

**US**

Morrison &amp; Foerster

**Volcker arrives**

**W**e knew it was coming. Section 619 of the Dodd-Frank Act called for a prohibition on proprietary trading by certain banking entities and limits investments in or sponsorships of private equity or hedge funds. A leaked version of the draft rule had been released several weeks ago. But, even having that leaked version out did little to soften the blow for market participants who have reacted sharply as the proposed regulations were approved for release by the banking agencies and the SEC.

Regulators have exercised their discretion under the statute to define various elements of the rule broadly in ways that are certain to have a significant impact on the derivatives market, the fixed income market, securitizations and fund activities, as well as on the activities of foreign banks in the US.

Proprietary trading by a covered banking entity is defined to include certain trading within a trading account of covered financial positions. Covered financial positions encompasses any position in any security, derivative, or commodity futures contract, as well as options on any of these instruments. Loans, commodities, foreign exchange and currency are among the types of instruments excluded from the prohibition.

The proposed regulation also broadly expands the concept of a trading account and creates rather narrowly tailored exemptions for permissible market making activities, which are sure to pose challenges for a number of market segments. Certain risk-mitigating hedging is permitted. In order to distinguish between proprietary trading and market making activities, the proposed regulation establishes a host of quantitative measures that are to be used regularly to monitor compliance with the regulation.

These complex tools are accompanied by onerous recordkeeping and compliance requirements. Finally, the proposed regulation permits limited investments in covered funds subject to various threshold limits provided that these exempted activities do not result in material conflicts of interest between the banking entity sponsor and its clients and that these activities not expose clients to particularly

high risk assets or trading strategies.

While the intended consequences of the proposed regulations are troublesome enough to many, it is the unintended and unforeseeable consequences that give rise to widespread anxiety.

**Contacts:**

1290 Avenue of the Americas  
New York, NY 10104-0050  
United States

Tel: +1 212 468 8000  
Fax: +1 212 468 7900  
Web: [www.mofo.com](http://www.mofo.com)