FRANKLIN TEMPLETON
INVESTMENTS

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Mr. Svein Andresen
Financial Stability Board
c/o Bank for International Settlements
CH – 4002 Basel
Switzerland

Re: Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions – FSB's March 4, 2015 Proposal

Dear Mr. Andresen:

Franklin Resources Inc. is pleased to provide comments on the FSB/IOSCO Consultative Document, "Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions – Proposed High-Level Framework and Specific Methodologies" (the "Proposal") of March 4, 2015. We appreciate the FSB's efforts to engage asset managers to further its understanding of the asset management industry in connection with its mandate to identify and monitor risks to the financial stability of global markets. We were happy to participate as a panelist at the FSB's April 14, 2015 meeting at the New York Federal Reserve; some of the comments that we made at that meeting are repeated below.

Franklin Resources is a global investment management organization known as Franklin Templeton Investments ("Franklin"). Headquartered in San Mateo, California, we employ over 9,000 people and have offices in 35 countries and clients in more than 150 countries. Our common stock is listed on the New York Stock Exchange under the ticker symbol "BEN" and is included in the Standard & Poor's 500® Index. As of April 30, 2015, Franklin had assets under management of over $894 billion, including significant assets in both U.S. and UCITS funds.

Over the last several years, Franklin, both directly and as a member of the Investment Company Institute ("ICI"), the European Fund and Asset Management Association ("EFAMA") and the Asset Management Group of the U.S. Securities Industry and Financial Markets Association ("SIFMA"), has supported efforts to enhance regulation in response to the events of the global financial crisis ("GFC"). As a significant investor (as agent on behalf of our clients) in virtually every global capital market and as an issuer of securities, we support appropriate regulation to ensure the resiliency and vibrancy of the global financial system.

We write today to endorse the ICI, EFAMA, SIFMA and Institute of International Finance ("IIF") comment letters filed with the FSB, to which we contributed. In addition, we provide below both general and specific comments on the Proposal (focusing on investment funds). Included in those comments are analyses of the impact of heavy redemptions on the trading activity of some of our bond funds and of our public funds' actual experience during the GFC.

Background on Franklin

Franklin has been in the asset management and investment fund business for 67 years and has been a leader in global investing since the 1950's. We have seen and managed our clients (both investment funds and institutional accounts) through every significant market cycle and crisis after the Great Depression. Such crises include the US market crash of 1987, the Mexican and other Latin American debt crises, the Asian crisis, the Russian crisis, the Dotcom Bubble and the GFC.

We manage over $500 billion in U.S. public (regulated) funds and over $200 billion in UCITS and other non-U.S. public funds. Thus we have both a historic and a global perspective on the Proposal. Based on our perspective and the long experience behind it, we make the following comments.

1. **"Failure" of a fund is a banking concept not relevant to the public fund market**

Throughout our history, including in various market crises, we have never seen anything even approaching a "run" on any of our investment funds. We think that this is in large part because our regulated funds (or, using the Proposal's term, "public" funds) are subject to detailed substantive regulation (by a variety of global securities regulators) in areas including portfolio liquidity and diversification, custody of assets, and limits on leverage and counterparty exposure. Thus, we strongly believe that the chances of "failure" or even "distress," of a large public fund are remote and close to nil. Moreover, even if the FSB insists on exploring this remote, speculative scenario, any such analysis must be based on empirical evidence and not conjecture, and as we discuss below, such analysis could only lead to the conclusion that the failure or distress of an individual public fund would not trigger systemic problems globally.

2. **The empirical data we have does not demonstrate that funds—especially individual ones—are potential generators of global systemic risk.**

Our Actual Experience Globally in Heavier Redemption Periods

We recently undertook an analysis of several of our funds (both U.S. and UCITS) and looked at month-end data from January 1, 2001- December 31, 2014 to identify periods of heavy redemptions (defined as days where the daily net redemption rate exceeded

1% of total net assets of a fund) (each a "Heavy Redemption Day"). We then reviewed portfolio trading activity during each Heavy Redemption Day to determine to what extent these days coincided with negative variances of 5% or more between the price of the security valued by the fund and the price at which the fund actually sold the security. A significant negative variance between the price at which the security was valued by the fund and the selling price could suggest a correlation between heavy redemption activity and a resulting lack of market liquidity, whereby a manager is unable to dispose of a security at the price at which the security is carried.

For one of our global fixed income portfolios, there was a negative variance of 5% or more for less than 1% of the sales during the Heavy Redemption Days. Put another way, for this portfolio, over 99% of the sales were made at a price where the fund received at least 95 cents on the dollar compared to the value of the security carried by the funds. Similarly, for one of our emerging market fixed income portfolios, there was a negative variance of 5% or more for less than 1% of the sales during the Heavy Redemption Days; stated otherwise, over 99% of the sales were made at a price where the fund received at least 95 cents on the dollar. And for one of our balanced portfolios, there was a negative variance of 5% or more for less than 2% of the sales during the Heavy Redemption Days; stated otherwise, over 98% of the sales were made at a price where the fund received at least 95 cents on the dollar. We believe that this analysis provides a strong indication of the liquidity of the global markets to support periods of heavy redemption activity.

Moreover, it is important to note that investment funds have forward pricing. Thus, even in the rare case of a 5% negative variance, a redeeming shareholder received 100% of the fair value of his or her holdings when he or she redeemed.

Our Actual Experience Globally During GFC

We would also like to share Franklin's experience during the GFC. During the height of the GFC (October 2007-March 2009), when global market indices such as the S&P 500, the FTSE 100 and the DAX saw 40-50% declines, monthly net outflows for Franklin's U.S. public funds (expressed as a % of assets as of the beginning of the month) averaged less than one-half of one percent (< 0.5%); those funds actually experienced positive net inflows in 4 of those 18 months. In the 18 month period after March 2009, Franklin's U.S. public funds experienced positive net inflows for all 18 months (advancing on average approximately 0.7% per month during this period). At the end of this 18-month period, our U.S. public fund assets totaled approximately $358 billion, down only slightly less than 5% from the beginning of the GFC.

Similarly, during the height of the GFC, monthly net outflows for Franklin's non-U.S. (mostly UCITS) funds (expressed as a % of assets as of the beginning of the month) averaged less than one percent (< 1%); those funds experienced positive net inflows in 8 of these 18 months. In the 18 month period after March 2009, Franklin's non-U.S. public funds experienced positive net inflows for all 18 months (advancing on

average 3.5% per month during this period). At the end of this 18 month period, assets in these funds totaled approximately $109 billion, an increase of more than 50% from the beginning of the GFC.

3. **The research does not show that individual funds could cause systemic risk in a particular market.**

In the Proposal, FSB proposes certain materiality thresholds relating to individual funds. In the discussion of the Asset liquidation/Market channel (6.2.2), the FSB cites "certain studies" that may have indicated that "concentrated selling by investment funds, particularly in less liquid markets (e.g., high yield corporate debt, emerging market debt) can result in significant pricing pressures that propagate market contagion". We have three serious concerns about that speculation.

First, as the Proposal itself notes, "The abundant academic research on capital markets contagion, however, does not generally focus on individual investment funds, but rather the investment funds' aggregate contribution to market movements". Thus, the cited research does not purport to show that (even a large) individual fund in a particular market could be systemically risky.

Second, we commend to your attention the detailed research performed by ICI and described in its April 2015 paper (the "ICI Paper") regarding the role of public investment funds in both debt and equity emerging markets.[1] The ICI research demonstrates that while public funds have contributed to the broad trend of portfolio capital flows to emerging economies over the past decade (and thus have been a helpful source of financing), they are unlikely to pose systemic risk to emerging markets. ICI's empirical research shows that there are three main reasons for this. First, fund holdings of emerging markets securities represent a small portion of the total value of emerging market equities and bonds. Second, public funds represent a very stable part of the foreign investor base in emerging market countries; on average, public funds accounted for less than 15% of the variance of foreign portfolio capital flows in emerging markets from 2005 to 2013. Third, public funds' holdings in emerging markets are well diversified across a wide number of such economies (at least 85 different countries).

Finally, our own experience as an investor in both debt and equity securities in virtually every emerging market has shown that, even in times of market turbulence (where emerging market economies often are the most affected) such as the GFC, neither our funds' shareholders nor our funds' portfolios have seen, let alone caused, any signs of distress. Indeed, the internal analysis in our point #2 above included fourteen years of experience for one of our emerging markets bond portfolios.

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[1] http://www.ici.org/pdf/icig_per02-01.pdf

It is certainly fair to conclude that if investment funds in the aggregate pose no systemic risk in respect of their activities in emerging markets, then an individual fund would not pose such risks.

4. **Geographic diversity of portfolio and investor base is risk-limiting, not risk-enhancing**

Many of our U.S. and non-U.S. funds invest on a global basis, and our primary UCITS umbrella is authorized for sale in 51 countries. It is our experience that investments in multiple jurisdictions - and for that matter, having investors in multiple jurisdictions - should be indicative of reduced potential for systemic risk due to the greater diversification of a fund's asset and investor bases. Thus, we believe that indictor 6.4.5 is fundamentally wrong and should be deleted.

As noted in our point #3 above, the ICI Paper found that public fund holdings in emerging market securities are diversified across a wide number of such markets, and this diversification limits the potential effects of their portfolio transactions on any particular market. As the ICI concludes, "Regulated fund holdings are spread across more than 85 different countries, and if there were investor outflows from U.S. and European regulated funds, funds could accommodate them by selling a small amount of securities from a wide range of those countries". This empirical reality highlights one of the central pillars of public fund regulation (and a hallmark of both the Investment Company Act of 1940 and the UCITS Directive): portfolio diversification requirements.

Similarly, a typical large UCITS fund has a widely diversified investor base across multiple countries (both within the EU and beyond) and across different investor types, including individuals, institutions, retirement plans and insurance accounts. (This is the natural consequence of the UCITS "passport".) Our experience over the past twenty-five years is that such investor base diversification provides a significant amount of stability to a fund, particularly in times of market disruptions. Investors in one country or region simply do not act in lockstep with investors in other countries or regions.[2]

5. **To the extent the FSB concludes that investment funds are potential sources of systemic risk, the primary fund regulators should be responsible for addressing these issues**

Even if the FSB were to conclude that certain investment funds pose systemic risks (notwithstanding the points noted above), we believe it is critical that it defer taking action to implement any possible restrictions until the funds' primary regulators

[2] While most U.S. public funds do not have multi-national investor bases, they likewise tend to have very diversified investors, including individuals, institutions, retirement plans and insurance accounts. These investors do not act in lock-step, and many of them invest on pre-programed schedules.

complete implementation of recently-adopted, risk-limiting regulations and have an opportunity to develop new regulations in this area. For example, as the U.S. Financial Stability Oversight Council points out, the SEC has announced several initiatives on its regulatory agenda for 2015 that would address many of the risks identified in the Proposal, including (i) rules requiring funds to adopt and implement liquidity management programs; (ii) rules for stress testing by large asset managers and funds; (iii) rules regarding the use of derivatives and how such use is disclosed to investors; (iv) enhanced reporting by funds on their operations and portfolio holdings; and (v) enhanced reporting by advisers regarding separately managed accounts.[3] Indeed, on May 20, 2015, the SEC proposed rules that will enhance its ability to monitor portfolio composition and risk exposures among advisers, funds and separate accounts, and which Chair White stated would enable the SEC to better monitor and address as appropriate any risks that the asset management industry may pose to the overall stability of the U.S. financial system.[4]

In the EU, significant regulation of funds and fund managers—notably under the UCITS and AIFIM Directives—has already addressed or will soon address some of the key risks identified in the Proposal. For example, under AIFMD, depositaries (most of which are already designated as G-SIBs) essentially have strict liability for safekeeping of fund assets. UCITS V will impose substantially that same liability on UCITS depositaries from early 2016. MiFID 2 will impose, among other things, significant new trade reporting, cost disclosure and product governance requirements. Both AIFMD and UCITS, moreover, have significant risk management program requirements that continue to be implemented by national regulators, with guidance from ESMA. Liquidity risk management is a key piece of such programs.

Moreover, the EU and the U.S. are working together both to implement regionally and to coordinate cross-border on new rules on the trading, clearing and reporting of derivatives. The EU's EMIR will require central clearing of many OTC contracts, and G-20 regulators are now adopting margin rules for uncleared derivative contracts. Given the fundamental role that the primary regulators play, we urge the FSB to allow these rulemaking processes to proceed before taking a decision whether to impose any new restrictions on asset managers and the funds and accounts that they manage.

We also wish to take issue with a recent tendency by banking regulators globally to suggest that securities regulation "only focuses on investor protection" and doesn't provide needed "prudential supervision." We believe that this is at best misleading. Many of the "investor protection" rules for public funds and asset managers provide precisely the sort of market-risk-limiting protections that FSB deems necessary. Pending and proposed rules will enhance those protections. Examples of these protections include: (1) leverage limitations; (2) liquidity requirements; (3) limits on counterparty exposure; (4) margin and other collateral requirements; (5) business continuity

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[3] Unified Agenda of Regulatory and Deregulatory Actions (Fall 2014)

[4] *See* Investment Company Reporting Modernization, SEC Rel. IC-31610 (May 20, 2015); Amendments to Form ADV and Investment Advisers Act Rules, SEC Rel. IA-4091 (May 20, 2015).

requirements; (6) risk (including liquidity risk) management programs; (7) portfolio diversification rules; (8) stress testing requirements; (9) enhanced reporting of derivatives, securities lending activities, liquidity and pricing of portfolio instruments; and (10) depositary/custody requirements.

6. **Designations of individual public funds would be bad for markets and investors**

Finally, we urge the FSB to consider another very practical reason why additional, "prudential" regulation of certain public funds by banking regulators would be a mistake: it would harm markets and investors.

As ICI has pointed out in the case of U.S. public funds, a SIFI designation would trigger U.S. Federal Reserve oversight. This could lead to a highly problematic situation where, in the case of a market or banking crisis, the Fed could direct a public fund not to honor certain redemptions, to make (or not make) certain investments or not to enforce or abide by certain trading or other agreements. This sort of scenario could directly harm fund investors by forcing fund managers to abdicate their fiduciary duties to such investors.

Moreover, a SIFI designation in any jurisdiction would impose unfair competitive restraints on designated funds and/or asset managers. Any resulting higher costs would be passed on to investors. Further, investors could be discouraged from investing in designated funds, as such funds could be subjected to the limitations on investments and redemptions noted above, thereby reducing competition.

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We appreciate the opportunity to share our views with the FSB. For the reasons noted, we believe that the proposed designation of public (regulated) investment funds (or their managers) as systemically important financial institutions has no credible basis and would only serve to harm investors and the financial markets.

Sincerely,

Craig S. Tyle
Executive Vice President and General Counsel