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Re: IOSCO Consultation Report on Money Market Fund Systemic Risk Analysis and Reform Options

Dear Sir/Madam,

UBS would like to thank IOSCO for the opportunity to comment on the Consultation Report on Money Market Fund Systemic Risk Analysis and Reform Options. Please find attached our response to the paper.

We would be happy to discuss with you, in further detail, any comments you may have. Please do not hesitate to contact Gabriele Holstein on +41 44 234 4486.

Yours sincerely,
UBS AG

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UBS Response to IOSCO on
Money Market Fund Systemic Risk Analysis and Reform Options

INTRODUCTION

UBS would like to thank IOSCO for the opportunity to comment on the Consultation Report (the "Paper") on Money Market Fund Systemic Risk Analysis and Reform Options. In particular, we appreciate your approach of outlining several alternative options based on thorough analysis in an early stage of the regulatory process.

Please find below our responses to the specific questions set out in the Paper.

Q1: Do you agree with the proposed definition of money market funds? Does this definition delimit an appropriate scope of funds to be potentially subject to the regulatory reform that the FSB could require to put in place, with an objective to avoid circumvention and regulatory arbitrage?

While we broadly agree with the proposed definition of MMFs, we do not believe that MMFs should be viewed as non-bank intermediaries for two reasons.

First, even if they offer daily liquidity while underlying holdings may have durations up to one year, there is no maturity intermediation as with banks. This is because MMFs (like any investment fund) package what is available in the market place with fund holders owning a share in the fund and hence receiving the return of the fund's holdings (minus costs) as opposed to bank deposit clients who receive a cash return as compensation for the claim against the bank.

Second, MMFs do not necessarily transform liquidity as the underlying holdings have daily liquidity like the MMF itself. However, due care must be given to liquidity risk management and other mitigating measure as liquidity in the market place might dry up temporarily.

For the reasons stated above, we do not regard MMFs as maturity or liquidity "intermediaries" but rather regulated collective investment schemes pooling assets and investing into short-term securities that are available in the market place. We would emphasize that the only intermediary function of MMFs relates to lot size where (retail) investors get a diversified short-duration exposure which they otherwise could not get due to minimum investment sizes of securities.

3. Systemic Risk Analysis

Q2: Do you agree with the description of money market funds' susceptibility to runs? What do you see as the main reasons for this susceptibility?

We by and large agree. As the main reason for the susceptibility to runs we see the combination of *market factors* and MMF *product features*.

Market factors are most critical when a long-lasting period of very low risk of short-term securities is followed by a sudden increase of credit risk as e.g. in the wake of the Lehman default.

In regards to product features, we highlight the fact that the more securities there are in an MMF, for example for risk diversification reasons, the higher the likelihood (but lower the impact in case of) that a fund owns a security that looses in value or, in the worst case, defaults implying a fall in value of the funds' NAV. As long as fund investors understand that MMF NAVs can and will fluctuate like any fund's NAV, the latter should not be a concern.

Problems arise in the case of CVAV MMF where fund holders almost never experience a NAV drop and as such are comforted by a seeming safety of CNAV MMFs which, however, does not exist. Where the NAV does drop, for example, due to a credit event of an underlying security, fund holders tend to overreact and (excessively) redeem units of the fund and as such adversely impacting the price of other securities not impacted in the first place.

Another disadvantage of CNAVs is their lack of transparency in terms of credit and liquidity risk as the security prices do not reflect changes in such risks. As such when issuer or liquidity risks increase, the lack of pricing transparency is likely to offer sophisticated investors a "first mover advantage" which is likely to intensify the downward spiral. Where these funds have an uncertain (implicit) sponsor guarantee, susceptibility to runs is increased. The more uncertain such a guarantee, for example when the sponsor itself has a credit problem in such time of market stress, the more likely it will be tested by market participants.

Given the arguments above, we would therefore argue that the reasons for the susceptibility of MMFs to runs are multifold: a joint spike of credit risk in combination with the "safe asset" perception of clients which is supported by the product feature of CNAV. Furthermore weak (implicit) sponsor guarantees. We would like to reiterate our view that we do not consider MMFs as risk-free investments and strongly support transparency in any form.

Q3: Do you agree with the description of the role of money market funds in short-term money markets? To what extent this role may create risks for short-term funding markets and their participants? Are there changes to be taken into account since the 2007-2008 experience? What are the interdependencies between banks and MMFs and the risks that are associated?

While we agree that MMFs are important providers of short-term funding, we do not support the view that there is a maturity mismatch of the MMF industry. Referring to our previous comments, MMFs wrap securities that are available in the market place and as such no maturity transformation occurs. Extra fragility, however, is brought into the financial system as a result of seemingly safe CNAV MMFs and in particular weak (implicit) sponsor guarantees during periods of general credit market stress. We therefore, and even more so since the experience of 2007-08, favour MMFs applying mark-to-market valuation principles and advocate to strongly regulate (implicit) sponsor guarantees to MMFs. As a minimum, a proper ex ante disclosure statement regarding the sponsor's guarantee in the sponsor's annual report and the fund's prospectus should be required.

Q4: What is the importance of sponsor support for MMFs? What is the respective percentage of bank versus non-bank sponsors in the MMF industry? Are there differences among MMFs depending on their sponsors? What are the potential systemic risks of support or protection against losses provided by sponsors?

The ('forced') sponsor support for MMFs is likely to be important. In our experience this is particularly the case for CNAV MMFs, but less so for VNAV MMFs. According to our estimates the percentage of bank sponsors versus non-bank / private insurance sponsors is much higher. This is because the latter require a contract which makes the potential support transparent (and costly from day one) and hence the MMF less competitive. In contrast the bank sponsor support only remains an implicit liability which may never materialize and thus appears to come for free. In our view the implicit bank sponsor support is likely to lead to a race to the bottom as the (discounted) ex ante insurance costs of an implicit guarantee are assumed to be zero, not paid and in many cases not properly understood by fund investors.

Differences among MMFs stem to a lesser degree from the extent MMFs depend on their sponsor, but rather to what extent MMFs can force their sponsors to step-in. We would reiterate our view that CNAV MMFs have more force over their sponsors than VNAV MMFs presumably because sponsors fear negative reputational effects.

Q5: Do you agree with the description of MMF benefits? Are there other benefits of MMFs for investors than those outlined in this presentation? What are the alternatives to MMFs for investors? How has investor demand for MMFs recently evolved? What would lead investors to move away from MMFs to other financial products?

We agree with the benefits outlined by IOSCO. For large institutional investors, the alternative to MMFs is direct holdings of short-term debt instruments albeit at higher portfolio management costs (as compared to the outsourcing solution). For retail investors the only feasible alternative, apart from structured products, is a bank deposit with both alternatives exhibiting huge counterparty risk.

Investor demand for MMFs was subdued in 2011 with net outflows totalling EUR 106bn globally (cf. table below).

We differentiate between strategic and tactical cash / MMF holdings. The latter only temporarily are invested in MMFs and will switch into bond, equity or multi-asset funds or other financial instruments as a function of expected returns and risks in these markets relative to cash.

Global Mutual Fund Net Flows, Full-Year 2011

€ Billion	Equity	Mixed	Bond	Other	Subtotal Long-Term	Money Market	Total
Asia (a)	21	-13	12	28	49	14	62
Europe Local (b)	-25	3	-32	2	-52	-63	-115
Int'l/Offshore (c)	-30	2	24	-7	-11	39	28
US (d)	-6	5	135	-	134	-95	39
Memo:							
Canada	*-5*	*19*	*5*	*-*	*19*	*-4*	*15*
Brazil(e)	*0*	*-10*	*20*	*12*	*22*	*4*	*25*
Total	***-46***	***5***	***165***	***35***	***160***	***-106***	***54***

Total includes Chile data as of Q3 2011.

US$ Billion							
Asia (a)	30	-18	18	39	69	19	88
Europe Local (b)	-35	5	-44	3	-72	-86	-158
Int'l/Offshore (c)	-41	2	34	-10	-16	52	36
US (d)	-9	7	188	-	187	-132	55
Memo:							
Canada	*-7*	*26*	*7*	*-*	*26*	*-6*	*20*
Brazil(e)	*0*	*-14*	*27*	*17*	*30*	*5*	*35*
Total	***-63***	***7***	***231***	***50***	***225***	***-149***	***76***

Total includes Chile data as of Q3 2011.

(a) Asia includes Japan, Korea, India, China, Hong Kong, Taiwan, Singapore, Philippines, Thailand, Malaysia and Indonesia, as well as offshore funds sold primarily in Asia, but excludes Australia. Data based on Simfund Global

(b) Europe Local includes funds with their primary market destination in Europe.
(c) International/Offshore includes international cross-border funds in Luxembourg/Dublin, as well as offshore funds domiciled in Cayman Islands, British Virgin Islands, Bermuda, etc.

(d) US data includes open-end, closed-end fund and variable annuities based on Simfund MF and VA.

(e) Brazil does not reflect 15 billion USD in flows that resulted from a reclassification by Anbima database in February 2011
Numbers may not sum due to rounding. US, Canada, Brazil results converted using year to date average exchange rate.

Source: Strategic Insight Simfund Global, MF and VA.

Q6: Do you agree with the proposed framework comparing money market funds and bank deposits? Are there other aspects to consider?

We agree that MMFs have a fiduciary duty and that investors in MMFs are shareholders rather than creditors as in the case of bank clients. We would stress the fact that an investor is a shareholder and not a creditor. As such there is no transformation of credit, maturity or liquidity and no such mismatch exists. The fund, in which the investor owns a share, only wraps existing securities (bought by the fund on behalf of its shareholders in the secondary market). This is true for maturity as well as credit exposure of an investment fund where the fund wraps securities that are available in the market place (namely short-term debt instruments with credit, i.e. default risk) and the fund holder receives the fund returns minus costs of the fund's holdings comparable to holding the securities directly, but adjusted for relative costs of management.

There is one caveat to above statement which concerns liquidity: under "normal" market conditions a MMF has daily liquidity as do the short-term debt instruments the fund invests into. As such no liquidity transformation takes place and no liquidity mismatch occurs. It is worth noting that this is also true for a MMF with daily liquidity even where its duration exceeds one day because the underlying securities have daily liquidity as well. While we are aware of certain academic research stating the contrary, we strongly defend our view. Only if the securities the fund is invested into no longer have daily liquidity, for example due to an abnormal market situation, and the fund maintains its daily liquidity to its investors (especially to those redeeming shares), there is a liquidity mismatch. Such a case would have to be addressed by liquidity risk management (as already established under UCITS IV) and where the situation does not improve, by a (temporary) suspension of redemption (equally possible under UCITS). Where liquidity dries up but not completely, illiquidity costs (actual transaction price below bid price) should be passed on to transacting investors by means of swing pricing thereby shielding long-term investors from trading costs of investors leaving the fund (of course, this is valid under normal and abnormal market conditions).

Q7: Are there other similarities or differences between CNAV and VNAV funds which would be useful for the analysis? Is there evidence (based on representative samples) showing differences in the fluctuation of the funds'

NAV depending on their model? What is the extent of the use of amortized cost accounting by VNAV funds? Has this practice evolved over time?

Under normal market conditions we would not assume persistent return differences between CNAV and VNAV funds when investing into the same securities albeit volatility of VNAV funds can be assumed to be slightly higher than of CNAV funds. Under market stress with elevated illiquidity, however, the two fund types might differ markedly as a result of different client behaviour based on different credit risk transparency levels of the two models. Whereas under the VNAV model an investor does not have any incentive to run away (because the fund's NAV always reflects the value of its underlying investments) this is the case for CNAV (and amortized cost valuation-based) funds because investors (rightly or wrongly) believe its value might be artificially kept at 100 and the (implicit) guarantee by the fund sponsor might break and therefore redeem shares as quickly as possible to get out at 100, thus actually increasing the problem.

For European domiciled MMFs, since 2011, amortized cost accounting is only feasible for short-term MMFs. UBS switched almost all Lux domiciled MMFs to mark-to-market and has not made any negative experiences. In our view informing clients about possible fluctuations and setting the right expectations are key.

Q8: What is the importance of ratings in the MMF industry? What is the impact of the monitoring function of credit rating agencies for MMFs? What are the potential systemic risks associated with ratings in the MMF industry?

Our wholesale MMFs are not rated and our retail clients have not requested that they should be. In our view ratings are more important to institutional clients. It is also important to bear in mind that ratings create dependency on rating agencies. Moreover, rating movements in the past produced herding behaviour in the market place and therefore a certain procyclicality, particularly on the downside.

Q9: Are existing rules adequately addressing risks regarding the management of collateral from money market funds? What are the risk management processes currently in place with regard to repo and securities

lending transactions? Do MMFs present unique issues with regard to their use of repo markets or would general policy recommendations that the FSB may issue regarding repo markets be applicable?

We have no comments to provide. Our UBS (CH & Lux) MMFs do not engage in repo (due to a too high dependency on a limited number of counterparties while not adding diversification to the portfolio) and sec lending transactions.

Q10: Are the above-mentioned changes in the environment of MMFs relevant factors to take into consideration? What are some of the implications for regulatory options? Are there other aspects to consider?

Yes, we believe recent ESMA guidelines on MMFs certainly are a relevant factor to take into consideration. We fully support the guidelines. We furthermore agree to the low interest rate factor which has a direct (performance) impact and an indirect (fee) impact: with cash rates close to zero, the pressure on fund providers to keep management fees close to zero persists. With the business being vastly unprofitable (especially when properly provisioning for possible future sponsor support), the outlined concentration trends may in turn lead to bigger future problems with regard to potential runs and contagion effects. Furthermore if fees continue to be nil, no reserves can be built for possible future support needs.

Q11: Do you agree with the systemic risk analysis and the rationale for reform presented in this section? Are there other factors to consider?

We by and large agree. We would like to reiterate our view that the biggest problem stems from the combination of increased market credit risk, amortized cost accounting and weak implicit guarantees by fund sponsors.

Sponsors / guarantors, whether bank or non-bank, should, as a minimum, be required to disclose in their own annual report contingent liabilities as a result of potential future support and actual past support (type, amount and beneficiary). As we do not consider MMFs to be risk-free investments, we prefer not to suggest a degree of safety which might not hold in extreme scenarios.

4. Policy Options

Q12: Do you agree with the benefits of imposing a mandatory move from CNAV to VNAV, which would amount to prohibiting the use of amortized cost valuation for any securities held by a MMF? Are the challenges identified in the US context valid in other jurisdictions currently authorizing CNAV funds? How could these challenges be overcome?

We would like to reemphasize our overall positive experience made in Europe (with mostly retail clients in our European MMFs) when moving from the amortized cost to the mark-to-market valuation approach. While initially experiencing resistance from sales colleagues who were worried that investors might redeem MMFs applying a mark-to-market valuation, such concerns proved to be unjustified. In our view it is key to explain the mechanics of a MMF to investors and that there are (normally small) fluctuations in market prices. We do not believe that US retail investors would react any different to investors in Europe.

Q13: What would be the main effects of establishing a NAV-buffer? What would be the most practical ways to implement such buffers? Should various forms of NAV-buffers be allowed or should regulators favor a single option? What would be a realistic size of the NAV-buffer and what would be the impact in terms of costs for running MMFs? In the case of subordinated shares, could the option be seen as creating a securitization position, with associated requirements in terms of retention?

We are not supportive of a NAV buffer and do not believe that this option should be pursued. We consider it to be a complicated system likely to give rise to numerous questions which will be difficult to answer including the potential size of the buffer, whether it is high enough and to whom it actually belongs when investors redeem shares. Furthermore establishing a reasonable buffer size of 0.5-5% can be expected to take a long time depending on the amount of credit risk the MMF is

exposed to. The complexity will be increased further should different forms of NAV buffer be allowed.

As an alternative to a NAV buffer for CNAV an explicit, disclosed contractual-based NAV guarantee by a third-party (bank or insurance company) continuously making up the difference of the mark-to-market based NAV and $1, could be required. We would, however, reemphasize our concern that any kind of guarantee or insurance might suggest a degree of safety which might not hold in an extreme scenario.

Q14: Do you agree with the description of the challenges associated with the establishment of a private insurance? Are there ways to address them?

We by and large agree. We have the following comments to offer: "the challenge to appropriately price risk" can be left to insurers. Only those who demonstrate they can do so sustainably can be expected to remain in the business. As for moral hazard, we would argue that insurance companies are sufficiently experienced in efficiently addressing it by self-selection mechanisms, i.e. offering a range of insurance policies with varying franchises and rates. In regards to a potential flight toward unregulated vehicles by institutional investors, we would argue that they should be dealt with should and as they appear. It is our view that the requirement of private insurance will disclose the true - but possibly very high - cost of implicit guarantees and as a result institutional investors not willing to pay the price to respond in a rational way. They are likely to in-source cash management and invest directly into short-term debt instruments leaving them with the market return, but also market price fluctuations which, in the past, they could off-load to fund sponsors for free.

Q15: Do you agree with the description of the challenges and potential second-round effects of a conversion of MMFs into special purpose banks? Are there ways to circumvent those effects?

We fully agree with the description of challenges. Unfortunately, we do not have a solution at hand to circumvent the second-round effects. We would yet again reiterate the fact safety does not come for free and that someone will have to bear

the market risk. In our view the most efficient as well as transparent market based solution would be to have market participants, i.e. investors bearing the risk of a fluctuating NAV. Investors unwilling to bear such risk are advised not to invest in such a market but instead to hold deposits, if required with several banks. We do not believe that there is a case to build SPBs (mirroring banks) at high costs.

Q16: What are the main advantages and drawbacks of two-tier system(s)? Would it be sufficient to address the risks identified? What could be the conditions applicable to CNAV funds? What could be the potential impact on investor demand? Should certain funds be exempted from certain risk limiting conditions due to their holdings?

The main advantage of coexisting VNAV and CNAV (the latter with an explicit capital protection guarantee) is that investors are given the 'option to choose'. In our view the following three conditions need to be met:

We expect the impact of such a framework on aggregate investor demand to be close to nil. Some investors might opt for CNAV and others for VNAV MMFs. In addition, we do not believe that there is a need to regulate risk limits or exemptions because there will be both low and high risk CNAV guarantee-backed and VNAV MMFs and clients will choose what serves their needs best and pay for what they get.

Q17: Do you agree with the suggestion that reserving CNAV funds for only certain investors (i.e. retail or institutional investors) would face practical challenges and would not be sufficient to address the risks identified?

Yes, we agree.

Q18: Regarding the different structural alternatives described in Section 1, what are the benefits and drawbacks of the different options described above? How could they be prioritized? What are the necessary conditions for their implementation?

Based on and subject to above answers and comments we would prioritize the different options as follows:

1) two-tier system
2) move to VNAV
3) CNAV with private insurance
4) CNAV with buffer variants
5) SPB

Q19: What are the main benefits and drawbacks of imposing the use of marked-to-market accounting for all the instruments held by MMFs? What is the availability of market prices for securities commonly held by money market funds? Are there situations where this general principle could not be applied?

As a result of new ESMA guidelines, we apply the mark-to-market valuation approach to our UBS (Lux) MMFs (apart form one MMF) since 2011. The main drawback/cost, if any, was the need to explain the new concept to our client investors. We benefit from the fact of no longer needing to build provisions early in time and writing them down over time in order to prevent the NAV from falling when a pre-defined difference between mark-to-market and amortized valuations is reached.

Where market prices for short-term debt securities are not readily available, we estimate fair value by making use of daily updated risk-free interest rate and appropriate credit spread curves. Due care should be given to market situations of reduced liquidity when an illiquidity factor is to be added. Apart from the two instances mentioned above, we are not aware of situations where mark-to-market valuation of all securities within a MMF could not be applied.

Q20: Should the use of amortized cost accounting be limited, and, if so, how? Are general restrictions on funds' WAM or WAL preferable? Are there practical impediments (e.g. availability of prices) to imposing stricter requirements on the use of amortized cost accounting than current existing regimes? What would be the potential effects on MMFs' investment allocation and short-term funding markets? What monitoring should be implemented? What conditions are advisable? In particular, please describe the rationale, feasibility and effects of limiting the residual maturity of instruments to [30-60-90-other] days. What materiality threshold could be proposed?

Yes, it should be limited as it is done under current European fund law to ensure a global level-playing field. However, the tighter the maturity limits, the lower the diversification across issuers and the yield curve and the more in danger the funding situation of banks.

Q21: What are the main benefits and drawbacks of imposing global liquidity restrictions? Should there be restrictions regarding (daily/weekly) liquid assets as well as regarding illiquid assets? Are global definitions of (daily, weekly) liquid and illiquid assets practical? Are there other conditions to consider (e.g. regarding the concentration of assets)?

We would stress our view that there should not be any (global) liquidity restrictions for liquid or illiquid assets. Such restrictions are not practical as the liquidity of short-term debt securities might change strongly over short periods of time. Instead we advocate for respective fund laws to specify responsibilities regarding liquidity risk management, i.e. that fund managers have liquidity risk management in place as, for example, required by UCITS IV.

Q22: To what extent are managers able to "know their customers" and anticipate redemptions? Are there practical obstacles for managers to "know their customers" (e.g., in the case of platforms, omnibus accounts) and how could they be addressed? What are the main features of the funds'

investor base to take into consideration from a liquidity risk management point of view? Should conditions, e.g., regarding the concentration of the investor base be considered? Would this requirement allow fund managers to better understand and manage the risks to which the fund is exposed?

While it is desirable from a liquidity risk management perspective to have redemption patterns and investor concentration figures, we would question the reliability of such data, in particular in regards to the intention of end investors. Even where the intention is known, it might change during a crisis, with many investors potentially seeking to redeem at the same time. We would argue instead that liquidity in the market place is the key determining factor.

Q23: Would such a liquidity fee generate a pre-emptive run? If so, when and are there ways that pre-emptive run risk could be reduced? How would shareholders react to the liquidity fee? Would it cause shareholders to transfer their MMF investments to alternative investment products? If so, which types of shareholders are most likely to make such transfers and to which products and will such a shift in investment create new systemic risks or economic, competitive, or efficiency benefits or harm? Would MMF board directors be able to impose a liquidity restriction despite potential unpopularity with investors and competitive disadvantage imposed on the fund? At what level such a liquidity trigger should be set?

For our UBS (CH and Lux) Fund range we introduced Single Swinging Pricing (SSP) in 2007 and moved to Partial SSP (PSSP) in 2010 ('partial' in the meaning that the fund-specific swing factor is only applied to its NAV if the daily net flow in % of funds' assets exceeds a pre-defined threshold). For the MMFs part of the fund range we have SSP in the Prospectus with the intention to invoke it by MMF BoD decision during times of market stress/reduced liquidity. By and large our experience with the system was positive. It effectively compensates the funds from transaction costs incurred by subscribing and redeeming investors. Swing factors are adjusted quarterly, thresholds annually.

A limited number of prospective clients were not willing to invest in the fund due to the swing factor that they potentially would have to bear. We, however, had no complaints of existing clients for moving to PSSP. When introducing the SSP system in 2007 we did not experience any pre-emptive runs. Although more sensitive, we believe that such a shift would work equally for MMFs as long as all MMFs introduce such a method.

Q24: How would shareholders react to a minimum balance requirement? Would it cause shareholders to transfer their MMF investments to alternative investment products? If so, which types of shareholders are most likely to make such transfers and to which products and will such a shift in investment create new systemic risks or economic, competitive, or efficiency benefits or harm?

A minimum balance per shareholder may not be practicable as (at least Continental European) fund providers normally do not know their end-clients and, hence, their specific holdings.

As an exceptional measure and for a short period of time in 2007/08, UBS restricted, by BoD decision, net outflows to 3% of fund's assets per day, put orders exceeding that threshold on a waiting list and allocated the 3% pro rata to redeeming clients. While this system worked, we believe it to be less efficient than PSSP as it effectively works like a first-come first-served system which cannot internalize transaction costs caused. Furthermore it is a solution too complicated for most investors.

Q25: What are the benefits of using bid price for valuing the funds? Are there other options (such as anti-dilution levy) which could be explored to reduce shareholders' incentive to redeem?

Even if a funds' holdings are valued at the bid price, which is standard practice today, transactions costs should be borne by transacting investors. In our view, this should also be the case for the potential difference between the bid price when actually selling and the bid price that was used for valuation purposes. Thus, bid

prices are appropriate for valuation purposes but are not enough to internalize all transaction costs caused by subscribing or redeeming investors.

In our view, it should not be about reducing shareholders' incentive to redeem given that it is the investors right to do so. We would argue instead that it is about internalizing transaction costs caused by those transacting. A more effective way to do so rather than only valuing at bid is the PSSP system which we apply and have outlined in our answer to Q23.

We consider the anti-dilution levy to be an alternative to the PSSP. The former is always applied as a pre-defined bps charge on the subscription and redemption side, respectively, whereas PSSP works differently. In case of net inflows (outflows) above some pre-defined threshold, the Valuation (or unswung) NAV is adjusted upwards (downwards) on that day by the cost-in (cost-out) swing factor to arrive at the Transaction (or swung) NAV. Cost-in/out factors may not be the same, depending on actual costs in the market place. Of course, the revenue out of the dilution levy or the swing factor belongs to the fund.

The disadvantage of the anti-dilution levy is that it is applied on the gross in- and out-flows rather than on net flows as it is the case with PSSP. What matters for transaction costs to the fund are net flows rather than gross flows. Thus, the anti-dilution levy actually overcharges investors if gross flows exceed net flows. Or in other words, if there are only in- or only outflows, the anti-dilution levy and PSSP converge (at least if the PSSP's threshold is set very low).

Q26: What are the benefits and drawbacks of allowing redemptions-in-kind? Are there practical impediments to implementing this option (e.g. some portfolio securities cannot easily be divided)?

In our view the statement "large cash redemption causes the MMF to sell securities, possibly in a down market, and transfer the loss pro rata to all remaining shareholders, <u>instead of isolating the loss to the redeeming shareholder</u>" would benefit from clarification. If the redemption is high enough to cause the market price of the funds' underlying securities to fall because the fund manager has to sell

part of them in order to meet the redemption request, it is absolutely appropriate that the new (lower) market prices of these securities are used for the (new) valuation in the fund and hence the remaining fund investors experience a lower NAV. The effect would be comparable to there being no fund and investors holding securities directly and some deciding to sell.

What needs to be isolated, in our view, is the transaction cost investors cause. If instead of receiving cash, redeeming investors would receive securities, they would seek to sell them in order to receive cash. This will lead to a decline in the market price of these securities as described above. As such while redemption in-kind is a (inefficient) way to internalize transaction costs, it is not a solution to prevent market prices from falling. Redemption in-kind is inefficient not only because of the lot size problem but also because small investors typically get even less favourable bid-ask spreads (due to small transaction sizes) compared to fund managers when selling. In addition, transactions in kind are also an operative hassle for the fund administrator and the broker settling the securities and hence will not come for free.

Q27: What are the benefits and drawbacks of requiring gates in some circumstances? Which situations should trigger gates to be imposed to redeeming investors? Would it be enough to permit gates in some jurisdictions? Would there be a risk of regulatory arbitrage?

Gates may be an option to temporarily smoothen illiquidity effects in a stressed market environment. Referring to our response in Q24, we are convinced that PSSP is more efficient than gates as prices are more efficient signals of scarcity than quantitative rationing. We do not believe that there is a risk of regulatory arbitrage if gates are not permitted in some jurisdictions such as the US (and Canada).

Q28: Do you agree with the suggestion that the establishment of a private liquidity facility faces challenges that make the option unworkable or do you see ways to circumvent these challenges?

Yes, we agree.

Q29: What are the main benefits and drawbacks of the provisions included in current regimes referring to external CRA ratings? Are there alternatives to credit ratings that reasonably can be substituted?

In our view the main benefit is that managers know what they have to do at the micro level if a rating changes (especially falling below investment grade). But at the same time this is also the biggest drawback as CRA ratings result in forced herding at the macroeconomic level. We hence suggest to delete all CRA rating wording in the provisions.

Credit risk assessment is a task that should not be delegated by investors (and if so, they should pay for that service rather than the issuer). The better alternative is to express credit risk in terms of credit spreads or spread duration instead.

Q30: What are the benefits of MMF ratings? Should a greater differentiation between MMF ratings be encouraged? To what extent are investors restricted in their investments to 'Triple-A' rated funds? What alternatives could there be (e.g. from other third parties)? What initiatives could be proposed to educate investors about MMF ratings?

We fully agree with the analysis provided.

We do not see the benefit of a MMF rating. Ratings are likely to give a false sense of security, not only in that they tend to be slow moving and pro-cyclical but they may lead investors not to sufficiently consider the credit risks they are exposed to. Referring to our earlier comments, it is primarily institutional (rather than private) investors that look for a MMF rating.

As far as Swiss/European institutional investors (primarily pension funds) are concerned, there is no regulatory requirement to only invest into 'Triple-A' rated MMFs when investing into MMFs. A lot of such restriction probably is self-imposed. A reason for such self-imposed restriction is the tendency for pension funds (and

their consultants) to allocating assets in terms of risk buckets, i.e. risk is taken in equities and not in fixed income (including cash and MMF).

5. Conclusions and additional questions

Q31: In addition to the options explored in the four sections above, do you see other areas to consider which could contribute to reinforcing the robustness of MMFs?

The MMF prospectus and marketing materials should clearly highlight that the objective of capital preservation is not a capital guarantee. MMFs are investment products like any other investment funds. Investors should therefore be aware of the risk that funds may not be able to provide liquidity in a distressed market.

We recommend that regulators should require MMFs to disclosure their portfolio holdings in a standardised format, and on a monthly basis. Regular, standardised disclosure would enable investors to assess risk, and exercise discipline over relatively risky MMFs.

Q32: Do differences between jurisdictions require different policy approaches or would a global solution be preferable, notably to ensure a global level playing field?

The regulation of investment funds differs significantly between the different regions of the globe. By way of illustration, it is well recognized that the UCITS Directive and the Investment Company Act are quite different pieces of legislations. Furthermore, there are important regional and national specificities that explain the different regulations and features of MMFs across the world as well as the different services that they bring to investors.

As long as there is no "world passport" for MMFs, we don't think it realistic and necessary to convergence towards identical regulation of MMFs across the globe. However, a certain minimum level of harmonization may be desirable. In addition, the implementation of the IOSCO principles should be monitored carefully.