Response to Consultation

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Anthony Gilsoul
Final

BEAMA Response to Consultation on the revision of the provisions on diversification of collateral in ESMA's guidelines on ETFs and other UCITS issues. (20/12/2013)

BEAMA[1] wishes to thank ESMA for submitting the proposed revision of the rules on diversification of collateral in the ad-hoc guidelines to consultation and seizes the opportunity to communicate the Association's opinion concerning this important topic.

General Comment

During the drafting of the Guidelines, several representatives of the Asset Management sector had already voiced concerns about the collateral diversification rules proposed by ESMA. Many underlined that ESMA's conception of collateral may have been wrong as the role of collateral is very different from that of investment diversification. Indeed, the primary role of collateral is to reduce counterparty risk whilst investment diversification takes place to reduce the idiosyncratic risk of a portfolio.

As those two types of risks are disaggregated, the primary considerations for collateral to play this role should be liquidity and quality whilst diversification has a smaller role to play as long as collateral is of excellent quality.

Answer to ESMA's specific questions

Q1: Do you believe that ESMA should revise the rules for the diversification of collateral received by UCITS that take the form of money market funds in the context of efficient portfolio management techniques and OTC transactions? If yes, do you agree with ESMA's proposal?

[1] BEAMA, www.beama.be , the Belgian Asset Managers Association, is the professional association of Belgian fund and asset managers. BEAMA has 114 members (64 effective members – 50 associated members), representing €225bn in assets under management as of the end of 2012. BEAMA is a founding member of Febelfin, the Belgian Federation of the Financial Sector.

BEAMA agrees with the principle of a revision of the rules on diversification of collateral received in the context of efficient portfolio management techniques and OTC transactions. As explained in our introduction, we firmly believe the current rules impose excessive burden to UCITS in comparison to what they are trying to achieve.
Although credit quality and liquidity remain the paramount characteristics of concern for a prudent collateral management, we also agree that a certain degree of diversification at the issue level remains necessary (in order to face the unlikely event of a debt restructuring). In that respect, the solution proposed by ESMA to align collateral diversification requirements with UCITS issuer concentration rules (Article 54(1) 2009/65/CE) seems both consistent and balanced provided the additional alignment we explain under question 3 also takes place.

Furthermore, we agree with the fact Money Market Funds are those that would mostly suffer from the current diversification rule when they proceed to reverse repurchase agreements. This is due to the very low remuneration they receive and the reduced choice of very high quality signatures for collateral.

However, we do not think the proposed revision of the rule should only apply to Money Market UCITS. In contrary, we strongly believe the proposed revised rules should apply to all UCITS. In our opinion, UCITS funds should not be put at disadvantage versus non-UCITS funds. Liquidity management is also an important activity for those funds and they should not be forced to accept lower quality collateral just in order to respect the diversification rules. Their access to the best quality collateral, high quality government bonds should equally remain unharmed especially as EMIR will require those funds to exchange higher amounts of collateral.
Moreover, maintaining a distinction between UCITS and MMF UCITS might create operational inconsistencies whereby different collateral policies and procedures have to be applied across the same UCITS fund range.

Q2: Do you think that ESMA should introduce additional safeguards for government bonds received as collateral (such as a specific issuer limit) in order to ensure a certain level of diversification? Please give reasons for your answer.

BEAMA supports ESMA's proposed revision with respect to the diversification level and does not see the explicit need to prescribe additional safeguards such as issuer limits.

Q3: Do you agree with the proposed requirement to diversify the government securities across at least six different issues?

BEAMA agrees with the diversification level which is consistent with the UCITS investments diversification level at the condition that this level is calculated again the fund's NAV and not against the total of received collateral. Indeed, we believe that collateral ratios should not be stricter than those for the portfolio investments. This would mean that as long as the received collateral does not exceed 35% of the NAV, there is no need to diversify across 6 emissions (see Art. 52(3) 2009/65/EC). Once the 35% NAV threshold is crossed, the received collateral should then be diversified with a maximum 30% NAV limit per emission (see Art. 54(1) 2009/65/EC) and with minimum 6 emissions in the fund.

BEAMA, Brussels – 31/01/2014