

COMMENT LETTER

February 12, 2018

ICI Global and SIFMA AMG Jointly Submit Letter to EU Policymakers on BRRD Proposed Moratorium Powers (pdf)

23 January 2018 Dear Sirs and Madams, RE: Impact of Proposal Published by the European Commission on 23 November 2016 (the “EC Proposal”) to Amend Moratorium Powers under Bank Recovery and Resolution Directive 2014/59/EU (“BRRD”) Following up on our 29 June 2017 letter (the “June Letter”),¹ the undersigned Associations² wish to provide data we have gathered that supports our continuing concerns with the EC Proposal to expand moratorium tools available under BRRD. The members of our Associations act as fiduciaries to pension funds, regulated funds, private funds, and other investors served by asset managers that in aggregate serve millions of individual investors. If adopted, the expanded moratorium powers would affect these individuals, more than our members, by (i) depriving investors of access to funds and investments during a moratorium, (ii) denying investors the benefit of the collateral associated with these investments, and (iii) possibly forcing the cessation of relationships with EU institutions to avoid these unnecessary risks. We note the following key risks of expanding the moratorium powers, and offer data regarding the size of the relevant markets in Europe that may be impacted if pension funds, regulated investment funds, private funds and other investors on whose behalf asset managers act as fiduciaries determine not to enter into transactions with, custody with, or invest in EU banks as a result of an expansion of the proposed moratorium powers:³

- Regulated investment funds, such as UCITS and US mutual funds, may not transact with or invest in EU banks due to the significant compliance and regulatory risks raised by expanded moratorium powers. For example, certain regulated investment funds are subject to requirements regarding the liquidity of their investments. An extended stay may raise concerns regarding the ability of 1 The Associations’ June Letter is available at: <https://www.ici.org/pdf/30761a.pdf>. 2 See end of letter for descriptions of each Association. 3 The survey data below for custodian services is from Funds Europe. The repo data is from data is from ICI tabulations of SEC form N-MFP. We note the impact of expanded moratorium powers would be greater, as they extend to derivatives generally. 2 regulated funds to satisfy these liquidity requirements, as well as the ability of both EU and US money market funds (“MMFs”) to satisfy regulatory requirements limiting the maximum maturity of their investments.⁴ The loss of recourse to collateral caused by an extended stay also may raise concerns regarding the ability of US investment funds to comply with rules and positions of the US Securities and Exchange Commission (“SEC”) regarding securities lending transactions and reverse repurchase agreements (“reverse repos”). 5 If extended moratorium powers are added to BRRD, a regulated investment fund’s manager will need to consider these issues as it evaluates its current and future investments in, and transactions with, EU banks. The manager must

consider worst case scenarios at the time of an investment, and cannot assume the ability to exit the position in advance of a moratorium being imposed. o In terms of the size of the repo market involving EU banks, the International Capital Market Association's European Repo Market Survey observed that the total value of repos and reverse repos outstanding on the survey date (June 7, 2017) was EUR 6.5 trillion.⁶ Of this, a significant percentage of these transactions are with buy side clients, providing significant liquidity to EU banks. This market would be threatened by expanded moratorium powers. o US MMFs, while organized outside of the EU, currently have significant exposure to EU banks amounting to USD 583 billion, or 22 percent of US taxable MMFs portfolios, either involving repo transactions with EU banks or direct investments in securities issued by EU banks as of November 2017.⁷ Expanded moratorium powers would severely constrain the ability to effect these transactions and investments. o Around 40 percent of repos (USD \$421 billion) done by US MMFs are with EU banks as of November 2017. US taxable MMFs invested in USD 58 billion of commercial paper issued by EU banks in November 2017, up from USD 53.4 These regulations require maturity to be determined based on when payments are due unconditionally and without optionality. ⁵ Registered US investment funds engaging in securities lending transactions must have the ability to terminate the loan at any time and recall the loaned securities within the ordinary settlement time. For a registered US investment fund to engage in reverse repos with a single issuer in an amount (when combined with the fund's other holdings in the issuer) in excess of 5% of the fund's assets (when combined with the fund's other holdings in the issuer), the fund must ensure the obligation to repurchase is "collateralized fully." ⁶ See International Capital Market Association, European Repo Market Survey (conducted June 2017, published October 2017), available at: <https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/repo-and-collateral-markets/icma-ercc-publications/repo-market-surveys/>. ⁷ Please refer to https://www.ici.org/viewpoints/view_17_mmf_exposure for the details of these data points. 3 billion in September 2017. ⁸ • Applying expanded moratorium powers to EU custody banks would be inconsistent with existing regulatory requirements applicable to regulated funds. The proposed expanded moratorium powers would apply to EU banks that serve as custodians, including those that serve as the EU sub-custodians of global custodians. Applying expanded moratorium powers to an EU custody bank would be inconsistent with EU and US regulatory requirements applicable to regulated funds. UCITS are required to use an EU bank to custody their assets, arrange settlement of transactions, and administer their income. A prolonged suspension of payment and delivery obligations owed by a custody bank to regulated funds could cause such funds to default on their own contractual obligations to investors, CCPs, and other counterparties. Under EU law, UCITS would not be able to engage a non- EU bank to provide this service. Applying the expanded moratorium to EU custody banks also could prevent regulated funds from being able to satisfy their regulatory obligations to provide liquidity to investors. UCITS and US mutual funds are required to offer investors the ability to redeem their shares. UCITS funds must offer bimonthly liquidity, although in practice they permit daily or weekly redemptions. US registered open-end funds must offer securities that can be redeemed within seven days, and must hold a portion of their portfolios in highly liquid assets to support their obligations. In addition, EU MMFs are prohibited from holding their deposits with credit institutions unless the deposit can be withdrawn at any time. Thus, the application of expanded moratorium powers to EU custodian banks could prevent regulated funds from being able to satisfy these regulatory requirements, and could impede the ability of asset managers to satisfy redemption requests from investors. o Of the eleven major custodians servicing asset managers globally, as of June 2016, six of them were EU banks, and accounted for EUR20.6 trillion of assets under custody (AUC). This figure represents around 22 percent of total AUC globally. In terms of AUC in Europe, Middle East, and Africa (EMEA), EU banks

comprised EUR 15.6 trillion which accounts for around 54 percent of the total AUC in EMEA held by banks.⁹ For EU banks, the expanded moratorium would constrain their custody business, particularly with 8 Please refer to ICI tabulations of SEC form N-MFP for details of these data points. To the extent that these repo transactions are being done with banks domiciled in Europe, subsidiaries of US banks domiciled in Europe are unlikely to be impacted by the expanded moratorium. ⁹ In our view, most of the AUC held in EMEA could be attributed to Europe. AUC data for Europe were sourced from Funds Europe. The six European banks are BNP Paribas Securities, HSBC Securities, Societe Generale Securities, Credit Agricole, Banque Pictet & Cie, and SEB bank. US registered mutual funds, to the extent that they are investing in European securities, would most likely utilize EU banks or EU subsidiaries of US banks. ⁴ respect to regulated funds. ^o As of June 2016, total AUC held by UCITS and non-UCITS in Europe was EUR11.3 trillion.¹⁰ This figure includes US registered fund assets subcustodied by EU banks and assets custodied by European subsidiaries of US banks. • Expanded moratorium powers would create significant uncertainty, and attendant risk, for pension funds, regulated investment funds, private funds and other investors served by asset managers that enter into collateralized, netted trading agreements with EU bank counterparties. Contractual uncertainty and increased counterparty risks due to extended moratorium tools would be unique to EU banks given that other major jurisdictions have enacted narrow moratorium powers, consistent with the FSB's Key Attributes of Effective Resolution Regimes of Financial Institutions. For example, while net exposures to EU banks under such trading agreements are required to be collateralized, a fund would have no assurances that the collateral delivered by an EU bank would be adequate to cover the exposure on the date a moratorium was lifted. Such a result would be inconsistent with the policies underlying global derivatives regulatory reform, which emphasize globally consistent reporting, exchange trading, central clearing, and risk-mitigating margining. Asset managers to regulated funds and other clients, as fiduciaries, would have to weigh the risks of transacting with EU banks, and would be disincentivated from entering into transactions with them. Even if they continue to transact with EU institutions, the rates and collateral requirements are likely to be less favorable than for institutions in FSB compliant regimes. For these reasons, the undersigned Associations believe that expansion of the BRRD moratorium is harmful to investors both within and outside of the EU and is harmful to EU markets. Given the size and importance of the European banks to the investing public, we urge the European Union to maintain the existing moratorium powers under BRRD that are aligned with other major jurisdictions.

Yours faithfully, /s/ Laura Martin Laura Martin /s/ Patrice Bergé-Vincent Patrice Bergé-Vincent

¹⁰ These data points were sourced from Funds Europe. ⁵ Managing Director & Associate General Counsel SIFMA Asset Management Group Managing Director, Europe ICI Global *** SIFMA's Asset Management Group ("SIFMA AMG") brings the asset management community together to provide views on U.S. and global policy and to create industry best practices. SIFMA AMG's members represent U.S. and global asset management firms whose combined assets under management exceed \$39 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds. ICI Global carries out the international work of the Investment Company Institute, the leading association representing regulated funds globally. ICI's membership includes regulated funds publicly offered to investors in jurisdictions worldwide, with total assets of US\$28.6 trillion. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of regulated investment funds, their managers, and investors. ICI Global has offices in London, Hong Kong, and Washington, DC.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.