



ICI VIEWPOINTS

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Securities Lending by Mutual Funds, ETFs, and Closed-End Funds: Are the Risks Systemic?

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Fourth in a [series of Viewpoints](#) on securities lending

The Financial Stability Oversight Council (FSOC), the U.S. Treasury's Office of Financial Research (OFR), and the Financial Stability Board (FSB) are charged with identifying systemic risks. When they examine a financial activity, the ultimate question is whether that activity has the potential to threaten financial stability.

This *Viewpoints* series has sought to shed light on that question with respect to one discrete activity: securities lending. In particular, it's examined securities lending as conducted by U.S. regulated funds—mutual funds, exchange-traded funds (ETFs), and closed-end funds registered under the Investment Company Act of 1940. To be clear, the FSOC, FSB, and OFR have never expressly concluded that securities lending by these funds is a potential source of systemic risk. In fact, they have never directly addressed securities lending by U.S. regulated funds at all. That's not a knock on the FSOC, FSB, or OFR; it's just a comment on the ambiguous nature of the discourse thus far.

Given the FSOC's recent announcement that it has directed its staff to “undertake a more focused analysis of industry-wide products and activities to assess potential risks associated with the asset management industry,” we expect their focus on securities lending to sharpen. And that's a good thing—the FSOC, OFR, and FSB are right to look carefully at securities lending. This activity involves many financial firms around the world, comprising, by some estimates, about \$1.8 trillion in securities. And [as we've argued before](#), to the extent that regulators believe specific activities or practices pose risks to the market or to the financial system, they can and should use their considerable rulemaking authority to address those risks through activity-based regulation.

The ultimate question in systemic risk policy discussions—that is, whether securities lending poses systemic risks—cannot be answered in the same way for all types of lenders. A generic discussion of securities lending that encompasses all lending—by all types of players, everywhere in the world—too often leaves the impression that securities lending must be systemically risky because some firms, such as [AIG during the financial crisis](#), took

outsized risks in their securities lending programs.

But not all lenders behave as AIG did before the crisis. In fact, very few institutional investors currently may take those kinds of risks. For example, if the FSOC, OFR, and FSB take a careful look at the way U.S. regulated funds lend securities, they will see that:

- *U.S. regulated funds take a conservative approach to securities lending.* As [we discussed in our first post](#), this conservative approach is dictated in part by a strong regulatory framework that imposes limits on the amount that funds can lend, restricts the types of collateral they can accept from borrowers, demands that the collateral be invested for maximum liquidity, and addresses potential conflicts of interest.
- *Securities lending is a relatively minor strategy for most U.S. regulated funds.* As we [discussed in our second post](#), not all U.S. regulated funds lend securities, and most of those that do lend far less than allowed by law. In fact, our review of the most recent financial statements for the 500 largest U.S. regulated funds, which hold about \$9.62 trillion in total assets, shows that these funds collectively had just \$95.1 billion in securities on loan—less than 1 percent of their total assets and about one-twentieth of the estimated \$1.8 trillion of securities on loan worldwide.
- *U.S. regulated funds' conservative investment of cash collateral should allay systemic risk concerns.* U.S. regulated funds don't engage in risky practices when investing cash collateral—they invest only in highly conservative and liquid investments.
- *Concerns over asset managers providing indemnification against collateral shortfalls are overstated.* A closer look at the indemnification offered by a lending agent—whether a bank, broker-dealer, or asset manager—shows that it is unlikely to be a source of stress on the agent's balance sheet.

We encourage the FSOC, OFR, and FSB to take a close look at securities lending by U.S. regulated funds. If they do, we're certain that they'll conclude that such lending by U.S. regulated funds simply does not pose a threat to financial stability, or provide a sound basis for designating these funds or their managers as systemically important.

Read the other entries in this Viewpoints series:

- [Securities Lending by Mutual Funds, ETFs, and Closed-End Funds: The Basics](#)
- [Securities Lending by Mutual Funds, ETFs, and Closed-End Funds: The Market](#)
- [Securities Lending by Mutual Funds, ETFs, and Closed-End Funds: Regulators' Concerns](#)
- [Securities Lending by Mutual Funds, ETFs, and Closed-End Funds: Are the Risks Systemic?](#)