FINANCIAL CONDUCT AUTHORITY

Finalised Guidance

FG22/3: Finalised Guidance (non-Handbook) on parts of the UK MMF Regulation

23 May 2022

1 Background

1.1 The FCA has a general duty to supervise authorised persons and a specific duty in article 41 of the UK Money Market Funds Regulation (UK MMFR) to take appropriate measures where a Money Market Fund (MMF) manager fails to comply with certain requirements relating to portfolio composition and valuation.

1.2 This guidance relates primarily to two issues – the requirements in UK MMFR article 34(1)(a) for public debt Constant Net Asset Value (CNAV) MMFs and Low Volatility Net Asset Value (LVNAV) MMFs, and the portfolio requirements in UK MMFR articles 24 and 25 which, together, apply to all UK MMFs. Article 24 applies to short term MMFs (public debt CNAV MMFs, LVNAV MMFs and short term Variable NAV (VNAV) MMFs), and Article 25 applies to standard VNAV MMFs.

1.3 As the Financial Stability Board (FSB) noted in its October 2021 Final Report on MMF resilience, regulatory thresholds may cause investors to redeem pre-emptively to avoid the possible consequences of the fund they are invested in crossing those thresholds. For certain MMFs in some jurisdictions, if liquid assets fall below specified thresholds, managers may be able (or required) to impose a fee or gate on redemptions. This may motivate investors to carry out additional redemptions as liquid assets levels approach the thresholds. There is some evidence for this effect occurring during the March 2020 'dash for cash' market stress.

1.4 Under the UK MMFR, there are certain conditions under which managers of those MMFs permitted to run a 'stable NAV' (LVNAV or public debt CNAV MMFs) are required to impose, or consider imposing, fees or gates. There may be views in the market that under the UK MMFR, LVNAV and public debt CNAV MMFs whose liquidity falls under the 30% minimum for weekly maturing assets **must** impose fees or gates. This is **incorrect**.

1.5 This guidance also reminds market participants that as per UK MMFR articles 24 and 25, if a MMF's liquidity ceases to meet the portfolio requirements, then the MMF manager needs to prioritise the correction of that situation, taking due account of the fund investors' (unitholders) interests. When deciding remedial action, the MMF manager will need to balance the speed at which it can return the fund to a position where the relevant portfolio requirements are satisfied against investor outcomes. The guidance also notes that articles 24 and 25 also provide for and envisage that MMFs may drop below minimum liquid asset requirements due to the exercise of subscription or redemption rights, or for reasons beyond the manager's control.

1.6 Note: the UK authorities also published a discussion paper on MMF policy reform in general on 23 May 2022.

2 Guidance

Article 34 – specific liquidity requirements for public debt CNAV MMFs and LVNAV MMFs

2.1 Article 34 of the UK MMFR requires managers of public debt CNAV MMFs and LVNAV MMFs to establish, implement and consistently apply prudent and rigorous liquidity management procedures for ensuring compliance with the applicable weekly liquidity thresholds.

2.2 Article 34(1)(a) is engaged where **both** of the following apply:

(i) the MMF has less than 30% of its total assets in weekly maturing assets; *and*
(ii) the net daily redemptions on a single working day exceed 10% of total assets.

2.3 When both of these conditions are satisfied the Board of the MMF manager must immediately be informed and the Board is then required to undertake a documented assessment of the situation and to determine the appropriate course of action having regard to the investors' interests. In particular, the Board of the MMF manager is required to decide which of the following one or more measures to adopt:

(i) impose **liquidity fees** on redemptions,
(ii) impose **redemption gates** of up to 10% of the shares or units in the MMF for a period of up to 15 working days,
(iii) **suspend redemptions** in the fund for up to 15 working days, or
(iv) **take no immediate action other than fulfilling the obligation in article 24(2)** (in broad terms, this is a requirement for the MMF to adopt as a priority objective correcting the imbalance in the MMF's assets taking due account of the interests of unitholders – see below).

2.4 So where article 34(1)(a) is engaged, the MMF manager of a public debt CNAV MMF or LVNAV MMF must take a decision on which measure(s) to implement, but has discretion about which of them to apply. Aside from complying with the obligation in article 24(2) (which is a free-standing obligation – see below), the MMF manager is not required to take any other immediate action such as imposing liquidity fees on redemptions, imposing redemption gates or suspending redemptions in the MMF.

Articles 24 and 25 - Portfolio rules for MMFs

2.5 Managers of short-term MMFs (stable NAV and short-term VNAV MMFs) are required to comply with article 24(2) whenever the relevant portfolio requirements are no longer met (for example, where the assets of stable NAV MMFs comprise of less than 30% of weekly maturing assets). Article 25(2) makes similar provision where 'standard' VNAV MMFs breach the portfolio requirements specified in article 25.

2.6 Articles 24(2) and 25(2) provide for and envisage that MMFs may drop below the limits set out, including the minimum liquid asset requirements, due to the exercise of subscription or redemption rights, or for reasons beyond the manager's control.

2.7 Under article 24(2) and article 25(2), MMF managers must make correcting a situation in which the MMF is no longer meeting the relevant portfolio requirements a 'priority objective', while (as the articles state) also taking due account of the interests of unitholders. To take due account of the interests of unitholders, the FCA would expect in particular an MMF manager to consider its obligations to act in the best interests of the MMF and the MMF unitholders, and to treat them fairly (see COLL 6.6A.2R (Duties of Authorised Fund Managers of UCITS schemes to act in the best interests of the scheme and its unitholders) and COBS 2.1.4R (Alternative Investment Fund Managers' best interests rules)).

2.8 If in the circumstances the MMF manager considers that the interests of unitholders are best served by taking actions which do not result in the MMF achieving the quickest possible correction (of a situation in which the MMF is not meeting the relevant portfolio requirements), the MMF manager may consider taking those actions instead. For example, a way in which an MMF manager might seek to correct an imbalance in the MMF's portfolio, in the shortest time period, could be to suspend dealing in the fund (if it is permitted to do so); another way could be to impose redemption gates (again, if permitted). However, rather than returning to the relevant portfolio requirements as quickly as possible by suspending the fund or imposing redemption gates, there may be other ways of rebalancing the MMF's portfolio which might better serve the interests of unitholders.

2.9 The FCA is not seeking to change the requirements of the UK MMFR or any other rules and law applying to MMFs authorised under UK MMFR with this guidance. For example, this guidance does not affect the requirements in article 34(1)(b) for the manager of public debt CNAV MMFs and LVNAV MMFs to take one of the specified actions where the level of weekly maturing assets falls below 10% of total assets. And the managers of such funds, if dealing in the fund at par, need to stop doing so whenever the relevant circumstances set out in the UK MMFR arise.

2.10 An MMF manager should act in the best interests of the unitholders and take whatever permitted action is necessary to do so. This may include use of a liquidity management tool such as liquidity fees (also known as anti-dilution levies). In certain circumstances, the interests of unitholders may be best served by suspending dealing in units of the MMF, or similar.

3 References – UK MMF Regulation (UK MMFR)

MMFR Article 34

Specific requirements for public debt CNAV MMFs and LVNAV MMFs

1. The manager of a public debt CNAV MMF or of a LVNAV MMF shall establish, implement and consistently apply prudent and rigorous liquidity management procedures for ensuring compliance with the weekly liquidity thresholds applicable to such funds. The liquidity management procedures shall be clearly described in the fund rules or instruments of incorporation, as well as in the prospectus.

In ensuring compliance with the weekly liquidity thresholds, the following shall apply:

(a) whenever the proportion of weekly maturing assets as set out in point (e) of Article 24(1) falls below 30 % of the total assets of the public debt CNAV MMF or of the LVNAV MMF and the net daily redemptions on a single working day exceed 10 % of total assets, the manager of the public debt CNAV MMF or of the LVNAV MMF shall immediately inform its board thereof and the board shall undertake a documented assessment of the situation to determine the appropriate course of action having regard to the interests of the investors and shall decide whether to apply one or more of the following measures:

(i) liquidity fees on redemptions that adequately reflect the cost to the MMF of achieving liquidity and ensure that investors who remain in the fund are not unfairly disadvantaged when other investors redeem their units or shares during the period;

(ii) redemption gates that limit the amount of shares or units to be redeemed on any one working day to a maximum of 10 % of the shares or units in the MMF for any period up to 15 working days;

(iii) suspension of redemptions for any period up to 15 working days; or

(iv) take no immediate action other than fulfilling the obligation laid down in Article 24(2); [*see below*.]

(b) whenever the proportion of weekly maturing assets as set out in point (e) of Article 24(1) falls below 10 % of its total assets, the manager of a public debt CNAV MMF or of a LVNAV MMF shall immediately inform its board thereof and the board shall undertake a documented assessment of the situation and, on the basis of such assessment and having regard to the interests of the investors, shall apply one or more of the following measures and document the reasons for its choice:

(i) liquidity fees on redemptions that adequately reflect the cost to the MMF of achieving liquidity and ensure that investors who remain in the fund are not unfairly disadvantaged when other investors redeem their units or shares during the period;

(ii) a suspension of redemptions for a period of up to 15 working days.

2. When, within a period of 90 days, the total duration of the suspensions exceeds 15 days, a public debt CNAV MMF or a LVNAV MMF shall automatically cease to be a public debt CNAV MMF or a LVNAV MMF. The public debt CNAV MMF or the LVNAV MMF shall immediately inform each investor thereof in writing in a clear and comprehensible way.

3. After the board of the public debt CNAV MMF or of the LVNAV MMF has determined its course of action with regard to both points (a) and (b) of paragraph 1, it shall promptly provide details of its decision to the FCA.

MMFR Article 24

Portfolio rules for short-term MMFs

1. A short-term MMF shall comply on an ongoing basis with all of the following portfolio requirements:

(a) its portfolio is to have a WAM of no more than 60 days;

(b) its portfolio is to have a WAL of no more than 120 days, subject to the second and third subparagraphs;

(c) for LVNAV MMFs and public debt CNAV MMFs, at least 10 % of their assets are to be comprised of daily maturing assets, reverse repurchase agreements which are able to be terminated by giving prior notice of one working day or cash which is able to be withdrawn by giving prior notice of one working day. A LVNAV MMF or public debt CNAV MMF is not to acquire any asset other than a daily maturing asset when such acquisition would result in that MMF investing less than 10 % of its portfolio in daily maturing assets;

(d) for a short-term VNAV MMF, at least 7,5 % of its assets are to be comprised of daily maturing assets, reverse repurchase agreements which are able to be terminated by giving prior notice of one working day, or cash which is able to be withdrawn by giving prior notice of one working day. A short-term VNAV 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;

(e) for LVNAV MMFs and public debt CNAV MMFs, at least 30 % of their assets are to be comprised of weekly maturing assets, reverse repurchase agreements which are able to be terminated by giving prior notice of five working days or cash which is able to be withdrawn by giving prior notice of five working days. A LVNAV MMF or public debt CNAV MMF is not to acquire any asset other than a weekly maturing asset when such acquisition would result in that MMF investing less than 30 % of its portfolio in weekly maturing assets;

(f) for a short-term VNAV MMF, at least 15 % of its assets are to be comprised of weekly maturing assets, reverse repurchase agreements which are able to be terminated by giving prior notice of five working days, or cash which is able to be withdrawn by giving prior notice of five working days. A short-term VNAV MMF is not to 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;

(g) for the purpose of the calculation referred to in point (e), assets referred to in Article 17(7) which are highly liquid and can be redeemed and settled within one working day and have a residual maturity of up to 190 days may also be included within the weekly maturing assets of a LVNAV MMF and public debt CNAV MMF, up to a limit of 17,5 % of its assets;

(h) for the purpose of the calculation referred to in point (f), money market instruments or units or shares of other MMFs may be included within the weekly maturing assets of a short-term VNAV MMF up to a limit of 7,5 % of its assets provided they are able to be redeemed and settled within five working days.

For the purposes of point (b) of the first subparagraph, when calculating the WAL for securities, including structured financial instruments, a short-term MMF shall base the maturity calculation on the residual maturity until the legal redemption of the instruments.

However, in the event that a financial instrument embeds a put option, a short-term MMF may base the maturity calculation on the exercise date of the put option instead of the residual maturity, but only if all of the following conditions are fulfilled at all times:

(i) the put option is able to be freely exercised by the short-term MMF at its exercise date;

(ii) the strike price of the put option remains close to the expected value of the instrument at the exercise date;

(iii) the investment strategy of the short-term MMF implies that there is a high probability that the option will be exercised at the exercise date.

By way of derogation from the second subparagraph, when calculating the WAL for securitisations and ABCPs, a short-term MMF may instead, in the case of amortising instruments, base the maturity calculation on one of the following:

(i) the contractual amortisation profile of such instruments;
(ii) the amortisation profile of the underlying assets from which the cash-flows for the redemption of such instruments result.

2. If the limits referred to in this Article are exceeded for reasons beyond the control of an MMF, or as a result of the exercise of subscription or redemption rights, that MMF shall adopt as a priority objective the correction of that situation, taking due account of the interests of its unit holders or shareholders.

3. All MMFs referred to in Article 3(1) of this Regulation may take the form of a short-term MMF.

MMFR Article 25

Portfolio rules for standard MMFs

1. A standard MMF shall comply on an ongoing basis with all of the following requirements:

(a) its portfolio is to have at all times a WAM of no more than 6 months;

(b) its portfolio is to have at all times a WAL of no more than 12 months, subject to the second and third subparagraphs;

(c) at least 7,5 % of its assets are to 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 its 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 is not to 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;

(e) for the purpose of the calculation referred to in point (d), money market instruments or units or shares of other MMFs may be included within the weekly maturing assets up to 7,5 % of its assets provided they are able to be redeemed and settled within five working days.

For the purposes of point (b) of the first subparagraph, when calculating the WAL for securities, including structured financial instruments, a standard MMF shall base the maturity calculation on the residual maturity until the legal redemption of the instruments. However, in the event that a financial instrument embeds a put option, a standard MMF may base the maturity calculation on the exercise date of the put option instead of the residual maturity, but only if all of the following conditions are fulfilled at all times:

(i) the put option is able to be freely exercised by the standard MMF at its exercise date;
(ii) the strike price of the put option remains close to the expected value of the instrument at the exercise date;
(iii) the investment strategy of the standard MMF implies that there is a high probability that the option will be exercised at the exercise date.

By way of derogation from the second subparagraph, when calculating the WAL for securitisations and ABCPs, a standard MMF may instead, in the case of amortising instruments, base the maturity calculation on one of the following:

(i) the contractual amortisation profile of such instruments;
(ii) the amortisation profile of the underlying assets from which the cash-flows for the redemption of such instruments result.

2. If the limits referred to in this Article are exceeded for reasons beyond the control of a standard MMF or as a result of the exercise of subscription or redemption rights, that MMF shall adopt as a priority objective the correction of that situation, taking due account of the interests of its unit holders or shareholders.

3. A standard MMF shall not take the form of a public debt CNAV MMF or a LVNAV MMF.