March 16, 2015

Financial Stability Oversight Council
United States Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

VIA ELECTRONIC SUBMISSION: http://www.regulations.gov

Re: Financial Stability Oversight Council (the "**Council**") docket number FSOC-2014-0001, "Notice Seeking Comment on Asset Management Products and Activities" (the **Notice**).

Dear Sir or Madam:

The Committee on Capital Markets Regulation (the "**Committee**") is grateful for the opportunity to comment on the December 2014 Notice that seeks guidance on the relationship between the asset management industry and financial stability.[1]

Founded in 2006, the Committee is dedicated to enhancing the competitiveness of U.S. capital markets and ensuring the stability of the U.S. financial system. Our membership includes thirty-seven leaders drawn from the finance, investment, business, law, accounting, and academic communities. The Committee is an independent and nonpartisan 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations.

In its Notice, the Council has indicated that it will adopt a products and activities approach when evaluating risks related to asset management. The Notice seeks comment on whether products or activities in the asset management industry have the potential to create, amplify, or transmit risks in a manner that could affect U.S. financial stability.[2] It also requests information about whether risks related to resolution of asset managers can have an adverse effect on financial stability.[3]

We applaud the Council for transitioning from an entity-based approach to a holistic evaluation of risks posed by particular products and services. Indeed, we also believe that the FSOC should take a similar approach to the insurance industry. The Committee has frequently commented on the issues of systemic risk and the designation of non-bank financial institutions as systemically important financial institutions ("**SIFIs**").[4] We have generally opposed use of the blunt tool of SIFI designation with

[1] http://www.treasury.gov/initiatives/fsoc/rulemaking/Documents/Notice%20Seeking%20Comment%20on%20Asset%20Management%20Products%20and%20Activities.pdf
[2] Notice at 4
[3] Notice at 6, 12, 17, 22
[4] *See* Non-bank SIFI designation FSB/IOSCO Letter (4/2014) http://capmktsreg.org/news/committee-submits-letter-on-non-bank-non-isurer-g-sifi-methodologies-to-fsbiosco/ OFR Report Letter (11/2013)

respect to non-bank financial institutions that do not pose appreciable levels of systemic risk.[5]

As we noted in our 2014 letter to the Financial Stability Board ("**FSB**"), "Systemic risk in capital markets is not confined to or concentrated in a few discrete entities. Rather, it shifts with capital flows, which themselves are driven by investor preferences and other market dynamics. Regulating the systemic risk posed by capital markets requires a focus on market infrastructure and on systemically risky activities and products. Shoehorning a multiplicity of entities ranging from mutual funds to broker dealers to venture capital firms into a regulatory schema designed for the banking industry may lead to suboptimal regulatory outcomes. It is also unsupported by any empirical data."[6]

We have previously expressed our belief that the failure of a large asset manager or its constituent funds would not pose systemic risk, because its bankruptcy "would not set off a chain reaction of financial institution failures" through contagious run-like behavior.[7] Therefore, we believe that the resolution of an asset manager would not have an adverse effect on financial stability. The Notice's focus on resolution is an apparent holdover from the Council's previous entity-based approach. The resolution of an asset manager is not directly relevant to the Council's new products and activities approach. If one does not view asset managers as systemically important institutions, then there is no reason to focus on their resolution. Moreover, asset manager resolution is a swift, certain, and transparent process. Asset managers regularly go out of business with no larger systemic implications.[8] For example, the Financial Stability Board noted in its first global-SIFI consultation that investment funds open and close and close regularly 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 2000-2012 observation period."[9]

An asset manager's assets under management ("AUM") are *owned* by clients and held by a custodian. This means that asset managers assume very little balance sheet risk, and client assets would not be drawn in to the liquidation or bankruptcy of a manager. Even where an asset manager fails, this segregation ensures that the resolution process is straightforward from the perspective of investors and involves the reassignment or sale of their assets to another manager or fund.[10] Such reassignment is easily achieved, because of the intense competition and low level of concentration in the asset management

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http://capmktsreg.org/news/committee-submits-comment-letter-to-sec-on-ofr-asset-management-report/ ; Non-bank SIFI designation FSOC letter (2/2013) http://capmktsreg.org/news/2874/

[5] Id.

[6] Non-bank SIFI designation FSB/IOSCO Letter at 3.

[7] Non-bank SIFI designation FSOC letter (2/2013) http://capmktsreg.org/news/2874/

[8] Gregory Brown et a., *Are Hedge Funds Systemically Important?*, 20.2 Journal of Derivatives 8 (2012)

[9] FSB/IOSCO Proposal, at 30. FSB and IOSCO, "Consultative Document – Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions: Proposed High-Level Framework and Specific Methodologies," Jan. 8, 2014 [hereinafter *Proposal*].

[10] Non-bank SIFI designation FSB/IOSCO Letter (4/2014) at 7 http://capmktsreg.org/news/committee-submits-letter-on-non-bank-non-isurer-g-sifi-methodologies-to-fsbiosco/

industry. Liquidation of failing firms has regularly taken place through several mechanisms, including: open market sales, private commitments from market participants, or through the traditional bankruptcy process. Therefore, we believe that the resolution of an asset manager would not have an adverse effect on financial stability.

The asset management industry is very diverse. As an example, according to the Investment Company Institute, over 800 sponsors managed mutual funds in the United States in 2013, and "[l]ong-run competitive dynamics have prevented any single firm or group of firms from dominating the market."[11] By the Herfindahl-Hirschman Index, a measure of market concentration that assigns a numerical weight based upon the relative size and number of firms in an industry, the market concentration of the mutual fund industry was 481 as of December 2013 (industries with index numbers below 1000 are considered "un-concentrated").[12] Thus, the failure of an asset manager can be easily managed through asset transfers, and does not create a risk of mass-redemptions or a self-reinforcing cycle of price declines and asset liquidations at "fire-sale" prices.

As previously noted, asset managers are frequently closed with no systemic consequences. Since 2009, at least four *distressed* asset managers have ceased operations or substantially restructured their businesses—with no discernable effect on financial stability.[13] In 2011, Axa Rosenburg substantially restructured its business after concealing a model error that produced substantial losses. Although the firm's initial $62 billion AUM declined by nearly one third—a dollar amount almost four times as large as the DTCC-registered credit default swap payments triggered by the bankruptcy of Lehman Brothers[14]—there was no disruption to the broader market.[15] Asset managers simply do not pose the types of risk that the Council was created to address, and we believe that the resolution of an asset manager does not create risks to U.S. financial stability.

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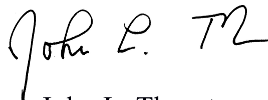
Thank you very much for your consideration of our views. Should you have any questions or concerns, please do not hesitate to contact the Committee's Director, Prof. Hal S. Scott (hscott@law.harvard.edu) or Interim Executive Director of Research, John Gulliver (jgulliver@capmktsreg.org) at your convenience.

Respectfully submitted,

R. Glenn Hubbard
CO-CHAIR



John L. Thornton
CO-CHAIR

Hal S. Scott
DIRECTOR

[13] http://www.sec.gov/comments/am-1/am1-35.pdf
[13] http://www.sec.gov/comments/am-1/am1-35.pdf
[13] http://www.sec.gov/comments/am-1/am1-35.pdf
[14] Scott, H. (2014) "Connectedness and Contagion" at 37
[15] Supra at 11.