IRISH FUNDS INDUSTRY ASSOCIATION

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Via e-mail: fsb@bis.org
Secretariat of the Financial Stability Board
c/o Bank for International Settlements
CH-4002
Basel
Switzerland

Consultative Document: Strengthening Oversight and Regulation of Shadow Banking – An Integrated Overview of Policy Recommendations

Dear Secretariat,

The Irish Funds Industry Association (IFIA) is the industry association for the international investment fund community in Ireland, representing the custodians, administrators, managers, transfer agents and professional advisory firms involved in the international fund services industry in Ireland.

As a leading international funds centre there is in excess of 2,200 billion Euros of assets in more than 12,700 investment funds administered in Ireland as of October 2012. These assets are comprised of 1,206 billion Euros in Irish domiciled funds, of which 949 billion Euros are in UCITS funds, and more than 1,000 billion Euros in non-Irish funds administered in Ireland. Furthermore, as of October 2012, assets in Irish domiciled Money Market Funds (MMFs) stood at 307 billion Euros. Accordingly, all developments in the investment funds arena and specifically Money Market Funds are of particular importance to the Irish industry.

The IFIA welcomes both the publication of, and the opportunity to comment on the Consultative Document: Strengthening Oversight and Regulation of Shadow Banking – An Integrated Overview of Policy Recommendations (“the Consultation Paper”). As our area of focus is investment funds we will limit our comments to Workstream 2 on Money Market Funds.

MMFs are highly valued in importance by a wide variety of investors, both retail and institutional. MMFs have gained widespread acceptance because of their ease of use, compelling investment benefits and conservative risk profile. MMFs provide investors with cost-effective access to investment expertise, including credit risk analysis and enable broad diversification across individual issuers. In addition, MMFs have emerged as a simple, stable and important source of short-term funding for a broad range of issuers. This includes financial, corporate, municipal and other government entities. As such, MMF funds play an important role in support of economic activity.

Globally, MMFs are already subject to an extensive, well-defined and rigorous regulatory framework. In the wake of the financial crisis the European Commission moved promptly in 2009 to enhance the regulation of investment funds through revision of the Undertakings for Collective Investment in Transferrable Securities (UCITS), which was followed in May 2010 by the adoption by the Committee of European Securities Regulators (now the European Securities and Markets Authority) of Guidelines on European money market funds which came into effect in 2011. In the United States, following the financial crisis, the Securities and Exchange Commission ("SEC") introduced broad amendments to Rule 2a-7 of the Investment Company Act of 1940, the primary framework for the regulation of U.S. MMFs. Both of these regulatory initiatives focused on enhancing liquidity, maturity, credit, issuer diversification and disclosure requirements designed to promote stability and investor protection. In our view, these measures have significantly reduced the potential risks that MMFs present to the financial system.

The comparison, among regulators, of MMFs with banks has resulted in a significantly overstated focus on fund pricing, and the deeply flawed recommendation that MMFs should be required to adopt a variable net asset value (VNAV). In the strongest terms, we do not believe there is a substantive difference between constant net asset value (CNAV) and VNAV funds and there is much reported evidence to suggest that a VNAV fund would remain equally prone to redemptions if investors lost confidence in its assets, and such redemptions would cause short-term funding to be withdrawn from financial institutions, businesses and governments.

In particular, changing the pricing mechanism of MMFs will neither dis-incentivise investor redemptions, nor better enable them to meet such redemptions as they arise without relying on secondary money markets. It will merely undermine their utility to a large number of investors. Introduction of a mandatory floating NAV requirement would challenge the defining characteristics of MMFs and undermine their ability to respond to well-developed investor expectations relative to price stability, daily liquidity and ease of use. In addition, this may have the perverse effect of driving investors towards less-regulated and less transparent investment products, thereby increasing rather than decreasing potential systemic risk. We strongly recommend the FSB should reject this option.

The IFIA believes the most appropriate regulatory response is the development of a globally consistent approach, with common standards applicable throughout the MMF industry.

The IFIA echoes the International Money Market Fund Association's (IMMFA) view in its response to IOSCO that the main objective of MMF reform should be to ensure that funds have sufficient natural liquidity to meet redemption payments and recommendations that:

Minimum liquidity requirements should be specified for MMFs, in order to be able to make redemption payments without relying on secondary market liquidity. Those requirements need to be proportionate to the role of MMFs in providing short term funding to the banks, companies and governments. The Securities and Exchange Commission (SEC) has struck a sensible balance by requiring US MMFs to hold at least 10% of their assets in overnight cash, and 30% in assets that mature within one week. The IMMFA code of practice requires no less than five percent of net assets in securities which mature the following business day and no less than twenty percent of net assets in securities which mature within five business days.

MMFs should be required to know their clients, in order to enable them to monitor subscription/redemption cycles and manage risks arising from shareholder concentration. Such measures may need to be accompanied by requirements on intermediaries to disclose the identity of underlying investors to MMFs.

Money market instruments are often held to maturity as opposed to equity and fixed income securities which often have high turnover. As such, while fixed income markets have readily available mark-to-market prices, money markets do not. In the absence of regular and reliable mark-to-market prices, MMFs make use of amortised cost prices as an estimate of mark-to-market prices. If amortised cost prices were not used, some other estimate would have to be used, such as pricing from a yield curve. Amortised cost has proven a reliable estimate over the years.

Research by the Investment Company Institute (ICI) shows that, between 2000 and April 2010 the average price of a USD prime VNAV fund would have been 0.999977 (i.e. an average variation from the CNAV of 0.23bps).

There should be controls around the use of amortised cost prices to ensure there is no material difference between the amortised cost price and the mark-to-market price however limits on amortised accounting need to be considered in conjunction with other risk constraints designed to protect investors, notably limits on: maximum Weighted Average Maturity (WAM); maximum Weighted Average Life (WAL); maximum final legal maturity; minimum liquidity requirements; minimum credit quality requirements; asset diversification requirements; etc.

CESR's Guidelines Concerning Eligible Assets for Investment by UCITS provides a helpful model and states as follows:

With respect to the criterion "value which can be accurately determined at any time", if the UCITS considers that an amortization method can be used to assess the value of a MMI [Money Market instrument], it must ensure that this will not result in a material discrepancy between the value of the MMI and the value calculated according to the amortization method.

The following UCITS/MMI will usually comply with the latter principles:

- *MMI with a residual maturity of less than three months and with no specific sensitivity to market parameters, including credit risk; or*
- *UCITS investing solely in high-quality instruments with as a general rule a maturity or residual maturity of at most 397 days or regular yield adjustments in line with the maturities mentioned before and with a weighted average*

maturity of 60 days. The requirement that the instruments be high-quality instruments should be adequately monitored, taking into account both the credit risk and the final maturity of the instrument.

These principles along with adequate procedures defined by the UCITS should avoid the situation where discrepancies between the value of the MMI as defined at Level 2 and the value calculated according to the amortization method would become material, whether at the individual MMI or at the UCITS level. These procedures might include updating the credit spread of the issuer or selling the MMI.

While we concur with much of IOSCO's Final Report on Policy Recommendations for Money Market Funds including prescribed minimum liquidity requirements and further work on 'Know Your Client' we do not support the IOSCO recommendations to impose more onerous obligations for stable NAV funds, in particular to encourage their conversion where practicable to variable NAV. Stable NAV and variable NAV money market funds should be treated equally, as securities products.

Thank you once again for the opportunity to comment on this important matter. MMFs provide a simple but valuable intermediation service between lenders and borrowers in the short- term debt markets and provide enormous benefits to a broad range of investors and issuers. Any changes to the current regulatory framework must be global in nature, measured, carefully considered and developed in light of the regulatory enhancements already introduced following the financial crisis in achieving the objectives sought and avoiding any unintended consequences such as a move to unregulated products.

Kind regards,

Patrick J Lardner

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Pat Lardner, Chief Executive