European Money Market Fund Reform – latest update

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One on One with Barry Harbison

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Q The European Parliament's Economic and Monetary Affairs Committee was set to vote on money market fund reform proposals, but the vote has been postponed. What are the details here?

A Let's take a look at some of the background before we get to the postponed vote. As you know, the European Commission published proposed reforms for European money market funds in September 2013. The principal reform within that proposal is that constant net asset value money market funds would have to either hold a capital buffer or they would have to convert to a variable net asset value. There are a number of other reforms included in the proposal such as a prohibition on fund ratings, increased 'know your client' policies and procedures, stress testing etc, but the principal reform was the capital buffer or floating net asset value. So the process for moving those reforms towards a final rule is that the European Parliament, which is made up of elected politicians from the Member States, and the European Council, which is made up of the Heads of State or Governments of all the Member States, would separately debate the Commission's proposals and come up with their final set of rules. The Parliament and the Council then come together to reach a compromise between their final positions. The Economic and Monetary Affairs Committee of the European Parliament has been considering and debating this issue since the rules were published. However, last week, they announced that they would not be moving forward with a vote and their proposed rules before the end of the current Parliament. This means that the European Parliament – one half of the final rulemaking – will not be able to come up with their final position on money market fund reform before the Parliamentary Elections in May of this year.

Q So why the postponement?

A Essentially what they've done is postponed the vote. The Committee is still expected to vote on their final rules on this matter which they'll then present to the Parliament, however that vote will not take place until Parliament returns later this year. I think the postponement indicates that there are differing views amongst members of the Committee and, following a lengthy period of discussion and negotiation within the Committee, they could not come to a consensus on their final proposed regulation.

Q What does this mean for money market fund investors in Europe?

A The delay doesn't have any direct or immediate impact on investors in a European-based money market fund. The delay relates to possible future regulations. The existing rules governing mutual funds, and money market funds in particular in Europe, remain in place, and funds continue to be governed and managed according to those rules.

Q Do you think that the postponement makes it more likely that reforms will not be enacted?

A I don't think that we can infer from this delay that no further reforms would be enacted in Europe. Certainly, the regulatory bodies and politicians in Europe remain committed to solving the perceived issues of run risk in money market funds and the potential knock-on effects of those run risks within the wider economy. Likewise, the money market fund industry in Europe remains committed to engaging on this topic and ensuring regulators and investors understand the implications of some of the proposed reforms. I think what we can take from this postponement and this delay is that there is now more time for those discussions to continue.

Q Assuming this is brought up again in the next Parliament, what are the steps – and I assume there are multiple steps – that need to be taken in order for this to become law?

A There are the Parliamentary elections in May this year and once those elections are concluded and Parliament sits again in July, they will then have to appoint members to the various committees within the Parliament, including the Economic and Monetary Affairs Committee which is looking at the proposed money market fund reforms. That means there may well be some new faces and different points of view on that committee, which could then shape the outcome of the final rules put to Parliament.

As mentioned previously, the European Council then must come up with their version of the final rules, and enter the process to come up with the consensus final rule. Once the final rule is agreed between the Parliament and the Council, it is sent to the European Parliament where it is ratified by a vote.

Q What was the original timeline expected for adoption and, ultimately, implementation of the reforms, and how does the postponement change those expectations?

A It is difficult to gauge how the delay impacts the overall process for coming up with the final rule, and the timeline for funds to comply with this.

In terms of coming up with the final rule itself, it means that the Parliament will not be able to come up with their rule until the new Parliament is in session later this year. There is clearly a knock-on effect in delaying the other steps that we talked about previously.

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In terms of the implementation timeframe, the current proposal is that money market funds would only have six months to comply with the rules once they come into force. Given the fundamental nature of some of the changes being proposed, a six-month window may not be sufficient to allow the necessary system changes for those funds.

I think we can expect further dialogue to take place between now and the final rules being published, to come up with an implementation timeframe to allow money market funds and their service providers to be able to adapt to any new rules in a prudent manner.

Q **In the US, we're still waiting to hear from the SEC regarding US money market fund reform. Do you see any crossover effects from the European postponement?**

A I don't see any direct impact of this delay on the proposed final rule in the US. As you mentioned, the SEC Commissioners are currently considering their proposed reforms. From what we understand, they appear to be sticking to the expected timeframe to come out with final rules towards the middle of this year.

In addition, the proposed rules that the SEC are considering differ significantly from the proposed reforms in Europe. For example, there is no capital buffer being considered in the US. The SEC are considering the use of liquidity fees and redemption gates as an effective solution to halt runs in money market funds, in addition to also considering whether prime institutional funds should be forced to have a variable net asset value.

Given those differences, I am not really sure that the discord among European legislators on their proposed rules will have any direct impact on US reforms.

I think the fact that US rules are likely to be agreed before Europe decides on their final rules will be interesting to watch. Whilst I don't necessarily think that Europe will be guided in any material way by the final rules that the SEC arrive at, it will be interesting to note how any SEC decision impacts the ongoing debate within the European Parliament later this year.

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