IMMFA

INSTITUTIONAL MONEY MARKET FUNDS ASSOCIATION

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European Securities and Markets Authority
103 rue de Grenelle
75345 Paris
France

ESMA CP 24 May 2017: ***Draft technical advice, implementing technical standards and guidelines under the MMF Regulation***

The Institutional Money Market Funds Association Ltd ("IMMFA") is pleased to submit its comments on the ESMA Consultation Paper on *Draft technical advice, implementing technical standards and guidelines under the MMF Regulation*.

IMMFA represents the European institutional money market fund industry that manages and promotes investment funds based on providing a constant Net Asset Value per share to investors. All IMMFA members' funds are UCITS, although it is possible that new entrants to the market could use the AIF structure in future. All but one are domiciled in Luxembourg and the Republic of Ireland (there is one UK fund).

The funds offer cash management services, effectively intermediating between investors and issuers in the money markets (prime and government), as well as providing risk diversification away from direct deposit taking by banks. Typically the investor profile includes institutions such as corporations, investment firms including banks, pension funds, charities, local authorities and other public bodies.

The money funds provide significant amounts of short term funding to the market, much of it for banks.

At the end of May 2017, funds under management for IMMFA members' money market funds amounted to €647 billion. A list of members may be found at www.immfa.org

Our members are interested in all parts of the consultation.

Summary of key points

I. We recognise that ESMA has to respond to specific tasks included in the Level 1 Regulation, and that the time available to do so is short. Nonetheless, we would urge that requirements are developed that take full account of the specificities of money market funds. The current level of prescription appearing in the draft advice and guidance would benefit from being more tailored to the way the money funds operate.

II. An overarching comment is that the consultation does not always appear to have taken full account of the very short term nature of the portfolios of money market funds, Short Term MMFs in particular. For example, credit assessment criteria used for bonds will not work in the same way, or effectively, when applied to money market instruments.

III. Insufficient weight been given to the substantial tightening of the rules around each MMF type in the MMF Regulation. The consequence is that the draft advice and the guidance are in places over-extensive and do not acknowledge that the provisions of Level 1 already deal substantially with certain issues. For example the requirements for reverse repo collateral that goes beyond 397 days maturity are already restricted in the Level 1 text to government securities only, and in the case of third country government debt this is also already subject in Level 1 to the full rigours of the credit assessment process. The required advice on liquidity and credit quality should be sharply focused to the narrowed band of collateral remaining.

IV. It is important not to undermine (inadvertently) the use of existing portfolio risk tools by inappropriate prescription. For example, the macro-economic scenarios that managers are asked to consider under stress testing have little useful application to the funds as the timeframes are so vastly different. A better approach would be to focus mostly on what the managers do day-to-day to manage risk in their funds and, in relation to macro events specifically, require the manager to identify and test for events that have the most potential to disrupt the funds.

V. Generally we suggest it is unhelpful to bury generic policy views within work on specific requirements. This occurs in the second half of paragraph 186 on share destruction (we cover the substantive point below). Where an interpretation is taken of the Level 1 text (MMF Regulation), it would be helpful for ESMA to identify and explain each instance clearly at the beginning of a section. It is important that policy issues are properly highlighted and explained so that market participants may assess them accordingly.

Share destruction

As mentioned, we were surprised to see, in paragraph 186, a potential policy statement on share destruction effectively buried within requirements on reporting. IMMFA does not share the interpretation that ESMA appears to be making in this paragraph.

The creation and cancellation (destruction) of shares is a dynamic process that currently operates in accordance with UCITS directive provisions, as authorised by a number of EU Competent Authorities. It is the mechanism by which all open-ended investment funds handle inflows and outflows of investment. We are not aware of any reference in the MMF

Regulation that seeks to change this process, nor would it be workable for any fund if this were the case.

If, as we believe may be the case, ESMA is referring to a prohibition on reverse distribution mechanisms, for example to deal with negative yield, we still do not accept that there is a prohibition on this in the Level 1 text. Share cancellation is an approved and widely accepted mechanism that is used at present in the context of negative interest rates, currently applicable for some currencies.

In relation to negative yield, managers assessed the options with investors some years ago when the euro first moved towards negative yield territory. Operationally neither funds nor investors had previously had to handle negative yields and many systems were not set up to deal with this scenario. On the cash front, many investors did not have the operational capacity to handle a constant traffic of small sums transferring back and forth daily to take account of negative yield and fee accruals, nor was this activity economically viable, as transfer fees outweighed the sums at issue. Investors therefore had an overwhelming preference for share cancellation or reverse distribution mechanism. This met their accounting needs, was cost effective and, crucially, placed the operational burden on the fund. To achieve this outcome the funds made prospectus changes at that time. The introduction of this required express shareholder consent, either through a vote at an Extraordinary General Meeting or a signed instruction from the shareholder mandating the fund to take this step, thus illustrating the process already undertaken, with regulatory permission, and the breadth of support from the investor base.

The mechanism is therefore applied only to take account of negative income in a fund when interest rates are negative. It supports the separate and entirely transparent treatment of yield and of capital. Attempting to introduce a restriction of this kind would make it operationally impossible to offer funds with negative yield currencies that use a stable price, in particular Public Debt CNAV and LVNAV funds. ESMA should understand that the consequences of pursuing this policy are severe and would be considered to be a frustration of the Level 1 text. The uncertainty introduced by this late interpretation has provided a set-back to preparations for the new regulatory regime and we ask for prompt clarification.

Questions

ARTICLE 15 technical advice on reverse repo collateral

Q1 . Do you agree that the abovementioned references to EU/US standards are relevant in the context of the issuance by ESMA of technical advice on quantitative and qualitative liquidity and credit quality requirements applicable to assets received as part of a reverse repurchase agreement in the context of the MMF Regulation? Do you identify other pieces of national/EU/International law that would be relevant in view of the work on this part of the advice?

We agree that it is sensible to consider other EU and US regulatory standards on collateral requirements. We believe ESMA have identified the most relevant standards for its analysis.

We recommend in addition that ESMA should consider the ESRB opinion on securities financing transactions (Section 5):
https://www.esrb.europa.eu/pub/pdf/other/20161004_esrbopinion.en.pdf?eb4c21d49897bfc6f7036b502eb631c2

We caution that it is important to bear in mind the different circumstances that apply in relation to each standard. MMF assets are inherently of very short maturity and reverse repo used by MMF is also very short term, typically overnight for Short Term MMFs. This produces a very different profile of usage when compared, for example, to pension funds collateralising OTC derivative contracts that may have 10 or more years to run.

Q2 Which of the options described above regarding credit quality and liquidity requirements would you favour?

We favour Option (a) for the credit quality requirement. We do not favour the other options in isolation, although we believe that some of the content of Option (b) could be added to Option (a) in relation to determining credit quality.

We favour Option (a) for the liquidity requirement, subject to changes being made to the proposed haircut.

Reverse repo is a highly commoditised activity. It is carried out subject to the application of market standard terms, such as a GMRA (Global Master Repurchasing Agreement). Funds will specify acceptable collateral sets at the outset, incorporating this into a schedule within the GMRA (or similar standard terms), as part of the on-boarding process with their counterparties. Most funds use tri-party repo for their reverse repo trades (see note attached for information on tri-party repo, marked ANNEX 1).

It is important to the money funds industry that the tri-party repo contractual arrangement should continue to be available in the future and that the practicalities of using it are respected and reflected in the advice drafted by ESMA. We believe that the draft advice with the heading Option (a) achieves this (page 97), but that the draft advice with the heading Option (b) does not, in particular in respect of paragraph 3 (page 99). By way of example, although the collateral provided in tri-party repo will be compliant with the collateral set a fund specifies in its GMRA schedule, precise information on each collateral asset will not be known to the manager until next day. Since most funds' reverse repo contracts are overnight, this will be after the contract has concluded. After the fact information on individual collateral assets has no practical purpose.

Combining Option (a) on credit quality (page 25) with a non-exhaustive list of assets drawn from Option (b) (also page 25) could be a way of providing additional certainty about permitted collateral sets. Option (b) references HQLA, from banking regulation, as acceptable collateral. Using HQLA to determine (in part) credit quality ties in with the reverse repo collateral credit quality requirements, which apply only in respect of EU member states and the pan-European institutions. This would give additional certainty in

relation to euro assets, although it should be noted that much of what constitutes HQLA would be ineligible for MMF reverse repo collateral as HQLA includes many assets that are not government securities. The non-euro assets of EU member states could be dealt with by reference to Article 11 of the Delegated Regulation 2015/61.

For liquidity requirements HQLA would have to be considered as a non-exhaustive reference list, as there is limited provision for non-euro and non-EU member states assets, including USD, GBP and other currencies. However Article 11 of the Delegated Regulation 2015/61 does, as mentioned, provide a steer on the treatment of third country assets, which could be referenced in the advice.

In relation to Option (c) on credit quality, we agree that there is some similarity between the requirement for high quality collateral to be posted to support a reverse repo agreement under the MMF Regulation and the requirement to post high quality collateral to support a non-cleared derivative contract under EMIR. However this similarity diminishes when the widely different settlement/maturity profile of the underlying contracts is taken into account. For money market funds, the vast majority of reverse repo activity undertaken by Short Term MMFs is overnight repo with "traditional collateral" i.e. against government or government-backed securities, carried out within tri-party contractual arrangements. The collateral accepted in relation to EMIR is much broader than for a MMF and the settlement/maturity profile of the contracts collateralised is much longer than that used by MMF. Further, Article 15 (6) of the MMF Regulation only allows collateral with a maturity greater than 397 days to be accepted if it is a Government security. For these reasons we do not support Option (c).

Option (d) on credit quality would be inappropriately confining. The Regulation was developed for bank holding purposes and should not be the sole reference point for short term collateral requirements.

Q3 With respect to option a), do you think the haircut policy should be determined as suggested, or should there be more flexibility given to the manager on this determination? Do you think that the decision of equivalence vis a vis third countries mentioned in this option should relate to the one mentioned in Article 114 (107 in the case of credit institutions) of CRR?

We believe that Option (a) is workable in principle, provided the haircut policy is changed. We advocate leaving greater discretion to the manager rather than applying a fully prescribed, standardised, haircut. Specifically therefore we do not agree with the haircut policy set out in sub-paragraph ii. of paragraph 94. The manager should be allowed to set an appropriate haircut based on the credit quality of the counterparty (which is dealt with in the draft advice) and of the collateral and crucially should retain the ability to adjust and react to market events. There is a substantial risk with a standardised haircut that the level of risk, as determined by the credit assessment of the counterparty and the collateral, may not be appropriately reflected.

A standardised haircut would also risk MMFs being at a competitive disadvantage to other buyers of reverse repo. Given the MMF Regulation requires reliance on reverse repo for daily liquidity requirements, it is critical that MMFs are not disadvantaged by having to apply prescribed haircuts at levels that may not be required for other market participants. Additionally this competitive disadvantage for sourcing repo would require funds to purchase more unsecured investments, prospectively increasing risk profiles.

The suggested haircut table (Article 4(2), page 98) has a number of flaws. It does not, for example, take into account that only high quality Government securities will be acceptable under Article 15(6), and that these must receive a favourable credit assessment. It includes asset classes that are not eligible for MMF reverse repo transactions (such as gold, equities and corporate debt that has a maturity longer than 397 days). There are in effect only two possible haircut outcomes on a prescriptive basis: the application of a 2% haircut for 1-5 year Government securities and of a 4% haircut for 5+ years Government securities (as shorter maturities would not be subject to article 15 (6)).

We refer ESMA to the ESRB opinion on securities financing transactions, Section 5, page 11, the table on page 12, footnote 15 and the embedded link to FSB work on numerical haircuts pages 6-8:
https://www.esrb.europa.eu/pub/pdf/other/20161004_esrbopinion.en.pdf?eb4c21d49897bfc6f7036b502eb631c2
The ERSB considered that the FSB approach to haircuts was reasonable, which meant that for these transactions no haircut would be required for Government collateral. Notwithstanding their opinion, we believe it is prudent to contemplate the application of a haircut to collateral received. However we are strongly of the view that this should primarily be based on assessing the evolving market environment. The best placed party to assess the required haircuts in this way are the risk managers themselves, i.e. the portfolio manager. Prescribed haircuts should only be applied in respect of specifically defined risks.

We therefore propose an alternative approach to prescribed haircuts that we believe better targets the risks identified by ESMA. This would see reverse repo contracts with unregulated counterparties made subject to a haircut based on liquidity considerations spelt out in quantitative terms in prudential regulation. The approach therefore takes account of the exposure limit established in the MMF Regulation for unsecured deposits/commercial paper, at 10% of assets. We provide suggested text for the Draft Advice below.

Reverse repo is a highly commoditised activity. As mentioned the best approach is one that can work successfully with the grain of established repo market operations. The best choice to respond to the highly commoditised nature of market operations is Option (a), with changes to the haircut provisions. It should also work for ensuring the quality of third country assets.

Draft advice
We recommend that ESMA re-word Article 4 of its draft advice covering Option (a) (page 98) both to reflect an appropriate haircut policy and to acknowledge a wider range of high

quality counterparties, as follows:

Article 3
If the counterparty to the reverse repurchase agreement is a credit institution, an institution for occupational retirement provision, an insurance undertaking or an investment firm under the applicable Union law….

Article 4
1 If the counterparty to the reverse repurchase agreement is not one of the entities referred to in Article 3, [] additional liquidity requirements shall apply depending on such factors as:

- time to maturity of the assets;
- volatility of the price of the assets;
- tenor of the reverse repo contract;
- appropriate policy on stress testing, as per Article 28 of the MMF regulation.

2 Depending on the abovementioned factors, a corresponding haircut shall apply to the assets referred to in Article 15(6) of the MMF Regulation in the event the reverse repo agreement exceeds 10% of the assets of the MMF. Such haircut shall be based, as a minimum, on the corresponding standards included in Article 224 of Regulation (EU) No 575/2013 for debt securities issued by entities described in Article 197(1)(b) of that Regulation, and shall reference the requirements of the 5 day liquidation period. []

3 Such haircut, if applicable, shall be revised on [] the revision of the abovementioned [] Regulation (EU) No 575/2013.

Q4 With respect to option b) on liquidity requirements, do you think that requiring assets convertible to cash in one business day or less is appropriate? Do you think this requirement should be more detailed and refer to trade date or settlement date, for example? With respect to that same option b), how do you think that the criteria mentioned in this option could be defined in more detail, and how could quantitative indicators be introduced? Do you think all the criteria mentioned in Article 2(3) of this option b) are relevant? Under this option, when the liquidity assessment of the manager is that the assets would no longer be liquid assets, the manager shall take immediately any appropriate action including the replacement of the collateral with another asset that would be qualified as liquid assets. Do you think that the replacement of the collateral could be carried out overnight?

We do not support Option (b). Although Option (b) would appear to aim to give the funds more flexibility in their collateral choice, it adds significant complexity and would be impractical and costly to apply. The requirement for assets to be convertible to cash in one business day goes beyond the requirements set out in the MMF Regulation and we are not convinced that it is needed here. We reject an intraday collateral conversion requirement as it would be difficult to apply under current market terms.

On the last question, collateral replacement takes place during working hours only in tri-party repos, although these are only reported overnight for the next working day. As Short Term MMFs for the most part use overnight reverse repo, it follows that by the time the collateral could be replaced it would anyway be irrelevant as the reverse repo contract would have settled.

The requirements set out in Option (b) of the draft advice (Article 2(3) and (5), page 99) would not be workable as drafted. The reverse repo market operates through application of market standard terms and the funds are able to specify their acceptable collateral sets in a schedule to the terms prior to trading taking place. It is not feasible to assess the liquidity of the assets in the way described, nor would it be necessary if the liquidity/quality requirements are established in advance through appropriate regulation and then applied via specification in the contractual collateral schedule.

Q5 What would be in your view the consequences in terms of costs of the chosen option, and of the other options mentioned above? Do you agree with reasoning mention in the CBA (annex III) in relation to the possible costs and benefits of the options as regards the abovementioned credit quality and liquidity requirements? Which other costs or benefits would you consider in this context?

We have mentioned that the market is highly commoditised. Options that work with the grain of the market, whilst preserving the necessary collateral quality requirements, will carry insignificant additional costs. Indeed, overnight repo with "traditional collateral" (government securities) already exists as a base to work from. Option (a) for credit quality, possibly with some limited application of the content of Option (b), and Option (a) for liquidity purposes, subject to a reworking of the haircut requirements, are all workable and could fit within the current market conventions.

By contrast the other options will carry high cost as they will require changes to existing systems and will not necessarily work seamlessly with market operations. Option (b) is considerably more complex than other options. It is difficult to quantify the exact level of the costs at this stage across the market.

ARTICLE 22 technical advice on the credit quality assessment procedure

Q6 Do you agree that the abovementioned references to EU and US standards are relevant in the context of the issuance by ESMA of technical advice on credit quality assessment under the requirements of the MMF Regulation? Do you identify other pieces of national/EU/International law that would be relevant in view of the work on ESMA technical advice on credit quality assessment under the requirements of the MMF Regulation?

We agree that it is helpful to assess standards that have already been set, as much may be learnt from them. A significant caveat is that just because a standard is about credit assessment, it does not mean it is suitable for a MMF. The ESMA 2014 Guidelines on MMF

are probably the most appropriate set of standards in this regard, as they do address MMF. We have not identified other relevant standards.

Q7 Do you agree with the proposed option on each of the requirements mentioned in Article 22 of the MMF Regulation? If not, could you specify which existing regulatory framework would you suggest as a basis for the work on the technical advice related to Article 22 of the MMF Regulation?

The proposed options are not entirely clear, although the draft Technical Advice provides some steer. An overarching comment is that the draft advice seems to seek to impose a very prescriptive approach. We do not think the level of prescription contemplated is the right approach for money market funds, in particular as it does not appear to take account of the very short term portfolio holdings in a MMF.

A concern for the industry is that the very different nature of money market funds, for example compared to bond funds, seems not to have been entirely understood. MMFs are liquidity funds and by their nature (and by regulation) must hold assets that are both very high quality in credit terms and very short term in duration. The limitations on WAM and WAL and asset maturity written into the MMF Regulation (and prior to that in the ESMA Guidelines on MMF, in the CRA rating requirements and the IMMFA Code of Practice) are the formal expression of this reality. It would be helpful if the guidance were to reflect the very short holding periods for assets within MMF and accept the consequent impact that this will have on a credit assessment.

We agree that the market based measures in paragraph 118 (page 34) would seem to incorporate suitable factors for inclusion in a credit assessment, as do those in paragraph 120. However the measures set out in Article 1 of the draft Technical Advice (page 102) appear more appropriate for a longer dated bond fund and we suggest these could be reworded (see below).

We therefore recommend a more principles based approach that leaves some discretion to the manager to determine which additional factors to use, over and above what is specified in the Level 1 Regulation, and when. An example of an additional factor is client-specific requirements that may impact the credit assessment, for example requiring the exclusion of certain types of asset. Unless this freedom is allowed, the credit assessments by managers are likely to converge and result in a herd mentality by portfolio managers, introducing market risk.

Credit rating scale

It is important that the fundamental differences between a credit analysis carried out by a fund manager and that carried out by a credit rating agency (CRA) should be acknowledged. While the CRAs look across the market and rate issuers/issuance on a comparative basis, managers will focus on a sub-set of instruments that are eligible from a regulatory and client/investment mandate perspective. This reflects the very different underlying economic dynamic of their types of business.

The managers will use the work produced by the CRAs as one piece of information only, in addition undertaking their own analysis as well as buying research from third parties and taking account of factors that are peculiar to their clients. The output of the CRAs is important to the managers because it covers the wider market, even though it provides only one, non-leading, factor in their overall credit assessment process. But it is why the credit process for the managers should not be modelled on that for the CRAs. Whilst CRAs use a scale system for credit rating, managers should be free to adopt their own system, based generally on instruments being classified approved/not-approved (i.e. pass and fail).

It would appear that the draft advice on Article 22(a) does at times expect the credit assessment to compare with a rating process carried out by a CRA – and this we believe is wrong. Article 3(3) is one example, Article 4(c) also steps close.

Material change

Much of the draft Technical Advice in Article 5 (pages 104-5) seems excessive and better suited to a long-duration bond fund. Sub-paragraphs 2 and 3 do not appear to us to advance the definition of a material change at all. We do, however, agree that a ratings downgrade of any instrument in the fund should potentially constitute a material change and be a flag for reassessment, as envisaged in sub-paragraph 4. This provides an objective measure external to the manager. There will be times when holding an asset to maturity will be the prudent approach despite changes to a credit assessment. We believe this independence of approach on the part of the manager supports the regulatory policy that there should be no mechanistic reliance on credit ratings.

Draft advice

We recommend that ESMA should re-word its draft advice on Article 22(a) as follows:

Article 1 (page 100)

Reword Article 1(1) as follows:

The credit quality assessment methodology shall be subject to validation by the manager of an MMF. []

Reword Article 1(2) as follows:

The criteria for [] validation [] shall be designed to:

(a)Examine the sensitivity of the [] methodology to changes in [] the underlying assumptions; []

(b) Perform [] regular reviews of the methodology applied;

(c) Ensure the use of reliable inputs, including appropriate size of the data samples.

(d) - delete

Article 1(3) - delete

Reword Article 1(4) as follows:

Article 1(4) (b) - delete

Article 1(4)(d) - delete

Article 3(3) (page 101) – delete.

Article 4(c) (page 102) - delete.

We recommend that ESMA should re-word its draft advice on Article 22(b), 22(c) and 22(d) as follows:

Article 1(a) (page 102) Quantitative criteria for assessing credit quality
Delete (a) and replace with:
Pricing information on money market instruments.

Article 3(a) (page 103) Aspects of an Issuer or Instrument to be assessed
Add wording:
(a) Financial condition of the issuer or guarantor of the instrument;
Article 4(2) (page 104) Overrides – delete

Article 5 (page 104-5) Material change
See comments above, to include deletion of sub-paragraphs (2) and (3).

Q8 In your view, what would be the consequences (including operational ones) of the level of detail and prescription suggested above in the proposed technical advice on credit quality assessment under the MMF Regulation (which would be broadly similar as in the delegated Regulation on the assessment of compliance of credit rating methodologies (447/2012), and in the technical advice on reducing sole and mechanistic reliance on external credit ratings (2015/1471))?

The main consequence would be to increase the running costs of the fund without improving the credit quality of its holdings. MMFs are not CRAs. Using a methodology designed for CRAs would be excessive and inappropriate when applied to MMFs. This is because the purpose for a MMF is to support a bespoke investment offering, whereas the CRAs have a different economic dynamic, which is to sell information to the wider market.

Additionally, we do not think that use of ratings should be ignored or the status of the information supplied underestimated, not least since this is now a regulated sector. Nor do we think that use of ratings as part of a wider credit process should be considered "sole and mechanistic" reliance on them: it is not, but rather part of the process of collecting relevant information.

Q9 What would be in your view the consequences in terms of costs of the chosen options described above in relation to the requirements included in the technical advice under Article 22 of the MMF Regulation? Do you agree with the assessment of costs and benefits mentioned in the CBA (annex III) on the technical advice under Article 22 of the MMF Regulation? If not, please explain why and provide any available quantitative data that the proposal would imply.

All of the options will give rise to set-up and running costs for firms. Whether these are substantial or less so will depend to an extent on how well established the firm's credit assessment process is at the moment.

Any provision that attempts to make the managers mimic the CRAs in terms of process and output will carry a high cost. This is because it would be trying to shoehorn what is part of a bespoke investment offering into a process that has a different economic dynamic, namely to sell information to the wider market.

REPORTING TEMPLATE implementing technical standards

Q10 Do you think other type of information should be considered as "characteristics" of the MMF?

As a general principal we think it is important that ESMA should only seek to collect information which is required to be submitted by law, or from which it can learn something identifiably useful.

The proposal put forward suggests that the same information should not be "requested and expressed" in two different ways for the AIFMD and MMF databases, but concludes that reporting will have to be carried out separately, meaning that AIF MMFs report to both. However the detail of the proposal leans heavily towards using much of the AIFMD specification. We do not, therefore support all aspects of the proposed approach. We summarise our reasons below.

We believe that the database should be bespoke to MMFs submitting reports under the MMF Regulation and be tightly defined against those requirements. It should be specified to allow data submission from multiple sources. This would not prevent ESMA from re-using some aspects of the design of its AIFM database, and security features, but would require more fundamental work to design the database to meet the MMF Regulation requirements explicitly from the outset. We suggest more consideration could be given to using relevant data collected by the European Central Bank. This may allow firms to use duplicate submission. For the reasons stated, we agree that it would be preferable to design the database by reference to the same ISO standard as that used for MiFIR and EMIR reporting.

ESMA should take account of the following:

a. The relatively narrow overlap between the required AIFMD data and the required MMFR data (as ESMA acknowledges in paragraph 176 of the CP).

b. The asset value and number of UCITS MMF (which are not subject to AIFMD reporting) heavily outweighs the value in AIF MMF

[Note: EFAMA Fact Book 2016 reports (end 2015 net assets, Table 5 p.350 and Table 8 p.353) UCITS €1,109,836 million and AIF €88,607 million].

c. The AIFM "one-size-fits-all" approach does not take account of the different types and sources of the data, nor the variation in timing for data submissions. These factors should be considered before concluding on the best approach for collection.

d. The European Central Bank already collects an enormous amount of data on UCITS MMF. We appreciate that each authority will wish (and is required) to hold its own MMF data. However where ECB required data also meets ESMA data requirements, consideration should be given to accepting a duplicate download, therefore taking account of the reporting design already in place for the ECB. This also militates against designing the MMF database alongside the AIFMD database.

e. We agree that a database will be necessary for data specified under Article 37 (2) (a), (b), (d) and (e), although as mentioned we believe the database should be bespoke to MMF Regulation reporting. In terms of data sourcing, most if not all of this data is expected to come from fund administrators.

f. In relation to reporting under Article 34 (2) (c), the mechanism for collecting information should respect the fact that the style and presentation of the report will vary from fund to fund. It should not attempt to force specific types of stress testing on MMF, beyond what the MMF Regulation requires, since this would defeat the object of the stress test. The proposed template as presented is over-complicated and appears to pre-judge much of the content of MMF stress testing.

g. Stress test reports are expected to come mostly from the manager of the MMF. Since the other Article 34 reporting requirements will likely be met by fund administrators, both parties must be able to report directly.

h. Reporting on liquidity breaches and follow-up actions will also require the submission of written reports, prospectively from more than one source.

We agree that the information set out in paragraph 185 describes the "characteristics" of the MMF. We do not see what other information could usefully be added in this area.

In response to paragraph 186, we do not believe that collecting information on liquidity indicators would serve any useful purpose. The MMF are not like other investment funds, in that they are liquidity funds holding very short term assets. Equity and fixed income investment funds will operate to entirely different maturity profiles – years rather than days. By contrast 99% of the assets in IMMFA MMF are held to maturity, with the majority of a MMFs assets turning over in 30-60 days. A snapshot liquidity report once a quarter is unlikely to deliver useful information for the future, reflecting as it does a portfolio that has already moved on. We believe that sufficient reporting on liquidity occurs through

collecting the WAM, the WAL and through the application of the weekly and daily liquidity thresholds and any breach thereof.

We were surprised to see, in paragraph 186, a potential policy statement on share cancellation effectively buried within requirements on reporting. We have commented on this in our introductory points.

Q11 Do you agree with the proposed way of reporting the yield of the MMF? If not, could you indicate what would be the more appropriate way to report yield in your views? Do you think the 7-days gross yield should be reported for each week of the reporting period? If not, what should be the appropriate frequency of reporting on this item?59 Do you think that the calendar year performance and yield could be calculated at (sub)fund level and at share class level? Which difficulties do you identify while doing so? At which frequency should it be reported?

In relation to paragraph 187, we agree that requiring reporting of the 7 day gross yield figure, in line with SEC requirements for MMF, would be the most appropriate data. We do not see that there would be value in reporting cumulative returns months after the event, given that the asset turnover in liquidity portfolios is so rapid.

In relation to paragraph 189, the information is available but we are not sure how useful it will be to collect. By the time it is received by regulators, the portfolio holdings will already have changed and the snapshot become wholly historic.

As share classes are not managed to different strategies, there is little point in collecting information other than at portfolio level.

Q12 Which type of measure would you suggest using to report the quantified outcome of the credit assessment procedure?

We do not believe that the results merit quantification, merely reporting at a higher level (i.e. pass and fail). This would allow regulators to compare fund manager output as opposed to interpreting data.

The Level 1 text in Article 37(2)(d)(i) is not precise about what information should be collected in relation to the credit quality assessment procedure. The other information collected in relation to portfolio assets in this sub-clause would seem to provide inherently the outcome of the credit quality assessment procedure. Collecting a snapshot of the outcome of the credit process would provide statistics on which assets, consequent on the credit assessment, were retained ("passed" or "approved") or rejected or removed ("failed" or "not approved").

Q13 With respect to reverse repurchase agreement, do you agree that the information requested is appropriate? With respect to repurchase agreements, do you think the value of cash received should be reported as a breakdown per investment purposes, i.e. liquidity management or investment in assets referred to in Article 15(6)? (given the

information on the amount of cash received as part of repurchase agreements that is also requested). What should be the appropriate frequency of reporting on this information? Do you think the value of unencumbered cash should be reported as a breakdown per country where the bank account is located and currency? (given the information on deposits that is also requested)

It would seem appropriate to collect the name and LEI of the counterparty. We do not believe that there is any intrinsic worth in ESMA receiving a breakdown of cash received in a repurchase agreement as this snapshot would be for one day in each time period. Similarly totals for the reporting period would be meaningless. The % of a portfolio that comprises of repo is already reported, as is the maturity. This is meaningful data that could be utilised by regulators to examine manager portfolios.

Q14 Do you think the information on the investor 'lock-up' period in days (report asset weighted notice period if multiple classes or shares or units) is relevant in the case of MMFs (this information is included in the AIFMD reporting template)?)? Do you agree with the proposed way to report stress tests?

The investor 'lock-up' period is irrelevant to MMFs, because they are liquidity funds offering same day or next day access to cash.

Q15 Do you identify other type of information that should be included in the requested information in the reported template? What would be in your view the consequences in terms of costs of the proposed options for the reporting template? Do you agree with the assessment of costs and benefits above for the proposal mentioned in the CBA (Annex III) on the reporting template? If not, please explain why and provide any available quantitative data on the one-off and ongoing costs (if any) that the proposal would imply. Do you have specific views on the potential use of the ISO 20022 standard?

We have not identified other information.

It would be beneficial to future data development to have established the database in line with the relevant ISO standard.

STRESS TESTING guidelines on scenarios

Q16 Do you agree that the abovementioned references to EU/international standards are relevant in the context of the issuance by ESMA of guidelines on stress testing of MMFs? Do you identify other pieces of EU/International law that would be relevant in view of the work on ESMA guidelines on stress testing of MMFs?

We agree that it is sensible to consider other EU and US regulatory standards on stress testing requirements. We believe ESMA have identified the most relevant standards for its analysis.

IMMFA member firms are experienced in conducting stress testing because they have been subject to the additional requirements in this regard of the IMMFA Code of Practice and of the rating agencies. The results of this stress testing are reported to Competent Authorities and the rating agencies now and provide a valuable historic record for ESMA to reference further in the development of guidelines.

In particular we believe the calibration of the stress factors by the rating agencies to be at the correct levels.

Q17 Do you have specific views on the interpretation of the requirements of Article 25(1) of the MMF Regulation on the meaning of the abovementioned "effects on the MMF"?

The objective of the stress testing is to identify extreme events that may lead to catastrophic losses in MMFs that are by their nature liquidity funds holding assets that are both very high quality in credit terms and very short term in duration.

The experience of our members in conducting stress testing for their money market funds over many years has led them to focus on the key risks of interest rate movements, credit spread movements and investor redemptions. This approach has been further supported by the requirements of the rating agencies, as these apply to the funds. The rating agencies have been able to use their extensive data, and long-standing experience, to design and optimise appropriate stress testing requirements for the funds.

The managers of IMMFA member funds are therefore experienced in using stress testing as a dynamic portfolio management tool, assisting them with daily risk management of the funds. The models used are not overly complex and work on the basis of sensitivity analysis based on the key risks identified, in many ways similar to what ESMA is proposing in the guidelines. The value in this approach is that it generates specific and timely information to be acted upon by a portfolio manager.

We advocate that this focused practical approach should be maintained with the output generated using the intermediate approach c) being reported to ESMA.

We have concerns over the breadth of some aspects of the proposed draft advice published by ESMA. Some of the suggested macro-economic testing requirements, for example, would seem to be hypothetical to a (non-useful) extreme. The extensive literature on default risk supports the premise that default probability creeps into the market over a period of time, which the daily stress testing picks up but the historical and hypothetical stress testing is highly unlikely to. The advice runs the risk that, when applied, it will result in resource being diverted from the real and present stresses to no benefit. For these reasons we suggest deleting or amending some of the guidelines. We urge ESMA not to lose the benefit of the simpler form of stress testing for a chimaera.

We attach several notes and papers by way of further information on these issues. ANNEX 2 provides a summary of risk issues encountered within Short Term MMFs that have relevance for stress testing purposes. A complementary summary is provided in ANNEX 3 on

default rates, drawing upon the wealth of quantitative data available. ANNEX 4, in 3 papers, provides details of the rating criteria for MMFs, including reference to stress testing.

The unfavourable effect of consequence is the inability of a money market fund to repay investors. This is related to the level of liquid assets within the portfolio, the ability to create liquidity through the redemption of assets at par at maturity, or the ability to sell assets to create liquidity at prices close to par in a requisite timescale.

Factors a, b & e relating to the NAV and the difference between constant NAV and the NAV per unit share only become relevant where assets are not held to maturity (normally more than 99% are for the Short Term MMFs of IMMFA member firms) and may not have unfavourable effects then. The volatility of NAV is a significant issue for Standard MMFs because of their lower regulatory liquidity requirements and the consequent reliance on the ability to be able to sell to the market to generate liquidity.

Comments on ESMA Draft Guidelines on stress test scenarios under Article 28

Section 5.1

Historical scenarios and hypothetical scenarios
Paragraph 13, amend as follows:
With respect to both stress test scenarios on i) the portfolio or net asset value of the MMF and ii) the liquidity bucket(s) of the MMF and/or the ability of the manager of the MMF to meet investors' redemption requests, managers could [delete] <u>develop historical and hypothetical scenarios.</u>

Paragraph 14
Replace the word “reproduce” with the word “reference”.

Paragraph 15
Delete last two sentences, beginning “By way of example….”

Aggregation of stress tests
Paragraph 18 – delete.

Reverse stress testing
Paragraph 19 – delete.

Section 5.5

Guidelines on the establishment of common reference parameters of the stress test scenarios in relation to hypothetical levels of redemption
Delete the section coming under the heading “Example”.

Section 5.7

Guidelines on the establishment of common reference parameters of the stress test scenarios in relation to hypothetical macro systemic shocks affecting the economy as a whole
Paragraphs 47 and 48 – delete.

Q18 Do you have views on the specifications of the following criteria:

level of changes of liquidity of the assets with respect to Article 28(1)(a),

- We believe that this criterion is much more relevant to Standard than to Short Term MMFs given the difference in the operating models between liquidity through marketability and hold to maturity
- 99% of the assets owned by Short-Term MMFs are held to maturity. In addition the MMF Regulation has formalised the requirement for these funds to hold 10% overnight maturing assets and 30% weekly maturing assets as immediate liquidity.
- Standard MMFs are required to carry much less immediate liquidity and are allowed three times longer Weighted Average Maturity and four times longer Weighted Average Life which increase the risk sensitivity commensurately. Taken together these factors limit the opportunities for portfolio management through reinvestment at maturity (see Credit Risk immediately following) and make the management of asset liquidity risk absolutely critically important. The criticality of this point to Standard MMFs should be reflected in the guidelines.

levels of changes of credit risk of the asset with respect to Article 28(1)(b),

- The portfolios of the MMFs operated by IMMFA member firms hold diverse portfolios of debt instruments the majority of which are issued by ECB, or equivalent, regulated entities. In the earlier section on Reverse Repo Collateral ESMA notes that the likelihood of downgrade or default of such entities within the investment horizon of, in particular, a Short Term MMF is extremely remote. This is consistent with the analyses of ratings performance produced by the credit rating agencies.
- The short dated portfolios of IMMFA MMFs are actively managed through reinvestment on a daily basis. This continuous activity constitutes dynamic credit management and presents regular opportunities to steer away from deteriorating credits. In practice it would be reasonable to expect that MMF portfolios would outperform the average experience for downgrade and default because of the active portfolio management employed.
- Credit spread risk is one of the key risks analysed by IMMFA MMF managers in the stress testing that they undertake. Conducting sensitivity analysis on this factor allows them to understand the impact of a downgrade or default on the NAV of the portfolio and its components.

- Such hypothetical NAV movements only become of practical significance to the extent the shadow NAV breaches a regulatory limit and/or if the security is not held to maturity.

levels of change of the interest rates and exchange rates with respect to Article 28(1)(c),

- Long term interest rates appear to have little relevance in consideration of the short dated actively managed portfolios of IMMFA members.

levels of redemption with respect to Article 28(1)(d),

- We advocate an approach based on investor concentrations and prescribed levels of aggregate redemption.
- The investor bases of IMMFA member funds vary widely and the drivers of subscription and redemption behaviour are not very well understood. As a result the approach of attributing a propensity to redeem based on the characteristics of individual investors is highly speculative and inappropriate.

levels of widening or narrowing of spreads among indexes to which interest rates of portfolio securities are tied with respect to Article 28(1)(e),

- Please see the introductory comment to this section.

identification of macro-systemic shocks affecting the economy as a whole with respect to Article 28(1)(f))? (how would set the calibration of the relevant factors in the case of the Lehman Brothers' event, and the two proposed scenarios A and B? With respect to scenario B mentioned above, do you think the duration of 12 months is appropriate?)

- We appreciate that this is a specific requirement of the regulation but believe that the requirement is sufficiently covered by the approach outlined above.

Q19 Are you of the view that ESMA should specify other criteria that should be taken into account? If yes, which ones?

ESMA should specify only the criteria that will provide information that is useful and timely. To this end the criteria should have the objective of highlighting information that would tend to prompt immediate remedial action. The creation of a historical data archive is not the purpose of stress testing.

Q20 Are you of the view that other topic should be covered in the ESMA guidelines under the requirements of Article 28 of the MMF Regulation?

No.

Q21 Do you agree with the assessment of costs and benefits mentioned in the CBA (Annex III) on the different options on the Guidelines on stress tests? If not, please explain why and provide any available quantitative data on costs (if any) that the proposal would imply.

We believe there has been a significant under-estimate of the costs and a considerable over-statement of the benefits in relation to the proposed options, for the reasons already given. The most important stress tests are those focusing, typically daily, on credit, interest rates and redemptions. These tests also work seamlessly with the very short term portfolios under management. Some of the other proposed stress tests simply do not present realistic scenarios of the risks faced by the funds. As mentioned already, the extensive literature on default risk supports the premise that default probability creeps into the market over a period of time, which the daily stress testing picks up but the historical and hypothetical stress testing is highly unlikely to.

Should the final advice focus on the significant factors that are directly relevant to money funds and that should therefore be the focus of the stress testing, the benefits will be significant. The options as presented do not yet place the advice in this space.