

**MEMO# 30492**

December 21, 2016

## **EU Policymakers Reach Agreement on MMF Reform**

[30492]

December 21, 2016 TO: ICI Members

Investment Company Directors

ICI Global Members

Money Market Funds Advisory Committee SUBJECTS: International/Global

Money Market Funds RE: EU Policymakers Reach Agreement on MMF Reform

Earlier this month, the European Council and the European Parliament reached an agreement on the regulation of money market funds.[\[1\]](#) The agreement, which is expected to be approved by the Parliament and then adopted by the Council during the first quarter of 2017, builds upon the legal framework governing the establishment, management, and marketing of collective investment undertakings that operate in the EU as either undertakings for collective investment in transferable securities (UCITS) or alternative investment funds (AIFs). For UCITS and AIFs that have the objective of offering returns in line with money market rates, or of preserving the value of the investment, and that seek to achieve these objectives by investing in short term assets, compliance with the new rules would be mandatory.

### **Types of Money Market Funds**

The agreement establishes three types of money market funds:

- Variable net asset value money market funds (VNAVs)—a type of money market fund that, as the name suggests, offers a variable net asset value that mainly depends on market fluctuations;
- Public debt constant net asset value money market funds (public debt CNAVs)—a new category of money market funds that
  - seeks to maintain an unchanging NAV per unit or share,
  - accrues daily income that is either paid out to the investor or used to purchase more units in the fund;
  - generally values its assets according to the amortised cost method and rounds its NAV to the nearest percentage point or its equivalent in currency terms (e.g., \$1.00); and
  - invests at least 99.5 percent of its assets in government debt or reverse repurchase agreements secured with government debt.
- Low volatility net asset value money market funds (LVNAVs)—a new category of money market funds intended as an alternative to existing CNAV money market funds (further information is described below).

## Requirements

Among other things, the agreement establishes rules regarding the assets in which money market funds can invest (articles 8, 9, 10, 11, 12, 12a, 13, 13a), diversification and concentration (articles 14 and 15) maturity and liquidity (articles 21, 22), know your customer policies (article 24), stress testing (article 25), valuation and calculation of NAVs (articles 26, 27, 27a, 27b), issue and redemption price (article 28), liquidity fees and redemption gates for public debt CNAV and LVNAV (article 29), a ban on external sponsor or third party support (article 35), and transparency and reporting requirements (articles 37, 38).

In particular, the agreement includes the following liquidity requirements:

- *LVNAV and public debt CNAV*s: a minimum portfolio investment of 10 percent in daily maturing assets and 30 percent in weekly maturing assets (of which up to 17.5 percent may be held in public debt instruments).
- *VNAV*s: A minimum portfolio investment of 7.5 percent in daily maturing assets and 15 percent in weekly maturing assets (of which up to 7.5 percent may be held in money market instruments or units or shares of other money market funds).

The agreement also includes the following diversification and concentration requirements:

- a 17.5 percent limit on investments in other money market funds;
- a 15 percent limit on reverse repurchase agreements;
- specified limits for covered bonds and deposits in the same credit institution; and
- an exemption for employee saving schemes from the diversification rules.

## LVNAVs

As noted above, the agreement includes a new category of money market funds that are designed as an alternative to the existing CNAV money market funds. LVNAV money market funds would be permitted to value at a constant NAV (calculated at least daily) rounded to two decimal places and to use amortised cost accounting for assets with a residual maturity of less than 75 days, provided the assets do not deviate from market prices by more than 10 basis points. All assets with a residual maturity of more than 75 days (or assets that deviate from market prices by more than 10 basis points) would be priced using mark-to-market or mark-to-model. If the constant NAV deviates from the shadow NAV by more than 20 basis points, the NAV would need to float.

## Fees and Gates

To ensure compliance with the weekly liquidity thresholds, the agreement includes specific requirements for public debt CNAV and LVNAV. Specifically, the agreement provides that if weekly liquid assets fall below 30 percent and net daily redemptions on a single business day exceed 10 percent of total assets, the manager of a public debt CNAV or a LVNAV must immediately inform its board. The board must then undertake a documented assessment of the situation to determine the appropriate course of action and decide whether to apply one or more of the following measures:

- impose liquidity fees on redemptions that adequately reflect the cost to the money market fund of achieving liquidity and ensure that investors who remain in the fund are not unfairly disadvantaged when other investors redeem their units or shares during the period;
- impose redemption gates that limit the amount of shares or units to be redeemed on any one working day to a maximum of 10 percent of the shares or units in the money

- market fund for any period up to 15 working days;
- suspend redemptions for any period up to 15 working days; or
- take no immediate action (other than ensuring that the money market fund adopts as a priority objective the correction of the situation, taking into account the interests of its unit holders).

If weekly liquid assets fall below 10 percent, the manager of a public debt CNAV or a LVNAV must immediately inform its board. The board must then undertake a documented assessment of the situation to determine the appropriate course of action and decide whether to apply one or more of the following measures:

- impose liquidity fees on redemptions that adequately reflect the cost to the money market fund of achieving liquidity and ensure that investors who remain in the fund are not unfairly disadvantaged when other investors redeem their units or shares during the period; or
- suspend redemptions for a period of up to 15 working days.

The total duration of the suspensions may not exceed 15 days within a 90 day period. After the board has determined its course of action in either of the situations listed above, it must promptly provide details of its decision to the fund's competent authority.

## **Review Clause**

The agreement also includes a review clause requiring the EU Commission to report after 5 years on the adequacy of the regulation, including its impact on investors, EU money market funds and their managers, and the short-term financing markets.

The Commission also must report on the feasibility of establishing an 80 percent EU public debt quota for public debt CNAVs. The report will consider the availability of short term EU public debt instruments and assess whether the LVNAV money market fund may be an appropriate alternative for the non EU government debt CNAV money market fund. If the Commission determines that an 80 percent EU public debt quota is feasible, the Commission must introduce legislative proposals that would require that at least 80 percent of the public debt CNAV assets be invested in EU public debt instruments.

## **Entry into Force**

Within 18 months after the regulation's date of entry into force (most likely during the first quarter of 2017), all existing UCITS or AIF money market funds must demonstrate compliance with the regulation. New money market funds must comply within 12 months.

Jane G. Heinrichs  
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## **endnotes**

[1] The European Council's December 7, 2016 press release and draft directive is available at [http://www.consilium.europa.eu/en/press/press-releases/2016/12/07-money-market-funds/?utm\\_source=dsms-auto&utm\\_medium=email&utm\\_campaign=Money+market+funds%3a+Council+confirms+deal+with+EP](http://www.consilium.europa.eu/en/press/press-releases/2016/12/07-money-market-funds/?utm_source=dsms-auto&utm_medium=email&utm_campaign=Money+market+funds%3a+Council+confirms+deal+with+EP).

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