EFAMA

European Fund and Asset Management Association

EFAMA RESPONSE TO ESMA CONSULTATION ON THE LEGISLATIVE REVIEW OF THE EU MONEY MARKET FUND REGULATION (MMFR)

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EXECUTIVE SUMMARY

EFAMA welcomes ESMA's preparatory work on the review of the MMFR, an effort that is also well-timed in the context of a broader debate on MMF reform options taking place within the international standard setting bodies (IOSCO and FSB) and in anticipation of their respective consultations in the coming weeks. Our view is that such reforms should aim to preserve the intermediary role that MMFs play in short-term money markets, while continuing to offer a critical alternative to traditional bank financing. Conscious of the narrower scope of the MMFR review, we nonetheless agree with the need to explore options to improve the functioning of the secondary market, especially under stressed conditions. Those aimed at incentivising liquidity provision by dealers, by at least not hampering it via punitive capital constraints, should be explored in depth at the international level as a matter of priority, thus avoiding that global reform efforts become too "one-sided" and risk reducing sources of financing to the detriment of issuers and investors. We would call on ESMA to reinforce this need through its participation in the international workstreams launched at the end of 2020 by IOSCO and the FSB as the leading global standard-setting bodies.

Efforts at reforming the current EU MMFR regime should remain strictly fact-based. Despite the broadly accurate analysis performed by ESMA in the opening sections of its consultation document, there are nevertheless a few key aspects that have not been adequately reflected. These relate firstly to the prudent management of liquidity by European MMFs, both before and throughout the March 2020 liquidity crisis. Secondly, we note that the exclusion from the scope of the ECB's Pandemic Emergency Purchase Programme (PEPP) of financial commercial paper and of securities denominated in non-Euro currencies in March 2020 would also not support many of the far-reaching reform options ESMA is presently considering.

Out of the options presented in the consultation document for consideration, we express a clear preference for decoupling the potential activation of liquidity fees or gates from a possible breach of the prescribed weekly (30%) and daily (10%) liquidity thresholds for LVNAV and public debt CNAV funds. The removal of what investors have perceived to be a "red line" is expected to relieve redemption pressures in such funds under stressed market conditions, when investors may perceive thinning liquidity levels as an early indication of forthcoming liquidity fees or gates for these funds. Of the different types of liquidity management tools put forward by ESMA in the consultation document, we consider that anti-dilution levies in the form of fixed liquidity fees represent the most appropriate solution for managers to counter unanticipated surges in redemption demands. Swing pricing, as ESMA has correctly also pointed out in its consultation document, remains operationally difficult to implement at times of heightened market stress, especially in light of an MMF's same-day settlement features that investors mostly value. One should nevertheless realise that the implementation of such tools will be possible only to the extent that liquidity in the underlying money markets does not become completely impaired.

As observed in the experience of EFAMA's Members at the height of the March 2020 market turmoil, such tools would not have worked in the absence of secondary market intermediation experienced then. Despite this, no European MMF resorted to liquidity management tools in the first half of 2020, proving that far-reaching changes to the MMFR are not required. In this regard, we would oppose the proposed recalibration of the existing liquidity levels under the options presented, adding that some of these risk introducing an inevitable "performance drag" to the detriment of corporate and institutional investors, thus diminishing the attractiveness of non-public debt MMFs in particular. Other considerations relate to the rigidities implied by "one-size-fit-all" calibrations that are not adaptable to specific investor demands and

profiles, that are difficult to adjust to reflect market contingencies, and which cannot foresee one-off, extreme market events (as the Covid pandemic). Lastly, we deem that some of the proposed solutions risk blurring the distinction between market-based financing vs. bank financing in the eyes of investors, supervisors and the general public.

The option to eliminate LVNAV and public debt CNAV remains concerning, especially in light of the resilience demonstrated by these structures, along with VNAV ones, in the course of last year's market correction. Moreover, the fact that public debt CNAV funds were actually able to attract inflows in March 2020 is well documented and would thus not support the above option. Certain types of investors continue to value stable NAV MMFs for precise reasons and options to replace LVNAV funds in the absence of viable alternatives will be detrimental to investors (especially corporate ones) as a result. More broadly, the proposed removal of certain MMF structures will reduce sources of market financing and increase reliance on traditional bank intermediation, thus also countering the EU's prospects for a Capital Markets Union.

Regarding ESMA's option to clarify and to potentially amend the current ban on "external support" under Article 35 of the MMFR, EFAMA is not in favour of it. We believe such ban should be maintained, marking an important difference with other global jurisdictions (notably the U.S.).

Lastly, as to the further options envisaged in the consultation paper – i.e. amendments to MMFs' disclosure requirements, a "Liquidity Exchange Facility" (LEF) and the sought-after clarifications to the scope of the MMFR under Article 1 and 6 – we do not believe these are warranted, nor would they help to mitigate some of the core fragilities identified in the structure and functioning of the underlying money markets as explained.

QUESTIONS

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

EFAMA broadly concurs with ESMA's well-balanced and reasoned analysis, serving to highlight three important features, i.e. (i) the considerable footprint of Euro Area (EA) MMFs in private money markets - the bulk of which consists of commercial paper (CP) issued by financial institutions – (ii) a high degree of portfolio overlap when investing in such paper, and (iii) the dependence on a secondary market which may experience illiquidity when faced with unprecedented symmetric shocks like the one in March 2020. Regarding the latter, however, we note that under normal market conditions, the CP market is not illiquid (unlike ESMA posits under paragraph 22 of the consultation document). Low volumes are explained by the tendency for MMFs to buy and hold onto short-term instruments until maturity (as noted further under paragraph 24), although this does not imply that the assets are *per se* illiquid. Generally, therefore, under normal market conditions managers do not have difficulties trading CP in secondary markets.

Of the three features above, we believe that the secondary market for money market instruments in March 2020 would deserve greater analysis and regulatory focus by supervisors and policy-makers in Europe and beyond. The ESMA consultation paper accurately addresses this at the outset, highlighting in particular how dealer banks need balance sheet capacity to be able to intermediate large amounts of CP when volatility increases. Their limited capacity to buy-back CP/CD in times of stress – in turn a reflection of their strict regulatory capital constraints - and the consequent contingent challenges for MMFs to sell their holdings to meet rising redemption demands, is well documented. Our view is that bank supervisors should to re-visit the Basel III bank capital constraints and recalibrate them

accordingly[1].

This remains a crucial point and one that has been confirmed by the market reaction to the several accompanying measures to the ECB's "Pandemic Emergency Purchase Programme" (PEPP) taken by the ECB and European Banking Authority (EBA) in the course of March and April 2020. These included the announcement of additional temporary capital and operational relief measures on 12 March[2], followed by those from the EBA via guidance to avoid triggering non-performing loan (NPL) criteria. These were in turn accompanied by a series of non-targeted "pandemic emergency longer-term refinancing operations" (PELTROs) as from 30 April 2020[3]. By easing these restraints, dealer banks were progressively able to resume their role as liquidity providers in the short-term secondary markets, while banks resumed their bidding in the CP market, also by buying back their own.

Somewhat understated in ESMA's analysis, although nonetheless very important, is the fact that on average EU MMFs entered March 2020 with sufficient liquidity levels, as a result of (i) better information of investor types stemming from the MMFR's "know your customer" provision, as well as (ii) in anticipation of seasonal client redemptions at the end of every quarter[4]. Our Members' experience has also demonstrated instances where funds chose to sell securities for the purpose of further consolidating their WLA balances, thereby warding off any speculation by investors that weekly liquidity levels could potentially approach their regulatory *minima*. Indeed, as we argue in the following responses, these findings do support the option of removing the existing link in the MMFR's provisions between liquidity thresholds and the potential for the boards of public debt CNAV/LVNAV funds to consequently adopt liquidity fees or gates in the interest of investors.

Absent from ESMA's analysis, but of no secondary importance to understand the difficulties confronted by European MMFs last year, is the limited scope of the ECB's PEPP. Announced on 18 March 2020, the PEPP foresaw a sizeable envelope of €750 billion in asset purchases to be conducted at least until the end of 2020. Through the PEPP, the ECB for the first time expanded the scope of eligible securities under its existing Corporate Sector Purchase Programmes (CSPP) to include non-financial CP as a mean to support corporate financing and address dysfunctions in the non-financial CP market. However, the exclusion of financial CP (as the single largest asset class held in non-public debt MMFs), as well as that of instruments denominated in non-Euro currencies, ruled-out a substantial part of USD- and GBP-denominated CP included in European MMF portfolios from the PEPP. Worthy of notice was also that non-bank financial institutions, including investment managers, had been expressly excluded under the PEPP from directly offering assets for purchase as eligible counterparties to the ECB's operations. As a result, MMF managers remained dependent on dealer banks, which in turn did benefit from the series of ECB/EBA support measures described above. Moreover, aided by the ECB's intervention, once corporate issuers (especially non-financial ones) were able to issue again, these

[1] EFAMA has made recommendations to this affect in its November 2020 report *European MMFs in the Covid-19 market turmoil: Evidence, experience and tentative considerations around eventual future reforms*; available at the following hyperlink

[2] These allowed banks to operate temporarily below the level of capital defined by the Pillar 2 Guidance (P2G), their capital conservation buffer (CCB) and their liquidity coverage ratio (LCR). Supporting these measures, banks' countercyclical capital buffers (CCyB) were also relaxed by the national macroprudential authorities. In addition, banks were permitted to waive Common Equity Tier 1 (CET1) capital conditions in view of meeting their Pillar 2 requirements. For further details, please refer to the relevant ECB webpage.

[3] The latter envisaged liquidity support to the Euro area money markets by providing an effective backstop following the expiry of the longer-term refinancing operations (LTROs). Eligible counterparties participating in PELTROs would be able to benefit from the collateral easing measures until the end of September 2021. These included an increase from 2.5% to 10% in the maximum share of unsecured debt instruments issued by any single banking group in a bank's collateral pool, as announced previously already by the ECB Governing Council on 7 April. For further details, please refer to the relevant ECB press release.

[4] For further insights and analysis, please refer to the EFAMA's November 2020 report *European MMFs in the Covid-19 market turmoil: Evidence, experience and tentative considerations around eventual future reforms*; available at the following hyperlink.

returned to invest in European MMFs, as demonstrated by a notable rebound in net inflows during the month of April[5]. Therefore, in terms of exploring the extent to which MMFs in Europe did benefit from central bank support, EFAMA cares to stress the notable differences between the scope of the ECB's PEPP with the bolder actions undertaken by the U.S. Federal Reserve at the same time[6]. One can by no means conclude in this regard that European MMFs were "bailed-out" by central bank intervention.

Concerning the role of liquidity constraints for LVNAVs (see paragraphs 38-45 of the consultation document), we question the purported trade-off between WLA requirements and NAV deviations (currently, the 20 basis-point "collar") in the context of future policy proposals. In the interest of removing the tie between regulatory liquidity requirements (with the prescribed NAV deviations in addition for LVNAV funds) and redemption fees/gates, we do not believe that adjusting WLA requirements, or modifying the permissible deviations between the fund's variable and constant NAV, would serve making LVNAV funds more resilient. Therefore, while retaining the current WAL 30% limit and 20 basis point "collar" for LVNAV funds, we wish to stress the importance of removing the explicit link between the former and the potential imposition of fees or gates.

As to the use of MMF ratings, certain kinds of investor consider it important to rely on an additional "check" on the overall credit quality of an MMF's portfolio. Yet ratings are only one element on which investors base their decisions and were certainly not a driver in the recent liquidity crisis. In fact, we underscore that, unlike in the global financial crisis of 2008-2009, the sizeable outflows from MMFs in March 2020 were not prompted by worries around the credit quality/solvency of the institutions issuing CP or other short-term instruments. As EFAMA and many other observers have noted, the March 2020 events were essentially prompted by an unprecedented public health crisis, leading to numerous government-imposed lock-down measures intended to limit the further propagation of the virus, with numerous economic activities being curtailed or blocked entirely, particularly in Europe. As such measures were announced and began to be implemented by European governments in the latter half of February and early March 2020, MMF investors – particularly in the corporate spaces most affected by the lock-down measures – began to demand cash and had to consequently draw down their holdings in MMFs to deal with the contingencies and uncertainties ahead. We understand that redemptions may have been accelerated in light of the express link between WLA requirements and potential imposition of gates or fees for LVNAV funds.

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?

We agree with ESMA's proposed assessment framework to guide the planned MMFR reforms and consider that the matrix of proposed assessment criteria and the accompanying questions – as listed

[5] These totalled approximately EUR 55 billion in April 2020, following the previous month's net outflows of approximately EUR 46 billion (Source: EFAMA).

[6] Under its Money Market Mutual Fund Liquidity Facility (MMLF), the U.S. Federal Reserve made loans available to eligible financial institutions that had to be secured by high quality assets which the financial institution purchased from MMFs. Although the operation did not qualify as a direct purchase of money market instruments, it did allow banks to pledge these assets as collateral to the Federal Reserve. Most importantly, risk-weighted capital or leverage capital charges for participating banks from their purchases of money market instruments were waived for the duration of the programme, i.e. until 30 September 2020. Such waivers of the regulatory constraints on bank dealers' intermediation capacities, accompanied by the relaxation of capital standards for banks participating in the MMLF, were the decisive factors that contributed to stabilise short-term markets, while offering substantial (though indirect) relief to MMFs. It should also be noted that the U.S. measures, including the MMLF, were not eligible to USD-denominated MMFs domiciled in the EU.

in the table under paragraph 80 of the consultation document - to score the various policy options are valid.

The questions linking the scoring of individual policy options to their likely effect on investor behaviour – as in paragraph 77 - are also pertinent given how these have behaved in the first part of 2020. Yet, clear policy conclusions would be obfuscated by a general lack of reliable or more granular data around the identity of such investors and their behaviour. As ESMA knows, an MMF's investor base includes a wide range of different market participants, including non-financial corporates, charities and foundations (non-profits), general government and related agencies, monetary financial institutions (MFIs), pension funds and insurance companies, investment funds, other financial institutions (OFIs) and private households, *inter alia*. Although the MMFR's "know your customer" requirement have helped substantially in aiding MMF managers to depict a more accurate picture of a fund's liability side and thus better anticipate investors' regular (quarter-end) redemption demands – as also demonstrated by managers' active cash provisioning before March 2020 – further breakdowns of the above broad categories remain difficult.

Given the very high degree of heterogeneity in a fund's liability composition, as for instance within the range of a fund's "corporate clients", parsing through each company's incentive to redeem remains prohibitive, especially given the unforeseen nature of exogenous shocks like the Covid-19 pandemic which has affected corporate clients very unevenly. Our Members' experience has confirmed that among their corporate clients, those most active in the travel and leisure industries naturally faced more severe cash needs, as did those active in areas like catering, compared to corporates in other sectors where some actually increased their MMF allocations (e.g. insurers). In hindsight, a more minute "bucketing" of MMF investors based on their liquidity preferences (apart from seasonal ones) could not have anticipated the sorts of withdrawals experienced from corporates in given industries in advance of the March 2020 turmoil. Similarly, even more frequent reporting requirements to supervisors (e.g. monthly) could not have anticipated most outflows because of the suddenness and unevenness of the shock. We therefore consider that disclosures requiring MMF managers to report on a more frequent basis than that of Article 37 of the MMFR to supervisors (and later to ESMA) would be ineffective.

Another important consideration is that neither MMF managers, nor supervisors, will know whether MMF clients also have alternative options to manage their emergency liquidity needs. Besides deposits and revolving credit lines available from their commercial banks, corporates may for instance also hold securities directly and rely on selling these to meet their cash needs. The prospect of a more granular client profiling, or "bucketing", implied under some options of the consultation document would thus not be sufficiently reliable, even if MMF managers were made aware of each client's cash or near cash alternatives to their investment in a given MMF. Among such alternatives, we note that at the height of the March 2020 market correction, investors in USD-denominated LVNAV funds chose to divest their holdings (albeit temporarily) in favour of USD-denominated public debt CNAV funds instead, mirroring a similar, yet far greater, shift in the U.S. from institutional prime MMFs into government ones[7].

Please refer to our answer to question 5 below for further details.

[7] Evidence suggests that over the first two weeks of March, net outflows across USD-denominated LVNAV funds reached some 29% of total AuM, with about 60% of these outflows finding their way into USD-denominated public debt CNAV funds.

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.

EFAMA supports the removal of the link for LVNAV and public debt CNAV between funds reaching their regulatory liquidity thresholds (WLA in particular) and the potential for fees on redemptions or gates following a fund board decision. Although under the MMFR redemption fees and gates are by no means automatic following a fund's board decision to convene, we concur with ESMA's analysis that investors have perceived thinning WLA buffers as an increased probability for a board to convene and consequently opt to impose fees or gates on redeeming investors. Although the MMFR provision of Article 34 has attempted to "break" the link between the two above elements via a "two-part" test – i.e. combining a breach of the 30% WLA ratio with a single net daily redemption in excess of 10% - and offering boards discretion on how to act in the interests of investors, we believe fund boards should ultimately be offered discretion over when to authorise fees or gates. We therefore favour the first option presented in the consultation document under paragraph 86.

Regarding LVNAV and public debt CNAV structures, insofar as the conditions for the potential imposition of gates are concerned, we believe the ultimate decision should rest with the fund's board, accompanied by a notification to the relevant national competent authority. Such consideration stems from the fund board's own responsibility to manage an MMF in the best interest of its investors. Prior to the decision to activate redemption gates, however, LVNAV and public debt CNAV fund boards may naturally consider milder forms of intervention according to the seriousness of investor redemptions at any given time.

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.

Given the nature of MMFs, we consider that liquidity management tools such as liquidity fees and comparable anti-dilution levies (ADLs) are usually not warranted and their activation should be a rare event. Yet, options should be available for managers to consider and activate. These tools should naturally accompany the removal of the existing clear link under the MMFR between breaching WLA thresholds and the consideration of redemption fees or gates by fund boards in the case of LVNAV and public debt CNAV funds. Moreover, by transferring the cost of liquidity onto the redeeming investors, such tools should be regarded for treating all investors equally and fairly, discouraging the so-called "first-mover advantage", all while offering funds a more gradual option compared to "last resort" means as gates.

However, it is important to note that in the presence of a significant freeze in secondary market trading activities - as experienced in the course of March 2020 – such tools will in any case not be effective. Rather, they can be activated when liquidity conditions are less extreme and where MMF managers can still rely on dealer banks and other buyers of short-term instruments to purchase holdings from their funds. Therefore, for milder episodes of money market stress, in concomitance with rising costs for the fund to trade the underlying securities, such suite of tools should be available to MMF managers,

so as to discourage redeeming investors from withdrawing their funds in the interest of those choosing to remain invested. Concurring with their advantages cited under paragraph 100 of the consultation document, we also do not object to some of the drawbacks of these tools, as presented in the following paragraphs 101-105. Naturally, their potential use should be considered in light of investors' profiles and in the latter's best interests.

More specifically, in relation to the open question under paragraph 101 (iii) of the consultation paper on swing pricing, we note that although the latter has proved itself as a useful tool for other (non-MMF) funds, it is not compatible with MMFs, as it mainly detracts from the opportunity to offer intra-day settlement which investors greatly value. Rather, in extraordinary circumstances, ADLs/liquidity fees (applied either as an entry or exit fee) can be used to a similar effect, albeit with at least two key advantages: (i) their activation is rules-based and operationally easier to implement, especially where the fee is fixed and is not affected by pricing anomalies as a result of rapidly deteriorating market conditions; and (ii), they do not affect the viability of constant price MMFs. We therefore believe that ADLs/liquidity fees should be largely preferred.

As to their activation and for the reasons expressed above, EFAMA concurs with ESMA in that (…) *the decision to use such liquidity mechanisms shall, in general, remain the responsibility of the manager of the MMF* (see paragraph 104 of the consultation document).

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? i) 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.

EFAMA is resolutely opposed to the requalification of the existing liquidity buffers for all types of MMFs, whether LVNAV, public debt CNAV or VNAV. From our Members' experience, events as those of March 2020 brought significant impairments to underlying money market liquidity, enough to make the effectiveness of all three options envisaged in the ESMA consultation document debatable. Additional liquidity buffers, in particular, are neither appropriate, nor effective, in countering the scarcity or absence of liquidity in the underlying short-term money markets. Our additional considerations are as follows:

First, we do not believe that a reconsideration of the existing MMFR liquidity thresholds, and more broadly of the portfolio rules under Articles 24 and 25 of the MMFR, is justified. In EFAMA's November 2020 study on the experience of European MMFs in the Covid-19 market turmoil, we document how well liquidity levels have been managed[8]. We therefore fundamentally question the need to review such requirements in the absence of any recorded breach, let alone any more significant market failure. While recognising that options implying additional liquidity requirements and/or capital buffers for MMFs are presently being considered by the IOSCO/FSB, we do not believe these should be further considered in the context of the MMFR review, in light of the robust and recently tested safeguards the Regulation already has in place. We also care to stress that the swift reversal of outflows and rebound for all short-term MMF categories in the course of April 2020 has convincingly demonstrated that there are no structural failures in European MMFs enough to justify such far-reaching changes to the existing

[8] Please refer to Section IV. (pages 15-17) of EFAMA's November 2020 report *European MMFs in the Covid-19 market turmoil: Evidence, experience and tentative considerations around eventual future reforms*; available at the following hyperlink.

rules[9].

We are also wary of any legislative proposal affecting the composition of the existing liquidity buffers in a way that could encourage MMFs to invest more prominently in European government securities. In the absence of a sufficiently deep and uniform debt market in Europe (unlike in the United States for federal debt denominated in one single currency), the outcome is likely to be a demand squeeze for a limited pool of the most highly-rated and liquid government securities (e.g. German Bunds, French BTFs, etc.).

Second, assuming that the current WLA levels were to be adjusted/increased, as implied under options 2 and 3 in the consultation document, the additional buffers would serve no purpose under extremely stressed market conditions, when the primary issuance of new instruments and secondary market dealing are either strongly impaired, or absent altogether. Moreover, investors are expected to be confronted with lower returns from funds holding excessive percentages of WLA, as part of an inevitable “performance drag”, were larger-than-necessary liquidity buffers to be introduced as part of the MMFR review. This would be true particularly for EUR-denominated MMFs, where returns on investable instruments remain low.

In relation to option 3, aimed at making liquidity buffers more “risk sensitive and flexible”, we would argue that this is already the case, as proven in the run-up to the March 2020 events and helped by the MMFR’s “know your customer” provision (Article 27) that enabled managers to anticipate redemptions and improve the calculation of their portfolios’ historical volatilities. A proposal to transform this into a regulatory requirement would in our view not be viable, as (i) the requirements for its calibration risk being “set in stone”, making their adjustment in a timely manner to reflect market contingencies difficult, where not impossible; (ii) a “one-size-fit-all” calibration may not be easily adaptable to fit specific client types and their related cash needs, known only to the manager; (iii) the buffer’s calibration will most likely not account for one-off, extreme events (as the Covid-19 pandemic) and consequent surge in net outflows; and (iv) it would blur the distinction between market-based vs. bank financing in the eyes of investors, supervisors and the general public. Moreover, if the proposal to decouple regulatory thresholds from fees or gates is adopted, particularly in relation to the 30% WLA requirement, then this could already be used counter-cyclically by fund boards.

Third, we strongly question the possible involvement of a fund’s supervisor or of ESMA/ESRB to play a coordination role in calibrating and administering the additional countercyclical buffer, as per option 2. We are also not convinced national supervisors would be comfortable and willing to assume such responsibility. For the reasons explained above, MMF managers must abide by their regulatory obligations to act in the best interest of a fund’s investors and are better placed to understand the composition of the fund’s liability side, as well as the prevailing money market conditions at any one point in time.

[9] Net assets of European MMFs dropped by only 4% in March, to recover again in the space of few weeks and reach EUR 1.44 trillion at the end of June, compared to EUR 1.32 trillion at the end of March and EUR 1.38 trillion at the end of 2019. Judging from the size of the total net outflows experienced in March and their consequent rebound in the second quarter of 2020, one concludes that MMF flows did not have the seismic effect some commentators have suggested.

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.

The question on whether public debt CNAV and LVNAV funds should continue to be offered is in EFAMA's view unwarranted. First and foremost, we do not believe this proposal would be a solution, nor is it warranted when assessing the experience of the sector during the recent market volatility. As noted, liquidity stresses in March 2020 affected all MMF types in Europe, as well as institutional Prime Funds in the U.S. As long as certain types of investors express a preference for stable NAV funds, for instance because these are more aligned with their internal investment procedures or because they prove practical for accounting purposes, intra-day settlement and trade execution, the offer of such funds should continue.

Secondly, the option to potentially remove public debt CNAV and LVNAV funds should also be assessed in light of investor flows. As also documented in EFAMA's aforementioned November 2020 study and confirmed by ESMA in its TRV Report of March 2021[10], the market turmoil in early 2020 led to a surge in public debt CNAV inflows, leading us to question why such funds would deserve to be phased-out. On their part, LVNAVs, while not breaching their 20 basis point "collar", did experience outflows, as did VNAV funds nonetheless. We therefore do not believe that a clear case exists in favour of removing such structures.

A third important consideration to justify their continuation has to do with investors' preference to continue investing in private credit. As demonstrated by the U.S. experience following the 2014 SEC reforms to money market regulations, assets invested in Prime and tax-exempt MMFs contracted substantially in the years leading up to the implementation of these reforms, to the advantage of government MMFs. By March 2020, the latter had reach a total of approximately USD 3.6 trillion of invested assets relative to Prime MMFs which totalled roughly USD 1.1 trillion[11]. The potential removal of LVNAV funds would leave investors no alternative but to invest in USD-denominated public debt CNAV as the only sufficiently liquid and sizeable market, albeit at substantially lower yields. Scalable alternatives in Europe, as public debt CNAV funds denominated in Euros or in Pounds/Sterling, at present or over the near- medium-term do not exist.

With far fewer alternatives to public debt CNAV and LVNAV funds, investors would increase their reliance on the banking sector, offering deposits and other types of committed liquidity facilities. Inevitably, an important source of market financing will be lost and reliance on the traditional bank intermediation will increase at the expense of the EU's prospects for a Capital Markets Union.

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.

The MMFR has introduced an explicit prohibition of "external support" that is intended to guarantee the liquidity of the MMF, or sustain its NAV. This has introduced an important difference between the regulatory reforms introduced in the EU relative to those introduced in the U.S. following the 2008

[10] See ESMA's Report on Risks Trends and Vulnerabilities (TRV) No. 1, 2021, published in 17 March 2021 and available at the following hyperlink.

[11] For further details, please refer to the Report of the President's Working Group on Financial Markets – Overview of Recent Events and Potential Reform Options for Money Market Funds, in particular pages 8-11, as published in December 2020 and available at the following hyperlink.

global financial crisis. However, we do not believe the existing ban on external support should be further clarified in the Level 1 text, nor amended. Contrary to the argument introduced by certain stakeholders under paragraph 139 of the consultation document, we do not believe that ESMA's July 2020 public statement[12] aims to challenge the Level 1 requirement of Article 35, but was aimed purely at clarifying the scope of such provision.

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.

Please refer to our preliminary considerations expressed in our answer to Q1 above.

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.

EFAMA would question the need to amend the stress-test requirements under Article 28. As ESMA also confirms in paragraph 157 of the consultation document, there has until now been no case of managers reporting the results of their stress tests to their NCA and indirectly to ESMA (presumably because no vulnerabilities have been detected). Lastly, we do not believe that amending the present stress-testing requirements would offer solutions in circumstances where there is a the general lack of secondary market liquidity as experienced in March 2020.

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

As per our answer to Q2, we do not believe that more frequent reporting requirements to NCAs and ESMA could have either averted or mitigated the stresses experienced by MMFs in early 2020.

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

Regarding the disclosure requirements under Article 37 of the MMFR, we believe that the information provided on a quarterly (or annual, if assets under management do not exceed EUR 100 million) basis

[12] Please refer to the ESMA public statement on external support under Article 35 of the Money Market Funds (MMF) Regulation, as published on 9 July 2020; available at the following hyperlink.

to NCAs (and further to ESMA after 30 days) is sufficient for supervisors to obtain a fairly accurate profile of an MMF's asset and liability composition under normal times. As mentioned in our response to Q2 and also echoed by ESMA under paragraph 167 of the consultation document, even an exhaustively detailed profiling of client types will only yield a partial analysis in terms of their behaviour, as clients may investment in money-market instruments directly, or rely on standing credit facilities as a matter of preference, when looking to raise cash immediately. More frequent reporting, although possible, will therefore not be fully reliable and is likely to fall short of supervisory expectations (including those favouring the constitution of an counter-cyclical capital buffer).

Moreover, from the experience of EFAMA's Members during their discussions with their national supervisors in the midst of the March 2020 events, it is often noted how access to more frequent (i.e. daily and weekly) market data alone would not be sufficient for supervisors to form an accurate and well-informed view of the contingent situations affecting MMFs. In fact, it was only through parallel and timely discussions with management companies that supervisory authorities were able to develop a better understanding of how MMFs and underlying money market conditions were at the time evolving. We therefore do not believe that a requirement to ensure the regular reporting of more frequent information to supervisors would substantially improve supervisors' readiness to anticipate liquidity stresses.

Lastly, besides increasing the frequency of existing reporting requirements (e.g. under volatile market conditions), it remains unclear which additional disclosure requirements ESMA would be considering for the purpose of reviewing Article 37.

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

We note that the option of introducing a Liquidity Exchange Facility (LEF) mirrors a parallel proposal in the U.S., as raised during past efforts at regulatory reform of MMFs. The December 2020 publication of the Report of the President's Working Group on Financial Markets, offers insights into how the facility – dubbed "Liquidity Exchange Bank" – would work. ESMA's proposed LEF structure bears many analogies to the U.S. structure, presently under the consideration of the U.S. SEC.

Cognisant of the similarities, but also of the key differences with the U.S. MMF market, EFAMA resolutely opposes the creation of such facility for the reasons previously highlighted:

- As it will need to be substantially pre-funded to a sufficient degree enough to offer a liquidity backstop under critical market circumstances, including *inter alia* through a charge levied periodically off investors' invested amounts, the LEF will inevitably increase costs for the latter;

- Where the structure is established as a banking entity with its own prudential capital requirements, we again concur with ESMA that the structure may give rise to "moral hazard", thereby blurring the crucial distinction between markets-based financing and traditional banking activities in the eyes of investors, as well as of policy-makers. Moreover, it is not clear how commercially viable such structure would be if constituted with the sole purpose of buying

assets from MMFs at times of financial difficulties; and

- We are in principle against forms of external support, especially if the facility were to discriminate between different types of MMF. In this regard, we expect that the LEF will most likely benefit those MMFs that can rely on their intra-group bank sponsor to offer initial capital of the LEF, at the expense of fully independent asset managers.

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

We do not believe that further clarifications are warranted.

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About EFAMA

EFAMA, the voice of the European investment management industry, represents 28 member associations, 58 corporate members and 24 associate members. At end Q1 2021, total net assets of European investment funds reached EUR 19.6 trillion. These assets were managed by more than 34,600 UCITS (Undertakings for Collective Investments in Transferable Securities) and almost 29,600 AIFs (Alternative Investment Funds). At the end of 2020, assets managed by European asset managers as investment funds and discretionary mandates amounted to an estimated EUR 27 trillion.

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