



Mr Jarkko Syyrila
The Committee of European Securities Regulators
11-13 Avenue de Friedland
75008 Paris
France

21st November 2005

Dear Jarkko

IMMFA's response to CESR's 2nd consultation on eligible assets in UCITS

The Institutional Money Market Funds Association (IMMFA) welcomes the opportunity to comment on CESR's 2nd consultation on eligible assets in UCITS. IMMFA is the trade body representing providers of triple-A rated Money Market Funds. IMMFA members cover nearly all of the major providers of this type of fund in Europe. Funds under management for IMMFA members alone were approximately a quarter of a trillion US dollars as at October 2005. You may obtain further information on triple-A rated Money Market Funds from our website, www.immfa.org.

Triple A rated money market funds are bought primarily by institutions to manage their liquidity positions and not for 'total return' investment purposes. Institutional clients include the treasury, fund management or dealing departments of: (i) Corporations; (ii) Banks and insurance companies; (iii) Pension funds; (iv) Asset managers, including hedge funds and SPVs; (v) Custodians and trustees; (vi) Charities; and (vii) Local authorities. Institutional money market funds are used as an alternative to bank deposits by many investor as they offer a practical means of consolidating and outsourcing short-term investment of cash.

IMMFA welcomes the CESR paper and believes that it reflects the necessary balance between the different types of money market funds that operate in Europe. The recognition by CESR of the legitimate use of amortised cost methods of valuation, under clear specified criteria that differentiate IMMFA style funds from other types of fund, is of fundamental importance to maintenance of this type of fund. This outcome will ensure that institutional money market fund providers will be able to continue to address the needs of investors.

We have some comment on the consultation. In view of concerns of triple-A rated money market funds, we have restricted our comments to the part of the draft advice which deals with the eligibility of money market instruments, and set out below several points that we wish to highlight to CESR. We also endorse the comments and recommendations made by the Investment Management Association about other aspects of CESR's draft advice.

Asset maturity of one year

CESR's advice at box 4 notes that that the following will usually comply with the principles "UCITS investing solely in high-quality instruments with as a general rule a maturity or residual maturity of at most one year or regular yield adjustments in line with the maturities mentioned before and with a weighted average maturity of 60 days." There are practical considerations that would make compliance with this requirement difficult and we recommend that CESR provide flexibility to allow the maturity to extend to 397 days.

In practice the requirement that the assets maturity be limited to one year may cause difficulties for fund compliance as this length of time does not take account of settlement periods for the instruments. Money market instruments tend to have maturities of 3, 6 or

Institutional Money Market Funds Association Ltd, 65 Kingsway, London, WC2B 6TD
Telephone: 020 7269 4669 Fax: 020 7831 4220 E-mail: admin@immfa.org

12 months. For the latter instruments there may be circumstances where the due to administrative requirements the maturity may extend slightly beyond the 12 month period. In these circumstances, the advice as currently drafted would mean that a UCITS would not be able to remain compliant and purchase the 12 month maturity security. For new issues the risk of such settlement period overrun may be higher as the settlement processes (dates, etc) may take longer to determine. In addition, there are different definitions of maturity – legal final, actual final and weighted average life. We would therefore suggest that CESR permit an additional period to be added to the maturity so as to ensure that settlement periods are covered.

We believe that it would be beneficial to allow flexibility in the definition of the asset maturity period and request that CESR consider a period of 397 days (ie 13 months). This would allow for UCITS to hold 12 month maturity assets without concern regarding breaching the requirements. This period is also in line with the approach taken to regulation of money market funds by the US Securities and Exchange Commission under its rule 2a-7. Thus, adopting a maturity period of 397 days would result in regulatory consistency between the US and Europe. As a number of these funds are provided by firms that operate in both jurisdictions, this would reduce costs and increase compatibility between jurisdictions.

Liquidity

With respect to the criterion "liquid", the advice identifies a set of "cumulative factors" that the instrument should fulfil. These are:

- frequency of trades and quotes for the instrument in question;
- number of dealers willing to purchase and sell the instrument, willingness of the dealers to make a market in the instrument in question, nature of market place trades (times needed to sell the instrument, method for soliciting offers and mechanics of transfer);
- size of issuance/program;
- possibility to repurchase, redeem or sell the MMI in a short period (e.g. 7 business days), at limited cost, in terms of low fees and bid/offer prices and with very short settlement delay;

The market in such instruments will generally meet the criteria but at an individual instrument level there will be particular occasions when the criteria might not be met or particular periods when they might not be met. Taking CDs as an example, as a money market fund holds instruments to maturity the implicit investment policy would be not to sell or trade. While there is generally a market in CDs there might be a limited frequency of trades or a low number of dealers willing to purchase and sell the instrument. Other MMIs reflect similar patterns and would not necessarily be able to meet all the criteria noted above.

The definition of liquidity at instrument level is of secondary importance to the definition at portfolio level. Typically, the portfolio of a money market fund comprises up to one hundred MMIs, and since they have relatively short maturity dates, the portfolio changes constantly. Fund liquidity risk reflects the fact that the various investments held in a portfolio have different liquidity profiles, that is, some will be easier to sell than others. A manager must structure their holdings so that a number of illiquid investments do not mature at the same time. They must also look at future contingencies that could make the liquidity structure of their portfolios more risky.

We feel that the key issue is to ensure portfolio level liquidity and would suggest that that the above instrument level list should not be considered as prescriptive for all factors that must be met. Instead they should be indicative that might be used to inform an investment manager's decision when considering whether an instrument is liquid.

We would seek clarification on meaning of the term "cumulative". We note, at paragraph 55, that the explanatory text states "These conditions should be considered as cumulative even if the fact that some of them are not fulfilled does not imply that the financial instrument should be automatically considered as non-liquid;..." We interpret this to mean that although some factors might not be met, the instrument would be considered liquid. This is useful if this is the case as we do not believe that all the factors can be achievable for all instruments on a continuous basis.

Types of instrument

The advice specifies particular instruments as MMIs. In particular, Treasury and local authority bills, certificates of deposit, commercial paper, and banker's acceptances. We note the reason given for this at paragraph 59 of the explanatory text where CESR notes its response to a "majority of public comments" that requested that the noted instrument be deemed to be money market instruments and should be included as level 3 advice. However, at paragraph 52 medium-term notes are noted as money market instruments but are not included in the equivalent list in the advice. We recommend that medium-term notes be included in the advice.

We presume that the list is indicative only and should not be considered as a definitive list of MMIs. It would appear inconsistent with the terms of the advice to set a number of criteria for eligibility and then list the instruments that can be accepted as MMIs. In addition, by defining the set of instruments, CESR would restrict the ability for the provision of new instruments or other innovations. Provided that an instrument meets the criteria of the advice it should be considered as eligible.

If it is the case that CESR would consider this list as more than indicative we suggest that additional instruments be included. In addition to medium-term note noted above there are several instruments, including deposits, repos, promissory notes, and funding agreements that are generally used in money market fund portfolios that are not included in this list but are comparable to those that are.

Issue or issuer of MMIs other than those dealt in on a regulated market (box 6)

The criterion requiring that the issue or the issuer of MMIs not admitted to or dealt in on a regulated market" is itself regulated for the purpose of protecting investors and savings" (Box 6), requires MMIs meet the following criteria:

- availability of information on both the issue or issuance program and the legal and financial situation of the issuer prior to the issue of the MMI;
- regular up-dating of this information (i.e. on an annual basis or whenever a significant event occurs);
- control of this information by an independent body specializing in the verification of legal or financial documentation and composed by persons meeting various standards of integrity and not subject to instructions from the organization they belong and from the issuers;

- a minimum amount of each issuance of EUR 150.000 or the equivalent in other currencies;
- free transferability and electronic settlement in book-entry form;
- availability of reliable statistics regarding the issue or issuance programs.

It appears that the above are set out to meet the ACI-STEP criteria for Euro commercial paper (ECP). CESR notes at paragraph 71 that "It is not the aim of CESR's advice to oblige some money market instruments to migrate to specific markets." However, at paragraph 74 CESR notes that it has positively taken into account a "reference to the necessity of establishment of reliable and available statistics allowing to ascertain transparency of the programs. From STEP promoters' point of view, these elements are necessary to create some incentive for European Commercial Papers to migrate towards the STEP initiative." This suggests that CESR is seeking to support the establishment of the STEP criteria for Euro Commercial Paper. While this may not be problematic in itself, by applying criteria across the board that may be appropriate for ECP but not for other money market instruments creates an onerous regime that a number of instruments may be unable to meet.

IMMFA believes that the requirements as set out in box 6 could be detrimental to the development of the market. The impact could be to reduce the demand for legitimately issued instruments and to reduce the diversification abilities of money market fund managers. We would suggest that the recommendations need to be seen in the context in which the fund operates, and that a number of the recommendations are either primarily a commercial decision or superfluous to a money market fund.

When these criteria are considered in more detail there are a number of the factors where the advice requires MMIs to meet inappropriate or unachievable criteria. Taking each in turn:

- we are concerned that the requirement that "...availability of information on both the issue or issuance program and the legal and financial situation of the issuer..." may be difficult for some forms of certificates of deposit. Certain forms of CDs are issued by institutions which may not themselves be 'credit institutions' in the terms of Article 19(1)(f) (for example, local authorities) and so will fall under Article 19(1)(h) and therefore be effected by this draft advice. UCITS managers investing in such CDs will not rely on an information on the issue, but rather financial information on the issuer. We would therefore suggest that the text should refer to the availability of information to relate to the issue, the programme or the issuer, rather than the issue or issuance programme and the issuer.
- regular up-dating of this information (i.e. on an annual basis or whenever a significant event occurs); if the comment at bullet one was accepted this point should not be problematic. However, the problem is exacerbated if regular updating is added to the requirements for "...the issue or issuance programme and the issuer."
- control of this information by an independent body. We do not think that this criterion works for most MMIs, as it would require an appropriate third party body that does not currently exist for all instruments. For example, which body would be responsible for verification of the issuer for MTNs or would be appropriate body for reviewing a CD's financial statements? The proposal does not reflect current market practice - while it is possible that market practice may evolve to provide the optional use of an independent authority, the case for it to be a regulatory requirement across all money market instruments has not been made.

- a minimum amount of each issuance of EUR 150.000 or the equivalent in other currencies. Not all MMIs would operate a minimum issuance and, where they do not it is not necessarily problematic to have a lower issuance. We cannot see how the provision of a minimum issuance amount helps with the protection of investors and savings.
- the requirement for electronic settlement in book-entry form appears unusually prescriptive of the method to be undertaken, especially as there are still some physical CDs in the market. While we do not fundamentally object to this bullet, we cannot see how it provides meaningful protection for UCITS.
- availability of reliable statistics regarding the issue or issuance programs. This appears to be a costly and onerous requirement that is not applicable for most MMIs and would not provide meaningful benefits. For example, how would statistics on CDs be collated and to what use would the information be put? There is currently no statistics collected on the CD market and it would be costly to develop such a programme with few benefits defined.

We suggest that CESR review the criteria above and limit the requirements to the first two bullets (suitably revised). We believe that these would represent meaningful criteria that could be applicable for all MMIs. If this suggestion is not accepted, we would ask that CESR limit the scope of box 6 to ECP only.

WAM limit

IMMFA exists to represent the providers of Triple-A rated money market funds, which are characterised by a 60-day WAM according to our code. We note our agreement with CESR's proposals regarding the 60-day limit but also flag that some IMMFA members plan to submit requests for an extension to a 90-day WAM. Current market conventions mean that firms allow for some flexibility in the prospectus to go to 90 day WAM, although in practice they generally operate at below 60days. A WAM of 90-days is permitted under the US SEC rule 2a-7 and it would be beneficial to have consistency across regulatory approaches. We would ask that CESR consider positively to these requests.

IMMFA would welcome the opportunity to explain in detail the operation of money market funds and the regulatory environment in which they operate. We would be very pleased to meet to further explore these issues should clarification be required.

Yours Sincerely,

Gerard Fitzpatrick
Secretary General, IMMFA

Appendix 1: IMMFA responses to questions (suggested response is in bold italics)

BOX 4

Questions:

Q 4. Do you agree with the approach as suggested in Box 4?

We agree with CESR's proposal that amortisation be permitted under specific circumstances and believe that IMMFA member funds will be able to fulfil the criteria. We have several issues of substance described in our letter regarding the residual maturity of the instrument, liquidity and the types of MMI noted in box 4.

Please give your view on the possible impacts of the proposed approach to your activity/ more broadly to the UCITS market, based on your experience.

The maintenance of the use of amortised valuation methods will have the effect of maintaining an expanding pan-European market for institutional money market funds.

Given the very low level of interest rates (especially in the eurozone), what are the thresholds currently used by the industry to qualify a discrepancy as being material?

Accepted industry practice sees a 50 basis point variation between a fund's mark to market valuation and its book value as being material. For a constant NAV fund, this is when a fund has a published share price or verified mark-to-market valuation amounting to 99.5% or less of the constant value of each share. The equivalent limit for an accumulating money market fund is deemed to be either when its published share price or its verified mark-to-market valuation per share falls below 99.5% of the highest level previously reached by the share price

Are these thresholds defined at the instrument and/or at the fund level?

These thresholds are set at the fund level, though most funds will also undertake monitoring at instrument level.

Does the industry use escalation procedures to prevent any discrepancy to become material? Please give details of these escalation procedures (discrepancy threshold, steps taken etc.).

The IMMFA Code of Practice requires that members should ensure that they have in place and adhere to an escalation procedure for occasions when the value of the fund under the straight-line method and under the mark-to-market method differs by more than a marginal amount. The escalation procedure should ensure that any variance in valuation is considered by people competent to act for the fund (usually the Directors of the fund or its Trustees) at an appropriate time. The purpose of the escalation procedure is to ensure that a fund's objective to preserve principal, and the investment strategy devised to deliver on this objective, are reviewed by individuals independent of the fund's investment management team at times when the portfolio is under stress. The escalation procedure should ensure that the board of directors, who have ultimate responsibility for the fund, be notified well before the 50bp differential is reached.

The steps to be taken would depend on the circumstances. If it was a credit event, the manager would need to decide whether further deterioration in the position would be likely, in which case consideration would be given to sell the security and realise the loss. If it is more likely that the position will not deteriorate, it would be preferable to monitor the situation on the basis that the security would return the principal. It would need to be an extremely large credit event to cause a fund to break the buck.

If it was a market wide event, such as a sudden spike in interest rates, consideration would need to be given as to whether there is a need to restrict client outflows. It should be noted that from an investor perspective the outcome of a major event, large enough to break the buck, would be the same, whether the fund was stable NAV or a short bond variable NAV fund. The fund would move by the same amount.

At 15bp, the administrator would contact the fund manager (although the fund manager should be aware due own monitoring). Fact finding would be undertaken to determine the cause (e.g. pricing source error, security default) and credit/risk teams and if necessary Credit Rating Agencies (CRAs) would be informed. If it was a security movement or an accounting error the manager would review whether clients affected.

At 30bp manager would run through checks as noted above and advise trustees and directors of the fund. If necessary sell the affected security /correct the income if an accounting error (and smooth using 5bp over 60 days).

50bp - material error - would be an issue for the management company board and trustees.

An alternative procedure would for the fund administrator to notify the fund manager at 10bp, senior management of the investment company at 20bp and the trustee/board of directors at 30bp.

BOX 5

Questions:

Q 5. Do you agree with the approach as suggested in Box 5?

We agree with the advice as set out in Box 5. We would note that IMMFA member fund assets fulfil the requirements of the conditions of "liquidity" and "accurate valuation".

Please give your view on the possible impacts of the proposed approach to your activity/ more broadly to the UCITS market, based on your experience.

We believe that the proposed approach should have no impact on IMMFA member funds. The funds neither seek exposure to precious metals through the investment in such instruments not undertake short selling of MMIs. IMMFA members take instrument level liquidity into consideration insofar as it affects portfolio level liquidity. Thus the proposals should confirm exiting market practice.

BOX 6

Questions:

Q 6. Do you agree with the approach as suggested in Box 6?

We have several issues of substance described in our letter regarding the requirements as set out in box 6.

Please give your view on the possible impacts of the proposed approach to your activity/ more broadly to the UCITS market, based on your experience.

IMMFA believes that the requirements as set out in box 6 could be detrimental to the development of the market. We consider that the requirements are appropriate to ECP but not to MMIs more generally. The impact could be to reduce the demand for legitimately issued instruments and to reduce the diversification abilities of money market fund managers.

BOX 7

Questions:

Q 7. Do you agree with the approach as suggested in Box 7?

We agree with the approach in box 7.

Please give your view on the possible impacts of the proposed approach to your activity/ more broadly to the UCITS market, based on your experience.

We believe that the proposed approach should have no impact on IMMFA member funds. IMMFA funds invest solely in investment grade instruments and as such the proposals should confirm exiting market practice.

BOX 8

Questions:

Q 8. Do you agree with the approach as suggested in Box 8?

We believe that the advice is only supposed to relate to a particular type of asset backed commercial paper (ABCP) issued in France, and as such should not be applicable to other types of ABCP issued in Europe. WE would therefore ask that CESR clarify that the advice on this point does not read-across to other types of ABCP.

Please give your view on the possible impacts of the proposed approach to your activity/ more broadly to the UCITS market, based on your experience.

Subject to the comments noted above we believe that this approach will not affect IMMFA's activity.

BOX 9

Questions:

Q 9. Do you agree with the approach as suggested in Box 9?

Yes.