

European MMF Regulatory Update

Significant progress has been made recently on the European Money Market Funds Regulation (MMFR) file. Prior to Slovakia taking over the Presidency of the Council in July, the Dutch were able to finalise the Council's text in order to move the file to trilogue negotiation with the Parliament and Commission. Negotiations are expected to occur through year end, with the second trilogue planned for September.

Once law, the MMF Regulation will have direct application in all EU Member States. Supervision remains the prerogative of national competent authorities, but the European Securities and Market Authority (ESMA) will be tasked with ensuring consistent application.

The Council's text differs from the Parliament's agreement—which was finalised in 2015—in many significant ways. The chart below illustrates the difference between the two proposals.

	COUNCIL TEXT	ECON COMMITTEE TEXT
Constant Net Asset Value (CNAV) Funds	<p>Full use of amortised cost accounting</p> <p>Limited to:</p> <ul style="list-style-type: none"> MMFs that invest a minimum of 99.5% in public debt instruments 	<p>Full use of amortised cost accounting</p> <p>Limited to:</p> <ul style="list-style-type: none"> MMFs that invest a minimum of 99.5% in EU public debt instruments Retail MMFs
Low Volatility Net Asset Value (LVNAV) Funds	<p>Limited use of amortised cost accounting</p> <ul style="list-style-type: none"> Securities maturing in 75 days or less Securities whose mark to market price does not deviate more than 10 basis points from amortised cost <p>If the portfolio NAV deviates more than 20 basis points from 1.00/share, the fund must convert to VNAV</p>	<p>Limited use of amortised cost accounting</p> <ul style="list-style-type: none"> Securities maturing in 90 days or less <p>If the portfolio NAV deviates more than 20 basis points from 1.00/share, the fund must convert to VNAV</p>
Variable Net Asset Value (VNAV) Funds	No amortised cost accounting with fund NAV/share rounded to nearest basis points (4 decimal places)	No amortised cost accounting with fund NAV/share rounded to nearest basis points (4 decimal places)
Capital Buffer Provisions	NA	NA
Sponsor Support	Banned	Banned
External Ratings	Allowed	Allowed
Liquidity Requirements	<p>CNAV MMF: 10% daily maturing assets and 30% weekly maturing assets</p> <p>LVNAV MMF: 10% daily maturing assets and 30% weekly maturing assets</p> <p>VNAV MMF: 7.5% daily maturing assets and 15% weekly maturing assets</p>	<p>CNAV MMF: 15% daily maturing assets and 30% weekly maturing assets</p> <p>LVNAV MMF: 15% daily maturing assets and 30% weekly maturing assets</p> <p>VNAV MMF: 10% daily maturing assets and 20% weekly maturing assets</p>
Fees and Gates	No fees and gates for VNAV funds. CNAV and LVNAV only if minimum weekly liquidity is breached	No fees and gates for VNAV funds. CNAV and LVNAV only if minimum weekly liquidity is breached
Sunset Clause	NA	LVNAV authorised for a period of 5 years

Background

In September 2013, the European Commission (Commission) released a proposal for new MMF regulation. Key components of this proposal included:

- 3% capital buffer for CNAV funds; all other funds convert to VNAV
- Minimum daily and weekly portfolio liquidity and additional diversification requirements
- Elimination of both amortised cost accounting and external credit ratings

The proposal initiated the lengthy legislative procedure known as codecision. Through the codecision procedure, the proposal is initially discussed in the Economics and Monetary Affairs Committee (ECON Committee) within European Parliament (Parliament) and the Economic and Financial Affairs Council (ECOFIN) within the Council of Ministers (the Council). Once the ECON Committee agrees upon a position, it is subject to plenary ratification by the full Parliament. Similarly, once the ECOFIN agrees upon a position, it is subject to ratification by the Council. When both have adopted a position, a trilogue (three-way negotiation) is held whereby the Commission, Parliament and the Council work to agree upon a single text.

On 26 February 2015, the ECON Committee reached a political agreement on MMF regulation. The text of this agreement was ratified by a full vote of Parliament on 28 April 2015. The Parliament text simply reflects its negotiated position as it enters trilogue with the Commission and Council. Historically, regulations are amended as they are worked through the trilogue process.

We will continue to provide updates on the progress of this file. Should you have any further questions, please contact your Morgan Stanley Relationship Manager.

Weighted average life (WAL): A measure of sensitivity to liquidity and/or credit risk. Weighted average life takes into account all call options exercised by the issuer as well as permissible maturity shortening devices such as demand features.

Weighted average maturity (WAM): Maturity measures the number of days remaining in the life of a bond. The weighted average maturity of the portfolio represents the market-weighted average of the maturities of the portfolio's individual holdings.

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