

MEMO# 31281

July 9, 2018

ICI and IDC Submit Joint Comment Letter on SEC Loan Rule Proposal

[31281]

July 9, 2018 TO: ICI Members

Investment Company Directors SUBJECTS: Audit and Attest

Audit Committees

Compliance

Fund Accounting & Financial Reporting RE: ICI and IDC Submit Joint Comment Letter on SEC Loan Rule Proposal

On May 2, the Securities and Exchange Commission issued for public comment proposed amendments to its auditor independence rule intended to address loans and debtor-creditor relationships.[\[1\]](#) The proposed amendments would refocus the analysis of the auditor's debtor-creditor relationships with shareholders of audit clients 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.

Earlier today the Institute and the Independent Directors Council filed a joint comment letter that broadly supports the SEC's proposal. The joint comment letter:

- Supports eliminating violations due to record ownership;
- Supports replacing the more than 10 percent bright-line ownership test with significant influence and "portfolio management processes" as a means to assess whether a lender to the auditor (that is also a beneficial owner of the fund's equity securities) has the ability to exercise significant influence over the fund;
- Recommends incorporating a materiality assessment into the analysis of debtor-creditor relationships to exclude loans that are not a legitimate threat to auditor independence;
- Recommends clarifying certain aspects of beneficial ownership, including by:
 - Narrowing "beneficial owner" for purposes of the rule to exclude shareholders with no economic interest in the fund;
 - Substituting a "known" standard (that would rely on publicly available ownership

information) for the proposed “known through reasonable inquiry” standard when identifying beneficial owners to alleviate uncertainty as to what constitutes reasonable inquiry; and

- Providing guidance on how audit firms can meet their obligation to monitor the compliance with the rule in a way that reduces unnecessary and costly beneficial ownership reviews.

The joint letter also supports narrowing the definition of audit client to exclude other funds in the complex and recommends extending the exclusion to include other pooled products, the investment adviser, and service providers.

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[Attachment](#)

endnotes

[1] *Auditor Independence with Respect to Certain Loans or Debtor-Creditor Relationships*, SEC Release No. IC-33091 (May 2, 2018), available at <https://www.sec.gov/rules/proposed/2018/33-10491.pdf>. See Institute [Memorandum No. 31198](#), dated May 7, 2018 for a detailed summary of the proposal.