June 20, 2013

Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland
Via e-mail: baselcommittee@bis.org

Consultative Document – Supervisory Framework for Measuring and Controlling Large Exposures

Dear Sir/Madam:

Municipal Employees' Retirement System of Michigan (MERS) welcomes the opportunity to comment on the Consultative Document ("Consultation") issued by the Basel Committee on Banking Supervision ("Basel Committee") regarding the measurement and control of large exposures. MERS is one of the largest public employee retirement systems in the United States, providing retirement benefits to over 100,000 retired and active individuals. In connection with meeting its funding obligations, MERS invests its assets globally, with diversified holdings and total assets of $7.7 billion as of December 31, 2012. While we agree with the core objective of reducing global systemic risk with a uniform large exposure framework, we are very concerned about the adverse impact of the Basel Committee's proposed framework ("the large exposure framework"). Specifically, we are concerned with the likely retraction in indemnified securities lending and the negative consequences on both credit markets and market liquidity, as well as securities lending revenue to MERS.

Since 2008, our U.S. custodial bank has been providing custody, securities lending and related services to MERS. Over that period, securities lending has generated over $24.98 million in incremental revenues to MERS. Not only is this revenue stream critical to MERS in its defraying of numerous administrative expenses, but also in offsetting its pension liabilities. In discussions with several market participants, we have become aware of the large exposure frameworks' punitive methodology for calculating securities lending, and other credit exposures and the potential for up to a 50% reduction in securities lending revenues globally.

MERS strongly urges the Basel Committee to better align the large exposure framework's credit exposure calculations with actual credit risk incurred by indemnification providers. As stated above, we have been engaged in securities lending for more than 5 years with our current custodial bank and have not suffered losses through cyclical times or various credit crisis. In addition to supporting securities lending for its incremental revenue, we are also cognizant and appreciative of its role in promoting efficient capital markets (both in the U.S. and globally) and related price discovery and market liquidity.

We also feel it is important to stress the vital role that our custodial bank plays as our securities lending agent. MERS relies on its custodial bank's robust trading, operations and credit functions to provide a seamless lending and collateral management service. Equally important to MERS is the borrower default indemnification provided by our custodial bank. The borrower default indemnification assures MERS that it can rely on the credit analysis and decisions made by such institution on its behalf and that such decisions will be made in a fashion that the objectives of MERS and the custodial bank are aligned in such decision.

Further, per our existing policy and risk management practices, in order for a bank to be eligible to lend securities on behalf of MERS, the bank must "execute an indemnification agreement satisfactory in form and content to the retirement system fully indemnifying the retirement system against loss resulting from borrower default or the failure of the bank or brokerage firm to properly execute the responsibilities of the bank or brokerage firm under the applicable securities lending agreement."

The inability of our custodial bank, or any other regulated financial institution, to provide borrower default indemnification would leave MERS with three difficult choices; (i) cease securities lending, (ii) operate its own lending program (with the attendant and exorbitant systems and other resource costs) or (iii) retain the securities lending services of a second tier, non-regulated institution. Considering the prohibitive financial impact of the first two options, MERS could well be left with the difficult task of retaining a suitable securities lending agent, as our existing policy and risk management practices further require that lending agents "be experienced in the operation of a fully secured securities loan program and maintain adequate capital in the prudent judgment of the retirement system to assure the safety of the securities."

Sincerely,

Jeb Burns
Chief Investment Officer
MERS of Michigan