

THE VOLCKER RULE: REALITY

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INTRODUCTION

Over the past several years, the world's major financial institutions have been operating in a legal and regulatory vacuum with respect to proprietary trading.¹ Section 619 of the Dodd Frank Act (also known as the Volcker Rule) introduced a general prohibition on proprietary trading, but the regulations implementing the law proved extraordinarily difficult to construct in a manner that accommodated the language and intent of the statute – notably provisions allowing banks to continue underwriting, market making, and risk-mitigating hedging activities.

This vacuum has at last been filled, in some measure, by final rules published by the agencies charged with implementing the Volcker Rule on December 10th. In brief, the final rules prohibit banking entities from

- Engaging in short-term proprietary trading of securities, derivatives, commodity futures and options on these instruments for their own account
- Owning, sponsoring, or having certain relationships with hedge funds or private equity funds, referred to as “covered funds”

The rules will come into force on April 1, 2014, but introduce a tiered compliance regime that allows banking entities to meet compliance requirements over time; the banks with the largest trading businesses will be required to begin reporting quantitative measurements from June 30, 2014 and bring trading activities into full compliance by July 21, 2015.

The final rules are lengthy and complex, but they address many of the key concerns raised on both sides of the debate during the public comment period – exemptions for permitted activities (e.g. market making) have been clarified, metrics have been streamlined and simplified, and the structure of the compliance program has been spelled out in exhaustive detail. This will provide some level of closure and clarity for the banks that are required to comply with the rules.

However, it isn't all good news. The agencies made a concerted effort to narrow the scope of the final rules, rolling back the extraterritorial reach of the restrictions on proprietary trading and creating a tiered compliance program for covered banking entities. These changes are already creating confusion, as banks (especially foreign banking organizations) struggle to understand the scope of activities and assets included in calculations used to determine each institution's requirements under the Volcker Rule.

Further, the effectiveness and impact of the Volcker Rule is ultimately in the hands of the regulators who will enforce the text. Unfortunately, there are already signs of discord among the agencies charged with implementing the final rules, with the CFTC releasing its own version of the preamble that asserts its role as “a primary regulator” for registered swap dealers. This promises to create significant jurisdictional overlap and may place the agency at odds with the three other primary enforcers of the rule (the OCC, SEC, and Federal Reserve).

At this early stage, we view the final rules (assuming they are enforced reasonably) as a step forward for the industry, its clients, and the broader economy. The final rules include critical refinements that reduce the threat to market liquidity, trading revenues, and the safety and soundness of the institutions the Volcker Rule will cover.² However, significant challenges lie ahead. The final rules will not be easy (or efficient) for banks to comply with nor for regulators to enforce – neither group has sufficient resources in place to handle this burden today. The challenges will be particularly onerous for banks on the margins of the Volcker Rule, especially US banks and foreign banking entities where trading primarily complements core lending, underwriting, or transaction banking businesses. The costs (and uncertainty) of compliance may change the calculus for these players, forcing difficult strategic decisions.

¹ As noted below, the Volcker Rule covers (1) proprietary trading and (2) certain interests in and relationships with covered funds. While both elements of the final rules raise important legal and strategic questions, this note focuses on the special challenges related to restrictions on proprietary trading.

² This is not to say the agencies have addressed every potential threat in the final rules – the tender-option bond (TOB) market for municipal securities and asset-backed commercial paper (ABCP) conduits, to highlight two markets, are facing significant disruptions as a result of specific provisions in the final rules.

NO (MAJOR) SURPRISES

The final rules are notable for their measured and consistent approach to restrictions on proprietary trading. There has been a clear shift in philosophy away from the presumption of guilt evident in the proposed rules, which relied on a series of tests and reported metrics to prove that desks (or trading units) were not engaged in prohibited proprietary trading. The final rules more accurately reflect and respect the difficulty of distinguishing prohibited proprietary trading from market making, shifting to a presumption that market making desks are what they claim to be, while requiring enhancements to risk management, reporting, and compliance processes to verify this presumption.

These enhanced requirements are significant and present a major challenge for covered banking entities, but the agencies have avoided some of the more radical proposals that the industry had feared, and some observers had predicted, to draw the line between prohibited and permitted activities. Critically, the final rules do not

- **Place excessive constraints on market making:** The final rules adopt a streamlined set of standards to identify market making activities that most legitimate market making desks will be able to satisfy relatively easily (in contrast to the proposed rules)
- **Prohibit banks from hedging risks at the portfolio level:** The final rules adopt a narrower definition of permitted hedging activities, but do not prohibit portfolio hedging outright
- **Require the delivery of new, complex metrics to demonstrate compliance:** The final rules reduce the number of core “Volcker metrics” from 17 to 7 and eliminate several of the more problematic proposed metrics, which would have been challenging or impossible to produce
- **Require CEOs to certify compliance with the general prohibition:** The final rules require CEOs (or equivalent officials) to attest that the compliance program is “reasonably designed” to achieve compliance with the rule; they do not require CEOs to attest that no prohibited proprietary trading takes place
- **Impose a one-size-fits-all compliance regime on all banks:** The final rules tailor the compliance requirements based on the size, US presence, and level of trading activity conducted by banking entities; *a summary of the compliance program and reporting requirements are provided at the conclusion of this note*

THE NEW REALITY

The Volcker Rule prohibits covered banking entities from engaging in proprietary trading activities, defined as “engaging as a principal for the trading account of the banking entity in any purchase or sale of one or more financial instruments”.³ The general prohibition remains largely unchanged from the original proposal.

However, the scope of application of the prohibition has been narrowed considerably through more careful definition of financial instruments and the trading account, clearer exemptions for permitted activities, and limitations on the extraterritorial reach of the final rules. Further, there are significant changes to the requirements for compliance, streamlining reporting metrics and more clearly detailing the required elements of the compliance program. These changes are addressed in turn below.

1. BROADER EXCLUSIONS FROM THE DEFINITION OF PROPRIETARY TRADING

The definition of the trading account was a critical, and problematic, provision of the proposed rules. The proposal relied on several exemptions to the definition of the trading account to “safe harbor” specific trading activities. The final rules have shifted tack, excluding these and other activities from the definition of proprietary trading in a manner that allows banking entities to

- Enter freely into repurchase or reverse repurchase (“repo”) agreements
- Conduct bona fide liquidity management activities
- Engage in clearing activities
- Act solely as a broker, agent, or custodian
- Collect and dispose of collateral (to satisfy a debt previously contracted)

2. CLEARER EXEMPTIONS FOR PERMITTED ACTIVITIES

The final rules also set out several exemptions for underwriting, market making, and risk-mitigating hedging activities. Each of these exemptions has been clarified substantially, but the refinement of the principles of market making is perhaps the most important revision to the proposed rules. The principles defined in the proposed rules were complex, difficult to interpret, and nearly impossible to satisfy consistently; the revised principles have been streamlined to require a market making desk to

- Stand ready to purchase and sell one or more financial instruments
- Hold inventory that does not exceed reasonably expected near-term demand of clients, customers, or counterparties
- Maintain an internal compliance program, with a clearly defined limit framework
- Develop and enforce limit exception policies and procedures
- Ensure compensation does not incentivize prohibited proprietary trading
- Maintain licenses or registration to conduct trading activity

Nearly all legitimate market making businesses will be able to satisfy these requirements with relative ease.

³ The definition of a financial instrument (formerly known as a covered financial position) remains the same, despite the name change. A financial instrument includes any security, derivative, contract for future delivery of a commodity, or option on any of the instruments listed above. Loans, spot commodities, and foreign exchange are excluded from the definition; banks can continue to trade freely in these instruments.

3. LIMITATIONS ON THE EXTRATERRITORIAL REACH OF THE FINAL RULES

The final rules make several modest concessions to concerns about the extraterritorial reach of the original proposal. The final rules continue to capture foreign banking entities, but relax some of the more aggressive elements of the proposed rule by

- Permitting foreign banking entities to trade freely with the foreign desks of US banking entities, provided no personnel of the US entity are involved in the arrangement, negotiation, or execution of the trade
- Extending the exemption for proprietary trading in US sovereign and municipal obligations to the sovereign obligations of the home country for each foreign banking entity, including the local affiliates of US banking entities
- Narrowing the scope of assets (to those associated with US activities) included in tests to determine whether foreign banking entities are subject to enhanced compliance and metrics reporting requirements

























The final concession is significant, but raises a number of questions regarding the assets (and liabilities) that should be included in the tests above. The precise scope will need to be clarified so foreign banking entities understand whether to run the calculations of US assets on the basis of booking location, counterparty domicile, underlying risk, or some other criterion.




4. SIMPLIFICATION OF THE REQUIRED METRICS

The final rules make two fundamental changes to the requirements for reporting quantitative measurements: the total number of metrics banking entities will be required to design, develop, and deliver to regulators has been reduced; the level at which the remaining metrics (7) will need to be calculated has been pushed down to the trading desk level.

The reduction in the total number of required metrics, and the shift to a set of metrics that most banking entities already produce today, will reduce the burden of the reporting requirements substantially (and likely provide regulators with a more accurate set of data on the trading activities of the desks they will monitor).

EXHIBIT 1: PROPOSED AND FINAL METRICS

Proposed metrics	Utilization	Final metrics	Utilization
VaR and Stress VaR		VaR and Stress VaR	
Risk Factor Sensitivities		Risk Factor Sensitivities	
Risk and Position Limits		Risk and Position Limits & Usage	
Comprehensive P&L Attribution		Comprehensive P&L Attribution ¹	
Inventory Risk Turnover		Inventory Turnover ¹	
Inventory Aging		Inventory Aging	
Customer-Facing Trade Ratio		Customer-Facing Trade Ratio - Trade Count & Value Based ¹	
Comprehensive P&L			
Portfolio P&L			
Fee Income & Expense			
Spread P&L			
VaR Exceedance			
Volatility of Comprehensive and Portfolio P&L			
Comprehensive and Portfolio P&L to Volatility Ratio			
Unprofitable Trading Days			
Skewness & Kurtosis of Portfolio P&L			
Pay-to-Receive Spread Ratio			

 In wide use today
 Possible with existing data, but rarely tracked today
 New metrics – significant costs/challenges to implement

1. Material changes have been made to proposed metric

By contrast, the shift from the trading unit to trading desk level will increase the burden on banking entities covered by the rule. Nearly all trading businesses track the metrics required in the final rules, but they may not do so at the “trading desk” level, as defined by the rule. This may represent a significant near-term challenge for these institutions, who were generally preparing for a “trading unit” view of the metrics.

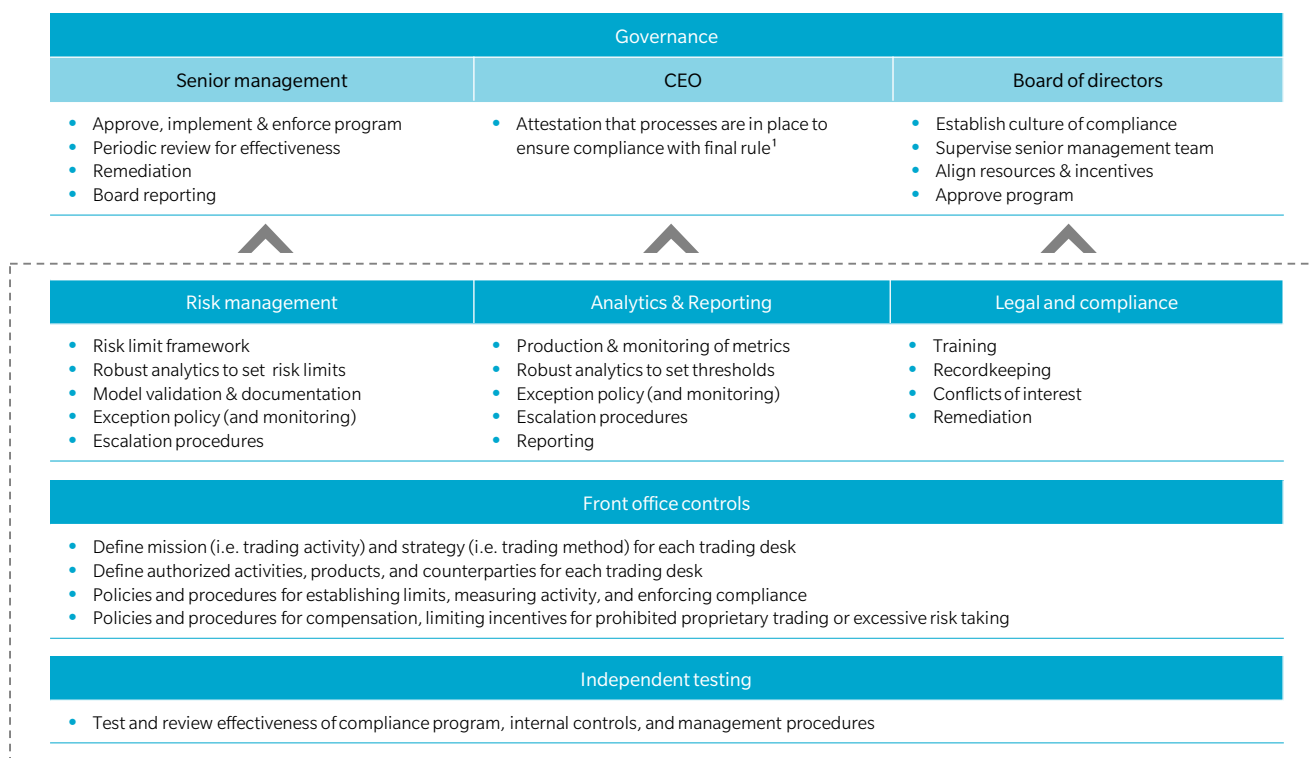
5. MORE PRESCRIPTIVE REQUIREMENTS FOR THE COMPLIANCE PROGRAM

While the regulators have reduced the volume of data they will collect from banking entities subject to the metrics reporting requirements, the final rules have substantially increased the requirements of the internal compliance program. All banks with \$10 BN or more in consolidated assets that engage in covered trading activities will be required to satisfy six basic elements of the standard compliance program

- a. Policies and procedures to monitor and limit trading activities
- b. Internal control systems designed to monitor compliance
- c. Management framework that assigns responsibility and accountability
- d. Independent testing of compliance effectiveness
- e. Training of trading staff in compliance enforcement
- f. Recordkeeping to demonstrate compliance

However, banks with total consolidated assets of \$50 BN or more, or banks that are required to report quantitative metrics, will be subject to the enhanced minimum standards and prescriptive requirements under each of these elements. The figure below highlights the enhanced requirements as we expect them to fall within the business.

EXHIBIT 2: ILLUSTRATIVE STRUCTURE OF ENHANCED COMPLIANCE PROGRAM



1. For foreign banks, attestation can be from the senior management officer of the US division

The enhanced compliance program mandated by the final rules generally follows the organizational structure and standard practices in place for all major trading businesses. However, the enhancements required are not trivial.

- **Revised trading policies and procedures:** All trading policies and procedures will need to be revised to reflect the new requirements of the final rule, including the authorized “mission”, strategy, activities, and counterparties of each trading desk
- **Updated limit frameworks:** Limit frameworks will need to be revised or supplemented to incorporate Volcker trading limits, requiring robust back-testing and historical analysis of trading activity to appropriately structure and set limits
- **Increased compliance burden:** Trading activity for the purposes of liquidity management and hedging will require extensive documentation, oversight, and monitoring to demonstrate compliance
- **Expanded oversight role for senior management:** Senior stakeholders will be required to take an active role in the compliance program, with board approval of the program structure, capacity of the management team to ensure compliance, and incentives. The CEO will be required to attest that the program is reasonably designed to ensure compliance. (In the case of a US branch or agency of a foreign banking entity, the attestation may be provided by the senior management officer of US operations)

UNFINISHED BUSINESS

The original notice of proposed rulemaking for the Volcker Rule was published in the Federal Register on November 7, 2011. Banks have had more than two years to assess the proposed rule, formulate a response, and bring their activities into conformance, with their expectations of the requirements of the final rules.

However, we see a wide spread in the level of readiness for Volcker Rule compliance today based on the work already completed in response to the proposed rules

- **Proactive response:** The majority of the US banks with significant trading operations were preparing for a more aggressive version of the final rules; nearly all of these institutions are well positioned to comply
- **Balanced response:** Foreign banks with significant trading operations have taken a less consistent approach than their US peers; these institutions will generally have to revisit their strategy and compliance program, especially given changes to the scope of the final rules outside the borders of the US
- **“Wait and See” response:** The majority of US and foreign banks with smaller trading operations were waiting for the final rules to make meaningful preparations; those impacted by the rule will now have to play catch up to close the gap, and potentially prepare to report metrics as soon as July 2014

Regardless of the level of readiness today, the final rules have added some new wrinkles that will demand course corrections and further investment from all covered institutions. There are some fundamental changes (e.g. focus on trading desks vs. trading units) that will influence technical, tactical, and strategic decision-making. Over the next several months, banks will need to assess the scope, requirements, and impact of the final rules and plan their response to these accordingly.

The work will need to cover several fronts. Existing risk management, trading controls, and compliance programs will need to be overhauled and enhanced – the final rules are far more prescriptive with respect to the structure, components, documentation, and supporting analysis required for the compliance program. Second, metrics reporting remains a prominent (though narrower) feature of the final rules, and banks will need to develop or modify trade, finance, and risk reporting systems to comply, quickly if the work has yet to begin.

The following table briefly outlines the key challenges facing institutions, depending on their approach to the proposed rule.

Approach to NPR	Common players	Common elements of response to date	New challenges
Proactive	Major US banks	<ul style="list-style-type: none">• Impact assessment• Tactical restructuring• Refined trading unit hierarchy• Initial compliance program implementation• Best efforts metrics design and development	<ul style="list-style-type: none">• Shift to trading desk view of Volcker metrics• Managing liquidity management exemption• Managing hedging exemption• Setting meaningful limit structure
Balanced	Major FBOs	<ul style="list-style-type: none">• Impact assessment• Tactical restructuring• Refined trading hierarchy (case by case)• Compliance program implementation planning• Limited metrics design and development	<ul style="list-style-type: none">• Assessing scope of foreign trading exemption• Shift to trading desk view of Volcker metrics• Managing liquidity management exemption• Managing hedging exemption• Setting meaningful limit structure
Wait & see	Smaller US and foreign players	<ul style="list-style-type: none">• Impact assessment	<ul style="list-style-type: none">• Assessing scope of application under tiered regime• Strategic decisions given cost of compliance• All of the above, depending on strategic decisions

So what is at stake for the banking industry under the new rules? The industry has already moved ahead with many of the structural reforms the Volcker Rule was meant to effect – nearly all ring-fenced proprietary trading desks have been wound down and related activities on market making desks curtailed. These actions have reduced the total potential impact of the final rules on the industry (vs. the work that has already been done).

Nevertheless, we expect the Volcker Rule to impose some level of incremental costs on the industry via

- **Prohibition of specific trading activities:** The majority of the structural reduction in topline revenue has been absorbed, but some incremental impact is likely to emerge as the banks retaining some form of ring-fenced proprietary trading wind down these businesses and trading desks with “unattractive” metrics come under increasing pressure
- **Cost of Compliance:** The costs of winding down businesses, restructuring trading desks and flows, and enhancements to risk management, trading controls, compliance, and reporting will be substantial
- **Chilling effects at the margins:** The final rules have further potential to reduce topline revenues through two different routes: (1) large dealers may turn away from “borderline” business; and (2) smaller, foreign dealers may curtail impacted business (i.e. servicing their corporate clients in trades through US markets) due to the prohibitive cost of compliance

NEXT STEPS FOR AFFECTED FIRMS

The agencies charged with implementing the Volcker Rule have, somewhat remarkably, given the state of the proposed rules, delivered a set of standards that the industry can realistically meet. While some uncertainty remains, it is now up to the industry to work to meet these standards quickly and efficiently. The next steps are clear and pressing

1. **Understand how and when the Volcker rule will apply to you.** The tiered compliance regime and staggered deadlines for compliance, while welcome features of the final rules that will help limit unintended consequences, do mean that each firm will need to assess exactly what requirements will apply, and what the associated deadlines will be. This is made more complex by the thresholds in the final rules, based on the global (for US banks) or US (for foreign banks) gross sum of trading assets and liabilities (net of positions in US government obligations)
2. **Immediately begin to adjust or build out your compliance program.** Most of the banks with major trading businesses have made substantial preparations to comply. These firms will need to review their capacity to calculate and report the required metrics at the trading desk level, and will likely need to develop additional limits for Volcker rule purposes with associated analysis and documentation of the rationale for those limit levels. Smaller firms, or those with less trading activity, will have longer periods before needing to report or come into conformance with the final rules, but these institutions should make an immediate start on development of a compliance program, given the potentially long lead times associated with changes to data collection, calculation, and reporting systems. Many foreign banks will also face planning and implementation challenges associated with the need to integrate such changes into preparations for the proposed Intermediate Holding Company (IHC) regulation, already a complex and resource-intensive effort for many foreign banking organizations
3. **Assess the impact of the final rules on your existing businesses.** We expect most US-based market-making businesses to be able to continue their existing trading activities (albeit under an expanded set of controls associated with the required compliance program). However, some outlier trading activities at particular desks may need to be further adjusted or curtailed. Each firm should plan on conducting a series of iterative reviews, increasingly granular as the compliance program is established, to identify such outlier activities. At this stage, we expect foreign banks to have relatively more such outliers that will need to be addressed
4. **Evaluate technical, tactical, and strategic moves to reshape your business.** Any outlier trading activities that are identified that would not be permitted under the final rules will need to be addressed by business changes. For major US dealers, we expect the scope of such adjustments to be relatively modest, and to be technical (e.g. clearer documentation for certain trades or hedges) or tactical (e.g. shifts in how positions are hedged that would not change the overall economics significantly). Other firms, especially foreign banks, may ultimately need to consider more strategic moves, such as the relocation of some trading operations outside of the US

TIERED COMPLIANCE PROGRAM & REPORTING TIMELINE

The final rules would provide compliance requirements that vary based on the size of the banking entity and the amount of activities conducted, reducing the burden on smaller, less complex entities. Banking entities that do not engage in activities covered by the final rules would have no compliance program requirements.

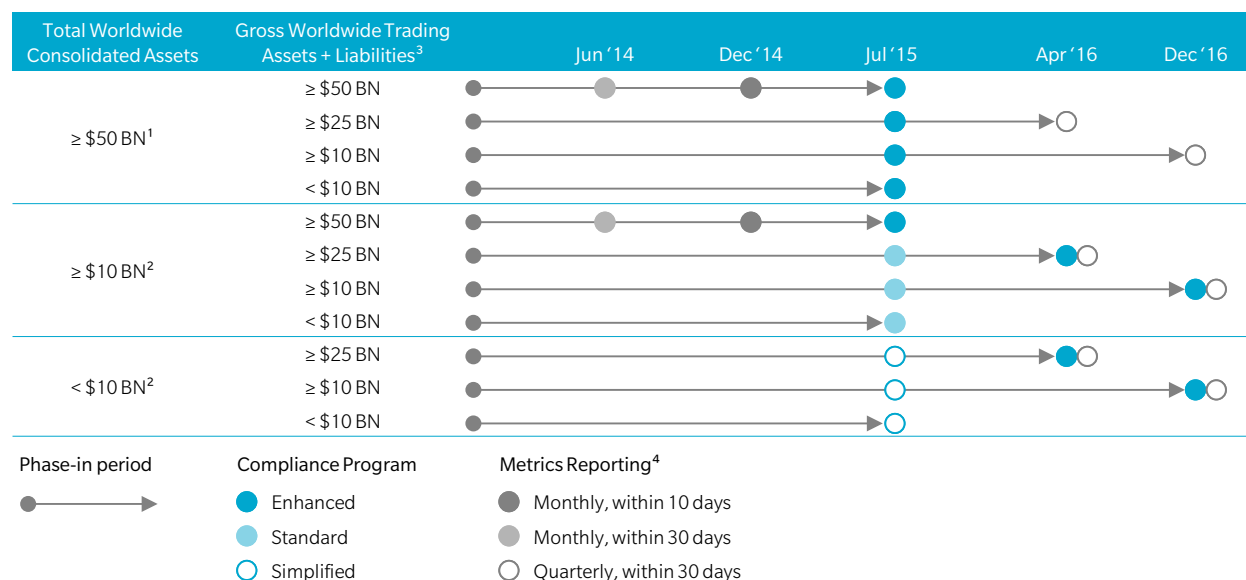
Simplified requirements: Simplified compliance requirements apply to banking entities with total consolidated assets of \$10 BN or less that engage in proprietary trading. No formal action is required, beyond including appropriate references to the requirements of the Volcker Rule in existing policies and procedures.

Standard requirements: Standard compliance requirements apply to banking entities with total consolidated assets of \$10 BN or more that engage in proprietary trading. The compliance program must include six elements

1. Written policies and procedures designed (1) to ensure compliance with the requirements of the final rule and (2) establish trading and exposure limits for the activities conducted by the banking entity
2. A system of internal controls to monitor and identify potential areas of noncompliance and to prevent prohibited activities
3. A management framework that delineates responsibility and accountability for compliance
4. Independent testing for the effectiveness of the compliance program
5. Training for appropriate personnel
6. Recordkeeping sufficient to demonstrate compliance

Enhanced requirements: Enhanced compliance requirements apply to banking entities with total consolidated assets of \$50 BN or more, or banking entities that are required to report quantitative metrics – based on more detailed criteria provided in Exhibit 3 for US institutions and Exhibit 4 for foreign banking entities. The final rule requires that the enhanced compliance program satisfy a variety of additional requirements and minimum standards designed to ensure that the banking entity has robust risk management processes, remediation processes, independent testing, reporting, and other compliance controls. Among these enhanced requirements is that the CEO of a banking entity with significant trading activities must, annually, attest in writing to the relevant agency that the banking entity has in place a compliance program reasonably designed to achieve compliance with section 13 and the final rule. A detailed illustration of the enhanced compliance program is provided in Exhibit 2.

EXHIBIT 3: US BANKING ENTITIES



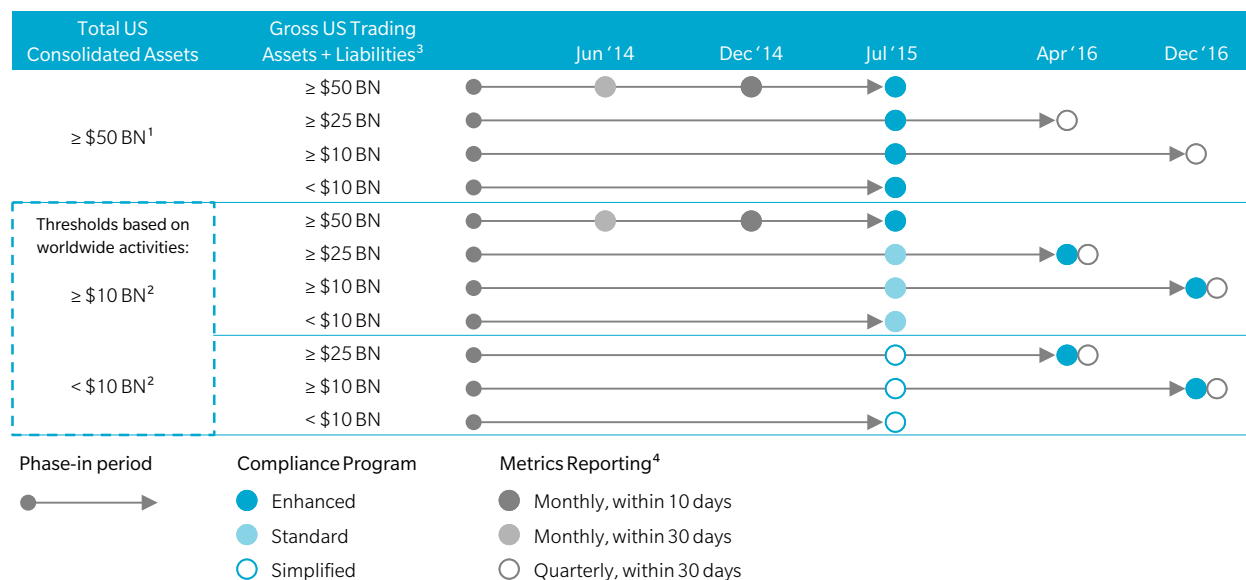
1. Reported total consolidated assets as of the previous calendar year end

2. Total consolidated assets as reported on December 31 of the previous two calendar years

3. Average gross sum (on a worldwide consolidated basis) of trading assets and liabilities (ex US government obligations) over the previous consecutive four quarters

4. According to the Federal Reserve Board Memo, reporting starts with data from the month following the threshold breach (i.e. banks breaching the limit in June 2014 would be required to report metrics in August 2014 with July 2014 data)

EXHIBIT 4: FOREIGN BANKING ENTITIES



1. Total US assets as of the previous calendar year end

2. Total consolidated assets as reported on December 31 of the previous two calendar years

3. Average gross sum of trading assets and liabilities (ex US government obligations) of the combined US operations of the foreign banking entity over the previous consecutive four quarters

4. According to the Federal Reserve Board Memo, reporting starts with data from the month following the threshold breach (i.e. banks breaching the limit in June 2014 would be required to report metrics in August 2014 with July 2014 data)

METRICS DEFINED

RISK-MANAGEMENT MEASUREMENTS

1. **Value-at-Risk and Stress Value-at-Risk:** VaR is the commonly used percentile measurement of the risk of future financial loss in the value of a given set of aggregated positions over a specified period of time, based on current market conditions. Stress VaR is the percentile measurement of the risk of future financial loss in the value of a given set of aggregated positions over a specified period of time, based on market conditions during a period of significant financial stress. In cases where a trading desk does not have a standalone VaR or Stress VaR calculation but is part of a larger aggregation of positions for which a VaR or Stress VaR calculation is performed, a VaR or Stress VaR calculation that includes only the trading desk's holdings must be performed consistent with the VaR or Stress VaR model and methodology used for the larger aggregation of positions
2. **Risk Factor Sensitivities:** Risk Factor Sensitivities are changes in a trading desk's Comprehensive Profit and Loss that are expected to occur in the event of a change in one or more underlying variables that are significant sources of the trading desk's profitability and risk
3. **Risk and Position Limits and Usage:** Risk and Position Limits are the constraints that define the amount of risk that a trading desk is permitted to take at a point in time, as defined by the banking entity for a specific trading desk. Usage represents the portion of the trading desk's limits that are accounted for by the current activity of the desk. Risk and Position Limits must be reported in the format used by the banking entity for the purposes of risk management of each trading desk. Risk and Position Limits are often expressed in terms of risk measures, such as VaR and Risk Factor Sensitivities, but may also be expressed in terms of other observable criteria, such as net open positions

SOURCE-OF-REVENUE MEASUREMENTS

4. **Comprehensive Profit and Loss Attribution:** Comprehensive Profit and Loss Attribution is an analysis that attributes the daily fluctuation in the value of a trading desk's positions to various sources. First, the daily profit and loss of the aggregated positions is divided into three categories: (i) profit and loss attributable to a trading desk's existing positions that were also positions held by the trading desk as of the end of the prior day ("existing positions"); (ii) profit and loss attributable to new positions resulting from the current day's trading activity ("new positions"); and (iii) residual profit and loss that cannot be specifically attributed to existing positions or new positions. The sum of (i), (ii), and (iii) must equal the trading desk's comprehensive profit and loss at each point in time. In addition, profit and loss measurements must calculate volatility of comprehensive profit and loss (i.e., the standard deviation of the trading desk's one-day profit and loss, in dollar terms) for the reporting period for at least a 30-, 60- and 90-day lag period, from the end of the reporting period, and any other period that the banking entity deems necessary to meet the requirements of the rule

CUSTOMER-FACING ACTIVITY MEASUREMENTS

5. **Inventory Turnover:** Inventory Turnover is a ratio that measures the turnover of a trading desk's inventory. The numerator of the ratio is the absolute value of all transactions over the reporting period. The denominator of the ratio is the value of the trading desk's inventory at the beginning of the reporting period. For derivatives, other than options and interest rate derivatives, value means gross notional value, for options, value means delta adjusted notional value, and for interest rate derivatives, value means 10-year bond equivalent value
6. **Inventory Aging:** Inventory Aging generally describes a schedule of the trading desk's aggregate assets and liabilities and the amount of time that those assets and liabilities have been held. Inventory Aging should measure the age profile of the trading desk's assets and liabilities. Inventory Aging must include two schedules, an asset-aging schedule and a liability-aging schedule
7. **Customer-Facing Trade Ratio – Trade Count Based and Value Based:** The Customer-Facing Trade Ratio is a ratio comparing (i) the transactions involving a counterparty that is a customer of the trading desk to (ii) the transactions involving a counterparty that is not a customer of the trading desk. A counterparty is considered to be a customer of the trading desk if the counterparty is a market participant that makes use of the banking entity's market making-related services by obtaining such services, responding to quotations, or entering into a continuing relationship with respect to such services. However, a trading desk or other organizational unit of another banking entity would not be a client, customer, or counterparty of the trading desk if the other entity has trading assets and liabilities of \$50 billion or more unless the trading desk documents how and why a particular trading desk or other organizational unit of the entity should be treated as a client, customer, or counterparty of the trading desk. Transactions conducted anonymously on an exchange or similar trading facility that permits trading on behalf of a broad range of market participants would be considered transactions with customers of the trading desk

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