Securities and Markets Stakeholder Group

30 June 2021
ESMA22-106-3439

ADVICE TO ESMA

SMSG response to the ESMA's Consultation Report on "EU Money Market Fund Regulation – legislative review"

Executive summary

The SMSG welcomes the opportunity to respond to the ESMA's consultation on the legislative review of the EU Money Market Fund Regulation ("MMFR"). The consultation seeks views in relation to the MMFR review clause and to the COVID-19 crisis. The group thanks ESMA for its clear assessments on the crisis, money markets difficulties, investor behaviours and money market funds that are accurate and insightful on many points.

Despite the March 2020 exceptional exogenous market event and increased redemptions, European money market funds ("MMFs") demonstrated resilience and investors reverted confidently back into these funds in one to (less than) three months' time (depending on the type of funds). Redemptions were mainly motivated by the pressing need for cash by investors, like corporates or institutions, in a very uncertain economic situation.

The SMSG believes that the central point to look at in the aftermath on the COVID-19 crisis is to see what can be done to improve the functioning of the underlying money markets. MMFs are only one player in this market. MMFs are useful vehicles for issuers, who can achieve a better diversification of funding sources. For investors, MMFs provide a diversified short term investment opportunity with easy and quick subscription/redemption mechanisms, low credit risk and diversification of counterparty risk.

ESMA explores 11 different options, some of them bearing potentially more or less consequences on the European MMFs' structures. 5 of them are reform options, four targeting either the liability side of MMFs, the asset side or both sides, and one targets an aspect external to the MMF.

Regarding the liability side, ESMA explores, in the case of two specific MMF structures, the option of "decoupling" the current link between on the one side the level of regulatory thresholds and on the other side the imposition of barriers to the investors' redemption possibilities, i.e. imposing suspensions and/or gates[1]. Also on the liability side, ESMA explores for all types of MMFs, the option of introducing an anti-dilutive mechanism[2] meant to allocate the cost of accessing liquidity on the redeeming investors.

[1] IOSCO definition of gates, February 2018, "Open-ended Fund Liquidity and Risk Management"
" Redemption gates are partial restrictions to investors' ability to redeem their capital, generally on a pro-rata basis."
[2] An anti-dilutive mechanism is a tool meant to protect existing investors from bearing the costs of buying or selling the underlying investments as a result of large inflows into or outflows from a fund. I could take the form of a "swing pricing" - where the liquidity cost is deducted from the NAV, an anti dilution levy ("ADL") or a redemption fee – where the cost is a fee outside the NAV.

On the asset side, ESMA's questions target the liquidity buffers. Options are investigated also on both asset and liability sides with questions pertaining to the elimination or conversion of MMFs that offer constant Net Asset Value (NAV). As a reform option external to MMFs, ESMA is enquiring into the current drafting of the ban on "sponsor support" (i.e., an external intervention meant to maintain the NAV or the liquidity of the MMF).

The further 6 reform options are linked to aspects where ESMA would like to get some feedback and are not related to the main reform themes.

The Money Market Fund Regulation ("MMFR") is a robust and recent piece of legislation. Its calibration is seen as appropriate and adapted to the specificities of the European money markets. Regarding the options proposed, the SMSG agrees to the usefulness of some of them like decoupling quasi automatic links in regulations, the usability of liquidity ratios so they can play a countercyclical role, using an anti-dilution mechanism to fairly allocate the cost of accessing liquidity with appropriate calibration, as well as improved transparency in money markets.

As money markets and MMFs are also scrutinized in international fora, and knowing that markets and regulations differ geographically, the SMSG is urging ESMA to focus on its own market specificities and to strongly voice the EU perspective.

I. Background

1. On 26 March 2021, ESMA launched a consultation on the possible review of the EU Money Market Fund Regulation ("MMFR").

2. This consultation document is linked to two contexts: first, the MMFR review clause as per Article 46, which provides that "[b]y 21 July 2022, the Commission shall review the adequacy of this Regulation from a prudential and economic point of view, following consultations with ESMA" and second, the COVID-19 sanitary crisis that was challenging for markets, including money markets, particularly in March 2020.

3. The COVID-19 context and related questions in the consultation report are also linked to the work undertaken at the international level in order to assess the situation faced by money markets, including effects on money market funds ("MMF") during the COVID-19 crisis.

4. The main MMF legislations (both at international and European levels) have been updated in the aftermath of the 2008 crisis. ESMA assesses in the light of the 2020 crisis the functioning and potential need for amendment of the current regulatory framework applicable to MMFs in the EU.

5. The consultation document touches upon several important issues with regards to money market funds but also to some aspects linked to money markets more broadly. The SMSG established a working group to discuss the topics covered in the consultation report. This response summarizes the global view of the SMSG with regards to different issues mentioned in the paper, but also other aspects deemed relevant by the SMSG.

II. General comments

5. ESMA's assessments on the crisis, money markets difficulties, investor behaviours and money market funds are accurate on many points. Despite the March 2020 exceptional exogenous market event, European MMFs demonstrated resilience: no European MMF used exceptional liquidity management

tools[3] ("LMTs") nor any type of sponsor or public money support and investors reverted confidently back to MMFs in one to (less than) three months' time (depending on the type of funds). Redemptions were mainly motivated by the "dash for cash"[4] in a very uncertain economic situation due to an unforeseeable sanitary pandemic that affected all economic players.

6. The SMSG believes that the central point to look at in the aftermath on the COVID-19 crisis is the underlying money market and see what can be done to improve the functioning of this market. MMFs are only one player in this market and the diversification gained through the intermediation of MMFs of funding sources for issuers as well as counterparty risk for liquidity placement for investors is important and should be preserved.

7. The SMSG believes indeed that regulatory attention is best directed to the characteristics of the underlying markets in which MMFs invest and in particular to the market for Commercial Paper[5] ("CP"), by searching to obtain a more efficient and resilient pan-European CP market with increased transparency and more standardisation creating the conditions to ensure more dealer participation in the secondary markets. As illustrated by the Covid-19 turmoil, although a positive move, the use of trading platforms is not a substitute for liquidity, particularly in times of volatility or market stress, and ultimately a functioning CP market requires dealer expertise and intermediation.

8. Some other comments by ESMA, pertaining for instance to the identification of certain vulnerabilities or to MMF self-resilience, i.e. ensuring "that regardless of the market conditions, they can operate without impacting financial stability" and avoiding interventions of central banks, are not entirely supported by the SMSG. Indeed, any investment fund is dependent on the orderly functioning of the underlying market and cannot operate in isolation, i.e. regardless of the severity of market deterioration. It is a key role of central banks to conduct monetary policy to achieve price stability (low and stable inflation) and to help manage economic fluctuations.

9. The SMSG believes ESMA is right in consulting stakeholders at this preliminary stage. It not only helps in preparing the future EU work in the matter, but also contributes to the international forum, as both IOSCO and the FSB have initiated work on MMFs. Post COVID-19 crisis, money markets have been prioritized as an area of assessment in 2021. A consultative report is due to be presented to the G20 in July 2021 with policy proposals, and a final report in October 2021. As money markets, as well as investor behaviour and money market fund regulations differ around the globe, a "one size fits all" approach might have serious side effects in some markets and in that respect should be avoided. European and USA money markets are essential segments in their respective financial markets. They share some aspects, but they also diverge, for instance on the existence of Federal Treasuries and the depth of money markets, on the investors' flight from Prime[6] funds[7] to government paper versus mere need of liquidity ("dash for cash",) or on the sponsor support. Accordingly, ESMA's focus should take into account the specificities of the EU market and regulatory framework. MMFR is conceived as a robust framework adapted to European money markets and the SMSG urges ESMA to strongly voice the EU perspective reflecting market and regulatory differences at the international level.

---

[3] Liquidity management tools are mechanisms available to use for funds in order to help them face redemption requests while ensuring fair treatment of fund invetors.

[4] "Dash for cash" designates the stringent and concomitant need for several economical actors to access and withdraw large sums of money.

[5] Commercial papers are short-trem debt instruments issued with a term from one day to one year by corporates, banks or states.

[6] In the USA, prime funds are money market funds that primarily invest in corporate debt securities, as opposed to government paper funds. The U.S. Securities and Exchange Commission (SEC) Rule 2a-7 defined 3 categories of money market funds based on the types of underlying investments of the fund: government, prime, and municipal.

[7] See FSB's "Holistic Review of the March Market Turmoil" on page 19 the section "Box 4.1: MMF developments during the market turmoil" https://www.fsb.org/2020/11/holistic-review-of-the-march-market-turmoil/

10. MMFs are important economic players as they finance the short end of the curve through the continuous roll of short-term instruments issued by corporates, financial entities and public organizations/governments. The SMSG understands the need to avoid systemic risk and the danger of underestimating the change of value of funds when liquidity dries up. The crisis affected all markets, not only money markets. Money markets might have been visible earlier precisely because of their short-term and liquid nature, giving them the potential for "signalling" early on a more general exogenous market stress that translated into rational "dash for cash" behaviours in times of uncertainly. The SMSG is of the opinion that MMFs did not cause the crisis nor have they amplified the risk on the market. The reform mix should ensure the robustness of MMFs while bearing in mind the role played by these funds to finance the economy and avoid disruptive measures as well as measures that would deter MMFs from correctly performing their intermediation role. It is important all actors draw the lessons learned from the recent crisis. However, the crisis would have taken place with or without the MMF actor. If MMFs would not have been there, the pressure from investors to access their cash might have put even more pressure on the banking system and redemptions might have occurred more heavily from longer term types of funds, which are less agile by construction to deal with such short-term redemption pressure. MMFs have actually fulfilled their role despite the pressure on the underlying market liquidity, and to some extent have taken pressure away from other market sectors by being able to meet their redemption demands, the bulk of them having been met even before the ECB intervention through the Pandemic Emergency Purchase Programme (the "PEPP"[8]) was effective. In addition, it should be recalled that the PEPP is not open to banking instruments (which make the major part of MMF investments) and concerns only issuances labelled in €.

11. European MMFs are mainly an institutional investor market. MMFs provide non-financial corporations a mechanism to invest short term liquidity and manage working capital. MMFs' unique structure offers a diversified short term investment opportunity with easy and quick subscription/redemption mechanisms and low credit risk compared to single name commercial papers. Any review of the regulatory framework aimed at limiting redemptions should give due consideration to the possible consequence of corporate users turning to other liquid instruments with potentially higher credit risk. Understanding investor behaviour and intentions are particularly important in money markets. Enhancing the Know Your Customer ("KYC") area, together with building solid confidence through the appropriate transparency on portfolios, as well as sharing market expertise are key characteristics of this market. The SMSG believes that the MMFR achieved a high level of resilience and constraint on MMFs. Subsequent reforms should also pursue the objective of avoiding to inadvertently curb the flexibility of the manager to deal with market situations in the best interest of investors and markets.

12. ESMA is looking not only to options linked to the objective of achieving more resilience in the aftermath of the crisis that relate to all European MMF structures, but also to options related to the review clause concerning the new Constant NAV structures created by the MMFR (LVNAV[9] – Low volatility NAV MMFs and PDCNAV[10] – Public debt constant NAV MMFs). The SMSG thinks that each crisis is different and that the MMFR came in the aftermath of a credit crisis, whereas the current reform

---

[8] Quote from the ECB website : "The ECB's pandemic emergency purchase programme (PEPP) is a non-standard monetary policy measure initiated in March 2020 to counter the serious risks to the monetary policy transmission mechanism and the outlook for the euro area posed by the coronavirus (COVID-19) outbreak. The PEPP is a temporary asset purchase programme of private and public sector securities. "

[9] An LVNAV is an MMF allowed to use constant NAV valuation and invested in all types of issuers, including private financial and non financial issuers. As of MMFR Article 2 Definitions : "12) 'low volatility net asset value MMF' or 'LVNAV MMF' means an MMF that complies with the specific requirements laid down in Articles 29, 30 and 32 and in Article 33(2)(b)".

[10] An PDCNAV is an MMF allowed to use constant NAV valuation and mainly invested in government debt. As of MMFR Article 2 Definitions : "(11) 'public debt constant net asset value MMF' or 'public debt CNAV MMF' means an MMF: (a) that seeks to maintain an unchanging net asset value (NAV) per unit or share; (b) where the income in the fund is accrued daily and can either be paid out to the investor or used to purchase more units or shares in the fund; (c) where assets are generally valued according to the amortised cost method and where the NAV is rounded to the nearest percentage point or its equivalent in currency terms; and (d) that invests at least 99,5 % of its assets in instruments referred to in Article 17(7), reverse repurchase agreements secured with government debt referred to in Article 17(7) and in cash"

comes after a liquidity crisis. The 2020 liquidity crisis can also be seen as a stress test on a recent regulation (applicable on the existing funds since January 2019 and delivering quarterly reporting since the 1st quarter 2020).

13. There are 11 different options that are explored by ESMA, some of them bearing potentially more or less consequences on the European MMFs' structures. 5 of them are linked to the main reform themes the consultation deals with, including (i) reforms targeting the liability side of MMFs (decoupling for LVNAVs and PDCNAVs regulatory thresholds from suspensions and/or gates; requiring an anti-dilutive mechanism), (ii) reforms targeting the asset side (focusing on liquidity buffers) or (iii) reforms targeting both asset and liability sides (eliminating or converting constant NAV MMFs) and (iv) a reform option external to MMFs (enquiring the ban on sponsor support). The further 6 reform options are linked to aspects where ESMA would like to get some feedback and are not related to the main reform themes.

Reforms targeting the liability side of MMFs

i. Decouple regulatory thresholds from suspensions/gates

14. The SMSG is globally favourable to decoupling regulatory thresholds from automatic triggers. In general, automatic links in regulation reduce agility in a crisis and can be procyclical. A prior example of this was the over-reliance on external credit ratings where the systemic risks identified required to withdraw any existing automatic link.

15. The MMFR established a link between suspensions/gates and the level of the liquidity buffer (together with another parameter: the level of redemptions) in order to preserve investor fairness for funds that offered order dealing at constant NAV. The MMFR states that LVNAVs and PDVNAVs "should have in place provisions for liquidity fees and redemption gates to ensure investor protection and prevent a 'first mover advantage'."

16. It seems that investors in LVNAV and PDCNAV feared the threshold that would trigger gates and some of them placed redemption orders pre-emptively, adding up to the redeeming orders placed by investors in desperate need for cash. In addition, this type of behaviour would have prevented this type of MMFs of freely making use of their regulatory liquidity buffers (of minimum 30%) without risking more investor flight.

17. When market participants can anticipate an outcome assessed as unfavourable to them, they might precipitate it (knowing that they can act at no cost to prevent the unfavourable outcome happening). In the present case, anticipating an adverse outcome with the imposition of fees/gates, investors may actually precipitate it as they attempt to pre-empt the imposition of such measures by redeeming ahead of others. The SMSG thus sees a risk of self-fulfilment and pro-cyclicality in automatically linked public triggers in the MMFR. Decoupling might not fully attenuate the risk of "first mover advantage" since investors, still able to monitor the liquidity ratios themselves, might have developed a propensity to overweight the importance of these ratios' fluctuation.

18. The SMSG acknowledges that de-linking liquidity parameters and gates leaves the question open on the liquidity fee imposition. The MMFR designed the liquidity fee as a fee that "should adequately reflect the cost to the MMF of achieving liquidity and should not amount to a penalty charge that would offset losses incurred by other investors as a result of the redemption." The question of who bears the potentially substantial cost of accessing liquidity in case of redemptions in very difficult markets, especially for structures where a valuation gap is authorized by construction, remains valid.

ii. Require MMFs to use swing pricing and/or anti-dilution levies (ADL) / redemption fees

19. ESMA envisages the option to require MMFs to use an anti-dilution mechanism.

20. The section is somewhat confusing at first, since it follows upon the previous discussion on the de-coupling of the regulatory threshold from suspensions/gates, which pertains to LVNAVs and PDC-NAVs only (and would require "removing Article 34(1)(a)(i) and 34(1)(a)(ii) of the MMF Regulation"). The section discusses the appropriateness of requiring these MMFs to use anti-dilution mechanisms instead and examines the merits of introducing such a mandatory tool for all MMFs alike.

21. In general, swing pricing[11] and other anti-dilution mechanisms are useful tools. They are already used on other types of funds, such as bond funds, small/mid cap funds, etc. During the crisis, this mechanism was used in several European jurisdictions. It helps allocating the cost of accessing liquidity more fairly, i.e. put the cost on the redeeming investor so as to protect the investors who remain invested in the fund. As ESMA anticipates, in certain circumstances "it would help reduce redemption requests under stressed market conditions."

22. From a theoretical standpoint, the SMSG sees the merits of this type of tool. However, the way it would be implemented in practice for MMFs is of utmost importance. The practical details will determine whether such a tool would work or not, or might, even worse, have side effects that would outweigh the benefits. The operational impact and practicality of any such measures should be taken into account.

23. The SMSG would like to bring to ESMA's attention the following aspects. Swing pricing is not per se a tool through which the manager deals with the fund's liquidity risk, nor a tool that works in extreme markets deterioration. Anti-dilution mechanisms allocate more fairly the increased cost of liquidity, but they should not be "penalties". Indeed, a very deteriorated market situation (or even a freeze) might not respond any more to the best interest of investors, as the cost of accessing liquidity – if any - would be disproportionate to this asset class's remunerations and pricing spreads. It is however a tool, as ESMA says, that "may help reducing redemption requests under stressed market conditions if redeeming investors finance the cost of liquidity, which may increase as a result of widening spreads on short-term funding market." Thus, the market window where the tool might be of use is extremely delicate to narrow down. Such a tool is unlikely to work effectively in times of lack of secondary trading in the underlying CP market.

24. Regarding the practical implementation, with swing pricing, a fund adjusts the NAV for inflows or outflows to take into account the costs of purchasing or selling assets of the fund. The exact same result of cost allocation between investors is also achieved through anti-dilution levies (ADL)[12], but it is implemented as an adjustment of the entry and exit charges of the fund, outside the NAV. Similarly, also a liquidity fee, on the exit side only, is implemented as an adjustment of the exit charges of the fund, outside the NAV. These options should also be assessed from an operational standpoint. Time to market is essential for investors in MMFs, as most MMFs offer same day liquidity. The more the practical specifications impose a high cost in time, expertise and complexity in calculation and implementation, frequency of use, etc., the higher the risk to generate side effects and make it inoperable.

25. Beyond the implementation and specification issues discussed above, the SMSG thinks that ESMA should in priority weigh the objective it assigns to the tool, if this option were to be envisaged, and

---

[11] IOSCO definition of swing pricing, February 2018, "Open-ended Fund Liquidity and Risk Management"
"Swing pricing refers to a process for adjusting a fund's net asset value (NAV) to effectively pass on transaction costs stemming from net capital activity (i.e., flows into or out of the fund) to the investors associated with that activity during the life of a fund, excluding ramp-up period or termination. In a liquidity-challenged environment, quoted bid/ask spreads and overall trading cost can widen and may not be representative of the executed prices that can be achieved in the market. In such circumstances, swing pricing can be a useful mechanism to:
• contribute to protect the interests of existing investors, specifically from the dilution of their holdings; and
• contribute to protect the value of the investors capital."

[12] An anti-dilutive mechanism is a tool meant to protect existing investors from bearing the costs of buying or selling the underlying investments as a result of large inflows into or outflows from a fund. It could take the form of a "swing pricing" - where the liquidity cost is deducted from the NAV, an anti dilution levy ("ADL") or a redemption fee – where the cost is a fee outside the NAV.

calibrate it accordingly. Investor acceptability is a central aspect to be factored in as well. In cases of severe stress, albeit short of a complete (secondary) market freeze, when cash is all that matters, a fair fee allocating the price of accessing liquidity might not represent a deterrent for investors, as redemption remains possible while fairness between investors is reinforced. Better allocating the cost of liquidity might slow down some redemptions on a limited timeframe. However, even with a fee, in case of very severe stress, the increase of uncertainty might not sufficiently restrain redemptions.

Reforms targeting the asset side of MMFs

iii. Increase liquidity buffers, review their calibration and/or make them usable/countercyclical

26. Introducing daily and weekly liquidity buffers for MMFs has been an important provision in the previous European MMF reform and ESMA is right in assessing their usefulness in the light of a procyclical risk.

27. EU MMFs managed to meet all redemption demands during the COVID-19 crisis, which represented a severe stress test. Mandating an increase in liquidity buffers, therefore, does not seem to be justified. As last year's market correction was in essence prompted by a lack of liquidity in the underlying short-term money markets, the purpose additional liquidity buffers would serve to relieve market stress remains unclear. Were the underlying liquidity conditions to freeze again as they did in March 2020, additional buffers would offer no comfort when securities simply cannot be traded.

28. CP markets are not illiquid. They are short term instruments that can be traded in the secondary markets. There is normally a very good primary market liquidity for CPs. As they are short-dated instruments, in normal times, investors tend to hold positions until maturity and thus the volume of transactions is low. A low volume of transactions in the secondary markets should not be mistaken for a lack of liquidity, because, if needed, managers can in ordinary market circumstances buy and sell positions on the secondary markets with no difficulty. It happened though that in the COVID-19 stressed markets, some dealers' ratios were sometimes and for a limited period of time saturated and additional demands could only be satisfied once the banking ratios were temporary relieved.

29. In regard of the three specific options ESMA is listing, the SMSG considers that in any case procyclical effects should be avoided. These non-desirable effects might arise when a quasi-automatic link exists between the publicly disclosed level of the buffers and a trigger on a restrictive measure on the liability side, as is currently the case for LVNAVs and PDCNAVs for triggering of fees and gates (upon decision of the fund's Board). To be countercyclical, liquidity buffers should be usable, when necessary, to face redemptions, under the asset managers' responsibility / fiduciary duty to work in the best interest of the investors. Currently, the use of VNAVs buffers is countercyclical, as the MMFR rightly allows to use them under the constraint of forbidding any new investment in the fund as long as the cash buffer is not replenished.

30. From an economic standpoint, it is not clear what the benefit would be of penalizing the investment target and performance objective of about €1 trillion EU MMFs (around 15% of the EU's funds industry) by sterilizing a portion of their portfolio, if this liquidity buffer cannot even play its smoothening role.

31. Regarding the calibration and composition of the buffers, these are minimum levels and the European asset players are managing the ratios on a fund-by-fund basis. Managers take into account several parameters, such as the asset liability pattern, the planned redemptions through the KYC, the market situation, etc. It should be reminded that money markets evolve as well as the monetary policy and the different regulations imposed on issuers, investors, banking entities and asset managers. All these aspects continuously shape the market, for instance by influencing the amount of issuances of short-term papers and the remuneration of risk compared to other market segments. Portfolios need to constantly adapt to the market. Preserving the necessary flexibility is key to achieve safer markets.

Reforms targeting both the liability and asset side of MMFs

iv. Eliminate stable NAV MMFs / Convert Public debt CNAV and LVNAV funds to Public Debt VNAV and VNAV / Convert only LVNAV funds to VNAV

32. MMFs provide non-financial corporations a mechanism to invest short term liquidity and manage working capital. MMFs' unique structure offers a diversified short term investment opportunity with low credit risk compared to single name commercial papers, they combine quick redemption, low credit risk and yield enhancement.

33. Investors, in particular corporates, report that LVNAVs and CNAVs work well in Europe. Any review of the regulatory framework aimed at limiting redemptions should give due consideration to the possible consequence of corporate users turning to other liquid instruments with potentially higher credit risk. Although unsure up to what extent, in the unfortunate case where redemption limits are too strictly designed, investors might prefer to see the structure evolving towards a VNAV than see too many illiquid barriers installed.

34. More generally, MMFs are key investment vehicles for corporates and other types of investors. They are low margin products giving access to same day liquidity. Restricting investors' access to liquidity should be avoided. When markets are under stress (and depending on the severity of the stress), working on fair fees linked to the cost of liquidity might be a better temporary solution than gates or suspensions.

Reforms that are external to MMFs themselves

v. Assess whether the role of sponsor support should be modified (e.g. amend the current requirement of article 35 of the MMF Regulation under which sponsor support is prohibited)

35. Regarding the sponsor support, ESMA asks whether the role of sponsor support should be modified, which would mean amending the current requirement of article 35 of the MMF Regulation under which sponsor support is currently prohibited.

36. The current prohibition represents a major difference between the European MMFR and the US 2a7 rule on MMFs, the latter allowing for sponsor support (a faculty that was used by a couple of US asset managers during the pandemic). The SMSG is not in favour of changing the current rule to allow sponsor support, as this radical change would mean additional moral hazard[13] for this particularly sensitive market segment. As a reminder, the implicit guarantee on a constant I $ value for the US MMF, called the Reserve Primary Fund, caused a market run in 2008 as soon as it "broke the buck". Investors lost confidence and fled to US Treasuries, agency securities, repos and cash deposits[14]. The Reserve Primary Fund debacle turned into a case study for all parties involved, and especially for investors.

37. The SMSG believes that making clear for investors the nature of MMFs, namely that they are investment funds with no external guarantee (as any other fund) is of paramount importance.

---

[13] In economics, moral hazard occurs when an entity has an incentive to increase its exposure to risk because it does not bear the full costs of that risk. Investors in MMFs that could benefit from sponsor support might have unfounded expections of an evergreen guarantee and overlook the necessary minimum due diligence allowing to grasp the the real risk return profile of the fund. MMFR explains that "Depending on the size of the MMF and the extent of the redemption pressure, sponsor support could reach proportions that exceed their readily available reserves." & " In those circumstances, the discretionary nature of sponsor support contributes to uncertainty among market participants about who will bear losses of the MMF when they do occur."

[14] See page 73 of the BIS Quarterly Review, March 2009 "US dollar money market funds and non-US banks" https://www.bis.org/publ/qtrpdf/r_qt0903g.pdf

38. The SMSG agrees that a Central bank intervention in its own market, such as the ECB's PEPP, should in no case be interpreted as an external support to MMFs. Central banks conduct monetary policy to achieve price stability (low and stable inflation) and help manage economic fluctuations.

i. Amend/specify the rules on ratings of MMFs

39. ESMA also looks into MMF ratings. The SMSG would like to mention that unlike the 2008 crisis, the COVID-19 crisis was a liquidity one with no concerns stemming from the credit side. MMF ratings do not seem to have played a role during the COVID-19 crisis.

40. In some markets, like the French market, investors typically do not require MMFs to be rated as they perform in depth due diligence on the funds in which they envisage to invest and require a thorough and regular knowledge of portfolio composition and performance. Despite the MMFR being in application since 2018, other investors' types continue to value the access to an external view, as an additional check, of a third party rating agency. This rating attribution comes at a cost, but also with an interaction between the fund and the actions of the agency. Indeed, rating actions (for instance downgrading) might trigger unwanted investor behaviour in some cases. The SMSG is of the view that at least investors should be made aware of the interaction (and potential conflict of interest) between the MMFR and the rating agency's terms (such as the MMFR's requirement to base the credit assessment of underlying assets on internal credit quality assessment procedures versus certain CRA's imposing limitations based on a minimum level of external ratings). The rating agency should assess and disclose these potential conflicts and risks to investors.

ii. Disclose money market instruments (MMIs) main categories of investors to regulatory authorities (e.g. detailed information on liabilities)

41. MMFs are not the sole players in money markets and ESMA is right to envisage this enhancement. The SMSG is supportive of more transparency in the underlying money markets, encompassing the structure and types of investors. The authorities' attention should primarily be focused on better understanding the underlying markets and ensuring increased transparency and efficiency on instruments dealt in those markets, namely commercial papers (issued with a term from one day to one year by corporates, banks or states).

42. More specifically, issuers prize commercial papers as they represent a rather easy and cheap financing means for them. For instance, the French NEU CPs (Negotiable EUropean Commercial Papers) are a successful type of commercial paper in the Eurozone that allow issuers to diversify their sources of funding and provide investment opportunities in euro (and other currencies). Statistics are available on the Banque de France website and they are considered as an eligible collateral by the ECB. This format along with other European CP formats (Euro CP, other domestic CP markets) may further increase their efficiency through better pan-European transparency (centralized tape), greater standardization as well as through improved secondary market liquidity (encompassing Central Bank eligibility as collateral, usability as repo and/or softer market dealers' ratios). The STEP initiative (short-term € paper pan-European label) has been aiming for some years to foster the integration of the European markets for short-term paper through the convergence of market standards and practices.

iii. Strengthen the role of MMF stress-testing (including from a system-wide perspective)

43. MMF stress testing is already an important tool at the micro level of supervision, with quarterly reporting and regulatory calibrations updated each year. The SMSG is of the opinion that micro supervision is also an effective and relevant element of macro supervision by the global regulatory design and calibration of the stress tests. A lot of data is thus already available and can be considered to reach conclusions also at macro level. The SMSG does not see the merits of developing new macro-prudential stress testing tools.

44. In addition, the utility of stress tests should not be overestimated. Stress tests may have effects in terms of driving some changes in the composition of the portfolio, but they do not deal with the status of liquidity of the underlying markets, which is at present the fundamental variable where authorities' efforts should be engaged. Moreover, the regulation sets the framework for MMF management with all sorts of ratios and limits (diversification, liquidity ratios, eligibility rules, etc) and the SMSG is of the opinion that additional stress tests should not become an additional layer of regulation on top of the regulatory and internal limits. Flexibility permits to adapt the portfolio to different market and liability situations, whereas stress tests - in spite of their usefulness to test different scenarios - cannot anticipate these particular situations.

iv. Further harmonise and enhance international MMFs reporting framework

45. There is always room to enhance harmonization and ESMA is right in preparing also in this domain However the SMSG thinks that the cost-benefit of such an action at such an early stage should be carefully considered. The European reporting framework is quite heavy and very recent (in application since the 1st quarter 2020). In addition, the European framework is robust with for instance stress tests' calibrations that are updated each year.

v. Set-up a liquidity exchange facility ("LEF") funded by MMF or asset managers and depending on the requirements of article 35 of the MMF Regulation, by third parties, on an on-going basis. This LEF could serve as a centralised source of liquidity and/or credit during periods of stress. This could mitigate liquidity pressures on MMFs and reduce the benefit of 'first mover advantage' for investors resulting in an accelerating spiral of investor redemptions and asset fire-sales

46. The LEF cannot be a substitute of the orderly functioning of the underlying markets. Preventing markets' deterioration as well as restoring the confidence on its recovery should in any event be the priority of authorities.

47. The SMSG recommends that ESMA does careful research on what the effects would be of the potential set-up of drastic solutions like the liquidity exchange facility ("LEF"). The costs of such a solution should be taken into account, as they could be prohibitive as MMFs evolve in a low to negative yield market. In addition, the efficiency of a LEF in times of crisis should be examined, in view of the volumes at stake in money markets, depending on the amplitude of the shock.

vi. Further clarify the scope of the MMF Regulation

48. The MMF definition is clear and functioning well since the MMFR clarified it. The SMSG does not see merits in further looking to refine the current definition.

This advice will be published on the Securities and Markets Stakeholder Group section of ESMA's website.

Adopted on 30 June 2021

Veerle Colaert
Chair
Securities and Markets Stakeholder Group

Adina Gurau Audibert
Rapporteur