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Agencies Release Volcker Rule FAQ on Seeding Periods for Registered Investment Companies and Foreign Public Funds

The Agencies responsible for implementing the Volcker Rule today released a long-awaited FAQ addressing the ability of banking entities to seed U.S. registered investment companies ("RICs") and foreign public funds ("FPFs"). Prior to the release of today's FAQ, it was uncertain whether a RIC or FPF seeding vehicle could itself be deemed a "banking entity" subject to the Volcker Rule's proprietary trading and covered fund investment prohibitions if the sponsoring banking entity owned a seed investment that exceeded 25% of the fund's voting securities. FAQ 16 describes the circumstances in which a seed investment would not cause a RIC or FPF to be deemed a banking entity, providing clarity requested by the industry while avoiding rigid time limits and burdensome application and approval requirements.

- Specifically, FAQ 16 provides: "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 FAQ does not impose a hard three-year time limit on the seeding period, a possibility that had raised concerns at many banking organizations. The FAQ notes that a seeding period "may take some time, for example, three years, the maximum period of time expressly permitted for seeding a covered fund under the implementing rules." While this likely suggests that there should be enhanced scrutiny of a seeding period that exceeded three years, the reliance on the Agencies' supervisory and anti-evasion authority rather than a rigid rule should provide flexibility to address seeding periods based on particular facts and circumstances, including local jurisdiction requirements.
- The Agencies will not require banking organizations to submit applications to the Federal Reserve Board "to determine the length of the seeding period." Many banking organizations, in the absence of clarity regarding seeding periods, have submitted applications requesting seeding periods of a specified length. Requiring such applications and related approvals on a routine basis to maintain seed investments would have created uncertainty for businesses as they launch new funds and imposed significant burdens on both banking organizations and Federal Reserve Board staff.
- The FAQ notes that the final implementing regulations require that a vehicle that is a covered fund (as opposed to a RIC or a FPF) during its seeding period and that is operated pursuant to a written plan to become a RIC must apply to the Board for an extension of the one-year seeding period initially granted to such covered funds.

The text of FAQ 16 is provided below.

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?

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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/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 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.

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