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Federal Reserve Issues Proposed Conformance Period Rules for the Volcker Rule

On November 17, the Federal Reserve Board requested comment on a proposed rule to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act that give banking firms a defined period of time to conform their activities and investments to the Volcker Rule. The Volcker Rule generally prohibits banking entities 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. The statute generally provides banking entities two years to bring their activities and investments into compliance with the Volcker Rule, and allows the Board to extend this conformance period for specified periods under certain conditions. The proposed rule does not address other aspects of the Volcker Rule that are subject to separate rulemaking requirements by other agencies.

In general, the prohibitions and restrictions of the Volcker Rule do not take effect until the earlier of July 21, 2012, or 12 months after the issuance of final regulations by the rule writing agencies under Section 13(b)(2) of the Bank Holding Company Act. The conformance period generally extends through the date that is two years after the date on which the prohibitions become effective or, in the case of a nonbank financial company supervised by the Board, two years after the company is designated by the Financial Stability Oversight Council for supervision by the Board, if that period is later.

The Volcker Rule permits the Board, by rule or by order, to extend the generally available two-year conformance period by up to three additional one-year periods, for an aggregate conformance period of five years. The proposed rule requires that any banking entity that seeks a one-year extension of the conformance period under this authority submit a request to the Board. Among other things, any such request for an extension must: (1) be submitted in writing to the Board at least 90 days prior to the expiration of the applicable time period, (2) provide the reasons why the banking entity believes the extension should be granted, and (3) provide a detailed explanation of the banking entity's plan for divesting or conforming the activity or investment(s).

The Dodd-Frank Act also includes a special provision to address the difficulty banking entities may experience in conforming investments in illiquid funds. This provision expressly permits a banking entity to request the Board's approval for an additional extension of up to five years in order to permit the banking entity to meet contractual commitments in place as of May 21 to a hedge fund or private equity fund that qualifies as an "illiquid fund." Any extended transition period with respect to an illiquid fund may not exceed five years and may be in addition to the conformance period available under other provisions of the Volcker Rule.

As a general matter, to qualify for the statute's extended transition period, a banking entity's investment in, or relationship with, a hedge fund or private equity fund must meet two sets of criteria. The first set of criteria focuses on the nature, assets and investment strategy of the hedge fund or private equity fund itself. The second set of criteria focuses on the terms of the banking entity's investment in the hedge fund or private equity fund. As provided in the Volcker Rule, the Board may grant a banking entity only one extended transition period with respect to any illiquid fund, which may not exceed five years. The Volcker Rule expressly states that any extended transition period will automatically terminate (unless it already expired by its terms) on the date on which the contractual obligation to invest in, or provide additional capital to, the illiquid fund terminates.

Comments on the proposal must be submitted within 45 days after publication in the *Federal Register*, which is expected shortly. The Dodd-Frank Act requires that the Board issue rules to implement the conformance period no later than January 21, 2011.

Read more.

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