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May 29, 2015

Mr. Svein Andresen
Financial Stability Board
c/o Bank for International Settlements
CH – 4002 Basel
Switzerland

Re: Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions from March 4, 2015

Dear Mr. Andresen:

The Institute of International Finance is pleased to provide comments on the FSB/IOSCO Consultative Document “Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions – Proposed High-Level Framework and Specific Methodologies” of March 4, 2015. This letter has been produced under the guidance of the IIF’s Non-Bank Non-Insurer Working Group. In offering these comments, we believe it is important to reiterate the industry’s support for targeted and proportionate measures designed to address potential systemic risks and thus make the global financial system more stable.

The IIF fully recognizes the importance of the FSB’s work (in cooperation with other agencies) on identifying sources of systemic risk. This is a very challenging task which, if done correctly, can reinforce financial stability but if not, could have unintended detrimental consequences on financial markets, those they serve, and economic growth. The Institute therefore appreciates the continued openness of the FSB and relevant agencies to industry perspectives and those of other stakeholders on this important subject.

As the FSB and IOSCO have declared their sector-specific methodologies for finance companies and market intermediaries “*near-final*” and since questions have only been asked with regards to investment funds and asset managers we will focus our response letter on the asset management industry.¹ With regards to finance companies we refer to our response letter to the First Consultative Document.

¹ For the purpose of this letter we are differentiating money market mutual funds (MMMFs) from traditional asset management. MMMFs are different from traditional asset management and have been reformed twice in the United States since the recent financial crisis.

Key Considerations:

- The IIF had fully endorsed the FSB's and IOSCO's original approach to focus on investment funds and not asset managers. We are concerned about the departure from this approach and believe this has not been sufficiently justified. As available data can demonstrate asset managers operate small balance sheets with low (if any) leverage; they do not perform any functions in which they would not easily be substitutable. These characteristics should clearly alleviate any potential concerns about asset managers being systemic.
- 'Size' is not a suitable indicator of an asset management entity's global systemic risk. From a risk perspective a single index fund with Assets under Management (AUM) of \$125 billion is not different from five funds tracking the same index with an AUM of \$25 billion each.
- Any crisis in the asset management industry has rather originated in the failure of a certain asset class or specific business model or in regulatory flaws than in the operations of a single entity.
- Investment funds in general are not prone to a 'first mover advantage.' Typically, the preconditions for a systemically relevant 'run'—a fixed repayment obligation or a flawed pricing mechanism—are not met.
- The asset management industry is not susceptible to contagion effects originating in a reputational crisis.
- The IIF has supported an approach to systemic risk that is focused on financial activities rather than entities. If there were any activities performed by asset managers that could give rise to concern these activities would have to be targeted system-wide by means of activity-based regulation. In our view, G-SIFI designations would be counterproductive.
- The Assessment Methodology should recognize the extent to which the asset management industry is already subject to industry-wide regulation as well as changes in the overall regulatory framework that have already been introduced to safeguard against and reduce systemic risk.
- The IIF reiterates its call for a transparent methodology that uses reliable data, objective metrics that are risk-based and risk-sensitive, is consistently applied across jurisdictions, and provides clear incentives for reducing systemic risk.

Asset management industry does not pose a systemic risk to the global financial system

The FSB, the International Monetary Fund (IMF) and the Bank for International Settlements (BIS) have defined “systemic risk as a risk of disruption to financial services that is (i) caused by an impairment of all or parts of the financial system and (ii) has the potential to have serious negative consequences for the real economy. Fundamental to the definition is the notion of negative externalities from a disruption or failure in a financial institution, market or instrument.”² In practical terms this definition implies the risk that the failure of a financial institution cannot be adequately handled and thus this institution might have to be rescued at the expense of taxpayers.

However, we do not think that asset management entities present systemic risk let alone on a global scale. We will argue below that given the unique nature of the business models in question, and the differences between asset management and banking, a well-calibrated risk-sensitive methodology should yield a null set of investment funds and asset managers. Furthermore, the characteristics of the industry, in particular the high degree of substitutability and investor mobility demonstrate that entity targeted designation and policy measures would be ineffective and inefficient. Rather, targeted regulation on an activity- or industry-wide basis would be the most appropriate response.

Singling out of certain entities may distort markets and competition

The IIF has consistently drawn attention to the shortcomings of approaches to systemic risk that rely on designating individual entities and the application of additional policy measures to these entities on a blanket basis. We believe such approaches increase moral hazard and distort competition. Against this background, the IIF would argue strongly from the very beginning that applying additional policy measures to a few individual entities or a subset of market participants is likely to be ineffective. This is especially true in highly substitutable markets like financial services in general and asset management in particular.

It is likely that the designation of certain entities as ‘systemic’ will result in ‘systemic’ activities shifting from such an entity to other, non-designated entities. For example, designation of an investment fund as ‘systemically relevant’ and applying limits and costly policy measures to it and not to its competitors would likely render the fund unattractive and prompt investors to redeem a substantial portion of its assets and to transfer them to a competitor that offers the same product or service without the regulatory burden due to the highly substitutable nature of the industry.

However, it is not at all obvious that a simple reallocation of business within the regulated industry and towards non-systemic entities will be the outcome. Instead, the effect may well be to drive some activities outside of the regulated sector. Such movement is unlikely to reduce systemic risk, but it would make the activities less visible. The incentives created could equally likely result in changes in business models and product mixes whose effects on systemic risk are hard to know in advance.

Furthermore, it has to be considered that roughly 75% of the world’s financial assets are not managed by asset managers but by the asset owner directly.³ It is estimated that from the remaining 25% ten percent-

² See *FSB/IMF/BIS, Guidance to Assess the Systemic Importance of Financial Institutions, Markets and Instruments: Initial Considerations - Report to the G-20 Finance Ministers and Central Bank Governors*, p. 2 (emphasis deleted) (<https://www.imf.org/external/np/g20/pdf/100109.pdf>).

³ See *McKinsey & Company, Strong performance, but health still fragile - Global asset management in 2013 - Will the goose keep laying golden eggs?*, p. 8, exhibit 2 (<http://www.btinvest.com.sg/system/assets/17804/2013%20asset%20management%20brochure%20final.pdf>)

age points are managed in separate accounts and 15 percentage points in funds.⁴ Competition to manage these assets is intense, with multiple managers offering highly substitutable products and services to highly mobile assets and asset owners. With respect to mutual funds in particular, the Investment Company Institute (ICI) reports that over 800 sponsors managed mutual fund assets in the United States in 2013 with intense competition preventing any single firm or group from dominating the market.⁵ These funds compete with a broad range of other products and they participate in the capital markets with other investors including central banks, corporate, state and municipal benefits plans, foundations and endowments, sovereign wealth funds, and wealthy individuals, among others, which are not subject to the proposed methodology. Against this backdrop, designating an individual fund as systemically relevant would at best be ineffective but could have severe negative repercussions on capital markets and systemic risk.

Regulatory focus on products and activities

To cope with these challenges the IIF has consistently argued that policy should focus primarily on the underlying activities involved and their associated risks, should be sufficiently forward looking, and should take into account the variety and complexity of activities rather than focusing on a few of the entities that conduct those activities. In general, we believe that the application of targeted regulation to properly identified risks on an activity- or industry-wide basis is the most appropriate response. Such regulation however should not be limited to the relevant industry in a narrow sense but include all capital markets participants that might offer a given product or engage in an activity. We are convinced that such an approach is better suited to foster financial stability than it is to attempt to identify and regulate risk by focusing exclusively on a certain industry and far better than designating a few individual entities as ‘systemic’. These considerations were recently supported by the International Monetary Fund (IMF). In its April 2015 Global Financial Stability Report the IMF stated that “investment focus appears to be relatively more important than size when gauging systemic risk.”⁶ Against this backdrop the IMF concluded that “a product- or activity-based emphasis seems to be important.”⁷

We fail to understand the FSB’s and IOSCO’s approach to analyze not only investment funds but also asset managers. Unfortunately the FSB and IOSCO do not provide any reasoning for their decision but simply refer to ‘considerations’ based on the responses that were received on the earlier Consultation. We believe making explicit and transparent such ‘considerations’ would have allowed respondents to address specific arguments and concerns and make the consultative process more complete. We were unable to comprehend the reference that “*responses also emphasized the relevance of a focus on activities of asset managers (or asset management activities)*”. We would be deeply concerned if our appeal for an activity and product based approach as an alternative to SIFI-designation had been misinterpreted to selectively expand the scope of the analysis from investment funds to asset managers alone but not to all the other market participants involved in the underlying activities or offering the according products and services.

We endorse the assessment in the Consultative Document that “*(s)ince the core function of an asset manager is managing assets as an agent on behalf of others in accordance with a specified investment mandate, asset managers tend to have small balance sheets and the forced liquidation of their own assets*

⁴ See *BlackRock*, Fund Structures as Systemic Risk Mitigants, Viewpoint - September 2014, p. 3, exhibit 1 (<https://www.blackrock.com/corporate/en-fi/literature/whitepaper/viewpoint-fund-structures-as-systemic-risk-mitigants-september-2014.pdf>).

⁵ See *ICI*, 2014 Investment Company Fact Book - A Review of Trends and Activities in the U.S. Investment Company Industry, p. 27 (http://www.icifactbook.org/pdf/2014_factbook.pdf).

⁶ *IMF*, Global Financial Stability Report, April 2015, chapter 3 – The Asset Management Industry and Financial Stability, p. 121 (<http://www.imf.org/external/pubs/ft/gfsr/2015/01/pdf/c3.pdf>).

⁷ *Id.*

would not generally create market disruptions.” Asset managers themselves are not direct participants in the capital markets. They do not act as lenders or counterparties, they have limited interconnections—particularly when compared to other financial institutions like banks and insurance companies—and none with respect to the assets they manage. If there were any activities that could raise concerns—for example the FSB and IOSCO are specifically asking for the involvement of asset managers in securities lending—these activities would not be limited to asset managers alone and thus would have to be analyzed on a comprehensive basis. Beyond standard industry practices we are not aware of any “*specific activities, for which (the asset manager) has developed a specific skill, and which would make the manager’s business not easily transferable in the event of a default.*” Therefore, we believe asset management entities present no systemic risk at the company level. However, and recognizing the G20 mandate to the FSB and IOSCO to assess whether there are any entities that should be designated as NBNI G-SIFIs, we are providing a comprehensive analysis below.

Methodology should use risk-based and risk-sensitive metrics

In producing a methodology that seeks to measure the systemic importance of entities, it should be transparent and designed in such way that it is adequately reflective of systemic importance by using reliable data, objective metrics that are risk-based and risk-sensitive, consistently applied across jurisdictions, and provide clear incentives for reducing systemic risk. While the industry acknowledges the need to avoid undue complexity, a balance must be made between having simple and adequately risk-based approaches. The benefits of an overly simple approach would be outweighed by the problems caused by a methodology that does not accurately identify sources of systemic risk.

The FSB’s and IOSCO’s role in assessing potential systemic risk

The IIF welcomes initiatives for reducing the systemic and moral hazard risks posed by SIFIs, and is grateful to the FSB and IOSCO for providing a forum for discussion on this issue. We believe that any reasonable public policy has to be based not only on theoretical considerations but also on solid data and sound empirical evidence. Therefore, we are of the view that before proposing any additional policy measure the FSB and IOSCO should assess whether or not a plausible threat to financial stability exists and to determine the probability and magnitude of any hypothetical threat based on robust empirical analysis. Given the potentially significant consequences of additional regulation intended to reduce systemic risk (and the negative effects that such regulation could have on the positive contribution of the asset management industry and capital markets to a well-functioning financial system and more broadly to economic growth), we believe the FSB and IOSCO must first demonstrate whether a plausible threat to financial stability really exists⁸ and how certain policy measures can contain this risk.

Data sources are available and should be utilized

In its Consultative Document the FSB and IOSCO on several occasions mention that “*(o)ne of the key challenges in assessing the global systemic importance of NBNI financial entities is the difficulty in ob-*

⁸ “(...) unless there is a plausible threat to the core of the system or potential for damaging fire sales, I would set a high bar for supervisory interventions to lean against the credit cycle. Such interventions would almost surely interfere with the traditional function of capital markets in allocating capital to productive uses and dispersing risk to the investors who willingly choose to bear it.”; Powell, Jerome H., Financial Institutions, Financial Markets, and Financial Stability, Stern School of Management, February 18, 2015, p. 16 (<http://www.federalreserve.gov/newsevents/speech/powell20150218a.pdf>).

taining appropriate and consistent data/information.” While we agree that “*data availability varies widely and is likely not to be consistent across jurisdictions*” this does not mean that meaningful data is not available in general. In fact, a significant amount of data is already available. We deem these data as crucial in monitoring and assessing potential risks in the global financial system. For example, fund managers in the United States have to file information such as financial statements, comprehensive holdings (including derivatives exposure) and custody information with the U.S. Securities and Exchange Commission (SEC)⁹. A thorough analysis of this trove of information should provide valuable insights into the functioning of the investment fund industry and its role in the capital markets and provide a better understanding of the risks that it may or may not present. Insights developed through analysis of this data should also be published to facilitate discussion and enable both better informed proposals such as this and comments on them.

In general, data transparency and availability have also increased significantly in recent years. In fact, it was one of the main regulatory initiatives initiated by the G20 to increase market transparency by moving over-the-counter (OTC) derivatives trading onto organized platforms. Regulators are in the process of implementing new rules requiring the reporting of data on the trading of OTC derivatives to trade repositories. This will provide regulators with a full picture of all OTC derivative positions for the entities they regulate and enable market-wide risk monitoring. The collection of all this market data only makes sense if it will be studied to determine if there are additional risks that should be addressed and to design specific and targeted regulation. Confidentiality of this data on a national basis should not preclude the FSB and IOSCO from using data in order to determine whether threats to the financial stability arise from these markets.

Furthermore, it has to be considered that several initiatives are pending aimed at filling data gaps and to further improving transparency. For example, the FSB in November proposed new standards and processes for the data collection and aggregation on global securities financing.¹⁰ In the United States the SEC is about to expand existing data requirements too. The Commission recently proposed new rules and forms to modernize and enhance data reporting and disclosure for both funds and advisers. In the proposal, a special focus is given to the reporting and disclosure of investments in derivatives, the liquidity and valuation of holdings, and securities lending practices.¹¹ Upon availability, all this data will provide supervisors, policy makers and the general public with additional and very helpful insights. We therefore respectfully recommend that the FSB and IOSCO should wait until this data has been collected and analyzed before proceeding to finalize any methodology and related policies.

We are convinced that meaningful data is available and can be collected with reasonable effort. If certain data should not be readily available the focus should be on generating this data or meaningful proxies instead of defaulting to supervisory discretion to bridge any gap in data availability. Without sufficient data and interpreting analytics any policy measure is likely to do more harm than good. Policy makers will be unable to seriously justify decisions to act, to defend a decision not to act, or to measure the (in) effectiveness of their actions or inactions.

⁹ Information is filed on forms such as 13D, 17h, ADV, N-CSR, N-MFP, N-Q, N-SAR, and PF. Over 2,300 advisers covering over 18,000 private funds and pertaining to \$7.3 trillion in private fund assets have filed form PF with the SEC; see *SEC Division of Investment Management, Annual Staff Report Relating to the Use of Data Collected from Private Fund Systemic Risk Reports*, pp. 5 et seq. (<http://www.sec.gov/news/studies/2013/im-annualreport-072513.pdf>).

¹⁰ See *FSB, Consultative Document – Standards and Processes for Global Securities Financing - Data Collection and Aggregation*; 13 November 2014 (<http://www.financialstabilityboard.org/wp-content/uploads/Global-SFT-Data-Standards-Consultative-Document.pdf>).

¹¹ See *SEC, Investment Company Reporting Modernization*, Release Nos. 33-9776; 34-75002, May 20, 2015 (<https://www.sec.gov/rules/proposed/2015/33-9776.pdf>).

Additionally, the FSB and IOSCO should provide NBNI entities formal opportunities to participate in the process, which should include the opportunity to engage directly with the FSB and IOSCO and present data and other information that is relevant to the issues under consideration. Further, the FSB and IOSCO should afford an assessed NBNI entity advance notice of its potential designation and allow the NBNI entity to comment on and respond to the narrative assessment prepared in support of its designation.

Reliance on supervisory judgment and discretion should be avoided

Against this backdrop, we do not share the conclusion that “*supervisory judgment likely needs to play a bigger role in methodologies for identifying NBNI G-SIFIs compared to the G-SIB or G-SII methodologies*”. We are afraid that the proposed International Oversight Group will not be able to guarantee international consistency. Instead, an excessive reliance on supervisory judgment and discretion may in fact undermine the credibility of the intended approach and will eliminate one of the most important benefits of clarity—modification in market behavior. Markets are self-correcting and respond swiftly and efficiently to changes in the economic and regulatory environment. If regulators convey clear messages about the definition of systemic risk and the costs associated with it, markets will adapt accordingly. If the messages are less clear the market reaction will be muted or disturbed.

We are concerned that key terms of the methodology—starting with ‘systemic risk’ but also extending to terms like ‘significant disruption,’ ‘wider financial system’ and ‘economic activity’—are opaque and require definition, modeling and measurement in this context. We are concerned about leaving things vague and potentially follow a ‘know it when you see it’-approach which will by necessity lead to a substantial amount of regulatory discretion. This, in turn, may not only lead to a temptation to respond to political pressures but also make measurement of policy effects and evaluation of policy alternatives all the more challenging.¹²

In contrast, the IIF supports the use of an objective approach, where measures of systemic risk should be based on the consistent and transparent use of common metrics that are objectively indicative of global systemic risk. Thus, ensuring data quality and consistency is essential to achieve a level playing field.

Progress in the general regulatory framework should be observed

In addition, the NBNI G-SIFI methodology should be framed in the context of the wide range of existing regulation and of other regulatory measures introduced post-crisis. For example, funds established under the Investment Company Act of 1940 (1940 Act) in the U.S. or UCITS (Undertakings for Collective Investment in Transferable Securities) in the European Union face specific restrictions with regards to the use of leverage and maintenance of liquidity that are much more restrictive than those applied to even the largest G-SIBs. This hard-wired resilience should be taken into consideration since it does not only serve to provide investor protection on an individual basis. On a collective level, the liquidity and diversification requirements also have positive repercussions on the stability of the financial system as a whole.

A multitude of new measures have been introduced since the crisis to safeguard against and reduce systemic risk. For example, the initiative to move OTC derivatives trading onto organized platforms with counterparty risk managed through a Central Counterparty (CCP) is intended to reduce systemic risk and to increase transparency. Further significant risk reduction has been achieved by establishing margin re-

¹² See Hansen, Lars Peter, Challenges in Identifying and Measuring Systemic Risk, Working Paper, February 11, 2013, p. 2 (<http://www.nber.org/chapters/c12507.pdf>). – Lars Peter Hansen, together with Eugene F. Fama and Robert J. Shiller, received the Nobel Prize in Economic Sciences 2013.

quirements not only for centrally cleared but also for non-centrally cleared derivatives.¹³ The broad scope of these and other new regulatory measures should allow the FSB to reserve G-SIFI designation only for those circumstances in which other regulatory actions clearly would be insufficient to address or limit the objective systemic risks.

In general, the sufficiency of existing or pending regulation should be evaluated carefully and taken into account in the design of any effort to identify, or design additional requirements for NBNI G-SIFIs. It is essential that any additional measures do not ignore, contradict, or replicate what is already in place.

Importance of Balance

We encourage the FSB and IOSCO to recognize the tangible progress that has been made in implementing many high priority regulatory reforms.¹⁴ Currently regulators that have authority to identify and regulate risk are looking at elements of the financial system, such as asset management, that did not cause the crisis and have performed well in previous crises. In reviewing these businesses and their products and activities, regulators should adopt a balanced approach that focuses on actual and plausible sources of risk rather than merely theoretical ones.

This process is taking place at a time that much of the world is still suffering from low growth. While economic growth accelerates in mature economies—with the U.S. and the Euro Area in the driving seat—Emerging Markets are still lagging behind.¹⁵ Thus, there is a common interest among policymakers, regulators, central banks and other authorities to assess whether the real sources of systemic risk have been adequately addressed and what costs and benefits to the economy have derived from the tools and policies that have been implemented. In other words, there should be an assessment of whether reforms are working as intended or whether aspects of the reforms themselves need fixing¹⁶ as well as a balanced review of the likelihood that any proposed new regulation will promote both economic growth and financial stability. A number of policy makers recognize that both are essential to produce sustainable growth¹⁷ and they understand that asset management can contribute to delivering it.¹⁸

¹³ See *BCBS/IOSCO*, Margin requirements for non-centrally cleared derivatives, September 2013, (<http://www.bis.org/publ/bcbs226.pdf>).

¹⁴ For details see chapter 6 of *FSOC*, 2014 Annual Report (<http://www.treasury.gov/initiatives/fsoc/Documents/FSOC%202014%20Annual%20Report.pdf>); and *FSB*, Overview of Progress in the Implementation of the G20 Recommendations for Strengthening Financial Stability - Report of the Financial Stability Board to G20 Leaders, November 14, 2014; (<http://www.financialstabilityboard.org/wp-content/uploads/Overview-of-Progress-in-the-Implementation-of-the-G20-Recommendations-for-Strengthening-Financial-Stability.pdf>).

¹⁵ For further details see e.g. *IIF*, February 2015 Global Economic Monitor: Year of Divergence; (<https://www.iif.com/publication/global-economic-monitor/february-2015-global-economic-monitor>).

¹⁶ See e.g. *Carney, Mark*, Regulatory work underway and lessons learned, Remarks at the 29th Annual G30 International Banking Seminar, Washington DC, October 12, 2014; (<http://www.bis.org/review/r141015c.htm>): “And we've learned about the unintended consequences of prudential capital and retention requirements on the securitisation market. Regulatory changes arguably treat asset-backed securities in ways that appear to be unduly conservative, particularly relative to other forms of long-term funding. Efforts to rebalance these incentives are now a priority.”

¹⁷ See e.g. *Hill, Jonathan*, Finance at your service – capital markets union as an instrument of sustainable growth, Brussels, February 4, 2015, p. 1: “So we need both financial stability and growth: we need sustainable growth. That is the new Commission's number one priority.” (http://europa.eu/rapid/press-release_SPEECH-15-4144_en.htm).

¹⁸ *Id.*, p. 2: “Well-functioning capital markets also help encourage greater diversity in funding, which reduces concentration of risk so they not only free up capital for growth but also support and strengthen financial stability. After all, it's important to remember that “capital markets” are not some abstract construct – they are someone's pension savings, someone's 'rainy day' money which is channelled to growth.”

Financial Services Industry as Part of the Solution

On this point we agree with observation recently made by *Lord Jonathan Hill*, the European Commissioner responsible for financial stability, financial services and the European capital markets union (CMU), when he said that “[w]e do not make the economy stronger by making our financial services weaker. We need to move from a position where the industry is seen as being part of the problem to one where it is seen as part of the solution.”¹⁹ The European Commission’s Green Paper on Building a Capital Markets Union builds on this notion and describes many of the ways in which capital markets and investment funds promote financial stability and economic growth.²⁰ The IMF,²¹ FSB, IOSCO²² and individual representatives of U.S. regulators like the Federal Reserve Board²³ have also recognized these benefits.

High Standard to Justify Intervention in Capital Markets

In addition to the widely recognized economic and financial stability benefits created by collective investment funds, their managers and the capital markets more broadly, there are other factors that require a high standard to be met in order to justify regulatory intervention in the name of mitigating hypothetical systemic risk. These include: (i) prudential supervisors’ evolving understanding of asset management²⁴ and relevant markets, (ii) a lack of empirical evidence that investment funds and their managers threaten financial stability and substantial evidence supported by sound theory that they do not²⁵, (iii) the difficulty

¹⁹ *Id.*, p. 2.

²⁰ See *European Commission*, Green Paper - Building a Capital Markets Union, COM(2015) 63 final, Brussels, February 18, 2015 (http://ec.europa.eu/finance/consultations/2015/capital-markets-union/docs/green-paper_en.pdf).

²¹ See e.g. *IMF*, Global Financial Stability Report October 2014 (<https://www.imf.org/external/pubs/ft/gfsr/2014/02/pdf/text.pdf>), p. 33: “From a financial stability perspective, credit intermediation through asset managers and markets has advantages over that through banks. For example, the investment risk is borne largely by investors in the fund, not the asset manager because there are no public guarantees like those the banking system has for deposits. Liquidity is provided mostly by markets, and not from bank holdings of liquid assets backed by central bank facilities. Finally, funds generally do not raise liabilities to fund assets and are therefore less leveraged than banks.” (footnote omitted).

²² See *FSB/IOSCO*, Consultative Document - Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions, January 8, 2014 (http://www.financialstabilityboard.org/wp-content/uploads/pr_140108.pdf), p. 29: “In addition, from a purely systemic perspective, funds contain a specific “shock absorber” feature that differentiates them from banks. In particular, fund investors absorb the negative effects that might be caused by the distress or even the default of a fund, thereby mitigating the eventual contagion effects in the broader financial system.”

²³ See e.g. *Liang, Nellie* (Director, Federal Reserve Board Office of Financial Policy Stability and Research), The Brookings Institution, Asset Management, Financial Stability and Economic Growth, February 9, 2015 (http://www.brookings.edu/~media/events/2015/01/09-asset-management/20150109_asset_management_transcript.pdf), p. 48: “(...) mutual funds in their current form have been around for a long time - 75 years now. And they’ve weathered all kinds of adverse market conditions without noticeably contributing to systemic risk. Indeed, they may provide a diversity of sources of funds for borrowers and may have had stabilizing influences on aggregate credit.”

²⁴ “Academics, practitioners and regulators have been studying banks, their behaviour and failure, for several centuries. Analysing and managing the behaviour of asset managers is, by contrast, a greenfield site.”; *Haldane, Andrew G.*, The age of asset management?, London Business School, London, April 4, 2014, p. 14, (<http://www.bankofengland.co.uk/publications/Documents/speeches/2014/speech723.pdf>).

²⁵ As has been acknowledged by *FSB/IOSCO*, “funds close (and are launched) on a regular basis with negligible or no market impact”; see *FSB/IOSCO*, *supra* note 22, p. 30.

of correctly diagnosing 'dangerous' conditions in asset markets²⁶ and controlling investors' behavior even in real time, let alone under future unknown market conditions, (iv) relatively untested macroprudential tools²⁷, (v) ineffectiveness of partial solutions, and (vi) unintended consequences of intervention that could damage financial markets, individual investors and issuers they serve, and economic growth.

We agree with the recent call for restraint by Federal Reserve Board Governor *Jerome Powell*: “the Fed and other prudential and market regulators should resist interfering with the role of markets in allocating capital to issuers and risk to investors unless the case for doing so is strong and the available tools can achieve the objective in a targeted manner and with a high degree of confidence.”²⁸ We believe that G-SIFI designation of investment funds and asset managers does not meet that standard. An examination of products and activities on a market-wide basis is more likely to yield constructive results, which is why we encourage the FSB and IOSCO to adopt that approach instead of continuing to pursue G-SIFI designation of investment funds and asset management firms.

Learning from history

In justifying the initial focus of the NBNI G-SIFI assessment the FSB and IOSCO refer to “*historical examples of financial distress or failures in these four sectors that had an impact (or potential impact) on the global financial system*”. Unfortunately, this reference is not further specified. We are aware of only two examples from the investment fund industry—Long Term Capital Management (LTCM) and Reserve Management Company (sponsor of the Reserve Fund). In our view, these examples deserve detailed analysis to understand the sources of systemic risk connected to the respective business models, which are distinct among investment funds. Upon closer examination, these instances also demonstrate activity rather than entity related risk.

We conclude that a methodology to identify NBNI G-SIFIs should recognize historical precedent and should be able to identify another LTCM or, Reserve Fund-type of situation during the build-up of systemic risk. We acknowledge that this is not an easy task. In our view history leads to the conclusion that the potential for systemic risk may rather be embedded in the failure of a certain asset class or a specific business model than in the operations of a single firm.²⁹ However, where a single firm has caused systemic disruption it generally results from highly leveraged operations which have accumulated significant under-protected exposures or have caused disruption through their lack of substitutability.

The importance of leverage

We appreciate that the FSB and IOSCO have decided to increase the importance of leverage in the proposed Assessment Methodology. However, we finally see no reason why the standards should be higher for funds than they are for banks under the Basel III-framework—a 3 percent Leverage Ratio for banks as

²⁶ “An important threshold question is whether supervisors will be able to correctly and in a timely manner identify “dangerous” conditions in credit markets, without too many false positives and without unnecessarily limiting credit availability by interfering with market forces.”; *Powell, supra* note 8, p. 16.

²⁷ “I often hear the view that macroprudential policy should be the “first line of defense” for maintaining financial stability. Unfortunately, this approach expects too much of tools for which our understanding is imperfect.”; *George, Esther L.*, Monetary and Macroprudential Policy: Complements, not Substitutes, Financial Stability Institute/Bank for International Settlements, Asia-Pacific High-Level Meeting, Manila, February 10, 2015, p. 5, (<http://www.kansascityfed.org/publicat/speeches/2015-George-Manila-BIS-02-10.pdf>).

²⁸ *Powell, supra* note 8, p. 17.

²⁹ See *Tarullo, Daniel K.*, Regulating Systemic Risk – Remarks at the 2011 Credit Markets Symposium, March 31, 2011, p. 6 (<http://www.federalreserve.gov/newsevents/speech/tarullo20110331a.pdf>).

opposed to a Leverage Ratio of 3 times (or 33 percent) in the proposed methodology for investment funds—or within domestic SIFI-designation frameworks, especially as applied in the United States by the Financial Stability Oversight Council (FSOC) in its non-bank SIFI designation process.

However—and not at least due to the experiences gathered in the LTCM crisis—the use of leverage in a number of investment products is subject to extensive regulation. We concur with the FSB and IOSCO that “*many public funds currently have legal and regulatory limitations on their ability to use leverage (either balance-sheet leverage or synthetic leverage)*”. While private funds in the U.S. are generally not subject to regulatory leverage restrictions, many agree to abide by leverage limits in their offering materials and provide transparency to investors regarding current leverage levels.

Additionally, regulatory and market changes implemented since 2008 have significantly reduced the systemic risk in the financial system. Central clearing, netting of risk positions, mandated changes to documentation and collateral practices, increased dealer requirements and other changes have significantly reduced counterparty risk, fundamentally changed trading practices, improved dealer risk management and therefore mitigated the potential impact of the insolvency of a private fund.

The importance of leverage has recently been pointed out by the FSOC in their inquiry of asset management products and activities. In principle, we agree with the FSOC that “*exposures created by leverage establish interactions between borrowers and lenders—and possible further interconnections between lenders and other market participants—through which financial stress could be transmitted to the broader financial system.*”³⁰ Indeed, if losses on investments where leverage is employed coincide with significant and not adequately managed exposures, losses may be incurred by counterparties (borrowers, trading partners) and may ultimately destabilize entities who might be systemically important in their own right. Even though we believe the current regulatory framework and common industry practices provide sufficient safeguards against such a theoretical scenario we nevertheless support the initiative by the SEC to review options for specific improvements such as to appropriately limit the leverage created by the use of derivatives in a 1940-Act fund.³¹

Resolution of asset management firms and replacement of managers

As the FSB and IOSCO (in their first NBNI G-SIFI consultation) and the FSOC have acknowledged, there is no evidence of a threat to financial stability from the resolution of investment funds and their advisers and significant evidence demonstrating that their resolution does not threaten financial stability. This is corroborated by the following observations:

First, the probability of failure is extremely low. Most funds and their managers operate with little or no leverage. Without excessive leverage or substantial fixed obligations, a fund cannot fail. Therefore, any policy action should tackle these issues in the first place.

In the case of LTCM as well as in the case of the Reserve Fund distress in specific products based on leverage or fixed obligations ultimately led to the closure of the asset management firm that sponsored those

³⁰ FSOC, Notice Seeking Comment on Asset Management Products and Activities [Docket No. FSOC–2014–0001], Federal Register, Vol. 79, No. 247, December 24, 2014, pp. 77,488–77,495 (p. 77,491) (<http://www.gpo.gov/fdsys/pkg/FR-2014-12-24/pdf/2014-30255.pdf>).

³¹ See *White, Mary Jo*, Enhancing Risk Monitoring and Regulatory Safeguards for the Asset Management Industry – The New York Times DealBook Opportunities for Tomorrow Conference Held at One World Trade Center, New York, N.Y., December 11, 2014, p. 5, (<http://www.sec.gov/News/Speech/Detail/Speech/1370543677722#.VQhH-cOFZvGw>).

products. While in each instance the product level distress had market impact, the ultimate closures of the asset management firms that managed the products were hardly newsworthy. Beyond LTCM and the Reserve Fund, there have been multiple examples of hedge funds dissolving or experiencing heavy losses with no systemic impact. As a conservative estimate, over one hundred major hedge fund product closures have occurred since 2006 with little evidence of systemic consequences. In general, it is common for asset managers to be replaced or wound down and for funds to merge or liquidate as part of the normal business cycle, without any effects on the stability of the financial system, regardless of its state at the time.³² We endorse the views the FSB and IOSCO expressed in the First Consultative Document that “even when viewed in the aggregate, no mutual fund liquidations led to a systemic market impact throughout the [2000 to 2012] observation period. Part of the explanation may be that many US investors hold mutual fund shares for retirement purposes. As such these investors’ investment horizon could be long-term, whereby they would prefer to remain invested rather than cash-out during a market downturn.”³³

Second, the impact of failure is also extremely low for many reasons, some of which the FSOC and other regulators have acknowledged. For example, the asset management industry is highly substitutable.³⁴ We agree with the FSOC that “clients have routinely replaced asset managers without significant impact in non-stressed situations”³⁵. The data show that the same is true in stressed markets. Any market impact is alleviated by the fact that in order to replace an asset manager—for whatever reason—assets would not have to be moved physically since they are being held by a custodian. If an asset manager goes out of business or an investor decides to substitute an asset manager the assets can remain with the same custodian in a client denominated account. In no case will the assets become subject to asset liquidation. Against this backdrop, we do not share the FSB and IOSCO’s concerns “*there could be delays or other obstacles in transferring its contracts to another asset manager*” in the event of a stress or default of a manager. We nevertheless think that initiatives to identify best practices to follow when transitioning client assets may be beneficial.³⁶ Such plans may be helpful in preparing advisers and their clients to deal with a transition in evolving markets. We note, however, that managers and other service providers already process a high volume of asset transfers daily and the crisis exposed no weaknesses in the processes that threatened financial stability.

Objective assessment should yield a null set

Finally and most importantly, it is not necessarily the case that individual NBNI entities that present a global systemic risk do in fact exist. We will argue below that given the unique nature of the business models in question, and the differences between NBNI and banking and insurance, a well-calibrated risk-sensitive methodology will yield a null set of NBNI G-SIFIs.³⁷ Furthermore, with respect to investment

³² The numbers of mutual funds and fund managers exiting the business each year are significant. For example, in the United States and in 2014 alone 362 funds were merged or liquidated and 25 fund sponsors left the business. The figures peaked in 2009 with 871 funds and 53 fund sponsors. See *ICI*, Response to Notice Seeking Comment on Asset Management Products and Activities, p. 75 (http://conferences.ici.org/pdf/15_ici_fsoc_ltr.pdf).

³³ *FSB/IOSCO*, *supra* note 22, p. 30, Fn. 38.

³⁴ “In other words, the investment fund industry is highly competitive with numerous substitutes existing for most investment fund strategies (funds are highly substitutable).”; *FSB/IOSCO*, *supra* note 22, p. 30.

³⁵ *FSOC*, *supra*, note 30, p. 77,493.

³⁶ See *White*, *supra* note 31, p. 5.

³⁷ A similar assessment with regards to domestic NBNI SIFIs in the U.S. was provided by Governor *Tarullo*: “All this suggests to me that the initial list of firms designated under section 113 of the Dodd-Frank Act should not be a lengthy one. (...) The potential for systemic risk contagion effects really reflects the potential failure of an asset class or business model more than a firm. These risks are, at least presumptively, more effectively addressed head-on.”; *Tarullo*, *supra*, note 29, p. 6.

funds and asset managers, the characteristics of the industry, in particular the high degree of substitutability and investor mobility, demonstrate that entity targeted designation and policy measures would be ineffective and inefficient. Rather, targeted regulation on an activity- or industry-wide basis would be the most appropriate response.

Designation procedure and policy measures

The FSB and IOSCO have announced their intention to finalize the Assessment Methodology in 2015 (phase 1) and that in phase 2 they will elaborate on the implications of being identified as NBNI G-SIFI (i.e., policy measures). We strongly believe that these potential policy measures should be subject to public consultation and that they should be different from those applied to banks or insurance companies. Importantly, we believe that as a matter of adequate policy making such measures should be concluded before publishing a list of NBNI G-SIFIs. While we appreciate the openness of the FSB and IOSCO to a dialogue with regards to the Assessment Methodology as well as to potential policy measures we nevertheless are concerned about any approach that would establish a designation methodology without simultaneously defining the respective policy measures, particularly since evaluating an Assessment Methodology is not easy a task as long as a discussion on potential implications has not even begun.

From a policy perspective it would be important to demonstrate that a SIFI designation by the FSB and IOSCO in conjunction with specific policy measures will lead to better results in terms of financial stability and other pre-determined factors than conventional—activities- or industry-based—regulation by national authorities. A comprehensive set of designation criteria and policy measures would further enable potential NBNI G-SIFIs to conduct a reasonable analysis as to how best to address the sources and factors of their potential designation. As a result the entity could either decide to accept the costs and burdens of designation and resultant regulation or to adjust the operations in order to avoid these consequences.³⁸ “Absent a clear rationale (...) and an “exit ramp” from designation, neither the company nor its regulators can realistically determine how best to proceed in reducing the company’s risk to the system and eliminating the “Too Big to Fail” status”.³⁹

Conclusion

Before referring to the specific questions raised by the FSB and IOSCO we would like to summarize our general concerns with this consultation: While we support the goal of reducing systemic risk we think that the proposed G-SIFI designation approach is not appropriate to achieve this goal. We believe the data available clearly demonstrates that the asset management industry is not prone to systemic risk in the first place. However, if certain critical products or activities should be identified these products or activities would have to be treated with targeted industry-wide regulation. Singling out certain entities that offer such products or conduct such activities would at best be ineffective but could have severe negative repercussions on capital markets and on systemic risk itself.

We think that the methodologies to identify systemic risk across all NBNI sectors should be transparent, using reliable data and objective metrics that are risk-based and risk-sensitive. Any additional regulation of the asset management industry has to be balanced, should be product- or activity-based, and be applied industry wide and consistent across jurisdictions.

³⁸ See *MetLife, Inc. vs. FSOC*, United States District Court for the District of Columbia, Civ.16-45 (Jan. 13. 2015), p. 42, (https://www.metlife.com/assets/cao/sifiupdate/MetLife_Complaint_1-13-2015.pdf).

³⁹ *Hamm, Adam*, View of Adam Hamm, the State Insurance Commissioner Representative, p. 13 (http://www.naic.org/documents/newsroom_2014_fsoc_metlife_sifi_dissent_hamm.pdf).

Specific comments:

In addition to the general comments presented above, the Institute would like to offer the following answers to the specific questions raised in the Consultative Document:

Q2-1. In your view, is the exclusion of (i) public financial institutions, (ii) sovereign wealth funds or (iii) pension funds from the definition of NBNI financial entities appropriate? If so, please explain the rationale.

In our view history leads to the conclusion that the potential for systemic risk may rather be embedded in the failure of a certain asset class or a specific business model than in the operations of a single firm.⁴⁰ However, where a single firm has caused systemic disruption it generally results from highly leveraged operations which have accumulated significant under-protected exposures or have caused disruption through their lack of substitutability.

As long as public financial institutions, sovereign wealth funds or pension funds don't assume significant leverage and operate on a sole equity basis we regard their exclusion from the analysis as appropriate.

We note, however, that one of the primary reasons the FSB and IOSCO offer for excluding pension funds also applies to investment funds and could justify their exclusion as well. In the current Consultative Document, the FSB and IOSCO have explained that the rationale for excluding pension funds is that “they pose low risk to global financial stability and the wider economy due to their long-term investment perspective.” However, in the First Consultative Document, the FSB and IOSCO had recognized that “many US investors hold mutual fund shares for retirement purposes. As such, these investors’ investment horizon could be long-term, whereby they would prefer to remain invested rather than cash-out during a market downturn.”⁴¹ Indeed, the vast majority of fund investments are retirement savings with 30 to 50 year time horizons for accumulation and distribution. Moreover, the average investor owns just \$20,000 to \$30,000 in a typical stock fund, and a bit more in bond funds.⁴² This explains why the FSB and IOSCO could observe no systemic impact from mutual fund liquidations from 2000 to 2012.⁴³

It also has to be recognized that public financial institutions, sovereign wealth funds and pension funds are significant players in the global financial markets. They contribute to the roughly 75% of the world’s financial assets not managed by third-party asset managers but by the asset owner directly. Even though these institutions may be excluded from the NBNI G-SIFI Assessment Methodology they have to be included in any thorough market analysis. Only a comprehensive analysis based on market data can generate reliable evidence and facilitate informed decision making.

⁴⁰ See *Tarullo, supra*, note 29, p. 6.

⁴¹ *FSB/IOSCO, supra* note 22, p. 30, Fn. 38.

⁴² See *Strategic Insight, Mutual Funds and Systemic Risk: The Reassuring Lessons of Stability Amid Past Periods of High Financial Markets Volatility*, p. 4 (<http://www.sionline.com/published/Mutual-Funds-and-Systemic-Risk/Mutual-Funds-and-Systemic-Risk.pdf>).

⁴³ “In addition, even when viewed in the aggregate, no mutual fund liquidations led to a systemic market impact throughout the observation period”; *FSB/IOSCO, supra* note 22, p. 30, Fn. 38.

Q2-2. Please explain any potential systemic risks associated with failure or financial distress of (i) public financial institutions, (ii) sovereign wealth funds or (iii) pension funds that, in your view, warrant their inclusion in the definition of NBNI financial entities so that NBNI G-SIFI methodologies would apply.

See our answer to Q2-1 above.

Q2-3. Please explain any other NBNI financial entity types that should be excluded from the definition of NBNI financial entities so that NBNI G-SIFI methodologies would not apply and their rationale.

We refer to the inconsistencies with regards to the treatment of long-term investors as explained in our answer to Q2-1 above. The reasons that have been offered for excluding pension funds also apply to investment funds and could justify their exclusion as well.

Sector-specific methodologies: Investment Funds

Q6-1. Please explain any potential systemic risks associated with the financial distress or disorderly liquidation of an investment fund at the global level that are, in your view, not appropriately captured in the above description of each risk transmission channel? Are there elements that have not been adequately captured? Please explain for each of the relevant channels separately.

Exposures / Counterparty channel

At the outset, it seems appropriate to mention that investment funds play an important role in the capital formation process: They collect funds from numerous investors and allocate these funds to the most productive uses by investing in assets like stocks and bonds. As such, investment funds are a source of efficient funding for corporate and government issuers. By making investment decisions on behalf of their customers, asset managers allocate the investment risks to these investors. In a nutshell, investment funds are collective investment vehicles that provide professionally managed exposure to investment risk. Based on their individual risk tolerance investors determine their desired exposures by investing in selected funds. Neither the manager nor the fund makes that choice for the ultimate owner of the asset—namely the investor. Therefore, rather than focusing on whether funds or managers ‘transmit’ risk, a more appropriate focus would be to assess whether the use of an asset manager or the investment in a collective fund creates or amplifies risk with sufficient probability and magnitude that it would threaten the stability of the global financial system. In this sense we agree with the following analysis: “It is important that the *net* systemic risk created by asset managers be considered in SIFI designation. It would be inappropriate and ineffective for asset managers to be viewed as responsible for actions that are essentially just the passing through of end-investor decisions.”⁴⁴ Absent excessive leverage, there isn’t much evidence that this is the case.

⁴⁴ Elliott, Douglas J., Systemic Risk and the Asset Management Industry, May 2014, p. 1 (Italics in the original); (http://www.brookings.edu/~media/research/files/papers/2014/05/systemic%20risk%20asset%20management%20elliott/systemic_risk_asset_management_elliott.pdf).

Some investment funds may employ leverage on behalf of their clients as part of the investment strategy of a particular investment fund or product. In the investment management context, we define ‘leverage’ as a strategy that creates investment exposure greater than the Net Asset Value (NAV) of the fund. Leverage in funds can occur in a number of ways, primarily through borrowing (balance-sheet leverage) and the use of derivatives (synthetic leverage). Asset management clients benefit from the potential upside provided by leverage, and similarly bear the risk of any increased asset price volatility. However, even the funds with the highest leverage operate with much lower leverage ratios than other entities in the financial sector (in particular banks for which leverage is an inherent aspect of their business models). As such, investment funds pose little or no risk to counterparties and the broader system.

In exemplifying their considerations the FSB and IOSCO refer to LTCM—as we did ourselves in our response to the First Consultative Document. However, it seems worth mentioning that LTCM is cited so frequently in discussions of systemic risk because it is the only obvious example of such an incident. The absence of similar fund specific distress threatening global financial stability in the recent financial crisis is instructive. In this context it is relevant to note what *Andrew Haldane* has underscored, observing that “The good news here is that, unlike in banking, history is not littered with examples of failing funds wreaking havoc in financial markets. The historical examples we have tend to be confined to small and isolated corners of the financial system.”⁴⁵

In considering leverage and the potential impacts of leverage on the markets, it is important to understand that leverage can occur not only at the product level, but also at the end-investor’s portfolio level. Importantly, the use of leverage is not limited to assets managed by investment funds. As we saw in the 2008 financial crisis, many wholesale and retail investors who had employed leverage on their own balance sheets were forced to liquidate investments to meet their individual liquidity needs and margin calls. Therefore, if existing regulation and reforms are found wanting to manage the risk of leverage in the investment fund industry, even after the comprehensive reforms to markets and market participants since the crisis, then any necessary additional reforms, after due consultation, should be applied sector-wide and focused on the activity, rather than only a small set of investment funds.

Asset liquidation / Market channel

We think that the concerns that have been raised by the FSB and IOSCO in this area are not substantiated. In our view, while theoretically this could be an area of analysis, such concerns are not supported by data or evidence.

First of all we do not believe that investors in investment funds in general are facing a ‘first-mover advantage’ in times of a crisis: A ‘first-mover advantage’ is characteristic for the depositor in a bank and is the textbook example of a prisoner’s dilemma that can indeed lead to a run on a certain bank and develop into a systemic crisis. The problem originates in the balance sheet of a bank: On the liability side a bank promises to repay the full amount of a customer’s deposit on demand whereas many assets, such as mortgage loans, are illiquid, hard to value and rarely, if ever, disclosed to the public in detail. Against the backdrop of this liquidity transformation a bank is typically unable to repay all its depositors at the same time and on short notice. If a deterioration in the quality of its assets raises concerns with regards to the solvency of a bank it is rational for each depositor to ‘run’ on the bank to withdraw his or her deposit and to leave the other depositors with worthless or at least illiquid claims.

⁴⁵ *Haldane, supra* note 24, p. 6.

Investment funds with a focus on listed securities (equity, fixed income) and a variable NAV typically do not show these characteristics. On the asset side of the balance sheet, a fund's assets are liquid, marked to market or fair valued daily, and publicly disclosed regularly. On the liability side of the balance sheet, the repayment obligation of an investment fund is derived from the aggregate value of the assets. A fund promises to repay only the current value of a shareholder's investment, based on the fund's NAV next determined after the redemption request is made (typically as of the close of trading). That current value at which the shareholder must be redeemed is based on the daily value of the fund's portfolio assets. These two features—the absence of a fixed repayment obligation competing for a limited amount of assets, combined with market/fair value pricing—effectively eliminate the conditions necessary for a run.

The dynamics of a bank run are indeed the source of a 'first mover advantage' for depositors. In the calculus of each individual investor it is rational to 'run' and the benefits of this behavior are obvious. In the case of investment funds, investors do not face similar incentives. The FSB and IOSCO seem to suggest that the first movers will leave the other investors behind with illiquid assets and that the costs of expected future redemptions may be predictable, large and borne by investors whose assets remain in a fund, which supposedly could prompt all investors to rush to redeem their shares, in an attempt to avoid the expected future costs.

From a theoretical point of view, however, the amount of hypothesized redemption costs has never been quantified nor has it been demonstrated that they would be substantial enough to motivate redemptions at a level that would cause asset sales to impact asset prices materially. Neither have the effects of these hypothetical dynamics on global financial stability been modelled.⁴⁶ We doubt that any theoretical costs are significant enough to influence decision making in practice. Even if one assumes that assets become illiquid the investment is not lost—as may be the deposits in a failing bank. As long as investors do not face any irrefutable liquidity needs they cannot cover from other sources they do not have to sell; and—as we will demonstrate in more detail below—in fact they do not sell.

Furthermore, the theoretical considerations do not reflect the liquidity management tools available and the practical decision making processes of portfolio managers. In reality, portfolio managers do not take a single approach to managing redemptions (e.g., selling liquid assets first, as the FSB and IOSCO seem to suggest) and thus they do not act homogeneously. When faced with substantial redemption demands portfolio managers will consider several factors when deciding which assets to sell, including how a security has performed against expectations, how liquid a security is, the size of a fund's exposure to that security, company, industry or region, and similar attributes of other securities in the fund's portfolio. In addition, portfolio managers have the ability to buffer the impact of redemptions by using a broad range of liquidity management tools (e.g., cash, inter-fund lending, committed or uncommitted lines of credit, delays in cash payout, payment in kind, short term redemption fees, or—as an ultimate measure—the suspension of redemptions) to respond to redemptions requests or by selling a proportionate share of all fund assets. In general, each portfolio manager will take a balanced and idiosyncratic approach in order to minimize the impact of selling illiquid assets, while ensuring that a fund remains invested at its targeted asset allocation.

Indeed, recent research demonstrates that asset managers are managing risks prudently today. Whereas bond fund redemptions reached about 4% in the worst three months during the recent financial crisis average cash holdings today amount to 4% to 7% across all U.S. corporate bond and high yield funds. In addition, industry data demonstrate that fund managers increase liquidity by the factor 1 to 3x in times of

⁴⁶ As former Federal Reserve Board Governor *Jeremy Stein* has observed, regulators do not “know enough about the empirical relevance of the AUM-run mechanism, to say nothing of its quantitative importance, to be making such recommendations at this point.”; *Stein, Jeremy C.*, Comments on “Market Tantrums and Monetary Policy,” a paper by Michael Feroli, Anil K. Kashyap, Kermit Schoenholtz, and Hyun Song Shin, 2014 U.S. Monetary Policy Forum, New York, February 28, 2014, p. 6 (<http://www.federalreserve.gov/newsevents/speech/stein20140228a.pdf>).

stress.⁴⁷ As a result, funds' cash holdings in fact serve as a buffer against short-term liquidations in a bear market. For example, during October 2008, fund investors redeemed under 2% of aggregate stock fund assets. However, during the same month, portfolio managers divested only 0.4% of assets held in stock funds, and less than one-third of the net redemptions by stock fund investors.⁴⁸

Thus, we think that the conditions for a 'run' are not met in the first place. In fact, in the 75-year history of the U.S. regulated fund industry, through market events of all kinds, stock and bond funds have never experienced a 'run on a fund'.⁴⁹ While this already challenges the substance of the argument we also think that the mentioned factors that theoretically could contribute to or amplify forced asset sales lack merit in practice.

(i) Loss of investor confidence:

In our view history leads to the conclusion that the potential for systemic risk may rather be embedded in the failure of a certain asset class or a specific business model than in the operations of a single firm. However, a precondition for such a crisis that could lead to a 'run' on a complete asset class is a fixed repayment obligation competing for a limited amount of assets or a flawed pricing mechanism.

The former is illustrated by the example of the Reserve Fund that triggered a run on prime Mutual Money Market Funds (MMMF). The run on prime MMMFs occurred after the Reserve Fund suffered losses on papers issued by Leman Brothers and 'broke the buck'. This event raised widespread concerns regarding the quality of the assets held by other prime MMMFs, demonstrated the limitations of the implicit repayment guarantee and caused a crisis in this specific asset class.

An example for the latter was German open real estate mutual funds. Because of the steady performance these funds had been marketed as an alternative to bank deposits or MMMFs to corporate and institutional investors in Germany before the financial crisis. Investors were entitled to withdraw unlimited amounts from these funds on a daily basis. Fund prices were adjusted daily but the properties had to be valued only annually. When the subprime crisis in the United States spurred concerns about the sustainability of the asset values investors started to withdraw heavily from these funds. Many portfolio managers had to make use of statutory redemption gates. Currently, funds representing about one fifth of the more than €80 billion market are either frozen or in resolution.⁵⁰ However, this event neither caused any systemic shocks in the real estate market nor did it have any contagious effects on other asset classes. Nevertheless, this episode led to a complete overhaul of the German regulation of investment funds.

We are not aware of any empiric evidence of a 'run' on an investment fund with a focus on listed securities. Research has demonstrated that during periods of market stress dating back to 1945 and through the most severe financial crises, mutual fund investors have not reacted precipitously to financial market shocks. For example, in the 17-month period November 2007 to March 2009, U.S. equity funds experienced net cash outflows of \$281 billion. The majority of these outflows (\$205 billion) occurred during the peak of the financial crisis, July to December 2008. However, over these six months the net outflows

⁴⁷ See *Morgan Stanley/Oliver Wyman, Wholesale & Investment Banking Outlook – Liquidity Conundrum: Shifting risks, what it means*, March 19, 2015, p. 4 (http://www.oliverwyman.com/content/dam/oliverwyman/global/en/2015/mar/2015_Wholesale_Investment_Banking_Outlook.pdf).

⁴⁸ See *Strategic Insight, supra*, note 42, p. 12 (with reference to ICI data).

⁴⁹ See *ICI, supra* note 32, p. 4.

⁵⁰ See *BVI Bundesverband Investment und Asset Management e.V., Offene Immobilienfonds, Stichtag 31. Januar 2015* (http://www.bvi.de/fileadmin/user_upload/Statistik/2015_01_OIF_Status_und_FV.pdf).

amounted to just 3.6 percent of equity fund assets.⁵¹ As the FSB and IOSCO have observed “(p)art of the explanation may be that many US investors hold mutual fund shares for retirement purposes. As such, these investors’ investment horizon could be long-term, whereby they would prefer to remain invested rather than cash-out during a market downturn.”⁵² In fact, these investors tend not only not to redeem in response to short-term market moves; due to automated investment processes, these investors often provide a buffer to large market movements because they will be buying when other investors are selling.

While we concede that individual funds may experience increased redemptions in periods of high volatility and market stress there is no historical evidence that redemptions of fund investors have induced fire sales by equity and bond funds and led to a collapse of securities prices and to the materialization of systemic risk. There is no empirical evidence to assert that they may do so in the future.

The various examples demonstrate that crises usually emanate from specific products or within specific assets classes. Against this backdrop we concur with the IMF that “investment *focus* appears to be relatively more important than *size* when gauging systemic risk.”⁵³

(ii) Distress of a highly leveraged investment fund attempting to meet margin requirements:

According to our experience systemic disruption caused by a single firm or fund generally results from highly leveraged operations which have accumulated significant under-protected exposures or have caused disruption through their lack of substitutability. If such a fund were to liquidate holdings in order to meet margin requirements the core of the problem are not the fire sales but the leverage the fund has assumed in the first place. Any policy measure would have to focus on leverage as the core of the problem as we have explained above.

(iii) Termination of securities loans leading to cash repayment obligations:

In general, most investment funds engage in securities lending only to a very limited extent. The various securities lending programs do not create material investment risk to the single fund let alone can they be the ultimate source of risk to the global financial stability. Typically, borrowers are required to post collateral between 102% and 112% of the value of the securities lent. In case of non-cash collateral the pledged securities are held by a third-party custodian and are not available for re-hypothecation. If cash is pledged as collateral the funds are typically invested in a MMMF.⁵⁴ In case of loans of fixed income securities cash collateral is invested in overnight repurchase agreements. Against the backdrop of established industry practice we regard it as factually impossible that a fund might be forced to execute fire sales of assets in order to return cash collateral received for securities loans.

(iv) Reputational risk caused by a fund managers distress or liquidation:

This hypothesis is not supported by the facts. The industry has indeed experienced several reputational crises of specific asset managers in the past.⁵⁵ Every crisis has induced the shift of significant amounts of

⁵¹ See *ICI*, Public Feedback on OFR Study on Asset Management Issues (SEC File No. AM-1), November 1, 2013, Appendix B, p. B-4 (http://www.ici.org/pdf/13_ici_ofr_asset_mgmt.pdf).

⁵² *FSB/IOSCO*, *supra* note 22, p. 30, Fn. 38.

⁵³ *IMF*, *supra* note 6, p. 121 (emphasis in the original).

⁵⁴ For technical details see *BlackRock*, Securities Lending: The Facts, May 2015 (<http://www.blackrock.com/corporate/en-us/literature/whitepaper/viewpoint-securities-lending-the-facts-may-2015.pdf>).

⁵⁵ For a comprehensive list see *BlackRock*, Response to Notice Seeking Comment on Asset Management Products and Activities, Appendix C (<http://www.blackrock.com/corporate/en-kr/literature/publication/fsoc-request-for-comment-asset-management-032515.pdf>).

client assets from one manager to others supporting the argument that even the largest asset managers and investment funds are easily substitutable. In no case, however, have these movements had a destabilizing effect on capital markets. For example, the departure of a renowned portfolio manager recently triggered the reallocation of over \$200 billion in fixed income assets from one asset management firm to several competitors. Despite challenging market conditions in fixed income markets at the time, these transactions did not have any noticeable market impact.⁵⁶

The IIF therefore comes to the following conclusion on this channel: With regards to investment funds, and while funds may experience periods of higher than normal redemptions, where funds maintain readily saleable assets and/or circuit-breaking mechanisms to deal with periods of high redemptions (as required by law/regulation in many instances) asset liquidation in our view is not a transmittal channel for systemic shocks.

Critical function or services / Substitutability channel

We agree with the FSB and IOSCO that “*the core function of an asset manager is managing assets as an agent on behalf of others in accordance with a specified investment mandate.*” We are not aware of any “*specific activities, for which (the asset manager) has developed a specific skill, and which would make the manager’s business not easily transferable in the event of a default.*” We concur with the FSB’s and IOSCO’s assessment in the previous Consultative Document that the investment fund industry is highly competitive with funds being highly substitutable.⁵⁷ This leaves investors with a broad range of options for obtaining all kind of services. Consequently, the substitutability channel is not applicable to investment funds.⁵⁸

Conclusion

For the reasons described above, we strongly believe that in the context of investment funds the only transmission channel that is relevant to the SIFI analysis is the exposure (counterparty) channel via leverage and this is where attention should be focused.

Q6-2. For the asset liquidation/market channel, to what extent is the potential for risk transmission heightened with respect to an individual fund that is a dominant player (e.g. its asset holdings or trading activities are significant relative to the market segment) in less liquid markets?

At the outset, we would like to mention that market liquidity issues are not primarily investment fund or asset management issues. In general, a lack of market liquidity impacts all market participants. Ensuring well-functioning, liquid capital markets is in the interest of all market participants and should be a high priority of policy-makers. Indeed, market depth and liquidity have recently deteriorated in the wake of both regulatory and market developments that have changed the economics of market making. To date, this problem is not yet fully recognized or understood. Consequently, institutional investors—including investment funds—must now manage liquidity risk previously assumed by the banking industry.⁵⁹

⁵⁶ See *IMF*, *supra* note 6, p. 103.

⁵⁷ See *FSB/IOSCO*, *supra* note 22, p. 30.

⁵⁸ *Id.*, p. 28.

⁵⁹ See Letter from *Timothy D. Adams* (President and CEO, IIF) to *Agustin Carstens* and *Marek Belka*, April 14, 2015 (<https://www.iif.com/publication/policy-letter/april-2015-iif-policy-letter-imfc-and-development-committee>).

However, concerns regarding the market liquidity of a certain asset class or a specific market have to be distinguished from concerns that redemption characteristics of investment funds could contribute to systemic risk. It may well be that in times of a crisis investors generally retreat from less developed markets. Any problems that may be caused by such behavior can of course not be blamed on a certain class of market participants. It is important to remember that investors in the same market can sell assets into the market on a daily basis just as an investment fund can. Thus, the fund has no different ability to transact in those assets than other investors do. There is no material economic difference to investors between investing in assets directly or through a collective fund and there is no economic difference at all if an investment fund or a direct investor buys or sells assets in a given market.

The first question should be whether a ‘less liquid market’ is relevant or material to global financial stability. We think that a nexus between a less liquid market and global financial stability has to be established in the first place.

Assuming a global systemic relevance of this market the second question would have to be whether a fund is likely to be a ‘dominant’ player in such a market. We deem this highly unlikely. If a market is large enough to be relevant to the global financial system, it seems to be highly unlikely that a certain fund or even a small group of funds could assume a dominant role in such a market. Given the intense competition in the industry that is fostered by low barriers to entry and high substitutability, a market of any importance will attract many investors, including investment funds.

On the fund level, it is one of the most basic principles of any prudent liquidity management to avoid becoming a dominant player in a specific market. Regulatory or management guidelines typically stipulate a threshold for holdings in a certain security and require a minimum level of diversification.⁶⁰ Further, there are also strong economic incentives that preclude funds from becoming a dominant player. Active managers are paid to outperform the market. If their fund dominates a market or ‘becomes’ the market, they cannot outperform it. Consequently, sponsors of actively managed funds regularly close funds to new investors when they can no longer invest new money consistently with a fund’s strategy.

In practical terms, funds invested in less liquid markets almost by definition face potentially greater liquidity and redemption challenges than other investment funds. However, those are the same challenges faced by other investors in those markets. Whether investing in those markets directly or through funds, investors in less liquid markets accept the general possibility that liquidity premia may rise during times of market stress. Investors that not only opt for this specific asset class but also to use the services of a portfolio manager instead of making a direct investment, benefit from increased diversity of holdings and professional management strategies. Indeed, liquidity management for those funds usually receives special attention by portfolio managers to meet redemptions. For example, a portfolio manager may maintain a higher level of cash for a fund holding a less liquid asset class, and increase this level during a period of market stress.⁶¹ In addition, portfolio managers can refer to a broad range of liquidity management tools like inter-fund lending, committed and uncommitted lines of credit, delays in cash payout upon redemption (within regulatory limits), payment in kind, short term redemption fees, or—as an ultimate measure—the suspension of redemptions.⁶²

⁶⁰ See the SEC rules for diversified funds. Under section 5(b)(1) of the 1940 Act, in order for a fund to be considered diversified, 75% of the value of the fund’s total assets must be invested in cash or government securities or issuers limited by not more than 5% of the fund’s total assets in any single issuer and not more than 10% of the outstanding voting securities of such issuer.

⁶¹ See *IMF*, *supra* note 6, p. 112 (Figure 3.12.)

⁶² *Id.*, p. 117.

Against that backdrop, we do not see any potential for risk transmission originating at the level of an individual investment fund.

Q6-3. Under what conditions might the asset liquidation/market channel apply to an individual fund in ways that are distinct from industry-wide behaviours in contributing to broader market contagion?

As we have argued before (see our answer to Q6-2) we think that with regards to investment funds the asset liquidation/market channel in general is not a transmittal channel for systemic shocks. Thus, we cannot recognize any distinctions between individual funds and industry-wide behavior.

Q6-4. Is the proposed threshold defined for private funds appropriately calibrated? If not, please explain the possible alternative level (e.g. USD 200 billion of GNE) that could be adopted with clear rationale for adoption and quantitative data to back-up such proposed level?

Regarding the materiality thresholds we refer to our comprehensive answer to Q6-5.

Q6-5. In your view, which option for the proposed threshold applied to traditional investment funds is the most appropriate initial filter to capture the relevant funds for detailed assessment and why? Also, are they appropriately calibrated? Please provide evidence (data or studies) to support your argument. If you prefer Option 2, please provide a practical definition of a dominant market player that can be applied in a consistent manner.

In general, the Consultative Document does not provide any arguments or data to support the proposed materiality thresholds or explains how the various suggested measures indicate potential risk to the global financial system. Furthermore, there is no explanation why different metrics shall be applied to private funds as opposed to traditional investment funds. Without further explanation of the respective rationale four different metrics are being suggested: Gross Notional Exposure (GNE), Net Asset Value (NAV), net Asset Under Management (net AUM), and Gross Asset Under Management (GAUM). We do not see the benefits of operating with this broad set of different metrics.

We are concerned that each of these measures as such is (i) too low to be relevant to global financial stability—for example as compared to global GDP, global aggregate value of financial assets or even the size of the median G-SIB, (ii) too high to identify any risk that could materialize in an asset class—for example as compared to the Reserve Fund’s AUM that peaked at approximately \$62 billion, and (iii) too simplistic as it does not consider the riskiness of the asset mix and leverage with which a fund operates. Any measurement of size alone provides limited insight, as the asset mix could be invested in many different ways and present a vast spectrum of ‘riskiness’ into which size provides no meaningful insight.

The largest funds have a significant percentage of their clients’ assets invested in long-only passive strategies in highly liquid markets. Long-only strategies appear to present minimal risk from a systemic perspective, and passive strategies present even less potential for systemic risk. From a risk perspective a single index fund with an AUM of \$125 billion is not different from five funds tracking the same index with an AUM of \$25 billion each. However, the former would exceed the materiality threshold and be perceived as potentially systemically relevant whereas the latter would be ignored.⁶³ Thus, any threshold

⁶³ See *Richardson, Matthew*, Asset Management and Systemic Risk: A Framework for Analysis, March 19, 2015, p. 30.

that simply connects to size is more or less arbitrary. We reiterate our argument that risk metrics that are risk-based and risk-sensitive should be devised to identify potential SIFIs.

If the FSB and IOSCO, for reasons of simplicity, want to use (improved) size metrics to provide the initial filter of entities for assessment we would argue that the thresholds are too low to be indicative of systemic relevance let alone potential risk. They are also inconsistent with the G-SIB methodology. To bring the NBNI G-SIFI assessment in line with the G-SIB framework the FSB and IOSCO should consider that the smallest G-SIB is operating with total assets of \$274 billion (as of 12/31/2014). However, even the smallest G-SIB operates with a leverage ratio of 11. Thus, any unleveraged size threshold for an investment fund would have to be much higher than the total assets of the smallest G-SIB to reflect a similar risk.

In principle, the thresholds should be carefully set and rather calibrated downwards in the course of the assessment process than set too aggressively in the first place. It should be considered that any SIFI assessment will require the dedication of significant resources within the scrutinized entities and this will lead to according internal and external costs.

Regardless of where the thresholds are ultimately set, they should include an inherent adjustment to accommodate the growth of the financial system such that the thresholds do not become more inclusive over time than is intended at their establishment.

Option 1:

In general, the suggested materiality threshold for traditional investment funds should be consistent with thresholds and standards developed by international and domestic authorities for similar purposes. For example, the Basel Committee on Banking Supervision (BCBS) has set a total leverage capital requirement of 3% or 33:1 leverage. In the United States FSOC's guidance for Nonbank Financial Company Determinations require a minimum of \$ 50billion in total consolidated assets. With regards to leverage, the Council intends to apply a threshold leverage ratio of total consolidated assets to total equity of 15 to 1.⁶⁴ These requirements do not connect to the proposed global materiality threshold of \$ 30billion in NAV in combination with a financial leverage of 3x NAV. There is no justification for deviating from these thresholds in the NBNI methodology and certainly no justification for setting a threshold for investment funds that is so much lower than the domestic threshold for non-banks in the U.S. and the minimum leverage requirement for large banks internationally.

Option 2:

We do not think that suggested measures like 'substitutability ratio' and 'fire sale ratio' have any practical relevance and can provide meaningful information. We refer to our general reservations with regard to the asset liquidation/market channel as expressed in our answers to Q6-1 and Q6-2.

From a more practical perspective it seems highly questionable to base any evaluation of the liquidity of the assets in an investment fund on the trading volumes in a certain asset class. Investment funds own and portfolio managers initiate trades in specific securities not in an asset class. Within each asset class the liquidity of a certain security can differ significantly. Thus, any analysis would have to be based on the

⁶⁴ See *FSOC, Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies* (12 CFR Part 1310), Federal Register, Vol. 77, No. 70 (April 11, 2012), pp. 21,637-21,662 (p. 21,662) (<http://www.gpo.gov/fdsys/pkg/FR-2012-04-11/pdf/2012-8627.pdf>).

specific portfolio composition of an investment fund and the liquidity of each specific security.⁶⁵ We regard the suggested metrics as theoretically meaningless and practically flawed. We are concerned that such metrics may create the impression of spurious accuracy and may lead to wrong conclusions.

Q6-6. In addition to the two options for traditional investment funds, the FSB and IOSCO also considered a simplified version of Option 2 using GAUM (e.g. USD 200 billion) with no dominant player filters. Please provide your views if any on this as a potential threshold with the rationale (especially compared to the proposed two options above).

We refer to our answer to Q6-5.

Q6-7. Please explain any proposed revised indicators set out above that, in your view, are not appropriate for assessing the relevant impact factors and its reasoning.

We reiterate our position that the only appropriate indicators are those relating to leverage, which are the indicators of complexity and interconnectedness. This assessment is supported by the fact that—for good reason—“the extent of the leverage of the company” is the first of a number of indicators the FSOC has to take into consideration when determining whether a nonbank financial company poses a threat to the financial stability of the United States.⁶⁶

Specifically, we are concerned with regards to the indicators on cross-jurisdictional activities. Global activities can generate many benefits through diversification and portfolio effects and as such reduce risk. When looking for potential systemic risk, any indicator should not be based on nominal figures or simplistic counting exercises, e.g. the number of jurisdictions in which an investment fund invests or has counterparties; rather the indicators should connect to the relevance of an investment fund to the global financial system. This could be achieved by analyzing in how many jurisdictions an investment fund is systemically relevant at the national level and whether financial stress in any of these jurisdictions (or in all of them) may cause a global systemic crisis.

Q6-8. What alternative indicators should be added and why would they be more appropriate? For example, do you see any benefits in adding price-based indicators? If so, please explain the rationale for inclusion and possible definitions of such indicators.

We strongly believe that in the context of investment funds posing a global systemic risk the only relevant transmission channel is leverage and this is where attention should be focused. Thus, any methodology and any indicator should be centered around the identification of leverage and a risk-sensitive approach to derivatives.

Specifically, we suggest that the FSB and IOSCO should consider initial margin as an additional indicator. For almost all types of financial contracts, a fund may be required to post an initial margin upon inception of a transaction in addition to posting margin to cover any mark-to-market losses during the duration of a trade (variation margin). The initial margin is set by the creditor and is intended to cover any

⁶⁵ See e.g. the limitations for share-buybacks in the European Union as stipulated in Article 5 of the Commission Regulation (EC) No 2273/2003 of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards exemptions for buy-back programmes and stabilisation of financial instruments (https://www.esma.europa.eu/system/files/MADImplReg_2273_2003.pdf).

⁶⁶ See Section 113(a)(2)(A) Dodd-Frank Wall Street Reform and Consumer Protection Act.

losses the counterparty might suffer from the moment a fund does not meet a margin call and thus triggers the termination of the trade until the completion of the closeout. Therefore, initial margin is set at a level estimated to cover the potential change in value while a trade is liquidated under stressful conditions. Margin calculations, whether for cleared or non-cleared derivatives, also take account of the relative riskiness of different derivative portfolios and their nonlinearity. Therefore the total initial margin posted by a fund is a good proxy for the risk of loss of that fund's portfolio of derivatives and moreover is set by the creditor at a level which the creditor deems to be sufficiently conservative to provide protection.

Furthermore, we could imagine an indicator that reflects the institutional framework and the maximum level of leverage that could theoretically be employed under such framework. For example, UCITS in the European Union face specific restrictions with regards to the use of leverage. This hard-wired resilience should be taken into consideration since it does not only serve to provide investor protection on an individual basis. On a collective level, the liquidity and diversification requirements also have positive repercussions on the stability of the financial system as a whole.

However, besides existing practices and regulations the significant counterparty risk-reducing derivative reforms already in train should also be taken into account when interpreting whether synthetic leverage actually poses a systemic risk. Also, as leverage can be employed by funds large and small, if existing regulation and reforms are found wanting to manage the risk of leverage in the investment fund industry, then any necessary additional reforms, after due consultation, should be applied sector-wide and focused on the activity, rather than only a small set of investment funds.

Finally, another indicator should be established to consider the degree to which the company is already regulated by one or more primary financial regulatory agencies. This would reconcile the FSB/IOSCO methodology with the statutory requirements in the U.S. demanding such a consideration to be made when deciding whether SIFI designation of a nonbank financial company is justified on a national level.⁶⁷

Q6-9. What are the practical difficulties (e.g. data availability, comparability) if any with collecting data related to these indicators? Please clarify which items, the practical problems, and possible proxies that could be collected or provided instead.

Not all of the required figures are standard reporting parameters and readily available. They would have to be calculated exclusively for the G-SIFI assessment. For managers with a large number of funds administrative costs would be large. Therefore, the IIF endorses the approach that only funds exceeding the initial threshold should be subject to providing metrics in support of the assessment of individual indicators.

Nevertheless, we reiterate our recommendation that regulators should focus most of their efforts on cataloging data they already have, filling any data gaps and developing the analytics necessary to interpret it. Without sufficient data and interpreting analytics any policy measure is susceptible to do more harm than good. Policy makers will be unable to seriously justify decisions to act, to defend a decision not to act, or to measure the (in) effectiveness of their actions or inactions.

Besides that, we believe there are definitional problems with regards to certain indicators. Leaving aside our assessment that these indicators are inappropriate, defining a strategy or category in a way that can be applied globally and actually capture the appropriate data would be very difficult.

⁶⁷ See Section 113(a)(2)(H) Dodd-Frank Wall Street Reform and Consumer Protection Act.

Q6-10. For “size”, should GNE be adjusted? If so, please explain how GNE should be adjusted and the practicality of such adjustment (e.g. data availability).

We think that GNE is a fundamentally flawed metric that would result in both false positives and false negatives. First, GNE does not reflect the economic or market exposure of an investment fund as it provides no adjustment for offsetting positions. For example, GNE would double-count the full notional values of two perfectly offsetting positions even though the fund’s net economic exposure would be zero. Furthermore, GNE does not recognize the relative riskiness of different types of derivatives. In similar situations, regulators have consistently acknowledged that derivatives referencing short-term interest rates are less risky than those referencing long-term interest rates and that asset classes such as interest rates and currencies are less risky than equities and commodities.⁶⁸ Finally, GNE also does not take account of the nonlinear nature of options and other similar derivatives. A fund whose derivative positions consist only of purchased options may have a high GNE, even after delta-adjustment; however, the maximum possible economic loss amounts only to the current value of the options.

For these reasons we ask the FSB and IOSCO to refrain from using GNE as metric in the NBNI Assessment Methodology and instead use a risk-sensitive measure such as initial margin (see our answer to Q6-8), the AIFMD commitment leverage or the SA-CCR method (see our answer to Q6-11 below).

Q6-11. For “interconnectedness”, should financial leverage measured separately from synthetic leverage?

In considering leverage and the potential impacts of leverage on the markets, it is important to understand that leverage can occur not only at the product level, but also at the end-investor’s portfolio level. Importantly, the use of leverage is not limited to assets managed by investment funds. As we saw in the 2008 financial crisis, many wholesale and retail investors who had employed leverage on their own balance sheets were forced to liquidate investments to meet their individual liquidity needs and margin calls.

Furthermore, it is important to note that there is no standard definition of leverage for the asset management industry. The subject is unnecessarily complicated by the lack of global regulatory agreement on definitions. Regulatory frameworks in the United States, in Europe, and in Asia use different approaches to define measure and limit leverage in investment funds. We would appreciate an initiative by the FSB and IOSCO aimed at increasing consistency and transparency with regard to this important risk factor.

As of today, the use of leverage in a number of investment products is subject to extensive regulation. We concur with the FSB and IOSCO that “*many public funds currently have legal and regulatory limitations on their ability to use leverage (either balance-sheet leverage or synthetic leverage)*”. For example, U.S. mutual funds are subject to specific leverage limitations, both in connection with borrowing and the use of derivatives. In the European Union regulatory regimes under both the UCITS and the AIFMD

⁶⁸ For example, bank regulatory capital requirements (Basel II, Basel III) apply different conversion factors to short-term and long-term derivatives and to different asset classes; in effect longer-term derivatives in commodity and equity classes are considered most risky whereas short-term interest rate and foreign exchange derivatives receive only small risk weightings; see BCBS, International Convergence of Capital Measurement and Capital Standards - A Revised Framework, Comprehensive Version, June 2006, Annex 4, No. 92(i), p. 274 (<https://www.bis.org/publ/bcbs128.pdf>).

framework similarly include explicit limits or disclosure obligations related to leverage.⁶⁹ Since the AIFMD framework is one of the newest and most comprehensive approaches, we suggest that policy-makers as well as the FSB and IOSCO try to align their approaches to measuring leverage on this template rather than developing another and potentially inconsistent methodology.

While private funds in the United States are generally not subject to regulatory leverage restrictions, many agree to abide by leverage limits in their offering materials and provide transparency to investors regarding current leverage levels. Additionally, regulatory and market changes implemented since 2008 have significantly reduced exposures and the systemic risk that a private fund can pose. Central clearing, netting of risk positions, mandated changes to documentation and collateral practices, increased dealer requirements and other changes have significantly reduced counterparty risk, fundamentally changed trading practices, improved dealer risk management and therefore mitigated the potential impact of the insolvency of a private fund.

Against this backdrop we suggest to measure financial leverage separately from synthetic leverage. Synthetic leverage should be measured by applying the Standardized Approach (SA-CCR) as introduced by the BCBS in 2014.⁷⁰ This approach was designed to be applied to a wide variety of derivatives transactions (margined and unmargined, as well as bilateral and cleared). Furthermore, it addresses known deficiencies of other metrics and ensures risk sensitivity without creating undue complexity.⁷¹ Finally, using SA-CCR within the NBNI G-SIFI Assessment Methodology would also have the benefit of creating a level playing field with banks.

Sector-specific methodologies: Asset Managers

Q7-1. Please describe any activities or services conducted by asset managers other than described above. In particular, please explain any other activities that, in your view, should be included in the scope.

Asset managers themselves are not direct participants in the capital markets. They do not act as lenders or counterparties, and accordingly they have very small balance sheets, and limited interconnections—particularly when compared to other financial institutions like banks and insurance companies—and none with respect to the assets they manage. Therefore, asset management entities present no systemic risk at the company level.

⁶⁹ AIFMD includes two measures of leverage: “gross leverage” provides a baseline measure of whether a fund is using derivatives and/or borrowing and to what degree. “Commitment leverage” provides a calculation designed to assess economic exposure obtained through the use of leverage by reflecting direct borrowings as well as derivatives exposure with netting allowed for many, but not all, macro/micro hedges as well as paired offsetting derivatives positions; see Article 8, Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision, L 83/1, 22.3.2013 (<http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0231&from=EN>).

⁷⁰ See BCBS, The standardised approach for measuring counterparty credit risk exposures, March 2014 (rev. April 2014) (<http://www.bis.org/publ/bcbs279.pdf>).

⁷¹ *Id.*, p. 1.

We therefore fully support the statement from the First Consultative Document that “(e)conomic exposures are created at the fund level as they emanate from the underlying asset portfolio held by the fund. It is therefore the portfolio of assets that creates the respective exposure to the financial system”.⁷² We also support the conclusion that “the manager acts as an ‘agent’, responsible for managing the fund’s assets on behalf of investors according to its investment objectives, strategy and time horizon”.⁷³ The asset management business is an ‘agent’ business and not a ‘principal’ business. Consequently we had strongly endorsed the FSB’s and IOSCO’s previous approach of focusing on the fund level.

Beyond standard industry practices we are not aware of any “*specific activities, for which (the asset manager) has developed a specific skill, and which would make the manager’s business not easily transferable in the event of a default.*” Against this backdrop we do not see any need to expand the scope of the analysis. If the FSB and IOSCO should come to a different conclusion we would argue that such critical activities would have to be regulated on an industry-wide basis. A SIFI-designation would by no means be appropriate. It would make no sense to attempt to identify and regulate any ‘specific activities’ by focusing on certain managers. If such activities are truly of concern, then the proper focus is at the activity level on any entity that conducts them, regardless of such entity’s size and type. After all, large managers may conduct no such ‘other activities’ beyond core investment funds’ management activities; and, even if the FSB and IOSCO regulated all of the large managers that did conduct such activities, they would not effectively regulate the market for such activities because other entities would not be covered.

Q7-2. Please explain any potential systemic risks associated with the financial distress or default of an asset manager at the global level that are, in your view, not appropriately captured in the above description of each risk transmission channel. Are there elements of the relevant channel that have not been adequately captured? Please explain for the relevant channel separately.

Exposures / Counterparty channel

At the outset it seems important to mention that asset managers do not act as counterparties to any transaction of the funds they manage—client trades, derivatives transactions, or securities lending arrangements. Every transaction is carried out between the fund and an independent third party—either another market participant or a CCP. Furthermore, it has to be recognized that the business model of asset managers does not entail the use of material balance sheet leverage that is present for banks—who inherently leverage their balance sheets as part of their business models. “Fluctuations in asset values do not threaten the insolvency of an asset manager as they would a bank. Asset managers are, to a large extent, insolvency-remote.”⁷⁴

As we have explained above (see our answer to Q6-1), we strongly believe that in the context of the asset management industry the only relevant transmission channel for potential global systemic risk under the FSB/IOSCO SIFI Framework is the exposure (counterparty) channel via leverage. This is where attention should be focused. Beyond leverage—if any—we are not aware that asset managers engage in counterparty behavior to a degree that could create or amplify systemic risk.

However, the use of leverage is not limited to the asset management industry. Excessive leverage can lead to systemic risks wherever it is employed. Against this backdrop there is no reason to differentiate between certain categories of market participants. The FSB and IOSCO do not provide any rationale why asset managers acting as principals should be treated differently from any other participant in the financial

⁷² FSB/IOSCO, *supra* note 22, p. 30 (footnote omitted).

⁷³ *Id.*

⁷⁴ Haldane, *supra* note 24, p. 6.

markets. As such, asset managers are not special and there is no reason why they should be treated differently.

If there were any activities that could raise concerns—for example the FSB and IOSCO specifically mention securities lending—these activities would not be limited to asset managers alone and thus would have to be analyzed on a comprehensive basis.

For further details we refer to our answer to Q7-3.

Asset liquidation / market channel

We endorse the assessment that “*asset managers tend to have small balance sheets and the forced liquidation of their assets would not generally create market disruption*”. We do not think that any off-balance sheet activities could cause market distress and a systemic crisis.

For further details we refer to our answers to Q7-3 (indemnifications) and Q7-4 (reputational/operational risk).

Critical function or services / Substitutability channel:

We endorse the assessment that “*asset managers primarily provide advice or portfolio management services to clients on an agency basis. This model makes their provision of this particular activity generally substitutable as there is considerable competition in the market place*”. Beyond this general characterization it is widely recognized that large, global managers have an advantage when it comes to stability and business continuity management in the face of business disruptions in a particular region or country (e.g., power outage, hurricane, earthquake, etc.) because they have the ability to shift operations to other offices or regions that may not be affected by the disruption. Managers that only operate in one country are more exposed to such disruptions.

Thus, if and when operational problems do occur within an asset management group they are typically remedied without any disruption in service. Even if there is a temporary disruption due to external factors it is likely to be limited to a few highly substitutable entities. However, these disruptions will not result in direct financial losses to the investors they serve. For example, if the investors in a mutual fund cannot redeem their shares temporarily due to a system outage their assets have not been lost. They remain safe with the custodian bank. Thus, the temporary unavailability of the assets does not create a systemic disruption to the financial system.

In the event of a stress or default of a manager the assets would not have to be moved physically. The assets are not being held by the asset manager but by a custodian. They can remain with the same custodian in a client denominated account until the investors have decided how to substitute the asset manager. Custodians hold the assets irrespective of which asset manager the asset owner selects to manage the respective assets. If the services of an asset manager are no longer available, clients can award the mandate to manage an existing portfolio of securities to another manager without touching the assets as such.

If instead, funds were to be redeemed or assets to be transferred between custodians these transactions take place frequently without impact to financial stability, including in times of market stress. Even during the worst weeks of the recent financial crisis, investors were able to redeem funds and to transfer as-

sets between managers seamlessly. During the whole crisis the transfer and settlement systems were able to process client requests without any major delays.⁷⁵

Q7-3. For the exposure/counterparty channel, to what extent does the assessment adequately describe the types of risks posed by asset managers' activities, such as securities lending, distinct from individual funds? Are there other activities that warrant further assessment?

Seed investments:

The FSB and IOSCO refer to 'seed investments' as an example for exposures that could create and transmit systemic shocks to counterparties in case of failure and distress of an asset manager. In fact, the 1940 Act requires a newly registered investment company to have at least \$100,000 of seed capital before distributing its shares to the public. In practical terms, asset managers often invest amounts ranging from \$5 million to \$10 million as initial investment. As the FSB and IOSCO correctly observe these investments are made out of the asset manager's equity—and they become equity on the fund's balance sheet. There are no further counterparties involved. The asset manager can redeem seed capital on the same terms as any other redeeming shareholder. Usually, the seed money is redeemed once the fund has sufficient investors and capital to operate efficiently and at a scale that allows it to achieve its investment objectives.

The only obvious risk with these seed investments is the general market risk. Even assuming that an asset manager has several seed investments in place and further assuming that a significant part of all of these investments would be lost, the amounts in question are minuscule in comparison to the equity and the profits of a potential G-SIFI asset manager under the proposed Assessment Methodology. Losses could easily be absorbed and would never be large enough to become a source of global systemic risk.

Securities Lending:

We endorsed the assessment that “(s)ince the core function of an asset manager is managing assets as an agent on behalf of others in accordance with a specified investment mandate, asset managers tend to have small balance sheets”. The assets of an asset manager in large part consist of goodwill, intangible assets, and accounts receivable. If the balance sheet shows 'collateral held under securities lending agreements' these originate in the asset manager's activity as lending agent (see next paragraph). Economically, the collateral is attributable to the clients. On the balance sheet these assets are offset by corresponding liabilities.

Indemnifications:

Some asset managers act as lending agents for their customers by arranging securities loans between lenders and borrowers. Over decades it has been the practice of lending agents to offer to some lenders indemnification against 'borrower default'—i.e., the borrower failing to return the securities that have been lent. This indemnification, however, is limited to the 'shortfall' that could occur in the event the collateral delivered is insufficient to acquire replacement securities for those out on loan. Thus, borrower default indemnification is only triggered if the counterparty defaults and the collateral is insufficient to

⁷⁵ See *Fidelity*, Response to Notice Seeking Comment on Asset Management Products and Activities, p. 34 with further references in footnotes 108 and 109 (https://common.money-media.com/php/image.php?id=272393&ext=.pdf&referrer_module=article).

cover the cost of replacing the securities.⁷⁶ To our knowledge such claims are extremely rare. We are not aware that securities loans indemnifications have ever been triggered to any sizeable extent—not even in the recent financial crisis.

Conclusion:

In a nutshell, we do not think there are any ‘other activities’ that warrant further assessment by the FSB and IOSCO. Even if there were, such activities would be best analyzed or regulated on an industry-wide basis and not by solely focusing on managers with a large amount of assets under management.

Q7-4. For the asset liquidation/market channel, to what extent and under what circumstances might reputational or operational risks of the asset manager impact the entity’s individual funds, contributing to high redemptions? How might it impact the transfer of SMAs?

It has been claimed that a ‘reputational crisis’ in which a negative incident with regards to a certain fund damages the reputation of the respective asset manager can lead to a ‘run’ on all of its investment funds under management and that could spread to others in the market. There is no empirical evidence to support such a theory.⁷⁷ The distinctiveness and the independence of the various funds and their respective investor base render such an event extremely unlikely.

As we have explained above (see our answer to Q6-1) this hypothesis is not supported by the facts. The industry has indeed experienced several reputational crises of specific asset managers in the past.⁷⁸ Every crisis has induced the shift of client assets from one manager to others supporting the argument that even the largest asset managers and investment funds are easily substitutable. In no case, however, have these movements had a destabilizing effect on capital markets. For example, the departure of a renowned portfolio manager recently triggered the reallocation of over \$200 billion in fixed income assets from one asset management firm to several competitors. Despite challenging conditions in fixed income markets at the time these transactions did not have any noticeable market impact.⁷⁹

Further, existing regulations protect both the liquidity needs of investors and the stability of asset prices. Additionally, as the FSB and IOSCO have observed, there are resilient mechanisms in place to dampen any potential systemic impact of a potential ‘run’. ”For instance, depending on national regulation, asset managers may temporarily implement specific liquidity management tools such as swing pricing, anti-dilution levies, redemption gates, side-pockets, redemptions in kind or temporary suspensions.”⁸⁰ Hence, despite the very low probability of massive redemptions in the first place, even if such redemptions from all the funds of a certain asset manager should take place the industry has statutory rules and circuit-breaking mechanisms in place which would prevent such a dynamic from having systemic consequences.

With regards to funds that dismiss their managers and to SMAs in particular, we reiterate our comment that in order to replace an asset manager—for whatever reason—assets would not have to be moved phys-

⁷⁶ See *BlackRock*, *supra* note 54, p. 4.

⁷⁷ To the contrary, a major IIF member headquartered in Europe during the financial crisis had to temporarily close three funds to protect investors (primarily because of the inability of the group to value these funds fairly). This did not trigger outflows from the other funds of this group. Rather, while the crisis worsened the MMMFs managed by this group experienced significant inflows.

⁷⁸ See *BlackRock*, *supra* note 55, Appendix C.

⁷⁹ See *IMF*, *supra* note 6, p. 103.

⁸⁰ *FSB/IOSCO*, *supra* note 22, p. 30.

ically since they are being held by a custodian. If an investor decides to substitute an asset manager the assets can remain with the same custodian in a client denominated account. These assets will not become subject to asset liquidation.

Q7-5. For the critical function/substitutability channel, are there any emerging activities that might be critical to a portion of financial clients that might in turn impair market functioning or risk management if no longer provided? Other than managing assets as an agent (i.e. core function), to what extent do asset managers engage in activities that may be relied upon by investors, financial institutions and corporations, and which are difficult to readily substitute?

We are not aware of any emerging activities that might become critical to clients at all. Asset managers do not engage in any activity in which they would not be easily substitutable.

Q7-6. Please explain any practical difficulties in applying the above proposed thresholds for an initial filter of the asset manager universe and limiting the pool of asset managers for which more detailed data will be collected and to which the sector-specific methodology (set out in Section 7.4) will be applied.

Certain items may be included in a company's financial statements because of accounting rules but do not present solvency risk to the company and are not available for the company's discretionary use or to the company's creditors as other assets are. We recommend that those items be eliminated for purposes of applying the proposed thresholds. For example, we recommend excluding 'separate account assets' and 'collateral held under securities lending agreements'. Separate account assets are offset by matching liabilities and unavailable to the manager or its creditors.

With respect to 'collateral held under securities lending agreements,' as we have explained above (see response to Q7-3), these items originate in the services some asset managers provide to their clients. The economic risk attached to these items is not borne by the asset manager but by the client.⁸¹ Consequently, equal and offsetting amounts are recorded in liabilities. Against the backdrop of the nature of an asset manager's business and the specific accounting rules it makes no sense to apply the materiality threshold to 'balance sheet total assets'. Instead, an adjusted figure should be used.

The elimination of these inflating positions would not only present a more accurate picture of the company's actual financial exposures but would also be consistent with other materiality screens that have been developed for the same purpose. For example, FSOC excludes separate account assets when calculating a company's leverage and short-term debt ratios as part of the quantitative materiality screen that it uses to identify non-banks that warrant additional review.⁸²

Q7-7. Please provide alternative proposals, if any, for a more appropriate initial filter (with the rationale for adoption and quantitative data to back-up such proposals).

In general, the Consultative Document does not provide any arguments or data to support the proposed materiality thresholds or explain how the various suggested measures indicate potential risk to the global financial system.

⁸¹ However, if and as far as an asset manager acts as lending agent and agrees to indemnify the funds for losses there is a marginal risk in these indemnifications.

⁸² See *FSOC, supra* note 64, p. 21,643.

Specifically in the case of investment funds, the total AUM provides limited insight, as the asset mix could be invested in many different ways and present a vast spectrum of 'riskiness' into which size alone provides no meaningful insight. The largest funds have a significant percentage of their clients' assets invested in long-only passive strategies in highly liquid markets. Long-only strategies appear to present minimal risk from a systemic perspective, and passive strategies present even less potential for systemic risk. Thus, any threshold that simply connects to size seems to some extent arbitrary. We reiterate our argument that risk metrics that are risk-based and risk-sensitive should be devised to identify potential SIFIs.

Furthermore, we see no merits in summing up the AUMs of single investment funds to determine a materiality threshold for the asset manager. We fully support the FSBs and IOSCOs earlier statement that "(e)conomic exposures are created at the fund level as they emanate from the underlying asset portfolio held by the fund. It is therefore the portfolio of assets that creates the respective exposure to the financial system."⁸³ It should be recognized that every investment fund is a separate legal entity with separate assets and different counterparties. Most importantly the investors in each fund are different, and are very much independent. This means that if, for example, one fund in a family experiences higher than normal redemptions, there is no direct conclusion that any other fund in the family will also experience such redemptions.

Finally, this approach would be inconsistent with earlier rule-making by the BCBS and IOSCO. In the context of margin requirements for non-centrally cleared derivatives the BCBS and IOSCO determined a threshold above which initial margins would have to be exchanged. With respect to investment funds, they clarified that the threshold would apply at the individual fund level as long as the fund is a distinct legal entity that is not collateralized by, or otherwise guaranteed or supported by, other investment funds or the fund adviser in the event of fund insolvency or bankruptcy.⁸⁴ Therefore, the BCBS and IOSCO decided to address counterparty risk at the level of the single investment fund rather than at the level of the fund complex or the asset manager.

If the FSB and IOSCO, for reasons of simplicity, want to use (improved) size metrics to provide the initial filter of entities for assessment we would argue that the thresholds are too low to be indicative of systemic relevance let alone potential risk. They are also inconsistent with the G-SIB methodology. To bring the NBNI G-SIFI assessment in line with the G-SIB framework the FSB and IOSCO should consider that the smallest G-SIB is operating with total assets of \$274 billion (as of 12/31/2014).

In principle, the thresholds should be carefully set and rather calibrated downwards in the course of the assessment process than set too aggressively in the first place. It should be considered that any SIFI assessment will require the dedication of significant resources within the scrutinized entities and this will lead to according internal and external costs.

Regardless of where the thresholds are ultimately set, they should include an inherent adjustment to accommodate the growth of the financial system such that the thresholds do not become more inclusive over time than is intended at their establishment.

⁸³ *FSB/IOSCO, supra* note 22, p. 30 (footnote omitted).

⁸⁴ See *BCBS/IOSCO, supra* note 13, p. 9, Fn. 10.

Q7-8. Please explain any proposed indicators set out above that, in your view, are not appropriate for assessing the relevant impact factors and its reasoning. What alternative indicators should be added and why would they be more appropriate?

We advocate prioritizing, and focusing on, leverage as a source of systemic risk. Therefore the indicators of complexity and interconnectedness (and only in the context of leverage) should be prioritized and given the bulk, and we would argue 100%, of the weighting in determining systemic risk.

Q7-9. What are the practical difficulties (e.g. data availability, comparability) if any with collecting data related to these indicators? Please clarify which items, the practical problems, and possible proxies that could be collected or provided instead.

We do not comment on this question in detail as we believe that most of the proposed indicators are not appropriate for asset managers.

Q7-10. Which of the proposed indicators set out above, in your view, should be prioritised in assessing the systemic importance of an asset manager?

We advocate prioritizing, and focusing on, leverage as a source of systemic risk. Therefore the indicators of complexity and interconnectedness (and only in the context of leverage) should be prioritized and given the bulk, and we would argue 100%, of the weighting in determining systemic risk.

If 'size' is to be used it must be risk-sensitive, and any threshold should be consistent with the G-SIB assessment process as discussed in our answer to Q6-5.

With regards to 'global activity' it brings many benefits through diversification and portfolio effects and as such reduces systemic risk. When looking for potential systemic risk, any indicator should not be based on nominal figures, e.g. the number of jurisdictions in which an asset manager has a presence; rather the indicators should connect to a potential global systemic relevance of an asset manager and global systemic risk. This could be achieved by analyzing in how many jurisdictions the asset manager is of systemic relevance and if financial stress in any of these jurisdictions (or in all of them) may cause a global systemic crisis.

Conclusion:

As we have stated in various occasions, we have fundamental concerns about designating individual entities as systemically important and applying different policy measures to these, as we believe that such designation further increases moral hazard and potentially systemic risk itself. Instead, we recommend that the FSB and IOSCO analyze products and activities across the asset management industry and capital markets as the IMF has recommended. While we do not support the proposed approach by the FSB and IOSCO, we have developed these comments with the intent of being constructive in this policy dialogue.

If the FSB and IOSCO should stick to the current approach our primary message is that any NBNI G-SIFI Assessment Methodology should be sufficiently transparent, adequately reflective of systemic importance by using reliable data, objective metrics that are risk-based and risk-sensitive, and consistently applied across jurisdictions. In this context, we would argue that within the scope of the proposed Methodology no NBNI entities will be identified by an objective methodology, and existing regulation and identified areas of true systemic risk should inform that process. Furthermore, if adopted and implemented, a methodology should provide clear indications of how companies can reduce their systemic importance. Similarly, any development of policy measures should be reflective of the results of the assessment process, and include an opportunity for the public to comment on the proposals.

We hope these comments are useful as the FSB and IOSCO consider the way forward in this area. Given the complexity of these issues, we believe direct dialogue with the industry is essential and appreciate the FSB and IOSCO's willingness to engage in that dialogue. The IIF and its Non-Bank Non-Insurance Working Group stand ready to provide additional views or clarifications.

Should you have any questions on the issues raised in this letter, please contact Andres Portilla (aportilla@iif.com), or Thilo Schweizer (tschweizer@iif.com).

Very truly yours,

A handwritten signature in black ink, appearing to read 'A. Portilla', with a large, stylized initial 'A' and 'P'.

Andres Portilla

cc: David Wright, IOSCO