Frankfurt am Main
31 January 2014

BVI`s response to ESMA`s Consultation Paper on the "Revision of the provisions on diversification of collateral in ESMA`s guidelines on ETFs and other UCITS issues"

BVI[1] gladly takes the opportunity to submit its comments on ESMA`s proposal for a revision of the provisions on diversification of collateral in ESMA´s guidelines on ETFs and other UCITS issues.

We support the initiative to revise the provisions on diversification of collateral in the guidelines. The proposed revision will align the guidelines with the regulatory framework for UCITS and will improve legal certainty for all market participants. However, the proposed derogation of the collateral diversification rule should be extended to all UCITS in order to enable a level playing field for all UCITS providers.

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?

Yes, we agree with ESMA`s assessment to review paragraph 43 (e) as the current guideline constrains the possibility for UCITS to apply an optimal collateral diversification policy. The current ESMA rules are much stricter than the diversification limits in the UCITS directive pursuant to Articles 52 para 3 and 54 para 1. A stricter collateral diversification rule is difficult to justify given the fact that the collateral received by the UCITS is of good credit quality and sufficiently liquid in order to warrant the possibility of a smooth disposal and adequate pricing.

We believe that good credit quality and liquidity of the collateral are much more important than the diversification of collateral. In this context we agree with ESMA`s evaluation that the restrictive collateral diversification rule could potentially have an adverse consequence as UCITS would be forced not to accept collateral of good quality to be able to meet the 20% issuer limit. Therefore, holding collateral with lower credit quality and liquidity but more diversified could lead to greater exposure of the fund in the event of a counterparty default.

We disagree with ESMA`s proposal to restrict the scope only to UCITS that meet the criteria for the definition of Money Market Fund (MMF) or Short-Term Money Market Fund of the guidelines on a common definition of European money market funds. We are in favor of option 2 as considered in Annex II. The proposed derogation of the collateral diversification rule should be extended to all UCITS in order to enable a level playing field for all UCITS providers. ESMA should take into consideration that only a small portion of the German investment funds/money market funds may profit from the revised guideline while all other UCITS funds are put at a disadvantage.

[1] BVI represents the interests of the German investment fund and asset management industry. Its 78 members currently handle assets of EUR 2.0 trillion in both investment funds and mandates. BVI enforces improvements for fund-investors and promotes equal treatment for all investors in the financial markets. BVI`s investor education programmes support students and citizens to improve their financial knowledge. BVI`s members directly and indirectly manage the capital of 50 million private clients in 21 million households. (BVI's ID number in the EU register of interest representatives is 96816064173-47). For more information, please visit www.bvi.de.

BVI
Bundesverband Investment und Asset Management e.V.

Kontakt
Fon +49 69 15 40 90 0
www.bvi.de

BVI Berlin
Unter den Linden 42
10117 Berlin

BVI Brüssel
Rue du Commerce 20–22
1000 Bruxelles

BVI Frankfurt
Bockenheimer Anlage 15
60322 Frankfurt am Main

Geschäftsführung
Thomas Richter Hauptgeschäftsführer
Rudolf Siebel Geschäftsführer

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.

No, we think that the current regulatory framework for UCITS is carefully calibrated in order to protect retail investors. Additional guidelines for government bonds which go beyond the UCITS directive should be avoided.

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

We acknowledge ESMA's intentions to maintain an appropriate level of investor protection, while ensuring a practical and workable solution for all stakeholders. We are still of the opinion that the credit quality and liquidity of collateral are – by far – the most important criteria, therefore we raise objections to diversify the government securities across different issues.

In our opinion the proposed diversification rule would limit UCITS in their ability to use securities lending, repo and OTC transactions in an unjustified way. It is not clear to us why collateral with good credit quality obtained by a UCITS should have repercussions on the calculations of overall investment limits and therefore limits UCITS in their ability to trade securities lending, repo and OTC transactions with a single counterparty. The quality of government securities and the credit risk of counterparty are not correlated. In addition, we doubt that ESMA has the power to introduce such a counterparty limit which in our view is contrary to the counterparty limit framework set by the UCITS Directive.

We do not think that the proposal for diversification across six different issues will result in any material additional safety for the investor, or result in better quality mitigation of counterparty risk because the credit default risk of the issues will be highly correlated. We therefore recommend that the issue diversification requirements should be removed.