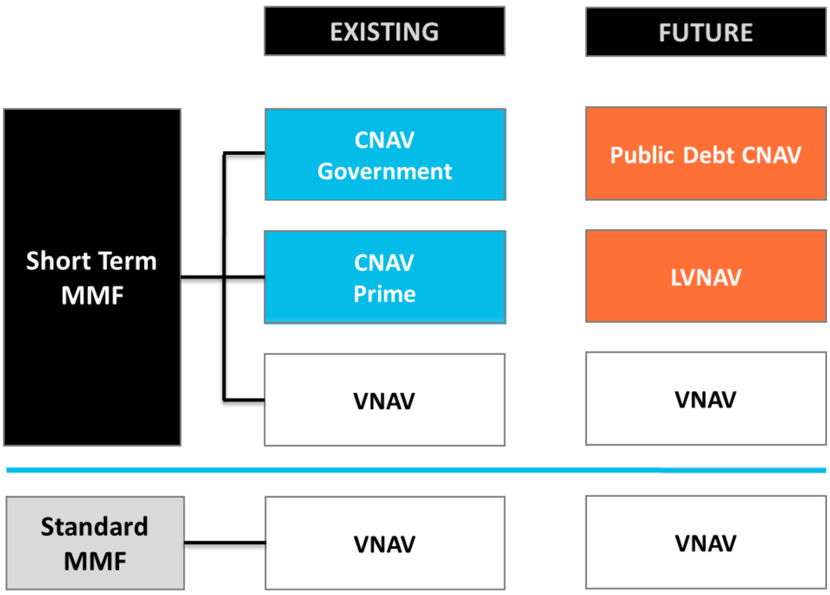
EUROPEAN MONEY FUND REFORM OVERVIEW

In 2008 the G20 group of countries agreed in principle to reform the money market fund (MMF) industry, amongst other financial reforms. The European Commission acted in 2013 by proposing draft legislation in the form of a Regulation. Following input from the other European institutions, the Regulation on Money Market Funds was agreed in December 2016, published in the European Union Official Journal on 30 June and came into force on 21 July 2017. New funds must comply from 21 July 2018. **Existing funds have until 21 January 2019 to comply with the new Regulation.**

NEW PRODUCT REGULATION

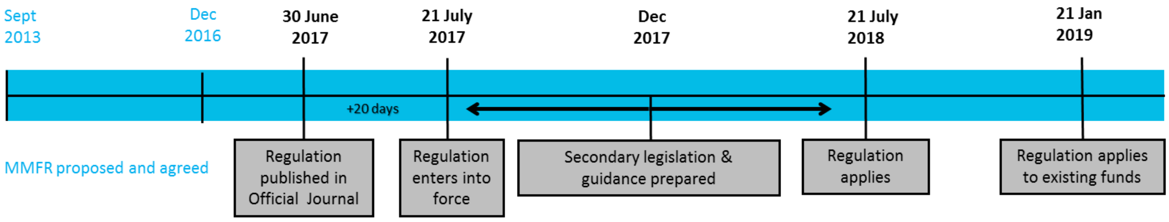
Under the new Regulation, all existing MMFs will face change. However MMFs defined in the new Regulation nonetheless display a high degree of continuity with existing MMF products, as illustrated in the chart below. The changes are greater for some funds, in particular those in which units/shares currently trade at a Constant Net Asset Value (CNAV).

The new Regulation establishes a product range for investment in short term instruments to meet most investor needs, offering considerable flexibility of choice. The Regulation incorporates tighter provisions that will apply equally to all MMF that are established, marketed or managed in the European Union (EU). These provisions are designed to provide consistency and security in financial markets for investors. It is worth noting that many of the enhanced restrictions, for example in relation to liquidity, are already in use within existing MMF through application of the ESMA Guidelines, adherence to credit rating and observance of the IMMFA Code of Practice. Whilst EU MMF reform has some thematic similarities with the US MMF reforms that came in to force in October 2016, it has significant differences in application, scope and impact for investors.



TIMELINE

The timeline for transition to the new Regulation begins in earnest when it is published in the EU Official Journal. The chart below shows the key dates, with the most important being the deadline of 18 months, to 21 January 2019, for existing EU MMFs to be compliant with the new provisions.



NEW MONEY MARKET FUND CATEGORIES

The table below sets out the new categories of MMF that may be set up and the key requirements applying to them under the new Regulation. Further explanation of key elements is provided on the next page.

New fund categories	Public Debt CNAV MMF	Low Volatility NAV MMF (LVNAV)	Variable NAV MMF (VNAV)	Standard (VNAV) MMF
Fund type	Short Term MMF	Short Term MMF	Short Term MMF	Standard MMF
Eligible investments	99.5% of portfolio to be invested in public debt securities, reverse repo secured with government securities, and cash Currency unrestricted	Money market instruments, securitisations and ABCP, deposits, derivatives, repo, reverse repo, other MMF	Money market instruments, securitisations and ABCP, deposits, derivatives, repo, reverse repo, MMF	Money market instruments, securitisations and ABCP, deposits, derivatives, repo, reverse repo, MMF
WAM / WAL	60 days / 120 days	60 days / 120 days	60 days / 120 days	180 days / 365 days
Minimum liquidity	30% weekly, includes 10% daily	30% weekly, includes 10% daily	15% weekly, includes 7.5% daily	15% weekly, includes 7.5% daily
Mandatory fees and gates	Apply when weekly liquidity falls below 10%	Apply when weekly liquidity falls below 10%	No	No
Discretionary fees and gates	Existing UCITS provisions on fund suspensions apply MMFR extra provisions apply on convergence of 2 events: weekly liquidity drops below 30% and daily net redemptions exceed 10%	Existing UCITS provisions on fund suspensions apply MMFR extra provisions apply on convergence of 2 events: weekly liquidity drops below 30% and daily net redemptions exceed 10%	Existing UCITS provisions on fund suspensions apply	Existing UCITS provisions on fund suspensions apply
Liquid asset restrictions	Minimum 12.5% cash, reverse repo, deposits Maximum 17.5% govt. securities to 190 days Other MMF not permitted	Minimum 12.5% cash, reverse repo, deposits Maximum 17.5% govt. securities to 190 days Other MMF not permitted	Minimum 7.5% cash, reverse repo, deposits Maximum 7.5% other MMF	Minimum 7.5% cash, reverse repo, deposits Maximum 7.5% other MMF
Valuation method	Amortised cost accounting for all securities	Amortised cost accounting for securities up to 75 days. Securities over 75 days at market/model. Securities more than 10bp away from market to be valued at market or model.	At market or model	At market or model
NAV - rounding	Fund collar – 50bp rounding (either side)	Fund collar – 20bp rounding (either side)	N/A	N/A
Fund valuation	To 2 decimal places - €/£/$1.00	To 2 decimal places - €/£/$1.00	To 4 decimal places - €/£/$1.0000	To 4 decimal places - €/£/$1.0000
Shadow NAV calculation	Required: daily "shadow" NAV to be calculated on a per asset M2M basis.	Required: daily "shadow" NAV to be calculated on a per asset M2M basis.	N/A	N/A
Review clause	Regulation reviewed 5 years post implementation Review to assess use of alternative product structure and feasibility of establishing 80% EU public debt quota	Regulation reviewed 5 years post implementation Review to assess regime for LVNAV product	Regulation reviewed 5 years post implementation	Regulation reviewed 5 years post implementation

FURTHER KEY INFORMATION ON EU MMF REFORM

This section expands on the information in the preceding table, highlighting areas of change.

New MMF categories

The new Regulation broadly continues with the MMF types established by the European Securities and Markets Authority (ESMA) in their 2010 Guidelines, adding new underlying categories to the Short Term and Standard MMF framework.

There will be three types of Short Term MMF:

- Public Debt CNAV
- Low Volatility NAV (LVNAV)
- Variable NAV (VNAV)

There will be one type of Standard MMF:

- Variable NAV (VNAV)

Short Term MMFs will be required to adhere to tighter investment rules than Standard MMF, as set out in the table above.

Within the Short Term MMF type, funds may be constantly or variably priced depending on the fund category. Only Public Debt CNAV and LVNAV MMF may be constantly priced.

Standard MMF are always variably priced.

WAM and WAL

The figures under the new Regulation continue to apply the WAM and WAL figures specified under the ESMA Guidelines, and in rating criteria and the IMMFA Code of Practice. They are congruent with what is applied to MMF globally, including in the USA.

Liquidity requirements

Currently the ESMA Guidelines do not specify minimum liquidity requirements. Nonetheless good practice, IMMFA Guidelines for CNAV Funds and certain rating criteria require funds to operate with daily and weekly liquidity figures now. These will need to be adjusted, rather than created, to comply with the new Regulation.

Fees and Gates

Existing investment fund legislation such as UCITS already provides for a temporary suspension of the purchase or redemption of fund shares, where this can be justified in the interests of holders of the shares. The aim is to ensure fair treatment of all investors in a fund.

The new Regulation has both discretionary and mandatory provisions on fees and gates. The measures apply to redemptions only in Public Debt CNAV and LVNAV MMFs. The fee is intended to reflect the cost of achieving liquidity. The gate refers to a limit on redemptions or a temporary suspension in redemptions.

- Discretionary provisions require that, when the trigger is passed, the fund Board must consider whether to take any action, including the use of fees and gates. The Board has full discretion on the decision and can choose to take no action. The trigger for Board involvement is when the 2 events described in the table above occur together: weekly liquid assets drop below 30% and daily net redemptions exceed 10%.
- By contrast the mandatory provision is hard edged: when the fund holds less than 10% in weekly liquid assets, fees and gates must be applied.

Fund valuation – constant NAV

For Public Debt CNAV and LVNAV funds, investors will be able to purchase and redeem at a constant NAV calculated to 2 decimal places: €/£/$1.00. Both types of fund may continue to use amortised cost accounting, although in the case of LVNAV MMF some additional limitations are imposed on this (see table above). To support integrity of pricing, Public Debt CNAV and LVNAV funds will be required to price at market or model at least once a day, creating a so called “shadow” NAV.

In order to publish a constant NAV, the net asset value of a LVNAV fund must fall within 20 basis points of a unit of €/£/$ 1.00 (the so called “fund collar”). The main difference between LVNAV and current CNAV pricing therefore is this narrower operating corridor of 20 basis points from the current market standard of 50 basis points.

Public Debt CNAV funds will continue to operate within a 50 basis point corridor, as they do now.

Fund valuation – variable NAV

Investors in all VNAV funds will purchase/redeem at a variable NAV calculated to 4 decimal places: €/£/$1.0000.

OTHER CHANGES BROUGHT ABOUT BY THE REGULATION

The Regulation:

- requires fund managers to operate a rigorous credit assessment process.
- bans support for money funds from any external source.
- requires money funds to obtain an additional authorisation as a MMF from their regulator (that is, additional to the authorisation as an investment fund already required under EU legislation, such as in UCITS). The legal personality of existing funds can therefore remain undisturbed.
- requires greater transparency of information both to investors and regulators. For investors, this includes information at least weekly on: MMF type, WAM and WAL, total assets, net yield, portfolio breakdown by maturity, credit profile and 10 largest investment holdings.
- applies directly in all Member States, in respect of funds managed, marketed or domiciled in the EU, without requiring transposition into domestic law.
- allows MMF to continue to solicit and pay for credit ratings, as they do now.

INVESTOR NOTE

Although the Regulation has now entered into force, nothing changes immediately. Funds which were in existence prior to 21 July 2017 have until 21 January 2019 to come in to compliance with the new Regulation.

You should engage with your fund providers to understand the changes that they will be making to their products. You may wish to plan in advance for communicating with your Board or relevant committee, as changes are likely to be required to investment mandates during 2018.

For more information please see our website at www.immfa.org or call us on +44 (0)207 269 4657