United States Senate
WASHINGTON, DC 20510

The Honorable Jacob Lew
Chairman
Financial Stability Oversight Council
1500 Pennsylvania Ave, NW
Washington DC 20220

January 23, 2014

Dear Chairman Lew:

We write to express our concern with the recent study produced on September 30, 2013 by the Office of Financial Research ("OFR"), *Asset Management and Financial Stability* (the "OFR Study"). The OFR was created as part of the Dodd Frank Act ("DFA") to provide independent, rigorous, and sophisticated analysis to the Financial Stability Oversight Council ("FSOC") and the member agencies on various aspects of and evolutions in the financial system. According to Section 111, the studies and reports developed by the OFR may be relied on and referenced by the FSOC "to support the work of the [FSOC]"[1]—including possible regulatory actions, such as designation of a firm as a systemically important financial institution ("SIFI").

The FSOC requested the OFR Study to help determine whether asset management threatens U.S. financial stability, whether additional regulation is necessary to address any potential threat and, if so, what form it should take. We think it is appropriate for the FSOC and OFR to conduct such a review as they attempt to identify threats to the U.S. financial system. However we believe the OFR Study falls short of FSOC's request to provide a comprehensive and robust analysis of the asset management industry and the goals Congress had for the OFR when it was created. The OFR Study mischaracterizes the asset management industry and the risks asset managers pose, makes speculative assertions with little or no empirical evidence, and in some places, predicates claims on misused or faulty information.

Asset managers function primarily as agents that manage money as fiduciaries on behalf of their clients subject to specific client guidelines—asset managers do not assume financial risk for the values of the assets they manage for clients. This structure, which the OFR does not adequately consider, makes it highly unlikely that an adviser would experience the type of financial distress that can affect banks and other proprietary-risk-takers let alone threaten the stability of the U.S. financial system.

The OFR Study also fails to appreciate the extensive existing regulation of the activities, advisers, funds and markets that comprise the asset management industry, all of which mitigate risk to individual investors and the broader financial markets. In particular, the SEC has regulated registered funds for more than 70 years, primarily under the Investment Company Act of 1940. This existing regulatory scheme serves both to protect investors and mitigate risks to the broader financial system. These protections include daily valuation of fund assets, high levels of required liquidity, restrictions on the use of leverage, limits on transactions with affiliated entities, portfolio diversification requirements, and extensive transparency and disclosure requirements, to name a few. As such, consumers, investors and the financial markets currently benefit from a high functioning, well regulated, and diverse registered fund industry that as a whole has withstood even the worst financial crises.

[1] Dodd Frank Act. Section 111(A)

We follow a long line of Senators, industry groups and even a 2012 GAO report in stating that one of the greatest problems with the OFR's activities and the FSOC's process for designation under Section 113 of DFA is a lack of transparency and accountability.[2] The issues raised by those commenters were evident in this particular Study, for which there was a lack of disclosure and identifiable process. In fact, if it were not for the Securities and Exchange Commission ("SEC") voluntarily soliciting comments on the OFR Study, it does not appear that there would have been any formal process for the public to comment on it to the OFR, the FSOC or any of its members.

The absence of process, transparency, and accountability may help explain the alarming dearth of accurate data, information, modeling, and metrics to substantiate the OFR Study's sweeping conclusions and broad assumptions. There are troubling errors made throughout the OFR Study, including an overstatement of one company's assets under management by approximately $200 billion, overstated redemption pressure on bond mutual funds during 2008 and an understatement of assets in mutual funds by more than $1 trillion. Moreover, the OFR Study includes numerous mischaracterizations about the asset management industry and its practices. For instance, the OFR Study inaccurately intimates that providing direct support to registered funds and separate accounts is a pervasive industry practice, when in fact, it is extremely uncommon and antithetical to the asset manager business model. These mischaracterizations and data inaccuracies raise serious concerns not only about the legitimacy of this study, but also about whether OFR is capable of fulfilling its mission to provide independent and sophisticated analytical support to the FSOC and the member agencies.

In designating a firm under Section 113 of DFA, the FSOC must determine that a nonbank financial company poses a "threat to financial stability to the United States" and that designation is the most effective and efficient way to address that threat. Therefore, the FSOC must determine both that the threat is not sufficiently mitigated by existing regulation. Further, the FSOC should have a reasonable expectation based in objective measurements or models that any "remedies"—most notably the Federal Reserve's bank holding company regulatory regime to be imposed on designated nonbanks—are in fact necessary, effectively address the specific risks that SIFI designation seeks to minimize, and the benefits achieved outweigh the costs. The FSOC cannot currently have such an understanding because the Federal Reserve has not finalized the regulations that would apply if a nonbank were designated.

The bank-centric prudential standards that flow from SIFI designation—such as, risked-based capital requirements, leverage limits, liquidity requirements, and stress tests as well as supervision by the Federal Reserve Board—are ill-suited and unnecessary for funds and asset managers, which do not present the same type or scale of risks to the financial system. While it is yet to be seen what the FSOC will choose to do with the OFR Study, we are concerned about the possible impacts that any resulting actions might have on an industry that has proven resilient even through the recent financial crisis.

We strongly encourage the FSOC to carefully review and consider the public comments filed with the SEC on the study. While we support OFR's examination of various industries to assess what, if any threats to financial stability exist, based on the points we made above we strongly urge the FSOC and other governing bodies to not base any policy or regulation actions grounded

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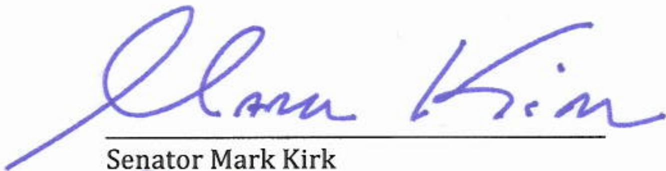
[2] U.S. Government Accountability Office, GAO-12-886, Financial Stability: New Council and Research Office Should Strengthen the Accountability and Transparency of Their Decisions 50-51 (2012)

on the information in the OFR Study. Furthermore, we are concerned that the OFR Study could potentially compromise the credibility of the OFR and, by extension, the FSOC.

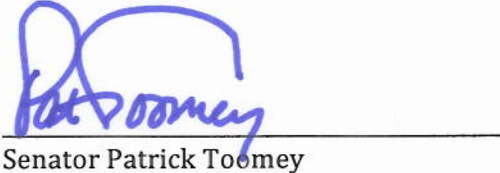
Any future study should be done with a comprehensive understanding of the industry under review, including working in greater consultation with the primary regulators[3], avoiding an over reliance on bank-centric perspectives when assessing non-banks, and ensuring that industry-specific and accurate data is used from the outset.

Respectfully,



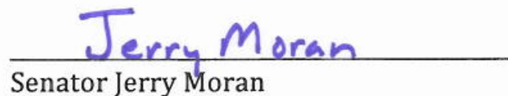
Senator Mark Kirk

Senator Thomas Carper



Senator Patrick Toomey

Senator Claire McCaskill



Senator Jerry Moran

CC:
The Honorable Ben Bernanke, Chairman, Board of Governors of the Federal Reserve System
The Honorable Thomas J. Curry, Comptroller of the Currency
The Honorable Richard Cordray, Director, Bureau of Consumer Financial Protection
The Honorable Mary Jo White, Chair, Securities and Exchange Commission
The Honorable Martin J. Gruenberg, Chairman, Federal Deposit Insurance Corporation
The Honorable Mark P. Wetjen, Acting Chairman, Commodity Futures Trading Commission
The Honorable Melvin L. Watt, Director, Federal Housing Finance Agency
The Honorable Debbie Matz, Chairman, National Credit Union Administration
The Honorable S. Roy Woodall, Jr., Member, Financial Stability Oversight Council
The Honorable Richard Berner, Director, Office of Financial Research
The Honorable Michael T. McRaith, Director, Federal Insurance Office
Mr. John M. Huff, Member, Financial Stability Oversight Council
Mr. John P. Ducrest, Member, Financial Stability Oversight Council

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[3] Section 152(e) of the Dodd-Frank Act specifically states that OFR can use any resources of other agencies it deems necessary to support its activities. In this way, Congress made clear its intention that the OFR should rely on other agencies as it conducts its work.