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EU Money Market Reform Regulation

Given that over 20% of the assets of all Irish domiciled funds are currently held within Money Market Funds (MMFs) it is no surprise that the EU Money Market Reform (MMF Regulation) regulation which was published on 14 June 2017 was met with particular interest to those involved in the Irish funds sector.

Types of MMF

Under the MMF regulation there are three types of MMF.

Variable Net Asset Value (VNAV) MMF	• invests in prime MMF assets and maintains a VNAV; • NAV calculated on marked-to-market/marked-to-model basis; and • liquidity management requirements.
Public Debt Constant Net Asset Value (CNAV) MMF	• must invest at least 99.5% of assets in government securities; • amortised cost valuation permitted; and • maintains a constant NAV.
Low Volatility Net Asset Value (LVNAV) MMF	• invests in prime MMF assets and maintains a variable NAV; • amortised cost valuation permitted (under strict conditions); and • maintains a constant NAV.

Features of the MMF regulation

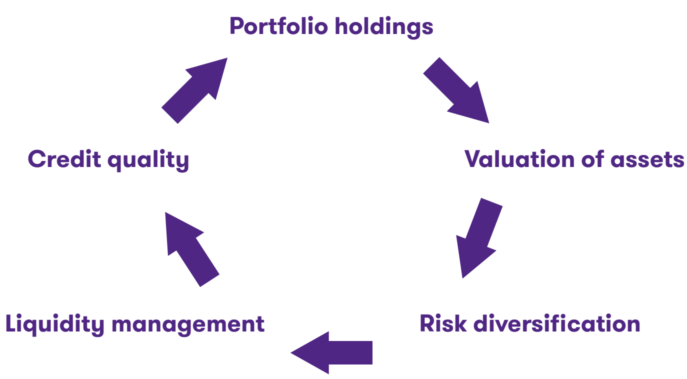
The MMF regulation introduces a number of new requirements for MMFs in particular around portfolio holdings, valuation of assets, risk diversification, liquidity management and credit quality and assessments. Summary impacts of each have been discussed above.

Portfolio holdings

Eligible portfolio holdings of a MMF under the MMF regulation include:

- money market instruments (subject to maturity limits);
- securitisations and other Asset Backed Commercial Papers (ABCPs) (subject to certain credit and liquidity limits);
- deposits;
- repurchase agreements for liquidity management purposes;
- reverse repurchase agreements with high quality, diversified and non-correlated security attached;
- units/shares of other MMFs; and
- certain financial derivative instruments.

MMFs may not engage in short selling or securities lending or have exposure to equities and/or commodities.



Valuation

The basis of valuations which can be applied by each respective MMF type is noted below:

- VNAV MMFs - NAV calculated on marked-to-market/ marked-to-model basis;
- CNAV MMFs - may use amortised cost in a similar way as to how used today; and
- LVNAV MMFs - can use amortised cost if residual maturity of assets is less than 75 days. Marked-to-market must be used if market price of the asset deviates from amortised cost by more than 10bps.

Dealing price

The units/shares of a LVNAV MMF may be bought/sold at a constant NAV provided that the constant NAV does not deviate from a market-to-market NAV by more than 20bps.

If this threshold is breached then LVNAV MMFs are required to buy/sell units on a variable NAV basis.

Diversification

In order to limit risk taking by MMFs, detailed rules on the diversification of eligible portfolio holdings and concentration limits are included in the MMF regulation.

Liquidity management

Existing CNAV MMFs are not subject to any regulatory liquidity requirements. Set out below are certain liquidity management thresholds MMFs must now have in place under the MMF Regulation:

VNAV MMF:

- 7.5% held in daily maturing assets; and
- 15% in weekly maturing assets (of which 7.5% can be held within money market instruments or other MMFs).

CNAV MMF:

- 10% held in daily maturing assets;
- 30% in weekly maturing assets (of which 17.5% can be held within government securitities); and
- liquidity fees and redemption gates considered/ applied in certain scenarios.

LVNAV MMF:

- 10% held in daily maturing assets;
- 30% in weekly maturing assets (of which 17.5% can be held within government securitities); and
- liquidity fees and redemption gates considered/ applied in certain scenarios.

Credit assessments and stress testing

The manager of a MMF must establish, implement and consistently apply internal credit quality assessment procedures to determine the credit quality of a MMFs assets.

The MMF Regulation also requires that the manager of a MMF on a bi-annual basis, conduct asset stress testing procedures. Details and guidance on the relevant parameters required for these stress testing procedures are expected to be included in the Level 2 regulations to be issued by the European Commission later this year.

Other points of note

Know-Your-Client (KYC) procedures

The manager of a MMF is responsible for implementing a KYC policy to understand the MMFs investor base with a view of establishing when large redemptions can be anticipated.

External support

The MMF Regulation prohibits sponsor support from third parties that is intended for or in effect would result in guaranteeing the liquidity of a MMF or stabilising the NAV per unit/share of a MMF.

Credit rating

The MMF Regulation allows a MMF to solicit or finance an external credit rating providing it complies with the credit rating agencies regulation and certain disclosures are included in the MMFs prospectus.

Reporting and transparency requirements

The reporting requirements included in the MMF regulation apply in addition to the MMFs current obligations under the UCITS and AIFMD directives. The MMF regulation requires the manager of a MMF to make certain information available to investors on a weekly basis such as a maturity breakdown of the portfolio holdings, the MMFs credit profile, net yield and details of the top ten holdings of the MMF. The MMF regulation also imposes additional requirements on external documents, including marketing materials, reports or statements.

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