T. ROWE PRICE ASSOCIATES, INC.

WWW.TROWEPRICE.COM

DAVID OESTREICHER
Chief Legal Counsel

P.O. Box 89000
Baltimore, Maryland
21289-1020

100 East Pratt Street
Baltimore, Maryland
21202-1009

Phone 410-345-2628
Fax 410-345-6575
david_oestreicher@troweprice.com

October 31, 2013

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: Office of Financial Research (the "**OFR**") – Report on Asset Management and Financial Stability (the "**OFR Report**")

Dear Ms. Murphy:

T. Rowe Price Associates, Inc.[1] appreciates the opportunity to comment on the OFR Report.[2] We strongly support the efforts of regulators to study systemic risk in the financial markets and, where warranted, enhance regulation to reduce such risks and promote a well-functioning financial system for all market participants. Such studies must be thorough and thoughtful, and take into consideration industry feedback, in order to ensure regulators most effectively evaluate the risks presented and whether additional regulation will appropriately address such risks.

Unfortunately, we believe the OFR Report lacks the necessary rigor to properly inform the Financial Stability Oversight Council (the "**FSOC**") in its mission. The OFR Report, is generally inconclusive due to its emphasis on anecdotal claims and a scarcity of supporting data. It is also important to recognize that while there are activities common to all asset managers, including their fiduciary duty to clients, there are many different types of managers and each carries its own degree of risk. The OFR Report does not adequately address these differences and the resultant differences in risk profiles. As a result, we recommend that the OFR work closely with the Securities and Exchange Commission (the "**SEC**") to further study the investment management industry, and the risks related to the various types of industry participants, before the FSOC or the SEC consider whether enhanced prudential regulation of asset managers would be appropriate to materially reduce systemic risk.

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[1] T. Rowe Price and its advisory affiliates provide investment management services to numerous individuals, institutions, and investment funds, including the T. Rowe Price family of mutual funds. As of September 30, 2013, T. Rowe Price Associates, Inc. and its affiliates managed approximately $647 billion in assets.

[2] The FSOC asked the Office of Financial Research to study the activities of large asset managers to assist the FSOC in its evaluation of whether, and how, to consider such firms for enhanced prudential regulation under Section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**"). Section 113 establishes a framework for additional regulation of a nonbank financial firm whose financial distress or failure, if it were to occur, could present systemic risks to the financial stability of the United States. Firms designated by the FSOC for additional regulation as systemically important financial institutions are referred to herein as "**SIFIs**."

We note that we are not alone in our concerns related to the OFR Report. Many important observations have been made, and we strongly endorse the comments contained in the letters filed by the Investment Company Institute, the US Chamber of Commerce, the Investment Adviser Association, and the Securities Industry and Financial Markets Association. We are also writing to state our views on this important topic.

As an initial matter, one overarching concern relates to the potential for confusing and conflicting mandates from multiple regulatory bodies. Although we understand and support the role of the FSOC, the circumstances surrounding the OFR Report bring into sharp focus the pitfalls of a lack of coordination and communication. It is not clear whether the OFR took full advantage of the SEC's expertise in this area, or adequately consulted with industry participants, before issuing its report. Clear and open communication with the primary regulator is critical to ensure the regulatory framework and risk profiles of asset managers are fully understood before any SIFI determination can be appropriately made.

General Observations & Industry Background

Although the OFR Report indicates that OFR's analysis of these issues is hindered by data gaps regarding the assets held in separate accounts, we note that even currently available data was not fully utilized or considered in reaching the OFR Report's conclusions. Further, recent initiatives (e.g., the SEC's large trader and Form PF reporting regimes) have improved transparency by supplementing existing frameworks to which asset managers are subject, such as Form 13F and 13G filing obligations. Regardless, we believe the evaluation as to what data is needed to adequately monitor the asset management industry should remain the purview of the SEC. Determining the scope of such data requests and coordinating their collection should reside with the SEC as the primary regulator of U.S. asset managers.

When policymakers evaluate systemic risk and asset managers' activities, there are some core concepts that must be acknowledged. For example, periodic shocks are an inevitable part of the complex, global marketplace and all financial market activities involve some element of risk. Market participants generally understand that such shocks and investment losses can occur. Additionally, asset managers routinely disclose investment, strategy, and market risks in various materials (e.g., prospectuses and Forms ADV) to raise the awareness of these and other risks to investors. Asset managers also do not promise particular levels of performance or guarantee that investors' portfolios will not depreciate or lose principal. The client selects or approves the mandate and risk profile of the investment – whether it be a mutual fund board approving the sponsor's launch of a new fund; a pension plan client negotiating a separately managed account; or an individual investor selecting an investment vehicle. Further, the core business of traditional asset managers is managing funds and portfolios comprised of client and investor assets as opposed to the manager's corporate assets. In the unlikely event of an asset manager's bankruptcy, client assets will not be at risk. Such assets must be held by a proper custodian, and there are specific rules governing the custody, safeguarding, and segregation of client assets. The asset management industry recently lived through one of the most significant shocks in the history of the financial markets – yet, the OFR Report devotes very little attention to the impact of the financial crisis upon the industry generally, other than citing anecdotes about money market funds and a few well-known fixed income funds that ran into trouble with significant derivatives exposures.

Assumptions about asset managers engaging in certain types of behaviors due to competitive pressures, such as "herding," "reaching for yield," and "fire sales" do not take into consideration historical market practices across the various market segments. Further, these types of behaviors are not isolated to asset managers, have existed in the markets since their infancy, and are subject to different asset manager viewpoints which could act as a stabilizing influence. The OFR Report appears to put significant weight on commonly understood market risks, or incorrect principles of conflicts of interest or proprietary exposures. In addition, it inappropriately transposes the redemption experience certain institutional money funds faced during the financial crisis onto other types of funds and asset classes subject to different market risks. Asset managers are typically subject to specific investment guidelines, restrictions, and objectives for each portfolio they manage. These requirements can be quite varied. An asset manager's clients are distinct funds, other legal entities, or natural persons. No client is responsible for the investments or actions of another. Asset managers have a fiduciary obligation to act in the best interests of each client on a stand-alone basis and managers cannot use client assets for their own purposes. Large institutional clients also tend to allocate their assets to a range of asset managers, investment strategies, and sectors. Viewing these factors together, we believe a traditional asset manager is unlikely to act in a coordinated fashion across its accounts in a way that would cause the types of systemic risks upon which the OFR Report has focused.

In light of this business structure and the absence of guarantees as noted above, many of the prudential standards contemplated by section 115 of the Dodd-Frank Act (for example, capital requirements and debt limits) are not well-suited for preventing systemic risk with respect to asset managers. Such standards are bank-oriented and, consequently, not appropriate for all entities.[3] More generally, when regulators consider designating a particular company (whether a bank or non-bank institution) as systemically important, it is crucial to recognize that while a company may possess some of the characteristics of being systemically risky, if the measures under Section 115 of the Dodd-Frank Act are not tailored to the risks presented by the company, then enhanced regulation is unlikely to be effective in addressing such risks and, therefore, will have no material benefit, but will carry added burden, complexity and expense.

[3] Moreover, Section 165 of the Dodd-Frank Act states that the Board of Governors of the Federal Reserve System is to consider the differences between nonbank financial companies and bank holding companies when identifying firms or categories of firms for prudential regulation and specifically notes that capital requirements and leverage limits may not be appropriate for certain activities such as asset management and the operation of mutual funds.

Specific Recommendations

<u>*Regulation Should be More Direct in Certain Areas*</u>. The OFR Report noted that certain distinct activities, such as repurchase agreement ("**repo**") transactions, securities lending, and derivatives trading, can be sources of systemic risk. We agree and note that various efforts have been undertaken to increase safety and transparency in many aspects of these markets. For example, the Dodd-Frank Act provides regulators with numerous new tools to address potential excessive risk, including comprehensive regulation of over-the-counter derivatives (such as central clearing/exchange trading, margining, reporting, and oversight of swap dealers and major swap participants). In addition, the Tri-Party Repo Infrastructure Task Force formed in 2009 addressed certain weaknesses in the repo market that surfaced during the financial crisis. Following a 2012 report from the Task Force, the Federal Reserve Bank of New York announced that it would intensify the supervisory oversight of market participants' efforts to implement the Task Force's recommendations.

Furthermore, to the extent more regulation is needed to reduce systemic risks in activities involving repos, securities lending, or derivatives, we believe it would be most effective to apply such regulation to these markets directly as opposed to seeking to address vulnerabilities by targeting a subset of market participants - asset managers - for SIFI oversight. The OFR Report also noted that there is concentration risk among asset managers' service providers (<u>e.g.</u>, certain custodians, pricing vendors, counterparties), which could lead to widespread disruptions. Again, we believe addressing any systemic issues related to these service providers through direct regulation of such activities is a more appropriate approach rather than subjecting asset managers to SIFI regulation.

<u>*Sharing of Data Used to Assess Causes of Systemic Risk*</u>. We also think it would be useful for the OFR and FSOC, following additional study, to provide the public with (a) the data it believes establishes that certain asset management activities are a source of specific systemic risks, and (b) the types of exposures and their magnitudes that suggest an individual firm could impact systemic risk. This process would give asset managers and members of the public a clearer understanding of the regulatory analysis and an opportunity to review the additional information in order to provide feedback.

<u>*Further Recognition of the Asset Management Industry's Varying Business Models*</u>. Lastly, as noted earlier, in our view it is unfortunate that the study's scope excluded an in-depth review of the various business models or investment strategies of asset managers. Complex and rapid trading behaviors and extensive use of leverage can materially increase risk. Asset managers that invest significant corporate assets in their own investment products on different terms than their clients or engage in proprietary trading, as opposed to generally focusing on traditional asset management, may also generate additional risks. However, even with the potential for more risk related to unique activities, we believe serious consideration should be given to addressing the specific activities through enhanced

regulation before applying SIFI designation to those industry participants engaging in such activities.

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We appreciate your consideration of our views on this significant topic. If you have any questions or would like to discuss our letter, please do not hesitate to contact us.

Sincerely,

David Oestreicher
Chief Legal Counsel