

Money Market Fund (MMF) Reform

Introduction

Regulation (EU) 2017/1131 of the European Parliament on MMFs (the **MMF Regulation**) was published in the Official Journal of the European Union on 30 June 2017. It will now enter into force on the twentieth day following that of publication. The MMF Regulation will be subject to a twelve month transitional period and must be implemented by EU member states by 21 July 2018 (with the exception of Article 11(4), Article 15(7), Article 22 and Article 37(4) which shall apply from 20 July 2017). Existing MMFs have an eighteen month transitional period which will end on 21 January 2019.

As well as introducing three categories of MMF, the MMF Regulation introduces new requirements for MMFs in particular, portfolio composition, valuation of assets, diversification, liquidity management and credit quality of investment instruments. The rules will apply to all MMFs, whether they are UCITS or alternative investment funds (AIFs).

Types of MMF

Under the Regulation there will be three types of MMF in Europe:

1. Variable Net Asset Value MMF (VNAV MMF):

VNAV MMFs calculate the MMF's net asset value (NAV) on the basis of a marked-to-market/marked-to-model basis. This is not a new type of MMF and the key changes to the current VNAV MMF model relate to liquidity management and eligible assets.

2. Public Debt Constant Net Asset Value MMF (CNAV MMF):

CNAV MMFs are required to invest at least 99.5% of their assets in EU or non-EU government securities and securities issued by central banks and other prescribed international financial institutions. On that basis they are permitted to use the amortised cost valuation methodology and accordingly calculate a constant NAV per share.

3. Low Volatility Net Asset Value MMF (LVNAV MMF):

Where a MMF does not qualify as a CNAV MMF by virtue of its portfolio composition, the LVNAV MMF is seen as a viable alternative. LVNAV MMFs are permitted, under strict conditions, to use the amortised cost valuation methodology and accordingly calculate a constant NAV per share.

Issue and redemption price

The units or shares of a LVNAV MMF may be issued or redeemed at a price that is equal to its constant NAV, provided the constant NAV does not deviate for the marked to market NAV by more than 20bps; if this limit is exceeded the LVNAV MMF is required to issue and redeem units on a variable NAV basis.

Liquidity

For LVNAV MMFs and CNAV MMFs, a minimum 10% of the MMF's portfolio investment must be in daily maturing assets, reverse repurchase agreements which can be terminated within one business day prior notice or cash which can be withdrawn within a one business day prior notice and a minimum 30% portfolio investment in weekly maturing assets. Of the minimum liquidity required in weekly maturing assets, up to 17.5% may be held in public debt instruments.

For VNAV MMFs, a minimum 7.5% of the MMF's portfolio investment must be in daily maturing assets, reverse repurchase agreements which can be terminated within one business day prior notice or cash which can be withdrawn within a one business day prior notice and a minimum 15% portfolio investment in weekly maturing assets. Of the minimum liquidity required in weekly maturing assets, up to 7.5% may be held in money market instruments or units/shares of other MMFs.

For CNAV and LVNAV MMFs, there are also additional safeguards such as 'liquidity fees and redemption gates', designed to prevent and limit the effects of sudden investor runs.

Risk diversification

The MMF Regulation contains detailed rules on the diversification of eligible investments for MMFs and the concentration limits that an MMF can hold in a single issuer. This aims to limit risk-taking by MMFs and subjects the portfolio of MMFs to clear diversification requirements.

Stress Testing

The MMF Regulation requires that a sound stress testing process is put in place for each MMF that identifies possible events or future changes in the economic conditions that could have unfavourable effects on the MMF. The frequency of stress testing may be decided by the board of directors of the MMF but must be carried out at least bi-annually. The board of directors of the MMF are required to take action to strengthen the robustness of the MMF, where necessary, following the results of the stress testing.

Reporting and Transparency requirements

The MMF Regulation includes increased transparency requirements. The reporting requirements apply to MMFs in addition to the requirements under AIFMD and the UCITS Directive (the **Directives**). The activities of the managers will continue to be subject to the Directives but the product rules contained under the UCITS framework and the AIF Rulebook will be supplemented by the product rules contained in the MMF Regulation.

Main Features of the MMF Regulation

Valuation rules

While the marked to market valuation method is the general method of valuation for MMFs, assets of CNAV MMFs and LVNAV MMFs (provided they have a residual maturity of up to 75 days) may also be valued by using the amortised cost method. Individual assets of a LVNAV MMF must be valued marked to market if the mark to market price of the asset deviates from the price calculated using amortised cost accounting by more than 10bps.

Existing UCITS or AIFs that invest in short term assets and have as distinct or cumulative objectives offering returns in line with money market rates or preserving the value of the investment must, within 18 months of entry into force of the MMF Regulation, submit an application to their relevant national competent authority to demonstrate compliance with the MMF Regulation. Competent authorities will then assess whether the MMF is in compliance and must issue a decision within two months of receipt of a completed application.

External support

The MMF Regulation prohibits sponsor support from third parties, including banks, that is intended for or in effect would result in guaranteeing the liquidity of the MMF or stabilising the NAV per unit or share of the MMF.

Review and next steps

The MMF Regulation includes a clause requiring the European Commission to undertake a review on the functioning of the MMF Regulation five years after its implementation, to consider whether any changes should be made including, issuing a report on the feasibility of establishing an 80% EU public debt quota for CNAV MMFs based on the availability of such securities.

Separately, ESMA is currently drafting implementing technical standards for submission to the European Commission with regard certain elements of the MMF Regulation which are expected by end 2017.

How A&L Goodbody can help you

A&L Goodbody acts for a large number of MMFs, and has assisted multiple 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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