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ICI Letter to SEC Calls for Withdrawal of Study by Office of Financial Research; Cautions FSOC Against Relying Upon Study

Washington, DC, November 4, 2013 - A recent report on the asset management industry by the U.S. Treasury Department’s Office of Financial Research (OFR) “falls far short” of providing an accurate and balanced view and should be withdrawn, the Investment Company Institute (ICI) said.

Regulators, including the Financial Stability Oversight Council (FSOC), should not depend upon the OFR study, “Asset Management and Financial Stability,” for policy decisions or regulatory action of any kind, ICI said in a comment letter submitted to the Securities and Exchange Commission (SEC) on November 1.

Study Reflects “Inaccurate Understanding” of Asset Management Industry

“The OFR study of the asset management industry reflects an inaccurate understanding of this industry, particularly registered funds,” said ICI President and CEO Paul Schott Stevens. “For that reason, the study does not provide any basis whatsoever for FSOC to make any policy decisions.”

The study speculates about potential “vulnerabilities” for asset managers that it claims could pose a threat to financial stability, but fails to provide data or historical experience to support its claims, ICI notes in its letter. The ICI letter, which focuses primarily on registered funds and their advisers, offers detailed analysis of mutual fund and investor behavior during periods of market stress, from 1945 through 2008, showing that, contrary to the OFR study’s suggestions, investors in mutual funds do not redeem precipitously during financial market shocks.

The OFR study also misuses or misinterprets data. For example, through double-counting and inclusion of overseas assets, the study exaggerates the size of the U.S. asset management industry by as much as $25 trillion, an error of almost 90 percent. It also misstates the experience of bond funds in 2008: While the OFR study says that government bond funds experienced outflows of $31 billion, ICI's data shows such funds had net inflows of $7.4 billion. Such flaws "call into question the credibility of the analysis set forth in the OFR Study," ICI's letter states.

Study Appears to Be "Results-Driven"

The OFR study is intended to inform FSOC's consideration of what threats to financial stability, if any, arise from asset management companies, and whether it would be appropriate to designate asset managers as "systemically important financial institutions" (SIFIs) and subject them to "enhanced" prudential regulation and supervision by the Federal Reserve Board.

The OFR Study "appears to be 'results-driven'," assuming from the outset that asset managers pose systemic risks, ICI says. "The OFR Study appears to conclude a priori that asset managers pose risks to the financial system at large and then hypothesizes circumstances to support that conclusion," the ICI letter says. "Further study should take a more objective approach."

OFR Study Loses Sight of Vital Industry Distinctions

The OFR study initially recognizes that asset managers invest in financial markets as agents—managing assets on behalf of clients—not as principals investing for their own accounts. But the study loses sight of this key difference and the way in which this factor distinguishes asset managers from banks and other market participants. An asset manager, such as a mutual fund adviser, does not bear any risk of investment gains or losses from the securities or other assets held by the fund. This business model makes it highly unlikely that an asset management firm would create or transmit risk to the financial system. Each registered fund and adviser is a separate legal entity, which limits the spillover of risks from one fund to another or to the adviser.

The OFR study also fails to recognize that the structure, operation, and regulation of registered funds and their managers not only protect investors but also serve to mitigate risk to the financial system. Such requirements as daily valuation, standards for liquidity, limits on leverage, and strict custody arrangements, among others, tend to limit risk to the broader financial system.
