March 23, 2015

Financial Stability Oversight Council
United States Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: Financial Stability Oversight Council docket number FSOC – 2014- 0001; "Notice Seeking Comment on Asset Management Products and Activities" (the "Notice")

The Security Traders Association ("STA") is pleased to offer comments on the Financial Stability Oversight Council (the "Council") notice "seeking public comment on aspects of the asset management industry in particular whether asset management products and activities may pose potential risks to the U.S. financial system". The STA is comprised of 24 affiliate organizations in North America. Our membership is comprised of individuals employed in the financial services industry. The STA relies on its Trading Issue Advisory Committees for input on its comment letters and for this particular comment letter the STA relied on its buy side membership.

The Notice recognizes that the asset management industry encompasses a broad range of participants. The Notice specifically seeks comments on four areas of the asset management industry which may pose systemic risk:

- Liquidity and redemption
- Leverage
- Operational risk
- Resolution

The STA will focus its comments on: general changes in the asset management industry since the 2008 financial crisis; liquidity and redemption practices; and operational risks pertaining to long only asset managers and hedge funds.

**General remarks on the state of asset management industry since 2008**

The financial crisis of 2008 saw the near collapse of the financial markets. The crisis played a key role in the failure of certain markets which prior had amble levels of liquidity to satisfy investor demands. These markets included, but were not limited to; auction rate securities, commercial mortgage-backed securities, money markets,



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and commercial paper. STA believes that these liquidity failures were major catalysts for certain changes to existing practices in the asset management industry.

STA strongly believes that any discussions or review of the asset management industry needs to be in the context that the asset management industry today is functioning properly and that there are no signs of significant deficiencies or an inability to perform its important function. In addition we agree with a statement made by Paul Schott Stevens, President and CEO of the Investment Company Institute ("ICI"), in its 2014 annual report:

> *"…the structure and comprehensive regulation of mutual funds and their managers protect investors while mitigating risks to the broader financial system".*[1]

**Evolution of certain industry practices**

In the aftermath of the 2008 financial crisis existing industry practices around risk management evolved in breadth and new practices emerged. Changes in the following areas have contributed positively in how asset managers understand and measure operational and liquidity risks.

- The increased levels of oversight and controls in place at asset management firms.
- The increased use of requests for proposals, "RFPs" and consultants by purchasers of asset management services.
- A willingness by regulators, with industry input, to define industry standards.
- Robust levels of activity in areas where technological or procedure failures may reside.

STA believes that as the Council conducts its review of the asset management industry, it should recognize how changes in these specific areas since 2008 have improved the overall soundness of the asset management industry for the benefit of individual investors.

**The increased levels of oversight and controls in place at asset management firms**

There has been meaningful growth in the amount of resources allocated to technology and personnel responsible for oversight at asset management firms. This can best be seen by the creation of control groups who are responsible for among other things ensuring policy and

[1] Investment Company Institute 2014 Annual Report to Members, pg 7.

procedures are in place. Stress testing has become a "new norm" in the asset management space. Testing across platforms such as portfolio management, trading and operations occur regularly and under a variety of disruptive scenarios in areas such as: interest rates; commodity disruptions and credit events. Reporting is more robust and frequent, and it helps to provide early warning signs to management. These reports include but are not limited to: outlier reports on activities; and concentration reports across the entire enterprise that include investment controls for ownership levels.

**The increased use of requests for proposals, "RFPs" and consultants by purchasers of asset management services.**

The use of RFPs in the selection process for asset managers has grown in frequency and detail since the 2008 crisis. Inquiries on how firms stress test for both normal and stressed markets are standard in the RFP process. In addition, inquiries on liquidity analysis and estimates for how many days to initiate and liquidate positions of specific levels based on such analysis are very common.

The role of investment consultants with retail and institutional purchasers of asset management services is meaningful and has grown in scope. Services performed by investment consultants cover the entire investment process including designing policy statements, asset allocation, designing requests for proposals ("RFPs") used in the manager selection process, and performance management. Purchasers of hedge fund management services also find investment consultants to be an attractive alternative to the fund of fund model.

As their role within the asset management has grown, so has their level of influence on overall flows. STA agrees with the statement made by BlackRock in its May 2014 report, titled; "Who owns your assets":

> *"All of these recommendations materially impact the decisions of asset owners and may significantly impact asset flows across products or asset classes".*[2]

Separate from making recommendations on investment decisions, STA believes it is reasonable to assume that in periods of market stress the role of investment consultants in providing education on particular assets, managers, and the legally separate relationship of asset ownership and fund management, can contribute positively to the investment decisions of retail and institutional investors. STA believes that an informed and educated investor is more apt to make better investment decisions.

[2] BlackRock Viewpoint, May 2014, "Who Owns Your Assets?", pg 9.

**A willingness by regulators, with industry input, to define industry standards.**

The STA believes benefits can accrue to individual investors when regulators, with industry input, define industry standards in appropriate areas. Having defined regulatory industry standards ensures information is accurate and uniformly available. In addition, such standards foster private market solutions which transcend to lower costs.

The advancement of technology and its ability to capture and record large amounts of data has yielded tremendous benefits to the asset management industry. A manager's ability to measure and monitor factors critical to operating their business has improved since 2008. However, it is STA's general view that there is an affordability gap in the technological resources and budgets of large managers compared to small and mid-sized managers (as identified as $10 billion in AUM or less). While STA acknowledges that there will always exist a gap in the resources, it is our view that this gap can and should be narrowed. To be clear, STA is not stating that mid to small size managers pose a greater risk to the financial system as compared to large managers. Instead, we believe that benefits to overall soundness can accrue to the benefit of all asset managers in the presence of regulatory industry standards. The STA is encouraged by the willingness of regulators, with industry input, to identify appropriate areas.

For example, the Securities and Exchange Commission recently solicited industry input on how to design industry standards on disclosing order routing and execution quality information that institutional investors could request from their broker dealers. In an industry letter to the Commission dated October 23, 2015 by the Investment Company Institute ("ICI"), Managed Funds Association ("MFA") and SIFMA, such a template was proposed.[3] Assuming the Commission, after more industry input adopted such industry standards, information on order routing would be uniformly available.

**Robust levels of activity in areas where technological or procedure failures may reside.**

The Notice seeks comment on operational risk within the asset management industry. One specific area the Council seeks input is:

*Risks associated with the transfer of significant levels of investor accounts or assets from one manager to another.*

It is our observation that there is regular activity where investor accounts or assets move from one manager to another. This activity serves to assess the overall state of the technological soundness which supports these functions. Gross flows, which measure the movement of

[3] October 23, 2014 SIFMA, MFA, ICI letter to SEC Chair White, Re: *Customer-Specific Order Routing Disclosures for Institutional Investors*

investor owned cash and investments between managers, are sizable. In 2013, gross flows for worldwide mutual funds were more than $19 trillion dollars.[4] This is a significant amount of activity by any measure which we believe demonstrates that any operational risks associated with the transfer of significant levels of investor accounts or assets from one manager to another is low.

In addition, there have been several instances where a high profile manager change has resulted in a large amount of redemptions for that fund. STA is not aware of any abnormal disruptions to asset prices changes resulting from these instances. This leads us to believe that the existing policies in place around large scale redemptions or partial gates at asset management firms and hedge funds are effective.

**Conclusion**

As stated previously, the STA strongly believes that the asset management industry today is functioning properly and that there are no signs of significant deficiencies or an inability to perform its important function. We hope that as Council conducts its research into the asset management industry's products and practices it does so in a transparent manner that provides for industry input and empirical data.

Once again, we greatly appreciate the opportunity to offer comment on this important issue and look forward to working with the Council further.

Rory O'Kane
Chairman of the Board

James Toes
President & CEO

[4] BlackRock Viewpoint, May 2014, "Who Owns Your Assets?", page 12.