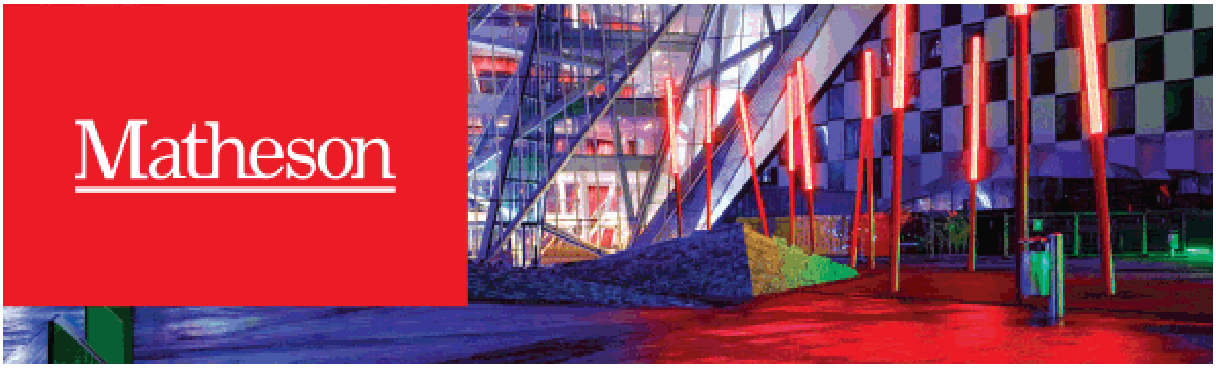

21 January 2019 - EU Money Market Fund Reform Deadline Set

Almost four years after the European Commission proposed new rules to regulate money market funds ("**MMFs**"), the regulation on money market funds ("**MMF Regulation**") has been published, starting the clock ticking on the implementation timeline. The MMF Regulation will apply to all MMFs, whether they are UCITS or alternative investment funds ("**AIFs**"). Existing MMFs have until 21 January 2019 to comply, whereas new MMFs created after 21 July 2018 must comply from inception.

The MMF Regulation covers a number of different topics; but the principal ones covered in this update are types of MMF, valuation, liquidity and redemption fees and gates. Our briefing note (which is available here) goes into more detail on these and sphere topics addressed in the MMF Regulation.

Types of MMF

The MMF Regulation permits four types of MMFs: (1) short-term variable NAV MMFs; (2) standard variable NAV MMFs; (3) public debt constant NAV MMFs ("**Public Debt CNAV MMFs**"); and (4) low volatility NAV MMFs ("**LVNAV MMFs**").

The main difference between a Public Debt CNAV MMF and an LVNAV MMF is that the former must invest 99.5% of its assets in government securities (either EU or non-EU), which obviously restricts its suitability for a large number of MMF strategies.

As the majority of existing Irish MMFs are constant NAV MMFs, this update will not cover either type of variable NAV MMF.

Valuation

Valuation using amortised cost is a key component of constant NAV MMFs and its use will still be permitted under the MMF Regulation:

- Public Debt CNAV MMFs may use amortised cost accounting in a way very similar to how they do so today;

- LVNAV MMFs, on the other hand, may only use amortised cost accounting in relation to assets that have a residual maturity of up to 75 days and for assets with an amortised cost price within 10 basis points of their mark to market price.

Dealing NAV

The defining feature of a constant NAV MMF is the fact that its units can be bought and sold at a constant price. This is still permitted under the MMF Regulation:

- The units of Public Debt CNAV MMFs are always bought and sold at a constant price;
- The units of LVNAV MMFs are bought and sold at a constant price, unless the constant NAV deviates from the mark to market NAV by more than 20 basis points, in which case units are bought and sold at a price equal to the mark to market NAV.

For LVNAV MMFs, this 20 basis point threshold is lower than the existing "break-the-buck" figure of 50 basis points but market reaction to date indicates that it is at least feasible for most fund types, though there may be challenges operationally and in terms of the yield cost of having to hold shorter dated assets than would otherwise have been the case.

Liquidity

Existing constant NAV MMFs are not subject to any regulatory liquidity requirements, though many MMF managers adopt liquidity limits as a result of rating agency requirements, industry body requirements or for alignment with how they manage their US funds.

Under the MMF Regulation, both Public Debt CNAV MMFs and LVNAV MMFs must have:

- 10% of NAV held in daily maturing assets; and
- 30% of NAV held in weekly maturing assets, save that 17.5% can be government instruments with a residual maturity of < 190 days.

Those MMF managers that voluntarily adopt a 30% weekly requirement often allow themselves to include highly liquid government securities in the calculations, even where their maturities are longer dated. The MMF Regulation also allows MMFs to include government securities that are highly liquid (ie, can be redeemed and settled within one business day and which have a residual maturity of up to 190 days), but only in the weekly liquidity bucket and only up to a maximum of 17.5% of assets. Again, while more restrictive than the current landscape, the new rules are nonetheless workable.

Redemption Fees and Gates

Technically speaking, redemption fees and gates have always been a tool in the arsenal of Irish regulated funds but, for obvious reasons, they have never been deployed by MMFs, even in stressed market environments. That mostly likely will not change in the new regime, but MMFs will at least be obliged to formally consider them in certain cases. Where the proportion of weekly maturing assets of a LVNAV MMF or Public Debt CNAV MMF falls below the 30% threshold and the net daily redemptions on a single business day exceed 10% of total assets, the MMF's board must consider whether or not to apply liquidity fees, redemption gates or a suspension of redemptions. Where the proportion of weekly maturing assets falls below 10%, the board must implement either liquidity fees on redemptions or a suspension of redemptions. If, within a period of 90 days, total duration of the suspensions exceeds 15 days, a LVNAV or Public Debt CNAV MMF will automatically cease to be a LVNAV or Public Debt CNAV MMF.

Comment

The reforms of MMFs are of particular interest to the Irish funds industry, as MMFs represented 23% of the assets of all Irish domiciled funds as at July 2016. Fortunately for that industry, and in no small part thanks to the efforts of industry participants during the legislative process, the MMF Regulation offers a viable regime for constant NAV MMFs to continue to thrive. As with most financial services legislation, the story does not end with the primary regulation. The MMF Regulation provides for level

2 regulations to be issued by the European Commission and for guidance and technical standards to be issued by the European Securities and Markets Authority ("**ESMA**"). ESMA has opened a public consultation on these, which is open until 7 August 2017, so while for all involved the bulk of the work on MMFs reform has been done and the end is in sight, there is a still significant amount of fine-tuning to be tackled. The partners at Matheson continue to work with clients, Irish Funds and the Central Bank of Ireland to ensure that the outcome of this work represents the best possible result for industry and investors.

As noted above, this update covers only some of the MMF Regulation. Our more detailed briefing note is available here.

Please get in touch with your usual Asset Management and Investment Funds Group contact or any of the contacts listed in this publication should you require further information in relation to the material referred to in this update.

Full details of the Asset Management and Investment Funds Group, together with further updates, articles and briefing notes written by members of the Asset Management and Investment Funds team, can be accessed at www.matheson.com.

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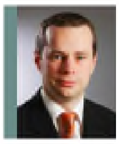

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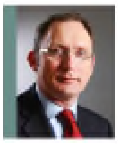

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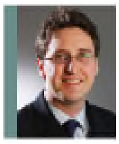

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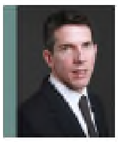

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