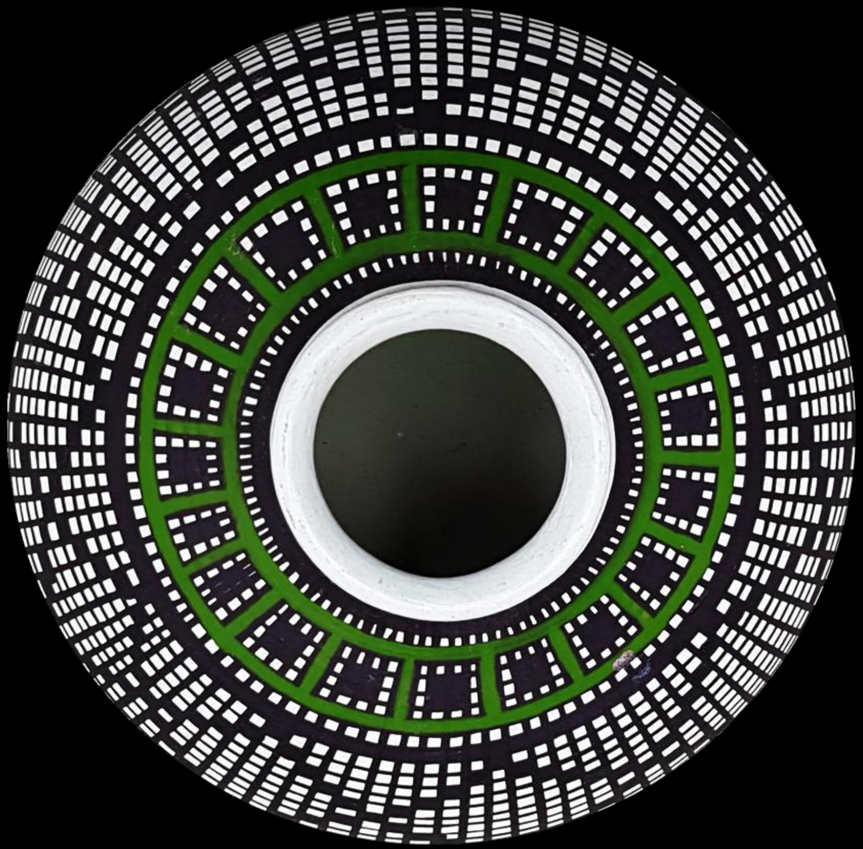

Introduction to Money Market Fund Regulation

Link 'n' Learn

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Getting Started

Here with you today

Fabian De Keyn
Director,
Financial Industry Solutions,
Luxembourg

Eoin Kelly
Manager,
Financial Services,
Ireland

Becki Sharp
Manager,
Financial Services,
Ireland

Agenda

1. MMF Regulation at a glance
2. Key attention points
3. ESMA Publication
4. Conclusions and key messages
5. Q & A

Preface

Link and Learn - Introduction to Money Market Fund Regulation

- ✓ This presentation is designed to give an **introductory overview** of the:
- ✓ Context of the Money market fund regulation
- ✓ Overview of the different roles and features of MMFs and their composition
- ✓ The main ideas behind the different sections of the Regulation
- ✓ A broad understanding about what is addressed under the release of the new ESMA Publication

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MMF Regulation at a glance

Context and background

- The financial crisis of 2007-08 showed the vulnerabilities of the MMFs
- An investor 'run' and liquidity crisis is likely when the investors redeem investments because of the risk perceived
- The regulation is aimed at making these funds more robust
- It sets out to maintain the essential role that money market funds play in financing the real economy

Weight of MMF in the EU's fund industry

EUR 1 trillion

(15 %)

- On 7 December 2016, the Permanent Representatives Committee approved an agreement with the European Parliament on money market funds (MMFs)
- The most up to date text of the Regulation itself was published for the EU Council on 26 April 2017
- Within 12 months, authorization of money market funds in accordance with the Regulation
- Existing UCITS or AIFs that invest in short-term assets operate to a longer timetable

MMF Regulation at a glance
Scope and timeline

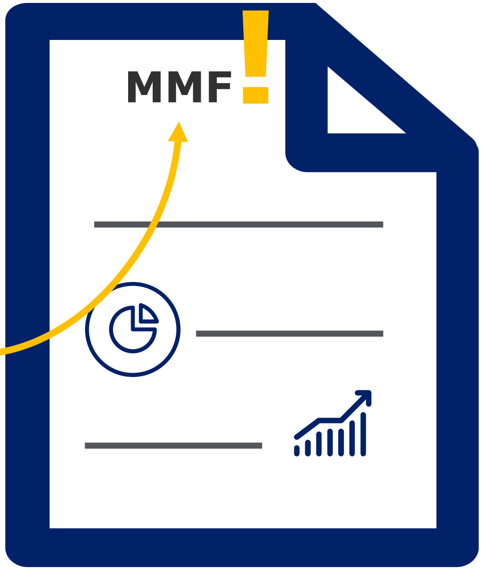
Scope

Scope of the MMFs Regulation

All UCITS &AIFs

- Established, Managed or Marketed in the Union
- That have the characteristics of MMFs:
  1. Invest in short-term assets
  2. Distinct or cumulative objectives offering returns in line with money market rates
  3. Preserving the value of the investment

When the fund is labelled 'Money Market Fund' or 'MMF`, the compliance with the MMFs Regulation is Mandatory



Timeline

SEP 2013
MMFR proposed and agreed

2017

May
Publication in Official Journal

June
Effective Date

December
Secondary legislation & guidance completed

2018

June
Implemented – new MMF

21 July
Regulation applies to new funds

December
Implemented – existing MMF

2019

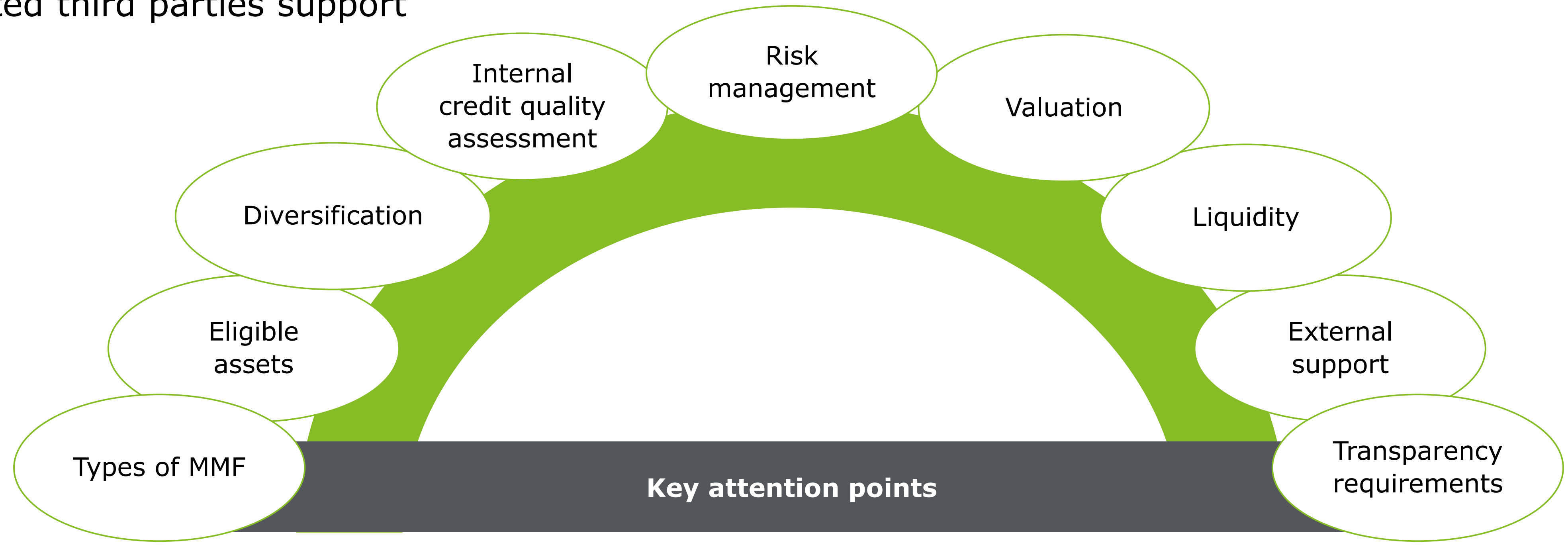
21 January
Regulation applies to existing funds

The Regulation comes into force directly in every EU Member State on 21 July 2017

MMF Regulation at a glance

Key attention points

- The regulation lays down rules for MMFs to ensure their stability and diversification
- It also introduces common standards to increase the liquidity of MMFs
- It establishes common rules to ensure good understanding of the investor behavior
- Prohibited third parties support



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Key attention points

Role and features of MMFs

Low Volatility NAV (LVNAV)

Minimum daily liquidity At least 10% of its assets	Minimum weekly liquidity At least 30% of its assets		Requirements	Valuation
Daily maturing assets Reverse REPOs (may be terminated in 1 day) Cash (may be withdrawn in 1 day)	Weekly maturing assets Reverse REPOs (may be terminated in 5 day) Cash (may be withdrawn in 5 days)	Up to **17,5%** of this limit can be Highly liquid asset: • Gobies and other institutions • Residual maturity < 190 days • May be redeemed in 1 day	WAM < 60 days WAL < 120 days	Amortised cost if: 1. Residual maturity of assets < 75 days and 2. Difference with mark-to-market method < 10bp

Public Debt CNAV

Invested at least **99.5%** either in: government debt, reverse REPOs (secured with gov. deb) and cash

Minimum daily liquidity At least 10% of its assets	Minimum weekly liquidity At least 30% of its assets		Requirements	Valuation
Daily maturing assets Reverse REPOs (may be terminated in 1 day) Cash (may be withdrawn in 1 day)	Weekly maturing assets Reverse REPOs (may be terminated in 5 day) Cash (may be withdrawn in 5 days)	Up to **17,5%** of this limit can be Highly liquid asset: • Gobies and other institutions • Residual maturity < 190 days • May be redeemed in 1 day	WAM < 60 days WAL < 120 days	• Amortised cost • Same rules as LVNAV in terms of differences Invested at least **99.5%** either in: government debt, reverse REPOs (secured with gov. deb) and cash

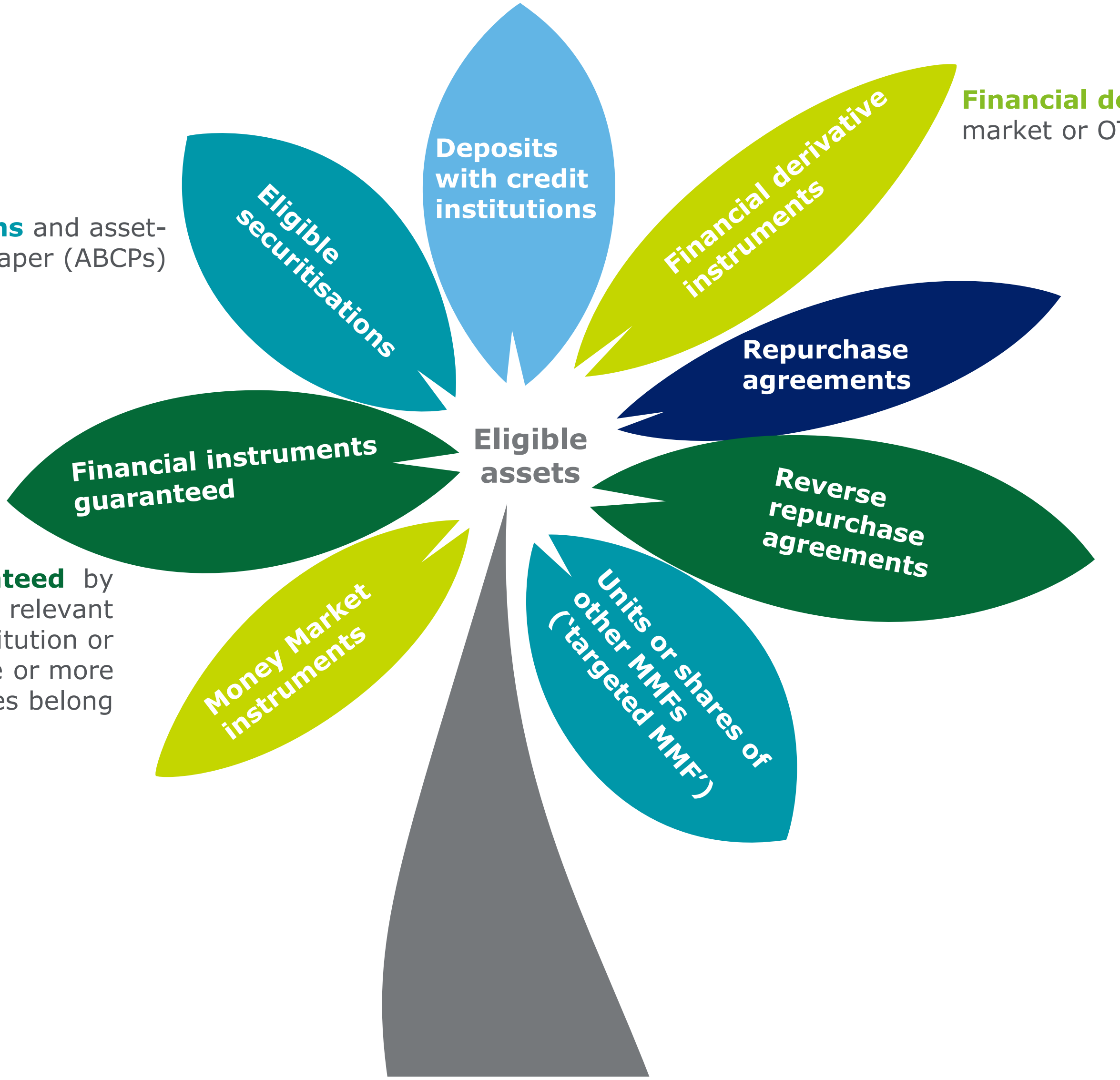
Short-term VNAV and Standard VNAV

Minimum daily liquidity At least 7,5% of its assets	Minimum weekly liquidity At least 15% of its assets		Requirements	Valuation
Daily maturing assets Reverse REPOs (may be terminated in 1 day) Cash (may be withdrawn in 1 day)	Weekly maturing assets Reverse REPOs (may be terminated in 5 day) Cash (may be withdrawn in 5 days)	Up to **7,5%** of this limit can be: • MM instruments • Units of other MMF (may be redeemed within 5 days)	• Short-term VNAV WAM < 60 days WAL < 120 days • Standard VNAV WAM < 6 months WAL < 12 months	Mark-to-Market / Mark-to-Model

Key attention points
Eligible assets

Eligible **securitisations** and asset-backed commercial paper (ABCPs)

Financial instruments guaranteed by the Union and any other relevant international financial institution or organization to which one or more Member States belong



Financial derivative instruments (regulated market or OTC, interest rate or exchange rates)

Key attention points

Diversification

Maximum Thresholds by category

(all % measures relative to the assets of the MMF)

1
- Money market instruments
- Securitisations and ABCPs

(**from the same issued body**)

5%

2
Deposit from the same credit institution

10%

3
Aggregate risk exposure to the same **OTC counterparty**

5%

Exposure to **securitizations and ABCPs** (after application delegated act)

20%

Exposure to **securitizations and ABCPs** (until application delegated act)

15%

Reverse repurchase agreements with same counterparty

15%

(Applicable to VANV MMF)
- Money market instruments
- Securitisations and ABCPs

(**from the same issued body, following rule 5%- 40%**)

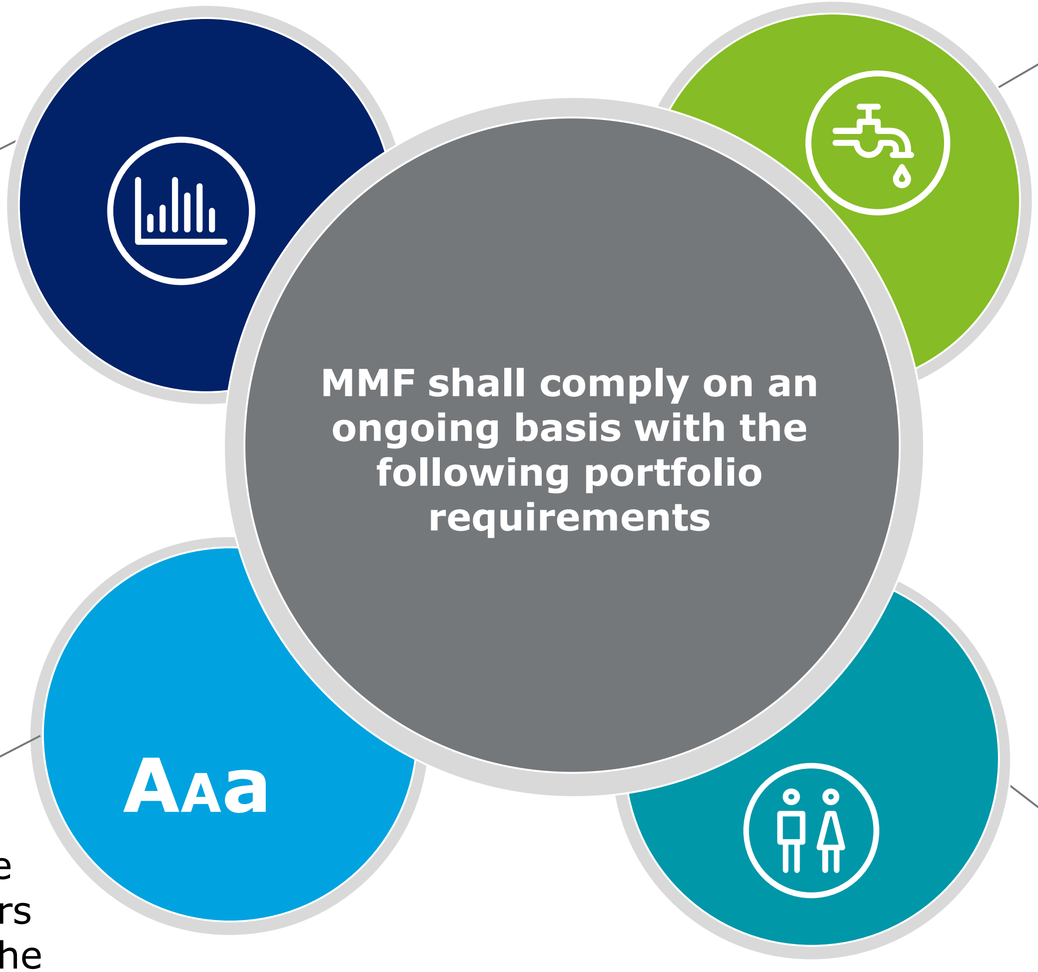
10%

1 + 2 + 3 **<15%**

(A targeted exemption from diversification rules for employee saving schemes)

Key attention points

Risk management



Stress testing

The MMF or the manager of an MMF shall regularly conduct stress testing for different possible scenarios

Maturity of the assets

A MMF shall comply on an ongoing basis with all of the requirements regarding the maturity of their assets and the **WAM** and **WAL** of their portfolio

Credit rating

When soliciting an external credit rating, disclose in the information sent to investors that it has be financed by the MMF or the manager of the MMF

Know your customer” policy

The manager shall exercise all due diligence with a view to anticipating the effect of concurrent redemptions by several investors

Key attention points

Valuation Rules

- The assets of an MMF shall be valued by using **mark-to-market whenever possible** and on at least a daily basis. Where use of mark-to-market is not possible or the market data is not of sufficient quality, an asset of an MMF shall be valued conservatively by using mark-to-model. **Amortized cost method** may be used **in some defined cases**

- The units or shares of an MMF shall be issued or redeemed at a price that is equal to the MMF's NAV per unit or share, notwithstanding permitted fees or charges as specified in the prospectus of the MMF

Low Volatility NAV (LVNAV)	The assets of LVNAV MMFs that have a residual maturity of up to 75 days may be valued by using the amortized cost method (in the event of deviation between the mark-to-market method and amortized cost method< 10bp)
Public Debt CNAV Invested at least 99.5% either in: government debt, reverse REPOs (secured with gov. deb) and cash	The valuation method for the Public debt CNAV MMF can choose whether to use the MTM or Amortized cost method
Short-term VNAV and Standard VNAV	Mark-to-Market / Mark-to-Model

Key attention points

Internal credit quality assessment procedure

On-going monitoring

The Management Company must monitor the credit quality of money market instruments on an on-going basis and not only at the moment of the purchase

High credit quality

Management Company must ensure the money market instruments invested in (ST) MMFs are of high credit quality

Management Company must determine the high quality standard

Internal assessment

Management Company must perform an internal credit quality assessment of money market instruments taking into account a range of factors including, but not limited to:

- Credit quality of the instrument
- Nature of the asset class represented by the instrument
- For structured financial instruments, operational and counterparty risks inherent to the transaction
- Liquidity profile

The internal credit risk model should **not** rely **solely** on the external credit rating of the instrument

Due diligence

When investing in structured financial instruments, the due diligence to perform by the Management Company should include a review of the specific risks attached to such securities:

- Nature of the underlying assets
- Entities involved in the structure and their respective roles
- Legal framework of the vehicle

Key attention points
Liquidity

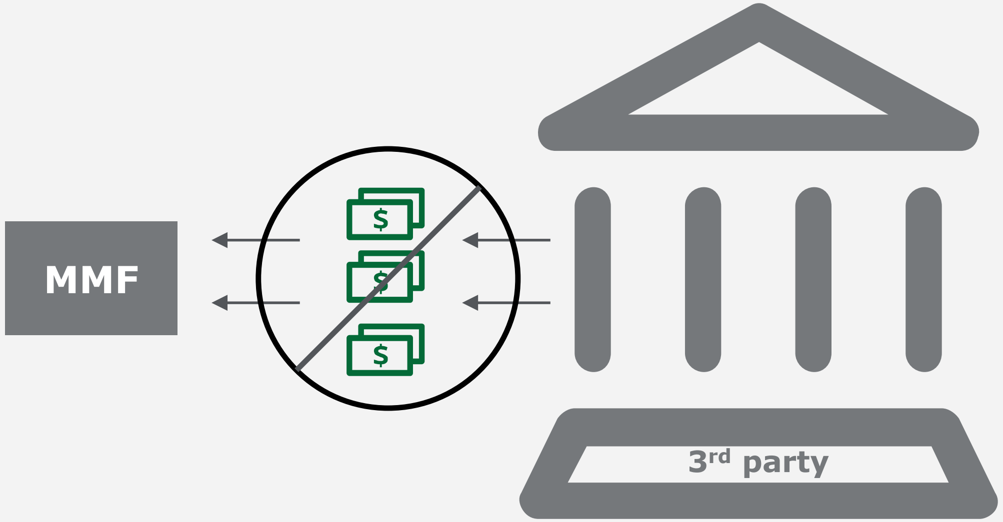
In such instances, they should automatically convert to a LVNAV MMF, or be liquidated

When, within a period of 90 days, the total duration of the suspensions exceeds 15 days, a public debt CNAV MMF or a LVNAV MMF shall automatically cease to be a public debt CNAV MMF or a LVNAV MMF

- MMFs will be subject to new and strengthened liquidity requirements as well as other safeguards.
- **In the case of CNAV and LVNAV MMFs**, there are also additional safeguards such as **'liquidity fees' and 'redemption gates'**. These will be designed to prevent and limit the effects of sudden investor runs

Key attention points
External Support

A MMF shall not receive external support (means direct or indirect support offered to a MMF by a third party) 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



Key attention points

Transparency Requirements

- **Maturity breakdown of the portfolio of the MMF**
- **The credit profile**

- A MMF shall indicate clearly the type of MMF to investors.
- At least **weekly, make all of the necessary information available** to the MMF's investors and board of directors including the ones in the boxes.
- For each MMF, the manager of the MMF shall report **information to the competent authority** of the MMF on **at least a quarterly basis** (unless special cases)

- **The WAM and WAL**
- **Details of the 10 largest holdings in the MMF**

- **Total value of the assets**
- **The net yield of the MMF**

Contents

Technical advice, implementing technical standards and guidelines

ESMA gathers the responses about the concerned topics and chooses the preferred one
Addressed topics

Specifying **liquidity and credit quality requirements** applicable to assets received as part of a reverse repurchase agreement

Credit quality assessment topics

i) the criteria for the validation of the credit quality assessment methodologies

ii) the meaning of the "material change" that would trigger a new credit quality assessment for a money market instrument

iii) the criteria for quantification of the credit risk and the relative risk of default of an issuer and instrument in which the MMF invests

iv) the criteria to establish qualitative indicators on the issuer of the instrument

Reporting template containing all the information managers of MMFs are required to send to the competent authority of the MMF

Common reference **parameters of the stress test scenarios** to be included in the stress tests managers of MMFs are required to conduct

ESMA consultation paper 28th September

New release from ESMA

Guidelines and instruction for MMFs to perform the required stress tests:

- Obligation to **monitor the fund's response** under various stressed conditions at both asset and liabilities levels
- Proposition of **common reference for MMF managers**, including: methodologies and scenarios to be applied

- **Liquidity stress test**

Options
- Apply **discount factor** to the bid price of each instrument in the fund
- Apply the **observed bid-ask spread** of each instrument

- **Credit stress**

- Either a multiplicative or an additive **shock to the credit spread** of the instruments in the portfolio
- An additional scenario is proposed where **the top 2 exposures** of the funds experience a default event.

- **Interest and FX rates**

- Direct **shock on interest rate** curves, government bond rates and FX rates

- **Redemption stress**

- **Reverse stress tests** that evaluate
  - The **maximum outflows** that the fund can generate to face stressed redemption scenarios without distorting portfolio allocation
  - The **coverage ratio** of weekly outflows by weekly liquid assets

An additional reverse stress test scenario is also proposed, where the MMF faces redemption of its 2 largest investors

With regards to calibration methodologies, while ESMA hints towards inspiration from the banking industry, market actors are invited to provide insight on the matter.

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Next Steps

- **Existing money market funds** will have to comply with the new Regulation by

21 January 2019

- The competent authority has a maximum of two months to assess whether the UCITS or AIF is compliant with this Regulation, therefore the **application should be submitted no later than 16 months after the date of entry into force (June 2017).**

- **5 years after the date of entry into force the MMFs Regulation**, the Commission shall present a report on the feasibility of establishing an **80 % EU public debt quota** (proposals to introduce such a quota, whereby at least 80 % of the assets of public debt CNAV MMFs are to be invested in EU public debt instruments)

80%

Q&A

Deloitte.