U.S. TREASURY DEPARTMENT
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FINANCIAL STABILITY OVERSIGHT COUNCIL RELEASES STATEMENT ON REVIEW OF ASSET MANAGEMENT PRODUCTS AND ACTIVITIES

WASHINGTON – The Financial Stability Oversight Council (Council) today voted unanimously to release a statement providing a public update on its review of potential risks to U.S. financial stability that may arise from asset management products and activities. The statement details the Council's views regarding potential financial stability risks and next steps to respond to these potential risks. The Council's evaluation of risks focused on the following areas: (1) liquidity and redemption; (2) leverage; (3) operational functions; (4) securities lending; and (5) resolvability and transition planning.

"The Council was created to bring the financial regulatory community together to look across the entire system, ask tough questions, and address potential risks to financial stability before they materialize. Our analysis of asset management products and activities is a crucial piece of that work," said Treasury Secretary Jacob J. Lew, Chairperson of the Council. "As financial markets evolve, the nature of potential risks shifts, and we need to be vigilant in monitoring and understanding these changes. The analysis and views in this update harnessed the expertise of the Council members and their staffs, and we look forward to continued engagement with stakeholders as this work moves forward."

The Council's public statement builds on an extensive review of potential financial stability risks in the asset management industry, including the Council's May 2014 public conference and its directive to staff at its July 2014 meeting to undertake a more focused analysis of industry-wide products and activities. In December 2014, the Council published a notice seeking public comment regarding whether and how certain asset management products and activities could pose potential risks to U.S. financial stability.

During the executive session of its meeting, the Council received an update on the Council's 2016 annual report.

Finally, the Council voted to approve the minutes of its previous meetings on March 2 and March 21. Additional information regarding the Council, its work, and the recently approved meeting minutes are available at http://www.fsoc.gov.

Below is a selection of key Council views described in the public statement. The full public statement is available here.

Liquidity and Redemption Risk

The Council believes financial stability concerns may arise from liquidity and redemption risks in pooled investment vehicles, particularly where investor redemption rights and underlying asset liquidity may not match. To help mitigate these potential financial stability risks, the Council believes that the following steps should be considered:

- Adoption of robust liquidity risk management practices for mutual funds, particularly with regard to preparations for stressed conditions by funds that invest in less-liquid assets;
- Establishment of clear regulatory guidelines addressing limits on the ability of mutual funds to hold assets with very limited liquidity, such that holdings of potentially illiquid assets do not interfere with a fund's ability to make orderly redemptions;
- Enhanced reporting and disclosures by mutual funds of their liquidity profiles and liquidity risk management practices;
- Steps to allow and facilitate the use of tools by mutual funds to allocate redemption costs more directly to investors who redeem shares; and
- Additional public disclosure and analysis of external sources of financing for mutual funds.

The Council also believes that regulators should consider whether these or other measures may be appropriate for reducing potential liquidity risks in collective investment funds and similar pooled investment vehicles subject to their respective jurisdictions.

Leverage Risk

The Council's analysis of data from the SEC's Form PF showed that many hedge funds use relatively small amounts of leverage, but leverage appears to be concentrated in larger hedge funds, based on certain measures. The Council acknowledges that the relationship between a hedge fund's level of leverage and risk, and whether that risk may have financial stability implications, is highly complex. While reporting on Form PF has increased transparency, it does not provide complete information on the economics and corresponding risk exposures of hedge fund leverage or potential mitigants associated with reported leverage levels. In addition, hedge funds' major counterparties are regulated by various regulators with different jurisdictions. Therefore, no single regulator currently has all the information necessary to evaluate the complete risk profiles of hedge funds.

Accordingly, the Council believes further analysis is needed, and therefore is creating an interagency working group that will share and analyze relevant regulatory information in order to better understand hedge fund activities and further assess whether there are potential risks to financial stability. The working group will:

- Use regulatory and supervisory data to evaluate the use of leverage in combination with other factors – such as counterparty exposures, margining requirements, underlying assets, and trading strategies – for purposes of assessing potential risks to financial stability;
- Assess the sufficiency and accuracy of existing data and information, including data reported on Form PF, for evaluating risks to financial stability, and consider how the existing data might be augmented to improve the ability to make such evaluation; and
- Consider potential enhancements to and the establishment of standards governing the current measurements of leverage, including risk-based measures of synthetic leverage.

This group will seek to report its consolidated findings to the Council by the fourth quarter of 2016.

Other Areas of Council Analysis

With regard to operational risks, the Council focused on potential risks that may be associated with the use of service providers and believes that continued analysis is called for in light of the growing reliance on service providers, the concentration of some service provider markets, and the continuously evolving nature of their services. This analysis will include continued engagement with industry participants and other stakeholders and will seek to develop a greater understanding of service providers, their operating infrastructure, and the measures used by asset managers and other financial institutions to mitigate potential risks from service providers.

With regard to securities lending, the Council believes that more comprehensive information on securities lending activities across the financial system is necessary to fully assess the materiality of potential risks. A number of data collection and data enhancement efforts are already underway, and the Council encourages improved and regular data collection and reporting, interagency data sharing, and additional engagement with international counterparts.

With respect to resolvability and transition planning, the Council has identified potential risks associated with stress scenarios affecting asset management entities. Steps to address those risks are described in the context of the Council's consideration of liquidity and redemption risks and leverage risks.

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