# Federal Agencies Release New Volcker Rule Guidance for Non-U.S. Banking Entities and Fund Sponsors Seeking to Rely on the "SOTUS" Covered Fund Exemption, Clarifying that the U.S. Marketing Restriction Does Not Apply to Third Parties

On February 27, 2015, the Board of Governors of the Federal Reserve System (the "Federal Reserve"), the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission and the Commodity Futures Trading Commission (collectively, the "Agencies") issued an addition to their list of Frequently Asked Questions ("FAQs") pertaining to section 13 of the Bank Holding Company Act of 1956 (the "Volcker Rule"). The guidance will be greeted by the industry with a sense of welcome relief.

Subject to certain exceptions, the Volcker Rule generally prohibits a "banking entity"[1] from, as principal, "sponsoring," acquiring or retaining an "ownership interest" in, or making certain transactions with, "covered funds," which include most hedge funds and private equity funds. The Volcker Rule provides an exemption for certain covered fund activities conducted solely outside of the United States by non-U.S. banking entities holding an ownership interest in, or acting as sponsor to, a covered fund, provided that certain requirements are met (the "SOTUS Exemption"). One such condition for the SOTUS Exemption is that no ownership interest in the covered fund is offered for sale or sold to a resident of the United States[2] (the "U.S. Marketing Restriction").

Following the release of the final rules implementing the Volcker Rule in December 2013, there was widespread concern that the U.S. Marketing Restriction applied generally to activities of third parties offering or selling ownership interests in the covered fund, rather than only applying to marketing activities conducted by non-U.S. banking entities. Because of this concern, many fund sponsors that were not themselves non-U.S. banking entities had organized parallel fund structures to accommodate non-U.S. banking entity investors. Many non-U.S. banking entities holding legacy investments in covered funds alongside U.S. investors, as well as sponsors of such funds, were concerned that the U.S. Marketing Restriction would compel them to undertake restructurings or transfers of those interests.

In the new FAQ, the staffs of the Agencies clarify that the U.S. Marketing Restriction only constrains the activities of non-U.S. banking entities seeking to rely on the SOTUS Exemption and does not apply more generally to the activities of unaffiliated third parties. The FAQ explains that this interpretation is consistent with the goal of limiting the Volcker Rule's "extraterritorial application to foreign banking entities while seeking to ensure that the risks of covered fund investments by foreign banking entities occur and remain solely outside of the United States." The FAQ reaffirms, however, that a non-U.S. banking entity (including its affiliates) that seeks to rely on the SOTUS Exemption still must comply with all of the conditions of the SOTUS Exemption, including the U.S. Marketing Restriction. In particular, a non-U.S. banking entity that participates in an offer or sale of covered fund interests to a resident of the United States cannot rely on the

[1] For the purposes of the Volcker Rule, "banking entities" include any depository institution insured by the FDIC, as well as any of the institution's parents, affiliates and subsidiaries. This generally includes: (i) FDIC-insured national or state banks; (ii) FDIC-insured savings associations, credit card banks and industrial loan companies; (iii) bank holding companies ("BHCs"); (iv) savings and loan companies; (v) non-U.S. banking institutions regulated as BHCs; (vi) and entities controlled by such organizations. A covered fund will not be a banking entity solely because it is an affiliate or subsidiary of a banking entity.

[2] An ownership interest is offered or sold to a U.S. resident if it has been sold in an offering that targets U.S. residents. U.S. resident is defined as it is in Regulation S.

SOTUS Exemption with respect to that covered fund. In addition, if a non-U.S. banking entity sponsors or serves, directly or indirectly, as the investment manager, investment adviser, commodity pool operator or commodity trading advisor to a covered fund, that banking entity will be viewed as participating in an offer or sale by the covered fund of ownership interests in the covered fund, making the SOTUS Exemption unavailable if it offers or sells ownership interests to a resident of the United States. Where non-U.S. banking entities serve as covered fund sponsors, complex Volcker Rule considerations potentially remain.

This clarification by the staffs of the Agencies is a highly favorable development for both non-U.S. banking entities and covered fund sponsors that are not themselves banking entities because it will eliminate the administrative complexity and expense of establishing parallel fund structures to accommodate non-U.S. banking entity investors in many situations.

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For additional information and guidance, the new FAQ can be found here.

If you have any additional questions about the Volcker Rule, please contact Mark V. Nuccio at mark.nuccio@ropesgray.com (617.951.7368) or Laurel C. Neale at laurel.neale@ropesgray.com (+44 20 3122 1238), or your usual contact at Ropes & Gray.