

MEMO# 30705

May 16, 2017

ICI Global Letter to Basel Committee on Step-In Risk

[30705]

May 16, 2017 TO: ICI Members

ICI Global Members

ICI Global Regulated Funds Committee

Money Market Funds Advisory Committee SUBJECTS: International/Global

Money Market Funds RE: ICI Global Letter to Basel Committee on Step-In Risk

In March, the Basel Committee on Banking Supervision (BCBS or Committee) published a second consultative document on the identification and measurement of step-in risk.[\[1\]](#) ICI Global has submitted the attached comment letter, which addresses the possible treatment of regulated funds under the Committee's proposed framework. A brief summary is provided below.

Background

The BCBS is seeking to develop a framework to facilitate the identification of unconsolidated entities that could entail significant step-in risk for banks. The Committee has described "step-in risk" as the risk that a bank may provide financial support to an entity beyond or in the absence of any contractual obligation to do so, should the entity experience financial stress. It has issued two consultations on the proposed framework, one in December 2015 and the other in March 2017.

Responding to the Committee's initial consultation, ICI Global raised concerns about the possible treatment of regulated funds under the proposed framework for identifying step-in risk. Our March 2016 letter explained the many reasons why regulated funds sponsored by banks or bank affiliates—both regulated money market funds and regulated stock and bond funds—are unlikely to present significant step-in risk and therefore should lie outside the scope of the framework.[\[2\]](#)

ICI Global Response to Second Consultation

The ICI Global letter observes that, in the second consultation, the Committee appears to be moving in a better direction. The Committee correctly points to an agency relationship (such as that which exists between a regulated fund and its bank sponsor) as a "counterexample" of step-in risk. It likewise suggests that certain types of funds may not pose such risks, including index funds, exchange-traded funds, and funds with variable net asset values (e.g., open-end mutual funds).

Notwithstanding these helpful improvements, the Committee’s second consultation still does not adequately distinguish between bank relationships with unconsolidated entities that pose significant step-in risk and bank relationships with regulated funds, where step-in risk is remote. The letter highlights two areas of concern for regulated funds.

First, the letter explains that the Committee has failed to account for the significant post-crisis reforms to regulated money market funds—reforms that sufficiently mitigate the risk of step-in by bank sponsors of these funds.

Second, the letter observes that although the Committee correctly recognizes variable NAV funds as “counterexamples” of step-in risk, its discussion of a new and “key” indicator—styled as “liquidity stress/first mover advantage”—injects some skepticism about certain variable NAV funds: those not holding large reserves in cash/cash equivalents, those not employing barriers to redemptions (such as gates), and those investing in less liquid assets. The Committee appears to be suggesting that funds having any of those three characteristics present step-in risk for bank-affiliated managers. ICI Global’s letter addresses the Committee’s specific concerns, explaining that those concerns are unfounded in the case of regulated stock or bond funds.

The letter concludes by recommending that any final framework contain a more balanced discussion of regulated funds. In the absence of such discussion, it could be possible for national supervisors to misconstrue how the framework should be applied to regulated funds or to second-guess a bank’s determination as to the existence and/or degree of step-in risk from a regulated fund. The letter also urges the Committee to indicate that any entity not presenting significant step-in risk should be excluded from this framework.

Rachel H. Graham
Associate General Counsel

Frances M. Stadler
Associate General Counsel & Corporate Secretary

[Attachment](#)

endnotes

[1] BCBS, *Consultative Document: Guidelines, Identification and management of step-in risk* (March 2017), available at <http://www.bis.org/bcbs/publ/d398.htm>.

[2] Letter to BCBS from Dan Waters, Managing Director, ICI Global (March 17, 2016), available at <https://www.iciglobal.org/pdf/29778.pdf>.