

SPEECH

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Asset Management and Financial Stability: Implications for Brazil and Emerging Markets Slides (pdf)

Asset Management and Financial Stability: Implications for Brazil and Emerging Markets
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What Is Systemic Risk? »The risk that a firm or group of firms will fail and disrupt the financial system's ability to funnel capital from investors to borrowers, thus causing damage to the broader economy »Policymakers initially focused on the banking sector, but now are focusing on asset managers and their products 20 May 2015 ANBIMA 2015 INVESTMENT FUNDS CONGRESS 1 What's the Banking Process? 20 May 2015 ANBIMA 2015 INVESTMENT FUNDS CONGRESS INSURED DEPOSITS UNINSURED LENDING INVESTMENT RISK INVESTMENT RISK BANK INVESTMENTS » Loans » Government Bonds 90% DEPOSITORS/CREDITORS » Individuals » Corporations » Financial Institutions » Money Market Funds 10% CAPITAL » Stock » Retained earnings 2 Asset Management: Who Are the Investors? » Individual investors, high-net-worth households, trusts » 93 million Americans invest about \$18 trillion in mutual funds, ETFs, and closed-end funds »Pensions, including 401(k)s, defined benefit plans » Most of the nearly \$25 trillion in US retirement assets is invested in an asset- managed product »Endowments, foundations »Corporations, state and local governments, sovereign wealth funds » 20% of corporate cash held in money market funds » Sovereign wealth funds hold \$5 trillion 20 May 2015 ANBIMA 2015 INVESTMENT FUNDS CONGRESS 3 How Do Asset Managers Deliver Services? »Publicly offered funds (mutual funds, ETFs, closed-end funds) issue shares that give pro rata interest in the fund's pool of assets »Privately offered funds (hedge funds, private equity, venture capital, real estate funds) issue pro rata interests in the fund's pool of assets »Collective investment funds issue pro rata interests in the fund's assets »Separate accounts engage an asset manager to oversee securities owned directly by an investor 20 May 2015 ANBIMA 2015 INVESTMENT FUNDS CONGRESS 4 What's the Asset Management Process? 20 May 2015 ANBIMA 2015 INVESTMENT FUNDS CONGRESS CAPITAL OWNERSHIP/INVESTMENT RISK MANAGEMENT INVESTMENT MANDATEASSET MANAGERS INVESTORS » Individual investors » Endowments, foundations » Pensions, including 401(k)s, defined benefit plans » Corporations, state and local governments, sovereign wealth funds INVESTMENT » Publicly offered funds » Privately offered funds » Collective investment funds » Separate accounts 5 What Are the Structural Implications of This Analysis? »Asset managers agents, investing at the direction of their clients »Asset managers generally do not take on investment risk with their own balance sheets » Investment risk remains with clients »Asset managers do not guarantee or promise a return of capital or a rate of return on investments »Asset managers have no government safety net »Publicly offered funds, such as mutual funds

and ETFs, use little or no leverage »Asset managers are not banks 20 May 2015 ANBIMA 2015 INVESTMENT FUNDS CONGRESS 6 How Does Regulation of Publicly Offered US Funds Limit Risk? »Funds are regulated under all four major securities laws— in particular, Investment Company Act »Fund regulation protects shareholders—and reduces potential for systemic risk »Funds’ borrowing and leverage are strictly limited »Funds are required to have a simple capital structure »Liquidity, daily mark-to-market valuation, diversification help funds meet redemptions in orderly and fair manner 20 May 2015 ANBIMA 2015 INVESTMENT FUNDS CONGRESS 7 Total Net Bond Fund Flows Are Modest in All Markets—Calm or Troubled Flows as a percentage of assets; monthly, January 1990–August 2014 -25 -15 -5 5 15 25 1 9 9 0 1 9 9 1 1 9 9 2 1 9 9 3 1 9 9 4 1 9 9 5 1 9 9 6 1 9 9 7 1 9 9 8 1 9 9 9 2 0 0 0 2 0 0 1 2 0 0 2 2 0 0 3 2 0 0 4 2 0 0 5 2 0 0 6 2 0 0 7 2 0 0 8 2 0 0 9 2 0 1 0 2 0 1 1 2 0 1 2 2 0 1 3 2 0 1 4 Top 10th percentile of funds Average fund (asset-weighted) Bottom 10th percentile of funds In Oct. 2008, 10% of bond funds had outflows of 8% or more. In Oct. 2008, 10% of bond funds had inflows of 4% or more. Fe d ti g h te n in g A si a n c ri si s R ec es si o n 2 0 0 8 C ri si s Eu ro zo n e cr is is Fe d ta p er t a lk s 20 May 2015 ANBIMA 2015 INVESTMENT FUNDS CONGRESS Source: Investment Company Institute 8 US Equity and Bond Mutual Fund Investors Are Households, Retirement Savers 20 May 2015 ANBIMA 2015 INVESTMENT FUNDS CONGRESS Household and institutional ownership of US stock and bond mutual funds Institutional investors 5% Households 95% Retirement account holdings of US stock and bond mutual funds US stock and bond mutual fund assets: \$13.1 trillion Retirement accounts* 53% Other investors 47% 9 *Retirement accounts includes defined contribution plans, e.g., 401(k) plans, as well as IRAs. Note: Figures report percentage of assets. Data are for December 2014 and exclude assets in exchange-traded funds. Source: Investment Company Institute How Do Funds Manage Liquidity and Redemptions? »Funds have many tools to counter first-movers: »Mark-to-market pricing and fair valuation requirements »Bid-pricing—used by 50% to 60% of mutual funds »Redemption fees »Offsetting redemptions with new sales »Managing market exposure through derivatives »Redemptions in kind—standard for ETFs and can be used by mutual funds »And selling fund shares is not risk-free for investors 20 May 2015 ANBIMA 2015 INVESTMENT FUNDS CONGRESS 10 Regulated Funds Are Unlikely to Pose Systemic Risk to Emerging Markets »Regulated funds’ share of the total value of emerging market securities is relatively small »Regulated funds provide a stable investor base »Their holdings are diversified across a wide number of emerging economies 20 May 2015 ANBIMA 2015 INVESTMENT FUNDS CONGRESS 11 Regulated Funds’ Share of the Total Value of Emerging Market Bonds Is Relatively Small 108 196 246 457 484 7,511 8,683 8,994 10,413 10,742 2009 2010 2011 2012 2013 Other investors Regulated funds 20 May 2015 ANBIMA 2015 INVESTMENT FUNDS CONGRESS 12 (1.4%) 7,619 8,879 9,240 11,226 10,871 (2.7%) (4.2%) (4.3%)(2.2%) Sources: EPFR Global and International Monetary Fund (IMF) Billions of US dollars (percentage of total); year-end, 2009–2013 13 Regulated Funds Represent a Small and Stable Investor Base for Brazilian Bonds Billions of US dollars; quarterly, 2005–2013 Sources: EPFR Global and International Monetary Fund (IMF) -15.0 -10.0 -5.0 0.0 5.0 10.0 15.0 20.0 2005 2006 2007 2008 2009 2010 2011 2012 2013 Other foreign investor portfolio capital flows to Brazilian bonds Net purchases of Brazilian bonds 20 May 2015 ANBIMA 2015 INVESTMENT FUNDS CONGRESS Regulated Fund Holdings Are Diversified Across a Wide Number of Emerging Economies 20 May 2015 ANBIMA 2015 INVESTMENT FUNDS CONGRESS 14 »US and European regulated funds held \$1.7 trillion in emerging market securities as of December 2014 »\$1.3 trillion was in emerging market equities »\$431 billion was in emerging market bonds »These holdings were spread across more than 85 different emerging market countries Source: EPFR Global

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