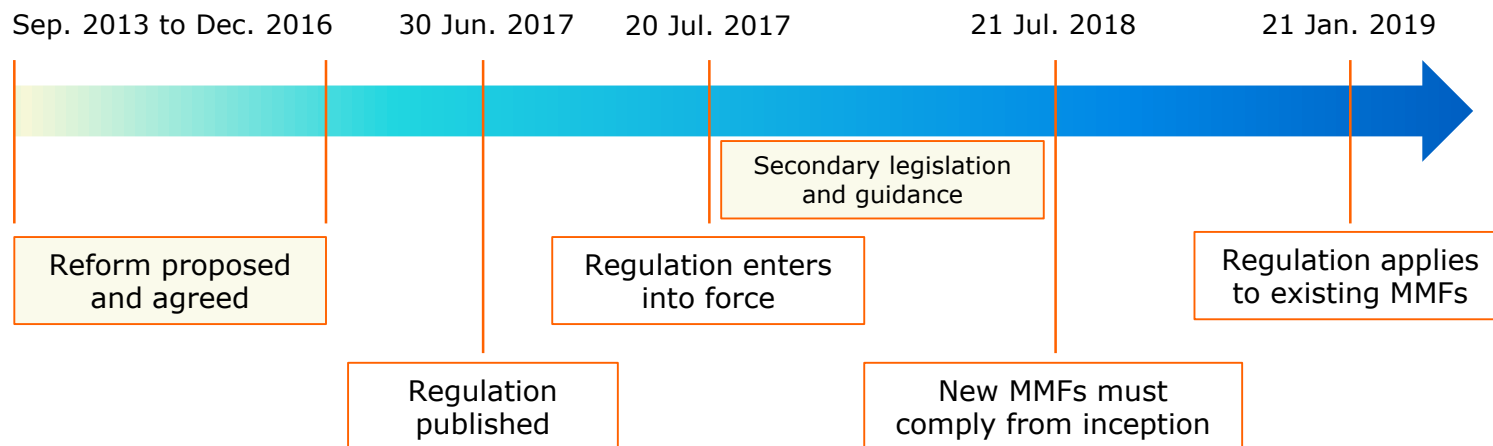# European MMF Reform

MMCG

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Context and Timeline

- In 2008, after the collapse of a large US Money Market Fund and its consequences on financial stability, the G20 agreed to reform the Money Market Funds industry.

- Because of MMFs interconnectedness between the banking sector and institutional, corporate or retail investors and of the high proportion of cross border investments and investors, public authorities spotted MMFs as entities of systemic importance.

- The European Parliament adopted a resolution on shadow banking in November 2012 and invited the Commission to submit a proposal with particular focus on the MMF issue .

- Nearly 4 years after the first text proposed by the European Commission, the Money Market Fund Regulation (EU 2017/1131) was published in the EU Official Journal on 30 June 2017.

- It applies on July 21st 2018 for new funds and January 21st 2019 for exiting funds.

Sep. 2013 to Dec. 2016	30 Jun. 2017	20 Jul. 2017	21 Jul. 2018	21 Jan. 2019

Reform proposed and agreed

Regulation published

Regulation enters into force

Secondary legislation and guidance

New MMFs must comply from inception

Regulation applies to existing MMFs

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Existing EU MMF Landscape

- Total AUM EU MMF approx. EUR 1.3trillion
- Evenly divided between CNAV and VNAV
- CNAV funds are mostly domiciled in Ireland or Luxemburg, but managed from the UK, while VNAV funds are mostly French domiciled.
- 1/3 is Standard MMF, predominantly French
- 2/3 is Short-Term MMF, predominantly CNAV
- Approx. 50% is denominated in EUR, 30% in USD, 15% in GBP and 5% in other currencies
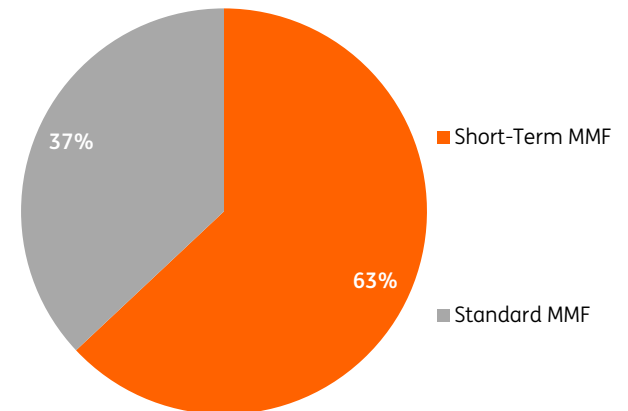
EU MMF Breakdown: CNAV vs. VNAV

- CNAV — 53%
- French VNAV — 31%
- Non-French VNAV — 14%
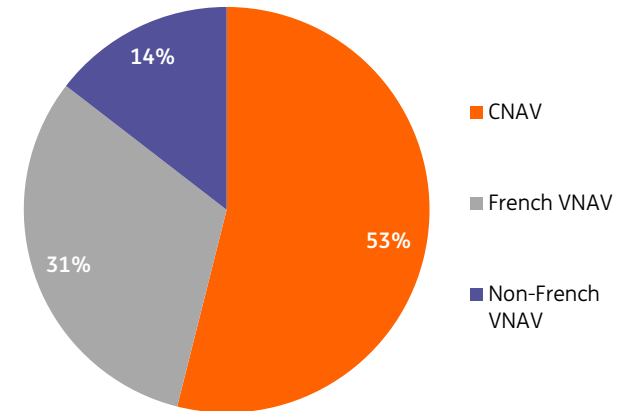
EU MMF Breakdown per Fund Type/Domicile
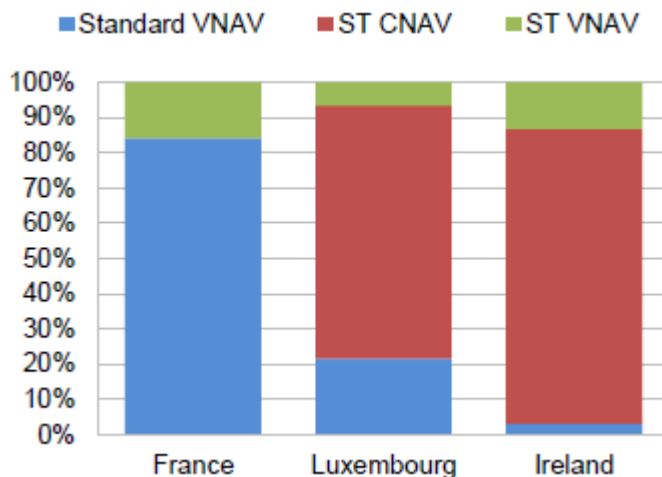
EU MMF Breakdown Short Term vs. Standard

- Short-Term MMF — 63%
- Standard MMF — 37%

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Scope & Requirements

- EU MMFR applies to UCITS and AIF money market funds registered or marketed in the European Union.

- The regulation mainly deals with :

  - ✓ **Valuation**

    Reduces the use of CNAV to government portofolios

  - ✓ **Liquidity**

    New daily and weekly rules

  - ✓ **Eligible assets and diversification**

    Limits on eligible instruments and on credit risk

  - ✓ **Fees and redemption gates**

    New mandatory rules on top of existing UCITS provisions

- Fund managers will also have to strengthen their credit assessment, stress-testing or KYC processes.

What is NOT Changing

- Portfolio and asset maturity limits

What IS Changing

- Liquidity requirements introduced
- Diversification requirements introduced on top of UCITS limiting
- Limits on use of securitised assets (incl. ABCP) and other MMFs counterpary and issuer exposures
- Internal credit assessment requirements
- Limited use of amortised cost accounting for closer reflection of market prices
- Liquidity fees, redemption gates for CNAV and LVNAV
- Strengthened risk management and reporting
- NO sponsor support

SUMMARY OF POST-REFORM EU MONEY MARKET FUND CATEGORIES

	Government CNAV	Low Volatility NAV	Short Term VNAV	Standard VNAV
Maximum Weighted Average Maturity (WAM)	60 days	60 days	60 days	180 days
Maximum Weighted Average Life (WAL)	120 days	120 days	120 days	360 days
Maximum individual security maturity	397 days	397 days	397 days	2 yrs
Minimum Daily Liquidity	10%	10%	7.5%	7.5%
Minimum Weekly Liquidity	30%	30%	15%	15%
Accounting method	Amortised Cost Accounting	Amortised Cost Accounting up to 75 days	Mark to Market or Mark to Model	Mark to Market or Mark to Model
New Fees and/or Gate Provisions	Yes	Yes	No[2]	No[2]
Eligible investments	Govt debt, reverse repo, cash	Money Market Instruments (Govt, Corp, ABCP etc.)	Money Market Instruments (Govt, Corp, ABCP etc.)	Money Market Instruments (Govt, Corp, ABCP etc.)

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Why EU MMF Reform will differ from the US

The US MMF Reform completed in the US led to a USD1 Trillion outflow from Prime MMF's into Government only Funds. Below the reasons why we do not expect this to happen in the EU:

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Existing EU MMF Landscape	The existing European MMF landscape is completely different to the US, as already approx. half of the market is already VNAV and therefore not much affected. In the US this fund type was non existing prior to the reform
Introduction of LVNAV Funds	The European reforms provide a new (money) fund type which is not available in the US—the low volatility net asset value fund (or LVNAV fund). These funds will offer investors the combination of "prime" assets and has the ability to buy non-government securities while maintaining an effective stable unit value per share.
Existing EU Fees & Gates Mechanisms	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. For the US this was new, in Europe most funds already have comparable mechanisms in place
Fees & Gates Mechanisms also for Govt funds	In the US these fees and gates are not applicable for Govt. funds, while in Europe they are, so no distinction is made.

US MMF Flows
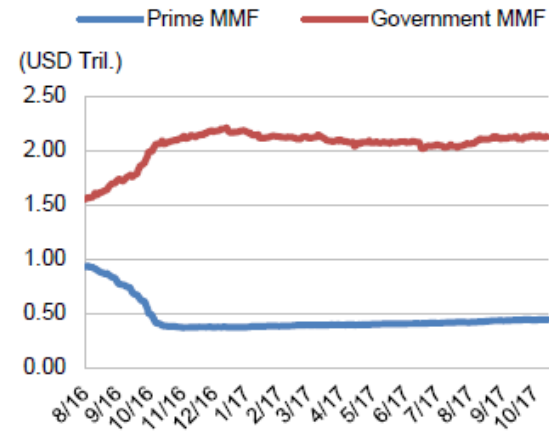
Source:Fitch

MMF Reform: Greatest Concerns in Europe

Source:Fitch

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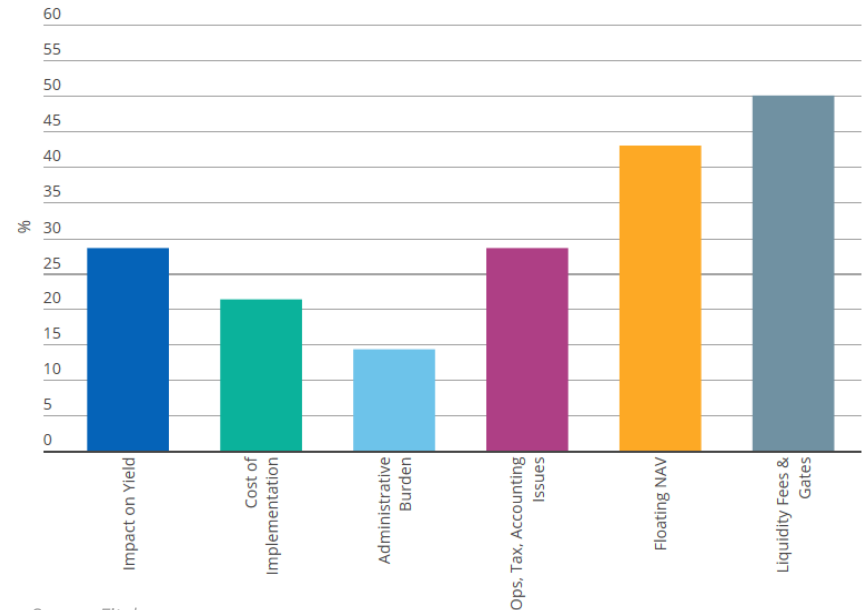
Post-Reform EU MMF Landscape

Note that the estimations below are subject to the "share cancelation debate", which could result in the unavailability of EUR Govt CNAV and EUR LVNAV funds

LVNAV Becomes Largest Segment

The market anticipates that low volatility net asset value (LVNAV) funds will be the largest European money fund segment post reform. Irrespective of the outcome of the recent regulatory discussion on LVNAVs denominated in euros, volumes in GBP and USD transitioning to this fund type will still make it the largest segment.

Standard VNAV Second

Standard (i.e. non "short-term") variable net asset value funds (VNAV) will most likely be the second-largest segment in Europe post reform. Assets in this segment are large already and the yield differential of these funds over short-term funds could prove compelling to some investors. To others, the greater risk tolerance and potential non-cash accounting treatment of these funds could stymie interest.

Multiple Influences on USD Funds

Potential repatriation, the experience of the 2016 US money fund reform process on firms headquartered there, and rising US rates bring uncertainty to the post-reform landscape for offshore US dollar funds. Notwithstanding repatriation-driven flows, we anticipate increased demand for US dollar government constant net asset value (CNAV) funds.

4Q2018 Peak Transition

The expectation is that there will be a peak of fund conversions in 4Q18, due to European public holidays in the immediate run-up to the conversion date.
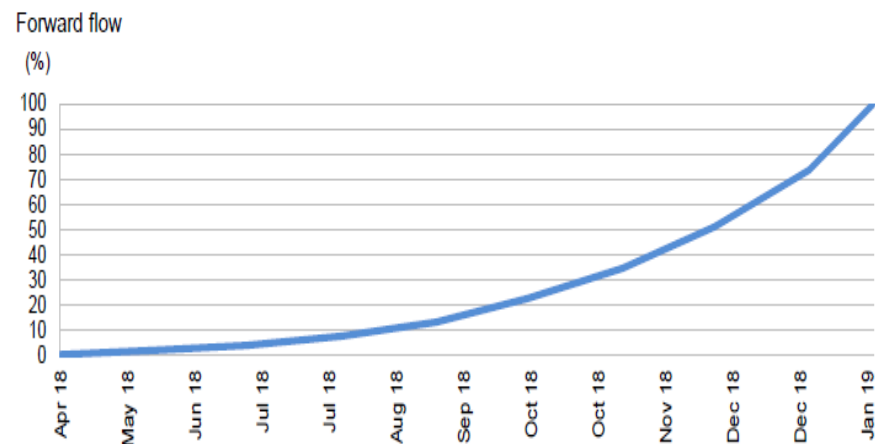
Transition Risk

European funds will face the risk of unexpected disruption during the transition process, although it is expected that fund managers to take steps to mitigate such risks.

Alternatives to Existing Prime CNAV; LVNAV is Preferred Option
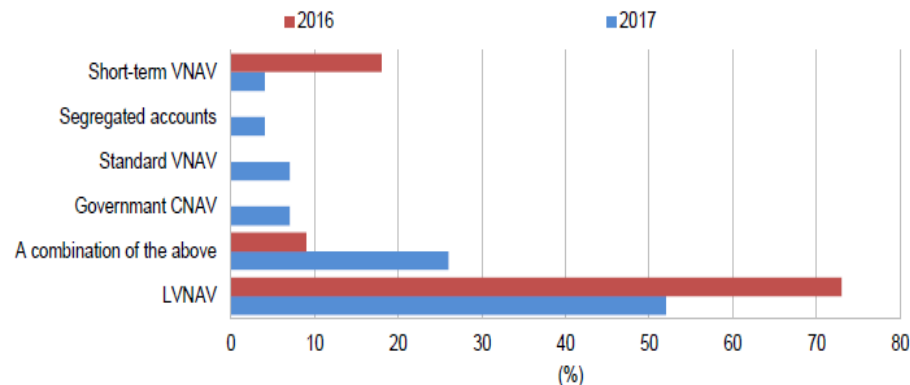
Source:Fitch

Applying the US Reform "flow curve" to EU Suggests High Late Flows

Source:Fitch

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