

## **Introduction to Money Market Fund Regulation**

**Link'n Learn**

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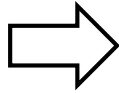
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# Preface



## 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 Role and features of MMFs and its composition
- ✓ The main ideas behind the different section 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

- 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 AIF that invests in short-term assets operate to a longer timetable

### Weight of MMF in the EU's fund industry

**EUR 1  
trillion**



**(15 %)**

# MMF Regulation at a glance

## Scope and timeline

### Scope of the MMFs Regulation

### Scope

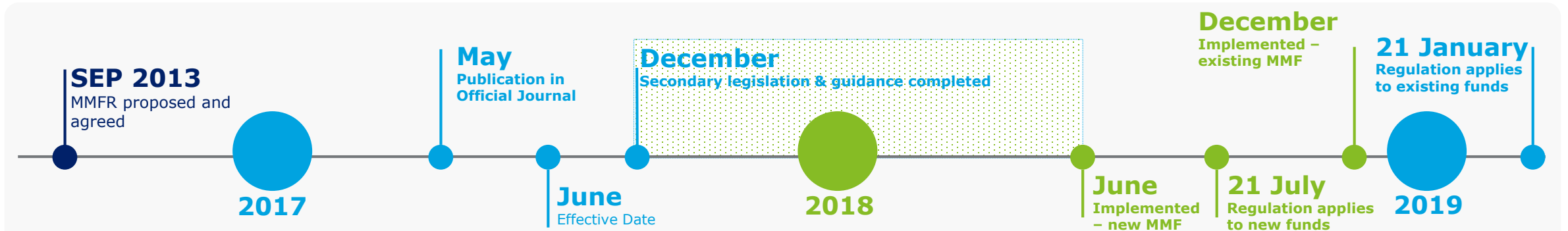
#### All UCITS & AIFs

- Established, Managed & 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



# MMF Regulation at a glance

## Key attention points

- The regulation lays down rules for MMFs to ensure the 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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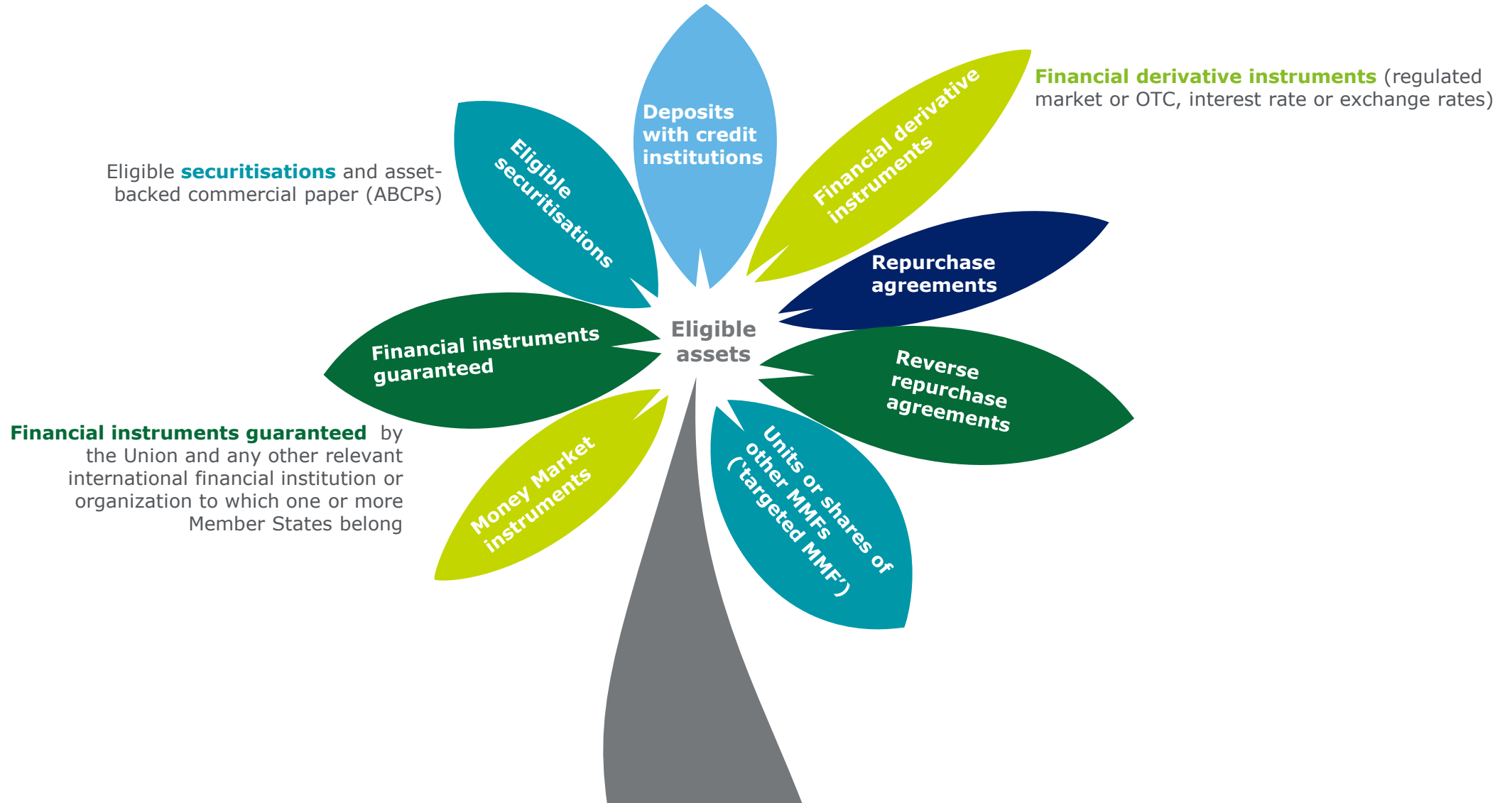
# Key attention points

## Role and features of MMFs

Low Volatility NAV (LVNAV)			
<p><b>Minimum daily liquidity</b> At least 10% of its assets</p> <p>Daily maturing assets</p> <p>Reverse REPOs (may be terminated in 1 day)</p> <p>Cash (may be withdrawn in 1 day)</p>	<p><b>Minimum weekly liquidity</b> At least 30% of its assets</p> <p>Weekly maturing assets</p> <p>Reverse REPOs (may be terminated in 5 day)</p> <p>Cash (may be withdrawn in 5 days)</p>	<p><b>Requirements</b></p> <p>WAM &lt; 60 days</p> <p>WAL &lt; 120 days</p>	<p><b>Valuation</b></p> <p>Amortised cost if:</p> <ol style="list-style-type: none"> <li>Residual maturity of assets &lt; 75 days</li> <li>Difference with mark-to-market method &lt; 10bp</li> </ol>
<p><b>Public Debt CNAV</b> Invested at least <b>99.5%</b> either in: government debt, reverse REPOs (secured with gov. deb) and cash</p>			
<p><b>Minimum daily liquidity</b> At least 10% of its assets</p> <p>Daily maturing assets</p> <p>Reverse REPOs (may be terminated in 1 day)</p> <p>Cash (may be withdrawn in 1 day)</p>	<p><b>Minimum weekly liquidity</b> At least 30% of its assets</p> <p>Weekly maturing assets</p> <p>Reverse REPOs (may be terminated in 5 day)</p> <p>Cash (may be withdrawn in 5 days)</p>	<p><b>Requirements</b></p> <p>WAM &lt; 60 days</p> <p>WAL &lt; 120 days</p>	<p><b>Valuation</b></p> <p>Amortised cost</p> <p>Invested at least <b>99.5%</b> either in: government debt, reverse REPOs (secured with gov. deb) and cash</p>
<p><b>Short-term VNAV and Standard VNAV</b></p>			
<p><b>Minimum daily liquidity</b> At least 7,5% of its assets</p> <p>Daily maturing assets</p> <p>Reverse REPOs (may be terminated in 1 day)</p> <p>Cash (may be withdrawn in 1 day)</p>	<p><b>Minimum weekly liquidity</b> At least 15% of its assets</p> <p>Weekly maturing assets</p> <p>Reverse REPOs (may be terminated in 5 day)</p> <p>Cash (may be withdrawn in 5 days)</p>	<p><b>Requirements</b></p> <ul style="list-style-type: none"> <li>Short-term VNAV WAM &lt; 60 days WAL &lt; 120 days</li> <li>Standard VNAV WAM &lt; 6 months WAL &lt; 12 months</li> </ul>	<p><b>Valuation</b></p> <p>Mark-to-Market / Mark-to-Model</p>

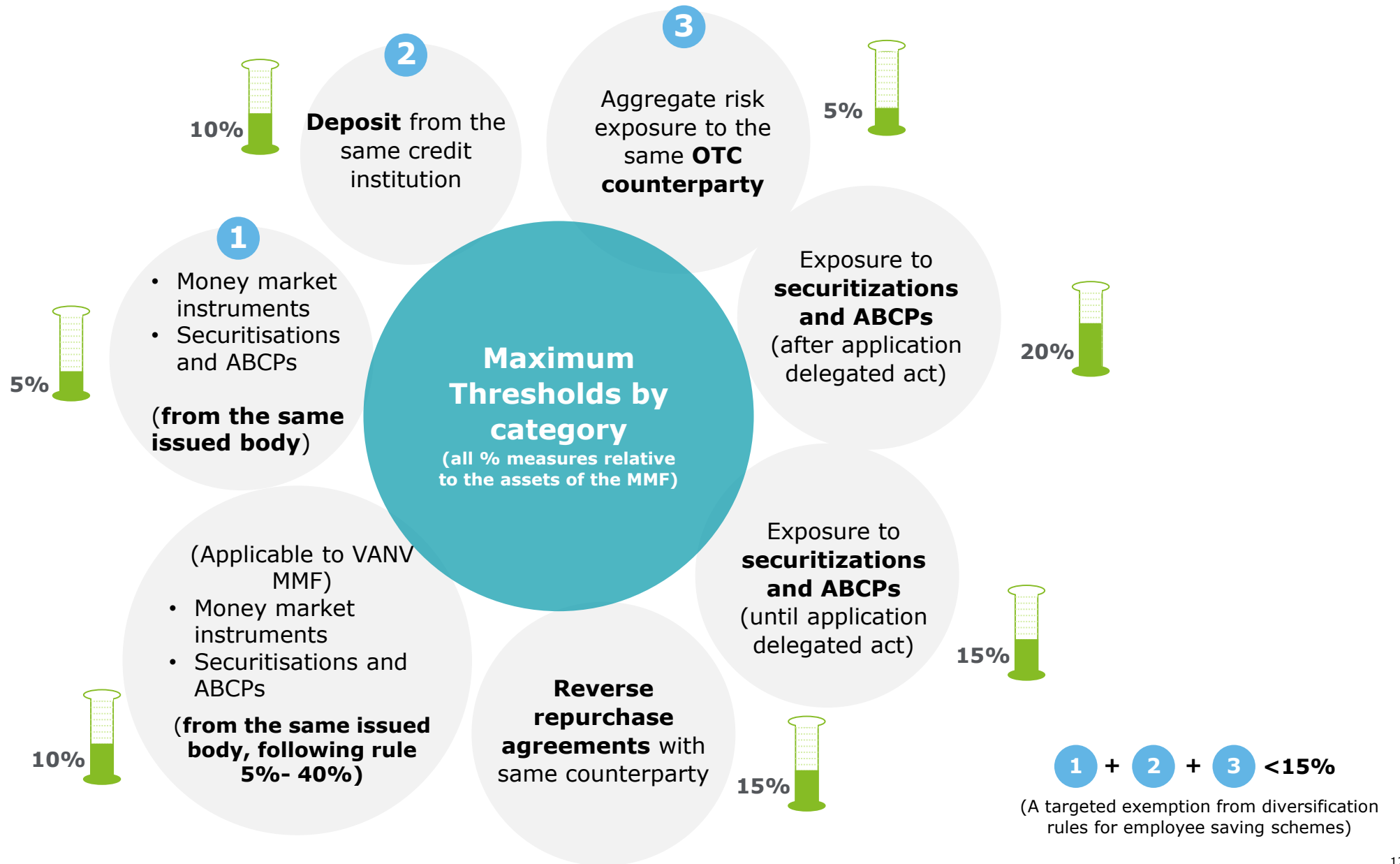
# Key attention points

## Eligible assets



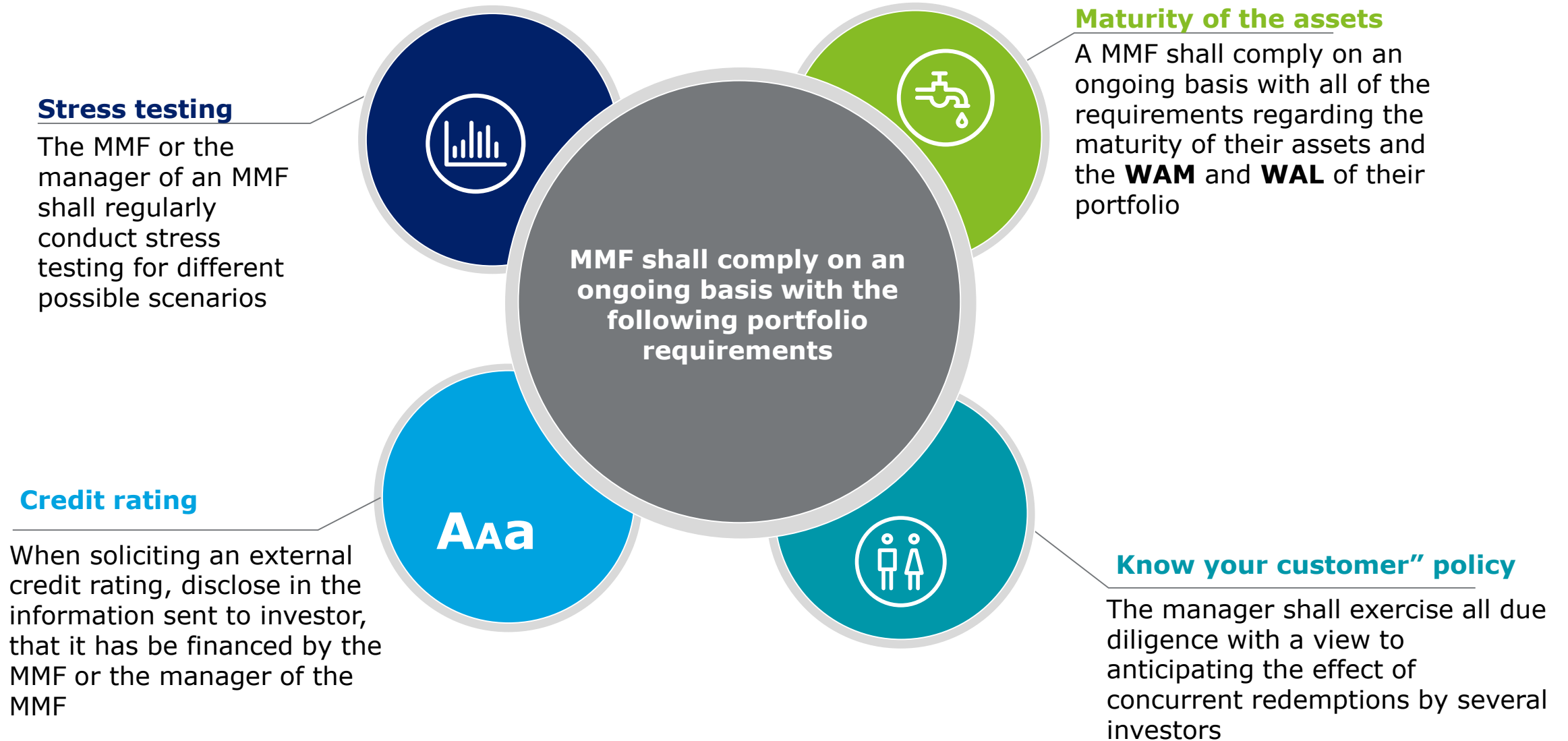
# Key attention points

## Diversification



# Key attention points

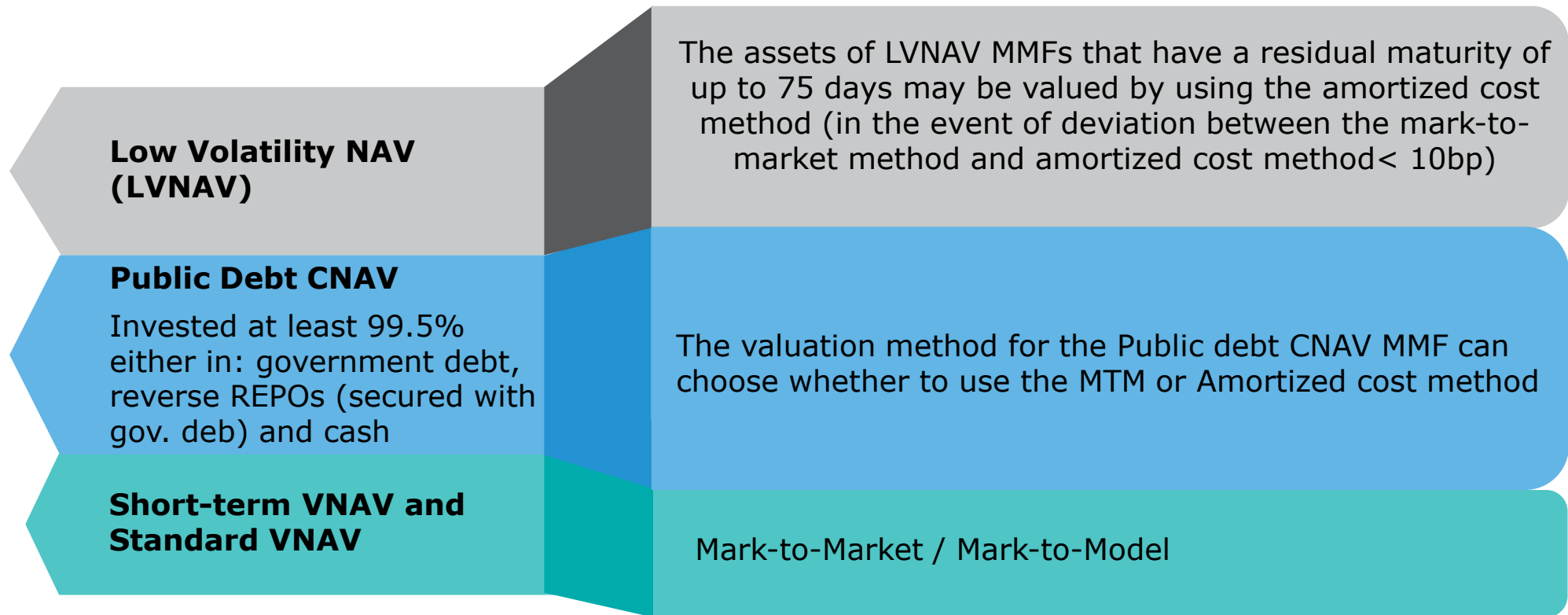
## Risk management



# 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



# 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

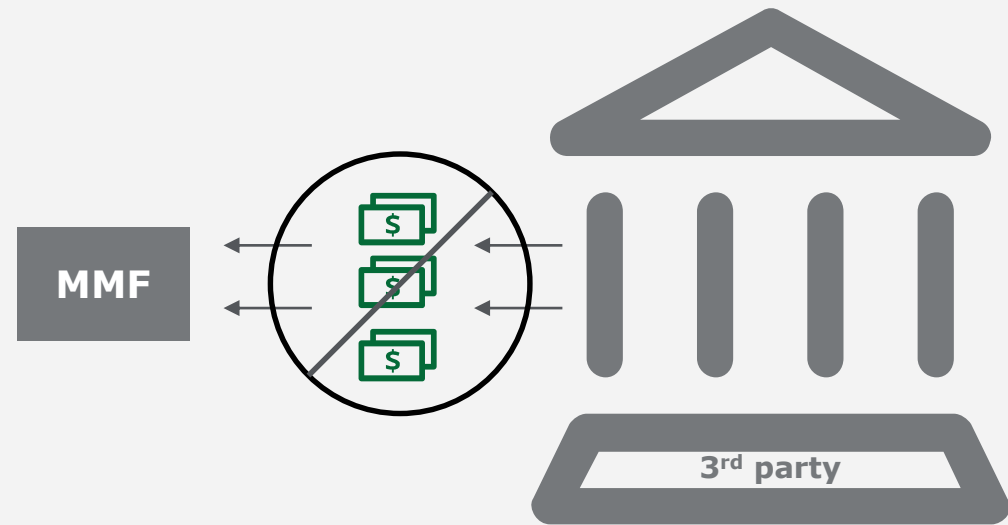
- MMFs will be subject to new and strengthened liquidity requirements as well as other safeguards.
- **In the case of CNAV and LVNAV MMFs**, there are also additional safeguards such as **'liquidity fees' and 'redemption gates'**. These will be designed to prevent and limit the effects of sudden investor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



# Key attention points

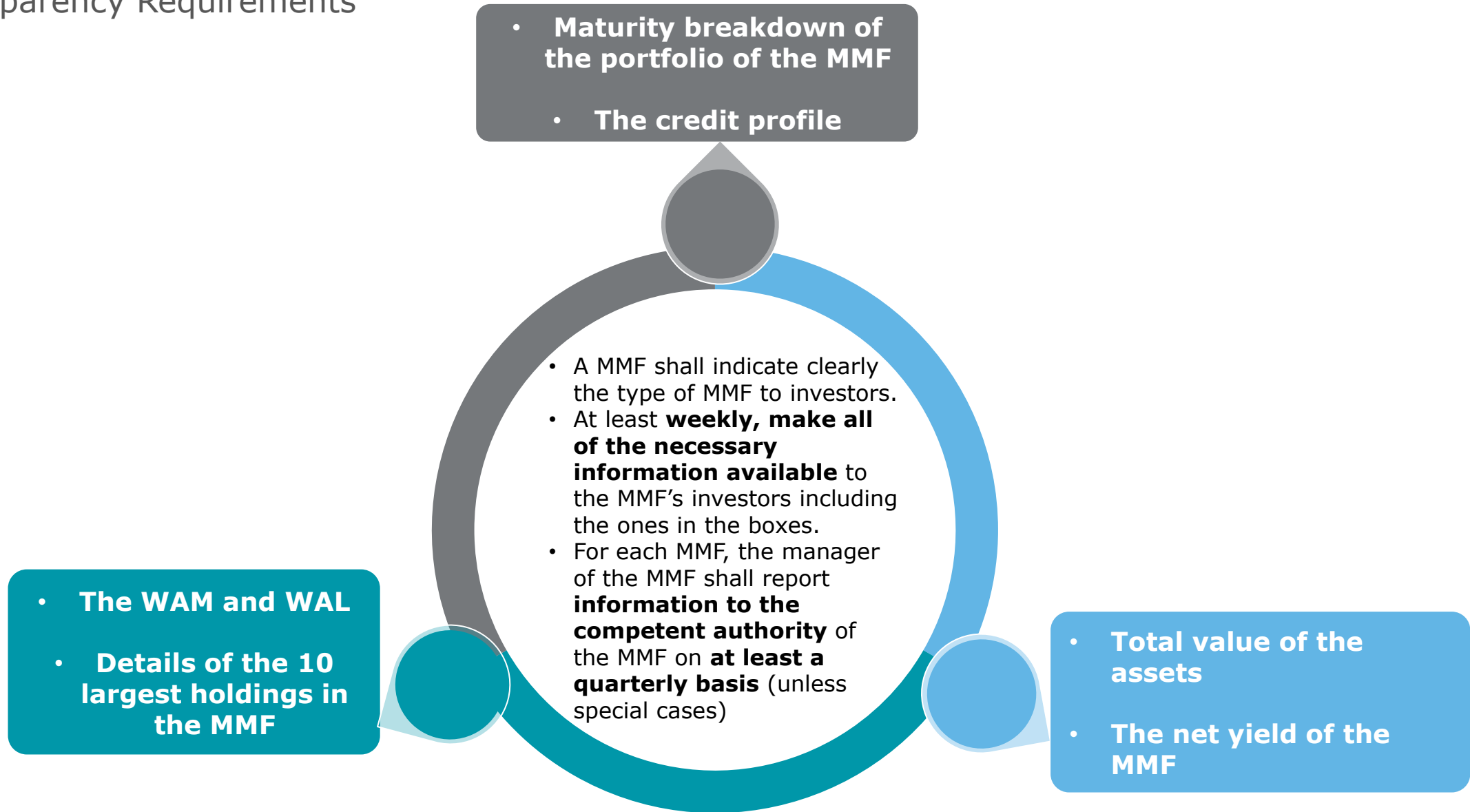
## External Support

**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



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# Technical advice, implementing technical standards and guidelines

ESMA gather 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

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**Next steps**

## Next Steps

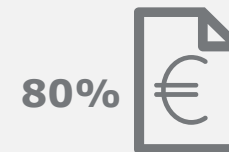
- **Existing money market funds** will have to comply with the new Regulation by

**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)



# Thanks for attending

## Do you have questions?



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