



Proposal for a Regulation on Money Market Funds. November 2013.

The European Commission (EC) has published, on the 4th September, a communication on shadow banking and a proposal for a regulation of the European Parliament and the Council on Money Market Funds (forward MMFs). This proposal is based on a EP resolution on shadow banking (November 2012) that requests the EC to prepare a regulation on MMFs as they are considered relevant part of the phenomenon of shadow banking due to MMFs systematic interconnection with the banking sector and the government and business funding .

The proposed Regulation covers money market funds (MMFs) domiciled, managed and/or marketed in the EU and seek to improve its liquidity profile and its stability:

- **Liquidity management:** MMFs would be required to have at least 10% of their portfolio in assets that mature within a day and another 20% that mature within a week. This requirement is there to allow the MMFs to repay investors who want to withdraw funds at short notice. In order to avoid that a single issuer bears undue weight in the net asset value (NAV) of an MMF, exposure to a single issuer would be capped at 5% of the MMF's portfolio (in value terms). For standard MMFs, a single issuer could account for 10% of the portfolio.
- **Stability:** to take account of the constant NAV, MMF's propensity to require sponsor support to stabilise redemptions at par, the new rules would require this type of MMF to establish a predefined capital buffer. This buffer will be activated to support stable redemptions in times of decreasing value of the MMFs investment assets.

The proposal consists of 9 chapters whose main changes are described below:

General provisions. MMFs must be expressly authorized in accordance with the new Regulation. Undertakings for Collective Investment in Transferable Securities (UCITs) will be authorized as a MMF as part of the authorisation procedure pursuant to Directive 2009/65/EC. Alternative Investment Funds (AIFs) shall be authorized as a MMF according to a new procedure established in this proposal. A UCITS or AIF shall use a designation that suggests a MMF or use terms such as "cash", "liquid", "money", "ready assets", "deposit-like" or similar words only where they have been authorized in accordance with this Regulation. The competent authorities shall inform ESMA of any authorisations granted or withdrawn. ESMA will keep a central public register identifying each MMF.

Investment Policy. MMFs shall invest only in one or more of the following 4 categories of assets: 1) money market instruments, that is, with legal or residual maturity of 397 days or less and high credit quality, 2) deposits with credit institutions that permit cash withdrawal at any time, 3) financial derivative instruments with the purpose of covering the risks of interest rate and exchange rate, and 4) reverse repurchase agreements whose underlying is an eligible money market instrument, the market value of the assets received is at least equal to the value of the cash given out, and upon a notice of maximum two working days the agreement can be cancelled. The proposal also lays down detailed rules on diversification of assets in which MMFs can invest and concentration limits per issuer, and introduces the obligation for managers to have an internal assessment procedure and an internal rating system to assess the credit quality of the assets.

Obligations concerning the risk management. There are two types of MMFs: short-term and standard. Short-term MMFs may invest in securities with shorter weighted average maturity (not exceeding 60 days) and weighted average life (not more than 120 days). The standard MMFs may invest in instruments with a weighted average maturity of no more than 6 months and weighted average life of no more than 12 months. The standard MMFs have less stringent diversification limits (may invest up to 10% of its assets in a single issuer and up to 15% of its assets in the combined limit) and shall not take the form of a constant Net Asset Value (NAV) MMF. MMFs shall not solicit or finance a credit rating agency from rating the MMF. The MMFs will have a "know your customer" policy to identify the number of investors, their needs, the amount of their holding to correctly anticipate the effect of concurrent redemptions by several investors so that redemption by an investor does not exceed the value of daily

maturing assets and does not materially impact the liquidity profile of the MMF. For each MMFs there shall be in place sound stress testing processes every year.

Valuation rules. The net asset value (NAV) per unit or share shall be calculated at least daily. The assets shall be valued by using marking to market whenever possible and, when it is not possible or market data are not of sufficient quality, assets shall be valued conservatively by using marking to model. For the purposes of the assets of a constant NAV MMFs, the amortized cost method may also be applied.

Specific requirements for constant NAV MMFs. The constant NAV MMFs explicitly authorized may apply the method of amortized cost valuation and publish a constant net asset value. The constant NAV MMFs must satisfy additional requirements, among them, the constant NAV MMF shall establish and maintain a NAV buffer amounting at all times to at least 3% of the total value of the fund's assets. The NAV buffer shall be used exclusively to cover differences between the constant NAV and the NAV. Whenever the amount of the NAV buffer falls below 3% it shall be replenished and, if it is not, the fund shall automatically cease to be a constant NAV MMFs. The NAV buffer shall be composed only of cash and shall be held in a protected reserve account opened at a credit institution and segregated from any other account. The depositary shall verify any transfers from the reserve account.

External support. External support shall mean a direct or indirect support offered by a third party that is intended for or in effect would result in guaranteeing the liquidity of the MMF or stabilising the NAV, for example, cash injections or guarantees for the benefit of the fund. MMFs other than constant NAV MMFs shall be allowed to receive external support only in exceptional circumstances or systemic implications caused by adverse market conditions.

Transparency requirements. MMFs shall indicate in any external or internal document, report statement, advertisement, letter or on any other written evidence whether it is a short-term, a standard MMF or a constant NAV MMF. Investors shall be informed of the method or methods used to value the assets and calculate the NAV. Any document used for marketing purposes shall include the following statements: the MMF is not a guaranteed investment, the risk of loss of the principal has to be borne by the investors and the MMF does not rely on external support for guaranteeing the liquidity of the fund or stabilising the NAV. The MMFs have quarterly reporting obligations to competent authorities who forwarded the information to ESMA in order to create a central database of all MMFs established, operated or marketed in the EU.

Supervision. The competent authority of the fund will be responsible for monitoring compliance with provisions on investment policy, risk management, valuation, transparency, constant NAV funds and external support. The competent authority of the manager will oversee its procedures and organization.

Final provisions. Existing funds shall submit, within six months from the entry into force of this Regulation, an application to its competent authority that shall have a period of two months to assess if the fund complies with the provisions of the new Regulation. Existing funds that meet the criteria of constant NAV funds have three years to gradually establish the NAV buffer.

If you want to read the whole text of the proposal for the Regulation, please, do click on: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2013:0615:FIN:EN:PDF>

If you want to read the EC press release on the road map for tackling the risks inherent in shadow banking, please, do click on: http://europa.eu/rapid/press-release_IP-13-812_en.htm?locale=en