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Contact: Neil Simon, 202-293-4222, neil.simon@investmentadviser.org

SIFMA AMG and IAA Demonstrate that the Asset Management Industry Does Not Present Systemic Risk, Urge Deference to SEC in Comments to FSOC

New York, NY and Washington DC, March 25, 2015 – SIFMA's Asset Management Group (SIFMA AMG), jointly with the Investment Adviser Association (IAA) (together, the "Associations"), today submitted a comment letter to the Financial Stability Oversight Council (FSOC) that clarifies important aspects of the asset management industry in response to FSOC's request for information regarding whether asset management products and activities may pose potential systemic risks to the U.S. financial system – FSOC's Notice Seeking Comment on Asset Management Products and Activities (the "Notice").

In the letter, the Associations demonstrate how asset managers and the funds they manage do not present systemic risk. The Associations call on FSOC to pause and allow the Securities and Exchange Commission (SEC), as the primary regulator of the industry, to complete its own review of asset manager products and activities and consider the cumulative impact of any new rules before taking any action.

"We appreciate the FSOC's effort to better understand the unique characteristics of risk associated with the asset management industry. It is imperative that policymakers recognize that the business structure of an asset manager and the funds they manage is fundamentally different from a commercial bank, does not present systemic risk, and as such should not be subject to SIFI designation, which would have a significant negative impact on investors and the capital markets," said Timothy Cameron, managing director and head of SIFMA's Asset Management Group, and Karen Barr, president & CEO, IAA.

"The unique features of the asset management industry have served investors well for 75 years without creating systemic risk. We urge FSOC to defer to the SEC's expertise and experience, as the primary regulator of the asset management industry, as it develops several upcoming initiatives addressing FSOC's concerns."

Cameron and Barr added, "The U.S. financial markets are an essential driver of growth in this country and enable investors to contribute to a thriving economy. Before taking any action, all regulators must carefully study key aspects of the asset management industry and consider the cumulative impact of new rules being implemented. Unnecessary rules targeting asset managers that disregard basic empirical facts about the industry could hamper managers' ability to serve investors and disrupt the broader capital markets system and economic growth."

Three themes run throughout the Associations' letter:

1. **The SEC and FSOC have distinct but complementary roles, and the SEC is already**

assessing issues raised in the FSOC Notice. The SEC should lead further inquiries into these issues, and FSOC should fully evaluate the actual impact of any such measures taken by the SEC before taking any further specific action of its own. The SEC, as the primary regulator of the asset management industry, has the responsibility and expertise for assessing where potential new data, regulations or other tools are necessary. In this context, FSOC has an important role but one that should be considered as supportive of the SEC, to serve as a forum for identifying and studying systemic risks.

2. **The scope of FSOC's assessment of "systemic risk" must be appropriately defined and circumscribed by FSOC.** To date, FSOC has not offered any significant data or analyses to suggest that the asset management industry presents systemic risks, and does not explain how the various hypothetical risks it describes could be converted into systemic risks. FSOC must recognize that investment funds and asset managers operate differently than other types of financial entities, and that their structural, operational, and behavioral features effectively prevent them from being sources or amplifiers of systemic risk.

3. **Thorough data analysis and appropriate coordination among regulators are essential steps to the formation of any potential regulatory response.**

The Associations' letter further addresses the specific questions and areas of focus identified in the FSOC Notice. Highlights include:

Liquidity and Redemptions: Risks associated with liquidity and redemptions in investment vehicles, such as mutual funds and closed-end funds, do not pose a threat to financial stability. These risks are already effectively mitigated by regulation, fund structures, and other market practices. Regulatory intervention designed to address hypothetical systemic risk could harm individual investors saving for long-term goals like retirement, increase issuers' cost of capital, negatively impact the diversity and resiliency of markets, and slow U.S. economic growth as a result.

Leverage: Many pooled investment vehicles such as mutual funds and closed-end funds significantly limit their use of leverage to comply with statutory as well as self-imposed investment restrictions or deploy no leverage at all. Many hedge funds, private funds and separate accounts are not levered or restrict their use leverage. The typical profile of funds or separate accounts using leverage is that they maintain average gross leverage ratios of less than 2 to 1. A regulatory regime that channels investors into a more limited array of instruments or strategies could have deleterious effects on the industry as a whole, including lulling investors into a false sense of security, stifling innovation, and preventing investors from properly hedging or reducing risk.

Operational Risk: Products and services offered by asset management firms are structured in ways that minimize the risk of disruptions associated with operational risk, even under conditions of extreme market volatility. Client assets are held at third-party custodians, not with the asset manager. Asset managers operate in a highly competitive environment – there are a variety of measures in place, both regulatory (SEC, OCC) and market driven, to control operational risks. The Associations' letter discusses these and other aspects of operational risk and how it's managed.

Resolution: The resolution of asset managers and investment funds does not present a risk to financial stability. The asset management business is inherently different from that of banks. The

structure of firms and funds provides flexibility and resiliency; it also facilitates easy resolution. For these and other reasons, the factors that require a unique resolution mechanism in the banking context simply do not apply to the asset management business. As such, there is no empirical evidence to support the premise that the resolution of investment funds or their managers could threaten the stability of the U.S. or, for that matter, the global financial markets. Indeed, asset managers and funds routinely enter and exit the industry, and investors regularly reallocate their assets among strategies and products, and these actions do not lead to disorder.

The Associations welcome the opportunity to continue to assist FSOC and the SEC as they further review asset manager products and activities. Click to view the full comment letter.

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