STATE STREET GLOBAL ADVISORS.

29 May, 2015

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

Via email: fsb@bis.org

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Consultative Document (2nd): Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions - Proposed High-Level Framework and Specific Methodologies

Dear Sir or Madam:

State Street Global Advisors ("SSGA"), the investment management division of State Street Bank and Trust Company, appreciates the opportunity to comment on the Financial Stability Board ("FSB")-International Organization of Securities Commissions ("IOSCO") Consultative Document (2nd) "Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions - Proposed High-Level Framework and Specific Methodologies" issued on March 4, 2015 (the "Consultation"), which proposes assessment methodologies for identifying non-bank non-insurer ("NBNI") global systemically important financial institutions ("NBNI G-SIFIs").

SSGA is the investment management division of State Street Corporation, managing $2.42 trillion in assets[1] for public and private retirement plans, large corporations, non-profit organizations, insurance companies, banks, sovereign wealth funds, central banks, and other official institutions. SSGA's parent company, State Street Corporation, is one of the world's leading providers of financial services to institutional investors including investment servicing, investment management and investment research and trading. With $28.47 trillion in assets under custody and administration, State Street operates in more than 100 geographic markets worldwide. State Street has been designated a Globally Systemically Important Bank ("G-SIB") by the FSB.

While I am writing today on behalf of SSGA, our comments today are consistent with the views of our parent company, State Street Corporation**.**

Summary

SSGA continues to support global regulator efforts to identify and mitigate sources of potential systemic risk across the financial system. We continue, however, to be concerned by the FSB and IOSCO's continued focus on the designation of individual asset managers or funds as Globally Systemically Important Institutions ("G-SIFIs"), which we believe will be counterproductive to global systemic risk reduction goals, and harm investors who depend on asset managers and funds to provide safe, low cost access to capital markets, particularly for retirement savings.

[1] As of March 31, 2015.

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Financial Conduct Authority.

Should the FSB and IOSCO proceed with the proposed asset management G-SIFI designation regime, SSGA remains concerned that, despite greater focus on leverage than in the first consultation, the proposed criteria still focus unduly on the size of the asset manager or fund. Size, unless paired with other factors, such as leverage, is not a reliable indicator of potential systemic risk, particularly for funds managed to diversified, highly liquid indexes. Should the FSB and IOSCO proceed with the proposed G-SIFI designation regime, we suggest the criteria be adjusted to more suitably focus on factors more relevant to systemic risk than size alone.

As an alternative to the FSB and IOSCO's current focus on designation of asset management G-SIFIs, SSGA recommends further work among policy-makers and regulators to review and identify potential systemic risks presented by market-wide asset management activities and practices. SSGA continues to believe that an industry-wide focus, supported by increased and more effective systemic risk data collection, will allow global regulators to address potential systemic risks without the market disruptions and negative impact on investors associated with designation of individual asset manager G-SIFIs.

Our comments below focus on three broad areas:

1) The lack of evidence that individual managers or funds meet the G-SIFI standard as laid out by the FSB in October 2010;
2) The undue influence of size alone as a key criteria in the proposed designation approach; and
3) The benefits of an alternative approach to systemic risk focused on market-wide activities and practices.

Individual managers or funds do not meet the G-SIFI standard.

As in our comment letter on the FSB and IOSCO's first proposal[2], we urge the FSB and IOSCO to reconsider their approach, and instead focus on market-wide practices and/or activities that could contribute to systemic risk, and consider potential enhancements to existing jurisdictions' regulatory regimes under which asset manager and investment funds provide services to investors.

The FSB has set a very high standard for identifying G-SIFIs, which they define as "institutions of such size, market importance, and global interconnectedness that their distress or failure would cause significant dislocation in the global financial system and adverse economic consequences across a range of countries.[3]" From SSGA's perspective, very few, if any, individual asset managers or investment funds meet this very high standard.

First, traditional asset management is an agency activity. Managers advise investors in a broad range of investment strategies--passive index strategies, active strategies, and, in some cases, leveraged strategies--which permits investors to take on financial market exposures of their choosing. As agents, asset managers have relatively small balance sheets, and earn income through fees assessed on the funds. Investment funds themselves are comprised of investors' funds, and simply hold assets on behalf of the fund's investors. As a

[2] "Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions", Financial Stability Board (January 8, 2014)

[3] "Reducing the moral hazard posed by systemically important financial institutions", Financial Stability Board (October 20, 2010)

result, the business model followed by asset managers is dramatically different than the business model of other market participants, such as banks, where credit intermediation is a key function.

Second, while the funds being considered for G-SIFI designation by the FSB and IOSCO may be large, size alone is a poor indicator of systemic risk for asset management.[4] The largest funds are typically passive funds tracking a major index, operating without leverage and with underlying assets in the most highly transparent and liquid markets. Such funds merely reflect investors' interest in holding highly diversified and liquid assets at a low cost, and are investment strategies that can easily be replicated by alternative providers or direct investment in the markets.

Third, existing regulations address many of the concerns raised by the FSB and IOSCO. For managers and funds, local jurisdictions impose comprehensive regulations, including, for example, liquidity rules and leverage limits for funds that offer daily liquidity to investors. Prudential rules on other market participants, particularly banks, also address the FSB's and IOSCO's concerns, by imposing capital, liquidity, and credit concentration limits on counterparties of investment funds. Perhaps most importantly, regulation of managers and funds focuses on the enforcement of clear, efficient, and effective segregation between clients' assets and the asset manager's balance sheet, greatly limiting the potential for systemic risk and contagion when either the fund or manager encounters financial stress.

Fourth, many of the most important concerns of the FSB and IOSCO, such as undue leverage, are being addressed indirectly through significant strengthening of the banking sector. A new global regulatory regime for swaps, which provides synthetic leverage to funds, is being implemented, and new prudential rules for banks (capital, leverage, liquidity, large exposures) will reduce systemic risks transmitted through borrowing of funds. Similar initiatives are underway to strengthen regulation and best practices for securities financing transactions ("SFTs"), including the securities lending activities often used by investment funds.

Finally, while not directly related to the FSB's and IOSCO's proposed designation process, we are concerned that identifying only certain managers or funds as G-SIFIs will have a distortive effect on capital markets, have a negative competitive effect for designated firms or funds, and unnecessarily hurt investors with no attendant reduction in systemic risk. On the contrary, systemic risk is likely to be *higher* as a consequence of a shift in both the supply and demand of investment funds. On the supply side, a size-guided designation that ignores existing regulatory frameworks would distort the current marketplace, making larger funds, particularly index funds, less attractive to be offered by the industry, limiting investor choices and raising costs, particularly for retail investors. On the demand side, the result could channel investment into smaller, presumably more leveraged and less regulated funds – raising systemic risk overall.

Overall, we continue to believe that individual managers or funds do not meet the G-SIFI standard, and urge the FSB and IOSCO to reconsider their designation-focused approach.

[4] See, for example, the IMF semi-annual Global Financial Stability Report, which found that the "investment focus" of managers or funds is more relevant to systemic risk than size: http://www.imf.org/External/Pubs/FT/GFSR/2015/01/index.htm

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The revised consultation still focuses too much on size.

In our commentary on the FSB's and IOSCO's first consultation on NBNI SIFIs, we strongly suggested that size alone should not be a defining factor in any SIFI designation criteria. We noted in particular that leverage, and the interconnectedness it creates with other market participants, is a key factor in identifying potential sources of systemic risk. We are encouraged that the second consultation places greater emphasis on leverage and other factors, in addition to size, both in its proposed materiality thresholds and a number of the specific indicators, adopting, in some cases a "relative" vs. "absolute" criteria for G-SIFI designation criteria.

Nevertheless, we remain concerned that size is still a dominant factor in the FSB's and IOSCO's identification of asset management entities that may pose systemic risk. We are particularly concerned with the over-emphasis on size in the materiality threshold and indicators for investment funds, where we fear that large index funds could inappropriately be captured by the proposed methodology.

Materiality Thresholds

With respect to the proposed materiality thresholds, we previously expressed opposition to the $100b AUM threshold for traditional investment funds proposed in the first consultation. We are pleased that the second consultation proposes two potential alternative approaches that each use fund leverage as a factor.

Unfortunately, we believe both proposed new alternatives are flawed, and require further refinement and clarification if ultimately adopted by the FSB and IOSCO. For both options, we also suggest the FSB and IOSCO consider distinguishing between publicly offered index funds and other types of investment funds. Publicly offered index funds, particularly those tracking broad, highly liquid indexes, create very few of the systemic risk concerns targeted by the FSB's and IOSCO's proposed indicators. While such funds may be large, and may be cross-border, they are by definition not complex or leveraged, and are highly substitutable. For the S&P 500 index, for example, over $7 trillion in assets are benchmarked to the index, with index assets comprising $1.9 trillion of that total. Stocks included in the index must meet liquidity requirements, offering active and deep markets, and companies in the index must meet certain size and financial viability requirements. Funds managed to track the S&P 500 index, are, as a result, not likely to be sources of systemic risk.

For Option 1, we agree with the proposal to include funds over $30 billion in AUM with financial leverage of three times NAV. While such funds may, after further review, still not be deemed systemically important, we agree that leverage of three times NAV could result in the types of systemic risk the FSB and IOSCO are attempting to identify and address. We disagree, however, with the size-only backstop of $100 billion net AUM, which we believe will capture numerous large, publicly offered index funds. Such funds are already highly regulated, use little or no leverage, and do not create the types of systemic risks which could justify designation as a G-SIFI. Should the FSB and IOSCO decide in favor of Option

1, we suggest the "backstop" be revised to exclude funds using little or no leverage[5], or that are managed to broad, highly liquid indexes.

Option 2 would deem any fund over $200 billion in GAUM as in scope for further review unless it can be demonstrated that the investment fund is not a dominant player in its markets. We view the use of GAUM as a reasonable method of identifying funds with the combination of asset size and leverage that might lead to systemic risk, but are still concerned that it could capture large index funds with little or no leverage. Similar to Option 1, we suggest an additional condition which would exclude funds using little or no leverage. In addition, as noted in the consultation, an appropriate definition of "dominant market player" will be needed. While the suggested use of a substitutability ratio or fire sale ratio could be workable, such concepts are not currently defined in the marketplace, and significant clarification will be needed, particularly with respect to the references to the "volume of the underlying asset class." In addition, and also as noted in the consultation, data availability for such calculations is a challenge. For index funds, a simpler approach may be to establish a definition of "dominant market player" simply by reference to the ratio of the AUM of the fund compared to the total market capitalization of the securities constituting the index. Data for such a calculation is readily available, and using such a ratio would be a simple means of putting the size of a large index fund in perspective with the underlying market to which it provides exposure.

Individual Indicators

We are concerned that Proposed Indicator 1-1, by relying solely on the net AUM (or NAV) of the fund, establishes size-only criteria for G-SIFI designation. While the NAV does, of course, represent the amount of assets held by investors in a fund, we disagree with the FSB and IOSCO that the NAV typically represents the "amount of money the investors in the investment fund may lose if the investment fund unexpectedly liquidates." While such losses are, perhaps, theoretically possible, for an index fund tracking a highly liquid index, such as the S&P 500, even the unexpected liquidation of the fund would result in investors being paid the fair market value of the securities in the index on the day of liquidation. By investing in such funds, investors are intentionally taking the market risk of the securities comprising the index. Market losses resulting from such investments are not the type of systemic risks the FSB and IOSCO are seeking to identify by designating G-SIFIs. We agree, however, with the FSB's and IOSCO's observations that the NAV does not "appropriately measure the exposure of the investment fund to the wider financial system" when a fund employs leverage.

It is difficult to envision the circumstances where a large index fund managed to a diversified, highly liquid index could present systemic risk solely due to its size. Investors in such index funds have a wide variety of fund managers to choose from, and large funds offer identical investment returns to small funds. Investors may choose one fund over another for convenience, fee structure, or some other reason, but the investment performance is the same, and the market impact of the total universe of investors choosing funds managed to a certain index is the same, regardless of the size or number of funds investors choose to invest in. A $100b fund, for example, has the exact same market impact as five $20b funds.

[5] The US mutual funds and EU UCITS limits on leverage could be a useful reference to establishing when a fund over $100 billion sufficiently limits leverage to be out of scope for possible G-SIFI designation.

Imposing new regulations on the $100b fund, but ignoring the five $20b funds would simply have no basis in logic, and would clearly incent large funds to restructure in a manner which puts them outside of the scope of possible G-SIFI designation.

As a result, we do not believe Indicator 1-1 is a suitable measure of the systemic risk presented by an investment fund. Should Indicator 1-1 be retained, we urge the FSB and IOSCO, through either calibration or some form of cap, to ensure that no fund can be designated based primarily on size, through a high score on Indicator 1-1.

We are also concerned that the Substitutability indicators (Indicators 3-1, 3-2, 3-3) may, if not properly designed and calibrated, unduly rely on the size of the fund and, like Indicator 1-1, result in higher than justified scores for large index funds.

For each of the Substitutability indicators, we urge the FSB and IOSCO to provide greater clarity with respect to the specific data elements expected to be used for the proposed ratios. We are particularly unclear with respect to the references to, for example, the "size of the underlying market," which, for an index fund, could mean the total AUM of funds managed to an index, the total value of assets comprising the market, the total available investable assets providing the same exposure to the index, or, for an ETF, the total volume of trading in the secondary market. Since the FSB's and IOSCO's goal with this indicator is to identify funds with low levels of "substitutability," and therefore few alternatives providing the same market exposures, we suggest adopting a measure of the "underlying market" which focuses on total investable assets providing the same exposure to the index. We have similar concerns with the references to the "daily trading activity" of a fund, which we suggest, in the case of an ETF, be calculated based on the primary market activity of the fund, rather than the trading volume of the ETF security in the secondary market.

We are particularly concerned with Indicator 3-2, which is based on the ratio of the holdings of the fund to the overall daily trading of the underlying market. This indicator seems to assume the underlying market should be positioned to absorb the full liquidation of a fund in a single day, a highly unlikely and improbable event. To the extent the FSB and IOSCO have proposed Indicator 3-2 as a measure of substitutability, we note that investors fleeing one broad based index fund due to idiosyncratic concerns with the manager, but seeking to maintain the same exposure, typically have many choices in the market, and any market impact of sales from the first fund due to redemptions will be offset by market buys for the second fund, as subscriptions increase. This effect is even more noticeable with ETFs, where baskets of securities returned to a redeeming Authorized Participant ("AP") can by used by the AP in the ETF creation process with another ETF provider to create new ETFs with the same market exposure as the redeemed ETF. Proposed Indicator 3-2 does not appear to recognize this market dynamic, and instead seems to target, at least for index funds, wholesale investor departures from index market segments, which should be viewed as simple market risk rather than systemic risk traced to individual market participants. As a result, we suggest Indicator 3-2 be dropped from the FSB's and IOSCO's determination methodology.

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The FSB and IOSCO should focus on data collection and market-wide activities.

As an alternative to designation of individual managers of funds as G-SIFIs, SSGA urges the FSB and IOSCO to consider other alternatives to address potential systemic risks related to asset management. Such efforts should be directed to all asset managers and funds, not just a selected group of funds designated as G-SIFIs by the FSB and IOSCO.

For example, as described in our recent comment letter to the U.S. Financial Stability Oversight Council ("FSOC")[6], we support additional efforts by regulators to 1) increase systemic risk data available to regulators, particularly with respect to separate accounts; 2) require more liquidity stress testing of funds; and 3) increase latitude for funds to use redemption fees and gates during times of liquidity stress.

We recommend the FSB and IOSCO focus on similar issues.

As noted in the Consultation, "one of the key factors in assessing the global systemic importance of NBNI financial entities is the difficulty in obtaining appropriate and consistent data/information." The FSB and IOSCO attribute these challenges to the traditional conduct of business regulation of such entities, and, in the case of asset management, to the confidentiality of data for certain fund types. As a result, the FSB and IOSCO concede the NBNI SIFI determination process will be more subjective--and therefore less transparent--than for other types of entities.

We do not disagree that data collection may, in some cases, be more challenging for NBNI institutions, including asset managers and funds, and we suggest the FSB and IOSCO focus on addressing any data deficiencies before considering possible designation of asset management G-SIFIs. The largest funds are typically registered funds (such as U.S. mutual funds and EU UCITS) subject to substantial reporting requirements. Private funds do raise confidentiality concerns in the context of the individual designation regime being considered by the FSB and IOSCO, but such issues should be resolvable if the goal is to raise market-wide, vs. firm specific, systemic risk related data. Separately managed accounts, which are not currently generally reported, do not raise the liquidity or other concerns that might be relevant to a G-SIFI designation process, and raise similar confidentiality concerns as private funds, but such accounts constitute an important element of the asset management business, and any monitoring of emerging systemic risks in asset management is incomplete without including some level of aggregate data from such accounts.

Overall, we believe the FSB, IOSCO and other policy-makers would be well served to evaluate and address any gaps in systemic risk related data collection across the industry, not just with designated G-SIFIs.

In addition to data collection, we urge the FSB and IOSCO to defer the establishment of a G-SIFI designation process in favor of a broader process to identify and address industry-wide practices to address emerging systemic risks, as it did with, for example, money market mutual fund reform.[7] Clearly, the

FSB's and IOSCO's goals with respect to money market funds could not have been accomplished by applying new requirements to a short list of asset management G-SIFIs.

For example, given the current concerns with liquidity in bond markets, we recommended the FSOC consider two additional protections for bond funds: first, we suggested greater ongoing liquidity stress testing of such funds, and second, we recommended regulators permit managers of bond funds more flexibility in using liquidity fees and gates in times of market stress. Neither of these suggestions would accomplish much with respect to systemic risk if applied only to a few firms or funds, but we believe both would have significant benefits if applied across the industry.

In addition, focusing on designation of individual asset managers ignores 75% of the world's financial assets that are self-managed by asset owners. [8] While we do not suggest that such asset owners are themselves G-SIFIs, we believe any review of the systemic risks which might present themselves in financial markets is incomplete without considering the full range of the investment ecosystem.

We note the "read-out" of the March FSB meeting in Frankfurt[9] included a reference to a new FSB asset management work stream, which appears to be focused on asset management activities that could contribute to systemic risk, rather than designation of individual firms. While we are anxious to learn more about the new work stream, we are encouraged by the announcement, and hope that it will lead to a fulsome discussion of systemic risks associated with asset management, hopefully as, at least for now, a replacement for the current work stream on asset management G-SIFI designations.

As part of this new work stream, we suggest additional FSB and IOSCO assessments of the fragmentation of funds regulation between the main financial centers. We continue to believe that strong market regulation of the funds industry is the most suitable means to address systemic risk, but the current fragmentation of such regulation could introduce opportunities for international regulatory arbitrage that could generate financial fragilities. A comprehensive review of the level of harmonization between funds regulation in major financial centers could help address such risks.

The new FSB and IOSCO work stream would also benefit from further exploration of means to reconcile exiting market regulation, which focuses largely on investor protection, with new policy initiatives to address systemic risk, market stability, and liquidity.

Conclusion

In conclusion, while we appreciate some of the changes made by the FSB and IOSCO between the first and second consultation, particularly the increased focus on leverage, SSGA continues to have significant concerns with the FSB's and IOSCO's approach, both in terms of the overall strategy to address systemic risk through designation of individual firms or funds, and in terms of the specific criteria under consideration. We continue to believe that regulators should address potential systemic risk in the asset management industry through identification of specific, industry-wide practices that could create such risks.

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Should the FSB and IOSCO nonetheless continue to focus on designation of individual firms or funds, we strongly suggest additional review of the proposed materiality thresholds and indicators to eliminate the overreliance on size as a predominate factor for asset management G-SIFI designations.

Once again, thank you for the opportunity to comment on this proposal. Please feel free to contact me with any questions, or if SSGA can provide further input into the FSB's and IOSCO's review of systemic risks for asset management.

Sincerely,

Richard Lacaille
Executive Vice President
Global Chief Investment Officer