Regulation of asset management companies

Ronald Anderson
London School of Economics

Remarks at CEPS "Business and regulatory challenges for the asset management industry"

10 March 2016

Macroprudential Regulation of institutionally managed funds?

- Lessons from the crisis
  - Non-bank credit creation fed excessive leverage and maturity transformation
  - Very heterogeneous institutions ensnared in market linkages.
  - Bear Stearns and Lehmann (IB’s regulated by SEC), AIG (insurance), money market mutual funds, Fannie Mae & Freddie Mac (sub-sovereign mortgage wholesalers), IKB (industrial bank), Northern Rock (home loan institution), WestLB (Landesbank), Greece (sovereign).

Macroprudential regulation of non-banks

- But how?
- “Regulate shadow banks” naïve.
  - Shadow banking is a process.
  - Market reaction. Innovation.
  - Futility of “regulating everything that moves”.
- Trying to increase transparency to identify new areas of systemic risk.
  - Trade repositories (EMIR, Dodd-Frank)
  - Reporting of securities financing transaction (Repo, SecLending)

What are the possible policy responses to perceived systemic risks?

- Regulatory Transparency → Public Transparency → Market Discipline?
  - Yes, but…Free rider problem.
- More active policy instruments?
  - “regulate risky behaviour not institutions”
    - E.g., tax on repos
  - But how? Where?
  - ESRB and FSOC do not have power to intervene whatever, wherever and whenever.
  - Pro-active coordination of diverse authorities? Hard to overcome institutional inertia.
  - Need a defined authority to intervene in specified institutions
    - (US capital surcharge based on reliance on repos…but only for SIFI’s)

SIFI designation of asset managers?

- FSB consultation paper (February 2015)
- Three channels of risk transmission:
  - *Counter-party channel*
  - *Market channel*
  - *Critical functions channel*
- But what entities?
  - funds
  - family of funds
  - asset managers on a stand-alone entity basis
    - (main focus of consultation)
  - asset managers and their funds collectively

Case against macropru of AMCs

- The AMC manages the clients' investments in funds but the client money is held in segregated accounts that are bankruptcy remote from the AMC.
- The management of the fund can be transferred (sold) to an alternative manager without much difficulty.
- The AMC's themselves do not have big balance sheets and are not particularly highly levered.
- Yes, there can be problems if segregation of client accounts has not been respected. But this is an issue of financial conduct not prudential regulation.
- Even very big fund managers have failed without major disruptions to the markets.
  - Example, MF Global managed both customer funds and proprietary funds taking large levered bets in European periphery bonds. Its bankruptcy in 2011 was one of the largest when measured by total assets held. However, its collapse did not result in a crisis. Its bankruptcy was settled in 2013 with claimants receiving 93 cents on the dollar.
-

Case in favour of macropru of AMCs

- Fast growth of fund management. Global links. (Haldane)
- Some funds use substantial leverage and maturity mismatch (eg., many synthetic ETFs)
- MF Global was a “near-miss”. Avoided the worst because effort underway to resolve the sovereign debt crisis.
- Problem of herding (Feoli, Kashyap Schoenholtz and Shin “Market Tantrums and Monetary Policy”).
- Fund managers can extend credit to investors in the funds that they manage, opening up a channel for spill-over of AMC insolvency to fund withdrawals.

Case in favour of macropru of AMCs (continued)

- AMCs supply market liquidity to funds. May provide liquidity backstops (Cunliffe speech October 2015).
- AMCs may centralize order execution across funds (e.g., cross trades internally). This process may be disrupted if the AMC fails and its funds are transferred to different fund managers who are unable to quickly reproduce this operating facility. Bankruptcy of AMC will reduce the value of funds because of loss of liquidity.
- More generally, failure of an AMC could provoke a withdrawal of investors in the funds they manage. Investors unsure about the links of AMC, managers and funds.
- AMCs systems give valuable access to interlinkages in large segments of the market. More tractable than new regulatory data sets.

Regulation of asset management companies

Ronald Anderson
London School of Economics

Remarks at CEPS "Business and regulatory challenges for the asset management industry"

10 March 2016