Client Update
Volcker Rule: Fed Issues Guidelines on Requesting Extension of Seeding Period for Covered Funds

On Monday, the Federal Reserve Board (the "FRB") released guidance[1] on the procedures banking entities should follow to request an extension of the one-year seeding period for a covered fund, as permitted by the Volcker Rule.

Below, we briefly provide background on the one-year seeding period, the regulatory framework for extensions and the new guidance.

BACKGROUND

The Volcker Rule generally prohibits banking entities from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a covered fund, subject to certain exemptions. One of those exemptions is commonly referred to as the "asset management exemption." Under that exemption, a banking entity may acquire and retain an ownership interest in a covered fund, so long as, among other requirements, the banking entity's ownership interest is reduced to three percent (or lower) of the total outstanding ownership interests in the fund after a one-year seeding period (the "per-fund limit").

A banking entity may apply to the FRB for an extension of the seeding period of up to two additional years. The implementing regulations provide that the FRB may consider the following factors when evaluating an extension request:

- Whether the investment would result, directly or indirectly, in a material exposure by the banking entity to high-risk assets or high-risk trading strategies;
- The contractual terms governing the banking entity's interest in the covered fund;

[1] SR 17-5: Procedures for a Banking Entity to Request an Extension of the One-Year Seeding Period for a Covered Fund, *available at* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20170724a.htm.

- The date on which the covered fund is expected to have attracted sufficient investments from investors unaffiliated with the banking entity to enable the banking entity to comply with the per-fund limit;
- The total exposure of the covered banking entity to the investment and the risks that disposing of, or maintaining, the investment in the covered fund may pose to the banking entity and the financial stability of the United States;
- The cost to the banking entity of divesting or disposing of the investment within the applicable period;
- Whether the investment or the divestiture or conformance of the investment would involve or result in a material conflict of interest between the banking entity and unaffiliated parties, including clients, customers or counterparties to which it owes a duty;
- The banking entity's prior efforts to reduce through redemption, sale, dilution, or other methods its ownership interests in the covered fund, including activities related to the marketing of interests in such covered fund;
- Market conditions; and
- Any other factor that the Board believes appropriate.

Before the guidance was issued, however, the application process for requesting an extension was left uncertain.

NEW GUIDANCE

Delegation of Authority to Federal Reserve Banks

The guidance indicates that the authority to grant (but not deny) extension requests is delegated to the Federal Reserve Banks, in consultation with FRB staff, if all of the following criteria are met:

- No significant issues have been identified regarding the banking entity's compliance program required under the implementing regulations;
- The banking entity has represented that all of the requirements under the Volcker Rule for organizing and offering a covered fund have been met, including the aggregate funds limitation and the capital deduction requirement;
- The banking entity provides a plan for reducing the permitted investment in a covered fund through redemption, sale, dilution, or other methods by the end of the extension period; and
- The primary federal agency responsible for enforcing compliance with the Volcker Rule by the banking entity that invests in or sponsors the covered fund (if different than the FRB) does not object to the extension.

Procedures and Processing Time

A request for an extension should be submitted to the Applications Unit of the appropriate Federal Reserve Bank at least 90 days prior to the expiration of the covered fund's initial one-year seeding period. The responsible Reserve Bank should expect to act on an extension request within 30 days of receiving "all required information," a phrase that suggests the 30-day clock will not start to run until the Reserve Bank (and FRB staff) are satisfied that a filing is complete (perhaps after requiring that a banking entity respond to requests for additional information).

If the request does not meet the requirements for delegated action by the appropriate Federal Reserve Bank then the request will be referred to the FRB. The FRB will then approve or deny based on the facts and circumstances and consideration of any relevant factors.

In addition, for all requests, if the banking entity is primarily supervised by another agency, the banking entity should provide a copy of the extension request to that agency and the FRB will consult with the agency before acting on the request.

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Please do not hesitate to contact us with any questions.

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