The Committee of European Securities Regulators
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21st December 2009

A Common Definition of European Money Market Funds – Consultation Paper

The CFA Institute Centre for Financial Market Integrity ("CFA Institute Centre") welcomes the opportunity to comment on the Committee of European Securities Regulators ("CESR") consultation on "A common definition of European money market funds" (the "Consultation").

The CFA Institute Centre[1] promotes fair, open, and transparent global capital markets, and advocates for investors' protection. We appreciate CESR's efforts to examine the issues related to European money market funds. Tensions in money markets related to systemic market events in the autumn of 2008, exacerbated by illiquidity in certain money market instruments and investor redemption requests, revealed a degree of risk inherent in money market funds that was not readily apparent to, or was poorly understood by, retail investors.

These events underline the need for improved product disclosures and clearer information to protect the interests of investors in money market funds. Accordingly, we welcome CESR's efforts to establish a common definition of money market funds throughout Europe.

Executive Summary

The Consultation proposes a two-tiered approach to the definition of a European money market fund. The definition classifies such funds which as either 'short-term' or 'longer-term' according to the portfolio duration.[2]

- CFA Institute Centre supports efforts to clarify the definition of a money market fund. A clearer definition would enable investors to better understand the product risks, and thus determine whether allocating cash to such funds is an appropriate alternative to bank deposits (or other similar saving facilities or investment schemes). Defining such funds as

[1] The CFA Institute Centre develops, promulgates, and maintains the highest ethical standards for the investment community, including the CFA Institute Code of Ethics and Standards of Professional Conduct, Global Investment Performance Standards ("GIPS®"), and the Asset Manager Code of Professional Conduct ("AMC"). It represents the views of investment professionals and investors before standard setters, regulatory authorities, and legislative bodies worldwide on issues that affect the practice of financial analysis and investment management, education and licensing requirements for investment professionals, and the transparency and integrity of global financial markets.
[2] The sensitivity of the value of the fund to changes in interest rates. See question 4 for details.

either 'short-term' or 'longer-term' captures the interest rate risk profile of the fund, which is the most relevant risk measure for investors in these products. Such segmentation also illustrates that money market funds do not have homogeneous risks.

- We also support the use of the money market fund definition contained within the Markets in Financial Instruments Directive as the basis for a common definition of a European money market fund.

- CFA Institute Centre agrees that the definition should apply to all European money market funds (UCITS or otherwise), in order to ensure a level playing field for both investors and product providers. A standard definition encourages competition amongst product providers, which should lower costs to the end investor.

- We broadly agree with the specific criteria for the definitions of both short-term and longer-term money market funds, as set out in Appendix 1 of the Consultation. The criteria should be sufficient to capture all relevant risks. Further details are provided in our responses to questions 7 through 19.

- CFA Institute Centre believes that the criteria for the Weighted Average Life for both short-term and longer-term money market funds should be based on option A (the longer of the two options. Refer to questions 9 and 16). This would allow greater flexibility for both managers and fund investors, who would benefit from greater investment choice without suffering a material increase in the risk profile of the fund.

- We believe that both short-term and longer-term money market funds should not be exposed to securities not denominated in the base currency of the fund. Foreign currency exposure represents a source of volatility that poses a risk to the primary objective of a stable net asset value (or capital preservation). Investors seeking foreign currency exposure should simply select money market funds denominated in other currencies.

- For short-term money market funds, we oppose the option contained in the definition that would, in effect, prohibit investment in securities not rated by a credit rating agency. This option would entrench the use of credit ratings in both the investment policy of the fund and in regulation, which would contradict the wider regulatory objective (as part of the package of regulatory reforms of credit rating agencies) to reduce the reliance on credit ratings. Such a move would also contradict international efforts, such as those in the United States, to remove references to credit ratings in regulation where applicable.

- We do not believe that longer-term money market funds should have the ability to have a constant net asset value. These funds are redeemable upon demand and therefore should reflect current value; namely, the value that investors should expect to receive if they were to liquidate their holdings on any given day. A constant NAV would mask the underlying economic exposure of the fund and could potentially mislead investors by providing them with (false) assurance that their capital is guaranteed. This could obfuscate investors' decision making processes as regards to the choice to invest in money market funds over the alternative of placing cash on deposit. In our view, fair value (or a

fluctuating NAV) is the most transparent valuation method, and is therefore most appropriate for investors' protection.

We attach our response that addresses the specific questions of the Consultation. Please do not hesitate to contact us should you wish to discuss any of the points raised.

Yours faithfully,

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The CFA Institute Centre is part of CFA Institute[3]. With headquarters in Charlottesville, VA, and regional offices in New York, Hong Kong, London and Brussels, CFA Institute is a global, not-for-profit professional association of more than 100,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 139 countries, of whom more than 88,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 136 member societies in 57 countries and territories.

Specific Comments

1. Do you agree that such clarification is desirable?

The Consultation notes that there are two existing definitions of a money market fund in European regulation. The first definition was established by the European Central Bank for statistical purposes. The second definition was established by the Markets in Financial Instruments Directive (MiFID), set out in the level 2 directive.

The Consultation proposes to use the MiFID definition as the basis for a common definition of European money market funds, supplementing it with additional clarification in certain areas. Specifically, the Consultation proposes a two-tiered approach that categorises money market funds as either 'short-term' or 'longer-term', according to the portfolio duration. There is also additional clarification on the use of derivatives as compared with the MiFID definition.

CFA Institute Centre supports these efforts to clarify the definition of a money market fund, based on the definition provided under MiFID. Firstly, the acute money market stress witnessed in 2008, along with the large volume of fund redemptions, highlight an insufficient appreciation of the risks inherent in money market funds by investors. These events underscore the need for a clearer and more detailed definition of money market funds so that investors can better understand the product characteristics and hence make more informed investment choices. In particular, a clearer definition would enable investors to better determine whether allocating cash to such funds is an appropriate alternative to bank deposits (or other similar saving facilities or investment schemes), having regard to the individual's risk and return preferences.

Secondly, the MiFID definition of a money market fund provides a sound basis on which to establish a common definition that is clear and readily understood. Use of the MiFID definition mitigates the risk of creating a new regulatory concept that may conflict with existing legislation and/or may be cumbersome to introduce.

2. Do you agree with the proposal to have a common definition of European money market funds? If not, please explain why.

We agree with the proposal – please see response to question 1.

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[3] CFA Institute is best known for developing and administrating the Chartered Financial Analyst curriculum and examinations and issuing the CFA Charter.

A common definition would also harmonise investor protections and help ensure that fund investors are treated fairly throughout Europe.

3. Do you agree with the proposal to apply the definition to harmonised (UCITS) and non-harmonised European money market funds?

The Consultation proposes that the definition should apply to UCITS funds as well as non-UCITS money market funds that are authorised by Member States. We agree with this proposal. The definition should apply to all European money market funds (UCITS or otherwise) in order to ensure a level playing field for both investors and product providers.

A standard definition across all money market funds (UCITS or non-UCITS) encourages competition amongst product providers, which should lower costs to the end investor. Further, a standard definition would improve product transparency and mitigate the scope for regulatory arbitrage.

4. Do you agree with the proposed two-tier approach?

CESR's proposed definition distinguishes between 'short-term' and 'longer-term' money market funds, based on the Weighted Average Maturity (WAM)[4] and Weighted Average Life (WAL)[5] of the fund. Short-term money market funds have a very short duration[6] compared with longer-term funds.

CFA Institute Centre believes that segmenting the definition according to duration is appropriate. Duration, in this case represented by WAM, is a measure of interest rate risk. Since money market funds are designed to provide capital preservation (alongside a steady income stream), interest rate risk – the risk of changes in the value of the fund in response to changes in interest rates – is the most relevant measure of risk for investors.

Further, distinguishing funds between short-term and longer-term provides greater clarity over the degree of heterogeneity within fund portfolios. Specifically, such segmentation illustrates that money market funds do not have homogeneous risks. It therefore helps investors better understand how these products differ from bank deposits.

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[4] The Consultation defines WAM in Appendix 1 as "a measure of the length of time to maturity of all of the underlying securities in the fund weighted to reflect the relative holdings in each instrument, assuming that the maturity of a floating rate instrument is the time remaining until the next interest rate reset, rather than the time remaining before the principal value of the security must be repaid. In practice, WAM is used to measure the sensitivity of a money market fund to changing interest rates. The sensitivity to changes in interest rates is also commonly known as 'modified duration'."

[5] The Consultation defines WAL in Appendix 1 as "the weighted average of the remaining life (maturity) of each security held in a fund, meaning the average time until the principal is repaid in full (disregarding interest and not discounting). Contrary to what is done in the calculation of WAM, the calculation of the WAL for floating rate securities and structured financial instruments does not permit the use of interest rate reset dates and instead only uses a security's stated (legal) final maturity. WAL is used to measure the credit risk, as the longer the reimbursement of principal is postponed, the higher is the credit risk."

[6] Portfolios with short duration are relatively less sensitive to changes in interest rates.

5. **Do you have any alternative suggestions?**

We have no alternative comments.

6. **Do you consider that the proposed transitional period for existing money market funds is sufficient to enable funds to comply with the definition?**

The Consultation proposes that money market funds would have a transitional period of 12 months after the introduction of the new definition (which will be introduced via Level 3 CESR guidelines) to comply. Funds that do not comply with the new criteria after this period would no longer be able to market themselves as money market funds.

We believe that a period of 12 months would be sufficient to enable funds to comply. The new definition would require the updating of marketing materials, fund prospectuses, the (forthcoming) Key Information Document, fund reports, and so forth. Operationally there should be little impact on the running of the fund. We are not aware of any reasons why 12 months would be insufficient to implement these changes.

Appendix 1

Short-Term Money Market Funds

The detailed definition of a short-term money market fund is set out in Appendix 1 of the Consultation. The definition has been reproduced in Box A on page 14 of this paper. To summarise, the main features of this definition require a short-term money market fund:

- To be authorised under the UCITS directive or authorised by an authority under national law and be subject to supervision;
- To have a constant or fluctuating net asset value;
- To have the primary investment objective of maintaining the net asset value of the fund;
- To invest in money market instruments of high credit quality (explicitly defined[7]) or in deposits with credit institutions;
- In assessing the quality of money market instruments the management company must consider factors in addition to the credit rating of the instrument;
- To limit investment in securities to those with a legal maturity or residual maturity of less than a specified time period (explicitly defined);
- To provide daily liquidity through same day or next day settlement;
- To have a WAM of no more than 60 days;
- To have a WAL of no more than a specified number of days or months (explicitly defined);
- To calculate WAL for structured finance instruments under certain conditions (explicitly defined) or to not invest in such instruments (see question 10);
- To comply with the criteria for money market instruments and eligible assets as set out under existing legislation and guidance;

[7] The consultation provides optional definitions in each case referred to. The options are the subject of the subsequent consultation questions.

- To not take direct exposure to equities or commodities, including via derivatives, and to only use derivatives in line with the strategy of the fund. Derivatives giving rise to foreign currency exposure may only be used for hedging purposes;
- To limit investment in other investment funds to those that comply with the definition of a short-term money market fund; and
- To have an appropriate risk management function, that takes a prudent approach to the management of currency, credit, interest rate and liquidity risk, and which incorporates a proactive stress-testing regime.

7. Do you agree with the proposed criteria for the definition of short-term money market funds?

Broadly, we agree with the proposed criteria, with one exception. We do not believe that short-term money market funds should be able to invest in other investment funds, as would be permitted under the penultimate bullet point in the definition. Portfolio exposure to other money market funds presents a potential source of systemic risk propagation.

In order to protect the safety and viability of these funds, we recommend restricting the portfolio to direct investment in a diversified portfolio of cash and money market instruments. We recommend amending the definition in accordance with these suggestions.

Our other specific comments are set out in the responses to questions 9 through 12.

8. Do you have alternative suggestions?

We have no alternative comments beyond those cited in the response to question 7.

9. Do you think that the proposed criteria adequately capture the risks attaching to such funds, in particular currency, interest rate, credit and liquidity risk? In particular:

- **Do you consider that Option 3A (120 days) or Option B (3 months) is more appropriate for the WAL limit? Should it be lower or higher?**
- **Subject to your views on question 10 below, would you recommend taking structured financial instruments into account in the WAL calculation through their expected average life[8], or through their legal final maturity?**
- **Do you consider that the WAM limit of 60 days is appropriate? Should it be lower or higher?**
- **In relation to investments in securities, do you agree with Option 2A (allowing investment of up to 10 percent of 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) or Option 2B (limiting investment in securities to those with a legal maturity or residual maturity of less than 397 days)?**

[8] Excluding any option exercise or mechanism that cannot be triggered at the fund's sole discretion.

Broadly, we agree that the proposed criteria are adequate to capture all relevant risks. We make the following specific observations, corresponding to the above bullet points:

- The essence of the proposal specified by Option 3A is to limit the WAL of the fund to one-third of a year, and for Option 3B, to limit the WAL to one-quarter of a year. We believe that Option 3A would be most appropriate, on the basis that it permits greater flexibility without materially increasing the interest rate risk profile of the fund. Indeed, Option 3B may exclude certain short-term government securities that would otherwise be eligible for investment in the fund and that would not materially contribute to an increase in risk. Option 3A would therefore provide managers with greater flexibility and investors with greater choice.

  In our view, it may be more appropriate to specify Option 3A as 4 months as opposed to 120 days. This permits greater flexibility without changing the substance of the proposal. For example, different types of securities accrue interest according to different day-count conventions[9]. Thus, securities using 'Actual' in the numerator of the day-count convention (for example, certain government bills and some commercial paper) may be ineligible for investment under Option 3A as drafted if they have a 4 month maturity amounting to (for example) 123 days. This would run counter to the intention of the proposal.

- We believe it is more appropriate for the WAL calculation for structured finance securities to be based on the legal final maturity. This would provide consistency and comparability with the WAL calculation for other securities, and would minimise any need for subjective inputs and/or assumptions in the calculation.

- The definition proposes to limit the WAM (or duration) of the fund to 60 days. We are not aware of any reason that 60 days would be inappropriate for a 'short-term money market fund'.

- We favour Option 2B. In our view, it is inappropriate for short-term money market funds to have assets that exceed a year to maturity.

10. In relation to the proposed requirements regarding structured financial instruments, do you prefer Option 4A or Option 4B above?

Option 4A would require the WAL calculation for floating rate securities, including structured financial instruments, to be based on the stated 'legal final maturity'. Option 4B would instead prohibit investment in structured financial instruments or asset-backed commercial paper (ABCP).

CFA Institute Centre favours Option 4A. Firstly, as noted in the response to question 9, we believe that it is appropriate to base the WAL calculation on the legal final maturity. Secondly, if short-term money market funds were prohibited from investing in such

[9] For example, day-count conventions include 30/360 (which assumes an equal 30 days in each month and a year of 360 days), Actual/360 (the actual number of days since the last coupon payment or interest rate reset date divided by 360 days), Actual/365, and Actual/Actual.

instruments, a potentially significant source of liquidity in the markets for structured finance instruments and ABCP would disappear. This could exacerbate illiquidity and valuation difficulties in these markets. Moreover, the withdrawal of these funds could have unintended adverse consequences for the wider funding markets, and could increase the cost of capital. Removal of a source of liquidity in such short-term instruments may force issuers to raise a greater proportion of capital from longer-term debt instruments, which by virtue of their longer duration carry a higher interest cost.

11. **In relation to currency exposure, do you think that short-term money market funds should limit the extent to which they invest in or are exposed to securities not denominated in their base currency?**

Foreign currency exposure represents a source of return volatility. In other words, currency exposure is a source of risk to the investment objective of capital preservation. This risk can be significant in funds where a material portion of the portfolio is exposed to foreign currency fluctuations. Accordingly, we believe that short-term money market funds should not be exposed to securities not denominated in the base currency of the fund. Should an investor wish to gain exposure to foreign currency, he could simply select those money market funds that are denominated in the currency of his choice.

Equally, it would be undesirable for the fund to enter into a significant volume of foreign currency derivatives to hedge any currency risk in the portfolio. The use of derivatives is counter-intuitive for a short-term investment product designed to preserve capital.

12. **In relation to the proposed requirements on ratings of instruments, do you prefer Option 1A or Option 1B above? In this context, do you believe that a money market instrument should be considered of high quality if the issuer of the instrument has been awarded the highest possible credit rating, even if the instrument itself has not been rated?**

Under Option 1A, short-term money market funds must:

"Invest in high quality money market instruments or deposits with credit institutions. A money market instrument will be considered to be of high quality if it has been awarded the highest available credit rating by each recognised rating agency which has rated that instrument, or if it is of a comparable credit quality, as determined by the management company or self-managed investment company, if not rated."

Option 1B would require short-term money market funds to:

"Invest in high quality money market instruments or deposits with credit institutions. A money market instrument will be considered to be of high quality if it has, 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 shall not be considered to be of a high quality."

CFA Institute Centre favours Option 1A, conditional on the inclusion of the subsequent bullet point in the proposed definition that "In assessing the quality of a money market instrument in which the money market fund invests, the management company or self-managed investment company must consider other factors in addition to the credit rating of the instrument."

We do not support Option 1B on the basis that limiting investment to rated instruments entrenches the use of credit ratings in both the investment policy of the fund and in regulation. This contradicts the wider regulatory objective (as part of the package of regulatory reforms of credit rating agencies) to reduce the reliance on credit ratings[10]. This also contradicts international efforts, such as those in the United States, to remove references to credit ratings in regulation where applicable.

The initiative to reduce excessive reliance on credit ratings also emphasises the importance (in the subsequent bullet point of the definition) for managers to consider other factors in addition to credit ratings when assessing the quality of an instrument.

In response to the second part of the question, we do not believe that it is sufficient to consider a money market instrument 'high quality' on the basis that the issuer of the instrument has been awarded the highest possible credit rating. In our view, it is not appropriate to infer the credit risk of an instrument from the creditworthiness of the issuer. The credit risk of an instrument is a function of its specific characteristics, such as its structure, underlying assets, cash flows, legal framework, and so forth. The credit risk of the issuer does not necessarily transfer linearly to the credit risk of the instrument.

Longer-Term Money Market Funds

The detailed definition of a longer-term money market fund is set out in Appendix 1 of the Consultation. The definition has been reproduced in Box B on page 16 of this paper. To summarise, the main features of this definition require a longer-term money market fund:

- To be authorised under the UCITS directive or authorised by an authority under national law and be subject to supervision;
- To have the primary objective of capital preservation;
- To have a fluctuating net asset value;
- To invest in money market instruments of high credit quality[11] or in deposits with credit institutions;
- In assessing the quality of money market instruments the management company must consider factors in addition to the credit rating of the instrument;

[10] CFA Institute Centre has expressed its support for reducing the reliance on credit ratings in its 2008 comment letter to the European Commission: http://www.cfainstitute.org/centre/topics/comment/2008/pdf/080905_2.pdf .

[11] In this case, the definition is consistent with Option 1A previously discussed, namely that "A money market instrument will be considered to be of high quality if it has been awarded the highest available credit rating by each recognised rating agency which has rated that instrument, or if it is of a comparable credit quality, as determined by the management company or self-managed investment company, if not rated."

- To limit investment in securities to those with a legal maturity or residual maturity of less than 397 days. It may also invest up to a maximum of 10 percent of assets in floating rate securities with a legal maturity or residual maturity of between 397 days and 2 years under certain conditions;
- To provide daily liquidity through same day or next day settlement;
- To have a WAM of no more than 6 months;
- To have a WAL of no more than a 6 months or 12 months (see question 16);
- To calculate the WAL for floating rate instruments including structured finance instruments based on the legal final maturity of the instrument;
- To comply with the criteria for money market instruments and eligible assets as set out under existing legislation and guidance;
- To not take direct exposure to equities or commodities, including via derivatives, and to only use derivatives in line with the strategy of the fund. Derivatives giving rise to foreign currency exposure may only be used for hedging purposes;
- To limit investment in other investment funds to those that comply with the definition of a short-term money market fund or a longer-term money market fund;
- To have an appropriate risk management function, that takes a prudent approach to the management of currency, credit, interest rate and liquidity risk, and which incorporates a proactive stress-testing regime; and
- To provide information to investors on the impact of the longer duration on the risk profile.

13. Do you agree with the proposed criteria for the definition of longer-term money market funds?

Broadly, we agree with the proposed criteria, with one exception. We do not believe that longer-term money market funds should be able to invest in other investment funds. Please reference our response to question 7.

Our other specific comments are set out in the responses to questions 15 through 19.

14. Do you have alternative suggestions?

We have no alternative comments beyond those cited in the response to question 13.

15. Do you think that the proposed criteria adequately capture the risks attaching to such funds, in particular currency, interest rate, credit and liquidity risk?

We agree that the proposed criteria are adequate to capture all relevant risks.

16. In particular:

- **In relation to the WAL limit, do you consider that Option 1A (12 months) or Option 1B (6 months) is appropriate? Should it be lower or higher?**

- **Would you recommend taking structured financial instruments into account in the WAL calculation through their expected average life[12], or through their legal final maturity?**
- **Do you consider that the WAM limit of 6 months is appropriate? Should it be lower or higher? Can this criterion be expressed in terms of interest rate sensitivity (corresponding limit set at 0.5)?**
- **In relation to investments in securities, do you believe that investment of up to 10 percent 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 date is less than 397 days?**

Our specific comments are as follows:

- We believe that Option 1A would be most appropriate, on the basis that it permits greater flexibility for both managers and fund investors, who would benefit from greater choice. If an investor determined that a WAL of 12 months was too long (having regard to their individual risk and return preferences), he could simply invest in a short-term money market fund instead.

- We believe it is more appropriate for the WAL calculation for structured finance securities to be based on the legal final maturity. This would provide consistency and comparability with the WAL calculation for other securities, and would minimise any need for subjective inputs and/or assumptions in the calculation.

- We are not aware of any reason that 6 months would be inappropriate for a 'longer-term money market fund'. It may be appropriate to express this limit as 0.5, provided that investors are informed how to interpret this number and what it represents, via clear and prominent disclosures in all relevant investment literature.

- We do not have an opinion on the appropriateness of the proposal specified in the fourth bullet point.

17. In relation to currency exposure, do you think that longer-term money market funds should limit the extent to which they invest in or are exposed to securities not denominated in their base currency?

We believe that money market funds should not be exposed to securities not denominated in the base currency of the fund. Please refer to our response to question 11.

The investment objective of capital preservation is consistent amongst the definitions for both short-term and longer-term money market funds; therefore we see no reason to differentiate foreign currency exposure limits between the two types of funds.

[12] Excluding any option exercise or mechanism that cannot be triggered at the fund's sole discretion.

18. Do you think that longer-term money market funds should have the ability to invest in lower-rated securities?

We are unable to comment on this proposal.

19. Do you consider that a longer-term money market fund should have the ability to have a constant NAV?

We do not believe that longer-term money market funds should have a constant NAV.

Unless the fund only holds cash deposits, which have no scope for capital appreciation or depreciation, a constant NAV hides the true (albeit small) credit and interest rate risks from investors. If there were a fixed holding period – to the extent that investors' expected time horizon exactly matched the maturity of the assets, which would redeem at par – then it may be reasonable to employ a constant NAV. However, given that these funds are redeemable upon demand (by definition, they must provide daily liquidity), they should reflect current value; namely, the value that investors should expect to receive if they were to liquidate their holdings on any given day. A constant NAV would mask the underlying economic exposure of the fund, and could potentially mislead investors by providing them with (false) assurance that their capital is guaranteed. Further, a constant NAV could obfuscate investors' decision making processes as regards to the choice to invest in money market funds over the alternative of placing cash on deposit. A constant NAV could lead investors to believe that the two products are the same, when they are inherently different.

In our view, fair value (or a fluctuating NAV) is the most transparent valuation method, and is therefore most appropriate for investors' protection.

21st December 2009

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Box A

Short-Term Money Market Fund: Definition

"A money market fund must indicate in its prospectus and, in the case of UCITS, the KII whether it is a **Short-Term Money Market Fund** or a **Longer-Term Money Market Fund**.

A Short-Term Money Market Fund may have a constant or fluctuating net asset value and must:

- Be a collective investment undertaking authorised under Directive 2009/65/EC, or which is authorised by an authority under the national law of a Member State and which is subject to supervision.

- Have the primary investment objective of maintaining the net asset value of the undertaking.

Option 1A

- Invest in high quality money market instruments or deposits with credit institutions. A money market instrument will be considered to be of high quality if it has 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.

OR

Option 1B

- Invest in high quality money market instruments or deposits with credit institutions. A money market instrument will be considered to be of high quality if it has, 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 shall not be considered to be of a high quality.

- In assessing the quality of a money market instrument in which the money market fund invests, the management company or self-managed investment company must consider other factors in addition to the credit rating of the instrument. In particular, when investing in asset-backed securities this should include a review of the specific risks attaching to such securities including information on the underlying assets, on the entities involved in the vehicle and their respective role, and on the legal framework of the vehicle.

Option 2A

- Limit investment in securities to those with a legal maturity or residual maturity of less than 397 days. It may also invest up to a maximum of 10 per cent of 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. Floating rate securities should reset to a money market rate or index.

OR

<u>Option 2B</u>

- Limit investment in securities to those with a legal maturity or residual maturity of less than 397 days.

- Provide daily liquidity through same day or next day settlement.

- Have a weighted average maturity (WAM) of no more than 60 days.

<u>Option 3A</u>

- Have a weighted average life (WAL) of no more than 120 days.

OR

<u>Option 3B</u>

- Have a weighted average life (WAL) of no more than 3 months.

<u>Option 4A</u>

- When calculating the WAL for floating rate securities including structured financial instruments, the maturity calculation must be based on the stated 'legal final maturity' of the instrument, i.e. the final date for repayment of capital.

OR

<u>Option 4B</u>

- Not invest in structured financial instruments or asset-backed commercial papers.

- Comply with the criteria for money market instruments as set out in the UCITS implementing Directive 2007/16/EC and CESR's guidelines concerning eligible assets for investment by UCITS. These include criteria for liquidity and valuation. Non-UCITS money market funds must ensure that the liquidity and valuation of the portfolio is assessed on an equivalent basis.

- Not take direct or indirect exposure to equity or commodities, including via derivatives; and only use derivatives in line with the money market investment strategy of the fund. Derivatives which give exposure to foreign exchange may only be used for hedging purposes.

- Limit investment in other investment funds to those which comply with the definition of a

Short-Term Money Market Fund.

- Have an appropriate risk management function. This must include a prudent approach to the management of currency, credit, interest rate and liquidity risk which incorporates a proactive stress-testing regime. In addition, managers of money market funds must have specific expertise and experience in managing these types of fund."

Box B

Longer-Term Money Market Fund: Definition

"A Longer-Term Money Market Fund must:

- Be a collective investment undertaking authorised under Directive 2009/65/EC, or which is authorised by an authority under the national law of a Member State and which is subject to supervision.

- Have the primary objective of preservation of capital.

- Have a fluctuating net asset value.

- Invest in high quality money market instruments or deposits with credit institutions. A money market instrument will be considered to be of high quality if it has been awarded the highest available credit rating by each recognised rating agency which has rated that instrument or if it is of a comparable credit quality, as determined by the management company or self-managed investment company, if not rated.

- In assessing the quality of a money market instrument in which a money market fund invests, the management company or self-managed investment company must consider other factors in addition to the credit rating of the instrument. In particular when investing in asset-backed securities this should include a review of the specific risks attaching to such securities, including information on the underlying assets, on the entities involved in the vehicle and their respective role, and on the legal framework of the vehicle.

- Limit investment in securities to those with a legal maturity or residual maturity of less than 397 days. It may also invest up to a maximum of 10 per cent of 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. Floating rate securities should reset to a money market rate or index.

- Provide daily liquidity through same day or next day settlement.

- Have a weighted average maturity (WAM) of no more than 6 months.

Option 1A

- Have a weighted average life (WAL) of no more than 12 months.

OR

Option 1B

- Have a weighted average life (WAL) of no more than 6 months.

- In the case of floating rate securities including structured financial instruments the maturity calculation must be based on the stated 'legal final maturity' of the instrument i.e. the final date for repayment of capital.

- Comply with the criteria for money market instruments as set out in UCITS implementing Directive 2007/16/EC and CESR guidelines concerning eligible assets for investment by UCITS. These include criteria for liquidity and valuation. Non-UCITS money market funds must ensure that the liquidity and valuation of the portfolio is assessed on an equivalent basis.

- Not take direct or indirect exposure to equity or commodities, including via derivatives; and only use derivatives in line with the money market investment strategy of the fund. Derivatives which give exposure to foreign exchange may only be used for hedging purposes.

- Limit investment in other investment funds to those which comply with the definition of a Short-Term Money Market Fund or a Longer-Term Money Market Fund.

- Have an appropriate risk management function. This must include a prudent approach to the management of currency, credit, interest rate and liquidity risk which incorporates a proactive stress-testing regime.

- Provide information to investors on the impact of the longer duration on the risk profile."