

Financial Institutions Regulatory Alert

Federal Reserve Will Extend Conformance Period for Treatment of CLOs as Covered Funds under the Volcker Rule

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This week, the Federal Reserve Board (“FRB”) issued a statement confirming that it intends to extend the period provided for under the Volcker Rule for banking entities to conform their ownership interests in and sponsorship of collateralized loan obligation vehicles (“CLOs”) with the requirements of the Volcker Rule.

Under the Volcker Rule, banking entities are generally prohibited from acquiring or retaining an “ownership interest” in and sponsoring hedge funds, private equity funds and other “covered funds”, subject to certain limited exceptions. Although CLOs are generally backed by loans and “loan securitizations” are excluded from the definition of covered funds under the Volcker Rule, some CLOs that hold non-conforming, non-loan assets such as bonds are considered covered funds under the Volcker Rule. This is particularly problematic since bonds can be found in many pre-Volcker Rule CLOs.

Although some commentators have suggested that regulators “grandfather” all CLOs established prior to the enactment of the Volcker rule, the FRB has instead decided to allow banks more time to come into compliance with the Volcker Rule requirements and to bring their CLOs under the exclusion for loan securitizations.

The conformance period had previously been extended by the FRB for one year until July 2015. The new conformance date will now be July 21, 2017. During the conformance period, banking entities will not be required to count their ownership interests in CLOs for determining their compliance with the Volcker Rule.

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