

**ALERT**

Rule Issued on Treatment of TruPS CDOs under Volcker Rule

Regulatory agencies recently adopted an interim final rule on the treatment of certain collateralized debt obligations backed by trust preferred securities (TruPS CDOs).¹ The interim final rule is a companion rule to the final rules adopted by the agencies to implement section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), also known as the Volcker Rule.²

Key Facts

- The interim final rule permits banking entities to retain an investment in a TruPS CDO if all of the following qualifications are met:
 - The TruPS CDO issuer was established, and the interest was issued, before May 19, 2010;
 - The banking entity reasonably believes that the offering proceeds received by the TruPS CDO issuer were invested primarily in Qualifying TruPS Collateral;³ and
 - The banking entity acquired its interest in the TruPS CDO on or before December 10, 2013 (or in connection with a merger with or acquisition of a banking entity that acquired the interest on or before that date).
- The FRB, FDIC, and OCC also released a non-exclusive list of qualified TruPS CDOs for use by banking entities in determining compliance with the interim final rule (i.e., these agencies will recognize the listed TruPS CDOs as meeting the requirements for retention).

¹ On January 14, 2014, the agencies that adopted the rule were the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (FRB), the Securities and Exchange Commission (SEC), and the Commodity Futures Trading Commission (CFTC).

² The interim final rule on the "Treatment of Certain Collateralized Debt Obligations Backed Primarily by Trust Preferred Securities with Regard to Prohibitions and Restrictions on Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds," is available at <http://www.occ.gov/news-issuances/news-releases/2014/nr-ia-2014-2a.pdf>.

³ Qualifying TruPS Collateral is defined as any trust preferred security or subordinated debt instrument issued prior to May 19, 2010, by (1) a depository institution holding company that, as of the end of any reporting period within 12 months immediately preceding the issuance of such security or instrument, had total consolidated assets of less than \$15 billion, or (2) a mutual holding company.

Key Impacts

- A banking entity holding investments in TruPS CDOs should assess those securities and determine which positions qualify for retention under the interim final rule because a security is included on the non-exclusive list, or if not, otherwise meets the qualifications for retention.
- A banking entity holding investments in qualifying TruPS CDOs would not be required to recognize other-than-temporary impairment solely as a result of the Volcker Rule.

Background. The Volcker Rule was adopted by the agencies on December 10, 2013, and becomes effective on April 1, 2014. Among other things, the Volcker Rule restricts banking entities and their affiliates from investing in and sponsoring *covered funds*. The final rule implementing the Volcker Rule defines covered funds as pooled investment vehicles, which includes many TruPS CDOs.⁴ Investments in covered funds must be divested by July 21, 2015, which is the end of the Volcker Rule conformance period.

Separately, section 171 of the Dodd-Frank Act, also known as the Collins Amendment, requires that trust preferred securities issued by depository institution holding companies must be phased out for purposes of determining Tier 1 regulatory capital, unless these securities were issued before May 19, 2010, by any depository institution holding company that had total consolidated assets of less than \$15 billion as of December 31, 2009, or that was a mutual holding company on May 19, 2010.

Community banking entities expressed concern that the Volcker Rule could require them to dispose of investments in TruPS CDOs, which appeared inconsistent with the Collins Amendment that grandfathered the ability of banking entities to include certain issued TruPS CDOs in regulatory capital. A disposal requirement may result in an impairment loss that would reduce regulatory capital, while the focus of the Collins Amendment was to ensure banking entities maintain strong, minimum capital levels.

Later in December 2013, the FRB, FDIC, and OCC issued a joint statement outlining some of the issues that should be considered in determining whether a TruPS CDO is a covered fund and committed to address the treatment of TruPS CDOs by January 15, 2014.⁵

Interim Final Rule. On January 14, 2014, the agencies issued the interim final rule to reconcile the relevant provisions of the Volcker Rule with the Collins Amendment by allowing certain TruPS CDOs to be permitted investments under the Volcker Rule. The interim final rule also clarifies that the relief relating to permitted TruPS CDOs also extends to activities of a banking entity that acts as a sponsor for these securitization vehicles. A banking entity may act as a market maker with respect to the interests of a qualifying issuer of TruPS CDOs in accordance with the applicable provisions of the Volcker Rule.

⁴ December 10, 2013, final rule implementing the Volcker Rule can be found at <http://www.federalreserve.gov/newsreleases/press/bcreg/bcreg20131210a1.pdf>.

⁵ KPMG's Defining Issues No. 13-57, Regulatory Agencies Announce Review of the Treatment of Certain Securities Under the Final Rule Implementing Section 619 of the Dodd-Frank Act, available at www.kpmginsitutes.com/financial-reporting-network.

The FRB, FDIC, and OCC also released a non-exclusive list of TruPS CDOs that meet the exemption requirements outlined in the interim final rule, and the agencies indicated that banking entities may rely upon that list.⁶ However, if a banking entity owns an investment in a TruPS CDO that is not included on the list, it does not automatically mean that the TruPS CDO must be disposed of during the Volcker Rule's conformance period. Instead, banking entities should evaluate whether that investment otherwise meets the requirements for retention under the interim final rule.

The accounting staffs of the agencies have stated that, consistent with generally accepted accounting principles, any actions taken by the agencies in January 2014 that occur before the issuance of December 31, 2013, financial reports (including the FR Y-9C and the Call Report) should be considered when preparing those financial reports. Therefore, the impact of the interim final rule on other-than-temporary impairment assessments should be considered for purposes of December 31, 2013, financial reports.

Effective Date. Community banks and others expressed significant concerns about the potential impact on their December 31, 2013, financial reports if TruPS CDOs are included in the Volcker Rule's definition of covered funds. The agencies believe there is an urgent need to address this issue and therefore have adopted the rule on an interim final basis without prior solicitation of comments. The interim final rule is effective on April 1, 2014. Comments on the interim final rule should be received on or before 30 days after publication in the Federal Register.

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⁶ The non-exclusive list of qualified collateralized debt obligations backed primarily by trust preferred securities is available at <http://www.fdic.gov/news/news/press/2014/pr14003b.pdf>.