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Failing to Understand the Nature of Our Capital Markets: The Office of Financial Research's "Asset Management and Financial Stability" Report

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As prepared for delivery.

Good morning, everyone. I'm Karrie McMillan, ICI's General Counsel, and I'm very pleased to welcome you to this, our 14th Annual Capital Markets Conference.

Before we get into our program, I'd like to recognize our sponsors, which are shown on the screen here.

The support of these companies—along with your participation and the very hard work of ICI staff—makes this conference possible. So, many thanks again to our sponsors, to my ICI colleagues—and of course to all of you for joining us today.

We are all here because we recognize the importance of robust capital markets. Our securities markets are overseen by a strong SEC, which just yesterday announced that it created a market structure website to promote better understanding of our equity markets through the use of data and analytics.

Beyond the functioning of the equity markets, it is critically important also to promote better understanding of the nature and value of our capital markets more broadly.

Sadly, a recent analysis by the Office of Financial Research focusing on the activities of asset managers fails to do so. For those of you unfamiliar with OFR, this office was created by the Dodd-Frank Act, and it is supposed to help "facilitate more robust and sophisticated analysis of the financial system." This particular report will facilitate robust dialogue—but otherwise misses that goal.

The report has many flaws. For example:

- It makes sweeping statements and broad generalizations, without apparent basis. As just one example, the Report states that "Investors' concerns about the liquidity of one fund can quickly spread to similar or related funds, or to the sponsor of a fund complex." Such spillover has been exceedingly rare in the long-term fund industry—and it has never caused an adviser to fail or created systemic risk.
- The report seems concerned with redeemability. It implies systemic risk could be created because "Any collective investment vehicle offering unrestricted redemption rights could face the risk of large redemption requests in a stressed market if investors believe that they will gain an economic advantage by being the first to redeem."

To which I say, let's examine what happens when investors exercise their free choice to redeem from an investment.

ICI research, which has been carried back as far as 1945, consistently shows that long-term fund investors react in a measured fashion to even the most severe stock and bond market downturns. During events such as the stock market crash in 1987, the bond market downturn in 1994, problems in emerging markets in 1997 and 1998, the bursting of the dot.com bubble in 2000, the 9/11 attacks, and most recently, the worst financial market crisis since the Great Depression—fund outflows have been modest, a small share of overall trading. Shareholder actions have solidly demonstrated that the behavior posited by the OFR simply is an academic fantasy.

As a result of being unable to divorce speculation from reality, the report makes it hard to discern "real" systemic concerns—and I dispute that any such concerns actually remain in the registered fund area—from a made-up litany of nightmare closet "could happens."

Rather, the report misses the one instance when the federal government had to orchestrate the rescue of a fund—the highly leveraged and under-regulated hedge fund, Long Term Capital Management.

We care about this report because we've learned the hard way that vague insinuations and incorrect data can lead to bad public policy. And we've learned that it's very easy for scary-sounding catch-phrases to become part of our regulatory lexicon.

I would like to thank the SEC for making this report public. I encourage everyone here to read the report—it's not that long—and send your thoughts to the SEC. It's important for the government to hear the voice of the capital markets. We certainly will be commenting, both on the broad policy issues raised, and to correct the Report's various inaccuracies.

Now, I've been deliberately provocative about this report, which is consistent with the tenor of an event like this, where we've gathered to look for the answers to a number of tough questions facing the industry. Some we will tackle today include:

- What are the operational risks in the markets and their impact on investor confidence?

and

- How can we help educate the public about today’s trading issues?

Though we may not find all the answers, our discussion is essential. Discussion fosters understanding, and understanding permits us to take the steps necessary to maintain investor confidence.

So let’s get the discussion going, starting with a speaker who is known for asking the tough questions.

Scott O’Malia was nominated by President Obama and sworn in as a Commissioner of the Commodity Futures Trading Commission four years ago.

He came to the post with experience in commodities stretching back to his childhood, growing up on his family’s farm in Michigan.

In Washington, DC, Commissioner O’Malia has worked in the private sector and a range of positions on Capitol Hill. Just prior to his CFTC appointment, he served as the staff Director to the Senate Appropriations Subcommittee on Energy and Water Development.

At the CFTC, Commissioner O’Malia has been outspoken on key issues that we’ll discuss today, particularly in his role as Chairman of the CFTC’s Technology Advisory Committee and his involvement with the Commission’s recently published concept release on automated trading.

He has also been a strong proponent of sensible rulemaking that is informed by thorough cost-benefit analysis.

Commissioner O’Malia, thank you for your leadership, and thank you for being with us today—despite the government shutdown—for a question and answer session. Ladies and gentlemen, Scott O’Malia.