association of the
luxembourg fund industry

ALFI responses to *ESMA consultation paper on draft technical advice, implementing technical standards and guidelines under the Money Market Fund Regulation*

Luxembourg, 7 August 2017

The Association of the Luxembourg Fund Industry (ALFI), the representative body for the Luxembourg investment fund community, was founded in 1988. Today it represents more than 1500 Luxembourg-domiciled investment funds, asset management companies and a wide variety of service providers including depositary banks, fund administrators, transfer agents, distributors, law firms, consultants, tax advisers, auditors and accountants, specialist IT providers and communications agencies.

Luxembourg is the largest fund domicile in Europe and its investment fund industry is a worldwide leader in cross-border fund distribution. Luxembourg-domiciled investment structures are distributed in more than 70 countries around the globe, with a particular focus on Europe, Asia, Latin America and the Middle East.

ALFI is pleased to be able to have the opportunity to respond to the ESMA consultation paper "*on draft technical advice, implementing technical standards, and guidelines under the MMFR*" (hereinafter the "ESMA Consultation").

Response to the ESMA consultation:

Q1. Do you agree that the abovementioned references to EU/US standards are relevant in the context of the issuance by ESMA of technical advice on quantitative and qualitative liquidity and credit quality requirements applicable to assets received as part of a reverse repurchase agreement in the context of the MMF Regulation? Do you identify other pieces of national/EU/International law that would be relevant in view of the work on this part of the advice?

ALFI generally agrees to the references to existing US and EU standards, especially in light of the close inter-link between the US and EU markets on the money market fund sector, with the exception of the US regulation suggesting to eliminate references to rating agencies by focusing on an internal assessment, which we briefly outline in the response to question 6 hereunder.

We believe that paragraph 86 of the ESMA Consultation is somehow confusing. Whilst we concur with ESMA's conclusion that article 15 of level 1 requires different requirements depending on whether the issuer is a EU member state or third country, we understand that the exemption to the 15% limit as per article 15(4) apply to all securities fulfilling requirements of article 17(7), which includes also third countries issuers. We do not understand the reference being made to European public debt as referred to in article 17(6).

Q2. Which of the options described above regarding credit quality and liquidity requirements would you favor?

ALFI prefers the following options

- *Credit quality - option a); and*
- *Liquidity option a).*

- MMFs are assuming counterparty exposure for a very short period (essentially overnight exposure). Also see reference to US SEC Rule 2a7.
- All approved counterparties need to be vetted through a credit assessment process (article 19-22).
- The same counterparties are entities, once approved via the credit assessment that MMFs would, generally, be comfortable lending to on an unsecured basis for tenors at least overnight and likely longer.

This begs the question as to whether a credit assessment (with the bar set as high as articles 19-22 would imply for direct exposures) should apply for indirect exposure to collateral supporting a reverse repo counterparty that MMFs have approved to lend to on an unsecured basis.

ALFI supports option (a) on credit quality requirements. Counterparty creditworthiness, separate and apart from the value of the collateral supporting the counterparty's obligation under the repurchase agreement, should be the fundamental determination of credit quality of a repo trade. Given that Article 15(1) (a) and (b) of the Regulation provides that a repo trade must be terminated within a maximum of 2 working days and must at least be fully collateralised, the MMF could reasonably rely on the credit assessment of the counterparty. Additionally the impact on the fund of adverse impacts to the counterparty would be limited due to the maximum 15% limit exposure to an individual reverse repo counterparty (Article 15(4)).

We additionally support option (a) for liquidity requirements. We agree that the fundamental determination of credit quality of a repo trade should be based on the creditworthiness of the counterparty, especially when the counterparty is a prudentially regulated entity. Where the risk of default is not likely to be realised within a 2 day duration (the maximum notice period for which a MMF can terminate an agreement) and the impact on the fund is limited based on the maximum 15% limit exposure to a single counterparty, then no additional credit or liquidity criteria need to be applied to the collateral.

ALFI would propose that insurance companies and pension funds be added as eligible counterparties alongside credit institutions, investment firms, etc. to the extent that these entities are subject to prudential supervision. These categories of entities may engage in reverse repos with MMFs and should be treated on a level playing field with other regulated financial counterparties.

ALFI does not agree with option (b) for liquidity requirements. Existing ESMA guidelines[1] already provide that that collateral received should be highly liquid and traded on a multilateral trading facility with transparent pricing in order that it can be sold quickly at a price that is close to pre-sale valuation. The collateral much be valued on at least a daily basis and under the UCITS must have an appropriate stress testing policy in place carried out under normal and exceptional liquidity conditions[2]. In the particular context of UCITS we believe that the current requirements for UCITS funds are sufficient to ensure the liquidity of the collateral received.

Q3. With respect to option a), do you think the haircut policy should be determined as suggested, or should there be more flexibility given to the manager on this determination? Do you think that the decision of equivalence *vis-à-vis* third countries mentioned in this option should relate to the one mentioned in Article 114 (107 in the case of credit institutions) of CRR?

ALFI believes that flexibility should be left to the asset manager, as haircuts would / should typically be market driven. ALFI further believes that this is consistent with the orientation that ESMA has taken in its Guidelines on ETFs and other UCITS issues (ESMA/2012/832 on 18 December 2012) and more particularly in paragraph 46 which indicates that "*A UCITS should have in place a clear haircut policy adapted for each class of assets received as collateral. When devising the haircut policy, a UCITS should take into account the characteristics of the assets such as the credit standing or the price volatility, as well as the outcome of the stress tests performed in accordance with paragraph 47. This policy should be documented and should justify each decision to apply a specific haircut, or to refrain from applying any haircut, to a certain class of assets*".

Q4. With respect to option b) on liquidity requirements, do you think that requiring assets convertible to cash in one business day or less is appropriate? Do you think this requirement should be more detailed and refer to trade date or settlement date, for example? With respect to that same option b), how do you think that the criteria mentioned in this option could be defined in more detail, and how could quantitative indicators be introduced? Do you think all the criteria mentioned in Article 2(3) of this option b) are relevant? Under this option, when the liquidity assessment of the manager is that the assets would no longer be liquid assets, the manager shall take immediately any appropriate action including the replacement of the collateral with another asset that would be qualified as liquid assets. Do you think that the replacement of the collateral could be carried out overnight?

With regard to the reference of "one business day or less", we would appreciate a confirmation that this requirement would exclude the settlement cycle. Requiring assets convertible to cash in two business days or less would be more appropriate, from the trade date. We believe that Spot settlement on T+2 would be more appropriate.

[1] see Article 43 of the ESMA/2014/937 Guidelines for competent authorities and UCITS management companies.
[2] see Article 45 of the ESMA/2014/937 Guidelines for competent authorities and UCITS management companies.

Regarding the replacement of illiquid assets we would prefer an "immediate" replacement action instead of an overnight replacement for the reasons explained below.

ALFI does not support Option (b). Option (b) significantly increases the complexity of trading a highly standardised product such as high-quality government backed reverse repo. In a market stress scenario it may not be possible or prudent to force a fund to convert assets to cash within one business day, especially where the collateral is MMF eligible as per MMF Regulation Art 15 (2), and for broader collateral this requirement goes beyond the requirements set out in the MMF Regulation. Under existing ESMA guidelines [footnote 3: see article 43 of the ESMA/2014/937 Guidelines for competent authorities and UCITS management companies], collateral received must be highly liquid and be able to be sold quickly at a price that is close to pre-sale valuation. We believe that the current requirements for UCITS funds are sufficient to ensure the liquidity of the collateral received. An intraday conversion requirement would be extremely difficult to apply under current market terms.

It should be noted that in Annex IV, Option (b) paragraph 7, collateral can only be fully enforceable in the case that a counterparty default occurs.

The majority of reverse repo trades conducted by a MMF are overnight, triparty agented trades where the collateral is a specified basket of eligible securities. In practice the exact securities delivered to the MMF are not known until after close of business on settlement date. Any assessment of the liquidity of the assets as referred to in Option (b) Article 2 (3) would be out of office hours and no action could be taken until the next business day when the maturity leg of the trade will already have been sent for processing. For the small minority of trades that are traded for longer than one business day, these will be limited to maximum 2 business days to maturity. The triparty agent will value the collateral received on at least a daily basis and make a margin call on the counterparty if required to ensure at least full collateralisation of the reverse repo trade.

Substitution and switching of collateral cannot take place after the timing of the last run of the tri-party agent until the start of the next business day. The counterparty to the trade will have committed collateral under other trades and these cannot be changed until the market opens.

Q5. What would be in your view the consequences in terms of costs of the chosen option, and of the other options mentioned above? Do you agree with reasoning mention in the CBA (annex III) in relation to the possible costs and benefits of the options as regards the abovementioned credit quality and liquidity requirements? Which other costs or benefits would you consider in this context?

The rules in particular as regards costs are so complex, that it is difficult to assess these at this stage in a short response.

Q6. Do you agree that the abovementioned references to EU and US standards are relevant in the context of the issuance by ESMA of technical advice on credit quality assessment under the requirements of the MMF Regulation? Do you identify other pieces of national/EU/International law that would be relevant in view of the work on ESMA technical advice on credit quality assessment under the requirements of the MMF Regulation?

The US regulation suggests eliminating references to rating agencies and focusing on internal credit risk assessment.

We note that Regulation (EU) 2017/1131 takes a much more balanced approach. While the Regulation requires from the manager of an MMF to establish, implement and consistently apply a prudent internal credit quality assessment procedure for determining the quality of eligible investments, it does not prevent the manager per se from having regard to external credit ratings as a supplementary information (article 19, 20 paragraph 1. and recital (31)).

Q7. Do you agree with the proposed option on each of the requirements mentioned in Article 22 of the MMF Regulation? If not, could you specify which existing regulatory framework would you suggest as a basis for the work on the technical advice related to Article 22 of the MMF Regulation?

Our members already have "internal processes" in place that achieve the requirements laid out under article 22. More specifically please see the comments below:

Regarding Article 22(a): In our opinion, mirroring the requirements applied to credit rating agencies under Regulation 447/2012 would go beyond the specific needs for the MMF Regulation credit quality assessment requirements. Smaller managers of MMFs might find it challenging to provide the necessary employees and technical capabilities to mirror the requirements applicable to external rating agencies. This would also mean that the requirements applicable to providers who offer the specific service of "credit ratings" are the same as the requirements for a fund manager, who needs to produce this alongside other requirements and services and only limited to his offering of MMFs. In our opinion this would go beyond the current mandate of the MMF Regulation.

Article 22(b) and (c): We agree that a mirroring of the guidance already provided (especially the JC Report JC 2016-71) is feasible and appropriate in this regard. This should also be taken in line with our answer to Article 22(a) as the quoted guidance under 22(b) and (b) does not go as far as the Regulation 447/2012 proposed under 22(a). The guidance proposed under 22(b) and (c) is more reasonable to be implemented by managers of MMFs.

Article 22(d): We generally agree to link "material change" to the risk factors monitored and stress test scenarios performed by the manager. However, the definition of "material change" must be specific to the issuer or at least should refer to criteria that have been specifically considered at the time the credit assessment was performed. For instance, changes in the macro economic environment can be deemed *material* but are not specific to an issuer. They might nevertheless influence the credit

assessment. An interest rate rise should not lead to the manager having to re-perform every credit assessment on each security in a relevant considered portfolio. Such nuance in the approach and implied requirements would be welcome.

We believe that the proposed wording of article 22 should be softened as to read “such as” instead of prescribing a closed list.

Considering there is no over-arching regulatory framework that mandates the removal of rating references in Europe, the CESR baseline of tier 2 could still apply as a foundation. If issuers rated below tier 2 remain on issuer list, managers must document the rationale to defend their action.

Q8. In your view, what would be the consequences (including operational ones) of the level of detail and prescription suggested above in the proposed technical advice on credit quality assessment under the MMF Regulation (which would be broadly similar as in the delegated Regulation on the assessment of compliance of credit rating methodologies (447/2012), and in the technical advice on reducing sole and mechanistic reliance on external credit ratings (2015/1471))?

We understand the issue of a systemic risk if guidance is too prescriptive and the market movements would be aligned due to similar assessment results out of all credit quality assessments. Thus, if the criteria are overly prescriptive, then the risk of the industry’s reaction to an issuer might cause a wholesale withdrawal unnecessarily.

However, a certain “comparability” needs to be achieved across the market. Widely diverging credit quality assessment results or credit quality assessments being e.g. determined based on insufficient amount of Information may lead to negative investor impacts. It should be in the interest of ESMA to create a base level of prescriptiveness and alignment within the market to ensure that the assessments do not result in fundamentally different results and therefore fundamentally different outcomes for investors, while leaving the manager the freedom to select an approach fitting best to the investible universe. From a practical perspective, this could imply that depending on the investible universe different combinations of external short term ratings, long term ratings as well as an internal assessments are to be used.

If the criteria is overly prescriptive, then the risk of the industry’s reaction to an issuer might cause a wholesale withdrawal unnecessarily.

Q9. What would be in your view the consequences in terms of costs of the chosen options described above in relation to the requirements included in the technical advice under Article 22 of the MMF Regulation? Do you agree with the assessment of costs and benefits mentioned in the CBA (annex III) on the technical advice under Article 22 of the MMF Regulation? If not, please explain why and provide any available quantitative data that the proposal would imply.

No response.

Q10. Do you think other type of information should be considered as “characteristics” of the MMF?

We welcome ESMA’s approach to have based its work upon AIFMD reporting and we encourage ESMA to further seek alignments in the file structure and all the relevant functional sections of the AIFMD reporting such as the AIFM Header file, Header Section and Assumption description should be foreseen as well (including e.g. version, creation and time of the file, reporting start date, reporting end date, etc).

We believe that lessons shall also be learnt from the AIFMD reporting experience. Under AIFMD, managers have made considerable investments in developing extensive reporting but still lack so far evidence that the voluminous information reported is pertinent to allow NCAs and ESMA to perform their supervisory roles. We believe that the root causes for this issues were due to the fact that the AIFMD reporting mingles a large variety of funds, with different features, but also to the fact that the content of the reporting was built fleshing out the directive requirements rather than setting upfront the exact information that NCAs and ESMA will need to discharge their supervision duties. Therefore, we would recommend:

- sticking to those items considered appropriate to collect in the specific case of MMFs by the MMFR;
- that the exact information needed by NCAs and ESMA be defined upfront, based on defined supervision objectives, before the content of the reporting be defined. We are conscious that this might delay the process upfront but we remain convinced that all will ultimately save time for all if the right information is included in the reporting.

We would also like to highlight the importance of being consistent with the regulation (see our below remarks on fields B.1.7, B.1.24 for instance).

We disagree with ESMA’s statement in paragraph 186 on page 49, when it mentions that “the destruction of shares is not allowed under the MMFR”. We do not agree with the reference to “destruction of shares” and a potential inconsistency with the content of the Regulations to the extent it refers to the “reverse distribution mechanism” put in place for certain distributing share classes (the “Relevant Distributing Share Classes”). This mechanism is the pendant of the dividend distribution mechanism by which shareholders have the possibility to mandate the board of the fund to reinvest their distribution proceeds into new shares and, as a result, to increase their shareholding in the fund instead of being paid distribution proceeds in cash. In subscribing into Relevant Distributing Share Classes shareholders give mandate to the board of directors of their fund to redeem their shares in certain markets environment and more specifically, in markets with negative interest rates. Shareholders do use the fundamental right they have in an open-ended investment fund to freely redeem their shares. In addition, to the best of our knowledge, suppressing this important feature that protects both investors and the markets in negative yield situations was never raised during the

legislation process nor was it the intention of the policy makers and it would go beyond the scope of the Regulation.

Regarding detailed comments on the reporting template, we refer to EFAMA answer. In addition, we would like to add the following comments:

- As all MMF's will be subject to a product authorisation (unlike the AIF situation under AIFMD), NCA's will have already received and reviewed information as part of their supervision process (like for instance, details on custodian (fields A.1.23.to A.1.25), mergers (fields A.3.17 to A.3.23)). We therefore wonder what is the value added of these fields?

- Item A.4.1 and 4.2: the total assets under management is a concept that is not relevant for UCITS - we would appreciate clarifying that this field only apply for AIF or that for UCITS, AUM equals NAV.

- Item A.4.10: Value of unencumbered cash: we do not believe that this information is relevant in the context of an MMF.

- Item A.6.1: We do not believe that the proposed breakdown (based on UCITS eligibility criteria) is the most relevant as a same instrument may tick the box for several of these categories.

- Items A.6.31 and following: we believe that it might be confusing to mingle items such as deposits, derivatives repos, reverse repos of UCI's in the same category as these instruments exhibit different features.

- Item B.1.7: Wording shall be corrected in order to be in line with the regulation: *"... how long did the price of an asset valued by using the amortised cost method of this asset deviated by more than 10 basis points* ~~from the price of that asset~~..." in order to be consistent with the regulations

- Item B.1.24: Wording shall be corrected in order to be in line with the regulation: *"whenever the proportion of weekly maturing assets ... falls below 30% of the total assets of the MMF* ~~*and whenever*~~ *the net daily redemptions on a single working day exceeds 10% of the assets"* in order to be consistent with the regulation.

Q11. Do you agree with the proposed way of reporting the yield of the MMF? If not, could you indicate what would be the more appropriate way to report yield in your views? Do you think the 7-days gross yield should be reported for each week of the reporting period? If not, what should be the appropriate frequency of reporting on this item?59 Do you think that the calendar year performance and yield could be calculated at (sub)fund level and at share class level? Which difficulties do you identify while doing so? At which frequency should it be reported?

We believe seven yield measurements as proposed - A.4.11 to A.4.17- are superfluous. As mentioned above, we would welcome understanding the supervisory objective pursued by ESMA when requiring this information. We believe that, given the nature of the MMF's strategy (less prone to fluctuation or volatility than other), performance figures (at subfund level) for the reporting period shall be sufficient.

Q12. Which type of measure would you suggest using to report the quantified outcome of the credit assessment procedure?

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Q13. With respect to reverse repurchase agreement, do you agree that the information requested is appropriate? With respect to repurchase agreements, do you think the value of cash received should be reported as a breakdown per investment purposes, i.e. liquidity management or investment in assets referred to in Article 15(6)? (given the information on the amount of cash received as part of repurchase agreements that is also requested). What should be the appropriate frequency of reporting on this information? Do you think the value of unencumbered cash should be reported as a breakdown per country where the bank account is located and currency? (given the information on deposits that is also requested)

We do not see the need to report unencumbered assets as this notion is not relevant for MMFs.

Q14. Do you think the information on the investor 'lock-up' period in days (report asset weighted notice period if multiple classes or shares or units) is relevant in the case of MMFs (this information is included in the AIFMD reporting template)?)? Do you agree with the proposed way to report stress tests?

We do not see the need to report investor "lock-up" as this notion is not relevant for MMFs.

Q15. Do you identify other type of information that should be included in the requested information in the reported template? What would be in your view the consequences in terms of costs of the proposed options for the reporting template? Do you agree with the assessment of costs and benefits above for the proposal mentioned in the CBA (Annex III) on the reporting template? If not, please explain why and provide any available quantitative

data on the one-off and ongoing costs (if any) that the proposal would imply. Do you have specific views on the potential use of the ISO 20022 standard?

In general, we believe the reporting exercise under MMFR should be mainly consistent with AIFMD reporting but with a narrower scope, focussing on the MMF's strategy and features (unlike MMFR, AIFMD is intended to capture a broad universe of funds). As indicated above, we would welcome if the costs/analysis benefit would elaborate on the objective pursued in the reporting exercise, in order to ensure that the information reported is relevant in the context of NCAs and ESMA's roles.

Q16. Do you agree that the abovementioned references to EU/international standards are relevant in the context of the issuance by ESMA of guidelines on stress testing of MMFs? Do you identify other pieces of EU/International law that would be relevant in view of the work on ESMA guidelines on stress testing of MMFs?

As a general comment we would like to highlight that aggregation of stress tests, as well as the proposed "reverse stress tests" are not within the mandate of ESMA under the MMF consultation mandate given by the MMF Regulation.

We also do not see the need to differentiate the stress tests between VNAV and LVNAV MMFs.

ALFI members agree with ESMA's approach to consider the current regulatory framework applicable to UCITS and to AIFMD. The MMF reform adopted in the US through the SEC ref. No. 33-9616 on 14 October 2014 share thematic similarities with the requirements expressed in the MMF Regulation. However, we would recommend to leave it up to the asset management companies to define the quantitative limits based on their respective risk appetite, and experience.

We would also like to draw your attention to ALFI risk management guidelines[3], which have been defined based on a set of international regulatory banking and/or asset management bodies, including "Principles for sound stress testing practices and supervision" issued by the Bank of International Settlement in May 2009, the final report of the Institute of International Finance (IIF) in July 2008 on "Principles of Conduct and Best Practice Recommendations", recommendations by the Counterparty Risk Management Policy Group in its August 2008 report "Containing systemic risk: the road to reform – The report of the CRMPG III), and the EBA (formerly CEBS) guidelines on stress testing for financial institutions published on 26 August 2010. All these guidelines address topics such as reverse stress-testing, the linkage between stress testing and risk appetite, and the governance of the stress-testing framework.

[3] http://www.alfi.lu/sites/alfi.lu/files/files/Publications_Statements/Brochures/Principles-for-sound-stress-testing-practices-final.pdf

Finally, different national competent authorities have established minimum standards for stress testing or explicit stress testing requirements (such as the stress test requirements within the Luxembourgish UCITS Risk Reporting, introduced by the CSSF in mid-2016).

Q17. Do you have specific views on the interpretation of the requirements of Article 25(1) of the MMF Regulation on the meaning of the abovementioned "effects on the MMF"?

The outcome of the stress test shall be put in perspective with the portfolio or net asset value of the fund as suggested by ESMA in point 205.a. Points b. to e. of the ESMA proposed guidelines are also in line with the liquidity risk principles of an MMF.

Special effects on the MMF should in particular encompass impact on the portfolios NAV (point a) as well as the means to meet redemptions (point d) without diluting the interest of remaining investors (meaning keeping a fairly constant liquidity profile after the stress event (point c)).

Likewise, the impact of the rebalancing of the portfolio (i.e. transaction costs) following large redemption requests may also be assessed as part of the stress testing in order to mitigate the risk of dilution of the investors remaining investors in the fund.

Stress-testing should incorporate spread shocks from both credit and interest rates and the effects on the NAV given various redemption scenarios. We believe that the effects on the MMF should include impact on weekly liquidity of the fund and the stability of the fund's NAV based on changes in rates, spreads, redemptions and credit impacts and combination thereof.

The specific view we have on stress tests is that the outcome should be measured in terms of NAV impact and liquidity ratio.

Q18. Do you have views on the specifications of the following criteria:

i. level of changes of liquidity of the assets with respect to Article 28(1)(a),
ii. levels of changes of credit risk of the asset with respect to Article 28(1)(b),
iii. levels of change of the interest rates and exchange rates with respect to Article 28(1)(c),
iv. levels of redemption with respect to Article 28(1)(d),
v. levels of widening or narrowing of spreads among indexes to which interest rates of portfolio securities are tied with respect to Article 28(1)(e),
vi. identification of macro-systemic shocks affecting the economy as a whole with respect to Article 28(1)(f))? (how would set the calibration of the relevant factors in the case of 71 the Lehman Brothers' event, and the two proposed scenarios A and B? With respect to scenario B mentioned above, do you think the duration of 12 months is appropriate?)

***As regards i)** "level changes of liquidity of the assets…":*

No response.

As regards ii) *"levels of changes of credit risk of the asset":*

We believe that there is not one universal approach, the following remarks can be made:

- Most of the options laid out in this section each has its own limitations. However, the option in which "managers could also consider parallel shifts of the credit spreads of a certain amount of the portfolio" may be added.

- OAS on the issuer may be used as an indicator of the market perspective of the credit quality of the issuers of MMF instruments.

- Spread risk is a reasonable proxy for credit risk as probabilities of default or rating migration could be hard to take into account in stress tests scenarios. To a certain extent, spread accounts for downgrade/ default risk.

As regards iii) *"Levels of change of the interest rates and exchange rates with respect to Article 28(1)(c)"*:

ALFI believes that the proposed stress tests are reasonable and are worth being included in the stress testing framework.

Again there is not a universal view, however, the options laid out in the section also had their limitations. Managers should be offered the option to consider a matrix of interest rates / credit spreads.

It is viewed that options that change some portion of the curve (e.g. front-end or long-term) as are less conservative than considering a parallel shift of rates across the entire curve. Additionally, we suggest that the test for increases in FX rates only be required for funds that engage in cross currency trades.

As regards iv) *"Levels of redemption":*

Having a clear picture on the largest five investors can be a rather challenging task, in particular when considering potential Sub-Distribution networks. As an alternative, fund's redemption history (i.e. both outflows and inflows) should be considered/analyzed as a basis to estimate expected levels of redemptions - also under stressed conditions.
The inherent difference between behavior of institutional investors and retail investors needs to be borne in mind.
X% redemption scenario should be complemented with assumptions about how assets would be sold to meet redemptions (proportionate liquidation or liquidation of the most liquid securities first) otherwise it makes it difficult to compare MMFs across EU

countries. Also assumptions on how much market price impact will be incurred by these assets sales in a distressed or potentially illiquid market environment.

We agree with the specification laid out in paragraph 226.

Later on in the guidelines, the requirements refer to liquidation methodology to meet hypothetical redemptions (paragraph 231). We would view any requirement to assume “vertical slicing” as being less realistic as the shortest most liquid assets would likely be used up first. Additionally, the requirement to incorporate fees & gates into redemption scenarios (Section 5.5.38, page 160) seems to add much complexity to the analysis without clear benefits and possibly less conservative outcomes. For example, in the case of a fee this would lead to a muting of the full impact to the NAV and a gate would lead to the halting of redemptions, which would reduce the level of liquidations necessary from the portfolio. Furthermore, the options to calibrate the level of redemptions to historical experience or investor behavior models based on investor type and different outflow assumptions each have their limitation. We could agree with the option in which redemption scenarios include a percentage of the liabilities (typically between 20-50%).

As regards v) *“levels of widening or narrowing of spreads among indexes to which interest rates of portfolio securities are tied with respect to Article 28(1)(e)”:*

We believe that the proposed stress tests are reasonable and are worth to be included into the stress testing framework.

As regards vi) *“identification of macro-systemic shocks…”:*

No response.

Q19. Are you of the view that ESMA should specify other criteria that should be taken into account? If yes, which ones?

We are questioning certain rationales for the proposed stress tests. From the reporting template we understand that for example the bid-ask spread multiplied by 4 is one result to be reported. What is the basis for the multiplication by 4?

Q20. Are you of the view that other topic should be covered in the ESMA guidelines under the requirements of Article 28 of the MMF Regulation?

No response.

Q21. Do you agree with the assessment of costs and benefits mentioned in the CBA (Annex III) on the different options on the Guidelines on stress tests? If not, please explain why and provide any available quantitative data on costs (if any) that the proposal would imply.

ALFI supports the choice of option 3, which provides a fair balance between costs and added value for the investment fund industry.

Option 1 would not be acceptable although appearing the least expensive for MMF managers and regulators, simply as it would make any comparison of stress tests results across the EU impossible. Option 3 is less expensive than Option 2 for regulators and still allows for sound comparison of stress test results across the EU.
Moreover, Option 3 has the added benefit of mitigating systemic related issues compared to Option 2.
The difficulty with Option 2 is in the choice of quantitative parameters, thresholds on factors to be imposed and the ones to be left at the discretion of the MMF manager. Although the quantitative values of the factors/thresholds/limits may change after review by the regulator, changing the nature of the factor to be imposed (for example changing from recommendations on interest rates only to recommendations on spreads or liquidity ratios levels) may bear additional cost for the MMF manager as he might regularly need to adapt his internal processes and controls.

Finally, alignment of the requirements with those requirements established already by the SEC for US Money Market Funds would lead to lower cost on a) the asset managers' side, at least those which are acting globally as well as b) also on the level of the service providers for those. Calibration of stress tests and identification of stress events as well as setting up operational processes would be much more efficient.