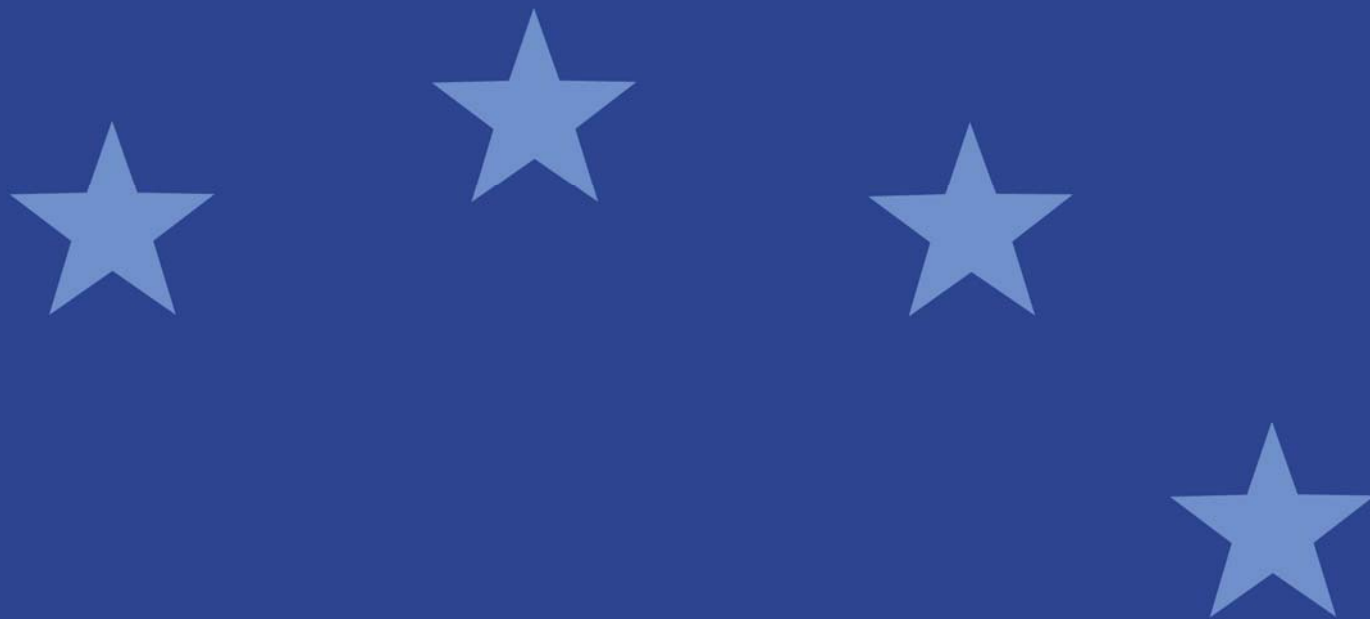


Questions and Answers

A Common Definition of European Money Market Funds



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I. Background

1. The revised Undertakings for Collective Investment in Transferable Securities (UCITS) Directive puts in place a comprehensive framework for the regulation of harmonised investment funds within Europe. The extensive requirements with which UCITS must comply are designed to ensure that these products can be sold on a cross-border basis. The UCITS framework is made up of the following EU legislation:
 - a. Directive 2009/65/EC, which was adopted in 2009. It is a 'framework' Level 1 Directive which has been supplemented by technical implementing measures (see the Level 2 legislation in b. below).
 - b. Directive 2007/16/EC¹; Directive 2010/43/EU²; Regulation No 583/2010³; Directive 2010/42/EU⁴; and Regulation No 584/2010⁵ (the Level 2 legislation).
2. National laws of Member States may apply to collective investment undertakings that are not UCITS.
3. On 19 May 2010, ESMA's predecessor (CESR) published guidelines on a Common Definition of European Money Market Funds (Ref. CESR/10-049).⁶ These guidelines apply to collective investment undertakings authorised under Directive 2009/65/EC and collective investment undertakings regulated under the national law of a Member State and which are subject to supervision and comply with risk spreading rules and which label or market themselves as money market funds.
4. ESMA is required to play an active role in building a common supervisory culture by promoting common supervisory approaches and practices. In this regard, ESMA has adopted this Q&A and will continue to develop other Q&As as and when appropriate.

II. Purpose

5. The purpose of this document is to promote common supervisory approaches and practices in the application of the guidelines on a Common Definition of European Money Market Funds developed by CESR by providing responses to questions posed by the general public and competent authorities.
6. The content of this document is aimed at competent authorities to ensure that in their supervisory activities their actions are converging along the lines of the responses adopted by ESMA. However, the answers are also intended to help management companies by providing clarity as to the content of

¹ COMMISSION DIRECTIVE 2007/16/EC of 19 March 2007 implementing Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards the clarification of certain definitions

² COMMISSION DIRECTIVE 2010/43/EU of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards organisational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a depositary and a management company

³ COMMISSION REGULATION (EU) No 583/2010 of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards key investor information and conditions to be met when providing key investor information or the prospectus in a durable medium other than paper or by means of a website

⁴ COMMISSION DIRECTIVE 2010/42/EU of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards certain provisions concerning fund mergers, master-feeder structures and notification procedure

⁵ COMMISSION REGULATION (EU) No 584/2010 of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards the form and content of the standard notification letter and UCITS attestation, the use of electronic communication between competent authorities for the purpose of notification, and procedures for on-the-spot verifications and investigations and the exchange of information between competent authorities

⁶ <http://www.esma.europa.eu/popup2.php?id=6638>

CESR's guidelines on a Common Definition of European Money Market Funds, rather than creating an extra layer of requirements.

III. Status

7. The Q&A mechanism is a practical convergence tool used to promote common supervisory approaches and practices under Article 29(2) of the ESMA Regulation.⁷
8. Therefore, due to the nature of Q&As, formal consultation on the draft answers is considered unnecessary. However, even if they are not formally consulted on, ESMA may check them with representatives of ESMA's Securities and Markets Stakeholder Group, the relevant Standing Committee's Consultative Working Group or, where specific expertise is needed, with other external parties.
9. ESMA will review these questions and answers to identify if, in a certain area, there is a need to convert some of the material into ESMA guidelines and recommendations. In such cases, the procedures foreseen under Article 16 of the ESMA Regulation will be followed.

IV. Questions and answers

10. This document is intended to be continually edited and updated as and when new questions are received. The date on which each question was last amended is included after each question for ease of reference.
11. Questions on the practical application of any of the requirements of CESR's guidelines on a Common Definition of European Money Market Funds may be sent to the following email address at ESMA:

moneymarketfunds@esma.europa.eu

⁷ Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC Regulation, 15.12.2010, L331/84.

Question 1: A management company's internal rating process

Date last updated: August 2011

Question: What are ESMA's expectations in terms of a management company's internal rating process?

Answer: A management company assesses the credit quality of a money market instrument using its internal rating process. The assessment of the credit quality of the instrument by the management company should be conducted according to the provisions of Article 23 of Directive 2010/43/EU on due diligence requirements.

Question 2: Treatment of instruments with only long-term rating

Date last updated: August 2011

Question: Where an instrument has a long-term rating and no short-term rating but otherwise fulfils the CESR criteria, can it be included in a short-term money market fund or money market fund?

Answer: In accordance with the CESR guidelines, in the absence of a short-term rating, an instrument should be considered to be unrated even if it has a long-term rating. However, such an instrument may be included in a short-term money market fund or money market fund if, based on the management company's internal rating process, it is of equivalent quality to an instrument which has been awarded one of the two highest short-term ratings and if it complies with the criteria set out in paragraph 3 of Box 2 of the guidelines. Indeed, when a management company assesses the quality of a money market instrument, other factors like the nature of the asset class, the operational and counterparty risk inherent within structured financial instruments and the liquidity profile should also be considered.

Question 3: Treatment of non-rated instruments

Date last updated: August 2011

Question: Where an instrument issued by a local or regional government is not rated but the debt issued by the country has been awarded one of the two highest ratings available and this instrument fulfils all the other criteria of CESR's guidelines, can it be included in a short-term money market fund or a money market fund?

Answer: In accordance with the CESR guidelines, in the absence of an instrument rating, an instrument issued by a local or regional government should be considered to be unrated, even if the debt issued by the country has been awarded with one of the two highest short-term issuer ratings available. However, such an instrument may be included in a short-term money market fund or money market fund if, based on the management company's internal rating process, it is of equivalent quality to an instrument which has been awarded one of the two highest short-term ratings for short-term money market funds or investment

grade for money market funds and if it complies with the criteria set out in paragraph 3 of Box 2 of the guidelines as stated in the response to question 2 above.

Question 4: Credit quality of deposits with credit institutions

Date last updated: August 2011

Question: How should the credit quality of deposits with credit institutions (i.e. banks) be considered?

Answer: When assessing the quality of deposits, management companies should take into account a range of factors such as the financial situation of the issuing credit institution, in accordance with paragraphs 3 and 4 of Box 2 of the guidelines.

Question 5: Determination of a recognised credit rating agency

Date last updated: August 2011

Question: What constitutes a 'recognised credit rating agency'?

Answer: Any credit rating agency which has been registered with ESMA in accordance with Regulation (EC) No 1060/2009 or subject to transitional provisions under Article 40 of the same Regulation should be considered to be a recognised credit rating agency. In the case of a credit rating issued in a third country, the credit rating must have been either endorsed by a credit rating agency registered in the Community by ESMA in accordance with Regulation (EC) No 1060/2009 or provided by a credit rating agency certified by ESMA under the same Regulation.

Question 6: Treatment of instruments rated by many credit rating agencies

Date last updated: August 2011

Question: If several credit rating agencies have rated an instrument, do management companies have to consider each rating that has been issued for an instrument?

Answer: Yes. In accordance with paragraph 4 of Box 2 and paragraph 1 of Box 3, the ratings awarded by each agency that has rated the instrument should be considered to determine if the instrument is of high quality.

However, when assessing the quality of a money market instrument, management companies should not only rely on ratings of the instrument provided by credit rating agencies but should take into account other factors as set out in paragraph 3 of Box 2 of CESR's guidelines.

Question 7: Calculation of the weighted average maturity of the fund

Date last updated: August 2011

Question: Should the WAM be calculated using the duration or final legal maturity for fixed rate instruments?

Answer: According to the definition of WAM on page 5 of CESR's guidelines, the WAM for fixed rate instruments should be calculated using the final legal maturity of the instrument and not the duration.

Question 8: Calculation of the weighted average life of the fund

Date last updated: August 2011

Question: Should the WAL be calculated for individual instruments?

Answer: No. According to the definition of WAL on page 5 of CESR's guidelines, the WAL should be calculated as the weighted average of remaining life (maturity) of the securities held in the fund.

Question 9: Residual maturity of instruments embedding a put option

Date last updated: August 2011

Question: Can an instrument whose residual maturity until legal redemption is longer than 397 days for short-term money market funds, or longer than two years for money market funds, be purchased if the instrument embeds a put option at the discretion of the management company where the exercise date is within 397 days for the short term money market funds or within two years for money market funds?

Answer: No. According to paragraph 5 of Box 2 and paragraph 4 of Box 3, the residual maturity until legal redemption cannot exceed 397 days for short-term money market funds and two years for money market funds provided that the time remaining until the next interest rate is less than 397 days.

Question 10: Exposure to equities

Date last updated: August 2011

Question: Can short-term money market funds or money market funds obtain direct or indirect exposure to equities?

Answer: No. According to paragraph 11 of Box 2 and paragraph 1 of Box 3 of the CESR guidelines, short-term money market funds and money market funds cannot take direct or indirect exposure to equities.

Question 11: Maturity of securities for money market funds

Date last updated: August 2011

Question 11a: Can money market funds invest in securities with a residual maturity until the legal redemption date of less than or equal to 2 years?

Question 11b: Can money market funds invest in a two-year fixed rate security provided the interest rate risk of the security is hedged against a money market rate (or index) with a reset less or equal to 397 days?

Response 11a: Yes, according to paragraph 4 of Box 3 of the CSER guidelines, 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 to a money market rate (or index) is less than or equal to 397 days. This feature corresponds to a two-year floating rate security that resets to a money market rate (or index).

Response 11b: No. Interest rate hedging arrangements should not be taken into account when considering the eligibility of securities.

Question 12: Investment in non-base currency cash

Date last updated: August 2011

Question: Are short-term money market funds and money market funds allowed to invest in non-base currency cash without hedging the currency exposure?

Answer: No. Paragraph 11 of Box 2 and paragraph 1 of Box 3 of CESR's guidelines require the currency exposure arising from investment in securities denominated in non-base currency to be fully hedged and should be understood as covering investments in non-base currency cash as well.

Question 13: Share classes in different currency

Date last updated: August 2011

Question: Can short-term money market funds and money market funds create currency share classes?

Answer: Yes, provided that share classes are allowed by national legislation and the exposure to non-base currency securities and cash is fully hedged back to the currency of the currency share class. Indeed, paragraph 11 of Box 2 and paragraph 1 of Box 3 of the CESR guidelines require that investment by short-term money market funds and money market funds in non-base currency securities be fully hedged.

Question 14: Probability to exercise a put option

Date last updated: August 2011

Question: In what circumstances should it be considered that there is a high probability of exercising a put option?

Answer: The policy approach developed in the guidelines confers on management companies the responsibility to define for themselves the criteria they should consider for assessing the probability of exercising a put option. However, while the CESR guidelines do not prescribe any specific criteria for this assessment, the assumptions taken by management companies should be realistic and demonstrable.

Question 15: Use of credit ratings provided by credit rating agencies

Date last updated: February 2012

Question: How should management companies assess the credit quality of instruments that are rated by credit rating agencies?

Answer: Management companies should ensure that they have proper procedures and processes in place to enable them to assess the credit quality of an instrument without relying solely on credit ratings provided by credit rating agencies. In particular, management companies should always conduct an internal assessment of the credit quality as a key element of their decision on whether to invest in that instrument.

Question 16: Corrective actions to be taken by management companies

Date last updated: February 2012

Question: What should the management company do when an instrument in which a short-term money market fund or a money market fund is invested no longer complies with the criteria set out in the guidelines?

Answer: The management company should immediately assess how best to bring the fund back into compliance with the guidelines. It should take remedial action as soon as reasonably practicable, taking into account the best interests of the investors at all times.