

**Meeting of the Board of Governors and the Managed Funds Association
September 28, 2016**

Participants: Vice Chairman Stanley Fischer, Governor Jerome Powell, and Governor Lael Brainard (Federal Reserve Board members); David Bowman, Mark Carey, Yao-Chin Chao, Robert Frierson, Anna Lee Hewko, and Katie Ross (Federal Reserve Board staff)

Benjamin Allensworth, Mark Bailey, Richard Baker, Michael Bausano, Darcy Bradbury, Leda Maria Braga, Paul Brannan, Eric Burl, Marc Charon, Anthony Coley, Adam Cooper, Louis Costantino Jr., Bruce Darringer, Natalie Deak Jaros, Anthony Deluca, Edward Dougherty, Lara Driscoe, Bryan Durkin, Duncan Ford, Joshua Gold, Christopher Greene, Jeanmarie Grisi, Gautam Gujral, David Haley, Jennifer Han, Drew Harlow, Michael Harris, Christopher Hayward, Christopher Hedberg, Joel Hinkhouse, Jonathan Hitchon, Roger Hollingsworth, Mikael Johnson, Stuart Kaswell, Carlotta King, Daniel Kochav, David Landers, Francis LaSalla, Timothy Levart, John Liftin, Michael Mendelson, Sarah Morgan, Ajay Nagpal, Matthew Newell, Leonard Ng, Edgar Ortega Barrales, Laura Powell, Gustav Rydbeck, Paul Simpson, George Sullivan III, Kimberly Summe, Eric Vincent, Steven Wagshal, Kimberly Walker, Nicola Watson, and Jeffrey Weber (Managed Funds Association members)

Summary: Members of the Federal Reserve Board met with representatives of the Managed Funds Association (MFA), a global trade association for the hedge fund and managed futures fund industry. The MFA submitted written materials in advance of the meeting, including the attached comments on pending regulatory proposals. The regulatory proposals were not discussed at the meeting, and the viewpoints expressed in the attachment are solely those of the MFA.

Attachment

Regulation WW, Docket No. R-1537

We share the concerns that, as regulators seek to buttress capital levels, other unintended risks may be magnified. For example, the recent news of JP Morgan's exit from the business of clearing and settling Treasury transactions has left participants with a single service provider to settle all trades in a vital market. As you know, this development has created a single-point of failure in the Treasury market and should be of concern as a systemic risk.

Recent regulatory initiatives are likely to extend that trend and may further reduce liquidity in markets that are central to MFA members' investment strategies and risk management. One such initiative is the Net Stable Funding Ratio proposal, which would require banks to maintain over a one-year period a minimum level of stable funding relative to the liquidity of their assets, derivatives, and commitments. The Fed notes the proposal is "designed to reduce the likelihood that disruptions to a banking organization's sources of funding will compromise its liquidity position."

- Liquidity in various markets may be adversely impacted. The proposed framework includes provisions that may disincentivize banks from funding customer short positions and participating in the repo market. Disincentives that make it uneconomical for banks to engage in low-risk, low-margin transactions with customers, create a risk of distorting market behavior toward higher-risk, higher-margin transactions.
- Given all the progress of other regulatory initiatives, the NSFR framework as proposed is likely to result in reduced liquidity and higher costs for end-users, with the potential for little additional prudential benefit. Academics have noted that the NSFR, as finalized at the Basel level, would require global banking organizations to raise approximately \$500 billion of additional long-term funding to support existing bilateral derivatives activities. We are certainly not experts in bank regulation, but we would encourage U.S. regulators to move forward on the issue in a way that does not increase costs on end-users.

Regulations Q and YY, Docket No. R-1523

MFA wishes to raise concerns about two proposals that we believe would not reduce systemic risk and that would impair the rights of hedge funds and their investors. First, on October 30, 2015, the Board issued a [notice of proposed rulemaking](#) on the "Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations; Regulatory Capital Deduction for Investments in Certain Unsecured Debt of Systemically Important U.S. Bank Holding Companies" (TLAC Proposal). In those rules, the Board proposed to prohibit systemically important U.S. bank holding companies and the intermediate holding companies of systemically important foreign banking organizations from guaranteeing a liability of an affiliate if such liability permits the exercise of a default right that is related, directly or indirectly, to that entity becoming subject to a resolution or insolvency proceeding (other than under the Orderly Liquidation Authority).

Regulations Q, WW, and YY, Docket No. R-1538

Separately, on May 3, 2015, the Board issued a notice of proposed rulemaking on “Restrictions on Qualified Financial Contracts of Systemically Important U.S. Banking Organizations and the U.S. Operations of Systemically Important Foreign Banking Organizations” (Stay Proposal). These proposed rules would generally prohibit certain globally systemically important banking organizations (GSIB) from being party to any qualified financial contract that permits the exercise of any default right related, directly or indirectly, to any GSIB or its affiliates becoming subject to a receivership, insolvency, liquidation, resolution, or similar proceeding.

Both of these rulemakings relate to a broader initiative by the Board and other members of the Financial Stability Board (FSB) to alter end-user’s exercise of their default rights during certain resolution and insolvency proceedings. MFA has consistently expressed our objections to this initiative and the related rules and regulations promulgated in the various FSB member jurisdictions. In September 2015, MFA published a white paper expressing our concerns, which we provided to the Board. In addition, MFA submitted a letter to the Board on the TLAC Proposal on February 19, 2016, and submitted comments on the Stay Proposal on August 5, 2016.

As noted in our letters, MFA believes that default rights are critically important to end-users when facing a troubled counterparty and serve important public policy goals of protecting investors and the stability of the financial markets. Thus, we are concerned that depriving end-users of these rights would exacerbate financial contagion, such as the “run on the bank” problem by encouraging end-users to seek to migrate business away from a large financial institution as soon as they have any concerns about its stability. We are also very troubled by the Board’s proposed restrictions on certain end-user default rights during U.S. bankruptcy proceedings, which we believe is inconsistent with Congressional intent and is a substantial constraint on a key risk mitigation tool that end-users need to protect themselves and their investors and/or beneficiaries.