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FINANCIAL MARKETS ALERT

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European Regulators Establish Two-Tiered Definition for Money Market Fund

On May 19, 2010, the Committee of European Securities Regulators (the "CESR") released its "Guidelines on a common definition of European money market funds" (the "Guidelines"). The purpose of the Guidelines is to improve investor protection by establishing criteria to be applied by investment funds (referred to in the Guidelines as "collective investment undertakings") labeling or marketing themselves as "money market funds".

Prior to the release of the Guidelines, there were no European-wide restrictions or criteria regarding what types of investment funds were to be recognized as money market funds. Instead, certain European Union member states and local industry associations had developed their own definitions and restrictions which, according to some commentators, may have led to investor confusion regarding the characteristics of such funds—including the eligible investments and maturities of the assets in which they could invest—during the recent financial crisis.

The Guidelines apply to investment funds authorized under a specified European Commission Directive, as well as investment funds regulated under the national laws of a member state which are subject to supervision by and comply with the risk-spreading rules of that member state. The basic assumption of the Guidelines is that investors in money market funds expect that the capital value of their investment will be maintained and that they will have the ability to withdraw their capital daily.

The Guidelines establish two categories of money market funds: (i) Short-Term Money Market Funds ("STMMFs") and (ii) Money Market Funds ("MMFs"). The primary difference between these categories is an investment fund's weighted average maturity ("WAM") (i.e., a measure of sensitivity to changing money market interest rates) and weighted average life ("WAL") (i.e., a measure of credit risk (based on the length of time until the stated final maturity of underlying securities) and liquidity risk). The Guidelines state that the CESR does not expect that so-called "enhanced money market fund strategies" will be able to qualify as money market funds.

The Guidelines provide specific criteria for investment funds to qualify as STMMFs, including that such funds:

- have the primary investment objective of maintaining principal and providing a return in line with money market rates;
- invest in money market instruments that their management determines are of "high quality", based on credit quality (including a minimum short-term rating requirement), nature of asset class, liquidity profile and, for structured financial instruments, inherent operational and counterparty risk profile;
- limit investment in securities to those with a residual maturity until the legal redemption date of no more than 397 days;

Additional Information

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- provide daily net asset value ("NAV") and price calculations and daily information regarding the subscription and redemption of units;

- ensure that their investment portfolio has a WAM of no more than 60 days and a WAL of no more than 120 days (taking into account, *inter alia*, the impact of financial derivative instruments, deposits and efficient portfolio management techniques);

- not take direct or indirect exposure to equities or commodities, including through derivatives, and limit the use of foreign exchange derivatives to hedging purposes; and

- have either a constant or fluctuating NAV.

The criteria for investment funds to qualify as a MMFs include, generally, the criteria applicable to STMMFs, except that MMFs are to:

- limit investment in securities to those with a residual maturity until the legal redemption date of no more than two years (provided that the time remaining until a security's next interest rate reset date is not more than 397 days and provided, further, that floating rate securities reset to a money market rate or index);

- ensure that their investment portfolio has a WAM of no more than 6 months and a WAL of no more than 12 months; and

- have a fluctuating NAV.

The CESR expects that each STMMF and MMF will provide specific disclosure to investors indicating which type of fund it is and explaining the implications of investing in the fund, including the difference between an investment in the fund and an investment in a bank deposit. For example, money market fund disclosure should make clear that a fund objective to preserve capital is not a guarantee of capital. The CESR also expects that MMFs will provide "sufficient information" to explain the impact of the longer duration (relative to STMMFs) of their risk profile.

The Guidelines are to become effective on July 1, 2011, although investment funds existing on that date will be granted an additional six-month transition period to comply.