***Via* e-mail: fsb@bis.org and mail.iosco.org**

April 7, 2014

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

Chairman Greg Medcraft
General Secretariat
International Organization of Securities Commissions
C/ Oquendo 12
28006 Madrid
Spain

Re: FINANCIAL STABILITY BOARD AND INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS, "Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions" (Jan. 8, 2014)

Dear Chairman Carney and Chairman Medcraft:

The Financial Services Roundtable ("FSR")[1] extends its appreciation to the Financial Stability Board ("FSB") and the International Organization of Securities Commissions ("IOSCO") for providing an opportunity for us to comment on the consultative document, "Assessment Methodologies for Identifying Non-Bank Non-

[1] The Financial Services Roundtable represents the largest integrated financial services companies providing banking, insurance, payment and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $92.7 trillion in managed assets, $1.2 trillion in revenue, and 2.3 million jobs. Learn more at FSRoundtable.org.

Insurer Global Systemically Important Financial Institutions: Proposed High-Level Framework and Specific Methodologies" (the "Proposed Framework").[2]

FSR recognizes the challenging task undertaken by the FSB to meet the request by the G20 Leaders to prepare methodologies to identify systemically important non-bank, non-insurer financial entities ("NBNI entities").[3] In reviewing the Proposed Framework, we commend the FSB and IOSCO on the significant thought and effort that they have afforded the issue, and we believe that an effective assessment methodology can be developed through the close cooperation of the FSB, IOSCO, NBNI entities and other relevant stakeholders. To that end, we are pleased to present our thoughts and comments on the Proposed Framework, and we would welcome future opportunities to assist the FSB and IOSCO in their effort to develop an assessment methodology that effectively and accurately identifies NBNI entities that present a systemic risk to the global financial system and economic activity across jurisdictions.

I. Executive Summary

- The Proposed Framework should be revised to utilize a risk-based approach—rather than an approach based primarily on asset size—and focus the assessment methodologies on those factors that clearly strengthen the three transmission channels identified in the Proposed Framework.

- An over-reliance on "supervisory judgment" in the assessment process may result in an inconsistent application of the methodologies across jurisdictions.

- NBNI entities assessed under the methodology should be given greater opportunities to participate in the designation process, which should include providing NBNI entities, as relevant, notice of their potential designation and an opportunity to respond.

- The assessment methodologies should account for existing laws and regulations that already mitigate the potential risks captured by the proposed indicators.

- In circumstances where the Proposed Framework calls for the consolidation of an assessed entity's balance sheet, assets and liabilities held by subsidiaries and affiliates that do not engage in financial activities should not be consolidated.

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2 FSB, Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions (Jan. 8, 2014), *available at* http://www.financialstabilityboard.org/publications/r_140108.pdf.

3 G20 Cannes Declaration (Nov. 2011).

- The definitions of “finance company” and “market intermediary” should be narrowed to reflect the fact that different types of finance companies and market intermediaries present significantly different risk profiles.

- The FSB and IOSCO correctly focused the assessment methodology for investment funds on individual funds and should not expand the scope of assessment to include families of funds or asset managers.

- If additional types of NBNI entities are proposed for assessment, the FSB and IOSCO should develop and submit for public consultation specific methodologies and indicators for each type of NBNI entity proposed for assessment, excluding those NBNI finance companies, market intermediaries, or investment funds for whom specific methodologies would apply.

- FSR has a number of specific comments on the indicators in the Proposed Framework, including where the indicators should be clarified, are poor measures of systemic risk or do not reflect the changes in the regulatory environment since the last financial crisis.

II. The Proposed Framework Should Be Revised To (1) Utilize a Risk-Based Approach, and (2) Promote the Consistent Application of the Assessment Methodologies.

FSR understands the objective of the assessment methodologies to be the identification of those NBNI entities “whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the global financial system and economic activity across jurisdictions.”[4] In undertaking this task, FSR believes that the assessment methodologies should be designed to result in the designation of only those NBNIs that present a real risk of disruption to the global financial system. We urge the FSB and IOSCO not to presume that NBNI G-SIFIs presently exist. Rather, we believe the FSB and IOSCO should consider the possibility that when they apply an objective, risk-based assessment that evaluates finance companies, market intermediaries, investment funds, and other types of NBNI financial institutions through the lens of the three transmission channels, an NBNI entity would not present global systemic risks.

A. *The Proposed Methodologies Should Utilize a Transparent, Risk-based Assessment Process That Ensures the Designation of Only Those Entities That Are Truly Systemically Important*

FSR believes that the most effective means of properly identifying NBNI financial institutions that have high potential to cause a disruption to the global financial

[4] Proposed Framework at 2.

system is to focus the assessment methodology on factors that clearly strengthen the three transmission channels identified in the Proposed Framework. To this end, FSR believes that the assessment methodologies should be conducted under a risk-based approach. Such an approach should include (i) a focus on systemically important financial activities, rather than a wide assessment of metrics that have no clear relationship to global financial stability; (ii) an understanding that an assessment of size, complexity and systemic interconnectedness is relevant only to the extent that it relates to the global financial system and economic activity across jurisdictions; and (iii) definitions of individual financial markets, as applicable, that are as broadly defined as possible such that a disruption of the defined market has a clear correlation to disruption of the global financial system.

B. *The Assessment Process Should Include Consideration of Existing Laws and Regulations*

FSR believes that the factors comprising the assessment methodologies should include consideration of current and proposed legal and regulatory structures that are applicable to finance companies, market intermediaries and investment funds. We believe that regulation of NBNI G-SIFI entities should occur only to the extent that an international backstop is necessary to protect the stability of the global financial system. Thus, when reviewing specific indicators in the assessment process, indicators assessing activities already covered by laws and regulations should not be considered, as a risk-based methodology would recognize that national regulators have already acted to counter any potentially destabilizing effects captured by these indicators.

C. *The Assessment Process Contains Several Procedural Shortcomings and Does Not Sufficiently Address Concerns about Consistency in the Application of the Proposed Methodology*

The assessment process laid out in the Proposed Framework is severely flawed because there is no notice or comment period regarding designation determinations or any apparent means for an entity to dispute a designation by the FSB as an NBNI SIFI. In contrast to the assessment methodologies for bank and insurer G-SIFIs,[5] the Proposed Framework relies heavily on qualitative assessments and the judgment of local regulators as an explicit substitute for consistent quantitative assessment across jurisdictions. This subjective process is therefore much more at risk for inconsistent application by national regulators and, therefore, incorrect designations.

[5] *See* Basel Committee on Banking Supervision, Global Systemically Important Banks: Updated Assessment Methodology and the Higher Loss Absorbency Requirement (Jul. 3, 2013); International Association of Insurance Supervisors, Global Systemically Important Insurers: Initial Assessment Methodology (Jul. 18, 2013).

It is crucial that the assessment methodologies are wholly consistent and, by extension, transparent in their application. FSR is concerned that the FSB and IOSCO have chosen to address the complexity and data collection issues relating to NBNIs through over-reliance on "supervisory judgment" in the designation process. Our primary concern is that such reliance on various national regulators to apply a general framework (along with the differing data available in each jurisdiction) will result in an assessment process that is highly subjective, and therefore variable, in its application.[6] Although the FSB and IOSCO recognize this concern in their decision to establish the international oversight group on NBNI G-SIFI assessment (the "IOG"), FSR believes that the Proposed Framework does not sufficiently detail how the IOG will ensure the consistent application of the assessment methodologies across jurisdictions or how it will resolve disagreements between different regulators. Nor does the Proposed Framework detail how disagreements between FSB and national regulators—or the IOG and national regulators—will be resolved.

Finally, FSR believes that providing notice and comment before designation is important since the FSB and IOSCO will not be proposing policies to apply to NBNI G-SIFIs until after the Proposed Framework has been finalized. As acknowledged by the FSB and IOSCO, NBNIs engage in a wide range of businesses and follow a variety of business models; therefore, any policies that are applied to an NBNI G-SIFI should be adapted to reflect this variation. Furthermore, if an NBNI entity believes that the proposed policies to be placed on an NBNI G-SIFI would not reduce the systemic risk identified by the FSB and IOSCO, an NBNI should have an opportunity to engage with the FSB and IOSCO (including in-person meetings) and present information and other data in support of its view that designation as an NBNI G-SIFI would not reduce systemic risks.

In order to begin addressing these serious concerns, FSR believes that it is extremely important for a proposed NBNI SIFI to have notice and opportunity to dispute the designation prior to any public notice and that the FSB and IOSCO should describe in detail how the various indicators should be weighted in the application of the methodologies of the Proposed Framework.[7] Furthermore, FSR recommends that the

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6 The FSB and IOSCO state that "The NBNI G-SIFI methodologies will rely on detailed analysis conducted primarily by national authorities . . . [and] the assessment by the home regulator will tend to use indicators more as guidance than as inputs to a common scale (i.e. rank-ordering)." Proposed Framework at 6. The FSB and IOSCO also state that "national supervisory judgment could also be used to add entities to the assessment pool even when they fall below the materiality threshold but are considered potentially globally systemic." Proposed Framework at 8.

7 *See, e.g.,* Basel Committee on Banking Supervision, Global Systemically Important Banks: Updated Assessment Methodology and the Higher Loss Absorbency Requirement (Jul. 3, 2013); International Association of Insurance Supervisors, Global Systemically Important Insurers: Initial Assessment Methodology (Jul. 18, 2013).

FSB and IOSCO limit the discretion provided to national regulators, which would avoid creating an unlevel playing field. National regulators should be required to use the same materiality thresholds and the same assessment methodologies to ensure consistent application across jurisdictions.

D. *The Assessment Process Should Not Consolidate Non-Financial Assets*

FSR is concerned with the lack of guidance on the use of consolidated data in the indicators for finance companies and market intermediaries. Both finance companies and market intermediaries may have subsidiaries and other affiliates that engage in non-financial activities. We do not believe that an assessment of a financial entity's assets, liabilities or other characteristics, when considered for the materiality threshold or as an indicator of systemic risk, should include assets or liabilities not linked to that entity's financial activities. For that reason, we recommend that the FSB and IOSCO provide guidance that, in circumstances where the Proposed Framework calls for consolidated balance sheets, assets held by nonfinancial subsidiaries and other affiliates are excluded.

III. <u>The Finance Company Assessment Methodology Should Be Revised To Be More Risk-Sensitive</u>.

As a threshold issue, FSR believes that the assessment methodology should reflect that financial companies have widely varying business models, funding sources and affiliate relationships. These variations result in significantly different risk profiles among finance companies. Because assessment should follow a risk-based approach, the assessment methodology should better capture the varying types of risk posed by the different business models of finance companies.

A. *Finance Companies Are Unlikely To Be Systemically Important*

FSR does not agree with the FSB's conclusion that finance companies "could be systemically important due to their significance in providing certain types of finance and the potential difficulty of substituting certain types of finance to the real economy that they provide."[8]

1. *Critical Function / Substitutability Channel.*

As we discussed above, it is critical that the assessment methodology focus on activities and markets the disruption of which has a clear relationship to the disruption of the global financial system. The FSB's discussion of finance companies' systemic importance through the "critical function/substitutability" channel fails to demonstrate how the activities of and markets in which finance companies operate are themselves

8 Proposed Framework at 15.

systemically important such that a disruption could cause a disruption of the global financial system.

Although finance companies may engage in economically important activities, the market in which these activities are performed is highly competitive, and the entities that are capable of performing such activities are highly substitutable. The market in which finance companies operate encompasses not only other finance companies currently operating in that market, but also banks and other credit providers that can easily and readily replace finance companies. Thus, FSR does not generally agree with the assertion in the Proposed Framework that there may be "barriers to entry such as the specialist expertise required to operate in certain markets."[9] The markets in which finance companies operate—consumer, mortgages, motor vehicles and business—do not typically require any special expertise that would be unique to a specific finance company.

2. *Exposures / Counterparty Channel.*

The FSB has not sufficiently demonstrated that a finance company's reliance on wholesale markets is an indication of its systemic importance. The issue of national regulators extending solvency and liquidity support to finance companies in order to support such finance companies' ability to lend to the real economy is an issue of national economic policy, and unless and until the FSB better demonstrates how reliance on wholesale funding by an individual finance company impacts the global financial system, the use of wholesale funding should not, in itself, be an indication of systemic importance.

Finance companies rely on wholesale funding from a variety of diverse sources, including bank loans, corporate bonds and securitizations. This diversity of funding further reduces a finance company's systemic importance because an individual finance company lacks concentrated exposures to other financial institutions. Additionally, many of the counterparties in these transactions are themselves already subject to regulations that reduce the potential systemic impact of the funding activity. For example, with regard to bank loans, banks are subject to lending limits, and as the FSB is well aware, the Basel Committee on Banking Supervision is currently working on regulatory guidance for controlling large exposures.[10] Similarly, other providers of funding, such as money market funds that may purchase the commercial paper issued by a finance

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9 Proposed Framework at 15.

10 BCBS, Supervisory Framework for Measuring and Controlling Large Exposures (March 2013).

company, operate under regulatory restrictions that limit their exposure to any single issuer.[11]

3. *Asset Liquidation / Market Channel.*

FSR does not believe that finance companies generally present any significant risk to the global financial system through the "asset liquidation/market" channel. Financial assets held by finance companies are often collateralized in a manner that results in a stable floor for the market value of the asset. Additionally, depreciation schedules applied to such assets tend to be reliable and conservative in application, which results in the carrying value of the asset on the balance sheet closely matching the market value of the asset. This significantly reduces the likelihood of a fire sale negatively impacting the prices of similar assets or otherwise disrupting trading or funding in key markets. Compared to larger financial companies, such as G-SIBs, the asset size of finance companies is significantly smaller, and therefore the sale of such assets is less likely to impact the broader financial markets.

B. *The Materiality Threshold Is Too Low*

FSR believes that the current materiality threshold for finance companies is too low in light of the G-SIFIs already designated. In order to bring the NBNI assessment methodology for finance companies into alignment with the G-SIB and G-SII methodologies, FSR notes that the smallest G-SIB has total assets greater than $200 billion.

In addition, given the lower riskiness of finance companies, FSR believes that the materiality threshold should be set higher than $200 billion. To this end, the FSB and IOSCO should calculate the materiality threshold in reference solely to "at risk" assets, which would be defined to capture only unsecured assets. This risk-weighted calculation is broadly in line with the Basel framework applicable to banking entities, which recognizes that different categories of assets have different risk profiles. Similarly, FSR urges the FSB and IOSCO to clarify that the materiality threshold does not include assets of a finance company that may be held by a non-financial subsidiary or affiliate.

Regardless of where the final materiality threshold is set, the proposed materiality threshold should not be a static designation but rather pegged to some appropriate measurement of the growth of the financial system.

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11 *See, e.g.*, Rule 2a-7 under the U.S. Investment Company Act of 1940 [17 C.F.R. § 270.2a-7] (setting diversification requirements for money market funds).

C. *The Specific Assessment Factors Should Be Revised To Be More Risk Sensitive*

FSR agrees that factors such as size, interconnectedness, complexity and substitutability are generally relevant in assessing a finance company's systemic importance, but we have strong concerns that the proposed assessment methodology fails to be properly risk-focused and account for the relative riskiness of different activities and factors. We believe that the assessment methodology for finance companies should be revised to develop assessment factors that properly identify and capture those factors that contribute to systemic risk through the transmission channels discussed above.

1. *Size.*

While we agree that size may contribute to an entity's systemic importance, the size of a finance company, as an independent measurement of systemic risk, is a poor assessment factor. Rather, size may amplify the importance of other assessment factors, such as complexity and interconnectedness. Therefore, FSR believes that the assessment methodology should place significantly less weight on size.

There are two proposed indicators of size, a finance company's total globally consolidated balance sheet assets (Indicator 1-1) and its total globally consolidated off-balance sheet exposures (Indicator 1-2). The Proposed Framework states that the "assessment methodologies should be applied at the highest level of the firm that is a financial entity and on a globally-consolidated basis."[12] The FSB and IOSCO should clarify the scope of such consolidation. For example, FSR believes that consolidation should not include assets held by nonfinancial subsidiaries and affiliates of a financial company, as an appropriate risk-based assessment should not assess assets that are not related to the financial activities of the finance companies**.** Furthermore, FSR is concerned about variation in the measurement of off-balance sheet assets, as this could lead to greater inconsistency in calculations across jurisdictions.

2. *Interconnectedness.*

FSR agrees that interconnectedness is an important assessment factor. However, FSR believes that the degree of risk posed by a finance company varies depending on the mix of assets and liabilities held by that entity. Therefore, a simple quantitative aggregation of the notional amount of various assets and liabilities does not provide an effective risk-based assessment. A risk-sensitive analysis would better identify those interconnections that present the greatest potential threat to financial stability, which analysis could be accomplished by providing guidance on the assessment and weighting of the relevant indicators. Additionally, in weighing these indicators, the FSB should

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[12] Proposed Framework at 8.

take into account, as we noted above, that many jurisdictions have implemented or proposed regulatory requirements that prevent financial entities from developing large exposures to individual counterparties. To the degree that such regulations apply to an asset or liability assessed under this factor, the FSB should reduce the weight placed on that factor in its assessment.

As to Indicator 2-1 (intra-financial system assets), it is unclear why this indicator is a sum of various asset classes. A finance company that held low amounts of each category in equal amounts would be assessed the same as a finance company that was highly exposed to one particular category. FSR believes it would be more appropriate to assess whether a finance company is especially interconnected with respect to a particular asset class, as this would be more indicative of systemic importance. Further, we do not understand the inclusion of several asset classes, such as lending to financial institutions and holding securities issued by other financial institutions, as finance companies simply do not engage in such activities. We recommend that the FSB revisit this indicator and better tailor it to the circumstances of finance companies' business practices.

In assessing a finance company's intra-financial system liabilities (Indicator 2-2), FSR does not believe it is appropriate to include all marketable securities issued by the finance company because a substantial portion of these securities may be held by non-financial entities. Again, we recommend that the FSB better adapt this indicator to the operations of finance companies.

FSR supports a granular assessment of a finance company's borrowings identified by type and maturity (Indicator 2-3). In particular, FSR believes that the FSB and ISOCO should consider, among other things, the maturity and terms of the liabilities and the netting of derivatives. FSR notes that finance companies are not engaging in proprietary trading or maturity transformation and, therefore, the maturity of the liabilities are highly correlated with the maturity of the assets. If properly applied, such an assessment would be more likely to identify actual risks that may arise from exposures to financial counterparties. FSR believes, however, that the FSB should only focus on those categories of borrowings that are potentially critical to the global financial system.

FSR recognizes that high levels of leverage may amplify disruptions arising from a finance company's failure (Indicator 2-4); however, FSR believes that the FSB should provide additional guidance for national authorities to determine what constitutes a particularly high leverage ratio for a finance company, and such guidance should account for variations in the risk profiles among finance companies. For example, captive finance companies often have support agreements with their parents (*e.g.,* keepwell agreements), and a risk-sensitive assessment of a finance company's leverage should take such agreements into account.

3. *Substitutability.*

FSR believes substitutability is an appropriate factor, but as we discussed above, finance companies operate in highly competitive markets and compete with a wide range of providers of credit, both banks and nonbanks. Further, the barrier to entry into these markets is very low. Thus, even where a finance company may fail, other market participants will quickly and smoothly fill any void left by that finance company.

Regarding Indicator 3-1 (qualitative assessment of substitutability), FSR has concerns that a qualitative approach to determining the substitutability of a finance company may not produce an objective and consistent assessment across jurisdictions. Specifically, we are concerned that the FSB and national regulators do not have sufficient data to understand the full competitive landscape for market participants. We believe that, to the extent that the FSB and national regulators are themselves defining the relevant market in which a finance company operates, they should be cautious about narrowing the scope of the market such that the assessment no longer captures a market that is significant to the global financial system. In addition, while certain entities may not engage in certain sub-markets of the financing market, FSR believes that many of these entities (including banks) could easily adapt to new sub-markets should opportunities arise. To prevent inconsistent market definitions across jurisdictions, FSR believes that the FSB and IOSCO should provide national regulators with more guidance on how to appropriately define the market for finance companies.

4. *Complexity.*

FSR believes that complexity is an important factor in a risk-based assessment methodology. However because finance companies operate pursuant to business plans that focus on a very limited set of activities, and given the existing resolution régimes applicable to finance companies, and the nature of their assets and liabilities, FSR believes that any risk-based assessment under this factor may not produce any findings that weigh in favor of designating the finance company a G-SIFI.

In conducting an assessment under this factor, FSR recommends that Indicator 4-1 (OTC derivatives notional amount) be substantially revised. The inclusion of this indicator appears to ignore the significant changes in regulations with respect to OTC derivatives since the financial crisis in 2008.[13] A risk-based assessment of a finance company's OTC derivatives transactions should make quantitative adjustments for applicable netting and place greater weight on an assessment of the finance company's

[13] *See, e.g.*, FSB, OTC Derivatives Reforms Progress – Report from the FSB Chairman for the G20 Leaders' Summit (Sept. 2, 2013) (noting that at least half of FSB member jurisdictions have fully implemented the G20 Leaders' comprehensive reform agenda for OTC derivatives); *See also* Dodd-Frank Wall Street Reform and Consumer Protection Act Title VII, Pub. L. 111-203, 1124 Stat. 1376 (July 10, 2010).

exposure amount, which accounts for the degree to which the transaction is collateralized, rather than the notional amount. Additionally, derivatives transactions should also be evaluated by the purposes for which they are used, with less weight placed on transactions used for hedging purposes.

FSR also recommends that Indicator 4-2 (Difficulty in resolving a firm) be better tailored for application to finance companies. We note that the FSB's *Key Attributes of Effective Resolution Regimes for Financial Institutions* were designed primarily for application on highly complex, internationally-active financial holding companies and universal banks.[14] Therefore, the application of these key attributes to finance companies may show that most finance companies would not pose any significant challenges in resolution, as they are significantly less complex than large banking entities, hold assets with highly stable market values and have no large exposures. Consequently, an appropriate risk-based assessment of this indicator may show that finance companies are not so complex that their distress or failure may be disruptive to the global financial system.

5. *Cross-Jurisdictional Activities.*

A G-SIFI is, by definition, an institution whose distress or failure may potentially disrupt the global financial system, and as such, FSR believes that an assessment of global activities is appropriate, but only to the extent that such an assessment appropriately captures cross-border risks. The FSB should revise this assessment factor so that, rather than merely counting the number of jurisdictions in which a finance company operates and the size of its operations in such jurisdictions, the assessment focuses on those activities that have the potential to spread risks across jurisdictions. For example, a finance company with self-funded and independent subsidiaries poses very little risk to the global financial system, even if it has a large presence in several jurisdictions. In determining which activities have the potential to spread risks across jurisdictions, the assessment methodology should focus on the provision of critical services or functions that, in operation, span multiple jurisdictions. Because none of the indicators in this factor truly provide a risk-based assessment, FSR requests that the FSB revise the indicators for this factor per our recommendations.

To the extent that the assessment factor does focus simply on the number of jurisdictions, the assessment factor should be referenced to the finance company's relative market share in each jurisdiction as a means to risk-weight the factor.

[14] FSB, Key Attributes of Effective Resolution Regimes for Financial Institutions (Oct. 2011).

IV. <u>The Market Intermediaries Assessment Methodology Should Be More Risk-Based</u>.

FSR believes that the definition of "market intermediary" is overly broad and should focus solely on NBNI entities that deal in securities or provide funding to their clients. The Proposed Framework defines "market intermediaries" to include entities that engage in any of the following activities: (i) receiving and transmitting orders (*i.e.*, brokers); (ii) proprietary trading/dealing on own account (*i.e.*, dealers); (iii) providing advice regarding the value of securities or the advisability of investing in, purchasing, or selling securities (*i.e.*, investment advisers); (iv) securities underwriting (*i.e.*, underwriters); (v) providing funding to clients (*e.g.*, margin loans, reverse repos) (*i.e.*, prime brokers); and (vi) placing of financial instruments without a firm commitment basis (*i.e.*, placement agents). The FSB and IOSCO do not analyze why each of these activities would raise systemic risks and we believe that, in fact, most of these activities would not. Brokers, investment advisers, underwriters[15] and placement agents act as agents for their clients, do not present systemic risks (as discussed below) and, therefore, should be excluded from the definition of "market intermediaries." Furthermore, we believe that the FSB and IOSCO (or the IOG) should exclude these entities from consideration in all jurisdictions so that the exclusions are not inconsistently applied across jurisdictions.

A. *Market Intermediaries Are Unlikely To Be Systemically Important*

We commend the FSB for acknowledging that, in general, market intermediaries would not be systemically important. We agree that market intermediaries present different risk profiles than banks and insurers, the only types of financial entities currently designated as G-SIFIs. In fact, we believe that any assessment of market intermediaries should consider existing laws and regulations, including customer asset segregation, capital and liquidity requirements, and resolution régimes.

1. *Exposures / Counterparty Channel.*

The FSB and IOSCO hypothesize that a market intermediary could be systemically important if it has "extensive exposures and liabilities in the financial system" with other systemically important counterparties or multiple counterparties. As a primary matter, this channel would eliminate agents (including brokers, investment

15 We note that underwriters would not be traditionally categorized as agents. However, we believe that, for purposes of this analysis, they would be appropriately categorized with the other agent market intermediaries. Although underwriters are exposed to certain risks associated with the inability to place of securities for which they have been engaged on a firm commitment basis, these are not the type of risks that would create systemic risk. Putting aside the placement risk, the activities of an underwriter are very similar to those of an agent. Furthermore, we note that there are likely only a small number of market intermediaries who are only engaged in underwriting.

advisers, underwriters and placement agents) who do not have any significant counterparties. Second, the FSB and IOSCO fail to account for the significant regulatory limitations placed on such systemically important institutions precisely to prohibit significant exposure that may lead to destabilizing impacts. Third, the FSB and IOSCO fail to consider that counterparty exposures supported with collateral or other risk-mitigating measures greatly reduces counterparty risks. For these reasons, FSR believes that the FSB and IOSCO should focus only on those activities where the market intermediary is acting as principal, there is not existing applicable regulation, and the activity is not subject to risk mitigation.

2. *Asset Liquidation / Market Channel.*

The Proposed Framework indicates that the financial distress of a market intermediary may create "potential for increased margin calls and/or fire sales in the broader market" because market intermediaries may be significant lenders or borrowers in the financial system.[16] Many of the entities that fall within the definition of "market intermediary" are not significant lenders or borrowers because they act as agents on behalf of clients, including brokers, investment advisers, underwriters, and placement agents. By the nature of the agency relationship, the failure of an agent does not require the client to liquidate the assets for which the agent was providing services. In fact, this analysis is not even applicable when the services the agent provides are execution services (such as a broker or placement agent), since an investor or issuer could simply find another agent to execute a particular transaction. In the case of investment advisers, who act as agents for their clients, the client's assets are held by the client's custodian—not by the agent.

3. *Critical Function / Substitutability Channel.*

Market intermediaries operate in highly competitive markets in which the products and services offered by any one market intermediary are often similarly offered into the same market by other market intermediaries.[17] In particular, the agency relationships that many market intermediaries have (including brokers, investment advisers, underwriters, and placement agents) are by their nature highly substitutable. Furthermore, not all of the activities identified as characterizing market intermediaries are

[16] Proposed Framework at 22. We note that the FSB and IOSCO conspicuously do not directly attribute increased margin calls and fire sales in the broader market to the distress of a market intermediary.

[17] *See, e.g.*, Financial Industry Regulatory Authority, Annual Report 2012 at 8 (noting that in the United States, there are nearly 4,300 brokerage firms and nearly 630,000 registered securities representatives); Investment Company Institute, 2013 Investment Company Fact Book at 13-14 (53rd Edition) (noting that in 2012, 776 financial firms competed in the US market to provide investment management services, with a net growth over the last three years of 95 new firms entering the market).

critical functions. For example, acting as a placement agent for private companies who engage in limited offering on only an intermittent basis is not a critical function or service, the failure of which would cause material disruption to the global financial system or economic activity across jurisdictions.

Thus, most market intermediaries are highly substitutable, and to the extent that any failed market intermediary offered a critical service or provided a critical function, a competitor would quickly fill the void. For this reason, FSR believes that the FSB and IOSCO should narrow the definition of activities that characterize market intermediaries by specifying only those critical functions or services for which there is limited substitutability.

B. *Materiality Threshold*

As with respect to finance companies, FSR believes that the FSB and IOSCO should evaluate potential NBNI G-SIFIs in relation to the G-SIFIs already designated, the smallest of which, as we noted earlier, had total assets of greater than $200 billion. However, as discussed above, because the risk profile of market intermediaries is also significantly different than banks and insurance companies, FSR believes that the materiality threshold should be set even higher and, similar to finance companies, should only include "at risk" assets. Finally, FSR believes that the materiality threshold should be calculated based on the total assets of the market intermediary itself and should not include any assets held by non-financial subsidiaries and affiliates; otherwise, the materiality threshold may be based on assets that are completely unrelated to the market intermediary's activities.

FSR recommends that the FSB and IOSCO revise the threshold to make clear that no client assets should count toward the threshold, even if the market intermediary is required under national accounting standards to consolidate the assets on its balance sheet. For example, the proposed definition of market intermediary could capture certain investment advisers to private funds that may be required to consolidate the assets of the private funds on their balance sheet under U.S. generally accepted accounting principles ("GAAP")[18], even though, as a legal matter, the assets of the private funds are not assets of the investment adviser.

Regardless of where the final materiality threshold is set, FSR believes that the proposed materiality threshold should not be a static designation but rather should be pegged to some appropriate measurement of the growth of the financial system**.**

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18 Financial Accounting Standards Board, Emerging Issues Task Force, Issue No. 04-5, "Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights" (May 26, 2005). *See also* Financial Accounting Standards Board, Proposed Accounting Standards Update, Consolidation (Topic 810): Amendments to Statements 167 for Certain Investment Funds (Dec. 4, 2009).

C. *The Specific Assessment Factors Are Not Sufficiently Risk Sensitive*

As we noted in our discussion of the finance company assessment methodology, factors such as size, interconnectedness, complexity and substitutability are generally appropriate to assess an entity's systemic risk. However, a sector-specific methodology requires that these general factors be calibrated to the specific risks raised by entities in that sector. As discussed by the FSB and IOSCO, such a risk-based assessment of market intermediaries should focus on indicators of interconnectedness and place less weight on other factors.

1. *Size.*

While a market intermediary's size may contribute to its systemic importance, it is a poor standalone indicator of systemic importance. The indicators proposed by the FSB and IOSCO capture many of the assets that are outside the market intermediary's control and therefore assess information that should be outside the scope of a risk-based assessment methodology.

In assessing the market intermediary's total global consolidated balance sheet assets (Indicator 1-1), FSR believes there are significant issues with relying solely on the consolidated balance sheets assets in determining systemic importance. As noted above, it is misleading to rely on consolidated balance sheets assets where the assets relate to non-market intermediary businesses or where the assets are included as a technical accounting matter (such as the consolidation of certain private fund assets on the balance sheet of their adviser under GAAP). FSR further believes that, unlike with the determination of the materiality threshold, the practical issues that may make access to consolidated assets easier are not applicable to the more detailed determination, since the FSB and IOSCO may request additional information from the market intermediary. Therefore, FSR believes that the FSB and IOSCO will be capable of making a more appropriate calculation of size that goes beyond consolidated balance sheet assets.

Regarding the assessment of total globally consolidated off-balance sheet exposures (Indicator 1-2), FSR is concerned that the FSB's instruction that "national authorities should consider off-balance sheet assets to the extent possible" may lead to two issues—the attribution of assets to the market intermediary that would not be affected in any significant manner by the entity's failure and inconsistent application of this indicator across jurisdictions.

Finally, FSR does not believe that an assessment of client assets outstanding is an appropriate indicator (Indicator 1-3). As noted above, we do not believe that market intermediaries who act as agents on behalf of clients are systemically risky, since, among other things, they are in a highly competitive industry and are replaceable. Furthermore, this indicator ignores the fact that, as the FSB and IOSCO acknowledge, market intermediaries are generally subject to regulation for the purpose of protecting client assets, which often requires that client assets are segregated from the market intermediary's assets. Therefore, at a minimum, FSR believes that this indicator should be narrowed to only those client assets that are not segregated from the assets of the market intermediary or subject to equivalent safeguards under the applicable laws and regulation.

Furthermore, the FSB's instructions that the assessment of this indicator should focus on "the potential for generalized market panic" lacks clarity and substance. The FSB and IOSCO have not provided any guidance for national authorities to determine how to assess whether the failure of the market intermediary, rather than broader market forces, may be causing a "generalized market panic." We also note that "generalized market panic" is not one of the transmission channels identified by the FSB and IOSCO, and as such, we do not believe that it should inform the assessment of market intermediaries.

In addition, FSR does not believe that client assets should be of increased importance solely because the market intermediary's business is managing individual portfolios. As noted above, we do not believe that investment advisory activity should be characterized as a market intermediary activity. However, it is unclear why providing investment advice (discretionary or non-discretionary) would increase the systemic importance of a client portfolio if that client portfolio were appropriately segregated from the market intermediary's proprietary assets or otherwise safeguarded.

2. *Interconnectedness.*

As discussed above, FSR believes that interconnectedness should be given significant weight in a risk-focused assessment of market intermediaries. However, FSR believes it is imperative that the assessment focus solely on the activities of the market intermediary that it conducts for its own accounts and utilizing its own assets. Any activities that are conducted at the direction of or on behalf of customers, utilizing customer assets, should not be attributed to the market intermediary. This is particularly relevant to the indicators that address intra-financial system assets and liabilities.

It is unclear to us why the FSB and IOSCO suggest that intra-financial system assets and liabilities should be a sum of a range of very different financial activities (Indicators 2-1 and 2-2). FSR believes that these indicators should be revised to better capture the risks that arise from a market intermediary's exposures. A risk-sensitive analysis would assess each sub-indicator individually because a distressed market intermediary whose intra-financial system assets and liabilities are concentrated in a single sub-indicator would be more likely to cause disruptions. With respect to the intra-financial liabilities, we do not believe it is appropriate to include all marketable securities issued by the market intermediary, since a substantial portion of these securities may be held by non-financial entities. Of course, as discussed previously, we do not think it is appropriate for the assessment to include factors that are addressed by regulations that limit large exposures between counterparties.

In reviewing the proposed assessment factors that capture the market intermediary's leverage ratio and short-term debt ratio (Indicators 2-3 and 2-4), we support the suggestion that these ratios should be evaluated in light of the quality of the underlying assets and the sources of funding. FSR urges the FSB and IOSCO to provide greater guidance on how the underlying assets and sources of funding should be assessed.

In assessing a market intermediary's OTC derivatives assets and liabilities (Indicator 2-5), FSR again emphasizes that it is imperative that the assessment focus solely on the activities the market intermediary conducts for its own accounts and utilizing its own assets. Furthermore, as discussed above, a risk-based assessment of a market intermediary's OTC derivatives transactions should make quantitative adjustments for applicable netting and place greater weight on an assessment of the market intermediary's exposure amount, which accounts for the degree to which the transaction is collateralized, rather than the notional amount. Additionally, derivatives transactions should also be evaluated by the purposes for which they are used, with less weight placed on transactions used for hedging purposes.

In considering the assessment of the amount of margin a market intermediary is required to post at clearing houses or central counterparties (Indicator 2-6), FSR reiterates the need to ensure that the assessment is properly calibrated to focus on the actual risks posed by the activities of market intermediaries by limiting the scope of the assessment to margin which supports those activities the market intermediary conducts for its own accounts and utilizing its own assets. It is not clear how margin posted by a market intermediary in support of customer positions is a useful proxy of either the overall size of risk being taken by the market intermediary or that entity's market interconnectedness. In fact this indicator appears to actually be a counter-indicator, since the margin is being posted for the purpose of reducing the riskiness of the associated transaction.

3. *Substitutability.*

FSR notes again that market intermediaries operate in a highly competitive market, and the products and services offered by any one market intermediary are often similarly offered into the same market by other market intermediaries. Thus, there should be a very high hurdle for an assessment under this factor to weigh in favor of designating a market intermediary a G-SIFI.

FSR believes that Indicator 3-1 (qualitative assessment of substitutability) lacks any meaningful instruction or guidance on how to conduct a qualitative assessment of whether "the market" relies on a critical function or service provide by the market intermediary. In particular, the FSB and IOSCO should provide guidance to assess when a market intermediary has assumed a "key role" or is "essential." Any assessment of whether an intermediary is "essential" should include an evaluation of the competitiveness of the larger market of market intermediaries and the ability of other market intermediaries to assume a similar "key role" without causing systemic disruption.

As with previous indicators, FSR recommends that the assessment of a market intermediary's total trading and transaction volumes (Indicator 3-2) be calibrated to measure the actual risks posed by the market intermediary by assessing only those activities the market intermediary conducts for its own accounts and utilizing its own assets. All trading and transactions on behalf of customers should be excluded from the assessment because activities undertaken as an agent are not indicative of a market intermediaries' systemic importance.

4. *Complexity*.

Although complexity is generally an important indicator of potential systemic risk posed by a financial institution, it is not as relevant in assessments of market intermediaries because their business models typically do not involve complex operations or opaque transactions. FSR believes that the indicators identified by the FSB to assess market intermediaries are not appropriate.

The indicator for "structural complexity" is a severely flawed measure in that it fails to assess the actual risk that the complexity of a market intermediary may pose to the global financial system (Indicator 4-1). We believe that attempting to measure such "structural complexity" by counting the number of legal entities consolidated into a market intermediary is a particularly ineffective process. In fact, counter to the suggestion in the Proposed Framework, a large number of legal entities may decrease the likelihood of market disruption upon the failure of a market intermediary, since the separate legal entities are often more insulated and separated for purposes of bankruptcies or other liquidation purposes. Furthermore, as noted above, certain pooled investment vehicles may be consolidated on the balance sheet, but a large number of such pooled investment vehicles (which are insulated from the other entities in the structure for liability purposes) clearly does not indicate greater complexity that could make liquidation more difficult.

We do not believe that the simple measurement of Level 3 assets is an appropriate risk-sensitive assessment of the potential risk arising from a market intermediary's complexity. FSR believes that the FSB should also consider (i) which Level 3 assets are complex to evaluate and (ii) in what situations the complexity to value Level 3 assets has a material impact on a market intermediary. Furthermore, as discussed above, the measurement should not include Level 3 assets held in client accounts.

5. *Cross-jurisdictional activities.*

FSR does not believe that a simple count of jurisdictions in which a market intermediary conducts operations, as measured by the number of jurisdictions in which it and/or its affiliates are licensed, registered, or recognized by or reportable to the market regulator, is an appropriate measurement of cross-jurisdictional activities (Indicator 5-1). As the FSB notes, market intermediaries may be subject to local regulatory jurisdiction but engage in *de minimis* business in that jurisdiction. We also note that the licensing or reporting of market intermediaries is fundamentally different than the opening of a branch of a bank. Additionally, the FSB and IOSCO should take into consideration the risk reducing effects of such licensing or registration.

In assessing a market intermediary's cross-jurisdictional claims and liabilities (Indicator 5-2), FSR again would like to stress that the assessment should focus on the market intermediary's claims and liabilities and not its customers. In addition, the indicator is unclear whether the FSB is focusing on market intermediaries that are diversified across a large number of jurisdictions or market intermediaries that are concentrated in a single geographic region.

V. <u>The Investment Funds Assessment Methodology Should Better Capture the Risks Actually Posed by Investment Funds</u>.

Similar to finance companies and market intermediaries, FSR believes that any assessment of investment funds should be tailored to the risks posed by investment funds. The FSB and IOSCO should consider the possibility that when they apply an objective, risk-based assessment to most large, passively-managed investment funds (*e.g.*, a large index mutual fund), the funds would not be globally systemically significant.

As an initial matter, FSR recommends that the FSB and IOSCO clarify in the definition of "collective investment schemes" that pension funds are not captured by the definition. This conclusion may be inferred from the definition, as pension funds do not issue units or shares, and therefore cannot redeem such. Pension funds are also subject to significant regulation. A revision to the definition would ensure that pension funds are not assessed and potentially designated as G-SIFIs.

A. *The Assessment Should Focus On Individual Funds*

FSR strongly supports the FSB and IOSCO's decision to focus the assessment methodology on investment funds individually and not (i) a family of funds, (ii) an asset manager on stand-alone basis, or (iii) an asset manager and its funds collectively.[19] The

[19] *See* Comment Letter of the Financial Services Roundtable on the US Office of Financial Research's Report "Asset Management and Financial Stability" (Nov. 1, 2013), *available at* http://www.sec.gov/comments/am-1/am1-17.pdf.

legal structures of funds limit the liability exposure of its asset manager. Additionally, funds sponsored by any one fund manager are independent of each other, with no cross-collateralization or cross-guarantees between funds. There is also no evidence that the closing of a single fund causes harm to other products sponsored by the same asset manager or, more broadly, the stability of the global financial system.

If, however, the FSB and IOSCO choose a level of focus for the assessment process that is not on investment funds individually, the assessment methodology for investment funds should be re-proposed for consultation in order that interested parties may submit fully informed and considered comments. FSR's comments in this letter are predicated on our understanding that the assessment methodology is to focus on investment funds individually, and our comments may be substantially altered if the level of focus were to be otherwise.

B. *Investment Funds Are Unlikely To Be Systemically Important*

We commend the FSB and IOSCO's recognition that investment funds present very different risk profiles compared to other types of financial entities. We believe it is critical in conducting an effective risk-based assessment of investment funds that the methodology acknowledges and takes into account that fund investors decide, based on full disclosures, to take on certain risks. To that purpose, we agree with the FSB and IOSCO that, from a systemic perspective, investment funds, unlike banks, have an inherent "shock absorber" because fund investors absorb losses as well as gains. Furthermore, unlike persons who deposit funds in an insured bank savings account expecting the return of principal plus interest, investors in investment funds do not seek shelter from risk. Rather, investors make investments in investment funds because they seek a certain level of risk and the opportunity to obtain the corresponding financial rewards of their risk-taking.

1. *Exposures / Counterparty Channel.*

FSR believes that in conducting a risk-based assessment that evaluates the systemic importance of an investment fund, the assessment factors should focus on indicators involving leverage and the resulting exposures to counterparties. However, as we have already discussed, in circumstances where mitigating regulation already seeks to address the potential destabilizing effects of the exposure being assessed, the FSB and IOSCO should recognize that the application of mitigating regulation weighs heavily against a determination of systemic importance.

2. *Asset Liquidation / Market Channel.*

We recognize that investment funds, just as with all financial entities, may have the capacity under certain circumstances to exert downward pressure on the market prices of assets the funds may be forced to sell off. However, we note that, given the frequency of fund liquidations,[20] there is no data to suggest that this downward pressure would impact global financial stability or economic activity across jurisdictions. Thus, a risk-sensitive assessment methodology should capture only those factors that accurately describe the systemic risk posed by investment funds individually and should not place undue emphasis on factors that assess more general effects and activities.

FSR supports the FSB and IOSCO's recognition that investment funds are sufficiently substitutable and do not provide critical functions or services, and therefore, we believe that an effective risk-based assessment methodology would not attempt to capture indicators that assess issues related to substitutability and the provision of critical functions or services.

C. *Materiality Threshold*

FSR believes that a simple assessment of a fund's net asset value is not an effective indication of systemic importance, even for the limited purpose of establishing the materiality threshold. Rather, the materiality threshold for investment funds should incorporate an indicator of the most critical assessment factor for investment funds—leverage. By utilizing both leverage and net asset value, the materiality threshold would more effectively capture only those investment funds that may potentially pose a risk to the global financial system. For example, we note the proposed materiality threshold would capture several large, passively-managed index mutual funds that utilize very little or no leverage. As these types of funds are clearly outside the scope of the FSB and IOSCO's discussion of the systemic importance of investment funds, we believe they should not be captured by the materiality threshold.

Regardless of where the final material threshold is set, FSR believes that the proposed materiality threshold should not be a static designation but rather should be pegged to the growth in global "investable assets"—a common measurement for the asset management industry in determining assets available for investment in reference to market share.

D. *Specific Assessment Factors*

1. *Size.*

FSR believes that net asset value is an appropriate measure for the size of investment funds, but that fund size should not be a significant assessment factor of systemic importance.

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[20] *See* Investment Company Institute, 2013 Investment Company Fact Book at 14-15 (53rd Edition) (noting that in the United States, 493 funds liquidated or merged in 2012, and 39 fund sponsors left the market).

2. *Interconnectedness.*

We believe that interconnectedness is an important assessment factor in properly assessing the potential systemic risk of an investment fund, provided that interconnectedness is properly defined. However, the assessment process should reflect recent, risk-mitigating regulatory changes designed to reduce potential systemic risks arising from financial connections between investment funds and their counterparties.

We agree that the leverage ratio of a fund is an important risk-based assessment factor (Indicator 2-1). We believe, however that the FSB and IOSCO should provide greater guidance on when a leverage ratio should be considered significant. We note, for example, that leverage incurred by investment funds is significantly less than the leverage incurred by banks.[21] This difference in leverage is especially true for U.S. registered investment companies that are subject to regulatory limits on leverage, but it is also true for hedge funds.

Similarly, the counterparty exposure ratio is also an adequate risk-based factor to assess a fund's interconnectedness (Indicator 2-2). However, to the extent that the assessment of intra-financial system liabilities assesses exposures to G-SIBs and G-SIIs that are already subject to regulatory controls (Indicator 2-3), such exposures should not be assessed.

3. *Substitutability.*

As we discussed above, FSR agrees with the FSB and IOSCO that investment funds do not present substitutability concerns.[22] Every year, funds are closing or merging with other funds in an orderly manner with no systemic impact and no government intervention. Thus, we do not believe that substitutability factors are relevant to a risk-focused assessment methodology.[23] To this end, we do not believe that any of the

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[21] *See* Paul Schott Stevens, President and CEO of the Investment Company Institute, *Financial Stability and U.S. Mutual Funds* (Speech given at the Mutual Fund and Investment Management Conference) (March 17, 2014) , *available at* http://www.ici.org/pressroom/speeches/14_pss_mfimc (citing data showing that the average leverage for U.S. commercial banks is 9:1 and the average leverage for the 15 largest U.S. funds is 1.04:1).

[22] Proposed Framework at p. 34.

[23] Indeed, the high level of substitutability among investment funds, in many ways, highlights the challenges of the entire NBNI SIFI designation process. To the extent designation of funds as G-SIFIs is accompanied by policy measures that increase the costs borne by the investors of such funds, investments may shift out of such funds and into less regulated (*i.e.*, non-designated) funds, resulting in a larger number of funds just below the materiality threshold. It is not clear whether a change in the fund market structure along these lines would actually reduce systemic risk or, conversely, better promote financial stability.

proposed indicators that focus on investments in securities, even in thinly traded markets, are appropriate. Neither the sale of securities nor the ultimate liquidation of a fund will have an impact on the companies in which it invests.

4. *Complexity.*

FSR agrees that complexity is a relevant assessment factor; however, some of the suggested indicators do not appear to be the type of complexity that could increase the systemic risks of investment funds. Complexity of the strategy engaged in by the fund does not make the fund more difficult to resolve. For example, a fund pursuing a complex strategy involving liquid securities would not be difficult to resolve, since, at the end of the trading day, the fund is holding liquid securities. FSR also believes that these indicators may suggest that the systemic risk regulation process should focus more on activities instead of entities.

Rather, the Proposed Framework should re-focus on the difficulty of winding up the fund (as was done with respect to finance companies and market intermediaries), taking into consideration the assets and liabilities of the fund and the legal and regulatory resolution régimes applicable to investment funds. If one focuses on the ease of winding up the fund, one would quickly come to the conclusion that most investment funds are easily resolved. As noted above, the immateriality of this factor is shown through the repeated liquidations of investment funds without government intervention.[24] We further note that the investors in liquidated funds receive a full distribution of their respective pro rata share of the fund; the fund's assets are not subject to any claims by the asset manager or its creditors prior to distribution to investors.[25]

In addition, some of the suggested indicators appear to be focused on interconnectedness with counterparties (*e.g.*, OTC derivatives and ratio of collateral that has been re-hypothecated). These indicators properly belong in the interconnectedness category since they only secondarily impact the complexity of resolution.

5. *Cross-jurisdictional activities.*

FSR does not believe that a simple of count of jurisdictions in which a fund invests, offers interests, or has counterparties is an accurate measure of cross-jurisdictional importance. In fact, FSR does not believe that it is appropriate to focus on

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[24] *See, e.g.*, Investment Company Institute, 2013 Investment Company Fact Book at 13-14 (53rd Edition)(discussing liquidation of registered investment funds).

[25] *See, e.g.*, Kirsten Grind, What to Do if a Fund Closes, The Wall Street Journal (Jul. 5, 2012)(noting that "[i]nvestor assets, though subject to market fluctuations, are protected from seizure, and on the day of closure, investors get the full value of their fund shares, just as if they had decided to sell on their own").

fund investors (Indicator 5-2) or fund investments (Indicator 5-1) with respect to cross-jurisdictional activities at all. As noted above, an investor is seeking risk when making an investment in a fund. Moreover, neither the sale of securities nor the ultimate liquidation of a fund will have an impact on the companies in which it invests. Finally, FSR notes that there are also significant diversification benefits from investing in multiple jurisdictions, which would significantly reduce the risks faced by an investment fund.

With respect to cross-jurisdictional counterparty exposure (Indicator 5-3), this indicator should be revised to capture the level of risk that the investment fund's activities in that jurisdiction actually pose and, in particular, the exposure amount to counterparties in other jurisdictions. The proposed indicator of a simple count of jurisdiction in which the fund has counterparties does not provide a meaningful measure of the potential for a global impact, particularly where the fund has only *de minimis* exposure to the other jurisdictions.

FSR does not believe that a fund's use of service providers in other jurisdictions should be considered as a possible indicator of cross-jurisdictional activity.[26] By the nature of a service provider's business and benefits of economies of scale, an individual investment fund rarely is a significant portion of a service provider's business; therefore, the liquidation of an individual investment fund would not spread systemic risk through its service providers. Service providers (in particular, custodians) are generally themselves subject to significant regulation, including prudential regulations relating to systemic risk.[27] The use of different custodians in multiple jurisdictions also diversifies both the risk of the failure of any particular custodian but also risks of holding assets in any particular jurisdiction. Therefore, the use of multiple service providers, including custodians, is often a mitigant of systemic risk and not an indicator. We also believe that an indicator based on the usage of service providers in other jurisdictions would be repetitious of Indicator 5-1, which counts the number of jurisdictions in which a fund invests, since the holding of securities in a jurisdiction almost always involves the use of a local custodian.

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[26] *See* Question 6-6 of the Proposed Framework (asking for comment on an indicator based on "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)").

[27] For example, many of the custodians have already been designated as global systemically important financial institutions, including the four largest custodians in the United States. FSB, 2013 Update of Group of Global Systemically Important Banks (G-SIBs) (Nov. 11, 2013), *available at* https://www.financialstabilityboard.org/publications/r_131111.pdf. We also note that The Depository Trust Company was designated as systemically important financial market utility by the United States government, in part, because it provides depository services for a wide range of securities. Designation of Systemically Important Financial Market Utilities, *available at* http://www.treasury.gov/initiatives/fsoc/designations/Pages/default.aspx, at 164.

VI. Separately Managed Accounts.

The FSB and IOSCO state that separately managed accounts or "separate accounts"[28] are not currently included in the Proposed Framework but should be subject to future assessment. FSR believes that any such assessment is unnecessary because of the inherent characteristics of separate accounts. The investor in a separate account has direct legal ownership of the assets held in the separate account; therefore, there is no "run" risk as has been postulated with respect to investment funds. The assets are held by a third-party custodian[29] that is selected by the investor, and the terms of the custodial relationship are set forth in an agreement between the custodian and the investor. There also are strict legal and regulatory requirements that ensure the safekeeping of the assets of separate accounts.[30] Finally, service providers (including investment advisers) are highly substitutable because the services they provide to separate accounts (including, in particular, the investment advisory services of the investment adviser) are easily transferable to another service provider.

As is the case with other funds managed by an investment adviser, the risks associated with separate accounts are wholly attributable to investors. Therefore, a risk-based assessment methodology should not attribute separate accounts to third parties, whether or not such parties provide services to the separate accounts.

VII. Assessment Methodologies for Other NBNI Financial Entities.

FSR believes that the proposed "backstop" framework is severely flawed and should be removed. First, it is unclear why the methodology for assessing other NBNI financial entities should be any less rigorous or informed than that applicable to finance companies, market intermediaries or investment funds. Therefore, the FSB and IOSCO should propose for comment specific methodologies and indicators that apply to specific categories of other NBNI financial entities, rather than rely on an undeveloped

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[28] For purposes of this discussion, FSR's comments focus on "separate accounts," which are utilized by institutional investors, including public-sector pension funds operating under statutory investment guidelines and sovereign wealth funds that are not permitted to comingle their assets with other investors.

[29] The four largest custodians in the United States have already been designated global systemically important financial institutions. *See supra* note 27.

[30] *See, e.g.*, Rule 206(4)-2 under the U.S. Investment Advisers Act of 1940 (regarding the custody of client assets). Compliance with these requirements is often one of the priorities of examinations by regulatory agencies. *E.g.*, U.S. Securities and Exchange Commission, Office of Compliance Inspections and Examinations, Examination Priorities for 2014 (Jan. 9, 2014), available at http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2014.pdf (discussing safety of assets and custody as one of the core priorities with respect to the examination of investment advisers).

generalized methodology. FSR believes that the FSB, IOSCO and the national regulators would benefit from receiving comment from the public, given the range of financial activities in which other entities engage, some of which may be significantly different than those conducted by more “traditional” financial institutions, such as banks, insurance companies, broker-dealers, finance companies and investment funds. Furthermore, a specific, customized methodology would ensure that other NBNI financial entities are treated consistently across the jurisdictions. Finally, FSR is concerned that this “backstop” methodology could be used to designate finance companies, market intermediaries or investment funds (or their affiliates) that would not otherwise qualify for designation under the specific framework prescribed for each of these categories of NBNI financial entities.

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FSR appreciates the opportunity to submit comments on the FSB and IOSCO's proposed assessment methodologies for NBNI G-SIFIs. We would welcome additional opportunities to assist the FSB and IOSCO in their effort to develop an assessment methodology that effectively and accurately identifies NBNI entities that present a systemic risk to the global financial system and economic activity across jurisdictions. If it would be helpful to discuss FSR's specific comments or general views on this issue, please contact Richard.Foster@FSRoundtable.org.

Sincerely yours,

Rich Foster

Richard Foster
Vice President and Senior Counsel for Legal and Regulatory Affairs

Financial Services Roundtable

With a copy to:
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The Honorable Luis A. Aguilar, Commissioner
The Honorable Daniel M. Gallagher, Commissioner
The Honorable Kara M. Stein, Commissioner
The Honorable Michael Piwowar, Commissioner

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