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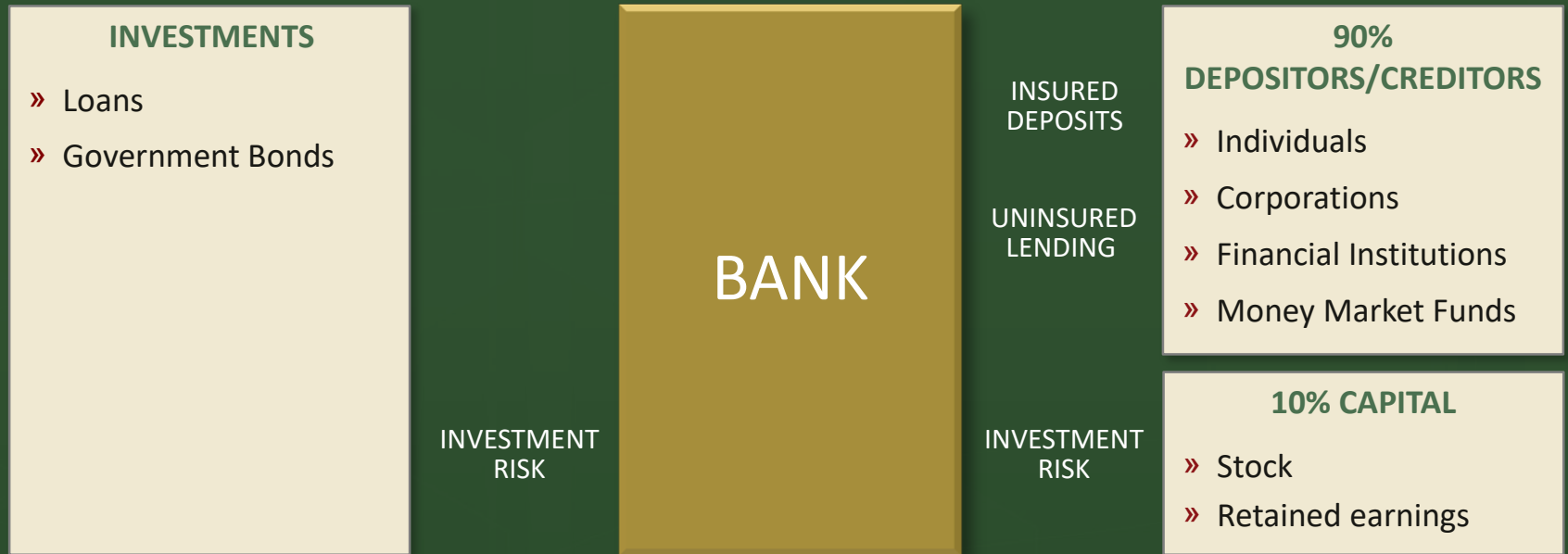
Global Risk Assessment for Pensions and Other Nonbank Financial Institutions

Dan Waters
Managing Director
ICI Global

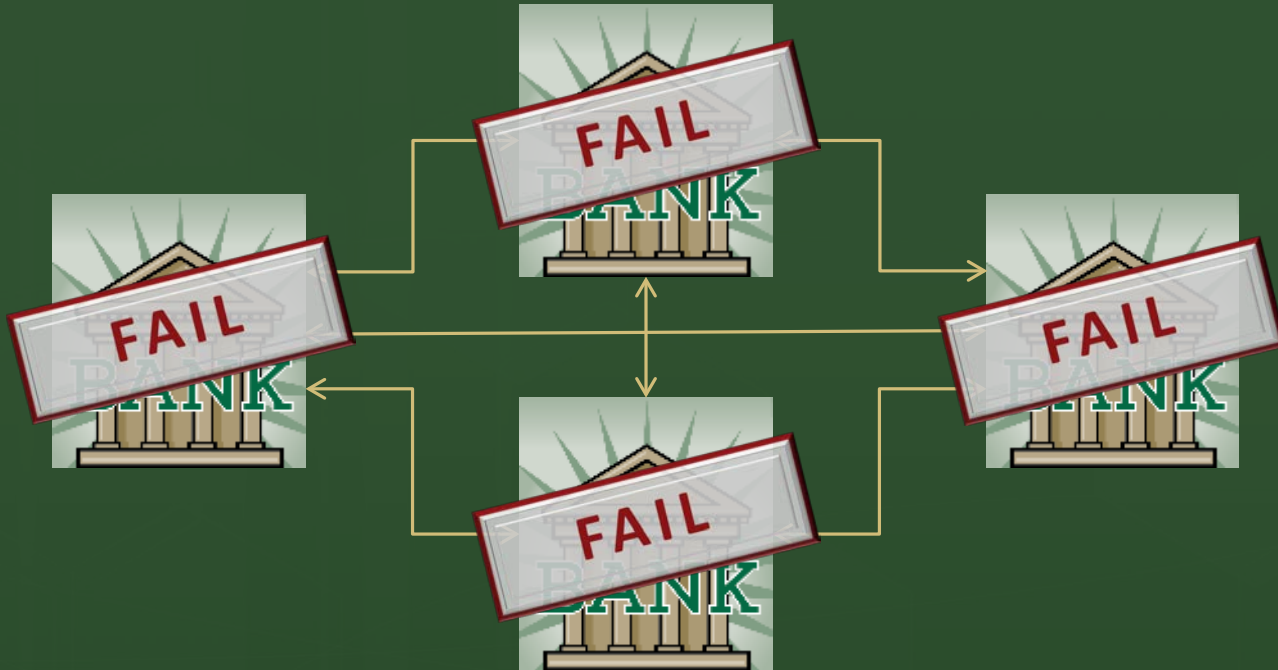
What Is Systemic Risk?

- » The risk that a firm or group of firms will fail and disrupt the financial system's ability to funnel capital from investors to borrowers, thus causing damage to the broader economy
- » Policymakers initially focused on the banking sector, but now are focusing on asset managers and their products, which could affect pension funds

What's the Banking Process?



What Happens When Banks Fail?



Asset Management: Who Are the Investors?

- » Individual investors, high-net-worth households, trusts
 - » 93 million Americans invest about \$18 trillion in mutual funds, ETFs, and closed-end funds
- » Endowments, foundations
- » Pensions, including 401(k)s, defined benefit plans
 - » Most of the nearly \$25 trillion in US retirement assets is invested in an asset-managed product
- » Corporations, state and local governments, sovereign wealth funds
 - » 20% of corporate cash held in money market funds
 - » Sovereign wealth funds hold \$5 trillion

How Do Asset Managers Deliver Services?

- » Publicly offered funds (mutual funds, ETFs, closed-end funds) issue shares that give pro rata interest in the fund's pool of assets
- » Privately offered funds (hedge funds, private equity, venture capital, real estate funds) issue pro rata interests in the fund's pool of assets
- » Collective investment funds issue pro rata interests in the fund's assets
- » Separate accounts engage an asset manager to oversee securities owned directly by an investor

What's the Asset Management Process?



What Are the Structural Implications of This Analysis?

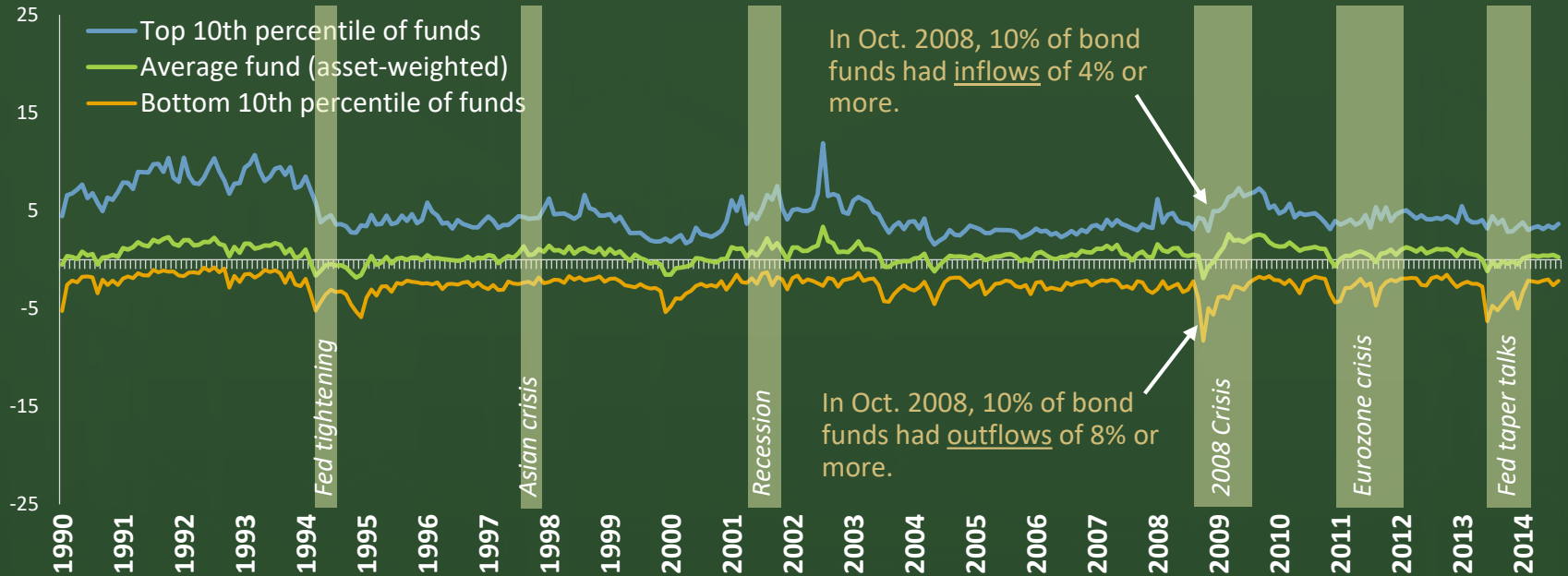
- » Asset managers agents, investing at the direction of their clients
- » Asset managers generally do not take on investment risk with their own balance sheets
 - » Investment risk remains with clients
 - » Asset managers do not guarantee or promise a return of capital or a rate of return on investments
 - » Asset managers have no government safety net
- » Publicly offered funds, such as mutual funds and ETFs, use little or no leverage
- » Asset managers are not banks

How Does Regulation of Publicly Offered US Funds Limit Risk?

- » Funds are regulated under all four major securities laws—in particular, Investment Company Act
- » Fund regulation protects shareholders—and reduces potential for systemic risk
 - » Funds' borrowing and leverage are strictly limited
 - » Funds are required to have a simple capital structure
 - » Liquidity, daily mark-to-market valuation, diversification help funds meet redemptions in orderly and fair manner

Total Net Bond Fund Flows Are Modest in All Markets—Calm or Troubled

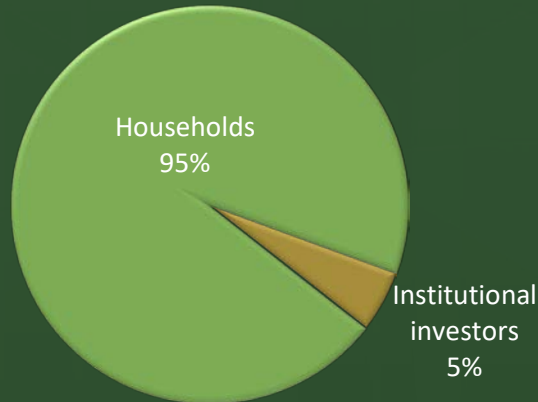
Flows as a percentage of assets; monthly, January 1990–August 2014



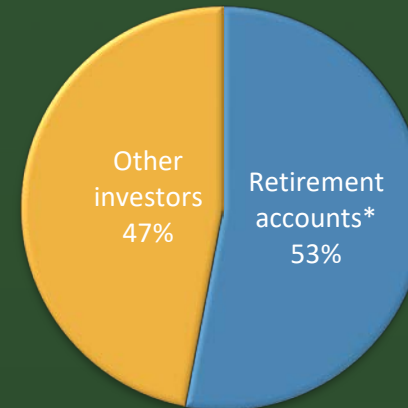
Source: Investment Company Institute

US Equity and Bond Mutual Fund Investors Are Households, Retirement Savers

Household and institutional ownership of US stock and bond mutual funds



Retirement account holdings of US stock and bond mutual funds



US stock and bond mutual fund assets: \$13.1 trillion

*Retirement accounts includes defined contribution plans, e.g., 401(k) plans, as well as IRAs.

Note: Figures report percentage of assets. Data are for December 2014 and exclude assets in exchange-traded funds.

Source: Investment Company Institute

How Do Funds Manage Liquidity and Redemptions?

- » Funds have many tools to counter first-movers:
 - » Mark-to-market pricing and fair valuation requirements
 - » Bid-pricing—used by 50% to 60% of mutual funds
 - » Redemption fees
 - » Offsetting redemptions with new sales
 - » Managing market exposure through derivatives
 - » Redemptions in kind—standard for ETFs and can be used by mutual funds
- » And selling fund shares is not risk-free for investors