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Coming Soon: Clarity on European Money Market Reform

European Union regulators have indicated that they will communicate their proposed changes to money market fund (MMF) regulations in the coming months. This document briefs investors on the process ahead.

Background

Market stress in March 2020 exposed shortcomings in existing regulations governing money market funds. In brief, at the start of the COVID-19 pandemic, institutional money funds experienced heavy redemptions, accompanied by a liquidity mismatch in the short-term funding markets. A review by the Financial Stability Board (FSB) found that rules enacted following the 2008-2009 financial crisis may have contributed to the volatility.

For instance, FSB determined that minimum liquidity thresholds — and accompanying fees, gates and/or pricing implications — "may have caused investors to pre-emptively redeem," regardless of whether funds held ample liquidity to meet redemptions. Meanwhile, in an effort to remain above the regulatory liquidity thresholds, portfolio managers sold less-liquid assets. In some cases, this caused net asset value (NAV) fluctuations that led to losses, fed stress in the short-term markets, and exacerbated volatility.[1]

Status of Reforms in Europe

The FSB issued its final report examining the volatility and proposing reforms in October 2021. The report called for global action, but recognized that individual jurisdictions need flexibility to tailor measures to their specific circumstances. Regulators in key countries are now evaluating the report, and are considering adopting some or all of the reforms, with the goal of improving MMF resilience.

In Europe, three reports will be released in 2022. The findings and recommendations within these reports will need to be reviewed before any reform will be enacted. The European Securities and Markets Authority (ESMA) and the European Systemic Risk Board (ESRB) will each publish its analysis and recommendations, based on the FSB report and a 2021 consultation FSB held with market participants. Finally, the European Commission will consider the proposed reforms.

In the longer term, there will be other international processes that could impact MMF regulation. By the end of 2023, the FSB and the International Organization of Securities Commissions (IOSCO) are slated to complete a stocktake of measures undertaken by member jurisdictions, and in 2026 they will review the effectiveness of those measures. Meanwhile, in light of the FSB report, IOSCO also plans to revisit its 2012 Policy Recommendations for MMFs, which were the basis for the last round of reforms, enacted following the financial crisis. Finally, in response to feedback gathered during the public consultation, the FSB and IOSCO intend to carry out follow-up work, complementing MMF reforms, to enhance the functioning and resilience of short-term funding markets.

The MMF industry has pushed back on some of FSB's policy options, to ensure that the reforms are in the best interest of investors. For instance, the industry is concerned that swing pricing may be difficult to administer, and may introduce "cliff-effect" risks similar to those attributed to fees and gates in March 2020.

For the moment, however, FSB emphasizes that all policy options should be considered by member countries. It has retained swing pricing as a policy option, but has made its recommendation more flexible by referencing swing pricing or economically equivalent measures.

State Street Global Advisors Role

We submitted feedback during the FSB's consultative process, and we continue to track the process closely in order to promote a favorable outcome and keep investors informed of the developments.

If you have additional questions, please feel free to contact your State Street Global Advisors' sales representative.

Endnote

1 Financial Stability Board, "Policy Proposals to Enhance Money Market Fund Resilience," 11 Oct. 2021, https://fsb.org/wp-content/uploads/P300621.pdf.

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