

Chapter – 4: Investment in the units of Collective Investment Scheme/ / Mutual Fund/ Private Equity Fund

4.1 Introduction

This chapter provides various options/ approaches to determine capital requirement for banks/DFIs' investment in the units of collective investment schemes including mutual funds, private equity funds and venture capital funds. The choice of option depends on the availability of information on the underlying exposure of each/individual collective investment scheme/ fund (hereinafter referred as 'fund') at all times.

4.2 Look-through Approach

The look through treatment is designed to capture the risks of an indirect holding of the banks/DFIs in underlying assets of the funds. The banks/DFIs shall calculate capital charge on their investments in units of captioned funds using any or combination of the following three approaches:

Look Through Approach (LTA)	The banks/DFIs shall use this approach if all of the following conditions are met: a) the fund provides the bank/DFI with sufficient information about the fund's underlying exposures to allow the bank/DFI to calculate the relevant risk weights; b) the fund provides that information at a frequency similar to financial reporting of the banks/DFIs or on more frequent basis; and c) the information is verified by an independent third party (for example, the depository, the custodian bank, or, where applicable, the fund management company). Under this approach, the banks/DFIs will calculate capital charge based on actual risk-weights applicable to the underlying assets of the fund as if such assets are directly held by them. Banks may rely on third-party calculations for determining the risk weights associated with their equity investments in funds (i.e. the underlying risk weights of the exposures of the fund) if they do not have adequate data or information to perform the calculations themselves. In such cases, the risk weights of 1.2 time higher than the applicable risk weights will be applied on underlying assets of the fund.
Mandate Based Approach (MBA)	The banks/DFIs will use Mandate Based Approach to calculate capital charge on underlying assets of the fund, where conditions for application of Look Through Approach (granularity, frequency and independently verification of information) are not satisfied but the bank/DFI has enough information from the fund's mandate, the applicable law or other reliable, public sources. Under this approach, the banks/DFIs will calculate capital charge on underlying assets of the fund by assuming that the fund invests to the greatest extent allowed under its offering document/mandate in assets that attract the highest capital requirements, and then progressively in other assets that attract lower capital requirements. If more than one risk weight can be applied to a given exposure, the maximum risk weight applicable must be used.
Fall Back Approach (FBA)	Where the banks/DFIs are unable to use above two approaches, they may use Fall Back Approach, as per which 1000% risk weights will be applied on banks/DFIs' investments in the fund.

Where the banks/DFIs have investment in units of a fund (Fund A), which in turn has investment in units of another fund (Fund B) and either the LTA or the MBA is used to calculate the risk weighted assets of Fund A, the risk weight to be assigned to Fund B can be calculated by using the LTA, MBA or FBA (as the available information permits). However, for subsequent layers (such as Fund B's investment in Fund C (and so on)), the risk weights applied to Fund C can be calculated by using the LTA only if the LTA is used for determining the risk weight for Fund B. Otherwise, the FBA must be applied.

4.3 Capital Treatment

4.3.1 Categorization of Investment as Banking or Trading Book:

Banks/DFIs may categorize their investments in units of funds in Banking or Trading Book depending upon their investment objective and nature of securities (listed/unlisted). Generally, investments held for purposes like short-term resale, earning profits from short-term price movements, locking in arbitrage profits, and hedging risks arising from instruments of Trading Book, are categorized as 'Trading Book'.

Banks/DFIs shall calculate capital charge for investments categorized as 'Banking Book', under credit risk Standardized Approach¹, whereas for investments categorized as 'Trading Book', the banks/DFIs will calculate capital charge for market risk as per SBP's relevant instructions².

4.3.2 Leverage Adjustment:

The capital charge calculated under LTA or MBA shall be subject to a leverage adjustment, which is product of leverage and average risk weights of the fund. The leverage of fund is calculated through dividing total assets by total equity of the fund, whereas average risk weights of fund are determined through dividing total risk weighted asset by total assets of the fund. The leverage adjustment is calculated as a product of leverage of fund (*Lvg*), average risk weights of the fund (*Avg RW*), and banks/DFIs' exposure in the fund, subject to maximum cap of 1000% risk weights as given below.

$\text{Leverage of Fund (Lvg)} = \frac{\text{Total Assets of Fund}}{\text{Total Equity of Fund}}$
$\text{Average Risk Weight of Fund (Avg RW)} = \frac{\text{Total Risk Weighted Assets of Fund}}{\text{Total Assets of Fund}}$
$\begin{aligned} \text{Risk Weighted Assets of Bank/DFI's Investment} \\ = \text{Min(Avg RW} \times \text{Lvg, 1000\%)} \times \text{Equity Investment in Fund} \end{aligned}$

4.3.3 Investments in Real Estate Investment Trusts (REITs):

The banks' investments in REITs shall be categorized in the Banking Book and will attract risk weight of 100%³.

4.4 Significant investment in the capital of Asset Management Company (AMC):

Asset Management Company (AMC) is considered as a financial entity for capital adequacy purposes and any significant minority and/or majority investments in the capital of AMC is subject to the same rules as described in the Scope of Application (chapter 1) and Investments in the Capital of Banking, Financial and Insurance Entities (section 2.4.9) of BPRD Circular No. 06 of 2013.

¹ Credit Risk Standardized Approach issued vide BPRD Circular No. 03 dated September 24, 2025.

² Chapter 5 of SBP's instructions issued vide BSD Circular No. 08 dated June 27, 2006.

³ Instructions issued vide BPRD Circular Letter No. 18 dated June 02, 2021.