association française des investisseurs institutionnels

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Af2i response to the European Commission's consultation on Undertakings for Collective Investment in Transferable Securities (UCITS) : Product Rules, Liquidity Management, Depositary, Money Market Funds, Long-term Investments

General comments

Af2i is the French association of institutional investors [1] welcome the opportunity to respond to the European Commission's consultation on Undertakings for Collective Investment in Transferable Securities (UCITS) Product Rules, Liquidity Management, Depositary, Money Market Funds, Long-term Investments.

Generally speaking, Af2i members are important users of asset management (between 30% et 70% of their assets) with different kind of products : mandates, UCITS, dedicated funds, AIF, etc.

[1] AF2i is the French association of institutional investors, created in 2002 to represent the different families of France based Institutional Investors (insurance companies, pension institutions, foundations, corporate, special institutions (Caisse des Dépôts; FRR; EDF, etc.) and to defend their interests in asset management issues, in France and in Europe. Af2i gather 76 major Institutional Investors as Members representing more than 1,7 trillion € of assets under management and 60 asset management companies or providers as associate members.

Therefore if UCITS managers should have access to a large scope of products within a regulatory structure in line with the UCITS philosophy, investors are still concerned by the global financial security offered by funds.

(1) Do you consider there is a need to review the scope of assets and exposures that are deemed eligible for a UCITS fund?

UCITS regulation has permitted to create quite robust products and investment strategies in order with most of the investors' needs.

Nevertheless, some new needs have appeared with the financial crisis consequences, new banking and insurance company's prudential regulation and very low yield markets. Some new products AUM are also increasing rapidly, as individual retirement savings plans and funds. In particular, this kind of products, which could be used for very long time frame, need flexibility in allocation and large diversification in order to provide over years a robust and consistent performance with a binding risk/reward couple.

So we would suggest that some UCITS could benefit from a larger scope of financial instruments or product without denying the philosophy of an actual UCITS fund.

Other non UCITS funds : private equity, real estate, infrastructures, Hedge funds or FofHF, securitization products, and generally speaking alternative vehicles subject to AIFM, should be accepted, if it in line with a long term strategic allocation product (i.e. target fund).

We consider that investments on commodities should be restricted to products with cash settlement only. Also we believe that the 10% limit should constitute an appropriate safeguard in addition to the management company's internal risk management policy.

(2) Do you consider that all investment strategies currently observed in the market place are in line with what investors expect of products regulated by UCITS?

UCITS are mainly used by professional and institutional investors, but main UCITS are targeted for UCITS retail investors.

(3) Do you consider there is a need to further develop rules on the liquidity of eligible assets? What kind of rules could be envisaged? Please evaluate possible consequences for all stakeholders involved.

Liquidity is very important for an open-ended fund. Financial crisis have conduct asset managers to create or reinforce a real liquidity risks management in the portfolio in order to maintain the ability of a UCITS to redeem investors' demand at all times. It is clear that UCITS management companies had nowadays implemented liquidity risk management. The future code of conduct of French asset management will point this duty.

Common standards or principles to be applied by UCITS in ensuring the liquidity of eligible assets and of portfolios will be supported by Af2i

(4) What is the current market practice regarding the exposure to non-eligible assets? What is the estimated percentage of UCITS exposed to non-eligible assets and what is the average proportion of these assets in such a UCITS' portfolio? Please describe the strategies used to gain exposure to non-eligible assets and the non-eligible assets involved. If you are an asset manager, please provide also information specific to your business.

In France, current rules allow retail non-Ucits funds to invest up to 10% in non-eligible assets which consist of financial securities and instruments.

Some investment funds may hold up to 10% of non Ucits funds as private equity or other entity. These funds are usually available in savings schemes sponsored by the employer.

(5) Do you consider there is a need to further refine rules on exposure to non-eligible assets? What would be the consequences of the following measures for all the stakeholders involved?:

Af2i think that exclude exposure to non-eligible assets would be very difficult in practice and would have consequence to reduce non UCITS collective investment schemes.

Investing in financial indices is the speciality of ETF. ESMA guidelines on UCITS ETFs and other UCITS issues have not proposed to exclude exposure to non-eligible assets. This approach is much better than any absolute restriction.

(6) Do you see merits in distinguishing or limiting the scope of eligible derivatives based on the payoff of the derivative (e.g. plain vanilla vs. exotic derivatives)? If yes, what would be the consequences of introducing such a distinction? Do you see a need for other distinctions?

Af2i consider herself as not the best person or entity to answer to this question.

(**7) Do you consider that market risk is a consistent indicator of global exposure relating to derivative instruments? Which type of strategy employs VaR as a measure for global exposure? What is the proportion of funds using VaR to measure global exposure? What would be the consequence for different stakeholders of using only leverage (commitment) as a measure of global exposure? If you are an asset manager, please provide also information specific to your business**.

VaR and commitment method can be useful tools and being available to measure global fund exposure. VaR is nowadays a very used method in finance and UCITS industry. The VaR method has been correctly used and has not created any problem.

Generally speaking, risk managers should have the flexibility to use the method (VaR or Commitment) they consider as an appropriate method, for evaluating the global exposure of a specific portfolio.

(8) Do you consider that the use of derivatives should be limited to instruments that are traded or would be required to be traded on multilateral platforms in accordance with the legislative proposal on MiFID? What would be the consequences for different stakeholders of introducing such an obligation?

Af2i consider derivatives can be useful to UCITS funds management, when the objective is to protect assets versus market risks

Box 2 – Efficient Portfolio Management (EPM)

EPM cover different techniques which seem for us quite useful to manage some types of funds and UCITS.

Still Af2i consider she is not the best qualified entity to describe the best ways and means of these subjects or to describe and talk about. So, please do refer to AFG's respond to questions 1 to 12.

(1) Please describe the type of transactions and instruments that are currently considered as EPM techniques. Please describe the type of transactions and instruments that, in your view, should be considered as EPM techniques.

(2) Do you consider there is a specific need to further address issues or risks related to the use of EPM techniques? If yes, please describe the issues you consider merit attention and the appropriate way of addressing such issues.

(3) What is the current market practice regarding the use of EPM techniques: counterparties involved, volumes, liquidity constraints, revenues and revenue sharing arrangements?

(4) Please describe the type of policies generally in place for the use of EPM techniques. Are any limits applied to the amount of portfolio assets that may, at any given point in time, be the object of EPM techniques? Do you see any merit in prescribing limits to the amount of fund assets that may be subject to EPM? If yes, what would be the appropriate limit and what consequences would such limits have on all the stakeholders affected by such limits? If you are an asset manager, please provide any information specific to your business.

(5) What is the current market practice regarding the collateral received in EPM? More specifically:

(6) Do you think that there is a need to define criteria on the eligibility, liquidity, diversification and re-use of received collateral? If yes, what should such criteria be?

(7) What is the market practice regarding haircuts on received collateral? Do you see any merit in prescribing mandatory haircuts on received collateral by a UCITS EPM? If you are an asset manager, please provide also information specific to your business.

(8) Do you see a need to apply liquidity considerations when deciding the term or duration of EPM transactions? What would the consequences be for the fund if the EPM transactions were not "recallable" at any time? What would be the consequences of making all EPM transactions recallable at any time?

(9) Do you think that EPM transactions should be treated according to their economic substance for the purpose of assessment of risks arising from such transactions?

(10) What is the current market practice regarding collateral provided by UCITS through EPM transactions? More specifically, is the EPM counterparty allowed to reuse the assets provided by a

(11) Do you think that there is a need to define criteria regarding the collateral provided by a UCITS? If yes, what should be such criteria?

(12) What is the market practice in terms of information provided to investors as regards EPM? Do you think that there should be greater transparency related to the risks inherent in EPM techniques, collateral received in the context of such techniques or earnings achieved thereby as well as their distribution?

Box 3 – OTC Derivatives

Af2i consider herself as not the qualified entity to give the best and appropriate answers on these subjects or to describe the best practices. So, please do refer to AFG's respond to questions 1 to 6.

(1) When assessing counterparty risk, do you see merit in clarifying the treatment of OTC derivatives cleared through central counterparties? If so, what would be the appropriate approach?

(2) For OTC derivatives not cleared through central counterparties, do you think that collateral requirements should be consistent between the requirements for OTC and EPM transactions?

(3) Do you agree that there are specific operational or other risks resulting from UCITS contracting with a single counterparty? What measures could be envisaged to mitigate those risks?

Counterparty risk is strongly regulated under the UCITS framework, with a maximum counterparty risk (per counterparty) limited to 10% of the fund's NAV. It seems sufficient.

(4) What is the current market practice in terms of frequency of calculation of counterparty risk and issuer concentration and valuation of UCITS assets? If you are an asset manager, please also provide information specific to your business.

(5) What would be the benefits and costs for all stakeholders involved of requiring calculation of counterparty risk and issuer concentration of the UCITS on an at least daily basis?

(6) How could such a calculation be implemented for assets with less frequent valuations?

Box 4 – Extraordinary Liquidity Management Tools

UCITS are already subject to liquidity risk management. It has been further enhanced with the entry of the UCITS IV Directive. UCITS managers ensure that the funds they manage can permit redemption requests from investors.

As far as we know, liquidity risk management process forms belong to the permanent risk management function, that UCITS investment management companies establish. We do not see the need for additional regulatory necessity

The IOSCO Consultation Report on Principles of Liquidity Management for Collective Investment Schemes explained the best practices which are already in application in the UCITS management.

(1) What type of internal policies does a UCITS use in order to facilitate liquidity constraints? If you are an asset manager, please provide also information specific to your business.

French MMF have reinforced liquidity risk management process since the beginning of the financial crisis with two objectives:

- monitor liquidity constraints;

- ensure that the fund may all time being redeem requests from investors in line with the redemption policy described in the prospectus.

It was a great demand from Fund users association as Af2i and AFTE (French treasurers association that stress liquidity monitoring and management was described somewhere.

Of course, the liquidity policies have to be in line with the typology of the portfolios, are regularly controlled.

For example: WAL is the one of the best criterion for Money Market Funds liquidity; liquidation price and the time or the estimate number of days needed to liquidate bond portfolios and equity portfolios. That is already typically things that investors ask during due diligence process.

In exceptional circumstances where – despite the liquidity management process in place – a UCITS would temporarily be unable to meet the redemption requests from investors, the fund manager still has the ability to temporarily suspend redemptions in the interest of its unit holders (as foreseen in Article 84 of the UCITS Directive).

This tool is supposed to protect investors. However, temporary suspension of redemptions must be the last resort measure and used with the greatest caution and for the shortest possible period of time by UCITS managers. We support that a better idea is to include "swing prices" inside the French UCITS regulation, which can permit a better flow of redemptions, whatever their amount or delay to execute the redemption demand.

(2) Do you see a need to further develop a common framework, as part of the UCITS Directive, for dealing with liquidity bottlenecks in exceptional cases?

The objective should be to mitigate the risk and size of sales and redemption requests from investors.

(3) What would be the criteria needed to define the "exceptional case" referred to in Article 84(2)? Should the decision be based on quantitative and/or qualitative criteria? Should the occurrence of "exceptional cases" be left to the manager's self-assessment and/or should this be assessed by the competent authorities? Please give an indicative list of criteria.

The best criteria could include very abnormal volume or unusual redemptions demand; price gaps, absence of liquidity, and of course all king of "force majeure" situations : market meltdown, acts of god, outbreak of war / civil insurrection, terrorism, breakdown in physical / IT infrastructure, capital controls, currency non-convertibility…

Of course, asset managers should have a prime role to define such situation and are still the best placed person to evaluate the exceptional characterisation. In case of the temporary suspension of redemption, asset managers can collaborate for exceptional case with the AMF.

(4) Regarding the temporary suspension of redemptions, should time limits be introduced that would require the fund to be liquidated once they are breached? If yes, what would such limits be? Please evaluate benefits and costs for all stakeholders involved.

Time limits can be the worst situation.

(5) Regarding deferred redemption, would quantitative thresholds and time limits better ensure fairness between different investors? How should such a mechanism work and what would be the appropriate limits? Please evaluate benefits and costs for all the stakeholders involved.

AF2i consider that swing prices, then the possibility for an asset manager to decide to suspend redemption are sufficient instrument to deal with extraordinary cases of illiquid markets - knowing that UCITS as a rule invest in liquid assets.

(6) What is the current market practice when using side pockets? What options might be considered for side pockets in the UCITS Directive? What measures should be developed to ensure that all investors' interests are protected? Please evaluate benefits and costs for all the stakeholders involved.

Side pockets have been already in the pas authorized by AMF in exceptional circumstances in the past for very special UCITS, generally alternative investment funds.

Side pockets are a good way to give some liquidity to investors and to permit redemptions or subscriptions.

(7) Do you see a need for liquidity safeguards in ETF secondary markets? Should the ETF provider be directly involved in providing liquidity to secondary market investors? What would be the consequences for all the stakeholders involved? Do you see any other alternative?

AF2i consider that ETF must ensure the availability of liquidity for their investors and fully recognize that the right for UCITS ETFs unit-holders or to sell in the market or to redeem their shares “at NAV”.

The very recent ESMA’s guidelines on ETF and other UCITS issues addressed this issue with the sufficient level of flexibility in their § 23. They affirm the principle and leave it to the fund to organize. Therefore owner of UCITS ETFs, like in any UCITS, should be allowed to redeem directly from the fund, at NAV.

(8) Do you see a need for common rules (including time limits) for execution or redemption orders in normal circumstances, i.e. in other than exceptional cases? If so, what would such rules be?

We do not see the need for additional rules, provided that time limits are properly disclosed in the fund documentation.

Box 5 - Depositary passport

(1) What advantages and drawbacks would a depositary passport create, in your view, from the perspective of: the depositary (turnover, jobs, organisation, operational complexities, economies of scale …), the fund (costs, cross border activity, enforcement of its rights …), the competent authorities (supervisory effectiveness and complexity …), and the investor (level of investor protection)?

What French investors think about advantages and drawbacks of a depositary passport is mainly related to the investment protection. As long as the security conditions will reach the French standards, French institutional investors will welcome the depositary passport enforcement.

The point is, of course about “reaching the French standards” of protection because the harmonization process will have to get through significant gaps remaining in different issues such as:

- The property of the securities / single credit right
- Obligation of result / obligation of means
- Bankruptcy laws
- Depositary status
- Custodian and sub custodian status
- Depositary preferences

So, French investors do think that the feasibility question has to be clarified, especially in a non emergent file.

Af2i consider that a full harmonisation of the status, role and liability regime of UCITS depositary is an unconditional pre-requisite for a depositary passport.

(2) If you are a fund manager or a depositary, do you encounter problems stemming from the regulatory requirement that the depositary and the fund need to be located in the same Member State? If you are a competent authority, would you encounter problems linked to the dispersion of supervisory functions and responsibilities? If yes, please give details and describe the costs (financial and non-financial) associated with these burdens as well as possible issues that a separation of fund and depositary might create in terms of regulatory oversight and supervisory cooperation

About 240 venues are operating on the European markets under the coverage of 28 regulators. French investors, and regulator likely, would appreciate to avoid any kind of extra complexity.

(3) In case a depositary passport were to be introduced, what areas do you think might require further harmonisation (e.g. calculation of NAV, definition of a depositary's tasks and permitted activities, conduct of business rules, supervision, harmonisation or approximation of capital requirements for depositaries…)?

The definition of the depositary tasks and permitted activities, conduct of business rules, supervision, capital requirements are relevant issues for short term harmonization. As for the depositary role and responsibility, a first relevant step is to actualize the mapping of the existing provisions of the different member states.

A consistent previous step should be to clarify and harmonize the valuation standards and calculation of NAV.

(4) Should the depositary be subject to a fully-fledged authorisation regime specific to depositaries or is reliance on other EU regulatory frameworks (e.g., credit institutions or investment firms) sufficient in case a passport for depositary functions were to be introduced?

Because of the important role of the depositary in the protection chain, a fully fledged specific authorization should be required.

(5) Are there specific issues to address for the supervision of a UCITS where the depositary is not located in the same jurisdiction?

Specific issues are to be addressed for the supervision of UCITs where the depositary is not located in the same jurisdiction, so that they allow the UCITs to get the same level of protection as if it was located in the same jurisdiction. Anyway this item has to be disclosed at the subscription.

Box 6 to 9 – Money Market Funds

Af2i has highly supported the recent working of ESMAS, European Commission, Financial Stability Board (FSB) and the IOSCO to reduce inefficiencies, systemic risks and possibilities of regulatory arbitrage in money market asset management.

Last report published on the 9th of October by IOSCO is globally in line with Af2i expectations. As well Af2i support the French asset managers association (AFG) currently working on a “code of best practices” for money market funds. This code will give more explanation on how to manage a VNAV French money market fund.

Since 2009, the MMFs have been in the centre to huge works and reforms that have really clarified the MMFs definition and management, strengthened their resilience, such as the ESMA (ex CESR) guidelines on a common definition of European MMFs.

Hence, at this stage, the reform of MMFs should focus on the fund's internal liquidity risk, including by requiring MMFs to adhere to certain liquidity requirements (such as by stipulating that a minimum amount of a fund's portfolio should mature within one day and within five business days) and to know their clients by taking into account client concentration and client segments, industry sectors and instruments, and market liquidity positions.

Also French money market managers are in favour of a more precise practice for the valuation of the fund. Therefore it is relevant that linear methodology should be restricted to maturities below 3 months as it is done for all other type of funds.

This said AFG members consider Money Market funds like other categories of UCITS funds being subject to eventually downside valuation. UCITS is in line with client's expectations. Clients are also now familiar with the CESR/ESMA guidelines for money market. It is then not necessary to set up specific part for MMFs.

Box 6 - Money Market Funds

(1) What role do MMFs play in the management of liquidity for investors and in the financial markets generally? What are close alternatives for MMFs? Please give indicative figures and/or estimates of cross-elasticity of demand between MMFs and alternatives.

MMFs are an important part in the management of the investor's liquidity, to prepare withdrawal or payments, as short term investment, or inside "barbell strategies".

"Alternatives" are mainly banks deposits or term deposits, short term Treasury bills or bonds and some kind of operations as repos or pensions. The cross-elasticity between MMFs and banks deposits mainly relies upon interest rates levels and creditworthiness in banks.

For French institutional investors answering our annual survey, MMF represent around 4,5 % of their assets and €66 billion, inside their liquid assets bucket and especially pregnant for small insurance and retirement institutions. This number was quite big compared the last years, because of the long term yield drop in 2011, making investors very cautious versus a steepening movement.

MMFs are instruments that provide to investors daily liquidity and asset diversification. Investors get a diversified short-duration exposure which they otherwise could not get due to minimum investment amounts of securities.

MMFs allow corporate treasurers and other institutional investors to manage deposit credit risk through diversification, thereby avoiding the risk associated with the concentration of deposits in a few select banks and the absence of unlimited deposit guarantee schemes. MMFs can also be used as an outsourcing tool in what concerns the analysis of credit and counterparty risks, as it is entitled to professional asset management teams.

It is important to highlight that MMFs contribute also to the demand for securities issued by corporate entities, offering them the possibility to diversify their financing from bank loans to securities. The same applies to Governments, public or financial institutions. MMFs constitute alternative funding for the real economy, which is particularly useful when traditional banking or market channels become temporarily impaired.

(2) What type of investors are MMFs mostly targeting? Please give indicative figures.

As far as we know, MMFs are targeting consistent investors with on-going flows and short term investment needs generated by their models. In the real world French MMFs under management in France reach nearly €350 billion at the same date, and so, the majority of the MMFs shares are located out of the institutional investors and corporate treasurers. Retail remain also important but this

(3) What types of assets are MMFs mostly invested in? From what type of issuers? Please give indicative figures.

Financial CD, French or Euro Commercial papers, short term bonds, Treasury bills and temporary operations as repos and pensions are the main instruments.Types of issuers are banks, financials, corporate issuers, sovereigns, agencies, supranational.

The ECB data show that MMFs held 2.7% of all debt securities issued by euro area nonfinancial sectors at end 2011, and 5.4% of all debt securities issued by euro area credit institutions.

In France, asset managements are by far the largest holders of local issues on certificates of deposit: 45% for banks - for which they are an essential source of funding - and 35% for non-financial companies.

With around 156 billion of French money market instrument held by money market funds, and for the sake of risk diversification, these funds hold in their portfolios some 131 billion euros of additional money market instruments issued on foreign markets.

Average for MMFs allocation would be: money market instruments namely about 65%, short term bonds 20%, and reverse repo/deposit account for 15%. The average by type of issuers would be: financial institutions 70% of the portfolio, corporate 10%, and government/supra national agencies 20%.

(4) To what extent do MMFs engage in transactions such as repo and securities lending? What proportion of these transactions is open-ended and can be recalled at any time, and what proportion is fixed-term? What assets do MMFs accept as collateral in these transactions? Is the collateral marked-to-market daily and how often are margin calls made? Do MMFs engage in collateral swap (collateral upgrade/downgrade) trades on a fixed-term basis?

Repos are used by MMFs to place cash on very short periods. Such repos involve a short-dated maturity and are fully collateralised. In addition, repos allow both parties to terminate the transaction early (within 24 or 48 hours), which is a positive feature for MMFs. In France bilateral repo is commonly used. On the other hand, securities lending is unusual for MMFs given the counterparty risk facing the securities lenders. Mainly Govies MMF are big users of repurchase agreements on treasury bills and bonds.

(5) Do you agree that MMFs, individually or collectively, may represent a source of systemic risk ('runs' by investors, contagion, etc…) due to their central role in the short term funding market? Please explain.

Variable NAV MMFs such as the ones which French investors mainly deal with don not represent a source of systemic risk for two reasons:

- There is no link between the banking system and the MMFs as banks are not creditors or sponsors for variable NAV MMFs
- There is less risk of run because there is no first mover advantage
- It is clearly admitted that variable NAV may vary in ways up and down

The remaining risk is a bottleneck on the short term funding market, but without any effect on the banking system.

MMFs are not responsible for the financial crisis. They have been caught up in it.

In 2007, some “cash-enhanced” funds had asset-backed securities in their portfolios to boost their returns. The difficulties experienced by these funds, which were not classified as MMFs, created confusion for investors about the definition, classification and risk characteristics of MMFs.

In 2008, with the Lehman failure, some euro MMFs has experienced net outflows only in the second half of the year, when short-term credit market ceased to function. Nevertheless, the French market of VNAV continued to have been growing as investors were looking for safe investments benefiting to very short term funds mainly invested in Treasury Bills.

MMFs are providers of short-term funding to government, financial institutions and corporate. Somehow this phenomenon should not be exaggerated. For instance, ECB data show that MMFs’ balance sheets represent 4% of the balance sheets of Financial monetary Institutions in the € area.

Bank and term deposit are the principle vehicle used by retail investors in Europe to manage their cash. MMFs have a reduced role in credit intermediation in Europe.

(6) Do you see a need for more detailed and harmonised regulation on MMFs at the EU level? If yes, should it be part of the UCITS Directive, of the AIFM Directive, of both Directives and a separate and self-standing instrument? Do you believe that EU rules on MMF should apply to all funds that are marketed as MMF or fall within the European Central Bank's definition?

EU regulation for MMFs is brand new and quite operational as far as we know, so we do not see any need for more regulation. Furthermore we should welcome a “rendezvous” of assessment within 3 years from now.

MMFs should stay under the UCITs regulation and there is no reason at all for a change.

ESMA (previously CESR) accomplished a very good job in defining rules for MMFs and short-term-MMFs

AF2i support the idea that the EU rules on MMF should apply to all funds that are marketed as MMF. No fund should be allowed to use the “MMF” label if it does not comply with all the EU rules on MMFs.

(7) Should a new framework distinguish between different types of MMFs, e.g.: maturity (short term MMF vs. MMF as in CESR guidelines) or asset type? Should other definitions and distinctions be included?

We have been working very hard recently with our national regulator and the CESR to settle a working MMFs regulation and we do not imagine any reason to change anything. It is important for us to insist that the MMF objective definition as described in IOSCO Report and ESMA guidelines is not correct.

In term of “objective”, Af2i considers that Money Markets Funds do not have (and never had) to deliver any implicit or explicit guarantee of assets preservation, neither to maintain the NAV.

The only acceptable objective to be achieved by an MMF is to seek an investment return linked to money market, net of fees. If such an objective is achieved, the client’s assets may be effectively preserved, but it supposes that the client has remained invested during the recommended period by the asset manager.

In other words, preserve the capital is a consequence of the investment objective and of the adequate assets inside the portfolio.

Af2i considers also that money market funds may invest in diversified money market instruments or bond market instruments or deposits, in line with CESR/ESMA and AMF regulation and described in the prospectus and KIID.

Box 7 - Valuation and Capital

(1) What factors do investors consider when they make a choice between CNAV and VNAV? Do some specific investment criteria or restrictions exist regarding both versions? Please develop.

French institutional investors generally do not use CNAV MMF because they consider that CNAV are subject to instability and no-transparency without providing any advantage in balance.

(2) Should CNAV MMFs be subject to additional regulation, their activities reduced or even phased out? What would the consequences of such a measure be for all stakeholders involved and how could a phase-out be implemented while avoiding disruptions in the supply of MMF?

As a consequence French institutional investors consider that CNAV should be forbidden in the EU without any damage.

(3) Would you consider imposing capital buffers on CNAV funds as appropriate? What are the relevant types of buffers: shareholder funded, sponsor funded or other types? What would be the appropriate size of such buffers in order to absorb first losses? For each type of the buffer, what would be the benefits and costs of such a measure for all stakeholders involved?

For MMFs like for any investment vehicle risk is supported by holders/subscribers but also we have to consider that there is no leverage in such funds. Therefore there is no need to increase capital request. We do not support this option for VNAV fund.

(4) Should valuation methodologies other than mark-to-market be allowed in stressed market conditions? What are the relevant criteria to define "stressed market conditions"? What are your current policies to deal with such situations?

We do not imagine any other valuation methodology than mark-to-market, even in stressed market conditions when transparency has to be the compulsory rule.

Box 8 - Liquidity and redemptions

(1) Do you think that the current regulatory framework for UCITS investing in money market instruments is sufficient to prevent liquidity bottlenecks such as those that have arisen during the recent financial crisis? If not, what solutions would you propose?

French institutional investors think that the current regulatory framework for UCITs is sufficient to prevent liquidity bottlenecks.

(2) Do you think that imposing a liquidity fee on those investors that redeem first would be an effective solution? How should such a mechanism work? What, if any, would be the consequences, including in terms of investors' confidence?

Liquidity fees are more a solution for AIF funds which may deal with non-liquid assets, or a way to keep investors still and/or increase the revenues of the fund.

(3) Different redemption restrictions may be envisaged: limits on share repurchases, redemption in kind, retention scenarios etc. Do you think that they represent viable solutions? How should they work concretely (length and proportion of assets concerned) and what would be the consequences, including in terms of investors' confidence?

See N°2 . In addition, redemption restrictions may have a part to play in open end AIF, especially when institutional investors are mixed with retail investors, what is never a smart way to work.

(4) Do you consider that adding liquidity constraints (overnight and weekly maturing securities) would be useful?

Adding liquidity constraints should create an extra mechanism without any obvious need and generate a shadow in a simple clear process

(5) Do you think that the 3 options (liquidity fees, redemption restrictions and liquidity constraints) are mutually exclusive or could be adopted together?

The 3 options (liquidity fees, redemption restrictions and liquidity constraints) are mutually exclusive because they are all to be applied to AIF funds and not at all for UCITs. They are not appropriate to MMFs

(6) If you are a MMF manager, what is the weighted average maturity (WAM) and weighted average life (WAL) of the MMF you manage? What should be the appropriate limits on WAM and WAL?

Af2i consider that CESR/ESMA guidelines provide a robust framework to limit the main risks to which MMFs could have been exposed, i.e., interest rate risk, credit/credit spread risk and liquidity risk.

Specifically, The WAM to no more than 60 days for short-term MMFs and 120 days for MMFs, limits the overall sensitivity of the funds' NAV to changing interest rates seem sufficient. As well for the reduction of the WAL to less than 6 months for short-term MMFs and less than 1 year for MMFs, limits credit and credit spread risk.

Box 9 - Investment criteria and rating

(1) Do you think that the definition of money market instruments (Article 2(1)(o) of the UCITS Directive and its clarification in Commission Directive 2007/16/EC16) should be reviewed?

French institutional investors think that the current regulatory framework for UCITs is sufficient to prevent liquidity bottlenecks

(2) Should it be still possible for MMFs to be rated?

Of course MMFs may be rated as it is a convenient first tool for the investors' assessment of the risks if a MMF is banned, the consequences for investors might be quite different according to the banning process and its motivations. Anyway, the reference to rating has to be excluded from the regulation texts. In other words, Af2i consider that asset management must make efforts to reduce over-reliance on rating agencies, create their own way of papers selection?

(3) What would be the consequences of prohibiting investment criteria related to credit ratings?

The credit rating is a useful assessment tool of the risks, and it has not any exclusion mission. As we said before, Af2i support the recent European Commission's proposals to reduce the risks of over-reliance on credit ratings and to introduce a requirement for the managers not to rely solely or mechanistically on external credit ratings for assessing the creditworthiness of a fund's assets.

Of course, external credit ratings may be used as one factor among others in this process but should not prevail.

We ask that the use of credit rating agencies to determine whether or not a MMF may invest in a money market instrument should also be reconsidered

(4) MMFs are deemed to invest in high quality assets. What would be the criteria needed for a proper internal assessment?

MMFs do invest in high quality assets. The needed criteria for proper internal assessment are obviously the compliance with the ESMA rules, even new rules, and the disclosed investment policy of the MMFs about sectors, maturity, interest rate, agreed level of risk.

Box 10 – Long Term Investments

Af2i support the idea long-term investments should be in mind of saving development and facilitated by the Funds asset management regulation.

Of course, regulators tend to consider that the immediate liquidity is a sine qua non condition for sale to the retail. We need to redevelop and meet the needs of both investors and issuers.

First of all, the important thing to have in mind is to not mix up financial product and fiscal and saving investment structure. UCITS can be included in special saving long term structure. In that case, introducing a small part of long term investments with a reduced liquidity is possible, It is clear that retail investors are targeting more and more short term and safe investments: daily valuation and a low equity percentage. But when they have a little saving experience combining with regular instalment, these inconvenient can disappear. All sorts of stable assets can be included in saving long term funds: real estate, private equity, infrastructure debt or equity, etc.

(1) What options do retail investors currently have when wishing to invest in long-term assets? Do retail investors have an appetite for long-term investments? Do fund managers have an appetite for developing funds that enable retail investors to make long-term investments?

We have to recognize that French retail investors generally do not wish to realize long term investments except in real estate. For a previous period the life insurance regime was making long term commitments (an average duration of 23 years from the subscription) compulsory, but this constraint do not exist anymore and life insurance is a very liquid asset. Furthermore the pension funds are very rare in France and retail investors are now used to take the easy way and not to invest in a long term vision.

Funds managers, as a consequence, do not try to develop long term “tunnel” funds for retail investors.

Having said that, some saving experiences in the past (and certain still existing) demonstrate that a combination of regular instalment, long term and well diversified risky assets plus a tactical asset allocation can give good results, in particular from wealthier/more sophisticated retail investors, but also in corporate saving plans. In the old days, the Monory SICAV (fully invest in stocks) then the Stocks saving plans (PEA) had a great success and could have include a small part of non listed assets, without difficulty.

Of course, investing in this type of asset require that the UCTS objective to be in line, and to be quite reasonable in term of percentage of assets (globally 5 to10%).

(2) Do you see a need to create a common framework dedicated to long-term investments for retail investors? Would targeted modifications of UCITS rules or a stand-alone initiative be more appropriate?

As we can imagine the future, we do think that the long term investment will remain the core business of institutional investors and the long term investment will develop in this framework as soon as a minimum of commitment duration is accepted again by the retail investors.

Targeted modifications of UCITs provisions are not relevant in this issue.

There is already too much saving plans and too much regulation complexity to create another one. So we should prefer to consider that as a part of UCITS regulation and wait gaining experience to do something else.

(3) Do you agree with the above list of possible eligible assets? What other type of asset should be included? Please provide definitions and characteristics for each type of asset.

A great deal of these long term assets, or tangible assets, where you should add the housing issue, are more relevant in AIF funds which have far less constraints of liquidity and daily valuation.

(4) Should a secondary market for the assets be ensured? Should minimum liquidity constraints be introduced?

For UCITs funds, a secondary market is likely to be ensured, even if, for institutional investor, there may be dedicated funds. Furthermore liquidity constraints depend on the kind of distribution of the funds, retail or institutional investors.

(5) What proportion of a fund's portfolio do you think should be dedicated to such assets? What would be the possible impacts?

The right proportion for such assets in the fund's portfolio is the disclosed proportion in the subscription documents, in accordance with the rules and strategy of the fund. It must be also in line with a long term objective and so, the asset manager should have plain freedom in tactical asset allocation.

(6) What kind of diversification rules might be needed to avoid excessive concentration risks and ensure adequate liquidity? Please give indicative figures with possible impacts.

See our answer to question 5

(7) Should the use of leverage or financial derivative instruments be banned? If not, what specific constraints on their use might be considered?

Leverage and financial derivatives have to be banned from the list of the UCITs fund's eligible assets. Some financial derivatives might be allowed if they cover a risk which is not supposed to be run by the investors in the fund

(8) Should a minimum lock-up period or other restrictions on exits be allowed? How might such measures be practically implemented?

Non-dedicated UCITs funds should invest in daily valuated assets in a mark to market process so that there is no first mover advantage and to threshold effect in the valuation of the shares. Besides, temporary lock-up periods or swing prices might be decided by the fund managers in cases of emergency under the control of the local regulators.

(9) To ensure high standards of investor protection, should parts of the UCITS framework be used, e.g. management company rules or depositary requirements? What other parts of the UCITS framework are deemed necessary?

UCITS framework is a good protection. So UCITs funds investing in long term assets have to be managed with all the UCITs provisions.

(10) Regarding social investments only, would you support the possibility for UCITS funds to invest in units of EuSEF? If so, under what conditions and limits?

EuSEF units are supposed to be eligible assets.

Box 11 – UCITS IV improvements

(1) Do you think that the identified areas (points 1 to 4) require further consideration and that options should be developed for amending the respective provisions? Please provide an answer on each separate topic with the possible costs / benefits of changes for each, considering the impact for all stakeholders involved.

The four identified areas addressing the UCITs IV directive seem to be necessary improvements of this text at levels 2 or 3 provisions.

(2) **Regarding point 5, do you consider that further alignment is needed in order to improve consistency of rules in the European asset management sector? If yes, which areas in the UCITS framework should be further harmonised so as to improve consistency between the AIFM Directive and the UCITS Directive? Please give details and the possible attached benefits and costs**.

UCITs framework and AIFM Directive have to cover the whole playing field of the asset management activities, with no kind of actor and no kind of asset escaping out of this system. There is no room for a third category of funds.

CITs and AIF funds are to be identified, as it is currently established in the European market for the time being, in accordance with the nature of assets and the kind of distribution.

For instance, UCITs funds should not invest in more than 10% of long term assets and AIF should be mainly dedicated to professional or institutional investors.

Different kinds of assets and different kinds of investors mean different rules in the processes of distribution, investment, asset management, accounting procedures, reporting,

But the investors' protection principles have to be equivalent and their implementation has to be harmonized as far as possible on issues such as the depositary's role and responsibility.

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