THE INVESTMENT ASSOCIATION
INVESTMENT MATTERS

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Ladies and Gentlemen

RE: **Notice of Proposed Rulemaking: Restrictions on Qualified Financial Contracts of Systemically Important U.S. Banking Organizations and the U.S. Operations of Systemically Important Foreign Banking Organizations; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions (FRB RIN No. 7100 AE-52; FRB Docket No. R-1538)**

The Investment Association **("The IA")** welcomes the opportunity to to provide comments to the Board of Governors of the Federal Reserve System (the **"Board")** on the notice of proposed rule making referred to above (the **"Proposed Rule").**

The IA is the trade body that represents UK investment managers, whose 200 members collectively manage over £5.5 trillion on behalf of clients from across the world. Our members typically enter into transactions as agent for underlying clients ranging from investment funds and insurance companies through to pension funds, sovereign wealth funds and other institutional as well as retail investors (please see Annex 1).

Our members will usually be responsible for trading and other documentation relating to the investment activities undertaken for their clients. This documentation is genarlly entered into by investment managers as agent for a number of underlying clients, and will create separate contracts between each client and the counterparty.

The IA supports the objectives of the Proposed Rule of improving the resolvability and resilience of systematically important financial institutions in order to ensure the stability of the US financial system. We have been involved in the work undertaken at an international level and by the International Swaps and Derivatives Association, Inc. **("ISDA")** to develop a market-wide approach which will facilitate buy-side compliance with requirements regarding the cross border contractual recognition of the powers relating to stays on termination rights provided under Special Resolution Regimes (the **"SRR Powers").** In particular, we have been involved in the development of the ISDA Resolution Stay Jurisdictional Modular Protocol (the**"JMP").**

One of the key objectives of the JMP was to establish a means of facilitating the agreement of buy-side counterparties to contractual recognition of the SRR Powers relevant to their bank counterparties, off the back of regulations/rules implemented in each relevant jurisdiction which require bank counterparties to seek such contracual provisions **("Cross Border Recognition Regulations").** It was acknowledged by the Financial Stability Board and financial regulators at a global level that as buy-side counterparties (inclduing investment managers acting as agent) are not subject to the SRRs themselves nor subject to bank regulation, it would be difficult to obtain buy-side agreement to contractual recognition of SRR Powers without some form of regulatory requirement imposed on the bank counterparties to ensure that relevant contracts comply. In particular, it was recognised that, it would be hard for investment managers acting for underlying clients to comply with their fiduciary duties to act in the clients' best interest by agreeing to contractual changes which could be detrimental to their clients' interests.

Likewise, it was also accepted that the ISDA 2015 Universal Dealer Protocol **("UDP")** (which was developped specifically to cover agreements between G-SIBs and other entities subject to SRR Powers) would not be an approriate tool to facilitate the amendments required to buy-side agreements.

The JMP has the following features not provided by the UDP which enable it to be a practical compliance method for the buy-side (including investment managers acting for underlying clients):

- An adherent only needs to agree to amend contracts in respect of bank counterparties in jursidictions which have implemented Cross Border Recognition Regulations.

- Each Juriscitional Module **("JM")** reflects the scope of the relevant Cross Border Recognition Regulations implemented in the juridiction in question. This means, for example, that all contracts covered by the relevant Cross Border Recognition Regulations are automatically covered. **This is also an important feature for regulators.**

- Subject to some limited exceptions, each JM does not impose requirements on adherants which are more onerous than those in the relevant Cross Border Recognition Regulations.

- Adherents are usually provided with three choices in terms of scope of adherance (subject to any further restrictions which may be provided in the relevant Cross Border Recognition Regulations) in respect of each JM: All members of G-SIB groups which have adhered, all entities subject to Cross Border Recognition Regulations who have adhered (each a "Regulated Entity"), on a Regulated Entity by Regulated Entity basis.

The JMP also applies retrospectively to all relevant contracts between the counterparties adhering. This is the case, notwithstanding the relavant Cross Border Recognition Regulations. **This is also an important feature for regulators**

Specific Comments on the Proposed Rule

The IA has reviewed the response provided by ISDA and broadly supports ISDA's comments and recommendations on the Proposed Rule. Our additional comments below cover specific points in the ISDA response on which we have additional comments relating to our members' position as well as an additional comment on the approach to agency agreements.

The Board Should Allow Covered Entities to Comply with the Final Rule by Adherence to the ISDA Resolution Stay Jurisdictional Modular Protocol.

The IA supports ISDA's proposals in Section I of their response in relation to a safe harbour for a US Jusridictional Module under the JMP, for the reasons we have set out above. In particular we agree with the proposed terms that such a US JM should contain in order to have the benefit of a safe harbour.

As mentioned above, the JMP has been specifically developped for wider market adherence, with the aim of ensuring as wide compliance as possible. Adherence to the UDP by buy-side entities was never anticipated, and would not be an attractive propostion as it does not contain the features mentioned above.

If the only safe harbour provided is by way of adherence to the UDP, it will be difficult for Covered Entities to conform their contracts with buy-side entities using the Protocol approach. This will lead to a proliferation of bi-lateral arrangements which not only will be burdensome on counterparties in terms of time and resources to negotaite, but will also not achieve the regulatory objective in a timely fashion, if at all. Providing a safe harbour for a US JM would limit the compliance burden on firms and would facilitate market wide compliance as buy-side entities would be more likely to use the JMP. We therefore strongly support the ISDA proposals in this regard, and encourage the Board to provide a safe harbour for a US JM in the final rule on the terms proposed by ISDA.

The Board should narrow the scope of the Proposed Rule in ways that would decrease the substantial compliance burden on Covered Entities and their counterparties without undermining the policy objectives of the Proposed Rule.

The definition of covered QFC should exclude certain transaction types

We also support ISDA's proposals regarding the exclusion of certain types of QFC from the Proposed Rule, in particular contracts relating to cash securities transactions, FX spot contracts, warrants, customer on-boarding documentation and contracts that do not contain relevant default rights or transfer restrictions, set out in Section III A of ISDA's response.

The ISDA response mentions the amount of time and resources that it would take for Covered Entities to conform all QFCs if such contracts were not excluded. Likewise, the inclusion of these contracts would also impose a substatnial burden on investment managers and their clients.

Many more clients of investment managers are covered by cash and FX spot trades, and investment managers have many more relationships with counterparties covering these types of transactions than in respect of e.g. OTC swaps, derivatives and securities finance transactions. In fact some investment managers and their clients only undertake transactions in the cash and FX spot markets. As a result they are unlikely to have been involved to date with the developments on cross border contractual stays and so including these types of contracts will create an addition educational need (both at investment manager and underlying client level).

Demand contracts

We also also support, like ISDA (see Section III B of ISDA's response), the Board's proposal that the definition of "default right" exclude rights that allow a party to terminate a QFC "on demand or at its option at a specified time, or from time to time, without the need to show cause". In particular, this would ensure that there was no regulatory conflict for entities, such as UCITS funds[1], which are required to be able to close out OTC derivative transactions at any time without cause at fair value. Excluding such default rights would also ensure that the US Cross Border Recogition Regulations do not cut across this requirement.

Application to contracts with affiliates of a counterparty

The IA supports ISDA's recommendations regarding the requirement to conform QFCs with all affiliates of a counterparty (see Section III E of ISDA's response). We agree with ISDA that this is impractical and imposes an unnecessary administrative burden on counterparties as well as Covered Entities.

In addition to the circumstances noted by ISDA, the requirement will be difficult to comply with where an agent is acting on behalf of a counterparty, for instance under a discretionary investment management mandate. The agent is unlikely to have any information on the other entities in the counterparty's group or the contracts that such entities may have with Covered Entities. It will not be able to provide the information required by Covered Entities in order to enable them to comply, and will have no relationship with the other entities in the counterparty's group. The Covered Entities, likewise will not have a direct relationship with the counterparty, who also may be using a variety of agents (e.g. different investment managers), each of whom will have a separate relationship with the Covered Entity in respect of the counterparty.

Clarity required with respect to cleared trades

The IA supports the exclusion from the requirements of QFCs with central counterparties **("CCPs").** However, we agree with ISDA that the scope of this exclusion needs to be clarified so that it is clear that the client leg of a cleared contract in a principal-to-principal client clearing model is also excluded (see Section V F of ISDA's response).

Principal-to-principal clearing is the preferred client clearing model of most European CCPs. In a principal-to-principal model the client has a direct contract with the clearing member who likewise has a direct back-to-back contract with the CCP on the same terms as the contract with the client. Margin payments flow through to the CCP, and in the event of default of the clearing member the default rules of the CCP will apply to the clearing member to client leg as well as the clearing member to CCP leg of the cleared trade.

We also propose that all links in a client clearing chain (e.g. where there is indirect clearing arrangement, as permitted by European Regulations MiFIR[2] and EMIR[3]) are also excluded from the scope of the final rule as they also make up part of the same cleared transaction which will be subject in any case to the default management rules of the relevant CCP.

[1] A UCITS fund is a fund established under the EU Directive relating to undertakings for collective investment in transferable securities, Directive 2009/65/EC as amended by Directive 2014/91/EU
[2] Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012
[3] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories

Clarity required with respect to position of agency agreements

The Proposed Rule states that the proposal would apply to a covered QFC regardless of whether the covered entity or the covered entity's direct counterparty is acting as a principal or as an agent (see page 47 under the heading: "Agency Transactions"). This would appear to imply that the proposal would seek to limit the exercise of default rights or transfer restrictions by the agent and all principals under any agency contract.

Where an Agent is acting for a counterparty whose transactions are excluded from the requirements (an **"Excluded Counterparty"),** then the agreement between the agent acting on behalf of the principal and the covered entity should not be a QFC. In this case the proposal should not apply to the agent, acting on behalf of the principal, or the principal acting on its own behalf under the contract.

Where an agent has entered into an umbrella master agreement in respect of more than one principal and has termination right in respect of the umbrella agreement as a whole, we agree that the agent should not be able to exercise these rights where one or more of the underlying principals is not an Excluded Counterparty.

However, where one of the principals under the umbrella master agreement is an Excluded Counterparty, the proposals should not apply to the contract created between that principal and the covered entity under the umbrella agreement.

We would ask the Board to further clarify the position of contracts entered into by agents for counterparties with covered entities, in particular where the underlying principal is an Excluded Counterparty and where the agency agreement is an umbrella master agreement covering multiple underlying principals.

We hope that you find our comments helpful in the context of your further consideration of the Proposed Rule and the the response provided by ISDA. Please contact Penny Froggatt: penny.froggatt@theia.org if you have any questions regarding this response or if you would like us to provide further information or assistance in relation to the development of the Proposed Rule.

Yours faithfully

The Investment Association

ANNEX I

ABOUT THE INVESTMENT ASSOCIATION

The Investment Association is the trade body that represents UK investment managers, whose 200 members collectively manage over £5.5 trillion on behalf of clients.

Our purpose is to ensure investment managers are in the best possible position to:

- Build people's resilience to financial adversity
- Help people achieve their financial aspirations
- Enable people to maintain a decent standard of living as they grow older
- Contribute to economic growth through the efficient allocation of capital

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks & shares ISAs.

The UK is the second largest investment management centre in the world and manages 37% of European assets.

More information can be viewed on our website.