Policy recommendations for Money Market Funds. November 2012.

IOSCO Board has published, the 9th October, a final report on Policy Recommendations for Money Market Funds (forward MMFs) which proposes recommendations to be the basis for common standards for the regulation and management of money market funds across jurisdictions; a majority of the commissioners of the SEC did not support its publication because they were in disagreement with the MMFs valuation method recommended and, in consequence with the Net Asset Value proposed. The key issue is, therefore, the portfolio assets valuation (Net Asset Value (NAV) that could be calculated by a constant Net Asset Value (CNAV)) or a variable Net Asset Value (VNAV)). The CNVA exists in USA, Japan, China and Canada and CNAV MMFs use the amortised cost method to value all the assets, while VNAV use the "marked to market" value and is applied in the UE. IOSCO, in particular, addresses the vulnerabilities of the CNAV MMFs because the susceptibility to run and the advantage of the first mover to redeem from a troubled MMF exacerbates the tendency to obtain looses to the holders of shares that remain in the fund.
IOSCO´s works have been developed in response to a Financial Stability Board (FSB) request to undertake a review of potential regulatory reforms of MMFs taking into account that, although MMFs did not cause the crisis, their performance during 2008 financial turmoil highlighted their potential to spread or even amplify a financial crisis. The FSB´s request is part of the efforts to strengthen the regulation of the shadow banking system. IOSCO issued, in late April, a consultation paper that analysed the potential risk that MMFs can entail for systemic stability and proposed different policy choices against such risks. The current 15 recommendations, issued taking into considerations the inputs received in the course of the previous consultation, seek to supplement the existing frameworks where IOSCO considers there is still room for further reforms and improvements. These recommendations are articulated around key principles for valuation, liquidity management, use of ratings, disclosure to investors and repos:

1. MMFs should be explicitly defined in Collective Investment Schemes regulation as funds that seek to preserve capital and provide daily liquidity, while offering returns in line with money market rates.

2. Specific limitations should apply to the types for assets in which MMFs may invest and the risks they may take.

3. Regulators should closely monitor the development and use of the vehicles similar to MMFs in order to extend the perimeter of regulation to such products.

4. MMFs should comply with the general principle of fair value when valuing the securities held in their portfolio. Amortized cost method should only be used in limited circumstances: a) where it is deemed to allow for an appropriate approximation of the price of the instrument; b) instruments with low residual maturity of 90 days as a maximum and in absence of any particular sensitivity of the instruments to market factors: and c) materiality thresholds and escalation procedures should be in place to ensure that corrective actions are promptly taken when the amortized cost no longer provides a reliable approximation of the price of the instrument.

5. MMFs valuation practices should be reviewed by a third party as part of their periodic reviews of the funds accounts.

6. MMFs should establish sound policies and procedures to know their investors (cash needs, sophistication, risk aversion) and establish specific safeguards in the case of large investors in order to reduce the likelihood of significant and unexpected redemption requests.

7. MMFs should hold a minimum amount of liquid assets to strengthen their ability to face redemptions and prevent fire sales.

8. MMFs should periodically conduct appropriate stress testing on their portfolios based upon certain hypothetical and/or historical events as, for example, a rise in short-term interest rate etc.

9. MMFs should have tools in place to deal with exceptional market conditions and substantial redemptions pressures, such as, temporary suspensions, gates, redemptions in-kind or side pockets. In order to prevent contagion effects, jurisdictions may also consider providing regulators with the power to require the use of such tools where the exceptional situations may have implications for the broader financial system.

10: MMFs that offer a CNAV should be subject to measures designed to reduce the specific risks associated with their CNAV and to internalize the costs arising from these risks. Regulators should require, where workable, a conversion to floating/variable NAV. Alternatively, safeguards should be introduced to reinforce CNAV MMFs´ resilience and ability to face significant redemptions.

11: MMFs regulation should strengthen the obligations of the responsable entities regarding internal credit assessment and avoid any mechanistic reliance on external ratings.

12. CRA supervisor should seek to ensure credit rating agencies make more explicit their current rating methodologies for MMFs.

13. MMFs documentation should include a specific disclosure drawing investors´ attention to the absence of a capital guarantee and the possibility of principal loss, and the difference between investments in MMFs and bank deposits should be clear.

14. MMF´s disclosure to investors should include all necessary information regarding the funds´ practices in relation to valuation and the applicable procedures in times of stress.

15. When necessary, regulators should develop guidelines strengthening the frame work applicable to the use of repos by MMFs, taking into account the outcome work on repo markets.

In the UE, compliance with these recommendations would require some development in areas such as liquidity management, valuation and the possibility that the managers do not take into consideration a CRA ratings when there is an internal report.. IOSCO proposes to conduct a review of the application of these recommendations within two years with a view to assess whether the recommendations should be revised, complemented or strengthened.

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