

Client Alert.

April 20, 2012

Volcker Rule: Guidance on the Conformance Period

On April 19, 2012, the Federal Reserve Board (the “Board”) issued an interpretation¹ that provides some clarity on the time period for a banking entity to comply with the Volcker Rule but that raises two other questions about timing. The interpretation also imposes a formal new requirement for a “conformance plan” and signals the possible imposition of recordkeeping and reporting requirements before the conformance deadline.²

The purpose of the guidance is to confirm that July 21, 2014, (and not July 21, 2012) is the date on which activities prohibited by the Volcker Rule must cease. By statute, the Volcker Rule takes effect on July 21, 2012, and covered banking entities have until July 21, 2014, to conform their trading operations and sponsorship or ownership of hedge funds or private equity funds to the requirements of the Rule, including the cessation of prohibited trading or fund activities. The statute is explicit on this point, but the Volcker regulations proposed by the Agencies³ created some uncertainty for the industry on whether the Agencies expected banking entities to end those activities by July 21, 2012.

Two important questions remain open, however. First, will the compliance deadline remain July 14, 2014? Because the Agencies will not finalize the Volcker regulation until after July 21, 2012, banking entities will, under the Board’s interpretation, face a compressed conformance period. The effectiveness and conformance dates in the statute contemplate a two-year conformance period, and the statute authorizes the Board to extend the period. The guidance recognizes this power, but it does not speak to whether the Board might choose to exercise it. Perhaps the Board does not or cannot know, a circumstance underscored by the fact that the Agencies do not now know when they will issue a final rule.

Second, to what extent (if any) may a banking entity start or expand a trading or fund business after July 21, 2012, knowing that the business will be prohibited as of July 21, 2014? The Board today advised that “every banking entity that engages in an activity or holds an investment covered by [the Volcker Rule] is expected to engage in good-faith efforts, appropriate for its activities and investments, that will result in the conformance” of its activities to the Volcker Rule. While the continuation of current activities may be acceptable, any new activity—a new proprietary trading desk or a new fund sponsorship—probably should be discussed with an entity’s primary federal regulator in advance.

A key element of good-faith efforts is “developing and implementing a conformance plan.” The conformance plan is in addition to the compliance framework that banking entities engaged in proprietary trading or fund sponsorship or investment must erect. The conformance plan should explain how an entity will conform all of its activities to the Volcker

¹ Statement of Policy Regarding the Conformance Period for Entities Engaged in Prohibited Proprietary Trading or Private Equity Fund or Hedge Fund Activities, available at <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20120419a1.pdf>.

² The Board has sole responsibility for establishing conformance periods and deadlines for the Volcker Rule. The four other agencies responsible for implementing and enforcing the Rule—the Commodity Futures Trading Commission (“CFTC”), the Federal Deposit Insurance Corporation (“FDIC”), the Office of the Comptroller of the Currency (“OCC”), and the Securities and Exchange Commission (“SEC”) (collectively, and together with the Board, the “Agencies”)—have signed off on the interpretation.

³ 76 Fed. Reg. 68846 (Nov. 7, 2011) (proposal of the Board, FDIC, OCC, and SEC); 77 Fed. Reg. 8332 (Feb. 14, 2012) (proposal of the CFTC).

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requirements by July 21, 2014. The plan should be “as specific as possible.” Doubtless all banking entities concerned about compliance with the Volcker Rule already have developed some kind of process for putting in place the appropriate risk management mechanisms, policies, and procedures, but they can now expect examiners to request a single document that explains this process in more specific detail.

The problem for all banking entities affected by the Volcker Rule, of course, is that the Agencies have not finalized the substantive regulations on the Volcker Rule. These entities thus cannot yet plan for the compliance structure they will need or how they will get there. The Agencies surely understand this fact and will not look for a conformance plan that cannot yet be prepared. However, affected banking entities still face a fixed deadline and, unless some extension is granted, they may need to produce a conformance plan on an expedited basis once the regulations are finalized.

In addition, today’s guidance provides that, notwithstanding the July 21, 2014 deadline, recordkeeping and reporting may be necessary before then:

Good-faith conformance efforts may also include complying with reporting or recordkeeping requirements if such elements are included in the final rules implementing section 13 of the BHC Act and the agencies determine such actions are required during the conformance period.

The recordkeeping and reporting requirements in the proposed rule are extensive. If they are adopted in the form as proposed and are imposed before July 21, 2014, then many banking entities will face a significant compliance burden. While a banking entity does not yet know precisely what records or reports will be required, it should, in its regular reviews of its recordkeeping and reporting systems, be attentive to the impact on these systems of future Volcker Rule recordkeeping requirements.

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