Consultation Report

EU Money Market Fund Regulation – legislative review

26 March 2021 | ESMA34-49-309

Responding to this paper

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

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

ESMA will consider all comments received by 30 June**.**

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

Publication of responses

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

Data protection

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

Who should read this paper?

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

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1 Executive Summary

Reasons for publication

This consultation document is developed in the context of Article 46 of the MMF Regulation, which provides that "[b]*y 21 July 2022, the Commission shall review the adequacy of this Regulation from a prudential and economic point of view, following consultations with ESMA"*.

The COVID-19 crisis has been challenging for MMFs. A number of EU MMFs faced significant liquidity issues during the period of acute stress in March 2020 with large redemptions from investors on the liability side, and a severe deterioration of liquidity of money market instruments on the asset side.

In this context, this consultation document discusses the potential reforms of the EU MMF regulatory framework that could be envisaged, in light of the lessons learnt from the difficulties faced by MMFs during the COVID-19 crisis in March 2020.

At international level, several workstreams have started to assess the situation faced by MMFs during this crisis, and which policy options should be considered in order to address the issues which have been observed, and potentially enhance further the reforms on MMFs adopted following the 2008 financial crisis.

In the EU context, the ESMA work takes the form of an assessment of the functioning and potential need for amendment of the regulatory framework applicable to MMFs in the EU, which is the Money Market Fund Regulation (MMF Regulation) and its implementing measures.

The input received through this consultation will therefore be of relevance in the context of the review of the MMF Regulation.

This consultation document represents the first step in the development of an ESMA opinion under Article 16a of the ESMA Regulation[1] on the issues described above and sets out proposals on which ESMA is seeking the views of external stakeholders.

Contents

Section 2.1 presents an overview of the EU MMF market.

Section 2.2 describe certain key features of the issues faced by MMFs during the COVID-19 crisis in March.

Sections 2.3 presents areas of reform of the MMF policy identified at international level.

Section 2.4 focuses on the potential areas of reform of the MMF Regulation and seeks stakeholders' input through specific questions.

The Annex sets out the list of questions contained in this paper.

Next Steps

ESMA will consider the feedback it received to this consultation in Q2 2021 and expects to publish its opinion on the review of the MMF Regulation in the second half of 2021.

[1] Article 16a(1) of the ESMA Regulation provides that "The Authority may, upon a request from the European Parliament, from the Council or from the Commission, or on its own initiative, provide opinions to the European Parliament, the Council and the Commission on all issues related to its area of competence".

2 Review of the MMF Regulation

1. This consultation document is developed in the context of Article 46 of the MMF Regulation, which provides that *“[b]y 21 July 2022, the Commission shall review the adequacy of this Regulation from a prudential and economic point of view, following consultations with ESMA”.* it discusses the potential reforms of the EU MMF regulatory framework that could be envisaged, in particular in light of the lessons learnt from the difficulties faced by MMFs during the COVID-19 crisis in March 2020.

2. The COVID-19 crisis has been challenging for MMFs. A number of EU MMFs faced significant liquidity issues during the period of acute stress in March 2020 with large redemptions from investors on the liability side, and a severe deterioration of liquidity of money market instruments on the asset side.

3. This was particularly the case for some of the Low Volatility Net Asset Value (LVNAV) MMFs in USD and some Variable Net Asset Value (VNAV) MMFs in EUR, which are both mainly exposed to money market instruments issued by financial institutions (Commercial Paper and Certificate of Deposits). Although no EU MMFs suspended redemptions or used liquidity fees on redemptions and redemption gates, the crisis calls for further work on the resilience of the EU MMF industry as well as money markets, following previous regulatory reforms.

4. In that context, at international level, several workstreams have started to assess the situation faced by MMFs during the crisis, and which policy options should be considered in order to address the issues which have been observed and potentially enhance further the reforms adopted following the 2008 financial crisis, which have focused, regarding MMF, on credit risks and risks of runs. This is the case in particular at FSB and IOSCO level.

5. At ESMA, the work focuses on the identification of the specific issues faced by MMFs in the EU, and the way to address them, in particular in the context of the abovementioned review of the MMF Regulation.

6. This consultation document is a key step in the process of developing the ESMA recommendations to the Commission on the upcoming review of the MMF Regulation.

7. Section 2.1 of the consultation document presents an overview of the EU MMF sector.

8. Section 2.2 of the consultation document describes certain key features of MMFs along with the issues faced by MMFs during the COVID-19 crisis in March 2020.

9. Section 2.3 of the consultation document relates to the potential areas of reform of the MMF regulatory framework which have been identified at this stage at international level.

10. Section 2.4 of the consultation document focuses on the potential areas of reform of the MMF Regulation, in view of its upcoming review.

2.1 Overview of the EU MMF sector

Economic functions of MMFs

11. Money market funds (MMFs) are key intermediaries in the financial system. They provide two economic functions to the financial system and real economy: (i) short-term funding to issuers, mainly banks; and (ii) are primarily used as cash management vehicles by investors.

Asset side: MMFs mainly exposed to banks

12. MMFs invest in a range of short-term instruments such as Commercial Paper (CP), Certificate of Deposits (CDs), short-term government debt, bank deposits or repurchase agreements (repo). MMFs are mainly exposed to financial institutions and in particular banks.

13. At the end of 2020, according to ECB data total assets of EA MMFs amounted to EUR 1,445bn. EA MMFs were mainly exposed to non-EA banks (33% of assets), EA banks (31%), other non-EA issuers (18%), EA sovereigns (18%) and EA non-financial corporates (4%). Overall, MMFs are equally exposed to EA issuers (EUR 711bn, 49% of total assets) and non-EA issuers (EUR 734bn, 51%).

14. The market footprint of MMFs is very high globally: US and EU USD MMFs are estimated to hold more than half of the USD CP market, and EU MMFs are estimated to hold around half or EUR and GBP financial CP markets. It is however not possible to provide more statistics and analysis on the size of global money markets and the role MMFs are playing there, because of the significant data gap.

Liability side: MMFs used as cash-management vehicles

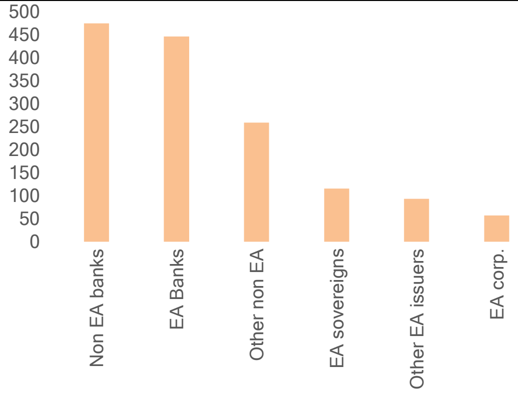
15. MMFs are primarily used as short-term cash management vehicles by investors. MMFs provide liquidity (daily redemption), diversification and relative stability of value (low fluctuation of MMFs shares); they remunerate investors with market yields. Compared to other assets, MMFs generally offer higher yields than bank deposits and higher liquidity than short-term bond funds. Investors might use MMFs for managing cash needs arising e.g. from redemptions or margin calls. Certain investors tend to consider MMFs as cash-like products, even though MMFs are required by regulation to clearly state to investors that they are different from deposits and not a guaranteed product[2]. In addition, under certain conditions, MMFs can be considered cash-equivalent from an accounting perspective.

16. EU MMFs are mainly held by institutional investors as there is a negligible share of retail investors in EU MMFs. Around 53% of MMF shares are held by foreign investors, while EA residents hold around 47% of the Net Asset Value (NAV). Within the EU, insurers, pension funds and investment funds are the main investors among financial institutions, while corporate treasurers also account for a significant share of the market.

[2] Article 36(3)(d): Any document of an MMF used for marketing purposes shall clearly include all of the following statements:[…] (d) : that the risk of loss of the principal is to be borne by the investor.

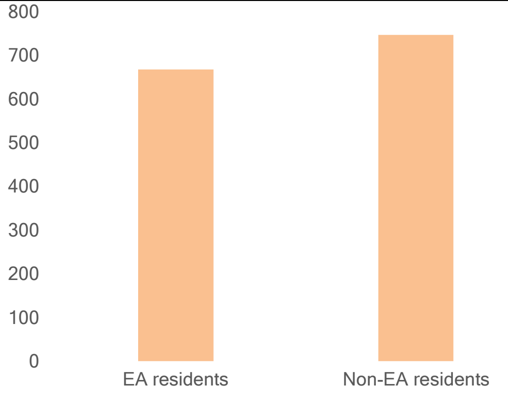
Chart 1:

Exposures of EA MMFs by issuer and domicile



Note: Assets of EA MMFs by issuer type, in EUR bn as of 2020Q4.
Sources: ECB, ESMA.

Holdings of EA MMF shares by domicile of the investor



Note: Holdings of MMF shares, in EUR bn, as of 2020Q4.
Sources: ECB, ESMA.

<u>Overview of the EU market</u>

17. Euro area MMFs hold about EUR 1.44 trillion in total assets (as of Q4 2020 according to ECB statistics). The funds are mainly denominated in euro (45%), US dollars (32%) and British pounds (23%) and are concentrated in a few countries, notably Ireland, Luxembourg and France.

18. The MMF Regulation provides for three main types of MMFs: Public debt constant net asset value (CNAV), which represent 7% of EU MMFs; low volatility NAV (LVNAV) which represent 48% of EU MMFs; and variable NAV (VNAV) which represent 45% of EU MMFs. Ireland and Luxembourg are the main domiciles of LVNAV and CNAV funds, whereas in France, only VNAV funds are present.

2.2 Key issues faced by MMFs during the COVID-19 crisis in March 2020

19. In March 2020, some segments of the US and EU MMF industry experienced a very high level of stress. MMFs exposed to private markets (LVNAVs and VNAVs in the EU, prime MMFs in the US) recorded very high outflows, while facing challenges to dispose of their assets due to the lack of liquidity in CP and CD markets. For USD-denominated MMFs, LVNAVs recorded high outflows, while CNAVs saw inflows of similar magnitude, reflecting a potential substitution effect (or flight-to-quality).

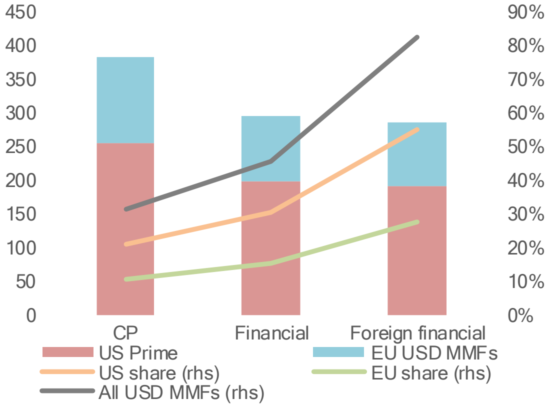
20. Following actions by central banks to support money markets through outright purchases of CP (ECB, BoE, FED) on the primary market or on the secondary market, lending facilities for banks to buy assets from MMFs (FED) and extending the eligible collateral to unsecured banks bonds (ECB), redemptions slowed while liquidity improved in money markets. No EU or US MMFs had to implement liquidity fees on redemptions or redemption gates or suspend redemptions. However, this episode shows that MMFs and more broadly money markets remain subject to a range of vulnerabilities.

21. Those vulnerabilities can be split across a few dimensions: (i) liquidity of underlying markets, (ii) regulatory requirements, and (iii) role of CRAs.

Chart 2

Market footprint

MMFs own the majority of the USD financial CP market



Note: US Prime and EU USD LVNAV and VNAVs exposures to US Commercial Paper market, in USD bn and % of oustanding, as of end-February 2020.
Sources: Federal Reserve, Banuque de France, ECB, Crane, ESMA.

22. Non-public debt MMFs are exposed to three intertwined challenges regarding liquidity on their asset side: MMFs have a large market footprint in the asset classes they invest in, those markets are not very liquid even in normal times, and MMFs – depending on their types and currencies – have a high degree of portfolio overlap.

23. MMFs have a very large market footprint in private money markets. As of February 2020, US prime MMF and EU USD LVNAVs and USD VNAVs exposures were estimated to account for around 1/3rd of the US commercial paper market. More importantly, those MMFs held more than half of CP issued by financial institutions, including 80% of all CP issued by foreign financial institutions (ESMA, 2021[3]). The footprint is lower in other currencies but still substantial: MMFs are estimated to hold more than 50% of the EUR and GBP financial CP market, although precise estimates are challenging due to limited transparency in some segments of the European CP market. MMF footprint on the underlying markets outlines the dependency of financial and non-financial issuers on MMFs as regards to the their short-term funding needs. MMFs play accordingly a key role in financing the EU economy (ECB, 2020[4]), especially in USD (BIS, 2021).

24. The activity of the CP secondary market is low, even in normal times for a range of reasons. First, investors tend to buy and hold the instruments until maturity, due to the short maturity of CP, implying low trading volumes on secondary markets and low liquidity[5].

25. The distribution of CP at issuance also plays a role. Most CP is sold through a group of dealers or banks that agree to sponsor and make markets in the CP issuer's program in exchange for a fee. Program members might provide liquidity in the secondary market, but they have no obligation to do so. Non-program institutions would generally not buy CP they did not help issue, due to reduced information on the issuer, or commercial reasons.

26. Finally, banks need balance sheet capacity to be able to intermediate large amounts of CP. In the US for example, dealer inventories of CP amounted to around USD 10bn end-February, less than 1% of the market, implying limited capacity to intermediate CP trading (Chart 2 above). Only after the launch of the FED Money Market Mutual Fund Liquidity Facility (MMLF), did dealers increase their inventories of CP.[6] The same applies to EU banks. Limited capacity (or willingness) of banks to buy back their own CPs and CDs (IOSCO, 2020[7]) as well as limited intermediation capacity by banks resulted in sharp increase in funding costs in March 2020 (FSB, 2020[8]).

[3] Report on Trends Risks and Vulnerabilities, No. 1 2021
[4] ECB Financial Stability Review, May 2020.
[5] We also note in the EU a limited depth and concentrated market, where CP and CD issuance of a quality sufficient to satisfy the eligibility requirements of the MMF Regulation are structurally insufficient to match the investment capacity of MMFs.
[6] The MMLF consists in loans made by the Federal Reserve to banks to fund the purchase of assets from MMFs. Such loans are collateralised by the assets purchased from MMFs.
[7] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD666.pdf International Organization of Securities Commissions (2020), 'Money market funds during the March–April episode', November
[8] Financial Stability Board (2020), 'Holistic review of the March market turmoil', 17 November.

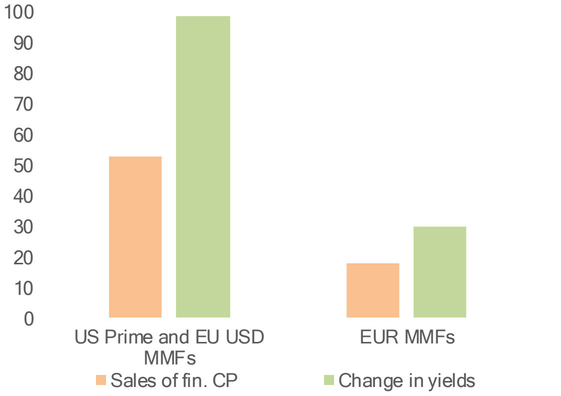
27. The limited absorption capacity of CP market was tested in March, as MMFs sold instruments to meet investors' redemptions. It is estimated that USD MMFs (US Prime and EU USD MMFs), sold more than USD 50bn of financial CP, more than five times average dealer inventories (ESMA, 2021, PWG, 2020[9]). Over the same period the yield on CP surged by almost 100bps. Similar patterns were also observed in EUR CP markets, with MMFs selling estimated at around EUR 18bn of CP, while yields rose by 30bps (Chart 3).[10]

28. Finally, MMFs tend to be exposed to the same type of assets and issuers depending on their types and currencies. ESMA (2021) shows a high degree of overlap between US Prime and EU USD MMFs in the financial CP market. Both types of MMFs tend to be exposed to a few banks, reflecting the concentration of the market on the issuance side. Such overlap implies that if one type of fund sells CP, other types of funds would face challenges selling the same instrument due to low level of liquidity.

Chart 3

Volume of sales and yields

Yields rose as MMFs sold CP



Note: Estimated sales of financial CP by US Prime and EU USD LVNAVs and VNAVs, (in USD bn), and by EUR MMFs (in EUR bn). CHange in 3M financial CP yield in basis points. All changes are between end-February and end-March.
Sources: ECB, Federal Reserve, Crane, ESMA.

[9] President Working Group (2020), "Report of the President's Working Group on Financial Markets. Overview of Recent Events and Potential Reform Options for Money Market Funds", December

[10] The volumes of sales of CP is proxied by the change in holdings of CP by MMFs between end-February and end-March for a sample of MMFs accounting for around 70% of the EU MMF sector. If CPs held end-February which matured in March are excluded, the volume of sales is around EUR 11bn.

29. The combination of those three characteristics (large market footprint, high degree of overlap and low liquidity in underlying markets) may make MMFs particularly vulnerable to symmetric shocks.

30. If several MMFs face large redemptions at the same time, they may all try to sell the same type of assets simultaneously. Given the limited market absorption capacity of the market, such sales could be challenging to execute, thereby creating liquidity issues for MMFs.

31. In cases of asymmetric shocks (affecting one or a few MMFs), these vulnerabilities might also play a role, as one MMF facing large redemptions could face some challenges selling assets.

32. The liquidity of a MMF depends on the liquidity of its assets, which is mainly composed of cash and negotiable money market instruments. Money markets have shown some vulnerabilities during the crisis as outlined above.

33. The secondary market of most money market instruments (e.g. CDs and CPs) is generally not very active. This is not an issue under normal or limited market stress conditions as MMFs usually holding these assets to maturity is compatible with the envisaged outflows. It becomes challenging under stressed conditions.

34. The COVID-19 crisis has also revealed reluctance or inability by certain banks to act as dealer in such circumstances, which may have, in turn, amplified the stress on the market.

35. Vulnerabilities of the underlying short-term funding markets are therefore a key issue that should be further taken into consideration.

36. For instance, the crisis has brought to light the need to remediate the lack of transparency of the primary and secondary markets.

37. Finally, the limited capacity of banks to act as dealers is also a key element. In that regards, it would be worth exploring options to improve the functioning of the secondary market and increase the attractiveness of money market instruments in order to incentivize dealers to provide liquidity, functioning of the short-term funding market (e.g. trading platforms might prove useful).

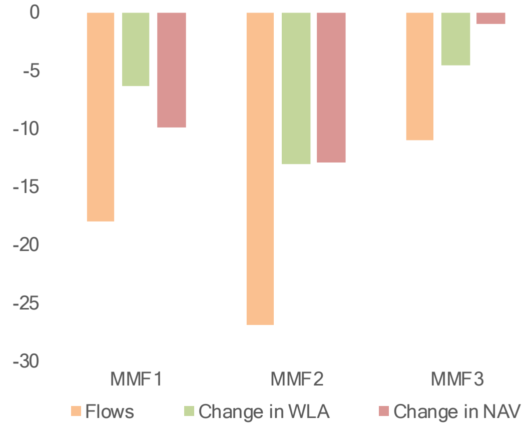
Role of regulatory constraints for LVNAVs

38. For MMFs providing redeemability at par, the EU regulatory framework provides tighter liquidity requirements. For CNAVs, which are currently mainly USD-denominated in Europe, these constraints might be less binding since these MMFs invest almost exclusively in government debt securities, which are generally more liquid than private debt and given that according to the MMF Regulation, "*The constant NAV per unit or share of a public debt CNAV MMF shall be rounded to the nearest percentage point or its equivalent when the constant NAV is published in a currency unit*".

39. However, for LVNAVs, the largest MMF type in the EU, regulatory constraints can be binding, especially since some of them might be conflicting. To meet daily redemptions, LVNAVs may have to sell instruments. At the same time, LVNAVs have to keep their Weekly Liquid Assets above 30% of NAV, and their NAV deviation below 20 basis points.

40. During periods of stress, LVNAVs could face challenges to meet all those constraints at the same time. Chart 4 shows three MMFs which faced very high outflows in March (more than 10% in two weeks as indicated by the orange bar). To meet those redemptions, funds can sell their most liquid assets, but that would result in a decline in WLA (green bar), and a risk of breaching the 30% WLA requirement. Funds can also choose to dispose of less liquid assets, but in that case the sales could result in mark-to-market losses due to liquidity strains of the underlying market under intense stress of the market. Such losses would result in a deviation between the mark-to-market NAV and the constant NAV. While some LVNAVs experienced NAV deviation close to the 20bps collar no funds breached the threshold during the acute period of stress in March.

Chart 4
MMF liquidation strategy
Trade-off between WLA and NAV deviation



Note: 7D net flows in % of assets and weekly change in WLA (in pp) and NAV deviation (in bps) as of 25 March 2020 for three USD LVNAVs.
Sources: Crane, ESMA.

41. In a stylized model, Baes et al. (2021)[11] shows how the interaction of regulatory constraints and limited liquidity in underlying markets could result in LVNAVs being unable to maintain a stable NAV and have WLA above the regulatory limit at the same time. When MMFs face large redemptions the manager may need to sell assets to raise cash. During stress periods the liquidity of the asset tends to deteriorate, implying that the manager might have to sell those assets at a discount, resulting in mark-to-market losses. These losses would fix a deviation between the mark-to-market NAV and the constant NAV, with a risk of breaching the 20bps collar. If the manager sells liquid assets (to reduce the impact on NAV), there is a risk that the WLA threshold will be breached.

42. In the same framework, ESMA (2021) shows how changes in regulatory requirements (WLA or NAV deviation) or improvement in underlying market liquidity can strengthen the resilience of LVNAVs.[12] Overall, according to the study, changing the level of WLA has limited effects: if WLA would decline to 10%, the amount of redemptions a fund could face without breaching regulatory thresholds would only increase by 6pp to 48%. On the other hand, increasing the NAV deviation has a large effect. Increasing the deviation from 20 to 50bps results in a rise in maximum redemptions of more than 20pp to 63% of NAV[13]. However, risks related to the use of constant NAV, including first-mover advantage and cliff effects related to the NAV collar, would remain. In the extreme case where LVNAV switch to a floating NAV, the constraint vanishes.

43. Finally, the analysis indicates that increasing the liquidity of the underlying markets has a very large effect on the resilience of MMFs. By reducing the price impact of trades, such reforms would allow MMFs to sell more assets at a lower cost, keeping NAV deviations limited.

44. Overall, the analysis indicates that to improve the resilience of LVNAVs (measured by the level of redemption a fund can face), increasing the NAV deviation is more effective than changing WLA requirements.

45. Changes to the structure of money markets resulting in higher liquidity of money market instruments would be largely effective in improving MMF resilience as well, although such changes are more of a long-term nature and partly outside of the regulatory perimeter.

The role of redemption fees and gates

46. Some market participants have argued that MMF regulatory reforms might have created a first-mover advantage by tying breaches of WLA to the use of redemptions fees and gates.

47. As the level WLAs decline towards the regulatory threshold of 30%, investors might have an incentive to pre-emptively run to avoid being subject to redemption fees and gates. In the US, Li et al. (2020)[14] provide evidence that US prime funds with the lowest WLA had higher outflows than MMFs with higher level of liquid assets and Cipriani and La Spada

[11] Baes, M., Bouveret, A. and E. Schaanning, (2021), 'Regulatory constraints for money market funds: The impossible trinity?', mimeo.

[12] The analysis assumes that an MMF has 35% WLA and 65% of its NAV on other assets. Liquidity parameters for WLA and other assets are taken from ESMA stress test scenario (10bps for WLA and 40bps for other assets). It is then possible to calculate the maximum level of redemption this MMF can face, depending on the NAV deviation requirement (ranging from 0 to 100bps) and on the required levels of WLA (ranging from 10% to 50%).

[13] However, based on current CRAs methodologies for MMF ratings, a deviation larger than 25bps would not be compatible with a AAAmmf rating for some CRAs, thereby limiting the additional flexibility for MMF managers.

[14] Li, L., Li, Y., Macchiavelli, M. and Zhou, X. (2020), 'Runs and interventions in the time of COVID-19: Evidence from money funds', available at SSRN: https://ssrn.com/abstract=3607593

Table 1

MMF ratings methodologies

Overview of CRAs approaches for MMFs

	S&P	Moody's	Fitch
Rating definition	Fund's ability to maintain principal value	Fund's ability to meet the dual objectives of providing liquidity and preserving capital	Fund's ability to provide principal preservation and liquidity through limiting credit, market, and liquidity risks
Credit risk exposures	100% A-1 or A-1+, 50% repo limit with A-2 counterparties. Exposures unrated by S&P are not eligible.	No formal limit, credit profile based on securities' ratings and maturities	100% F1 or higher (except for repo), 25% repo limit with F2 counterparties. Unrated exposures not eligible, unless rated by Moody's or S&P.
NAV deviation limit	25 bps	No formal limit	No formal limit

(2020[15]) found that this effect was significant for MMFs sold to institutional investors (but not for retail investors).

48. In the EU, rules are slightly different as for redemption fees and gates to be considered, the MMF has to breach the 30% WLA thresholds and record daily outflows higher than 10%. In that context, some market participants consider that existing rules are adequate.

49. Splitting LVNAVs into high and low WLA groups, ESMA (2021) shows that MMFs with low WLAs record higher outflows than MMFs with high WLAs. This analysis can be interpreted as evidence that institutional investors redeem from MMFs to avoid being subject to fees and gates.

Role of credit rating agencies

MMF ratings

50. In some jurisdictions, most funds typically have money market fund ratings from Credit Rating Agencies (CRAs). Money market fund ratings are different from credit ratings: they do not assess credit risk but rather the ability of MMF to preserve capital and maintain liquidity (see Table 1 on CRA methodologies). Since MMF ratings do not typically meet the definition of a credit rating as set out under the CRA Regulation, they are not considered credit ratings and therefore do not fall within the scope of the regulatory requirements of the CRA Regulation.

[15] Cipriani, M. and La Spada, G. (2020), 'Sophisticated and unsophisticated runs', Federal Reserve Bank of New York Staff Reports, No 956, December.

51. Using a sample of MMFs domiciled in Ireland and Luxembourg covering around 60% of the EU universe, more than 99% of those MMFs have at least a MMF rating from one of the three CRAs, and more than 80% of MMFs are rated by at least two CRAs (ESMA, 2021). However, in France, very few MMFs are rated, implying that at the EU level the share of rated MMFs is more likely to be around 60%.

52. All rated MMFs have a AAAmmf rating. The use of MMF ratings is related to the predominance of institutional investors, whose investment policy usually restricts them to invest only in MMFs rated AAAmmf by at least two CRAs.

Credit ratings

53. To reduce over-reliance on external ratings, the MMF Regulation requires MMFs to perform internal credit quality assessment. External credit ratings in their portfolio may be considered, but they cannot be mechanically relied upon. Looking at detailed portfolio holding data, credit ratings continue to play an important role. MMFs that obtain an MMF rating invest only in highly-rated instruments and issuers: for example MMFs rated by one CRA invest 100% in instruments and issuers which have credit ratings from the same CRA (ESMA, 2021).

54. This close relationship can be explained by constraints related to CRAs MMF rating methodologies. For some CRAs, MMFs can only invest in highly-rated issuers, and in most cases any exposure below some credit rating level would not be compatible with a AAAmmf for the MMF. For one CRA, MMF are restricted to invest only in instruments rated by the same CRA, while others CRAs might allow ratings from other CRAs to be taken into account. Rated-MMFs tend to invest almost exclusively in instruments rated by the CRA that also rates the MMF. In some cases, there is no significant differences between rated and non-rated MMFs exposures to instruments with a credit rating, implying that MMF rating methodologies might not be that constraining. However, for one CRA, MMF which are rated invest disproportionally more in instruments with a credit rating from this CRA (98% of NAV) compared with other non-rated MMFs (only 65% of NAV).

55. Given the importance of CRAs and MMF ratings, any regulatory reform's objectives may be unsettled in their application by how CRAs rate MMF.

56. For example, for one CRA an MMF using amortized cost can only be AAAmmf if the NAV deviation remains below 25bps.

57. Relatedly, in the MMF Regulation LVNAVs deviating more than 20bps should convert to VNAV, but this change in pricing might have an impact on MMF ratings[16].

Q1: i) Do you agree with the above assessment of the difficulties faced by MMFs during the COVID-19 March crisis? Do you agree with the identification of vulnerabilities? ii) What are your views in particular on the use of MMF ratings by

[16] One CRA has clarified that the switch to VNAV per se would not automatically trigger a downgrade from AAAmmf, however if the switch would trigger large outflows resulting in liquidity strains for the fund, the MMF would be downgraded.

investors? Are you of the view that the use of such ratings has affected the behaviors of investors during the March crisis?

2.3 Areas of reform of the MMF policy and regulatory framework identified at international and EU level

58. At international and EU level, various workstreams have started to assess the situation faced by MMFs during the March crisis, and which policy options should be considered in order to address the issues which have been identified. This is the case in particular at FSB and IOSCO level.

59. The objectives of that work include in particular: i) Enhance MMF resilience and ensure that regardless of the market conditions, they can operate without impacting financial stability; ii) Avoid interventions of central banks.

60. IOSCO recently published a *Thematic note on MMFs during the March-April episode*[17], that provides for a thorough analysis of the events in spring 2020 and summarises where the work stands at IOSCO on these issues.

61. The ongoing discussions at international and EU level and which relate to the need for reforms of the MMF regulatory framework can be summarised by the below chart:

	ESRB	**EC**
Scope and structure	– Non-Bank Expert Group (NBEG)	– Review of MMF Regulation – ESMA role: Advice to EC
Content	– NBEG: Additional risk analysis with focus on interconnectedness between MMFs and banks[18] – Potential ESRB Advice to the Commission on the review of the MMF Regulation	– Review by the Commission to be launched By 31/7/2022, following consultation with ESMA
	IOSCO	**FSB**
Scope and structure	– Financial Stability Engagement Group (FSEG)	– Standing Group on Non-Bank Financial Intermediation (SCN)
Content	– Follow-up proposal: Policy recommendations following FSB "Holistic review[19]"	- Follow-up proposal: Policy recommendations following FSB "Holistic review"

[17] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD666.pdf
[18] https://www.esrb.europa.eu/pub/pdf/reports/nbfi_monitor/esrb.202010_eunon-bankfinancialintermediationriskmonitor2020~89c25e1973.en.pdf
[19] https://www.fsb.org/2020/11/holistic-review-of-the-march-market-turmoil/

62. This work at international level highlighted the importance of having a common view on the role that MMFs should have in the financial system and in the economy as a whole, as a precursor to agreeing policies to enhance resilience in the sector. MMFs are structured in the same way as other open-ended funds and provide short-term financing to financial institutions and non-financial firms.

63. In the MMF Regulation, MMFs are also comparable to other investment funds, and their investors should expect to bear greater risks as compared to cash deposits. Liquidity mismatch related issues in stress market conditions should therefore be further addressed and considered as a priority of the work on potential reforms of the MMF regulatory framework.

64. The main objective of the final policy proposals at international level would be to enhance MMF resilience while preserving their useful functions, including with respect to the appropriate structure of the sector and of underlying short-term funding markets.

65. Given the above, a number of proposals of MMF reforms can be considered. These proposals can be categorised into a) proposals relating to MMF investors and the funds themselves (i and ii below), and b) proposals that also aim to enhance MMF resilience but are "external" to them (iii below):

    i. Reforms targeting the *liability side* of MMFs (e.g. related to swing pricing, redemptions in kind, holdbacks, minimum balance at risk, or removal of stable NAV).

    ii. Reforms targeting the *asset side* of MMFs (e.g. related to restrictions on asset holdings, increase liquidity buffers and/or make them usable/countercyclical, decouple regulatory thresholds from suspensions/gates).

    iii. Reforms that are *external to MMFs themselves* (e.g. related sponsor support, enhance liquidity of underlying instruments in which MMFs invest, liquidity exchange bank, enhanced MMF reporting to and stress testing by authorities).

66. Some of these proposals relate to the specific MMF regulatory framework (in the EU, the MMF Regulation), while other relate to MMF related issues, which do not fall within the remits of the MMF Regulation. This is in particular the case for the proposals related to changes to the prudential treatment of bank exposures to MMFs and money market instruments, central bank liquidity provision to MMFs & short-term funding markets, or the disclosure of CP/CD issuance and outstanding amount to the market.

67. It is also to be noticed that some reforms falling in the category of reforms "external to MMFs", such as i) Disclose MMF investor types to regulatory authorities ii) Harmonise and enhance international MMFs reporting framework iii) Sponsor support, in the EU, actually fall in the scope of the MMF Regulation (in particular Article 37 on MMF reporting and Article 35 on external support).

2.4 Potential areas of reform of the MMF Regulation

68. In light of i) the above assessment in section 2.3 on the ongoing work at international level on the need for MMF reforms and ii) the assessment of certain key features of the difficulties faced by MMF during the COVID-19 crisis in March 2020 included in section 2.2 of this consultation document, ESMA is of the view that a number of proposals of amendments to the MMF Regulation could be considered, in view of its review to be completed in 2022, according to Article 46 of the MMF Regulation.

69. Article 46 of the MMF Regulation specifies that "[b]*y 21 July 2022, the Commission shall review the adequacy of this Regulation from a prudential and economic point of view, following consultations with ESMA and, where appropriate, the ESRB, including whether changes are to be made to the regime for public debt CNAV MMFs and LVNAV MMFs*".

70. Given that this review clause includes the need for consultation with ESMA, the corresponding input should presumably be provided to the Commission in the course of 2021, or in early 2022. It is therefore appropriate to consult at this stage on the areas of reforms that ESMA will need to consider.

71. This section intends to set out the potential different policy options that could be envisaged to address the issues highlighted in section 2.2, focusing on those issues that may be addressed through a modification of the requirements of the MMF Regulation. It is important to specify that these potential policy options are, at this stage, preliminary and no decision has been taken yet on the advice that ESMA would give to the Commission in the context of the abovementioned article 46 of the MMF Regulation.

72. It is also important to specify that for the sake of the assessment of the potential policy options that are described in the next paragraphs, it has been assumed at this stage that the assessment of the role and economic function played by MMFs in the EU, as conducted by the Commission when the MMF Regulation was first issued[20], is still relevant. ESMA is of the view that the main objective of the review of the MMF Regulation should be to make MMFs more resilient to stressed market conditions without the need of (implicit) central bank support and to reduce their contribution to the building up of risk in the financial system. This objective is not conflicting with the preservation of the key intermediation role that MMFs perform in the short-term segment of money markets. On the contrary, tackling the vulnerabilities emerged in the Covid-19 turmoil would make more clear and transparent to investors and issuers of the financial instruments purchased by the MMFs the allocation of costs and risks that is implied by the intermediation function offered by MMFs. In addition, this will allow to preserve the current economic functions played by MMFs, in particular cash management, and short-term funding to issuers.

73. It should be highlighted that the analysis and assessment of investor behaviour during the March/April episode is key when drawing conclusions on the policy options. However, while there are ongoing exchanges on this issue at international level, data is scarce and information limited, due in particular to the status of the current reporting framework for MMFs. ESMA would therefore welcome any feedback, based on accurate data, on the behavior of investors during the MMF March 2020 crisis, and how this behavior has affected the shape of the MMF crisis.

[20] Underlying the European Commission, (2013), "Impact assessment accompanying the document proposal for a Regulation of the European Parliament and of the Council on Money Market Funds", September

Background

74. While selecting potential areas of reforms of the MMF regulatory framework as well as corresponding policy options to amend the MMF Regulation, it is necessary to set clearly the criteria that should be used to select those options.

75. In that respect, ESMA will make use of the grid of following criteria (formulated below as questions), which stakeholders should also take into account when responding to subsequent questions in this section on their assessment of the potential policy options referred to in paragraphs 81 and 82 aimed at revising the MMF Regulation[21]:

Impact on the resilience of MMFs

76. To assess the extent to which a policy option would affect the resilience of MMFs, the following questions could be used:

    i. How would the policy option work in mitigating the structural vulnerabilities of MMFs (as described in section 2.2, but also in relation to credit risk, interest rate risk, liquidity risk and any other potential vulnerabilities)?

    ii. Would it apply to all MMFs or only to certain types of MMFs?

    iii. Is the option currently in place in any jurisdiction, and if so, has it been helpful? How would it represent a change from current rules or practices in other jurisdictions? Has the option been implemented previously and, if so, what were the main findings?

Effects on investor behaviour

77. These criteria involve assessing how each option is likely to affect MMF investor incentives that are relevant to the funds' vulnerabilities in stress events. To assess the extent to which a policy option would impact investor behaviour, the following questions could be used:

    i. From a micro perspective (viewing the MMF in isolation), how would the policy option affect investors' incentives to redeem during stress events?

    ii. From a macro perspective, how would this option mitigate the effects of a generalised "dash for cash" as seen in March 2020; and/or runs prompted by a credit crisis, as seen in September 2008?

    iii. Does the option effectively shift MMF risks to investors? Does it make those risks more salient and transparent for investors? Are investors treated equally?

[21] Not all criteria are equally relevant for all options, and not all criteria need to be systematically used to assess all options, but this grid provides for a guide to seek the right questions to be asked when assessing options. For each option, stakeholders could also include in their responses to the questions listed in paragraphs 77 to 80, whether they are of the view that these questions are more or less relevant for the specific policy option they assess. Stakeholders could also indicate which criteria are in their view the most relevant, for a specific policy option (ranking of criteria per policy option).

Effects on fund managers

78. These criteria involve assessing how each option would affect the management of MMFs, including managers' incentives and tools that are relevant to the funds' vulnerabilities. To assess the extent to which a policy option would impact fund managers, the following questions could be used:

    i. How would the policy option affect MMFs' liquidity management in normal versus stressed times?

    ii. How would it impact the ability or willingness of MMFs to invest in short-term funding instruments or use the repo market?

Broader impacts on the stability and functioning of short-term funding markets

79. This implies describing the broader consequences of reform options on short-term funding markets. Such consequences would depend in part on whether the option would enhance the differences between MMFs and cash deposit. To assess the extent to which a policy option would impact the stability and functioning of short-term funding markets, the following questions could be used:

    i. Where are investors likely to move if MMFs become less attractive as a result of the policy option? Do these substitutes have vulnerabilities to runs? Are they transparent to investors and regulators? Are they regulated? Do they embed more risks for investors (e.g. counterparty risk) or be more costly?

    ii. What alternative sources of short-term funding are available for borrowers that currently rely on MMFs for financing? Are these alternative sources more stable than MMFs at all times? Can they in effect be scaled to replace MMF economic function? Would this address the financial stability issues noted or would risks simply be transferred elsewhere in the market without mitigating them effectively?

    iii. Would the policy option have different effects on MMFs denominated in domestic and foreign currencies?

80. Not all of these questions should be systematically answered when assessing a specific policy option, but this same matrix of criteria should be used to asses all options, so that a global consistent assessment can be drawn. The questions listed in paragraphs 76 to 79 are also summarized in the below table.

I. **Impact on the resilience of MMFs**
i. How would the policy option work in mitigating the structural vulnerabilities of MMFs?
ii. Would it apply to all MMFs or only to certain types of MMFs?
iii. a) Is the option currently in place in any jurisdiction, and if so, has it been helpful?
b)How would it represent a change from current rules or practices in other jurisdictions?
c) Has the option been implemented previously and, if so, what were the main findings?

II. **Effects on investor behaviour**
i. From a micro perspective (viewing the MMF in isolation), how would the policy option affect investors' incentives to redeem during stress events?
ii. From a macro perspective, how would this option mitigate the effects of a generalised "dash for cash" as seen in March 2020; and/or runs prompted by a credit crisis, as seen in September 2008?
iii. a) Does the option effectively shift MMF risks to investors?
b) Does it make those risks more salient and transparent for investors? Are investors treated equally?
III. **Effects on fund managers**
i. How would the policy option affect MMFs' liquidity management in normal versus stressed times?
ii. How would it impact the ability or willingness of MMFs to invest in short-term funding instruments or use the repo market?
IV. **Broader impacts on the stability and functioning of short-term funding markets**
i. a) Where are investors likely to move if MMFs become less attractive as a result of the policy option?
b) Do these substitutes have vulnerabilities to runs?
c) Are they transparent to investors and regulators?
d) Are they regulated?
e) Do they embed more risks for investors (e.g. counterparty risk) or be more costly?
ii. a) What alternative sources of short-term funding are available for borrowers that currently rely on MMFs for financing?
b) Are these alternative sources more stable than MMFs at all times?
c) Can they in effect be scaled to replace MMF economic function? d) Would this address the financial stability issues noted or would risks simply be transferred elsewhere in the market without mitigating them effectively ?

Policy options to amend the MMF Regulation

81. Given the above, the proposals of amendments of the MMF Regulation that ESMA suggest to focus on at this stage (as detailed in the next paragraphs of this document) include:

Reforms targeting the liability side of MMFs

i. Decouple regulatory thresholds from suspensions/gates;

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

Reforms targeting the asset side of MMFs

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

Reforms targeting both the liability and asset side of MMFs

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

Reforms that are external to MMFs themselves

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

82. In addition, ESMA seeks to collect feedback from market participants on other proposals, which are also currently being considered:

i. Amend/specify the rules on ratings of MMFs.

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

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

iv. Further harmonise and enhance international MMFs reporting framework;

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

vi. Further clarify the scope of the MMF Regulation.

Q2: i) Do you agree with the above assessment on the potential MMF reforms related to the review of the MMF Regulation? ii) What are your views on the abovementioned

assessment of the interaction between potential MMF reforms and the behaviour of investors during the MMF March 2020 crisis?

Reforms targeting the liability side of MMFs

Decouple regulatory thresholds from suspensions/gates

83. The rationale behind this proposal is described above in the part "role of gates" of the section 2.2 of this consultation document. Certain stakeholders have argued that the link between the WLA threshold and the requirement for the manager to use suspensions/gates might have created a first-mover advantage by tying breaches of WLA to the use of gates.

84. As the WLAs level declines towards the regulatory threshold of 30%, investors might perceive an incentive to pre-emptively run to avoid being subject to gates. In the US, evidence was provided[22] that US prime funds with the lowest WLA had higher outflows than MMFs with higher level of liquid assets.

85. Two options could be considered, as follows:

86. Removal of tie between liquidity and liquidity fees on redemptions/redemption gates: as mentioned above[23], definitive thresholds for permissible imposition of liquidity fees and redemption gates may have the unintended effect of triggering pre-emptive investor redemptions as funds approach the relevant thresholds. Removing completely the tie between the thresholds and the imposition of fees and gates is one possible reform. Fund boards could or should be required to impose fees or gates when doing so is in the best interest of the fund, without reference to any specific level of liquidity.

87. Reform of conditions for imposing redemption gates: Reforming rules regarding redemption gates to reduce the likelihood that gates may be imposed could diminish investors' incentives to engage in pre-emptive runs. For example, funds could be required to obtain permission from regulatory authorities or notify regulatory authorities prior to imposing gates. Alternatively, fund boards could be required to consider other measures, such as liquidity fees, swing pricing or notice and settlement periods, before gates, making it less likely that gates would be imposed. This option could be limited to removing regulatory thresholds tied to gates or also cover thresholds tied to fees.

88. In the EU, in the case of LVNAV and CNAV, Article 34(1) of the MMF Regulation implies that the manager of the MMF shall decide to apply certain measures, including liquidity fees (Article 34(1)(a)(i)) or gates (Article 34(1)(a)(ii)) if the WLA ratio falls below 30% and the net daily redemptions on a single working day exceeds 10% of total assets.

89. In the context of the review of the MMF Regulation, one way to address the abovementioned issue could simply be to remove Article 34(1)(a)(i) and 34(1)(a)(ii).

[22] Li et al. (2020)
[23] Please also note that this measure is a pre-condition for allowing the usability of liquidity buffers, discussed in the following paragraphs of this section 2.4

90. These measures could be replaced with the implementation of swing pricing or ADL, as described in the following paragraphs.

Q3: Do you agree with the above assessment of the i) potential need to decouple regulatory thresholds from suspensions/gates and the corresponding proposals of amendment of the MMF Regulation ii) potential reforms of the conditions for the use of redemption gates? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

Require MMFs to use swing pricing, or anti-dilution levies (ADL) / liquidity fees

91. Given the above proposal to decouple regulatory thresholds from suspensions/gates, and therefore to possibly remove Article 34(1)(a)(i) and 34(1)(a)(ii) of the MMF Regulation, it could be appropriate to require at the same time MMF to use mechanisms such as swing pricing, and/or anti-dilution levies (ADL) / liquidity fees.

92. Using such mechanisms would allow the transfer of the liquidity costs of assets sale to redeeming investors; the cost would otherwise be borne by investors who remain invested in the fund.

93. It would help reduce redemption requests under stressed market conditions.

94. With swing pricing, a fund adjusts the dealing price for inflows or outflows to take into account the costs of purchasing or selling assets of the fund. With ADL / liquidity fees, a fund adjusts entry and exit charges.

95. It may help reducing redemption requests under stressed market conditions if redeeming investors finance the cost of liquidity, which may increase as a result of widening spreads on short-term funding market.

96. Swing pricing may either apply to every transaction ("*full swing pricing*") or only when transactions exceed a pre-defined swing threshold ("*partial swing pricing*").

97. There could be only one threshold or more, each with a different swing factor, which should not be made public to avoid introducing trigger effects. It could be applied only to redemptions or to both redemptions and subscriptions.

98. Regulation applicable to funds could require that legal documents incorporate the swing pricing and/or ADL mechanisms in view of ensuring that all funds would be equipped with such tool. It may also imply introducing additional governance procedures for swing pricing.

99. It should be noted that for those options to be effective, it is important to set a minimum level of transparency in CP and CD market (ISIN, pre and post trade transparency, ability to trade on exchanges etc.). Market transparency could facilitate the application of swing pricing mechanism to MMF. Such transparency could in addition enhance stress-test relevance.

100. A few advantages of using of swing pricing or ADL include:

i. They could better reflect costs in times of illiquidity;

ii. They could be effective in reducing first mover advantage.

iii. Price adjustments or increasing fees may be more preferable than suspensions in time of stress, maintaining access.

101. However, certain potential drawbacks or effectiveness related issues, on which ESMA would also welcome feedback from stakeholders, need to be assessed:

i. With respect to effectiveness, may swing pricing or ADL still lead to outflows if investors see more price volatility in near future?

ii. If not mandatory, while the tools may be available to MMFs, they may choose not to use them.

iii. Does swing pricing have effects on existing structures under the MMF Regulation, such as Public-Debt CNAV or LVNAV?

iv. While this is not per-se a drawback, would there be possible cliff-edge from rating downgrades of MMFs and impact on balance sheets due to accounting considerations should be assessed (please see below on MMF ratings)?

v. While this is not per-se a drawback, due to the lack of transparency of private money markets (CP and CDs), it can be challenging to assess market prices. A transparent and robust swing would likely need to be accompanied with information on the CP and the CD market (both the primary and secondary markets).

102. Swing pricing can be associated to a lack of transparency and to an increase of costs to the investors in stress market conditions (if swing factors are not disclosed, they are difficult to assess). One could argue that such mechanism may therefore need to be subject to strict supervision by supervisory authorities.

103. Given the above, it should also be assessed the extent to which "continuous" swing pricing, with terms depending on the liquidity of the underlying market, should be preferred to trigger-based swing pricing, to avoid nonlinearities under stressed conditions.

104. On a more general standpoint, it can be argued that the activation of such liquidity mechanisms such as, but not limited to, swing pricing may result from i) a punctual decision from the manager ii) an automatic trigger or; iii), if i) and ii) do not entail enough incentives, or are not properly adapted, in the specific case of ii), to activate these mechanisms, a decision from an external party, such as a regulator. This regulator could be a direct supervisor or/and (in coordination with) an EU macro-prudential authority. It should however be emphasised that the decision to use such liquidity mechanisms shall, in general, remain the responsibility of the manager of the MMF.

105. For MMFs using amortised cost valuation, systematic swing pricing would not be appropriate and it should also be assessed whether other similar measures such as liquidity fees / anti-dilution levies (ADL) might be better suited than swing pricing (ADL / liquidity fees would indeed be available in all circumstances, and not only in the context of the conditions laid down in the abovementioned Article 34 of the MMF Regulation).

106. In the MMF Regulation, these proposals could imply adding in Article 33 "Issue and redemption price", a new paragraph Article 33(3) allowing for/imposing the use of swing pricing, specifying its use and the conditions under which it may or shall be used.

Q4: i) Do you agree with the above assessment of the potential need to require MMFs to use swing pricing and / or ADL / liquidity fees and the corresponding proposal of amendment of the MMF Regulation (including the above list of corresponding potential benefits and drawbacks)? ii) If you are of the view that swing pricing might not be workable for certain types of MMFs, which instruments would you suggest as an alternative for these types of MMFs going forward? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

<u>Reforms targeting the asset side of MMFs</u>

Increase liquidity buffers and/or make them usable/countercyclical

107. Under the MMF Regulation, MMFs are currently required to maintain a certain level of liquidity in their portfolio, commonly defined as a percentage of daily and weekly liquid assets out of the total net assets (e.g. 7.5% daily and 15% weekly liquid assets).

108. MMFs' incentives to maintain WLAs well above the minimum regulatory thresholds, even in the face of significant outflows, may include a desire to avoid:

i. prohibitions on purchasing assets that are not WLAs;

ii. raising investor concerns about the potential imposition of fees or gates; and

iii. potential scrutiny resulting from public disclosure of low WLA amounts.

109. The purpose of liquidity buffers and of their minimum as imposed by the MMF Regulation might need to be clarified; they may be used during a limited period of time (VNAV) or trigger the use of Liquidity Management Tools (CNAV and LVNAV). This might prove to be pro-cyclical at times of stress.

110. In order to address this issue, one could review the calibration and/or composition of these minimum liquidity buffers.

111. Under this approach, the current minimum daily and/or weekly WLA requirements could automatically decline in certain circumstances, such as when net redemptions are large or when the regulatory authority provides temporary relief from WLA requirements. Any thresholds linked to a fund's minimum WLA requirements (e.g., fee or gate thresholds) would also move with the minimum (option 1).

112. Alternatively, the WLA could be defined as the greater of the current WLA and a buffer calibrated by the regulator based on stress tests performed by MMF managers in accordance with shocks defined by the regulators (this buffer would, however, not need to be fund specific).

113. Such buffer could either be relaxed, at the initiative of a supervisor in times of stress or by the managers in the interest of investors and for financial stability purposes (assessment of the supervisor/ EU macro-prudential authority). To avoid any non-intended consequences, the buffer would be non-public (option 2).

114. This would allow funds to deploy liquid assets more flexibly in a crisis and could mitigate liquidity strains. Under option 2, an EU coordination role might be crucial here to avoid regulatory arbitrage across jurisdictions, and hence a role for ESMA/ESRB could be considered.

115. These countercyclical liquidity buffers could also be combined with mandatory swing pricing, as referred to above (when the counter-cyclical buffer is used); in order to limit any trigger effect, the counter-cyclical buffer and the liquidity position would not be made public.

116. A further measure to make liquidity buffers more risk sensitive and flexible is to differentiate the level of liquidity buffers according to funds' structural exposure to funding risk (i.e. similar to the concept of stable and unstable funding for banks' LCR).

117. Under this option (which would be an option 3) funds with a larger share of volatile institutional investors could be required to hold larger buffers. To this end, the proposal to disclose MMF investor types to regulatory authorities should be seen a necessary prerequisite (see below).

118. In the MMF Regulation, these proposals would imply modifying:

i. Article 24 (portfolio rules for short-term MMFs);

ii. Article 25 (portfolio rules for standard MMFs);

iii. Article 34(1) (as mentioned above).

Q5: i) Do you agree with the above assessment of the potential need to increase liquidity buffers and/or make them usable/countercyclical and the corresponding potential proposal of amendment of the MMF Regulation? ii) With respect to option 1 above, views are sought in particular on the relevant threshold (on the size of redemptions) from which WLA would need to be automatically adjusted. When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

Reforms targeting both the liability and asset side of MMFs

Eliminate CNAV (and LVNAV) funds

119. This proposal suggests that all MMFs should always deal on the basis of a floating NAV, irrespectively of the investor base or the assets they hold. The rationale behind this proposal is that CNAV and LVNAV mechanisms imply nonlinearities (cliffs effects) by definition, and are therefore intrinsically prone to first-mover advantages and other amplification effects.

120. This change would enable the value of MMFs to move in accordance with the prices of the components of their portfolio and reflect market conditions, while preserving the cash like nature of such vehicles (same day settlement) under normal market conditions.

121. This proposal would enhance MMF resilience by removing nonlinearities inherent in CNAV and LVNAV structures that amplify the first-mover advantage under stressed market conditions. These nonlinearities are related to the risk of “breaking the buck” associated to CNAVs and the risk of conversion to VNAV associated to LVNAVs (by breaching the 20bp collar in Europe).

122. Floating NAVs would make portfolio risks more transparent to investors and authorities and could clarify the objective of MMFs.

123. This proposal may not significantly alter the cash-like nature of MMFs during normal market conditions while it would shift portfolio risks from MMFs to investors on a continuous basis in stressed market conditions.

124. VNAV rules do not include thresholds triggering the application of suspensions or gates, therefore this reform would also reduce the link between regulatory thresholds and the application of suspensions or gates.

125. The MMF Regulation has explicitly been structured in order to allow CNAV and LVNAV to be maintained, considering that the costs of eliminating the CNAV and LVNAV model would be significant, and the co legislators therefore preferred to set out specific rules aiming at ensuring the financial stability of these vehicles, rather than requiring a mandatory move to the VNAV model in Europe.

126. More than ten years after the start of these discussions, and in connection with the analysis expressly required by article 46(1) of the MMF Regulation (see paragraph 69 above) one key question is therefore whether the considerations which led to the choice made in the MMF Regulation to maintain the model of CNAV and LVNAV should now be questioned (included the 20 bps collar applying to LVNAV to limit the use of the amortised cost to certain conditions) in light of the recent market events that took place during the March 2020 crisis, and while not only stable-NAV MMFs faced difficulties during the March 2020 crisis, but also VNAVs.

127. An alternative could be to focus on the option to move only LVNAV to VNAV. With respect to that specific option (moving only LVNAV to VNAV), a few advantages can be listed as follows:

i. It could remove the threshold (e.g. LVNAV collar) that may have contributed to investors behaviours in March;

ii. VNAV may be more responsive to changes in value/cost of liquidity (but in the case of LVNAV, if those types of MMFs were to remain, this could also be mitigated by implementing new liquidity management tools need to be implemented);

iii. In the EU, VNAV funds do not have thresholds for suspensions (except the 15% weekly liquidity requirement) as LVNAV (please note that this could also potentially be addressed by amending the requirements of article 34 of the MMF Regulation).

128. However, certain potential drawbacks of this option need to be assessed. This include the following issues:

i. While it is uneasy to anticipate the behaviour of market participants in such a new regime, there could be cliff-edge from rating downgrades of MMFs (please however see also the specific section on the role of CRAs in paragraphs 144 and following ones) and impact on balance sheets due to accounting considerations, should such funds remain noted as per the current applicable methodologies;

ii. One would also need to consider the effect of holdings being reallocated outside of the MMF sector completely, e.g. to banks or even in other much less regulated vehicles (e.g. segregated accounts). This may not be advisable from a financial stability perspective, as the run-risk may still remain but move towards the banking system instead.

Q6: What are your views on the potential need to eliminate CNAV and LVNAV funds, in light of the recent market developments, and the corresponding potential proposal of amendment of the MMF Regulation? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

Reforms that are external to MMFs themselves

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

129. As rules on sponsor support of MMFs vary internationally, it is important to assess the relevancy of the EU rules on that issue, to assess the consistency of the EU rules with international standards, in case in particular of a global crisis.

130. On external support, options could be an outright ban of sponsor support (as currently in the MMF Regulation) or the development on an ex-ante framework that could be defined to allow it, while seeking to mitigate the risks that might arise from sponsor support.

131. In the EU, Article 35 of the MMF Regulation specifies that "*A MMF shall not receive external support*".

132. However, the March crisis has raised some questions on the exact implementation of this requirement under certain exceptional circumstances, as well as in the usual course of business.

133. In that context, ESMA has issued a Statement on the application of this Article 35 of the MMF Regulation.[24]

134. In the context of the difficulties faced by certain MMFs during the COVID crisis in March 2020, efforts and measures of the central banks, and in particular the market liquidity brought by some of these measures may have also indirectly benefited MMFs through the intermediation of credit institutions purchasing short-term assets held by MMFs.

[24] https://www.esma.europa.eu/sites/default/files/library/esma34-39-1096_esma_statement_mmf_art35.pdf

135. The abovementioned statement on Article 35 of the MMF Regulation was issued to coordinate the supervisory approaches of NCAs in light of these and any future liquidity challenges for MMFs in the context of the current COVID-19 pandemic. It is aimed at recalling certain conditions the aforementioned intermediation must comply with under the requirements of the MMF Regulation.

136. In the normal course, MMFs may enter into transactions with affiliated or related parties. Such affiliated or related parties may also have directly benefited from some of the measures mentioned above.

137. According to Article 35 of the MMF Regulation, MMFs are unable to receive external support, defined as "*direct or indirect support offered to an MMF by a third party, including a sponsor of the MMF, that is intended for or in effect would result in guaranteeing the liquidity of the MMF or stabilising the NAV per unit or share of the MMF*".

138. The statement aims at clarifying the potential interaction between the abovementioned intermediation of credit institutions and the requirements of Article 35 of the MMF Regulation, specifying certain conditions under which such intermediation does not constitute external support.

139. Certain stakeholders have considered that while useful, the abovementioned clarification brought by this statement was limited, to the extent that, as a level 3 regulatory tool, it could not directly amend certain aspects of the level 1 requirements included in the abovementioned Article 35.

140. It could therefore be considered to amend directly Article 35 of the MMF Regulation to introduce certain clarifications. These clarifications should cover general clarifications on the requirements of Article 35 of the MMF Regulation in order to further define the general circumstances under which external support is to be banned and under which circumstances related party transactions would be permissible.

141. Another option could be to soften or amend the express ban of external support in all circumstances, as currently specified in Article 35(1). Indeed, in times of stress, the current ban may reduce the tools available to directly or indirectly alleviate the stress. It could be envisaged to define a framework that would allow certain types of support under certain circumstances, while seeking to mitigate the risks that might arise from sponsor support.

142. Sponsor support has been an important feature of stress events, but the expectation of support is largely implicit. The failure of one sponsor to provide support was a trigger for runs in 2008. A framework that would set rules ahead of a stress event could mitigate destabilising surprises. A more formalised external support framework could act to provide ex ante confidence to the market that all MMF types were capable of withstanding significant stresses. For instance, a liquidity exchange bank or another third party/mechanism with similar functions could serve as a centralised source of liquidity during periods of stress. This could mitigate liquidity pressures on MMFs and reduce the likelihood of fire-sales. This further option is further detailed below in paragraphs 173 and following ones.

143. However, reforms to sponsor support (e.g., making it explicit ex ante) would have far-reaching effects. Explicit support would favor bank-sponsored funds, could cause funds to be consolidated on sponsors' balance sheets, and would likely increase concentration. Banning sponsor support may, on the contrary, increase the importance of other type of support.

Q7: What are your views on the extent to which Article 35 of the MMF Regulation should be clarified and/or amended? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

<u>*Other potential reforms*</u>

Rating of MMFs and the role of credit rating agencies (CRAs)

144. As described in section 2.2 of this consultation document, a large share of MMFs receive MMF ratings from CRAs. In certain cases, the MMF rating methodology used by CRAs to provide MMF ratings can limit further the flexibility available to MMFs to deal with large redemptions, as MMFs would face the risk of being downgraded.

145. When deciding on the opportunity to impose the use of certain liquidity management tools (as mentioned above for swing pricing) or simply allow for the use of these tools under certain circumstances, it should therefore be assessed the consequences of these requirements on the MMF ratings of MMFs, as provided by CRAs, in order to avoid unexpected consequences of the use of these tools.

146. Alternatively, it could be considered to clarify the rules that may be applied by CRAs MMF rating methodologies in order to provide an MMF with a rating, and the extent to which these methodologies should avoid including direct triggers between i) the use of liquidity management tools and ii) a certain level of MMF rating.

147. The MMF Regulation currently includes a provision on MMF credit ratings (Article 26 – please see below). However, the title of this Article is somewhat confusing and can lead to the impression that the underlying provisions refer to MMFs and the solicitation of MMF ratings, which it does not.

"*Article 26*

MMF Credit ratings

An MMF that solicits or finances an external credit rating shall do so in accordance with Regulation (EC) No 1060/2009. The MMF or the manager of the MMF shall clearly indicate in the MMF's prospectus, and in all communication to investors in which the external credit rating is mentioned, that the rating was solicited or financed by the MMF or by the manager of the MMF"

148. A straightforward interpretation of this Article is that the first sentence requires that if an MMF solicits a credit rating (not a MMF rating) it shall only solicit a credit rating from an EU registered CRA. This is a standard requirement that has been replicated in other pieces of EU regulation. The second sentence could be interpreted as requiring that if an MMF refers to a credit rating in its prospectus that it has solicited from an EU registered CRA it should indicate whether that the rating was solicited by the MMF. This is another standard requirement and reflects provisions under CRAR where CRAs need to disclose whether a credit rating was solicited or unsolicited by the rated entity.

149. As a result, the main element of this Article that could be understood as creating inconsistency with CRAR is the title “MMF Credit Ratings”, as it is the title that implies MMF ratings are credit ratings. If the Article was titled “MMFs and Credit Ratings”, there would be less potential for confusion.

150. Providing this clarification however does not address the issue as to whether MMF ratings are subject to any or equivalent regulatory requirements as credit ratings. As a result, in addition to clarifying the title it could be considered to extend the scope of this article to propose putting MMF ratings under the regulatory framework used for credit ratings. This would at least ensure that the MMF ratings that are being used by investors, and which fall out of scope of the CRA Regulation, are subject to some minimum standards.

Q8: i) Do you agree with the above assessment of the potential need to assess the role of MMF ratings in light of the difficulties faced by MMFs during the March crisis, and the potential need to introduce regulatory requirements for MMF ratings? ii) In your view, based on your experience, what are the benefits of MMF rating from investors' perspective, having in mind that rules applying to MMFs are already very stringent? What would be the likely consequence on investors from the downgrade of one or several MMFs? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

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

151. The current requirements of article 28 and 37 of the MMF Regulation, complemented by the ESMA Guidelines on MMF stress tests, which are updated every year as per article 28(7), specify:

i. the types of stress tests that managers need to have in place, the risk parameters they should take into account (including shocks to credit risk, interest rates or redemptions) (article 28(1)),

ii. the frequency of the stress tests exercise (article 28(2)),

iii. the type of reporting of the results of these stress tests to National Competent Authorities and ESMA (article 37 and ESMA Guidelines on MMF stress tests), and

iv. the corrective measures that managers of MMFs need to take, in case the stress tests reveal vulnerabilities of the MMFs (article 28(3) to 28(6)).

152. In the context of the ESMA Guidelines on MMF stress tests, the ESRB and ESMA define annually a stress test scenario that is then applied to all EU MMFs, the results of which shall be sent to National Competent Authorities and ESMA, as mentioned just above.

153. A key issue is that while individual MMFs might be able to be resilient to the adverse scenario when considered in isolation, this might not be the case when all MMFs face a shock at the same time (as observed in March 2020).

154. This is because individual MMF do not take into account what other MMFs might do at the same time. This coordination failure can create additional stress, especially given the high portfolio overlap, high market footprint and low liquidity of the markets MMFs invest in.

155. Article 28(6) indicates that the report sent to National Competent Authorities containing the corrective measures that the manager of an MMF will take when results of stress tests reveal vulnerabilities of a specific MMF is also sent to ESMA.

156. The extent to which this coordination mechanism between National Competent Authorities and ESMA is sufficient to address the abovementioned system-wide related issues needs to be assessed.

157. However, given this regulatory framework as set out in the Article 28 of the MMF Regulation is recent and has not been tested yet, given ESMA has not received yet any report as per Article 28(6), it is still to be assessed whether the current framework would not be sufficient to meet these objectives. ESMA would welcome feedback from stakeholders on these issues.

158. In order to strengthen this coordination mechanism, and the corresponding abovementioned corrective measures, several options could be envisaged, such as:

i. Specifying that ESMA would, together with the National Competent Authority, receive directly from the manager of the MMF the report mentioned in Article 28(5) of the MMF Regulation[25], so that ESMA can play its coordination role with National Competent Authorities in the more effective way, and in real-time (which might be of a value in such crisis situations as in March 2020);

ii. Specifying further the corrective measures that managers of MMFs need to take when stress tests reveal vulnerabilities of a specific MMFs (currently, Article 28(4) indicates that the manager of an MMF shall take "*action to strengthen the robustness of the MMF, including actions that reinforce the liquidity or the quality of the assets of the MMF*") or specify the process of adoption of such measures and the role of supervisors in that process.

Q9: Do you agree with the above assessment of the potential need to amend the requirements on stress tests included in the Article 28 of the MMF Regulation? When

[25] which implies IT developments at ESMA level that would need to be dully taken into account when specifying these requirements in the revised version of the article 28.

you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

Further harmonise and enhance international MMFs reporting framework

159. The MMF Regulation includes a detailed reporting framework from managers of MMFs to NCAs and ESMA, which is set out in Article 37 and its implementing measures (Commission Implementing Regulation 2018/708 with regard to the template to be used by managers of money market funds when reporting to competent authorities[26] and ESMA Guidelines on MMF reporting[27]).

160. Given the difficulties faced by MMFs during the 2020 March crisis, the extent to which this reporting framework should be reviewed should be considered in the review of the MMF Regulation.

161. In particular, the current reporting is provided to NCAs and ESMA on a quarterly basis for MMFs with Asset under Management (AuM) above EUR 100 million and on a yearly basis for funds below such threshold, which is not enough to grasp the evolution of funds positioning during a crisis such as the March 2020 one.

162. In particular, Authorities would need to monitor on a continuous basis the cash level in the funds, as well as the type and characteristics of instruments being held in portfolios and the extent to which some instruments (i.e. overnight certificate of deposit) could be considered as cash. Data pertaining to the composition of the passive side of funds (i.e. investors, subscription and redemption activity) need to be available for Authorities in a timely manner (e.g. monthly) to ensure an efficient monitoring of systemic risks, the potential interconnectedness and the investors access to short term funding.

163. Overall, the current reporting frequency does not appear sufficient in case of a crisis such as the one experienced in March 2020 where Authorities need up-to-date data to assess the shocks and monitor the developments in the money markets.

164. A reporting on at least a monthly basis for larger funds/managers in terms of AuM and quarterly for smaller funds/managers would be fit for purpose. It shall be noted that MMFs (at least the largest ones) already produce the information and report data on a monthly basis to supervisory authorities in different jurisdictions and commercial data providers.

165. However, it should be assessed whether this need for information on a more continuous basis could be requested only during crisis event (which would mean modifying the frequency and contents of the reporting only in times of crisis) or more generally during the life of the MMF, and whether a differentiation should be made between VNAV and LVNAV/CNAV in that respect (in particular in terms of contents and frequency of the information provided).

166. A more frequent reporting could indeed be activated in stressed market conditions (e.g. daily) with a subset of key indicators of the MMF Regulation reporting (e.g. Total Net asset value (TNA), WLA) to monitor the crisis, rather than systematically collecting the full MMF Regulation reporting on a monthly basis. It shall be noted that collecting the data on an ad-

[26] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R0708&from=EN
[27] https://www.esma.europa.eu/sites/default/files/library/esma34-49-173_guidelines_on_mmf_reporting_en.pdf

hoc basis, though on side allows for more flexibility, on the other it may be detrimental in terms of timeliness and consistency of reporting.

Q10: Do you agree with the above assessment on the potential need to review the reporting requirements under the MMF Regulation? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

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

167. Disclosing information on the main investors in money markets would help to understand the dynamics of the market based on the behaviour of the main categories of investors as well as potential interconnectedness. It may be the case for example that institutional investors are both invested in MMF and MMIs directly and may have divested from MMFs while they were selling MMIs during the COVID-19 outbreak.

168. Information on new issuance and outstanding amounts of money markets may be available broken-down on some market per categories of issuers, ratings, maturities. Daily information on average interest rate per category of issuers, maturity and rating would be a valuable complement. Post-trade information (volumes and prices) could also be introduced on a daily basis (end of day) and be made available to market participants on the secondary market. This information would prove useful for market participants.

169. The disclosure of investor types to authorities would provide valuable information to be better prepared to anticipate the potential spill over effects in case a crisis occurs. This information would prove useful for regulators.

170. There could also be a link between the policy options on liquidity buffer (please see the corresponding section above "*Increase liquidity buffers and/or make them usable/countercyclical*"), and the disclosure of main categories of investors to regulatory authorities. The level of liquidity buffers referred to above could indeed be differentiated according to funds' structural exposure to funding risk (i.e. similar to the concept of stable and unstable funding for banks' LCR, funds with a larger share of volatile institutional investors could be required to hold larger buffers). To this end, the proposal to disclose MMF investor types to regulatory authorities should be seen a necessary prerequisite.

171. Under that option, Authorities would require a periodical disclosure of the investor base in normal market conditions; the frequency could be increased in stressed market conditions

172. It has to be noticed that under the requirements of Article 37 of the MMF Regulation, managers of MMFs already have to disclose certain information on the liabilities and assets of MMF, but these reporting requirements are quarterly (or yearly). As a result of the abovementioned additional need of disclosure, there might be a need to amend the

requirements of Article 37 of the MMF Regulation on the disclosure of liabilities and assets of MMFs, but this could be supplemented by additional disclosure requirements on MMIs and their investors, which go beyond the strict requirements of the MMF Regulation.

Q11: Do you agree with the above assessment of the potential need to include additional requirements in the MMF Regulation, and/or potentially in other types of EU piece of legislation on the disclosure of money market instruments (MMIs) and main categories of investors to regulatory authorities (e.g. detailed information on liabilities)? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

Set-up a liquidity exchange facility ("LEF") funded by MMF or asset managers

173. This option considers setting-up a liquidity exchange facility ("LEF") funded by MMF or asset managers and, depending on the interpretation of the requirements of Article 35 of the MMF Regulation, by third parties, on an-going basis. Subject to EU supervision, this LEF could serve as a centralised source of liquidity and/or credit during periods of stress.

174. This could mitigate liquidity pressures on MMFs and reduce the benefit of 'first mover advantage' for investors resulting in an accelerating spiral of investor redemptions and asset fire-sales. This would mean the creation of a centralised and pre-funded facility for MMFs to transact with during a crisis. It is to be noted though that there are a number of alternative models and structures, including options to provide both liquidity and/or credit support. Under these options, funding could be provided by money market funds, by independent parties, by non-private funding or by a combination of funding sources.

175. One possible structure is that of a 'liquidity stability mechanism': MMFs would be mandated to pay each year a charge based on each fund's AuM. The income from these charges would then be pooled together and ring-fenced within a single, central entity.

176. This central entity would then be used in times of severe market strain, especially when specific money markets were closed, to stabilise money market instrument prices and trading, helping MMFs (even those not transacting with the centralised pool) and wider market functioning by purchasing eligible MMF assets.

177. Such a structure could be set up as a banking entity, with funding from MMFs providing a strong capital base[28]. Under this option, the entity would not provide credit support. However, this proposal may be open to the possibility of indirect access for MMFs – via this liquidity exchange mechanism – to central bank facilities, which may raise concerns in terms of moral hazard as well as central banks' operational framework for the implementation of monetary policy.

178. A more formalised external support framework could act to provide greater ex-ante confidence to the market that all MMF types were capable of withstanding significant

[28] See p31, *Report of the President's Working Group on Financial Markets* https://home.treasury.gov/system/files/136/PWG-MMF-report-final-Dec-2020.pdf.

market instability, in the event of credit and/or liquidity stresses impacting either (or both) the asset and liability side of MMFs. Depending on the structure and features of the support mechanism, it could serve as a centralised source of liquidity and/or credit during periods of stress. This could mitigate liquidity pressures on MMFs and reduce the benefit of 'first mover advantage' for investors resulting in an accelerating spiral of investor redemptions and asset fire-sales.

179. Depending on the particular support structure, the timing, frequency and method of support provided would differ. However, the impact would be most beneficial in periods of market stress. Under the liquidity exchange model suggested above, whilst the central entity would be funded on an ongoing basis, it would only be expected to purchase and sell assets under stressed conditions as a backstop measure.

180. While it would need to be subject to supervision, an external support mechanism would be complementary to other reforms, such as buffers, limits or other risk mitigation measures. It should also provide additional protection to keep vital markets functioning during severe stresses.

181. The establishment and effectiveness of an external support facility is reliant on MMFs being permitted to access it when required. This may require accompanying changes to the Article 35 of the MMF regulation under which external support is prohibited. Where such a facility is only available in certain jurisdictions or to a subset of MMFs, it should be emphasised that it may introduce additional redemption risk under stress as investors redeem out of "uncovered" MMF funds and to seek "covered" funds.

Q12: i) Do you agree with the above assessment on the potential creation of a LEF? In your view, which entity should supervise such a LEF? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80. ii) Several open questions related to the creation of the LEF, on which ESMA would specifically welcome feedback from stakeholders, include:

- **What should be the appropriate size of such a pooling vehicle as the LEF?**
- **In terms of funding, how much MMF would have to pay each year to participate in the pool? How much of the funding would/should be provided by other sources?**
- **How long would it take to establish such a LEF?**
- **Under which conditions would the LEF be activated?**
- **Who would be responsible for activating the LEF?**

Further clarify the scope of the MMF Regulation

182. The scope of the MMF Regulation is defined in particular in Articles 1 and 6 of the MMF Regulation.

183. Article 1 defines an MMF as follows:

"*This Regulation applies to collective investment undertakings that:*

(a) require authorisation as UCITS or are authorised as UCITS under Directive 2009/65/EC or are AIFs under Directive 2011/61/EU;

(b) invest in short-term assets; and

(c) have distinct or cumulative objectives offering returns in line with money market rates or preserving the value of the investment"

184. Article 6 (use of designation as MMF) specifies that:

"1. *A UCITS or an AIF shall use the designation 'money market fund' or 'MMF' in relation to itself or the units or shares it issues only where the UCITS or the AIF has been authorised in accordance with this Regulation. A UCITS or an AIF shall not use a misleading or inaccurate designation which would suggest it is an MMF, unless it has been authorised as an MMF in accordance with this Regulation. A UCITS or an AIF shall not have characteristics which are substantially similar to those referred to in Article 1(1), unless it has been authorised as an MMF in accordance with this Regulation.*

2.The use of the designation 'money market fund', 'MMF' or of another designation that suggests that a UCITS or AIF is an MMF shall mean use in any external documents, prospectuses, reports, statements, advertisements, communications, letters or any other material addressed to or intended for distribution to prospective investors, unit-holders, shareholders or competent authorities in written, oral, electronic or any other form."

185. Against this background, it has been argued that in the cases of certain investment funds investing in short-term assets, the assessment of the criteria set out in Article 1 above is not obvious and that a consistent approach across the EU on these cases is required, given in particular that MMFs are marketed cross-border.

186. It has been argued that the implementation of Article 6 mentioned above may also be uneasy and that a consistent approach across the EU should also be achieved on this matter.

187. ESMA is therefore of the view that further clarifications could be provided in relation to the abovementioned articles 1 and 6 of the MMF Regulation, given that in case of any future potential systemic crisis, it should be clear which types of funds are captured by the requirements of the MMF Regulation.

Q13: Do you agree with the above assessment on the potential need of further clarification of the requirements of articles 1 and 6 of the MMF Regulation? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

3 Annex

Summary of questions

Q1: i) Do you agree with the above assessment of the difficulties faced by MMFs during the COVID-19 March crisis? Do you agree with the identification of vulnerabilities? ii) What are your views in particular on the use of MMF ratings by investors? Are you of the view that the use of such ratings has affected the behaviors of investors during the March crisis?

Q2: i) Do you agree with the above assessment on the potential MMF reforms related to the review of the MMF Regulation? ii) What are your views on the abovementioned assessment of the interaction between potential MMF reforms and the behaviour of investors during the MMF March 2020 crisis?

Q3: Do you agree with the above assessment of the i) potential need to decouple regulatory thresholds from suspensions/gates and the corresponding proposals of amendment of the MMF Regulation ii) potential reforms of the conditions for the use of redemption gates? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

Q4: i) **Do you agree with the above assessment of the potential need to require MMFs to use swing pricing and / or ADL / liquidity fees and the corresponding proposal of amendment of the MMF Regulation (including the above list of corresponding potential benefits and drawbacks)? ii) If you are of the view that swing pricing might not be workable for certain types of MMFs, which instruments would you suggest as an alternative for these types of MMFs going forward? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.**

Q5: i) Do you agree with the above assessment of the potential need to increase liquidity buffers and/or make them usable/countercyclical and the corresponding potential proposal of amendment of the MMF Regulation? ii) With respect to option 1 above, views are sought in particular on the relevant threshold (on the size of redemptions) from which WLA would need to be automatically adjusted. When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

Q6: What are your views on the potential need to eliminate CNAV and LVNAV funds, in light of the recent market developments, and the corresponding potential proposal of amendment of the MMF Regulation? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

Q7: What are your views on the extent to which Article 35 of the MMF Regulation should be i) clarified ii) amended? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

Q8: i) Do you agree with the above assessment of the potential need to assess the role of MMF ratings in light of the difficulties faced by MMFs during the March crisis, and the

potential need to introduce regulatory requirements for MMF ratings? ii) In your view, based on your experience, what are the benefits of MMF rating from investors' perspective, having in mind that rules applying to MMFs are already very stringent? What would be the likely consequence on investors from the downgrade of one or several MMFs? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

Q9: Do you agree with the above assessment of the potential need to amend the requirements on stress tests included in the article 28 of the MMF Regulation? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

Q10: Do you agree with the above assessment on the potential need to review the reporting requirements under the MMF Regulation? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

Q11: Do you agree with the above assessment of the potential need to include additional requirements in the MMF Regulation, and/or potentially in other types of EU piece of legislation on the disclosure of money market instruments (MMIs) and main categories of investors to regulatory authorities (e.g. detailed information on liabilities)? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.

Q12: i) Do you agree with the above assessment on the potential creation of a LEF? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80. ii) Several open questions related to the creation of the LEF, on which ESMA would specifically welcome feedback from stakeholders, include:

- **What should be the appropriate size of such a pooling vehicle as the LEF?**
- **In terms of funding, how much MMF would have to pay each year to participate in the pool? How much of the funding would/should be provided by other sources?**
- **How long would it take to establish such a LEF?**
- **Under which conditions would the LEF be activated?**
- **Who would be responsible for activating the LEF**

Q13: Do you agree with the above assessment on the potential need of further clarification of the requirements of articles 1 and 6 of the MMF Regulation? When you answer this question, please also take into account the grid of criteria listed in paragraphs 76 to 80.