

Client Alert

July 21, 2015

Volcker Rule: Federal Agencies Issue New Guidance Regarding the Seeding Period Treatment for Registered Investment Companies (RICs) and Foreign Public Funds (FPFs)

By Henry M. Fields

Under guidance issued on July 16, 2015 by the federal agencies responsible for implementing the Volcker Rule (the “Agencies”) RICs and FPFs need not be treated as banking entities during a seeding period of up to three years.

The Volcker Rule restricts “banking entities” from sponsoring or investing in covered funds. Registered investment companies (RICs) and foreign public funds (FPFs) are not “covered funds” as defined in the Volcker Rule.¹ However, while they are being organized and “seeded” with capital, investment funds generally are privately held—and in the case of RICs are not registered—and do not qualify as RICs or FPFs, thus creating an issue as to whether the banking entities may seed them.

The Final Rule recognizes this problem for RICs, and explicitly excludes from the definition of a “covered fund” any issuer that is formed and operated pursuant to a written plan to become a RIC. However, the Final Rule does not address how to treat a foreign fund formed for the purpose of becoming a FPF during its seeding period (when it does not meet the definition of a FPF). In June 2014, the Agencies published guidance 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.”²

The preamble to the Final Rule acknowledges that a seeding vehicle that does not meet the definition of a RIC during the seeding period will not be viewed as violating the requirements of the Volcker Rule during the seeding period if the banking entity establishing the seeding vehicle “operates the vehicle pursuant to a written plan [...] that reflects the banking entity’s determination that the vehicle will become a [RIC].”³

Under the new guidance, the Agencies will not treat a RIC or a FPF that is controlled during its seeding period by a banking entity as a banking entity during a seeding period of up to three years, absent evidence that the seeding vehicles were established in order to circumvent the Volcker Rule. The Agencies will not require an application to be submitted to the Federal Reserve to determine the length of the seeding period of a particular RIC or FPF as long as it is within the three-year time frame.⁴

¹ 12 C.F.R. §248.10(c)(1) and (12).

² See <http://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm#5>.

³ 79 Fed. Reg. 5536, 5677 (Jan. 31, 2014).

⁴ Unlike covered funds that must apply for an extension of the one-year seeding period already granted under the Volcker Rule to such covered funds. 12 C.F.R. §248.12(e).

Client Alert

The new guidance also acknowledges that SEC-regulated business development companies (“BDC”) are treated like RICs under the Final Rule and, consistent with the parallel treatment of the two vehicles, a BDC would not become a banking entity during a three-year seeding period, solely because it is controlled by a banking entity.

The text of the Agencies’ new guidance is attached as an appendix to this Client Alert and is also available at <http://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm#16>.

Contact:

Henry M. Fields

(213) 892-5275

hfields@mofo.com

Julian Hammar

(202) 887-1679

jhammar@mofo.com

Oliver Ireland

(202) 778-1614

oireland@mofo.com

Jiang Liu

(212) 468-8008

jiangliu@mofo.com

Barbara R. Mendelson

(212) 468-8118

bmendelson@mofo.com

About Morrison & Foerster:

We are Morrison & Foerster—a global firm of exceptional credentials. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology and life science companies. We’ve been included on *The American Lawyer’s* A-List for 11 straight years, and *Fortune* named us one of the “100 Best Companies to Work For.” Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at www.mofo.com.

Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations. Prior results do not guarantee a similar outcome.

Client Alert

Appendix A

Seeding Period Treatment for Registered Investment Companies and Foreign Public Funds

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?

Posted: 7/16/2015

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/bankinfo/reg/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

Client Alert

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.