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Secretariat of the Financial Stability Board
c/o Bank for International Settlements
CH-4002, Basel
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Via email: fsb@bis.org

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

Dear Sir or Madam:

State Street Global Advisors, the investment management division of State Street Bank and Trust Company ("SSgA"), appreciates the opportunity to comment on the Financial Stability Board ("FSB")-International Organization of Securities Commissions ("ISOCO") Consultative Document "Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions - Proposed High-Level Framework and Specific Methodologies" issued on January 8, 2014 (the "Consultation"), which proposes assessment methodologies for identifying non-bank non-insurer ("NBNI") global systemically important financial institutions ("NBNI G-SIFIs").

SSgA is the investment management division of State Street Corporation, managing $2.3 trillion in assets[1] for public and private retirement plans, large corporations, non-profit organizations, insurance companies, banks, sovereign wealth funds, central banks, and other official institutions. SSgA's parent company, State Street Corporation, is one of the world's leading providers of financial services to institutional investors including investment servicing, investment management and investment research and trading. With $27.4 trillion in assets under custody and administration, State Street operates in more than 100 geographic markets worldwide. State Street has been designated a global systemically important bank ("G-SIBs") by the FSB.

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

[1] As of December 31, 2013.

Summary

While SSgA supports the FSB's continued efforts to identify and mitigate systemic risk in the financial system, we are concerned that the proposed focus on designating individual investment funds or asset managers as NBNI G-SIFIs may not in fact address the systemic risks that may arise in connection with asset managers and the activities they conduct on behalf of their clients, and will be counterproductive to the FSB's systemic risk reduction goals. We urge the FSB to reconsider this approach, and continue to focus coordinated global regulatory attention on market-wide practices and activities that could contribute to systemic risk, and potential enhancements to existing jurisdictional regulatory regimes under which asset managers and investment funds provide services.

Asset managers operate on an agency basis, managing assets owned by their clients in investment funds or separate accounts. This makes investment funds and asset management firms fundamentally different than banks, insurance companies and other financial institutions. Unlike bank depositors who own the risk of loss if the bank defaults, risk of market loss is owned by fund investors, who invest funds with the specific goal of capturing market returns associated with specific investment strategies or indexes.

Andrew Haldane, with the Bank of England, noted the differences between banks and asset managers in a recent speech[2], when he notes that "on the face of it, then, the structure of banking and asset management is not too dissimilar. But the risks to these balance sheets are also quite different. As an agency function, asset managers do not bear credit, market and liquidity risk on their portfolios… Fluctuations in asset values do not threaten the insolvency of an asset manager as they would a bank. Asset managers are, to a large extent, insolvency-remote." We agree with this assessment, and believe it argues strongly against designation of individual funds or asset managers as NBNI G-SIFIs.

While we disagree with the FSB that individual funds, families of funds or asset managers are likely to, on their own, create sufficient systemic risk to merit designation as NBNI G-SIFIs, we acknowledge that there are circumstances where the asset management industry as a whole can contribute to systemic risk, and we agree with the FSB that the potential transmission channels for systemic risk in asset management are: 1) passing on of losses through counterparties or other exposures (the "counterparty channel"), and 2) indirect impact on other investors through asset liquidation in times of stress (the "market channel"). We also agree that the third potential transmission channel raised in the Consultation (the "critical function or service/substitutability channel") is not relevant to asset management.

The Counterparty Channel

For the counterparty channel, to the extent the activities of asset managers contribute to systemic risk, we believe the emphasis should be on interconnectedness rather than simply size. Large, passively managed funds, for example, including several funds that currently exceed the proposed $100 billion materiality threshold, do not, merely by being large, disproportionately contribute to systemic risk. Such funds can have investment losses simply due to a decline in asset values in the market segment the investment fund tracks. These losses are passed on to investors in those funds and are not the legal liability of the asset manager. In the absence of financing or other types of

[2] http://www.bankofengland.co.uk/publications/Documents/speeches/2014/speech723.pdf.

leverage, however, such losses will not lead to the type of counterparty defaults or other contagion that exacerbates systemic risk. Individual investment funds simply are not sufficiently interconnected to counterparties to create systemic risk.

In evaluating the systemic importance of investment funds, leverage is a key indicator of interconnectedness. However, high degrees of leverage on their own do not necessarily lead to systemic risk. To create systemic risk, leverage needs to be concentrated within a market segment and of sufficient scale to create destabilizing impacts on counterparties, many of which are themselves are large, highly regulated institutions, often G-SIBs subject to existing and tightening regulations imposing higher capital, leverage, credit concentration, and liquidity requirements.

We believe it is highly unlikely that a single investment fund, regardless of size and degree of leverage, could create sufficient contagion in today's regulatory environment to prompt a systemic failure. We do not dismiss, however, the possibility that correlated practices or exposures across the industry, or undue concentration of exposures with limited counterparties, could create risk of a systemic event. Data from a single investment fund, family of funds or a particular asset manager is insufficient to evaluate the potential or emerging systemic risks. Regulators need an aggregated view, which would only be available through combining exposures and leverage data across the entire industry, or perhaps through service providers such as prime brokers. Regulators have access to much of this data already, and recent enhancements to existing regulations, such as the U.S. Form PF and Form PQR filing requirements, are improving regulatory insight into industry trends and practices. To the extent existing data collection is deemed insufficient, however, we suggest global regulators address such deficiencies across the industry, rather than targeting a few large investment funds or asset managers.

The Market Channel

For the market channel, concentration by asset managers in a particular market segment or investment funds with a highly correlated investor base are relevant factors that might contribute to systemic risk.

Concentration in a particular market segment significant enough to create systemic risk is rare at the asset management firm level. For example, 5 of the 10 largest US mutual funds that exceed the FSB's proposed $100 billion materiality threshold are broad-based index funds; that is they are managed to track the investment performance of particular index (or group of indices) by owning the index constituents in their index weights. While these funds have large AUMs, they are relatively small in relation to the total market segment that they track. SSgA manages the SPDR S&P 500 ETF, which has total assets of $162.9 billion[3]. Compared to the total market capitalization of the S&P 500 Index that the ETF tracks --- $17.7T --- the ETF's overall market exposure is relatively small. Investment funds that track an index, even when large in terms of AUM, do not present systemic risk.

Concentration of a particular investor base in an investment fund significant enough to create systemic risk would also be rare. The behavior of asset owners (pension funds, sovereign wealth funds) is at least as important as that of asset managers in the context of liquidations that may cause systemic risk. These risks, however, are not typically idiosyncratic, they are more general, such as reaction to the EU sovereign debt crisis,

[3] Total Net Assets as of April 2, 2014.

the U.S. debt ceiling limit disruptions, the global financial crisis, tapering of central bank liquidity, or geopolitical unrest. These risks generally present themselves across markets, and would not be captured through increased prudential or other standards for a small group of designated investment funds or asset managers.

Idiosyncratic asset management related failures have occurred, but, as Haldane noted[4], "history is not littered with examples of failing funds wreaking havoc in financial markets. The historical examples we have tend to be confined to small and isolated corners of the financial system: the cornering of the silver market by the Hunt brothers in the 1970s; the distortions in the copper market caused by Sumitomo bank in the 1990s; the dislocations in the cocoa market caused by hedge fund Armajaro in 2010. These were examples of idiosyncratic market abuse rather than systemic market failure."

It is possible that highly correlated asset owners (for example, those that employ similar trading strategies or those that invest in similar asset classes) could accelerate asset liquidations in a particular market segment. For regulated asset owners, regulatory changes could contribute to this acceleration. For example, while not expected to have systemic implications, the U.S. Volcker Rule could require banks to liquidate certain previously permissible holdings, leading to potential "fire sales" of assets due to regulatory changes. Potential risks associated with such correlated activity between asset owners, however, cannot be addressed through designation of individual investment funds or asset managers as NBNI G-SIFIs, and it remains unlikely that such circumstances could lead to widespread systemic events.

The investment decisions an asset manager makes with regards to an investment fund it manages are unlikely to create a systemic issue. Passively managed funds, where the manager is managing to track the return of an index and does not have discretion otherwise, should be entirely out of scope for NBNI G-SIFI designation. Investment decisions made by asset managers of active funds could conceivably fuel an asset liquidation trend, but even then, a systemic event is likely to be across the broader market, and decisions made by a single manager for a single investment fund, even for a large fund, are very unlikely to have widespread impact on their own.

Detecting potential systemic risks transmitted through the market channel is challenging. For a single fund, systemic impact would be exceedingly rare, and would only be possible if the fund was very large in comparison to the markets it was investing in, and was subject to a "run on the fund" arising from decisions by its investors. This could be amplified by sales of similar funds with the same exposures. In terms of the decision by owners to liquidate, this risk is heightened if ownership of a fund is concentrated, or if owners' behavior is correlated, perhaps because of their similar status, or herding. Detecting the concentration of ownership of an asset class or sector is not easy, but clearly holds the key to detecting the potential for this risk.

Regulatory Response to Systemic Risk and Asset Management

The large investment funds that are within scope for possible designation under the Consultation based on the AUM threshold are already subject to extensive regulation, as are their service providers and counterparties.

Existing and emerging regulations already address many of the concerns identified in the Consultation. The Dodd Frank Act and the European Market Infrastructure

[4] http://www.bankofengland.co.uk/publications/Pages/speeches/2014/723.aspx

Regulation, for example, have introduced substantial new regulation to the OTC swaps markets, where the G20 commitment to higher transparency and movement to central clearing for most swaps is intended to reduce counterparty risk. Additional emerging regulations, such as limits on rehypothecation of margin will further address systemic concerns related to counterparty risk from swaps activity.

Other potential systemic risks related to asset management are also being addressed through a variety of other regulatory changes. Money market fund reform is progressing in both the U.S. and the EU. Many counterparties and service providers to investment funds and asset managers have already been designated as G-SIBs, imposing higher capital, leverage, credit concentration, and liquidity requirements on such firms. The EU AIFMD imposes additional and more stringent risk-mitigating practices on a broad range of alternative investment funds, and UCITS V appears to be following a similar course for UCITs compliant funds. The FSB's "shadow banking" agenda will address risks related to securities financing transactions ("SFTs"), including securities lending and repo, and new U.S. registration and reporting requirements for larger hedge or private equity funds will provide regulators far greater insights into alternative investment fund management risks and practices.

Despite this broad regulatory response to the financial crisis, there remain areas of potential risk related to asset management that deserve further scrutiny, and we expect new risk to continue to emerge. For example, the liquidity of fixed income markets is a growing concern of asset managers and investors, and market structure in general deserves review. These, or other, risk areas should be evaluated by regulators and the industry in general, and could be subject to broad-based regulatory proposals or changes. Designating individual investment funds or asset managers as systemically important, however, will not address potential systemic risks which we believe only arise across markets or market segments, or through specific industry-wide practices.

Separate Accounts

The Consultation referenced separate accounts as an area of future attention by regulators. While additional data collection and analysis may be useful in this area, management of separate accounts does not raise systemic risk concerns. Separate accounts provide asset owners direct ownership and control of investment assets, without the pooling present in investment funds or other collective investment schemes. As a result, separate accounts have no risk of "runs", and are easily transferred to an alternative manager at the direction of the asset owner. A recent survey of separate accounts advised by large asset managers conducted by the SIFMA Asset Management Group[5] showed that nearly all (99%) of separate accounts in the survey were long-only strategies, the majority of which (53%) were index strategies, and that very few used leverage.

Conclusion

There are potential systemic risks in investment markets that should be monitored by global regulators, and there will be instances where global regulators act to address activities that create systemic risk. We disagree, however, that these risks can be properly addressed by designating investment funds or managers as NBNI G-SIFIs.

[5] SIFMA AMG letter to FSB, April 4, 2014.

Systemic risk associated with asset management needs considerable further review before designating firms or investment funds as NBNI G-SIFIs. Designation of individual investment funds or asset managers may, in fact, exacerbate systemic risk, by focusing regulatory attention on a few, and losing sight of broader market trends or practices that deserve regulatory review.

Rather than designating a small number of investment funds or asset managers as NBNI G-SIFIs, regulators should focus on data collection and analysis, with a goal toward identifying market-wide activities that could contribute to systemic risk, particularly focused on: 1) aggregate and concentrated leverage, and 2) concentration in asset management market participants or investor in identified market segments.

Once again, thank you for the opportunity to comment on the Consultation. SSgA would be pleased to discuss these matters further. Please feel free to contact me or Charles Cullinane (617-664-6465, Charles_Cullinane@ssga.com) with any questions.

Sincerely,

Richard Lacaille
Executive Vice President
Global Chief Investment Officer

cc: Jacob J. Lew, Secretary of the Treasury and Chairperson of FSOC
Janet Yellen, Chairman, Board of Governors of the Federal Reserve System
Martin J. Gruenberg, Chairperson, Federal Deposit Insurance Corporation
Mary Jo White, Chair, Securities and Exchange Commission
Mark Wetjen, Chairman, Commodity Futures Trading Commission
Richard Cordray, Director, Consumer Financial Protection Bureau
Mel Watt, Director, Federal Housing Finance Agency
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David Massey, Deputy Securities Administrator, North Carolina Department of the Secretary of State, Securities Division
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