

MEMO# 27424

July 31, 2013

SEC Staff Issues Guidance Regarding Counterparty Risk Management Practices with Respect to Tri-Party Repo

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TO: SECURITIES OPERATIONS ADVISORY GROUP RE: SEC STAFF ISSUES GUIDANCE REGARDING COUNTERPARTY RISK MANAGEMENT PRACTICES WITH RESPECT TO TRI-PARTY REPO

The Securities and Exchange Commission's Division of Investment Management has issued guidance for money market funds on counterparty risk management practices with respect to tri-party repos. [\[1\]](#) The IM staff guidance is in response to the Financial Stability Oversight Council's 2013 Annual Report, which warned that the tri-party repo market remains vulnerable to runs by lenders in the event that concerns emerge regarding the financial condition of borrowers such as securities broker-dealers. Accordingly, as a matter of prudent risk management, the staff guidance encourages money market funds and their investment advisers to consider the legal and operational steps they may need to take if a repo counterparty fails and the repos it issued default. The guidance refers to a checklist that ICI prepared for funds holding repos in the event of a repo counterparty insolvency, [\[2\]](#) and it suggests that a fund's adviser should prepare in advance for a default, including the following steps:

- Review the master repurchase agreements and related documentation to consider any specified repo default procedures. If these procedures call for notifications or other documents, the fund may consider having templates prepared in advance.
- Consider operational aspects of managing a repo default. For example, funds may want to evaluate whether the systems at the fund or its custodian are capable of appropriately holding, valuing, trading, and accounting for the collateral underlying the fund's repos.
- Consider, to the extent possible, whether there are potential legal considerations under the Investment Company Act of 1940 or otherwise that the fund could consider in advance or will need to evaluate at the time of any repo default. For example, money market funds may want to consider whether they can hold certain types of repo collateral and remain in compliance with Rule 2a-7, and they also may want to identify any required notifications to the SEC and to determine the effect of

bankruptcy laws. The fund also may want to evaluate what notifications and information the adviser should provide to the fund's board of directors regarding the default and what disclosures, if any, the fund should provide to its shareholders.

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endnotes

[1] See IM Guidance Update 2013-03 (July 2013), available on the SEC's website at <http://www.sec.gov/divisions/investment/guidance/im-guidance-2013-03.pdf>.

[2] ICI's checklist for the event of dealer insolvency is available at http://www.ici.org/policy/current_issues/11_mmf_repo_checklist.

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