association française des investisseurs institutionnels

May 28th, 2012

Association Française des Investisseurs Institutionnels – Af2i – answer to IOSCO consultation about the

Money Market Fund Systemic Risk Analysis and Reform Options

The Af2i association welcomes the IOSCO initiative to review the MMFs situation, as a non-bank financial intermediation entity, regarding the systemic risks.

As a cover note, we wish to stress several important points:

- MMFs do not receive deposit and do not operate any transformation process of risk and duration
- MMFs do not use any funding from banks
- MMFs invest in very short term portfolios of diversified and high quality debt
- As for Variable NAV MMFs runs risk is very limited
- MMFs do not issue any guaranty or any commitment of any kind towards the investors
- MMFs provide the economy with important amounts of genuine funding
- MMFs have been recently re-defined by the CESR and ESMA with a strong support from the Af2i, in such conditions as these CIS are fully regulated

So, the Af2i association accepts to deal with IOSCO about MMFs systemic risks whereas we do not share the puzzling view which is exposed in this consultation paper.

Q1 No, we do not agree with a messy definition of MMFs after a great lot of works for re-defining the MMFs with the CESR/ESMA quite recently. Please use our foreword as elements of definition as they are far more relevant than “preservation of capital” and “short term interest rates”. We think that the IOSCO organization might make some positive and low cost work in defining what should be, in his opinion, a systemic risk-less MMF.

Q2 Following this option, it clearly appears that the Constant NAV MMFs may provoke far more run risk than the variable NAV MMFs because of no, or less, “first mover advantage”. Furthermore, it might be possible to built closed end MMFs without any run risk.

Q3 MMFs are big providers of short term funding to the economy and furthermore, the very short maturities they deal with allow them to be very reactive on the market and so to be able to cope with most of the changes on the market. So, except in the case of a general credit crash concerning portfolios of high quality debt instruments the MMFs are able to use flexible rate conditions and play on their part in the short term funding market.

In addition let us stress again that MMFs do not use bank funding and banks are not supposed to invest in MMFs, they just might market to investors their shares.

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Q4 As far as we use to practice MMFs such as described in our foreword, there is no part for sponsors, no need from investors and no contagion effect of any kind, at least for Variable NAV MMFs. Of course, if we try to deal with an uncertain available support from a sponsor, we get an unreliable business model with obvious contagion risks. But this not the model we deal with.

Q5 Diversified and safe alternative to bank deposits, ability to react promptly in the short term funding market, organized liquidity and consistent part to play in the financing of the economy are major benefits in the view of the institutional investors.

There is no simple alternative vehicle to the MMFs and bank deposits and the investors demand has not much varied recently. The only reason for investors to move away from MMFs is the poor return on investment nowadays, especially net of management fees.

Q6 The main element of the comparison between bank deposits and MMFs is the risk on banks situations which might be less transparent than MMFs in a recent period.

Q7 The main difference between the CNAV and the VNAV is that CNAV do not provide any consistent advantage while bringing a far higher risk of runs, because runs are most often provoked by cliff effects which are a characteristic of CNAV. In the VNAV mark to market model, the NAV moves freely and continuously and does not offer any occasion for any “first mover advantage”.

Q8 External credit rating is an important tool, among other tools which are to be described in the MMFs management policy, for selecting some debt instruments portfolios but the external rating should not remain in the regulation and provoke any addiction. The AAA notation of CNAV MMFs might be a dangerous habit and generate cliff effects. As for the notation of MMFs themselves, fund managers have to apply the strategy they have elaborated when launching the funds, obviously the use of an external notation of a fund has to be implemented in its policy from the very beginning.

Q9 MMFs invest in very short term, high quality, diversified and mark to market portfolios. Every general prudential issue is to be applicable to MMFs activities.

Q10 The main change which has to be stressed at the moment is the change in the banks activities of credit in relation with the Bale III regulation which are squeezing very important volumes of credit out the banks scopes and balance sheets. So, the MMFs regulation against systemic risks should not be considered from the today situation of MMFs assets in natures and volumes, but from a predictable situation when MMFs will have captured a great deal of the banks short term credit activities.

Q11 The systemic risk analysis should be more accurate and deal with and recognize the absence of leverage and a question about closed end funds risks.

Q12 The Af2i association agrees with the idea of a mandatory move of the CNAV to the VNAV and would like to recommend in a very short time to forbid the launching or the distribution of new CNAV MMFs.

Q13 Maintaining CNAV by requiring smart sophisticated financial innovation resources is a waste of time and brain. MMFs have a specific advantage for the investors of any kind which is to be rather readable and transparent what is an obvious quality for the time being. Please, remain simple and efficient.

Q14 The insurance of investors risks in MMFs is a non-sense. Investors and especially institutional investors investing in MMFs are wise people who select their investment and MMFs are probably their safest assets.

Q15 For trying to help CNAV MMFs to survive against the most obvious financial logics, one thinks to allow them to access to government insurance and lender of last resort facilities, what is exactly what may provoke and systemic risk, just a wider one.

Q16 There no issue for such an additional complexity.

Q17 CNAV should not survive because they do not bring more advantage than drawbacks and might meet some unpredictable situation. So, it is not a matter of client, it is just a higher hazard in both cases.

Q18 The various structural initiatives of the section 1 are smart and creative, no one can doubt about that, but it looks quite obvious to us that they are a waste of time and energy. A secured mandatory move of the CNAV to the VNAV is the only simple solution.

Q19 The mark to market valuation should be the rule for MMFs assets. If some of these assets cannot meet any market valuation, these assets should be isolated in a defined sub portfolio and the size of the sub portfolio and its valuation process or model should be described in the strategy of the fund.

Q20 MMFs and their assets have been described recently by the CESR/ESMA regulatory issues, we do not see any reason to change these provisions ; beside some other kinds of funds may exist out of the MMFs family with other regulation and other systemic risks management. For a fair competition, the most important is that all MMF (European VNAV MMFs for instance) should use the same valuation rules. For us, amortized cost valuation should be limited to 90 days papers, but as it is in the French MMF regulation, it should be an allowance and not a right.

Q21 The Af2i association is far more favorable to liquidity requirements which might impose to the fund to be managed carefully with a majority of liquid assets and a few less liquid assets and than to liquidity restrictions which might apply to investors. In practice, the MMF industry build up already an important part of liquid asset (from 1 to 7 days). In our view, liquidity requirements have to be designed in relation with the type of fund (CNAV or VNAV), the kind of distribution and the size of the fund, under the MMF manager's charge. For example, liquidity requirement may be higher in small funds and in the retail business.

Q22 Of course, in the "know your client" process the main issue concerning the management of liquidity is the concentration of the investor base. If the concentration reaches a significant degree, it is possible, and even easy, to have a close relationship with the main investors and so, to get some information about tactical asset allocation. If the concentration degree is not so high, the run risk is lower but the mass run risk as cliff effect consequence is higher.

Q23 The liquidity fees must not be a flag for a cliff effect event. We think that it is possible to demonstrate that every redemption potentially damages a MMF at least through the assets moves, even in fair conditions in the market. So, the idea we should like to propose is to establish a permanent liquidity fee system for CNAV MMF where the fees should be calculated continuously in relation with the redemption volumes and the markets conditions, something like swinging prices. Of course these liquidity fees are a benefit for the fund and so for the remaining investors or the newcomers. VNAV funds do not need such a liquidity fee, because the valuation already include the price of liquidity.

Q24 The minimum balance requirement should not be welcome by institutional investors as they use to invest or to cut investments without being held back in a minimum deposit the level of which is rather difficult to establish.

Q25 The bid price valuation principle sounds sensible and may be applied for mark to market assets only and if the fund strategy requires it.

Q26 In-kind redemption is not a relevant solution with many operational difficulties.

Q27 MMFs are not gate-like CIS as their liquidity is mainly related with the very short duration of the majority of assets. Gates are wise provision when a fund management has mixed retail and professional investors and when there might be assets liquidity issues. We do not anticipate any regulatory arbitrage risk, it is just a matter of nature of CIS and distribution.

Q28 A private liquidity facility might be a support for very small occasions and events. Dealing with systemic risk the Af2i association emphasize the necessity to forbid or reduce radically any leverage effect. In this view, it cannot be considered as wise to have private liquidity facility. It looks wiser to impose a reduce pocket of liquidities in the assets of the MMFs.

Q29 Remove references to external ratings from MMFs regulation is absolutely necessary and will reduce the over-reliance on external ratings, but these ratings will continue to play an important role in the selection of the assets. The main issue in our view is that the investor has to be aware of the methods and the models which are the elements of the selection process, including the external ratings if so. This kind of information should be described in the KIID. All the major investors and asset managers have elaborated their own credit rating methods, their practices will spread to many actors soon undoubtedly.

Q30 Encouraging a greater differentiation in ratings of the MMFs cannot be a policy. The point is that it is not projected to have different scales of ratings in relation with natures of CIS. AAA rated funds have to be AAA worth and then give sense of security. We understand that false AAA gives a false sense of security but we do not imagine it, furthermore we do not see any reason to “educate” investors about anything else.

Q31 No this document has probably gone far out of bounce yet.

Q32 Every global solution is preferable with a global playing field and fair competition conditions, but it is a very ambitious target for the time being. Beside the true positive move to operate is that investors and asset managers of each jurisdiction perfectly know the mapping of their own jurisdiction and manage in the best information conditions.

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(1) AF2i is the French association of institutional investors, created in 2002 to represent the different families of Institutional Investors (insurance companies, pension institutions and funds, corporate, special institutions, etc.) and to defend their interests in asset management issues, in France and in Europe. Af2i gather 74 major Institutional Investors as Members representing around 1.6 trillion € of assets under management and 60 asset management companies or providers as Associate Members.