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June 3, 2016

By electronic submission to www.regulations.gov

Mr. Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Single-Counterparty Credit Limits for Large Banking Organizations (Docket No. R–1534, RIN No. 7100 AE–48)

Dear Mr. deV. Frierson:

The Asset Management Group ("AMG") of the Securities Industry and Financial Markets Association ("SIFMA") appreciates the opportunity to comment on the Federal Reserve's proposed rule (the "Proposal") to establish single counterparty credit limits ("SCCL") for large U.S. bank holding companies and foreign banking organizations with U.S. operations.[1] (For purposes of this letter, we refer to top-tier U.S. bank holding companies and foreign banking organizations subject to the Proposal as "BHCs.") AMG members are U.S. asset management firms the combined global assets under management of which exceed $34 trillion. The clients of 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. Some AMG members are affiliated with BHCs, and thus would have some of their business activities restricted under the Proposal. Many AMG members are customers of, and frequent counterparties with, BHCs and their affiliates, and thus would be affected indirectly by the restrictions the Proposal would impose on BHCs and their affiliates.

We understand and share the stated purpose of the Proposal: reducing the risks to a BHC arising from a significant counterparty's failure. In this context, it is critical to identify accurately (1) the types of entities that are related to a BHC such that they should be considered to be part of the "covered company" when determining the BHC's overall counterparty exposures; (2) the types of counterparties that are so economically related to each other that they should be considered a single counterparty of the covered company; and (3) the types and amounts of exposures that the covered company has to its counterparties. As discussed in further detail in this letter, we believe that the Proposal is overbroad in each of these respects, and in its conservatism, the Proposal would have unintended negative consequences for BHCs' asset management affiliates and their clients ***and*** BHCs' unaffiliated asset management counterparties and their clients.

Part I of this letter discusses the Proposal's definition of "covered company." Part II discusses the Proposal's definition of "counterparty." Part III discusses the Proposal's treatment of investment fund exposures. Finally, Part IV summarizes our recommendations to improve the Proposal.

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1 81 Fed. Reg. 14,328 (Mar. 16, 2016).

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I. The Proposal's Definition of "Covered Company" is Overbroad

The statutory mandate and purpose of the SCCL is to prevent a top-tier bank holding company from failing or sustaining outsized losses as a result of its concentrated exposure to a single counterparty.[2] The Proposal would therefore apply aggregated credit limits to a BHC and all of its subsidiaries, collectively defined as the "covered company," under the assumption that the BHC is exposed to its direct and indirect subsidiaries' counterparties. As discussed further below, we believe an accurate and workable definition of "covered company" for purposes of the SCCL should capture any entity that satisfies both of two conditions: (1) the entity has an economic relationship to the BHC that meaningfully exposes the BHC to that entity's counterparty exposures, and (2) the entity is actually controlled by the BHC. The Proposal's definition of "covered company" is overbroad for these purposes because it would capture entities not meeting one or both of these two conditions.

Under the Proposal, a "subsidiary" of a specified company would mean any company that is directly or indirectly controlled by the specified company. "Control" would be defined by reference to the definition set forth in the Bank Holding Company Act of 1956, as amended (the "BHCA").[3] Under the BHCA, a specified company controls another company if:

(A) the specified company directly or indirectly or acting through one or more other persons owns, controls, or has the power to vote 25 percent or more of any class of voting securities of the other company;

(B) the specified company controls in any manner the election of a majority of the directors or trustees of the other company; or

(C) the Federal Reserve determines, after notice and opportunity for hearing, that the specified company directly or indirectly exercises a controlling influence over the management or policies of the other company.[4]

The Federal Reserve has interpreted the meaning of the third prong of this definition – the "controlling influence" test – in formal and informal guidance over several decades.[5]

A. The BHCA Control Standard Would Inappropriately Capture Entities the Failure or Distress of Which Would Not Meaningfully Expose the BHC to Loss

The BHCA definition of "control" can capture a variety of entities that would not necessarily transmit to the BHC the losses they suffer due to their own exposures to counterparties. Under the BHCA standard, a BHC could control an entity through the BHC's investment in the entity (including certain sizable common stock, preferred stock, and debt investments); through its governance rights over the entity (including voting rights and director appointment rights); or through its other contractual rights and obligations with respect to the entity (including covenants and business relationships).[6]

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[2] *See* Section 165(e) of the Dodd-Frank Act, codified at 12 U.S.C. § 5365(e).

[3] *See* 12 C.F.R. § 252.2.

[4] 12 U.S.C. § 1841(a)(2).

[5] *See, e.g.*, Board of Governors of the Federal Reserve System, Policy Statement on Equity Investments in Banks and Bank Holding Companies (the "Policy Statement").

[6] *See* Policy Statement at 12–14.

A BHC's investment in an entity would clearly create a mechanism for loss transmission. If the entity incurred a loss, the value of the BHC's common stock in the entity would sustain an associated loss. The value of a debt or preferred stock investment by the BHC in the entity would also decrease if, and to the extent that, the entity's losses are extensive enough to impair the principal, interest, dividend, or liquidation amounts to which the debt or preferred stock is entitled. Certain contractual arrangements, such as a commitment by the BHC to provide financial support to the entity, or cross-default provisions with respect to the entity, could also create a loss transmission mechanism.

Many other contractual arrangements and governance rights, however, would ***not*** create a loss transmission mechanism, even though they could create a controlling relationship under the BHCA. These would include, for example, the following:

- An affiliate of a BHC may advise, sponsor, manage, or serve as general partner or managing member of an investment fund. If the BHC-affiliated adviser, sponsor, manager, or general partner has investment discretion with respect to the fund, the BHC affiliate could have a controlling influence over the fund under the BHCA. Indeed, control could be deemed to arise in this context even if the BHC affiliate has not made any investment in the fund, committed to support the fund financially, or included in any contracts cross-default provisions with respect to the fund.

- An affiliate of the BHC could serve as agent or trustee with investment discretion for an account. This arrangement could provide the BHC affiliate with "control" over the account even though neither the BHC affiliate nor the BHC would have any exposure as principal to the account's investments.

In most of these structures, the BHC would not be exposed to ***any*** credit or market losses as a result of the fund's activities.

While BHC-affiliated asset managers generally do not make contractual commitments to support financially the funds that they advise, sponsor, manage, or for which they serve as general partner or managing member, we understand that the Federal Reserve may be concerned about "step-in" risk, *i.e.*, the risk that the BHC affiliate would voluntarily step in and provide financial support to such a fund. We believe any such concerns are unwarranted based on historical evidence and post-crisis reforms.

During the financial crisis of 2007-2008, some sponsors purchased portfolio securities from their money market funds ("MMFs") or provided other forms of financial support to sponsored MMFs to prevent those funds from "breaking the buck." However, in 2014 the Securities and Exchange Commission ("SEC") made significant amendments to the rules governing MMFs, providing MMFs with new tools that can be used to stem heavy redemptions and avoid the type of contagion that occurred during the financial crisis.[7] The SEC now requires institutional prime funds to implement floating net asset values ("NAVs") to eliminate the "first mover advantage" that had incentivized institutional investors to redeem fund shares in times of stress when a MMF's market-based NAV (its "shadow price") was less than $1.00 per share. Under these new rules, institutional funds are simply incapable of "breaking the buck." In addition, the SEC's amended rules also provide retail and institutional MMFs the ability to impose liquidity fees (to offset liquidity costs and protect the impairment of the MMFs' NAVs) and redemption gates (to temporarily halt redemptions and provide the MMFs time to generate internal liquidity while the gates are in place). These enhancements have increased MMF resilience, reduced run risk, and significantly reduced the likelihood that MMF sponsors would be required to support their MMFs in future moments of financial stress.

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[7] *See* 79 Fed. Reg. 47,736 (Aug. 14, 2014).

In addition, regulatory reforms have reduced step-in risk for other types of funds as well, such as open-end mutual funds, closed-end mutual funds, private equity funds, and hedge funds. The SEC has proposed mutual fund liquidity rules that, when finalized, will require the creation of liquidity risk management programs and enhancements to disclosure.[8] These rules aim to enhance the robustness and liquidity positions of MMFs and mutual funds to make them less susceptible to runs and, consequently, less likely to need a sponsor to step-in. In addition, under the Volcker Rule, a banking entity is now prohibited from providing financial support to a private equity fund or hedge fund that the banking entity sponsors as a condition of the Volcker Rule's exemption for seeded funds, and the fund's offering documents must have disclosures to that effect.[9] A slew of other post-crisis reforms in bank capital and liquidity regulation and accounting standards have also disincentivized step-ins.[10]

If the Federal Reserve finalized the Proposal's definition of "covered company," with its reference to the BHCA control standard, a BHC-affiliated asset manager could be limited in its ability to take positions for clients due to the parent BHC's consolidated credit limits, even where the BHC would not itself be exposed to loss from such positions. The SCCL would therefore potentially conflict with an asset manager's fiduciary duties and contractual obligations as adviser, sponsor, manager, general partner, managing member, or agent for its clients, which could reduce clients' investment returns. For example, an investment adviser acting as a fiduciary has an obligation to obtain "best execution" for the client's transactions, meaning that the pricing and other terms for each client transaction generally must be the most favorable terms reasonably available under the circumstances.[11] Such an obligation would be in conflict with the SCCL rule if the most favorable terms were only available from a counterparty near the limits of the covered company's consolidated SCCL. If the investment adviser were precluded from engaging in the transaction on the most favorable terms because of the SCCL, the investment adviser would be forced to engage in the transaction at less favorable terms or not at all, either of which would be detrimental to the investment adviser's clients. In addition, the Proposal could adversely affect market liquidity by subjecting a significant number of investors – *i.e.*, investors that BHCs are deemed to control under the BHCA – to limits on transactions with certain counterparties.

B. The BHCA Control Standard Would Inappropriately Capture Entities That the BHC Would Not Have the Ability to Actually Control

A BHC's direct or indirect investment in an entity could give rise to a control relationship even where the BHC has no actual ability to control the entity's exposures. For instance, the BHCA control standard would generally be satisfied if a BHC's asset management affiliate had a 34 percent non-voting equity stake in a fund, even though in practice, the affiliate may have very little ability to prevent such a fund from taking a position in, or extending credit to, one of the BHC's major counterparties.[12] In terms of how closely an entity is integrated into the operations and risk limits of a BHC, there is a real difference between an entity that a BHC plainly controls through majority ownership and an entity in which the BHC has only a minority investment.

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8 *See* 80 Fed. Reg. 62,287 (Oct. 15, 2015).

9 *See* 12 C.F.R. § 248.11(a).

10 For an overview of these reforms, please see the Global Financial Markets Association's March 17, 2016 comment letter in response to the Basel Committee on Banking Supervision's consultation on step-in risk, available at http://gfma.org/correspondence/item.aspx?id=797.

11 Securities Brokerage and Research Services, Release No. 34-23170 (Apr. 23, 1986); In the Matter of Kidder, Peabody & Co., Inc., et al., Investment Advisers Act Release No. 232 (Oct. 16, 1985); Securities Exchange Act Release No. 12251 (Mar. 24, 1976); Securities Exchange Act Release No. 9598 (May 9, 1972).

12 *See* Policy Statement at 10.

Of course, any entity that the BHC controls for purposes of the BHCA already must satisfy certain requirements as a result of such a relationship. For example, a BHC-controlled entity would not be permitted to engage in nonbanking activities other than as permitted under section 4 of the BHCA. However, these existing types of requirements are static, straightforward to impose through covenants, and relatively easy for the BHC to monitor through periodic information reports. For an entity that has no plans to engage in nonbanking activities, compliance with the limits of section 4 of the BHCA presents very little burden. On the other hand, the proposed SCCL restrictions would be dynamic based on the BHC's positions at any given time; cannot be imposed through covenants due to the constant shift in exposure values; and would need to be monitored by the BHC in real time. If the entity were an investment fund formed to take advantage of market opportunities as they arise, it would be unduly burdensome for the entity to adhere constantly to the BHC's shifting position limits.

More fundamentally, the SCCL rule would impose a significant restriction on BHCs' client-facing asset management activities. For instance, a BHC-affiliated asset manager often will serve as a general partner for a "fund of funds," which then might make sizable minority, non-voting investments in other investment funds. As a result of the expansive BHCA control standard, numerous investment vehicles down the BHCA "control chain" to which the BHC is not meaningfully economically exposed, and that the BHC does not in fact control, could become subject to the BHC's consolidated SCCL, upending the BHC-affiliated asset manager's ability to serve its clients effectively.

Importantly, by requiring a covered company with $250 billion or more in total consolidated assets or $10 billion or more in on-balance sheet foreign exposures (a "Large Covered Company") to calculate its exposure to a third-party investment fund using the "full look-through approach" in certain circumstances, the Proposal would already require the BHC to include in its own gross credit exposure its *pro rata* share of such a fund's gross credit exposures to counterparties, even if the fund were not considered to be a part of the covered company.[13] While the BHC would not be able to force the fund to limit or divest its positions in order to comply with the SCCL rule, the BHC would still have an incentive to manage the counterparty exposures it incurs through its investment in the fund and it could sell its interest in the fund if necessary to comply with its overall limits.

C. The SCCL Rule Should Incorporate Regulatory Capital Consolidation Standards to Define the Scope of a Covered Company

Rather than use the BHCA control standard, the final SCCL rule should define "covered company" to include the BHC and all entities consolidated with the BHC for purposes of the U.S. banking agencies' regulatory capital rules, which generally follow the operative accounting treatment of the entities. U.S. Generally Accepted Accounting Principles ("GAAP") include two models of consolidation – the voting interest model and the variable interest model – and a company is generally required to consolidate any entity that it controls under either model. Under the voting interest model, a company generally consolidates any entity in which it holds a majority voting interest – a reasonable proxy that the company has ***both*** a significant economic exposure to the entity ***and*** operational control over the entity (subject to important exceptions described below). Under the variable interest model, a company that has the power to direct the most significant economic activities of a variable interest entity ("VIE") will consolidate the VIE if the company also holds a variable interest[14] in the VIE, including as a result of the company's explicit or implicit obligation to support the VIE financially.[15] As with the voting interest model, the variable interest model

13 We discuss this requirement in Part III of this letter.

14 Variable interests in a VIE are contractual, ownership, or other pecuniary interests in a VIE that change with changes in the fair value of the entity's net assets exclusive of variable interests. *See* ASC 810-10-20.

15 *See* ASC 810-10-22-50 to -54.

generally results in consolidation if and only if the company has ***both*** a significant economic exposure to the VIE ***and*** operational control over the VIE (subject to certain exceptions). Therefore, U.S. GAAP is a considerably more accurate method than the BHCA control standard for determining what entities should be considered to be part of the covered company.

If the SCCL rule followed the consolidation treatment of entities under the regulatory capital rules, then the consolidation method used to calculate the numerator of the SCCL (the BHC's consolidated net credit exposure) would be the same as the consolidation method used to calculate the denominator of the SCCL (the BHC's consolidated regulatory capital), making the SCCL internally consistent.

At the same time, we believe two exceptions from this general consolidation treatment rule would be warranted:

- ***Seeded Funds.*** A BHC-affiliated asset manager may make an investment in a fund it sponsors to "seed" the fund for a limited period This investment may be as high as 100 percent of the fund's interests, in the case of a mutual fund, or as low as a few percentage points of the fund's interests, in the case of a private equity fund or hedge fund that is a "covered fund" under the Volcker Rule. Generally, a "seeded" fund would have an independent board during the seeding period, meaning that the sponsor would have limited practical ability to influence the fund, even if the sponsor consolidated the fund on its balance sheet during that time. The final SCCL rule should exclude a seeded fund from the scope of the covered company. A Large Covered Company would still be required to include in its own gross credit exposure its *pro rata* share of such a fund in certain circumstances, which should substantially mitigate any concerns by the Federal Reserve that material exposures would not be captured as a result of the fund not being considered with the covered company.[16]

- ***Merchant Banking Portfolio Companies.*** An asset manager affiliated with a financial holding company ("FHC") may make a majority or minority investment in a portfolio company that is engaged in any activity that is not financial in nature under the merchant banking authority of section 4(k) of the BHCA, for a prescribed period. Notwithstanding the fact that the FHC could "control" the portfolio company for purposes of the BHCA and also be required to consolidate the portfolio company on its balance sheet under accounting standards, section 4(k) of the BHCA forbids the FHC from routinely managing or operating the portfolio company except as may be necessary or required to obtain a reasonable return on investment upon resale or disposition.[17] Therefore, by law the FHC may not be permitted to control the portfolio company's compliance with a rule as dynamic as the SCCL rule, which fundamentally restricts the business transactions in which a company may engage. The final SCCL rule should exclude any portfolio company held under the merchant banking authority from the scope of the covered company. Even if the portfolio company were not considered to be a part of the covered company, the covered company would still be required to treat the portfolio company as a counterparty for purposes of the rule (including, potentially, under the full look-through approach if the portfolio company were an investment fund).

[16] Moreover, under the Volcker Rule, any risk to the BHC arising out of the BHC affiliate's investment in a seeded covered fund would be addressed by the Volcker Rule's requirement to deduct the investment from the BHC's Tier 1 capital. *See* 12 C.F.R. § 248.12(d)

[17] 12 U.S.C. § 1843(k)(4)(H)(iv); 12 C.F.R. § 225.171(a).

II. The Proposal's Definition of "Counterparty" is Overbroad

The Proposal would require a covered company to treat two entities as a single counterparty if one entity controlled the other entity. This approach reflects the assumption that entities that are connected by a control relationship would suffer losses or failure together, *i.e.*, that the entities are economically interdependent. However, we believe the Proposal's definitions of such control relationships would capture entities that are not in fact economically interdependent. And in so doing, the Proposal would appear to impose serious burdens on counterparties, whether or not they are affiliated with BHCs, because of the control analyses that covered companies would be required to undertake.

As a general standard, the Proposal would combine two entities into a single counterparty if one entity (i) owns, controls, or holds with a power to vote 25 percent or more of a class of voting securities of the other entity; (ii) owns or controls 25 percent or more of the total equity of the other entity; or (iii) consolidates the other entity for financial reporting purposes.[18] While we appreciate that each of these prongs of the general standard would impose a bright-line test, for the reasons discussed in the previous section of this letter, the first two prongs of the standard could capture situations where the two entities would not necessarily be exposed to each other, much less be economically interdependent. The more accurate method would be to combine entities into a single counterparty for purposes of this general standard only where one entity consolidates the other entity for financial reporting purposes, as discussed in Part I.C of this letter, above.

The Proposal would then impose two additional aggregation tests. First, under the economic interdependence test, a covered company would be required in certain circumstances to determine whether multiple unaffiliated counterparties are economically interdependent, and if so, to aggregate its exposures to the counterparties as if they were a single counterparty.[19] The inclusion of this test would have the result that the set of entities considered to be part of a banking organization in its capacity as a counterparty could be larger than the set of entities considered to be a part of the same banking organization in its capacity as a covered company.

Second, under the Proposal's control aggregation test, a covered company would be required to assess whether multiple counterparties are connected by control relationships due to the following factors: (i) the presence of voting agreements; (ii) the ability of one counterparty to significantly influence the appointment or dismissal of another counterparty's administrative, management or governing body, or the fact that a majority of members of such body have been appointed solely as a result of the exercise of the first counterparty's voting rights; and (iii) the ability of one counterparty to exercise a controlling influence over the management or policies of another counterparty.[20] If so, the covered company would aggregate its exposures to the counterparties as if they were a single counterparty. By including the term "controlling influence," this additional control test would align the counterparty aggregation requirements with the BHCA control standard. For the reasons discussed in the previous section of this letter, we believe this standard is inappropriate because it could require aggregation of two entities even where the entities were not exposed to each other, much less economically interdependent.

The proposed control aggregation test, with its incorporation of the BHCA control standard, would have significant unintended consequences. Counterparties generally do not publicly disclose the type of

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18 81 Fed. Reg. at 14,350 (col. 1) & 14,357 (col. 2) (proposed definition of "counterparty").

19 For instance, a BHC-affiliated asset manager might be required to confirm whether its external clients are economically interdependent with any dealer counterparties, and if so, the BHC and its affiliates could be limited in the trades in which they engage with any such dealer.

20 81 Fed. Reg. at 14,355 (col. 1-2) & 14,363 (col. 3).

information that would be relevant to a control analysis under the BHCA, even if they were public reporting companies. Our members expect that covered companies would be forced to request a significant volume of information from every existing and prospective customer and counterparty in order to comply with their obligations under the control aggregation test. To conduct a control analysis under the BHCA, a covered company would need to know, among other things: the identity of every entity in which the counterparty has an investment; the counterparty's ownership level in each entity; the counterparty's voting and director appointment rights in each entity; the counterparty's other contractual rights with respect to each entity; and the counterparty's other business relationships with each entity, including, for instance, transaction-level information. The Proposal could even be read to require such information to be provided on a real-time basis.

Our members and their clients – whether or not they are affiliated with BHCs – have serious concerns about the information that BHCs will be required to request of their counterparties as part of this sweeping due diligence exercise:

- ***Information sensitivity.*** Some information that would be relevant to making a control determination is sensitive personal financial information or other proprietary nonpublic information. For example, a covered company's counterparty may be a family investment vehicle, and revealing information about the vehicle's precise voting structure could involve divulging highly sensitive personal information to the covered company.

- ***Competitive considerations.*** To conduct a control analysis of a counterparty that is itself a financial institution, the covered company would need to request nonpublic information that could create significant competitive issues if shared with the covered company. For example, a covered company's counterparty may be a competitor investment fund that would be required to provide the covered company with its proprietary fund agreements, and/or information about its business relationships (including trading volumes) with other dealers. The covered company might obtain inappropriate visibility into its counterparty's operations.

- ***Counterparty obligations.*** To conduct a control analysis of a counterparty, the covered company would need nonpublic information that is sensitive not only for the counterparty, but also for third parties such as clients and business partners of the counterparty. The counterparty may be prohibited from sharing this third party information by law, contract, or ethical obligation.

- ***Inability to access timely information.*** Both from a covered company and counterparty perspective, passive investors in collective investment vehicles may have a particularly difficult time tracking their ownership percentages on a real time basis as purchases or redemptions of other holders may not be communicated promptly, if at all, to all the investors in a fund.

- ***Data minimization principles.*** Requiring a covered company to collect vast amounts of sensitive information from its counterparties is incompatible with data security best practices, which dictate that financial institutions should collect the minimum amount of customer information necessary for their business and regulatory purposes. Data minimization reduces the risks to a financial institution in the event that collected data is compromised.

- ***Information walls.*** A business line unit at a counterparty may not always have full information about its company's dealings; as a result, aggregating this information may require information to be shared across information walls of the counterparty. Likewise, a business line unit at a covered company could learn information about its counterparties that would not be permitted to be shared across information walls of the covered company.

- ***Complexity.*** Applying the "controlling influence" standard involves a nuanced and complicated legal analysis with which most nonbank firms are unfamiliar. A counterparty may not understand the covered company's need for information about the counterparty's governance rights and contractual rights with respect to an entity in which the counterparty has a mere minority investment.

- ***Regulatory arbitrage.*** Requiring covered companies to ask for volumes of sensitive information from every counterparty would put BHCs at a significant disadvantage relative to other types of financial institutions that are subject to a different regulatory regime than BHCs and therefore are not required to ask counterparties for such information.

- ***Access to services.*** A prospective client or counterparty would be required to provide this information to every covered company with which it seeks to establish a relationship. This requirement would make it difficult for counterparties to access necessary financial services quickly, and would create significant barriers for less sophisticated counterparties.

- ***Time and expense.*** Cataloging and analyzing control relationships under the BHCA's facts-and-circumstances standard for every single counterparty of a covered company would be an extraordinarily time-consuming and expensive undertaking for the covered company. Likewise, gathering this information would be time-consuming for the covered party's counterparties.

While the Proposal's control aggregation standards would impose significant burdens on covered companies and their counterparties, these burdens would not be outweighed by any marginal benefit in accuracy for the vast majority of the covered company's counterparty relationships, which will not come near the limits of the SCCL rule.

Accounting consolidation standards provide a more appropriate method for defining control than the BHCA standard, for the reasons discussed in Part I.C of this letter. In the counterparty aggregation context, accounting standards have an additional advantage: counterparties will have already done a consolidation analysis for purposes of preparing financial statements, which would significantly reduce (if not eliminate) the burden associated with the aggregation requirement. Because they are superfluous and significantly burdensome, the first two prongs of the Proposal's general control standard (relating to voting and total equity interests) should be eliminated, as should the Proposal's additional requirement for covered companies to assess whether multiple counterparties are connected by control relationships due to (i) the presence of voting agreements; (ii) ability of one counterparty to significantly influence the appointment or dismissal of another counterparty's administrative, management or governing body, or the fact that a majority of members of such body have been appointed solely as a result of the exercise of the first counterparty's voting rights; and (iii) ability of one counterparty to exercise a controlling influence over the management or policies of another counterparty.

At a minimum, the final SCCL rule should include a *de minimis* threshold for control aggregation, just as it does for the economic interdependence aggregation test. A covered company should only be required to assess whether a counterparty is connected to other counterparties by control relationships under the first two prongs of the Proposal's general control standard and conduct the Proposal's additional control analysis if the covered company's net credit exposure to one of the counterparties is 5 percent or more of the covered company's eligible capital base (*i.e.*, Tier 1 capital or capital stock and surplus). Such a *de minimis* threshold would reflect the reality that the vast majority of a covered company's counterparty relationships will not be anywhere near the limits of the SCCL rule. At the same time, the covered company would still assess all of its counterparties' control relationships based on financial reporting consolidation standards.

Finally, the final SCCL rule should clarify that a covered company conducting a control analysis of a counterparty (1) is not required to obtain backup documentation from the counterparty, and (2) does not have an obligation to update the analysis unless it has reason to believe there has been a material change to the counterparty's control structure. These changes will ensure that the final rule is less operationally burdensome for covered companies and their counterparties.

III. The Proposal Would Overstate Covered Companies' Exposures to Investment Funds and their Underlying Assets

As asset managers, our members are deeply interested in ensuring that covered companies' exposures to investment funds are calculated accurately and without undue burden; any overstatement or excessive burden could cause covered companies to restrict the services they provide to our members and their clients.

The Proposal would require a Large Covered Company to use the full look-through approach for each investment fund "in which it invests pursuant to § 252.73(a)," unless the Large Covered Company can demonstrate that its gross credit exposure to the issuer of each underlying asset held by the investment fund, considering only the credit exposures to that issuer arising from the Large Covered Company's investment in the particular fund, is less than 0.25 percent of the covered company's eligible capital. Under the full look-through approach, the Large Covered Company would calculate its *pro rata* portion of the fund's underlying gross credit exposures as its own gross credit exposures. In addition, the Large Covered Company would be required to recognize a gross credit exposure to each third party that has a contractual or other business relationship with the fund such that the failure or material financial distress of that third party would cause a loss in the value of the Large Covered Company's investment in the fund.

In this context, we believe the Proposal's full look-through approach framework should be revised in several ways to improve its accuracy and operational simplicity.

A. The Look-Through Approach Should Only Apply Where a Large Covered Company Has an Equity or Equity-Like Exposure to an Investment Fund

The Proposal's reference to investments made "pursuant to § 252.73(a)" could be read to require a Large Covered Company to use the full look-through approach for any investment fund with which the Large Covered Company engages in any credit transaction as counterparty, whether or not the Large Covered Company has an equity exposure to the fund, because section 252.73 of the proposed text lists a wide range of credit transactions. At the same time, we do not believe that most exposure types listed in section 252.73 of the proposed text are "investments" under the common meaning of the term. Credit exposures, unlike equity exposures, do not provide a Large Covered Company with *pro rata* exposure to the underlying assets held by an investment fund. A creditor to a diversified investment fund, unlike a shareholder, would not necessarily suffer *any* losses if the fund suffered modest losses due to a failure or distress of one or more counterparties. The full look-through approach is intended to be a method for capturing a Large Covered Company's *pro rata* exposure to a fund's underlying assets, ***not*** as a method for determining a fund's economic interdependence with the issuers in which it has invested, which the Proposal covers separately by including economic interdependence aggregation requirements. Therefore, the final SCCL rule should clarify that only equity or equity-like exposures to an investment fund require the use of the full look-through approach.

B. The *De Minimis* Threshold Should Be Calculated with Respect to the Size of a Large Covered Company's Investment in an Investment Fund, Not the Large Covered Company's Exposures to the Fund's Underlying Assets

The Proposal's *de minimis* threshold, as currently formulated, provides little relief from the burden of calculating fund exposures on a look-through basis. The threshold would require a Large Covered Company to calculate its exposures to the underlying assets of an investment fund on a full look-through basis if the Large Covered Company cannot demonstrate that its exposure to the issuer of each underlying asset held by the fund is less than 0.25 percent of the Large Covered Company's Tier 1 capital. Yet, the Large Covered Company would only be able to make this showing by actually calculating its exposure to the issuer of the underlying asset on a full look-through basis, in large part rendering moot the relief that the threshold is intended to provide. The *de minimis* threshold of the Proposal should therefore be revised so that a Large Covered Company would use the look-through approach if its investment in the ***fund***, not the issuer of each of the fund's underlying assets, is less than a particular percentage of the Large Covered Company's capital. An appropriate percentage for this *de minimis* threshold would be 5 percent of the Large Covered Company's Tier 1 capital, which would align this *de minimis* threshold with that of the Proposal's economic interdependence test.

C. A Large Covered Company Should Not Be Required to Double Count its Exposures to an Investment Fund

In addition to requiring a Large Covered Company to recognize gross credit exposure to the issuer of each underlying asset of an investment fund under the full look-through approach, the Proposal would require a Large Covered Company to recognize gross credit exposure to each third party that has a contractual or other business relationship with the fund where the failure or material financial distress of the fund would cause a loss in the value of the Large Covered Company's investment in the fund. The preamble to the Proposal states that fund managers would "potentially" satisfy this standard.[21] However, the value of an equity interest in a fund depends on the value of the fund's underlying assets, after reflecting any borrowings. We do not believe that the failure or financial distress of a fund manager – even if it has made a commitment to support the fund financially – would generally affect the value of an investment in the fund.[22]

IV. Summary of Recommendations

For the reasons described above, the Federal Reserve should make the following changes to the Proposal to make the final SCCL rule more accurate and less burdensome:

- ***Definition of "covered company."*** The final SCCL rule should define "covered company" to include the BHC and all entities consolidated with the BHC financial reporting purposes except for (a) investment funds sponsored by the BHC or any of its affiliates, and (b) portfolio companies of the BHC held under the authority of section 4(k) of the BHCA.

- ***Definition of "counterparty."*** The final SCCL rule should define "counterparty" only to include, with respect to a company, the company and all persons that that counterparty consolidates for financial reporting purposes; that is, the first two prongs of the Proposal's general control standard (relating to voting and total equity interests) should be eliminated. In addition, the rule should not include a control aggregation test. At a minimum, the final SCCL rule should include a *de minimis* threshold for control aggregation, so that a covered company is only required to assess whether a counterparty is connected to other counterparties by control relationships under the voting and equity interests tests and under the control aggregation test if the covered company's net credit exposure to one of the counterparties is 5 percent or more of the covered company's eligible capital base (*i.e.*, Tier 1 capital or capital stock and surplus). Moreover, the final rule should clarify that a covered company conducting a control analysis of a

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21 81 Fed. Reg. at 14,343 (col. 2).

22 For a discussion of why the failure or financial distress of an asset manager would not adversely affect the funds it manages, please see pages 63-64 of our March 25, 2015 comment letter to the Financial Stability Oversight Council regarding Asset Management Products and Activities, available at http://www.sifma.org/issues/item.aspx?id=8589953776.

counterparty (1) is not required to obtain backup documentation from the counterparty, and (2) does not have an obligation to update the analysis unless it has reason to believe there has been a material change to the counterparty's control structure.

- ***Exposures to investment funds.*** The final SCCL rule should clarify that only equity or equity-like exposures of a Large Covered Company to an investment fund require the use of the full look-through approach. The *de minimis* threshold for use of the full-look through approach should require a Large Covered Company to calculate its exposures to the underlying assets of an investment fund on a full look-through basis only if the Large Covered Company cannot demonstrate that its exposure to the fund is less than 5 percent of the Large Covered Company's Tier 1 capital.

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We appreciate the Federal Reserve's consideration of our concerns. Should you have any questions, please do not hesitate to contact us at Tim Cameron at (202) 962-7447 or tcameron@sifma.org or Laura Martin at (212) 313-1176 or lmartin@sifma.org, or our counsel at Covington & Burling LLP, John C. Dugan at (202) 662-5051 or jdugan@cov.com or Randy Benjenk at (202) 662-5041 or rbenjenk@cov.com.

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