

December 20, 2016

## Volcker Rule: FRB Issues Policy Statement on Extensions for Non-Conforming Legacy Illiquid Funds; Applications Due by Jan. 20, 2017

On December 9, 2016, the Federal Reserve Board (the “Board”) issued a Statement of Policy (the “Policy Statement”)<sup>1</sup> regarding extension of the conformance period for investments in legacy illiquid covered funds under the final regulations implementing the Volcker Rule.<sup>2</sup> The Board had previously given banking entities until July 21, 2017 to conform covered fund investments with the requirements of the Volcker Rule.<sup>3</sup>

Applications for the five-year extension must be filed on or before January 20, 2017 (*i.e.*, 180 days before the end of the current conformance period). If an extension request is granted, final, complete conformity with the Volcker Rule may be extended until July 21, 2022.

The Policy Statement indicates that the Board expects investments in illiquid funds by banking entities will generally qualify for extensions so long as the banking entity has demonstrated meaningful progress to conform or divest its illiquid funds, maintains an adequate Volcker Rule compliance program, and has not taken action that would raise concerns regarding the evasion of its Volcker Rule obligations.

### Short Deadline for Filing of Extension Requests

In order to obtain an extension, the banking entity must follow the procedures set forth in the Conformance Rule and submit to the Board a written request before January 20, 2017.<sup>4</sup> Requests should be submitted in writing to the Applications Unit of the appropriate Federal Reserve Bank by the top-tier banking entity in the district where it is headquartered. The Policy Statement notes that to facilitate this consultation, a banking entity should provide a copy of its extension request to its primary federal regulator.

### Eligible Funds

To be eligible for an extension, an investment in a covered fund must meet two standards. First, it must be “principally invested” in—and hold itself out as a strategy to invest in—illiquid assets (*e.g.*, private equity, real estate and venture capital funds). Second, a banking entity must have certain “contractual obligations” with the illiquid fund that are both (1) current and ongoing, and (2) were in effect before May 1, 2010. The substance of

<sup>1</sup> Federal Reserve Board, Procedures for a Banking Entity to Request and Extended Transition Period for Illiquid Funds, SR 16-18 (Dec. 9, 2016), *available here*.

<sup>2</sup> The Volcker Rule statute, Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), added a new section 13 to the Bank Holding Company Act of 1956 (“BHC Act”). *See* 12 U.S.C. 1851. The statute provides the possibility of an additional conformance period only for interests in an illiquid fund, or provision of additional capital to the fund, if the banking entity had a contractual obligation to provide funds to the illiquid fund that was in effect on May 1, 2010. *See* 12 U.S.C. 1851(c)(3).

<sup>3</sup> *See* Conformance Period for Entities Engaged in Prohibited Proprietary Trading or Private Equity Fund or Hedge Fund Activities, 76 Fed. Reg. 8265 (Feb. 14, 2011) (“Conformance Rule”); Federal Reserve Board Press Release, Order Approving Extension of Conformance Period (July 7, 2016), *available here*.

<sup>4</sup> For Federal Reserve-regulated banking entities, notices may be submitted electronically through the Federal Reserve System’s Electronic Applications System, E-Apps.

#### Attorneys

Mark V. Nuccio

Richard Loewy

Gideon Blatt

those contractual obligations must be to make or hold investments in that fund, or act as sponsor or investment adviser.

The Policy Statement makes clear that banking entities are not obligated to exercise any available “regulatory-out” provisions or otherwise seek consent from third parties (such as the general partner or other investors in the fund) to terminate an illiquid fund investment. This guidance also potentially provides relief to entities that were faced with having to terminate investments by bank employees in bank-sponsored legacy illiquid funds before July 21, 2017, even where the bank entity itself held no investment in the fund, in order to satisfy a Volcker Rule fund sponsorship exception.

### Requirements for Submitting Requests

The Board’s guidance specifies the information a banking entity should submit with respect to its extension request. A firm requesting an extension of the conformance period for an illiquid fund relationship should provide:

- A list or simple chart of illiquid funds for which an extension is sought.
- A short description of each fund, including the investment strategy and types of investments made by each fund, which entity within the firm holds the investment, the size of each fund, the total exposure of the banking entity to each fund, the date by which each remaining illiquid fund is expected to mature by its terms or be conformed to section 13, and the banking entity’s relationship with the fund (*e.g.*, general partner, sponsor, investment adviser, investor).
- A description of the banking entity’s specific efforts to divest or conform its illiquid funds, including a description of the overall covered funds (both liquid and illiquid) that have been divested or conformed to date and the progress that has been made towards divesting or conforming the investments for which an extension is being sought.
- A certification by the General Counsel or Chief Compliance Officer of the entity that sponsors or invests in the illiquid funds that each fund meets the definition of ‘illiquid fund.’<sup>5</sup>
- The length of the requested extension of the conformance period and a description of the banking entity’s plan for divesting or conforming each illiquid fund prior to the end of the requested extension period.

The certification requirement may present additional pressure to an already difficult time constraint for banking entities seeking to meet the January 20, 2017 filing deadline.

### Period of Extension

The maximum length of any extension is the earlier of (i) the fund’s natural expiration date or (ii) July 21, 2022. If the extension request is approved, the Board retains authority to impose restrictions on activities or investments for the duration of the extension period.

### Conclusion

The Policy Statement clarifies the favorable approach that banking regulators are taking with regard to extending the time periods during which banking entities can exit their legacy illiquid covered funds that do not conform to the Volcker Rule. Filing extension requests by January 20, 2017 should be an immediate priority for

---

<sup>5</sup> The appropriate person also must certify that the extension is necessary to fulfill a contractual obligation of the banking entity that was in effect on May 1, 2010.

banking entities that wish to extend the July 21, 2017 conformance deadline for investments in illiquid legacy funds. However, it would not be surprising to see the impending Volcker Rule conformance deadline in mid-2017 be cited by the incoming Trump administration and the Republican-controlled Congress as a reason for pushing the full repeal of the Volcker Rule to the top of the regulatory simplification agenda in the new year.

For additional information and guidance, the Federal Reserve Board's Press Release (Dec. 12, 2016) can be found [here](#).

If you have any additional questions about the Volcker Rule, please contact [Mark V. Nuccio](#), [Richard Loewy](#), [Gideon E. Blatt](#), or your usual contact at Ropes & Gray.