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Australian Securities & Investments Commission

IOSCO and FSB's work on asset management and liquidity

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Investment Company Institute Global – Asia-Pacific Chapter Meeting, (Sydney, Australia)
4 November 2015

CHECK AGAINST DELIVERY

Introduction

Good evening, and thank you for the very kind invitation to speak tonight.

First, I want to personally acknowledge and thank Dan for his tireless advocacy of the interests of your industry during a period of very intense focus by policy makers on asset management and the risks it is said to pose.

This advocacy has, I think, contributed to the positive developments we have seen over recent months in the international policy debate.

I'd like to do three things tonight:

- first, to revisit why global policy makers have been focussing on asset management
- second, to outline the work the Financial Stability Board (FSB), on which I sit, is currently doing in this space, and
- third, to outline the work IOSCO, which I Chair, is doing.

Why the focus on asset management

Let me first briefly outline the recent history of policy maker interest in asset management.

You will of course all be aware of the Group of Twenty (G20) and the Financial Stability Board (FSB)'s post-crisis interest in understanding and addressing the sources of risk to the stability of the global financial system following the global financial crisis. This work focused initially on identifying and addressing the risks posed by the largest global banks and insurers.

With this work winding up, the interest shifted back in 2013 to identifying the risks posed by other parts of the financial services sector, particularly asset management.

The Investment Company Institute, IOSCO and industry more generally, were rightly concerned about the FSB's work in this space – and particularly its efforts to designate asset managers and their activities as systemically important.

IOSCO decided at its Board meeting in June this year to push back on the FSB's focus on designation. We urged the FSB to first focus on better understanding the activities of asset managers and the risks they pose before going down the designation route.

In pushing back, we made three points.

- The first was that the FSB should only be considering or making recommendations after a careful and informed analysis of the available evidence. This should include consideration of the experience and expertise of securities regulators. This was clearly not happening.
- The second was our belief that financial stability risks posed by asset management were being overstated. We felt that the tools asset managers and regulators have to address run risks were not being properly recognised.
- The third and most obvious was that if we get to the point of having to regulate, the FSB must recognise funds are not banks – and they should be regulated differently.

Our efforts were successful. The FSB decided in July to put the designation work on hold, pending a more thorough analysis and understanding of the systemic risks asset management activities pose.

It is worth noting that the early work in this space has been undertaken in the context of concerns about market liquidity – particularly in corporate bond markets. The concern has been that that asset management might be amplifying those risks and threatening systemic stability (particularly given the prospect of changes in US monetary policy later this year). This concern has driven where this work has gone.

Current FSB activity

Let me now turn to what the FSB has been doing since the change in direction in July. They have taken the more constructive evidence-based path we had urged. They have also agreed to a greater role for securities regulators in this work. We now have wider and more vocal representation in each of the main work streams at the FSB.

The FSB's work has been divided into two streams:

- one driven by the Standing Committee on Assessment of Vulnerabilities (SCAV), and
- the other by the Standing Committee on Supervisory and Regulatory co-operation (SRC).

Standing Committee on Assessment of Vulnerabilities (SCAV)

Let me first turn to the work of SCAV. This work has been about better understanding near term market liquidity issues and contingency plans key managers have in place to address those issues. This work – which is now completed – has acknowledged two key points.

- The first is that asset sales of open-ended funds are unlikely to be large enough on their own to lead to a systemic event – and that large redemptions in bond funds may not occur even in an adverse risk scenario.
- The second is that liquidity mismatch does not appear to have been a source of vulnerability in the past.

This work was informed by some great work by IOSCO's Committee on Emerging Risks who provided a number of examples of how liquidity management tools have been used during periods of actual stress; examples which underscored the resilience of the sector.

This work is likely to lead to the official sector doing no more at this stage than highlighting to those it regulates the importance of robust liquidity-management measures – and stress testing in particular – when flagging the near term risks associated with liquidity stresses.

Standing Committee on Supervisory and Regulatory Co-operation (SRC)

Turning now to the work of the SRC. Their work is a longer-term project focused on the structural vulnerabilities associated with asset management activities. The work has been divided into three key sub streams looking at three possible sources of structural vulnerability. Specifically:

- liquidity mismatch between fund assets and fund units, and associated run risks
- leverage in funds, and
- operational risks and challenges in transferring assets between managers.

This work is being complemented by two exploratory work streams – one on pension and sovereign wealth funds the other on securities lending activity.

Recommendations – if any – about policy work in this space are expected in the first quarter of next year.

It is worth noting that the main work streams are being jointly led by markets regulators – with ASIC leading the work stream on liquidity mismatch. Our input is critical. It means the recommendations we end up with will have the benefit of expertise in asset management markets and how they are regulated.

IOSCO's work

Let me turn, finally, to some of the other work IOSCO is undertaking in the asset management space. I want first to mention two pieces of work which we've undertaken in the context of our current work with the FSB.

The first is work to understand and address the gaps in the information we collect about asset management activity. We've established a small group which will be developing guidance on the data regulators should be capturing to help us monitor and better understand the risks we might be facing in your space. This will help us – in the longer term – to address some of the misunderstandings and preconceptions which have driven the debates in this area to date.

The second is a study about how liquidity is in fact being managed by asset managers. We will soon be publishing the results of a survey of 35 members about the ways in which liquidity is managed in their jurisdictions. Our report will identify the widespread use of pre-emptive tools (such as rules on eligible assets, liquidity thresholds, leverage and stress testing) and tools addressing run risks (including gates, fees, side pockets and suspensions)

We are also actively looking at other issues in the asset management space. For instance, we:

- recently published a report, *Good practices for reducing reliance on CRA's*[1] *in asset management*
- will shortly publish a report on good practices for custody of collective investment schemes (CIS) assets, and
- will also continue our work on fees and expenses for CIS's and on termination of CIS's, with work in both areas expected to be finalised next year.

Of relevance to the more general issue of liquidity, IOSCO has also embarked on a comprehensive market survey of industry and regulators on secondary market liquidity for corporate bonds. This should allow IOSCO to:

- assess whether liquidity has decreased
- understand why liquidity has decreased and whether the decrease might continue, and
- hear from industry about whether markets can solve this or whether regulatory action is needed.

This work can also be fed into the FSB deliberations on structural vulnerabilities and will add to the quality of the proposals that are being worked.

[1] Credit rating agencies.

Conclusion

To conclude, I think the debates in asset management this year have shown the benefits of ensuring a concerted and co-ordinated focus on evidence-driven policy making. The debate has highlighted the importance of three things:

- The first is ensuring the FSB recognises the need for any work in this space to be informed by a full and careful analysis of how markets are working and how they are regulated.
- The second is ensuring the FSB engages with IOSCO in policy affecting securities markets.
- he third is ensuring we continue to work the way we have with industry to ensure your voice is heard.

Again, thank you for the opportunity to speak. I'm very happy to take questions and to carry on discussing these points through the evening.