IMMFA

INSTITUTIONAL MONEY MARKET FUNDS ASSOCIATION

11 September 2009

Mr Arnoud Vossen
Committee of European Banking Supervisors
25 Old Broad Street
London
EC2N 1HQ

Dear Mr Vossen

RE: Consultation paper on draft implementation guidelines on the revised large exposures regime

The Institutional Money Market Funds Association (IMMFA) is grateful for the opportunity to comment on the draft implementation guidelines for the revised large exposures regime.

IMMFA is the trade association which represents the European triple-A rated money market funds industry. Triple-A[1] rated money market funds are managed according to rigid and transparent guidelines, in order to offer safety of principal, liquidity and competitive money market returns. Increasingly, these funds are used by institutional investors to manage liquidity and act as important alternatives to cash accounts. Since its inception in 2000, IMMFA's funds in Europe have grown from around €40 billion to over €425 billion (as at July 2009). Further information on the association and triple-A rated funds are available on the IMMFA website, www.immfa.org.

As stated above, money market funds are actively managed to provide capital security and liquidity. Investors in our members' funds include credit institutions, and therefore any investment by such institutions in money market funds is subject to the large exposure requirements. These funds, as collective investment schemes, have underlying assets. Consequently, our comments relate only to the proposals for investment in schemes with underlying assets.

We agree that the most prudent treatment for exposures to schemes with underlying assets should be full look-through to all the underlying assets. However, this is in practice highly unlikely for actively managed schemes due to the number of underlying assets which may be included within a portfolio and the frequency with which those assets may change. We therefore welcome the recognition that performing a full look-through analysis of the underlying instruments within a scheme will not be practical or feasible in every instance. The need for an alternative approach is essential, and that alternative should be more conservative than full look-through. However, we do not consider that the proposed

[1] References to money market funds in this letter means funds rated specifically AAAm by Standard & Poor's, Aaa/MR1+ by Moody's Investors Service and AAA/V1+ by Fitch Ratings – that price on an amortised accounting basis.

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alternative approach for unknown instruments within a scheme adequately reflects the nature of a collective investment scheme.

Article 106(3) of the revised CRD provides for the treatment of exposures which have underlying assets, whereby the treatment should be determined by the economic substance and the risks inherent in the structure of the transaction. The consultation paper outlines four proposals for how such exposures should be calculated.

The consultation questions whether there should be additional flexibility to deal with different types of schemes. We consider this a necessity. At present, the proposed alternatives to full look-through do not, in our opinion, fully reflect the risk inherent in the transaction. As a minimum, we highlight the treatment of schemes authorised under the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive 85/611/EEC, and propose an alternative solution to that contained within the consultation paper.

The UCITS framework has been a success (managing over €5 trillion of assets in the EU), and provides legislation which establishes a number of parameters within which the funds must operate. Article 1 of the Directive states that UCITS shall be undertakings which operate on the principle of risk-spreading. The European Commission has stated that 'Institutionalised risk-diversification, through fixed investment limits, has proven to be one of the successes of the UCITS model' (Commission Staff Working Paper, Annex to the Green Paper, July 2005). This concept of diversification provides one of the fundamental benefits of investment in a scheme, i.e. that risk will be reduced when compared against direct investment.

Investment in a UCITS should therefore avoid large exposures arising directly from that investment by virtue of the fact that its investment is subject to fixed investment limits. However, there does not appear to be any appreciation of the principle of diversification in the treatment of exposures to collective investments. UCITS are subject to diversification requirements with the maximum exposure to the same entity generally limited to 5%[2]. The Directive also limits exposure to a group of connected counterparties. Article 22(5) states that

> Member States may allow cumulative investment in transferable securities and money market instruments within the same group up to a limit of 20%.

Given the diversification requirements which are imposed by legislation, it does not appear appropriate to treat total unknown exposures which arise through investment in a UCITS as an exposure to a single client. This simply cannot happen. Taking the worst-case scenario, a UCITS would have five exposures to disparate groups of connected counterparties, thereby amounting to 20% each.

Assuming then that where there is investment in more than one UCITS, the worst case scenario would be for there to be consistency in the underlying assets of each UCITS. However, the maximum exposure to a single counterparty would be limited to 20% of the total investment in UCITS. Whilst the underlying assets remain unknown, a large exposure would only arise where 20% of the total investment in UCITS was greater than 10% of own funds. We consider that applying a 20% maximum single counterparty limit for UCITS when calculating large exposures is the most prudent approach to take, given the legislative requirements which are imposed upon these schemes. It is certainly not acceptable to

[2] Higher limits apply to EU government guaranteed fixed income instruments.

consider all unknown exposures as relating to a single counterparty when this cannot legally happen.

For other schemes, we consider that a similar approach should be implemented where the applicable legislative or regulatory diversification obligations are of an equivalent standard to the requirements contained in the UCITS directive.

It is imperative that the treatment of unknown exposures is appropriate as we consider that in practice institutions will either conduct full look-through or treat exposures as unknown. Our proposed alternative treatment for investment in UCITS would implement a more prudent approach whilst also mitigating the impact of potential cross-holdings within UCITS. It should also be sufficiently conservative (given that most UCITS will consist of more than five underlying instruments) to encourage investors to utilise the full look-through approach where this is both feasible and practical.

We would welcome the opportunity to discuss these matters with you further.

Yours sincerely

Nathan Douglas.

Nathan Douglas
IMMFA Secretary General