European Money Market Fund Handbook

April 2018

FitchRatings

Contents

What Investors Need to Know: European Money Market Fund Reform 3

Euro LVNAV Viability Now Hinges on Higher Interest Rates 8

European MMF Investors Await Clarity as Reform Beckons 9

European MMF Reform Won't Affect Corporate Cash Analysis 10

Fitch Launches 'MMF Compare' Interactive Money Fund Comparison Tool 11

European MMF Reform Made Easy 12

Fitch: Qatar Exposure Cuts Main Change in European MMFs in 2Q17 18

Fitch Affirms Ratings on 110 Money Market Funds with $1.3 Trillion in Assets 19

European Money Market Fund Overview - April 2017 20

Fitch: EU Money Fund Reform May Spark Further Consolidation 21

Why European Money Fund Reforms Will Differ from the US 22

Fitch: European Money Fund Regulatory Liquidity High 24

Teleconference Replay: European Money Fund Reform Finalised; What Happens Next? 25

Latest on European Money Fund Reform 26

Teleconference Replay: MMF Reform 27

Reform Gate Risk Low for European Money Funds 28

Analysts

Alastair Sewell, CFA
APAC and EMEA, Analytical
+44 203 530 1147
alastair.sewell@fitchratings.com

Abis Soetan
T +44 203 530 1311
abis.soetan@fitchratings.com

Evangelia Gkeka
T +44 20 3530 1829
evangelia.gkeka@fitchratings.com

Minyue Wang, CFA
T +33 203 530 1406
minyue.wang@fitchratings.com

Investor Development

Charlotte Quiniou, CFA
+33 1 44 29 92 81
charlotte.quiniou@fitchratings.com

Business

David Turner
+44 203 530 1442
david.turner@fitchratings.com

Kathleen Plunkett
+44 203 530 1435
kathleen.plunkett@fitchratings.com

What Investors Need to Know: European Money Market Fund Reform

Click to View Report

What Investors Need to Know: European Money Market Fund Reform

21 September 2017

What is Changing

Four Money Fund Types: The "prime" constant net asset value (CNAV) money-market funds (MMFs) commonly used by corporate and public-sector treasurers will no longer exist in their current form. Instead, investors will need to choose between four different MMF types. These will include two new variants: the low volatility net asset value (LVNAV) MMF; and the public-debt CNAV MMF, both of which will be classified as "short-term" funds. Short-term and standard variable net asset value (VNAV) funds will continue to exist with limited changes. The new fund types have specific characteristics in terms of liquidity thresholds and valuation.

Ratings Expected to Remain Stable: The main risk European money market fund reforms pose to ratings is from unexpected disruption during the transition process. However, we expect fund managers to take steps to mitigate risks, including strengthening liquidity during the transition. The new rules will not change our approach to rating MMFs and therefore should not directly affect ratings unless funds' underlying credit, market or liquidity risks increase.

The reforms were signed into law in July 2017 and will become effective for new funds in July 2018 and existing funds in January 2019. Understanding the reforms and the new fund types will be a priority for investors.

In this report we address the following frequently asked questions.

- What do the MMF reforms change for investors?
- Will the reforms change Fitch's rating approach?
- How does liquidity risk factor in the reforms?
- How does Fitch's rating approach differ from the reforms?
- Are there differences in rating agency methodologies?
- How do reform-driven liquidity fees and redemption gates work?
- How would Fitch respond to a gate being imposed?
- Will we see significant reform-driven MMF asset flows, similar to the US?
- How will the reforms affect competition in the industry?

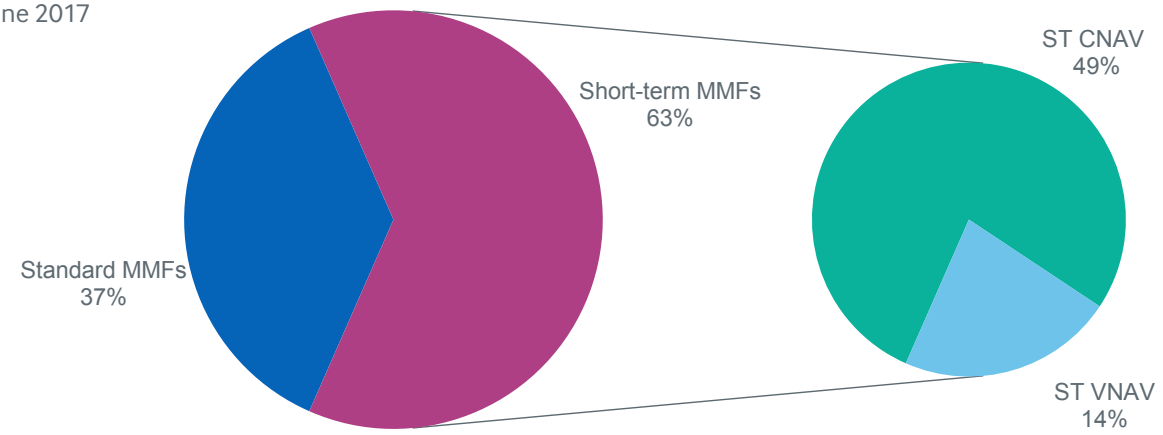
Throughout the report there are links to our relevant research and commentary, which provide more information and our credit views on the relevant topics. Our dedicated **Credit Hotspot** on European MMF reform contains regular updates on the reforms. Our interactive tool, **European MMF Reform Made Easy**, provides investors with an overview of, and insight into, the details, mechanics and effects of European MMF reform.

What do the MMF reforms change for investors?

European "Prime" CNAV MMFs will cease to exist in their current form when the reforms become effective. European corporate and public-sector treasurers who are accustomed to CNAV funds will experience the greatest change, although the new LVNAV fund type will, in many ways, look and feel much like pre-reform prime CNAVs. Those investors using Short-Term and Standard VNAV MMFs will experience less change. We estimate total assets under management in the European MMF industry at EUR1.3 trillion as of end-June 2017.

Investors will need to understand the new fund types and update their investment guidelines to accommodate the fund types they deem appropriate for cash management. One likely consequence of reform is further downward pressure on MMF yields as funds increase weekly liquidity levels. As such, some investors may also consider other cash management products to complement post-reform MMFs. For example, some treasurers are selectively adding short-term bond funds to their cash investment policies driven by improving forecasting capabilities and cash segmentation on the one hand, and the combination of persistently low-to-negative yields on the other.

European MMF Fund Type
As at 31 June 2017



Source: Fitch, Lipper, Aum of MMF domiciled in Europe

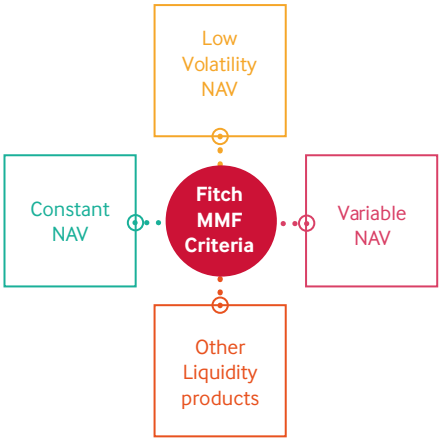
Will the reforms change Fitch's rating approach?

The reforms will not change Fitch's rating approach, which is described in its **Global Money Market Fund Rating Criteria**, dated 27 April 2017. The rating criteria already address the MMF types which will be available in Europe after the reform. Fundamentally, an MMF's risk profile drives its rating over its accounting treatment. Fitch's rating approach is identical for all short-term money-market fund types.

"Fitch's MMF criteria are applicable to CNAV, variable/floating net asset value, and European LVNAV funds as the focus is on a manager's ability to provide timely liquidity and avoid losses through limiting credit, market and liquidity risk rather than the particular accounting convention used to calculate net asset value. The criteria are also applicable to other liquidity/cash management products, such as separately managed accounts that have comparable investment objectives."

We review our criteria periodically in accordance with Fitch's policies and applicable regulatory requirements

The Post Reform Cash Landscape



Source: Fitch

How does liquidity risk factor in the reforms?

Liquidity risk is a central factor in the reforms and a central pillar of Fitch's rating criteria. The reforms introduce specific, minimum liquidity requirements for MMFs which did not exist – from a regulatory perspective - pre-reform. That is not to say that funds are/were not highly liquid pre-reform: funds can only achieve the highest rating if they meet specific overnight and weekly liquidity thresholds under Fitch's rating criteria. When we estimated the post-reform liquidity levels of the Fitch-rated (based on current portfolio composition) we found that the vast majority of rated funds already had liquidity levels well in excess of the post-reform regulatory minimums. See: **Fitch: European Money Fund Regulatory Liquidity High**, dated 15 March 2017.

The minimum liquidity requirements are substantially higher in public-debt CNAV and LVNAV funds than VNAV. The reforms set minimum liquidity thresholds of 10% and 30% for overnight and weekly liquidity respectively for LVNAV and public-debt CNAV funds. In contrast, the minimum levels for VNAV funds are 7.5% and 15% for overnight and weekly liquidity, respectively.

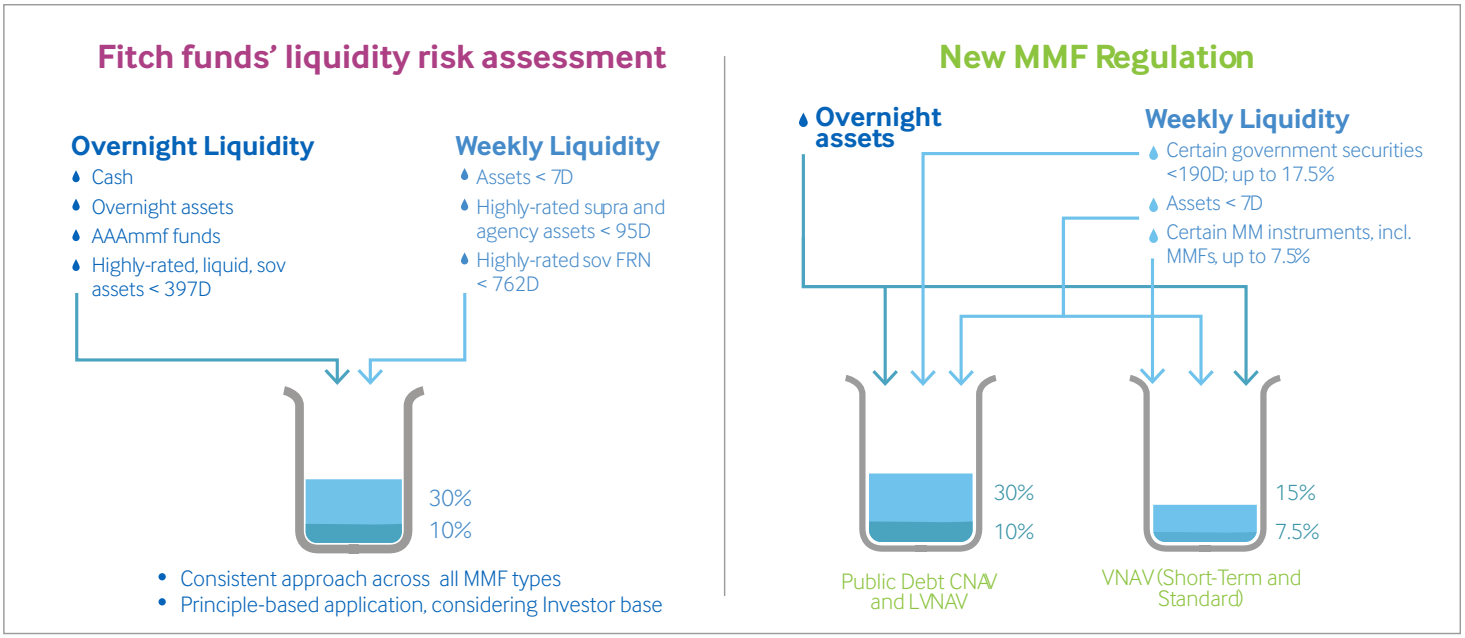
How does Fitch's rating approach differ from the reforms?

Fitch's rating criteria are aligned with the reforms in some areas – for example weighted-average maturity and weighted-average life limits. However, there are material differences.

Ratings

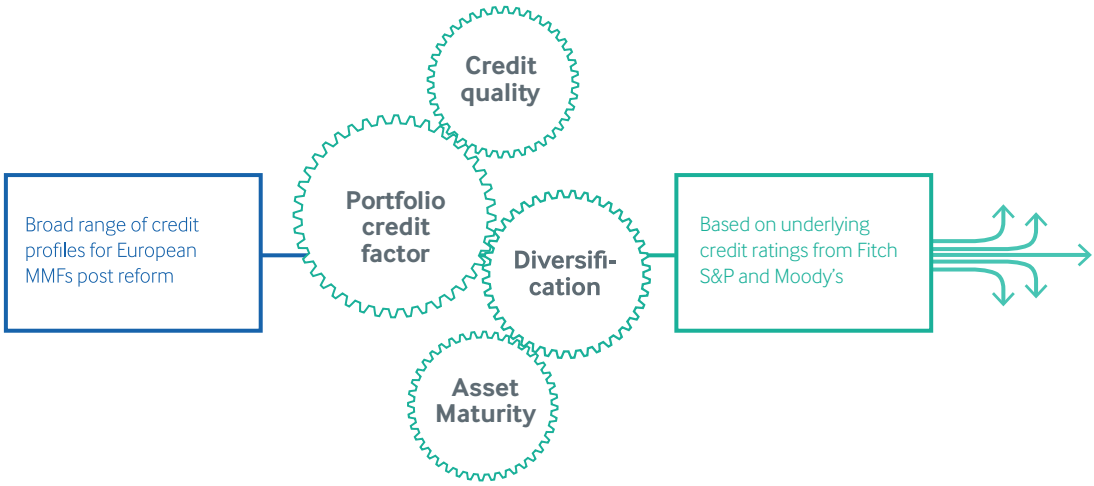
Credit ratings on the instruments held in a fund's portfolio serve as a primary input to Fitch's rating approach, whereas the reforms only consider ratings and rating changes as a factor to be addressed in the credit approval processes used by investment managers' in determining whether an asset receives a "favourable" credit assessment. The use of instrument-level credit ratings to drive our overall credit analysis of a fund brings transparency and consistency to our approach. Fitch establishes minimum credit quality guidelines, based on ratings, which ensure highly rated MMFs do not have exposure to lower credit quality issuers. Fitch's Portfolio Credit Factor, which is driven both by ratings and maturity profile further limits funds' ability to take excessive risk.

Comparing and Contrasting Fitch's View on liquidity with the Reforms



Source: Fitch, Regulatory Documents

Fitch's Fund Credit Risk Assessment



Source: Fitch

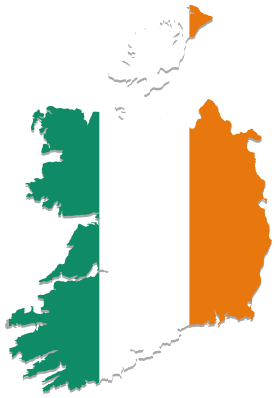
Liquidity

Fitch's baseline liquidity thresholds for 'AAAmmf'-rated funds are the same as those set out in the reform for public- debt CNAV and LVNAV funds. However, Fitch also takes into consideration investor concentration in its assessment of liquidity.

There are also important differences between the reforms and Fitch's rating criteria in terms of assets considered "eligible" for inclusion in weekly liquidity. Fitch sets specific credit quality (rating) and maturity limits for assets to be treated as eligible for weekly liquidity. In contrast, the reforms set longer acceptable maturity limits than Fitch's rating criteria and require only that the asset in question has a "favourable" credit assessment by the investment manager. This could lead to wide disparity in the composition of unrated fund's eligible weekly liquidity assets.

For example, short-dated Irish sovereign debt would be deemed an eligible investment for a 'AAAmmf'-rated fund, but would not count towards weekly liquidity under Fitch's rating criteria. On the other hand, the same Irish short-term debt would potentially count towards weekly liquidity under the reforms, provided an investment manager had a "favourable" internal credit assessment on Ireland.

Eligible Assets for Liquidity – Case Study on Ireland ('A/F1')



	Fitch MMF Criteria	Europe MMF Regulation
Eligible portfolio holding?	✔ Exposure to A/F1 consistent with AAAmmf	✔ Provided eligible under asset manager's internal credit assessment
Assets eligible to O/N liquidity?	✘ Sovereign assets may be eligible to O/N liquidity if rated 'AA-' or higher	✘ No sovereign assets
Assets eligible to weekly liquidity?	✘ Sovereign assets may be eligible to weekly liquidity if rated 'AA-' or higher	✔ Sovereign assets

Source: Fitch, Regulatory Documents;

Note: image refers to sovereign assets which would not otherwise count towards overnight or weekly liquidity due to maturity dates longer than one day (O/N liquidity) and seven days (weekly liquidity) respectively.

Are there differences in rating agency methodologies?

Fitch's rating criteria explicitly addresses MMF's ability to achieve both principal preservation and provide timely liquidity. Accordingly, Fitch's rating criteria sets objective, quantitative rating limits for the three risks (credit, market and liquidity risk) which can influence a MMF's ability to achieve this dual objective.

Standard & Poor's takes a very different approach. Its MMF ratings are primarily concerned with principal preservation. As such, a fund may still be rated 'AAA' by S&P despite throwing up a redemption gate (up to five business days) or imposing a liquidity fee. That is, S&P will maintain a 'AAA' rating on a fund that has failed to provide timely liquidity.

It is important, in our view, that investors fully appreciate the fundamental differences in rating methodologies that exist when developing investment guidelines and investing in rated money-market funds.

How do reform-driven liquidity fees and redemption gates work?

Liquidity fees and redemption gates are not new in Europe. All UCITS funds already feature an array of extraordinary liquidity management techniques which are documented in their prospectuses. For example, fund boards often have the ability to apply discretionary suspension of redemption or to apply liquidity fee or dilution levies. Some can also apply daily redemption limits or meet redemptions in kind rather than in cash above certain thresholds and for certain client types.

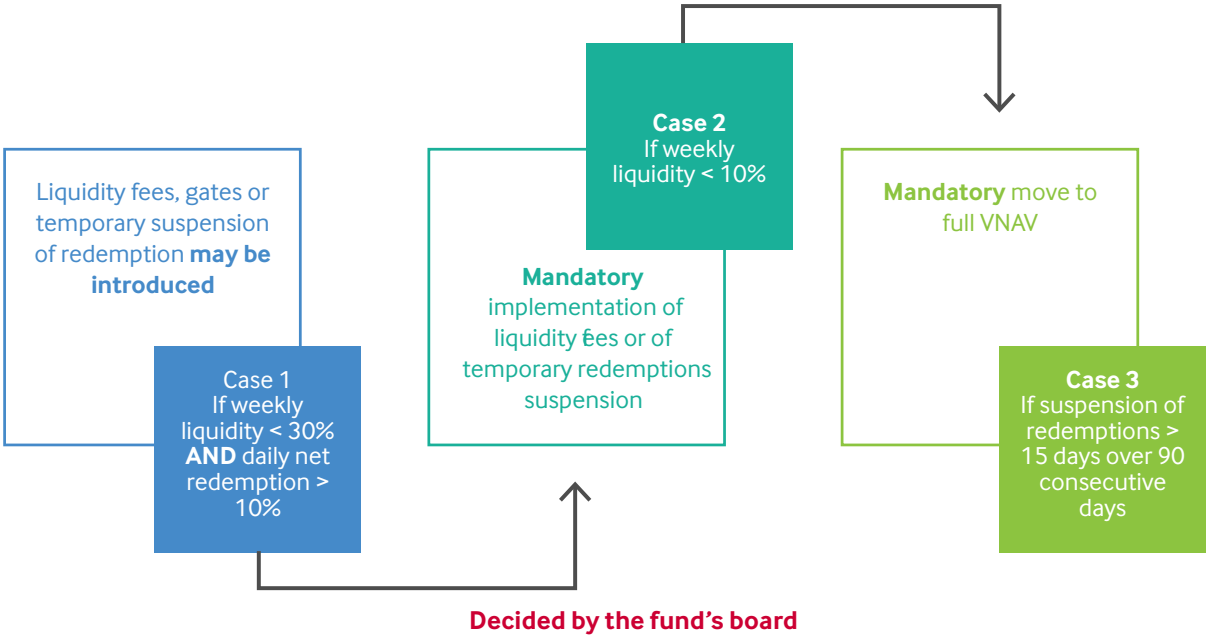
The reforms introduce additional gates and fees above and beyond those which already exist, tied to specific liquidity metrics. These only apply to public-debt CNAV and LVNAV funds.

Case 1: if weekly liquidity drops below 30% and simultaneously the fund experiences daily net redemptions of more than 10%, then the fund's board must consider if a liquidity fee of up to 3% or a redemption gate should be applied. This is a discretionary step.

Case 2: if weekly liquidity drops even further to below 10% then the board must apply a liquidity fee or redemption gate. This is a mandatory step, although the fund's board retains discretion over whether a fee or a gate is in investors' best interest.

Case 3: if redemptions are suspended for more than 15 days in any consecutive 90 day period the fund is forced to convert to a VNAV fund.

Liquidity Fees and Redemption Gate Mechanics



Source: Fitch, Regulatory Documents

How likely is a reform-driven fee or gate?

In the absence of a systemic shock or an idiosyncratic credit event, Fitch considers the risk of a mandatory fee or a gate being imposed as relatively low. The agency reviewed the most recent five years of data on weekly liquidity levels across the entire universe of rated European CNAV funds and could not find a single instance of fund liquidity falling below 10%. Clearly highly rated funds run high liquidity levels, but on the other hand the fact that liquidity levels never dipped too low indicates that fund managers have been managing in- and outflows effectively. However, it is not impossible that a fund's weekly liquidity could drop below 10%, particularly were credit conditions less benign than in recent years.

The probability of the board of directors needing to consider applying a fee or gate is higher, although still very low. The discretionary fee or gate requires a joint probability event, which, all else being equal is lower than either of the two events in isolation. Fitch estimates a probability (using the same five-year data) of about 7bp of a fund experiencing a net outflow of 10% at the same time that weekly [something] has dropped below 30% on any given day. In other words, that is a one in around 1,500 event.

In the US, we observed fund managers increasing liquidity levels in response to reform, to 40%-50% in many cases. If we see the same behaviour in Europe, then the probability of gates or fees being triggered will be lower still.

How would Fitch respond to a gate being imposed?

While the presence of liquidity fees and/or redemption gates features on their own in an MMF does not affect the fund's rating, the activation of these mechanisms is not viewed as consistent with a 'AAAmmf' rating. Activating redemption gates or imposing a liquidity fee would have negative rating implications.

Will we see significant reform-driven MMF asset flows, similar to the US?

We do not expect European MMF reform to trigger anywhere near as significant asset flows as we saw in the US where over USD1 trillion (or about a third of the industry) shifted from prime CNAV to government CNAV funds. There are structural differences with the US reforms as we describe in our Why Forum article: **Why European Money Fund Reforms Will Differ from the US**, dated 20 February 2017.

How will the reforms affect competition in the industry?

We believe that European MMF reform may spark further consolidation in the industry in response to increased regulatory cost and the challenge of developing and timing the launch of new or conversion of existing funds to the new fund types (see **Fitch: EU Money Fund Reform May Spark Further Consolidation**, dated 3 July 2017). Conversely, and notwithstanding the events of the financial crisis of 2007-08, there has been relatively little change in the industry. The disruption engendered by the reforms may enable new and potentially disruptive market entrants.

Alastair Sewell, CFA
APAC and EMEA, Analytical
+44 203 530 1147
alastair.sewell@fitchratings.com

Evangelia Gkeka
Associate Director
+44 20 3530 1829
evangelia.gkeka@fitchratings.com

Euro LVNAV Viability Now Hinges on Higher Interest Rates

Fitch Ratings-London-06 February 2018: The launch of euro-denominated "low volatility net asset value" (LVNAV) funds now appears to hinge on a rise in interest rates, following the European Commission's statement on 2 February 2018 that share cancellation mechanisms will not be allowed under European money market fund (MMF) reforms, Fitch Ratings says. Without share cancellation or a change in the regulatory mindset, LVNAV funds will not be viable unless short-term euro interest rates turn positive. One-week euro LIBOR was -43bp on 2 February.

Given low euro interest rates, euro-denominated constant net asset value (CNAV) MMFs routinely apply share cancellation to maintain a stable net asset value per share, an important feature for many investors. Most providers thought they would convert their CNAV funds to the new LVNAV fund category being introduced by the reforms, and saw LVNAV funds as central to their post-reform product line-up.

But the launch of euro LVNAV funds is now in doubt unless short-term rates rise to the extent that such funds could sustainably deliver positive yields and thus avoid need to apply share cancellations. We do not expect significant rate rises in the near term. We expect the ECB policy rate to stay at 0% in 2018 and to rise only to 0.5% in 2019.

Most participants in a poll of corporate treasurers attending a Fitch workshop in October 2017 said their preferred option for CNAV funds was to convert to LVNAV funds, rather than variable net asset value (VNAV) MMFs or other options. A key attraction of the LVNAV fund type for investors is its ability to offer a stable price per share provided certain conditions are met. However, while short-term rates remain low or negative, euro CNAV providers may have little option but to convert to VNAV MMFs. We estimate assets under management of about EUR100 billion in euro CNAV MMFs.

The launch of LVNAV funds in US dollars and sterling does not appear at risk, given the higher short-term rates for these currencies. We estimate about USD350 billion in US dollar CNAV funds and GBP220 billion in sterling CNAV funds.

The reforms will apply to new funds from 21 July 2018 and to existing funds from 21 January 2019.

Click here for Credit Hotspot: European Money Market Fund Reform.

Contact:

Alastair Sewell
Senior Director
Fund and Asset Managers
+44 20 3530 1147

David Prowse
Senior Analyst
Fitch Wire
+44 20 3530 1250

European MMF Investors Await Clarity as Reform Beckons

Fitch Ratings-London-22 January 2018: With one year to go until European money market fund (MMF) reforms take full effect, two key issues - regulatory treatment of share cancellation mechanisms and accounting treatments - are still awaiting full clarification, Fitch Ratings says. Cash investors appeared to shift their attention towards these issues in 2017, as the reforms, which will apply to new funds from 21 July 2018 and existing funds from 21 January 2019, drew closer.

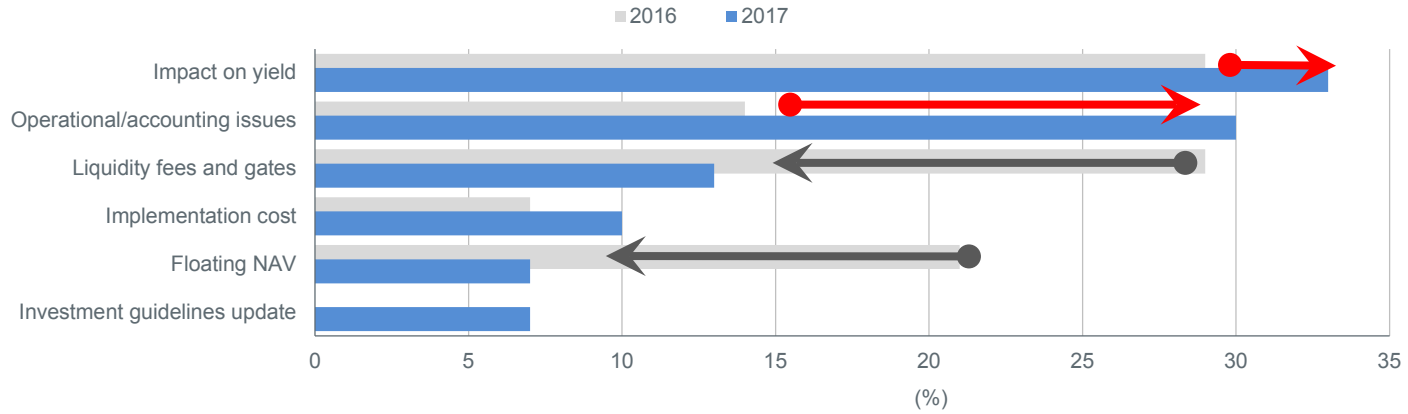
Many euro-denominated MMFs apply share cancellation mechanisms to maintain a stable net asset value per share while passing negative market yields to investors. The market is awaiting clarification from the European Securities and Markets Authority, expected in early 2018, on the applicability of this approach after the reforms take effect. The outcome will be vital for the launch of euro-denominated "low volatility net asset value" (LVNAV) funds, a new fund category being introduced by the reforms. If share cancellation mechanisms are allowed to continue, we believe that LVNAV funds could eventually account for the highest share of assets in European MMFs. These funds would be able to transact at a stable price provided certain conditions are met, and should be particularly attractive to investors already accustomed to stable-priced funds.

The reforms could challenge the treatment of MMFs as cash, because funds will be required to impose a fee or temporarily suspend redemptions if liquidity falls below certain thresholds. It is possible that some regulatory or accounting treatments may change as a result, but this is not yet clear.

We will still typically consider MMFs in developed jurisdictions as equivalent to cash in our calculations of corporate net debt metrics and immediate liquidity resources for corporates with conservative financial policies. Barring a systemic market credit event, the likelihood of the liquidity thresholds being breached appears very low in our rated European MMF portfolio. Weekly liquidity data for the portfolio over the past five years shows no instance of fund liquidity falling below 10%, the level at which a liquidity fee or redemption suspension will become mandatory. Furthermore, we expect fund managers will increase liquidity levels to limit the risk of mandatory fees or suspensions being triggered.

Our poll of corporate treasurers attending a Fitch workshop in October 2017 suggested that concerns around floating pricing and the potential for liquidity fees and gates (redemption suspensions) had eased, compared with a similar poll in December 2016, while concerns around operational impacts (e.g., share cancellation) and accounting impacts (e.g., cash equivalence) had increased markedly.

Shift in Concerns Over European MMF Reform



Source: Fitch, audience vote at Dec 2016 and Oct 2017 treasurer events

Contact:

Alastair Sewell
Senior Director
Fund and Asset Managers
+44 20 3530 1147

David Prowse
Senior Analyst
Fitch Wire
+44 20 3530 1250

Fitch: European MMF Reform Won't Affect Corporate Cash Analysis

Click to View Report

Fitch: European MMF Reform Won't Affect Corporate Cash Analysis

17 November 2017

Fitch Ratings-London-17 November 2017: Holdings in new forms of European money market funds will still typically be considered as equivalent to cash in Fitch Ratings' calculations of corporate net debt metrics and immediate liquidity resources.

MMFs are typically treated as cash under our corporate rating criteria when they are located in developed jurisdictions and used by a corporate with broadly conservative financial policies. This reflects our view that they allow timely, unconditional availability of cash to the rated entity and offer reasonable certainty that the attributable value at par will be available.

European MMF reforms being introduced could appear to challenge this view because they require some funds to either impose a fee or temporarily suspend redemptions if the fund's liquidity is too low. However, analysis of our rated European MMF portfolio suggests the likelihood of this happening will be very low.

The regulation requires these funds' boards to consider imposing a gate or a fee if weekly liquidity drops below 30% and daily net redemptions exceed 10%. The fee or gate becomes mandatory if weekly liquidity drops below 10%. MMFs can already impose fees and gates under their governing documentation, but this is the first time there has been a mandatory objective trigger.

Our analysis of weekly liquidity data for our entire rated European MMF portfolio over the last five years has not identified a single instance of fund liquidity falling below 10%. This analysis covered a relatively benign period for credit conditions. But it supports the position that under the new regulations, which become effective for new funds in July 2018 and for existing funds in January 2019, MMFs will still be considered as cash equivalent.

Other elements of the reforms require a more conservative approach from managers compared to the previous regulations and this also supports our view that these funds can still be treated as cash equivalent under our criteria. They introduce minimum liquidity requirements, which had not existed before from a regulatory perspective. Low volatility net asset value (LVNAV) funds will need to maintain at least 30% weekly liquidity, while short-term variable net asset value (VNAV) funds will need to maintain at least 15%.

Diversification requirements have also been strengthened, while the weighted average maturity (WAM) limit for short-term funds (including LVNAV and short-term VNAV) remains unchanged at 60 days.

The cash equivalence of MMFs is also a key question for companies' own financial reporting. Under IFRS, a "cash equivalent" instrument requires a very strong credit rating, WAM of not more than 90 days, insignificant risk of changes in value, a highly diversified portfolio, low liquidity risk and a way for the funds to benchmark returns (for example by reference to short-term money market interest rates).

The attractiveness of money funds to cash investors could be significantly reduced if there were a stricter application of the cash equivalent definition driven by management/auditor judgement or industry practice. But the reclassification of MMFs to the "investment" category from "cash equivalent" in a company's financials generally would not affect Fitch's classification of MMFs as cash in its corporate analysis.

Frederic Gits, Managing Director
Corporates
+33 1 44 29 91 84
frederic.gits@fitchratings.com

Kazim Razvi, Director
Accounting Research and Policy
+44 20 3530 1220
kazim.razvi@fitchratings.com

Alastair Sewell, CFA
APAC and EMEA, Analytical
+44 203 530 1147
alastair.sewell@fitchratings.com

Simon Kennedy
Senior Analyst
+44 20 3530 1387
simon.kennedy@fitchratings.com

Fitch Launches 'MMF Compare' Interactive Money Fund Comparison Tool

Click to View Report

European Money Market Fund Compare - July 2017

21 September 2017

Fitch Ratings-London-21 September 2017: Fitch Ratings has launched 'MMF Compare', a new European money market fund (MMF) interactive comparison tool to provide investor education and help promote more informed investment decision-making in the run-up to European MMF reform implementation in July 2018.

"MMF Compare allows investors to select a particular Fitch-rated fund and benchmark its portfolio credit, market and liquidity risk attributes against its rated peer group. It covers in total about half a trillion euros equivalent assets under management across 50 Fitch-rated MMFs," said Alastair Sewell, Head of EMEA and APAC Fund Ratings at Fitch.

The portfolio metrics in 'MMF Compare' are derived from Fitch's MMF rating surveillance process. Fitch receives regular portfolio holdings data from fund administrators and managers, which it cleans, standardises and enriches in accordance with a globally consistent rating methodology. These data serve as the basis for calculating key portfolio credit, market and liquidity risk metrics that Fitch uses when rating MMFs.

FitchRatings

European Money Market Funds Data July 2017

										Credit Quality (%)				Liquidity (%)			Maturity (days)	
Fund Name	Asset Manager	Fund Type	NAV Type	Fund Currency	Fitch Rating	Peer Category	Fund Domicile	Assets (mln)	PCF	F1+	F1	F2	Daily Liquidity	Weekly Liquidity	Illiquid Assets	WAM	WAL
Aberdeen Liquidity Fund (Lux) - Canadian Dollar Fund	Aberdeen	Prime	CNAV	CAD	AAAmmf	Prime_CAD	Luxembourg	73	0.87	66%	34%	0%	35%	37%	0%	46	53
Aberdeen Liquidity Fund (Lux) - Euro Fund	Aberdeen	Prime	CNAV	EUR	AAAmmf	Prime_EUR	Luxembourg	864	0.97	38%	62%	0%	45%	48%	0%	40	47
Aberdeen Liquidity Fund (Lux) - Sterling Fund	Aberdeen	Prime	CNAV	GBP	AAAmmf	Prime_GBP	Luxembourg	16,110	1.09	39%	61%	0%	29%	34%	0%	53	58
Aberdeen Liquidity Fund (Lux) - US Dollar Fund	Aberdeen	Prime	CNAV	USD	AAAmmf	Prime_USD	Luxembourg	1,428	1.12	48%	52%	0%	16%	32%	0%	47	68
Amundi Money Market Fund - Short Term (EUR)	Amundi	Prime	CNAV	EUR	AAAmmf	Prime_EUR	Luxembourg	1,977	1.15	42%	58%	0%	31%	38%	2%	43	61
Amundi Money Market Fund - Short Term (GBP)	Amundi	Prime	CNAV	GBP	AAAmmf	Prime_GBP	Luxembourg	733	1.02	41%	59%	0%	18%	36%	4%	40	64
Amundi Money Market Fund - Short Term (USD)	Amundi	Prime	CNAV	USD	AAAmmf	Prime_USD	Luxembourg	863	0.79	58%	42%	0%	19%	48%	3%	27	68
BlackRock ICS Institutional Euro Government Liquidity Fund	BlackRock	Government	CNAV	EUR	AAAmmf	Government_EUR	Ireland	304	0.01	89%	11%	0%	81%	92%	0%	43	45
BlackRock ICS Institutional Euro Liquidity Fund	BlackRock	Prime	CNAV	EUR	AAAmmf	Prime_EUR	Ireland	26,469	1.03	39%	66%	0%	25%	36%	0%	53	54
BlackRock ICS Institutional Sterling Government Liquidity Fund	BlackRock	Govt	CNAV	GBP	AAAmmf	Govt_GBP	Ireland	3,216	0.03	61%	39%	0%	83%	100%	0%	35	35
BlackRock ICS Institutional Sterling Liquidity Fund	BlackRock	Prime	CNAV	GBP	AAAmmf	Prime_GBP	Ireland	38,138	1.16	42%	58%	0%	18%	35%	0%	47	58
BNY Mellon U.S. Dollar Liquidity Fund	BNY Mellon	Prime	CNAV	USD	AAAmmf	Prime_USD	Ireland	7,241	0.90	54%	46%	0%	43%	56%	0%	43	42
CCLA Public Sector Investment Fund - The Public Sector Deposit Fund	CCLA	Prime	CNAV	GBP	AAAmmf	Prime_GBP	UK	447	1.05	23%	75%	0%	27%	36%	0%	49	49
Deutsche Global Liquidity Series p.l.c - Deutsche Managed Dollar Fund	Deutsche AM	Prime	CNAV	USD	AAAmmf	Prime_USD	Ireland	10,852	1.05	53%	47%	0%	16%	29%	0%	31	67
Deutsche Global Liquidity Series p.l.c - Deutsche Managed Euro Fund	Deutsche AM	Prime	CNAV	EUR	AAAmmf	Prime_EUR	Ireland	5,550	1.26	41%	59%	0%	19%	29%	0%	58	65
Deutsche Global Liquidity Series p.l.c - Deutsche Managed Sterling Fund	Deutsche AM	Prime	CNAV	GBP	AAAmmf	Prime_GBP	Ireland	7,330	1.13	38%	62%	0%	26%	33%	0%	46	63
Federated Short-Term Sterling Prime Fund	Federated	Prime	CNAV	GBP	AAAmmf	Prime_GBP	UK	3,084	1.28	46%	54%	0%	26%	34%	0%	51	74
Federated Short-Term U.S. Prime Fund	Federated	Prime	CNAV	USD	AAAmmf	Prime_USD	Ireland	2,900	1.26	57%	43%	0%	34%	38%	0%	54	61
Goldman Sachs Euro Liquid Reserves Fund	Goldman Sachs AM	Prime	CNAV	EUR	AAAmmf	Prime_EUR	Ireland	8,191	1.08	34%	66%	0%	23%	34%	0%	48	52
Goldman Sachs Sterling Liquid Reserves Fund	Goldman Sachs AM	Prime	CNAV	GBP	AAAmmf	Prime_GBP	Ireland	10,933	1.25	35%	65%	0%	25%	32%	0%	49	66
Goldman Sachs US Dollar Liquid Reserves Fund	Goldman Sachs AM	Prime	CNAV	USD	AAAmmf	Prime_USD	Ireland	43,661	1.24	56%	44%	0%	33%	43%	0%	33	76
Insight Liquidity Funds plc - ILF GBP Liquidity Fund	Insight IM	Prime	CNAV	GBP	AAAmmf	Prime_GBP	Ireland	23,608	0.95	34%	66%	0%	36%	47%	0%	40	51
Insight Liquidity Funds p.l.c. - ILF USD Liquidity Fund	Insight IM	Prime	CNAV	USD	AAAmmf	Prime_USD	Ireland	591	0.66	50%	50%	0%	47%	60%	0%	35	34
JPMorgan Liquidity Funds - Euro Liquidity Fund	JPMorgan AM	Prime	CNAV	EUR	AAAmmf	Prime_EUR	Luxembourg	13,864	1.14	36%	64%	0%	20%	36%	0%	52	61
JPMorgan Liquidity Funds - Sterling Gilt Liquidity Fund	JPMorgan AM	Government	CNAV	GBP	AAAmmf	Government_GBP	Luxembourg	178	0.01	66%	34%	0%	100%	100%	0%	38	54
JPMorgan Liquidity Funds - Sterling Liquidity Fund	JPMorgan AM	Prime	CNAV	GBP	AAAmmf	Prime_GBP	Luxembourg	12,106	1.26	36%	64%	0%	33%	36%	0%	58	71
JPMorgan Liquidity Funds - US Dollar Government Liquidity Fund	JPMorgan AM	Government	CNAV	USD	AAAmmf	Government_USD	Luxembourg	2,557	0.01	87%	13%	0%	79%	92%	0%	32	63
JPMorgan Liquidity Funds - US Dollar Liquidity Fund	JPMorgan AM	Prime	CNAV	USD	AAAmmf	Prime_USD	Luxembourg	92,074	1.39	47%	53%	0%	23%	35%	0%	28	77
JPMorgan Liquidity Funds - US Dollar Treasury Liquidity Fund	JPMorgan AM	Government	CNAV	USD	AAAmmf	Government_USD	Luxembourg	33,000	0.05	54%	38%	0%	84%	100%	0%	20	58
LGIM Liquidity Funds PLC - LGIM Sterling Liquidity Fund	L&G IM	Prime	CNAV	GBP	AAAmmf	Prime_GBP	Ireland	29,908	1.15	43%	57%	0%	35%	44%	0%	50	61
LGIM Liquidity Funds PLC - LGIM US Dollar Liquidity Fund	L&G IM	Prime	CNAV	USD	AAAmmf	Prime_USD	Ireland	1,187	0.77	47%	53%	0%	52%	57%	0%	38	41
LO Funds (CH) - Short-Term Money Market (USD)	Lombard Odier IM	Prime	VNAV	USD	AAAmmf	Prime_USD	Switzerland	1,209	1.24	31%	69%	0%	16%	32%	0%	36	61
MS Liquidity Funds - Euro Liquidity Fund	Morgan Stanley IM	Prime	CNAV	EUR	AAAmmf	Prime_EUR	Luxembourg	6,415	1.09	37%	63%	0%	25%	34%	0%	47	51
MS Liquidity Funds - Sterling Liquidity Fund	Morgan Stanley IM	Prime	CNAV	GBP	AAAmmf	Prime_GBP	Luxembourg	2,712	0.95	47%	53%	0%	30%	36%	0%	47	52
MS Liquidity Funds - US Dollar Liquidity Fund	Morgan Stanley IM	Prime	CNAV	USD	AAAmmf	Prime_USD	Luxembourg	20,422	1.46	61%	39%	0%	19%	34%	0%	33	78
Natixis Cash ASPI	Natixis AM	Prime	VNAV	EUR	AAAmmf	Prime_EUR	France	210	1.17	34%	66%	0%	18%	31%	0%	42	58
Royal London Bond Funds ICVC - Royal London Short-Term Money Market Fund	Royal London AM	Prime	CNAV	GBP	AAAmmf	Prime_GBP	UK	3,763	1.12	55%	45%	0%	26%	35%	0%	57	62
Short-Term Investments Co. (Global Series) plc - Euro Liquidity Portfolio (Invesco)	Invesco	Prime	CNAV	EUR	AAAmmf	Prime_EUR	Ireland	2,362	0.80	48%	52%	0%	33%	43%	0%	41	43
Short-Term Investments Co. (Global Series) plc - Sterling Liquidity Portfolio (Invesco)	Invesco	Prime	CNAV	GBP	AAAmmf	Prime_GBP	Ireland	1,733	1.21	47%	53%	0%	30%	36%	0%	48	65
Short-Term Investments Co. (Global Series) plc - US Dollar Liquidity Portfolio (Invesco)	Invesco	Prime	CNAV	USD	AAAmmf	Prime_USD	Ireland	4,046	1.39	46%	54%	0%	26%	35%	0%	28	65
Standard Life Investments Euro Liquidity Fund	Standard Life Investments	Prime	CNAV	EUR	AAAmmf	Prime_EUR	Ireland	1,525	0.80	36%	64%	0%	36%	44%	4%	33	47
Standard Life Investments Sterling Liquidity Fund	Standard Life Investments	Prime	CNAV	GBP	AAAmmf	Prime_GBP	Ireland	15,784	1.01	38%	62%	0%	19%	35%	10%	48	56
State Street Global Advisors Liquidity PLC - SSgA EUR Liquidity Fund	SSGA	Prime	CNAV	EUR	AAAmmf	Government_USD	Ireland	4,630	0.80	38%	62%	0%	22%	38%	0%	27	37
State Street Global Advisors Liquidity PLC - SSgA GBP Liquidity Fund	SSGA	Prime	CNAV	GBP	AAAmmf	Prime_GBP	Ireland	4,460	0.83	35%	65%	0%	24%	45%	0%	35	52
State Street Global Advisors Liquidity PLC - SSgA USD Liquidity Fund	SSGA	Prime	CNAV	USD	AAAmmf	Prime_USD	Ireland	13,464	1.02	59%	41%	0%	23%	38%	0%	33	52
State Street US Treasury Liquidity Fund	SSGA	Government	CNAV	USD	AAAmmf	Government_USD	Ireland	308	0.02	31%	69%	0%	100%	100%	0%	8	8
UBS (Irl) Select Money Market Fund - EUR	UBS Asset Management	Prime	CNAV	EUR	AAAmmf	Prime_EUR	Ireland	219	0.57	52%	48%	0%	28%	38%	0%	40	49
UBS (Irl) Select Money Market Fund - GBP	UBS Asset Management	Prime	CNAV	GBP	AAAmmf	Prime_GBP	Ireland	842	1.04	31%	69%	0%	27%	35%	0%	54	73
UBS (Irl) Select Money Market Fund - USD	UBS Asset Management	Prime	CNAV	USD	AAAmmf	Prime_USD	Ireland	1,968	1.39	52%	48%	0%	22%	36%	0%	24	74
Western Asset Liquidity Funds plc - Western Asset US Dollar Liquidity Fund	Western Asset	Prime	CNAV	USD	AAAmmf	Prime_USD	Ireland	1,869	1.21	48%	52%	0%	20%	43%	0%	37	58

Source: Fitch, Fund administrators, Fund managers

FitchRatings

Selected European Money Market Fund versus Peer Group Click Here to Select Fund July 2017

Fund Name (select from list): JPMorgan Liquidity Funds - Euro Liquidity Fund

Peer Category: Prime_EUR — Number of funds in peer group: 12

Portfolio Credit Factor (PCF) — Fund 1.14; Peers 1.50

Portfolio Liquidity (% Portfolio) — Actual Asset Maturity; Additional Eligible Assets; Peers — O/N Liquidity; 7D Liquidity

Overall Profile vs Peers — PCF; O/N Liquidity; WAL; 7D Liquidity; WAM; Peers; Fund; Criteria

Rating Mix (% Portfolio) — Inner circle: Peers; Outer circle: Fund; F1+; F1; F2

Portfolio Maturities (Days) — Fund; Peers; WAM; WAL

The shaded area represents the limit of Fitch's AAAmmf criteria range. Note - O/N and 7D liquidity are inverted (ie the outer limit is the minimum level for these metrics).
The limits at the AAAmmf rating level are as follows:
PCF: 1.50 WAM: 60 WAL: 120
7D Liquidity: 30% O/N Liquidity: 10%

Maturity Mix (% Portfolio) — Fund; Peers — O/N; 2 - 7 D; 8 - 30 D; 31 - 90 D; 91 - 180 D; 181 - 397 D; 398 - 762 D

Asset Mix (% Portfolio) — Fund; Peers — Cash; TD; Repo; CD; CP; ABCP; Corp Bd/N; Govt/ Agency; Other

Source: Fitch, Fund administrators, Fund managers

Alastair Sewell, CFA
APAC and EMEA, Analytical
+44 203 530 1147
alastair.sewell@fitchratings.com

Abis Soetan
Director
+44 20 3530 1311
abis.soetan@fitchratings.com

Evangelia Gkeka
Associate Director
+44 20 3530 1829
evangelia.gkeka@fitchratings.com

Minyue Wang, CFA
Analyst
+44 20 3530 1406
minyue.wang@fitchratings.com

European MMF Reform Made Easy

Click to View Report

European MMF Reform Made Easy

Overview

European MMF reform has finally arrived. The final text of the new European MMF regulation has been agreed, with an implementation period of 12 months for new funds and 18 months for existing funds.

Short-term investors will need to prepare for the significant changes European MMF reform will bring. Updating treasury investment policies in a timely manner to reflect both the details of reform and the realities of today's cash investing landscape will be an important priority for investors.

European MMF Reform Made Easy provides investors with an overview of, and insight into, the details, mechanics and effects of European MMF reform. Throughout there are links to Fitch's relevant research and commentary, which provide more information and Fitch's credit views on the relevant topics.

Fitch rates European MMF today and will continue to do so post-reform. Our **rating criteria** is applicable to the new fund types – specifically the LVNAV fund, which will now be available to investors.

Further information on European MMF reform as well as Fitch's updated MMF rating criteria is available **here**.

We maintain an extensive analyst pool covering the MMF sector. Our analysts are available to discuss any of these points with investors.

Key Takeaways

Low-volatility net asset value (LVNAV) is likely to be a workable alternative for existing constant net asset value (CNAV) investors.

Fitch's global money fund rating criteria is specifically applicable to LVNAV, as well as other fund types.

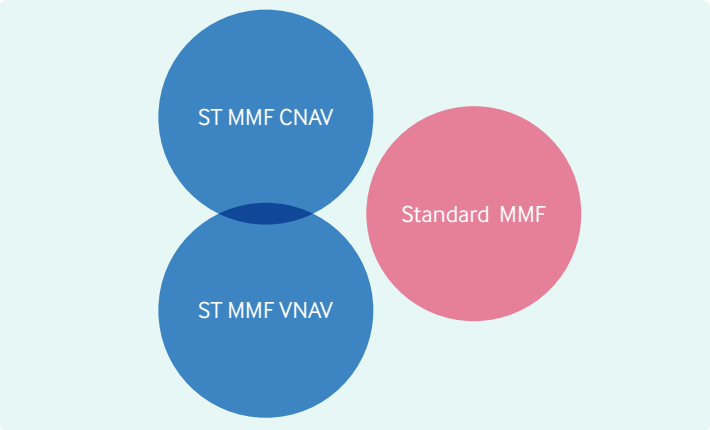
In contrast to the US, there are unlikely to be massive flows from prime to government assets.

Liquidity fees and redemption gates are features of CNAV and LVNAV, but the probability of triggering a mandatory gate is low.

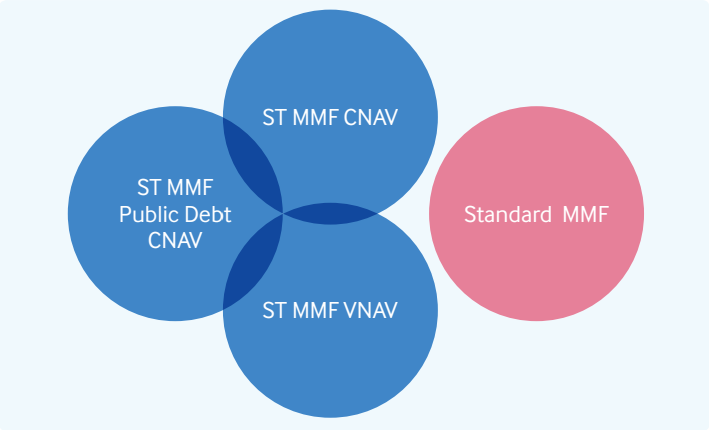
A broad range of European money market fund (MMF) profiles will persist, but complexity will increase relative to existing fund types.

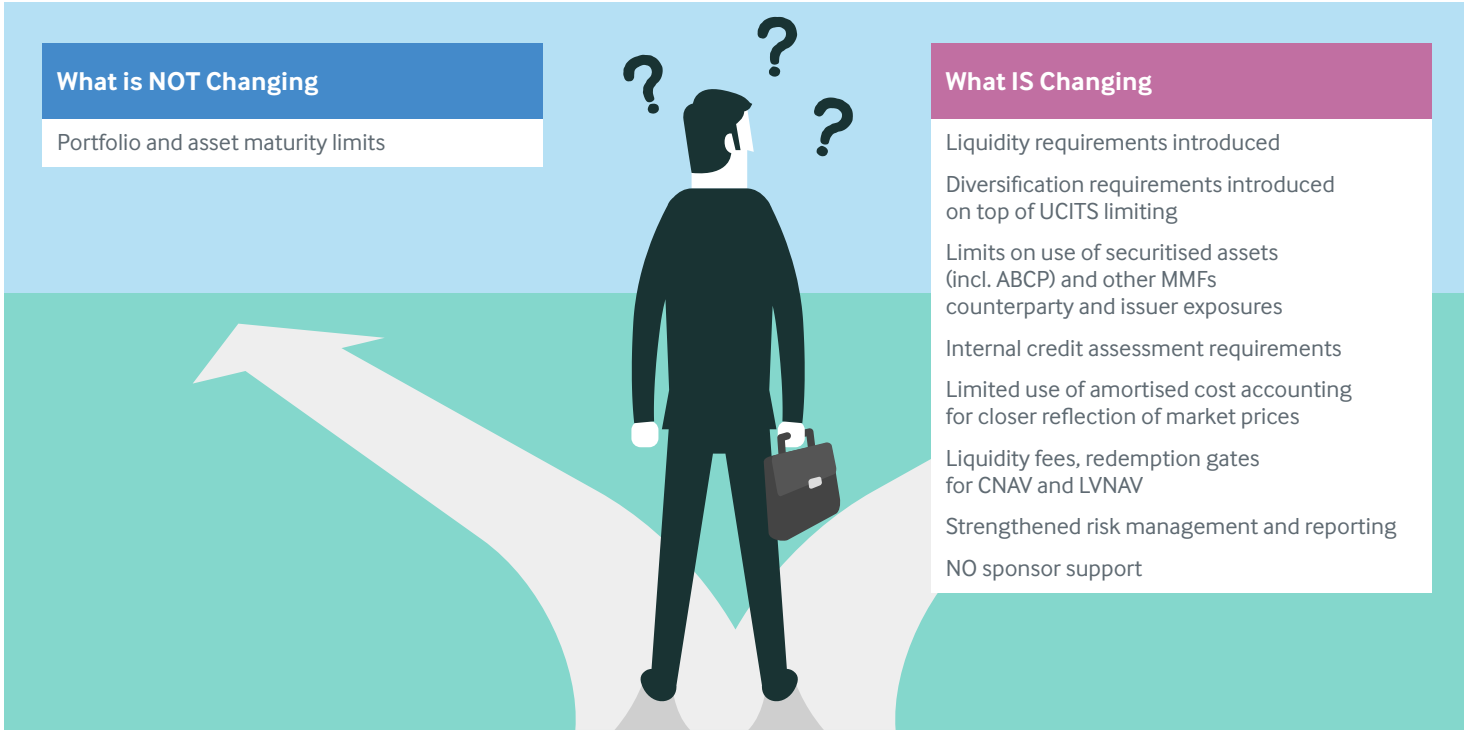
The timely update of investment guidelines is a priority for short-term investors.

ESMA 2 MMF Segments



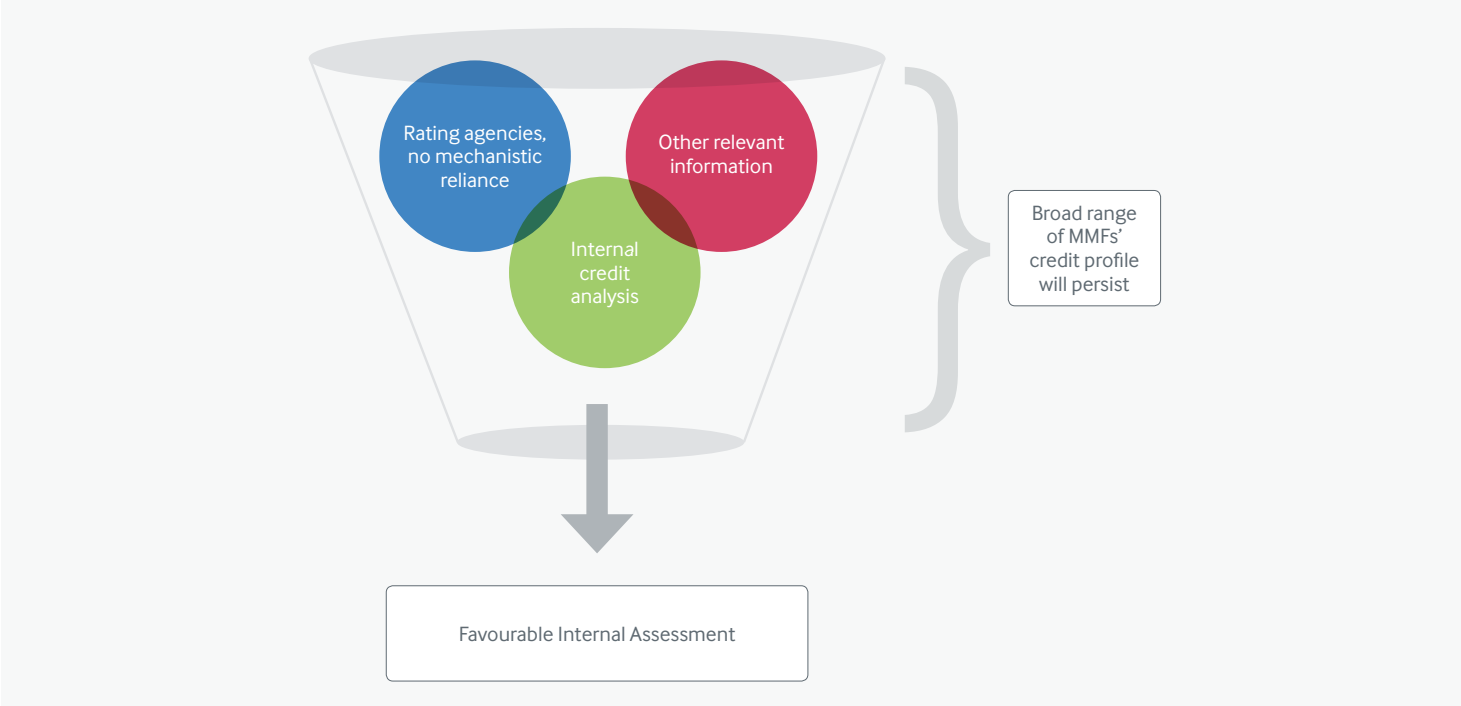
New Regulation: 4 MMF Types





Credit Risk

Credit Quality



Central to the reforms is the concept of a "favourable" credit assessment by the fund manager for an asset to be eligible for investment. The reforms also introduce an extensive list of diversification and eligibility requirements.

In contrast with the reforms, credit ratings are central to our approach to measuring fund credit risk. Conceptually, a low quality entity, e.g. one rated 'BBB-', which has received a "favourable" assessment by the fund manager could be included in an unrated – but regulatory compliant – fund. However, such an exposure would be ineligible in a fund rated 'AAAmmf'.

Asset Maturity

Short-Term MMFs	Public Debt CNAV	397 days
	LVNAV	
	Short-Term VNAV	
Standard MMFs	(VNAV Only)	2 years, with 397 days max to next interest rate reset date

Eligible Assets for Investment

Short-Term MMFs	Public Debt CNAV	99.5% government assets cash or reverse repo backed by government assets
	LVNAV	Money market instruments Certain securitisations or ABCP Instantly accessible deposits Short-dated reverse repo Other short-term MMFs provided no circularity Currency and interest rate derivatives (for hedging purpose only)
	Short-Term VNAV	
Standard MMFs	(VNAV Only)	

Diversification

	Short-Term MMFs			Standard MMFs
	Public Debt CNAV	LVNAV	Short-Term VNAV	VNAV Only
Max 10% per issuer and max 40% aggregate in issuers > 5%			✔	✔
Max 15% per reverse repo counterparty	✔	✔	✔	✔
Max 5% per issuer		✔		
Max 10% per deposit 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 15% overall exposure to securitisation and ABCPs		✔	✔	✔
Max 17.5% overall MMF exposure		✔	✔	✔

Source: Fitch

Market Risk

Restrictions on market risk for short-term MMF will be unchanged by the reforms, with caps on weighted average maturity (WAM, which measures interest-rate risk) of 60 days and on weighted average life (WAL, which measures credit spread risk) of 120 days. Standard MMF will be able to invest at longer WAM levels.

WAM

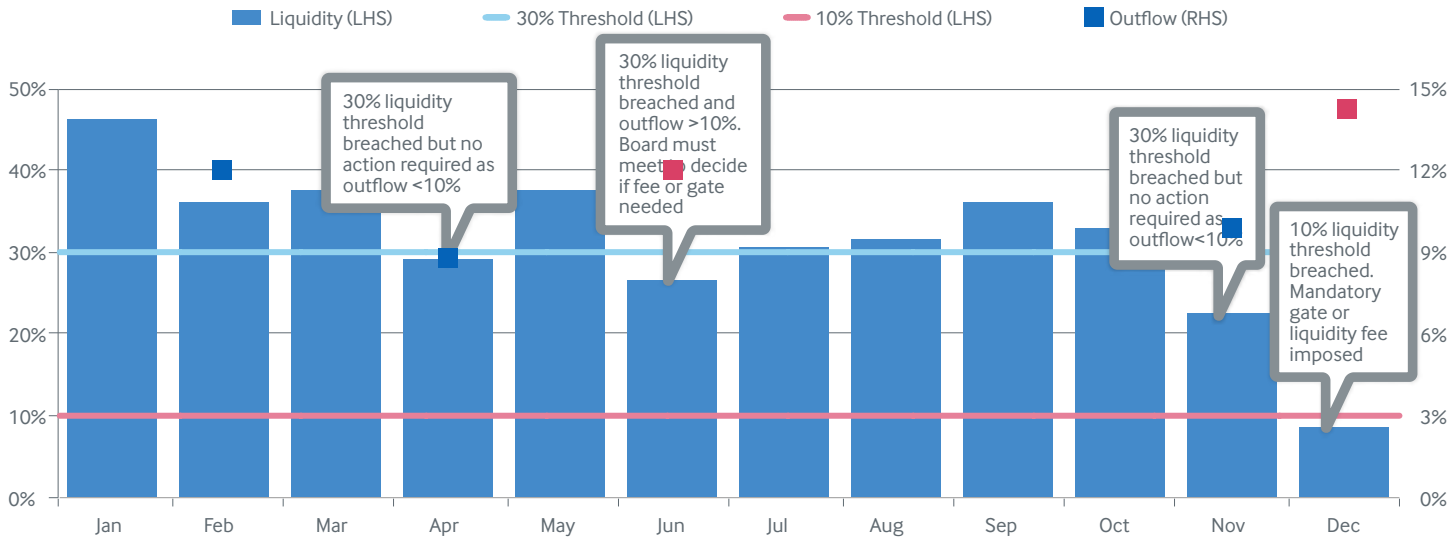
	60 Days	120 Days	6 Months	12 Months
Public Debt CNAV				
LVNAV				
Short-Term VNAV				
Standard MMF				

WAL

	60 Days	120 Days	6 Months	12 Months
Public Debt CNAV				
LVNAV				
Short-Term VNAV				
Standard MMF				

Liquidity Risk

Triggers for Liquidity Fees and Redemption Gates



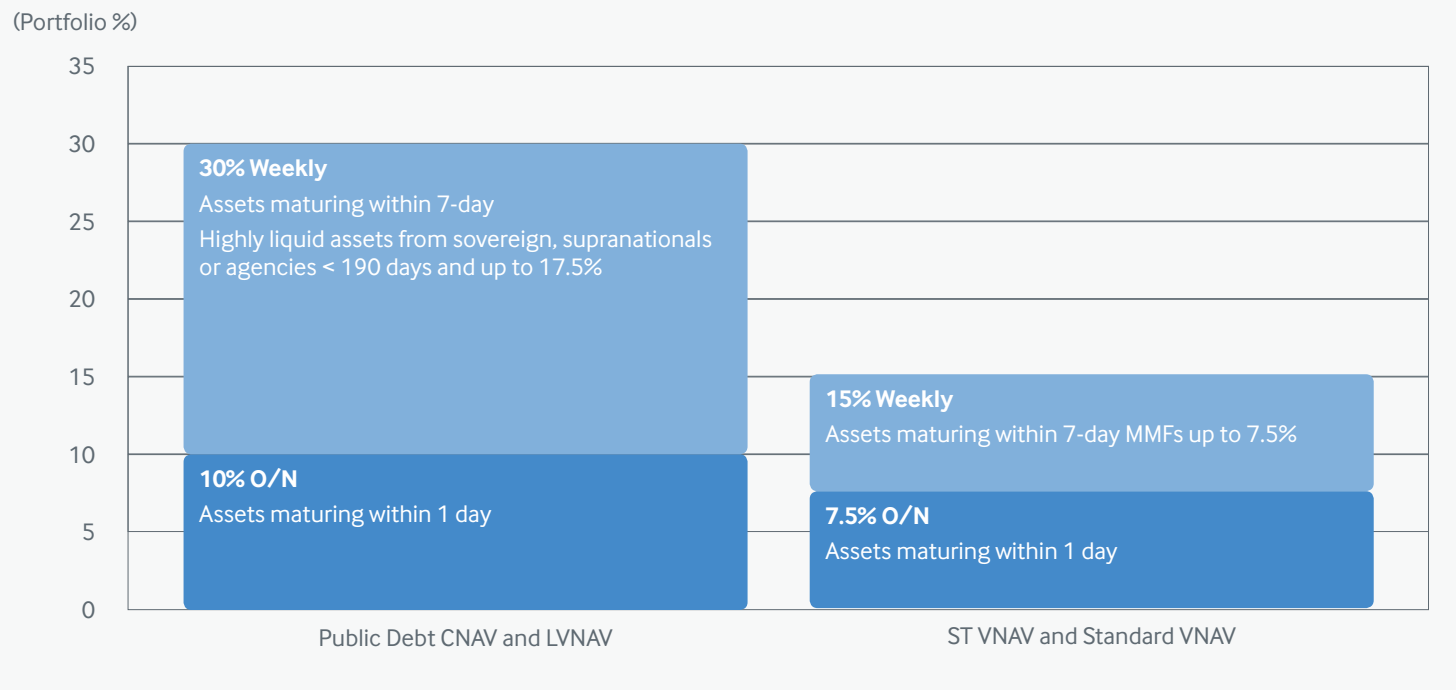
Source: Fitch, Regulatory Documents

Liquidity risk is a central pillar of our rating framework. The reforms introduce new minimum overnight and weekly liquidity requirements, although there are differences between fund types. VNAV funds will have lower minimum liquidity requirements than stable price funds, including LVNAVs.

If weekly liquidity falls below certain pre-defined thresholds, stable price funds will be forced to consider applying liquidity fees or redemption gates. We estimate the probability of a gate or fee being applied as very low. However, were such a measure to be applied we would consider it a negative rating event.

Liquidity levels in Fitch rated European MMF are high, relative to regulatory thresholds. A Fitch commentary on this topic can be accessed by clicking **here**.

Liquidity Requirements

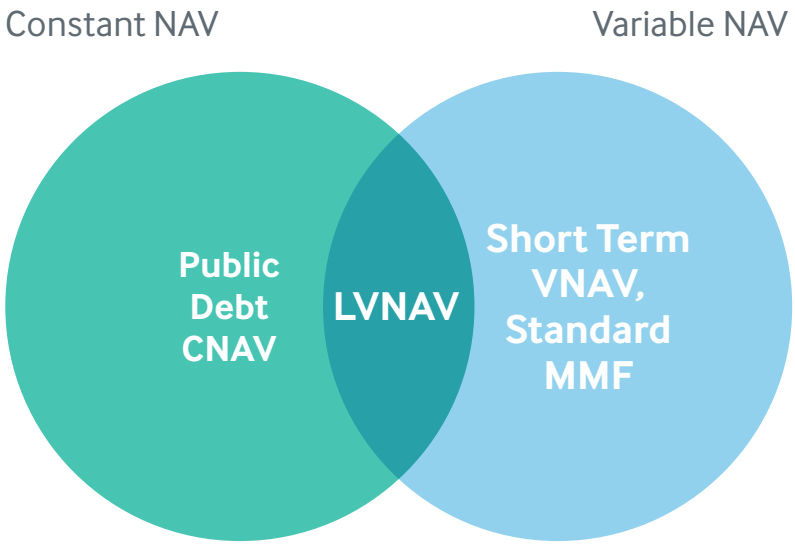


Source: European Parliament, Fitch

Valuation

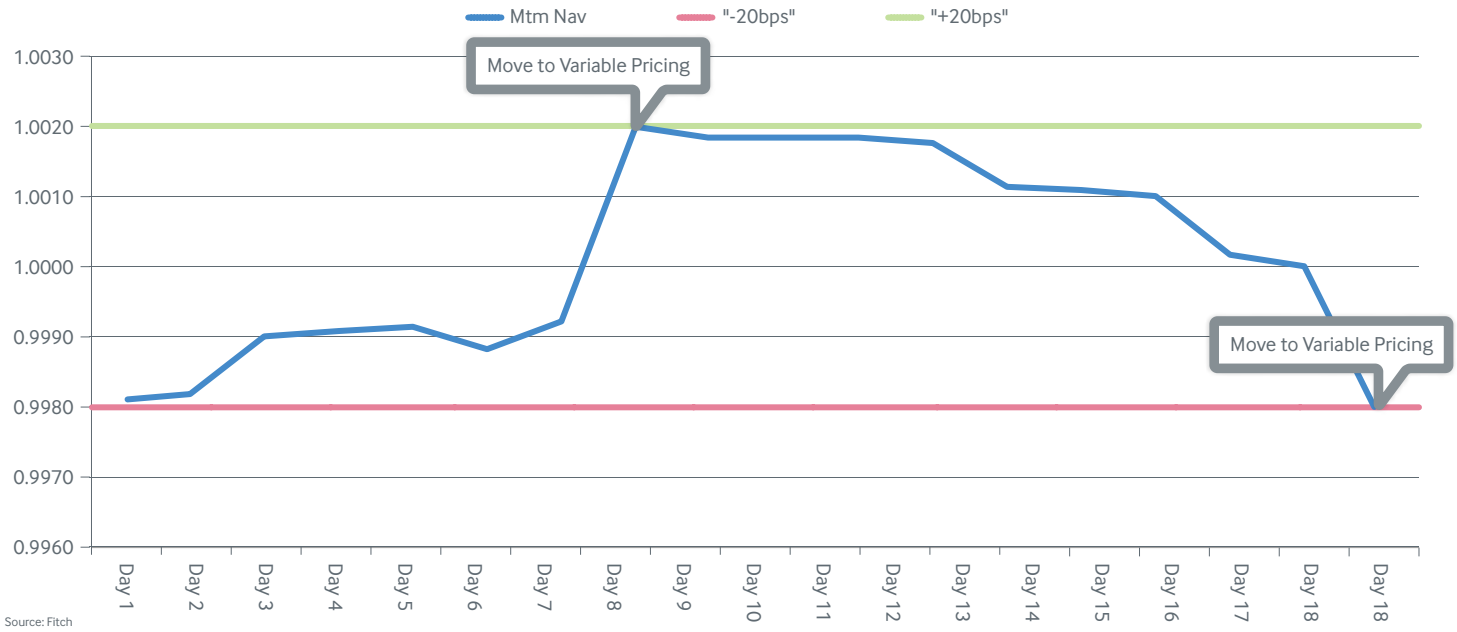
Two types of short-term MMF –public debt CNAV and LVNAV funds – will be able to transact at a constant unit value per share, much like the pre-reform CNAV funds. However, the LVNAV fund will need to keep the difference between its mark-to-market price and its book value (or amortised cost price) within a tight range: +/-20bp (compared with the pre-reform range) of +/-50bp). If the fund breaches this range it will move to variable pricing. We estimate a low probability of an LVNAV fund deviating from this 20bp range.

Net Asset Value Calculation



LVNAV: Move to Variable Pricing if Corridor Breached

+/- 20 bp range



Source: Fitch

Fitch: Qatar Exposure Cuts Main Change in European MMFs in 2Q17

Click to View Report

European MMF Quarterly - 2Q17

16 August 2017

Fitch Ratings-London-16 August 2017: Fitch Ratings says that a reduction in Qatar exposure was the most significant allocation change in European prime constant net asset value money market funds (CNAV MMF) in 2Q17. Other events, such as the elections in France, had no significant impact on asset allocation or flows.

Qatar exposures and, specifically, Qatar National Bank (QNB, F1+/AA-/RNW), declined significantly across all portfolios, albeit from a low base. Exposures were reduced due to externally imposed constraints or liquidity risks, rather than concerns about credit fundamentals. Fitch placed Qatar (F1+/AA) on Rating Watch Negative on 12 June 2017 after a number of countries in the region cut diplomatic and logistical ties with Qatar.

French elections had minimal impact on asset allocation and flows in France. France remains the largest country exposure across all currencies. Some managers decided to slightly reduce maturities as a precaution against unexpected volatility around the elections.

Sterling funds increased exposure to UK government bonds amid a lack of supply of high-quality, short-term bank paper and due to limits on the amount of cash that can be left un-invested with custodians. Fitch believes that the current paucity of supply, if sustained, may lead some funds to consider adding limited, fully hedged non-sterling exposures to their portfolios.

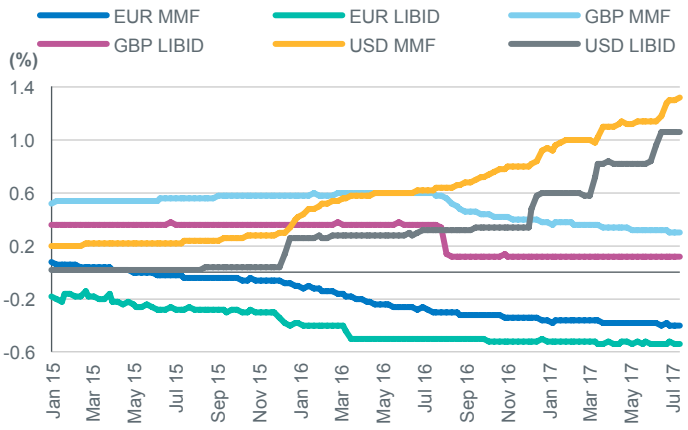
CNAV MMFs' assets under management declined to EUR619 billion at end-2Q17 from EUR644 billion at end-1Q17. Fitch attributes the decline to regular seasonal effects. Flows were within normal historical ranges, both at the level of individual funds and aggregate currency groups.

US dollar prime funds' seven-day gross yield increased to a high of 1.29% at end-2Q17 (a level last seen at the beginning of 2009), reflecting an increase in the federal funds rate. In contrast, the seven-day gross yield in EUR and GBP prime funds dropped to minus 0.4% and 0.3% respectively.

European money market fund reform was finalised at end-2Q17. All new MMFs in Europe will have to comply with the reforms by 21 July 2018 and existing funds by 21 January 2019.

Additional information on European money fund reform is available under our dedicated Credit Hotspot - **www.fitchratings.com/site/fam/mmfr**

MMF 7D Gross Yields & LIBID

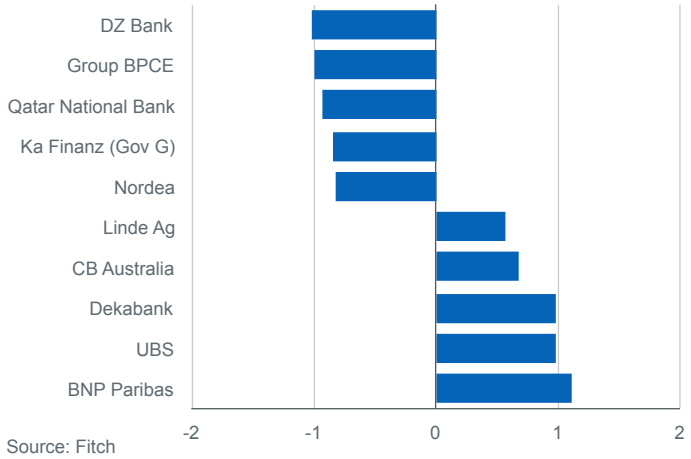


Source: iMoneyNet, Bloomberg

Fitch-Rated Sterling MMFs

Largest Changes in Issuer Exposure

(Quarterly changes, % of portfolio)



Source: Fitch

Evangelia Gkeka
Associate Director
+44 20 3530 1829
evangelia.gkeka@fitchratings.com

Minyue Wang, CFA
Analyst
+44 20 3530 1406
minyue.wang@fitchratings.com

Fitch Affirms Ratings on 110 Money Market Funds with $1.3 Trillion in Assets

Click to View Report

Fitch Affirms Ratings on 110 Money Market Funds with $1.3 Trillion in Assets

26 July 2017

Fitch Ratings-New York-26 July 2017: Fitch Ratings has affirmed the ratings on 110 money market funds (MMFs) following a regularly scheduled global review of the sector. Collectively, the funds comprise about $1.3 trillion of assets under management (AUM). A complete list of the funds and the associated ratings is included at the end of this press release.

Key Rating Drivers

The main rating drivers for the affirmations are:

- The MMF portfolios' overall credit quality and diversification;
- Low exposure to interest rate and spread risks;
- Holdings of daily and weekly liquid assets consistent with shareholder profiles;
- Maturity profiles meeting Fitch's rating criteria;
- The capabilities and resources of the respective investment advisors.

Portfolio Credit Quality/Diversification

Consistent with Fitch's criteria for rating MMFs at 'AAAmmf', the reviewed funds maintain high credit quality portfolios by investing exclusively in short-term securities rated at least 'F1' by Fitch or the equivalent. MMFs rated 'AAmmf' and 'Ammf' may elect to invest a small percent of their assets in securities rated 'F2' by Fitch or the equivalent.

These MMFs rated at 'AAAmmf' manage their portfolios to limit their exposures to individual issuers at 10% of the fund's assets, with no more than 5% of assets for those exposures above seven days in tenor. Minor and temporary deviations from these parameters may occur from time to time, mainly due to cash outflows. The funds also limit their individual repurchase agreement (repo) exposures to individual counterparties to 25% of a fund's total assets, provided the counterparties are rated 'A' or higher and that such repos are fully collateralized by high credit quality and liquid government securities. In the case of repo with counterparties rated 'A-/F2' or 'BBB+/F2', funds limit their exposure to individual counterparties to 10% of assets, as long as the repo is collateralized by high-quality government securities and matures in one week or less. MMFs also limit their exposure to government agencies, with exposures above 35% of assets limited to short-dated securities.

The reviewed prime MMFs' Portfolio Credit Factor (PCF), which is a risk-weighted measure that considers the credit quality and maturity profile of the portfolio securities, generally met Fitch's 'AAAmmf' rating criterion of 1.50 or less.

Maturity Profiles

The reviewed MMFs seek to limit interest rate and spread risk by maintaining their weighted average maturity (WAM) and weighted average life (WAL) below 60 days and 120 days, respectively. These funds also limit the maturity date of any single investment to 397 days with the exception of floating-rate securities issued by highly rated sovereigns, supranationals, or government agencies benefiting from strong market liquidity, which could have maturities as long as 762 days. Portfolios and/or individual securities maturity limits may be lower, in line with the funds' or asset managers' investment policy and depending on issuers' creditworthiness.

Liquidity Profiles

The funds seek to maintain sufficient levels of daily and weekly liquidity to meet investors' redemption requests. Specifically, taxable MMFs rated 'AAAmmf' invest at least 10% of total assets in securities offering daily liquidity and at least 30% of total assets in securities providing weekly liquidity in line with Fitch's rating criteria. Tax-exempt MMFs invest at least 30% of their assets in securities offering weekly liquidity, consistent with Fitch's MMF rating criteria.

Investment Advisors

Fitch views the investment advisory capabilities, resource commitment, operational controls, corporate governance, and compliance procedures of the respective funds' investment advisors as consistent with the ratings assigned to the funds.

European Money Fund Reform

European Union money fund legislation was finalized in June 2017, with a 12-month implementation period for new funds (to July 2018) and 18 months for existing funds (to January 2019). Fitch's rating criteria allows it to rate both existing European money funds and the funds which will be available in Europe post-reform, including the Low Volatility Net Asset Value fund type.

Surveillance

Fitch receives regular holdings information and other pertinent fund data from the funds' administrators and managers to conduct surveillance against ratings guidelines and maintain its money market fund ratings.

For additional information about Fitch's MMF ratings guidelines, please review the criteria referenced below.

Rating Sensitivities

The ratings may be sensitive to material changes in the credit quality, market risk, and/or liquidity profiles of the funds, or large changes in shareholder asset flows. Temporary deviations from Fitch's criteria need not automatically result in rating changes, provided the fund manager is able to address them with credible near-term remedial actions. However, material adverse and continued deviations from Fitch's criteria for any key rating driver may lead to the rating being placed on Rating Watch Negative or downgraded.

European Money Market Fund Overview

Click to View Report

European Money Market Fund Overview - April 2017

April 2017

Industry Flows Higher but not Extreme in 2016

Some weekly net flows in 2016 were higher than historical averages in the European Money Market Funds (MMF) industry, often going in the opposite direction to those observed historically, notably in Q4 (potentially related to political risk). Nevertheless, the proportion of extreme industry flows (+/-3%) remained below the long-term average.

EUR CNAV Flow Volatility Higher than GBP and USD

Historically, flow volatility has been greater for euro than pound sterling and US dollar denominated MMF. In 2016, fund flow volatility was in line with 10-year observations for all currencies. Minimum allocations to overnight and weekly assets (above 10% and 30%, respectively, for funds rated 'AAAmmf' by Fitch) are essential to meet spikes in redemptions, particularly at end-Q4, when higher redemption activity reduces fund liquidity. Weekly MMF liquidity was consistently below historical averages, but remained high in 2016.

European MMF Flows Show Seasonality

European-domiciled MMFs typically show outflows at year-end and quarter-end followed by inflows at the beginning of each calendar year and quarter. This seasonality is due to the typical funding and distribution needs of public bodies and corporates around those dates. The absence of large MMF outflows in June 2016 around the time of the Brexit vote suggests some organisations were hoarding cash in the face of uncertainty by placing it with MMF.

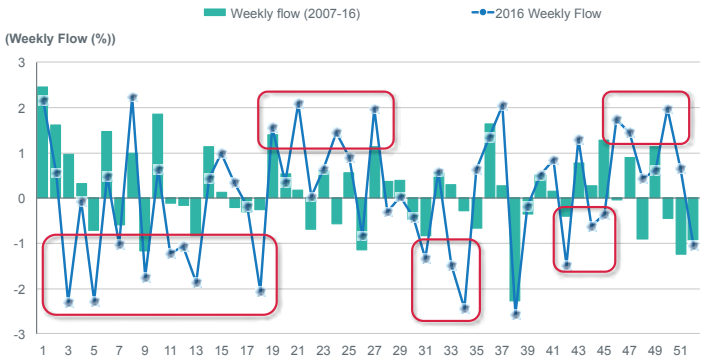
Flow Concentration Higher in CNAV than VNAV Funds

The top-25 European-domiciled MMF have accounted for 64% of flows since 31 December 2012 (60% in 2016). The "Winner Takes it All" effect is even stronger in the CNAV universe, where the top-five funds accounted for 46% of inflows (around 30% for all MMF) over the last three years. Furthermore, in 2016, the top-five CNAV funds accounted for 60% of inflows. The same effect is observed at the MMF asset manager level: around 60% of flows in 2016 were concentrated in the top-five fund houses.

Co-Manager Risk Higher in CNAVs

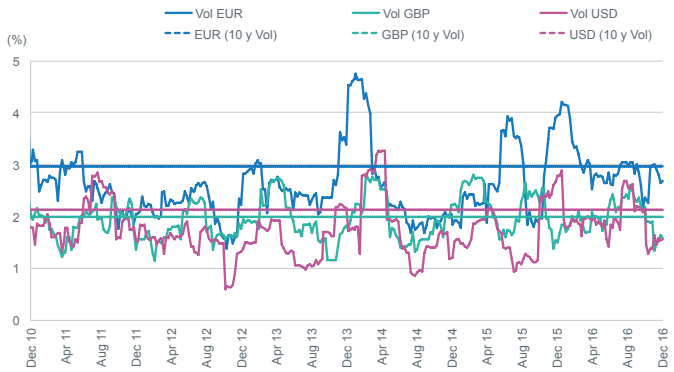
As MMF management is a scale business, there are fewer funds and providers available than in other strategies/asset classes. Specifically, the CNAV industry is becoming increasingly "concentrated", following the proposed merger between Standard Life Investments and Aberdeen AM, based on Herfindalh Hirschmann Index calculations. This means that the co-manager risk (i.e. the risk of being collectively exposed to the same manager) is higher for MMF (and particularly CNAV) investors than other fund investors.

Average Weekly Flow by Calendar Week



Source: Fitch, iMoneyNet

Weekly Flow Volatility: Euro MMF Flows More Volatile



Source: Fitch iMoneyNet, 12-week rolling standard deviation, local currencies

Manuel Arrivé, CFA
Senior Director
+33 1 44 29 9177
manuel.arrive@fitchratings.com

Evangelia Gkeka
Associate Director
+44 20 3530 1829
evangelia.gkeka@fitchratings.com

Fitch: EU Money Fund Reform May Spark Further Consolidation

Click to View Report

Credit Hotspot: European Money Market Fund Reform

3 July 2017

Fitch Ratings-London-03 July 2017: European money fund reforms published in the EU's Official Journal on 30 June will impose additional costs and may accelerate consolidation as fund managers seek to quickly build scale in new fund types, Fitch Ratings says.

Money fund providers are faced with the costs and challenges of developing new products, or amending existing ones, to comply with the reforms, while corporate treasurers and other short-term investors are determining which best meet their needs. Managers currently offering constant net asset value (CNAV) funds are largely focused on the new Low Volatility Net Asset Value (LVNAV) fund type, but investor appetite for this new product is by definition untested.

Providers unable to absorb the added costs of new products and investor education, or unable to differentiate themselves could look to exit the business, leading to more consolidation. The industry has already been consolidating for some years, with more recent consolidation in the US in relation to US money fund reform.

The timing of product launches and conversions may become an important competitive dynamic, as will effective investor outreach and education. Achieving efficient and early regulatory approval may provide an advantage, as funds are concentrated in just a handful of jurisdictions, creating the risk of approval delays and backlogs. But any advantage will depend on whether investors understand the new products and are willing to make the switch early, or will want to wait. If the US experience with money fund reform is a guide, investors may wait as long as possible before exercising their option to move monies.

The reforms will become effective in 20 days. This will trigger an implementation period, with new funds required to comply with the reforms by 21 July 2018 and existing funds by 21 January 2019.

Alastair Sewell, CFA
APAC and EMEA, Analytical
+44 203 530 1147
alastair.sewell@fitchratings.com

Roger Merritt
Global Group Head, Analytical
+1 212-908-0636
roger.merritt@fitchratings.com

Simon Kennedy
Senior Analyst
+44 20 3530 1387
simon.kennedy@fitchratings.com

Why European Money Fund Reforms Will Differ from the US

Click to View Report

Why European Money Fund Reforms Will Differ from the US

April 2017

No trillion dollar question for European Money Funds.

Nearly seven years after talks started, European money fund reform has finally been agreed upon. The new rules, which we should see in force by the end of 2018, look superficially similar, but on closer examination, really quite different to the approach recently adopted in the US. We explain why these changes and differences matter, and offer some views on how investors can prepare themselves.

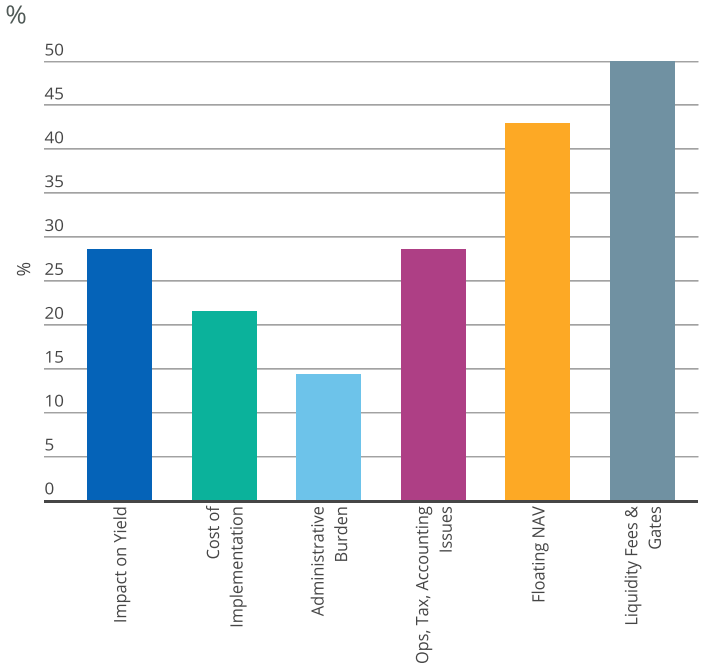
Money fund reform in the US, completed in October 2016, has led to a staggering USD1 trillion flowing from "prime" funds—that is, funds which invest the majority of their assets in non-government and non-treasury securities—into government-only funds. The attraction of these funds was two-fold:

First, government funds in the US were allowed to retain a stable unit value per share (allowing operationally simple cash management), which has been the industry norm over the last 30 years, whereas prime funds had to move to a floating unit value per share (susceptible to price fluctuation).

Second, the US rules introduced liquidity fees and redemption gates in certain scenarios for prime funds. These are mechanisms designed to either charge investors for withdrawing money from the funds or temporarily halt withdrawals in their entirety in certain stress scenarios.

We surveyed institutional investors on their thoughts on European money fund reform at a recent investor-only event. Our investor audience told us they have concerns with floating net asset values per share and with potential liquidity fees and redemption gates.

MMF Reform: Greatest Concerns in Europe



Perhaps European investors are anchoring their views on the recent US experience? However, there are some important differences with the US in the European approach which they may not appreciate. The European reforms provide for a brand new (money) fund type which is not available in the US—the low volatility net asset value fund (or LVNAV fund in the alphabet soup terminology of European money fund reform). These funds will offer investors the combination of "prime" assets, that is, the ability to buy non-government securities, and an effective stable unit value per share.

In many ways, the investor experience of these funds will be similar to the existing prime funds in Europe. As such, investors clearly see these funds as a preferred option post-reform. In comparison with the US, this is an important development as it may mitigate a structural shift of assets into government-only funds. The fact that fees and gates will also apply to government funds in Europe (in direct contrast with the US) will also be a mitigating factor even if the construction of these funds makes the imposition of fees and gates a remote possibility.

On the surface, LVNAV funds appeal to investors. However, there are some important factors investors should consider

First, these funds will offer a stable unit value per share. However, it is possible that these funds convert to a floating or variable unit value per share in more stressful scenarios. Specifically, if the market-to-market price of an LVNAV fund strays 20 b.p. away from its stable value, then it is forced to convert to a floating NAV fund. Absent some large exogenous shock, we think this outcome is unlikely. In all likelihood, managers of these funds will adopt even more conservative portfolio management practices to mitigate not only the risk of the mark-to-market price moving out of the corridor but also investor perceptions of that risk.

Second, they come with the potential for gates and fees. Fees and gates were a significant issue in the US. In Europe, fees and gates may be less of a concern. Under Europe's UCITs rules, funds already have a smorgasbord of extraordinary liquidity management tools available to them ranging from delayed redemptions through fees, gates and even payment-in-kind in some scenarios. Nonetheless, the prominence of fees and gates in the reform debate may still be a headline issue. In practical terms, the European rules define a specific threshold at which a fund's board of directors must consider applying a fee or gate, followed by a second threshold at which the fund must apply a fee or gate, both tied to available weekly liquidity (30% and 10% respectively). The fact that the fee or gate is discretionary at the first threshold means we can expect more investor interest in fund board composition and processes. That being said, we anticipate that fund providers will up the conservatism of their liquidity management in these products to avoid either threshold in their entirety. Even more than now, liquidity management is going to be critical to funds in a post-reform world where there will be a heightened focus on a funds' proximity to the new regulatory thresholds.

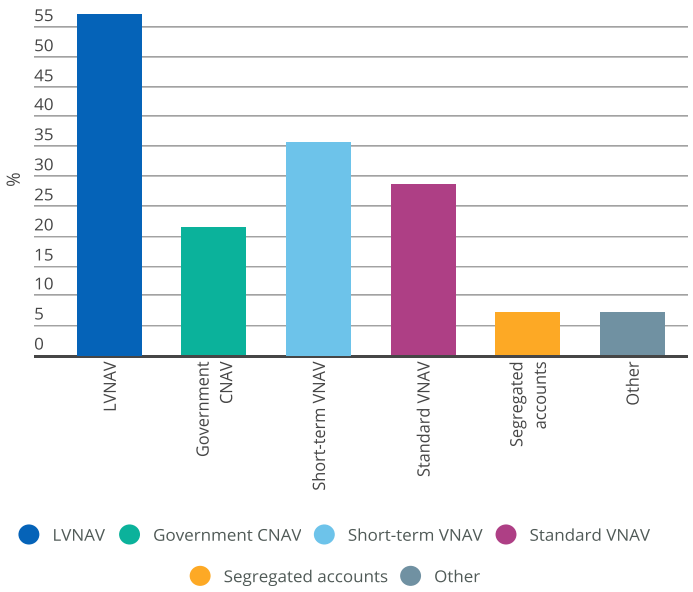
Coupled with the yield cost which will come with the conservative fund management strategies needed for such funds, this presents a rather formidable challenge for the market. That said, investors may still see such funds as preferable to the alternatives.

One intriguing possibility is whether we see funds that invest in lower quality or peripheral European sovereign debt. The new reform rules make it a possibility provided the issuers achieve a "favourable" credit assessment, to use the Council's exact phrase. Whether we see such funds or not, we do still expect a plethora of fund launches—notably LVNAV funds—over the coming months as fund providers prepare for European money fund reform.

Conclusion

Changes to the landscape of money funds and liquidity products are clearly on the horizon. So what can investor do and why is it important to prepare? At the very least, they can prepare themselves by understanding the rule changes and what this means for cash management options. They can also proactively review their investment guidelines and dialogue with internal stakeholders to make sure they are 'fit for purpose' for what lies ahead.

Which of the following are you likely to use as alternative to existing prime CNAV MMFs?



Video: What to Expect from European Money Fund Reform?

Alastair Sewell, CFA
APAC and EMEA, Analytical
+44 203 530 1147
alastair.sewell@fitchratings.com

Fitch: European Money Fund Regulatory Liquidity High

Click to View Report

Fitch: European Money Fund Regulatory Liquidity High

15 March 2017

Fitch Ratings-London-15 March 2017: Fitch Ratings says that liquidity levels in rated European money funds are high, relative to regulatory thresholds that are expected to go into effect late 2018. Average weekly liquidity was 38% across the portfolio of Fitch-rated funds as of end-December 2016, well above the 10% threshold at which government-only constant net asset value (CNAV) and low volatility net asset value (LVNAV) funds would be forced to impose a liquidity fee or redemption gate once the reforms are in force (likely in late 2018).

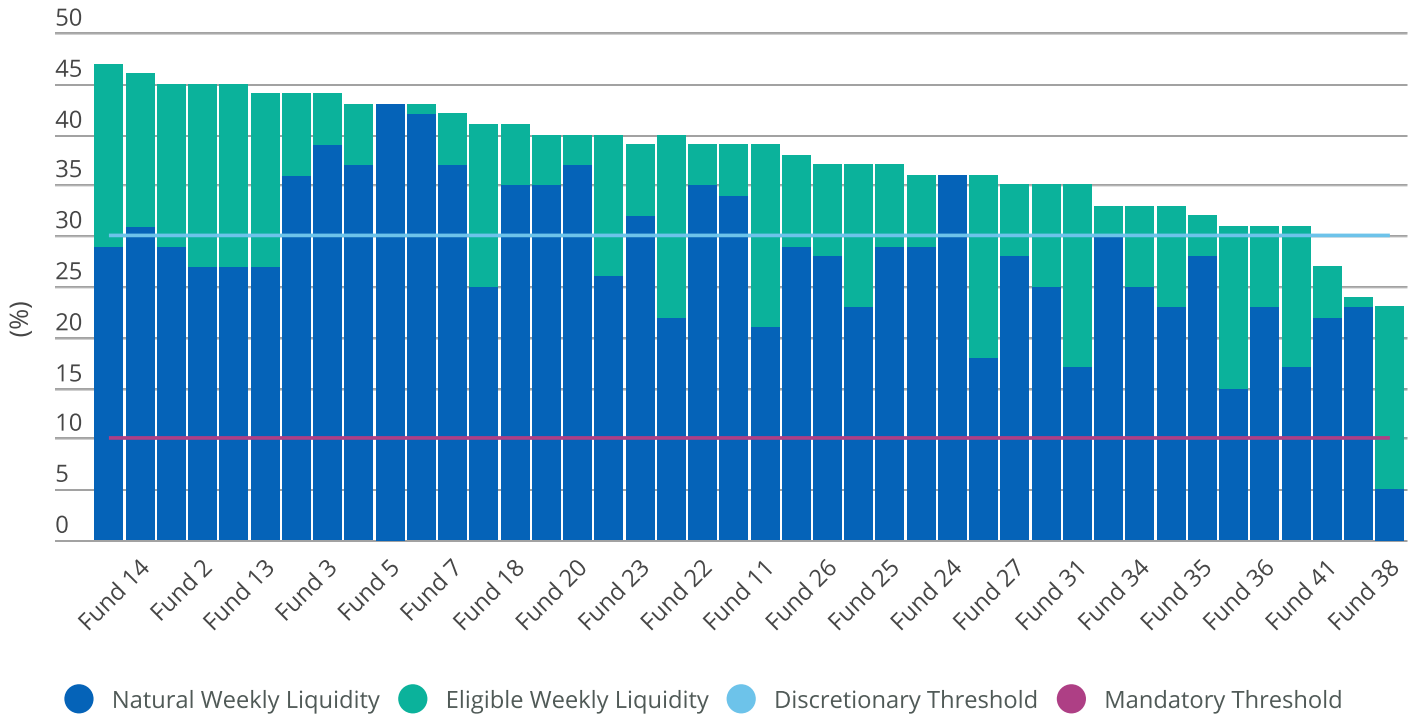
Pending European reforms will also require the fund's board of directors to consider on a fully discretionary basis a liquidity fee or redemption gate if weekly liquidity falls below 30%. However, a further condition for the application of a discretionary fee or gate also requires the breach to coincide with daily outflows in excess of 10% of a fund's assets, which materially lessens the likelihood of a discretionary gate or fee being applied.

In most cases, funds meet the requirements with natural liquidity (securities maturing within seven days), although some place a greater reliance on eligible securities. These are securities with longer maturity than seven days, but which Fitch nonetheless believes meet the criteria for inclusion in the weekly liquidity bucket according to the forthcoming reforms, for example, certain agency securities.

A minority of rated funds (7%) had weekly liquidity below the 30% discretionary threshold, largely driven by year-end effects when we typically see large in- and out-flows and the fact that the 18 month implementation period for reform provides ample time for adjustments to liquidity.

This analysis reflects the current Fitch-rated portfolio of prime CNAV funds. After the reform these funds will no longer exist in their current form, as they are being replaced by government-only CNAV, LVNAV or variable net asset value funds. Furthermore, for the first two categories we expect funds will be managed even more conservatively, resulting in even higher liquidity.

High Regulatory Liquidity



Source: Fitch, Fund Administrators

Alastair Sewell, CFA
APAC and EMEA, Analytical
+44 203 530 1147
alastair.sewell@fitchratings.com

Evangelia Gkeka
Associate Director
+44 20 3530 1829
evangelia.gkeka@fitchratings.com

Teleconference Replay: European Money Fund Reform Finalised; What Happens Next?

Click for Teleconference Replay

European Money Fund Reform Finalised; What Happens Next?

20 July 2017

Fitch Ratings held a teleconference to discuss European money market fund reform. The reforms were signed into law on 30th June 2017 with the implementation period starting 20 days later – Thursday 20th July 2017. The reforms will herald important changes to the European money market fund landscape which investors will need to understand and update investment policies and practices.

Speakers:

Alastair Sewell, Senior Director, Fund and Asset Manager Rating Group

Evangelia Gkeka, Associate Director, Fund and Asset Manager Rating Group

Key discussion points included:

What the reforms will mean for short-term investors:

- New fund types
- New fund features

What the European money market fund landscape will look like post-reform:

- Fund flows
- Fund risk profiles

What happens next:

- Reform timing
- Rating implications

Alastair Sewell, CFA
APAC and EMEA, Analytical
+44 203 530 1147
alastair.sewell@fitchratings.com

Evangelia Gkeka
Associate Director
+44 20 3530 1829
evangelia.gkeka@fitchratings.com

Latest on European Money Fund Reform

VIDEO

Latest on European Money Fund Reform

4:12

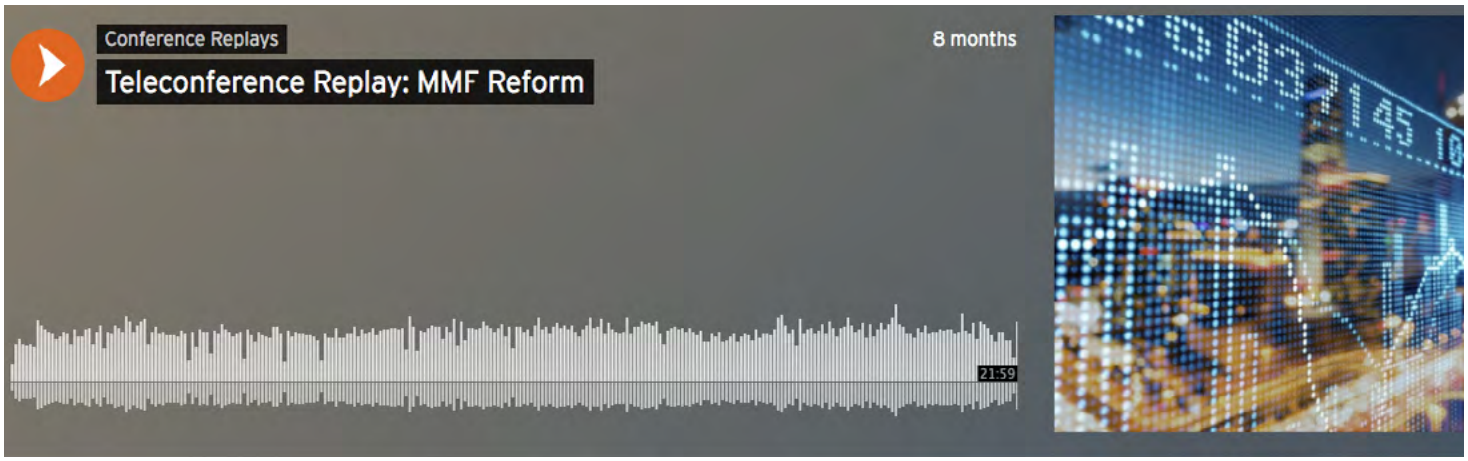
European money fund reform is finally here. The reforms are significant & will change the landscape in Europe for short-term investors. Alastair Sewell, regional head of EMEA/APAC FAM group discusses key features & changes.

Alastair Sewell, CFA
APAC and EMEA, Analytical
+44 203 530 1147
alastair.sewell@fitchratings.com

Teleconference Replay: MMF Reform

Click for Teleconference Replay

Money Fund Reform



Key discussion points included:

- Timing and implications of European money fund reform in light of the USD1trillion asset transfer resulting from US money fund reform
- New fund types – the low volatility net asset value fund
- The inner workings of liquidity fees and redemption gates

Alastair Sewell, CFA
APAC and EMEA, Analytical
+44 203 530 1147
alastair.sewell@fitchratings.com

Reform Gate Risk Low for European Money Funds

Reform Gate Risk Low

Fitch believes the probability of a discretionary or mandatory liquidity fee or redemption gate being imposed on European money market funds (MMFs) is low, absent a systemic shock or idiosyncratic credit event.

Weekly Liquidity Robust

There were no incidents of weekly liquidity (ie the percentage of portfolio assets maturing within one week) dropping below 10% in the European Fitch-rated constant net asset value (CNAV) MMF universe in the last five years reviewed, albeit a relatively benign credit environment. Under the July 2017 EU MMF reform measures, weekly liquidity below 10% triggers a mandatory redemption gate or fee.

Large Outflows Highly Infrequent

Daily net outflows from CNAV MMFs exceeded 10% in only one of every 125 cases observed over the last five years. The already low probability of large outflows is even less when idiosyncratic factors such as pre-planned investor movements are excluded. Along with minimum weekly liquidity of 30%, this is a critical metric under the reforms in determining whether extraordinary actions must be taken by a fund's board.

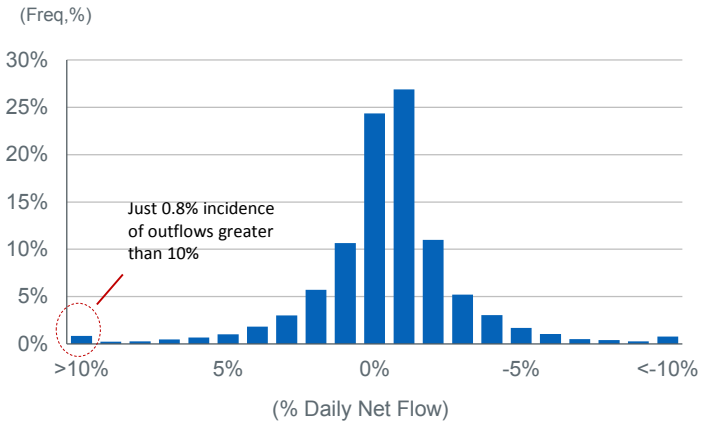
Reform to Boost Fund Liquidity

Fitch expects Low Volatility Net Asset Value (LVNAV) funds will have very high overnight and weekly liquidity as a result of the reforms. Public Debt CNAV and LVNAV funds must maintain minimum overnight and weekly liquidity level of 10% and 30%, respectively; liquidity limits have also been introduced for the first time in Short-term and Standard variable net asset value (VNAV) MMFs.

Critical Role of Directors

Fund Boards must decide if liquidity fees or temporary suspension of redemptions should be activated in the unlikely event of a fee and gate trigger. Therefore, the reforms put more emphasis on the role of MMF Board of Directors and their independence.

Large outflows highly infrequent



Source: Fitch, Bloomberg; Study of 5 years of daily AUM movements in 64 European prime money market funds (EUR,GBP & USD) ending May 23,2017. N = approx. 61,000 observations

Abisodun Soetan
+44 20 3530 1311
abisodun.soetan@fitchratings.com

Alastair Sewell, CFA
+44 20 3530 1147
alastair.sewell@fitchratings.com

Low Likelihood of Triggering a Redemption Gate

Fitch considers the probability of a mandatory MMF reform-driven liquidity fee or redemption gate being imposed as low, barring any systemic shock or idiosyncratic credit event.

There have been no incidents of weekly liquidity dropping below 10% in the Fitch-rated CNAV MMF universe over the last five years, reflecting funds' adherence to Fitch's minimum liquidity criteria standards and successful outflow management through prudent liquidity positioning.

The 10% one-week liquidity level is significant, as this is the point at which the reforms require a fund's board of directors to apply a redemption gate or liquidity fee. Importantly, even in this mandatory scenario, the board retains discretion over whether a fee or a gate serves investors' interests best.

In the period reviewed, MMF managers were largely able to maintain regulatory and rating agency liquidity guidelines by maintaining liquidity buffers and anticipating large redemptions. Fitch recognises, however, that credit conditions were relatively benign in the period reviewed.

Fitch observed a one in 1,436 instance (0.07% or 7bp) of triggering the discretionary threshold for imposing a fee or gate based on an historical five-year dataset of highly rated European Prime CNAV Money Market Funds[1]. This reflects the fact that the test for a discretionary gate or fee is a joint event under the European reforms – ie a joint probability event – combining both weekly liquidity falling below 30% and the fund suffering a simultaneous net outflow of more than 10%. All else being equal, a joint probability is usually lower than the individual probability of two events. Fitch did not assess correlation between weekly liquidity levels and daily outflows. Depending on actual correlation levels the probability of a discretionary gate would be higher but could not be higher than the individual probabilities of a 10% outflow (0.8%) or weekly liquidity falling below 30% (8.7%), ie assuming 100% correlation. Actual correlation between these two events will be time-variable, driven both by idiosyncratic and market factors.

Smaller Funds More Vulnerable to New Measures

CNAV MMF with less than 2 billion (EUR, GBP or USD) in AUM had more than twice as many instances of dropping below the reform's weekly liquidity (discretionary) threshold for LVNAV fund types, according to the above-mentioned historical five-year dataset, without taking into consideration the magnitude of the drop in liquidity.

Smaller funds were more sensitive to redemptions, causing those rated 'AAAmmf' to hold 5%- 7% more weekly liquidity than their larger equivalently-rated counterparts to manage liquidity risk, according to the same study.

The risk of a fund's liquidity deteriorating below the discretionary threshold remains low despite smaller funds being more vulnerable. Prospectively, the risk is expected to be further mitigated by fund managers increasing their weekly liquity levels, as was the case in the US following its fee and gate reform – where Prime funds now hold about 10% more weekly liquidity on average than at pre-reform levels.

Fitch's MMF rating criteria recognises that funds may temporarily deviate from portfolio attributes such as minimum liquidity thresholds. Fitch's MMF rating criteria provides for reasonably short grace periods to remedy deviations, provided the remediation plan is credible, achievable, and does not put MMF investors at risk.However, the activation of redemption gate or liquidity fee mechanisms would be considered a credit negative and inconsistent with a 'AAAmmf' rating.

[1] Study based on Fitch and Bloomberg data looking at five years of weekly regulatory liquidity levels and daily AUM movements in 54 European highly rated prime CNAV money market funds (EUR/GBP/USD) ending 1Q17. N = over 61,000 observations. The study did not place any threshold on weekly liquidity levels ie a weekly liquidity level of 29.99% would count equally with a weekly liquidity level of 23%

Probability of a Fee or Gate

- 0.07% hypothetical historic instance of triggering the discretionary threshold for imposing a fee or gate
- 0.8% historic incidence of large net outflow (greater than 10% of fund net assets) on any given day
- 8.7% historic incidence of weekly liquidity dropping below 30% at any given quarter end in the past five years
- 5% of the time, funds with AUM above EUR/GBP/USD2 billion experienced weekly liquidity below 30% (18 out of 363 observations)
- 12% of the time, funds with AUM of less than EUR/GBP/USD2 billion experienced weekly liquidity below 30% (26 out of 221 observations)

A Step-Change in Liquidity Levels

Some investors are sensitive to fees and gates according to a recent Fitch survey, where it was cited as the area of greatest concern. Therefore, LVNAV managers are likely to hold much higher levels of weekly liquidity to position the portfolio against large unanticipated redemptions. Some fund providers and investors may also focus on short-term VNAV funds as their preferred post-reform option, as these funds will not feature reform-driven gates and fees (but will be subject to the standard extraordinary liquidity management measures authorised under the UCITS regime).

Board Independence in Focus

The July 2017 EU MMF reforms codified how and when redemption gates and liquidity fees should be applied for Public debt CNAV and LVNAV funds.

If weekly liquidity falls below 30% and there is a simultaneous net outflow of over 10%, a fund's Board of Directors is required to consider applying a discretionary gate or fee; if weekly liquidity falls below 10%, the Board must apply a gate or fee.

As a result, a lot of emphasis is put on the role of Fund Board of Directors and their independence, as they ultimately make the decision to take action or not – in the best interest of investors.

Limited Flows Between Fund Types Compared with the US

We do not expect to see a significant shift between fund types in Europe, as was witnessed in the US following its reforms.

Over USD1 trillion in AUM moved from prime funds to government and treasury funds[2] driven by the introduction of fees and gates in the prime MMF category. The other key driver was the compulsory switch to VNAV for prime funds.

In Europe, four important factors mitigate the likelihood of an equivalent shift:

1. The presence of reform-related fees and gates in both European government only and LVNAV funds mitigate the risk of a mass flow of assets into government-only funds, as seen in the US, given that US prime funds feature fees and gates, while US government funds do not.

2. The introduction of the LVNAV fund category can be viewed as embodying characteristics seen within the equivalent US Government and Prime fund types; specifically, the flexibility to invest in non-government securities, but permitted to maintain a stable asset value. Early indications suggest investors view this fund type as their preferred option in Europe post-reform.

3. Liquidity fees, redemption gates and a host of other liquidity control measures already exist in European mutual fund regulations and fund prospectuses, including in MMFs. Therefore European investors are likely more accustomed to their presence than US investors who had only encountered them previously as exceptional measures.

4. We estimate only a low probability of gates and fees being triggered based on historic data. Factoring in a likely change in fund behaviour post-reform to increase liquidity reduces that probability further

2 Fitch report. 2017 Outlook: Money Market Funds (30 December 2016).

Appendix:
Investor Guide to Fees and Gates in MMFs

General Application of New Measures

- New measures introducing liquidity fees and redemption gates are applicable to public debt CNAV MMFs and LVNAV MMFs only. VNAV funds are not subject to these measures.
- Fund managers must comply with weekly liquidity thresholds applicable for their fund type.
- Liquidity management procedures consistent with the new measures must be clearly described in the fund rules or instruments of incorporation, as well as in the prospectus.
- In scenarios 1 and 2 set out below, fund Boards are obliged to provide details of their decisions to the competent authority of the MMF.

Scenario 1

The proportion of weekly maturing assets falls below 30%, and net daily redemptions on a single working day exceed 10% of total assets.

Regulation: The fund manager shall immediately inform the Board, which in turn must undertake a documented assessment of the situation to determine an appropriate course of action, including deciding whether to apply one or more of the following measures:

i. Apply a liquidity fee of up to 3% on redemptions.

ii. Limit redemption to 10% of the MMF's units on any one working day, for any period up to 15 working days.

iii. Suspend redemptions for any period up to 15 working days.

iv. Prioritise correcting the breach of discretionary threshold experienced by the fund.

Scenario 2

The proportion of weekly maturing assets falls below 10% of total assets.

Regulation: The fund manager shall immediately inform the Board, which in turn must undertake a documented assessment of the situation and apply one of more of the following measures, documenting the reason for its choice:

i. Apply a liquidity fee adequately reflecting the cost to the MMF on redemptions.

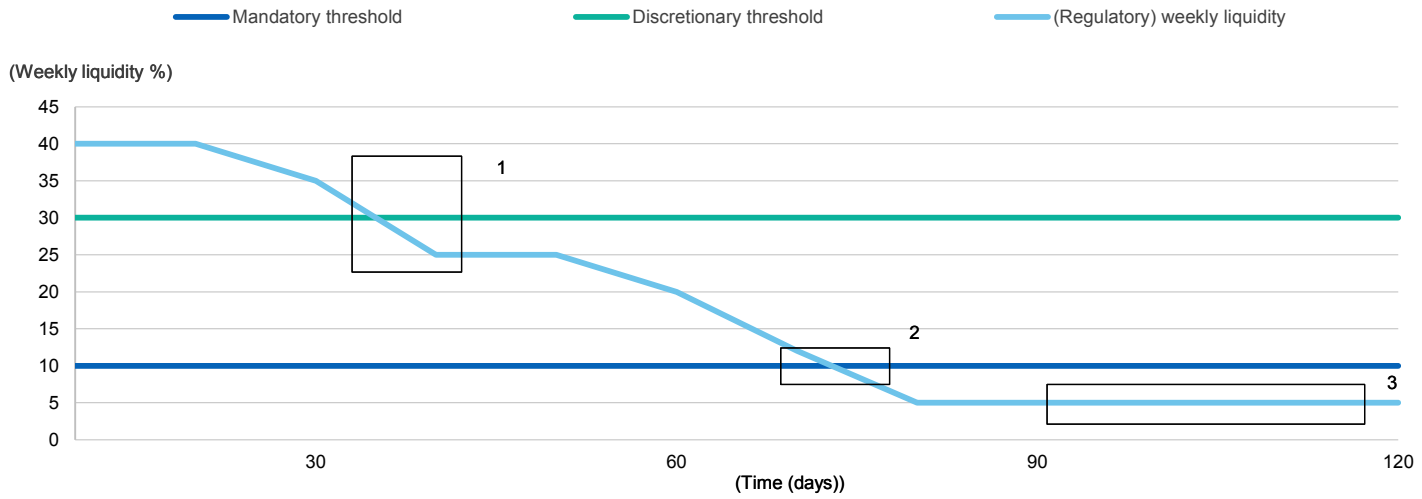
ii. Suspend redemptions for a period of up to 15 working days.

Scenario 3

If within a period of 90 days the total duration of suspensions exceeds 15 days, then the public debt CNAV MMF or LVNAV MMF shall automatically lose the fund type classification (ie convert to a VNAV fund and as such no longer be subject to reform-driven fees or gates) and must immediately inform each investor in the fund in writing.

Board Obligation: In scenarios 1 and 2 above; fund Boards are obliged to provide details of their decision to the competent authority of the MMF.

Weekly Liquidity Threshold Scenarios



Source: Fitch