January 16, 2024

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, D.C. 20551
Attention: Ann E. Misback, Secretary

Federal Deposit Insurance Corporation
550 17th Street NW
Washington, D.C. 20429
Attention: James P. Sheesley, Assistant Executive Secretary, Comments/Legal OES

Office of the Comptroller of the Currency
400 7th Street, SW, Suite 3E-218
Washington, D.C. 20219
Attention: Chief Counsel's Office, Comment Processing

Re: Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity (Federal Reserve Docket No. R1813, RIN 7100-AG64; FDIC RIN 3064-AF29; Docket ID OCC-2023-0008)

Ladies and Gentlemen:

Nuveen Fund Advisors, LLC ("Nuveen") appreciates the opportunity to comment on the joint notice of proposed rulemaking issued by the Board of Governors of the Federal Reserve System, the Officer of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively, the "Agencies") to revise the risk-based regulatory capital requirements for large U.S. banking organizations (the "Proposal").[1] The Proposal would implement, with modifications, the international capital standards set in response to the 2008 financial crisis by the Basel Committee on Banking Supervision in 2010 and revised in 2017 ("Basel III"). The Proposal would also standardize certain capital requirements across all U.S. banking organizations with total assets of at least $100 billion and their depository institutions subsidiaries ("large U.S. banks"), rather than only applying to subsets of large U.S. banks as is currently required. While directly applicable to large U.S. banks, the Proposal also would affect bank counterparties and the broader financial system through everyday lending, mortgages and retail banking.

Nuveen is the asset management arm of the TIAA group of companies and is the largest adviser of closed-end investment companies registered under the Investment Company Act of 1940 ("closed-end funds"), advising 46 closed-end funds. Nuveen advises 28 municipal closed-end funds which invest primarily in municipal bonds that are exempt from federal income tax. Closed-end funds, including municipal bond funds, may issue preferred stock to seek to enhance fund returns. Currently, Nuveen closed-end funds have $12.9 billion in preferred stock outstanding, and over $6.2 billion of this is directly held by large U.S. banks.

[1] *See Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity*, 88 F.R. 64028 (Sept. 18, 2023).

We appreciate and agree with the concerns raised by both the Investment Company Institute and Securities Industry and Financial Markets Association in their letters submitted in response to the Proposal. Although we appreciate the Proposal's policy objectives, we have serious concerns about its sweeping nature and its potential impact on closed-end funds that have issued, or may issue, preferred stock. In particular, the Proposal's introduction of a new definition for "subordinated debt instrument" could be interpreted to include preferred stock issued by closed-end funds. Such a result could significantly harm closed-end funds and raise costs for investors who tend to be individuals, would be flatly inconsistent with the stated policy purposes underlying the new definition and would further no other legitimate policy purpose.

I. Potential Treatment of Closed-End Fund Preferred Stock Under the Proposal

The Proposal would introduce the new defined term "subordinated debt instrument" and generally would assign a 150 percent risk weight to such exposures.[2] Among other instruments, the proposed definition would include "any preferred stock that is not an equity exposure."[3] The proposed definition could be interpreted to include preferred stock issued by closed-end funds. We believe such a result would be erroneous and potentially harmful while furthering no legitimate policy purpose.

The Agencies state in the Proposal that the definition of "subordinated debt instrument" is "meant to capture the types of entities that issue subordinated debt instruments *and for which the level of subordination is a meaningful determinant of the credit risk of the instrument*."[4] As discussed below, preferred stock issued by closed-end funds does not carry the same subordination risks that are present in typical preferred stock offerings by operating companies for both structural and regulatory reasons. Further, if applicable to closed-end fund preferred stock, the proposed definition would assign a greater risk weight than the weight assigned to closed-end fund common stock, despite the fact that common stock poses a greater risk of loss than preferred stock and has a lower priority than preferred stock with respect to distributions and in the event of a fund's liquidation.[5]

II. Preferred Stock of Closed-End Funds Is Less Risky Than Operating Company Preferred Stock and Other Subordinated Debt Instruments

Closed-end funds are subject to a comprehensive statutory and regulatory regime under the Investment Company Act of 1940 (the "1940 Act"), which provides specific and meaningful protections for holders of closed-end fund preferred stock that has no analogue to the operating company context.[6] Further, the vast majority of closed-end funds also must meet diversification requirements with respect to their investments under the Internal Revenue Code that serve to reduce risk as compared to operating companies, which may be focused on a particular line of products or services. Certain prevailing and protective market practices also set closed-end preferred stock apart from operating company preferred stock. These differences strongly support different treatment under the capital requirements.

---

[2] Proposal at 64043.
[3] Proposal at 64187.
[4] Proposal at 64042 (emphasis added).
[5] *See* 12 C.F.R. § 217.53; 88 F.R. 64028, 64078. Currently and under the Proposal, closed-end fund common shares generally are treated as "equity exposures." For risk-weighting purposes, these are permitted to be "looked through" to the underlying investments of the closed-end fund, which often results in a risk weight significantly lower than 150 percent.
[6] 15 U.S.C. §§ 80a-1 – 80a-64.

A. Asset Coverage Requirement of Closed-End Fund Preferred Stock

Under the 1940 Act, closed-end funds must have at least 200 percent asset coverage for any preferred stock at the time of issuance and upon the declaration date of any common share distribution.[7] This means that for each $1.00 of closed-end fund preferred shares issued, the fund must have $2.00 of assets to cover the preferred shares. There is no such regulatory requirement for preferred shares of operating companies. Further, the 1940 Act allows closed-end funds to subordinate their preferred stock only to senior securities subject to 300 percent asset coverage.[8] The preferred stock of operating companies can be subordinate, and often is subordinate, to both secured and unsecured senior securities with no regulatory asset coverage requirement. In addition to this regulatory requirement, the provisions in closed-end fund preferred stock documentation typically require higher asset coverage than 200 percent (e.g., 225 percent) and typically will require a closed-end fund to cure any breach of such provisions reasonably quickly. There typically are also provisions that limit a closed-end fund's use of "effective leverage," which includes senior debt securities, preferred stock and/or borrowings, in addition to the leverage effects of certain derivatives and other investments. These regulatory and practical asset coverage requirements significantly reduce the risk of default of preferred stock issued by closed-end funds as compared to preferred shares issued by the typical operating company. In a liquidation scenario, it would be highly unlikely that a preferred shareholder of a closed-end fund does not recoup their investment.

B. Structural Protections Generally under the 1940 Act, Internal Revenue Code, and Prevailing Market Practices

The 1940 Act and the rules thereunder provide additional structural protections which meaningfully differentiate preferred stock of closed-end funds from those of operating companies. The statutory framework of the 1940 Act and the rules thereunder applicable to closed-end funds: (i) significantly limit transactions between closed-end funds and their affiliates to prevent affiliated persons from taking advantage of closed-end funds;[9] (ii) require disclosure of and limit changes to fundamental investment policies without shareholder approval;[10] (iii) restrict investments in securities of other registered investment companies[11] (including other closed-end funds),[12]

---

[7] *See* § 80a-18(a)(2).

[8] *See* § 80a-18(a)(1).

[9] *See* §§ 17(a), 17(d). 17 C.F.R. §§ 270.0-1(a)(7), 17a-7, 17d-1 (generally prohibiting affiliated persons, acting as principal, (1) from buying property from, or selling property to, a fund and (2) from participating in or effecting any transaction in which a fund is a joint or a joint and several participant with the affiliate without prior SEC approval). *See also* 15 U.S.C. § 80a-10(f) (prohibiting knowingly acquiring any security during an underwriting when a principal underwriter of the security is an affiliate of the company).

[10] *See* § 80a-8(b)(1)-(2) (including policies regarding classification and sub-classifications of the fund, borrowing money, issuance of senior securities, underwriting securities of other persons, concentration, transactions in real estate and commodities, making loans to others, portfolio turnover, and any other policies that may only be changed by shareholder vote). *See also* § 80a-13(a).

[11] *See* § 80a-12(d)(1)(A) (generally limiting investments by a fund to: (1) no more than 3% of the total outstanding voting stock of any one investment company; (2) securities issued by an investment company having an aggregate value of no more than 5% of the value of the total assets of the investing fund; or (3) securities issued by an investment company and all other investments companies (other than treasury stock of the investment company) having an aggregate value of no more than 10% of the total value of the assets of the investing fund). Rule 12d1-4 under the 1940 Act provides certain exemptions to these requirements, but contains provisions designed to prohibit complex funds of funds structures. *See* 17 C.F.R. § 270.12d1-4.

[12] *See* 15 U.S.C. § 80a-12(d)(1)(C) (prohibiting a fund and any company controlled by the fund from acquiring any security issued by a closed-end fund, if immediately after such acquisition, the fund, other investment companies having the same investment adviser, and companies controlled by such investment companies own more than 10% of the total outstanding voting stock of the closed-end fund).

insurance companies,[13] and securities-related issuers;[14] (iv) impose borrowing limitations, including on the use of derivatives;[15] (v) restrict loan making;[16] and (vi) impose fair valuation methodologies that require a closed-end fund that strikes a daily net asset value per share to mark its investments to market on a daily basis.[17] Furthermore, closed-end funds are only permitted to issue one class of preferred stock under the 1940 Act, whereas operating companies generally may issue any number.[18] Distributions for closed-end fund preferred stock also must be cumulative, which are required, fixed distributions of earnings.[19] Finally, closed-end fund preferred shareholders, voting as a class, are entitled to elect at least two directors at all times and to vote along with common shareholders on the remaining directors.[20] There is no comparable regulatory framework for operating companies, which results in their preferred stock being inherently more risky than that of closed-end funds.

Further, the vast majority of closed-end funds are managed to meet the regulated investment company ("RIC") diversification requirements under the Internal Revenue Code which requires exposure to different companies.[21] Compare this to operating companies, which generally are

[13] *See* § 80a-12(d)(2) (prohibiting a fund from purchasing or otherwise acquiring any security issued by or other interest in an insurance company if the fund and any company controlled by the fund will hold in the aggregate greater than 10% of the insurance company's outstanding voting stock).

[14] *See* § 80a-12(d)(3); 17 C.F.R. § 270.12d3-1 (generally prohibiting a fund or any company controlled by the fund may acquire securities of any issuer that derives more than 15% of its revenues from securities-related activities (including securities brokerage, underwriting and investment advisory services) only to the extent that immediately after such purchase, the fund: (1) owns not more than 5% of a class of outstanding equity securities of the issuer; (2) owns not more than 10% of the outstanding principal amount of the issuer's debt securities; and (3) has invested not more than 5% of the value of its total assets in the securities of the issuer).

[15] *See* 15 U.S.C. §§ 80a-18(a)(1), 80a-18(g); and 17 C.F.R. § 270.18f-4. Sections 18(a) and (g) of the 1940 Act prohibit a closed-end fund from engaging in borrowing and entering into other indebtedness unless: (a) the fund has asset coverage of 300% for all borrowings and other indebtedness of the fund (calculated at the time of borrowing and as the ratio of the fund's total assets (less all liabilities and indebtedness not represented by senior securities) over the aggregate amount of the fund's outstanding senior securities representing indebtedness) and complies with certain additional limits; or (b) such borrowing is for temporary purposes only, provided that such temporary borrowings are in an amount not exceeding 5% of the fund's total assets at the time when the borrowing is made). Rule 18f-4 under the 1940 Act permits a fund to enter into derivatives transactions and other transactions that create future payment or delivery obligations, including short sales, notwithstanding the senior security provisions of the 1940 Act as discussed above if the fund complies with certain value-at-risk leverage limits and derivatives risk management program and board oversight and reporting requirements or complies with a "limited derivatives users" exception limiting the fund's derivatives notional value to 10% of the fund's net assets on an ongoing basis. Rule 18f-4 also permits a fund to enter into reverse repurchase agreements or similar financing transactions notwithstanding the senior security provisions of the 1940 Act as discussed above if the fund either (1) aggregates the amount of indebtedness associated with its reverse repurchase agreements or similar financing transactions with the aggregate amount of any other senior securities representing indebtedness when calculating its asset coverage ratios as discussed above or treats all such transactions as derivatives transactions for all purposes under Rule 18f-4.

[16] *See* 15 U.S.C. § 80a-21 (prohibiting a fund from lending money or property to any person if (1) the loan is prohibited by the fund's investment policies, or (2) the borrower controls or is under common control with the fund, other than a company which owns all of the outstanding securities of the fund).

[17] *See* 17 C.F.R. §§ 270.2a-5; 31a-4 (requiring (1) periodic assessments and management of valuation risks, (2) establishment and application of fair value methodologies to fund investments (3) fair value determinations be made by the fund's board or a "valuation designee" and (4) funds or their advisers to maintain appropriate documentation to support fair value determinations).

[18] *See* 15 U.S.C. § 80a-18(c).

[19] *See* § 80a-18(a)(2)(E).

[20] *See* § 80a-18(a)(2). This section also provides preferred shareholders a right to elect a majority of the directors if at any time dividends on the preferred stock are unpaid in an amount equal to two full years' dividends on the preferred stock, which right would continue until all dividends have been paid in arrears or otherwise provided for.

[21] To qualify as a RIC under the Internal Revenue Code, a fund must satisfy a two-part diversification standard. *See* 26 U.S.C. § 851(b)(3)(A). To qualify, on the close of each quarter of the taxable year at least 50% of the fund's total

dependent on a singular management team and may be dependent on a particular product or service line. The availability of "look-through" treatment for investments in common stock of closed-end funds under both the current rule and the Proposal highlights this point. The primary risks of a closed-end fund are derived from the risks of its exposures to other companies rather than internal risks.

Additionally, closed-end fund preferred stock benefits from prevailing and protective market practices that preferred stock of operating companies generally do not. For instance, to our knowledge, substantially all closed-end fund preferred stocks are investment grade and generally include mandatory de-leveraging provisions in the event asset coverage declines.[22] Closed-end fund preferred stock also typically includes provisions limiting the closed-end fund's ability to issue debt senior to the preferred stock.

III. Treating Preferred Stock of Closed-End Funds as a Subordinated Debt Instrument Will Have an Adverse Market Impact

If the definition of "subordinated debt instrument" was interpreted to include preferred stock of closed-end funds, it would significantly disincentivize large U.S banks, which are the predominant investors in closed-end fund preferred stock, from purchasing such preferred stock. If large U.S. banks are no longer available as a source of investment in preferred stock, many closed-end funds would be forced to seek leverage capital from alternative sources, which likely would be more costly and less stable. Any increased expenses for closed-end funds would be passed on to common shareholders, which are predominately individuals. Forcing closed-end funds to seek alternative sources of borrowings also would interject a significant amount of unintended refinancing risk into this market segment because alternative preferred sources of capital are considerably less predictable. If municipal closed-end funds, which often issue preferred stock, for example, needed to transition from preferred stock to debt sources of borrowings (also typically provided by banking organizations), we estimate that the cost of capital would increase by more than 1.5 percent in today's market environment without any meaningful difference in risk exposure to banking organizations. These unintended negative consequences for closed-end funds would result from regulatory action not taken by their primary regulator, the Securities and Exchange Commission.

Additionally, this aspect of the proposal would negatively impact large U.S. banks. As noted above, substantially all closed-end fund preferred stock is rated investment grade. Specifically, the preferred stock of municipal closed-end funds is typically rated in the AA category and the preferred stock of closed-end funds with taxable strategies are typically rated either AA or A. These ratings appropriately reflect the risk of loss inherent in these instruments. As a high-quality asset, large U.S. banks would be deprived of the benefits of investing in closed-end fund preferred stock. Indeed, nearly all closed-end fund preferred stock held by large U.S. banks have definitive "holding tenors" that can range from less than 90 days to 3 years, which provide an additional layer of protection beyond those discussed above.

---

assets must be invested in cash, cash items (including receivables), Government securities, securities of other RICs, and investments in other securities, so long as no more than 5% are invested in the securities of any one issuer and the fund does not own more than 10% of the outstanding voting securities of any one issuer. Additionally, no more than 25% of the investment company's total assets may be invested in securities (other than government securities or securities of other RICs) of any one issuer or two or more issuers that the fund controls and that are engaged in the same or similar trade or business. *See* § 851(b)(3)(B).

[22] *See e.g.*, Fitch Ratings, *Fitch Affirms Preferred Shares of Western Asset Municipal Closed-End Funds*, (Oct. 3, 2023), available at https://www fitchratings.com/research/fund-asset-managers/fitch-affirms-preferred-shares-of-western-asset-municipal-closed-end-funds-03-10-2022.

IV. Proposed Solutions

Instead of introducing this potentially harmful ambiguity as a part of the Proposal, we recommend modifying the Proposal through any of the following solutions. One simple and appropriate solution would be to clarify the language of the proposed regulations to explicitly carve out preferred stock issued by closed-end funds from the definition of "subordinated debt instrument." Alternatively, the Agencies could clarify the definition of "subordinated debt instrument" to exclude preferred securities that are issued by closed-end funds that do not have any other outstanding "senior security or securities representing indebtedness," as defined under Section 18(g) of the 1940 Act.[23] Another modification to the definition of "subordinated debt instrument" would only include preferred stock to the extent that it is issued by an operating company. Still another appropriate option would be for the Agencies to assign a risk-weight to preferred stock that would be no higher than the risk weight for common stock or underlying assets of the same issuer. We believe that any of these solutions would clarify that preferred stock of closed-end funds should not be deemed a subordinated debt instrument subject to a 150 percent risk weighting.

* * *

We appreciate the opportunity to provide comments on the Proposal. If you have any questions, please contact me (at 704-988-6543), my colleagues Nate Jones (at 312-917-9778) or Mark Winget (at 312-917-7883) or Corey F. Rose of Dechert LLP at 202-261-3314.

Sincerely,

John M. McCann
Managing Director & Associate General Counsel

cc: Nate Jones
Mark Winget
Corey F. Rose

[23] 15 U.S.C. § 80a-18(g).