INVESTMENT COMPANY INSTITUTE

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May 28, 2015

The Honorable Jacob J. Lew
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Janet Yellen
Chair
The Federal Reserve System
20th Street and Constitution Ave, NW
Washington, DC 20551

The Honorable Mary Jo White
Chair
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Financial Stability Board's Second Consultation on Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions

Dear Secretary Lew, Chair Yellen and Chair White:

I am writing on behalf of the Investment Company Institute[1] concerning the second consultation by the Financial Stability Board (FSB) and the International Organization of Securities Commissions (IOSCO) regarding assessment methodologies for identifying non-bank non-insurer global systemically important financial institutions. We will be submitting a letter to the FSB responding in detail to the second consultation. I am writing to you, as heads of U.S. regulatory agencies deeply involved in the work of the FSB and IOSCO, to express our significant concern about the basis for the consultation. We respectfully urge you to use your influence as representatives of the United States before the FSB and IOSCO to redirect this effort away from entity designation. We urge that you encourage those bodies

[1] The Investment Company Institute (ICI) is a leading, global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's U.S. fund members manage total assets of US$18.1 trillion and serve more than 90 million U.S. shareholders. Members of ICI Global, the international arm of ICI, manage total assets of US$1.5 trillion.

instead to inform themselves more closely about, and assess risks to financial stability that may arise from, activities and practices in the asset management sector—as the Financial Stability Oversight Council (FSOC), under your leadership, has said it is undertaking to do.

Over the past several years, ICI has been active in its support of efforts to address the abuses and excessive risk-taking highlighted by the global financial crisis and to bolster areas of insufficient regulation, such as the OTC derivatives markets. Our members, as both investors in the capital markets and issuers of securities, welcome appropriate regulation to ensure the resiliency and vibrancy of the global financial system and applaud close cooperation among financial regulators globally.

In this spirit, we provided in response to the initial consultation an array of information and perspective on asset management generally, and regulated funds and their managers specifically. Regrettably, fundamental problems persist in the second consultation, which discounts key aspects of the extensive public commentary that the FSB and IOSCO received on their initial consultation. Our concerns with the second consultation are several fold.

First, the current consultation continues to place undue emphasis on the size of a fund, thus singling out many large, highly regulated U.S. stock and bond funds as candidates for potential designation. The second consultation adds criteria to sweep large asset managers into the designation net, possibly based entirely on the amount of assets under management. The approach, too, would result in identification of candidates for potential designation that are almost solely U.S. firms—in this case, asset managers.

In principle, we favor efforts to coordinate among regulators across the globe and to harmonize regulation to mitigate risks to the financial system. It is not apparent, however, why the standards emerging from this multilateral process, which has no formal status or sanction under our law, should target almost exclusively U.S. firms and capital markets. In this regard, it is notable that the Chairman of the FSB, invoking the authority of the G20 Leaders, has said that the standards developed under the FSB "must ... be implemented fully, consistently, and in a timely manner." With this backdrop, we are troubled by the fact that the FSB work stream responsible for the second consultation is being led by a member of the Board of Governors of the Federal Reserve, as the process set in motion by the consultation ultimately could be used to exert multilateral influence on the FSOC to expand the regulatory reach of the Federal Reserve itself to include U.S. funds, managers, and capital markets.

Second, the group of U.S. stock and bond funds that stand to be identified for possible designation demonstrated a remarkable degree of stability during the financial crisis. They are in fact among the most comprehensively regulated and highly transparent parts of the global financial system. They do not have the riskiness of banks, they make little use of leverage (in many cases, none at all), and all attendant investment losses or gains are incurred by fund shareholders. A focus on these funds produces a very odd result for a process ostensibly designed to identify lurking risks of global dimension.

Third, the way in which the second consultation proposes to derive this target set of U.S. stock and bond funds and their managers defies logic, because it does not take leverage into account. The second consultation does not justify the proposed size thresholds that automatically entail a fund or manager being considered for designation—not the "backstop" for investment funds (more than US$100 billion in net assets under management), nor the alternative option (more than US$200 billion in gross assets under management), nor the threshold for advisers (more than US$1 trillion in assets under management or with more than $100 billion in balance sheet assets). These thresholds are wholly arbitrary. Neither a $90 billion fund without leverage nor an unleveraged $110 billion fund poses a grave risk to global financial stability—but the consultation would single the latter out for designation while exempting the former.

Fourth, the second consultation proposes to exclude pension funds and sovereign wealth funds from any assessment for systemic risk. Some of these large pools of managed assets are many times the size of the U.S. stock and bond funds that the methodologies would target. We do not suggest that pension funds and sovereign wealth funds should be assessed for systemic risk based on their size alone. The second consultation's justification for excluding them, however, is hollow, and we question whether those investment vehicles are as comprehensively regulated or are as transparent as the U.S. stock and bond funds that would be identified—solely on the basis of *their* size—for review.

Fifth, the proposed methodologies set forth in the two consultations have been advanced without giving sufficient weight to empirical data, historical experience, industry structure and practice, existing regulation, and other factors that might bear on the existence or severity of the risks that the methodologies posit. Instead, both consultations simply hypothesize or speculate about various risks without due regard to the likelihood that a given risk would arise. This in turn leads to conjectures, such as a "risk" that *all* the shareholders of one or more of the world's largest, most diversely held mutual funds will redeem *all* their shares in the fund on the same day. In the United States, the regulated fund industry is now 75 years old, and thus offers a wealth of relevant data across very many different cycles in equity and fixed income markets. This includes data about how fund shareholders react in times of severe market stress and on redemption activity during such periods. It is frankly odd and dismaying that these and many other real-world empirical inputs appear to be of little significance in the construction of the methodologies. It simply is not possible to make reasoned, effective policy if choices are uninformed by real-world experience and consequences.

Finally, we believe it is important to point out that regulators are not permitted under United States law to exercise their authority in a manner that is arbitrary and capricious. Instead, U.S. regulators are required to examine relevant data and articulate a satisfactory basis for their actions, including a rational connection between the facts found and regulatory choices made. Mere conclusory statements and unsupported conjectures do not suffice, nor may agencies simply ignore contradictory evidence in the record before them. They may not impose substantial new burdens on regulated entities to guard against illusory or wholly improbable risks. By these standards, we believe the second consultation altogether fails as a predicate for any regulatory action in the United States. Indeed, we believe the second consultation fails to meet basic standards for regulatory policymaking elsewhere embraced by multilateral organizations sensitive to the rule of law.[2]

As we have said repeatedly, a sector-wide appraisal of activities and practices is the appropriate way in which to evaluate any potential out-sized risks in asset management. We applaud the FSB for recently inaugurating a separate work stream to this end. We stand ready to assist in this process in any way that we can with respect to regulated funds and their advisers.

Nonetheless, the current consultation remains of deep concern to ICI and its members. With great respect, we urge you to encourage your counterparts at the FSB and IOSCO to conduct this more informed review of activities and practices in the broad asset management sector and to abandon the current effort to develop a methodology that would result in possible designation of U.S. regulated funds based on their size alone.

Thank you most sincerely for your consideration of these views. If you or your staff have any questions regarding this letter, or if you would like additional information, please feel free to contact me at (202) 326-5901 or paul.stevens@ici.org.

Sincerely,

Paul Schott Stevens
President & CEO
Investment Company Institute

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[2] *See*, e.g., IOSCO, Objectives and Principles of Securities Regulation (June 2010) and (May 2003) (principles for the regulator), available at www.iosco.org.