Money Market Fund (MMF) Reform

Background

On 29 April 2015, the European Parliament agreed its position on MMF reform following a plenary vote. The agreed text was consistent with that put forward in March by the Economic and Monetary Affairs Committee (**ECON**), which had proposed a Regulation on MMF reform. ECON had voted on this report in February, and released a press release at the time stating that it had "approved a draft law that would make MMFs safer, provide for more transparency, investor information and investor protection".

Proposals

Under the draft proposals there would be three types of MMF in Europe:

- A Retail Constant NAV (**CNAV**) MMF, which will only be available for subscription by retail investors.
- A Public Debt CNAV MMF, which would be required to invest 99.5% of its assets in public debt instruments and, by 2020, at least 80% of its assets in EU public debt instruments.
- A Low Volatility NAV MMF (**LV-NAV MMF**), which would be permitted to value at a constant NAV rounded to two decimal places. Under the legislation, as currently proposed in the Parliamentary Report, the permitted level of volatility for LVNAV MMF (i.e. the difference between the NAV calculated using amortised cost and market value) would be 20bps; if this limit is exceeded the LV-NAV MMF would be required to issue and redeem units on a variable NAV basis.

The proposals include a sunset clause whereby the authorisation of a LV-NAV MMF will lapse five years after the reforms come into effect. The proposals contemplate a review of the performance of the LVNAV MMF model by the Commission after four years, following which the five year sunset clause may be removed, allowing LV-NAV MMFs to continue indefinitely.

The proposals also provide for a system of liquidity fees and/or redemption gates to be imposed by each of the three new forms of MMF on their investors in order to prevent significant redemptions during times of market stress.

The earlier proposal for the imposition of a 3% capital buffer has been removed, as has the proposed ban on soliciting an external credit rating.

Earlier proposals relating to enhanced daily and weekly liquidity requirements, risk diversification, stress testing, reporting and transparency requirements have all been retained with some modification.

Next Steps

Following approval of the proposals by the European Parliament the Council of Ministers must also now agree its position on MMF reform, and this may not take place until early 2016. After the Council of Ministers has finalised its position inter-institutional negotiations will commence. In their current format the proposals allow for a nine month transition period; similar proposals last year in the US allowed for a two year transition.

Potential Issues

A number of potential issues (which are likely to be the subject of much lobbying by interested parties) have been identified with the current proposals, including the following:

- The sunset clause for an LV-NAV MMF needs to be removed as it creates a large element of uncertainty and its retention could discourage MMF fund promoters from engaging with this new form of MMF.
- The permitted level of volatility for an LV-NAV MMF is too restrictive and needs to be increased from 20bps to a minimum of 25bps.
- The imposition of liquidity fees and redemption gates should be voluntary and not mandatory for a Retail CNAV MMF and a Public Debt CNAV MMF.
- The definition of "retail" for the purposes of a Retail CNAV MMF is too narrow and needs to be expanded to include "natural persons" and any account for which the ultimate beneficial owner is a natural person (e.g. pension funds).
- The required 80% exposure to EU government debt by 2020 is unrealistic for a Public Debt CNAV MMF and will impact negatively on the take up of this new form of MMF. The 80% figure needs to be removed and such funds need to be able to invest in US government debt and other non EU government debt.
- Government debt should be included in the daily liquidity requirements.
- The proposed transition period of nine months is unrealistic and needs to be extended to a minimum of two years.

Irish Funds Industry Association response

Following approval of the proposals by the European Parliament, Pat Lardner, Chief Executive of the Irish Funds Industry Association (**IFIA**) said:

"As currently drafted, we do not believe the proposals deliver an alternative which will adequately meet the needs of existing CNAV investors. Additionally, there is a significant risk that the solutions outlined in the current proposal will undermine and potentially destabilise the move to a Capital Markets Union in Europe. Efficient capital markets rely on exactly the type of liquidity which MMFs provide to fund public and private sector entities across the EU and beyond.

"As the decision making process moves to the Council of Ministers and trilogue negotiations, IFIA will continue to engage with the relevant parties and advocate to reach an outcome that meets the needs of European investors and the financing requirements of the real economy, while at the same time addressing the policy objectives of ensuring a robust regulatory framework for money market funds."

Advice

A&L Goodbody acts for a large number of MMFs, and has assisted a number of clients in establishing, re-domiciling and merging such funds. We will continue to monitor developments on MMF reform and will keep clients updated accordingly.

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