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June 28, 2013

Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Re: Supervisory Framework for Measuring and Controlling Large Exposures

Dear Sir or Madam:

The Investment Company Institute ("ICI")[1] and ICI Global[2] appreciate the opportunity to comment in response to the Consultative Document ("Consultative Document") published by the Basel Committee on Banking Supervision entitled *Supervisory framework for measuring and controlling large exposures* ("Framework").[3]

On behalf of our member funds—which are both issuers of securities and major investors in the financial markets around the world—ICI and ICI Global have engaged actively with policymakers on a broad range of legislative and regulatory issues emanating from the global financial crisis. Our members have a strong interest in efforts, such as the Framework, to promote a strong and well-regulated global financial system. To this end, we support the Framework's goals of strengthening banks' monitoring and management of counterparty and concentration risks. At the same time, we have concerns about the potential implications of the Framework's proposed treatment of banks' investments in regulated funds and other investment vehicles. Our comments focus in that area.

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[1] ICI is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds ("ETFs"), and unit investment trusts ("UITs") registered under the Investment Company Act of 1940 ("Investment Company Act").[1] ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of U.S. registered funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $15.2 trillion and serve more than 90 million shareholders.

[2] ICI Global is the global association of regulated funds publicly offered to investors in leading jurisdictions worldwide. ICI Global seeks to advance the common interests and promote public understanding of global investment funds, their managers, and investors. Members of ICI Global manage total assets in excess of U.S. $1 trillion.

[3] Basel Committee on Banking Supervision, *Supervisory framework for measuring and controlling large exposures* (March 2013), available at http://www.bis.org/publ/bcbs246.pdf.

Proposed Treatment of Collective Investment Undertakings, Securitizations and Other Vehicles

Look-Through Approach

The Consultative Document outlines a "look-through" approach ("LTA") that would apply to bank investments in certain vehicles, such as collective investment undertakings and structured finance vehicles, that themselves invest in underlying assets. Under this approach, banks first would need to determine whether the vehicle's underlying assets meet a "granularity" test. As described in the Consultative Document, "a transaction may be considered sufficiently granular if its largest underlying exposure does not exceed 1% of the total value of the transaction (i.e. the threshold being applied to each individual underlying asset)."[4] In that event, the bank would not be required to "look through" and consider its exposure to the underlying assets for purposes of the large exposure limit. If one underlying asset were above the 1% threshold, however, the bank would have to apply the LTA to *all* underlying assets held by the vehicle, adding the bank's indirect exposures to those assets to any other direct or indirect exposures that the bank has to the same assets. Recognizing that the LTA may not be feasible in all cases, the Framework provides that where a bank cannot look through to all underlying assets, it would have to treat those exposures as an "unknown client," aggregating all unknown exposures as if they related to a single counterparty to which the large exposure limit would apply.

ICI and ICI Global understand that, in some situations, a bank's investments could result in indirect exposures that would have a material impact on the bank's large exposures. We are concerned, however, that compliance with the LTA as proposed would be unduly burdensome, and in some cases impossible, and thus could discourage banks from investing in certain types of vehicles. For example, under U.S. Securities and Exchange Commission ("SEC") rules, registered mutual funds and closed-end investment companies are required to disclose their portfolio holdings on a quarterly basis, within 60 days after the end of the quarter.[5] Thus, a bank that invests in such a fund would not have real-time access to portfolio holdings information and might have to treat its investment in the fund as an "unknown client."[6] The effect could be to deter banks from investing in these U.S funds and other, similarly regulated non-U.S. funds, a result that would not seem to further the goals of the Framework.

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[4] Consultative Document at 21.

[5] *See* Section 30(e)(2) of the Investment Company Act of 1940 and Rules 30e-1 and 30b1-5 thereunder. Money market funds are required to disclose on their websites their portfolio holdings on a monthly basis, within five business days after month end. *See* Rule 2a-7(c)(12)(ii); Form N-MFP under the Investment Company Act.

[6] The Consultative Document indicates that underlying assets could remain fully or partially opaque and states that "this situation is deemed undesirable." Consultative Document at 22. We note that the frequency and timeliness of U.S. registered fund portfolio holdings disclosure reflect the SEC's carefully considered policy judgment. When it adopted requirements increasing the frequency of required portfolio holdings disclosure from semi-annually to quarterly, the SEC stated: "We are not requiring more frequent portfolio disclosure [than quarterly], or a shorter delay [than 60 days], because we take seriously concerns that frequent portfolio holdings disclosure and/or a shorter delay for the release of this information may expand the opportunities for predatory trading practices that harm fund shareholders." See *Shareholder*

We support the recommendations with regard to the proposed LTA in the joint comment letter dated June 28, 2013 filed by The Clearing House Association, the American Bankers Association, the Global Financial Markets Association, The Financial Services Roundtable, International Swaps and Derivatives Association, Inc., and The Structured Finance Industry Group (collectively, "Associations"). The Associations recommend replacing the proposed LTA with a "Pillar 2" approach under which banks would monitor and document their exposures at the underwriting stage, if applicable, and thereafter on a quarterly basis to monitor changes in exposure size. Alternatively, they recommend narrowing the scope of the LTA and excluding registered mutual funds and other types of funds that are subject to stringent regulatory regimes intended to minimize risk, leverage, and conflicts of interest. Either of these alternative approaches would address our concerns with the LTA as proposed.

Assessment of "Additional Risks"

The Consultative Document asserts that in addition to the potential exposure risks associated with underlying assets, "additional events" related to third parties can pose risks to banks that invest in certain types of investment vehicles, such as investment funds. The Framework thus would require banks to "assess possible additional risks that do not relate to the identification and exposure measurement of the structure's underlying assets." As an example of such a risk, the Consultative Document states that:

> in the case of investment funds, the risk might arise that the bank suffers losses because of fraud on the part of the fund manager. Such losses might occur even in a situation where these funds are appropriately diversified and the assets are performing well in terms of returns. *By investing in multiple funds managed by the same manager, a bank might become excessively concentrated vis-à-vis this individual manager*.[7]

ICI and ICI Global disagree with the suggestion that investing in multiple regulated funds with the same manager would subject a bank (or other investor) to concentration risk vis-à-vis the fund manager. In the case of U.S. registered investment companies, for example, an investment in a fund does not expose the investor to risk associated with the welfare of the manager (or the welfare of other funds managed by the same manager). Each fund is a separate legal entity and each fund's assets must be held in a separate account by a custodian (normally a bank) meeting strict requirements. Similar requirements typically apply to regulated funds in other jurisdictions. In the highly unlikely event that

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Reports and Quarterly Portfolio Disclosure of Registered Management Investment Companies, SEC Release No. IC-26372 (February 27, 2004), available at http://www.sec.gov/rules/final/33-8393.htm, at p. 14.

[7] Consultative Document at 24 (emphasis added). The Consultative Document further indicates that where the identity of the fund manager constitutes an additional risk, "the manager would have to be regarded as a distinct counterparty so that the bank's investments to all funds managed by this manager would be subject to the large exposure limit, with the exposure value being the total value of the investment." *Id.*

a U.S. registered fund's manager were to go bankrupt, the fund's assets would be transferred to another manager, subject to fund board approval, through a procedure that is governed by the Investment Company Act of 1940 and is outside the manager's bankruptcy proceeding.

The Consultative Document acknowledges that there may be cases in which "the identity of the manager may not comprise an additional risk factor - for example, if the legal framework governing the regulation of particular funds requires separation between the legal entity that manages the fund and the legal entity that has custody of the fund's assets." While this statement is helpful, we are concerned that the Consultative Document portrays these circumstances as the exception rather than the rule. As a result, the Framework may place an unnecessary burden on banks to assess immaterial or nonexistent risks.

In their comment letter, the Associations recommend removing the "additional risks" requirement. They express the view that it duplicates regulatory mechanisms that are already in place to address fraud and other operational risks. We support removing the requirement as it would eliminate the concern described above. Alternatively, if the final version of the Framework requires banks to assess "additional risks" that may be associated with fund managers for purposes of the large exposure limits, we recommend that it expressly exclude from this requirement managers of U.S. registered investment companies or other regulated funds that are separate legal entities and whose assets must be held in custody according to applicable regulatory requirements.

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We thank you for this opportunity to share our views. If we or our members can be of further assistance as you consider this important matter, please do not hesitate to contact the undersigned.

Sincerely,

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