Federal Financial Analytics, Inc.

New Report Lays Out U.S. Systemic Standards for Big Asset Managers

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CONTACT: Tish Thomas (202) 589-0880

Federal Financial Analytics, Inc. has released the attached white paper on actions the Financial Stability Oversight Council (FSOC) will consider later today when it takes up systemic regulation for U.S. asset managers. As this report makes clear, FSOC has moved away from trying to designate individual asset-management firms as systemically-important financial institutions (SIFIs) – the industry has made this all but impossible from a political point of view.

Instead, FSOC has bowed not just to this opposition, but also to growing policy worries about firm-specific designation to focus now on identifying the activities and practices in which asset managers engage that – especially outside the scope of big-bank prudential rules – could pose systemic risk.

"I support this activity-and-practice" approach because it means that like-kind activities are governed in like-kind fashion, limiting the extent to which rules drive business to different financial-industry charters regardless of real risk," said the managing partner of Federal Financial Analytics, Karen Shaw Petrou. "This paper now takes our analytics

one step further to assess which asset-management operations are first-up for FSOC," she continued.

The Federal Financial Analytics white paper focuses in particular on the types of asset-management offerings that are under FSOC scrutiny. Leveraged funds, especially those in families of funds with "herded" risk are a major and immediate concern, as are asset-manager contributions to sponsored funds designed to show investors that the firm has "skin in the game." Credit-market effects of growing loan books in asset-management funds are also a top priority.

In the wake of new big-bank margin rules, FSOC is also looking at areas where asset managers have a competitive advantage over big banks subject to capital, liquidity, and similar standards, especially given growing concern about the ability of asset managers to handle orderly resolution if collateral is rehypothecated or commingled. The new margin rules for banks – which regulators believe will require an additional $300 billion in new collateral – come with added regulatory costs that do not apply to asset managers. As a result, non-cleared swaps – the risky trades regulators seek to curb – may gravitate outside banks to non-bank asset managers absent activity-or-practice regulation.

FSOC is also increasingly worried about the ability of the central counterparties (CCPs) to handle stress without downstreaming it to members which, if they are non-bank asset managers, may lack the capital and liquidity resources to handle it. "If a CCP blows, so does financial-market stability," Petrou said. "CCPs are more than all well and good, but

only if they can handle stress without downstreaming it to members, especially those without resources to take it on," she added.

Federal Financial Analytics, Inc. has provided objective advice on financial-industry policy and strategic issues since 1985. Clients include large financial-services firms, regulators, investors in this sector and others whose names may be found on the firm's website. The firm does not lobby for clients.

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