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September 21, 2016
Secretariat of the Financial Stability Board
c/o Bank for International Settlements
CH-4002
Basel, Switzerland

Re: Consultative Document: Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities

Dear Sir or Madam:

This letter presents the comments of Federated Investors, Inc. and its subsidiaries ("Federated") with respect to the Financial Stability Board's consultation regarding activities in the asset management sector (the "Consultation").[1] Federated is one of the largest investment management firms in the United States (the "U.S."). Federated's advisory subsidiaries managed $255 billion in money market assets and $367.2 billion in total assets as of June 30, 2016. As investment adviser to 123 registered funds and a variety of separately managed account options, Federated provides comprehensive investment management to more than 8,400 institutions and intermediaries including corporations, government entities, insurance companies, foundations and endowments, banks and broker/dealers.

Federated generally supports many of the recommendations made in the Consultation. We also agree with the recommendation that the International Organization of Securities Commissions ("IOSCO"), and national regulators, more generally, should take ample time (specifically, until year-end 2017) to study market and fund structures to develop any further guidance that might be appropriate. We do not, however, believe that the regulated fund industry, particularly in the U.S., creates financial stability risk, which appears to be the major premise of the Consultation. In particular, we agree with detailed comments provided by the Investment Company Institute that demonstrate that U.S. mutual funds do not contribute systemic financial risk and that additional prudential regulation is not warranted.[2] Furthermore, we emphasize that burdensome regulation that is motivated solely by theoretical concerns and is not supported on a cost/benefit basis will likely be challenged and defeated in many jurisdictions.[3] Therefore, the recommendations made by the Consultation should be viewed as

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[1] FIN. STABILITY BD., CONSULTATIVE DOCUMENT: PROPOSED POLICY RECOMMENDATIONS TO ADDRESS STRUCTURAL VULNERABILITIES FROM ASSET MANAGEMENT ACTIVITIES (2016), *available at* http://www.fsb.org/wp-content/uploads/FSB-Asset-Management-Consultative-Document.pdf.

[2] Letter from Paul Schott Stevens, President & CEO, Inv. Co. Inst., to Secretariat, Fin. Stability Bd. (Sept. 21, 2016) (on file with author).

[3] In the U.S., the U.S. Administrative Procedures Act, *see* 5 U.S.C. § 706(2)(A) (2014), and principles adopted by the U.S. Securities and Exchange Commission, *see* OFFICE OF INSPECTOR GEN., SEC, FOLLOW-UP REVIEW OF COST-BENEFIT ANALYSES IN SELECTED SEC DODD-FRANK ACT RULEMAKINGS 31–36 (2012), *available at* https://www.

guidance for national regulators to consider factors relating to the liquidity, leverage and other risks that are identified therein, but not a call to arms to enact burdensome new regulation intended to address hypothetical risk scenarios.

With this in mind, Federated directs its comments to three of the Consultation's recommendations. Set forth below are Federated's specific comments on Recommendations 4, 5 and 13.

I. **Recommendation 4: Where appropriate, authorities should widen the availability of liquidity risk management tools to open-ended funds, and reduce barriers to the use of those tools, to increase the likelihood that redemptions are met even under stressed market conditions. In this regard, IOSCO should review its existing guidance and, as appropriate, enhance it.**[4]

The U.S. Securities and Exchange Commission (the "SEC") recently issued a proposed rule on liquidity risk management that appears to address many of the specific considerations that the Consultation has outlined.[5] Federated agrees with many aspects of the SEC's proposed rule, although it strongly disagrees with certain proposals on the specific forms of granular data collection and reporting, as well as with the SEC's apparent determination that swing pricing is preferred to other alternatives.[6] Federated believes that IOSCO, and the SEC in particular, should give greater consideration to several suggestions made in Recommendation 4 with regard to the alignment of redemption features of regulated funds with asset class liquidity characteristics.

In particular, Federated recommended that the SEC set forth uniform requirements on fund redemption policies for less liquid asset classes, or those generally subject to greater transaction costs. As an example, the SEC should consider requiring that funds invested in less liquid asset classes settle redemption proceeds over a period of time consistent with the normal security settlement period for the underlying asset class. If this were done uniformly across the fund industry, and all advisers were subject to this requirement, then a material degree of mismatch could be eliminated without the need for further regulation or additional liquidity limitations on fund management.

Federated also strongly agrees with the Consultation's recommendation that regulators allow the use of a notice period as an effective tool to manage liquidity risks. Particularly in less liquid asset classes, regulators should allow funds to require that large redemptions be subject to a notice period of one, two, or more days. A large redemption made on day T would be processed and irrevocable on day T, but would be subject to day T + x pricing (where x is the notice period). In this

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sec.gov/about/offices/oig/reports/audits/2012/rpt499_followupreviewofd-f_costbenefitanalyses_508.pdf, require that new regulations be justified on a cost/benefit basis.

[4] FIN. STABILITY BD., *supra* note 1, at 17.

[5] Open-End Fund Liquidity Risk Management Programs; Swing Pricing; Re-Opening of Comment Period for Investment Company Reporting Modernization Release, 80 Fed. Reg. 62,274 (Oct. 15, 2015).

[6] Letter from J. Christopher Donahue, President and Chief Executive Officer, Federated Investors, Inc. & Michael R. Granito, Chief Risk Officer, Federated Investors, Inc., to Brent J. Fields, Secretary, SEC (Jan. 13, 2016) (*available at* https://www.sec.gov/comments/s7-16-15/s71615-50.pdf).

way, the fund adviser would be able to create the necessary liquidity to fund the redemption in an orderly way and the redeeming shareholder would experience the associated price uncertainty. Such a framework would also enable funds to coordinate the use of redemption fees with the use of a notice period. For instance, a fund could require that for redemptions above a certain threshold (say $250,000), the investor may choose between: (i) immediate pricing (day T) with normal settlement, in which case a redemption fee of y % is assessed; or (ii) giving the x day notice referenced above, in which case there is no redemption fee but proceeds are received with a delay. Such a framework would employ existing industry pricing mechanisms and operational infrastructure, and would not impose disruptive, costly and potentially risky alternatives such as swing pricing.

The SEC's rule proposal on liquidity risk is silent on both of these alternatives, and Federated has recommended both in its comment letter to the SEC.[7]

II. **Recommendation 5: Authorities should make liquidity risk management tools available to open-ended funds to reduce first-mover advantage, where it may exist. Such tools may include swing pricing, redemption fees and other anti-dilution methods. In this regard, IOSCO should review its existing guidance and, as appropriate, enhance it.**[8]

Federated agrees that regulators should provide tools to assist in liquidity risk management and we particularly agree with the Consultation's assessment that first-mover advantage does not *automatically* exist in open-end mutual funds. Federated believes that first-mover risks are not a material concern in U.S. open-end mutual funds due to the effectiveness of existing regulation, including the application of redemption fees under rule 22c-2 under the U.S. Investment Company Act of 1940.[9] We also strongly concur with the Consultation's approach, which advises that IOSCO commit to studying the issues and develop a toolkit over an ample period of time appropriate to the complexity of the questions.[10]

Federated has responded to the SEC's request for comment on its proposal to allow U.S. open-end mutual funds to adopt swing pricing or other alternatives, such as dual pricing.[11] In general, FII believes that cost/benefit analysis sufficient to conclude that swing pricing should be allowed, but that the other less onerous liquidity management tools should not be pursued, has not been conducted. In particular, the SEC has not considered the proposed alternatives identified above, which may provide a far simpler and less costly means of achieving their objectives than swing pricing, and the fund industry has not had an opportunity to comment on the relative merits of these approaches. As outlined in our comment letter, we also believe that swing pricing contains significant deficiencies compared to alternatives that have not been adequately evaluated by the SEC. Specifically:

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[7] *See id*.
[8] FIN. STABILITY BD., *supra* note 1, at 18.
[9] 17 C.F.R. § 270.22c-2 (2006). In addition to the impact of rule 22c-2, the growth of exchange traded funds has resulted in a decrease in much of the short term and momentum trading in open end mutual funds.
[10] FIN. STABILITY BD., *supra* note 1, at 18 ("IOSCO is encouraged to develop a toolkit of policy tools that may be effective to deter first-mover advantage, where it may exist, and to incorporate the toolkit into its principles of liquidity risk management by the end of 2017.").
[11] *See* Donahue & Granito, *supra* note 6.

1. Swing pricing could improperly enrich some investors at the expense of others.

2. Swing pricing may not have a beneficial impact on systemic risk. (Partial swing may create a first-mover advantage compared to full swing.)

3. Swing pricing could lead to increased volatility in fund performance and unnecessary randomness in both reported performance and in realized fund returns for individual investors.

4. Swing pricing could inevitably lead to efforts to game trading in a manner that would harm investors and the integrity of mutual funds generally. There is anecdotal evidence that improper communication currently takes place in some European jurisdictions that employ swing pricing.

5. Although "optional," the adoption of the proposed rule will effectively force larger funds to adopt swing pricing. Other funds may then be pressured to adopt if it were perceived that early adopters gained a business advantage

6. There are significant operational hurdles to implementing swing pricing.

7. The SEC's proposed requirement that funds may base swing procedures on information developed from "reasonable inquiry" is naïve and provides an inadequate standard for fund valuation practices. The "reasonable inquiry" standard tells the transacting shareholder that they can only be "reasonably confident" that they received the correct price, as opposed to one that improperly enriched other shareholders or penalized their account.

8. Without adequate investor education, swing pricing could lead to investor confusion and impair mutual funds as an investment vehicle.

For these reasons, Federated recommends that IOSCO and national regulators follow the advice provided by the Consultation and develop their liquidity management toolkits over a span of time (proposed as 18 months) that allows for an adequate cost/benefit assessment of the available alternatives.

III. **Recommendation 13: Authorities should have requirements or guidance for asset managers that are large, complex, and/or provide critical services to have comprehensive and robust risk management frameworks and practices, especially with regards to business continuity plans and transition plans, to enable orderly transfer of their clients' accounts and investment mandates in stressed conditions.**[12]

Federated agrees with the Consultation's guidance that advisers should have strong risk management disciplines including business continuity plans. Federated has also commented on

[12] FIN. STABILITY BD., *supra* note 1, at 31.

the SEC's recent rule proposal on this subject.[13] As we point out in that comment,[14] we believe that the regulated open-end fund industry has not been a material source of financial stability risk and the nature and frequency of transition events among U.S. mutual fund advisers does not warrant the creation and maintenance of costly transition plans as envisioned by the SEC's rule proposal. Instead, we believe that transition plans should be higher-level principles-based documents that identify how an adviser would approach asset transitions in normal or stressed market environments. Any more detailed or granular statements of transition planning, for instance, in stressed market conditions, would be completely speculative as the specifics of any transition are highly dependent on the particular circumstances of giving rise to the transition. If a regulator is particularly concerned regarding certain assets, such as OTC derivatives, that might be particularly impacted in any transition, or may more likely require sale or termination, then such information can be readily maintained. An open-ended codification of detailed transition planning as outlined in the SEC's proposed rule, however, is not realistic or justified on a cost/benefit basis.

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Federated hopes that the Financial Stability Board finds these comments helpful and constructive and is happy to provide additional information relating to our comments or discuss any questions you may have.

Yours very truly,

M. Granito

Michael R. Granito
Senior Vice President
Chief Risk Officer

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[13] Adviser Business Continuity and Transition Plans, 81 Fed. Reg. 43,530 (July 5, 2016).
[14] Letter from Michael R. Granito, Senior Vice President & Chief Risk Officer, Federated Investors, Inc., to Brent J. Fields, Secretary, SEC (Sept. 2, 2016)