



European Securities and
Markets Authority

Final Report

ESMA opinion on the review of the Money Market Fund Regulation





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1 Executive Summary

Reasons for publication

The Money Market Fund Regulation (2017/1131) (MMF Regulation) provides that “by 21 July 2022, the Commission shall review the adequacy of this Regulation from a prudential and economic point of view, following consultations with ESMA”.

The COVID-19 crisis has been challenging for MMFs. A number of EU MMFs faced significant liquidity issues during the period of acute stress in March 2020 with large redemptions from investors on the liability side, and a severe deterioration of liquidity of money market instruments on the asset side.

At international level, several workstreams have assessed the situation faced by MMFs during this crisis, and which policy options should be considered in order to address the issues which have been observed, and potentially enhance further the reforms on MMFs adopted following the 2008 financial crisis.

In the EU context, the ESMA work takes the form of an assessment of the functioning and potential need for amendment of the regulatory framework applicable to MMFs in the EU, which is the MMF Regulation and its implementing measures.

Following the publication of a consultation document¹, this final report contains in annex I the ESMA opinion² which outlines proposals on the review of the MMF Regulation, as well as in annex IV the quantitative input to the Commission for the purpose of its review.

Contents

Section I explains the background to the ESMA proposals on the review of the MMF Regulation.

Annex I contains the ESMA Opinion on the review of the MMF Regulation.

Annex II contains the Feedback statement from the consultation document on the review of the MMF Regulation, that ESMA published while developing the present Final report.

Annex III contains the advice of the Securities and Markets Stakeholder Group.

Annex IV contains the ESMA quantitative input on the MMF sector³.

Next Steps

Following the receipt of the ESMA Opinion, the European Commission will review the adequacy of the MMF Regulation as foreseen in its review clause.

2 Overview

1. This final report is the outcome of the work that ESMA has conducted on the reforms of the EU MMF regulatory framework that should be envisaged in light of the lessons learnt from the difficulties faced by MMFs during the COVID-19 crisis in March 2020, in the context of the upcoming review of the MMF Regulation, to be launched by the European Commission later in 2022.
2. Article 46 of the MMF Regulation specifies that “[b]y 21 July 2022, the Commission shall review the adequacy of this Regulation from a prudential and economic point of view, following consultations with ESMA and, where appropriate, the ESRB, including whether changes are to be made to the regime for public debt CNAV MMFs and LVNAV MMFs”.
3. The COVID-19 crisis has been challenging for MMFs. A number of EU MMFs faced significant liquidity issues during the period of acute stress in March 2020 with large redemptions from investors on the liability side and a severe deterioration of liquidity of money market instruments on the asset side. This was particularly the case for some of the Low Volatility Net Asset Value (LVNAV) MMFs in USD and some Variable Net Asset Value (VNAV) MMFs in EUR, which were both mainly exposed to money market instruments issued by financial institutions (Commercial Paper – ‘CP’- and Certificate of Deposits- ‘CD’). Although no EU MMF suspended redemptions or used liquidity fees on redemptions and redemption gates, the crisis calls for further work on the resilience of the EU MMF industry as well as underlying money markets, following recent regulatory reforms.
4. In that context, at international level, several workstreams have assessed the situation faced by MMFs during the crisis, and which policy options should be considered in order to address the issues which have been observed and any remaining vulnerabilities. This aimed at potentially enhancing further the reforms adopted following the 2008 financial crisis, which have focused, regarding MMF, on credit risks and risks of runs. This is the case in particular at the FSB, which published its final report on policy proposals to enhance MMF resilience in October 2021⁴, IOSCO⁵ and ESRB, which have published an issues note on systemic vulnerabilities of MMFs and preliminary policy considerations to reform MMFs⁶.
5. At ESMA, this work has focused on the identification of the specific issues faced by MMFs in the EU, and the way to address them, in the context of the abovementioned review of the MMF Regulation.
6. In that context, as a preliminary step in the development of the input that ESMA provide to the Commission under Article 46 of the MMF Regulation, on 26 March 2021 ESMA has published a consultation report on the review of the MMF Regulation⁷.

¹ https://www.esma.europa.eu/sites/default/files/library/esma34-49-309_cp_mmf_reform.pdf

² Article 16a(1) of the ESMA Regulation provides that “The Authority may, upon a request from the European Parliament, from the Council or from the Commission, or on its own initiative, provide opinions to the European Parliament, the Council and the Commission on all issues related to its area of competence”.

³ Under Article 43 and 46(2) of the MMF Regulation, ESMA is due to provide the Commission with this input for the purpose of the review of the MMF Regulation.

⁴ <https://www.fsb.org/wp-content/uploads/P111021-2.pdf>

⁵ <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD666.pdf>

⁶ https://www.esrb.europa.eu/pub/pdf/reports/esrb.report.210701_issues_note_on_systemic_vulnerabilities~db0345a618.en.pdf

⁷ <https://www.esma.europa.eu/press-news/consultations/consultation-eu-money-market-fund-regulation-%E2%80%93-legislative-review>

7. Against this background, this final report i) includes the ESMA Opinion on the review of the MMF Regulation (Annex I), containing in particular the policy proposals that ESMA suggest to put forward in order to address the difficulties faced by MMFs in March 2020 ii) summarizes and assesses the feedback received from stakeholders on this consultation report (this can be found in Annex II and III), iii) summarizes and presents the additional quantitative input that ESMA is to provide to the Commission under Art. 46(2) and 43(3) of the MMF Regulation (Annex IV).
8. The abovementioned input under Article 46(2) and 43(3) presented in Annex IV includes: (i) an analysis of the experience acquired in applying the MMF Regulation, the impact on investors, MMFs and the managers of MMFs in the Union; (ii) an assessment of the role that MMFs play in purchasing debt issued or guaranteed by the Member States, taking into account the specific characteristics of the debt issued or guaranteed by the Member States and the role that the debt plays in financing the Member States; (iii) an assessment of the impact of the Regulation on the short-term financing markets; and (iv) an assessment of the feasibility of establishing an 80 % EU public debt quota, and whether LVNAV MMFs might be an appropriate alternative to non-EU public debt CNAV MMFs.⁸
9. Article 43(3) of the MMF Regulation specifies that the input requested under Article 46(2) should be based, to the extent possible, on the data extracted from the MMF database, that is set under Article 37 of the MMF Regulation.
10. It is to be noted that part of the input requested under these articles was not available to ESMA, and the corresponding information cannot be extracted from the MMF database set up under Article 37 of the MMF Regulation, or from any commercial database, since this is information specific to each Member State (e.g. experience acquired at national level in applying the MMF Regulation, in particular information about supervisory practices of National Competent Authorities (NCAs) during the March 2020 crisis). ESMA has therefore launched a survey among NCAs in order to collect the corresponding information. The responses to this survey are summarised and presented in Annex IV(A), while the quantitative input provided by ESMA by using the data included in the MMF database, or commercial databases, is included in Annex IV(B).

ESMA Consultation report on the review of the MMF Regulation and feedback received from respondents

11. Since the consultation document was a key step in the process of developing the ESMA recommendations to the Commission on the upcoming review of the MMF Regulation, it presented potential modifications of the MMF Regulation, but also the assessment of ESMA on the difficulties faced by MMFs during the March crisis.
12. The consultation document was composed of i) an overview of the EU MMF sector, ii) a description of certain key features of MMFs along with the issues faced by MMFs during the COVID-19 crisis in March 2020, iii) a presentation of the potential areas of reform of the MMF regulatory framework which have been identified at this stage at international level and iv) a presentation of the potential areas of reform of the MMF Regulation. Parts

⁸ Article 46(2) also specifies that « If the Commission concludes (...) that the introduction of an 80 % EU public debt quota and the phasing out of public debt CNAV MMFs that include an unlimited amount of non-EU public debt are not feasible, it should present the reasons for that. In the event that the Commission concludes that the introduction of an 80 % EU public debt quota is feasible, the Commission may make legislative proposals to introduce such a quota, whereby at least 80 % of the assets of public debt CNAV MMFs are to be invested in EU public debt instruments. In addition, if the Commission concludes that LVNAV MMFs have become an appropriate alternative to non-EU public debt CNAV MMFs, it may make appropriate proposals to remove the derogation for public debt CNAV MMFs altogether »

ii) and iv) above are specified in the following paragraphs, together with a high-level summary of the feedback received from respondents (the detailed feedback statement is included in Annex II).

13. ESMA has received 38 responses, mostly responses from asset managers (16) and European, international and national association of asset managers (7), but also responses from professional investors (3), rating agencies (3), the ESMA SMSG⁹, and the Eurosystem.

Key features of MMFs along with the issues faced by MMFs during the COVID-19 crisis in March 2020

Contents of the consultation document (section 2.2)

14. In relation to the difficulties faced by MMFs in March 2020, the consultation document indicated that MMFs are exposed to three intertwined challenges regarding liquidity on their asset side: i) MMFs have a large market footprint in the asset classes they invest in, ii) those markets are not very liquid even in normal times, and iii) MMFs – depending on their types and currencies – have a high degree of portfolio overlap.
15. The combination of those three characteristics makes MMFs particularly vulnerable to symmetric shocks. If several MMFs face large redemptions at the same time, they will all try to sell the same type of assets simultaneously. Given the limited absorption capacity of the market, such sales will be challenging to execute, thereby creating liquidity issues for MMFs. In cases of asymmetric shocks (affecting one or a few MMFs), these vulnerabilities might also play a role, as one MMF facing large redemptions could face some challenges selling assets.

Feedback received

16. Respondents' views on ESMA's assessment were mixed. A majority of respondents (asset managers and associations of asset managers) agreed that the COVID-19 crisis had been a challenge for all market participants, including MMFs, but they were of the view that the lack of liquidity in the secondary market during the COVID-19 crisis was the driving factor of the crisis. Those respondents believed that the challenging situation faced by MMFs gave evidence that MMFs are resilient in crisis time, since no MMFs had to use fees and gates or suspend redemptions. Other respondents however noted that the episode had revealed structural vulnerabilities of MMFs.

Potential areas of reform of the MMF Regulation: contents of the Consultation document (section 2.4), and feedback received

17. In light of i) the ongoing work at international level (IOSCO, FSB, and ESRB) on the need for MMF reforms and ii) the above assessment of certain key features of the difficulties faced by MMF during the COVID-19 crisis in March 2020, a number of proposals of amendments to the MMF Regulation were made.

⁹ https://www.esma.europa.eu/sites/default/files/library/esma22-106-3439_smsg_advice_on_mmf_review.pdf This Advice is also included in Annex III

18. The proposals of amendments of the MMF Regulation on which the consultation report suggested to focus are presented in the following paragraphs, together with the feedback received from respondents on these proposals.

Reforms targeting the liability side of MMFs

19. **Decouple regulatory thresholds from suspensions/gates** (MMF regulatory reforms might have created a first-mover advantage by tying breaches of WLA to the use of redemptions fees and gates. As the level WLAs decline towards the regulatory threshold of 30%, investors might have an incentive to pre-emptively run to avoid being subject to redemption fees and gates);
20. **Feedback received:** the vast majority of respondents supported the proposal to decouple regulatory thresholds from the activation of suspension and gates, which would mean, in the view of most of these respondents, a full repeal of Article 34 of the MMF Regulation.
21. **Require MMFs to use swing pricing, anti-dilution levies (ADL), and redemption fees** (Using swing pricing allows the transfer of the liquidity costs of assets sale to redeeming investors and would help reduce redemption requests under stressed market conditions);
22. **Feedback received:** the majority of respondents did not support the proposal to require MMFs to use swing pricing, because in their view key features of MMFs, including in particular intra-day liquidity constraints, make it a less appropriate policy option for MMFs. On the other hand, respondents were more split on the possibility to use liquidity fees and/or ADL (anti-dilution levies): several respondents supported them, provided that the decision to use liquidity fees or ADL remains at the discretion of the manager of the MMF (i.e. it is not mandatory nor a decision of a supervisor/regulator).

Reforms targeting the asset side of MMFs

23. **Increase liquidity buffers, review their calibration and/or make them usable/countercyclical** (The purpose of liquidity buffers and of their minimum as imposed by the MMF Regulation is not fully clear; they may trigger the use of Liquidity Management Tools (CNAV and LVNAV). This might prove to be pro-cyclical at times of stress).
24. **Feedback received:** the majority of respondents objected to any increase of the liquidity ratios, arguing in particular that decoupling regulatory thresholds from the activation of suspension and gates, as suggested above, would address most liquidity related issues faced by MMFs. Several respondents, however, indicated that they could support a proposal which would make part of the (existing) liquidity buffer of all MMFs releasable during periods of stress.

Reforms targeting both the liability and asset side of MMFs

25. **Eliminate stable NAV MMFs / Convert Public debt CNAV and LVNAV funds to Public Debt VNAV and VNAV** (in line with the proposals made following the 2008 crisis, given that most issues on MMFs materialised for LVNAVs MMFs);
26. **Feedback received:** A majority of respondents objected to the removal of CNAV and/or LVNAV MMFs, arguing in particular that the impact of such a decision on investor

behaviour could be severe¹⁰, and that other types of MMFs (VNAV, and in particular standard VNAV) had also faced difficulties during the March 2020 crisis. However, at least one large asset manager was in favor of removing the use of amortised cost by LVNAVs.

Reforms that are external to MMFs themselves

27. **Assess whether the role of sponsor support should be modified** (e.g. amend the current requirement of article 35 of the MMF Regulation under which sponsor support is prohibited), and / or clarify the requirements on external support, in line with the statement on external support that ESMA published in the summer 2020¹¹.
28. ***Feedback received:*** The majority of respondents were of the view that the Article 35 of the MMF Regulation should not be amended (even in times of stress), and that it is clear enough as it stands. Several respondents, however, indicated that the clarifications that ESMA has brought in the abovementioned statement on external support could be incorporated in the Article 35 of the MMF Regulation.

Other complementary proposals

29. **Amend/specify the rules on ratings of MMFs** (a significant part of the MMF market have money market fund ratings from Credit Rating Agencies (CRAs)). MMF ratings are different from credit ratings: they do not assess credit risk but rather the ability of MMF to preserve capital and maintain liquidity.¹² Constraints related to CRAs MMF rating methodologies imply that for some CRAs, MMFs can only invest in highly-rated issuers, and in most cases any exposure below some credit rating level would not be compatible with a AAA for the MMF. Any regulatory reform has to take into account how those changes would be considered by CRAs MMF rating methodologies.
30. ***Feedback received:*** The majority of respondents did not see merit in amending the regulatory framework on the ratings of MMFs, given in their view, these ratings have not played a key role in the difficulties faced by MMFs during the March 2020 crisis. Several respondents, however, supported more transparency on the methodologies that CRAs use when rating MMFs.
31. **Disclose money market instruments (MMIs) main categories of investors to regulatory authorities** (e.g. detailed information on liabilities), in order to facilitate the supervision of MMFs by regulators, and the identification of the sources of any further MMF crisis, such as any concentration of holdings;
32. ***Feedback received:*** Several respondents supported more transparency on the disclosure of MMIs and main categories of investors at macro level for European MMF (frequent publication of amounts of MMI by category, allocations by type of instruments, type of credit risk, investor typologies, currencies).
33. **Strengthen the role of MMF stress-testing** (including from a system-wide perspective);
34. ***Feedback received:*** The majority of respondents indicated they did not see merit in amending the currently existing requirements on stress tests included in Article 28 of the

¹⁰ In the view of these stakeholders, this proposal may lead investors to move their activities to other bank products, other products that may have constraints or risks or are less transparent, or possibly outside the regulated financial market.

¹¹ https://www.esma.europa.eu/sites/default/files/library/esma34-39-1096_esma_statement_mmf_art35.pdf

¹² To reduce over-reliance on external ratings, the MMF Regulation requires MMFs to perform internal credit quality assessment. External credit ratings in their portfolio may be considered, but they cannot be mechanically relied upon.

MMF Regulation, which are considered to be already very detailed. These respondents disagreed with the assessment made by ESMA on the informative value of the use of macro stress tests. In contrast, one respondent supported the inclusion of features that facilitate a better understanding of the systemic vulnerabilities of MMFs. Especially, in the view of this respondent, MMF shares are used as a cash management vehicle by many financial entities and non-financial counterparties, which are likely to need liquidity precisely when MMF portfolios become less liquid.

35. Further harmonise and enhance international MMFs reporting framework;

36. **Feedback received:** Several respondents were of the view that a more frequent reporting could be activated in stressed market conditions (e.g. daily) with a subset of key indicators of the MMF Regulation reporting (e.g. Total Net asset value (TNA), WLA) in order to monitor the crisis, rather than systematically collecting the full MMF Regulation reporting on a monthly basis. Some of these respondents specified that this information was already asked by their supervising NCA in March 2020.

37. **Set-up a liquidity exchange facility (“LEF”)** funded by MMFs or asset managers and, depending on the requirements on external support, by third parties, on an-going basis. This LEF could serve as a centralised source of liquidity and/or credit during periods of stress. This could mitigate liquidity pressures on MMFs and reduce the benefit of ‘first mover advantage’ for investors resulting in an accelerating spiral of investor redemptions and asset fire-sales;

38. **Feedback received:** All respondents except one objected to the potential creation of such a LEF, given in particular it would be costly, for the managers and the investors of MMFs, it would not address the first mover advantage related issues, it would not be accepted by investors of MMFs, and it would also further enhance the misguided perception of MMFs that they are guaranteed investments.

39. **Further clarify the scope of the MMF Regulation** (in line with the supervisory briefing on the scope of the MMF Regulation, approved by the ESMA BoS in 2019¹³, but not made public).

40. **Feedback received:** The majority of respondents were of the view that the scope of the MMF regulation was clear and saw no need to amend the related articles of the MMF Regulation. Several respondents acknowledged that there was already well-established practices among industry participants on the interpretation of the scope of the MMF Regulation. However, a limited number of respondents indicated, they would see merit in clarifying the difference between an MMF, and ultra-short bond fund which does not fall in the scope of the MMF Regulation.

41. **Additional feedback received** (other proposals of amendments of the EU MMF regulatory framework, which had not been put forward in the ESMA CP): In addition to assessing the proposals of changes to the MMF Regulation put forward by ESMA in the consultation report, certain respondents, including the Eurosystem, suggested other policy options to improve the resilience of MMFs, and some of those suggested by the Eurosystem have been discussed at the FSB and ESRB level. These proposals included in particular requirements on the (mandatory) holdings of liquid public assets.

¹³ <https://sherpa.esma.europa.eu/sites/INIIVM/ layouts/15/DocIdRedir.aspx?ID=ESMA34-49-174>

ESMA key policy proposals on the review of the MMF Regulation

42. In light of the abovementioned feedback to the ESMA consultation paper on the review of the MMF Regulation, while taking also into account the final report on policy proposals to enhance MMF resilience published in October 2021¹⁴ by the FSB, and ESRB Recommendation on the review of the MMF Regulation, published in January 2022¹⁵, ESMA suggests the below policy proposals on the review of the MMF Regulation.

A. Major reforms
<u>A.1. Addressing threshold effects for constant NAV MMFs</u>
A.1.1 Removing the possibility to use amortized costs for LVNAVs
A.1.2. Decoupling regulatory thresholds from suspensions/gates/redemption fees for LVNAV/CNAV
<u>A.2. Addressing liquidity related issues</u>
A.2.1 Mandatory availability of at least one LMT (liquidity management tool) for all MMFs; activation of these LMTs by the manager of the MMF
A.2.2 Amendments of the DLA/WLA of VNAV (and LVNAV) MMFs, as well as the pool of eligible assets, including public debt assets, which can be used to satisfy these liquidity ratios
A.2.3. Inclusion/ <u>Reinforcement</u> of the possibility to temporarily use liquidity buffers in times of stress
B. Complementary / crisis preparedness reforms
B.1. Enhancement of MMF reporting requirements
B.2. Enhancement of the MMF stress testing framework
B.3. Clarification of the requirements on external support
B.4. New disclosure requirements on ratings of MMFs

¹⁴ <https://www.fsb.org/wp-content/uploads/P111021-2.pdf>

¹⁵ <https://www.esrb.europa.eu/news/pr/date/2022/html/esrb.pr.220125-32ad91c140.en.html>



43. These proposals are explained, and detailed in the ESMA Opinion on the review of the MMF Regulation, presented in Annex I.



3 Annexes

3.1 Annex I: ESMA Opinion on the review of the MMF Regulation

OPINION

Review of the MMF Regulation

Legal basis

1. ESMA's competence to deliver an opinion to the institutions is based on Article 16a of Regulation (EC) No 1095/2010 (the 'Regulation'). In accordance with Article 44(1) of the Regulation the Board of Supervisors has adopted this opinion.
2. In this opinion, ESMA sets out its view on the review of the MMF Regulation, as set out in Article 46 of the MMF Regulation, that specifies that *"by 21 July 2022, the Commission shall review the adequacy of this Regulation from a prudential and economic point of view, following consultations with ESMA and, where appropriate, the ESRB, including whether changes are to be made to the regime for public debt CNAV MMFs and LVNAV MMFs"*.

Background

3. The COVID-19 crisis has been challenging for MMFs. A number of EU MMFs faced significant liquidity issues during the period of acute stress in March 2020 with large redemptions from investors on the liability side and a severe deterioration of liquidity of money market instruments on the asset side. This was particularly the case for some of the Low Volatility Net Asset Value (LVNAV) MMFs in USD and some Variable Net Asset Value (VNAV) MMFs in EUR, which were both mainly exposed to money market instruments issued by financial institutions (Commercial Paper – 'CP'- and Certificate of Deposits- 'CD'). Although no EU MMF suspended redemptions or used liquidity fees on redemptions and redemption gates, the crisis calls for further work on the resilience of the EU MMF industry as well as underlying money markets, following recent regulatory reforms (please see section II of the present Opinion).
4. In that context, at international level, several workstreams have assessed the situation faced by MMFs during the crisis, and which policy options should be considered in order to address the issues which have been observed and any remaining vulnerabilities. This could lead to potentially enhancing further the reforms adopted following the 2008 financial crisis, which have focused, regarding MMF, on credit risks and risks of runs. This is the case in particular at FSB, which published its final report on policy proposals to enhance MMF resilience in October 2021¹⁶, IOSCO, which participated in the work at FSB level, and published in November 2020 a thematic note on MMFs during the March-April 2020 episode¹⁷, and ESRB, which published in July

¹⁶ <https://www.fsb.org/wp-content/uploads/P111021-2.pdf>

¹⁷ <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD666.pdf>

2021 an issue note on systemic vulnerabilities of MMFs and preliminary policy considerations to reform MMFs¹⁸ and its Recommendation on the review of the MMF Regulation¹⁹.

5. At ESMA, this work has focused on the identification of the specific issues faced by MMFs in the EU, and the way to address them, in the context of the abovementioned review of the MMF Regulation.
6. In that context, as a preliminary step in the development of the present Opinion, on 26 March 2021 ESMA published a consultation report on the review of the MMF Regulation²⁰.
7. Against this background, the present Opinion, based in particular on an assessment of the key issues faced by MMFs during the COVID-19 crisis in March 2020 and taking into account feedback received from the aforementioned consultation, intends to suggest potential amendments of the MMF regulatory framework, and corresponding amendments of the MMF Regulation.

Opinion

- I. Key issues faced by MMFs during the COVID-19 crisis in March 2020
8. In March 2020, some segments of the US and EU MMF industry experienced a very high level of stress. MMFs exposed to private markets (LVNAVs and VNAVs in the EU, prime MMFs in the US) recorded very high outflows, while facing challenges to dispose of their assets due to the lack of liquidity in underlying CP and CD markets. In the EU, for USD-denominated MMFs, LVNAVs recorded high outflows²¹, while CNAVs saw inflows of similar magnitude, reflecting a potential substitution effect (or flight-to-quality), following a pattern similar to their onshore US equivalents. Other private debt funds such as VNAVs, also faced outflows.
9. Following actions by central banks to support money markets through outright purchases of CP (ECB, BoE, FED) on the primary market or on the secondary market, lending facilities for banks to buy assets from MMFs (FED) and extending the eligible collateral to unsecured banks bonds (ECB), redemptions slowed while liquidity improved in money markets. No EU or US MMFs had to implement liquidity fees on redemptions or redemption gates or suspend redemptions. However, this episode shows that MMFs and more broadly financial markets for money markets instruments remain subject to a range of vulnerabilities. Those vulnerabilities can be split across the two main dimensions: (i) liquidity of underlying markets and (ii) risk of first-mover advantage. The economic assessment of ESMA of these vulnerabilities is as follows.
10. Private debt MMFs are subject to three intertwined vulnerabilities: (i) high market footprint in the short-term markets they invest in (MMFs hold more than 50% of the CP market), (ii) high portfolio overlap (MMFs tend to have exposures towards the same

¹⁸

https://www.esrb.europa.eu/pub/pdf/reports/esrb.report.210701_Issues_note_on_systemic_vulnerabilities~db0345a618.en.pdf

¹⁹ <https://www.esrb.europa.eu/news/pr/date/2022/html/esrb.pr.220125-32ad91c140.en.html>

²⁰ <https://www.esma.europa.eu/press-news/consultations/consultation-eu-money-market-fund-regulation-%E2%80%93-legislative-review>

²¹ This has been documented for example in Chart 5 p.20 of the ESRB report "Issues note on systemic vulnerabilities": https://www.esrb.europa.eu/pub/pdf/reports/esrb.report.210701_Issues_note_on_systemic_vulnerabilities~db0345a618.en.pdf

issuers) and (iii) low liquidity of underlying markets. Those vulnerabilities are related to structural factors external to the Money Market Fund Regulation. These factors include (i) the structure and functioning of short-term debt markets and (ii) Relatively low number of firms with high credit ratings (which contributes to portfolio overlap).

11. In addition, when faced with redemptions, LVNAVs are subject to a trade-off, related to the regulatory requirements they need to comply with: either sell liquid assets to maintain their NAV at the risk of breaching WLA or sell less liquid assets to maintain the WLA at the risk of breaching the NAV collar.
12. For LVNAVs, a range of potential reforms have been assessed in a stylized model (Baes et al, 2021)²². In that set-up the effectiveness of reforms is measured by the maximum amount of redemptions a fund could face over a given time horizon without breaching regulatory requirements:
 - a. Removing stable NAV would have the largest impact: the maximum amount of redemptions would increase from 40% of NAV to 80%²³.
 - b. Increasing liquidity requirements would moderately improve the resilience of LVNAVs: Increasing WLA levels by 10 percentage point (to 40%) would only increase the maximum amount of redemptions by 3 percentage points.
 - c. Requiring more liquid assets as part of WLA has a significant impact: If WLAs were constituted of more liquid assets (such that liquidation costs would decline²⁴), funds would be able to meet higher level of redemptions. This effect also illustrates the impact of possible reforms to short-term funding markets (which would reduce the price impact of sales).
 - d. Introducing counter-cyclical liquidity buffers would have a slightly larger impact than increasing liquidity requirements: If an additional WLA requirement could be released during stress periods (from 40% to 30% for example), funds' ability to meet redemptions would be higher by 5 percentage points

The role of redemption fees and gates

13. Some market participants have argued that, for LVNAVs and CNAV, MMF regulatory reforms might have created an additional risk of first-mover advantage²⁵ by tying breaches of WLA to the use of redemptions fees and gates.

²² https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3884890

Please note that this paper does not assess the costs of the different measures, since it focusses on the resilience of MMFs. For more details on the way the potential reforms listed in paragraph 12 are assessed in this paper, please refer to the contents of the abovementioned weblink.

²³ Increasing the NAV deviation would improve the resilience of LVNAVs by relaxing one of the regulatory constraints. However, allowing larger NAV deviations could create an expectation among investors that LVNAVs are more stable than they actually are. In addition, the change in the NAV collar might be subject to external constraints related to CRAs. For some CRAs, a AAmmf-rated fund using amortized cost cannot have a NAV deviation above 25bps before being downgraded. Given the reliance of institutional investors on MMF ratings, such downgrade would likely trigger large outflows.

²⁴ For example, if liquidation costs were to decline by 0.1 percentage point for WLAs (i.e. if the liquidity discount factors were higher by 0.1pp), the maximum amount of redemptions a MMF could face would increase.

²⁵ For the sake of clarity, ESMA endorses the definition of first-mover advantage as stated in the FSB's Final Report on "[Policy Proposals to Enhance Money Market Fund Resilience](#)" (emphasis added): " *First-mover advantage occurs when, under certain*

14. As the level of WLAs decline towards the regulatory threshold of 30%, investors might have an incentive to pre-emptively run to avoid being subject to redemption fees and gates. In the US, Li et al. (2020) provide evidence that US prime funds with the lowest WLA had higher outflows than MMFs with higher level of liquid assets and Cipriani and La Spada (2020) found that this effect was significant for MMFs sold to institutional investors (but not for retail investors).
15. In the EU, rules are slightly different as for redemption fees and gates to be considered, the MMF has to breach the 30% WLA thresholds and record daily outflows higher than 10%.
16. Splitting LVNAVs into high and low WLA groups, ESMA (2021)²⁶ shows that MMFs with low WLAs record higher outflows than MMFs with high WLAs. This analysis can be interpreted as evidence that institutional investors²⁷ redeem from MMFs to avoid being subject to fees and gates. Additionally, studies by Avalos and Xia (2021), Darpeix (2021) and, Dunne and Giuliana (2021) show that the liquidity ratios were key drivers to redemptions in the case of LVNAVs, but not in the case of VNAVs, thus pointing to the additional vulnerabilities placed on LVNAVs by Article 34 of the MMF Regulation.
17. Further assessment of the key issues faced by MMFs in March 2020 can be found in the thematic note published by IOSCO²⁸, in the ESMA consultation report on the review of the MMF Regulation (section 2.2)²⁹, in the FSB final report to enhance money market funds resilience³⁰, and in the ESRB issues note and recommendation³¹.

II. Suggested amendments of the MMF Regulation

18. Based on the above assessment of the key issues faced by MMFs during the COVID-19 crisis, ESMA has identified several vulnerabilities of MMFs that the proposed amendments of the MMF regulatory framework, and in particular the MMF Regulation, shall aim to address: a) threshold effects for constant NAV MMFs, and specific first-mover advantage related issues applicable to these funds, and b) liquidity related issues, including liquidity transformation related issues. These liquidity related issues include the fact that currently, investors may not effectively bear the costs of redemptions initiated by them.
19. These vulnerabilities shall be addressed in order to make MMF more resilient, and for the stability of financial markets as a whole.

*circumstances, investors who redeem their shares first do so on more favorable terms than investors in the same fund who redeem late. It can occur if, for example, the transaction costs for assets sold to meet redemptions are not properly allocated to redeeming investors. Another example of the first-mover advantage occurs if in a scenario of declining values of a fund's assets, investors can redeem before the fund's NAV adjusts to fully reflect those declines in value. **An investor who redeems solely in anticipation of further market deterioration is not considered as benefiting from a first-mover advantage. First mover advantage may lead to pre-emptive runs**".*

²⁶ Report on Trends Risks and Vulnerabilities, No. 1 2021

²⁷ Please also refer to Annex IV(B) of the final report "Overview of the MMF sector", and to the following ESRB working paper "Do liquidity limits amplify money market fund redemptions during the COVID crisis?":

<https://www.esrb.europa.eu/pub/pdf/wp/esrb.wp127-b73bc97c49.en.pdf?4bf6bce1c8725add32d0a35cadcbd67>

²⁸ <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD666.pdf>

²⁹ https://www.esma.europa.eu/sites/default/files/library/esma34-49-309_cp_mmf_reform.pdf

³⁰ <https://www.fsb.org/wp-content/uploads/P111021-2.pdf>

³¹ https://www.esrb.europa.eu/pub/pdf/reports/esrb.report.210701_Issues_note_on_systemic_vulnerabilities--db0345a618.en.pdf
<https://www.esrb.europa.eu/news/pr/date/2022/html/esrb.pr.220125-32ad91c140.en.html>

20. The proposed amendments of the MMF Regulation which would reduce threshold effects would aim at eliminating the unintended consequences of two existing requirements of the MMF Regulation.
21. First, they aim at addressing the issues stemming from the LVNAV's ability to offer a stable NAV under most circumstances. Under the MMF Regulation, these MMFs are allowed to use the amortised cost valuation method to value certain assets and need to keep their NAV as calculated using the amortised cost method for certain assets within a collar range of 20 bps as compared to the NAV using entirely the mark-to-market/model valuation method. When their NAV breaches this collar (Article 33(2) of the MMF Regulation), these MMFs need to use mark-to-market/model valuation for all of their assets. The use of the amortised cost valuation method is crucial to being able to offer a stable NAV to investors and exposes MMFs to a risk of a first-mover advantage as investors can redeem from the MMF at values of the underlying assets that do not necessarily reflect at all times the market valuations of those assets.
22. Second, when thresholds laid down under Article 34 of the MMF Regulation are breached, managers of LVNAV and public debt CNAV MMFs have to undertake a documented assessment to determine the appropriate course of action, including the potential imposition of liquidity fees to investors and putting in place redemption gates. This may amplify the run-risk by investors as there seems to be a perception³² in the market (as responses to the ESMA consultation have shown) that the imposition of these liquidity management tools (LMTs) is automatic based on these regulatory requirements. Therefore, the removal of these regulatory thresholds included in Article 34 should eliminate any such confusion in the future.
23. In relation to liquidity related issues, the proposed amendments of the MMF Regulation which would reduce the liquidity transformation of MMFs would aim at improving the asset-liability matching of MMFs, both in normal and crisis times. MMFs should be able to meet periods of heightened redemption requests without destabilising underlying money markets. The objective should not be to avoid any sales of assets by MMFs, even in time of crisis, so that MMFs could continue to perform their function as cash management vehicles. The objective is to address excessive procyclicality by eliminating incentives for investors to redeem ahead of the others, even if they do not have an immediate need to raise cash, as well as the likelihood of destabilizing sales by MMFs.
24. The proposed amendments of the MMF Regulation which would impose on redeeming investors the cost of their redemptions³³ would aim at reducing the impact that redeeming investors have on other investors and should hence provide for protection from dilution and remove the risk of a first-mover advantage. In that context, LMTs should be available to all types of MMFs. MMFs should, in particular, have available at least one LMT aiming at appropriately reflecting redemption costs for those departing investors. Such specific LMTs could be, in particular, anti-dilution levies, liquidity fees³⁴, and could also include swing pricing. These tools would ensure that redeeming investors bear the costs associated with their transactions, and not the investors

³² Which may be partly linked to a confusion between US and EU rules on this issue.

³³ Please note that the case of subscriptions is equally relevant every time the words "redemption"/"redeeming investors" are referred to in that paragraph (they are not repeated so that the paragraph is clearer and easier to follow).

³⁴ Contrary to swing pricing or anti-dilution levies, which must be commensurate with the actual cost of liquidity, liquidity fees are usually discretionarily fixed by the managers. Please note that liquidity fees are currently already referred to in Article 34 of the MMF Regulation.

remaining in the fund, therefore mitigating the perception that there is a first mover advantage.

25. In addition, requiring higher levels of liquidity buffers, through weekly and daily maturing assets, and the possibility of holding public debt asset to meet daily and weekly liquidity ratios should ensure greater liquidity and reduced risk in the portfolio of MMFs. These additional liquidity requirements shall, however, be appropriately calibrated, depending in particular on the type of MMF (VNAV or LVNAV), the availability of public debt in different currency areas, and the chosen measure aimed at addressing the abovementioned issues stemming from the LVNAVs' ability to offer a stable NAV under most circumstances.
26. Finally, other proposed amendments of the MMF Regulation which would enhance crisis preparedness and monitoring of the MMF market will in particular aim to provide national competent authorities (NCAs) and ESMA with the necessary data/information to identify systemic vulnerabilities in the MMF sector. These measures will allow to better understand the investor base of MMFs. In stressed market situations in particular, enhancing and harmonizing crisis-specific data-sharing arrangements will improve authorities' understanding of the systemic risk posed by MMFs and allow for potential further mitigating policy actions to be adopted.
27. Based on the abovementioned categorization of the vulnerabilities of MMFs, and corresponding corrective measures proposed to be taken, ESMA suggests the following package of reforms, and corresponding amendments of the MMF Regulation, which will be detailed in the next sections of the present Opinion.

A. Major reforms

A.1 Major reforms aimed at addressing threshold effects for constant NAV MMFs:

A.1.1 Removing the possibility to use amortized costs for LVNAVs

A.1.2. Decoupling regulatory thresholds from suspensions/gates/redemption fees for LVNAV/CNAV

A.2. Major reforms aimed at addressing liquidity related issues

A.2.1. Mandatory availability of at least one LMT (liquidity management tool) for all MMFs; activation of these LMTs by the manager of the MMF

A.2.2. Amendments of the Daily liquidity assets ratios (DLA)/ Weekly liquidity assets ratios (WLA) of VNAV (and LVNAV) MMFs, as well as the pool of eligible assets, including public debt assets, which can be used to satisfy these liquidity ratios.

A.2.3. Inclusion/Reinforcement of the possibility to temporarily use liquidity buffers in times of stress

B. Complementary / crisis preparedness reforms, aimed at enhancing the MMF resilience as a whole, in view of any future crisis events they might have to face

B.1. Enhancement of MMF reporting requirements

B.2. Enhancement of the MMF stress testing framework

B.3. Clarification of the requirements on external support

B.4 New disclosure requirements on ratings of MMFs.

28. It should be highlighted that these proposed reforms should be considered as one single package of combined and interdependent policy measures, to be implemented jointly in order to efficiently address the issues identified in the March 2020 crisis (i.e. it would not make sense to implement separately the abovementioned various options, in particular those referred to above as “major”, because one of these options treated separately would not be efficient enough to prevent another event of the type of stress observed at the outbreak of the pandemic for MMFs).
29. The abovementioned proposed package of reforms has been determined taking into account i) the feedback received on the consultation document, ii) the final report on policy proposals to enhance MMF resilience, published by the FSB in October 2021 iii) the work at the ESRB on the review of the MMF Regulatory framework³⁵, and iv) the ESMA economic assessment of the key issues faced by MMFs during the COVID-19 crisis, presented above in section I.
30. It has to be noted that the present Opinion does not include requirements for MMFs to have capital buffers or a minimum balance at risk. ESMA is of the view that such own fund requirements are not needed in the EU, provided in particular that features that make MMFs similar to deposit taking institutions are reduced and features that make MMF similar to other investment funds are further increased.
31. The abovementioned package of suggested amendments of the MMF regulatory framework is detailed in the following paragraphs of the present Opinion.

A. Major reforms

A.1 Major reforms aimed at addressing threshold effects for constant NAV MMFs

A.1.1 Removing the possibility to use amortized costs (and stable NAV pricing³⁶) for LVNAVs

32. As indicated above, the amendments of the MMF Regulation which would reduce threshold effects for constant NAV MMFs should first aim at addressing the issues, related in particular to first-mover advantages, stemming from the ability for LVNAVs to offer a stable NAV under most circumstances.
33. It is proposed that no private debt MMFs should be able to use the amortised costs method, irrespectively of the investor base or the assets they hold. This would mean a ban of such a valuation method for LVNAV MMFs. The rationale behind this proposal is that these LVNAV mechanisms based on the amortised cost method imply

³⁵ <https://www.esrb.europa.eu/news/pr/date/2022/html/esrb.pr.220125-32ad91c140.en.html>

³⁶ As per paragraph 36 below

nonlinearities (cliffs effects) by definition, and make LVNAV MMFs therefore intrinsically prone to first-mover advantages and other amplification effects. However, it is not suggested to fully remove LVNAVs³⁷.

34. The MMF Regulation has explicitly been structured in order to allow CNAV and LVNAV to be maintained, considering that the costs of eliminating the CNAV and LVNAV model would be significant, and the co legislators therefore preferred to set out specific rules aiming at ensuring financial stability while permitting these vehicles, rather than requiring a mandatory move to the VNAV model in Europe. However, more than ten years after the start of these discussions, ESMA is of the view that the considerations which led to the choice made in the MMF Regulation to maintain the model of LVNAV could now be revisited, in particular in light of the recent market events that took place during the March 2020 crisis. Indeed, while not only stable-NAV MMFs faced difficulties during the March 2020 crisis, but also VNAVs (and in particular standard VNAVs)³⁸, as indicated in section I of the present Opinion, it appears that the specific issues raised by nonlinearities inherent in LVNAV structures should be addressed. The economic analysis required by article 46(1) of the MMF Regulation, partly presented in section I of the present Opinion, and in the Annexes of the final report, also tends to highlight this.
35. Under the MMF Regulation, LVNAV MMFs are allowed to use the amortised cost valuation method to value certain assets and need to keep their NAV as calculated using this amortised cost method within a collar range of 20 bps as compared to the NAV using entirely the mark-to-market valuation method. When their NAV breaches this collar (Article 33(2) MMFR), these MMFs need to use mark-to-market valuation for all of their assets. The use of the amortised cost valuation method is therefore crucial to being able to offer a stable NAV to investors and provides a first-mover advantage as investors can redeem from the MMF at values of the underlying assets that do not necessarily reflect the market valuations of those assets. This is the reason why, ESMA consider that it is sufficient to remove the ability for LVNAV to use amortised cost, rather than completely removing LVNAV from the MMF Regulation.
36. It is to be noticed that ESMA suggest to retain other specific requirements for LVNAV MMFs, such as the higher liquidity requirements, so that these vehicles still constitute a valid investment option for investors. However, ESMA suggests to abolish the rule currently applying under Article 32(2) of the MMF Regulation by which the constant NAV per unit or share of a LVNAV MMF shall be rounded to the nearest percentage point³⁹. As a consequence, LVNAVs would need to apply the same rules on rounding that currently apply to VNAV MMFs (the NAV per unit or share shall be rounded to the nearest basis point⁴⁰, as per Article 30(2) of the MMF Regulation). This would remove the possibility of stable NAV pricing for LVNAV MMFs. It is recognized that this proposed change may result in a material change to the European MMF landscape, with LVNAV MMFs currently constituting 46% of the market⁴¹. Following the adoption of such a change in the MMF Regulation, ESMA would be carefully assessing its consequences on investors and financial stability, and in particular whether investors may seek to rely on other products offered by banks or non-banks

³⁷ Their investment constraints could still enable them to offer a marked-to-market/model NAV that would be less volatile than VNAVs.

³⁸ The difficulties faced by LVNAVs and VNAVs differed given in particular i) almost half of the redemptions observed in March 2020 for VNAVs corresponded to the long observed end-quarter outflows that characterize VNAVs, a feature not equally observed for LVNAVs ii) the majority of VNAVs are standard VNAVs (i.e. with a longer maturity than LVNAVs).

³⁹ i.e., 2 digits.

⁴⁰ i.e., 4 digits.

⁴¹ See Annex IV (section 3.4), paragraph 6

and the related risks be transferred elsewhere in the wider financial services market, both within the EU and globally. As part of ESMA's consultation and review process, ESMA has assessed alternative options including further enhancing the liquidity requirements of LVNAVs whilst maintaining stable NAV features, but these alternative options were considered less preferable in terms of addressing the specific issues related to LVNAV MMFs.

The corresponding amendments of the MMF Regulation would read as follows:

Article 29(7) of the MMF Regulation is deleted.

Articles 32 is deleted.

Article 33(2)(b) is deleted.

In the second subparagraph of Article 36(5), the words “and LVNAV MMFs” are deleted.

Article 37(3) is deleted.

A.1.2. Decoupling regulatory thresholds from suspensions/gates/redemption fees for LVNAV/CNAV

37. As indicated above, MMF regulatory reforms might have created a further first-mover advantage by tying breaches of WLA to the use of redemptions fees and gates. As the level WLAs decline towards the regulatory threshold of 30%, investors might have an incentive to pre-emptively run to avoid being subject to redemption fees and gates.
38. The vast majority of respondents to the ESMA (as can be seen in the feedback statement included in Annex II of the final report) and FSB consultation reports supported the proposal to decouple regulatory thresholds from the activation of suspension and gates.
39. ESMA therefore suggests to remove Article 34 of the MMF Regulation, in order to decouple regulatory thresholds from the activation of suspensions of redemptions, redemptions fees and gates. ESMA is of the view that this amendment is also relevant in the case of CNAVs, even if those MMFs have not faced the same difficulties as LVNAVs in March 2020, because the inherent weakness related to the existence of a threshold appear to be equally relevant for all MMFs⁴².

The corresponding amendments of the MMF Regulation would read as follows:

Article 34 of the MMF Regulation is removed.

Article 37(3)(c), which contains references to Article 34, is also removed.

⁴² But Article 34 of the MMF Regulation relates to CNAV and LVNAV MMFs, not to VNAV MMFs.

A new paragraph is added to Article 24(2) (this is the former first paragraph of Article 34):

“The manager of an 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”

A.2. Major reforms aimed at addressing liquidity related issues

A.2.1. Mandatory availability of LMTs (liquidity management tools) for all MMFs; activation of these LMTs by the manager of the MMF

40. So that investors effectively bear the costs of redemptions, ESMA suggests that each MMF put in place at least one type of liquidity management tool (LMT), which would be clearly presented in the documentation to the investor.
41. As indicated above, the corresponding amendments of the MMF Regulation which would impose on redeeming investors the cost of their redemptions⁴³ would aim at reducing the impact that redeeming investors have on other investors, hence to avoid dilution. In that context, liquidity management tools (LMTs) shall be available to all type of MMFs. All MMFs should have available at least one LMT aiming at appropriately reflecting redemption costs for those departing investors. Such LMTs could be, in particular, anti-dilution levies (ADL), liquidity fees⁴⁴, and could also include swing pricing.
42. Using such mechanisms would allow the transfer of the liquidity costs of assets sale (which may increase as a result of widening spreads on short-term funding market) to redeeming investors; the cost would otherwise be borne by investors who remain invested in the fund. Aside from preventing dilution of remaining investors, it would also help reduce redemption requests under stressed market conditions.
43. With ADL / liquidity fees, a fund adjusts entry and exit charges. With swing pricing, a fund adjusts the dealing price for inflows or outflows to take into account the costs of purchasing or selling assets of the fund.
44. These LMTs should be activated by the manager of the MMF, and not by the authorities since there is a risk that when the authorities decide to activate a tool it would actually trigger the very contagion it intended to contain, because it could intervene too soon / too late / disproportionately given that the authority often does not, and not at all times, possess the detailed information on market situation and investor behaviour to be able to take action. The anticipation of the activation of LMTs by public authorities could also

⁴³ Please note that the case of subscriptions is equally relevant every time the words “redemption”/redeeming investors” are referred to in that paragraph (they are not repeated so that the paragraph is clearer and easier to follow).

⁴⁴ Contrary to swing pricing or anti-dilution levies, which must be commensurate with the actual cost of liquidity, liquidity fees are usually discretionarily fixed by the managers.

create the perception of a first-mover advantage and precipitate redemptions ahead of such decision (therefore prompting the need to such activation).

45. However, in order to harmonize the use of such LMTs by managers of MMFs, ESMA is of the view that the Commission shall adopt a delegated act specifying the circumstances under which these LMTs shall be used. The specifications or criteria for the use of such LMTs included in this delegated act shall, however, not introduce any threshold effects, which would be detrimental to the stability of financial markets.
46. ESMA is aware that in the context of the review of the AIFM Directive, the Commission has recently put forward proposals on the mandatory availability of LMTs for all AIFs and UCITS⁴⁵. However, given the outcome of the negotiations at level 1 on these issues in the framework of the AIFMD and UCITS Directive is still unclear, at this early stage of the review process, ESMA is of the view that specific proposals on this issue related to MMFs should still be included in the review process of the MMF Regulation. At a later stage of the review process of the AIFMD, UCITS Directive and MMF Regulation, consistency should be sought, on the contents of the requirements, and in particular on the definition of what is meant by the different types of LMTs contemplated under the different legislative and regulatory frameworks.

The corresponding amendments of the MMF Regulation would read as follows:

A new Article named “Liquidity management tools” is included in the MMF Regulation.

This Article could replace the currently existing Article 34, so that this new Article is the new Article 34.

The contents of this new Article 34 would read as follows:

“ 1. The manager of each MMF shall put in place at least one liquidity management tool, among the list of tools included in paragraph 2, which would ensure that the investors who remain in (leave) the fund are not unfairly disadvantaged (advantaged) when other investors redeem (keep) their units or shares.

2. These liquidity management tools shall be anti-dilution levies, liquidity fees, or swing pricing mechanism.

‘Anti-dilution levies’ means a charge applied to individual transacting investors, payable to the MMF, to protect remaining investors from bearing the costs associated with a MMF’s purchases or sales of assets because of large inflows or outflows. An anti-dilution levy does not involve any adjustment to the value of the fund’s shares (e.g. NAV).

⁴⁵ https://ec.europa.eu/finance/docs/law/211125-proposal-aifmd_en.pdf (in particular page 29, point 2b, that also refer to the Annex V of the proposal of review, which lists the liquidity management tools put forward by the European Commission in this proposal)

'Liquidity fees' means a charge applied to individual transacting investors, payable to the MMF, to protect remaining investors from bearing the costs associated with a MMF's purchases or sales of assets because of large inflows or outflows. Such charge is not derived specifically from the associated transaction costs, but instead is a flat (or tiered) fee outlined in advance. A liquidity fee does not involve any adjustment to the value of the fund's shares (e.g. NAV).

'Swing pricing' means a liquidity management tool that applies a dilution adjustment to a MMF's NAV to pass on to investors who redeem or purchase shares the liquidity costs stemming from net flows into or out of the MMF.

3. The manager of an MMF shall implement detailed policies and procedures for the activation and deactivation of any selected liquidity management tool and the operational and administrative arrangements for the use of such tool.

The liquidity management tool(s) that is put in place by the manager of an MMF, as well as the conditions under which the manager of the MMF would activate this (these) tool(s), shall be clearly described in the fund rules or instruments of incorporation, as well as in the prospectus of the MMF.

4. The Commission shall adopt a delegated act specifying the conditions/criteria for the activation and use of the abovementioned liquidity management tools, as well as gates and suspensions of redemptions, by the manager of an MMF. The specifications or criteria for the use of such liquidity management tools included in this delegated act shall not introduce any threshold effects.

'Redemption gates' means a liquidity management tool that prevents investors in the fund from withdrawing a portion of their capital for a period of time.

'Suspension of redemptions' means a liquidity management tool that prevents investors in the fund from withdrawing their whole capital for a period of time.'

A.2.2. Amendments of the DLA/WLA of VNAV (and LVNAV) MMFs, as well as the pool of eligible assets, including public debt assets, which can be used to satisfy these liquidity ratios.

47. As indicated above, amendments of the MMF Regulation should also ensure that MMFs are better able to meet periods of heightened redemption requests without destabilising underlying money markets. As such, requiring higher levels of liquidity buffers, through weekly and daily maturing assets, and the possibility of holding of public debt asset to meet daily and weekly liquidity ratios should ensure greater liquidity and reduced risk in the portfolio.

48. Given their different nature, and the different package of policy options that ESMA suggests to apply to them, these additional liquidity requirements need, however, to be differentiated between VNAVs and LVNAVs.
49. **With respect to VNAVs** (both short-term and standard), the DLA and WLA requirements should be increased to $7.5\%+X(\text{VNAV})\%$ / $15\%+Y(\text{VNAV})\%$ respectively (as compared to the current 7.5%/15%) while leaving the option to managers to include a maximum proportion of public debt (of a maturity up to 190 days) ($Z(\text{VNAV})\%$) in the computation of the WLA (similarly to what currently applies to LVNAV, according to Art. 24(1)(g)).
50. Detailed economic evidence is needed to set the exact values of $X(\text{VNAV})\%$, $Y(\text{VNAV})\%$, and $Z(\text{VNAV})\%$, and because such a complete economic evidence does not seem to be available at the moment, ESMA is of the view that it is uneasy, at this stage, to include definitive exact values in the present Opinion. In case the Commission would consider that the present policy proposal is relevant, ESMA stands ready to further detail this economic assessment, in order to be able to fine-tune this proposal, and in particular suggest specific values for $X(\text{VNAV})\%$, $Y(\text{VNAV})\%$, and $Z(\text{VNAV})\%$. In that context, ESMA would also assess further the maximum maturity of the abovementioned public debt and the extent to which the maturity of 190 days currently referred to in Article 24(1)(g)) should be amended.
51. However, at this early stage of the review of the MMF Regulation, ESMA is of the view that the current levels of liquidity of MMFs, as shown in Annex IV(B) of the final report “Overview of the MMF sector”, tend to suggest that the proposals of limited increase of $X(\text{VNAV})\%$ (=2.5%), $Y(\text{VNAV})\%$ (=5% for short-term VNAV MMFs ; 10% for standard VNAV MMFs)%, and $Z(\text{VNAV})\%$ (=5% for short-term VNAV MMFs ; 10% for standard VNAV MMFs), differentiated between short-term VNAV MMFs and standard VNAV MMFs, included in the ESRB Recommendation on MMFs⁴⁶ are a relevant working basis to set such exact values of $X(\text{VNAV})\%$, $Y(\text{VNAV})\%$, and $Z(\text{VNAV})\%$.
52. In relation to public debt holding, ESMA does not suggest to impose mandatory holding of public debt for MMFs, since it could create a 2-tier liquidity buffer (DLA/WLA being a single tier in this context) with potential unintended consequences, such as shifting the risks to the sovereign debt market in case of crisis. If this new buffer is dedicated to meet expected large redemptions should a new dash for cash episode occur, then, market participants might potentially expect that a wave of sales of short-term public debt could flood the market. In such a situation, no dealer would be willing to be the first buyer and sovereign debt would mechanically drop in value. Certain market participants could even see benefits to sell public debt ahead of the wave. The impact could be magnified if the crisis is a sovereign debt crisis, such as in 2012. In addition, it is to be noticed that imposing a mandatory public debt holding in addition to DLA and WLA requirements would to a certain extent implicitly imply that the value (in EUR terms) of public debt securities with a residual maturity of up to 190 days would be less volatile / risky than the value of private debt assets with residual maturity up to 5 days. This might not be obvious considering (i) that the price of debt with 190 days residual maturity is far more sensitive to change in interest rates (difference of “duration”) than debt with 5 days maturity and (ii) not all public debt securities have identical levels of liquidity or resilience to market stress. On the contrary, ESMA sees merits in offering

⁴⁶ <https://www.esrb.europa.eu/news/pr/date/2022/html/esrb.pr.220125-32ad91c140.en.html>

the possibility for MMFs, up to a certain percentage, to include public debt assets in the pool of assets allowing them to meet the WLA requirements.

53. **With respect to LVNAVs**, ESMA is of the view that no additional liquidity requirements should apply to LVNAVs, since the DLA/WLAs for these MMFs are already higher than for VNAVs, and these funds also already have the possibility to meet WLA with certain public debt assets, under Art. 24(1)(g).
54. As indicated above, here again, more detailed economic evidence is needed to set the exact values of X(LVNAV)%, Y(LVNAV)%, and Z(LVNAV)%, and because such a complete economic evidence does not seem to be available at the moment, ESMA is of the view that it is uneasy, at this stage, to include definitive exact values in the present Opinion. In case the Commission would consider that the present policy proposal is relevant, ESMA stands ready to further detail this economic assessment, in order to be able to finetune this proposal, and in particular suggest specific values for X(LVNAV)%, Y(LVNAV)%, and Z(LVNAV)%. In that context, ESMA might also assess further the maximum maturity of the abovementioned public debt and the extent to which the maturity of 190 days currently referred to in Article 24(1)(g)) should be amended.
55. However, at this early stage of the review of the MMF Regulation, ESMA is of the view that the current levels of liquidity of MMFs, as shown in Annex IV(B) of the final report “Overview of the MMF sector”, tend to suggest that the proposals of limited increase of X(LVNAV)% (=5%), Y(LVNAV)(=15%)%, and Z(LVNAV)% (=15%), included in the ESRB Recommendation on MMFs⁴⁷ are a relevant working basis to set such exact values of X(LVNAV)%, Y(LVNAV)%, and Z(LVNAV)%.

The corresponding amendments of the MMF Regulation would read as follows:

In Articles 24(1)(d) and 25(1)(c), the words “7.5%” are replaced with the words “7.5%+ X(VNAV)%”.

In Articles 24(1)(f) and 25(1)(d), the words “15%” are replaced with the words “15%+ Y(VNAV)%”.

In Article 24(1)(g), a new subparagraph is added:

“For the purpose of the calculation referred to in point (f), 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 short-term VNAV MMF, up to a limit of Z(VNAV)% of its asset”

⁴⁷ <https://www.esrb.europa.eu/news/pr/date/2022/html/esrb.pr.220125~32ad91c140.en.html>

A.2.3. Inclusion/Reinforcement of the possibility to temporarily use liquidity buffers in times of stress

56. In stressed market conditions, in light of the difficulties faced by MMFs during the COVID-19 crisis in March 2020, ESMA is of the view that it should be possible to relax, for a limited period of time, the liquidity requirements set out in Articles 24 and 25 of the MMF Regulation.
57. The release of these liquidity requirements should, however, not be activated by authorities on their own initiative, since there is a risk that when the authorities decide to release these requirements it will actually trigger the very contagion it intended to contain or simply because it could intervene too soon / too late / disproportionately given that the authority often does not or does not at all times currently possess the detailed information on the market situation to be able to take action⁴⁸. The anticipation of the activation of LMTs by public authorities could also create the perception of a first mover advantage and precipitate redemptions ahead of such decision (therefore prompting the need to such activation).
58. On the other hand, Article 24 (portfolio rules for short-term MMFs) and Article 25 (portfolio rules for standard MMFs) could be complemented by adding a paragraph indicating that under certain conditions (stress market conditions) a portion of each ratio (or of some of the ratios) referred to in Article 24(1)(c)(d)(e)(f) and Article 25(1)(c)(d) could be released.
59. These “certain conditions” and any potential quantification of the release should be left to be specified in a delegated act (level 2), especially not to create new threshold effects. This is likely to deserve thorough technical analysis, and possibly a certain degree of flexibility in its implementation (because it is difficult to anticipate the exact shape of the next crisis).
60. Finally, it should be noted that several NCAs have indicated that the meaning of Articles 24(2) and 25(2) of the MMF Regulation (qualifications of breaches of portfolio rules by MMFs as a result of the exercise of subscription or redemption rights) could be specified or clarified. These NCAs have indicated in particular that the wording of these provisions could be aligned with the corresponding ones set out in Article 57(2) of the UCITS Directive⁴⁹. However, others consider that the parallel with art. 57(2) of the UCITS Directive is not appropriate, given it relates to diversification risk, with potential upward breaches due to subscriptions, while the Articles 24 and 25 of the MMF Regulation is primarily related to liquidity risks, with potential downward breaches due to redemptions.

The corresponding amendments of the MMF Regulation would read as follows:

In Articles 24(2) and 25(2), two new subparagraphs are added:

“Under certain stress market conditions, the limits referred to in this Article may be partly relaxed. The manager of an MMF shall notify the National Competent

⁴⁸ In that scenario, that measure might also be applied differently by different Authorities (for the same reasons), and may hardly be appropriate for all MMFs, which would be in very different situations, given their differences in terms of investors and portfolio composition.

⁴⁹ i.e. replacing “as a result of the exercise of subscription or redemption rights” with “as a result of the exercise of subscription rights”)

Authority of such a decision of relaxation of the limits referred to in this Article without delay.

The Commission shall adopt a delegated act specifying the abovementioned stress market circumstances under which these limits may be relaxed, as well as the conditions under which the limits can be relaxed. The specifications included in this delegated act shall not introduce any threshold effects.”

B. Complementary / crisis preparedness reforms, aimed at enhancing the MMF resilience as a whole, in view of any future crisis events they might have to face

B.1. Enhancement of MMF reporting requirements

61. The amendments of the MMF Regulation which would enhance crisis preparedness and monitoring of the MMF market aim to provide authorities with the necessary information to identify systemic vulnerabilities in the MMF sector. This is in particular the case with respect to the enhancement of reporting requirements to authorities under Article 37 of the MMF Regulation.
62. In stress market conditions, enhancing and harmonizing crisis-specific data-sharing arrangements should in particular improve authorities' understanding of the systemic risk posed by MMFs and allow for potential further mitigating policy actions to be adopted.
63. The corresponding amendments of the MMF regulatory framework relating to Article 37 “Reporting to competent authorities” of the MMF Regulation are specified in the next paragraphs.

Stress market conditions

64. Article 37 shall be amended to specify that in stress market conditions, more frequent reporting (daily) would be expected on a certain number of key indicators. This would build on the experience which was acquired by national competent authorities during previous crisis times, such as the March 2020 events, developing ex ante a common EU reporting format for managers of MMFs to report to authorities, and then for the latter to ESMA and macroprudential authorities, such as the ESRB, in the more effective way in such crisis time, where time is of essence.
65. The specification of the exact indicators to be reported in these circumstances should be left to a delegated act, as well as the criteria that would define when exactly these requirements applying in crisis time only should be activated. These key indicators, which would be specified in more details in such a delegated act, would be i) Total Asset, NAV and, in the case of Public debt CNAV and LVNAV, the mark to market NAV, WAM, WAL; ii) inflows and outflows; iii) weekly maturing assets; iv) daily maturing assets. In addition, it could be specified that, where relevant, ad-hoc indicators could be requested by authorities in stress market conditions, given the difficulty to anticipate ex ante which indicators exactly would be appropriate in a given stress market circumstance. ESMA should play a coordination role in relation to this process of collection of additional ad-hoc indicators.

66. As regards the set-up of the of this overall reporting process, ESMA proposes to follow the already established practice where the information is reported to the competent authority of the MMF and, subsequently, shared with ESMA and other authorities. However, in light of the Strategy on supervisory data in EU financial services adopted by the European Commission in December 2021⁵⁰, which envisages a number of measures with respect to the standardisation of data, modernising the reporting and ensuring efficient data sharing among authorities, ESMA stands ready to work further on this matter when the review takes place, with the objective of ensuring the most practical set-up of the reporting regime, in line with the above-mentioned strategy and other reporting regimes applicable to the funds industry.

Normal market conditions

67. Apart from crisis times, ESMA is of the view that the frequency of reporting should also be raised in normal times from quarterly to monthly, for MMFs whose assets under management exceed EUR 100 000 000, and from annually to quarterly, for MMFs whose assets under management do not exceed EUR 100 000 000. This would be more in line with the ECB reporting requirements, and would allow for more informed decisions from NCAs and ESMA (e.g. in relation to the supervision of MMFs).

68. However, ESMA is of the view that it has appeared that these thresholds, included in Article 37(1), for defining reporting frequencies might not work properly, given that, because the trigger is purely based on the size of a MMF, the MMF can disappear from the MMF data base precisely when it would be relevant to investigate it. It is therefore suggested to monitor carefully this issue, in the next years, in order to consider whether any additional change would be needed.

69. Finally, Article 37 could be amended to add requirements on the reporting of information on the investors of MMFs, but this should be supplemented by a proposal to enhance the disclosure of MMIs and investors of MMFs (including to the managers of MMFs), which goes beyond the scope of the MMF Regulation. It is to be noted that on this issue (information on liabilities of MMFs) central banks currently have information which are missing for competent authorities and ESMA.

70. In that context, it is to be noticed that the European market for short-term debt securities is currently fragmented and composed of four main submarkets: the market for negotiable European commercial paper (NEU-CP), for Euro commercial paper (Euro-CP), other national commercial paper and certificate of deposit markets, and the market for sovereign short-term bills. This fragmentation and the lack of information on these markets, in particular on secondary OTC markets, impairs the assessment of their size and of their liquidity, which is important to enable MMFs to meet large redemption requests via the selling of assets if necessary.

71. Disclosing information on the main investors in money markets would indeed help to understand the dynamics of the market based on the behaviour of the main categories of investors as well as potential interconnectedness. It may be the case for example that institutional investors are both invested in MMF and Money market instruments (MMIs) directly and may have divested from MMFs while they were selling MMIs during the COVID-19 outbreak.

⁵⁰ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2021:798:FIN>

72. Information on new issuance and outstanding amounts of money markets may be available broken-down on some markets per categories of issuers, ratings, maturities. Daily information on average interest rate per category of issuers, maturity and rating would be a valuable complement. Post-trade information (volumes and prices) could also be introduced on a daily basis (end of day) and be made available to market participants on the secondary market. This information would prove useful for market participants.
73. The disclosure of investor types to authorities would provide valuable information to be better prepared to anticipate the potential spillover effects in case a crisis occurs. This information would prove useful for regulators.
74. It has to be noticed that under the requirements of Article 37 of the MMF Regulation, managers of MMFs already have to disclose certain information on the liabilities and assets of MMF, but these reporting requirements depend on the extent to which manager of MMF are able to possess the corresponding information. As a result of the abovementioned additional need of disclosure, there might be a need to supplement the currently existing reporting requirements under the MMF Regulation by additional disclosure requirements, in particular on MMIs and their investors, which go beyond the strict requirements of the MMF Regulation.

The corresponding amendments of article 37 of the MMF Regulation would read as follows:

Article 37(1) is amended as follows:

In the first sub-paragraph, the word “quarterly” is replaced with the word “monthly”.

In the second sub-paragraph the words “on an annual basis” is replaced with the word “on a quarterly basis”.

In the third sub-paragraph, the words “and second sub-paragraphs” are replaced with the word “paragraph”.

After Article 37(3), a new Article 37(3)(a) is inserted, and reads as follows:

“1. Under stressed market circumstances, for each MMF that it manages, the manager of the MMF shall report a subset of key indicators, on a daily basis, to the competent authority of the MMF. The competent authority of the MMF shall without undue delay make available any information reported in accordance with Article to ESMA, to the ESRB and to the competent authority of the manager of the MMF, if different from the competent authority of the MMF.

2. The key indicators reported pursuant to paragraph 1 shall comprise the following points: a) portfolio indicators such as the Total Assets, NAV, WAM, WAL; b) in the case of Public debt CNAV and LVNAV, the mark to market/model NAV; c) subscription and redemption activity (inflows and outflows) d) daily and weekly maturing assets

If necessary and duly justified, competent authorities may, where relevant, solicit additional key indicators.

3. The Commission shall adopt a delegated act in accordance with Article 45 in order to supplement this Regulation by specifying what should be understood by the stressed market circumstances referred to in paragraph 1.

ESMA shall develop draft implementing technical standards to establish:

- ***the data standards and formats for the information to be reported;***
- ***the methods and arrangements for reporting;***
- ***the template and content of such reports, which shall include all the information (key indicators) referred to in paragraph 2.***

ESMA shall submit those draft implementing technical standards to the Commission by XX/YY/ZZZ.

Power is conferred on the Commission to adopt the implementing technical standards referred to in the first subparagraph in accordance with Article 15 of Regulation (EU) No 1095/2010. ”

B.2. Enhancement of the MMF stress testing framework

75. The current requirements of article 28 and 37 of the MMF Regulation, complemented by the ESMA Guidelines on MMF stress tests, which are updated every year as per Article 28(7), specify: a) the types of stress tests that managers need to have in place, the risk parameters they should take into account (including shocks to credit risk, interest rates or redemptions) (article 28(1)), b) the frequency of the stress tests exercise (article 28(2)), c) the type of reporting of the results of these stress tests to National Competent Authorities and ESMA (article 37 and ESMA Guidelines on MMF stress tests), and d) the corrective measures that managers of MMFs need to take, in case the stress tests reveal vulnerabilities of the MMFs (article 28(3) to 28(6)).
76. In the context of the ESMA Guidelines on MMF stress tests, the ESRB and ESMA define annually a stress test scenario that is then applied to all EU MMFs, the results of which shall be sent to respective National Competent Authority and ESMA, as mentioned above.
77. A key issue is that while individual MMFs might be able to be resilient to the adverse scenario when considered in isolation, this might not be the case when all MMFs face a shock at the same time (as observed in March 2020). This is because individual MMF do not take into account what other MMFs might do at the same time. This coordination failure can create additional stress, especially given the high portfolio overlap, high market footprint and low liquidity of the markets MMFs invest in.

78. In addition, Article 28(6) indicates that the report sent to National Competent Authorities containing the corrective measures that the manager of an MMF will take when results of stress tests reveal vulnerabilities of a specific MMF is also sent to ESMA. The extent to which this coordination mechanism between National Competent Authorities and ESMA is sufficient to address the abovementioned system-wide related issues needs to be assessed.
79. In order to address these issues, Article 28 should be amended to specify that ESMA would, together with the National Competent Authority, receive directly from the manager of the MMF the report mentioned in Article 28(5) of the MMF Regulation, so that ESMA can play its coordination role with National Competent Authorities in a more effective way, given in particular real-time information is of a significant value in such crisis situations as in March 2020.
80. In addition, the hypothetical macro systemic shock specified in Article 28(1)(f) should include relevant features to allow for the possibility to assess the systemic vulnerabilities of MMFs. It should explicitly require making assumptions (therefore also in the implementing guidelines on MMF stress tests) on other MMFs, financial entities and non-financial counterparties behavior. This would mean adding the words “*including, where relevant, the behavior of other market participants*” to Article 28(1)(f). The Guidelines on MMF stress tests would specify this new requirement, in the stress tests managers of MMFs conduct for their own operational purposes on the one hand (sections 4.1 to 4.7 of the Guidelines on MMF stress tests⁵¹), in the standardized stress tests the results of which are reported by managers of MMFs to NCAs, and then ESMA, on the other hand (sections 4.8 and 5 of the Guidelines on MMF stress tests).

The corresponding amendments of the MMF Regulation would read as follows:

In Article 28(1)(f), after the words “as a whole”, the following words are added “*including, where relevant, the behavior of other market participants*”.

In the second subparagraph of Article 28(5), after the words “the MMF for review” the following words are added “*and, for information, to ESMA.*”

The Article 28(6) is deleted.

B.3. Clarification of the requirements on external support

81. In relation to sponsor support, ESMA does not suggest amending the contents of Article 35 of the MMF Regulation on the ban of external support, but it suggests adding in the clarifications brought by in the ESMA Statement on external support published in July 2020⁵².
82. Article 35 of the MMF Regulation specifies that “*A MMF shall not receive external support*”. The March 2020 crisis has raised some questions on the exact implementation of this requirement under certain exceptional circumstances, as well as

⁵¹ https://www.esma.europa.eu/sites/default/files/library/esma34-49-291_2020_guidelines_on_mmf_stress.pdf

⁵² https://www.esma.europa.eu/sites/default/files/library/esma34-39-1096_esma_statement_mmf_art35.pdf

in the usual course of business. In that context, ESMA has issued the abovementioned Statement on the application of this Article 35 of the MMF Regulation.

83. In the context of the difficulties faced by certain MMFs during the COVID crisis in March 2020, efforts and measures of the central banks, and in particular the market liquidity brought by some of these measures may have also indirectly benefited MMFs through the intermediation of credit institutions purchasing short-term assets held by MMFs. The abovementioned statement on Article 35 of the MMF Regulation was issued to coordinate the supervisory approaches of NCAs in light of these and any future liquidity challenges for MMFs in the context of the current COVID-19 pandemic. It is aimed at recalling certain conditions the aforementioned intermediation must comply with under the requirements of the MMF Regulation.
84. In the normal course, MMFs may enter into transactions with affiliated or related parties. Such affiliated or related parties may also have directly benefited from some of the measures mentioned above. According to Article 35 of the MMF Regulation, MMFs are unable to receive external support, defined as “direct or indirect support offered to an MMF by a third party, including a sponsor of the MMF, that is intended for or in effect would result in guaranteeing the liquidity of the MMF or stabilising the NAV per unit or share of the MMF”. The statement aims at clarifying the potential interaction between the abovementioned intermediation of credit institutions and the requirements of Article 35 of the MMF Regulation, specifying certain conditions under which such intermediation does not constitute external support.
85. Certain stakeholders have considered that while useful, the abovementioned clarification brought by this statement was limited, to the extent that, as a level 3 regulatory tool, it could not directly amend certain aspects of the level 1 requirements included in the abovementioned Article 35.
86. ESMA agrees with this assessment and therefore suggest to amend directly Article 35 of the MMF Regulation to introduce these clarifications.

The corresponding amendments of the MMF Regulation would read as follows:

In Article 35(2)(b), after the words “inflated price”, the following words are added:

“For the purposes of examining whether a third party provides the external support, transactions with third parties relating to the assets of the MMF are not purchased at an inflated price where they are executed at arm’s length conditions;”.

In Article 35(2)(e) after the words “share of the MMF”, the following words are added:

“An indication of the direct or indirect objective is where third parties execute transactions solely with the MMFs to which they are affiliated”

B.4 New disclosure requirements on ratings of MMFs

87. As described in the ESMA consultation document on the MMF Review, a large share of MMFs receive MMF ratings from CRAs. In certain cases, the MMF rating methodology used by CRAs to provide MMF ratings can limit further the flexibility available to MMFs to deal with large redemptions, as MMFs would face the risk of being downgraded.
88. The MMF Regulation currently includes a provision on MMF credit ratings (Article 26). However, the title of this Article can give the impression that the underlying provisions refer to MMFs and the solicitation of MMF ratings, which it does not.

“Article 26

MMF Credit ratings

An MMF that solicits or finances an external credit rating shall do so in accordance with Regulation (EC) No 1060/2009. The MMF or the manager of the MMF shall clearly indicate in the MMF's prospectus, and in all communication to investors in which the external credit rating is mentioned, that the rating was solicited or financed by the MMF or by the manager of the MMF'

89. A straightforward interpretation of this Article is that the first sentence requires that if an MMF solicits a credit rating (not a MMF rating) it shall only solicit a credit rating from an EU registered CRA. This is a standard requirement that has been replicated in other pieces of EU regulation. The second sentence could be interpreted as requiring that if an MMF refers to a credit rating in its prospectus that it has solicited from an EU registered CRA it should indicate whether that the rating was solicited by the MMF. This is another standard requirement and reflects provisions under CRAR where CRAs need to disclose whether a credit rating was solicited or unsolicited by the rated entity.
90. As a result, the main element of this Article that could be understood as creating inconsistency with CRAR is the title “MMF Credit Ratings”, as it is the title that implies MMF ratings are credit ratings. If the Article was titled “MMFs and Credit Ratings”, there would be less potential for confusion.
91. Providing this clarification, however, does not address the issue as to whether MMF ratings are subject to any or equivalent regulatory requirements as credit ratings. As a result, in addition to clarifying the title it could be proposed considering putting MMF ratings under the regulatory framework used for credit ratings. This would at least ensure that the MMF ratings that are being used by investors, and which fall out of scope of the CRA Regulation, are subject to some minimum standards
92. Indeed, when deciding on the opportunity to impose the use of certain liquidity management tools or simply allow for the use of these tools under certain circumstances, the consequences of these requirements on the MMF ratings of MMFs, as provided by CRAs, should be assessed in order to avoid unexpected consequences of the use of these tools. Putting MMF ratings under the regulatory framework used for credit ratings would clarify the interaction between ratings of MMFs and the use of certain liquidity management tools.
93. However, ESMA is of the view that this amendment is broader than the mere review of the MMF Regulation and should therefore be contemplated separately by the Commission. It is therefore suggested to the Commission to consider, in the future,

putting in place a supervisory framework of the ratings activity of CRAs on MMFs, but not in the context of the review of the MMF Regulation.

94. In the meantime, however, as a first step, ESMA suggest to make it mandatory for MMFs to disclose that they are rated, as well as the main features of that rating (especially the conditions under which the ratings are downgraded). Because the prospectus should not be automatically modified by the manager every time certain features of the rating, or the rating methodology change, it should be specified that such an update is needed only in case of material changes of the rating / rating methodology. What should be understood by “material” would need to be specified in a delegated act.

The corresponding amendments of the MMF Regulation would read as follows:

In the title of Article 26, the word “MMF” is replaced with the words “MMFs and”.

A new Article 26a is created, and reads as follows:

“MMF ratings,

The manager of an MMF may solicit the rating of an MMF by an entity regulated and certified in accordance with Regulation (EC) No 1060/2009 of the European Parliament and of the Council. The MMF or the manager of the MMF shall clearly indicate in the MMF's prospectus, and in all communication to investors in which the rating of the MMF is mentioned, that i) the MMF rating was solicited or financed by the MMF or by the manager of the MMF, and ii) the main features of this rating, including the conditions under which the rating could be downgraded.

The prospectus shall be accordingly updated only if the changes related to the abovementioned features of the rating and conditions under which the rating could be downgraded are material.

The Commission shall adopt a delegated act specifying what shall be understood as a material change, as referred to in the present article.”



3.2 Annex II: Feedback statement

Feedback statement of the ESMA consultation document on the review of the MMF Regulation

ESMA has received 38 responses, mostly responses from asset managers (16) and European, international and national association of asset managers (7), but also responses from professional investors (3), rating agencies (3), the ESMA SMSG⁵³, and the Eurosystem.

Introductory comments

1. Respondents generally used the introductory comments section to introduce their field of activity, give summaries of their responses and provide some general observations on MMFs, and the MMF regulatory framework in the EU.
2. Many respondents commented on the importance of MMFs and their role in the financial systems, and the EU economy. Key features of MMFs mentioned by respondents included the fact that they give corporations viable options for managing their cash balances, contribute to the diversification of funding sources and provide investors with a diversified short term investment opportunity with low credit risk, while being subject to a robust regulated framework.
3. Respondents also shared observations made during the 2020 crisis. Several respondents noted that the need for cash (the so called “dash for cash”), due to the sanitary situation worldwide, dramatically increased during the crisis, which, in turn, led to large outflows and redemptions in MMFs. In their view, this, in combination with a freeze in the underlying markets, which MMFs are dependent upon, led to a great decrease in liquidity.
4. In general, respondents were in agreement that the MMF framework could be further improved. However, respondents had different views on the needed magnitude of these potential changes. One respondent noted that regulatory reforms were needed to increase the resilience of MMFs, in particular from a macroprudential perspective and from an ex-ante perspective. Most other respondents believed it was key that the review focuses on areas where carefully selected targeted needs can be identified. In that context, several respondents indicated that no activation of liquidity management tools (LMTs) had been observed in the first half of 2020, which supported their view that the existing MMF Regulation framework is largely robust. Similarly, some respondents wished to highlight the usefulness of MMFs and the MMF Regulation in the crisis itself. In their view, during the crisis, MMFs took pressure away from other market sectors to meet investor cash demand, and due to the high liquidity of these funds, investors could first turn to MMFs rather than other less liquid funds.
5. Many respondents also took the opportunity to mention their preferred policy options among those on which ESMA has consulted in the consultation document on the review of the MMF Regulation. These options included, *inter alia*, first, decoupling potential activation of liquidity fees or gates from a possible breach of liquidity thresholds, building countercyclical liquidity ratios, consider using liquidity management tools, such

⁵³ https://www.esma.europa.eu/sites/default/files/library/esma22-106-3439_smsg_advice_on_mmf_review.pdf This Advice is also included in Annex III

as liquidity fees, and, to a lesser extent, improving the reporting requirements for MMFs. Some respondents also voiced their scepticism, or concern, regarding certain proposed policy options such as changes in rules on liquidity buffers, mandatory application of swing pricing and the creation of a Liquidity Exchange Facility.

6. In addition, the vast majority of respondents suggested that policy options related to improving the underlying markets should be explored, for example by increasing its transparency, its resilience and its functioning. However, it was pointed out that this policy option would not strictly enter into the scope of the amendments of the MMF Regulation.
7. Respondents also made comments on the role of central banks. A few respondents suggested further coordination between central banks and more intensive sharing of information in order to be able to use the same wide array of types of intervention. The ECB programs such as PEPP and CSPP were supported by some respondents, including some asset managers, whereas others argued that liquidity provided through the PEPP was primarily flowing to issuers of money market paper rather than money market funds or intermediaries, resulting in limited effects on MMFs and secondary market liquidity. In addition, some respondents did not agree that the intervention of central banks should be entirely excluded in the future, notably when there are highly stressed market conditions.
8. On the role of credit rating agencies (CRAs) and the use of ratings, the majority of respondents did not have concerns about neither the current role of CRAs nor the use of ratings for MMFs and did therefore not believe any significant regulatory changes were needed.
9. Lastly, comments were also made by several respondents calling for maintaining the LVNAV and CNAV fund structure in the MMF Regulation, due to their importance as cash management structures for certain investors. Nevertheless, there was also support from a limited number of respondents to reconsider the use of these structures.

ESMA's response: In line with the feedback received from respondents, including the SMSG, and based on the assessment of the key issues faced by MMF during the COVID-19 crisis (detailed in question 1 below), ESMA has identified several vulnerabilities of MMFs that amendments of the MMF regulatory framework, and in particular the MMF Regulation, shall, generally speaking, aim to address: a) threshold effects for constant NAV MMFs, and specific first-mover advantage related issues applicable to these funds b) liquidity related issues, including liquidity transformation related issues. These liquidity related issues include the fact that currently, investors may not effectively bear the costs of redemptions. Finally, other amendments of the MMF Regulation would enhance crisis preparedness and monitoring of the MMF market.

Based on the abovementioned categorization of the vulnerabilities of MMFs, and corresponding corrective measures to be taken, ESMA suggests a package of reforms, and corresponding amendments of the MMF Regulation, which is detailed in the Opinion included in the Annex I of the present Final report, as well as in the next ESMA responses to questions 3 to 13. In that respect, it is to be noticed that some of the issues raised by stakeholders on

underlying markets and central banks (as referred to above in paragraphs 6 and 7) go beyond the scope of the review of the MMF Regulation.

QUESTION 1:

Q1: i) Do you agree with the above assessment of the difficulties faced by MMFs during the COVID-19 March crisis? Do you agree with the identification of vulnerabilities? ii) What are your views in particular on the use of MMF ratings by investors? Are you of the view that the use of such ratings has affected the behaviours of investors during the March crisis?

i) Do you agree with the above assessment of the difficulties faced by MMFs during the COVID-19 March crisis? Do you agree with the identification of vulnerabilities?

10. Respondents' views on ESMA's assessment were mixed. Some respondents generally concurred with ESMA's analysis whereas others partially agreed to various extents and a few indicated that the MMFs they manage did not experience stress in March 2020.
11. A majority of respondents agreed that the COVID-19 crisis was due to a shock triggered outside of the financial sector and resulting in liquidity stress for all market participants, including MMFs. The lack of liquidity in the secondary market during the COVID-19 crisis was acknowledged by most respondents, of which some believed that the fact that no MMFs had to use gates or fees in those challenging conditions gave evidence that MMFs are resilient in crisis time, whereas other respondents noted that the episode had revealed structural vulnerabilities of MMFs e.g. the ECB.

Identification of vulnerabilities

12. Most respondents agreed with the vulnerabilities identified by ESMA, however there were diverging views on the relative importance of those vulnerabilities during the COVID-19 crisis.
13. A few respondents did not agree with the vulnerabilities of MMFs identified by ESMA. It was in particular noted by some respondents that for LVNAVs no fees, gates or suspension of redemptions had been introduced during the crisis, and none of those funds breached their collars. A few respondents also made similar assessments as ESMA by differentiating the performance of fund types, noting in particular that public debt CNAV MMFs recorded inflows during the crisis. Several respondents therefore cautioned in drawing general conclusion across fund types was therefore expressed.
14. Others agreed with the vulnerabilities listed in the consultation paper, in particular in relation to the vulnerabilities related to liquidity in private money markets. However, several of those respondents also disagreed with the assertion in paragraphs 22 and 24 of the consultation paper, which state that markets are not very liquid even in normal times. It was argued that low volumes are explained by MMFs tending to buy and hold onto short-term instruments until maturity, but that liquidity – defined by one respondent as the rapidity and easiness to sell a position – is high in normal times. Some respondents indicated that due to regulatory reforms in the banking sector after the 2008 crisis, banks were less willing and able to provide liquidity in CP and CD, leading to a reduction in the ability of MMFs to dispose of assets during stress periods.

15. Respondents also concurred with ESMA's assessment in paragraph 46 and 47 of the consultation paper, stating that regulatory constraints for LVNAVs prescribing a tie between minimum WLA levels to the use of fees and gates resulted in pro-cyclical behaviour (please also question 3).
16. Furthermore, some respondents agreed with ESMA's assessment regarding the underlying short-term market and acknowledged that the lack of transparency remains a vulnerability and also supported the views expressed by ESMA that increased liquidity in these underlying markets would strengthen the resilience of MMFs.

Central bank interventions

17. Lastly, some respondents wished to highlight that central bank interventions such as the European Central Bank's (ECB's) Pandemic Emergency Purchase Programme ('PEPP') had been largely inaccessible to MMFs, as assets typically held by MMFs (financial CP and CP on non-EUR currencies) were ineligible for the PEPP and financial CP markets were one of the few fixed income markets that was not directly supported by the ECB (unlike corporate, sovereign, covered bonds and securitised products). Instead, MMFs have only been indirectly assisted by these interventions.

ii) What are your views in particular on the use of MMF ratings by investors? Are you of the view that the use of such ratings has affected the behaviours of investors during the March crisis?

18. Respondents generally believed that MMF ratings provided by CRAs as external providers are important and appreciated by investors, providing investors with an independent review and aids in ensuring as well as assuring the quality of MMFs. Several respondents indicated that AAA ratings were required by some investors to invest in MMFs.
19. Several respondents did not believe that the use of MMF ratings during the crisis had any impact on investor behaviour or that such ratings had a connection to the liquidity crisis at all. An argument used to support this statement was that the COVID-19 crisis was not linked to a credit issue but rather a global sell-off liquidity issue, fuelled by heavy redemptions by investors needing cash.
20. As such, most respondents did not agree that MMF ratings were an area of vulnerability during the crisis and a few respondents explicitly noted that they did not believe it was an issue worth addressing in the context of the review of the MMF Regulation. Some respondents added that unrated funds witnessed similar redemption activity to rated funds, suggesting no difference in vulnerability due to fund rating.

ESMA's response: In line with the feedback from most respondents, and the assessment of the abovementioned difficulties faced by MMFs in March 2020, ESMA is still of the view that private debt MMFs are subject to three intertwined vulnerabilities: (i) high market footprint in the short-term markets they invest in (MMFs hold more than 50% of the CP market), (ii) high portfolio overlap (MMFs tend to have exposures towards the same issuers) and (iii) low liquidity of underlying markets. However, ESMA has duly taken into account the views expressed by



respondents (including the SMSG) that one of the main drivers of the March 2020 crisis was the lack of liquidity in the secondary market during the COVID-19 crisis, and the corresponding need to improve the liquidity of these markets.

This economic assessment has helped ESMA to develop the proposed amendments of the MMF Regulation, which are detailed in the Opinion included in the Annex I of the present Final report, as well as in the next ESMA responses to questions 3 to 13.

QUESTION 2

Q2:

i) Do you agree with the above assessment on the potential MMF reforms related to the review of the MMF Regulation?

21. Respondents welcomed the ESMA consultation to ensure resilience in MMFs and the money market and many respondents expressed their agreement with the global assessment made as well as the proposed assessment framework. As such, respondents especially shared the view that the aim of the reform should be to make MMFs more resilient to stressed market conditions, while preserving the key intermediation role that MMFs have in the short-term funding markets.
22. Several respondents wished to highlight that the key issue experienced in March 2020 was a problem of liquidity in the market and that this was not structural to, nor caused by, MMFs. In their view, due to the nature of MMFs, these vehicles should not be seen as the source of exogenous market stress and “dash for cash” behaviour but rather revealing early signals of uncertain times. As such, there was a call from these respondents to consider reforms affecting the (underlying) markets themselves (in terms of transparency in particular) as opposed to strictly limiting the focus of the review to MMFs. Respondents therefore welcomed ESMA’s views on the broader impacts of potential reforms to the stability and functioning of the short-term markets.
23. Generally, respondents only saw a need for a partial reform of the MMF Regulation. While a common feature of these responses included a call for maintaining the flexibility and resilience of the framework, the support for these partial reforms was to some extent split in terms of what those reforms should consist of. Overall, the approach to potential reforms of the MMF Regulation which were most favoured by respondents included: i) decoupling regulatory thresholds from gates and fees (Article 34 of the MMF Regulation); ii) keeping the prohibition of external support unchanged (Article 35 of the MMF Regulation); iii) abstaining from imposing any Liquidity Exchange Facility regime; and iv) if any LMT is considered for MMFs, favouring liquidity fees (exit fees) to swing pricing.
24. Some respondents commented on the need to avoid a “one-size-fits-all approach”. This was the case both in terms of differentiating the specificities of each type of MMF and taking a specific European perspective on the review of the MMF Regulatory framework (as opposed to imposing reforms in the EU framework which would be mostly relevant in other non-EU jurisdictions).

25. Lastly, one respondent (a public authority) indicated that it is in their view indispensable to significantly enhance the resilience of MMFs from an ex-ante perspective, which should be a key objective of MMF regulatory reforms. The focus of reforms should be in the view of this respondent on MMFs with investments in private sector debt. In particular, this respondent supports reforms that will result in an appropriate reduction in the liquidity mismatch across fund types and jurisdictions. This could be achieved by making the assets of MMFs more liquid, reflecting their use by investors as a cash management vehicle. This could be facilitated through a requirement on the holdings of liquid public assets. A reduction of the liquidity mismatch would reduce the need of funds to raise cash during stress periods and thereby mitigate spillovers to short-term debt markets and corporate funding. Such policies would also help close the gap between investors' use of MMFs as cash management vehicles and the liquidity of MMF portfolios in crisis situations. Policies aimed at reducing the asset liquidity mismatch in MMFs should be, in the view of this respondent, complemented (but not replaced) by measures to help improve the usability of liquidity buffers, mitigate possible cliff effects and reduce the first-mover advantage.
26. More specifically, this respondent specified that, in their view, given their heightened vulnerability to liquidity shocks, certain MMFs (low-volatility net asset value (LVNAV) and variable net asset value (VNAV) funds) should be subject to requirements that enhance the overall liquidity risk profile of their portfolio assets. For instance, they could be required to invest a minimum percentage of their assets in highly liquid public debt that could be temporarily drawn down without triggering any fees or gates for investors at the direction of macroprudential authorities. According to this respondent, public debt markets are substantially more liquid and deeper than CP and CD markets, as it has been demonstrated during the COVID-19- related market turmoil. The limited public debt holdings of euro area private debt MMFs are currently concentrated in the most liquid public debt. Increasing these holdings would ensure that they have sufficient liquid assets to meet large-scale redemptions during a liquidity shock. A minimum requirement for public debt could apply in parallel to existing requirements on weekly liquid assets. To achieve the desired reduction in the liquidity mismatch and alleviate concerns of risk shifting, assets counting towards the new requirement should not be used to meet other requirements. This new requirement could be partially fulfilled with short-term reverse repos against government securities.

ii) What are your views on the abovementioned assessment of the interaction between potential MMF reforms and the behaviour of investors during the MMF March 2020 crisis?

27. Respondents agreed with ESMA on the importance of considering the potential impacts of each reform option on investor behaviour, in particular in light of the patterns of investor behaviour observed during the pandemic.
28. A group of respondents shared their observations on investor behaviour during the crisis, which were identified as primarily being institutional investors. Those observations included institutional investors (composed of non-financial firms, corporates, pension funds and insurance companies) exiting from MMF to cover short cash needs such as employee payrolls, pensions (quarter ends in one Member State), paying suppliers and operating expenses as they were being confronted with a halt in their activity and incoming revenues during the crisis episode. When they also faced

difficulties to roll issuances of short-term papers/place short term paper to finance themselves, their needs for cash amplified.

29. The proceeds of sales were reported by one respondent as being directly used or placed in banking deposits. Whereas a few respondents especially noted that corporates expressed stringent need for cash, another respondent highlighted that the needs of this investor group and other MMF investors were not entirely clear. Given the large and diverse range of investors, this respondent believed it would be extremely difficult to extract exact data on investor behaviour and their incentives for redemptions.
30. Some respondents generally agreed with ESMA's findings in paragraph 46 and 47 of the consultation paper⁵⁴ and stated that some of the MMFR requirements tying minimum liquidity levels to the use of fees and gates, inadvertently encouraged a "first-mover-advantage" behaviour where the 30 % WLA threshold was perceived as a "bright line" by investors, thus reinforcing procyclical behaviour. One asset manager shared its experience that it had to sell longer-dated assets into the secondary market, creating further downward pressure on the prices of those assets and exacerbating stresses in both the secondary markets and on MMFs specifically in order to avoid the 30 % WLA threshold. This respondent, along with others, believed investors were concerned about the possibility of gates being imposed as MMFs' WLA approached 30%. Only a very limited number of respondents noted the differences between the EU's and the US' regulatory frameworks on this specific issue.
31. In addition, respondents noted that the alternatives to MMFs that investors may turn to are less regulated and offer less transparency than MMFs. As such, these respondents believed that ineffective reforms could pose a risk as it may lead to a change in investor behaviour whereby investors may turn to other liquid instruments with potentially higher credit risk and less transparency.
32. Lastly, a few respondents (associations of managers of funds) reported that their members (asset managers) had observed, for a small part of their assets, some international corporations switching from Standard MMFs to ST MMFs. However, the vast majority of those respondents' members had not observed trends of switching standard MMFs to short term MMFs or switching MMFs to government paper. Those respondents indicated that their members had not reported concerns of redemptions for margin needs or repo collateral in their national market.

ESMA's response: ESMA acknowledges that several respondents, including the SMSG, are of the view that the scope of the amendments of the MMF Regulation that are needed to improve the resilience of MMFs vis a vis stressed market conditions should be limited (and should in particular focus on the decoupling of regulatory thresholds from gates and fees). However, ESMA maintains that other changes to the MMF Regulation are relevant and should be considered.

⁵⁴ Paragraph 46 and 47 reads: "46. Some market participants have argued that MMF regulatory reforms might have created a first-mover advantage by tying breaches of WLA to the use of redemptions fees and gates.
47. As the level WLAs decline towards the regulatory threshold of 30%, investors might have an incentive to pre-emptively run to avoid being subject to redemption fees and gates. In the US, Li et al. (2020)¹⁴ provide evidence that US prime funds with the lowest WLA had higher outflows than MMFs with higher level of liquid assets and Cipriani and La Spada (202015) found that this effect was significant for MMFs sold to institutional investors (but not for retail investors)."



Based on the assessment of the key issues faced by MMF during the COVID-19 crisis (detailed in question 1 below), ESMA has indeed identified several vulnerabilities of MMFs that amendments of the MMF regulatory framework, and in particular the MMF Regulation, shall aim to address: a) threshold effects for constant NAV MMFs, and specific first-mover advantage related issues applicable to these funds b) liquidity related issues, including liquidity transformation related issues. These liquidity related issues include the fact that currently, investors may not effectively bear the costs of redemptions.

Finally, other amendments of the MMF Regulation which would enhance crisis preparedness and monitoring of the MMF market will in particular aim to provide NCAs and ESMA with the necessary information to identify systemic vulnerabilities in the MMF sector. These measures will allow to better understand the investor base of MMFs. In stressed market situations in particular, enhancing and harmonizing crisis-specific data-sharing arrangements will improve authorities' understanding of the systemic risk posed by MMFs and allow for potential further mitigating policy actions to be adopted.

Based on the abovementioned categorization, ESMA proposes a package of reforms, and corresponding amendments of the MMF Regulation, which is detailed in the ESMA Opinion included in Annex I of the present Final report, as well as in the ESMA responses to questions 3 to 13 below.

QUESTION 3

Q3: Do you agree with the above assessment of the i) potential need to decouple regulatory thresholds from suspensions/gates and the corresponding proposals of amendment of the MMF Regulation ii) potential reforms of the conditions for the use of redemption gates? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

i) Potential need to decouple

33. Overall, the vast majority of respondents supported a reform of Article 34 of the MMF regulation whereby regulatory thresholds (WLA) are decoupled from suspensions/gates. Several of those respondents supported an alternative regime where it is left to the discretion of the fund management company to impose such measures on the fund when it is in the best interest of the investors. Some respondents called for a removal of not only Article 34(1)(a)(i) and (ii)⁵⁵, but a full removal of Article 34 (thus also including Article 34(1)(a)(iii)⁵⁶ on suspensions). A reason for this was the

⁵⁵ Article 34(1) of the MMF Regulation implies that the manager of the MMF shall decide to apply certain measures, including liquidity fees (Article 34(1)(a)(i)) or gates (Article 34(1)(a)(ii)) if the WLA ratio falls below 30% and the net daily redemptions on a single working day exceeds 10% of total assets.

⁵⁶ Article 34(1)(a)(iii) of the MMF Regulation implies that the manager shall decide to apply suspension of redemptions for any period up to 15 days if the WLA ratio falls below 30% and the net daily redemptions on a single working day exceeds 10% of total assets.

belief that a partial removal would only shift investor focus from one restricting measure to another.

34. The comments from respondents are described in the following paragraphs below according to the table of criteria set out in paragraphs 76 to 80 of the Consultation Paper.

I. Impact on the resilience of MMFs

35. Most respondents noted that the link between thresholds and suspensions/gates had the unintended consequence of increasing redemptions in a period of market stress. The same respondents believed that a decoupling of thresholds from the activation of suspension/gates would allow the liquidity buffer to be used in a more efficient manner, strengthening the resilience of short-term funding markets in times of stress. Some of these respondents also noted that, as a result of this policy option, MMFs would not hold less liquidity, as the 30 % WLA threshold should be met in any case.
36. A few respondents drew comparisons between the U.S. MMF market, and corresponding regulatory framework, with the EU MMF market and the MMF Regulation. In the U.S., higher outflows from prime MMFs than European MMFs had been witnessed, which was believed to have been linked to regulatory thresholds being more tightly tied to fees and gates in the U.S. as compared to the EU. Respondents also noted that the U.S. is considering a reform in its regulatory MMF framework too, and indicated that a report by the President's Working Group on Financial Markets⁵⁷ published in December 2020 suggested that the linkage of thresholds to use of liquidity management tools induced pre-emptive runs in March 2020.

II. Effects on investor behaviour

37. Respondents that agreed with ESMA's proposal argued that the proposal would mitigate first-mover advantage-related issues, especially in stressed market conditions. It was mentioned by some respondents that investors have, under the current regime, perceived thinning WLA buffers as an increased probability of fees or gates being imposed by the board. It was suggested that the current regulatory framework, both from a micro and a macro perspective, may create an incentive for investors to redeem pre-emptively even when they do not have cash needs, which means that the rules have established a "bright line". Furthermore, certain respondents believed that this direct link had become a focal point for investors during their decision-making in March 2020 and could promote pro-cyclical redemption behaviour.
38. Respondents therefore generally supported the view that if the decision to impose measures such as suspension/gates was left to the board instead, risks of large investor outflows would be mitigated. It was highlighted by these respondents that Article 36 MMFR titled 'Transparency' would continue to provide investors with transparent liquidity levels, and that risks would be spread more equally between investors as first-mover advantages are reduced.
39. Nevertheless, it was also cautioned by some respondents, after mentioning point 84 of the consultation document which refers to studies that establish a link between WLA downward trend and redemption upward trend, that the existence of regulatory

⁵⁷ December 2020 Report of the President's Working Group ("PWG") on Financial Markets ["Overview of Recent Events and Potential Reform Options for Money Market Funds."](#)

mandatory fees and/or gates should not be assumed to fully explain this link (although it may amplify it).

40. Finally, one respondent urged further research to be undertaken in order to better understand investor behaviour to inform potential reforms on this point.

III. Effects on fund managers

41. Some respondents noted that the current regulatory framework may provide incentives to portfolio managers to sell assets when not required to do so, or to boost liquidity buffers rather than meeting investor redemptions. Respondents observed in this regard that fund managers had *increased* their WLA levels during the 2020 pandemic, ranging to well over 40 %. Some respondents believed that the liquidity buffer coupled with the use of suspensions/gates had disincentivised fund managers from using the buffer in times of stress, which undermined the role they were meant to play in such times. This meant that the thresholds were treated as floors for LVNAV funds.
42. By decoupling the regulatory thresholds from suspensions/gates, several respondents believed that fund managers could become more inclined to use liquidity buffers under periods of stress. It was also believed by one respondent that fund managers would be able to use liquidity buffers in the best interest of investors and avoid unnecessary sales to supplement buffers when not necessary.

IV. Broader impacts on the stability and functioning of short-term funding markets

43. No respondent believed investors would be inclined to move to other alternatives to MMFs based on the proposed policy option.

ii) potential reforms of the conditions for the use of redemption gates

44. Respondents reiterated that use of liquidity management tools should not be mandatory but should ultimately be left to the discretion of the fund management company to be exercised in the best interest of the investors. Some respondents supported a full removal of the requirement in Article 34 rather than reforming the conditions as it was believed it would only move the “bright line”, which would not have the desired effect on investor behaviour.
45. Several respondents objected to an imposed condition to obtain permission from regulatory authorities prior to introducing gates, as it was believed to be impractical (especially in times of stress), inefficient, demand further resources from all parties and could result in undue delays. This was believed could be of detriment to investors in time-critical situations.
46. Some respondents also objected to any rule on prior notification to authorities before introducing gates, whereas one respondent believed such notification was appropriate and a few also noted that this was already required in their jurisdictions.

Other comments

47. Lastly, a few respondents submitted further proposals that could be considered in relation to Article 34 of the MMF Regulation (and which also relate to other questions of this consultation, such as question 4), e.g. to make it possible for regulators to grant

exceptional leeway from the 30% WLA requirement during times of stress or allow MMFs to use 20% of the weekly liquid asset buffer while leaving the 10% level as the threshold at which the board may consider a gate. Another suggestion by one respondent was to increase liquidity buffers to help offset concerns around the potential to drop below thresholds and enable funds to dip into liquidity buffers more regularly, should concerns about liquidity levels exist. A few respondents also wished to highlight that a change such as the one proposed by ESMA would require rating agency methodologies to be modified accordingly (please see in that context the response to question 8 of this consultation).

ESMA's response: ESMA agrees with the vast majority of respondents, including the SMSG, who indicated they see a need to decouple regulatory thresholds from suspensions/gates and the corresponding proposals of amendment of the MMF Regulation.

This amendment of the MMF Regulation would reduce threshold effects and aim at eliminating the unintended consequences of the existing requirements of Article 34 of the MMF Regulation.

Indeed, currently, when thresholds laid down under Article 34 of the MMF Regulation are breached, managers of LVNAV and public debt CNAV MMFs have to undertake a documented assessment to determine the appropriate course of action, including the potential imposition of liquidity fees to investors and putting in place redemption gates. This may amplify the run-risk by investors as there seem to be a perception in the market that the imposition of these LMTs is automatic based on these regulatory requirements. Therefore, the removal of these regulatory thresholds included in Article 34 should eliminate any such confusion in the future.

QUESTION 4

Q4:

- i) Do you agree with the above assessment of the potential need to require MMFs to use swing pricing and / or ADL / liquidity fees and the corresponding proposal of amendment of the MMF Regulation (including the above list of corresponding potential benefits and drawbacks)?

48. A great majority of respondents were against imposing rules on mandatory swing pricing. Some of these respondents admitted that swing pricing may be appropriate and useful for other types of open-ended funds, but that the key features of MMFs, including intra-day liquidity constraints in particular (please also see below), make it a less appropriate policy option for MMFs. On the other hand, respondents were more split on the possibility of using liquidity fees and/or ADL (anti-dilution levies). Several respondents supported these options as opposed to swing pricing.

49. In general, respondents objected to imposing mandatory LMTs on MMFs because in their view, it may restrain the liquidity of MMFs, which was perceived to be a key feature

of these highly liquid investment vehicles. Instead, respondents generally concurred that LMTs should in general, remain an available option for the manager of the MMF.

50. The comments from respondents are described in the following paragraphs below according to the table of criteria set out in paragraphs 76 to 80 of the Consultation Paper:

I. Impact on the resilience of MMFs
i. How would the policy option work in mitigating the structural vulnerabilities of MMFs?
ii. Would it apply to all MMFs or only to certain types of MMFs?
iii. a) Is the option currently in place in any jurisdiction, and if so, has it been helpful?
b) How would it represent a change from current rules or practices in other jurisdictions?
c) Has the option been implemented previously and, if so, what were the main findings?
II. Effects on investor behaviour
i. From a micro perspective (viewing the MMF in isolation), how would the policy option affect investors' incentives to redeem during stress events?
ii. From a macro perspective, how would this option mitigate the effects of a generalised "dash for cash" as seen in March 2020; and/or runs prompted by a credit crisis, as seen in September 2008?
iii. a) Does the option effectively shift MMF risks to investors?
b) Does it make those risks more salient and transparent for investors? Are investors treated equally?
III. Effects on fund managers
i. How would the policy option affect MMFs' liquidity management in normal versus stressed times?
ii. How would it impact the ability or willingness of MMFs to invest in short-term funding instruments or use the repo market?
IV. Broader impacts on the stability and functioning of short-term funding markets
i. a) Where are investors likely to move if MMFs become less attractive as a result of the policy option?

b) Do these substitutes have vulnerabilities to runs?
c) Are they transparent to investors and regulators?
d) Are they regulated?
e) Do they embed more risks for investors (e.g. counterparty risk) or be more costly?
ii. a) What alternative sources of short-term funding are available for borrowers that currently rely on MMFs for financing?
b) Are these alternative sources more stable than MMFs at all times?
c) Can they in effect be scaled to replace MMF economic function?
d) Would this address the financial stability issues noted or would risks simply be transferred elsewhere in the market without mitigating them effectively ?

1. Impact on the resilience of MMFs

Swing pricing

51. Several respondents raised concerns as to the effects of imposing mandatory swing pricing on MMFs, in particular the ability of MMFs to provide same-day settlement and intraday trading for T+0 funds. It was mentioned that swing pricing would eliminate intraday trading and same-day settlement since it would require net flow information at the end of the day (which would not be available for intraday movements). Most respondents noted that this feature is a key pillar of MMFs, especially for CNAV, LVNAV and short term VNAV funds. Furthermore, it was observed by some respondents that trading costs for securities held by MMFs are very low, implying that they would not trigger any meaningful dilution of the funds. Swinging the NAV based on trading costs would therefore be small as well. Some respondents also stated that swing pricing is not by nature a tool used by managers to handle liquidity risk and was believed to be less appropriate in extreme market deteriorations.

52. Finally, it was noted that no jurisdiction or MMF utilised swing pricing, and that swing pricing would not have had an impact in managing redemptions of MMFs as witnessed in the March 2020 crisis since there was little secondary market liquidity and transparency in CP markets.

Liquidity fees and ADL

53. On fees and comparable ADL, it was mentioned by certain respondents that they may be effective in less extreme liquidity conditions such as those experienced in March 2020, where MMF managers can still rely on dealer banks and other buyers of short-term instrument to purchase holdings from their funds. However, respondents were more sceptical in situations where the market stress is more extreme (such as that in March 2020). In relation to liquidity fees, a few respondents also noted that an

advantage was that it would not compromise key features of MMFs including intra-day liquidity.

2. Effects on investor behaviour

Swing pricing

54. Several respondents believed that mandatory swing pricing would make MMFs unattractive from an investor's point of view, as they would not allow for intra-day trading and same day settlement. Swing pricing could in turn create uncertainties for investors willing to redeem in T+0 funds as they would have to wait longer for their money upon a redemption request and because it would add another layer of uncertainty, in terms of price volatility.
55. Furthermore, respondents noted there could be potential issues related to the transparency of swing pricing. Lack of certainty over the application and scale of swing pricing could create challenges for investors, whereas on the other hand greater transparency could establish a bright line as investors withdraw their cash in anticipation of partial swing pricing. Nevertheless, it was noted by one respondent that swing pricing would be able to equally distribute portfolio restructuring costs between investors without restricting liquidity in the same way that gates would. Another respondent noted that a smooth, continuous adjustment of its parameters (e.g. swing factor and swing threshold) according to changes in market conditions, could avoid threshold effects and fully pass on to redeeming investors the costs that they impose on the fund.

Liquidity fees and ADL

56. One respondent claimed that ADL and liquidity fees should be rejected as well as they would eliminate a key feature of LVNAV and CNAV funds for investors, namely the high probability that one euro, pound or dollar invested can be redeemed for the same amount. On the other hand, other respondents noted that the advantage of tools such as liquidity fees and comparable ADLs are that they can be regarded as treating all investors equally and fairly, as well as discouraging "first-mover advantage" by transferring cost of liquidity onto the redeeming investor, whilst still being an option less extreme compared to gates. However, some respondents raised the same argument as presented above in relation to swing pricing, namely that an imposition of ADL could incentivise investors to pre-emptively redeem prior to the imposition of such LMT (thus establishing a bright line and having pro-cyclical effects). In addition, it was urged to take investor acceptability of the proposed tool into account. In this regard, the importance of flexibility and free access to liquidity was highlighted by some respondents. It was noted that a complex environment where gains or losses would arise whenever an investor invests or de-invest from an MMF could lead investors to consider other alternatives. Investors with a sophisticated liquidity management system could see increased operational costs, making MMFs less attractive for them.

3. Effects on fund managers

57. Some respondents argued that swing pricing would entail substantial implementation challenges for fund managers as certain MMFs strike their net asset value multiple times a day, calculations of swing factors would be problematic due to low level of transparency in the market, and because it would require significant modifications of current distribution practices. The suggestion to apply swing pricing only to

redemptions and not subscriptions was also believed to be problematic by one respondent, who foresaw operational challenges for MMFs that operate a single NAV.

Liquidity fees and ADL

58. On the other hand, it was believed by a few respondents that liquidity fees were operationally easier to implement and would be more compatible with same-day liquidity.
59. Respondents also mentioned that ADL, as an alternative option, carried less stigma compared to gates and that it could be deployed under a rule-based format. One respondent mentioned that it could, however, raise operational challenges for fund managers who would have to communicate new calculations for redemption/exit fees to intermediaries.

4. Broader impacts on the stability and functioning of short-term funding markets

60. Respondents argued that the implementation of swing pricing adversely affects the role of MMFs as liquid investment vehicles by reducing their ability to offer quick settlements and act as substitutes for cash holdings. As such, several respondents believed that investors would likely prefer to leave their money accessible in bank accounts or deposits, which was noted as problematic as the deposit market may not have the capacity to absorb the liquidity currently in MMFs. Other respondents warned that complicated frameworks and mandatory swing pricing could make corporate users turn to instruments with higher credit risk, less transparency, less diversified exposures and/or liquidity issues which could result in higher risk-taking and higher costs. From a larger perspective, it was believed that this could shift and concentrate liquidity strains to other parts of the financial markets in a future stress scenario and could create liquidity problems for corporates.
61. Furthermore, it was also claimed by some respondents that the short-term market could at present not provide a globally satisfactory level of transparency in terms of pricing and various indicators to create a solid basis for swing pricing implementation or other LMT triggering. As such, it was believed that an important prerequisite for this option would need to entail fair and objective pricing sources being established.

Liquidity fees and ADL

62. On the other hand, an advantage of liquidity fees noted by one respondent was that it would maintain the utility of MMFs as its key features are kept.
 63. A rating agency who answered to the consultation, also noted that a decision to use LMT could eventually lead to rating changes.
- ii) If you are of the view that swing pricing might not be workable for certain types of MMFs, which instruments would you suggest as an alternative for these types of MMFs going forward? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.
64. Some respondents noted that the liquidity fees as made available to managers under Article 34 of the MMF Regulation should be maintained and that the provisions to link

these tools to liquidity thresholds should simply be removed. It was also recommended that these tools be allowed for all types of MMFs and not only CNAV and LVNAV. Whereas some respondents believed that a solution worth exploring was to leave the authorisation to use such fee to a regulatory or external body, possibly with a “market” trigger, others believed it should be in the hands of the board, taking into account investors’ best interest. It was also suggested that adjustable exit fees would be the most appropriate option and that a framework rather than a hard trigger would be appropriate. In that context, one respondent suggested that all MMFs should be equipped with an exit fees set-up in their legal documentation, and another suggested that MMFs be required to maintain policies and procedures on the implementation of fees, which could then be reviewable by national authorities.

65. Lastly, one respondent mentioned that redemptions in-kind had been useful in the past 2008 global financial crisis.

ESMA’s response: While maintaining that the use of LMTs is a key aspect of the resilience of MMFs vis a vis liquidity issues, ESMA has duly taken note of the views expressed by respondents, including the SMSG, in relation to the various potential operational issues associated with the use of certain LMTs for MMFs.

In light of this feedback, ESMA is of the view that in relation to liquidity related issues, the amendments of the MMF Regulation should reduce the liquidity transformation of MMFs and aim at improving the asset-liability matching of MMFs, both in normal and crisis times. MMFs need to be able to meet periods of heightened redemption requests without destabilising wider money markets.

Certain amendments of the MMF Regulation therefore need to impose on redeeming (and subscribing) investors the cost of their redemptions (and subscriptions). This would aim at reducing the impact that redeeming (subscribing) investors have on other investors. In that context, LMTs should be available to all type of MMFs. MMFs should, in particular, have available at least one LMT aiming at appropriately reflecting redemption (and subscription) costs for those departing (or incoming) investors. Such specific LMTs could be, in particular, anti-dilution levies, liquidity fees, and could also, for VNAV MMFs, include swing pricing. These tools would ensure that redeeming (subscribing) investors bear the costs associated with their transactions, and not the investors remaining in the fund.

These LMTs should be activated by the manager of the MMF, and not by the authorities since there is a risk that when the authorities decide to activate a tool it would actually trigger the very contagion it intended to contain, because it could intervene too soon / too late / disproportionately given that the authority often does not possess the detailed information on market situation to be able to take action. The anticipation of the activation of LMTs by public authorities could also create the perception of a first mover advantage and precipitate redemptions ahead of such decision (therefore prompting the need to such activation).

However, in order to harmonize the use of such LMTs by managers of MMFs, ESMA is of the view that the Commission shall adopt a delegated act specifying the circumstances under which these LMTs shall be used by the manager of an MMF. The specifications or criteria for the use of such LMTs, which might be to some extent specific to MMFs, included in this delegated act shall not introduce any threshold effects.

ESMA is aware that in the context of the review of the AIFM Directive, the Commission has recently put forward proposals on the mandatory availability of LMTs for all AIFs and UCITS. However, given the outcome of the negotiations on the proposed amendments to the AIFMD and UCITS Directive is still unclear, at this early stage of the review process, ESMA is of the view that specific proposals on this issue related to MMFs should still be included in the review process of the MMF Regulation. In later stages of the review processes of the AIFMD, UCITS Directive and MMF Regulation, consistency should in any case be sought, on the contents of the requirements, and in particular on the definition of what is meant by the different types of LMTs contemplated.

These proposed amendments are further specified in the ESMA Opinion on the review of the MMF Regulation, included in annex I of the present Final report.

QUESTION 5

Q5:

i) Do you agree with the above assessment of the potential need to increase liquidity buffers and/or make them usable/countercyclical and the corresponding potential proposal of amendment of the MMF Regulation?

66. There was a general disagreement amongst many respondents to increase the liquidity ratios as this was not believed to be an effective solution to difficulties faced by MMFs during the March crisis. It was noted that 30% was a satisfactory liquidity level and that fund managers already held WLA above this threshold pre-crisis thanks to the requirements of Article 27 (Know your customer) and pre-crisis assessments by fund managers. However, a single respondent noted that liquidity requirements could be raised for EU VNAV MMFs, because this respondent saw no justified explanation that could warrant lower requirements for these types of funds.
67. On the contrary, several respondents believed that the best solution to these liquidity related issues was to preserve a minimum regulatory level and a flexibility to adapt to higher levels anytime needed, depending on each portfolio and liability context.
68. Specifically on the options presented by ESMA⁵⁸, only a few respondents mentioned their preference, and no steer on the most favoured option could be clearly distinguished.
69. Many respondents reiterated the point that it was necessary and preferable to delink the 30% WLA threshold from fees and gates in order to ensure that the liquidity of a fund can be used as intended in times of stress (please also see the responses to question 3). This was believed to be a more effective way of reaching the sought aims.
70. Finally, one respondent specified that making part of the liquidity buffer of all MMFs releasable during periods of stress could further enhance their usability. A releasable buffer component could allow macroprudential authorities to act more effectively in adverse market conditions. The additional buffer could be released in periods of

⁵⁸ Specified in paragraphs 111 to 117 of the ESMA consultation report on the review of the MMF Regulation

system-wide stress, enabling managers to draw down on their liquidity buffers, thereby mitigating the risk of fire-sales and suspensions. The releasable buffer could be made part of the existing buffer (rather than added on top of existing buffers) under the precondition that the fund's liquidity risk profile is substantially improved, for instance through higher investments in public debt (please see the introductory remarks).

71. The comments from respondents are described in the following paragraphs below according to the table of criteria set out in paragraphs 76 to 80 of the Consultation report.

I. Impact on the resilience of MMFs

72. A limited number of respondents, who favoured option 1⁵⁹, believed that, if this option was chosen, the set-up would, however, need a clear framework with pre-set rules to ensure that individual funds' ability to act in the best interest of investors does not get adversely affected. Whereas one argument supporting this option was that it could reduce pressure for assets to be sold from MMFs, an argument against this option was that it might prevent MMFs to efficiently meet future redemptions.

73. On option 2, it was highlighted by several respondents that stress tests can quickly become out-dated which may render them irrelevant for a particular stress event a fund is facing, be complex to administer, or be considered irrelevant for future stress conditions. One respondent also noted that the procedure leading to the calibration of an additional buffer should be done at fund level and be in the hands of the asset managers, as it was believed that such a process would require sufficient information on clients' intentions and daily monitoring of the liability structure of the MMF.

74. On option 3, several respondents argued that the aim of this option to make liquidity buffers more flexible was already fulfilled, in the context of the requirements of e.g. Article 27 "Know your customer". A further regulatory requirement was believed by those respondents to be too rigid, not allowing for adaptations to funds' specificities and difficult to implement, given defining what "volatile institutional investors", as per paragraph 117 of the ESMA consultation report on MMF, might not be straightforward.

⁵⁹ Option I, II and III are described in paragraphs 112 to 117 of the ESMA Consultation paper on the review of the MMF Regulation, as follows:

In order to address this issue, one could review the calibration and/or composition of these minimum liquidity buffers. Under this approach, the current minimum daily and/or weekly WLA requirements could automatically decline in certain circumstances, such as when net redemptions are large or when the regulatory authority provides temporary relief from WLA requirements. Any thresholds linked to a fund's minimum WLA requirements (e.g., fee or gate thresholds) would also move with the minimum (option 1).

Alternatively, the WLA could be defined as the greater of the current WLA and a buffer calibrated by the regulator based on stress tests performed by MMF managers in accordance with shocks defined by the regulators (this buffer would, however, not need to be fund specific). Such buffer could either be relaxed, at the initiative of a supervisor in times of stress or by the managers in the interest of investors and for financial stability purposes (assessment of the supervisor/ EU macro-prudential authority). To avoid any non-intended consequences, the buffer would be non-public (option 2). This would allow funds to deploy liquid assets more flexibly in a crisis and could mitigate liquidity strains. Under option 2, an EU coordination role might be crucial here to avoid regulatory arbitrage across jurisdictions, and hence a role for ESMA/ESRB could be considered. These countercyclical liquidity buffers could also be combined with mandatory swing pricing, as referred to above (when the counter-cyclical buffer is used); in order to limit any trigger effect, the counter-cyclical buffer and the liquidity position would not be made public.

A further measure to make liquidity buffers more risk sensitive and flexible is to differentiate the level of liquidity buffers according to funds' structural exposure to funding risk (i.e. similar to the concept of stable and unstable funding for banks' LCR). Under this option (which would be an option 3) funds with a larger share of volatile institutional investors could be required to hold larger buffers. To this end, the proposal to disclose MMF investor types to regulatory authorities should be seen a necessary prerequisite"

Lastly, one respondent believed this option would disadvantage some funds over others depending on their investor base, not taking into account whether one fund is managed more prudently than another.

II. Effects on investor behaviour

75. In general, respondents did not believe the options would address issues with “bright lines” and incentivised redemptions.
76. A few respondents noted that option 1, which envisages a possibility of temporary relief from WLA requirements, could have unintended pro-cyclical effects, as it was cautioned it might trigger pre-emptive redemptions. Respondents believed that the bright line would simply be moved as investors were likely to continue to place pre-emptive redemptions (unless the thresholds are delinked from fees or gates). It was also argued that investors would consider riskier those funds that have had relief applied, which is why a few respondents urged that if the option was selected, the buffer reduction should not be assessed in relation to individual funds but rather to all EU funds (including all fund types such as CNAV and LVNAV).
77. On option 2, several respondents noted that, as investors would have no transparency on the additional buffer (e.g. when it would be increased or decreased), they would face greater uncertainty. This uncertainty could fuel redemptions in stressed environments. Some respondents also believed that focus on the existing buffer level would likely persist and would ultimately generate pre-emptive redemptions.
78. On option 3, respondents argued that it would be challenging to draw conclusions on the redemption risk and anticipated investor behaviour during times of unprecedented stress based solely on the investor category, as not all investors behave the same way and have the same needs during times of stress. There could also be unforeseen consequences in relation to investor behaviour, as it would create an incentive for institutional investors to be the sole institutional investor in an otherwise retail fund.

III. Effects on fund managers

79. One respondent who preferred option 2 noted that gathering historic data could aid in balancing the increasing of the buffer.
80. On option 3, the operational challenges for funds which would potentially need to recalibrate their buffer on a daily basis depending on investor activity was raised by a few respondents, pointing to the fact that data would quickly become out-dated.

IV. Broader impacts on the stability and functioning of short-term funding markets

81. Most respondents made comments similar to those already outlined in the previous sections.

ii) With respect to option 1 above, views are sought in particular on the relevant threshold (on the size of redemptions) from which WLA would need to be automatically adjusted. When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

82. One respondent believed that a 10% redemption that took the fund to less than 30% weekly liquid assets was still appropriate, but the fund needs the ability to use the

weekly liquidity. A further 10% of outflows over the subsequent week could be a cause for concern and would likely prompt the asset manager to sell assets anyway. Another respondent proposed to align LVNAV and VNAV liquidity buffers, where the higher LVNAV standard applies to both LVNAV and VNAV, but the lower VNAV threshold be a new lower bound buffer. This lower level would then be available on a temporary basis and could be used passively when there are large redemptions.

83. Lastly, a few respondents mentioned other alternatives that could be considered. A few respondents suggested to explore options that could be established if the 30% WLA is breached (e.g. cure mechanisms). One of these respondents suggested that when one of the two liquidity assets of a MMF breaches its regulatory limit for a pre-determined amount of time, the asset manager could be required to directly notify its national authorities, which would be followed by bilateral discussions to remedy the situation by e.g. establishing for how long the breach were allowed to last. Other suggestions included *inter alia* to link the liquidity buffer to the settlement cycle, to explore the concept of “dynamic WLA management” and to improve the ratio on the qualitative side by having MMFs propose internal models to be approved by their supervisory authorities (similar to LCR for banks).

84. A few other respondents suggested to reconsider the qualification of high quality government securities as liquid assets, arguing that these assets have been proven to be liquid in the past. A few of those respondents also commented on a possibility to review the MMFR to permit EU MMFs to count investments in 5-day repo as part of the WLA.

ESMA’s response: ESMA acknowledges that the majority of respondents, including the SMSG, do not see a need to amend the requirements on liquidity ratios of MMFs in the MMF Regulation.

However, ESMA maintains that certain amendments of the MMF Regulation are needed in this area.

Indeed, in relation to liquidity related issues, the amendments of the MMF Regulation which would reduce the liquidity transformation of MMFs should aim at improving the asset-liability matching of MMFs, both in normal and crisis times. MMFs should be able to meet periods of heightened redemption requests without destabilising underlying money markets. The objective should not be to avoid any sales of assets by MMFs, even in time of crisis, so that MMFs could continue to perform their function as cash management vehicles. The objective is to address excessive procyclicality by eliminating incentives for investors to redeem ahead of the others, even if they do not have an immediate need to raise cash, as well as the likelihood of destabilizing sales by MMFs.

Requiring higher levels of liquidity buffers, through weekly and daily maturing assets, and the possibility of holding public debt asset to meet daily and weekly liquidity ratios should ensure greater liquidity and reduced risk in the portfolio of MMFs. These additional liquidity requirements should, however, be appropriately calibrated, depending in particular on the type of MMF (VNAV or LVNAV), the availability of public debt in different currency areas, and the



chosen measure aimed at addressing the abovementioned issues stemming from the LVNAVs' ability to offer a stable NAV under most circumstances.

The DLA and WLA requirements should be increased while leaving the option to managers to include a maximum proportion of public debt in the computation of the WLA (similarly to what currently applies to LVNAV, according to Art. 24(1)(g)).

Detailed economic evidence is needed to set the exact values of this increase, and because such a complete economic evidence does not seem to be available at the moment, ESMA is of the view that it is uneasy, at this stage, to include definitive exact values in the present Opinion.

However, at this early stage of the review of the MMF Regulation, ESMA is of the view that the current levels of liquidity of MMFs, as shown in Annex IV(B) of the final report "Overview of the MMF sector", tend to suggest that the proposals of limited increase included in the ESRB Recommendation on MMFs⁶⁰ are a relevant working basis to set such the exact values of such an increase.

In relation to public debt holding, ESMA does not suggest to impose mandatory holding of public debt for MMFs, since it could create a 2-tier liquidity buffer (DLA/WLA being a single tier in this context) with potential unintended consequences, such as shifting the risks to the sovereign debt market in case of crisis. If this new buffer is dedicated to meet expected large redemptions should a new dash for cash episode occur, then, market participants might potentially expect that a wave of sales of short-term public debt could flood the market. In such a situation, no dealer would be willing to be the first buyer and sovereign debt would mechanically drop in value. Certain market participants could even see benefits to sell public debt ahead of the wave. The impact could be magnified if the crisis is a sovereign debt crisis, such as in 2012. In addition, it is to be noticed that imposing a mandatory public debt holding in addition to DLA and WLA requirements would to a certain extent implicitly imply that the value (in EUR terms) of public debt securities with a residual maturity of up to 190 days would be less volatile / risky than the value of private debt assets with residual maturity up to 5 days. This might not be obvious considering (i) that the price of debt with 190 days residual maturity is far more sensitive to change in interest rates (difference of "duration") than debt with 5 days maturity and (ii) not all public debt securities have identical levels of liquidity or resilience to market stress. On the contrary, ESMA sees merits in offering the possibility for MMFs, up to a certain percentage, to include public debt assets in the pool of assets allowing them to meet the WLA requirements.

These proposals are specified in the ESMA Opinion on the review of the MMF Regulation, included in annex I of the present Final report.

QUESTION 6

Q6: What are your views on the potential need to eliminate CNAV and LVNAV funds, in light of the recent market developments, and the corresponding potential proposal of

⁶⁰ <https://www.esrb.europa.eu/news/pr/date/2022/html/esrb.pr.220125~32ad91c140.en.html>

amendment of the MMF Regulation? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

85. A great majority of respondents were against removing CNAV and LVNAV MMFs. Several respondents also cautioned against removing these structures and urged ESMA to fully consider the consequences of any recommendation to eliminate them, including the effects on investor behaviour. Respondents added that these fund types should be allowed to exist as long as investor information is clear and transparent and there is market demand for them (which was noted as being the case).
86. In relation to the difficulties faced by MMFs in March 2020, many respondents were of the view that the crisis had been indiscriminate to fund structures and to how the NAV of the fund is calculated.
87. Furthermore, several respondents observed that the events in early 2020 had led to inflows in public debt CNAV and that VNAV funds, as other MMFs, had faced significant redemptions pressures and outflows.
88. However, one respondent (a public authority) was of the view that removing the stable value for LVNAV funds may complement reforms for improving funds' liquidity risk profiles. In the view of this respondent, the March 2020 market turmoil highlighted that the asset liquidity of LVNAV funds was often not commensurate with the promise of stable value and daily liquidity that these funds offered. Their relatively narrow collar of 20 basis points around the stable value turned out to be a source of concern for investors and hence did not safeguard LVNAV funds from liquidity stress as intended. A further narrowing of the collar would therefore not help remove the possible cliff effects triggered by these thresholds, and could possibly increase first-mover advantages instead of making these MMFs less vulnerable to runs. To the contrary, this respondent is of the view that removing the stable value from LVNAV funds would have the benefit of fully removing unintended cliff effects related to possible transformations from CNAV to VNAV in stress periods. A variable share price would also reflect the underlying asset value more accurately and therefore reduce first-mover advantages associated with a decline in asset value. However, it would also eliminate an important property of LVNAV funds that is valued by market participants for their cash management. Under the precondition that the fund's liquidity risk profile is substantially improved, this respondent specified that it might not be necessary to remove the stable value from LVNAV altogether. Indeed, in the view of this respondent, it was MMFs holding investments in private sector debt with both variable and constant NAV that proved particularly vulnerable during the COVID-19-related market turmoil, suggesting that the removal of the stable value will not, in itself, sufficiently address the vulnerabilities seen during this period.
89. The comments from respondents are described in the following paragraphs below according to the table of criteria set out in paragraphs 76 to 80 of the Consultation Paper.
- I. Impact on the resilience of MMFs
90. Some respondents who were in favour of keeping CNAV and LVNAV structures argued that there were no structural vulnerabilities that would be mitigated should these fund types be eliminated and that their removal would not improve resilience in the short-

term funding markets either. Furthermore, some respondents argued that a variable asset valuation methodology does not in itself address liquidity problems. VNAV funds were not believed to be more resilient than other types of MMFs, as witnessed by the events in March 2020.

91. Lastly, there was disagreement between some respondents regarding whether the events in March 2020 had shown that the 20 bps collar in the LVNAV structure presents a “cliff edge” risk that incentivise outflows. One respondent who believed that the collar of the LVNAV structure did increase first-mover advantages further believed that a variable share price would reflect the underlying asset value more accurately and would therefore reduce first-mover advantages associated with a decline in asset value. However, as indicated above, this respondent also noted that this characteristic of the LVNAV structure was highly valued by certain market participants and questioned whether it was necessary to remove the stable NAV from LVNAV in full.

II. Effects on investor behaviour

92. Those few respondents who agreed with eliminating CNAV and LVNAV funds argued the removal of a floating NAV for all MMFs would be more transparent for investors, reduce confusion and improve consistency for investors. One respondent was of the opinion that investors would need to be informed on the benefits of the VNAV structure so as to overcome the issue of some investors preferring the LVNAV structure. It was also noted that this policy option would remove the cliff edge risk and first mover advantage associated with the deviation corridor of LVNAV funds.
93. Those who disagreed with the removal of the CNAV and LVNAV argued that this would lead MMFs to become significantly less attractive to investors. The drawbacks of eliminating these funds included reduction of investor choice, accounting concerns for investors, forcing investors to change investment policies, and introducing the complexity of the VNAV structure as opposed to CNAV and LVNAV to investors. Respondents also noted the advantages investors perceive in these fund types, such as facilitating sweeps, intra-day settlement and trade execution. Lastly, a few respondents noted that it would remove the option of amortized cost methods, which institutional and corporate investors may prefer.

III. Effects on fund managers

94. A few respondents were of the view that those investors transitioning from AAA fund rated LVNAV or CNAV MMFs to Short Term VNAV funds were likely to expect the same high level of liquidity. According to these respondents, for that reason, the appetite for investments of the fund would be likely to remain unchanged. These respondents also noted that the investor base would shrink as not all investors would move to VNAV fund types. The amounts invested by MMFs were believed to therefore subsequently shrink, resulting in a reduction of the flow to the short-term funding market.
95. One respondent who believed the LVNAV could be transformed to VNAV noted that lower VNAV regulatory liquidity buffers would make liquidity management easier in times of market stress and managers would not be required to sell assets to maintain the LVNAV value within the 20bps deviation corridor.

IV. Broader impacts on the stability and functioning of the short-term funding markets

96. Respondents noted that the proposal may lead issuers and investors to move their activities to other bank products, other products that may have constraints or risks or are less transparent, or possibly outside the regulated financial market. This could lead to a less stable funding for the part of the European economy and could create systemic risk, and market financing could be lost. It was also pointed out that holdings would not be considered as “cash equivalent” from an accounting perspective. Consequently, it was argued that it would result in many users moving to a small number of bank accounts instead, which could result in a concentration of counterparty risk. However, such alternative could be limited by lack of demand in the deposit market. A few respondents believed that LVNAV investors would turn to invest in USD-denominated public debt CNAV if the LVNAV was eliminated.
97. On the other hand, one respondent believed that clients were more likely to adapt and accommodate the use of VNAV. Another respondent called for clarity on the issue of the accounting treatment of MMFs, arguing that it is not clear whether short term VNAVs should not be considered as cash equivalent.

ESMA’s response: ESMA acknowledges that the majority of respondents, including the SMSG, do not see a need to amend the requirements on LVNAV in the MMF Regulation, and in particular to abolish LVNAVs given, in their view, LVNAVs have not faced more difficulties than VNAVs in March 2020.

However, ESMA maintains that certain amendments of the MMF Regulation are needed in this area.

Indeed, the amendments of the MMF Regulation which would improve the resilience of MMFs and reduce threshold effects should aim at addressing the issues stemming from the LVNAVs’ ability to offer a stable NAV under most circumstances. Under the MMF Regulation, these MMFs are currently allowed to use the amortised cost valuation method to value certain assets and need to keep their NAV as calculated using the amortised cost method for certain assets within a collar range of 20 bps as compared to the NAV using entirely the mark-to-market/model valuation method. When their NAV breaches this collar (Article 33(2) of the MMF Regulation), these MMFs need to use mark-to-market/model valuation for all of their assets. The use of the amortised cost valuation method is crucial to being able to offer a stable NAV to investors and exposes MMFs to a risk of a first-mover advantage as investors can redeem from the MMF at values of the underlying assets that do not necessarily reflect at all times the market valuations of those assets.

It is therefore proposed that no private debt MMFs should be able to use the amortised costs method, irrespectively of the investor base or the assets they hold. This would mean a ban of such a valuation method for LVNAV MMFs. The rationale behind this proposal is that these LVNAV mechanisms based on the amortised cost method imply nonlinearities (cliffs effects) by definition, and make LVNAV MMFs therefore intrinsically prone to first-mover advantages and other amplification effects. However, it is not suggested to fully remove LVNAVs.

The MMF Regulation has explicitly been structured in order to allow CNAV and LVNAV to be maintained, considering that the costs of eliminating the CNAV and LVNAV model would be significant, and the co legislators therefore preferred to set out specific rules aiming at ensuring

financial stability while permitting these vehicles, rather than requiring a mandatory move to the VNAV model in Europe. However, more than ten years after the start of these discussions, ESMA is of the view that the considerations which led to the choice made in the MMF Regulation to maintain the model of LVNAV should now be revisited in light of the recent market events that took place during the March 2020 crisis. Indeed, while not only stable-NAV MMFs faced difficulties during the March 2020 crisis, but also VNAVs⁶¹, as indicated in section I of the ESMA Opinion included in Annex I, it appears that the specific issues raised by nonlinearities inherent in LVNAV structures should be addressed.

These proposals are specified in the ESMA Opinion on the review of the MMF Regulation, included in annex I of the present Final report.

QUESTION 7

Q7: What are your views on the extent to which Article 35 of the MMF Regulation should be i) clarified ii) amended? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80

Keeping unchanged the Article 35 of the MMF Regulation

98. The majority of respondents were of the view that the Article 35 of the MMF Regulation should not be amended (even in times of stress), and that it was clear enough as it stands. These respondents considered that the current regulatory framework in the EU that prohibits sponsor support for MMFs, as opposed to the situation in the U.S, is appropriate, and should not be changed, as MMFs are investment funds with no explicit or implicit guarantee attached.
99. One of these respondents specified that it is desirable that a MMF is able to withstand significant market stress situations without the need for actions by central banks to support money markets or the fund sponsor to support fund liquidity. Relying on a sponsor support may induce the fund manager to take a less conservative approach to mitigating risks. In addition, a supporting sponsor carries also a potential (concentration) risk of a default triggered by a significant stress event. There could also be a shift of investments from unsupported to supported MMFs with implications for the whole market. In the view of this respondent, it should be ensured that neither the fund manager nor a related party is providing any form of guarantee regarding the MMF.
100. Some of these respondents added that the issues associated with sponsor support include: (i) confusing investors as to the fundamental nature of MMFs as an investment product, that has risk, and is not guaranteed, (ii) creation of moral hazard if managers of MMFs believe they will be bailed out by their sponsor should an issue arise (which could lead to an increase in the credit risk taken or levels of liquidity maintained), and (iii) for bank-sponsored MMFs, the risk of contagion to the affiliated banking organisations. In the view of this respondents, investors in EU MMFs should

⁶¹ The difficulties by LVNAVs and VNAVs slightly differed given in particular i) part of the redemptions observed for VNAVs seemed to depend on the cyclical nature of these MMFs – which is not equally observed for LVNAVs ii) the majority of VNAVs are standard VNAVs (i.e. with a longer maturity than LVNAVs)

make an investment decision in an EU MMF based on the credit work of managers, not the ability of a sponsor to bail out a fund.

101. Some of these respondents specified that in their view, it was obvious that the ECB intervention is not a fund external support, and it is therefore not needed to amend the Article 35 of the MMF Regulation to further specify this requirement.

Potential limited specifications of the requirements of Article 35 of the MMF Regulation

102. Several respondents indicated however that some further clarification could be brought by ESMA, potentially at level 3, or in Article 35, along the line of what was included in the Statement published by ESMA on the application of this Article 35 of the MMF Regulation in July 2020⁶². Several respondents indicated that the clarification brought by the abovementioned Statement had been useful for the market, and specified it should be incorporated in the Article 35 of the MMF Regulation.
103. One of these respondents specified that in their view a key area of confusion with regards to this provision during the market volatility was whether the definition of “third-party” in the Article 35 of the MMF Regulation included public-sector authorities and, more pertinently, whether this precluded central banks from providing direct support to the MMF sector. This respondent indicated that this was not the intention of either the Council or European Parliament, nor the European Commission.

Opportunity to amend the rule on sponsor support in the EU

104. A limited number of respondents indicated that the Article 35 of the MMF Regulation should be amended, in order to clarify that certain types of sponsor support should be allowed. One of these respondents indicated that limits must be given to sponsors on what they can and cannot do, leaving to funds the necessary operating space where to act effectively. In the view of this respondent, it is up to regulators to set out how to define an ex-ante framework that permits certain kind of support on determined circumstances, and that in parallel tries to reduce risks that could be generated from sponsor support, on the basis of context assessments.

ESMA’s response: ESMA acknowledges that while the vast majority of respondents, including the SMSG, do not see a need to significantly amend Article 35 of the MMF Regulation, some stakeholders indicated that they would support including the clarifications brought by the ESMA statement on external support in the Article 35 of the MMF Regulation.

ESMA agrees with this assessment, in particular that the ban of sponsor support is one of the key pillars of the MMF Regulation, and should not be put into question, but that the phrasing of this requirement could be even further clarified, and therefore suggest to amend directly Article 35 of the MMF Regulation to introduce the clarifications included in the ESMA statement on external support, as specified in the ESMA Opinion on the review of the MMF Regulation, included in annex I of the present Final report.

⁶² https://www.esma.europa.eu/sites/default/files/library/esma34-39-1096_esma_statement_mmf_art35.pdf

QUESTION 8

Q8: i) Do you agree with the above assessment of the potential need to assess the role of MMF ratings in light of the difficulties faced by MMFs during the March crisis, and the potential need to introduce regulatory requirements for MMF ratings? ii) In your view, based on your experience, what are the benefits of MMF rating from investors' perspective, having in mind that rules applying to MMFs are already very stringent? What would be the likely consequence on investors from the downgrade of one or several MMFs? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80

Role of CRAS and ratings of MMFs – absence of need to amend the regulatory framework on the ratings of MMFs

105. The majority of respondents did not see merit in amending the regulatory framework on the ratings of MMFs, given in their view, ratings of MMFs have not played a key role in the difficulties faced by MMFs during the March 2020 crisis.
106. Several of these respondents highlighted the positive impact, in their view, of ratings of MMFs. In their view, these ratings give comfort to the investor, which results in an additional commitment of the fund manager to restrict its investments universe to a certain category of assets (rated by the CRA "X") and accepting to pay fees to be checked on this by the said agency. Those respondents specified that the rating of the MMF is de facto a rating of its components (which have to be rated by CRA "X" to be purchase by the said MMF) and very often, in case of downgrade of a CP (as an example), the MMF will take appropriate measures to have sold the CP before the CRA will engage in measures to downgrade the concerned MMF.
107. One respondent specified that most of their investors have it written into their investment policies that they can only invest in AAA rated funds, as such they would likely have to redeem units if there was a downgrade. In practice, unless there is a credit event on the fund, given the internal monitoring the managers do, in their view, there should be sufficient time and warning for the managers to ensure they are still rated AAA before there is an issue.
108. Another respondent specified that MMF ratings are different from credit ratings: they do not assess credit risk, but rather the ability of the MMF to preserve capital and maintain liquidity. Since MMF ratings do not typically meet the definition of a credit rating as set out under the CRA Regulation, they are not considered credit ratings and therefore do not fall within the scope of the regulatory requirements of the CRA Regulation.
109. One respondent also mentioned that MMF ratings are an important tool for investors, also because the rating agencies review certain criteria which are not addressed in the EU MMFR (and with respect to which MMFs are not directly subject to the provisions under the EU MMFR), including due diligence of the MMF provider's



organisation, investment and asset class experience, reporting and oversight, compliance, systems and controls, and fund board/governance structures.

Ratings of MMFs and the March 2020 Covid crisis

110. Several of these respondents also emphasized that the Covid crisis did not deliver an example of downgrade of an MMF (probably due to the speed of crisis and recovery: the first stage would have been to downgrade the assets/issuers and then the said MMF). In the view of some of these respondents, should it have happened, it would however have resulted in divestments from MMF holders with an amplified problematic for the fund to find bids of lower rated assets in a disrupted market.
111. Some of these respondents indicated they do not agree with ESMA that the MMF rating methodology used by CRAs to provide MMF ratings limits the flexibility available to MMFs to deal with large redemptions. In their view, MMF managers' actions are driven by market conditions, investors' expectations, and regulatory requirements.

Segments of the MMF market without ratings

112. Certain respondents specified that a number of VNAV MMFs are not rated, as their clients require detailed knowledge on the MMFs' portfolios and do not seem to need an external verifier to certify the quality of the management of funds. In addition, these respondents specified that external ratings are given on an issuer pay model, which is costly to the fund and ultimately to the investor.

Wording of the title of the Article 26 of the MMF Regulation

113. With respect to the exact wording of the title of Article 26 of the MMF Regulation ("MMF Credit Ratings"), some respondents indicated that in their view, MMFR simply wanted to say "MMF ratings given by CRAs", which is why the word "rating" is used. In their view, it does not seek to designate credit ratings.
114. However, other respondents agreed with the proposed change of title of this Article by ESMA ("MMFs and credit ratings").
115. One respondent suggested that there may have been an assumption when drafting the MMF Regulation that ratings of MMFs by credit rating agencies were, in fact, credit ratings. In the view of this respondent, this is understandable given that a number of the criteria assessed by credit rating agencies when assigning MMF ratings include assessments of issues related to creditworthiness (e.g. minimum credit quality and counterparty credit risk). Article 26 should in their view be amended to require a similar prospectus disclosure where a credit rating *or MMF rating* is solicited or financed by an MMF or the manager of an MMF.

Need for transparency and potential assessment of the methodologies used by CRAs for the ratings of MMFs

116. Some respondents supported more transparency on the methodologies that CRAs use when rating MMFs. That would be an extension of the reform that led to the adoption of the Regulation (EC) No 1060/2009. In their view, the use of regulatory

approved liquidity management tools should not necessitate an automatic downgrade of an MMF. However, such use should result in a discussion between the MMF manager and the rating agency as to why such determination was made. Then, after considering the basis and the remaining portfolio composition, a rating agency should be free to take whatever action they deem appropriate.

117. Similarly, another respondent indicated that whilst they do not agree with the wider point of the potential need to introduce regulatory requirements for MMF ratings, they do have some similar concerns to ESMA on rated funds becoming forced sellers of assets purely because they are rated. The impact of this varies by CRA, because the methodologies of the CRAs vary; some adopt a risk budgeting approach, others apply a more formulaic approach (for example with cure periods). A strict formulaic approach is a concern which this respondent believes ESMA should review, as this can create unnecessary risk. Indeed, in the view of this respondent, becoming a forced seller of assets due to downgrades (or indeed if an asset ceases to be rated by that CRA where no event has taken place or credit opinion changed) can put additional pressure on collars as well as the MMF's rating. In these cases, cure periods vary (for example, based on the credit rating and aggregate holding size) but the result can be an extremely short time period allowed for resolution or "cure". This formulaic approach adopted by some CRAs can unnecessarily exasperate the situation, and compares unfavourably to the risk budgeting approach of other CRAs which allows more flexibility with a portfolio level view to scoring (vs a single asset approach, where a single downgrade can create a problem).
118. More specifically, one respondent indicated that the rating attribution comes with a cost but also with an interaction between the fund and the terms of the agency which might become a new actor in the field. Indeed, rating actions (for instance downgrading) might trigger unwanted investors' behavior in some cases. This respondent is of the view that at least investors should be made aware of the interaction (and potential conflict of interest) between the MMFR and the own rating agency terms (like the MMFR's requirement to base the underlyings' credit assessment on the internal credit quality assessment procedures versus certain CRA's imposing limitations based on a minimum level of external rating). In the view of this respondent, the rating agency should assess and disclose these potential conflicts and risks to investors.
119. However, other respondents indicated, on the contrary, that with regard to the introduction of regulatory requirements for MMF ratings, they would be against any measures which impeded the independence of the ratings process and methodology. It is vital to ratings integrity that the rating assessment, including the ability to downgrade when deemed necessary, should remain the sole purview of the CRAs, without outside influence. They would echo the importance of Article 23 of the EU Credit Rating Agencies Regulation (CRAR) which states that 'In carrying out their duties under this Regulation, ESMA, the Commission or any public authorities of a Member State shall not interfere with the content of credit ratings or methodologies'.
120. One respondent specified that liquidity products that compete with MMFs (deposit accounts, term deposits, reverse repo and government treasury bills) are all provided by institutions that have ratings provided by credit rating agencies. Although the nature of MMF ratings is different to those of other credit ratings as they do not directly assess creditworthiness, in the view of this respondent, it would be anomalous for CRAs to be prevented from assigning any form of rating to one segment of the market for liquidity products. As many investors will have policies that only allow them to invest in funds that have a certain credit rating restriction, they expect that a



downgrade of all or one or several MMFs would lead to material divestments in a relatively short space of time. If CRAs were to be prevented from providing any kind of rating for MMFs, they would expect a permanent reallocation of some investors away from MMFs, most likely to bank deposits.

ESMA's response: ESMA acknowledges that the vast majority of respondents do not see a need to significantly amend the requirements on MMF ratings in the MMF Regulation, given, in their view, ratings have not played an important role in the difficulties faced by MMFs in March 2020.

However, ESMA maintains that certain amendments of the MMF Regulation are needed in this area.

First, ESMA suggests to clarify the wording of the title of Article 26 of the MMF Regulation, so that MMF ratings are clearly distinguished from credit ratings.

Providing this clarification, however, does not address the issue as to whether MMF ratings are subject to any or equivalent regulatory requirements as credit ratings. As a result, in addition to clarifying the title it is proposed considering putting MMF ratings under the regulatory framework used for credit ratings. This would at least ensure that the MMF ratings that are being used by investors, and which fall out of scope of the CRA Regulation, are subject to some minimum standards

Indeed, when deciding on the opportunity to impose the use of certain liquidity management tools or simply allow for the use of these tools under certain circumstances, it should be assessed the consequences of these requirements on the MMF ratings of MMFs, as provided by CRAs, in order to avoid unexpected consequences of the use of these tools. Putting MMF ratings under the regulatory framework used for credit ratings would allow clarifying the interaction between ratings of MMFs and the use of certain liquidity management tools.

However, ESMA is of the view that this amendment is broader than the mere review of the MMF Regulation and should therefore be contemplated separately by the Commission. It is therefore suggested to the Commission to consider, in the future, putting in place a supervisory framework of the ratings activity of CRAs on MMFs, but not in the context of the review of the MMF Regulation. Indeed, the ratings activity of CRAs, or other entities, on MMFs should be primarily addressed in the context of the review of the CRA Regulation, or other pieces of EU legislation, rather than in the current context of the standalone review of the MMF Regulation.

In the meantime, however, as a first step, ESMA suggest to make it mandatory for MMFs to disclose that they are rated, as well as the main features of that rating (especially the conditions under which the ratings are downgraded).

These proposals are specified in the ESMA Opinion on the review of the MMF Regulation, included in annex I of the present Final report.

QUESTION 9

Q9: Do you agree with the above assessment of the potential need to amend the requirements on stress tests included in the article 28 of the MMF Regulation? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

121. The majority of respondents indicated they did not see merit in amending the currently existing requirements on stress tests included in Article 28 of the MMF Regulation, given the current requirements are very much detailed already. According to one of these respondents no other area/asset class/fund type faces as detailed requirements.
122. Some of these respondents were of the view that stress tests are commonly helpful to identify changes and assess strengths and weakness on the long term, not in stressed market conditions.

On stress tests at macro level

123. Other respondents disagreed with the assessment made by ESMA on the informative value of the use of macro stress tests. In the view of those respondents, the relevant indicators are to be looked at in the market, not intermediated via MMF stress tests (knowing in addition that MMFs are not the only party that intervenes in these markets). According to these respondents, when there is no market functioning, there is no use to stress the industry to see if there is a difference between one fund that cannot sell paper or all funds that cannot sell. Indicators on the market such as spread widening, volatility spikes, volumes sell-off etc. are already very explicit indicators to assess the state of the underlying market. Some of these respondents indicated that, as observed during March, stress tests were not the tool which enabled the asset manager to identify and manage risks in the fund. The models being used within the stress testing processes have only partially been able to reflect the real liquidity situation in the market.
124. However, one respondent indicated that it can be useful to perform stress tests at an aggregated level, i.e. overall MMF market, in order to better monitor money market industry behavior. This respondent was of the view that this kind of global approach has to be handled by ESMA, and that is the reason why they are ready to send the quarterly report to ESMA to improve the coordination (and not only to NCAs). In the view of this respondent, it is also important to raise that this set of systemic stress tests must be supplemented by additional reliable market data indicators, more particularly by developing a more transparent infrastructure on money market instruments, and detect a lack of functioning of such markets. The sole normative stress tests cannot predict atypical client behaviors (this point being handled by the manager through a strict shareholder monitoring with qualitative assessment), or the total absence of liquidity in the secondary market faced in March 2020.
125. Another respondent indicated that improvements to stress-testing requirements would increase supervisors' and market participants' understanding of MMF exposures to common shocks and could complement reforms that significantly enhance the structure and functioning of MMFs. The COVID-19-related market turmoil showed that MMFs are exposed to common liquidity shocks. Moreover, MMF shares are used as a cash management vehicle by many financial entities that need liquidity precisely when MMF asset portfolios have tended to become illiquid. Enhancing stress-testing requirements to include features that facilitate a better understanding of the systemic vulnerabilities of MMFs could, in the view of this respondent, instil investor confidence



in the sector but cannot be a substitute for the implementation of resilience-enhancing measures.

On the opportunity to send the report referred to in Article 28 directly to ESMA

126. However, several respondents agreed with the suggestion to send the report under Article 28 of the MMF Regulation to ESMA at the same time as to the NCAs, it is believed this measure could strengthen the coordination mechanism. Other respondents believed it is most appropriate to maintain the submission process through the NCA and continue the current model of engagement between the manager and the NCA. In the view of these respondents, it is important to have streamlined communication when managing through a dynamic market event and communicating to two regulatory bodies at the same time risks misalignment and potential time delays which may prove critical in managing an event.

On the specification of the corrective measures referred to in Article 28 of the MMF Regulation

127. Regarding the corrective measures referred to in Article 28 of the MMF Regulation, several respondents do not oppose to trying to specify further the corrective measures that managers of MMFs need to take when stress tests reveal vulnerabilities of a specific MMF, but others alert that the imposition of mandatory actions for stress testing is not likely to result in positive change. Such actions could really only take the form of portfolio repositioning (i.e., the sale of longer-dated, lower credit quality assets to be replaced by more liquid, higher credit quality assets) but that relies on a functioning short-term market. In the view of several respondents side effects of leaving less room for flexibility and increasing uniformity of response in a time of stress should also be carefully assessed.

ESMA's response: ESMA acknowledged that the majority of respondents, including the SMSG, indicated they did not see merit in amending the currently existing requirements on stress tests included in Article 28 of the MMF Regulation. However, given also the views expressed by other EU institutions, including the ESRB, ESMA is of the view that certain improvements of the stress test framework for MMFs are relevant. Some of these changes would be implemented at the level of the ESMA Guidelines on MMF stress tests, and a specific consultation document is to be issued by ESMA on this matter in the course of 2022. Other changes, however, might be needed in the Article 28 of the MMF Regulation itself.

In particular, currently, the hypothetical macro systemic shock specified in Article 28(1)(f) does not fully include relevant features to allow for the possibility to assess the systemic vulnerabilities of MMFs. That is why it should be explicitly required to make assumptions (therefore also in the implementing guidelines on MMF stress tests) on other MMFs, financial entities and non-financial counterparties behavior. This would mean adding the words "*including, where relevant, the behavior of other market participants*" to Article 28(1)(f). The Guidelines on MMF stress tests would specify this new requirement, in the stress tests managers of MMFs conduct for their own operational purposes on the one hand (sections 4.1 to 4.7 of the Guidelines on MMF stress tests⁶³), in the standardized stress tests the results of

⁶³ https://www.esma.europa.eu/sites/default/files/library/esma34-49-291_2020_guidelines_on_mmf_stress.pdf

which are reported by managers of MMFs to NCAs, and then ESMA, on the other hand (sections 4.8 and 5 of the Guidelines on MMF stress tests).

In addition, ESMA has taken note that respondents agreed with the suggestion to send the report under Article 28 of the MMF Regulation to ESMA at the same time as to the NCAs, it is believed this measure could strengthen the coordination mechanism.

The corresponding proposed amendments of the MMF Regulation are further specified in the ESMA Opinion on the review of the MMF Regulation, included in annex I of the present Final report.

QUESTION 10

Q10: Do you agree with the above assessment on the potential need to review the reporting requirements under the MMF Regulation? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80

More transparency in stressed market conditions

128. Several respondents were of the view that a more frequent reporting could indeed be activated in stressed market conditions (e.g. daily) with a subset of key indicators of the MMF Regulation reporting (e.g. Total Net asset value (TNA), WLA) in order to monitor the crisis, rather than systematically collecting the full MMF Regulation reporting on a monthly basis. According to these respondents, this would help in addition to be able to add some information specifically needed in the context of the individual stressed episode. However, these respondents recalled that the priority in a crisis is to manage the situation in the best interest of investors and that any new regulatory reporting during a stress period should be mindful of the additional burden and thus consider the cost/benefit ratio.
129. One of these respondents indicated however that it would be difficult to define precise parameters to trigger an additional reporting in stressed market conditions and the precise content and frequency of the reporting would need to vary depending on the nature of the crisis in question. Therefore, it may be more effective if the MMF Regulation were amended to include a general power for regulators to request more frequent reporting in stressed market conditions.
130. Some of these respondents added that the current reporting under Article 37 of the MMFR has been recently implemented, is quite heavy to perform and, in addition, updated by ESMA each year (new calibrations on stress test reporting). In the view of these respondents, it would therefore be appropriate to make a first assessment when ESMA and NCAs have some lengthier feedback on how the current reporting is functioning before envisaging to reshape it.
131. Another of these respondents noted that MMFs reprice assets at least daily and publish daily and weekly pricing reports for all assets. Some CRAs (credit rating agencies) receive portfolio holdings at least weekly from all MMFs which they rate, including data on portfolio investments. They receive information more frequently in times of market stress. They consider that transparency about the ability of MMFs to withstand “peak” shareholder redemption requests is also an important element, as

understanding capacity to manage shareholder flows is a factor in their MMF rating analysis. In the short term, according to this respondent, it is possible that transparency on relative weaknesses in a fund's portfolio or management procedures could have a negative effect on market confidence and potentially encourage redemptions. However, the longer-term benefits of transparency may be to enhance standards across more MMFs and allow investors to better differentiate their characteristics.

132. Lastly, one respondent supported additional reporting requirements for MMFs and the sharing of data with all relevant authorities in a timely manner. Especially in crisis scenarios, this respondent indicated that central banks and macroprudential authorities require up-to-date and high-frequency data to monitor risks to financial stability and monetary policy transmission and to inform policy decisions. In addition to the higher frequency of data reporting, in the view of this respondent, new variables would need be included: daily and weekly liquidity ratios, for which market data have very low coverage, would be essential. During normal times, additional reporting will be used to help calibrate tools. During the COVID-19-related market turmoil, some authorities relied heavily on market data and market intelligence to gain insights into developments in the MMF sector. While these are valuable sources of information, market data tend to have selective coverage, may lack full comparability and may be of lower quality than regulatory data. The importance of the MMF industry for monetary policy and financial stability therefore calls for enhanced data collection and sharing across relevant authorities. In particular, in the view of this respondent, all relevant European institutions with responsibilities in the areas of price stability and financial stability should have prompt access to relevant MMF data, including the European Central Bank (ECB), the European Systemic Risk Board (ESRB) and national authorities with a macroprudential mandate.

Existing Reporting to National Competent Authorities in stressed market conditions

133. Several respondents noted that the additional ad hoc reporting that was introduced by NCAs at the onset of the pandemic proved to be very effective and useful to monitor developments. Some of these respondents were of the view that it is sufficient for managers of MMFs to report in this way to their NCAs (as opposed to increase the frequency of reporting under Article 37 of the MMF Regulation).

Limitations of any additional reporting requirements, including in stressed market conditions

134. Several respondents, however, were of the view that additional reporting, even in stressed market conditions, would not be needed, nor useful, given it would be costly, and given the current reporting framework (quarterly reporting), in their view, is sufficient.
135. Several respondents indicated that providing additional or more frequent reporting only during a crisis event would also be problematic. During a crisis fund managers and service providers (fund administrators and transfer agents) experience significantly higher volumes of work due to increased investor activity, increased market trading activity, valuation checks/challenges, tolerance breaches to be investigated, etc. Demanding additional reporting during the busiest time would, in the view of these respondents, create more operational stress on the system and risk that the core role of ensuring the smooth running of MMFs could be jeopardised.

QUESTION 11

Q11: Do you agree with the above assessment of the potential need to include additional requirements in the MMF Regulation, and/or potentially in other types of EU piece of legislation on the disclosure of money market instruments (MMIs) and main categories of investors to regulatory authorities (e.g. detailed information on liabilities)? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80

136. Several respondents supported more transparency on the disclosure of MMIs and main categories of investors at macro level for European MMF (frequent publication of amounts of MMF by category, allocations by type of instruments, type of credit risk, investor typologies, currencies, ...).

Improving transparency on short-term markets

137. Several respondents indicated that data / studies provided by private institutions are often well processed but suffer from incompleteness in terms of market coverage and instruments considered. According to these respondents, the recourse to public authorities in echo to what is made for CP-CD (commercial paper (CP) and certificates of deposit (CDs)) on NEU CP (Negotiable European Commercial Papers) and STEP (Short-Term European Paper) by respectively the Banque de France and ECB would be worth being considered. Several respondents also suggested the implementation of a trade repository easily accessible, enabling a follow-up of the issuers outstanding volumes and displaying the characteristics of the short-term papers issued (nature, eligibility, maturity, ISIN, sector ...). According to these respondents, as in the case of NEUCP, it would be useful to create a European regulated market for EuroCP, with better transparency on pricing, issue and secondary market volumes, and it should be permitted that all these papers be eligible as collateral with the ECB.
138. In that context, one respondent noted that the French NEU CPs are a successful type of commercial paper in the Euro zone that allow issuers to diversify their sources of funding and provide investment opportunities in euro (and other currencies). Statistics are available on the Banque de France website and they are considered as an eligible collateral by the ECB. This format along with other European CP formats (Euro CP, other domestic CP markets) may further increase their efficiency through better pan-European transparency (centralized tape), greater standardization as well as through improved secondary market liquidity (encompassing Central Bank eligibility as collateral, usability as repo and/or softer market dealers' ratios). The STEP initiative (short-term € paper pan-European label) aims for some years to foster the integration of the European markets for short-term paper through the convergence of market standards and practices.
139. One respondent also specified that data reporting on holdings of commercial paper and certificates of deposit would complement rather than substitute structural reforms. In the view of this respondent, the quality of data on CP and CD markets, where MMFs are the main investors, remains poor and the coverage fragmented. More specifically, while certain market segments are well documented, such as those with Short-Term European Paper (STEP) or Negotiable European Commercial Paper (NEU CP) labels, the extent to which CPs are dual labelled and held by MMFs is largely

unknown. Additional disclosure on MMF holdings, investors (including data on stocks and flows with granular information on maturity, geography, instrument types, sectors and ratings) and general fund information (fund type, regulatory ratios, ratings, etc.) would help to bridge the data gaps. Given the increasing MMF footprint in short-term funding markets, reliable figures on MMF activity in these markets would inform the assessment of monetary policy transmission and the analysis of the build-up of financial stability risk, as well as benefiting supervision and oversight.

KYC

140. With respect to information on investors, several respondents indicated that the KYC for MMFs is an important tool to manage funds efficiently. Although the ultimate beneficiary and very granular data is rarely available (according to that respondent, detailed information on investors is very difficult to have for asset management companies; the only way to get it would be a regulation which would require distributors to disclose such information), the management by identification of the main broad categories of investors (treasurers, corporates, funds, insurance, etc) is an appropriate way to deal with investor behaviour.

Intermediaries

141. Several respondents stressed that there is a gap in the information that is currently provided to a MMF through an intermediary. For an intermediated investor, the shareholder/unitholder in the MMF will generally be a nominee of the intermediary. The intermediary (or its nominee) will complete the subscription/application form, and the manager will conduct due diligence on the intermediary and its nominee for anti-money laundering purposes and to obtain the information required by different regulations. There may be an agreement in place between the manager and the intermediary (e.g., a platform agreement, distribution agreement or other agreement for the provision of services by the intermediary). In such circumstances, the MMF manager will generally be reliant on the intermediary to provide information regarding the underlying investor.
142. In the experience of one of these respondents, however, intermediaries do not provide this information, and even if they do, such information will be limited and out-of-date. Whilst MMF managers are required to ask for such information under MMFR, intermediaries are not subject to a regulatory obligation to provide such information to the MMF manager. Consequently, intermediaries often will not accept the inclusion of 'know your customer' provisions in agreements, and intermediaries will often not engage with MMF managers requesting information regarding underlying investors. In the view of this respondent, the absence of an obligation on intermediaries under MMFR contrasts with the product governance provisions under MiFID II that imposes requirements on Member States to ensure manufacturers have visibility of end clients for the purposes of the product governance obligations, and to ensure distributors make information available to manufacturers.
143. As a consequence, this respondent suggested amending MMFR (or MiFID II) to assist MMF managers to obtain information regarding end/underlying investors by imposing an obligation on intermediaries to provide information regarding the profile of individual end investors to enable the MMF manager to understand the MMF's liquidity risk. The respondent proposed the following:

- a. The obligation should be expressed with sufficient granularity to ensure the MMF manager receives the information it may require.
- b. The intermediary should be required to provide such information promptly. This is essential for the arrangement to be effective in a time of market volatility.

144. The MMF manager should be able to request that the intermediary notify the MMF manager where a single end investor has a “large” share/unit holding in order to enable the MMF manager to identify investors whose share/unit holding exceeds the daily liquidity requirement (which the MMF manager is required to track under Article 27(2) of MMFR).

Reporting to authorities in crisis time

145. Managers of MMFs already disclose the breakdown by investors in the MMF quarterly reporting to authorities. According to these respondents, if needed, this section could be reported more frequently during a stress period (but not in normal times). However, these respondents stressed that any new regulatory reporting during a stress period should be mindful of the additional burden and thus consider the cost/benefit ratio.

146. One respondent also indicated that even an exhaustively detailed profiling of client types will only yield a partial analysis in terms of their behaviour, as clients may invest in money-market instruments directly, or rely on standing credit facilities as a matter of preference, when looking to raise cash immediately. According to this respondent, more frequent reporting, although possible, will therefore not be fully reliable and is likely to fall short of supervisory expectations, and it was only through parallel and timely discussions with management companies that supervisory authorities were able to develop a better understanding of how MMFs and underlying money market conditions were at the time evolving in March 2020.

Limitations of additional disclosure requirements

147. Other respondents did not see the need to introduce further disclosures regarding MMFs. Regarding additional disclosures to investors, these respondents indicated that there was in general no particular increase in requests by investors observed. Therefore, they do not assume that there is a need for further disclosures from an investor’s perspective. Regarding additional disclosures to regulators, these respondents indicated that depending on the fulfilment of certain criteria, funds are subject to a semi-annual risk reporting that already provides valuable information to authorities. In addition, those respondents indicated that more and more frequent reporting would not have helped regulators during the March 2020 crisis.

148. Several respondents noted that institutional investors in MMFs have differing liquidity needs/profiles which evolve over time (e.g., over the course of a financial year, economic cycle etc.). In the view of these respondents, seeking to determine ex-ante where investors might sit on a spectrum of presupposed volatility does not match up to the reality of investors’ dynamic liquidity needs. As such, while they understand what ESMA is seeking to achieve in proposing to introduce additional requirements regarding the disclosure of investor types in terms of improving understanding of where risk may sit in the system, in their view, the reality is that it would be challenging and

potentially misleading to draw conclusions on redemption risk and anticipated investor behaviour during times of unprecedented stress based solely on the investor category.

149. One respondent indicated that MMFs already make very detailed reporting submissions on a quarterly basis, any increase to the frequency of that reporting cycle does not necessarily support management through a crisis given that the data is historical, the reporting takes time to verify and submit meaning that the picture may have changed by the time it has been submitted or reviewed. According to that respondent, the existing reporting cycle is lengthy and requires appropriate resourcing, it is not feasible to alter the quarterly schedule at short notice and for that reason it is not feasible to increase reporting frequency during a crisis

ESMA's response to questions 10 and 11: ESMA acknowledged the overall positive feedback received from respondents on reporting related issues, in particular on the reporting referred to in question 11 and the need for appropriate additional reporting in crisis times, and is also still of the view that enhancing those requirements is a key measure to prepare for the next crisis events that MMF might face in the future.

The amendments of the MMF Regulation which would enhance crisis preparedness and monitoring of the MMF market aim, indeed, to provide authorities with the necessary information to identify systemic vulnerabilities in the MMF sector. This is in particular the case with respect to the enhancement of reporting requirements to authorities under Article 37 of the MMF Regulation.

In stress market conditions, enhancing and harmonizing crisis-specific data-sharing arrangements should in particular improve authorities' understanding of the systemic risk posed by MMFs and allow for potential further mitigating policy actions to be adopted.

Stress market conditions (response to comments made by respondents from paragraphs 128 to 133 above)

Article 37 shall be amended to specify that in stress market conditions, more frequent reporting (daily) would be expected on a certain number of key indicators. This would build on the experience which was acquired by national competent authorities during previous crisis times, such as the March 2020 events, developing ex ante a common EU reporting format for managers of MMFs to report to authorities and ESMA in the more effective way in such crisis time, where time is of essence.

The specification of the exact indicators to be reported in these circumstances should be left to a delegated act, as well as the criteria that would define when exactly these requirements applying in crisis time only should be activated.

Normal market conditions (response to comments made by respondents in paragraphs 134 and 135 above, and as a response to question 11)

Apart from crisis times, ESMA is of the view that the frequency of reporting should also be raised from quarterly to monthly, for MMFs whose assets under management exceed EUR 100 00 000, and from annually to quarterly, for MMFs whose assets under management do not exceed EUR 100 00 000. This would be more in line with the ECB reporting requirements,



and would allow for more informed decisions from NCAs and ESMA (e.g. supervision, triggering of any possible LMTs).

However, ESMA is of the view that it has appeared that these thresholds, included in Article 37(1), for defining reporting frequencies might not work properly, given, because of the trigger is purely based on the size of a MMF, the MMF can disappear from the MMF data base precisely when it would be relevant to investigate it. It is therefore suggested to monitor carefully this issue, in the next years, in order to consider whether any additional change would be needed.

Finally, Article 37 could be amended to add requirements on the reporting of information on the investors of MMFs, but this should be supplemented by a proposal to enhance the disclosure of MMIs and investors of MMFs, which goes beyond the scope of the MMF Regulation. It is to be noted that on this issue (information on liabilities of MMFs) central banks currently have information which are missing for competent authorities and ESMA.

In relation to the responses by respondents to question 11, disclosing information on the main investors in money markets would indeed help to understand the dynamics of the market based on the behaviour of the main categories of investors as well as potential interconnectedness. It may be the case for example that institutional investors are both invested in MMF and Money market instruments (MMIs) directly and may have divested from MMFs while they were selling MMIs during the COVID-19 outbreak.

Information on new issuance and outstanding amounts of money markets may be available broken-down on some market per categories of issuers, ratings, maturities. Daily information on average interest rate per category of issuers, maturity and rating would be a valuable complement. Post-trade information (volumes and prices) could also be introduced on a daily basis (end of day) and be made available to market participants on the secondary market. This information would prove useful for market participants.

The disclosure of investor types to authorities would provide valuable information to be better prepared to anticipate the potential spillover effects in case a crisis occurs. This information would prove useful for regulators.

It has to be noticed that under the requirements of Article 37 of the MMF Regulation, managers of MMFs already have to disclose certain information on the liabilities and assets of MMF, but these reporting requirements depend on the extent to which manager of MMF are able to possess the corresponding information. As a result of the abovementioned additional need of disclosure, there might be a need to supplement the currently existing reporting requirements under the MMF Regulation by additional disclosure requirements, in particular on MMIs and their investors, which go beyond the strict requirements of the MMF Regulation

QUESTION 12

Q12: i) Do you agree with the above assessment on the potential creation of a LEF (Liquidity Exchange Facility) ? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80. ii) Several open questions related to the creation of the LEF, on which ESMA would specifically welcome feedback from stakeholders, include:

- **What should be the appropriate size of such a pooling vehicle as the LEF?**
- **In terms of funding, how much MMF would have to pay each year to participate in the pool? How much of the funding would/should be provided by other sources?**
- **How long would it take to establish such a LEF?**
- **Under which conditions would the LEF be activated? • Who would be responsible for activating the LEF**

150. All respondents to this question except one objected to the potential creation of a Liquidity Exchange Facility (LEF). In the views of the respondents, the drawbacks of the establishment of a LEF would be numerous and severe:

- It would increase the costs for the industry globally, and therefore also for investors; according to one respondent although the LEF might theoretically seem the only recourse for an MMF to obtain a direct access to central bank money in case of a serious crisis, in order to be able to provide for billions of redemptions (for instance a magnitude of 50 bn in redemptions for French MMFs as of the March 2020 crisis), it would be such a costly solution that it could potentially disrupt the market.
- It would not address the first-mover advantage mover related issues.
- Considering the nominal sizes traded on Money Markets, if the status of the LEF would be a banking institution able to deal with ECB on repo and PEPP (or any like vehicle), the capital needs would be extremely high and not reasonable for stakeholders. Established as a banking entity with its own prudential capital requirements, the structure may give rise to “moral hazard”.
- The governance and operational set up and management of such a mechanism will be a challenge which seems oversized versus the potential benefits expected; A Liquidity Stability mechanism being funded by a charge on the AUM would take years to grow to any meaningful size.
- In addition, the service proposed – providing bids on eligible assets – is already offered by the banking industry and is efficient in normal market conditions.
- It is unlikely it would be accepted by investors of MMFs.
- A LEF would also further enhance the misguided perception of MMFs that they are guaranteed investments. Much of the regulatory reform work has been to remove this perception, a LEF would undo this; one of the respondents specified they are in principle against forms of external support, especially if the facility were to discriminate between different types of MMF. In this regard, they expect that the LEF will most likely benefit those MMFs that can rely on their intra-group bank sponsor to offer initial capital of the LEF, at the expense of fully independent asset managers.

151. Some respondents noted that the option of introducing a Liquidity Exchange Facility mirrors a parallel proposal in the U.S., as raised during past efforts at regulatory reform of MMFs, and that the December 2020 publication of the Report of the



President's Working Group on Financial Markets, offered insights into how the facility – dubbed "Liquidity Exchange Bank" – would work.

152. One respondent indicated that a reserve fund, that is activated during a crisis, could be useful, and that ESMA should be in charge of activating it during a crisis, and monitoring it.

ESMA's response: ESMA acknowledged that the vast majority of respondents, including the SMSG, objected to the creation of a LEF, for the various reasons detailed above in paragraph 150.

ESMA globally agrees with this assessment and has decided not to suggest to the Commission the creation of such a vehicle, having regards to the difficulties related to its establishment, and the uncertainty around the efficiency of its functioning, both in normal and stress market times.

QUESTION 13

Q13: Do you agree with the above assessment on the potential need of further clarification of the requirements of articles 1 and 6 of the MMF Regulation? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80

153. The majority of respondents were of the view that the scope of the MMF regulation was clear and saw no need to amend Articles 1 and 6 of the MMF Regulation.
154. However, several respondents indicated that this was partly due to the fact that there were already well-established practises among industry participants on the interpretation of these articles of the MMF Regulation. Some of these respondents suggested that if a clarification was to be brought by regulators, it could take the form of level 3 guidance.
155. As opposed to this, a limited number of respondents indicated they would see merit in clarifying the scope of the MMF Regulation and in particular the difference between an MMF, subject to the MMF Regulation, and ultra-short bond funds, that would not fall in the scope of the MMF Regulation. In that context, one respondent indicated that outside Europe, the designation of MMF is singularly applied to funds that adhere to rules similar to those under the MMFR for short term MMFs, while Standard MMFs are categorised as ultra-short bond funds.

ESMA's response: ESMA acknowledges that the vast majority of respondents, including the SMSG, objected to the further specification of the scope of the MMF Regulation, given in their view, the scope of the Regulation is already clear enough.

ESMA has duly taken note of these views and has decided not to suggest amendments of the Articles of the MMF Regulation related to the scope of the Regulation.



Instead, ESMA will continue working on a case-by-case basis to ensure convergence of supervisory approaches on the extent to which it should be further investigated whether certain funds, such as bond funds, should be, under certain conditions, considered as MMFs falling in the scope of the MMF Regulation.



3.3 Annex III: Advice of the Securities and Markets Stakeholder

Executive summary

ADVICE TO ESMA

SMSG response to the ESMA's Consultation Report on "EU Money Market Fund Regulation – legislative review"

The SMSG welcomes the opportunity to respond to the ESMA's consultation on the legislative review of the EU Money Market Fund Regulation ("MMFR"). The consultation seeks views in relation to the MMFR review clause and to the COVID-19 crisis. The group thanks ESMA for its clear assessments on the crisis, money markets difficulties, investor behaviours and money market funds that are accurate and insightful on many points.

Despite the March 2020 exceptional exogenous market event and increased redemptions, European money market funds ("MMFs") demonstrated resilience and investors reverted confidently back into these funds in one to (less than) three months' time (depending on the type of funds). Redemptions were mainly motivated by the pressing need for cash by investors, like corporates or institutions, in a very uncertain economic situation.

The SMSG believes that the central point to look at in the aftermath on the COVID-19 crisis is to see what can be done to improve the functioning of the underlying money markets. MMFs are only one player in this market. MMFs are useful vehicles for issuers, who can achieve a better diversification of funding sources. For investors, MMFs provide a diversified short term investment opportunity with easy and quick subscription/redemption mechanisms, low credit risk and diversification of counterparty risk.

ESMA explores 11 different options, some of them bearing potentially more or less consequences on the European MMFs' structures. 5 of them are reform options, four targeting either the liability side of MMFs, the asset side or both sides, and one targets an aspect external to the MMF.

Regarding the liability side, ESMA explores, in the case of two specific MMF structures, the option of "decoupling" the current link between on the one side the level of regulatory thresholds and on the other side the imposition of barriers to the investors' redemption possibilities, i.e. imposing suspensions and/or gates⁶⁴. Also on the liability side, ESMA explores for all types of MMFs, the option of introducing an anti-dilutive mechanism⁶⁵ meant to allocate the cost of accessing liquidity on the redeeming investors.

On the asset side, ESMA's questions target the liquidity buffers. Options are investigated also on both asset and liability sides with questions pertaining to the elimination or conversion of MMFs that offer constant Net Asset Value (NAV). As a reform option external to MMFs, ESMA is enquiring into the

⁶⁴ IOSCO definition of gates, February 2018, "Open-ended Fund Liquidity and Risk Management"

"Redemption gates are partial restrictions to investors' ability to redeem their capital, generally on a pro-rata basis."

⁶⁵ An anti-dilutive mechanism is a tool meant to protect existing investors from bearing the costs of buying or selling the underlying investments as a result of large inflows into or outflows from a fund. It could take the form of a "swing pricing" - where the liquidity cost is deducted from the NAV, an anti dilution levy ("ADL") or a redemption fee - where the cost is a fee outside the NAV.



current drafting of the ban on “sponsor support” (i.e., an external intervention meant to maintain the NAV or the liquidity of the MMF).

The further 6 reform options are linked to aspects where ESMA would like to get some feedback and are not related to the main reform themes.

The Money Market Fund Regulation (“MMFR”) is a robust and recent piece of legislation. Its calibration is seen as appropriate and adapted to the specificities of the European money markets. Regarding the options proposed, the SMSG agrees to the usefulness of some of them like decoupling quasi automatic links in regulations, the usability of liquidity ratios so they can play a countercyclical role, using an anti-dilution mechanism to fairly allocate the cost of accessing liquidity with appropriate calibration, as well as improved transparency in money markets.

As money markets and MMFs are also scrutinized in international fora, and knowing that markets and regulations differ geographically, the SMSG is urging ESMA to focus on its own market specificities and to strongly voice the EU perspective.

I. Background

1. On 26 March 2021, ESMA launched a consultation on the possible review of the EU Money Market Fund Regulation (“MMFR”).
2. This consultation document is linked to two contexts: first, the MMFR review clause as per Article 46, which provides that “[b]y 21 July 2022, the Commission shall review the adequacy of this Regulation from a prudential and economic point of view, following consultations with ESMA” and second, the COVID-19 sanitary crisis that was challenging for markets, including money markets, particularly in March 2020.
3. The COVID-19 context and related questions in the consultation report are also linked to the work undertaken at the international level in order to assess the situation faced by money markets, including effects on money market funds (“MMF”) during the COVID-19 crisis.
4. The main MMF legislations (both at international and European levels) have been updated in the aftermath of the 2008 crisis. ESMA assesses in the light of the 2020 crisis the functioning and potential need for amendment of the current regulatory framework applicable to MMFs in the EU.
5. The consultation document touches upon several important issues with regards to money market funds but also to some aspects linked to money markets more broadly. The SMSG established a working group to discuss the topics covered in the consultation report. This response summarizes the global view of the SMSG with regards to different issues mentioned in the paper, but also other aspects deemed relevant by the SMSG.

II. General comments

5. ESMA’s assessments on the crisis, money markets difficulties, investor behaviours and money market funds are accurate on many points. Despite the March 2020 exceptional exogenous market event, European MMFs demonstrated resilience: no European MMF used exceptional liquidity

management tools⁶⁶ (“LMTs”) nor any type of sponsor or public money support and investors reverted confidently back to MMFs in one to (less than) three months’ time (depending on the type of funds). Redemptions were mainly motivated by the “dash for cash”⁶⁷ in a very uncertain economic situation due to an unforeseeable sanitary pandemic that affected all economic players.

6. The SMSG believes that the central point to look at in the aftermath on the COVID-19 crisis is the underlying money market and see what can be done to improve the functioning of this market. MMFs are only one player in this market and the diversification gained through the intermediation of MMFs of funding sources for issuers as well as counterparty risk for liquidity placement for investors is important and should be preserved.
7. The SMSG believes indeed that regulatory attention is best directed to the characteristics of the underlying markets in which MMFs invest and in particular to the market for Commercial Paper⁶⁸ (“CP”), by searching to obtain a more efficient and resilient pan-European CP market with increased transparency and more standardisation creating the conditions to ensure more dealer participation in the secondary markets. As illustrated by the Covid-19 turmoil, although a positive move, the use of trading platforms is not a substitute for liquidity, particularly in times of volatility or market stress, and ultimately a functioning CP market requires dealer expertise and intermediation.
8. Some other comments by ESMA, pertaining for instance to the identification of certain vulnerabilities or to MMF self-resilience, i.e. ensuring “that regardless of the market conditions, they can operate without impacting financial stability” and avoiding interventions of central banks, are not entirely supported by the SMSG. Indeed, any investment fund is dependent on the orderly functioning of the underlying market and cannot operate in isolation, i.e. regardless of the severity of market deterioration. It is a key role of central banks to conduct monetary policy to achieve price stability (low and stable inflation) and to help manage economic fluctuations.
9. The SMSG believes ESMA is right in consulting stakeholders at this preliminary stage. It not only helps in preparing the future EU work in the matter, but also contributes to the international forum, as both IOSCO and the FSB have initiated work on MMFs. Post COVID-19 crisis, money markets have been prioritized as an area of assessment in 2021. A consultative report is due to be presented to the G20 in July 2021 with policy proposals, and a final report in October 2021. As money markets, as well as investor behaviour and money market fund regulations differ around the globe, a “one size fits all” approach might have serious side effects in some markets and in that respect should be avoided. European and USA money markets are essential segments in their respective financial markets. They share some aspects, but they also diverge, for instance on the existence of Federal Treasuries and the depth of money markets, on the investors’ flight from Prime⁶⁹ funds⁷⁰ to government paper versus mere need of liquidity (“dash for cash”,) or on the sponsor support. Accordingly, ESMA’s focus should take into account the specificities of the EU market and regulatory framework. MMFR is conceived as a robust framework adapted to European money markets and the SMSG urges ESMA to strongly voice the EU perspective reflecting market and regulatory differences at the international level.

⁶⁶ Liquidity management tools are mechanisms available to use for funds in order to help them face redemption requests while ensuring fair treatment of fund investors.

⁶⁷ “Dash for cash” designates the stringent and concomitant need for several economical actors to access and withdraw large sums of money.

⁶⁸ Commercial papers are short-term debt instruments issued with a term from one day to one year by corporates, banks or states.

⁶⁹ In the USA, prime funds are money market funds that primarily invest in corporate debt securities, as opposed to government paper funds. The U.S. Securities and Exchange Commission (SEC) Rule 2a-7 defined 3 categories of money market funds based on the types of underlying investments of the fund: government, prime, and municipal.

⁷⁰ See FSB’s “Holistic Review of the March Market Turmoil” on page 19 the section “Box 4.1: MMF developments during the market turmoil” <https://www.fsb.org/2020/11/holistic-review-of-the-march-market-turmoil/>

10. MMFs are important economic players as they finance the short end of the curve through the continuous roll of short-term instruments issued by corporates, financial entities and public organizations/governments. The SMSG understands the need to avoid systemic risk and the danger of underestimating the change of value of funds when liquidity dries up. The crisis affected all markets, not only money markets. Money markets might have been visible earlier precisely because of their short-term and liquid nature, giving them the potential for “signalling” early on a more general exogenous market stress that translated into rational “dash for cash” behaviours in times of uncertainty. The SMSG is of the opinion that MMFs did not cause the crisis nor have they amplified the risk on the market. The reform mix should ensure the robustness of MMFs while bearing in mind the role played by these funds to finance the economy and avoid disruptive measures as well as measures that would deter MMFs from correctly performing their intermediation role. It is important all actors draw the lessons learned from the recent crisis. However, the crisis would have taken place with or without the MMF actor. If MMFs would not have been there, the pressure from investors to access their cash might have put even more pressure on the banking system and redemptions might have occurred more heavily from longer term types of funds, which are less agile by construction to deal with such short-term redemption pressure. MMFs have actually fulfilled their role despite the pressure on the underlying market liquidity, and to some extent have taken pressure away from other market sectors by being able to meet their redemption demands, the bulk of them having been met even before the ECB intervention through the Pandemic Emergency Purchase Programme (the “PEPP”⁷¹) was effective. In addition, it should be recalled that the PEPP is not open to banking instruments (which make the major part of MMF investments) and concerns only issuances labelled in €.
11. European MMFs are mainly an institutional investor market. MMFs provide non-financial corporations a mechanism to invest short term liquidity and manage working capital. MMFs’ unique structure offers a diversified short term investment opportunity with easy and quick subscription/redemption mechanisms and low credit risk compared to single name commercial papers. Any review of the regulatory framework aimed at limiting redemptions should give due consideration to the possible consequence of corporate users turning to other liquid instruments with potentially higher credit risk. Understanding investor behaviour and intentions are particularly important in money markets. Enhancing the Know Your Customer (“KYC”) area, together with building solid confidence through the appropriate transparency on portfolios, as well as sharing market expertise are key characteristics of this market. The SMSG believes that the MMFR achieved a high level of resilience and constraint on MMFs. Subsequent reforms should also pursue the objective of avoiding to inadvertently curb the flexibility of the manager to deal with market situations in the best interest of investors and markets.
12. ESMA is looking not only to options linked to the objective of achieving more resilience in the aftermath of the crisis that relate to all European MMF structures, but also to options related to the review clause concerning the new Constant NAV structures created by the MMFR (LVNAV⁷² – Low volatility NAV MMFs and PDCNAV⁷³ – Public debt constant NAV MMFs). The SMSG thinks that

⁷¹ Quote from the ECB website : “The ECB’s pandemic emergency purchase programme (PEPP) is a non-standard monetary policy measure initiated in March 2020 to counter the serious risks to the monetary policy transmission mechanism and the outlook for the euro area posed by the coronavirus (COVID-19) outbreak. The PEPP is a temporary asset purchase programme of private and public sector securities. “

⁷² An LVNAV is an MMF allowed to use constant NAV valuation and invested in all types of issuers, including private financial and non financial issuers. As of MMFR Article 2 Definitions : “(12) ‘low volatility net asset value MMF’ or ‘LVNAV MMF’ means an MMF that complies with the specific requirements laid down in Articles 29, 30 and 32 and in Article 33(2)(b)”.

⁷³ An PDCNAV is an MMF allowed to use constant NAV valuation and mainly invested in government debt. As of MMFR Article 2 Definitions : “(11) ‘public debt constant net asset value MMF’ or ‘public debt CNAV MMF’ means an MMF: (a) that seeks to maintain an unchanging net asset value (NAV) per unit or share; (b) where the income in the fund is accrued daily and can either be paid out to the investor or used to purchase more units or shares in the fund; (c) where assets are generally valued according

each crisis is different and that the MMFR came in the aftermath of a credit crisis, whereas the current reform comes after a liquidity crisis. The 2020 liquidity crisis can also be seen as a stress test on a recent regulation (applicable on the existing funds since January 2019 and delivering quarterly reporting since the 1st quarter 2020).

13. There are 11 different options that are explored by ESMA, some of them bearing potentially more or less consequences on the European MMFs' structures. 5 of them are linked to the main reform themes the consultation deals with, including (i) reforms targeting the liability side of MMFs (decoupling for LVNAVs and PDCNAVs regulatory thresholds from suspensions and/or gates; requiring an anti-dilutive mechanism), (ii) reforms targeting the asset side (focusing on liquidity buffers) or (iii) reforms targeting both asset and liability sides (eliminating or converting constant NAV MMFs) and (iv) a reform option external to MMFs (enquiring the ban on sponsor support). The further 6 reform options are linked to aspects where ESMA would like to get some feedback and are not related to the main reform themes.

Reforms targeting the liability side of MMFs

i. Decouple regulatory thresholds from suspensions/gates

14. The SMSG is globally favourable to decoupling regulatory thresholds from automatic triggers. In general, automatic links in regulation reduce agility in a crisis and can be procyclical. A prior example of this was the over-reliance on external credit ratings where the systemic risks identified required to withdraw any existing automatic link.
15. The MMFR established a link between suspensions/gates and the level of the liquidity buffer (together with another parameter: the level of redemptions) in order to preserve investor fairness for funds that offered order dealing at constant NAV. The MMFR states that LVNAVs and PDVNAVs "should have in place provisions for liquidity fees and redemption gates to ensure investor protection and prevent a 'first mover advantage'."
16. It seems that investors in LVNAV and PDCNAV feared the threshold that would trigger gates and some of them placed redemption orders pre-emptively, adding up to the redeeming orders placed by investors in desperate need for cash. In addition, this type of behaviour would have prevented this type of MMFs of freely making use of their regulatory liquidity buffers (of minimum 30%) without risking more investor flight.
17. When market participants can anticipate an outcome assessed as unfavourable to them, they might precipitate it (knowing that they can act at no cost to prevent the unfavourable outcome happening). In the present case, anticipating an adverse outcome with the imposition of fees/gates, investors may actually precipitate it as they attempt to pre-empt the imposition of such measures by redeeming ahead of others. The SMSG thus sees a risk of self-fulfilment and pro-cyclicality in automatically linked public triggers in the MMFR. Decoupling might not fully attenuate the risk of "first mover advantage" since investors, still able to monitor the liquidity ratios themselves, might have developed a propensity to overweight the importance of these ratios' fluctuation.
18. The SMSG acknowledges that de-linking liquidity parameters and gates leaves the question open on the liquidity fee imposition. The MMFR designed the liquidity fee as a fee that "should adequately reflect the cost to the MMF of achieving liquidity and should not amount to a penalty charge that

to the amortised cost method and where the NAV is rounded to the nearest percentage point or its equivalent in currency terms; and (d) that invests at least 99,5 % of its assets in instruments referred to in Article 17(7), reverse repurchase agreements secured with government debt referred to in Article 17(7) and in cash"



would offset losses incurred by other investors as a result of the redemption.” The question of who bears the potentially substantial cost of accessing liquidity in case of redemptions in very difficult markets, especially for structures where a valuation gap is authorized by construction, remains valid.

ii. Require MMFs to use swing pricing and/or anti-dilution levies (ADL) / redemption fees

19. ESMA envisages the option to require MMFs to use an anti-dilution mechanism.
20. The section is somewhat confusing at first, since it follows upon the previous discussion on the decoupling of the regulatory threshold from suspensions/gates, which pertains to LVNAVs and PDCNAVs only (and would require “removing Article 34(1)(a)(i) and 34(1)(a)(ii) of the MMF Regulation”). The section discusses the appropriateness of requiring these MMFs to use anti-dilution mechanisms instead and examines the merits of introducing such a mandatory tool for all MMFs alike.
21. In general, swing pricing⁷⁴ and other anti-dilution mechanisms are useful tools. They are already used on other types of funds, such as bond funds, small/mid cap funds, etc. During the crisis, this mechanism was used in several European jurisdictions. It helps allocating the cost of accessing liquidity more fairly, i.e. put the cost on the redeeming investor so as to protect the investors who remain invested in the fund. As ESMA anticipates, in certain circumstances “it would help reduce redemption requests under stressed market conditions.”
22. From a theoretical standpoint, the SMSG sees the merits of this type of tool. However, the way it would be implemented in practice for MMFs is of utmost importance. The practical details will determine whether such a tool would work or not, or might, even worse, have side effects that would outweigh the benefits. The operational impact and practicality of any such measures should be taken into account.
23. The SMSG would like to bring to ESMA’s attention the following aspects. Swing pricing is not per se a tool through which the manager deals with the fund’s liquidity risk, nor a tool that works in extreme markets deterioration. Anti-dilution mechanisms allocate more fairly the increased cost of liquidity, but they should not be “penalties”. Indeed, a very deteriorated market situation (or even a freeze) might not respond any more to the best interest of investors, as the cost of accessing liquidity – if any - would be disproportionate to this asset class’s remunerations and pricing spreads. It is however a tool, as ESMA says, that “may help reducing redemption requests under stressed market conditions if redeeming investors finance the cost of liquidity, which may increase as a result of widening spreads on short-term funding market.” Thus, the market window where the tool might be of use is extremely delicate to narrow down. Such a tool is unlikely to work effectively in times of lack of secondary trading in the underlying CP market.
24. Regarding the practical implementation, with swing pricing, a fund adjusts the NAV for inflows or outflows to take into account the costs of purchasing or selling assets of the fund. The exact same

⁷⁴ IOSCO definition of swing pricing, February 2018, “Open-ended Fund Liquidity and Risk Management”

“Swing pricing refers to a process for adjusting a fund’s net asset value (NAV) to effectively pass on transaction costs stemming from net capital activity (i.e., flows into or out of the fund) to the investors associated with that activity during the life of a fund, excluding ramp-up period or termination. In a liquidity-challenged environment, quoted bid/ask spreads and overall trading cost can widen and may not be representative of the executed prices that can be achieved in the market. In such circumstances, swing pricing can be a useful mechanism to:

- contribute to protect the interests of existing investors, specifically from the dilution of their holdings; and
- contribute to protect the value of the investors capital.”

result of cost allocation between investors is also achieved through anti-dilution levies (ADL)⁷⁵, but it is implemented as an adjustment of the entry and exit charges of the fund, outside the NAV. Similarly, also a liquidity fee, on the exit side only, is implemented as an adjustment of the exit charges of the fund, outside the NAV. These options should also be assessed from an operational standpoint. Time to market is essential for investors in MMFs, as most MMFs offer same day liquidity. The more the practical specifications impose a high cost in time, expertise and complexity in calculation and implementation, frequency of use, etc., the higher the risk to generate side effects and make it inoperable.

25. Beyond the implementation and specification issues discussed above, the SMSG thinks that ESMA should in priority weigh the objective it assigns to the tool, if this option were to be envisaged, and calibrate it accordingly. Investor acceptability is a central aspect to be factored in as well. In cases of severe stress, albeit short of a complete (secondary) market freeze, when cash is all that matters, a fair fee allocating the price of accessing liquidity might not represent a deterrent for investors, as redemption remains possible while fairness between investors is reinforced. Better allocating the cost of liquidity might slow down some redemptions on a limited timeframe. However, even with a fee, in case of very severe stress, the increase of uncertainty might not sufficiently restrain redemptions.

Reforms targeting the asset side of MMFs

iii. Increase liquidity buffers, review their calibration and/or make them usable/countercyclical

26. Introducing daily and weekly liquidity buffers for MMFs has been an important provision in the previous European MMF reform and ESMA is right in assessing their usefulness in the light of a pro-cyclical risk.
27. EU MMFs managed to meet all redemption demands during the COVID-19 crisis, which represented a severe stress test. Mandating an increase in liquidity buffers, therefore, does not seem to be justified. As last year's market correction was in essence prompted by a lack of liquidity in the underlying short-term money markets, the purpose additional liquidity buffers would serve to relieve market stress remains unclear. Were the underlying liquidity conditions to freeze again as they did in March 2020, additional buffers would offer no comfort when securities simply cannot be traded.
28. CP markets are not illiquid. They are short term instruments that can be traded in the secondary markets. There is normally a very good primary market liquidity for CPs. As they are short-dated instruments, in normal times, investors tend to hold positions until maturity and thus the volume of transactions is low. A low volume of transactions in the secondary markets should not be mistaken for a lack of liquidity, because, if needed, managers can in ordinary market circumstances buy and sell positions on the secondary markets with no difficulty. It happened though that in the COVID-19 stressed markets, some dealers' ratios were sometimes and for a limited period of time saturated and additional demands could only be satisfied once the banking ratios were temporary relieved.
29. In regard of the three specific options ESMA is listing, the SMSG considers that in any case pro-cyclical effects should be avoided. These non-desirable effects might arise when a quasi-automatic link exists between the publicly disclosed level of the buffers and a trigger on a restrictive measure

⁷⁵ An anti-dilutive mechanism is a tool meant to protect existing investors from bearing the costs of buying or selling the underlying investments as a result of large inflows into or outflows from a fund. It could take the form of a "swing pricing" - where the liquidity cost is deducted from the NAV, an anti dilution levy ("ADL") or a redemption fee - where the cost is a fee outside the NAV.

on the liability side, as is currently the case for LVNAVs and PDCNAVs for triggering of fees and gates (upon decision of the fund's Board). To be countercyclical, liquidity buffers should be usable, when necessary, to face redemptions, under the asset managers' responsibility / fiduciary duty to work in the best interest of the investors. Currently, the use of VNAVs buffers is countercyclical, as the MMFR rightly allows to use them under the constraint of forbidding any new investment in the fund as long as the cash buffer is not replenished.

30. From an economic standpoint, it is not clear what the benefit would be of penalizing the investment target and performance objective of about €1 trillion EU MMFs (around 15% of the EU's funds industry) by sterilizing a portion of their portfolio, if this liquidity buffer cannot even play its smoothening role.
31. Regarding the calibration and composition of the buffers, these are minimum levels and the European asset players are managing the ratios on a fund-by-fund basis. Managers take into account several parameters, such as the asset liability pattern, the planned redemptions through the KYC, the market situation, etc. It should be reminded that money markets evolve as well as the monetary policy and the different regulations imposed on issuers, investors, banking entities and asset managers. All these aspects continuously shape the market, for instance by influencing the amount of issuances of short-term papers and the remuneration of risk compared to other market segments. Portfolios need to constantly adapt to the market. Preserving the necessary flexibility is key to achieve safer markets.

Reforms targeting both the liability and asset side of MMFs

iv. Eliminate stable NAV MMFs / Convert Public debt CNAV and LVNAV funds to Public Debt VNAV and VNAV / Convert only LVNAV funds to VNAV

32. MMFs provide non-financial corporations a mechanism to invest short term liquidity and manage working capital. MMFs' unique structure offers a diversified short term investment opportunity with low credit risk compared to single name commercial papers, they combine quick redemption, low credit risk and yield enhancement.
33. Investors, in particular corporates, report that LVNAVs and CNAVs work well in Europe. Any review of the regulatory framework aimed at limiting redemptions should give due consideration to the possible consequence of corporate users turning to other liquid instruments with potentially higher credit risk. Although unsure up to what extent, in the unfortunate case where redemption limits are too strictly designed, investors might prefer to see the structure evolving towards a VNAV than see too many illiquid barriers installed.
34. More generally, MMFs are key investment vehicles for corporates and other types of investors. They are low margin products giving access to same day liquidity. Restricting investors' access to liquidity should be avoided. When markets are under stress (and depending on the severity of the stress), working on fair fees linked to the cost of liquidity might be a better temporary solution than gates or suspensions.

Reforms that are external to MMFs themselves

v. Assess whether the role of sponsor support should be modified (e.g. amend the current requirement of article 35 of the MMF Regulation under which sponsor support is prohibited)

35. Regarding the sponsor support, ESMA asks whether the role of sponsor support should be modified, which would mean amending the current requirement of article 35 of the MMF Regulation under which sponsor support is currently prohibited.
36. The current prohibition represents a major difference between the European MMFR and the US 2a7 rule on MMFs, the latter allowing for sponsor support (a faculty that was used by a couple of US asset managers during the pandemic). The SMSG is not in favour of changing the current rule to allow sponsor support, as this radical change would mean additional moral hazard⁷⁶ for this particularly sensitive market segment. As a reminder, the implicit guarantee on a constant 1 \$ value for the US MMF, called the Reserve Primary Fund, caused a market run in 2008 as soon as it “broke the buck”. Investors lost confidence and fled to US Treasuries, agency securities, repos and cash deposits⁷⁷. The Reserve Primary Fund debacle turned into a case study for all parties involved, and especially for investors.
37. The SMSG believes that making clear for investors the nature of MMFs, namely that they are investment funds with no external guarantee (as any other fund) is of paramount importance.
38. The SMSG agrees that a Central bank intervention in its own market, such as the ECB’s PEPP, should in no case be interpreted as an external support to MMFs. Central banks conduct monetary policy to achieve price stability (low and stable inflation) and help manage economic fluctuations.

i. Amend/specify the rules on ratings of MMFs

39. ESMA also looks into MMF ratings. The SMSG would like to mention that unlike the 2008 crisis, the COVID-19 crisis was a liquidity one with no concerns stemming from the credit side. MMF ratings do not seem to have played a role during the COVID-19 crisis.
40. In some markets, like the French market, investors typically do not require MMFs to be rated as they perform in depth due diligence on the funds in which they envisage to invest and require a thorough and regular knowledge of portfolio composition and performance. Despite the MMFR being in application since 2018, other investors’ types continue to value the access to an external view, as an additional check, of a third party rating agency. This rating attribution comes at a cost, but also with an interaction between the fund and the actions of the agency. Indeed, rating actions (for instance downgrading) might trigger unwanted investor behaviour in some cases. The SMSG is of the view that at least investors should be made aware of the interaction (and potential conflict of interest) between the MMFR and the rating agency’s terms (such as the MMFR’s requirement to base the credit assessment of underlying assets on internal credit quality assessment procedures versus certain CRA’s imposing limitations based on a minimum level of external ratings). The rating agency should assess and disclose these potential conflicts and risks to investors.

ii. Disclose money market instruments (MMIs) main categories of investors to regulatory authorities (e.g. detailed information on liabilities)

⁷⁶ In economics, moral hazard occurs when an entity has an incentive to increase its exposure to risk because it does not bear the full costs of that risk. Investors in MMFs that could benefit from sponsor support might have unfounded expectations of an evergreen guarantee and overlook the necessary minimum due diligence allowing to grasp the the real risk return profile of the fund. MMFR explains that “Depending on the size of the MMF and the extent of the redemption pressure, sponsor support could reach proportions that exceed their readily available reserves.” & “ In those circumstances, the discretionary nature of sponsor support contributes to uncertainty among market participants about who will bear losses of the MMF when they do occur.”

⁷⁷ See page 73 of the BIS Quarterly Review, March 2009 “US dollar money market funds and non-US banks” https://www.bis.org/publ/qtrpdf/r_qt0903g.pdf

41. MMFs are not the sole players in money markets and ESMA is right to envisage this enhancement. The SMSG is supportive of more transparency in the underlying money markets, encompassing the structure and types of investors. The authorities' attention should primarily be focused on better understanding the underlying markets and ensuring increased transparency and efficiency on instruments dealt in those markets, namely commercial papers (issued with a term from one day to one year by corporates, banks or states).
42. More specifically, issuers prize commercial papers as they represent a rather easy and cheap financing means for them. For instance, the French NEU CPs (Negotiable EUROpean Commercial Papers) are a successful type of commercial paper in the Eurozone that allow issuers to diversify their sources of funding and provide investment opportunities in euro (and other currencies). Statistics are available on the Banque de France website and they are considered as an eligible collateral by the ECB. This format along with other European CP formats (Euro CP, other domestic CP markets) may further increase their efficiency through better pan-European transparency (centralized tape), greater standardization as well as through improved secondary market liquidity (encompassing Central Bank eligibility as collateral, usability as repo and/or softer market dealers' ratios). The STEP initiative (short-term € paper pan-European label) has been aiming for some years to foster the integration of the European markets for short-term paper through the convergence of market standards and practices.

iii. Strengthen the role of MMF stress-testing (including from a system-wide perspective)

43. MMF stress testing is already an important tool at the micro level of supervision, with quarterly reporting and regulatory calibrations updated each year. The SMSG is of the opinion that micro supervision is also an effective and relevant element of macro supervision by the global regulatory design and calibration of the stress tests. A lot of data is thus already available and can be considered to reach conclusions also at macro level. The SMSG does not see the merits of developing new macroprudential stress testing tools.
44. In addition, the utility of stress tests should not be overestimated. Stress tests may have effects in terms of driving some changes in the composition of the portfolio, but they do not deal with the status of liquidity of the underlying markets, which is at present the fundamental variable where authorities' efforts should be engaged. Moreover, the regulation sets the framework for MMF management with all sorts of ratios and limits (diversification, liquidity ratios, eligibility rules, etc) and the SMSG is of the opinion that additional stress tests should not become an additional layer of regulation on top of the regulatory and internal limits. Flexibility permits to adapt the portfolio to different market and liability situations, whereas stress tests - in spite of their usefulness to test different scenarios - cannot anticipate these particular situations.

iv. Further harmonise and enhance international MMFs reporting framework

45. There is always room to enhance harmonization and ESMA is right in preparing also in this domain. However the SMSG thinks that the cost-benefit of such an action at such an early stage should be carefully considered. The European reporting framework is quite heavy and very recent (in application since the 1st quarter 2020). In addition, the European framework is robust with for instance stress tests' calibrations that are updated each year.

v. Set-up a liquidity exchange facility ("LEF") funded by MMF or asset managers and depending on the requirements of article 35 of the MMF Regulation, by third parties, on an on-going basis. This LEF could serve as a centralised source of liquidity and/or credit during periods of stress. This could mitigate liquidity pressures on MMFs and reduce the benefit of 'first mover advantage' for investors resulting in an accelerating spiral of investor redemptions and asset fire-sales



46. The LEF cannot be a substitute of the orderly functioning of the underlying markets. Preventing markets' deterioration as well as restoring the confidence on its recovery should in any event be the priority of authorities.
47. The SMSG recommends that ESMA does careful research on what the effects would be of the potential set-up of drastic solutions like the liquidity exchange facility ("LEF"). The costs of such a solution should be taken into account, as they could be prohibitive as MMFs evolve in a low to negative yield market. In addition, the efficiency of a LEF in times of crisis should be examined, in view of the volumes at stake in money markets, depending on the amplitude of the shock.

vi. Further clarify the scope of the MMF Regulation

48. The MMF definition is clear and functioning well since the MMFR clarified it. The SMSG does not see merits in further looking to refine the current definition.

This advice will be published on the Securities and Markets Stakeholder Group section of ESMA's website.

Adopted on 30 June 2021

Veerle Colaert
Chair
Securities and Markets Stakeholder Group

Adina Gurau Audibert
Rapporteur

3.4 Annex IV: ESMA quantitative input under Article 43 and 46(2) of the MMF Regulation

A. Survey to National Competent Authorities on the review of the MMF Regulation, under Article 46 of the MMF Regulation (11 NCAs⁷⁸ responded to the survey)

I. *Assessment of the experience acquired in applying the MMF Regulation, the impact on investors, MMFs and the managers of MMFs in the Union*

On the liability side: Investor characteristics and needs

1. Professional investors of MMFs in your Member State:

a. Are they long-term investors in MMFs ? (i.e. do they redeem rarely and/or remain investor of the same MMF for a long period of time?)

Respondents generally indicated that MMFs mostly serve the purpose for cash/treasury management performed by investors in MMFs (e.g. other financial institutions, corporates, investment funds). As a result, investments in MMFs are rather of short-term, data showing that subscriptions and redemptions are substantially more important than for other fund categories, and, depending on investors, exhibit given seasonality patterns / cyclicity (e.g. monthly or quarterly subscriptions / redemptions).

This does however not exclude that some investors (e.g. other investment funds) also invest structural excess cash positions on longer time horizons in MMFs depending on their specific cash / treasury positions and risk appetite. Hence, subscriptions and redemptions experienced high levels (40% of total MMFs NAV) during the first semester of 2021.

b. Is their investment cyclical in nature? (e.g. do redemptions and subscriptions follow seasonal patterns (e.g. end of quarter redemptions)?)

Professional investors' investments are cyclical in nature. Respondents generally indicated that the end-of-quarters and year-end are the periods where MMFs record net outflows. The cyclical pattern is dependent, however, on the type of investor and their usage of MMFs (cash/treasury management usage). Certain respondents specified that based on their observations there was, however, no pattern, e.g., because these MMFs are mainly used as a temporary investment for money originated by the divestment from other UCITS / securities before it is reallocated in more stable uses.

⁷⁸ These were NCAs from the following Member States: BE, ES, FI, FR, IE, IT, LU, NL, PT, RO, SI.

- c. **Do they invest on behalf of retail investors (e.g. insurance, funds of funds, pension funds, intra-group investment (e.g. Funds from Asset manager ABC parking cash in MMFs from the same manager), etc.)?**

Respondents generally indicated that the part of retail investors (and households) in MMFs is fairly low, bearing in mind that the MMF regulation provides for a look-through to the ultimate beneficial owners where known or possible. Given the limitation of look-throughs in front e.g. of non-money market funds invested in MMFs and other institutional investors, it is not possible to determine the exact participation of retail investors in MMFs by means of the data available.

2. **Alternative products (for MMFs):**

- a. **In your Member State, what are the alternative products for each use case (long-term, cyclical, on behalf of retail investors)?**

According to respondents, the following could be considered as alternatives to MMFs (but not as substitute): they might provide some of the same benefits for investors and borrowers, but not all at the same time:

- Bank deposits are a natural alternative to MMFs for cash management purpose for all types of investors but banks might discourage their clients to deposit large amounts of cash due to prudential requirements.
- Direct investment in money market instruments is also possible for institutional investors who are large enough to maintain a proper infrastructure, but it would be more difficult for smaller investors. Direct investing could hardly be as competitive as MMFs due to the economy of scale they provide through cost mutualization, risk diversification, credit assessment and order management.
- Short-term bond funds would not be usable as a substitute to MMFs because they are not cash equivalent: they carry more risks and are less liquid as they have no obligation to hold a cash buffer.
- Reverse repo is limited by the size and credit quality of the lender of the cash, and only open to a small number of mostly institutional investors due to the attached operational burden.
- Segregated accounts may also constitute an alternative for more sophisticated clients, but seem currently more marginal.

- b. **Do investors use those alternative products and in which proportion compared to MMFs? Where possible, please detail the answer by distinguishing the main categories of investors**

Respondents generally indicated that it is not possible to provide details on proportions and categories of investors involved for these alternative products. However, it can be assumed that, e.g., some investors may switch temporarily between MMFs and deposit accounts, based on the rates offered by banks on deposit accounts. Indeed, banks are notably also actively managing their liquidity with the level of deposit rates offered to investors. For longer term

investments, the low interest environment for some currencies may attract investors to short-term bond funds.

Regulatory/legal incentives to invest in MMF at national level

- 3. Is there any legal and/or regulatory incentive and/or obligation to invest in MMFs or disinvest from MMFs? If yes, could you specify the list of these incentives and/or obligations, amount concerned, etc.?**

The vast majority of respondents reported the absence of regulatory incentive and/or obligation to invest in MMFs or disinvest from MMFs. One respondent indicated that as often a cash balance at a bank is not possible (due to regulatory constraints banks are not willing to hold the amount of cash pension funds need to set aside), MMFs are the instruments that fulfil the requirements of setting cash aside and offer the liquidity needed for margin calls. Another respondent indicated that the accounting's cash equivalence of certain MMFs is a valuable feature for institutional investors. Cash equivalence allows institutional investors to offset their debt and reduce their net debt (total debt - cash). In addition to capital preservation, minimal risk and returns in line with market rates (usually higher than bank deposits), risk diversification requirements are also an important feature in comparison to bank deposits. Due to the particular context of EU low (negative) interest rates and prudential requirements, this respondent indicated that banks may discourage their clients to hold large cash deposits

- 4. Are there any regulatory or accounting obstacles to invest in certain types of MMFs?**

Most of the respondents indicated that there are not any regulatory or accounting obstacles to invest in MMFs. One respondent draws a special attention to the fact that certain investors may prefer to invest only in CNAV MMFs due to: i) the domestic taxation requirements in the investor's home market, (ii) system limitations (cannot handle a non €/£/\$ 1 valuation), (iii) simplicity of use/understanding and (iv) alignment with how similar investments work in other countries (primarily the United States). This respondent also indicated that certain investors have risk and listing requirements for investments. For MMFs, this often translates into these investors only being able to invest in highly rated MMFs (i.e. AAA rated), those of a particular size (i.e. over 1 Billion in assets), that their investment does not constitute a large percentage of the overall MMF (i.e. they do not want to hold more than 5% of all units) or the MMF has to be in operation for a number of years. Therefore, (particularly as it relates to ratings), this often means that those investors are limited to CNAV and LVNAV MMF's, and do not have the ability to invest in VNAV/STVNAV MMFs.

Information and analysis on cost:

- 5. Do you have any information on the breakdown and evolution of MMFs fees (e.g. management fees, depositary, etc.) since the MMF Regulation was implemented?**



Most respondents indicated that they cannot provide any information on the breakdown and evolution of MMFs fees. One respondent notified that the fees applicable to MMFs have not evolved much between 2017 and 2020. Several respondents indicated that since MMF Regulation was implemented MMFs fees have been decreasing (about 2/3 since 2018, 0,07/0,08% in 2020).

II. Supervision of MMFs and managers of MMFs during the March 2020 crisis

6. Implementation of safeguards mechanisms in MMF Regulation during the crisis: a. Number of cases where the safeguards related to regulatory thresholds were triggered

Members indicated that no LMTs were activated by managers of MMFs during the March 2020 crisis.

b. Number of suspensions of closures of (re-)authorised MMFs since March 2019

Members reported that no suspension or closure has happened since March 2019.

c. What is your analysis of this data? In your view, should there be more consistent application/supervision of the implementation of these mechanisms or any additional mitigation measures?

While respondents indicated that they are facing a lack of data on this matter, they raised concerns that the requirements laid down in article 34 MMFR led to cliff effects. One respondent recommended to use a daily reporting to monitor the evolution of MMFs.

d. Application of KYC requirements – do you see a potential need for changes?

Respondents generally did not have observations about the application of KYC requirements and any potential need for changes. Two respondents highlighted the importance of KYC requirements and the need of additional work (e.g. guidance) around the consistent interpretation and application of the KYC requirements laid down in the MMFR.

Valuation: use of Mark to market and Mark to model to estimate NAV (including shadow NAV for LVNAV and CNAV):

- o Convergence between the rules of the EU member states**
- o Supervision**

7. **For CNAV and LVNAV, during the 2020 crisis, analysis of the evolution of the difference between the amortized cost and NAV at each valuation date and on a cumulative basis:**
 - a. **In your view, how was/is this evolution monitored by asset managers during the crisis and after?**
 - § **Evolution of the composition of MMFs assets**
 - § **E.g. Sale/replacement of assets to avoid triggering regulatory safeguards**

Two respondents indicated that for CNAV and LVNAV, during the 2020 crisis, the evolution of the difference between the amortized cost and NAV at each valuation date and on a cumulative basis was monitored by asset managers by using daily reporting - the difference between the constant NAV and the shadow NAV. The NAV difference was tracked by MMF managers, the oversight included more senior staff in the consultation process.

- b. **How was/is this supervised/monitored by your NCA ? E.g.**
 - § **Access to information in real time**
 - § **Surveillance of valuation inconsistencies**
 - § **Monitoring**

During the 2020 crisis and afterwards respondents indicated they increased their engagement with MMFs by the introduction of a daily MMF characteristics report. One respondent stopped this reporting at the end of July 2021. Another respondent indicated that the daily reporting continues (around month/quarter/year-end).



B. Overview of the MMF Sector, based on the MMF Reporting (ESMA own analysis, based on the MMF Reporting under Article 37 of the MMF Regulation)

Background

1. This part of the Annex, which is an ESMA economic analysis, making use of the MMF Reporting under Article 37 of the MMF Regulation, provides a first description of the MMF sector based on data from MMFR reporting. First, we describe the structure of the EU MMF sector by regulatory type, currency and domicile. Next, we provide information on the portfolio composition of EU MMFs and finally we report data on liquid assets, and EU public debt, as an asset of MMFs, in the context of the “EU public debt quota” referred to in Article 46(7) of the MMF Regulation.
2. The data presented relate to end-2020 data and cover 435 MMFs domiciled in 11 different EU countries⁷⁹. In line with AIF Annual Statistical Reports, feeder funds were excluded to avoid double counting.
3. A few methodological choices have been made:
 - a. Asset composition: the portfolio of MMFs assets has been calculated by adding portfolio data and information on exposures (including deposits, derivatives and reverse repo).
 - b. Reclassification: Since information on issuers’ type was not always consistent (i.e. private issuers reported as public, non-financial corporates reported as credit institutions etc.), the issuer type was reclassified using a range of external sources (commercial database, registers etc.).
 - c. Public debt: Unless specified, public debt refers to any debt instrument issued by local, regional, national or supranational entity. Instruments issued by public credit institutions have also been included as public exposures⁸⁰.

MMF by regulatory type, currency and country

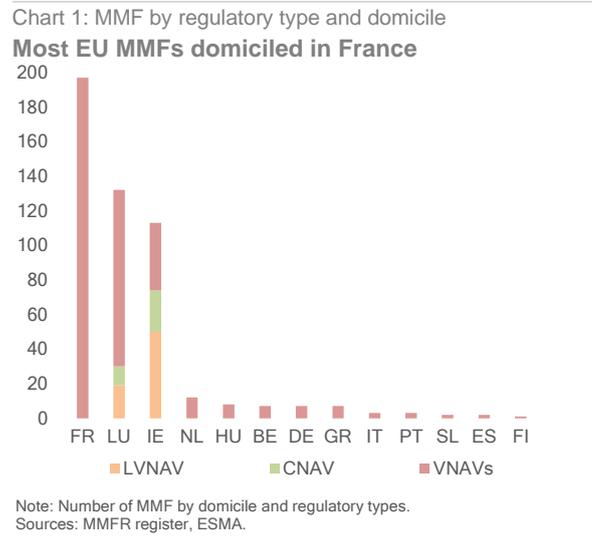
4. **The EU MMF market can be split into three parts.** First, French MMFs which are VNAVs and almost exclusively denominated in EUR and cater for domestic investors. Second, MMFs in Luxembourg and Ireland are mainly in non-EU currencies and set up as CNAVs or LVNAVs and targeted at non-EU investors. Finally, MMFs authorised in other countries, which are small, are VNAVs denominated in other EU domestic currencies⁸¹.

⁷⁹ These were NCAs from the following Member States: BE, DE, ES, FI, FR, HU, IE, IT, LU, NL, SI

⁸⁰ The choices made on reclassification of issuers and the scope for EU public debt issuers could overstate MMFs’ exposures to corporates and public debt. However, since absolute exposures are limited (EUR 90bn for non-financial corporates, and EUR 60bn for EU public debt).

⁸¹ The structure of the MMF industry remains broadly similar when using more recent data (as of June 2021), even though the data cover a smaller sample (since smaller MMFs have to report on an annual basis). Total assets as of June 2021 amount to EUR 1342bn.

- VNAVs are domiciled in 13 EU countries⁸², while CNAVs and LVNAVs are only domiciled in Luxembourg and Ireland.** As of November 2021, 494 MMFs are authorized in the EU as reported in ESMA public register. Most of MMFs are concentrated in three jurisdictions: France (197), Luxembourg (132) and Ireland (113) account for 89% of the number MMFs authorized in the EU, while the remaining EU countries have less than 15 MMFs (Chart 1).

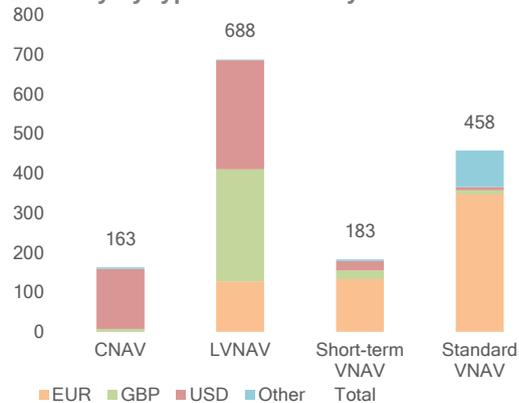


- Private debt MMFs account for 89% of total assets.** Overall, total assets of EU MMFs amounted to EUR 1,384bn as of end-2020 (Chart 2). Unlike the US, private debt MMFs account for the largest share of assets, with LVNAVs amounting to 46% and VNAVs for 43%. Public debt CNAVs amount only to 11% of total assets (Chart 3).
- MMFs are mainly denominated in non-EU currencies.** Non-EU currency MMFs amount to 59% of total assets, with 31% for USD, 22% for GBP and 7% for other currencies (mainly for standard VNAVs). EUR MMFs amount to 41%, mainly driven by VNAVs (32 percentage points).
- Around half of EU MMFs provide a stable NAV in non-EU currencies.** In terms of total assets, 37% of EU MMFs are LVNAVs in USD and GBP and 11% are PDCNAVs in the same non-EU currencies (almost exclusively in USD).

⁸² These were NCAs from the following Member States: BE, DE, ES, FI, FR, GR, HU, IE, IT, LU, NL, PT, SI; Most of the analysis was done using end-2020 data with 11 countries. Only this chart uses November 2021 data which cover 13 countries

Chart 2: Total assets of EU MMFs end-2020

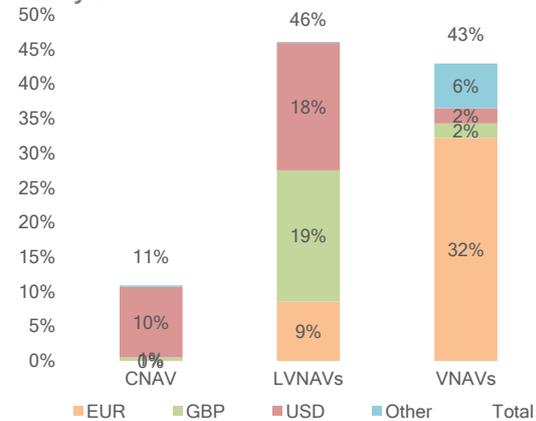
Diversity by type and currency



Note: MMF assets by MMF type and currency, end of 2020, in EUR bn. Sources: MMFR database, ESMA.

Chart 3: Share of total assets of EU MMFs by type

Mainly LVNAV and VNAVs

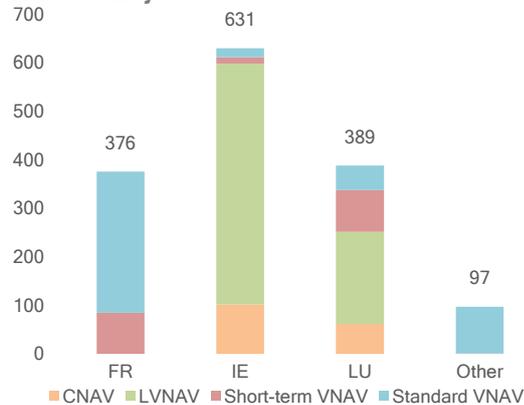


Note: MMF assets by MMF type and currency, end-2020, in %. Sources: MMFR database, ESMA.

9. EU MMFs are mainly domiciled in three jurisdictions. Ireland accounts for 42% of MMF assets, mainly concentrated in LVNAVs and CNAVs in non-EU currencies (Chart 4). Luxembourg amounts to 26% of assets, spread across MMF types and currencies (Chart 5), France accounts for 25% of the market, exclusively in VNAVs. Other countries represent 7%, exclusively in VNAVs.

Chart 4: Total assets of EU MMFs end-2020

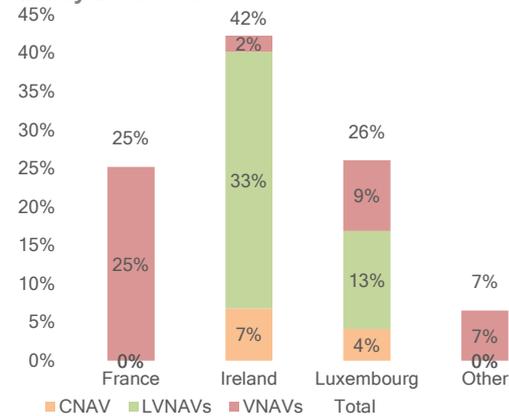
Three main jurisdictions



Note: MMF assets by MMF type and domicile, end of 2020, in EUR bn. Sources: MMFR database, ESMA.

Chart 5: Share of total assets of EU MMFs by type

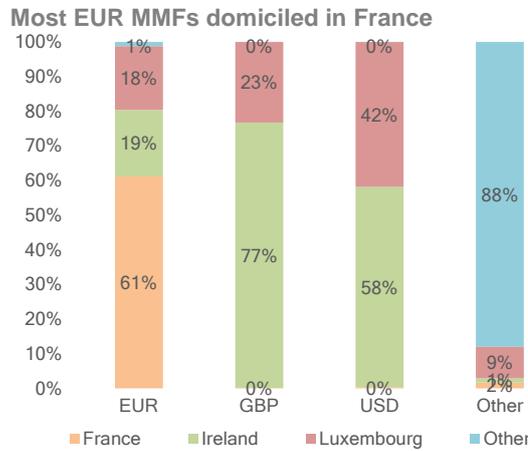
Mainly LVNAV and VNAVs



Note: MMF assets by MMF type and domicile, end-2020, in %. Sources: MMFR database, ESMA.

10. EUR MMFs are mainly domiciled in France, while non-EU currency MMFs are mainly in Ireland and Luxembourg. The share of MMF by country of domicile and currency indicates that France accounts for 61% of EUR MMF assets (Chart 6). In contrast with non-EU currencies, EUR MMFs offer mainly a floating NAV (22% are short-term VNAVs, 57% are standards VNAVs). The market for USD and GBP MMFs is exclusively domiciled in Ireland and Luxembourg. Finally, most MMFs in other currencies (EUR 102bn) are domiciled in other EU countries.

Chart 6: Total assets of EU MMFs by domicile



Note: MMF assets by MMF currency and domicile, end-2020, in %.
Sources: MMFR database, ESMA.

Investors' composition

11. Professional investors hold 90% of MMFs with a limited role for retail investors.

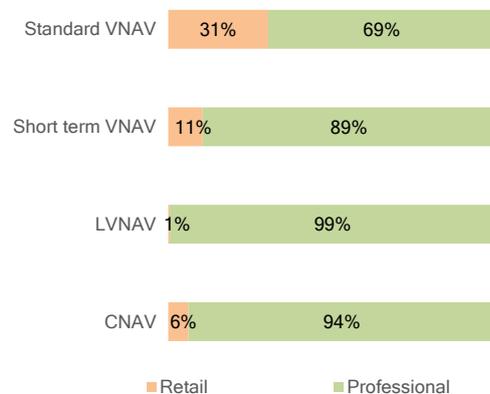
Professional investors account for 94% of the NAV for CNAV and 99% for LVNAV (Chart 7). For VNAV, and especially standard VNAV, the share of retail investors is higher, with respectively 21% (for all VNAVs) and 31% for standard VNAVs.

12. In Ireland and Luxembourg, retail investors play a marginal role.

Ireland has almost no retail investor (Chart 8), while in Luxembourg the share of retail investors amount to 8% of NAV⁸³, mainly in VNAVs. For France, the share of retail investors is higher than 20%.

Chart 7: Investor type

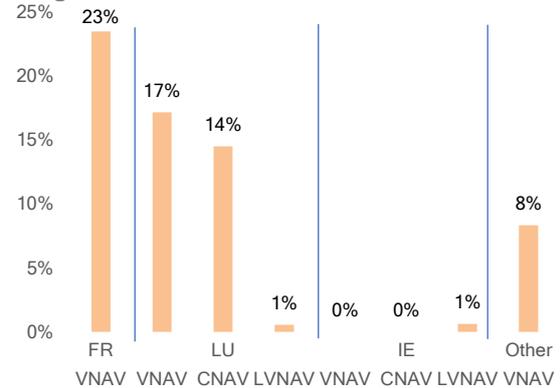
Overwhelmingly institutional investors



Note: Share of NAV by investor type, in %.
Sources: MMFR database, ESMA.

Chart 8: Retail investors

Marginal role in LU and IE



Note: Share of retail investor by domicile and regulatory type of MMFs, in % of NAV.
Sources: MMFR database, ESMA.

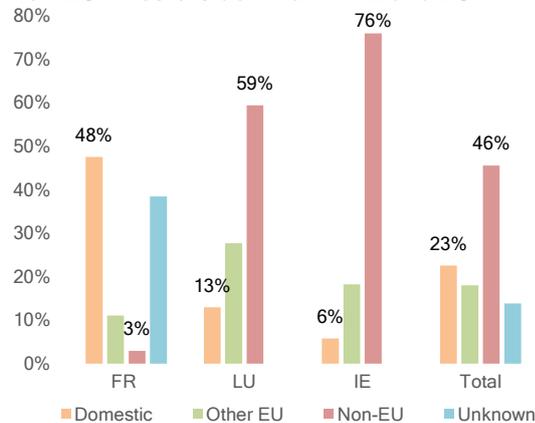
⁸³ 17% for VNAVs, 14% for CNAVs, and 1% for VNAVs

13. Non-EU investors are dominant in LU and IE. Reflecting the importance of MMFs in non-EU currencies, non-EU investors account for more than 76% of the NAV of Irish MMFs (Chart 9, including 57% from the UK and 10% from the US) and close to 60% for Luxembourg (including 33% from the UK and 8% from the US). In contrast, domestic investors account for close to 50% of NAV in France (compared with 13% in LU and 6% in IE). LU MMFs have the largest share of non-domestic EU investors (28% compared with 18% for IE and 11% for FR). Finally, a large share of French MMFs were not able to allocate the NAV by country, resulting in a large unknown category (38%).

14. Financial institutions are the main investors in MMFs across types. Other financials account for 40% of the NAV (Chart 10), followed by insurance and pension funds (10%) and banks (9%). Non-financial corporates account for 20% of NAV. A large share of French MMFs were not able to allocate the NAV by investor category, resulting in a large unknown category for VNAV (34%).

Chart 9: Investors by country

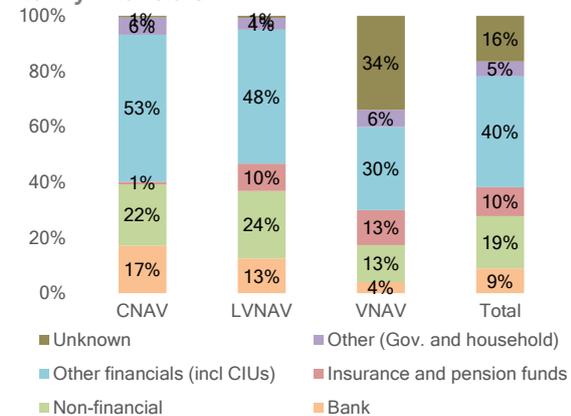
Non-EU investors dominant in IE and LU



Note: Share of NAV by investor domicile, in %.
Sources: MMFR database, ESMA.

Chart 10: Investor categories

Mainly financials



Note: Share of NAV by investor type, in %.
Sources: MMFR database, ESMA.

Portfolio composition

15. EU MMFs are mainly exposed to the financial sector. Exposures to banks amount globally to 66% of total assets, including 38% in money market instruments issued by banks, 15% in deposits and 12% in repo (Chart 11). Exposures to banks amount to 77% for LVNAVs and 63% for VNAVs. Data had to be adjusted due to misclassification of issuers by reporting MMFs (banks or corporates reported as sovereigns for example).

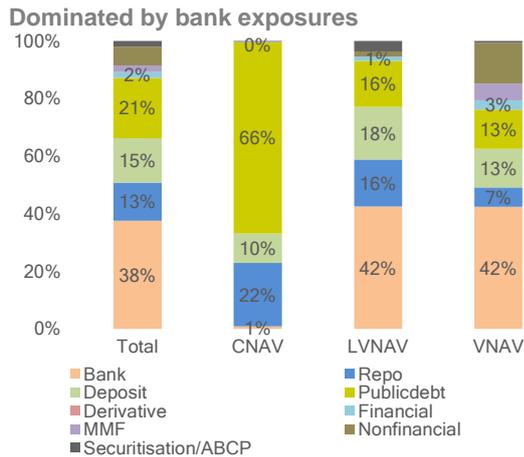
16. Exposures to non-financial corporates remain small. Non-financial corporates exposures amount to only EUR 89bn (6% of total assets) and are mainly concentrated in VNAVs (EUR 77bn or 14% of VNAVs assets).

17. Exposures to public debt amount to EUR 290bn, mostly towards non-EU issuers⁸⁴. Those exposures relate mainly to CNAVs (66%) but also to LVNAVs (16%) and VNAVs (13% of total assets, Chart 11).

⁸⁴ Public debt includes local, national and supranational issuers as well as publicly-owned credit institutions.

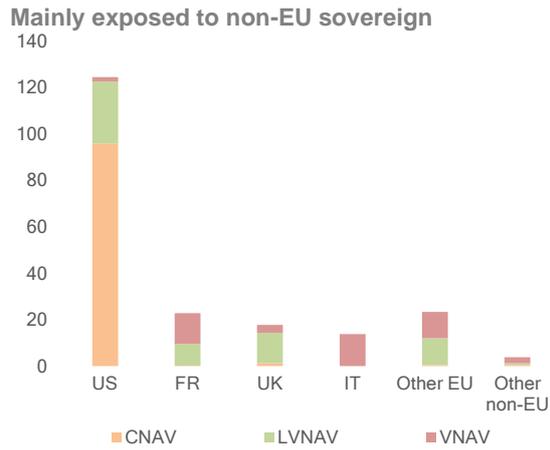
18. Exposures to sovereign debt amounts to EUR 206bn, mainly towards non-EU sovereigns (70%). US sovereign debt accounts for 60% of all MMF sovereign debt exposures (Chart 12), followed by France (11%), UK (9%) and Italy (7%). Looking at MMF regulatory types, EU sovereign debt accounts for 34% of sovereign debt exposure of LVNAVs (EUR 21bn); for VNAVs, EU sovereign debt represents 83% of sovereign debt exposure (EUR 39bn). EU sovereign debt accounts for less than 1% of CNAV sovereign exposures (EUR 0.5bn).

Chart 11: Portfolio composition



Note: Total assets of EU MMFs by regulatory type, end-2020, in %
Sources: MMFR database, ESMA.

Chart 12: Sovereign exposures

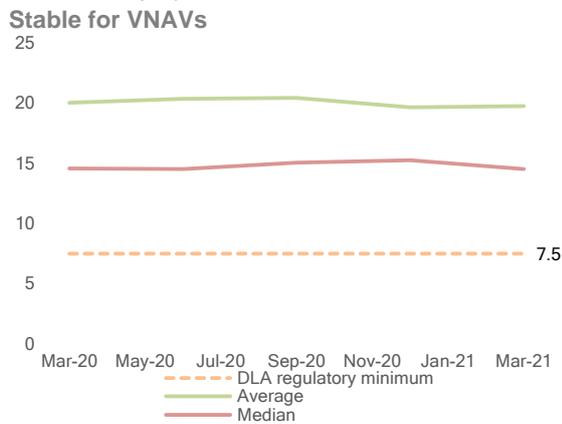


Note: Exposures of EU MMFs to sovereign debt, in EUR bn and in %, end-2020.
Sources: MMFR database, ESMA.

Daily and weekly liquid assets

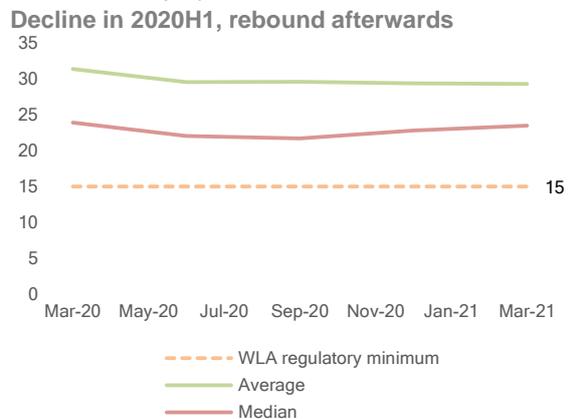
19. Liquid assets remain above regulatory minimum. For VNAVs, the median DLA and WLA have remained around 5 and 10 percentage points above daily and weekly regulatory minimum of respectively 7.5% and 15% (Charts 13 and 14). Same observations apply to LVNAVs, where the median DLA and WLA are respectively 20 percentage points above regulatory requirements of respectively 10% and 30% (Charts 15 and 16). For short-term VNAVs, average WLA and DLA show non-realistic values (higher than 100%) and are therefore not displayed.

Chart 13: Daily liquid assets for standard VNAVs



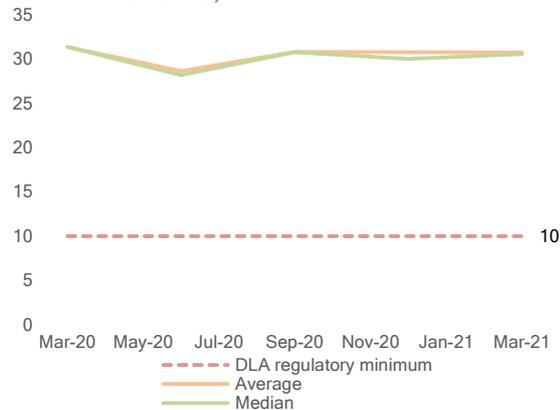
Note: DLA of VNAV MMFs, in % of total assets.
Sources: MMFR database, ESMA.

Chart 14: Weekly liquid assets for VNAVs



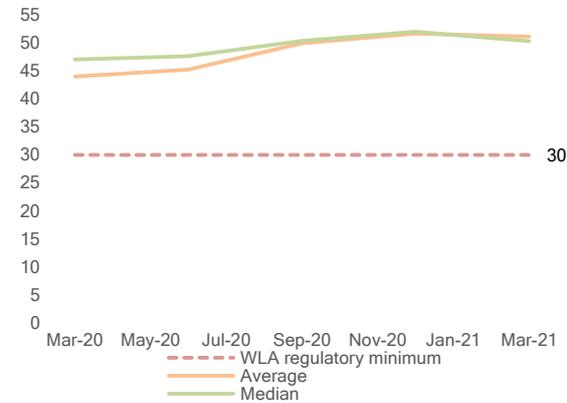
Note: WLA of VNAV MMFs, in % of total assets.
Sources: MMFR database, ESMA.

Chart 15: Daily liquid assets for LVNAVs
Decline in 2020Q2, rebound since



Note: DLA of LNAV MMFs, in % of total assets.
Sources: MMFR database, ESMA.

Chart 16: Weekly liquid assets for LVNAVs
Increase since March 2020



Note: WLA of LVNAV MMFs, in % of total assets.
Sources: MMFR database, ESMA.

EU public debt quota (Article 46(2) of the MMF Regulation)

20. **All PDCNAVs are in non-EU currencies.** USD CNAVs amount to EUR 151bn and GBP to EUR 7bn while EUR CNAVs are almost non-existent (one MMF with assets below EUR 60Mn).
21. **PDCNAVs are a small share of non-EU currency MMFs.** PDCNAVs only account for 2% of GBP MMFs assets and 32% for USD MMFs.
22. **Imposing a 80% EU public debt quota on PDCNAVs would make CNAVs very large holders of EU public debt in non-EU currencies.** The supply of EU public debt issued in non-EU currencies is relatively low: EUR 163bn in USD and EUR 38bn in GBP. Based on the current size of CNAVs, imposing a 80% EU public debt quota would imply that USD CNAVs would have to hold EUR 125bn of EU USD debt (75% of the available supply) and GBP CNAVs would hold EUR 5.6bn (15% of the market).
23. **The quota would also mechanically limit the size of non-EU currencies CNAVs.** The size of CNAVs in non-EU currencies is capped by the available EU public debt in foreign currencies, resulting in a maximum size of EUR 48bn (GBP) and EUR 205bn (USD).
24. The above assessment on the feasibility of setting an EU public debt quota is aimed at showing preliminary insights and findings based in particular on the data extracted from the MMF database under Article 37 of the MMF Regulation. Upon request from the European Commission, ESMA stands ready to complement this economic assessment on other aspects of this issue that the Commission would deem useful to investigate further, such as limited supply related issues (MMF being only one of the participants in such public debt markets, the price impact of any such quota could therefore be significant).

