MUTUAL FUND DIRECTORS FORUM

The FORUM *for* FUND INDEPENDENT DIRECTORS

May 29, 2015

Via email to fsb@bis.org

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

Re: Request for Comment on Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions (2nd Consultative Document)

To the Financial Stability Board:

The Mutual Fund Directors Forum ("the Forum")[1] welcomes the opportunity to respond to the request for comments of the Financial Stability Board ("FSB") on its second consultative document on Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions ("the Request").

The Forum is an independent, non-profit organization for the independent directors of U.S. based investment companies and is dedicated to improving mutual fund governance by promoting the development of concerned and well-informed independent directors. Through education and other services, the Forum provides its members with opportunities to share ideas, experiences and information concerning critical issues facing investment company independent directors and also serves as an independent vehicle through which Forum members can express their views on matters of concern.

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We recognize the value in and importance of the FSB's continued exploration of whether non-bank, non-insurer actors such as investment funds pose systemic risks within the global financial system. Asset managers and the investment funds they manage are important players globally, and hence their role in and effect upon the global financial system is important to analyze and understand. However, as has been pointed out by numerous other commentators, the asset management industry, considered broadly, is less likely than other segments of the

[1] The Forum's current membership includes over 887 independent directors, representing 122 mutual fund groups. Each member group selects a representative to serve on the Forum's Steering Committee. This comment letter has been reviewed by the Steering Committee and approved by the Forum's Board of Directors, although it does not necessarily represent the views of all members in every respect.

financial services industry to be a source of systemic risk, largely because asset managers typically act as agents for other investors[2] and the risks inherent in their activities are more investment risks borne by asset owners than systemic risks to the global financial system. We will not repeat those arguments here, but strongly urge the FSB to analyze the nature and extent of any risks posed by asset managers in the context of the types of risks posed by other groups that play key roles in the markets and the financial services industry.

As an organization for the directors of U.S.-based mutual funds, our comments are focused primarily on whether, and under what conditions, mutual funds registered under U.S. law should be designated as systemically important entities. As we discuss in further detail below, we believe that the nature and quality of U.S. regulation of funds combined with the oversight of registered funds by independent boards of directors renders them unlikely to be sources of systemic risk.[3]

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If adopted, the approach outlined in the Request for identifying globally systemically important investment funds would rely largely on quantitative factors to determine whether an individual investment fund, including an individual U.S.-based mutual fund, is globally systemically important. These factors include the size of the fund, its leverage ratio and other measurements of its use of leverage, its exposures to counterparties, the liquidity of the underlying securities in which it invests, the level of its cross-jurisdictional activities and so forth.

In all likelihood, few individual U.S.-registered mutual funds would meet the size- and leverage-based materiality requirements proposed in the Request, much less trigger concern under the other quantitative factors the Request suggests would be used in a deeper analysis. Hence, under the analysis the Request suggests, we believe that virtually no U.S.-based mutual funds could be deemed systemically important. However, even if adoption of the proposed framework would not lead to this conclusion, we are concerned that the framework is flawed, as we believe it ignores important qualitative factors, including the manner in which the U.S. fund industry is regulated and the important role that independent directors play in the oversight of U.S. mutual funds.

The context of U.S. regulation is important. Unlike other pooled asset management vehicles, mutual funds (or, more broadly, registered investment companies, including registered

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2 *See, e.g.,* Investment Company Institute, "Viewpoints: Simple Answers to the Federal Reserve's Quandaries" (Feb. 24, 2015) (citing ICI studies on fund investor behavior that show that mutual funds are unlikely to pose serious run risk in times of financial stress) (available at http://www.ici.org/viewpoints/view_15_fed_response).

3 While we believe that money market funds registered and regulated in the United States under the Investment Company Act of 1940 are also unlikely to pose systemic risks, we do not address these funds in detail below, as these funds have been subjected to an extensive regulatory process in the United States designed to mitigate whatever systemic risks they might pose.

closed-end funds) are extensively regulated under the Investment Company Act of 1940 (the "Investment Company Act"). This regulatory regime results in a type of investment fund that is both distinct from other types of investment funds and unlikely to pose systemic risk. Among other things, the Investment Company Act imposes standards and limitations on:

- The use of leverage and borrowings by registered funds;
- The portfolio liquidity of registered funds;
- The ability of registered funds to invest in illiquid and levered securities;
- The manner and timeframes within which registered funds accept and meet redemption requests; and
- The manner in which portfolio securities are valued and net asset values are computed.

Regardless of investment strategy, all funds must comply with the strictures of the Investment Company Act. These limitations result in retail investment products that use less aggressive investment techniques, and are thus less susceptible to rapid changes in value that may prompt runs. More broadly, considered together, these regulatory restrictions prevent funds from implicating the types of concerns identified in the Request and thus significantly reduce the risks that funds pose to the financial system as a whole.

Moreover, a fund's compliance with these restrictions is not solely controlled by an asset manager who may have conflicts or divided loyalties; rather, a fund's compliance with regulatory requirements is overseen by a board that is independent of the manager. Indeed, the requirement that a U.S. based mutual fund have an independent board of directors that both oversees the fund's compliance with applicable law and seeks to ensure that the fund is operated in the best interests of its shareholders is unique to the U.S. system of regulation.

Fund boards are extremely valuable because they add a qualitative approach to a regulatory system that is mainly quantitative in nature (that is, it sets specific standards that funds must meet such as liquidity and average portfolio duration). Boards also supplement the efforts of regulators by being able to respond quickly to the specific situations their funds face and by having the flexibility to develop solutions, within the context of the regulatory structure, to address the facts and circumstances of the funds they oversee. This flexibility, including the Board's ongoing oversight of the manner in which the adviser complies with the liquidity and leverage limitations in the Investment Company Act, tends to mitigate significantly the small risks posed by mutual funds to the financial system even further.

Additionally, the United States Securities and Exchange Commission ("SEC") has adopted a proactive approach to the question of systemic risk. The SEC's familiarity with the nature and operations of U.S.-based mutual funds allow its regulatory actions to be more sensitive to the regulatory and financial context in which mutual funds exist than any framework that might be imposed by a different regulator or standards-setting body less familiar with the nature and operations of U.S.-based mutual funds. Specifically, in 2009 the SEC established the Division of Economic and Risk analysis which is charged with identifying, analyzing, and responding to risks and trends associated with financial products. In addition, the SEC's regulatory agenda, as highlighted in recent speeches by its Chair, makes clear that the SEC is

focusing on many of the issues raised in the Request.[4] Compared with the uniform and quantitative based approach that the FSB is considering, the SEC's experience leaves it much better positioned to address these issues and analyze the full effect of any possible regulatory changes on the industry, on investors and on the financial system. The SEC's ability to oversee a broad swath of the industry and balance factors ranging from investor protection to the mitigation of risks inherent in the system is critical to ensuring that markets operate fairly, efficiently and without imposing unintended and unmitigated risks to overall financial stability. We encourage the FSB not to undermine the SEC's role.

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For similar reasons, we believe that an asset manager should not be declared systemically important merely because the complex of U.S.-registered funds that it advises and manages, considered in isolation, might appear to trigger the quantitative factors that the FSB identifies when discussing both investment funds and asset managers. Each individual fund overseen by a single manager is subject to the same regulatory restrictions, including oversight by an independent board of directors. For the reasons that we have already discussed, these facts render any single fund unlikely to pose systemic risk, and similarly keep the complex as a whole from posing systemic risk.

Finally, we urge the FSB to keep in mind the costs of unnecessarily declaring funds to be systemically important or creating a framework that will force advisers to manage their funds in a manner to avoid triggering additional, unnecessary regulatory requirements. As we have outlined above, funds and fund complexes are unlikely, by themselves, to pose systemic risks. But they do play a crucial role in the financial system – in the United States, mutual funds are the primary vehicles by which families save for their retirement, their children's education, and other family financial goals. Regulation is often costly for mutual funds, and when that regulation does not produce real benefits, the cost is ultimately borne by fund investors.

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In conclusion, we very much appreciate the opportunity to participate in the FSB's examination of whether investment funds pose significant risks to global financial stability on behalf of our independent director members. As our comments, and the likely comments of many other industry participants, demonstrate, the mutual fund segment of the asset management industry is unlikely to pose risk. We believe that the FSB should not adopt a framework for analyzing investment funds that fails to recognize the importance of the structure of U.S. registered funds. Quantitative factors embedded in the Investment Company Act, such as those that limit leverage and require funds to maintain certain levels of portfolio liquidity, combined with the qualitative oversight provided by mutual fund independent directors tend to mitigate any systemic risk posed by registered funds. In addition, the SEC has the necessary experience with

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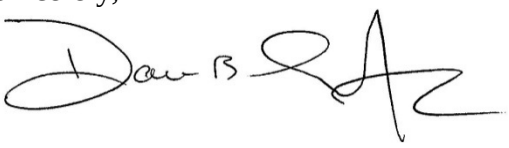
[4] *See, e.g.*, Mary Jo White, "Enhancing Risk Monitoring and Regulatory Safeguards for the Asset Management Industry" (Dec. 11, 2014) (available at http://www.sec.gov/News/Speech/Detail/Speech/1370543677722#.VQCiCeGu-ao). The SEC recently proposed an initial set of rules focused on data gathering to advance these goals. *See Proposed Rules: Investment Company Reporting Modernization*, Release No. 33- 9776 (May 20, 2015) (available at http://www.sec.gov/rules/proposed/2015/33-9776.pdf).

U.S. registered funds to make any necessary enhancements to the regulatory regime to manage any systemic risk posed by registered funds. We urge the FSB not to create a framework that would add unnecessary regulatory requirements that would compromise America's savings goals without producing any real benefits to the global financial system.

We welcome the opportunity to discuss our comments with you in more detail. Please feel free to contact Susan Wyderko, the Forum's President, at 202-507-4490 or David Smith, the Forum's General Counsel, at 202-507-4491, if you would like to follow up on any of our comments.

Sincerely,



David B. Smith, Jr.
General Counsel