IMMFA position on the Money Market Fund Regulation (2013/0615) ("MMFR") for trialogue

INTRODUCTION

The IMMFA members' position on the MMFR takes account of the European Commission, Parliament and Council's respective positions. Three big remaining issues from the Council are:

- Daily and weekly eligible liquid assets need further revision for CNAV and LVNAV MMF to be workable;
- The operation of fees and gates needs clarifying, to support investor understanding;
- A further review is required of the rules applying across all 3 MMF types (CNAV Government, LVNAV and VNAV) to check that financial stability objectives are met and to make sure that the rules will be understood by investors in the funds.

There remain quite a number of loose ends and inconsistent drafting, all of which need to be eliminated to make sure the rules work as a practical matter.

The position addresses (1) what works, (2) the areas that require change before they will work and (3) concludes with comments on other items of concern to the industry.

WHAT WORKS

Product structure - Articles 2, 2a, 26, 27, 28

In most respects a workable result was achieved by the Council in relation to product structure, addressing financial stability issues and continuity of existing CNAV MMF. Whilst facing stringent new regulation, the proposed CNAV Government and LVNAV funds are both products that should prove attractive and useful to investors and support short term funding for issuers. However:

- Holding high quality government securities for liquidity purposes in both CNAV Government and LVNAV MMF must continue to be permitted (it is allowed now) if the products are to be viable.

- The LVNAV product should not be made subject to any further limitations. Any further constraints beyond those already set out in the Council's position would seriously impact its viability with investors (examples of some of the restrictions are the limits on the use of high quality government securities as liquid assets, WAM, WAL, the 20bp fund collar, the 10bp asset collar, the 75 day limit on amortised cost accounting).

- We support the removal of the 5 year "sunset" clause for the LVNAV product in the Council proposal. UCITS funds, including MMF, are established with longevity in mind. A 5 year life would be untenable for investors wishing to use the utility of a MMF as a long term alternative to bank deposits, or to MMFs that exist today.

Internal credit assessment - Articles 16-20

The Council's wording for the internal credit assessment is clear and supports the objective of a high quality credit assessment for all MMF assets. The Council's amendments to Article 9 (1(c), requiring issuer and issuance to be of high quality further assist this objective. We therefore support the Council's position as it brings about a proportionate and workable solution.

We do not see a need for delegated acts, since MMF managers and Credit Rating Agencies are the parties primarily involved in credit assessment and both will be subject to stringent regulation.

Authorisation - Article 3

The Council approach that requires MMF to obtain authorisation under the MMFR in addition to (rather than instead of) an existing UCITS authorisation is clear and workable.

Fund ratings - Article 23

We agree with the Council and Parliament that a MMF or its manager should be able to obtain and pay for a rating for a fund, with disclosure to end-investors.

External support - Article 35

We agree with the Council and Parliament that there should be a ban on external/sponsor support for all MMF. We qualify this statement to the extent that the drafting still needs to ensure that legitimate activities (such as seeding a new fund) are not swept into the ban inadvertently.

Implementation of MMFR - Articles 43, 46

We support the 24 month implementation period (6+18 months) agreed by the Council and therefore oppose the much shorter time proposed by the Commission (6 months) and Parliament (9 months). Twenty four months is a realistic minimum in which to deal with substantial change involving regulators, MMF products, managers and investors.

WHAT REQUIRES FURTHER CHANGE

The definition of liquid assets for LVNAV and CNAV Government MMF in the Council position is over-complex and unduly limiting in terms of the eligibility of government securities. It would make certain products non-viable.

Liquidity rules for Short Term MMF - Article 21

The assets allowed now for the daily and weekly liquidity threshold calculation include government securities. These are securities that come within the limit of 397 days maximum residual maturity for investment holdings in the fund and are considered cash equivalent because of the speed with which they may be sold.

The Parliament position does not dwell on eligible assets, although an amendment to Recital 35 states that government securities may be included as daily maturing assets. By contrast the

Council position amends the rules for weekly maturing assets so that sharply different standards apply to CNAV/LVNAV MMF and VNAV.

The liquidity rules for CNAV/LVNAV MMF in the Council position run counter to the trend of legislation applying to banks through Basel 3/CRR. The regulatory pressure on banks to fund themselves longer term has caused a dearth of short term bank paper in the market. There are also capital disincentives against taking short term deposits; and reverse repo markets require an active bank presence to function in the way set out for the MMFR. It is risky to make the liquidity requirements for MMFs reliant on bank participation, whilst setting a diametrically opposed objective for banks to reduce their use of short term funding. The long-accepted and best way of dealing with the liquidity needs of the funds is to continue to allow high quality government securities to be held as liquid assets with little or no restriction. For CNAV MMF it also better meets the spirit of the minimum 99.5% government asset requirement set out in the MMFR.

Fees and Gates - Article 29

The escalation procedure surrounding the control of weekly liquidity needs refinement and clarity. The proposed procedure requires full Board involvement for every dip below the 30% liquidity threshold and for every occasion on which net redemptions exceed 10% of total assets. This is disproportionate and likely to produce unintended consequences:

- The breach of liquidity thresholds risks being hard-wired into fund platforms at the discretionary level of 30%, rather than at the mandatory level of 10%. This could create a “cliff edge” effect, with investor and possible market detriment if it triggers automatic redemptions.
- Many expected cyclical liquidity drops are of very short duration, for example occurring at month and quarter ends. Calling a full Board meeting and specifying the required actions for every liquidity dip, however small or short-lived, is disproportionate to the actual risk of a run on the funds. A more nuanced approach could be more effective in engaging the Board - and would not, by reason of cost, become a barrier to entry for new funds, which the existing hard edged procedures do.
- To avoid the impact of a threshold breach at 30%, funds are likely to operate with significant buffers above the regulatory thresholds. This will further compound pressure on liquid assets and force even more reliance on the banking system in respect of the use of reverse repos and deposits. Again, a more nuanced and proportionate approach should avoid this outcome without creating any additional risk in the funds.

We suggest a proportionate approach could be to continue to mandate reporting to the Board at 30%, but require the Board to set its own policy for liquidity management when the liquidity level drops below 30%. At 20% it would be reasonable to impose the specific requirements set for the Board in the Council text, which effectively are the same (but discretionary) as the mandatory requirements established for a breach of the 10% minimum liquidity level. This more graduated escalation should help to prevent the adverse effects identified.

A complementary approach would be to allow a very short “grace” period in which the manager may bring the fund back within the liquidity threshold before triggering the required reporting and Board activity.

IMMFA CNAV MMF already adhere to liquidity requirements, prescribed in the IMMFA Code of Practice and internal policies. These have operated effectively and without cause for concern to investors or regulators for many years, despite occasional dips below the prescribed level.

Diversification - Article 14.1(a)

The diversification limits set out in the Council text have become complex. There are, for example, limits that appear not to have a strong supporting rationale, also some limits within limits. This will make it difficult for investors to assess the risk profile of what are meant to be utility products.

We ask that the UCITS diversification limits, which are tried and tested and well understood by many investors, should be used instead.

Eligible reverse repo - Article 13.1(a) and 13.4

The UCITS limit of 7 days maturity for a reverse repo contract has been changed to a 2 day notice period for MMF in all versions of Article 13; whilst 5 working days is referenced for reverse repo contracts in Article 21(d) of the Council's text.

We ask that the UCITS limit of 7 days maturity should be applied in all instances to ensure a clear and consistent approach.

Collateral received on a reverse repo trade should not count towards a fund's diversification limit (as required in Article 13.4). Collateral is held not for investment purposes but to convert to cash should cash not be returned under the repo agreement.

Investment in MMF and Master/feeders – Articles 8 and 13a

We support the Council approach that allows MMF to invest in other MMF, in line with the existing UCITS limitations.

In addition, the use of Master/feeder structures under UCITS rules should explicitly be permitted. These are conduits for channelling investment into a MMF and are often used to manage different tax and distribution rules within different Member States.

OTHER IMPORTANT ISSUES

Independent pricing of assets - Article 26

We disagree with the Council and Commission approach, which does not require independent pricing of assets. We believe that this important requirement sought by the Parliament (Article 26.4) should be imposed. It represents best practice within the industry and avoids a conflict of interest arising. Without it, the scrutiny of asset values in a fund is non-transparent and therefore compromised, with consequent potential investor detriment and a risk of poor quality information to Regulators.

VNAV investment and risk controls - Articles 14, 21

We disagree with some aspects of the Council approach to VNAV, when compared with CNAV and LVNAV, which has allowed certain control requirements that should be the same across all MMF to be watered down.

A VNAV can be:

i. a Short Term MMF, with some of the same investment and risk controls as the LVNAV MMF but more areas of freedom; or
ii. a Standard VNAV MMF, with much increased freedom in terms of applicable investment controls.

Stability issues can – and did, during the financial crisis – arise across all MMF. The application of investment and risk controls should be assessed across all 3 MMF types – CNAV, LVNAV and VNAV if proper account is to be taken of the financial stability objective.

For example, the introduction of increased limits (15% - Article 14.1b)) for term deposits in a connected credit institution could in some circumstances undermine the objective of avoiding contagion in financial firms.

For investors, the Council text introduces a real risk of confusion between MMF product types - and potentially therefore of both investor mis-selling and contagion across MMF types.

Capital buffers – Articles 29-33

We do not support the use of capital buffers proposed by the Commission.

Employee savings schemes – Article 13a(3a)

We are puzzled by the special arrangements for employee savings schemes in the Council position, which lack definition. It would seem that these may allow employee savings schemes to invest in a MMF in which no diversification restrictions apply. As these schemes appear to be open to natural persons only, we would wish to understand the particular reasons why retail consumers appear in this circumstance to be offered fewer regulatory protections, as this would not usually be the case.

About IMMFA

IMMFA represents the institutional money market fund industry that sponsors and promotes funds based on providing a constant Net Asset Value per share to investors. In practical terms this means offering an investment product that, without guaranteeing a result, expects to return €1 plus yield (calculated daily) for each €1 invested. At the end of 2015, funds under management amounted to about €578 billion. A list of members may be found at www.immfa.org

Money market fund investors include large and small corporations, pension funds, charities, public bodies and investment firms. The funds provide two principal capital market benefits:

- Investors have somewhere other than banks to store and manage their cash: they obtain professional cash and credit management and risk diversification (i.e. from bank deposits);
- Investment activity supports short term funding in the markets, including bank funding.

In that light, IMMFA's focus is to make sure that all MMFs remain viable for clients, as well as continuing to support short-term funding in the capital market.