

To: Public Comment File – Docket No. OCC–2023–0008

From: Carl Kaminski, Assistant Director, Bank Advisory Group, Chief Counsel’s Office

Date: June 26, 2024

Subject: Meeting with representatives from the Investment Company Institute (ICI) to discuss: Notice of Proposed Rulemaking: “Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity”

Staff of the Office of the Comptroller of the Currency met with representatives from the Investment Companies Institute (ICI) regarding the agency’s Notice of Proposed Rulemaking on Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity (the “NPR”), which was published in the Federal Register on September 18, 2023 (88 FR 64028).

The ICI representatives discussed the NPR’s potential impact on the cost of bank services provided to investment companies, regulated funds, defined contribution plans, and investment advisers, as described in their comment letters. In particular, the ICI representatives focused on the proposed capital requirements for corporate exposures that are not publicly traded, seed capital investments, securities financing transactions, credit valuation adjustment risk for derivative transactions, and operational risk.

The ICI representatives provided a slide deck outlining their concerns. That deck is attached to this summary.

Attendees

OCC

Michael Hsu
Margot Schwadron
Carl Kaminski

ICI

Eric Pan
Paul Cellupica
Rachel Graham

Debevoise & Plimpton LLP

Chen Xu

Basel III Endgame – Key Issues

June 27, 2024

Background

Capital increases may increase costs and reduce market liquidity

- ICI represents the interests of U.S. registered investment companies (“RICs”), similar funds organized outside the U.S. and US business development companies (“BDCs”) (together “regulated funds”). We also represent the interests of the investment advisers that manage regulated funds and other investment products intended for the benefit of individual investors, including collective investment trusts that are offered in defined contribution plans (“CITs”).
- Regulated funds and CITs use banks to provide “mission critical” services – **we are concerned that the proposal’s capital increases would increase the cost of these services and reduce market liquidity**, ultimately impacting individual investors.
- Many areas of the proposal require further study and re-calibration; given the significant over-calibration, **the most appropriate course of action is to re-propose the rule.**

Regulated Funds and CITs

Factual and Regulatory Background

- RICs operate under a **comprehensive regulatory framework**, including the Investment Company Act, the Investment Advisers Act and federal securities laws that aim to protect investors and mitigate risks to the financial system.
- CITs are structured to meet an exclusion to the definition of “investment company” under the Investment Company Act by limiting their investors to tax qualified plans and eligible government retirement plans “maintained by a bank.”
 - **CITs are subject to regulation under OCC rules or by relevant state banking law.**
 - The sponsoring bank and any subadvisors to which it delegates investment management responsibilities are subject to the fiduciary requirements and transaction provisions of the Employee Retirement Income Security Act of 1974.

Impact of Basel III Endgame Proposal

Regulated Funds Rely on Bank Services

- Regulated funds and CITs use a variety of bank services including among others:
 - Custody;
 - Trusteeship;
 - Lines of credit;
 - Securities financing transactions (“SFTs”); and
 - Derivatives.
- **The proposal may increase the cost of each of these services**, through provisions such as the public listing requirement for investment grade corporate exposures, minimum haircuts for SFTs, the credit valuation adjustment (“CVA”) risk framework and the approach to operational risk.

Impact of Basel III Endgame Proposal, cont'd.

Proposal may create "friction" in financial markets

- Regulated funds and CITs transact on behalf of investors across all major financial asset classes.
- Availability of market liquidity – whether a position can be acquired or sold in a timely and cost-efficient manner with minimal price impacts – is a critical investment criterion.
- Overbroad regulatory requirements create “friction” which **reduces market liquidity, and could lead to wider bid-ask spreads, less quoted depth, lower trading volumes and greater price impact.**
- In critical markets, including corporate bonds and U.S. Treasuries, past regulatory changes have led to challenges for regulated funds, CITs and other market participants to obtain adequate liquidity in certain markets.

Recommendations

We reiterate that we believe re-proposal is the most appropriate course; we also offer some specific recommendations and observations below.

Issue	Description	Recommendation
Corporate Risk Weights	<ul style="list-style-type: none"> ➤ Investment-grade corporates would receive a preferential 65% risk weight only if they are publicly-listed 	<ul style="list-style-type: none"> ➤ Remove the public listing requirement for highly regulated entities, such as RICs, foreign public funds and BDCs, or drop the requirement altogether
Operational Risk	<ul style="list-style-type: none"> ➤ Proposal's operational risk framework would raise costs of "mission critical" services for regulated funds and CITs (and ultimately individual investors). 	<ul style="list-style-type: none"> ➤ Reconsider the significant over-calibration of the proposal's operational risk framework, particularly as it relates to fee-based businesses
SFTs	<ul style="list-style-type: none"> ➤ Minimum haircut floors would treat transactions with "unregulated financial institutions" where collateral posted falls below haircut floor as fully uncollateralized 	<ul style="list-style-type: none"> ➤ Retain the proposed exclusion of RICs and foreign public funds from minimum SFT haircuts ➤ Extend the exclusion to cover other highly regulated entities (i.e., CITs that hold ERISA plan assets and BDCs)
CVA	<ul style="list-style-type: none"> ➤ Costs associated with increased bank capital requirements for CVA risk may be passed on RICs and could reduce competition in the derivatives market ➤ Proposal would apply CVA charges to client-cleared derivatives despite no CVA risk existing for the client-facing leg 	<ul style="list-style-type: none"> ➤ Adopt more calibrated CVA risk weight for RICs and BDCs ➤ Exempt the client-facing leg of a cleared derivative transaction from CVA capital requirements
Seed Capital	<ul style="list-style-type: none"> ➤ Proposal would require use of the revised market risk framework for certain exposures to investment funds, including seed capital investments in RICs and foreign public funds 	<ul style="list-style-type: none"> ➤ Permit banking organizations to elect the use of the banking book for seed capital investments in sponsored funds, provided they can demonstrate lack of trading intent

Appendix

Comparison of Key Provisions with International Basel III Endgame Proposals

Item	U.S. Proposal	U.K. / E.U. Proposals
Corporate Risk Weights	➤ Public listing required for preferential risk weight treatment	➤ No public listing requirement
Operational Risk	➤ Internal loss multiplier (“ ILM ”) floored at 1	➤ ILM set to 1
SFTs	➤ Minimum SFT haircuts implemented	➤ No minimum SFT haircuts
CVA	➤ Client-facing leg of cleared derivative subject to CVA capital requirements	➤ Client facing leg of cleared derivative exempt from CVA requirements
Output Floor	➤ 100% output floor due to Collins Amendment	➤ 72.5% output floor
Transition Period	➤ 3-year transition period starting at 80%	➤ 5 to 7-year transition period ending at 72.5%