# REFORMATION AGE

UPDATED AND REFORMED MONEY MARKET FUND REGULATIONS WILL BE IMPLEMENTED THIS YEAR, PROVIDING CERTAINTY AND SUPPORT. JANE LOWE EXPLAINS

It may have taken years, but when the EU finally agreed its money market fund (MMF) reform legislation, things leapt forward very quickly. The Money Market Funds Regulation should now be in law by summer 2017. Full implementation will, however, take many months after this, which means there is time for everyone to prepare.

Fortunately, the EU chose to work from the existing base of MMF products. In addition, many existing provisions from the Institutional Money Market Funds Association (IMMFA) code of practice were in the event incorporated into the regulation. Much of the detail of the new regulation will therefore be familiar to institutional investors. This, together with a product range that recognisably links the old regime to the new, should help to provide continuity for investors.

It is worth emphasising that, after an extended period of uncertainty about the direction of regulation, the outcome very much supports a viable future money fund industry. Within the boundaries set by the regulation, fund managers should be able to develop a resilient range of funds to meet investors' needs and risk appetite.

## What was agreed: the new product range

The new product rules reflect a clear risk/reward arc drawn across the permitted future range of four MMF types. Three types are classified as short-term MMFs:

- Public Debt CNAV MMF (akin to today's CNAV government MMF);
- Low Volatility NAV/LVNAV MMF (effectively the 'son of' CNAV prime/corporate MMF); and
- Variable NAV/VNAV MMF (floating NAV, as now).

(Key: NAV = net asset value; CNAV = constant net asset value; LVNAV = low-volatility net asset value; VNAV = variable net asset value.)

These product types thus mirror the guidance on MMFs issued in 2010 by the European Securities and Markets Authority (ESMA is the supervisory authority, made up of securities regulators from each member state), on which all current products are based. Although the new rules will, in some areas, become more stringent, particularly for the Public Debt CNAV and LVNAV funds, both are still recognisably MMFs that may value to a stable price and provide same-day liquidity to investors.

There is also a standard MMF. This equates to the ESMA 'Money Market Fund' type. It sits in the spectrum between short-term MMFs and short-term, fixed-income funds.

The regulation applies to investment funds that are established, managed and marketed as MMFs in the EU. Since the funds are already authorised and regulated, for instance via the UCITS Directive (undertakings for collective investment in transferable securities), the regulation provides for a 'top-up' authorisation.

Diversification and concentration risk are dealt with in detail, as one would expect. Both are cornerstones of investment fund regulation that had previously been covered in the IMMFA code of practice, in rating requirements (where credit ratings are obtained) and in the UCITS Directive.

The credit assessment process, another cornerstone of MMF management, is also included in the regulation in substantial detail. Again, the provisions bear much similarity to what the managers do now.

And, from the systemic risk perspective, a critical requirement has been to place a bar on banks, and similar institutions with a connection to an MMF, from providing balance-sheet support to that fund if it is in difficulty.

## Understanding the process

So what is the purpose of the regulation? Fundamentally, it is meant to deal once and for all with systemic risk in the money markets that may be attributable to investment funds in the EU.

Although investor protection was not at the forefront of the MMF reforms, in practical terms,

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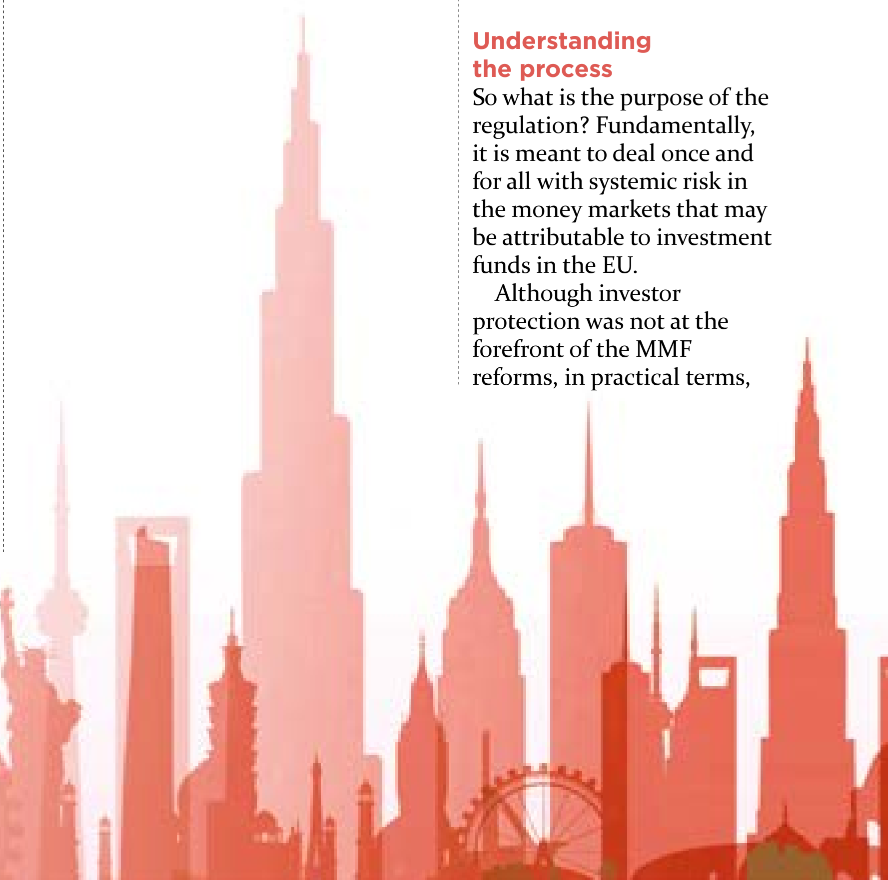

much of the rule-making will also benefit investors. Perhaps the most significant investor benefit will be the clarity over the product structure carried forward in the new regulation. At the same time, common investment rules applying by law to all MMFs should offer a significant degree of comfort to investors.

To recap, the legislation has followed a four-stage process. The European Commission proposed legislation in 2013 and the European Parliament and the member states, through the Council of Ministers, then each adopted a position on this, which occurred respectively in 2015 and 2016. Lastly, all three institutions tussled it out between them to arrive at a final political text. This was the point reached in December 2016.

Since then, the text has seen further work to sort out technical issues, a legal review has been undertaken and the text translated into the 24 languages applying across the Union. Once the text is fully polished, it will be confirmed by both European Parliament and member states. It is then published in the *Official Journal of the European Union* and becomes law 20 days later.

As the legislation takes the form of a regulation, it will apply directly in each member state without needing to be transposed into domestic law. As a law-making approach, it is often chosen because it means there will be no difference between rules applying in different countries in the EU.

Of course, that is still not quite the end. There is a limited amount of secondary legislation for the Commission to work on, which it will do with technical assistance from ESMA. ESMA has also to issue guidance annually on regulatory reporting and stress testing. But, relatively speaking, it will be dealing with points of detail and issues requiring clarification. It is therefore perfectly possible to see the whole shape of the regulation now.

## The timetable

We do not yet know the exact date that the regulation will become law, although the assumption is around late May 2017.

From the date that the regulation does come into effect, each member state has up to 12 months to set up an authorisation process for MMFs, therefore by about May 2018. During this time, ESMA must prepare guidance (on stress testing and reporting to regulators) and must also respond to a mandate from the European Commission for advice on so-called 'Delegated Acts' – which, in due course, will then come into law. Topics include eligible collateral for reverse-repo trades, eligible securitisation and further guidance on credit assessments.

Existing MMFs are allowed more time to become authorised – 18 months. What this means in practical terms is that MMFs that are offered now *may* choose to become compliant with some or all of the new rules during the implementation period, but *must* be both compliant and re-authorised by about November 2018 at the latest.

In summary, the new regulation has put in place detailed and exacting rules for European MMFs in the future. While some clarification is still awaited, money fund managers are now able to design products that both meet investors' needs and will be compliant with the new regulation. Investors can, as soon as they choose, begin to assess the product offerings with a high degree of certainty.

IMMFA will publish its own guides to the new regulation, the aim of which will be to support investor understanding of the new MMF regime and the choices available under it. Feedback on this and other matters is always welcome from investors – please see our website at www.IMMFA.org

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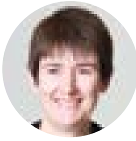

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