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Mr. Tilman Lueder
Head of Unit G4
Asset Management
European Commission

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Re: European Commission Consultation Document
Undertakings for Collective Investment in Transferable Securities (UCITS)
Product Rules, Liquidity Management, Depositary, Money Market Funds, Long-term Investments

Dear Mr. Lueder,

CFA Institute appreciates the opportunity to comment on the European Commission's Consultation Document "Undertakings for Collective Investment in Transferable Securities (UCITS) - Product Rules, Liquidity Management, Depositary, Money Market Funds, Long-term Investments."

We are a global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion for ethical behaviour in investment markets and a respected source of knowledge in the global financial community. The end goal is to create an environment where investors' interests come first, markets function at their best, and economies grow. CFA Institute has more than 117,000 members in 139 countries and territories, including more than 108,000 Chartered Financial Analyst® charterholders, and 137 member societies. For more information, visit www.cfainstitute.org.

CFA Institute appreciates the importance of this consultation and considers that – in view of the recent deep regulatory changes -- it is important for the European Commission to reflect on fund regulation from a broader perspective. However, the pace of regulatory change is cause for concern: UCITS IV has only recently been implemented; the AIFMD is still to come; UCITS V is still under discussion; proposals for systemic risk/shadow banking regulation are in preparation. We encourage the European Commission to carefully review the need for fundamental change in the UCITS framework and/or the creation of new regulatory regimes, and in particular the speed of any changes. We also recommend that the Commission await the results of the discussions on systemic risk/shadow banking by global regulators (FSB/IOSCO)

before proceeding with proposals at EU level. In order to inform our replies on the subject of Money Market Funds CFA Institute has polled its members in the USA and in Europe. The results of such survey are attached in Annex I.

Executive Summary

CFA Institute does not support a broad review of eligible assets, and considers that ESMA's *Guidelines on ETFs and other UCITS Issues*[1] already provide a good tightening of existing UCITS rules, as long as they are correctly implemented and enforced.

Securities lending, repos and reverse repos should remain eligible as EPM techniques, based on the framework provided under ESMA's *Guidelines on ETFs and other UCITS Issues*. We see these as effectively dealing with the risks arising from these techniques, and from collateral.

The Commission should clarify the treatment of OTC derivatives cleared through central counterparties for the purposes of counterparty risk. CFA Institute supports consistency of treatment of collateral for OTC derivatives and EPM transactions, as proposed by ESMA.

As the reasons that might require restrictions on redemptions vary in nature, it would be difficult to develop detailed rules to deal with all possible liquidity issues. Sufficient flexibility must be retained by UCITS management companies, while maintaining investor protection and balancing the interests of all investors.

We see the UCITS Directive as the appropriate legal framework for money market funds ("MMFs") and *CESR's Guidelines on a common definition of European money market funds* as providing the appropriate regulation regime. Constant net asset value ("CNAV") money market create a threat to the stability of the financial system due to the size of the industry, the liquidity issues posed by on-demand withdrawal of investors and mismatched maturities of assets and liabilities, and the use of MMFs as a funding mechanism for commercial banks and others. To remedy these concerns we support better transparency of the risks of CNAV MMFs, sponsor-provided capital reserves and enhanced liquidity management structures.

The European Commission should consider either adapting the AIFMD framework to allow for long-term retail funds with a pan-EU passport, or creating a separate framework for such investment vehicles. In either case, investors should be adequately protected and informed, to avoid mis-selling.

Regarding the need for amendments to the UCITS Directive following UCITS IV, we agree with the Commission. However, further alignment with AIFMD does not seem necessary.

[1] ESMA/2012/474 - http://www.esma.europa.eu/content/Report-and-consultation-paper-guidelines-ETFs-and-other-UCITS-issues

1. Eligible Assets and use of derivatives

Box 1

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

No, CFA Institute does not consider that the Commission should review the scope of assets and exposures deemed eligible for UCITS, as UCITS should continue to be able to offer a broad scope of exposures to retail investors, while maintaining flexibility and a high level of investor protection.

What needed to be tightened are the rules relating to financial indices that have made it possible in the past to create under the UCITS Directive products for institutional investors that "stretched" the limits of eligible assets and now would better fit under the AIFM Directive. Some of the so-called "Newcits" mirroring offshore hedge funds are examples of these stretched limits. ESMA's *Guidelines on ETFs and other UCITS Issues* have provided such tightening, but their implementation and in particular their enforcement must be ensured.

Until now, UCITS were the only fund product with an EU passport, and for that reason the boundary between UCITS and hedge funds had begun to blur. With the AIFM Directive, some riskier products clearly targeting institutional investors are likely to migrate to the AIFM framework. What remains unaddressed is an EU passport for non-UCITS retail products. There are many such funds currently regulated at national level, and some of them enable retail exposure to assets ineligible for UCITS (real estate, for example). The creation of retail AIFs with an EU passport would not only provide broader investment possibilities in many Member States, but also harmonize and enhance investor protection in the EU, while maintaining a clear distinction vs. UCITS funds.

Attempts to restrict retail access to some categories of assets are not likely to work, as retail investors can buy non-fund products such as structured notes/certificates to gain exposure to all kinds of assets, in spite of the potentially higher counterparty risk and far lower investor protection. It would be in the interests of investors if investments were possible within a well-regulated fund framework. When considering such a framework, however, liquidity requirements should be adapted to the underlying assets, as daily liquidity as required by UCITS may be impossible to provide (see also our reply to Questions in Box 10).

(2) Do you consider that all investment strategies current observed in the marketplace are in line with what investors expect of a product regulated by UCITS?

Retail investors do not have an understanding of the characteristics of the UCITS framework, and of the differences vis-à-vis other funds, or non-fund products. However, UCITS products are also widely distributed to institutional investors, who know well and appreciate the

characteristics of UCITS. We are not aware of dissatisfaction by institutional investors with UCITS offerings.

(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.

No, CFA Institute considers that current rules are adequate. The UCITS Directive already imposes strict requirements on the liquidity of eligible assets. Art. 40 (4) of the Level 2 Directive 2010/43/EU also requires that the UCITS management companies must “employ an appropriate liquidity risk management process" to ensure that each UCITS they manage is able to comply with redemption requests at any time.

(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.

UCITS may gain indirect exposure to non-eligible assets through closed-ended funds, structured products, or derivatives based on financial indices. Direct exposure to non-eligible assets is limited to 10% of fund assets by Article 50 (2) of the UCITS Directive.

(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 stakeholders involved:

- Preventing exposure to certain non-eligible assets (e.g. by adopting a "look through" approach for transferable securities, investments in financial indices, or closed ended funds).

- Defining specific exposure limits and risk spreading rules (e.g. diversification) at the level of the underlying assets.

No, CFA Institute does not see the need to further define rules on exposure to non-eligible assets in the UCITS Directive.

(6) Do you see merit 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?

CFA Institute has no comment

(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 method) as a measure of global exposure? If you are an asset manager, please provide also information specific to your business.

CFA Institute has no comment.

(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 MiFIR? What would be the consequences for different stakeholders of introducing such an obligation?

CFA Institute has a long-standing position supporting standardisation, central clearing and exchange-trading of derivative contracts. Nonetheless, we consider that it should be possible for UCITS to enter into bespoke contracts which due to their characteristics may not be eligible for trading on multilateral platforms, as long as such contracts are subject to appropriate regulation, collateralisation and transparency.

2. Efficient Portfolio Management (EPM)

Box 2

(1) Please describe the type of transaction 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.

Transactions currently considered as Efficient Portfolio Management ("EPM") techniques are securities lending, repurchase agreements (repos) and reverse repurchase agreements. They should continue to be considered as eligible EPM techniques, subject to appropriate regulation.

(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.

ESMA recently addressed many issues related to securities lending, repos and reverse repos in its *Guidelines on ETFs and other UCITS issues*. Such Guidelines already provide a good framework to deal with the risks arising from EPM techniques, particularly as it harmonises the treatment of collateral from different sources, and provides for rules on securities lending and repos, which were previously not specifically regulated at EU level.

However, we consider that ESMA should have differentiated further among EPMs in some cases, in view of their different legal and economic basis. In particular, we have concerns regarding the restrictions placed by ESMA on the use of cash from repos: as there is a full transfer of ownership of the securities (delivered) and of the cash (received), the cash should continue to be considered as part of fund assets and not collateral, and it should be possible to utilize the cash thus obtained for a variety of purposes, including posting of collateral on derivative contracts. This will become very important once regulation mandating central clearing is implemented in the European Union and globally.

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

CFA Institute has no comment.

(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 also information specific to your business.

CFA Institute has no comment.

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

- are EPM transactions as a rule fully collateralized? Are EPM and collateral positions marked-to-market on a daily basis? How often are margin calls made and what are the usual minimum thresholds?

CFA Institute has no comment.

- does the collateral include assets that would be considered as non-eligible under the UCITS Directive? Does the collateral include assets that are not included in a UCITS fund's investment policy? If so, to what extent?

Aside from current practice or national regulation regarding UCITS, it should be remembered that EU regulation regarding central clearing (the "EMIR" Regulation[2]) currently mandates that collateral posted by any financial counterparty to a Central Counterparty ("CCP") must be "highly liquid". The draft implementing Technical Standards by ESMA do not define all assets

[2] Regulation (EU) No 648/2012

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to be considered as "highly liquid", and the final decision will be made by individual CCPs. We anticipate that – aside from cash -- collateral considered as "highly liquid" by a CCP will not be an investable asset for many UCITS, due to their investment policies. For example, an equity fund will not be able to invest in government bonds, which are the most likely alternative to cash.

It is not necessary to require correlation of collateral assets with the UCITS investment policy, as the purpose of collateral is not to provide market exposure, but simply to protect investors in case of the counterparty's default. What matters regarding collateral is its quality and liquidity, to ensure a quick sale with minimum value loss.

- to what extent do UCITS engage in collateral swap (collateral upgrade/downgrade) trades on a fix-term basis?

CFA Institute has no comment.

(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?

Yes, and CFA Institute considers that ESMA's Guidelines already provide a very good basis for regulation such issues (see our reply to Q2 above).

(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 in EPM? If you are an asset manager, please provide also information specific to your business.

CFA Institute has no comment on market practices. Regarding the proposal to prescribe mandatory haircuts on collateral received by a UCITS, we are concerned that such prescriptiveness would not give sufficient flexibility to adapt haircuts to market developments.

(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?

We consider that a distinction needs to be made between securities lending transactions and repos/reverse repos. It should be possible to terminate securities lending transactions at any time, whereas in the repo market most transactions have a fixed maturity.

(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?

Yes, we think that EPM transactions should be treated according to their economic substance for the purpose of risk assessment.

(10) What is the current market practice regarding collateral provided by UCITS through EPM transactions? More specifically, is the EPM counterparty allowed to re-use the assets provided by a UCITS as collateral? If so, to what extent?

CFA Institute has no comment.

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

No, we see no need for such rules. Rules on collateralization will be included already in derivatives regulation, both for centrally cleared and bilateral contracts. More detailed choices regarding eligible collateral will be made either by central counterparties or by the parties to a bilateral contract.**(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?**

CFA Institute supports the disclosure requirements included by ESMA in its *Guidelines on ETFs and other UCITS issues*, covering the use of EPM techniques and related risks, costs and fees and collateral policy, as well as standards for haircuts and reinvestment of cash collateral. Details on transactions and revenues, as well as costs and fees must be included in the annual report.

We welcome in particular the Guidelines' requirements for enhanced disclosure to investors regarding income and costs from EPM transactions. However, it should be considered whether the Guidelines go far enough: they require that "*all the revenues arising from efficient portfolio management techniques, net of direct and indirect operational costs, should be returned to the UCITS*", We believe it would serve investors' interests better for the fund to recognize all revenue and expenses related to EPM transactions. It is regrettable that any prospective investor will not get details of the costs, as the annual report is normally provided only to existing investors and the KIID does not contain any information on securities lending costs.

3. OTC Derivatives

Box 3

(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?

Yes, we consider that a modification of the rules on measurement of counterparty risk exposure and concentration limits for cleared OTC derivatives is necessary with the upcoming implementation of EU rules requiring the central clearing of OTC derivatives ("EMIR"

Regulation). If the UCITS rules are not modified, they will conflict with EU obligations to centrally clear through CCPs.

Current provisions only apply to exchange-traded derivatives, and are included in Recommendation 2004/383/EC of 27 April 2004 by the European Commission:

"*5.1. Criteria for the limitation of counterparty risk exposure to OTC derivatives - Member States are recommended to ensure that all the derivatives transactions which are deemed to be free of counterparty risk are performed on an exchange where the clearing house meets the following conditions: it is backed by an appropriate performance guarantee, and is characterised by a daily mark-to-market valuation of the derivative positions and an at least daily margining*."

In view of the counterparty risk mitigation by the clearinghouse, new provisions should ensure that, when calculating counterparty limits according to Art. 52 (1) of the UCITS Directive, the exposure to a clearinghouse for bilateral OTC derivatives should also be considered equal to zero, or have a very low weighting in line with risk weights for the capitalization of bank exposures.

(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?

Yes, they should be consistent (but see our comments in the above section).

(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?

Although the counterparty risk is limited to a maximum of 10%, diversification would be desirable. , At the same time, however, operational complexity and related risks increase with the number of counterparties, and this fact should be taken into account. Depending on the type of derivative contract and its bespoke nature, it might also be difficult to find multiple counterparties.

In case the UCITS has a single counterparty, CFA Institute considers it very important to disclose the fact very clearly to investors, together with the other information regarding derivatives use and collateral required by the ESMA Guidelines.

(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.

CFA Institute has no comment.

(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?

CFA Institute has no comment.

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

CFA Institute has no comment.

4. Extraordinary Liquidity Management Tools

Box 4

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

CFA Institute has no comment.

(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?

(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.

(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.

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

(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.

Extraordinary liquidity management tools were a key issue during the financial crisis, and as a result some EU member States have developed frameworks to deal with UCITS liquidity crises and temporary suspensions of redemptions. However, such measures are not harmonized and vary considerably.

The reasons to impose redemption restrictions vary in nature (large size of redemptions, illiquidity of holdings, impossibility to sell assets due to market closure, desire to maintain portfolio structure to protect remaining investors in case of large redemptions), and the time length of restrictions should vary accordingly.

While some harmonized principles on extraordinary liquidity management might be helpful (and IOSCO recently consulted on such principles), it would be difficult to develop very detailed rules to deal with all possible liquidity issues. Any measures should ensure investor protection and balance the interests of both redeeming and remaining investors, but given the variety of possible causes of liquidity constraints, UCITS management companies must retain sufficient flexibility to manage the emergency, depending on the severity of the problem.

(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?

No, the ETF provider should not be directly involved in providing liquidity to secondary market investors on a regulated market. Under exceptional circumstances (when liquidity is disrupted on secondary markets), ETF investors should have the right to redeem directly from the ETF provider, as required by ESMA in its recent *Guidelines for ETFs and other UCITS issues*.

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

No, we do not see a need for further rules applying in normal circumstances.

5. <u>Depositary Passport</u>

<u>Box 5</u>

(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)?

(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.

(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…)?

(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?

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

CFA Institute has no comments on this section of the Consultation Report.

6. Money Market Funds

Box 6

(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.

Investors, including investment managers, use MMFs for a variety purposes. Firstly, they use these instruments to invest small amounts of money over short periods while deciding how to invest the funds for longer periods. They also use MMFs as an investment vehicle for investors with short-term investment horizons who do not wish to risk significant principal loss. Investors in this group include, on the one hand, retail investors and, on the other, companies that use MMFs to invest cash reserves before those funds are used for the payment of expected payables, such as payroll.

The alternatives to MMFs are bank deposits, which also constitute an important part of MMF portfolios. There is significant cross-elasticity between MMFs and alternatives such as bank deposits. In fact, the growth of MMFs in the 1970s and 1980s was largely due to investors' ability to earn higher yields with MMFs than bank deposits. However, according to European

Central Bank ("ECB") statistics, bank deposits in the Euro area have become more popular with investors since 2008, perhaps due to increased deposit guarantees offered by Member States to protect bank retail clients against loss of principal.

As deposit guarantee schemes do not protect institutional investors, MMFs provide an important alternative to banks for diversification of counterparty risk.

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

MMFs target investors across the spectrum, including individuals, companies and other entities with funds available for investment over short periods of time.

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

In general, investors expect MMFs to invest in instruments with maturities of one-year or less, such as the following:

- bank certificates of deposit;
- commercial paper from high-quality corporate issues, but including high-quality asset-backed commercial paper;
- short-term sovereign debt; and
- repurchase agreements, typically collateralized by high-quality sovereign instruments and arranged with highly rated counterparties.

(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?

With regard to securities lending, we believe that investors would not expect MMFs to engage much in such activities, as this would imply that other market participants are engaged in the short selling of the type of securities in which MMFs invest. The cost for brokers to locate securities that are rare, have limited price transparency, illiquid trading markets, and short durations would likely be difficult and costly in the money markets.

(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.

The problems at some MMFs during September and October 2008 were due largely to withdrawal demands of investors concerned about the quality of investments held by certain MMFs involved. These concerns sent ripple effects into other parts of the financial markets, including other MMFs. Ultimately, investor concerns about MMFs affected the funding options

— asset-backed commercial paper, and repurchase agreements, for instance — available to commercial banks.

While the maturity mismatch for MMFs is not as large as it typically is for commercial banks, the ability of MMF investors to withdraw their funds on demand — or at least on short-term notice — creates the potential for liquidity problems. Considering this potential liquidity risk together with the size of the MMF sector in the EU — about €1 trillion, according to ECB statistics – and their importance to banks as a funding source means that prudential regulators should view MMFs as a risk to financial market stability.

While we received no clear direction on this issue from our members in the attached poll results, we nevertheless have concerns about the potential threat to financial market stability posed by MMFs due to the factors described above.

6) Do you see a need for more detailed and harmonized regulation on MMFs at the EU level? If yes, should it be part of the UCITS Directive, of the AIFM Directive, of both Directives, or 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 definition15?

CFA Institute considers that MMFs should remain under the UCITS Directive, and that *CESR's Guidelines on a common definition of European money market funds*[3] already provide a sufficiently strict regime for the regulation of MMFs.

In order to avoid possible arbitrage, the same rules should apply both to UCITS and non-UCITS funds, in other words to any funds using the label "Money Market Fund".

(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?

CFA Institute agrees with the categories used by CESR in its MMF definitions, but we would not support the creation of more categories of MMFs, or of MMFs that permit assets with longer maturities.

6.1. Valuation and capital

Box 7

(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.

[3] CESR/10-049 (http://www.esma.europa.eu/system/files/10_049.pdf)

Institutional investors often have restrictions placed on the types of investments they may make and hold, including how they invest their cash reserves. Consequently, some are unable to invest in VNAV instruments.

The investment criteria for retail investors often have to do with the kind of instruments to which these investors are accustomed. The availability of CNAV or VNAV MMFs varies depending on the jurisdiction, and in the European Union, CNAV funds are marketed to institutional investors, while VNAV funds are distributed both to institutional and to retail clients.

A stable NAV clearly has the potential to mislead retail investors (even more so if coupled with bank-like features such as check-writing), but all MMFs could be mis-sold to retail clients if the risks and differences between MMFs and bank deposits are not appropriately disclosed.

Consequently, we strongly support better and more prominent disclosure of risks and investment criteria included in MMF KIIDs, marketing materials and prospectuses.

(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?

We would support improved regulation for CNAVs, including maintenance of capital reserves by sponsors who provide capital guarantees, and enhanced liquidity management structures. We also support better and more prominent disclosure of risks and investment criteria to overcome misleading marketing of MMF instruments as “riskless” short-term instruments.

Given their role in providing short-term financing for companies, banks and government entities, a primary concern is that phasing out certain MMF activities may negatively affect the ability of high-quality issuers to obtain competitive financing costs.

(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?

We would support capital buffers for CNAVs, financed by fund sponsors. Some MMF sponsors have suggested that buffers greater than 70 basis points would make it difficult for fund sponsors to cover their costs of capital, and thus making it difficult for sponsors to offer such products to investors.

(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 only support valuation methodologies related to mark-to-market. At the same time we recognize that not all of the investment instruments used by MMFs have active trading markets that facilitate mark-to-market valuations.

Sufficient guidance exists with respect to fair-value techniques for valuation of MMF portfolio holdings and which are feasible on a daily basis that use a hierarchy of calculation methods. IFRS 13 provides such guidance.

6.2. Liquidity and redemptions

Box 8

(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?

We consider that the current UCITS framework already provides sufficient tools to deal with 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?

We would not support a fee for investors who redeem first, as such fees are unlikely to prevent damaging runs on MMFs but could harm investor returns. There is the potential that such fees might compensate remaining shareowners for the dilution resulting from the redemptions of other investors, though that will largely depend on the assets held by the fund and the size of the fee.

We would prefer other options, as discussed in Question 3 in Section 7.1 above, and Question 3 in Section 7.2 immediately below.

(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?

Firstly, and most importantly, we believe any such restrictions should apply only in situations of market stress and heavy redemptions. To permit restrictions in any other market conditions could create incentives for fund managers to invest in riskier instruments, knowing that they can rely upon redemption restrictions to prevent investor runs on their funds should their investment strategies fail.

With regard to the type of redemption restrictions we would find most favorable, we would support redemption restrictions that include the holding back of a small minimum balance, according to a survey of our members. The logic behind such restrictions is that they would

enable fund managers to liquidate assets in an orderly fashion without unnecessarily impairing the NAVs of remaining investors. We do not believe that such minimum balances should exceed 10% of an investor's assets invested in the fund, and the restriction period should not exceed one month.

A less favorable, though still acceptable, restriction would involve extending the advance notice period for redemption. In this case, we believe such advance notice should not exceed one week.

In either case, we do not believe such restrictions should apply except in extreme market circumstances. In such circumstances, we expect that such restrictions would impair investor confidence in the funds involved and, perhaps, for the managers of such funds. This is a natural reaction on the part of investors to such situations which should encourage more prudent investing on the part of MMF sponsors and managers lest they find their fund franchise value impaired.

(4) Do you consider that adding liquidity constraints (overnight and weekly maturing securities) would be useful? How should such a mechanism work and what would be the proposed proportion of the assets that would have to comply with these constraints? What would be the consequences, including in terms of investors' confidence?

We do believe that fund managers should act prudently and maintain portfolios of instruments that enable them to meet investor redemption requirements on a regular basis. While we do not have specific suggestions on how much should be maintained in overnight or weekly instruments, we do believe that this type of mechanism would improve investor confidence.

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

As stated above, we do not support liquidity fees. On the other hand, we would support redemption restrictions in times of market stress and believe that liquidity risk management systems, as proposed in Question 4 immediately above, are relevant for all MMFs, regardless of market circumstances.

(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?

Not applicable.

6.3. Investment criteria and rating

<u>Box 9</u>

(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? What changes would you consider?

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We see no reason to modify the definitions of money market instruments in place.

(2) Should it be still possible for MMFs to be rated? What would be the consequences of a ban for all stakeholders involved?

We believe that credit rating agencies ("CRAs") should be permitted to rate MMFs, and that MMFs should be able to obtain ratings. Such information provides a valuable service to investors and helps them compare different funds on equal bases.

On the other hand, we do not believe that either statute or regulation should require the rating of MMFs. Such requirements remove the incentive for CRAs to conduct thorough research and to fully consider the possible scenarios under which their ratings might perform, and encourage reliance on ratings by investors in MMFs.

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

CRAs provide useful information on a wide range of investment instruments that would be difficult for fund managers to replicate on a cost-effective basis. The information and analyses they provide should be available to assist managers in decisions on potential investments.

CFA Institute strongly opposes forcing fund managers to rely upon ratings of CRAs. Doing so creates a captive market for the CRAs that reduces their incentive to invest in new methods and analyses to produce higher-quality ratings. Nevertheless, we believe MMFs should be *permitted* to use ratings as part of their investment criteria. We support the recent Commission proposals[4] aimed at reducing excessive reliance on CRA ratings, and encourage the Commission and ESMA to eliminate the remaining references in the CESR definition of MMFs.

(4) MMFs are deemed to invest in high quality assets. What would be the criteria needed for a proper internal assessment? Please give details as regards investment type, maturity, liquidity, type of issuers, yield etc.

CFA Institute has no comment.

7. Long-Term Investments

Box 10

(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?

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[4] Proposal for a Directive of the European Parliament and of the council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to UCITS and Directive 2011/61/EU on Alternative Investment Funds Managers in respect of the excessive reliance on credit ratings and proposal for a regulation amending Regulation (EC) No 1060/2009 on credit rating agencies.

Retail investors certainly show appetite for investing in long-term assets, as witnessed by their direct investment in real estate and by the many existing investment vehicles (currently regulated at national level, and which will fall under the AIFM Directive). Investment managers are also interested in developing products to feed this appetite, but investors must be protected by an appropriate regulatory framework and by extensive disclosure, in view of the lower liquidity of long-term assets.

(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?

Most opportunities for retail investors to make long-term investments are indeed fragmented at national level, and such fragmentation will persist even after the implementation of the AIFM Directive. Modifications to the UCITS Directive to include investment in long-term assets would conflict with the UCITS' requirement to allow for frequent redemptions (usually on a daily basis), and might dilute the UCITS brand in the eyes of non-EU regulators.

As a result, the creation of a standalone regime, or the harmonization of the AIFMD regime for retail products (with an EU passport for such products) would be better than an attempt to "tweak" the UCITS Directive.

(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.

We agree with the inclusion of infrastructure, direct investment in unlisted companies, real estate and other physical assets, third party funds investing in unlisted companies, and European Social Entrepreneurship Funds ("EuSEFs") as eligible assets. We also believe that commodities should also be included in this list. It should also be possible to invest in asset classes currently eligible for UCITS investment, alongside long-term assets, so long as they are consistent with the investment strategies promoted in the KIID and prospectus.

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

The right to direct redemptions at Net Asset Value should clearly be limited in frequency, but CFA Institute has no specific preference regarding a requirement for secondary market trading. Whether a secondary market exists or not, disclosure to investors must be extensive and clearly point to the liquidity risks, as well as to the risks arising from a possible gap between secondary market pricing and Net Asset Value).

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

CFA Institute has no specific comment.

(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.

CFA Institute has no comment.

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

It does not seem necessary to ban the use of leverage or derivatives, as they are allowed under the UCITS Directive. Restrictions should be imposed, though, as these would be retail products. Furthermore, some types of long-term investments such as real estate or infrastructure require external financing and therefore some borrowing for the fund.

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

Yes, restrictions/lock-up periods should be allowed, and such features should be prominently disclosed to investors.

(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?

Yes, any new regimes should provide the high standards of investor protection of the UCITS Directive (which are also partially included in the AIFM Directive).

(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?

UCITS already can invest up to 10% of the fund in non-eligible assets, so they can invest in EuSEFs. CFA Institute has no opinion on whether EuSEFs should specifically be included in eligible assets, and what limitations should apply.

8. UCITS IV Improvement

Box 11

(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.

Yes, we agree.

(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.

Alignment is clearly needed between UCITS Directive and AIFMD, although the AIFMD should take into account the specificities of alternative investments and does not impose specific investment restrictions. We consider that the AIFMD is already sufficiently aligned with the UCITS Directive (after UCITS V).

We hope our comments will be of assistance to the Commission. Please do not hesitate to contact us should you wish to discuss any of the points raised:

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Kind regards,

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CFA Institute

Annex I

MONEY MARKET FUNDS SURVEY REPORT

October 2012

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About the Survey

Background and Purpose

Following the financial crisis and the first wave of regulation, global regulators are focusing on other areas of financial services that may create systemic risk including “Shadow Banking,” which was introduced by the Financial Stability Board in 2011. The International Organization of Securities Commissions (IOSCO) and the European Commission have consulted on Shadow Banking and Money Market Funds (MMFs), and the European Commission is currently consulting on the regulation of UCITS funds, which include MMFs and ETFs.

Many of the proposed reforms take different shapes, but share a common approach: they would impose variable net asset values (VNAVs), capital requirements and/or forms of capital guarantees. MMFs are either “CNAV” funds, i.e. funds with constant Net Asset Value (for example at $1.00), or are “VNAV” funds whose NAV is variable and fluctuates on a daily basis. In some jurisdictions (the US, for example), the market is dominated by CNAV funds, while in others VNAV funds are much more prevalent. In the European Union, CNAV funds represent approximately half of the MMF market and target institutional investors.

Some regulators consider that CNAV funds are inherently prone to “runs” by investors in case of market stress due to their constant value, and therefore require more profound reform. In the US, in response to the Prime Reserve money market fund “breaking of the buck” in October 2008, the Chairman of the SEC is currently proposing to require either a floating net asset value or a stable-NAV coupled with capital requirements and redemption restrictions.

To inform a response to the European Commission, CFA Institute conducted a survey of a sample of members on the issue of money market funds and proposed reforms.

Methodology

On 27 September 2012, all CFA Institute members in the European Union plus a random sample of 15,000 members in the United States were invited via email to participate in an online survey. One reminder was sent to non-respondents on 3 October and the survey closed on 9 October 2012. 637 valid responses were received, for a response rate of 2% and a margin of error of ± 3.8%. As the number of valid responses per question varies (due to survey logic, drop-offs and no opinion responses), the margin of error also varies by question. Valid responses for each question (N) are noted on each chart.

Respondent Profile

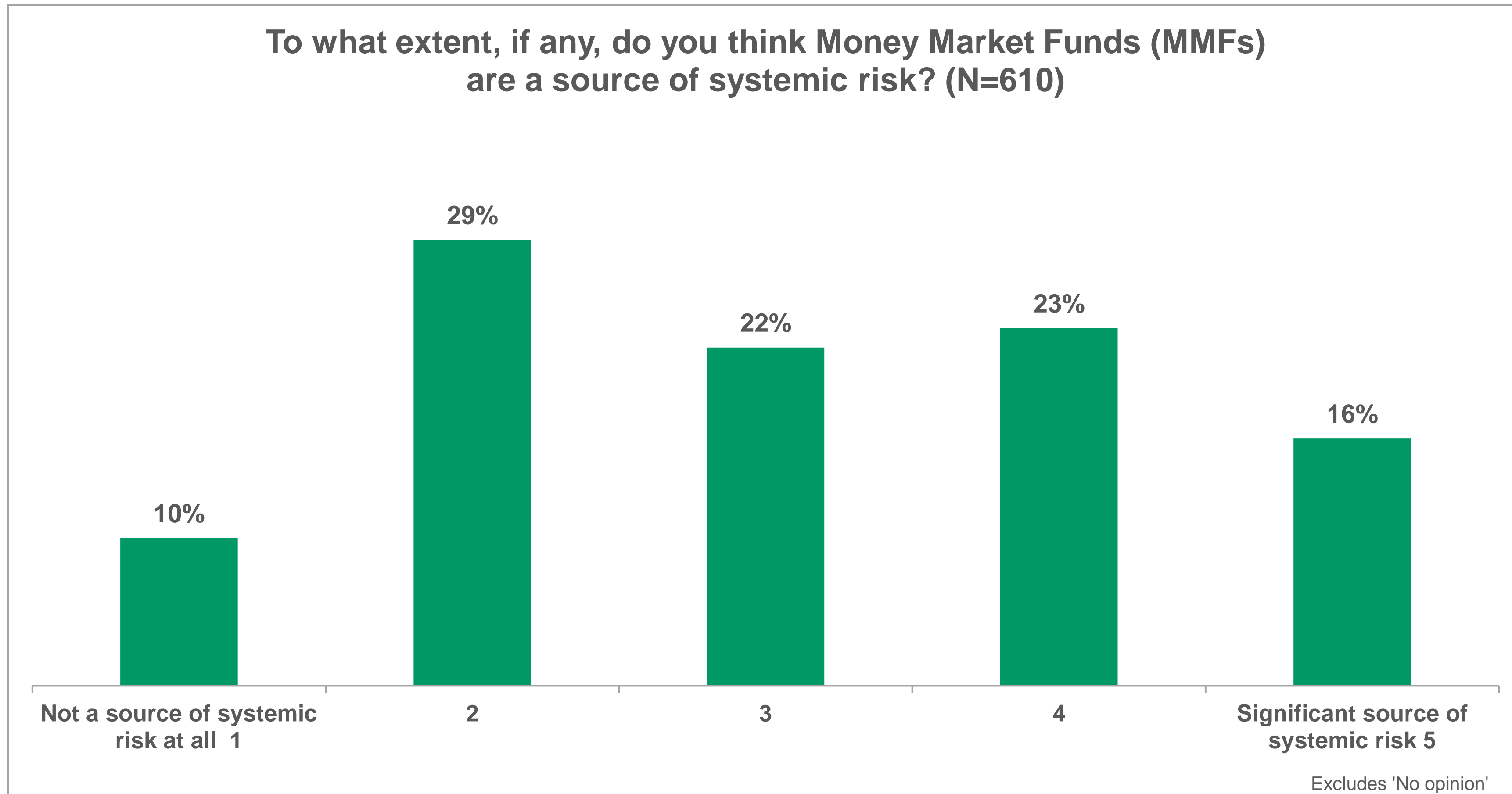
Of the 637 members that responded, 57% are from the Americas and 43% from the European Union. 92% of respondents are CFA Institute charterholders. Global (total) results have been re-weighted to accurately reflect the population (83% from the United States and 17%% from the European Union). Statistically significant regional differences are noted throughout the report. Significance testing (z-test) was conducted at the 95% confidence level to determine statistically significant differences by region.

The top job functions of respondents are portfolio manager (24%), research Analyst (12%), financial Advisor (7%), consultant (6%) and risk manager (6%). 39% of respondents listed other occupations (less than 6% each) and 4% of respondents did not provide an occupation.

Survey Results

Money Market Funds and Systemic Risk

39 percent of respondents think MMFs are a source of systemic risk and 39 percent do not think they are a source of systemic risk.



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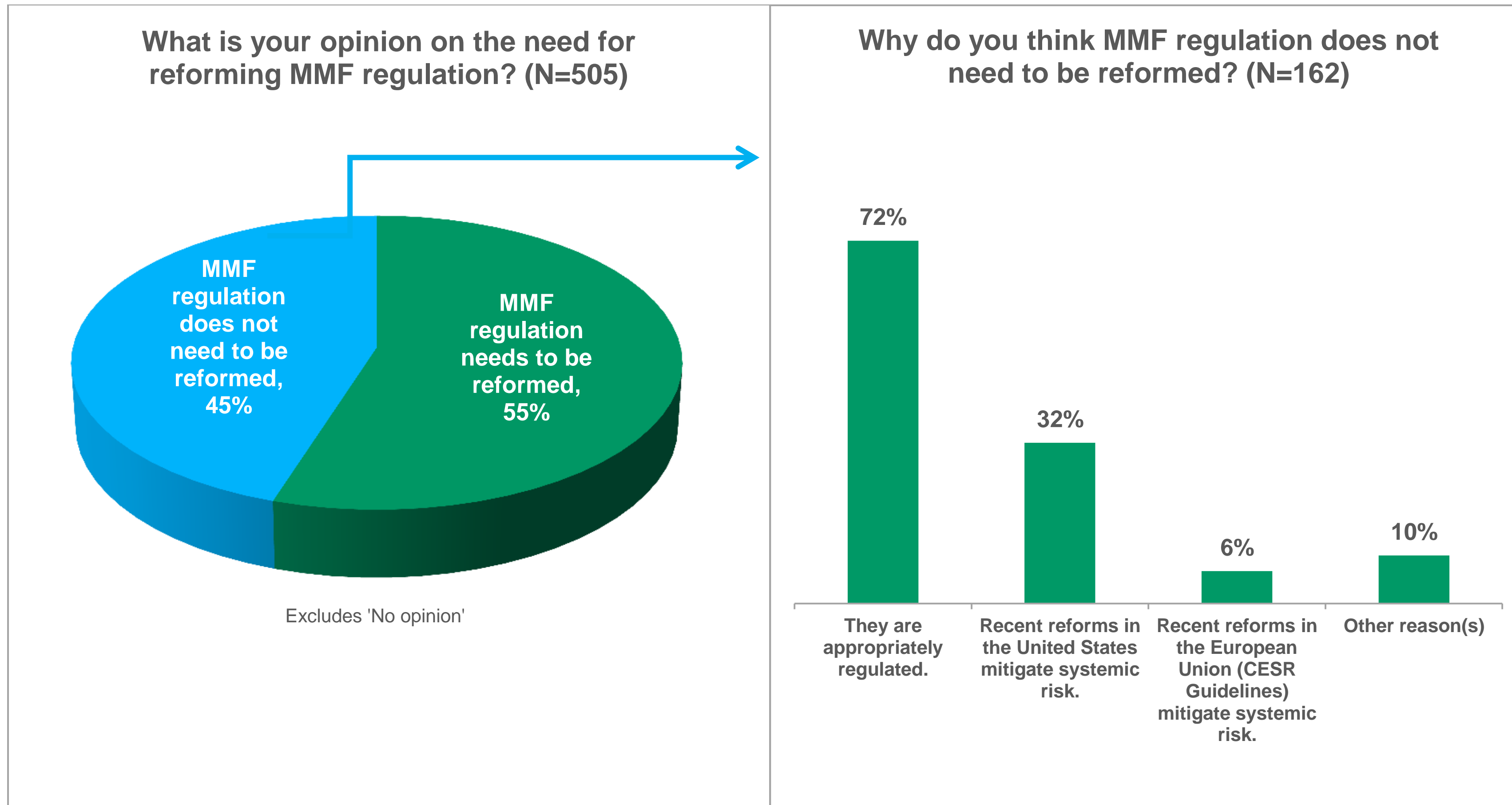
Money Market Fund Reform

Slightly more than half of respondents (55 percent) think MMF regulation needs to be reformed. Of the 45 percent who do not think MMF regulation needs to be reformed, 72 percent say it is because they are appropriately regulated and 32 percent say recent reforms in the United States mitigate systemic risk.



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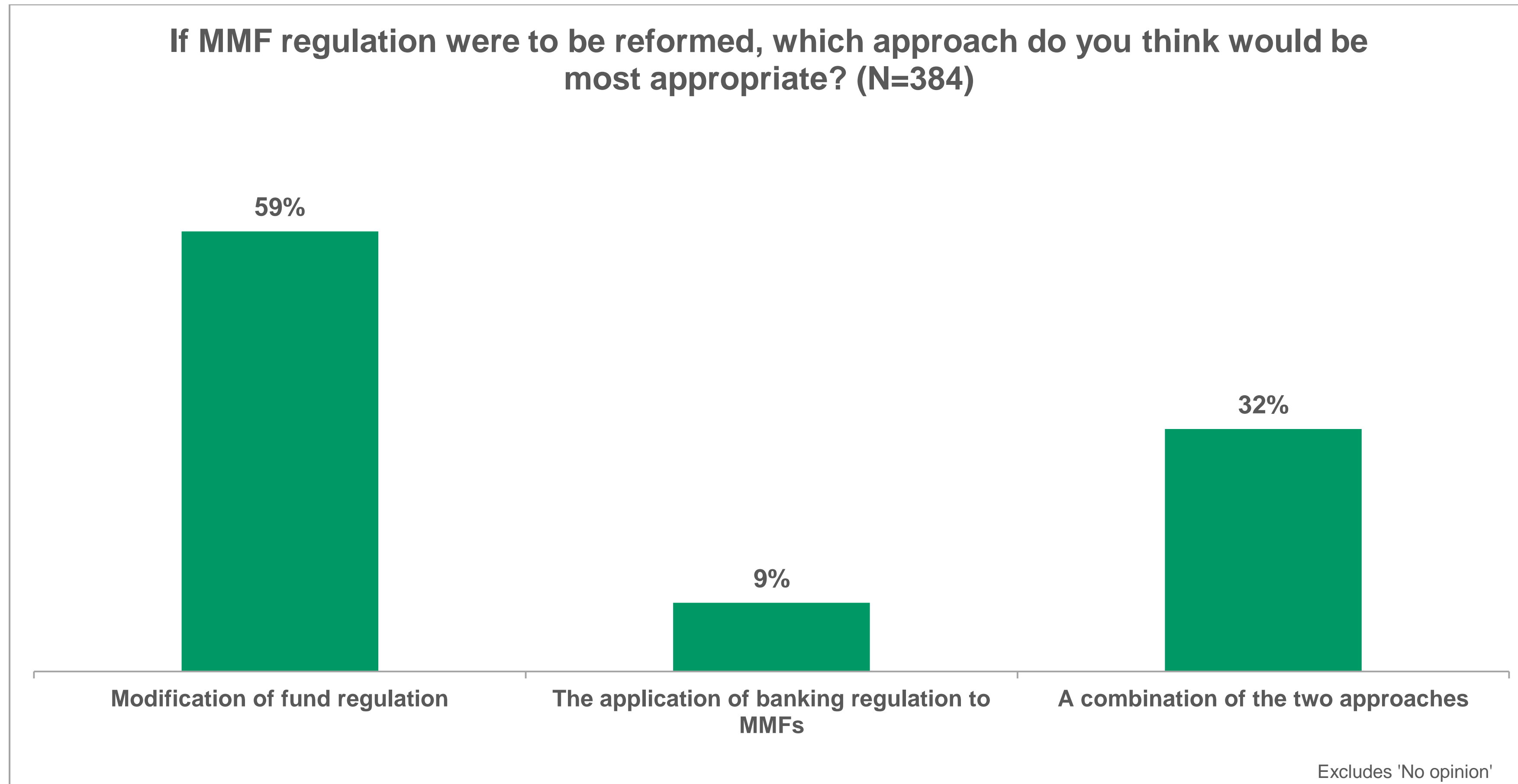
Proposed Money Market Fund Reforms

59 percent of respondents think modification of fund regulation would be the most appropriate approach to reform MMF regulation. 9 percent think the application of banking regulation would be most appropriate, and 32 percent think a combination of applying banking regulation to MMFs and modifying fund regulation would be most appropriate.



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The top three proposed reforms that respondents agree with include ‘All MMFs should have liquidity risk management mechanisms to manage “runs” on the funds’ (85 percent), ‘Disclosure to retail investors regarding investment risks and the lack of guarantees for all MMFs should be strengthened, particularly for CNAV MMFs as they may provide a false sense of security’ (78 percent), and ‘MMF sponsors that provide capital guarantees to investors should be subject to capital requirements’ (75 percent). Significant differences between respondents in the United States and European Union are highlighted in purple.

Please indicate whether you agree or disagree with each of the following proposed reforms:	Agree			Disagree			Not sure		
	Total	USA	EU	Total	USA	EU	Total	USA	EU
All MMFs should have liquidity risk management mechanisms to manage “runs” on the funds	85%	85%	86%	6%	7%	3%	8%	8%	11%
Disclosure to retail investors regarding investment risks and the lack of guarantees for all MMFs should be strengthened, particularly for CNAV MMFs as they may provide a false sense of security	78%	77%	82%	16%	17%	6%	7%	6%	12%
MMF sponsors that provide capital guarantees to investors should be subject to capital requirements	75%	75%	76%	13%	13%	11%	12%	12%	13%
CNAV MMFs should have to maintain capital reserves	61%	62%	54%	25%	25%	26%	14%	13%	20%
All MMFs (CNAV and VNAV) should have to maintain capital reserves	47%	48%	43%	37%	37%	40%	15%	15%	17%
MMF capital reserves should be financed by fund sponsors	42%	44%	32%	35%	33%	44%	23%	23%	23%
CNAV MMFs should be required to switch to a Variable NAV	41%	39%	53%	41%	45%	17%	18%	16%	31%
Investors in CNAV MMFs should benefit from protection by insurance or guarantee schemes, and the fund/investors should make contributions towards such coverage	33%	32%	36%	39%	39%	41%	28%	29%	23%
The use of amortized cost should be prohibited for all MMFs	30%	28%	42%	29%	31%	21%	40%	41%	37%
MMF capital reserves should be financed by fund investors	29%	28%	30%	47%	47%	47%	25%	25%	23%
Investors in all MMFs (CNAV and VNAV) should benefit from protection by insurance or guarantee schemes, and the fund/investors should make contributions towards such coverage	24%	24%	25%	51%	51%	51%	25%	25%	25%
Private insurance should be used instead of capital reserves, but only to wind up a fund	23%	24%	17%	45%	44%	54%	32%	33%	28%
Private insurance should be used instead of capital reserves to provide a liquidity facility in case of “runs”	15%	15%	11%	57%	56%	62%	29%	29%	27%
MMFs in the European Union already dispose of sufficient liquidity risk management mechanisms	9%	6%	25%	16%	15%	23%	75%	79%	53%
Only institutional investors should be allowed to invest in CNAV MMFs	7%	5%	19%	78%	81%	61%	15%	14%	21%

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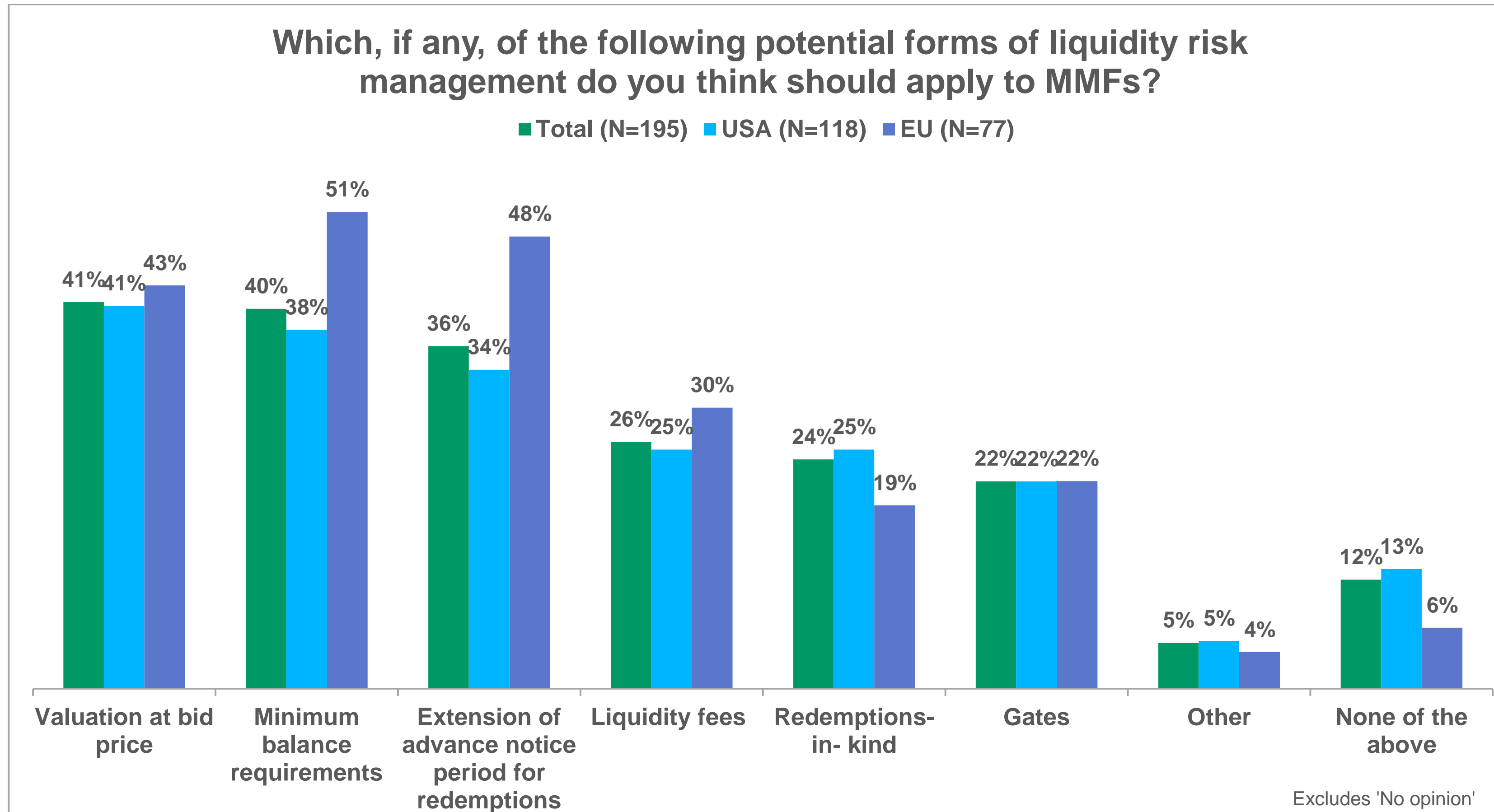
Liquidity Risk Management

78 percent of respondents think liquidity risk management mechanisms should apply only in the case of heavy redemptions or in stressed markets, with a higher proportion of those in the European Union (81 percent) than in the United States (77 percent).

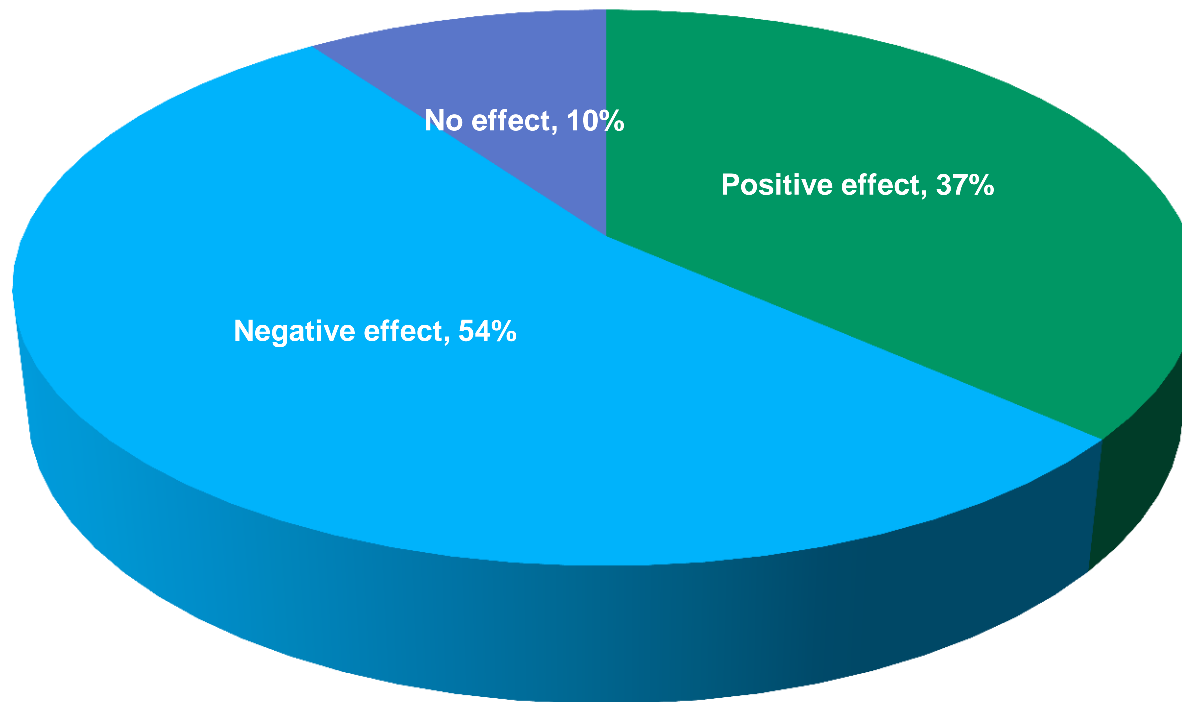
The potential forms of liquidity risk management respondents think should apply to MMFs include valuation at bid price (41 percent), minimum balance requirements (40 percent), extension of advance notice period for redemptions (36 percent), liquidity fees (26 percent), redemptions-in-kind (24 percent) and gates (22 percent). 5 percent of respondents listed other potential forms of liquidity risk management and 12 percent indicated none of the forms listed should apply to MMFs.



Other Issues Related to Money Market Funds

54 percent of respondents think the imposition of capital requirements would have a negative effect on MMFs and 37 percent think it would have a positive effect. 10 percent do not think capital requirements would have an effect on MMFs.

In your opinion, what effect, if any, would the imposition of capital requirements have on MMFs? (N=397)



Excludes 'No opinion'

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If the use of amortized cost is prohibited, 73 percent of respondents think it would be feasible to calculate a fair value on a daily basis for all assets held by MMFs. A higher proportion of those in the European Union (81 percent) than in the United States (71 percent) think this is feasible.