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Z/EU-CEBS response
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Dear Sir/ Madam

CEBS Large Exposures Questionnaire

Baillie Gifford & Co is an independent fund management firm based in Edinburgh with around £47bn under management and advice as at the end of March 2006. The firm is a private partnership under the laws of Scotland and includes a group of companies which are regulated by the FSA in the UK. Around half of total assets are managed on behalf of UK pension funds, in both the public and private sectors, and about a quarter is for North American pension funds, again both private and public. The remainder of our clientele consists of UK investment trusts, charities, OEICs and insurance funds and two joint ventures, one with a major Japanese bank and the other with an American mutual life assurance company.

We are grateful for this opportunity to comment on the large exposures issues which impact on our group. We also endorse the comments which are to be made by our trade body, the Investment Management Association in respect of this matter.

These rules make little sense in the context of investment management firms. Usually, the only large exposures of an investment management firm are accrued fees owing from the funds it manages. It makes little sense to treat such accrued fees as large exposures because: they generally represent unaudited profits and are thus not part of regulatory capital (so bad debts would reduce current period profits rather than hitting capital directly); they are short-term in nature with no history of default (since, in many cases, the manager can take the fee directly from the funds managed); and they have no impact on client assets in the event that the counterparty does not pay or becomes insolvent (since the client assets of investment management firms are ordinarily held by an independent custodian rather than the investment management firm itself).

The previous UK investment management regulator, IMRO, issued time-limited waivers to these rules by which firms could come back into compliance once the exposures had been cleared. To obtain this waiver, firms produced an annual cash flow statement which showed

A list of partners' names is available at the above address

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that any large exposures were extinguished within a reasonable time period. However, this waiver option has been removed by the Financial Services Authority (FSA) as they felt that it would be inconsistent with their obligations under the European Directive.

The most common large exposure of an investment management firm is likely to be performance fees, which are usually only paid once a year and are unquantifiable until they are crystallised. As they are based on relative performance, they can be highly variable and, as some are uncapped, they can be extremely large if performance has been good. The large exposure rules would therefore paradoxically penalise the best performing asset managers by requiring them to hold larger amounts of capital which we believe in any event is quite unnecessary. In addition, we envisage very great practical difficulties in establishing the amount of additional capital, given the variability of the performance fees both in terms of payment and amount.

We still believe that investment management firms should be exempted from the large exposure rules, or, at the very least, that accrued fees should be added to the list of exemptions from those rules where such fees are receivable within 90 days.

Yours faithfully

Baillie Gifford & Co