The Asset Management Industry
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INVESTMENT COMPANY INSTITUTE

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June 6, 2016

ICI Letter on Implications for U.S. and Non-U.S. Regulated Funds of Proposed Counterparty Exposure Limits for Banks

[29961]

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TO: ICI GLOBAL REGULATED FUNDS COMMITTEE No. 38-16
SEC RULES MEMBERS No. 24-16 RE: ICI LETTER ON IMPLICATIONS FOR US AND NON-U.S. REGULATED FUNDS OF PROPOSED COUNTERPARTY EXPOSURE LIMITS FOR BANKS

In March, the US Federal Reserve Board ("Board") re-proposed a rule to limit the exposures of a large banking organization ("covered company") to its individual counterparties, as required by Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. [*] ICI filed a comment letter on June 3, a copy of which is attached.

The ICI letter expresses support for the Proposal's goals of strengthening covered companies' monitoring and management of counterparty and concentration risks. It expresses concern, however, with certain possible implications for regulated U.S. and non-U.S. funds of the proposed exposure limits. Specifically, the letter discusses why:

- The final rules should not treat regulated funds as subsidiaries or otherwise part of covered companies. The letter explains that regulated funds are not controlled by their sponsors or advisers, and that this is true even for regulated non-U.S. funds that do not have independent boards of directors/trustees. The letter further urges the Board to clarify that an adviser's or sponsor's ownership of more than 25 percent of the voting shares of a regulated (U.S. or non-U.S.) fund for a reasonable seeding period would not require aggregation of the fund's exposures with those of its covered company adviser or sponsor.
- The final rules should not treat regulated funds as part of a counterparty due to a sponsor or adviser relationship. The letter articulates similar rationales to those summarized above.
- Regulated funds should be excluded from the proposed "control relationship" standard. As proposed, this standard potentially could require a covered company to aggregate its exposures to a counterparty and a regulated non-U.S. fund(s) sponsored or advised by the counterparty. The letter explains why such a result would not be

appropriate or serve the Proposal's policy objective and, accordingly, urges the Board to exclude regulated funds from the control relationship standard.

- Large covered companies should not be required to "look through" to the portfolio investments of diversified regulated funds. The Proposal includes a detailed look-through provision that appears to pose considerable compliance challenges for large covered companies (those with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance sheet foreign exposures). The letter explains why it is highly unlikely that a large covered company's investment in a diversified regulated fund—which investment already would be directly limited by the proposed exposure limits—would materially increase the company's exposure to any one underlying issuer. On this basis, the letter urges the Board to exclude diversified regulated funds from the Proposal's look-through provision.
- A large covered company that invests in a regulated fund should not be required to recognize a second, equivalent exposure to the fund's manager or any other service provider. The Proposal would require large covered companies to recognize a gross credit exposure to each third party that has a contractual or other business relationship with a securitization vehicle, investment fund, or other SPV, in cases where failure or material financial distress of the third party would cause a loss in the value of the covered company's investment in or exposure to the investment fund. The proposed rule text specifically identifies "fund managers" as potential third parties. ICI's letter explains in detail why large covered company investments in regulated funds should be excluded from this provision.

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Attachment

endnotes

[*] US Federal Reserve Board, Single-Counterparty Credit Limits for Large Banking Organizations, 81 Fed. Reg. 14328 (Mar. 16, 2016) ("Proposal"). Certain aspects of the Board's Proposal reflect the Basel Committee on Banking Supervision's framework for measuring and controlling large exposures, which was finalized in 2014. See Basel Committee on Banking Supervision, Supervisory framework for measuring and controlling large exposures (April 2014), available at http://www.bis.org/publ/bcbs283.pdf.