



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D.C. 20551

DIVISION OF SUPERVISION
AND REGULATION

SR 16-18

December 9, 2016

**TO THE OFFICER IN CHARGE OF SUPERVISION AT EACH FEDERAL RESERVE
BANK AND TO FINANCIAL INSTITUTIONS SUBJECT TO SECTION 13 OF
THE BANK HOLDING COMPANY ACT**

**SUBJECT: Procedures for a Banking Entity to Request an Extended Transition Period for
Illiquid Funds**

Applicability: This guidance applies to all banking entities, including those banking entities with \$10 billion or less in total consolidated assets, subject to section 13 of the Bank Holding Company Act, regardless of the banking entity's primary financial regulatory agency.

The Federal Reserve is issuing this letter to provide banking entities¹ with information on the procedures for submitting a request for an extended transition period for a hedge fund or private equity fund (referred to as "covered fund") that qualifies as an illiquid fund pursuant to section 13 of the Bank Holding Company Act of 1956 (BHC Act).² Under the statute, a banking entity must apply to the Board for an extended transition period for an illiquid fund regardless of the banking entity's primary financial regulatory agency.

Background

Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act added a new section 13 to the BHC Act, also known as the Volcker Rule, which generally prohibits any banking entity from engaging in proprietary trading or from acquiring or retaining an ownership

¹ The term "banking entity" is defined by statute to include, with limited exceptions: (i) any insured depository institution (IDI) (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)); (ii) any company that controls an IDI (including a bank holding company, savings and loan holding company, and any other company that controls an insured depository institution but that is not a BHC or SLHC, such as the parent company of an industrial loan company); (iii) any company that is treated as a bank holding company for purposes of section 8(a) of the International Banking Act of 1978 (for example, any foreign bank operating a branch or agency in the United States); and (iv) any affiliate or subsidiary of any of the foregoing (for example, a broker-dealer subsidiary of a BHC). 12 U.S.C. 1851(h)(1).

² 12 U.S.C. 1851(c)(3)-(4) and (h)(7).

interest in, sponsoring, or having certain relationships with a covered fund, subject to certain exemptions.³ The restrictions and prohibitions of section 13 of the BHC Act became effective on July 21, 2012;⁴ however, the statute provided banking entities a grace period until July 21, 2014, to conform their activities and investments to the requirements of the statute and any rule issued by the Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Commodity Futures Trading Commission (CFTC), and the Securities and Exchange Commission (SEC). The statute also granted exclusively to the Board authority to provide banking entities additional time to conform or divest their activities and investments covered by section 13.

The statute provides that the Board may, by rule or order, extend this general conformance period “for not more than one year at a time,” up to three times, if in the judgment of the Board, an extension is consistent with the purposes of section 13 and would not be detrimental to the public interest.⁵ On July 7, 2016, the Board issued an Order extending the final one year conformance period for banking entities to conform investments in and relationships with covered funds and foreign funds that were in place prior to December 31, 2013 (legacy covered funds) until July 21, 2017.⁶

Section 13 also permits the Board, upon the application of a banking entity, to provide an additional transition period of up to 5 years to conform investments in a limited class of legacy illiquid funds.⁷ An illiquid fund is defined by the statute as a fund that is “principally invested” in illiquid assets and holds itself out as employing a strategy to invest principally in illiquid assets.⁸ The statute provides that this extension applies only to the extent that the banking entity’s retention of the ownership interest in the fund, or provision of additional capital to the fund, is necessary to fulfill a contractual obligation of the banking entity that was in effect on May 1, 2010.⁹ The statute provides that the Board may grant an extension for each illiquid fund only once and for a period of up to five years.¹⁰ The Board’s Conformance Rule sets forth provisions governing the submission and review of extension requests.¹¹

³ See 12 U.S.C. 1851.

⁴ See 12 U.S.C. 1851(c)(1).

⁵ See 12 U.S.C. 1851(c)(2). The Board issued rules implementing the Volcker Rule conformance provisions in 2011. See Conformance Period for Entities Engaged in Prohibited Proprietary Trading or Private Equity Fund or Hedge Fund Activities, 76 *Fed. Reg.* 8265 (2011) (“Conformance Rule”).

⁶ See Board press release, July 7, 2016, at: <http://www.federalreserve.gov/newsevents/press/bcreg/20160707a.htm>.

⁷ See 12 U.S.C. 1851(c)(3)-(4) and (h)(7).

⁸ See 12 U.S.C. 1851(h)(7).

⁹ See 12 U.S.C. 1851(c)(3)(A). In addition, the statute provides that a banking entity may not engage in a prohibited covered fund investment after the date on which the contractual obligation to invest in the illiquid fund terminates. See 12 U.S.C. 1851(c)(4)(A).

¹⁰ See 12 U.S.C. 1851(c)(3)(B).

¹¹ See 12 CFR 225.181 and 225.182.

In its statement of policy for legacy illiquid covered funds, the Board also generally outlined a simplified and streamlined process for granting extensions of the holding period for illiquid funds. That process is outlined below.

Requirements for Submitting Requests

In filing a request for an extended transition period for illiquid funds, a banking entity is expected to provide:

- A list or simple chart of illiquid funds for which an extension is sought.
- A short description of each fund, including the investment strategy and types of investments made by each fund, which entity within the firm holds the investment, the size of each fund, the total exposure of the banking entity to each fund, the date by which each remaining illiquid fund is expected to mature by its terms or be conformed to section 13 of the BHC Act, and the banking entity's relationship with the fund (for example, general partner, sponsor, investment adviser, investor).
- A description of the banking entity's specific efforts to divest or conform its illiquid funds, including a description of the overall covered funds (both liquid and illiquid) that have been divested or conformed to date, the progress that has been made towards divesting or conforming the investments for which an extension is being sought (for example, the number of funds sold, the number of funds that continue to be held, and the amount of investments remaining in each fund and in aggregate).
- A certification by the General Counsel or Chief Compliance Officer of the entity that sponsors or invests in the illiquid funds that each fund meets the definition of illiquid funds in section 13 of the BHC Act and the Board's Conformance Rule, including that the extension is necessary to fulfill a contractual obligation of the banking entity that was in effect on May 1, 2010.¹²
- The length of the requested extension of the conformance period and a description of the banking entity's plan for divesting or conforming each illiquid fund prior to the end of the requested extension period.

In addition, the Federal Reserve may, on a case-by-case basis, require a banking entity to provide a progress report on fund sales, maturities, or other conformance efforts as appropriate at any time during the period that the banking entity continues to hold illiquid funds in reliance on an extension.

¹² See 12 U.S.C. 1851(c)(3)-(c)(4) and (h)(7); and 12 CFR 225.180(f).

A banking entity would not be required to exercise a so-called “regulatory out” provision¹³ or otherwise seek consent from third parties (for example, the general partner or other investors in the fund) to terminate an investment in an illiquid fund in order to qualify for the extended transition period.

Procedures for Filing an Extension Request

A request for an extended transition period for illiquid funds should be submitted in writing to the Applications Unit of the appropriate Federal Reserve Bank by the top-tier banking entity in the district where it is headquartered (referred to as the “responsible Federal Reserve Bank”).¹⁴ The request may be submitted at any time at least 180 days prior to the expiration of the general conformance period (that is, at least 180 days prior to July 21, 2017).¹⁵ In the case where the banking entity that sponsors or invests in the illiquid fund is supervised primarily by another federal banking agency, the SEC, or the CFTC, the top-tier banking entity should also provide a copy of the extension request to the relevant agency for the subsidiary banking entity.¹⁶ A banking entity also should provide the name, phone number, and email address of the banking entity’s point of contact to whom Board and Reserve Bank staff may submit all inquiries.

Authority to grant (but not to deny) requests has been delegated to the Federal Reserve Banks, in consultation with Board staff. Federal Reserve Banks may approve extension requests if all of the following criteria are met:

- The extension request relates only to illiquid funds;
- No significant issues have been identified regarding the firm’s compliance program required under section __.20 of the final rule designed to help ensure and monitor compliance with the prohibitions and restrictions of the Volcker Rule;
- The primary federal agency responsible for compliance with the Volcker Rule by the banking entity that invests in or sponsors the illiquid fund (if other than the Federal Reserve) does not object to the extension;
- The banking entity has made meaningful progress toward conforming the majority of its covered fund investments (including funds other than illiquid funds) as of the date of the extension request; and

¹³ So-called “regulatory-out” provisions are provisions whereby a banking entity’s contractual obligation to remain invested in a fund may be excused or otherwise terminated if the banking entity’s compliance with the obligation would cause, or would be reasonably likely to cause, the banking entity or the fund to be in violation of applicable laws and regulations.

¹⁴ For banking entities not regulated by the Federal Reserve, the following link provides information on each of the 12 Reserve Banks, including their addresses: www.federalreserveeducation.org/about-the-fed/structure-and-functions/districts/. For Federal Reserve regulated banking entities, notices may also be submitted electronically through the Federal Reserve System’s Electronic Applications System, E-Apps.

¹⁵ See 12 CFR 225.181(c)(1).

¹⁶ See List of Contacts at Other Agencies in Attachment One.

- The banking entity provides supporting information regarding its efforts to conform the illiquid funds for which an extension is being sought. Such supporting information could include, but would not be limited to, information regarding specific bids that have been sought and other specific actions taken to conform the funds for which an extension is being sought.

Consistent with the statute, the extension would be granted for the shortest of (i) five years from the date of the expiration of the general conformance period (that is, July 21, 2017), (ii) the date by which each remaining fund is expected to mature by its terms or be conformed to section 13 of the BHC Act, or (iii) a shorter period determined by the Board. The responsible Federal Reserve Bank should expect to act on an extension request within 30 days of receiving all required information. If the request does not meet the requirements for delegated action, the Federal Reserve Bank will immediately refer the matter to the Board. The Board may then approve or deny the request based on the relevant facts. The Board expects that the illiquid funds of banking entities will generally qualify for extensions, though extensions may not be granted in certain cases—for example, where the banking entity has not demonstrated meaningful progress to conform or divest its illiquid funds, has a deficient compliance program under the Volcker Rule, or where the Board has concerns about evasion. Refer to Attachment Two, Sample Acknowledgment Letter.

Federal Reserve Banks are asked to distribute this letter to their supervised financial institutions and to appropriate supervisory staff. The Federal Reserve has provided a copy of this letter to the other agencies to inform their supervised institutions of this guidance. Questions regarding this guidance may be directed to:

- Division of Supervision and Regulation: Anna Harrington, Senior Supervisory Financial Analyst, at (202) 452-6406, and Kevin Tran, Supervisory Financial Analyst, at (202) 452-2309.
- Legal Division: Flora Ahn, Counsel, at (202) 452-2317, and Brian Chernoff, Senior Attorney, at (202) 452-2952.

In addition, questions may be sent via the Board's public website.¹⁷

Michael S. Gibson
Director

Attachments

- *Attachment One: List of Contacts at Other Agencies*
- *Attachment Two: Sample Acknowledgment Letter*

¹⁷ See <http://www.federalreserve.gov/apps/contactus/feedback.aspx>.

**SR letter 16-18, “Procedures for a Banking Entity to Request
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**Attachment One
List of Contacts at Other Agencies**

Last Updated: December 9, 2016

Office of the Comptroller of the Currency

Ted Dowd
Director, Securities and Corporate Practices Division
(202) 649-5510
ted.dowd@occ.treas.gov

Federal Deposit Insurance Corporation

Peter Yen
Chief, Capital Markets Strategies
Risk Management Supervision Division
(202) 898-6568
pyen@fdic.gov

Commodity Futures Trading Commission

Erik Remmler
Deputy Director, Registration and Compliance
Division of Swap Dealer and Intermediary Oversight
(202) 418-7630
eremmler@cftc.gov

Securities and Exchange Commission

Aaron T. Gilbride
Division of Investment Management, Chief Counsel’s Office
(202) 551-6906
gilbridea@sec.gov

**SR letter 16-18, “Procedures for a Banking Entity to Request
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**Attachment Two
Sample Acknowledgment Letter**

[DATE]

[NAME]

[TITLE]

[FIRM NAME]

[ADDRESS]

[CITY, STATE, ZIP CODE]

Dear [NAME]:

This is to acknowledge receipt by the Federal Reserve Bank of [DISTRICT] (“Reserve Bank”), as of [RECEIPT DATE], of the request dated [APPLICATION DATE], by [APPLICANT], [CITY], [STATE] (the “Applicant”), for an extended transition period for hedge funds or private equity funds (“covered funds”) that qualify as illiquid funds pursuant to section 13 of the Bank Holding Company Act (the “BHC Act”), 12 U.S.C. 1851.

Consistent with the statute, the extension would be granted for the shortest of (i) five years, (ii) the date by which each remaining fund is expected to mature by its terms or be conformed to section 13 of the BHC Act, or (iii) a shorter period determined by the Board.¹

Please contact [RESERVE BANK PRIMARY CONTACT] at [PHONE NUMBER] or [ALTERNATE RESERVE BANK CONTACT], if you have any questions regarding this letter.

Sincerely,

Name of Reserve Bank Official
Title

¹ Authority to grant requests has been delegated to the Federal Reserve Banks in consultation with Board staff, if all of the delegation criteria have been met.