Response form for the Consultation Paper on the EU Money Market Fund Regulation – legislative review

29 March 2021

European Securities and Markets Authority

Date: 29 March 2021

Responding to this paper

ESMA invites responses to the questions set out throughout this Consultation Paper and summarised in Annex 3. Responses are most helpful if they:

1. respond to the question stated and indicate the specific question to which they relate;

2. contain a clear rationale; and

3. describe any alternatives ESMA should consider.

ESMA will consider all comments received by **Wednesday 30th June 2021.**

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

Instructions

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the steps below when preparing and submitting their response:

4. Insert your responses to the consultation questions in this form.

5. Please do not remove tags of the type <ESMA_QUESTION_MMFR_1>. Your response to each question has to be framed by the two tags corresponding to the question.

6. If you do not wish to respond to a given question, please do not delete it but simply leave the text "TYPE YOUR TEXT HERE" between the tags.

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

8. Upload the form containing your responses, in Word format, to ESMA's website (www.esma.europa.eu under the heading 'Your input – Open consultations' → 'Consultation on EU Money Market Fund Regulation – legislative review').

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. If you do not wish for your response to be publicly disclosed, please clearly indicate this by ticking the appropriate box on the website submission page. 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.

General information about respondent

Name of the company / organisation	Investment Company Institute/ICI Global
Activity	Global Trade Association
Are you representing an association?	☒
Country/Region	United States of America

Introduction

Please make your introductory comments below, if any:

<ESMA_COMMENT_MMFR_1>
The Investment Company Institute (ICI), including ICI Global,[1] appreciates the opportunity to provide its views on the European Securities and Markets Authority Consultation Report on EU Money Market Fund Regulation—Legislative Review. Individuals and institutions rely on the $8.5 trillion global money market fund industry as a low cost, efficient, transparent, cash management vehicle that offers market-based rates of return.[2] Money market funds also are an important source of direct financing for governments, businesses, and financial institutions, and of indirect financing for households. Without money market funds, governments, institutions, and individuals would need to seek more expensive, less transparent, and less efficient forms of financing.

The reform option presented in the consultation document that has the most potential for addressing ESMA and other policymakers' concerns while preserving key characteristics of money market funds is removing the tie between money market fund liquidity and fee and gate thresholds. The regulatory tie between liquidity and fee and gate thresholds made money market funds more susceptible to financial market stress in March 2020 and would likely do so in future periods of stress. ICI's data supports the conclusion that this regulatory tie was likely a dominant trigger for redemptions as opposed to the conditions or structure of the funds. On the other hand, reforms such as swing pricing or the option to eliminate constant net asset value (CNAV) funds (*i.e.*, require all money market funds to float their net asset values (NAVs)) are reforms with significant drawbacks, ranging from potential detrimental impacts on money market funds, their investors, and the market to regulatory, structural, and operational barriers to implement.

ICI and its members are committed to working with international policymakers to strengthen the money market fund industry for the benefit and further protection of investors and the performance of broader financial markets and the economy more generally. Although many of our responses are mainly based on the experiences of US money market funds during the COVID-19 crisis, we hope they will still be helpful to ESMA as it considers how best to advance toward this important policy goal.

<ESMA_COMMENT_MMFR_1>

[1] The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$30.8 trillion in the United States, serving more than 100 million US shareholders, and US$9.7 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in Washington, DC, London, Brussels, and Hong Kong.

[2] Data as of March 2021, *see* International Investment Funds Association (IIFA). Total net assets broken down by region include, $4.7 trillion in Americas, $1.7 trillion in Europe, and $2.0 trillion in Asia-Pacific. ICI compiles worldwide regulated open-end fund statistics on behalf of the IIFA.

1. 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?

<ESMA_QUESTION_MMFR_1>

(i) The March 2020 liquidity crisis placed severe strains on and impaired the functioning of the short-term funding markets. Indeed, during the March 2020 "dash for cash," *all* investors—not just US prime and European non-public debt money market funds—were scrambling for liquidity and were forced to navigate the resulting stress in the short-term funding markets, including the commercial paper market. Based on iMoneyNet data, US dollar denominated (USD) money market funds domiciled in Europe held an estimated $135 billion in USD commercial paper,[3] representing 12 percent of the $1.1 trillion in USD outstanding commercial paper at the end of February 2020.[4] Altogether, US prime money market funds (public institutional, non-public institutional, and retail) and European USD money market funds held $459 billion in USD commercial paper, representing a "market footprint" of 40 percent of outstanding commercial paper at the end of February 2020. Entities that are not money market funds held the remainder (60 percent), which means that although an important source of financing, money market funds are not the only participants in the short-term funding markets.

According to the Securities and Exchange Commission's Form N-MFP data, US prime money market funds held a modestly higher share of outstanding USD financial commercial paper than overall USD commercial paper (financial, nonfinancial, and asset-backed) in February 2020. US prime money market funds held $203 billion in financial commercial paper, representing 36 percent of the $562 billion in outstanding financial commercial paper, only modestly higher than their 29 percent share of overall outstanding commercial paper. ICI was unable to find publicly available data on European USD money market funds' holdings of financial and foreign financial commercial paper.

US prime money market funds, in aggregate, did not pull back significantly from the commercial paper market before the Federal Reserve's Money Market Mutual Fund Liquidity Facility (MMLF) was announced on March 18, 2020. Indeed, US public institutional and retail prime money market funds reduced their overall holdings of commercial paper by only $6.2 billion (a $5.6 billion reduction in nonfinancial and financial commercial paper holdings and a negligible $600 million reduction in asset-backed commercial paper holdings) in the week before the MMLF was announced. The $5.6 billion reduction accounted for just 19 percent of the reduction in financial and nonfinancial commercial paper outstanding during the week-ended March 18, meaning that 81 percent of the decline is attributable to entities that are *not* US prime money market funds. According to ICI's data, prime money market funds sold $23 billion in commercial paper from March 19 through March 24 to banks that ultimately pledged the commercial paper as collateral to the MMLF. These sales, which were primarily for the purpose of accessing the liquidity offered through the MMLF to keep the level of their weekly liquid assets well above 30 percent, did not add to market stress. In fact, the Federal Reserve explicitly noted that sales to the MMLF helped relieve stresses in the short-term funding markets.[5]

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[3] Data from iMoneyNet include UCITS money market funds that are both domiciled in Ireland, Luxembourg, and the United Kingdom and are members of the Institutional Money Market Funds Association (IMMFA).

[4] *See* Board of Governors of the Federal Reserve System (US), Commercial Paper Outstanding [COMPOUT], retrieved from FRED, Federal Reserve Bank of St. Louis.

[5] For a detailed discussion of ICI's research of the March 2020 events and the role of money market funds, *see* comment letters on the President's Working Group (PWG) Report on Money Market Funds from Eric J. Pan, President and CEO, Investment Company Institute, to Vanessa Countryman, Secretary, US Securities and Exchange Commission (April 12, 2021), Section 4, available here; (May 12, 2021) available here; and (June 3, 2021) available here.

Similar to US prime money market funds, European USD money market funds modestly reduced their commercial paper holdings prior to the Federal Reserve's MMLF announcement. According to iMoneyNet, commercial paper holdings of European USD money market funds fell by $9.7 billion from March 6 to March 13, 2020 and by an additional $7.8 billion from March 13 to March 20, 2020. It wasn't until *after* the Federal Reserve calmed and unlocked the short-term funding markets through the MMLF that European USD money market funds substantially reduced their commercial paper holdings—$27.0 billion from March 20 to March 27, 2020.

It is therefore inaccurate to assume that money market funds caused the short-term funding markets, and in particular, the commercial paper market, to freeze up in advance of the Federal Reserve's announcement of the MMLF on March 18. Indeed, even as US prime money market funds experienced substantial outflows in the week before the MMLF was announced, they continued to make gross purchases of commercial paper, although tilting them increasingly toward overnight issuances to build liquidity. Rather, the regulatory tie between weekly liquid assets and fees and gates made US prime money market funds *less resilient* to redemptions and *more dependent* on financial intermediaries. ESMA, itself, acknowledges that the COVID-19 crisis revealed reluctance or inability by certain banks to act as dealers in such circumstances, which in turn "amplified the stress on the market."[6] We wholeheartedly agree with ESMA's observation that "the limited capacity of banks to act as dealers" was a key element and that 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" to improve the functioning of the short-term funding market.[7]

<ESMA_QUESTION_MMFR_1>

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?

<ESMA_QUESTION_MMFR_2>
See responses to Questions 3, 4, 5, 6 and 12.
<ESMA_QUESTION_MMFR_2>

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.

<ESMA_QUESTION_MMFR_3>
(i) We support a reform that would remove the tie between the 30 percent weekly liquid asset threshold and the imposition of fees and gates (also known as suspension of redemptions). The regulatory tie between liquidity and fee and gate thresholds made money market funds more susceptible to financial market stress in March 2020 and would likely do so again in future periods of stress. ICI's data on US money market funds supports the conclusion that this regulatory tie was likely a dominant trigger for redemptions as opposed to the conditions of the funds.[8] Given that investors could not predict how a fund board might

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[6] ESMA Report at paragraph 34.

[7] *Id.* at paragraph 37.

[8] For information on ICI's data showing that by mid-March 2020 institutional investors accelerated their redemptions for those prime money market funds that started *approaching* (*not reaching*) the 30 percent weekly liquid asset threshold because they feared the

act if the fund reached this threshold, the 30 percent weekly liquid asset requirement in effect became a hard liquidity floor rather than a liquidity cushion to absorb higher-than-usual redemptions, as it was meant to be.[9]

(ii) ICI members report that investors view access to their money as paramount during a period of market stress and are less concerned with “losing a few pennies” through, for example, a fee. ICI therefore believes that redemption gates should be limited to extraordinary circumstances that present a significant risk of a run on a fund and potential harm to shareholders, such as when a money market fund intends to suspend redemptions to facilitate an orderly liquidation of the fund.[10]
<ESMA_QUESTION_MMFR_3>

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.

<ESMA_QUESTION_MMFR_4>
ICI does not support swing pricing for money market funds. Importantly, swing pricing is not necessary for money market funds because they already have extensive tools at their disposal, such as liquidity fees (or anti-dilution levies), which serve a similar purpose and are more appropriate tools for money market funds. Swing pricing also is particularly challenging for money market funds that include key features, such as pricing multiple times per day and same-day (T+0) settlement. These essential features allow money market fund shareholders to sell shares and receive the proceeds from their redemptions on the same day, often within hours—features that are critical for corporations, government entities, not-for-profits, and other institutional investors to effectively and efficiently manage their day-to-day operating cash, meet payroll and other liabilities, and maintain appropriate levels of liquidity on a daily basis. Forcing funds to give up these features would fundamentally change the nature of the funds and their utility to investors.[11] Indeed, because receipt of shareholder flow information is fundamental to determining first whether the swing threshold has been crossed and then to swing the NAV on any given day, it is unlikely most money market funds could gather this information before the NAV calculation process and still have sufficient time to calculate and apply a swing pricing mechanism multiple times a day and/or accommodate T+0, including the transmittal of redemption proceeds to institutional investors.[12]
<ESMA_QUESTION_MMFR_4>

potential imposition of fees or gates, *see* Letter on the President’s Working Group Report on Money Market Funds from Eric J. Pan, President & CEO, Investment Company Institute, to Vanessa Countryman, Secretary, US Securities and Exchange Commission (April 12, 2021), Section 3.1.1.

[9] For more discussion on why ICI believes removing the tie between money market fund liquidity and fee and gate thresholds is a reform option that holds the most potential for addressing policymaker’s concerns with the least negative impact, *see id.*

[10] For example, US Rule 22e-3 under the Investment Company Act of 1940 permits a money market fund to suspend redemptions only to facilitate an orderly liquidation of the fund.

[11] For a discussion of the NAV calculation process for all floating NAV funds in the United States, including institutional prime money market funds, *see* Letter on the President’s Working Group Report on Money Market Funds from Eric J. Pan, President & CEO, Investment Company Institute, to Vanessa Countryman, Secretary, US Securities and Exchange Commission (April 12, 2021), Section 3.2.1. For a discussion regarding how the industry distribution model and the use of intermediaries in the United States complicates the use of swing pricing, *see* Investment Company Institute, “Evaluating Swing Pricing: Operational Considerations (November 2016).

[12] As policymakers consider the feasibility of swing pricing for money market funds, it is important to recognize that the NAV calculation process and the use of intermediaries differs among jurisdictions.

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.

<ESMA_QUESTION_MMFR_5>

ICI believes a countercyclical weekly liquid asset requirement is unlikely to address the liquidity-related stresses that were evident in March 2020. Under this requirement, the current liquidity thresholds could automatically decline in certain circumstances, such as when net redemptions are large or when the regulatory authority provides temporary relief from weekly liquid assets requirements. Any thresholds linked to a fund's minimum weekly liquid asset requirements (*e.g.*, fees or gate thresholds) also would move with the minimum. Current money market fund rules do not preclude funds from using weekly liquid assets to meet redemptions or prohibit funds from falling below the 30 percent thresholds. Indeed, in the United States, ICI data shows that before the SEC's 2014 reforms that tied a fund's ability to impose a fee or gate to the weekly liquid asset thresholds (which were first added to Rule 2a-7 in 2010), money market funds regularly dipped below 30 percent without raising questions about the resiliency of the funds.[13] Thus, at that time, money market funds in effect could already avail themselves of a countercyclical liquidity buffer. In March 2020, money market funds were not able to use their weekly liquid assets to meet redemptions because investors feared the mere possibility of fees or gates if a fund dipped below 30 percent (and not because rules precluded funds from using this liquidity). We therefore do not believe this reform will improve the usability of weekly liquid asset requirements.

<ESMA_QUESTION_MMFR_5>

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.

<ESMA_QUESTION_MMFR_6>
ICI is highly skeptical that requiring all money market funds (such as retail prime in the United States and LVNAV funds in Europe) to float their NAVs would reduce risks in any meaningful way. A floating NAV did not stop heavy redemptions in March 2020 for US institutional floating NAV prime money market funds or certain European VNAV money market funds. Indeed, the other features of these funds and the nature of the short-term funding market itself still make certain money market funds susceptible to sudden, high redemption requests.

First, a floating NAV does not alter investors' views about whether money market funds are low risk-investments. Under normal conditions, the shadow prices of stable (constant) NAV money market funds and the market prices of floating NAV money market funds' portfolios generally deviate very little from $1.00. This is simply a reflection of the fact that all money market funds invest in very short-term, high-quality, fixed-income securities and the price of these securities deviates little from their amortized cost value absent a large interest rate movement or credit event. Regardless of their valuation method, money market funds continue to be exposed to interest rate and credit risk. When risk intolerant investors seek to move away from certain funds or broad sectors of the markets during future crises, the transition would continue to be potentially disruptive.

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[13] *See* Letter on the President's Working Group Report on Money Market Funds from Eric J. Pan, President & CEO, Investment Company Institute, to Vanessa Countryman, Secretary, US Securities and Exchange Commission (April 12, 2021), Section 3.1.1.

Moreover, the short-term funding market itself historically is susceptible to liquidity pressures. Lenders in this market typically need ready access to their cash and have a low tolerance for financial risk. Borrowers depend on these markets to meet their immediate funding needs. Rollover issuances are a very high percentage of the outstanding short-term securities. During periods of financial stress, risk intolerant investors can and do move quickly out of the markets, leaving large supply and demand imbalances, which can cause volatility in short-term interest rates.

The combination of these factors results in the short-term funding market and money market funds operating for long periods of time in relative tranquility punctuated by stress events. Investors' desire to have exposure to the short-term funding market, either directly or through money market funds, declines during these periods of stress. Floating the NAV of all money market funds would not reduce the likelihood of investors wanting to move away from the short-term funding market during these events.

<ESMA_QUESTION_MMFR_6>

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.

<ESMA_QUESTION_MMFR_7>

<ESMA_QUESTION_MMFR_7>

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.

<ESMA_QUESTION_MMFR_8>

<ESMA_QUESTION_MMFR_8>

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.

<ESMA_QUESTION_MMFR_9>

<ESMA_QUESTION_MMFR_9>

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.

<ESMA_QUESTION_MMFR_10>

<ESMA_QUESTION_MMFR_10>

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.

<ESMA_QUESTION_MMFR_11>

<ESMA_QUESTION_MMFR_11>

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:

1. **What should be the appropriate size of such a pooling vehicle as the LEF?**
2. **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?**
3. **How long would it take to establish such a LEF?**
4. **Under which conditions would the LEF be activated?**
5. **Who would be responsible for activating the LEF**.

<ESMA_QUESTION_MMFR_12>
Over ten years ago, ICI developed a preliminary framework for a private liquidity facility, including how it could be structured, capitalized, governed, and operated.[14] Our framework also described many drawbacks, limitations, and challenges to creating a private liquidity facility, including its substantial initial and ongoing costs and vast regulatory complexity. In 2014, the SEC adopted different money market fund reforms, including a floating NAV requirement for all prime and tax-exempt money market funds sold to institutional investors and new fee and gate tools for all prime and tax-exempt money market funds, including retail funds. As a result of those reforms, the prime money market fund industry, including the number of prime fund sponsors, substantially shrunk. When we originally considered a liquidity facility in January 2011, prime money market funds' assets totalled $1.6 trillion and there were 105 prime fund sponsors. Today, the US prime money market fund industry is vastly more concentrated—with total net assets of $503 billion among just 26 sponsors as of April 30, 2021. Given the significant costs and other challenges of establishing a viable liquidity facility that could provide meaningful liquidity for money market funds in stress events, ICI members have indicated that they would simply stop sponsoring money market funds if membership to a liquidity facility was required.
<ESMA_QUESTION_MMFR_12>

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.

<ESMA_QUESTION_MMFR_13>

<ESMA_QUESTION_MMFR_13>

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[14] For details regarding the proposed liquidity facility, including its estimated costs and challenges, *see* Letter from Paul Schott Stevens, President & CEO, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (January 10, 2011) (comment letter to the 2010 President's Working Group Report on Money Market Fund Reform Options (File No. 4-619).