MAYER • BROWN

Mayer Brown LLP
71 South Wacker Drive
Chicago, Illinois 60606-4637

Main Tel +1 312 782 0600
Main Fax +1 312 701 7711
www.mayerbrown.com

Timothy S. Bishop
Direct Tel +1 312 701 7829
Direct Fax +1 312 706 8607
tbishop@mayerbrown.com

October 31, 2013

VIA SEC WEB COMMENT FORM

Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Office of Financial Research, *Asset Management and Financial Stability* (Sept. 2013): Comments in Response to SEC Request, File No. AM-1

Dear Ladies and Gentlemen:

We represent entities that would be impacted by the September 2013 report of the Office of Financial Research ("OFR") entitled *Asset Management and Financial Stability* (the "OFR Report") if that Report were to figure into decision-making by the Financial Stability Oversight Council ("FSOC" or "Council") with regard to the designation of non-bank financial companies as Systemically Important Financial Institutions ("SIFIs") subject to enhanced supervision and prudential standards under Section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") or any other regulatory action. We appreciate the opportunity provided by the Securities and Exchange Commission ("SEC") to comment on the OFR Report, which is seriously defective in many important respects, both as to the facts stated and OFR's analysis. The Report fails to provide a realistic assessment of risk within the industry, let alone any threats to financial stability alleged to arise from it. Indeed, OFR's Report confirms Nobel economics laureate Lars Peter Hansen's view that "systemic risk" is currently a "grab bag" of "vague" concepts used to justify unguided "regulatory discretion" and provides only "superficial answers" that would "lead to bad policy advice."[1]

A DEFECTIVE PROCESS HAS RESULTED IN A SERIOUSLY DEFICIENT AND SPECULATIVE REPORT FULL OF BASIC ERRORS OF FACT AND ANALYSIS

1. ***OFR failed to accept or seek out expert industry assistance in its description and analysis of the asset management industry, leading it to produce a deeply flawed report.*** In a final rule issued in April 2012,[2] FSOC indicated that it had asked OFR to study asset management companies and activities in order to inform FSOC's analysis of whether and how to

---

[1] Lars Peter Hansen, *Challenges in Identifying and Measuring Systemic Risk* in *Risk Topography: Systemic Risk and Macro Modeling* (Markus K. Brunnermeier & Arvind Krishnamurthy, eds., forthcoming) (Feb. 11, 2013 manuscript at 1-2), available at http://www.nber.org/chapters/c12507.pdf.

[2] Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 77 Fed. Reg. 21637, 21644 (Apr. 11, 2012).

consider those companies and activities for enhanced prudential standards and supervision by the Federal Reserve under Section 113 of the Dodd-Frank Act, 12 U.S.C. § 5323. The asset management report that OFR recently issued in response to FSOC's request focuses narrowly on the asset management industry and the registered-investment-company, separately-managed-account, and collective-investment products that asset managers create and manage. It does not address money market funds, hedge funds, private equity funds, or other types of private funds.

In the nearly 18 months it took OFR to produce its 30-page Report, OFR refused to make more than a show of consulting with asset management industry participants to learn the facts. OFR personnel met with representatives of some leading asset managers/fund firms and their trade associations—but during those meetings OFR personnel revealed almost nothing about their process, concerns, or areas of interest, and they did not take advantage of repeated industry offers to supply data and analysis about fund features, regulation, and management practices. Nor did OFR ever share either its preliminary conclusions or any draft of the Report with industry representatives. According to press reports, OFR did share a draft of its Report with the SEC—the principal federal regulator of asset managers and registered funds—but then "failed to take a number of the SEC's critical feedback into account" in the final Report.[3]

Indeed, even now that OFR's superficial and admittedly incomplete report has been made public, neither OFR nor FSOC has sought any feedback from the industry or invited formal comments, despite the wave of informed criticism directed at the report since its publication. Our comments are submitted at the invitation of the *Securities and Exchange Commission*, not FSOC or OFR. We nonetheless urge FSOC and OFR to consider carefully these and other comments submitted to the SEC.

Because OFR failed to interact meaningfully with industry experts—substituting window-dressing meetings for substantive engagement with those who are most familiar with relevant industry operations and regulations—its report is beset by glaring factual errors, shallow and faulty analysis, gaping data holes, and rampant speculation.[4] The result is a report that appears designed far more to recite propositions that would support redundant and overlapping regulation of asset managers and certain of the products they manage than to describe and analyze the industry from an objective, neutral perspective. OFR's report is so flawed and incomplete that it is essentially useless—indeed, affirmatively misleading—for its intended purpose of providing information that FSOC can rely on in considering whether it would be appropriate to exercise its Section 113 authority in the asset management area or whether any

---

3 Sarah Lynch, *SEC Sees Flaws in New Treasury Asset Manager Report: Sources*, Reuters, Oct. 7, 2013, available at http://www.reuters.com/article/2013/10/07/us-sec-assetmanager-report-idUSBRE9960XD20131007; see *ibid.* (reporting on SEC's "months"-long call for "major changes" to be made to the "deeply flawed" draft study).

4 See *ibid.* (reporting that "[t]he SEC has * * * been concerned that the people involved in the study lack a fundamental understanding of the fund industry itself").

other additional regulation might be appropriate, for the OFR Report neither "examine[s] the relevant data" nor "articulate[s] a satisfactory explanation" for its conclusions.[5]

2. ***OFR's lack of transparency and engagement reflects a well-documented pattern of similar problems with OFR and FSOC.*** OFR's lack of transparency and engagement is deeply distressing given the enormous consequences of SIFI determinations for individual asset management companies, the industry as a whole, investors, and the Nation's economy. It is unacceptable for OFR to complain that areas of asset management are "not well understood"[6] or that describing asset managers' "activities and interconnections is difficult"[7]—and then to reach conclusions anyway—when OFR failed either to avail itself of the expert assistance offered by those engaged in the industry or to heed the advice of the SEC as the long-time expert regulator of a substantial portion of the industry.

These defects are just the latest example of FSOC's and OFR's cavalier approach to the Section 113 designation authority. No less respected an agency than the U.S. Government Accountability Office ("GAO") documented extensive procedural shortcomings in its September 2012 report, *Financial Stability: New Council and Research Office Should Strengthen the Accountability and Transparency of their Decisions* ("GAO Report"). The GAO Report demonstrates how poorly equipped OFR was to conduct the asset management study, and its conclusions are confirmed by the poor quality of OFR's final product.

FSOC and OFR have failed to engage with industry experts. The GAO was especially critical of FSOC's and OFR's failure "to leverage external resources," including through "collaboration among FSOC members and external stakeholders," and called for the development of policies to formalize such collaboration.[8] Although the GAO advised that FSOC cannot "[s]uccessfully implemen[t]" its Dodd-Frank responsibilities without "actively work[ing] together" with "external stakeholders,"[9] OFR failed to meaningfully do so in preparing the asset management report, despite industry participants' repeated efforts to engage with OFR. One-sided meetings in which OFR fails to disclose or seek relevant information are simply for show—they are not the "effective collaboration" or "transparency and accountability" that the GAO recognized is critically important.

OFR operations are hampered by lack of internal expertise. The GAO observed that as a new and relatively unknown research organization OFR has faced difficulties recruiting experienced staff, and that OFR admitted it would take "many years" for OFR to be able to

---

5 *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

6 OFR Report at 16.

7 *Id.* at 26.

8 GAO Report, Highlights at 2.

9 *Id.* at 50.

"provide the insights" expected of it.[10] It has thus been reported that the SEC believed drafts of the OFR Report "appeared to be written by people with limited understanding of the industry"[11] which is borne out by the many errors in the final product.[12] And as noted above, OFR failed to fill the gaps in its internal expertise by seeking assistance from industry participants and experts.

FSOC has failed to prioritize threats. The GAO also criticized FSOC's failure to develop processes for systematically prioritizing threats to the U.S. financial system, instead identifying 30 threats "without prioritizing them," which "makes focusing on those that are most important difficult for decisionmakers."[13] Only this failure to prioritize can explain FSOC having had OFR devote 18 months to a study of the asset management industry, much of which is already heavily regulated by the SEC and which no one would describe as a leading, high-priority threat to the U.S. financial system.[14] To the contrary, the asset management industry has a long history of repeatedly weathering severe U.S. financial crises, without mass redemptions, fire sales, liquidity management problems, or contagion effects. Indeed, the fact that OFR's evidence of systemic risk in the asset management industry is principally limited to "[h]eightened redemptions" for funds managed by "asset management divisions" of failed investment banks and isolated reactions to losses in individual funds managed by Bank of America and Oppenheimer confirms the modest nature of any risks posed by the asset management industry.[15]

OFR lacks basic analytic tools to assess systemic risk. The GAO concluded that FSOC and OFR "have not yet developed and implemented systematic and comprehensive mechanisms for identifying and monitoring" "risks to the U.S. financial system."[16] Without "rigorous methods—such as quantitative indicators and models—to assess vulnerabilities," and lacking robust "qualitative inputs," GAO concluded that FSOC and OFR are "not * * * well positioned to judge which potential threats" warrant agency attention.[17] OFR's asset management report proceeds on the basis of speculation, supposition, and anecdote—ultimately, poorly informed guesswork—because OFR does not have the data, or the analytic tools to analyze data, necessary for the study FSOC ordered it to undertake. And more generally, the lack of "a systematic forward-looking approach to identify [financial system] threats" makes it impossible, the GAO concluded, to identify threats "consistently."[18] Consistency, however, is the *sine qua non* of

---

10 *Id.* at 10.

11 Lynch, *supra* note 3.

12 See GAO Report at 17-19 (discussing OFR's difficulties in staffing at both manager and researcher levels and its lack of established "performance measures").

13 *Id.*, Highlights at 2.

14 See Lynch, *supra* note 3 (reporting that OFR is "seeing more risk in the asset management business than anyone at the SEC would recognize").

15 OFR Report at 14, 18, 19.

16 GAO Report at 22.

17 *Ibid.*

18 *Id.* at 53; see also *id.* at 48 (warning of "potential inconsistencies in identifying" threats).

lawful regulation, mandated both by statutory requirements that agency action not be arbitrary and capricious and by the constitutional demands of due process and equal protection.[19]

OFR's "vague," "know it when they see it" approach to systemic risk is highly problematic, as one Nobel laureate recently remarked, because it invites "a substantial amount of regulatory discretion," which can "lead to bad government policy."[20] Without the "disciplin[e]" that comes from careful "models, methods, and measurements" that could produce "useful measurements of systemic risk," the "temptation [is] to respond to political pressures."[21] The OFR Report jumps to conclusions that suggest that is what happened here.

FSOC has put the cart before the horse. The GAO identified a number of ways in which FSOC has proceeded illogically in a manner that undermines its mission. One is its failure to prioritize threats, already discussed. Another is its failure to establish processes to assess whether Section 113 SIFI designations will have their intended effect, including by taking into account the "economy-wide costs" of heightened prudential regulation and its "individual costs" to designated entities.[22] OFR pays no attention to how markets and market participants would react to SIFI designation of an asset manager or a product it creates or manages, such as a mutual fund—a question as to which there is great uncertainty.[23] Notably, OFR's mandate in preparing its asset management study appears to have excluded any consideration of these important types of costs and market reactions not to mention their impact on financial services competition and investor returns.[24]

Furthermore, the GAO concluded that FSOC has not established for any industry the sort of "baseline" that would allow it to determine if its actions are effective. Decisionmakers therefore lack "the information they will need to determine whether designating new entities for enhanced supervision and other requirements and restrictions is addressing a perceived gap in the regulatory system and improving the stability of the financial system."[25] Given the meager understanding of the asset management industry demonstrated in the OFR Report, it is clear that FSOC is not anywhere near being able to establish such a baseline. Pursuing designation of any asset manager or managed product under Section 113 would therefore amount to a random attack

---

19 *E.g.*, *Kreis v. Secretary of the Air Force*, 406 F.3d 684, 687 (D.C. Cir. 2005); *LeMoyne-Owen Coll. v. NLRB*, 357 F.3d 55, 61 (D.C. Cir. 2004).

20 Hansen, *supra* note 1, at 2.

21 *Id.* at 2, 14.

22 GAO Report at 44-45; see, *e.g.*, *Business Roundtable v. SEC*, 647 F.3d 1144, 1148-51 (D.C. Cir. 2011).

23 See Letter from Paul Schott Stevens, President & CEO of Investment Company Institute, to FSOC 4 (Nov. 5, 2010), available at http://www.regulations.gov/#!documentDetail;D=FSOC-2010-0001-0061 ("Nov. 5, 2010 ICI Letter").

24 See *infra* pp. 25-29 (detailing unexamined consequences).

25 GAO Report at 46.

on a problem that has not been shown to exist and for which any "improvement" resulting from bank-style Federal Reserve regulation is speculative and cannot be measured. There is a high likelihood that unguided intervention would harm investor welfare, the financial system, and the whole economy.

Regulators have not explained what enhanced prudential requirements will apply to designated SIFIs. Another glaring example of FSOC's "ready, fire, aim" approach is that neither FSOC nor the Federal Reserve has disclosed what SIFI designation would mean for a nonbank financial institution, *i.e.*, what enhanced prudential regulation would apply to designated entities. Accordingly, in addressing whether an asset manager or managed product should be so designated, FSOC is working in a vacuum. Plainly, as OFR acknowledged, asset managers and managed products are very different from bank holding companies—and yet the Federal Reserve has not indicated that they will be subject to prudential requirements any different from the requirements imposed on banks. Rational consideration of *whether* a company should be designated as a SIFI first requires a more specific understanding than is currently possible of *what that designation means* in terms of how the company will be required to conduct itself differently and how different conduct will provide any measurable protection to the economy that justifies not only the expense borne by shareholders and accountholders but also the unintended adverse effects on systemic risk and investor costs of forcing asset managers or managed products to operate like too-big-to-fail banks.[26] Given the complete lack of transparency regarding the substance of any heightened regulation that would apply to designated firms, OFR could not possibly identify risks posed by asset managers or managed products *that would be addressed by designation.*

The GAO is far from the only expert to have questioned the transparency, accountability, and engagement with which FSOC goes about its business. For example, Senator Crapo, Ranking Member of the Senate Banking Committee, has requested a comprehensive GAO study of the designation process, including the criteria used, consistency of the designations, communications with evaluated institutions, and the nature of the Federal Reserve's planned supervision—all defects noted above.[27] The Chairman and Ranking Member of the Senate Subcommittee on Securities, Insurance, and Investment called on FSOC to promulgate asset-management-specific metrics before any evaluation for SIFI designation proceeds in this sector, to "explain how such metrics are indicative of systemic risk as applied to individual companies and across non-bank financial firms," and to make related OFR studies public for comment, in order to ensure "a transparent evaluation and analysis process with robust public comment."[28]

---

[26] See *infra* pp. 25-29 (discussing costs and unintended effects).

[27] Letter from Sen. Mike Crapo to Gene Dodaro, Comptroller General, GAO (July 15, 2013), available at http://www.crapo.senate.gov/issues/banking/documents/CrapoLettertoGAOComptrollerGeneralFSOC-July152013.pdf.

[28] Letter from Sens. Jon Tester and Mike Johanns to Jacob Lew, FSOC Chairman (Apr. 25, 2013), available at http://bipartisanpolicy.org/sites/default/files/files/2013-04-25%20FSOC%20SIFI%20 Letter.pdf ("Tester-Johanns Letter").

FSOC brushed off that request simply by pointing to the same hopelessly vague and incomplete designation guidance that prompted the Senators' request for more clarity and transparency.[29] And during its evaluation of Prudential Financial, Inc., for SIFI designation the FSOC did not even heed the advice of those who were appointed to the Council *because of their insurance expertise*. The Council's independent member having insurance expertise and state insurance commissioner representative both disagreed with the Council's Section 113 designation, citing the Council majority's basic misunderstandings of the insurance industry and its existing regulation.[30]

Far from correcting the defects in FSOC and OFR procedures that the GAO and others highlighted, OFR's asset management report shows that opaque and unaccountable practices continue to dog FSOC's analysis of systemic risk.[31] Deep and pervasive errors and gaps in OFR's data, analysis, and conclusions—which could have been averted had OFR engaged in appropriate collaboration and been transparent about its activities—reveal the designation process for non-bank financial companies to be built on a house of cards.

3. ***The OFR Report is full of errors and assumptions that thoroughly undermine its credibility.*** We describe in the sections of these comments that follow some fundamental failings of OFR's analysis. Here, without attempting to be comprehensive, we summarize selected problems that are sufficiently obvious that they undermine the credibility of the entire OFR Report. The Report is largely an exercise in catch-phrases and labeling—"concentration," "leverage," "fire-sale," "interconnectedness," "contagion," and so on—without any plausible showing that the facts justify attaching those labels to asset managers or the heavily regulated products they manage.

---

29 Letter from Alastair M. Fitzpayne, Asst. Sec. for Legislative Affairs, Department of the Treasury, to Sen. Tester (May 30, 2013).

30 Basis for the Financial Stability Oversight Council's Final Determination Regarding Prudential Financial, Inc. (Sept. 19, 2013), available at http://www.treasury.gov/initiatives/fsoc/designations/Documents/Prudential%20Financial%20Inc.pdf; Resolution Approving Final Determination Regarding Prudential Financial, Inc. (Sept. 19, 2013) (collecting dissenting views), available at http://www.treasury.gov/initiatives/fsoc/council-meetings/Documents/September%2019%202013%20Notational%20Vote.pdf.

31 The Chairmen of the House Committee on Financial Services and its Subcommittee on Oversight and Investigations called on the Treasury Department to implement the GAO's recommendations following GAO's "especially disturbing" findings—apparently to little effect. Letter from Reps. Spencer Bachus and Randy Neugebauer to Timothy Geithner, FSOC Chairman (Sept. 12, 2012), available at http://articles.law360.s3.amazonaws.com/0378000/378117/GOPLetter.pdf; Press Release, GAO Audit Finds Two Powerful Regulatory Entities Created by Dodd-Frank Lack Effective Level of Accountability and Transparency (Sept. 13, 2012), available at http://www.mhmarketingsalesmanagement.com/home/corp-press-releases/4042-gao-audit-finds-two-powerful-regulatory-entities-created-by-dodd-frank-lack-effective-level-of-accountability-and-transparency.

Basic factual errors about mutual fund companies. We have been informed by industry participants that Figure 2 in the OFR Report overstates or understates assets under management ("AUM") of individual asset managers by *hundreds of billions* of dollars. Figures 2 and 3 even get the names of asset management companies wrong, though correct information is readily available from public sources and is common knowledge to anyone familiar with the industry. For example, Figure 3 labels "Fidelity Investments" the "Highest Level Asset Management Entity" for Fidelity managed products, when even cursory research would show that Fidelity asset management companies Fidelity Management and Research Co. and FMR Co., Inc. are subsidiaries of FMR LLC and that "Fidelity Investments" is not an asset manager at all. Similarly, OFR reports "BlackRock Inc." as the asset manager with the greatest WW AUM. There is no record on the SEC's IARD of a BlackRock Inc. that is registered as an investment adviser. Instead there are at least two BlackRock entities, BlackRock Advisors, LLC, and BlackRock Capital Management, that are registered investment advisers managing large amounts of AUM from different clientele. Further, Amundi, ranked 11th on Figure 3 with $959 billion in WW AUM and $363 billion in registered fund AUM (*i.e.*, 38% of WW AUM is attributable to registered funds) has two active asset managers registered with the SEC, based on IARD searches: Amundi Investments USA (reporting $355 million regulatory AUM and 11-25% of advisory clients as investment companies (*i.e.*, registered funds)), and Amundi Japan Ltd. (reporting $35 billion in regulatory AUM and no investment company clients). Thus it appears that the $363 billion in registered fund AUM is inaccurate—at most, $90.75 million (*i.e.*, 25% of $355 million) is Amundi's registered fund AUM, a far cry from $363 billion. Moreover, that OFR would use data from Pensions & Investments ("P&I") as the authority for its analysis and conclusions, instead of the IARD on the SEC's official web site, is incomprehensible. A comparison of the P&I information published in the OFR Report and the IARD's reported regulatory assets under management reveals that the P&I data is not the most accurate or current information OFR could have used to reach conclusions on such an important initiative. These errors are not trivial. If such sloppy research pervades even the basic company information set forth in Figures 2 and 3—which purport to "provide an overview of the asset management industry and its firms and activities"[32]—there is no reason to trust what the OFR Report has to say about the far more complex issues addressed in the Report.

Competitiveness and concentration. OFR concedes that the asset management "industry is highly competitive," but then asserts that it is also "highly concentrated."[33] That is nonsense. In 2012 no fewer than 776 registered fund sponsors competed in the U.S. market to provide asset management services to registered fund investors.[34] These firms opened 628 new mutual funds in 2012 alone, bringing the number of such funds to 8,752.[35] And there are exponentially more investment companies when closed-end funds, exchange traded funds ("ETFs"), and unit

---

[32] OFR Report at 3.

[33] *Ibid.*

[34] Investment Company Institute, *2013 Investment Company Fact Book* 13 (53d ed.) ("ICI Fact Book").

[35] *Id.* at 15.

investment trusts ("UITs") that are competing for the same investor dollars are considered, bringing the total to 16,380 firms—to say nothing of additional thousands of hedge and private equity funds that are competing investments frequently chosen over mutual funds or separate accounts.[36] Investors can—and do—readily move assets from one managed product to another and from one manager to another, because investors control the assets. There are numerous competitors for virtually every type of product and strategy. This intense competition has "prevented any single firm or group of firms from dominating the market."[37] Two standard indicia show that the mutual fund industry is neither highly concentrated nor a safe haven for the biggest asset managers. First, the Herfindahl-Hirshman Index ("HHI") for the mutual fund industry is 465. On the HHI, developed by the U.S. Department of Justice's Antitrust Division specifically to measure market concentration and competitiveness, index numbers below 1000 show an industry is unconcentrated. Second, of the largest 25 fund complexes in 1995, only 15 remained in this top grouping by the end of 2012. This confirms that competition can rapidly elevate smaller industry participants, making any asset manager-specific regulation futile.[38]

Size. OFR focuses on the largest asset managers, in terms of assets under management, but the causes and transmission mechanisms of financial crises are "not necessarily a function of size at all," and that is especially true in the asset management arena.[39] Indeed, larger complexes often have more levels of, devote more resources to, and have a sharper focus on risk management at both the portfolio and aggregate levels. They also tend to be better equipped to handle any market disruption because the diversification of big asset managers promotes revenue stability and individual funds benefit from the high quality research, pricing power, lower fees, and better trade execution that come with larger complexes.

Furthermore, the size of AUM is neither an indicator of the magnitude of on- and off-balance sheet risks or of likely impact of losses on the U.S. financial system, because AUM are by definition owned by advisory clients, not by the manager. Tellingly, several of the anecdotes in the OFR Report that supposedly demonstrate systemic risk in the asset management industry involve OppenheimerFunds, even though the asset manager for the OppenheimerFunds is not among the top 20 asset managers cited in the Report.[40] The Investment Company Institute has

---

36 *Id.* at 18, Fig. 1.11.

37 *Id.* at 24.

38 *Id.* at 24-25.

39 Daniel K. Tarullo, Member of Bd. of Governors of Fed. Reserve Sys., Regulating Systemic Risk, Remarks at 2011 Credit Markets Symposium 3 (Mar. 31, 2011), available at http://www.federalreserve.gov/newsevents/speech/tarullo20110331a.pdf ("Tarullo Remarks"); see also S. Rep. No. 111-176, at 48-49 (2010) ("Size alone should not be dispositive in the Council's determination").

40 See OFR Report at 2, 14, 18.

cogently explained why size is not a useful criterion under Section 113 for mutual funds.[41] Yet OFR takes none of ICI's points into account.[42]

Overgeneralization and inattention to important distinctions. OFR's analysis does not adequately distinguish between the industry as a whole and individual asset managers; among asset managers; between asset managers and the mutual funds they advise; or among the large variety of mutual fund products, other managed products (such as closed-end funds, ETFs, and collective investment funds), and the vast array of additional managed account capabilities and programs. OFR recognizes that these distinctions exist and are important.[43] But because it lacks the data to make use of those distinctions it reverts to constant references to the asset management industry as if it were homogenous, which results in overgeneralized conclusions that could not survive close attention to the features and practices of particular asset managers and the variety of products they manage. OFR appears willing to apply a broad brush to this multifaceted industry in a quick one-size-fits-all approach. Quite simply, one size will never fit all.

For example, OFR lumps together asset managers that are part of financial holding companies already regulated by the Federal Reserve, managers that are part of insurance conglomerates—including one, Prudential, that has been designated a SIFI—and independent asset managers like Vanguard and Fidelity, without paying any attention to the differences in their operations and regulation.[44] Most of the managers listed in Figure 3 are affiliated with banks or insurers; yet 76 percent of all registered fund complexes are managed by independent investment advisers, and these firms manage 63% of investment company assets.[45] OFR acknowledges significant differences between these types of asset managers, including in the way they are regulated,[46] yet its analysis fails to take account of these distinctions, much less recognize how existing regulation may obviate any supposed need for enhanced supervision and prudential standards.[47]

---

41 See Nov. 5, 2010 ICI Letter, *supra* note 23, at 5-7; Letter from Paul Schott Stevens, President & CEO of Investment Company Institute, to FSOC 3 (Feb. 25, 2011), available at http://www.regulations.gov/#!documentDetail;D=FSOC-2011-0001-0035.

42 See *PPL Wallingford Energy LLC v. FERC*, 419 F.3d 1194, 1198 (D.C. Cir. 2009) ("unless [an agency] answers objections that on their face seem legitimate, its decision can hardly be classified as reasoned").

43 OFR Report at 3, 7; see also, *e.g.*, *id.* at 7 ("Risk management practices and structures vary significantly among firms" and are "important"); *id.* at 5 (listing variations in unregistered AUM); *id.* at 8 (listing variations in business lines).

44 *Id.*, Fig. 3.

45 ICI Fact Book, *supra* note 34, at 13.

46 OFR Report at 27.

47 See, *e.g.*, OFR Report at 19 (pointing to "material distress" at asset managers during financial crisis—identifying Bear Stearns and Lehman Brothers, which were leveraged about 30-to-1 when they failed, in contrast to the maximum 1-to-3 leverage ratio permitted for registered mutual funds).

Similarly, individual managed products cannot be lumped together, because asset managers must manage such products in a manner consistent with advisory client-imposed restrictions that impact investment objectives, policies, and limitations. Managed account clients have a voice in the way in which their account assets are managed. And mutual funds and closed-end funds are governed by boards of directors or trustees. Due to the variety of individuals, owners, boards, etc., that have a direct voice in how assets placed under an asset manager's discretion will be managed, and given the myriad restrictions and limitations that these voices impose on managed products, it is unrealistic to assess "the industry" as if it were homogeneous.

In fact, the OFR Report glosses over the fundamental question of what types of entities could be considered for SIFI designation. Could it be asset managers, their holding companies, particular mutual funds, closed-end funds, ETFs, collective investment funds, separate accounts, managed account programs of a retail or institutional nature, or something else? That question is important because there is one very clear and simple point that OFR fails to recognize or give proper weight to—registered fund products and managed account programs (and the separate accounts themselves) are legally separate and distinct from the asset managers that service them. The OFR Report seems to proceed on the unstated assumption that designating an "asset management firm" would cover all affiliated managers and the products they manage, just as designating a bank holding company covers all of its subsidiaries. That assumption is wrong because mutual funds and other managed products are not subsidiaries of either their asset managers or any parent entities. They are separate legal entities owned by their shareholders, which simply hire the asset manager to provide investment advice and related services. Indeed, both the Investment Company Act and the Investment Advisers Act prohibit commingling an adviser's assets with registered fund and other advisory client account assets.[48] And the way in which registered fund and managed account assets are invested presents a potential for risk to the market that is completely separate and different from how an asset management firm, mostly privately owned, chooses to deal with its own assets and balance sheet. Accordingly, given the legal, regulatory, and operational separations between registered funds and managed accounts on the one hand and their managers on the other, it is not appropriate to attribute registered fund or managed account risks to asset managers, or asset manager risk to the products they manage. Thus it is crucial to know which entities FSOC could be considering for designation before an appropriate analysis of risk and available regulatory remedies can be performed.

Speculation and conjecture. Perhaps the most common words in the OFR Report, and certainly the most telling, are "could," "may," "potentially," and the like. These signal that OFR's analysis and conclusions are speculative, not grounded in data or experience. Yet on the basis of this flimsy conjecture OFR reaches conclusions about leverage, redeemability, interconnectedness, and contagion that are calculated to establish a basis for exercising FSOC's Section 113 authority or taking other regulatory action.

---

[48] See 15 U.S.C. § 80a-17(f); 17 C.F.R. § 275.206(4)-2.

OFR's summary conclusion is a case in point. OFR speculates that "a certain combination of fund- and firm-level activities within a large, complex firm, or engagement by a significant number of asset managers in riskier activities, could pose, amplify, or transmit a threat to the financial system."[49] Yet the predicate for this conclusion is pure speculation and highly counter-factual. Essentially, OFR assumes that managers at major, closely regulated fund complexes of all sorts, with layers of internal risk management, will ignore limitations imposed by fund documents, trustees, and their fiduciary obligations to clients. And it assumes that all mitigating factors will fail and none of the stabilizing effects of applicable regulation will materialize.[50]

For example, OFR assumes that managers will "take on extra risks" to chase yield and meet competitive pressures.[51] Yet it acknowledges that "investment mandates," managers' "strong incentives to provide clients investment strategies matching their risk-return profiles," "fund- and firm-level investment risk management," "regulatory restrictions," portfolio "disclosure," and clients' ability to "freely move their accounts to another adviser" all mitigate that risk.[52] It is entirely illogical to lay out all of these powerful limitations on managers, who owe a fiduciary duty to their advisory clients, and yet to conclude that managers may take on risks that advisory clients do not expect or even allow, and that these risks may then "suddenly become apparent," spurring redemptions that may "trigger adverse market contagion."[53]

Another example of rampant speculation in the face of contrary facts is OFR's treatment of sponsor support for a fund in times of crisis. OFR acknowledges that "managers are not required to provide such support."[54] It concedes too that "[m]utual funds * * * generally offer no guarantees that investors will be protected from principal loss."[55] Nevertheless, based on two instances in which support was voluntarily provided, and speculation based on undisclosed sources that some additional but unidentified and unquantified support occurred during the most recent financial crisis, OFR jumps to the conclusion that investors may "expect their investments to be protected by explicit or implicit backstops" and "could" redeem funds in large numbers "if there is any sign that protections are eroding."[56] OFR also offers an extraordinarily misleading table of some asset manager "book values,"[57] apparently to suggest that firms would be unable to offer adequate support in a crisis. Given the lack of any legal obligation to support, any evidence

---

49 OFR Report at 7.

50 See *infra* pp. 14-20.

51 OFR Report at 9.

52 *Ibid.*

53 *Id.* at 9-10.

54 *Id.* at 14.

55 *Ibid.*

56 *Ibid.*

57 *Id.* at 20.

about the frequency, amounts, sources, and other circumstances of any support, or any evidence at all that investors expect support, OFR's treatment of the sponsor-support issue would get a failing grade in a student paper. Yet it is offered here as a potential justification for imposing a whole new level of costly and disruptive government regulation.

Throughout its Report, and in key areas such as herding, leverage, firm risk, fire sales, and transmission channels, OFR proceeds in this same way. It acknowledges but then dismisses risk mitigants because they "may" not be effective, refers to a few anecdotes of isolated incidents rather than any hard analysis of data, makes the most implausible but damaging assumptions about manager, investor, and market behavior, and then concludes that mutual funds "may" cause negative cascading effects across the financial markets. But "may" and "could" are vague terms that cover a wide range of probabilities and, if accepted, would justify arbitrary regulatory intervention. OFR makes no attempt whatsoever to assess probabilities of particular asset manager or investor or counterparty conduct, which makes its speculative conclusions as to what may or could occur useless as a practical matter.

OFR instead goes in the opposite direction and creates a composite bogeyman, posing every speculative risk, to characterize each asset manager. For instance, the OFR Report expresses great concern about herding and about redemption risks linked to illiquidity, and it proceeds as if virtually all asset managers and managed products present those risks.[58] The Report acknowledges in passing, however, that liquidity is not an issue for any registered funds or separate accounts considered in the Report and that any liquidity risk for unregistered funds is often controlled by redemption restrictions. Why then should herding and redemption be deemed risks that could affect any asset management entity in a way that would harm the broader financial system? And why should it be assumed—as the OFR Report assumes—that the same entities presenting herding and redemption risks "may" also be among the few entities that reach for yield in undisclosed ways and use excessive amounts of leverage? Isolated anecdotes notwithstanding, nothing in the OFR Report suggests that any actual entity would ever present the supposed "combination of fund- and firm-level activities" that "could" generate systemic risks.[59] And the OFR Report certainly makes no effort to tie its composite bogeyman to any of the asset managers identified in the Report as leading participants in the industry.

Furthermore, OFR apparently assumes the direst, most low-probability financial crisis. As one member of the Board of Governors of the Federal Reserve has explained, however, by assuming a "point of sufficiently high stress" in the financial markets, OFR could find that "virtually all firms pose systemic risk."[60] If Section 113 is to serve a useful purpose "it makes little sense to hypothesize all such crisis moments," rather than "a moderate amount of stress."[61] Because "the tool of designating firms" under Section 113 "is a limited one" and the "list of

---

58 OFR Report at 10-13.

59 *Id.* at 7.

60 Tarullo Remarks, *supra* note 39, at 7.

61 *Ibid.*

firms designated" "should not be a lengthy one,"[62] using assumptions and probability levels that would permit designation of virtually *any* financial firm cannot be what Congress intended.

Separate accounts. OFR makes much of the existence of separate accounts, yet admittedly proceeds on the basis of ignorance and speculation.[63] For example, OFR remarks on the lack of regulatory limits on leverage in separate accounts (and unregistered funds)—but is forced to concede (in a footnote) that "leverage levels for unregistered funds and accounts may be restricted under investment mandates."[64] Separate accounts are typically owned by sophisticated and often institutional investors, who impose investment mandates that OFR admits it lacks the data to assess.[65] That lack of information does not, however, stop OFR from engaging in rank speculation—hypothesizing, for example, that "a firm could manage a number of large, highly leveraged unregistered funds which have strategies that turn out to be correlated in ways firm risk managers did not anticipate."[66] As with its other assessments of risk, OFR makes no effort to quantify the likelihood of this event occurring, the severity of any market effects if it did occur, or how designation would address the problem. The reality, which OFR could learn if it asked institutional asset managers, is likely to be that most separate account managers do not use leveraged strategies to manage these assets. The largest segment of separate account assets is likely to be ERISA-governed retirement plans and state governmental plans, which are unlikely to be invested in instruments that create leverage. These large separate accounts allocate their assets among a number of products, and it is probable that any leverage occurs in the investment allocations to products other than separate accounts or unregistered funds. But OFR has not taken the time to investigate or understand the separate account business to find out. It is therefore impossible to test OFR's conclusion—and thus impossible to credit it.

THE OFR REPORT IMPROPERLY DISCOUNTS THE REGULATORY REGIMES GOVERNING THE ASSET MANAGEMENT INDUSTRY

Another fundamental defect in the OFR Report is its failure to fully acknowledge how the existing regulatory regimes control the risks purportedly posed by asset managers and managed products. That failure leads OFR to grossly exaggerate supposed vulnerabilities of the industry to financial shocks.

1. ***Registered funds are already subject to comprehensive regulation by expert agencies.*** Section 113 requires FSOC to consider "the degree to which the company is already

---

62 *Id.* at 5-6.

63 See OFR Report at 2, 18.

64 *Id.* at 17 & n.33.

65 *Id.* at 18 (data is "insufficient to understand the exposures and the extent of leverage in separate accounts").

66 *Id.* at 19.

regulated by [one] or more primary financial regulatory agencies."[67] It does so because—as FSOC has recognized—SIFI designation is just one of the tools available to regulators seeking to address potential systemic risk.[68] Designation serves to fill gaps in the existing regulatory framework. Accordingly, when a financial company is already heavily regulated, designation will rarely be appropriate. The primary regulator is the expert on the industry in which the company operates, any areas of regulatory concern, and the applicable regulatory scheme. It is best positioned to identify regulatory gaps and take the necessary regulatory actions.[69] In addition, a company already subject to extensive regulation is much less likely to pose risks to financial stability and much more likely already to have robust internal controls and compliance procedures that mitigate any risks.

A host of laws and rules aimed at protecting investors and limiting financial risks comprehensively regulate asset managers and mutual funds. And regular examinations, periodic reporting, and required policies and procedures for risk management ensure compliance.

The SEC—the primary regulator in most situations—enforces and administers at least four different laws that govern asset managers and registered funds:

- The Investment Company Act of 1940,[70] which imposes strict governance, compliance, diversification, concentration, liquidity, disclosure, leverage, and conflict-of-interest/affiliated transaction obligations on registered funds and their asset managers;

- The Investment Advisers Act of 1940,[71] which imposes fiduciary, disclosure, record-keeping, compliance, custody, and marketing obligations on registered asset managers;

- The Securities Act of 1933,[72] which imposes extensive disclosure, marketing, registration, and offering obligations in connection with the issuance of securities;

67 12 U.S.C. § 5323(a)(2)(H).

68 Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 76 Fed. Reg. 64264, 64267 (Oct. 18, 2011).

69 See, *e.g.*, *Gordon v. N.Y. Stock Exch.*, 422 U.S. 659, 689-90 & n.13 (1975) (recognizing "the expertise of the SEC," "the active rol[e] the SEC" had taken, the "degree of scrutiny" the SEC had exercised, and "the confidence the Congress has placed in the agency" in rejecting competing scheme that "would conflict with the regulatory scheme" adopted by the SEC); *Credit Suisse Sec. (USA) LLC v. Billing*, 551 U.S. 264, 273 (2007) (siding with the SEC when making industry subject to parallel regime would risk "'conflicting standards'").

70 15 U.S.C. §§ 80a-1 et seq.

71 15 U.S.C. §§ 80b-1 et seq.

72 15 U.S.C. §§ 77a et seq.

- The Securities Exchange Act of 1934,[73] which closely regulates securities trading, broker-dealer activity, financial reporting by securities issuers, and manipulative and deceptive conduct.

Significantly, although the legal regime established under these statutes is informed by the SEC's mission to "protect investors, maintain fair orderly and efficient markets, and facilitate capital formation,"[74] it also addresses issues such leverage, liquidity, and concentration that FSOC and bank regulators globally have focused on since the 2008 financial crisis.

In addition, asset managers that manage pension plan assets are regulated by the Department of Labor under the Employee Retirement Income Security Act of 1974, which imposes fiduciary duties, prohibits certain transactions, mandates periodic reporting and disclosures, and requires managers to carry bonds to compensate for any losses due to fraud or dishonesty.[75] The CFTC regulates asset managers and registered funds that effect transactions for clients in commodities, futures, swaps, and other similar investments under the trading, disclosure, and registration requirements of the Commodity Exchange Act.[76] And the Internal Revenue Code sets further requirements regarding portfolio diversification and distribution of earnings for registered funds seeking to achieve pass-through tax treatment.[77]

Asset managers registered as broker-dealers, futures commission merchants, or other financial intermediaries (including registered fund principal underwriters) also are subject to the applicable trading, disclosure, and marketing rules of the Financial Industry Regulatory Authority,[78] the National Futures Association,[79] and other self-regulatory organizations. And investment advisers, through the Investment Advisers Act, have strict fiduciary duties that require them to act in the best interests of funds and clients with undivided loyalty and utmost good faith.[80]

These extensive regulatory regimes directly address virtually all of the supposed vulnerabilities of asset managers and the products they manage, registered funds in particular. For instance, the possibility of "reaching for yield" is severely constrained by the laws and regulations that require registered fund assets to be managed in accordance with the fund's stated

---

[73] 15 U.S.C. §§ 78a et seq.

[74] See *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, Securities and Exchange Commission, http://www.sec.gov/about/whatwedo.shtml.

[75] 29 U.S.C. §§ 1021, 1104, 1106, 1107, 1112.

[76] 7 U.S.C. §§ 1 et seq.

[77] 26 U.S.C. §§ 851-855.

[78] FINRA Rules 2010-2370.

[79] NFA Rules 2-1 to 2-48.

[80] See, *e.g.*, *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963).

investment objectives, principal investment strategies, and investment limitations,[81] as well as by the regulations that require asset managers to adhere to advisory client-imposed restrictions on how account assets are to be managed.[82] Likewise, "herding" is largely controlled by diversification and industry concentration restrictions under the Investment Company Act and other laws.[83] "Redemption risk" poses little realistic threat because the SEC requires registered open-end funds (*i.e.*, all mutual funds) to maintain at least 85% of their investments in highly liquid assets that can quickly be sold at carrying value.[84] And the Investment Company Act strictly limits the ability of registered mutual funds to take on "leverage," requiring at least 300% asset coverage for the limited leverage that is permitted,[85] and requiring derivative and other positions that create debt leverage to be "covered" with liquid assets or otherwise offset.[86]

Other regulatory measures also contribute to the stability of registered funds and their asset managers. For example, the Investment Company Act strictly limits transactions between registered funds and their asset managers or other affiliates that could allow asset managers to take advantage of registered funds and their investors.[87] In addition, several regulations promote registered fund transparency in order to prevent "surprises" that could destabilize a fund. Registered funds generally calculate their net asset value per share once each business day, with most funds publishing these values on a daily basis.[88] And registered funds must include detailed descriptions of their investment strategies and policies in the prospectus, and report their portfolio holdings to investors on a quarterly basis.[89] Further, a registered fund's abilities to

---

81 15 U.S.C. §§ 80a-8(b)(1)-(3), 80a-13(a)(3); SEC Form N-1A, Items 2, 4, 9.

82 See 17 C.F.R. § 270.3a-4.

83 See 15 U.S.C. §§ 80a-5(b), 80a-13(a)(3); 26 U.S.C. § 851(b).

84 Revisions of Guidelines to Form N-1A, SEC Release No. IC-18612, 57 Fed. Reg. 9828 (Mar. 20, 1992). The SEC further prohibits money market mutual funds from purchasing illiquid securities if, after the purchase, more than five percent of the fund's portfolio will be illiquid securities. 17 C.F.R. § 270.2a-7(c)(5).

85 15 U.S.C. § 80a–18(f).

86 See, *e.g.*, Securities Trading Practices of Registered Investment Companies, SEC Release No. IC-10666, 44 Fed. Reg. 25128 (Apr. 27, 1979). Closed-end funds are also restricted in the leverage they can assume.

87 15 U.S.C. §§ 80a-10, 80a-17(a), (d), (e); 17 C.F.R. § 270.17d-1.

88 17 C.F.R. § 270.22c-1.

89 15 U.S.C. § 80a-29; 17 C.F.R. §§ 270.30b1-1, 270.30b1-5; SEC Form N-1A, Items 2, 4, 9. See Shareholder Reports and Quarterly Portfolio Disclosure of Registered Management Investment Companies, SEC Release No. IC-26372, 69 Fed. Reg. 11244 (Mar. 9, 2004). In addition, any asset manager that manages $100 million in equity securities traded on a stock exchange must report those holdings quarterly pursuant to 15 U.S.C. § 78m(f).

invest in other funds or acquire securities issued by persons engaged in a securities-related business are carefully limited.[90]

The OFR Report, to be sure, mentions some of these laws and regulations. But the Report discounts the possibility that they effectively eliminate the supposed vulnerabilities threatening asset managers and managed products. The Report simply speculates that the vulnerabilities "could" nonetheless remain through one unproven mechanism or another. The regulatory regime carefully crafted by Congress, the SEC, and other regulators over the last 80 years deserves far more respect than that.

2. ***The SEC and other regulators have proactively moved to reduce systemic risks revealed by the 2008 financial crisis.*** The SEC has a long history of promptly and proactively regulating registered funds and asset managers to mitigate emergent financial stability risks. In the wake of the 2008 financial crisis, the SEC has taken several steps to address potential risks posed by registered funds. For example, to address the only part of the registered fund business implicated in any threat to financial stability during the financial crisis, the SEC imposed a host of new regulations on money market funds to address the unique problems presented by the practice of maintaining stable net asset values for such funds.[91] The new regulations enhance liquidity requirements, require stress testing, increase portfolio disclosure obligations, and create mechanisms for orderly liquidation of funds.[92] And the SEC is currently evaluating additional proposals to prevent runs on money market funds by requiring a floating net asset value for some funds, allowing fees and limits on redemption in times of stress, and mandating additional disclosures.[93] The SEC's Division of Enforcement has also been aggressively pursuing misconduct during the financial crisis that might have contributed, in a real or perceived way, to systemic instability. For example, the SEC has brought actions against fund advisers, and fund boards of directors, for failure to properly value fund holdings affected by turmoil in the capital markets.[94]

The SEC's efforts have not been limited to money market funds and other registered funds. Consistent with the Dodd-Frank Act, the SEC has promulgated new rules requiring advisers to private funds, such as hedge funds and private equity funds, to register as investment advisers, thereby subjecting them to the various compliance responsibilities that apply to all registered investment advisers.[95] It also has promulgated new rules for expanded oversight of

---

[90] See 15 U.S.C. § 80a-12(d); 17 C.F.R. § 270.12d3-1.

[91] Money Market Fund Reform, SEC Release No. IC-29132, 75 Fed. Reg. 10060 (Mar. 4, 2010).

[92] 17 C.F.R. § 270.2a-7.

[93] Money Market Reform; Amendments to Form PF, SEC Release No. IC-30551, 78 Fed. Reg. 36834 (June 19, 2013).

[94] See, *e.g.*, Morgan Asset Management, Inc., SEC Release No. 34-64720, IA-3218, IC-29704, AAER-3296 (June 22, 2011); J. Kenneth Alderman, SEC Release No. IC-30557 (June 13, 2013).

[95] Rules Implementing Amendments to the Investment Advisers Act of 1940, SEC Release No. IA-3221, 76 Fed. Reg. 42950 (July 19, 2011). SEC staff has acknowledged that these statutory and rule

and reporting by investment advisers to private funds.[96] According to the staff of the SEC's Division of Investment Management, these new reports on Form PF have been filed by over 2,300 advisers covering over 18,000 private funds, pertaining to nearly $7.3 trillion in assets, providing the SEC, CFTC, FSOC and other regulators with heretofore unprecedented information about the activities of private funds.[97]

In the context of derivatives and other complex financial products, the SEC and other regulators have also been active. The SEC has sought public comment on the use of derivatives by registered funds.[98] In addition, the CFTC has narrowed the exemptions previously available to operators of funds (both registered funds and private funds) from status as a "commodity pool operator," requiring the investment advisers of many registered funds that make use of swaps and other derivatives to register with the CFTC and the NFA.[99] Regulators have also taken important steps to address potential risks raised by other financial products, adding to the general stability of the whole financial system. To cite just two examples, the CFTC and SEC have adopted rules to transform the over-the-counter derivatives market,[100] and the Federal Reserve has overseen several reforms to the repo market.[101]

The OFR Report does not give adequate weight to these recent regulatory efforts. It relies heavily on the possibility that events associated with the 2008 financial crisis could be

---

changes resulted in the registration of approximately 1,500 investment advisers. *See* Norm Champ, Director, SEC Division of Investment Management, Remarks to the Investment Management Institute 2013 (Mar. 7, 2013), available at https://www.sec.gov/News/Speech/Detail/Speech/1365171515032.

[96] Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, SEC Release No. IA-3308, 76 Fed. Reg. 71128 (Nov. 16, 2011); Rules Implementing Amendments to the Investment Advisers Act of 1940, SEC Release No. IA-3221, 76 Fed. Reg. 42950 (July 19, 2011)

[97] See SEC, Annual Staff Report Relating to the Use of Data Collected from Private Fund Systemic Risk Reports (July 25, 2013).

[98] Use of Derivatives by Investment Companies Under the Investment Company Act of 1940, SEC Release No. IC-29776, 76 Fed. Reg. 55237 (Sept. 7, 2011).

[99] Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations, CFTC Release 2012-3390, 77 Fed. Reg. 11252 (Feb. 24, 2012).

[100] See FSOC, *2013 Annual Report* 117-19 (2013), available at http://www.treasury.gov/initiatives/fsoc/Documents/FSOC%202013%20Annual%20Report.pdf.

[101] Fed. Reserve Bank of N.Y., *Recent Developments in Tri-Party Repo Reform* (Dec. 20, 2012), available at http://www.newyorkfed.org/newsevents/statements/2012/1220_2012.html; Fed. Reserve Bank of N.Y., *Update on Tri-Party Repo Infrastructure Reform* (July 18, 2012), available at http://www.newyorkfed.org/newsevents/statements/2012/0718_2012.html; see also William C. Dudley, President and CEO, Fed. Reserve Bank of N.Y., Introductory Remarks at Workshop on "Fire Sales" as a Driver of Systemic Risk in Tri-Party Repo and Other Secured Funding Markets (Oct. 4, 2013), available at http://www.newyorkfed.org/newsevents/speeches/2013/dud131004.html (describing past and future reforms).

repeated—and could be attributed to the activities of investment advisers to registered funds and managed accounts, though that was not the case in 2008—without accounting for the new regulations that make such events much less likely. That is why the OFR Report's few anecdotes regarding isolated financial stress in certain mutual funds in 2008 are hopelessly stale. And the fact that OFR can offer so few anecdotes suggests that even the regulations in effect in 2008 were exceptionally effective.

The extensive and ongoing effort to regulate asset managers and registered funds by regulators with unparalleled expertise confirms that SIFI designation is not necessary. The ability of the SEC to handle vulnerabilities of money market funds through industry-wide activity-based regulation conclusively establishes that SIFI designation is not needed to deal with the supposed vulnerabilities hypothesized in the OFR Report. To the extent that existing regulations do not adequately address those vulnerabilities, the SEC and other regulators can do so with industry-wide activity-based regulation, either on their own initiative or at the FSOC's urging under Sections 112 or 120 of the Dodd-Frank Act.[102] And they can do so with the benefit of industry knowledge and experience that OFR clearly does not have.

Indeed, industry-wide activity-based regulation by the SEC—or even market-wide financial services or capital markets regulation designed by the SEC or the CFTC—would be far superior to SIFI enhanced supervision and prudential standards. The OFR Report confirms that the SEC has a far better handle on how the asset management industry operates, what risks it poses, and how the regulatory regime can be improved. The selective regulation that comes with SIFI designation would likely just shift the systemic risks to undesignated firms, given the industry's competitive landscape and the lack of any showing that the supposed systemic risks are somehow limited to a small number of identifiable asset managers or managed products. As Federal Reserve Governor Tarullo has recognized, when a systemic risk cannot be isolated to an individual firm because it "reflects the potential failure of an asset class or business model more than a firm," industry-wide activity-specific regulation rather than SIFI designation is the proper remedy.[103]

The OFR Report nevertheless seems designed to push FSOC headlong into a massive expansion of SIFI regulation that would vastly increase the authority of the Federal Reserve at the expense of other agencies with long expertise with registered funds and advisers. That would be a very dangerous road to take on such a flimsy basis.

---

[102] Section 120, codified at 12 U.S.C. § 5330, allows the FSOC to recommend regulations to a primary regulator, which must impose the regulations unless it explains in writing why it has decided not to do so. Section 112 makes it FSOC's duty to "recommend to the member agencies general supervisory priorities and principles reflecting the outcome of discussions among the member agencies" and to "make recommendations to primary financial regulatory agencies to apply new or heightened standards and safeguards for financial activities or practices that could create or increase risks of significant liquidity, credit, or other problems spreading among bank holding companies, nonbank financial companies, and United States financial markets." 12 U.S.C. § 5322(a)(2)(F), (K).

[103] Tarullo Remarks, *supra* note 39, at 6.

BANK-STYLE ANALYSIS AND REGULATION IS INAPPROPRIATE FOR THE ASSET MANAGEMENT INDUSTRY

The stated purpose of the OFR Report is to inform FSOC's "analysis of whether—and how—to consider [asset management] firms for enhanced prudential standards and supervision under Section 113 of the Dodd-Frank Act."[104] Yet the Report skates over the fact that asset managers and registered funds have little if anything in common with the banks and bank-like entities that the Dodd-Frank Act created SIFI designation to control. The OFR Report does not consider whether the purported vulnerabilities of asset managers, managed accounts, and registered funds resemble the bank vulnerabilities targeted for enhanced supervision and prudential standards. Nor does it consider whether supposed vulnerabilities of asset managers and the accounts and funds they manage could be remedied by the bank-style regulation that accompanies SIFI designation. The failure to do so makes the OFR Report useless as a tool for assessing whether or not designating asset managers or the products they manage would be an appropriate regulatory response.

The Dodd-Frank Act authorizes designation and enhanced regulation of SIFIs in order to control systemic risks created by the banking business model. The law automatically designates all bank holding companies with at least $50 billion in assets,[105] and it allows the FSOC to designate non-bank financial companies only in accord with considerations—like leverage, role in providing credit and liquidity, and ownership rather than management of assets—that largely focus on whether the company is operating substantially like a bank.[106] The prudential standards contemplated by the Dodd-Frank Act involve enhanced forms of traditional banking regulation, such as capital and liquidity requirements and limits on leverage, concentration, and short-term debt.[107] Other Dodd-Frank provisions that apply to SIFIs—such as the Volcker Rule's capital requirements and quantitative limits,[108] or the Collins Amendment's minimum risk-based-capital and leverage-capital requirements[109]—also reflect banking regulation concepts. And, of course, the assigned regulator for SIFIs is the Board of Governors of the Federal Reserve System, which historically has regulated banking firms.[110] In short, as the Chairman and Ranking Member of the Senate's Subcommittee on Securities, Insurance, and Investment recently wrote in a joint letter to FSOC's chairman, "the SIFI designation authority and regulatory scheme are based" on "the banking business model."[111]

---

[104] OFR Report at 1.

[105] 12 U.S.C. § 5365(a)(1).

[106] 12 U.S.C. § 5323(a)(2).

[107] See 12 U.S.C. §§ 5325, 5365.

[108] 12 U.S.C. § 1851.

[109] 12 U.S.C. § 5371.

[110] 12 U.S.C. §§ 5361, 5362, 5365.

[111] Tester-Johanns Letter, *supra* note 28, at 1.

Consequently, in deciding whether to apply the SIFI scheme to a non-bank financial industry, it is crucial to understand whether that industry resembles the banking industry and would be susceptible to banking regulation. The OFR Report acknowledges that the activities of asset management firms "differ in important ways from commercial banking and insurance activities."[112] But the Report ignores those crucial differences on the ground that asset managers supposedly create substitutes for "money-like liabilities," engage in "liquidity transformation," and provide liquidity.[113] But those supposed parallels—which the Report never explains or examines—do not change the fact that the "distinct differences" between the business model for banking and that for asset management result in very different systemic risk profiles and make asset managers and the products they manage unsuited for bank-style regulation.[114]

One central difference between banking and asset management is that banks make proprietary loans and investments with funds borrowed from their customers, while asset managers direct investments owned by registered-fund and separate-account clients on behalf of those clients. Asset management is an agency business in which registered fund investors and separate account clients, rather than asset managers, own the fund or account assets and absorb all gains and losses. That means that the kind of capital requirements, for instance, that come with the SIFI regime make no sense for asset managers or managed products. Asset managers need no capital to absorb fund losses, have small balance sheets, and fund their operations with stable fee-based income. These facts are precisely why one of the statutory considerations for SIFI designation is "the extent to which assets are managed rather than owned by the company,"[115] reflecting Congress's view—which OFR and FSOC need to recognize—that mere asset management is not indicative of a threat to financial stability.

Registered funds and separate accounts also differ from banks because the possibility that fund customers and separate account clients may lose money is both inherent in the investment decision and fully disclosed in prospectuses, Forms ADV, and investment management agreements. Bank customers, by contrast, expect deposits to maintain their value, and bank regulation (including FDIC insurance) protects that expectation by limiting the chance that modest financial problems at a bank will start a run on deposits. Because mutual fund customers understand and tolerate that their investments may lose value, without insurance against fluctuations from the federal government, the effects of losses on them and on the stability of the financial system are very different than the implications of bank deposit losses; and in variable net asset value funds—especially those without leverage—there is no risk of a run on a fund.[116]

---

[112] OFR Report at 1.

[113] *Ibid.*

[114] Tester-Johanns Letter, *supra* note 28, at 1.

[115] 12 U.S.C. § 5323(a)(2)(F).

[116] To be sure, money market funds' stable net asset value makes them different from other mutual funds in this respect. But the OFR Report disclaims any intent to address money market funds and, as we have explained, the SEC has already undertaken a series of industry-wide activity-specific regulatory reforms addressed to such funds. The President's Working Group on Financial Markets praised the SEC's new

In fact, as many have observed, mutual fund outflows have remained "modest," as a share of overall trading, during every market downturn over the last generation, from the 1987 stock market crash to the 2008 financial crisis.[117] This may be due in part to the fact that a substantial portion of mutual fund assets—41% in 2012—are held by retirement plans and accounts, which have long-term investment horizons.[118]

The transparency of registered fund capital structures and balance sheets adds to the greater stability of mutual funds. The capital structure is simple; every mutual fund investor knows that each investor is getting an undivided pro rata interest in the fund's net assets, with only slight but fully disclosed variation for closed-end funds.[119] Fund investors also know that a registered fund's assets must be invested in accordance with the fund's name, investment objectives, and prospectus disclosures.[120] Registered funds regularly disclose a wealth of information about the fund, including detailed reports on portfolio holdings that identify each security held and its value.[121] These disclosures are available to investors, regulators, media, and services that analyze, rate, and compare registered funds. In addition, registered funds calculate (and most publish) their net asset value per share every business day, using market prices where readily available and fair value for other assets.[122] By giving investors and regulators access to so much crucial financial information—and so much more information than banks reveal—registered funds avoid the kind of opacity that was a major contributor to the banking crisis in 2008 and other previous financial crises (*e.g.*, Long Term Capital Management, the S&L crisis).

The leverage limits and liquidity requirements already mentioned further aid the stability of registered funds and distinguish them from banks. As a result of the Investment Company Act's restrictions on leverage,[123] most mutual funds operate with little if any leverage and could never come close to the 10-to-1 to 30-to-1 historical asset-to-equity leverage ratios for large banks. Likewise, the Investment Company Act's requirement that 85% of mutual fund assets be

---

rules for "mak[ing] MMFs more resilient and less risky and therefore reduc[ing] the likelihood of runs on MMFs." President's Working Grp. on Fin. Markets, *Report of the President's Working Group on Financial Markets: Money Market Fund Reform Options* 3 (2010), available at http://www.treasury.gov/press-center/press-releases/Documents/10.21%20PWG%20Report%20Final.pdf.

[117] Karrie McMillan, General Counsel of the Investment Company Institute, Opening Remarks, ICI Capital Markets Conference (Oct. 10, 2013).

[118] ICI Fact Book, *supra* note 34, at 132.

[119] 15 U.S.C. § 80a-18.

[120] 15 U.S.C. §§ 80a-8(b)(1)-(3), 80a-13(a)(3); SEC Form N1-A, Items 2, 4, 9.

[121] See 15 U.S.C. § 80a-29; 17 C.F.R. §§ 270.30b1-1, 270.30b1-5; SEC Form N1-A, Items 2, 4, 9. See also Shareholder Reports and Quarterly Portfolio Disclosure of Registered Management Investment Companies, SEC Release No. IC-26372, 69 Fed. Reg. 11244 (Mar. 9, 2004).

[122] See 17 C.F.R. § 270.22c-1.

[123] 15 U.S.C. § 80a-18(f).

liquid means that mutual funds already are required to be far more liquid than banks.[124] And that liquidity has long allowed mutual funds to handle large numbers of redemptions without consequences to the broader financial system. In 2009, for instance, stock fund redemptions totaled 28 percent of assets and bond fund redemptions totaled 33 percent of assets.[125]

In fact, the financial stability of mutual funds has allowed them to serve as a stabilizing force in financial markets during times of crisis. As the OFR Report acknowledges, funds "with the financial strength and liquidity to buy assets trading significantly below their intrinsic values potentially could help to stabilize declines in prices."[126] And even when 2008 crisis-related redemption requests caused some mutual funds to sell assets, they tended to sell well-performing stocks with stable prices, which had a "stabilizing effect" on the prices of distressed financial stocks.[127]

The nature of asset management also protects companies in the industry from the risk faced by banks that losses in one part of the bank will threaten the stability of the entire bank. Asset managers, as we have said, do not absorb the losses of the registered funds and separate accounts they manage. And even if fund or account performance could somehow affect them, asset managers also are protected by the great diversity of assets they typically manage, which far surpasses the range of assets owned by banks. As for the stability of the managed products, asset managers cannot tap the funds or accounts they manage for their own purposes.[128] And each fund in a fund complex operates independently of every other fund, with virtually no commingling of assets or cross-fund covering of losses.[129] In short, if a fund "fails" it threatens neither the asset manager nor other registered funds.[130] And if an asset manager somehow "failed," the funds it managed would be unharmed.[131]

---

124 Revisions of Guidelines to Form N-1A, SEC Release No. IC-18612, 57 Fed. Reg. 9828 (Mar. 20, 1992).

125 Nov. 5, 2010 ICI Letter, *supra* note 23, at 12.

126 OFR Report at 12.

127 *Id.* at 23.

128 15 U.S.C. §§ 80a-17(a), (d), (e), 80b-6(3).

129 See 15 U.S.C. § 80a-17(a), (d); see also, *e.g.*, Mutual Series Fund Inc., SEC No-Action Letter (Nov. 7, 1995), available at http://www.sec.gov/divisions/investment/noaction/1995/mutualseriesfund110795.pdf; Delaware Statutory Trust Act, 12 Del. Code §§ 3801 et seq.

130 Significantly, a fund "failure" is surpassingly improbable because a shrinking asset base could make a fund insolvent only in the unlikely event that the fund becomes unable to repay any leverage obligations or pay its trade creditors before it winds downs its affairs and distributes its net assets to fund investors.

131 Indeed, the Investment Advisers Act requires each registered asset manager with discretionary authority or custody of client assets to give clients notice if it is in a precarious financial condition so that clients can terminate the investment management agreement and move assets to a new asset manager. Form ADV, Part 2A, Item 18B.

Asset managers fold up shop and registered funds wind down on a regular basis without any disruption to financial markets. From 2002 to 2012, 476 fund sponsors left the business and 6,396 mutual funds merged or liquidated.[132] Yet those departures had no effect on the industry's stability. The industry is highly competitive, with very modest differences in fees driving fund and manager selection. Practically every fund has a close substitute, and fund assets are easily portable. Managers are often readily replaced, and several firms even provide transition services. Barriers to entry are low—the sponsors and funds that departed between 2002 and 2012 were replaced by 528 new sponsors and 6,752 new funds, so that by the end of 2012, there were 776 fund sponsors and 16,380 registered funds.[133] And winding up a registered fund usually requires only that the fund distribute its assets to fund investors on a pro rata basis and in some cases file a form with the SEC.[134] All of this is very different from the situation in the banking industry, where resolving a failed bank—especially a big one—is a disruptive and unwieldy endeavor. Bank-style regulation aimed at preventing and dealing with bank failures, while needed for banks, is neither necessary nor appropriate in the asset management industry.

It is past time for FSOC and OFR to recognize that the original non-bank targets of the Dodd-Frank Act—investment banks, financing companies, and other "shadow banks"—all now are out of business, have become bank holding companies, or have been designated.[135] Designation should proceed against other non-banks only on the clearest showing that those entities present bank-like systemic risks and that SIFI designation is the most efficient and effective means to address those risks. The OFR Report utterly fails to demonstrate either of these things.

THE OFR REPORT IGNORES AND EXACERBATES THE COSTS OF THE SIFI DESIGNATION PROCESS

As a potential basis for SIFI designation decisions, the OFR Report's unguided, undisciplined, and unsupported analysis of risks in the asset management industry is both dangerous and costly. The burdens likely to result from designating asset managers or registered funds based on such analysis would be numerous, heavy, and widespread. Yet OFR pays those

---

[132] ICI Fact Book, *supra* note 34, at 14-15.

[133] *Id.* at 14-15, 18.

[134] 17 C.F.R. § 270.8f-1.

[135] Indeed, in the development of the Dodd-Frank Act, Federal Reserve Chairman Bernanke pegged the number of "systemically significant" firms at "about 25," "virtually all of" which "are organized as bank holding companies or financial holding companies" already under the Federal Reserve's "umbrella supervision." *Regulatory Perspectives on the Obama Administration's Financial Regulatory Reform Proposals, Part II: Hearing before the House Committee on Financial Services*, 111th Cong. 47-48 (2009). Federal Reserve Governor Tarullo likewise has noted that the initial list of designated non-banks "should not be a lengthy one," because "the most obvious pre-crises candidates—the large, formerly free-standing investment banks—have either become bank holding companies, been absorbed by bank holding companies, or gone out of existence." Tarullo Remarks, *supra* note 39, at 6.

burdens no mind. In order to consider whether FISI designation authority could be appropriately used in the asset management industry and weigh it against regulatory alternatives, the probability and magnitude of the burdens must be carefully measured, modeled, and weighed against any alleged benefits.

The enhanced supervision and prudential standards that come with SIFI designation intentionally impose tremendous costs on designated entities. More demanding capital and liquidity requirements and more stringent concentration and debt limits reduce returns and increase funding costs.[136] Additional public-disclosure, regulatory-reporting, and risk-management requirements impose greater operating and compliance expenses.[137] And SIFIs have to pay an annual "supervision and regulation" fee.[138] Unlike for banks, which are accustomed to bank-style regulation by the Federal Reserve, these costs would not be merely incremental for asset managers and registered funds; they would be entirely novel, requiring new practices, new policies, new staff, and new regulatory relationships. And all of those costs of bank-style regulation would come without any of the funding-subsidy benefits—like FDIC deposit insurance and access to the Federal Reserve discount window—that banks receive from the federal government's banking safety net.[139]

The tremendous costs that SIFI designation would impose on an asset manager or registered fund would likely have disruptive and adverse consequences on the designated entity, markets in which it participates, the financial system, and the broader U.S. economy. As we have explained, asset management—and mutual fund management in particular—is highly competitive and highly substitutable, with multiple client and investor options for virtually every strategy and fees measured in basis points (0.01%). Both asset managers and mutual fund customers are extremely sensitive to costs, which can impose a significant drag on fund returns. Indeed, fund investors have even sued investment advisers over management fees that allegedly compare unfavorably to other advisers or funds.[140] In this market environment, asset managers or registered funds under the threat of designation have only two realistic choices.

They could try to avoid designation by exiting the lines of business and kinds of investments deemed systemically risky. But doing so would harm their ability to serve the needs of clients and investors, placing them at a competitive disadvantage and reducing management choice. Furthermore, the targeted risks would remain. Undesignated asset managers and registered funds would be free to continue the supposedly risky practices and scoop up the disaffected advisory clients and investors of designated entities. And designation in the asset

---

136 See 12 U.S.C. § 5365(b)(1)(A)(i), (ii), (v), (B)(i), (iii).

137 See 12 U.S.C. § 5365(b)(1)(A)(iii), (iv), (B)(ii).

138 See 12 C.F.R. §§ 246.1-246.6.

139 See *Fahey v. Mallonee*, 332 U.S. 245, 250 (1947) ("Banking is one of the longest regulated and most closely supervised of public callings").

140 See, *e.g.*, *Jones v. Harris Assocs. L.P.*, 559 U.S. 335, 341-43 (2010).

management industry predictably would both accelerate investor flight to products and jurisdictions less regulated than U.S. registered funds and push assets to too-big-to-fail banks, increasing systemic risk.

Alternatively, asset managers or registered funds could stick with the lines of business and kinds of investments deemed systemically risky. But they would have to pass the costs of designation along to clients and investors in the form of higher fees and lower returns. The mere prospect of higher fees and lower returns may prompt investors in a designated fund to start redeeming fund shares. Perversely, those redemptions could put the fund on the road to the redemption-related liquidation that designation was intended to avoid. And, again, the assets pulled out of designated funds or moved away from designated asset managers would likely be moved to other funds, managers, and products that carry the same, if not greater, risks. Moving forward with SIFI designation in the asset management industry thus threatens serious harm to those designated, yet promises to do little if anything to reduce systemic risk.[141]

SIFI designation in the asset management industry also would likely create a dangerous moral hazard problem.[142] Market participants would relax their own diligence with respect to a designated asset manager or registered fund based on the assumption that the government had mitigated any systemic risks. They might believe that designation implies that the government will intervene to protect the designated entity in any financial market disruption. Or they might think that the designated entity is effectively supervised by the bank-style regulation that comes with SIFI designation. As the Lehman Brothers collapse demonstrated, mistaken beliefs about government intervention and regulation increase the risk of destabilizing events.[143]

Along the same lines, subjecting designated asset managers or registered funds to the same regulatory scheme as the existing SIFIs could force all of those entities to adopt similar risk mitigation strategies, similar business models, and similar asset portfolios. Indeed, SIFI designation could incentivize non-banks to open banking operations or merge with existing banks in order to avail themselves of the regulatory benefits that banks enjoy in exchange for enduring the costs of bank-style regulation. The resulting homogeneity among the leading firms throughout the entire financial services sector would dangerously correlate risks among those firms. And such correlation would exacerbate the threat of multiple, simultaneous failures—precisely the kind of systemic risk with which FSOC and OFR are supposed to be concerning themselves.

---

[141] See SEC Div. of Inv. Mgmt., *Protecting Investors: A Half Century of Investment Company Regulation* i (1992) ("overly broad regulation can limit the choices of investors, and unnecessary regulatory costs are ultimately passed through to investors") (statement of SEC Chairman Breeden).

[142] See Tarullo Remarks, *supra* note 39, at 7.

[143] In addition, the OFR Report itself threatens to foster a similar moral hazard by greatly exaggerating the likelihood of sponsor support for managed products that suffer investment losses. See OFR Report at 14. Such support is exceedingly rare outside of the money market fund context, and suggesting otherwise would only encourage investors to ignore material investment risks.

Designating asset managers and registered funds also would unnecessarily dilute SIFI oversight. To have any hope of meaningfully reducing alleged systemic risks in the asset management industry, numerous asset managers and/or funds would have to be designated. But doing so would add tremendously to the burden on the Federal Reserve Board of Governors—which is already responsible for close oversight of dozens of SIFIs—and divert its regulatory attention. With the SEC, other federal agencies, state and foreign regulators, and self-regulatory organizations extensively regulating asset managers and mutual funds, there is no reason to risk lessening the rigor of SIFI regulation or shifting resources from its intended targets in order to expand it to the asset management industry. And dividing primary authority over asset managers and registered funds would only create confusion over regulatory responsibilities and applicable SEC and bank regulation.[144]

Before any proper judgment can be made about FISI designation in the asset management industry, all of these potentially heavy burdens must be rigorously modeled, precisely measured, and carefully weighed against the supposed benefits of designation. Needless to say, the OFR Report does not even begin to do any of those things, opting instead to dismiss or ignore the burdens of designation. And that faulty approach is only one of the many ways in which the OFR Report fails at the basic task of giving any real guidance as to whether any entity in the asset management industry should be designated. The Report says nothing about whether the analysis should focus on asset managers, asset classes, particular registered funds, particular activities, or something else. It gives no guidance on how to distinguish an entity that should be considered for designation from one that should not. And it does not even try to analyze how SIFI designation and supervision would improve upon the extensive regulation of asset managers and registered funds by the SEC and others.

Those fatal flaws not only make the Report useless for the FSOC or any other regulatory agency going forward, they also create enormous confusion and uncertainty as to who, if anyone, in the asset management industry might be designated. That confusion and uncertainty hampers asset managers and mutual funds in creating reliable long-term strategic plans for growing their businesses. And it interferes with the ability of those entities to deal with advisory clients and business partners (*e.g.*, banks, insurers, brokers, etc.) on a predictable basis.

Beyond creating these irreparable and unnecessary costs for the asset management industry, the OFR Report greatly damages the credibility of OFR. And it will have the same effect on FSOC or any other regulator that attempts to use it as the basis for policy recommendations or regulatory actions. As we have said, the Report's many obvious and demonstrable errors call into question everything said in the Report. Those errors also alarmingly suggest that OFR understands little about the operation of the asset management industry for which it appears set to start the SIFI designation process. At the same time, OFR's

[144] See, *e.g.*, Jason Marisam, *Duplicative Delegations*, 63 Admin. L. Rev. 181, 184, 198, 222 (2011) (to avoid "ceaseless duplication and interagency conflict" and "burdens [on] regulated entities," Congress "does not want agencies to duplicate or interfere with each other's behavior" or "perfor[m] a redundant task").

decision to disregard offers of assistance and requests for input from the SEC and industry members alienates potential allies in assembling a reasoned and accurate analysis of systemic risks in the asset management industry. And proceeding with the designation process based on the fatally flawed OFR Report raises the likelihood that any SIFI designation will be overturned as arbitrary and capricious.

Plainly, the OFR Report is a thoroughly inadequate basis for any regulatory action. In an area of policy with such critical economic consequences, and where "the temptation to respond to political pressures" with "quick answers" is acute, OFR has shown it lacks "a coherent set of tools" to analyze issues that are "complex" and have "many dimensions."[145] OFR simply "remain[s] too close to the Potter-Stewart 'we know it when we see it' view of systemic risk."[146] But legitimate questions about the role of asset-management-industry participants and their current regulation in the capital markets and the financial system more broadly still deserve analysis. We therefore suggest that the SEC and other experienced regulators in the asset management space—with input from industry participants, outside experts, and other stakeholders—take the lead in designing any additional analytical endeavors on those topics and ensure that they are conducted using transparent and rigorous methods. Such analysis should include assessments of the costs and benefits of existing regulation and any additional regulatory action that might be recommended. That kind of rigorous analysis would be invaluable to the regulatory community generally and to FSOC specifically in answering the questions FSOC has asked about the asset management industry.

Sincerely,

Timothy S. Bishop

Timothy S. Bishop

cc: *Financial Stability Oversight Council:*
Chairman Jacob J. Lew, Secretary of the Treasury
Ben S. Bernanke, Chairman of the Board of Governors of the Federal Reserve System
Richard Cordray, Director of the Consumer Financial Protection Bureau
Thomas J. Curry, Comptroller of the Currency
Edward DeMarco, Acting Director of the Federal Housing Finance Agency
Gary Gensler, Chairman of the Commodity Futures Trading Commission
Martin J. Gruenberg, Chairman of the Federal Deposit Insurance Corporation
Debbie Matz, Chairman of the National Credit Union Administration

---

[145] Hansen, *supra* note 1, at 2, 3, 9.

[146] *Id.* at 9.

S. Roy Woodall, Jr., Independent Insurance Expert
Richard Berner, Director of the Office of Financial Research
John Ducrest, Commissioner of the Louisiana Office of Financial Institutions
John Huff, Director, Missouri Department of Insurance, Financial Institutions, and Professional Registration
David Massey, Deputy Securities Administrator, North Carolina Department of the Secretary of State, Securities Division
Michael McRaith, Director, Federal Insurance Office, Department of the Treasury