European Securities and Markets Authority

Response Form to the Consultation Paper

Report on highly liquid financial instruments with regards to the investment policy of central counterparties (EMIR Article 85(3a(e)))

19 November 2021 | ESMA 91-372-1593

Responding to this paper

ESMA invites comments on all matters in this consultation paper and in particular on the specific questions summarised in Annex III. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **24 January 2022.**

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 below steps when preparing and submitting their response:

1. Insert your responses to the questions in the Consultation Paper in the present response form.

2. Please do not remove tags of the type <ESMA_QUESTION_CCP investment policy_1>. Your response to each question has to be framed by the two tags corresponding to the question.

3. 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.

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

5. 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 financial instruments eligible for investments by CCPs, including EU Money Market Funds”).

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publicly disclosed. 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 Legal Notice.

Who should read this paper?

All interested stakeholders are invited to respond to this consultation. In particular, this paper may be specifically of interest for EU central counterparties, clearing members and clients of clearing members.

General information about respondent

Name of the company / organisation	INSTITUTIONAL MONEY MARKET FUNDS ASSOCIATION
Activity	
Are you representing an association?	☒
Country/Region	Europe

Introduction

Please make your introductory comments below, if any

<ESMA_COMMENT_CCP investment policy_00>

Dear Sir or Madam,

We are pleased to respond to ESMA's consultation on highly liquid financial instruments with regards to the investment policy of central counterparties. The Institutional Money Market Funds Association (IMMFA) is the trade association which represents the European money market fund (MMF) industry. IMMFA's mission is to promote and support the development and integrity of the MMF industry by engaging with and informing policy makers and, amongst other things, providing a primary point of contact.

IMMFA currently has 27 members, consisting primarily of asset managers but also custodial banks and other firms. Of the 27, 19 are asset managers (referred to as Full Members). IMMFA MMFs are overwhelmingly institutional funds.

As of mid-December 2021, IMMFA MMFs had EUR907bn equivalent in assets under management (AUM). All IMMFA MMFs have AAA MMF ratings by one or more authorised credit rating agency.[1] At the end of the third quarter 2021, IMMFA MMFs represented approximately 60% of total European MMF AUM.[2] IMMFA assets have increased approximately 40%[3] since the implementation of the EU Money Market Fund Regulation (MMFR) [4] in March 2019, reflecting investor confidence in the regulatory framework and the continued utility of MMFs.

There are 3 main currencies within the IMMFA universe: USD, GBP and EUR. USD is the largest currency (USD516bn), followed by GBP (GBP260bn), and EUR (EUR146bn).[5] IMMFA MMFs are domiciled in Ireland and Luxembourg.[6] Although 96% of IMMFA MMFs are stable Net Asset Value

[1] AAAmmf/Aaa mf/AAAm money market fund ratings by one or more of Fitch Ratings, Moody's Investors Services and S&P Global Ratings.

[2] According to the ECB Statistical warehouse, total MMF AUM in Europe were EUR1,365bn as of 30 September 2021. As of 24 September 2021, IMMFA AUM were EUR812bn equivalent.

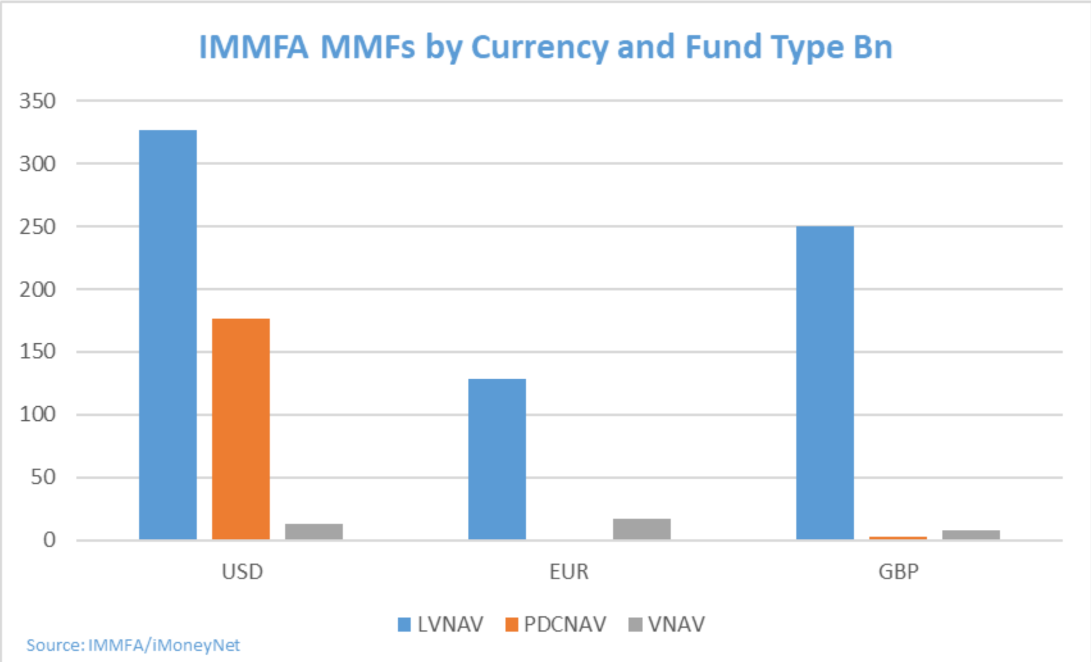
[3] As of 22 March 2019, AUM were the equivalent of EUR639bn versus EUR907bn on 10 December 2021.

[4] Regulation EU 2017/1131 of the European Parliament and of the Council of 14 June 2017 (MMFR).

[5] As of 10 December 2021, sources iMoneyNet and IMMFA. The split between currencies remains fairly constant.

[6] With one exception, a GBP fund in the UK.

(NAV), in the form of either Public Debt Constant NAV (PDCNAV) funds or Low Volatility NAV (LVNAV), IMMFA represents all money market fund types and many of our members offer a range of funds including Variable NAV (VNAV) MMFs. The overwhelming majority of PDCNAV MMFs are denominated in USD and these account for 34% of the USD516bn total in USD denominated MMFs. [7]



Summary of our response

IMMFA recommends that shares in Public Debt Constant Net Asset Value (PDCNAV) MMFs should be included as permissible investments for CCPs. PDCNAV MMFs invest almost exclusively (99.5%) in assets which meet the existing criteria for CCP investments and as such are highly liquid and have minimal credit and market risk. We do not agree with ESMA's suggestion that such potential eligibility is inappropriate at this time, the reason cited being that policy decisions regarding changes to the regulation governing European MMFs have not yet been finalized. PDCNAV MMFs specifically, which are overwhelmingly denominated in USD, saw very substantial inflows during the crisis as investors sought the most conservative and cash-like fund type. Given the resilience which PDCNAV MMFs demonstrated, they are not the focus of reforms which strengthens the case for considering them now. PDCNAV MMFs are already very robust and the intended outcome of regulatory reform is to strengthen MMFs further, which would support the argument to include them now.

We believe the PDCNAV MMF product offers significant benefits as an outlet for CCPs. PDCNAVs have a proven track record of resilience, highly regulated status and they are scalable. MMFs are used by investors globally for cash management purposes, alongside bank deposits and government bonds. The EU framework has provided a leading example on transparency, high levels of liquidity and codified standards.

[7] As of 10 December 2021, sources iMoneyNet and IMMFA.

The other fund categories, if not included now, should be scheduled for examination following the outcome of reforms to EU MMFR. Whilst usage by CCPs has been low in the US and other jurisdictions, we believe that European CCPs would benefit from the opportunity to invest in MMFs and that this would allow them to diversify risk. We also believe that allowing CCPs to do so would mitigate procyclical risks.

In our capacity as a representative of the European MMF industry, we have responded to those questions relating directly or indirectly to MMFs.

We look forward to continued engagement with ESMA and remain at your disposal should you have any questions on our response or wish to discuss it in more detail.

Yours faithfully,

Veronica Iommi
Secretary General
IMMFA
<ESMA_COMMENT_ CCP investment policy_00>

Questions

Q1 : Does the above section describe accurately the requirements on CCP investments outside the EU? Are there other jurisdictions that ESMA should consider to inform its analysis?

<ESMA_QUESTION_CCP investment policy_01>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_ CCP investment policy_01>

Q2 : Does the above section provide an accurate description of CCP practices regarding their investment and collateral policies?

<ESMA_QUESTION_ CCP investment policy _02>

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<ESMA_QUESTION_ CCP investment policy_02>

Q3 : Does the above section accurately describe the trade-offs faced by CCPs when developing their investments strategies? What other factors or trade-offs can influence CCP investment strategies?

<ESMA_QUESTION_ CCP investment policy_03>

From our perspective, this is an accurate description of the trade-offs faced by CCPs. However, we think that the importance of risk diversification is understated given that it is a key aspect of a CCP's investment strategy. Paragraph 64 describes the counterparty risk faced by CCPs when depositing cash with a commercial bank. CCPs often use one or only a small number of commercial banks, meaning that their risk is relatively concentrated. Whilst most CCP investment with commercial banks will be on a secured basis, collateralised with eligible securities, this option may not be available later in the trading day, especially for Initial Margin, as highlighted by Paragraph 63. Allowing CCPs to invest in PDCNAV MMFs would enable CCPs to diversify their investment risk further whilst also allowing for more non-domestic currency reinvestment, in US Dollars for example, later in the day.

<ESMA_QUESTION_CCP investment policy_03>

Q4 : Do you agree with ESMA's premise that changes to the list of financial instruments for CCP investments should be in line with the PFMI?

<ESMA_QUESTION_ CCP investment policy_04>

We agree that changes to the list of financial instruments for CCP investments should be in line with the PFMI. However, ESMA appears to limit its analysis to 'debt instruments' whilst ESMA's mandate refers to 'financial instruments' not 'debt instruments'. We are concerned that the somewhat narrower term 'debt instrument' could be construed as excluding MMF shares. For the reasons elaborated on below, we believe that MMF shares would provide a valuable alternative to commercial banks for CCPs to invest their cash in securely.

<ESMA_QUESTION_ CCP investment policy_04>

Q5 : Do you agree with ESMA's policy approach that benefits should outweigh risks to support a policy change?

<ESMA_QUESTION_ CCP investment policy_05>

We agree that the benefits should outweigh the risks to support a policy change. However, as per our response to question 3 above, additional weight could be given to the benefit which risk diversification would offer CCPs as well as the operational benefits of PDCNAV MMFs, especially where CCPs do not have access to a Central Bank for non-domestic currency reinvestment.

<ESMA_QUESTION_ CCP investment policy_05>

Q6 : Do you agree with ESMA's approach to focus on the list of conditions to define highly liquid instruments bearing minimal credit and market risk? Do you believe it would be appropriate to align EMIR with other definitions of highly liquid instruments in the EU financial legislation, such as CRR?

<ESMA_QUESTION_ CCP investment policy_06>

As noted in paragraph 76, ESMA is required to consider a potential review of 'the list of financial instruments that are considered highly liquid with minimal market and credit risk, in accordance with Article 47' rather than to review Article 47 itself. However, ESMA's mandate is worded "*whether the list of financial instruments that are considered highly liquid with minimal market and credit risk, in accordance with Article 47, <u>could be extended</u> and whether that list <u>could include one or more money market funds</u> authorised in accordance with Regulation (EU) 2017/1131 of the European Parliament and of the Council*." We would respectfully question how ESMA could recommend extending a list without modifying the Annex II where required. We note that the co-legislators have adopted an Article at Level 1 with an Annex to this Article which suggests that they anticipated that the Annex could be modified later without having to amend Article 47 itself.

We are concerned that a very formal approach (i.e., considering maintaining Annex II and its limitation to debt instruments that are issued or explicitly guaranteed by: (i) a government; (ii) a central bank; (iii) a multilateral development bank as listed under Section 4.2 of Part 1 of Annex VI to Directive 2006/48/EC; (iv) the European Financial Stability Facility or the European Stability Mechanism where applicable, -.) could create further barriers to the inclusion of MMFs. We would recommend that ESMA interpret 'financial instruments' in Annex II as meaning *money market and* debt instruments and thereby potentially include MMF shares.

<ESMA_QUESTION_ CCP investment policy_06>

Q7 : With regards to condition (a) on public entities outlined in Annex II:

i. Should the list of international organisations be expanded beyond the EFSF and the ESM to explicitly include the EU?
ii. Should it include other international organisations (IMF? BIS? Others?)?
iii. Do you agree with ESMA's legal analysis that it is not necessary to explicitly include regional governments and local authorities as these should be covered by the generic term of government under condition (a)(i)? Should ESMA consider adding conditions similar to those outlined in Article 115 of the CRR?
iv. Should ESMA consider limiting the list of governments and central banks in particular to those from third-countries deemed to have equivalent regulatory and supervisory arrangements?
v. Do you agree that the list of multilateral development bank listed under Article 177(2) of CRR is suitable?

<ESMA_QUESTION_ CCP investment policy_07>

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<ESMA_QUESTION_ CCP investment policy_07>

Q8 : Should ESMA consider expanding condition (a) to certain debt instruments issued or backed by private entities? If so, to which type of corporate debt securities (Commercial Paper, Certificates of Deposits, covered bonds, etc.)? Under what conditions? How would the benefits outweigh the added risks?

<ESMA_QUESTION_ CCP investment policy_08>

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<ESMA_QUESTION_ CCP investment policy_08>

Q9 : With regards to condition (b) on CCP internal assessments in Annex II:

i. What are, to your knowledge, the best practices used by CCPs to identify low credit and market risk?

ii. What are the safeguards put in place to avoid overreliance on external opinions, notably CRAs?

iii. In order to avoid supervisory divergence, do you deem necessary that ESMA issue further guidance on how NCAs should assess these provisions?

<ESMA_QUESTION_ CCP investment policy_09>

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<ESMA_QUESTION_ CCP investment policy_09>

Q10 : With regards to condition (c) on the average time to maturity, do you believe that this time period is appropriate? Should its calculation be further specified in the RTS?.

<ESMA_QUESTION_ CCP investment policy_10>

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<ESMA_QUESTION_ CCP investment policy_10>

Q11 : With regards to conditions (d), (e), (f) and (g) under Annex II, should these be amended?

<ESMA_QUESTION_ CCP investment policy_11>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_ CCP investment policy_11>

Q12 : Do you agree with this conclusion? To what extent are MMFs currently used as collateral or CCP investments beyond the EU?

<ESMA_QUESTION_ CCP investment policy_12>

We have taken the word 'conclusion' in this question to refer primarily to the data which suggests that take-up of MMFs by CCPs has been only moderate. We have also taken it more broadly to encompass whether we agree or disagree with the general conclusions drawn in characterising the MMF market and the events of March 2020.

Usage of MMFs

Although usage of MMFs by non-EU CCPs appears to be moderate we do not see this as a reason to continue their exclusion from the investment choice of EU CCPs. As the use of MMFs by EU CCPs has not been permitted, it would be erroneous to conclude that CCPs would not avail themselves of the option should it be permissible. We believe that EU CCPs would invest in MMFs if they had this tool at their disposal. Allowing MMFs as part of a balanced set of investment alternatives would bring CCPs the benefits of diversification and flexibility. Should the rules permit it, we would expect to see appetite.

US CFTC rules include MMFs as permissible investments for clearing members and CCPs, subject to certain conditions. As a result, US CCPs are using MMFs for cash reinvestment. Relatively low take-up levels are likely to reflect greater depth and availability in the US treasury market as well as direct CCP access to the US Federal Reserve System. Comparable access does not exist in Europe for all currencies, as highlighted in Paragraph 63.

While usage of MMFs by CCPs in the US and other jurisdictions has been moderate or low, the optionality afforded mitigates risk, particularly as market circumstances change or future liquidity issues occur.

The conclusions on MMFs

With regard to some of the conclusions on the overall context for MMFs, there are areas we would like to clarify. In particular, we would highlight that the liquidity stress experienced by MMFs during the COVID-19 crisis was a function of a broader malfunctioning of short-term funding markets. Liquidity stress was not confined to MMFs but was reflected across almost all asset classes. As suggested in paragraph 119, not all MMFs experienced liquidity strains during the crisis. Experience varied by both fund type and currency, with some private debt MMFs recording high outflows. The consultation does not add that PDCNAV MMFs, the most conservative fund type, in fact benefitted from substantial inflows as investors sought the closest proxy to cash. Given this distinction, we expect reforms to focus on private debt MMFs, meaning that there would be no reason, as per ESMA's suggestion, to delay including PDCNAV MMFs as eligible investments on the basis that further reforms are likely.

As noted in paragraph 114, the EU MMFR introduced rules 'to make MMFs more resilient and to limit contagion'. To achieve this, EU MMFR introduced stringent rules on eligible assets, portfolio credit quality and diversification. It also increased transparency and mandated minimum liquidity ratios in both overnight and weekly maturities, ensuring that MMFs are structured to hold consistently high levels of liquidity to meet redemptions, a feature which should weigh strongly in their favour when considering their eligibility. MMFs were previously excluded from eligible CCP cash investments on the basis that MMFs had experienced issues in the 2007-2008 global financial crisis and the EU did not have a harmonized regulatory framework. The absence of a harmonized framework has since been rectified with the implementation of EU MMFR in March 2019. The ability of MMFs to withstand stress during the subsequent COVID-19 crisis in March 2020 illustrated that the reforms were effective in enhancing MMF resilience. We therefore believe it is appropriate that PDCNAV MMFs should be considered eligible as cash investments for CCPs now rather than postponing further.

Paragraph 115 sets out the two broad categories of standard and short-term MMFs and notes that standard MMFs are permitted to invest in longer maturities. However, in stating that standard MMFs 'invest mainly in assets maturing within 6 months' and short-term 'invest mainly in assets maturing 120 days', the comparison misleadingly conflates two different risk parameters, namely weighted average maturity (WAM) and weighted average life (WAL). There are very significant differences between short-term and standard MMFs in these crucial duration metrics. The correct comparison would be 6 months (to be precise, 180 days) for standard MMFs, versus 60 days for short-term MMFs. Whilst short term MMFs are limited to a 60-day WAM, standard MMFs have a 180-day limit. Similarly, short term MMFs have a 120-day WAL compared to 365 days in the case of standard MMFs, and a maximum final maturity of 397 days versus 2 years for standard MMFs. The correct comparison is therefore 60/180 (short-term/standard) WAM and 120/365 WAL, not 120/180 as stated. The significantly shorter maturity profile of short-term MMFs, combined with the higher liquidity requirements, means that the risk profile between the two types is very different.

Paragraph 115 goes on to suggest that LVNAV MMFs invest in a broader range of instruments than short term VNAV funds, *which is not the case*. Apart from the crucial distinction that LVNAVs are required to maintain higher liquidity requirements, the only difference between LVNAV and short term (as distinct from standard) VNAV MMFs is the pricing methodology; the investment parameters are the same. PDCNAV MMFs, on the other hand, do have much more conservative investment parameters since they buy 99.5% public debt assets. Given we feel it would be appropriate that the inclusion of private debt MMFs be considered once future reforms have been agreed, we believe it is important to be precise on the relative risk parameters.

Pricing methodology (i.e., stable NAV such as LVNAV or PDCNAV, versus Variable NAV) was not a key determinant in outflows in the COVID-19 crisis. As partially noted in paragraph 119, both Euro-denominated standard VNAV, USD Prime MMFs (which are variable) and USD-denominated short term LVNAV MMFs (which are stable) experienced similar levels of elevated redemptions.

We agree that the COVID-19 market turmoil created a real-life test of MMF resilience (paragraph 117) and, by implication, the effectiveness of the MMFR. It also highlighted an area where the regulation had not operated as intended, namely the link between liquidity thresholds and the possible imposition of liquidity management tools. We, along with other stakeholders, expect this to be addressed in future reforms, which will increase resilience further. Paragraph 120 goes on to say that 'the rapidly deteriorating situation required substantial intervention by central banks through purchases of CP on primary and secondary markets.' Again, we would emphasise that what MMFs experienced was the result of wider market dysfunctionality and that central bank interventions in Europe were by no means aimed exclusively at MMFs.

Central Bank Intervention

Paragraph 120 suggests that the situation with MMFs prompted substantial intervention. Interventions to support short-term markets were part of a series of measures to support the markets and restore confidence far more broadly. Indeed, European MMFs had little or no direct benefit from intervention. Contrary to the statement in paragraph 120, there were no 'funding facilities for banks to buy MMFs'. The Federal Reserve's Money Market Mutual Fund Liquidity Facility (MMLF), which was targeted at MMFs, made loans available to eligible financial institutions secured on high-quality assets purchased from money market funds, an important distinction. It was highly effective in enabling dealers to provide liquidity. Intervention in the markets in Europe, in the form of various asset purchase programmes, including those targeted at corporate CP issuance, provided minimal help to European MMFs. The European Central Bank's (ECB) Corporate Sector Purchase Programme (CSPP) and the Bank of England's Covid Corporate Financing Facility (CCFF) were successful in providing funding to corporates and thereby to the real economy, but they contributed little or no direct benefit to private debt MMFs since the overwhelming majority of their assets are in commercial paper issued by financial institutions (i.e, financial CP). The ECB's extension of eligible collateral helped bank liquidity but brought no direct benefit to MMFs.

The operational integrity of IMMFA MMFs was maintained without recourse to asset purchase facilities as the fund assets were ineligible.[8] Refinancing operations, on the other hand, were effective in providing liquidity to banks and unlocking their ability to resume intermediation in the wider markets, demonstrating the crucial role that dealers play in enabling markets to function efficiently. European MMFs had sufficient liquidity buffers to meet redemptions, which demonstrates their ability to provide the high levels of liquidity required for a CCP cash investment. Those IMMFA MMFs which had experienced outflows, quickly recovered once the broader markets stabilised.

<ESMA_QUESTION_ CCP investment policy _12>

Q13 : Do you agree with the premise that the assets held by eligible MMFs for CCP investment should at least meet the same criteria as for other financial instruments?

<ESMA_QUESTION_ CCP investment policy_13>

PDCNAV MMFs meet the criteria

This question appears to imply that all the assets held by eligible MMFs should be highly liquid with minimal credit and market risk. As pooled investment funds in which investors are effectively securitised on the underlying portfolio, MMFs mitigate credit and market risk by having a diversified range of high-quality assets and holding substantial liquidity buffers. In our view, it would therefore not be a necessary requirement that every asset meet the same criteria as for other financial instruments permitted as CCP investments.

Leaving aside the theoretical point about outright versus pooled risk, in the case of PDCNAV MMFs the assets held *do indeed meet* the strict criteria since they hold 99.5% of their assets in public debt in the form of short-dated government securities or short dated reverse repo collateralised by government securities. PDCNAV assets therefore ‘can be considered highly liquid, bearing minimal credit and market risk’. PDCNAV MMFs offer same day settlement, meaning that they can be redeemed on a T+0 basis. The ability to do so is based on their substantial overnight reverse repo holdings of government securities, which are typically 102% collateralised. We therefore believe that PDCNAV MMFs should be considered eligible for CCP investment based on i) the underlying asset quality, which meets the relevant strict criteria, ii) their liquidity and iii) their resilience, as demonstrated during the crisis. Both liquidity and asset quality are transparent and can be viewed daily.

Regarding MMFs more generally and other types of MMF, we note that MMFs are required by MMFR to hold very high-quality instruments which by their nature are relatively liquid and have limited credit and market risk. The key objectives of a short term MMF[9] are to provide liquidity and preserve capital. This is achieved by investing in a diversified portfolio of high-quality liquid assets. Within this portfolio, which will consist of numerous different pooled assets, there will be cash, reverse repo, securities such as commercial paper, certificates of deposit as well as some public debt securities (in the case of a PDCNAV MMF public debt will account for 99.5% of the portfolio). In particular, very short-term assets

[8] Low Volatility NAV (LVNAV) MMFs held less than 3% in corporate paper on 29 February 2020 (Source, Crane Data).

[9] A short-term MMF is a specific category of MMF introduced under MMFR and includes both the PDCNAV and LVNAV MMF types which dominate the category, as well as Short-term VNAV MMFs which form a smaller share.

such as overnight deposits or very short-term reverse repo transactions generate daily cash, which is the most liquid asset. Both PDCNAV and LVNAV MMFs (which account for over half the market, the other half being standard VNAV MMFs) are structured to hold significant amounts of liquidity to meet redemptions. In the case of PDCNAV and LVNAV MMFs this is a minimum of 10 % daily liquid assets (DLA) and 30 % weekly liquid assets (WLA). In practice, short-term PDCNAV and LVNAV MMFs typically maintain buffers in excess of the regulatory minimums. These liquid assets, which consist primarily of overnight deposits or reverse repo transactions secured on government collateral, or other maturing paper which has rolled down, generate cash organically and that cash is used to meet shareholder redemptions. These liquidity buffers mean that not *all* the assets MMFs hold have to be highly liquid since redemptions will normally be paid out using the cash in daily or weekly liquidity.

It is important in this context to correct a commonly held misconception that during the crisis MMFs were selling assets to meet redemptions, as this was not the case. MMFs were generally selling securities not to meet redemptions but to replenish their liquidity buffers. This was prompted by the investor focus on so-called ‘bright lines’, namely the link between the minimum 30% WLA threshold and the possible imposition of suspensions, gates or fees, noted in paragraph 116, which was a key concern to investors. The link between liquidity thresholds and the potential imposition of fees, gates and suspensions inadvertently operated as a procyclical accelerant on redemptions. The 30% WLA requirement effectively became a ‘bright line’ that investors were highly sensitive to at the expense of a more holistic view of fund metrics. As access to liquidity became an even greater priority to investors, an approach towards the 30% level caused some investors to redeem pre-emptively. This in turn meant that fund managers became forced sellers of longer-term assets, not in order to meet redemptions, but to boost levels of weekly liquid assets.

The possibility of delinking the minimum 30% threshold and the imposition of suspensions, fees and gates has been central to the debate on possible reforms and is now widely considered to be an option which would improve fund resilience. It has been included in the SEC proposed MMF reforms published on 15 December 2020 which suggest removing fees and gate provisions.[10] There is a growing consensus that such delinking should and will be implemented. Removing the link would significantly improve the usability of liquidity buffers, which, as noted, are maintained at high levels as an intrinsic part of the MMF structure. Despite the acute liquidity stress on the markets during March 2020, no EU MMFs imposed suspensions, fees or gates and MMFs continued to meet redemptions and to function as intended.

Whilst we strongly recommend that PDCNAV MMFs be included as eligible investments now, we would also suggest that other types of MMF be considered once the current regulatory review is concluded.

<ESMA_QUESTION_ CCP investment policy _13>

[10] SEC fact sheet on the MMF proposed reforms: https://www.sec.gov/files/mmf-reforms-fact-sheet_1.pdf.

Q14 : In your view, how could ESMA bridge the need for macroprudential tools for MMFs and the need for high quality and highly liquid collateral for CCPs?

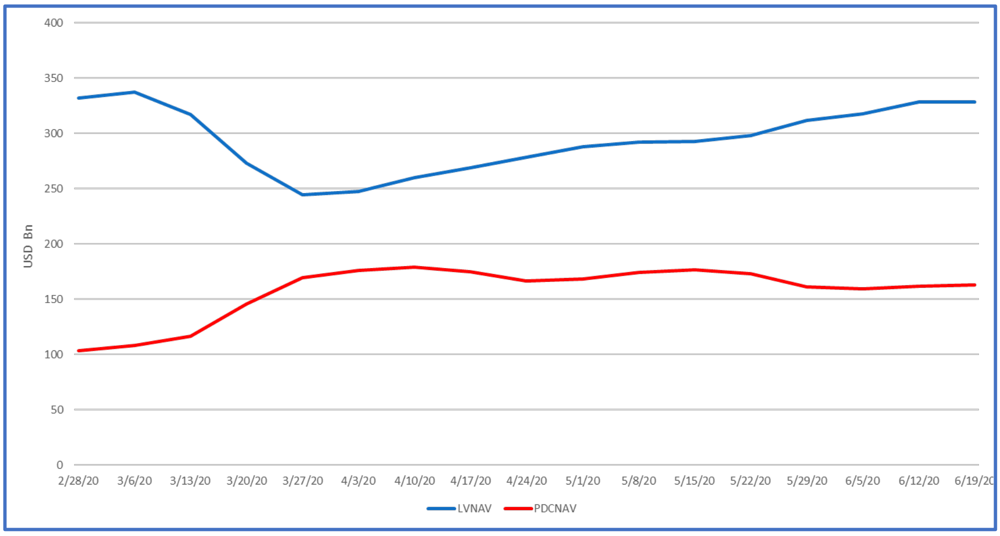
<ESMA_QUESTION_ CCP investment policy_14>

In this question we take ESMA's wording of the 'need for macroprudential tools' to refer to the use by MMFs of fees, gates and suspensions.

In the US, the use of liquidity fees and gates is optional for government MMFs. The overwhelming majority of fund managers choose not to be subject to them since the likelihood of having to use them in a government fund is extremely remote. Under EU MMFR, the use of fees, gates and suspensions is permitted for PDCNAV MMFs if weekly liquid assets (WLA) fall below 30% *and* daily net redemptions exceed 10%. The likelihood of this happening in practice in a PDCNAV MMF is remote. In addition to high levels of overnight or very short-term reverse repo, they hold highly liquid assets in the form of government securities. Furthermore, fees or suspensions only become mandatory if weekly assets fall under 10%. Since 17.5 % of highly liquid assets[11] maturing within 190 days count towards WLA, and the PDCNAV portfolio consists 99.5% of government assets and the portfolio is subject to a maximum 60-day WAM, there will always be sufficient assets to meet the 10% weekly liquidity threshold.

No EU MMF activated any fees, gates or suspensions during the March 2020 liquidity crisis. Post crisis global consultations from ESMA, the PWG in the US and the FSB all concur that the delinking of fees, gates and suspensions from hard liquidity requirements must be considered. As noted above, the SEC proposed MMF reforms which were recently announced include the removal of fee and gate provisions (see footnote 9 above). The resilience of PDCNAV MMFs was clearly demonstrated during the crisis when they experienced inflows which boosted liquidity levels. The flows for USD[12] PDCNAV and LVNAV MMFs are illustrated in the chart below.

USD LVNAV & PDCNAV Fund Flows



<ESMA_QUESTION_ CCP investment policy_14>

[11] Article 24 1 (g) of EU MMFR 'highly liquid assets which can be redeemed and settled within one working day and have a residual maturity of up to 190 days may also be included within the weekly liquid assets of a LVNAV and public debt CNAV'
[12] USD denominated MMFs account for 97% of the PDCNAV market.

Q15 : Do you agree with ESMA that it is not appropriate at this stage to decide on the potential eligibility of MMFs for CCP investments before policy discussions on MMFs at the international and EU levels are finalized?

<ESMA_QUESTION_ CCP investment policy_15>

No, we do not agree. PDCNAV MMFs should be included as an option for CCPs. They demonstrated their resilience during the crisis, their assets meet the underlying criteria, and they are not the focus of future reforms which are directed at private debt MMFs. Although policy discussions are not yet finalized, in our view, MMFs demonstrated their resilience in the crisis and reforms are intended to enhance that resilience further. The ability of PDCNAVS to withstand stress has in any case not been questioned. Assuming the proposed reform to delink liquidity thresholds from the possible imposition of liquidity management tools applies to PDCNAV MMFs as well as LVNAVs, then this would only strengthen the liquidity position of PDCNAVs further.

MMFs are used for cash management by investors globally alongside bank deposits and government bonds and the EU framework has provided a leading example on the world stage for transparency, high liquidity and codified standards.

PDCNAV MMFs are an appropriate cash investment for CCPs for a number of reasons:

- They are structured to provide very high levels of same-day liquidity.
- They are the most conservative money market fund type.
- They are highly regulated and transparent with look through to liquidity levels and portfolio composition available daily.
- The regulatory regime, already robust, is likely to be enhanced further by future reforms, in particular proposals which would make liquidity buffers more accessible.
- All IMMFA PDCNAV MMFs are rated AAA[13] by at least one authorised credit agency.
- The objective of a PDCNAV MMFs is to preserve capital and provide liquidity.
- In the case of PDCNAV MMFs the underlying investments qualify with the criteria for eligible financial instruments.
- PDCNAVs demonstrated their resilience during the COVID-19 crisis when they saw inflows (and therefore even higher liquidity)
- PDCNAV MMFs hold very substantial liquidity buffers to meet redemptions.
- The maximum maturity of investments is limited to 397 days, which further enhances the underlying portfolio liquidity.
- The average life of the portfolio is very short: a 60-day WAM and a 120-day WAL.
- The risk is related to the underlying securities, not to the investment manager.
- Investments in MMFs are fully segregated with own legal entity and assets are ring fenced with an independent custodian.
- They maintain a constant price of $1/£1/€1 provided that the NAV remains within a 20bp collar.

Despite the magnitude of the stress experienced during the COVID-19 crisis, European MMFs demonstrated their resilience and continued to serve their purpose, thus passing the first real-life stress test of European money market reforms. No European MMFs imposed fees, gates or

[13] The AAA is an MMF rating, AAAmmf (Fitch Ratings), Aaa-mf (Moody's Investors Service) or AAAm (S&P Global Ratings).

suspensions and no NAV collars were breached.[14] By introducing measures to improve portfolio credit quality, diversification, risk management and transparency, the EU MMFR contributed significantly to this resilience. The EU MMFR has ensured that the sector is highly regulated and transparent, offering strong levels of protection to investors and a high degree of visibility to both regulators and investors. It is our view that the EU MMFR remains robust and broadly appropriate. Investor confidence in the MMF product and the regulatory framework is reflected in the substantial growth post reform, which totals 41% since implementation in March 2019.[15] We welcome efforts to enhance resilience further, but it is also our view that MMFs demonstrated their robustness and will emerge stronger from the next round of reforms.

If ESMA wish to await the outcome of the latest round of MMF examination, as specified in the original text for 1131/2017 as a 5-year review, then the PDCNAV MMF product should be added now given the resilience and popularity as a high-quality vehicle cited by ESMA, the FSB and other authorities following the 2020 liquidity crisis. PDCNAV MMFs, which are overwhelmingly denominated in USD, saw very substantial inflows during the crisis as investors sought the most conservative and cash-like fund type. The other MMF fund types, if not included at this stage, should be scheduled for examination following the outcome of any changes to MMFR.

PDCNAV MMFs can be used as eligible collateral for initial margin for OTC derivatives under Delegated Regulation (EU) 2016/2251 Article 4 (1(r)). In order to be consistent, it may be appropriate to afford the same ability to CCPs to access these highly liquid financial instruments through a pooled structure, i.e., via the purchase of an MMF. Consideration could also be given to the appropriateness of defining PDCNAV MMFs as an eligible collateral option in their own right rather than via the UCITS asset class.

Allowing PDCNAV MMFs as an investment choice for European CCPs would provide CCPs with more flexibility and optionality, enabling them to diversify risk further. It would also align European practice with the US market, providing a more level playing field.
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Q16 : What would be the costs and benefits of extending the list of financial instruments considered highly liquid with minimal market and credit risk, in the context of EU CCPs' investment policies?

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Q17 : What would be the costs and benefits of extending the list of financial instruments to money market funds authorised in accordance with MMFR?

[14] NAV collars apply to LVNAV and PDCNAV (stable NAV) MMFs, the vast majority of which are IMMFA funds. We are not aware of any non-IMMFA stable NAV funds breaking their collars. None have been reported.
[15] IMMFA AUM were EUR643bn equivalent as of 29 March 2019, versus EUR907bn on 10 December 2021.

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