



Volcker Rule Update: Federal Reserve Issues Guidance on Conformance Period for Entities Engaged in Proprietary Trading or Private Fund Activities

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Last week, the Federal Reserve issued a statement of policy on the period of time banking entities have to bring their activities and investments into compliance with Section 13 of the Bank Holding Company Act (the “Volcker Rule”). The Volcker Rule, which was enacted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, imposes certain prohibitions and restrictions on banking entities engaging in proprietary trading and sponsoring and/or investing in private equity and hedge funds. While the Volcker Rule becomes effective on July 21, 2012, the key date is July 21, 2014, which is the statutory deadline by which banking entities must conform their activities and investments to the Volcker Rule. The Federal Reserve’s recent guidance confirms that banking entities will have this entire two-year “conformance period” to come into compliance with the Volcker Rule.

While the two-year conformance period is provided by statute, confusion surrounded certain statements the federal banking and financial regulators made as part of the proposed rules on the Volcker Rule.¹ The preamble to the proposed rules stated that the agencies would expect banking entities to “fully conform” all of their activities and investments to the proposed rules “as soon as practicable within” the conformance period. In addition, the preamble stated that banking entities are not authorized to engage in “new” or “additional” prohibited activities or investments during the conformance period. These statements, however, went further than the statutory language of the Volcker Rule, which stated that banking entities must bring their activities and investments into compliance “not later than 2 years after the date on which the requirements become effective.”²

¹ The proposed rules were issued by the Federal Reserve, the other federal banking agencies and the Securities and Exchange Commission in October 2011. A substantially similar proposal was issued by the Commodity Futures Trading Commission in January 2012. The proposed rules remain pending, and in testimony before the House Financial Services Committee, on February 29, 2012, and the Senate Banking Committee, on March 1, 2012, Federal Reserve Chairman Bernanke acknowledged that the proposed rules are not likely to be finalized prior to the Volcker Rule’s effective date of July 21, 2012. For background regarding these proposed rules, please see our client memorandum, titled “Regulations Proposed to Implement the Volcker Rule,” dated October 13, 2011, *available at* <http://www.simpsonthacher.com/content/Publications/pub1275.pdf>. Rules regarding the availability of, and process for obtaining, extensions to the two-year conformance period were adopted by the Federal Reserve in February 2011. See 76 Fed. Reg. 8265 (Feb. 14, 2011).

² 12 U.S.C. § 1851(c)(2).

The statement of policy is important because it reassures banking entities that they will not need to take definitive steps to restructure or terminate operations covered by the Volcker Rule until later in the conformance period after the Volcker Rule implementing regulations have been finalized and adopted. However, the Federal Reserve will expect these banking entities to engage in “good-faith efforts,” appropriate for their activities and investments, that “*will result*” in the conformance of “*all*” of their activities and investments to the Volcker Rule by no later than July 21, 2014 (or potentially later if an extension is granted by the Federal Reserve). Good-faith conformance efforts of a banking entity will include: (i) an evaluation of the extent to which it is engaging in activities and investments that are covered by the Volcker Rule and (ii) the development and implementation of a conformance plan that is “*as specific as possible*” about how the banking entity will “*fully conform*” all of its covered activities and investments to the Volcker Rule and any final implementing rules. Good-faith conformance efforts may also include complying with reporting and recordkeeping requirements “if” such elements are included in the final rules implementing the Volcker Rule and the agencies determine that such actions are required during the conformance period.

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We continue to monitor key developments under the Volcker Rule. For more information regarding the Federal Reserve’s recent statement of policy, please contact any of the members of our Financial Institutions or Private Funds groups.

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