

Federal Reserve Bank of San Francisco  
101 Market Street, San Francisco, California 94105

October 12, 2011

To State Member Banks, Bank  
Holding Companies, Financial Holding  
Companies, Foreign Bank Offices and  
Savings and Loan Holding Companies  
in the Twelfth Federal Reserve District

**Federal Reserve Board Seeks Comment on Proposal to Implement "Volcker Rule" Requirements of the Dodd-Frank Act**

The Federal Reserve Board on October 11, 2011 requested public comment on a proposed regulation implementing the so-called "Volcker Rule" requirements of section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 619 generally contains two prohibitions. First, it prohibits insured depository institutions, bank holding companies, and their subsidiaries or affiliates (banking entities) from engaging in short-term proprietary trading of any security, derivative, and certain other financial instruments for a banking entity's own account, subject to certain exemptions. Second, it prohibits owning, sponsoring, or having certain relationships with, a hedge fund or private equity fund, subject to certain exemptions.

The act also prohibits banking entities from engaging in an exempted transaction or activity if it would involve or result in a material conflict of interest between the banking entity and its clients, customers, or counterparties, or that would result in a material exposure to high-risk assets or trading strategies, in each case as defined by the rule. The act similarly prohibits banking entities from engaging in an exempted transaction or activity if it would pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States.

The proposal, which was developed jointly with the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Securities and Exchange Commission, and the Commodity Futures Trading Commission, clarifies the scope of the act's prohibitions and, consistent with statutory authority, provides certain exemptions to these prohibitions. It is anticipated these agencies will issue a comparable proposal today or in the near future.

Transactions in certain instruments, including obligations of the U.S. government or a U.S. government agency, the government-sponsored enterprises, and state and local governments, are exempt from the statute's prohibitions. Consistent with the statute, other activities exempted include market making, underwriting, and risk-mitigating hedging. The statute also permits banking entities to organize, offer, and invest in a hedge fund or private equity fund subject to a number of conditions.

The proposed rule would require banking entities that engage in these activities to establish an internal compliance program that is designed to ensure and monitor compliance with the statute's prohibitions and restrictions, and implementing regulations. The proposed rule provides commentary intended to assist banking entities in distinguishing permitted market making-related activities from prohibited proprietary trading activities.

The proposal also requires banking entities with significant trading operations to report to the appropriate federal supervisory agency certain quantitative measurements designed to assist the federal supervisory agencies and banking entities in identifying prohibited proprietary trading in the context of certain exempt activities and identifying high-risk assets or trading strategies. It also includes a number of elements intended to reduce the burden of the proposal on smaller, less-complex banking entities. For example, the proposal limits the extent to which smaller banking entities are required to report quantitative measurements.

Comments on the proposal will be received through January 13, 2012.

**Additional Information**

All circulars and documents are available on the Internet through the Federal Reserve Bank of San Francisco's website, at <http://www.frbsf.org/banking/letters>.

For additional information, please contact:

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**Attachment:** [Notice of proposed rulemaking \(1.1 MB PDF\)](#)