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June 25, 2021

Ms. Anneli Tuominen, Interim Chair
Ms. Natasha Cazenave, Executive Director
European Securities and Markets Authority
201-203 rue de Bercy
CS 80910
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Re: Consultation Report on EU Money Market Fund Regulation – legislative review
Submitted via https://www.esma.europa.eu/press-news/consultations/consultation-eu-money-market-fund-regulation-%E2%80%93-legislative-review#registration-form_consultation

Dear Mses. Tuominen and Cazenave:

The Institute of International Finance (IIF) [1] and its member firms welcome the opportunity to contribute to the work of the European Securities and Markets Authority (ESMA) on potential reform measures for Money Market Funds (MMFs), as highlighted in the Consultation Report: EU Money Market Fund Regulation – legislative review (Consultation Report). [2] This effort is a significant contribution to the initiatives being undertaken at the global level by the G20, the Financial Stability Board (FSB) and the International Organization of Securities Commissions (IOSCO) to enhance the resilience of the non-bank financial intermediation (NBFI) sector while preserving its benefits. We recognize that the European Union (EU) has advanced considerable legislative efforts to promote the smooth functioning and resilience of MMFs in the region.[3] Those efforts have contributed significantly to the mitigation of risk and the avoidance of disruption in the short-term funding markets and to the resilience of those markets. However, the unprecedented COVID-19 crisis has revealed some further structural vulnerabilities in MMF and short-term funding markets that should be addressed through a holistic review of the impact of market

[1] The Institute of International Finance is the global association of the financial industry, with more than 450 members from more than 70 countries. Its mission is to support the financial industry in the prudent management of risks; to develop sound industry practices; and to advocate for regulatory, financial and economic policies that are in the broad interests of its members and foster global financial stability and sustainable economic growth. IIF members include commercial and investment banks, asset managers, insurance companies, sovereign wealth funds, hedge funds, central banks, and development banks.
[2] ESMA 2021. *"Consultation Report: EU Money Market Fund Regulation – legislative review"* (March)
[3] Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds: https://eur-lex.europa.eu/eli/reg/2017/1131/oj.

structure on the resilience of the short-term funding markets, taking into account important differences in market and product structure and market specificities across jurisdictions.

We believe that a holistic review of market structure impacts can produce targeted and proportionate measures for the specific segments of the MMF sector and short-term funding markets that experienced significant stress in the March 2020 market turmoil. As ESMA is aware, non-public debt MMFs experienced greater stress and outflows than public debt MMFs. Accordingly, we encourage ESMA to focus its attention on the non-public portion of the market.

ESMA's consultation comes at a time when several proposals for MMF and short-term funding market reform and for the strengthening of NBFI resilience more broadly are under consideration. We strongly encourage ESMA to coordinate its initiatives with respect to the NBFI sector, short-term funding markets and MMFs with those underway at the G20, the FSB, IOSCO and other standard-setting bodies and regulators and supervisors in key jurisdictions.[4]

We would like to highlight some of the work programs and initiatives currently underway among the global financial services standard-setting bodies. As the Report acknowledges, the FSB has announced in its 2021 Work Programme that one of the key deliverables this year would be *"policy proposals to enhance MMF resilience and a report on progress in the work programme for strengthening NBFI resilience"*.[5] IOSCO has also stated that it will further contribute *"to FSB policy work relating to MMFs and the underlying short-term funding-markets.*[6] We welcome these initiatives, as they are focused holistically at the NBFI sector and at the short-term funding markets, rather than narrowly at MMFs. We encourage ESMA to take a similar holistic approach that focuses on the root causes of the March 2020 market dislocations in order to propose a comprehensive set of reforms that would improve market functioning and increase market resilience to a range of possible future disruptions arising from different sources or catalysts. We also encourage ESMA to engage in dialogue with IOSCO to collaborate and exchange views on appropriate measures to enhance the resilience of MMFs and short-term funding markets, again taking into account important market and product structures and market specificities across jurisdictions.

We appreciate the attention that is being given at the global, regional and jurisdictional levels to these important issues. However, we are concerned about the potential for these initiatives to lead to regulatory fragmentation, conflicting or duplicative regulation or supervision, or potential barriers to market access or to a level playing field for all market participants given the global nature of financial markets and participants.

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[4] At the jurisdictional level, on February 4, 2021, the U.S. Securities and Exchange Commission (SEC) published a request for comment on potential reform measures similar to those contained in the Consultation Report to improve the resilience of money market funds: https://www.sec.gov/news/press-release/2021-25. While there are significant differences between the EU and U.S. markets, it may be valuable for ESMA to engage in a dialogue with the SEC to exchange views on measures that are appropriate in the two markets and to explore whether there are measures that might be appropriate in both markets.

[5] FSB 2021. *"FSB Work Programme for 2021"* (January)

[6] IOSCO 2021. *"IOSCO Board Priorities - Work Program 2021-2022"* (February)

ESMA's active engagement in global efforts among industry standard setters and coordination with regulators in other key markets could help reduce regulatory and market fragmentation by carefully aligning measures to address the need for greater resilience in MMFs and short-term funding markets. We reiterate the IIF's frequent calls to seek globally harmonized regulation and the application of the principle of 'same activity, same risk, same regulation' to the greatest extent possible, taking into account local specificities, and jurisdictional differences in market and product structures.

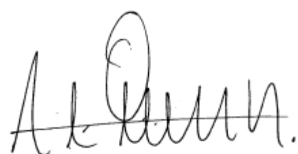
We encourage ESMA and other standard setters, regulators and supervisors to coordinate their review of the need for reforms with the central banks that supported the money markets in some jurisdictions during the March 2020 period of stress. Coordination with central banks could help to devise holistic solutions that minimize the risk of moral hazard by addressing the root causes of the March 2020 market dislocations and by improving short-term funding market functioning.

We understand that various national and regional authorities are issuing different surveys to market participants in an effort to better design regulatory or supervisory reforms for the MMF sector. While we appreciate the need for additional information in order to construct an appropriate official sector response, these requests for information or data should be coordinated through a central global standard setter or authority such as IOSCO. This coordination could also facilitate a better exchange of information among regulators and supervisors which, in turn, could lead to collaborative solutions.

We also encourage ESMA to consider a greater focus on market participants' own stress tests and scenario analyses in lieu of standardized market-wide scenarios. Bespoke tests and scenarios can be useful techniques to field test different liquidity risk management tools and business continuity plans designed to respond to stressed market conditions.

The IIF appreciates ESMA's openness to seek public comment on the Consultation Report. We remain committed to active participation and engagement in the discussion of potential reforms to MMF Regulation.

Sincerely,



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

A1: In general, we agree with the findings made by the Report.

However, we have a different view on the Report's finding in Paragraph 34 that the *"COVID-19 crisis has also revealed reluctance or inability by certain banks to act as dealer in such circumstances, which may have, in turn, amplified the stress on the market".* Dealer inventory in March 2020 reflected the level of market activity, dealer capacity, and the difficulty of refinancing maturing CP issuances, rather than the appetite of dealers. As the Report correctly acknowledges in Paragraph 33, "[t]he secondary market of most money market instruments (e.g., CDs and CPs) is generally not very active" as many investors hold these instruments until maturity, due to their short duration. The report of the President's Working Group of Financial Markets in the U.S also highlighted that dealers in CP markets (as well as issuing dealers and banks) *"have not had a substantial role in making secondary markets in CP and other private short-term debt instruments that prime MMFs hold."* and that *"there was no reason to expect dealers to take a materially increased intermediation role in these assets in March [2020]"*. [7]

We have also been advised that, in at least some European markets, dealers increased their CP inventories in March 2020 in order to meet the needs of European MMFs. Moreover, dealer inventory increased after the introduction of support measures by the official sector.[8]

Instead of a narrow focus on MMFs, we encourage ESMA to research the impact of market structure on the resilience of short-term funding markets. In particular, we note the largely bilateral nature of the CP market, which can impede effective intermediation. Other markets may have operational complexities which make intermediation less efficient than could be the case if those markets could be streamlined.

Finally, we encourage ESMA to more fully recognize the diverse nature of the MMFs. As IOSCO has observed, *"MMFs behaved differently – both across jurisdictions and even within the same MMF category in a particular jurisdiction, and faced different contexts and issues as a result of their characteristics such as investor profiles, portfolio holdings and regulatory requirements"*.[9] For example, euro-denominated VNAV[10] funds experienced both outflows and inflows during the 2020 market turmoil but stabilized in May 2020 and have since then recorded inflows.

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[7] PWG 2020. *"Overview of Recent Events and Potential Reform Options for Money Market Funds"* (December)

[8] For example, see dealer inventory data in the Federal Reserve Bank of New York report: https://libertystreeteconomics.newyorkfed.org/2021/03/did-dealers-fail-to-make-markets-during-the-pandemic.html. However, aspects of the narrative surrounding dealer inventory in this report does not correspond to the data contained in the report. For example, the authors claim that there was a "bottoming out" of primary dealer net positions in CP in the week of March 18 while the accompanying data shows only a slight decline in these positions, which reversed quickly in March (as opposed to in April, as stated in the report).

[9] IOSCO 2020. *"Money Market Funds during the March-April Episode"* (November)

[10] Variable net asset value MMFs.

Q2: 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?

A2: i) We generally agree that certain elements of the MMF Regulation would benefit from review by ESMA with a view towards implementing targeted and proportionate reforms designed to address specific weaknesses or vulnerabilities. We believe that the focus on structural vulnerabilities noted in Paragraph 76 should be the primary focus of ESMA's review. We also agree with the emphasis on financial stability and the avoidance of moral hazard, as stated in Paragraph 72 of the Consultation Report. A holistic review that is focused on the structure and potential sources of instability of short-term funding markets is more likely to produce recommendations and potential reforms that address the root causes of the March 2020 market disruptions than would a narrower review targeted at MMFs alone. As noted above, this review should take into consideration the market and product structure differences across jurisdictions as well as other market specificities.

A2: ii) We agree that ESMA has identified the correct criteria for assessing how MMF reform options would affect investor incentives. Some of the reforms we favor, such as decoupling MMF liquidity requirements and gate thresholds, would have positive effects on investor behavior, including mitigating the risks of a 'dash for cash' as was seen in March 2020.

However, as we have noted throughout this response, consideration of needed reforms should transcend a narrow focus on MMFs and consider broader questions of market structure.

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

Q3: i) We believe that removing the tie between MMF liquidity requirements and gate thresholds has considerable merit. While liquidity requirements are intended to operate as a buffer, these requirements can act as a 'bright line' cliff that incents investors to redeem prior to the imposition of a gate or redemption fees. As a result, funds are incented to hold liquidity in excess of requirements, thus contributing to broader market illiquidity.

To address the "dash for cash" that occurred in certain MMFs in March 2020, ESMA should provide MMF governing bodies with greater flexibility and discretion to impose redemption gates by decoupling those gates from the weekly liquid asset requirement, particularly for LVNAVs, for which those requirements generally are most binding. A MMF's board or governing body could make a determination that redemption gates are in the best interest of the fund and its investors without that determination being tied to a certain level of liquidity. Similarly, an MMF's board or governing body could make a determination that other measures designed to disincentivize pre-emptive runs are in the best interests of the fund and its investors (e.g. fees).

Q3: ii) We do not favor the option of requiring funds to obtain permission from regulatory authorities or to notify those authorities prior to imposing gates. Fund boards or governing

bodies need the flexibility to react quickly in a stress event and a requirement to pre-clear actions in response to market stress could render those actions ineffective. In the absence of a mandated course of action in the event of market stress, fund boards generally could be expected to consider a broad range of responsive measures, including imposition of liquidity fees.

Q4: i) Do you agree with the above assessment of the potential need to require MMFs to use swing pricing and / or ADL / liquidity fees and the corresponding proposal of amendment of the MMF Regulation (including the above list of corresponding potential benefits and drawbacks)? 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.

A4: i) We believe that swing pricing would not have materially reduced redemption activity during the March 2020 market turmoil. Swing pricing is dependent upon overall redemption activity that is unknown to the redeeming investor. It is also unclear the extent to which an additional charge would impact investor behavior – particularly the behavior of institutional investors.

Moreover, swing pricing is operationally complex for many MMFs. A T+0 settlement feature, which is critical to investors in many MMFs, would make the implementation of swing pricing very challenging as it may not permit sufficient time for price discovery (especially during a stress period) to calculate the appropriate swing factor to apply. This timing issue is magnified for MMFs that strike their NAVs multiple times per day, as there would not be sufficient time to implement a swing factor between NAV cutoffs. We also believe that there would be major challenges in calibrating a swing price in a manner that internalizes transactional costs for redeeming investors, as the cost/benefit equation can change over time and shift rapidly in times of stress. Liquidity fees, which are already operationally feasible in MMFs, provide the same effect of directing costs to redeeming shareholders.

A4: ii) As noted above, ADLs or liquidity fees can serve a purpose similar to swing pricing with fewer implementation challenges and impediments and we believe it is the better mechanism to allocate some of the transactional costs to redeeming shareholders, when necessary.

Q5: i) Do you agree with the above assessment of the potential need to increase liquidity buffers and/or make them usable/countercyclical and the corresponding potential proposal of amendment of the MMF Regulation? 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.

A5: i) We do not favor the imposition of additional buffers. We believe that the imposition of additional buffers would substantially increase the costs of MMFs and, thus, render MMFs less able to perform their important role of funding a wide range of market participants (with different credit risk profiles) and facilitating maturity transformation. Returns to MMF investors would be

negatively impacted by the costs of establishing and maintaining the buffer. The imposition of a large mandatory buffer would fundamentally change and could potentially destabilize the MMF market and the MMF sector.
A5: ii) Lowering regulatory liquidity requirements during a time of stress would send a signal to the market that liquidity buffers are intended to be used. As a result, investors are likely to be less concerned about the potential imposition of fees or gates. ESMA could consider this option in conjunction with decoupling the link between liquidity requirements and redemption gates and in conjunction with providing fund boards or governing bodies with the authority to determine whether and to what extent gates should be imposed.

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

A6: Converting all MMFs to a floating NAV should be the subject of further study by ESMA and other market authorities; as such, it is difficult to respond definitively to this question. We note that some floating NAV MMFs faced high rates of redemption in the March 2020 market disruption. A floating NAV does not necessarily remove first-mover advantage, as early redeemers are likely to receive a better price than later redeemers in a stressed market. We also note that the conversion of all MMFs to a floating NAV could impact negatively the size and liquidity of the market for MMFs and reduce demand from both issuers and investors.

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

A7: We do not believe that Article 35 of the MMF Regulation needs to be clarified or amended. While sponsor support options may create loss absorption capacity during market stress, the option itself does not address the management of liquidity pressures and would not have prevented investor redemptions experienced during March 2020. Furthermore, implicit support, or step-in risk, is already addressed under the Basel framework and extends to a bank's involvement in asset or funds management and to the sponsorship of MMFs. In the EU, the evaluation of implicit support is part of the Supervisory Review and Evaluation Process pursuant to Section III of CRD IV.

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

A8: i) In our view, credit rating downgrades were not a direct cause of MMF outflows during the initial phase of the March market turmoil. Indeed, to our knowledge, while MMF sector outlooks were revised downwards, rating downgrades affected some of the issuers represented in MMF portfolios, not the funds themselves. Credit rating agencies (CRA) changed their outlooks on MMFs well after they observed outflow from the MMFs.[11] These actions were announced well after central bank interventions and the subsequent stabilization of the markets. Given the limited role of CRAs in the March 2020 market turmoil, we believe that ESMA's focus should be broader and encompass a holistic review of the impact of market structure on the resilience of the short-term funding markets, taking into account differences in market and product structures and market specificities across jurisdictions.

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

A9: Stress testing is a useful technique that can be employed to field test different liquidity risk management tools and business continuity plans designed to respond to stressed market conditions.
We encourage ESMA to consider a greater focus on MMFs' own stress tests and scenario analyses in lieu of standardized market-wide exercises. Differences among funds and their regulatory requirements, shareholder composition and historical performance and behavior render market-wide, undifferentiated stress tests or scenario analyses of limited utility. These differences could result in aggregated results that are misleading and unreliable. The scope and calibration of any stress test or scenario analysis should reflect the fund's unique composition and risk profile as well as historical shareholder behavior. It should also recognize the availability and range of liquidity risk management tools that are available to address redemption requests under stressed market conditions.

Q12: 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

A12: We believe that the establishment of a liquidity exchange facility (LEF) to serve as "a centralised source of liquidity during periods of stress" would be operationally complex, costly

[11] For example, see Fitch Ratings' articles: ["European LVNAV Money Market Fund Sector Outlook Goes Negative"]() and ["US Prime Money Mkt Fund Outlook Negative on Liquidity Challenges"]()

and impractical. In our view, the costs of establishing and maintaining a LEF would outweigh any potential benefits. As IOSCO noted in its Money Market Fund Systemic Risk Analysis and Reform Options, it is uncertain whether the establishment of LEFs would mitigate the "dash for cash" during a crisis. IOSCO also noted that, for a LEF to be effective, *"its structure and operations would have to be carefully designed to ensure that the facility has sufficient capacity during a crisis and that the facility itself is not vulnerable to runs. A depleted facility could trigger or amplify a run on MMFs."*[12]

[12] IOSCO 2012. *"Money Market Fund Systemic Risk Analysis and Reform Options"* (April)