Financial Stability Oversight Council Work on Asset Management

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Context For Federal Register Notice

- Investment risk is inherent in capital markets, representing a normal part of market functioning.
- U.S. financial stability is the threshold consideration for action by the Council.
- Potential risks are generally consistent with areas of ongoing debate and conversations among industry, regulators, and other stakeholders.
- High-quality data is critical.

Liquidity & Redemptions

- The Council is evaluating whether structural features of pooled investment vehicles create a "first-mover advantage" that could make fire sales more likely, in particular in less-liquid asset classes.

- Sample questions:
  - Do pooled vehicles in less-liquid asset classes pose greater liquidity and redemption risks than others?
  - Could redemption incentives from pooled vehicles make fire sales of the portfolio assets, or of correlated assets, more likely than if the portfolio assets were held directly by investors?
  - What liquidity and redemption risk management practices do different types of vehicles use, and what factors or metrics do asset managers consider in assessing and managing liquidity risk?

Leverage

- The Council is interested in the degree to which the use of leverage by investment vehicles may increase the potential for forced asset sales, or expose lenders or other counterparties to losses or unanticipated market risks.

- Sample questions:
  - How could the use of leverage by investment vehicles increase the likelihood of forced selling in stressed markets?
  - What risk management practices do different types of investment vehicles use to monitor and manage leverage risks?
  - What are the best metrics for assessing the degree and risks of leverage in investment vehicles? What additional data or information would be useful?

Operational Risk

- The Council is exploring the potential risks associated with the transfer of significant levels of client accounts or assets from an asset manager, particularly in a time of stress.
- The Council is also interested in potential issues associated with asset managers relying on a limited number of affiliated or unaffiliated service providers for key functions.

- Sample questions:
  - What are the risks associated with transferring client accounts or assets from one manager to another and how do they vary depending on the nature of the client, the asset types, or how the asset is traded or cleared?
  - Do asset managers rely on affiliated or third-party service providers in a concentrated or exclusive manner for any key functions (e.g., asset pricing and valuation, portfolio risk modeling platforms, order management and trade processing, trading, securities lending agent services, and custodial services)?

Resolution

- The Council is interested in the potential risks that financial interconnections could present if an asset manager, investment vehicle, or affiliate were to become insolvent, declare bankruptcy, or announce an intent to close.

- Sample questions:
  - What financial interconnections exist within an asset management “complex” that could pose obstacles to an orderly resolution?
  - Could the failure of an asset manager or an affiliate provide counterparties with the option to accelerate, terminate and/or net derivative or other types of contracts of affiliates or investment vehicles that have not entered insolvency?