in accordance with, for transactions cleared on a derivatives clearing organization, the Commodity Exchange Act, CFTC regulations, and the rules or procedures of the derivatives clearing organization, or, for transactions cleared on a clearing agency, the rules or procedures of the clearing agency, or, for transactions cleared on a designated financial market utility that is neither a derivatives clearing organization nor a clearing agency, the rules or procedures of the designated financial market utility:

(iii) Any purchase or sale in connection with and related to the management of a default or threatened imminent default of a member of a clearing agency, a member of a derivatives clearing organization, or a member of a designated financial market utility;

(iv) Any purchase or sale in connection with and related to the management of the default or threatened default of a clearing agency, a derivatives clearing organization, or a member of a designated financial market utility;

(v) Any purchase or sale that is required by the rules or procedures of a clearing agency, a derivatives clearing organization, or a designated financial market utility to mitigate the risk to the clearing agency, derivatives clearing organization, or designated financial market utility that would result from the clearing by a member of security-based swaps that reference the member or an affiliate of the member.

(8) Market risk capital rule means the market risk capital rule that is contained in subpart F of 12 CFR part 3, 12 CFR parts 208 and 225, or 12 CFR part 324, as applicable.

(11) Market risk capital rule covered position and trading position means a financial instrument that is both a covered position and a trading position, as those terms are respectively defined:

(i) In the case of a banking entity that is a bank holding company, savings and loan holding company, or insured depository institution, under the market risk capital rule that is applicable to the banking entity; and

(ii) In the case of a banking entity that is affiliated with a bank holding company or savings and loan holding company, other than a banking entity to which a market risk capital rule is applicable, under the market risk capital rule that is applicable to the affiliated bank holding company or savings and loan holding company.

(12) Municipal security means a security that is a direct obligation of or issued by, or an obligation guaranteed as to principal or interest by, a State or any political subdivision thereof, or any agency or instrumentality of a State or any political subdivision thereof, or any municipal corporate instrumentality of one or more States or political subdivisions thereof.

(13) Trading desk means the smallest discrete unit of organization of a banking entity that purchases or sells financial instruments for the trading account of the banking entity or an affiliate thereof.

§ 255.4 Permitted underwriting and market making-related activities.

(a) Underwriting activities—(1) Permitted underwriting activities. The prohibition contained in §255.3(a) does not apply to a banking entity’s underwriting activities conducted in accordance with this paragraph (a).

(2) Requirements. The underwriting activities of a banking entity are permitted under paragraph (a)(1) of this section only if:

(i) The banking entity is acting as an underwriter for a distribution of securities and the trading desk’s underwriting position is related to such distribution;

(ii) The amount and type of the securities in the trading desk’s underwriting position are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, and reasonable efforts are made to sell or otherwise reduce the underwriting position within a reasonable period, taking into account the liquidity, maturity, and depth of the market for the relevant type of security;

(iii) The banking entity has established and implements, maintains, and
enforces an internal compliance pro-
gram required by subpart D of this part
that is reasonably designed to ensure
the banking entity’s compliance with
the requirements of paragraph (a) of
this section, including reasonably de-
signed written policies and procedures,
internal controls, analysis and inde-
pendent testing identifying and ad-
dressing:

(A) The products, instruments or ex-
posures each trading desk may pur-
chase, sell, or manage as part of its un-
derwriting activities;
(B) Limits for each trading desk,
based on the nature and amount of
the trading desk’s underwriting activities,
including the reasonably expected near
term demands of clients, customers, or
counterparties, on the:
(1) Amount, types, and risk of its un-
derwriting position;
(2) Level of exposures to relevant risk
factors arising from its underwriting
position; and
(3) Period of time a security may be
held;
(C) Internal controls and ongoing
monitoring and analysis of each trad-
ing desk’s compliance with its limits;
and
(D) Authorization procedures, includ-
ing escalation procedures that require
review and approval of any trade that
would exceed a trading desk’s limit(s),
demonstrable analysis of the basis for
any temporary or permanent increase
to a trading desk’s limit(s), and inde-
pendent review of such demonstrable
analysis and approval;
(iv) The compensation arrangements
of persons performing the activities de-
scribed in this paragraph (a) are de-
signed not to reward or incentivize pro-
hibited proprietary trading; and
(v) The banking entity is licensed or
registered to engage in the activity de-
scribed in this paragraph (a) in accord-
ance with applicable law.
(3) Definition of distribution. For pur-
poses of this paragraph (a), a distribu-
tion of securities means:
(i) An offering of securities, whether
or not subject to registration under the
Securities Act of 1933, that is distin-
guished from ordinary trading trans-
actions by the presence of special sell-
ing efforts and selling methods; or
(ii) An offering of securities made
pursuant to an effective registration
statement under the Securities Act of
1933.
(4) Definition of underwriter. For pur-
poses of this paragraph (a), underwriter
means:
(i) A person who has agreed with an
issuer or selling security holder to:
(A) Purchase securities from the
issuer or selling security holder for dis-
tribution;
(B) Engage in a distribution of secu-
rities for or on behalf of the issuer or
selling security holder; or
(C) Manage a distribution of securi-
ties for or on behalf of the issuer or
selling security holder; or
(ii) A person who has agreed to par-
ticipate or is participating in a dis-
tribution of such securities for or on
behalf of the issuer or selling security
holder.
(5) Definition of selling security holder.
For purposes of this paragraph (a), sell-
ing security holder means any person,
other than an issuer, on whose behalf a
distribution is made.
(6) Definition of underwriting position.
For purposes of this paragraph (a), un-
derwriting position means the long or
short positions in one or more securi-
ties held by a banking entity or its af-
iliate, and managed by a particular
trading desk, in connection with a particu-
lar distribution of securities for which
such banking entity or affiliate is
acting as an underwriter.
(7) Definition of client, customer, and
counterparty. For purposes of this para-
graph (a), the terms client, customer,
and counterparty, on a collective or in-
dividual basis, refer to market partici-
pants that may transact with the
banking entity in connection with a par-
ticular distribution for which the
banking entity is acting as under-
writer.
(b) Market making-related activities—
(1) Permitted market making-related ac-
tivities. The prohibition contained in
§255.3(a) does not apply to a banking
entity’s market making-related activi-
ties conducted in accordance with this
paragraph (b).
(2) Requirements. The market making-
related activities of a banking entity
are permitted under paragraph (b)(1) of
this section only if:
Securities and Exchange Commission § 255.4

(i) The trading desk that establishes and manages the financial exposure routinely stands ready to purchase and sell one or more types of financial instruments related to its financial exposure and is willing and available to quote, purchase and sell, or otherwise enter into long and short positions in those types of financial instruments for its own account, in commercially reasonable amounts and throughout market cycles on a basis appropriate for the liquidity, maturity, and depth of the market for the relevant types of financial instruments;

(ii) The amount, types, and risks of the financial instruments in the trading desk's market-maker inventory are designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers, or counterparties, based on:

(A) The liquidity, maturity, and depth of the market for the relevant types of financial instrument(s); and

(B) Demonstrable analysis of historical customer demand, current inventory of financial instruments, and market and other factors regarding the amount, types, and risks, of or associated with financial instruments in which the trading desk makes a market, including through block trades;

(iii) The banking entity has established and implements, maintains, and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of paragraph (b) of this section, including reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing:

(A) The financial instruments each trading desk stands ready to purchase and sell in accordance with paragraph (b)(2)(i) of this section;

(B) The actions the trading desk will take to demonstrably reduce or otherwise significantly mitigate promptly the risks of its financial exposure consistent with the limits required under paragraph (b)(2)(ii)(C) of this section; the products, instruments, and exposures each trading desk may use for risk management purposes; the techniques and strategies each trading desk may use to manage the risks of its market making-related activities and inventory; and the process, strategies, and personnel responsible for ensuring that the actions taken by the trading desk to mitigate these risks are and continue to be effective;

(C) Limits for each trading desk, based on the nature and amount of the trading desk's market making-related activities, that address the factors prescribed by paragraph (b)(2)(ii) of this section, on:

(1) The amount, types, and risks of its market-maker inventory;

(2) The amount, types, and risks of the products, instruments, and exposures the trading desk may use for risk management purposes;

(3) The level of exposures to relevant risk factors arising from its financial exposure; and

(4) The period of time a financial instrument may be held;

(D) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits; and

(E) Authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis that the basis for any temporary or permanent increase to a trading desk's limit(s) is consistent with the requirements of this paragraph (b), and independent review of such demonstrable analysis and approval;

(iv) To the extent that any limit identified pursuant to paragraph (b)(2)(iii)(C) of this section is exceeded, the trading desk takes action to bring the trading desk into compliance with the limits as promptly as possible after the limit is exceeded;

(v) The compensation arrangements of persons performing the activities described in this paragraph (b) are designed not to reward or incentivize prohibited proprietary trading; and

(vi) The banking entity is licensed or registered to engage in activity described in this paragraph (b) in accordance with applicable law.

(3) Definition of client, customer, and counterparty. For purposes of paragraph (b) of this section, the terms client, customer, and counterparty, on a collective
or individual basis refer to market participants that make 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, provided that:

(i) A trading desk or other organizational unit of another banking entity is not a client, customer, or counterparty of the trading desk if that other entity has trading assets and liabilities of $50 billion or more as measured in accordance with §255.20(d)(1) of subpart D, unless:

(A) 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 for purposes of paragraph (b)(2) of this section; or

(B) The purchase or sale by the trading desk is conducted anonymously on an exchange or similar trading facility that permits trading on behalf of a broad range of market participants.

(4) Definition of financial exposure. For purposes of this paragraph (b), financial exposure means the aggregate risks of one or more financial instruments and any associated loans, commodities, or foreign exchange or currency, held by a banking entity or its affiliate and managed by a particular trading desk as part of the trading desk’s market making-related activities.

(5) Definition of market-maker inventory. For the purposes of this paragraph (b), market-maker inventory means all of the positions in the financial instruments for which the trading desk stands ready to make a market in accordance with paragraph (b)(2)(i) of this section, that are managed by the trading desk, including the trading desk’s open positions or exposures arising from open transactions.

§255.5 Permitted risk-mitigating hedging activities.

(a) Permitted risk-mitigating hedging activities. The prohibition contained in §255.3(a) does not apply to the risk-mitigating hedging activities of a banking entity in connection with and related to individual or aggregated positions, contracts, or other holdings of the banking entity and designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts, or other holdings.

(b) Requirements. The risk-mitigating hedging activities of a banking entity are permitted under paragraph (a) of this section only if:

(1) The banking entity has established and implements, maintains and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity’s compliance with the requirements of this section, including:

(i) Reasonably designed written policies and procedures regarding the positions, techniques and strategies that may be used for hedging, including documentation indicating what positions, contracts or other holdings a particular trading desk may use in its risk-mitigating hedging activities, as well as position and aging limits with respect to such positions, contracts or other holdings;

(ii) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(iii) The conduct of analysis, including correlation analysis, and independent testing designed to ensure that the positions, techniques and strategies that may be used for hedging may reasonably be expected to demonstrably reduce or otherwise significantly mitigate the specific, identifiable risk(s) being hedged, and such correlation analysis demonstrates that the hedging activity demonstrably reduces or otherwise significantly mitigates the specific, identifiable risk(s) being hedged;

(2) The risk-mitigating hedging activity:

(i) Is conducted in accordance with the written policies, procedures, and internal controls required under this section;

(ii) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate and demonstrably reduces or otherwise significantly mitigates one or more specific, identifiable risks, including market