HM Treasury

Money Market Funds Framework

Policy Note

December 2023

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Contents

Chapter 1	**Context**	**6**
Chapter 2	**Purpose**	Error! Bookmark not defined.
Chapter 3	**Policy Background**	**8**
Chapter 4	**Summary of the Statutory Instrument**	**10**
Chapter 5	**Stakeholders**	**14**
Chapter 6	**Next Steps**	**15**
Chapter 7	**Further Information**	**16**

Chapter 1
Context

1.1 This statutory instrument (SI) is part of HM Treasury's programme to build a Smarter Regulatory Framework (SRF) for financial services which is tailored to the UK.

1.2 The Financial Services and Markets Act 2023 repeals retained EU law (REUL) relating to financial services. This enables the government to deliver a Smarter Regulatory Framework for financial services. Retained EU law will be repealed and replaced with rules set by our independent and expert regulators, operating within a framework set by government and Parliament.

1.3 As well as setting the UK regulatory framework for financial services, legislation will also govern how the UK interacts with financial services regimes in overseas jurisdictions. Where relevant, legislation that covers overseas regimes will enable the government to recognise the regulatory approach of an overseas jurisdiction for specific purposes.

1.4 The government is publishing a near final version of this SI, alongside an explanatory policy note. The government welcomes any technical comments on the draft SI by **24th January 2024.**

Chapter 2
Purpose

2.1 The note sets out the policy background for the regulation of Money Market Funds, a summary of the policy intent and how this is achieved by the statutory instrument, how stakeholders are likely to be impacted and how to comment on the SI.

2.2 This publication is the near-final version of this SI. It is being published for technical checks, such as any significant errors or oversights in the legal drafting that would mean that the SI would not achieve the desired outcomes explained in this note, or that would lead to significant unintended consequences.

2.3 The draft instrument is still in development. Whilst the policy approach in this area is settled, the drafting approach, and other technical aspects of the proposal, may change before the final instrument is laid before Parliament.

Chapter 3
Policy Background

What did any law do before the changes made by this instrument?

3.1 The Money Market Funds Regulation (MMFR) derives from EU law which became retained EU law following the UK's departure from the EU. It set requirements for Money Market Funds (MMFs) and is repealed by the Financial Services and Markets Act 2023, subject to commencement.

3.2 MMFs are collective investment undertakings or collective investment schemes which typically invest in short-term assets including government or corporate debt, and aim to provide returns in line with money market rates or preserve their value. MMFs are often used in the UK by local government, institutional investors (e.g. pension funds and insurers) and businesses as an alternative to bank deposits.

3.3 The MMFR came into force in the UK and EU in 2017 after events during the financial crisis shed light on features of MMFs that make them vulnerable when there are difficulties in financial markets, and their ability to spread or amplify risks throughout the financial system. It set a common framework for MMF regulation across European member states to avoid divergences in essential investor and financial stability protections which could distort the market.

3.4 MMFR requires funds which call themselves MMFs or have MMF-like characteristics to become authorised as MMFs by the Financial Conduct Authority (FCA). This includes unauthorised Alternative Investment Funds, for which the MMFR included a route to become authorised as MMFs. Provisions inserted via the Financial Services and Act 2021 also allow for certain overseas MMFs to be established, marketed or managed in the UK without UK authorisation, where they fall within the overseas MMF regime, or where they currently have, or have had temporary recognition to market into the UK.

3.5 MMFR defines three types of MMF which are subject to regulation: Variable Net Asset Value (VNAV) fund, Low Volatility Net Asset Value (LVNAV) fund, and Public Debt Constant Net Asset Value (PD CNAV). The regulations then set out requirements for how these MMFs should be valued and what assets they are permitted to hold.

3.6 The MMFR also sets requirements on MMF portfolio composition, eligible assets, their maturity, liquidity and diversification, as well as on the credit quality of issuers and of money market instruments.

3.7 In October 2021 the Financial Stability Board issued a report setting out policy proposals to enhance the resilience of MMFs with the expectation that members review and address MMF vulnerabilities in their jurisdiction in line with the proposals. As a first step towards this, the FCA and Bank of England issued a joint discussion paper in May 2022 on strengthening MMF resilience. Detailed firm-facing requirements for MMFs will sit in the FCA's rulebook. The FCA have simultaneously issued a consultation on the rules to apply to MMFs. .

Chapter 4
Summary of Statutory Instrument

4.1 This SI replaces retained EU law related to MMFs and creates a new framework governing their regulation. The areas not restated will be broadly replicated in rules by the FCA, the financial services regulator responsible for the regulation of funds including MMFs.

What does the policy instrument do?

4.2 This instrument provides the replacement framework for MMFR, the repeal of which will be commenced in a separate SI. The changes made through the SI to the MMF framework are limited. Where necessary, the FCA will be provided with further rule-making powers to make detailed firm-facing rules. The FCA is consulting on their new rules alongside the publication of this SI. The SI also makes a number of consequential amendments to ensure the accuracy of the statute book.

4.3 The new legislative framework for MMF regulation sets out:

- **The permitted types of MMF-** The instrument requires that MMFs be one of three types: Low Volatility Net Asset Value (LVNAV), Variable Net Asset Value (VNAV), or Public Debt Constant Net Asset Value (PD CNAV). These three types permit the MMF to be valued in a certain way and to hold certain asset types. The definitions of these terms will be fully set out in the FCA's rules for MMFs, which they are consulting on alongside this instrument. There has been no policy change to the definitions, although there are some minor tweaks to reflect the deletion of EU law and the definitions will be fixed at the point the SI is laid.
- **The requirement for MMFs to be authorised or approved-** The instrument sets out that, in order to establish, market or manage an MMF in the UK, an MMF will need to be:
    - a fund which is authorised by the FCA as an MMF -to note this will be limited to funds which are Authorised Unit Trusts, Authorised Contractual Schemes or Open Ended Investment Companies; or
    - an approved MMF within the overseas regime.
    - For EU funds which are currently or were previously marketing under one of the Temporary Marketing Permissions Regime, there will be a transitional provision

allowing them to continue to be established, managed or marketed in the UK until the end of 2027.

- **The liability of MMF managers-** The instrument sets out that MMF managers are liable for breaches of the requirements set within it, in any legislation made under it, or the FCA's MMF rules.
- **The regime for approving overseas MMFs-** The instrument provides for determinations to be made by the Government which will enable MMFs from overseas jurisdictions to market into the UK, provided they register with the FCA under either section 271A FSMA (where applicable), section 272 of FSMA, or the UK's National Private Placement Regime.
- **The treatment of unauthorised AIF MMFs-** The instrument ensures that existing funds which are not one of the three types of UK authorised funds but are UK authorised specifically as MMFs continue to be permitted to be established, managed, and marketed in the UK. It does so by considering such funds to fall within the general definition of authorised MMFs. It also provides FCA rulemaking powers to extend their rules applying to other UK authorised MMFs to these funds.
- **The reporting requirements for MMFs-** The instrument provides the FCA powers to require reporting from UK and approved overseas MMFs, in line with current requirements.

4.4 The instrument will also include the FCA's general supervision and enforcement powers in relation to MMFs. However, these are not included in the published draft as they are being considered as part of wider approaches to supervision and enforcement under the SRF.

What will change in comparison to the previous REUL provisions?

4.5 The majority of the legislative framework will remain the same as under MMFR. Responses to the May 2022 FCA and Bank of England Discussion Paper on MMFs demonstrated that industry did not see the benefit of widespread reforms in this area. However, this instrument will deliver the following limited reforms when it replaces the existing MMFR:

- No longer permitting unauthorised Alternative Investment Funds to become authorised as MMFs. The MMFR previously had a route for unauthorised Alternative Investment Funds to become authorised as MMFs. This route is very rarely used and adds considerable complexity to the MMF regime. Existing funds that have used this route in the past will continue to be treated as authorised MMFs and will be subject to the FCA's rules for authorised MMFs.

- Deleting certain passporting provisions, subject to a transitional period. In 2021, the Government introduced a route allowing MMFs to be established, managed or marketed in the UK, where they had previously been passporting into the UK and had temporary marketing permissions, or had previously had temporary marketing permissions and were now marketing under section 272 FSMA or the UK's National Private Placement Regime. This route is not included in the SI, with the intention that, in future, all overseas MMFs must be from an equivalent overseas jurisdiction in order to market in the UK. To ensure no cliff edge risks, the SI includes a transitional provision to ensure this route remains operational until the end of 2027.
- Makes changes to the overseas MMF regime. This SI makes a number of changes to the overseas regime for approving MMFs to allow them to market into the UK. The Treasury can make a determination in respect of a jurisdiction if this determination meets three policy outcomes:
    - protecting the financial integrity or stability of the financial markets of the United Kingdom;
    - promoting effective market competition for consumers; and
    - facilitating the competitiveness of the United Kingdom.
- In deciding whether the above policy outcomes would be met, the legislation requires the Treasury to take into account key elements of the regulatory approach used in the relevant overseas jurisdiction. The legislation would also provide government with an explicit power to impose conditions on incoming funds as a part of its determination. This is in line with the Government's policy (as set out in the Guidance Document for the UK's Equivalence Framework for Financial Services, published in November 2020) that determinations may, in some circumstances, be made on a conditional basis

What will not change in comparison to the previous REUL provisions?

4.6 In the majority of areas, the SI makes no changes to the existing legislative framework:

- **The definition of MMF and the scope of the regime.** This remains the same as that under the MMFR.
- **The three permitted forms an MMF may take**. The policy instrument continues to state that MMFs can only be one of three types. Responses to the FCA's discussion paper indicated all three types of funds provide significant investor utility, as their stable price allows them to be treated like cash.

- **The requirement for MMFs to be authorised or approved**. The instrument continues to require MMFs to be authorised or approved under the overseas MMF regime, with some changes to the scope of which funds can be deemed authorised, as set out above.
- **The liability of MMF managers.** MMF managers will continue to be liable for breaches of MMF requirements. This means that MMF investors, including business will continue to have the ability to sue MMF managers for breaches of requirements. This is in contrast to other areas of financial services regulation where only persons can sue for breaches of requirements.

What are the firm facing impacts going to be?

4.7 This SI will predominantly impact the managers of MMFs and their investors. However, changes to the existing legislative framework are limited. There are limited impacts for some individual firms as listed below.

4.8 Managers of unauthorised AIFs currently authorised as MMFs: Unauthorised AIFs will no longer be able to be authorised as MMFs. However, any funds currently using this route will, in perpetuity - subject to complying with regulatory obligations - be treated as though they are authorised MMFs, and subject to the same legislative framework, limiting the impact of this change.

4.9 Managers of EEA MMFs currently, or previously, marketing under the TMPR: In future, these funds will be required to market to the UK using the overseas MMFs regime. However, the SI introduces a transitional regime with the aim of avoiding cliff-edge risks.

4.10 The remaining parts of the retained EU law in this area will be repealed, to be replaced with regulator rules where the FCA considers it appropriate. Alongside this draft SI and policy note, the FCA is publishing a consultation on their draft rules for Money Market Funds.

Chapter 5
Stakeholders and Contact

5.1 The policy set out in this note is now predominantly settled.

Comments on this SI

5.2 HM Treasury will consider technical comments on this draft statutory instrument, focused on any changes that need to be made to this draft instrument to achieve the policy intent set out in section four of this policy note.

5.3 Any comments should be provided to MMFLegislationFeedback@hmtreasury.gov.uk by 24th January 2024.

Chapter 6
Next Steps

6.1 HM Treasury will consider the responses and set out a timeline for laying once responses have been received and considered.

6.2 This legislation will commence at the same time as the FCA makes new rules.

Chapter 7

Further Information

7.1 Read HM Treasury's **Policy statement – Building a smarter financial services framework for the UK**

HM Treasury contacts

This document can be downloaded from www.gov.uk

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