fefsi
fédération européenne des fonds et sociétés d'investissement
european federation of investment funds and companies
europäische investmentvereinigung

Mr. William J. McDonough
Chairman
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Bank for International Settlements
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Berlin, 31 May 2001

Dear Mr McDonough,

BIS Consultative document: The New Basel Capital Accord, January 2001

FEFSI[1] welcomes the opportunity to comment on the second consultation of the Basel Committee on Banking Supervision on the proposal for a revised regulatory capital regime.

FEFSI is very concerned, however, on several counts about the impact of capital requirements on the European investment fund industry, especially given the singling out of a new category of risk (i.e. operational risk) that according to the consultation would require a significant and yet to be accurately defined capital charge.

A level playing field

The Basle Committee proposal for a new Accord has been designed to apply only to the banking industry and its affiliated entities. If this, as we understand, includes such entities dedicated to the management of investment funds, it would constitute an important distortion of competition as fund management companies that belong to insurance groups or to non-financial services groups would be excluded from the scope of the new Capital Accord. We believe that it is imperative that a level playing field in the investment fund business must be maintained and therefore strongly urge the Basle Committee not to include investment funds in the scope of the

[1] FEFSI, the *Fédération Européenne des Fonds et Sociétés d'Investissement*, represents the interests of the European investment funds industry. Through its members, the national associations of the 15 EU member states, the Czech Republic, Hungary, Norway, Poland and Switzerland, FEFSI represents some 900 management companies and over 36,000 investment funds with EUR 4.5 trillion in investment assets.

new Capital Accord at this point in time. In this way, at least a partially level playing field could be maintained between banks and other financial services providers.

The methodology

Fund management companies that are part of a banking group would primarily be affected by the proposed rules on operational risk. As the Basel Committee itself states, this area is still in its infancy and the methodology to assess these risks still needs to be developed. In this context, the Basel Committee also asks for more qualitative data to enable the definition of meaningful rules in this area. FEFSI has commissioned an independent European study by the University of Toulouse concerning this subject, a draft of which should be completed by autumn 2001.

FEFSI noted the Basel Committee's statement that it intends to work with the industry further on this topic and we accordingly look forward to hearing in more detail how the Basel Committee plans to deal with the question of operational risk. We support the recent suggestion from the banking federations of Canada, Japan, USA and the European Union to provide interim reports possibly before August enabling a response from industry by October.

Banks investing in investment funds

FEFSI urges the Basel Committee to address specifically the treatment of units/shares of regulated collective investment undertakings (CIUs) in the 1st Pillar of the new capital accord. The capital charge for investments by banks in CIUs should be linked either to the issuer of the units/shares of the CIU itself or to the issuer of the assets, which are held in the CIU's portfolios ("look-through approach"). The two options should be permissible for banks' investments in CIUs, in both the bank's <u>trading</u> and <u>non-trading book</u>.

This approach is justified as CIUs are subject to prudential regulation, which significantly mitigates the risks of investments. Moreover, there is a practical necessity to add this measure, as there is already considerable bank investment in CIUs in some European countries.

The proposal (no. 89) "that the haircut to be applied to eligible UCITS/Units in mutual funds is the highest haircut that would be applicable to any of the assets in which the fund has a right to invest" in, is overstating the credit risk inherent in investment funds [2]. At least the option should be provided that the haircut to be applied to eligible CIUs is the asset weighted average of the

[2] Example: in case of an investment fund which invests 70% of its assets in "AAA-rated one year bank bonds" and 30% of the assets in "main index equities" this would mean that the haircut for the total fund is equal to the 20% haircut applicable to the "main index equities". This treatment completely ignores the fact that the haircut for the vast majority of assets is only 1 per cent. This proposal furthermore denies the additional benefits of risk diversification provided by a regulated investment fund as opposed to direct investments and largly overstates the credit risk of the fund.

haircuts that would be applicable to the assets in which the fund invests.

On a more general note and in conclusion, FEFSI urges the Basel Committee, when it reviews the feasibility of its original timetable for implementation of the new rules, to take into consideration the complexity of the new capital accord, which is exacerbated for the investment fund industry due to the fact that a new capital charge for operational risk is contemplated whilst the impact of such a measure still needs adequate assessment. FEFSI believes it essential to get the new rules right and looks forward to a continuing dialogue with the Basel Committee on this subject.

Naturally my colleagues and I remain at your disposal for further explanation and comments.

Yours sincerely,

Steffen Matthias
Secretary General