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Committee of Banking Supervisors
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Dear Sirs

Response to the questionnaire on large exposures and concentration risk

We write in response to the questionnaire on market practices with regards to concentration risk. Morley Fund Management Group and its subsidiaries manage in excess of £150 billion of funds under management in a number of countries, including several in the European Union. We therefore welcome this opportunity to input to the European Commission's review of Large Exposures.

Where relevant, we have responded to individual questions in the appendix to this paper. However, as a general point, we note that the questionnaire understandably focuses on banking and trading activities. It makes no allowance for the relatively simple nature of most investment management operations. A truly risk-based large exposure regime would do so.

Morley is not unusual as an investment manager in that:

- we do not operate a credit portfolio on our own account;
- we do not trade on our own account; and
- we have no direct exposure to the markets in which the funds that we manage are invested.

The primary risk of exposure to a small number of clients or markets is a strategic risk. We believe that the most effective way to assess and manage this risk is to determine the impact of adverse scenarios on the business, which naturally forms part of the internal capital adequacy assessment process, together with any mitigating actions.

In contrast, the exposures on our balance sheet are mainly short-term items arising from the normal course of business, such as fee income accruals and debtors, cash balances and amounts due in respect of unit trust transactions. We do not believe there are significant credit risks associated with these exposures, especially when viewed in light of the fact that we control

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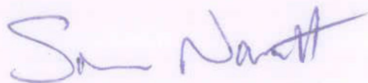
substantial assets of our clients and could in many cases deduct amounts due from those assets.

Further, any loss suffered from the default of a debtor would ordinarily be covered by current year profits and would only affect regulatory capital if they resulted in significant losses. This does not bear comparison with the position of banks with credit portfolios or trading positions, where concentration of exposures in particular sectors or markets may lead to losses of capital.

We suggest therefore that the application of exposure limits to normal investment management business is unnecessarily burdensome and too simplistic. Such limits have an adverse impact on an entity receiving large fees from a small number of funds (such as annual performance fees), regardless of the risk of default. They also potentially penalise "in-house" investment management subsidiaries of larger financial groups, by placing limits on intragroup balances which might be argued to be less risky than external amounts.

Instead of set limits, we believe that the most appropriate means of addressing this risk is by way of the Internal Capital Adequacy Assessment Process required of firms by the Capital Requirements Directive.

Yours faithfully



Simon Narracott
Financial Reporting Manager

Appendix
Responses to detailed questions

Note that we do not have a trading book. All responses are therefore in respect of the non-trading book.

General approach to concentration risk

1. In general terms do you, for internal purposes, adopt an approach to concentration risk measurement and management which is closely linked to the limits and reporting requirements contained in the current national regulatory regime. If so, please describe your approach. Note if your answer to this question is positive, many of the questions set out below may not be relevant to your circumstances.

Our approach to the measurement and management of concentration risk in the balance sheet is driven by the regulatory requirements.

The risk of dependency on one single client or group of related clients is taken into account in strategic decisions and on-going management of the business. However we do not attempt to measure this risk, nor do we set internal limits in its management.

Nature of concentration risk

2. What is your understanding of the nature of concentration risk?

We do not have a credit portfolio and do not consider our group's balance sheet to be particularly exposed to concentration risk. We therefore view concentration risk from large exposures within the regulatory limits.

Of more importance to our business is undue dependency on one single client (or group of related clients) or to particular markets where the funds that we manage are invested.

Counterparties and relationships between counterparties for singlename concentration risk:

3. For your internal risk measurement and/or management purposes, how do you define 'connectedness' of counterparties? What factors do you consider determine 'connectedness'? To what extent and how, for your internal risk measurement and/or management purposes, do you take account of relationships / connections between counterparties (e.g. parent and subsidiary)?

We consider counterparties to be connected if they are under common control and treat exposures to parents and subsidiaries as if they were to one counterparty when measuring our large exposures.

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4. For your internal risk measurement and/or management purposes how do you approach the issue of exposures to entities or products consisting of underlying assets or items (e.g. exposures to special purpose entities, collective investment units)? In what circumstances if any do you adopt a 'look through' approach? How do you calculate your risks in this context?

We do not have any exposures of this nature.

Measurement of exposures:
5. For internal measurement purposes, how do you define the amount at risk? In particular please outline your approach to loans, undrawn facilities, guarantees and similar obligations, derivative exposures (with future volatility), structured transactions, intra day and settlement exposures.

6. For your internal risk measurement and/or management purposes, How do measure:
(a) single name concentration risk?;
(b) other concentration risk? – sectoral, geographic, etc.

7. Are these approaches closely integrated into your internal business decision making? – please give examples. For how long have you adopted this approach?

Our business is straightforward and the exposure is the amount due from the counterparty, less any payments received on account to cover such amounts. The measurement of concentration risk is not key to internal decision-making, since it is not viewed as a significant risk. Dependence on our largest clients is a key element of strategic thinking and decision-making.

8. In relation to securities financing transactions (repurchase agreements, securities/commodities lending/borrowing agreements, margin lending), what approach do you take to the measurement of singlename exposures? Do you make use of an 'expected positive exposure' methodology? Please describe in detail the approach adopted and the conceptual basis.

Not applicable.

Monitoring and management of risk:
9. What is your approach to the management of single name concentration risk and other concentration risk (e.g. sectoral, geographic, etc.) Please provide a comprehensive and detailed descriptions and explanations.

See responses to questions 1 and 2 above.

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Stress testing

10. Do you adopt an approach to managing concentration risk based on stress testing? If so please provide a detailed description/explanation.

We do not routinely perform stress tests on our large exposures, although we consider the impact on them of major business decisions.

Single entity vs. Group level

11. Do you set limits and/or apply your concentration risk measurement and management policies at a group level, subgroup level, and/or at individual entity level? Please provide details and explanation.

12. In relation to intragroup exposures please describe in detail the approach that you adopt. How do you set limits, allocate economic capital, etc in respect of such exposures? How do you approach the question of crossborder intragroup exposures?
Please provide as detailed as possible an explanation of the conceptual basis for your approaches in the above regards.

We apply measurement at an individual entity level, since that is how the rules apply. Strategic considerations are made at a group level. Our limits are as set by the relevant regulations.

Credit risk mitigation

13. Do you use credit risk mitigation techniques as part of your approach to reduce singlename concentration risk? If so, please describe the methods that you use (e.g. collateral, guarantees, netting etc) and the circumstances in which you would adopt a particular approach and why you use that approach.

We are not exposed to significant credit risk. For the largest exposures, we arrange payments on account in order to mitigate the risks.

'Indirect Concentration Risk'

14. For your internal risk measurement and management purposes how do you deal with the issue of 'indirect concentration risk' – that is singlename or other concentration risk arising in respect of indirect exposures to the issuers of collateral or the providers of unfunded credit protection?

This is not applicable to us.

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Governance and reporting

15. Please describe your internal governance and reporting policies and procedures relating to singlename and other concentration risk.

See the response to question 1 above.

Regulatory Environment

16. Please set out your experience of, and views concerning, the current large exposures regulatory regime.

The current regime applies limits to balance sheet exposures on a "one-size fits all" basis, which is inconsistent with risk-based regulation and individual firm capital adequacy assessments. If limits are the most appropriate way of regulating this risk, then it is our view that they are only relevant to credit portfolios and trading books. They ought not to apply to short-term balances that arise in the normal course of business and that are not subject to significant credit risk.

17. What is your perception of how the large exposures regime is applied across different member states? Is it applied in a consistent way? If not, what differences have you encountered and how have they impacted on your business.

In our experience the large exposures regime applies in Ireland as it does in the UK, but it is still in development in Poland.