asset management group

April 4, 2014

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

Re: "Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions"

Dear Sirs/Madams:

The Asset Management Group (the "**AMG**")[1] of the Securities Industry and Financial Markets Association ("**SIFMA**") appreciates the opportunity to comment on the consultative document entitled "Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions" (the "**Consultative Document**") published by the Financial Stability Board (the "**FSB**") and the International Organization of Securities Commissions ("**IOSCO**"). The AMG's members are U.S. asset management firms and our letter will focus on the investment fund assessment methodology.

We appreciate the FSB's and IOSCO's efforts to understand the asset management industry's perspective and appreciate the challenge the FSB and IOSCO face as they attempt to create an assessment methodology without a clear understanding of the additional regulation that will be imposed on non-bank non-insurer ("**NBNI**") global systemically important financial institutions ("**G-SIFIs**"). It is difficult, if not impossible, to design a methodology for identifying companies that may warrant different regulation without knowing what that regulation will be. We also appreciate the FSB's and IOSCO's interest in developing uniform assessment methodologies for all G-SIFI financial entities.

In the Consultative Document, the FSB and IOSCO take the position that, in order to be a G-SIFI, a company must present essentially the same threat to the global financial system, and be subject to a "broadly consistent" G-SIFI assessment framework, regardless of its industry.[2] We generally agree with the FSB and IOSCO that a consistent regulatory approach will lead to regulation that is consistent

---

1 The AMG's members represent U.S. asset management firms whose combined assets under management exceed $30 trillion. The clients of AMG member firms include, among others, registered investment companies, endowments, state and local government pension funds, private sector Employee Retirement Income Security Act of 1974 pension funds and private funds such as hedge funds and private equity funds.

2 FSB and IOSCO, Consultative Document, "Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions," January 8, 2014 (the "Consultative Document"), at 1-2.

with the objective of the "SIFI Framework": "to address the systemic risks and the associated moral hazard problem for institutions that are seen by markets as [too-big-to-fail]."[3] We also recognize that designing a uniform assessment methodology for all potential G-SIFIs is not an easy task.

As the FSB and IOSCO correctly recognize, investment funds have fundamentally different risk profiles than banks and insurers and lack many of the characteristics that were cited to support bank and insurance company G-SIFI designations. The requirements that every G-SIFI must have the same essential risk characteristics and must be subject to consistent identification frameworks creates a tension that is clear in the Consultative Document between the need for a regulatory approach that is consistent across multiple industries and market sectors and a regulatory approach that recognizes that NBNI financial entities, including investment funds, possess unique risk characteristics and operate in ways that are fundamentally different than banks and insurance companies, the types of entities that have already been designated as G-SIFIs.

The collective view of our members is that risk among investment funds, and in the asset management industry and the capital markets more broadly, is not concentrated in individual entities. Rather, it is broadly distributed and migrates across sectors of the industry as markets shift and respond to exogenous factors. The FSB and IOSCO seem to be sensitive to the fact that risk is distributed broadly among investment funds when they ask, in Q6-4, whether the investment fund assessment methodology should focus on whether particular activities or groups of activities, rather than individual investment funds, pose systemic risks. We believe it would be more productive to assess and regulate activities in which investment funds and other capital markets participants engage than it would be to try to identify individual entities that represent concentrated risk to such a degree that they warrant different regulation than their competitors.[4] Therefore, we request that the FSB and IOSCO shift the focus of the investment fund assessment methodology from investment funds to their activities.[5]

The assessment methodology should focus on activities (such as engaging in uncollateralized credit or other unsecured derivatives transactions, high frequency trading, engaging in securities finance transactions and related activities (*e.g.*, cash collateral reinvestment) or employing highly leveraged investment strategies) rather than a few quantifiable characteristics of individual investment funds (such as size and number of jurisdictions in which an investment fund invests). In industry sectors, such as asset management, where risk is broadly distributed and easily transferred among many participants, risk is unlikely to be concentrated in individual entities as we believe it must be in

---

[3] FSB, Report of the Financial Stability Board to the G-20, "Progress and Next Steps Towards Ending 'Too-Big-To-Fail' (TBTF)," September 2, 2013, at 7, available at http://www.financialstabilityboard.org/publications/r_130902.pdf (the "SIFI Framework Document") (The "SIFI Framework" seeks to meet its objective "by reducing the probability of SIFIs failing through requirements for additional loss absorbency and increased supervisory intensity, and by reducing the impact of failure through effective resolution regimes…").

[4] Regulators have employed an activities- or product-based approach to regulating many aspects of the asset management industry. For example, since the financial crisis, regulators have proposed a new scheme to regulate money market funds and adopted new rules to regulate derivative trades (*e.g.*, central clearing and minimum margin requirements). Regulators seem to have recognized that they would not have been able to address risks associated with those products and activities effectively by regulating only the largest players in the relevant markets.

[5] If the FSB and IOSCO revise their investment fund assessment methodology to focus on any other class of entity or consolidated group of entities, we think the revised methodology should consider the activities of those entities or consolidated groups of entities. See also our response to Q6-3.

order to justify G-SIFI designation.[6] Furthermore, we believe G-SIFI designation cannot effectively apply to individual investment funds because, even if risk does concentrate at one or more funds at a particular point in time, investors could (and likely would) move their assets away from designated investment funds to other un-designated investment funds pursuing the same or similar strategy. Thus, G-SIFI designation of a few large investment funds is not likely to reduce the overall level of risk associated with the activities of investment funds and other capital markets participants because entities that are not designated will continue to engage in the same activities. Accordingly, we believe that the FSB and IOSCO should modify their assessment methodology to focus on the activities of the participants in the capital markets. Regardless of whether the FSB and IOSCO shift their focus to activities, or remain focused on individual entities, we request that they publish any revised methodology for additional consultation.

We believe that a productive discussion of assessment methodologies should consider the regulatory and potential market implications of designation, and, throughout our letter, we explain our view that G-SIFI designation and selective regulation of a small number of investment funds would likely have perverse and negative regulatory and market consequences. We fundamentally believe that G-SIFI designation of a few large investment funds would not reduce the overall level of risk associated with global asset management activities. ***Throughout this letter, we emphasize our position that the appropriate structural approach for regulation of investment funds (and capital markets participants generally) is to seek to address the risks arising from the activities they conduct and products they offer on an industry-wide basis (regulatory approaches we refer to as "activities-based" and "products-based," respectively, throughout this letter) and is not restricted to a small number of entities.***

Regardless of whether the FSB and IOSCO ultimately develop an activities-based assessment methodology or continue to develop an entity-specific assessment methodology, we believe that the final investment fund assessment methodology must be transparent, clearly defined, objective, based on reliable data and applied consistently across jurisdictions. We believe that the proposed investment fund assessment methodology fails to meet that standard and we identify in this letter aspects of the proposed methodology that we believe should be clarified or revised in order for it to do so.

INTRODUCTION

I. No Specific Mandate Requires G-SIFI Designation of Investment Funds.

The FSB mandate from the G20 does not include an instruction to designate investment funds regardless of whether they possess the necessary mix of characteristics to be designated NBNI G-SIFIs. In their 2011 Cannes Summit Final Declaration, the G20 Leaders asked the FSB in consultation with IOSCO to "prepare methodologies to identify systemically important non-bank financial entities."[7] The G20 Leaders' request, which has been affirmed since 2011, does not express a view regarding whether investment funds possess the necessary mix of characteristics to be considered G-SIFIs and does not instruct the FSB to develop an assessment methodology that necessarily captures them in its definition of G-SIFIs.[8]

---

6 *See generally* SIFI Framework Document.

7 G20 Leaders, Cannes Summit Final Declaration, "Building Our Common Future: Renewed Collective Action For The Benefit Of All," November 2011.

8 We note that publications by other regulatory bodies that evaluate whether the asset management industry is a source of systemic risk openly concede that the industry generally does not present systemic risk. For example, the Committee on Economic and Monetary Affairs recently published a motion regarding a

We understand that the FSB and IOSCO decided to develop assessment methodologies for investment funds, finance companies and broker-dealers because of their "relatively large size in the non-bank financial space" and in light of "historical examples of financial distress or failures in these three sectors that had an impact on the global financial system." Although investment funds regularly close with little market impact[9] (as the FSB and IOSCO acknowledge in the Consultative Document[10]), they fail very rarely. An investment fund (like any other financial entity) "fails" when it becomes insolvent or is unable to meet its obligations to its creditors and other counterparties. Unless credit and counterparty relationships cause an investment fund to become insolvent and expose its creditors and counterparties to the risk of loss, even severe declines in the value of an investment fund's assets that may cause the fund to close will be borne by the fund's investors and will not cause the fund to fail.

It is uncontroversial to presume failure and employ a "loss given default" model when considering banks because bank failures have occurred with some frequency historically and as banks have a business model based on leverage, they are typically highly leveraged. Presuming failure is more controversial with respect to companies that fail infrequently but can fail, such as insurance companies. It is unrealistic, however, to presume that a fund with no leverage – that is effectively 100% equity capital with no fixed obligations to investors – could fail for purposes of designing the G-SIFI assessment methodology. We are concerned that the Consultative Document may encourage inappropriate regulation of investment funds because it rests on such a presumption.

We think, particularly in light of the nature of the most prominent historical examples of investment fund "failures" that are cited as having raised systemic impact concerns (the near-failure of Long-Term Capital Management ("**LTCM**") in 1998 and the losses suffered by the Reserve Primary Fund in 2008, both discussed below) and the lack of specificity with respect to investment funds in the G20 mandate, that the FSB and IOSCO should not design a methodology to capture specific, predetermined investment funds and, instead, should design a methodology that applies equally to all NBNI financial entities.[11]

---

proposed recovery and resolution framework for non-bank institutions in which it explains "[t]he size and business model of the asset management sector does not typically present systemic risk" and observes that asset segregation and custodian arrangements are a "substantial safeguard" and that "an effective securities law regime could mitigate many of the issues involved in case of failure of a large crossborder asset manager." European Parliament Committee on Economic and Monetary Affairs, Motion for a European parliament resolution on recovery and resolution framework for non-bank institutions (Oct. 22, 2013).

9 For example, a recent Morningstar study found that 41% of U.S. mutual funds operating ten years ago closed before 2014. Tepper, Taylor, "Mutual Funds Gone Down the Drain," in Money Magazine, March 7, 2014, *available at* http://money.cnn.com/2014/03/01/investing/mutual-funds.moneymag/.

10 Consultative Document at 30 ("funds close (and are launched) on a regular basis with negligible or no market impact" and "even when viewed in the aggregate, no mutual fund liquidations led to a systemic market impact throughout the observation period [(from 2000 to 2012)]").

11 In Q6-3, the FSB and IOSCO asked for feedback on their decision to focus their assessment methodology on individual investment funds, rather than families of funds, asset managers or asset managers and their funds on a consolidated basis. Although we encourage the FSB and IOSCO to shift their focus to activities rather than entities, we believe that, of the alternatives mentioned, focusing on individual investment funds is the most appropriate. If the FSB and IOSCO elect to focus on a different "level," we request that they publish another consultative document so that industry participants have an opportunity to comment and offer detailed feedback. See our response to Q6-3 below.

The Consultative Document explains that the FSB's and IOSCO's "overarching objective" in developing the proposed assessment methodologies was to identify NBNI financial entities that met the definition of G-SIFI: an institution "whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause *significant disruption to the global financial system and economic activity across jurisdictions*."[12] The assessment methodologies the FSB develops should be crafted to help regulators determine *whether* NBNI financial entities exist whose distress or disorderly failure could damage the global financial system to the extent described in the G-SIFI definition. The assessment methodology should not be designed, or reverse-engineered, to make sure that certain NBNI financial entities are designated regardless of whether they can fail or whether their failure would cause significant disruption to the global financial system and economic activity across jurisdictions.[13]

During the recent financial crisis, regulators' efforts to prevent damage to the global financial system and to limit the impact of certain financial institution failures prompted government intervention that was costly, increased moral hazard, and ultimately motivated the G-SIFI designation program. We agree with the observation of the Basel Committee on Banking Supervision (the "**Basel Committee**") of the Bank for International Settlements ("**BIS**") that "the financial and economic costs of these interventions and the associated increase in moral hazard mean that additional measures need to be put in place to reduce the likelihood and severity of problems that emanate from the failure of [G-SIFIs]."[14] It follows from the Basel Committee's observation that if no systemic problems of this type are likely to emanate from a class of NBNI financial entities, these additional measures may not be warranted. As we explain in detail below, investment funds do not possess the risk characteristics of G-SIFIs and should not be subject to G-SIFI regulation.

II. Investment Funds Lack Key Characteristics Possessed by Other G-SIFIs.

The FSB has published several reports that consider proposals to reduce moral hazard problems that may be associated with G-SIFIs and eliminate "too big to fail" and has developed methodologies to evaluate potential G-SIFIs. In these reports and methodologies, the FSB has indicated that G-SIFIs have certain characteristics present in combination, including limited ability to absorb losses (often associated with high balance sheet leverage ratios), limited substitutability with other entities, risk of complex and protracted resolution proceedings, and risk of widespread economic harm in the event of

---

12 Consultative Document at 2 (emphasis added).

13 We acknowledge that the Consultative Document asserts that "the methodologies' emphasis is on identifying indicators that point to systemic impact on failure, rather than an institution's likelihood of failure" but we think that the FSB, as it composes the methodology for investment funds, must consider the low likelihood of fund failure both in absolute terms and when compared to banking and insurance entities. Consultative Document at 2.

14 BIS, Basel Committee on Banking Supervision, *Global Systemically Important Banks: Updated Assessment Methodology and the High Loss Absorbency Requirement,* 2, *available at* http://www.bis.org/publ/bcbs255.pdf (the "G-SIB Methodology").

distress or failure of the entity, that could compel taxpayer bailouts.[15] The FSB has defined this G-SIFI mix of characteristics in the bank and insurance company contexts.[16]

As we describe below, and as the Consultative Document acknowledges, investment funds lack certain of these characteristics and, as a result, we believe that the FSB and IOSCO are not likely to find investment funds that are G-SIFIs and that G-SIFI designation of any investment fund thus is not warranted. In fact, not only would such a designation fail to mitigate market risk, it is also likely to cause much more damage and market distortion than it could reasonably be expected to prevent.

We appreciate that the Consultative Document acknowledges that certain characteristics of investment funds differentiate them from other types of financial entities. In particular, the Consultative Document notes that investment funds are highly substitutable, that asset managers are agents of their clients, that investors provide investment funds a "shock absorbing" function that differentiates investment funds from banks and that an investment fund's assets are not available to claims by creditors of the investment fund's manager.[17] We are concerned, however, that the Consultative Document does not appear to recognize fully that these characteristics make investment funds highly unlikely to meet the standard necessary for designation and that, even if they did, those same characteristics would make the selection of a small number of large investment funds for different, additional regulation an ineffective method of reducing any risks that may be associated with investment funds' activities. For example, annual G-SIFI determinations would quickly become stale because investment funds are "highly substitutable," the investment fund industry is "highly competitive," and investment activities of one investment fund are easily replicated by other investment funds.[18]

In addition to the characteristics of investment funds the FSB and IOSCO acknowledge, the following characteristics reduce the systemic risk associated with any individual investment fund and cause any risk to distribute throughout the asset management industry and to re-allocate continuously among investment funds of various size and investment strategy:

- Many investment funds, including U.S. mutual funds and other registered funds, use relatively little or no leverage. Without leverage, an investment fund cannot become insolvent or "fail." An unleveraged investment fund consists of 100% equity capital;

- Neither investment funds nor their managers guarantee investment results or backstop losses;

---

15 FSB defines SIFIs as "institutions whose distress or disorderly failure, because of their size, complexity *and* systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity." Consultative Document at 1 (emphasis added).

16 *See* G-SIB Methodology; and International Association of Insurance Supervisors, *Global Systemically Important Insurers: Initial Assessment Methodology, available at* http://www.iaisweb.org/view/element_href.cfm?src=1/19151.pdf.

17 Consultative Document at 29-30.

18 Consultative Document at 30. We know that the FSB is employing a comparable annual review process in its G-SIB Methodology to evaluate banks, which are generally not substitutable. (G-SIB Methodology at 11.) We caution the FSB that, although we understand its desire to create similar assessment methodologies for various financial entities, the market for investment funds is too fluid and investment funds are too easily replaced, for annual classification to yield effective, consistent or meaningful regulation.

- Investment funds offer investors important benefits, including risk reducing benefits, such as transparency, scale and diversification;
- From an investor's perspective, investment funds are interchangeable vehicles; and
- Investors control their assets and select investment funds with strategies that meet their investment needs.

Investment funds are very different from risk and regulatory perspectives than banks which generally (i) have very high balance sheet leverage, (ii) engage in maturity transformation,[19] (iii) guarantee deposits and, in some products, interest on deposits, (iv) are not substitutable because they have businesses that are less easily replicated by competitors, and (v) are less interchangeable, relative to investment funds, because they provide essential functions and because high barriers to entry, regulatory restrictions on business activities and the capital intensive nature of the banking business create obstacles for new market entrants. We believe that it is not appropriate to view investment funds through a bank regulatory lens and are concerned that the proposed investment fund assessment methodology takes that approach. Certain impact factors that are relevant to banks do not translate meaningfully to investment funds. Similarly, certain characteristics that can be assumed with respect to banks should not be assumed with respect to investment funds.[20]

In our response to Q2-1, we propose that the FSB and IOSCO add three new impact factors to the assessment methodology for investment funds: leverage; maturity transformation; and inadequate existing regulation. We believe that leverage and interconnectedness, which is included in the proposed assessment methodology, are the most important risk factors for determining whether investment funds present the combination of characteristics required for G-SIFIs. After leverage and interconnectedness, we believe that maturity transformation and inadequate existing regulation are secondary factors, and that size is an impact factor to consider only if these other factors are present. Indicators related to leverage, interconnectedness, maturity transformation and inadequate existing regulation should be prioritized in assessing the systemic importance of investment funds.

We argue that the different characteristics of banks, insurance companies and investment funds make certain impact factors (such as substitutability) that are predictive of risks for banks and insurance companies less predictive of risk for investment funds. We also argue that the different characteristics of banks, insurance companies and investment funds make it inappropriate to assume investment funds possess certain impact factors (specifically, leverage and maturity transformation) that are implied risks for all banks and insurance companies. Evaluation of leverage, maturity transformation and existing regulation will help balance the investment fund assessment methodology with the bank and insurance company assessment methodologies in order to determine whether there are any investment funds that meet the G-SIFI standard in a manner that is consistent with the bank and insurance company methodologies.

III. Effective Regulation of Investment Funds is Activities-Based and Not Selective.

Even if the FSB and IOSCO identify one or more investment funds that may meet the G-SIFI standard, which we think is highly unlikely, the characteristics of investment funds outlined above

[19] We discuss "maturity transformation" (the difference between the terms of an entity's assets and liabilities) in our response to Q2-1.

[20] See also our response to Q6-2.

and the types and levels of risk that may be posed by their investment activities indicate that ***effective regulation of investment funds would best be achieved through a broad activities-based approach and should not single out individual entities deemed to be G-SIFIs for disparate treatment.***[21] A broad approach that focuses on risks associated with an activity or product on an industry- or market-wide basis would be more effective and efficient than selective designation. There are good examples of the successful application of activities-based regulation in many jurisdictions, including the United States.

Existing regulation of investment funds and the capital markets in the United States is activities- or product-based. These existing regimes already address many market risks associated with the asset management industry and the capital markets generally. These regulatory regimes reflect the characteristics of the industries and markets they regulate. As with many regulatory regimes, they have been reformed substantially since the recent financial crisis and are subject to ongoing reform. The investment fund assessment methodology must, in our view, consider existing regulation.[22]

As the Consultative Document acknowledges, existing regulation of investment funds seeks to ensure compliance with a variety of regulations that create multiple benefits "not only from an investor perspective, but also from a systemic perspective."[23] These regulations protect investors from fraud and create a high degree of transparency in the industry – both for investors and for regulators. Asset managers and investment funds are currently subject to extensive reporting requirements.[24] In addition to investor protection and transparency, existing regulation addresses market risk by monitoring and imposing restrictions and conditions on certain trading activities and investment contracts that could contribute to financial instability.

We believe that the assessment methodology for investment funds should include a careful evaluation of the existing regulation that comprehensively regulates investment funds, their managers, the trading activities in which they engage, and the securities, derivatives and other investment

---

21 Governor Daniel K. Tarullo, Speech, "Regulating Systemic Risk," March 31, 2011, *available at* http://www.federalreserve.gov/newsevents/speech/tarullo20110331a.htm ("March 2011 Speech by Governor Tarullo") ("The potential for systemic risk from contagion effects really reflects the potential failure of an asset class or business model more than a firm. . . . potential contagion effects are best contained by directly addressing them, rather than by trying to indirectly address them through designating large numbers of nonbank-affiliated institutions.").

22 In this regard, we note that Section 113(a)(2)(H) of the Dodd-Frank Act requires the United States Financial Stability Oversight Council (the "FSOC") to consider "the degree to which the company is already regulated by 1 or more primary financial regulatory agencies" when considering whether to designate a non-bank financial entity a SIFI and that FSOC included "Existing Regulatory Scrutiny" in the methodology it developed to evaluate whether a nonbank financial company should be subject to heightened regulation. Under Section 113 of the Dodd-Frank Act, the FSOC may determine that a nonbank financial company will be supervised by the Board of Governors of the Federal Reserve System and be subject to enumerated prudential standards if either (i) material financial distress at the nonbank financial company, or (ii) the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the nonbank financial company, "could pose a threat to the financial stability of the United States." *See* Final rule and interpretive guidance, FSOC, Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 77 Fed. Reg. 21,637 (April 11, 2012) ("FSOC Final Rules Release").

23 Consultative Document at 29.

24 SIFMA AMG and Investment Adviser Association, "'Asset Management and Financial Stability' Study by the Office of Financial Research", Nov. 1, 2013, available at: http://www.sec.gov/comments/am-1/am1-16.pdf (the "SIFMA AMG OFR Response Letter").

instruments in which they invest. We are concerned that the Consultative Document does not sufficiently consider existing risk regulation, including instances where the regulation was recently proposed or implemented to address systemic risk and threats to financial market stability. As we discuss in more detail in our response to Question 2-2, we believe that investment funds are not appropriate for G-SIFI designation because they are subject to extensive regulation that is more effective than any regime based on selective regulation, such as the G-SIFI Framework, could be.

It is instructive that current reform initiatives also reflect an activities-based approach to regulation. In particular, money market fund reform, tri-party repurchase agreement (**"repo"**) reform, swaps regulatory reforms pursuant to Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the **"Dodd-Frank Act"**) (including *e.g.*, margin requirements, central clearing and exchange trading), and securities lending regulation (including collateral requirements) all reflect an activities-based regulatory approach and all seek to address market risk. We note that the G20, in its discussions of regulation of "shadow banking" activities (including those of money market funds and the repo market) appears to take an activities-based approach to certain topics that overlap with risks the Consultative Document associates with investment funds.[25] The assessment methodology should consider whether additional regulation of investment fund G-SIFIs would duplicate other regulatory efforts, whether G-SIFI regulation would be less effective than other existing and proposed regulation, and whether sufficient regulatory benefit can be identified to justify the additional costs (which are likely to be significant) that would be associated with G-SIFI designation of investment funds. It is not clear to us, and no data has been presented that suggests, that any of these benefits will materialize as a result of G-SIFI designation of investment funds.

IV. The FSB Should Consider Jurisdictional and Regulatory Implications for Investment Funds of G-SIFI Designation as it Develops its Assessment Methodology.

The Consultative Document does not acknowledge the jurisdictional implications for investment funds of the proposed assessment methodology and we believe that it should. For example, designation as a systemically important financial institution in the United States has a very specific meaning under Title I of the Dodd-Frank Act. As drafted, the assessment methodology seems to qualify only U.S. investment funds for review.

As we propose in Section III of this Introduction, we believe that a threshold question for G-SIFI designation of any investment fund should be whether existing national regulation effectively addresses systemic risks related to the investment fund. For example, we believe that the FSB should consider whether U.S. registered investment companies, which are already subject to a comprehensive regulatory regime that limits their investment activities, and U.S. money market funds, which in addition to that comprehensive regulatory regime are also subject to an even more restrictive regulatory scheme designed to address systemic risk, should be subject to the assessment methodology and potentially subject to duplicative regulation as G-SIFIs. It is not clear to us, and no data has been presented suggesting, that individual NBNI investment funds meet the G-SIFI standard or that selective regulation of investment funds will produce any benefits. We are concerned that G-SIFI designation of these entities would create substantial costs and market distortions that would adversely impact individual investment funds, investors, the financial markets and the economy. Given the potential adverse consequences and

---

[25] G20 Leaders, Cannes Summit Final Declaration, "Building Our Common Future: Renewed Collective Action For The Benefit Of All," November 2011 (explaining that "shadow banking activities" include "money markets funds, securitization, securities lending and repo activities"). *See also* Financial Stability Board, Interim Report of the FSB Workstream on Securities Lending and Repos, "Securities Lending and Repos: Market Overview and Financial Stability Issues," April 27, 2012.

likely significant costs of selective regulation, G-SIFI designation and regulation of investment funds requires a rigorous objective analysis of costs, benefits and alternatives. We believe that such an analysis would demonstrate that G-SIFI designation of investment funds would be unjustifiable. Thus, we believe the FSB and IOSCO should conduct that analysis and present the results prior to designating any investment fund a G-SIFI.

We believe that, although it may reduce risks associated with other types of financial institutions, selective regulation will not reduce risks associated with the activities of investment funds. After all, there are multiple ways that investors can achieve the market/risk exposure they want. Investors can invest their own assets directly or can move their assets into an investment fund or account managed by a professional manager who is able to provide their desired exposure. Large, established asset managers can easily terminate underperforming products and launch new investment funds (and do so regularly), competition among investment funds is intense, and investment funds and managers are highly substitutable. We believe that, because investors in registered investment funds (and, to a lesser extent private investment funds) can easily redeem their interests and move their assets to new investment opportunities, and because asset managers can replicate investment strategies easily to meet a new investor's mandate, it is likely that G-SIFI designation will have a negative impact on designated investment funds. This may be the result even if the only immediate consequence of designation is uncertainty about the regulatory impact.[26] It will certainly be the result if G-SIFI designation subjects investment funds to increased costs, investment or redemption limitations, or new operational restrictions.

V. The FSB and IOSCO Should Revise their Investment Fund Assessment Methodology to Clearly Define Terms and Provide the Data it Analyzed to Determine Quantitative Thresholds.

We are concerned that there appears to be no science or empirical analysis underlying the investment fund assessment methodology. Key terms used in the assessment methodology are also undefined. These include: "*failure* of NBNI financial entity" and "*significant disruption* to the *wider financial system* and *economic activity.*" In order to be applied consistently and achieve its objectives, an assessment methodology must include well defined terms based on objective criteria.

For example, what does "failure" of an investment fund mean if it does not mean insolvency? Insolvency is the "failure" that the FSB SIFI Framework seeks to address.[27] Sudden insolvency of an investment fund is rare and generally is associated with investment funds that have fixed obligations that represent a substantial percentage of their assets (such as pension funds) or that use highly leveraged investment strategies. Traditional mutual funds and UCITS funds that use little or no leverage do not possess the insolvency risk that other types of financial institutions possess. Without leverage or substantial fixed obligations, we do not believe that an investment fund can "fail" – its investments may lose all or substantially all of their value and the investment fund may close but it will not become insolvent and investors, who knowingly accept the risk of loss, will bear the investment fund's losses.[28]

---

[26] Alternatively, although less likely in our view, G-SIFI designation might cause assets to migrate to investment funds deemed to be G-SIFIs because they are perceived to be safe investment opportunities, thereby inadvertently increasing the concentration of investors' assets, distorting markets and increasing asset concentration in a fund that regulators deem to be a threat to financial stability.

[27] *See* SIFI Framework Document.

[28] *See* Consultative Document at 29.

In addition, the only numerical criteria provided in the Consultative Document are seemingly arbitrary quantitative thresholds, such as total assets and number of jurisdictions in which a fund invests. There is no explanation of how these quantitative thresholds indicate potential systemic risk and no data provided that could support such an assertion. The importance of data is underscored by the fact that the FSB and IOSCO ask commenters to provide quantitative support for any alternative thresholds they may propose. We are struck by the fact that the FSB and IOSCO provide no support for the thresholds it proposes.

In fact, the FSB and IOSCO cite lack of data in support of their assertion that more regulatory discretion is warranted in the design and application of their assessment methodologies. We believe, if one lacks sufficient data to inform a decision, the only reasonable conclusion is that more data is needed – not that the lack of data justifies increased discretion or use of arbitrary criteria. As noted above, given the potential adverse consequences and likely significant costs of selective regulation, it is crucial that any materiality threshold, which will ultimately lead to the identification of particular investment funds for potential designation, be based on sufficiently detailed data that supports the use of the particular threshold. The stakes are far too high for individual funds, investors, the financial markets and the economy for such determinations to be arbitrary and subject to the significant discretion of regulators.

Failure to define systemic risk succinctly and apply clear quantitative thresholds to any measurement of systemic risk could undermine the assessment of regulatory initiatives to mitigate such risk.[29] Lars Peter Hansen, an economist and Nobel laureate, in his study of systemic risk measurement and regulation, observed:

> The need to implement new laws with expanded regulation and oversight puts pressure on public sector research groups to develop quick ways to provide useful measurements of systemic risk. This requires shortcuts, and it also can proliferate superficial answers . . . . Stopping with short term or quick answers can lead to bad policy advice and should be avoided.[30]

In essence, the proposed assessment methodology amounts to an arbitrary size threshold plus regulatory discretion. We do not believe that it represents a valid "methodology" and are concerned that the proposal is an inadequate basis for any regulatory action. It certainly cannot justify regulatory action that is intended to have a substantial impact on individual entities and the global financial system.

We understand the FSB's and IOSCO's view that, because NBNI financial entities are generally subject to activities-based regulation and confidential reporting requirements that vary across jurisdictions, "supervisory judgement likely needs to play a bigger role in methodologies for indentifying NBNI G-SIFIs compared to G-SIB or G-SII methodologies,"[31] but caution that no matter how well-intentioned, the exercise of essentially unlimited regulatory discretion will not result in consistent, objective identification of systemically important NBNI financial entities or effective mitigation of systemic risk and is likely to do more harm than good.

---

29 *See* Lars Peter Hansen, "Challenges in Identifying and Measuring Systemic Risk" (Feb. 11, 2013), *available at* http://www.nber.org/chapters/c12507.pdf.

30 Hansen, *supra* note 29 at 2.

31 Consultative Document at 6.

If the FSB and IOSCO develop entity-specific assessment methodologies for NBNI financial entities, the methodologies should be objective, rigorous, consistent and transparent. If the FSB and IOSCO clearly communicate to participants in capital markets their concerns about the activities and products that create systemic risk and the consequences of engaging in such activities or developing such products, market participants will be able to evaluate the costs and benefits of doing so and to make informed choices about their businesses. We believe that many market participants would seek to manage the extent of their activities and products deemed to create systemic risk, especially if they knew that doing so would impact the amount of additional regulation and costs that they face. This result would do far more to reduce risk in the system than designating a few companies for disparate regulation for reasons that are unclear or highly discretionary.

Finally, the ambiguity in the methodology and the absence of data impede the public's ability to comment in a meaningful way and prevent the proposal from having the beneficial effects that a transparent, objective, methodology would have. All participants in the asset management industry are stakeholders in this discussion and have an interest in its outcome. It is incumbent upon the regulators to proceed transparently and provide sufficient detail (including data) to enable stakeholders to understand and comment on their proposal. Those comments, and the transparent, objective, consistent methodology we believe they will encourage, will help the regulators achieve the outcome that we all desire – an efficient, resilient financial system that meets the needs of its participants and supports economic growth.

RESPONSES TO CONSULTATIVE QUESTIONS

1. Systemic risk and transmission mechanisms

Q1-1. In your view, are the three transmission channels identified above most likely to be the ones transmitting financial distress of an NBNI financial entity to other financial firms and markets? Are there additional channels that need to be considered?

We believe that the transmission channels identified in Section 1 of the Consultative Document are relevant to transmitting financial distress of certain NBNI financial entities, but that the channels are not equally relevant to all NBNI financial entities. In particular, mitigating factors make them less relevant to investment funds. We have no additional channels to recommend.

The first channel identified in the Consultative Document, "Exposures / Counterparty," refers to the risks that may occur "when distress or failure of an investment fund leads to losses or other impairment incurred by banks, brokers and other counterparties (not including equity investors)."[32] The FSB explains that risks may occur if an investment fund that has received debt financing through counterparties or direct trading linkages fails and suffers extensive losses that, in turn, destabilize its creditors.[33] We believe that the Exposures / Counterparty channel will be much less relevant for many investment funds than it is for other types of financial entities. Investment funds that use little or no leverage, such as U.S. mutual funds and other registered funds, will transmit relatively little risk to creditors and counterparties (if any) compared to highly leveraged private funds. We also note that existing regulation applicable to registered and private investment funds, including rules implemented since 2010 under the Dodd-Frank Act, seeks to address counterparty risk. In particular, new margin and collateral requirements for certain derivative instruments (discussed more fully in our response to Q2-2 below) seek to reduce counterparty risk relevant to investment funds.

[32] Consultative Document at 29.

[33] Consultative Document at 29.

The second channel, "Asset liquidation / Market," refers to the indirect impact on other market participants, including other investment funds and entities with similar holdings, that could be caused by the sudden liquidation of an investment fund's assets. The FSB explains its concern that "individual funds may be significant investors and/or providers of liquidity in some asset classes. In times of stress (when there might be an increase in correlations between asset classes), forced liquidation of positions by investment funds could cause temporary distortions in market liquidity and/or prices that cause indirect distress to other market participants."[34] We note that the risk of forced asset liquidation is relatively low for investment funds compared to other types of financial entities. The concepts of "forced liquidation" and "market distortion" are not relevant to investment funds that mark-to-market the assets in their portfolio on a daily basis and that are not leveraged. The Consultative Document notes that "the potential for forced liquidations and market distortions may be amplified by the use of leverage" but the assessment methodology should also recognize that investment funds that are not leveraged and mark to market daily have no risk of insolvency and forced liquidation because they have no credit exposure and provide no first-mover advantage.[35] We are aware of very large outflows from registered mutual funds that have occurred without causing any systemic effect in capital markets and without causing these funds to fail.

In Section 6, the Consultative Document correctly notes that investors in investment funds will absorb losses that result from the decline in the value of a fund's portfolio of assets and contrasts investment fund investors' "shock absorber" function with the requirement that banks set aside capital to protect depositors who do not absorb losses associated with a bank's portfolio of loans and whose assets are insured against loss.[36] The FSB and IOSCO also highlight that a comprehensive disclosure regime seeks to assure that investors in investment funds are aware that their investments may lose value and that investment results are not insured or otherwise guaranteed.[37] The Consultative Document does not, however, acknowledge that, even though investors accept investment risk, stringent liquidity requirements play a role with respect to registered mutual funds that is analogous to bank capital requirements.

The liquidity requirements applicable to registered mutual funds seek to protect investors and seek to assure that investors are able to redeem shares on each business day and that even significant redemption requests will not impair investors' ability to redeem their investments. In the United States, mutual funds, including exchange traded funds ("**ETFs**"), are required to maintain at least 85% of their portfolios in liquid securities[38] and money market funds must comply with even more stringent liquidity requirements.[39] The risk of forced liquidation is also low for other types of investment funds as a result of

---

34 Consultative Document at 29.

35 *See also* Tarullo, Speech, *supra* note 21.

36 Consultative Document at 29-30.

37 Consultative Document at 29.

38 The SEC has taken the position historically that a registered open end fund must limit its holdings of illiquid securities (that is, those that cannot be sold within seven days at current value) to no more than 15% of the fund's assets. *See* Revisions of Guidelines to Form N-1A, 57 Fed. Reg. 9828 (Mar. 20, 1992). In addition, mutual funds are required to pay out redemptions within seven days.

39 A money market fund must limit its holdings of illiquid securities (that is, those that cannot be sold within seven days at current value) to no more than 5% of the fund's assets. Rule 2a-7(c)(5) under the Investment Company Act of 1940.

certain characteristics generally applicable to investment funds. For example, investment funds are generally able to distribute their assets in kind to meet investors redemption requests, an option that helps minimize the market impact of fund dissolution. Finally, we note that for every seller of a distressed asset at a loss, there is a buyer with the potential to realize a gain, perhaps significant, over time once the value of such asset recovers.

Although we recognize the significance of the final transmission channel, "Critical function or service / Substitutability," to other types of financial entities, we agree with the FSB's and IOSCO's determination that it is not applicable to investment funds because they are highly substitutable.[40] We discuss in our responses to Q3-3 and Q6-1 our concern that the proposed assessment methodology does not appear to appreciate fully the significance of the high degree of substitutability of investment funds. For example, in order for an entity to be a G-SIFI, its distress or disorderly failure has to "cause significant disruption to the global financial system and economic activity across jurisdictions." This type of significant disruption can only occur where the entity in question is highly interconnected (*e.g.*, via significant contracts with financial institution counterparties and creditors, generally associated with a high level of leverage) and not substitutable. As we discuss throughout this letter, certain characteristics of investment funds and asset managers make them highly substitutable. For example, third-party custody arrangements facilitate the substitution of asset managers. In the case of separate accounts, clients may easily change asset managers in the event of unsatisfactory performance or in order to pursue different investment strategies by removing trading discretion from one manager and granting it to another. In those cases, assets may never move from an existing custody bank and there may be no immediate sales of assets in the market.

2. High-level framework for identifying NBNI G-SIFIs

Q2-1. Does the high-level framework for identifying NBNI G-SIFIs (including the five basic impact factors) adequately capture how failure of NBNI financial entities could cause significant disruption to the wider financial system and economic activity? Are there any other impact factors that should be considered in addition to those currently proposed or should any of them be removed? If so, why?

We appreciate the difficulty the FSB and IOSCO face as they attempt to design a high-level framework for identifying NBNI G-SIFIs that (i) will relate to a wide range of different types of NBNI financial entities and (ii) is "broadly consistent" with the impact factors used to evaluate banks and insurance companies.[41] The Consultative Document notes that the very different nature of risk and regulation among sectors of the financial markets complicate any attempt to design a single, uniform assessment methodology for all financial entities. As we describe in Section II of the Introduction to this letter, we believe that it is inappropriate to assume that investment funds possess certain impact factors (specifically, leverage and maturity transformation) that are implied risks for all banks and insurance companies and that such characteristics, which are taken for a given with respect to banks and insurance companies, should be considered specifically with respect to investment funds. We believe that uncertainty about how to identify specific investment funds that may pose higher risk than other investment funds reflects the fact that ***G-SIFI designation may not be a useful tool in the asset***

---

40 Consultative Document at 29 and 30.

41 Consultative Document at 2 and 5.

management industry where effective regulation is activities-based, and not necessarily concentrated in or linked over time to specific entities.[42]

We do not suggest that any impact factor in the proposed assessment methodology be removed, but believe that "size" should not be a high priority impact factor or used as a materiality threshold and believe that three new impact factors should be added to the methodology. We believe that "size" is not indicative of systemic risk for an investment fund; and the assertion that "the importance of a single entity for the stability of the financial system generally increases with the scale of financial activity that the entity undertakes"[43] is not supportable in the context of investment funds. As a stand-alone materiality threshold, size will capture too many large but not systemically important investment funds and may miss highly leveraged but relatively small investment funds that could be sources of systemic risk. We believe that size is a counterintuitive impact factor because small investment funds that hold concentrated portfolios can create higher risk, while large, diversified investment funds are likely to be less risky. We propose that a size impact factor, if considered, should not be the assessment methodology's primary impact factor or stand-alone materiality threshold.

Interconnectedness (an impact factor in the proposed assessment methodology) and three new impact factors (leverage, maturity transformation and inadequate existing regulation) should take priority over size in the assessment methodology.[44] We believe that interconnectedness and leverage are the most important impact factors for determining whether investment funds present the combination of characteristics required for G-SIFIs. After interconnectedness and leverage, maturity transformation and inadequate existing regulation are secondary impact factors, and size should be considered only if these impact factors are present. We note that the U.S. Financial Stability Oversight Council (the "**FSOC**") included leverage, liquidity risk and maturity mismatch, and existing regulatory scrutiny among the evaluation factors in its systemic risk evaluation framework.[45] As we discuss in our response to Q3-2, the materiality threshold for investment funds should consider size only if leverage and inadequate existing regulation are present.

Interconnectedness

We strongly agree with the FSB's and IOSCO's decision to include interconnectedness among the impact factors relevant to investment funds. While leverage, which we believe should be an impact factor (rather than an indicator under interconnectedness[46]), helps determine an investment fund's susceptibility to failure, interconnectedness measures whether an investment fund's failure could harm other financial entities – the critical element of any systemic risk analysis. In this regard, we think that the focus on "total net counterparty credit exposure," defined as the "total sum of all residual uncovered

---

42 FSB and IOSCO acknowledge that NBNI financial entities "are primarily and traditionally regulated from a conduct of business (or investor/consumer protection) perspective." Consultative Document at 6. As we demonstrate throughout this letter, we believe that this conduct of business or activities-based regulatory approach reflects the character of the asset management industry.

43 Consultative Document at 5.

44 Although we do not discuss them in our response letter, we believe that the "complexity" and "global activity" impact factors in the proposed assessment methodology are appropriate, although lower in priority than leverage, interconnectedness, maturity transformation and inadequate existing regulation.

45 FSOC Final Rules Release.

46 See our response to Q6-5.

exposures that the fund positions represent for its counterparties, after considering valid netting agreements and collateral/margin posted by the fund to its counterparties," appropriately focuses on uncollateralized positions as potential avenues under which an investment fund's creditors and contract counterparties could be exposed to harm if the investment fund defaults. The total number of an investment fund's counterparties, and whether such counterparties are G-SIFIs themselves, is less important from a systemic risk perspective than the extent to which positions are collateralized. The evaluation should focus on the potential exposure of an investment fund's counterparties to the investment fund's credit risk. We also note that an evaluation of an investment fund's interconnectedness should focus on an investment fund's relationships with its creditors and contract counterparties, and not with issuers of debt securities in which the investment fund may invest.

U.S. regulators considered interconnectedness and systemic risk in defining "major swap participant" and "major security-based swap participant" (collectively, "**MSPs**"), new categories of registrants created in Title VII of the Dodd-Frank Act, and their guidance strikes us as relevant and helpful to the FSB and IOSCO as they design NBNI G-SIFI assessment methodologies. Pursuant to a Dodd-Frank Act mandate to reduce risk and regulate participants in swap markets, the Securities and Exchange Commission (the "**SEC**") and the Commodity Futures Trading Commission (the "**CFTC**") designed standards to evaluate whether an entity's "substantial position" in swaps or security-based swaps pose market risks or whether an entity's "outstanding swaps or security-based swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets."[47] Entities that fall within the definition of "major swap participants" or "major security-based swap participants," are subject to registration requirements and heightened regulation. The definitions focus on uncollateralized counterparty exposures and default-related credit risks, consider whether swap contracts are cleared or subject to daily mark-to-market margining requirements, and account for netting arrangements that may reduce a counterparty's exposure.[48] We suggest that the FSB and IOSCO take a similar approach as the MSP tests in measuring interconnectedness.

Leverage

We believe that leverage should be an impact factor used to evaluate whether an investment fund is a G-SIFI. A high level of leverage can create risk of failure of an investment fund (as it can with any company) and will increase the risk of forced liquidation and insolvency that otherwise might not exist with respect to an unleveraged investment fund. National regulators recognize that leverage is a primary source of risk in the asset management industry and certain activities-based regulation already helps address the risks associated with high levels of leverage. For example, U.S. registered investment companies are subject to strict leverage limits[49] and U.S. investment funds are

47 SEC and CFTC, Joint Final Rule, "Further Definition of 'Swap Dealer,' 'Security-Based Swap Dealer,' 'Major Swap Participant,' 'Major Security-Based Swap Participant' and 'Eligible Contract Participant,'" 77 Fed. Reg. 30,596 (May 23, 2012) (the "MSP Release").

48 MSP Release at 30,661-30,697.

49 Under Section 18 of the ICA, registered funds generally may not incur indebtedness or otherwise issue "senior securities" without having an asset coverage of at least 300 percent (including the amount borrowed). Registered closed-end funds also must comply with this asset coverage requirement with regard to issuances of debt securities and must have at least 200 percent asset coverage in the event of issuances of preferred stock (including the involuntary liquidation preference of such preferred stock). In addition, the SEC and its staff generally view any transaction that exposes a registered fund to a risk of loss greater than the amount of the investment as raising senior security concerns. *See* SEC, General Statement of Policy, "Securities Trading Practices of Registered Investment Companies," 44 Fed. Reg. 25,128 (April

subject to regulation, including new rules adopted under Title VII of the Dodd-Frank Act (*e.g.*, margin and collateral requirements), that limit the amount of leverage embedded in derivative instruments that they can incur.

The Consultative Document explains that the FSB sought to select impact factors for NBNI financial entities that are broadly consistent with the impact factors used to identify systemically important banks and insurance companies.[50] The impact factors set out in the Consultative Document, which do not expressly include leverage, reflect that approach. We believe that the impact factors for banks and insurance companies do not include leverage because those companies are inherently highly leveraged and exposed to liquidity risk and, therefore, leverage is an implied impact factor with respect to those companies. In the case of investment funds, leverage may not be present and should not be assumed. Consequently, we believe that it should be an explicit impact factor for investment funds.

Maturity Transformation

We believe that maturity transformation should be an additional impact factor. Maturity transformation (*i.e.*, the difference between the maturities of a company's assets and liabilities) can be a source of risk for investment funds (and other types of financial entities) because, like high levels of leverage, maturity transformation exposes investment funds to liquidity risk and risk of distress and possible failure. The strict liquidity requirements applicable to U.S. registered investment funds limit maturity transformation risk for those funds.

Banks, as financial intermediaries, engage in maturity transformation when they accept demand deposits and make longer-term loans. Bank are subject to risk associated with the different terms of their deposits and loans because they are obligated to return the full amount of their customers' deposits at any time on demand. Unlike an investment fund's investors, depositors will not absorb the bank's balance sheet losses. Investment funds may be exposed to maturity transformation risk if they are leveraged, hold illiquid investments or engage in a large amount of certain types of transactions. Investment funds, however, generally seek to manage redemption risk by either maintaining a high percentage of liquid assets or employing other liquidity management tools (including redemption gates, redemptions in kind and the other tools mentioned in the Consultative Document[51]) depending on the type of investment fund. They are also not exposed to the same level of maturity transformation risk as banks because, as the FSB and IOSCO acknowledge, investment fund investors bear the risk of loss of their investments.

Investment funds that are subject to maturity transformation risk, such as investment funds that engage in a significant amount of securities lending and repo transactions, engage in activities that differentiate them from other investment funds. We believe that investment funds that are subject to maturity transformation risk are best regulated on an activities- or product-basis, and not by selective G-SIFI designation. We note that current regulation, such as liquidity requirements applicable to registered

---

27, 1979). Without resolving whether certain derivatives transactions that create leverage are senior securities, the SEC staff generally will not treat leveraged transactions as senior securities provided that a fund enters into a fully offsetting transaction (*e.g.*, owning a security that the fund has sold short) or by segregating or earmarking on its custodian's books liquid assets equal in value to the fund's potential exposure from the leveraged transaction.

[50] Consultative Document at 2.

[51] Consultative Document at 30.

investment funds, addresses and proposed regulation, such as money market fund reform, seeks to address, risks associated with these activities.

Inadequate Existing Regulation

We believe that the extent to which investment funds are currently regulated should be an additional impact factor because existing regulation may effectively address and monitor the types of risk exposure that G-SIFI designation would seek to address and monitor, and new regulation should be avoided if it would be duplicative and/or ineffective. For example, registered investment companies in the United States are subject to extensive regulation, including leverage limits and liquidity requirements among other rules, that prevents them from acquiring the characteristics necessary to meet the G-SIFI standard. We provide more detail about the impact of existing regulation in our response to Q2-2.

Q2-2: Is the initial focus on (i) finance companies, (ii) market intermediaries, and (iii) investment funds in developing sector-specific methodologies appropriate? Are there other NBNI financial entity types that the FSB should focus on? If so, why?

The assessment methodology does not focus on certain significant market participants that engage in potentially high risk investment activities on their own behalf and may hold large investment portfolios on their own balance sheets. Entities that invest directly without engaging an investment adviser to manage their assets, including some real estate investment trusts, sovereign wealth funds, family offices, central banks, and highly leveraged private entities, may be sources of potential systemic risk and may be subject to a lower level of regulation than "investment funds" as defined in the Consultative Document. We do not understand why these entities would not be captured by the proposed assessment methodology while investment funds would be.

We believe that the FSB and IOSCO should focus their efforts to identify NBNI G-SIFIs on NBNI financial entities that are likely to meet the G-SIFI standard and could be regulated effectively by entity-specific designation. U.S. investment funds and asset managers are subject to extensive regulation that is generally activities-based and prevents any of them from possessing certain characteristics that are necessary for entities to be considered G-SIFIs. Moreover, as discussed above, selective regulation also would not effectively reduce risk among investment funds because risk could easily migrate to undesignated investment funds. The high degree of substitutability of investment funds and the ease with which asset managers can enter new markets and deploy new investment funds that pursue new strategies makes investment funds inappropriate for G-SIFI designation.

We believe that existing and proposed regulation effectively and comprehensively regulates U.S. investment funds. We summarize certain current regulation applicable to U.S. investment funds, asset managers and market activities in the following subsections of our response to Q2-2.

Regulation of U.S. Investment Funds

U.S. investment funds that are registered with the SEC are subject to extensive regulation under the Investment Company Act of 1940 (the "**ICA**") and related rules. Under the ICA, registered funds must comply with asset safekeeping and custody requirements, recordkeeping requirements, leverage restrictions, restrictions on transactions with affiliated persons, conflicts of interest rules, diversification and liquidity requirements, among other things. Investment fund managers are subject to inspection and examination by the SEC for compliance with its rules. U.S. investment funds are also subject to reporting and disclosure requirements under the ICA and the Securities Exchange Act of 1934.

Additionally, the Dodd-Frank Act created MSPs, a new category of registrant which may include investment funds, to address concerns that certain nondealer market participants can create a high level of risk that could significantly impact the U.S. financial markets if left unregulated.[52] MSPs are additions to the category of dealers which captures traditional entities that make a market in swaps and security-based swaps. Congress tasked the CFTC and the SEC with further defining key concepts in the definition of MSP used in the Dodd-Frank Act. The final rule release indicates that the CFTC and SEC determined that it would not be appropriate to regulate investment advisers as MSPs since no risk associated with swap positions is attributable to them. Instead, the CFTC and SEC clarified that the MSP test should be performed on a fund-by-fund basis.[53] These rules would apply to investment funds that create excessive amounts of swap exposure by requiring them to post additional margin and hold additional capital, as well as to make additional reporting and take other measures to mitigate risk.

Regulation of U.S. Asset Managers

Asset managers are subject to regulation by multiple regulators under multiple regimes worldwide. In the United States, under the Investment Advisers Act of 1940 (the "**Advisers Act**") and related rules, a large majority of asset managers must register with the SEC and comply with an extensive set of conflict of interest, record keeping, disclosure, custody, reporting and other requirements. Registered investment advisers are subject to inspection and examination by the SEC. Registered investment advisers are required to file a report on Form ADV, which is made public, that describes their business activities, total assets under management, ownership, disciplinary history, and extensive private fund information, among other things. Investment advisers to private funds with at least $150 million in assets under management must file Form PF with the SEC to provide the regulators detailed information about their geographic, market, credit and liquidity risk exposures. Asset managers that direct investments in listed equities and exchange-traded options over a certain threshold must register with the SEC as "large traders." Broker-dealers, in turn, must record trading information and report such information to the SEC upon request.

The CFTC also regulates asset managers that offer investment advice with respect to commodity interests such as futures, commodity options and swaps and/or sponsor collective investment vehicles that trade such instruments. Asset managers that direct investments in futures and options, and in certain swaps, above certain thresholds are subject to the CFTC's large trader reporting regimes and must report the positions that they take on behalf of their clients promptly upon demand. In addition, exchanges maintain position limits and accountability levels that are designed to cap the size of the trading positions that asset managers and accounts deemed to be within their control can take in certain commodity futures contracts, on an aggregate basis, in order to curb any single trader's ability to

---

[52] *See* MSP Release.

[53] MSP Release at 30,689-30,690. The final rules provide numeric tests regarding whether an investment fund or other entity exceeds certain thresholds in its amount of swap exposure to determine whether these entities should be regulated as MSPs by the CFTC and/or the SEC. In the final rules defining MSP, the CFTC and the SEC stated that they chose certain thresholds to capture an entity before it reaches a level of risk that could be deemed systemic. MSP Release at 30,666. We believe that these thresholds may be instructive for the FSB and IOSCO with respect to assessing NBNI entities.

influence or control a market.[54] The CFTC is also in the process of proposing new rules relating to position limits for other commodity futures and swaps contracts.[55]

The CFTC rules also impose reporting, recordkeeping and disclosure requirements on certain asset managers and certain affiliated entities that fall within the commodity pool operator ("**CPO**") or commodity trading advisor ("**CTA**") registration requirements. A substantial number of operators of both private funds and registered funds, including asset managers, are registered as CPOs and/or CTAs. Significant periodic reporting requirements are imposed on registered CPOs and CTAs in Form CPO-PQR and Form CTA-PR, respectively, which require registered CPOs and CTAs to provide detailed schedules of their investments and other information to the CFTC. The reporting obligations for CTA registrants require disclosure relating to separate accounts managed by registered CTAs.

Regulation of Market Activity in the United States

The CFTC and SEC have proposed and/or implemented a number of rules pursuant to Title VII that are transforming certain aspects of trading in derivatives. The Title VII regulations are designed to address risks, including systemic risks associated with excessive leverage at certain financial institutions and the lack of transparency in derivatives trading, that played a role in the financial crisis. The new initiatives include:

(a) mandatory clearing and execution on new trading platforms of certain swaps designed to increase transparency and limit counterparty risk in standardized contracts,[56]

(b) margin requirements for both uncleared and cleared swaps designed to limit counterparty risk in derivative contracts and limit the amount of leverage created by these instruments,[57]

(c) capital requirements for swap dealers and MSPs to reduce the likelihood of insolvency,[58] and

(d) new data reporting and recordkeeping requirements to give the CFTC and SEC greater transparency into trading in derivatives and improve their ability to monitor trading activity.[59]

Each of these measures is intended to reduce leverage, increase transparency, aid in monitoring trading activity, and mitigate risk in derivatives transactions and each measure addresses a

---

54 *See* Section 737 of the Dodd-Frank Act.

55 *See* Section 737 of the Dodd-Frank Act; Commodity Futures Trading Commission, Proposed Rule, "Position Limits for Derivatives," 78 Fed. Reg. 75680 (Dec. 12, 2013); and Commodity Futures Trading Commission, Proposed Rule. "Aggregation of Positions," 78 Fed. Reg. 68946 (Nov. 15. 2013).

56 *See* Sections 723 and 763(a) and (c) of the Dodd-Frank Act.

57 *See* Sections 731 and 764(a) of the Dodd-Frank Act.

58 *See* Sections 731 and 764(a) of the Dodd-Frank Act.

59 *See* Sections 728, 763(i) and 766 of the Dodd-Frank Act.

potential source of risk to the financial markets and its participants. These regulations do not apply only to a handful of entities identified once each year as the NBNI G-SIFI requirements would; rather, they apply to all entities that engage in certain activities. These new regulations are designed to help protect the financial system, including investment funds and accounts and their investors.

In addition to CFTC and SEC derivatives regulation, other efforts are underway to mitigate the market risks that arose during the financial crisis. For example, the Treasury Market Practices Group ("**TMPG**") of the Federal Reserve Bank of New York ("**FRBNY**") recently implemented revised settlement guidelines to support more timely trade confirmations in the tri-party repo market.[60] Further reforms required by FRBNY will mitigate intraday credit risks, enhance transparency and mitigate risks related to defaulted securities.[61] Similar to the margin requirements for swaps, TMPG also has required margining for forward-settling mortgage-backed securities, which will mitigate risk inherent in these instruments and limit any leveraging effect of investments in securities that settle at a later date. Recently, the Financial Industry Regulatory Authority ("**FINRA**") also proposed changes to its rules, formalizing these requirements for FINRA member broker-dealers and the counterparties they trade with, which include investment funds and accounts.[62]

3. Operational Framework for NBNI G-SIFI Methodologies

Q3-2. In your view, are the above proposed materiality thresholds (including the level) for the NBNI financial entity types appropriate for providing an initial filter of the NBNI financial universe and limiting the pool of firms for which more detailed data will be collected and to which the sector-specific methodology will be applied? If not, please provide alternative proposals for a more appropriate initial filter (with quantitative data to back-up such proposals).

We do not believe that size on a standalone basis is an appropriate materiality threshold for, or a meaningful indicator of risk related to, investment funds. Investment funds' risk is related to portfolio composition and investment strategy. It may concentrate at relatively small investment funds with highly leveraged portfolios or highly concentrated investment strategies or be dispersed across a large number of small unaffiliated firms that pursue the same strategy or engage in the same activities. ***We believe that the materiality threshold for investment funds should consider size only if other risk factors, including leverage and inadequate existing regulation, are present.***

We are concerned that the proposed materiality threshold for investment funds (USD 100 billion in net assets under management ("**AUM**"), or, in the case of hedge funds, USD 400-600 billion in Gross Notional Exposure ("**GNE**")) seems to qualify only U.S. investment funds for designation. The threshold appears to be arbitrary and the FSB and IOSCO offer no evidence that it is indicative of potential systemic risk in investment funds. As we discuss in Section IV of the Introduction to this letter, the Consultative Document should acknowledge the jurisdictional implications of the proposed assessment methodology for investment funds.

60 *See* Treasury Markets Practice Group, "Best Practices for Treasury, Agency Debt, and Agency Mortgage-Backed Securities Markets," Revised May 2013, *available at* www.newyorkfed.org/tmpg.

61 TMPG, "TMPG Announces Market Practice Recommendations to Support More Timely Trade Confirmation in the Tri-Party Repo Market" (May 23, 2013).

62 *See* FINRA, *FINRA Requests Comment on Proposed Amendments to FINRA Rule 4210 for Transactions in the TBA Market, FINRA Regulatory Notice 14-02*, Jan. 2014, available at http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p439087.pdf.

We do not believe that GNE is a good measure of hedge fund risk. Leverage risk is related to the character of a hedge fund's underlying assets and the type of leverage employed by the fund. The definition of GNE does not account for the fact that all leverage does not create the same level or type of risk. For example, interest rate swaps will create a high level of GNE but do not create a high level of risk. We believe that an appropriate measurement of exposure would be risk-weighted. Finally, the assessment methodology should clarify how hedged investments would be counted towards GNE. Because derivatives generally settle on a net basis, including the notional value of derivatives in GNE could limit the utility of the metric and is likely to obscure the actual risk level of the fund.

Leverage should be one element of the materiality threshold for investment funds. We think that the quantitative thresholds the FSOC will apply to evaluate nonbank financial companies under Section 113 of the Dodd-Frank Act in the first stage ("**Stage 1**") of its three-stage evaluation process are a valuable model for the FSB's NBNI assessment methodologies. Like the materiality threshold in the FSB assessment methodologies, the FSOC's Stage 1 factors are an initial filter of financial entities eligible for designation. Stage 1 of the FSOC process "is designed to narrow the universe of nonbank financial companies to a smaller set [of entities] . . . by applying uniform quantitative thresholds that are broadly applicable across the financial sector to a large group of nonbank financial companies."[63] Any entity with $50 billion or more in total consolidated assets and any one of five different quantitative indicators, including a 15:1 or higher leverage ratio, will be evaluated in the second stage of the FSOC analysis.[64] We think a 15:1 leverage ratio is an appropriate materiality threshold and that the FSB should design a materiality threshold that, like the FSOC Stage 1 factors, acknowledges that size, unless present in combination with other risk factors, should not qualify an investment fund for G-SIFI designation.

The FSB and IOSCO should also adopt a higher size threshold for their investment fund assessment methodology than the FSOC has adopted in its Stage 1 non-bank financial entity evaluation process under Section 113. The Basel Committee has determined a leverage threshold applicable to banks that are systemically important and we do not think that investment funds should be held to a different standard.[65] The FSB's bank assessment methodology uses a €200 billion materiality threshold.[66] We are not aware of any evidence that suggests that investment funds are a greater source of systemic risk than banks and do not think that investment funds should be held to a lower materiality threshold than banks. Evidence that banks may be a significantly larger source of systemic risk than investment funds suggests to us that the investment fund materiality threshold should be significantly higher than the threshold applicable to banks. Finally, the assessment methodology must include existing regulation in the materiality threshold for investment funds. We think that consideration of existing regulation early in the G-SIFI evaluation process will help the FSB and IOSCO focus their concern on investment funds, if any exist, that may be sources of unmitigated and unregulated systemic risk. ***We believe that the FSB and IOSCO should adopt a materiality threshold composed of (i) a 15:1 or higher leverage ratio, (ii) inadequate existing regulation, and (iii), only if elements (i) and (ii) are present, assets above €200 billion.***

Q3-3. Are there any practical difficulties in applying the materiality thresholds?

---

63 FSOC Final Rules Release at 21,642.

64 FSOC Final Rules Release at 21,643.

65 *See* G-SIB Methodology at 11.

66 The G-SIB Methodology requires "all banks with a leverage ratio exposure measure exceeding €200 billion . . . to ensure that the 12 indicators used in the assessment methodology are made publicly available" and to be subject to annual G-SIB review and, potentially, classification. G-SIB Methodology at 11.

Because assets are highly mobile and asset managers and investment funds are easily substitutable, the investment funds that are in the NBNI G-SIFI assessment pool at any point in time could change quickly if size is the initial materiality threshold. In fact, we believe the initial assessment pool would be likely to change quickly if investors were to perceive classification as a NBNI G-SIFI as a negative status because investors might withdraw from investment funds that have AUM or GNE above the threshold.

The Consultative Document proposes creating a "buffer" below the materiality threshold to assure that investment funds that attempt to avoid designation are captured by the methodology. It proposes that national authorities would have discretion to add investment funds in their jurisdiction that are below the materiality threshold.[67] We are concerned that increasing regulators' discretion will lead to non-transparent and inconsistent regulation and that asset mobility and manager substitution could undermine any regulatory regime that attempts to regulate specific investment funds based on their AUM or GNE. Moreover, identifying investment funds annually is not likely to be a sufficiently flexible mechanism due to the easy mobility of investment funds' assets.

Q3-5. Do you think that it would be beneficial to set additional materiality thresholds based on "global activity"? If so, please explain the possible indicator and the level on which materiality thresholds should be set (with reasons for selecting such indicator, the level and any practical challenges).

We do not believe that it would be beneficial to set additional materiality thresholds based on "global activity" because: (i) if a manager sponsors investment funds in multiple jurisdictions, each investment fund will be organized separately in those jurisdictions and losses in one investment fund will not necessarily have any impact on the performance of an investment fund in another jurisdiction; (ii) the global investment activities of a single investment fund do not complicate the resolution of the investment fund because, unlike banks and other types of financial entities, investment funds do not branch; and (iii) global diversification could be a risk mitigating factor for investment funds and should not necessarily be viewed as a source of additional risk.

6. Sector-Specific Methodologies: Investment Funds

Q6-1. In your view, does the proposed definition of investment funds provide a practical basis for applying the specific methodology (i.e. indicators) to assess the systemic importance of NBNI financial entities that fall under the definition?

The definition captures many types of funds and investment products that are subject to different levels and types of regulation and that attract different types of investors with different risk appetites. For example, the definition captures both money market funds and hedge funds. We believe that the definition is so expansive that it is difficult to believe that a coherent set of regulations could be developed to apply if any individual investment funds were captured by the assessment methodology. We understand that the methodology may call on national authorities to identify and assess the investment funds in their jurisdiction, and that it may give national authorities discretion to include investment funds that are not captured by the assessment methodology. It is critical that the assessment methodology be applied consistently and that data be collected and analyzed in a consistent manner across jurisdictions. In particular, we believe that it will be important to standardize the definition of "hedge fund" to avoid regulatory arbitrage.

---

[67] Consultative Document at 11.

Q6-2. Does the above description of systemic importance of asset management entities adequately capture potential systemic risks associated with their financial distress or disorderly failure at the global level?

The description of the systemic importance of asset management entities correctly acknowledges many characteristics of investment funds (and the asset management industry generally) that mitigate potential systemic risks and differentiate investment funds from other types of financial entities (and differentiate the asset management industry from other sectors of the financial industry). For example, we agree with the FSB's summary of factors that "dampen the global systemic impact of a fund failure" including: (i) investment funds contain a "shock absorber" feature because investors absorb an investment fund's losses; (ii) investment managers are agents of their clients; (iii) investment funds and asset managers are highly substitutable and investment fund assets are highly mobile; and (iv) investment funds may use one or more liquidity management tools, such as in kind redemption, temporary suspensions, gates and side-pockets. However, the description also overstates certain risks.

We are concerned that the description overemphasizes the risk of forced liquidation of (or a "run" on) an investment fund or a family of investment funds. The risk of fund liquidation described in the Consultative Document is inconsistent with the experiences of our members and includes no supporting data to substantiate the concern. The Consultative Document similarly overstates risks associated with highly correlated trading strategies (i.e., "herding" or "crowded trades").

We do not think that the description of systemic importance of investment funds acknowledges the low likelihood of a destabilizing liquidation of an investment fund's assets, particularly in the context of U.S. registered investment companies. The Consultative Document asserts, without providing supporting data, that investment funds may experience a run on their financing through redemptions or increased margin calls that could cause forced liquidations and market distortions, and claims that "the loss of investor confidence in one specific asset class as a result of the distress of one particular fund" could lead to runs on other funds "presenting similar features or conducting a similar strategy."[68] We are concerned that, in these statements, the Consultative Document is referring to market theories previously alleged about one area of the asset management industry (money market funds) to support a conclusion that these fact patterns and market theories describe the entire asset management industry, without providing data or a theoretical basis to support that leap or, at a minimum, explaining why these patterns and theories have equal applicability in other contexts.

The Consultative Document exaggerates the potential for redemption risk in individual investment funds, the connections among investment funds and the risk that significant redemptions in one investment fund will cause other investment funds to suffer significant redemptions. As we discuss in our response to Q1-1, leverage limits and liquidity requirements applicable to U.S. registered investment companies that generally use little or no leverage and do not have fixed liabilities, including mutual funds, ETFs and registered closed-end funds, give these types of investment funds a different risk profile than the risk profile of highly leveraged private funds. We are concerned that the description of systemic risk related to investment funds does not appear to consider the risk mitigating impact of existing regulation and recent regulatory initiatives relevant to many types of investment funds.[69]

---

[68] Consultative Document at 29. Likewise, in the description of its rationale for the proposed focus on funds in the assessment methodology, the FSB explains that "second round effects on the financial system may occur due to a run on a fund."

[69] See our response to Q2-2.

The Consultative Document asserts, without providing clear or conclusive supporting data, that "during turbulent market conditions, if an investment fund or a group of investment funds in distress is forced to unwind positions that in turn could lead to a spiral of self-reinforcing movements for other investment funds (whose strategies may be identical or highly correlated – i.e. the so-called 'crowded trade' phenomenon), their counterparties and prime brokers, and the wider market, possibly exacerbated by an increase in investor redemptions." This statement does not reflect the fact that investment funds will react differently to periods of market stress based on their differing investment mandates, restrictions, investor demographics and other factors. Investment funds provide investors access to professional asset management resources and opportunities to direct and specify how their assets are invested. Fund managers provide advice to, and act as agents on behalf of, investors seeking exposure to certain investment strategies and their attendant investment results. We believe that investment funds, managed by professional asset managers, may lead to greater diversity of opinion in evaluating investment options in particular assets or asset classes and more thoughtful response in periods of market turbulence and, in that sense, may serve as a counter to herding behavior. As fiduciaries, asset managers must invest their clients' assets pursuant to investment mandates determined by their clients. Asset managers actively manage risks within the particular investment mandates of their clients and, therefore, function more as risk reducers than as risk takers. The Consultative Document does not explain how G-SIFI designation of a select number of investment funds would cure the risks it claims are associated with highly correlated investment patterns across a large number of investment funds. We do not believe that selective regulation would cure any risk of "crowded trades."

The description of risk associated with investment fund failure is not consistent with our understanding of historical examples of fund failures. The Consultative Document's description of hedge fund failures[70] focuses on a very specific type of hedge fund failure that perhaps most famously occurred when LTCM failed in 1998, but not all hedge fund strategies involve the type of highly-leveraged arbitrage investment strategies that contributed to the failure of LTCM. The failure of LTCM illustrates the fact that excessive use of leverage by investment funds can present systemic risk. Recent regulatory initiatives that seek to address risk related to leverage embedded in derivative instruments and liquidity risk, including the regulations (such as margin requirements and MSP designation) summarized in our response to Q2-2, also help address the types of leverage and liquidity risk that affected LTCM.

Finally, we understand that the losses experienced by the Reserve Primary Fund, a large money market fund, in 2008, without analysis, may seem to link large investment funds to systemic risk. Nonetheless, we believe it is important to distinguish the Reserve Primary Fund from other types of investment funds. The important lessons from the losses experienced by the Reserve Primary Fund are that characteristics of some money market funds, including a fixed net asset value and certain of their investor demographics, present unique risks that differentiate money market funds from other investment funds and that money market funds consequently warrant different regulation. We believe that the regulatory reforms already made and currently pending in the money market fund sector demonstrate an appropriate structural approach to the regulation of money market funds.

Money market fund regulation seeks to address all investment funds that engage in money market activities (*i.e.*, it is activities-based). It seeks to identify a type of investment fund believed by regulators to be more susceptible to systemic risk and to regulate them, as a class, in a manner that is appropriate for the class and different from investment funds that are less exposed to risk. An approach that targeted only large money market funds would be less effective than the comprehensive, activities-based regulations currently in place and under review.

---

[70] Consultative Document at 31.

Q6-3. Which of the following four levels of focus is appropriate for assessing the systemic importance of asset management entities: (i) individual investment funds; (ii) family of funds; (iii) asset managers on a stand-alone entity basis; and (iv) asset managers and their funds collectively? Please also explain the reasons why you think the chosen level of focus is more appropriate than others.

As we discuss in our response to Q6-4 and in the Introduction to this letter, we believe that FSB and IOSCO should revise the investment fund assessment methodology to focus on the activities of investment funds and other participants in the capital markets. If, however, FSB and IOSCO elect to focus on asset management entities, we agree with the FSB's and IOSCO's proposal to focus the assessment methodology on investment funds rather than families of funds, asset managers on a stand-alone entity basis or asset managers and their funds collectively. We agree with the FSB's and IOSCO's assessment that investment-related economic exposures are created at the investment fund level and appreciate their important observations that "the assets of a fund are not available to claims by general creditors of the asset manager" and funds are organized as separate legal entities from their managers.[71] Investment funds are also separate entities from one another.

We appreciate FSB's and IOSCO's recognition that information is currently made available to regulators at the fund level.[72] A substantial amount of information about the activities and investments of investment funds is already made available to regulators in a multitude of forms. It is our view that multiple entities should not be viewed on an aggregated basis merely because they have the same asset manager. Rather investment funds are legally separate, have different investment mandates, portfolio managers, contractual relationships and pools of investors, and they separately custody their assets.

We feel strongly that asset managers on a stand-alone basis would be an inappropriate class of financial entity to subject to G-SIFI designation and commend FSB and IOSCO for their determination to focus their assessment methodology on investment funds. As we discuss in our response to Q6-2 and the proposal acknowledges, asset managers are agents of their clients and are bound to abide by their clients' investment mandates in their investment activities. The distinction between managers and investment funds is key to understanding how and where risk exists in the asset management industry. In the United States, pursuant to applicable regulation, investment fund assets are not commingled with the assets of other investment funds or the proprietary assets held in the asset manager's name and are typically held by independent custodians. An asset manager's balance sheet is relevant to its financial wherewithal and its ability to operate its business, but is irrelevant with respect to its clients' investment experiences, whether gains or losses, and the potential impact of investment fund losses on financial markets. Consequently, we believe that focusing the assessment methodology on asset managers would not meaningfully evaluate systemic risk related to investment activities.

Finally, if the FSB and IOSCO decide to evaluate asset managers or asset managers and their funds collectively, we request that they publish a revised draft assessment methodology and provide the industry an opportunity to comment.

Q6-4. Should the methodology be designed to focus on whether particular activities or groups of activities pose systemic risks? If so, please explain the reason why and how such a methodology should be designed.

---

[71] Consultative Document at 30.

[72] Consultative Document at 30.

The Consultative Document notes that, although the approach would be inconsistent with the approach taken in the assessment methodology designed to evaluate banks and insurance companies, "another possible approach to assessing systemic risk in the asset management sector could be to consider possible financial stability risks that could arise out of certain asset management-related activities. Under this approach, the methodologies would consider how particular activities or group of activities might pose systemic risks." The differences between banks and insurance companies, on the one hand, and asset management entities, on the other, warrant a different approach to assessing risk. ***We believe that an assessment methodology that seeks to identify risk that may arise from the asset management industry, and from the capital markets broadly, should focus on investment activities and not specific entities because risk is highly unlikely to be concentrated in individual asset management entities and effective regulation of investment funds, other asset management entities and the capital markets is activities-based.***

An assessment methodology that identifies investment funds under an arbitrary set of impact factors (such as size on a standalone basis) designed to evaluate banks and insurance companies, and any selective regulation of entities identified under such assessment methodology, are not likely to identify or meaningfully reduce systemic risk that may arise from investment funds' activities as capital markets participants. An investment fund or other financial entity of almost any size that employs a very high level of leverage and engages in very high risk investment activities could theoretically have a systemic impact. The proper regulatory response to the risk posed by investment funds is activities-based regulation – and is not G-SIFI designation of a select number of investment funds.[73] To properly evaluate investment funds and address systemic risk, the assessment methodology must focus on investment funds engaged in high risk activities. We are concerned that this question highlights the challenges inherent in designating G-SIFIs without understanding what additional regulation will be applied to designated entities.

An activities-based assessment methodology will move away from entity designation which would be an outcome consistent with our understanding of how risk may arise from investment funds, the asset management industry and the capital markets generally. An activities-based approach would not lead to selective regulation of designated G-SIFIs. It would lead to regulation designed to mitigate risk associated with certain investment activities and types of investment funds, which we believe would be an effective and appropriate structure for regulation.

We believe that examples of concentrated risk at large institutions are far less prominent in the asset management industry than in other sectors. Because risks are more closely linked to specific investment activities and specific types of investment instruments than to particular entities, the asset management industry is best regulated on an activity basis, without heightened regulation imposed on a subset of the largest firms. Existing regulation of asset managers, investment funds and investment activities is generally composed of industry-wide and activity- and investment product-focused requirements – an approach that is responsive to the diffuse nature of risk in the asset management industry.[74] We note that certain ongoing regulatory initiatives, discussed in our response to Q2-2, reflect

---

[73] Tarullo, Speech, *supra* note 21 ("[T]he rationale for regulation provided by the potential for contagion effects is really an argument for sound regulation of the type of financial firm or instrument under consideration. If a small money market fund's travails can provoke a run on the entire industry, then all such funds should be subject to requirements that reduce the fragility of their business model. The potential for systemic problems would be essentially as great in an industry structure with many mid-sized funds as in one with a smaller number of large funds.")

[74] See our response to Q2-2.

an activities-based approach to regulation including: (i) derivatives regulatory reform; (ii) securities lending reform; (iii) money market fund reform; and (iv) repo market reform.

Q6-5. Are the proposed indicators appropriate for assessing the relevant impact factors? If not, please provide alternative indicators and the reasons why such measures are more appropriate.

Generally, we believe that certain of the proposed indicators are appropriate but that the focus on size on a standalone basis is misplaced because risk may concentrate in relatively small investment funds or across a large group of market participants of various sizes that that employ the same practices. We propose that leverage should be an impact factor, and a materiality threshold criterion, in the methodology, and not merely an indicator under "Interconnectedness" for investment funds. As we note in our response to Q3-2, we believe that the materiality threshold for investment funds should consider size only if other risk factors including leverage and inadequate existing regulation are present.

More granularly, the following indicators seem to miss the mark:

Indicator 1-1: Net assets under management (AUM or NAV) for the fund. We disagree with the assertion that the larger the size of an investment fund, the greater its potential impact on counterparties and markets. As discussed above, we believe that a size indicator on a standalone basis will identify too many large but not systemically important investment funds.[75]

Indicator 1-2: For hedge funds, GNE as an alternative indicator. The FSB and IOSCO are correct to identify use of leverage by private funds as a factor that distinguishes private funds from registered funds and increases their risk profile relative to registered funds with the same AUM. We do not support the proposal to measure hedge funds' size by GNE as a substitute for evaluating leverage. As discussed above, we do not believe that GNE is a good measure of a hedge fund's risk level because it is not risk-weighted. Rather than relying on GNE as a proxy for leverage, the investment fund assessment methodology should incorporate risk-weighted leverage as a stand-alone impact factor.[76]

Indicator 2-1: Leverage Ratio. The measure of an investment fund's leverage should be a stand-alone impact factor and should be risk-weighted to accurately measure the possible impact on counterparties of the investment fund and financial markets in the event of distress or failure of the investment fund.

Indicator 3-1: Turnover of the fund related to a specific asset / daily volume traded regarding the same asset. We do not believe that portfolio turnover related to a specific asset or trading regarding the same asset is a meaningful reflection of an investment fund's substitutability and are concerned that proposed Indicator 3-1 does not account for the fact that, in many instances, high portfolio turnover rates have no relevance to an evaluation of an investment fund's systemic risk level (for example, high turnover may reflect investments in assets that turnover naturally, such as fixed income securities, or portfolio rebalancing transactions). The FSB and IOSCO do not explain why they believe turnover related to a specific asset or trading regarding the same asset is relevant

75 See our response to Q2-1.

76 See our response to Q3-2.

to their evaluation of investment funds. We also note that the Indicator does not provide a relevant period for measuring turnover and should be clarified to do so.[77]

Indicator 3-2: Total fund turnover vs. total turnover of funds in the same category/classification. We do not believe that proposed Indicator 3-2 is a meaningful reflection of an investment fund's substitutability or necessarily relevant to the systemic risk associated with an investment fund. The FSB and IOSCO do not provide support for their assertion that "[t]he higher the ratio of fund turnover to total turnover of funds in the same category, the higher the potential systemic risk of the fund." Without additional explanation and support, we believe that the Indicator is not clearly relevant to an assessment of an investment fund's systemic risk profile and will be applied inconsistently.[78]

Indicator 3-3: Investment strategies (or asset classes) with less than 10 market players globally. Please see our response to Q6-8 below.

Indicator 4-1: OTC derivatives trade volumes at the fund / Total trade volumes at the fund. It is not necessarily true that investment funds that engage in a significant volume of OTC derivatives transactions in comparison to their total trading activity will be exposed to higher counterparty risk. An investment fund's level of counterparty risk will depend on the credit risk profiles of its counterparties and whether, and to what extent, counterparty risk is diversified across a number of counterparties. We are concerned that the Consultative Document makes this statement without offering any data or other support for it.

Indicator 4-4: Weighted-average portfolio liquidity (in days) / Weighted average investor liquidity (in days). We agree that portfolio liquidity and investor liquidity are important risk indicators, but propose that maturity transformation (i.e., the difference between the maturities of a company's assets and liabilities) be a primary impact factor in the investment fund assessment methodology rather than a subpart of the "Complexity" indicator.

Indicator 4-5: Ratio of unencumbered cash to GNE (or gross AUM). We do not believe that an investment fund's ratio of unencumbered cash to GNE (or gross AUM) is a meaningful measure of an investment fund's systemic risk, and, in particular, do not believe it is relevant to registered investment funds. Other regulatory regimes, including new derivatives margin requirements, seek to address the concerns the FSB and IOSCO raise regarding an investment fund's ability to satisfy margin calls or post collateral. We are concerned that a flat ratio would not be a useful metric and that it may be misleading.

Indicator 5-1: Number of jurisdictions in which a fund invests. It is not necessarily true that investment funds that invest globally may have a larger global impact than investment funds that invest in the securities of only a few jurisdictions. In fact, global investment strategies provide investment funds and their investors a risk mitigating diversification benefit that may not exist with respect to more concentrated funds. Moreover, a simple tally of the number of jurisdictions in which a fund invests will not

77 See our response to Q6-9.

78 See our response to Q6-9.

provide regulators meaningful information about systemic risk. Such a metric values all jurisdictions equally without regard for their relative political and regulatory risk levels, or relative levels of importance to the global financial system. It also values all investment activity equally without considering whether the investment activity in a given jurisdiction is important to the asset classes or markets in which the fund is invested or to the fund itself, and without considering whether that market is important to the financial system as a whole.

Indicator 5-2: Number of jurisdictions in which the fund is sold/listed. Just as with Indicator 5-1, a simple tally of the number of jurisdictions in which a fund is sold or listed will not provide regulators meaningful information about systemic risk. Because it does not account for the risk levels associated with the various relevant jurisdictions, the metric seems arbitrary and meaningless.

Q6-6. For "crossjurisdictional activities", should "the fund's use of service providers in other jurisdictions (e.g. custody assets with service providers in jurisdictions other than where its primary regulator is based)" be used?

We do not believe that using service providers in foreign jurisdictions should be an additional risk factor in the assessment methodology. Although investment funds routinely rely on foreign custodians, their relationships with foreign custodians are often managed and guaranteed by local custodians. We also note that separate account clients often select their own custodians. Q6-6 seems to suggest that an investment fund's custodian could be a source of risk. If that is the case, appropriate regulation should address custodians rather than a handful of investment funds that are their customers. We also believe that, in some instances, foreign service providers may insulate investment funds from risk and offer a diversification benefit to investment funds.

Q6-7. Is the definition of "net AUM" and "GNE" appropriate for assessing the "size" (indicators 1-1 and 1-2)?

We do not believe that GNE is appropriate measure of a hedge fund's size or an appropriate substitute for leverage in evaluating a hedge fund's potential systemic risk. Please refer to our response to Q3-4 above regarding GNE.

Q6-8. Is the definition of "investment strategies" sufficiently clear for assessing the "substitutability" (indicator 3-3)?

"Investment strategy" is not clearly defined in Indicator 3-3. The Consultative Document does not make clear whether an investment fund's "investment strategy" means the assets in which the investment fund invests, or the assets in which the investment fund invests and the investment fund's particular investment approach and/or trading style. For example, a merger arbitrage investment fund and a targeted single-industry long-only investment fund may invest in the same securities and have comparable portfolios at certain points in time but clearly should not be deemed to have the same investment strategy.

We are concerned that national authorities would encounter significant difficulty in evaluating investment funds on the basis of their investment strategies even if the term were clearly defined, and do not think that national regulators in different jurisdictions are likely to define or regulate investment funds' strategies consistently. Many investment funds' investment mandates, while targeted to achieve a certain market exposure or capture a specific strategy, permit the investment funds to invest in a wide range of asset classes so that reviewing an investment fund's disclosure regarding its investment

mandate may not provide regulators a meaningful understanding of the fund's investments. Reviewing investment funds' portfolios to determine their investment strategy also is not a realistic regulatory process. National authorities would have to spend a tremendous amount of time and consume extensive resources to determine and evaluate, on a case by case basis, the investment strategies of investment funds in order to evaluate whether an investment fund uses an investment strategy sufficiently unique to make it not substitutable. In particular, it would be difficult to determine the investment strategies of private funds that generally do not publicize their offering documents and report only summary information to their regulators.

The Consultative Document asserts, without offering any data or other support for the statement, that "there may be particular niche markets where a large fund invests heavily, either cornering or occupying a significant portion of the market, and where like substitutes may not be available."[79] We note that proposed position limits may in part address, in a systematic and measureable way, the systemic risk concern that the Consultative Document attempts to address in this indicator. We also note that, in many market sectors, investment funds' ability to achieve synthetic exposure to investment opportunities may create a type of substitutability that may be overlooked by evaluating the assets in which an investment fund invests.

Q6-9. Would collecting or providing any of the information included in the indicators present any practical problems? If so, please clarify which items, the practical problems, and possible proxies that could be collected or provided instead.

In addition to the difficulties highlighted in our response to Q6-8 that we believe would make any attempt by national authorities to evaluate, on a case-by-case basis, the investment strategies of investment funds a useless assessment process, we think that the indicators related to substitutability lack clearly defined terms and we are concerned that national authorities will not be able to identify and compare investment funds consistently based on the indicators. The description of *Indicator 3-1: Turnover of the fund related to a specific asset / daily volume traded regarding the same asset* in the Consultative Document explains that "attempts to measure a fund's substitutability by its turnover related to a specific asset, as measured by the fund's percentage of daily trading volume with respect to that asset's underlying market."[80] The description of *Indicator 3-2: Total fund turnover vs. total turnover of funds in the same category/classification* in the Consultative Document explains that "the higher the ratio of fund turnover to total turnover of funds in the same category, the higher the potential systemic risk of the fund."[81] None of the terms underlined in the preceding descriptions of Indicators 3-1 and 3-2 are defined or clear in context. We are concerned that the absence of clear definitions in the methodology will provide insufficient guidance to national authorities and may lead them to make improper assumptions and recommend investment funds for designation inappropriately. We are also concerned that the assessment methodology would be deployed inconsistently in each jurisdiction subject to it.

---

79 Consultative Document at 35. We think this Indicator 3-3 is flawed conceptually. Given the intense competition among investment funds and the ease with which large asset managers launch and close new investment funds, if a few funds dominate a market, the market is likely to be much too small to be relevant to the global financial system. The discussion in the Consultative Document of Indicator 3-3 seems to assume that "financial entities" are the only potential investors in a market and to ignore other market participants including wealthy individuals, family offices, and government sponsored entities like sovereign wealth and pension funds.

80 Consultative Document at 34 (emphasis added).

81 Consultative Document at 34 (emphasis added).

As we explain in the Introduction to this letter, we feel strongly that the assessment methodology be revised so that the impact factors and indicators are clear, the assessment process is transparent, clearly defined, objective, based on reliable data and applied consistently across jurisdictions so that national authorities are not given unlimited discretion to identify investment funds that exceed an arbitrary materiality threshold. U.S. investment funds provide an enormous amount of information about their businesses to U.S. regulators.[82] We believe that any additional request for information should be made only after carefully reviewing available information and using any comparable data already provided. New requirements to provide data to regulators, which impose significant burdens on asset management companies, should be preceded by a careful cost-benefit analysis.

Q6-10. Are there additional indicators that should be considered for assessing the relevant impact factors? For example, should "the fund's dominance in a particular strategy (as measured by its percentage of net AUM as compared to the total AUM" also be considered for "substitutability"? Similarly, should "leverage" or "structure" of a fund also be considered for assessing "complexity"? Please explain the possible indicators and the reasons why they should be considered.

In our response to Q2-1, we propose that leverage, maturity transformation and inadequate existing regulation should be additional impact factors in the investment fund assessment methodology. We think that, if the FSB and IOSCO add the new impact factors we propose, *leverage ratio* should be an indicator related to the new leverage impact factor and *weighted-average portfolio liquidity (in days) / Weighted average investor liquidity (in days)* should be an indicator related to the new maturity transformation impact factor.

We do not think that "the fund's dominance in a particular strategy (as measured by its percentage of net AUM as compared to the total AUM)" should be considered for "substitutability" because merely having a focused strategy or a sizeable share of a particular market is not indicative of a high-level of risk. At a minimum, an indicator that seeks to measure risk associated with an investment fund's dominance in a particular investment strategy would have to define "strategy" and then be risk-weighted to assess the level of risk that may be associated with an investment fund's underlying assets. We are concerned that the case-by-case analysis that would be required to evaluate an investment fund under such an indicator is not a practical or clear regulatory tool. "Dominance in a particular strategy" has no clear meaning and it is not likely that national authorities will interpret or apply the indicator in a consistent manner. As we have noted in preceding sections of this letter, we believe that the assessment methodology should be revised to include clear and specifically measurable standards to reduce the level of discretion given to national authorities and increase the transparency of the methodology.

Q6-11. Should certain indicators (or impact factors) be prioritised in assessing the systemic importance of investment funds? If so, please explain which indicator(s) and the reasons for prioritisation.

We believe that leverage and interconnectedness are the most important impact factors for determining whether investment funds present the combination of characteristics required for SIFIs. As we explain above, leverage can be taken for granted for banks and insurers so it is understandable that it would be considered an indicator rather than an impact factor for those businesses. Many investment funds employ little or no leverage and should not be presumed to employ it. The assessment methodology should reflect the fact that leverage must be employed by an investment fund in order for it to be able to fail and present the types of risk the FSB SIFI Framework seeks to address. After leverage and interconnectedness, we believe that maturity transformation and inadequate existing regulation are

[82] *See* SIFMA AMG OFR Study Response Letter.

secondary factors. Indicators related to these risk factors should be prioritized in assessing the systemic importance of investment funds. As we have discussed above, size should be a component of the materiality threshold but should not be used to evaluate investment funds without first considering leverage and inadequate existing regulation. As we noted above, we do not believe that size, considered without other portfolio-related risk factors, is a meaningful indicator of risk.

* * *

We appreciate the opportunity to comment afforded to us by the FSB and IOSCO, and stand ready to provide any additional information or assistance that the FSB or IOSCO might find useful. Should you have any questions, please do not hesitate to contact Tim Cameron of AMG at 212-313-1389, Matt Nevins of AMG at 212-313-1176 or Maria Gattuso of Willkie Farr & Gallagher LLP at 212-728-8294.

Sincerely,

Timothy W. Cameron, Esq.
Managing Director and Asset Management Group, Head
Securities Industry and Financial Markets Association

Matthew J. Nevins, Esq.
Managing Director and Associate General Counsel, Asset Management Group
Securities Industry and Financial Markets Association

cc: Mary Jo White, Chairman, Securities and Exchange Commission
Luis A. Aguilar, Commissioner, Securities and Exchange Commission
Daniel M. Gallagher, Commissioner, Securities and Exchange Commission
Kara M. Stein, Commissioner, Securities and Exchange Commission
Michael S. Piwowar, Commissioner, Securities and Exchange Commission
Norm Champ, Director of the Division of Investment Management, Securities and Exchange Commission
Jacob J. Lew, Secretary of the Treasury, Department of the Treasury
Mary J. Miller, Under Secretary for Domestic Finance, Department of the Treasury
Richard Berner, Director of the Office of Financial Research

asset management group

April 4, 2014

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

Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: "Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions"; "Asset Management and Financial Stability" Study by the Office of Financial Research

Dear Sirs/Madams:

Over the past few months, some policy makers have alluded to a lack of transparency into separate accounts managed by asset managers[1] which has led to significant conjecture regarding the risk profile of these portfolios. The OFR Study on Asset Management and Financial Stability[2] specifically cited data gaps related to separate accounts, and consultative document published by the Financial Stability Board (the "FSB") and International Organization of Securities Commissions ("IOSCO") on "Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions" referenced separate accounts as an area for further research.[3] In order to help policy makers gain insight into these accounts, the Asset Management Group ("AMG")[4] of the Securities Industry and Financial Markets Association ("**SIFMA**") asked its members and other firms listed in the "top 20 asset managers by AUM" in the OFR Study to respond to a survey regarding the separate

---

[1] One frequent source of confusion is the phrase "separate accounts" which has a very different meaning for insurance companies. Insurance separate accounts ("ISAs") were originally designed for investment-linked variable annuities. While there is a separate allocation of assets for an ISA, an ISA is reflected on the balance sheet of the insurance company to the extent there is a call on the general account assets of the insurance company. Non-ISA separate accounts managed by asset managers, on the other hand, are not included on the balance sheet of the asset manager and are generally held in a segregated account at an independent custodian.

[2] See Office of Financial Research, "OFR Study of Asset Management and Financial Stability" (Sept. 30 2013) (the "OFR Study").

[3] See FSB and IOSCO Consultative Document, "Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions," January 8, 2014.

[4] The AMG's members represent U.S. asset management firms whose combined assets under management exceed $30 trillion. The clients of AMG member firms include, among others, registered investment companies, endowments, state and local government pension funds, private sector Employee Retirement Income Security Act of 1974 pension funds and private funds such as hedge funds and private equity funds.

accounts that they manage. This letter summarizes the process undertaken and the findings of the survey.

The survey asked respondents to answer a number of questions about the separate accounts that they manage including investment strategy and asset class, use of leverage, investment in illiquid assets, use of securities lending, and the regulatory status of the underlying clients. The majority of questions in the survey asked respondents to focus on separate accounts with assets under management ("AUM") of $75 million or more ("Large Surveyed Separate Accounts"). Participants were also asked to detail their risk management processes, as well as the nature of their approach towards monitoring counterparty and other risks for separate accounts.

We are pleased to report that 9 managers with a combined firm total AUM of $11.2 trillion, and a median firm total AUM of $435 billion, voluntarily participated in this survey. In aggregate, these managers are responsible for $3.98 trillion in assets managed in separate accounts across a wide range of investment strategies – Large Surveyed Separate Accounts represent $3.86 trillion in AUM, or approximately 97% of the total separate account AUM reported in the survey. Additionally, the sum of each firm's 10 largest separate accounts represents just 8% of the combined firm total AUM. As detailed in the tables in the attached Appendix, 99% of the Large Surveyed Separate Accounts AUM reported in the survey were invested in long-only strategies, and 53% were invested in passively managed, index strategies.

In looking at the portfolios, we also asked firms to report the number of their Large Surveyed Separate Accounts that use leverage, hold illiquid assets, and engage in securities lending. In aggregate, less than 4% of the number of Large Surveyed Separate Accounts employ leverage and the average leverage reported for these accounts is modest.[5] Likewise, less than 2% of the number of these Large Surveyed Separate Accounts held illiquid securities.[6] Finally, less than 2% of the number of Large Surveyed Separate Accounts engage in securities lending and the majority of these portfolios are passively managed.[7]

In addition to looking at the investment strategies and investment practices, we asked the surveyed asset managers to provide information about the owners of these assets. Note that large institutional investors often prefer separate accounts over commingled investment vehicles for one of several reasons, including: the ability to negotiate fees, the ability to tailor the investment guidelines, and the ability to own the assets outright rather than owning a partial interest in the assets of a fund. Approximately 35% and 15% of the Large Surveyed Separate Accounts based on AUM are owned by

[5] Leverage was defined in the following manner: long market value that exceeds NAV for equity or gross market exposure minus margin for derivatives; long-only accounts that use derivatives for the purpose of hedging or benchmark replication were excluded.

[6] Illiquid securities were defined as tradeable securities that cannot be sold in 30 days or less at the price the security is current valued at.

[7] Simply because separate accounts hold illiquid assets or engage in securities lending does not imply that the entirety of the securities in the account are illiquid or are on loan. As such, a calculation using the portion of a separate account's assets that are invested in illiquid securities or on loan would be more precise and likely significantly smaller than the figures reported.

pension funds and insurance companies, respectively. These assets are subject to regulation by the clients' regulators (e.g., ERISA for certain US pension plans), in addition to the SEC's oversight of the asset managers. In addition, 10% of the Large Surveyed Separate Accounts AUM are subject to other types of regulatory oversight. The remaining approximately 40% of Large Separate Accounts AUM is managed primarily for official institutions, foundations and endowments, or are sub-advisory mandates. The clients who own the assets in separate accounts are sophisticated investors who monitor these portfolios for compliance with guidelines and to understand the risk exposures, or they employ an independent third party to perform these functions, in addition to the oversight provided by asset managers.

As a complement to the quantitative separate account data requested in the survey, we also asked firms to describe the risk management processes that they employ in the management of separate accounts. We are pleased to report that 100% of respondents monitor counterparty risk for their separate accounts and employ robust procedures to this end. As a primary measure, counterparty selection is a multi-departmental process with a strict evaluation of potential counterparties based on factors ranging from their creditworthiness, pricing, regulatory oversight, and trading capacity. Some counterparties may be approved for use in all markets, whereas others may be limited based on their review. After the selection process, asset management firms continue to monitor counterparties on a daily basis and particularly focus on their exposures (both current and potential future exposure) and any change in the counterparty's creditworthiness.

Asset managers also monitor a number of other risk metrics in the course of separate account management, such as traditional portfolio risk measures, including duration, convexity, volatility, concentration risk, and liquidity risk. Many of the responding asset managers also reported using stress test analyses to observe the sensitivities of portfolios to particular factors, as well as value-at-risk models. These tests may be performed by a variety of disciplines within an asset manager, including the portfolio management, risk management, and compliance teams to ensure risk is managed appropriately and accounts adhere to their mandates. In summary, asset management firms treat separate client accounts using the same process applied to all fiduciary assets and accounts that they manage. A more detailed summary of the findings of our survey relating to risk management is included in the attached Appendix.

*　　　*　　　*

AMG, together with investment managers who participated in this survey, have provided this information to better inform discussions of separate accounts. We welcome the opportunity to engage further on this topic if warranted. Should you have any questions, please do not hesitate to contact Tim Cameron at 212-313-1389 or Matt Nevins at 212-313-1176.

Sincerely,

Timothy W. Cameron, Esq.
Managing Director and Asset Management Group, Head
Securities Industry and Financial Markets Association

Matthew J. Nevins, Esq.
Managing Director and Associate General Counsel, Asset Management Group
Securities Industry and Financial Markets Association

cc: Mary Jo White, Chairman, Securities and Exchange Commission
Luis A. Aguilar, Commissioner, Securities and Exchange Commission
Daniel M. Gallagher, Commissioner, Securities and Exchange Commission
Kara M. Stein, Commissioner, Securities and Exchange Commission
Michael S. Piwowar, Commissioner, Securities and Exchange Commission
Norm Champ, Director of the Division of Investment Management, Securities and Exchange Commission
Jacob J. Lew, Secretary of the Treasury, Department of the Treasury
Mary J. Miller, Under Secretary for Domestic Finance, Department of the Treasury
Richard Berner, Director of the Office of Financial Research

Appendix

Separate Account Data Tables[8]

General Information about Sample ($ billions)		
Total Firm AUM Responding	$	11,241
Total Separate Account AUM	$	3,975
Separate Account AUM (accounts >$75M)	$	3,861
Total Number of Separate Accounts		12,197
Total Number of Separate Accounts w/AUM >$75M		5,463

Asset Class by AUM ($ billions)

		AUM	% of Sep. Accts. >$75M	% of Total Sep. Accts.
Equity (long-only)	$	1,539	40%	39%
Fixed Income (long Only)	$	1,621	42%	41%
Multi-Asset (long-only)	$	349	9%	9%
Cash Management	$	330	9%	8%
Subtotal: Long-only	*$*	*3,839*	99%	97%
Alternatives	$	22	1%	1%
TOTAL	*$*	*3,861*	*100%*	*97%*

Investment Approach by AUM ($ billions)

		AUM	% of Sep. Accts. >$75M	% of Total Sep. Accts.
Passively Managed	$	2,042	53%	51%
Active (long only)	$	1,797	47%	45%
Active - Alternative	$	22	1%	1%
TOTAL	*$*	*3,861*	*100%*	*97%*

[8] The data were aggregated from 9 participating firms. Please note that responding firms may have provided good faith estimates in response to certain questions. Totals may not sum exactly due to rounding.

Asset Class by Number of Accounts

	Number of Sep. Accounts	% of Sep. Accts. >$75M	% of Total Sep. Accts.
Equity (long-only)	1,693	31%	14%
Fixed Income (long Only)	2,680	49%	22%
Multi-Asset (long-only)	644	12%	5%
Cash Management	347	6%	3%
Subtotal: Long-only	*5,364*	*98%*	*44%*
Alternatives	99	2%	1%
TOTAL	*5,463*	*100%*	*45%*

Investment Approach by Number of Accounts

	Number of Sep. Accounts	% of Sep. Accts. >$75M	% of Total Sep. Accts.
Passively Managed	1,891	35%	16%
Active (long only)	3,473	64%	28%
Active - Alternative	99	2%	1%
TOTAL	*5,463*	*100%*	*45%*

Leverage in Separate Accounts

Leverage was defined as the following: long market value that exceeds NAV for equity or gross market exposure minus margin for derivatives. Long-only accounts that use derivatives for the purpose of hedging or benchmark replication purposes were excluded.

	Number of Sep. Accounts	% of Sep. Accts. >$75M	% of Total Sep. Accts.
Separate Accounts that Employ Leverage	207	3.79%	1.70%
Average Gross Leverage for separate accounts that employ leverage:		1.35x	

Illiquid Securities in Separate Accounts

Illiquid securities were defined as tradeable securities that cannot be sold in 30 days or less at the price the security is currently valued at. Importantly, even if a separate account holds illiquid securities, only a portion of the securities in the portfolio may be illiquid.

	Number of Sep. Accounts	% of Sep. Accts. >$75M	% of Total Sep. Accts.
Separate Accounts that Invest in "Illiquid" Securities	71	1.30%	0.58%

Separate Accounts the Engage in Securities Lending

Importantly, even if a separate account engages in securities lending, only a portion of all of the securities in the portfolio may be on loan.

	Number of Sep. Accounts	% of Sep. Accts. >$75M	% of Total Sep. Accts.
Equity (long-only)	28	0.5%	0.2%
Fixed Income (long Only)	13	0.2%	0.1%
Multi-Asset (long-only)	13	0.2%	0.1%
Cash Management	0	0.0%	0.0%
Subtotal: Long-only	54	1.0%	0.4%
Alternatives	6	0.1%	0.0%
TOTAL	60	1.1%	0.5%

Separate Accounts that Use Manager or Affiliate as Lending Agent

(for accounts that engage in securities lending)

	Number of Sep. Accounts	% of Sep. Accts. >$75M	% of Total Sep. Accts.
Equity (long-only)	3	0.1%	0.0%
Fixed Income (long Only)	3	0.1%	0.0%
Multi-Asset (long-only)	0	0.0%	0.0%
Cash Management	0	0.0%	0.0%
Subtotal: Long-only	6	0.1%	0.0%
Alternatives	0	0.0%	0.0%
TOTAL	6	0.1%	0.0%

Separate Accounts that Use Performance Fees

	Number of Sep. Accounts	% of Sep. Accts. >$75M	% of Total Sep. Accts.
Separate Accounts that charge performance fees	682	12%	5.59%

Regulatory Status of Separate Accounts by AUM ($ billions)

	AUM	% of Sep. Accts. >$75M	% of Total Sep. Accts.
Pension Regulation (i.e. ERISA, government pension rules, non-US pension rules)	$ 1,363	35.3%	34.3%
Insurance Regulation	$ 568	14.7%	14.3%
Other*	$ 386	10.0%	9.7%
TOTAL	*$ 2,317*	*60.0%*	*58.3%*

*Other includes SEC in the US, FCA in the UK, FINMA in Switzerland, FSA in Japan, MAS in Singapore and other various local regulators for clients around the world.
The majority of clients not subject to the above regulatory oversight are Central Banks and other official institutions, endowments, foundations, subadvisory relationships, and multi-family offices.

Regulatory Status of Separate Accounts by Number of Accounts

	Number of Sep. Accounts	% of Sep. Accts. >$75M	% of Total Sep. Accts.
Pension Regulation (i.e. ERISA, government pension rules, non-US pension rules)	1,903	35%	16%
Insurance Regulation	672	12%	6%
Other*	860	16%	7%
TOTAL	*3,435*	63%	28%

*Other includes SEC in the US, FCA in the UK, FINMA in Switzerland, FSA in Japan, MAS in Singapore and other various local regulators for clients around the world.
The majority of clients not subject to the above regulatory oversight are Central Banks and other official institutions, endowments, foundations and multi-family offices.

10 Largest Separate Accounts

Sum of AUM of 10 largest accounts at each firm:	$ 861
% of Firm AUM Represented in Survey	*8%*

Risk Management

Have Chief Risk Officer or Equivalent?	8 out of 9 firms that responded said they have Chief Risk Officers or the equivalent
Monitor Counterparty Risk for Separate Accounts?	100% of firms that responded said they monitor counterparty risk for separate accounts.

The following three tables represent a compilation of the responses received from the participating firms regarding risk management.

How firms monitor Counterparty Risk for Separate Accounts

Description	Approach
Overview of Counterparty Selection	Counterparty selection and review is a multi-departmental process. Several of the following functions are typically involved: Trading, Investment, Operations, Risk Management, Compliance, and Legal. Several areas may produce independent reporting and maintain oversight of counterparty activity. Counterparty selection and monitoring are multi-step, and on-going, processes.
Risk Management Systems	Firms may use proprietary (in-house) and/or external systems for reporting, portfolio simulation, risk analysis, correlations studies, indices studies, value-at-risk (VaR), and time series analysis.
Counterparty Approval	Counterparties may be approved for use in all markets, specified markets, or on an ad hoc basis for specified trades. The use of a counterparty may be limited based on the particular review. The review process tends to be a dynamic one and is conducted both on a periodic and as-needed basis. Firms reported that counterparties may be reviewed based on the following criteria: • Most recent available audited financial statements • Years in business • Capital structure • Reputation in local market(s) • Operational robustness • Any concerns that could significantly affect the counterparty's relations, liquidity, or solvency • Sanctions, fines, and penalties • Execution quality • Commitment of capital • Confidentiality • Research • Responsiveness • Creditworthiness • Market risk and settlement risk information of the country

	or countries of origin • Access to and stability of long term funding • Systemic importance and regulatory oversight • Equity, bond and swaps prices • Compliance rigor • Risk management focus • Capacity and willingness to provide trading liquidity
Credit Limits	Counterparty limits may be determined, reviewed and approved by a number of parties within a firm. There may be individual counterparty risk sub-limits within the overall limit. Credit limits may be set for each counterparty based on: • Credit risk appetite • Creditworthiness of each counterparty • View of the prospects for each counterparty
Counterparty Monitoring	Firms reported that they may monitor counterparties based on the following: • Calculation of aggregate counterparty risk exposure • Review and approval of collateral used for term derivative exposure • Daily oversight and reports (may include current (mark-to-market) counterparty exposures by product type (both long and short exposures are monitored)) • Consistent and detailed exposure analysis • Monthly analysis and reporting of Potential Future Exposure (PFE) which extends the exposure analysis to include a VaR component • Any material adverse changes in the view of the quality of a counterparty • Management of the watch list of potentially risky counterparties • Negative statements or downgrades from the rating agencies • At some firms, counterparties for OTC derivatives must maintain a minimum rating at all times

Risk metrics typically measured and monitored on an ongoing basis in the course of management of separate accounts

Description	Approach
Risk Monitoring Overview	Firms employ a holistic approach towards establishing risk metrics for separate accounts. In many instances, several teams (e.g., portfolio management, risk management, compliance department, and business operations) are all involved in the process. Additionally, portfolio management and risk management teams may be responsible for the day to day risk management of the strategies. Teams may meet to discuss and set the following criteria: • Formulation of risk appetite • Strategies

	• Policies and limit structures • Objective challenges to investment theses • Operational risk control, such as information/security risk, IT disaster recovery and business contingency planning exercises. • How management style has been affected by recent market conditions, changes to the team and other aspects of the investment decision making process. Besides the more quantitative risk metrics *(see Types of Risk Metrics below)*, some firms believe that the best approach to monitor the risks in separate accounts is to continually invest in their research teams. By having experienced analysts with the resources to know a company inside and out, firms can manage risk from the bottom up.
Types of Risk Metrics	Firms reported that they may monitor the following risk metrics in the course of separate account management: • Traditional portfolio risk sensitivities (i.e. duration, convexity, spread duration, basis risk, FX exposure, equity exposure, yield curve exposure, country exposures, sector exposure, commodity exposure, volatility, etc.) • Ex-ante tracking error • VaR - Monte Carlo simulations based on long and short term trading models, parametric, and historical • Stress testing analysis - historical stress testing, such as the market crashes and hypothetical scenario testing, such as commodity shocks, sensitivity analysis (direct and indirect) • Factor Risks - robust vendor based factor models • Macro scenario analysis • Sharpe ratios • Tail risk measures • Diversification - sector, security type and issuer limits • Concentration risk • Liquidity risk - time to liquidate and estimated incremental loss from the disposition of the asset • Transaction costs • Collateral sufficiency • Risk-adjusted performance • Risk decomposition (by risk factor) • Performance attribution • Exposures (delta and beta adjusted) • Portfolio turnover and portfolio performance against benchmarks and peer groups

Risk management processes firms typically employ in the management of separate accounts (besides counterparty risk)

<table>
<tr><th>Description</th><th>Approach</th></tr>
<tr><td>Risk Management Processes Overview</td><td>Many firms have stated that risk management begins at the investment team, or portfolio manager level, which has daily oversight and responsibility for the risk management and compliance of their respective separate account portfolios. These groups strive to be forward-looking in their ability to view and gauge risk, which means teams look to continuously expand and enhance risk management procedures, security risk factors, and systems to keep up with a constantly evolving world.

Additionally, many firms feel that establishing a system of checks and balances is important to the risk management process, so other groups monitor the investment/portfolio teams' adherence to procedures, client mandates, and objectives.</td></tr>
<tr><td>Risk Management Processes</td><td>Firms reported that they may employ the following risk management process in the management of separate accounts:

• Monitor adherence to targets or benchmarks for sectors, durations, etc. based on market weights and exposures.
• Communicate targets between the investment teams and other parties involved in risk management (other parties provide independent challenges to theses)
• Integration of risk analytics with portfolio management and other systems (i.e. accounting and reporting)
• Generate risk analytics reports that are reviewed daily, weekly or monthly depending on the type of report
• Policies and procedures implemented and assessed by individual business areas and undergo further review and enhancement by other policy and operational committees
• Regular account reviews for asset mix, currency, country and industry exposures, portfolio concentration, and attribution of relative performance
• Portfolio manager risk/return awareness and reviews
• Performance attribution and analysis
• Portfolio managers check orders/trades for compliance with all relevant limits or restrictions</td></tr>
</table>