EFAMA

European Fund and Asset Management Association

CONSULTATION RESPONSE

Brussels, 13 May 2022

EFAMA REPLY TO EC TARGETED CONSULTATION ON THE FUNCTIONING OF THE MONEY MARKET FUND REGULATION

To the European Commission – DG FISMA's attention:

EFAMA welcomes and is grateful for the opportunity to submit its comments on the future review of the MMFR framework. As the European trade association representing asset managers in Europe, and after having consulted several of our Members for the purpose of preparing the following response, we believe the "questionnaire" format chosen by the services of DG FISMA for the purpose of reviewing key pieces of EU legislation – as the MMFR - is not appropriate. Our reasons are the following:

- Questions at the top of the multiple-choice grid are generic and may therefore be interpreted in very different ways. Respondents are "forced" into a box-ticking exercise that may not necessarily reflect their intent to respond according to a 1 to 5 range answer (from "least effective" to "most effective");

- While recognising that the "grid style" questions may expedite the elaboration of stakeholder responses by the Commission's services for the purpose of compiling summaries of the feedback received, we remain concerned that a mere "box-ticking exercise" (especially if processed electronically) will generate false outcomes which risk at least blurring, where not distorting, the views expressed; and

- Lastly, we regret the limitations in terms of character-count in the several response "boxes" of the questionnaire. As the Commission's services will appreciate, a consultation is a unique opportunity for stakeholders to offer evidence and their in-depth views on ways EU legislation should be proposed or amended. Limiting such opportunities through word or character limitations is in our view against the principles of the EU's Better Regulation Guidelines.

Our views in this respect reflect those of several of our Members which have also struggled to convey their views due to the evident limitations of the multiple-choice questionnaire format. For this reason, we attach a longer response document (in pdf) to the many questions raised by the services of DG FISMA around the review of the MMFR.

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1. Questions addressed to all

Question 1. In your view, what is the impact of the MMFR on the MMF industry in the EU?

a) Effectiveness: Has the Regulation been overall effective in delivering on its objective in terms of

	1 (least effective)	2 (rather not effective)	3 (neutral)	4 (rather effective)	5 (most effective)	Don't know - No opinion – Not applicable
Ensuring the liquidity of the fund is adequate to face redemption requests	☐	☐	☐	☐	☒	☐
Preventing risk of contagion	☐	☐	☐	☐	☒	☐
Enhancing the financial stability of the internal market	☐	☐	☐	☐	☒	☐
Increasing MMF investor protection	☐	☐	☐	☐	☒	☐
Reducing first mover advantage incentives in times of stress	☐	☐	☐	☐	☒	☐
Transparency	☐	☐	☐	☐	☒	☐
Supervision	☐	☐	☐	☐	☒	☐
Other aspects	☐	☐	☐	☐	☐	☒

Please explain your answer to question 1 a), providing quantitative information to the extent possible:

EFAMA notes that the effectiveness of the MMFR regime has been decisively proven by the March 2020 market events as the MMFR's first true "test". More specifically, we observe the following:

i. The regime's liquidity thresholds were tested, yet not breached, with managers of European MMFs – irrespective of their type (VNAV, LVNAV or public debt CNAV) and of their base currency denominations – continuing to operate by effectively meeting all redemptions. This occurred throughout the initial months of the pandemic and despite the adverse liquidity conditions in the underlying money markets. Such conclusions have been amply demonstrated in EFAMA's November 2020 report on *European MMFs in the Covid-19 market turmoil* and confirmed by ESMA[1]'s and the ESRB[2]'s own analysis;

ii. There were no recorded instances of public debt CNAV or LVNAV funds having to activate fees, gates or suspensions. For LVNAV funds, none were forced to temporarily convert to variable pricing for their units upon breaching the bounds of their 20 basis point "collar";

iii. MMFs continued to provide a high-quality, well-diversified and liquid investment option at a time when markets underwent considerable stress, while offering both investors and regulators complete transparency around funds' portfolio holdings and liquidity levels; and

iv. "External support", defined under Article 35 of the MMFR as "direct or indirect support offered to an MMF by a third party, including a sponsor of the MMF" (intended to guarantee its liquidity or to stabilise its NAV per unit/share) did not occur as a result of the MMFR's clear ban of this practice.

Based on these facts, one may safely conclude that the MMFR's design and implementation have been robust, allowing the European MMF industry to successfully withstand the March 2020 pandemic-induced market shock.

What factors have reduced the effectiveness / rendered the framework less effective than anticipated? Which rules have proven less effective than anticipated?

As we elaborate further below, to further increase the effectiveness of the MMFR regime in the face of exceptional market conditions, the Commission should reconsider the clear link under Article 34 of the Regulation between the breaching of mandatory liquidity requirements and the potential activation of LMTs (in the form of fees, gates or suspensions) by the Boards of public debt CNAV and LVNAV funds. In line with international and European (ESMA and ESRB) reform proposals, we believe that the resilience of these funds could be further helped by removing such relationship altogether, thereby granting Boards full discretion as to when LMTs should be activated in the interest of unitholders. Considering the potential review of the MMFR, it is also important that analogous regulatory "triggers" are not introduced, neither deliberately nor unintendedly. As we note further below, some of ESMA's proposals, as per its February 2022 *Opinion*, could lead in this direction.

[1] See for instance Charts 13-16 depicting the dynamics of daily and weekly liquidity requirements for VNAV and LVNAV funds under Annex IV of ESMA's Final Report (pages 97-98), published on 14 February 2022.
[2] See for instance Chart 6 a) showing declines of LVNAV weekly liquid assets (WLA) at the end of March 2020 in the ESRB's Issues Note on systemic vulnerabilities of and preliminary policy considerations to reform money market funds (MMFs) - Systemic vulnerabilities of MMFs (page 22), as published in July 2021.

b) Efficiency: Has the framework been cost efficient?

☐ 1. Least efficient

☒ 2. Rather not efficient

☐ 3. Neutral

☐ 4. Rather efficient

☐ 5. Most efficient

☐ 6. Don’t know / no opinion / not applicable

Please explain your answer to question 1 b), providing quantitative information to the extent possible:

In terms of cost efficiency, the MMFR has undoubtedly “raised the bar” in terms of regulatory expectations for management companies offering MMFs as a part of their product suites. As a result, EFAMA noted in its October 2020 *Market Insights* study that the stringent regulatory requirements introduced by the MMFR – effective as from 21 July 2018 - resulted in a 16% decline in the number of UCITS MMFs in the first quarter of 2019, as a number of asset managers chose to close down their MMFs. This concerned particularly small MMFs where extra costs of complying with the MMFR were considered to be too high. Despite the substantial decline in the number of MMFs, the total net assets of European MMFs declined by less than 1% in Q1 2019, reflecting the value placed in MMFs by European investors[3].

In terms of cost efficiency, the Commission should also be mindful of costs to users of MMF products, especially where some – as LVNAV funds – are targeted under the MMFR review. To counter the proposal that these should be phased-out, there is evidence that investors in such funds have since the entry into application of the MMFR undertaken significant investments and efforts to familiarise themselves with the new LVNAV product by, for instance, updating and renewing their investment guidelines, their risk management frameworks, their oversight and governance controls, etc. These changes have been possible also with the considerable help of third-party service providers (e.g. accountants, auditors, lawyers, etc.) to advise on the initial regime stemming from the MMFR. Absent fundamental flaws in the LVNAV construct, as witnessed during the March 2020 events, any justification for the removal of such structures will need to also account for significant sunken costs to investors.

In sum, while the MMFR has from an operational perspective been less cost efficient compared to the *status quo ante*, our conclusion is that its advantages, particularly in terms of the regime’s comprehensiveness, rule harmonisation, and diversity for investor choice, have outweighed some if its drawbacks. The latter would notably include higher operating costs (e.g. from extensive - and at times duplicative - reporting requirements, internal assessments of issuer creditworthiness, burdensome yearly adjustments to ESMA’s stress-testing methodologies, etc.) and industry concentration (as evidenced further above). Regarding reporting requirements in particular, EFAMA would note that their related costs remain elevated even for large players, leaving smaller ones to often confront prohibitive offers for reporting services from external providers.

[3] Please refer to the EFAMA *Market Insights* (Issue #2) study, published in October 2020 and available at the following hyperlink.

Should enforcement of the rules and supervision be strengthened?

In the absence of an MMF-specific market failure and besides individual enforcement cases that NCAs may wish to pursue individually, we believe there is no convincing case that would call for the current degree of supervision across EU jurisdictions to be strengthened.

Since the March 2020 Covid-induced market events, certain global (FSB) and European (ESRB) reform proposals have attempted to characterise the interventions of central banks as a *de facto* "bail-in" of the MMF industry, justifying a host of reform proposals that are particularly ill-suited if applied to MMFs. Among these, *inter alia*, are those aimed at complementing the existing fund-level stress-tests with "macroprudential" ones, as well as proposals which have considered assigning the activation of LMTs to ESMA, or even to a macroprudential supervisor.

We question such proposals, as they would ultimately blur the responsibilities of the Board/management company to manage liquidity in the best interest of investors, with repercussions on the ultimate choice of the most appropriate LMTs in light of rapidly evolving market events emanating from a shock (whatever its nature may be). While we do recognise that the activation of certain LMTs may require some degree of consultation and coordination with their respective NCAs, this should not detract from the fact that liquidity management continues to primarily fall under the responsibility of the Board/management company of the MMF.

Moreover, in relation to the further development of macro stress-testing tools, we believe these would not serve a purpose given the high degree of heterogeneity in an MMF's liability composition. For instance, even within the range of a fund's corporate clients, parsing through each company's incentive to redeem *ex ante* would prove prohibitive, especially considering the unforeseen nature of exogenous shocks like the Covid-19 pandemic which has affected corporate clients very unevenly. Our Members' experience has in fact 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 were actually able to increase their MMF allocations (e.g. insurers). In addition, the exhaustively detailed profiling of client types will only yield a partial analysis in terms of their behaviour, as clients may choose to rely on alternatives, as for instance invest in money-market instruments directly, or rely on standing credit facilities as a matter of preference, when looking to raise cash immediately. In hindsight, even a more minute "bucketing" of MMF investors based on their liquidity preferences (apart from seasonal ones) could not have therefore predicted the sorts of withdrawals experienced from corporates in the most affected industries in advance of the March 2020 turmoil.

These reasons therefore lead us to strongly doubt the degree of predictability for any macro, or sector-wide stress-test, even assuming that the evident supervisory data gaps can be filled beforehand. Important is to also consider that significant market events like those of March 2020, or of the previous 2008 global financial crisis, can not only have different origins, but also develop in ways previously unimagined. This beckons the need for market participants and supervisors alike to guard some degree of flexibility when confronting unprecedented market contingencies.

c) Relevance: Is the framework overall relevant (in terms of evolving objectives and needs, has the market significantly evolved compared to when the MMFR was designed?)?

☐ 1. Least relevant

☐ 2. Rather not relevant

☐ 3. Neutral

☐ 4. Rather relevant

☒ 5. Most relevant

☐ Don’t know / no opinion / not applicable

Please explain your answer to question 1 c), providing quantitative information to the extent possible:

To remain “relevant" the MMFR framework must necessarily adapt to market evolutions. While maintaining that investors have shown strong demand for all three types of MMF structure (VNAV, LVNAV and public debt CNAV) since the original application of the MMFR, any revision to the regime must ensure that MMF rules generally remain adaptable to future market environments, as characterised by more or less predictable elements. Among these, the direction of interest rate policies by leading central banks based on their outlook for inflation and growth will be paramount to define a visibly new economic backdrop for the years ahead (as central banks gradually begin reversing their previous quantitative easing, albeit with their own respective timelines). A too prescriptive regime, we believe, may therefore prove too rigid for managers to adjust to cyclical market conditions.

How relevant is it, or what needs to change, in light of market developments?

Removal of “threshold effects”

EFAMA believes that the regulatory requirement tying the breach of daily and weekly liquidity requirements with the hypothetical activation of liquidity fees, gates and/or of suspensions for public debt CNAV or LVNAV funds by their respective Boards – as per Article 34 of the MMFR – deserves to be removed. In practice, evidence from the recent March 2020 events has demonstrated that the link between liquidity requirements and the potential activation of liquidity management tools (LMTs) can act as a procyclical signaling mechanism in the eyes of investors and of the broader market. Indeed, redemptions for LVNAV MMFs may have been exacerbated when investors perceived that public weekly liquidity levels were approaching the 30% limit. They consequently may have increased redemptions pressure on these funds while looking to pre-empt other investors and avoid what may have then been perceived as a forthcoming activation of LMTs by the funds’ Boards. In line with ESMA’s February 2022 *Opinion* on the review of the MMFR, as well as with other global reform initiatives, EFAMA supports the removal of the explicit link between regulatory thresholds and the potential imposition of fees, gates or temporary suspensions through the deletion of Article 34 of the MMFR.

In light of the recent market experience, the EU co-legislator should carefully ponder the introduction of new requirements likely to generate “new" threshold effects. In this regard, we would caution against the adoption of a delegated act defining “critical market circumstances” (in line with ESMA’s February 2022 *Opinion*), especially where its corresponding announcement may in investors’ eyes lead managers to relax the MMFR’s liquidity constraints. We elaborate more on this further below.

d) Coherence

	1 (least coherent)	2 (rather not coherent)	3 (neutral)	4 (rather coherent)	5 (most coherent)	Don't know - No opinion – Not applicable
Is the legislative framework coherent with other related frameworks, at EU level?	☐	☐	☐	☐	☒	☐
Are existing EU provisions coherent with each other?	☐	☐	☐	☐	☐	☒

Please explain your answers to question 1 d), providing quantitative information to the extent possible:

The review of the MMFR will necessarily have to consider the extent to which natural counterparties of MMFs, as dealer banks, proved to be constrained at the height of the March 2020 market correction in terms of their own balance sheet usage, stemming in turn from Basel III capital requirements and related liquidity ratios. Such constraints have *de facto* made liquidity conditions worse in the underlying money markets by making dealer intermediation prohibitive, as demonstrated by the markets' reaction to the Covid-19 lock-down measures, combined with banking authorities' own temporary measures[4].

e) EU value-added: Has intervention at EU level been justified, and does it continue to be justified?

☐ 1. Least successful

☐ 2. Rather not successful

☐ 3. Neutral

☒ 4. Rather successful

☐ 5. Most successful

☐ Don't know / no opinion / not applicable

[4] For further details, please refer to EFAMA November 2020 Report on *European MMFs in the Covid-19 market turmoil*, commenting on the effects of the temporary relaxation of supervisory requirements for dealers (pages 19-20 thereof).

Please explain your answer to question 1 e), providing quantitative information to the extent possible:

The introduction of an EU-wide regulatory regime for MMFs post-Global Financial Crisis has undoubtedly had merits and these were demonstrated by the resilience of the European MMF industry in the course of the March 2020 market correction. EU intervention continues to be justified in view of further refining the existing framework via targeted changes. Among these, and in line with our earlier responses, EFAMA believes there is indeed a need to decouple regulatory liquidity requirements from the potential activation of liquidity management tools for public debt CNAV and LVNAV funds.

What has been the value-added compared to national frameworks?

An EU-wide regime for MMFs has offered managers and investors clarity and consistency in the designation of the product offer, as well as through the standardisation of key requirements; i.e. authorisation requirements, investment policy rules (e.g. asset eligibility requirements, diversification, etc.), risk management, operational (e.g. common valuation rules) and transparency requirements to name only the most important. The MMFR has thus succeeded in creating a truly harmonised framework across EU jurisdictions for a critical investment product, as well as for an important source of market financing (especially for credit institutions). In this regard, it has also substantially furthered the integration of the EU's capital markets in line with the Commission's CMU ambitions.

Question 2. a) To what extent has MMFR made MMFs more resilient during March 2020 and compared to 2007 (i.e. considering equivalents to MMFs at that time)?

☐ 1. Least successful

☐ 2. Rather not successful

☐ 3. Neutral

☐ 4. Rather successful

☒ 5. Most successful

☐ Don't know / no opinion / not applicable

Please explain your answers to question 2 a), in case you have the experience / information to make such a comparison:

By introducing a dedicated regulatory regime for MMFs, the MMFR has undoubtedly made these more resilient by introducing a common "money market fund" designation, as well as the standardisation of the various product rules. Prior to the MMFR, and besides the minimum harmonisation requirements through the national implementation of the UCITS Directive in the late 1980s, the regulation, supervision and enforcement of MMFs adhered to national requirements, or alternatively to industry codes of conduct. Consequently, products with varying regulatory approaches in their structure and risk characteristics could be sold cross-border under the same "MMF" rubric, despite the potential for regulatory arbitrage. As a result of events that characterised the Global Financial Crisis of 2007-2008, ESMA's predecessor CESR (Committee of European Securities Regulators) sought to develop Guidelines for a common definition of European MMFs. These Guidelines were finalised in May 2010 and came into effect in 2011, thus pre-dating the Commission's initial MMFR proposal of September 2013.

The following are in our view non-exhaustive examples of how the MMFR has improved the resilience of the European MMF industry:

- Stringent asset eligibility requirements and portfolio rules;
- Valuation rules, as well as rules for an internal credit quality assessment;
- A comprehensive reporting regime to national competent authorities;
- An explicit ban on "external support" to avoid that credit institutions be tempted to support affiliated MMFs through direct transfers, viewed as a potential source of financial contagion; and
- A harmonised stress-testing framework, complemented by ESMA's own annually updated Guidelines establishing common reference parameters for MMFs' stress-test scenarios.

Question 2. b) Through which channels has MMFR made MMFs more resilient during March 2020 and compared to 2007?

	1 (least successful)	2 (rather not successful)	3 (neutral)	4 (rather successful)	5 (most successful)	Don't know - No opinion – Not applicable
MMFR rules on credit risk	☐	☐	☐	☐	☒	☐
MMFs asset composition	☐	☐	☐	☐	☒	☐
Definition of liquidity	☐	☐	☐	☐	☒	☐
Other	☐	☐	☐	☐	☒	☐

Please specify to what other channel(s) you refer in your answer to question 2 b):

Please consider our responses above.

Please explain your answers to question 2 b), in case you have the experience /information to make such a comparison:

Please consider our responses above.

Question 3. If LVNAV were not available anymore, what impacts would you expect on you, and other relevant stakeholders? Please explain:

The survival of LVNAV MMFs is crucial for the preservation of investors' choice and of diversity in the European MMF landscape. Since the entry into effect of the MMFR regime, LVNAV MMFs across all three available currency denominations of Euro, U.S. Dollar and Pound/Sterling have amassed a total of EUR 705 billion, accounting for 46% of the total AuM managed by European MMFs (EUR 1,5 trillion) at the end of 2021[5]. Given their significant market share, EFAMA has resolutely argued against recent ESMA and ESRB proposals considering the removal of the LVNAV structure altogether.

While welcoming the Commission's review of the structure as per the explicit requirement in the MMFR review clause, we believe that the simple removal of LVNAV would have significant negative consequences:

i. Firstly, it promises to impact a considerably large investor base that wishes to preserve the structure's stable NAV feature, especially if this is more aligned with internal investment procedures, facilitates intra-day trading and settlement at par, and renders trade execution more convenient from an accounting and tax perspective for funds based in certain jurisdictions. The same considerations hold true for public debt CNAV funds, given their stable NAV feature;

ii. Investors wish 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 totaled roughly USD 1,1 trillion[6]. The potential removal of LVNAV funds in Europe 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 to the U.S. Treasury market do not exist at present, nor in the foreseeable future, implying that the market share of Euro- or Pound/Sterling denominated public debt CNAV funds is not expected to grow substantially;

iii. Absent a valid alternative in public debt CNAVs, investors will inevitably be left with the imposed choice of relying on lower-yielding bank deposits, or on other committed credit facilities offered by traditional banks, as venues to store their cash or meet their short-term funding needs. Where investors value MMFs as a short-term investment and cash management tool, an important source of investment diversification would be lost, further increasing investors' dependence on forms of traditional bank intermediation, with the consequent concentration of credit risk. Such an outcome would be at the expense of the EU's ambitions behind the Capital Markets Union project, aiming to diversify investment and funding channels away from credit institutions; and

[5] Source: IMMFA & EFAMA

[6] 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.

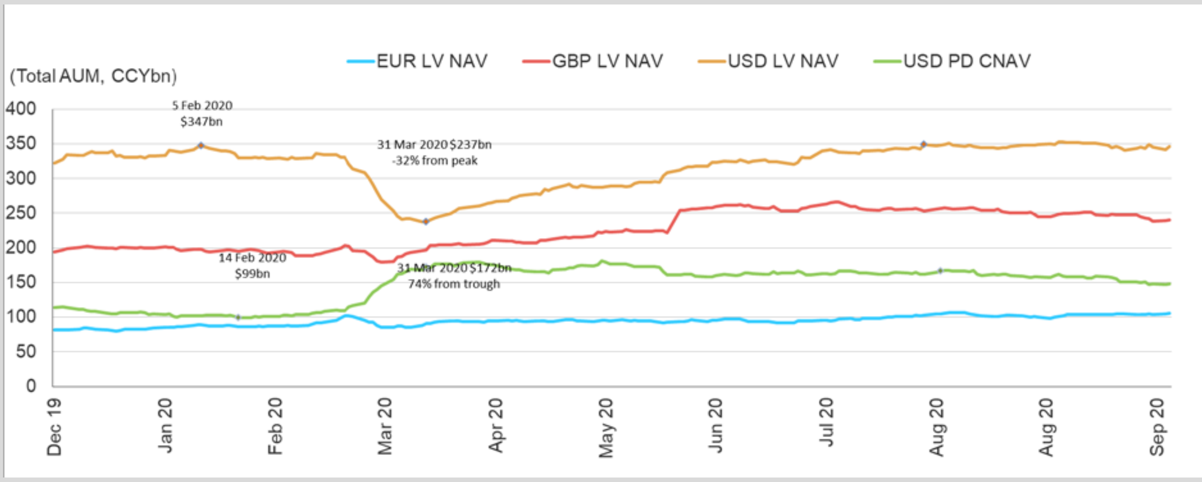
iv. European credit institutions stand to also be penalised in at least two important ways: First, they would need to hold more sizeable deposit accounts, with an impact on their own regulatory ratios and ultimate profitability; and second, they would confront the evaporation of an important short-term funding source in the LVNAV structure.

Moreover, no LVNAV MMF was reported to have breached its 20 basis point "collar", followed by a forced NAV conversion to mark-to-market. Even as liquidity conditions remained impaired in short-term funding markets – with dealer banks refusing to make use of their balance sheet by bidding to buy-back their financial commercial paper and certificates of deposit from non-government MMFs – investors remained focused on accessing their cash, regardless of the accounting mechanism employed to calculate the MMF's NAV.

Based on the above arguments, the hypothetical option to remove LVNAV MMFs should therefore be discarded.

Question 4. If Public Debt CNAV MMFs were not available anymore, what impacts would you expect on you, and other relevant stakeholders? Please explain:

There is ample evidence to demonstrate that public debt CNAV funds in non-Euro currencies attracted considerable inflows at the height of the March 2020 liquidity squeeze in European money markets, just as non-government funds experienced significant outflows due to a "substitution effect" where investors sought the temporary shelter of government securities. EFAMA's November 2020 report on *European MMFs in the Covid-19 market turmoil* illustrated these opposite – yet only temporary - trends through the chart below, comparing U.S. Dollar denominated public debt CNAVs with LVNAVs. These findings were also corroborated by ESMA and by the ESRB[7] in their follow-up considerations around the March 2020 events.



Source: Fitch Ratings, iMoneyNet

Based on the evidence at hand and supposing that public debt CNAV had not been available in March 2020 to accommodate a considerable influx of cash, this would have found its way into the traditional banking system thereby increasing investors' over-reliance on the latter. Mindful as well of certain

[7] See for instance Chart 15 presenting the cumulated daily flows in 2020 by type of MMF in the ESRB's Issues Note on systemic vulnerabilities of and preliminary policy considerations to reform money market funds (MMFs) - Systemic vulnerabilities of MMFs (page 20), as published in July 2021.

investors' preferences to invest their cash balances in stable NAV funds, we conclude there is no convincing case as to why the public debt CNAV structure should be removed.

In sum, **EFAMA believes that any recommendation to remove the fund structures that have been successfully established since and due to the introduction the MMFR in 2017 would do a great disservice to European investors (financial and non) and issuers, in a manner that is contrary to the goals of the Capital Markets Union**.

Question 5. What elements of the MMFR could in your view be improved?

☐ Know your customer policy

☐ Disclosure / transparency

☐ Role of credit rating

☐ Limitations on the use of amortised cost method

☒ Regulatory triggers for LMTs

☒ Data sharing Scope

☐ Other

To what degree is it important to improve the "know your customer policy"?

☐ 1. Not important

☐ 2. Rather not important

☐ 3. Neutral

☒ 4. Rather important

☐ 5. Most important

☐ Don't know / no opinion / not applicable

To what degree is it important to improve the disclosure and/or the transparency?

☐ 1. Not important

☐ 2. Rather not important

☒ 3. Neutral

☐ 4. Rather important

☐ 5. Most important

☐ Don’t know / no opinion / not applicable

To what degree is it important to improve the role of credit rating?

☐ 1. Not important

☐ 2. Rather not important

☐ 3. Neutral

☐ 4. Rather important

☐ 5. Most important

☒ Don’t know / no opinion / not applicable

To what degree is it important to improve the limitations on the use of amortised cost method?

☒ 1. Not important

☐ 2. Rather not important

☐ 3. Neutral

☐ 4. Rather important

☐ 5. Most important

☐ Don’t know / no opinion / not applicable

Please explain your answer about the improvement of the limitations on the use of amortised cost method:

EFAMA would <u>not</u> support the removal of amortised cost accounting for LVNAV, unlike ESMA’s *Opinion* in favour of such option (allegedly to address the so-called “threshold effects”). Where from a policy-making standpoint the objective would be to remove the potential for such effects to occur, we believe that the option to finally decouple breaches of regulatory liquidity requirements from the potential activation of LMTs largely addresses supervisors’ concerns around non-linearities. The simple removal of amortised cost accounting appears disproportionate, considering that i) no LVNAV MMF breached, or came close to breaching, its 20 basis point “collar”; and that ii) the use of amortised cost accounting by LVNAVs is very restrictive and limited to securities with maturities of 75 days or less (and even then, only if such securities’ mark-to-market price lies within 10 basis points of their amortised cost price).

To what degree is it important to improve the regulatory triggers for LMTs?

☐ 1. Not important

☐ 2. Rather not important

☐ 3. Neutral

☐ 4. Rather important

☒ 5. Most important

☐ Don’t know / no opinion / not applicable

Please explain your answer about the improvement of the regulatory triggers for LMTs:

With respect to regulatory triggers, we make the following important considerations, especially with reference to some of the recommendations reflected in ESMA’s February 2022 *Opinion*:

I. Removing regulatory triggers

In terms of preventing contagion risks and the “first-mover advantage”, EFAMA believes that the regulatory requirement tying the breach of daily and weekly liquidity requirements with the hypothetical activation of liquidity fees, gates and/or of suspensions for public debt CNAV or LVNAV funds by their respective Boards – as per Article 34 of the MMFR – deserves to be removed. In practice, evidence from the recent March 2020 events has demonstrated that the link between liquidity requirements and the potential activation of liquidity management tools (LMTs) can act as a procyclical signaling mechanism in the eyes of investors and the broader market. Indeed, redemptions for public debt CNAV and LVNAV MMFs may have been exacerbated when investors perceived that public weekly liquidity levels were approaching the 30% limit. They consequently may have increased redemptions pressure on the fund while looking to pre-empt other investors and avoid what may have then been perceived as a forthcoming activation of LMTs by the funds’ Boards.

In line with ESMA’s February 2022 *Opinion* on the review of the MMFR, as well as with other global reform initiatives, **EFAMA supports removal of the explicit link between regulatory thresholds and the potential imposition of fees, gates or temporary suspensions through the deletion of Article 34 of the MMFR**.

II. Amending MMFR liquidity requirements

Related to regulatory triggers are recent proposals to also amend the present Article 24 and Article 25 portfolio rules for short-term and standard MMFs respectively. On the back of the ESRB’s December 2021 *Recommendations*, ESMA’s successive *Opinion* in this regard has targeted an increase of the current daily and weekly liquidity requirements, as well as an optional public debt quota as part of the MMF’s weekly liquidity ratio. Such changes would be justified “ (…) to ensure that MMFs are better able to meet periods of heightened redemption requests without destabilising underlying money markets”[8].

However, the evidence presented above – including ESMA’s and the ESRB’s very own empirical findings – would question the need to increase the existing liquidity thresholds, especially where one considers that none were ever breached and managers entered the March 2020 volatility episode with sufficient liquidity at hand. This was facilitated in part due to a more accurate knowledge of their client base stemming from the Article 27 “know your customer” requirement,

[8] Please refer to paragraph 47 of the ESMA February 2022 *Opinion*, as well as to Recommendation B of the ESRB’s own reform proposals of December 2021.

but also in anticipation of the heavy seasonal quarter-end withdrawals from their corporate clients (as for instance, from institutional corporates based on their quarter-end accounting needs, or pension funds which need to meet regular pay-outs to scheme holders). We note that this latter aspect has been undervalued in the relevant reports of the global standard setters (IOSCO and FSB), as well as in the ESRB's and ESMA's own subsequent stock-takes when considering the size of MMF outflows in early 2020. Such regular cyclical outflows have not been accounted for, nor has their relative proportion compared to the gross ouflows recorded in March 2020 been estimated. It is therefore safe to conclude that not all outflows then recorded represented a "dash for cash" induced by governments' lockdown measures[9].

Of particular concern to EFAMA are the ESRB's proposed changes to the existing MMFR liquidity requirements, as per its December 2021 *Recommendations*. For instance, Recommendation B considers to not only increase, but to also differentiate between the liquidity buffers applicable to VNAV funds (between short-term and standard). Accordingly, the new liquidity requirements for short-term VNAV MMFs should be at least equal to 20% of their assets (split between at least 15% of weekly maturing ones, at least 10% of daily maturing ones; and at least 5% of additional public debt). For standard VNAV MMFs, the new liquidity requirements should be at least equal to 25% of their assets (split between at least 15% of weekly maturing ones, at least 10% of daily maturing ones; and at least 10% of additional public debt assets). Such differentiation between short-term and standard VNAVs is <u>not</u> justified, particularly considering the fact that standard VNAVs would intuitively be less sensitive to liquidity risks as a result of a more diversified portfolio with comparatively longer maturities *vis-à-vis* their short-term equivalents, thereby questioning the rationale behind a higher liquidity threshold for standard VNAVs. We would also note that standard VNAV MMFs do not embed higher credit risks compared to other MMFs, as the MMFR credit assessment provisions apply to all categories of MMFs indistinctly.

We remain concerned by the fact that ESMA's *Opinion* also differentiates between short-term and standard VNAV liquidity requirements, although considers that an eligible public debt ratio should only be **optional** and form part of the MMF's weekly maturing assets[10]. While welcoming the latter element, **EFAMA does <u>not</u> support the increase of VNAVs daily and weekly liquidity requirements away from their respective current thresholds of 7.5% and 15% of their assets, nor do we support their differentiation between short-term and standard VNAV funds.**

Lastly, considering the utility of further increasing liquidity requirements through a **mandatory** public debt quota, as per the ESRB's Recommendation B outlined above, EFAMA would <u>not</u> support such outcome, especially as there are better (i.e. more liquid) alternatives, as overnight deposits and repurchase agreements, to meet sudden cash needs. Furthermore, and as ESMA also correctly notes in its *Opinion* (paragraph 52), the holding of public debt securities with a residual maturity of 190 days would also be more sensitive to changes in interest rates (duration risk), thereby exposing the fund's portfolio to potential mark-to-market losses. In other terms, an additional mandatory public debt quota would only serve to introduce a potentially larger maturity mismatch, thus contravening one of the reform's key objectives. The Commission should also consider that, even within the broad short-term public debt category, there may be significant differences in terms of asset prices and their volatility, potentially also heightened by contingent

[9] For an estimate of the scale of such seasonal redemptions under normal market conditions compared to the ones experienced in March 2020, please refer to the May 2021 study by the French AMF's Pierre-Emmanuel Darpeix and Natacha Mosson, *Detailed analysis of the portfolios of French money market funds during the Covid-19 crisis in early 2020*; available at the following hyperlink.

[10] Please refer to paragraphs 51 and 49 respectively of the ESMA February 2022 *Opinion*.

credit quality concerns in relation to specific sovereigns (as at the time of the 2011 Eurozone crisis). **For these reasons, we resolutely oppose the introduction of mandatory public debt liquidity buffers as per the ESRB's recommendation, preferring to concur with the ESMA Opinion's approach to allow managers for all types of MMF to continue investing in eligible public debt** (of a maturity up to 190 days) **as part of their weekly liquidity requirements**.

The Commission should also consider evident supply constraints due to the insufficient depth of European public debt markets (compared to the global one for U.S. Treasuries, for instance) and with regard to the unknown future evolution of the European MMF industry's size. Supply of eligible short-term public debt is additionally exacerbated from the competing high demand for high quality government issues by other financial market actors for investment purposes or for collateral (e.g. public authorities, pension funds, credit institutions to meet their Basel III requirements, etc.). Such constraints are bound to affect – and potentially also dislocate - the price of government securities for MMFs' most sought-after maturities/tenors, thereby proving detrimental to MMF unitholders were these to be recommended by EU policy-makers in the form a specific quota. We analyse such constraints in greater depth in the Box below.

Box I: Public debt ratios for European MMFs: Is the European short-term public debt market large enough?

The market turmoil of March 2020 led some categories of European MMFs to experience significant withdrawals with consequent liquidity concerns. However, the overall European MMF industry, aided by the comprehensiveness of the EU MMFR framework, proved robust in this recent crisis[11]. Yet, both the ESRB and ESMA have made proposals aimed at amending the MMFR in order to make MMFs more resilient. While some would indeed result in a more resilient MMFR industry, such as the recommendation to de-link liquidity thresholds from the possible imposition of fees and gates, others would prove impractical, where not plainly unfeasible.

Belonging to these latter categories is the ESRB's recommendation for additional public debt liquidity requirements for VNAV and LVNAV funds. Accordingly:

- Short-term VNAV should have at least 5% of additional public debt assets;
- Standard VNAV should have at least 10% of additional public debt assets;
- LVNAV should have at least 15% of additional public debt assets.

Although ESMA believes that the additional public debt liquidity buffer should be optional, it nevertheless considers that the ESRB's Recommendations could be a good "working basis" for its future calculations.

Where made mandatory – as per the ESRB's own December 2021 *Recommendations* (Recommendation B) - these additional liquidity buffers would prove unworkable for two interrelated reasons. Firstly, data suggests that the portion of the EUR-denominated short-term public debt market for the constitution of an additional public debt liquidity buffer is simply not large enough. Secondly, other (non-MMF) players, such as banks and other financial institutions typically make heavy use of

[11] Please refer to the EFAMA *Market Insights* (Issue #2) study, published in October 2020 and available at the following hyperlink.

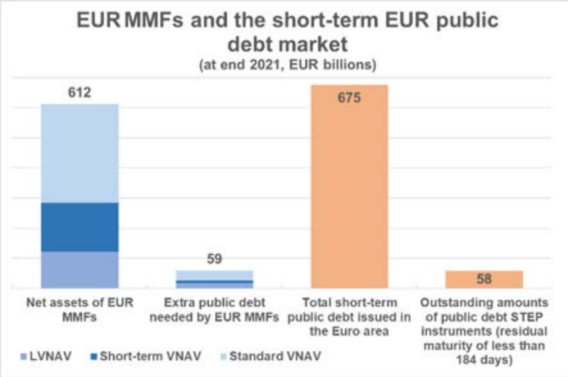
high-quality short-term public debt and could suffer from supply constraints if MMFs were to compete for these as well.

EUR MMFs and the EUR short-term public debt market.

Net assets of EUR MMFs amounted to about EUR 612 billion at the end of 2021, of which 20 % were LVNAV and an estimated 53% standard VNAV and 27% short-term VNAV[12]. Applying the additional public debt liquidity requirements proposed by the ESRB would result in roughly EUR 59 billion of additional short-term public debt assets that EUR MMFs would require. Total outstanding short-term debt (with less than a year of original maturity) issued in the euro area at end 2021 amounted to EUR 675 billion. This would mean that the additional public debt liquidity requirements for EUR MMFs would require 9% of all outstanding EUR short-term public debt. However, the MMFR imposes additional requirements such as a maximum residual maturity of 190 for the public debt holdings of short-term MMFs. This will evidently limit even further the potential supply of short-term public debt that can be used for additional liquidity buffers. Data on debt with a shorter maturity than 1 year is hard to find. Data on the STEP (Short-term euro paper) market could give an indication. STEP is a quality label for short-term debt, established to foster the integration of the European markets for short-term paper through the convergence of market standards and practices. The total size of the public STEP market with a residual maturity of less than 184 days amounted to EUR 58 billion. An important caveat on this data is that several of the largest EUR public short-term debt issuers, such as France and Germany, are however not included.

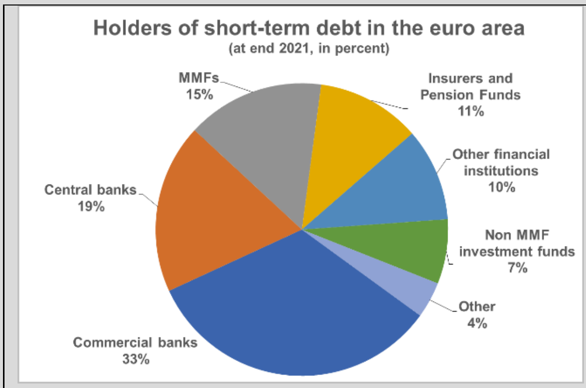
Supply constraints due to other short-term debts players

Even if the total EUR short-term public debt market would, in theory, be large enough to accommodate the additional public debt buffer for MMFs suggested by the ESRB, the above analysis is not taking into account the other users of this type of paper. Looking at which types of investors currently hold EUR short-term public debt, MMFs currently hold only 15% of the total. Commercial banks are the largest holders of public debt, holding about a third of the total short-term public debt issued in the euro area. This type of paper plays a crucial role in their liquidity ratios. Also other large investors such as insurers and pension funds (11%) and long-term investment funds (7%) make heavy use of short-term public debt. A sudden increase in demand for short-term public debt by MMFs, especially for the more highly rated and shorter-dated segments, could cause significant supply shortages for these other users.



Source: EFAMA, IMMFA & ECB

[12] Please note that the share of short-term public debt CNAVs proved negligible and has not been included.



Source: ECB

In sum, EFAMA questions the proposed changes to the existing MMFR liquidity thresholds and is resolutely against a mandatory quota of public debt holdings as a means to provision for adequate liquidity in the event of a market downturn. More sensible, as per ESMA's *Opinion*, is for managers to optionally consider investments in eligible public debt as part of their weekly liquid asset ratio.

III. Temporary relaxation of liquidity thresholds and definition of exceptional market circumstances

ESMA's proposals for the reform of the MMFR also expressly consider the opportunity for MMFs to dip below their regulatory liquidity buffers in times of heightened stress. While appreciating that it should <u>not</u> be up to public authorities to decide when such requirements deserve to be relaxed – as we agree this could indeed trigger the same procyclical investor behaviors the reforms are set to avert – EFAMA would nevertheless <u>not</u> support such proposal, nor the accompanying suggestion that the definition of exceptional market circumstances be defined once and for all through an accompanying delegated act.

According to the relevant paragraphs of Article 24 and Article 25 of the MMFR, funds are obliged to promptly replenish their daily and weekly maturity asset thresholds where these dip below the prescribed thresholds and without needing a supervisory decision to this effect. Yet, we fear that the accompanying ESMA proposal for the Commission to adopt a delegated act specifying stressed market circumstances and the conditions under which such thresholds can be relaxed would *de facto* recreate confusion around their use for investors, who in turn may again decide to redeem pre-emptively in anticipation of a public announcement confirming that the conditions enshrined in the abovementioned delegated act have been met. Such outcome thus promises to only perpetuate the same "threshold effects" that the parallel proposal to decouple regulatory liquidity thresholds from a possible activation of LMTs (for public debt CNAV and LVNAV funds) seeks to remove.

By the same token, we also question the ESMA proposal's intent of achieving a comprehensive definition of "stressed market circumstances" when it is generally known that such circumstances (often unforeseeable) – as testified by the Covid-19 pandemic - and their underlying causes can vary widely. **These reasons therefore lead us to not only strongly doubt the comprehensiveness of any regulatory definition, but also to warn of its inherent flaws if combined with references to liquidity limits**.

To what degree is it important to improve the data sharing?

☐ 1. Not important

☒ 2. Rather not important

☐ 3. Neutral

☐ 4. Rather important

☐ 5. Most important

☐ Don't know / no opinion / not applicable

Please explain your answer about the improvement of the data sharing:

EFAMA observes that the above question should have been more precise. For instance, by specifying who the ultimate recipients of the shared data are and for which purposes it is being collected. As phrased, the question elicits responses that can vary significantly.

We understand the object in question is supervisory reporting data. Before responding to the question and extending our considerations also to the contents of the recent ESMA *Opinion*, there is a fundamental premise that we wish to recall by referencing the following passage from the Commission's December 2021 Communication related to its *Strategy on supervisory data in EU financial services*[13]:

> *Data should be reported* ***only once*** *and then shared and reused as needed by the different authorities overseeing the financial system in the EU. The Commission therefore intends to put in place a system where reporting entities provide high quality data and authorities share the data they collect as much and as efficiently as possible, while safeguarding data security and professional secrecy* (emphasis added by EFAMA).

The main tenet that data should be reported only once is critical to the efficiency of any reporting framework, avoiding duplications, saving managers and supervisors precious time and resources, and ultimately guaranteeing that the data reported is effectively used for the intended purposes. We strongly advocate for this principle to be respected in the upcoming review of the MMFR regime, as its successful evolution will inevitably depend on it. Having analysed the recent ESMA reform proposals around the enhancement of reporting requirements, we nevertheless note that some of these fall short of the above principle.

Regarding "stressed market circumstances", our previous consideration that these cannot be defined through a delegated act remains valid. However, where the purpose is for ESMA to more efficiently collect daily data for a few selected indicators from NCAs, then our industry could support a harmonised narrow data template with the four categories of indicators, as per paragraph 65 of the ESMA *Opinion* and draft new Article 37(3)(a) in the MMFR[14]. In our Members' experience from liaising with their respective NCAs in the course of March 2020, these indicators would suffice for supervisors – and indirectly, for ESMA and the ESRB – to access the most relevant data offering insights into near real-

[13] Please refer to the European Commission's Communication on its *Strategy on supervisory data in EU financial services*

[14] Accordingly, the four indicators would be i) Total assets, NAV and, in the case of public debt CNAVs and LVNAVs, the mark-to-market NAV, WAM, and WAL; ii) inflows and outflows; iii) weekly maturing assets; and iv) daily maturing assets.

time market developments. Complementing this information with additional *ad hoc* indicators *ex ante* and in the absence of a concrete market context is not warranted, especially where these indicators are not yet foreseen under the current reporting requirements of Article 37 of the MMFR.

As to reporting under "normal market conditions", EFAMA does not support ESMA's proposal to increase the current reporting requirement frequency, judging that the suggested increases from quarterly to monthly (for MMFs with an AuM in excess of EUR 100 million) and from yearly to quarterly (for MMFs with an AuM below such amount) would not substantially improve NCAs ability to monitor developments. Our primary justification is that MMF portfolios can change substantially over the course of a few weeks and with the average maturity of the assets being no more than one month, the reported monthly/quarterly figures will be stale and thus of little use other than for statistical purposes. In addition, even more frequent reporting requirements to supervisors (e.g. monthly instead of quarterly) could not have anticipated most outflows because of the suddenness and unevenness of the Covid-19 pandemic shock. In addition, from the experience of EFAMA's Members while engaging with their national supervisors in the midst of the March 2020 events, it is often noted how supervisors' access to more frequent (i.e. daily and weekly) market data alone would not have been sufficient for them to form an accurate view of the live contingencies affecting MMFs at the time. 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 reporting of more frequent information to supervisors would substantially improve supervisors' readiness to anticipate liquidity stresses. Instead, it promises to only increase the present reporting burdens. Lastly, as the March 2020 liquidity episode has demonstrated, authorities should exercise their right to request more timely information from managers to monitor the evolution of the market, as well as more specific client information when needed.

Doubtful is also ESMA's suggestion to further enhance reporting disclosures on underlying investor profiles, when we believe this is already a clear requirement under the MMFR's relevant Article 37(2) letter e) provision and where the resulting information is already abundantly factored into MMFs' stress-testing scenarios as reviewed on a yearly basis by ESMA. Regarding the broader insights into the money markets (broken down by asset classes, issuers, maturities, ratings, etc.) and other investor categories for the purpose of monitoring interconnectedness, we consider that it would be far simpler and more efficient over the short-term for NCAs or ESMA to equip themselves with access to leading commercial databases where this information is more complete and closer to real time. Over the longer term, it is nevertheless important to build on central bank initiatives aimed to improve and enhance data quality for Euro-denominated commercial paper (CP). On these we elaborate further in our answer to question 8b) below.

To what degree is it important to improve the scope?

☐ 1. Not important

☒ 2. Rather not important

☐ 3. Neutral

☐ 4. Rather important

☐ 5. Most important

☐ Don't know / no opinion / not applicable

To what degree is it important to improve this/these other element(s) of the MMFR?

☐ 1. Not important

☐ 2. Rather not important

☐ 3. Neutral

☐ 4. Rather important

☐ 5. Most important

☒ Don’t know / no opinion / not applicable

Question 6. What regulatory developments at international level should be taken into account in the MMFR and why? Please explain:

In light of the FSB’s own conclusions and policy proposals to enhance MMF resilience published in October 2021, and with a view to the ongoing reforms in the United States led by the U.S. SEC, there is a shared consensus that the removal of the regulatory link between MMFs’ liquidity requirements and the potential activation of LMTs for certain types of fund structures is warranted. As per our previous responses, EFAMA fully supports ESMA’s recent proposal to this effect.

Question 7. Would the proposal on Liquidity Management Tools under the AIFMD/UCITS review contribute to strengthen the liquidity risk management in MMFs?

☐ Yes

☐ Partially

☒ No

☐ Other

☐ Don’t know / no opinion / not applicable

Please explain your answer to question 7:

EFAMA believes that the ongoing review of the AIFMD – aimed *inter alia* at harmonising the liquidity management toolkit for AIF/UCITS managers – should not necessarily influence the MMFR review by seeking the same outcomes. As the MMFR is a specific fund regime developed for a product that is presumed to be a cash-equivalent and as such must by definition invest in short-term money market instruments and offer investor daily liquidity, Boards/management companies will under normal market conditions naturally activate those LMTs designed to avoid dilution and assign redemption costs only to those investors preparing to exit (thereby also discouraging any “first-mover advantage”). Consequently, we would emphasise that redemption fees remain the most appropriate to consider for all types of MMFs.

In relation to swing pricing, we note that although the latter has proved itself as a useful tool for other (non-MMF) funds, its compatibility with MMFs is questionable (as also amply recognised in ESMA’s analysis of the responses to its March 2021 consultation), as it is not compatible with daily settlement which investors greatly value. Rather, in extraordinary circumstances, redemption 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), unlike swing pricing, they do not affect the viability of constant price MMFs.

Naturally, redemption gates for LVNAV and public debt CNAV funds, accompanied by the suspension of subscriptions and redemptions for fund Boards/management companies to consider under more extreme circumstances should continue to be made available under a revised MMFR framework.However, EFAMA would <u>not</u> support ESMA's proposal for a delegated act to specify the conditions and criteria for the activation of LMTs for the reasons expressed in our responses above.

Question 8 a) Do you have any comment on the impact of the MMFR on the functioning of short-term markets (via investments in short-term instruments issued by banks, insurances, non-financial corporates, etc.), both in terms of costs/convenience, but also in terms of financial stability/contagion in times of crisis?

Please explain further and provide quantitative information if possible:

We generally do not believe the MMFR has an appreciable impact on the functioning of short-term money markets. Rather, from a careful analysis of recent liquidity events affecting the pricing of securities in such markets, we conclude that the opposite appears to be true. This proves that MMFs may actually mitigate a liquidity crisis, much unlike the early assumptions and analysis published by certain standard-setting bodies.

Question 8 b) In your view, is there sufficient transparency both in terms of issuance, underlying collateral and rates of short-term money market instruments in the EU insofar as covered by the MMFR?

☐ Yes

☒ Partially

☐ No

☐ Don't know / no opinion / not applicable

Please explain your answer to question 8 b):

From the experience of European MMF managers in the first half of 2020, conditions for asset eligibility under the ECB's Pandemic Emergency Purchase Programme (PEPP) were not sufficiently defined, nor adequately disclosed by some of the six participating Eurosystem central banks. In addition, MMF managers noted that some national central banks' market operations were uncoordinated and proved uneven, especially in terms of not standardising the eligibility of various money market instruments. In this regard, better coordination between central banks – both between the ECB and the Eurosystem national central banks, as well as between the ECB and its non-Eurozone peers - and a greater degree of transparency around the operational details of future purchase programmes would be desirable.

Moreover, EFAMA would be supportive of initiatives aimed at creating a specific trade repository for easily accessible data, enabling a view of issuers' outstanding volumes and displaying the characteristics of the short-term paper issued (e.g. nature, eligibility, maturity, ISIN, sector, etc.). In this regard, we consider the gradual development of a market for Euro-denominated CP, with better transparency on pricing, issuance and secondary market volumes, including the opportunity for such CP to be eligible as collateral with the ECB. Initiatives undertaken by the ECB and other national central banks to centralise and publish statistics, as those of negotiable European commercial paper (NEU CP) and of negotiable European medium-term notes (NEU MTNs) proposed by the *Banque de France*[15] or the deepening of the market-led STEP initiative, are particularly valuable in this regard[16].

Naturally, any initiative to enhance transparency, information-gathering and consolidation by EU authorities around issuance in short-term funding markets will benefit market participants and EU authorities alike, in particular during periods of market or broader economic stress. As most information must be collected from issuers and/or brokers directly, it should be undertaken outside of the scope of a future MMFR review, avoiding the risk that MMFs forcefully become a conduit for such information.

EFAMA

ABOUT EFAMA

EFAMA, the voice of the European investment management industry, represents 27 member associations, 59 corporate members and 25 associate members. At end Q4 2021, total net assets of European investment funds reached EUR 21.9 trillion. These assets were managed by more than 35,000 UCITS (Undertakings for Collective Investments in Transferable Securities) and more than 30,000 AIFs (Alternative Investment Funds). At the end of Q3 2021, assets managed by European asset managers as investment funds and discretionary mandates amounted to an estimated EUR 31.3 trillion.

More information is available at www.efama.org

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[15] Please refer to the following hyperlink for further information.
[16] The latter is managed by the European Money Markets Institute and has celebrated its 15th anniversary in June 2021 year. More information is available at the following hyperlink.