

Latham & Watkins Financial Institutions Group

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## Two Volcker Rule Updates: Foreign Excluded Funds and Seed Investments

***Two recent developments involving the Volcker Rule have significant implications for financial regulation in both the US and internationally.***

### Update 1: Temporary Relief for Certain Foreign Funds

On July 21, 2017, the Board of Governors of the Federal Reserve System (Federal Reserve Board), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (together with the Federal Reserve Board and the FDIC, the Agencies) released a statement to address concerns about the potential unintended consequences and extraterritorial impact of Section 13 of the Bank Holding Company Act of 1956, as amended, and its implementing regulations (the Volcker Rule) on those foreign funds that are excluded from the “covered fund” definition (foreign excluded funds) but that may nonetheless be subject to the Volcker Rule’s proprietary trading restrictions by virtue of falling within the definition of “banking entity” as a result of being affiliated with a foreign banking entity (controlled foreign excluded funds).<sup>1</sup>

Among other considerations, the Agencies are weighing the argument that controlled foreign excluded funds would be at a competitive disadvantage as compared to foreign excluded funds that are not affiliated with a foreign banking entity against the argument that US banking entities would be at a competitive disadvantage as compared to foreign banking entities that could use a controlled foreign excluded fund to avoid Volcker Rule requirements that would otherwise be applicable to such foreign banking entities. As the Agencies consider options to address these concerns, they have proposed not to take any action for a one-year period that will end on July 21, 2018 against (i) a foreign banking entity based on the attribution of the activities and investments of controlled foreign excluded funds to such foreign banking entity or (ii) controlled foreign excluded funds as “banking entities”, in each case where the foreign banking entity’s relationship with the controlled foreign excluded fund would meet the Volcker Rule requirements for permitted covered fund activities and investments solely outside the US, as if such foreign excluded fund were a covered fund.

### Update 2: Extension of Seeding Period for Covered Funds

The Federal Reserve Board separately issued a letter on July 24, 2017, to provide banking entities with information pertaining to procedures for submitting an application for an extension of the one-year

seeding period for a covered fund.<sup>2</sup> Under the Volcker Rule, a banking entity is permitted, subject to certain requirements, to acquire and retain an ownership interest in a covered fund in connection with organizing and offering such fund for the purpose of (i) establishing the fund and providing the fund with sufficient initial equity for investment to permit the fund to attract unaffiliated investors (seed investment) or (ii) making a *de minimis* investment, subject to several limitations. The Volcker Rule requires a banking entity that is making a seed investment to actively seek unaffiliated investors to reduce its investment in the covered fund to an amount that is not more than 3% of the total outstanding ownership interests in the fund (the per-fund limitation) within one year after the date of establishment of the fund. A banking entity is permitted to request an extension for up to two additional years to conform an investment to the per-fund limitation.

A banking entity that wishes to file an extension request must:

- Provide the reasons for filing the application;<sup>3</sup>
- Explain its plan for reducing the permitted investment in each covered fund to the per-fund limitation by the end of the extended seeding period; and
- Represent whether or not it meets all of the applicable Volcker Rule requirements in connection with permitted organizing and offering of a covered fund.

Extension requests should be submitted to the Applications Unit of the Federal Reserve Bank in the district where the top-tier banking entity is headquartered at least 90 days prior to the expiration of the applicable time period. Federal Reserve Banks have the authority to grant (but not to deny) extension requests and are expected to act on such requests within 30 days of receiving all required information.<sup>4</sup> In the event the Federal Reserve Bank is unable to grant an extension request, the matter will immediately be referred to the Federal Reserve Board for a decision.<sup>5</sup>

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## Endnotes

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<sup>1</sup> Statement regarding Treatment of Certain Foreign Funds under the Rules Implementing Section 13 of the Bank Holding Company Act (July 21, 2017), available at <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20170721a1.pdf>.

<sup>2</sup> Procedures for a Banking Entity to Request an Extension of One-Year Seeding Period for a Covered Fund, SR 17-5 (July 24, 2017), available at <https://www.federalreserve.gov/supervisionreg/srletters/sr1705.pdf> [hereinafter *Seeding Period Extension Request Procedures*].

<sup>3</sup> For a list of the relevant factors that must be addressed in connection with the reasons for filing the application, refer to Attachment A of the Seeding Period Extension Request Procedures.

<sup>4</sup> Refer to the Seeding Period Extension Request Procedures for a list of the criteria to be considered by Federal Reserve Banks in determining whether to approve an extension request.

<sup>5</sup> In reviewing an extension request, the Federal Reserve Board may consider any of the factors in the implementing rules (see 12 CFR § 248.12(e)(2)).