Date: 19 May 2010
Ref.: CESR/10-545

FEEDBACK STATEMENT

CESR's guidelines on a common definition of European money market funds

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Executive Summary

1. In this document CESR gives feedback on the responses received to the consultation on a common definition of European money market funds (Ref. CESR/09-850).

2. In general, respondents were broadly supportive of the approach proposed by CESR. Respondents to the consultation supported the proposal to have a common definition of European money market funds and agreed that clarification was needed. They felt that this would greatly contribute to reducing investor confusion about the risk and reward characteristics of money market funds and achieving a more integrated and transparent European market for money market funds.

3. Respondents also welcomed CESR's proposal to apply the guidelines to both UCITS money market funds and non-UCITS money market funds in order to ensure a level playing in Europe and improve investor protection.

4. CESR's two-tier approach was also supported by stakeholders who believed it had the advantage of distinguishing one type of money market fund from another in terms of risk/return profiles and investment strategies. However, some respondents expressed concerns on the names of the two categories of money market fund and asked CESR to reconsider its proposal.

5. With respect to the transitional period, most respondents considered the proposed period for existing money market funds sufficient to enable funds to comply with the definition. One stakeholder, who agreed with the principle of transitional period, thought securities purchased before 1 January 2008 should be outside the scope of the new rules and be 'grandfathered' for an unlimited period, while another respondent felt the proposed duration was too short and would have preferred at least 2 years.

Background

1. In the light of market events in 2008, CESR agreed in December of that year that better co-ordination between its members on funds in general and money market funds in particular was needed, as well as an improved understanding of the categorisation of money market funds, given the lack of a harmonised definition.

2. A review by CESR of the situation of money market funds in the EU had indicated that practice varies widely. Some Member States provide a definition or classification system in domestic law or regulation. In other jurisdictions, local industry associations have developed a definition. In the majority of cases, recognition as a money market fund requires predominant investment in money market instruments and compliance with restrictions on the maturity of investments.

3. Following its initial work, CESR developed draft guidelines, which were published for consultation in October 2009 (Ref. CESR/09-850), with a view to establishing a common definition of European money market funds. The deadline for responses was 31 December. CESR received a total of 31 responses from a range of stakeholders, including individual investment managers, associations and the European Central Bank

General comments

1. The broad support from stakeholders to the approach proposed by the Committee comforted CESR in its views to have a common definition of European money market funds.

2. Respondents expressed mixed views on the names CESR proposed for the two categories of money market fund. It was suggested by some respondents that the 'longer-term' money market funds denomination should be replaced by 'regular money market funds' or 'short term bond funds'.

3. Regarding the transitional period, most respondents considered the proposed transitional period for existing money market funds sufficient. Four investment management trade associations agreed with the general approach but proposed that all existing money market funds falling outside the agreed definition after this one year period should be regrouped in a separate category in national fund classifications, under the name 'other' money market funds. This was in order to give such funds sufficient time to change their policies in significant ways to comply with the agreed definition. However, at the latest on 30 June 2012, the funds that would continue to fall outside the agreed definition would no longer be classified as money market funds and at this time, the 'other' money market funds categories would cease to exist.

4. One management company agreed with the principle of CESR's proposal but thought that securities purchased before 1 January 2008 should be outside the scope of the new rules and be 'grandfathered' for an unlimited period. On a similar note, several other respondents felt the transitional period of one year should only apply to the WAL limits and the residual maturity limits relating to securities held before 1 January 2008.

Taking into account the support from stakeholders for the idea of having a common definition, CESR confirmed the following approach in the final guidelines:

- The guidelines will apply to both UCITS money market funds and non-UCITS money market funds;

- They will be based on a two-tier categorisation.

Regarding the names of the two categories of fund, following feedback from the consultation and after further discussions between its members, CESR decided to replace the name 'Longer-Term Money Market Funds' with 'Money Market Funds'. This takes into account the fact that the phrase 'longer-term' is not consistent with the generally recognised concept of money market funds in some jurisdictions i.e. as being short-term, relatively liquid instruments. Therefore, the two categories of European money market fund will be 'Short-Term Money Market Funds' and 'Money Market Funds'.

Concerning the transitional period, CESR saw merit in aligning the date of application of the guidelines with the transposition deadline for the revised UCITS Directive (1 July 2011). This took account of the fact that legislative changes may be needed in some Member States in order to apply the guidelines. In addition, CESR took the view that some existing money market funds may need some time to adjust to the new criteria due to the prevailing conditions in the money, bond and securitisation markets. In order to take advantage of potential improvements in market conditions in the coming years, CESR believes that existing money market funds should be granted a longer transitional period. Moreover, a more flexible transitional process may help reduce the risk of correlated sales in the market. Therefore, existing money market funds will be granted a transposition period of six months (until 31 December 2011) after the guidelines enter into force.

However, all funds that intend to operate as money market funds under the new guidelines should reflect this in their documentation from 1 July 2011 and any new investment after this date will have to comply with the guidelines; similarly, any funds that do not intend to conform (i.e. those that will cease to call themselves money market funds) should make this clear in their documentation from the original implementation date of 1 July 2011.

The guidelines on the transitional period are contained in Box 4 of the final guidelines.

Short-Term Money Market Funds

1. CESR asked for stakeholders' views on the proposed criteria for the definition of Short-Term Money Market Funds. Respondents expressed the following concerns or suggestions:

    - The requirement of daily liquidity should be interpreted in the sense of allowing investors to redeem their units daily, whereas the actual payment should be made according to the standard settlement terms as established in every country.

    - One respondent suggested that Short-Term Money Market Funds should comply with the following two portfolio liquidity requirements:

        - a minimum of 5% of the fund's asset must be held in cash, Treasury securities, or other securities and repurchase agreements that would be accessible within one day; and

        - at least 20% of the fund's assets should be held in cash, Treasury securities, or other securities that would be accessible within seven days.

    - One respondent felt that Short-Term Money Market Funds should not be able to invest in other investment funds as this could present a potential source of systemic risk.

    - One stakeholder believed that CESR should include the requirement that money market funds should perform stress-testing.

    - One respondent felt that Short-Term Money Market Funds should not be allowed to have a constant net asset value (NAV) because there may be a perception that such funds carry an implicit guarantee of support from the fund provider.

2. CESR consulted also on a set of specific criteria with which Short-Term Money Market Funds should comply. Respondents made the following points in this context.

    Weighted Average Life (WAL)

    Mixed views were expressed in relation to the WAL limit: 8 respondents considered option 3B (3 months) appropriate while 9 respondents favoured option 3A (120 days). Some stakeholders proposed a limit of 6 months.

    Calculation of the WAL

    In relation to the calculation of the WAL, CESR asked for stakeholders' views on the possibility to take into account structured financial instruments either through (i) their expected average life or (ii) their legal final maturity. A majority of respondents (10) expressed a preference for the first option while 6 stakeholders favoured the second option. Some respondents suggested that for puttable instruments, the exercise date would be more appropriate.

    Weighted Average Maturity (WAM)

A majority of respondents expressed a preference for a WAM limit of 60 days as proposed by CESR, while only a few suggested other limits (90 days, 45 days or 75 days).

Maturity of the securities

In relation to the maturity of the securities for Short-Term Money Market Funds, views were broadly split between the two options. 11 respondents were of the view that Short-Term Money Market Funds should be allowed to invest up to 10 per cent of their assets in floating rate securities with a legal maturity or residual maturity of between 397 days and 2 years, provided that the time remaining until the next interest rate reset date is less than 397 days (option 2A), while 9 respondents felt that Short-Term Money Market Funds should invest in securities with a maturity of less than 397 days (option 2B).

Investment in structured financial instruments

According to a clear majority of respondents composed of investment managers and trade associations, investment in structured financial instruments should not be prohibited on the basis that a significant source of liquidity in the market for structured financial instruments and asset-backed commercial paper would otherwise disappear.

However, a minority of respondents (4) representing investors and associations of financial advisors were of the view that Short-Term Money Market Funds should be prohibited from investing in structured financial instruments, or should be limited in some way e.g. such instruments should have a maximum legal maturity of 1 year, or represent no more than 5 per cent of the fund's assets.

Investment in securities denominated in foreign currencies

CESR sought stakeholders' views on the necessity for Short-Term Money Market Funds to limit the extent to which they invest in or are exposed to securities not denominated in their base currency.

According to a clear majority of respondents, investment in securities denominated in foreign currencies should not be limited provided that the positions were fully hedged. A minority of respondents were of the view that investment in securities not denominated in the fund's base currency should not be allowed.

Credit quality of the instruments

CESR proposed in the consultation paper that Short-Term Money Market Funds should invest in high quality money market instruments and sought stakeholders' views on two options for how this criterion could be assessed.

According to the first option (option 1A), a money market instrument would be considered to be of high quality if it had been awarded the highest available credit rating by each recognised rating agency which has rated that instrument, or it is of a comparable credit quality, as determined by the management company or self-managed investment company, if not rated. According to the second option (option 1B) an instrument would be considered to be of high quality if it had, at a minimum, been awarded the highest available credit rating by each recognised rating agency which has rated that instrument. An instrument which is not rated by any recognised rating agency would not be considered to be of a high quality.

A majority of respondents disagreed with option 1B on the basis that it would introduce a prohibition on instruments which have not been rated by any recognized agency. Some of the stakeholders that favoured option 1B suggested that in the case of non-rated instruments, the assessment of the credit quality should be carried out by an external body that is independent from the management company.

Respondents also made it clear that in assessing the quality of a money market instrument, the management company must consider others factors in addition to the credit rating of the instrument, such as the nature of the assets and their liquidity.

Several respondents believed that the ratings allowed under the definition of 'high quality money market instrument' should include 'investment grade'.

WAL Limit

On the WAL limit, CESR decided to keep the option 3A with a 120 day limit taking into account the feedback from stakeholders.

Calculation of the WAL

For the calculation of the WAL, CESR noted that the majority of respondents favoured the use of the expected maturity. Nevertheless, CESR felt it would be more appropriate to require a calculation based on the legal final maturity (i.e. the residual maturity until the legal redemption date) of structured financial instruments, since this is the only date by which the management company can be certain that the instrument will have been reimbursed.

However, CESR saw merit in taking into account the characteristics of financial instruments that embed a put option by allowing the exercise date of the option to be used in the WAL calculation, provided that certain specific criteria are respected at all times by the financial instruments (see paragraph 9 of Box 2 of CESR's Guidelines).

WAM Limit

In line with the views expressed by the majority of respondents, CESR decided to fix a WAM limit at 60 days.

Maturity of the securities

Concerning the maturity of securities in which Short-Term Money Market Funds can invest, CESR chose to set a limit of 397 days (option 2B). Therefore, when a Short-Term Money Market Fund invests in securities, including structured financial instruments, the residual maturity until the legal redemption date must be less than 397 days.

Investment in structured financial instruments

While noting the concerns expressed by some respondents, CESR retained option 4A in the final guidelines (i.e. allowing investment in structured financial instruments). In line with the views expressed by the majority of respondents, CESR took the view that a prohibition would have been disproportionate and that the risks posed by such instruments should be mitigated by the other criteria set out in the guidelines.

Investment in securities denominated in foreign currencies

CESR saw merit in aligning itself with the views of the majority of respondents that Short-Term Money Market Funds should be permitted to invest in securities denominated in foreign currencies, provided that the positions are fully hedged. However, CESR made it clear that all risks incurred by these investments, such as interest rate risk on a foreign market, must be appropriately disclosed to investors in the prospectus of the fund.

Credit quality of the instruments

In this area, CESR shared the opinion expressed by some respondents that over-reliance on credit ratings should be avoided while recognizing they have a certain role to play. Therefore, CESR has prescribed in the final guidelines that the credit quality is only one of the elements that should be taken into account when assessing the quality of an instrument and that the responsibility for the assessment of the quality of money market instruments lies with the management company.

For the purposes of the assessment of the credit quality, the guidelines make clear that money market funds should consider as high quality money market instruments only instruments that have been awarded one of the two highest available short-term credit ratings by each recognized credit rating agency that has rated the instrument or, if the instrument is not rated, it is of an equivalent quality as determined by the management company's internal rating process.

Daily liquidity and settlement date

CESR agreed with respondents who stated that requirements on settlement could be addressed at a national level according to local practices. However, CESR expects that for UCITS money market funds, settlement should not exceed T+3.

In addition, CESR notes that the requirement for daily subscription and redemption of units may be inconsistent with the functioning of some non-UCITS money market funds marketed through employee savings schemes, in which investments are made on a long-term basis. Therefore, a non-UCITS money market fund marketed through an employee savings scheme may provide weekly subscription and redemption opportunities to investors in accordance with its home state regulation.

Constant or fluctuating NAV

In line with the broad support from stakeholders for its proposal, CESR has confirmed in the guidelines that Short-Term Money Market Funds should be allowed to have a constant NAV.

However, as set out in CESR's guidelines concerning eligible assets for investment by UCITS (Ref. CESR/07-044b), strict requirements should apply to credit quality, sensitivity to market parameters, diversification and maturity of these holdings and the portfolio must be marked to market on a regular basis.

Money Market Funds[1]

1. CESR asked for stakeholders' views on the proposed criteria for the second category of money market fund. A number of general comments were made by respondents, including that there should be greater flexibility for longer-term money market funds in order to differentiate sufficiently between the two categories. These respondents felt this would give fund managers a wider range of possibilities and would avoid confusing investors by having two categories of money market fund with very similar risk and reward profiles. A similar comment was made on the specific issue of daily liquidity.

2. Respondents made the following points on the criteria CESR proposed for Money Market Funds.

   WAL Limit

   Some respondents were strongly in favour of having a WAL limit of 12 months, while some even suggested expanding this limit to 1½ years in order to make a sufficient distinction between the two categories of fund.

[1] As set out above, in the guidelines published for consultation the second category of money market fund was named 'Longer-Term Money Market Fund'. This has now been changed to 'Money Market Fund'.

Calculation of the WAL

Respondents' views on this point were in line with those expressed on calculation of WAL for Short-Term Money Market Funds i.e. there was a consensus in favour of using the expected maturity rather than the legal maturity.

WAM Limit

There were mixed views among respondents in relation to the WAM limit: 11 respondents felt the limit was too low and should be increased to 1 year while 6 respondents agreed with the proposed limit of 6 months.

Maturity of the securities

With respect to the maturity of the securities CESR asked whether an investment up to 10% of assets in floating rate securities with a legal maturity or residual maturity of more than 2 years would be appropriate, provided that the time remaining until the next interest rate reset is less than 397 days.

It was suggested by some respondents that money market funds should be allowed to invest 10% of assets in securities with a legal or residual maturity longer than 2 years but with a limit of 5 years. Other respondents suggested that the percentage should be raised to 15% of the assets and without any limitation on the maturity. Several stakeholders felt the limit on the interest rate reset was too restrictive and requested an extension to 720 days, or proposed to raise the limit from 10% to 50%.

Investment in securities denominated in foreign currencies

Respondents' views on this point were in line with those expressed on the same issue in the context of Short-Term Money Market Funds.

Credit quality of the instruments

A majority of respondents took the view that Money Market Funds should be able to invest in securities rated at least investment grade, while stressing that over-reliance on credit ratings should be avoided.

Constant or fluctuating NAV

Most respondents were not in favour of allowing Money Market Funds to have a constant NAV.

WAL Limit

Due to the broad support for option 1A, CESR decided to prescribe a WAL limit of 12 months for Money Market Funds.

Calculation of the WAL

CESR took the same approach as it adopted for Short-Term Money Market Funds regarding the calculation methodology for the WAL i.e. it should be based on the residual maturity until the legal redemption date.

WAM Limit

CESR reflected carefully on the suggestion made by some respondents to have a WAM limit of

1 year but considered it more appropriate to have a 6-month limit, together with a WAL limit of 12 months.

Maturity of the securities

CESR came to the conclusion that the 10% restriction in securities with a final maturity or residual maturity between 397 days and 2 years could be considered superfluous given the other criteria in the guidelines. In particular, the fact that the WAL of Money Market Funds must not exceed 1 year would automatically restrict funds in their ability to invest in instruments with a maturity of more than 1 year.

Therefore, CESR decided to prescribe in its guidelines that Money Market Funds can invest in securities with a residual maturity until the legal redemption date of less than or equal to 2 years, provided that the time remaining until the next interest rate reset date is less than or equal to 397 days.

Investment in structured financial instruments

Taking into account the views expressed by the majority of respondents, particularly fund managers and investment management associations, CESR retained option 4A in the final guidelines (under which the maturity calculation when calculating the WAL for floating rate securities must be based on the residual maturity until the legal redemption date).

Investment in securities denominated in foreign currencies

CESR adopted the same approach in this context as for Short-Term Money Market Funds.

Credit quality of the instruments

Concerning the credit quality of eligible instruments for Money Market Funds, CESR adopted the same approach as for Short-Term Money Market Funds with the exception that a Money Market Fund may hold sovereign issuance of at least investment grade quality. CESR introduced this provision taking into account the possible difficulties that would arise for funds based in certain Member States if they were no longer able to invest in the sovereign debt of that jurisdiction, and the need for financing of short-term sovereign debt across the EU.

Daily liquidity and settlement date

The approach taken in the final guidelines is consistent for both Short-Term Money Market Funds and Money Market Funds.

Constant or fluctuating NAV

In line with the general reluctance among respondents to allow Money Market Funds to have a constant NAV, CESR excluded this possibility in the final guidelines.

Annex 1 – List of respondents

	Name of respondent
1.	ALFI
2.	Association Française des Trésoriers d'Entreprise
3.	The Swedish Investment Fund Association
4.	Natixis Asset Management
5.	JP Morgan Asset Management
6.	CCR Asset Management
7.	Acer Finance
8.	Associazione Nazionale Promotori Finanziari
9.	Irish Funds Industry Association
10.	Financial Services Consumer Panel
11.	Investment Company Institute
12.	Inverco
13.	Bundersverband Investment und Asset Management
14.	CNMV's Advisory Committee
15.	International Capital Market Association
16.	Austrian Federal Economic Chamber
17.	Crane Data
18.	CPR Asset Management
19.	Association Française des Investisseurs Institutionnels
20.	Aberdeen Asset Management
21.	CFA Institute
22.	Investment Management Association
23.	SWIP
24.	Czech National Bank
25.	European Central Bank

26.	Aviva Investors
27.	EFAMA/IMMFA
28.	Invesco
29.	Association Française de la Gestion Financière
30.	Santander Asset Management
31.	Raiffeisen Capital Management