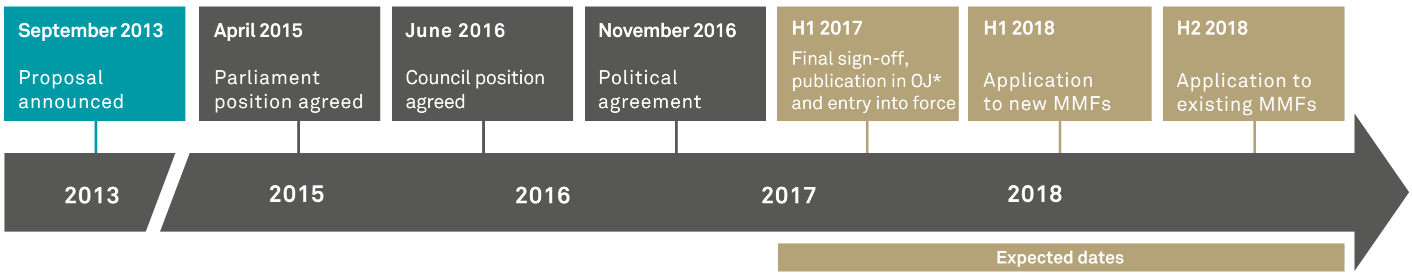
EU Money Market Reform: An Overview

As a result of the Financial Crisis in 2008, the European Commission proposed new rules for Undertakings for Collective Investment in Transferable Securities (UCITS) money market funds in 2013. These new rules have been finally agreed to by the various regulatory bodies including the European Parliament and Council of EU Member States with the final compromise published by the Council of the European Union in November 2016. It is expected that the rules will receive final signoff and publication in the Official Journal during the first half of 2017 with a compliance date 18 months from publication.



Source: BNY Mellon Investment Management and Council of European Union.
*Official Journal.

Summary of the new rules

The new regulations mainly focus on the following topics: structure, composition, valuation, liquidity requirements, liquidity fees/redemption gates, understanding investor behavior and information reporting.

Money Market Funds will be categorized into two types of money market funds: Short Term Money Market Funds and Standard Money Market Funds. Within these categories, there are three structural options available:

Structural Options	Short Term Money Market Funds	Standard Money Market Funds
Government Constant Net Asset Value (CNAV)	X	
Low Volatility Net Asset Value (LNAV) - NEW	X	
Variable Net Asset Value (VNAV)	X	X

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While European money market funds have traditionally offered both CNAV and VNAV funds, the new proposal restricts the use of CNAV funds to government portfolios while creating a new structural option for non-government funds, the Low Volatility Net Asset Value (LNAV) Fund.

Low Volatility Net Asset Value (LVNAV) Money Market Funds — A New Structural Option

Investors will be able to purchase and redeem at a stable NAV to two decimal places, provided the fund is managed to certain restrictions:

- Value portfolio securities < 75 days' maturity using amortised cost as long as mark to market valuation does not deviate by more than 10 bps. If greater than 10 bps, security must be valued at mark to market.
- Value portfolio securities > 75 days maturity at mark to market.
- Value portfolio at amortized cost as long as mark to market valuation does not deviate by more than 20 bps. If greater than 20 bps, the fund must be valued using mark to market to four decimal places.
- Minimum liquidity requirements: Daily Liquid Assets (DLA) must be 10% or greater, Weekly Liquid Assets (WLA) must be 30% or greater.

Other notable changes for Short Term Money Market Funds (CNAV & LVNAV) include:

- Minimum Weekly Liquidity: Increase minimum Weekly Liquid Assets (WLA) from 20% to 30%.
  - Categorized as highly liquid assets from sovereign, supranational or agencies with maturities less than 190 days and up to 17.5%, provided 1-day settlement.
- Fee and gate provisions: While UCITS money market funds currently have the ability to gate redemptions up to 10% of a fund's total assets, the new provisions provide additional options for Fund boards to utilize in times of market stress.
  - If WLA < 30% **and** daily net redemptions > 10%: Fund board may impose liquidity fees (= cost of liquidity), gate redemptions up to 10% per day up to 15 days, or suspend redemptions up to 15 days if it is in the best interest of shareholders.
  - If WLA <10%: Fund board must impose liquidity fees or suspend redemptions up to 15 days.
    - If redemption suspension is > 15 days over 90 consecutive days: Fund must convert its portfolio pricing to a Variable Net Asset Value up to 4 decimal places.
- External support is prohibited.

Short Term VNAV Money Market Funds:

- Minimum Daily Liquidity: Decrease minimum DLA from 10% to 7.5%.
- Minimum Weekly Liquidity: Decrease minimum WLA from 20% to 15%.
- Gate provision: Standard UCITS redemption gates will still apply.
  - If shareholder redemption activity is more than 10% of a fund's total assets, the Fund board may limit redemptions pro rata to all shareholders wishing to redeem that day and shares not redeemed, but which would otherwise have been redeemed, will be carried forward for redemption on each subsequent Valuation Day until all shares to which the original redemption request related have been redeemed.
- Stricter diversification requirements.

On the next page is a detailed comparison of the new categories of money market funds that highlight product structure, composition, and valuation methods.

	Short-term MMFs			Standard MMFs
	Government CNAV*	**LVNAV**	**VNAV**	**VNAV**
Max asset maturity	397 days.	397 days.	397 days.	2 years, with 397 days max to next interest rate reset.
Max weighted average maturity (WAM)	60 days.	60 days.	60 days.	6 months.
Max weighted average life (WAL)	120 days.	120 days.	120 days.	12 months.
Min daily liquidity	10%	10%	7.5%	7.5%
Min weekly liquidity	30%	30%	15%	15%
Weekly liquidity eligible assets	Highly liquid assets from sovereign, supranationals or agencies < 190 days and up to 17.5% provided 1-day settlement.	Highly liquid assets from sovereign, supranationals or agencies < 190 days and up to 17.5% provided 1-day settlement.	MMFs up to 7.5%.	MMFs up to 7.5%.
Eligible assets for investment	99.5% government assets, cash or reverse repo[1] backed by government assets.	Money market instruments, certain securitizations or Asset Backed Commercial Paper (ABCP), instantly accessible deposits, short-dated reverse repo[1], other short-term MMFs provided no circularity, currency and interest derivatives (for hedging purposes only).	Money market instruments, certain securitizations or ABCP, instantly accessible deposits, short-dated reverse repo[1], other short-term MMFs provided no circularity, currency and interest derivatives (for hedging purposes only).	Money market instruments, certain securitizations or ABCP, instantly accessible deposits, short-dated reverse repo[1], other MMFs provided no circularity, currency and interest derivatives (for hedging purposes only).
Diversification[2]	• Max 100% per sovereign, agency or European supranational, across at least 6 issues, max 30% per issue. • Max 15% per reverse repo[1] counterparty.	• Max 5% per issuer. • Max 10% per deposit. counterparty. • Max 15% per reverse repo[1] counterparty. • Max 100% per sovereign, agency or European supranational, across at least 6 issues, max 30% per issue. • Max 5% risk exposure per derivative counterparty. • Max 5% per MMF.	• Max 10% per issuer and max 40% aggregate in issuers > 5%. • Max 10% per deposit counterparty. • Max 15% per reverse repo[1] counterparty. • Max 100% per sovereign, agency or European supranational, across at least 6 issues, max 30% per issue. • Max 5% risk exposure per derivative counterparty. • Max 5% per MMF.	• Max 10% per issuer and max 40% aggregate in issuers > 5%. • Max 10% per deposit counterparty. • Max 15% per reverse repo[1] counterparty. • Max 100% per sovereign, agency or European supranational, across at least 6 issues, max 30% per issue. • Max 5% risk exposure per derivative counterparty. • Max 5% per MMF.
Aggregate diversification	—	• Max 15% overall exposure to securitization and ABCPs. • Max 17.5% overall MMF exposure.	• Max 15% overall exposure to securitization and ABCPs. • Max 17.5% overall MMF exposure.	• Max 15% overall exposure to securitization and ABCPs. • Max 17.5% overall MMF exposure.
Credit quality	Favorable assessment based on internal credit quality assessment. Credit rating agency ratings as inputs to internal assessment, among others.			
Security level valuation	Amortized cost.	Mark-to-market/mark-to-model > 75 days maturity.[3]	Mark-to-market/mark-to-model only.[3]	Mark-to-market/mark-to-model only.[3]
Portfolio valuation[4]	Amortised cost.	Amortised cost for assets < 75 days and with a gap vs mark-to-market < 10 bps.	Mark-to-market.	Mark-to-market.
NAV	Constant NAV per unit/share.	Constant NAV per unit/share. Move to four decimal place VNAV when mark-to-market NAV deviates by more than 20bps from constant NAV.	Variable NAV.	Variable NAV.
Liquidity Fees / Redemption gates	**There are three stages:** 1. A discretionary fee/gate by the fund's board if the weekly liquid assets fall below 30% of total assets AND the daily net redemptions exceed more than 10% of the fund's value. 2. Mandatory fee or temporary gate will be imposed if the weekly liquid assets fall below 10%. 3. If a redemption suspension is 15 days or more within a 90-day period the fund must convert to a floating NAV fund.	**There are three stages:** 1. A discretionary fee/gate by the fund's board if the weekly liquid assets fall below 30% of total assets AND the daily net redemptions exceed more than 10% of the fund's value. 2. Mandatory fee/gate will be imposed if the weekly liquid assets fall below 10%. 3. If a redemption suspension is 15 days or more within a 90-day period the fund must convert to a floating NAV fund.	• Decrease of minimum overnight liquidity from 10% to 7.5%. • Decrease of minimum Weekly Liquid Assets from 20% to 15%. • Gate provision: If shareholder redemption activity is more than 10% of a fund's total assets, the Fund board may limit redemptions pro rata to all shareholders wishing to redeem that day and shares not redeemed, but which would otherwise have been redeemed, will be carried forward for redemption on each subsequent Valuation Day until all shares to which the original redemption request related have been redeemed. • Stricter diversification requirements.	• Decrease of minimum overnight liquidity from 10% to 7.5%. • Decrease of minimum Weekly Liquid Assets from 20% to 15%. • Gate provision: If shareholder redemption activity is more than 10% of a fund's total assets, the Fund board may limit redemptions pro rata to all shareholders wishing to redeem that day and shares not redeemed, but which would otherwise have been redeemed, will be carried forward for redemption on each subsequent Valuation Day until all shares to which the original redemption request related have been redeemed. • Stricter diversification requirements.

Source: Council of the European Union, Fitch as of January 2017.
*There is a possibility of government money market funds being allowed to invest in lower credit quality government securities.
[1]Where fund is effectively lending cash in return for collateral.
[2]Companies included in the same group for the purpose of consolidated accounts shall be regarded as a single body for the purpose of diversification requirements.
[3]Use of mark-to-model valuation method where use of mark-to-market method not possible or where market data is not of sufficient quality.
[4]All types of MMF mark-to-market valuation must be published daily.

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