EU: New money market funds regulation

5 April 2017

In brief

Money Market Funds (MMFs) are an important source of short-term financing for financial institutions, corporations and governments. MMFs hold almost half of short-term debt issued by the banking sector, government and corporations. On the demand side, MMFs are short-term cash management tools that provide high degree of liquidity, diversification, stability of value of the principal invested combined with a market-based yield. MMFs represent a crucial link bringing together demand and offer of short-term money.

On **4 November 2013**, the EU Commission put forward an initial draft of a MMF regulation. After lengthy negotiations, the Council presidency of the EU, the EU Commission and the EU Parliament reached on **14 November 2016** a provisional agreement on the draft regulation.

On **7 December 2016**, the Committee of Permanent Representatives (Coreper) approved legislation final text.

On **5 April 2017**, the European Parliament voted to adopt the final text of the regulation.

What's new?

The Regulation foresees the following rules for MMFs:

A-Scope

The Regulation will apply to all MMFs that are established, managed or marketed in the EU. A MF is a UCITS or an AIF that invests in short term assets and has distinct or cumulative objectives to offer returns in line with money market rates or preserve the value of investments.

B -Types of MMFs

According to the regulation, there are three types of MMFs:

- Variable NAV MMF ("VNAV"),
- Public Debt Constant NAV MMF ("Public Debt CNAV" or "CNAV"), and
- Low Volatility NAV MMF ("LVNAV").

Here are their main features of the three categories:

1. VNAV MMFs:

VNAV MMFs calculates their Net Asset Value (NAV) using mark-to-market prices, or, by default, mark-to-model prices. The use of amortised cost is not allowed anymore.

2. Public Debt CNAV MMFs:

Public Debt CNAV MMFs aims at maintaining an unchanged NAV (or constant NAV), through daily distribution of income, the use of amortised cost method and rounding of the nearest percentage point. They will be required to invest 99.5% of their assets in public debt instruments or cash.

3. LVNAV MMFs:

LVNAV MMF's will be able to apply amortised costs to money market instruments with a remaining maturity below 75 days, as long as the difference between such amortised cost and market price of the instruments remain below 10 basis points and as long as the cumulated difference (difference between the NAV calculated under this method and the NAV calculated under the VNAV method) deviates by not more than 20 basis points.

C - Eligible assets

- Derivative contracts will only be allowed for currency and interest rate hedging purposes.
- Investment in other MMFs will be capped to 17.5%.
- Exposure to securitisations and ABCP will be limited to 15% (20% if falling under the scope of the Simple, Transparent and Standardised securitisation and ABCP regulation, once adopted).
- Securities lending, borrowing as well as taking indirect exposure to commodities are not allowed.

D - Liquidity requirements

MMFs are subject to liquidity requirements that differ depending on the type of MMFs:

- VNAV MMFs: at least 7.5% of daily maturing assets (including cash and reverse repo) and 15% in weekly maturing assets (which may include up to 7.5% of assets that may be sold within five business days).
- CNAV and LVNAVs MMFs: at least 10% of daily maturing assets (including cash and reverse repo) and 30% in weekly maturing assets (which may include up to 17.5% of public debts instruments with a residual maturity up to 190 days).

E -Liquidity fees and gates

Whenever the weekly maturing assets of a CNAV MMF or an LVNAV MMF falls below 30% of the total assets of the MMF and whenever daily redemption request exceeds 10% of the total assets of the MMF, the MMF board of directors will consider whether it is appropriate to apply liquidity fees on redemptions, redemption gates or suspension of redemptions. Whenever the weekly maturing assets falls below 10%, the board applies at least one of these measures.

F - Internal credit quality assessment

MMFs managers will establish and implement a prudent internal credit quality assessment procedure, which will be reviewed annually by the management and the board. The EU Commission will adopt delegated acts on the credit quality assessment.

G - Stress testing

Stress tests will be conducted regularly (at least bi-annually), including factors such as changes in liquidity, credit risks, movements in interest rate, hypothetical redemption requests, changes in spreads and macro systemic shocks. In case vulnerabilities are revealed, extensive reports on the results of the stress testing will be submitted to the board of directors of the MMF and reviewed by the national competent authorities who will send them to ESMA. ESMA will issue guidelines on stress testing that will be updated annually based on market developments.

H- External support

External support (such as cash injection, purchase of assets at inflated prices, purchase of units to maintain liquidity or providing guarantees) is prohibited.

I - Transparency requirements

- **Daily**: CNAVs and LVNAVs have to publish daily on their website the difference between the NAV/unit they apply to subscription and redemption (calculated using amortised costs as described above) and the NAV per unit calculated using the variable NAV methodology (valuing assets to mark-to market or mark-to-model).

- **Weekly**: All MMFs must make available weekly information on maturity breakdown of the portfolio, credit profile, WAM, WAL, ten largest holding, total value of assets and net yield.

- **Quarterly** reporting to competent authorities (annually if AUM<EUR 100 millions). ESMA will prepare draft ITS within six months of entry into force.

J - Know your customer (KYC) policy

MMFs managers will have to implement procedures and due diligence processes in order to be in a position to anticipate the effects of concurrent redemptions requests. If the value of the units or shares held by a single investor exceeds the amount of daily liquidity requirement of the fund, MMFs managers shall consider several factors amongst which the type of investors, the number of shares in the fund owned by a single investor, evolution of inflows and outflows, identifiable patterns in investors cash needs, level of correlation or close links between different investors, risk of aversion of different investors). MMFs managers will have to require necessary information from the intermediary in order to manage the liquidity of the MMF as well as investor concentration. It shall ensure that the value of units or shares held by a single investor does not materially impact the liquidity profile of the MMF.

K - Review clause

The sunset clause formerly proposed by the EU parliament has been abandoned in favour of the review clause suggested by the Council of the EU. The review of the regulation will take place five years after entry into force. The review will examine the LVNAV and CNAV regimes. It will in particular consider the feasibility of introducing an 80% EU public debt quota for Public debt CNAV MMFs.

L - Application date and grandfathering

The regulation will enter into force 20 days after publication in OJEU (expected early Q2 2017) and will apply 12 months later (Q2 2018). Existing funds (UCITS, AIFs) will be grandfathered for 18 months after entry into force (Q4 2018).

What's next?

The final text shall be published shortly in the Official Journal of the EU, which will trigger entry into force 20 days later.

Let's talk

Olivier Carré	Partner	+352 49 48 48 4174	olivier.carre@lu.pwc.com
Nathalie Dogniez	Partner	+352 49 48 48 2040	nathalie.dogniez@lu.pwc.com
Sebastian Schieck	Manager	+352 49 48 48 3361	sebastian.schieck@lu.pwc.com