Securities Regulation Daily Wrap Up, RISK MANAGEMENT—New G-SIFI draft almost fated to provoke ire of asset managers, others, (Mar. 5, 2015)

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The Financial Stability Board (FSB) and the International Organization of Securities Commissioners (IOSCO) yesterday heralded a new proposal as the next step on the road to extending the global systemically important financial institutions (G-SIFI) framework for banks and insurers to other types of financial institutions. The second draft of the framework would cover non-bank, non-insurers, which collectively go by the moniker NBNI G-SIFIs. Key players in the securities markets wasted no time in decrying the new draft as nothing more than a tired version of an older one that still treats big U.S. funds too harshly.

Scale, sector and backstop. The latest FSB-IOSCO proposed framework for designating NBNI G-SIFIs can be represented by a matrix that takes in data about an entity's scale and the sector in which it operates. The new proposal is needed, the organizations said, to get more comments on the proposed method for designating investment funds and asset managers as NBNI G-SIFIs. Work by the FSB on finance companies, and by IOSCO on securities broker-dealers, is nearly finished.

Scale is evaluated for all four sectors by reference to five "impact factors" that account for an entity's size, interconnectedness, substitutability (*i.e.*, do other firms provide like services), complexity, and global activities. These factors are then augmented by sector-specific criteria. A key threshold for all sectors is the $100 billion mark for total assets on balance sheet or assets under management. Investment funds and asset managers would have more variants of this threshold than will finance companies and securities broker-dealers.

Moreover, the draft includes a fall back rule for entities that do not explicitly fit within the four sectors. These potential NBNI G-SIFIs are firms that primarily engage in financial intermediation or related auxiliary financial activities. According to the draft, financial intermediation means fund-raising that involves taking on liabilities in order to shunt funds to other firms by making loans or buying financial assets. Auxiliary financial activities are separate from intermediation and cover a more diffuse set of activities.

Significantly, the FSB-IOSCO second draft does not offer any policy requirements or name specific entities for designation as NBNI G-SIFIs. Designations are to be made based on policy measures that will be developed in phases. By late 2015, the organizations plan to revise the methodologies set out in the second draft. Then the FSB, IOSCO, and other standard setting bodies are to hammer out incremental policy measures. The last phase will see the creation of an international oversight group to manage the designation process and to ensure that policy measures are uniformly applied.

The FSB and IOSCO said the job of creating a methodology to designate NBNI G-SIFIs is complicated by the diversity of the firms that could be designated, and by the lack of data on these firms due to the investor/consumer protection focus of the government regulations the firms must live by. Comments on the second draft are due by May 29, 2015.

Securities industry broadside. The Securities Industry and Financial Markets Association (SIFMA) today urged the FSB and IOSCO to "pause" their efforts to eventually designate NBNI G-SIFIs and to instead let home state regulators (such as the SEC) finish their work on many of the same issues. Timothy Cameron, Managing Director and Head of SIFMA's Asset Management Group, said the FSB-IOSCO draft is headed in the "wrong direction" and offers few workable ideas for taming systemic risk.

"This consultation appears to disregard the meaningful and substantive comments received by the FSB and IOSCO regarding the first methodology consultation, which demonstrated how asset managers and investment funds have fundamentally different risk profiles than banks, making G-SIFI designation at the entity level inappropriate," said Cameron. SIFMA's Cameron was one of nearly fifty commenters on the first draft.

Likewise, Paul Schott Stevens, President and CEO of the Investment Company Institute (ICI), said the FSB-IOSCO proposal is “a giant step backward.” According to Stevens, the latest draft belies its targeting of big U.S. funds for designation as NBNI G-SIFIs. This he said is evidenced by the draft’s “undue emphasis” on fund size and its use of a $100 billion threshold for assets under management.

Stevens, like SIFMA’s Cameron, also worried about how much weight industry comments on the first draft got from the FSB and IOSCO. He said the ICI will follow-up its comment from last year with a new letter stating its views on the second draft.

Companies: The Securities Industry and Financial Markets Association; Investment Company Institute

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