European Securities and Markets Authority

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

29 March 2021

European Securities and Markets Authority

Date: 29 March 2021

Responding to this paper

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

1. respond to the question stated and indicate the specific question to which they relate;

2. contain a clear rationale; and

3. describe any alternatives ESMA should consider.

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

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

Instructions

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

4. Insert your responses to the consultation questions in this form.

5. Please do not remove tags of the type <ESMA_QUESTION_MMFR_1>. Your response to each question has to be framed by the two tags corresponding to the question.

6. If you do not wish to respond to a given question, please do not delete it but simply leave the text "TYPE YOUR TEXT HERE" between the tags.

7. When you have drafted your response, name your response form according to the following convention: ESMA_MMFR_nameofrespondent_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA_MMFR_ABCD_RESPONSEFORM.

8. Upload the form containing your responses, in Word format, to ESMA's website (www.esma.europa.eu under the heading 'Your input – Open consultations' → 'Consultation on EU Money Market Fund Regulation – legislative review').

Publication of responses

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

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading 'Data protection'.

Who should read this paper?

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

General information about respondent

Name of the company / organisation	Association of the Luxembourg Fund Industry
Activity	Asset Manager Association
Are you representing an association?	☒
Country/Region	Luxembourg

Introduction

Please make your introductory comments below, if any:

<ESMA_COMMENT_MMFR_1>
The Association of the Luxembourg Fund Industry (ALFI) represents the face and voice of the Luxembourg asset management and investment fund community. The Association is committed to the development of the Luxembourg fund industry by striving to create new business opportunities, and through the exchange of information and knowledge. Created in 1988, the Association today represents over 1,500 Luxembourg domiciled investment funds, asset management companies and a wide range of business that serve the sector. These include depositary banks, fund administrators, transfer agents, distributors, legal firms, consultants, tax advisory firms, auditors and accountants, specialised IT and communication companies. Luxembourg is the largest fund domicile in Europe and a worldwide leader in cross-border distribution of funds. Luxembourg domiciled investment funds are distributed in more than 70 countries around the world.

We would like to thank the European Securities and Markets Authority for the opportunity to respond to the Consultation Paper on the EU Money Market Fund Regulation – legislative review.
<ESMA_COMMENT_MMFR_1>

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

<ESMA_QUESTION_MMFR_1>
i) At the beginning of the COVID-19 pandemic, the outlook of a potential economic crisis triggered significant risk aversion and the demand for cash started to increase (ESMA report on Trends, Risks and Vulnerabilities, September 2020, p. 29). As a result, market liquidity came under pressure and fell sharply, not only for riskier assets, but briefly also in high-quality markets, such as the US Treasury and money markets, as both financial and non-financial sectors demanded cash (ECB Financial Stability Review, May 2020 p. 7 and the respective graphic 1 in our attachment). European investment funds experienced outflows for different fund types, including, but not limited to, Money Market Funds (MMFs) (ESMA report on Trends, Risks and Vulnerabilities, September 2020, p. 35 and the respective graphic 2 as well as graphic 1 in our attachment).

In this context also some segments of the EU short-term MMF industry faced liquidity challenges, in particular LVNAV MMFs while CNAVs recorded high inflows and VNAVs overall limited outflows although individual VNAV funds may have been subject to large outflows (ESMA report on Trends, Risks and Vulnerabilities, September 2020, p. 32 and the respective graphic 3 in our attachment). In general, outflows were amplified by seasonal, quarter-end factors in view of non-financial corporate investor redemptions in the second half of March, whereas those of other clients segments remained more stable (see e.g. EFAMA, European MMFs in the Covid-19 market turmoil, November 2020 p. 11). In this context, we would like to point out the market impact of quarter end balance sheet pressures on liquidity. As banks reduce their balance sheets approaching reporting period ends, this directly impacts both the amount of liquidity a MMF can hold in the fund, and also how liquid the market is. Redemption pressure timed ahead of a quarter end was in our view a material factor in the lack of liquidity in markets.

Among the outflows, the ones from both euro and USD-denominated funds were significant, especially USD-denominated LVNAV funds, while preliminary USD-dominated CNAV funds received net inflows (ECB Financial Stability Review, May 2020, p. 86 f.). This could also be observed for Luxembourg MMFs (IOSCO Thematic Note, Money Market Funds during the March-April Episode, November 2020, p. 8 and the respective graphic 4 in our attachment).

In the USA, similar developments took place with a large rebalancing between Prime MMFs and Treasury & Government MMFs (here and the following: ESMA report on Trends, Risks and Vulnerabilities, September 2020, p. 32 f.). The US Federal Reserve started to support US MMFs through lending facilities for dealers purchasing assets from MMFs, the so-called “Money Market Mutual Fund Liquidity Facility” and through outright purchases of money market instruments via the “Commercial Paper Funding Facility”. In the Euro area, the European Central Bank (ECB) put in place a purchase programme of commercial paper issued in euro by non-financial corporates, the so-called Pandemic Emergency Purchase Program (PEPP). However, it has to be noted that European USD MMFs were neither eligible for the US Federal Reserve facilities, nor for the ECB Commercial Paper programme. Overall, the PEPP only provided limited support to MMFs as it covered only debt issued by non-financial companies and denominated in euro whereas European MMFs invest predominantly in commercial paper and certificates of deposits issued by financial institutions and denominated for the most part in non-euro currencies (EFAMA Market Insights October 2020 – Money Market funds in Europe – State of Play, p. 6). According to our understanding, the Central Bank intervention also rather aimed in the first place at addressing systemic risks in general that arose during a market liquidity crisis than at addressing risks in MMFs in particular.

At the end of the first quarter 2020, the situation relaxed and inflows into MMFs were observed as graphics 1-3 show.

Even though there was neither a direct support of European MMFs by the US Federal Reserve via its programmes nor a broad support by the ECB via the PEPP, their quick reaction helped to maintain investor confidence in the market and thereby limited the impact by investor behaviour. However, the intervention may have led to the impression that MMFs were not resilient enough.

In this context, we do not agree with Paragraph 22 which states *markets are not very liquid even in normal times.* In normal market conditions there is sufficient liquidity. The portfolio construction of MMFs organically

has high levels of liquidity as it holds at least 30% WLA. Assets within the WLA will generate cash due to natural maturity schedule without the sale of any position. Therefore, the need to sell to meet redemptions from investors is very limited in normal times due to the nature of the instrument. Moreover, it should be noted that short-term European MMFs entered March 2020 already with weekly liquidity levels well above their regulatory minima and that the average liquidity levels for the whole first half of 2020 remained at around 50% (EFAMA, European MMFs in the Covid-19 market turmoil, November 2020 p. 17). In addition, it is worth mentioning that when the crisis evolved, the demand for cash resp. liquidity existed predominantly in the US, as the existing market conditions had already been tighter and the banking system did not contain reserves in the same way as it was the case in the Euro area (ECB Financial Stability Review of May 2020, p. 39).
Moreover, despite the liquidity challenges faced by European MMFs, none of them had to introduce redemption fees or gates or suspend redemptions during the market turmoil in March 2020 (ESMA report on Trends, Risks and Vulnerabilities, September 2020, p. 34). This as well as the quick recovery show that the systems operated well. The crisis was rather an evidence of the resilience of the MMFs in Europe and does not per se justify any amendments to the MMFR.

ii) Ratings are an important tool helping investors as independent checks. However, ratings are not the only basis for investors' interest in MMFs. Furthermore, ALFI is of the opinion that credit ratings were not the driver during this crisis to redeem shares, which was a liquidity crisis (in view of a pandemic) rather than a credit crisis as experienced in 2008. It is also important to understand the particularity of MMFs that preliminary corporate investors are choosing them looking for returns. In this context, the "know your customer provisions" under art. 27 MMFR were of great help to better understand the nature of these investors and anticipate their behaviour. The investor redemptions during the crisis impacted LVNAV funds as well as Euro Standard VNAV funds. Euro Standard VNAV funds are predominately not AAA rated which allows them to take incremental risks in order to offer a higher yield as result which is what their core target investors seek. Whereas, AAA MMF investors seek to preserve capital and access to liquidity with yield being a secondary consideration.
<ESMA_QUESTION_MMFR_1>

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?

<ESMA_QUESTION_MMFR_2>
As elaborated above and developed in the below answers, the crisis is rather evidence of the resilience and does not per se justify amendments to the MMFR.
<ESMA_QUESTION_MMFR_2>

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.

<ESMA_QUESTION_MMFR_3>
i) ALFI supports the proposal of removing the automatic link and ii) instead leaving it at the responsibility of the board to impose these measures to the fund when it is in the best interest of the fund, without reference to any specific level of liquidity. In our view, this could lower the risks of investor outflows as especially gates can have a negative connotation for investors. In addition, this would fall in the already existing responsibilities of the board as under the current requirements, it needs already to perform an assessment of the situation and to determine next steps when liquidity falls below the thresholds. As an alternative, in times of stress, regulators could grant some exceptional leeway from the 30% WLA requirement.
<ESMA_QUESTION_MMFR_3>

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.

<ESMA_QUESTION_MMFR_4>
i) Liquidity management tools ("LMT") are used to ensure a fair treatment of shareholders, in particular in exceptional market stress situations. LMTs actually provide a broad tool box, which supports both the daily management of funds and the management of crises.

However, Swing-pricing should not be mandatory as we do not believe this would bring an added value, particularly for short-term papers. We believe that the concept of a mandatory swing threshold is not meaningful for MMFs. A swing threshold is the level of net flows at which a fund would determine to swing the NAV (e.g., a fund might swing the NAV if a fund experiences a net 5 percent inflow or outflow). This makes sense in the context of long-term funds, because while such funds typically maintain some cash and overnight assets with which to meet redemptions, a larger flow will require transactions in the underlying portfolio, imposing the costs swing pricing is intended to address. MMFs, on the other hand, routinely hold substantial amounts of short-term and maturing assets, and regularly see predictable, high levels of inflows and outflows (e.g., at month and quarter end). Moreover, given the short duration of MMF assets generally, portfolio managers can plan for these redemptions by allowing portfolio assets to mature, rather than transacting in the secondary market. Thus, tying the execution of a NAV adjustment to net flows, as with swing pricing, does not bring any added value for MMFs on a mandatory basis.

Additionally, to assess daily net flows for purposes of determining whether the swing threshold has been met, MMFs would likely need to suspend intraday settlement, a feature of MMFs that is highly valued by investors. Same-day settlement (once per day) could also be compromised. This is because all daily flows must be received, and the NAV calculated, before a price can be swung, meaning that intra-day pricing could not incorporate a swing. The end-of day operational process would also likely take several hours, so unless a fund stopped accepting transactions early, it would be unlikely to meet the deadline for same-day settlement.

Generally speaking, ALFI is of the opinion that the use of Liquidity Management Tools should be left at the board's discretion. Please also note that ALFI has historically argued that Swing Pricing is an anti-dilution tool, not a true liquidity tool, and that mandatorily imposing its introduction would have significant impacts on LVNAV and CNAV structures and thus investor behaviours.

As clearly disclosed in ESMA's recent Report on the ESRB Recommendation on liquidity risk in investment funds (ESMA34-39-1119) (the "ESMA Report"), LMTs are already extensively available in several EU jurisdictions.

ii) We would like to refer to our answer under point i) in which we propose to leave the use of LMTs to the discretion of the board.
<ESMA_QUESTION_MMFR_4>

Q5 i) Do you agree with the above assessment of the potential need to increase liquidity buffers and/or make them usable/countercyclical and the corresponding potential proposal of amendment of the MMF Regulation? ii) With respect to option 1 above, views are sought in particular

on the relevant threshold (on the size of redemptions) from which WLA would need to be automatically adjusted. When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

<ESMA_QUESTION_MMFR_5>
i) As stated in our response to Q3 above, ALFI supports the proposal of removing the automatic link between liquidity buffers and suspensions/gates. As decoupling will make liquidity buffers usable and allow them to be used for countercyclical purposes. We do not agree with the need of increasing the liquidity buffer. But the daily and weekly liquidity buffers should be adaptable to the circumstances by the management of the fund in the interest of the investors or in very exceptional market circumstances, by the regulator. There should be no direct link between the liquidity requirements and the use of redemption fees and gates. We would welcome any flexibility provided in this regard.
ii) N/A
<ESMA_QUESTION_MMFR_5>

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.

<ESMA_QUESTION_MMFR_6>
Based on our experience the recent market developments did not raise any particular concerns regarding the CNAV and LVNAV regime. These types of MMFs are particularly useful for certain markets and investors. Therefore we strongly advocate against an elimination of these fund types. MMFs are an important source of short-time financing in general and for European governments in particular. Institutional and corporate investors may prefer to have these options of amortized cost methods of CNAV and LVNAV funds. These funds are particularly useful for the proper functioning of the corporate treasuries and money markets in general. During the crisis many VNAV funds also experienced significant outflows. Conversely, USD CNAV funds seen increased demand from investors during the crisis. If these fund types were to be eliminated, this could lead to a moral hazard where investors would seek to find alternatives which may be subject to capacity constraints and risks, or may turn to unregulated products.
<ESMA_QUESTION_MMFR_6>

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.

<ESMA_QUESTION_MMFR_7>
i) At this stage we do not see the need to amend or clarify article 35 MMF Regulation.
ii) N/A
<ESMA_QUESTION_MMFR_7>

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.

<ESMA_QUESTION_MMFR_8>
i) Referring to our answer to question 1 i), we are of the opinion that credit ratings were not the driver during this crisis, which was a liquidity crisis (in view of a pandemic) rather than a credit crisis as experienced in 2008. In addition, ratings are not the only basis for investors' interest in MMFs. Therefore, we do not see a need for changes to the regulatory requirements for MMF ratings. Moreover, changes could lead to increasing costs that may borne by the investor eventually.
ii) As mentioned in our answer to question 1 i), ratings are an important tool helping investors as independent checks. However, it should be noted that ratings are not the only basis for investors' interest in MMFs.
<ESMA_QUESTION_MMFR_8>

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.

<ESMA_QUESTION_MMFR_9>
There are several items that should be taken into consideration. 1) The current requirements are very much detailed already. No other area/asset class/fund type faces as detailed requirements. These requirements are sufficiently comprehensive in our view. 2) Adding mandatory actions when thresholds are breached could lead to investor and/or market wide detrimental outcomes (e.g. market impact, herding, liquidity dry up). In addition, we are of the opinion that it would be good to contrast the suggestion of such mandatory actions with the above mentioned suggestion of introducing countercyclical measures as there is a clear tension between the two. 3) Instead of establishing mandatory actions when thresholds are met, we would propose to require that managers develop a clear contingency plan that includes stress testing, like it is required e.g. for liquidity risk management. In our view, this would be a better way to ensure each organization has thought through such adverse scenarios and is prepared to face such outcomes.
<ESMA_QUESTION_MMFR_9>

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.

<ESMA_QUESTION_MMFR_10>
It should be distinguished between reporting under normal and under stressed conditions. Under stressed conditions, a more frequent reporting could be useful. This could be covered by additional ad hoc reporting as needed. To our knowledge, the additional ad hoc reporting that was introduced by National Competent Authorities (such as the IFM notification on fund issues and large redemptions that was launched by the CSSF) at the onset of the pandemic proved to be very effective and useful to monitor developments. Therefore, we do not believe that there is a need to review the existing reporting requirements under the MMF Regulation.
<ESMA_QUESTION_MMFR_10>

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.

<ESMA_QUESTION_MMFR_11>
We do not see the need to introduce further disclosures.

Regarding additional disclosures to investors, we would like to mention that there was in general no particular increase in requests by investors observed. Therefore, we do not assume that there is a need for further disclosures from an investor's perspective. Regarding additional disclosures to regulators, we would like to highlight depending on the fulfilment of certain criteria, funds are subject to a semi-annual risk reporting that already provides valuable information to authorities.
<ESMA_QUESTION_MMFR_11>

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:

1. **What should be the appropriate size of such a pooling vehicle as the LEF?**
2. **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?**
3. **How long would it take to establish such a LEF?**
4. **Under which conditions would the LEF be activated?**
5. **Who would be responsible for activating the LEF**.

<ESMA_QUESTION_MMFR_12>
i) As in our view, MMFs proved to be resilient during the onset of the crisis and that the current system worked well, we do not see the need to establish a LEF. In the current low yield environment, a LEF would create even further costs for the funds that eventually may have to be borne by the investor. In addition, we see the risk that for the purpose of the LEF, funds could be grouped regardless of how they are being managed which could create additional unnecessary administrative burdens. The crisis highlighted that MMFs already have sufficient tools at their disposal to manage a liquidity crisis. Therefore, a LEF is not necessary. A LEF would also further enhance the misguided perception of MMFs that they are guaranteed investments. Much of the regulatory reform work has been to remove this perception, a LEF would undo this.
ii) N/A
<ESMA_QUESTION_MMFR_12>

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.

<ESMA_QUESTION_MMFR_13>
The market has over years developed its common interpretation of articles 1 and 6 of the MMF Regulation, so ALFI would not deem it necessary to perform any changes to level 1. If there should be a need to clarify certain aspects, we suggest to address them at level 3, especially as it pertains to ultra-short bond funds.
<ESMA_QUESTION_MMFR_13>