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Who Are the FSB 14?

By Mike McNamee

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

In their search for ways that investment funds can pose risks to the financial system, regulators and central bankers from around the globe have proposed an arbitrary threshold: any investment fund with assets of more than $100 billion should automatically be subjected to further examination and consideration as a possible "global systemically important financial institution," or G-SIFI. The Financial Stability Board (FSB)—composed of financial regulators and central bankers from around the globe—said it needed to define a "practical and manageable number" of funds to subject to further analysis.

Well, the FSB got a "manageable number." Only 14 funds worldwide lie above this threshold—all of them regulated U.S. funds.

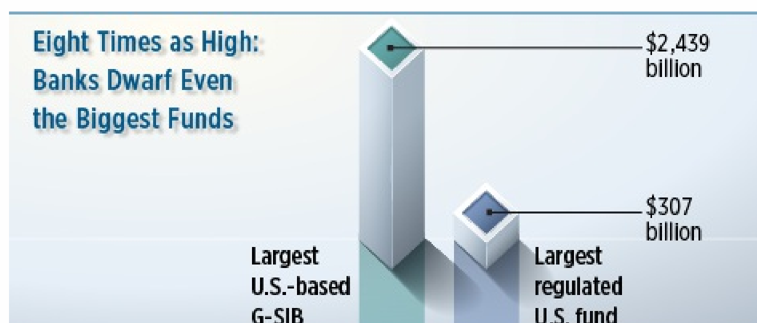
But this process of selecting these funds—or *any* regulated fund—will not bring the regulators any closer to finding or managing systemic risk.

Of these 14 funds, three are money market mutual funds, one is an index-based exchange-traded fund (ETF), and 10 are stock and bond mutual funds, of which six are index-based and four are actively managed. Let's take an even closer look at them.

Common Characteristics

In addition to being a popular choice for investors—hence their size—the 14 funds share a number of other characteristics: they are comprehensively regulated, highly efficient, and relatively low-cost funds within their asset classes. They also are older funds, with inceptions ranging from 1952 to 1996, that have attracted their assets over a long period of time.

Although they are the largest investment funds worldwide, they are virtually free of leverage and are small compared to the banks designated as global systemically important banks (G-SIBs). The world's largest mutual fund, the Vanguard Total Stock Market Index Fund, is a $307 billion index mutual fund that tracks the entire U.S. stock market. The largest G-SIB based in the United States had assets of $2.4 *trillion*, about eight times higher. Taken as a group, the 14 largest funds have average assets of $159 billion; average assets for U.S. G-SIBs are $1.3 trillion, also about eight times higher.



These funds also have a stable investor base of individual shareholders. The vast majority of shares in the FSB 14's 11 stock and bond funds are held in 20 million retail accounts. Institutional investors, by contrast, hold less than $100 billion out of the funds' combined $1.6 trillion of assets under management.

Sixty-two percent of total net assets of the FSB 14 funds are held through retirement accounts, such as defined contribution plans or individual retirement accounts (IRAs). Research shows that, of investors who use mutual funds to help meet the long-term goal of retirement saving, few sell shares or reallocate assets during periods of financial stress.

One ETF, Three Money Market Funds

The only ETF in the FSB 14, the SSgA SPDR S&P 500 Index Trust, was the very first exchange-traded fund in the United States, launched in 1993. This ETF—one of the most heavily traded funds in the world—tracks the S&P 500 Index, which comprises extremely liquid securities.

Three money market funds each have assets exceeding the $100 billion threshold and, under the FSB's proposed methodology, would thus automatically be subject to further examination. However, money market funds have already undergone significant reforms following the extraordinary market conditions in the fall of 2008.

In 2010, the SEC amended Rule 2a-7 to impose tighter standards for the liquidity, maturity, and credit quality of money market funds' holdings. These reforms were thoroughly tested by significant challenges to the financial markets in the summer of 2011 caused by the U.S. federal debt-ceiling standoff and deteriorating conditions in Eurozone debt markets. Additional reforms remain under active consideration by the SEC, the appropriate and primary regulator of the mutual fund industry. The SEC's approach is an example of an activity-based focus on risk mitigation, which we'll cover in detail in a future post.

Competitive Funds in a Competitive Market

As the FSB's consultation itself notes, the investment funds sector is "highly competitive with numerous substitutes existing for most investment fund strategies." The 14 largest funds pursue investment strategies that are comparable to those of literally hundreds of competing funds in the U.S. market. For example, five of these funds fall into the group that Morningstar categorizes as "Large Blend"—where they must compete with more than 500 other funds in the same Morningstar category.

Investors in U.S. funds are highly sensitive to fund costs and their effect over time on fund returns. It's no accident that the funds that have attracted the most investor assets also are some of the more cost-effective options among their competitors: the asset-weighted average expense ratio for the 14 largest funds is 31 basis points, while ICI research shows that the asset-weighted average expense ratio for all equity mutual funds is 77 basis points. (Expense ratios for bond and money market funds are generally lower than those for equity funds.)

The 14 funds singled out by the FSB's proposed threshold are all highly diversified. The six index funds in the group have hundreds to thousands of individual holdings, with the largest typically making up less than 3 percent of the funds' assets. This diversification makes it unlikely that a fund could hold a very large position in a particular market, because the largest funds are not highly specialized but generally invest most of their assets in the world's deepest and most liquid markets.

No Need to Punish Success

The FSB 14 are the largest investment funds for a good reason—they have proved to be valuable tools for investors to access capital markets inexpensively, efficiently, and transparently. Singling them out for G-SIFI evaluation won't do anything to advance the cause of mitigating systemic risk. National and international regulators shouldn't threaten these funds with the possibility of SIFI designation and all the harm that could bring investors.

For more information on ICI's views and research on financial stability, please visit our Financial Stability Resource Center or read the other 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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