INVERCO REPLY TO IOSCO'S CONSULTATION REPORT ON MONEY MARKET FUND SYSTEMIC RISK ANALYSIS AND REFORM OPTIONS

INTRODUCTION

INVERCO (Spanish Association of Collective Investment Schemes and Pension Funds) represents more than six thousands collective investment schemes and more than 1,300 pension funds, with assets under management over EUR 276 billion.

INVERCO congratulates IOSCO for their complete and deep analysis of Money Market Funds in different jurisdictions and for their evaluation of possible policy options that could be relevant in this matter.

As a general comment, INVERCO wants to emphasize the importance of Money Market Funds, as an appropriate instrument for investors and an instrument for invigorate the economy. Additionally, in Europe and, in particular, in Spain, Money Market Funds are extremely regulated entities that make them robust in case of financial crisis, they have not enough size to generate systemic risks and they have significant differences from bank deposits.

Many policy options proposed by IOSCO are already included in regulations in Europe and, specially, in Spain. Consequently, IOSCO policy options should only be interpreted as a way to give more flexibility for existing strict rules and should never be additional requirements that impede development of MMF.

COMMENTS

Money Market Funds are a very appropriate way of investment with many advantages for investors that are, among others:

1. Safety. Money Market Funds are assets separated from entities in charge of their management (Management Company) and of safe-keeping of their investments (Depositary). Besides, participants are their owners, being perfectly identified by entities in charge of their marketing.

2. Supervision. Money Market Funds, their Management Companies and their Depositaries are supervised by Competent Authorities that get information from them and supervise them not only by distance but also on site.

3. Diversification and control of risks. Investment in assets of the same issuer must comply with maximum percentages (5%, in general). In case bankruptcy, investors only would be affected in the mentioned low percentage.

4. Liquidity. Daily Net Asset Value (NAV), daily price calculation and daily subscription and redemption of units are provided for investors.

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5. Transparency. Investors receive and can have access to broad periodic and up-to-date information about the Money Market Funds and their investments.

6. Professional Management and enlargement of investors' possibilities. Management Companies are professional entities that manage Money Market Funds in interest of their participants. Money Market Funds join contributions of many participants, so, with a little investment, participants have access to every kind of investments and markets.

7. Adaptation to investment profile. Investors know previously restrictions on investment policies of Money Market Funds and definition of their risk profile, so they can decide if such investment fits their requirements.

Money Market Funds are fundamental for economy, because:

1. They channels savings to productive sectors, giving financial support to companies.

2. They promote efficiency in markets, providing liquidity to traded securities.

3. They finance public sector, due to their investment in Governments securities and their compliance of their taxation commitments.

Definition of Money Market Funds, given by IOSCO, is comprehensive enough to include Funds with this consideration in different jurisdictions. However, not all Funds that could fit this definition would need the regulatory reform proposed by FSB. In particular, European Money Market Funds would not need additional reforms due to the following reasons:

1. European Money Market Funds are subject to rules of ESMA[1] that already face and avoid systemic risks by imposing more detailed and stricter rules on eligible investments, valuation and liquidity. Besides, harmonized MMF are subject to strict rules on management of liquidity risk by article 40 (3) and (4) of Commission Directive 2010/43/EU of 1 July 2010. These rules include, among others, stress tests which enable assessment of the liquidity risk of the harmonized MMF under exceptional circumstances.

2. Susceptibility to runs affects the kind of entity or financial instrument in unusual situations. However, due to abovementioned strict regulatory framework, in Europe and, in Spain, particularly, Money Market Funds are able to comply adequately with their redemption and subscriptions obligations in adverse circumstances derived from financial crisis, without requiring government intervention or exceptional measures.

3. Systemic risk can't be generated by entities with a relative small size. Although Money Market Funds are very important in United States due to their volume, this is not the case of MMF in Europe where their volume is half of MMF in United States and is distributed among different countries. In the cases of Ireland and Luxembourg (that accrue 60% of MMF's assets in Europe), as they are transnational distribution centres, investors are diversified in all European countries. Consequently, at least in Europe, Money Market Funds are not big enough to create systemic risks.

[1] CESR's Guidelines on a common definition of European Money Market Funds, 19 May 2010, (CESR/10-049).

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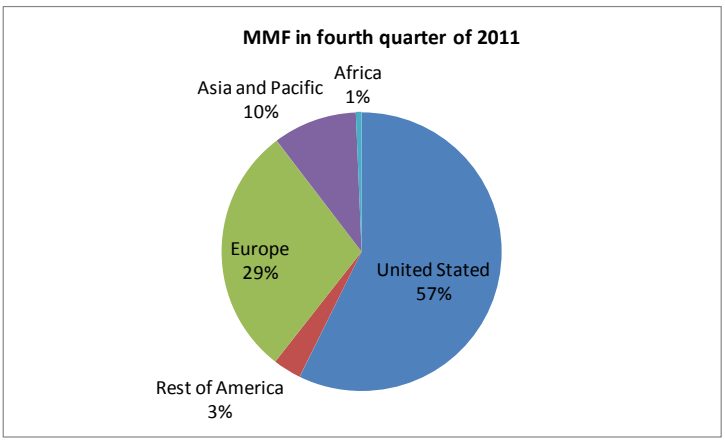
	Total net assets fourth quarter of 2011
United Stated	2.080.085
Rest of America	118.515
France	347.584
Ireland	281.974
Luxembourg	299.473
Rest of Europe	124.037
Asia and Pacific	352.999
Africa	24.166
Total	3.628.833

Source International Investment Funds Association
Millions of euros



4. MMF are quite different from banking activity and bank deposits. These differences are:

   - *Ownership.* Investors in MMF are shareholders not creditors.

   - *Transparency.* Unlike bank deposits, investors in MMF have periodic information on Money Market Funds and their investments.

   - *Stricter limits on investment and borrowings.* Investment policy of MMF restrict investment to short-term and high-quality assets and, for harmonized MMF, borrowings must be temporary and limited to 10% (article 83 (2) Directive 2009/65/EC).

   - *Diversification.* In general terms, harmonized MMF shall invest no more than 5 % of its assets in transferable securities or money market instruments issued by the same issuer or 20 % of its assets in deposits made with the same financial entity (article 52 (1) Directive 2009/65/EC).

   - *Minimum credit, maturity and liquidity mismatch.* As it has been mentioned, eligible securities must have high quality and low residual maturity; portfolio of MMF must have a reduced weighted average maturity (WAM) and weighted average life (WAL) and MMF's liquidity risk must be continuously managed and monitored.

In particular, considering Spain, Money Market Funds are subject to many obligations to avoid liquidity risks, some of them are policy options proposed by IOSCO:

1. Requirements related to characteristics of MMF's investments and MMF's portfolio. Spain has adopted entirely the abovementioned rules of ESMA. Consequently, there are two kinds of relevant categories: Short-Term Money Market Funds and Money Market Funds. The rules restrict investment of MMF to those eligible securities with high quality and low residual maturity and portfolio of MMF to those with a reduced weighted average maturity (WAM) and weighted average life (WAL).

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2. Variable NAV and valuation marked to market. In Spain, all Money Market Funds have to publish daily variable NAV and, since a regulatory reform in 2008, their entire portfolio is valued marked to market.

3. Minimum coefficient of liquidity. In Spain, liquid assets of MMF must be, as a minimum, 3% of their net assets and, Spanish Supervisor (CNMV) can raise this percentage, up to 10%, in certain cases when exists or would be predictable the existence of difficulties.

4. Control of the liquidity risk. Management Company must have internal systems to verify that there is suitable liquidity management which makes it possible to control the market depth of the financial instruments in which the MMF invests, taking into account the usual trading and amount invested so as to obtain ordered settlement of the positions of the MMF through normal trading mechanisms in order to guarantee that their ability to meet requests for redemption of units or sale of assets is not reduced, and respects at all times equal treatment for all investors.

   In particular, liquidity risk must be analysed both at the level of the managed Collective Investment Scheme (CIS) and at the level of the financial instruments in the investment portfolios:

   a) The evaluation of the liquidity of the managed CIS will take into account factors such as the structure of unit-holders or shareholders and their level of concentration, the quality of the information on patterns of unit redemption or disposal of shares of the managed CIS and the existence of restrictions on the redemption of units or disposal of shares of the managed CIS included in its prospectus.

      At any event, the liquidity of the managed CIS will be evaluated individually for each CIS, as well as overall for all the managed CIS, including any other portfolios managed by the CIS management company.

   b) The evaluation of the liquidity of a financial instrument will take into account factors such as trading frequency, trading volume and the number of transactions, the availability of market prices, the analysis, as the case may be, over a certain period of time, of the bid and ask prices and the spread, including a comparison with available market prices, the quality and number of financial intermediaries involved in trading the financial instrument, the investment volume of the managed CIS in the financial instrument compared with the total outstanding volume, and the time necessary to dispose of a significant amount of the investment in the financial instrument without causing serious damage to the unit-holders or shareholders.

      For this purpose, the CIS management company may assign a liquidity ratio to each financial instrument in the portfolio of the managed CIS. At any event, the evaluation of the liquidity risk, both at the level of the CIS and at the level of the financial instrument in their investment portfolios, will be submitted to the stress testing.

5. Exceptional measures for redemptions. These include the followings:

   - Possibility of requiring a forewarning of 10 days in case of redemptions over 300.000 €, provided that this forewarning is mentioned in the rules of the MMF.
   - If trading of securities was suspended and affected to securities that represent more than 5% of MMF net assets, subscriptions and redemptions would be partial

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considering the NAV referred to assets not affected. The rest of subscriptions and redemptions would be made when trading would start again.

- Redemptions in kind in exceptional cases that the Management Company must justify and CNMV must approve provided that this possibility is mentioned in the rules of the MMF.

These measures are more than enough to achieve an adequate control of eventual risk that could be associated to MMF. There is no necessity to impose any other one measure. What is more, some of these requirements should be adapted; in particular, valuation at amortized cost for instruments with a next residual maturity and constant NAV for Short Term MMF should be an option. Using controls and restrictions, as those mentioned previously (requirements related to characteristics of MMF's investments and MMF's portfolio, minimum coefficient of liquidity, control of the liquidity risk and exceptional measures for redemptions), the use of this mechanism of valuation will be safe and will promote Money Market Funds with their abovementioned advantages for investors and economy. For example, although constant NAV has never been used in Spain, valuation at amortized cost for instruments with next residual maturity was permitted previously in Spain (before 2008) and there has never been any problem during the period of use of this system of valuation.

Finally, ***the use of constant NAV and amortized cost for valuation by MMF are prescribed by ESMA.*** In this sense, constant NAV is only possible for Short Term Money Market Funds[2] and valuation at amortization method is only possible for Money Market Instruments with a residual maturity of less than three months and with no specific sensitivity to market parameters, including credit risk, and for certain UCITS[3]. ***Policy options proposed by IOSCO only should be addressed to give more flexibility to ESMA rules, amplifying possibilities for use of constant NAV and amortized cost for valuation by MMF, and they should never be additional requirements, because they would make impracticable development of MMF.***

Madrid, 28th May 2012

[2] Paragraph 13 of Box 2 in CESR's Guidelines on a common definition of European Money Market Funds, 19 May 2010, (CESR/10-049).

[3] Pages 8 and 9 of CESR's Guidelines concerning eligible assets for investment by UCITS March 2007, updated September 2008 (CESR/07-044b).

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