SUPPORTING STATEMENT
Prohibitions/Restrictions on Proprietary Trading
(OMB No. 3064-NEW)

## INTRODUCTION

The FDIC is requesting approval from the OMB to establish a new information collection comprised of reporting, recordkeeping and disclosure requirements contained in a notice of proposed rulemaking entitled *Prohibitions and Restrictions on Proprietary Trading and Certain Interests In, and Relationships With, Hedge Funds and Private Equity Funds*, jointly issued by the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Federal Reserve Board (FRB), and the Securities and Exchange Commission (SEC) (collectively, "the Agencies"), to implement section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), Pub. L. No. 111-203, 124 Stat 1376 (2010).

## JUSTIFICATION

1. Circumstances and Need

Section 619 of the Dodd-Frank Act added a new section 13 to the Bank Holding Company ("BHC") Act (to be codified at 12 U.S.C. § 1851) that generally prohibits any banking entity from engaging in proprietary trading or from investing in, sponsoring, or having certain relationships with a hedge fund or private equity fund ("covered fund"), subject to certain exemptions. New section 13 of the BHC Act also provides for certain nonbank financial companies that engage in such activities or have such investments or relationships to be subject to additional capital requirements, quantitative limits, or other restrictions. Section 13(d)(1) of the BHC Act sets forth exemptions from these prohibitions for certain permitted activities, including:

- Trading in certain government obligations;
- Underwriting and market making-related activities;
- Risk-mitigating hedging activity;
- Trading on behalf of customers;
- Investments in Small Business Investment Companies and public interest investments;
- Trading for the general account of insurance companies;
- Organizing and offering a covered fund (including limited investments in such funds);
- Foreign trading by non-U.S. banking entities; and
- Foreign covered fund activities by non-U.S. banking entities.

Section 13 of the BHC Act contains two additional limits on the amount by which banking entity may invest in funds organized and offered by the banking entity or an affiliate or a subsidiary. First, for any particular covered fund, a banking entity may not own directly, and/or indirectly, more than 3 percent of the value or ownership interests of that fund. Second, a banking entity's aggregate direct and/or indirect ownership in all covered funds may not exceed 3 percent of the banking entity's Tier 1 capital. Further, any ownership interest in a covered

fund that is held by a banking entity must be deducted from the banking entity's Tier 1 capital, including ownership amounts that fall within the limitations described above.

In addition, section 13 of the BHC Act provides that otherwise allowable trading activity or covered funds activity is not permissible if it would involve or result in a material conflict of interest between the banking entity and its clients, customers, or counterparties; would result, directly or indirectly, in a material exposure by the banking entity to a high risk position or a high risk trading strategy; or would pose a threat to the safety and soundness of the banking entity or U.S. financial stability.

Section 619 of Dodd-Frank also required the Financial Stability Oversight Council to conduct a study and make recommendations on the implementation of section 13 of the BHC Act. The Council study was issued on January 18, 2011, and included a detailed discussion of key issues related to implementation of section 13 and recommended that the Agencies consider taking a number of specified actions in issuing regulations. The Council study also recommended that the Agencies adopt a four-part implementation and supervisory framework for identifying and preventing prohibited proprietary trading, which included: (1) a programmatic compliance regime requirement for banking entities, (2) analysis and reporting of quantitative metrics by banking entities, (3) supervisory review and oversight by the Agencies, and (4) enforcement procedures for violations. The Agencies fully considered the Council study in the development of the proposed rule. The proposed rule provides certain conditions that would be applied to the application of the permitted activity exemptions in section 13 of the BHC Act.

The provisions of section 13 of the BHC Act generally apply to all banking entities, including insured depository institutions ("IDIs"), companies controlling IDIs, companies treated as bank holding companies, and any affiliate or subsidiary (including subsidiaries that are broker-dealers and futures commission merchants) of the foregoing.

2. Description of Information Collection

The proposed rule contains requirements subject to the PRA. The reporting requirements are found in sections __.7(a) and __.12(e); the recordkeeping requirements are found in sections __.3(b)(2)(iii)(C), __.5(c), __.7(a), __.11(b), __.13(b)(3), __.20(b), __.20(c), and __.20(d); and the disclosure requirements are found in sections __.11(h)(1) and __17(b)(1). The recordkeeping burden for the following sections is accounted for in the __.20(b) burden: __.4(a)(2)(i), __.4(b)(2)(i), __.5(b)(1), __.5(b)(2)(i), __.5(b)(2)(v), __.13(b)(2)(i), __.13(b)(2)(ii)(A), __.13(b)(2)(ii)(D), and __.15(a)(1). Each of these information collection requirements is explained more fully below.

Section __.3(b)(2)(iii)(C) would require a covered banking entity to establish a documented liquidity management plan in order to rely on an exclusion from the definition of "trading account" for certain positions taken for the bona fide purpose of liquidity management.

Section __.5(c) would require that, with respect to any purchase, sale, or series of purchases or sales conducted by a covered banking entity pursuant to section __.5 for risk-

mitigating hedging purposes that is established at a level of organization that is different than the level of organization establishing the positions, contracts, or other holdings the risks of which the purchase, sale, or series of purchases or sales are designed to reduce, the covered banking entity document, at the time the purchase, sale, or series of purchases or sales are conducted:

(1) The risk-mitigating purpose of the purchase, sale, or series of purchases or sales;
(2) The risks of the individual or aggregated positions, contracts, or other holdings of a covered banking entity that the purchase, sale, or series of purchases or sales are designed to reduce; and
(3) The level of organization that is establishing the hedge.

Section __.7(a) would require a covered banking entity engaged in any proprietary trading activity pursuant to sections __.4 through __.6 to comply with the reporting and recordkeeping requirements described in Appendix A if the covered banking entity has, together with its affiliates and subsidiaries, trading assets and liabilities the average gross sum of which (on a worldwide consolidated basis) is, as measured as of the last day of each of the four prior calendar quarters, equal to or greater than $1 billion, as well as such other reporting and recordkeeping requirements as a relevant Agency may impose to evaluate the covered banking entity's compliance with this subpart.

Section __.11(b) would require that, with respect to any covered fund that is organized and offered by a covered banking entity in connection with the provision of bona fide trust, fiduciary, investment advisory, or commodity trading advisory services and to persons that are customers of such services of the covered banking entity, the covered banking entity document how the covered banking entity intends to provide advisory or similar services to its customers through organizing and offering such fund.

Section __.11(h)(1) would require that, with respect to any covered fund that is organized and offered by a covered banking entity in connection with the provision of bona fide trust, fiduciary, investment advisory, or commodity trading advisory services and to persons that are customers of such services of the covered banking entity, the covered banking entity clearly and conspicuously disclose, in writing, to any prospective and actual investor in the covered fund (such as through disclosure in the covered fund's offering documents):

(1) That "any losses in [such covered fund] will be borne solely by investors in [the covered fund] and not by [the covered banking entity and its affiliates or subsidiaries]; therefore, [the covered banking entity's and its affiliates' or subsidiaries'] losses in [such covered fund] will be limited to losses attributable to the ownership interests in the covered fund held by the [covered banking entity and its affiliates or subsidiaries] in their capacity as investors in the [covered fund]";
(2) That such investor should read the fund offering documents before investing in the covered fund;
(3) That the "ownership interests in the covered fund are not insured by the FDIC, and are not deposits, obligations of, or endorsed or guaranteed in any way, by any banking entity" (unless that happens to be the case); and

(4) The role of the covered banking entity and its affiliates, subsidiaries and employees in sponsoring or providing any services to the covered fund

Section __.12(e) would extend the time to divest an ownership interest in a covered fund. Upon receipt of an application from a covered banking entity, the Board may extend the period of time to meet the requirements under paragraphs (a)(2)(i)(A) and (B) of that section for up to 2 additional years, if the Board finds that an extension would be consistent with safety and soundness and not detrimental to the public interest. An application for extension must:

(1) Be submitted to the Board at least 90 days prior to the expiration of the applicable time period;
(2) Provide the reasons for application, including information that addresses the factors in paragraph (e)(2) of that section; and
(3) Explain the covered banking entity's plan for reducing the permitted investment in a covered fund through redemption, sale, dilution or other methods as required in paragraph (a)(2)(i) of that section.

Section __.13(b)(3) would require that, with respect to any acquisition or retention of an ownership interest in a covered fund by a covered banking entity pursuant to § __.13(b), the covered banking entity must document, at the time the transaction is conducted:

(1) The risk-mitigating purpose of the acquisition or retention of an ownership interest in a covered fund;
(2) The risks of the individual or aggregated obligation or liability of a covered banking entity that the acquisition or retention of an ownership interest in a covered fund is designed to reduce; and
(3) The level of organization that is establishing the hedge.

Section __.17(b)(1) would require investment advisers, commodity trading advisors, and commodity pool operators to make clear, timely, and effective disclosure of the conflict of interest, together with other necessary information, in reasonable detail and in a manner sufficient to permit a reasonable client, customer, or counterparty to meaningfully understand the conflict of interest; and would make such disclosure explicitly and effectively, and in a manner that provides the client, customer, or counterparty the opportunity to negate, or substantially mitigate, any materially adverse effect on the client, customer, or counterparty created by the conflict of interest.

Section __.20(b) would require a compliance program with respect to covered fund activities and investments that shall, at a minimum, include:

(1) Internal written policies and procedures reasonably designed to document, describe, and monitor the covered trading and covered fund activities and investments of the covered banking entity to ensure that such activities and investments are compliant with section 13 of the BHC Act and this part;
(2) A system of internal controls reasonably designed to monitor and identify

potential areas of noncompliance with section 13 of the BHC Act and this part in the covered banking entity's covered trading and covered fund activities and investments and to prevent the occurrence of activities or investments that are prohibited by section 13 of the BHC Act and this part;

(3) A management framework that clearly delineates responsibility and accountability for compliance with section 13 of the BHC Act and this part;

(4) Independent testing for the effectiveness of the compliance program conducted by qualified personnel of the covered banking entity or by a qualified outside party;

(5) Training for trading personnel and managers, as well as other appropriate personnel, to effectively implement and enforce the compliance program; and

(6) Maintenance of records sufficient to demonstrate compliance with section 13 of the BHC Act and this part, which a covered banking entity must promptly provide to the Agency upon request and retain for a period of no less than 5 years.

Section __.20(c) would require the compliance program of a covered banking entity to also comply with the requirements and other standards contained in Appendix C if the covered banking entity: (i) engages in proprietary trading and has, together with its affiliates and subsidiaries, trading assets and liabilities the average gross sum of which (on a worldwide consolidated basis), as measured as of the last day of each of the four prior calendar quarters (A) is equal to or greater than $1 billion, or (B) equals 10 percent or more of its total assets; or (ii) invests in, or has relationships with, a covered fund and (A) the covered banking entity has, together with its affiliates and subsidiaries, aggregate investments in one or more covered funds, the average value of which is, as measured as of the last day of each of the four prior calendar quarters, equal to or greater than $1 billion, or (B) sponsors and advises, together with its affiliates and subsidiaries, one or more covered funds, the average total assets of which are, as measured as of the last day of each of the four prior calendar quarters, equal to or greater than $1 billion.

Section __.20(d) would require a covered banking entity that does not engage in activities or investments prohibited or restricted in subpart B or subpart C of the proposed rule, in order be deemed to have satisfied the requirements of § 351.20, to ensure that its existing compliance policies and procedures include measures that are designed to prevent the covered banking entity from becoming engaged in such activities or making such investments and which require the covered banking entity to develop and provide for establishment of the compliance program required under § 351.20(a) of the proposed rule prior to engaging in such activities or making such investments.

3. Use of Technology to Reduce Burden

Banks may use technology to the extent feasible and/or desirable or appropriate to make the required reports and to maintain the required records.

4. Efforts to Identify Duplication

The reporting and recordkeeping requirements in the rule are new and are not otherwise duplicated.

5. Minimizing the Burden on Small Banks

The proposed rule will affect all banking organizations, including those that have been defined to be "small businesses" under the Regulatory Flexibility Act. However, only certain limited requirements would be imposed on entities that engage in little or no covered trading activities or covered fund activities and investments. Significantly, the reporting and recordkeeping requirements of § _.7 and Appendix A of the proposed rule apply only to banking entities with average trading assets and liabilities on a consolidated, worldwide basis equal to or greater than $1 billion for the preceding year. This is a threshold that a small banking entity typically would not meet.

Second, the scope and size of the compliance program requirements set forth in subpart D and Appendix C of the proposed rule would vary based on the size and activities of each covered banking entity. Only banking entities with average trading assets and liabilities on a worldwide consolidated basis equal to or greater than $1 billion or 10 percent or more of their total assets, or that have aggregate investments in, or sponsor or advise, covered funds with aggregate total assets of more than $1 billion must establish, maintain and enforce a full compliance program under the proposed rule. Banking entities that engage in trading activities or covered fund activities and investments under these thresholds must adopt, at a minimum, only the six core compliance requirements set forth in §_.20 of the proposed rule. Banking entities that do not engage in any covered trading or fund activities, typical of small banking entities, must ensure only that their compliance programs include measures designed to prevent the entities from becoming engaged in covered activities unless they first adopt a compliance program.

6. Consequences of Less Frequent Collection

The disclosure requirements are imposed on a per occurrence/transaction basis. Less frequent disclosures would impair the ability of investors to adequately evaluate the investment potential of each transaction. The recordkeeping requirements to develop liquidity management plans and policies and procedures to monitor compliance with regulatory requirements are one-time burdens, although the agencies expect that covered banking entities will review their policies and procedures to reflect any changed conditions no less frequently than annually. Reporting requirements for quantitative metrics on covered trading activities is to be done on a monthly basis. The Agencies believe that, given the complexity of the trading activities involved, reporting on less than a monthly basis would significantly impair the ability of regulators to effectively monitor on a timely basis prohibited activity and/or exposure of covered banking entities to high-risk assets and high-risk trading strategies.

7. Special Circumstances

As indicated above, monthly reports of quantitative metrics on covered trading activities is deemed necessary to effectively monitor exposure to high-risk assets and high-risk trading strategies and compliance with section 13 of the BHC Act.

8. Consultation With Members of the Public

The agencies have published a joint notice of proposed rulemaking (76 FR 68846, November 7, 2011 seeking public comment on all aspects of the proposal. The request for comment includes specific questions on each aspect of the proposal on which the agencies are seeking feedback. The Agencies will consider all comments received in development of the final rule and will respond to all comments received in the preamble of the final rule document.

9. Payment or Gift to Respondents

No payments or gifts will be provided to respondents.

10. Confidentiality

Respondent data will be treated as confidential to the extent permitted under the Freedom of Information Act (5 U.S.C. § 552) and Part 309 of the FDIC's regulations (12 C.F.R. Part 309) or the Right to Financial Privacy Act (12 U.S.C. §§ 3401 et seq.) and part 332 of the FDIC's regulations (12 C.F.R. Part 332). The information may be afforded confidential treatment pursuant to sections (b)(4), (b)(6), and (b)(8) of the Freedom of Information Act (5 U.S.C. §§ 552(b)(4), (b)(6), and (b)(8); and section 1103 of the Right to Financial Privacy Act (12 U.S.C. § 3403; and any other applicable law or regulation.

11. Information of a Sensitive Nature

None of the information required to be reported, disclosed or maintained is of a sensitive nature.

12. Estimated Burden

In determining the method for estimating the paperwork burden the Agencies made the assumption that affiliated entities under a holding company would act in concert with one another to take advantage of efficiencies that may exist. The paperwork burden for such entities has been taken by the FRB at the holding company level. Therefore, the FDIC burden estimates are only for FDIC-supervised institutions that are not under a holding company.

**(Section 619 of the Dodd-Frank Act)**
**FDIC Burden**

| | *Number of respondents* | *Annual frequency* | *Estimated average hours per response* | *Estimated annual burden hours* |
|---|---|---|---|---|
| **Initial Set-up** | | | | |
| **Reporting burden** | | | | |
| Section .7 (large institutions) | 0 | 12 | 6 | 0 |
| Section .7 (small institutions) | 0 | 12 | 6 | 0 |
| Section .12(e) | 24 | 1 | 50 | 1,200 |
| ***Total Reporting Burden*** | | | | 1,200 |
| **Recordkeeping burden** | | | | |
| Section .3(b)(iii)(C) | 0 | 1 | 3 | 0 |
| Section .5(c) (large institutions) | 0 | 1 | 35 | 0 |
| Section .5(c) (small institutions) | 0 | 1 | 6 | 0 |
| Section .7 (large institutions) | 0 | 1 | 440 | 0 |
| Section .7 (small institutions) | 0 | 1 | 350 | 0 |
| Section .11(b) | 24 | 1 | 10 | 240 |
| Section .13(b)(3) | 24 | 1 | 10 | 240 |
| Section .20(b) | 24 | 1 | 795 | 19,080 |
| Section .20(c) | 0 | 1 | 3,600 | 0 |
| Section .20(d) | 1139 | 1 | 8 | 9,112 |
| ***Total Recordkeeping Burden*** | | | | 28,672 |
| **Disclosure burden** | | | | |
| Section .11(h)(1) | 24 | 26 | 0.10 | 62 |
| Section .17(b)(1) | 0 | 1 | 2 | 0 |
| ***Total Disclosure Burden*** | | | | 62 |
| ***Total Initial Set-Up*** | | | | 29,934 |
| **Ongoing** | | | | |
| **Reporting burden** | | | | |
| Section .7 (large institutions) | 0 | 12 | 2 | 0 |
| Section .7 (small institutions) | 0 | 12 | 2 | 0 |
| Section .12(e) | 24 | 1 | 20 | 480 |
| ***Total Reporting Burden*** | | | | |

| | | | | |
|---|---|---|---|---|
| **Recordkeeping burden** | | | | |
| Section .3(b)(iii)(C) | 0 | 1 | 1 | 0 |
| Section .5c (large institutions) | 0 | 1 | 35 | 0 |
| Section .5c (small institutions) | 0 | 1 | 6 | 0 |
| Section .7 (large institutions) | 0 | 1 | 440 | 0 |
| Section .7 (small institutions) | 0 | 1 | 350 | 0 |
| Section .11(b) | 24 | 1 | 10 | 240 |
| Section .13(b)(3) | 24 | 1 | 10 | 240 |
| Section .20(b) | 24 | 1 | 265 | 6,360 |
| Section .20(c) | 0 | 1 | 1,200 | 0 |
| Section .20(d) | 1139 | 1 | 8 | 9,112 |
| ***Total Recordkeeping Burden*** | | | | 15,952 |
| | | | | |
| **Disclosure burden** | | | | |
| Section .11(h)(1) | 24 | 26 | 0.1 | 62 |
| Section .17(b)(1) | 0 | 1 | 2 | 0 |
| ***Total Disclosure Burden*** | | | | 62 |
| ***Total Ongoing*** | | | | 16,494 |
| | | | | |
| ***Total Initial & Ongoing*** | | | | **46,428** |

13. Estimate of Total Annual Cost Burden

Under the rule's new compliance regime, covered entities will be required to establish and maintain a compliance regime and to prepare reports, maintain records and make disclosures with respect to certain activities. There likely will be certain additional costs associated with the compliance program requirements, including personnel modifications, new or additional computer hardware or software, ongoing systems maintenance, consultation with outside experts, independent testing, and training. The scope and size of compliance programs will vary based on the size and activities of each covered banking entity. Only banking entities with average trading assets and liabilities on a worldwide consolidated basis equal to or greater than $1 billion or 10 percent or more of their total assets, or that have aggregate investments in, or sponsor or advise, covered funds with aggregate total assets of more than $1 billion must establish, maintain and enforce a full compliance program under the proposed rule. Banking entities that engage in trading activities or covered fund activities and investments under these thresholds must adopt, at a minimum, only the six core compliance requirements set forth in §_.20 of the proposed rule. Banking entities that do not engage in any covered trading or fund activities, typical of small banking entities, must ensure only that their compliance programs include measures designed to prevent the entities from becoming engaged in covered activities unless they first adopt a compliance program. Given these variables, it is difficult to develop estimates of capital and start-up costs and operating and systems maintenance costs that

distinguish between those pertaining to reporting, recordkeeping, and disclosure requirements and those otherwise related to satisfying the requirements of the rule. The Agencies have, however, encouraged commenters to provide relevant data on the rule's economic impact.

14. Estimate of Total Annual Cost to the Federal Government

The majority of the records required by the proposed rule will generally be maintained at the financial institutions. Therefore, the cost to the FDIC will be negligible. For those periodic reports required to be filed with the FDIC, cost to the FDIC will be minimal since evaluation of the information will be performed by existing staff.

15. Reason for Change in Burden

This is a new information collection.

16. Publication

The information collected will not be published by the FDIC.

17. Display of Expiration Date

The expiration date will be set forth in the preamble to the final rule.

18. Exceptions to Certification

This is not a statistical information collection.

B. COLLECTION OF INFORMATION EMPLOYING STATISTICAL METHODS

Not applicable.