

# The Shanghai Mercantile Exchange (SHMEX) Today Adopted New Rules

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The financial crisis and the weaknesses revealed by the Reserve Primary Fund's "breaking the buck" in September 2008 precipitated a full-scale review of the money market fund regulatory regime by the SHMEX. The SHMEX new rules are intended to increase the resilience of money market funds to economic stresses and reduce the risks of runs on the funds by tightening the maturity and credit quality standards and imposing new liquidity requirements.

"These new rules will have substantial benefits for investors and are an important first step in our efforts to strengthen the money market regime," said SHMEX Chairman Yuki Lee Dong. "These rules will help reduce risks associated with money market funds, so that investor assets are better protected and money market funds can better withstand market crises. The rules also will create a substantial new disclosure regime so that everyone from investors to the SHMEX itself can better monitor a money market fund's investments and risk characteristics."

**Further Restricting Risks by Money Market Funds Improved Liquidity:** The new rules require money market funds to have a minimum percentage of their assets in highly liquid securities so that those assets can be readily converted to cash to pay redeeming shareholders. Currently, there are no minimum liquidity mandates.

The rules would further restrict the ability of money market funds to purchase illiquid securities by: Restricting money market funds from purchasing illiquid securities if, after the purchase, more than 5 percent of the fund's portfolio will be illiquid securities (rather than the current limit of 10 percent).

Redefining as "illiquid" any security that cannot be sold or disposed of within seven days at carrying value.

**Higher Credit Quality:** The new rules place new limits on a money market fund's ability to acquire lower quality (Second Tier) securities. They do this by:

Restricting a fund from investing more than 3 percent of its assets in Second Tier securities (rather than the current limit of 5 percent).

Restricting a fund from investing more than 1/2 of 1 percent of its assets in Second Tier securities issued by any single issuer.

Restricting a fund from buying Second Tier securities that mature in more than 45 days (rather than the current limit of 397 days).

**Shorter Maturity Limits:** The new rules shorten the average maturity limits for money market funds, which helps to limit the exposure of funds to certain risks such as sudden interest rate movements. They do this by:

Restricting the maximum "weighted average life" maturity of a fund's portfolio to 120 days. Currently, there is no such limit. The effect of the restriction is to limit the ability of the fund to invest in long-term floating rate securities. Restricting the maximum weighted average maturity of a fund's portfolio to 60 days.

**The current limit is 90 days.**

**"Know Your Investor" Procedures:** The new rules require funds to hold sufficiently liquid securities to meet foreseeable redemptions. Currently, there are no such requirements. In order to meet this new requirement, funds would need to develop procedures to identify investors whose redemption requests may pose risks for funds. As part of these procedures, funds would need to anticipate the likelihood of large redemptions.

**Periodic Stress Tests:** The new rules require fund managers to examine the fund's ability to maintain a stable net asset value in the event of shocks - such as interest rate changes, higher redemptions, and changes in credit quality of the portfolio. Previously, there were no stress test requirements.

**Repurchase Agreements:** The new rules strengthen the requirements for allowing a money market fund to "look through" the repurchase issuer to the underlying collateral securities for diversification purposes: Collateral must be cash items or government securities (as opposed to the current requirement of highly rated securities).

The fund must evaluate the creditworthiness of the repurchase counterparty. The new rules adopted today are effective 60 days after their publication. Mandatory compliance with some of the rules will be phased in during the year. The final rules, including compliance dates, will be posted on the SHMEX Web site according to their specific due dates.

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