

FSB Has No Basis in Data, Analysis for Targeting U.S. Funds, Asset Managers in Flawed G-SIFI Designation Process: ICI

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Institute Calls on U.S. Officials to ‘Redirect’ FSB Toward Activities, Practices

Washington, DC, June 1, 2015—The proposed approach by the Financial Stability Board (FSB) to evaluating investment funds and asset managers for designation as global systemically important financial institutions (G-SIFIs) is fatally flawed and continues to place “undue emphasis on the size of a fund,” thus focusing on highly regulated U.S. stock and bond funds and U.S. fund managers, even as the process considers exempting other, far larger investment pools, the Investment Company Institute (ICI) asserted in a [comment letter](#) filed Friday.

The letter reiterates the reasons regulated funds don’t threaten financial stability and explains how the FSB’s methodology for designating funds or asset managers, if implemented and followed by U.S. regulators, will harm investors in U.S. stock and bond funds through higher costs, lower returns, and less vibrant capital markets.

In a [second letter sent to U.S. regulators](#), ICI President and CEO Paul Schott Stevens questioned “why the standards emerging from this multilateral process, which has no formal status or sanction under our law, should target almost exclusively U.S. firms and capital markets.” Stevens noted that “the process set in motion by the [FSB] consultation could ultimately be used to exert multinational influence on the [Financial Stability Oversight Council] to expand the regulatory reach of the Federal Reserve itself to include U.S. funds, managers, and capital markets.” This result could occur even though “the

second consultation altogether fails as a predicate for any regulatory action in the United States” because the FSB has failed to meet “basic standards for regulatory policymaking” required by U.S. law and envisioned in international regulatory principles.

Stevens urged Treasury Secretary Jacob Lew, Federal Reserve Chair Janet Yellen, and Securities and Exchange Commission Chair Mary Jo White to use their influence to “redirect” the FSB toward a market-wide, activity-based approach to regulation. “As we have said repeatedly, a sector-wide appraisal of activities and practices is the appropriate way in which to evaluate any potential out-sized risks in asset management,” the letter to U.S. regulators states.

“The methodologies being developed by the FSB are not grounded in data, historical experience, industry practices, or existing regulation. The process is deeply flawed, and the methodologies have at least the appearance of being reverse-engineered to achieve the outcome of identifying highly regulated U.S. stock and bond funds as G-SIFs, and ultimately subjecting those funds to bank-like regulation by the Federal Reserve,” said Stevens. “One thing is certain: without justification, the FSB continues to zero in on the most highly regulated, transparent, and unleveraged funds for possible designation.”

“The large U.S. regulated stock and bond funds targeted by the FSB process were among the most stable institutions in the financial system during the global financial crisis,” Stevens noted. “At the same time, the FSB proposes to exclude from consideration a large swath of other, even larger investment funds—public financial institutions, pension funds, and sovereign wealth funds—further undermining the reasoning behind their methodology.”

To underscore the logical flaws in this exemption, the ICI comment letter lists nine sovereign wealth and pension funds that are larger than the world’s largest regulated fund, and an additional 26 that exceed US\$100 billion in assets, one of the FSB’s size-based evaluation thresholds. ICI does not advocate designating these investment pools as G-SIFs, but instead questions the FSB’s “hollow” reasons for exempting them.

U.S. funds and their investors would face higher costs if the FSB recommends bank-like regulation or the FSOC follows the Dodd-Frank Act’s “remedies” for designated funds, ICI warns. The resulting competitive imbalances would distort the fund marketplace, potentially leading to regulatory arbitrage and reducing investor choice. Designation also could have far-reaching implications for how a fund’s portfolio is managed, and introduce a deeply conflicted form of regulation, pitting a manager’s duty to manage the fund solely in the best interest of its shareholders against the Federal Reserve’s regulation of the fund to serve the interests of the banking system.

To learn more about why registered investment funds do not pose a threat to global financial stability and to follow ICI’s work on this issue, visit [ICI’s financial stability resource page](#).