

Money Market Funds Regulation Legislative Tracker

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The Simmons & Simmons Money Market Funds Regulation Legislative Tracker

This Legislative Tracker provides you with an update on the EU's proposed Money Market Funds (MMF) Regulation, setting out:

- a high level background to, and summary of the main aims of, the MMF Regulation, and
- a table of the key dates in the process of agreeing the Level 1 text (with links to the relevant documents)
- an annex setting out what specific Level 2 / Level 3 measures ESMA must develop, the timing of ESMA's work (where known) and which ESMA document (discussion paper, consultation paper or Final Report) deals with each measure.

Background

The 2008 global financial crisis revealed important regulatory gaps in the European financial system. In response, the European Union (EU) adopted a range of measures to render the banking system more stable. These included strengthened capital requirements, rules on improved governance and supervision and resolution regimes.

However, the crisis also highlighted problems in areas where non-bank credit activities took place, so-called "shadow banking". In coordination with the work undertaken by the Financial Stability Board and G20, the European Commission (the Commission) undertook a review of the regulation of shadow banking, which the Commission defines as "a system of credit intermediation that involves entities and activities outside the regular banking system".

On 19 March 2012, the Commission published a green paper, *Shadow banking*, in order to "take stock of current development, and to present on-going reflections on the subject [of shadow banking]".

One aspect at which the Commission looked was that of **Money Market Funds** (MMFs) - a type of investment fund investing in short-term debt, such as money market instruments issued by banks (which account for approximately 85% of the EUR 1000 billion of financial instruments issued to MMFs),

governments (which account for a further 10%) and corporates (5%). The money market instruments concerned typically include treasury bills, commercial paper and certificates of deposit.

Although MMFs had been seen as relatively stable vehicles and “a useful tool for investors because they offer characteristics similar to those of bank deposits: instant access to liquidity and stability of value”, in the Commission’s view, they could, nonetheless pose a systemic risk – “money market funds are nonetheless investment funds, subject to market risk. During periods of high market turbulence, it is difficult for these funds to maintain liquidity and stability, particularly in the face of investor runs. Consequently they could pose a serious risk of contagion”.¹

On 26 July 2012, the Commission published a *consultation paper* looking at product rules, liquidity management, depositary, MMFs and long-term investments in contemplation of a further revision of the UCITS Directive, a so-called “UCITS VI”.

However, the Commission concluded that the better approach would be to deal with the regulation of MMFs separately, rather than in the context of UCITS.

Specifically, the Commission’s work focussed on the risks posed by investor ‘runs’ on MMFs, the Commission regarding these risks as being of a systemic nature because of both (a) the close links between MMFs and the real economy given the role played by MMFs in satisfying the short-term financing needs of entities using the money market as a funding tool, and (b) the links between MMFs and their sponsors – typically banks.

Summary

On 04 September 2013, the Commission adopted a *proposal for a Regulation on Money Market Funds*.²

Following lengthy and complex negotiations, political agreement for a Level 1 text (the MMF Regulation) was reached between the Council of the EU (the Council) and the European Parliament (EP). This was subsequently adopted by a plenary vote of the EP on 05 April 2017 and formally endorsed by the Council on 16 May 2017.

The *MMF Regulation* was formally published in the Official Journal on 30 June 2017 (see ‘*Next steps*’, below).

Scope

The MMF Regulation applies to any MMF established, managed or marketed in the EU, whether it is governed by the UCITS Directive or is an AIF under the AIFMD.

The MMF Regulation relies on the existing UCITS authorisation procedures for MMFs which are UCITS and, because the AIFMD leaves authorisation of AIFs at the discretion of Member States, Article 5 introduces a harmonised authorisation procedure for MMFs which are AIFs, mirroring that foreseen for UCITS.

Although managers will continue to be regulated by either the UCITS Directive or AIFMD, as applicable, managers (and funds) falling within scope of the MMF Regulation will have to comply with its additional level of MMF-specific rules.

¹ Commission Communication, *Shadow banking – Addressing New Sources of Risk in the Financial Sector*, 04 September 2013.

² A separate element in the Commission’s work on shadow banking is the Securities Financing Transactions (SFT) Regulation – please see the Simmons & Simmons SFT Legislative Tracker on elexica.com.

What is an MMF?

The MMF Regulation defines (at Article 1(1)) an MMF as being a collective investment undertaking which

- requires authorisation under either the UCITS Directive or AIMFD
- invests in short term assets (i.e., those with a residual maturity not exceeding two years) and
- has distinct or cumulative objectives offering returns in line with money market rates or preserving the value of the investment.

Types of MMF

Under Article 3 of the MMF Regulation, an MMF can be one of three types:

- a variable net asset value (VNAV) MMF
- a public debt constant net asset value (CNAV) MMF or
- a low volatility net asset value (LVNAV) MMF.

Issues covered in the MMF Regulation

In addition to setting out provisions on definitions, the authorisation process for MMF and the use of the MMF designation, the MMF Regulation includes the following sections:

- obligations concerning investment policies (Articles 8 to 16)
- restrictions on investment policies (Articles 17 to 18)
- internal credit quality assessment (Articles 19 to 23)
- risk management (Articles 24 to 28)
- valuation (Articles 29 to 33)
- specific requirements for public debt CNAV MMFs and LVNAV MMFs (Article 34)
- external support (Article 35)
- transparency and reporting requirements (Articles 36 to 37).

Summary of key provisions

(a) Eligible assets in which an MMF may invest

An MMF may only invest in one of the following asset types:

- eligible money market instruments
- eligible securitisations and asset-backed commercial paper (ABCP)
- eligible deposits with credit institutions
- eligible financial derivative instruments
- eligible repurchase (repo) agreements
- eligible reverse repo agreements
- units or shares in another MMF.

(b) Eligibility criteria for assets

The following (non-exhaustive) requirements apply in order for an asset type to be eligible for investment by an MMF

- **money market instruments**
 - the instrument must fall within one of the categories of money market instruments referred to in Article 50(1)(a), (b), (c) or (h) of the UCITS Directive
 - it has either:
 - a legal maturity at issuance of 397 days or less or
 - a residual maturity of 397 days or less
 - its issuer and the quality of the money market instrument must both have received a favourable assessment under the MMF Regulation's credit quality provisions (see section (d) below)

- **securitisations and ABCPs**
 - a securitisation must fall within the definition in Article 13 of Commission Delegated Regulation (EU) 2015/61 made under the Capital Requirements Regulation (CRR)
 - an ABCP issued by an ABCP programme must:
 - be fully supported by a regulated credit institution that covers all liquidity, credit and material dilution risks, as well as ongoing transaction costs and ongoing programme-wide costs related to the ABCP, if necessary to guarantee the investor the full payment of any amount under the ABCP
 - not be a re-securitisation and the exposures underlying the securitisation at the level of each ABCP transaction do not include any securitisation position
 - not include a synthetic securitisation as defined in Article 242(11) of the CRR
 - a securitisation or ABCP must be simple, transparent and standardised (STS)

- **deposits with credit institutions**
 - the deposit must be repayable on demand or be able to be withdrawn at any time
 - the deposit must mature in no more than 12 months
 - the credit institution must have its registered office in a Member State or, where its registered office is in a third country, it must be subject to prudential rules considered equivalent to those in the EU in accordance with Article 107(4) of the CRR.

- **financial derivative instruments**
 - the derivative must be dealt in on a regulated market as referred to Article 50(1)(a), (b) or (c) of the UCITS Directive or OTC
 - its underlying must consist of interest rates, foreign exchange rates, currencies or indices representing one of those categories
 - it must serve only the purpose of hedging the interest rate or exchange rate risks inherent in other investments of the MMF
 - in respect of an OTC derivative
 - the counterparties must be institutions subject to prudential regulation and supervision and belonging to the categories approved by the competent authority of the MMF
 - the derivative must be subject to reliable and verifiable valuation on a daily basis and can be sold, liquidated or closed by an offsetting transaction at any time at fair value at the MMF's initiative.

- **repo agreements**

- the repo agreement must be used
 - on a temporary basis, for no more than seven working days
 - only for liquidity management purposes
 - only for the investment purposes referred to in the third bullet point below
- the counterparty receiving assets as collateral from the MMF under the agreement cannot sell, invest, pledge or otherwise transfer them without the MMF's prior consent;
- the cash received by the MMF as part of the repurchase agreement must be able to be
 - placed on deposits in accordance with Article 50(1)(f) of the UCITS Directive or
 - invested in assets referred to in Article 15(6) of the MMF Regulation (see under 'reverse repo agreements' below) but not otherwise invested in eligible assets, transferred or otherwise reused
- the MMF must have the right to terminate the agreement at any time on no more than two working days' notice.

- **reverse repo agreements**

- the assets received by the MMF as part of the agreement must:
 - be eligible money market instruments (not securitisations or ABCPs)
 - however, such assets may be liquid transferable securities or non-eligible money market instruments provided the conditions in Article 15(6) of the MMF Regulation are met, namely that those assets are issued or guaranteed
 - by the Union, a central authority or central bank of a Member State, the European Central Bank, the European Investment Bank, the European Stability Mechanism or the European Financial Stability Facility provided that a favourable internal credit quality assessment has been received (see section (d) below)
 - by a central authority or central bank of a third country, provided that a favourable internal credit quality assessment has been received (see section (d) below)
 - not be sold, reinvested, pledged or otherwise transferred
 - be sufficiently diversified with a maximum exposure to any given issuer of 15% of the MMF's NAV, except where those assets take the form of money market instruments that fulfil the requirements of Article 17(7) of the MMF Regulation
 - be issued by an entity that is independent from the counterparty and is expected not to display a high correlation with the performance of the counterparty.
- the MMF must be able to recall the full amount of cash at any time on either an accrued basis or a mark-to-market basis
- the MMF must have the right to terminate the agreement at any time on no more than two working days' notice.

- **units or shares of MMFs**

- subject to certain restrictions (see section (c) below), an MMF may invest in units or shares of another MMF (the targeted MMF) provided that the targeted MMF is authorised under the Regulation.

(c) Investment restrictions

The MMF Regulation prohibits an MMF from

- investing in assets other than those listed in section (a) above
- short selling any money market instruments, securitisations, ABCPs or units or shares in another MMF
- taking direct or indirect exposure to equity or commodities, including via derivatives, certificates representing them, indices based on them, or any other means or instrument that would give an exposure to them
- entering into securities lending agreements or securities borrowing agreements, or any other agreement that would encumber the assets of the MMF or
- borrowing and lending cash.

The MMF Regulation sets out a number of **diversification** provisions including

- an MMF may not invest more than
 - 5% of its assets in money market instruments, securitisations and ABCPs issued by the same body
 - 10% of its assets in deposits made with the same credit institution – however, where the banking sector in the MMF’s Member State is such that there are insufficient viable credit institutions to meet this requirement and it is not economically feasible for the MMF to make deposits in another Member State, up to 15% of the MMF’s assets may be deposited with the same credit institution.
- notwithstanding the above, a VNAV MMF can invest up to 10% of its assets in money market instruments, securitisations and ABCPs issued by the same body provided that the total value of such assets which the VNAV MMF holds in each issuing body in which it invests more than 5% of its assets does not exceed 40% of the value of its assets.
- under Article 11(4) of the MMF Regulation, the Commission must develop a Level 2 measure identifying STS securitisations and ABCPs (see the Annex below)
 - until the date of application of the measure, the aggregate of all of an MMF’s exposures to securitisations and ABCPs must not exceed 15% of the MMF’s assets
 - from the date of application of the measure, the aggregate of all of an MMF’s exposures to securitisations and ABCPs must not exceed 20% of its assets – of this amount, 15% may be invested in securitisations and ABCPs that do not comply with the criteria set out in the Level 2 measure
- the aggregate risk exposure to the same counterparty of an MMF arising from **OTC derivative transactions** must not exceed 5% of the MMF’s assets
- the aggregate amount of cash provided to the same counterparty of an MMF in **reverse repo agreements** must not exceed 15% of the MMF’s assets
- an MMF must not combine investments in money market instruments, securitisations and ABCPs issued by a single body, deposits made with that single body and OTC financial derivative instruments giving counterparty risk exposure to that body where this would result in the MMF investing more than 15% of its assets in that body (or 20% of its assets where the financial market in the MMF’s Member State is such that there are insufficient viable financial institutions to meet this requirement and it is not economically feasible for the MMF to use financial institutions in another Member State).

In addition, where the MMF invests in

- **a repo agreement**
 - the cash received by the MMF as part of the agreement must not exceed 10% of its assets
- **a reverse repo agreement**
 - the market value of the assets received as part of the agreement must at all times be at least equal to the value of the cash paid out
- **units or shares of another MMF**
 - no more than 10% of the assets of the targeted MMF may, under its fund rules or instruments of incorporation, be able to be invested in aggregate in units or shares of other MMFs
 - the targeted MMF must not hold units or shares in the acquiring MMF
 - no more than 5% of the acquiring MMF's assets may be invested in units or shares of a single MMF (a derogation applies in respect of an MMF which is an AIF)
 - no more than 17.5% in aggregate of the acquiring MMF's assets may be invested in units or shares of other MMFs (again, a derogation applies in respect of an MMF which is an AIF).

The MMF Regulation also includes provision on **concentration**, in general (though subject to the exclusion set out in Article 18(2)) limiting an MMF to holding no more than 10% of the money market instruments, securitisations and ABCPs issued by a single body.

(d) Internal credit risk assessment

In addition, the MMF Regulation introduces a provision whereby the manager of the MMF must 'establish, implement and consistently apply' a prudent internal credit quality assessment procedure for determining the credit quality of money market instruments, securitisations and ABCPs. The assessment procedure must be approved by the manager's senior management, governing body, and, where it exists, the manager's supervisory function. The procedure must also be based on, among other things, a thorough analysis of the information available and pertinent and should include all relevant driving factors that influence the creditworthiness of the issuer and the credit quality of the instrument. The manager must avoid 'mechanistic over-reliance' on external ratings provided by credit rating agencies

The methodology which the manager should use when undertaking the internal assessment procedure will be developed by the Commission as part of its work on Level 2 measures (see the Annex below). When in operation, these methodologies must be reviewed at least annually by the manager to determine whether they remain appropriate for the MMF's current portfolio – where the manager becomes aware of errors in the credit quality assessment methodology or its application, it must correct those errors immediately.

(e) Risk management

Portfolio rules

The MMF Regulation sets out a number of provisions in respect of risk management obligations depending on whether the MMF is a short-term MMF (which may only invest in eligible money market instruments set out in Article 10(1) of the MMF Regulation) or a standard MMF (which may invest in eligible money market instruments set out in Article 10(1) or (2) and which is subject to different portfolio rules).

For a **short-term MMF**

- the weighted average maturity (WAM) of the portfolio must be no more than 60 days
- the weighted average life (WAL) of the portfolio must be no more than 120 days

- daily maturing assets, reverse repos agreements capable of being terminated on one working day's notice or cash which can be withdrawn on one working day's notice must account for at least
 - 10% of the assets of LVNAV MMFs and public debt CNAV MMFs
 - 7.5% of the assets of VNAV MMFs
- weekly maturing assets, reverse repos agreements capable of being terminated on five working days' notice or cash which can be withdrawn on five working days' notice must account for at least
 - 30% of the assets of short-term LVNAV MMFs and short-term public debt CNAV MMFs – for the purpose of this calculation, such MMFs can include highly liquid assets up to a limit of 17.5% of the MMF's assets, provided such assets can be redeemed and settled within one working day and have a residual maturity of up to 190 days
 - 15% of the assets of short-term VNAV MMFs - for the purpose of this calculation, money market instruments or units or shares of other MMFs can be included within the weekly maturing assets of the short-term VNAV MMF, up to a limit of 7.5% of its assets, provided that such money market instruments, units or shares can be redeemed and settled within five working days.

For a **standard MMF**

- the weighted average maturity (WAM) of the portfolio must be no more than 6 months
- the weighted average life (WAL) of the portfolio must be no more than 12 months
- daily maturing assets, reverse repos agreements capable of being terminated on one working day's notice or cash which can be withdrawn on one working day's notice must account for at least 7.5% of the MMF's assets
- weekly maturing assets, reverse repos agreements capable of being terminated on five working days' notice or cash which can be withdrawn on five working days' notice must account for at least 15% of the assets of VNAV MMFs - for the purpose of this calculation, money market instruments or units or shares of other MMFs can be included within the weekly maturing assets of the standard VNAV MMF, up to a limit of 7.5% of its assets, provided that such money market instruments, units or shares can be redeemed and settled within five working days.

External credit ratings

Where the MMF solicits or finances an external credit rating, it must comply with the Credit Rating Agencies Regulation and its prospectus and all communications to investors in which the external credit rating is mentioned must clearly indicate that the rating was solicited or financed by the MMF or by its manager.

Know Your Customer (KYC) policy

The manager of the MMF must establish, implement and apply a KYC policy, the aim of which is to anticipate the effect of concurrent redemptions by several investors, taking into account at least the type of investor, the number of units or shares in the fund owned by a single investor and the evolution of inflows and outflows.

The manager of the MMF must ensure that the value of the units or shares held by a single investor does not materially impact the MMF's liquidity profile where it accounts for a substantial part of the MMF's total NAV.

Stress testing

An MMF must have in place sound stress testing processes to identify possible events or future changes in economic conditions which could have unfavourable effects on the MMF. The MMF or its manager must assess the possible impact that such events or changes could have on the MMF.

The MMF or its manager must conduct stress testing for different possible scenarios regularly (and at least bi-annually) – the exact frequency is to be determined by the directors of the MMF or of its manager, having considered what would be an appropriate and reasonable interval in light of market conditions and any envisaged changes in the portfolio of the MMF.

For public debt CNAV MMFs and LVNAV MMFs, the stress tests must additionally estimate the difference between the CNAV per unit or share and the NAV per unit or share under different scenarios.

(f) Valuation

An MMF's assets must be valued on at least a daily basis, using mark-to-market whenever possible.

Where mark-to-market is not possible or market data is not of sufficient quality, the asset must be valued conservatively on a mark-to-model basis, using a model which accurately estimates the intrinsic value of the asset, based on:

- the volume and turnover in the market of the asset
- the issue size and the portion of the issue that the MMF plans to buy or sell and
- market risk, interest rate risk, credit risk attached to the asset.

When using mark-to-model, the amortised cost method may not generally be used - the assets of public debt CNAV MMFs, however, may additionally be valued by using the amortised cost method.

An MMF's units or shares must be issued or redeemed at a price equal to the MMF's NAV per unit or share, notwithstanding permitted fees or charges as specified in the prospectus of the MMF.

In the case of a public debt CNAV MMF, however, its units or shares may be issued or redeemed at a price equal to that MMF's CNAV per unit or share. In the case of a LVNAV MMF, its units or shares may be issued or redeemed at a price equal to its CNAV per unit or share, but only where this value does not deviate from the NAV per unit or share by more than 20 basis points.

(g) External support

An MMF may not receive external support, defined as "direct or indirect support offered to an MMF by a third party, including a sponsor of the MMF, that is intended for or in effect would result in guaranteeing the liquidity of the MMF or stabilising the NAV per unit or share of the MMF" – this would include (among other things) support in the form of a third party (a) providing cash injections, (b) purchasing assets of the MMF either at an inflated price or to provide liquidity or (c) issuing any kind of explicit or implicit guarantee, warranty, letter of support for the benefit of the fund.

(h) Transparency and reporting requirements

Transparency requirements

An MMF must indicate clearly in any written communication which it or its manager issues to, or intended for distribution to, prospective investors, unit-holders, or shareholders which type of MMF it is (see 'Types of MMF' above) and whether it is a short-term or a standard MMF.

The MMF's manager must make the following information available to the MMF's investors on at least a weekly basis

- the maturity breakdown of the MMF's portfolio
- the MMF's credit profile
- the MMF's WAM and WAL
- details of the 10 largest holdings in the MMF (including the name, country, maturity and asset type and, in the case of repo or reverse repo agreements, the counterparty)
- the total value of the MMF's assets

- the net yield of the MMF.

Any document used for marketing the MMF must clearly include all of the following statements

- that the MMF is not a guaranteed investment
- that an investment in MMFs is different from an investment in deposits, with particular reference to the risk that the principal invested in an MMF is capable of fluctuation
- that the MMF does not rely on external support for guaranteeing the liquidity of the MMF or stabilising the NAV per unit or share
- that the risk of loss of the principal is to be borne by the investor.

Investors in an MMF must be clearly informed of how the MMF values its assets and calculates its NAV. Public debt CNAV MMFs and LVNAV MMFs must explain clearly to investors and potential investors any use of the amortised cost method or of rounding or both.

Reporting requirements

For each MMF that it manages, an MMF manager must report specified information to the MMF's competent authority, and to its own competent authority, if different from that of the MMF, on at least a quarterly basis (or at least annually where the MMF's total assets under management do not exceed EUR 100 million).

The information to be reported includes

- the type and characteristics of the MMF
- portfolio indicators such as the total value of assets, NAV, WAM, WAL, maturity breakdown, liquidity and yield
- the results of stress tests and, where applicable, the proposed action plan
- information on the assets held in the portfolio of the MMF, including
 - the characteristics of each asset, such as name, country, issuer category, risk or maturity, and the outcome of the internal credit quality assessment procedure;
 - the type of asset, including details of the counterparty in the case of derivatives, repurchase agreements or reverse repurchase agreements;
- information on the MMF's liabilities, including:
 - the country where the investor is established
 - the investor category
 - subscription and redemption activity.

Next steps

Political agreement on a Level 1 text was reached between the Council and the EP on 14 November 2016. The text was adopted by a plenary vote in the EP on 05 April 2017 and subsequently endorsed by the Council on 16 May 2017.

The *MMF Regulation* was published in the Official Journal on 30 June 2017.

The Regulation formally entered into force on 20 July 2017 (the twentieth day after publication) and the majority of it applies from 21 July 2018.

However, Articles 11(4), 15(7), 22 and 37(4), which require the Commission or ESMA to develop Level 2 or Level 3 measures will apply from entry into force.

The Commission and ESMA are in the process of developing the Level 2 and Level 3 measures set out in the Annex below in order to supplement the Level 1 text. ESMA submitted its *Final Report* to the Commission containing draft Level 2 and Level 3 measures on 13 November 2017.

Note that the timing of some Level 2 measures is dependent on the date of entry into force of the *Regulation on Simple, Transparent and Standardised Securitisations* (the STS Regulation). The STS Regulation was published in the Official Journal on 28 December 2017 and entered into force on 17 January 2018 (the twentieth day following publication).

The MMF Regulation will be reviewed by the Commission five years after entry into force.



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Where are we in the process?

Table 1: Key stages in development of Level 1 text

Level 1 Text	Date
Commission <i>proposal</i>	04 September 2013
Council <i>compromise proposal (1)</i>	10 November 2014
Council <i>compromise proposal (2)</i>	27 November 2014
Council <i>compromise proposal (3)</i>	17 December 2014
Council <i>Italian Presidency progress report</i>	17 December 2014
Council <i>compromise proposal (4)</i>	12 April 2016
Council <i>compromise proposal (5)</i>	10 May 2016
Council <i>compromise proposal (6)</i>	10 June 2016
<i>Council General Approach</i>	15 June 2016
European Parliament <i>draft report</i>	04 March 2015
European Parliament <i>text adopted in plenary vote</i>	29 April 2015
<i>Political Agreement</i>	14 November 2016
<i>European Parliament adoption</i>	05 April 2017
<i>Council endorsement</i>	16 May 2017
<i>Publication in OJ</i>	30 June 2017
Entry into force	20 July 2017

Table 2: Development of Level 2 / Level 3 measures

CP	Covers	Published	Closes	Submission to Commission
ESMA34-49-82	Criteria identifying STS securitisations and ABCP (Article 11(4))	24 May 2017	07 August 2017	
	Specification of quantitative and qualitative liquidity and credit quality requirements (Article 15(7))			ESMA published a Final Report on 13 November 2017
	Criteria for the validation of the credit quality assessment (Article 22(a))			ESMA published a Final Report on 13 November 2017
	Criteria for the quantification of the credit risk and relative risk of default of an issuer and of the instrument (Article			ESMA published a Final Report on 13 November 2017

22(b)	
ESMA34-49-82 (cont'd)	<p>Criteria for establishing qualitative indicators on the issuer of the instrument (Article 22(c))</p> <hr/> <p>The meaning of material change that could have an impact on the existing credit quality assessment of an instrument (Article 22(d))</p> <hr/> <p>Establishment of a template for reporting information regarding the MMF to its Competent Authority (Article 37(4))</p> <hr/> <p>Establishing common parameters for the stress test process (Article 28(7))</p>
	<p>ESMA published a Final Report on 13 November 2017</p> <hr/> <p>ESMA published a Final Report on 13 November 2017</p> <hr/> <p>ESMA published a Final Report on 13 November 2017</p> <hr/> <p>ESMA published a Final Report on 13 November 2017 and final Guidelines on 21 March 2018</p>

Annex

Note

Article numbers referred to below are those contained in the text of the political agreement on Level 1. These may differ from those in the version eventually published in the Official Journal (OJ), following review by the Commission's legal services.

The MMF Regulation contains a number of provisions in respect of which the Commission and/or ESMA are mandated to develop the following Level 2 or Level 3 measures:

Level 2 measures

- Criteria identifying simple, transparent and standardised securitisations and ABCP ([Article 11\(4\)](#))
- Specification of quantitative and qualitative liquidity and credit quality requirements ([Article 15\(7\)](#))
- Criteria for the validation of the credit quality assessment ([Article 22\(a\)](#))
- Criteria for the quantification of the credit risk and relative risk of default of an issuer and of the instrument ([Article 22\(b\)](#))
- Criteria for establishing qualitative indicators on the issuer of the instrument ([Article 22\(c\)](#))
- The meaning of material change that could have an impact on the existing credit quality assessment of an instrument ([Article 22\(d\)](#))
- Establishment of a template for reporting information regarding the MMF to its Competent Authority ([Article 37\(4\)](#))

Level 3 measure

- Establishing common parameters for the stress test process ([Article 28\(7\)](#))

Looking at each of these in turn:

(i) Level 2 Measures

A. Criteria identifying simple, transparent and standardised securitisations and Asset Backed Commercial Papers (ABCP)

(i) What does Level 1 say?

[Article 11\(1\)](#) of the Regulation states that:

“Both a securitisation and ABCP shall be considered to be eligible for investment by a MMF provided that the securitisation or ABCP is sufficiently liquid and has received a favourable assessment in accordance with Articles 19 to 22, and is any of the following:

[...]

(c) is a simple, transparent and standardised securitisation or ABCP.”

(ii) What is the Commission’s mandate?

Article 11(4) of the Regulation states that:

“The Commission shall adopt [...] a delegated act [...] amending [Article 11 of the Regulation] by introducing a cross-reference to the criteria identifying [simple, transparent and standardised (STS)] securitisations and ABCPs in the corresponding provisions of [the future STS Regulation].

[...]

For the purposes of the first sub-paragraph, the criteria identifying STS securitisations and ABCPs shall at least include the following:

- (a) requirements relating to the simplicity of the securitisation, including its true sale character and the respect of standards relating to the underwriting of the exposures;
- (b) requirements relating to standardisation of the securitisation, including risk retention requirements;
- (c) requirements relating to the transparency of the securitisation, including the provision of information to potential investors;
- (d) for ABCPs, in addition to points (a), (b) and (c), requirements relating to the sponsor and to the sponsor support of the ABCP programme;

(iii) Timing

The Commission must adopt the delegated act referred to in **Article 11(4)** within 6 months from the date of entry into force of the future STS Regulation, with the amendment of Article 11 of the MMF Regulation to become effective at the latest (a) 6 months after the entry into force of the delegated act or (b) from the date of application of the corresponding provisions in the STS Regulation, whichever is the later.

ESMA consulted on measures under **Article 11(4)** in its *Consultation Paper ESMA34-49-82*. The consultation period closed on **07 August 2017**. ESMA will subsequently submit draft technical advice to the European Commission.

B. Specification of quantitative and qualitative liquidity and credit quality requirements

(i) What does Level 1 say?

Article 15 of the Regulation states that:

“2. The assets received by the MMF as part of a reverse repurchase agreement shall be money market instruments that fulfil the requirements set out in Article 10.

[...]

6. By way of derogation from paragraph 2 of this Article, an MMF may receive as part of a reverse repurchase agreement liquid transferable securities or money market instruments other than those that fulfil the requirements set out in Article 10 provided that those assets comply with one of the following conditions:
- (a) they are issued or guaranteed by a central authority or central bank of a Member State, the European Central Bank, the European Investment Bank, the European Stability Mechanism or the European Financial Stability Facility provided that a favourable assessment has been received pursuant to Articles 19 to 22;
 - (b) they are issued or guaranteed by a central authority or central bank of a third country [...].”

(ii) What is the Commission’s mandate?

Article 15(7) of the Regulation states that:

“The Commission shall be empowered to adopt delegated acts [...] to supplement this Regulation by specifying quantitative and qualitative liquidity requirements applicable to assets referred to in paragraph 6 and quantitative and qualitative credit quality requirements applicable to assets referred to in point (a) of paragraph 6 of this Article.

For this purpose the Commission shall take into account the report referred to in Article 509(3) of [the Capital Requirements Regulation].”

(iii) Timing

The Commission must adopt the delegated act referred to in **Article 15(7)** no later than 6 months after entry into force of the Regulation. (The Regulation will enter into force 20 days following its publication in the Official Journal.)

ESMA consulted on measures under **Article 15(7)** in its *Consultation Paper ESMA34-49-82*. The consultation period closed on **07 August 2017**. ESMA submitted draft technical advice to the European Commission in its *Final Report* dated **13 November 2017**.

C. Validation of the credit quality assessment methodology

(i) What does Level 1 say?

Article 19(1) of the Regulation states that:

“A manager of an MMF shall establish, implement and consistently apply a prudent internal credit quality assessment procedure for determining the credit quality of money market instruments, securitisations and ABCPs, taking into account the issuer of the instrument and the characteristics of the instrument itself.”

Article 19(3) of the Regulation states that:

“The internal assessment procedure shall be based on prudent, systematic and continuous assessment methodologies. The methodologies used shall be subject to validation by the manager of an MMF based on historical experience and empirical evidence, including back testing.”

(ii) What is the Commission’s mandate?

Article 22(a) of the Regulation states that:

“The Commission shall adopt delegated acts [...] to supplement this Regulation by specifying the following points:

- (a) the criteria for the validation of the credit quality assessment methodology, referred to in **Article 19(3)**.”

(iii) Timing

The Regulation does not specify a time by which the Commission must adopt the delegated acts referred to in **Article 22(a)**.

ESMA consulted on measures under **Article 22(a)** in its *Consultation Paper ESMA34-49-82*. The consultation period closed on **07 August 2017**. ESMA submitted draft technical advice to the European Commission in its *Final Report* dated **13 November 2017**.

D. Quantification of the credit risk and relative risk of default of an issuer and of the instrument

(i) What does Level 1 say?

Article 17(1) of the Regulation states that:

“A manager of an MMF shall apply the [internal credit quality assessment] procedure laid down in **Article 19** to determine whether the credit quality of a money market instrument, securitisation or ABCP receives a favourable assessment. Where a credit rating agency registered and certified in accordance with [the Credit Rating Agencies Regulation] has provided a rating of that money market instrument, the manager of the MMF may have regard to such rating and supplementary information and analysis in its internal credit quality assessment, while not solely or mechanically relying on such rating in accordance with Article 5a of [the revised Credit Rating Agencies Regulation].”

Article 20(2)(a) of the Regulation states that the credit quality assessment must take into account the following factor:

“the quantification of the credit risk of the issuer and of the relative risk of default of the issuer and of the instrument.”

(ii) What is the Commission’s mandate?

Article 22(b) of the Regulation states that:

“The Commission shall adopt delegated acts [...] to supplement this Regulation by specifying the following points:

[...]

- (b) the criteria for quantification of the credit risk, and of the relevant risk of default of an issuer and of the instrument, as referred to in point (a) of **Article 20(2)**”

(iii) Timing

The Regulation does not specify a time by which the Commission must adopt the delegated acts referred to in **Article 22(b)**.

ESMA consulted on measures under **Article 22(b)** in its *Consultation Paper ESMA34-49-82*. The consultation period closed on **07 August 2017**. ESMA submitted draft technical advice to the European Commission in its *Final Report* dated **13 November 2017**.

E. Qualitative indicators on the issuer of the instrument

(i) What does Level 1 say?

Article 20(1) of the Regulation states that:

“A manager of an MMF shall apply the [internal credit quality assessment] procedure laid down in **Article 19** to determine whether the credit quality of a money market instrument, securitisation or ABCP receives a favourable assessment. Where a credit rating agency registered and certified in accordance with [the Credit Rating Agencies Regulation] has provided a rating of that money market instrument, the manager of the MMF may have regard to such rating and supplementary information and analysis in its internal credit quality assessment, while not solely or mechanistically relying on such rating in accordance with Article 5a of [the revised Credit Rating Agencies Regulation].”

Article 20(2)(b) of the Regulation states that the credit quality assessment must take into account the following factor:

“qualitative indicators on the issuer of the instrument, including in the light of the macro-economic and financial market situation.”

(ii) What is the Commission’s mandate?

Article 22(c) of the Regulation states that:

“The Commission shall adopt delegated acts [...] to supplement this Regulation by specifying the following points:

[...]

- (c) the criteria for establishing qualitative indicators on the issuer of the instrument, as referred to in **Article 20(2)(b)**”

(iii) Timing

The Regulation does not specify a time by which the Commission must adopt the delegated acts referred to in **Article 22(c)**.

ESMA consulted on measures under **Article 22(c)** in its *Consultation Paper ESMA34-49-82*. The consultation period closed on **07 August 2017**. ESMA submitted draft technical advice to the European Commission in its *Final Report* dated **13 November 2017**.

F. The meaning of material change that could have an impact on the credit quality assessment of an instrument

(i) What does Level 1 say?

Article 19(4)(d) of the Regulation states that:

“The manager of an MMF shall ensure that the internal credit quality assessment procedure complies with the all of the following general principles:

[...]

- (d) while there is to be no mechanistic over-reliance on external ratings in accordance with Article 5a of [the revised Credit Rating Agencies Regulation], the manager of an MMF shall undertake a new credit quality assessment for a money market instrument, securitisations and ABCPs when there is a material change that could have an impact on the existing assessment of the instrument.”

(ii) What is the Commission’s mandate?

Article 22(d) of the Regulation states that:

“The Commission shall adopt delegated acts [...] to supplement this Regulation by specifying the following points:

[...]

- (d) the meaning of material change as referred to in point (d) of **Article 19(4)**.”

(iii) Timing

The Regulation does not specify a time by which the Commission must adopt the delegated acts referred to in **Article 22(d)**.

ESMA consulted on measures under **Article 22(d)** in its *Consultation Paper ESMA34-49-82*. The consultation period closed on **07 August 2017**. ESMA submitted draft technical advice to the European Commission in its *Final Report* dated **13 November 2017**.

G. Establishment of a template for reporting information regarding the MMF to its Competent Authority

(i) What does Level 1 say?

Article 37(1) of the Regulation states that:

“For each MMF that it manages, the manager of the MMF shall report information to the competent authority of the MMF on at least on a quarterly basis.

By way of derogation from the first subparagraph, for an MMF whose assets under management in total do not exceed EUR 100 million, the manager of the MMF shall report to the competent authority of the MMF on at least an annual basis. [...]”

Article 37(2) of the Regulation states that:

“The information reported pursuant to paragraph 1 shall comprise the following points:

- (a) the type of characteristics of the MMF;
- (b) portfolio indicators such as the total value of assets, NAV, WAM, WAL, maturity breakdown, liquidity and yield;
- (c) the results of stress tests and, where applicable, the proposed action plan;
- (d) information on the assets held in the portfolio of the MMF, including:

- (i) the characteristics of each asset, such as name, country, issuer category, risk or maturity, and the outcome of the internal credit quality assessment procedure;
 - (ii) the type of asset, including details of the counterparty in the case of derivatives, repurchase agreements or reverse repurchase agreements;
- (e) information on the liabilities of the MMF, including:
- (i) the country where the investor is established;
 - (ii) the investor category;
 - (iii) subscription and redemption activity.

If necessary and duly justified, competent authorities may solicit additional information.

Article 37(3) of the Regulation states that:

“In addition to the information referred to in paragraph 2, for each LVNAV MMF that it manages, the manager of the MMF shall report the following:

- (a) every event in which the price of an asset valued by using the amortised cost method in accordance with the first subparagraph of **Article 29(7)** deviates from the price of that asset calculated in accordance with **Article 29(2), (3) and (4)** by more than 10 basis points;
- (b) every event in which the constant NAV per unit or share calculated in accordance with **Article 32(1) and (2)** deviates from the NAV per unit or share calculated in accordance with **Article 30** by more than 20 basis points;
- (c) every event in which a situation mentioned in **Article 34(3)** occurs and the measures taken by the board in accordance with points (a) and (b) of **Article 34(1)**.

(ii) What is ESMA’s mandate?

Article 37(4) of the Regulation states that:

“ESMA shall develop draft implementing technical standards to establish a reporting template that shall contain all the information listed in paragraphs 2 and 3.

(iii) Timing

ESMA must adopt the draft implementing technical standards (ITS) referred to in **Article 37(4)** no later than 6 months after entry into force of the Regulation. (The Regulation will enter into force 20 days following its publication in the Official Journal.)

ESMA consulted on measures under **Article 37(4)** in its *Consultation Paper ESMA34-49-82*. The consultation period closed on **07 August 2017**. ESMA submitted draft ITS to the European Commission in its *Final Report* dated **13 November 2017**.

(ii) Level 3 Measure

A. Establishing common parameters for the stress testing process

(i) What does Level 1 say?

Article 28(1) of the Regulation states that:

“Each MMF shall have in place sound stress testing processes that identify possible events or future changes in economic conditions which could have unfavourable effects on the MMF. The MMF or its

manager shall assess the possible impact that those events or changes could have on the MMF. The MMF or the manager of an MMF shall regularly conduct stress testing for different possible scenarios.

The stress tests shall be based on objective criteria and consider the effects of severe plausible scenarios. The stress test scenarios shall at least take into consideration reference parameters that include the following factors:

- (a) hypothetical changes in the level of liquidity of the assets held in the portfolio of the MMF;
- (b) hypothetical changes in the level of credit risk of the assets held in the portfolio of the MMF, including credit events and rating events;
- (c) hypothetical movements of the interest rates and exchange rates;
- (d) hypothetical levels of redemption;
- (e) hypothetical widening or narrowing of spreads among indices to which interest rates of portfolio securities are tied;
- (f) hypothetical macro systemic shocks affecting the economy as a whole.”

(ii) What is ESMA’s mandate?

Article 28(7) of the Regulation states that:

“ESMA shall issue guidelines with a view to establishing common reference parameters of the stress test scenarios to be included in the stress tests taking into account the factors specified in [Article 28(1)].

The guidelines shall be updated at least every year taking into account the latest market developments.”

(iii) Timing

The Regulation does not specify a time by which the ESMA must issue the Guidelines referred to in **Article 28(7)**.

ESMA consulted on measures under **Article 28(7)** in its *Consultation Paper ESMA34-49-82*. The consultation period closed on **07 August 2017**. Following its *Final Report* dated **13 November 2017**, ESMA formally published its final *Guidelines* on **21 March 2018**.

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