THE MONEY MARKET FUNDS (MMFs) REGULATION

REGULATORY MEMO • Q1 2017

ABOUT THE MMFs REGULATION

Money Market Funds (MMFs) are an important source of short-term financing for financial institutions, corporates and governments and therefore are viewed as part of shadow banking. MMFs are one of five workstreams identified by the FSB (Financial Stability Board) in 2012 in relation to the Shadow Banking System.

In September 2013, partly, the European Commission (EC) issued a draft text proposal on MMFs. The proposal had two key objectives:

- Enhance financial stability within European markets by preventing the risk of contagion potentially transmitted by the "run" of MMFs to money markets and to their sponsors (mainly financial institutions)
- Increase investor protection by reducing the disadvantages for late redeemers in stressed market conditions

On 14 November 2016 the EU Council and Parliament reached a compromise which will have to be approved by the Parliament in plenary session and by the Council.

SCOPE

The MMFs Regulation is applicable to all MMFs products whether UCITS- or AIF-regulated.

The compromise text distinguishes:

- Two natures of MMFs depending on their weighted average maturity and life: short term MMFs and standard MMFs

Three types of MMFs:

- Variable Net Asset Value (VNAV): MMFs which offer unit/share purchases and redemptions at a variable price
- Two types of MMFs which offer unit/share purchases at a fixed price (Constant NAV per unit/share):
  - Public Debt Constant Net Asset Value (CNAV) MMFs, which invest at least 99,5% of their assets in public debt
  - Low volatility Net Asset Value (LVNAV) MMFs, whose CNAV per unit/share must not deviate from the NAV per unit/share by more 20 basis points

The compromise text expands on the current CESR (Committee of European Securities Regulators) money market fund guidelines published in May 2010 by requiring:

- **New Investment requirements to:**
  - Expand minimum daily and weekly liquidity allocations
  - Limit eligible assets, and in particular prohibit the use of short-selling, securities lending, borrowing
  - Limit maximum allocations by non public issuer counterparty and asset type
- **New valuation rules** which limit the use of amortised cost methods to the calculation of the constant NAV per unit/share
- **New risk managements requirements which impose:** internal processes to determine credit quality for money market instruments, and "Know Your Customer" policies and procedures
- **Stress testing**
- **New liquidity management requirements for CNAV and LVNAV MMFs.** External support to guarantee the liquidity of a MMF or to stabilise its NAV are prohibited.
- **New transparency requirements to investors and competent authorities.** Level 2 and level 3 texts will complete the MMF regulation as regards:
  - Cross-reference to criteria identifying simple, transparent and standardised securitisation and, ABCPs in the provisions of the STS securitisation Regulation, when it will be adopted
  - Stress tests scenarios
  - Reporting to competent authorities

INDUSTRY IMPLICATIONS OF THE MMFs REGULATION

- Stricter diversification rules could affect the ability of non-public issuers (in particular) to fund short-term
- Costs resulting from new requirements could also damage MMF returns. In this respect LVNAV and MMFS which publish a CNAV, but do not invest all their assets in public debt, will be most impacted by the new constraints as they have to comply with specific liquidity management and reporting
- All MMFs will be affected by more complex risks managements and transparency requirements

Therefore a further concentration in this asset management sector is expected.

BNP PARIBAS SECURITIES SERVICES' VIEW

- This initiative has created a lot of debate among the asset management community as some countries have opted for VNAV MMFs only (France) while others mainly issue CNAV MMFs (Luxembourg and Ireland). As a result it was very challenging to obtain a consensus on this legislation
- The outcome of this negotiation process is a highly regulated and transparent product. It strengthens significantly the requirements imposed to money market funds, as compared to other products, in areas such as:
  - Know your customer
  - Credit risk monitoring
  - Liquidity risk monitoring

For additional information, please contact your local relationship manager or email: **securitiesservices@bnpparibas.com**

KEY DATES

SEPTEMBER 2013
Publication of the draft MMFs Regulation by the European Commission, alongside the EC's communication on Shadow Banking

JULY 2014
SEC revised rules in the US

NOVEMBER 2016
The EU Council and Parliament reached a provisional agreement

Q1 2017
Publication of level 1 text in the Official Journal is expected

2017
Level 2 texts and level 3 texts are expected

Q1/Q2 2017
Expected final regulatory technical standards (RTS) on reporting of trades

Q3-Q4 2018
Entry into effect for all MMFs

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