Dear Madam or Sir,

Please allow us a short introduction to our relation to MMF.

European Aeronautic Defence and Space Company N.V. is the holding of a group of companies which manages a group cash position of about EUR 16 bn (as of 31 Dec 2012). EUR 2 to 3 bn (up to 20% of the cash) is invested in MMF. We run our own MMF due diligence process. Currently, we have the authorization to trade in 14 EUR-denominated MMF (CNAV and VNAV), 5 EUR-denominated Government MMF and 5 USD-denominated MMF (CNAV).

We prepared the answers to the questions in the consolidation report as large institutional investor in MMF. We remain at your disposal if you need any further information. Moreover, we would be grateful if you could put us on your distribution list for any further correspondence with regard to MMF regulation.

Yours sincerely,

Jörg Weber
Head of Dealing Room,
EADS Treasury (CF/FT/T)

Question 1

We understand from the Consultation Document, that MMF is determined by the following criteria:

(i) Objective to preserve capital,

(ii) Daily liquidity, and

(iii) Diversified portfolio of high-quality, low duration fixed-income instruments.

We agree to this definition in general. However, this definition is less precise than the definitions of Short Term Money Market Funds and Money Market Funds as used in the CESR's Guidelines on a common definition of European money market funds. However, we believe that the different use of the term money market fund is the core of the problem and creates the misperception of the assumed characteristics of money market funds by investors and regulators.

Question 2

MMFs are as susceptible to runs as any other asset class. The fund prospectus (i) provides the possibility to close MMFs for redemptions, and (ii) do not provide an explicit capital guarantee (although a stable NAV could foster such expectation). It is a pure misperception of investors to expect an unrestricted daily liquidity, a higher yield as compared to overnight bank deposits without taking additional risks.

Question 3

MMFs cannot be blamed for an inappropriate funding structure of banks which is caused by an insufficient mix of different refinancing sources and an inappropriate asset-liability-match in terms of maturities and currencies. Therefore, any regulation should be focused on tighter liquidity ratios for banks in first instance rather than restricting MMF.

We took notice from the Consultation Document that institutional investors account for the majority of MMF-investors. However, there is no reference in the Consultation Document that banks are dominant investors in MMFs. We could also not find publicly available figures about the share of banks in MMF, but we would like to stress that banks have direct access to ECB deposits (unlike insurers, pension funds or non-financial corporates) and therefore would probably tend more to deposit with ECB rather than placing money in MMF which in addition triggers the need for the bank investor to designate equity to such fund investment.

Central banks play a more important role in the money markets now by providing nearly unlimited and cheap liquidity to banks and also by bridging the currency gap by FX swap facilities.

Question 4

The Consultation Document refers to a study published by Moody's. Unfortunately, the study does not distinguish between plain ST Money Market Funds (compliant to the classification as set out in CESR's Guidelines on a common definition of European money market funds) and other money market funds (dynamic, enhanced etc. with significant allocation to floating rate notes and/or ABS-, ABCP-structures) which indeed required sponsors' support but are less systemic for the money markets.

We see a clear misperception by investors to expect a sponsor support for MMF by whatever nature. A sponsor concept were contrary to the investor's intention to invest in a high quality, widely diversified money market vehicle since a sponsor concept would conceptually lead to a risk consolidation at the sponsor level. Moreover, there is no binding support language in any MMF prospectus.

We do not have exact figures about the percentage of bank sponsored and independent funds but we see 4 different categories of MMF

(i) owned by but ringfenced from a bank which may potentially benefit from at least a weak support by the owner (e.g. JPMorgan AM, Goldman Sachs AM, StateStreet Global Advisors, BNP Investment Partners, Robeco, DB Advisors etc.),

(ii) owned by but ringfenced from an insurance which may benefit from at least a weak support by the owner (e.g. Swiss Life AM, Allianz Global Investors/RCM, AXA Investment, Aviva etc.),

(iii) joint ventures of banks and/or insurers which are ringfenced from their shareholder's, which are not strategic assets of their shareholders anymore and were a potential support of shareholders seems to be unlikely (e.g. Amundi etc.), and

(iv) fully independent asset managers without any significant shareholder support (e.g. Blackrock, Fidelity, Western Asset Management, Groupama).

It is also worth to mention that several banks have recently announced that they do not see asset management for institutional clients as core business activity anymore and put the asset management activities on sale (Unicredit for Pioneer, Deutsche Bank for DB Advisors, Rabobank for Robeco etc.).

We also suppose that the likelihood of a sponsorship shrinks in line with the amount of assets under management (AuM) held by a particular fund since the owning bank or insurance would not be able to provide a sizeable support for the fund. Please consider, the AuM of several flagship liquidity money market funds (e.g. HSBC Global Liquidity Fund EUR 7.8 bn and USD 23.1 bn, JPMorgan Liquidity Fund EUR 20.7 bn and USD 81.4 bn, Goldman Sachs Liquid Reserves Fund EUR 10.9 bn and USD 26.6 bn – all data from Bloomberg as of 21 May 2012) to underline this thesis. A very prudent and conservative investment approach is what we see from our own MMF due diligence for these flagship liquidity funds.

Question 5

We are perhaps not the representative investor in MMF but we share your view that (i) it is an appropriate outsourcing for a portion of short term investments, and (ii) it provides an efficient way to diversify among different counterparties and maturities. We would face significant size issues if we could not use MMFs and would potentially increase our allocation to short term sovereigns and agencies but to a lower extent in CPs, CDs and deposits with banks.

Among our qualitative assessment (such as risk clusters in a particular portfolio, material changes in the investment style), a fast decline of the AuM in a MMF would immediately trigger a reallocation from the respective fund to other MMFs. As many other investors, we apply a 10% holding ratio.

Question 6

As already stated before, it is a misperception of investors that MMFs provide a guarantee on the principal invested and offer daily liquidity. The prospectus allows a closing of a MMF for redemptions.

We agree to the rest of your assessment in clause 3.2.1 and would like to add one more point. Bank deposits may be included in a general account pledge which is not the case for investments in MMF.

Question 7

VNAV and CNAV funds do not form separate asset classes. At least for the 12 CNAV funds, which we use and frequently monitor, it is just a separate share class

within a fund which offers VNAV (distributing and accumulating) and CNAV (distributing) share-classes but the underlying asset pool, investment guidelines and accounting principles are the same for such fund regardless of the share class.

Beside these Luxembourg and Ireland registered funds we use and frequently monitor MMF registered in France. The French MMFs apply contrary to the Ireland and Luxembourg funds for some of their assets MtM accounting but not for deposits, putable structures and investments with a maturity of up to 3 months. Thus, ultimately also results in accounting at amortised cost for the vast maturity of their investments. Most of these funds also offer same day liquidity but have earlier cut-off times and the precise equivalent amount in money is not yet known at the time of trading.

The selection of a VNAV or a CNAV fund is therefore merely driven by convenience reasons rather than by material investment decisions.

Question 8

We have established our own MMF rating process and do not rely on the opinion of external rating agencies in first instance.

Indeed, there is strong evidence that other corporate treasuries, pension funds, insurers or even treasuries of smaller regional banks incorporated rating restrictions for MMF in their investment guidelines. A downgrade of one single fund would lead to a run in the respective fund. However, an external driver for a potential downgrade which would apply to all MMFs (e.g. downgrade of the US debt) would most likely not result in the same run since investors would not have investment alternatives with the same capacity. Moreover, the ratings across the banking sector are worse than a MMF downgraded by up to 3 notches.

It is worth to mention that the average weighted rating of an AAA rated MMF is between AA- and A+. The rating of a single counterparty is only a part of the rating inputs which take in addition the diversification between different counterparties, liquidity buffers, and proper maturity profile of the asset pool into account.

Ultimately, it would also be interesting to assess if the rating directly has an impact on the investors' decision or the restrictions that such a rating imposes on the investment guidelines. We see the main benefits more in the indirectly imposed investment restrictions.

Question 9

We have assessed the risks linked to repos transactions used by some of our MMF. In general, the repos are governed by Global Master Repurchase Agreements (GMRA) which form a widely harmonized framework agreement. However, credit elements such as threshold amounts for posting additional collateral, events of default or applicable haircuts are individually agreed, take into consideration the individual credit profile and needs of the counterparties and are subject to a credit decision between the counterparties. It is difficult to imagine that a potential involvement in such credit process by regulators could provide additional benefits.

Question 10

We can confirm that your description to the changes in the environment of MMFs is more than complete. However, we assess the relevance of some topics different since (i) it is our general philosophy that an investor cannot be released from its own, thorough analysis of an investment product by regulators, rating agencies or sponsors, and (ii) MMF are not the main reason for the current dislocation in the money markets but the banking sector's inappropriate refinancing policy. Moreover, we see a potential risk of a liquidity drain in MMFs and an accelerated consolidation pressure for the MMF industry in the case of overshooting regulatory initiatives. The materialization of such potential risks could even further increase the stress in money markets.

Question 11

Except for the first bullet point, we agree to the remaining bullet points. As already set out several times in our answers, we see the reason for the current dislocation in money markets in the inappropriate refinancing policies of banks (which need to be addressed directly with the banks) rather than by MMF.

Question 12

We can just answer from our point of view with this regard but a move from CNAV to VNAV MMF does not cause issues. The preference for CNAV MMF is only due to convenience reasons as set out in our answer to question 7. However, we see practicability issues to obtain market prices for certain securities and deposits.

Question 13

All proposals may create tax and accounting issues for the investor. Probably, none of the proposed options would be seen by investors as a practicable solution and also not appreciated as an efficient safety feature. If one of the proposed options would apply, we would definitely consider removing CNAV MMF from our list of autorised investments.

We would like to comment the different options case by case:

To a) Assuming a hypothetical equity ratio of 5% and a pretax remuneration of such subordinated debt of only 5% (which is more at the lower end of market usances), the total expense ratio of such MMF would be increased by 25 bps which is higher than the current yield of EUR and USD MMF.

To b) It shifts the benefits from the frontend to the backend but does not treat all investors equally since there is no clear distribution mechanism.

To c) Investors, in particular risk adverse investors, are typically not allowed to subscribe for subordinated or equity like funds or shareclasses.

To d) The sponsor of an escrow needs to apply its own funding cost plus a margin which takes into account the subordinated character of funds pledged in such escrow. The same calculation as set out in our comment to option a) would apply.

Question 14

Yes, we do agree. In addition, please consider the size of Luxembourg's or Ireland's public total balance sheet in relation to the assets under management held in MMF registered in both countries with regard to a private-public depositary insurance. A purely private insurance is unlikely to be cheaper than subordinated debt from an arbitrary point of view (please refer to our comment in relation to question 13, option a) above).

Question 15

There would not be a major difference anymore between entering into deposits with a (smaller regional savings) bank. Please, also consider the cost of equity (please refer to our comment in relation to question 13, option a) above).

Question 16

The distinction between CNAV and VNAV MMF is misleading. A precautious investment style is just a residuum of a CNAV MMF but does not prevent a VNAV MMF to apply the same principles. In our point of view it is more important (i) to apply a clear labeling for MMF comparable to – may be more detailed than - CESR's Guidelines on a common definition of European money market funds, and (ii) to consider regulatory improvements for the different categories. Typically, the major allocation is in ST MMF (as defined in CESR's Guidelines on a common definition of European money market funds) as they are seen by investors as less risky and more robust. ST MMF should be subject to a tighter regulation of whatever nature.

However, it is worth to mention that the MMF (as defined in CESR's Guidelines on a common definition of European money market funds), which are typically VNAV, suffered in 2007/08 relatively stronger (more funds were closed for redemptions, required sponsor support, reported losses, significant redemptions) than ST MMF, which by accident have CNAV and VNAV share classes.

Another observation in 2007/08 is also, that investors redeemed in particular smaller ST MMF and MMF with assets under management (AuM) of less than EUR 2 bn and have not re-attracted sizable subscriptions since. Contrary, the flagship ST MMF, merely also offering CNAV share classes, with AuM of more than EUR 5 bn could benefit from the consolidation of the sector and did not suffer the same percentage of net redemptions or could at least stabilize the fund volume in a short timeframe.

Many ST MMF offer CNAV and VNAV, both distributing and accumulation, in the same fund in different share classes only, which allows the fund to attract higher amounts. The proposal to introduce separate CNAV MMF would result in smaller funds and could potentially result in smaller funds, which are more vulnerable in a run.

Question 17

Yes, we do agree.

Question 18

We share partly the assessment of the particular risk of CNAV MMF but not the conclusions drawn from such assessment. Regulation should not be misunderstood as the full release of investors from their duty to analyse the particular performance and also liquidity risk of an investment in MMF. Also, the refinancing risk of banks should be addressed directly with banks and not indirectly through MMF. We would see the major improvement in a regulatory initiative containing the following elements:

(i) Clear distinction between plain MMF (comparable to a ST MMF), which requires more regulation, and other ‘enhanced’ or ‘dynamic’ MMF with more aggressive risk profile which should be less or not at all regulated.

(ii) Each MMF should be obliged to limit investments from a single investor in a MMF, e.g. at [5%] of the total assets under management, to avoid risk clusters for redemptions.

(iii) Clear guidance for the maximum concentration of an issuer, preferably also reflecting the credit rating (the lower the rating the lower the permitted concentration) and the size of such issuer. This must include a consolidation of issuers belonging to one group of companies (majority owned or controlled, guaranteed). We discovered clusters in MMF of up to 8% by applying such consolidation rules for highly fragmented issuers, e.g. BPCE/Natixis/Palatine or Santander/Abbey/Banesto/Totta. Furthermore, some MMFs do not appropriately consider the size of an issuer and such MMF can be considered as one of the largest lenders to a small issuer (e.g. high allocation in several MMF to Pohjola Bank with EUR 41 bn total balance sheet only).

(iv) Clear guidance on portfolio liquidity (WAL and WAM), restriction of less liquid assets (small issues in floaters without daily price quotations, holdings in private placements or putables, ABS and ABCP pools etc.).

(v) Harmonized accounting rules.

(vi) Increased transparency by the MMF by releasing a monthly holdings report.

(vii) Intervention mechanism to close a MMF for redemptions and a clear procedure to re-open or liquidate a MMF.

Questions 19 and 20

In principle, we would appreciate a mandatory change to MtM evaluation, provided that CNAV MMF will be abandoned. However, there are several practical problems to obtain tradable prices for wide range of money market instruments.

(i) There are no secondary market prices for term deposits.

(ii) There are no frequently quoted secondary market prices for (a) the majority of CP/CD issued by other issuers than core sovereigns and agencies or highly rated corporates, and (b) bonds issued by other issuers than core sovereigns and agencies and a maturity of less than 1 year. Due to tightening capital rules, most banks have significantly downsized or even closed their credit books for secondary trading with significant impacts on prices. Thus, banks same as brokers just provide prices on a back-to-back basis. Moreover, typical bond investors are biased medium and long term and do not cover short term offers.

(iii) Some MMFs, which apply MtM, have nevertheless a strong tendency to 'bypass' a market pricing. They acquire securities where they are sole investor in a particular issue. The arranger of such issue typically provides a 'liquidity commitment' for such instrument which is subject to a credit approval. There is a high likelihood that the arranger quotes the instrument very close to par without having an enforceable obligation to repurchase such issue. MtM price requires benchmark size for an issue and a restriction in terms of holding in a single issue (e.g. maximum 10% of the total outstanding in a security) to assure price conformity.

(iv) Bonds and CPs, T-Bills issued or guaranteed by highly rated government or agencies (credit rating not less than AA-/Aa3) can be considered as liquid, fairly priced and MtM evaluation is fully applicable (except for private placement and structures with an implicit guarantee of a sovereign only).

This being provided, MtM evaluation is desirable but cannot be applied for all instruments. Exemptions for instruments with a remaining maturity of less than 3 months should definitely be considered. The introduction of a maximum holding ratio in bonds could significantly limit the misuse of private placements and putables.

The envisaged change to MtM with exemptions for short term instruments would certainly increase the volatility of the MMF unit prices but would also decrease the allocation to more illiquid investments indirectly imposed through tightened investment guidelines and increase the transparency for investors.

Question 21

We consider globally harmonized liquidity requirements comparable to the U.S. regulation as a key element. Although the regulation would allow for a weighted average remaining maturity of 60 days, most of the flagship CNAV MMF do not use this envelop in distressed markets. Currently, WAM is closer to a range between 40 to 45 days. In parallel, we see a further mitigation in restrictions to reduce (i) the allocation to less liquid assets (no private placements, maximum 10% holding ratio in a single security other than CP/CD or deposit), (ii) clusters in certain issuers (see our answer 18 (iii)), and (iii) investors' holdings in a particular MMF (see our answer 18 (ii). Due to ongoing changes in the money markets and significant differences between different regional money markets, we would not recommend to release global definitions of liquid and illiquid assets. We believe that a tighter accounting framework would indirectly impose a higher focus on liquidity even in changing market conditions (see our answer 20)

Question 22

Due to our extensive use of MMF as a corporate treasury, we can confirm that the magnitude of redemptions and subscriptions in MMF is not precisely predictable. We would consider a maximum holding of up to [5%] of a single investor in a particular MMF as reasonable and practicable. Furthermore, MMF should also improve the appropriate information flow. It is not understandable, that none of the MMF e-banking tools (mono-manager) or the few multi-manager platforms do not offer the possibility to put orders up to one or two weeks ahead of the trading date. The current range is maximum 24 hours.

Question 23

We do not consider this as a practicable and transparent mitigation of the risk of the run. The sales force of a fund would probably tend to pass on some insider knowledge to key investors in such fund.

Question 24

Every investor in MMF has the benefits of higher returns in MMF as compared to overnight deposits and should therefore admit that a higher yield is linked to a higher risk. Therefore, we suppose that the minimum balance requirement is the most appropriate reaction to a run scenario as ultima ratio. The potential downside could be the exit of investors from MMF which use MMF inappropriately (e.g. sweep accounts, retirement plans for running service cost).

Question 25

We outlined our observations on the validity of price are already in our answer to questions 19 and 20 before. In practical terms, there will only be a limited share of securities – likely less than 40% in a ST MMF – for which according to our reservations a real MtM is applicable. Provided that MMFs have to follow in addition a tighter liquidity assessment (no private placements, maximum holding ratio), the ask/bid spread should not be a main concern anymore. We would still tend to apply the compound mid-prices to facilitate an equal treatment between subscribers and redeemers.

Question 26

The proposal is contrary to a concept of the intended equal treatment of all shareholders. Since not all securities are transferable and fully divisible it may create arbitrage opportunities. Finally, it is also linked to an appropriate evaluation of the securities to be transferred. In our opinion, a transfer in kind should only be considered in a full liquidation scenario of a MMF, comparable to the Lehman Liquidity Fund. Operationally, it also requires appropriate custody arrangements on investors' side. The typical MMF investor has outsourced such custody arrangements to the fund manager and would need some time to put in place such arrangements.

Question 27

The standard MMF prospectus contains the possibility to close the fund in full or in part in a few jurisdictions for redemptions. The only benefit would be a harmisation between different jurisdictions. A closing is perhaps not the most appreciated but ultimately unavoidable measure rather than postponing the inherent problem through a liquidity facility (see answer 28 below). A closing requires a strong governance structure in the face of obvious conflicts of interest and the pressure from large investors.

Question 28

In our view, an external private liquidity facility addresses the key problem only partly since it (i) may remunerate a less robust liquidity management by the fund manager, (ii) imposes additional cost to the fund (commitment fees, interest) which are significantly higher than the running yield in such fund based on the fact that funds do not have direct access to repo facilities of central banks, (iii) does not absorb losses, and (iv) creates further imbalances due to the applied haircuts.

Question 29

We share your concern that the reliance on external credit ratings is contra-productive to establish a more rigorous MMF internal counterparty-risk assessment. In parallel, the wider downward shift of ratings by the rating agencies in general creates problems for the funds to assure an appropriate weighted average rating on portfolio level and to keep the diversification of a MMF. The waiver of rating restrictions would not necessarily create a material deterioration of the credit risk of the MMF portfolio but might deteriorate the liquidity profile of the assets held by a MMF since most of the money market investors also beside MMFs apply rating restrictions and are forced to sell assets when downgraded.

We would appreciate the following guidance

(i) External ratings should just be a general filter to select the eligible assets for a particular MMF (tighter hurdles for ST MMF desirable). Rating restrictions – if kept ultimately – should be reconsidered to take into account the general downward pressure of credit ratings (e.g. opening investment criteria for BBB names but only up to [3 months]. The range of short term ratings is not detailed enough. Reference should be made to long term ratings.

(ii) MMFs should run their own credit assessment in parallel. The risk management must be focused on potential risk clusters and also consolidation issues, review the counterparties with split rating in particular to assign an own internal rating, develop a limit policy which takes into account the rating and size of an issuer and the tenor of a particular investment.

(iii) Risk management must also embed appropriate early warning signals (traded CDS, bond- or equity implied spreads) since some funds run security selection merely by the absolute yield without taking into account the weighted CDS factor of a portfolio which is often more in line with a A- to BBB rated basket despite a weighted average portfolio rating of A to A+. This implies also an increased liquidity risk.

Question 30

The rating is an opinion and not a guarantee as widely misunderstood by investors. It does in particular not replace the need for the investor's independent credit assessment. Thus, a proper labeling of MMF and an improved transparency (publishing of portfolio holdings, applied evaluation techniques etc.) is a fundamental basis to form an own opinion.

The rating process for a MMF is more focused on a portfolio concept with the heavy weight on portfolio liquidity, diversification and weighted average spread of a portfolio (Moody's) rather than on the rating of singular counterparties. A rating action for one counterparty would not trigger a downgrade of a well diversified portfolio. The rating concept perhaps overestimates the correlation benefits of a diversified portfolio which are less effective in distressed markets.

Unfortunately, we do not see viable alternatives to the existing rating agencies. Although not always right and in time, it is difficult to find a more credible institution with such a long term track record.

Question 31

We consider the assessment of the consultation report as comprehensive.

Question 32

We agree that a global harmonization would be desirable to avoid regulatory arbitrage but given significant differences of the underlying governing jurisdictions and the lengthiness of such international co-ordination we do not assign a high likelihood to an harmonized policy ap