EUROPEAN / AMERICAN MMF

Review of the new regulations
Money Market Funds - MMF

**Rationale of the investor’s choice**

**Main reasons**

1. **Daily liquidity**: same day liquidity or the day after without any penalty,

2. **Diversification**: in line with the ESMA rules, the funds have to invest in at least 6 different names with a cap of 20% per name,

3. **Risk**: investment in high quality paper (A2/P2/F2 minimum) with an external rating

4. **Depository**: need for an external depository with a strict segregation of the assets
Two types: CNAV and VNAV

CNAV price mechanism

Key differences

CNAV use the ACA methodology (Amortized Cost Accounting) on the whole of the portfolio

CNAV pay a dividend at regular periods without obligation to declare daily profit or loss due to the investments

CNAV use the « penny rounding » method making possible to keep a stable price within a +/- 50 bps range

VNAV have a MtM price with 4 decimals computation

ACA and « penny rounding » are the main risks for different international authorities (FSB, IOSCO, …)
Two structurally-different markets

US MMF
- Government MMF: 29%
- Retail MMF: 33%
- Prime Institutional MMF: 38%

European MMF

A full CNAV market of $2.600Yds

Source: IMMFA, October 2013

A market of €953 Mds€ with a split 53%/47% VNAV/CNAV

Source: IMMFA, October 2013
European CNAV investors are mainly institutional

CNAV MMF investors

- Corporates, 29%
- Mutual funds and pension funds, 19%
- Distributors (corporates, retail), 21%
- Public sector and charities, 7%
- Insurance companies, 10%
- Other financial institutions, 14%

CNAV distribution

- USD Prime MMF, 41.3%
- Europe Prime MMF, 16.5%
- Sterling Prime MMF, 27.1%
- USD Gov MMF, 14.5%
- Euro Gov MMF, 0.1%
- Sterling Gov MMF, 0.6%

Only 21% from retail

55% in US dollar
85% of Prime MMF

Source: IMMFA, October 2013
Main investments in bank papers (~90-95%)
US MMF regulations decided by the SEC in July 2014

3 types of funds

**Floating NAV MMF**
- Conversion of the existing Prime MMF
- Mark to Market valuation + 4 digits (1,0000$)

**Retail MMF**
- No change for the CNAV Retail MMF
- « fees and gates » principle and shadow price with 4 digits

**Government MMF**
- No change for the Government CNAV MMF with a minimum of 99.5% in cash or T-Bills
- No « fees and gates »

Only Prime CNAV MMF are impacted by the 2a-7 rule from SEC (38% of the US market)

Some details

« Fees and gates »:
- « Fees »: Possibility for a liquidity fee when assets less than 1 week are below 30%; Obligation below 10% (100bp)
- « Gates »: Possibility to freeze the repayment when liquid assets are below the 30% for a maximum of 10 days
  ⇒ Gates already in place in Europe for AIF and UCITS

New regulation:
- Diversification ratio at 5% maximum per group
- Stress tests mandatory and KYC policy
- More transparency

Tax:
- Tax simplification for floating NAV
- Wash sale in case of losses
Transposition of the US regulations in Europe?

Funding structure

1,061 Yds€ of eligible assets for European MMF with 62% of sovereign or supras

Source: BCE, Dec 2012

<table>
<thead>
<tr>
<th>Type</th>
<th>%</th>
<th>Total (k€)</th>
</tr>
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<tbody>
<tr>
<td>Supra</td>
<td>15%</td>
<td>154,703</td>
</tr>
<tr>
<td>Sovereign</td>
<td>47%</td>
<td>499,136</td>
</tr>
<tr>
<td>Covered</td>
<td>16%</td>
<td>172,977</td>
</tr>
<tr>
<td>Other (banks, CORPORATEs, ...)</td>
<td>22%</td>
<td>234,800</td>
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Possible risks in Europe

4 Errors to avoid

1. **Diversification**: being too strict on diversification ratios will increase the sovereign part rather than banks (38% of bank issuances are MMF).

2. **Liquidity**: the 1 wk minimum liquidity ratios at 30% may push investments to US treasuries.

3. **Gates**: gates already exist in UCITS and AIF regulations.

4. **Gvt MMF**: the European prime CNAV are 85% of the CNAV market with investments at around 90-95% in banks. Some US funds have already communicated a conversion of their Prime CNAV funds to Gvt MMF (Fidelity, Federated).

Less securitization in the European Banking system compared to the US
**ECON commission proposal**

<table>
<thead>
<tr>
<th>CNAV/VNAV</th>
<th>3 types of CNAV: Retail CNAV, Govt CNAV and LVNAV (Low volatility Net Asset Value) with ACA for investments up to 90 days, MtM above</th>
<th>2 types of VNAV: short term and standard: differences in diversification and liquidity ratios</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital buffer</td>
<td>Disparition of the capital buffer proposal</td>
<td>Obligation of liquidity fees and gates on redemption in case of market stress for the CNAV</td>
</tr>
<tr>
<td>Diversification</td>
<td>5% for a bank and 8% for a group for Short term MMF, 10% for a bank and 15% for a group for Standard MMF</td>
<td></td>
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<tr>
<td>Liquidity</td>
<td>Daily liquidity ratio at 10% and weekly at 20% for a short term or a standard VNAV</td>
<td>Daily liquidity ratio at 15% and weekly at 30% for a CNAV</td>
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ECON commission proposal

**WAM / WAL**
- WAM capped at 60 days and WAL at 120 days for Short term MMF
- WAM capped at 6 months and WAL at 12 months for Standard MMF

**Eligible assets**
- Money market papers, deposits, repo and reverse, derivatives for hedging purposes,
- Ban of other MMF parts investments
- Investment in ABS or ABCP possible but still restrictive conditions: eligible at the LCR and assets with 397 days residual maturity maximum and capped at 10% of the assets.

**Ratings**
- Ban of external ratings usage for a fund
- Obligation to have an internal rating methodology
Expected consequences

**Diversification**
- Negative for banks funding from short term MMF (5% bank / 8% group ratio)
- Positive for Govies investment

**Eligible Assets**
- Negative for ABCP/ABS due to asset duration limitation
- No possibility to invest in other MMF parts: reduction of the duration in bank papers

**Liquidity**
- Management of the funds in barbell due to 1wk ratio (30 or 20%): either very short term or investment at the WAL (120 days or 12 months)
- Very short duration due to the WAM/WAL rule: reduction of the duration in bank papers
- Initial duration for term money (cd's or deposits) for Crédit Agricole Group: 4 months in average for US MMF, 11 months in average for European MMF.

**Ratings**
- The lack of external rating may push investors to leave.
- Proposal: keep the actual framework with an obligation for an internal rating and a rotation in rating agencies.
European MMF regulation

Heavy discussions

Three sides in Europe:

- Pro VNAV: France, Germany, Spain and Italy
- Pro CNAV: Irlande, Luxembourg, UK
- Anti CNAV: mainly other countries of EU where CNAV are forbidden

The ECON commission adopted the text on February 26th:

- Compromise between CNAV and VNAV
- But, only the very first step for the adoption of the regulation

Next Steps

Vote at the European parliament on April 27th-30th session,

Vote at the European council possibly before 30th of June

Value date of the regulation?

1. If we have a positive vote at the Parliament in April: best estimate is H2 2016,

2. If we have a blocking vote at the Parliament: best estimate H1 2018