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Comparison of New EU Proposals on Proprietary Trading and Ring-Fencing Against US, UK, French and German

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If you wish to receive more information on the topics covered in this publication, you may contact your regular Shearman & Sterling contact person or any of the following:

Contacts

Barnabas W.B. Reynolds
London
+44.20.7655.5528
barney.reynolds@shearman.com

Donald N. Lamson
Washington, DC
+1.202.508.8130
donald.lamson@shearman.com

Bradley K. Sabel
New York
+1.212.848.8410
bsabel@shearman.com

Thomas Donegan
London
+44.20.7655.5566
thomas.donegan@shearman.com

Pierre-Nicolas Ferrand
Paris
+33.1.53.89.71.77
pferrand@shearman.com

Winfried M. Carli
Frankfurt
+49.69.9711.1000
wcarli@shearman.com

Azad Ali
London
+44.20.7655.5659
azad.ali@shearman.com

Kolja Stehl
London
+44.20.7655.5864
kolja.stehl@shearman.com

The European Commission has published a legislative proposal that would prohibit certain large EU banks from engaging in selected types of risky proprietary trading. The proposal would also potentially require such banking groups to push out and ring-fence certain other high-risk trading activities. The UK, France and Germany have already adopted separate national ring-fencing legislation, while in the US the Volcker Rule, which bans proprietary trading, is now in final form. International banking groups will need to continue work on restructuring their businesses to comply with the overlapping and at times inconsistent sets of rules. This note summarises the key provisions of each measure.

Introduction

The European Commission has published a draft regulation (the "Proposed Regulation") to prohibit certain large and systemically important banks from proprietary trading.[1] The Proposed Regulation also gives national regulators in the EU various powers to require 'risky' trading activities (including market-making, securities underwriting, securitisation and complex derivatives) to become ring-fenced within those institutions into a separate legal entity from the retail bank. A retail bank is one that takes insured deposits under the Deposit Guarantee Scheme Directive.

1 The Proposed Regulation is available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52014PC0043:EN:NOT.

Contacts (cont.)

Mak Judge
London
+44.20.7655.5182
mak.judge@shearman.com

Christina Broch
Washington, DC
+1.202.508.8028
christina.broch@shearman.com

Jared R. Gianatasio
New York
+1.212.848.4384
jared.gianatasio@shearman.com

The measures reflect and expand upon proposals originally included in the Liikanen Report.[2] They go further than the Liikanen Report by imposing an outright ban on proprietary trading. If the Proposed Regulation is approved by June 2015, the ban on proprietary trading would apply from 1 January 2017 and the ring-fencing powers would come into effect from 1 July 2018.

In the US, the Volcker Rule imposes a general prohibition on banking entities and their affiliates from engaging in proprietary trading, subject to various exemptions.[3] Some EU Member States have already enacted legislation providing for national bank ring-fencing requirements, and the intention in many cases was for these to be an alternative to a proprietary trading ban, as imposed by the Volcker Rule. In the UK, the Financial Services (Banking Reform) Act 2013 (the "UK Act"), which implements the reforms proposed by the Independent Commission on Banking, requires deposit-taking banking services to be ring-fenced from proprietary trading and other related activities.[4] Recent French and German legislation also requires banks and banking groups to separate their proprietary trading and certain other high risk activities from their deposit-taking business.[5] However, the Proposed Regulation is essentially a "Volcker Rule-lite," plus a form of ring-fencing (lite).

The Proposed Regulation includes an option for Member States to apply to the European Commission for a derogation decision to exempt a bank from the ring-fencing requirements of the Proposed Regulation if the bank is already subject to a national ring-fencing regime that meets similar standards. The decision applies to instances where national primary legislation had been adopted prior to 29 January 2014 (including secondary legislation subsequently adopted), which covers the UK, France and Germany. In the event that the technical standards mandated by the Proposed Regulation create further discrepancies between the pan-European regime and pre-existing national regimes, the use of derogation decisions may become increasingly desirable for European banks seeking to avoid multiple ring-fences. No statements have currently been made by any major European governments or regulators on their intention to rely on these derogation provisions and it is somewhat unclear whether they will be able to do so. The test for similarity appears to favour the

2 The Liikanen Report is available at: http://ec.europa.eu/internal_market/bank/docs/high-level_expert_group/report_en.pdf.

3 Previous client notes on the Volcker Rule are available here.

4 The UK Act is available at: http://www.legislation.gov.uk/ukpga/2013/33/contents/enacted/data.htm and our client note on the same is available here.

5 The Act on Ring-fencing and Recovery and Resolution Planning for Credit Institutions and Financial Groups is available at http://www.bundesrat.de/cln_330/SharedDocs/Drucksachen/2013/0301-400/378-13,templateId=raw,property=publicationFile.pdf/378-13.pdf. The Law of 26 July 2013 on the Separation and Regulation of Banking Activities (Law no. 2013-672) is available at http://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000027754539.

UK and French reforms, though it is hard to believe the German would not be recognized also (perhaps with minor adjustment).

The UK Act requires regulators to review, within 12 months of the UK's ring-fencing requirement taking effect (currently expected in 2019), proprietary trading activities engaged in by all regulated financial institutions in the UK (and not just deposit-taking banks). The UK regulators are also required to review the UK's ring-fencing rules themselves within five years. It is therefore not yet clear whether the UK would rely on derogation decisions or instead seek to align its approach with that under the Proposed Regulation.

The table at the end of this note compares the Proposed Regulation with current requirements in the US, UK, France and Germany. While these regimes may, at first glance, appear similar, international banking groups will need to undertake detailed analysis to ensure they are appropriately structured to comply with each applicable requirement.

Scope of Proposed Regulation and Impact of Volcker Rule on Banks Established Outside the US

Proposed Regulation

The requirements of the Proposed Regulation will apply to "credit institutions" and "EU Parents." "Credit institutions" comprise, essentially, banks regulated in the EU. "EU Parents" include holding companies in the EU of groups that include credit institutions. The following organisations will be covered by the Proposed Regulation:

EU credit institutions and banking groups headquartered in the EU

- any credit institution or EU Parent identified as being a global systemically important institution ("G-SII") under the EU's Capital Requirements Directive IV ("CRD IV") (and all their branches and subsidiaries wherever located) (the "G-SII test"); or
- any EU credit institution or EU Parent with a credit institution established in the EU (and all their branches and subsidiaries, wherever located) where, for a period of three consecutive years, its total assets amount to at least €30 billion and it has trading activities amounting to at least €70 billion in combined value or 10% of its total assets (the "size test");

Credit institutions and banking groups outside the EU

- the EU bank sub-group that meets one of the above tests, with all the branches of the EU entities and subsidiaries which drop down below the EU entities; and
- an EU branch of a third country (e.g. US) bank provided that it meets the size test.

However, the European Commission would be entitled to determine that a third country regulatory regime is "equivalent" to the requirements under the Proposed Regulation, comprising both the proprietary trading ban and the ring-fencing requirement. For this test to be met, the third country's legal framework must be capable of recognizing structural measures provided for in the laws of other countries. The Commission FAQs on the Proposed Regulation imply that it is intended that the US is capable of being equivalent given various provisions of Bank Holding Company Act legislation which predate Volcker. Notably, the US regime is technically able to take into account the Proposed Regulation, though whether this ends up being the case in practice remains to be seen. Presumably the intent behind the Proposed Regulation is a grand negotiation on the topic between the EU and US. As in other recent EU legislation (e.g. EMIR), the equivalence determination is at the discretion of the European Commission.

Where the European Commission makes an equivalence determination, the Proposed Regulation will not apply to:

- EU branches of that third country's credit institutions; or
- third country subsidiaries of EU Parents.

Where there is no equivalence between the Proposed Regulation and the third country regime, a national regulator may exempt a third country subsidiary of an EU Parent from the structural split requirement provided that a resolution plan is agreed between the group level EU authority and the third country host authority and the resolution strategy has "no adverse effect on the financial stability of the member state where the EU Parent and other group entities are established."[6] In other words, where (most likely) an effective multiple point of entry resolution strategy is implemented, a national regulator will have the power to exempt a third country subsidiary of an EU Parent.

Comparison with Jurisdictional Scope of the US Volcker Rule

The Volcker Rule similarly has some level of extraterritorial reach. In addition to domestic institutions, it applies to the banking operations of banking groups headquartered outside the United States, subject to certain key exemptions. The main exemption in this context is the "solely outside the United States" or "SOTUS" exemption. The SOTUS exemption is available where, in respect of a purchase or sale of a financial instrument for a trading book:

- the banking entity headquartered outside the United States acts as principal outside the United States;
- the entity and relevant personnel that make the trading decision are located outside the United States;
- trading is not accounted for as principal in the United States;
- a US affiliate does not provide financing for the trading; and
- the trading is not conducted with or through any US entity, other than on an anonymous basis on a US exchange or through a US central counterparty, or in a transaction with the non-US operations of a US entity.[7]

Interaction of EU and US Regimes International Banking Groups

Unless and until the European Commission deems the US regime equivalent to the Proposed Regulation, there is the potential for substantial overlap and even conflict between the Proposed Regulation and the Volcker Rule.

Many large US-headquartered banking groups currently operate in the EU through branches. If the European Commission makes an equivalence determination with respect to the US, a US bank operating in the EU through a branch would not be subject to the Proposed Regulation. An EU subsidiary of a US bank would be subject to both the Proposed Regulation and the Volcker Rule unless an exemption applied under the US regime.

Given the difficulties of applying different proprietary trading standards in different countries, many banking institutions may well choose to comply with the more restrictive standards globally.

Prohibition on Proprietary Trading

The Proposed Regulation prohibits in-scope entities from engaging in proprietary trading in financial instruments and commodities. Whereas the in-scope entities under the Proposed Regulation are limited to EU credit institutions having total assets of more than €30 billion, or who are already deemed to be "globally systemic," the Volcker Rule applies the prohibition on proprietary trading to a broader group of "banking entities," that includes any insured depository institution, its holding company, a bank headquartered outside the United States that is treated as a bank holding company under the International Banking Act of 1978, as amended, and any subsidiary or affiliate of any of these entities.

6 Proposed Regulation, Article 4(2).

7 79 Fed. Reg. 5535, at 5786 (Jan. 31, 2014).

The Proposed Regulation also defines "proprietary trading" more narrowly compared to the UK Act and the Volcker Rule. Unlike the UK Act and the Volcker Rule, the definition does not start with reference to the EU activity of "dealing in investments as principal" or "engaging as principal," respectively. Instead, a new definition is proposed of using own capital or borrowed money to take positions in any type of transaction regarding a financial instrument or commodity for the sole purpose of making a profit for one's own account. Any purpose connected to actual or anticipated client activity or hedging the entity's risk as a result of actual or anticipated client activity would mean the trade falls outside the definition.

The Volcker Rule adopts a broader definition of proprietary trading, where any short-term principal trading (of securities, derivatives or futures contracts) by a banking entity that does not fall neatly within one of the enumerated exemptions (discussed further below) will be presumed to be prohibited proprietary trading for purposes of the Rule. The Volcker Rule also adopts a wider and more objective view by relying on the trading desk as the smallest discrete unit of organization to measure compliance with the Rule's restrictions and limitations. Proprietary trading under the Proposed Regulation is limited to activity conducted through the use of desks, units, divisions or individual traders specifically dedicated to such position taking and profit making, including through dedicated web-based proprietary trading platforms.

Presumably the final text of the Proposed Regulation will not allow self-made structures which feed client and proprietary trading into the same desk, thereby falling outside the definition. However, nevertheless, the intention appears to be to impose a version of the Volcker Rule that is narrower and less objective than that being imposed in the US, with the ring-fencing provisions being included as a fail-safe.

As a result of this narrow definition, hedging, market-making and underwriting activities would generally be outside the ban, albeit such activities may be subject to ring-fencing instead. Specifically, market-making, the issuance, investment and sponsorship activities linked to risky securitizations and the structuring, arranging and execution of complex derivatives are intended to subject to the structural separation requirement rather than the proprietary trading ban.

There is also a specific exemption for trading in debt issued by Member States. The Volcker Rule contains an exemption for trading in securities linked to the US sovereign debt, which was extended recently to cover certain kinds of non-US sovereign debt, so this exception is broadly equivalent to that in the US. There are also exemptions for cash management and trading in cash and cash equivalent instruments (defined as being of less than 397 day maturity with returns no greater than the rate of return of three-month high quality government bonds).

There is a prohibition on investment in alternative investment funds ("AIFs"), derivatives linked to AIFs or shares or units in an entity that invests in AIFs. Investments are permitted in closed-ended and unleveraged AIFs, EU venture capital funds, EU social entrepreneurship funds and EU long-term investment funds. Each of these must be established in the EU under the Alternative Investment Fund Managers Directive ("AIFMD"), or established elsewhere and marketed into the EU in accordance with the AIFMD.

There is also a prohibition on investing in entities that engage in proprietary trading.

The management of entities subject to the ban will be required to ensure compliance. Remuneration arrangements are required to contribute to the prevention of circumvention of the ban.

Mandatory Separation of Other High-Risk Trading Activities

The European Commission has stated that it believes that legal separation of certain particularly risky financial activities within a large banking group is also crucial for a safe and efficient EU banking system. Under the Proposed Regulation, any such separation would be independent of an assessment of a bank's recovery and resolution plan which may call for additional separation if deemed necessary (under the current version of the proposed Bank Recovery and Resolution Directive, which is still subject to the EU legislative process).

National regulators will be obliged to review the trading activities of in-scope entities at least annually with a view to determining whether the trading business should be required to be split, and ring-fenced from, the retail bank. The review must include an assessment of certain metrics, which if exceeded result in a decision by that national regulator that the retail bank must not carry out trading activities. These metrics include relative trading book size (trading assets divided by total assets), leverage (trading assets divided by core Tier 1 capital), counterparty credit risk (fair value of derivatives divided by total trading assets), complexity (measured largely by reference to derivatives), profitability (trading income divided by total net income), associated market risk (difference between trading assets and liabilities in absolute value, divided by average of trading assets and trading liabilities), interconnectedness (based on CRD IV criteria), and finally credit and liquidity risk from commitments and guarantees.

Particular assessment is to be made of market-making given its risks and interconnectedness. Similar scrutiny is to be made of securitization, which is seen as giving risk to significant liquidity risk. The EBA will draft Regulatory Technical Standards ("RTSs") which will be endorsed by the European Commission. The Commission will specify the relevant limits of the metrics, how many metrics must be exceeded for the test for separation to be met, as well as the level of aggregate significant risk being measured.

If these metrics are met and the national regulator determines there is a risk to the financial stability of the retail bank or the EU financial system as a whole, the process for splitting off the trading businesses will be triggered unless the institution can demonstrate the lack of any such risk to the satisfaction of the national regulator. Further, the national regulator can order a split if it identifies a risk to the stability of the bank or the EU financial system regardless of the metrics being surpassed. The Commission will specify what sorts of securitization do not propose a threat to the financial stability of the core credit institution or the EU financial system as a whole.

If such trading activities are required to be separated, they would need to be assigned to a separate legal entity (a "trading entity") pursuant to an agreed separation plan. The retail bank will only be able to carry on trading in order prudently to manage its capital, liquidity and funding, for which it can only use interest rate, FX and credit derivatives eligible for CCP-clearing, unless the Commission adds to that list, in order to hedge overall balance sheet risk. The hedging must mitigate individual or aggregate positions. In addition, the bank may provide risk management services to clients.

Ring-fenced entities must have strong independent governance and address regulatory capital and large exposures on a functional sub-group basis.

Remuneration practices must be aimed at hedging being determined by reference to its effectiveness in reducing risk, not on profits.

Compliance

The Proposed Regulation requires the disclosure of information to regulators in order to ensure that the calculation of assessments is possible as well as to facilitate the monitoring of compliance with the requirements. Further, transactions, document systems and processes must be registered with regulators to enable the regulators to monitor compliance.

There are provisions for the imposition of administrative sanctions against corporate entities and individuals (management) responsible for breaches. Member States are permitted also to apply criminal sanctions for breaches of the ban on proprietary trading and any manipulation of information on trading activities that is submitted to regulators.

Interaction of the Proposed Regulation with the UK Act and the Volcker Rule

At a high level there are arguably subtle differences of intent between the various key regimes. The European Commission's primary objective is to isolate risky trading activity and eliminate purely speculative trading. The UK Act primarily seeks to protect deposit-taking banks from risks generated by the investment banking part of the wider group where, ultimately, a taxpayer-funded bail-out might be required to prevent depositor runs. The Volcker Rule, in contrast, is motivated by philosophical concerns that banks should exist only to do customer business.

The Proposed Regulation's requirements are not as strict as, and are in some ways more flexible than, the UK Act and the Volcker Rule. The ban on proprietary trading is in principle narrower than the Volcker Rule, requiring fewer exceptions to be developed. The provisions will apply the ring-fence - but not a ban - to many trading and investment banking activities such as lending to venture capital and private equity funds, investment and sponsorship of risky securitisation, and the sale and trading of derivatives. The ability to ring-fence such trading activities, rather than an outright ban in relation to some aspects of these as per the Volcker Rule, provides greater flexibility for banks in the types of activities they can undertake. Further, under the Proposed Regulation, ring-fencing is not automatically mandatory, but is at the discretion of national regulators on a case-by-case basis, albeit subject to the harmonised metrics set by the EBA. This makes the ring-fencing provisions more flexible than the UK Act, which provides a mandatory ring-fence of all deposit-taking activity. However, as neither the EBA metrics nor the UK secondary legislation are finalised, developments will need to be monitored. Moreover, national derogations may be used instead of the regime under the Proposed Regulation.

Unless derogations are used, it is possible that the combined effect of the Proposed Regulation and the UK Act will be to require some of Europe's largest banks to construct two ring-fences: one around their retail arm (as required by the UK Act) and one around their trading activities (as set out in the Proposed Regulation), in addition to satisfying any additional ring-fencing requirements under French or German legislation. Non-US banks would also need to ensure compliance with the SOTUS and other applicable exemptions for their operations outside the US to ensure they remain outside the scope of the Volcker Rule. US banks will likely ensure compliance with the Volcker Rule as a first step before looking at the EU or UK regimes, given that the Volcker Rule is more burdensome than either of these two regimes in most respects.

Anti-avoidance Measures: New EU Rules Regarding SFTs

The European Commission published a draft regulation on the reporting and transparency of securities financing transactions (the "SFT Regulation")[8] on the same day as the Proposed Regulation. The SFT Regulation applies to repurchase transactions (as defined in the Capital Requirements Regulation ("CRR")),[9] securities or commodities lending and borrowing, and any transaction having an equivalent economic effect and posing similar risks such as buy-sell back or sell-buy back transactions (collectively defined as securities financing transactions ("SFTs")). The SFT Regulation is aimed at increasing transparency in the shadow banking sector and squeezes the brakes on collateral velocity, a phenomenon prevalent in the shadow banking arena. The goal is to mitigate contagion and systemic risk contributed by shadow banking transactions but at the cost, perhaps, of increasing the scarcity of collateral at a time when there is increasing demand for high quality collateral.

[8] The proposed SFT Regulation is available at http://ec.europa.eu/internal_market/finances/docs/shadow-banking/140129_proposal_en.pdf.

[9] The CRR is available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:176:0001:0337:EN:PDF.

The key requirements of the SFT Regulation are:

- counterparties to SFTs will have to report such transactions to a registered trade repository and keep records of SFTs that they report. Counterparties for this purpose include EU financial counterparties and their branches (wherever located), non-financial counterparties (as defined in EMIR), non-EU counterparties (if the transaction is concluded in the course of operations of an EU branch) and central counterparties;
- management companies of undertakings for collective investment in transferable securities ("UCITS"), UCITS investment companies and alternative investment fund managers will have to inform their investors on the use they make of SFTs as well as other financing structures and will have to include information on the SFTs they are authorized to use in pre-investment documents; and
- counterparties will have to meet minimum conditions if they wish to rehypothecate financial instruments including obtaining written consent of the collateral provider, disclosure of the risks to the collateral provider (in particular the potential risks in the event of the default of the counterparty) and the transfer of the financial instruments received as collateral to an account in the name of the receiving counterparty. Counterparties for this purpose include EU financial counterparties and their branches (wherever located), non-financial counterparties (as defined in EMIR), non-EU counterparties (if the rehypothecation is concluded in the course of operations of an EU branch or an EU counterparty or an EU branch is the provider of the collateral).

It is expected that the SFT Regulation will enter into force by the end of 2015. The reporting requirement will apply 18 months after the SFT Regulation comes into force and the requirements relating to reporting by fund managers to investors will apply six months after the SFT Regulation enters into force.

Comparison of Proposed US, EU, UK, French and German Banking Structural Reforms

REGULATORY ISSUE	US	EU	UK	FRANCE	GERMANY
Ban on proprietary trading / ring-fencing requirement	*Ban*: the ban applies to 'banking entities', a term which includes insured depository institutions, their holding companies, any bank headquartered outside the US that is treated as a bank holding company under the US International Banking Act of 1978 and any subsidiary or affiliate of any of these entities.	*Ban and ring-fencing* The *ban* relates to ***proprietary trading*** and applies to deposit-taking banks, which under EU legislation means: (i) credit institutions and EU Parents which are G-SIIs under CRD IV (including all branches and subsidiaries wherever located); (ii) credit institutions and EU Parents with a credit institution established in the EU (including all branches and subsidiaries wherever located) where the relevant entity passes the threshold test of: (a) total assets amounting to at least €30 billion; and (b) trading activities amounting to at least €70 billion or 10% of total assets (the calculation of these is subject to further technical standards); (iii) EU branches of third country credit institutions, where the relevant entity passes the size test above; (iv) EU bank sub-groups that meets one of the above tests (including all the branches of the EU entities and subsidiaries which drop down below the EU entities. Certain of the above entities may be exempt depending on third country equivalence decisions (discussed below). The *ring-fencing* provisions relate to ***trading activities*** and provide a flexible mechanism whereby if certain metrics (to be defined by the European Banking Authority) are triggered or there is otherwise a	*Ring-fencing*: only ring-fenced bodies are banned from proprietary trading. A ring-fenced body is a deposit-taking bank. The ban does not apply to banking affiliates. It is anticipated that secondary legislation will contain an exemption for a bank whose retail deposit book does not exceed *circa*. £25 billion. Draft secondary legislation prohibits a ring-fenced body from maintaining or establishing a branch in any non-EEA state (except for Jersey, Guernsey and the Isle of Man) or having any participating interest in a company incorporated outside the EEA unless such company's activities would be exempt from regulation if they were conducted in the UK. The Prudential Regulation Authority is mandated to conduct a review of proprietary trading within 12 months of the UK Act to consider whether more far-reaching restrictions are required.	*Ring-fencing*: proprietary activities must be ring-fenced into a subsidiary. Credit institutions (*établissements de crédit*), financial companies (*compagnies financières*) and mixed financial holding companies (*compagnies financières holding mixtes*) are prohibited from carrying out proprietary trading activities in financial instruments, when their trading activities exceed exposure thresholds to be set out by Decree (*décret*).	*Ring-fencing*: deposit-taking banks and their affiliates shall be prohibited from engaging in certain activities perceived as particularly risky for financial institutions, unless such activities are transferred to a separate legal entity which is subject to further regulatory requirements (a so called "financial trading institution" (*Finanzhandelsinstitut*)). This ring-fencing requirement applies if a deposit-taking bank, or its banking group as a whole, exceeds one of the following thresholds: (i) for the past financial year the assets qualifying as "held for trading" or "available for sale" under IFRS (or the trading book and the liquidity reserve under German GAAP) exceed €100 billion on a stand-alone or consolidated basis; or (ii) for the past three financial years total assets amount to or exceed €90 billion on a stand-alone or consolidated basis, and the assets "held for trading" or "available for sale" under IFRS (or the trading book and the liquidity reserve under German GAAP) exceed 20% of the total assets. In addition, the German regulator may issue individual prohibition and separation orders in relation to certain market-making activities and certain other activities perceived as particularly risky to any deposit-taking bank and any of its affiliates on a case by case basis

REGULATORY ISSUE	US	EU	UK	FRANCE	GERMANY
		threat to the financial stability of a core credit institution (a bank subject to EU deposit guarantee legislation) or the EU financial system as a whole, a national regulator may impose a ban on the relevant core credit institution from engaging in one or more trading activities. Such trading activities can then only be undertaken by an affiliate which is legally, economically and operationally separate from the core credit institution.			irrespective of the size of the bank and of the business to be separated.
Application to third country banks and extra-territoriality	A 'banking entity' can include non-US banks (see above). The ban applies to all activities of an entity within scope. However an exemption applies to trades entered into "solely outside the US" by banking organisations headquartered outside the US, provided further requirements are met in relation to the trade.	If a credit institution falls within scope (see above) the ban and ring-fencing provisions apply to all branches and subsidiaries, irrespective of location. However the ban and ring-fencing provisions do not apply to: (i) non-EU subsidiaries of EU Parents; or (ii) EU branches of credit institutions headquartered outside the EU, if the relevant non-EU regulatory regime is deemed equivalent by the European Commission. The ring-fencing provisions do not apply to non-EU subsidiaries of EU Parents even if there is no equivalence in the regulatory regimes if a resolution strategy is agreed between the relevant regulators with no risk to the EU financial system.	Regime applies to UK incorporated entities only, irrespective of where the deposit-taking activity occurs. Branches and establishments of non-UK banks operating within the UK are not within scope.	The ring fencing obligation applies to the entire banking group including subsidiaries and/or branches located outside France. All branches and/or subsidiaries of non-French banks located in France approved as credit institutions or investment firms by ACPR are within the scope of the ring-fencing requirement.	The ring-fencing requirement applies to credit institutions within the meaning of article 4 para. 1 nr. 1 of the CRR and entities forming part of a group of institutions (*Institutsgruppe*), a financial holding group (*Finanzholding-Gruppe*), a mixed financial holding group (*gemischte Finanzholding-Gruppe*) or a financial conglomerate (*Finanzkonglomerat*) which also includes a credit institution within the meaning of article 4 para. 1 nr. 1 of the CRR. While the CRR definition does not specify its territorial scope of application, it is generally assumed that the requirements apply to German credit institutions.

REGULATORY ISSUE	US	EU	UK	FRANCE	GERMANY
Definition of proprietary trading	*Proprietary trading* is generally defined as engaging as principal for the trading account of the banking entity in any transaction to purchase, sell, or otherwise acquire or dispose of specified financial instruments.	*Proprietary trading*, for the purposes of the ban is defined more narrowly than the Volcker Rule and refers to activities specifically dedicated to taking positions for making a profit for own account, without any connection to client activity or hedging risk. However the definition is wider than the Volcker Rule with respect to the financial instruments covered (with commodities being included). The ban also covers acquiring or retaining units or shares in a fund or investing in derivatives, certificates or indices linked to such units or shares, as well as units or shares in any entity that, in turn, engages in proprietary trading or holds units or shares in a fund. Given the narrowness of the definition of proprietary trading, hedging, underwriting and market making activities are generally permitted and are not within scope of the ban. The definition of ***trading activities*** for the purpose of the ring-fencing provisions is very wide and would cover any activity other than deposit-taking, lending activities, payment services, money broking, custody, credit reference services and the issuance of electronic money unless a relevant exemption applies (see below).	*Proprietary trading* is defined with reference to the regulated activity of 'dealing in investments as principal'. Various 'excluded activities' will be specified in secondary legislation. Dealing in commodities has also been proposed as an excluded activity. The draft secondary legislation, which is currently subject to consultation provides certain key exceptions, noted below. Central bank transactions will be permitted, as are transactions for the transfer of liquid assets to manage a ring-fenced entity's liquid assets buffer. The acquisition of shares from companies in satisfaction of loans to such companies as part of their ordinary working capital is permitted.	*Proprietary trading* is defined as the activity of concluding transactions in relation to one or more financial instruments using own capital or leveraged funds. Like the Proposed Regulation, the definition of proprietary trading is narrow to the extent it excludes the provision of investment services to clients, netting of financial instruments, hedging, market-making activities, sound and prudent management of a group's cash and the group's investment operations.	*Proprietary trading*; the high risk activities subject to ring- fencing include: (i) proprietary trading in financial instruments that does not constitute a service for clients (*Eigengeschäft*); (ii) high frequency trading on own account with the exception of certain market making activities; and (iii) extending credit or guarantees to certain hedge funds, funds of hedge funds and highly leveraged alternative investment funds or their respective management companies.

REGULATORY ISSUE	US	EU	UK	FRANCE	GERMANY
	Financial instruments include securities, derivatives and futures contracts but exclude loans, spot commodities, spot foreign exchange and US Federal and State securities.	*Financial instruments* are defined with reference to MiFID. Proprietary trading excludes: (i) financial instruments issued by Member States; (ii) the use, by a fund, of its own capital as part of its cash management process where it exclusively holds, purchases, sells or otherwise acquires or disposes of cash or cash equivalent assets.	*Investments* are specified with reference to the FSMA 2000 (Regulated Activities) Order 2001 which includes financial instruments regulated under MiFID and some other financial products.	*Financial instruments* include both financial securities and financial contracts. Financial securities include: equity securities issued by joint-stock companies; debt securities, with the exception of bills of exchange and interest-bearing notes; units or shares in undertakings for collective investment. Financial contracts, also referred to as "financial futures," are futures contracts that appear on a list established by decree.	*Financial instruments* are specified with reference to the defined term transposing MiFID.
Key exemptions	*Hedging* activities are permitted, provided these are risk-mitigating, related to identifiable financial positions, reduce one or more specific identifiable risks related to the entity's positions and do not rise to significant new or additional risks.	*Hedging* does not fall within the narrow scope of the proprietary trading ban. Ring-fenced entities are permitted to hedge for the purposes of prudently managing capital, liquidity and funding, including entering into cleared (but not OTC) interest rate, foreign exchange and credit derivatives.	*Hedging* would be permitted where transactions are entered into to limit the adverse effects of changes in interest rates, exchange rates, commodity prices, credit risk or liquidity risk.	*Hedging* is permitted, provided that the instruments used for hedging transactions are economically related to the risks identified.	*Hedging* transactions for the purpose of mitigating interest, foreign exchange, liquidity and credit risk are permitted, in addition to hedging of transactions entered into with clients (other than certain highly leveraged alternative investment funds or their respective management companies).
	Underwriting activities are permitted where they are 'client facing', are limited to distributions of securities by an underwriter and the underwriting position is disposed of within a reasonable period. Guidance provides that the exemption includes stabilisation, syndicate short positions, aftermarket short covering and other mitigation measures. *Market making* is permitted where it	*Underwriting*, *market making* and *securitisation* activities do not fall within the narrow scope of the proprietary trading ban. Market-making and securitisation activity would be assessed by regulators when deciding whether to impose a ring-fence and could be prohibited (in addition to underwriting activity) as part of any imposed ring-fence. *Client derivative transactions* for a	*Underwriting*, and *market making* activities are not specifically permitted and a ring-fenced entity would be prohibited from conducted such activities. *Securitisation* activities are permitted where a ring-fenced entity transfers securities to a special purpose securitisation vehicle. Exposures to other securitisation companies are permitted where the underlying assets do not relate to a	*Underwriting services* and *services relating to underwriting* are exempted from the requirement to ring-fence. *Market making* activities are not required to be ring-fenced, provided that the activity meets the applicable thresholds set by the French Minister of Economy and Finance. The definition of market making includes transactions that are required, in the ordinary course of	*Client transactions*, *market making* and *underwriting* do not fall within the definition of proprietary trading as these are client-related transactions. They are therefore outside the ring-fencing requirement. *Investment operations* are permitted where these relate to purchasing or selling long term investments.

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	is 'client facing', does not exceed the reasonably expected near-term demands of clients, and complies with certain principles centered on enabling the intermediation of trading. *Securitisation* and similar structures, including CDO transactions, may be restricted. In particular, there continues to be uncertainty as to how the Volcker rule applies to various aspects of such transactions, and market participants have already noted certain (possibly unintended) consequences for banking entities holding interests in such transactions.	ring-fenced credit institution when providing risk management services, including selling interest rate, foreign exchange, credit, emission and commodity derivatives to certain of its customers provided this is for hedging purposes only and resulting position risk does not exceed certain own funds ratios to be specified in delegated legislation.	financial institution and are being provided to the securitisation company as security for a loan provided by the ring-fenced entity. *Client derivative transactions* with account holders in relation to currencies, interest rates or commodities are permitted where there is evidence to assess the fair value of the investment in accordance with IFRS 13, provided that the position risk requirement of such transactions, combined with those from permitted hedging activities is less than 0.5% of own funds and the sum of position risk requirements attributable to an account holder is less than 20% of the bank's credit risk capital requirement (without offsets).	business, to complete purchase or sale orders of clients or to respond to a client's request to buy or sell. *Group's investment operations* are permitted where they consist of long term investment in securities or investment in securities issued by entities of the bank's group. Such activities do not fall within the scope of requirement to ring-fence. (Note that where ring-fencing applies, the deposit-taking entity requires regulatory approval prior to subscribing in a capital increase of the trading entity).	
Legal separation	N/A	Under the ring-fencing regime, the core credit institution must be legally, economically and operationally separate from the trading entity. A deposit-taking entity shall not hold capital instruments or voting rights in a trading entity unless permitted by the national regulator where the holding of such instruments is indispensable for the functioning of the group.	The relevant regulator (the PRA or the FCA) will publish rules relating to restrictions on shares or voting power that a ring-fenced body may hold in another company, provided that the UK Treasury may issue directions to any ring-fenced body on the same.	The trading entity shall be capitalised and funded independently and is required to have a business name and managers different from the banking group. A deposit-taking entity shall not take an active part in the management of the trading entity. The deposit-taking entity shall seek approval from the ACPR prior to subscribing to a capital increase in the trading entity.	The financial trading institution may remain a member of the same banking group as the deposit taking bank, provided, however, that it is economically, organisationally, and legally independent from the deposit taking bank and its other affiliates.

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Intra-group lending	N/A	The ring-fenced entity and trading entity shall issue their own debt on an individual or sub-consolidated basis (provided this is not inconsistent with the resolution plan agreed by the relevant resolution authorities in accordance with the Bank Recovery and Resolution Directive).	The relevant regulator will publish rules restricting payments that a ring-fenced body may make (by way of dividend or otherwise) to other members of its group.	The ring-fenced entity and trading entity are permitted to issue their debts individually or as a group by constituting a banking pool.	The financing of the financial trading institution needs to be ensured on a stand-alone basis.
Other intra-group transactions	N/A	All contracts and other transactions entered into between the ring-fenced entity and the trading entity shall be as favourable to the ring-fenced entity as are comparable contracts and transactions with or involving entities not belonging to the same sub-group (*i.e.* conducted on an arm's length basis).	The relevant regulator will publish rules restricting intra-group agreements, except if made on an arm's length basis.	Transactions between the ring-fenced entity and the trading entity are not prohibited by French law. However, the ACPR may require major intra-group transactions to be reported.	Transactions between the deposit taking bank and the financial trading institution shall be treated in the same manner as transactions with unrelated third parties.

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Remuneration	Banks must design compensation structures which do not incentivise proprietary trading. Policies and procedures in relation to permissible activities must also be designed to avoid proprietary trading.	The remuneration policies of the ring-fenced entity must be aligned to prevent any residual or hidden proprietary trading activities. A majority of members of the management body of the ring-fenced entity must not be members of the management body of the trading entity and *vice versa*.	The relevant regulator will publish rules requiring ring-fenced bodies to act in accordance with specific remuneration policy requirements and ensuring that its board of directors is independent of other members of its group.	The subsidiary shall have managers different from the ring-fenced entity.	Information and supervision requirements in relation to the activities of the financial trading institution and the associated risks apply at the level of both the deposit taking bank and the financial trading institution.
Additional large exposure limits (intra-group and third party)	N/A	A ring-fenced entity cannot incur an exposure exceeding 25% of its eligible capital to a single financial entity or 200% of eligible capital to all financial entities (taking into account credit risk mitigation). These exposure limits apply on an individual and sub-consolidated basis. A ring-fenced entity cannot incur an intra-group exposure (calculated on a sub-consolidated basis and taking into account credit risk mitigation) that exceeds 25% of its eligible capital to a non-group entity.	Draft secondary legislation proposes that a ring-fenced body be prohibited from financial institution exposures except for hedging against interest rate, exchange rate, commodity or credit risk. Intra-group exposures are permitted where these are not short-term, are commercial arm's length transactions and comply with any PRA rules. Short term exposures are permitted so long as the individual exposure is not ≥2% of own funds and the aggregate short term exposure is not ≥10% of own funds. Additional restrictions on overdrafts to financial institutions have been proposed.	The trading entity shall comply with the management rules intended to ensure their liquidity and solvency for depositors and, more generally, third parties, as well as the stability of their financial structure. The ring-fenced entity shall not have unsecure exposure to leverage effect vis-à-vis certain funds or entity. For the purposes of the bank's large exposure restrictions, trading entities must not be treated as a member of the banking group.	The financial trading institution may not rely on a waiver regarding compliance with large exposure requirements on a stand-alone basis. Any transactions of the deposit-taking bank with the financial trading institution shall be subject to the same exposure requirements as transactions with unrelated third parties.

BROADGATE WEST | 9 APPOLD STREET | LONDON | EC2A 2AP