Financial Stability Board
Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

12th August 2021

IMMFA Response to FSB Policy Proposals to Enhance Money Market Fund Resilience

Dear Sir or Madam,

The Institutional Money Market Funds Association (IMMFA) welcomes the opportunity of responding to this important consultation. As a trade association representing the European money market fund (MMF) industry we are committed to promoting and supporting the development and integrity of the MMF industry. We do this by providing a single point of contact and by engaging with and informing policy makers. In this instance this means representing our member views on reform proposals which have potentially far-reaching consequences for the industry.

IMMFA currently has 27 members, consisting primarily of asset managers, but also custodial banks and other firms. Of the 27, 19 are asset managers. IMMFA MMFs are overwhelmingly institutional, and all have AAA MMF ratings by one or more authorised credit rating agency.[1]

IMMFA MMFs currently have EUR843bn Euro equivalent[2] in assets under management (AUM). Assets have increased 32% since the implementation of EU Money Market Fund Regulation in March 2019, reflecting investor confidence in the regulatory framework and the continued utility value of MMFs.[3]

As a share of total European MMF AUM, IMMFA represented approximately 57% as of the end of the first quarter 2021, the most recent data point for the whole industry.[4] IMMFA MMFs are (with one exception) domiciled in Ireland and Luxembourg.[5] The majority of other European MMFs are domiciled in France and consist predominantly of standard VNAV MMFs.

Within the IMMFA universe of funds there are 3 main currencies: USD, GBP and EUR. USD is the largest currency (currently USD501bn), followed by GBP (GBP242bn), and lastly EUR (EUR132bn).[6] Although 96% of IMMFA MMFs are stable Net Asset Value (NAV) in the form of Low Volatility NAV

---

[1] AAAmmf/Aaa mf/AAAm money market fund ratings by one or more of Fitch Ratings, Moody's Investor Services and S&P Global Ratings.
[2] Source iMoneyNet and IMMFA as of 6 August 2021.
[3] Regulation EU 2017/1131 of the European Parliament and of the Council of 14 June 2017.
[4] ECB Statistical warehouse 31 Mar 2021, total MMF AUM in Europe were EUR1,398bn. As of 26 March 2021, IMMFA AUM were EUR798bn.
[5] With one exception, a GBP fund in the UK.
[6] As of 6 August 2021, sources iMoneyNet and IMMFA. The split remains fairly constant.

Institutional Money Market Funds Association Ltd, 27 Clements Lane, London, EC4N 7AE
Telephone: 0203 319 1698 E-mail: admin@immfa.org

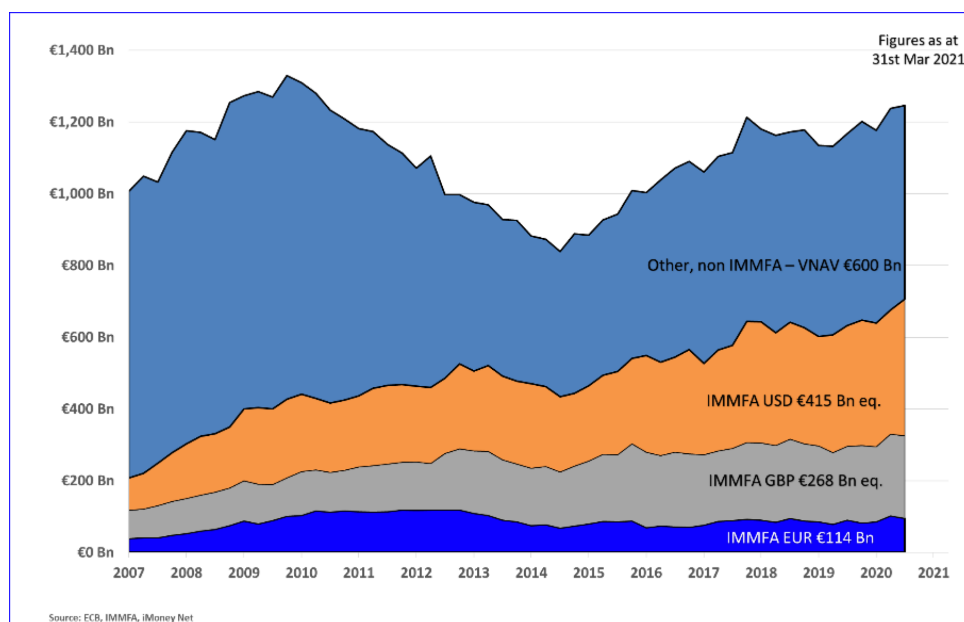
Company limited by guarantee in England and Wales. Registered number 4014176.
Registered office: The Mill House, Boundary Road, Loudwater, High Wycombe, Bucks, HP10 9QN
EU Transparency Register No. 525785119947-01

(LVNAV) or Public Debt Constant NAV (PDCNAV) funds, IMMFA represents all money market fund types and many of our members offer a range of funds including Variable NAV (VNAV) MMFs. Many members also have a presence in the US MMF market. PDCNAV MMFs account for 32% of IMMFA USD funds, but only 1% in GBP and 0.06% in EUR.[7]

During the crisis IMMFA funds experienced net outflows of less than 5% in the three-week period ending 27th March. Flows varied by currency and by fund type, with USD LVNAVs experiencing the highest redemptions, whilst flows in EUR and GBP were mixed and significantly less volatile. In the three weeks ending 27th March 2020, IMMFA assets fell from EUR739bn (equivalent) to EUR705bn (-4.6%). During that period USD LVNAVs declined 27% whilst USD PDCNAVs increased 57%. EUR assets declined 6%, while GBP were increased slightly.[8] The liquidity shock coincided with outflows which are always expected at quarter ends, exacerbating its impact. By the 3rd of April 2020, IMMFA AUM had more than fully recovered to EUR748bn. Thereafter, all three currencies resumed growth which continued to a new high of EUR877bn in July 2020.

The chart below illustrates IMMFA AUM by currency in Euro equivalent and as a share of the European total since 2007 up until 31st March 2021.[9] Since 96% of IMMFA funds are stable NAV and the overwhelming majority of non-IMMFA funds are variable NAV, this illustrates the split in European MMF assets between the two fund types.

The European MMF Landscape



[7] USD PDCNAVs USD162bn, GBP2.7bn, EUR0.0817bn as of 6 August 2021. Sources iMoneyNet and IMMFA.
[8] EUR and GBP net outflows were concentrated in the week ending 20 March 2020 when they fell 13% and 8% respectively. Sources iMoneyNet and IMMFA.
[9] As per ECB Statistical warehouse 31 Mar 2021, total MMF AUM in Europe were EUR1,398bn.

IMMFA

INSTITUTIONAL MONEY MARKET FUNDS ASSOCIATION

Summary

The economic fall-out from the pandemic created a systemic liquidity event impacting not only MMFs, but all asset classes. The unprecedented 'dash for cash' meant that MMFs also experienced challenging conditions. Nevertheless, MMFs continued to serve their purpose in preserving capital and providing liquidity, with no MMFs imposing gates or fees, and all MMFs staying within their collars.[10] We feel strongly that questions of how MMFs performed should be considered in the context of the broader ecosystem and that any proposed solutions should take into account the interconnectedness of MMFs with other parts of the short-term markets, rather than isolating MMFs, as has been the case.

The March crisis was the first true stress test of the reforms introduced in response to the global financial crisis of 2008, including, in Europe, the EU Money Market Fund Regulation (EU MMFR). As a trade association which represents, promotes, and supports the development of the European money market fund industry, we engaged extensively and contributed to the co-legislators' efforts during the establishment of the regulation. Those reforms, to which the FSB and IOSCO contributed, proved instrumental in providing MMFs with increased resilience, a point which is understated in the report. Although the March liquidity crisis clearly demonstrated that there are areas of money market regulation which could be improved upon in order to strengthen MMFs further, the outcome does not suggest that radical reforms are required. In our opinion, policy makers should consider how to address structural issues in the short-term markets. MMFs are only one part of the equation which means it is important to seek a holistic solution. This would also serve to increase the effectiveness of any reforms specific to MMFs.

We are in favour of targeted, proportionate and consistent policy responses which seek to recognise and build on existing fund resilience without undermining the key characteristics of MMFs or reducing their utility value to investors and issuers. On this basis, we are strongly supportive of the policy option to remove the tie between regulatory liquidity thresholds and the potential imposition of fees, gates and suspensions ('delinking'). This would allow those MMFs which are subject to the link to deploy their liquidity buffers during times of stress, when it is in the best interests of investors to do so, thereby freeing up liquidity buffers to serve their intended countercyclical purpose. US Prime Institutional MMFs and European stable NAV MMFs are mandated to hold substantial amounts of liquidity; formally enabling them to access that liquidity will significantly enhance their resilience. In conjunction with this, we also recognise that redemption fees could be modified to ensure that their application is effective.

A number of the other options proposed in the report are neither proportionate nor necessary. It is also not clear that they would address the specific issues faced in a liquidity event. Some would undermine the viability of MMFs as well as being regressive in terms of overall efforts to encourage efficient capital markets, reduce reliance on banks and avoid interconnectedness between banks and other parts of the financial system. Given that MMFs are structured to maintain high levels of liquidity, and that they were able to maintain those high levels, despite the combined pressure of elevated redemptions and challenging market conditions, the outcome of the March episode does not justify radical reforms. In many cases MMFs were selling not to meet investor redemptions but in order to maintain liquidity buffers. The key objective should be to ensure that all funds maintain

[10] In Europe collars only apply in the case of LVNAV and PDCNAV MMFs. The vast majority of these are IMMFA MMFs. IMMFA is not aware of any non IMMFA funds breaking their collar.

high levels of liquidity and that liquidity buffers, which were designed to absorb shock in a stressed market, should be made accessible.

In our view, delinking would be an appropriate and proportionate reform that would achieve the objective of ensuring that MMFs have adequate liquidity whilst also preserving their key functions in providing an important cash management tool for investors and a flexible and efficient source of funding for borrowers. Reforms which go significantly beyond this are not warranted. In particular, removal of stable NAV MMFs is unjustified given that fund structure was not the determining factor in outflows. Both US Prime Institutional funds, which are floating NAV, and European VNAV funds also experienced heavy outflows. Given a choice between variable and stable NAV, investors have chosen to place over half of EU MMF assets into stable NAV MMFs (i.e., PDCNAV and LVNAV funds). Since both stable and variable funds had outflows, we see no evidence to suggest this choice should be removed.

The report suggests that the role of MMFs could readily be replaced by other products or funding sources, thereby improving financial stability. We do not think this is feasible, for a number of reasons. Deposits are the closest proxy for an MMF, however, since banks have little appetite for non-operating deposits post Basle III reforms, there is insufficient capacity in the deposit market to provide an alternative to MMFs on the scale required. This point is crucial. Furthermore, other alternatives, such as short-term bond funds, are not equivalent to MMFs in terms of investor exposure to volatility and credit risk. Neither are they structured to hold the same levels of liquidity. Those investors who need liquidity for operational reasons will still need to sell or redeem assets in a liquidity crisis. It may be harder to meet this need when funds are invested directly or in disaggregated asset classes given that, unlike MMFs, there will be no structural obligation to hold high liquidity balances. This may exacerbate the impact of a liquidity shock.

Given capacity constraints and other factors will limit the availability of deposits, suppressing MMFs will drive investors towards riskier products which will be less regulated and less transparent to regulators than MMFs, increasing systemic risk. With regard to the role played by MMFs in providing a vital source of funding, we also question the ability of substitutes to supply this need, in particular the appetite or capacity of banks to provide low yielding short term loans, or the ability of banks themselves, who are major borrowers in the short-term markets, to fund elsewhere with the same efficiency.

In response to the report's finding that liquidity mismatch is a structural vulnerability, we would note that the liquidity transformation gap in MMFs is already the narrowest of any investment vehicle. The minimum liquidity thresholds introduced under previous reforms remain the most appropriate way to address this risk once thresholds are delinked from the imposition of liquidity management tools. Ensuring that MMFs can utilise their liquidity buffers as intended will further reduce the liquidity gap.

With regard to specific policy options, we are strongly opposed to the application of swing pricing to MMFs on the basis that it is operationally incompatible with MMFs. Applying swing pricing would remove the ability to offer intra-day liquidity or same day (T+0) settlement, which we regard as a key component of MMF utility. Additionally, swing pricing brings no incremental benefit over the use of liquidity fees, which MMFs already have at their disposal and should retain. Our members support the use of swing pricing for longer term open-ended funds, but consider it unworkable for MMFs which, unlike other funds, are structured to hold high levels of liquidity specifically in order to meet redemptions.

The report locates a 'key vulnerability' in MMFs' inability to sell the underlying money market instruments (MMIs). Commercial Paper (CP) and Certificates of deposit (CDs) are not widely traded because they are very short, buy-to-hold instruments. That is not to say they are illiquid under normal conditions. Much of the market illiquidity can be attributed to the widespread withdrawal of bank intermediation in response to market events. In this respect we feel it is especially important to look at the broader context and the role of bank intermediators post prudential reforms, rather than concluding that the instruments themselves constitute a vulnerability. Again, the issue of liquidity could be substantially resolved by allowing funds to utilise their buffers. Other measures to facilitate underlying liquidity by reducing market fragmentation, promoting transparency and market congruency could complement this and should be explored.

MMFs are a vital cash management tool for many investors and provide an invaluable source of funding to a wide range of issuers, thereby contributing to the real economy. Some of the reform options proposed would not preserve these functions. Those reform options which would drive MMFs investors to seek alternatives could, in fact, as stated, be counterproductive by shifting risk elsewhere in the system into riskier, less regulated products. Those options which lead to fund sponsors exiting the market would also reduce investor choice and the supply of credit to short-term borrowers.

In conclusion, we remain committed to efforts to build on the positives of the EU Money Market Regulation and to engaging with regulators and policy makers to secure the best possible outcome for all stakeholders.

We look forward to our continuing engagement with the FSB on this report 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

IMMFA
INSTITUTIONAL MONEY MARKET FUNDS ASSOCIATION

IMMFA RESPONSE TO CONSULTATION QUESTIONS

1. **What are the key vulnerabilities that MMF reforms should address? What characteristics and functions of the MMFs in your jurisdiction should be the focal point for reforms?**

   The market turmoil in March 2020 caused severe disruption across financial markets as a result of an unprecedented demand for liquidity. As the global economy shut down, the economic shock caused sharp pressure in short-term funding markets. The MMF sector, which is the most transparent constituent of short-term funding markets, also experienced stress as investors sought to redeem their most liquid assets. This redemption pressure revealed areas of weakness where regulation had not worked as intended and vulnerabilities in the short-term ecosystem as a whole. Unlike the credit crisis of 2008, the liquidity crisis was an exogenous event, neither originated nor transmitted by MMFs. Another important distinction is that there was no concern about the credit quality of MMF assets in March 2020. The very visibility offered by MMFs appears to have made them the focal point for reform, which in our view is disproportionate to the part which they played in the crisis. More importantly, some of these proposed reforms are unwarranted and would challenge the viability of the product and, in our view, shift risks elsewhere by suppressing the MMF sector.

   Despite the magnitude of the stress, 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 suspensions and no NAV collars were breached.[11] By introducing measures to improve portfolio quality, risk management and transparency, the European money market fund regulation (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 regulators. It is our view that the EU MMFR remains robust and broadly appropriate. Investor confidence in the product and the regulatory framework is reflected in the substantial growth post reform, 31% since its implementation in March 2019.[12] We welcome efforts to enhance resilience further, but we are also of the opinion that policy makers should consider MMFs in context to determine what can be done to improve the functioning of the underlying markets by addressing structural issues. This would also help secure the effectiveness of reforms to MMFs.

   In our view, the key vulnerability was caused by the ‘bright lines’ associated with a breach of the 30% weekly liquid asset (WLA) requirement which meant that MMFs were effectively unable to use their liquidity buffers as intended, to countercyclical effect. Although the EU MMFR permits funds to temporarily dip below the 30% and provides a ‘dual trigger’ (whereby a fall below 30% must also coincide with net daily outflows exceeding 10%) before fund managers have the discretion to impose fees, gates or suspensions, in practice funds felt unable to use liquidity buffers as investors associated a breach with the potential imposition of fees and gates and sought to redeem pre-emptively. We believe this is best addressed by removing the tie between liquidity thresholds and the imposition of fees, gates and suspensions,[13] thereby enabling fund managers to meet redemptions from their natural liquidity. MMFs are structured to hold substantial amounts of liquidity in order to meet redemptions. Had they felt able to access this liquidity they could have met redemptions without the need for sale of assets into a stressed market. Unlocking this liquidity would significantly strengthen their ability to cope with elevated redemptions during times of stress.

[11] 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.
[12] As of 29 March 2019, IMMFA AUM were EUR643bn versus EUR843bn on 6 August 2021.
[13] Elsewhere also referred to as ‘delinking’ or decoupling’.

MMFs are highly valued by investors as a cash management tool. The ability to access cash on a same day basis is key to investor utility and, in our view, must be preserved. Some of the reform suggestions, such as swing pricing, minimum balance at risk, and removal of the stable NAV model[14], impact this key aspect of functionality. The focus of reforms should be enhancing the ability of MMFs to provide this key function by targeted, proportionate and consistent changes. More radical measures are likely, as noted throughout the report, impose significant challenges and costs resulting either in industry consolidation or in a shift of short-term liquidity to other parts of the system where less transparent and regulated products would be likely to create more systemic risk. Avoiding such a shift would enable MMFs to continue to provide their valuable role in funding the real economy.

2. What policy options would be most effective in enhancing the resilience of MMFs, both within individual jurisdictions and globally, and in minimising the need for extraordinary official sector interventions in the future?

Although broad alignment on MMF regulation is a laudable objective, the US and European jurisdictions are quite distinct and solutions which work for one may not be the most appropriate for the other. As an industry body which represents the European MMF industry, we will therefore address our comments to the European jurisdiction, drawing on US onshore experience where relevant and reflecting our broader view only in generic terms. We would be in favour of a more consistent approach within Europe and a move towards a more global consensus on what constitutes an MMF. At the same time, we recognise the obstacles to a broad-brush approach. For instance, the proposal that MMFs be required to hold a higher percentage of government debt may be practicable in USD but is much less so in other currencies.

With regard to central bank intervention, we note that interventions to support short-term markets were part of a series of measures to support the markets and restore confidence far more broadly. Whilst the Federal Reserve's Money Market Mutual Fund Liquidity Facility (MMLF) was specifically targeted at MMFs and was highly effective in enabling dealers to provide liquidity, intervention in Europe, in the form of various asset purchase programmes, including those targeted at corporate 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 contributed little or no direct benefit to private debt MMFs since the vast majority of their assets are in financial paper. The operational integrity of IMMFA MMFs was maintained without recourse to asset purchase facilities as the fund assets were ineligible.[15] 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.

We do not feel that the outcome of March 2020 suggests wide ranging policy reform of MMFs is required. In our view, policy makers should review the functioning of short-term funding markets as a whole, taking into consideration the broader context when considering reforms specific to MMFs. This could include the impact of prudential regulation on market making activities, an analysis of market intermediation in times of stress and how policy makers might facilitate this. Such a review should also examine the underlying market structure as it relates to CP and CDs, which in Europe, in particular, is highly fragmented. We agree with the observations (page 41) that further standardisation and increased market transparency could benefit the market and we support efforts to address this. Whilst we accept

[14] Some investors who sweep require a stable NAV.
[15] Low Volatility NAV (LVNAV) MMFs held less than 3% in corporate paper on 29 February 2020 (Source, Crane Data).

that such considerations may be complex and may require time, we believe that MMFs are only one part of the equation and that a more holistic solution should be sought. As the report notes, 'MMF reforms by themselves will not likely solve the structural fragilities in STFMs' (page 5).

Policy options which would improve resilience

I. Removal of the ties between liquidity thresholds and the potential imposition of fees and gates.
We are strongly supportive of this proposal on the basis that it would be an appropriate and effective reform. Although the EU MMFR succeeded in making funds more robust, the provisions regarding liquidity buffers did not operate as intended. We believe that removing the tie would ensure the usability of the liquidity inherent in the MMF structure, thereby substantially improving the ability to withstand stress. The link between liquidity thresholds and the potential imposition of fees, gates and suspensions inadvertently operated as an accelerant on redemptions. The 30% weekly liquid asset (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.

II. Impose a cost of redemption- e.g., a liquidity fee to reduce the incentive to redeem.
Many of our members manage longer term open-ended mutual funds which employ swing pricing and confirm that the swing pricing mechanism can be a useful tool for such funds. However, our members are fundamentally opposed to its implementation for MMFs for a number of reasons which we expand on later, including that it is operationally unworkable. We suggest instead that liquidity fees are the most appropriate tool.

The EU MMFR already makes the use of liquidity fees (which are economically equivalent to an anti-dilution levy) available to funds under certain conditions. We believe these fee provisions to be the most appropriate and see no further benefit to be gained by the use of swing pricing which cannot be applied to MMFs. In conjunction with the removal of the above tie, which makes the use of liquidity management tools (LMT) conditional upon a breach of regulatory thresholds, we recommend that the ability to use fees, gates and suspensions be applied to all money market fund types. This would result in a more consistent approach across the European MMF sector. The existing provisions within MMFR Article 34 (b) (i) are already robust and are the most appropriate to provide a form of anti-dilution mechanism which can be used in the best interests of the fund shareholders. Whilst we recognise policy maker concerns about the extent to which fees should be a matter of autonomy rather than prescribed by regulators, we firmly believe that discretion to use liquidity management tools should rest with the fund manager and/or board in the course of exercising their fiduciary duty. Fund managers and the board are best positioned to understand the specificities of a fund, including its investor base, their concentration, their needs and likely behaviour. These are factors which must be taken into account when considering whether a redemption fee is appropriate to reduce incentives to redeem and to protect remaining shareholders. Individual fund metrics are also vital considerations in calculating the fee to ensure that it provides the right level of deterrence. Since individual fund circumstances are unique, a 'one size fits all' approach is unlikely to be the best solution. Furthermore, prescriptive criteria may be counterproductive (as evidenced by the way in which the link between fees and gates and thresholds inadvertently became procyclical by nullifying the benefit of buffers) as well as creating market-wide incentives for funds to respond the same way to stress ('herd behaviour').

We would recommend considering a customisation of liquidity fees to make their application more effective. Measures could include more formalised and detailed policies subject to board level approval and to discussion with the relevant NCA. These protocols could provide high level guidance for when to impose and how to calculate redemption fees. In contrast to swing pricing, the use of redemption fees can accommodate the idiosyncratic features of MMFs, including their ability to offer same day value, which we regard as a crucial characteristic.

3. How can the use of MMFs by investors for cash management purposes be reconciled with liquidity strains in underlying markets during times of stress?

In our view MMFs are appropriately structured to cope with large outflows. The challenge for those MMFs where regulatory thresholds are tied to the potential imposition of LMT was the inability to use the high levels of liquidity mandated in the regulations. For US Prime Institutional, European LVNAV and PDCNAV MMFs this is 10% in daily liquid assets (DLA) and 30% in weekly liquid assets (WLA), versus 7.5% and 15% respectively for European VNAVs, where fees, gates and suspensions do not apply under the EU MMFR. Put simply, these MMFs (i.e., US Prime Institutional, European LVNAV and PDCNAV MMFs) *had ample liquidity, but were unable to use it*. Removal of the ties between thresholds and LMT would resolve this. Given the short-term nature of the underlying holdings and the mandated levels of daily and weekly maturing assets combined with the limitation on portfolio duration, short-term MMFs generate large amounts of liquidity organically, without the necessity to sell assets.

We urge policy makers to consider how to address the underlying structural issues in the short-term funding markets. Whilst post global financial crisis (GFC) prudential reform clearly strengthened bank balance sheets, in our view, it was also a significant contributory factor in banks' reluctance to intermediate during the crisis. We note that the FSB do not find this to be a 'dominant' factor although at the same time the report recognises that prudential requirements affect how dealers manage their balance sheet capacity. Although money market instruments (MMI), due to their buy to hold nature, are not widely traded in normal times, liquidity is generally ample to support the needs of MMFs. This is because MMFs are designed to fund redemptions from internal liquidity generated organically via the portfolio maturity schedule. On this basis we disagree with the characterisation of MMIs as being fundamentally illiquid even in normal times and therefore constituting a 'key vulnerability' (page 4). The report also finds 'similarities in portfolios' (page 4) to present contagion risk. On the contrary, we would respectfully point out that those issuers with large outstandings and deep, well diversified investor bases are in fact more liquid. Our member experience suggests that illiquidity was not dictated by name, maturity or volume of oustandings but by a more profound phenomenon which was the reluctance or inability on the part of dealers to make markets in any paper. This view is supported by the fact that other far more actively traded and ostensibly liquid products, including US treasuries and fixed income bonds, also suffered from significant market disruption, suggesting that the lack of intermediation did not relate uniquely to the underlying instrument. The liquidity of many such longer term instruments also benefits from quantitative easing, whereas MMIs do not. The expectations for liquidity conditions in MMIs cannot be considered to be immune from much broader liquidity challenges. Given the report recognises that banks may be unable to make markets in periods of stress when flows are substantial and one-directional (page 21), it is important to explore what can be done to alleviate stress at such times. Finally, we would add that in a market based financial system it is not possible to eradicate all such risk.

Forms, functions and roles of MMFs

4. Does the report accurately describe the ways in which MMFs are structured, their functions for investors and borrowers, and their role in short-term funding markets across jurisdictions? Are there other aspects that the report has not considered?

We welcome the more balanced assessment of fund structures, plus the recognition that some options would cause a shift out of MMFs with associated consequences for funding. We also support the insights into the role of dealers and their incentives (in Box 3), though we feel the report fails to follow through on the implications of these observations which, in our view, strongly suggest further examination is required.

In a number of areas we arrive at different conclusions, which we discuss below. In our view, reforms which depress MMFs by making them less attractive to investors or significantly increasing costs are likely to shift existing risks elsewhere in the system into areas which are less transparent and regulated, and/or introduce new risks. There are some investors, such as those who need to use Qualifying MMFs under MIFID II, who are unable to invest directly in securities or short-term bond funds. Disaggregated investments will not necessarily represent less systemic risk. Reforms that penalise investors by forcing a contraction in yields through changes to the asset mix are similarly likely to push investors elsewhere.

We note that there is a strong rationale for investors valuing MMFs' cash-like qualities. MMFs represent the least risky investment vehicle for those aiming to preserve capital and have access to liquidity. The robust regulatory framework and the high levels of transparency give comfort that these objectives will be met. The strong post-crisis recovery in AUM demonstrates that investors retained confidence in the product even after the upheavals of March. Less than four months after the crisis IMMFA AUM had increased 24% to a new high of EUR877bn.[16] MMFs are also specifically designated 'cash equivalent' for accounting purposes in certain jurisdictions, including France and the USA. However, investors recognise that MMFs carry risk and are not guaranteed products (a distinction which some of the proposed reforms would blur). The EU MMFR contains provisions to ensure that these risks are clearly communicated. The European investor base for MMFs is predominantly institutional and institutional investors are likely to have a more sophisticated understanding of the risks associated with their investments. There is also little evidence to suggest that other cash-like instruments such as direct investments (proposed as a substitute) performed better in the crisis.

5. Does the report accurately describe potential MMF substitutes from the perspective of both investors and borrowers? To what extent do these substitutes differ for public debt and non-public debt MMFs? Are there other issues to consider?

We do not see substitutes being as readily available as the report suggests, nor as offering equivalence in terms of either utility or risk profile. The only example of material growth in an alternative is that of the 2016 US reforms when, as the report notes, Government funds grew as Prime funds shrunk. Extrapolating this example to European MMFs is extremely problematic. Comparable growth in European PDCNAVs is unlikely given the absence of a deep and well-diversified public debt market. Predicting material growth in the other substitutes is also far from straightforward. For public debt MMFs, there is no obvious substitute other than direct investment in government paper. The drawbacks of direct investment, which is not available to everyone, are discussed below. In our view, public debt

[16] As of 27 March 2020, AUM were EUR705bn compared to EUR877bn on 10 July 2020. Source iMoneyNet and IMMFA.

MMFs, which experienced inflows, demonstrated their resilience and do not, in any case, require substitution.

Substitutes should represent either an equal level of risk for the end user or less risk, not more. Practical obstacles in European jurisdictions mean that public debt MMFs cannot offer a substitute for non-public MMFs. Substituting public debt for non-public debt MMFs would also dramatically reduce the flow of private credit to banks and other non-financial issuers. Neither are standard VNAV MMFs a substitute for short term MMFs in Europe, as the investor objectives are quite different. In the same vein, ultra-short bond funds are not a substitute for US Prime MMFs or European short term MMFs. Standard VNAV MMFs already closely resemble short-term bond funds; the latter would only offer similar or increased volatility and credit risk, with less liquidity. Other substitutes, from different asset classes, are discussed in more detail below.

Whilst substitutes for investors may arise to fill a vacuum left by MMFs, we see a strong likelihood of such substitutes introducing new risks or transferring existing risks into a more opaque and less regulated part of the system. As noted in the report on page 16, accounting rules are a crucial consideration with regard to whether such substitutes would count as 'cash equivalent', a vital factor for many corporate investors. On the funding side, we think it is yet more complicated, as there are no easy substitutes. We see the reintermediation of bank lending as a regressive step which would have a significant impact on both the supply and pricing to non-financial borrowers. It also runs counter to the objectives of Capital Markets Union. We consider the various alternatives below and find that all of them have drawbacks.

From the perspective of investors.
We consider the investor alternatives individually below.

Deposits
The report posits that a shift out of funds would give rise to the growth in alternatives including bank deposits and short-term bond funds (page 17). The former seems very unlikely in Europe given banks' well publicised lack of appetite for non-operating deposits post the implementation of Basle III. This is noted as a factor 'in some jurisdictions' on page 16. It is indeed one of the reasons why the MMF sector has grown so strongly and, indeed, can be expected to continue to do so. Given bank aversion to short-term assets which do not benefit their regulatory ratios, we do not see deposits as a scalable alternative. In our view, the report is therefore misleading to conclude that financial stability can be improved by banks taking on more deposits as MMFs decline.

Deposits also have a number of other drawbacks as a substitute. Unlike MMFs which are diversified and collateralised by the fund assets, deposits represent a single exposure credit risk and are unsecured.

Given the lack of capacity in the bank deposit market we think investors would either be penalised by lower yields or forced down the 'quality tree'. The lack of appetite for short-term cash may also oblige depositors to lock in money for longer periods, meaning deposits would not serve the same cash management objectives as MMFs.

Repo
For investors seeking additional bilateral bank exposure through the use of repo (to be precise, reverse repo) rather than deposits, similar constraints to those for deposits would apply. Investors may be forced to accept either lesser quality counterparties and/or riskier collateral. The option to do reverse repo is limited by the size and credit quality of the lender of the cash, and only open to a small number of mostly

institutional investors. It also comes with a high operational burden. Re-intermediating banks in this way would appear to run counter to the objectives of capital markets union.

Short-term Bond Funds

Short-term bond funds are not a substitute for MMFs: they are materially different from a risk and liquidity perspective; they have greater volatility and take more credit risk, consequently, as the FSB notes, they 'have larger fluctuations in value' (page 17) which in itself may deter investors; and they are also not mandated to carry significant cash buffers, unlike MMFs. The assumption that price variation would dampen redemptions would not necessarily hold true during times of stress when access to cash may be an unavoidable operational requirement, as was the case for many MMF investors during the pandemic. In other words, investors with genuine cash needs would try to redeem anyway and this would only be more difficult given the absence of liquidity buffers.

Ultra-short bond funds in Europe are also already effectively encompassed in standard VNAV MMFs which have significantly less stringent investment criteria, enabling them to offer a yield uplift. Standard VNAVs have had limited take-up outside France, suggesting that they have a muted appeal to the international investor base. They are considered cash equivalent under French accounting standards, something which may vary in other jurisdictions. For these reasons, it is very unlikely investors in AAA rated LVNAV or PDCNAV MMFs will shift to standard VNAVs. Likewise, investors can be expected to want only limited exposure to ultra short bond funds which operate on similar, or even less, conservative principles.

Direct Investment

Direct investment would be significantly less transparent to regulators. As noted by the report (page 17), direct investment 'does not offer liquidity on demand' which, the report concludes, mitigates systemic risk. However, these investors, such as corporates, pension funds and insurers, are still likely to have genuine operational needs for working capital or cash in a liquidity crisis. Lack of access to liquidity could create other pressures in the economy, such as failure to pay supply chains or dividends, or to meet margin calls, resulting in defaults.

The option to invest directly would only be available to the largest investors since for many it is not practical or economically viable to manage their own portfolios. Maintaining the necessary expertise in-house is operationally burdensome and resource intensive, requiring an ability to track a large number of alternative credits, custody arrangements, back-office capacity and relationships with dealers. Capacity constraints will limit certain products such as deposits and repo (see comments above), forcing direct investors to take more risk. Direct investors are also likely to be non-experts lacking in credit resources relative to fund managers, which could lead to excessive risk taking. There have been many precedents for such behaviour which regulation has tried to prevent.

Direct investors will not get the same levels of execution as an MMF. If, as discerned in the report on page 17, direct investors discover that there is a cost of liquidity when they come to sell, (direct investment 'does not offer the liquidity on demand') they are likely to reduce their investments, undermining the ongoing viability as a substitute as well as causing strains elsewhere in the system, as mentioned above.

Separately managed accounts would, as noted on page 17, incur higher charges. More importantly from a systemic view, they would not have high mandated levels of liquidity.

As with bank deposits, direct investment does not offer the investor the same level of diversification (as noted on page 25), which will further diminish its appeal and force investors to take additional unwanted risk.

The regulatory disclosures and reporting requirements to supervisors under the extensive provisions of the EU MMFR mean that MMFs offer regulators far greater transparency than disaggregated investments whether they be in cash, other fund types, direct investments or segregated accounts.

Public Debt MMFs

PDCNAV MMFs do not currently offer a scalable alternative in Euro or Sterling and are therefore only a viable substitute 'where they are available', as noted on page 16, which is currently in USD. 97% of the European PDCNAV market consists of US Dollar denominated funds. PDCNAV MMFs in Sterling are currently only GBP2.7bn and in Euro EUR0.08bn[17], reflecting a lack of investor demand as well as supply constraints. 'Material growth' (page 17) in public debt MMFs is currently unlikely outside USD. The example of US reform as a precedent for growth in government funds was unique to the US which has an exceptionally deep treasury market. Lack of a deep and uniform European sovereign debt market would be a significant constraint on the growth of Euro denominated PDCNAVs. The pool of very highly rated and liquid government securities in Euro is essentially limited to German *Bubills* and French *Bons du Trésor á taux fixes* (BTFs). Similarly, there is insufficient capacity in the UK treasury bill market to provide enough assets for GBP denominated PDCNAVs to replace private debt GBP denominated MMFs.[18] IMMFA GBP LVNAVs and short-term VNAVs were currently £239bn in AUM as of 6th August 2021.[19] UK T bill outstandings are currently only £62.5bn and they are in high demand from banks as HQLA as well as from pension funds and local authorities. Unlike in the US, there is no scalable agency or municipal bond market to supplement sovereign supply. The supply issue is compounded by the convention that Government bills are issued by auction rather than on a 'reverse enquiry' basis as for CP and CDs, and often for periods 3 months or longer.

Treasury bills, notes and other sovereign debt are already in high demand from other investor types. Even in USD, large investors in private debt MMFs may be reluctant to move into PDCNAVs due to concerns about investor concentration (i.e., how much of the fund they account for).

US onshore government funds have access to the Federal Reserve's repo facility which enables them to borrow US treasuries directly. Even with this access, supply constraints still occasionally arise, despite the US treasury market being the deepest in the world.

New Substitutes

The suppression of MMFs could, as the report suggests, lead to the 'emergence of new substitutes' (page 17) but it is hard to see how any such new products, which must try to replicate the key features of MMFs, could present less systemic risk given the exceptionally robust levels of regulation and the high levels of transparency surrounding MMFs. For instance, in the case of ETFs, these would be fully invested, have a longer settlement cycle, and would still rely on market makers who would have the same reluctance to intermediate CP and CDs in a liquidity crisis. Also, ETFs are typically not treated as cash equivalent for accounting purposes, an important limiting factor.

[17] As of 6 August 2021, source iMoneyNet/IMMFA.
[18] There are other non-IMMFA GBP denominated MMFs although these are relatively small.
[19] LVNAVs GBP233bn, short term VNAVs GBP6bn, source iMoneyNet/IMMFA.

We welcome the recognition that 'potential substitutes also exhibit vulnerabilities' (page 18). As investors are forced to take on more risk, the attraction of new unregulated asset classes, such as crypto currencies, should also not be dismissed.

In our view it is highly likely that both existing and new substitutes would simply 'shift the risks to other parts of the financial system' (page 17). We note the report concludes that the potential for such risk shifting should not delay reforms, though we would suggest a cautionary approach given that disaggregating funds may not mitigate systemic risk and may make it harder for regulators to target policy measures.

From the perspective of Borrowers

We consider the borrower alternatives individually below

Firstly, it is important to note that with regard to the fact that MMFs reduced their asset purchases during the crisis and the related impact on borrowers, this was entirely prudent given the fiduciary duty of MMFs to their shareholders.

The report notes the advantages provided by MMFs in terms of funding costs, flexibility in diversification away from bank lending and access to foreign currencies. It assumes that non-financial borrowers will be able to borrow from banks, albeit at an increased cost. In our view this availability is not a given due to the lack of appetite for low margin lending. Short-term loans to high quality credits may be a negative arbitrage for banks who are far more balance sheet sensitive post prudential reforms. Borrowing from banks would be a much more inefficient and expensive source of funding, especially given bank funding itself would also be impaired. It would also leave non-financials dependent on one source of short-term funding, creating a vulnerability. Short-term loans to highly rated non-financials are likely to represent a negative arbitrage for banks who would find such low yielding assets unattractive given the sensitivity to regulatory ratios. Alternatively, such issuers could borrow in the long-term markets, which would also be more expensive and inflexible, unlike CP which allows issuers to match fund working capital requirements. Only the largest non-US issuers would be able to access the domestic US CP market. Issuing USD to fund non-dollar liabilities would also require the issuer to hedge the exposure, again reducing flexibility and introducing a new element of counterparty risk and pricing variability. With regard to sovereigns, supra-nationals and agencies (SSAs), only 'pure' sovereigns would be able to increase their financing through increased bill auctions. Again, for these issuers, the economics of short-term borrowing from banks would not work due to the negative arbitrage.

For working capital requirements such as funding receivables, non-financial issuers currently able to issue CP or, in the case of smaller companies, fund via bank sponsored ABCP programmes, may be forced to look to companies which offer supply chain financing, such as Greensill. These companies are significantly less regulated and transparent.

The report also rightly notes that MMFs are an important source of CP, CD and repo funding for banks themselves (page 16). It is unclear how banks would replace this important source of wholesale funding. We see no ready substitute for their short-term general financing which comes not only in the form of CP and CD issuance, but also repo funding.

The report corroborates the suggestion that alteration in MMFs would result in the growth of funding substitutes using the example that the shift out of Prime funds in the US did not cause material increases in funding costs. However, there was a significant widening of short-term credit spreads leading up to the conversion date for the US 2a7 amendments of 2014 which, although temporary, took time to

normalize. It is also unclear that those investors taking up any funding shortfall would not also be subject to the same liquidity pressure in a systemic event and therefore likewise reduce or suspend their purchases, creating the same impact on short-term funding. These investors may not be as readily identifiable, homogenous or regulated as MMFs, so it cannot be assumed that they represent less roll-over risk during a stressed event.

The report suggests that an additional source of funding may be large institutional investors, such as insurance companies and pension funds, that normally invest outside money markets (pages 17 and 26). It is very unclear why such investors would be motivated to invest in money market instruments if they have not done so to date. On the contrary, it is probable they would be involved already if the products suited their objectives, given the market is very well established. Short-term investments are unlikely to suit the risk-return and maturity objectives of such longer-term investors. Some such large institutions are already investing their short-term cash in direct investments. The absence of MMFs will not give existing investors access to new names or opportunities, therefore their current credit limits will continue to cap exposure. The incentives to invest in CP and CDs will not be increased by reforms unless they result in substantially higher yields, which would be a sub-optimal outcome for borrowers. In our view, it is unlikely that such new, yield hungry investors will replace existing funding sources to any meaningful degree. On this basis we think the report's statement on page 25 that 'Issuers would depend on other types of investors to scale up their lending and borrowing costs might rise, if only on a transitory basis', significantly overestimates the capacity of other sources to replace core funding.

From a borrower's perspective, new funding sources may be fragmented, unreliable and come from unregulated sources. This may create additional risk rather than making funding more resilient in times of market stress.

Vulnerabilities

6. Does the report appropriately describe the most important MMF vulnerabilities, based on experiences in 2008 and 2020? Are there other vulnerabilities to note in your jurisdiction?

The report focuses on the 'structural vulnerability stemming from liquidity mismatch'. The liquidity transformation gap in an MMF is already very narrow relative to other investment vehicles and would narrow further with the removal of the tie between liquidity buffers and regulatory thresholds, since this would mean that the buffers could be used to their intended purpose to meet redemptions, including during stressed periods. As noted above, we think MMFs are adequately structured to provide liquidity, but the linking of buffers and thresholds impaired their ability to do so, thereby exacerbating redemption pressure. Many redemptions in March 2020 were driven by genuine cash needs for operating purposes or margin requirements, not only by investors pre-emptively anticipating the potential imposition of fees and gates. Delinking would remove the incentive to redeem pre-emptively thereby mitigating the regulatory threshold vulnerability. Redemptions driven by a genuine need for cash can be met from structural liquidity, provided funds can access that natural liquidity. Additionally, in the event that stress exceeds certain boundaries, the use of a liquidity or redemption fee could allocate the costs of redemption more fairly and be calibrated to reduce first mover advantage. The inability to sell assets would be far less material if MMFs could use their buffers, as was intended, to meet redemptions during times of stress.

The report correctly distinguishes between the impact of a credit crisis and a liquidity crisis (page 18), a point which we have emphasised in our own analysis. In our view, the EU MMFR successfully mitigated

the idiosyncratic risks associated with a credit crisis. Those reforms also intended to make MMFs more robust from a liquidity point of view, but the buffers could not operate as intended. This should now be addressed with a view to enhancing resilience further.

The report also locates a 'key vulnerability' in the underlying instruments held by private debt MMFs which are said to be illiquid even in normal conditions. This conclusion extrapolates a lack of liquidity from the low levels of trading in normal markets, whereas these are buy-to-hold, short maturity instruments which by their nature trade infrequently. Whilst we wholeheartedly support efforts to improve the underlying liquidity of CP and CDs, particularly in Europe where the markets are fragmented, by looking at the market infrastructure surrounding them, we note that they were not the only instruments to suffer.[20] The illiquidity was a function of a much broader market dislocation and MMIs could not be expected to be immune to circumstances which equally affected other far more liquid markets, including even US treasuries. In our view, the inability of banks to provide intermediation was a major factor in the illiquidity and that inability or reluctance to intermediate was at least partly attributable to prudential regulation. In our view, the key vulnerability is not in the instruments themselves so much as the ability of the short-term credit markets to function adequately in a stress event.

The report goes on to state that stable NAV funds are particularly exposed to credit risk (page 23). The stable NAV MMF sector consists of AAA[21] rated funds subject to 10% and 30% DLA and WLA liquidity requirements plus a range of stringent criteria. The stable NAV sector is therefore significantly *less* risky from a credit perspective. The standard VNAV model allows for greater duration risk and longer final maturities, combined with *lower* levels of liquidity. With respect to the NAV collar, we restate that despite severe market challenges no funds broke their NAV collars. We note also that LVNAVs only amortise the portion of their portfolio which is under 75 days and less than 10bp away from the mark to market price. Furthermore, the overwhelming majority of LVNAV MMFs, which are managed by IMMFA members and therefore subject to the IMMFA code of practice, mark to market their holdings on a daily basis through independent third-party sources. Despite elevated redemptions in USD denominated LVNAV MMFs, average NAV deviations for AAA rated MMFs remained well within the collar. In the case of Sterling, NAV deviations were muted and on average were positive. (Euro NAV deviations are not strictly comparable as most yields are negative, meaning that shares 'decumulate'. See Appendix A for NAV deviations)

With regard to concentration risk on the liability side, we note that not all investors within a given type will behave the same way. For instance, the impact of the crisis on corporate cash flows varied vastly according to their sector. Fund providers also have KYC requirements under the provisions of the EU MMFR and internal risk procedures to manage concentration risk, including measures to anticipate cash flow requirements. Managing finely calibrated concentration limits can be challenging given MMFs can be sold via intermediaries (such as platforms or portals) and assets under management fluctuate daily.

Policy proposals to enhance MMF resilience

7. Does the report appropriately categorise the main mechanisms to enhance MMF resilience? Are there other possible mechanisms to consider? Should these mechanisms apply to all types of MMFs?

[20] The ICMA are working on a White Paper which looks at the fragmentation of European CP and CD markets.
[21] AAA MMF rating.

The report is thorough in considering a wide range of mechanisms, their variants and their potential impact. The categories (to impose cost of redemption, to absorb losses, to reduce threshold effects and to reduce liquidity transformation) are appropriate groupings.

Removal of the ties associated with WLA is the clearest way to make MMFs more resilient by making liquidity buffers accessible to meet redemptions in times of stress. Current MMF regulation is very effective at mitigating idiosyncratic risks and delinking would further enhance resilience. In our view, regulations more typical of banks (such as capital buffers, sponsor support, LEB - all of which have a similar net result) are not appropriate for funds and it is important to keep clear water between the banking and fund sectors. This demarcation helps both to promote the proper perception of an MMF as a non-guaranteed product and to reduce interconnectedness. Such measures are also more effectively designed to absorb credit losses rather than address liquidity risk. The ability to absorb credit losses was addressed in the EU MMFR and previous reforms in the US when such options were considered but ruled out.

8. Does the assessment framework cover all relevant aspects of the impact of MMF policy reforms on fund investors, managers/sponsors, and underlying markets? Are there other aspects to consider?

The report does consider all aspects but, in our view, overestimates the extent to which the suppression of MMFs would propagate the ready growth of alternatives such as bank deposits. It also assumes that cumulatively these alternatives would imply less risk, which is not our assessment.

We have explored in more detail above the implications of a shift into alternatives including, but not limited to, deposits, short-term bond funds and direct investments. As concluded above (our response to Q5) we do not find that disaggregating investments necessarily results in mitigating systemic risk. Rather it shifts risk around the system to areas with less transparency and regulation and may actually increase systemic risk should cash investors park cash in less liquid alternatives.

Some of the proposed reforms would increase costs and remove benefits to the extent of undermining viability and in our view would result in industry consolidation. We expand on this below.

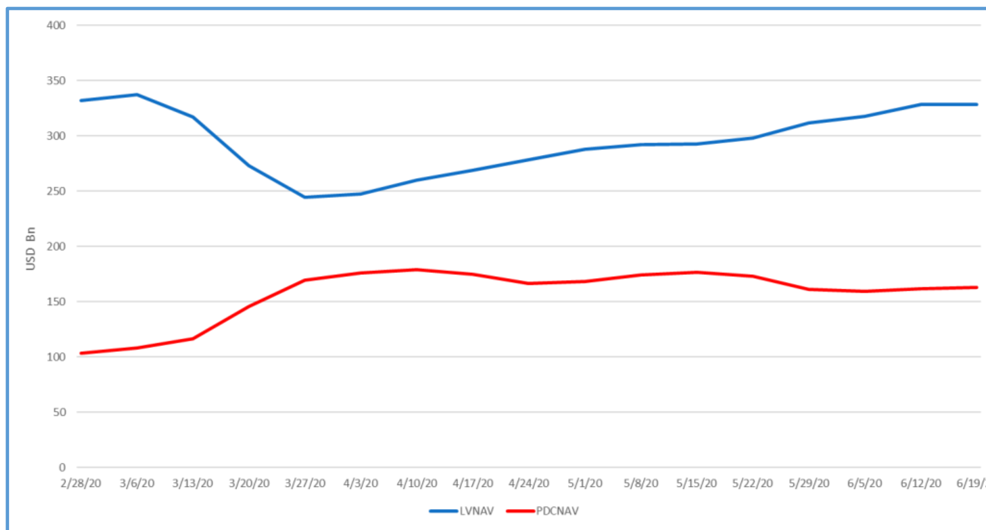
9. Are the representative policy options appropriate and sufficient to address MMF vulnerabilities? Which of these options (if any) have broad applicability across jurisdictions? Which of these options are most appropriate for public debt and non-public debt MMFs? Are there other policy options that should be included as representative options (in addition to or instead of the current ones)?

We believe a combination of the removal of ties between regulatory thresholds and the imposition of fees, gates and suspensions combined with the use of liquidity fees (as opposed to swing pricing) to be the most appropriate and sufficient solution.

A number of the options are in excess of the mitigation/enhancement required. These include swing pricing, capital buffers, removal of stable NAV, required membership of LEB, use of MBR and redemptions in kind. These options would be very challenging and burdensome for fund providers, as well as punitive for investors. Capital buffers, membership of an LEB and redemptions in kind would impose undue costs on investors. As recognised in the report, these options could threaten the viability of the business for some fund providers leading to industry concentration and reduced investor choice. Reducing investor choice could in turn lead to investors being forced to take more risk in other less regulated and less transparent products, as could reducing investor returns. See our response to question 10 for more detail.

In our view, no reforms are necessary for PDCNAVs. Investors rotated into USD PDCNAV MMFs because of the risk that fees and gates would be imposed was only remote. This shift reflected a pattern seen in the US onshore market where investors moved out of Prime Institutional funds into Government funds. As many offshore USD denominated MMFs are managed by investors headquartered in the USA, the onshore behaviour was also a key driver of USD flows in Europe. The liquid nature of short-term high quality public debt like US Treasury Bills at all times (including times of market stress) combined with the WLA calculation afforded by EU MMFR makes (made) breaching the 30% WLA trigger virtually impossible. PDCNAVs offer a lower risk option which can be valuable at times of 'flight to quality'.[22]

USD LVNAV & PDCNAV Fund Flows



Source: iMoneyNet/IMMFA

10. **Does the summary assessment of each representative option adequately highlight the main resilience benefits, impact on MMFs and the overall financial system, and operational considerations? Are there any other (e.g., jurisdiction-specific) factors that could determine the effectiveness of these options?**

We consider the individual representative options and their variants below.

We believe the options which would curtail same day settlement such as swing pricing or delayed settlement would remove a key tenet of fund utility. The requirement for capital buffers, liquidity exchange bank membership and the imposition of minimum balance at risk would substantially reduce the viability of MMFs. These options would require extensive changes to funds and their operating environment and would be likely to cause investors to seek alternatives which could ultimately create more risks.

We support the removal of the tie between thresholds and gates, fees and suspensions, and a consideration of how liquidity fees could best be customised to enhance their efficacy. See our remarks on redemption fees in Q2.

[22] GBP and EUR denominated PDCNAV were not sizeable enough to serve the same purpose.

Representative Option: Swing Pricing
As noted above in our response to Q2, many of our members manage longer-term open-ended funds which use swing pricing and where they recognise its utility. They are, however, strongly opposed to its application to MMFs for a number of reasons, including:

- Swing pricing is not operationally feasible for MMFs which offer intra-day and same day (T+0) settlement. Because the swing factor is based on net outflows it can only be calculated at the end of the day. Swing pricing would therefore effectively preclude intraday and same-day settlement, a critical feature of MMFs highly valued by investors and a key tenet of their utility.
- Swing pricing is ill adapted to MMFs as MMFs are structured to hold substantial liquidity in order to meet redemptions. This is not the case with longer term funds since they typically rely on selling assets to meet redemptions and settle on at least a T+1 basis.
- One element of swing pricing is the bid-offer spread when determining the swing factor. Longer term funds typically price assets to mid-market. In the case of LVNAV and PDCNAV MMFs, Article 29 of the MMFR already requires that assets be valued ‘at the more prudent side of bid or offer’, which is bid. This lessens the impact of a ‘swing’.
- Lack of visibility in the underlying markets could make it difficult to secure an accurate assessment of liquidity costs, particularly during a stressed period.
- MMFs already have the provision for liquidity fees which can be used to allocate a cost of redemption and as a suppressant of first mover advantage. The board should retain the ability, as *per* Article 34 of the current regulations, to impose liquidity fees on redemptions ‘that adequately reflect the cost to the MMF of achieving liquidity and ensure that investors who remain in the fund are not unfairly disadvantaged’, i.e., the same outcome as swing pricing.
- MMFs absorb large inflows and outflows as part of their normal business, unlike longer term funds. Fees, including swing pricing, should only be imposed in a stressed situation which is best determined by the fund manager/board.
- Swing pricing could undermine the core premise of a stable NAV fund by taking away the price certainty.
- If swing pricing factors are disclosed, this could create a new ‘bright line’. The report suggests that in some circumstances ‘authorities may need to impose certain requirements to ensure swing pricing is effective’ (page 29). This implies that swing pricing would be linked to specific fund metrics. We would be concerned that tying fees to another threshold would also create a new bright line. If macroprudential authorities were to determine the use of swing pricing, this would result in questions over how to define the parameters for a stress period, how to calibrate the fee and whether such activation would apply to some or all MMFs. Given the time sensitivity, investors may anticipate any such action by pre-emptively redeeming.
- It is not clear that swing pricing would be effective at curtailing the risks associated with a systemic liquidity event. Those investors with a genuine need for liquidity are likely to redeem anyway and swing pricing would bring no incremental benefit over the use of a liquidity fee.

Representative Option: Minimum Balance at Risk (MBR)
This is not a typical feature of funds and would inevitably cause aversion by both managers and investors. A similar proposal (for 3% holdback to absorb first losses if a fund could not maintain stable NAV) was considered and rejected in the US in 2012-13. The concept is intended to cover default not to address liquidity issues. The EU MMFR mitigated against credit risks by improving portfolio requirements for diversification, limiting maturities and preventing reliance on external ratings. MBR would impair liquidity when liquidity is available in the fund whereas we are in support of reforms which improve access to liquidity. It is not clear that the use of MBR helps mitigate liquidity risk; other measures are better designed to do so, such as a liquidity fee (which is economically equivalent to an anti-dilution

levy). MBR is very different from a fee as the redemption restriction is constant. In contrast, a fee can be used in certain pre-defined circumstances. Funds may be very reluctant to declare a holdback given the severity and implications of doing so.

MBR could create a perverse incentive to redeem early at the first signs of stress in anticipation of losses, thus negating the intended mitigation of first mover advantage.

MBR restrictions are also costly, operationally complex, and difficult to implement and administer. Operationally, there would be serious challenges to implementing this for MMFs sold via intermediaries. There may also be legal considerations in some jurisdictions regarding the subordination of shares which is not common practice in open ended investment companies.

As noted by the report on page 31, MBR may affect the accounting treatment of MMFs by calling the designation 'cash equivalent' into question. Investors are unlikely to invest in MMFs with redemption restrictions. Capital preservation is a key investor objective which MBR would undermine.

Substantially the same result can be achieved by the use of fees.

Representative Option: Capital Buffers
We do not support capital buffers for a number of reasons. It is not evident that capital buffers would mitigate the issues arising from a market liquidity event. The application of capital buffers to MMFs would not improve funds' ability to access liquidity in the underlying market. Buffers are more typical in banking regulation because banks are highly leveraged and hold long-term assets. MMFs, on the other hand, are not leveraged (they are 100% capitalised by the assets) and hold short-term assets. In the case of MMFs, they are not guaranteed products and investment risk is intended to be carried by the investors. In this respect buffers could make MMFs less investment-like by blurring the bank/fund distinction. They would also increase the interconnectedness of the bank and non-bank financial sectors which policymakers have aimed to reduce.

Capital buffers would be prohibitively expensive, particularly in a low to negative yield environment, and are therefore likely to cause industry consolidation reducing investor choice (as noted on page 32). Costs are likely to be passed on to investors by reducing returns. Given there would be no case for applying capital buffers to government funds, it is worth considering what the implications of their application specifically to non-public debt funds would mean. Yields on government funds set a floor on the yields that a non-public debt fund can return to an investor. This in turn limits the extent to which the additional cost of capital buffers could be passed on to investors since no investor would invest in a non-public-debt MMF which offered a lower return than a government or public-debt MMF.

As noted by the report, we agree that some investors would seek higher yielding alternatives and that a shift into short-term bond funds presents similar or, we would argue, greater risk.

Capital buffers favour bank sponsors, although it is important to note that banks will not want the risk of having to consolidate funds on balance sheet. Buffers also create moral hazard by giving a misleading impression that a fund has some sort of guarantee.

Variant options

Sponsor Support
With regard to the variant of allowing support, we are in favour of the current prohibition of support in Europe. It appropriately demarcates the agency fund sector from the banking system for systemic risk purposes, reduces interconnectedness and moral hazard, and creates a more level playing field for bank and non-bank sponsored MMFs. Sponsor support raises many of the same issues as capital buffers.

Requiring LEB Membership
We do not support this variant option. Whilst we recognise the appeal to policymakers, in our view, the creation of an LEB is neither economically nor logistically viable. This option would not be conducive to preserving the viability of the industry. Given a long period of low interest rates, income is already reduced, limiting the flexibility of fund providers. Pre-funding costs would reduce investors returns, potentially leading them to seek alternatives with the associated risks outlined above.

The cost would be a significant barrier. It would be funded by MMFs but only be required during periods of significant stress. It is plausible that fund managers would exit the industry rather than incur the very substantial costs involved, resulting in consolidation and reduced competition. This outcome would be bad for the industry, the issuers who use the CP and CD markets to fund, and the investors.

By socialising risk, the existence of an LEB may create a potential moral hazard by encouraging MMFs to take additional excessive exposure as risk is effectively syndicated across the industry.

An LEB would be very complex from a regulatory point of view, particularly given the various jurisdictions and the various currencies involved in Europe. To have a meaningful impact any such facility would arguably need the ability to borrow from a Central Bank, negating the intention to make any such need for intervention necessary.

Uncertainty over access could undermine other more targeted reforms seeking to limit first mover advantage.

If the LEB is to operate like a commercial bank it would be better, in our view, to incentivise existing banks to fulfil their normal market making capacity.

Representative Option: Removal of Ties Between Regulatory Thresholds and Imposition of Fees and Gates
We are strongly supportive of this proposal. We believe it would ensure the usability of the liquidity inherent in the MMF structure. The 30% weekly liquid asset (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 pre-emptively redeem. 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 WLA. EU MMFR does allow managers to temporarily dip below 30% and additionally provides a 'dual trigger' whereby managers have discretion to impose fees and gates only when a dip below 30% is accompanied by a net daily outflow of more than 10%. Nevertheless, investors became unduly focused on the 30% threshold ('bright lines') and the possible imposition of fees and gates with the result that managers felt unable to utilise their natural liquidity as it had been intended. Formally enabling MMFs temporarily to dip below the 30 % WLA would allow fund managers to use WLA to meet redemptions. As per the current regulations, MMFs dipping below 30% would be required thereafter only to purchase assets that were accretive for liquidity purposes until levels were restored.

The report suggests that this reform could increase uncertainty for investors regarding the use of fees and gates and that MMFs may be reluctant to use them due to stigma. In our opinion, even if this is a risk the benefit of ample liquidity buffers being available for countercyclical use is a major net positive which outweighs the risk. Fees were not deployed during the crisis because they were not triggered. Furthermore, it may be possible to customise fees and/or a cure mechanism to alleviate these concerns (see our comments above in Q2) . The report also cites concern that MMF managers may be more willing to use internal liquidity (to invest) rather than maintaining thresholds. This is not realistic. Minimum liquidity requirements can only be breached passively not actively. Again, provisions for a cure period, as currently provided in the MMFR[23] or indeed, reinforced, will avoid this.

(See also our response to Q3 above)

Variant options

Authorities Activating Fees

This option assumes that the link between thresholds and the imposition of LMT remains. We believe this tie should be removed as *per* the above comments. Any intervention by regulators would necessarily be subject to a time delay which would be highly counterproductive in a stressed period. Fund managers themselves can be much more responsive. Fund managers and boards are best placed to understand the precise circumstances of their individual funds and the needs of their clients. Any regulatory action is only effective in a systemic event and cannot address idiosyncratic fund risk. Regulatory action could also be misinterpreted by investors and fuel concerns, leading them to redeem pre-emptively.

Concentration Limits

In our view, fund managers already manage concentration risk prudently. Imposing investor concentration limits could be operationally challenging particularly where funds are sold via intermediaries. As noted, this option could lead to correlated behaviour. Generalised assumptions based on investor type could be misleading as individual behaviour can vary significantly within a given categorisation. For example, corporates may have very different cash flows needs according to their sector and not all insurance companies use MMFs for margin purposes. Both the US and EU MMF regulation address KYC and client concentration risk. This is bolstered by credit rating agency criteria that monitor portfolio coverage for such concentrations on an ongoing basis.

Countercyclical Buffers

As noted above, EU MMFR technically permits the countercyclical use of buffers since it does not prohibit MMFs from falling below 30% and therefore *in theory* availing themselves of WLA to meet redemptions. However, in practice, the regulation did not have the intended effect and MMFs were unable to do so due to the link with the potential imposition of fees and gates.

In our view delinking buffers would have the effect of making them countercyclical, as was intended, and therefore additional regulatory relief should not be required. MMFs hold substantial amounts of liquidity, often in excess of the regulatory minimums, but this liquidity was effectively locked up. Permitting MMFs to use it would significantly improve their resilience. Available liquidity, once detached, should be accessible to all MMFs in a consistent manner regardless of fund type. Fund managers can then be relied upon to do their fiduciary duty and use that liquidity in the best interests of shareholders.

[23] Article 24 1.

Any action by regulators would be subject to time delays, reducing its effectiveness. If the tie between thresholds and the imposition of LMT has not been removed, the 'bright lines' will remain, meaning that investors will continue to harbour the same concerns and are likely to redeem pre-emptively whilst waiting for regulatory relief. MMFs typically aim to increase liquidity during times of stress if this is possible. Regulatory signalling that lower levels are permissible may deliver the wrong message and could even exacerbate investor concerns.

With respect to the scenario where countercyclical buffers are added to existing buffers, our reservation would be the creation of a secondary buffer may not change investor behaviour and that a 'bright line' would remain. If release of the additional buffer were subject to a regulatory trigger, then this would again be vulnerable to time delays. Investors would be likely to redeem ahead of action rather than waiting. Additionally, action by regulators would only be effective if it is a market-wide issue. In the case of idiosyncratic risk, where for instance one fund suffers due to particular circumstances, they would be of limited use and could be counter-productive in causing contagion.

If buffers are not delinked, then such regulatory relief would be more important.

Representative Option: Removal of Stable NAV
We are opposed to the removal of stable NAV MMFs. As the FSB note, VNAVs also experienced similar redemption pressure. The experience of March 2020 **clearly shows that fund structure was not the issue**. The primary consideration should be liquidity not NAV methodology. It is important to remember that stable NAV funds account for over half of total AUM in EU MMF assets: given a choice between variable and stable NAV fund types, investors in EU MMF assets have chosen to invest the majority of their funds in stable NAV MMFs (either PDCNAV and/or LVNAV MMFs). IMMFA MMFs currently have approximately EUR810bn equivalent in stable NAV MMFs, illustrating their importance to investors and to the provision of short-term funding in the capital markets.

We are very supportive of EU MMFR which has been positive in enhancing transparency and consistency and significantly improving resilience. It also served to reinforce investor confidence in MMFs post-2008 crisis and to provide a widely recognised minimum standard for the product in Europe that is now recognised by global investors. This is evidenced by the 31% growth in assets under management since the implementation of EU MMFR in March 2019.[24] As a trade association which represents, promotes, and supports the development of the European money market fund industry, we engaged extensively and contributed to the co-legislators' efforts during the establishment of the regulation. The success of the regulation was borne out in the liquidity crisis, which was its first real test. In designing the EU MMFR, extensive consideration was given to the integrity of the stable NAV model. In our view, the outcome of the March 2020 crisis does not suggest that this debate should be reopened. In fact, the resilience demonstrated by stable NAV MMFs during the COVID-19 March crisis (including the fact that no such MMFs imposed gates, suspensions or redemption fees) proves that the previous reforms achieved their goal of strengthening resilience.

Furthermore, USD denominated PDCNAVs in Europe and US government MMFs proved to be the most robust and resilient fund types. They saw substantial investor inflows and provided investors with the opportunity to rotate into a lower risk alternative. (See chart in Q9 above). On this basis, we see no justification for their withdrawal.

With respect to LVNAV funds, they provide important investor optionality. Some investors are required to invest in stable NAVs in line with their internal investment procedures or because LVNAV funds are

[24] As of 29 March 2019, Euro equivalent AUM for IMMFA MMFs was EUR643bn compared to EUR843bn as of 8 August 2021.

more practical for sweeps, intraday settlement and trade execution. The fact that stable NAV funds may also be designated 'cash equivalent' is another very important factor in their uptake. Although VNAVs are recognised by the AMF as cash equivalent and the SEC has similarly confirmed their acceptance as such, other international jurisdictions do not provide the same clarity. Some investors require an MMF to have an objective to maintain a constant NAV for other regulatory reasons, for example in the UK under the FCA requirements for CASS 7 client money "its primary investment objective must be to maintain the net asset value of the undertaking either constant at par (net of earnings), or at the value of the investors' initial capital plus earnings"

We would also draw attention to the fact that LVNAV MMFs only amortise those assets under 75 days and no more than 10bp away from the mark to market price. Selling longer term assets will therefore have a muted impact on the NAV. We also note that in accordance with the IMMFA code of practice, IMMFA MMFs, which account for the overwhelming majority of stable NAV MMFs in Europe, mark to market their holdings on a daily basis through independent third-party sources.

The removal of LVNAV MMFs (but not PDCNAVs) would result in a substantial diminution of funding to the private sector given that they represent an important source of efficient short-term finance to a range of borrowers including, as noted by the report, a large number of banks. This bank funding in turn provides finance indirectly to the real economy. Other borrowers include corporates, insurance companies and asset-backed issuers. LVNAV funds thereby play an important role in the capital markets.

Given VNAV MMFs experienced similar elevated redemptions, we see no evidential basis for the removal of stable NAV MMFs.

Representative Option: Limits on Eligible Assets
MMFs already hold substantial amounts of liquidity to meet redemptions and we believe that delinking will provide a further substantial boost to their liquidity resilience. We outline some of our specific reservations below, whilst also acknowledging the validity of some of the suggestions.

Holding Higher Buffers
Holding higher buffers is in principal the simplest way to improve fund liquidity further. However, stable NAV MMFs in Europe (along with Prime Institutional funds in the US, which are floating NAV) already hold very substantial amounts of liquidity, often in excess of the regulatory minimums which in themselves are high. The principle problem for these funds was that they were unable to unlock that liquidity, forcing them to sell other assets. As per our comments above, we believe that delinking is crucially important in releasing that liquidity so that it can be used countercyclically.

Requiring MMFs to hold higher buffers or shorter assets would present a number of challenges. As noted in the report, shorter issuance would increase issuers' rollover risk. Some issuers, most obviously banks, will be uninterested in issuing shorter paper as it increases refinancing risk and, in the case of banks, does not contribute to liquidity ratios. There are also very significant supply constraints in the overnight deposit and reverse repo market which can limit the extent to which MMFs can simply increase these assets. These constraints can be particularly acute on reporting dates. Stable NAV MMFs, which are typically rated AAA[25], have stringent requirements on counterparties and collateral which limit them to high quality risk.

In our view there should be greater consistency between fund types as to how buffers are calculated. Article 24 of MMFR allows for a significantly less stringent definition of the composition of WLA for VNAV

[25] AAAmmf/Aaa mf/AAAm money market fund ratings. All IMMFA MMFs are AAAmmf/Aaa mf/AAAm by one or more of Fitch Ratings, Moody's Investor Services and S&P Global Ratings

MMFs. LVNAV/PDCNAVs can include 17.5 % of assets up to 190 days provided these assets subject to Article 17 (7) are 'highly liquid' and can be redeemed and settled within one working day. In contrast, VNAV MMFs may include up to 7.5 % (i.e., half of their WLA) of assets in 'money market instruments or units or shares of other MMFs…provided they are able to be redeemed and settled within five working days'. This not only significantly widens what is acceptable (allowing non-public debt that faced severe liquidity challenges during the pandemic to be included in liquid assets) it also allows for a longer period for liquidation, i.e., five days versus one. In our view, what counts towards WLA should be equalised across the different fund categories. Public debt names as defined under MMFR article 17a7 should be the only type of securities eligible for the liquidity buffers other than true daily and weekly maturing assets.

As part of the above consideration, we would recommend removing the 17.5% cap on the 'highly liquid' assets up to 190 days which can count towards the 30 % WLA of an LVNAV (or PDCNAV) MMF. This is generally considered to refer to sovereign, supranational or agency debt and the cap therefore appears to be an unnecessary additional constraint. Given the objective is to ensure that funds have sufficient liquidity that is usable, the restriction makes little sense.

In our response below to the Eurosystem proposal (see below) that MMFs hold more public debt we make the case that supply constraints in the sovereign market would make fulfilling minimum quotas extremely challenging, particularly in currencies other than USD. Removal of the cap is not inconsistent with this observation. The Eurosystem proposal to hold a minimum quota in public debt arises from the assumption that such securities will generally benefit from greater liquidity and that MMFs should therefore be encouraged to increase their exposure to public rather than private debt. The 17.5 % cap, on the other hand, runs directly counter to this by placing a cap rather than a floor on public debt as a component of liquid assets. Removing the cap would mean that MMFs had the ability to use public debt as part of WLA when available. In both cases we believe MMFs would be better served by flexibility as to how they deploy public debt assets to improve their liquidity.

Eurosystem Proposal to Hold More Public Debt

We note the Eurosystem's proposal in response to the recent ESMA consultation which recommends a scenario where private debt MMFs are required to hold additional paper in public debt securities. Whilst requiring MMFs to hold more liquid paper has a clear logic we question the availability of public debt to fulfil such a quota outside the US Dollar market. Were such a proposal to allow funds a degree of flexibility in fulfilling their obligation it may be an appropriate way of reinforcing liquidity, for instance by holding higher levels of reverse repo collateralised by sovereign debt or more overnight deposits. Short term public debt markets in Euro and Sterling are subject to severe capacity constraints. This constraint also applies to the repo market and can be very acute on reporting dates. In Euro this is exacerbated by the absence of a deep and uniform sovereign market. Given market limitations, this option would only be potentially viable if MMFs were given access to something akin to the US Federal Reserve's reverse repo program (RRP) or if other measures were taken to ensure an adequate supply of short public debt assets. Even with access to the RRP, US onshore funds occasionally experience supply constraints despite an exceptionally deep treasury market. These factors should be taken into account when considering increased holdings of public debt as a solution. It would also be important to avoid creating new 'bright lines' through the creation of an additional visible quota.

Variant options on Limits on eligible assets

Limit MMFs to Government Debt
We do not believe MMFs should be limited to government debt. As *per* our comments above on the Eurosystem proposal, there are significant supply constraints in Euro and Sterling. Given market limitations, this option would only be potentially viable if MMFs were given access to something akin to the US Federal Reserve's RPP. Even with this facility, supply is not always adequate despite the unparalleled depth of the US treasury market. As noted, this would effectively limit MMFs to government MMFs. There has been limited investor demand for public debt MMFs in Euro and Sterling to date. Supply constraints would in any case limit the extent to which government MMFs could substitute for non-public debt MMFs outside of the US market.

Buffers Based on Investor Concentrations
In our view, KYC policies can address investor concentration risk. Specifically linking buffers to liability concentrations could disadvantage some funds over others, for example funds with high concentrations of institutional investors, even if managed more prudently than a comparable fund with more retail investors.

The profile of investors in a fund can change significantly over time, particularly with large redemptions, which are likely in stressed conditions. Any data used to analyse this can quickly become out of date. This option could have the unintended consequence of institutional investor dominated funds being deemed to be riskier, even when managed prudently, thereby fuelling redemptions from these funds which would result in greater market instability.

Investors use MMFs for cash management and their cash needs can be very different depending on their overall cash portfolio. Some investors use MMFs in conjunction with deposits, direct securities and reverse repo, whilst others may use only MMFs. It is possible to have two very similar investors in the same institutional category, such as two corporates, using the same fund but with very different cash needs during a time of stress, for instance an airline versus a supermarket chain. Even within the same sector, for instance retail, those corporates could have vastly different profiles.

Redemption in Kind
Redemptions in kind would not be possible within an appropriate time frame. They require significant amounts of planning as assets are transferred between custodians. Some of the assets held by MMFs are non-transferable (such as deposits and reverse repo). In practice this option is only available to institutional investors since it requires a custody account to receive securities. Not all MMF investors have such accounts and so would be incurring additional costs for a service only required *in extremis*. It would take longer to arrange a redemption in kind than to liquidate and provide cash thereby defeating the purpose of the solution.

Non-daily Dealing
The ability to provide same day liquidity is key to MMF utility. Removal of this capacity would affect 'cash equivalence' which is also a very important factor to some investors, particularly corporates. Enabling MMFs to access their inherent liquidity will go a long way to mitigating the impact of large redemptions. It can be combined with other measures, such as use of liquidity fees, to ensure that the overall impact is to reduce liquidity transformation.

Liquidity Based Redemption Deferrals
The arguments which apply to non-daily dealing also apply here. Same day liquidity is a central to the utility value of MMFs. Uncertainty about repayment would be likely to impact the accounting treatment

as 'cash equivalent' and would also undermine the fundamental concept of a stable NAV. Deferral triggers would likely incentivise investors to redeem early in cases of stress for fear that they may have future redemptions deferred.

Representative Option: Additional Liquidity Requirements and Escalation Procedures
For our thoughts on holding higher levels of liquidity please see our comments on eligible assets above and reservations based on supply constraints. With respect to increasing liquid assets from 1 to 2 weeks, a third layer of assets is unnecessary and adds undue complexity without bringing a benefit. The repo market is effectively an overnight market, reflecting the fact that banks use repo to finance their trading books. Bank appetite for deposits does not increase between 1 and 2 weeks as neither has value from a prudential ratio perspective. Most issuers will not issue very short paper because they require security of funding and issuing very short paper merely increases their rollover risk. Given the lack of additional supply, in practical terms an extension from 1 to 2 weeks would simply mean the inclusion of additional assets rolling down. This would not provide a material benefit.

With respect to escalation procedures, most fund managers already have liquidity protocols surrounding the use of escalation procedures which would provide for gates being imposed only after fees. As per our comments above, fees could be customised by building on manager protocols and playbooks in conjunction with the relevant NCA. Providing a framework for the use of fees, as distinct from gates, could help allay investor concerns about the latter, since investors have a far greater aversion to gates than to fees.

As noted, regulatory thresholds would remain focal points for investors.

11. Is the description of variants and the comparison of their main similarities/differences vis-à-vis the representative options appropriate? Are there other variants to consider?

As stated at the outset, we are in favour of incremental and proportionate reforms. To the extent the variant options are more severe, we find the representative option to be sufficient. A number of the variant options are also characterised by a move away from manager discretion towards macroprudential intervention. Given that in a crisis situation time is of the essence, we strongly recommend risk management be located with the board and /or fund manager.

We discuss the variant options above. We have no other variants to suggest.

12. Are measures to enhance risk identification and monitoring by authorities and market participants appropriate complements to MMF policies? Which of these measures are likely to be most effective and why? Are there other measures to consider?

We do not believe that additional reporting and stress testing are the solution to addressing the challenges observed in March 2020. The existing reporting and stress testing frameworks are comprehensive and detailed. Stress testing is already calibrated very conservatively.

Existing reporting requirements are already a significant undertaking involving custodians, administrators and transfer agents. All IMMFA MMFs are over the minimum EUR 100 million and

therefore report quarterly. It would be challenging to speed up the production of the existing reporting given the amount of data and sources from which it is compiled.

Whilst there could be some benefit in greater transparency provided to regulators, reporting is, by its nature, backward looking and lagged. The regulatory reporting put in place for MMFs is particularly onerous when compared to other fund types. However, it is already a month out of date before it makes it way to regulators and given the short nature of MMF investments, a 'live' view of the fund could look very different compared with the regulatory filing.

Providing additional or more frequent reporting only during a crisis event would also be problematic. During a crisis fund managers and service providers (fund administrators and transfer agents) experience significantly higher volumes of work due to increased investor activity, increased market trading activity, valuation checks/challenges, tolerance breaches to be investigated, etc. Demanding additional reporting during the busiest time would create more operational stress on the system and risk that the core role of ensuring the smooth running of MMFs could be jeopardised.

Some European funds already provided additional reporting at the request of their local national competent authority such as the CBI and the CSSF.

We would be very supportive of more transparency in the short-term markets including post-trade information and on outstandings.

Considerations in selecting policies

13. Are the key considerations in the selection of policies to enhance MMF resilience appropriate? Are there other considerations that should be mentioned?

We would highlight the fact that many redemptions in the crisis were driven by genuine operational requirements. This need for cash cannot simply be dispersed by moving funds elsewhere into less liquid products. Investors will still seek liquidity and alternatives which offer less liquidity will only result in strains elsewhere.

The key considerations are appropriate although in our view the risk of substitutes being insufficient and failing to equate to MMFs is underestimated.

14. Which options complement each other well and could potentially be combined? What are the most appropriate combinations to address MMF vulnerabilities in your jurisdiction? Which combinations are most effective for different MMF types and their functions?

As per our comments above, we recommend removing the tie between regulatory thresholds and the potential imposition of fees and gates. The use of liquidity management tools (delinked) should be maintained. We suggest that these provisions apply to all European fund types to foster greater consistency.

As noted by the FSB, a good starting point is to consider tools that MMFs have at their disposal. Liquidity fees are already allowed for under Article 34 and are designed to help manage a severe liquidity event by allocating the cost of providing liquidity to redeeming investors. The likelihood of having to use such

measures is reduced by making the buffers accessible. This combination, and applying fees consistently to all fund types, would be 'coherent'.

15. To what extent should authorities seek to align MMF reforms across jurisdictions? Is there a minimum set of policies or level of MMF resilience that should be considered at the international level to avoid fragmentation and regulatory arbitrage?

The report is right to recognise the differences in jurisdictions. In our view, it is important to reflect the different market dynamics between the US and Europe and the fact that even within a given jurisdiction, funds are not homogenous. For instance, the report correctly notes that currency of denomination is an important consideration. The US market benefits from one currency, the deepest treasury market in the world and significantly better data transparency. Another point of divergence is the definition of an MMF, which is broader in Europe. European reforms have been successful in improving fund resilience and we continue to support the European prohibition on external support.

We would support a more uniform approach to the definition of an MMF across jurisdictions. The concept of an MMF should share common DNA as it pertains to the key characteristics. The report suggests ultra-short bond funds would be a substitute for MMFs but in Europe standard VNAVs are the equivalent of ultra-short bond funds in the US. Ultra-short bond funds which are not designated MMFs would, as noted by the FSB, represent substantially the same or, in our view, greater risks.

Short-term Funding Markets (STFMs)

16. **Does the report accurately describe problems in the structure and functioning of STFMs and how these have interacted with MMFs in stress periods?**

Short term funding markets seized up in March 2020 not due to perceived risk of asset quality, but due to a systemic lack of market-wide liquidity. This affected all asset classes, not just MMFs, a point which seems to be overlooked in the laser focus on MMFs. A systemic liquidity squeeze meant that almost all investors were positioned the same way whereas a functioning market requires two directional flows. Historically, banks would have been better able to price the premium for such liquidity and intermediate, but they have reduced appetite to do so since the post 2008 reforms. Prudential reforms have encouraged them to act on an agency rather than principal basis, intermediating flows between buyers and sellers, making two way flows all the more important. Whilst this is a positive for bank solvency, the liquidity and trading risk in the market did not go away, although it was displaced off bank balance sheets.

We disagree on the intrinsic illiquidity of the instruments ('Secondary markets for CP and CDs are generally not liquid', 'limited liquidity, even under normal conditions'). These instruments are short term and are normally held to maturity, meaning the market is characterised by low trading volumes, which is not the same. Neither do we agree with the report's statement that 'similarities in portfolios may present contagion risk' (page 6). On the contrary, the larger issuers tend to benefit from greater liquidity as they are more widely accepted by investors which equates to a deep, diverse investor base. Current MMF regulation which requires high standards in credit risk determination is very effective in mitigating credit risk and thereby limiting contagion risk. High levels of transparency further mitigate the risk that bad news in one fund causes redemptions from others. Money markets normally benefit from mutual interest in similar money market instruments because of their high credit quality (which was not

questioned during the crisis). This allows MMFs to reposition portfolios and trade securities under normal circumstances.

We believe that policy makers should aim to improve underlying market functioning. We particularly support measures which may improve the limited incentives for dealers to intermediate during stress periods. In our view, this requires consideration of prudential regulations such as temporary relief measures – capital and liquidity ratios- which can be effective. It also requires changes in the 'microstructure', such as the report suggests (page 41) including more standardisation and greater transparency.

The report concludes that 'prudential requirements were not a dominant factor' whereas we find that they did have a material impact in changing banks' appetite and capacity for intermediation.

17. What other measures should be considered to enhance the overall resilience of STFMs? How would those measures interact with MMF policy reforms and how effective are they likely to be in preserving market functioning in stress times?

Enhancing the overall resilience of STFMS has a number of different aspects.

The Underlying Instruments
As stated above (Q16), we do not regard the liquidity of the underlying MMIs as being the determining factor in the seizing up of secondary markets in March 2020. We attribute this to a far deeper cause, namely, the sudden withdrawal of dealer intermediation. However, we certainly support efforts to improve underlying liquidity through increased convergence on market standards and practices, greater transparency and improved data. Since its relatively recent inception in the 1980s the European CP market has grown to be significant and now represents an enormously important funding source for a wide range of issuers who value its cost efficiency and flexibility. It predominantly consists of the internationally orientated Euro CP market and the substantial domestic French CP market, now largely homogenised under NEU CP. A number of smaller domestic markets also co-exist. As such, the pan-European market remains deeply fragmented. Divisions arise because of differences between local versus international jurisdictions which determine legal frameworks, regulation and settlement, and because, outside local markets, issuers also borrow in a number of different currencies, predominantly Dollars and Sterling. The CD market, which predates CP and historically followed different conventions, is now increasingly but not completely integrated with CP and is similarly fragmented ('Yankee' CDs trade differently from Euro CDs, for instance). Moves to reduce market fragmentation need to look at the market infrastructure (data, platforms, legal frameworks etc). The lack of homogeneity in both CP and CD markets led to very different outcomes with regard to eligibility for asset purchase programmes. For instance, some, but not all, STEP[26] labelled paper may have been considered eligible. These matters require further analysis and dialogue with all the relevant stakeholders, including dealers, issuers, investors and platforms.

The Role of Intermediators in Times of Stress
The report identifies a number of the factors which led banks to pull back from their customary market making role (Box 3). The widespread withdrawal of dealer intermediation had far-reaching consequences for other parts of the short-term eco-system, including MMFs. In some cases, banks were even unable to provide liquidity in their own name, which appears unprecedented. Measures which

[26] The Short-Term European Paper (STEP) initiative was launched in 2006 with the objective of fostering integration of European markets.

provided temporary regulatory relief combined with those which sought to assure banks about the availability of liquidity at reasonable cost (such as the targeted longer-term refinancing operations (TLTRO), the pandemic emergency longer-term refinancing operations (PELTRO) and collateral easing measures) were effective in enabling banks to resume their secondary market activity, demonstrating the importance of this function and the ability of central banks to manage their ability to do so.

Asset Purchase Programmes in Times of Stress
As noted in our response to Q2, there was significant variation in the effectiveness of central bank intervention. European asset purchase programmes were of little or no direct benefit to MMFs. Asset eligibility was limited, insufficiently defined and inconsistently applied by participating central banks. Ensuring that such programmes, if and when implemented, are appropriately designed, targeted and communicated would enable markets to recover more quickly.

Additional considerations

18. Are there any other issues that should be considered to enhance MMF resilience?

We would recommend that policy makers consider the use of MMFs as eligible collateral for bilateral margin calls. One of the key drivers of the extraordinary flows observed by MMFs during the height of the turmoil in March was due to investors responding to increased margin calls, as a result of the extreme market volatility. This was particularly the case for MMFs denominated in Euro and Sterling which are often used by liability driven investment (LDI) investors to manage the liquidity component of their portfolio. In order to meet margin calls, investors withdrew cash from MMFs, although when markets (and therefore margin levels) normalised, these flows returned. Receivers of the cash collateral, such as central counterparty clearing houses (CCPs), had to reinvest the additional cash collateral into securities similar to those owned by MMFs.

As such, we would encourage policymakers to consider further the use of MMFs for the purposes of collateral for bilateral margin requirements. While we are not questioning the appropriateness of margin requirements, which were a cornerstone of the post-2008 reforms and a key commitment of G20 Leaders at the Pittsburgh Summit, we believe policymakers can take a number of steps in order to mitigate the market-wide pressure as described above.

We understand that there are ongoing discussions, in the context of EMIR Refit[27], on the possibility of CCPs being able to reinvest the cash collateral which they receive into MMFs. We are supportive of broader industry efforts in this regard. A more holistic solution would be for policymakers to further facilitate MMF units being posted directly as margin. While this is permitted under EU regulatory requirements, in practice, margin is predominantly posted (and collected) in the form of cash, particularly with regards to variation margin. This would avoid the circular scenario whereby investors redeem from MMFs to post cash collateral, only for this to be reinvested in money market instruments by the CCP/collecting counterparty.

Similarly, the ability to avail of the use of MMFs to be posted as an alternative to cash will be helpful in the context of Uncleared Margin Rules (UMR) – particularly as Phases 5 and 6 will significantly broaden the scope of counterparties subject to regulatory initial margin, thereby increasing the industry demand for collateral.

[27] EMIR Refit- European Market Infrastructure Regulation, Regulatory and Fitness Performance Programme.

We believe that MMFs demonstrated high levels of resilience in what were extremely challenging circumstances, and that this resilience could be further enhanced by some of the measures discussed above. Consideration of how to implement liquidity fees to ensure their maximum efficacy will involve further detailed analysis and dialogue with regulators.

IMMFA
INSTITUTIONAL MONEY MARKET FUNDS ASSOCIATION

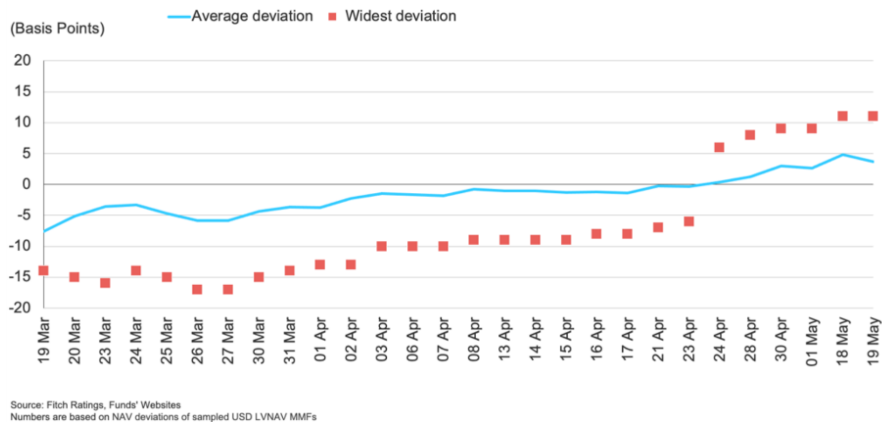
APPENDIX A

NAV deviations

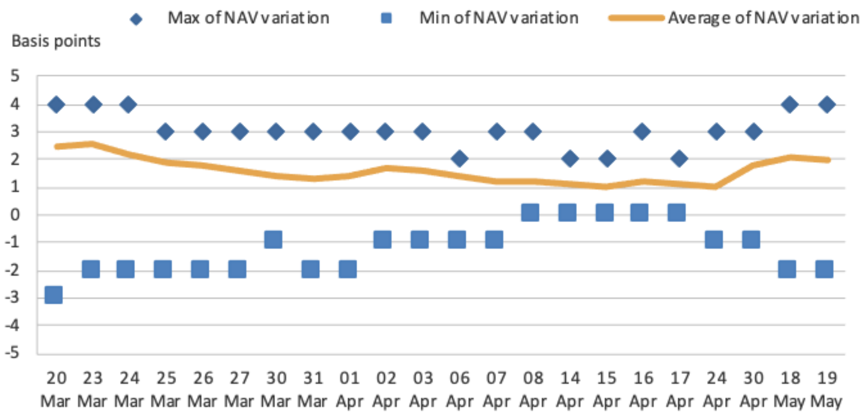
The charts below show NAV deviations for AAA rated LVNAV MMFs.

Fitch Ratings NAV Data

Fitch Ratings USD AAAmmf LVNAVs



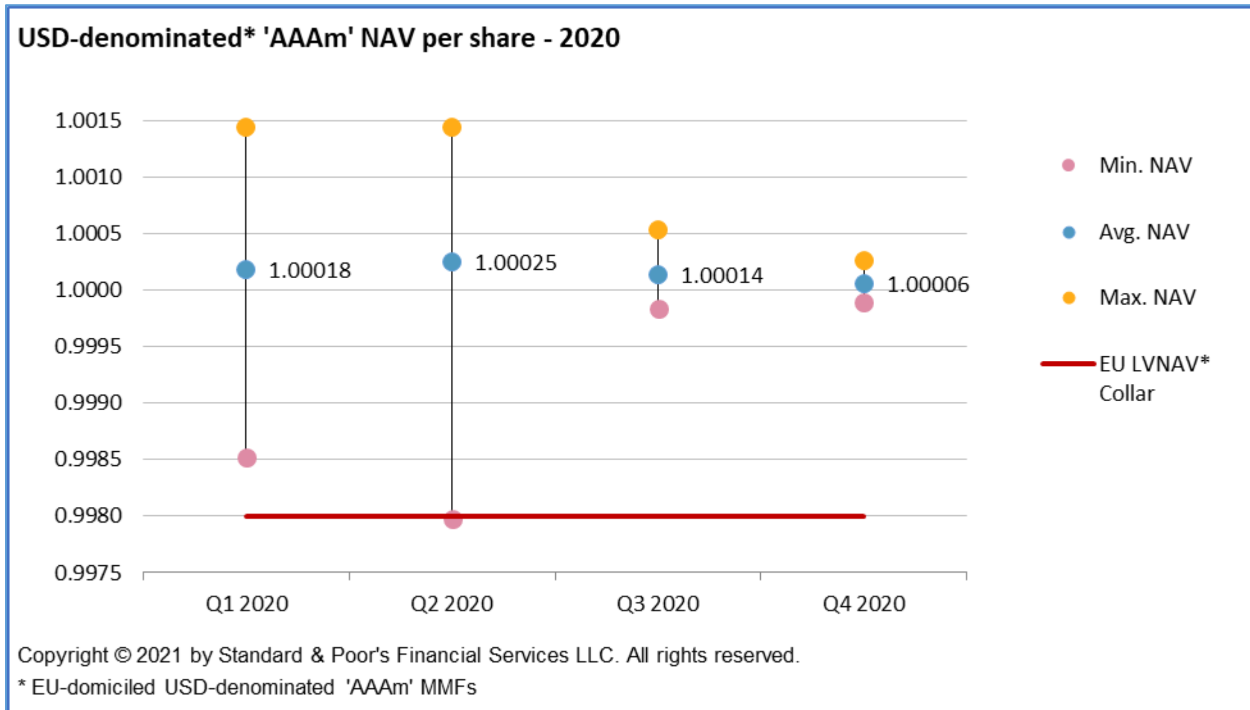
Fitch Ratings Sterling AAAmmf LVNAVs



IMMFA
INSTITUTIONAL MONEY MARKET FUNDS ASSOCIATION

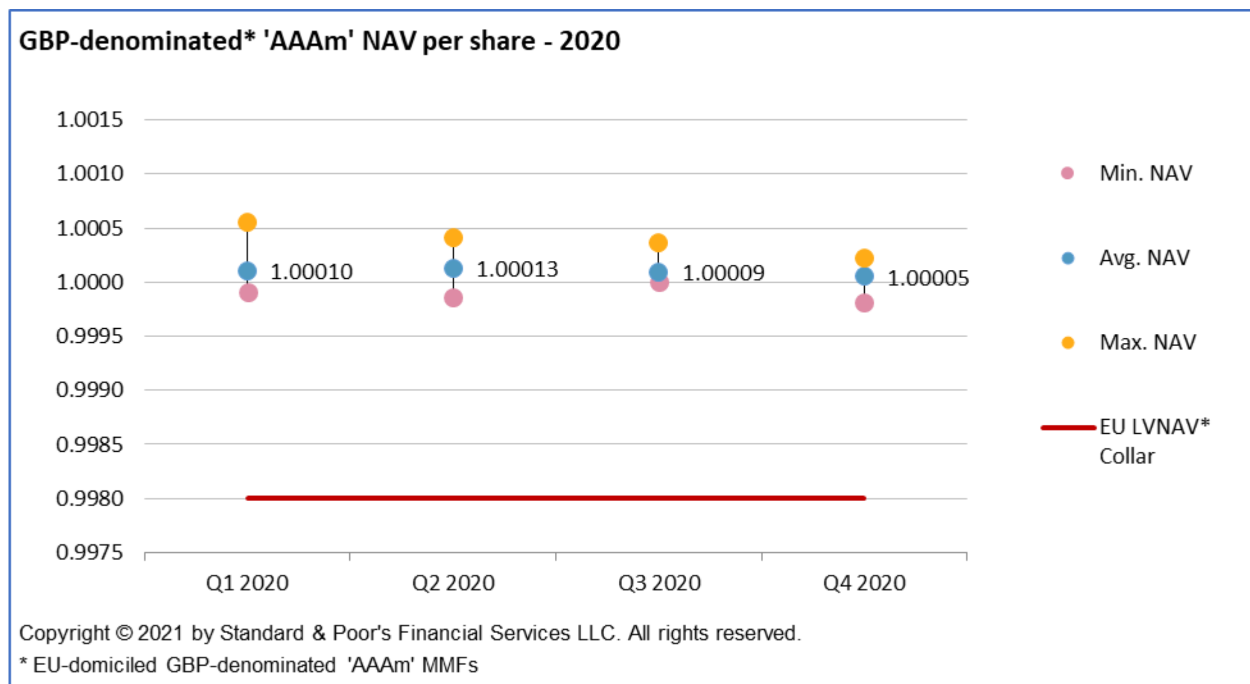
S&P Global Ratings NAV Data

S&P Global Ratings USD AAAm LVNAVs



Copyright © 2021 by Standard & Poor's Financial Services LLC. All rights reserved.
* EU-domiciled USD-denominated 'AAAm' MMFs

S&P Global Ratings GBP AAAm LVNAVs



Copyright © 2021 by Standard & Poor's Financial Services LLC. All rights reserved.
* EU-domiciled GBP-denominated 'AAAm' MMFs

S&P Global Ratings EUR AAAm LVNAVs