The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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ICI Letter on Proposed Enhanced Prudential Standards for "SIFIs" and Large Bank Holding Companies

[26118]

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TO: BOARD OF GOVERNORS No. 5-12
CLOSED-END INVESTMENT COMPANY MEMBERS No. 21-12
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 30-12
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 17-12
SEC RULES MEMBERS No. 33-12 RE: ICI LETTER ON PROPOSED ENHANCED PRUDENTIAL STANDARDS FOR "SIFIs" AND LARGE BANK HOLDING COMPANIES

Earlier this year, the Federal Reserve Board ("Board") issued proposed rules to implement certain provisions in Title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") that apply to (1) nonbank financial companies designated as systemically important financial institutions ("SIFIs") by the Financial Stability Oversight Council ("FSOC") and (2) bank holding companies with at least $50 billion in total consolidated assets ("large BHCs"). [1] In particular, the Board proposed to implement various portions of Section 165 of the Dodd-Frank Act, under which the Board is required to establish enhanced prudential standards for SIFIs and large BHCs (collectively "covered companies"), and Section 166, concerning early remediation requirements for covered companies.

ICI has filed a comment letter on the Proposal. The letter is attached and briefly summarized below.

Summary of Comment Letter

The letter begins by noting that ICI previously has expressed its strongly held view that SIFI designation would not be appropriate for registered investment companies ("registered funds") or their investment advisers because, among other things, they do not present the risks that such designation is intended to address. The letter expresses hope that the FSOC, to the extent that it evaluates any registered funds or fund advisers for possible designation, will reach the same conclusion. It explains that because no SIFIs have been named yet and the precise scope of SIFI designations remains an open question, ICI has

decided to comment on the application of the Proposal to SIFIs. It states that our comments also address an issue the Proposal raises that is of concern to money market funds sponsored by large BHCs.

I. Application of the Proposal to SIFIs

The letter indicates that the Proposal—which would apply bank-oriented prudential standards to all covered companies—strengthens the conclusion that SIFI designation would not be an appropriate regulatory tool for addressing any perceived risks that registered funds or their advisers might raise. It states that it is premature to apply the Proposal to SIFIs— which have yet to be identified—and points out that the Board cannot comply with its statutory obligations under Section 165 without knowing which entities will be subject to enhanced prudential standards.

The letter explains why the overall approach of the Proposal, which would apply the "same set" of enhanced prudential standards to all covered companies, is inconsistent with the requirements of Section 165. It also discusses the problems with applying a bank-oriented regulatory framework to all covered companies. The letter recommends that the Board exclude SIFIs from the Proposal and propose for public comment a process for prescribing appropriate enhanced standards and requirements for SIFIs that takes into account the characteristics and risks of those entities so designated.

II. Application of Single Counterparty Credit Limits to Sponsors or Advisers of Registered Funds

The letter then addresses the Board's proposed single-counterparty credit limits for covered companies and their subsidiaries, an issue of concern to money market funds sponsored or advised by large BHCs (or by SIFIs, if they are not excluded from the Proposal).

Under the 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 notes, 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 requests 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 this rule and whether the 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 letter explains that sponsored or advised registered funds, including money market funds, do not meet any of the standard indicia of a subsidiary. The letter then states 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 explains 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.

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Attachment

endnotes

[1] 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) ("Proposal"), available at http://www.gpo.gov/fdsys/pkg/FR-2012-01-05/pdf/2011-33364.pdf. The Board subsequently extended the comment deadline for the Proposal from March 31, 2012 to April 30, 2012.