Mr Carlo Comporti  
Secretary General of CESR  
11-13 avenue de Friedland  
75008 Paris, France  

16 December 2009

Dear Mr Comporti,

We are writing to you jointly on behalf of the European Fund and Asset Management Association and the Institutional Money Market Funds Association in response to the consultation paper regarding a common definition of European money market funds (CESR/09-850).

The European Fund and Asset Management Association (EFAMA) is the representative association for the European investment management industry. EFAMA represents through its 24 member associations and 44 corporate members about EUR 12 trillion in assets under management of which EUR 6.8 trillion was managed by around 54,000 investment funds at end September 2009.

The Institutional Money Market Funds Association (IMMFA) is the trade association which represents the European triple-A rated money market funds industry, with assets of EUR 425 billion at end September 2009.

We strongly agree with the need to implement a regulatory definition of European money market funds. As you will be aware, we jointly issued a proposed classification of money market funds in July 2009 following extensive industry discussions. The broad consistency between our classification and the proposals in the CESR’s paper is most welcome, though we have taken the liberty to point out several differences in our response.

Both Associations are committed to the implementation of a common European definition of a money market fund, which will provide much needed clarity to both investors and markets. In order to ensure that this clarity is provided, we would be pleased to work with you further to finalise the definition.

Yours sincerely,

Peter De Proft  
Director General, EFAMA

Gail Le Coz  
Chief Executive, IMMFA
RESPONSE of EFAMA and IMMFA
TO THE CONSULTATION PAPER ON CESR’S PROPOSAL FOR
A COMMON DEFINITION OF EUROPEAN MONEY MARKET FUNDS (CESR/09-850)

1. Do you agree that such clarification is desirable?

EFAMA and IMMFA fully agree with the approach taken by CESR to clarify the definition of money market funds provided in the MiFID Level 2 Directive.

In general we would have reservation against using the MiFID definition as the basis for the classification of all European money markets funds. The “qualifying money market fund” as defined in the MiFID Level 2 Directive article 18 (1) (d) restrictively applies to investment firms “depositing client funds” in respect with the principle of “safeguarding the clients rights”. It does not properly apply to CESR’s proposed definition which is targeted to inform investors regarding their own investment choice. Therefore the MiFID criteria should not be fully incorporated on its own in the common definition of European money market funds. In this respect, we recommend that the ongoing review process of MiFID should include a harmonisation of the money market fund definitions between MiFID Level 2 and the forthcoming Level 3 CESR Guidelines.

More generally, there is a need for a common definition that recognizes the diversity of the European money market fund universe and allows sufficient differentiation within this universe between the very short-term oriented funds and those seeking a slightly higher yield while still targeting capital preservation. This is a consideration that the MiFID definition did not appreciate. It should also be clear that the common definition should only create one European category for money market funds, with two types of funds: short-term and “longer-term”/”regular” money market funds.

Finally we consider that an essential characteristic of a money market fund is the possibility to redeem units/shares daily. On the other hand, the actual payment to investors should be made according to the standard settlement cycle for securities (often T+2 or T+3), which varies across Europe. The MiFID same day settlement requirement for money market funds must be seen against the background of securing the safety of client monies which are held by a MiFID regulated investment advisor. Client monies should not remain for too long in the hands of investment advisors. This is a special situation which should not be generalized for all money market funds.

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

We strongly welcome CESR’s intention to enforce a common definition of money market funds across Europe. This step will greatly contribute to reducing investor confusion about the risk characteristics of money market funds and achieving a more integrated and transparent European market for money market funds.
We also fully support CESR’s proposal to move outside the perimeter of money market funds those funds which place yield ahead of capital preservation.

Concerning the objective of money market funds, it would be appropriate to note that money market funds should operate with the primary (rather than the sole\(^1\)) objective of preserving capital\(^2\) and maintaining strong liquidity. It should be clear indeed that the objectives of short-term and longer-term money market funds are not exactly the same. Both types of funds share as their primary objective the preservation of capital but they differ to the extent that “longer-term”/“regular” money market funds give a slightly lower importance to liquidity than short-term money market funds in order to achieve a slightly higher yield.

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

We strongly agree with the proposal to apply the harmonized definition of money market funds to both UCITS and non-UCITS money market funds. All funds carrying the “money market” fund label should comply with the agreed definition. Proceeding differently would generate confusion for investors and create a loophole that would allow funds that place yield ahead of capital preservation to label themselves as money market funds.

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

We appreciate that the two-tier approach proposed by CESR is broadly in line with the EFAMA/IMMFA recommendation, which indeed includes two types of money market fund.

This approach has the advantage of distinguishing one type of money market fund from another in terms of risk/return profiles and investment strategies.

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

To ensure that the distinction between the two types of money market funds facilitate investor choice, we recommend that fund managers commit to indicate in their funds’ prospectus and marketing materials the type of their money market fund (short-term or “longer-term”/“regular”) and remind the investors about the objective and risk characteristics of this type to make them comfortable with their choice.

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\(^1\) As noted in paragraph 15 of the consultation paper.

\(^2\) The objective of preserving capital should be understood “gross of fees” in order to prevent any confusion for investors. This point is particularly important as the current level of money market rates is very low.
We also believe that it should be a requirement for financial advisors under MiFID to inform investors of the difference in risk/return profile between the two types of money market fund when meeting clients interested in investing in money market funds.

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

We agree with providing money market funds a transitional period of one year to adjust their portfolio, investment strategy and marketing documentation to the agreed definition.

We also propose 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, to give sufficient time to those money market funds that will have to change their policies in significant ways to comply with the agreed definition.

It should be clear, however, that at the latest on 30 June 2012, the funds that would continue to fall outside the agreed definition will no longer be classified as money market funds. At this time, the “other” money market funds categories would cease to exist.

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

Subject to the clarifications made in our answers to questions 8-12, we agree with the criteria proposed by CESR to define short-term money market funds.

8. Do you have alternative suggestions?

We have reservations regarding the proposal to request that short-term money market funds provide daily liquidity through same day or next day settlement for the following reason. In our view, what is crucial for money market funds is to allow investors to redeem their shares daily. On the other hand, the actual payment to investors should be made according to the standard settlement cycle for securities (often T+2 or T+3), which varies across Europe. Same day settlement in money market funds is a special service which is valued by institutional investors. As explained above, this should not become a requirement that all money market funds should comply with.

To support the importance of offering daily trading of units and shares, the EFAMA/IMMFA proposal recommends limiting the liquidity risk of short-term money market funds by setting the following requirements:

- Short-term money market funds should implement internal standard to be able to meet reasonably foreseeable liquidity demand of their clients, taking into account client concentration and client segments, industry sectors and instruments, and market liquidity conditions.
Short-term money market funds should comply with two portfolio liquidity requirements:

- A minimum of 5 percent of their assets must be held in cash, Treasury securities, or other securities and repurchase agreements that would be accessible within one day.

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

These requirements should only apply when a security is purchased. A temporary breach is acceptable if the liquidity position is used to meet a redemption that causes the fund’s liquid assets to fall below the 5 and/or 20% requirements. New investments should be in such liquid instruments.

Finally, we propose that management companies and self-managed investment companies should be required to have credit assessment resources that are proportionate to the nature, scale and complexity of their businesses. This will help managers correctly determine whether securities should be included in money market funds, without requiring regulators to maintain a list of approved securities. As such, there would be no need to update regulation to reflect market developments and the introduction of new types of securities.

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 3B (3 months) is more appropriate for the WAL limit? Should it be lower or higher?

We consider short-term money market funds should be afforded greater flexibility in managing credit/credit spread risk and allowed a maximum WAL of 6 months.

It should be clear that money market fund managers may opt for a more conservative WAL. This will be the case for money market funds represented by IMMFA, which will maintain a maximum WAL of 120 days, as well as a AAA rating. This market practice should be seen in light of the commitment of those funds to keep a AAA rating. As it is accepted that not all short-term money market funds should be AAA, CESR should agree to a limit of 6 months maximum (i.e. 180 days).

It is also worth noting that according to Fitch’s revised money market fund ratings, the WAL of ”AAAmmf”, “AAmmf” and “Ammf” rated money market funds can be as a high as 120, 180 and 240 days, respectively. Fitch considers that those limits are consistent with the ability of “AAAmmf”, “AAmmf” and “Ammf” rated funds to preserve an extremely strong capacity, very strong and strong to achieve the objective of preserving capital, respectively.
This viewpoint confirms it is reasonable to set the WAL limit of short-term money market funds to 6 months without compromising on the overall objective of preserving principal.

Additionally, it is important to consider current trends in bank issuance of short-term securities. With new liquidity requirements that oblige banks to issue more longer-dated paper, there is a danger that the EUR 1.3 trillion money market fund industry may not be able to find sufficient supply of securities should the WAL be set at 3 months (as in Option 3 B).

**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, or through their legal final maturity?**

We consider that in respect of structured finance instruments the maturity calculation may be based on the “expected life” rather than the stated “legal life” of the instrument. Considering that the vast majority of ABS are paid/called within the most likely life scenario the calculation of WAL based on the much longer legal life concept would artificially shorten the likely WAL of the portfolio to the detriment of the investor. Without the occurrence of any credit event, the “expected life” materialises. And the probability of a credit event should be reflected in the credit rating of the debt instrument.

**Do you consider that the WAM limit of 60 days is appropriate? Should it be lower or higher?**

Given that the primary objective of short-term money market funds is to preserve principal, we fully support CESR’s proposal to limit the WAM to maximum 60 days.

**In relation to investments in securities, do you agree with Option 2A (allowing investment of up 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) or Option 2B (limiting investment in securities to those with a legal maturity or residual maturity of less than 397 days)?**

We support Option 2A as we have established that short-term money market funds should be allowed to invest up to a maximum of 10 percent of their assets in floating rate securities with a legal or residual maturity of between 397 days and 2 years\(^3\) (provided that the time remaining until the next interest rate reset date is less than 397 days). The 10 percent limit is sufficiently restrictive to address credit risk in a very conservative manner and provide a reasonable opportunity for investment in floating rate securities.

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

\(^3\) Just as the maturity limit imposed on eligible instruments is 397 days instead of 1 year, some flexibility should be allowed with regard to the maturity of floating rate securities, provided it remains below 26 months.
We are strictly opposed to restrictions that would forbid investment in structured financial instruments or asset-backed commercial papers (ABCP). There is no reason to consider a priori that high-quality structured financial instruments and ABCP would increase the overall level of risk of short-term money market funds. Many efforts are currently being made to relaunch securitisation across Europe, and this policy objective is fully supported by the Financial Stability Board. Excluding money market funds as purchasers of high-quality, short-dated ABCP would eliminate an important investor base and be detrimental to this relaunch. We strongly believe that the success of short-term money market funds depends upon thorough credit review processes to ensure that those funds invest in money market instruments and securities with the highest credit quality at the time of purchase. These processes would be supported by the credit resources mentioned earlier.

To address the risk of investing in new and complex instruments, we recommend that all short-term money market funds be required to establish strong risk management and valuation procedures including new product procedures to review and approve novel securities, structured financial instruments or investment techniques.

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?

We are in favour of prohibiting money market funds from taking any economic exposure to foreign currencies as we believe that the volatility observed in foreign exchange markets may increase the risk of funds exposed to foreign currencies above reasonable limits. Currency risk is an additional source of risk (and reward) that is not typical of low risk savings products. Therefore currency exposure should not be allowed in MMFs whose primary objective is capital preservation. We understand that no economic exposure to foreign currencies means that there will be no unhedged foreign exchange positions in the portfolio of a money market fund. We do not propose an overall limit on the hedged foreign exchange positions as the hedging will occur only on a diversified basis with a minimum number of high quality counterparties required by law.

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?

We have strong reservation concerning Option 1B for two reasons. Firstly, we consider that CESR should accept a mechanism to assess the credit quality of instruments that are not rated by any recognised rating agency. Several weaknesses of credit rating agencies came to light during the crisis, and there has already been regulation to try to address some of these.

Moreover, a requirement for a rating from a credit rating agency would substantially narrow the investment universe for money market funds, and thereby reduce their ability to diversify. This is
because there are a lot of high quality debt instruments fulfilling the credit quality criteria both for short-term and longer-term money market funds, however not all are rated by a credit rating agency.

As a result, we consider that credit analysis of money market instruments and securities should not be exclusive purview of credit rating agencies. An internal (e.g. credit department) or external body (e.g. competent rating agency, broker) that is independent from the fund manager should be allowed to assess the credit quality of any portfolio investment. Hence, we propose as an alternative to Options 1A and B the following text:

"Invest in high quality money market instruments, securities or deposits with credit institutions. A money market instrument or security will be considered to be of high quality if it has been awarded the highest available credit rating by a recognized rating agency which has rated that instrument, or it is of comparable credit quality, as determined by an internal body that is independent from the fund management company, or by an external body that is independent from the management company or self-managed investment company."

It is also essential to define the concept of “highest available credit rating”. In our view, short-term money market funds must invest exclusively in money market instruments and securities with the highest credit quality at the time of purchase (e.g. F1 or F1+ by Fitch, P1 by Moody's, A1 or A1+ by Standard & Poor’s or equivalent other external or internal rating) or, in its absence, the equivalent long-term credit assessments (e.g. AAA to A- by Fitch and Standard and Poor’s, and Aaa to A3 by Moody’s or equivalent other external or internal rating).

Both Fitch and Standard & Poor’s have a “+” designation which can be added on to F1 and A1 ratings, respectively. As shown in the description from the agencies’ websites below, F1+ and A1+ are not separate ratings categories. Therefore, the highest available short-term credit rating from these two agencies is F1 / F1+ and A1 / A1+.

A-1: A short-term obligation rated “A-1” is rated in the highest category by Standard & Poor's. The obligor's capacity to meet its financial commitment on the obligation is strong. Within this category, certain obligations are designated with a plus sign (+). This indicates that the obligor's capacity to meet its financial commitment on these obligations is extremely strong.

F1: Highest short-term credit quality. Indicates the strongest intrinsic capacity for timely payment of financial commitments; may have an added “+” to denote any exceptionally strong credit feature.

It should also be understood that in case of default or downgrading, the portfolio adjustment should be done in the best interests of investors in money market funds.
13. Do you agree with the proposed criteria for the definition of longer-term money market funds?

We agree with the approach taken by CESR to define the second type of money market fund, but we have reservations about the limitations on some proposed risk-limiting criteria as well as on the suggested name. Our reservations are explained below.

In general, we recommend providing the second type of money market fund greater flexibility than foreseen by CESR in order to differentiate sufficiently the average risk/return profile of this type of money market fund. This approach has the advantage of giving fund managers a wider range of possibilities to manage their position on the interest rate curve in line with their expectations about short-term interest rates, whilst avoiding concentrations on some points of the curve. Moreover, if the risk/return profile is too similar between the two categories, this could contribute to create investor confusion rather than removing it.

The criteria proposed below fully preserve the very strong/strong capacity of the second type of money market funds to achieve the investment objective of preserving principal.

Regarding the proposed name, the restriction imposed on the maximum interest reset/time to maturity (less than 397 days) is not compatible with a name suggesting that the second type of money market funds are long-term funds. It would be against the nature of a Money Market fund (funds which invest in instruments with interest rate risk below 1 year) to imply that they are exposed to long-term maturities. And this would be misleading for investors because long-term investment funds are designed for investors who can accept some degree of NAV volatility in exchange for long-term growth potential. As the proposed “longer-term” money market funds invest in short-term high quality money market instruments and are used by investors as an alternative to bank deposits, we strongly recommend to refer to “regular money market funds” the name also adopted in the European Fund Classification⁴ and accepted by its members: fund providers and rating agencies/data vendors.

In addition to avoiding confusion on the part of investors, the choice of this name – “regular money market funds” would also allow for straightforward translation in national laws. Translating “longer-term” would be much more challenging.

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⁴ The EFC is a pan-European classification system that has been developed by the European Fund Categorization Forum. To know more about the EFCF, please visit the EFAMA website at the following address: http://www.efama.org/index.php?option=com_wrapper&Itemid=45.
14. Do you have alternative suggestions?

Please see below.

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?

Please see below.

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?

In line with our response to question 9, we consider that “longer-term” money market funds should be offered greater flexibility in managing their WAL. We therefore propose to set the WAL limit at 1.5 years with a view to differentiating sufficiently “longer-term” money market funds from short-term money market funds. It is meaningful to have two types of money market funds if the definitions of WAM/WAL are sufficiently different. Under normal circumstances, the difference in risk and return between a money market fund of WAM/WAL = 60 days/3-4 months and a money market fund of WAM/WAL=180 days/6-12 months will be very small as both funds are investing at the very short end of the yield curve. The increase of risk is however beneficial from a classification and communication point of view. Setting the WAL limit at 1.5 year is also important to give “longer-term” money market funds the possibility to diversify their investments towards floating rate securities with a residual maturity of between 2 and 5 years.

Would you recommend taking structured financial instruments into account in the WAL calculation through their expected average life, or through their legal final maturity?

We consider that in respect of structured finance instruments the maturity calculation may be based on the “expected life” rather than the stated “legal life” of the instrument. Considering that the vast majority of ABS are paid/called within the most likely life scenario the calculation of WAL based on the much longer legal life concept would artificially shorten the likely WAL of the portfolio to the detriment of the investor. Without the occurrence of any credit event, the “expected life” materialises. And the probability of a credit event should be reflected in the credit rating of the debt instrument.

Do you consider that the WAM limit of 6 months is appropriate? Should it be lower or higher?
We believe that the maximum WAM of longer-term money market funds should be increased to one year. To the extent that it was credit and liquidity risks, not interest rate risk, that caused problems for money market funds in relation to the unfolding financial crisis, we believe that a one year WAM or modified duration is a sound interest rate risk limit for regular money market funds. This proposal should also be seen in the light of the proposal to prohibit longer-term money market funds from investing in securities with a maturity or residual maturity of more than 397 days or in floating rate securities with a time remaining until the next interest rate reset of more than 397 days. This restriction ensures that the portfolio average WAM or modified duration will always be significantly lower than one for “longer term” money market funds, as proper diversification strategy will ensure that a large part of the portfolio will be invested in securities with a maturity or residual maturity of less than 397 days.

**Can this criterion be expressed in terms of interest rate sensitivity (corresponding limit set at 0.5)?**

It has become practice to use the WAM, which is also commonly known as “modified duration”, to measure the interest rate risk of money market funds. We therefore recommend confirming the use of this criteria.

**In relation to investments in securities, do you believe that investment of up to 10 per cent 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?**

We consider that “longer-term”/”regular” money market funds should be allowed to invest up to a maximum of 10 percent of their assets in floating rate securities with a legal or residual maturity of between 2 and 5 years (provided that the time remaining until the next interest rate reset date is less than 397 days). The 10 percent limit on floating rate securities with maturity of more than 2 years is sufficiently restrictive to address credit risk in a very conservative manner and provide a reasonable opportunity for investment in floating rate securities.

**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 are in favour of prohibiting money market funds from taking any economic exposure to foreign currencies, as we believe that the volatility observed in foreign exchange markets may increase the risk of funds exposed to foreign currencies above reasonable limits. Currency risk is an additional source of risk (an reward) that is not typical of low risk savings products. Therefore currency exposure should not be allowed in MMFs whose primary objective is one of capital preservation. We understand that no economic exposure to foreign currencies means that there will be no
unhedged foreign exchange positions in the portfolio of a money market fund. We do not propose an overall limit on the hedged foreign exchange positions as the hedging will occur only on a diversified basis with a minimum number of high quality counterparties required by law.

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

In the view of EFAMA and IMMFA, “longer-term”/”regular” money market funds should be allowed to invest in high quality investment grade money market instruments and securities at the time of purchase. High quality investment grade means investment grade short-term credit assessment (e.g. P1-P3 by Moody’s or equivalent other external or internal rating) or equivalent long-term credit assessments (e.g. Aaa to Baa3 by Moody’s or equivalent other external or internal rating). As noted above, the credit quality assessment of the MMF investment is first and foremost the duty of the fund manager. Regulatory incentives leading to overreliance on credit ratings need to be avoided.

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

We believe that the flexibility given to longer-term money market funds to manage their overall portfolio is not consistent with the commitment to keep a constant NAV. Hence, we recommend reserving the possibility of maintaining a constant NAV to short-term money market funds only.

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