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The IAA to the FSB and IOSCO: Proposed Methodology for Designating Asset Managers as G-SIFIs "Unwarranted and Inappropriate"

Washington, DC (June 1, 2015) – Singling out asset managers for a sector-specific methodology is unwarranted and designating individual asset managers as globally systemically important financial institutions (G-SIFIs) would not achieve the Financial Stability Board's and International Organization of Securities Commissioners' regulatory goals, the Investment Adviser Association (IAA) told the FSB and IOSCO in a May 29 comment letter.

The IAA letter responded to the FSB and IOSCO Consultation on methodologies for identifying non-bank non-insurer G-SIFIs. While acknowledging that traditional asset management is not a source of systemic risk, the Consultation nevertheless proposed a new methodology specifically for asset managers that appears largely based on hypothetical risk arising from some asset managers' non-core activities.

"That approach is misguided, both in singling out asset managers for a sector-specific methodology and, more fundamentally, in pursuing the designation of particular firms as G-SIFIs," the IAA argues in its comment letter. "Any specific activities that raise systemic concerns should be evaluated across all firms and sectors, not through the designation of individual asset managers."

The IAA letter notes that the Financial Stability Oversight Council (FSOC) and the International Monetary Fund (IMF) have adopted just such an approach, shifting their focus to products and activities and away from the notion of designating specific asset managers for heightened supervision.

The IAA also cautions the FSB and IOSCO to fully evaluate the impact of current Securities and Exchange Commission (SEC) rulemaking. The SEC – the primary regulator of U.S. asset managers – is undertaking several substantive initiatives to address financial stability concerns, including regulatory proposals for liquidity management, stress testing, transition planning and enhanced data reporting.

Because of the fundamental nature of asset managers and the regulation of the asset management business, even the largest and most complex asset managers should not be designated as G-SIFIs, the IAA letter asserts.

"There is an absolute separation between an asset manager's assets and liabilities and the assets and liabilities of the fund or account it manages, there is no legal obligation for an asset manager to back-stop investor losses or guarantee investment performance, and there are strict prohibitions on commingling client assets with asset managers' proprietary assets or using the assets of one client to

meet the obligations of another client," the IAA letter says. "As agents, asset managers do not put their own capital at risk when they engage in financial markets on behalf of their (clients)."

"This is a fundamental and critical distinction between asset managers and banks or broker-dealers, which often act as principals in their dealings with customers or act with respect to their own balance sheets in ways that might put their customers' assets at risk… Unlike banks or broker-dealers who can default on obligations to their depositors or customers, asset managers do not accept deposits, hold client assets, or clear or settle trades. They are not counterparties to or on behalf of their clients, and so cannot default in any way that would imperil client or other counterparties' assets. "

As a result, the IAA letter says, "the concepts of 'distress' and 'disorderly failure' derived from the banking context have little relevance to asset managers."

The imposition of prudential regulation on an asset manager as a G-SIFI could interfere with its fiduciary duties to its clients and fail to reach the FSB's and IOSCO's regulatory goals, the IAA argues.

"Asset managers cannot – and should not be made to – make investment decisions for their own good or the good of the system as a whole. They must do what is right for their client," the letter says. "A prudential overlay on a firm designated as a G-SIFI could significantly impede that firm's ability to follow client directives and apply its own judgement premised on fiduciary duties, risk management and regulatory compliance."

Perhaps most importantly, "a designation approach ignores the practical reality that any risk in the asset management industry is not concentrated in individual entities, but rather broadly distributed and borne of practices engaged in by many industry participants across sectors," the IAA's comment letter says. "G-SIFI designation may constrain certain activity by a few large asset managers, but other asset managers may collectively account for more of that activity than the largest firms. As a result, the constraints on the largest firms would not eliminate and may not even meaningfully reduce the overall level of risk associated with those activities."

Further, designation of an individual asset manager as a G-SIFI would lead to additional constraints on that individual asset manager's activities, which "would lead to an unlevel playing field, imposing additional costs and burdens on those managers designated as G-SIFIs. To the extent that those costs and burdens translated into higher operating expenses or reduced investment performance, investors could (and most likely would) move their assets away from designated asset managers to other asset managers who can pursue the same or similar strategy."

The letter also highlights the differences between the "failure" of an asset manager and that of a bank or other financial institution. The IAA argues that by virtue of their basic structural and regulatory characteristics, asset managers would not experience distress or fail in a way that would cause significant disruption to the global financial system and economic activity across jurisdictions.

The newly proposed sector-specific methodology for asset managers is "unwarranted and inappropriate," the IAA letter argues. It urged FSB and IOSCO to abandon efforts to designate asset

managers as G-SIFIs and focus instead on addressing risks directly through monitoring or regulation of activities across all firms and sectors.

The full text of the IAA's comment letter is available here.

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