

November 18, 2010

## Fed Issues Proposed Rule for Conformity with Volcker Rule

Much has already been written about the possible impact of the Volcker Rule on the financial services industry. Taking an initial step in helping the market understand when the impact will come, although not yet what it will be, the Federal Reserve Board (the “Fed”) on November 17, 2010 requested comment on a proposed rule to implement provisions of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (the “Dodd-Frank Act”) that give banking entities a defined period of time to conform their activities and investments to the so-called Volcker Rule. In general, the date by which banking entities must comply with new Section 13 of the Bank Holding Company Act of 1956 (the “Volcker Rule”) is two years after the earlier of July 21, 2012 or the date on which the final Volcker Rule regulations are adopted. The proposal, among other things, sheds further light on how banking entities can obtain potentially very lengthy extensions beyond this initial conformance period for compliance with the Volcker Rule. The proposal does not address the substantive issues reserved for subsequent regulations that will define the actual contours of the Volcker Rule.

The Volcker Rule generally prohibits banking entities – broadly defined to include banks, parents of banks and subsidiaries and affiliates of either of them – from engaging in proprietary trading in securities, derivatives, or certain other financial instruments, and from investing in, sponsoring, or having certain relationships with a hedge fund or private equity fund, subject to certain exceptions. The Dodd-Frank Act requires the Fed to issue rules implementing the Volcker Rule’s conformance period. The comment period is open for about 45 days. The Fed’s announcement is available [here](#).

By statute, banking entities may apply to the Fed for additional time to comply with the restrictions of the Volcker Rule beyond the initial two-year conformance period. First, banking entities may apply for up to three additional one-year extensions, for a potential total five-year conformance period. The Fed must determine that granting such an extension is consistent with the purposes of the Volcker Rule and will not be detrimental to the public interest. Second, banking entities may apply for a single extended transition period of up to five years, in order to meet contractual obligations to illiquid hedge funds or private equity funds that were in effect as of May 21, 2010. The proposal defines terms necessary to implement the extended transition period, including “illiquid fund,” “liquid asset,” and “principally invested.” While this extended transition period may be granted in addition to the conformance period, it terminates automatically when the banking entity is no longer subject to the contractual commitment.

Under the proposed rule, a banking entity must request a conformance period extension or extended transition period at least 90 days prior to the expiration of its applicable period. The written request must set forth the reasons the Fed should grant the request and the banking entity’s plan to divest or conform its activity or investment. Although the proposed rule permits the Fed to consider any facts or circumstances when considering an application, the proposed rule sets forth a non-exclusive list of eleven factors the banking entity must address, to the extent relevant, in its application. These factors include the nature and activity of the investment, information regarding the fund and the banking entity’s total exposure to the

activity or investment and the risks posed to the banking entity or the country if the banking entity maintains or disposes of the investment. In approving a request, the Fed has the authority to impose conditions on the banking entity as it deems necessary or appropriate to further the purposes of the Volcker Rule. No general conditions are set forth under the proposed rule; thus as currently drafted, any conditions would be imposed on the banking entities on a case-by-case basis. If another federal banking agency, the Securities and Exchange Commission, or the Commodity Futures Trading Commission primarily supervises the applicant, the Fed will consult with the agency during its review of the application and before imposing any conditions on the banking entity.

The transitional compliance period provided for entities that newly find themselves subject to the Volcker Rule is one of the more interesting aspects of the proposal. A company is given two years to comply with the Volcker Rule from the date it becomes a banking entity. This two-year conformance period will apply to companies that acquire or otherwise first become affiliated with banking entities after July 21, 2010, and will continue to apply to new banking entities even after the Volcker Rule and its implementing regulations become fully effective.

The Fed is specifically seeking input on a number of issues. For example, the Fed invites comments on the appropriateness of the proposed definitions, whether the Fed should consider any additional factors in granting the requests, the potential impact of the proposed rule on the banking entities and whether the Fed should impose conditions in connection with its approval by rule or on a case-specific basis. Industry groups representing the banking industry as well as the broader investment community will likely submit comments on the proposal. Banking entities, as well as hedge fund or private equity fund sponsors that have banking entities as investors, should follow this development closely.

If you have questions about the proposed rule or its impact on your business, please contact Ropes & Gray Banking Practice co-heads [Mark V. Nuccio](#) or [Alan Priest](#), or your usual contact at the firm.

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