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| 29 March 2021 |

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| Response form for the Consultation Paper on the EU Money Market Fund Regulation – legislative review |
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| Date: 29 March 2021 |

**Responding to this paper**

ESMA invites responses to the questions set out throughout this Consultation Paper and summarised in Annex 3. Responses are most helpful if they:

* respond to the question stated and indicate the specific question to which they relate;
* contain a clear rationale; and
* describe any alternatives ESMA should consider.

ESMA will consider all comments received by **Wednesday 30th June 2021.**

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Your input - Consultations’.

**Instructions**

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the steps below when preparing and submitting their response:

* Insert your responses to the consultation questions in this form.
* Please do not remove tags of the type <ESMA\_QUESTION\_MMFR\_1>. Your response to each question has to be framed by the two tags corresponding to the question.
* If you do not wish to respond to a given question, please do not delete it but simply leave the text “TYPE YOUR TEXT HERE” between the tags.
* When you have drafted your response, name your response form according to the following convention: ESMA\_MMFR\_nameofrespondent\_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA\_MMFR\_ABCD\_RESPONSEFORM.
* Upload the form containing your responses, in Word format, to ESMA’s website ([www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Your input – Open consultations’ → ‘Consultation on EU Money Market Fund Regulation – legislative review’).

**Publication of responses**

All contributions received will be published following the close of the consultation, unless you request otherwise. If you do not wish for your response to be publicly disclosed, please clearly indicate this by ticking the appropriate box on the website submission page. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

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Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘[Data protection](https://www.esma.europa.eu/about-esma/data-protection)’.

**Who should read this paper?**

This document will be of interest to (i) MMF managers and their trade associations, as well as (ii) institutional and retail investors (and associations of such investors) investing in MMF.

# General information about respondent

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| --- | --- |
| Name of the company / organisation | Institutional Money Market Funds Association |
| Activity | European Trade Association |
| Are you representing an association? |[x]
| Country/Region | Europe |

# Introduction

Please make your introductory comments below, if any:

<ESMA\_COMMENT\_MMFR\_1>

**Introduction**

**The Institutional Money Market Funds Association (IMMFA)**

The Institutional Money Market Funds Association (IMMFA) is the trade association which represents the European money market fund (MMF) industry. IMMFA’s mission is to promote and support the development and integrity of the MMF industry by engaging with and informing policy makers and, amongst other things, providing a primary point of contact.

IMMFA currently has 27 members, consisting primarily of asset managers but also custodial banks and other firms. Of the 27, 18 are asset managers (referred to as Full Members). IMMFA MMFs are primarily institutional funds.

IMMFA MMFs currently have EUR812bn Euro equivalent in assets under management (AUM).[[1]](#footnote-2) This number represents a 27% increase since the implementation of EU Money Market Fund Regulation (MMFR) in March 2019.[[2]](#footnote-3) At the end of the first quarter 2021, the most recent period for which a total market number is available, IMMFA AUM totalled EUR798bn, which represented 57% of the European MMF industry.[[3]](#footnote-4) The IMMFA share of total European MMFs remains fairly constant. Within the IMMFA universe of funds there are 3 main currencies: USD, GBP and EUR. USD is the largest currency, (USD501bn), followed by GBP, (GBP233bn), and lastly EUR, (EUR118bn).[[4]](#footnote-5) The split between currencies also remains fairly constant. Although the overwhelming majority of IMMFA MMFs are LVNAV or PDCNAV, IMMFA represents all fund types and many of our members offer a range of funds.

**Summary of our Response**

Given the importance of MMFs to the real economy and building a strong capital markets in Europe, IMMFA welcomes the opportunity of responding to this important consultation.

The economic fall-out from the pandemic created a systemic liquidity event which impacted all asset classes, not just MMFs, which also experienced challenging conditions. We feel strongly that questions of how MMFs fared should be considered in the context of the broader ecosystem and that any proposed solutions should take this symbiosis into account, rather than isolating MMFs. The March crisis was the first test of the reforms introduced under EU MMFR. Those reforms proved instrumental in providing MMFs with the increased resilience which enabled them to pass this test. We note that MMFs continued to serve their purpose in preserving capital and providing liquidity, with no MMFs imposing gates or fees, and all IMMFA MMFs staying within their collars.[[5]](#footnote-6)

Having considered the experiences of last March, we conclude that fund structure was not the overriding issue. In the consultation, ESMA singles out CNAV and LVNAV MMFs, in particular, inviting our views on their elimination, whereas the evidence shows that *both* VNAV (US Prime Institutional and Euro denominated Standard VNAV) and LVNAV MMFs came under strain.

The crisis clearly demonstrated that there are areas of money market regulation which could be improved upon, in order to strengthen MMFs further. In particular, enabling MMFs to utilise their liquidity buffers when it is in the best interests of investors to do so, should be facilitated by the delinking of regulatory liquidity thresholds from the potential imposition of fees, gates and suspensions. This would mean that liquidity buffers could serve their intended countercyclical purpose. Furthermore, we recognise that such delinking may mean that redemption fees should be modified to make their application more effective. We are strongly opposed to the application of swing pricing to MMFs on the basis that it would remove the ability to offer intra-day liquidity or same day settlement, which we regard as a key component of their utility to our investor base. Additionally, swing pricing brings no incremental benefit over the use of redemption fees.

MMFs are a vital cash management tool for many investors and provide an invaluable source of funding to a wide range of issuers, thereby contributing to the real economy. We welcome ESMA’s stated desire to preserve the viability of the industry whilst also seeking to increase fund resilience and reduce systemic risk. Some of the reform options proposed would not serve this purpose. Those reform options which would drive MMFs investors to seek alternatives could, in fact, be counterproductive by shifting risk elsewhere in the system *into products which are significantly less transparent and regulated than MMFs*. We would include the options to eliminate CNAVs and to impose swing pricing in this category. In a liquidity event, the investors’ need for liquidity will remain. It may be harder to meet this need when funds are invested in other disaggregated assets classes given that, unlike MMFs, those asset classes will not be structurally bound to hold high liquidity balances.

We do not share ESMA’s concerns about the role of the credit rating agencies and the use of ratings. While fund ratings are an important complementary element to the IMMFA investor base, they were not a key driver of fund behaviour.

IMMFA supports efforts to make the underlying markets more transparent with a view to improving underlying liquidity, but we note that the fact that CP and CDs are not widely traded is largely because they are very short, ‘buy to hold’ instruments. Much of the market illiquidity in March 2020 can be attributed to the widespread withdrawal of bank intermediation in response to market events. In this respect we feel it is especially important to look at the broader context and the role of bank intermediators post prudential reforms, rather than concluding the instruments themselves constitute a vulnerability. The issue of liquidity could be substantially resolved by allowing funds to utilise their buffers. We wish to highlight that in many cases MMFs were *not selling assets to meet redemptions,* but to maintain liquidity buffers. As stated, delinking would make liquidity buffers countercyclical and, on this basis, we see no requirement for buffers to be increased.

In our view, the option of a liquidity exchange facility is extremely problematic, and we question whether this would be economically or logistically viable. With regard to stress testing and reporting, we think additional measures would not be effective tools in addressing the challenges observed in March.

In conclusion, we remain committed to efforts to build on the positives of the EU Money Market Regulation and to engaging with regulators and policy makers to secure the best possible outcome for all stakeholders.

Our response addresses the individual questions in the ESMA grid wherever applicable. Our comments in Question 4, relating to alternative funding sources, apply throughout. We deem these sources to be manifestly insufficient to meet issuers needs and likely to result in impaired market access.

<ESMA\_COMMENT\_MMFR\_1>

* 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 behaviors of investors during the March crisis?

<ESMA\_QUESTION\_MMFR\_1>

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

**Post Crisis Analysis**

The economic fallout of the COVID-19 pandemic in March 2020 resulted in significant disruption across a broad range of market sectors globally, including short-term funding markets. With regard to the impact on short-term markets, and money market funds in particular, we agree that some USD LVNAV and Euro Standard VNAV MMFs faced severe challenges in the form of simultaneous pressure from large redemptions and a severe deterioration in market liquidity. Despite these unprecedented conditions, MMFs met their regulatory requirements and repaid all redemptions in full. It is also important to acknowledge that despite the exceptional pressure on redemptions and severe market disruption, all Low Volatility Net Asset Value (LVNAV) MMFs stayed within their Net Asset Value (NAV) collars.

We agree that, as stated above, the funds most affected were USD LVNAVs and Euro Standard Variable NAV (VNAV), whilst other funds, such as PDCNAV or Euro and Sterling LVNAV were much less affected and in some instances saw significant inflows. This heterogeneity of experience illustrates the error in drawing generalised conclusions based on fund type. Fund experience varied significantly by jurisdiction, type, currency and manager.

**Reforms**

The EU Money Market Funds Regulation (MMFR) had a very positive effect in reinforcing fund resilience. However, in our view, whilst the Regulation mitigated against idiosyncratic risk, what markets experienced in March was a systemic breakdown driven by the unprecedented economic shutdown resulting from the pandemic. We support efforts to improve MMF resilience further, but feel it is important to view what happened to MMFs in the context of the broader eco-system. The crisis was not just an issue affecting MMFs: it was system-wide and any solution must take that broader context into account.

In our view, some of the regulatory options being proposed would not address the issues for MMFs during a systemic liquidity crisis such as that experienced in March 2020.

**Central Bank Intervention in Europe**

Whilst we recognise that central bank actions helped to stabilise markets, in particular the benefit which US domiciled MMFs derived from the US Federal Reserve’s Money Market Mutual Fund Liquidity Facility (MMLF) and its consequent positive spill-over effect in Europe, we wish to highlight that in Europe IMMFA MMFs did not benefit directly from central bank facilities and that their recovery was largely organic and the result of broader market stabilisation. As noted by ESMA, European non-public debt MMFs primarily hold commercial paper issued by financial institutions, or financial paper. Under the scope set out by the ECB, financial paper was not eligible for the Pandemic emergency purchase programme (PEPP). European facilities were targeted at corporate paper, which unevenly benefitted Standard MMFs who hold a material proportion of their funds in lower rated or unrated non-financial securities. For non-public debt Short Term MMFs, there is a scarcity of highly rated corporate paper. European capital markets continue to be a heavily bank intermediated which only contributes to the imbalance of supply of highly rated short term money market instruments versus financial issuers.

**The Focus on LVNAVs**

Whilst we understand that ESMA has a specific remit to review the adequacy of the Regulation, including whether changes are to be made to the regime for PDCNAV and LVNAV MMFs (ESMA paragraph 69), and has therefore taken this opportunity to combine the scheduled review with a consideration of the performance of LVNAV MMFs in the crisis, we feel that the particular focus on how the LVNAV structure responded to events is not entirely warranted. Since reforms were implemented, both LVNAV and VNAV fund structures have proven their utility to investors. The LVNAV fund-type have been a very strong addition to the EU landscape, and we see no reason to doubt the fundamental viability of this important investment vehicle for investors. Our view, as expressed throughout this paper, is that the pressures were not a function of fund structure. As noted by ESMA (3), Euro VNAVs also experienced heavy outflows, whereas, for example, Sterling LVNAV funds showed much less volatility. Fund experience does not suggest that a mandatory move to VNAV across the market is the solution to any issues raised in an analysis of the events of last March. This can be substantiated by a consideration of what happened to US institutional prime funds, which also operate with a variable NAV, and which experienced heavy outflows*.* Given fund experience was not homogenous by either fund type or currency, it is not possible to draw conclusions based on generalisations related to type or currency. We also believe it is vital to preserve investor choice.

**Do you agree with the identification of vulnerabilities?**

**Liquidity of Underlying Markets**

We welcome ESMA’s recognition that there was a lack of liquidity in the underlying markets (ESMA paragraph 21). We would go further in saying that in our view this is directly related to post 2008 prudential banking reforms. Whilst those reforms had an enormous positive effect in reinforcing bank balance sheets, they also had important consequences for MMFs. Firstly, the resulting change in bank appetite for non-operating cash deposits drove demand to find an alternative short term liquidity solution which MMFs were able to provide. Secondly, reforms impacted the allocation of balance sheet to market making and the provision of liquidity in the secondary markets, where restrictions became apparent during the market stress caused by the pandemic. With regard to the latter and its impact on the liquidity of underlying markets at times of stress, we believe the role of bank intermediaries needs to be examined and we support efforts to understand the role which they played. These dynamics have been recognised by policymakers, including by the former chairman of the US Commodity Futures Trading Commission (CFTC), Christopher Giancarlo. Giancarlo observed that since the 2008 financial crisis, regulators have been focused on keeping big banks solvent, and have not turned their attention to other market risks until recently: When solving for solvency risks, we’ve engendered a market liquidity risk, a trading liquidity risk’.[[6]](#footnote-7)

Additionally, changes in the derivative markets post-2008, with a movement towards cleared transactions and the expansion of bilateral margin requirements into non-cleared transactions, have increased the likelihood of a system wide ‘dash for cash’ during times of stress as market wide volatility increases margin calls. Exploring operational and regulatory changes which can help address these specific pressures (for example, exploring how to make shares of MMFs eligible for margin purposes) can help alleviate this facet of potential market stresses faced by MMFs without obviating the need to significant changes to the funds themselves.

We do not agree with the statement that markets ‘are not very liquid even in normal times’ (ESMA paragraph 22). Low trading volume does not mean low market liquidity in this instance. The market in the underlying instruments is characterised by low secondary trading volumes for a number of reasons. Short Term LVNAV and PDCNAV MMFs seldom if ever need to sell holdings to meet redemptions because of the high levels of organic liquidity maintained in the funds. Short Term MMFs are required to maintain at least 30% in weekly liquid assets (WLA) which is generally made up of holdings that mature overnight (10% minimum) and within one week. These weekly liquid assets generate cash automatically as they mature. Much of this WLA quota is held in overnight bilateral bank assets in the form of overnight deposits and reverse repurchase agreements. We think it is important to clarify that the portion of assets denoted WLA should not, as ESMA appears to imply (paragraph 40), be viewed as an indicator of transferability. The sales activity that occurred during the pandemic involved non-WLA assets, and the proceeds were used to maintain the required 30% WLA (reinvested in daily maturing assets such as overnight repo or deposits). Short term managers were not selling WLA assets (for example, holdings that mature overnight) to meet redemptions.

The experience of our members is that there is in fact ample liquidity under normal conditions to reposition portfolios. Even in the case of such repositioning, opportunities present themselves organically given the speed with which portfolio holdings roll down. Short Term MMFs are required to position themselves with relatively short weighted average lives (WAL) and weighted average maturities (WAM). The instruments themselves are also short term and therefore MMFs, and indeed other buyers of CP and CDs, tend to be buy-and-hold investors. A deep investor base for CP and CDs under normal circumstances means there will always be a willing buyer (which we address further below when commenting on ‘overlap’).

Whilst recognising that liquidity deteriorates during times of acute stress when the market does not function as normal, we feel it is misleading to draw conclusions regarding the asset quality and functionality of MMFs *based on illiquidity in conditions of extreme market stress*. We note again that almost all asset classes were adversely affected, including many that are more actively traded.

With this background in mind, we feel that although it is correct to say that activity in the secondary CP and CD markets is low (as indicated in ESMA paragraphs 24 and 33), we wish to highlight that high quality paper *can be sold in normal conditions* and that the volume of such sales is normally comfortably accommodated by the dealer community. In short, liquidity is available during normal times, but is typically not required due to the nature of the instrument (short-term) and the investors’ normal behaviour (hold to maturity).

We would also draw attention to an important distinction between VNAV and LVNAV MMFs regarding the definition of WLA, which is more stringent for LVNAVs and includes an additional constraint in the limit on the amount of highly liquid assets which can count towards WLA. In the case of VNAV MMFs, the definition of weekly liquid assets is significantly more permissive, allowing for the inclusion of any ‘*money market instrument or unit or shares of other MMFs*’ up to 7.5 % of the 15% WLA requirement, provided they can be redeemed and settled within *five* days. This would qualify non-public debt that faced severe liquidity challenges during the pandemic. In the case of LVNAV and PDCNAVs, additional assets may be included up to 17.5% of the 30% WLA provided these assets are, subject to Article 17 (7), *‘highly liquid’*, have a residual maturity of *up to 190 days* and can be redeemed and settled in *one* working day. This is effectively made up of public debt instruments. **In our view the 17.5 % cap on government debt that may be counted as liquidity should be removed. It is an unnecessary constraint. High quality government securities are the most liquid under stress and this cap places an arbitrary limit on their ability to contribute to liquidity.**

**The Footprint of MMFs**

With regard to the footprint of MMFs versus the size of the total CP market, we note and agree with ESMA’s conclusion (23) that due to data on the underlying markets it is not possible to be definitive on the share of outstanding CP and CDs held by MMFs. We would highlight that CP is only one asset class held by MMFs. The median average combined holding of CP and CDs as a share of LVNAV AUM as of April 2021 was between 51% and 60%, as follows:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **LVNAVs** | **CP %** | **CD %** | **Total %** | **AUM** | **Amount of CP/CDs held** |
| USD | 36% | 24% | 60% | USD325bn |  USD195bn |
| GBP | 18% | 37% | 55% | GBP229bn |  GBP126bn |
| EUR | 30% | 21% | 51% | EUR104bn |  EUR53bn |

 Source IMMFA

As well as illustrating the relative weight of CP and CD holdings, these numbers suggests that although substantial, MMFs form only a part of a much larger investor base for CP and CDs. Given other direct investors in CP and CDs would also have reduced their holdings in the market wide ‘dash for cash’, MMFs would not have been wholly responsible for the observed drop-off in funding.

We strongly support efforts to improve transparency on issuance volumes and levels across markets. For instance, having accurate information on programme outstandings[[7]](#footnote-8) would be very helpful for MMFs for the purposes of managing concentration risk. It is in the interest of our members to have transparent, market-based data on pricing, trading and issuance.

**Lack of clarity on eligibility for asset purchase facilities**

Clarity on eligibility for central bank asset purchase programmes is also very important. The European CP market has evolved with a number of different programme types used in the various jurisdictions, including ECP, ECDs (programme or non-programme), STEP labelled paper and French NEU CP as well as other smaller domestic CP markets. Eligibility for asset purchase programmes relates to the programme type rather than the issuer or type of debt (all CP/CDs being senior and *pari passu*), resulting in unhelpful anomalies. Some, but not all, STEP labelled paper was deemed eligible for the ECB’s Pandemic emergency purchase programme (PEPP) in March and responses varied between national competent authorities (NCAs). This acted to further inhibit liquidity and meant that the PEPP not did lead to a meaningful improvement in liquidity conditions in short term markets.

**Portfolio Overlap**

We do not agree that a high portfolio overlap increases risk (ESMA paragraphs 22, 28, 30) and feel this is another case where the conclusion drawn does not follow from an extrapolation of normal conditions. Whereas ESMA find that illiquidity was partly a function of all MMFs holding the same names, we would suggest the contrary may be the case. Larger issuers, who are approved or accepted by many MMFs and other investors because of their high quality and regular market presence, can be expected to have a broader, deeper investor base and are therefore typically more liquid. These issuers will be more readily tradeable as more investors have undertaken a (favourable) credit assessment and therefore have approval for credit exposure to the issuer. This dynamic of issuance versus liquidity can be observed in other markets where ‘frequent issuers’ may often be the most liquid, meaning that portfolio overlap should not be construed as increased risk.

**Dealer Intermediation**

The breakdown in dealer intermediation in March was not primarily related to the concentration of issuers nor to the credit worthiness of the assets (which remained unimpaired). It arose because many MMFs and other investors were seeking liquidity at the same time and it should be viewed in the context of a much broader ‘dash for cash’ across markets, including markets normally characterised by active secondary trading and much higher levels of liquidity - such markets were also temporarily disrupted. The difficulty in selling was not confined to bank names which have a high overlap: in some cases, MMFs experienced equal difficulty in selling very high-quality short-dated agency paper. In our view the breakdown was due to intermediaries being unable or unwilling to deploy their balance sheets (as indicated in ESMA paragraph 34) almost regardless of the nature of the paper. As noted by ESMA (paragraph 26), banks need balance sheet to intermediate and this capacity dropped sharply, including the unprecedented refusal of banks to buy back their own direct issuance. The issue was exacerbated further by the approaching quarter end when access to bank balance sheets is more challenging, even during normal market conditions.

**MMFs structurally designed to meet redemptions out of their liquidity buffers.**

We feel the statement ‘that the liquidity of an MMF depends on the liquidity of its assets’ (ESMA paragraph 32) fails to take into account a key structural feature unique to money market funds. Unlike other funds, MMFs hold substantial amounts of daily and weekly liquidity specifically in order to meet redemptions and under normal circumstances will not sell assets to do so. The crucial issue during the crisis was that these liquidity buffers effectively could not be utilized. In paragraph 27 ESMA state that ‘MMFs sold instruments to meet investors’ redemptions’. This was not the case for European Short Term MMFs. In fact, many managers were selling assets not to meet redemptions but to maintain mandated liquidity levels or boost these higher because they had become ‘bright lines.’ We believe this can be addressed by making buffers more usable, through delinking liquidity thresholds from fees and gates. As mentioned above, paragraph 40 suggests that MMFs sell WLA to meet redemptions (‘can sell their most liquid assets, but that would result in a decline in WLA’). MMFs do not sell WLA to meet redemptions: the function of these buffers is to ensure that MMF portfolios are constantly replenishing short-term liquidity which they use to meet redemptions.

**Conclusion**

In conclusion, we support efforts to make the underlying markets more transparent and to improve secondary liquidity – including efforts to incentivize dealers to provide liquidity (as indicated in ESMA paragraphs 36-37), to increase the homogeneity of paper, to clarify central bank eligibility and to have more market data. As noted by ESMA (paragraph 45), some of these changes are more of a long-term nature.

**Regulation**

We are very supportive of the EU Money Market Funds Regulation. The MMFR was very positive for MMFs in that it enhanced transparency and consistency and significantly improved resilience. It also served to reinforce investor confidence in MMFs post-2008 crisis and to provide a widely recognised minimum standard for the product in Europe that is now recognised by global investors. This is evidenced by the 27% growth in assets under management since the implementation of MMFR in March 2019.[[8]](#footnote-9)

As a trade association which represents, promotes, and supports the development of the European money market fund industry, we engaged extensively and contributed to the co-legislators’ efforts during the establishment of the regulation. The success of the regulation was borne out in the liquidity crisis, which was the first real test, and we welcome the due recognition that all MMFs met redemptions, despite market stress.

Notwithstanding the above, we agree that certain aspects of the regulation could be improved upon to make MMFs more resilient. We also agree with ESMA’s analysis (paragraphs 46-47) that reforms to liquidity thresholds which tied a breach to the use of fees and gates inadvertently resulted in their becoming procyclical. We originally noted this in our ‘IMMFA Recommendations’ of September 2020 where we suggested that liquidity buffers be delinked from fees and gates.

Although we believe that MMFR allows for a fall below 30% for various unforeseen reasons and in the normal course of business, in practice, the threshold has become a ‘bright line’, limiting the manager’s ability to manage liquidity with optimal flexibility and in the best interests of investors. As investors are very focused on the 30%, an approach towards or pass below 30% can cause additional pressure on outflows, thereby making a limit designed to reduce vulnerability, unintentionally procyclical. Removal of the link between liquidity thresholds and the imposition of fees and gates (and suspensions) would therefore, we believe, enhance the overall resilience of the sector by reducing incentives to redeem during times of challenging market liquidity.

For avoidance of doubt, we are not suggesting lower levels of liquidity or transparency.

We recommend that MMFs should retain the ability to use fees and gates under MMFR amended provisions, even if Article 34, which links them to thresholds, were removed.

**CRAs**

We do not agree with the identification of the role of CRAs as a vulnerability. Unrated funds, such as Euro denominated Standard VNAVs, also experienced elevated redemptions, once again illustrating that fund type did not determine vulnerability. With regard to the use of fund ratings, it is important to recognise the different investor constituencies and their objectives. The jurisdiction where AAA fund ratings are not required by investors is largely a domestic market dominated by the Standard VNAV structure. Standard VNAVs are permitted to take on more interest rate, credit and liquidity risk and typically offer a yield uplift as a reward for additional risk. In contrast, investors in AAA rated MMFs are seeking to preserve capital and have access to liquidity and for these investors, yield is a secondary consideration. Many of these investors have the requirement for a AAA fund rating built into their investment policies. Given their objectives, it is unlikely that these international investors would be prepared to invest in unrated MMFs or to take the additional risks of an unrated Standard VNAV MMF. It should also be noted that due to the wider parameters and the quality of the assets consequently held by Standard VNAV MMFs, including a sizeable weighting in unrated corporate paper, they would typically not qualify for a AAA rating.

Given the widespread acceptance of ratings in the broader financial markets we feel investors are justified in using them as an additional element of assurance to support their internal decision-making processes. Many of our investors (which include pension funds, insurance companies and other asset managers) would be accustomed to using debt ratings in the evaluation of longer-term asset classes. These investors value the independence of the CRAs and their function as an additional check on fund health.

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?**

IMMFA MMFs (currently EUR812bn in AUM) are typically assigned AAA fund ratings by one or more European regulated credit rating agencies. As stated above, for many investors in IMMFA MMFs a AAA fund rating is a prerequisite and the requirement forms part of their investment policy guidelines or mandate. Fund ratings are very important to these investors. Investors take comfort in the additional independent oversight provided by the rating agencies. This oversight compliments the regulatory framework of both MMFR and UCITS, the fund manager’s internal controls, and the custodial functions.

In our view the rating agency criteria serve a useful purpose in both reinforcing the conservative regulatory requirements and providing an independent review of portfolios, by skilled professionals. Ratings criteria are closely aligned with the regulatory requirements and serve to supplement and enhance them. Given this close alignment, in our view they do not determine fund manager behaviour.

Use of ratings is driven by the needs of the investor base. While high levels of transparency are generally available for MMFs (many MMFs go beyond the regulatory requirements, e.g., by disclosing full holdings on a weekly basis rather than just the top 10, as required by article 36 of MMFR) and many investors would not have the resources (in the form of time and expertise) to analyse all of the holdings in an MMF on a regular basis. For example, credit rating agencies review portfolios on a very regular basis as part of their surveillance practices.

In our view, neither investor behaviour nor the behaviour of fund managers during the March 2020 crisis was driven by concerns over fund or credit ratings. Investor behaviour was driven primarily by the need for cash for operational requirements or for margin calls combined with concerns over access to that cash. Investors became particularly focused on the regulatory liquidity thresholds and concerned that as these approached the 30% minimum, they risked the imposition of fees and gates. The primary focus, therefore, was access to liquidity, not ratings. It is true that the imposition of fees and gates could result in a downgrade from the AAA status, but access to cash was the concern, not the rating *per se*.

 In conclusion, we do not agree with the identification of ratings as a vulnerability. Given the widespread acceptance of credit ratings in international markets as an indicator of risk, we believe an absence of ratings could reduce the utility value of MMFs for investors.

<ESMA\_QUESTION\_MMFR\_1>

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

<ESMA\_QUESTION\_MMFR\_2>

1. **Do you agree with the above assessment on the potential MMF reforms related to the review of the MMF Regulation?**

We welcome the review of the regulation to ensure that it is fit for purpose and meets the goal of enhancing the resilience of MMFs and broader short-term markets. We believe fund resilience, investor behaviour, manager behaviour and broader market impacts are the right areas of focus. Some of the policy options outlined, however, would not be effective in achieving the stated goals. These are discussed in more detail in the responses to the following questions.

The events of March were a market-wide liquidity event. MMFR was well designed for increasing resilience in the face of idiosyncratic risks and was certainly a positive in terms of making MMFs generally more robust. However, it is hard for any regulation to provide against a system wide event such as occurred in March.

The disruption affected almost all market sectors and as MMFs are closely interconnected to other parts of the short -term ecosystem, they suffered the knock-on impact, most acutely from the sudden withdrawal of bank intermediation.

This was the first test of the EU MMF Regulation and we would emphasise that funds passed the test without breaching the collars, without imposing fees and gates and in the case of IMMFA funds, without any direct benefit from asset purchase programmes instituted by central banks.[[9]](#footnote-10)

Given some of the reform options proposed would be likely to significantly detract from the utility value of MMFs, we question whether such measures would contribute to overall market stability. Many of the alternatives which investors would be likely to or indeed forced to turn to are substantively less regulated and offer less transparency than MMFs. Investors would still need to access cash and therefore need to liquidate investments in the event of a systemic liquidity crisis such as we experienced; that pressure would merely be moved to another market sector. In our view, disaggregated investments would be far less likely to hold structurally high levels of liquidity to face such an eventuality, unlike MMFs which are required to do so. Enabling MMFs to use these high liquidity balances is, in our view, the key to reducing risk.

1. **What are your views on the abovementioned assessment of the interaction between MMF reforms and the behaviour of investors during the MMF March 2020 crisis?**

In our view, MMF reforms which tied minimum liquidity levels to the use of fees and gates inadvertently undermined the utility of those liquidity buffers during times of stress, with the result that they reinforced procyclical behaviour. On this basis, whilst we may not go so far as ESMA paragraphs 46 and 47 in saying that the tie encouraged ‘first mover advantage’ behaviour, it very clearly undermined the ability of the buffers to act countercyclically, as intended . As investors became very focused on WLA thresholds, these became ‘bright lines’, meaning that fund managers could not use them as intended in the best interest of investors.

In almost all cases, MMFs had liquidity in excess of the 30% threshold and therefore had ample liquidity to meet redemptions - but they were unable to use it.

<ESMA\_QUESTION\_MMFR\_2>

1. 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.

<ESMA\_QUESTION\_MMFR\_3>

1. **Potential need to decouple regulatory thresholds from suspensions/gates and the corresponding proposals of amendment of the MMF Regulation**.

Yes, we do agree with the need to decouple regulatory thresholds from fees, gates and suspensions. *We are taking this question to include fees.*

We very much agree with the need to decouple escalation procedures which could lead to the imposition of fees/gates from breaches of minimum weekly liquidity levels. We recommend the full removal rather than the reform of conditions as the latter would just move the ‘bright line’ which would not have the desired effect on investor behaviour. Reforming the conditions to require regulatory permission would create uncertainty for investors and therefore they would likely continue existing behaviour. Decoupling of fees/gates from liquidity levels would help to address the unintended consequences noted by ESMA and ensure the MMFR provisions operate as intended, as it would allow an MMF to utilise the liquidity buffers in a countercyclical manner. We believe the fund board should be allowed to use its discretion to apply liquidity management tools as and when this is deemed to be in the best interest of the fund investors.

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| **I Impact on the Resilience of MMFs** |
| *i How would the policy option work in mitigating the structural vulnerabilities of MMFs?** We have taken this question to include the imposition of fees in addition to gates and the use of suspension (as per MMFR Article 34).
* The decoupling of regulatory thresholds from fees, gates and suspensions would have a positive impact in making MMFs more resilient.
* In our view, the linking of minimum liquidity thresholds with fees and gates meant, in practice, that the liquidity buffers did not have their intended countercyclical effect. Instead, the linking of fees, gates and suspensions with the 30% weekly liquid asset (WLA) threshold had the unintended consequence that investors became focused on one metric at the expense of a more holistic view of fund health. We believe that decoupling the liquidity thresholds from fees, gates and suspensions would encourage a more proportionate assessment of key fund metrics by both investors and managers and help to ensure that liquidity buffers can serve their intended, countercyclical, purpose.
* Decoupling would reduce investor and fund manager sensitivity to WLA thresholds and mitigate against procyclical redemption behaviour. It would enable fund managers to use liquid assets in the best interests of investors, as intended. Appropriate cure mechanisms could be designed to ensure that funds restore liquidity levels if WLA thresholds are breached.
 |
| *ii Would it apply to all MMFs?** This option would not apply to VNAV funds as they have no mandated fees, gates or suspensions.
* We are in favour of a consistent approach across fund types, where possible. We note in this context that VNAV funds have lower daily (DLA) and weekly liquid assets (WLA) requirements (7.5% and 15 % respectively, versus 10 and 30% for LVNAV and PDCNAV funds) and much more permissive definition of what assets can count towards WLA. See our comments above regarding the additional constraint of the 17.5 % cap on highly liquid holdings for LVNAV and PDCNAVs where we recommend this be removed.
 |
| *iii a)* Is the option currently in place in any jurisdiction, and if so, has it been helpful? Not currently – see below for historical precedent. c) Has the option been implemented previously and, if so, what were the main findings? The US SEC 2014 reforms of 2a-7 funds introduced fees and gates for US Institutional Prime MMFs. In the event that the fund breached the 30% minimum liquidity threshold (introduced in 2010 reforms) the fund was permitted to impose fees or gates. Prior to the 2014 reforms becoming effective, MMFs were able to use liquidity flexibly. This was observed to work well during the European debt crisis of 2011 when European banks came under pressure. Aversion to European bank risk caused a shift from Prime to Government funds and consequently increased outflows from Prime funds. Prime MMFs availed themselves of the liquidity buffers and this reallocation between fund types took place in a very orderly way. The ability to draw down on buffers as needed was crucial to this transition, illustrating how buffers could and should be used at times of increased outflows. |

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| **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?* The WLA threshold has become a ‘pre-trigger’ metric. An approach towards the 30% can cause investor concerns and potentially generate outflows. There was evidence to suggest that MMFs closer to the 30% limit saw greater redemption pressure than those with more headroom.
* Removing the perceived causal link between liquidity thresholds and the imposition of liquidity management tools would reduce incentives to redeem.
 |
| *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?* Decoupling would encourage investors to retain cash within the MMF and thereby mitigate the risk of first mover advantage. This in turn would encourage stability.
 |
| *iii a)* Does the option effectively shift MMF risks to investors?* Yes. By enabling MMFs to use liquidity buffers as intended, countercyclically, decoupling makes MMFs more resilient.

 *b)*Does it make those risks more salient and transparent for investors? Are investors treated equally?* Liquidity levels will continue to be transparent.
* Yes, investors are treated equally. Decoupling reduces the incentive for first mover advantage and thereby helps to distribute risk more equally.
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| **III Effects on Fund Managers** |
| i How would the policy option affect MMFs’ liquidity management in normal versus stressed times?  Decoupling will not detrimentally affect MMFs’ liquidity management in normal times. MMFs will continue to run high levels of liquidity in compliance with the regulatory requirements.  We anticipate that liquidity thresholds and transparency will continue to be key factors in maintaining investor confidence, meaning that managers will be incentivised to maintain transparently high levels of liquidity. Decoupling will, however, mean that levels of WLA, maintained above regulatory thresholds, should not be the major factor in redemptions, but rather one aspect of an investor’s holistic assessment of fund health.Decoupling will allow managers to utilise liquidity buffers in the best interests of the investor at times of stress, rather than being forced sellers of assets into a distressed market. During the crisis many fund managers were selling in order to maintain buffers at or in many cases above the 30%. This is contrary to the assumption in ESMA paragraph 27 which states that managers sold to meet redemptions. The ability to use buffers as intended should mean that fund managers do not have to resort to forced and unnecessary sales in order to maintain buffers but can instead use buffers when to do so is in the best interest of the fund shareholders. We therefore envisage that buffers will be maintained in normal conditions but utilised during times of stress.  Fees and gates will continue to be important provisions, which we support. We recommend such provisions be retained under MMFR although delinked from liquidity thresholds.  In a stressed event MMFs would be able to use the buffers as intended, to meet redemptions. Decoupling should reduce the investor focus concerning fees and gates as liquidity thresholds approach 30%. This in turn should enable fund managers to avoid unnecessary sales just to supplement buffers and to return to their usual investment activity sooner than would currently be the case. |
| ii How would it impact the ability or willingness of MMFs to invest in short-term funding instruments or use the repo market?In our view decoupling would have a positive impact on the ability and willingness of MMFs to invest. Many MMFs felt that they had to maintain WLA levels in excess of the regulatory minimum in order to avoid approaching the ‘bright line’ of 30%. This constrained their ability to invest in assets beyond one week. Decoupling would have the benefit of enabling MMFs to respond more flexibly to a stress event, using the buffers as intended, to meet redemptions. This in turn would enable MMFs to resume normal activity sooner and would therefore have a positive impact on their ability and willingness to invest. If a fund falls below the minimum liquidity requirement, then it should be prohibited from buying any longer dated asset until the liquidity minima have been replenished. |

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| **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?* This option would not cause investors to move out of MMFs.
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1. **Potential reforms of the conditions for the use of redemption gates?**

From an investor standpoint, the use of redemption gates is far graver than the imposition of fees as it blocks, rather than impairs, access to cash. Gating could be highly problematic given that, in a liquidity event, redemptions remain heavily influenced by operational cash flow needs. The imposition of gates by one fund could also cause contagion to others. We recommend, therefore, that gates be limited to extraordinary situations.

We believe that the imposition of fees, gates and /or suspensions should be a matter for the fund board.[[10]](#footnote-11) Providing regulators or supervisors with a role in granting permission for the imposition of either fees or gates would result in a less timely response, creating additional uncertainty. Externalising the decision-making process could also risk unwanted publicity which would make investor runs more likely.

The board of directors should at all times have the ability to impose fees/gates/suspensions in the best interest of investors, not just when certain liquidity levels and outflow thresholds are triggered. We would recommend the decoupling but enhance the board’s ability to use fees/gates/suspensions for all fund types, not just LVNAV and PDCNAV, given the issues discussed above for VNAV funds in the EU and US.

We do not think the waterfall approach (where suspensions are a last resort) would change investor behaviour as the risk would remain at a given ‘bright line’ which would continue to encourage existing investor behaviour due to the first mover advantage.

<ESMA\_QUESTION\_MMFR\_3>

1. 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)? 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.

<ESMA\_QUESTION\_MMFR\_4>

1. **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)?**

We do not believe swing pricing to be an appropriate liquidity management tool for MMFs given the reasons detailed on below.

With regard to other forms of fee, be these called ADL, liquidity fees or some other term to denote a form of applying a cost of redemption, we agree that some form of fee may be a useful mechanism for reducing the incentive to redeem in certain stressed circumstances. Such a fee would help to ensure that those investors remaining in the fund are treated equally and that those redeeming do not benefit unfairly. MMFs already have the provision for the imposition of fees, and we recommend that this be retained in MMFR (delinked from thresholds). In our view, the use of such fees is best served by allowing the board discretion over how and when to deploy liquidity management tools. Individual fund circumstances are likely to be unique, meaning a ‘one-size fits all’ is unlikely to be the best solution. In addition, prescriptive criteria may be counterproductive (as evidenced by the way in which the link between fees and gates and specific liquidity thresholds inadvertently became procyclical by nullifying the benefits of the buffers) and any such measures must therefore be very carefully finessed. Prescriptive corrective mechanisms can create market-wide incentives for funds to respond to pressure in the same way and such ‘herd behaviour’ can exacerbate stress.

We would recommend considering a modification of redemption fees to make their application more effective. In contrast to swing pricing, this could achieve a similar outcome but one which accommodates the idiosyncratic benefits of MMFs, including their ability to offer same day value. Providing a framework for the use of fees, as distinct from gates, could help allay investor concerns about the latter, since investors have a far greater aversion to gates than to fees.

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| **I Impact on the Resilience of MMFs** |
| *i How would the policy option work in mitigating the structural vulnerabilities of MMFs?** In our view the use of swing pricing does not mitigate any specific structural vulnerability.
* It is not evident that swing pricing directly addresses the issue of a liquidity event such as the market experienced in March 2020.
* It is our view that swing pricing would act as a deterrent and operational obstacle to the ongoing utility of MMFs, would be damaging for users, forcing a concentration into other products for intraday liquidity and perhaps concentrating risk in other areas of the market. Swing pricing would not fix the fundamental issue of underlying market illiquidity which was caused by widespread market disruption linked to the withdrawal of intermediators and which affected even the most liquid markets.
 |
| *ii Would it apply to all MMFs?** In our view swing pricing is not an appropriate tool for MMFs in general, given their structure and characteristics. Furthermore, swing pricing is *particularly ill adapted* to MMFs which offer same day settlement, a core aspect of the utility value to investors.
* We base the view that swing pricing is not appropriate for MMFs on a number of reasons which include:
* Swing pricing is less appropriate to MMF portfolios where bid/offer spreads are tight under normal conditions. One element of swing pricing is a consideration of the bid-offer spread when determining the applicable swing factor. This reflects the market practice of longer-term mutual funds which typically price assets to a mid-market. In the case of LVNAV and Public Debt Constant NAV (PDCNAV) MMFs, Article 29 of MMFR already requires that assets be valued at ‘the more prudent side of bid or offer’, which is bid, mitigating the impact of a ‘swing’. LVNAV and PDCNAV MMFs mark to market all assets over 75 days and those assets which deviate from the amortised cost by more than 10bp. This objection would be less relevant for Standard VNAV MMFs which are permitted to use mark-to-model pricing.
* Low Volatility Net Asset Value (LVNAV) MMFs currently have and should retain liquidity management tools, in the form of liquidity fees, at their disposal, which could achieve substantially the same result as swing pricing by being deployed to impose a cost of redemption. We recommend that language for the provisions of fees, gates and suspensions be retained within MMFR (as opposed to relying solely on UCITS) but Article 34 be amended to remove the link between these liquidity management tools and liquidity thresholds. The board would thereby retain the ability to apply ‘liquidity fees on redemptions that adequately reflect the cost to the MMF of achieving liquidity and ensure that investors who remain in the fund are not unfairly disadvantaged’.
* MMFs already hold substantial liquidity buffers, unlike longer term mutual funds which i) either do not settle same day and/or offer only one valuation point ii) are typically fully invested. These funds typically sell a vertical slice of assets to meet redemptions, in order not to treat remaining investors unfairly (by using the most liquid assets first to meet redemptions), whereas MMFs hold substantial buffers specifically for this purpose.
* Swing pricing would effectively curtail intraday settlement, a feature of MMFs highly valued by investors and a key tenet in the utility of MMFs as a treasury management tool.
* In order to offer T+0 settlement, a critical feature for investors, many Short Term MMFscalculate their net asset valuesat multiple points throughout the day. The application of a swing pricing factor would be predicated on the observation of fund flows over a day, making it operationally impractical to apply such swing factors at multiple valuation points.
* Swing pricing would increase the settlement risk arising from operational complexity. A shift to next day settlement would remove one of the fundamental features valued by LVNAV MMF investors.
* Swing pricing would be an unfamiliar and relatively complex concept for some MMF investors.
* Swing pricing could undermine the core premise of a stable NAV MMF and thereby diminish the utility value to those investors who value this. It would result in the loss of the price certainty features provided by PDCNAV and LVNAV funds.
* Under MMFR, LVNAV MMFs are already required to mark to market assets over 75 days and also those where the market value deviates by more than 10 bp from the amortised value. All IMMFA MMFs use independent third-party pricing for this asset valuation which takes the bid side as the most prudent.
* Given that PDCNAVs predominantly buy government paper, they are unlikely to experience the same redemption pressure as LVNAV or VNAV MMFs, so in our view should therefore be excluded from the discussion.
* The suggestion that swing pricing could be applied only to redemptions and not subscriptions would create operational challenges. MMFs currently operate a single NAV price for subscriptions and redemptions (rather than dual prices i.e., a different NAV for subscription or redemption). This would also create challenges where trades are netted at a distributor level.
* Our comments relate to the application of swing pricing to LVNAV and PDCNAV MMFs. Swing pricing may be suitable for other fund types that do not price their portfolios at bid and which offer only T+1 settlement, for instance, some Standard VNAVs.
* ESMA note in the consultation paper (101 iii) that swing pricing would not work for LVNAV or PDCNAV where the fund is trading at a constant NAV per share. We agree that swing pricing should only be considered for VNAV funds.
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| *iii a)* Is the option currently in place in any jurisdiction, and if so, has it been helpful?* Swing pricing is not in use in any jurisdictions for MMFs.
* Whilst swing pricing has been an effective tool in longer term open ended mutual fund types in Europe by assigning larger trading costs to those responsible for them, it is not appropriate for Short Term MMFs for reasons outlined above. Unlike MMFs, the funds deploying swing pricing do not offer same day settlement. Implementing swing pricing would impact the ability of MMFs to offer same day settlement - a defining characteristic of MMFs which investors value very highly.
* MMFs are structurally very different from longer term bond or equity funds which are fully invested and therefore typically rely on selling assets to meet redemptions, making swing pricing an appropriate tool. MMFs, on the other hand, expect inflows and outflows as part of their normal business and hold substantial amounts of liquidity to meet redemptions. **The crux is to make that liquidity usable**.
* Swing pricing was rejected in previous round of reforms. It was felt that as MMFs already had provisions for liquidity fees, swing pricing did not bring sufficient incremental benefits. In the US the SEC concluded that the liquidity fee regime under Rule 2a-7 served a similar purpose and was a more appropriate tool for managing liquidity costs.
* MMFs should continue to benefit from the provision to use liquidity fees (see above) under amended MMFR.
* LVNAV and PDCNAV MMFs already value their assets to the prudent side of bid or offer (see above). Swing pricing is currently used in longer term mutual funds which mark to a mid-market price and can therefore ‘swing’ to the bid side.
* As noted by ESMA, swing pricing would require greater market transparency on CP and CD pricing in order to calculate and apply an appropriate swing factor – this information would be required on a real-time basis as the factor would likely change quickly during a stressed market as observed in March 2020.

 *b)* How would it represent a change from current rules or practices in other jurisdictions?* Swing pricing is not in use for MMFs.
* Unlike in Europe, swing pricing is not commonly used for longer term funds in the US, which further reduces investor familiarity.

 *c)* Has the option been implemented previously and, if so, what were the main findings?* Swing pricing has been successfully used in Europe for other open-ended funds (see above). These funds are structurally very different from MMFs and what is appropriate for them in our view is not appropriate for MMFs, for reasons explained above, which include: MMFs settle same day, structurally hold high levels of liquidity to meet redemptions and already mark to bid.
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| **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?* In our view, swing pricing detracts from the utility value of MMFs. Decoupling can mitigate the risks of investor incentives to redeem/first mover advantage by making buffers available.
* With reference to paragraph 101 i), swing pricing could lead to outflows as sophisticated investors may seek to remove funds before a swing factor is implemented.
* Investor behaviour will largely depend on their need for the cash. We agree that swing pricing could potentially incentivise different investor behaviour by imposing a cost for liquidity to be borne by the redeeming investor. This could lead to different investor behaviour whereby investors only redeem if their cash needs outweighed that cost of liquidity. To this extent, it may reduce ‘opportunistic’ redemptions (e.g., those redeeming to gain first mover advantage). However, if the redeeming investor needs the cash e.g., to make a margin call, then the cost of the swing price would be unlikely to change their redemption behaviour.
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| *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?* In our view swing pricing does not mitigate the risk of a generalised ‘dash for cash’ as it does not address the fundamental liquidity issue experienced in March which related to certain factors exogenous to the fund structure. In so far as the redemption pressure was a reflection of first mover advantage, this could be better addressed by decoupling liquidity buffers from thresholds.
* The application of swing pricing would impact the ability of MMFs to provide same day settlement which is key to investors.
* Swing pricing would effectively curtail intraday settlement, a feature of Short Term MMFs highly valued by investors and a key tenet in the utility of MMFs as a treasury management tool. Delaying settlement runs counter to global efforts to speed up the settlement of various instruments.
* Since full swing pricing effectively translates into a variable price, it could undermine or impair (‘effect existing structure of PDCNAV or LVNAV’ (ESMA paragraph 101 iii)) the stable NAV structure.
* Many investors require a stable NAV in line with their internal investment procedures or because LVNAV funds are more practical for sweeps, intraday settlement and trade execution. As per our previous comment, the stable NAV could be compromised by the use of swing pricing. The use of liquidity fees (as opposed to swing pricing), which would remain an option under amended MMFR, would only be applied at times of stress, so would not alter the fundamental structure.
 |
| *iii a)* Does the option effectively shift MMF risks to investors?* Swing pricing is designed to shift the cost of liquidity to redeeming investors -however, MMFs will only need to sell assets (and hence incur a liquidity cost) to meet redemptions if their short term liquidity is insufficient to meet outflows.
* If swing factors are fully disclosed, swing pricing risks creating a new ‘bright line’ and therefore an incentive for first mover advantage.
* If the implementation of swing pricing were to have an impact on fund ratings, this could create additional ‘cliff-edge’ risk.

 *b)*Does it make those risks more salient and transparent for investors? Are investors treated equally?* We believe that investors already understand that they bear credit and liquidity risks when investing in an MMF.
* Daily mark to market (MTM) pricing and publication of liquid assets has proved useful to investors. A swing factor would be another bright line with a net negative impact on investors and the MMF product.
* Investors may not appreciate that swing factors are likely to change quickly during a stressed environment. The value of their investment proceeds is unlikely to be known at the time of the redemption. Given MMFs are used as a cash management tool to meet other financial obligations, the unknown value could create further issues from an investor utility perspective.
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| **III Effects on Fund Managers** |
| *i* How would the policy option affect MMFs’ liquidity management in normal versus stressed times?* Unlikely to affect liquidity management in normal times.
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| *ii* How would it impact the ability or willingness of MMFs to invest in short-term funding instruments or use the repo market?* Unlikely to affect ability and willingness to invest but *could result in a reduction in overall assets under management.*
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| **IV** **Broader Impacts on the Stability and Functioning of Short-term Funding Markets** |
| * Swing pricing is not the answer in our view. It does not help functionality and removes a key tenet of MMF utility.
* Swing pricing could effectively suppress a large part of the industry by removing the ability to transact on a same day basis.
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| *i a)* Where are investors likely to move if MMFs become less attractive as a result of the policy option? * Investors are most likely turn to deposits. This would be problematic due to the lack of bank demand for non-operating cash.
* In our view the deposit market has neither the appetite nor capacity to absorb the liquidity currently held in MMFs.
* Lack of bank appetite for deposits would be likely to force investors down the ‘quality tree’.
* This also applies to investors seeking to do repo as an alternative, where supply is similarly constrained. This could force investors to take more counterparty risk in terms of lower credit risk as well as more collateral risk by accepting riskier collateral.
* Investors could shift to segregated funds, other non-pooled investments or other areas similarly less transparent and less regulated than MMFs. Segregated funds would be subject to a minimum size requirement which would disadvantage smaller investors.
* Larger investors may choose to invest directly which would be significantly less transparent to regulators. These investors would still need cash in a liquidity crisis but would not be able to avail themselves of the liquidity held by MMFs. The option to invest directly would only be available to the largest investors: for many it is not economically viable to manage their own portfolio. It is operationally burdensome and resource intensive to maintain the necessary expertise in-house, requiring the ability to track a large number of alternative credits, custody arrangements, back-office capacity and relationships with dealers.
* Additionally, for those smaller investors who did choose to invest directly, they may lack the resources to manage risk to the same (high) standards as an MMF.

  *b)* Do these substitutes have vulnerabilities to runs?* Yes - the need for liquidity for operational purposes or margin calls remains the same. In a systemic event such as March 2020, when the liquidity needs of investors triggered elevated fund redemptions, investors would still have the requirement for cash and would still need to liquidate investments to meet those needs. The pressure would then be moved to another, less transparent, part of the system.
* Direct investors are more likely to react in a systemically risky way as they are unlikely to maintain structural levels of liquidity to the same conservative levels as an MMF (i.e., 30% or more) when there is no obligation to do so. This would leave the market more exposed to financial instability.
* Segregated accounts are also unlikely to hold the same high levels of liquidity as an MMF.

 *c)* Are they transparent to investors and regulators?* Whilst the deposit market is effectively regulated through bank oversight, we think certain investors will be forced into other less transparent and regulated areas by the reluctance of banks to take deposits. Thus, the answer to this question would be no. Systemic risk is likely to be exacerbated.
* A move into segregated funds or direct investment would be significantly less transparent to regulators.
* Direct investment would not be transparent.

 *d)* Are they regulated?* Direct investment is not regulated and could result in investors buying unregulated products.
* Segregated accounts and other non-pooled investments would be less transparent.
* Other investment options may be unregulated and opaque.

 *e)* Do they embed more risks for investors (e.g. counterparty risk) or be more costly?* Yes, the alternatives would likely result in investors taking additional risk and incurring more costs.
* MMFs allow investors to outsource cash management expertise at minimal operational cost by providing a low-risk alternative that is fully and diversely collateralised by high grade instruments, rather than taking single name, concentrated exposure to banks.
* In addition, in the example of MMF investors moving to direct investment, many investors that may wish to access the market may be unable to do so if not of sufficient size. There would be additional costs for both the investor and the dealers. Today dealers are able to access large pools of liquidity by serving a relatively small number of MMFs (economies of scale). If investors were to invest directly, dealers would have to maintain significantly more relationships and the number of lower monetary value trades that would have to be done to equate to today’s MMF volume would be significantly higher. This would likely lead to lower levels of aggregate liquidity across short term markets and higher costs, further restricting the access of smaller investors.
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| *ii a)* What alternative sources of short-term funding are available for borrowers that currently rely on MMFs for financing?* The deep pool of liquidity created by MMFs is a vital source of funding to a wide range of short-term issuers including banks, sovereigns, supra-nationals, agencies, corporates and other financial institutions. These issuers are able to borrow through the CP, CD or bill markets by tapping into demand from MMFs. Such short-term debt is easily accessed, attractively priced and flexible, allowing issuers to manage fluctuating or seasonal cash flow and working capital requirements at competitive funding levels, and also to diversify their investor base. For most investment grade non-financial borrowers this is more efficient than bank borrowing. For banks themselves it provides an efficient means of financing trading books and is a crucial alternative source of funding. It is unrealistic to expect an alternative source of finance for these issuers which would allow the same ease of access, cost efficiency and flexibility. Alternatives are limited and less adapted to an issuer’s needs.
* As noted by ESMA, non-public MMFs hold substantial amounts of bank paper. This funding cannot readily be replaced so in our view any suppression of MMFs would result in a reduction of the flow of private credit. Whilst banks may be able to source more funding through the US CP market by issuing US CP or Yankee CDs, this funding is subject to foreign exchange (FX) risk if not being used to fund USD assets (i.e., Euro funding becomes subject to FX cross-currency risk. Smaller European banks are likely to fund at better levels in Europe than in the US where investors demand a very regular market presence and high volumes and where smaller issuers would lack name recognition.
* Non-financials would have to fund through banks which is inefficient and expensive. Such bank intermediation also goes against Capital Markets Union which seeks to diversify funding sources. The above comments on access to the US CP being subject to certain requirements such as size, regularity and name recognition, are also true for non-financials and are likely to be more acute in the case of non-financial issuers who will be smaller.
* Some highly rated non-financials have lower funding costs than banks due to their scarcity value and credit quality. This means that if they depend on banks, they will have to pay higher margins to borrow.
* This is particularly true for other non-financial categories such as governments, state agencies and supra-nationals. These also have lower funding costs than banks, so, again, will be penalised if dependent on bank borrowing.
* These issuers would have to fund in the longer-term markets which would give them significantly less flexibility and higher funding costs.
* For working capital requirements such as funding receivables, non-financial issuers currently able to issue CP or, in the case of smaller companies, fund via bank sponsored ABCP programmes, may be forced to look to companies which offer supply chain financing (such as Greensill). These companies are significantly less regulated and transparent.

 *b)* Are these alternative sources more stable than MMFs at all times?* Committed bank funding is stable but would be very expensive. These costs could ultimately be passed on to consumers.
* Long term funding will also be more expensive and is an inefficient method of funding short term assets such as seasonal working capital requirements or temporary operational cash needs.

 *c)* Can they in effect be scaled to replace MMF economic function?* No.
* Any reduction in the supply of credit to the economy is likely to have a downstream impact, particularly in the case of the withdrawal of funding by such a large established market as the MMF sector.
* We note and welcome ESMA’s intention to preserve the economic function of MMFs and caution against reforms which would be an impediment to such preservation.
* The ECP market provides an important source of flexible efficient funding for a multiplicity of issuers, including European banks, governments and agencies etc. It is likely the market would be negatively impacted by a reduction in MMFs.

 *d)* Would this address the financial stability issues noted or would risks simply be transferred elsewhere in the market without mitigating them effectively?* Swing pricing does not address the financial stability issues raised and a shift of funds out of MMFs would in our view result in risks being transferred to elsewhere in the system
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1. **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?**

 In our view decoupling achieves the objective of making liquidity buffers usable and therefore swing pricing should not be necessary. Swing pricing also brings no incremental benefit over the use of redemption fees. The fund board should retain the discretion to use fees and gates when deemed appropriate and in the best interests of the overall client base.

 As per our introductory comments above, we would recommend considering a modification of redemption fees to make their application more effective. In contrast to swing pricing, this could achieve a similar outcome but one which accommodates the idiosyncratic benefits of MMFs, including their ability to offer same day value. Providing a framework for the use of fees, as distinct from gates, could help allay investor concerns about the latter, since investors have a far greater aversion to gates than to fees .

<ESMA\_QUESTION\_MMFR\_4>

1. 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? 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.

<ESMA\_QUESTION\_MMFR\_5>

We agree there is a need to make buffers accessible and countercyclical and we believe that delinking will achieve this. We believe that the intention of MMFR was that WLA assets could be used when deteriorating market conditions required it and, in our view, delinking would restore this ability. On this basis we see no need for liquidity thresholds to be increased further. The 30 percent WLA requirement ensures that funds hold robust liquidity levels to meet redemptions. Delinking can be combined with guidance on what happens in the event that a fund falls below the 30% WLA (i.e., a cure mechanism which could be designed to ensure that funds restore liquidity levels). These measures will go a long way to making the liquidity buffers usable at times of stress, as was originally intended.

With regard to taking the principle of a countercyclical buffer further by linking WLA to net outflows or other triggers, we are concerned that such an approach would create new ‘bright lines’ and would not change investor behaviour. We expand on the reasons why below.

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| Option 1. Current DLA and/ or WLA could automatically decline in certain circumstances, such as when net redemptions are large or when the regulatory authority provides temporary relief |
| * We do not believe that DLA and/or WLA levels should be linked to net redemptions. This would not change investor behaviour as the removal of fees/gates or alteration to WLA requirements would be subject to some other event (flows or regulatory approval). Investors would continue to focus on the ‘normal’ levels and behaviour would not change as a result of option 1.
* As we support delinking, we see no necessity for the regulator to provide relief at times of stress, assuming that thresholds have been delinked. Certainly, the provision of regulatory relief should not be the sole solution to the question of how to make buffers countercyclical. However, to the extent that any such sanction may encourage investors to regard temporary drops below the mandated thresholds as admissible and appropriate at times of stress, we agree it may be helpful in bringing stability under certain circumstances.
* Any such regulatory relief must reduce buffers across the entire industry, not only certain types, and must not be limited to specific funds as this could be a stigma. The relaxation should also follow pre-set rules. This would help managers to reduce the risk of investors interpreting this the wrong way. If that cannot be done, there should be a clear decision-making body that can act in a timely fashion as would be required in a time of stress.
* If buffers are not delinked, then regulatory relief would be more important.
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| Option 2. 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 the shocks defined by the regulators (this buffer would not need to be fund specific). Such buffer could either be relaxed at the initiative of the 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). The buffer would be non-public. |
| * We do not support any thresholds being calibrated to stress test results. Portfolio stress tests can become out of date quickly and also become irrelevant in stressed conditions when there are likely to be large redemptions changing the composition of the portfolios.
* Option 2 is also very opaque to investors in order to avoid non-intended consequences. As a result, investors would likely focus on the existing level of WLA and continue with existing behaviour. We do not support policy options that promote a lack of transparency for investors.
* Option 2 could also become subject to regulatory arbitrage.
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| Option 3. Differentiate funds with a larger share of volatile institutional investors and require them to hold larger buffers. |
| * We do not support option 3. It could disadvantage some funds over others, for example funds with high concentrations of institutional investors, even if managed more prudently than a comparable fund with more retail investors.
* The profile of investors in a fund can change significantly over time, particularly with large redemptions, which are likely in stressed conditions. Any data used to analyse this can quickly become out of date.
* Option 3 could have the unintended consequence of institutional investor dominated funds being deemed to be riskier, even when managed prudently, thereby fuelling redemptions from these funds which would result in greater market instability.
* Investors use MMFs for cash management and their cash needs can be very different depending on their overall cash portfolio. Some investors use MMFs in conjunction with deposits, direct securities and repo, others may use only MMFs. It is possible to have two very similar investors in the same sector, for instance two corporates in the same industry, using the same fund but these two investors could have very different cash needs during a time of stress depending on their other cash options, revolving credit facilities (RCF), other cash management tools etc.
* Investors often come via an intermediary, in which case specific details of the underlying investor may not always be available on a same-day basis.
* Option 3 would also be very challenging to administer.
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**With Regard to Increasing Buffers**

We believe that decoupling liquidity buffers from thresholds would result in a significant benefit to fund resilience and we support that reform option. Given that the outcome of decoupling would be to make liquidity buffers usable and allow them to fulfil their intended countercyclical purpose (see our comments to Q3 above) we do not believe that MMFs should be additionally required to hold higher liquidity buffers. The key requirement is that buffers should be readily accessible when needed. Substantial liquidity buffers are a structurally important feature of MMFs, allowing funds to meet redemptions without selling assets. With this in mind we believe that a 30% minimum for WLA and 10% minimum for DLA are appropriate levels, with the key proviso that those buffers be made available.

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| **I Impact on the Resilience of MMFs** |
| *i How would the policy option work in mitigating the structural vulnerabilities of MMFs?** We do not believe MMFs should be required to hold higher liquidity buffers.
* 30% in WLA is already a substantial amount of liquidity and ensures that funds have robust liquidity levels to meet redemptions.
* Additionally, many MMFs consistently hold WLA in excess of the regulatory minimums.
* Based on experience during the crisis, there is no empirical evidence to support the need for buffers over 30%. In many cases fund managers were selling to sustain high levels of WLA to boost buffers because of the ‘bright lines’, not, as sometimes assumed, to meet redemptions. Making the buffers usable would limit the need to do this.
* It is crucial that fund managers be able to use this liquidity during times of stress, as was intended.
* Increasing liquidity buffers further may result in MMFs struggling to find sufficient outlets for the placement of cash inside a week. There is little or no bank appetite to take overnight cash, either secured or unsecured, creating very severe capacity constraints.
* Countercyclical buffers linked to redemptions or stress tests would be complex to administer and would bring little added value if liquidity thresholds were decoupled from liquidity management tools. **Allowing fund managers to use WLA (through delinking) would effectively allow buffers to be used to countercyclical effect, to meet redemptions during times of stress.**
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| *ii Would it apply to all MMFs?** We are in favour of any changes being applied consistently across fund types.
* LVNAV MMFs already have significantly higher minimum liquidity thresholds than VNAV MMFs. This should make them better able to withstand redemption pressure, providing that the buffers are made usable.
* In our view consideration should be given to the standardisation of liquidity buffers and the definition of WLA across fund types.
* Article 24 of MMFR allows for a significantly less stringent definition of the composition of WLA for VNAV MMFs. LVNAV/PDCNAVs can include 17.5 % of assets up to 190 days provided these assets subject to Article 17 (7) are ‘highly liquid’ and can be redeemed and settled within one working day. VNAV MMFs may include up to 7.5 % (i.e., half of their WLA) of assets which can include ‘money market instruments or units or shares of other MMFs…provided they are able to be redeemed and settled within five working days’. This would qualify non-public debt that faced severe liquidity challenges during the pandemic for inclusion.
* As part of the above consideration, we would recommend removing the 17.5% cap on the ‘highly liquid’ assets up to 190 days which can count towards the 30 % WLA of an LVNAV (or PDCNAV) MMF. This is generally considered to refer to sovereign, supranational or agency debt and the cap therefore appears to be an unnecessary additional constraint. Given the objective to ensure funds have sufficient liquidity that is usable, the restriction makes little sense.
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| *iii a)* Is the option currently in place in any jurisdiction, and if so, has it been helpful?* With regard to the definition of DLA and WLA noted above, in the US there is no limit placed on the amount of US Treasury securities that can count towards DLA. US Federal Agency Discount Notes that mature within 60 days can be included in WLA without limits.
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| **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?* In our view increasing buffers is not necessary if buffers are delinked. Decoupling would enable fund managers to use liquidity buffers which would reduce investor incentives to redeem and mitigate first mover advantage.
* In our view delinking buffers would have the effect of making them countercyclical. We therefore do not see a need for further countercyclical measures, for instance linking buffers to redemptions. These would be complex to administer and would not change investor behaviour and would therefore not reduce investor incentives to redeem.
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| *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?* As per our above response, we believe that decoupling would enable fund managers to use liquidity buffers which in turn would reduce investor incentives to redeem, thereby mitigating the risk of First Mover Advantage. This would increase the utility value of buffers as a countercyclical tool and reduce the likelihood of a generalised ‘dash for cash’.
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| *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?* Mitigating the risk of first mover advantage helps ensure investors are treated equally.
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| **III Effects on Fund Managers** |
| i How would the policy option affect MMFs’ liquidity management in normal versus stressed times?* Higher buffers may be difficult to invest given the lack of appetite in the banking market for very short-term deposits and reverse repo.
* This would be particularly acute around reporting dates when it can already be difficult to find a home for cash.
* Higher liquidity levels would also increase the rollover risk for issuers by reducing the supply of liquidity available.
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| ii How would it impact the ability or willingness of MMFs to invest in short-term funding instruments or use the repo market?* Higher buffers would require managers to invest a greater percentage of assets in overnight deposits or reverse repo. We reiterate the point made above, that this could be very problematic given supply constraints and could therefore amplify stress around reporting dates when this is already acute.
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| **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? * See our answer to Q4 above for response to this section.
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<ESMA\_QUESTION\_MMFR\_5>

1. 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 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.

<ESMA\_QUESTION\_MMFR\_6>

In our view there is certainly no need to eliminate the CNAV and LVNAV fund structures. The experience of March 2020 clearly shows that the structure of the fund was not the issue.

We note that VNAV funds were amongst the types of MMF that came under the most strain: US Institutional Prime funds (which are equivalent to VNAV) and EUR Standard VNAV. As has been noted by various policymakers, peak outflows in USD LVNAV and EUR Standard VNAV were substantially similar. However, when considering outflows in the context of regulatory requirements, the practical implications were different given LVNAV buffers are twice the percentage of total assets compared to VNAVs.

The events of March 2020 show that the primary point that needs to be reflected on is liquidity, not how funds calculate their NAV.

The variable NAV provides a valuable option for those investors comfortable with the fluctuating pricing model. It has the benefit of flexibility, transparency and simplicity. Other investors, however, may be required to invest in stable NAV MMFs, in line with their internal investment procedures or because LVNAV funds are more practical for sweeps, intraday settlement and trade execution. The variable asset valuation methodology, whilst suiting the needs of some investors, does not in itself address liquidity problems.

Discontinuation of the LVNAV option would be detrimental in that it would

* reduce investor choice
* increase demand for PDCNAVs which are not necessarily scalable in Euros and Sterling
* significantly reduce the supply of private credit.

For many investors the inclusion of LVNAV MMFs as cash equivalent for the purposes of accounting is very important. Although VNAV MMFs are considered cash equivalent in France, this can vary in other jurisdictions, making VNAV MMFs less attractive to such investors.

Some investors require an MMF to have an objective to maintain a constant NAV for other regulatory reasons, for example in the UK under the FCA requirements for CASS 7 client money “its primary investment objective must be to maintain the net asset value of the undertaking either constant at par (net of earnings), or at the value of the investors’ initial capital plus earnings”

In our view there is certainly no reason to eliminate PDCNAV funds given they saw inflows in March and were the most robust and resilient of all the MMF types during the period of stress.

The European PDCNAV market consists of 97% US Dollar denominated funds. PDCNAV MMFs in Sterling are only GBP3bn and in Euro EUR0.1bn, reflecting a lack of investor demand to date. This means that PDCNAV MMFs in Euro and Sterling do not currently provide a scalable alternative to LVNAV MMFs.

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| **I Impact on the Resilience of MMFs** |
| * In our opinion, the experience of MMFs during the March crisis does not indicate that VNAV MMFs are more resilient. Both US Prime funds and Euro Standard MMFs, both of which operate with a floating NAV, also experienced significant redemption pressure, suggesting that fund structure was not the key determinant. As noted by the Central Bank of Ireland, ‘VNAVs experienced significant stress in March in France and the US, albeit for different periods.[[11]](#footnote-12) Experience also varied by currency: USD LVNAVs, where investor behaviour is to a certain degree also influenced by developments in the US market, were subject to greater pressure than Sterling and Euro LVNAV MMFs. *Given fund experience was not homogenous by either fund type or currency, it is not possible to draw conclusions based on generalisations related to type or more specifically, valuation methodology.*
* The market events triggered by the Pandemic were exogenous: they were not a question of fund type and, as such, a change to either the LVNAV or VNAV methodology does not solve issues arising from such a liquidity event.
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| *i How would the policy option work in mitigating the structural vulnerabilities of MMFs?** VNAV MMFs remain vulnerable to run risk, so eliminating LVNAV and/or CNAV funds does not mitigate risk.
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| *ii Would it apply to all MMFs?** No. This option excludes VNAV funds.
* In our view there are no arguments for eliminating PDCNAV funds given they saw inflows in March and were the most robust and resilient of all the MMF types during the period of stress. We are also against the elimination of LVNAV funds.
* Whilst the VNAV model may be suited to some sectors, certain parts of the investor base prefer either LVNAV or PDCNAV structures. Investor flows since the regulatory reforms implemented in 2019 shows strong support for the LVNAV structure. Continued growth in LVNAV AUM since the events of March 2020 demonstrates the ongoing appeal of the product. It is our view that it is important to preserve investor choice.
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| *iii a)* Is the option currently in place in any jurisdiction, and if so, has it been helpful?* Reforms introduced in the US market after the 2008-09 global financial crisis changed institutional Prime funds from a constant to a floating NAV, whilst Government funds continued to be CNAV.[[12]](#footnote-13) This resulted in a large-scale reallocation of assets out of Prime into Government funds, which grew by more than USD1 trillion after reforms were implemented in 2016. Government MMFs now account for 77% of the US industry net assets and Prime MMFs account for only 20%. This reallocation away from Prime funds was driven by two changes: the shift to a floating NAV and the fact that Prime funds became subject to liquidity fees and redemption gate provisions, whereas US Government MMFs did not.
* USD denominated PDCNAV MMFs are heavily reliant on a single issuer in the form of US government debt. Capacity constraints and idiosyncrasies in the European sovereign market make this hard to replicate in EUR denominated PDCNAV MMFs.
* US Prime funds, now floating NAV, experienced heavy redemptions in March 2020. As a percentage of fund size outflows for publicly offered institutional Prime MMFs exceeded those in September 2008.[[13]](#footnote-14) Over the two-week period from March 11 to 24 net redemptions totalled 30% (approximately USD100bn) of fund assets. This compares with outflows of 26% in a two-week period in September 2008. *This would strongly suggest that the change from stable to variable NAV has not resulted in MMFs being less susceptible to outflows.*

 *b)* How would it represent a change from current rules or practices in other jurisdictions?* European Union Money Market Fund Regulation was notably successful in facilitating a smooth investor transition from CNAV MMFs into LVNAV funds with minimal disruption to short term markets.
* Recognition of high EU standards makes it an attractive marketplace for global MMF investors.
* The investor base is best served by a spectrum of funds which offers choice.

 *c)* Has the option been implemented previously and, if so, what were the main findings?* As mentioned above, the move from stable to floating NAV for Institutional Prime MMFs took place in 2014 and resulted in a huge shift of assets out of Prime and into Government MMFs. Any such move would be particularly difficult in Europe because of i) capacity constraints in the PDCNAV market other than for USD denominated funds and ii) it would result in a significant reduction of funding to those issuers currently tapping into the liquidity provided by LVNAV MMFs.
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| **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?* In our view a move to VNAV for all funds would not reduce investor incentives to redeem. Both US Prime and Euro Standard MMFs, both of which operate with a floating NAV, also experienced significant redemption pressure, suggesting that valuation methodology was not the key determinant.
* The risk of ‘bright lines’ could be mitigated by delinking liquidity thresholds from the imposition of fees, suspensions and gates, thereby strengthening LVNAVs relative to VNAVs with regard to investor incentives to redeem.
* We see LVNAVs as the institutional investor’s choice and we strongly believe that choice should be preserved.
 |
| *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?* As per above, we do not believe that eliminating CNAV and LVNAV reduces run risk in a liquidity crisis.
* With regard to a credit event, EU MMFR provided more stringent measures to protect investors against market volatility. An LVNAV MMF operates under a so called ‘fund collar’ which is the permissible deviation between a stable unit value (1.00) and the mark to market NAV.
* As part of IMMFA MMFs’ commitment to the IMMFA Principles of Best Practice, IMMFA MMFs use independent third-party pricing, unlike Standard VNAVs which under MMFR are able to use, and typically do use, mark to model pricing.
* In our view the elimination of CNAV and LVNAV MMFs would force investors to find alternative products. These options and the various impacts are discussed below (IV i) a). With regard to the macro risk of a shift into other products, the need for liquidity would remain. The ‘effects of a generalised “dash for cash”’ are unlikely to be mitigated and could in fact be more severe given that MMFs are structurally bound to hold high levels of liquidity which would not be true of the available disaggregated alternatives.
* In addition to the fact that liquidity risks would not be mitigated, other products are very likely to be less regulated and less transparent, creating more macro risk.
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| *iii a)* Does the option effectively shift MMF risks to investors?* Under MMFR, LVNAV MMFs are required to mark to market all assets over 75 days as well as those assets where the mark to market deviates by more than 10bp from the amortised cost. Therefore, it is only with regard to the mark to market of assets under 75 days and not included in WLA (30% for an LVNAV, 15% for a VNAV) that an LVNAV differs from a VNAV fund. If an LVNAV sells an asset longer than 75 days or one which deviates by more than 10b from the amortised cost, there will be no impact on the NAV assuming the mark to market is correct. This risk is mitigated by the further requirement for an LVNAV to mark to market at the most prudent side of bid and offer, which is the bid side, as opposed to taking a less conservative mid-price.

 *b)*Does it make those risks more salient and transparent for investors? Are investors treated equally?* MMFs are already very transparent.
* We believe that investors understand the risks which are clearly disclosed.
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| **III Effects on Fund Managers** |
| *i* How would the policy option affect MMFs’ liquidity management in normal versus stressed times?* As VNAVs are permitted to run lower levels of liquidity (7.5% and 15 % versus 10% and 30% for an LVNAV or PDCNAV) fund managers would have the option of running lower levels of liquidity. It is unlikely, however, that current investors in AAA LVNAV or PDCNAVs would accept lower liquidity levels, making it highly likely that fund managers would continue to manage to the higher levels of WLA even if the funds were variable NAV.
* The lower liquidity thresholds available to VNAV MMFs would be beneficial in allowing more flexibility in stressed conditions, however, the same result could be achieved by delinking the current thresholds from fees and gates which would enable the managers of LVNAV MMFs to temporarily drop below the minimum thresholds.
* The main consideration is investor demand for the product. Some fund providers already offer the VNAV alternative to LVNAV/PDCNAV investors, but the investors choose LVNAV/PDCNAV funds out of preference for those fund types.
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| *ii* How would it impact the ability or willingness of MMFs to invest in short-term funding instruments or use the repo market?* In so far as investors were to transition into Short Term Variable NAV funds, those investors currently holding AAA fund rated LVNAV or PDCNAV MMFs are likely to continue to expect the same high levels of liquidity even in a different fund structure, as mentioned above. The fund’s willingness to invest would therefore likely remain the same.
* In order to maintain a AAA fund rating the fund would likely maintain very similar structural levels of liquidity, even if it became a Short Term VNAV, in which case the same applies. By the same logic, the fund would likely continue to minimise or exclude unrated credit exposures.
* Given the subjective definition of WLA for VNAV MMFs, the fund would have the ability to avail itself of the less conservative definition of WLA. MMFR also allows a VNAV portfolio to be less diversified (Article 17).
* In so far as some investors would not shift from LVNAV/PDCNAV to VNAV MMFs, either because a variable NAV did not suit their purposes or they were uncomfortable with it, the amounts invested by MMFs would shrink substantially reducing the flow of credit to the short-term funding market.
* If investors currently invested in LVNAV or PDCNAV MMFs moved to Standard VNAV MMFs (which we think is very unlikely), this would result in the sector as a whole taking on increased risk due to the less stringent criteria applied to Standard VNAVs.
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| **IV Broader Impacts on the Stability and Functioning of Short-term Funding Markets** |
| * We do not believe that eliminating CNAV and LVNAV will improve stability.
* The evidence does not suggest that VNAVs are inherently more stable.
* Removing the option of CNAV and LVNAV MMFs would create significantly more demand for deposits as an alternative. Given the lack of appetite on the part of banks for short term deposits, this may also create stress in the system and also force investors into riskier less transparent, less regulated areas, thereby adding to systemic risk.
* Suppression of the LVNAV sector would mean a substantial reduction in the flow of credit to issuers using the short-term funding markets, likely resulting in increased funding costs and less certainty of funding for CP and CD.
* There is no apparent alternative to these funding sources which could offer issuers the same benefits of cost efficiency and flexibility. Issuers would have to issue longer term – this increases their costs and significantly reduces flexibility. Non-financials would have to borrow from banks, but bank lending is likely to be limited by both appetite and funding ability. In the case of highly rated names the banks would have to pay a higher interest rate than the issuers themselves, meaning they cannot effectively intermediate.
* Creating greater dependence on banks and re-intermediating them in the lending market runs counter to the objectives of Capital Markets Union.
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| *i a)* Where are investors likely to move if MMFs become less attractive as a result of the policy option?* Eliminating CNAV and LVNAV MMFs could significantly alter the cash-like nature of MMFs. This would force some investors into other asset classes which may lead to them assuming more risk as well as creating more systemic risk for regulators.
* Changes which reduce the availability or attractiveness of LVNAV MMFs would be likely to lead to a shift into government MMFs (PDCNAVs) if these were still available, at least in the case of USD. Some investors may move into Short Term VNAVs, though not all will be able to do so.
* As a result of the 2016 reforms in the US, USD1trn moved from Prime to Government funds, partly due to the change to a floating NAV. Any such rotation in Europe would reduce the supply of private credit.
* This is highly problematic given the lack of a scalable alternative in Euro and Sterling PDCNAVs. Investors would be reluctant to have a larger proportionate share of a smaller fund as this would reduce overall fund liquidity (i.e., the PDCNAV funds are small, large investors would account for a disproportionate share). Fund providers would also be reluctant for large investors to hold dominant positions. It would also increase demand for government securities and commensurately reduce demand for private[[14]](#footnote-15) credit instruments. This could have significant implications for the supply of private credit to the real economy.
* The closest alternative for an MMF investor would be to invest in deposits. The ability to shift from funds into deposits will be limited by lack of demand in the deposit market. Banks will likely only take longer dated deposits which will limit investor flexibility and may also come with breakage fees.
* A move towards reliance on the banking products creates additional dependency on banks which runs counter to the EU objective of creating a strong capital market.
* This lack of demand in the deposit market is likely to push investors down the ‘quality tree’ towards accepting lower quality banks as counterparties, or into other more risky and less transparent products.
* For some investors, reverse repurchase agreements (repo) may be an alternative. The risk of investors being forced to take lower quality counterparty exposure also applies to investments in reverse repo where the ability to deal with high quality reverse repo counterparties is constrained by supply. This could force investors to transact either with lower quality counterparties and/or to take lower quality collateral.
* It is also possible that investors seeking alternatives take on more risk by buying longer dated assets; longer dated securities have more price volatility and entail more credit risk.
* Very large investors may be able to invest directly which would also be less transparent to regulators.
* Investors may move to less regulated products such as segregated accounts which would allow treatment of assets up to 90 days to be treated as cash equivalent and valued at amortised cost.
* Alternatively, investors may be forced into short duration bond funds which may not be an appropriate home for their daily cash.

 *b)* Do these substitutes have vulnerabilities to runs?* In our view MMF fund structure is not a primary factor in vulnerability to runs.
* As evidenced by the experience of US Prime institutional MMFs and Euro Standard VNAVs, floating NAV MMFs are also subject to outflow pressure under stress.
* Investors’ need for liquidity will remain. It may be harder to meet this need for liquidity when funds are invested in other disaggregated assets classes given that, unlike MMFs, those asset classes will not be structurally bound to hold high liquidity balances.

 *c)* Are they transparent to investors and regulators?* Some USD LVNAV investors are likely to shift into PDCNAV MMFs if these were still available. These are regulated and transparent.
* A move into segregated accounts would also be less transparent and such accounts would be unlikely to have the in-built liquidity of an MMF, which may also lead to increased systemic risk.

 *d)* Are they regulated?* In the case of direct investments, this activity would not be regulated.
* Segregated funds are less highly regulated than MMFs, would be less transparent and unlikely to be as resilient to liquidity stress as MMFs.
* Due to lack of alternatives in the form of deposits (lack of appetite), PDCNAV funds (not scalable in Euros and Sterling), or direct investment/segregated accounts (require minimum size and resources), investors will likely be forced to take more risk.
* Disaggregated risk is likely to be harder for regulators to control.

 *e)* Do they embed more risks for investors (e.g., counterparty risk) or be more costly?* Yes, due to the lack of supply in the case of low-risk alternatives investors are likely to be driven to more risky areas and to take more counterparty risk.
* Yes, they are likely to be more costly. MMFs are very cost efficient for investors.
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| *ii a)* What alternative sources of short-term funding are available for borrowers that currently rely on MMFs for financing? * See our response to Q4 for this section.
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<ESMA\_QUESTION\_MMFR\_6>

1. 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.

<ESMA\_QUESTION\_MMFR\_7>

As a general principle, we support the rational of the Article 35 ban on sponsor support. This appropriately demarcates the agency fund sector from the banking system for systemic risk purposes, thereby reducing interconnectedness. Any softening of Article 35 would erode this core principle. In addition, it would: i) favour banking sponsors over others and reduce competition; ii) introduce moral hazard; and iii) may require asset managers to take a first loss position – a role for which they are not compensated (threatening the viability of funds). We also note the stigma associated with sponsor support means that it is not desirable from an investor perspective.

It is worth noting that while some MMFs in the US entered into transactions with affiliated entities which are not prohibited but require disclosure under US 2a-7 rules, it is not clear if any such similar transactions took place in Europe, given there is no reporting requirement.

Any prohibition/clarification of sponsor support should apply evenly to all types of MMFs and to treat all MMFs equally.

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| **I Impact on the Resilience of MMFs** |
| *i How would the policy option work in mitigating the structural vulnerabilities of MMFs?** We support the rationale for Article 35.
 |
| *ii Would it apply to all MMFs?** Any provisions should apply to all funds equally.
 |
| *iii. a)* Is the option currently in place in any jurisdiction, and if so, has it been helpful?* In the US onshore market, sponsors are permitted to buy assets from their affiliated MMFs at market value. Under 2 (a) 7 rules, these transactions must be reported to the SEC.

  *b)* How would it represent a change from current rules or practices in other jurisdictions?* The US market does allow sponsors to buy assets from their funds at fair market value. Any such transaction is then reported to the SEC.
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| **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?* It is vital that any clarifications on support treat all funds equally otherwise investors may be more likely to redeem from one fund type than another.
 |
| *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?* Lack of clarity could cause runs on those funds perceived to be weaker because support was uncertain.
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| **III Effects on Fund Managers** |
| i How would the policy option affect MMFs’ liquidity management in normal versus stressed times?* Clarifying Article 35 is unlikely to affect liquidity management. Funds are already managed to very conservative standards.
* A number of fund providers use their funds for sweep arrangements and therefore already have an additional powerful incentive to manage to a high standard of care.
 |
| ii How would it impact the ability or willingness of MMFs to invest in short-term funding instruments or use the repo market?* No impact.
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| **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?* See our responses above.
 |
| *ii a)* What alternative sources of short-term funding are available for borrowers that currently rely on MMFs for financing?* See our response to Q4.
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<ESMA\_QUESTION\_MMFR\_7>

1. 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.

<ESMA\_QUESTION\_MMFR\_8>

1. **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?**

We do not agree. Ratings were not a key driver of March events. See our response to Question 1 ii above. Fund ratings are very important to the IMMFA investor base. This community of investors are primarily investing in Short Term MMFs, domiciled in Ireland and Luxembourg. All IMMFA MMFs have a AAA fund rating from one or more European regulated credit rating agency (CRA). This is distinct from other jurisdictions, such as the French market, which consists overwhelmingly of Standard VNAVs, and where investors are comfortable without ratings. Investors understand that the AAA fund rating reflects the MMF’s ability to preserve capital, limit exposure to principal losses due to credit risk, and to provide liquidity.[[15]](#footnote-16)

Credit (debt) ratings are an international standard for quality control, used widely in the bond markets. IMMFA investors, who comprise primarily institutional investors, are typically familiar with credit ratings and value their utility. Fund ratings also bring the added benefit of additional transparency on data.

With regard to the introduction of regulatory requirements for MMF ratings, we 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. We 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.’

With respect to bringing MMF ratings under the scope of CRAR, we would note that CRAR is designed specifically to regulate credit ratings. There may be certain processes that are less appropriate for MMF ratings. We agree that the title of Article 26 implies MMF ratings are ‘Credit ratings’. Given that MMF ratings are not ‘Credit ratings’ under the CRAR framework, the wording of MMFR should be corrected.

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| **I Impact on the Resilience of MMFs**Ratings are positive for resilience by providing an additional layer of oversight by skilled professionals which is aligned with and enhances and supports the MMF regulation. |
| *i How would the policy option work in mitigating the structural vulnerabilities of MMFs?** We do not feel that bringing MMF ratings under the scope of CRAR and/or regulating them more would add to fund resilience.
 |
| *ii Would it apply to all MMFs?** No - only to rated MMFs which are primarily LVNAV and PDCNAV.
* It is counter-intuitive that the lowest risk funds, rated AAA because they meet the most exacting criteria, would be subject to additional regulation.
 |
| *iii a)* Is the option currently in place in any jurisdiction, and if so, has it been helpful?* Some jurisdictions, France being by far the largest, have money fund industries where investors do not seek fund ratings. This is a domestic market consisting mainly of the less conservative money market fund type, Standard VNAV. These investors are comfortable without fund ratings.
* The investor base in other jurisdictions is very different and therefore we do not feel that conclusions about the international investor base can be drawn from looking at the Standard VNAV market.

 *b)* How would it represent a change from current rules or practices in other jurisdictions?* It is unlikely that the majority of international investors would accept unrated funds (see above). The withdrawal of ratings would be likely to make them seek alternatives which could lead to them taking more risk.

 *c)* Has the option been implemented previously and, if so, what were the main findings?* No. Fund ratings are an established feature of US and European MMFs, outside certain largely domestic jurisdictions (i.e., in the 56% of European funds represented by IMMFA)
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| **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?* Any action which resulted in the removal of ratings would not be in the best interests of investors as they value ratings.
* Investors like the fact that an independent, expert firm is looking at the holdings of a fund on a regular basis. This gives them reassurance that the manager is managing the fund in a prudent manner without having to constantly review the holdings. It gives them assurance that the assets in the fund are of good credit quality as generally unrated exposures are not permitted.
 |
| *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?* With regard to a credit crisis, EU MMFR was designed to make funds more resilient in the face of a credit event and we believe has succeeded in doing so.
* Introducing more regulatory requirements for CRA’s would not mitigate risks.
 |
| *iii a)* Does the option effectively shift MMF risks to investors?* No, risks remain the same. It would make it harder for investors to assess risk as ratings are a helpful tool.

 *b)*Does it make those risks more salient and transparent for investors? Are investors treated equally?* Clearly not: removing ratings would make it harder for investors to assess risk.
* Providing more regulatory requirements of the CRAs would be unlikely to be a priority to investors.
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| **III Effects on Fund Managers** |
| *i* How would the policy option affect MMFs’ liquidity management in normal versus stressed times?* Ratings criteria are aligned with the regulatory requirements and therefore do not determine liquidity management.
* Fund and credit (debt) ratings had little impact on the way the MMFs were managed in March.
 |
| *ii* How would it impact the ability or willingness of MMFs to invest in short-term funding instruments or use the repo market?* If ratings were removed, MMFs would be likely to continue to take issuer ratings into account when purchasing assets, although investment decisions are based on internal credit procedures as per MMFR.
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| **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? * Our comments on alternative assets in the answers to questions above apply here.
* We would add that investors currently invested in AAA Short term MMFs would be unlikely to shift into unrated MMFs.
* We would caution against any action that somehow suggests MMF ratings are less valid or robust because they do not currently fall under CRAR.

  *b)* Do these substitutes have vulnerabilities to runs?* Disaggregated investments may create more systemic risk, as noted above.

 *c)* Are they transparent to investors and regulators?* As noted above, ratings bring the benefit of additional transparency to both investors and regulators.

 *d)* Are they regulated? *e)* Do they embed more risks for investors (e.g., counterparty risk) or be more costly?* Investors in AAA rated MMFs are likely to seek very conservative alternatives such as deposits or reverse repo. In our view the availability of these alternatives will be limited, forcing investors to take more risk.
 |
| *ii a)* What alternative sources of short-term funding are available for borrowers that currently rely on MMFs for financing? * See our response to this section in Q4
 |

1. **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?**

Prior to the introduction of MMFR, the guidelines for fund AAA ratings were the most binding rules on an MMF. As a result of MMFR, as ESMA states, the rules are now ‘very stringent’, which has been in large part very positive for fund resilience. This change also meant that ratings did not drive fund behaviour during the crisis, as noted above. However, many investors have the AAA fund rating requirement built into their investment policies and mandates and this is unlikely to change barring a significant cultural shift, which we think is unlikely.

The AAA fund rating provides an additional reassurance in the form of an independent, external, third party risk assessment and provides another layer of oversight and protection designed to safeguard the investor. In this respect ratings provide a valuable function. Many institutional investors use fund and credit (debt) ratings across other products and find them useful to support internal credit analysis – in our view ratings are embedded in the capital markets framework.

<ESMA\_QUESTION\_MMFR\_8>

1. 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.

<ESMA\_QUESTION\_MMFR\_9>

We preface our comments on stress testing by reiterating that the March 2020 episode has been a real-life test of an unprecedented magnitude for MMFs and other market segments. Simply put, MMFs demonstrated their resilience in March-April 2020 despite severe stress and large outflows. MMFs have passed the March 2020 stress test.

With regard to the process for submitting stress tests, we feel they should continue to be submitted by managers to their NCA only, not directly to ESMA. ESMA should then obtain the stress tests from the NCAs. We feel that submission exclusively to the local regulator is most helpful in trying to avoid the risk of misaligned communication between the industry and the local/European regulator.

With regard to clarification, some further guidance could be helpful but any such clarification should avoid overly prescriptive requirements that constrain a manager from acting in the best interests of the fund and its investors. We also note that the recalibration of stress tests issued earlier this year are significantly more stringent than previous tests and should go some way towards enhancing the robustness of MMFs and therefore reducing the need to amend requirements.

We note that stress tests can quickly become out of date and prescriptive corrective measures could add to fund instability under stressed conditions.

It is also important to note that, as also 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. Amongst other reasons, this is due to the fact that the models have to be used within the stress testing procedures. On this basis, we would not recommend establishing fixed triggers or criteria directly relating to specific stress test levels, but to leave further remediating actions to the discretion of the manager of the fund.

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| **I Impact on the Resilience of MMFs** |
| *i How would the policy option work in mitigating the structural vulnerabilities of MMFs?** Additional stress testing is not the best way to mitigate structural vulnerabilities.
* Any actions taken to strengthen the robustness of the MMF, including liquidity and quality of assets would likely be portfolio repositioning i.e. the sale of longer dated, lower credit quality assets to be replaced by more liquid, higher quality credit assets. Any such portfolio repositioning relies on the functioning of the short term markets i.e. the ability of the MMF to sell assets and replace with more appropriate alternatives. In trying to increase liquidity during March, MMFs were aiming to achieve such a repositioning. The challenge was the lack of a functional short term market and the ability to reposition without significant cost. While the actions of managers in March 2020 were not as a direct result of outcomes from stress tests, the behaviour was consistent across managers given the market environment and investor activity. As stress tests are backwards looking it is likely that fund managers will already have taken or attempted to take corrective action by repositioning their portfolios.
 |
| *ii Would it apply to all MMFs?* * Yes
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| **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?* Stress testing would not impact investor behaviour.
 |
| *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?* In certain scenarios, stress testing could create more herd mentality e.g., if managers all send their results to ESMA and ESMA tell managers reduce risk then you would see again consistent behaviour from managers all at the same time – this was in part the issue faced during March 2020, albeit not on the back of ESMA/Stress testing instruction. See above our response to I (i) of this section.
 |
| *iii b)*Does it make those risks more salient and transparent for investors? Are investors treated equally?* Stress testing does not add to transparency for investors.
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| **III Effects on Fund Managers** |
| *i* How would the policy option affect MMFs’ liquidity management in normal versus stressed times? * More stringent stress tests would impact the managers’ behaviour and would likely lead to more conservative portfolios. However, we believe the existing regulations already provide a suitable framework and more stringent tests are not warranted.
 |
| *ii* How would it impact the ability or willingness of MMFs to invest in short-term funding instruments or use the repo market?* See above answer to III (i).
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| **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? * N/A Stress testing does not affect investor behaviour.
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<ESMA\_QUESTION\_MMFR\_9>

1. 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.

<ESMA\_QUESTION\_MMFR\_10>

We believe the current reporting is already very detailed and frequent and therefore should not be increased further. The existing reporting requirements are already a significant undertaking involving custodians, administrators and transfer agents. All IMMFA MMFs are over the minimum EUR 100 million and therefore report quarterly. It would be challenging to speed up the production of the existing reporting given the amount of data and sources from which it is compiled.

Whilst there could be some benefit in greater transparency provided to regulators, reporting is, by its nature, backward looking and lagged. The regulatory reporting put in place for MMFs is particularly onerous when compared to other fund types. However, it is already a month out of date before it makes it way to regulators and given the short nature of MMF investments, a ‘live’ view of the fund could look very different compared with the regulatory filing.

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 create more operational stress on the system and risk that the core role of ensuring the smooth running of MMFs could be jeopardised.

Some funds already provided additional reporting at the request of their local NCAs (CBI/CSSF).

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| **I Impact on the Resilience of MMFs** |
| *i How would the policy option work in mitigating the structural vulnerabilities of MMFs?** Increased reporting will not bring greater stability to MMFs.
 |
| *ii Would it apply to all MMFs?** Any additional reporting should apply to all MMFs.
 |
| *iii b)* How would it represent a change from current rules or practices in other jurisdictions?* Reporting requirements for MMFs are already onerous compared to other types of funds.
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| **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?* Additional reporting to regulators would not affect investor behaviour.
 |
| *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?* The principle of additional reporting would be to provide regulators with advance warning of stress in the system. Given the operational constraints on reporting which is already very detailed it is unlikely in our view that data could be sufficiently ‘real-time’ to make this objective likely.
 |
| *iii a)* Does the option effectively shift MMF risks to investors?* No.

 *b)*Does it make those risks more salient and transparent for investors? Are investors treated equally?* No. Additional reporting provides more transparency to regulators not investors.
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| **III Effects on Fund Managers** |
| *i* How would the policy option affect MMFs’ liquidity management in normal versus stressed times?* Additional reporting would not impact fund manager behaviour as the fund manager is concerned with running the fund in the best interests of investors, the reporting is only providing transparency into what has already happened in the fund.
 |
| *ii* How would it impact the ability or willingness of MMFs to invest in short-term funding instruments or use the repo market?* No impact.
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| **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?* See our response to Q4 above for our answer to all parts of this section.
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<ESMA\_QUESTION\_MMFR\_10>

1. 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.

<ESMA\_QUESTION\_MMFR\_11>

We do not believe that additional reporting would provide an effective tool in addressing some of the challenges observed in March 2020. On the asset side, disclosure of money market instruments held is already provided to the NCAs. We see no benefit to be gained from making the current disclosure more detailed. On the liability side, disclosure of investor types in MMFs is already provided as part of reporting obligations. However, predicting likely redemption behaviour on the basis of investor categorisations can be misleading. Individual investors within the same investor type category may react very differently, depending on their specific needs during a time of stress and the nature of that stress. Whilst it may be appropriate to classify ‘institutional’ investors as more likely to redeem that ‘retail’ investors, there are certainly nuances underlying. We are therefore concerned about inferring stability from the investor type. For example, when volatility increased dramatically in March, margin calls led to a need for cash for some institutional investors, however this was not the case for all institutional investors.  The need for cash was dependent on the underlying exposures that each institutional investor has, along with their other options for cash management (e.g., use of bank deposits, repo and other cash management tools) which is often not known by the MMF manager.

In our view, it would similarly be misleading to make generalised, blanket assumptions about corporate behaviour as this will clearly vary according to sector. For example, during the crisis, there were corporates that redeemed their shareholdings in MMFs as other sources of funding disappeared. Many needed cash for business needs, for example, airlines were effectively shut down overnight and had no more bookings/cash coming in. The same was true for the hospitality and hotel sectors, where cash flow was suddenly dramatically reduced. In contrast, other corporates, such as supermarkets, prospered as they were one of the very few retailers allowed to remain open.

Another major category is funds. If we consider funds, for instance hedge funds, as an example, some generated significant profits during the pandemic as they were short sectors such as airlines and hospitality whereas others did not and may have needed to draw down on MMF balances. It is therefore very challenging or even misleading to draw conclusions on the generalisations about investor type.

Whilst it is a given that a diversified investor base makes for a more stable AUM level within a fund, it is a question of what type of diversification: investor type, strategy or sector? This is particularly important in Europe given the small proportion of MMFs that is held by household or ‘retail’ investors.

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| **I Impact on the Resilience of MMFs** |
| *i How would the policy option work in mitigating the structural vulnerabilities of MMFs?** We see limited upside in additional disclosure of MMF liabilities, given the challenges in using investor type as a generalised predictor of redemption behaviour, for the reasons given above.
 |
| *ii Would it apply to all MMFs?** Any additional measures should apply to all MMFs.
 |
| *iii b)* How would it represent a change from current rules or practices in other jurisdictions?* Reporting obligations are already very detailed compared to other fund types.
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| **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?* Additional reporting would not affect investor incentive to redeem.
* This option would not mitigate the ‘dash for cash’. It would not affect investor behaviour. It is about predicting investor behaviour which, for reasons outlined above, we feel would have limited benefits.
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| **III Effects on Fund Managers** |
| *i* How would the policy option affect MMFs’ liquidity management in normal versus stressed times?* We would be supportive of more transparency in the short-term markets including the post trade information outlined earlier. More transparency **on market data** (for instance on outstandings and issuance) would be helpful.
* Please note the above answer addresses the broader part of this question (“potentially other types of EU legislation on the disclosure of money market instruments”) and does not relate to additional disclosure by MMFs on MMF assets and liabilities.
* Disclosure does not affect MMF liquidity management.
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| **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? * Please see our response to Q4 above for answers to all of this section.
 |

<ESMA\_QUESTION\_MMFR\_11>

1. i) Do you agree with the above assessment on the potential creation of a LEF? 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:
2. **What should be the appropriate size of such a pooling vehicle as the LEF?**
3. **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?**
4. **How long would it take to establish such a LEF?**
5. **Under which conditions would the LEF be activated?**
6. **Who would be responsible for activating the LEF**.

<ESMA\_QUESTION\_MMFR\_12>

1. **Do you agree with the above assessment on the potential creation of a LEF?**

In our view, the creation of an LEF is neither economically and nor logistically viable. Any substantial additions to the fund provider cost base are likely to be passed on to the investor base giving them a strong incentive to seek alternatives. Such a shift in assets would entail the risks outlined in our earlier responses, namely investor being forced to take more risk and risks being shunted elsewhere in the system to less transparent and less regulated areas with a likely increase in systemic vulnerability.

In addition, a substantial increase in costs could also result in industry consolidation, which in turn would likely increase costs and reduce choice for investors. This option would therefore not preserve the viability of the industry which, as noted in ESMA paragraph 72, serves a key intermediation role and economic function. Given long period of low interest rates, income is already reduced, limiting the flexibility of fund providers.

The cost would be a significant barrier. It would be funded by MMFs but only be required during periods of significant stress. It may not make economic sense to run such a facility 99% of the time during normal market times. It is likely that fund managers would exit the industry rather than incur the very substantial costs involved, resulting in consolidation and reduced competition. This would result in a bad outcome for the industry, the issuers who use the CP and CD markets to fund, and the investors.

Furthermore, the existence of an LEF may create a new moral hazard where MMFs may be encouraged to take additional excessive risk as there is effectively a syndication of risk across the industry. Given it would be paid for by MMFs, there would be incentive to get some value from the cost, which could encourage excessive risk taking.

Finally, establishing an LEF or Liquidity Exchange Bank would be very complex from a regulatory point of view. To have a meaningful impact any such facility would arguably need the ability to borrow from the Central Bank, somewhat negating the intention to make any such need for intervention necessary.

1. **Specifics on how big/conditions etc**

 The sizing of the requirement would be a challenge. The LEF would have to be sufficient to cover the entire industry for a future stress event. Any shortfall may still have to be funded by a central bank. If the LEF is to provide liquidity for the assets outside WLA this is 70% for LVNAVs and 85 % for VNAVs. Any size limit could give rise to concerns that the LEF might run dry meaning it may not solve the ‘first mover advantage’ for investors.

 The important question also arises as to whether this would this be a global facility open to all MMFs or restricted only to EU member states? Would it encapsulate all currencies or EUR only? If the latter, it would not solve for potential market events.

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| **I Impact on the Resilience of MMFs** |
| *i How would the policy option work in mitigating the structural vulnerabilities of MMFs?*We do not feel an LEF is the appropriate solution.  |
| *ii Would it apply to all MMFs?** Yes. To work it would have to cover all MMFs.
* It would have to include all currencies, not just Euros.
 |
| *ii a)* Is the option currently in place in any jurisdiction, and if so, has it been helpful?* No.

 *b)* How would it represent a change from current rules or practices in other jurisdictions?* Other jurisdictions do not have LEFs.

 c) Has the option been implemented previously and, if so, what were the main findings?* A framework for an LEF was developed in the US in response to a June 2009 Treasury Department paper on regulatory reform. It was agreed by the industry on certain conditions (which were not met). The SEC chose not to adopt this measure.
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| **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?* Investors may still redeem rather than rely on a third-party mechanism.
 |
| *iii a)* Does the option effectively shift MMF risks to investors?* No. Arguably the existence of an LEF shifts further risks onto fund providers and by socialising those risks, may have adverse consequences.
* Concentrating more risk in the banking sector would go counter to previous reforms.

 *b)*Does it make those risks more salient and transparent for investors? Are investors treated equally?* Socialising risk outside the fund itself to an LEF may make risks less transparent and encourage investors to rely on external support.
 |

<ESMA\_QUESTION\_MMFR\_12>

1. 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.

<ESMA\_QUESTION\_MMFR\_13>

We do not currently consider the need for further clarification of the requirements of Articles 1 and 6.

<ESMA\_QUESTION\_MMFR\_13>

1. As of 18 June 2021. [↑](#footnote-ref-2)
2. EUR639bn 22 March 2019. [↑](#footnote-ref-3)
3. ECB Statistical warehouse 31 Mar 2021, total MMF AUM in Europe were EUR1,398bn. [↑](#footnote-ref-4)
4. As of 18 June 2021. [↑](#footnote-ref-5)
5. Applies to LVNAV and PDCNAV MMFs. [↑](#footnote-ref-6)
6. Comments made at the ICI conference in May 2021. [↑](#footnote-ref-7)
7. The amount of total debt issued and not matured under the programme ceiling at any one time. [↑](#footnote-ref-8)
8. As of 22 March 2019, Euro equivalent AUM for IMMFA MMFs were EUR639bn compared to EUR812bn as of 18 June 2021. [↑](#footnote-ref-9)
9. This assessment excludes non IMMFA funds such as Standard VNAVs which may have had some benefit from selling unrated corporate paper. The assets of IMMFA funds were almost entirely ineligible. [↑](#footnote-ref-10)
10. Note that under UCITS the ability to suspend the fund can be taken by the fund manager without board approval. [↑](#footnote-ref-11)
11. [https://www.centralbank.ie/docs/default-source/publications/economic-letters/vol-2020-no-9-the-persisting-effect-of-the-pandemic-on-money-market-funds-and-money-markets-(golden).pdf?sfvrsn=19](https://www.centralbank.ie/docs/default-source/publications/economic-letters/vol-2020-no-9-the-persisting-effect-of-the-pandemic-on-money-market-funds-and-money-markets-%28golden%29.pdf?sfvrsn=19) p.6 [↑](#footnote-ref-12)
12. Retail Prime MMFs also continue to be CNAV. [↑](#footnote-ref-13)
13. The dollar amount was less because the funds are now significantly smaller. Non-public funds had only 6% outflows. [↑](#footnote-ref-14)
14. In the sense of non-government, not a reference to a private offering mechanism. [↑](#footnote-ref-15)
15. Individual credit rating agencies may have slight differences in their definitions. These are disclosed on the relevant websites. [↑](#footnote-ref-16)