The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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June 5, 2015

ICI Sends Letter to US Federal Reserve Board Urging Immediate Action on Volcker Rule Implementation Issues Affecting Regulated Funds

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TO: ICI GLOBAL ASIA-PACIFIC CHAPTER No. 10-15
ICI GLOBAL REGULATED FUNDS COMMITTEE No. 29-15
ICI GLOBAL STEERING COMMITTEE No. 12-15
INTERNATIONAL MEMBERS No. 21-15
INVESTMENT COMPANY DIRECTORS No. 16-15
SEC RULES MEMBERS No. 37-15 RE: ICI SENDS LETTER TO US FEDERAL RESERVE BOARD URGING IMMEDIATE ACTION ON VOLCKER RULE IMPLEMENTATION ISSUES AFFECTING REGULATED FUNDS

Earlier this week, ICI sent the attached letter to the US Federal Reserve Board ("Federal Reserve") urging that it and other US regulators (collectively, the "Agencies") take immediate action to clarify the treatment of US registered investment companies ("RICs") and similarly regulated non-US funds (collectively, "regulated funds") under the final regulations ("Final Rule") implementing the Volcker Rule. Specifically, the letter requests that (1) the Federal Reserve promptly provide a sufficient (multi-year) seeding period for existing regulated funds and make clear that, going forward, a multi-year seeding period will be equally available for newly-formed regulated funds, and (2) the Agencies issue public guidance to clarify that regulated funds that are "foreign public funds" under the Final Rule will not be treated as banking entities. Each of these issues is discussed briefly below.

Seeding Period

Under the Final Rule, the Agencies indicated that banking entities may hold 25 percent or more of a class of a RIC's voting securities without treating the RIC as a banking entity during a specified seeding period. The staff of the Agencies, in a FAQ, also confirmed that foreign public funds would be afforded a similar treatment during their seeding period. Under the Final Rule and FAQ, banking entities are afforded a one-year seeding period with respect to RICs and foreign public funds, and they may apply to the Federal Reserve for an

extension of “up to 2 additional years.”

The letter explains that multi-year seeding periods are quite common for (and necessary to) the successful launch of regulated funds and that, to launch new funds, banking entities require certainty that they will be able to avail these funds of a sufficient seeding period. It asks that the Agencies clarify that the Final Rule was not intended to affect regulated funds’ well-established seeding practices, which to our knowledge have posed no regulatory or risk issues in the past.

To underscore the importance and urgency of this request, the letter explains that many regulated funds currently in their seeding periods will need additional time beyond the upcoming July 2015 compliance deadline to avoid being deemed “banking entities” under the Final Rule. In the absence of guidance or a clear extension of the compliance deadline as it relates to seeding, the banking entities sponsoring these funds likely will be forced to restructure or liquidate the funds, with adverse consequences for third-party fund investors. The letter further notes that, in the absence of clarity and certainty regarding the allowable seeding period, some banking entities simply will refrain from launching new regulated funds, the consequence of which will be to lessen investor options with respect to investment products that the Volcker Rule was never designed to affect.

Exclusion for Foreign Public Funds

The letter raises an additional concern stemming from the interaction of the terms “covered fund” and “banking entity” in the Final Rule, and the fact that RICs and foreign public funds were specifically excluded from the first definition but not from the second. In the preamble to the Final Rule, the Agencies addressed this issue for RICs, noting that (1) a RIC would be a banking entity under the Final Rule only if it were an affiliate of an insured depository institution covered by the Final Rule, and (2) pursuant to a long line of Federal Reserve precedent, a RIC ordinarily would not be considered an affiliate of such an insured depository institution. The letter explains that the Agencies did not address the fact that many foreign public funds do not and, in many cases, cannot operate in the same manner as RICs and thus cannot rely on those Federal Reserve precedents. As a result, the letter notes, the Agencies left unresolved the question of whether foreign public funds could be captured by the term “banking entity.”

The letter asserts that treating a foreign public fund as a banking entity would defeat the Agencies’ stated goal of limiting the extraterritorial application of the Volcker Rule. Such a result would mean that foreign public funds would receive worse treatment under the Final Rule than covered funds (the very vehicles with which the US Congress was concerned in enacting the Volcker Rule) and quite different treatment than RICs (the treatment of which the Agencies attempted to mirror for foreign public funds). To avoid this nonsensical outcome, the letter requests that the Agencies promptly issue public guidance to clarify that foreign public funds will not be treated as banking entities under the Final Rule.

Rachel H. Graham
Associate General Counsel

Frances M. Stadler
Associate General Counsel

Attachment