The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 27218

May 3, 2013

ICI Letter on Proposed Enhanced Prudential Standards for Foreign Banking Organizations and Foreign "SIFIS"

[27218]

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 38-13
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 11-13
SEC RULES MEMBERS No. 42-13 RE: ICI LETTER ON PROPOSED ENHANCED PRUDENTIAL STANDARDS FOR FOREIGN BANKING ORGANIZATIONS AND FOREIGN "SIFIs"

Late last year, the Federal Reserve Board ("Board") issued a proposal to implement Sections 165 and 166 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") with respect to foreign banking organizations and foreign nonbank financial companies designated for supervision by the Board ("FBO Proposal"). [1] Those provisions concern enhanced prudential standards (Section 165) and early remediation requirements (Section 166). In response to the FBO Proposal, ICI recently filed a comment letter reiterating certain comments we made in response to the Board's earlier proposal ("U.S. Proposal") to implement the same Dodd-Frank Act provisions with respect to U.S. bank holding companies with at least $50 billion in total consolidated assets ("large BHCs") and U.S. nonbank financial companies designated for supervision by the Board ("SIFIs"). [2] The letter is attached and briefly summarized below.

The letter notes that the 2012 ICI Letter addressed, among other things, an issue of concern to U.S. money market funds (and, potentially, other types of funds) sponsored by large BHCs or by SIFIs (if SIFIs are not excluded from the proposal as ICI recommended). The issue related to the application of single counterparty credit limits, as required by Section 165(e) of the Dodd-Frank Act, to a "covered company" [3] that sponsors or advises registered investment companies ("registered funds").

In particular, under the U.S. Proposal, a fund or other investment vehicle that is sponsored or advised by a covered company typically would not be considered a subsidiary of the covered company (and therefore not subject to the proposed aggregate net credit exposure limits that would apply to covered companies and their subsidiary companies). The preamble noted, however, that excluding funds from the single-counterparty credit limits

may be at odds with the support that some money market funds received from their sponsors during the recent financial crisis to enable those funds to meet investor redemption requests without having to sell assets into then fragile and illiquid markets. The Board requested comment on whether money market funds or other funds or vehicles that a covered company sponsors or advises should be included as part of the covered company for purposes of the proposed rule and whether the U.S. Proposal's definition of "subsidiary" should be expanded to include any investment fund or vehicle advised or sponsored by a covered company or any other entity.

As a threshold matter, the 2012 ICI Letter explained that sponsored or advised registered funds, including money market funds, do not meet any of the standard indicia of a subsidiary. The letter then stated that treating registered funds in this manner will not further the purpose of the single-counterparty credit limits, and will unnecessarily disrupt the operations of the funds while creating potential conflicts of interest between the funds and their covered company adviser. Moreover, the letter explained that such treatment may create the inaccurate perception that support from a fund's adviser or sponsor is likely—a result directly contrary to the Board's objective. For all of these reasons, we strongly disagreed that sponsored or advised funds, including money market funds, should be included as part of a covered company or that the definition of "subsidiary" should be expanded to include any fund advised or sponsored by a covered company or any other entity.

The FBO Proposal raises the same issue with respect to certain U.S. funds that would not be implicated by the U.S. Proposal, such as those that are advised or sponsored by a U.S. registered investment adviser that is a subsidiary of a foreign banking organization. Our comment letter explains that for the same reasons discussed in the 2012 ICI Letter, we do not believe that sponsored or advised U.S. funds [4] should be included as part of a foreign banking organization's U.S. intermediate holding company or combined U.S. operations for purposes of applying single counterparty credit limits. It states that the points we made previously apply equally, regardless of whether, for example, the entity that sponsors or advises a U.S. registered fund has a foreign parent.

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Attachment

endnotes

[1] See Board of Governors of the Federal Reserve System, Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies, 77 Fed. Reg. 76628 (Dec. 28, 2012).

[2] See Board of Governors of the Federal Reserve System, Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies, 77 Fed. Reg. 594 (Jan. 5, 2012).

[3] "Covered company" is defined to include any large BHC or SIFI.

[4] As in the 2012 ICI Letter, our letter notes that while some of our arguments may apply broadly to various types of funds, our comments focus on registered funds.