MFSA

MALTA FINANCIAL SERVICES AUTHORITY

Circular to the industry on the regulatory developments relating to the MMF Regulation particularly in the context of stress tests scenarios under Article 28 of the MMF Regulation

1.0 Introduction

Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on Money Market Funds ("the MMF Regulation") aims at increasing the resilience of Money Market Funds ("MMFs") notably in adverse market conditions. The MMF Regulation serves as a basis for prevention of precarious liquidity situations, which could potentially have negative effects on the overall financial system. The Regulation, which is directly applicable, came into force on 21 July 2017[1].

The Regulation also reinforces the need for stress testing to be conducted against various scenarios, in order for MMFs to identify possible events which could have unfavourable effects on their position with implications on investors. Article 28 of the MMF Regulation sets out reference parameters which should be taken into consideration when conducting a stress test, including such factors as: changes in the level of liquidity of the assets, hypothetical levels of redemption and/ or hypothetical macro systemic shocks affecting the economy as a whole.

2.0 Regulatory developments within the MMF landscape

The MMF Regulation adds substantially to the 2010 CESR's Guidelines on a common definition of European money market funds ("the Guidelines"), which served as a benchmark for the national framework in the context of MMFs. Naturally, the current versions of the Rulebooks regulating the Collective Investment Schemes, namely: AIF, PIF and UCITS, will be amended in order to reflect the changes.

2.1 New category of MMFs

The MMF Regulation categorises MMFs as short-term MMFs or as standard MMFs. In addition, it further classifies MMFs in three categories, based on their Net Asset Value: (a) variable net asset value (VNAV) MMFs; (b) public debt constant net asset value (CNAV) MMFs; (c) low volatility net asset value (LVNAV) MMFs. MMFs authorised by the MFSA shall explicitly state in their name, offering documentation and other marketing materials both their type and their investment objectives (public or private debt). A standard MMF shall not take the form of a public debt CNAV MMF or a LVNAV MMF.

[1] The applicable timeline is outlined in section 4.0 of this Circular

2.2 Treatment of existing UCITS and AIFs

Based on Article 44 of the MMF Regulation, by 21 January 2019, all existing Collective Investment Schemes licensed in Malta as MMFs shall submit to the MFSA an application, supported by documents and evidence necessary to demonstrate the compliance with this Regulation.

The Authority draws the attention to the fact that the Collective Investment Schemes that have the characteristics of MMFs shall be identified as MMFs and shall be able to comply on an ongoing basis with the MMF Regulation.

2.3 Naming convention

The use of the designation 'MMF' or any other term that suggests that a fund shares the characteristics of MMFs, should be prohibited unless that fund is authorised as an MMF by the Authority.

2.4 Valuation methodology and sponsoring entities

The changes brought about by the MMF Regulation include restrictions on the composition of the portfolio and the valuation methodology of the underlying assets. It is to be achieved by ensuring diversification and high credit quality instruments. The MMF Regulation moreover provides for common standards to increase the liquidity of funds which is crucial in the case of unexpected redemption requests. The MMF Regulation reinforces the need for the fund managers to know the investors and to provide them with information on a constant basis. Moreover, it explicitly prohibits MMFs from obtaining support from third party sponsoring entities, including credit institutions.

2.5 Reporting to Competent Authorities

MMFs are required to report to the MFSA the information stipulated in Article 37(2) of the MMF Regulation. MMFs whose Assets under Management (AuM) is lower than EUR 100 million should report on an annual basis, whilst MMFs whose AuM is higher than this threshold should report on a quarterly basis. The reporting format is expected to be in XML mark-up language and the relevant templates and the precise requirements and the reporting deadlines will be communicated at a later date.

2.6 Portfolio composition

To reduce the portfolio risk of MMFs, it is important to set maturity limitations, providing for a maximum allowable weighted average maturity (WAM) and weighted average life (WAL). In this regard, the new Regulation sets out a number of requirements which a standard MMFs shall comply with on an ongoing basis, *including:*

(a) all times a WAM of no more than 6 months;
(b) at all times a WAL of no more than 12 months, subject to additional criteria set in Article 25 of the MMF Regulation;
(c) at least 7.5% of fund's assets shall be comprised of daily maturing assets, reverse repurchase agreements which can be terminated by giving prior notice of one working day or cash which can be withdrawn by giving prior notice of one working day. A standard MMF is not to acquire any asset other than a daily maturing asset when such acquisition would result in that MMF investing less than 7.5% of its portfolio in daily maturing assets;
(d) at least 15% of fund's assets are to be comprised of weekly maturing assets, reverse repurchase agreements which can be terminated by giving prior notice of five working days or cash which can be withdrawn by giving prior notice of five working days. A standard MMF should acquire

any asset other than a weekly maturing asset when such acquisition would result in that MMF investing less than 15% of its portfolio in weekly maturing assets. Additional conditions regarding to the calculation under this point shall apply to money market instruments or units or shares of other MMFs.

3.0 Stress tests scenarios

The Regulation, supported by the ESMA Guidelines on stress tests scenarios under Article 28 of the MMF Regulation, introduces the stress testing exercise to be conducted by MMFs. As part of prudent risk management, MMFs should, at least bi-annually, conduct stress testing to identify possible events or future changes in economic conditions which could have unfavourable effects on the MMF. The UCITS ManCos and/or the AIFMs of the respective MMF are expected to take appropriate and timely remedial action whenever the results of stress testing indicate vulnerabilities.

The MMF or its Manger shall assess the possible impact that those events or changes could have on the MMF, taking into account various possible scenarios. The stress tests shall be based on objective criteria and consider the effects of severe plausible scenarios.

3.1 Reporting obligations

The Board of Directors of an MMF, or where applicable, the Board of Directors of the Fund Manager shall determine the frequency of the stress tests which in any event shall not be less than bi-annual. In line with Article 37 of the MMF Regulation, where the stress test reveals any vulnerability of the MMF, the Fund Manager shall draw up an extensive report with the results of the stress testing and a proposed action plan which shall then be submitted to the MFSA. The applicable deadlines to submit the report and, where applicable, the proposed action plan to the MFSA will be communicated at a later date with the Reporting Requirements stated in Section 2.5 above. The extensive report and the action plan shall be kept by the MMF for a period of at least 5 years.

3.2 ESMA Guidelines on stress testing

On 21 March 2018, the European Securities and Markets Authority (ESMA) issued Guidelines establishing common reference parameters for the stress test scenarios to be included in a MMF's stress tests. The Authority advises the Board of Directors of MMFs and the relevant UCITS ManCos and AIFMs to carefully consider these Guidelines, which can be accessed at:
https://www.esma.europa.eu/document/guidelines-stress-tests-scenarios-under-article-28-mmf-regulation

MMFs are required to comply with these Guidelines by 21 January 2019. Failure to comply with the said Guidelines will be considered as a breach of licensing conditions.

ESMA Guidelines, which are to be updated at least every year taking into account the latest market developments, provide common reference parameters of the stress test scenarios to be included in the stress tests taking into account the below factors.

The Guidelines shall be updated in a manner allowing the MMFs Managers to access information needed to fill in the corresponding fields in the reporting template in line with provisions of Article 37 of the MMF Regulation. This information will include specifications on the type of the stress tests and their calibration, as well as the way to report the results to the MFSA.

3.3 Reference parameters

It is essential that the impact of the various factors leading to hypothetical severe scenarios should be taken into consideration in stress testing exercise. The common reference parameters foreseeing hypothetical changes should be included in stress testing should be based on the following factors:

(a) impact on the portfolio or net asset value of the MMF,
(b) impact on the minimum amount of liquid assets,
(c) impact on the ability of the manager of the MMF to meet investors' redemption requests,
(d) impact on the ability of the manager to comply with the different diversification rules
(e) impact on the difference between the constant NAV per unit or share and the NAV per unit or share - *for public debt CNAV MMFs and LVNAV MMFs only.*

4.0 Applicable timeline

Date	Action	MMFR Article / Hyperlink
20 July 2017	Entry into force of the MMF Regulation	Article 11(4) Article 15(7) Article 22 Article 37(4)
21 July 2018	Entry into force of the MMF Regulation	Full Regulation except for above-stated Articles
13 November 2017	Final Report on Technical advice, draft implementing technical standards and guidelines under the MMF Regulation	https://www.esma.europa.eu/sites/default/files/library/esma34-49-103_final_report_on_mmf_cp.pdf
21 January 2018 (not yet applicable)	European Commission's Delegated Act on Money Market Funds Regulation specifying quantitative and qualitative liquidity requirements applicable to assets received as part of a reverse repurchase agreement	https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2018-245681_fr

	and on credit quality assessment	
21 March 2018	Guidelines on stress tests scenarios under Article 28 of the MMF Regulation	https://www.esma.europa.eu/sites/default/files/library/esma34-49-115_mmf_guidelines_on_stress_tests.pdf
21 July 2018 – 21 January 2019	Timeframe for existing UCITS or AIF acting as MMFs to submit to the MFSA an application, together with all documents and evidence necessary to demonstrate the compliance with the MMF Regulation	Article 44
21 July 2022	European Commission's Review Reports	Article 46

5.0 Action Required by MMF

A free format application, duly supported by the pertinent documentation as may be necessary, showing how the relevant MMF is complying with the MMF Regulation should be submitted to the Authority via e-mail on: ausecurities@mfsa.com.mt.

The deadline for this submission is 30 November 2018 to ensure compliance by 21 January 2019 in line with Article 44 of the MMF Regulation.

Contacts

Any queries or requests for clarifications in relation to this Circular are to be addressed to the following officials at the Securities and Markets Supervision Unit, MFSA by e-mail on:
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Communications Unit
Malta Financial Services Authority
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