April 7, 2014

Secretariat of the Financial Stability Board
c/o Bank for International Settlements
CH -4002
Basel, Switzerland

International Organization of
Securities Commissions
C/ Oquendo 12
28006 Madrid
Spain

RE: **Consultative Document: Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions**

Dear Sir or Madam:

The U.S. Chamber of Commerce ("the Chamber"), the world's largest business federation, represents the interests of more than three million businesses and organizations of every size, sector, and region. The Chamber established the Global Risk and Governance Initiative ("GRGI") to promote modern and appropriate international structures for capital formation, risk management and corporate governance needed by businesses to fully function in a 21st century economy. The GRGI appreciates the opportunity to comment on the Consultative Document, ***Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions*** ("Document"), issued by the Financial Stability Board ("FSB") and the International Organization of Securities Commissions ("IOSCO").

The GRGI supports efforts to monitor and manage systemic risk on a national and global level and appreciates the work of the FSB and IOSCO in these efforts. However, we are very concerned that the Document proposes a methodology ("Fund Methodology") for evaluating investment funds for designation as non-bank non-insurer ("NBNI") global systemically important financial institution ("NBNI G-SIFI"). U.S.-based investment funds, registered as investment companies ("U.S. registered funds") with the U.S. Securities and Exchange Commission ("SEC") and already subject to potential domestic systemic risk designation and regulation under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA"), would appear to be the only entities eligible for an NBNI G-SIFI designation. Accordingly, this matter is not global in nature and would appear to be outside the remit of the FSB and IOSCO. Accordingly, we would recommend that the FSB and IOSCO withdraw the Fund Methodology.

Discussion

While the Document indicates that FSB and IOSCO have yet to determine any specific policy measures that would apply to NBNI G-SIFIs, the existence and implications of the proposed Fund Methodology and the threat of an NBNI G-SIFI designation, even with unknown consequences, may have an unwarranted and inappropriate adverse impact on U.S. registered funds, their investors, the capital markets in which they participate, and on economic growth.

Any consideration by the FSB of designating particular U.S. registered funds as NBNI G-SIFIs must take into account: (i) the authority of the FSB to mandate or require U.S. regulatory authorities to impose special requirements on U.S. registered funds; and (ii) the authority of the SEC to impose special requirements on U.S. registered funds that are designated as NBNI G-SIFIs. On this critical point, it is clear that the FSB does not have any binding legal authority to direct U.S. regulatory authorities to take specific actions with respect to a U.S. registered fund that may be designated an NBNI G-SIFI. Furthermore, the U.S. regulatory authority with responsibility for U.S registered funds, the SEC, does not exercise its rulemaking authority in a manner that would impose special requirements on an individual U.S. registered fund that is designated as an NBNI G-SIFI thereby treating it differently from its competitors.

We believe it is wholly inappropriate for the FSB and IOSCO to begin a process, which is directly targeted at U.S. registered funds, that:

- is not supported by any reasonable empirical evidence or analysis regarding the history and performance of U.S. registered funds;
- is not supported by any economic model that suggests that U.S. registered funds could disrupt the global financial system;
- does not fully consider the nature, scope, and adequacy of U.S. regulation of U.S. registered funds;

- does not take account of the lack of FSB legal authority to direct U.S. regulatory authorities to impose special requirements on a U.S. registered fund designated as an NBNI G-SIFI; and

- ignores the scope of SEC authority to impose special requirements on a U.S. registered fund designated as an NBNI G-SIFI.

Accordingly, we respectfully request that the FSB and IOSCO withdraw the proposed Fund Methodology. Instead, we recommend that the FSB and IOSCO pursue the alternative, suggested in the Document, of focusing on the sectorial activities-based national enhancements to the regulation of investment funds.

I. The Document Does Not Provide a Supportable Basis for Treating U.S. Registered Funds as a Category of NBNI Entities to Be Considered for an NBNI G-SIFI Designation

Under the proposed Fund Methodology, investment funds with over $100 billion in assets would be evaluated for a potential NBNI G-SIFI designation. Applying this criterion would result in NBNI G-SIFI consideration for approximately 14 U.S. registered funds.[1]

Despite the direct and exclusive focus on U.S. registered funds, the Document does not provide any explanation or rigorous analysis of why the FSB and the IOSCO believe that such funds may reasonably be viewed as presenting a threat to global financial stability. We suggest that a credible and analytically rigorous approach to the issues would *first* require definition of goals, the identification of specific risks that are of concern on an institutional and systemic basis, and public exposure of detailed findings supporting the inclusion of investment funds, rather than jumping directly to methodologies of designation. In our view, a very important first step has been skipped, and to that extent, the credibility of conclusions reached by the FSB and IOSCO is significantly diminished.

[1] Fitch Wire, FSB's Nonbank SIFI Rules Will Have Narrow Impact, Jan. 14, 2014; Remarks of Paul Schott Stevens, President and CEO, Investment Company Institute, Mutual Fund and Investment Management Conference, March 17, 2014.

Indeed, the statements contained in the Document itself demonstrate why U.S. registered funds should not be considered for NBNI G-SIFI designations.

- Fund investors understand that they are putting their money at risk and that they may experience gains or losses on their investments in funds. The Document effectively acknowledges that this structural element of the investment fund sector protects against funds impacting systemic stability, since fund investors bear the financial consequences of negative fund performance. It describes this as a "shock absorber" feature. It notes that unlike with the failure of an operating institution, "fund investors absorb the negative effects that might be caused by the distress or even default of a fund, thereby mitigating the eventual contagion effects in the broader financial system."[2]

- There is a range of factors related to the operation of investment funds that may dampen the global systemic impact of a fund failure by, among other things, addressing liquidity and redemption demands.[3]

- The investment fund sector is highly competitive and substitutable and funds regularly close with negligible or no market impact.[4]

The determination to treat investment funds as a category of NBNI entities that would be considered for NBNI G-SIFI status was based on two systemic risk transmission channels: (i) the exposures/counterparty channel, and (ii) the asset liquidation/market channel. Yet no empirical discussion or analysis of these purported risk transmission channels is contained in the Document. Nor does it discuss how the U.S. regulatory structure for U.S. registered funds and the business environment for such funds impacts these two purported systemic risk channels.[5]

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[2] Document at 29.
[3] *Id.* at 30.
[4] *Id.*
[5] For purposes of this letter, references to "U.S. registered funds" refer to open-end funds that operate with a floating net asset value ("NAV"). The term does not include U.S. money market mutual funds ("MMFs") that operate with an objective of maintaining a stable NAV. Such funds are currently the subject of an SEC rulemaking proceeding considering potential changes to the regulation of MMFs.

An examination of U.S. registered funds demonstrates that neither of these systemic risk triggers is appropriate for such funds. U.S. registered funds do not present a significant risk to counterparties, due largely to the SEC's guidance generally requiring a U.S. registered fund to earmark or segregate assets equal to 100% of the fund's exposure to its derivatives counterparties. This requirement acts to protect such counterparties in the event that a fund encounters financial difficulties.

Furthermore, U.S. registered funds do not present a significant risk to the asset liquidation/market channel. The focus on this risk transmission channel is based on the concern that a fund will have inadequate liquidity to respond to rapid redemption requests by shareholders, and will be forced to sell assets at prices that will destabilize particular asset markets. The SEC-administered regulatory structure has numerous elements that largely eliminate this risk. A key protection in this regard is that U.S. registered funds are generally required to maintain at least 85% of their assets in investments that qualify as liquid assets. Moreover, subject to SEC approval, a fund may suspend redemptions under certain conditions. Furthermore, investors in U.S. registered funds are fully accustomed to a continually floating net asset value ("NAV") and recognize that a fund's NAV will naturally fluctuate over time.

U.S. registered fund shareholders are largely long-term investors, with substantial portions of their investments targeted as retirement savings.[6] In that regard, it is significant—but not surprising—to consider that even during the 2008 financial crisis, mutual funds experienced only modest net outflows.[7]

Most notable is the recognition in the Document that the actual performance of U.S registered funds even during the most troubled financial period experienced in decades has been exemplary from a systemic financial stability perspective. The FSB and IOSCO reviewed U.S. mutual fund data for the period from 2000 to 2012, and concluded that:

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[6] Data compiled by the Investment Company Institute ("ICI") indicates that, in 2011, 73 percent of households owning mutual funds indicated that their primary financial goal for their fund investments was saving for retirement, and 93 percent of such households indicated that they were using mutual funds to save for retirement. ICI, *Characteristics of Mutual Fund Investors,* 2012 6 (2012), *available at* http://www.ici.org/pdf/per18-07.pdf.

> *even when viewed in the aggregate, no mutual fund liquidations led to a systemic market impact throughout the observation period*. Part of the explanation may be that many U.S. investors hold mutual fund shares for retirement purposes. As such, these investors' investment horizon could be long-term, whereby they would prefer to remain invested than cash-out during a market downturn.[7]

While the Document is aimed at U.S. registered funds, it does not contain a single word of discussion about the U.S. regulatory structure for U.S. registered funds that was established by the U.S. Congress in enacting the Investment Company Act of 1940 ("ICA"). The SEC has more than 70 years of experience in administering the ICA. The SEC's regulatory efforts are widely recognized for both (i) ensuring that investors are well informed about operations and risks of U.S. registered funds, and (ii) promoting financial stability in connection with the operations of U.S. registered funds.

We believe that a thorough review by the FSB and IOSCO of the structure, performance and regulatory scheme applicable to U.S. registered funds would lead the FSB and IOSCO to conclude that U.S. registered funds do not raise a global financial stability concern and thus should not subject them to a potential NBNI G-SIFI designation.

II. Analyses and Actions Taken by the FSB and IOSCO Should Be Consistent with Regulatory Principles and Authorities of the Implementing Country

The Document requests comment on the Fund Methodology and other questions regarding the operation and regulation of investment funds. The Document notes that the FSB and IOSCO have not at this time proposed any specific NBNI entities for an NBNI G-SIFI designation or any policy measures that would apply to an entity that it designated as an NBNI G-SIFI.[8] The FSB, in cooperation with IOSCO, will begin to develop within the SIFI framework what they describe as

[7] *Id*. at 30 n. 38 (emphasis added).
[8] *Id*. at 2.

the incremental policy measures needed to address the systemic risks posed by NBNI G-SIFIs, once the identification methodologies have been finalized and published.[9]

Based on the statements in the Document, it appears that, if the FSB were to identify a U.S. registered fund as an NBNI G-SIFI, it would develop "policy measures" with respect to that NBNI G-SIFI or to a few such funds. Since the FSB does not operate as an independent stand-alone regulatory structure, we assume that it would seek to implement such policy measures by having relevant national authorities implement enhanced prudential standards specified for the particular category of NBNI G-SIFIs, such as U.S. registered funds ("Fund Policy Measures"). The FSB and IOSCO have not divulged how this process would operate in regard to U.S. registered funds designated as NBNI G-SIFIs. As discussed below, we believe that there are significant impediments to the FSB's ability to implement such an approach.

The FSB has no authority to bind the SEC to any particular action, nor can it confer additional authority on the SEC to carry out any Fund Policy Measures it may develop for U.S. registered funds.[10] In that regard, given the Charter of the FSB, it and IOSCO should ensure that they do not promote the implementation by member jurisdictions of principles and regulatory standards that are inconsistent with the authority and practices of regulatory authorities that are committed to implementing them. For example, any action proposed with regard to investment funds in the U.S. would be dependent on the SEC's authority to implement it. Congress provided the SEC in the ICA with the authority to issue regulations to implement that statute with respect to U.S. registered funds,[11] which the SEC has repeatedly exercised.

In applying its rulemaking authority, the SEC does not generally single out an individual U.S. registered fund for stricter regulatory requirements than other U.S. registered funds. Its rulemaking consistently focuses on rules of general and equal

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[9] *Id*. at 2 n. 7.

[10] The FSB operates under the Charter of the Financial Stability Board, which was most recently approved by the Heads of State and Government of the Group of Twenty on June 19, 2012 ("Charter"). The FSB Charter provides that the FSB will, among other things, promote member jurisdictions' implementation of agreed commitments, standards and policy recommendations through monitoring of implementation, peer review and disclosure. Charter, Article 2(1)(i). Most significantly, the Charter states that it "is not intended to create any legal rights or obligations." *Id.* Article 23. Accordingly, any Fund Policy Measures directed at U.S. registered funds would have no force or effect on entities in the United States and would not constitute legally binding obligations of the United States Government or its departments or agencies, including the SEC, the Board of Governors of the Federal Reserve System ("FRB") and the Department of the Treasury, which are participants in the FSB.

[11] 15 U.S.C. § 80a-37(a).

applicability.[12] Thus, action planned by FSB and IOSCO to impose special enhanced Fund Policy Measures on certain U.S. registered funds would be inconsistent with SEC practice, and likely, its legal authority. Thus, we believe that there are serious questions regarding the SEC's authority to implement prudential regulatory standards proposed by the FSB and IOSCO that target individual U.S. registered funds for heightened regulation.

Under Title I of the DFA, the U.S. Financial Stability Oversight Council ("FSOC") has the authority under limited circumstances to designate a nonbank financial company as a systemically important financial institution ("SIFI") that is subject to supervision by the FRB.[13] Pursuant to the limits of this authority set forth in the DFA, the FSOC has adopted regulations and guidance that describe its process for considering whether to designate a nonbank financial company as a SIFI under the DFA.[14]

In order to designate a nonbank financial company as a SIFI, the FSOC must determine that either (i) material financial distress at the nonbank financial company, or (ii) the nature, scope, size, concentration, interconnectedness, or mix of the activities of the nonbank financial company, could pose a threat to the financial stability of the United States. To date, the FSOC has designated three companies as SIFIs, and none is a U.S. registered fund.

An NBNI G-SIFI designation by an international body, such as the FSB, would not directly trigger any of the factors that the FSOC would be required to consider in making its own determination of whether an entity should be designated as a SIFI. Moreover, one of the statutory factors that the FSOC is required to take into account in making a designation decision under the DFA is the degree to which

[12] U.S. registered funds may seek exemptive relief from the SEC from particular requirements of the ICA or the SEC's rules thereunder. In the context of providing relief to particular U.S. registered funds the SEC may impose individualized conditions on the fund seeking exemptive relief. In some instances, typically after a number of similar exemptive orders have been issued by the Commission, the SEC will grant exemptive relief on an across-the-board basis through a formal rulemaking process. This process results in a relaxation of general regulatory requirements for a particular fund or category of funds, rather than the imposition of stricter regulatory requirements on a particular U.S. registered fund.
We note that section 38(a) of the ICA permits the SEC to classify persons, securities, and other matters within its jurisdiction and prescribe different requirements for different classes of persons, securities, or matters. 15 U.S.C. § 80a-37(a). We do not believe that the SEC could impose a stricter form of regulation on an individual NBNI G-SIFI that is a U.S. registered investment fund based on this classification authority under section 38(a) of the ICA.

[13] DFA, section 113.

[14] 12 C.F.R. Part 1310.

the entity under consideration is already regulated by one or more designated U.S. financial regulatory agencies, including the SEC. The Document does not suggest that such considerations were part of the process it presents to the public.[15] Thus, we believe that there is a significant disconnect and inconsistency between the standards and metrics employed by the FSB and IOSCO and those required to be employed by the FSOC, FRB, and SEC. Such global regulatory inconsistency increases the chances that the results of the regulatory process will be counterproductive, unnecessarily burdensome, and unduly costly, if they are implemented at all. That is a result that global policymakers must avoid.

In a speech last year, FRB Governor Tarullo stressed that "international efforts to develop new regulatory mechanisms or approaches should build on experience derived from national practice in one or more jurisdictions." He advised his audience that the "challenges encountered during the initial effort to devise an LCR in the Basel Committee, with little or no precedent of national quantitative liquidity requirements from which to learn, should counsel caution in trying to construct new regulatory mechanisms from scratch at the international level."[16] The challenges that the authors of the Document face are equally obvious and at least as daunting.

The Document is based not on "experience derived from national practice" but on international efforts with respect to banks and insurance companies. In fact, it is clearly at odds with national practice with respect to investment funds in the U.S., and other jurisdictions with which we are familiar, and with the characteristics of investment funds that the Document acknowledges differentiate them from banks. We discuss many of these characteristics elsewhere in the letter, including the substitutable competitive nature of the investment fund sector that helps explain why national authorities regulate the activities and practices of managers and their funds uniformly as a class rather than on an individualized basis.

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15 For the reasons discussed in Section I above, we believe that structure, performance, and regulatory factors associated with U.S. registered funds would not support a SIFI designation of such a fund under the DFA. There is also a serious legal question as to whether a U.S. registered fund may properly be treated as a nonbank financial company that is potentially subject to a SIFI designation by the FSOC.
Moreover, FSOC does not impose enhanced prudential standards on nonbank financial companies that are designated as SIFIs. That responsibility is given to the FRB under Title I of the DFA. The FRB recently indicated that it plans to implement this authority in the future with respect to entities that are designated as SIFIs, with an opportunity for notice and comment regarding such standards for companies that are designated as SIFIs. 79 Fed. Reg. 17241, 17245 (March 27, 2014).

16 *See* Daniel K. Tarullo, Governor, Board of Governors of the Federal Reserve System, Speech at the Cornell International Law Journal Symposium: The Changing Politics of the Central Banks (Feb. 22, 2013), *available at* http://www.federalreserve.gov/newsevents/speech/tarullo20130222a.htm.

The Document takes the opposite approach and proposes a methodology to determine whether individual investment funds present risks that are different from, and therefore deserve regulation that is different than, their competitors. To their credit, the authors of the Document have asked commenters whether they should abandon their entity-based proposal and desire for consistency in favor of an activity-focused approach that reflects the key characteristics of the asset management industry and builds on the structure and experience of national regulators. We believe they should.

III. FSB and IOSCO Should Look to Sectoral Activities-Based National Enhancements Rather than the Proposed Entity-Based NBNI G-SIFI Approach

The FSB and IOSCO acknowledge that an alternative approach to NBNI G-SIFI designation may focus on the extent to which certain activities or groups of activities might contribute to systemic risk.[17] We agree with such an approach, and believe it is consistent with the Document's acknowledgment that NBNI financial entities often have different legal forms, business models, and profiles that make it difficult for the FSB and IOSCO to apply consistent standards for identifying G-SIFIs, let alone regulating them.[18] Such an approach should also account for the high degree of substitutability and competition in the investment fund industry,[19] existing regulatory frameworks in different countries, and the extent to which they already address those activities that pose systemic risk.

As noted above, for example, U.S. registered funds are already subject to regulations that largely eliminate the systemic risk triggers the Document identities with respect to investment funds. Employing the indicators identified in the Document and ignoring that regulation could lead the FSB to designate only funds that are already subject to the world's most established and proven regulatory regime, while potentially ignoring investment funds that are engaged in practices that give rise to significant systemic risk collectively simply because those funds do not trigger the indicators FSB establishes for designating NBNI G-SIFIs. To avoid this outcome, the FSB should instead focus on identifying those activities that potentially contribute

[17] Document at 32.
[18] *Id.* at 5.
[19] Document at 30.

to systemic risk. Each country's regulatory regime could then be examined in order to determine whether it adequately addresses the identified risks, and recommendations can be made, where appropriate, for national regulators to adopt enhancements to their existing regulations. We request that the FSB and IOSCO publish for public comment any approach they propose to use for assessing activities and national regulatory schemes.

IV. Responses to Questions Posed in Section 6 of the Document

The FSB and IOSCO posed a series of questions in Section 6 of the Document. The following are our responses to certain of the questions:

Q6-2. Does the above description of systemic importance of asset management entities adequately capture potential systemic risks associated with their financial distress or disorderly failure at the global level?

We believe a single definition for the wide array of types of funds (including floating NAV mutual funds, MMFs, and ETFs) and investment strategies is not practical or appropriate. Furthermore, even with the same category of fund, there are vastly different investment strategies between funds, with significant variance in the volatility and risks associated with these strategies, as well as vastly different regulatory regimes and investor demographics. Each fund should be evaluated individually rather than as a single, homogenous category.

Similarly, combining the various types of asset management entities into a single category fails to recognize the unique characteristics of each entity and the specific regulations applicable to each type of entity. However, we believe that the Document's references to the level of leverage or interconnectedness as risk factors are appropriate.

Q6-3. Which of the following four levels of focus is appropriate for assessing the systemic importance of asset management entities: (i) individual investment funds; (ii) family of funds; (iii) asset managers on a stand-alone entity basis; and (iv) asset managers and their funds collectively? Please also explain the reasons why you think the chosen level of focus is more appropriate than others.

We believe that it would be most appropriate to assess activities conducted by funds and other capital markets participants. Among the alternative levels suggested for a methodology focused on entities, only assessment at the individual investment fund level is appropriate. Each individual fund is unique and has a balance sheet and risk profile (as reflected in its prospectus, investor demographics, etc.) that is different from other funds. Furthermore, each fund's unique risk profile, both in terms of risks to shareholders and potential risks to markets, makes collective analysis inappropriate. Such analysis would obscure or exaggerate potential risks rather than illuminating them.

Q6-4. Should the methodology be designed to focus on whether particular activities or groups of activities pose systemic risks? If so, please explain the reason why and how such a methodology should be designed.

Yes, we believe that the FSB and IOSCO should focus on activities and review sectorial activities-based regulation in the various national jurisdictions to determine whether recommendations for enhancements in particular national regulations are appropriate.

Q6-5. Are the proposed indicators appropriate for assessing the relevant impact factors? If not, please provide alternative indicators and the reasons why such measures are more appropriate.

We believe that leverage and interconnectedness are two key factors to consider for systemic risk.

Q6-6. For "cross-jurisdictional activities", should "the fund's use of service providers in other jurisdictions (e.g. custody assets with service providers in jurisdictions other than where its primary regulator is based)" be used?

We do not believe that this criterion should be used because the locations of a fund's service providers bears little or no relation to the outward risks the fund might pose to the marketplace or the financial system. Furthermore, the Document provides no support for the notion that any one service provider would be critical to the financial stability of any country or group of countries.

Q6-9. Would collecting or providing any of the information included in the indicators present any practical problems? If so, please clarify which items,

the practical problems, and possible proxies that could be collected or provided instead.

We believe that collecting or providing information will impose costs, which should be considered in the analysis. Specifically, the FSB and IOSCO should weigh the benefits of a particular method of collecting information against the costs and burdens of the method on the subject fund or other entity.

Q6-11. Should certain indicators (or impact factors) be prioritised in assessing the systemic importance of investment funds? If so, please explain which indicator(s) and the reasons for prioritisation.

Yes, we believe that the strength of current regulations should be prioritized over the type of investment fund.

Conclusion

We have serious concerns that the existence and implication of the proposed Fund Methodology and the threat of an NBNI G-SIFI designation, even with unknown consequences, may have an unwarranted and inappropriate adverse impact on U.S. registered funds, their investors, the capital markets in which they participate, and on economic growth.

However, we also have deeper substantive concerns as well. The GRGI supports the need of domestic and international regulatory bodies to deal with systemic risk and that these efforts and systems are coordinated to respond to global issues and resolve cross-border matters. However, the scope of activities contained in the Document does not fit that construct.

In its current form, the proposed Fund methodology targets U.S. registered funds only, without providing any empirical evidence that U.S registered funds pose a risk to the global financial markets or considering the adequacy of existing U.S. regulation of U.S. registered funds. As such, the Document does not have a global scope and would seemingly be outside of the G-20 remit. In addition, the FSB does not have any binding legal authority to direct U.S. regulatory authorities to take specific actions with respect to a U.S. registered fund that may be designated an NBNI G-SIFI. Accordingly, the GRGI believes that the FSB and IOSCO should withdraw the proposed Fund Methodology.

Sincerely,

David Hirschmann

cc: The Honorable Mary Miller, U.S. Department of the Treasury
The Honorable Mary Jo White, U.S. Securities and Exchange Commission
The Honorable Luis Aguilar, U.S. Securities and Exchange Commission
The Honorable Dan Gallagher, U.S. Securities and Exchange Commission
The Honorable Mike Piwowar, U.S. Securities and Exchange Commission
The Honorable Kara Stein, U.S. Securities and Exchange Commission