



March 25, 2015

Submitted electronically <http://www.regulations.gov>

Financial Stability Oversight Council
1500 Pennsylvania Ave., NW
Washington, DC 20220

Attention: Patrick Pinschmidt
Deputy Assistant Secretary for the Financial Stability Oversight Council

Dear Sir:

RE: Financial Stability Oversight Council Notice Seeking Comment on Asset Management Products and Activities (the "Consultation Paper")

Docket Number FSOC-2014-0001

We are writing to provide comments of the Members of The Investment Funds Institute of Canada in response to the Consultation Paper.

About the Institute

The Investment Funds Institute of Canada is the voice of Canada's investment funds industry. IFIC brings together 150 Canadian fund managers, distributors and service providers to foster a strong, stable investment sector where Canadian investors can realize their financial goals. The organization is proud to have served Canada's mutual fund industry and its investors for more than 50 years.

General Comments in response to Consultation Paper

We continue to believe that the risk of a mutual fund or mutual fund manager contributing to the instability of the financial system is purely theoretical, and for all practical purposes is a risk that is dispelled by the data. In all historical market conditions mutual funds and fund investors have not exhibited the behaviours that the Council advances as creating the potential for systemic risk.

Although we acknowledge the importance of assessing and identifying entities whose activities or participation in the markets could pose risk to the financial system in a market crisis, we maintain that regulation of capital markets participants is properly left to the capital markets regulators who best understand those markets and those entities that operate within them.

Inasmuch as the Consultation Paper seeks responses to specific questions about the U.S. market in the areas of liquidity and redemptions, leverage, operational functions and resolution, we will largely defer to the very detailed research and analysis that has been conducted by our colleagues at the Investment Company Institute ("ICI"), and fully endorse the analysis and the comments submitted in ICI's response to the Consultation Paper, and in earlier submissions. Nonetheless, given the high degree of similarity of Canadian retail mutual funds to U.S. mutual funds created under the Investment Company Act of 1940, a similarity which the Securities and Exchange Commission ("SEC") has long recognized in its rulemaking, we have in this letter provided general commentary about the inquiries in the Consultation Paper in an effort to counter the Council's notion that mutual funds and mutual fund management firms may pose risks to the U.S. financial system and should therefore be subject to prudential oversight by the Council.

We share ICI's concerns that the Council in the U.S., and the Financial Stability Board globally, are single-mindedly pursuing their systemic risk mandates through bank-oriented prudential measures, based largely on their familiarity with risks in the banking system. The apparent lack of familiarity with the distinguishing characteristics of the capital markets, in which market risk is an essential element that is necessary to generate investment returns, the participants in those markets, and the extensive and comprehensive legislation and regulation that applies to all aspects of their operations in those markets, leads us to recommend that the appropriate regulatory bodies to monitor and deal with any systemic risks generated in those markets is best left to the capital markets regulators.

In his remarks at a recent industry conference¹, SEC Commissioner Michael Piwowar stated:

“Despite incontrovertible evidence to the contrary, there is a continuing false narrative that one reason for the financial crisis was ‘the expansion of a largely unregulated “shadow banking system” rivaling the traditional banking sector in size.’ Yet capital markets have always been about risk and, in the United States, where capital markets are subject to a comprehensive system of regulation overseen by the Commission and the Commodity Futures Trading Commission, capital market-based financing has dominated bank-based financing.”

It is inappropriate to ignore the historical data presented by ICI that demonstrates unequivocally that mutual funds are not, and have historically not demonstrated themselves to be, systemically risky entities – a very different result than for banks and insurers. Mutual funds make little to no use of leverage; they do not fail in the way banks and insurance companies do; the structure and regulation of mutual funds and their managers protects investors and limits systemic risks and risk transmission; and historical data confirms mutual funds and their investors have never demonstrated the behaviours the Consultation Paper identifies as posing systemic risk. We note the striking absence of any data or academic research supporting the proposition that a mutual fund or mutual fund management firm poses risk to a domestic or global financial system.

Comments on the Council's identified areas of risk

It is appropriate to highlight the fundamentals of a mutual fund - it is a highly regulated collective investment vehicle that offers individual investors with similar investment objectives the ability to pool their money in a professionally managed, diversified portfolio of securities, allowing them to purchase or redeem shares of the fund at any time at the net asset value of the fund's portfolio of assets, established daily. The mutual fund's manager acts as the agent of the fund's shareholders, which means each investor, not the manager, bears the risks and rewards of the fund.

ICI's research and submissions addresses in detail the Council's focus on potential risk posed by the asset management industry in the four areas expressed in the Consultation Paper.

Leverage

A significant component of the comprehensive regulation of retail mutual funds is the detailed restrictions on the investment activities that are permitted to be carried out by such funds. We noted in our general comments that mutual funds make little to no use of leverage. We need only cite the Council's own confirmation in the Consultation Paper that, in the U.S., “the Investment Company Act constrains the amount of leverage that may be employed by mutual funds and other

¹ Michael S. Piwowar, remarks at the Investment Company Institute and the Federal Bar Association 2015 Mutual Funds and Investment Management Conference (March 16, 2015), available at http://www.sec.gov/news/speech/031615-spch-cmsp.html#_VRLJb2d0xes.

registered funds. Mutual funds may only incur indebtedness through bank borrowings with 300 percent asset coverage”.²

Operational Functions

The comprehensive regulatory structure also imposes rigorous controls over investment fund operations, particularly in the key areas of custody of portfolio assets, valuation of assets and portfolio management. Again the establishment and maintenance of the appropriate regulatory requirements and the detailed oversight of these functions and managers’ compliance is properly the bailiwick of the SEC. The SEC is, therefore, the appropriate regulator to assess those regulatory requirements for any weaknesses that could expose the financial markets to potential risks, and to remedy any weaknesses that may be identified.

Resolution

ICI data demonstrates that, in the U.S. each year and for a variety of reasons, hundreds of mutual funds are closed or merged, and dozens of fund managers exit the business, with no negative impact on the investors or the capital markets, and no requirement for government intervention or taxpayer assistance. When a mutual fund liquidates, it follows an established and orderly process to distribute its remaining assets *pro rata* to its investors and to wind up its affairs, in accordance with federal and state law requirements and under the oversight of the fund’s board of directors or trustees. When a fund manager exits the business, another manager simply assumes management of the funds. The closure of a mutual fund or a fund manager, therefore, creates no adverse impact on financial markets or the economy.

Liquidity and Redemptions

The Council identifies the “redeemable on demand” feature of mutual funds as the basis of a potential risk that, during a financial crisis, fund investors may redeem their holdings to such an extent that the fund is forced to liquidate its portfolio in a “fire sale” manner that might destabilize the markets. The manner in which a fund redeems shares, and the historical data, refute such a conclusion. On the contrary, the redeemable on demand feature makes liquidity management a fundamental and continuous fund manager function.

While each fund may apply a different approach, due to each fund’s unique liquidity profile, the following are relevant characteristics are common to all mutual funds, in particular U.S. funds, that prevent the outcomes suggested by the Council:

- *daily valuation* - a net asset value (“NAV”) is struck for each fund at the close of markets each business day,
- *forward pricing* - shareholders buy and redeem their fund shares at the next NAV that is struck after receipt of their purchase order;
- *minimum liquid security threshold* - requires that no less than 85% of a mutual fund’s portfolio assets must be assets that can be sold within 7 days at approximately market value; and
- *daily subscriptions* - on a daily basis new or existing fund shareholders subscribe to purchase new or additional shares.

In the case of money market funds, which in the U.S. appear to be used by shareholders in a similar manner to bank accounts, the SEC did identified potential concerns relating to liquidity and these funds’ ability to manage significant redemptions. To address these concerns, the SEC

² The Consultation Paper, at page 14.

introduced appropriate additional liquidity requirements, along with control measures that fund boards may use to better manage redemption activity in the event of a market event.

We urge the Council to thoughtfully consider ICI's detailed comments and the research and data that it has provided in support of its conclusions that mutual funds and fund managers pose no systemic risks to the financial markets of the United States.

The Canadian Approach

In support of our view that the SEC is the appropriate regulator of participants in the U.S. capital markets, including as to systemic risk considerations, we encourage the Council to consider the systemic risk framework for capital markets entities that is being adopted in Canada.

In Canada the constitutional power to regulate securities and capital markets rests exclusively with the provinces; as such there is no federal regulator akin to the SEC. Nevertheless the provinces have developed a reasonably harmonized set of securities laws and rules across the country. Recently the federal government, in conjunction with five participating provinces, issued draft framework legislation to create a single multi-jurisdictional capital markets regulator ("Capital Markets Regulatory Authority" or "CMRA"). The CMRA will oversee and enforce a uniform capital markets law in the participating provinces, and oversee and enforce across the country federal capital markets stability legislation which creates a systemic risk framework over capital markets products and capital markets participants. Although the details of the framework have not yet been released, and there will certainly be collaboration and cooperation among the CMRA, the Bank of Canada and the federal prudential bank and insurance regulator, the most noteworthy feature is that it will be the CMRA, in its role as capital markets systemic risk regulator, and not a bank or prudential regulator, that will assess systemic risk among capital markets participants and apply to designated entities additional oversight appropriate for capital markets participants.

Although we maintain, as explained above, that mutual funds and mutual fund managers do not pose a systemic risk to the financial markets, we believe the Canadian approach is the appropriate model for systemic risk oversight of the capital markets generally. We urge the Council to adopt a similar approach and allow the SEC to pursue its mandate of overseeing the U.S. securities markets, including assessment and remediation of any systemic risk concerns that may arise within them.

We thank you for considering our comments. Should you have any questions, or should you wish to discuss any of our comments in more detail, please feel free to contact me at jdelaurentiis@ific.ca or at (416) 309-2300, or Ralf Hensel, IFIC's General Counsel, Corporate Secretary and Vice President, Policy at rhensel@ific.ca or at (416) 309-2314.

Yours very truly,
THE INVESTMENT FUNDS INSTITUTE OF CANADA



By: Joanne De Laurentiis
President & CEO

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