

Asset Management and Systemic Risk*

Thierry Roncalli
Department of Economics
University of Évry, France

Guillaume Weisang
Graduate School of Management
Clark University, MA, USA

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Abstract

As regulators around the world progress towards prudential reforms of the global financial system to address the issue of systemic risk, the sweeping scope of the task touches areas and actors of the financial markets that have typically not been seen as systemically important before. The idea that the asset management industry can contribute to systemic risk is new, and warrants detailed examination in order to shape adequate policies. In this paper, after reviewing the definition of systemic risk and how systemically important banks and insurance are designated, we review the activities of the asset management industry and the ways they can contribute to the transmission of systemic risk. We then look in detail at the March 2015 proposal by FSB-IOSCO for an assessment methodology for the identification of non-bank non-insurance systemically important financial institutions. We compare and discuss with empirical data how the methodology fares against what the literature and the aftermath of the 2007-2008 crisis reveals about the role of the asset management industry in contributing to systemic risk. We find that the current proposal in part fails to adequately identify natural candidates for the “systemically important” designation and perhaps confuses large institutions with systemically strategic institutions giving wealth loss too much importance over the potential for “real” economic disruption and market dislocation. Finally, we call for a more robust and risk-sensitive approach to identifying systemically important financial institutions.

Keywords: Systemic risk, SIFI, asset managers, asset owners, interconnectedness, liquidity risk, reputational risk, business risk, counterparty credit risk, market risk, liquidation period, index funds, money market funds, exchange traded funds, hedge funds.

JEL classification: G01, G18, G23.

1 Introduction

The 2007-2008 financial crisis that precipitated the Great Recession can be seen as the superposition of the subprime crisis, affecting primarily the mortgage and credit derivative

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