AGA - n° 3044_05/Div.

International Organization of Securities Commission
IOSCO

Paris, 25 May 2012

AFG's response to the IOSCO's consultation report on "Money Market Fund Systemic Risk Analysis and Reform Options"

The Association Française de la Gestion financière (AFG)[1] welcomes the opportunity given by the IOSCO to express the French asset management's opinion on the MMF topic. Our MMF industry represents € 347,6 Bn as of end of December 2011, that is about one third of overall French funds. In Europe, the French industry represents a third of MMFs. French MMFs obey to CESR/ESMA rules on MMFs and follow the specificities set by the AMF fund classification.

[1] The Association Française de la Gestion financière (AFG)[1] represents the France-based investment management industry, both for collective and discretionary individual portfolio managements.

Our members include 411 management companies. They are entrepreneurial or belong to French or foreign banking or insurance groups.

AFG members are managing 2600 billion euros in the field of investment management, making in particular the French industry the leader in Europe in terms of financial management location for collective investments (with nearly 1600 billion euros managed from France, i.e. 23% of all EU investment funds assets under management), wherever the funds are domiciled in the EU, and second at worldwide level after the US. In the field of collective investment, our industry includes – beside UCITS – the employee savings schemes and products such as regulated hedge funds/funds of hedge funds as well as a significant part of private equity funds and real estate funds. AFG is of course an active member of the European Fund and Asset Management Association (EFAMA) and of the European Federation for Retirement Provision (EFRP). AFG is also an active member of the International Investment Funds Association (IIFA).

Question 1: 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?

If we agree that MMFs have an objective of daily liquidity and preservation of capital, we strongly believe that the definition of money market funds **should also make reference to the objective of delivering a performance in line with those of money markets.** We believe IOSCO should add this objective to the money market fund definition, as this is fundamental to money market funds (by the way, just have a look to their name: **money market** funds…).

Indeed, it should also be reminded that MMFs are investment funds and as such, there has always been an understanding from our investors that the objective of an MMF is to deliver a performance in line with money markets. Preservation of capital has always been understood as a second objective. This "Philosophical" difference between "capital preservation" objective (more CNAV oriented) and "yield in line with the one offered by money markets" (more VNAV oriented) may explain a much higher tolerance of investors for declines in value for VNAVs compared to CNAVs. In other words, **the yield objective is more appropriate to an investment fund and explains better the fund's behaviour in stressed market periods.** For instance, French clients are comfortable with VNAVs fluctuation and know that there is capital risk. Having as primary objective the capital preservation may imply that the fund is supposed to use instruments and techniques especially designed to preserve value no matter how money markets are evolving. In this case, we think that this type of objective may very well be assigned to a structured fund/guaranteed fund and we know in Europe there is a demand for this…

We also have another observation concerning MMFs and other CIS. We believe the difference is not as material as presented because each category of funds (treasury, equity, fixed income, balanced, structured, etc) is particular and MMFs are a category among others that are all part of a classification. An asset management program would not be complete without the MMF category.

Question 2: Do you agree with the description of money market funds' susceptibility to runs? What do you see as the main reasons for this susceptibility?

First, we believe a distinction should be made between two different concepts that are "systemic risk" on one side and "run risk" on the other side. "Systemic risk" is very difficult to fight as by definition "tail risks" cannot structurally be covered. Conversely "run risk" can be better addressed.

For instance, the "first mover advantage" that can accentuate the likelihood of a run does not exist on VNAVs thanks to the fact that the NAV reflects the marked to market value of the underlings in the portfolio. There is no such thing compared to **"breaking the buck" effect** in our industry. The cliff effect and collective type of threshold induced by "breaking the buck" constitutes a material difference of CNAV funds with other types of funds, where every investor may have his individual threshold that may trigger a redemption linked to his individual loss aversion and time horizon. This is possible as the fund continues operations despite a drop in the NAV and potential redeemers that incurred their cost of liquidity. Also,

the concept of "first mover advantage" is not coherent with our major principle and regulation of **shareholders equality.**

Their value fluctuates in line with money markets' evolution and it may decline, as it was the case recently (some examples are shown in the chart reproduced hereafter).[2]

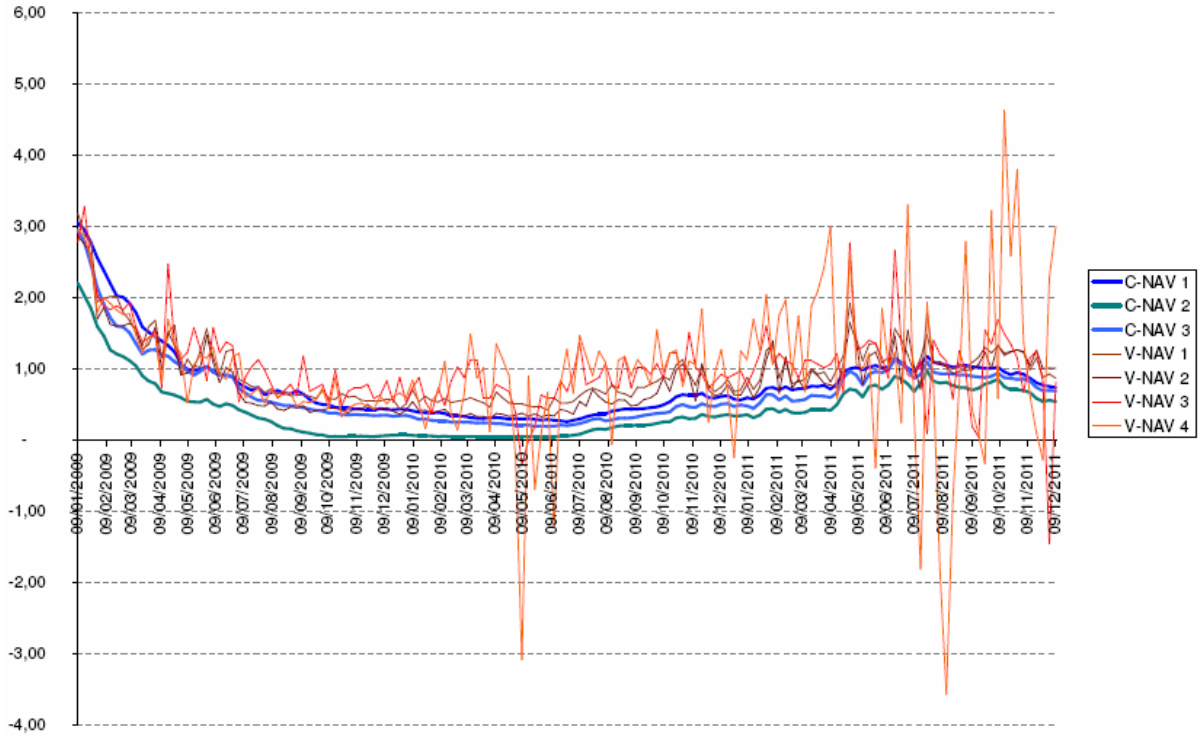


Chart: Annualised weekly performances compared of 7 European MMFs since june 2009 to November 2011

Subscriptions and redemptions are done at the NAV level and there is no intervention to maintain a stable level. Indeed, the prospectus of the fund clearly states that there is no guarantee to maintain the price of the share and that it may fall. Thus, there is no systemic risk linked to these funds. Risks linked to underlyings' evolution (ex: credit risk) are supported by investors.

During market turmoil, the NAV variability contributes to prevent any risk of run since there is no bonus for a potential first mover, instead there is equal treatment between investors. The application of the principle of equal treatment is closely supervised by the French regulator.

We agree to a lesser extent to the assertion (second paragraph page 5 of the consultation) that vulnerability to runs would depend on the perception that the fund might suffer a loss. If this were true, every single type of fund would be subject to runs and consequently no asset management product could continue operations! A clear **distinction should be made between runs on one side and large outflows** that can occur on MMFs on the other side. The latter are generally seen as "business as usual" by asset managers (due for example to

[2] We would like to clarify that we are presenting data, figures and arguments relative to the VNAVs' variability because of recent arguments that may be presented by some against VNAVs with the only objective to draw regulator's attention away from issues pertaining specifically to CNAV structures.

clients' cyclical needs) and that can be perfectly managed as portfolios are designed to cope with these large potential in/outflows.

We also think that the assertion (on page 6 last paragraph) that institutional investors would exhibit extreme risk aversion leading them to pre-emptively redeem at the first sight of heightened risk is incorrect. This cannot be said as a general principle for all types of institutional investors no matter where they are located. There are different degrees of risk averse. But let's suppose that this assertion were true, this means that those investors are not interested by an asset management product but by a deposit account. MMFs have prospectuses and the risks to be borne are clearly identified.

Some of our members believe that market practices as stress tests may also provide a consistent framework in order to manage and construct a dynamic portfolio considering future potential risks. Stress tests provide an analysis on potential shocks (yields and credits) as well as on investor concentration by investment specificities. Future potential cost estimations lead to a reduction of global risk and a better consistency on liquidity management in order to satisfy client redemptions.

Moreover, market practices as conservative approaches on short term liquidity (with instruments maturing within 1/7 days representing 10-15% of the portfolio) provide flexibility on potential outflows. (please see our answer at Q21)

Also, French funds are generally not rated, thus there is no potential cliff effect on this side. Investors do their own due diligence on firms and funds.

In addition, French MMFs cannot be used as a payment means by the investor; there is no check writing on MMFs units.

We thus firmly think that French MMFs do not bear by nature fragilities that would make them prone to the run risk.

Question 3: 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?

We agree in general with the description given. We believe that in general French MMFs do not create risks to short-term funding markets and their participants as they use intensively internal in-depth credit analysis so as their investments correspond to objective criteria (since 1987). Cases identified of MMFs having relied heavily on subjective "headline" risk instead of objective credit analysis should be closely analysed in order to understand which inner fragilities had lead to such a situation.

Question 4: 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?

Concerning the French MMFs, classified as such by the AMF, there was no need of a sponsor support during the crisis. The only few funds that benefited from sponsor support were

enhanced treasury funds that were not classified as MMFs by AMF and that have never been MMFs.

Sponsor support is voluntary and may concern any type of fund. However, this is not to be confused with an implicit guarantee. Explicitly, there is no expectation of support that is factored in by the fund producer and any potential support comes as an exception.

In France, the vast majority of sponsors are of bank and insurance types. There are also some independent actors.

The potential systemic risk may only come from an implicit support / guarantee that may come with a CNAV structure. Regarding the French VNAVs, this question is irrelevant. We recall that the NAV may drop (and investors already experienced funds where the NAV has already gone down without systematically choosing to redeem).

Question 5: 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?

Yes, we agree. We believe that as an asset management class subscribed by other funds, or funds of funds, there is no good alternative. Regarding the market evolution, there has been for instance a strong (and successful) incentive for retail to reallocate towards bank deposits.

Question 6: Do you agree with the proposed framework comparing money market funds and bank deposits? Are there other aspects to consider?

Yes, we agree. We would like to add that investors benefit from a diversified credit pool with very limited counterparty risk through MMFs whereas they bear full counterparty risk with a deposit.

Question 7: 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?

We do not agree with the argument saying that both CNAVs and VNAVs are prone to the run risk because of the maturity transformation. With this type of argument, one can say that every type of fund may give rise to run risk. The question here is much more linked to the difference in materiality and as we have already said, the "break the buck" collective threshold that creates a first mover advantage creates a non negligible difference between how the two types of structures may be prone to run risk. We would also like to remind that large cyclical outflows are not the run risk.

We would like to recall that as for any other asset management product, French MMF's NAV is subject to the fund's underlyings' behaviour and as such, it fluctuates and it can fall.

We have studied the compared variability of weekly performances[3] of European VNAVs and CNAVs to Eonia since January 2009 to December 2011. We have observed 15 VNAV funds (first 15 French MMFs by their AUM weight; the average sum of AUMs is about 100 Bn EUR) and 19 CNAV MMFs (17 Irish domiciled and 2 Luxembourg domiciled funds).

To illustrate with a graphical example, we have taken two representative funds of respectively VNAV and CNAV.

For VNAV funds, the following charts show the compared performances with Eonia:

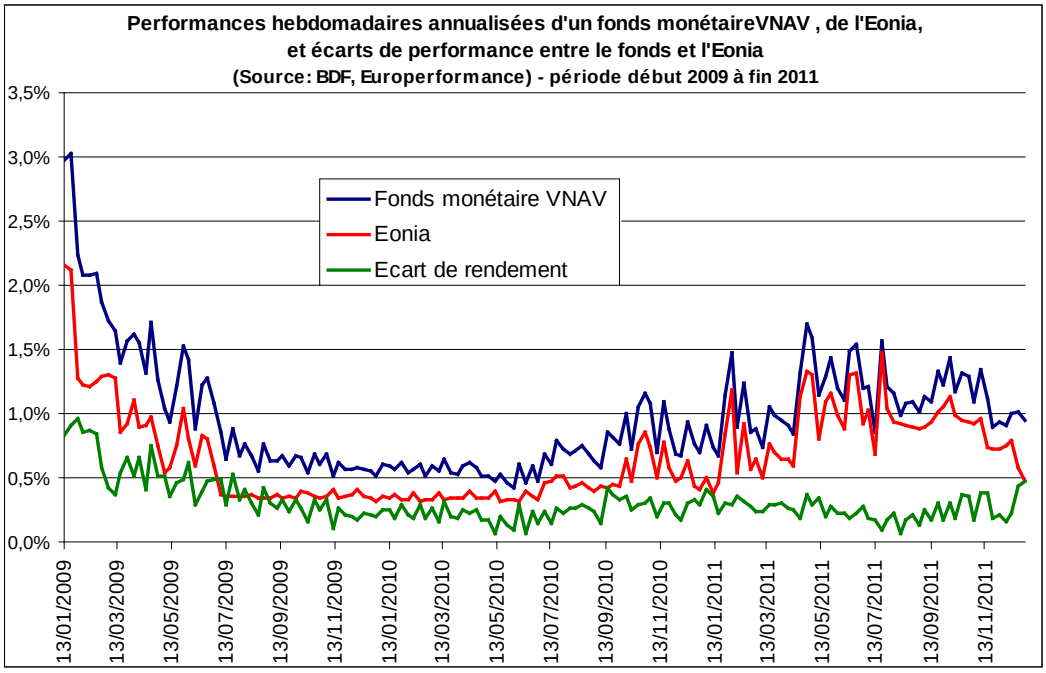


Chart: In blue, annualised weekly performance of a MMF VNAV. In red, annualised weekly performance of Eonia; in green, difference in weekly performances between the fund and Eonia

[3] The study is based on annualised weekly performances of the MMFs and annualised average on each week of daily Eonia rate

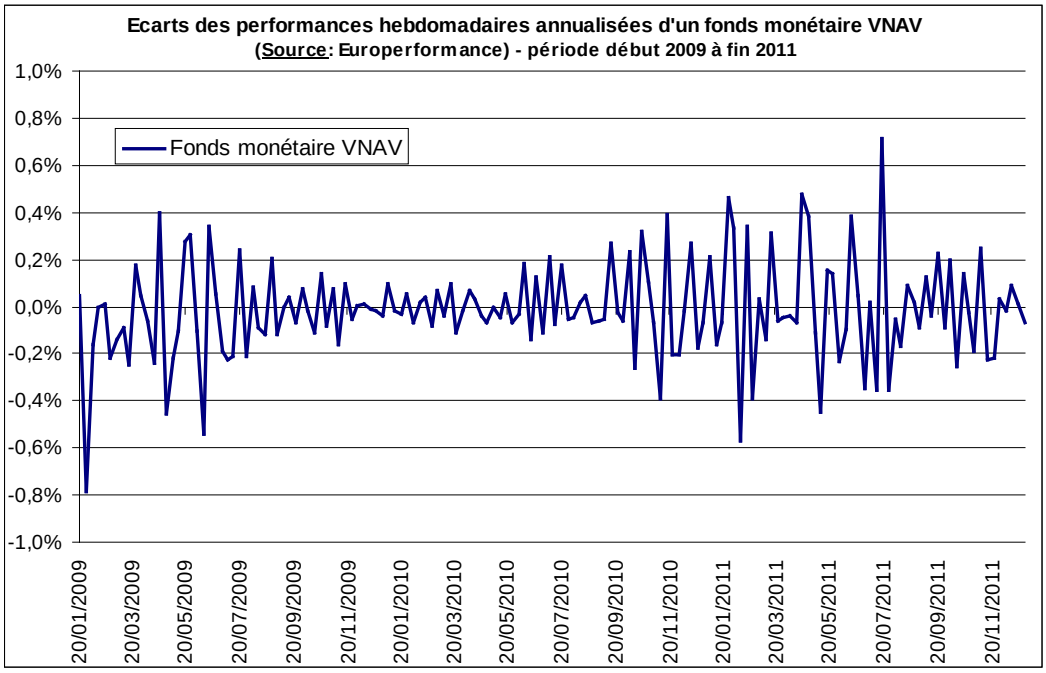


Chart: successive variations compared to Eonia of the (precedent's chart) VNAV's annualised weekly performances

For CNAV funds, the following charts show the compared performances with Eonia:

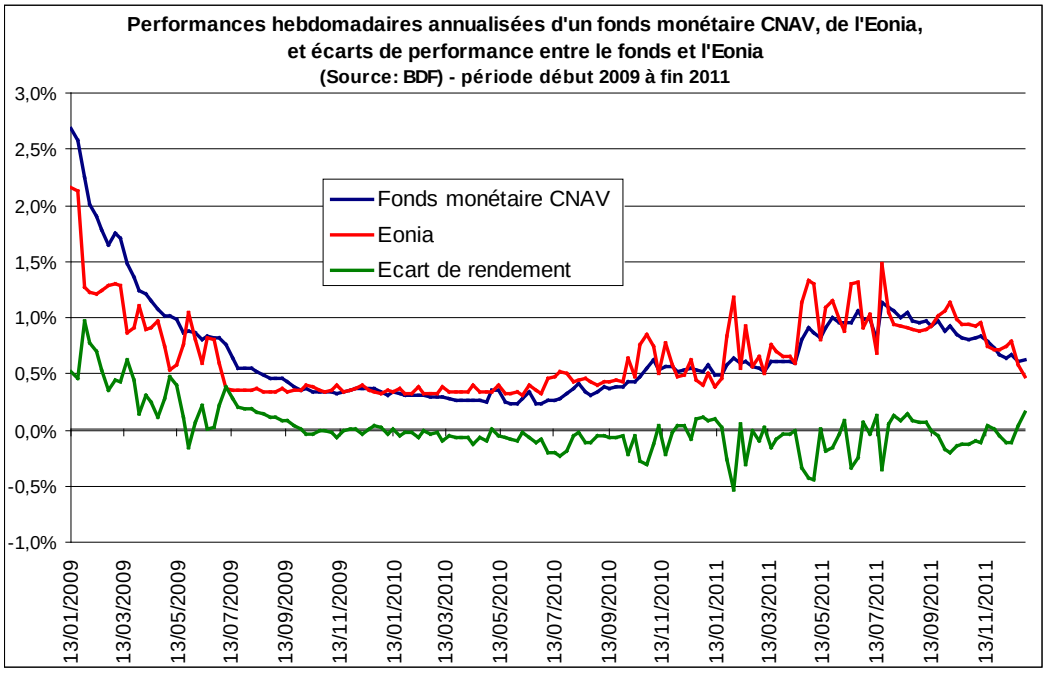


Chart: In blue, annualised weekly performance of a MMF CNAV. In red, annualised weekly performance of Eonia; in green, difference in weekly performances between the fund and Eonia

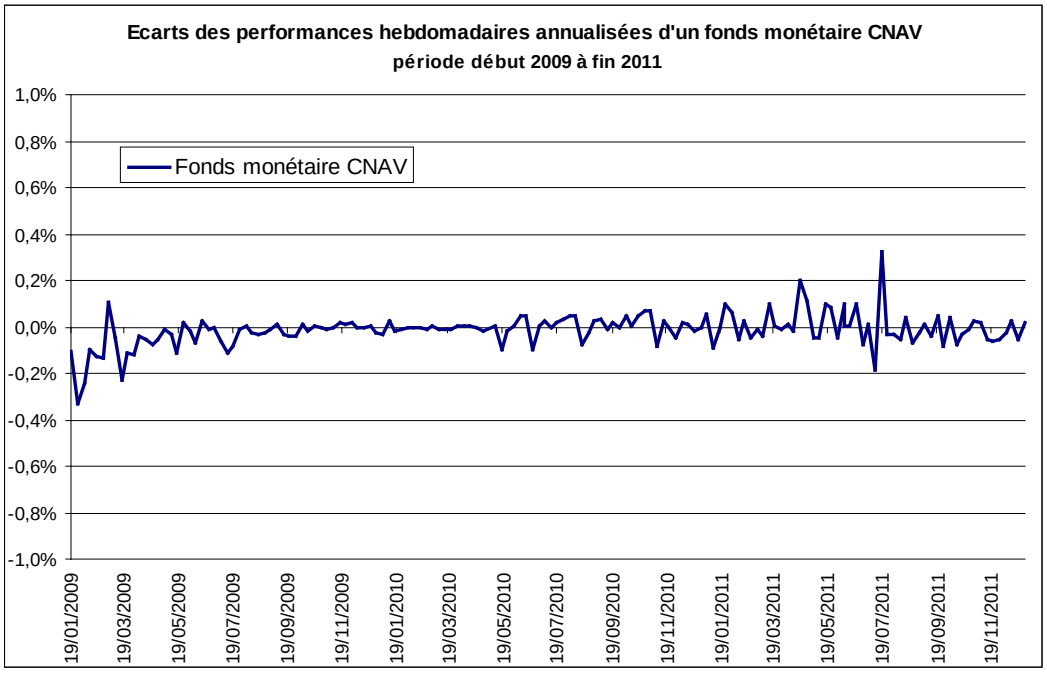


Chart: successive variations compared to Eonia of the (precedent's chart) CNAV's annualised weekly performances

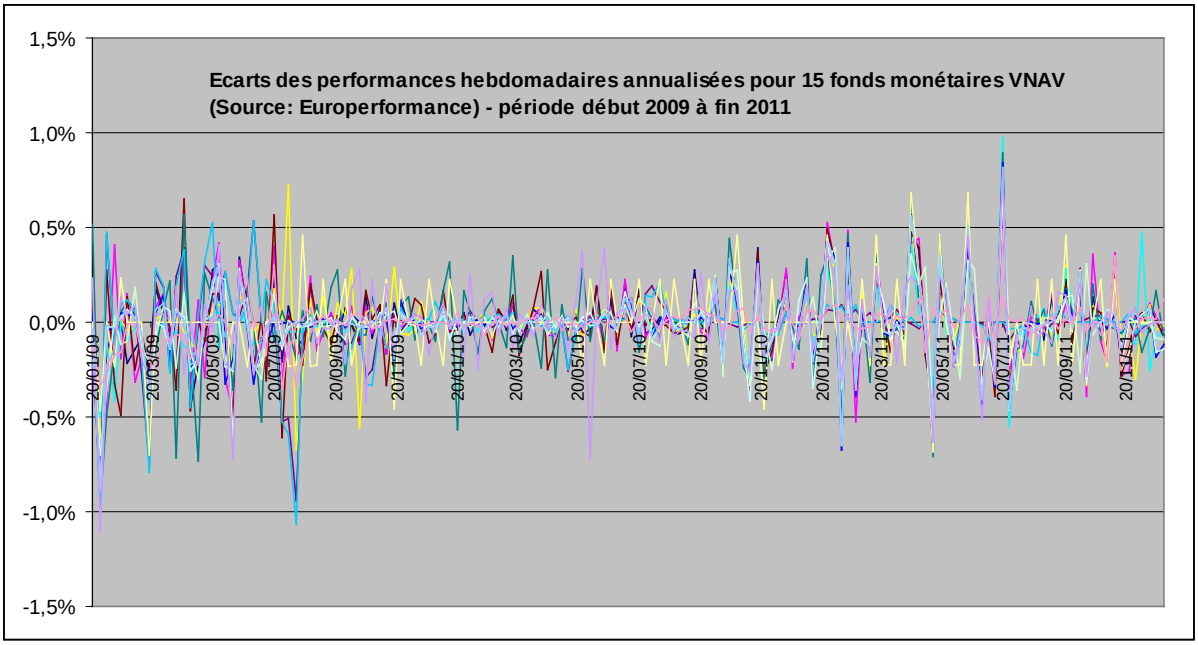


Chart: Summary chart - annualised weekly performances compared to Eonia for the VNAVs in the study

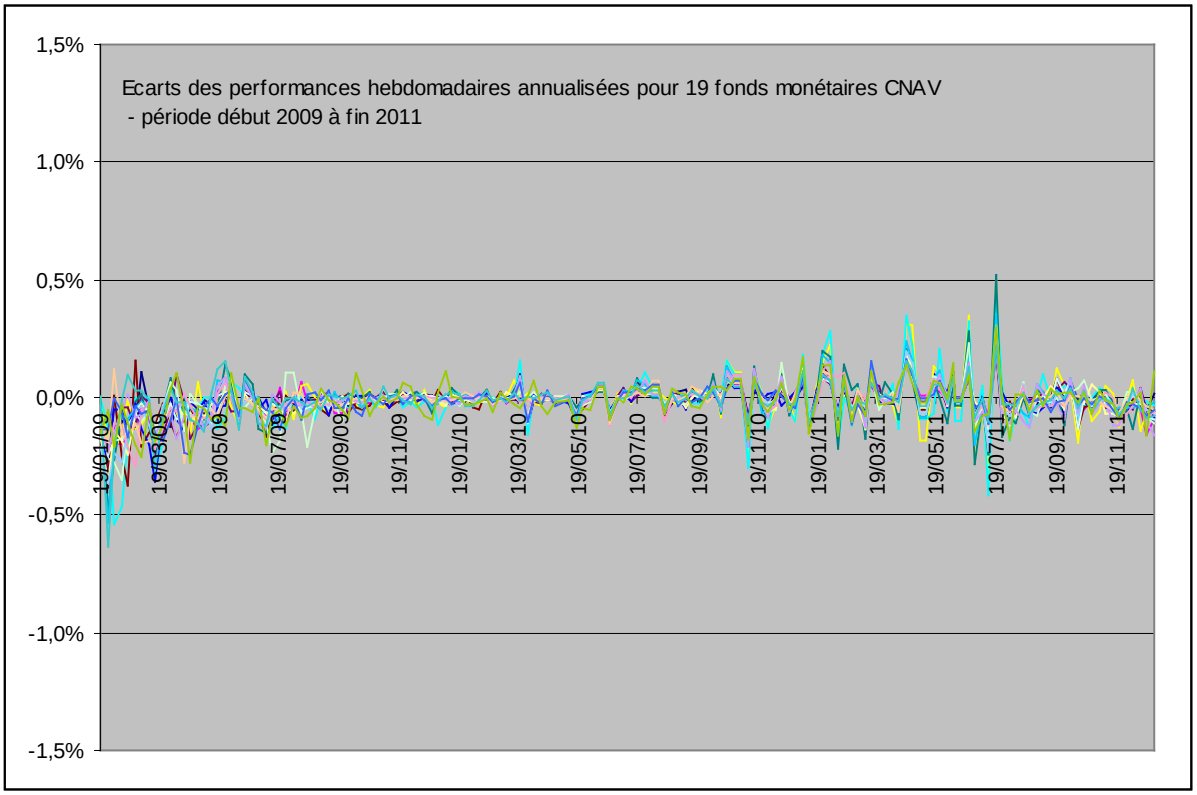


Chart: Summary chart - annualised weekly performances compared to Eonia for the CNAVs in the study

Our study concluded that French MMFs, as any other asset management product, have their own natural variability of the NAV, that can be seen when compared to their benchmark (Eonia) and that is due to the active management of their underlyings. The variability of the NAV corresponds to the "look-through" made possible by a marked to market valuation of the fund's underlyings.

Indeed, it should be reminded that French VNAV MMFs have the same valuation rules as any other asset management fund and the principle is: marked to market valuation.

There is one exception for less than three months instruments. Funds are authorised – instrument by instrument - to apply amortised cost accounting only for negotiable debt securities with less than three months residual maturity and that have no specific sensitivity to market parameters. This faculty exists because the current system would need costly implementations to deal with more complicated models when market prices are not available at the very short end of the yield curve and/or for OTC instruments such as CDs, CPs etc..

For French VNAV MMFs it would be possible to move to a 100% marked to market VNAV, however the operational costs would outcome the "benefits" of such a measure. Indeed, French VNAVs are essentially marked to market vehicles, the amortised cost being only used for cases where there are market reasons that explain the need for such a marked to model pricing. This less than three months amortised cost accounting is a simplifying valuation model that can be used when there is no particular sensitivity to markets. It should be reminded that this faculty implies no material difference with the market price. We can therefore say that French VNAVs are as marked to market as possible.

This “exception” is controlled very strictly by the risk manager of the asset manager, the auditor and the local regulator that are bound by the Chart of Accounts that is the reference text[4].

The risks of using amortised cost accounting for negotiable debt securities with less than three months maturity are very small: the interest rate risk over a three months period is much lesser than on 397 days and the credit risk is four times smaller; also, the three months period corresponds to the cycle of publication of results by issuers, meaning that a paper under three months has a very high likelihood to be reimbursed at par at maturity.

Thus, the use of amortized cost accounting may be considered almost the same only for funds (VNAVs and CNAVs) that invest only in instruments below 3 months and that, for papers sold on urgency below their valuation in the fund, are not authorised to amortise the loss[5]. Conversely, 397 days amortised cost accounting vs 90 days are not the same in terms of valuation (different interest-rate risk and credit risk) and in terms of transparency as fluctuating NAVs offer transparent information for the investors on the risk taken in the portfolio.

We therefore think that 3 months in the case of VNAVs (under specific conditions for certain types of instruments) versus 13 months amortization in the case of CNAVs (for the whole portfolio) is not comparable, there is a material scales difference.

Hereafter, are given examples of Bloomberg price curves of three floating rate notes with respectively the 13 months and 3 months linear lines drawn. It can be seen that the use of 3M amortised cost helps not capturing the market “noise” without diverging too much form the price curve.

---

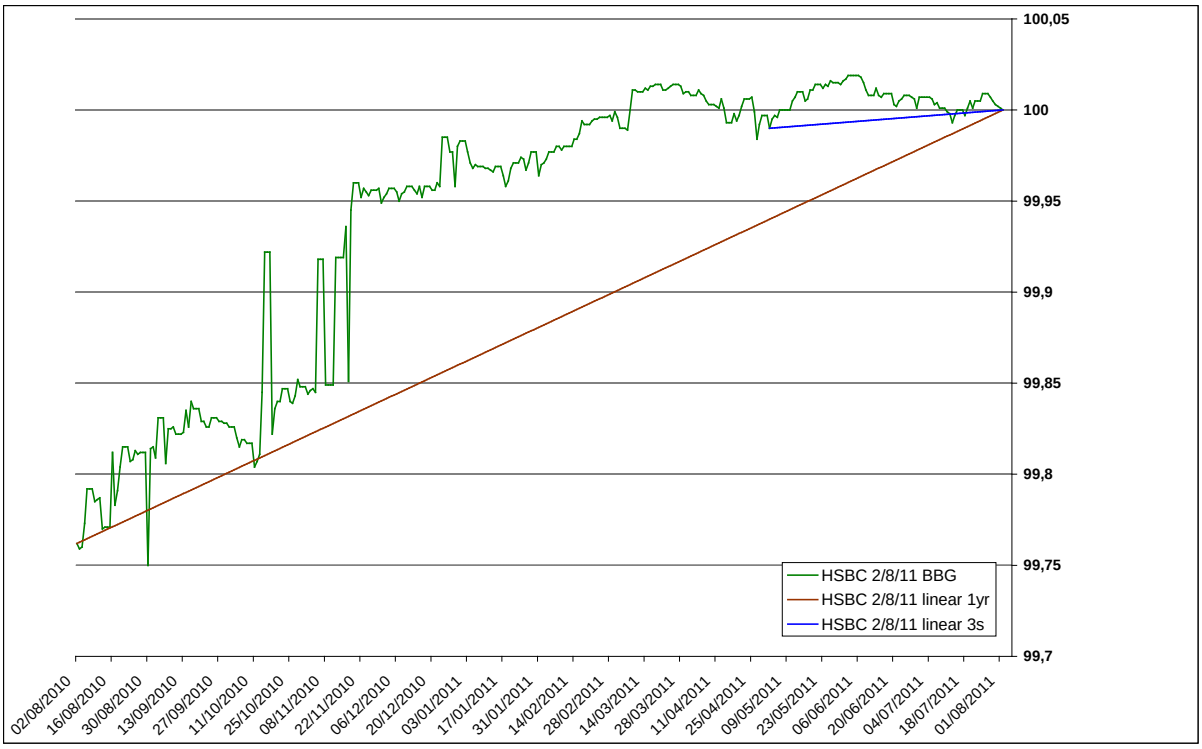
[4] 332-1 - Valeur actuelle
L’OPCVM valorise les dépôts et les instruments financiers à la valeur actuelle. Toutefois, les titres de créances négociables d’une durée résiduelle inférieure ou égale à trois mois peuvent être valorisés selon une méthode simplificatrice de valorisation en l’absence de sensibilité particulière au marché.

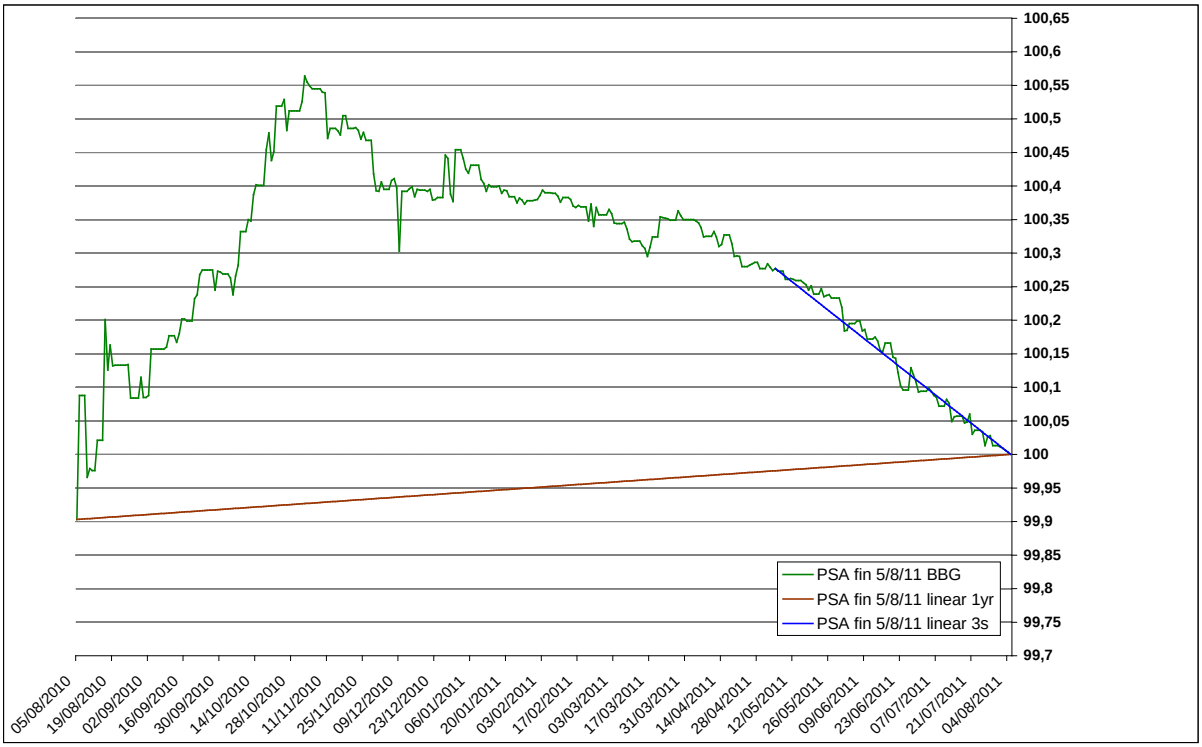
333-22 - Méthode simplificatrice

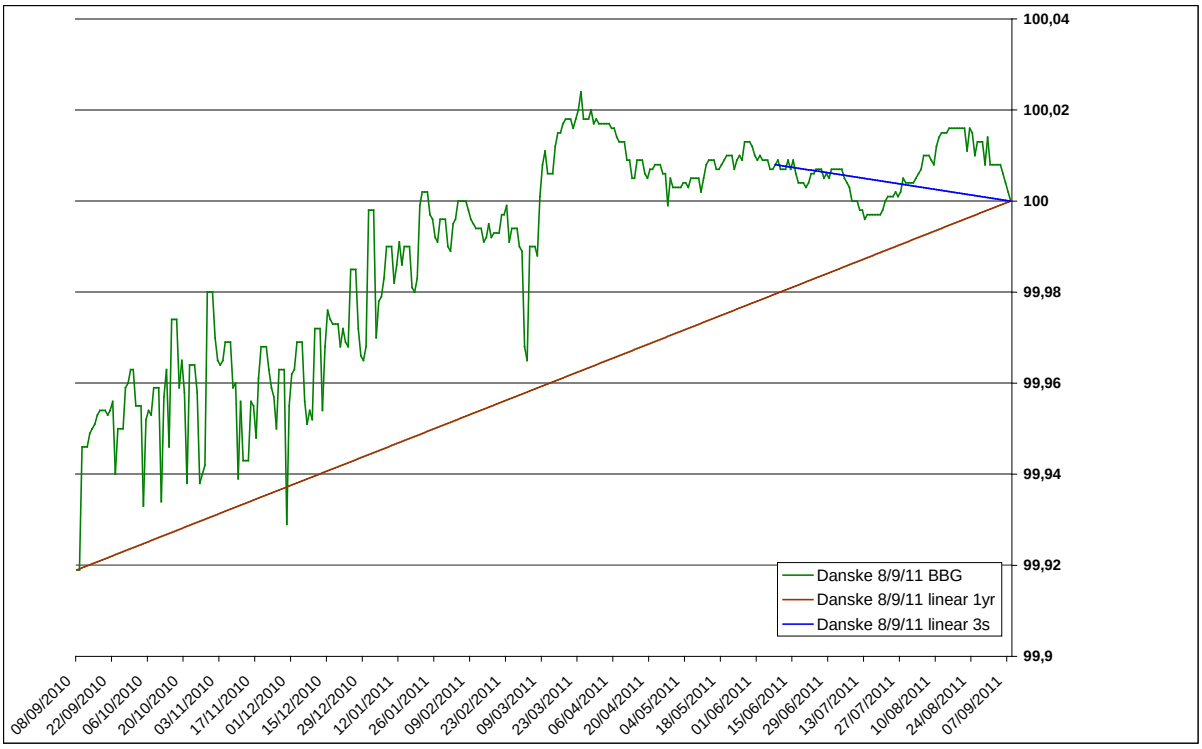
Cette méthode est applicable aux titres de créances négociables d’une durée résiduelle inférieure à trois mois. Ils sont évalués en étalant linéairement sur la durée de vie résiduelle la différence entre la valeur d’acquisition et la valeur de remboursement.

En application du principe de prudence, les valorisations résultant de l’utilisation de ces méthodes spécifiques sont corrigées du risque émetteur ou de contrepartie. Toutefois, en cas de sensibilité particulière de certains titres aux risques de marché (taux,…), la méthode simplificatrice doit être écartée ».

[5] French funds are not authorised to amortise losses. In any case, from the point of view of the equality of treatment between investors, it would be difficult to accept such an accounting faculty.


100,05
100
99,95
99,9
99,85
99,8
99,75
99,7
HSBC 2/8/11 BBG
HSBC 2/8/11 linear 1yr
HSBC 2/8/11 linear 3s
02/08/2010
16/08/2010
30/08/2010
13/09/2010
27/09/2010
11/10/2010
25/10/2010
08/11/2010
22/11/2010
06/12/2010
20/12/2010
03/01/2011
17/01/2011
31/01/2011
14/02/2011
28/02/2011
14/03/2011
28/03/2011
11/04/2011
25/04/2011
09/05/2011
23/05/2011
06/06/2011
20/06/2011
04/07/2011
18/07/2011
01/08/2011


100,65
100,6
100,55
100,5
100,45
100,4
100,35
100,3
100,25
100,2
100,15
100,1
100,05
100
99,95
99,9
99,85
99,8
99,75
99,7
PSA fin 5/8/11 BBG
PSA fin 5/8/11 linear 1yr
PSA fin 5/8/11 linear 3s
05/08/2010
19/08/2010
02/09/2010
16/09/2010
30/09/2010
14/10/2010
28/10/2010
11/11/2010
25/11/2010
09/12/2010
23/12/2010
06/01/2011
20/01/2011
03/02/2011
17/02/2011
03/03/2011
17/03/2011
31/03/2011
14/04/2011
28/04/2011
12/05/2011
26/05/2011
09/06/2011
23/06/2011
07/07/2011
21/07/2011
04/08/2011



Charts above: Price curves for three stocks and their respective 13 months and 3 months straight lines.

The portion of amortised assets in a French VNAV depends on the proportion of less than 3 months negotiable debt securities versus all the other assets and on the market sensitivities of the underliers. A very short maturity portfolio with very low market sensitivities may have a high portion of its assets eligible to cost accounting.

The evolution to be noted in the portfolios is linked to the proportion of liquidity instruments with less than 7 days maturity that is systematically implemented in the French portfolios coupled in general with a shorter maturity portfolio (directly linked to the market characteristics coupled with current client demand).

Question 8: 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 view related to MMFs AAA ratings is that in their great majority, either MMFs are awarded the AAA or they are not rated. The scale granularity is generally not used and during the crisis, MMFs susceptible to be downgraded became not rated. Thus, generally AAA rating looks more like a **label**.

French institutional clients are not required by their internal branch rules to select rated MMFs and that explains why French MMFs do not ask to be rated. Nevertheless, we acknowledge that some institutional clients situated in other European countries either have rules linked to AAA ratings or prefer rated funds when they buy third country managed MMFs. Notwithstanding the methodological efforts made by rating agencies, we believe that using asset liability management proves often more dynamic and efficient than relying on

ratings that use one-size-fits-all type of methodologies. In addition, the monitoring role is performed in France by the regulator which regularly questions the industry on their holdings and management practices.

Also, we would like to reiterate AFG's general position that backs regulators' efforts to reduce over-reliance on rating agencies related both to requirements on ratings of instruments in the fund and ratings for the fund itself.

Related to current ratings' reference in the "CESR's Guidelines on a common definition of European money market funds", we believe there should be no mandatory reference to CRAs' ratings or level. Indeed, we believe MMF managers should assess internally the instrument's quality and CRAs' ratings should only be an optional input and not a mandatory & mechanistic eligibility criterion.

We believe the eligibility criteria should not be mechanistically linked to all external ratings given to the instrument, rather the mandate of the fund should specify that best quality/highest short term credit levels instruments are eligible and that the quality is assessed by the asset manager. **The asset manager has to ensure by all means at his disposal that the credit risk taken is consistent with the fund's objective as a MMF**. He should also indicate his policy on the taking into account of ratings, if any, of the instruments in the portfolio.

Question 9: 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?

Sales repurchase agreements, also known as "repos", are one of the most secure money market operations for funds.

A repo ("pension" in French) is a transaction whereby a seller sells financial assets against the payment of the purchase price by the buyer, with simultaneous agreement to buy back from the counterparty those same assets at a pre-set price and pre-set future date They are contractually well-defined and implemented so as to reduce legal and operational risks.

We do not think that repos in MMFs present unique issues. In the funds' daily practice, repos are an integral part of MMFs normal dealings, especially so for "government MMFs" (MMF's whose investment policy only allows government securities). They represent about 5% - 15% on average in portfolios, and more in a govies MMF. French MMFs use only very short term callable (24h/48h) repos entered with MMF eligible counterparties. The nature of the financial assets used in repos entered by French MMFs is of very liquid type and voluntarily restricted to straight bond type (no structured features). As repos are used very short term in French MMFs, in practice there is no reuse, repledge or reinvestment of these financial assets. However, a rule restricting these operations on the nature of the financial assets may be counterproductive in the future in relation with other pieces of regulation, EMIR and initial/variation margin rules for instance.

In France, from a legal standpoint, the repo financial assets buyer has full property over the assets having been delivered to it. All transactions are governed by so-called "master

agreements" which directly refer to the French Code Monétaire et Financier. This legal feature intends to completely remove a risk because the financial assets buyer would be able to keep the financial assets in case of failure of the financial assets seller.

From an operational risk standpoint, repos in France must be executed with physical delivery of the financial assets through an electronic "cash against delivery" settlement system which removes a risk where cash would be released but financial assets not delivered against it. Physical delivery of the financial assets to a ring-fenced custodian account in the name of the fund is of course a very important feature in terms of risk being adequately addressed.

Important aspects are the "Agreements" in place whereby cash is to be released either from the financial assets buyer so as to protect both parties against market value changes of the financial assets.

Repos offer a very useful, flexible and safe financial instrument in MMFs. Again, for a given counterparty/issuer, repos are safer than other typical MMF investments. For example, it is safer for an MMF to engage into a repo transaction with Bank XYZ where the MMF buys financial assets, pays the price and receives or pays variation margins, as opposed to just buying a CD for that same Bank XYZ without any guaranty such as collateral.

There is probably scope for policy recommendations with the aim of strengthening the global regulatory framework with regard to repos' specific features:

- make sure that repos are being executed as part of a well-defined legal framework;

- make sure that repos involve physical delivery of the financial assets into a ring-fenced account in the name of the fund;

- make sure that repos are executed through electronic "cash against delivery" settlement systems;

- implement minimum credit quality requirements for the repo counterparty;

- for the financial assets received: implement minimum credit quality requirements and/or appropriate haircuts and/or overcollateralise by margin calls;

- make sure there is little correlation between counterparty and financial assets received.

Question 10: 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 would like to specify that only bilateral repos are available in the French market and they have been in use for about 20 years with a secured contractual framework and a very selective risk management process of eligible counterparties for MMFs.

We would also like to stress that French MMFs are tightly regulated funds since 1987 and are a full part of an asset management program. They are not of hybrid type nor of banking type; they are an investment fund UCITS regulated. Any regulatory measure possibly touching the French MMFs should be consistent with asset management / UCITS rules.

CESR's Guidelines on a common definition of European money market funds were released in July 2010 and are fully applied to all funds marketing themselves as MMFs since 1st of

January of this year. This piece of regulation is a high quality pan-European set of regulation that clearly defines MMFs and **restricts the use of the word MMF for "Money Market Funds" and "short term Money Market Funds"**. This reform has required

- the conformity of the portfolios with the new rules with a transition period of one year and a half since the publication and 6 months since the French transposition (for those funds wishing to stay classified as MMFs)/;

- the migration in classification (towards short term bonds or balanced funds) for those funds wishing to keep their investment objective unchanged.

Question 11: Do you agree with the systemic risk analysis and the rationale for reform presented in this section? Are there other factors to consider?

French money market funds are not "Shadow banking" products. They are asset management products that are highly regulated. Asset management companies have been regulated especially for that purpose several years ago.

If it is true that MMFs favour the encounter between investors and short term funding needs, it should be clearly reminded that they are not themselves a source of credit.

As already stated above, French MMFs are not of hybrid nature, they cannot be used as a payment means by the investor and there is no check writing on MMFs units. We thus believe that any new measure should clearly be consistent with the collective investment management framework.

We would like to comment the argument that amortized cost accounting is encountered for both types of funds (CNAV and VNAV) and as such "Tweedledee and tweedledum, it is all the same"… As we have already stated at Q7 above, we believe that marked to market with a 3 months faculty (under specific conditions for certain types of instruments) versus 13 months amortization (for the whole portfolio) is not comparable, there is a difference of degree.

Regarding the 3 months amortization faculty, we propose at Q20 to specify the framework of its use (as even if on an individual basis, French managers have already their internal risk rules, we believe useful to propose a collectively objective framework).

POLICY OPTIONS

Question 12: 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 think that implementing the reform option of a mandatory move to 100% floating VNAV would prove to be extremely difficult for a whole industry to make, as this is such a major

change. In the case such a move is decided, it may lead to a sort of “big bang” throughout the industry; thus, why not considering (so as to avoid a brutal change in the fund’s behaviour) a smooth transition of the portfolio with a sufficient delay/transition period.

For instance, in France portfolios have known two heavy reforms:

- in 2002/2003 where marked to market principle has been clarified ; no position with more than 3 months maturity could be subject to amortization and strict conditions for less than 3 months amortization have been specified (1 year and a half transition period);
- in 2010/2011 where CESR/ESMA guidelines were introduced (1 year and a half transition period since the publication and 6 months since the French transposition).

Even for French VNAV MMFs, whose NAV is valued based on the most current market valuation, it would be possible but difficult to implement from an operational standpoint. It should be reminded that MMFs are funds like any other and that valuation rules should respect the same principle which is: marked to market valuation. When prices are difficult to find or are inaccurate, instruments may be valued using a model. The UCITS Directive enables both valuation methods. Cost accounting valuation is a type of marked to model valuation.

We believe that another terminology should be used for CNAVs because the word “constant” may imply that the fund is not marked to market and cannot lose value (and may even wrongly imply there is a guarantee of the principal). For instance “daily distribution fund” may be more appropriate.

French MMFs are not authorised to distribute capital gains until 01/01/2013 (and starting with this date, only realised capital gains - and not unrealised - could be distributed). Thus, French domiciled MMFs cannot be created with a constant NAV, but only with a floating NAV, as any other asset management fund. We believe an impact study should be made from a fiscal standpoint on European MMFs market. An MMF, as any UCITS, may have both distribution and accumulation shares. Accumulating NAV funds and distributing NAV funds generally operate under the same investment guidelines, however income is accrued daily for the first and distributed for the latter. In the case of accumulating NAV funds, income is reflected in an increase in the value of the fund shares and is realized upon redemption of those shares at a higher price. Depending on the laws of the investors’ country of residence, the tax treatment of distribution and accumulation shares may be different. Also, the fiscal definition of what may be distributed or not (interest, dividends, realised vs unrealised income) differs. It should be clarified 1) if a classical share has the same fiscal effect as a “1 dollar/euro” accounting and 2) how to achieve fiscal coherence throughout Europe on the definition of what may be distributed.

We very strongly disagree with the assertion that there would be some evidence suggesting that both types of funds are prone *similarly* to run risk and first mover advantage. As already stated at Q2 we believe the “first mover advantage” that can accentuate the likelihood of a run do not really exist on VNAVs where there is no cliff effect and collective type of threshold induced by a “constant” level to be maintained. We disagree with the idea that the “limited liquidity” alone would induce *similarly* on both types of fund an incentive to be the first mover (with any perception of heightened risk). If this was true, we believe every single type of fund would be subject to runs and consequently no asset management product could continue operations.

Questions 13 to 18

Question 13: 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?

Question 14: Do you agree with the description of the challenges associated with the establishment of a private insurance? Are there ways to address them?

Question 15: 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?

Question 16: 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?

Question 17: 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?

Question 18: 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?

French MMFs are only created with a VNAV structure. Thus, the options proposed here do not concern our funds. These options are envisaged as “pledges” in order to be able to maintain the constant structure of CNAVs. They are very diverse and each transforms the fund in a different manner, thus we understand the objective is to maintain the system, no matter if the remedy triggers the fund’s structure into one direction or the other. It is thus somewhat different from our stance, as we believe (inspired by the French example) that MMFs are asset management products where the risks of the fund are borne by the investors in a fair and equal manner. The fund’s structure is transparent; it does not create a shield between investors and investments.

Subject to above, we believe that in order to prevent run risks, a fund should seek the equal treatment of investors. Equal treatment of investors is a fundamental concept to be observed for collective asset management vehicles and it should be clearly reaffirmed for all funds and in particular for MMFs. Indeed, operations on the fund (such as valuation, management of subscriptions/redemptions, etc) should not prejudice interests of investors (either new or existing investors). Marked to market valuation respects this principle. Any marked to model

valuation has to earn investors' common confidence that they are treated equally. Thus, the fund management's duty is to seek on an ongoing basis to create favourable conditions to apply equal treatment for the sake of the mutualised interest of investors in a collective scheme (and not privilege individual investors or past/new investors over each other).

In this respect, we believe liquidity buckets and marked to market valuation favour the equal treatment by ensuring there is no first mover advantage. When the NAV is a look-through of the market prices, there is confidence in the sincerity of the valuation.

- Relative to NAV buffers, we would be concerned about investors' equal treatment.

- Relative to the subordinated equity share class / securitisation solution, the structure of the fund is not UCITS compliant.

- For other solutions proposed to constitute the buffers, we question their effectiveness to absorb serious shocks.

- Relative to the insurance solution, given current market yields, there are questions of viability.

- The Special Purpose bank solution transforms the structure which is not a collective investment product any more.

- Relative to the option of CNAV reserved for either retail or institutional investors, we observe that there is an asymmetry of information between the two when information about the shadow price is not known equally by investors. A daily publication of the shadow NAV would permit investors to take equally informed decisions. Institutional investors seem to have a higher volatility and be more qualified to perform due diligences on asset managers and funds and set their own risk averse thresholds. Thus, VNAV funds are suited for institutional investors (in any case, in French VNAV funds are well subscribed by all types of investors including institutional investors).

MMF VALUATION AND PRICING FRAMEWORK

Question 19: 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?

It should be reminded that MMFs are funds like any other and that valuation rules should respect the same principle which is: marked to market valuation. When prices are difficult to find or are inaccurate, instruments may be valued using a model. In Europe, the UCITS Directive enables both valuation methods. Cost accounting valuation is a type of marked to model valuation. We thus believe that imposing the use of mark to market valuation is in line with the requirements any fund follows already. We support this proposal as the one that marks the fact that MMFs belong fully to the collective investment.

As to the availability of market prices, the current system would need costly implementations to deal with more complicated models when market prices are not available at the very short end of the yield curve. Funds are authorised – instrument by instrument - to apply marked to model pricing. The practice in France is to apply amortised cost accounting (a subset of mark

to model) only for negotiable debt securities with less than three months residual maturity and that have no specific sensitivity to market parameters.

Even if we believe that marked to market could be imposed on every line of a MMF, the benefits of such a measure would be outpaced by the cost of providing a more sophisticated mark to model and documenting every single act of valuation. We believe that from an operational standpoint, the faculty of using 3-months amortised cost accounting should be kept. This less than three months amortised cost accounting is a simplifying valuation model that can only be used when there is no particular sensitivity to markets. It should be reminded that this faculty implies no material difference with the market price.

Question 20: 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?

We would rather propose an even stricter framework as a mix of Option 1 and Option 2, ie restricting the amortized cost accounting use <u>and</u> using a materiality threshold.

The application of this amortisation faculty is to be controlled very strictly by the risk manager of the asset manager, the auditor and the custodian.

The risks of using amortised cost accounting for negotiable debt securities with less than three months maturity are very small: the interest rate risk over a three months period is much lesser than on 397 days and the credit risk is four times smaller. Also, the three months period corresponds to the cycle of publication of results by issuers, meaning that a paper under three months has a very high likelihood to be reimbursed at par at maturity.

The framework authorising the use of cost accounting should specify clearly that only negotiable debt securities with a residual maturity of less than 3 months and that have no particular sensitivity to markets can use amortised cost accounting. This is to be understood as a simplifying method to be used only in cases where:

1) there is operational difficulty to access updated and reliable market prices, and

2) in the absence of any particular sensitivities (to credit risk, interest rate risk,..etc), cost accounting proves to be an appropriate approximation (that justifies not to have the need for a more advanced model that would take into account credit curves for instance), and

3) the asset manager has procedures in place, escalation plans, as well as commensurate human & technical means in order to monitor the possible difference that may arise between amortised cost and marked to market (or marked to a more advanced model) price consolidated at the portfolio level.

The **escalation plan** could define a **materiality threshold** where the asset manager has to analyse the need to take corrective action so as to keep the pricing difference at or below the threshold level. Corrective action may take the form of switching to a marked to market (if possible) or to a more advanced marked to model price (that would take into account credit curves for instance) in order to value the instrument. The threshold could be for instance 10 bp (alert level) measured on a consolidated level for the entire portfolio and 25 bp (corrective action level).

It is understood that apart this faculty, instruments (including instruments maturing in more than three months) are marked to market (or, if needed, to an appropriate model that takes into account credit spreads for instance).

OPTIONS REGARDING LIQUIDITY MANAGEMENT

Question 21: 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)?

Even if the CESR's Guidelines on a common definition of European money market funds do not impose specific liquidity measures, they are nonetheless already applied by the asset managers in the context of their liquidity risk management. French MMFs already apply liquidity buckets on an individual basis. We welcome a regulators' collective threshold that would harmonise practices. Daily monitoring by the risk department should be in place and monthly publication through the fund's reporting.

The liquidity cushion is to be monitored taking into account instruments that can be **transformed in cash without uncertainty**, therefore a common definition of liquidity has to be linked to the concept of **maturity**. Eligible instruments should mature / have callable features **within 1 to 7 days**: cash, overnight and less than 7 days maturity instruments and deposits, repos with a call at 7 days or less, money market funds.

The weight of the liquidity bucket depends on the mix of measures each fund has put in place depending on its asset liability pattern. Notwithstanding the aforementioned, MMFs could be required to hold a minimum level of liquidity measured as a **one month moving average** of **10%-15%** with instruments maturing in less than 1/7 day. A temporary difference should be acceptable if the liquidity bucket is used to meet a redemption that causes the fund liquid assets to fall below the liquidity ratios.

Question 22: 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?

We believe that the principle of making the best efforts to know the fund's shareholders, especially for funds with institutional investors that have cyclical needs, is definitely a highly

effective measure allowing to better scale the portfolio (asset side) so as to match the liability side.

The use of asset liability matching techniques help to address liquidity issues naturally, through the structure of the portfolio and through active adjustments of the portfolio (with for example active bond selection).

The knowledge and monitoring of the clients' base as well as their subscription/redemption cycles allows building the fund on the maturity scale and monitoring the needed level of liquidity cushion. Especially in presence of institutional investors, managers should monitor the client base concentration as well as type of behaviour (by the means of statistical study and/or ongoing dialogue with clients). Measures to favour liquidity on liability side are already in place for French VNAVs.

Nevertheless, it must be kept in mind that investors have the right to subscribe/stay/exit a fund depending on their needs. Liquidity buckets are also highly useful. Measures to favour liquidity on asset side also are already in place for French VNAVs on an individual basis. In conclusion, there are several techniques that, used in conjunction, lead to the appropriate mix fund by fund. Indeed, liquidity is not an easy and stable concept, the manager's flexibility to set up the most appropriate mix of measures is very valuable.

Question 23: 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?

Generally, we are not favourable to redemption "restrictions" (in a strict sense) for MMFs. Redemption restrictions are a very useful and appropriate tool for intrinsic illiquid strategies where the fund has already distant redemption windows (hedge funds for instance). MMFs are intrinsic liquid strategies and apart a complete dry out of liquidity (where in any case a fund cannot substitute itself to the market), there is always potential to pay for redemptions (and of course those who need liquidity pay the price of liquidity as the NAV mirrors the market pricing).

We firmly believe that VNAVs through their mark to market pricing already place the price of the needed liquidity by redeemers on those redeemers. We understand that the proposed liquidity fee measure is **adapted in the case of a CNAV MMF** as it precisely permits to switch from the constant price (where it would have been the remaining holders who would have paid the price of liquidity) to the shadow/mark to market pricing (as it is already done in a VNAV) so as the redeemers pay for their need of liquidity. In that respect, we believe this is an excellent measure that places the real price on redeemers, does not destruct the structure of the fund and permits continuing operations.

We also believe that for this measure to be effective it **should be permanent in nature and there should be no specific trigger**. Indeed, in a fund the investors bear the risks of the fund with a fair and equal treatment and the price of liquidity is born by redeemers at any time. If this measure is trigger based, it is likely it would be ineffective as the message conveyed to investors is that the fund has two speeds delimited by a cliff effect. And by the way, it is

somewhat improper to call the measure liquidity "fee" as there is no additional fixed levy that is paid, but simply the **"market pricing"**.

Question 24: 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?

In the case of a VNAV fund, if the MMF loses value, redeeming investors already pay the price reflecting the loss. Thus, the option is undoubtedly proposed **in the case of a CNAV MMF only.** We believe that a precise and fair measure is that the redeemer pays the current market pricing every time he redeems (see Q23 above).

Question 25: 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?

We believe that in cases of market stress that can have consequences on the NAV, managers should have the option to switch to a bid valuation (the bid valuation option would be clearly stated in the prospectus). This is a comprehensive measure that reflects even heavier the current price of liquidity on the redeeming investors. We believe it may even incentivise incoming investors. We recall that French MMF investors are of the institutional type, and some of them have already experienced this type of measure. Also, for some specific cases depending on the type of strategy and targeted type of investors, some French MMFs have chosen to permanently value at bid pricing.

No, we are not favourable to redemption "restrictions" (such as anti-dilution levy) for MMFs. As already explained at Q23, MMFs are not illiquid types of strategies and redeemers should not be restricted to exit the fund if they do need liquidity, nor they should be imposed fees/levies that exceed the real price of liquidity. MMFs should accept and pay for redemptions (as long as there is no complete dry out of liquidity, where any fund cannot substitute itself to the market) with the redeemers paying the price of obtaining that liquidity (market price).

Question 26: 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 Europe, redemptions in kind are not allowed for UCITS funds and investors are not always allowed to receive in-kind. In addition, French investors specified that it is the asset manager's job to deal with the fund and obtain liquidity, not the investor's job.

Question 27: 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?

Policy restrictions regarding liquidity on investor side (such as redemption restrictions, gates, liquidity fees, in kind…)

No, we are not favourable to redemption "restrictions" (such as gates) for MMFs. As already explained at Q23, a gate is a liquidity instrument that is effective and adapted for illiquid/hedge fund type of strategies. MMFs are not illiquid types of strategies and redeemers should not be restricted to exit the fund if they do need liquidity.

We believe that funds that mark to market instruments elder than 3 months are showing through their valuation the current state of the markets, thus permitting investors to decide to stay/exit/enter the fund in "full knowledge of the facts". **It would not make sense to restrict the redeemer willing to pay the price of liquidity.**

By the way, in the hedge fund world, X% of the redemptions are paid pro-rata to redeemers and the outstanding redemption is added to the new redemptions on the next redemption window and if the gate is triggered again, only X% is paid pro-rata. A typical redemption window is a quarter and markets may change during the time period. Operationally speaking, how to apply the gate principle to a daily liquidity vehicle? Also, there is often a loss of confidence from the investors when a fund triggers a collective gate that may give rise to new/herd redemptions (this is one of the reasons of some hedge funds designing "individual" permanent gates, where one cannot exit the fund for more than X% on any redemption window).

Question 28: 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?

We believe that the establishment of a private liquidity facility is neither needed nor desirable for French MMFs. In any case, we believe it is unworkable and it will be too costly in a low interest environment.

Question 29: 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?

We would like to reiterate AFG's general position that backs regulators' efforts to reduce over-reliance on rating agencies related both to requirements on ratings of instruments in the fund and ratings for the fund itself.

Related to current ratings' reference in the "CESR's Guidelines on a common definition of European money market funds", we believe there should be no mandatory reference to CRAs' ratings (no more instrument eligibility linked mechanistically to external ratings). Indeed, we believe MMF managers should internally assess the instrument's quality and CRAs' ratings should only be an optional input.

We believe the eligibility criteria should not be mechanistically linked to all external ratings given to the instrument, rather the mandate of the fund should specify that best quality/highest short term credit levels instruments are eligible and that the quality is assessed by the asset manager. The responsibility of the asset manager is reaffirmed. **The asset manager has to ensure by all means at his disposal that the credit risk taken is consistent with the fund's objective as a MMF**. He has to indicate his policy on the taking into account of ratings, if any, of the instruments in the portfolio.

We believe that it is not desirable to substitute the external ratings provided by CRAs. There should always be an independent "standard unit" to whom different parties may refer. An investor may always want to see a breakdown by CRA's rating of the portfolio, but this is a view, a comparison, a "sanity" check; it should not be an eligibility criteria.

Question 30: 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?

Our view related to MMFs AAA ratings is that in their great majority, either MMFs are awarded the AAA or they are not rated. The scale granularity is generally not used and during the crisis, MMFs susceptible to be downgraded became not rated. Thus, generally AAA rating looks more like a label.

French MMFs do not ask in general to be rated. French institutional clients are not required by their internal branch rules to select rated MMFs. They perform in depth due diligences on the MMFs and the managing company. French MMFs have always been closely supervised by the regulator. Auditors also monitor MMFs.

Nevertheless, we acknowledge that some institutional clients situated in other European countries either have rules linked to AAA ratings or prefer rated funds when they buy third country managed MMFs (they delegate in a certain sense due diligences to the rating agencies). Notwithstanding the methodological efforts made by rating agencies, we believe that using asset liability management proves often more dynamic and efficient than relying on ratings that use one-size-fits-all type of methodologies. In addition, a non rated fund is not subject to the cliff effect risk inherent to ratings.

We believe that a well-informed knowledgeable investor that has the experience of conducting its own due diligences added to a strongly supervised regulatory framework is effective and responsible.

Question 31: 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?

No.

Question 32: Do differences between jurisdictions require different policy approaches or would a global solution be preferable, notably to ensure a global level playing field?

Two aspects are to be taken into account when discussing globalisation matters: matters related to the **level playing field in a same market place** and regional specificities that may require different regulations.

Markets are more and more global, so we would rather back a same level playing field. It would thus be required that funds respect the same underlying rules. We believe CNAVs and VNAVs can co-exist. However, **if underlying rules are different for funds sold in a same market, then it would be difficult to explain the difference in regulation by regional**

specificities. Thus, in case of unlevel playing field, funds with different underlying rules are unable to be sold in the same field.

In addition, a uniform fiscal treatment for MMFs would permit to lift a certain unlevel playing field favouring on an unjustified manner some structures over the others.

If you need any further information, please don't hesitate to contact Eric Pagniez, at +33.1.44.94.94.06 (e.pagniez@afg.asso.fr) or Adina Gurau Audibert, at +33.1.44.94.94.31 (a.gurau.audibert@afg.asso.fr) or myself at +33.1.44.94.94.29 (p.bollon@afg.asso.fr).

Sincerely Yours,

(signed)

Pierre Bollon