August 20, 2024

VIA ELECTRONIC SUBMISSION

Federal Reserve Board of Governors
Attn: Ann E. Misback, Secretary of the Board
Mailstop M-4775, 2001 C St. NW
Washington, DC 20551

Re: Proposed Agency Information Collection Activities; Comment Request, OMB No. 7100–0341

MFA[1] appreciates the opportunity to provide comments on the Board of Governors of the Federal Reserve System's (the "**FRB**") request for comment (the "**Proposed Rule**")[2] to amend the scope of Form FR Y-14 to collect additional information on bank lending to nondepository financial institutions ("**NDFIs**").

MFA supports the FRB's goals in collecting information on Form FR Y-14Q "to assess the capital adequacy of large firms using forward-looking projections of revenue and losses, to support supervisory stress test models, and continuous monitoring efforts, as well as to inform the Federal Reserve's operational decision making."[3] Nonetheless, we believe that the proposed data collection for NDFIs could be better tailored to the FRB's objectives without unduly disrupting banks' relationships with NDFI counterparties. Certain of the proposed new data fields, we note, would be redundant or irrelevant to evaluate NDFI creditworthiness.

We submit these comments to improve the efficacy of the Proposed Rule and ensure it is appropriately risk-based and tailored to different aspects of the asset management industry, which serves all segments of the U.S. private fund community—from retail financial planners to managers serving institutional investors such as pension funds, endowments, and large foundations.

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[1] Managed Funds Association ("**MFA**"), based in Washington, DC, New York, Brussels, and London, represents the global alternative asset management industry. MFA's mission is to advance the ability of alternative asset managers to raise capital, invest, and generate returns for their beneficiaries. MFA advocates on behalf of its membership and convenes stakeholders to address global regulatory, operational, and business issues. MFA has more than 180 member fund managers, including traditional hedge funds, credit funds, and crossover funds, that collectively manage over $3.2 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time.

[2] FRB: Proposed Agency Information Collection Activities; Comment Request, 89 Fed. Reg. 52042 (June 21, 2024), *available at* https://www.govinfo.gov/content/pkg/FR-2024-06-21/pdf/2024-13798.pdf.

[3] FRB, "FR Y-14Q Capital Assessments and Stress Testing", *available at* https://www.federalreserve.gov/apps/reportingforms/Report/Index/FR_Y-14Q.

The private fund industry, both in the US and abroad, is exceedingly diverse in terms of strategies, asset levels, trading needs, and from the bank-dealer's perspective, risk profiles. It would be inappropriate to impose a "one-size-fits-all" borrower template across this diverse and important sector of the US economy.

We of course would be pleased to meet with FRB staff to provide additional background on the industry and context for our comments.

I. Executive Summary

The private fund industry is remarkably diverse, offering a myriad of different investment strategies to sophisticated, primarily institutional investors and as such a one-size fits all checklist of "know your borrower" requirements is ill-suited. Private funds typically provide detailed financial statements to lending banks and, absent extraordinary circumstances, the FR Y-14Q should reflect these long-standing, well-established, well-regulated practices between lending banks and private funds. Thus, we recommend that the FRB refine its approach to reporting requirements to better reflect market practice.

If the FRB decides against adopting our recommendation to base reporting requirements on market practice, we recommend that:

- the FR Y-14Q should only require banks to collect and report "Short Term Debt" or "Long Term Debt" if they already receive such disclosures from counterparty NDFIs on a quarterly basis, such as those contained in borrower financial statements; and

- the instructions should be amended to provide minimum thresholds for disclosure of some fields that are not material to NDFIs.

In addition, we recommend narrowing the definition of "financial sponsor" to control entities as it is overly broad and would capture entities beyond the intended scope of the proposal. Lastly, for proposed field 36, disclosure of "Security Type," the instructions should (i) provide workable definitions for each set of collateral types listed or leave the categories in their current form and (ii) introduce more appropriate granularity.

II. Industry Background and Borrower-Counterparty Risks

To provide context for our comments on specific provisions of the Proposed Rule, first we provide background on the private fund industry, our members, and their relationship with lending banks.

A. Description of the Private Fund Industry

Generally, the term "private fund" refers to a diverse class of pooled investment vehicles sponsored and managed by a single investment adviser. It is typical for an RIA to be affiliated with private funds and to manage several affiliated private funds (referred to herein as a "**Private Fund**" or "**Private Funds**"). Investor monies are pooled together and become assets of the Private Fund, which is usually organized as a limited partnership or limited liability company. In return, an investor acquires an ownership interest (e.g., a limited partnership interest) in the Private Fund in proportion to its contribution. Investors participate in the gains and losses of the Private Fund through their respective ownership interests.

To be eligible to invest in private funds under U.S. federal securities laws, an investor generally must qualify in most cases as a "qualified purchaser," and, less frequently, an "accredited investor," depending on the Private Fund (investors often are required to represent to both standards as a matter of practice). An accredited investor is defined as individuals with a net worth of at least $1 million (not including the individual's primary residence) or annual income of at least $200,000 in the past two years, and institutions with assets in excess of $5 million.[4] A qualified purchaser is defined as individuals with at least $5 million in investments or institutions with at least $25 million in investments.[5] A common minimum subscription amount is $1 million (and often times more).

Private Funds employ a myriad of investment strategies, each creating a distinct risk profile reflecting the strategy and the fund itself. From the perspective of bank considering making a loan to a Private Fund, a Private Fund employing a fundamental-based long-only strategy will have a very different risk profile than a quant fund or a long-short fund or a Private Fund focusing on emerging markets. A lending bank will be required to reserve capital against each Private Fund loan, and of critical importance is the fund itself and the collateral used to secure the underlying loan. The risk profile of a long-short private fund, for example, also will be very different than the risk profile of a private fund or other entity engaged in specialty finance company or a nonbank provider of residential mortgages or auto loans. Application of any know-your-borrower requirements for the lending bank also will be very different depending on the size and nature of the borrower.

B. Private Funds' Relationship with Banks

Private Funds borrow from banks primarily to fund investments, such as financial assets or portfolio companies, with the purpose and structure of the financing depending on the specific investment(s). For example, a credit fund may look to a banking organization to help fund its portfolio of loans and fixed income securities and hedge interest rate risks arising from those holdings. On the other hand, a private equity fund may seek a line of credit to help bridge drawdowns of limited partner capital commitments. Private Funds also may borrow from banks in the form of repurchase agreements, total return swaps and

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4 *See* 17 C.F.R. 230.501(a)(5) and (6) (setting forth the requirements applicable to individual investors); 17 C.F.R. 230.501(a)(3) and (7) (setting forth the requirements applicable to institutions).

5 *See* 15 U.S.C. § 80a-2(a)(51).

other derivative instruments to provide the private fund with additional purchasing power to increase the amount of and value of private fund portfolio holdings. Thus, Private Funds (and NDFIs more generally) are a far cry from a homogenous universe of counterparties, and as such the Proposed Rule's reliance on a prescriptive "checklist" of items for a lending bank to require is misplaced and ill-suited for the diverse array of NDFIs to whom US banks lend.

As such, the information necessary for banking organizations to evaluate creditworthiness of a Private Fund borrower varies based on the Private Fund's strategy and the nature of the collateral. A bank that provides a revolving credit facility to an asset-backed security issuer or credit fund may underwrite the loan primarily based on the assets securing the facility rather than the identity of the borrower, whereas a bank that lends to a private credit fund in connection with an investment in a portfolio company may underwrite the loan based on the fund's track record and the financial performance of the target company, with different collateral requirements. Still different are the underwritings of syndicated loans where the private credit fund is a purchaser of the loans underwritten by multiplate banks in a syndicate. NDFI borrowers other than Private Funds will provide still different types of collateral (such as rights to the underlying mortgages for a NDFI mortgage originator).

Private Funds typically provide annual audited financial statements in connection with the initial loan, supplemented with ongoing quarterly financial (and other) information in the form of specific reporting standards based on the bank's assessment of the counterparty (typically including a borrowing base certificate) and/or the fund's unaudited quarterly financial statements (prepared in accordance with GAAP or an equivalent accounting standard), as well as annual audited financial statements following each year end when the facility is outstanding. Additional contractual protections also exist for the lending bank, such as notification requirements for a change in auditor or custodian (in addition to other material events), and protections against the departure of key personnel. The critical point is that the lending bank has conducted extensive due diligence and underwriting on the borrowing counterparty and is best positioned to identify and require that information the bank reasonably determines necessary to satisfy its risk management obligations.

III. Specific Comments on the Proposed Rule

A. Private funds typically provide detailed financial statements to lending banks and, absent extraordinary circumstances, the FR Y-14Q should reflect these long-standing, well-established practices.

In the preamble to the Proposed Rules, the FRB asks, "Which, if any, of the financial data fields (fields 52 through 82) would be especially difficult to provide for NDFI obligors due to differences in financial statement frameworks or other obstacles?"[6]

Market Practice. Notwithstanding any regulatory reporting mandate, as part of simple good business practices, banks typically negotiate reporting requirements with counterparties to ensure the bank can monitor the risks a counterparty poses on an individual and portfolio level, often building in contractual protections to mitigate those risks. For example, a bank may restrict the type of assets in which a counterparty NDFI may invest and require regular reports of asset levels to evidence compliance. Many of these disclosure requirements have become market practice, and reflect data-driven differentiation based on a variety of factors, including counterparty type (*e.g.*, a credit fund will be treated differently from a long-short equity fund). The large number of financial institutions and NDFIs has thus resulted in an efficient "market of terms" that strikes an appropriate balance between a bank's safety and risk management concerns on the one hand, and the counterparty's compliance and operational burdens on the other hand. The development of such market practices is well understood by bank lenders and Private Fund borrowers and has evolved through multiple market cycles.

The FR Y-14Q, as proposed to be amended, should recognize these well-developed practices, with banks collecting and reporting to regulators borrower financial information that is aligned with information they already receive from counterparty NDFIs on a quarterly basis. For example, a bank that receives quarterly unaudited financial statements from a Private Fund would only report information actually received, absent a specific determination by the lending bank that additional information is warranted based on the financial information it received or other information learned by the bank. A bank that receives more frequent or more detailed reporting not because it wants or needs the information to assess credit risk, but solely to report additional information to regulators, will only increase the compliance and operational burdens on the lending bank, and increase the likelihood of erroneous information being reported to regulators. This is particularly true when the categories of information requested do not align with or are irrelevant to the activities and investments of the Private Funds that a bank is lending to (as discussed further herein), creating the risk of "junk data" being reported.

[6] 89 Fed. Reg at 52046.

It therefore is important that the lending bank, which is in the best position to assess its risk in lending to the NDFI, be permitted to tailor its reporting requirements to reduce the burden on the banks and NDFIs. A flexible, risk-based approach also would reduce the FRB's burden by omitting any unnecessary items and disclosing only the items that are most relevant to measuring counterparty risk. In particular, this would permit the FRB to customize disclosure requirements according to the idiosyncratic risks of NDFIs without having to engage itself in the time-intensive market research that would be involved in designing such measures *ex nihilo*.

We also would note, as we discuss in greater detail below, that a number of the items that would be required under the Proposed Rule are simply inapplicable to Private Funds. Data elements such as inventory, for example, are more appropriate for an operating company as opposed to a Private Fund and MFA recommends that the Proposed Rule be adopted to expressly carve-out those data elements that are inapplicable to a Private Fund.

GAAP Financial Statements. The most common form of reporting required by banks and provided by Private Funds is in the form of the Private Fund's most recent annual audited financial statements, supplemented by unaudited quarterly financial statements based on Generally Accepted Accounting Principles ("**GAAP**"). Accounting standards, such as GAAP provide clear, consistent, and comparable information on borrowers' financial condition. Auditing standards work together with accounting standards to ensure that those financial statements that purport to be prepared in accordance with accounting standards can be independently verified.[7]

For purposes of credit underwriting, financial statements thus provide a common set of information by which banking organizations (and Private Fund investors) can evaluate the Private Fund borrower's financial performance and creditworthiness. Moreover, standards for the preparation and presentation of financial statements balance the need for useful, detailed information against the need for a broadly applicable baseline of financial information that enhances comparability. Thus, banks that choose to require GAAP financial statements also utilize the GAAP standards to balance reporting costs against utility. MFA urges the proposed amendments to the FR Y-14Q to be revised to not require reporting of data items that would go beyond GAAP standards, unless banks themselves have determined that additional information is necessary as part of their underwriting process. Banks are in the business of lending and have developed robust and risk-based information requirements from NDFI borrowers that have long been the subject of fulsome regulatory oversight and development and at the bank are buttressed by detailed corporate governance, risk management, and internal audit processes.

[7] The Public Company Accounting Oversight Board has adopted similar standards for audits for public companies.

We note that from a risk-management perspective, audited financials may not be necessary or appropriate for all NDFI borrowers. A newly-formed entity, such as a collateralized loan obligation fund that has not commenced the warehousing process, may not have assets or income to audit and in these cases requiring fund investors to bear the expense of an audit would be an imprudent use of fund investor assets. Here, the lending bank should be entitled to rely on its own due diligence, including knowledge of the borrowing manager and verification of its assets and income, and not insist on an audit of a newly formed entity with no assets.

Evasion Risk. Understandably, the FRB may be concerned that narrowing the required disclosures in this way would increase the risk of evasion, but these concerns are exceedingly unlikely to materialize in practice. First, as noted, the banks have an interest in ensuring they receive the information they need to evaluate the credit risk of any loan they make, so their interests are aligned with the FRB's. Second, the reporting requirements in Form FR Y-14Q are secondary to the bank's regulatory obligation to properly account for counterparty credit risk, which is also supervised by the FRB (or other bank regulators). Many Private Fund-bank lending relationships have existed and flourished for years: the banks know very well the Private Funds to which they are lending. Lastly, and most importantly, if the FRB determines that a bank is "evading" the reporting requirement by amending its counterparty's required disclosures, the bank would be violating its existing regulatory obligations, and the FRB has the authority to require the bank to revert to its original practice and/or take additional action against the bank.

Alternative. If the FRB decides against adopting our recommendation to base reporting requirements on market practice, we recommend that the FRB adopt at least the following 2 alternatives:

1. <u>The FR Y-14Q should only require banks to collect and report "Short Term Debt" or "Long Term Debt" if they already receive such disclosures from counterparty NDFIs on a quarterly basis, such as those contained in borrower financial statements.</u>

Two items that would be particularly burdensome, and particularly unnecessary for NDFIs to report quarterly (if they do not already do so) would be short term debt and long-term debt holdings. General market practice for many Private Funds is to report short- and long-term debt only annually, typically supplemented with quarterly certifications. As discussed in our general recommendation, adding these elements to the Form FR Y-14Q would require NDFIs to report these more frequently despite the bank's risk-based determination not to require quarterly reporting. Again, banks are best positioned to determine the information and reporting they reasonably require to manage credit risk.

Moreover, short-term and long-term debt can often play key roles in executing a Private Fund's strategy, and providing disclosure of this sensitive, proprietary information more frequently increases the risk that an NDFI will be required to divulge proprietary information that the NDFI would consider to be a trade secret and critical to its investment strategy. For example, an NDFI that has an investment strategy based on interest rates may have a portfolio of short- and long-term debt obligations; reporting the shifts in such strategy every quarter provides competitors crucial information on its strategy in a manner that would not enhance the banking organizations' ability to evaluate the creditworthiness of the counterparty (as determined by the banking organization itself).

Thus, we would recommend excluding any unnecessary and potentially dangerous more granular reporting of "Short Term Debt" and "Long Term Debt" from the list of fields an NDFI must report quarterly given the burden and prominence of such items in an NDFI's strategy, unless the lending bank has already required, and the NDFI has already agreed, to report such fields to the bank quarterly.

2. The instructions should be amended to provide minimum thresholds for disclosure of some fields that are not material to NDFIs

Unlike commercial enterprises, NDFIs typically do not generate profit from sales of assets or services. As such, many of the fields in the current Form FR Y-14Q are inapplicable or immaterial to most NDFIs and the FRB would gain no utility in collecting such disclosures, even where they are reportable in a financial statement. If the FRB only required banks to report information the bank currently receives, many of these items would be filtered out by market practice or GAAP financial requirements, but if that recommendation is not implemented, given the limited value of many of these items, we would recommend adding de minimis qualitative or quantitative qualifiers on these items, either specific to NDFIs or widely applicable. Fields we would recommend qualifying include:

- Net Sales (Current and Prior Year);
- Operating Income;
- Depreciation & Amortization;
- Accounts Receivable (A/R) (Current and Prior Year);
- Inventory (Current and Prior Year);
- Current Assets (Current and Prior Year);
- Tangible Assets;
- Fixed Assets;
- Accounts Payable (Current and Prior Year);
- Retained Earnings; and
- Capital Expenditures.

Of course, some of these items might be material to some NDFIs; for example, "Tangible Assets" can include real estate and so would likely be a key disclosure for NDFIs providing financing to downstream commercial or residential real estate borrowers. However, if such assets are material to an NDFI's strategy, then the item would likely be above any minimum threshold the FRB sets and would be disclosed. Assigning a *de minimis* threshold would allow the FRB to capture NDFIs that may execute unique strategies that implicate these items, but would avoid the redundancy of having other NDFIs track and disclose items that are not relevant to their strategy.

B. The definition of "financial sponsor" is overly broad and will capture unintended entities.

The definition of "financial sponsor" is overly broad and would include any entity that is in the principal business of acquiring, holding, and selling investments that is not integrated with another entity. We think that this definition is overly broad and would capture a myriad of intermediate holding companies that may not be in "control" relationships with the NDFI borrower. We recommend narrowing the definition of "financial sponsor" to those entities that control – i.e., have the legal authority to direct the policies of the NDFI.

C. No matter which recommendation above is adopted, for proposed field 36, disclosure of "Security Type," the instructions should (i) provide workable definitions for each set of collateral type listed or leave the categories in their current form and (ii) introduce more appropriate granularity.

The Proposed Rule would expand the types of categories listed in the "Security Type" field (field 36). The preamble notes that this is aimed at providing more granularity in the types of collateral reported, and in that vein, the Proposed Rule also includes a field if a bank marks the "Security Type" as "other" to "capture the full range of collateral types."[8] While we appreciate the intention to achieve more granularity in disclosure, the expanded list in the Proposed Rule does not use established industry terms or provide definitions for any of the items on the list. For example, "leveraged loan" is not a term of art and is not defined, so it is not clear what types of loans would fit in the category of "Corporate loans –Leveraged" where banks could take different interpretations. Without more specific guidelines to implement the categories list, banks will use their own definitions, making disclosures significantly less standardized and comparable. These ambiguities are likely to lead many banks and counterparties to report disparate items in the "other" category, further diluting the usefulness of the disclosure.

Moreover, if the aim of the disclosure is to understand the risk inherent in a position, the FRB should break down larger categories of loans based on other characteristics, such as seniority. Understanding whether a loan is a first lien loan, a second lien loan, a PIK loan or etc. would better capture the division between more and less risky loans, and without this level of granularity, data collected will be less useful and potentially misleading.

We therefore recommend that the FRB (i) define the terms in this field or use more established terms and (ii) increase the granularity of the disclosure to collect more useful data.

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8 *Id.*

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MFA reiterates its strong support of the FRB's goals to evaluate the capital adequacy of large bank holding companies and optimize stress testing and has long supported the FRB's effort to promote safety and soundness in the banking system. We appreciate the opportunity to provide these comments to the FRB in response to the Proposed Rule. If you have any questions about these comments, or if we can provide further information, please do not hesitate to contact Jeff Himstreet (jhimstreet@mfaalts.org) or the undersigned (jflores@mfaalts.org).

Respectfully submitted,

/s/ Jillien Flores

Jillien Flores
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