Frankfurt am Main
14 January 2013

BVI's response to the FSB Consultative Document "Strengthening Oversight and Regulation of Shadow Banking: A Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos"

BVI[1] is grateful for the opportunity to submit its comments on the policy recommendations for addressing systemic risk in securities lending and repos developed by the FSB workstream WS5. As representatives of the German fund industry which is subject to long-established rules regarding securities lending and repos, we will focus our remarks on possible benefits and drawbacks of the proposed approach to the regulated fund sector in Germany and Europe.

***Q1:** Does this consultative document, taken together with the earlier interim report, adequately identify the financial stability risks in the securities lending and repo markets? Are there additional financial stability risks in the securities lending and repo markets that the FSB should have addressed? If so, please identify any such risks, as well as any potential recommendation(s) for the FSB's consideration.*

Many of the financial stability risks identified by WS5 do not apply to European investment funds due to the already existing regulation on securities lending and repos.

Since nearly two decades German investment funds have been bound by demanding standards on cash collateral reinvestment. Recently, similar standards have been introduced by ESMA for all UCITS. Under the ESMA Guidelines, cash collateral received from securities lending can be either placed on deposits, invested in high-quality government bonds, used for reverse repo transactions with regulated credit institutions or invested in short-term MMFs[2]. These restrictions on cash-collateral reinvestment effectively eliminate the risk of maturity and liquidity transformation challenged by WS5. Similarly, due to the requirement for non-cash collateral not to be sold, re-invested or pledged and to be held by the UCITS depositary in case of title transfer[3], re-hypothecation of assets received as collateral is generally excluded. The new ESMA Guidelines for UCITS also mitigate the risk of improper valuation of collateral by providing for valuation on at least a daily basis and making the acceptance of collateral displaying high price volatility more difficult[4].

[1] BVI represents the interests of the German investment fund and asset management industry. Its 80 members currently handle assets of EUR 2.0 trillion in both investment funds and mandates. BVI enforces improvements for fund-investors and promotes equal treatment for all investors in the financial markets. BVI`s investor education programmes support students and citizens to improve their financial knowledge. BVI`s members directly and indirectly manage the capital of 50 million private clients in 21 million households.BVI's ID number in the EU register of interest representatives is 96816064173-47. For more information, please visit www.bvi.de.
[2] Cf. Para 43 j) of the ESMA Guidelines on ETFs and other UCITS issues dated 17 December 2012 (ESMA/2012/832).
[3] Para. 43 g) and i) of the ESMA Guidelines on ETFs and other UCITS issues.
[4] Para. 43 b) of the ESMA Guidelines on ETFs and other UCITS issues.

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Q2: *Do the policy recommendations in the document adequately address the financial stability risk(s) identified? Are there alternative approaches to risk mitigation (including existing regulatory, industry or other mitigants) that the FSB should consider to address such risks in the securities lending and repo markets? If so, please describe such mitigants and explain how they address the risks. Are they likely to be adequate under situations of extreme financial stress?*

The policy recommendations presented in the consultation documents are in parts quite far-reaching and might lead to significant changes to the established market practices. This pertains in particular to the minimum standards for methodologies to calculate haircuts (section 3.1.2) and the reporting requirements for fund managers if applied in an extensive manner (section 2.4).

In this context, it appears irritating that the consultation document puts a particular emphasis on recommendations applicable to investment funds and in some instances disregards the risks posed by banks and regulated broker-dealers engaging in securities lending and repos (cf. our subsequent remarks on Q16 and Q19). However, the regulatory restrictions explained above make it obvious that the market activities of UCITS and other regulated European investment funds cannot be the primary source of concern in systemic terms.

Therefore, it is indispensable for the effective reduction of systemic risk that the future global standards on collateralization of securities lending and repo transactions apply consistently to all market participants. Any other outcome e.g. in relation to the minimum haircuts would also lead to grave competitive disadvantages for those entities affected by the new policy rules compared to other market players.

Q3: *Please explain the feasibility of implementing the policy recommendations (or any alternative that you believe that would more adequately address any identified financial stability risks) in the jurisdiction(s) on which you would like to comment?*
Q4: *Please address any costs and benefits, as well as unintended consequences from implementing the policy recommendations in the jurisdiction(s) on which you would like to comment. Please provide quantitative answers, to the extent possible, that would assist the FSB in carrying out a subsequent quantitative impact assessment.*

From the viewpoint of the European fund industry, the feasibility of implementing the policy recommendations as well as the related costs depend in a crucial way on the extent to which the existing regulation on securities lending and repos pertaining specifically to investment funds will be taken into account by the authorities.

European investment funds are already bound by high regulatory standards in terms of securities lending and repos. In addition to the requirements for collateral mentioned in our reply to Q1 above, there is a whole array of measures aiming at mitigating potential risks from those investment techniques. In particular, it must be noted that under the German law, securities lending to one counterparty is limited on a gross basis to 10% of the fund's NAV. Transactions with several counterparties belonging to the same corporate group are all counted towards the same limit[5]. According to the new ESMA Guidelines for UCITS, the combined counterparty risk exposure in relation to OTC derivative transactions, securities lending and repos must not exceed 10% in case the counterparty is a credit institution and 5% in other cases[6]. The new ESMA Guidelines also require

[5] Cf. § 54 para. 1 second sentence of the German Investment Act.
[6] Cf. para. 41 of the ESMA Guidelines for ETFs and other UCITS issues with reference to Article 52(1) third subparagraph of the UCITS Directive.

UCITS to put in place a clear haircut policy taking into account the characteristics of each class of assets especially in terms of credit standing or price volatility. The collateral and haircut policy must be clearly communicated in the fund prospectus[7].

Given the existence of these demanding rules which effectively address many of the financial stability concerns identified by WS5 in addition to tackling issues relating to investor protection, we believe that the final FSB report should call upon the authorities to evaluate their national regimes in the first place in order to assess whether and to which extent further regulatory measures are needed.

Q5: *What is the appropriate phase-in period to implement the policy recommendations (or any alternative that you believe would more adequately address any identified financial stability risks)?*

The length of an appropriate transitional period depends upon the details of final implementing rules and the extent of associated changes to the currently prevailing market standards. In case such changes require introduction of new reporting processes or renegotiation of securities lending and repo agreements e.g. to ensure compliance with new haircut requirements, we would expect the phase-in period to be no less than 18 months following the adoption at national level.

Q6: *Do you agree with the information items listed in Box 1 for enhancing transparency in securities lending and repo markets? Which of the information items in Box 1 are already publicly available for all market participants and from which sources? Would collecting or providing any of the information items listed in Box 1 present any significant practical problems? If so, please clarify which items, the practical problems, and possible proxies that could be collected or provided to replace such items.*

We agree with the recommendation 1 to collect more granular data on securities lending and repo exposures amongst large international financial institution. The term "large international financial institution" should be further defined in order to promote consistent implementation in global terms. In this context, we support the objective to align the scope of application with the approach adopted by the FSB Data Gaps Group which is focused on global systematically important banks.

Asset managers and regulated investment funds should not be considered as falling into this category. Asset managers act only as agents managing their clients' assets without dealing on own account or otherwise taking any risks on their trading books. Regulated investment funds, on the other hand, are generally bound by regulatory requirements on risk spreading and thus cannot take excessive risk in relation to one issuer or counterparty[8]. This significantly reduces the potential a fund's failure could have on other financial institutions.

In addition, European investment funds are already subject to extensive reporting duties regarding their engagements in securities financing or will be bound by such duties in near future. For instance, all investment funds domiciled in Germany are obliged to report on an annual basis the volume of their securities lending, repo and reverse repo transactions both for the entire reporting period and at the closing date[9]. These new reporting requirements are the consequence of implementing the EU UCITS

[7] Para. 46 and 47 of the ESMA Guidelines for ETFs and other UCITS issues.
[8] Under the UCITS Directive, for instance, the general limit to issuer risk is set at 5% of the fund assets (can be raised to 10%). Similarly, the risk exposure to one counterparty arising from OTC derivative transactions, securities lending or repos cannot exceed 10% of the fund assets. The combined maximum amount of investments in transferrable securities or money market instruments issued by an entity, deposits made with that entity and counterparty exposure to that entity cannot exceed 20% of the fund assets, cf. Article 52 para. 1 and 2 of Directive 2009/65/EC (UCITS Directive).
[9] Cf. § 28c of the Ordinance on risk management and risk measurement concerning the use of derivatives in investment funds (Derivateverordnung) and section 2.4 and 3.3. of the corresponding instructions by BaFin.

IV reform in Germany and have been introduced in similar way in other EU jurisdictions at least with regard to UCITS.

For other investment funds, the new EU Directive on Alternative Investment Fund Managers AIFMD taking effect in July 2013 will require extensive regulatory reporting on a quarterly basis[10]. These reports shall encompass information on borrowing and exposure risk of each managed fund, including value of borrowings of cash or securities, value of securities borrowed for short positions as well as value of collateral posted to other counterparties and where applicable, percentage of its re-hypothecation[11]. More detailed reporting comprising specification of five largest sources of borrowed cash or securities are incumbent on funds employing leverage on a substantial basis[12]. These items represent only a small fraction of the very challenging reporting requirements to become mandatory for fund managers under AIFMD.

Thus, given the low relevance of investment funds and their managers in systemic terms and the extent of data already available to the authorities under the existing EU rules, we see definitely no need to collect further information from the European fund industry on the basis of the FSB recommendations.

Q7: *Do you agree TRs would likely be the most effective way to collect comprehensive market data for securities lending and/or repos? What is the appropriate geographical and product scope of TRs in collecting such market data?*
Q8: *What are the issues authorities should be mindful of when undertaking feasibility studies for the establishment of TRs for repo and/or securities lending markets?*

In principle, we agree that TR would be the most effective way for collecting global data for securities lending and repos from large international financial institutions. In this regard, we recommend taking avail of the work already conducted in different jurisdictions in the context of OTC derivative clearing on the role and mechanisms of TR for collecting the relevant market data[13]. In particular, is appears desirable to align the accessibility and functioning of the envisaged TR for securities lending and repo trades with the already settled databases in the area of OTC derivative clearing.

Q9: *Do you agree that the enhanced disclosure items listed above would be useful for market participants and authorities? Would disclosing any of the items listed above present any significant practical problems? If so, please clarify which items, the practical problems and possible proxies that could be disclosed instead.*
Q10: *Do you agree that the reporting items listed above would be useful for investors? Would reporting any of the items listed above present any significant problems? If so, please clarify which items, the practical problems and possible proxies that could be reported instead.*

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[10] Cf. Article 110 (3) of the Commission Delegated Regulation supplementing Directive 2011/61/EU (provisional version as provided on 19 December 2012, not yet published in the Official Journal of the EU).
[11] Cf. items 15, 16, 26 and 28 of the reporting template on AIF-specific information according to Article 24(2) of Directive 2011/61/EU included in Annex IV of the Commission Delegated Regulation supplementing Directive 2011/61/EU (provisional version published on 19 December 2012).
[12] Item 4 of the reporting template on AIF-specific information according to Article 24(4) of Directive 2011/61/EU included in Annex IV of the Commission Delegated Regulation supplementing Directive 2011/61/EU (provisional version published on 19 December 2012).
[13] In Europe, the TR concept is stipulated by the Regulation (EU) 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (EMIR).

We understand that WS5 suggests the reporting requirements for fund managers to be tailored to the information needs of the end-investors and therefore, be exempted from the general disclosure standards for financial institutions envisaged in recommendation 4. Indeed, this is the only reasonable interpretation of the discussed approach to transparency as there is a great deal of overlap concerning the required information items. Moreover, any disclosure by fund managers to investors should be anyway expected to take place as part of the fund's accounting and be included in the regular reports. Therefore, we focus our comments on the WS5's considerations under section 2.4.

The underlying assumption of these considerations is the finding that "securities lending and repos allow fund managers to access leverage on their clients' portfolios". This observation does certainly not apply to European regulated retail funds such as UCITS. In the securities lending market, UCITS are only allowed to act as lenders of securities with the corresponding counterparty risk being subject to strict collateralization requirements under the new ESMA guidelines. The acceptable collateral should be highly liquid, valued on at least a daily basis, of high credit quality and sufficiently diversified[14]. Moreover, as explained above, non-cash collateral received by UCITS cannot be sold, re-invested or pledged and should be held by the depositary in case of a title transfer. Cash collateral may only be reinvested in high-quality government bonds or short-term MMFs[15]. ESMA appears determined to extend these restrictions to the treatment of proceeds from repos and reverse repos which would fully eliminate any risk of leverage associated with these transactions, notwithstanding the inconsistencies of this approach in legal and economic terms (cf. our comments on Q19 below)[16].

Hence, it is very clear that under the UCITS framework securities lending and repos cannot be used for building up leverage in the fund's portfolios. Moreover, the new ESMA guidelines for UCITS already introduce reporting requirements to investors in relation to the exposure obtained through securities lending and repo trades, the identity of counterparties, the type and amount of collateral received by the UCITS and the revenues arising from these activities together with operational costs and fees incurred[17]. In our view, these reporting items are fully sufficient to account for the information needs of retail investors and must not be further enhanced or refined based on FSB's recommendations.

In this context, we have also serious doubts about the potential of fund reporting on securities lending or repos to be useful for dampening systemic risk and pro-cyclical effects associated with securities financing. Clearly, the details of reporting contemplated by WS5 are far too sophisticated for retail investors and cannot be reasonably expected to have any controlling impact on the retail markets. Professional fund investors may be interested in the suggested data and are certainly provided with it to some extent for the purpose of accounting or regulatory reporting. However, also in this regard, the steering effect of disclosure for "due consideration of the risks taken by fund managers" as anticipated by WS5 depends principally upon the question whether the fund manager is at all allowed to build up significant additional risks by engaging in securities lending or repos under the applicable fund regime.

Therefore, we request the FSB to make clear in its final recommendations that the detailed fund reporting towards investors shall be applied by the authorities in a proportionate manner taking especially into account the potential for additional exposure to be incurred to the fund portfolio by securities lending and repo engagements.

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[14] Cf. Para. 43 of the ESMA Guidelines on ETFs and other UCITS issues.
[15] Para. 43 g), i) and j) of the ESMA Guidelines on ETFs and other UCITS issues.
[16] This objective is quite clear from para. 42 of the ESMA Guidelines on ETFs and other UCITS issues.
[17] Para. 35 of the ESMA Guidelines on ETFs and other UCITS issues.

Q11: *Are the factors described in section 3.1.2 appropriate to capture all important considerations that should be taken into account in setting risk-based haircuts? Are there any other important considerations that should be included? How are the above considerations aligned with current market practices?*

The suggested factors to be taken into account for setting risk-based haircuts are in our opinion very ambitious. Especially, it should be very difficult to capture all the other risk considerations and specific characteristics of the collateral as proposed in subsection (ii) as the calculation methodologies for haircuts are generally based on the historical or simulated volatility of assets.

Q12: *What do you view as the main potential benefits, the likely impact on market activities, and possible unintended consequences of introducing a framework of numerical haircut floors on securities financing transactions where there is material procyclicality risk? Do the types of securities identified in Options 1 and 2 present a material procyclical risk?*

Q13: *Do you have a view as to which of the two approaches in section 3.1.3 (option 1 – high level or option 2 – backstop) is more effective in reducing procyclicality and in limiting the build-up of excessive leverage, while preserving liquid and well-functioning markets?*

In principle, we do not object to WS5's recommendation to introduce numerical floors on haircuts for securities financing transactions. We also agree with the assessment that bonds, securitised products and equities display material procyclicality risk and therefore should be captured by the numerical framework. The same should be true for investment funds focusing on investments in these types of assets.

Furthermore, we concur with the view that the proposed numerical haircuts should be considered a floor framework and be set at a level below the prudent market standards for actual haircuts in normal circumstances. **Therefore, we have a clear preference for option 2 (backstop level) as it leaves market participants more flexibility to apply higher haircuts based on their own analysis.** Option 1, in contrast, runs the risk of becoming an effective market standard due to its alignment with the actual market practice. As a consequence, option 1 might prompt market participants to automatically apply the minimum haircuts without conducting proper assessment of collateral risks. Moreover, option 1 can unduly increase the costs of securities financing if the risks of certain assets diminish due to positive market conditions such as higher liquidity supply.

We comment on the floor levels deemed appropriate for specific assets in our reply to Q14 below.

Q14: *Are there additional factors that should be considered in setting numerical haircut floors as set out in section 3.1.3?*

In our opinion, the most important characteristics of assets eligible as collateral are liquidity and proper up-to-date valuation. Asset classes featuring high liquidity and subject to reliable valuation should be assigned comparatively low minimum haircuts.

On this basis, significantly lower haircuts than suggested by WS5 should apply to equities. The market experience has shown that equities are by far the most liquid instruments with effective pricing which can be easily sold even in crisis situations. On the other hand, sovereign bonds display comparably low liquidity which should be adequately reflected in the applicable numerical floor.

Haircuts for UCITS should be set at a very low level. UCITS ensure high liquidity by offering daily redemption opportunities. In addition, UCITS are bound by strict diversification standards meaning that the market and counterparty risk in a UCITS portfolio is markedly lower compared with direct investments in single stocks or bonds. **Therefore, we believe that the floor for haircuts applicable to UCITS should be in any case equivalent to the lowest floor for individual securities. A second-best solution would be a look-through approach to the UCITS portfolio complemented by a discount on the relevant average haircut to account for the additional protection by risk-spreading.**

> ***Q15:*** *In your view, how would the numerical haircut framework interact with model-based haircut practices? Also, how would the framework complement the minimum standards for haircut methodologies proposed in section 3.1.2?*

The framework for numerical haircuts should determine the minimum level of haircuts applicable in all circumstances without suspending the obligation for market participants to conduct their own analyses based on sound calculation methodologies. For this reason, we favour the approach under option 2 which defines backstop levels of haircuts and cannot be mistaken for effective market standards (cf. our reply to Q12/13 above).

> ***Q16:*** *In your view, what is the appropriate scope of application of a framework of numerical haircut floors by: (i) transaction type; (ii) counterparty type; and (iii) collateral type? Which of the proposed options described above (or alternative options) do you think are more effective in reducing procyclicality risk associated with securities financing transactions, while preserving liquid and well-functioning markets?*

We agree with the considerations made by WS5 with regard to the transaction types to be affected by the numerical floor framework. In particular, we support the proposal to exclude cash collateralised securities lending transactions from the scope of the new haircut requirements.

In contrast, we do not see any proper reason to limit the application of the proposed standards depending on the counterparty type. Arguably, if securities lending and repos are considered "bank-like" activities due to their potential to create money-like liabilities, carry out maturity/liquidity transformation and obtain leverage[18], then the negative implication of such activities for the financial stability should be tackled for all market participants. In particular, it appears unacceptable to exclude the biggest actors in the securities lending and repo markets such as banks or broker-dealers from the scope of the numerical floor regime. Such limited application might tamper the effectiveness of the entire policy framework for combating systemic risk and must be expected to negatively impact the competitiveness of securities lending and repo transactions for other market participants.

Therefore, we are generally in favour of implementing numerical haircut floors via market-wide regulation as envisaged by WS5 in option 2 on page 19. This approach is clearly the best choice in terms of effective regulation as it would subject any entity engaging in securities financing transactions to the same requirements.

In this context, it must be recognised that "direct appropriate regulation of liquidity and leverage" pertains not only to banks and broker-dealers. Regulated investment funds such as UCITS and other types of mutual funds are subject to even more granular rules on liquidity and leverage which are

[18] Cf. Section 1.2.5 on page 11 of the FSB Consultative Document „Strengthening Oversight and Regulation of Shadow Banking: An Integrated Overview of Policy Recommendations" dd. 18 November 2012.

relevant for the composition of individual portfolios (cf. our remarks on Q9/10 above as well as detailed explanation of the applicable restrictions in our comments on section 3.2.1 of the FSB Consultation Document "Strengthening Oversight and Regulation of Shadow Banking: A Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities). **Thus, should the FSB decide to exempt "regulated financial intermediaries" from the new standards for haircuts, we request to widen the scope of such exemption to include regulated investment funds and fund managers acting on their behalf.**

Similarly, it appears not justified to exclude sovereign bond collateral from the numerical haircut requirements. As already explained, sovereign bonds feature rather low liquidity and hence should be subject to appropriate haircuts if accepted as collateral. Moreover, in the current market environment it cannot be seriously claimed that sovereign bonds display no default risk or are generally not prone to procyclicality.

On balance, we believe that a numerical framework taking into account major differences between the asset classes the application of which is calibrated to securities financing transaction in contrast to securities borrowing is well suited to reduce procyclicality risk without impairing the well-functioning of the markets.

Q17: *Are there specific transactions or instruments for which the application of the numerical haircut floor framework may cause practical difficulties? If so, please explain such transactions and suggest possible ways to overcome such difficulties.*

We do not perceive any practical difficulties in this regard.

Q18: *In your view, how should the framework be applied to transactions for which margins are set at the portfolio basis rather than an individual security basis?*

In the market practice, margin and haircut requirements apply mostly on the portfolio basis. Most market participants use baskets of assets which can be chosen by the counterparty as collateral. This practice also provides for netting opportunities in case of opposing transactions. The terms and conditions generally accord to master agreements provided by ISDA or local trading bodies.

Q19: *Do you agree with the proposed minimum standards for the reinvestment of cash collateral by securities lenders, given the policy objective of limiting the liquidity and leverage risks? Are there any important considerations that the FSB should take into account?*

We concur with the view expressed by WS5 that the minimum standards for cash collateral reinvestment "should apply to all financial entities that are engaged, with or without an agent, in securities lending against cash collateral where the cash collateral is reinvested in a portfolio of assets". This depiction of the scope of application implies that the proposed standards should not pertain to cash obtained through repo transactions and such cash proceeds should not be treated as collateral.

At EU level ESMA has recently taken a stance in the context of the UCITS regulation according to which cash received by UCITS in the course of repo trades shall be treated as collateral and shall be bound by the same restrictions on reuse or reinvestment[19]. This effectively eliminates the possibility for UCITS to use cash from repos for collateralisation of OTC derivative transactions and hence makes it

[19] Cf. para. 42 of the ESMA Guidelines on ETFs and other UCITS issues.

very difficult to participate in the central clearing of OTC derivatives where cash collateral is needed for the provision of the variation margin.

We are convinced that proceeds from repo transactions should not be treated as collateral from both legal and economic perspective. Legally speaking, the concept of repos is clearly different from securities lending as it provides for the transfer of the economic ownership of the relevant assets subject to a repurchase obligation at a future point of time. Repos can be concluded in one deed or by means of two separate buy and sell-back agreements where the nature of the transaction as a genuine purchase contract becomes even more evident. From the economic point of view, repos are predominantly used by European investment funds as financing transactions e.g. to bridge liquidity gaps in a more cost-efficient way than unsecured bank credits. This is a profound difference to securities lending which serves the sole purpose of generating additional profits for the fund from the lending fees or interests on cash collateral.

Under the approach adopted by ESMA, UCITS might be effectively forced to engage in collateral upgrade transactions involving additional fees and potentially creating further counterparty risks. Another possibility would be to avoid as far as possible central clearing by concluding non-standardised OTC derivatives which are cleared in a bilateral manner. This solution, however, would counteract the G20 objective of extending the central clearing of derivatives and raise insolvency risks which could be avoided in the CCP model.

Therefore, it would be very helpful if the FSB could endorse in its final policy recommendations that the principles for cash collateral reinvestment have no impact for cash obtained from repo transactions.

Further on the scope of application, we see no reason to limit the standards for cash collateral reinvestment to the activities of non-bank entities. Even though it is mostly investment or pension funds who act as securities lenders, the relevant requirements should be introduced by means of a market-wide regulation and thus be binding on any entity engaging in securities lending in exchange for cash collateral.

Lastly, we have some remarks on the specific standards for cash collateral reinvestment as proposed by WS5:

- **Standard 2.2.a:** Short-term Money Market Funds as defined in the CESR Guidelines on European MMFs should be recognized as an equivalent alternative to short-term bank deposits and short-tenor transactions. Short-term European MMFs invest in money market instruments of high quality and must ensure a weighted average maturity (WAM) of no more than 60 days and a weighted average life (WAL) of no more than 120 days at the portfolio level[20]. The suitability of short-term MMFs for reinvestment of cash collateral has been already acknowledged by ESMA in the context of the UCITS provisions[21].

- **Standard 4.1:** We understand that the disclosure obligation of an agent lender should be directed towards its clients such as a fund or its manager. However, equating clients with the beneficial owners of securities is misleading as in the fund situation the beneficial ownership might be held by the fund investors. Therefore, we suggest to either delete the reference to

[20] For further details, cf. Box 2 of the CESR's Guidelines on a Common Definition of European Money Market Funds dated 19 May 2010 (CESR/10-049).
[21] Cf. para. 43 j) fourth indent of the ESMA Guidelines on ETFs and other UCITS issues.

beneficial ownership in this context or make clear that in case of transactions concluded on behalf of an investment fund, disclosure to the fund or its manager is deemed sufficient.

***Q20:** Do you agree with the principles set out in Recommendation 9?*

European regulated investment funds are not allowed to engage in re-hypothecation of client assets. Nonetheless, we support the FSB's efforts to enhance and streamline the global regulatory standards in this regard.

***Q21:** Do you agree with the proposed minimum standards for valuation and management of collaterals by securities lending and repo market participants? Are there any additional recommendations the FSB should consider?*

The requirement that "securities lending and repo market participants should only take collateral types that they are able following a counterparty failure to hold outright without breaching laws or regulations" (section 3.4 para. 1) should not imply an obligation for investment funds to accept only collateral compliant with their investment policy as defined in the fund rules or instruments of incorporation. It is common practice for investment funds to collateralise transactions with assets which do not form part of the fund portfolio (e.g. an equity fund takes high quality government bonds as collateral for securities lending). This is due to the fact that collateral is being provided as means of secondary recourse and in case of default immediately liquidated in order to acquire securities matching the defined investment policy. As a consequence, regulatory measures for investment funds focus in the first place at ensuring that the received collateral is of good credit quality, highly liquid and subject to frequent valuation in order to warrant the possibility of smooth disposal following the counterparty's insolvency. This approach has been only recently endorsed by ESMA in its Guidelines for ETFs and other UCITS issues[22].

***Q22:** Do you agree with the policy recommendations on structural aspects of securities financing markets as described in sections 4.1 and 4.2 above?*

We agree with the WS5's conclusions as to the lack of a pressing need for regulatory or other action regarding the discussed structural aspects of the securities lending and repo markets.

In terms of recommendation 12, we support the envisaged evaluation of the costs and benefits of introducing central clearing of transactions. Such evaluation should take into account the current obstacles for market participants to obtain direct access to CCPs. Fund managers are generally not able to become direct CCP clearing members because they do not hold the necessary trading licenses. Hence, they need to approach a CCP indirectly by signing clearing agreements with direct clearing members, usually brokers who can provide such services. This intermediation increases clearing costs for fund investors and adds to the complexity of transactions in anyway strictly regulated products.

As regards the contemplated changes to bankruptcy law treatment of securities lending and repo transactions, we are very skeptical about both the underlying reasoning and the potential to reduce systemic risk. In fact, depriving assets provided as collateral from the exemption from automatic stay would put into question the general purpose of collateral which is protection against insolvency risk of

[22] In the preceding consultation ESMA has considered requiring a high level of correlation between the collateral and the fund investment policy, but has refrained from this step following the feedback received from market participants, cf. para. 42 and 43 of the Feedback Statement published in the ESMA Report and Consulation paper dated 25 July 2012 (ESMA/2012/474).

counterparties. For investment and pension funds, it would result in significant impairment of the investors' interests and deteriorate the means of investor protection. Moreover, the FSB should not underestimate the potential of such reduced exemption to eventually increase systemic risk. Under the discussed scenarios, assets deemed "risky" or "illiquid" would become effectively ineligible for collateral for most market participants even if applying high haircuts. Hence, the range of acceptable collateral would be more restricted which might lead to collateral concentrations and increase the risk of fire sales in times of crisis.

Accordingly, we strongly advise against recommending the discussed changes to the bankruptcy law or even declaring such changes "viable theoretical options" as proposed by WS5.