BLACKROCK

May 29, 2015

Secretariat of the Financial Stability Board
c/o Bank for International Settlements
CH-4002
Basel, Switzerland

Submitted via email to: fsb@bis.org

RE: Comments on the Consultative Document (2nd) Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions

BlackRock, Inc. (together with its affiliates, "BlackRock")[1] is pleased to comment on the Financial Stability Board ("FSB") and International Organization of Securities Commissions ("IOSCO") Second Consultative Document ("Second Consultation") of Assessment Methodologies for Identifying Non-Bank Non-Insurer ("NBNI") Global Systemically Important Financial Institutions ("G-SIFIs"). BlackRock supports identifying systemic risks and pursuing policy measures to address risks and improve the financial ecosystem for all market participants. We appreciate the work of banking and securities regulators to make our financial system safer in 2015 than it was in 2008, including measures to improve the safety and soundness of the banking system, the movement to central clearing of over-the-counter ("OTC") derivatives, the reform of cash pools, the introduction of stress testing for certain funds, and the increased transparency required of various funds and market practices. We agree that no entity should be "too-big-to-fail" and that taxpayers should be protected from bailouts that would support such entities. BlackRock recognizes the significant challenges facing regulators charged with ensuring that the 2008 financial crisis (the "2008 Crisis") is not repeated. With this in mind, we have a number of comments and suggestions that we think will provide helpful perspective to the FSB and IOSCO in evaluating potential measures to mitigate systemic risk.

While the G20 has tasked the FSB and IOSCO to create metrics to designate NBNI G-SIFIs, it should be recognized that "NBNI financial institution" is not synonymous with "asset manager" or "investment fund" nor does a directive to create metrics for NBNIs imply that asset managers or investment funds are the intended targets.[2] Rather, the methodology should objectively evaluate whether certain NBNIs meet the criteria for G-SIFI designation based on real and identifiable risks to the financial system. We believe that an objective analysis will find that

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1 BlackRock is one of the world's leading asset management firms. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

2 The G20 has not called for targeting of specific types of NBNIs such as asset managers or investment funds. In reviewing G20 Communiqués and Leader Declarations since 2008, the G20 has never instructed the FSB to designate asset managers nor to develop an assessment methodology that necessarily captures asset managers. In 2011, the G20 tasked the FSB, in consultation with IOSCO, "to prepare methodologies to identify systemically important non-bank financial entities." In 2013, the G20 reaffirmed this, stating, "We ask the FSB, in consultation with the International Organization of Securities Commissions (IOSCO) and other standard setting bodies, to develop for public consultation methodologies for identifying global systemically important non-bank non-insurance financial institutions by end-2013." *See* G20, Cannes Summit Final Declaration, Building Our Common Future: Renewed Collective Action for the Benefit for All (Nov. 2011), available at https://g20.org/wp-content/uploads/2014/12/Declaration_eng_Cannes.pdf, ("G20 Cannes Declaration"); G20, Saint Petersburg Leaders' Declaration (Sep. 2013), available at http://www.g20.utoronto.ca/2013/Saint_Petersburg_Declaration_ENG.pdf, ("G20 Saint Petersburg Declaration").

the appropriate focus of this effort (as concluded in the FSB's First Consultation) is on investment funds,[3] particularly those that are highly leveraged. We agree with the FSB and IOSCO's initial conclusion in the First Consultation, as explained in our April 2014 response letter to the FSB and IOSCO.[4] The Second Consultation states, "The FSB and IOSCO recognise that there are a variety of policy tools available for addressing potential financial stability risks that could arise out of asset management activities and products including changes to industry-wide regulation and designation."[5] We believe that risks in asset management are *not* risks "for which designation may be the more appropriate tool".[6] Rather, these risks warrant enhancements to regulation of investment products and practices across the market ecosystem.

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Executive Summary

1. **A holistic approach with a view to the entire market ecosystem is needed to reduce risk.** To address systemic risk, the overall market ecosystem of which asset managers and funds are only one component, must be considered. This includes assets managed directly by asset owners and assets outsourced to external asset managers. In addition, the variety of investment vehicles such as mutual funds, separate accounts, hedge funds, private equity funds, etc., must be recognized. Because designations target individual entities in the market ecosystem, designation of individual funds or asset managers may *shift* risk around the system but will not *reduce* risk. For example, concerns about "herding" into or out of an asset class cannot be addressed by designation of certain funds or asset managers, given that asset owners control the strategic allocation of their assets and, therefore, the flow of assets into and out of asset classes. Before proceeding with designations of asset managers and/or funds, policy makers need to develop a better understanding of asset owners, including why asset owners allocate their assets to a certain market or asset class and how asset owners decide when to manage assets in-house versus outsourcing this function. As currently proposed, the Second Consultation would exempt (i) public financial institutions, (ii) sovereign wealth funds and, (iii) pension funds, as well as (iv) asset management subsidiaries of G-SIBs or G-SIIs.[7] In order to reduce risk, it is necessary to take a holistic approach that encompasses the investment activities of all asset owners and all asset managers.

2. **Until the specific risks posed by NBNIs that need to be addressed are identified, designation metrics are premature.** The objective of G-SIFI designations is to reduce risks to global financial stability. It logically follows that systemic risks need to be identified so that policy measures can be targeted to address those risks. Without first identifying the risks and specifying policy measures to address the risks, any metrics developed will likely produce a

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[3] FSB Consultative Document, "Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions" (Jan. 8, 2014), available at http://www.financialstabilityboard.org/wp-content/uploads/r_140108.pdf. ("First Consultation") at 7 stated that "Since exposures are created at the fund level and data is available on an individual fund basis, the consultation methodology focuses on individual investment funds."

[4] BlackRock Letter to FSB and IOSCO, "Comments on the Consultative Document of Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions" (Apr. 4, 2014), available at http://www.blackrock.com/corporate/en-us/literature/publication/nbni-gsifi-fsb-iosco-040414.pdf. ("April 2014 First Consultation Response").

[5] Second Consultation at 31.

[6] Second Consultation at 31.

[7] Second Consultation at 5 states "the FSB and IOSCO are considering excluding public financial institutions (e.g. multilateral development banks, national export-import banks), sovereign wealth funds, and pension funds from the scope." Second Consultation at 10 states "NBNI financial subsidiaries of banks/insurance groups would be excluded from scope of NBNI G-SIFI assessment if the parent entity has been assessed by the BCBS or the IAIS on a consolidated basis and the NBNI financial subsidiaries are captured in prudential consolidated regulation and supervision of the parent entity."

new set of "false positives" and "false negatives" and will fail to achieve the overarching goal. Further, the premature focus on designations could run at cross-purposes with the G20's stated objectives of increasing economic growth by encouraging greater participation in public-private partnerships, more investment in infrastructure projects, and the availability of financing for small-medium enterprises ("SMEs") through "long-term financing from institutional investors and encourag[ing] market sources of finance".[8] We recommend starting this process by identifying the risks that need to be addressed and then identifying policy measures that are consistent with the G20's objectives.

3. **Asset managers are not the source of systemic risk as discussed in this Consultation**. In reviewing the transmission mechanisms and impact factors outlined in the Second Consultation, we find that none of the transmission mechanisms or impact factors are applicable to asset managers. Asset managers are fundamentally different from banks and other financial institutions. The relationship of an asset manager to the investment vehicles it manages is analogous to the relationship that a provider of services has to its customers – the company provides specified services and receives fees for those services. The relationship of an asset manager to the investment vehicles it manages is *not* analogous to commercial banks and other balance sheet lenders that utilize the capital and deposits of the bank or other affiliates to finance the lending or other activities of another member of the affiliated group, thereby making resolution efforts applicable. Asset managers are not the counterparties to client trades or derivative transactions and do not control the strategic asset allocation of their clients' assets. Client assets are held separately from the asset manager by a custodian. Custodians facilitate changes from one manager to another. Asset managers are highly regulated entities with specific regulatory requirements for business continuity management and disaster recovery planning, all of which is designed to protect clients. Global operations do not complicate the "resolution" of an asset manager because client assets are segregated from the asset manager and held by a custodian. In other words, client assets are not included in bankruptcy proceedings for an asset manager and, therefore, do not impact the resolution of an asset manager, regardless of where it is domiciled.

4. **Enhancing the regulation for all funds would be more effective at addressing systemic risks than G-SIFI designations for individual funds.** Based on our review, the transmission channels and impact factors would only be applicable for a small number of highly leveraged funds. Leverage is key to systemic risk as financial failures usually result from a "liquidity crunch" due to a mismatched term structure or an excessive amount of leverage. Risk emanating from highly levered entities is not limited to large funds. Therefore, attempts to identify highly levered funds should not be predicated on assets under management ("AUM") as is contemplated in the Second Consultation. Rather, leverage should be used as a first screen followed by further analysis of other factors. This approach will avoid missing smaller entities that could create systemic risk. Where certain structural issues associated with categories of funds may exist (e.g., fund structures exposed to first-mover advantage dynamics, money market funds, etc.), these issues need to be addressed across the category of funds. A G-SIFI designation is intended to address risks specific to a particular entity, not those inherent to a category of funds, thereby rendering designation a less effective policy approach to these types of issues. Developing the toolkit for all funds to manage redemptions, creating principles for stress testing funds, and defining additional data that could facilitate risk identification and monitoring would have a greater benefit than

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[8] Communiqué, *G20 Finance Ministers and Central Bank Governors Meeting*, (Feb. 9-10, 2015), available at https://g20.org/wp-content/uploads/2015/02/Communique-G20-Finance-Ministers-and-Central-Bank-Governors-Istanbul1.pdf, ("G20 Istanbul Communiqué") at 2.

designation.[9] We note that there already exist a variety of regulatory regimes for funds and that there is room to upgrade the structural features of some of them based on existing approaches used in other jurisdictions.

5. **Risk should be evaluated in the context of the current regulatory environment,** including post-2008 Crisis activities of both banking and securities regulators. Many of the reforms implemented have made the system in 2015 safer than it was in 2008. Banking regulators have strengthened banks through capital and liquidity rules and stress testing. Likewise, the Securities and Exchange Commission ("SEC"), Office of the Comptroller of the Currency ("OCC"), European Commission, European Securities and Markets Authority ("ESMA"), and IOSCO have undertaken reforms and issued standards to address the composition and structure of money market funds (including those used for the re-investment of cash collateral in securities lending transactions), use of derivatives, data reporting, and stress testing of funds. Any additional reform measures should factor in the reforms that have already been taken or are in process.

6. **A product- and activities-based approach to asset management oriented to improving systemic stability would greatly benefit the market ecosystem by reducing risk:**
   a. Improve market structure for central clearing of OTC derivatives by requiring greater financial resources for central clearing counterparties ("CCPs") and clear rules for recovery and resolution.
   b. Revisit private fund reporting to standardize definitions, reduce overlap and bespoke requirements. The Alternative Investment Fund Managers Directive ("AIFMD") provides a framework that should be emulated in other jurisdictions.
   c. Clearly and consistently define leverage to improve oversight and reduce risk. This should include derivatives, while recognizing that derivatives that are offsetting or hedging risks do not create leverage.
   d. Further develop the "toolkit" for managing redemptions in funds.
   e. Establish principles for stress testing fund liquidity using the AIFMD as the starting point.
   f. Establish a global standard classification system for exchange-traded products ("ETPs") and review structural features of certain ETPs (e.g., leveraged, inverse, and bank loan).
   g. Standardize guidelines for using cash re-investment vehicles in securities lending.
   h. Improve underlying market structure for bank loans and for corporate bonds.
   i. Broaden understanding and transparency of the entire financial market ecosystem.
   j. Address the longevity crisis and pension underfunding.

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[9] On May 20, 2015, the SEC issued proposed rules to enhance the collection of data regarding 1940 Act mutual funds and separate accounts managed by U.S. Registered Investment Advisors. *See* SEC Proposed Rule, *Amendments to Form ADV and Investment Advisers Act Rules"* (May 20, 2015), available at http://www.sec.gov/rules/proposed/2015/ia-4091.pdf. ("SEC Data Reporting Proposed Rule").

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[10] Please note that we set out the questions in their entirety below and our responses to each.

I. A Holistic Approach with a View to the Entire Market Ecosystem is Needed to Reduce Risk

The current approach focused on designation of individual investment funds and asset managers is at cross-purposes to both the G20's stated goals to foster investment and the EU's stated goals to develop an EU Capital Markets Union ("CMU"). In the Communiqué issued from the G20 Finance Ministers and Central Bank Governors Meeting in February 2015 in Istanbul, the G20 cited a commitment to "boosting investment in our countries." In the same Communiqué, the group encouraged measures to promote greater participation in public-private partnerships, more investment in infrastructure projects, and increased availability of financing for SMEs through "long-term financing from institutional investors and encourag[ing] market sources of finance, including securitization."[11] Similarly, in its Green Paper on Building a Capital Markets Union, the European Commission highlights that the "asset management industry plays a pivotal role in channelling investors' money into the economy" and emphasizes that "the development of capital markets in the EU will depend on the flow of funds into capital market instruments."[12] Commissioner Hill has underscored the need for growth and the role of market-based finance, stating in a recent speech, "We want to remove the barriers that stand between investors' money and investment opportunities; overcome the obstacles that are preventing those who need financing from reaching investors; and make the system for channelling those funds – the investment chain – as efficient as possible."[13] We support the G20's and others' efforts to promote growth by seeking additional avenues to provide financing to companies and projects. In our recent *ViewPoint,* "The European Capital Markets Union: An Investor Perspective,"[14] we noted that bank finance and market finance each play an important role in addressing growth challenges.

With this in mind, efforts that seek to genuinely address risks to global financial stability must consider the overall market ecosystem; recognizing that investment funds and asset managers are not the only components of the market ecosystem, which includes a variety of different asset owners and other market participants. As explained in our April 2014 response to the First Consultation, the concerns raised reflect risks that are not specific to individual funds or to individual asset managers. Rather these risks result from common activities undertaken across most if not all market participants. As such, we recommend that investment products and practices that may create systemic risks first be identified and rigorously validated by the FSB and IOSCO, followed by work with national regulators to create a harmonized regulatory framework to specifically address these concerns. This includes recognizing that assets are managed directly by asset owners as well as outsourced to asset managers. While estimates vary, according to the International Monetary Fund ("IMF"), 60% of assets are managed directly by asset owners and 40% are outsourced to asset managers.[15] McKinsey & Company estimates that approximately 75% of the world's financial assets are managed directly by the asset owner,[16]

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11 G20 Istanbul Communiqué.

12 European Commission, Green Paper, *Building a Capital Markets Union* (Feb. 2015), available at http://ec.europa.eu/finance/consultations/2015/capital-markets-union/docs/green-paper_en.pdf.

13 Lord Hill, UK Commissioner Speech, *The Role Financial Markets Can Play in Growth and Jobs* (Feb. 27, 2015), available at http://www.euintheus.org/press-media/speech-by-commissioner-hill-the-role-financial-markets-can-play-in-growth-and-jobs//

14 BlackRock, *ViewPoint, The European Capital Markets Union: An Investor Perspective* (Feb. 2015), available at http://www.blackrock.com/corporate/en-us/literature/whitepaper/viewpoint-cmu-investor-perspective-february-2015.pdf.

15 IMF Global Financial Stability Report finds that the asset management industry intermediates 40% of global financial assets. Note that loans are not included in total global financial assets in this calculation. IMF, Global Financial Stability Report (Apr. 2015), available at http://www.imf.org/External/Pubs/FT/GFSR/2015/01/pdf/text.pdf ("IMF GFSR") at 94.

16 *See* McKinsey & Company, *Strong Performance but Health Still Fragile: Global Asset Management in 2013. Will the Goose Keep Laying Golden Eggs?* (2013). Note that the percent of externally managed assets is lower than the IMF's calculation since this

with the remaining approximately 25% managed by asset managers in separate accounts (approximately 10%) and funds (approximately 15%).[17] Further, a recent study of 177 asset owners representing approximately $6 trillion in assets found a correlation between the size of asset owners and the percentage of assets managed in-house. The study found that over three-quarters of pension funds with AUM greater than $50 billion ("large pension funds") manage at least half of their assets directly, with 69% of large pension funds reporting that they manage more than 75% of their assets in-house. The survey results showed that 94% of official institutions with AUM greater than $50 billion ("large official institutions") manage at least half of their assets directly, and 88% of large official institutions manage more than 75% of their assets in-house.[18] As this data illustrates, attempting to address potential risks – particularly those related to asset allocation decisions – by focusing solely on asset managers and investment funds will fail to fully address the issues given that a majority of assets are managed directly by asset owners.

In the absence of a holistic regulatory approach to systemic risk concerns, or if regulation is targeted at a subset of participants or investment vehicles through the G-SIFI designation efforts, the FSB and IOSCO's work will inevitably *shift* risks from one part of the market ecosystem to another and potentially create market distortions without materially reducing risk. A few examples will help illustrate why a holistic view of the market ecosystem is essential to the FSB's and IOSCO's success in efforts to address threats to global financial stability:

1. The FSB and IOSCO have raised questions in the Second Consultation about securities lending. Securities lenders ("lenders") include a wide variety of asset owners, including large institutional investors such as pension funds and collective investment vehicles ("CIVs"). Lenders can choose to lend directly or they can select a securities lending agent to act on their behalf. Securities lending agents include custodians, asset managers, and independent businesses that specialize in securities lending.[19] As such, the risks associated with various activities within securities lending – be it haircuts, cash reinvestment, or borrower default indemnification – need to be addressed at the activity-level, not the entity level. In fact, by focusing specifically on securities lending by external asset managers, many active securities lending agents will necessarily be out of scope.

2. Policy makers have expressed concerns about the mismatch in liquidity that may exist between the daily redemption structure of certain mutual funds and their underlying assets,[20] commonly referred to as a "liquidity illusion". However, if hypothetically, it

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calculation includes loans in total global financial assets. *See also* BlackRock, *ViewPoint, Who Owns the Assets? Developing a Better Understanding of the Flow of Assets and the Implications for Financial Regulation* (May 2014), available at http://www.blackrock.com/corporate/en-us/literature/whitepaper/viewpoint-who-owns-the-assets-may-2014.pdf ("Who Owns the Assets *ViewPoint*").

17 S*ee* BlackRock, *ViewPoint*, *Fund Structures as Systemic Risk Mitigants* (Sep. 2014), available at http://www.blackrock.com/corporate/en-us/literature/whitepaper/viewpoint-fund-structures-as-systemic-risk-mitigants-september-2014.pdf ("Fund Structures *ViewPoint*").

18 BNP Paribas and YouGov, Global Risk Report 2015, *Risk Analytics – Challenges and Perspectives in a Low Yield Environment* at 29 (2015), available at http://securities.bnpparibas.com/to-receive/bp2s-yougov/global-risk-survey-2015.html ("BNP Paribas Global Risk Report 2015").

19 Securities lending agents include BMO Global Asset Management, BNP Paribas, Bank of New York Mellon ("BNY Mellon"), Brown Brothers Harriman, Citibank, Comerica Bank, Credit Suisse, Deutsche Bank, eSecLending, Frost Bank, Goldman Sachs Agency Lending, JP Morgan, Northern Trust, Schwab, Scotia Capital (USA) Inc., State Street Bank, Sumitomo Mitsui Trust Bank (USA) Ltd, US Bank, Vanguard Group, and Wells Fargo.

20 *See for example* Jaime Caruana, *"Financial Reform and the Role of Regulators: Evolving Markets, Evolving Risks, Evolving Regulation,"* Speech at GARP 16th Annual Risk Management Conference (Feb. 24, 2015), available at http://www.bis.org/speeches/sp150225.htm.

was determined that the "solution" to address this risk were to mandate an explicit cash buffer in every mutual fund, the result would be a performance lag in mutual funds, likely incentivizing migration to other investment vehicles such as separate accounts. While large institutional investors and small and medium sized institutional investors would be able to set up separate accounts or manage their assets internally, individual investors would inevitably be disadvantaged. Likewise, if the solution were a designation of a subset of funds, investors might shift assets towards these funds making them even larger, or may shift assets away from these funds to other similar funds. In either case, these actions would *shift* risks within the market ecosystem, however, risk would not be reduced.

Several individuals who participate in the FSB and IOSCO represent institutions that have already called for a focus on products and activities in asset management. In December 2014, the U.S. Financial Stability Oversight Council ("FSOC") issued a Request for Comment that focused primarily on "products and activities" in asset management, as opposed to the entity specific approach that has been adopted in the Second Consultation. In April 2015, the IMF, after conducting extensive research, stated in its Global Financial Stability Report: "given that the [asset management] industry is diverse and that differences in investment focus seem to matter significantly for funds' contribution to systemic risk, a product- or activity-based emphasis seems to be important."[21] Further, several FSB members have made public statements indicating that there is merit in considering a products- and activities-based approach. For example, in a November 2014 speech, FSB Chairman Mark Carney said, "there may be merit in this activity-based systemic risk assessment over and above a purely firm-focussed approach to systemic designation."[22] While many have cited risks in asset management as worth investigating, the concerns raised reflect issues with activities or products such as open-end mutual funds or securities lending.

Likewise, as described in the FSB's press release from the Plenary Meeting in Frankfurt in March 2015, members of the FSB Standing Committee on Assessment of Vulnerabilities (FSB SCAV) are reviewing "financial stability risks associated with market liquidity in fixed income markets and asset management activities in the current conjuncture."[23] This undertaking highlights an investigation of important issues for the market ecosystem that is necessary for understanding risk and identifying potential policy measures.[24] It logically follows that this work needs to conclude before it can be determined that pursuit of designation metrics for individual entities is necessary, especially given that entity-specific designations are unlikely to lead to policy measures that would reduce systemic risks. At present, there is not even a clear articulation of what an entity-specific designation would mean, let alone a persuasive demonstration or defense of its efficacy. In contrast, the focus on "products and activities" reflects a growing understanding of the nature of risks in asset management, and we encourage

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21 IMF GFSR at 121.

22 Mark Carney, *The Future of Financial Reform"*, Speech at 2014 Monetary Authority of Singapore Lecture, (Nov. 14, 2014), available at http://www.bankofengland.co.uk/publications/Documents/speeches/2014/speech775.pdf.

23 Financial Stability Board, Press Release, *Meeting of the Financial Stability Board in Frankfurt* (Mar. 26, 2015), available at http://www.financialstabilityboard.org/wp-content/uploads/Press-Release-FSB-Plenary-Frankfurt-final-26Mar15.pdf.

24 This is further developing work that has been done by the FSB on "shadow banking", which focused on five economic functions: (i) management of collective investment vehicles with features that make them susceptible to runs; (ii) loan provision that is dependent on short-term funding; (iii) intermediation of market activities that is dependent on short-term funding or on secured funding of client assets; (iv) facilitation of credit creation; and (v) securitisation-based credit intermediation and funding of financial entities. *See* FSB *Strengthening Oversight and Regulation of Shadow Banking: Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities* (Aug. 29, 2013), available at http://www.financialstabilityboard.org/wp-content/uploads/r_130829c.pdf?page_moved=1.

the FSB and IOSCO to consider an activities-based approach that takes into account the impact of such activities on the entire market ecosystem, rather than focusing on narrowly scoped designation metrics for asset managers and investment funds. We have provided suggestions for activities that would be worthwhile to consider in Section IV of this letter.

We recognize that some members of the FSB may believe that there is a place for both designation and a products- and activities-based approach to regulation of asset management. We disagree with the view that designation is an effective means to regulate asset managers or investment funds and believe that a products- and activities-based approach is the only way to reduce systemic risk emanating from the market ecosystem. At the very least, improvements to the regulation of products and activities should *precede* a determination of whether designation methodologies are needed. Further, it should be noted that conducting these two initiatives (development of designation methodologies and review of products and activities) simultaneously may result in the two efforts running at cross-purposes with one another, given that improvements to regulation will likely mitigate the concerns that have been raised in the Second Consultation.

II. Until the Specific Risks Posed by NBNIs that Need to be Addressed are Identified, Designation Metrics are Premature

We agree with the Second Consultation statement that "any potential policy measures that would be applied to the identified NBNI G-SIFIs should be designed to target the risks and externalities associated with such entities."[25] It logically follows that a set of risks would need to be identified *prior* to developing designation metrics so that the designation criteria appropriately capture the entities that pose risk, thereby allowing policy measures to be tailored and targeted to address those risks. Without first identifying the risks and specifying the remedies or policy measures to address the risks, any metrics developed are likely to produce "false positives" and "false negatives." This can lead to undue regulatory burdens on investors and market distortions, without achieving the objective of improving global financial stability. A few examples will help to illustrate this important issue:

1. The IMF[26] and Bank for International Settlements ("BIS")[27] have expressed concerns about asset flows to and from emerging markets. To address these concerns, policy makers would need to consider asset owners as well as asset managers given that asset owners control the strategic asset allocation decisions across their portfolios.[28] In addition, using the proposed materiality thresholds, neither the largest emerging markets debt ("EMD") funds nor the largest external managers of EMD (Appendix A) would be included on the "Stage 0" list that would subject them to being "assessed in more detail by the relevant national authorities using the NBNI G-SIFI methodologies."[29]

2. Similarly, some commentators have expressed concerns about open-end mutual funds that invest in bank loans. The largest bank loan mutual fund is less than $20

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25 Second Consultation at 2.

26 IMF GFSR; IMF, *Global Financial Stability Report* (Oct. 2014), available at http://www.imf.org/external/pubs/ft/gfsr/2014/02/pdf/text.pdf. ("Oct. 2014 IMF GFSR").

27 BIS, Quarterly Review (Sep. 2014), available at http://www.bis.org/publ/qtrpdf/r_qt1409.pdf.

28 Who Owns the Assets *ViewPoint*.

29 Second Consultation at 13.

billion in AUM and therefore, will not be captured by the proposed materiality thresholds.[30]

3. In the U.S., the Office of Financial Research ("OFR") has expressed concerns about leveraged separate accounts. To address these concerns, policy makers would need to consider asset owners and asset managers given that leverage is often borne at the asset owner entity portfolio level rather than in individual separate accounts. In addition, the proposed metrics are unlikely to identify external managers that might employ these strategies as they are more likely to be firms that are well under the proposed materiality thresholds ($1 trillion AUM or $100 billion balance sheet) and specialize in alternative investment strategies.[31]

4. The Second Consultation raises concerns about "unique" activities such as commodities or structured products.[32] We do not believe that these strategies represent unique activities. Nonetheless, the proposed methodologies for investment funds and the proposed methodology for asset managers are unlikely to address concerns with these products as the proposed materiality thresholds bear no relation to these concerns and would not necessarily bring in scope investment funds or asset managers offering these strategies.

III. Assessing the Applicability of the G-SIFI Framework to Asset Managers and Investment Funds

We recognize that the FSB would like to ensure that "[t]he general framework for the methodologies should be broadly consistent with methodologies for identifying G-SIBs and G-SIIs, i.e., an indicator-based measurement approach where multiple indicators are selected to reflect the different aspects of what generates negative externalities and makes the distress or disorderly failure of a financial entity critical for the stability of the financial system (i.e., 'impact factors such as size, interconnectedness, and complexity)."[33] In line with this rationale, the Second Consultation identifies three transmission mechanisms: (a) exposures / counterparty channel, (b) asset liquidation / market channel, and (c) critical function or service / substitutability and five impact factors: (i) size, (ii) interconnectedness, (iii) substitutability, (iv) complexity, and (v) cross-jurisdictional activities. However, when analyzed, neither the transmission mechanisms nor the impact factors are applicable to asset managers or the vast majority of investment funds suggesting that the proposed framework is not an effective means of identifying or addressing risks that may result from the activities of asset managers or funds.[34]

The relationship of asset managers to the investment vehicles they manage is *not* analogous to commercial banks and other balance sheet lenders. Banks utilize the capital and

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30 According to Morningstar, as of May 2015, the largest bank loan mutual fund is Oppenheimer Senior Floating Rate Fund which has an AUM of approximately $16 billion.

31 SIFMA, Comment Letter, *Response to the FSB's Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions and the OFR's Asset Management and Financial Stability* (Apr. 4, 2014), available at http://www.sifma.org/issues/item.aspx?id=8589948419 ("SIFMA Separate Account Study"). The report detailed the separate account data of 9 asset managers with aggregate assets under management ("AUM") of $11.2 trillion, $3.98 trillion of which was separate account AUM. The SIFMA Separate Account Study at 2 concluded that 99% of large separate accounts that were included in the survey "were invested in long-only strategies, and 53% were invested in passively managed, index strategies."

32 Second Consultation at 49.

33 Second Consultation at 3.

34 The G20 tasked the FSB with preparing methodologies to identify systemically important non-bank financial entities, but did not suggest using the same framework applied to banks. *See* G20 Saint Petersburg Declaration; G20 Cannes Declaration.

deposits of the bank or other affiliates to finance the lending or other activities of another member of the affiliated group. In contrast, asset managers merely facilitate financing and securities transactions as agents, and client assets are legally separate from that of the manager and from the assets of other clients held by custodians. These transactions are contractually between the asset owners and their counterparties; the asset managers do not act as counterparties to client trades, derivatives transactions, or securities lending transactions.[35] Moreover, except in the case of leveraged funds, the claims of investors in asset management products are all equity claims, meaning that the asset owners are explicitly bearing the market and market liquidity risks of the fund's assets.

Asset managers do not offer government insured deposits nor do they have access to central bank liquidity. Asset managers use minimal to no leverage in their capital structures and are, thus, not materially exposed to short-term funding liquidity risk.[36] In circumstances where the asset manager provides borrower default indemnification, the exposure is limited to the difference between the securities on loan and the value of the collateral which is marked-to-market daily. Asset managers do not cease operations the way a bank can suddenly fail and do not create the systemic exposures that banks create. [37]

The services provided by an asset manager including asset management services, securities lending agent services, and asset management technology operate within a highly competitive landscape with multiple competitors. Given the high degree of substitutability, including the ability of clients to choose to manage their own assets without hiring an asset manager, no individual fund or asset manager provides a "critical" function or service to the financial markets.

In reviewing the transmission mechanisms and impact factors in the Second Consultation, the vast majority of investment funds should be out of scope. The one exception may be highly levered investment funds, as we explained in our response to the First Consultation.[38] While we do not believe that designation is the best way to address the risks associated with highly levered funds, if the FSB and IOSCO decide to pursue a designation framework for "systemically important funds", we highlight the importance of agreeing on the definition for leverage. As discussed in our recent response to the FSOC, there is considerable variation across jurisdictions in terms of the definition and measurement of leverage.[39] It is our view that measures of leverage that capture the economic exposure that results from the use of derivatives and borrowing, and

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35 Some asset managers have affiliates that may be banks, broker-dealers, insurers, or other types of institutions. We are referring specifically to the asset management entity. Additionally, like most corporations, asset managers may engage in hedging activities using derivatives. However, this is generally miniscule in comparison to the transactions executed by the asset manager on behalf of clients.

36 Note that asset managers may borrow to make acquisitions, for their own working capital, and similar purposes.

37 The "resolution" of asset managers is discussed in BlackRock, Comment Letter, Supplemental Response to SEC and OFR Study on Asset Management and Financial Stability (Mar. 14, 2014), available at http://www.blackrock.com/corporate/en-us/literature/publication/am-res-sec-031414.pdf ("Supplemental Letter to SEC"). *See also* Committee on Capital Markets Regulation, Comment Letter, Financial Stability Oversight Council Notice Seeking Comment on Asset Management Products and Activities (Mar. 16, 2015), available at http://capmktsreg.org/app/uploads/2015/03/2015_03_16_FSOC_Notice_on_Asset_Management_Products_Activities.pdf ("Committee on Capital Markets Regulation FSOC Response"); ICI, *"Orderly Resolution" of Mutual Funds and Their Managers* (Jul. 15, 2014), available at http://www.ici.org/viewpoints/view_14_orderly_resolution ("ICI Resolution Paper").

38 April 2014 First Consultation Response. See discussion on leverage on pages 13, 27, 29, 32. As noted in our letter, "the potential for forced liquidations and market distortions are amplified by the use of leverage. Where a fund has no leverage, to the extent the fund receives redemption requests, it must simply sell down its assets on a one-to-one basis to meet the redemptions."

39 BlackRock, Comment Letter, Request for Comment on Asset Management Products and Activities (Mar. 25, 2015), available at http://www.blackrock.com/corporate/en-us/literature/publication/fsoc-request-for-comment-asset-management-032515.pdf ("FSOC Response").

accounts for the fact that hedging reduces risk in a portfolio is most meaningful in determining the level of risk presented by an investment fund. Given our familiarity with various regulations in this space, we believe that a good starting point is the AIFMD "commitment leverage" calculation.

A. Transmission Mechanisms: Asset Managers

After reviewing "(i) funds; (ii) family of funds; (iii) asset managers on a stand-alone entity basis; and (iv) asset managers and their funds collectively," the First Consultation concluded that "[s]ince exposures are created at the fund level and data is available on an individual fund basis, the consultation methodology focuses on individual investment funds."[40] We agree with this initial conclusion as outlined in our April 2014 response and we are not aware of other respondents that encouraged the FSB and IOSCO to focus on asset managers.[41] As such, we are perplexed by the inclusion of asset managers in the methodology in the Second Consultation. In this section, we explain why asset managers do not present systemic risk at the company level and why the transmission mechanisms described in the Second Consultation are not applicable to asset managers.

(i) Exposures / Counterparties Channel

Asset managers are not transmitters of risk in the "exposures / counterparties channel". As we have explained in various documents[42], the "exposure / counterparties channel" is not relevant to asset managers because asset managers are not the counterparties to client or investment fund trades, derivative transactions, or securities lending arrangements.[43]

The Second Consultation makes several references to securities lending which we believe reflect a misunderstanding of the role of a securities lending agent. Given the continuing misunderstandings in this area, we recently published a *ViewPoint* entitled "Securities Lending: The Facts"[44] which is summarized here. As the Second Consultation notes, some asset managers may provide services to clients as securities lending *agents*. Securities lending agents are *not* the counterparties in securities loans; rather they arrange a transaction between a client who wishes to lend securities ("lender") and an entity that wishes to borrow securities ("borrower"). BlackRock acts as a lending agent for some of its asset management clients and when BlackRock is the lending agent, all securities loans are made only to borrowers that are *independent* of BlackRock. Consistent with a combination of regional regulatory requirements, market practices, and BlackRock's policies and procedures, BlackRock does not arrange transactions between the lenders for which it acts as securities lending agent and entities for which it acts as investment manager. Furthermore, regulatory requirements and market practice require that borrowers post collateral for securities loans in excess of the value of the security being lent. This collateral is marked-to-market daily and the borrower may be required to deliver additional collateral to maintain the required excess level. BlackRock typically requires borrowers to post collateral between 102% and 112% of the value of the securities lent. This overcollateralization provides an additional "safety cushion" in the event that a borrower fails to

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40 First Consultation at 7.

41 FSB, *Public Responses to January 2014 Consultative Document Assessment Methodologies for Identifying NBNI G-SIFIs* (Apr. 25, 2014), available at http://www.financialstabilityboard.org/2014/04/r_140423/.

42 *See* for example April 2014 First Consultation Response; FSOC Response; Who Owns the Assets *ViewPoint*.

43 *See* footnote 35.

44 BlackRock, *ViewPoint*, *Securities Lending: The Facts (*May 2015), available at http://www.blackrock.com/corporate/en-us/literature/whitepaper/viewpoint-securities-lending-the-facts-may-2015.pdf ("Securities Lending *ViewPoint*").

return the security that is out on loan. BlackRock does not rehypothecate non-cash collateral. In BlackRock's securities lending program, the borrower posts all non-cash collateral directly to a custodial account for the benefit of the lender. The collateral is not used by either the lender or lending agent, except in the event that the borrower defaults, at which time the collateral would be sold to cover the replacement cost of the securities that were on loan.

Borrower default indemnification by securities lending agents does *not* entail a guarantee of the investment performance of the securities lending arrangement, including the returns on any cash investment vehicle. Rather, in the event that the borrower fails to return the securities that have been lent and the collateral amount pledged is insufficient to cover the cost of replacing the securities, the borrower default indemnification requires the lending agent to cover the shortfall between the value of the collateral pledged and the replacement cost of the securities lent. BlackRock provides borrower default indemnification to some clients for which it acts as lending agent. BlackRock (and its predecessors) has never had its indemnification agreements triggered or had to use its own monies to repurchase a security on a lending client's behalf.[45]

(ii) Asset Liquidation / Market Channel

As the Second Consultation states, "asset managers tend to have small balance sheets and the forced liquidation of their own assets would not generally create market disruptions."[46] We agree with this statement. Given the nature of an asset manager's balance sheet, asset managers are not transmitters of risk in this channel. Asset managers do not transmit risk in this channel, even indirectly, because even in the worst-case scenario where an asset manager was unable to operate at all, clients would be able to transition the management of their investments to another manager.[47] We note that transitioning the management of a client's account need not entail the selling of assets, as client assets are segregated from the asset manager's own assets and are held by a custodian.[48]

In the case of separate accounts, separate account clients regularly initiate and terminate investment management agreements ("IMAs") for a variety of reasons, including changes in the client's choice of asset allocation, poor performance or client service on the part of the asset manager, and administrative consolidation. Such changes can be implemented on short notice, sometimes in as little as 24 hours, with no noticeable market impact. While a typical search by an institutional client for a new manager usually takes several weeks or even months, clients can and do move quickly when situations necessitate. In our experience, there have been numerous situations where we assisted a client by taking on investment management responsibility for a separate account

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[45] As disclosed in BlackRock's 10-K, the amount of securities on loan in BlackRock's securities lending program subject to indemnification as of Dec. 31, 2014 was $145.7 billion. Borrowers posted $155.8 billion as collateral for indemnified securities on loan at Dec. 2014. The fair value of these indemnifications was not material at Dec. 31, 2014. Securities lending agents, including asset managers, may hold capital against potential indemnification exposure. For example, BlackRock holds $2 billion in unencumbered liquidity against potential indemnification exposure to which it is subject and has access to an additional $6 billion of liquidity, both in the form of unencumbered cash and a $4 billion, 5-year bank credit facility as of December 2014. BlackRock does not rely on wholesale funding or government-insured deposits to support its liquidity. We are currently rated A1 and AA- by Moody's and S&P, respectively, which is among the highest in the asset management industry, and equal to or higher than other securities lending agents.

[46] Second Consultation at 48.

[47] *See* FSOC Response at 55.

[48] Note that cleared derivative positions may be held through a different entity such as a futures commissions merchant ("FCM") and not held directly by the custodian. Nonetheless, derivative positions are not held by the asset manager.

on extremely short notice.[49] Substituting asset managers can be achieved quickly because client separate account and fund assets are held with custodians who are contractually obligated to the asset owner or fund (not the asset manager). Custodians hold the assets regardless of which asset manager the asset owner selects to manage their assets. As such, clients can re-direct the management of an existing portfolio of securities to another manager. Importantly, assets are not required to physically move when there is a change of asset managers; assets remain with the custodian in client denominated accounts.

There are several examples where the management of CIVs was transferred from one asset manager to another without requiring significant asset liquidations or causing any other disruptions to markets. For example, the chief executive and founder of Strong Capital Management was implicated in facilitating market timing abuses in September 2003, at which time Strong Capital managed approximately $42 billion in client accounts. Because of the severe reputational damage caused to Strong Capital as a result of this issue, the funds managed by Strong Capital were acquired by Wells Fargo in 2005.[50] Through this transaction, Strong Capital's funds were reorganized into the Wells Fargo Funds® family. The legal entities comprising the Strong Financial complex were subsequently liquidated. In a similar example during the same time period, Pilgrim Baxter & Associates, manager of the PBHG fund family, suffered severe reputational damage when principals Gary Pilgrim and Harold Baxter were accused of fraud and breach of fiduciary duty for allowing market timing abuses in the funds they managed at the end of 2003.[51] As a result of the reputational damage from the scandal, PBHG funds lost more than one-third of their AUM in one year. The PBHG funds were rebranded under the name of Pilgrim Baxter & Associates' parent company, Old Mutual, in 2005, and Pilgrim Baxter & Associates changed its name to Liberty Ridge Capital. To our knowledge, neither of these situations resulted in forced asset liquidations and neither situation had a material market impact.

The recent example of outflows from PIMCO's Total Return Strategy following the resignation announcement of lead portfolio manager, Bill Gross, is a good example of the ability to transition large amounts of AUM from one manager to another without market disruption. This event also demonstrates the large number of competitors in the industry, belying any concerns about "substitutability". Outflows from PIMCO funds were primarily observed in products most closely associated with Bill Gross as the portfolio manager. October 2015 outflows from PIMCO totaled $48 billion, 70% of which came from funds previously managed by Gross.[52] Likewise, the PIMCO Total Return Fund saw overall outflows of $68 billion from October 2014 through January

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[49] For example, Barclays Global Investors ("BGI") took on several international equity mandates on short notice in 2003 when Putnam Investors experienced significant reputational harm due to concerns that two portfolio managers were accused of market timing abuses in their funds.

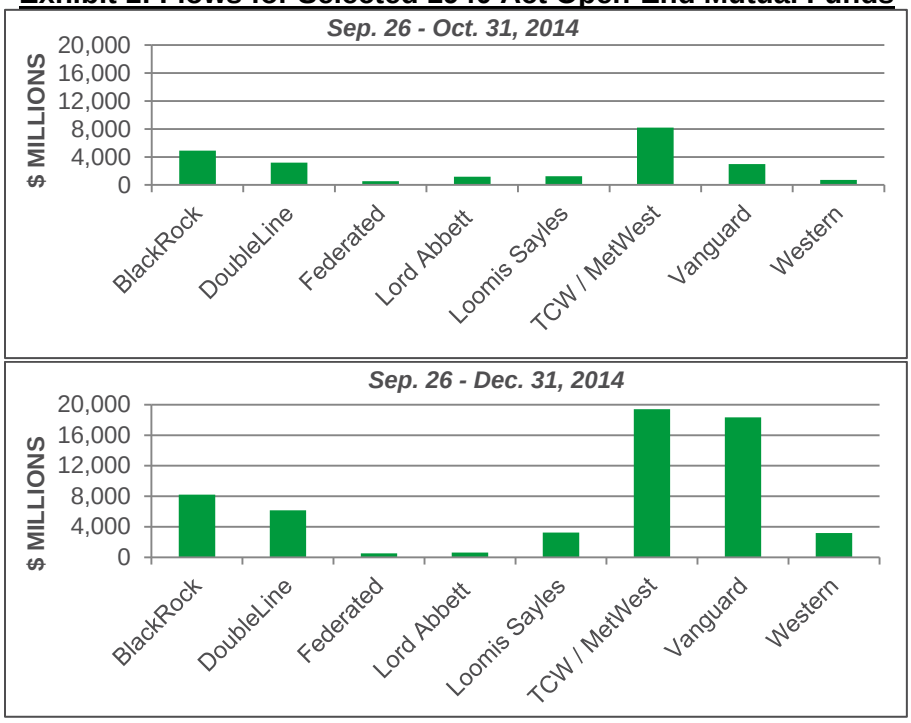
[50] Wells Fargo, Press Release, (May 26, 2004), available at http://www.wellscap.com/docs/press_releases/5.26.04.pdf. Agreed to in 2014, the transaction closed in early 2005. Wells Fargo, Press Release, *Wells Fargo Becomes One of Nation's 20 Largest Mutual Fund Companies with Acquisition of Strong Financial Corporation Assets* (Jan. 3, 2005), available at http://www.prnewswire.com/news-releases/wells-fargo-becomes-one-of-nations-20-largest-mutual-fund-companies-with-acquisition-of-strong-financial-corporation-assets-53825057.html.

[51] Leticia Williams and Jonathan Burton, *Pilgrim Baxter Charged with Fraud*, MarketWatch, available at http://www.marketwatch.com/story/pilgrim-baxter-founders-face-fraud-charges?siteid=google&dist=google. On November 17, 2004, the SEC issued a press release stating that both Pilgrim and Baxter had agreed to personally pay a total of $160 million to settle the fraud charges and both were also permanently barred from the investment industry and Pilgrim Baxter and Associates were required to pay $90 million to be distributed to injured investors. *See* SEC Press Release, *Harold Baxter and Gary Pilgrim Agree to Pay a Total of $160 Million to Settle Fraud Charges Concerning Undisclosed Market Timing* (Nov. 17, 2004), available at http://www.sec.gov/news/press/2004-157.htm.

[52] *See* Kirsten Grind, *Pimco Sees $48 Billion in Outflows After Gross Departure*, The Wall Street Journal (Nov. 5, 2014), available at http://www.marketwatch.com/story/pimco-sees-48-billion-in-outflows-after-gross-departure-2014-11-05. Oliver Suess, *Pimco Offers Special Post-Gross Bonus to Retain Talent* (Nov. 7, 2014), Bloomberg, available at http://www.bloomberg.com/news/articles/2014-11-07/pimco-offers-special-post-gross-bonus-to-retain-talent.

2015, with larger outflows in both January 2015 and December 2014 than in November 2014.[53] While specific attribution of the aggregate outflows to receiving funds is difficult to fully confirm, public data show that the flows were spread across multiple firms, products, and investment strategies, reflecting the high level of competition in the asset management industry. Various asset owners chose between active, passive, and unconstrained strategies offered by more than a half-dozen asset managers (see Exhibit 1); publicly available data indicates that some clients may have bought shares in fixed income exchange-traded funds ("ETFs").[54] Despite this activity, fixed income markets, including related derivative instruments, continued to function in an orderly manner during this period of relatively low market liquidity.

Exhibit 1: Flows for Selected 1940 Act Open-End Mutual Funds



Source: Morningstar. Feb. 6, 2015. The data shown includes actively managed and index intermediate-term, short-term and unconstrained bond strategies. Excludes ETFs.

As these examples demonstrate, neither the inability of a manager to operate nor a major reputational event creates systemic risk. In part, this reflects that there is no first-mover exit behavior or reactionary liquidation of assets, like that which may be associated with a bank failure. As transition of the management of client assets occurs regularly, asset managers, custodians, and clients have considerable experience making these transitions effectively.

(iii) Critical Function or Services / Substitutability Channel

As the Second Consultation states, "asset managers primarily provide advice or portfolio management service to clients on an agency basis. This model makes their provision of this particular activity generally substitutable as there is considerable competition in the market place." We agree with this statement. Asset managers do not transmit risk through this channel.

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[53] *See* PIMCO Press Releases, available at http://www.pimco.com/en/pressreleases/Pages/PressReleasesOverview.aspx.

[54] BlackRock, *ViewPoint*, *ETFs Help Improve Market Stability: A Closer Look at Fixed Income ETF Behavior During Recent Bond Market Movement* (Oct. 30, 2014), available at https://www.blackrock.com/corporate/en-us/literature/whitepaper/etfs-help-improve-market-stability-october-2014.pdf.

The asset management industry is highly competitive and there are numerous competitors across asset classes and investment strategies. Asset owners can manage their own assets internally, or they can consult one of several commercially available data sources that provide information about asset managers and their investment products, or they can consult with their institutional investment consultant or financial advisor who oftentimes maintains proprietary databases with information on asset managers and investment funds.[55] In the event an asset manager is unable to operate, a substitute manager can easily be sourced as a replacement, and a transition of management services can be completed very quickly.[56]

The Second Consultation advanced the idea that "if an asset manager was a significant pricing provider, securities lending agent, or provider of certain systems used by market participants and critical to their activities, their distress or failure could leave the market without ready substitutes."[57] While we agree that securities lending activities help support well-functioning securities markets, as described above, multiple entities offer securities lending agent services. Most institutional custodians act as securities lending agents and can easily step into this role if a client desires to make a change. In addition, there are several independent providers of securities lending agent services, giving clients additional options to choose from. In the event an asset manager is no longer able to provide services as a securities lending agent, the asset owners could replace this service by retaining another agent, lending its assets directly, or choosing not to lend securities from their portfolio. Further, as the Second Consultation states, "most securities lending transactions are facilitated by custodian banks."[58]

The Second Consultation similarly suggested that the provision of asset management technology was a "critical" service or function provided by some asset managers. The market for asset management technology is highly competitive, with multiple vendors for various types of data and technology, relatively low costs of moving from one vendor system to another, and relatively low barriers to entry. Examples of vendors to asset management include:

- **Benchmark Providers:** Barclays, FTSE, MSCI, Russell, and S&P
- **Order Management Systems**: Aladdin, Bloomberg, Charles River, Eze Castle, Fidessa LatentZero, Linedata, and Simcorp Dimension
- **Performance and Accounting**: Aladdin, BNY Mellon Eagle, Portia, Princeton Financial Systems, Simcorp Dimension and SS&C CAMRA
- **Pricing Providers:** Bloomberg, Interactive Data, Markit and Thomson Reuters

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[55] For example, eVestment is one of several commercially available institutional manager research databases that offer comprehensive information on asset managers including information about their investment strategies and investment vehicles that may be offered including separate accounts. Strategic Insight's Simfund, Lipper, and Morningstar offer various analytical and research tools and databases; their mutual fund databases contain information about registered investment products such as mutual funds and ETFs. Additionally, many institutional investment consultants maintain their own proprietary manager research databases to collect asset manager and investment strategy information for due diligence, monitoring, research, and evaluation purposes. Some of these databases are made commercially available to clients and other market participants. Examples include: Albourne (Moatspace), Cambridge Associates, Mercer Global Investment Manager Database (GIMD), Towers Watson, and Wilshire Associates (Compass).

[56] Most large institutional investors have existing relationships with multiple managers, even sometimes with different managers retained for the same strategy. In such cases, given that assets are custodied away from the manager, transition of management control can be particularly efficient.

[57] Second Consultation at 49.

[58] Second Consultation at 48.

- **Risk Analytics**: Aladdin, Barclays POINT, Citi YieldBook, FactSet, MSCI Barra, IBM Algorithmics, IDC BondEdge, Markit, UBS Delta, and Wilshire Axiom

- **Security Data Providers:** Bloomberg and Thomson Reuters

We discuss the use of technology in greater detail in our *ViewPoint*, "The Role of Technology within Asset Management."[59] The paper explores asset management technology, which is primarily used to support data management and information processing. Asset managers and asset owners who manage their assets directly, require systems to maintain data and support the flow of information.

We agree with much of the FSB and IOSCO's analysis about the role of asset managers in these channels — asset managers do not transmit risk through counterparty exposures, asset liquidation or the unique provision of critical services. A more complete understanding of asset owner asset allocation decisions and securities lending activities would allay the concerns raised about transmission risks arising from external asset managers.

B. Impact Factors: Asset Managers

The Second Consultation identifies five "impact factors" derived from the Global Systemically Important Bank ("G-SIB") and Global Systemically Important Insurer ("G-SII") framework. The impact factors do not reflect risks that are present for asset managers.

(i) Size

The Second Consultation states that "Asset Managers with higher amounts of AUM may have a greater potential impact on the global financial system."[60] We respectfully disagree with this assertion. The simple fact that "[d]ata regarding an asset manager's global AUM generally is readily available,"[61] does not imply that the size of an asset manager's AUM is correlated with systemic risk nor is there any evidence to support this assertion in the Second Consultation. A recent analysis by the IMF concluded that "larger funds and funds managed by larger asset management companies do not necessarily contribute more to systemic risk: the investment *focus* appears to be relatively more important for their contribution to systemic risk."[62]

The largest asset managers tend to be diversified across asset classes, investment strategies, and/or types of clients. In BlackRock's case, our AUM is spread across equity, fixed income, cash, and alternative investments. These assets are managed by well over 100 independent investment teams, each responsible for the investment decisions in the portfolios they manage and accountable for the performance of these portfolios. No single individual or committee governs the investment decisions of these different portfolio management teams. On the other hand, firms that specialize in a particular asset class or investment strategy may be more likely to have a single investment team with a "house view" and align all of the portfolios that

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[59] BlackRock, *ViewPoint, The Role of Technology within Asset Management* (Aug. 2014), available at http://www.blackrock.com/corporate/en-us/literature/whitepaper/viewpoint-asset-management-technology-auG2014.pdf ("Technology *ViewPoint*").

[60] Second Consultation at 52.

[61] Second Consultation at 52.

[62] IMF GFSR at 93.

they manage with this view. Finally, asset owners and their consultants,[63] control strategic asset allocation and manager selection decisions.

Regardless of size, asset managers do not have discretion to invest in "anything they want to," but rather are contractually obligated to invest according to the investment guidelines specified in the separate account or fund documents. These guidelines specify the investment objective and constraints within which the portfolio must be managed and are agreed to by the asset owner and asset manager, typically in advance of the engagement of the asset manager.

A second measure of size is the balance sheet of an asset manager. Again, we find no correlation to systemic risk and the Second Consultation presents no evidence of correlation. While balance sheet size may drive the potential systemic impact of a commercial bank, this is not the case for an asset manager. A commercial bank's business models commit the commercial bank's balance sheet to its core activities of taking in deposits and making loans and the use of significant balance sheet leverage, with revenue derived from the spread between its assets and liabilities. A commercial bank promises depositors to return their principal (a promise often supported at some level by government-provided deposit insurance or other deposit protection programs). On the other hand, the business model of asset managers is fee-based—asset managers provide a service and receive a fee. If an asset manager's services are no longer needed or desired, its revenue decreases, and if its revenue decreases significantly, the asset manager will cease operations. This typically occurs over an extended period and is unlikely to occur suddenly given that asset managers do not rely on short term wholesale funding to operate their businesses. Further, asset managers do not promise a return of principal to investors. The inability of an asset manager to operate for any reason, therefore, does not incentivize the first-mover exit incentives or liquidation of assets associated with a commercial bank failure.

Asset managers' balance sheets are negligible in comparison to any of the G-SIBs or G-SIIs. The balance sheet of an asset management firm generally comprises working capital, an investment portfolio related to seed and co-investment capital, property, premises and equipment, thereby requiring a modest amount of capital. In addition, asset managers that act as securities lending agents who provide borrower default indemnification may hold liquidity to cover a potential loss associated with the provision of such indemnification. Because the business of asset management is not capital intensive, asset managers do not routinely use short-term debt instruments to fund their operations and thus, unlike banks and broker-dealers, asset managers are not dependent on continued liquidity from short-term markets.

Under U.S. and international accounting standards, client assets are sometimes consolidated on the balance sheet of an asset manager. For example, it is common for assets to be managed on behalf of UK pension schemes using an insurance company structure.[64] Accounting rules require that these equal and offsetting separate account assets and liabilities be recorded in the consolidated balance sheet of the asset manager. However, the assets that must be consolidated under the accounting rules are "ring-fenced" from the asset manager's assets and are not available to creditors of the asset manager. This requirement leads to a misleading depiction of these asset managers' total assets due to the inclusion of these assets and liabilities on their balance sheet. To put this in perspective, as disclosed on BlackRock's 10-K, our adjusted balance sheet assets which exclude the consolidated assets related to UK pension

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[63] According to Pensions & Investments, the largest institutional investment consultants as of June 2014 are Mercer, Cambridge Associates, Aon Hewitt Investment Consulting, Russell Investments, and Towers Watson Investment Services.

[64] We are aware of several managers operating in the UK using this structure including: Aberdeen, BlackRock, Fidelity, HSBC, Invesco, J.P. Morgan, Legal and General, Prudential, Schroder, and UBS.

schemes are $41.1 billion including $30.3 billion in goodwill and intangible assets.[65] We understand that the Financial Accounting Standards Board ("FASB") is currently reviewing insurance company accounting, although there can be no certainty as to whether they will modify this presentation. See Appendix C for an excerpt from BlackRock's 10-K providing detail on BlackRock's balance sheet.

(ii) Interconnectedness

Asset managers are not the counterparties to client trades, derivatives, or securities lending transactions. The application of this impact factor to external asset managers conflates the asset manager with its clients. Unlike banks, asset managers do not have highly leveraged balance sheets or significant exposures to short-term wholesale funding. Further, asset managers do not have asset-liability mismatches on their balance sheets like commercial banks do. Asset managers do not engage in the activities that commercial banks and broker-dealers engage in, which can lead to a "liquidity squeeze." Asset managers who act as securities lending *agents* are not interconnected with banks or broker-dealers. Their role is as an agent to the asset owner. Where a lending agent provides borrower default indemnification, the exposure is limited and the party at risk of non-performance is the asset owner, not the borrower. Contingent liabilities arising from borrower default indemnification are disclosed in the financial statements of the securities lending agent and, in the case of BlackRock, potential losses are offset by the maintenance of liquidity sources should indemnification be triggered. Given the agency business model of an asset manager, this impact factor does not apply.

(iii) Substitutability

As acknowledged by the FSB and IOSCO in the Second Consultation, the asset management industry is highly competitive and there are numerous "substitutes" across asset classes and investment strategies. Asset owners can manage their own assets internally, or they can consult one of several commercially available data sources to obtain information about asset managers and their products.[66] Most large institutional investors have existing relationships with multiple managers, often with multiple managers retained for the same strategy. In such cases, given that assets are custodied away from the manager, transition of management control can be particularly swift. Given the high degree of substitutability of asset managers, this impact factor does not apply.

(iv) Complexity

Complexity is an indicator that is designed to determine how difficult it would be to "resolve" a commercial bank or similar institution. Asset managers are fundamentally different than banks and other financial institutions that have substantial balance sheets including significant liabilities of the entity. The relationship of an asset manager to the investment vehicles it manages is most analogous to the relationship any provider of services has to its customers – they provide specified services and receive fees for those services. The relationship of an asset manager to the investment vehicles it manages is *not* analogous to commercial banks and other balance sheet lenders that utilize the capital and deposits of the bank or other affiliates to finance the lending or other activities of another member of the affiliated group, thereby making resolution potentially complicated. Asset managers do not cease operations in the manner that banks can suddenly "fail." Even in the case where an asset manager might stumble, the segregation of

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[65] BlackRock Form 10-K, available at http://www.blackrock.com/corporate/en-us/investor-relations/financial-information at 45.

[66] *See* footnote 55.

client assets from the manager ensures that the resolution process is "straightforward from the perspective of investors and involves the reassignment or sale of their assets to another manager or fund."[67] Fund managers routinely exit the asset management business, and "even when these exits occur during, or are precipitated by, a period of severe market stress, they do not occasion disorder broadly affecting the investing public, market participants or financial markets."[68]

Commercial banks have multiple business lines which may contribute to a more challenging "resolution," but this is not the case for asset managers given the general lack of reliance on short-term funding. The evidence suggests that asset management firms with diversified sources of revenue are more stable than those with less diversified sources of revenue, which is contrary to the assumption embedded within the "complexity" channel. Diversification of an asset management company may be along any of three dimensions: (a) by product or investment strategy, (b) by client type, or (c) by geography. Different products or investment strategies units will perform differently and different clients may react differently to different market scenarios. Therefore, if clients decide to exit an investment strategy or product, the revenues of an asset management firm with a diverse product set and client base will be more resilient.[69]

In many cases, one type of client will be reallocating out of a sector or investment style (e.g., from active to passive) while another group of clients may be increasing their allocation. For example, "retail" flows can often offset "institutional" flows and vice versa. In contrast, firms that narrowly focus on only one investment strategy are exposed to the potential for significant redemptions, such as when a founder or a well-known portfolio manager retires or leaves, or when a core strategy falls out of favor.[70] A larger, more diversified firm is more likely to withstand these changes. As a result, the "complexity" impact factor does not apply for asset managers.

(v) Global Activities / Cross-Jurisdictional Activities

The Second Consultation *incorrectly* asserts that "[t]he more cross-border activities an asset manager engages in, the more likely its distress or failure will have a global impact."[71] This is an assumption that, while sensible for commercial banks or other balance sheet lenders, negates the agency business model of asset managers. Global operations do not complicate the "resolution" of an asset manager because client assets are segregated from the asset manager and held by the client's custodian. In other words, client assets are not included in bankruptcy proceedings for an asset manager and therefore do not impact the resolution of an asset manager, regardless of where it is domiciled. In addition, a global footprint can provide benefits to stability. Business continuity management ("BCM") can incorporate the ability to move important functions out of harm's way in the event of a disruption. For example, BlackRock was able to continue to provide services to our clients through natural and unnatural disasters including Superstorm Sandy, the Tohoku Tsunami in Japan, and the Boston Marathon bombing.

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67 Committee on Capital Markets Regulation FSOC Response.

68 ICI Resolution Paper.

69 Two examples of large asset management firms that experienced substantial fund outflows and managed through the situation are Capital Group, which manages the American Funds, and FMR LLC, the parent of investment adviser Fidelity Management and Research Co. In 2011, the American Funds experienced outflows of $82 billion, nearly 9% of their AUM. In the case of Fidelity, the Magellan Fund reached its peak of $110 billion in 2000 and then experienced outflows bringing the fund to $15 billion by year-end 2013. Both Capital Group and FMR LLC continue to be recognized as leading asset managers today.

70 For example, an investment strategy based on investing principally in internet companies was successful in 1998 but by 2002 much less so. In that regard, Van Wagoner Emerging Growth Fund whose strategy was focused on "dotcom" companies, went from $189 million in assets in 1999 to $1.5 billion in early 2002 but had declined to less than $100 million AUM by the end of 2002.

71 Second Consultation at 55.

Global activities of asset managers do not complicate their "resolution" and do not impact the return of control of assets to clients. Therefore, the "global activities / cross-jurisdictional activities" impact factor does not apply for asset managers.

C. Transmission Mechanisms: Investment Funds

(i) Exposures / Counterparties Channel

We agree that highly levered investment funds could potentially have significant counterparty exposure. Were such counterparty exposure deemed to create systemic risk, the best solution would be to address this on an activities basis by restricting the total amount of leverage that is permitted in a fund, without any regard to who is the manager. We note in this context that most investment funds, including the vast majority of funds managed by BlackRock, are subject to regulatory requirements that significantly limit the amount of permissible leverage. As such, rules already exist that limit the degree of exposure that funds can have.[72] In addition to such regulations, asset managers typically have robust processes for monitoring and mitigating counterparty risks faced by individual investment funds. For example, as part of BlackRock's counterparty risk management program, each direct trading counterparty to a client or fund is independently reviewed, approved, and monitored. The counterparty review takes into account the fundamental creditworthiness (ownership structure, financial strength, and regulatory oversight) and commercial reputation of each counterparty. This includes scrutiny of the type, volume, settlement, and delivery mechanism of the proposed transactions. Research materials from the recognized credit rating agencies allow for additional considerations to be built into the credit decision process. As part of the counterparty monitoring process, due diligence of each counterparty is conducted annually. In addition, the concentration of each portfolio to individual counterparties is regularly monitored. While individual portfolios may have a specific reason why a concentration may be appropriate, such concentrations are reviewed and may be rebalanced. BlackRock believes that maintaining an independent counterparty risk management function with deep subject matter expertise represents a best practice in the asset management industry that should be adopted broadly.

(ii) Asset Liquidation / Market Channel

We agree with the FSB and IOSCO's assessment that highly levered funds could potentially be subject to asset liquidation issues. While leverage in a fund in and of itself does not necessarily equate to systemically significant levels of risk, the term structure and relative amount of leverage can be key indicators of the asset liquidation risk presented by a leveraged fund. This is an area requiring further review, particularly given that global definitions of leverage vary considerably across jurisdictions which make the monitoring and measurement of leverage at a global level more difficult.

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[72] For example, UCITS are limited to leverage of no more than two times net assets using one of two methods and in the U.S. For 1940 Act Funds, borrowings are limited to 33.3% of total fund assets. Further, the SEC has interpreted Section 18 of the 1940 Act, which governs the capital structure of 1940 Act Funds, as applying to certain transactions (including derivatives) that create potential structural leverage. According to SEC interpretations, a 1940 Act Fund can avoid the creation of a "senior security" under Section 18 by segregating "liquid" assets to cover its payment obligations under such instruments or otherwise "cover" its obligations under such instruments (e.g., by owning or having the right to acquire a security it has sold short). Similarly, alternative investment funds ("AIFs") in Europe are subject to greater transparency and reporting requirements if commitment leverage exceeds three times net assets. While private funds such as hedge funds and private equity funds in the U.S. are not subject to specific regulatory requirements that limit leverage, due to regulatory reform, the ability to obtain a very high degree of leverage has been reduced.

The Second Consultation implicates the presence of a first-mover advantage in some types of funds as part of its rationale for the proposed application of this channel to investment funds stating: "[w]ith respect to open-end funds, investors could have an incentive to redeem before other investors to avoid sharing the costs associated with other investors' redemptions, particularly for funds investing in less-liquid asset classes" and citing the FSOC Request for Comment on Asset Management Products and Activities ("FSOC Request for Comment").[73] As we discussed in our response to the FSOC Request for Comment, the risk of a "first-mover advantage" is a structural issue in certain categories of funds.[74] G-SIFI designation is not appropriate to address risks that are inherent across a large category of products managed by hundreds of managers. In order to effectively mitigate product-wide risks, remedies must be implemented across the entire category. The Second Consultation acknowledges, "the abundant academic research on capital markets contagion…does not generally focus on individual investment funds, but rather the investment funds' aggregate contribution to market movements."[75] This is because this is a broad product issue, *not* an individual fund issue.

We have recommended that securities regulators further develop the "toolkit" of measures to help funds manage redemptions and to codify best practices for liquidity risk management and stress testing of individual funds.[76] The potential for a "first-mover advantage" is a relatively new area of concern, and, one where regulatory practices have evolved recently across different jurisdictions. For example, mutual fund regulation in the U.S. dates back to 1940, and there is no reason to presume that existing fund mechanisms could not be updated to make funds more resilient.

(iii) Critical Function or Services / Substitutability Channel

We understand the theoretical academic concern associated with applying a "Critical Function or Services/Substitutability Channel". However, we are not aware of evidence that an investment fund provides any service to the market that would be considered "critical" in the manner implied by the Second Consultation. This transmission mechanism does not practically apply at a systemic level because individual investment funds are not essential to conducting capital markets activities. In the absence of an investment fund, asset owners can (and often do) manage their assets directly, making investment funds inherently substitutable. Likewise, asset owners can choose to outsource assets to a large number of managers as there are multiple competitors in each asset class and investment strategy. The Second Consultation conjectures that "a fund could attract significant investment and present features that are, in combination, fairly unique and may potentially have very few immediate substitutes. For example, an investment fund may provide such a significant function or service to a particular market or market segment."[77] This does not represent a "critical" function because even if there was only one fund offering a particular strategy, *asset owners always have the ability to manage their assets directly or to hire a separate account manager*. In addition, the barriers to entry for new funds, particularly from established managers, are low, and if there is sufficient demand for a particular strategy, competitors will enter the market. We find little evidence that investment funds providing "unique" investment strategies or access to a unique asset class exist, and if they do, they certainly do not represent a material amount of assets. As such, we do not see any

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[73] Second Consultation at 33.

[74] FSOC Response at 17-23.

[75] Second Consultation at 34.

[76] FSOC Response at 4-6.

[77] Second Consultation at 35.

evidence that there are "investment funds that are investing in markets where liquidity is low, trading activity is low and substitutes are potentially scarce,"[78] that are of material size or consequence that would create global systemic risk. This is further supported by the fact that 60% to 75% of assets are managed directly by the asset owner, not in a separate account or investment fund.[79] Further, a recent study of 177 asset owners representing approximately $6 trillion in assets found that over three-quarters of pension funds with AUM greater than $50 billion ("large pension funds") manage at least half of their assets directly, with 69% of large pension funds reporting that they manage more than 75% of their assets in-house. The survey results showed that 94% of official institutions with AUM greater than $50 billion ("large official institutions") manage at least half of their assets directly, and 88% of large official institutions manage more than 75% of their assets in-house.[80]

A review of the asset classes that are often cited as being "less liquid," produces a long list of competing products. Exhibit 2 shows the number of publicly available investment funds and separate account managers for several investment strategies.

Exhibit 2: Substitutability of Investment Funds

	Emerging Markets Debt Funds	Global Bond Funds	High Yield Bond Funds	Bank Loan Funds
1940 Act Funds				
# of Funds Listed in SimFund Database*	139	131	255	85
Undertakings for Collective Investment of Transferable Securities ("UCITS") Funds				
# of Funds Listed in SimFund Database*	459[a]	805[b]	85[c]	Not Permitted
Separate Accounts (Global)				
# of separate account managers listed in eVestment Database	72	78	117 (US HY) / 44 (Global HY)	63

**Includes ETFs, Open-End Funds, and Closed-End Funds.*
a Includes all Morningstar Global Emerging Markets Bond categories including local currency and EUR biased.
b Includes all Morningstar Global Bond categories including currency hedged and currency-biased global bond strategies for several different currencies.
c Includes the Morningstar category USD High Yield Bond only.

D. Impact Factors: Investment Funds

(i) Size

The Second Consultation states that "[i]n theory, the larger the size of a fund, the greater its potential impact on counterparties (counterparty channel), markets (markets channel) and other market participants that may depend on it for critical functions (critical function / substitutability channel)."[81] Although "large equals impact" is a concept which may have application in the commercial bank context, we see no empirical evidence consistent with this theory as applied to asset management. The statement contains a series of hypotheticals that are not borne out in reality. To the contrary, the opposite has been observed. As acknowledged

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[78] Second Consultation at 41.

[79] *See* footnote 15.

[80] BNP Paribas Global Risk Report 2015 at 29.

[81] Second Consultation at 38.

in the Second Consultation, investment funds are highly substitutable, and this elasticity exists regardless of size. Large outflows from one of the largest bond funds in the world, the PIMCO Total Return Fund, in Fall 2014, and the large concomitant inflows to other funds serves as a prime example of the level of substitutability among funds. Further, the ability of an asset owner to either manage its assets directly or invest in another fund illustrates that individual funds do not perform "critical functions", regardless of size. As explained in our response to the First Consultation, the focus on size of investment funds can be misleading as it can lead to "false positives" (e.g., designating large index funds that are unlikely to present material risk to the financial system) and "false negatives" (e.g., not designating a highly levered fund that could present systemic risk but has less assets). Rather, the presence of a high degree of leverage may be correlated with systemic risk in the context of the counterparty and market channels and is a better measurement of "systemic size" in this context than AUM. Proper measurements of leverage (e.g., the AIFMD commitment leverage) will provide information about the size of the system's exposure to a fund and is a much more pertinent indicator of risk than size of AUM. However, we again highlight that the preponderance of funds do not use material amounts of leverage due to regulatory restrictions such as those present for 1940 Act funds and UCITS or due to client guidelines. In our experience, hedge funds are the greatest users of material amounts of leverage.

(ii) Interconnectedness

We recognize that highly levered funds could be interconnected through leveraged exposure to counterparties. Those of us who were engaged with the markets in 1998 saw first-hand issues that arose due to the distress of the Long Term Capital Management Portfolio. The efforts to increase reporting of data that have been implemented or are in process through Form PF, Form CPO-PQR, Form CTA-PR, the AIFMD, and the SEC's proposals released on May 20 that would require greater data reporting by mutual funds and separate accounts including data on derivatives and securities lending activities,[82] will continue to improve regulators' transparency into the amount of leverage being used by investment vehicles whose use of leverage is not already constrained by regulatory statute.

Further, reporting of swap positions (both cleared and uncleared) into data repositories will allow regulators to monitor swaps activity in ways not available pre-Crisis and to identify concentration risks among counterparties, be they dealer-to-dealer or fund-to-dealer. On a related note, we underscore that given the steps already taken (and those in process) to increase central clearing, ensuring that CCPs have the proper financial resources and robust safeguards in place is of heightened importance given that CCPs are rapidly becoming a large concentration of counterparty risk. As explained in further detail on page 27-28, we encourage policy makers to focus on this issue before CCPs become even more critical in the market ecosystem.

(iii) Substitutability

This indicator is not applicable to investment funds given the high degree of substitutability among funds offering various investment strategies (Exhibit 2).

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[82] SEC Data Reporting Proposed Rule.

(iv) Complexity

This channel could be applicable to highly levered funds that obtain leverage through highly bespoke and uncleared derivatives positions. We note that this issue is likely limited to levered hedge funds given the regulatory restrictions on other types of investment funds. Given the move to greater standardization of derivatives and the ongoing move to central clearing, this indicator will become less and less applicable over time.

(v) Global Activity / Cross-Jurisdictional Activities

Funds can be offered in multiple jurisdictions and they can invest in multiple jurisdictions. Each of these activities raises different issues that need to be managed. Where a fund is offered in multiple jurisdictions, these activities are regulated – the country of the fund's domicile typically regulates the activities of the fund (and often the fund's investment manager) while other countries where the fund is offered regulate the marketing activities associated with the distribution of the fund. Some funds cannot be offered across borders as they may be restricted to investors in a specific jurisdiction or with a specific tax status e.g., domestic pension funds. However, UCITS and Alternative Investment Funds ("AIFs") offered in Europe can be sold across borders, subject to approval by the fund's home state regulator (which is responsible for confirming the fund meets the requirements to have the EU passport available under the relevant regime). Private funds can generally be sold across borders, subject to the offering and/or private placement rules in each jurisdiction where they are sold. ETFs and other exchange-listed funds may be purchased through financial intermediaries, and thus are often available to investors in jurisdictions other than the country of the fund's domicile. In fact, some ETFs are cross-listed in multiple jurisdictions. However, cross-border distribution does not raise systemic risk issues.

The Second Consultation states, "[t]he global nature of an investment fund's activities may also tend to complicate the resolution of the distressed investment fund due to legal disputes, potentially various law regimes at play or simply getting access to all interested parties."[83] We disagree with this assertion. Each fund is a separate legal entity. In addition, the assets of the funds are held by a custodian. With the possible exception of highly levered funds, this indicator does not apply.

Nonetheless, asset managers consider several factors when investing or offering products in any market as described below.

- Compliance with Local Laws and Regulations: Fund managers need to ensure that they have legal and compliance professionals with sufficient expertise in each jurisdiction where funds are distributed or where funds invest. Additionally, some markets may require that traders, sales, or other types of professionals hold certain licenses or certifications to carry out their responsibilities in that market (e.g., FINRA licenses in the U.S.). Care must be taken to ensure that the appropriate licenses have been obtained and that related ongoing compliance requirements are met. This allows fund managers to avoid potential regulatory sanctions or other penalties. In addition to experienced and properly trained in-house legal and compliance professionals, asset managers can employ outside legal counsel with expertise in a particular country's regulations for additional expertise when needed.

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[83] Second Consultation at 45.

- Custody Arrangements: Most countries require securities purchased in that country to be held by a local custodian bank. Therefore, funds that invest in multiple jurisdictions need to ensure that custody arrangements are in place in all jurisdictions where it invests. For funds that invest in multiple countries, the fund's assets are generally held within a custodian's sub-custodian network. The largest custodians are multinational, which facilitates oversight of cross-border custodial/sub-custodial arrangements. Global custodians employ robust vendor risk management programs to monitor the performance of the sub-custodian. As with all custody arrangements, fund assets are segregated from the custodian bank's assets and from the manager or other funds. For 1940 Act Funds, there is a significant amount of standardization with local sub-custodians, since 1940 Act rules require contractual arrangements with such local firms to contain standard provisions regarding the maintenance of assets. This standardization lends predictability to the custody marketplace. Recent changes to UCITS and AIFs in the EU apply similar comprehensive controls over the selection and monitoring of sub-custodians with stringent liability standards on the global custodian in the event of a loss to the fund caused by a sub-custodian.

- Required Documentation: Most markets require funds to have documentation in place with the country to allow the fund to transact in that market. Fund managers need to ensure that the proper documentation is in place with all countries where the fund will invest. The length of time needed to get documentation approved varies from country to country. In some circumstances, explicit delays could occur in transitioning the management of a fund if the new manager is required to complete new documentation to transact in a particular market, though these issues arise infrequently, as the newly selected manager is likely to already have similar arrangements in place.

- Settlement of Securities: Some emerging or frontier markets may have atypical settlement processes known to delay the settlement of securities traded in that market. These risks are disclosed to investors. Fund managers must review the dynamics of settlement in each market and put in place measures to mitigate the impact of such potential issues. For example, many funds that invest in emerging markets maintain bank lines of credit to address settlement delays, especially in markets where such delays are common practice.

- Geopolitical Concerns: Geopolitical concerns in a particular country also need to be reviewed. For example, funds may need to comply with financial sanctions which require fund managers to have an ability to monitor and track securities that are no longer permissible investments to avoid purchasing such securities. Likewise, consideration should be given to any financial crime issues that may be present in a particular country. Geopolitical risks associated with a fund's investment in a particular country are disclosed to investors.

Ongoing analysis and monitoring of these issues represents prudent risk management and operational controls. The Second Consultation states "The greater the number of markets a fund invests in or has interaction with, the greater its global footprint and its importance for global financial stability." We are not aware of any evidence to support this assertion nor is any evidence provided in the Second Consultation. In fact, it appears that this element of the proposed framework will run directly counter to initiatives to promote cross-border investment; in particular, the European CMU initiative. As described in the European Commission's Green

Paper, one of the key principles of the CMU is to "create a single market for capital for all 28 Member States by removing barriers to cross-border investment within the EU and fostering stronger connections with global capital markets."[84] The application of this impact factor to investment funds should be re-assessed to ensure that the NBNI G-SIFI framework does not impede one of the key principles of the CMU by creating a methodology that distinctly penalizes funds that invest cross-border, especially since the issues described do not reflect systemic risk.

IV. A Product- and Activities-Based Approach Would Benefit the Market Ecosystem by Reducing Risk

The proposed NBNI G-SIFI designation methodology is bank-centric and follows a similar process that used to identify G-SIBs and G-SIIs. To the best of our knowledge, no regulatory authority has defined the policy measures that would be applied to an asset manager. Hence the attempt to define candidates for designation without first defining the remedies for perceived "problems" appears to be "putting the cart before the horse". Given the fundamental differences between asset managers and banks and insurers, a different approach is needed to address potential risks associated with asset management. The proposed NBNI G-SIFI methodologies for asset managers and funds conflate the roles and exposures of asset owners and asset managers, and conflate AUM with the assets on a bank's balance sheet. Asset managers, unlike banks, are not the counterparty to client trades and derivative transactions.[85] Nor are the assets of funds supported by tax-payer guaranteed deposits. Rather, the market risk of funds is absorbed by the asset owners because the asset owners, not the asset managers, own the assets. Moreover, the flow of assets into and out of individual asset classes and investment products is substantially driven by asset owners making decisions about their own assets. These decisions can be driven by the asset owner's investment objectives (e.g., fund liabilities) and constraints (e.g., regulation of pension funds such as ERISA in the U.S. or regulation of insurers such as Solvency II). As a result, we return to the importance of taking a holistic approach in assessing and remediating risks across the entire market ecosystem, not just a short list of seemingly "large" managers.[86] We recommend focusing on the following areas:

A. Improve market structure for central clearing of OTC derivatives by requiring greater financial resources for CCPs and clear rules for recovery and resolution.

The requirement that OTC derivatives be centrally cleared is one of the most significant reforms that has emerged post-Crisis. In the US, Dodd-Frank devoted an entire title to OTC derivatives reform requiring the SEC and Commodity Futures Trading Commission ("CFTC") to comprehensively change and oversee this market. In Europe, OTC derivative markets regulation is being reformed as part of European Market Infrastructure Regulation ("EMIR"), as well as the Capital Requirement Directive IV ("CRD IV"). We are supportive of the concept of central clearing to reduce counterparty risk. However, we are concerned that risks are being concentrated in CCPs, and we encourage measures to reduce the likelihood of a CCP failure and avoid a contagion effect of such failure (which might occur if initial and/or variation margin is haircut to recover a CCP). As detailed in our April 2015 letter to the CFTC, we recommend regulators focus on: (i) establishing capital standards for CCPs, (ii) requiring stress testing of CCPs, (iii) providing transparency to counterparties of the CCP, and (iv) identifying a resolution plan,

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[84] *See* footnote 12.

[85] *See* footnote 35.

[86] *See* IMF GFSR at 121 concluding that "given that the [asset management] industry is diverse and that differences in investment focus seem to matter significantly for funds' contribution to systemic risk, a product- or activity-based emphasis seems to be important.")

including a clear waterfall, in the event of a CCP failure. In addition, it is paramount to create clear rules that protect customer initial margin ("IM") and variation margin ("VM") in the event of a clearing member default. In particular, we believe that the use of customer VM could have a procyclical effect because this approach would likely cause end-users (at least sophisticated end-users) to periodically realize profits from in-the-money swaps in order to reduce VM exposure to the CCP, increasing transaction costs and reducing the size of this potential funding source.[87]

B. Revisit private fund reporting to standardize definitions, reduce overlap and bespoke requirements. The AIFMD provides a framework that should be emulated in other jurisdictions.

Greater harmonization of data reporting required by regulators in various jurisdictions is needed. Consistent data collection facilitates analysis across jurisdictions and would benefit regulators by providing "information", not just raw data. In particular, harmonization would facilitate better risk monitoring and identification efforts. Several new regulations require data reporting by alternative funds, including hedge funds and other private funds. Examples of these requirements include the AIFMD regulatory reporting for AIFs and the Dodd Frank Act mandated reporting in the U.S through Form PF and Form CPO-PQR. The data requested on these forms is often similar but requested in a slightly different manner on each form. We estimate that one-third of data requested by Form PF and the AIFMD is directly overlapping, one-third is substantially similar, and one-third is unique to one of these forms. By not harmonizing these reports or the underlying definitions – which share the purpose to better understand alternative / private funds and their potential implications for the financial system – large amounts of fragmented data are being produced. Standardization would enable regulators to better aggregate and analyze the data, and would facilitate comparisons at a global level. We ask regulators to take a close look at this area with a view towards establishing global data collection standards to facilitate greater monitoring of the use of leverage by private funds. We encourage regulators who are considering implementing new reporting requirements to harmonize new reports with those already in place in other jurisdictions.

C. Clearly and consistently define leverage to improve oversight and reduce risk. This should include derivatives, while recognizing that derivatives that are offsetting or hedging risks do not create leverage.

When discussing regulation regarding leverage, we find the conversation unnecessarily complicated by the lack of global regulatory agreement on the definitions of leverage. For example, mutual funds in Europe, Asia, and the U.S. utilize different regulatory approaches to defining, measuring and/or limiting leverage in funds. The definitions and the rules on the uses of derivatives differ, sometimes even within one regulatory framework. A clear definition of "leverage," including, as appropriate, the use of borrowings and derivatives that create leverage (recognizing that derivatives that are offsetting or hedging risks do not create leverage), combined with uniform metrics for measurement and clear rules on derivatives usage, will improve transparency to investors, fund boards, and regulators. Further, once a robust and consistent definition of leverage has been determined, regular reporting to the appropriate national regulator would be a useful measure to promote greater transparency to regulators and allow for comparisons across jurisdictions.[88] This transparency will, in turn, enable regulators to

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[87] BlackRock, Comment Letter, Roundtable on Recovery of Derivatives Clearing Organizations (Apr. 27, 2015), available at http://www.blackrock.com/corporate/en-us/literature/publication/cftc-recovery-of-derivatives-clearing-organizations-042715.pdf.

[88] We note that the SEC Data Reporting Proposed Rule at 10 proposes reporting related to the use of borrowing and derivatives in separately management accounts.

monitor exposures and limit usage, as appropriate, given the type of fund and its investor base. We encourage policy makers to actively engage with the asset management industry to establish clear definitions and rules that can be applied to different types of funds and strategies.

D. Further develop the "toolkit" for managing redemptions in funds.

We recommend further consideration of the "toolkit" of measures (many of which are already in use in various jurisdictions) to help funds better address periodic market liquidity challenges. These are based on the best practices we have identified by reviewing regulatory structural features of funds and practices across multiple global jurisdictions where BlackRock currently does business. Based on our analysis, we recommend that policy makers consider the costs and benefits associated with several fund features including pricing mechanisms for subscriptions and redemptions such as measures to allocate transaction costs to subscribing/redeeming shareholders; redemption provisions including the discretion to include a gate in a fund structure or suspend redemptions in an emergency;[89] guidance for use of redemptions in-kind; borrowing for short-term purposes; limits on illiquid securities; and enhanced disclosure regarding liquidity risks associated with a particular fund. We have explored these fund features in our response to the FSOC.[90] While each of these tools is already in place for certain funds, we believe that their availability more broadly across fund structures and jurisdictions would be beneficial. The implementation of any of these features where they do not already exist must, of course, include engagement with the industry through industry forums and notice and comment periods to ensure that all consequences are fully understood and addressed. Importantly, to be effective, the tools in the expanded toolkit should be made available consistently, as opposed to being prescribed only for certain funds or asset classes. We are not advocating isolated measures, but rather consideration of and potential enhancements to the package of features that are currently available to funds to help mitigate redemption risk. We further note that if these measures are applied only to certain funds or in isolation, they would likely create market distortions without mitigating risk.

E. Establish principles for stress testing fund liquidity using the AIFMD as the starting point.

We support the SEC's plan to enhance transparency and efforts to improve liquidity risk management through appropriately-calibrated stress testing of funds, as outlined recently by SEC Chair White[91] as well as the IMF's and the European Central Bank's ("ECB's") calls for similar stress testing efforts.[92] We recommend that industry participants and regulators work together to develop best practices for redemption and liquidity risk management. In reviewing existing regulations of funds, we find that the AIFMD provides a good model for conducting stress testing of fund portfolio holdings in relation to various redemption scenarios, and we recommend that regulators in other jurisdictions emulate this approach rather than develop a new methodology. We have outlined how stress testing under the AIFMD requirements works in our response to the

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89 The use of gates was also recommended in IMF GFSR though the IMF noted that caution must be employed in the application of this tool as there could be unintended consequences associated with its use.

90 *See* FSOC Response at 5.

91 Mary Jo White, SEC Chair, *Enhancing Risk Monitoring and Regulatory Safeguards for the Asset Management Industry*, Speech at The New York Times DealBook Opportunities for Tomorrow Conference (Dec. 11, 2014), available at http://www.sec.gov/News/Speech/Detail/Speech/1370543677722 ("SEC Chair White Speech").

92 IMF GFSR; Vitor Constâncio, Vice-President of the ECB, *Reinforcing Financial Stability in the Euro Area,* Speech at the OMFIF City Lecture (May 8, 2015), available at https://www.ecb.europa.eu/press/key/date/2015/html/sp150508.en.html.

FSOC.[93] Moreover, we believe that predictive models to understand potential future redemptions could be enhanced by greater data transparency into omnibus accounts where sufficient transparency does not already exist.

However, we note that several commentators have suggested stress testing of asset managers similar to what is already being conducted for banks. It is important to keep in mind that asset managers have relatively small balance sheets and are not balance sheet lenders. In addition, asset managers are neither the counterparty to client transactions nor the provider of liquidity to funds or other product guarantees. Thus, we do not see a need for "manager-level" stress testing.

F. Establish a global standard classification system for ETPs and review structural features of certain ETPs (e.g., leveraged, inverse, and bank loan).

While all ETFs share certain characteristics, "ETF" has become a blanket term describing many products that have a wide range of different structures, which has led to a great deal of confusion. A standard classification system would help both policy makers and investors better understand the structure of various ETPs and hone in on key sectors of the ETP market where further analysis of the structure of the ETP may be warranted. We have outlined a potential classification system in Exhibit 3.

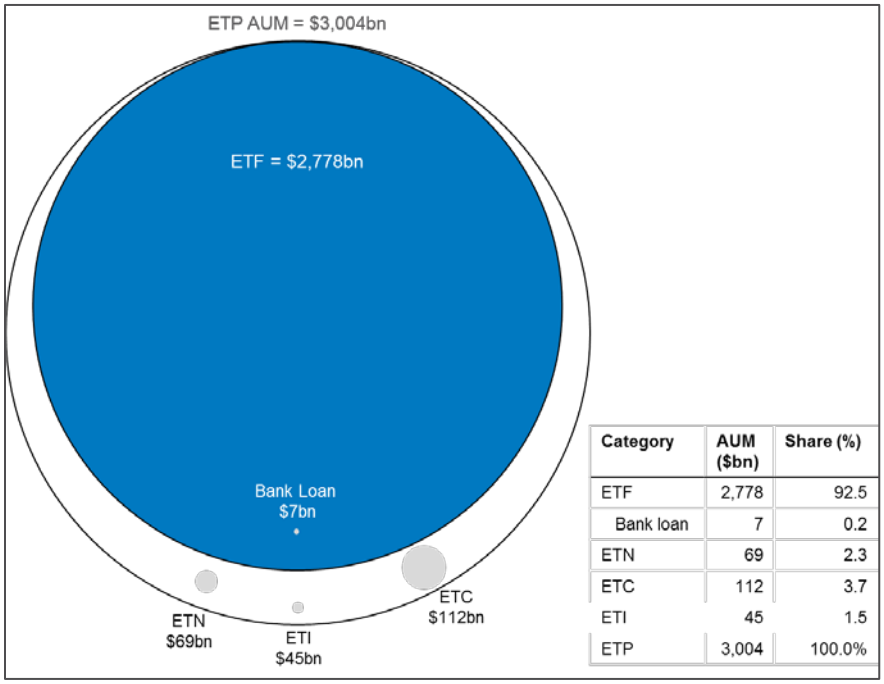
Exhibit 3: Recommended Classifications for ETPs

ETP	**Exchange Traded Product**	• Catch-all term for any portfolio exposure product that trades on an exchange. • ETFs, ETCs, ETNs, and ETIs, are all subsets of ETP.
ETF	**Exchange Traded Fund**	• ETFs are structured as publicly-offered investment funds that trade on an exchange. • ETFs can be passive (tracking a specific index) or active (via a transparent basket) that meet diversification and liquidity thresholds as mandated by the regulators and exchanges. • ETFs' exposures can be achieved by both holding the physical securities or by holding synthetic instruments. • ETFs' underlying securities can include stocks, bonds, and bank loans • As noted below, this category should exclude funds with embedded leverage or inverse features as they will not track the index performance.
ETN	**Exchange Traded Note**	• Debt instruments that provide an index-based return. ETNs may or may not be collateralized, but depend on the issuer's solvency and willingness to buy and sell securities to deliver fully to expectations. • The extent of regulation varies by region.
ETC	**Exchange Traded Commodity**	• A variety of fully-collateralized legal structures that are not ETNs but seek to deliver the unleveraged performance of a commodity, or basket of commodities. • Some ETCs may hold physical commodities, while others invest in commodity futures. • ETCs that invest in commodity futures may raise special issues because futures do not precisely track spot commodity prices.
ETI	**Exchange Traded Instrument**	• An ETI is any ETP that has embedded structural features designed to deliver performance that will not track the full unlevered positive return of the underlying index or exposure (that is, products that seek to provide a leveraged or inverse return or a return with caps on upside or downside performance).

[93] *See* FSOC Response at 36-37.

Exhibit 4 illustrates the size of the ETF market relative to other ETPs. The vast majority of ETPs are ETFs that are managed using long-only passive strategies that are designed to track a specific capitalization-weighted index. However, the number and size of non-capitalization-weighted index ETFs (including "smart beta" or fundamental index ETFs) and non-index-based (or "active") ETFs are increasing. A number of these strategies make use of derivatives as a means to obtain an economic exposure. That said, over 90 percent of ETPs are ETFs that do not have embedded leverage or inverse features.[94] Levered ETIs and inverse-levered ETIs, which currently comprise approximately 1.3 percent of the ETP market,[95] utilize leverage to magnify returns relative to an index. The risks of these products are still being debated.[96] We have previously noted our concern that levered and inverse-levered ETIs create significantly different risks than those presented by traditional ETFs[97] and have recommended that these products not use the ETF label.[98] Similarly, bank loan ETFs introduce several issues that are not present for bank loan mutual funds. Given the features associated with bank loans (physical contracts not publicly traded securities and relatively long settlement periods), these loans cannot be used for in-kind redemptions with an Authorized Participant ("AP"). We recommend a closer analysis of these types of ETPs to determine if any special provisions are needed to mitigate potential risk.

Exhibit 4: Global ETP Classification



Category	AUM ($bn)	Share (%)
ETF	2,778	92.5
Bank loan	7	0.2
ETN	69	2.3
ETC	112	3.7
ETI	45	1.5
ETP	3,004	100.0%

Source: BlackRock as of April 2015. Note: diagram not to scale.

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94 Source: BlackRock as of April 2015.

95 *Id*. We note that leveraged and inverse ETIs comprise the majority of ETIs.

96 Ivan Ivanov and Stephen Lenkey, *Are Concerns About Leveraged ETFs Overblown?* Federal Reserve Board (Nov. 19, 2014), available at http://www.federalreserve.gov/econresdata/feds/2014/files/2014106pap.pdf; Tugkan Tuzun, *Are Leveraged and Inverse ETFs the New Portfolio Insurers?* Federal Reserve Board (Jul. 16, 2013), available at http://www.federalreserve.gov/pubs/feds/2013/201348/201348pap.pdf.

97 BlackRock, *ViewPoint, Exchange Traded Products: Overview, Benefits and Myths* (Jun. 2013), available at http://www.blackrock.com/corporate/en-us/literature/whitepaper/viewpoint-etps-overview-benefits-myths-062013.pdf ("June 2013 ETFs *ViewPoint*").

98 iShares, *ETFs: A Call for Greater Transparency and Consistent Regulation* (Dec. 2011), available at http://www.blackrock.com/corporate/en-us/literature/whitepaper/transparency-and-consistent-regulation-oct-2011.pdf.

G. Standardize guidelines for using cash re-investment vehicles in securities lending.

Post-crisis, many aspects of securities lending have been scrutinized leading to changes including stricter rules on collateral management, modifications to fee structures, and increased transparency. Given the extensive changes already made, we recommend focusing on finalizing a few specific rules. For example, while the SEC, Office of the Comptroller of the Currency ("OCC"), and ESMA have made major reforms to cash funds used in securities lending programs, the short-term investment funds managed by state-chartered banks in the U.S. have not yet been required to be modified.

H. Improve underlying market structure for bank loans and for corporate bonds.

Market liquidity issues are not just fund or asset management issues. In many cases, a lack of market liquidity in the marketplace results from certain challenges related to market structure, which are separate and distinct from potential risks that could be related to funds. Market liquidity impacts all market participants, and ensuring well-functioning, liquid capital markets benefits the economy as a whole. As such, we believe addressing market structure issues to improve market liquidity should be a high priority for global regulators. Indeed, there are many reforms that would serve to improve market liquidity, including standardizing the settlement period for bank loans, providing more transactional transparency in markets, promoting greater standardization of large corporate bond issuances and promoting increased electronic trading of bonds. We elaborated on many of these suggestions in our recent response to the UK Authorities' Consultation on Fair and Effective Markets Review as they relate to fixed income, currency, and commodity markets.[99]

I. Broaden understanding and transparency of the entire financial market ecosystem.

To date, numerous studies have focused on mutual funds and/or on the assets managed by external asset managers. To truly understand the dynamics at play and effectively address systemic risk, the overall market ecosystem, of which asset managers and funds are only one component, must be considered. This includes assets managed directly by asset owners and assets outsourced to external asset managers. Examples of asset owners include pension funds, insurers, sovereign wealth funds, foundations, endowments, family offices, and individuals. In addition, the variety of investment vehicles such as mutual funds, separate accounts, hedge funds, private equity funds, etc., must be recognized. For example, concerns about "herding" into or out of an asset class cannot be addressed by designation of certain funds or asset managers, given that asset owners control the strategic allocation of their assets and, therefore, the flow of assets into and out of asset classes. In order to implement policy measures that will reduce risk, there needs to be a greater understanding of asset owners and their investment objectives and constraints. Similarly, it is important to understand the role of intermediaries and the governance structure around asset management decisions including (i) asset allocation, (ii) the decision to outsource management of an asset owner's assets versus managing one's assets directly, (iii) how asset owners select asset managers, and (iv) how asset owners decide which investment vehicle is appropriate. We believe this review will reinforce the importance of a products- and activities-based approach in order to reduce systemic risk.

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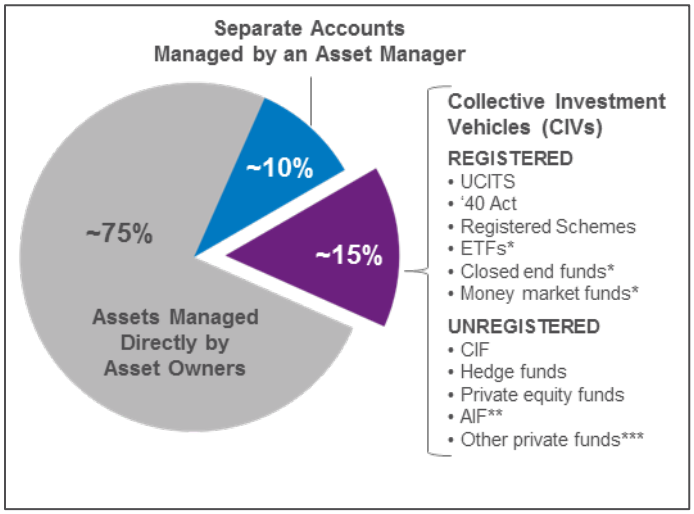
[99] BlackRock, Response to UK Authorities' Fair and Efficient Markets Review (Jan. 22, 2015), available at http://www.blackrock.com/corporate/en-gb/literature/publication/femr-how-fair-and-effective-are-the-ficc-markets-hmt-boe-fca-012215.pdf.

Exhibit 5: Market Ecosystem and Estimated Breakdown of Global Investable Assets



Source: BlackRock estimates using data from McKinsey & Company, ICI, Hedge Fund Research, and Preqin.
* Can be offered under several regulatory regimes (e.g., '40 Act, UCITS, etc.). Note that some closed end funds are not registered funds.
** Some AIFs are registered funds.
*** Examples of other private funds include private real estate and private infrastructure funds.

J. Address the longevity crisis, and pension underfunding.

Interest rates have been held at extremely low levels for an extended period of time due to global monetary policies. In the aftermath of the 2008 Crisis, these policies promoted much needed financial and economic stability. However, in 2015, the prolonged nature of these policies is having profound consequences of its own. The OFR stated in its April 2015 Financial Markets Monitor, "Persistently low yields can encourage excessive investor risk-taking and excessive leverage. There has already been material evidence of excessive risk-taking during the extended post-crisis period of low interest rates and low volatility."[100]

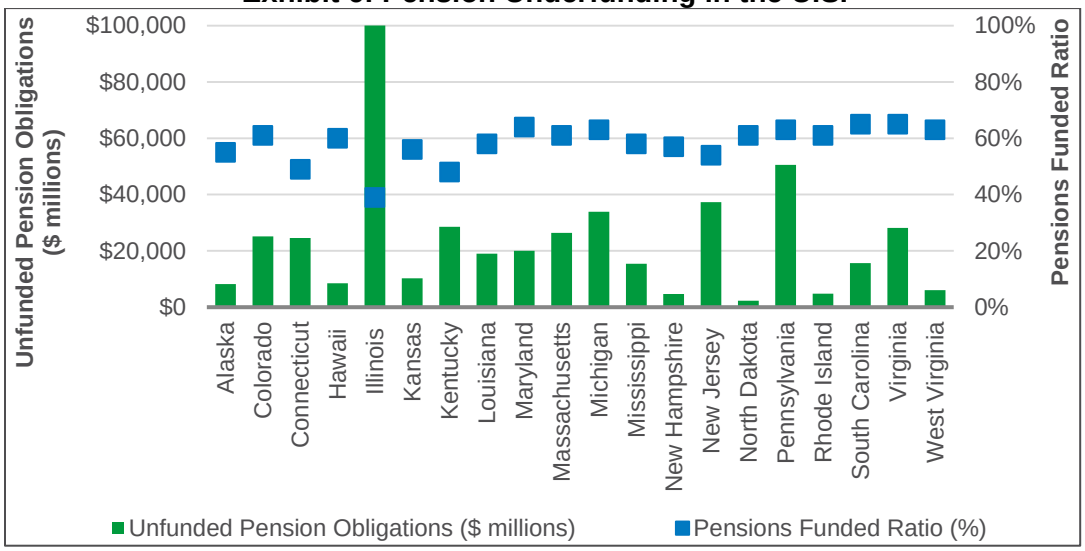
For retirees and savers that are reliant upon their savings to support themselves in retirement, the prolonged nature of an extremely low interest rate environment has challenged their ability to meet their investment objectives by reducing the income their assets generate and in many cases forcing them into riskier assets as they necessarily "reach for yield," taking on more risk in order to meet their liabilities or income requirements. Similarly, insurers and other investors have been forced to choose between extremely low yielding bonds and riskier investment strategies. Monetary policy is thus, a primary driver of increasing allocations to higher yielding assets such as high yield bonds, emerging markets debt and bank loan assets.

Further, the funding status of pension plans have become an important issue facing many defined benefit ("DB") pension plans. Many corporate and public DB plans were created in an era when life expectancies were shorter. As life expectancies around the world have continued to rise, so have the liabilities of many pension plans. According to Milliman, as of February 2015, the largest 100 corporate pension plans in the U.S. had nearly $350 billion in unfunded

[100] Office of Financial Research, "Markets Monitor: The Puzzle of Low U.S. Treasury Yields" (Apr. 27, 2015), available at http://financialresearch.gov/financial-markets-monitor/files/OFR-FMM-2015-04-27-puzzle-of-low-us-treasury-yields.pdf.

liabilities.[101] State and local pension plans in the U.S. had over $1 trillion in unfunded liabilities as of 2015 according to Pew.[102] A similar trend exists in Europe. For example, in the UK, the defined-benefit plan deficit of the FSTE 350 companies has almost doubled from 2013 to 2014 and exceeds £100bn.[103] Similarly, in Germany, the funding ratio for German blue-chip companies has fallen from 65.7% in 2013 to 56% in 2014.[104] The underfunding of these plans may lead to reductions in benefits and/or higher taxes to improve the funding status. The cumulative size of underfunded plans is staggering and left unaddressed, presents a systemic risk of its own.

Exhibit 6: Pension Underfunding in the U.S.



Source: Loop Capital Markets, Individual state CAFRs, BlackRock. As of year-end 2013.

* * * * *

We thank the FSB and IOSCO for providing BlackRock the opportunity to express its views on the Second Consultation. We welcome and encourage ongoing engagement between the asset management industry and members of the FSB and IOSCO. We would like to suggest a single day forum or a series of shorter sessions to explore various aspects of asset management. Please contact the undersigned if you have questions on asset management, our response to this Consultation, or if you would like to pursue the idea of a forum.

Sincerely,

Barbara Novick
Vice Chairman

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101 John Ehrhardt and Zorast Wadia, "Milliman Analysis: Funded Status Drops by $6 billion in March", *Milliman 100 Pension Funding Index* (Mar. 2015), available at http://us.milliman.com/uploadedFiles/insight/Periodicals/pension-funding-index/pfi-04-22-15.pdf.

102 Ken Willis, *The Fiscal Health of State Pension Plans, Pew* (Apr. 8, 2014), available at http://www.pewtrusts.org/en/research-and-analysis/analysis/2014/04/08/the-fiscal-health-of-state-pension-plans-funding-gap-continues-to-grow.

103 Mags Anderson, *Low Interest Rates Double FTSE 350 DB Pension Scheme Deficits from £56bn to £107bn Over 2014*, Mercer (Jan. 6, 2015), available at http://www.mercer.com/content/mercer/global/all/en/newsroom/low_interest_rates_double_ftse350_db_pension_scheme_deficits.html.

104 Chris Brian, *European Companies Dig Deeper to Fill Pension Holes*, Financial Times (Feb. 8, 2015) available at http://www.ft.com/cms/s/0/40158032-ab84-11e4-b05a-00144feab7de.html.

CC:

Natasha Cazenave,
Deputy Head of the Regulatory Policy and International Affairs Directorate,
Autorité des Marchés Financiers

Mark Zelmer,
Deputy Superintendent,
Office of the Superintendent of Financial Institutions

V. Responses to Individual Questions

A. Section 2

Q2-1. In your view, is the exclusion of (i) public financial institutions, (ii) sovereign wealth funds or (iii) pension funds from the definition of NBNI financial entities appropriate? If so, please explain the rationale.
Q2-2. Please explain any potential systemic risks associated with failure or financial distress of (i) public financial institutions, (ii) sovereign wealth funds or (iii) pension funds that, in your view, warrant their inclusion in the definition of NBNI financial entities so that NBNI G-SIFI methodologies would apply.
Q2-3. Please explain any other NBNI financial entity types that should be excluded from the definition of NBNI financial entities so that NBNI G-SIFI methodologies would not apply and their rationale.

These questions are closely related, therefore, we are providing an aggregated answer. As described in our cover letter, we believe policy makers should take a products- and activities-based approach which goes across the entire market ecosystem. Based on our evaluation of the Second Consultation, we do not find justification for G-SIFI designations of asset managers. We define asset managers to include asset owners that manage their assets in-house, asset owners that outsource their assets, or asset managers that manage assets as a fiduciary to asset owners. Assuming the goal is to address risks that may pose financial stability concerns, each of these entities is part of a broader market ecosystem which necessitates regulation at the product and activity level. The very need to consider excluding certain entities from consideration highlights the problematic nature of using the proposed framework to create a methodology to designate asset managers.

It has been acknowledged by many sources that asset owners have the ability to manage their assets internally (in-house management), or outsource this function to an asset manager (external management), or to use a combination of these approaches.[105] McKinsey and the IMF, respectively, estimate 75% and 60% of the world's financial assets are managed in-house by asset owners.[106] Further, a recent study of 177 asset owners representing approximately $6 trillion in assets concluded that there is a "clear correlation…between the size of an organisation's assets and the proportion of activities conducted in-house. In other words, organisations with greater AUM tend to manage a greater proportion of their assets in-house." For example, the study found that large pension funds manage at least half of their assets directly, with 69% of large pension funds reporting that they manage more than 75% of their assets in-house. The survey results showed that 94% of large official institutions manage at least half of their assets directly, and 88% of large official institutions manage more than 75% of their assets in-house.[107]

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[105] Who Owns the Assets *ViewPoint*.

[106] The Second Consultation states: "According to the FSB Global Shadow Banking Monitoring Report 2014, (i) finance companies, (ii) market intermediaries (broker dealers), and (iii) investment funds comprise 70-80% of the total financial assets of all NBNI financial entities (as proxied by Other Financial Intermediaries) in 25 jurisdictions at the end of 2013." In reviewing the report cited, we found that "Other Financial Intermediaries" excludes "public financial institutions, central banks, insurance, and pension funds". The exclusion of these entities from the denominator of total NBNI assets, inflates the percentage of NBNI assets managed by the four categories of NBNIs cited in the Second Consultation. It seems inconsistent to exclude these assets that are being managed from a methodology whose purpose is to develop a better understanding of systemic risks that might emanate from asset management.

[107] BNP Paribas Global Risk Report 2015 at 29.

The decision to manage assets in-house or to outsource the management of assets is based on several factors. These factors include: (i) a comparison of costs; (ii) a desire for specific expertise; and (iii) a lack of interest in taking on the operational aspects of asset management. In the case of investing in funds, there is also consideration of the potential for increased diversification afforded by commingled investment. This is why investment in funds is often a preferred option for asset owners with smaller asset bases.

Regardless of the approach, asset owners control entity level asset allocation decisions and the asset owners are the counterparty to all transactions, including derivatives contracts. Asset owners also make key decisions regarding securities lending, including whether or not to lend any securities, whether to lend directly or hire a securities lending agent, whom to hire as their lending agent if any, investment guidelines for reinvesting cash collateral, and whether or not to include borrower default indemnification in their contract with their securities lending agent. A key responsibility of asset owners is to make decisions on the level of risk to target in their overall portfolio as well as specify the mandates that they assign, if any, to external asset managers. Further, in-house managers rely on technology systems and need to manage a host of operating risks, just as external managers need to address these issues. And, importantly, asset owners need to manage their liquidity risk based on factors including the timing and need for cash to pay various obligations and the sources of cash from their overall portfolio. During the 2008 Crisis, mismatches of liquidity at the asset owner level triggered asset sales and a spike in hedge fund redemptions.[108] There is no obvious reason to differentiate between asset owners and asset managers in considering the potential for systemic risk.

Although the Second Consultation provides a rationale for excluding certain entities, there are numerous exceptions to the reasons stated as well as questions that should be raised. For example, the Second Consultation states that the excluded entities "are owned and fully guaranteed by a government." Given the breadth of excluded entities, this statement appears to be overly broad. For example, there are public financial institutions that may be partially owned by a government, owned by a government with a relatively weak credit rating, or have limited government backing. In addition, given that the purpose of identifying G-SIFI's is to prevent a future taxpayer bailout, we question why the provision of a government guarantee or presupposed government bailout of a particular entity would result in exclusion from the methodology given the type of outcome the G20 and other policy makers are attempting to eliminate.

In the case of pension funds, the rationale includes "their long-term investment perspective" which results in "low risk to global financial stability" and that they are "covered indirectly through contractual relationships with asset managers or the use of investment funds."[109] Pension funds that manage their assets in-house would not be covered in this manner. In addition, the investment horizon varies considerably amongst this group of asset owners. Likewise, the degree of risk in pension portfolios varies widely from one pension plan to another.

Another group that is proposed to be excluded from the Second Consultation is the asset managers that are wholly-owned subsidiaries of G-SIBs or G-SIIs. In reviewing the largest twenty managers in the world, we note that nine are wholly-owned subsidiaries. This subset of the group

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[108] *See* Bennett W. Golub and Conun Crum, *Risk Management Lessons Worth Remembering from the Credit Crisis of 2007-2009*, 36(3) Journal of Portfolio Management 21-44 (Spring 2010).

[109] Second Consultation at 5.

collectively manages over $12 trillion in AUM which represents 42% of the total AUM of the whole group.[110]

Importantly, the risks associated with asset management are substantially different than the risks associated with balance sheet entities such as banks and insurers. The Second Consultation implies that asset management subsidiaries are already covered by prudential regulation. We are interested in learning what prudential measures are being applied to these asset management subsidiaries as this may help to better understand what policy measures are being contemplated for external asset managers.

We strongly recommend a products- and activities-based approach to managing risk in asset management as outlined in our cover letter. This approach would address systemic risk across the market ecosystem regardless of the entities involved. As highlighted in the response to these questions, there is no obvious reason for then excluding the assets of public financial institutions, sovereign wealth funds or pension plans, or the assets managed by subsidiaries of G-SIBs or G-SIIs. To put this in perspective, the proposed approach to addressing systemic risk through the designation of certain asset managers is the equivalent of reducing carbon emissions by exempting government entities, smaller utilities, and other selected groups that use coal-fired plants and focusing only on large, private sector coal plants. Clearly, this approach would not result in cleaner air for the world to breathe.

[110] Source: BlackRock, Pensions & Investments, as of December 31, 2013.

B. Section 6

Q6-1. Please explain any potential systemic risks associated with the financial distress or disorderly liquidation of an investment fund at the global level that are, in your view, not appropriately captured in the above description of each risk transmission channel? Are there elements that have not been adequately captured? Please explain for each of the relevant channels separately.

The Second Consultation states in the section on systemic relevance of investment funds that "the distress or forced liquidation of an investment fund that has extensive exposures and liabilities in the financial system or that provides a critical role in certain markets could have a destabilizing impact on other market participants or, counterparties in a cascading manner that could lead to a broader financial system instability." We agree that a fund which has obtained a substantial amount of leverage could be subject to large counterparty exposure; though we note that the vast majority of funds are subject to restrictions on the use of leverage either by regulation or by the fund's constituent documents and IMAs with clients. We do not find any evidence that there exists a fund that "provides a critical role in certain markets" as the fund industry is highly competitive with multiple competing products in each category and asset owners can manage their asset directly in the absence of an investment fund. We fully describe our reservations with the Second Consultation's discussion of transmission mechanisms in relation to investment funds on pages 21 to 23 of this document.

Q6-2. For the asset liquidation/market channel, to what extent is the potential for risk transmission heightened with respect to an individual fund that is a dominant player (e.g. its asset holdings or trading activities are significant relative to the market segment) in less liquid markets?

Given that the fund industry is highly competitive with multiple fund offerings in each asset class and strategy as well as the fact that between 60% and 75% of the world's financial assets are managed directly by asset owners, we do not see evidence of individual funds that are "dominant players" in "less liquid" markets (see Exhibit 2). Even in "less liquid" asset classes, the majority of the assets are held directly by asset owners, not via funds.[111]

Q6-3. Under what conditions might the asset liquidation/market channel apply to an individual fund in ways that are distinct from industry-wide behaviours in contributing to broader market contagion?

We agree with the FSB and IOSCO's assessment that highly levered funds could potentially be subject to asset liquidation issues. While leverage in and of itself does not equate to systemically significant levels of risk, the term structure and relative amount of leverage can be a key indicator of the asset liquidation risk presented by a leveraged fund. In other words, borrowings or derivatives need to be considered together with the redemption terms of the fund. For example, mutual funds offering daily redemptions are typically restricted in the amount of leverage they can use by regulation. The 1940 Act subjects 1940 Act open-end mutual funds and ETFs to rules regarding limits on borrowing and on collateralizing derivative exposures. Borrowings are limited to 33.3% of total fund assets (i.e., the fund must have asset coverage of

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[111] *See* BlackRock, *ViewPoint*, *Who Owns the Assets? A Closer Look at Bank Loans, High Yield Bonds and Emerging Markets Debt* (Sep. 2014), available at http://www.blackrock.com/corporate/en-us/literature/whitepaper/viewpoint-closer-look-selected-asset-classes-sept2014.pdf .

300%), which equates to a total asset limit of 1.5 times net assets.[112] UCITS limits leverage to two times net assets using one of two methods. With respect to 1940 Act closed-end funds ("CEFs"), leverage is also limited under the 1940 Act. Like 1940 Act Open-End Mutual Funds, borrowings by CEFs are limited to 33.3% of total fund assets. Although, CEFs may issue a single class of preferred stock (subject to a 200% asset coverage requirement), the closed-end structure mitigates the risk of redemption mismatch. In considering hedge funds, the redemption provisions must be factored into the analysis.

Q6-4. Is the proposed threshold defined for private funds appropriately calibrated? If not, please explain the possible alternative level (e.g. USD 200 billion of GNE) that could be adopted with clear rationale for adoption and quantitative data to back-up such proposed level?

We appreciate the FSB and IOSCO's greater focus on leverage in the Second Consultation in response to feedback from the First Consultation. However, the proposed materiality threshold for private funds is not appropriate for capturing the systemic relevance of private funds. Attempts to identify risk associated with highly levered private funds should not be based on Gross Notional Exposure ("GNE") because GNE does not necessarily measure, and is poorly correlated with, the risk of an investment portfolio.

GNE is calculated by adding the absolute value of notional positions for derivatives. This calculation ignores offsetting positions and derivatives that are being used for hedging. We are concerned that GNE is being used as a short-hand for concepts such as liquidity risk, counterparty risk, and volatility but unfortunately GNE is a highly misleading proxy for these three important risks. Take a hypothetical example of a $30 billion hedge fund that uses derivatives to fully hedge its currency risk. As a result of the use of derivatives for hedging purposes, the hedge fund has a gross leverage ratio of 14 times NAV for total GNE of $420 billion qualifying the hedge fund for potential G-SIFI designation. Another hypothetical hedge fund with $27 billion in AUM that is using derivatives to gain large exposures to the Swiss Franc could have the same gross leverage ratio of 14 times net asset value ("NAV") ($378 billion GNE). Under the proposed metrics, the second hypothetical hedge fund would not even be considered in "Stage 0" for further evaluation while the first hedge fund would be reviewed for designation. As demonstrated by this example, use of GNE as a metric can result in an arbitrary outcome that is not representative of the overall risk profile of a private fund or its relevance to financial stability.

Another example in which GNE may be misleading is with respect to interest rate derivatives. GNE does not take into account the use of hedging to explicitly reduce interest rate risk or the volatility of the underlying contract. For example, many portfolios purchase investment grade or Agency mortgage-backed security ("MBS") debt and hedge the interest rate risk using Treasury futures. A portfolio that uses this hedge will have a lower risk than the unhedged portfolio, but twice the GNE because GNE is the sum of the *absolute value* of notional positions. Similarly, GNE does not take into account the volatility of the security. For example, at equal notional sizes, the volatility of a 10 Year Note Treasury future is approximately 70 times greater than that of a Eurodollar future. This is due to differences in the duration of these two instruments and the different volatilities of the key rate points on the yield curve to which they are exposed.

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[112] 15 U.S.C. § 80a-18(a)(1)(B). In addition, although the Internal Revenue Code does not contain explicit limitations on leverage, borrowing may impact the tax character of distributions paid to shareholders and interest expense may not be deductible for tax purposes in certain circumstances. In addition, income received from certain derivatives contracts may not constitute qualifying income for purposes of the gross income test applicable to regulated investment companies. Together, the provisions further limit the ability of 1940 Act Funds to utilize leverage.

Yet, GNE would only count the notional value, treating Eurodollar contracts the same as 10-year Notes futures.

Address Inconsistent Regulatory Definitions of Leverage

We disagree that G-SIFI designation is the best way to address risks associated with highly levered private funds. Numerous existing global regulations constrain the use of leverage by funds; we agree with this regulatory approach. Unfortunately, the regulation and analysis of risks associated with leverage is unnecessarily complicated by the lack of global regulatory agreement on definitions. We believe that as an alternative to designation, the FSB and IOSCO should work with global regulators to address this situation with several steps:

1. Policy makers should differentiate between different types and uses of leverage to enable regulators to tailor solutions appropriately. In particular, we emphasize the distinctions between *temporary leverage* – which we define as borrowing for short-term purposes, such as meeting redemptions – and *structural leverage* which we view as embedded in investment strategies to enhance returns consistent with fund mandates, regulatory status, and client guidelines.

2. Policy makers should differentiate between various types and uses of derivatives in order to develop appropriate constraints. For example, derivatives can be used to lever a portfolio, in essence creating additional economic exposure. However, in other cases, derivatives are used to hedge (mitigate) risks and thus do not result in the creation of leverage and, in fact may specifically reduce economic exposure.

3. In 2011, the SEC commenced a process to broadly address the use of derivatives in funds established under the 1940 Act. We recommend that the SEC work with the industry to move forward with its Derivatives Concept Release of 2011,[113] with a goal of finalizing rules for the use of derivatives in 1940 Act Funds and using these rules in place of interpretive guidance. We recommend the SEC consider the guidelines set forth in the AIFMD in an effort to establish global standards that are consistent across jurisdictions.

4. In 2013, European regulators implemented the AIFMD which considers both borrowings and derivatives (with a recognition that derivatives positions that are offsetting or used for hedging do not create leverage) when measuring leverage, thereby providing the ability to gauge structural leverage and actual borrowings.[114] As one of the newest and most comprehensive approaches, we recommend that policy makers try to harmonize their approach to measuring leverage, rather than developing a completely new and potentially inconsistent methodology.

5. Finally, we recommend clear disclosure in all funds on the use of leverage and derivatives. Investors should be informed on the investment strategies in place or potentially in place, the types of financial instruments being used to exercise these

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[113] Use of Derivatives by Investment Companies Under the Investment Company Act of 1940, SEC Concept Release, 76 Fed. Reg. 55237, Derivatives Concept Release at 55242 (Sep. 7, 2011), available at https://www.sec.gov/rules/concept/2011/ic-29776fr.pdf ("Derivatives Concept Release")

[114] UCITS guidance is conceptually similar to the AIFMD, but differs in some key aspects where we believe that the AIFMD employs more consistent overall standards.

strategies, and the risks associated with the strategies and/or the financial instruments.

A clear definition of "leverage," including, as appropriate, the use of borrowings and derivatives that create leverage (e.g., derivatives that are not used for hedging), combined with uniform metrics for measurement and clear rules on their usage, will improve transparency to investors, fund boards, and regulators. This transparency will, in turn, enable regulators to monitor exposures and limit usage as appropriate, given the type of fund and its investor base. We encourage policy makers to actively engage with the asset management industry to establish clear definitions and rules that can be applied to different types of funds and strategies.

The AIFMD Approach to Leverage

The AIFMD introduces a common method to calculate leverage for all funds. The AIFMD uses two measures of leverage: (i) "gross leverage" and (ii) "commitment leverage" which together provide a comprehensive representation of leverage. Gross leverage provides a baseline measure of the use of derivatives by a fund, regardless of whether the fund is using the derivatives positions for hedging, whether long and short positions are offsetting, or whether derivatives are being used to obtain economic exposure. Recognizing that gross leverage does not provide an indication of a view of economic exposure as described above, the AIFMD additionally requires the calculation of commitment leverage. Commitment leverage provides a calculation designed to assess economic exposure obtained through the use of leverage by reflecting direct borrowings as well as derivatives exposure (with netting allowed for many, but not all, macro/micro hedges as well as paired offsetting derivatives positions). The AIFMD allows derivatives used for hedging security holdings and offsetting derivative positions to be excluded in the commitment leverage calculation, subject to specific netting/hedging calculation rules.[115] There are also a variety of more specific rules for what is allowed to be removed under netting and hedging under the commitment leverage approach.

Under the AIFMD, the entire portfolio exposure (NAV scaled up to include calculated leverage) based on both calculations of leverage for AIFs must be reported to regulators but the gross leverage figure is simply for informational purposes to highlight the use of derivatives by a fund. Importantly, under the AIFMD, if a fund's exposure exceeds three times its NAV using the commitment approach, it is considered to be employing leverage on a "substantial basis" and may become subject to additional reporting requirements and other restrictions.[116]

BlackRock strongly believes that gross leverage should *not* be used to obtain a view on the risk a fund is obtaining through leverage. Rather, this can be gleaned from the commitment leverage figure. While individual asset managers may use more precise measures of leverage for individual funds and the calculation of commitment leverage may require an element of subjective application of judgment or complex models,[117] the AIFMD approach to leverage is capable of being applied on a relatively consistent basis across funds and provides a comprehensive measure of leverage. Furthermore, because it is currently required as part of

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[115] Article 8, Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision.

[116] Article 111, AIFMD Level 2 Regulation of Dec. 19, 2012.

[117] BlackRock, Comment Letter, Response to ESMA on Implementing Measures Under AIFMD (Sep. 13, 2011), available at http://www.esma.europa.eu/system/files/ESMA_consultation_13_09_11_FINAL_SUBMISSION.pdf. Not all hedging strategies fall within the definition of hedging or netting allowed in the commitment approach such as, for example, offsetting the currency risk of one geographical market by taking a position in another market.

reporting under the AIFMD, it is already being reported to some regulators for AIFs, and there is expertise in the industry around its calculation. In addition, there are third party service providers who could assist in calculating commitment leverage. We recommend globally expanding the use of commitment leverage and conforming regulatory reporting requirements.

Q6-5. In your view, which option for the proposed threshold applied to traditional investment funds is the most appropriate initial filter to capture the relevant funds for detailed assessment and why? Also, are they appropriately calibrated? Please provide evidence (data or studies) to support your argument. If you prefer Option 2, please provide a practical definition of a dominant market player that can be applied in a consistent manner.

While we appreciate that the proposed metrics have responded to comments received from the First Consultation and incorporated leverage, the materiality thresholds remain predicated on size of AUM which suggests that the only type of levered funds that can present systemic risk are those that are also large in terms of AUM; we do not believe this is the case. The inclusion of size as measured by AUM in the materiality thresholds will result in a systematically arbitrary list of funds that include many "false positives" and "false negatives". The following are two hypothetical examples which illustrate this issue:

1. Under the proposed materiality threshold, a $20 billion investment fund that is levered 9 times using complex derivatives positions would not make the Stage 0 list of funds requiring further review.

2. In contrast, a $101 billion S&P 500 equity index fund that is passively managed, long-only, and does not use any leverage would make the "Stage 0" list requiring the national regulator to conduct a further review.

These examples demonstrate that using size of AUM as a primary factor in the materiality thresholds could lead to inconsistency and the mis-identification of many investment funds. As acknowledged in the Second Consultation, NAV (or AUM) "does not…appropriately measure the exposure of the investment fund to the wider financial system, if the investment fund employs balance-sheet leverage or derivatives-based leverage (also referred to as 'synthetic leverage')."[118]

We categorically disagree that G-SIFI designation of investment funds is an appropriate measure to address risks in the investment fund industry and instead recommend that the FSB and IOSCO pursue a product- and activities-based approach. Nevertheless, if the FSB and IOSCO are intent upon designing metrics for NBNIs that target investment funds – even before determining and then explaining what such a designation would mean and how it would mitigate perceived systemic risks – then the best approach would be to screen funds using commitment leverage as the criterion. We suggest that the FSB and IOSCO establish a *de minimis* leverage test whereby funds whose leverage falls below the *de minimis* threshold criteria are excluded and <u>all other funds</u> are deemed to be in scope for further analysis.

In the event that the FSB and IOSCO decide to pursue designations, we would recommend screening funds for inclusion on the Stage 0 list using the AIFMD commitment leverage calculation as the basis. In particular, we would define the *de minimis* criteria as total exposure using the commitment leverage calculation that exceeds the fund's NAV by more than

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[118] Second Consultation at 38.

$5 billion *and* a commitment leverage factor that is greater than 3.0 times NAV. In other words we recommend considering a fund not *de minimis* and adding that fund to the Stage 0 list if:

1) Commitment Leverage* – NAV > $5 billion; AND

2) $\frac{\text{Commitment Leverage*}}{\text{NAV}} > 3.0$

**By commitment leverage, we are referring to AIFMD commitment leverage.*

This approach would capture all funds that are significant debtors to the financial system regardless of their AUM, while excluding funds that are not. This approach would create a pool of funds that might have the potential to create systemic risk and therefore are worthy of further analysis. We also note that while there arguably may be better or more precise definitions of leverage than the AIFMD commitment leverage definition, consistency with global standards is more valuable than creating yet another regulatory definition for leverage. This is particularly the case given that there is existing industry expertise around the AIFMD rules and calculation would be sufficient to capture a broad set of investment funds for further review. Further, AIFs that have a commitment leverage factor greater than 3.0 are already making enhanced disclosures to regulators, potentially reducing the burden of making disclosures related to the G-SIFI analysis. As such, while we recognize that AIFMD commitment leverage is an evolving metric, we believe that market participants would be better served by focusing on evolving and improving this existing metric that could be adopted more broadly, rather than attempting to "reinvent the wheel" with a new metric.

We explicitly recognize that the criteria we recommend cast a wide net across the asset management industry; this is no accident. Since we fundamentally believe in the need for a product- and activities-based approach to genuinely address systemic risk, the only way we can imagine systemic risk mitigation efficacy through a designation-based approach is through one that would capture the activities of highly leveraged investment funds, regardless of their legal structure.

A follow-on analysis using measures pertinent to investment funds could be applied by each national regulator to the funds meeting this *de minimis* screen. We believe a useful follow-on analysis should look at the following factors, taking into account both portfolio assets and liabilities.

Portfolio Assets / Holdings

(i) Relative Liquidity of Fund Assets: National authorities could conduct liquidity stress tests of each fund on the "Stage 0" list to measure the liquidity of the fund's portfolio holdings relative to expected fund redemptions under different scenarios using the AIFMD framework as a model. Perhaps then, the FSB and IOSCO could develop a scoring system to allow for a comparison of the results of the stress tests across funds.

(ii) Complexity of Instruments: The FSB and IOSCO could determine a list of complex financial instruments that it is concerned about, such as "OTC derivatives that are

not cleared through a CCP"[119] and then review the list of Stage 0 funds to determine the extent to which each fund uses complex instruments as defined by the FSB and IOSCO and for what purposes such instruments are used. We note that the list of "complex" instruments will need to be updated over time, particularly as more OTC derivatives move to central clearing, as well as the likelihood of continued financial innovation.

Portfolio Liability Structure / Redemption Rules

(iii) Counterparty Relationships: National authorities could review the processes and procedures each fund has in place to approve, monitor, and manage its counterparty exposure and compare these procedures to best practices. National authorities could also review the level of exposure to each counterparty that is maintained by each fund on the Stage 0 list.

(iv) Redemption Provisions: The redemption provisions associated with a fund – whether by regulation or in its contractual documents with investors – including frequency of redemptions (e.g., daily, monthly, etc.) and notice periods, ability of the fund to be gated, ability to suspend redemptions, ability to delay settlement, etc. are all important to understanding a fund's potential liquidity needs and should be taken as context when reviewing other aspects of the fund's liability structure and liquidity profile.

(v) Durability of Funding: This could include a review of the fund's backup funding sources such as bank lines of credit, repo, interfund lending, etc. An analysis of backup funding sources should also consider the probability of each funding source being available to the fund to meet redemptions under various market stress scenarios.

Other Considerations

(vi) Exposure to Value-at-Risk ("VaR") Models: National regulators should review how these levered funds are managed with respect to VaR models. Strict VaR limits imposed by the fund's prime broker may lead to correlated and/or pro-cyclical selling during periods of market stress. Additionally, to the extent that a leveraged fund posts collateral and the level of collateral is dependent on VaR, the fund may be required to post additional liquidity in response to margin calls during periods of increased market stress.

[119] Second Consultation at 21.

Q6-6. In addition to the two options for traditional investment funds, the FSB and IOSCO also considered a simplified version of Option 2 using GAUM (e.g. USD 200 billion) with no dominant player filters. Please provide your views if any on this as a potential threshold with the rationale (especially compared to the proposed two options above).

As described previously, and as supported by research and analysis recently conducted by the IMF, size of AUM is not a good indicator of systemic risk. Therefore, we do not believe that the materiality thresholds with or without a "dominant player" filter is a useful metric. See our responses to Questions 6-4 and 6-5.

Q6-7. Please explain any proposed revised indicators set out above that, in your view, are not appropriate for assessing the relevant impact factors and its reasoning.

(i) Size: The statement in the Second Consultation that "[i]n theory, the larger the size of a fund, the greater its potential impact on counterparties (counterparty channel), markets (markets channel) and other market participants that may depend on it for critical functions (critical function / substitutability channel),"[120] contains a series of assumptions that are not supported by the facts. As described above, and as acknowledged in the Second Consultation, investment funds are highly substitutable, and this elasticity exists regardless of size.

As such, we do not believe that either of the sub-indicators proposed in the Second Consultation is a valid measure of the risk presented by an investment fund. For example, sub-indicator 1-1 is "Net assets under management for the fund".[121] Given that the size of an investment fund is not correlated with its systemic relevance, this indicator is irrelevant to the systemic risk that could be presented by a fund. Further, the discussion of indicator 1-1 incorrectly asserts that "NAV represents the amount of money the investors in the investment fund may lose if the investment fund unexpectedly liquidates."[122] Even in an extreme scenario, it is extraordinarily unlikely that a fund with no leverage would lose its entire value. Investment funds close on a regular basis and the liquidation of a fund (whether unexpected or not) does not imply that the value of the fund will necessarily go to zero due to the fund's liquidation.[123] This assertion reflects a misunderstanding of the nature of investment funds.

Proposed Indicator 1-2 includes GNE for hedge funds, which is a poor proxy for risk as explained in our response to Question 6-4.

(ii) Interconnectedness: We agree that highly levered funds could potentially be interconnected through leveraged exposure to counterparties. However, we believe that a comprehensive measure of leverage that is risk-based and incorporates leverage obtained through borrowing and derivatives while accounting for the fact that derivatives used for hedging reduce risk in a portfolio is the best approach to measuring leverage. As described in our response to Question 6-4, the framework for measuring leverage included in the AIFMD is a reasonable starting point for developing a meaningful view of the use of leverage by an investment fund. We believe this would be a better approach than using the proposed sub-indicators to measure "interconnectedness".

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120 Second Consultation at 38.

121 *Id.*

122 *Id.*

123 ICI Resolution Paper.

(iii) Substitutability: This indicator is not applicable to investment funds given the high degree of substitutability among funds offering various investment strategies which is described on pages 22 to 23.

(iv) Complexity: This could be applicable to highly levered funds that obtain leverage through highly bespoke and uncleared derivatives positions. However, there are very few funds that obtain leverage through "highly bespoke and uncleared derivatives positions". Given the move to greater standardization of derivatives and the ongoing move to central clearing, this impact factor will become less and less pertinent over time.

(v) Cross-Jurisdictional Activities / Global Activity: Funds can be offered in multiple jurisdictions and they can invest in multiple jurisdictions. Each of these activities raises different issues that need to be managed including compliance with local laws and regulations, custody arrangements, required documentation, settlement of securities, and geopolitical issues. See detailed discussion in our cover letter of page 25 to 27.

Q6-8. What alternative indicators should be added and why would they be more appropriate? For example, do you see any benefits in adding price-based indicators? If so, please explain the rationale for inclusion and possible definitions of such indicators.

We disagree that G-SIFI designation of investment funds is an appropriate measure to address risks in the investment fund industry and instead recommend that the FSB and IOSCO pursue a product and activities based approach. However, if the FSB is intent upon pursuing this effort, we provided an alternative methodology in our response to Question 6-5. The alternative methodology includes a *de minimis* threshold criterion and suggested factors to include in a follow-on analysis of funds that are not *de minimis*.

Q6-9. What are the practical difficulties (e.g. data availability, comparability) if any with collecting data related to these indicators? Please clarify which items, the practical problems, and possible proxies that could be collected or provided instead.

We believe that the alternative methodology for reviewing investment funds that was explained in our response to Question 6-5 could be conducted using a variety of data provided by each fund or its manager to its national authority. This data may already be reported to regulators or could likely be produced by fund managers if sufficient notice is given. In particular, the alternative methodology would require obtaining the fund's NAV, a list of portfolio holdings, a list of counterparties and counterparty exposures, and written documentation regarding the fund's procedures for approving counterparties and managing and monitoring counterparty risk. Redemption terms could be obtained by reviewing applicable law and the fund's constituent documents. For funds that are not already subject to the AIFMD requirements, the alternative methodology would require the calculation of AIFMD commitment leverage and performing a liquidity stress test. While this may be new for certain funds, existing industry expertise around the AIFMD could help to facilitate the production of these components of the analysis. Additional information could be obtained by engaging directly with the fund's manager.

Q6-10. For "size", should GNE be adjusted? If so, please explain how GNE should be adjusted and the practicality of such adjustment (e.g. data availability).

As described above, GNE is a poor proxy for risk. We recommend the use of the AIFMD commitment leverage approach for measuring leverage. The AIFMD commitment leverage calculation is already being reported to regulators by AIFs in several jurisdictions. Given that expertise around the calculation of AIFMD commitment leverage already exists within the

industry, this could facilitate the production of such calculations for funds where this is not already a regulatory requirement. Please see our response to Question 6-4 for further detail.

Q6-11. For "interconnectedness", should financial leverage be measured separately from synthetic leverage?

Leverage should be differentiated based on how it is being used to enable regulators to tailor solutions appropriately. In particular, we emphasize the distinctions between *temporary leverage* (financial leverage) – which we define as borrowing for short-term purposes, such as meeting redemptions; and *structural leverage* which we view as embedded in investment strategies to enhance returns consistent with fund mandates, regulatory status, and client guidelines – meaning that structural leverage can include both synthetic and financial leverage. We believe this is a more meaningful way to differentiate the uses of leverage than the categorization described in this question. As explained in our response to Question 6-4, we believe that the AIFMD commitment leverage approach is a good existing framework for measuring leverage. While we recognize that AIFMD commitment leverage is an evolving metric, we believe that market participants would be better served by focusing on evolving and improving this existing metric that could be adopted more broadly, rather than attempting to "reinvent the wheel" with a new definition.

C. Section 7

Q7-1. Please describe any activities or services conducted by asset managers other than described above. In particular, please explain any other activities that, in your view, should be included in the scope.

Some asset managers conduct the activities described in the Second Consultation including "securities lending agent services (the provision of indemnification to securities lenders), provision of risk management platforms or pricing services to clients, and consulting/advisory services that rely on the asset managers' breadth of asset expertise." However, all of the activities described in the Second Consultation are conducted by custodian banks, specialist firms, technology companies, and consulting firms in addition to asset managers. As such, these activities are not specific to asset managers nor is there any interaction with the asset management business that changes the nature of or risks associated with these activities. Further, there are numerous competitors providing each of these services to clients, and therefore, none of the services provided by asset managers are "critical" to the functioning of the global financial system.

For the FSB and IOSCO's reference, we have provided examples of companies offering the services described in the Second Consultation:

- **Advisory Service Providers:** BlackRock Solutions, Deloitte, KPMG, McKinsey, Oliver Wyman, PriceWaterhouseCoopers, and Promontory
- **Benchmark Providers:** Barclays, FTSE, MSCI, Russell, and S&P
- **Order Management Systems**: Aladdin, Bloomberg, Charles River, Eze Castle , Fidessa LatentZero, Linedata, and Simcorp Dimension
- **Performance and Accounting**: Aladdin, BNY Mellon Eagle, Portia, Princeton Financial Systems, Simcorp Dimension, and SS&C CAMRA
- **Pricing Providers:** Bloomberg, Interactive Data, Markit, and Thomson Reuters
- **Risk Analytics**: Aladdin, Barclays POINT, Citi YieldBook, FactSet, MSCI Barra, IBM Algorithmics, IDC BondEdge, Markit, UBS Delta, and Wilshire Axiom
- **Security Data Providers:** Bloomberg and Thomson Reuters

As stated previously, if the FSB and IOSCO are concerned about these particular activities, the FSB and IOSCO should conduct an activity-based analysis that looks at all of the different entities that conduct each activity as opposed to focusing solely on asset managers. The results of this analysis will help determine whether changes to the regulation of a particular activity are needed.

Q7-2. Please explain any potential systemic risks associated with the financial distress or default of an asset manager at the global level that are, in your view, not appropriately captured in the above description of each risk transmission channel. Are there elements of the relevant channel that have not been adequately captured? Please explain for the relevant channel separately.

The transmission channels described in the Second Consultation are not applicable to asset managers as described in detail in our cover letter on pages 12 to 17. The analysis of asset managers in relation to the transmission channels in the Second Consultation incorrectly assumes that an asset manager's business model and the risks associated with an asset manager's activities are similar to that of a commercial bank, which they are not. Asset managers are fundamentally different than banks and other financial institutions and this has not been appropriately considered in the Second Consultation's analysis of asset managers. The relationship of an asset manager to the investment vehicles it manages is most analogous to the relationship any provider of services has to its customers – they provide specified services and receive fees for those services. The relationship of asset managers to the investment vehicles it manages is *not* analogous to commercial banks and other balance sheet lenders that utilize the capital and deposits of the bank or other affiliates to finance the lending or other activities of another member of the affiliated group. Asset managers do not offer insured deposits, nor do they have access to central bank liquidity, nor are not materially exposed to short-term funding liquidity risk.[124] Asset managers do not cease operations the way a commercial bank can suddenly fail and, therefore, do not create the systemic exposures that banks create.[125]

The client assets managed by an asset manager are held in portfolios that are legally separate and distinct from the manager. Each client portfolio (fund or separate account) has its own IMA and its own investment guidelines specifying the investment objectives and constraints for that portfolio. Importantly, each client selects a custodian and contracts with that custodian – as such, client assets are held by the custodian, meaning that a change in asset manager does not necessitate the physical movement of the client's assets. Unlike a bank that uses customer deposits to fund its lending and other activities, the client assets are not held by the asset manager and hence are not on the balance sheet of the asset manager,[126] and client assets are not intermingled with the assets of the asset manager.

Transitioning managers does not entail "run-like" behavior that can cause "fire sales" of assets; often the process does not even involve the sale of any assets. The inability of a large asset manager or its constituent funds to operate therefore would not create systemic risk because their financial distress "would not set off a chain reaction of financial institution failures."[127] Although concerns have been raised about client behavior in the event of a reputational event at an asset manager, the actual experience of managers facing reputational events does not support the hypotheses around potential run behavior. In the case of the

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[124] *See* footnote 36.

[125] Supplemental Letter to SEC.

[126] We note that some asset managers (including Aberdeen, BlackRock, Fidelity, JP Morgan, HSBC, Invesco, Leal & General, Prudential, and Schroder) offer investment advisory services to pension plans through separate accounts held by an affiliate regulated as a life insurer in the United Kingdom. These separate accounts represent segregated clients assets held solely for the purpose of funding individual and group pension contracts; they are not available to creditors of the asset manager, and the holders of the pension contracts have no recourse to the asset manager's assets. While the separate accounts represent assets for the benefit of clients, under applicable accounting standards they are reported as separate account assets on the consolidated balance sheet of the asset manager, and the obligation to pay clients under the contracts are recorded as equal and offsetting liabilities.

[127] Committee on Capital Markets Regulation FSOC Response.

reputational events we have witnessed over the past twenty-five years, while significant amounts of client assets have moved from one manager to another, these movements have not destabilized financial markets. For example, in the past six months, we have seen over $200 billion in fixed income assets move from a single manager to multiple managers during a period of reduced market liquidity.[128] In this example, the securities and derivatives markets continued to function, and there was no negative knock-on effect on any counterparties or banks. In Appendix B, a list of asset managers that have experienced reputational events has been included.

Q7-3. For the exposure/counterparty channel, to what extent does the assessment adequately describe the types of risks posed by asset managers' activities, such as securities lending, distinct from individual funds? Are there other activities that warrant further assessment?

The assessment does not provide an adequate description of the types of risks posed by asset managers' activities. The Second Consultation states that "To the extent that an asset manager acts not only as an agent, but also as a counterparty, then the failure or distress of the asset manager could be transmitted to other market participants through this channel." As we have explained in various documents,[129] asset managers are not the counterparties to client or investment fund trades, derivative transactions, or securities lending arrangements.[130] Therefore, asset managers are not transmitters of risk in this channel. The Second Consultation suggests several ways that this channel might apply to asset managers. Below we highlight the key reasons why the activities cited do not represent examples of the exposure/counterparty risk transmission channel.

(i) Seeding

Asset managers may invest some seed capital in new products and may invest alongside clients as a means of demonstrating an alignment of incentives. The value of these investments tends to be relatively small as reflected in the relatively small size of asset manager balance sheets. Further, seed investments are often only used as a temporary means to help a new product generate a performance track record. These investments do not represent an example of the exposure/counterparty risk transmission channel nor are seed investments a source of systemic risk.

(ii) Securities Lending Agent

Securities lending is a well-established practice in the global financial system that provides liquidity to markets while also generating additional returns to investors who lend securities. There are many misunderstandings about securities lending, including several specific to BlackRock's securities lending practices. We recently published a *ViewPoint* entitled "Securities Lending: The Facts" explaining the mechanics of securities lending transactions and BlackRock's practices to try to correct these misunderstandings.[131]

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[128] *See* Allianz, *Allianz – A Strong Community* (Feb. 26, 2015), available at https://www.allianz.com/v_1424930390000/media/investor_relations/en/results/2014_fy/fy14_analyst_presentation.pdf. Pacific Investment Management Company, LLC ("PIMCO") net flows for 3Q14 and 4Q14 totaled €194 billion or approximately $235 billion using Bloomberg 12/31/14 exchange rate.

[129] *See* First Consultation Response; FSOC Response.

[130] *See* footnote 35.

[131] Securities Lending *ViewPoint*.

As the Second Consultation notes, some asset managers may provide services to clients as a securities lending *agent*. Securities lending agents are *not* the counterparty in securities loans; rather they arrange a transaction between a lender and aborrower. Given that securities lending agents are not the counterparty, this does not represent an example of the exposure/counterparty transmission channel. BlackRock acts as a lending agent for some of its asset management clients and when BlackRock is the lending agent, all securities loans are made to borrowers that are *independent* of BlackRock. Furthermore, regulatory requirements and market practice require that borrowers post collateral for securities loans in excess of the value of the security being lent. This collateral is marked-to-market daily, and the borrower may be required to deliver additional collateral to maintain the required excess level. BlackRock typically requires borrowers to post collateral between 102% and 112% of the value of the securities lent. This overcollateralization provides an additional "safety cushion" in the event that a borrower fails to return the security that is out on loan. BlackRock does not rehypothecate non-cash collateral.[132]

We note that securities lending is a good example of a capital markets activity for which additional oversight and reporting may be warranted. However, regulating individual providers or only a subset of providers will not reduce the risks inherent in this activity as this would result in the activity shifting to another provider. We note that the SEC released a proposal on May 20, 2015 that calls for additional reporting on the use of securities lending by mutual funds.[133]

(iii) Securities Lending Borrower Default Indemnification

Borrower default indemnification by securities lending agents does *not* entail a guarantee of the investment performance of the securities lending arrangement, including the returns on any cash reinvestment vehicle. Rather, in the event that the borrower fails to return the securities that have been lent and the collateral amount pledged is insufficient to cover the cost of replacing the securities, the borrower default indemnification requires the lending agent to cover the shortfall between the value of the collateral pledged and the replacement cost of the securities lent. BlackRock provides borrower default indemnification to some clients for which it acts as lending agent. BlackRock (and its predecessors) has never had its indemnification agreements triggered or had to use its own monies to repurchase a security on a lending client's behalf.[134]

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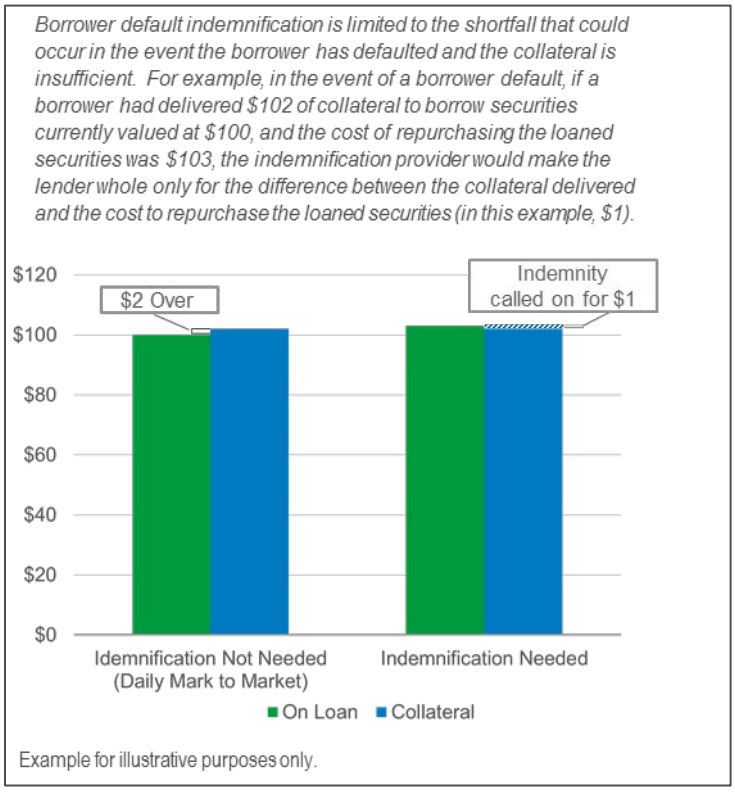
[132] Securities Lending *ViewPoint*.

[133] SEC Data Reporting Proposed Rule.

[134] Securities Lending *ViewPoint*.

Exhibit 7: Illustration of Indemnification



Q7-4. For the asset liquidation/market channel, to what extent and under what circumstances might reputational or operational risks of the asset manager impact the entity's individual funds, contributing to high redemptions? How might it impact the transfer of SMAs?

As noted in our cover letter on pages 13 to 15, the industry has experienced situations where the management of a fund was transferred from one manager to another without requiring large-scale asset liquidations. As such, it is important to keep in mind that even if a reputational or operational event were to cause high redemptions from funds or necessitated a change of management of a separate account or fund, this would not have a systemic impact because no first-mover advantage or incentive to immediately liquidate securities arises in this scenario. In the past six months, we have observed the experience of PIMCO after the departure of portfolio manager, Bill Gross. Since the announcement, PIMCO has experienced over $200 billion in fixed income AUM in outflows and these assets have moved to multiple managers.[135] In this example, the securities and derivatives markets have continued to function, and there was no negative knock-on effect on any counterparties or banks; all during a period of reduced market liquidity. Below we have addressed each of the concerns raised in this section of the Second Consultation and how the concerns are addressed.

(i) Operational Risk

Asset managers come in various shapes and sizes, which are reflected in numerous variations in operating business models. These differences include the management of the

[135] *See* footnote 128.

company's capital structure, the product focus such as specialty asset classes or investment vehicles versus multiple product strategies, the client focus such as specific types of clients or client geographies versus multiple distribution channels, and the degree of insourcing versus outsourcing of middle and back office functions. In assessing the potential operational risk of an asset manager, understanding the differences in their operating models is crucial.

Regardless of the differences in operating models for asset managers, operational risks faced by asset managers do not present the same type of risk to financial stability that the operational risk facing commercial banks presents. Even in the worst-case scenario where an asset manager was unable to effectively operate at all, clients would be able to transition the ongoing management of their investments to another manager. Transitioning the management of client assets from one manager to another regularly occurs in the normal course of business. Furthermore, transitioning the management of a client's account need not necessarily entail the selling of assets, as client assets are segregated from the asset manager's own assets and are held by a custodian.[136] The inability of an asset manager to operate, therefore, does not incentivize the type of first-mover exit behavior or liquidation of assets associated with a bank failure.

Nevertheless, operational risk does exist in asset management and operating errors do occur. Asset managers can and do manage operational risks and business continuity risks, including those related to preventing and responding to operating errors by a third party service provider. In addition to internal processes and controls that should be overseen by independent operational and risk management personnel, asset managers necessarily conduct due diligence of critical third party service providers and perform ongoing oversight and monitoring to ensure that their service providers are meeting agreed upon performance standards. In the normal course of business, asset managers implement measures to mitigate the impact of potentially disruptive events through operational risk management programs, including maintaining business continuity plans ("BCPs") and technology disaster recovery plans ("DRPs"). This starts with having an independent risk management function with separate reporting lines from the portfolio management function. There should be individuals within risk management that are responsible for managing operational and technology risk. Sound operational risk management practices by asset managers are reinforced by the demands of institutional clients and consultants, who often conduct operational due diligence prior to hiring an asset manager,[137] and through regulatory oversight which requires asset managers to have robust operational risk management and BCPs. In certain jurisdictions, regulators are highly prescriptive of the operational risk management practices of asset managers.

Importantly, as agents on behalf of their clients, asset managers participate in the broader financial system, and they and their clients utilize the existing financial market infrastructure, including exchanges, electronic trading and affirmation platforms, trade messaging systems, and depositories that facilitate the movement of securities, foreign exchange, and other positions from one counterparty to another to execute the management of client assets. CCPs are used for exchange traded futures and centrally cleared OTC derivatives. Improvements to regulation in response to the 2008 Crisis have improved the safety and soundness of the financial

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[136] *See* FSOC Response at 55.

[137] *See* Tim Sturrock, *Endowments Ramp Up Due Diligence Demands on Managers,* FundFire (Feb. 19, 2015), available at http://fundfire.com/c/1068143/111203/endowments_ramp_diligence_demands_managers?referrer_module=emailMorningNews&module_order=0&code=UVd4bGVHbHpMbEp2YzJWdVlteDFiVUJDYkdGamExSnZZMnN1WTI5dExDQXlNREUwTWpjM0xDQXhPVEUzT1RBeE5qTTU.

system and reduced the likelihood of certain operational risks.[138] While a number of market entities have been designated systemically important financial market utilities ("SI-FMUs") by the FSOC and subjected to greater regulatory safeguards that are calibrated to their importance within the financial system,[139] there may be room for additional improvements in certain areas. In particular, we would highlight that regulatory reform has concentrated what were once bi-lateral risks into CCPs, and CCPs now represent one of the largest concentrations of risk within the financial system.

(ii) Business Continuity Risk

Business disruptions can occur from a variety of natural and man-made events resulting in the loss of facilities, technology systems, and the inability of personnel to perform their duties. In order to manage the business continuity risk that could arise as a result of business disruptions, asset managers must have procedures in place to recover business operations and supporting technology in the event of a disruption. We believe that planning for these types of events requires a comprehensive program that includes: (i) business continuity planning, (ii) technology DRPs, and (iii) a crisis management framework to coordinate in crisis situations. As mentioned above, a key component of our overall strategy and a key differentiator for BlackRock is our ability to transfer work across our offices globally. By having staff that utilize shared systems and common processes, we are able to service our client base from our offices around the world. In the event of a disruption that impacts one office or region, work can be transferred to staff at other locations. This capability is included in BCPs and in many cases is utilized in the course of normal business.

BlackRock's BCM program employs a "three lines of defense" model. In our experience, similar models have been or are being implemented by many asset managers across the industry. The three lines of defense in this model are: (i) *first line - b*usiness units are responsible for creating and testing BCPs that are in adherence with centrally defined requirements; (ii) *second line – a* central business continuity team defines policy, oversees adherence with planning requirements, conducts quality checks and reports to management; and (iii) *third line -* internal and external audit are responsible for auditing individual business plans as well as the overall business continuity program and framework. There are several elements of managing business continuity risk that we believe are employed by most asset managers:

a. Business Continuity Planning: At a practical level, BCP includes planning, training, testing, and regular reporting of risks that could arise from major disruptions to facilities or systems. Certain best practices exist for BCP programs and are followed by many managers, including:
   - Threat analysis to define the probability and potential impact of external threats and hazards;

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[138] For example, the Federal Reserve Bank of New York created a Tri-Party Repo Reform Task Force that made recommendations which have resulted in improvements to the tri-party repo settlement systems of the tri-party repo clearing banks, Bank of New York Mellon and J.P. Morgan, "in ways that significantly reduce the amount of intraday credit needed for daily settlement," among other reforms that have improved the safety and soundness of the tri-party repo market. Federal Reserve Bank of New York, *Update on Tri-Party Repo Infrastructure Reform* (Feb. 13, 2014), available at http://www.newyorkfed.org/newsevents/statements/2014/0213_2014.html ("NY Fed Update on Tri-Party Repo Reform").

[139] *See* Federal Reserve Board, *Designated Financial Market Utilities* (Jan. 29, 2015), available at http://www.federalreserve.gov/paymentsystems/designated_fmu_about.htm; Financial Services Roundtable, Comment Letter, Response to FSB-IOSCO's Consultation Regarding Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions (Apr. 7, 2014), available at http://fsroundtable.org/letter-re-assessment-methodologies-for-identifying-non-bank-non-insurer-global-sifis-4-7-14/.

- Written plans that analyze potential impacts to business units, outline the recovery strategy, and define key team members, critical records, dependencies, key third parties, and technology requirements needed to facilitate technology DRP;
- Ongoing training of staff in order to ensure they understand their roles and how the firm will operate during a crisis; and
- Testing of plans through annual exercises to confirm adequacy of recovery strategies, including use of remote access, recovery sites, alternate offices and transfer of critical processes. At a minimum, this should include annual all-staff awareness training and all-staff accountability tests to ensure the company's ability to contact and account for staff during a crisis. Finally, this can also entail participation in industry recovery exercises.

b. Technology Disaster Recovery Planning: Technology DRPs are a part of any business continuity program and include processes and procedures to recover technology systems and infrastructure that are critical to the management of client accounts. As we described in our *ViewPoint* entitled "The Role of Technology Within Asset Management," different asset managers have adopted many different technology systems to support their businesses.[140] As such, this could result in differences in technology DRPs. In our DRP, we strive to ensure minimal downtime and minimal data loss for all applications that support critical business processes in the event of a disruption to technology. We maintain a highly redundant technology infrastructure that is designed to ensure that recovery timelines can meet business requirements.

c. Crisis Management: When business disruptions do occur, a crisis management framework can be used to manage incidents that require coordination across multiple business lines or across multiple locations. Asset managers, typically develop a framework that defines how coordination will take place during a crisis event. This includes communication and escalation procedures (across business, technology, management, etc.) as well as with clients, regulators, and other third parties. The frameworks should include local, regional, and global crisis teams that respond to and facilitate the recovery from disruptive events.

(iii) Reputational Risks

There are numerous examples of reputational issues that have occurred at asset management companies over time. However, these reputational issues experienced by asset managers have created little or no market impact, much less systemic risk (see Exhibit 8). This is due to the agency nature of asset managers and the fact that client assets are segregated from the asset manager, and therefore, protected regardless of the financial strength or reputation of the asset manager. This business model protects against reputational events resulting in systemic risk. This is not to say that reputational risk does not exist in asset management or that protections are not in place to prevent and mitigate the impact of such risks. Like any commercial enterprise, reputational issues can have negative implications for the commercial success of an asset manager which provides an incentive to prevent and contain such risks. As we describe in Exhibit 8, reputational issues can and do occur at asset managers but there are many steps that asset managers take to mitigate these risks and, indeed, regulation may also require companies to put in place procedures to reduce the likelihood of certain issues from occurring (e.g., fraud

[140] Technology *ViewPoint*.

prevent regulation). Regardless, reputational issues at asset manager do not rise to systemic importance like they may present for commercial banks because a reputational issue at an asset manager does not result in client assets being at risk of loss, which can lead to the type of first-mover advantage behavior the can become an issue for deposit-taking institutions.

Exhibit 8: Examples of Reputational Risks to Asset Managers

Risk	Examples	Measures to Prevent and/or Mitigate Risk
Departure of Key Person	• Bill Gross' departure from PIMCO on 9/26/14. Over $200 billion in fixed income assets moved from PIMCO to multiple managers over the course of a few months.	• Team approach with a deep bench of potential successors. • Multiple teams with independent investment decisions.
Fraud	• In 2011, SEC charged Axa Rosenberg with fraud for concealing an error in a quantitative model, which caused $217 million in investor losses. Required to make clients whole and pay a fine. Co-founder banned from industry for life. • In 2009, it was discovered that UK hedge fund, Weavering Macro Fund, had fraudulent dealings with an offshore company owned by the firm's founder which was being used to prop up the value of the fund. Founder received thirteen year jail sentence.	• Annual SSAE 16 report on internal controls as required under the Sarbanes-Oxley Act of 2002 rules (and international equivalent standards such as ISAE 16). This document is reviewed by an external auditor. • Maintaining an independent internal audit function. • External audits of company financials and fund financials.
Insider Trading	• Portfolio managers at SAC Capital Management accused of insider trading. Converted to family office.	• Written policies regarding insider trading and personal trading. • Requiring pre-trade clearance from an independent compliance function for trades in employees' personal accounts and disclosure of personal holdings.
Regulatory Sanction	• In 2003 Putnam, Pilgrim Baxter, Janus Capital, and Strong Capital faced regulatory sanctions and paid fines due to market timing abuses. Firms faced significant outflows and multiple funds were closed, sold, or re-branded.	• Independent Legal & Compliance function with appropriate expertise for products being offered and jurisdictions of operation. • Written policies on business conduct and ethics. • Avenues for employees to escalate potential issues or unethical behavior. • Continuous training of personnel whose activities are subject to regulation.

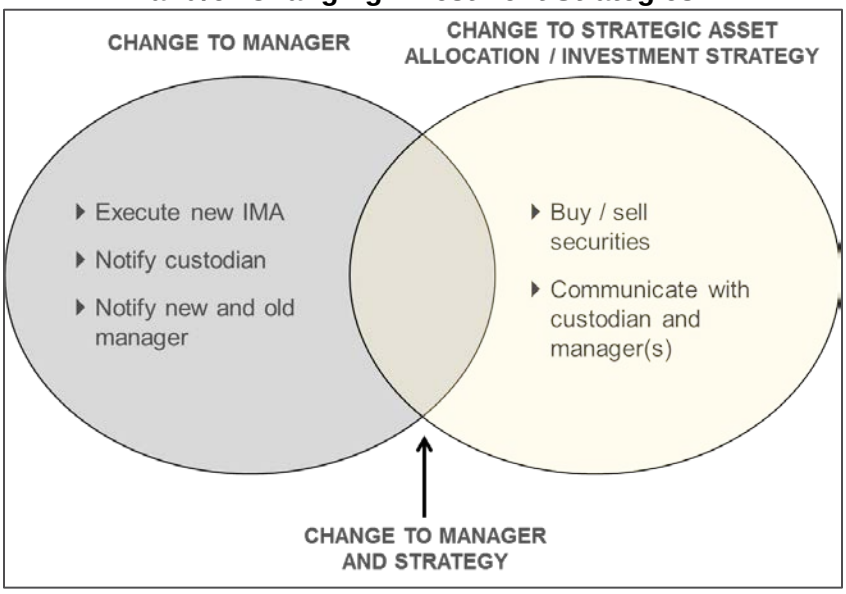
(iv) Transitioning Management of Client Accounts

The fact that client assets are held by a custodian, not by the asset manager, means that in the event an asset manager experiences an operational or reputational issue, clients can change managers without physically moving or selling securities. Further, when transitioning management of an account from one asset manager to another, an asset owner has no incentive to sell securities because it will incur transition costs and potentially lost opportunity from being out of the market. In our experience, large-scale asset liquidations are not correlated with a change in the management of assets from one manager to another. Further, in instances where a large institutional client is invested in a fund and decides to change to another fund, an in-kind redemption may be requested, as this provides an option to reduce the transaction costs that could be associated with redeeming a large position in a fund for cash and then re-establishing a similar set of exposures by subscribing to a similar fund managed by a different manager.

The liquidation of certain securities only becomes necessary if the *asset owner* makes a decision to alter their asset allocation. For illustrative purposes, we will use a hypothetical example of how this occurs in practice. Let's assume that a large pension plan decides to reduce its allocation to EMD by 10% and increase its allocation to U.S. fixed income by 10% at the advice of its institutional investment consultant. The pension's holdings in EMD are currently managed by an EMD specialist asset manager. The client conducts a manager search for a U.S. fixed income manager, including issuing a request for proposal ("RFP") and attending several onsite due diligence meetings with its consultant. The search concludes, and the client selects a new manager for the new allocation to U.S. fixed income. To effectuate the change in asset allocation – reducing EMD holdings and increasing U.S. fixed income holdings – the client hires a transition manager to coordinate the transition and minimize the transaction costs associated with this change in strategic asset allocation. A new IMA is executed with the new manager and the client's custodian is notified of the change. The EMD specialist manager is notified that the client will be reducing its allocation and possibly terminating its contract. As demonstrated by this example, the decision to change investment strategy from EMD to U.S. fixed income is a separate decision from the change to investment manager. The buying and/or selling of securities is the result of the change in strategic asset allocation, not the change in manager. In this typical example, the process takes several weeks or months.

In contrast, the change from one manager to another without a change to strategy only requires documentation (e.g., IMAs) that can be executed very quickly. Further, a change to manager without a change to strategy does not require (or in any way incentivize) the buying and/or selling of securities. This would be true both in the normal course of business and in extreme scenarios where an asset manager would suddenly be unable to operate. In our experience, when the situation necessitates, clients can and do effectuate changes to investment managers very quickly and without impacting markets. Exhibit 9 outlines the different actions required when changing managers and changing strategies at a high level.

Exhibit 9: Actions Required when Changing Managers and/or Changing Investment Strategies



In the event an asset manager is unable to operate, a substitute manager can quickly be sourced as a replacement, and a transition of management services completed.[141] Transitioning the management of client assets from one manager to another occurs regularly in the normal course of business. In the case of separate accounts, separate account clients initiate and terminate IMAs frequently for a variety of reasons, including changes in the client's asset allocation, poor performance or client service on the part of the asset manager, and administrative consolidation. Such changes can be implemented on short notice, sometimes in as little as 24 hours, with no noticeable market impact.[142] While a typical search by an institutional client for a new manager takes several weeks or even months, clients can and do move quickly when situations necessitate. In our experience, there have been numerous situations where we assisted a client by taking on investment management responsibility for a separate account on extremely short notice.[143] Substituting asset managers can be achieved quickly because client separate account and fund assets are held with custodians who are contractually obligated to the asset owner or fund (not the asset manager). Custodians hold the assets regardless of which asset manager the asset owner selects to manage their assets. As such, clients can re-direct the management of an existing portfolio of securities to another manager. Importantly, assets are not required to physically move when there is a change of asset managers; assets remain with the custodian in client denominated accounts.

(v) Transitioning Derivatives Positions

Some commentators have focused on the transfer of "derivatives" positions as a potential impediment to transferring the management of client accounts from one asset manager to another. The use of central clearing as a result of OTC derivative market reforms has resulted in greater standardization and transparency for centrally cleared OTC derivatives. Continued standardization of terms in the derivatives market will increase transparency, minimize customized terms, and help ease the process of transferring derivatives positions from the trading control of one manager to another. An important point of context within this discussion is that the transfer of derivative positions differs by type of derivative. For example, the dynamics of transferring management of exchange traded derivatives differ substantially from transferring management of OTC derivative positions. Likewise, there is differentiation based on the underlying asset class (e.g., foreign exchange ("FX") forwards, commodity futures and interest rate options). Exchange traded derivative contracts are normally held at the central clearinghouse in client designated accounts which can be transferred easily and quickly from the control of one manager to another. This is particularly true when the same clearing member is used by both the new and existing (or "legacy") asset manager. Transitioning OTC derivatives contracts presents more operational challenges; however, such transitions can be managed, though they may take longer to accomplish. The terms (including economic and non-economic terms) of OTC contracts may be negotiated by the asset manager on behalf of a number of clients rather than by the individual clients themselves. Thus, transitioning these contractual arrangements may be more expeditiously accomplished, in some cases, through the unwinding of contracts rather than amending agreements to reflect the contract terms available to the new asset manager. The positions would then be re-established under new contractual

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[141] *See* footnote 57.

[142] We believe that the transition of separate accounts from one manager to another is typically no more difficult or impactful than transitions of other types of accounts or pooled vehicles. In some cases, asset sales may be directed by the client, but based on our experience, this would apply to a very limited amount of separate account assets. Therefore, these transitions would not contribute to systemic risk. *See* BlackRock, Comment Letter, Addendum to Feedback on OFR Study on Asset Management and Financial Stability – SEC (Dec. 3, 2013), available at http://www.blackrock.com/corporate/en-us/literature/publication/ofr-study-addendum-sec-120313.pdf.

[143] *See* footnote 49.

arrangements. The standard transition management practice for OTC instruments is for the legacy manager to close positions and the new manager to open desired positions concurrently. For liquid and transparent OTC derivatives, this provides clients with the ability to economically move positions among managers quickly and efficiently with minimal cost and risk. The recent experience with the PIMCO Total Return Strategy was instructive in this regard. In our experience with separate accounts that were transferred from PIMCO to BlackRock, all OTC derivatives positions were unwound by PIMCO during this time period for cash and re-executed by BlackRock, where necessary, and in line with the investment strategy that we agreed to with the client.

(vi) Guarantees

Guarantees of investment performance are in most jurisdictions prohibited by law or regulations.[144] We are not aware of any U.S. asset managers providing a guarantee of their investment management products. The lack of a guarantee on fund performance is clearly disclosed to investors in U.S. mutual funds.[145]

(vii)Securities Lending Indemnification

See our response to Question 7-3 for discussion of securities lending indemnification.

Q7-5. For the critical function/substitutability channel, are there any emerging activities that might be critical to a portion of financial clients that might in turn impair market functioning or risk management if no longer provided? Other than managing assets as an agent (i.e. core function), to what extent do asset managers engage in activities that may be relied upon by investors, financial institutions and corporations, and which are difficult to readily substitute?

As the Second Consultation states, "asset managers primarily provide advice or portfolio management service to clients on an agency basis. This model makes their provision of this particular activity generally substitutable as there is considerable competition in the market place." We agree with this statement. Asset managers do not transmit risk in this channel. The asset management industry is highly competitive and there are numerous competitors across asset classes and investment strategies. Asset owners can manage their own assets internally, or they can consult one of several commercially available data sources that provide information about asset managers and their investment products, or they can consult with their institutional investment consultant or financial advisor, who often maintains proprietary databases with information on asset managers and investment funds.[146] In the event an asset manager is unable to operate, a substitute manager can quickly be sourced as a replacement, and a transition of management services completed.[147]

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144 For example. Form N1-A, the SEC registration form for 1940 Act Open-End Mutual Funds and 1940 Act ETFs (available at http://www.sec.gov/about/forms/formn-1a.pdf), requires these funds to disclose that an investment in these funds is not a bank deposit, and not insured or guaranteed by the FDIC or any other government agency.

145 Form N-1A, requires each fund to disclose its principal investment strategies and risks, including the types of investments and techniques used by a fund to achieve its investment objective, and that the use of such investments and techniques may result in the fund losing money.

146 *See* footnote 55.

147 *See* footnote 56.

The Second Consultation advanced the idea that "if an asset manager was a significant pricing provider, securities lending agent, or provider of certain systems used by market participants and critical to their activities, their distress or failure could leave the market without ready substitutes."[148] The Second Consultation also states, "most securities lending transactions are facilitated by custodian banks".[149] Simply put, multiple entities offer securities lending agent services. Most institutional custodians act as securities lending agents and can easily step into this role if a client desires to make a change. In addition, there are several independent providers of securities lending agent services, giving clients additional options to choose amongst. In the event an asset manager is no longer able to provide services as a securities lending agent, the asset owners could replace this service by retaining another agent, lending its assets directly, or choosing not to lend securities from their portfolio.

The Second Consultation similarly suggested that the provision of asset management technology was a "critical" service or function provided by some asset managers. The market for asset management technology is highly competitive, with multiple vendors for various types of technology, relatively low costs of moving from one vendor system to another, and relatively low barriers to entry. Examples of asset management technology vendors and systems include:

- **Benchmark Providers:** Barclays, FTSE MSCI, Russell, and S&P
- **Order Management Systems**: Aladdin, Bloomberg, Charles River, Eze Castle , Fidessa LatentZero, Linedata, and Simcorp Dimension
- **Performance and Accounting**: Aladdin, BNY Mellon Eagle, Portia, Princeton Financial Systems, Simcorp Dimension and SS&C CAMRA
- **Pricing Providers:** Bloomberg, Interactive Data, Markit and Thomson Reuters
- **Risk Analytics**: Aladdin, Barclays POINT, Citi YieldBook, FactSet, MSCI Barra, IBM Algorithmics, IDC BondEdge, Markit, UBS Delta, and Wilshire Axiom
- **Security Data Providers:** Bloomberg and Thomson Reuters

We discuss the use of technology in greater detail in our *ViewPoint* entitled, "The Role of Technology Within Asset Management."[150] The paper explores asset management technology, which is primarily used to support data management and information processing. Asset managers and asset owners who manage their assets directly require systems to maintain data and support the flow of information.

In reviewing the analysis in the Second Consultation and assessing the concerns raised, it is clear that asset managers do not transmit risk through critical function / substitutability channel because they do not provide critical services. A more complete understanding of asset owner asset allocation decisions and securities lending activities would allay the concerns raised about transmission risks arising from external asset managers.

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[148] Second Consultation at 49.

[149] Second Consultation at 48.

[150] Technology *ViewPoint*.

Q7-6. Please explain any practical difficulties in applying the above proposed thresholds for an initial filter of the asset manager universe and limiting the pool of asset managers for which more detailed data will be collected and to which the sector-specific methodology (set out in Section 7.4) will be applied.

As noted above, we disagree with the assertion in the Second Consultation stating that "[a]sset Managers with higher amounts of AUM may have a greater potential impact on the global financial system."[151] As such, while "[d]ata regarding an asset manager's global AUM generally is readily available,"[152] the application of AUM-based measurements as the initial filter in the NBNI G-SIFI methodology is not appropriate. A recent IMF analysis concluded that "funds managed by larger asset management companies do not necessarily contribute more to systemic risk. The investment *focus* appears to be relatively more important than *size* when gauging systemic risk."[153] We agree with this conclusion. AUM is not an indicator of the potential for an asset manager to present risk to financial stability. The largest asset managers tend to be diversified across asset classes, investment strategies, and/or types of clients. In BlackRock's case, our AUM is spread across equity, fixed income, cash, and alternative investments. These assets are managed by over 100 independent investment teams, each responsible for the investment decisions in the portfolios they manage and accountable for the performance of these portfolios.

A second measure of size that the Second Consultation proposes as an initial filter is the balance sheet of an asset manager. Again, there is no correlation to systemic risk. While balance sheet size may drive the potential systemic impact of a commercial bank, this is not the case for asset managers. The balance sheet of an asset management firm generally comprises working capital, an investment portfolio related to seed and co-investment capital, property, premises and equipment, thereby requiring a modest amount of capital. We note that accounting standards may lead to misleading conclusions. This is particularly important for asset managers which due to U.S. and international accounting standards, may be required to consolidate client assets on their balance sheets. For example, it is common for assets to be managed on behalf of UK pension schemes using an insurance company structure.[154] Accounting rules require that these equal and offsetting separate account assets and liabilities be recorded in the consolidated balance sheet of the asset manager. However, the assets that must be consolidated under the accounting rules are "ring-fenced" from the asset manager's assets and not available to creditors of the asset manager. This requirement has led to a misleading depiction of these asset managers' total assets due to the inclusion of these assets and liabilities on their balance sheet. We understand that the FASB in currently reviewing insurance company accounting, although there can be no certainty as to whether they will modify this presentation. Further, goodwill and intangible assets can also be a large component of asset managers' balance sheets. In the case of BlackRock, goodwill and intangibles and segregated client assets in which BlackRock has no economic interest or liability account for more than 95% of the assets on BlackRock's balance sheet as of December 2014. A simple review of the total assets under U.S. GAAP results in a misleading picture of BlackRock's balance sheet. Therefore, if a materiality threshold using balance sheet assets was used, it would make sense to deduct segregated clients assets as well as goodwill to establish the economic assets on balance sheet.

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151 Second Consultation at 52.

152 Second Consultation at 52.

153 April 2015 IMF GFSR at 93.

154 *See* footnote 64.

Exhibit 10: Analysis of BlackRock's Balance Sheet

Total Assets Under U.S. GAAP Basis:	$239,808 million
– Segregated Client Assets in which BlackRock has no Economic Interest*:	$198,728 million
– Goodwill and intangible assets, net:	$30,305 million
Economic Assets:	$10,775 million

**Includes Separate Account Assets / Collateral, Consolidated VIEs, Consolidated Sponsored Investment funds*
Source: BlackRock 10-K, as of December 31, 2014.

Appendix C provides an excerpt from BlackRock's 10-K filing, which includes a more detailed breakdown of BlackRock's balance sheet.

Q7-7. Please provide alternative proposals, if any, for a more appropriate initial filter (with the rationale for adoption and quantitative data to back-up such proposals).

We do not believe that metrics designed specifically to target asset managers are appropriate because asset managers are not the source of systemic risk. In reviewing the transmission mechanisms and impact factors outlined in the Second Consultation we find that none of the transmission mechanisms or indicators are applicable to asset managers. Asset managers are fundamentally different from banks and other financial institutions. Asset managers are not the counterparty to client trades or derivative transactions and do not control the strategic asset allocation of their clients' assets. Client assets are held separately from the asset manager by a custodian. Custodians facilitate changes from one manager to another.

Alternatively, a products- and activities-based approach that defines potential risks to financial stability and seeks to address them by improving regulation across the market ecosystem would be a better approach. We have identified several areas for consideration:

a. Improve market structure for central clearing of OTC derivatives by requiring greater financial resources for CCPs and clear rules for recovery and resolution.
b. Revisit private fund reporting to standardize definitions, reduce overlap and bespoke requirements. The AIFMD provides a framework that should be emulated in other jurisdictions.
c. Clearly and consistently define leverage to improve oversight and reduce risk. This should include derivatives, while recognizing that derivatives that are offsetting or hedging risks do not create leverage.
d. Further develop the "toolkit" for managing redemptions in funds.
e. Establish principles for stress testing fund liquidity using the AIFMD as the starting point.
f. Establish a global standard classification system for ETPs and review structural features of certain ETPs (e.g., leveraged, inverse, and bank loan).
g. Standardize guidelines for using cash re-investment vehicles in securities lending.
h. Improve underlying market structure for bank loans and for corporate bonds.
i. Broaden understanding and transparency of the entire financial market ecosystem.
j. Address the longevity crisis and pension underfunding.

We have explained each of these issues in more detail in our cover letter.

Q7-8. Please explain any proposed indicators set out above that, in your view, are not appropriate for assessing the relevant impact factors and its reasoning. What alternative indicators should be added and why would they be more appropriate?

As explained in our cover letter, we do not believe that any of the impact factors are applicable to asset managers. Therefore, we do not believe that any of the indicators are appropriate. See cover letter for further detail.

Q7-9. What are the practical difficulties (e.g. data availability, comparability) if any with collecting data related to these indicators? Please clarify which items, the practical problems, and possible proxies that could be collected or provided instead.

As explained in our cover letter, we do not believe that any of the impact factors are applicable to asset managers. Therefore, we do not believe that any of the indicators are appropriate. See cover letter for further detail.

Q7-10. Which of the proposed indicators set out above, in your view, should be prioritised in assessing the systemic importance of an asset manager?

As explained in our cover letter, we do not believe that any of the impact factors are applicable to asset managers. Therefore, we do not believe that any of the indicators are appropriate. See cover letter for further detail.

Appendix A: Emerging Markets Debt

10 Largest Emerging Markets Debt Funds

Fund Name	AUM ($ billions)	Domicile	Metric: AUM > $30B?
PIMCO Emerging Local Bond Fund A	8.5	US	NO
Stone Harbor Emerging Markets Local Currency Debt Fund	7.2	Europe	NO
Pictet-Emerging Local Currency Debt Fund	5.6	Europe	NO
HSBC GIF Global Emerging Markets Bond Fund	5.6	Europe	NO
Templeton Emerging Markets Bond Fund	5.5	Europe	NO
MFS® Emerging Markets Debt Fund	5.2	US	NO
Julius Baer BF Local Emerging Bond Fund	5.1	Europe	NO
PIMCO GIS Emerging Markets Bond Fund	4.8	Europe	NO
T. Rowe Price Emerging Markets Bond Fund	4.6	US	NO
Pioneer Funds – Emerging Markets Bond	4.5	Europe	NO

Source: Morningstar. As of date for fund AUM varies from February to March 2015. Includes 1940 Act Open-End Mutual Funds (U.S.) and Open-End UCITS (Europe). AUM has been converted to USD.

10 Largest Emerging Markets Debt Managers (incl. retail and institutional)

Manager	EMD AUM ($ billions)	Total Firm AUM ($ billions)	Primary Domicile	Metric: Firm AUM > $1T
Itau Unibanco	93	153	Brazil	NO
Banco do Brasil	84	209*	Brazil	NO
Bradesco	44	131*	Brazil	NO
Caixa Econômica Fed.	39	679*	Brazil	NO
HSBC Group	36	427.8**	UK	NO
Santander Group	34	199***	Spain	NO
PIMCO	28	1,680	US	YES
Stone Harbor	19	56.3	US	NO
Citigroup	18	-	US	NO
Pictet & Cie	15	151	Switzerland	NO

Source: eVestment, company websites.

* = Converted using Brazilian Real-US Dollar exchange rate at market close on Dec. 31, 2014 (0.3773). Source: Bloomberg.

** = Data as of Dec. 31, 2013

*** = Converted using British Pound-US Dollar exchange rate at market close on Dec. 31, 2014 (1.5577). Source: Bloomberg.

As of date ranges between December 2014 and January 2015 unless otherwise noted.

Appendix B: Firm and Fund Closures, Large Outflows, and Related Events in the Asset Management Industry over the Past 25 Years

Name	Event	Year	Resolution	AUM year of event (if known)	AUM after event (if known)
Barlow Clowes	Investment losses Fraud	1988	• Firm closed, funds liquidated, UK government made ex gratis payment to investors • UK Government repaid from trustees GBP120mn of GBP153mn payment-2011	GBP 188mn	GBP 30mn
Hyperion (Term Trusts 1997,99,03)	Investment losses-MBS	1993	• Civil litigation • Regulatory fines for fund marketers	U.S.D 1.5bn	U.S.D1.2bn
Piper Jaffrey/ Institutional Government Bond Fund	Investment losses-MBS	1994	• Fund closed to new investors - assets run off • Civil litigation. • Parent of manager sells stake to ITT insurance 1997	Fund: U.S.D 750mn	Initial drop to U.S.D 590mn then run off to zero.
TCW/Term Trusts 2000 & 2003	Investment losses-MBS	1994	• Civil litigation • Regulatory fines for fund marketers • Manager firm ownership change 1996	Two trusts: U.S.D 1.5mn	Initial drop to U.S.D 1.0mn Trusts liquidate at term end
Community Bankers MMF	Investment losses in structured notes	1994	• Fund liquidated September 1994	U.S.D 82mn	None
LTCM	Investment losses	1998	• Creditor investments to avoid loss • Firm closed • Creditors make small profits when unwind completed	U.S.D 5bn	U.S.D 60mn Creditors made whole
Advanced Investments Management	Breach of client guidelines (all separate accounts)	2002	• Firm closes 2002 • Civil litigation • Regulatory fines	U.S.D 5.5bn	U.S.D 15mn
Canary Capital Partners	Market timing Late trading	2003	• Fines • Principal receives 10 year bar	U.S.D 500mn	Not known
Alliance Capital Management	Market timing	2003	• Fines and Disgorgement • Management changes • Renamed Alliance Bernstein in 2006	U.S.D 434bn	U.S.D 456bn (U.S.D790m of mutual fund outflows from August 31 to November 30, 2003, increase in AUM attributed to market appreciation)

Name	Event	Year	Resolution	AUM year of event (if known)	AUM after event (if known)
Janus Capital Management	Market timing	2003	• Fines • Management changes	U.S.D 149bn	U.S.D 151bn (outflows of $3.2b from 8/31/2003 to 9/30/2003, increase in AUM attributed to market appreciation)
Pilgrim Baxter	Market timing	2003	• Principals barred • Old Mutual (owner since 2000) closes some funds; rebrands	U.S. 7bn	U.S.D 5.4b (20% decline from September 30, 2003 to December 31, 2003)
Putnam	Market timing	2003	• Management changes • Fines • Sold to Great West Life in 2007	U.S.D 277bn	U.S.D 263bn $14bn (5%) decline in first week of November 2003; U.S.D 141bn at 9/30/2013
Strong Capital	Market timing	2003	• Principal barred • Asset sale to Wells Fargo in January 2005	U.S.D 34bn	U.S.D 29bn
Absolute Capital Management	Securities fraud	2007	• Founder criminally charged • Multiple enforcement actions • Civil suits	U.S.D 3bn	U.S.D 885mn
Reserve Primary Fund	Investment losses	2008	• Fund in liquidation • Firm in liquidation	U.S.D 65 bn in fund U.S.D 125bn in total AUM	De minimis
Galleon Group	Insider trading	2009	• Firm closed • Founder criminally convicted • Funds liquidated 2009	U.S.D 7bn	None
Gartmore Group	"Star" manager departures	2010	• Sold to Henderson 2011	GBP 22bn	GBP 16bn
Axa Rosenberg	Concealed model error (fraud alleged)	2011	• Founder barred • Management changes	U.S.D 61bn	U.S.D 42bn
SAC Capital Management	Allegations of insider trading by portfolio managers	2008-2012-	• Firm to convert to internal management (per media reports)	U.S.D 15bn	U.S.D 9bn
PIMCO*	Key personnel departure	2014	• Management changes	U.S.D 1.97tn	U.S.D 1.68tn
Everest Capital / Everest Capital Global Fund	Investment losses-Swiss franc	2015	• Fund closed	U.S.D 3.0bn	U.S.D 2.2bn
Ashmore*	AUM fell by 15 per cent year on year – Emerging market volatility	2015	• Met $9.8bn in redemptions	U.S.D 75bn	U.S.D 63.7bn

*Represents large outflows, not fund or manager closures.

Appendix C
Excerpt-- BlackRock Form 10-K (information as of December 31, 2014)

As Adjusted Balance Sheet

The following table presents a reconciliation of the consolidated statement of financial condition presented on a GAAP basis to the consolidated statement of financial condition, excluding the impact of separate account assets and separate account collateral held under securities lending agreements (directly related to lending separate account securities) and separate account liabilities and separate account collateral liabilities under securities lending agreements, consolidated VIEs and consolidated sponsored investment funds.

The Company presents the as adjusted balance sheet as additional information to enable investors to exclude certain assets that have equal and offsetting liabilities or noncontrolling interests that ultimately do not have an impact on stockholders' equity (excluding appropriated retained earnings related to consolidated collateralized loan obligations ("CLOs")) or cash flows. Management views the as adjusted balance sheet, a non-GAAP financial measure, as an economic presentation of the Company's total assets and liabilities; however, it does not advocate that investors consider such non-GAAP financial measures in isolation from, or as a substitute for, financial information prepared in accordance with GAAP.

Separate Account Assets and Liabilities and Separate Account Collateral Held under Securities Lending Agreements

Separate account assets are maintained by BlackRock Life Limited, a wholly owned subsidiary of the Company, which is a registered life insurance company in the United Kingdom, and represent segregated assets held for purposes of funding individual and group pension contracts. The Company records equal and offsetting separate account liabilities. The separate account assets are not available to creditors of the Company and the holders of the pension contracts have no recourse to the Company's assets. The net investment income attributable to separate account assets accrues directly to the contract owners and is not reported on the Company's consolidated statements of income. While BlackRock has no economic interest in these assets or liabilities, BlackRock earns an investment advisory fee for the service of managing these assets on behalf of the clients.

In addition, the Company records on its consolidated statements of financial condition the separate account collateral received under BlackRock Life Limited securities lending arrangements as its own asset in addition to an equal and offsetting separate account collateral liability for the obligation to return the collateral. The collateral is not available to creditors of the Company, and the borrowers under the securities lending arrangements have no recourse to the Company's assets.

Consolidated VIEs

At December 31, 2014, BlackRock's consolidated VIEs included multiple CLOs and one private investment fund. The assets of these VIEs are not available to creditors of the Company and the Company has no obligation to settle the liabilities of the VIEs. While BlackRock has no material economic interest in these assets or liabilities, BlackRock earns an investment advisory fee, as well as a potential performance fee, for the service of managing these assets on behalf of clients.

Consolidated Sponsored Investment Funds

The Company consolidates certain sponsored investment funds primarily because it is deemed to control such funds. The Company may not be readily able to access cash and cash equivalents held by consolidated sponsored investment funds to use in its operating activities. In addition, the

Company may not be readily able to sell investments held by consolidated sponsored investment funds in order to obtain cash for use in the Company's operations.

	December 31, 2014				
		Segregated client assets generating advisory fees in which BlackRock has no economic interest or liability			
(in millions)	GAAP Basis	Separate Account Assets/ Collateral	Consolidated VIEs	Consolidated Sponsored Investment Funds	As Adjusted
Assets					
Cash and cash equivalents	**$ 5,723**	**$ —**	**$ —**	**$ 120**	**$ 5,603**
Accounts receivable	**2,120**	**—**	**—**	**—**	**2,120**
Investments	**1,921**	**—**	**—**	**17**	**1,904**
Assets of consolidated VIEs	**3,630**	**—**	**3,630**	**—**	**—**
Separate account assets and collateral held under securities lending agreements	**194,941**	**194,941**	**—**	**—**	**—**
Other assets[(1)]	**1,168**	**—**	**—**	**20**	**1,148**
Subtotal	**209,503**	**194,941**	**3,630**	**157**	**10,775**
Goodwill and intangible assets, net	**30,305**	**—**	**—**	**—**	**30,305**
Total assets	**$ 239,808**	**$ 194,941**	**$ 3,630**	**$ 157**	**$ 41,080**
Liabilities					
Accrued compensation and benefits	**$ 1,865**	**$ —**	**$ —**	**$ —**	**$ 1,865**
Accounts payable and accrued liabilities	**1,035**	**—**	**—**	**—**	**1,035**
Liabilities of consolidated VIEs	**3,634**	**—**	**3,634**	**—**	**—**
Borrowings	**4,938**	**—**	**—**	**—**	**4,938**
Separate account liabilities and collateral liabilities under securities lending agreements	**194,941**	**194,941**	**—**	**—**	**—**
Deferred income tax liabilities	**4,989**	**—**	**—**	**—**	**4,989**
Other liabilities	**886**	**—**	**—**	**18**	**868**
Total liabilities	**212,288**	**194,941**	**3,634**	**18**	**13,695**

	December 31, 2014				
		Segregated client assets generating advisory fees in which BlackRock has no economic interest or liability			
(in millions)	GAAP Basis	Separate Account Assets/ Collateral	Consolidated VIEs	Consolidated Sponsored Investment Funds	As Adjusted
Equity					
Total stockholders' equity[2]	**27,366**	**—**	**(19)**	**—**	**27,385**
Noncontrolling interests	**154**	**—**	**15**	**139**	**—**
Total equity	**27,520**	**—**	**(4)**	**139**	**27,385**
Total liabilities and equity	**$ 239,808**	**$ 194,941**	**$ 3,630**	**$ 157**	**$ 41,083**

(1) Amounts include property and equipment and other assets.

(2) GAAP amount includes $19 million of an appropriated retained deficit related solely to consolidated CLOs in which the Company has no equity exposure.