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For Concerns About Risk, a Better Way Forward

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Seventh in a series of Viewpoints *postings on funds and financial stability*

Since the financial crisis, regulators in the United States and abroad have been looking for ways to prevent a repeat. But recently it seems they've gone off course.

In a span of months, both the U.S. Financial Stability Oversight Council (FSOC) and the global Financial Stability Board (FSB) have begun examining whether regulated funds or their managers could pose risk to the overall financial system and thus should be deemed systemically important financial institutions, or SIFIs. U.S. mutual funds designated as SIFIs would be subject to new, bank-style prudential regulation that could significantly harm funds and the investors who rely upon them. Singling out individual mutual funds for inappropriate regulation or supervision would raise costs for fund investors and distort competition, among other harmful effects.

A More Sensible Approach

There's a better way to address any activities or practices that regulators believe could cause risks to the markets or the financial system. Under an activity-based approach, regulators identify specific activities and practices that pose *demonstrable* risk—and address those risks as necessary and appropriate.

For activities involving the capital markets, regulators with relevant experience and expertise—such as the Securities and Exchange Commission (SEC)—should drive the process for identifying issues and considering appropriate solutions. Under this process, regulators adhere to standard rulemaking procedures, including public meetings (with advance notice and reporting after), opportunities to comment on proposals, and requirements to apply rigorous cost-benefit analysis.

Regulators' rulemaking authority was substantial before the financial crisis, and further strengthened by the Dodd-Frank Act. SEC Chair Mary Jo White confirmed at an April 2014 Congressional hearing that the Commission has the authority it needs to adequately regulate the asset management industry.

The Activity-Based Model at Work

Regulators have taken and are continuing to take actions to mitigate risk in the financial system, or to make markets and market participants more resilient to future shocks.

These include increasing the resiliency of depository institutions through higher capital and other requirements; improving transparency and regulatory oversight of hedge funds and their managers; implementing reforms to the regulation and oversight of credit-rating agencies; implementing comprehensive reforms of over-the-counter derivatives markets; and enhancing regulatory cooperation and information sharing between jurisdictions. In addition, securities lending and repurchase agreement transactions are currently the subject of specific regulatory efforts, with additional efforts on the horizon.

The SEC's Division of Investment Management is working to expand its asset manager risk-oversight program, which includes development of a proposal to enhance its collection of data on U.S. regulated funds. This initiative, supported by ICI, is designed to provide the SEC with more timely and useful information about regulated fund operations and portfolio holdings.

In addition to these regulatory developments, ICI's Board of Governors has endorsed a voluntary initiative led by the Depository Trust & Clearing Corporation to shorten settlement cycles for a range of securities from trade date plus three days (T+3) to T+2. The move to T+2 is expected to lower liquidity and operational risks, promote better use of capital, and create significant process efficiencies for market participants—all changes that would benefit investors. The move also is expected to align U.S. settlement cycles with those around the world, which could help global funds better manage cash flows and reduce risk.

Together with our members, ICI is engaging—and will continue to engage—across the range of initiatives described above to address market-related issues, without imposing undue costs and burdens on regulated funds and their investors.

For more information on ICI's views and research on financial stability, please visit our *Financial Stability Resource Center* *or read the previous entries in this* Viewpoints *series:*

- SIFI Designation for Funds: Unnecessary and Harmful
- Size by Itself Doesn't Matter—Leverage Does
- The Market Crash That Never Came
- Who Are the FSB 14?
- How SIFI Designation Could Lead to a New Taxpayer Bailout
- Overseas Overreach
- For Concerns About Risk, a Better Way Forward

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