IRISH FUNDS INDUSTRY ASSOCIATION

DG MARKT Unit 02
European Commission
Rue de Spa, 2 1049
Brussels
Belgium

June 15, 2012

Re: **Green Paper on Shadow Banking**

Dear Sir

The Irish Funds Industry Association[1] ("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 the leading international funds centre there is in excess of 2,000 billion Euros of assets in almost 12,000 investment funds administered in Ireland as of March 2012. These assets are comprised of 1,116 billion Euros in Irish domiciled funds, of which 871 billion Euros are in UCITS funds, and more than 900 billion Euros in non Irish funds administered in Ireland. Furthermore, as of March 2012, assets in Irish domiciled Money Market Funds ("MMFs") stood at 296 billion Euros and assets in Irish domiciled Exchange Traded Funds ("ETFs") are estimated at 62 billion Euros. Accordingly, all developments in the investment funds arena and specifically MMFs and ETFs are of particular importance to the Irish funds industry.

The IFIA welcomes both the publication of, and the opportunity to comment on European Commission Green Paper on Shadow Banking ("Green Paper") Consultation Report. We have chosen not to answer each individual question in the Green Paper but set out some specific commentary to the pertinent elements of the Shadow Banking discussion that are of the greatest impact and concern to our membership.

The IFIA appreciates the work currently undertaken by the European Commission, the International Organization of Securities Commission ("IOSCO") and the Financial Stability Board ("FSB") to ensure the long term safety and stability of investment funds and welcome the opportunity to specifically comment on two asset classes highlighted; namely Money Mark Funds and Exchange Traded Funds.

**The Inclusion of MMF & ETFs in the definition of Shadow Banking**

The IFIA supports the analysis and reasoning of Institutional Money Market Funds Association ("IMMFA") and the European Fund and Asset Managers Association ("EFAMA"); both of whom specifically analyse the Green Paper definition of "Shadow Banks" and reason in a very logical manner that investment funds and in particular MMFs and ETFs do not merit being included as part of umbrella category of entities referred to as "Shadow Banking".

The term "shadow" is particularly misleading and infers with it a sense of inappropriateness, which the IFIA would reject as being associated with two fund classes that are very highly regulated in the EU.

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***Money Market Funds***

Money Market Funds are very transparent in their dealings. We are writing on behalf of Irish domiciled MMFs, all of which are regulated either as UCITS under Directive 2009/65/EC or under regulations imposed by the Irish Central Bank which are equivalent to the regulations applicable to Irish UCITS MMFs. Many of the promoters of Irish domiciled MMFs are members of IMMFA and manage their Irish funds in accordance with the IMMFA Code of Practice. A variety of reporting is made available, stress testing for Irish funds is a regulatory requirement and a weekly comparison of Mark to Market prices to amortised cost prices is in place with prescribed escalation ladders for differing deviations, including disclosure to the Irish Central Bank and/or the Governing Bodies of the funds.

The suggestion that MMFs are banks or "bank-like" reflects a fundamental misconception of MMFs and the role they play in the financial markets.

- MMFs do not use leverage; while they do use repo transactions to invest cash and earn a return, the goal of the repo usage is diversification of the credit risk of a cash balance;
- MMFs do not take deposits; they take investments that are made in line with an underlying prospectus/investment document that sets a goal of investment; and
- MMFs do not make loans; they invest in short term financial instruments.

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, MMFs play an important role in support of economic activity in the 'real economy' for many businesses managing working capital and internal treasury needs.

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, however by extention to say that MMFs are "bank-like" is a position the IFIA rejects.

Banks have never had a monopoly on credit intermediation and there have always been other types of credit intermediaries whose structures and features do not resemble banks. The ways in which different types of financial institutions provide credit intermediation varies, but the mere fact that credit intermediations is a feature of products and/or institutions is not a sufficient criterion for aggregating together all diverse financial institutions under one definition of Shadow Banking.

The IFIA urges the European Commission to take note of the submissions by the relevant trade associations and industry participants to the IOSCO Consultation Report on Money Market Fund Systemic Risk Analysis and Reform Options (Consultation Report) which highlighted the very serious risks associated with material structural reforms to MMFs and the impact such risks could have on the short term markets. A copy of the IFIA response to the IOSCO Report has been attached to this submission.

***Exchange Traded Funds***

The IFIA's level of concern on the inclusion of MMFs in the Shadow Banking debate is matched by our concern that ETFs are also included in the umbrella category of Shadow Banking entities. The majority of EU domiciled ETFs are organized and regulated as UCITS funds and, as such, are already subject to one of the most respected and widely recognized regulatory frameworks for public investment funds in the world. The concerns about ETFs, which have been raised by the Commission are largely addressed by the existing UCITS framework. Furthermore, ESMA's recent consultation paper on UCITS ETFs addresses some of the additional concerns, which will further improve the quality of UCITS ETFs.

The primary difference between an UCITS ETF and a traditional UCITS is that ETFs are listed and traded on an exchange, which provides the investors with more, not less, liquidity. In addition, many of the ETF issues raised in the Green Paper such as securities lending and derivative (swap) transactions are not issues specific or limited to just ETFs but are contemplated by, and comprehensively regulated within, the UCITS framework. In fact these instruments/securities are widely used across other types of UCITS and non-UCITS investment funds. The logical extension of the Green Paper would be to include all Collective Investment Funds as part of Shadow Banking. Clearly, this is not appropriate.

By including ETFs in the definition of Shadow Banking, the Commission runs the risk of losing focus on the core issues that it wishes to address. Any regulation of ETFs is better handled through the existing EU regulatory framework for Collective Investment Schemes. It is important to note that ETFs represent only a very small percentage of the regulated fund market (3%) in Europe and, with less than €300 billion of AUM, clearly do not have systemic significance.

It is the strong view of the IFIA that MMFs and ETFs are not banks, they are investment funds, and as such should be, and currently are, regulated as investment funds. Appropriately, after studying the lessons from the 2007-2009 financial crisis, the European Commission moved promptly and responsibly 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 European Securities and Markets Authority) of Guidelines on European money market funds which went into effect in 2011.

The IFIA echoes IMMFA's view that the main objective of MMF reform should be to ensure that funds have sufficient natural liquidity to meet redemption payments and recommends that:

A. There should be specification on minimum liquidity requirements 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, corporates 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.

B. Specification that MMFs must 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.

MMFs, which the FSB has included in its proposed definition of Shadow Banks, are an important part of the financial system. The inclusion of MMFs within the term of Shadow Banks is largely due to, what we believe to be, a flawed perception that the objectives of daily liquidity, preservation of capital and payment of an interest rate are 'bank-like'. In addition there is the supposition that MMFs have aspects of liquidity transformation and maturity transformation.

**Regulation of Funds**

The IFIA do not disagree that there is liquidity and maturity transformation but it is a very managed process and the principle benefit of this transformation is credit diversification from exposure to one banking entity to several credit entities. It is further noted hereunder, that the Promoters of MMFs that are domiciled in Ireland are established as UCITS funds and are regulated by the Central Bank of Ireland. It should also be noted that many of the promoters of such funds are members of IMMFA, which requires them to adhere to strict guidelines on Liquidity and Maturity profile.

Money Market Funds are governed in three very specific manners:

(a) The majority of Money Market Funds are UCITS meaning they are subject to 1) the requirements in UCITS legislation [Directive 2009/65/EC] and 2) any supplemental regulations imposed in the fund's domicile such as Ireland;

(b) "Short Term Money Market Funds" as termed under the CESR/ESMA definition of Money Markets in the Offshore space are largely part of IMMFA. To align their product to IMMFA the manager must adopted the voluntary Code of Practice of IMMFA which has strict prescriptive rules on Liquidity Ladders, Weighted Average Maturities, Weighted Average Life and Know Your Client; and

(c) The Irish Central Bank also mandates that Irish domiciled MMFs conduct stress testing in its regulations. This has been supplemented by a practice note from IMMFA to its members on how they could conduct same.

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 general regulation of investment funds through revision of the Undertakings for Collective Investment in Transferable Securities (UCITS), which was followed in May 2010 by more specific provisions in the adoption by the Committee of European Securities Regulators (now European Securities and Markets Authority) of Guidelines on European money market funds which went 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 common concern in relation to MMF across the FSB, IOSCO, the ECB, the SEC and this Green Paper is risk of a run on funds and the ability to meet the redemption requests. As outlined above, we believe, the measures introduced by both the Commission and the SEC together with the provisions of the IMMFA Code of Practice will continue to ensure that MMFs have the necessary liquidity to meet redemptions in times of market stress.

In conclusion the IFIA would hold the opinion that investment vehicles, including MMFs and ETFS are already subject to robust regulation and regulatory scrutiny and as such would oppose the inclusion of these funds in the Shadow Banking definition which, by many, is used to infer a lack of regulation.

**The Pricing Debate of Constant NAV(CNAV) & Variable NAV(VNAV)**

The comparison, amongst 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 CNAV and VNAV funds and it is self-evident that a VNAV fund would remain 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.

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Changing the pricing mechanism of MMFs will neither disincentivise investor redemptions, nor better enable them to meet such redemptions as 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 to the Commission that any advances toward VNAV or Floating NAV be rejected.

**Global Homogeneity Of Regulation**

Any changes to the current regulatory framework must be global in nature, measured, carefully considered and developed in light of the regulatory enhancements introduced already implemented following the financial crisis in achieving the objectives sought and avoiding any unintended consequences such as a move to unregulated products.

The ECB in its *Occasional Paper No 133 Shadow Banking in the Euro Area* concurs with this opinion when it said "Any initiative concerning the scope of the safety net should be coordinated at international level, to avoid arbitrage among jurisdictions." Vitor Constancio, VP of the ECB recently said at the European Commission Conference 'Towards better regulation of the Shadow Banking system' on April 27th added "one of the main risks stemming from Shadow Banking relates to regulatory arbitrage, it is important and indeed crucial in Europe, to ensure consistency of policy initiatives across countries."

The IFIA, upon consultation with our members, partners and industry colleagues, concur with this sentiment and ardently believe that any further regulatory requirements should be coordinated at international level, to avoid arbitrage among jurisdictions.

**The Law of Unintended Consequences**

In Europe MMF's are a major supplier of short-term funding to banks. Many of the investors in European MMF's are corporate treasurers who use MMFs to diverse credit risk. Any additional regulatory overlay imposed on MMFs and ETF's on top of what is already a highly regulated investments funds sector could have unintended consequences for the growth potential of the European economy at a time which growth is urgently needed.

Yours sincerely,

Patrick J Lardner

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Pat Lardner

Chief Executive