

MEMO# 27678

November 4, 2013

ICI Submits Comments Regarding OFR Study on Asset Management and Financial Stability

[27678]

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TO: ACCOUNTING/TREASURERS COMMITTEE No. 29-13
BANK, TRUST AND RETIREMENT ADVISORY COMMITTEE No. 37-13
BOARD OF GOVERNORS No. 14-13
BROKER/DEALER ADVISORY COMMITTEE No. 49-13
CLOSED-END INVESTMENT COMPANY MEMBERS No. 89-13
ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 34-13
ETF ADVISORY COMMITTEE No. 35-13
INVESTMENT ADVISER MEMBERS No. 70-13
INVESTMENT COMPANY DIRECTORS No. 23-13
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 30-13
OPERATIONS MEMBERS No. 19-13
SEC RULES MEMBERS No. 100-13
SMALL FUNDS MEMBERS No. 60-13
TRANSFER AGENT ADVISORY COMMITTEE No. 77-13
UNIT INVESTMENT TRUST MEMBERS No. 19-13 RE: ICI SUBMITS COMMENTS REGARDING
OFR STUDY ON ASSET MANAGEMENT AND FINANCIAL STABILITY

In late September, the Office of Financial Research (OFR) issued a study (OFR Study) on the asset management industry and “how asset management firms and the activities in which they engage can introduce vulnerabilities that could pose, amplify or transmit threats to financial stability.” [\[1\]](#) The Financial Stability Oversight Council (FSOC) had requested the study in order to inform its analysis of whether—and how—to consider asset management firms for enhanced prudential standards and supervision by the Federal Reserve Board under Section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. ICI has filed a comment letter with the Securities and Exchange Commission, which invited public feedback on the OFR Study. A brief summary is provided below. [\[2\]](#)

The letter begins by asserting that the OFR Study reflects an inaccurate understanding of the asset management industry in general and registered investment companies (“registered funds”) in particular, and that it “falls far short” of the standards we would

expect for a study of its importance. The letter then discusses what ICI believes to be the most significant deficiencies of the OFR Study:

- First, we note that problems with methodology, data, and the presentation of information pervade the OFR Study and call into question the credibility of the analysis. In an appendix to the letter, we describe in some detail how the OFR Study is replete with sweeping conclusions unsupported by data; lacks clarity, precision, and consistency in its scope and focus; and misuses or misinterprets data. We caution that these flaws have great potential to confuse or mislead policymakers and the public, and that they raise doubts about the level of analytical rigor involved in conducting and documenting OFR's work.
- Second, we explain in detail why the core thesis of the OFR Study—that herding, redemptions, and fire sales pose systemic risks—is not supported by empirical research regarding registered funds. Previous ICI research has demonstrated that during periods of market stress, from 1945 through the most severe financial crises, mutual fund investors have not reacted precipitously to financial market shocks. Hence, the OFR Study's concern—that fire sales by stock and bond fund asset managers could lead to a collapse of securities prices and create systemic risks—is without any historical basis. The letter further explains why the OFR Study's examination of exchange-traded funds similarly falls short.
- Third, we express concern that the OFR Study loses sight of the key distinction between banks and asset management firms—the agency nature of an asset manager's business, which results in a vastly different risk profile. The letter explains that an asset manager itself does not take on the risks inherent in the assets it manages for registered funds or other clients, nor does it own client assets. Rather, investment gains and losses from a client account are solely attributable to that account, and do not flow through to the manager. With regard to registered funds, the letter asserts that the OFR Study does not adequately consider that each fund and each adviser is a separate legal entity, which prevents risks from flowing among funds, advisers, and the broader financial markets.
- Fourth, we observe that the OFR's attempt to describe in broad terms the “activities” of asset managers has the unfortunate effect of obscuring the regulatory protections to which registered funds already are subject. This approach by OFR suggests a failure to understand, or to give due weight to, the importance of these protections, both individually and collectively, in serving the interests of registered fund shareholders and in mitigating risk to the broader financial system. The letter briefly describes several of these existing regulatory protections.

The letter reiterates ICI's strong view that SIFI designation and prudential regulation are neither warranted nor appropriate for registered funds and their advisers, and concludes that the OFR Study provides no predicate for FSOC to exercise its SIFI designation authority. We note that the OFR Study discounts or disregards recent and ongoing regulatory reform efforts, and that the “remedies” that flow from SIFI designation—including the imposition of capital requirements—would be neither practical nor effective for dealing with the purported “vulnerabilities” identified in the OFR Study.

Given the many shortcomings of the OFR Study, the letter asserts that it should not serve as the basis for policy decisions or regulatory action of any kind and, accordingly, should be withdrawn. The letter further recommends that any future study of the asset management industry should be conducted methodically—taking into account all the various segments of the industry, the differing ways in which they are regulated, and relevant historical experience—and in close cooperation with the SEC, the regulator with the greatest

expertise and experience in capital markets and asset management.

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endnotes

[1] OFR, Asset Management and Financial Stability (Sept. 2013), available at http://www.treasury.gov/initiatives/ofr/research/Documents/OFR_AMFS_FINAL.pdf. For a brief summary of the OFR Study, see Institute Memorandum 27613 (Oct. 1, 2013), available at http://www.ici.org/my_ici/memorandum/memo27613.

[2] The ICI letter is available at http://www.ici.org/pdf/13_ici_ofr_asset_mgmt.pdf.

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