

Mr Niall Bohan
DGMarkt
European Commission
Brussels

1 March 2006

Dear Niall,

CESR'S ADVICE TO THE EUROPEAN COMMISSION ON CLARIFICATION OF DEFINITIONS CONCERNING ELIGIBLE ASSETS FOR INVESTMENTS OF UCITS (Ref: CESR/06 - 005)

I am writing on behalf of the undersigned members of the International Capital Market Association's Euro Commercial Paper (ECP) Committee who, between them, represent around 95% of ECP market outstandings. They have very strong concerns that, on two particular points, CESR's advice (Ref: CESR/06 – 005) is likely to cause severe disruption to the European short-term debt markets if it passes into law unchanged.

The ECP market is centred in the EU. Virtually all ECP programmes are documented under the laws of EU countries. The euro has so far been a great catalyst for growth in the ECP market, with EUR420 billion equivalent of short-term notes now outstanding. Within the total, the asset-backed ECP (ABECP) market has grown from virtually nil to 31% of the market in 5 years. (The annex to this letter explains why the ECP market is important for the EU.) But two of the changes proposed by CESR – affecting the terms under which various types of ECP would qualify as eligible assets for UCITS – have the potential to reverse the progress that has been made so far and risk driving many market practitioners out of the EU. This letter makes practical suggestions to prevent this.

We would welcome the opportunity to come to Brussels to discuss them with you in more detail as soon as possible.

Box 6

We disagree with the proposal (point 2, first bullet, 3rd indent) that: " - control of this information by an independent body specialising in the verification of legal of financial documentation and composed by persons meeting various standards of integrity and not subject to instructions from the organisation they belong and from the issuers."

In the ECP market, the information memorandum is the disclosure document prepared by the issuer and their counsel. It is reviewed by the dealers on the programme and their counsel. It is distributed by the dealers to those investors whom they have vetted and to whom they are cleared to sell. The dealers are keen to make sure that the document accurately reflects the nature of the securities which they propose to sell to their investors. No responsible dealer would fail to review documents and fully understand the programme, and rely solely on an independent body.

Investors rely on the information memorandum when purchasing ECP. The information memorandum summarises the terms of the programme and includes a description of the issuer. On 27 October 2005, ICMA released a standard information memorandum developed by an ICMA working group involving experienced ECP practitioners and three prominent international law firms. This document is regarded as a market standard of best practice.

Frequent updates in the information memorandum are not standard in the ECP market, as the terms of the programme do not change frequently. Unnecessary updates impose costs in terms of legal fees and time, and would discourage global borrowers from participating in the European markets. Funds could easily be raised in the larger, more liquid, and more established US market and swapped into euro. Borrowers who currently use only bank borrowing will be less inclined to access short term markets, given the increase in the administrative burden.

ECP is sold by large, highly regulated financial institutions primarily to major wholesale investors who have the means and resources to make responsible investment decisions. Financial information needed to analyse borrowers' creditworthiness is readily available through company websites, rating agencies, bank research, Bloomberg, Reuters and financial media. ECP issuers are keen to satisfy investor requests for additional information, and are often open to meeting investors directly.

UCITS outside France currently invest in very large amounts of ECP without the need for some external body to oversee the production of information memoranda. If they do not like the information memorandum or trust those responsible for putting it together, they do not buy the paper.

ECP was exempted from the Prospectus Directive (as was all debt with an original maturity of under 365 days), following scrutiny by the Commission, European Parliament and CESR. An additional level of due diligence by an "independent body" is not necessary.

We therefore consider that ECP should be exempt from point 2, first bullet, 3rd indent, as a result of:

- the ECP market's track record and the high creditworthiness of ECP issuers (see annex);
- the depth of information already available and the strength of current controls over the preparation and distribution of information memoranda; and
- the precedent established by the exemption from the Prospectus Directive.

Box 8

The preamble to Box 8 is not accurate. As we have previously pointed out to CESR, the French ABCP (or ABBT) market is small, at around EUR20 billion, in comparison to the much larger ABCEP market, at around EUR130 billion. The “two-tier” structure referred to in CESR’s advice is not representative of the vast majority of programmes in this sector, and does not provide any additional protection to investors.

The investors in ABCEP are some of the most sophisticated in the market. ABCEP is their short-term financial asset of choice. They fully understand how ABCEP structures work and appreciate the safeguards and supervision which are put in place. In our experience, UCITS are seeking to increase the proportion of money they invest in this product rather than reduce it.

If ABCEP is not classified as an eligible asset, UCITS will be forced to cut purchases of ABCEP dramatically to 10% or less of their assets, limiting investment opportunities, and forcing issuers to turn to alternative sources of funding, such as the US market. Over 80% of ABCEP issued in European markets is currently sponsored by European institutions. The majority of ABCEP sponsors are major European banks, and hence regulated in their own jurisdictions.

The 19(1)(h) indent effectively bars ABCEP from being an eligible asset (outside of the 10% bucket), as ABCEP conduits (ie special purpose vehicles (SPVs)) do not publish financial information, nor do they often have EUR10 million in capital and reserves. Box 8 seeks to clarify the position, but fails to do so. We propose clarification as follows:

“Asset-backed commercial paper, issued by an SPV for the purpose of funding – either directly or indirectly – a portfolio of assets, shall be an eligible asset providing it meets the criteria of being a money market instrument, dealt in on a market which is liquid and having a value which can be accurately determined at any time. The SPV should benefit from a banking liquidity line (or some other means of assuring the liquidity of the notes which has been approved by an internationally recognised rating agency), from an entity which meets the restrictions in indents 1, 2 or 3. The programme should also be rated by at least one internationally recognised rating agency (eg Moody’s, S&P or Fitch).”

Conclusion

Most market participants will be prepared to accept some change and expense in order to assist in the development of a better pan-European market. However, if the Commission imposes too heavy a burden of regulation, ECP issuers and investors will simply use the US market instead of the EU. The hard-won progress in the development of the ECP market to date will evaporate, with the result that UCITS will be left with a far less attractive set of assets in which to invest.

I am copying this letter to Jarkko Syyrila at CESR.

Yours sincerely,

Paul Richards
International Capital Market Association

On behalf of:

Peter Eisenhardt, Bank of America (Chairman of ICMA ECP Committee)

Robert Ruisch, ABN AMRO Bank NV

Reem Tawfic, Barclays Capital

Colin Withers, Citigroup

Amaury Gosse, Commerzbank AG

Susan Hindle Barone, Credit Suisse Securities (Europe)

John Ford, Deutsche Bank AG

Alexander Stumpf, Dresdner Bank AG

Andrew Ellis, Goldman Sachs International

Jon Ford, Lehman Brothers International (Europe)

Daniel Fisher, Merrill Lynch International

Lee Harding, Morgan Stanley & Co. International

Ian Bedford, The Royal Bank of Scotland

Maria Zlotnick, Skandinaviska Enskilda Banken AB

Thomas Mallory, UBS

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ANNEX: WHY THE ECP MARKET IS IMPORTANT FOR THE EU

The Euro Commercial Paper (ECP) market is a well-functioning, competitive, high quality, professional short-term debt market which offers excellent opportunities for issuers to raise working capital and other short-term funding as well as for institutional investors to make varied and reliable short-term investments. Since 1994, there have been no defaults in the ECP market and, in the 21 year history of the market, there has not been any scandal nor accusations of improper dealing.

The ECP market has grown strongly since the introduction of the euro with EUR420 billion equivalent of short-term notes now outstanding. The compound annual growth rate since the beginning of 1999 is over 20%. The market now provides a deep and realistic alternative to the USCP market for all types of commercial enterprise seeking to access liquid and well-priced funding. It also provides a wealth of investment opportunities for the wide range of investors who have contributed to the great success of the market in recent years.

In 1999, the ECP market was just 1/9th the size of the USCP market. As a result of its growth since 1999, the ECP market is now close to 1/3rd the size of the USCP market. (CDs are not included in the US or European figures.) In other words, it has been growing towards a size which would be more representative of the relative sizes of the EU and US economies.

The dealers and issuing and paying agents in the market are a mixture of European and US investment banks, all of which are regulated by national regulators in the EU. All take their responsibilities towards investors and issuers very seriously.

Within the ECP market, asset-backed ECP (ABECP) is the fastest growing sector. ABECP has grown from virtually nil to a 31% market share over the past 5 years. ABECP is well-structured and actively reviewed by both rating agencies and dealers, and monthly investor reports are produced to keep participants abreast of developments.

ECP and ABECP borrowers are highly rated institutions. Almost 90% of ECP is rated "short term A-1/P-1-or-better", which generally equates to A1/A+ long term. All 100% of ABECP is rated A-1/P-1 (or equivalent) or better and is often A-1+/P-1, which equates to at least Aa3/AA- long term. Corporate and ABECP programmes must have backstop liquidity facilities¹ (or equivalent mechanisms) from highly-rated banks to pay off maturing CP should it not be possible to roll over the CP with investors. Bank issuers are highly regulated and have access to the interbank market and central banks for liquidity.

ABECP conduits (or special purpose vehicles (SPV)) are established usually by highly-rated banks for a limited purpose (ie funding a set of broadly defined assets), so that investors can readily evaluate their investment by reviewing information memoranda, rating agency reports and other available information. Conduits issue regular monthly "pool reports", which broadly describe current assets and verify compliance with programme requirements for the benefit of investors.

¹ For example, repo conduits, which do not have liquidity lines, as they are not deemed necessary by the rating agencies given the matched funding nature of the conduits.

UCITS represent the largest single investor group in the ECP market and play an even more significant role in the ABCEP sector. One of the most obvious obstacles to the continuing development of a harmonised short-term debt market across Europe has been the imposition on French UCITS of a 10% limit on the amount of ECP they can buy. The French UCITS are a particularly well-informed and active sector of the ECP market and are particularly active buyers of ABCEP. They would clearly prefer not to be restricted to the 10% limit so that they could obtain free access to the ECP market. ICMA and ECP market practitioners support the removal of this obstacle.