P I M C O

<u>Via Electronic Submission</u>

November 1, 2013

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Office of Financial Research Report on Asset Management and Financial Stability

Dear Ms. Murphy:

Pacific Investment Management Company LLC ("PIMCO") appreciates the opportunity provided by the U.S. Securities and Exchange Commission (the "SEC") to comment on the Office of Financial Research's (the "OFR's") Report on Asset Management and Financial Stability (the "Report").[1]

PIMCO is a global investment management firm that serves an array of clients and manages retirement and other assets for millions of people in the United States and throughout the world. Our clients include state, municipal, union and private sector pension and retirement plans, educational foundations, endowments, philanthropic and healthcare institutions, in addition to millions of individual mutual fund investors. PIMCO manages assets in a fiduciary capacity on behalf of more than an estimated 12 million mutual fund investors and 1,800 institutional separate account clients. PIMCO acts as an agent, not as a principal, for its clients' investments and does not invest for its own account.

As a large, institutional asset manager, PIMCO sees several fundamental flaws in the Report and accordingly submits this comment letter with a view to assisting the OFR in better understanding the asset management industry. First, the Report mistakenly assumes a correlation between the size of an asset manager's assets under management and the risks that an asset manager may pose. Second, the assertion that asset managers are vulnerable to destabilizing behaviors such as "reaching for yield," "herding" and selling into fire sales, is misleading and does not reflect the practices of institutional asset managers such as PIMCO.[2] Third, the Report does not adequately consider the substantial amount of valuable industry-related data, or the extensive and comprehensive regulatory landscape within which such data is reported and collected.

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1 Office of Financial Research, *Asset Managers and Financial Stability*, Sept. 2013.

2 Like the Report, we do not in this letter consider asset managers of money market funds, which are separately being considered by the Council.

Because the conclusions in the Report are based on a number of inaccurate assumptions about how asset managers, including institutional asset managers, operate, the Report should not be relied upon by the Council in its review of the asset management industry. PIMCO urges the SEC, as a member of the Council, to recommend that the Council revise and re-issue the Report and not use the report as a basis of future policymaking. As a member of the Council with knowledge of the asset management industry, PIMCO believes that the SEC should lead and oversee any future report in this regard. Lastly, any new or modified report should seek input from the industry, preferably through a more formalized process similar to the notice and comment procedures under the Administrative Procedure Act.

In each section below, we summarize and explain PIMCO's concerns regarding the Report.

The Report Reflects a Fundamental Misconception about the Nature of Assets Under Management

In describing the asset management industry, the Report observes that the industry is "highly concentrated," with ten firms having more than $1 trillion in global assets under management, and concluding that higher concentrations could increase the market impact of firm-level risks or increase the risk of fire sales.[3] The assertion that an asset manager's assets under management are a meaningful metric to measure the potential vulnerability of the asset manager in times of market stress reflects a fundamental misunderstanding of the role of asset managers within the financial system.

A. *The Report mistakenly links the size of an asset manager's assets under management to its systemic risk profile.*

The Report seems to view assets under management as a single pool of assets that are deployed on a monolithic basis at the sole discretion of the asset manager. In practice, however, a firm's assets under management reflect an aggregation of smaller pools of assets, which are owned by many separate and distinct clients. PIMCO's assets under management represent more than 1,800 institutional separate accounts and hundreds of mutual funds for which PIMCO serves as an investment manager. These clients are separate legal entities; they have separate and distinct investment mandates, guidelines and risk parameters; their assets are custodied at third-party custodians of their choosing; and they make deliberate and distinct decisions about redemptions and contributions which are, in many cases, directed by separate boards of directors. PIMCO is contractually and legally obligated as a fiduciary to make investment decisions that are appropriate for, and in the best interests of, each particular client based on the parameters and restrictions specified in contractual obligations between PIMCO and its clients. Accordingly, assets under management should be considered as a collection of distinct and separate mandates

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3 Report at 3.

and pools of assets with idiosyncratic guidelines and risk tolerances and not as a single monolithic amount over which an institutional asset manager has discretion.

PIMCO notes that the Council has previously recognized that in the banking context, higher assets may reflect higher levels of lending for a bank, and potentially higher risks to the financial system from a default of that bank. However, for an asset manager, greater assets under management result in higher fees for the manager, increased resources for important functions such as risk management and operations, and greater efficiencies for its clients through economies of scale, which are collectively indicative of greater stability – not increased risk.[4]

B. Institutional asset managers do not hold client assets on their balance sheets, unlike banks.

The Report does not give sufficient weight to the fundamental difference between institutional asset managers' balance sheets and those of banks or other types of financial firms. One of the principal factors the Council takes into account when designating non-bank financial institutions as systemically important is the size of the institution's balance sheet. This reflects Congress's determination that a larger balance sheet is characteristic of potentially higher risks to the U.S. financial system upon a firm's default or insolvency. Institutional asset managers, however, do not hold their clients' assets on their balance sheets and therefore assets under management is not a meaningful metric in understanding any risk they might present to the financial system. The Report does not give adequate consideration to the significant difference between financial institutions that make use of their balance sheets and traditional, institutional asset managers that do not.[5]

Many investment products offered by banks and insurance companies ultimately do rely on the institution's financial strength and its ability to pay out on the obligations it incurs from those investment products. But, this is not the business model of the traditional asset manager. PIMCO, like most traditional asset managers, does not guarantee – even implicitly – the

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4 In fact, Moody's Investor Service recently proposed a new methodology for evaluating the credit quality of asset managers. In that proposal, Moody's notes that "[a]sset management tends to be a highly profitable business evidenced by average industry margins in the high 20s (%) due to a high proportion of variable costs to fixed costs, which provides flexibility in maintaining high levels of profitability in all types of market conditions." Moody's Investors Service, *Global Rating Methodology for Traditional and Alternative Asset Managers*, Request for Comment (Oct. 13, 2013) ("Moody's RFC") at 10.

5 For example, the Report does not distinguish between large, diverse, asset managers and smaller asset managers that may engage in activities that are more likely to contribute to systemic risk. The Moody's RFC notes that there is a continuum of asset managers, such as "traditional asset managers that make little use of their balance sheet and alternative asset managers who make significant use of their balance sheet to invest alongside their clients in less liquid private equity or other alternative investments." Moody's RFC at 7. Accordingly, size alone does not necessarily equate to systemic risk and the Report should distinguish between activities and size.

investment results of the funds and client accounts it manages. The risk of losses lies clearly with the fund or client account. The Report states that asset managers may be pressured into providing financial support for client losses in order to protect the asset manager's reputation.[6] We believe that traditional asset managers in fact do not engage in such activity, except for the narrow case of those managers who have voluntarily supported their money market funds.[7]

Because client assets are not held on the asset manager's balance sheet, an asset manager's creditors do not have recourse to client investments. Similarly, in the event of a client's default or bankruptcy, the client's creditors do not have recourse to the asset manager's assets. This is an important distinction between asset managers that function as an agent for their clients, and banks that act in their capacity as principal, which the Report does not adequately consider. In view of this fundamental difference, the Report does not explain how an asset manager itself would be at risk, or how an institutional investment manager's activities could result in the transmission of risks to the U.S. financial system.

Arrangement of Leverage for Clients is not a Source of Risk for Asset Managers

A. Any leverage arranged on behalf of clients by an asset manager is subject to client or regulatory limits, and there is no risk of contagion because the obligations of each client are separate from those of other clients and from the asset manager.

The Report states that the "use of leverage" by asset managers is a potential vulnerability for asset managers in times of market stress. We see no basis for this reasoning.

To the extent that institutional asset managers arrange leverage on behalf of their clients at all, the gains or losses on each client's investments are borne only by that client. The obligations of each client are separate from those of other clients, and any default by one client on its obligations does not implicate either the asset manager or any other of the asset manager's clients. Client assets are held by their own selected custodians. At no time does the asset manager (or any other client) have a claim on the client's assets.

Typically, all derivatives transactions (including derivatives that have embedded leverage) arranged by PIMCO for its clients are non-recourse obligations. This means that the lender can only look to the particular client account for payment. Further, as client accounts are separately custodied, there is no ability for a manager to use assets from one client to satisfy the

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6 Report at 14.

7 As noted in note 2, this letter does not address money market fund managers. Further, we note that situations like the one cited in the Report, in which an asset manager assisted its advised fund in meeting its contractual obligations, are extremely rare and, in all cases, are made either voluntarily or as a result of an impending settlement or court order premised on misconduct of the adviser. Report at 14.

obligations of another. We believe other institutional asset managers follow a similar practice. Dealer counterparties understand that they can only seek payment from the assets in the relevant client account. Payment obligations for such transactions typically are marked-to-market daily.

For most institutional asset managers, mutual funds comprise the majority of the manager's assets under management. As noted in the Report, the Investment Company Act of 1940 ("1940 Act") restricts the amount of leverage that may be employed by registered funds and requires those funds to segregate assets to cover any uncovered liabilities. These significant leverage restrictions have operated successfully through volatile markets, including those experienced during every financial crisis since 1940. Indeed, PIMCO is not aware of any registered investment company that has ever been declared insolvent.[8]

B. Client guidelines, with which asset managers are legally obligated to comply, restrict the use of leverage.

The Report states that separate accounts and their effects on the market are "not adequately understood" and that regulators are unable to "fully assess the nature or extent of any financial stability risk." Because we have managed assets on behalf of separate account clients from our firm's inception, we believe we can provide some insight into these separate account clients.

At PIMCO, our separate account clients largely consist of institutional investors, which include large state and local retirement plans, university endowments, foundations and non-profit organizations, multi-employer retirement plans, central banks and corporate defined benefit plans. They typically are fiduciaries and have an investment staff that reports to an oversight board. These clients usually must receive approval before proceeding with an investment strategy or a modification to that investment strategy. These institutions are long-term investors that measure performance on a typical 3-5 year basis, and their programs are designed to cover longer term liabilities, usually in the form of accruing and payable retirement benefits. Most of these clients have in-house or outsourced risk management systems and personnel that help the clients monitor their risk exposures across investment managers.

Moreover, these clients are typically subject to strict concentration, sector leverage and liquidity limits, due to regulatory requirements (*e.g.*, ERISA and state or local laws) or the

[8] We note that the Oppenheimer example cited in the Report, in which an asset manager provided support to a fund in meeting its contractual obligations, is only one example and is not indicative of a common practice, and further, does not support the view that such instance gives rise to systemic risk. In addition, the Oppenheimer case involved an administrative proceeding whereby Oppenheimerfunds, Inc. and Oppenheimerfunds Distributor, Inc. settled various charges, including making misleading statements in its mutual fund prospectus, and agreed to pay over $35 million in a penalty. *In the Matter of Oppenheimerfunds, Inc. and Oppenheimerfunds Distributor, Inc*., Investment Advisers Act Rel. No. 3417 (June 6, 2012).

investment guidelines outlined by their boards, or both, and tend to have relatively conservative asset allocations to meet their specific liability profile. In fact, many clients favor investing in a separate account versus a commingled vehicle because they can better customize risk guidelines, including concentration and liquidity requirements, as well as ascertain daily transparency of their holdings and receive customized risk reporting.

By not considering the highly constrained institutional investment guidelines that are imposed on institutional asset managers, the Report does not provide a complete picture of the context in which institutional asset managers must operate.

C. Systemic risk in the derivatives market has been inherently reduced by the comprehensive regulatory framework adopted under Title VII of the Dodd-Frank Act.

Finally, the Report does not consider recent regulatory developments that mitigate the risk of leverage obtained through the use of derivatives. William Dudley, the President and CEO of the Federal Reserve Bank of New York recently stated that "systemic risk is being reduced in a number of ways," in reference to new requirements for central clearing and margin requirements for swaps and enhanced regulation of central counterparties.[9] Similarly, SEC Chairwoman Mary Jo White recently noted that Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") reduces systemic risk in the market, including through central clearing and margin requirements for derivatives.[10] In this regard, the Report does not consider the degree to which derivatives and their associated leverage are used by asset managers actually to diversify and reduce risks and create investment products that are more robust during times of market stress. We note that PIMCO was an early adopter of central clearing, and began voluntarily clearing client swap transactions due to the

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[9] William C. Dudley, President and CEO of the Federal Reserve Bank of New York, *Remarks at the 2013 OTC-Derivatives Conference, Paris, France,* Sept. 12, 2013. Mr. Dudley described the reforms as follows: "Systemic risk is being reduced in a number of different ways. First, mandating the standardization, whenever possible, and central clearing of OTC derivative trades can reduce risk by transforming a complex web of bilateral firm exposures into a smaller set of net exposures between each dealer and the central counterparty (CCP) . . . . Second, increasing capital and liquidity requirements, improving governance, risk management, and resolution and recovery, as well as implementation of the Principles for Financial Market Infrastructures (PFMIs) promulgated by the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO) should make FMIs more robust and resilient . . . Third, firm-level risk management is being strengthened in a variety of ways such as requiring mandatory margin requirements for bespoke, non-cleared trades. Firms need to understand the risks associated with OTC derivatives activity and set aside capital and exchange margin to cover these risks. Moreover, authorities are developing supervisory approaches to oversee market infrastructures and participants to oversee market infrastructures and participants to ensure compliance with evolving regulatory frameworks."

[10] Mary Jo White, Chairwoman, U.S. Securities and Exchange Commission, *Testimony on Mitigating Systemic Risk in the Financial Markets through Wall Street Reforms*, July 30, 2013.

benefits of counterparty credit risk reduction years before the requirements of the Dodd-Frank Act were effective.

Importantly, Title VII of the Dodd-Frank Act further mandates registration requirements and regulation of swap dealers and major swap participants ("MSPs"). Indeed, the MSP category was specially designed to address swap users that, by virtue of high levels of swaps or security-based swap activities, "create substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets."[11] These derivatives market reforms are comprehensive and are specifically designed to reduce systemic risk and create transparency in the market.[12] In fact, there is a leverage component in the MSP threshold test that is designed to capture those entities that may cause systemic risks from their activities. The Report should have taken into consideration these significant developments, which have fundamentally transformed derivatives markets in the past several years.

In short, the Report does not: (i) explain why an asset manager's *arrangement* of debt or other forms of leverage for clients gives rise to potential systemic risks; (ii) consider the significant restrictions on leverage that institutional asset management clients are currently under; and (iii) evaluate the risk-mitigating derivatives regulations that have come into effect since the financial crisis.

Institutional Asset Managers Are Less Likely to "Reach for Yield" and Engage in "Herding" than Other Market Participants

A. Due to the nature of institutional clients and asset manager portfolio risk management practices, asset managers are able to exercise investment discipline that mitigates the behaviors and vulnerabilities described in the Report.

The Report asserts that an extended low interest rate investment climate, low market volatility, or competitive factors may lead some asset managers to "reach for yield."[13] The Report also states that some asset managers may "herd" into popular asset classes or securities, regardless of their size or liquidity. The Report identifies these behaviors as potential "vulnerabilities" of asset managers in times of financial crisis.

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[11] 7 U.S.C. § 1a(33) (2010); *Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant,"* 77 Fed. Reg. 30596, 30661 (May 23, 2012). We note that neither PIMCO nor any of our clients are MSPs.

[12] *See* White, Testimony on Mitigating Systemic Risk in the Financial Markets through Wall Street Reforms, supra note 10.

[13] Report at 9.

If by "reaching for yield" the Report is referring to a scenario in which asset managers would seek higher returns by investing in riskier assets, then we believe the Report is inaccurate and does not reflect PIMCO's experience. In fact, institutional asset managers, such as PIMCO, are less likely to sell into a declining market as a result of undisciplined trading or a herd mentality. Indeed, many long-term investors do consider declining or distressed markets as a buying opportunity.

The Report assumes that institutional investors hand over sums of money to asset managers to be managed in any way the asset manager sees fit. On the contrary, as discussed above, institutional asset managers have fiduciary duties to their clients and must comply with their clients' particular investment guidelines, designated benchmarks and targeted risk return objectives, all of which are contractually agreed upon. These guidelines generally include concentration limits and other types of restrictions on over-allocations to a particular asset class or market sector.

PIMCO has robust portfolio management and risk management processes that are designed to ensure it does not subject clients to undue risk in their portfolios – particularly during times of market stress. These processes, and the investment discipline that they reflect, result in the risks associated with "reaching for yield" being mitigated, not aggravated, by institutional asset managers. The Report does not consider the extent to which institutional asset managers are highly constrained by client guidelines and benchmarks, and the degree to which institutional asset managers police their own behavior through extensive risk management systems.

B. The studies cited in the Report do not fully support the assertion that asset managers are susceptible to "reaching for yield" or "herding."

To support its assertions about the potential for asset managers to engage in "herding" and "reaching for yield" behaviors, the Report cites studies by Richard Sias and Russ Wermers. These studies, however, do not fully support the Report's conclusions. The Sias study concludes that mutual funds are the least likely among institutional investors to engage in "herding." The Sias study further references three earlier studies that failed to find any evidence of "herding" behavior by asset managers, none of which are explained or otherwise addressed by the Report. Similarly, the Wermers study indicates that asset managers who make similar investments are not "herding" but are trading based on new information. Indeed, the Wermers study indicates that this behavior actually has the beneficial effect of markets rapidly incorporating the new information into prices, which facilitates price discovery.[14]

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[14] We also note that Sias (2004), Wermers (1999) and Dasgupta, Prat and Verardo (2011), which are each cited to support the proposition that asset managers may herd into popular asset classes, all analyze data sets that include only equity trading. Thus, the cited studies do not address whether the large market of asset managers or other institutional investors exhibit "herding" behavior when trading in other types of asset classes, such as fixed income asset management. The Report's assertion over-generalizes the behavior of asset managers as a group, and in particular, PIMCO, which invests primarily in fixed income. Richard W. Sias, *Institutional*
(…continued)

Other research not cited in the Report indicates that during periods of market turmoil, asset managers provide their clients with some measure of stability, rather than engaging in "herding," trading aggressively, or destabilizing prices. For example, a study by Marc Lipson and Andy Puckett found that money managers and pension plan sponsors tend to trade against the market when there are large intra-day changes in the market.[15] This supports the conclusion of the Sias study that mutual funds and independent advisers are less likely to engage in "herding" than other types of institutional investors.[16] The Lipson and Puckett study also notes that asset managers act based on implementation strategy, not based solely on current market conditions. That is, institutional asset managers and their clients have long term investment goals and see rising or falling markets as opportunities to achieve previously determined investment goals and often buy and sell against any given price trend.

Contrary to the assertions made in the Report, academic studies and the actual experience of institutional asset managers and other market participants during the financial crisis show that institutional asset managers are less likely to "reach for yield" and engage in "herding" than investors who do not use asset managers, or than other market participants.

Institutional Asset Managers Do Not Contribute to the Risk of Fire Sales

A. Institutional asset managers provide liquidity to the market in the event of a crisis or distress and do not blindly sell into a declining market.

The Report asserts that "higher demand for liquidity associated with fire sales can magnify and spread quickly across various asset classes and financial institutions, causing market prices to decline and market confidence to fall across market sectors."[17] The Report lists factors that can increase the likelihood and severity of fire sales (*e.g.*, large market positions, illiquid markets, reputational risk), but does not explain why they specifically affect asset

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Herding, The Review of Financial Studies 17, no. 1 (2004): 165-206; Russ Wermers, *Mutual Fund Herding and the Impact on Stock Prices*, Journal of Finance 54, no. 2 (1999): 581-622; Amil Dasgupta, Andrea Prat and Michela Verardo, *Institutional Trade Persistence and Long-Term Equity Returns*, Journal of Finance 66, no. 2 (2011): 635-653.

15 Marc Lipson and Andy Puckett, *Institutional Trading During Extreme Market Movements*, Mar. 2010, *available at* http://www.darden.virginia.edu/web/uploadedFiles/Darden/Faculty_Research/Directory/Full_time/Extreme_2010_WP.pdf.

16 "Bank trust departments, unclassified investors, and independent advisers more often herd than mutual funds or insurance companies." Sias, *supra* note 14, at 199.

17 Report at 21-22.

managers, how they can spread to other asset classes or market participants, and how they can broadly contribute to systemic risk. The Report does not provide evidence of how an institutional investment manager's activities could result in the transmission of risks to the U.S. financial system.[18] The idea that systemic risk resulting from asset manager-induced fire sales could have the potential to eventually pose a threat to the U.S. financial system is unsubstantiated.

In fact, institutional asset managers are *more* likely to pay attention to and mitigate any potential market effect of their sales. Large institutional asset managers, like PIMCO, conduct their own stress testing and analyses to determine how portfolios will act under various scenarios. PIMCO plans for adverse conditions by having adequate cash buffers and liquid securities that can be sold in lieu of selling declining assets. Institutional asset managers are managing as a general matter for individual and institutional clients who have longer-term investment views and as a result, declining asset prices do not necessarily trigger a need to sell securities.

It has been PIMCO's experience during various crises over our 40 plus year history that institutional managers do not cause fire sales. Rather, institutional managers act as a source of liquidity, selecting and purchasing disfavored assets that are dumped on the market by banks and others who have immediate needs to sell to preserve their balance sheets.

Further, the Report does not explain why the possibility of fire sales would require a regulatory response for asset managers even if they were a likelihood. The Council has expressly acknowledged this fact by noting that "[i]n separately managed accounts, investment losses fall solely on the account owner, *so these accounts generally do not raise direct financial stability concerns*."[19] (emphasis added) While there may be instances where market confidence falls and asset prices decline in particular market sectors or asset classes, these events are the normal and expected outcome of a functioning marketplace. Investment losses are a foreseeable and potential consequence of investing. Clients understand the potential for, and assume the risk of, investment losses. Risks – including the risk of principal losses – are well documented and provided to clients through asset managers' filings on Form ADV, in offering documents for pooled investment vehicles, and in marketing and other materials readily available from most asset managers. Neither does the Report consider the extent to which funds, such as those

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[18] The Report cites Bhattacharya, Lee, and Pool (2013) to support its claim that an asset manager who experiences financial instability in a particular fund can disseminate the shock throughout its other funds. However, the study is limited to a discussion of funds operating under 17(d)(1)(G) of the 1940 Act, which authorizes a limited type of mutual fund that can invest only in affiliate funds. The Report extrapolates this statement to make broader statements about fund families in general, which are not supported by the paper. Utpal Bhattacharya, Jung Hoon Lee and Veronika Krepely Pool, *Conflicting Family Values in Mutual Fund Families*, Journal of Finance 68, no. 1 (2013): 173-200.

[19] Financial Stability Oversight Council, 2011 Annual Report at 65.

managed by PIMCO, were able to provide liquidity and therefore help to stabilize distressed markets.

The Report also does not adequately evidence how the financial system would be at risk, even if an asset manager were to fail. Clients and mutual fund boards are free to terminate the asset manager and port their investments, which are held at third-party custodians, to a different manager at any point, without the need to liquidate their investments or expose them to market risk. In fact, in PIMCO's experience, transferring assets in-kind from one manager to another manager – without any liquidations or consequent market impact – is a common practice among clients, especially separate account clients.

B. The Report does not take into consideration the profile of the clients of institutional asset managers, the diversity of their investments, or the long-term nature of their investment horizon.

The Report does not discuss the nature of mutual fund shareholders, who are typically long-term investors saving for retirement[20] and historically have not been inclined to redeem en masse, even in a market downturn. In our experience, these investors have longer-term strategic asset allocations and time horizons versus those that are more short-term and tactical. A case in point is the experience with PIMCO's Total Return Fund ("Fund") in the fourth quarter of 2008 during the height of the financial crisis. For this period, the Fund, one of the largest mutual funds in the world at that time, experienced net redemptions amounting to 2.1% of the Fund's assets. In subsequent quarters, the Fund actually experienced net subscriptions. PIMCO's actual experience during the market crisis of 2008 is directly in contrast to the Report's assertions. Moreover, it is our observation over multiple market cycles that even when some clients are redeeming from funds, other retail or institutional clients are buying into those same funds. This supports our view that the entirety of an asset manager's assets under management does not move in lockstep.

In PIMCO's experience, institutional clients do not hastily move into and out of investment strategies that could result in significant declines of portfolio holdings. PIMCO's clients generally sell assets due to a fundamental, strategic change in their view of the market or a particular asset class. Asset price declines may actually trigger institutional clients to further rebalance into the class that is in decline. These decisions typically are not made in response to temporary market dislocations; rather institutional clients make decisions after careful fiduciary consideration, further analysis by their boards and in consultation with expert advisers, such as the asset manager and independent consultants. Accordingly, institutional clients generally do

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[20] *See* the ICI Research, *Characteristics of Mutual Fund Investors (Nov. 2012).* This research report notes that "[a]lmost all mutual fund investors were focused on retirement saving."

not contribute to pro-cyclical activity during market movements, and are unlikely to react to market stress in a way that would cause significant redemption risk in a run on the market.

Finally, we note that institutional asset managers are incentivized to obtain the highest prices for client assets and to retain assets rather than sell them. Similarly, during the last market crisis institutional asset managers, such as PIMCO, were incentivized to retain assets that they believed were undervalued due to market panic and reversible market conditions, and in fact held on to those assets – which ultimately recovered in value. This is a phenomenon that even the Report acknowledges by stating that "funds sought to avoid realizing potentially large losses from selling stocks with the most depressed prices . . . this strategy had a stabilizing effect."[21] Without institutional asset managers working to preserve the value of client assets, there likely would have been far greater sales of assets in the markets at low prices during the financial crisis.

The Facts Do Not Support the Assertion that "Data Gaps" Prevent Regulators from Having a Full Picture of the Asset Management Industry

The Report asserts that "there are limitations to the data currently available to measure, analyze, and monitor asset management firms and their diverse activities, and to evaluate their implications for financial stability."[22] However, the Report does not analyze the substantial amount of information, which includes data on separate accounts, currently reported to regulators by many asset managers.

As the SEC is aware, PIMCO provides detailed information about its business, assets under management, securities trading activities, management strategies, and securities positions on numerous regularly filed reports, including Forms ADV (adviser registration and disclosure form), 13F (report of holdings by institutional investment managers in 13(f) securities), 13D/13G (reports regarding equity ownership over 5%), 13H (large trader holding reports) and PF (reporting by investment managers to private funds and other commodity pools). We note in particular, Form PF is the product of rules that were adopted pursuant to the Dodd-Frank Act and is designed "to enable [the Council] to obtain data that will facilitate monitoring of systemic risk in the U.S. financial markets."[23] While this Form is currently filed by investment managers on private funds to provide the SEC and other regulators with additional, detailed information, including leverage, there is no indication in the Report that any of this information was evaluated when considering the risks asset managers may pose to the financial system.

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[21] Report at 23.

[22] Report at 2.

[23] *Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF*, 76 Fed. Reg. 71128, 71129 (Nov. 16, 2011) (joint SEC and CFTC action).

Moreover, large asset managers, such as PIMCO, also provide extensive reporting to the Commodity Futures Trading Commission ("CFTC") as a result of the regulatory requirements adopted pursuant to the Dodd-Frank Act. The CFTC adopted an equivalent to Form PF, Form CPO-PQR and now also requires Form CTA-PR, which must be filed by commodity pool operators and commodity trading advisors. Form CPO-PQR in particular provides important information regarding the holdings and other activities of commodity pools advised by the investment manager. Again, the Report does not acknowledge or analyze this information, or consider how this information could inform the OFR's opinions regarding asset manager activities and whether they pose systemic risk.

Regulators have access to an extensive amount of other information regarding the holdings of asset managers. Large asset managers, such as PIMCO, are required to file numerous reports about their holdings with the U.S. Department of Treasury on Forms TIC S, TIC SLT, TIC C, TIC D, and TIC SHLA. In addition, FINRA has proposed additional disclosure requirements for dark pools, which would provide regulators with information about trading activities conducted away from securities exchanges. Under the new derivatives reporting regime mandated by the Dodd-Frank Act, detailed trade information regarding swaps is now available to regulators through swap data repositories. Similar information will be available in the future with respect to security-based swaps.

As mentioned above, Title VII of the Dodd-Frank Act also imposes new registration and regulatory requirements for MSPs, including additional regulatory reporting to the CFTC (or in the case of major security-based swaps participants, to the SEC). Asset managers are also subject to examination by the SEC and, if registered with the CFTC, by the National Futures Association. As part of these examinations, regulators can obtain additional information about asset managers and their trading activities, including information about separate accounts.

The Report fails to consider the wide range of information already available to regulators about asset managers and their activities. The Report does not provide any support for why data gaps on separate accounts and securities lending would even be relevant to the financial stability of the markets.

Asset Managers Did Not Contribute to the Financial Crisis

The Report seeks to identify potential systemic risks that could occur during a hypothetical market crisis, and yet fails to use the experience of the recent financial crisis to influence its assessment of asset managers. The Report should have considered that no large independent asset manager received assistance from the Troubled Asset Relief Program ("TARP"), the Treasury, or the Federal Reserve during the financial crisis. To the extent that any non-money market fund manager failed during that period, we are not aware of any collateral or systemic issue that resulted from the failure of the asset manager.

We also note then when client assets are custodied at a third-party custodian selected by the client, which is true of all PIMCO clients, they can move or change investment managers with relative ease in the extremely unlikely event of a failure. Moreover, there is no evidence, either in the Report or otherwise, that the issues which arose during the 2007-2008 financial crisis stemmed from or were exacerbated by asset management firms.

The Activities of Asset Managers Are Subject to Significant Federal Regulation

The Report underestimates the importance and risk-mitigating effects of the current federal regulatory regimes that apply to asset managers and the markets in which they operate. In fact, a large asset manager, such as PIMCO, that has extensive and diverse operations and product offerings, is required to comply with numerous comprehensive regulatory regimes. As the SEC is aware, asset managers must comply with the Investment Advisers Act of 1940. The Report did not consider the extensive regulatory regime under which asset managers must operate, and that this is an important omission in the Report.

We also note that client characteristics also require investment managers to comply with a host of other regulations. For example, advisers to retirement plans that are subject to ERISA require the asset manager to comply with Department of Labor rules and regulations. These requirements are extremely strict in how they govern investment manager conduct when transacting for a plan and the penalties for non-compliance can be quite severe.[24] Further, public plan clients are subject to municipal regulations that are imposed on asset managers.

Finally, as described earlier in this letter, Title VII of the Dodd-Frank Act imposes a comprehensive regulatory framework for monitoring and reducing sources of systemic risk in the derivatives market, including clearing and reporting requirements. The MSP category, in particular, is specifically designed to monitor and regulate large traders in the swaps market. These regulatory requirements are not adequately considered in the Report.

Conclusion

PIMCO believes that any meaningful review of the asset management industry needs to be thorough, thoughtful and deliberate and ultimately led by the primary regulator of this industry. Because this Report demonstrates fundamental misunderstandings of the asset management industry, the Report should not be used as a basis for policymaking or regulation of the asset management industry. We urge the SEC to use its position as a member of the Council to recommend that the Report be revised and re-issued, and to take the lead on any further analyses of the asset management industry. We also believe that a more transparent process for

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[24] Penalties for engaging in a non-exempt prohibited transaction can result in a penalty and fine of up to the amount of the transaction plus 15% excise tax.

soliciting and considering industry comments will help the OFR to gain a better understanding of the asset management industry.

We thank the SEC for the opportunity to comment on the Report and would be happy to discuss any part of our letter. If you have any questions, please do not hesitate to call me at (949) 720-6000.

Sincerely,

Douglas M. Hodge
Managing Director, Chief Operating Officer
Pacific Investment Management Company LLC