected to generate less than 1% of the total annual revenues of each of Goldman Sachs and Sumitomo; and (ii) committed that all other business relationships between Goldman Sachs and Sumitomo would generate less than 0.5% of the total annual revenues of each of Goldman Sachs and Sumitomo.

2. Board Letter, Oct. 24, 1995, determined that Eaton Vance Corp. ("Eaton Vance") would not be deemed to control Investors Bank & Trust Company ("IBTC") for purposes of the BHCA after divesting its 77.3% interest in the sole class of IBTC's voting securities in connection with a spin-off and IPO of IBTC, even though, in the aggregate, officers and directors of Eaton Vance would control approximately 19.2% of the combined voting power and approximately 14.7% of the common shares of Investors Financial Services Corp. ("IFSC"), the holding company that would hold the IBTC shares as a result of the spin-off.

Eaton Vance committed to the Board that (a) no officer or director of Eaton Vance or its subsidiaries would serve as a director, officer or employee of IFSC or IBTC; (b) Eaton Vance and its subsidiaries, officers and directors would not acquire, in the aggregate, 25% or more of any class of voting securities of IFSC; (c) Eaton Vance or its subsidiaries would not acquire, in the aggregate, 5% or more of any class of voting securities of IFSC; and (d) Eaton Vance and its subsidiaries (and their officers and directors) would not expand beyond the existing business relationships with IBTC and IFSC (and their officers and directors), and all existing relationships would be conducted on arm's-length terms. The Board noted that IBTC's business relationships with Eaton Vance generated approximately 21% of IBTC's net operating revenue.

3. Board staff informally advised that a BHC may engage in certain strategic business relationships with an unaffiliated securities firm engaged in impermissible activities in which the BHC had made a small (i.e., less than 5%), non-controlling investment. See, e.g., FBR Prospectus for shares of Class A Common Stock of Friedman Billings Ramsey Group ("FBR"), which described a 4.9% investment by PNC and an MOU between PNC and FBR pursuant to which PNC and FBR would cross-refer business and explore other capital markets relationships; FBR would be the exclusive broker-dealer to which PNC refers underwriting and high-yield business, PNC would provide derivatives, asset securitization, bridge lending and other financing products to FBR's client base, and FBR would include PNC as a co-lead underwriter or co-placement agent on referred business.

4. Board Letter, Nov. 19, 2007, permitted Bear Stearns to create an Employee Stock Ownership Plan Trust to hold 17% of the voting shares of Bear Stearns on behalf of 20% of its employees (i.e., not merely senior executive officers or management officials), without Bear Stearns losing grandfather rights under BHCA § 4(f) related to ownership of a state non-member bank (Custodial Trust Company), under circumstances where such grandfather rights would not be available to a company which might acquire control of Bear Stearns.

   The Board Legal Division indicated that it would not recommend that (a) the Board find that the Trust would control Bear Stearns or Custodial Trust Company for purposes of the BHCA, (b) the Trust be deemed to be a BHC, or (c) Bear Stearns lose its grandfather rights, under circumstances where (i) an unaffiliated bank would act as trustee and administrator of the Trust; (ii) the Trust would not have any directors, officers or employees, and would not engage in any activities other than holding and voting Bear Stearns shares; (iii) the Trust would vote the shares held on behalf of an employee in accordance with instructions received from the employee (and any unallocated shares in the Trust (e.g., shares held by the Trust if an employee terminates employment before the employee's shares have vested), as well as any shares for which no voting instructions have been received from the relevant employee, would be voted by the Trust in the same percentages as allocated shares for which voting instructions were received); and (iv) the Trust (A) would not, without the Board's prior approval, acquire 25% or more of any class of the voting securities or otherwise acquire control of any bank or BHC, Bear Stearns or Custodial Trust Company; (B) would notify the Board prior to acquiring any non-voting equity interest in any bank or BHC, Bear Stearns or Custodial Trust Company; and (C) would not make any investments that could not be made by a BHC under the BHCA, and would notify the Board prior to acquiring more than 5% of the voting securities of any company other than Bear Stearns.

5. The Board approved an investment by Mitsubishi UFJ of up to 24.9% of the voting shares of Morgan Stanley. See Mitsubishi UFJ Financial Group, 95 Fed. Res. Bull. B34 (2009). The Board relied on "passivity commitments" (Mitsubishi UFJ Letter to the Board, dated Oct. 7, 2008) that permitted Mitsubishi UFJ to have one director representative on the Morgan Stanley board and one representative as an observer at board meetings. In addition, Mitsubishi UFJ's commitment regarding transactions with Morgan Stanley includes an exception for transactions in the ordinary and usual course of business on arm's length terms.

   Mitsubishi UFJ completed its initial investment in Morgan Stanley by purchasing preferred stock, and subsequently acquired Morgan Stanley common stock. Mitsubishi UFJ's authority to make additional investments in Morgan Stanley expired in April 2011. As of June 2011, Mitsubishi UFJ was deemed (including in the context of preferred stock conversion rights) to own 19.2% of Morgan Stanley's voting shares. In June 2011, in connection with Mitsubishi UFJ's proposal to convert all of its convertible preferred stock into

Morgan Stanley common stock and make additional acquisitions of Morgan Stanley shares, the Board issued a second order authorizing Mitsubishi UFJ to acquire up to 24.9% of the voting shares of Morgan Stanley. See Mitsubishi MS 2011 Order.

In connection with the Mitsubishi MS 2011 Order, the Board determined that Mitsubishi UFJ's investment in Morgan Stanley would continue to be non-controlling even if two representatives of Mitsubishi UFJ serve on the board of directors of Morgan Stanley (which Mitsubishi UFJ sought in order to adopt the equity method of accounting for its investment in Morgan Stanley). Mitsubishi UFJ committed that (a) Mitsubishi UFJ members would not constitute more than 15% of the membership of the board of Morgan Stanley, (b) neither Mitsubishi UFJ representative could second a motion of the other, and (c) Mitsubishi UFJ's representatives could cast only one vote on any board committee or subcommittee. The Board also considered that a majority of the members of the Morgan Stanley board would continue to be independent of management, Mitsubishi UFJ and other investors, and that Morgan Stanley is a substantial organization in its own right. Furthermore, the Board considered Mitsubishi UFJ's record of compliance with its prior passivity commitments and its agreement to maintain at least a 20% proportional interest in Morgan Stanley and to support Morgan Stanley's efforts to obtain funding from other sources. See also Board Letter, Apr. 22, 2011.

6. The Board issued two letters, dated Dec. 15, 2009, and Dec. 30, 2011, stating that Barclays PLC and Bank of America, respectively, did not control BlackRock for purposes of the BHCA.

    a. The first letter confirmed that Barclays PLC would not control BlackRock for purposes of the BHCA as a result of Barclays (i) making an equity investment in BlackRock constituting 4.9% of the voting common shares and 19.9% of the total equity of BlackRock, (ii) having two director representatives on BlackRock's board, and (iii) having certain business relationships with BlackRock. The investment did not trigger a presumption of control under the Board's Regulation Y because of the presence of other large shareholders of BlackRock.

The preferred shares that Barclays acquired are convertible into voting shares upon transfer and allow Barclays to control the disposition of 38.6% of BlackRock's common stock. In addition to the standard passivity commitments (including "blocker" provisions regarding transfers of the preferred shares), Barclays committed not to transfer shares of BlackRock to unaffiliated third parties constituting, in the aggregate, more than 33.3% of BlackRock's common stock. The Board also relied on certain transfer restrictions in a shareholders agreement between Barclays and BlackRock that limited the influence that Barclays might otherwise have over BlackRock as a result of Barclays' shareholdings.

Barclays acquired its equity interest in BlackRock as a result of BlackRock's acquisition of BGI from Barclays, and the two firms proposed to have continuing business relationships. The Board permitted non-exclusive, ordinary course, arm's-length business transactions, provided that the gross revenue to either party from such transactions does not exceed more than 2.5% of such party's consolidated gross revenue. <u>See also</u> Comptroller Conditional Approval No. 934 (Nov. 19, 2009) (approving BlackRock's acquisition of control of BGI under the CBCA).

In May 2012, Barclays announced the sale of its remaining 19.6% interest in BlackRock valued at $6.1 billion, of which $1 billion was purchased by BlackRock itself. <u>See</u> <u>Wall St. J.</u>, May 21, 2012.

b. The second letter confirmed that Bank of America would no longer be deemed to control BlackRock for purposes of the BHCA as a result of Bank of America's (i) owning less than 1% of the voting and total equity of BlackRock, (ii) no longer having a right to have a representative on BlackRock's board of directors, and (iii) <u>de minimis</u> business relationships. In making its determination, the Board noted that where one company has controlled another company for a significant period of time, the first company may be able to continue to exert a controlling influence even after a substantial divestiture. The Board found that three factors supported the non-control determination:

(i) Bank of America had divested or reduced its investment to below 5% of each of the voting shares and the total equity of BlackRock, which would not trigger a rebuttable presumption of control under the BHCA;

(ii) Bank of America's remaining investment conformed to the Board Control Guidance; and

(iii) Another entity (PNC) had a larger voting and equity ownership interest in BlackRock and was considered to control BlackRock for purposes of the BHCA.

The Board permitted Bank of America to retain certain business relationships with BlackRock, including (i) a dual employment agreement pursuant to which subsidiaries of BlackRock and Bank of America shared approximately 40 employees and (ii) a distribution agreement under which Merrill Lynch was required to distribute BlackRock products on terms at least as favorable as those related to other products distributed by Merrill Lynch. The Board noted that Bank of America and BlackRock also intended to engage in other business relationships on an arms-length basis, including investment management and advisory services, fund administration, securities borrowing and lending, and portfolio management and analysis.

7. Other examples of investment interrelationships between banking and securities organizations include, e.g., Goldman Sachs: FRBNY Letters, dated May 17, 2013, Dec. 18, Sept. 28, 2012, and July 15, 2011 (9.0% investment in a BHC determined to be non-controlling subject to passivity commitments; 9.9% investment in a thrift holding company determined to be non-controlling subject to passivity commitments (including detailed commitments regarding representation and participation in board committees) and subsequent relief from passivity commitments upon reduction of investment in thrift holding company to a de minimis amount; relief from passivity commitment to permit de minimis business relationships with a non-controlled BHC), 97 Fed. Res. Bull. 22 (2011) (9.8% investment in a BHC determined to be non-controlling subject to passivity commitments); Board TARP Letter (permitting companies to acquire more than 25% of a bank or BHC's total equity without controlling the bank/BHC where the equity acquired consists of preferred shares

sold by Treasury at auction, subject to passivity commitments); Citigroup, Goldman Sachs, Morgan Stanley: Board Letters, Oct. 12, 2012, June 29, 2011 (investments in a thrift holding company determined to be non-controlling subject to passivity commitments; subsequent limited relief from commitment to permit Citigroup to sell a portfolio of loans to the thrift holding company's subsidiary); Morgan Stanley, 95 Fed. Res. Bull. B86, B93 (2009) (in each case including variations on the commitment limiting business relationships between the entities involved); Board Letters re: Rabobank-Robeco Group Jan. 30, Mar. 3, 1997, CCH Fed. Banking L. Rep. ¶¶ 80-251, 80-253; BNP-Neuberger Order/BNP-N&B Letter; U.S. Trust Corp., 58 Fed. Reg. 31390 (June 2, 1993) (solicitation of public comments) (approved July 7, 1993) (including commitments); Board 1994 Control Letter (Board refusal to determine that acquisitions by investment managers on behalf of clients of more than 10% but less than 25% of the voting shares of banking organizations would not constitute "control" for CBCA purposes); Board Letter, Mar. 7, 1990 (Prudential Insurance 21% non-voting investment in USAT Holdings; "look through" calculation of equity in subsidiary United Savings Association of the excess; non-voting investment to become voting in connection with certain transfers); Board Letter, Dec. 24, 1987 (LTCB 18% non-voting interest in MAS; see also Part XII.B.3 above); Board Letter, Aug. 7, 1987 (24.99% non-voting limited partnership interest coupled with option to buy up to a 49.9% limited partnership interest); Letters, Oct. 1, 1986, with respect to investments by Norstar Bancorp and Fleet in financial guaranty insurer, as modified by Letter, Jan. 29, 1990; Letter, May 21, 1986, with respect to the investment by BNYM in insurance agency limited partnership.

D. ACQUISITION-RELATED CONSIDERATIONS

Important acquisition-related considerations include the overall and financial sector-specific business/economic climate as well as the regulatory environment at the time of a proposed transaction.

1. An FHC generally is not required to obtain Board approval before acquiring a non-bank company (other than a thrift) that is engaged only in financial activities. 12 C.F.R. § 225.85.

a. Without prior Board approval, an FHC may acquire a non-bank company that is engaged primarily in financial activities (i.e., at least 85% of the company's consolidated total annual gross revenues are derived from, and at least 85% of the company's consolidated total assets are attributable to, the conduct of financial activities) but also engages to a limited extent in activities which are not financial activities, if, within two years after the date of the FHC's investment, the company terminates or divests activities that are not financial activities (and are not otherwise permissible for an FHC), or otherwise restructures its relationship with the company to satisfy BHCA requirements. See 12 C.F.R. § 225.85(a)(3).

b. However, Dodd-Frank § 163 requires FHCs/BHCs with total consolidated assets of $50 billion or more to provide written notice to the Board before acquiring direct or indirect control of any voting shares of any non-bank financial company with total consolidated assets of $10 billion or more. Shares acquired pursuant to BHCA §§ 4(c)(6) (acquisition of less than 5 percent of the outstanding voting shares) or 4(k)(4)(E) (acquisition of voting shares as part of underwriting, dealing in, or making a market in securities) are exempt. See 12 U.S.C. § 5363. Furthermore, Dodd-Frank § 604(e) requires any FHC to obtain prior Board approval in any transaction in which the total consolidated assets to be acquired by the FHC exceed $10 billion. See 12 U.S.C. § 1843(k)(6)(B).

c. Dodd-Frank § 622 also imposes a concentration limit on large financial firms, and the Board issued a final rule implementing the concentration limit on November 5, 2014. 79 Fed. Reg. 68095. The concentration limit generally prohibits a financial company from merging or consolidating with, acquiring all or substantially all of the assets of, or otherwise acquiring control of another company if the liabilities of the resulting financial company would be greater than 10% of aggregate financial sector liabilities, which, according to the Board's calculations, equalled approximately $21.8 trillion effective July 1, 2016. 81 Fed. Reg. 45288 (July 13, 2016). Certain securitization transactions are excluded from the concentration limit as long as the acquiring institution complies with the credit risk retention requirements at § 941 of the Dodd Frank Act. In addition, the final concentration limit rule provides general consent for transactions that, in aggregate, result in an increase in liabilities of $100 million or less, when aggregated with all other acquisitions by the company pursuant to the general consent over the prior 12 month period. Such de minimis transactions must be notified to the Board within 10 days of consummation.

However, in the current environment, mergers and acquisitions by large financial firms are subject to intense regulatory scrutiny well before they approach this concentration limit established by Dodd-Frank. Federal Reserve Governor Daniel Tarullo has suggested that acquisitions by G-SIBs will be subject to a presumption against regulatory approval. See Remarks by Gov. Daniel K Tarullo, Oct. 10, 2012.

2. If prior Board approval is not sought for an acquisition of a non-bank company, notification procedures under Hart-Scott may apply. See 15 U.S.C. § 18a; 16 C.F.R §§ 801-803; 81 Fed. Reg. 4299 (Jan. 26, 2016). See also FTC and DOJ, Hart-Scott-Rodino Annual Report (2015). Dodd-Frank also requires that acquisitions subject to §§ 163 and 604(e) (see Part XII.D.1.b above) be subject to the Hart-Scott notification procedures notwithstanding the requirements in those provisions to seek prior Board approval. See 12 U.S.C. §§ 1843(k)(6)(B)(iii) and 5363(b)(5). See also Part I.A.9 above.

   a. Jurisdictional Tests: Unless an exemption applies, Hart-Scott requires all parties to a large transaction with a significant U.S. connection to file notification forms with the FTC and the Antitrust Division and observe a waiting period.

      (i) Hart-Scott applies to acquisitions of assets, voting securities or non-corporate interests "valued" at more than $78.2 million. The "value" of a transaction is the acquisition price or, in some instances, the market price of voting securities to be acquired or the fair market value of assets to be acquired, if greater than the acquisition price.

         A) In acquisitions of voting securities of an incorporated entity, Hart-Scott notification is potentially required even where the acquiror would not acquire control of the issuer (i.e., 50% or more of the voting securities of the issuer or the contractual right to appoint 50% or more of the directors). The formation of or acquisition of an interest in an unincorporated entity, however, potentially would be reportable under Hart-Scott only if one or more parties would hold a controlling interest in the entity (i.e., the right to 50% of the profits of the entity or 50% of the assets upon dissolution of the entity).

B) A later acquisition of voting securities by an acquiror that previously provided notification of an acquisition requires a separate notification if the acquisition is net within five years of the initial filing or would cause the acquiror's holdings to meet or exceed one of five notification thresholds: (a) \$78.2 million, (b) \$156.3 million, (c) \$781.5 million, (d) 25% of the issuer's outstanding voting securities if valued greater than \$1.563 billion, or (e) 50% of the issuer's outstanding voting securities if valued greater than \$78.2 million.

C) An acquiror has one year from the end of the Hart-Scott waiting period to "cross" a notified threshold and five years during which it can acquire up to the next higher threshold without an additional notification.

(ii) A transaction valued at more than \$78.2 million but less than \$312.6 million is not notifiable unless: (i) the transaction involves the acquisition of voting securities or assets of a person engaged in manufacturing that has annual net sales or total assets of \$15.6 million or more, by any person that has total assets or annual net sales of \$1.563 million or more; (ii) the transaction involves the acquisition of voting securities or assets of a person not engaged in manufacturing that has total assets of \$15.6 million or more, by any person that has total assets or annual net sales of \$156.3 million or more; or (iii) the transaction involves the acquisition of voting securities or assets of a person with annual net sales or total assets of $156.3 million or more, by any person that has total assets or annual net sales of $15.6 million or more.

b. Notification Forms: both acquiror and target must submit Hart-Scott forms to the FTC and the Antitrust Division.

(i) The Hart-Scott form requires parties to produce SEC filings and financial records, and all documents prepared by or for officers or directors that analyze competitive aspects of the transaction (including certain documents prepared by investment bankers, outside consultants or advisers).

(ii) There is a filing fee of (i) $280,000 for transactions valued at $781.5 million or more, (ii) $125,000 for transactions valued at $156.3 million or more but less than $781.5 million, and (iii) $45,000 for transactions valued at under $156.3 million.

c. Waiting Period: Hart-Scott prohibits closing an acquisition until expiration of a waiting period.

(i) The waiting period usually runs until 30 days after the filing (15 days for cash tender offers), but “early termination” may be granted.

(ii) A “second request” for additional information -- a broad subpoena for data and documents -- can extend the waiting period until 30 days after compliance.

d. Transactions Involving Securities Firms: Hart-Scott and related antitrust issues related to securities firm acquisitions include:

(i) Where an FHC acquires a securities firm, the Antitrust Division will look at horizontal and vertical integration issues and ask whether the combined firm could use its position in any relevant market to harm competition.

(ii) In general, securities firm acquisitions should not raise significant issues under the antitrust laws both because the relevant markets are not geographically limited and because there is significant competition in each product market.

In the Antitrust Division's review of the Citicorp/Travelers Acquisition, investment banking, debt underwriting, equity underwriting and advisory services, annuities, mutual funds, and credit card processing were defined as national markets with numerous competitors. See Remarks of Antitrust Division Litigation Chief Kramer, Apr. 14, 1999.

(iii) During the Hart-Scott waiting period, merging companies must avoid integrating their operations ("gun-jumping"). Activities during the waiting period that may trigger a violation include (i) transfer of profits or losses, (ii) combining management, marketing or operations, (iii) acquiror having authority over target operations, (iv) target employees working for the acquiror, and (v) target relinquishing operating control or authority over business decisions. See generally Remarks of FTC General Counsel Blumenthal, Nov. 10, 2005. But see, e.g., Wall St. J., May 24, 2008 (describing measures taken by JPMorgan Chase while its acquisition of Bear Stearns was pending due to the latter's shaky financial condition).

(iv) The acquisition of voting securities of a non-U.S. person is exempt from Hart-Scott unless such person either: (i) holds assets in the U.S. (other than investment assets, voting or non-voting securities of another person, and certain other exempted assets) having an aggregate total value of over $78.2 million; or (ii) made aggregate sales in or into the U.S. of over $78.2 million in its most recent fiscal year. See 16 C.F.R. § 802.51. Hart-Scott exempts the acquisition of assets located outside the U.S. unless the foreign assets that the acquiror would hold as a result of the acquisition generated sales in or into the U.S. of over $78.2 million during the acquired person's most recent fiscal year. See 16 C.F.R. § 802.50. In addition, certain other exemptions may be available.

(v) The antitrust agencies have been receptive to the use of remedies such as divestiture, licensing and business restrictions to address concerns regarding the potential competitive impact of a transaction. Agencies are unlikely to challenge a merger unless it will result in a significant increase in concentration.

A) Minority Acquisitions: Acquisitions of 10% or less of a company's voting securities made "solely for the purpose of investment" are exempt from Hart-Scott.

i) Investments in stock of a company that the investor is considering acquiring generally are not considered to be solely for investment purposes.

ii) Manulife Financial, a Canadian insurance and financial services company, settled charges brought by the DOJ that the company violated Hart-Scott when it failed to file a notification before acquiring more than $50 million (1.5%) of John Hancock common stock at a time when Manulife was considering an acquisition. U.S. v. Manulife Financial, CCH Trade Cas. ¶ 74,426 (D.D.C. 2004).

iii) Investments in stock of a company where the investor is interested in participating in the "formulation, determination, or direction of the basic business decisions of the issuer" are not considered to be solely for investment purposes. See 16 C.F.R. § 801.1(i)(1). Examples of actions that are not consistent with a holding for investment purposes only include nominating a candidate for the board of directors, holding a board seat or being an officer, proposing corporate action that requires shareholder approval, soliciting proxies, or being a competitor of the issuer. See 43 Fed. Reg. 33,450, 33,465 (Jul. 31, 1978).

iv) Third Point LLC, a U.S. management company, settled charges brought by the DOJ that the company violated Hart-Scott when it failed to file a notification before acquiring in excess of $66 million (the then-applicable size of transaction threshold) of Yahoo voting securities and subsequently engaged in conduct inconsistent with passive investment, including assembling an alternate slate for the Yahoo board of directors, internally discussing a proxy battle, and stating publicly that it was prepared to propose a slate of directors at Yahoo's next annual meeting. U.S. v. Third Point Offshore Fund, LTD, et al., Civ. No. 15-cv-01366-KBJ (D.D.C. Dec. 18, 2015).

B) Acquisitions by Institutional Investors: Acquisitions of 15% or less of a company's voting securities made directly by banks, broker-dealers and other institutional investors in the ordinary course of business and "solely for the purpose of investment" are generally exempt from Hart-Scott. See 16 C.F.R. § 802.64.

C) Acquisitions by Underwriters: Acquisitions of voting securities "by a person acting as a securities underwriter, in the ordinary course of business, and in the process of underwriting" are exempt from Hart-Scott. The FTC has informally clarified that it interprets this exemption to apply to all acquisitions of voting securities by broker-dealers for the purpose of resale in the ordinary course of business. See 16 C.F.R. § 802.60.

3. A securities firm acquisition will trigger a number of securities law and related approval requirements:

    a. FINRA Rule 1017 requirements for approval by the FINRA District Office of a change in control of a broker-dealer.

    b. Customer approval requirements (including those related to changes in control of investment advisers and/or investment company share distributors), and investment company board/shareholder approval requirements.

    c. Securities/futures exchange, state and foreign requirements, as well as pre-transaction notice requirements to other government agencies (e.g., the SBA with respect to a change in control of an SBIC).

    d. Filings with the CFTC (with respect to a change in control of an FCM), securities clearing firms, etc. to be made following an acquisition.

    e. Review of aggregate FHC/securities firm investments in public companies as to whether revised Schedule 13Ds or comparable forms and notices (particularly respecting regulated industries) would need to be filed.

    f. The possibility of a CFIUS review under circumstances where the investment is made by a non-U.S. person or entity in a U.S. firm. See Part VII above.

4. Structural and strategic issues play a critical part in completing an acquisition and involve:

    a. "Operational Considerations"

        (i) What business a securities firm subsidiary would target and whether other vehicles exist to address such target.

(ii) Whether such a firm would further corporate goals and operating plans and/or represent a strategic repositioning.

(iii) Whether the FHC would be prepared to accept a securities firm's earnings volatility.

(iv) To what extent the FHC would be willing to devote management time, attention and resources to the acquisition/build-up/integration process.

(v) Whether the FHC's infrastructure would support a securities firm, and whether it has the resources to operate and manage the information technology used by the securities firm.

(vi) Whether a securities firm's "investment banking" culture will mesh with the culture of the FHC.

(vii) Whether any activities of the securities firm will need to be changed, terminated or divested following the acquisition as a result of regulatory or other considerations.

(viii) Whether any cross-border considerations need to be evaluated. See, e.g., Lewkow, "Corporate and Securities Law Considerations for a Foreign Purchaser Planning an Acquisition in the [U.S.]", Manual of Foreign Investment in the [U.S.] (2009 supp.)

b. Evaluation of the way in which the proposed acquisition would fit within the FHC's business plan, in particular:

(i) Is there a compelling strategic rationale?

(ii) Does the FHC's management understand the business that is being acquired?

(iii) Will the combination enhance the FHC's market position or profitability?

(iv) How large is the transaction compared to the FHC's resources?

(v) Will the combination lead to more stable or diverse revenues and earnings?

(vi) Will additional conflicts of interest arise and, if so, will proper mitigants be implemented?

c. Determining an appropriate structure for the transaction:

(i) Stock vs. cash, or a combination.

(ii) Acquisition accounting.

(iii) Tax considerations.

(iv) Impact of the transaction on FHC capital, risk-weighted/trading assets and leverage.

(v) Lock-ups (including management/shareholder support agreements); options/"cash puts"; fiduciary termination rights; exclusivity/non-solicitation arrangements; "go shop" provisions; "bust-up" fees; "reverse termination" fees.

(vi) Ability of acquiror to obtain regulatory and antitrust approvals, as well as related "regulatory" or "antitrust reverse termination or break-up fees."

(vii) Possibility of "bear hug"/hostile approach.

(viii) Acquisition of 100% or less; creation of joint venture; acquisition of only a portion of a securities firm's business lines; "contractual" alliances; transfer of customer relationships only.

d. Properly correlating the price to be paid ("up front" at closing and/or contingent, deferred, "vesting" or other "earn out" arrangements) to anticipated revenue or income growth, cost savings or the like, including fixed price/exchange, pricing formulas and collars/walk-aways/“kill or fill” provisions.

e. Setting up a due diligence investigation (focusing on Dodd-Frank implications, compliance and risk management, trading, conflicts of interest, earnings capability, undisclosed liabilities, potential cost savings/synergies, technology and systems matters) and evaluating individual business units for integration, discontinuation or downsizing.

f. Controlling information “leaks” at both the FHC and the securities firm; confidentiality agreements.

g. Determining an acceptable scope of representations, warranties, interim operating covenants, conditions to closing (“material adverse change” clauses, fiduciary outs, etc.).

h. Addressing human resource (“autonomy”/“turf war”) and compensation issues (including equity-linked incentives (restricted stock, “phantom” shares, options, etc.)), both within the securities firm and within the FHC; addressing “performance-based” compensation issues; identifying (and retaining) key producers; allocating purchase consideration between shareholders and employees; arriving at appropriate “retention pools” and employment and/or non-competition arrangements (“golden handcuffs”).

i. Synthesizing risk appetite, valuation, management and compliance systems.

j. Evaluating the impact of affiliation between a bank and a securities firm on existing and prospective client relationships.

Domestic Bank Holding Companies Which Have Effectively Elected to Become Financial Holding Companies[1] as of September 15, 2016

-A-

ACNB Corp., Gettysburg, Pennsylvania
Alerus Financial Corp., Grand Forks, North Dakota
Ally Financial, Detroit Michigan
Alpine Bancorporation, Belvidere, Illinois
AmeriBancshares, Wichita Falls, Texas
American Bancorporation, Sapulpa, Oklahoma
American Bank Holding Corp., Corpus Christi, Texas
American Express Company, New York, New York
American National Corp., Omaha, Nebraska
Ameris Bancorp, Moultrie, Georgia
AMG National, Denver, Colorado
Andover Bancorp, Andover, Ohio
Ann Arbor Bancorp, Ann Arbor, Michigan
Apple Financial Holdings, New York, New York
Aquesta Financial Holdings, Cornelius, North Carolina
Arbor Bancorp, Ann Arbor, Michigan
Arneson Bancshares, Clear Lake, Iowa
Associated Community Bancorp, Greenwich, Connecticut
Astra Financial Corp., Prairie Village, Kansas

[1] This list generally includes only top-tier filers. Some of these companies have second-tier bank holding companies or foreign banks that have also elected to become or to be treated as financial holding companies. **Bold print** represents domestic bank holding companies with consolidated assets of $5 billion or more as of December 31, 2015.

-B-

Backlund Investment Co., Peoria, Illinois
Baker Boyer Bancorp, Walla Walla, Washington
Banc of California, Irvine, California
Banc Ed Corp., Edwardsville, Illinois
BancFirst Corp., Oklahoma City, Oklahoma
BancIndependent, Sheffield, Alabama
Bancorp Inc., Wilmington, Delaware
Bancorp of Montana Holding Company, Missoula, Montana
Bancorp of Southern Indiana, Seymour, Indiana
BancorpSouth, Tupelo, Mississippi
Bancshares, Jennings, Louisiana
Bankers Bancorp of Oklahoma, Oklahoma City, Oklahoma
Bankers Bancshares, Worthington, Ohio
Bank of America Corp., Charlotte, North Carolina
Bank of New York Mellon, New York, New York
Banterra Corp., Eldorado, Illinois
BB&T Corp., Winston-Salem, North Carolina
BCC Bankshares, Phenix, Virginia
BCI Financial Group, Miami, Florida
Belle Fourche Bancshares, Spearfish, South Dakota
Berkshire Hills Bancorp, Pittsfield, Massachusetts
Bern Bancshares, Bern, Kansas
Big Sioux Financial, Estelline, South Dakota
Blackhawk Bancorp, Beloit, Wisconsin
BOK Financial Corp., Tulsa, Oklahoma
BOU Bancorp, Ogden, Utah
Brannen Banks of Florida, Inverness, Florida
Bridger Company, Bridger, Montana
Bridgewater Financial, Raynham, Massachusetts
BSB Community Bancorporation, Benton, Wisconsin
Byron Bancshares, Byron, Illinois

-C-

C3 Bancorp, Encinitas, California
Cadence Bancorp, Houston, Texas
Canandaigua National Corp., Canandaigua, New York
Capital City Bank Group, Tallahassee, Florida

Capital One Financial Corp., McLean, Virginia
Carbon County Holding Company, Rawlins, Wyoming
Cardinal Financial Corp., McLean, Virginia
Carlson Bancshares, West Memphis, Arkansas
Cass Information Systems, Bridgeton, Missouri
CCB Corp., Kansas City, Missouri
CCFNB Bancorp, Bloomsburg, Pennsylvania
Centerstate Banks, Davenport, Florida
Central Agency, Inc., Lincoln, Nebraska
Central Bancorporation, Provo, Utah
Central Community Corp., Temple, Texas
Central Louisiana Capital Corp., Vidalia, Louisiana
Central Ohio Bancorp, Waverly, Ohio
Centre 1 Bancorp, Beloit, Wisconsin
Champlain Bank Corp., Willsboro, New York
Chemical Financial Corp., Midland, Michigan
Chemung Financial Corp., Elmira, New York
Chesapeake Financial Shares, Kilmarnock, Virginia
ChoiceOne Financial Services, Sparta, Michigan
CIT Group, Livingston, New Jersey
Citigroup, New York, New York
CitizensAda Financial Corp., Ada, Oklahoma
Citizens Bancorp,.Corvallis, Oregon
Citizens Bancorp of Oviedo, Oviedo, Florida
Citizens Financial Group, Providence, Rhode Island
Citizens National Bancshares of Bossier, Bossier City, Louisiana
City Holding Company, Charleston, West Virginia
Civista Bancshares, Sandusky, Ohio
CNB Financial Corp., Clearfield, Pennsylvania
CNB Financial Corp., Litchfield, Minnesota
CNB Financial Corp., Taylor, Texas
CNB Financial Services, Berkeley Springs, West Virginia
Coastway Bancorp, Warwick, Rhode Island
CoBiz, Denver, Colorado
Comerica, Dallas, Texas
Commerce Union Bancshares, Brentwood, Tennessee
Commercial Bancshares, Upper Sandusky, Ohio
Commercial National Financial Corp., Ithaca, Michigan
Community Bancorp, Chanute, Kansas
Community Bank System, DeWitt, New York

Community Bancshares, McArthur, Ohio
Community Bancshares of West Plains, West Plains, Missouri
Community Financial Services, Benton, Kentucky
Community & Southern, Atlanta, Georgia
Cornerstone Alliance, Winfield, Kansas
Cortland Bancorp, Cortland, Ohio
Crystal Valley Financial, Middlebury, Indiana
CSB Bancorp, Millersburg, Ohio
C.S. Bancshares, Chillicothe, Missouri
Cullen/Frost Bankers, San Antonio, Texas

-D-

Dakota Community Bancshares, Hebron, North Dakota
DCB Financial Corp., Lewis Center, Ohio
Decatur Investment, Oberlin, Kansas
Delhi Bancshares, Delhi, Louisiana
Delta Investment Company (Cayman), George Town, Cayman Islands
Diamond A. Financial, Dallas, Texas
Discover Financial Services, Riverwoods, Illinois
Docking Bancshares, Arkansas City, Kansas
Dolphin Family Management, Blaine, Minnesota
Drexel Morgan & Co., Radnor, Pennsylvania
Drummond Banking Co., Chiefland, Florida
Durant Bancorp, Durant, Oklahoma

-E-

East West Bancorp, San Marino, California
Eberly Investment Company, Stanton, Nebraska
Emclaire Financial, Emlenton, Pennsylvania
Enterprise Financial Services Corp., Clayton, Missouri
ESSA Bancorp, Stroudsburg, Pennsylvania
Evans Bancorp, Angola, New York
Exchange Company, Kearney, Nebraska

-F-

F & M Bancorp, Miamisburg, Ohio
Fairfield Bancshares, Fairfield, Illinois
Faribault Bancshares, Faribault, Minnesota
Farmers Bancorp, Frankfort, Indiana
Farmers & Merchants Bancorp, Archbold, Ohio
Farmers Enterprises, Great Bend, Kansas
Framers National Banc, Canfield, Ohio
FCB Bancorp, Louisville, Kentucky
FCB Bancshares, Cullman, Alabama
FCB Financial Services, Marion, Arkansas
FFD Financial, Dover, Ohio,
FFW Corp, Wabash, Indiana
Fifth Third Bancorp, Cincinnati, Ohio
Financial Institutions, Warsaw, New York
First Alamogordo Bancorp, Alamogordo, New Mexico
First Altus Bancorp, Altus, Oklahoma
First American Bancorp, Athens, Georgia
First American International Corp., Brooklyn, New York
First Antlers Bancorporation, Antlers, Oklahoma
First Bancorp, Damariscotta, Maine
First Bancorp, Ketchikan, Alaska
First BanCorp, San Juan, Puerto Rico
First Bancshares, Hattiesburg, Mississippi
First Bancshares, Whiting, Indiana
First BancTrust Corp., Paris, Illinois
First Bank Corp., Fort Smith, Arkansas
First Belleville Banshares, Abilene, Kansas
First Belmond Bancorporation, Belmond, Iowa
First Bethany Bancorp, Bethany, Oklahoma
First Burke Banking Company, Waynesboro, Georgia
First Busey Corp., Champaign, Illinois
First Business Bancorp, Chicago, Illinois
First Citizens Bancshares, Dyersburg, Tennessee
First Citizens Bancshares, Raleigh, North Carolina
First Co Bancorp, Collinsville, Illinois
First Commerce Bancorp, Somerset, Kentucky
First Commonwealth Financial Corp., Indiana, Pennsylvania
First Community Bancshares, Bluefield, Virginia

First Fabens Bancorporation, Fabens, Texas
First Farmers Financial Corp., Converse, Indiana
First Financial Bankshares, Abilene, Texas
First Financial Corp., Terre Haute, Indiana
First Greene Bancorp, Mount Dora, Florida
First Horizon National Corp., Memphis, Tennessee
First Interstate BancSystem, Billings, Montana
First Laurel Security Co., Laurel, Nebraska
First Liberty National Bancshares, Liberty, Texas
First Live Oak Bancshares, Three Rivers, Texas
First Merchants Corp., Muncie, Indiana
First Mid-Illinois Bancshares, Mattoon, Illinois
First Missouri Bancshares, Brookfield, Missouri
First NBC Bank Holding Company, New Orleans, Louisiana
First National Bancorp, Kalamazoo, Michigan
First National Bancshares of Weatherford, Weatherford, Oklahoma
First National Bank Corp, Cloverdale, Indiana
First National Bankers Bankshares, Baton Rouge, Louisiana
First National Capital Corp., Walnut Ridge, Arkansas
First National Corporation of Ardmore, Ardmore, Oklahoma
First of Minden Financial Corp., Minden, Nebraska
First of Waverly Corp., Waverly, Iowa
First Okmulgee Corp., Okmulgee, Oklahoma
First Paragould Bankshares, Paragould, Arkansas
First Poteau Corp., Poteau, Oklahoma
First Pulaski National Corp., Pulaski, Tennessee
First Savings Financial Group, Clarksville, Indiana
First Security, Owensboro, Kentucky
First Security Bancorp, Searcy, Arkansas
First Sonora Bancshares, Sonora, Texas
First Southern Bancorp, Stanford, Kentucky
First Southern Bancshares, Florence Alabama
First State Bancshares, Farmington, Missouri
First State Bancshares, Middlesboro, Kentucky
First State BancShares, Scottsbluff, Nebraska
First State Bancshares of Yoakum, Yoakum, Texas
First State Holding, Lincoln, Nebraska
First Valley National Corp., Clarksdale, Mississippi
First Western Financial, Denver, Colorado
First York Ban Corp, York, Nebraska

Fishback Financial Corp., Brookings, South Dakota
FirstBank Holding Company, Lakewood, Colorado
Florida Community Bankshares, Ocala, Florida
F.N.B. Corp., Pittsburgh, Pennsylvania
Forcht Bancorp, Corbin, Kentucky
Franklin Bancorp, Winnsboro, Louisiana
Franklin Financial Network, Franklin, Tennessee
Franklin Financial Services Corp., Chambersburg, Pennsylvania
Frederick County Bancorp, Frederick, Maryland
Fredonia State Bankshares, Fredonia, Kansas
Frontier Management, LLC, Omaha, Nebraska
Fryburg Banking Company, Fryburg, Pennsylvania
F.S. Bancorp, Lagrange, Indiana
FSB Financial, New Madison, Ohio
FSB Financial Services, Waterloo, Iowa
FSB Mutual Holdings, Perkasie, Pennsylvania
Fulton Financial Corp., Lancaster, Pennsylvania

-G-

Galva Investment, Galva, Illinois
Glenville Bank Holding Company, Scotia, New York
Glenwood Bancorporation, Glenwood, Iowa
GN Bankshares, Girard, Kansas
Goering Management Company, Moundridge, Kansas
Goldman Sachs Group, New York, New York
Goodenow Bancorporation, Okoboji, Iowa
Graff Family Inc., McCook, Nebraska
Grant County Bank ESOP, Ulysses, Kansas
Great Plains Bancshares, Hollis, Oklahoma
Great Southern Bancorp, Springfield, Missouri
Green Dot Corp., Pasadena, California
Greenville National Bancorp, Greenville, Ohio
Greenwoods Financial Group, Lake Mills, Wisconsin

-H-

Hancock Holding Company, Gulfport, Mississippi
Hanmi Financial Corp., Los Angeles, California
Haviland Bancshares, Haviland, Kansas

Hawthorn Bancshares, Jefferson City, Missouri
HBancorporation, Lawrenceville, Illinois
Heartland Bancorp, Bloomington, Illinois
Heartland Bancorp, Gahanna, Ohio
Herring Bancorp, Amarillo, Texas
Homestreet, Seattle, Washington
Hometown Bancorp, Kent, Ohio
Hometown Community Bancorp, Morton, Illinois
Hometrust Bancshares, Ashville, North Carolina
Horizon Bancorp, Michigan City, Indiana
Huntington Bancshares, Columbus, Ohio
Huron Community Financial Services, East Tawas, Michigan

-I-

IBERIABANK Corp., Lafayette, Louisiana
Independent Alliance Banks, Fort Wayne, Indiana
International Bancshares Corp., Laredo, Texas
Investar Holding, Baton Rouge, Louisiana
Isabella Bank, Mt. Pleasant, Michigan

-J-

Jeff Davis Bancshares, Jennings, Louisiana
Johnson International, Racine, Wisconsin
J.P. Morgan Chase & Co., New York, New York

-K-

Kandi Bancshare, New London, Minnesota
Ken Bancorp, Kentland, Indiana
Kentucky Bancshares, Paris, Kentucky
KeyCorp, Cleveland, Ohio
Kinderhook Bank, Kinderhook, New York
King Bancshares, Kingman, Kansas
Kish Bancorp, Belleville, Pennsylvania
Kleberg and Company Bankers, Kingsville, Texas
Klein Financial, Chaska, Minnesota
Knott Holding Company, Carrollton, Missouri

-L-

Lakeland Bancorp, Oak Ridge, New Jersey
Lakeland Financial Corp., Warsaw, Indiana
Lake Financial, Baldwin, Michigan
Lakin Bancshares, Lakin, Kansas
Lauritzen Corp., Omaha, Nebraska
LCNB Corp., Lebanon, Ohio
Lea County Bancshares, Hobbs, New Mexico
Liberty Financial Services of St. Cloud, Saint Cloud, Minnesota
Lolyn Financial Corp., Raymore, Missouri
Lordsburg Financial Corp., Lordsburg, New Mexico
Louisiana Community Bancorp, DeRidder, Louisiana

-M-

M&P Community Bancshares, Newport, Arkansas
M&T Bank Corp., Buffalo, New York
Macon-Atlanta Bancorp, Macon, Missouri
Maedgen & White, Ltd., Lubbock, Texas
Magnolia Bancshares, Hodgenville, Kentucky
MainSource Financial Group, Greensburg, Indiana
Mansura Bancshares, Mansura, Louisiana
Marblehead Bancorp, Marblehead, Ohio
Market Bancorporation,Elko New Market, Minnesota
Market Place Bancshares, Champaign, Illinois
Marlin Business Services Corp., Mt. Laurel, New Jersey
Marquette National, Chicago, Illinois
Martinsburg Bancorp, Martinsburg, Missouri
MB Financial, Chicago, Illinois
Medina Community Bancshares, Hondo, Texas
Mercantile Bank Corp., Grand Rapids, Michigan
Merchants Financial Group, Winona, Minnesota
Metropolitan Capital Bancorp, Chicago, Illinois
MidAmerica National Bancshares, Canton, Illinois
Mid-Iowa Bancshares, Algona, Iowa
Midland Bancshares, Midland, Texas
Midland States Bancorp, Effingham, Illinois
MidSouth Bancorp, Lafayette, Lousiana
Midwest Banc Holding Co., Pierce, Nebraska

Midwest BankCentre, St. Louis, Missouri
MidWestone Financial Group, Iowa City, Iowa
Minnehaha Bancshares, Sioux Falls, South Dakota
Minster Financial Corp., Minster, Ohio
Monitor Bancorp, Big Prairie, Ohio
Morgan Capital Corp., Fort Morgan, Colorado
Morgan Stanley, New York, New York
Mutualfirst Financial, Muncie, Indiana
MNB Bancshares, Malvern, Arkansas
M.S.B Bancorporation, Marion, Wisconsin
MVB Financial Corp., Fairmont, West Virginia

-N-

Nacogdoches Commercial Bancshares, Nacogdoches, Texas
National Bankshares, Blacksburg, Virginia
National Commerce Corp., Birmingham, Alabama
NATBC Holding, Hollywood, Florida
NBC Corp. of Oklahoma, Oklahoma City, Oklahoma
NBT Bancorp, Norwich, New York
Nebraska Bancshares, Farnam, Nebraska
Neighbor Insurance Agency, Marion, Iowa
New Peoples Bancshares, Honaker, Virginia
New York Private Bank & Trust Corp., New York, New York
Nexiter, Kittanning, Pennsylvania
Nicolet Bankshares, Green Bay, Wisconsin
Northern Missouri Bancshares, Unionville, Missouri
Northern Trust Corp., Chicago, Illinois
Northfield MHC, Northfield, Vermont
Northwest Financial, Arnolds Park, Iowa
Northwest Indiana Bancorp. Muster, Indiana

-O-

OFG Bancorp, San Juan, Puerto Rico
Ohio Valley Banc Corp., Gallipolis, Ohio
Oklahoma Bancorporation, Clinton, Oklahoma
Oklahoma State Bancshares, Vinita, Oklahoma
Old National Bancorp, Evansville, Illinois
Oliver Bancorporation, Center, North Dakota

Origin Bancorp, Ruston, Lousiana
Orrstown Financial Services, Shippensburg, Pennsylvania
OSB Bancorp, Osgood, Ohio
Osceola Bancorporation, Osceola, Iowa

-P-

Palmetto Heritage Bancshares, Pawleys Island, South Carolina
Panhandle Bancshares, Guymon, Oklahoma
Park National Corp., Newark, Ohio
Pathfinder Bancorp, Oswego, New York
Pedcor Capital LLC, Carmel, Indiana
Peoples Bancorp, Marietta, Ohio
Peoples Bancorp, Rock Valley, Iowa
Peoples Bancorporation, Cuba, Missouri
Peoples Bankshares, Pratt, Kansas
Peoples Commercial Bancorp, Stilwell, Oklahoma
Peoples Financial Group, Iva, South Carolina
Peoples National Banchsares, New Lexington, Ohio
People's United Financial, Bridgeport, Connecticut
Phelps County Bankshares, Rolla, Missouri
Pinnacle Bancorp, Central City, Nebraska
Pinnacle Financial Partners, Nashville, Tennessee
Pioneer Development Co., Sergeant Bluff, Iowa
Platte Valley Financial Service Companies, Scottsbluff, Nebraska
PNC Financial Services Group, Pittsburgh, Pennsylvania
Poca Valley Bankshares, Walton, West Virginia
Popular, San Juan, Puerto Rico
Portage Bancshares, Ravenna, Ohio
Prism Group, Hamilton, Missouri
Professional Holding, Coral Gables, Florida
Progressive Bancorp, Monroe, Louisiana
Prosperity Bancshares, Houston, Texas
Provident Financial Services, Jersey City, New Jersey
Putnam Bancshares, Hurricane, West Virginia

-R-

Raymond James Financial, Saint Petersburg, Florida
RCB Holding Company, Claremore, Oklahoma

Regions Financial Corp., Birmingham, Alabama
Reliable Community Bancshares, Perryville, Missouri
Republic Bancorp, Louisville, Kentucky
Resource One, Ulysses, Kansas
Richland State Bancorp, Rayville, Louisiana
Rockhold Bancorp, Kirksville, Missouri
RSI Bancorp, MHC, Rahway, New Jersey

-S-

S&T Bancorp, Indiana, Pennsylvania
Salin Bancshares, Indianapolis, Indiana
Salisbury Bancorp, Lakeville, Connecticut
Security Financial Services Corp., Enid, Oklahoma
Security National Corp., Omaha, Nebraska
Security State Agency of Aitkin, Aitkin, Minnesota
Shamrock Bancshares, Coalgate, Oklahoma
Shore Bancshares, Easton, Maryland
Silex Bancshares, Silex, Missouri
Simmons First National Corp., Pine Bluff, Arkansas
SJN Banc Co., St. John, Kansas
SNBNY Holdings Limited (Safra National Bank of New York),
Marina Bay, Gibraltar
Southern Illinois Bancorp, Carmi, Illinois
Southern Michigan Bancorp, Coldwater, Michigan
Southern National Banks, Fort Walton Beach, Florida
South Central Bancshares of Kentucky, Glasgow, Kentucky
Southside Banchsares, Tyler, Texas
Southwest Bancorp, Stillwater, Oklahoma
Spring Bancorp, Springfield, Illinois
Standard Financial Corp., Export , Pennsylvania
STAR Financial Group, Fort Wayne, Indiana
Stark Bank Group, Fort Dodge, Iowa
State Capital Corp., Greenwood, Mississippi
State Street Corp., Boston, Massachusetts
Stephenson National Bancorp, Marinette, Wisconsin
Sterling Bancorp, Montebello, New York
Sterling Bancshares, Poplar Bluff, Missouri
Steuben Trust Corp., Hornell, New York
Stifel Financial, St. Louis, Missouri

Stockman Financial Corp., Miles City, Montana
Stock Yards Bancorp, Louisville, Kentucky
Strategic Growth Bank, El Paso, Texas
Sturgis Bancorp, Sturgis, Michigan
Summit Financial Group, Moorefield, West Virginia
Sunflower Financial, Salina, Kansas
Suntrust Banks, Atlanta, Georgia
Susquehanna Community Financial, West Milton, Pennsylvania
SVB Financial Group, Santa Clara, California
Synovus Financial, Atlanta, Georgia

-T-

Tampa Banking Company, Tampa, Florida
Tensas Bancshares, Newellton, Louisiana
Terre Haute Springs MHC, Terre Haute, Indiana
Tescott Bancshares, Tescott, Kansas
Texas Capital Bancshares, Dallas, Texas
Texas Heritage Bancshares, Hondo, Texas
Texas Independent Bancshares, Texas City, Texas
Texstar Bancshares, Universal, Texas
Thomasville Bancshares, Thomasville, Georgia
Three Shores Bancorporation, Orlando, Florida
Tolleson Wealth Management, Dallas, Texas
Tompkins Trustco, Ithaca, New York
Town & Country Bancorp, Springfield, Illinois
Tri-County Financial Corp., Wellington, Kansas
Tri-Parish Bancshares, Ltd., Eunice, Louisiana
Triumph Consolidated Cos., Dallas, Texas
Truxton Corp., Nashville, Tennessee
Two Rivers Financial Group, Burlington, Iowa

-U-

UBT Bancshares, Marysville, Kansas
UMB Financial Corp., Kansas City, Missouri
Umpqua Holdings Corp., Portland, Oregon
Union Bankshares, Mena, Arkansas
Union Market Bancshares, Richmond, Virginia
Union State Bancshares, Uniontown, Kansas

United Community Financial, Grand Rapids, Michigan
United Financial Bancorp, Glastonbury, Connecticut
United Iowa Bancshares, Newton, Iowa
USAmeribancorp, Clearwater, Florida
U.S. Bancorp, Minneapolis, Minnesota

-V-

Valley View Bancshares, Overland Park, Kansas
Villages Bancorporation, The Villages, Florida
Vision Bancshares, Ada, Oklahoma

-W-

Washington Trust Bancorp, Westerly, Rhode Island
Webster Financial Corp., Waterbury, Connecticut
Wells Fargo & Company, San Francisco, California
Wesbanco, Wheeling, West Virginia
West Alabama Capital Corp., Reform, Alabama
West Bend Bancorp, West Bend, Iowa
West Plains Bancshares, West Plains, Missouri
Wichita Falls Bancshares, Wichita Falls, Texas
Wilcox Bancshares, Grand Rapids, Minnesota
Wintrust Financial Corp., Lake Forest, Illinois
Woodlands Financial Services Company, Williamsport, Pennsylvania
Wyoming National Bancorporation, Riverton, Wyoming

-Y-

Young Americans Education Foundation, Denver, Colorado

-Z-

Zions Bancorporation, Salt Lake City, Utah

Foreign Banking Organizations Which Have Effectively Elected to Become Financial Holding Companies[2] as of September 15, 2016

-A-

Australia and New Zealand Banking Group, Melbourne, Australia

-B-

Banco Bradesco, Osasco, Brazil,
Banco do Brasil, Brasilia, Brazil
Banco Mercantil del Norte, S.A., Monterrey, Mexico
Banco Santander Central Hispano, Madrid, Spain
Bank Hapoalim, Tel Aviv, Israel
Bank of Ireland, Dublin, Ireland
Bank of Nova Scotia, Toronto, Canada
Barclays PLC, London, England
BMO Financial Group (Bank of Montreal), Montreal, Canada
BNP Paribas, Paris, France

-C-

Canadian Imperial Bank of Commerce, Toronto, Canada
Commerzbank, Frankfurt, Germany
Crédit Agricole, Paris, France
Crédit Suisse Group, Zurich, Switzerland

[2] This list generally includes only top-tier filers. Some of these companies have second-tier bank holding companies or foreign banks that have also elected to become or to be treated as financial holding companies. **Bold print** represents foreign banking organizations with consolidated assets of $5 billion or more as of December 31, 2015.

-D-

DnB Nor ASA, Oslo, Norway
Desjardins Group, Levis, Canada
Deutsche Bank, Frankfurt, Germany
DZ Bank, Frankfurt, Germany

-G-

Grupo Financiero Banorte, Monterrey, Mexico

-H-

HSBC Holdings, London, United Kingdom

-I-

Itausa – Investimentos Itaú S.A. (Banco Itaú), Sao Paulo, Brazil

-K-

KB Financial Group, Seoul, Korea
KBC Bank, Brussels, Belgium

-L-

Landesbank Baden-Württemberg, Stuttgart, Germany
Lloyds TBS Group, London, England

-M-

Mitsubishi UFJ Financial Group, Tokyo, Japan
Mizuho Financial Group, Tokyo, Japan

-N-

National Australia Bank, Limited, Melbourne, Australia
National Bank of Canada, Montreal, Canada
Natixis, Paris, France
Norinchukin Bank, Tokyo, Japan

-R-

Rabobank Nederland, Utrecht, The Netherlands
Royal Bank of Canada, Montreal, Canada
Royal Bank of Scotland Group, Edinburgh, Scotland

-S-

Skandinaviska Enskilda Banken, Stockholm, Sweden
Société Générale, Paris, France
Sumitomo Mitsui Financial Group, Tokyo, Japan

-T-

Toronto-Dominion Bank, Toronto, Canada

-U-

UBS, Zurich, Switzerland
Unicredito Italiano, Milan, Italy

-W-

Westpac Banking Corp, Sydney Australia

National Bank Financial Subsidiaries[1]
as of September 15, 2016

-A-

Access National Bank, Reston, Virginia (purchase/sell/service loans)
Alerus Financial, National Association, Grand Forks, North Dakota (insurance agent; lease personal property)
Algonquin State Bank, National Association; Algonquin, Illinois (hold/manage assets)
American National Bank & Trust Company, Danville, Virginia (insurance agent)
ANB Bank, Denver, Colorado (data processing; make loans/extend credit; purchase/sell/service loans)
American National Bank of Texas, Terrell, Texas (insurance agent/broker)
American National Bank, Omaha, Nebraska (purchase/sell/service loans)
American National Bank, Wichita Falls, Texas (insurance agent/broker)
Associated Bank, National Association, Green Bay, Wisconsin (lending/investing for others; broker/agent)

-B-

Ballston Spa National Bank, Ballston Spa, New York (insurance agent)
Banker's Bank of Kansas, National Association, Wichita, Kansas (insurance agent/broker)
Bank First National, Manitowoc, Wisconsin (insurance agent; investment advisor)
Bank of America California, National Association, San Francisco, California (hold/manage assets; affiliate services; purchase/sell/service loans)
Bank of America, N.A., Charlotte, North Carolina (insurance agent/broker; permissible BHCA § 4(c)(8) activities; management consulting; investment/financial adviser; finder; securities broker; underwrite/deal in securities; holding/managing assets; check

[1] **Bold print** represents a national bank with consolidated assets of $5 billion or more as of December 31, 2015.

guaranty; data processing; make/purchase/sell/service loans/extend credit; affiliate services; correspondent services; real estate settlement; other subsidiary activity)

Bank of New York Mellon Trust Company, National Association, Los Angeles, California (investment adviser; securities broker; underwrite/deal/in market securities; insurance agent/broker; real estate settlement)

Barrington Bank & Trust Company, Barrington, Illinois (make/purchase/sell/service loans; real estate settlement; insurance agent/broker; hold/manage assets)

Bessemer Trust Company, New York, New York (trust activities)

Beverly Bank & Trust Company , Chicago, Illinois (hold/manage assets)

Blackrock Institutional Trust Company, San Francisco, California (multiple subsidiaries)

BMO Harris Bank National Association, Chicago, Illinois (insurance agent/broker; subsidiary activity; annuities; make loans/extend credit)

Bremer Bank, National Association, South St. Paul, Minnesota (purchase/sell/service loans; hold/manage assets)

Bridgehampton National Bank, Bridgehampton, New York (insurance agent/broker)

-C-

Cadence Bank, N.A. Birmingham, Alabama (trust activities)

Capital One, National Association, **McLean, Virginia** (insurance agent/broker; non-controlling investment in company that engages in merchant processing; make loans/extend credit; real estate settlement; act as finder; data services; merchant services; tax planning)

Central National Bank & Trust Company of Enid, Oklahoma (insurance agent/broker; lending/exchange; investment for others; other subsidiary activity)

Chase Bank USA, National Association, Newark, Delaware (other subsidiary activity; insurance agent/broker)

Citibank, National Association, Sioux Falls, SD (check guaranty; data processing; holding/managing assets; other subsidiary activity; direct bank investment; trust activities)

Citizens First National Bank, Storm Lake, Iowa (insurance agent/broker)

Citizens Bank, National Association, Providence, Rhode Island (insurance agent/broker; permissible BHCA §4(c)(8) activities; investment adviser)
Citizens National Bank, Henderson, Texas (insurance agent/broker)
Citizens National Bank, Sevierville, Tennessee (investment adviser; insurance agent/broker)
City First Bank of D.C. National Association, Washington, D.C. (holding/managing assets)
City National Bank, Los Angeles, California(underwrite/deal in market securities; insurance activities)
City National Bank of Florida, Miami, Florida (holding/managing assets; lease personal property; make loans/extend credit)
City National Bank of West Virginia, Charleston, West Virginia (permissible activities)
Commerce Bank, National Association, Kansas City, Missouri (affiliate services)
Commerce National Bank & Trust, Winter Park, Florida (holding/managing assets)
Community Bank, National Association, Canton, New York (insurance agent/broker)
Communityone, National Association, Asheboro, North Carolina (insurance agent/broker; financial adviser)
Community State Bank, National Association, Ankeny, Indiana (underwrite credit insurance)
Consumers National Bank, Minerva, Ohio (insurance agent)
Cornerbank, Winfield, Kansas (data processing)
Crockett National Bank, Ozona, Texas (insurance agent/broker)

-D-

DNB First, National Association, Dowingtown, Pennsylvania (insurance agent/broker)

-E-

Evans Bank, National Association, Angola, New York (insurance agent)

-F-

Farmers' National Bank of Canfield, Canfield, Ohio (agent/broker; insurance agent)
Far East National Bank, Los Angeles, California (hold/manage assets; make loans/extend credit)
FIA Card Services, National Association, Wilmington, Delaware (agent/broker)
First Citizens National Bank, Dyersburg, Tennessee (hold/manage assets; insurance agent)
First Community Bank, N.A., Sugar Land, Texas (affiliate services; insurance agent/broker; hold/manage assets)
First Community National Bank, Cuba, Missouri (securities broker)
First Fidelity Bank, N.A., Oklahoma City, Oklahoma (insurance agent/broker)
Fidelity Bank of Florida; Merritt Island, Florida (hold/manage assets)
First Farmers Bank & Trust; Converse, Indiana (hold/manage assets)
First Financial Bank, National Association, Abilene, Texas (insurance agent/broker)
First Financial Bank, N.A., Hamilton, Ohio (insurance agent/broker)
First Financial Bank, N.A., Terre Haute, Indiana (hold/manage assets; investment adviser)
First Liberty National Bank, Liberty, Texas (insurance agent/broker)
First Merchants Bank, National Association, Muncie, Indiana (hold/manage assets; purchase/sell/service loans)
FirstMerit Bank N.A., Akron, Ohio (insurance agent/broker; hold/manage assets)
First National Bank & Trust Company, Chickasha, Oklahoma (manage/hold assets; insurance agent)
First National Bank & Trust Company of Broken Arrow, Broken Arrow, Oklahoma (hold/manage assets)
First National Bank & Trust Company of Iron Mountain, Iron Mountain, Michigan (make loans/extend credit; purchase/sell/service loans)
First National Bank & Trust Company of Rochelle, Rochelle, Illinois (insurance agent; agent/broker-annuities)
First National Bank & Trust Company, Shawnee, Oklahoma (various activities)
First National Bank & Trust, Elk City, Oklahoma (insurance agent/broker)
First National Bank, Davenport, Iowa (data processing)

First National Bank, Fort Pierre, South Dakota (data processing; insurance agent/broker)
First National Bank, Slayton, Minnesota (data processing)
First National Bank, Goodland, Kansas (make loans/extend credit; purchase/sell/service loans)
First National Bank, Greenfield, Iowa (insurance agent)
First National Bank, Hamilton, Alabama (hold/manage assets; make loans/extend credit)
First National Bank – Fox Valley; Neenah, Wisconsin (hold/manage assets)
First National Bank of Berlin, Berlin, Wisconsin (insurance agent/broker)
First National Bank of Chadron, Chadron, Nebraska (insurance agent/broker; financial adviser; securities broker; lending/exchange; investment for others)
First National Bank of Crystal Falls, Crystal Falls, Minnesota (data processing)
First National Bank of Dennison, Dennison, Ohio (engage as agent/broker)
First National Bank of Durango, Durango, Colorado (insurance agent)
First National Bank of Elk River, Elk River , Minnesota (insurance agent/broker; securities broker; finder)
First National Bank of Fredericksburg, Fredericksburg, Pennsylvania (insurance agent/broker)
First National Bank of Hartford, Hartford, Wisconsin (insurance agent/broker)
First National Bank of Hughes Springs, Hughes Springs, Texas (agent/broker)
First National Bank of Kinmundy, Kinmundy, Illinois (investment adviser)
First National Bank of Litchfield, Litchfield, Connecticut (lease personal property)
First National Bank of Manchester, Manchester, Tennessee (make loans/extend credit)
First National Bank of McGehee, McGehee, Arkansas (insurance agent/broker; financial adviser; investment adviser; tax planning)
First National Bank of Northern California, San Francisco, California (various activities)
First National Bank of Norway, Norway, Michigan (data processing)
First National Bank of Omaha, Omaha, Nebraska (hold/manage

assets; purchase/sell/service loans; make loans/extend, affiliate services; investment advisor)
First National Bank of Oneida, Oneida, Tennessee (hold/manage assets; make loans/extend credit; real estate settlement)
First National Bank of Ottawa, Ottawa, Illinois (securities broker)
First National Bank of Pennsylvania, Greenville, Pennsylvania (hold/manage assets)
First National Bank of Raymond, Raymond, Illinois (hold/manage assets)
First National Bank of Scotia, Scotia, New York (insurance agent/broker)
First National Bank of Sterling City, Sterling City, Texas (insurance agent)
First National Bank of Waverly, Waverly, Ohio (insurance agent/broker)
First National Bank of Waynesboro, Waynesboro, Georgia (insurance agent)
First National Bank of Weatherford, Weatherford, Texas (correspondent services)
First National Bank of Williamson, Williamson, West Virginia (insurance agent/broker)
First Niagara Bank, Buffalo, New York (insurance agent/broker)
First Southern National Bank, Lancaster, Kentucky (insurance agent)
First Tennessee Bank, National Association, Memphis, Tennessee (underwrite/deal in/market securities; insurance agent/broker; securities broker; financial advice; personal property leasing; make loans/extend credit; investment advisor to others; finder; agent/broker annuities; holding/managing assets)
First Texoma National Bank, Durant, Oklahoma (purchase/sell/service loans)
Florida Capital Bank, National Association, Jacksonville, Florida (make loans/extend credit; purchase/sell/service loans)
Flagstar Bank, Troy Michigan (purchase/sell service loans)
FNB Bank, National Association, Danville, Pennsylvania (other subsidiary activity)
Fort Sill National Bank, Fort Sill, Oklahoma (underwrite/deal in/market securities)

-G-

Glens Falls National Bank & Trust Company, Glens Falls, New York (insurance agent)
Grand Bank, National Association, Hamilton, New Jersey (make loans/extend credit; purchase/sell/service loans)
Greenville National Bank, Greenville, Ohio (insurance agent)

-H-

Hamilton Bank, Baltimore, Maryland (holding/managing assets; act as insurance agent)
Herald National Bank, New York, New York (insurance agent/broker)
Hillsdale County National Bank, Hillsbank, Missouri (insurance agent/broker)
Honesdale National Bank, Honesdale, Pennsylvania (insurance agent)
HSBC Bank USA, N.A., McLean, Virginia (agent/broker; insurance agent; other subsidiary activity; provide check guaranty services)
Huntington National Bank, Columbus, Ohio (financial advice; make loans/extend credit; purchase/sell/service loans; investment advisor; provide check guaranty services; data processing)

-I-

Inter National Bank, McAllen, Texas (hold/manage assets)

-J-

JPMorgan Chase Bank, N.A., Columbus, Ohio (asset management; courier services; data processing; tax planning; financial advice; trust activities; other subsidiary activity; investment advisor)

-K-

Keybank National Association, Cleveland, Ohio (managing assets; services to bank/affiliates; credit insurance underwriter; insurance agent/broker; permissible BHCA §4(c)(13) activities; make loans/extend credit; make/purchase/sell/service loans/extend credit; financial advice; securities broker; check guaranty; data processing; investment advisor to others; act as finder; correspondent services;

services to bank affiliate; agent/broker annuities; real estate settlement services; reinsurance; holding/managing assets; lease personal property)

Kleberg First National Bank of Kingsville, Kingsville, Texas (make loans/extend credit)

-L-

Landmark Bank, N.A., Columbia, Missouri (insurance agent)

Landmark National Bank, Manhattan, Kansas (hold/manage assets)

Liberty Bank, Twinsburgh, Ohio (insurance agent)

Litchfield National Bank, Litchfield, Illinois (insurance agent/broker)

Lone Star National Bank, Pharr, Texas (insurance agent/broker; hold/manage assets)

Lorain National Bank, Lorain, Ohio (make loans/extend credit)

-M-

Marathon National Bank of New York, Astoria, New York (purchase/sell service loans)

Mars National Bank, Mars, Pennsylvania (insurance agent)

MB Financial Bank, Chicago, Illinois (insurance agent)

Mercantil Commercebank & Trust Co., Coral Gables, Florida (trust activities; other subsidiary activity)

MidAmerica National Bank, Canton, Illinois (insurance agent/broker)

Midsouth Bank, Lafayette, Louisiana (hold/manage assets)

Morris County National Bank of Naples, Naples, Texas (holding/managing assets)

MUFG Union Bank, National Association, San Francisco, California (various activities; investment adviser)

-N-

National Bank, Gatesville, Texas (management consulting)

National Bank of California, Los Angeles, California (other subsidiary activity)

National Bank of Kansas City, Overland Park, Kansas (holding/managing assets)

National Bank & Trust Company of Sycamore; Sycamore, Illinois (hold/manage assets; purchase/sell service loans)
National Penn Bank, Allentown, Pennsylvania (affiliate services; trust activities; investment advisor)
NBH Bank, National Association, Kansas City, Missouri (holding and managing assets)
New Covenant Trust Company, Jeffersonville, Indiana (underwrite/deal in securities)
Nicolet National Bank, Green Bay, Wisconsin (provide data services)

-O-

OceanFirst, Toms River, New Jersey (hold/manage assets)
Old National Bank, Evansville, Indiana (hold/manage assets)
Old Plank Trail Community Bank, National Association, New Lenox , Illinois (hold/manage assets)
Old Point National Bank of Phoebus, Hampton, Virginia (hold/manage assets; insurance agent)
Old Second National Bank, Aurora, Illinois (hold/manage assets; purchase/sell/service loans)

-P-

Park National Bank, Newark, Ohio (insurance agent; make loans/ service loans; hold/manage assets, engage as agent/broker)
Peoples Bank, National Association, Marietta, Ohio (hold/manage assets; engage as agent/broker)
Peoples National Bank, Colorado Springs, Colorado (insurance agent; real estate settlement)
Peoples National Bank, Mount Vernon, Illinois (make loans/extend credit; purchase/sell/service loans)
People's United Bank, Bridgeport, Connecticut (insurance agent/broker; hold/manage assets)
PNC Bank, Wilmington, Delaware (permissible BHCA § 4(c)(8) activities; insurance agent/broker; personal property leasing; check guaranty; data processing; make loans/extend credit; financial advice; securities brokerage; check guaranty; agent/broker annuities; investment real estate settlement services; reinsurance; finder; holding/managing assets; lease personal property)
Powell Valley National Bank, Jonesville, Virginia (insurance agent)

-R-

Range Bank National Association, Marquette, Michigan (hold/manage assets; make loans/extend credit)

-S-

Safra National Bank of New York, New York, New York (underwrite/deal in/market securities, hold/manage assets; financial advice)
Savannah Bank National Association, Savannah, New York (hold/manage assets)
SCBT National Association, Orangeburg, South Carolina (various activities)
Schaumburg Bank & Trust, Schaumburg, Illinois (hold/manage assets)
Seacoast National Bank, Stuart, Florida (insurance agent/broker)
Seaside National Bank & Trust, Orlando, Florida (engage as agent/broker; insurance activities)
Security National Bank of Omaha, Omaha, Nebraska (insurance agent/broker)
Simmons First National Bank, Pine Bluff, Arkansas (insurance activities)
Stearns Bank, National Association, St. Cloud, Minnesota (hold/manage assets)
Sterling National Bank, Montebello, New York (make loans/extend credit)
Suffolk County National Bank of Riverhead, Riverhead, New York (insurance agent)
Sunflower Bank, National Association, Salina, Kansas (insurance agent/broker; various activities)
Sun National Bank, Vineland, New Jersey (insurance agent/broker)
Superior National Bank & Trust Company, Hancock, Michigan (insurance activities)
Swineford National Bank, Middleburg, Pennsylvania (other subsidiary activity)

-T-

TCF National Bank, Sioux Falls, South Dakota (make loans/extend credit; purchase/sell/service loans; personal property leasing; data processing; affiliate services; hold/manage assets; management consulting)

TD Bank, N.A., Wilmington, Delaware (insurance agent/broker annuities; securities broker; investment/financial adviser; purchase/sell loans; agent/broker; underwrite/deal in/market securities)

Texas Capital Bank, National Association, Dallas, Texas (insurance agent; make loans/extend credit; purchase and sell loans; agent/broker; management consulting)

The First, A National Banking Association, Hattiesburgh, Mississippi (insurance agent/broker)

Thumb National Bank and Trust Company, Pigeon, Michigan (insurance agent)

Tri City National Bank, Oak Creek, Wisconsin (insurance agent/broker)

Trustmark National Bank, Jackson, Mississippi (insurance agent)

-U-

UMB Bank, National Association, Kansas City, Missouri (insurance agent/broker; investment adviser; other subsidiary activity; make loans/extend credit; purchase/sell service loans; lease personal property)

Union Bank, National Association, San Francisco, California (insurance agent; broker; finder; agent/broker annuities; investment/financial advice; underwrite/deal in securities; hold/manage assets; purchase/sell/service loans; debt cancellation insurance)

U.S. Bank National Association, Cincinnati, Ohio (check guaranty; data processing; real estate settlement; make loans/extend credit; securities broker; hold/manage assets; purchase/sell/service loans; correspondent services; provide information safekeeping)

-V-

Valley National Bank, Passaic, New Jersey (insurance agent/broker; financial adviser; hold/manage assets)

Vision Bank, Ada, Oklahoma (insurance agent/broker; affiliate services)

-W-

Webster Bank, Waterbury, Connecticut (trust activities; hold/manage assets; make loans/extend credit)
Wells Fargo Bank, National Association, Sioux Falls, South Dakota (insurance agent/broker; underwrite/deal in/market securities; investment advisor; check guaranty; data processing; correspondent services; real estate settlement; affiliate services; other subsidiary activity; make loans/extend credit; purchase/sell/service loans)
Wells Fargo Financial National Bank, Las Vegas, Nevada (purchase/sell/service loans)
Wilmington Savings Fund Society, Wilmington, Delaware (hold/manage assets)
Wilmington Trust, National Association, Wilmington, Delaware (provide financial advice, investment advisor)
Winona National Bank, Winona, Minnesota (insurance agent/broker affiliate services)
Wintrust Financial Corporation, Lake Forest, Illinois (loans/extensions of credit) Acquired Advantage National Bank Corp's assets
Woodhaven National Bank, Fort Worth, Texas (insurance agent/broker)

-Y-

-Z-

Zions First National Bank, Salt Lake City, Utah (investment adviser; tax planning; financial adviser; securities broker; underwrite/deal in/market/securities; insurance agent/broker; data processing; other subsidiary activity)

ANALYSIS OF MUTUAL FUND[1] ACTIVITIES PERMITTED PURSUANT TO THE BOARD ADMINISTRATIVE ORDERS

POWER[2]	PROPRIETARY FUNDS[3]	ADVISED FUNDS[4]	THIRD-PARTY FUNDS[5]
Sponsor,[6] underwrite or distribute[7] fund shares or control fund	No.[8]	No.[8]	No.[8]
Provide advisory services to the fund	Yes.	Yes.	Not applicable.
Purchase and sell shares of fund as agent on a non-discretionary basis for account of customers	Yes.	Yes, subject to Section 225.125.	Yes.
Distribute prospectuses or other sales literature	Yes.	Yes.	Yes.
Recommend customer purchase of fund shares	Yes.	Yes, subject to Section 225.125.	Yes.
Refer customers to fund	Yes.	Yes.	Yes.
Provide names of bank customers to fund or its distributor	Yes.	Yes.	Yes.

POWER[2]	**PROPRIETARY FUNDS**[3]	**ADVISED FUNDS**[4]	**THIRD-PARTY FUNDS**[5]
Provide "Administrative Services" to the fund and receive compensation (including according to a formula dependent on the amount of fund assets):[9]			
a) Administrative Services	Yes, but only to funds whose boards of directors consist of a majority of disinterested persons (the "Disinterested Board Requirement").	Yes, subject to the Disinterested Board Requirement.	Yes, subject to the Disinterested Board Requirement.
b) Have representatives of the Administrator serve as "Interlocking Directors" of the fund	Yes, subject to the Disinterested Board Requirement.	Yes, subject to the Disinterested Board Requirement.	Yes, subject to the Disinterested Board Requirement.
c) Fund name similar to, or variation of, the name of the BHC or any of its subsidiary banks	Yes, subject to Section 225.125.	Yes, subject to Section 225.125.	Not applicable.

POWER[2]	**PROPRIETARY FUNDS**[3]	**ADVISED FUNDS**[4]	**THIRD-PARTY FUNDS**[5]
BHC to purchase and sell as principal up to 5% of any fund's voting securities	Yes, subject to the requirement that BHC's ownership not be used in marketing securities of the fund; greater ownership interest may also be possible.[10]	Yes, subject to the requirement that BHC's ownership not be used in marketing securities of the fund; greater ownership interest may also be possible.[10]	Yes, subject to the requirement that BHC's ownership not be used in marketing securities of the fund; greater ownership interest may also be possible.[10]
Furnish "seed capital"	Yes, subject to First Union Letter and the Volcker Rule.	Yes, subject to First Union Letter and the Volcker Rule.	Yes, subject to First Union Letter and the Volcker Rule.
Purchase in sole discretion securities of fund in fiduciary capacity	Yes, subject to fiduciary requirements.	Yes, subject to fiduciary requirements; the purchase must be authorized by the instrument creating the fiduciary relationship, by court order or by applicable law.	Yes, subject to fiduciary requirements.
Extend credit to fund	Yes, subject to safety and soundness requirements.[11]	Yes, subject to safety and soundness requirements.[11]	Yes, subject to safety and soundness requirements.

POWER[2]	PROPRIETARY FUNDS[3]	ADVISED FUNDS[4]	THIRD-PARTY FUNDS[5]
Accept securities of fund as collateral for loan to purchase such securities	Yes, subject to safety and soundness requirements.[11]	Yes, subject to safety and soundness requirements.[11]	Yes, subject to safety and soundness requirements.
Act as registrar, transfer agent or custodian for fund	Yes.	Yes.	Yes.

Notes

1. Capitalized terms used in this chart have the same meaning as set out in the text of this Guide. This Appendix B addresses the BHCA § 4 permissibility of activities involving mutual funds, which are generally more restrictive than activities with respect to closed-end funds or UITs.

Note, however, that the Volcker Rule's restriction on investments in and transaction with certain hedge funds and private equity funds has implications for FHC/BHC/bank fund activities. See Part II above.

2. (a) The Board's interpretive rule on BHC investment advisory activities, Section 225.125, restricts the ability of a BHC or any of its subsidiaries to act as adviser to a fund that has a name similar to the BHC or any of its subsidiary banks, or purchase in its sole discretion in a fiduciary capacity securities of an Advised Fund advised by the BHC (or a non-bank subsidiary). Section 225.125 also requires that, in cases in which a customer purchases or sells securities of the fund through the BHC or is advised by the BHC to purchase securities of the fund, the customer be informed in writing (i) of the involvement of the BHC with the fund, and (ii) that the securities of the fund are not federally insured, and are not guaranteed by, or obligations of, any bank.

(b) Not all of the Section 225.125 restrictions (nor all of the other restrictions outlined in this Appendix B) are necessarily imposed where a *bank* or a subsidiary of a *bank* (rather than a non-bank subsidiary of a BHC) acts as an investment adviser to a fund. See, e.g., Letters No. 647 and 648.

(c) Sections 23A/23B (discussed in Part III above) could apply to certain types of transactions between a *bank* or a subsidiary of a *bank* (but not a non-bank subsidiary of a BHC), on the one hand, and a Proprietary Fund or an Advised Fund, on the other (see notes 3 and 4).

3. The term "Proprietary Fund" refers to a fund whose securities are sold primarily to customers of subsidiary banks of the BHC in question. A Proprietary Fund may or may not also be an Advised Fund.

4. The term "Advised Fund" refers to a mutual fund for which a bank or non-bank affiliate of the BHC serves as an adviser.

The activities listed in this column that are permissible with respect to Advised Funds are subject to the restrictions set forth in Section 225.125.

5. The term "Third-Party Fund" refers to a fund which is neither a Proprietary nor an Advised Fund.

6. “Sponsor” means acting as registrant in connection with a 1933/1940 Act registration statement. See also Volcker Rule discussion in Part II. A above.

7. “Distribute” includes (a) acting as technical seller (“underwriter”) of the fund and distributing prospectuses for the fund, (b) entering into an agreement containing an obligation to engage in sales activities, (c) entering into any distribution agreement with the fund, and (d) filing advertising materials with respect to the fund with the FINRA/SEC.

8. An FHC would have the authority to engage in sponsorship, underwriting and distribution activities.

9. The approved “Administrative Services” include the following (subject to the Board Administrative Orders):

(a) maintaining and preserving fund records;

(b) computing net asset value, dividends, performance data and financial information;

(c) furnishing statistical and research data to the fund;

(d) preparing and filing materials with securities regulators;

(e) preparing reports and other informational materials regarding the fund (including prospectuses, proxies and other shareholder communications), reviewing prospectuses, assisting in transmitting proxy statements and gathering proxies, and similar activities;

(f) providing legal and regulatory advice to the fund;

(g) providing office facilities and clerical support for the fund;

(h) monitoring compliance with regulatory requirements and with the fund’s investment objectives, policies and restrictions;

(i) providing fund accounting services and liaison with auditors;

(j) preparing and filing tax returns and monitoring tax compliance;

(k) reviewing and arranging for payment of fund expenses;

(l) providing communication and coordination services with regard to the fund's adviser, transfer agent, custodian, distributor and other organizations that render distribution, recordkeeping or shareholder communication services ("Service Organizations");

(m) preparing advertising materials, sales literature and marketing plans;

(n) providing information to distributors and Service Organizations concerning fund performance and administration;

(o) providing marketing support with respect to sales of fund shares through financial intermediaries, including participating in seminars and meetings designed to present information to intermediaries concerning the operations of the fund (but not in connection with the sale of fund shares to the public), and concerning the administrative services provided to the fund;

(p) assisting the fund in the development of additional portfolios;

(q) providing reports to the fund's board of directors; and

(r) providing telephone shareholder services (under circumstances where operators will not solicit callers to purchase fund shares or make outgoing calls to solicit investors).

The subsidiary providing the Administrative Services is referred to as the "Administrator". The Administrative Services are comparable to those approved by the Comptroller in Letters No. 647 and No. 648.

10. BHCA § 4(c)(6) or 4(c)(7) could provide a basis for the acquisition of more than 5% of the shares (including non-voting shares) of a fund. FHCs would have broader acquisition authority. The Volcker Rule affects acquisition authority, depending on the nature of the fund. See Part II.A above.

11. Sections 23A/23B could apply to these transactions under certain circumstances. See note 2(c).

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