INTERNATIONAL ASSOCIATION
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Questionnaire concerning the implementation of the BASEL III guidelines and the regulatory framework for Managers of Alternative Investment Funds

Banking, Finance and Capital Markets Law Commission

52nd Annual AIJA Congress

Prague, 2014

USA National Report

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1. **Introduction**

2. **The implementation of the Basel III guidelines**

2.1 Is there a basic intend in you country to implement the Basel III guidelines?

If yes: Why does your country intend to implement the Basel III guidelines?

Yes, in July 2013 the Federal Reserve Board of Governors approved final rules for implementation of Basel III. "The Final Rule brings the United States substantially into compliance with the Basel III capital framework agreed upon internationally in December 2010, replaces the existing US modified Basel I risk-based capital regime (the "Current Rules") with one based in part on the Basel II standardized approach (previously proposed but not adopted in the United States) and in part on the Basel II advanced approaches, and implements several changes to the US regulatory capital regime required by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). The new US capital framework imposes higher minimum capital requirements, additional capital buffers above those minimum requirements, a more restrictive definition of capital, and higher risk weights for various assets, which in combination result in substantially more demanding capital standards for US banking organizations."[1]

"Aside from a handful of key changes primarily responding to the concerns of smaller, less complex banking organizations and some technical clarifications, the major elements of the capital framework adopted in the Final Rule are largely unchanged from the Agencies' capital proposals issued in June 2012 (collectively, the "Proposed Rules").[2]

If not: What is the reason for not implementing the Basel II guidelines?

If not: What is planed instead? Are there any similar rules already in force in your country?

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1 (http://www.mayerbrown.com/files/Publication/faa77388-68ec-407c-b3a9-764c3067854a/Presentation/PublicationAttachment/04485ac9-4866-480e-bf61-d2b9bfb65328/UPDATE-Corp_Final_Rule-to-Implement_Basel_III_Approved_0713_V2.pdf)

2 http://www.mayerbrown.com/files/Publication/faa77388-68ec-407c-b3a9-764c3067854a/Presentation/PublicationAttachment/04485ac9-4866-480e-bf61-d2b9bfb65328/UPDATE-Corp_Final_Rule-to-Implement_Basel_III_Approved_0713_V2.pdf

2.2 In which stage of the implementation of the Basel III guidelines is your country currently? When will the rules be enacted?

Initially proposed rules had set a Jan. 1, 2013 deadline, though the main regulators responsible for the implementation (Federal Reserve, FDIC, and Comptroller of the Currency) had not completed the rules in time, according to press reports in 2013 when the final rules were prepared. According to the Federal Reserve, the US is now in "substantial compliance."

2.3 Is there a delay in the implementation of the Basel III guidelines? If yes, what is the main cause for it?

The Federal Reserve indicated that the reasons for delay were technical, and assured financial regulators in the EU of the US intention to implement the rules (despite not having implemented Basel II).

2.4 Does the national implementation of the Basel III guidelines meet, exceed or undercut the stated minimum standards concerning the below mentioned issues?

The Federal Reserve recently issued rules aligning the market risk capital rules with Basel III.[3]

According to the official publication in the Federal Register, "The final rule also adopts changes to the agencies' regulatory capital requirements that meet the requirements of section 171 and section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act. … The proposed minimum capital requirements in section 10(a) of the Basel III NPR, as determined using the standardized capital ratio calculations in section 10(b), would establish minimum capital requirements that would be the ''generally applicable'' capital requirements for purpose of section 171 of the Dodd-Frank Act."[4]

"Regarding the counter-cyclical capital buffer, "the agencies are adopting most aspects of the proposals, including the minimum risk-based capital requirements, the capital conservation and countercyclical capital buffers, and many of the proposed risk weights. The agencies have also decided to apply most aspects of the Basel III NPR and Standardized Approach NPR to all banking organizations, with some significant changes. Implementing the final rule in a consistent fashion

[3] (http://www.federalreserve.gov/newsevents/press/bcreg/20131206a.htm)

[4] (http://www.gpo.gov/fdsys/pkg/FR-2013-10-11/pdf/2013-21653.pdf)

across the banking system will improve the quality and increase the level of regulatory capital, leading to a more stable and resilient system for banking organizations of all sizes and risk profiles. The improved resilience will enhance their ability to continue functioning as financial intermediaries, including during periods of financial stress and reduce risk to the deposit insurance fund and to the financial system. The agencies believe that, together, the revisions to the proposals meaningfully address the commenters' concerns regarding the potential implementation burden of the proposals."[5]

The Final Rule adopts "new minimum capital ratios that are consistent with the Basel III international package and unchanged from the Proposed Rules. These include a new 4.5% common equity tier 1 ("CET1") capital requirement, a 6.0% tier 1 capital requirement (increased from 4.0% under the Current Rules), and an 8.0% total capital requirement (same as under the Current Rules)."[6]

"The Final Rule requires that all banking organizations maintain a "capital conservation buffer" consisting of CET1 capital in an amount equal to 2.5% of risk-weighted assets in order to avoid restrictions on their ability to make capital distributions and to pay certain discretionary bonus payments to executive officers. Banking organizations with capital levels that fall within the buffer will be forced to limit dividends, share repurchases or redemptions (unless replaced within the same calendar quarter by capital instruments of equal or higher quality), and discretionary bonus payments."[7]

"The Final Rule imposes a tier 1 minimum leverage ratio of 4.0% for all banking organizations and an additional supplementary tier 1 leverage ratio of 3.0% for Advanced Banks. The 3.0% supplementary leverage ratio (which, consistent with Basel III, will take effect in January 2018 but be reported beginning in January 2015) incorporates in the denominator certain off-balance sheet exposures that are not included in the standard leverage ratio."[8]

If you country does not implement one of the above mentioned Basel III standards, is there any alternative regulation?

N/A

[5] (http://www.gpo.gov/fdsys/pkg/FR-2013-10-11/pdf/2013-21653.pdf)

[6] http://www.mondaq.com/unitedstates/x/251298/Commodities+Derivatives+Stock+Exchanges/Bank+Regulators+Approve+Final+Rule+To+Implement+Basel+III+Capital+Requirements+In+The+United+States

[7] Ibid.

[8] Ibid.

2.5 How many systematically relevant financial institutions are located in your jurisdiction?

Eight U.S. banks are considered to be systemically important, according to the FDIC (Federal Deposit Insurance Corporation and the Financial Stability Board.9

2.6 How does your country regulate the capital requirements for systematically relevant financial institutions?

US financial institutions are required to file a detailed Resolution Plan with the Federal Reserve and Federal Deposit Insurance Corporation or submit to an annual Federal Reserve Stress Test.

2.7 Do you think that many banks in your country will struggle to meet the requirements of Basel III? Why do you think so?

No, sound financial institutions with an understanding of the issues that led to the last downturn will be forced by the regulators and by their shareholders – as well as by peer pressure of other banks – to meet these requirements and avoid difficulties that plagued the financial system in the last decade.

3. Regulatory Framework for Managers of Alternative Investment Funds

3.1 Is there any legislation in your jurisdiction concerning Managers of Alternative Investment Funds?

Yes, the Dodd-Frank Act of 2010 (the Dodd-Frank Wall Street Reform and Consumer Protection Act. Requirement that certain investors who were previously exempt now register under the 1940 Act. There are also various state and local laws regulating hedge funds. Whether a fund has to be registered depends on the size of the "Regulatory Assets Under Management" as determined by the SEC.

3.2 Is your jurisdiction member of the EU or the EAA and therefore legally obligated to implement the AIFM directive 2011/61/EU? If yes: Is the implementation of the AIFM directive 2011/61/EU already successfully completed?

No.

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9 http://www.fdic.gov/regulations/reform/resplans/ and http://www.financialstabilityboard.org/publications/r_111104bb.pdf.

3.3 At which point in time was the legislation concerning AIFM enacted?

N/A

3.4 What is the name of the competent supervisory authority for Alternative Investment Funds in your country?

Certain hedge funds are regulated by the U.S. Securities and Exchange Commission while others are regulated by the Commodity Futures Trading Commission (depending on the number of investors and/or the size of the fund, with funds having more investors and/or of a greater size being required to register with the SEC).

3.5 Which minimum-capital does an AIFM require in order the obtain a licence or authorization?

There are no minimiums. Hedge funds are subject to the same trading reporting and record-keeping requirements as other investors in publicly traded securities.[10]

3.6 How long is the duration of authorisation process to obtain an AIFM-Licence?

This depends on which regulator is accepting the registration, the size of the fund, whether it has been identified as having elements of systemic risk.

3.7 What are the key elements of the authorisation process?

Reporting to the regulatory agency (including quarterly and annual reports for larger funds) and registration of the managers, fund type and investors targeted.

3.8 Is it mandatory for AIFM to have a local residence in your jurisdiction?

A hedge fund would have to have a registered office in the jurisdiction (state) where it is incorporated as well as in any state where it is authorized to operate. Not surprisingly, Delaware is a popular choice for corporate registrations.

3.9 Does the legislation distinguish between different types of AIFM? What are the key differences between them?

Yes, there are various corporate structures for investment funds, (see question 3.10) and various regulatory and registration requirements, depending on the type of corporate structure, the type of investments, and the investors to whom the fund is marketed.

[10] https://www.managedfunds.org/issues-policy/issues/globalhedge-fund-regulation/

3.10 Are there any legislative restrictions regarding legal structures of AIFM?

Generally hedge funds in the United States are set up as limited partnerships (often for taxation purposes). They may also be set up as corporations (generally limited liability corporations) with the specific legal entity typically chosen for tax purposes.

3.11 If you are a member of the EU or EEA, can AIFM in your country obtain an EEA/EU Passport which enables to distribute AIFs to professional investors?

N/A

3.12 Do AIF themselves require to be licensed or authorised by a competent supervisory authority?

Yes, as described in more detail in the response to point 3.4 above.

3.13 How are AIFs categorized and what is the authorisation or licence requirement for each category?

Funds in the US are generally categorized by the type of investments (equities, fixed income, long and short funds, etc.

3.14 How long does the process of authorisation or licensing of AIFs take?

This depends on how many levels of registration are necessary. Obviously, if no registration is required, then it will only take the time necessary to set up a partnership or corporation, which could be done in a matter of minutes or hours. It would take longer to prepare the necessary offering documentation. If registration with the SEC or elsewhere is needed, this could take several weeks or more.

3.15 Are there certain legal structures for AIFs? Please name them.

Yes, see the response to question 3.10.

3.16 What are the key differences with reference to the authorisation and marketing of AIFs that are distributed to retail investors and those only distributed to professional investors?

See the response to question 3.18.

3.17 Are there any special requirements for leveraged AIFs?

Not that I am aware of, beyond those described for all types of hedge funds.

3.18 Are there any special regulations with regard to private investors or semi-professional investors?

Generally hedge funds can only be offered to “accredited investors” including institutional investors and high-net-worth individuals. There is a further limitation under the Investment Company Act of 1940 to “qualified purchasers.”