

Money Market Fund Reform

Link Asset Services have provided the following advice in respect of Money Market Fund reform.

Background

In July 2017 the Money Market Fund Regulation was published in the EU Official Journal. This formally began the compliance process for new and existing funds. The Regulation came into force on 21 July 2018, which immediately affected any new funds created. For existing funds, they will have to be compliant, as described in Article 44 of the Regulation, by no later than 21 January 2019.

The Regulation provides investors with an option for investing their short-term cash in two types of Money Market Funds (“MMFs”):

- Short-term MMFs - Funds that maintain the existing conservative investment restrictions currently provided under the European Securities and Market Authorities (ESMA) Short-Term Money Market Fund definition, including a maximum Weighted Average Maturity (WAM) of 60 days (inclusive of Floating Rate Note interest rate reset days) and maximum Weighted Average Life (WAL) of 120 days (inclusive of Floating Rate Note maturity dates);
- Standard MMFs – Funds that reflect the existing ESMA Money Market Fund definition - maximum WAM of 6 months and maximum WAL of one year.

In addition, there are three structural options:

- **Public Debt Constant Net Asset Value (“CNAV”) MMFs** - must invest 99.5% of their assets into government debt instruments, reverse repos collateralised with government debt, cash, and are permitted to maintain a constant dealing NAV. This Fund is already in existence and there is no change proposed to the current structure;
- **Low Volatility NAV (“LVNAV”) MMFs** - permitted to maintain a constant dealing NAV provided that certain criteria are met, including that the market NAV of the Fund does not deviate from the dealing NAV by more than 20 basis points (bps). This is a more stringent approach, as currently on a CNAV Fund they have a 50bps collar. Funds will have amortised cost accounting for investments out to 75 days. This means that they can value such investments at par, thus these investments should not affect the underlying Fund’s NAV;
- **Variable NAV (“VNAV”) MMFs** – Funds which price their assets using market pricing and therefore offer a fluctuating dealing NAV. No change to the current approach.

Credit analysis/rating and stress testing:

The Regulation requires that MMF managers perform a rigorous internal credit quality assessment of money market instruments, as well as implementing a prudent stress testing regime. Moreover, such credit analysis is to be undertaken by individuals separate from the team responsible for the day-to-day management of the MMF portfolio. Given our understanding of the market, via detailed

discussions with existing fund managers, we do not believe that this change will materially alter current investment approaches.

There was a proposal to abolish MMFs from obtaining an external fund rating. This has not been approved and MMFs may continue to carry external fund ratings which must be disclosed in the prospectus and marketing materials.

Liquidity fees and redemption gates:

Similar to existing rules and practices in Europe, liquidity gates and redemption fees are put in place to protect investors in public debt CNAVs and LVNAVs in times of stress. Under the new rules, the application of a fee/gate would be optional if weekly liquidity falls below 30% and net redemptions from the fund exceed 10% in one day. However, if weekly liquidity falls below 10%, some form of action (either a gate or a fee) would be mandatory. Note that fees and gate mechanisms are already in place for the majority of Money Market Fund structures. These were previously brought in by funds to cater for the move in European money market rates to below 0%. It is important to stress that these changes are there to come into action under “extreme” market circumstances, rather than during more “normal” situations. They are there to help ensure that all investors are treated in the same manner, not to penalise investors.

Portfolio diversification and transparency:

The new rules strengthen requirements for portfolio diversification and transparency for all MMFs, providing for weekly disclosure of portfolio information and formalised reporting to regulators.

Implementation period:

As highlighted above, new funds will have to be compliant from 21 July 2018, while existing funds will have to be compliant no later than 21 January 2019. As a result, the approved changes will not have an immediate impact on MMFs.

Summary:

The Money Market Fund sector is now in the last stages of introducing new regulations. These will see existing non-government Constant Net Asset Value (CNAV) funds convert to Low Volatility Net Asset Value (LVNAV) pricing. Note that government-type funds will remain as “CNAV” funds under the new regulations.

This change is expected to occur in the very early stages of 2019. As such, if you have not done so already, you will need to update your current TMSS to incorporate the use of LVNAV funds. This update needs to be done for the 2018-19 TMSS, due to the timing of the change.

Timetable for conversion

MMF	Shareholder vote?	Date of shareholder vote	Conversion Date
Aviva	No	N/A	3rd September 2018
Insight	Yes	EGM 16th Nov	26th November 2018
BNP	No	N/A	30th November 2018
Northern Trust	No	N/A	30th November 2018
JP Morgan	Yes	Done	3rd December 2018
LGIM	Yes	Done	3rd December 2018
UBS	No	N/A	7th January 2019
Federated	No	N/A	11th January 2019
Aberdeen	No	N/A	11th January 2019
Fidelity	Yes	Q4 2018	11th January 2019
Blackrock	No	N/A	14th January 2019
Deutsche	Yes	In November	14th January 2019
Goldman Sachs	Yes	Done	14th January 2019
Invesco	No	N/A	14th January 2019
Morgan Stanley	yes	Done	14th January 2019
HSBC	Yes	Tuesday 13th November	16th January 2019
SSGA	No	N/A	January – exact date tbc
Amundi	No	N/A	by 21st January 2019
CCLA	No	N/A	Q1 2019