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ICI VIEWPOINTS

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Overseas Overreach

By Mike McNamee

Sixth in a series of Viewpoints postings on funds and financial stability.

The Financial Stability Board (FSB)—composed of financial regulators and central bankers from around the globe—is proposing a flawed methodology that inappropriately puts regulated U.S. funds under scrutiny for possible designation as global systemically important financial institutions—or G-SIFIs.

The potential global spillover effect onto U.S. funds became clear in January, when the FSB issued a consultation proposing methods for determining whether investment funds and other non-bank financial institutions should fall under a G-SIFI designation.

For investment funds, the FSB proposed a "materiality threshold" as a starting point for evaluation: any fund with $100 billion or more in assets should automatically be examined for possible designation. The $100 billion threshold apparently was selected so the FSB could define a "practical and manageable number" of funds to subject to further analysis.

Though the FSB intends to take a global approach, in practice its $100 billion threshold puts regulated U.S. funds squarely in the crosshairs. Only 14 funds meet the FSB's threshold—and all are regulated U.S. funds.

As we've argued before, size alone is not an accurate indicator of systemic risk. Any initial screen should also incorporate balance-sheet leverage—the essential fuel for financial crises. But this is only one problem with the FSB approach.

Serious Concerns

We have serious concerns about many aspects of the assessment process as outlined in the consultation. The proposed process would provide the FSB and "national authorities" with tremendous discretion to engage in highly subjective deliberations—the outcome of which could have devastating effects. In addition, the process—including the development of an assessment methodology—is not governed or guided by any specific law or statute. Funds being considered for G-SIFI designation would face a great deal of uncertainty. They may have little or no information as to the basis upon which specific decisions are being or will be made. They would have no assurances as to even basic fairness because there are no transparency or "due process" requirements.

For example, national authorities might decide to assess a fund as "potentially globally systemic" even if it is too small to meet the FSB's materiality threshold. In such a case, there's no requirement for regulators to notify the fund. Nor are they required to notify large funds (those that clear the threshold) that they will *not* be designated. Regulators are not required to permit funds to provide information that they believe is relevant to a designation determination, or to consider the relative costs and benefits of a potential designation. And there is no formal (or informal) mechanism for challenging a G-SIFI determination.

Time to Face Facts

What's especially troubling is the appearance of a mutually reinforcing, circular relationship between the FSB and the FSOC. The FSB's examination of global investment funds for possible G-SIFI designation is being led by Federal Reserve Board Governor Daniel Tarullo. And in the U.S., media reports suggest that the FSOC is considering two asset managers for designation, well in advance of the public conference it has scheduled for May 19. These moves fly in the face ofbipartisan concern about the Council's lack of transparency—and the fact that these managers pose no threat to the stability of the financial system.

Before proceeding further, the FSB and the FSOC should pause to consider more deeply and carefully the structure, operations, and regulation of the asset management industry, as well as what problems—if any—they are trying to solve. Careful study would establish clearly that neither regulated funds nor their managers—neither in the United States nor in other jurisdictions—pose any threats to financial stability. The FSB and the FSOC need to break their closed loop and open up to the facts.

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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