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The Honorable Janet L. Yellen
Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

The Honorable Thomas J. Curry
Comptroller of the Currency
400 7th Street SW
Washington, D.C. 20219

The Honorable Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Office of Financial Research Report "Asset Management and Financial Stability" (September 2013).

Dear Chair Yellen, Comptroller Curry, and Chairman Gruenberg:

The American Bankers Association (ABA) would like to share some thoughts on the September 2013 report of the Department of the Treasury's Office of Financial Research (OFR), *Asset Management and Financial Stability* (Report). The OFR published the Report in response to a request by the Financial Stability Oversight Council (FSOC or Council) after the Council had, "decided to study the activities of asset management firms to better inform its analysis of whether—and how—to consider such firms for enhanced prudential standards and supervision under Section 113 of the Dodd-Frank Act." On September 30, 2013, the Securities and Exchange Commission (SEC) announced that it was seeking public comments about the Report. ABA wishes to comment. In particular, we wish to direct comments to the FSOC Members whose agencies have principal responsibility for regulation and examination of our member institutions.

ABA represents the interests of banks, savings associations, and trust companies (collectively, banks) of all sizes and business models, including institutions whose primary or significant business lines include asset management services. Banks with trust powers have long provided these services to trusts, estates, families, charitable organizations, employee benefit plans, and governmental entities. They have done so while subject to a fiduciary duty as prescribed by applicable common law, state statutes, banking regulation, and the Employee Retirement Income Security Act of 1974 (ERISA).

Fiduciary Activities of Banks

The Report identifies what it considers to be a number of risks to domestic financial stability from the provision of asset management services by various institutions, including banks. The risks, or vulnerabilities, identified include (1) "reaching for yield" and herding behaviors, (2) redemption risk in collective investment vehicles, (3) use of leverage, and (4) asset management firms as a source of risk. As many others have commented in letters to the SEC, the Report makes broad statements and conclusions about these potential systemic risks without giving adequate consideration to their relative likelihood or to the moderating influence of existing regulation and supervision, including the role that the Federal Reserve, the OCC, and the FDIC have long played in monitoring and supervising bank management of these activities. For example, the Report states that asset managers may "seek higher returns by purchasing relatively riskier assets than they would otherwise for a particular investment strategy" or may "crowd or 'herd' into popular asset classes or securities" magnifying "market volatility and distress if the markets … face a sudden shock."[1]

Although the Report notes that regulatory restrictions and practices can mitigate such risks, there is little discussion of the fiduciary obligations imposed on banks by applicable common law, state statutes, banking regulation and guidance, as well as ERISA. When providing these services, banks are and have been governed by heightened fiduciary obligations while simultaneously investing in a manner consistent with widely accepted modern portfolio theory and the particular investment strategy of that account.

Under guidance and regulations for banks, national and state-chartered banks that provide investment advice for a fee are acting in a fiduciary capacity. [2] As such, these institutions must conduct periodic

[1] Report, page 9.

[2] Office of the Comptroller of the Currency 12 CFR Part 9; Federal Deposit Insurance Corporate Trust Examination Manual; and Federal Reserve Board of Governors Commercial Bank Examination Manual Section 4200 (citing 12 CFR Part 9 as being "considered the industry standard for fiduciary activities of all financial institutions operating in the United States.").

reviews of the administration of the account (administrative review) and the appropriateness of the account's assets (investment review). This fiduciary and regulatory regime mitigates what pressure there might be to "herd" clients into popular asset classes or invest in riskier assets than otherwise by imposing on the bank an obligation to consider the individual investment needs of the accounts and legal liability for not acting prudently. According to OCC Bulletin 2008-10, the investment review process should ensure that account investment objectives are current and appropriate, that investments are consistent with those objectives, and that the investment review provides for an annual assessment of the portfolio in its entirety. In other words, the accounts should be given appropriately individualized management and not simply "herded" into certain classes.

In addition to the moderating influence of fiduciary obligations and banking regulation, it is important to note the examination of banks by the FSOC Member agencies. The Report does not even acknowledge the fact that bank trust departments are examined at least once every twelve months, or once every eighteen months for smaller institutions, by specially-trained trust or asset management examiners. At a minimum, the frequency of examinations should be explicitly considered a significant factor in the relatively likelihood of the Report's identified risks.

Bank Common Trust Funds and Collective Investment Funds

The Report makes a number of comments, implicit and explicit, that mischaracterize bank common trust funds and collective investment funds. For example, on page 13, the Report refers to short-term investment funds (STIF) as a "money-like" option for investors without appropriately recognizing the fact that these funds are not available to the general investing public. Indeed, only eligible investors may participate in these funds, which are limited to accounts where the bank serves in a fiduciary capacity or to qualified employee benefit plans. On page 17, the Report broadly states that "unregistered funds and accounts are not subject to" regulatory restrictions on leverage, failing to acknowledge the inherent fiduciary duty governing the bank manager of the unregistered fund. Such obligations will often discourage the bank fiduciary from employing leverage with common trust funds and collective investment funds even if there are no regulatory restrictions.

Lastly, ABA would comment on the bullet point on page 28, that states, "Bank common and collective investment funds are similarly excluded from rules under the 1940 Act, but, as noted earlier, are *often* subject to rules established by banking regulators." [Emphasis added]. The statement implies that these bank funds are not subject to the same level of oversight to which registered funds are subject. As you know, that is far from being the case. Again the Report does not give consideration to fiduciary obligations and constraints, which can be as important as banking regulation to bank trustees of these funds. We hope that these particular references to bank common trust funds and collective investment funds do not leave the wrong impression with the FSOC or the general public.

Conclusion

We appreciate this opportunity to share our comments on the Report with the FSOC Members whose agencies have principal responsibility for regulation and examination of our member institutions. We wish to highlight the fact that banks with trust powers have long provided asset management services to the public while subject to a fiduciary duty under applicable law. The Report should have given more consideration to the moderating influence of those fiduciary duties, as well as the existing regulatory and examination structure. In addition, we hope that the references to bank common trust funds and collective investment funds do not leave the wrong impression with the FSOC and the general public.

Sincerely,

Cecelia A. Calaby
Senior Vice President