

Order Approving Extension of Conformance Period Under Section 13 of the Bank Holding Company Act

Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act added a new section 13 to the Bank Holding Company Act of 1956 (“BHC Act”) (codified at 12 U.S.C. § 1851) that generally prohibits banking entities from engaging in proprietary trading and from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a hedge fund or private equity fund (together, a “covered fund”).¹ These prohibitions are subject to a number of statutory exemptions, restrictions, and definitions.

The restrictions and prohibitions of section 13 of the BHC Act became effective on July 21, 2012; 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 implementing rules issued by the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, and the Commodity Futures Trading Commission (collectively, “the Agencies”).² Under the statute, the Board may, by rule or order, extend the two-year conformance period for one year at a time, for a total of not more than 3 years, 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. This would allow extensions of the conformance period until July 21, 2017. Section 13 also permits the

¹ See 12 U.S.C. § 1851. A banking entity is defined by statute as any insured depository institution, any company affiliated with an insured depository institution, as well as any foreign bank that has a branch or agency in the U.S., with certain limited exceptions.

² 12 U.S.C. § 1851(c).

Board to provide banking entities an additional transition period of up to five years to conform certain illiquid funds.

In December 2013, the Agencies approved a final regulation implementing the provisions of section 13 of the BHC Act.³ In connection with issuing the final rule, the Board also extended the conformance period until July 21, 2015.⁴ In addition, the Board issued a statement in April 2014 indicating that it intended to grant two additional one-year extensions of the conformance period, one this year and one next year, that would allow banking entities additional time to conform ownership interests in and sponsorship activities of collateralized loan obligations (“CLOs”) that are backed in part by non-loan assets and were in place as of December 31, 2013.⁵

Since approval of the final rule, a number of banking entities, private equity funds, trade associations, and members of Congress have requested additional extensions of the conformance period to allow banking entities additional time to conform or divest covered fund investments and relationships. Commenters requested additional time to identify funds that are covered by the statutory provisions, determine whether those funds can be conformed to the statute and final rule or must be divested, and divest or conform non-conforming investments in covered funds.

³ See Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Fund and Private Equity Funds, 79 Fed. Reg. 5536 (Jan. 31, 2014); 79 Fed. Reg. 5808 (Jan. 31, 2014).

⁴ See Order Approving Extension of Conformance Period (Dec. 10, 2013), available at <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20131210b1.pdf>.

⁵ See Statement Regarding the Treatment of Collateralized Loan Obligations Under Section 13 of the Bank Holding Company Act (April 7, 2014), available at <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20140407a1.pdf>.

Commenters argued that, prior to adoption of the final rule, banking entities were permitted to make and did make significant investments in many thousands of covered funds that, following adoption of the final rule, must be evaluated and conformed to the new requirements of section 13. Commenters asserted that an extended period of time is needed to allow for the orderly sale of covered fund interests that must be divested, including divestitures that must, by statute, be made by employees, officers, and directors of banking entities.⁶ In addition, banking entities contended that the statutory requirements to change the names of covered funds and restrict relationships with covered funds that may be retained by banking entities would require additional time to allow consultation with, and the consent of, investors in and managers of covered funds.⁷ Private funds that are sponsored by non-banking entities have also indicated that a number of investors in their funds include foreign banks subject to section 13 and the final rule. These non-banking entities have requested additional time to restructure, conform, redeem, or sell investments by foreign banks in these third-party funds. Moreover, commenters argued that additional time is needed for foreign funds that have some activities in the U.S. and their managers and investors to determine whether they must take steps to modify their sales practices, governance, or ownership structure to ensure compliance with various provisions of section 13.

⁶ The statute prohibits employees and directors of a banking entity from investing in certain types of funds sponsored by the banking entity unless the director or employee is directly engaged in providing investment advisory or other services to the covered fund. See 12 U.S.C. § 1851(d)(1)(G)(vii).

⁷ The statute prohibits a fund sponsored by a banking entity from sharing the same name or a variation of the same name with the banking entity or any affiliate for corporate, marketing, promotional, or other purposes. See 12 U.S.C. § 1851(d)(1)(G)(vi). The statute also imposes limits on lending and other transactions between a covered fund and a banking entity that sponsors, manages, or advises the fund. See 12 U.S.C. § 1851(f).

Providing banking entities with additional time to conform investments that were made in covered funds prior to the adoption by the Agencies of implementing rules for section 13 would allow banking entities to terminate existing activities and divest existing investments in an orderly manner consistent with protecting the safety and soundness of those banking entities. It would also reduce the potential disruptive effects that significant divestitures of covered funds could have on markets and on the investments of others not subject to section 13, as well as allow banking entities additional time to work with other investors and investment managers to take steps to conform covered funds to the requirements of the statute and the final rule (such as by issuing disclosures, changing fund names, and conforming employee investments).

The legislative history of section 13 indicates that an extended conformance period was intended to give markets and firms an opportunity to adjust to the prohibitions and requirements of the statute and any implementing rules.⁸ The Board believes granting a one-year extension of the conformance period for banking entities to conform investments in and relationships with covered funds and foreign funds that may be subject to the provisions of section 13 and that were in place prior to December 31, 2013 (“legacy covered funds”), is consistent with the purposes of section 13 of the BHC Act and would facilitate the effective implementation of the statute. Moreover, a one-year extension of the conformance period would not be detrimental to the public interest and would ensure that there are no unnecessary disruptions to the financial markets as banking entities restructure their covered fund activities and investments.

⁸ See 156 Cong. Reg. S5898 (daily ed. July 15, 2010) (statement of Sen. Merkley).

The Board also intends next year to exercise the authority granted by section 13 of the BHC Act to grant the final one-year extension in order to permit banking entities until July 21, 2017, to conform ownership interests in and relationships with legacy covered funds. This action would be consistent with the action already promised by the Board regarding legacy investments in CLOs. The Board will also consider whether to take action regarding illiquid funds.

This extension would permit banking entities additional time to divest or conform only legacy covered fund investments and relationships made by banking entities prior to December 31, 2013. All investments and relationships related to investments in a covered fund made after that date must be in conformance with section 13 of the BHC Act and the implementing rule by July 21, 2015. The extension would not apply to proprietary trading activities, which must conform to the final rule by July 21, 2015.

During the conformance period, each banking entity would be expected to engage in good-faith efforts to conform of all its activities and investments to the requirements of section 13 and the implementing rule by no later than the end of the applicable conformance period.⁹ Good-faith efforts include evaluating the extent to which a banking entity is engaged in activities and investments that are covered by section 13 and the final rule as well as developing and implementing a conformance plan that is appropriately specific about how the banking entity will fully conform all of its covered activities and investments by the end of the applicable conformance period. Moreover,

⁹ The Board issued a Statement of Policy Regarding the Conformance Period for Entities Engaged in Prohibited Proprietary Trading or Private Equity Fund or Hedge Fund Activities in which the Board clarified the activities that are permissible during the conformance period. See 77 Fed. Reg. 33949 (June 8, 2012).

during the extended conformance period, banking entities are expected to make plans well in advance of the end of the extended conformance period regarding how they will conform or divest legacy covered fund investments in an orderly and safe and sound manner. Banking entities are encouraged to take steps to divest covered funds or conform such funds to the statute and final rule during the extended conformance period.

The other Agencies charged with enforcing the requirements of section 13 of the BHC Act and the final rule plan to administer their oversight of section 13 and the final rule in accordance with the Board's conformance rule and this extension of the conformance period. Nothing in this Order restricts in any way the authority of any agency to use its supervisory or other authority to limit any activity or investment the agency determines to be unsafe or unsound or otherwise inconsistent with applicable law.

Based on the foregoing, the Board hereby extends the conformance period under section 13 of the BHC Act for all banking entities to conform investments in and relationships with legacy covered funds for one year, until July 21, 2016.¹⁰

By order of the Board of Governors of the Federal Reserve System, effective December 18, 2014.

Margaret McCloskey Shanks (signed)
Margaret McCloskey Shanks
Deputy Secretary of the Board

¹⁰ Pursuant to the Board's regulation regarding the conformance period, a company that was not a banking entity or a subsidiary or an affiliate of a banking entity on July 21, 2010, must bring its activities into conformance before the later of the general conformance date, or two years after the date on which the company becomes a banking entity or a subsidiary or an affiliate of a banking entity. 76 Fed. Reg. 8265 (February 14, 2011).