

**ASSET MANAGEMENT AND INVESTORS COUNCIL**

Richard STOBO  
Investment Management SC  
European Securities and Markets Authority  
103 rue de Grenelle  
75007 Paris  
France

London, January 31, 2014

Dear Richard,

**Revision of the provisions on diversification of collateral in ESMA's guidelines on ETFs and other UCITS issues.**

The ICMA Asset Management and Investors Council ('AMIC') was established in March 2008 to represent the buy-side members of the ICMA membership. ICMA is one of the few trade associations with a European focus having both buy-side and sell-side representation.

The AMIC composition embraces the diversification and the current dynamics of the industry – representing the full array of buy side interests both by type and geography. The AMIC's focus is on issues which are of concern to its broad membership, rather than having a specific product focus.

The members of the AMIC welcomes the opportunity to discuss ESMA's approach to diversifying collateral in the context of the guidelines on ETFs and other UCITS issues that entered into force on 18 February 2013.

AMIC members welcome the distinction made between collateral diversification and diversification of assets held by funds – as suggested by ESMA's approach. The purpose of collateral diversification is to reduce counterparty risk while the purpose of diversification of assets held for investment is to prevent excessive concentration of investments. Collateral is an asset that has been legally dedicated by one party to provide a source of compensation to a counterparty in the event that the first party defaults on his obligation to service or repay a loan, or fails to perform some other contractual obligation or meet some contractual condition. And this imperative calls for the collateral to be of high quality and liquid, characteristics which are met by high quality sovereign debt.

We understand that MMFs are among the largest users of Reverse Repo (RR) and particularly hit by the existing guidelines. In fact all UCITS are impacted by the current wording of the guidelines. We consider that the proposal in this consultation paper is

not consistent with a coherent UCITS investor protection policy. Collateral is the 'insurance' that managers require to make investors whole in the event of failure to return the securities. The key driver for collateral is the speed at which collateral can be liquidated in order to buy back lent assets on a failure of redelivery. This favours the inclusion of very liquid or short term instruments such as government securities, in case of all UCITS funds.

AMIC members also consider that limitations on collateral should not be greater than those applied to assets directly held by UCITS funds, as these limitations perform different functions for the fund managers. Moreover, the amendment proposed by ESMA would grant greater flexibility only to MMFs when a European Money Market Fund Regulation is currently under consideration.

**1. Do you believe that ESMA should revise the rules for the diversification of collateral received by UCITS that take the form of money market funds in the context of efficient portfolio management techniques and OTC transactions? If yes, do you agree with ESMA's proposal?**

We welcome the fact that ESMA is considering changing the rules of diversification of collateral received by UCITS that take the form of money market funds in the context of efficient portfolio management (EPM) techniques and OTC transactions. This should be a minimum step as AMIC members believe that receiving high quality government bonds by way of reverse repo is essential to the effective operation of money market funds and short term money market funds. The use of high quality collateral avoids introducing additional asset specific risks (such as reduced credit quality or exchange risk), ensuring that the overall management of the fund is aligned with investor expectations regarding the high quality and the liquidity of MMFs.

However AMIC members believe that this change should be applied to all types of UCITS (as proposed in Option 2 in the consultation paper). This extension builds upon the need for high liquidity and stability of collateral for all UCITS funds in times of market stress. And unsurprisingly sovereign debt has remained the most desirable form of collateral.

In opting for option 1, the ESMA guidelines would force UCITS funds engaging in EPM techniques to restrict the amount of sovereign debt they can accept as collateral from a single government issuer, and seems counter-intuitive from an investor protection policy perspective. To obtain appropriate levels of diversification in high quality government issuers as required by Guideline 43 (j), managers in many cases would be forced to take on exposure to currencies other than those of the base currency of the fund. To avoid taking on this currency risk the alternative is to hold higher levels of cash deposits but this then comes with increased credit risk to the deposit taker which is not in investors' interests.

As borrowers find it increasingly complex to finance the required diversified pool of collateral, they may also look at cash collateral as a replacement solution which is not palatable to many European funds because of the extra credit risk of having cash on deposit. The result would be balances falling off in favour of funds which did accept cash.

AMIC members would welcome the changes to the ESMA guidelines to follow Option 2 of the Consultation Paper.

**Q2. Do you think that ESMA should introduce additional safeguards for government bonds received as collateral (such as a specific issuer limit) in order to ensure a certain level of diversification? Please give reasons for your answer.**

No, we think that there is no need for additional requirement on government bonds received as collateral or in the framework of a reverse repo transaction. There are already high standards for selecting counterparties and monitoring collateral.

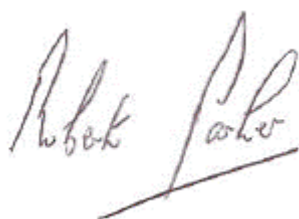
**Q3. Do you agree with the proposed requirement to diversify the government securities across at least six different issues?**

AMIC members understand that diversifying the government securities across different issues (at least six when the collateral represent 100% of the NAV of the fund) will spread the risk. However AMIC members would like to highlight the operational burden that will be associated with such a guideline – and would urge ESMA to consider the introduction of proportionality to ensure firms can adequately fulfill their collateral requirements in the market. Indeed ESMA should consider the issue of trade sizes for repo transactions. For example, standard ‘clips’ in the euro government repo market tend to be 25mm nominal. If funds are transacting in small sizes, and then splitting these into 6 separate transactions, they may struggle to get ‘market’ prices in the required size.

AMIC members would like to support ESMA’s role to ensure the consistent implementation of its guidelines throughout all Member States, and would like to prevent gold-plating by some Member States.

The AMIC would be happy to discuss further with you the points made in this letter. The Secretary of the AMIC, Nathalie Aubry-Stacey, can be reached at [Nathalie.aubry-stacey@icmagroup.org](mailto:Nathalie.aubry-stacey@icmagroup.org) should you need further information.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Robert Parker', with a horizontal line underneath the name.

Robert Parker  
AMIC Chairman