

MEMO# 31260

June 25, 2018

ICI Draft Comment Letter on SEC's Proposed Amendments to the Loan Provision; Comments Due to ICI by Monday, July 2

[31260]

June 25, 2018 TO: Accounting/Treasurers Committee

Auditor Independence Working Group

Chief Compliance Officer Committee

Closed-End Investment Company Committee

SEC Rules Committee

Small Funds Committee RE: ICI Draft Comment Letter on SEC's Proposed Amendments to the Loan Provision; Comments Due to ICI by Monday, July 2

In May, the Securities and Exchange Commission proposed amendments to its auditor independence rules intended to address concerns that the portion of the rules dealing with loans and debtor-creditor relationships, the "Loan Provision," may not be functioning as intended.^[1] In particular, the Commission had become aware of certain fact patterns in which an auditor's objectivity and impartiality were not impaired despite a failure to technically comply with the rule. The proposed amendments would refocus the analysis of the auditor's debtor-creditor relationships on those relationships that may present a legitimate threat to an auditor's independence. The proposed amendments would do so by: i) eliminating violations solely due to record ownership; ii) replacing the existing more than 10 percent bright-line ownership test with the concept of "significant influence;" iii) adding a "known through reasonable inquiry" standard when identifying beneficial owners of the audit client's equity securities; and iv) narrowing the definition of "audit client" to exclude funds that would be considered affiliates of the audit client.

ICI's draft comment letter on the proposed amendments is attached for your review. **Please provide any written comments to Greg Smith at smith@ici.org by close of business on Monday, July 2.** Comments are due to the SEC by Monday, July 9.

The draft letter strongly supports the proposed amendments. In it, we recommend that the SEC:

- *Eliminate Record Owners from the Scope of the Loan Provision.*

- *Substitute “Significant Influence” for the 10 Percent Bright-Line Test and Maintain the Concept of “Portfolio Management Processes.”* This would include:
 - Reiterating its guidance regarding “portfolio management processes” in any adopting release.
 - Clarifying the steps that an audit firm should take for funds to determine whether significant influence over the fund’s portfolio management processes exists.
- *Incorporate a Materiality Assessment into the Lending Relationship Analysis.*
- *Provide Additional Guidance on the “Significant Influence” Test.* This would include:
 - Clarifying and narrowing “beneficial owner” for purposes of the Loan Provision to exclude shareholders with no economic interest in the audit client.
 - Changing the proposed “known through reasonable inquiry” standard to a “known” standard when determining beneficial ownership.
 - Providing additional guidance on what it means to have “significant influence” in the context of certain registered funds with unique characteristics (closed-end funds, variable insurance products, and ETFs); and
 - Providing additional guidance on how audit firms can meet their requirement to monitor the Loan Provision on an ongoing basis.
- *Narrow the Scope of “Audit Client.”* The Commission should further narrow the term “audit client” to exclude all pooled investment vehicles related to, and affiliates of, an audit client fund.
- *Narrow the Scope of Lending Relationships.* The Commission should limit the scope of lending relationships to those entities that can affect an audit (*i.e.*, those entities that own the fund shares or control the owner of the fund’s shares).

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[Attachment](#)

endnotes

[1] See *Auditor Independence with Respect to Certain Loans or Debtor-Creditor Relationships*, Release No. 33-10491 (May 2, 2018), available at <https://www.sec.gov/rules/proposed/2018/33-10491.pdf>. For a summary of the proposed amendments, see *SEC Proposes Amendments to Auditor Independence Loan Rule*, ICI Memorandum No. 31198 (May 7, 2018), available at https://www.ici.org/my_ici/memorandum/memo31198.

should not be considered a substitute for, legal advice.