MEMO# 15595

January 30, 2003

INSTITUTE COMMENT LETTER TO EUROPEAN UNION ON REVISIONS TO THE CAPITAL ADEQUACY DIRECTIVE

[15595] January 30, 2003 TO: INTERNATIONAL COMMITTEE No. 14-03 RE: INSTITUTE COMMENT LETTER TO EUROPEAN UNION ON REVISIONS TO THE CAPITAL ADEQUACY DIRECTIVE Attached is a copy of a comment letter that the Institute submitted to the EU Commission on its Working Document on Capital Requirements for Credit Institutions and Investment Firms. The Commission's Working Document is intended to provide the basis for a dialogue on how best to reflect the new Basel Accord, which is scheduled to be adopted in the fall of 2003, into a revised EU capital adequacy framework. The Commission is expected to issue the final consultation paper on a proposal to revise the Capital Adequacy Directive in the summer of 2003. The Institute's letter reiterates our position that it would be unwise to introduce into the Capital Adequacy Directive bank-style capital requirements for operational risk for asset management firms. The letter attaches an Institute paper authored by two prominent academics on the regulation of operational risk in asset management companies. The paper concludes that the justification for bank-style capital requirements does not apply to the asset management industry, that there are better ways than capital requirements to protect asset management clients, and that high capital requirements in asset management have anti- competitive effects. The letter also states that, if the Commission, despite the Institute's arguments, determines to impose bank-style capital requirements on asset management firms, the Commission should (1) apply a lower calibration for imposing capital charges for operational risk on asset management than for banks and (2) permit firms to offset capital with insurance. To assist the Commission in recognizing insurance, the Institute will be forwarding (in the next few weeks) data on the US industry's experience in using insurance to cover certain operational risks. In response to member comments, the final letter includes a discussion about requirements to consolidate capital. In the Working Document, the Commission is considering revising the specific conditions under which member states may grant waivers to investment firm groups from the requirements for consolidated capital. The letter expresses particular concern about the proposed condition that would require all the investment firms within a group to be authorized and supervised by the same member state to be eligible for the waiver. 2 The letter argues that this proposed condition would prevent member states from granting waivers to groups whose holding company structure does not pose particular risks. The letter also requests clarification that managers of both UCITS and other assets will not be required to include the management of UCITS funds within the business lines for purposes of calculating capital requirements under the Standardized Approach. Finally, the letter recommends that the Commission exclude UCITS fund activities for purposes of calculating capital for banks and bank holding companies whose affiliates also manage

UCITS funds. Jennifer S. Choi Associate Counsel Attachment Attachment (in .pdf format)