

## Box I

## NEW STATISTICAL DEFINITION OF EURO AREA MONEY MARKET FUNDS

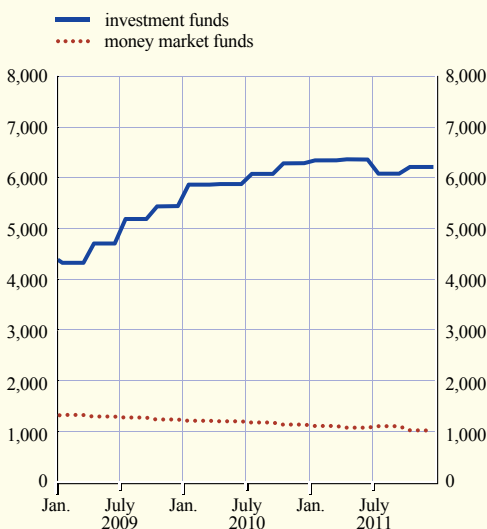
The Committee of European Securities Regulators (the predecessor of the European Securities and Markets Authority) published in May 2010 guidelines on a new, common definition of European money market funds for supervisory purposes, which is currently being implemented in most EU countries. These guidelines improve investor protection by setting out clear-cut quantitative and qualitative criteria to be applied by any fund marketing itself as a money market fund. They aim to restrict the various types of risk associated with money market funds, i.e. interest rate, liquidity, credit and credit spread risk. The Governing Council of the ECB decided in August 2011 to adopt the new European definition of money market funds also for statistical purposes by means of a regulation.<sup>1</sup> The new definition had to be implemented for the reporting of monetary financial institutions in the data collection for monetary statistics from 1 February 2012 at the latest. Against this background, this box briefly discusses the impact of the new statistical definition for monetary statistics and monetary analysis.

Money market funds represent a significant share of investment funds (see Chart A). In general, in view of the liquidity features of their shares/units and their investment strategy, money market funds are viewed by investors as a close substitute for short-term deposits. Together with the stability of principal value, i.e. redemption at nominal value, these characteristics mean that money market fund shares/units are considered as monetary assets and classified under “marketable instruments” in the broad monetary aggregate M3. Given the prominent role of money in the two-pillar monetary policy strategy of the ECB, money market fund shares/units contribute to the ECB’s analysis of risks to future price developments stemming from monetary developments.

One important feature of money is its nominal capital certainty. In the challenging business

Chart A Total assets of money market funds and investment funds (excluding money market funds) in the euro area

(EUR billions)



Source: ECB.

<sup>1</sup> See Regulation ECB/2011/12 amending Regulation (EC) No 25/2009 concerning the balance sheet of monetary financial institutions (ECB/2008/32). According to the new definition, money market funds have the primary investment objective of maintaining the principal of the fund and aim to provide a return in line with money market rates. In addition, money market funds may invest only in high-quality money market instruments. In making its investment decisions, the fund management has to take into account a broad set of factors including, but not limited to: (a) the credit quality of the instrument; (b) the nature of the instrument’s asset class; (c) inherent operational and counterparty risk for structured financial instruments; and (d) the liquidity profile. The earlier ECB regulation defined money market funds as those collective investment undertakings (i) issuing units which are close substitutes for deposits; (ii) primarily investing in (a) money market instruments, (b) money market shares/units, (c) other fungible debt instruments with a residual maturity of up to one year, and/or (d) bank deposits; and/or (iii) pursuing a rate of return that approaches the interest rates on money market instruments. The two definitions also deviate from each other in that the new criteria and thresholds apply to the entire money market fund investment portfolio, while the ECB’s former statistical criteria applied to only 85% of the investment portfolio.

environment for money market funds during episodes of the financial crisis, the nominal capital certainty of some money market fund shares/units was called into question. Funds that used innovative financial products with the aim of achieving a better risk/return profile than the majority of funds using a more traditional investment approach were particularly affected. The lack of nominal capital certainty and the unconventional characteristics of these particular funds put the business model of money market funds and their reputation as an investment class at risk. This has contributed to sizeable outflows from such funds in the course of the financial crisis. Moreover, it has hampered the substitutability of money market fund shares/units for other M3 components, thus limiting their degree of “moneyness”.

### Impact of the new definition on monetary aggregates

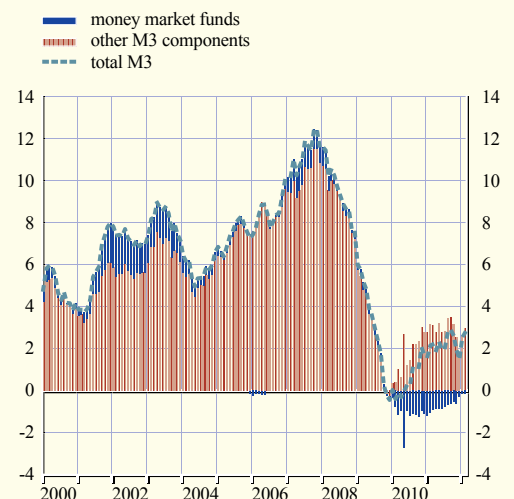
Preliminary estimates suggest that the change in the definition brought about by the new regulation significantly alters the picture of the money market fund industry in some Member States. In particular, in Ireland and Luxembourg, the redefined money market fund industry was approximately 28% and 22% smaller respectively in terms of the total net asset value. The overall impact of changes to the reporting population in the euro area amounts to a reduction of €193.7 billion (18%) of the money market fund sector’s total net asset value since July 2011.

Turning to the impact of the new definition on the monetary aggregate M3, only money market fund shares/units held by the euro area resident money-holding sector are affected. Given that in some countries, such as Ireland and Luxembourg, the change in the composition of the reporting population mainly applies to fund shares/units held by non-euro area residents and other MFIs (with MFIs being classified as part of the money-issuing sector), the impact on monetary aggregates is much smaller. The effect on the money market fund shares/units held by the euro area money-holding sector is equivalent to a reduction of only about €69 billion, corresponding to 0.7% in terms of M3 outstanding amounts in February 2012. Importantly, there has been no direct effect on M3 transactions and growth rates, as the change in the reporting population was corrected for through statistical reclassifications, shifting these funds from the money market to the investment fund sector. It should be noted, however, that, in addition to funds that have been reclassified under the investment fund sector, there are also money market funds that have adapted their investment policy in response to the new supervisory definition. This may have had a certain, albeit smaller, impact on the data, although the actual effect is difficult to disentangle from other factors that may have influenced the development of the money market fund sector, for example the low interest rate environment.

As shown in Chart B, the contribution of money market fund shares/units to the annual growth rate of M3 has been, overall, limited. Consequently, any potential distortion in the

**Chart B M3 annual growth and contributions of money market fund shares/units and other M3 components**

(annual percentage changes; contributions in percentage points)



Sources: ECB and ECB calculations.

information content of the broad monetary aggregate for monetary analysis can be regarded as small. Nevertheless, the new, more detailed and narrower definition of money market funds is warranted in order to safeguard the quality of monetary statistics for monetary policy purposes.