|  |
| --- |
| 29 March 2021 |

|  |
| --- |
| Response form for the Consultation Paper on the EU Money Market Fund Regulation – legislative review |
|  |

|  |
| --- |
| 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.

**Data protection**

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

|  |  |
| --- | --- |
| Name of the company / organisation | Prudential plc |
| Activity | Investor |
| Are you representing an association? |  |
| Country/Region | UK |

# Introduction

Please make your introductory comments below, if any:

<ESMA\_COMMENT\_MMFR\_1>

Prudential plc (“Prudential”) is a UK listed insurer subject to group-wide supervision in Hong Kong that provides life and health insurance and retirement and asset management solutions to customers in Asia, Africa and the United States of America.

Prudential’s group treasury team manages the central liquidity of the group and invests in a variety of highly-liquid highly-rated products, including EU domiciled money market funds (MMFs), term deposits, certificates of deposit, reverse repo and short-term government securities with the size of the portfolio being between USD 2-3bn. They are the principal users of EU MMFs within the group although some of our Asian business units also invest in these funds. The MMFs used by Group Treasury are incorporated in EU member states (Ireland and Luxembourg) and are subject to EU MMF regulation. We use a total of 14 MMFs (6 GBP and 8 USD) all of which are regulated as LVNAVs and have AAA MMF ratings from credit rating agencies (CRAs). In addition, we have historically used government only CNAVs to invest cash collateral received from counterparties for derivative transactions. We are classified as Tier 1 issuers of commercial paper (“CP”) given our short-term credit rating and our CP is eligible for purchase by prime MMFs. We are therefore concerned with the potential impact of regulatory changes both in terms of how they affect the market for EU-regulated MMFs and the related demand for short-term money market investments, including CP.

Our approach to investing these funds is conservative and we strive to a balance between credit diversification, liquidity and capital preservation. We are aware that due to the nature of a MMF’s holdings, there is a risk of ‘breaking the buck’ as set out in paragraph 121 of the consultation document, and that there may in times of stress be a trade-off for MMF management between maintaining a stable NAV and complying with WLA requirements. However, we consciously accept the remote risk of ‘breaking the buck’ or the imposition of fees and/or gates as we view the diversification benefits of MMFs as being of greater importance, and hence prefer them to undiversified unsecured bank deposits.

We are concerned that the proposed reforms may lead to the erosion of the investment case for EU-regulated MMFs, which at present offer significant counterparty risk diversification to investors regardless of investor size or sophistication, combined with same day liquidity, and a very high probability but not certainty that investments can be made or redeemed without suffering frictional gains or losses. We do not consider that any of the alternatives offer this combination of attributes, particularly for smaller investors.

We have addressed those question which are relevant to us as investors in EU MMFs and issuers of CP eligible for purchase by prime LVNAVs and that reflect our expertise and experience as follows.<ESMA\_COMMENT\_MMFR\_1>

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) We agree with the assessment of the difficulties faced by MMFs in March 2020, but note that despite the challenges posed by market disruption, in the case of LVNAVs no EU MMF breached the NAV corridor or allowed WLA to fall below 30%, and for all funds, none suspended redemptions or made use of liquidity fees or redemption gates. This is despite the fact that for GBP- and USD-denominated funds, there was no access to any central bank support mechanisms. The Bank of England did not provide one and that of the Federal Reserve (the Money Market Mutual Fund Liquidity Facility) was only available to US domiciled funds. We therefore conclude that the existing regulatory framework for LVNAV and CNAV MMFs is robust and has led to beneficial outcomes for MMFs themselves and their investors in a stress scenario. This contrasts favourably with the experience of certain US-regulated funds that made use of sponsor support or suffered greater relative deviations in their NAVs by comparison to EU LVNAV MMFs. All EU LVNAV MMFs remained within the 99.8-100.2 corridor, while a US prime fund (all of which are obliged to sell and redeem shares at NAV) dropped to 99.76 (source: https://www.sec.gov/files/prime-mmfs-at-onset-of-pandemic.pdf ) We therefore urge ESMA and the Commission to reject fundamental reform of the existing MMF regulatory framework and potentially damaging unintended consequences for market functioning that we discuss further below.

ii) Although the use of MMFs is overwhelmingly the province of institutional investors, it is not the case that all institutional investors have equal capabilities to carry out detailed assessments of the ability of MMFs to preserve capital and maintain liquidity. For investors with lesser capabilities in this area, rating agencies play a useful rule by providing an independent view. As we exclusively use AAA-rated MMFs, none of whose ratings changed during the crisis, ratings did not affect our behaviour during March 2020. If any of the funds had been downgraded, we would have disinvested from those funds then and would do so now. We see the information from independent credit ratings as beneficial and would not support any move to limit the ability of the credit rating agencies to provide their opinions in this area. It would likely lead to a reduction in the total size of the MMF universe, and would in turn reduce demand for commercial paper, which is at present the main alternative to bank finance as form of short term funding.

<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>

No comment<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>

i) We support the proposal to decouple regulatory thresholds from suspensions/gates in order to avoid the perverse incentive of investors to instruct redemptions on a precautionary basis as WLA declines towards 30%, which makes the imposition of gates or redemption suspensions more likely. The imposition of gates would likely result in a very high level of redemptions once they are revoked, even if the fund then had no fundamental challenges in terms of capital or liquidity, as the fund’s management would be perceived by investors to have failed in their duty to keep the MMF as a fundamentally liquid investment.

ii) We believe that the decision to impose suspensions/gates should lie solely with the management of the MMF if they judge it to be in the best interest of the fund and its investors. MMFs provide a wide variety of investment opportunities and we would view a CNAV government fund and VNAV property fund as fundamentally different and a “one size fits all” set of regulatory constraints of this nature are unlikely to be appropriate for all funds. In our opinion the management and boards of the funds are best placed to understand the particular risk characteristics of each fund and to respond accordingly. We do not support the proposal to require regulatory approval or notification prior to the use of such mechanisms, as they introduce additional uncertainties that may affect the ability of MMF boards to manage their funds in the best interests of investors.

Other measures (liquidity fees, swing pricing or changes to notice and settlement periods) would represent fundamental operational changes to funds that would significantly diminish their attractiveness to investors on a permanent basis. For example, MMFs are utilised as part of Prudential’s own liquidity management through a process of automatic sweeps from bank accounts at a fixed time each day, varying by currency. Decisions over which funds to invest in and amounts can be made on a daily basis. The automatic nature of the sweep allows cash left in bank account to be kept near zero, which is attractive from a counterparty risk management standpoint, without sacrificing Prudential’s ability to meet urgent unexpected liquidity outflows. If the settlement period were to increase to T+1, then liquidity management would be complicated as larger amounts would need to be left in bank accounts to meet payments outside of forecasts. This is less efficient from a returns perspective (as yields on MMFs are greater than on bank current accounts) and a counterparty perspective due to the lack of diversification. It would also increase the investment community’s dependence upon the banking system.<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>

i) Investors who focus on the preservation of capital are likely to seek out MMFs over saving accounts and deposit accounts due to the diversification of the credit exposure. LVNAV funds invest in cash-like securities, cash equivalents and high-rated debt based securities that are all traded and settled T0 and take away the administrative and operational and risk management burden from investing directly. For this reason, swing pricing should be rejected as a potential reform as it would rule out T0 settlement. Similarly, ADL and liquidity fees should be rejected as they would effectively lead to the abolition of a key attraction of LVNAV and CNAV funds from an investor perspective, namely the very high probability than one euro, pound or dollar invested can be redeemed for the same amount. We recognise that there is a remote risk that are CNAV fund will suffer volatility in the value of their portfolio and be required to become a VNAV fund. We consider that this existing approach is appropriate and does not require changing.

In an environment in which frictional gains or losses would arise whenever funds were invested in or divested from an MMF, there would be a direct impact on the complexity of investment reconciliation and cash flow forecasting. As a result, investors averse to the complexity would consider alternative investments that did not exhibit the volatility in pricing and the size of the EU MMF universe would reduce. The more sophisticated investors who possess robust systems for their liquidity management would expect an increased operational burden that would increase operational costs which would make investments in MMFs less attractive.

ii) Alternatives for MMFs in terms of short term investments include deposit accounts, term deposits, certificates of deposit, reverse repurchase transactions and direct investments in high-rated debt-based securities such as government treasury bills or commercial paper. None of these offer the diversification benefits of MMFs, and in the case of banks products (term deposits and certificates of deposit), do not typically offer the instant access to liquidity at T0. On the other hand, investments in securities markets require a significant investment in operational and legal infrastructure, hence it is accessible to large corporates and financial institutions only. It should also be noted that following the implementation of Basel III, deposits with terms of 90 days or less are relatively unattractive to banks, due to the high ratio of risk-weighted assets that they attract. This means that short term deposits offer unattractive returns to investors, which makes the trade-off between liquidity and returns stark. <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>

As noted above, despite the challenges posed by market disruption, in the case of LVNAVs no EU MMF breached the NAV corridor or allowed WLA to fall below 30%, and no funds suspended redemptions or made use of liquidity fees or redemption gates. For this reason, we do not believe that fundamental changes are required in this area. If ESMA or the Commission believe that some funds came too close to breaching their obligations in March 2020 despite not doing so, we would advocate an increase in the % of daily or weekly assets required for the different fund types. This would improve the ability of funds to respond to stressed market conditions without fundamentally altering their operations. We see issues with all the proposed solutions:

• If MMFs are allowed to run lower buffers when outflows are high, this imperils their ability to meet future redemptions and thus could encourage investors to accelerate withdrawals, making illiquidity more likely

• We do not favour making any buffers that can be relaxed by regulatory authorities non-public. This would likely lead to investor speculation regarding what the non-public buffer was and could result in precautionary divestments from investors that would exacerbate liquidity issues. In our view any changes should lead to more transparency not less.

• Varying liquidity buffers according to the types of investors participating in the fund would likely pose serious operational changes for funds, as their required buffer could vary on a daily basis depending on the pattern of investments and divestments. <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>

As noted above, we do not see any need to eliminate CNAV and LVNAV funds and would support their continuation strongly.

The experience of money market reform in the United States shows that when a stable NAV product was prohibited for prime funds (i.e. those containing a mixture of corporate and government asset), it resulted in very large outflows from this asset class. As noted in the consultation document, prime MMFs are the largest purchasers of US commercial paper. In effect, the MMF reform has significantly reduced the size of the US commercial paper market, and the ability of US corporates and financial institutions to access short-term funding outside the banking system. If this effect were replicated in Europe, it would run contrary to the Commission’s aims to develop EU capital markets (i.e. through the Capital Markets Union) and would likely increase the role of banks in providing short-term finance. If CNAVs were abolished in addition to LVNAVs, it may lead to a significant investor reallocation away from these funds, reducing the available investor pool for EU government debt which could lead to higher funding costs for the governments of the Member States. At the onset of COVID-related market volatility in March and in subsequent months, it was notable that deposits at banks increased significantly, as many corporates chose to draw committed facilities and leave the proceeds in bank accounts, despite the undiversified unsecured counterparty risk this posed. <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>

We do not believe that permitting sponsor support would be a progressive development for EU MMFs. The absence of sponsor support means that the credit worthiness of each fund is truly assessed on a standalone basis. Such a development could introduce an element of moral hazard and lead to inappropriate investment behaviour. Further prohibiting such support eliminates potential cross default risk in the case of a sponsor’s financial distress. Permitting sponsor support would also favour MMFs sponsored by banks due to their greater capacity to provide direct support by comparison to standalone asset managers, which would again run counter to the Commission’s objective to strengthen non-bank forms of financing within the EU.<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>

i) As noted above we see value in the opinions produced by credit rating agencies but can see merit in reviewing this area to see if greater clarity on the nature of the opinion could be provided.

ii) Liquidity products that compete with MMFs (deposit accounts, term deposits, reverse repo and government treasury bills) are all provided by institutions that have ratings provided by credit rating agencies. Although the nature of MMF ratings is different to those of other credit ratings as they do not directly assess creditworthiness, it would be anomalous for CRAs to be prevented from assigning any form of rating to one segment of the market for liquidity products. As many investors will have policies that only allow them to invest in funds that have a certain credit rating restrictions, we expect that a downgrade of all or one or several MMFs would lead to material divestments in a relatively short space of time. If CRAs were to be prevented from providing any kind of rating for MMFs, we would expect a permanent reallocation of some investors away from MMFs, most likely to bank deposits.<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 do not see a requirement to amend the requirements on stress tests, as despite all MMFs facing a shock simultaneously in March 2020 no funds breached regulatory requirements or failed in their commitments to meet divestments to investors on a timely basis. We have no objection to the recommendation in paragraph 158 i) , namely that ESMA would, together with the National Competent Authority, receive directly from the manager of the MMF the report mentioned in Article 28(5) of the MMF Regulation , so that ESMA can play its coordination role with National Competent Authorities in the more effective way, and in real-time (which might be of a value in such crisis situations as in March 2020). We do not support the proposal in paragraph 158 ii) and believe that the corrective measures taken by MMF managers in response to revealed weaknesses should be determined by MMF boards and their agents alone.<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 that it would be beneficial to enhance the reporting requirements under the MMF Regulation as proposed in the consultation document. This is to enhance transparency and identify possible performance issues and behaviour trends. <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 would urge ESMA and the Commission to review information that is already available from commercial sources on money market instruments before considering the imposition of additional reporting requirements on market participants that will impose incremental costs that might be passed on to investors. As noted in our response to Question 5 above, we do not favour varying liquidity buffers according to the types of institutional investors participating in the fund as it could contribute to discriminatory treatment of different investor types. We also wish to emphasise that there are challenges in terms of data collection on investor types for MMFs, as some investments take place using nominees (i.e. when a bank invests in an MMF on a client’s behalf) that obscures the true origin of the funds and hence the underlying investor type. We question how certain the contention is that different types of investors behave in different ways consistently with respect to MMFs and urge ESMA and the Commission to consult MMF providers for further insights into how they factor such information into their operational policies and processes.<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:

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

<ESMA\_QUESTION\_MMFR\_12>

We do not believe that a LEF is necessary or would be beneficial to investors in EU MMFs. Such a facility would result in higher operating costs for EU MMFs, which already offer low returns to their sponsors in the current interest rate environment. Imposing higher costs would likely lead to the most marginal sponsors exiting the market, leading to a more concentrated EU MMF universe that would exacerbate the problems of portfolio overlap and market footprint noted in the consultation document. The costs of a LEF would most likely be spread across funds on a basis such as AUM that would penalise those more liquid funds with a lower need for liquidity. As noted above we consider that the responsibility for ensuring sufficient liquidity is available on a fund by fund basis should rest with the management and boards of the funds.<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>

No comment<ESMA\_QUESTION\_MMFR\_13>