Securities Regulation Daily Wrap Up, RISK MANAGEMENT—FSB's flawed G-SIFI designation process unfairly targets U.S. firms, ICI says, (Jun. 3, 2015)

Securities Regulation Daily Wrap Up

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By John Filar Atwood

Fundamental problems persist in the Financial Stability Board's (FSB) second attempt to develop assessment methodologies for identifying non-bank, non-insurer global systemically important financial institutions (G-SIFIs), according to the Investment Company Institute (ICI). Among other things, the FSB's flawed approach continues to place undue emphasis on the size of a fund, which singles out large, highly-regulated U.S. funds as candidates for designation, ICI said.

Problems persist. In a comment letter to the FSB, ICI reiterated concerns with the process that it had expressed in a 2014 comment letter on the initial consultation. The problems remain in the second attempt, ICI noted, and the changes that have been made do not suggest a more informed understanding of the asset management industry on the part of the FSB.

In ICI's view, the FSB's methodologies are not grounded in data, historical experience, industry practices, or existing regulation. ICI also said that the methodologies have the appearance of being reverse-engineered to result in the identification of highly regulated U.S. stock and bond funds as G-SIFIs and subjecting them to bank-like regulation by the Federal Reserve.

In addition to over-emphasizing the size of a fund, ICI believes the FSB's efforts are misdirected because the group of U.S. funds that stand to be identified for possible designation demonstrated a high degree of stability during the financial crisis. They are not as risky as banks, ICI explained, and are among the most comprehensively regulated and highly transparent parts of the global financial system.

Arbitrary thresholds. ICI also stated that the way in which the FSB proposes to derive its target set of U.S. stock and bond funds is illogical because it does not take leverage into account. The FSB does not justify the proposed the size thresholds for automatically targeting a fund or manager to be considered for designation, ICI added, which makes the thresholds seem arbitrary.

Another criticism ICI leveled against the proposed system is that it would exclude pension funds and sovereign wealth funds from any assessment for systemic risk. ICI identified nine sovereign wealth and pension funds that are larger than the world's largest regulated fund. ICI does not believe these funds should be designated as G-SIFIs, but questioned the FSB's reasons for exempting them.

Help from regulators. In addition to submitting a comment letter to the FSB, ICI president, Paul Schott Stevens, wrote to SEC Chair Mary Jo White, Treasury Secretary Jacob Lew, and Federal Reserve Chair Janet Yellen to ask them to help direct the FSB away from the process of entity designation. In that letter, Stevens reiterated ICI's view that a sector-wide appraisal of activities and practices is the appropriate way in which to evaluate any possible out-sized risks in asset management.

In a press release, ICI warned that U.S. funds and their investors would face higher costs if the FSB recommends bank-like regulation or the Financial Stability Oversight Council follows the Dodd-Frank Act's remedies for designated funds. The resulting competitive imbalances would distort the fund marketplace and could have far-reaching implications for how a fund's portfolio is managed, ICI concluded.

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