INVESTMENT COMPANY INSTITUTE

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June 3, 2010

The Honorable Barney Frank
Chairman
Committee on Financial Services
U.S. House of Representatives
2252 Rayburn House Office Building
Washington, DC 20515-2104

The Honorable Spencer Bachus
Ranking Minority Member
Committee on Financial Services
U.S. House of Representatives
2246 Rayburn House Office Building
Washington, DC 20515-0106

The Honorable Christopher J. Dodd
Chairman
Committee on Banking, Housing & Urban Affairs
U.S. Senate
448 Russell Senate Office Building
Washington, DC 20510-0702

The Honorable Richard C. Shelby
Ranking Minority Member
Committee on Banking, Housing & Urban Affairs
U.S. Senate
304 Russell Senate Office Building
Washington, DC 20510-0103

Re: Restoring American Financial Stability Act of 2010

Dear Conferees:

I am writing on behalf of the Investment Company Institute[1] to express our concerns with certain elements of the financial services reform legislation passed by the Senate on May 20. ICI has supported and continues to support Congressional efforts to modernize the U.S. financial services regulatory framework. Nonetheless, we strongly urge you to address the following issues in conference to avoid possible adverse consequences to mutual funds and other registered investment companies and—by extension—to their millions of investors:

Systemic Risk. Sections 165 and 171 of the bill would subject mutual funds to unworkable, bank-oriented prudential standards—including capital requirements—in the unlikely event a fund is deemed

[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $11.97 trillion and serve almost 90 million shareholders.

to pose systemic risks.[2] Mutual funds are not banks. Their structure and operations are fundamentally different from those of banks, and accordingly mutual funds are subject to a wholly different—but no less stringent—regulatory scheme under the Investment Company Act and other federal securities laws. Unlike banks, mutual funds simply have neither the need nor the ability to meet capital requirements. Their "capital" comes from the investors who own fund shares—shares that represent the shareholders' pro rata interests in all the underlying assets of the fund.

ICI has shared these concerns widely with members of Congress and their staffs. Our communications have been met with widespread expressions of understanding and acknowledgement that the legislation is not intended to lead to this result. Regrettably, despite the efforts of many to work with us to resolve our concerns, the necessary modifications could not be completed before the vote on final passage of the Senate bill.

We urge that the legislation be revised during the conference process to require the application of suitable enhanced regulatory requirements—in lieu of unworkable bank-oriented prudential standards such as capital requirements—to any mutual fund designated as systemically significant. An amendment offered by Senators Cardin and Mikulski (Amendment No. 3981) follows this approach. We note, however, that the Cardin-Mikulski amendment relates only to Section 165 of the bill and therefore would not resolve our similar concerns regarding Section 171, which was added to the bill by unanimous consent shortly before Senate passage. Accordingly, we recommend adding language to the bill along the lines of the Cardin-Mikulski amendment as necessary to avoid the imposition of unworkable requirements on mutual funds.

Treatment of Creditors of a Company in Liquidation. The bill raises significant concerns for mutual funds that are creditors of a nonbank financial company undergoing 'orderly liquidation' as outlined in the bill.

- ***Enforcement of Financial Contracts.*** Section 210(c)(10)(B) of the bill would impose a delay of up to three business days in the enforcement of "qualified financial contracts" with a nonbank financial company being liquidated. This delay would be problematic for mutual funds that entered into repurchase agreements with the company, because the collateral securing such agreements could deteriorate significantly in value over three trading days.

[2] Section 165 would require the Federal Reserve, on its own or pursuant to recommendations by the Financial Stability Oversight Council under Section 115, to impose "prudential standards" and reporting and disclosure requirements on any nonbank financial company designated by the Council as systemically significant. These standards "shall" include risk-based capital requirements, leverage limits, liquidity requirements, resolution plan and credit exposure report requirements, and concentration limits. Section 171, which incorporates an amendment offered by Senator Collins (Amendment No. 3879), would impose new leverage capital and risk-based capital requirements on any nonbank financial company designated as systemically significant.

Moreover, the prospect of a three-day delay could affect funding to nonbank financial companies as a general matter. This is because Investment Company Act rules would require funds to count any investments in repurchase agreements that are not immediately enforceable toward a five percent limit on investments in any particular company's debt obligations. The application of this limit means that money market funds and other investment companies that previously invested five percent of their assets in commercial paper, notes and other debt instruments issued by these companies could no longer engage in repurchase agreements unless they reduce their other holdings. Money market funds, for example, would probably stop buying a financial company's unsecured commercial paper so that they could continue to engage in fully secured repurchase agreements. Given that money market funds typically account for 40 percent of commercial paper investment, this could result in serious market dislocations.

We believe these outcomes are easily avoided by reducing the enforcement delay to one business day, which is consistent with the treatment of financial contracts in a resolution by the Federal Deposit Insurance Corporation of an insured depository institution. A one-day delay does not materially impair a fund's right to liquidate collateral, as it generally takes a full day to provide the required notifications and prepare to sell the collateral following an event of insolvency. Accordingly, a one-day delay would not raise the concerns we have outlined above.

- ***Treatment of Similarly Situated Creditors.*** Sections 210(b)(4), (d)(4) and (h)(5)(E) of the Senate bill would give the FDIC broad discretion—far broader than its existing authority in resolving failing insured depository institutions—to treat similarly situated creditors differently. Moreover, creditors—including mutual funds—who believe they have been disfavored would have little recourse because the legislation provides for only very limited, after-the-fact judicial review. While certain changes to earlier drafts of the Senate bill may have been intended to mitigate concerns about the FDIC's exercise of its authority, those changes did not address the fundamental issue. As a result, the bill would create significant uncertainty for funds and other fixed income investors. It could result in unfair discrimination among similarly situated creditors and have unintended and adverse effects on the bond market.

  We recognize the need to empower the FDIC to act rapidly and use some judgment in performing its responsibilities as receiver. Nevertheless, we recommend that additional steps be taken to minimize the possibility that subjective factors could inappropriately influence the FDIC's actions and result in unfair discriminatory treatment of similarly situated creditors including mutual funds.

Orderly Liquidation Assessments. We remain concerned that mutual funds could be taxed to pay for the costs of liquidating a failing nonbank financial company. While the final Senate bill no longer requires the establishment of a $50 billion orderly liquidation fund, Section 210(o) continues to authorize post-liquidation assessments on certain financial companies. We recognize that the

assessment criteria suggest it may be appropriate to impose lower assessments on mutual funds based on their lesser degree of risk. Nonetheless, mutual funds cannot "fail" in a manner requiring systemic liquidation and their 90 million shareholders should not be at risk of having to foot the bill for those firms that can and do.

Broker Discretionary Voting. Section 957 of the Senate bill would prohibit broker discretionary voting in *uncontested* elections of directors for all publicly traded operating companies and two types of registered investment companies -- closed-end funds and exchange-traded funds (ETFs). This ignores the differences between registered investment companies and operating companies. Closed-end funds and ETFs are registered investment companies just like traditional mutual funds. Unlike operating companies, they typically have no employees; rather they simply are investment vehicles. Unlike operating companies, they are subject to stringent regulation under the Investment Company Act, and their shareholders are guaranteed the right to vote on key issues, including when the investment company proposes to change its status (*e.g.*, from a closed-end fund to a mutual fund) or to take certain actions (*e.g.*, borrowing money, issuing senior securities). Further, investment companies have a far higher proportion of retail shareholders than operating companies. Because these shareholders tend *not* to vote, eliminating broker discretionary voting would create significant difficulties and impose substantial cost for closed-end funds and ETFs in achieving quorums and electing directors. The New York Stock Exchange (with approval by the SEC, after extensively considering the issue of broker voting, determined it was appropriate to continue to allow broker discretionary voting in uncontested elections for directors of registered investment companies, but to prohibit it in elections for directors of all other issuers. We strongly believe that the bill should likewise preserve broker discretionary voting for closed-end funds and ETFs.

Authority of the Consumer Financial Protection Bureau. Section 1027 of the Senate bill includes several provisions intended to limit the Consumer Financial Protection Bureau's authority over various classes of persons. With respect to persons regulated by the SEC and CFTC, Sections 1027(i) and (j) respectively state that the Bureau would have no authority "to enforce" Title X of the bill. Section 1027(g) similarly provides that, subject to certain exceptions, the Bureau may not exercise "any rulemaking or enforcement authority" with respect to products or services that relate to employee benefit and compensation plans and certain other arrangements. By contrast, other provisions in Section 1027—for example, subsection (a), which applies to merchants and retailers, and subsection (d), which applies to accountants and tax preparers—state that the Bureau may not exercise "any rulemaking, supervisory, enforcement or other authority under [Title X of the bill]" with respect to such persons. These disparities in language could suggest that the limitations on the Bureau's authority for persons regulated by the SEC and CFTC and for products and services excluded from the Bureau's authority under subsection (g) should be read more narrowly than other limitations in Section 1027, a result that does not appear to be intended. We accordingly recommend that subsections (i), (j), and (g) be revised to state that the Bureau may not exercise any rulemaking, supervisory, enforcement or other authority under Title X of the bill with respect to the persons (or products or services, as the case may be) intended to be excluded under those provisions.

Limited Purpose Thrifts and Trust Companies. A number of our members operate within larger financial services firms that include a limited purpose thrift or trust company that provides various fiduciary, custodial, and asset management services. Some of these members are concerned that the legislation might subject their firm to stricter or more extensive regulation solely on the basis that they operate such a thrift or trust—even though these limited purpose institutions do not accept demand or other deposits from the public or make commercial loans. Such a result seems to ignore the circumscribed nature of the activities conducted by these limited purpose institutions, as well as the regulatory framework under which they already operate, and would not advance the goals of the legislation. We urge that the conferees address these concerns.

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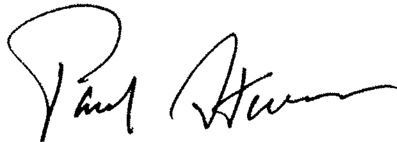
We recognize the significant challenges involved in crafting sweeping reform legislation and look forward to continuing to work with Congress to resolve the issues outlined above.

Sincerely,



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President & CEO
Investment Company Institute

CC: Conferees