

**MEMO# 30761**

June 30, 2017

## **ICI Global and SIFMA AMG File Comment Letter on EC Proposal to Amend BRRD to Expand Moratorium Stay Powers**

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June 30, 2017 TO: ICI Members

Investment Company Directors

ICI Global Members

Derivatives Markets Advisory Committee

ICI Global Regulated Funds Committee SUBJECTS: Derivatives

International/Global

Investment Advisers

MiFID, EMIR, AIFMD, UCITS V

Trading and Markets RE: ICI Global and SIFMA AMG File Comment Letter on EC Proposal to Amend BRRD to Expand Moratorium Stay Powers

ICI Global and the Asset Management Group of the Securities Industry and Financial Markets Association (“SIFMA AMG”) have filed a comment letter with the European Commission (“Commission”) on the Commission’s proposal to amend the Bank Recovery and Resolution Directive (“BRRD”) to, among other things, expand the powers of resolution authorities to suspend payment and delivery obligations of an institution subject to resolution powers under the BRRD (“Affected Institution”). The comment letter is attached, and is summarized below.

The BRRD currently provides EU resolution authorities with the power to suspend, for a maximum period of two business days, subject to certain exceptions, payment and delivery obligations of an Affected Institution, including the right of counterparties of the Affected Institution to enforce security interests and the right of counterparties to terminate contracts with the Affected Institution. In November 2016, the Commission issued a proposal that would amend the BRRD to add two new broad powers to suspend payment and delivery obligations. One of these proposed moratorium powers would apply at the pre-resolution phase, while the other would apply at the resolution phase, each for up to five working days each time either such power is used (“Additional Moratorium Powers”).

Our comment letter takes the view that the Additional Moratorium Powers disproportionately and unnecessarily shift risks to pension funds, regulated investment funds (e.g., US mutual funds and UCITS), private funds and other investors for whom asset

managers serve as fiduciaries by undermining important contractual rights in financial contracts and bank account relationships. The letter explains that, by creating lengthy suspension of payment and delivery obligations subject to only very limited exceptions, the Additional Moratorium Powers undermine protections that are part of financial contracts and arrangements that asset managers and funds enter into, on behalf of their clients, with Affected Institutions. The ability to suspend drastically alters credit risk profiles of Affected Institutions, an important factor assessed when entering into such arrangements. It likewise undermines important rights, including contractual termination and the ability to access collateral and bank accounts that protect clients against the deteriorating credit of an Affected Institution.

The letter asserts that this proposed expansion is inconsistent with principles of the Financial Stability Board ("FSB") and relevant laws applicable to buy-side market participants, and market participants generally, in the EU and US. Consequently, the risk of becoming subject to the Additional Moratorium Powers is likely to curtail the ability of regulated investment funds and investment managers regulated in the US and Europe to deal with banks in the EU and with their affiliated companies.

The letter explains that no Additional Moratorium Powers should be introduced for the following three reasons:

- The Additional Moratorium Powers conflict with the FSB's Key Attributes of Effective Resolution Regimes of Financial Institutions endorsed by the G20 in November 2011 (which, among other things, recommended a maximum stay of two business days) and create a disproportionate and unnecessary divergence from the agreed international approach to orderly resolution of financial institutions.>
- Globally significant market documentation such as the ISDA Master Agreements and the Global Master Repurchase Agreement typically provide for very short grace periods for non-payment which are significantly less than five working days. Daily margin calculations and transfers are also hard-wired into these contracts in order to prevent the build-up of large deficiencies and unsecured risk. In order for our members to avoid cross defaulting under their obligations under these documents with other counterparties, and even the Affected Institution itself, during the extended moratoria contemplated under the Additional Moratorium Powers, they would need access to funds from a source other than the Affected Institution and significantly could only have certainty of funds if dealing with an institution outside of the scope of the new powers.
- Proposed changes to the BRRD are not compatible with or weaken the EU legislative framework designed to protect investors. Buy-side market participants and asset managers operating in the EU are subject to a range of EU laws that govern the operation of investment funds and outline the responsibilities of their management companies. The letter explains how the Additional Moratorium Powers would be inconsistent, for example, with the UCITS Directive requirement that funds to offer investors bimonthly liquidity (although in practice most UCITS funds offer daily or weekly redemptions), as well as, potentially, requirements under the AIFM Directive and the UCITS Directive that managers of regulated funds retain an Affected Institution as depositary to hold their assets, arrange settlement of their transactions and administer their income. Although the BRRD explicitly protects liabilities that arise from holding client money from bail-in, there is no provision in the proposal which guarantees that depositaries will continue to perform all of their obligations

during the application of the Additional Moratorium Powers even to the limited extent of honouring obligations to pay cash on deposit or deliver assets in custody.

The letter also explains that the potential application of Additional Moratorium Powers may curtail the ability of regulated investment funds and US investment managers to invest in Affected Institutions subject to these new powers. For example, both UCITS and US money market funds are subject to limitations on the maximum maturity of investments and are (or will be in the case of UCITS money market funds under new EU regulations) required to hold portions of their portfolio in instruments maturing in one or in seven days. Regulations require maturity to be determined based on when payments are due unconditionally or without optionality. The Additional Moratorium Powers would introduce an element of optionality that may prevent these funds from accurately determining a bank instrument's maturity with any certainty and thereby prevent them from using these instruments to satisfy regulatory requirements. The letter also notes the adverse implications the Additional Moratorium Powers could have for US mutual funds seeking to comply with the new rule under the Investment Company Act of 1940 ("1940 Act") requiring liquidity risk management programs for US registered funds.

The letter asserts that the Additional Moratorium Powers could cause a loss of recourse to collateral which could impede investments. This could have adverse implications under Rule 5b-3 under the 1940 Act, which allows investment companies to engage in reverse repurchase agreements in excess of this limit, provided the obligation to repurchase is "collateralized fully." Moratorium powers that would limit recourse to collateral beyond the period envisioned by the FSB Principles could force US funds to treat reverse repurchase agreements as equivalent to unsecured extensions of credit. Apart from regulatory concerns, diminution of collateral protection could dissuade investment managers and funds from engaging in reverse repurchase agreements, securities loans, and derivative contracts as a response to increased credit risks.

Finally, the letter explains that the Additional Moratorium Powers are inconsistent with other EU standards requiring all market participants to make payments and deliveries within a short timeframe. For example, EMIR requires that in order to mitigate counterparty credit risk, market participants that are subject to the clearing obligation should have risk-management procedures that require the timely, accurate and appropriately segregated exchange of collateral in respect of uncleared OTC derivatives.

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[Attachment](#)