May 29, 2015

Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2, CH-4002 Basel
Switzerland

VIA ELECTRONIC MAIL: fsb@bis.org

Re: "Assessment methodologies for identifying non-bank non-insurer global systemically important financial institutions" (the "**Consultation**")

Dear Sir or Madam:

The Committee on Capital Markets Regulation (the "**Committee**") is grateful for the opportunity to comment on the Consultative Document released by the Financial Stability Board ("**FSB**") and the International Organization of Securities Commissions ("**IOSCO**") on Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions ("**NBNI G-SIFIs**").

Founded in 2006, the Committee is dedicated to enhancing the competitiveness of U.S. capital markets and ensuring the stability of the U.S. financial system. Our membership includes thirty-four leaders drawn from the finance, investment, business, law, accounting, and academic communities. The Committee is chaired jointly by R. Glenn Hubbard (Dean, Columbia Business School) and John L. Thornton (Chairman, The Brookings Institution) and directed by Hal S. Scott (Nomura Professor and Director of the Program on International Financial Systems, Harvard Law School). The Committee is an independent and nonpartisan 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations.

Description of the Consultation

The Consultation's proposed designation framework applies to four different types of NBNI financial entities: (i) finance companies; (ii) broker-dealers; (iii) investment funds; and (iv) asset managers. The designation process has four steps. In the first step a list of "Stage 0" firms that will be candidates for G-SIFI designation is identified. Firms will be designated as "Stage 0" firms if they equal or exceed certain quantitative "materiality thresholds." Each type of NBNI financial entity has a different materiality threshold. The materiality thresholds for investment funds and asset managers are set forth in Appendix 1. The list of Stage 0 firms will then be communicated to national regulators.

The second step is carried out by national regulators that measure the systemic importance of "Stage 0" firms according to five categories of quantitative indicators as proposed by the Consultation: (1) size; (2) interconnectedness; (3) substitutability; (4) complexity; (5) cross-jurisdictional activity. Each type of NBNI has a different set of indicators. The indicators for investment funds and asset managers are also set forth in Appendix 1. In the third step, national regulators provide the FSB and IOSCO with a summary of their findings, and a recommendation to designate or not designate specific firms. The FSB and IOSCO will review this information and "convey its views" to national regulators. The national regulator will then review FSB and IOSCO comments, "conduct follow-up analyses where necessary," and then the national regulators will reach a preliminary designation determination.

Analysis of the Consultation

The Committee has commented extensively on the issue of SIFI designation with respect to non-banks.[1] We have three primary concerns with the Consultation. First, we believe that asset managers, including managers of registered investment companies and managers of private funds, do not pose systemic risk because their bankruptcy would not set off a chain reaction of financial institution failures. We therefore generally oppose designating these NBNIs as systemically important. Second, our analysis finds that the only asset managers affected by the Consultation are U.S. firms. We do not believe that the FSB is an appropriate forum for determining regulatory policies that will affect a single country.[2] Third, we are concerned that the Consultation uses derivatives gross notional exposure ("GNE") when measuring the size of an investment fund during Stage 0 screening.[3] Notional values are not an accurate measure of risk or size.

Asset Managers and Investment Funds Should Not be Designated as SIFIs

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[1] See Letter from Comm. On Capital Mkts. Reg. to Lance Auer, Deputy Assistant Secretary, U.S. Treasury Dep't (Dec. 19, 2011), http://capmktsreg.org/2011/12/fsoc-comment-regarding-its-authority-to-require-supervision-and-regulation-of-certain-nonbank-financial-companies/ [hereinafter Dec. 19 Letter], Letter from the Comm. On Capital Mkts. Reg. to Timothy Geithner, Chair, Fin. Stability Oversight Council (Nov. 5, 2010), http://www.capmktsreg.org/pdfs/2010.11.05_Volcker_Rule_letter.pdf, Letter from the Comm. On Capital Mkts. Regulation to Lance Auer, Deputy Assistant Secretary, U.S. Treasury Dep't (Feb. 22, 2011), http://capmktsreg.org/2011/02/fsoc-authority-to-require-supervision-and-regulation-of-certain-nonbank-financial-companies/, Letter from the Comm. On Capital Mkts. Regulation to Neal Wolin, Chairman, Financial Stability Oversight Council (Feb. 15, 2013), http://capmktsreg.org/app/uploads/2013/02/FSOC.non-bank.SIFI_.comment.ltr_..pdf, Letter from Comm. On Capital Mkts. Reg. to Elizabeth Murphy, Secretary, Securities and Exchange Commission (Nov. 1, 2013), http://capmktsreg.org/app/uploads/2013/11/CCMR-asset-mgr-comment-ltr-2013-11-01.pdf, Letter from Comm. On Capital Mkts. Reg. to the Secretariat of the Financial Stability Board (Apr. 7, 2014), http://capmktsreg.org/app/uploads/2014/05/FSB.IOSCO_.comment.ltr_.pdf, Letter from Comm. On Capital mkts. Reg. to the Financial Stability Oversight Council (Mar. 16, 2015), http://capmktsreg.org/app/uploads/2015/03/2015_03_16_FSOC_Notice_on_Asset_Management_Products_Activities.pdf.

[2] Committee on Capital Markets Regulation (2015) "Nothing but the Facts: FSB-IOSCO Proposal for SIFI Designation." http://capmktsreg.org/app/uploads/2015/03/2015-03-24_Nothing_But_the_Facts_FSB_asset_managers.pdf

[3] Section 6.4.1

The 2008 financial crisis was, at its core, a contagious run on short-term debt.[4] As the Committee has previously stated, investment funds are not a significant source of short-term funding to the financial system, and are therefore unlikely to trigger system-wide instability.[5] Even money market funds do not provide banks with significant quantities of short-term funding. As of March 31, 2015, U.S. money market mutual funds *collectively* provided the largest U.S. bank holding companies with the following funding (expressed as a percent of total assets): Wells Fargo 3.8%; JPMorgan 2.4%; Bank of America 2.3%; Citigroup 1.7%; and, Goldman Sachs 1.4%.[6]

In the Consultation concern was expressed that widespread redemptions on investment funds could result in the fire sales of assets, which would exacerbate market instability. If this is indeed a problem, it *cannot* be addressed by SIFI designation because investors in designated entities could simply shift their capital to smaller funds that hold similar assets, but would not face the regulatory restrictions imposed on SIFIs.[7]

Whatever the concern with investment funds, there is no case for designating asset management firms as SIFIs. As reflected in our earlier comment letters, an asset management firm's assets under management ("AUM") are not indicative of the systemic risk posed by the firm, because these assets are *owned* by clients and held by a custodian. This means that asset management firms assume no balance sheet risk for the performance of those client assets, and that client assets would not be drawn into the liquidation or bankruptcy of an asset management firm. If an asset management firm fails, this segregation ensures that the resolution process is straightforward from the perspective of investors and involves the reassignment or sale of their assets to another management firm or fund.[8]

The asset management industry is also very diverse, so multiple possibilities exist for dealing with the fund assets of a failed firm. The Herfindahl-Hirschman index—a measure of a market's concentration that assigns a numerical weight based upon the relative size and number of firms in an industry—of the mutual fund industry was 481 as of December 2013.[9] Industries with index numbers below 1000 are considered "un-concentrated."[10] Only 25% of global financial assets are actually managed by a third party,[11] so self-management is also an alternative to investing in a fund that is managed by an asset management firm.

Indeed, asset management firms have recently been closed with no systemic consequences. Since 2009, at least four *distressed* asset management firms have ceased

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[4] Scott, H. (2014) "Connectedness and Contagion."
[5] http://capmktsreg.org/app/uploads/2013/02/FSOC.non-bank.SIFI_.comment.ltr_.pdf
[6] Crane Data.
[7] http://capmktsreg.org/app/uploads/2013/02/FSOC.non-bank.SIFI_.comment.ltr_.pdf
[8] Non-bank SIFI designation FSB/IOSCO Letter (4/2014) at 7 http://capmktsreg.org/news/committee-submits-letter-on-non-bank-non-isurer-g-sifi-methodologies-to-fsbiosco/
[9] Id.
[10] Id.
[11] McKinsey & Company. "Strong Performance but Health Still Fragile: Global Asset Management in 2013. Will the Goose Keep Laying Golden Eggs?"

operations or substantially restructured their businesses—with no discernable effect on financial stability.[12] In 2011, Axa Rosenberg substantially restructured its business after concealing a model error that produced substantial losses. Although the firm's initial $62 billion AUM declined by nearly one third—a dollar amount almost four times as large as the DTCC-registered credit default swap payments triggered by the bankruptcy of Lehman Brothers[13]—there was no disruption to the broader market.[14]

Asset Management Designation under the Consultation Affects only U.S. Firms

We are concerned that G-SIFI designation of asset management firms under the Consultation would only apply to U.S. institutions. As illustrated in the figure below, there are 15 investment management firms whose AUM would breach the $1 trillion materiality threshold for inclusion as a Stage 0 candidate. Of these 15, 11 are affiliated with a global systemically important bank ("G-SIB") or a global systemically important insurer ("G-SII"). The Consultation excludes asset management firms affiliated with a G-SIB or G-SII from designation as a G-SIFI, as these asset management firms are already subject to regulation under a SIFI framework. As demonstrated in Figure 1, the four independent asset managers subject to designation under the Consultation are exclusively U.S. firms. We do not think the U.S. should outsource to the FSB or IOSCO decisions that only affect U.S. firms.

Figure 1: Twenty Largest Global Asset Managers in Q1 2015

Rank	Manager	Nationality	Assets ($ millions)
1	**BlackRock**	**US**	**$4,651,895**[15]
2	**Vanguard Group**	**US**	**$3,000,000**[16]
3	State Street Global	US	$2,448,000[17]
4	**Fidelity Investments**	**US**	**$1,980,000**[18]
5	Allianz Global Investors	Germany	$1,952,462[19]
6	J.P. Morgan Chase	US	$1,744,000[20]
7	BNP Paribas	France	$1,717,000[21]
8	Bank of New York Mellon	US	$1,710,000[22]
9	AXA Group	France	$1,383,780[23]
10	**Capital Group**	**US**	**$1,366,084**[24]

[12] http://www.sec.gov/comments/am-1/am1-35.pdf
[13] Scott, H. (2014) "Connectedness and Contagion" at 37
[14] Supra at 11.
[15] Blackrock, Annual Report (Form 10-K) 1, 29 (Feb. 27, 2015).
[16] Vanguard Group, *Fast Facts about Vanguard* (2015), *available at* https://about.vanguard.com/who-we-are/fast-facts/.
[17] State Street Corporation, Annual Report (Form 10-K) 1, 47 (Feb. 20, 2015).
[18] Fidelity Investments, *Fidelity by the Numbers: Corporate Statistics* (2015), *available at* https://www.fidelity.com/about-fidelity/fidelity-by-numbers/corporate-statistics.
[19] Allianz Group, Annual Report (2014) 1, 3. Dollar figure based on current EUR-USD exchange rate.
[20] JPMorgan Chase & Co., Annual Report (Form 10-K) 1, 102 (Feb. 24, 2015).
[21] BNP Paribas Securities Services, *Key Figures* (2015), *available at* http://securities.bnpparibas.com/about-us/key-figures.html.
[22] Bank of New York Mellon, Annual Report (Form 10-K) 1, 2 (Feb. 27, 2015).
[23] AXA Group, Press Release (March 12, 2015) 1, *available at* http://www.axa.com/lib/en/uploads/pr/group/2015/AXA_PR_20150312_b.pdf. Dollar figure based on current EUR-USD exchange rate.

11	Deutsche Bank	Germany	$1,260,000[25]
12	Goldman Sachs Group	US	$1,180,000[26]
13	Prudential Financial	US	$1,180,000[27]
14	Amundi	France	$1,100,000[28]
15	UBS	Switzerland	$1,032,000[29]
16	HSBC Holdings	UK	$954,000[30]
17	**Northern Trust Asset Management**	**US**	**$934,000[31]**
18	**Wellington Management**	**US**	**$892,000[32]**
19	Natixis Global Asset Management	France	$890,000[33]
20	**Franklin Templeton**	**US**	**$880,100[34]**

**A highlighted row indicates that an asset manager is unaffiliated with a G-SIB or a G-SII.*

Gross Notional Exposure is an Inappropriate Measure of Both Risk and Size

With respect to investment funds, we do not believe that derivatives gross notional exposure should relate to SIFI designation, because gross notional exposure is not an accurate or sensible measure of risk, size, interconnectedness, or market footprint. Notional values vary wildly by asset class and duration and ignore netting, collateralization, and clearing status. For example, according to the Bank for International Settlements ("BIS"), the notional value of all outstanding OTC derivatives stood at roughly $690 trillion after the first half of 2014.[35] This large notional value translated into only around $17 trillion of gross market value ("GMV"), a measure that, as opposed to notional amounts, is linked to actual market values and risk.[36] Even GMV can overstate risks, as it does not incorporate the risk-reducing effects of netting and collateral. With netting taken into account, global OTC derivatives outstanding produced

[24] Capital Research and Management Company, Form ADV 1, 5 (Jan. 1, 2015), *available at* https://www.thecapitalgroup.com/content/dam/cgc/shared-content/documents/policies/Form_ADV_CRMC_part2A.pdf. Figure as of June 30, 2014.

[25] Deutsche Bank, *Overview* (2015), *available at* https://fundsus.deutscheawm.com/EN/about-us/who-we-are.jsp.

[26] The Goldman Sachs Group, Inc., *Annual Highlights* 1 (2015), *available at* http://www.goldmansachs.com/media-relations/press-releases/current/pdfs/2014-q4-results.pdf.

[27] Prudential Financial, *By the Numbers* 1 (2015), *available at* http://www3.prudential.com/fi/pdf/pfi_by_the_numbers.pdf.

[28] Amundi, *Quarterly Key Figures* 1, 2 (2015). Dollar figure based on Amundi calculated EUR-USD exchange rate.

[29] UBS, *UBS Corporate Profile 4Q14* 1, 2 (2015).

[30] HSBC, Annual Report 1, 106 (2015).

[31] Northern Trust, *About Northern Trust* (2015), *available at* https://www.northerntrust.com/about-northern-trust.

[32] Wellington Management, *Facts and Figures* (2015), *available at* https://www.wellington.com/en/facts-and-figures. As of September 30, 2014.

[33] Natixis Global Asset Management, *Key Figures* (2015), *available at* http://ngam.natixis.com/global/1250190074395/Key+Figures.

[34] Franklin Resources, Inc., *Franklin Resources Inc. Announces Month-End Assets Under Management* (Mar. 9, 2015), *available at* http://phx.corporate-ir.net/phoenix.zhtml?c=111222&p=irol-newsArticle&ID=2023990.

[35] http://www.bis.org/publ/otc_hy1411.pdf at 15 Table 1

[36] Id at 2. BIS states "The gross market value represents the maximum loss that market participants would incur if all counterparties failed to meet their contractual payments and the contracts were replaced at current market prices."

only $2.8 trillion in gross credit exposure ("GCE").[37] This value is further reduced when the risk reducing effects of collateral are considered. Until 2012, the International Swaps and Derivatives Association published annual estimates of GCE, adjusted for collateral. The group found that, after adjusting for collateral, adjusted GCE was generally around 70% lower than raw GCE.[38] For example, in 2012 $3.9 trillion in raw GCE fell translated to just $1.1 trillion of adjusted GCE.[39] The global regulatory community has clearly recognized that notional value of derivatives is not the appropriate metric for measuring market risk or counterparty risk, among others. In the interest of regulatory efficiency, we suggest that the FSB look to all such existing measures, which themselves are the product of considerable deliberations by international and domestic regulatory bodies.

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Thank you very much for your consideration of our views. Should you have any questions or concerns, please do not hesitate to contact the Committee's Director, Prof. Hal S. Scott (hscott@law.harvard.edu) or the Executive Director of Research, John Gulliver (jgulliver@capmktsreg.org) at your convenience.

Respectfully submitted,

Robert Glenn Hubbard

R. Glenn Hubbard	John L. Thornton	Hal S. Scott
CO-CHAIR	CO-CHAIR	DIRECTOR

[37] Id.
[38] http://www2.isda.org/functional-areas/research/studies
[39] http://www2.isda.org/attachment/NTY4MQ==/ISDA%20Year-End%202012%20Market%20 Analysis%20FINAL.pdf

Appendix 1: Materiality Thresholds for Inclusion in Stage 0 Candidate List

Investment Funds (Section 6)
Applies to open-end and closed-end funds, i.e. MMFs, ETFs, hedge funds, private equity funds, and venture capital.

Materiality Threshold	• For "private funds" i.e. hedge funds and private equity.
	  o $400bn Gross Notional Exposure[40] ("GNE")
	• Two options are being considered for "traditional investment funds."
	  o NAV >= $30bn and balance sheet leverage >= 3 <u>or</u> NAV >= $100b
	  o Gross assets under management >= $200bn <u>except</u> funds with substitutability ratio[41] <= 0.5% or fire sale ratio[42] <= 5%

(1) Size	• NAV = Net AUM • Gross notional exposure for hedge funds
(2) Interconnectedness	• Ordinary balance sheet leverage • Leverage computed as (Total Borrowings + NAV)/NAV • GNE / NAV • Collateral posted / NAV • NCCE • NCCE to G-SIFIs • Nature of investors in fund (e.g. are they G-SIFIs?)
(3) Substitutability	• Daily trading volume of fund compared to overall daily trading volume in the same market segment. • Holdings of fund assets compared to overall daily trading volume in the same asset class. • NAV compared to size of underlying market.
(4) Complexity	• Derivatives not centrally cleared / total fund trading volume • Fraction of collateral posted by counterparties that has been re-used by fund • Fraction of portfolio using HFT strategies • Portfolio liquidity profile • Unencumbered cash / GNE • Unencumbered cash / NAV • Amount of illiquid assets
(5)Cross-Jurisdiction	• Number of jurisdictions in which fund invests • Number of jurisdictions in which fund is sold / listed • Number of jurisdictions where fund has counterparties

Asset Managers (Section 7)

[40] GNE is sum of all longs and all shorts. For derivatives, notional is used, although the Consultation includes an undefined "delta adjustment."
[41] Substitutability ratio "can be defined as the fund's trading volume in relation to the daily trading volume of the underlying asset class."
[42] Fire sale ratio "can be defined as the extent to which the total net AUM of the fund could easily be absorbed, in a stressed market scenario, by the daily trading volume of the underlying asset class."

Materiality Threshold	Two options are being considered. (1) “A particular value (e.g. $100bn) in balance sheet total assets.” (2) “A particular value (e.g. $1trn) in AUM”
(1) Size	• Net AUM • Balance sheet assets
(2) Interconnectedness	• Leverage ratio • Guarantees and off-balance sheet exposures
(3) Substitutability	• Manager’s revenue / total industry revenues in relevant business • AUM in a particular strategy / AUM in same strategy for all managers
(4) Complexity	• Impact of organizational structure, e.g. what are effects of failure on subsidiaries and affiliates? • Difficulty in resolving a firm, e.g. how easily are contracts transferred to another firm.
(5)Cross-Jurisdiction	• Number of jurisdictions in which asset manager has a presence.