

European Money Market Fund Regulatory Update

LIQUIDITY | GLOBAL LIQUIDITY TEAM | DECEMBER 2016

On December 7, 2016, the Permanent Representatives Committee approved, on behalf of the Council of the European Union (EU), an agreement with the European Parliament on money market funds (MMFs). This agreement follows three years of arbitration between EU member states and trails the implementation of SEC Money Market Fund Reform in the United States, which came into effect on October 14, 2016.

It is anticipated the new rules will be formally published in Q1 2017. Twenty days after the regulation is formally published, an eighteen month implementation timeframe will commence, providing investors and managers with significant time to prepare for the changes.

The key points and important changes are highlighted below, focusing on the differences between the three fund types allowed under the new European MMF Regulations: Constant Net Asset Value Funds (CNAV), Low Volatility Net Asset Value Funds (LVNAV) and Variable Net Asset Value Funds (VNAV). All three structures are relevant to short-term MMFs. Only the VNAV structure continues to be relevant to standard MMFs.

Short-Term Money Market Fund Structures Post Reform¹

	PUBLIC DEBT CONSTANT NET ASSET (CNAV) FUNDS*	LOW VOLATILITY NET ASSET VALUE (LVNAV) FUNDS	VARIABLE NET ASSET VALUE (VNAV) FUNDS
NAV/Accounting Method	Constant 1.00 NAV Full use of amortised cost accounting with fund pricing to two decimal places	Constant 1.00 NAV, with limitations Limited use of amortised cost accounting with fund pricing to two decimal places – Limited to assets with residual maturity of <75 days and when price deviation compared to mark-to-market is below 10 basis points If the portfolio NAV deviates more than 20 basis points from 1.00/share, the fund must convert to VNAV	Variable NAV No amortised cost accounting with fund NAV/share rounded to nearest basis points (four decimal places)
Fees and Gates	Applicable if minimum weekly liquidity of 30% is breached**	Applicable if minimum weekly liquidity of 30% is breached**	Not subject to fees and gates

* Must invest a minimum of 99.5% in public debt instruments

** Liquidity fees, gates or temporary suspension of redemptions may be introduced if weekly liquidity < 30% and daily net redemption > 10%. If weekly liquidity < 10%, mandatory implementation of liquidity fees and/or temporary redemptions suspension. If suspension of redemptions exceeds 15 days over 90 consecutive days, the fund must move to VNAV.

We anticipate that the new rules will dramatically change the MMF industry in Europe, with the most significant changes being limitations on the types of short-term MMFs that can continue to use amortised cost accounting to support transacting at a CNAV and the potential for fees and gates on certain money fund structures. As such, investors and providers will be required to adjust offerings and tailor investment decisions accordingly. We will continue to provide updates and our perspectives on the finalized reforms.

Additional considerations and changes of note that were agreed to on December 7th are summarized below:

Additional Considerations/Changes¹

	CONSTANT NET ASSET VALUE (CNAV) FUNDS	LOW VOLATILITY NET ASSET VALUE (LVNAV) FUNDS	VARIABLE NET ASSET VALUE (VNAV) FUNDS*
Portfolio Maturity Requirements	WAM: 60 days WAL: 120 days Maximum final maturity: 397 days	WAM: 60 days WAL: 120 days Maximum final maturity: 397 days	WAM: 60 days WAL: 120 days Maximum final maturity: 397 days
Liquidity Requirements	10% daily maturing assets and 30% weekly maturing assets	10% daily maturing assets and 30% weekly maturing assets	7.5% daily maturing assets and 15% weekly maturing assets
Capital Buffer Provisions		Not applicable	
Sponsor Support		Prohibited	
Internal Credit Quality Assessment	The internal credit quality assessment methodology is required to be reviewed and validated annually, with transmission of the review report to the relevant authority		
External Ratings	Permitted		
Stress Testing	Performed at least bi-annually, with frequency determined by the fund board		
5 Year Review Clause	Five years after entry into force, with possible changes to the public-debt CNAV and the LVNAV regimes		Not applicable

* Standard MMFs vary from short-term MMFs in that their maximum WAM is 6 months, maximum WAL is 12 months and maximum final maturity is two years.

Should you have any further questions, please contact your Morgan Stanley Relationship Manager.

¹ Source: Council of the European Union Final Compromise Text of the European Parliament and the Council on Money Market Funds.

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STABLE NAV FUNDS: You could lose money by investing in the Fund. Although the Fund seeks to preserve the value of your investment at \$1.00 per share, it cannot guarantee it will do so. An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The Funds' sponsor has no legal obligation to provide financial support to the Fund, and you should not expect that the sponsor will provide financial support to the Fund at any time.

FLOATING NAV FUNDS: You could lose money by investing in the Fund. Because the share price of the Fund will fluctuate, when you sell your shares they may be worth more or less than what you originally paid for them. The Fund may impose a fee upon the sale of your shares or may temporarily suspend your ability to sell shares if the Fund's liquidity falls below required minimums because of market conditions or other factors. An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The Funds' sponsor has no legal obligation to provide financial support to the Fund, and you should not expect that the sponsor will provide financial support to the Fund at any time.

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