Client Update

New Volcker Rule FAQ Provides Guidance on Fund Seeding Periods

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Yesterday, the Federal Reserve and other agencies charged with implementing the Volcker Rule issued a new Frequently Asked Question ("FAQ") regarding the seeding period permissible for registered investment companies ("RICs"), business development companies ("BDCs") and so-called "foreign public funds" ("FPFs"). We've highlighted below key takeaways from the FAQ, number 16 in the list the agencies have issued, and also have attached the full FAQ to this Client Update for reference.

- The FAQ appears to permit a greater than 3-year seeding period for RICs, BDCs and FPFs without application or other filing with the regulators. The FAQ does not prescribe explicit bounds for the seeding period, but notes that the guidance would not apply if a RIC, BDC or FPF was being used to evade the Volcker Rule.
- The guidance does not explicitly address the issue of how to determine the date on which a seeding period begins; however, in light of the flexibility for a multiyear seeding period, this question seems less important.
- The FAQ appears to treat covered funds that are formed and operated pursuant to a written plan to become a RIC, BDC or FPF in a more restrictive fashion than a vehicle that itself is a RIC, BDC or FPF. In particular, the FAQ says that a "vehicle that is a covered fund (as opposed to a RIC or a FPF) during its seeding period and that is formed and operated pursuant to a written plan to become a RIC" must apply to the Federal Reserve "for an extension of the one-year seeding period already granted to such covered funds."

With the release of this FAQ, the agencies have resolved a key interpretive and compliance issue for the industry, but a number of other issues remain outstanding, including: (1) the intersection of the "banking entity" definition and so-called "foreign excluded funds" and (2) the treatment under the Volcker Rule of certain family office / private wealth investment vehicles, including with respect to the application of the "Super 23A" restrictions to those vehicles.

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Please do not hesitate to contact us with any questions.

Volcker Rule FAQ #16

16. Is a registered investment company or a foreign public fund a banking entity subject to section 13 of the BHC Act and implementing rules during its seeding period?

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The rule implementing section 13 of the Bank Holding Company Act ("BHC Act") and the accompanying preamble make clear that a registered investment company ("RIC") and a foreign public fund ("FPF") are not covered funds for purposes of the statute or implementing rules.[35] The preamble to the implementing rules also recognize that a banking entity may own a significant portion of the shares of a RIC or FPF during a brief period during which the banking entity is testing the fund's investment strategy, establishing a track record of the fund's performance for marketing purposes, and attempting to distribute the fund's shares (the so-called seeding period).[36]

Staff of the Agencies would not advise the Agencies to treat a RIC or FPF as a banking entity under the implementing rules solely on the basis that the RIC or FPF is established with a limited seeding period, absent other evidence that the RIC or FPF was being used to evade section 13 and the implementing rules. The staffs of the Agencies understand that the seeding period for an entity that is a RIC or FPF may take some time, for example, three years, the maximum period of time expressly permitted for seeding a covered fund under the implementing rules.[37] The seeding period generally would be measured from the date on which the investment adviser or similar entity begins making investments pursuant to the written investment strategy of the fund.[38] Accordingly, staff of the Agencies would not advise the Agencies to treat a RIC or FPF as a banking entity solely on the basis of the level of ownership of the RIC or FPF by a banking entity during a seeding period or expect an application to be submitted to the Board to determine the length of the seeding period.[39]

35. *See* §248.10(c)(1) (excluding a FPF from the definition of covered fund); §248.10(c)(12) (excluding from the definition of covered fund an issuer that is a RIC under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8)).

36. *See* 79 FR at 5676-77; *see also* §248.10(c)(12) (excluding from the definition of covered fund an issuer formed and operated pursuant to a written plan to become a RIC); FAQ #5, *available at*: http://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm#5 (stating that "it would be appropriate that an issuer that will become an excluded foreign public fund be treated during its seeding period the same as an issuer that will become an excluded RIC").

37. *See* § 248.10(c)(12); § 248.12(a)(2)(i)(B)); § 248.12(e); § 248.20(e).

38. *See* § 248.12(a)(2) (describing seeding periods for a covered fund that is not issuing asset-backed securities).

39. The final rule requires a vehicle that is a covered fund (as opposed to a RIC or a FPF) during its seeding period and that is formed and operated pursuant to a written plan to become a RIC to apply to the Board for an extension of the one-year seeding period already granted to such covered funds. *See* § 248.10(c)(12); § 248.12(a)(2)(i)(B)); § 248.12(e); § 248.20(e). The implementing rule also excludes from the definition of covered fund an issuer that has elected to be regulated as a business development company pursuant to section 54(a) of the Investment Company Act and has not withdrawn that election ("SEC-regulated BDC"), or that is formed and operated pursuant to a written plan to become a business development company as described in § 248.20(e)(3) of subpart D and that complies with the requirements of section 61 of the Investment Company Act of 1940 company. *See* § 248.10(c)(12)(iii). The staffs, consistent with the final rule's parallel treatment of RICs, FPFs, and SEC-regulated BDCs, also would not advise the Agencies to treat an SEC-regulated BDC as a banking entity solely on the basis of the level of ownership of the SEC-regulated BDC by a banking entity during a seeding period.