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Background on OFR Asset Management Study

The U.S. Treasury Department's Office of Financial Research (OFR) study on asset management, "Asset Management and Financial Stability", suffers from serious flaws and shortcomings. It should not be used to support any regulatory action of any type and, accordingly, should be withdrawn.

Study Reflects Inaccurate Understanding of Asset Management Industry

- An asset manager does not bear the investment risk of the assets it manages for mutual funds or other clients. Investors understand that portfolio results—whether gains or losses—belong solely to them, and do not flow through to the manager. This is in stark contrast to the principal capacity in which banks operate. The OFR study fails to fully understand this defining characteristic, for example, in implying that "concentration of risks" among funds could make an asset management *firm* a source of risk.

- With respect to mutual funds, the OFR study does not adequately consider that each fund and each adviser is a separate legal entity, which prevents risk from flowing among funds, advisers and the broader financial markets.

- The OFR study fails to recognize that mutual funds are subject to a comprehensive regulatory scheme that serves both to protect investors and mitigate risks to the larger financial system. These protections include liquidity requirements, leverage limitations, requirements for independent custody of assets, limits on affiliated transactions and extensive transparency and disclosure requirements. Mutual funds also have independent directors that serve as watchdogs for the interests of fund shareholders.

Study Lacks Evidence to Support its Core Arguments

- The OFR does not substantiate its core argument that investors and asset managers "herd" into the same assets, magnifying market volatility in times of stress. In fact the OFR study ignores publicly available empirical evidence showing that stock and bond fund investors do not redeem heavily during periods of market stress – from 1945 through the most recent financial crises, mutual fund investors have not reacted precipitously to financial market shocks.

- The OFR's claims about exchange-traded funds' (ETFs) role in the flash crash of May 2010 misinterpret the joint report of the SEC and CFTC which found that domestic equity-based ETFs overwhelmingly were the recipients of liquidity shocks from the futures and equity markets and not the transmitters of such shocks.

Study is Rife with Inaccuracies, Calling into Question its Entire Analysis and Conclusions

Two illustrative examples:

- The study misstates the experience of bond funds in 2008–While the OFR study says that government bond funds experienced outflows of $31 billion, ICI's data shows such funds had net *inflows* of $7.4 billion.

- Through double-counting and apparent inclusion of assets denominated in foreign currencies and assets managed for non-U.S. clients, the study vastly overestimates the size of the U.S. asset management industry, possibly by as much as $25 trillion. Specifically, the study states that the U.S. asset management industry oversees the allocation of approximately $53 trillion in financial assets. In comparison, assets reported by Pensions & Investments estimates the total for assets under management for U.S. clients at $28 trillion.

Study Appears to be Results Driven

- The OFR study was conducted to inform the FSOC's consideration of what threats to financial stability, if any, arise from asset management companies, and whether such threats can be mitigated by designating one or more asset managers as systemically important financial institutions (SIFIs) or whether they "are better addressed through other regulatory measures." Unfortunately, the OFR study appears to conclude at the outset that asset managers pose risks to the financial system at large and *then* hypothesizes circumstances to support that conclusion.

OFR's Process is Opaque and Flawed

- The OFR has not disclosed its methodology or process for conducting this study. Even though the FSOC tasked the OFR with studying the industry to inform its SIFI analysis, the study disregards the specific methodology adopted by the FSOC as a guide for determining whether nonbank financial companies should be candidates for SIFI designation.

- The OFR failed to fully utilize available resources to produce an accurate and thorough study on the asset management industry. It did not fully avail itself of the data and knowledge of the industry's primary regulator, the SEC, in crafting its study. Further, if the SEC had not voluntarily published the study, it seems unlikely the public would have had an opportunity to review or comment on it.

SIFI Designation is Not Warranted or Appropriate for Mutual Funds and their Advisers

- The OFR study does not establish that any of the "vulnerabilities" to which it alludes have the potential to threaten U.S. financial stability.

- SIFI designation should be used *only* when absolutely necessary under the circumstances. The Dodd-Frank Act gives regulators many new tools to address abuses and excessive risk taking by financial market participants. These new authorities plus existing regulatory tools should allow front-line regulators—*e.g.*, the SEC—to take actions to mitigate risk in the system and make markets and their participants more resilient to market shocks. The OFR study gives short shrift to recent and ongoing regulatory efforts—for example, with respect to repo transactions, securities lending and derivatives—that will have broad application and impact.

- The "remedies" that flow from SIFI designation, *e.g.*, capital requirements, are inappropriate and unnecessary for mutual funds and their advisers.