



The future Regulation on Money Market Funds. February 2017.

On 7 December 2016, the Permanent Representatives Committee approved, on behalf the European Union's behalf, an agreement with the European Parliament creating the draft Regulation of the European Parliament and Council on Money Market Funds (MMFs). The 2007-2008 financial crisis had shown the vulnerability of MMFs when mass redemptions forced them into fire sales of assets to raise liquidity, triggering adverse knock-on effects in other parts of the financial system. The MMF regulation stemmed from the initiative by the G20 and FSB to strengthen oversight and Regulation of shadow banking. The European Commission published its proposal for MMF Regulation more than three years ago (in September 2013), alongside its communication on shadow banking, which was designed to deal with the systemic interconnection between MMFs and the banking sector and their role in channelling finance to public bodies and private companies.

The future MMF Regulation is an important step forward for the EU given that other jurisdictions already regulate MMFs. In the USA for instance reforms have been in force since October 2016. Until this Regulation was published, the only European recommendations on MMFs were the CESR (precursor of ESMA) guidelines on a common definition of European money market funds (May 2010), as amended by an ESMA opinion (August 2014) on overreliance on external credit ratings.

PROPOSAL FOR A REGULATION

MMFs are funds, either undertakings for collective investment in transferable securities (UCITS) or alternative investment funds (AIFs), which invest in short-term assets - maturities of two years or shorter - and which aim to offer returns in line with money market rates or to preserve the investment value or both simultaneously. MMFs are classed as either short-term MMFs or standard MMFs depending on the legal maturity and residual maturity of the assets in which they are allowed to invest.

The draft Regulation seeks to tighten up MMF Regulation so as to guarantee the smooth functioning of the short-term finance market and maintain its essential role in financing the real economy, particularly SMEs.

TWO NEW CATEGORIES

The European Parliament's biggest contribution to the Commission's initial draft was to introduce, in addition to variable net asset value MMFs (VNAV MMFs), whose price depends essentially on market fluctuations, two new permanent classes of MMF: a) the low volatility net asset value MMF (LVNAV MMF) and b) the constant net asset value public debt MMF (CNAV public debt MMF). The CNAV public debt MMF maintains an unchanging net asset value for subscriptions and redemptions and is obliged to invest 99.5% of their assets in public debt instruments, reverse repurchase agreements secured by EU institutions and in cash.

Low volatility NAV MMFs must meet special conditions on valuing their portfolio and liquidity management. Regarding portfolio valuation, they have to calculate a daily constant NAV based on the amortized cost of

assets and a daily real NAV, which is marked to market. Subscriptions and redemptions are priced at the constant NAV per share or unit unless this deviates by more than 20 basis points from the real NAV at market prices. Regarding liquidity management, and this also applies to constant NAV MMFs, the Regulation sets out strict daily and weekly liquidity requirements to meet possible redemption demands, as well as a system of liquidity fees and redemption gates and suspensions in the event of a liquidity shortfall to prevent or limit the effects of sudden investor runs.

NEW CONTROL AND TRANSPARENCY SYSTEMS

All MMFs will be subject to new control and transparency systems. MMFs will have to run robust stress tests at least twice yearly. Also, MMF assets will have to be valued at least daily and the results published each day in the public section of the fund's website. The Parliament's proposals would also require public disclosure of the MMF's ten biggest holdings. Enhanced transparency is meant to ensure that investors and supervisors alike have timely and appropriate information. In addition, fund managers must have know-your-customer policies that allow them to identify the class of investor, number of fund units held and patterns of subscriptions or redemptions so that they can appropriately anticipate the impact of simultaneous exits by multiple investors.

MMF PORTFOLIOS

MMF portfolios must be made up of a set of assets considered eligible according to its high credit rating: a) money market instruments; b) deposits with credit institutions; c) financial derivative instruments; d) eligible securitisations and asset backed commercial paper (ABCP); and d) repurchase and reverse repurchase agreement under certain conditions. Also, MMF managers must carry out their own credit quality assessments on all money market instruments and assign an internal credit rating to each issuer. As from the date of application of the future Regulation laying down common rules on securitisation and creating a European framework for simple, transparent and standardised securitization, the aggregate of all exposure to securitisations and ABCPs shall not exceed 20% of the assets of a MMF whereby up to 15% of the assets of a MMF may be invested in securitisations and ABCP not compliant with the criteria for the identification of simple, transparent and standardised securitisations and ABCPs.

LIQUIDITY AND DIVERSIFICATION REQUIREMENTS

The new stricter **liquidity requirements** for MMFs are as follows:

- LVNAV and CNAV MMFs must invest at least 10% of their assets in daily maturing assets and at least 30% in weekly maturing assets. Of the minimum liquidity required in weekly maturing assets, MMF can invest up to 17.5% of their weekly maturity liquidity requirement in public debt instruments highly liquid so that those instruments can be redeemed and liquidated in one trading day and have a residual maturity of up to 190 days.
- Variable NAV MMFs must invest at least 7.5 % of their assets in daily maturing assets, and at least 15 % in weekly maturing assets. They can invest up to 7.5% of their weekly maturity liquidity requirement in money market instruments or shares/units of other MMFs.

The new portfolio **diversification requirements** are as follows: a 17.5% limit on investments in other MMFs, with a safeguard to prevent "circular" investments; a 15% cap on reverse repurchase agreements; specified limits for covered bonds and deposits at any single credit institution; and a targeted exemption from diversification requirements for employee saving schemes.

PUBLIC DEBT MMF

Regarding public debt CNAV MMFs, the European Commission will report after five years on the feasibility of establishing an 80% EU public debt quota. This report will have regard to the availability of short-term EU

public debt instruments and assess whether LVNAV MMFs might be an appropriate alternative for non-EU government debt CVNAV MMFs.

The Regulation includes a more general review clause obliging the European Commission to report back on how the Regulation is working after five years. Parliament is expected to approve the Regulation on first reading and it will then be submitted to the European Council for adoption.

Links:

[Proposal for a Regulation of the European Parliament and of the Council on Money Market Funds](#)

[CESR guidelines](#)

[ESMA Opinion](#)