INVESTMENT COMPANY INSTITUTE

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November 2, 2009

CESR Issues Consultation on a Common Definition for European Money Market Funds

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TO: INTERNATIONAL OPERATIONS ADVISORY COMMITTEE No. 15-09 RE: CESR ISSUES CONSULTATION ON A COMMON DEFINITION FOR EUROPEAN MONEY MARKET FUNDS

On October 20, 2009, the Committee of European Securities Regulators (CESR) issued a proposal for a common definition of European money market funds. CESR is proposing two classifications: (1) short-term money market funds and (2) longer-term money market funds. [1] We have attached a chart of the proposed criteria for the two types of money market funds. The definitions will apply to European UCITS money market funds and CESR recommends that the same approach be followed by member states for national-level non-UCITS money market funds. [2]

We intend to submit a comment letter supporting CESR's efforts to establish a common definition for money market funds and generally identifying the areas of the proposed classification that are similar to requirements for U.S. money market funds.

Proposal

Generally, a European money market fund will be required to indicate in its prospectus and, in the case of a UCITS, in its key investor information document, whether the fund is a short-term money market fund or a longer-term money market fund. Various criteria, and options for criteria, for both short-term and longer-term money market funds are set forth. Specific questions also are posed by CESR. [3] While short-term money market funds may be constant net asset value ("NAV") or fluctuating NAV, longer-term money market funds must have a fluctuating NAV. [4] Consistent with such an approach, short-term money market funds should have the primary investment objective of maintaining the NAV of the fund while the longer-term money market fund's primary objective should be preservation of capital. The key criteria for distinguishing between short-term and longer-term money market funds generally are based on differences related to criteria for high quality money market instruments and the proposed limits for the maturity of securities and the restrictions on average weighted maturity and weighted average life.

For short-term money market funds, CESR proposes that these types of money market funds should have a weighted average maturity ("WAM") [5] of no more than 60 days and has asked for comment on whether the weighted average life ("WAL") [6] should be no more than 120 days or no more than 3 months. For longer-term money market funds, CESR has proposed that such funds should have a WAM of no more than 6 months and has asked for comment on whether the WAL for the longer-term money market funds should be no more than 6 months or 12 months. In connection with the requirement to invest in high quality money market instruments, CESR is seeking comment on whether an unrated money market instrument should not be considered a high quality instrument for short-term money market funds. Neither short-term money market funds nor longer-term money market funds would be able to take direct or indirect exposure to equity or commodities and would only be able to invest in other funds which, in the case of a short-term money market fund, meet the definition of short-term money market fund, or in the case of a longer-term money market fund, meet the definition of either the short-term or longer-term money market fund. Both types of money market funds must have appropriate risk management functions. Longer-term money market funds must provide information to investors on the impact of the longer duration on the risk profile of the fund. [7]

If you have comments or questions about the proposal, please contact me at 202-326-5813 (solson@ici.org) or Jane Heinrichs at 202-326-5410 (jheinrichs@ici.org).

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Attachment

endnotes

[1] Committee of European Securities Regulators, Consultation Paper: A Common Definition of European Money Market Funds (CESR/09-850), October 20, 2009, available at http://www.cesr-eu.org/data/document/09_850.pdf.

[2] The definition of money market funds will be issued as Level 3 CESR guidelines. CESR members have agreed that any fund labeling or marketing as a money market fund after issuance of final guidelines must comply with the final definition.

[3] For example, CESR seeks comment on currency exposure and the extent to which short-term and longer-term money market funds can invest or be exposed to securities not denominated in their base currency (Questions 11 and 17). CESR also seeks comment on structured financial instruments and the calculation of average weighted life (Questions 9 and 16). For longer-term money market funds, CESR asks whether such funds should have the ability to invest in lower-rated securities (Question 18).

[4] CESR has asked for comment on whether longer-term money market funds should have the ability to have a constant NAV (Question 19).

[5] CESR defines WAM 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.

[6] CESR defines WAL 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 the 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. WAL limits also help to limit the effects of changes in interest rate spreads (i.e., the additional yield paid on a security above the risk-free rate of return on their funds' portfolio).

[7] On September 24, 2009, the Autorité des Marchés Financiers ("AMF") announced the position that it intended to advocate as part of CESR's work on the classification of money market funds. In addition to existing French money market fund criteria of a maximum sensitivity of 0.5 and a prohibition on equity exposure, the AMF proposed the following: (1) the WAL of the portfolio should be less than 6 months; (2) the maximum residual maturity of the securities in the portfolio should be less than 2 years; (3) the WAL and the maximum residual maturity allowed by the manager or a fund should be disclosed in the prospectus in a standardized table; (4) the creation of a "short-term money market fund" category, with a WAL for the portfolio and a maximum residual maturity of the securities of the portfolio reduced to 3 months and one year, respectively; and (5) tightening the credit risk criteria for securities acquired by funds and improving disclosures on fund credit risk management policies. In addition, the AMF proposed changes related to disclosure and the marketing of money market funds. The AMF's press release is available at http://www.amf-france.org/documents/general/9097_1.pdf.
