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Carlo Comporti
Committee of European Securities Regulators (CESR)
11-13, Avenue de Friedland
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AFG RESPONSE TO CESR'S CONSULTATION ON A COMMON DEFINITION OF EUROPEAN MONEY MARKET FUNDS

Ref.: CESR/09-850

Dear Mr Comporti,

The Association Française de la Gestion Financière (AFG)[1] welcomes CESR's consultation on a common definition of European money market funds.

We are glad of the opportunity to express the point of view of the French asset management industry and underline our strong commitment to the implementation of this European label as money market funds represent a **major share** of French collective investments (41%) and of **European money market funds (38%)** with assets of EUR 502 billion at end October 2009.

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 409 management companies. They are entrepreneurial or belong to French or foreign banking or insurance groups.

AFG members are managing 2400 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 1400 billion euros managed from France, i.e. 21% 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).

Given the importance of the share of European money market funds that our members represent, **we strongly wish that CESR gives us the opportunity to express our views personally in a meeting if it turned out that its final decision could differ significantly from our following comments.**

Introduction

AFG fully agrees with the need to implement a regulatory definition of European money market funds which will provide more transparency to investors. We welcome CESR's classification which is broadly in line with EFAMA/IMMFA proposal issued in July 2009. However we take the opportunity in our response to point out several differences and some points of approach that should be clarified.

AFG insists that it is mostly important that the common definition to be implemented should **create a true level playing field amongst the Member States.** In particular we strongly believe that money market funds **valuation rules need to be strictly codified** in order to maintain a high level of transparency to the investor and to avoid any performance analysis distortion.

As it was noticed by CESR, AFG underlines that money market funds largely contribute to provide overnight and short term funding to banks and other financial institutions. Therefore we recommend cautiousness in the approach when defining credit, market and liquidity risk limit exposure criteria in order to avoid highly negative by-side effects in money markets.

AFG also recommends that the current situation of European money markets with very low interest rates should draw the attention in the approach for the definition of European money market funds. In particular we believe that it raises the need to clarify the capital preservation objectives that money market funds should comply with.

ANSWERS

Q1 - Do you agree that such clarification is desirable?

AFG acknowledges the lack of any appropriate regulatory requirements at a European level and thus **fully agrees with the need to establish a common definition of money market funds.**

However AFG considers that cautiousness should be taken in the approach of using MiFID definition as the basis for the classification of all European money markets funds. We believe that the "qualifying money market fund" as defined in the MiFID Level 2 Directive article 18 (1) (d) restrictively applies to investment firms "depositing client funds" in respect with the principle of "safeguarding the clients rights". It does not properly apply to the proposed CESR's definition which is targeted to inform investors regarding their own investment choice. Therefore AFG considers that the MiFID criteria should not be fully incorporated on their own in the common definition of European money market funds.

In this respect, we recommend that the ongoing revision process of MiFID directive should include a harmonisation of the money market fund definitions between MiFID Level 2 and forthcoming Level 3 CESR Guidelines.

We also recommend that it should be well outlined that the objective of preserving capital should be understood "gross of fees" in order to prevent any confusion for investors. This point is particularly important as the current level of money market rates is very low, then it is possible that a fund daily returns may not occasionally exceed the daily accrued management fees charged. Hence, **it should be made clear that the objective to preserve capital is not at any case a capital guarantee.**

Q2 - Do you agree with the proposal to have a common definition of European money market funds? If not, please explain why.

AFG welcomes CESR's proposal to enforce a common definition of European market funds in the purpose of improving investor protection. We clearly consider the harmonisation of money market funds characteristics as a crucial step towards more transparency and a better level playing field in European markets.

It should be made clear that this common definition should only create **one single European category for money market funds** without providing any double classification system. In particular, we believe that the definition of short-term money market funds should only be regarded as a sub type of a single common category represented by the longer-term money market funds. Then we recommend that CESR should precise what should be the required transparency conditions in case of a shift between the two types. It is our suggestion that they should be a fund holder information disclosure and an updating of the KID.

Q3 - Do you agree with the proposal to apply the definition to harmonised (UCITS) and non-harmonised European money market funds?

AFG is not opposed to apply the European definition of money market funds to both UCITS and non-UCITS money market funds. Then it should be well underlined that all funds carrying the "money market" label should comply with the agreed definition.

Should this be the case, it is mostly important to us that non-UCITS funds qualifying for the money market fund label should also comply with the existing UCITS investment rules in order to maintain a level playing field between non-UCITS and UCITS money market funds.

Above all, in order to ensure a level of credit, market and liquidity risks compliant with the overall risk implied in the European money market label, AFG considers it should be appropriate to reinforce CESR proposed criteria with credit exposure by issuer and counterparties limits.

In respect with liquidity, AFG members recommend that subscription and redemption of money market fund units should be carried out through same day to T+3 settlement in order to match the delivery/settlement standard dates in force in securities markets.

Q4 - Do you agree with the proposed two-tier approach?

AFG welcomes the two-tier approach proposed by CESR which is broadly in line with the EFAMA/ IMMA recommendation. In the light of the market events, we acknowledge that this segregation is bound to carry out more transparency for investors in terms of risk/returns profile and investment strategies.

However we insist once again that **CESR should clarify that this two-tier approach is not leading to create a double classification of money market funds.**

Q5 - Do you have any alternative suggestion?

In addition, it seems important to us to recommend that both short term and longer term money market funds should only be permitted to a mark to market valuation of all the holdings. A single valuation requirement should also bring more transparency to the investor and would prevent performance analysis distortions amongst money market funds.

We would like to remind that the use of an amortised cost method of valuation may convey important valuation risks in case of a sudden and swift rise in interest rates which may particularly occur in a very low money market rate environment.

Hence, AFG strongly supports **a limitation in the use of an amortised cost method of valuation** as regards money market funds. **It should only be tolerated for securities with a legal or residual maturity strictly inferior to 3 months, and only in case of an absence of divergence between this method of valuation and the mark to market price.**

Q6 - Do you consider that the proposed transitional period for existing money market funds is sufficient to enable funds to comply with the definition?

As regards existing money market funds, AFG is in favour of adapting the proposed 12-months transitional period in order to achieve the two fold objective of enhancing investor protection and give enough time to money market fund managers to comply with the new agreed definition.

We consider that the 12-months transitional period should only be applied to the two following criteria:

- WAL limits
- Residual maturity limits relating to securities hold before 01.01.2008

All other proposed criteria should be enforced by the date of publication of Level 3 CESR Guidelines.

SHORT-TERM MONEY MARKET FUNDS

Q7 – Do you agree with the proposed criteria for the definition of short-term money market funds?

AFG agrees with the approach taken by CESR to define short-term money markets funds, but we ask for clarification of several proposed criteria, as explained in our answers to questions 8 to 12.

As it was previously underlined, we advocate that extra specific criteria regarding credit exposure by issuer and counterparty limits should explicitly be set out for non-UCITS in order to prevent any concentration risk which should not be in line with the objectives of money market funds definition. We suggest that those limits should comply with criteria set out in the Directive 2009/65 EC.

Q8 – Do you have alternative suggestions?

It is our opinion that a harmonisation of the definition of "a high quality money market instrument" should be undertaken between MiFID Level 2 Directive and the future definition of money market funds in Level3 CESR guidelines. In particular, we insist that a clarification is essential to have a common understanding of what means the "highest available credit rating" which qualifies a high quality money market instrument.

AFG considers that the MiFID criteria of "high quality money market instrument" should not be strictly applied to the European definition of a money market fund. As we have already emphasised, the perimeter of the subject is not the same. Thus, in our opinion, **the European definition should clearly refer to "investment grade" for both short term credit assessments** (e.g. P1-P3 by Moody's or equivalent) **and long term credit assessments** (e.g. Aaa to Baa3 by Moody's or equivalent) **which is the ongoing practice**. Considering the weight of European money market funds, any other restrictive interpretation should bear a huge refinancing risk for both banks and corporates as many money market issuers might not be eligible to the European label of money market funds.

Hence **we strongly support that short-term money market funds should have the ability to invest in any security awarded with an "investment grade" credit assessment at the time of purchase.**

However, if a security already held by a money market fund is downgraded at a below investment grade level by one of the provider of the assessment, the fund manager should be obliged to take the most appropriate course of action in order to preserve capital.

Q9 – Do you think that the proposed criteria adequately capture the risks attaching to such funds, in particular currency, interest rate, credit and liquidity risk? In particular:

A/ Do you consider that Option 3A (120 days) or Option 3B (3 months) is more appropriate for the WAL limit? Should it be lower or higher?

AFG is in favour of Option 3B with a WAL limited to 3 months as this criterion is appropriate enough to manage credit/credit spread risk with the other proposed criteria defining short term money market funds.

B/ Subject to your views on question 10 below, would you recommend taking structured financial instruments into account in the WAL calculation through their expected average life or through their legal final maturity?

We consider it is advisable to take into account the legal final maturity of structured financial instruments in order to calculate the WAL. However, as regards puttable instruments we believe it would be more appropriate to allow considering the date of the put exercise instead of the legal final maturity.

C/ Do you consider that the WAM limit of 60 days is appropriate? Should it be lower or higher?

Given short term money market funds give the highest importance to liquidity, AFG supports CESR's proposal to limit WAM at a maximum of 60 days.

D/ In relation to investments in securities, do you agree with Option 2A (allowing investment of up 10 per cent of assets in floating rate securities with a legal maturity or residual maturity between 397 days and 2 years, provided that the time remaining until the next interest rate reset date is less than 397 days) or Option 2B (limiting investment in securities to those with a legal maturity of less than 397 days)?

AFG believes that limiting investment in securities with a legal maturity of less than 397 days (Option 2B) would provide enough flexibility to the management of a short term money market fund with a WAM limited to 60 days.

Q10 – In relation to the proposed requirements regarding structured financial instruments, do you prefer Option 4A or Option 4B above?

AFG is strongly against restrictions that would prohibit investments in structured financial instruments or asset-backed commercial papers (ABCP). There is no evidence that the overall risk of a short-term money market fund would increase with investments in high quality structured financial instrument and ABCP. Thus, we prefer Option 4A.

Q11 – In relation to currency exposure, do you think that short-term money market funds should limit the extent to which they invest in or are exposed to securities not denominated in their base currency?

AFG is highly in favour of prohibiting money market funds from taking any currency risk exposure. However we consider that holding securities denominated in foreign currencies should be permitted without any limit providing that they should be fully currency-hedged.

Q12 - In relation to the proposed requirements on ratings of instruments, do you prefer Option 1A or Option 1B above? In this context, do you believe that a money market instrument should be considered of high quality if the issuer of the instrument has been awarded the highest possible credit rating, even if the instrument itself has not been rated?

As we already made the remark, we strongly recommend that the perimeter of ratings that should be retained in the definition of a "high quality money market instrument" should precisely refer to **"investment grade"** credit rating at the time of purchase. AFG also **advocates that the credit quality of a money market instrument assessed by an internal** (e.g. credit department) **or external body** (e.g. bank, broker) should be allowed as an **alternative even if recognised rating agency has already rated the instrument**. Hence we favour Option 1A.

In the same way, we believe that CESR should authorize short-term money market funds to invest in non-rated instruments used by issuers awarded with an investment grade rating. **To make it short, we are opposed to any regulation making mandatory the use of CRAS's.**

<u>LONGER-TERM MONEY MARKET FUNDS</u>

Q13 - Do you agree with the proposed criteria for the definition of longer-term money market funds?

AFG considers that the criteria proposed by CESR to define longer-term money markets funds should be appropriate if clarified according to our answers to questions 14 to 19.

The precisions below are in our members' view, the necessary conditions to fully preserve the capacity of longer-term money market funds to achieve the investment objective of preserving capital gross of fees.

Q14 – Do you have alternative suggestions?

As we already underlined, it should be made clear that longer-term money market funds represent the main category of the new label for European money market funds, from which short-term money market funds should derive. Hence, the required criteria for a longer-term money market fund should be seen and defined as the pillar of the risk characteristics of European money market funds.

Q15 – Do you think that the proposed criteria adequately capture the risks attaching to such funds, in particular currency, interest rate, credit and liquidity risk?

Please, see our remarks below as regards currency, interest rate and credit risk.

As we made the remark for short-term money market funds, we advocate that credit exposure by issuer and by counterparty should be limited following the existing rules applied to UCITS funds in order to prevent any concentration risk.

As regards liquidity risk, we already pinpointed that ours members do not believe that it is fully hedged by providing a same day or next day settlement as the recent market turmoil has revealed evidence. We consider it would be advisable to allow a settlement date at T+3 as it turns out to be a widespread standard on the security markets.

Q16 - In particular

A/ In relation to the WAL limit, do you consider that Option 1A (12 months) or Option 1B (6 months) is appropriate? Should it be lower or higher?

AFG favours Option 1A (a weighted average life (WAL) limited to a maximum of 12 months). We believe this limit would provide enough flexibility to manage credit/credit spread risk with the other proposed criteria defining longer-term money market funds.

B/ Would you recommend taking structured financial instruments into account in the WAL calculation through their expected average life, or through their legal final maturity?

We consider it is advisable to take into account the legal final maturity of structured financial instruments in order to calculate the WAL. However, as regards puttable instruments we believe it would be more appropriate to allow considering the date of the put exercise instead of the legal final maturity.

C/ Do you consider that the WAM limit of 6 months is appropriate? Should it be lower or higher? Can this criterion be expressed in terms of interest rate sensitivity (corresponding limit set at 0.5)?

AFG supports CESR proposal to fix a **6 months WAM limit** for longer-term money market funds. We also agree that **it could be expressed as a 0.5 interest rate sensitivity limit.**

In our opinion, this interest rate limit exposure is consistent enough with the objective of preservation of capital and should prevent a major disruption of the funds in case of a sudden move in money market interest rates.

D/ In relation to investments in securities, do you believe that investment of up to 10 per cent of assets in floating rate securities with a legal maturity or residual maturity of more than 2 years would be appropriate, provided that the time remaining until the next interest rate reset date is less than 397 days?

AFG believes that limiting investment in securities with **a legal maturity of less than 2 years** would provide enough flexibility to the management of longer-term term money market fund with a WAM limited to 0.5 interest rate sensitivity. Thus, **we are not in favour of allowing**

investments in floating rates securities with a legal or residual maturity that could exceed this limit.

We agree with CESR's proposal to prohibit floating securities that would not reset to a money market rate or index.

Q17 – In relation to currency exposure, do you think that longer-term money market fund should limit the extent to which they invest in or are exposed to securities not denominated in their base currency?

As regards currency exposure, AFG members share the opinion that both short-term and longer term money market funds should be prohibited from taking any currency risk exposure. However we consider that holding securities denominated in currencies different from the base currency of the fund should be permitted without any limit providing that they should be fully currency-hedged.

Q18 - Do you think that longer-term money market funds should have the ability to invest in lower-rated securities?

Once again, we strongly insist that the perimeter of instrument ratings that should authorized to money market funds should precisely be defined as "investment grade" credit rating at the time of purchase, whatever the provider of the assessment, each recognised credit agency or any equivalent external or internal body. As a matter of course, we are opposed to any investment that should be lower than an "investment grade" credit rating at the time of purchase.

However, if a security already held by a money market fund is downgraded at a below investment grade level by one of the provider of the assessment, the fund manager should be obliged to take the most appropriate course of action in order to preserve capital.

Q19 – Do you consider that a longer-term money market fund should have the ability to have a constant nav?

We already recommended that money market funds should only be permitted to mark to market valuation of all their holdings in most of cases. Hence we are not in favour of funds with a constant nav since we believe it may lessen transparency to the investor.

Please do not hesitate to contact myself at +33.1.44.94.94.14 (p.bollon@afg.asso.fr) or Eric Pagniez, at +33.1.44.94.94.06 (e.pagniez@afg.asso.fr) or Bertrand du Guerny, at +33.1.44.94.94.31 (bduguerny@afg.asso.fr).

Sincerely Yours,

Pierre Bollon