WHITE PAPER

Implementing Compliance Program under the Volcker Rule

– A practitioners perspective

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On 10 December 2013, five federal agencies viz., the Federal Deposit Insurance Corporation ("FDIC"), the Federal Reserve Board ("Fed"), the Office of the Comptroller of the Currency ("OCC"), the Securities and Exchange Commission ("SEC"), and the Commodity Futures Trading Commission ("CFTC") approved the final "Volcker Rule" that would implement section 13 of the Bank Holding Company Act ("BHC Act"). Volcker Rule intends to restrict a banking entity from undertaking speculative activities and investments that put their customer funds at undue risk. It is also to avoid a repeat of the financial crisis of 2008 and avoid any systemic risks generated due to low capitalization of banks.

Because the term banking entity ("bank") is broadly defined - it includes a U.S. banking entity and all its affiliates (branch, subsidiary, sister concern) globally, irrespective of whether they are incorporated in or doing business in the U.S. - the impact of Volcker Rule for a bank is global.

Figure 1: Five pillars of the Volcker Rule

In this paper, we present an overview of a compliance program under the Volcker Rule. We also cover the likely challenges Banks will face during implementation of such a program along with a suggested approach to overcome these challenge using the Infosys™ framework for implementation.

Overview of the compliance program requirements under the Volcker Rule

The compliance program is described under Section 20 and appendix A and B of the Volcker Rule. Objective of the compliance program is to establish a culture of compliance, make sure that banks stay away from prohibited activities and ensuring that prescribed reporting goes out to regulators in a timely manner. The degree to which a bank will be required to adopt compliance programs depend on -

- Extent of its permitted proprietary trading and covered fund investment activities
- Size of its consolidated trading assets and liabilities and total consolidated assets.

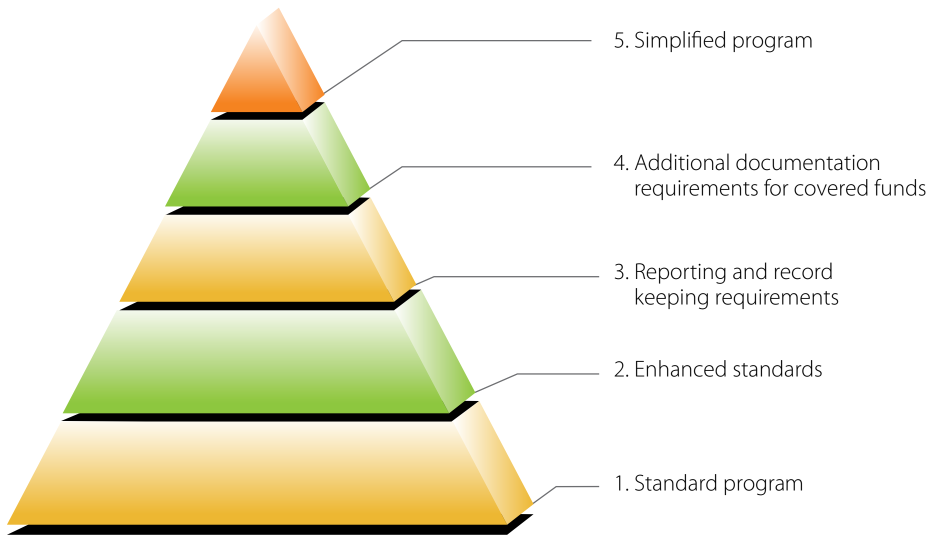


Figure 2: Constituents of the compliance program

1. Standard program

The Standard program applies to all impacted banks except to less active banks to which a "Simplified Program" applies. The Standard Program requires the banks to cover the following basic elements

a. policies and procedures to govern bank's proprietary trading and covered fund investment activities.

b. internal controls to monitor compliance and prevent prohibited activities from occurring.

c. management framework to fix responsibility and accountability for compliance.

d. independent audit and testing of the compliance program implementation.

e. personnel training on enforcing the compliance program.

f. recordkeeping to demonstrate compliance.

2. Enhanced standards

Under the enhanced standards requirements, the board of directors (or a committee thereof), senior management and business line managers are responsible for various aspects of the compliance program. These enhanced standards have to be satisfied by banks that

a. engage in permitted proprietary trading (and have to satisfy reporting requirements under point 3 below), or

b. if their previous calendar year's total consolidated assets are $50 billion or more, in the case of a non-U.S. bank, the total U.S. assets are $50 billion or more (including all U.S subsidiaries, affiliates, branches and agencies).

Appendix B of the Volcker Rule enlists these standards. Under the enhanced standard requirement, among other things, a bank must

a. monitor and report permitted trading and covered fund activities and address the resulting risks.

b. maintain detailed records to explain compliance with the applicable provisions.

c. conduct periodic independent review and testing of its compliance program

d. ensure its board of directors and chief executive officer (or equivalent) of the bank review the effectiveness of the compliance program.

3. Reporting requirements for proprietary trading activities

A bank engaged in permitted proprietary trading activities has to furnish periodic reports to the regulators covering the 7 quantitative measurements (prescribed in Appendix A of the Volcker Rule) for each trading desk. These quantitative measurements are - Risk and position limits and usage; Risk factor sensitivities; Value-at-Risk and stress VaR; Comprehensive profit and loss attribution; Inventory turnover; Inventory aging; and Customer-Facing trade ratio.

The applicability of reporting requirements to a bank is based on its consolidated trading assets and liabilities. Banks also have to maintain records documenting the preparation and content of these reports for a period of 5 years.

4. Additional documentation requirements for covered funds

Banks having more than $10 billion in total consolidated assets on December 31 of the

Chief executive officer of a bank has to attest that the bank's compliance program is designed to achieve compliance as prescribed under the Volcker Rule.

previous two calendar years, must

a. have documentation to support the exclusions in determining that a sponsored fund is not a covered fund.

b. document a plan incorporating prescribed details on how a current seeding vehicle will eventually become a registered investment company or SEC-regulated business development company.

c. document the ownership interest owned by the bank in each foreign public fund upon satisfying the prescribed requirements.

5. Simplified program

Simplified program is applicable to banks that do not engage in proprietary trading or covered fund activities. Such banks should establish a compliance program prior to becoming engaged in such activities.

The Simplified program is also applicable to banks that engages in proprietary trading or covered fund activities but has total consolidated assets of $10 billion or less. These banks should include in existing policies and procedures references to requirements of the Volcker Rule.

Compliance program implementation timelines:

Below is the graphical representation of the timelines for achieving compliance based on the size of the consolidated trading assets and liabilities and total consolidated assets of the banks. The Volcker Rule permits the Fed to grant extensions on these timelines.

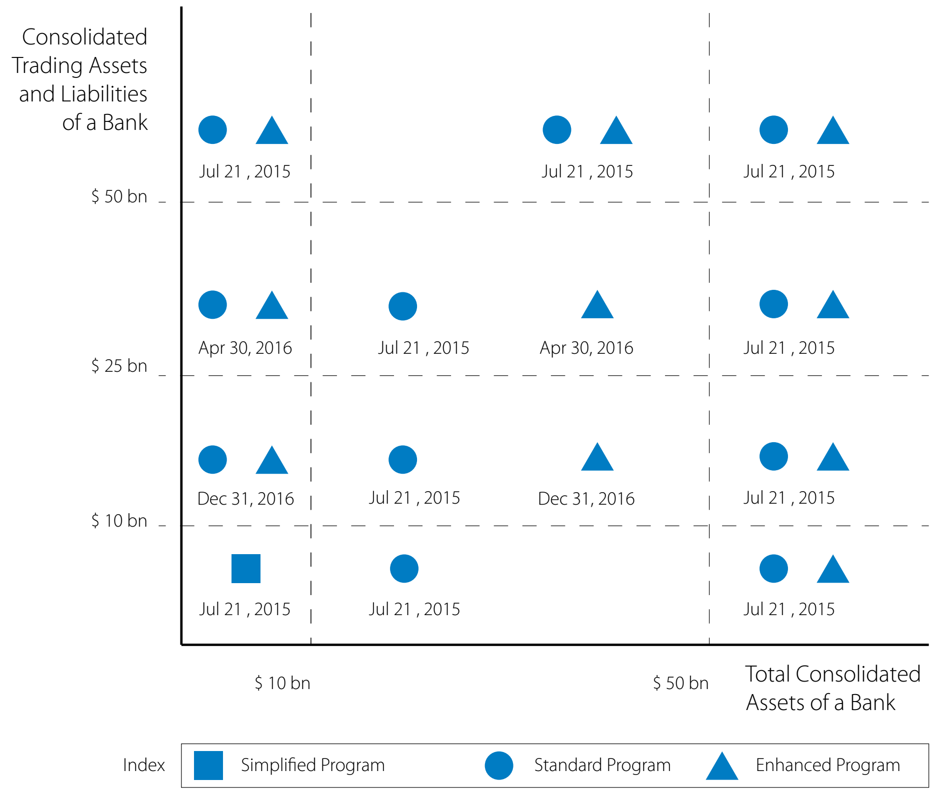
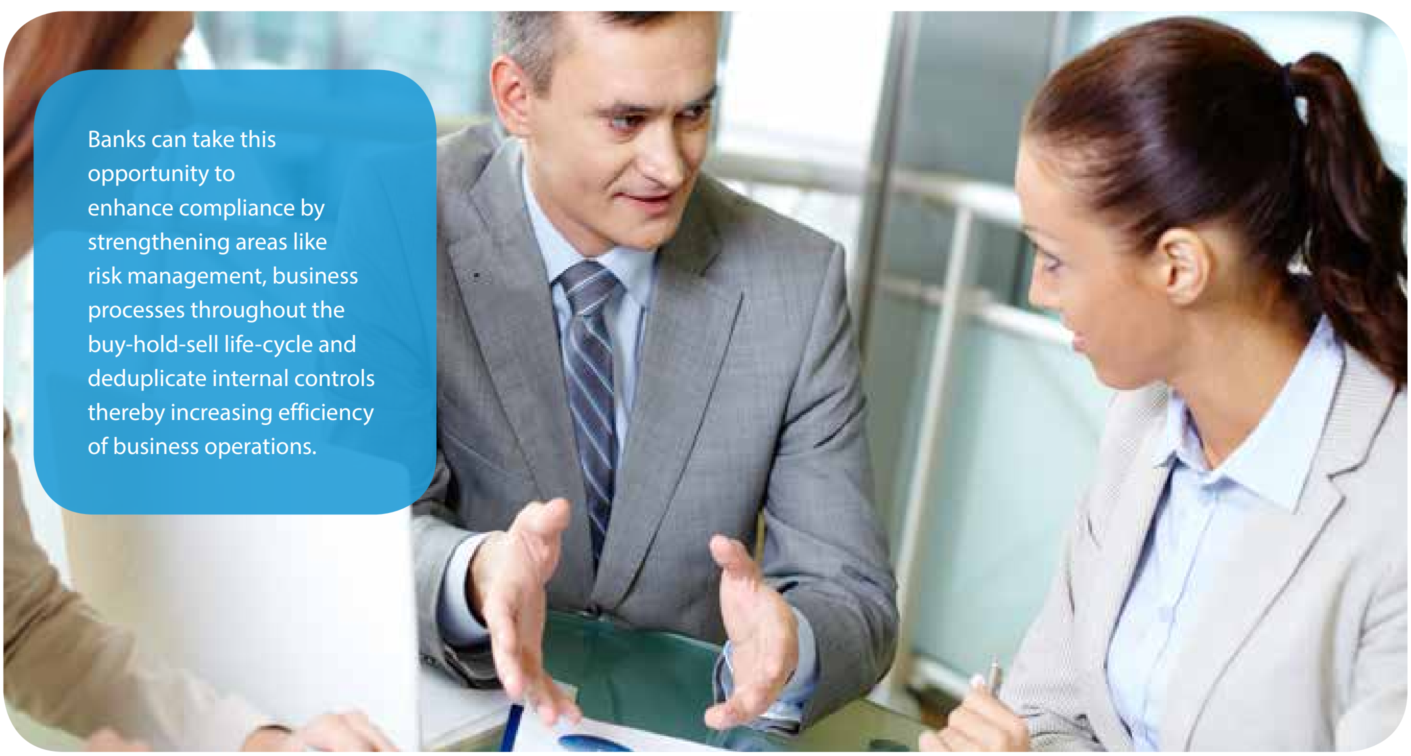


Figure 3: Current implementation deadlines for the compliance program



Challenges that banks will face in implementing the compliance program requirements

The scope and nature of the Volcker compliance program means that its implementation is going to be complicated. It will require sustained efforts from multiple teams that are geographically spread out. During the course of such an implementation, the executives are likely to face a number of challenges. Understanding problems and careful navigation through them will help in tidy and timely implementation of the compliance program.

CHALLENGE	RECOMMENDED APPROACH
Assessing the impact on the current state Volcker requirements are likely to impact a number of existing policies and internal controls of a bank that can potentially differ from one business line to another. The difficult part is to identify the impacted areas and prepare a detailed yet crisp catalog on where the impact lies.	**Develop requirements checklist and turn it into a heat map** In order to overcome this difficulty the banks should for each of the identified work streams develop a checklist enumerating the implementation requirements. Such a checklist should be extended to draw a heat map depicting the severity of impact of such requirements on existing policies and internal controls. The reasons for such determination should also be mentioned there.
Define the end state for the enterprise In a complex implementation like this, end state is one of the important drivers of the effort and defining the end state is one of the early things executives would like to achieve. However, it is easier said than done and could perhaps become one of the most difficult tasks to achieve on the to-do list.	**Close coordination between business lines** The end state should be drawn for each business line and then integrated at the enterprise level. Such an approach gives required flexibility to each business line to define their vision and sets the tone for implementation in their businesses. The senior executives from business, strategy, compliance, operations and technology should participate in such an effort. Further the end state should be re-calibrated as and when needed.
Quality of gap assessment Superimposing the end state policies and control requirements on the current state will lead to finding gaps which needs to be plugged to achieve the end state. The introduction of new and realignment of existing policies and controls depends on the findings from this step. Hence, the quality of gap assessment coupled with the speed of such assessment will remain a key challenge in our view.	**Details, details and details** The devil is in details. A detailed result oriented approach to gap assessment would be to leverage the requirements checklist built during the current state assessment phase and classify each requirement in there to one or more business activities (like market making, underwriting, covered fund prohibitions etc.) for each business line. Another step in this approach is to tag existing systems and controls to realizing these requirements. Such a detailed exercise would result in identifying the implementation requirements that are fully realized, partially realized or are complete gaps.

CHALLENGE	RECOMMENDED APPROACH
Talent Because of the fact that certain requirements are not yet fully clear and clarifications are still coming in from regulatory agencies, finding subject matter experts on Volcker Rule that can manage end-to-end implementation of the compliance program will remain a challenge for most banks.	**Internal + External hires** While external resources bring in industry experience and fresh ideas, to overcome the dearth of experienced external resources banks should train a team internally on various aspects of the Volcker implementation. Banks should hire external resources at appropriate stages of implementation to blend their industry knowledge and 'what others are doing' with internal strategy to achieve successful compliance program implementation.
Effective change management Due to the broad impact of Volcker Rule on banks, implementing the process and technology changes in the applicable time duration will remain a key hurdle for most teams. Banks are likely to stretch their bandwidth on managing the changes across the organization.	**Select correct tools, methods and processes** Volcker Rule implementation is influenced by various internal and external factors. In order to handle such influences executives have to identify and sequence the deployment of change tools, methods and processes in a manner that is optimum for their banks situation. For e.g. imparting training on Volcker Rule should begin early in the implementation process.

Framework for implementing the compliance program

Infosys has developed a detailed 7 component framework and drilled down list of activities to help banks conceptualize and methodically implement the compliance program requirements in a timely and cost effective manner.

Banks have to conceptualize and implement the compliance program in a systematic manner with clear accountabilities and deadlines. In our view, a comprehensive current state assessment of the existing policies, procedures, internal controls and other infrastructural aspects will be critical to lay down the foundation of a solid and long term compliance program that will not only take care of one-time compliance but compliance on an ongoing basis as well.

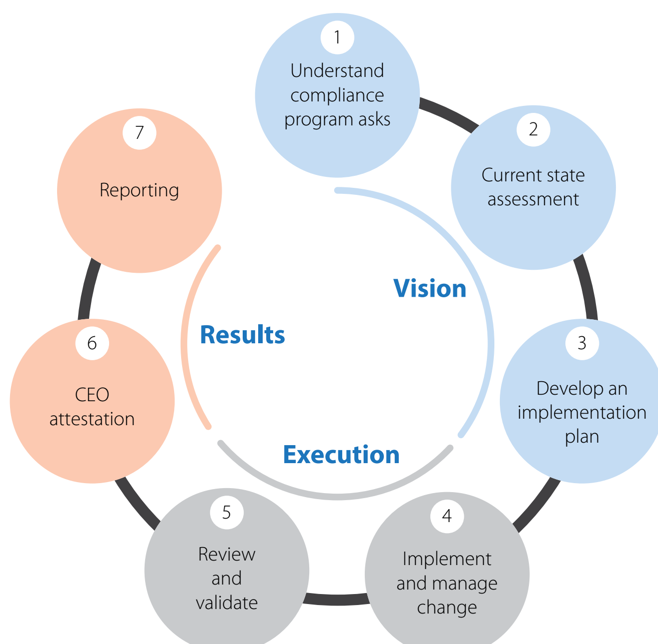


Figure 4: Infosys™ framework for compliance program implementation

In the table below we expand our 7 component framework, recommend key high level activities that should be accounted for during strategizing the compliance program structure and list the advantages that such activities will bring to banks.

Components of the framework	Recommended high level activities (to drive the compliance program structure)	Significant advantages (from using the Infosys™ framework)
Understand Compliance Program ask	• Analyze compliance requirements • Develop a detailed compliance requirements matrix • Map requirements at enterprise, • business line, trading desk level • Communicate requirements	• Know what is required at inception • Methodical solutionizing • Firm requirements base for future IT and process changes
Current state assessment	• Inventorize existing policies and controls • Fit gap analysis of requirements • Develop a heat map depicting criticality of requirements • Identify covered fund investments • Identify trading desks engaged in proprietary trading	• Identify organizational competencies and areas where more focus and resources are required during implementation • Provides critical inputs during planning • Serve the recordkeeping requirement • Gauge quantum of changes required
Develop an implementation plan	• Assess areas where policy and control augmentation is required • Define the level at which implementation will be done – enterprise, business unit or trading desk level • Define implementation work streams, associated accountability and duration of activities • Provision to develop training modules to enforce the compliance program	• Identification of work streams will sharpen implementation focus • Help in accurate implementation
Implement and Manage Change	• Develop new or enhance existing policies • Establish desk level procedures and controls on proprietary trading and covered fund investment activities • Establish internal controls: - Pre trade controls - Post trade controls - Surveillance - Exception reports • Control and remediate any deviations from the scope of permitted activities during implementation • Develop a "feedback loop" on internal control aspects	• Achieve coherent implementation • Feedback loop helps in maintaining robust internal controls
Review and validate	• Allowance for a periodic review of the compliance program • Independent validation of effectiveness of the compliance program	• Periodic review of compliance program will timely identify any implementation deviations from the requirements
CEO Attestation	• Build CEO dashboard • Build a digest providing details of realization of the compliance program requirements • Certifications from business managers	• Dashboard and digest will help to provide appropriate level of details and aid in recordkeeping • Business manager certifications will ensure accountability at lower levels in the organization
Reporting	• Design the solution • Gather accurate data at a trading desk level to prepare for metrics reporting • Fix reporting responsibility	• Drive technology changes in a timely and methodical manner

How Infosys can help

Infosys can help banks business and technology divisions on a number of Volcker initiatives

Compliance Program Management

- Create Volcker specific management framework & methodology for compliance program implementation
- Program plan creation and end-to-end program management
- Oversee creation of relevant compliance manuals
- Ensure state of readiness for CEO attestation

Metrics Reporting

- Business analysis for developing metrics based reporting
- Conceptualize, develop and implement reporting solution to comply with the reporting requirements
- Validation and ongoing support services for reporting

Process Management

- Detailed evaluation of the existing internal controls and business processes
- Set-up processes for monitoring trading desk activities and covered fund investments

Technology Services

- Define IT target operating model
- Develop and implement IT solutions
- Perform independent testing on the Volcker implementation
- Develop and implement training programs and monitor completion

Conclusion

Volcker compliance program is driving the next wave of compliance changes at impacted banks. Implementing the requirements is going to be a detailed process which would run cross divisionally at banks. We believe that running the implementation with all the facts on the table and in a time bound manner is going to be the key to success.

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References

Volcker Rule text, preamble and various FAQ's issued by the agencies.

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