



**IMMFA Response to the European Commission's targeted consultation 'Assessing the adequacy of macroprudential policies for NBFIs'**  
**Dated 19 November 2024**

On behalf of the European short term money market fund industry, IMMFA welcomes the opportunity to respond to the European Commission's targeted consultation 'Assessing the adequacy of macroprudential policies for NBFIs'.

**Introduction to the Institutional Money Market Fund Association**

The Institutional Money Market Fund Association (IMMFA) is the trade association which represents the European short term money market fund (MMF) industry. IMMFA's mission is to promote and support the development and integrity of the MMF industry by engaging with and informing policy makers and, amongst other things, educating investors and providing a primary point of contact for data and expertise.

IMMFA has 30 members, consisting primarily of asset managers but also custodial banks, credit rating agencies, and technology and other service providers. Of the 30, 17 are asset managers. IMMFA MMF assets under management (AUM) as of 1 November 2024 were EUR1,123bn EUR equivalent. This was comprised almost exclusively of institutional funds, denominated in three main currencies, USD, GBP and EUR, of which USD is the largest (USD650bn), followed by GBP (GBP239bn) and EUR (EUR238bn).

Although the overwhelming majority of IMMFA MMFs are stable NAV in the form of either Low Volatility Net Asset Value (LVNAV) (79%) or Public Debt Constant Net Asset Value (PDCNAV) (18%), many of our members also offer a range of funds including short term and standard Variable NAVs. The overwhelming majority of IMMFA MMFs are domiciled in Ireland and Luxembourg,<sup>1</sup> and are all rated AAA (MMF rating) by one or more authorised credit rating agency.

Funds are distributed globally to a wide range of investors. 77% are sold in Europe.

As of the end of June 2024, the ECB recorded total European MMF assets under management as EUR1,796bn, meaning that IMMFA MMFs (EUR1,040bn equivalent at that time) accounted for 58% of the total market. The balance of the market is dominated by French domiciled standard variable NAV MMFs which are typically unrated.

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<sup>1</sup> Two are in France and one is in the UK.

*All of our responses apply only to the MMF sector. More specially, given the particular characteristics of IMMFA MMFs as outlined above, they apply to IMMFA MMFs.*

## **Summary of Key Positions**

MMFs serve two important economic functions in providing short term funding to a wide range of issuers and a cash management tool for investors. They also act as an essential store for liquidity in the system, a role which has become increasingly important as prudential regulatory reforms have discouraged banks from taking deposits. More recently, moves towards the centralised clearing of derivatives have made the role of liquidity even more prominent.

MMFs have demonstrated resilience through a number of recent stress events during which they have continued to serve their purpose of providing liquidity and preserving capital, whilst also continuing to meet their regulatory objectives. MMFs benefit from robust dedicated regulation in the form of EU Money Market Fund Regulation (MMFR) which has demonstrated its effectiveness in improving resilience and mitigating the risks identified in the consultation.

## **Mitigating key vulnerabilities identified in the report.**

### **1) Liquidity mismatches**

MMFR introduced prescriptive requirements around credit diversification, portfolio duration, minimum liquidity levels and transparency. Structural liquidity buffers already provide a pre-emptive macroprudential tool. The risk of liquidity mismatch in stable NAV MMFs should be further mitigated by decoupling/delinking minimum liquidity thresholds from the potential use of liquidity management tools. This proposal is now globally supported by policy makers and stakeholders.

### **2) Excessive Leverage**

Although a minimal level of leverage is permissible under MMFR, IMMFA MMFs do not use leverage as we do not view it as compatible with the investment objectives of a AAA rated MMF.

### **3) Interconnectedness**

MMFR specifically limited interconnectivity by prohibiting sponsor support. It also imposes portfolio diversification requirements and concentration risk limits which mitigate the risk of interconnectedness.

Interconnectedness arising from the effect of margin calls could be mitigated by facilitating the use of MMFs directly as margin collateral which would reduce procyclical pressure on MMF redemptions.

MMFs do not invest in crypto assets or intermediaries.

The above features mean that the risks which are inherent in many other types of fund or NBFI, and the three key vulnerabilities identified in the report, are already mitigated by the specific requirements of MMFR.

#### **Other questions specific to MMFs**

##### **Reverse Distribution Mechanism (RDM)**

The MMF industry opposed the ban of RDM in 2019. Although interest rates have now normalised and its use is not currently foreseeable, there is no reason from a policy perspective to ban the use of the mechanism.

##### **Current definition of a money market instrument (MMI)**

The current definition is appropriate. In our view it is not practical to require MMIs to be traded on a regulated exchange given the nature of the product and in any case, this would not guarantee secondary liquidity.

##### **Short term funding markets**

We are in favour of measures such as improved transparency and greater standardisation which could improve overall market functionality.

Measures to support the asset backed CP market would be the most effective means of broadening the scope of funding opportunities for smaller issuers. Investing directly in smaller or unrated issuers or start-ups would not be compatible with the objectives and requirements, including regulatory requirements, of an MMF and particularly of a AAA rated MMF.

The key objective should be to facilitate the ability of bank intermediaries to make markets as this would help secondary market activity in a stress event. Here we go further than the consultation invites and propose that the most impact could be achieved by ensuring that all high-quality CP and CDs are made eligible for central bank repo facilities and also be counted towards high quality liquid asset (HQLA) ratios.

##### **Stress testing and Reporting**

An effective and robust stress testing framework specific to MMFs is already in place and is updated annually by ESMA.

MMFR currently requires reporting on a quarterly basis, but national competent authorities (NCAs) already have the ability to ask for more frequent data should it be deemed necessary.

We recommend that the existing exhaustive approach to data reporting be simplified to encapsulate a more targeted set of meaningful metrics which could be equally



valuable in identifying risks. We would be pleased to work with the authorities in achieving this.

**Supervision**

Regulatory coordination should be finessed through incremental steps rather than a fundamental shift in supervisory powers.

Supervisory powers should be applied consistently across asset managers irrespective of size.

We look forward to engaging further with the European Commission on these matters.

**Question 1.** Are there other sources of systemic risks or vulnerabilities stemming from NBFIs' activities and their interconnectedness, including activity through capital markets, that have not been identified in this paper?

*We are confining our responses to MMFs. In our view, the extent to which MMFs are a source of systemic risk and vulnerabilities has already been the subject of considerable focus and exhaustive analysis since the events of March 2020. There are no other risks associated with MMFs that we are aware of. MMFs have demonstrated a high level of resilience during recent stress events and are already highly transparent to both investors and regulators.*

MMFs are subject to specific regulation introduced under the EU 2017/1131 Money Market Fund Regulation (henceforward referred to as MMFR) in 2017 which introduced prescriptive requirements on daily and weekly liquidity *minima*, portfolio composition, reporting and transparency. The portfolio composition requirements include rules on eligible assets, maturity and duration of assets, diversification and the credit quality of investments as well as the credit process.

In their review of the adequacy of MMF Regulation published in July 2023, the Commission recognised that MMFR had been effective in 'significantly strengthening the regulatory regime for MMFs'. They concluded that 'MMF Regulation successfully passed the test of liquidity stress during the COVID-19 related market turmoil of March 2020, the recent interest rate increases, and related asset re-pricing'. As the Commission noted, no EU MMF had to introduce redemption fees or gates or to suspend redemptions during those stress events. Neither did they during the more recent UK gilt crisis which occurred in September 2022.

Although much of the wider commentary by some authorities since the events of March 2020 has focused on the help provided by central banks in providing support, the industry as a whole (not just IMMFA) has emphasised that although intervention was successful in stabilising the broader markets, the extent to which EU MMFs were able to take advantage of asset purchase programmes was extremely limited given the nature of their asset base, the vast majority of which were financial issuers that did not qualify.

We would therefore reiterate that MMFs have demonstrated a high level of resilience and are already highly transparent to both investors and regulators.

All IMMFA MMFs have a AAA MMF rating from one or more authorised credit rating agency, and they do not employ leverage. The rating considers their ability to preserve capital and provide liquidity. No IMMFA MMF or any other MMF that we are aware of has been downgraded during recent stress events.

Contrary to what the report suggests (p.9), stable NAV MMFs did not experience stress levels which were greater than those of variable NAV MMFs. Both Euro denominated VNAVs and US Prime funds, both of which have a variable NAV, experienced substantially similar levels of stress to those experienced by USD LVNAVs.

**Question 2.** What are the most significant risks for credit institutions stemming from their exposures to NBFIs that you are currently observing? Please provide concrete examples.

*Risks to credit institutions from MMFs are very limited as they have little direct exposure. Direct support by a fund sponsor is prohibited under MMFR.*

According to the ESRB's latest NBFI Monitor, banks 'play only a minor role as holders of investment funds, accounting for 1% of investors in MMFs'.<sup>2</sup> Where financial institutions are buying, these are typically banks buying in nominee format on behalf of underlying clients, not directly for their own ownership.

Credit institution exposure is further limited by MMFR which prohibits direct support by the sponsor of an MMF (see more detail below).

As IMMFA MMFs do not borrow and are not leveraged there is no other direct exposure.

MMFs themselves have large exposures to credit institutions as buyers of highly rated short-term debt issued by credit institutions. Credit institutions using the Commercial Paper (CP) or Certificate of Deposit (CD) markets to fund therefore have indirect exposure in terms of *funding risk* which we discuss in question 3 below.

**Question 3.** To what extent could the failure of an NBFI affect the provision of critical functions to the real economy or the financial system that cannot easily be replaced? Please explain in particular to which NBFI sector, part of the financial system and critical function you refer to, and if and how you believe such knock-on effect could be mitigated.

*MMFs act as key intermediaries in the financial system, providing valuable short-term funding to a wide range of issuers including credit institutions which in turn lend to the real economy. Temporary disruption to the CP/CD market should be manageable for such issuers who do not rely exclusively on the CP/CD market and typically have access to alternatives sources. .*

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<sup>2</sup> ESRB NBFI Monitor no.9, June 2024, page 21



MMFs are, in particular, large buyers of short-term issuance from credit institutions. In a stress event, MMFs have a fiduciary duty to act in the best interest of their shareholders. This is likely to mean that if liquidity is scarce, they will first service redemptions and then maintain or build liquidity. This may be done by investing only in shorter assets (e.g., overnight deposits/reverse repo), not rolling over assets such as CP or CDs or renewing that CP/CD to a shorter maturity.

Post 2008 prudential reforms aimed to ensure that banks do not rely excessively on short-term funding, including that provided by the CP and CDs. This tempers the impact on bank funding in the event that these markets are temporarily disrupted. In a stress event, however, banks may nevertheless decide to retrench their balance sheets as funding, including that provided by MMFs, becomes scarcer and more expensive. Banks may also, as happened in the March 2020 crisis, have to preserve their balance sheets for committed loans which are likely to be drawn down as other uncommitted sources of liquidity, such as CP, become unavailable to their clients. In such a case, as we saw, this may limit the ability of banks to commit capital to intermediation in the CP/CD markets

It is important to note that in such a stress scenario, MMFs will not be the only factor limiting market liquidity and that a well-managed credit institution will have other sources of funding, including access to emergency facilities intended for such a market-wide event. Therefore, although the fact that MMFs may not necessarily renew a maturing asset, this will likely have a limited impact on credit institutions and should be seen in the context of what would likely be a broader liquidity squeeze *originating outside MMFs*.

### **Risk Mitigation**

The Commission's report on the adequacy of the MMFR from a prudential and economic point of view, published in July 2023 following its review of MMFR, concluded that the regulation had successfully passed the test of liquidity strains of recent stress events including the COVID-19 turmoil. It did however identify shortcomings, including the existing provisions which link a breach of minimum liquidity requirements to the possible imposition of fees and gates which applies in the case of stable NAV MMFs, i.e. Low Volatility Net Asset Value (LVNAV) and Public Debt Constant Net Asset Value (PDCNAV) MMFs. The Commission noted that decoupling fees and gates from liquidity requirements would improve MMF resilience.

Decoupling (also referred to as delinking) would remove the tie between minimum liquidity thresholds and the possible imposition of fees and gates. This will make liquidity more available to MMFs by allowing them to use their liquidity buffers when needed, as we believe was originally intended.

The recently completed review of AIFMD UCITS Directives regarding the use of Liquidity Management Tools (LMTs) will also benefit MMF resilience, providing clarity to investors and managers with respect to the use of LMTs which should be applied at the discretion of the fund manager and in the best interest of investors.

With respect to broader measures which could mitigate risks from the NBFIs sector, the Bank of England Contingent NBFIs Repo Facility is an example of how authorities could mitigate risk by providing a structural solution in the event that normal market functioning breaks down. Although the Bank of England make clear that NBFIs should first and foremost be responsible for liquidity risk, they also acknowledge that this may not be feasible in an extreme market event. It is important to note that the facility is limited to pension funds, insurance companies and liability driven investments funds enabling them to borrow against gilts and is not offered to MMFs. We cite it only as an example of contingency planning to mitigate knock on effects, as per the question.

**Interconnectedness is limited**

MMFR mitigated interconnectedness between bank sponsors and their funds by introducing rules which explicitly prohibit sponsor support with the intent of guaranteeing liquidity or stabilising the NAV per unit or share price (Article 35). This provision was introduced to limit the contagion risk between an MMF and a bank sponsor.

**Question 4.** Where in the NBFIs sectors could systemic liquidity risk most likely materialise and how? Which specific transmission channels of liquidity risk would be most relevant for NBFIs? Please provide concrete examples.

*MMFs become more subject to redemptions during periods of market volatility when investors redeem cash to meet margin calls. Facilitating the use of MMFs as margin collateral would mitigate the risk of procyclical pressure.*

As regulatory reforms aimed at reducing counterparty risk have encouraged a move towards central clearing and collateralised trading, the role of liquidity has become ever more important. At the same time, prudential reforms have significantly suppressed bank appetite for short term deposits which has encouraged the use of MMFs as a means of managing short-term cash. Consequently, MMFs now play a more important role in cash management and the movement of liquidity around the system.

MMFs served a vital function in providing liquidity during the recent liquidity stress events including the March 2020 ‘dash for cash’ and the September 2022 turmoil in the UK gilt market. On both occasions, as market volatility led to spikes in margin collateral calls, there was an observable correlation in MMF flow activity in terms of, initially, more redemptions as margin sensitive investors redeemed MMF investments to post cash collateral. On both occasions, outflows were swiftly followed by



substantial inflows, with a brief period of elevated redemptions reflecting market volatility. This was followed by sustained subscriptions directly thereafter once markets stabilised, resulting in AUM fully recovering going on to exceed pre crisis levels.

In many cases, cash needed for collateral is redeemed from MMFs only to be reinvested into MMFs or a very similar money market assets when posted. Enabling MMFs to be posted directly as margin collateral would mitigate this procyclical pressure and thereby contribute to overall systemic resilience.

IMMFA responded to the FSB's June 2024 consultation report on 'Liquidity Preparedness for Margin and Collateral Calls' recommending that authorities consider facilitating the use of MMFs as margin collateral for this reason. The ability to tokenise MMFs will make them more portable, removing some of the operational barriers, but regulatory obstacles remain.

**Question 5.** *Where in the NBFi sectors do you see build-up of excessive leverage, and why? Which NBFIs could be most vulnerable? Please provide concrete examples.*

*IMMFA MMFs are not leveraged. As noted in the ESRB's Monitor, MMFs have 'unlikely or insignificant engagement' with leverage.<sup>3</sup>*

A *very limited* use of repurchase agreements is permissible under MMFR Article 14 which states that repurchase shall only be eligible if used on a temporary basis, for no more than seven working days, only for liquidity management purposes and not for investment purpose except in certain eligible assets, can be terminated by the MMF within two days and do not exceed 10% of assets.

IMMFA MMFs do not use leverage. Although permissible, the lending of assets would be incompatible with investor expectations of a AAA rated MMF whose objectives are to preserve capital and provide liquidity.

(The use of *reverse* repurchase where an MMF *receives* assets is treated separately under MMFR. It does not increase leverage).

**Question 6.** *Do you observe any systemic risks and vulnerabilities emerging from crypto assets trading and intermediaries in the EU?*

*MMFs do not invest in crypto assets or intermediaries.*

MMFR introduced strict limits intended to limit investment risk in MMF portfolios. Such assets would not be compatible with the primary objectives of an MMF which are to preserve capital and to provide liquidity.

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<sup>3</sup> NBFi Monitor, as above, page 25

**Question 7.** Considering the role NBFIs have in providing greater access to finance for companies and in the context of the capital markets union project, how can macroprudential policies support NBFIs' ability to provide such funding opportunities to companies, in particular through capital markets? Please provide concrete examples.

*Policies which support the asset backed commercial paper (ABCP) market could help broaden funding opportunities for companies including small and medium sized enterprises (SMEs).*

Like other NBFIs, MMFs now play an important role in financing real economic activity both by providing short term funding and offering a valuable cash management tool.

More specifically, MMFs play a vital role in providing short-term finance through their purchases of short-term debt in the form of Euro Commercial Paper (ECP) and Certificates of Deposit (CDs) and in some cases other assets such as Floating Rate Notes (FRNs), Euro Medium Term Notes (EMTNs), issued by both financial and non-financial institutions, as well as governments, agencies and supra-nationals.

Due to demand from MMFs and other investors, Commercial Paper (CP) in its various forms has become a very important asset class. The European CP market, currently estimated to be over USD1 trillion, has been very successful and has become a vital source of funding to a wide range of issuers, offering flexible and cost-efficient short-term funding.

CP issuance in Europe continues to be dominated by financial institutions for a number of reasons, but in particular the lack of supply of non-financial alternatives. This is because very few non-financial issuers meet the size and credit quality criteria of large investors. MMFs, like the overwhelming majority of money market investors, are seeking a high level of security (i.e., low risk) and a high degree of liquidity for their investments. This means they prefer to (or indeed, for regulatory reasons, have to) buy paper issued by highly rated issuers. The exception to this may be that non IMMFA unrated MMFs may buy unrated issuers who are 'household names', as may happen in domestic markets. In the broader (i.e., not domestic) markets, the requisite size and credit quality criteria are almost exclusively met by large, highly rated issuers such as banks or governments and supranational/ agency issuers and a relatively small number of large non-financial issuers.

MMFR sought to limit the credit risk taken by MMFs by introducing prescriptive rules around portfolio quality, weighted average maturity, weighted average life and also concentration and diversification. Hence, MMFs invest only in the highest quality assets. They are also required to diversify their portfolios, including limiting how much of an individual programme's outstanding issuance that they own (Article 18) . The CP

market has a finite supply of highly rated non-financial issuers, and few are large, frequent issuers in the market. Smaller, lower rated non-financial issuers are therefore unlikely to meet the strict investment criteria of a AAA rated MMF.

Whilst MMFs would naturally seek to diversify as much as possible through exposure to non-financial sectors, their ability to do so is constrained by lack of supply of suitable issuers. Funding smaller unrated issuers such as startups would not be compatible with the objectives of a short term MMF and would be very difficult to reconcile with the portfolio requirements of MMFR.

With respect to the Commission's objective of broadening funding for SMEs and startups in the context of capital markets union, we would suggest the following. For the reasons given above, MMFs are not an appropriate source of direct funding. However, for small or medium sized issuers who require short term financing, for instance to finance receivables or predictable cash flows, Asset Backed Commercial Paper (ABCP) vehicles provide a possible alternative. Because ABCP is highly rated and the investor typically has recourse to the sponsor bank, ABCP is considered an attractive investment by many MMFs.

We would therefore be very supportive of policies which encouraged the ABCP market as a method of providing market-based financing to small and medium sized companies.

Policies which support the better functioning of the Short-Term Funding Markets (STFMs), including those which encourage more transparent and harmonised CP markets across jurisdictions, could also help towards a strong capital markets union. We discuss this in more depth below.

### **Supervisory powers**

**Question 8.** What are pros and cons of giving the competent authority the power to increase liquidity buffer requirements on an individual or collective basis in the event of system-wide financial stability risks? Under which other situation do you believe MMF liquidity buffers should be increased on an individual or collective basis by the competent authority? Please explain.

*An increase would be highly counterproductive if introduced in response to a stress event. MMFs have demonstrated their resilience during various stress events, and on this basis, we would argue that there is no case for an increase in buffers. Delinking will significantly improve the availability of existing buffers.*

*We think there would be significant challenges around the effectiveness of managing dynamic supervisory buffers across countries, different national competent authorities (NCAs) and varying fund types. Establishing predetermined, unchanging minimum*

*required levels, as is currently the case under MMFR, provides clarity to investors and managers.*

The question appears to suggest that competent authorities (CAs) should be empowered to increase liquidity buffers in response to a specific stress event. This would be highly counterproductive as it would have the procyclical effect of adding to liquidity strains. See our response to this in the final paragraphs of this section.

If however, we take the question to refer to the proposition that ESMA and the competent authorities exercise their power in a way which mirrors their intervention powers under AIFMD Article 25, including a need to temporarily reduce buffers in the event of a liquidity crisis, the suggested powers would effectively create what has previously been referred to as dynamic or countercyclical buffers.<sup>4</sup> Our view is that there would be significant challenges around the effectiveness of managing dynamic supervisory buffers across different countries, different national competent authorities and varying fund types. We are also opposed to dynamic buffers on the basis that NCAs are unlikely to be able to act on a sufficiently timely basis in a fast-moving crisis when real-time information is crucial.

Furthermore, allowing an NCA to alter MMF liquidity buffers should not be compared to the imposition of leverage limits as utilised under Article 25 of AIFMD. Even allowing for differences between fund types, MMFs are a relatively homogenous fund group, serving a far wider investor base than the more heterogeneous, far less transparent and sometimes 'niche' leveraged fund strategies. This is the basis of the dedicated MMF regulation and the reason why that regulation has proven largely successful in mitigating risks specific to MMFs.

Establishing predetermined, unchanging minimum required daily and weekly liquidity levels, as is currently the case under MMFR, provides clarity to investors and managers. The weekly liquid asset (WLA) level in particular is highly transparent to investors and provides a very useful metric with which they are highly familiar. Giving CAs the power to increase buffers on either an individual or collective basis would, in contrast, be confusing and complicated.

Collective intervention by a CA risks being negatively interpreted by the market and by shareholders who may be incentivised to redeem, creating a first mover advantage and contagion risk. If conducted at an individual fund level it would be very hard to achieve confidentiality.

In our view, it is important that there be a single rule book for MMF minimum liquidity requirements within the EU, regardless of where an individual fund is domiciled. Liquidity requirements should be commensurate with the fund's structural features.

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<sup>4</sup> See FSB Report 'Proposals to enhance MMF Resilience' June 2021, page 35

Introducing an element of dynamic supervisory levels would not be conducive to clarity or consistency. Consistency across borders where funds are distributed today would be helpful to ensure that funds continue to be broadly available for the benefit of investors.

We would, however, recommend that authorities should have a role in normalising the perception that MMF liquidity buffers are there to be used. Supervisory guidance should make clear that MMFs can be expected to use their buffers when in the best interest of investors to do so, as permitted under MMFR. This will help remove any stigma which remains post delinking.

The focus should be on the use of liquidity management tools (LMTs) to mitigate potential risks rather than supervisory intervention. LMTs address the risk of first mover advantage more effectively by reducing the incentive to redeem early and ensuring fair treatment of investors. The AIFMD and UCITS review, which was identified by the Commission as an opportunity to increase MMF resilience, will require MMFs to select at least one LMT by 2026. The review supported the principle that the manager of an OEF should be entrusted with the ultimate responsibility to manage fund liquidity. We would agree that the fund manager is best placed to protect the best interest of investors. Intervention by an NCA would contravene this principle.

***If the question refers to ad hoc powers to increase buffers in the event of system wide risk to stability***

If the question, as it reads, is indeed suggesting that competent authorities should be empowered to *increase* liquidity buffers in response to a specific stress event, we would respond that this would be highly counterproductive given that it is vital that MMFs be able to use their liquidity at such a time. It has been recognised that enabling MMFs to access their liquidity buffers is an important step in mitigating the risk of second order effects and that delinking will help in this regard. *Increasing buffers in response to liquidity strains would only add to pressure.*

Some MMF reform proposals, such as those consulted on by the FSB<sup>5</sup> in June 2021, have included the suggestion that national competent authorities (NCAs) be granted the ability to temporarily **decrease** minimum liquidity requirements in a stress event, thereby enabling funds to use their buffers to meet redemptions and avoid forced asset sales. Our response to previous proposals that NCAs have the ability to **decrease** buffers was that NCAs would be unable to respond on a sufficiently timely basis in a fast-moving crisis. Industry stakeholders, policy makers and regulators have since moved towards a consensus on the delinking of liquidity thresholds from the activation of fees and gates, meaning that stable NAV funds, which are currently

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<sup>5</sup> See FSB extensions and variants ‘authorities approving countercyclical liquidity buffers’, FSB Policy Proposals to Enhance MMF Resilience Consultation Report June 2021 p.35

subject to the link, would have the ability to use their liquidity buffers, negating the need for temporary relief.

**Delinking will significantly increase the availability of liquidity**

As stated above, establishing predetermined, unchanging minimum required levels, as is currently the case under MMFR, provides clarity to investors and managers. However, it was clear during March 2020 that managers did not feel able to use their liquidity buffers during a stress event even though existing regulation allows for it. Hence proposals to delink thresholds from the activation of fees and gates. For delinking to be fully effective, it is vital that funds feel able to use their buffers.

To avoid the 'bright line' created by the link due to concerns about approaching the liquidity threshold, and to make liquidity more usable, we have supported policy proposals to delink regulatory thresholds from the activation of liquidity management tools. This recommendation was identified by the Commission in their report on the effectiveness of MMFR as an area that should be further assessed, with a view to strengthening MMF resilience. As noted above, it is also widely supported by many market stakeholders including practitioners, policymakers and regulators. Delinking has already been enacted in the US and was also proposed by the UK authorities in their Consultation on updating the regime for MMFs.<sup>6</sup> To ensure that delinking is effective, it is crucially important that MMFs have the ability to dip into the liquidity buffers when necessary.

It is vital that the use of buffers be seen as a normal process which helps avoid exacerbating a stress event. CAs will have an important role in communicating and reinforcing this message.

Article 24 of MMFR provides that once a threshold is breached, an MMF may only invest in weekly maturing assets, that is assets which count towards the minimum weekly liquid asset requirement. This ensures that any dip will be corrected, and liquidity replenished as soon as possible. The article also specifies that if any limit is breached 'for reasons beyond the control of an MMF, or as result of the exercise of subscription or redemption rights', that MMF shall adopt correction of the situation as a priority objective (Article 24 (2)).

**Question 9.** [How can ESMA and ESRB ensure coordination and the proper use of this power and what could be their individual roles? Please provide specific examples or scenarios to support your view.](#)

*We do not see a role for ESMA or the ESRB in increasing buffers.*

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<sup>6</sup> FCA CP 23/28 Updating the regime for Money Market Funds, December 2023, question 2.

As per our answer to question 8 above, we think that liquidity buffers should be predetermined and established as they are under the current regulation, rather than subject to variation by and between the competent authorities which would result in inconsistency and lack of clarity. We therefore see no role for ESMA or the ESRB in ensuring proper use of such powers.

One area where a single rule book would be helpful is the accounting treatment of MMFs as cash or cash equivalent. Accounting treatment of MMFs is jurisdiction specific at the moment resulting in inconsistent approaches and outcomes. The VNAV fund type is treated as cash equivalent in France and the USA (where Prime funds have a variable NAV), where the authorities have made clear they should be treated as such. This is not the case in other jurisdictions within Europe.

### **Reporting requirements**

**Question 10.** *In view of the new UCITS supervisory reporting obligations and improvements to AIFMD reporting, how could reporting requirements under the MMFR be aligned, simplified and improved to identify stability risks (such as liquidity risks) and to ensure more efficient data sharing?*

*A simplified reporting framework with more targeted data could provide more effective reporting. It is important to ensure that reporting requirements are interpreted and applied consistently across jurisdictions.*

MMFR reporting is tailored to address the specificities of MMFs. In contrast, the new UCITS supervisory reporting obligations and improvements to AIFMD reporting aim to capture comparable data for a highly heterogeneous group of funds. The two-reporting frameworks fulfil different needs and have two different purposes:

- Providing tailor-made information to capture the specificities of a particular strategy and product for MMFs in the case of MMFR
- Providing comparable, yet detailed, information on a large universe of funds with diverging profiles in the case of the new UCITS and AIFMD reporting framework.

With respect to alignment and simplification of the MMFR and the new requirements under UCITS, we would say the following. Given that the two frameworks serve different purposes, they do not lend themselves readily to alignment. However, where possible, overlap and duplication should be avoided.

The existing quarterly reporting under MMFR is exhaustive and challenging to produce. A simplified and more targeted set of metrics could be equally effective in identifying risks. We would be pleased to work with the authorities in achieving a better balance between meaningful and useful data which can be produced in a timely fashion.



Additionally, with respect to aligning reporting more broadly, MMFR reporting requirements should be interpreted consistently across all MMF jurisdictions.

Article 37 of MMFR currently requires MMFs with assets of more than EUR100m to report on 'at least a quarterly basis'. In addition, NCAs have a tool at their disposal in that the authority can request additional information should they deem it 'necessary and justified' (article (37)(2)(e)), which includes the ability to request information more frequently. Authorities have availed themselves of this tool.

### **Stress testing framework**

**Question 11.** Do you believe that the proposed enhancements to the stress testing framework listed above are sufficient to identify and mitigate liquidity risks effectively? If not, what specific elements would you suggest including in the strengthened supervision and remediation actions for detecting liquidity risks?

Stress testing of MMFs including liquidity provisioning is already thorough and conducting biannually as required by MMFR article 28. The MMF specific guidelines, including parameters and methodology, are updated by ESMA on annual basis, also in accordance with MMFR. The test already covers hypothetical risks in liquidity, and in addition, credit, interest rates, exchange rates, redemptions, spreads and macro systemic shocks.

We would add that stress testing is not a panacea and should be understood as complementary tool within the manager's broader risk management framework. As such, it can help to identify possible risks but does not *per se* mitigate those risks.

Stress testing provides only a snapshot in time. Given the short duration and rapid turnover in MMF portfolios, such a picture is subject to constant change. More exhaustive testing would not bring meaningful benefits.

With respect to the specific measures proposed (p.18)

1) Additional elements on the knowledge of the investor base and investor concentration.

Article 27 of MMFR already imposes 'Know Your Customer' (KYC) provisions which support a better understanding of the investor base and ability to anticipate their behaviour. Managers already take into account the composition and concentration of their investor base and their likely liquidity needs in determining what are the most appropriate liquidity buffers to hold.

2) Strengthened supervision and remediation action in case liquidity risks are detected.



MMFR already provides for corrective action to be taken in the event of a liquidity threshold being crossed.

Article 24 provides that once a threshold is breached, an MMF may only invest in weekly maturing assets, that is assets which count towards the minimum weekly liquid asset requirement. This ensures that any dip will be corrected, and liquidity replenished as soon as possible. The article also specifies that if any limit is breached 'for reasons beyond the control of an MMF, or as result of the exercise of subscription or redemption rights', that MMF shall adopt correction of the situation as a priority objective (Article 24 (2)).

3) Improved reporting for supervisory purposes (including stress testing)  
See question 10 above

4) A Union-wide stress test run at fund and asset management level.  
More stress testing would not bring meaningful benefits. See question 12 below

In summary, an effective and robust stress testing framework is already in place.

**Question 12.** What are the costs and benefits of introducing an EU-wide stress test on MMFs? Should this stress test focus mainly on liquidity risks?

*Stress testing guidelines for EU MMFs, including liquidity provisioning, are already detailed, thorough and updated by ESMA on an annual basis in accordance with MMFR Article 28 (7).*

There would be significant costs associated with developing and maintaining an EU wide stress testing framework. It would also impose an increased operational burden on MMFs to comply with additional requirements

As noted above (q11), stress testing provides only a snapshot in time which can quickly become out of date given the fast-changing nature of MMF portfolios which are short duration and have a rapid turnover.

In our view, additional and/or system wide stress testing would not result in a meaningful addition to resiliency and a cost benefit analysis should be done before making it more strenuous. Moreover, it is hard to imagine a scenario that could be worse than the COVID-19 crisis, when European MMFs proved that they were resilient.

#### **Reverse distribution mechanism**

**Question 13.** What are your views on the EU ban on a reverse distribution mechanism by MMFs?

*The industry opposed the original ban. Given the normalisation of interest rates it is highly unlikely to be useful in the foreseeable future but there is no reason from a policy perspective to preclude its use.*

The reverse distribution mechanism (RDM) allows MMFs to maintain a stable 1.00 NAV by deducting the number of outstanding shares from an investor's account by an amount equal to the negative yield on their investment on a daily basis, in a process of 'cancellation'.

RDM represented a practical solution to the problem of negative interest rates, and its use was supported by both the relevant NCAs, namely the Commission de Service du Secteur Financier in Luxembourg (CSSF) and the Central Bank of Ireland (CBI), where the overwhelming majority of IMMFA MMFs are domiciled. Despite this, RDM was banned in 2019 before the implementation of the 2017 reforms of MMFR. Instead, funds roll negative income into the daily price.

At the time of the ban, the MMF industry was opposed to it on the basis that the use of RDM was a very practical and efficient method of accommodating negative interest rates.

Given current interest rates are comfortably in positive territory, it is unlikely that RDM would be useful again in the foreseeable future. In the meantime, both managers and investors have adjusted their processes to the use of 'accumulating' share prices (which 'de-cumulate' as value is eroded by negative interest rates). It is therefore likely that some clients would be happy to retain the status quo, however since interest rates have once again turned positive there have been significant inflows to EUR denominated MMFs, particularly distributing shares of LVNAV and PDCNAVs.

We would support the reintroduction of RDM on the basis that flexibility would be a benefit and may allow for a wider user base in a scenario where there was a return to negative interest rates. Although not currently foreseeable, it may be helpful to have the option and there is no reason from a policy perspective to ban its use.

**Question 14.** [Can you provide insights and data on how the reverse distribution mechanism has impacted in practice the stability and integrity of MMFs?](#)

*The use of RDM did not impact the stability or integrity of MMFs. It was a practical means of accommodating negative returns. After its ban, which the industry opposed, the industry found an alternative solution in the form of 'accumulating' share classes.*

When the returns of Euro-denominated MMFs moved to a negative yield in 2015, the industry introduced the RDM as a solution. RDM replaced monthly dividend

distribution. Since the implementation of EU MMFR in 2019, European MMFs are no longer allowed to offer share classes that utilise RDM.

The use of RDM did not impact the stability or integrity of MMFs. RDM was a practical means of accounting for negative yields. Negative income could be applied daily to reduce the number of shares held by the investor. It replaced monthly dividend distribution and allowed funds to continue with a stable price of 1.00 per share. This method of accounting for fractional daily price changes provided stability which suited some investors for operational and accounting reasons.

After the prohibition, of RDM, MMF managers accommodated negative yields through use of the accumulating share class which allows the share price to reflect small negative accruals. Many managers had offered both distribution and accumulating share classes for many years, leaving the choice to investor preference. Some investors preferred accumulating share classes as they served their operational requirements while some investors stopped using MMFs all together until distributing classes were once again offered in previously negatively yielding currencies.

#### **Liquidity and short-term instruments**

**Question 15.** Should regulatory requirements for MMFs take into account whether the instrument they are investing in is admitted to trading on a trading venue (regulated markets, multilateral trading facilities or organised trading facilities) with some critical level of trading activity? Please explain your answer.

*We don't believe that any benefit would arise from regulatory requirements taking into account whether the money market instruments in which MMFs invest are traded on a trading venue. MMIs are traded OTC and given their short maturity, listing, for instance, would not be economically viable for most money market instruments. Admission to a trading venue does not in any case guarantee liquidity which is largely determined by other factors.*

The definition of eligible money market instruments (MMIs) is already set out clearly in MMFR and as such is robust and well tested. Commercial Paper (all types, including ECP) and Certificates of Deposit are traded over the counter (OTC) and there is no reason to consider whether they are admitted to a trading venue.

MMFs invest primarily in bank deposits, reverse repurchase agreements and short-term securities. Those short-term securities include CP and CDs, short government paper (in the form of CP or bills) and may also include, to a lesser extent, Floating Rate Notes and Euro Medium Term Notes.

In the case of CP and CDs, these are over the counter instruments, traded bilaterally, and are not traded on an exchange or venue. The maturity is almost always limited to a one year maximum under programme documentation. Given the costs of listing and

the limited maximum maturity, the instruments are too short to make listing economically viable for the issuers.

The purpose of a CP/CD programme is to match the specific needs of both issuers and investors enabling issuers to achieve a lower cost of funds. The fact that issuance is 'tailor made' and is continuously offered (across a range of maturities and in a range of currencies) rather than achieved via a single draw down, also means that paper is not issued in fungible tranches, unlike treasury bill auctions, for instance. For these reasons, it is both economically unfeasible and impractical to trade them on a trading venue. To do so would entail prohibitive costs and bring no meaningful benefit.

Even in the case of those short-term instruments which are listed, such as some treasury/government bills or a tranche of a listed EMTN programme, the listing does not in any case guarantee that the paper will be more liquid.

CP and CDs benefit from a legal framework which governs the issuers' programmes and sets the standards for documentation including the information memorandum. There is also regulation in the relevant jurisdiction around the set up and functioning of the programme. These factors create a standardised product offering in both ECP and NEU CP, the two largest markets

#### **Link between liquidity mismatch and liquidity risks**

**Question 16.** How can NCAs better monitor the liquidity profile of OEFs, including redemption frequency and LMTs, in order to detect unmitigated liquidity mismatches during the lifetime of OEFs?

*In the case of MMFs, liquidity mismatch is already mitigated through prescribed minimum liquidity requirements which are highly transparent.*

MMFs are subject to regulatory minimum liquidity thresholds portfolio requirements in the form of Daily Liquid Assets (DLA) and Weekly Liquid Assets (WLA). These limit the liquidity mismatch and are intended to ensure that they have enough cash to meet redemptions.

The ability of MMFs to continue to meet these requirements during recent stress events demonstrated the resilience of the framework.

**Question 17. [To NCAs/EU bodies]** What is the supervisory practice and your experience with monitoring and detecting unmitigated liquidity mismatches during the lifetime of OEFs?

What is the data that you find most relevant when monitoring liquidity risks of OEFs?

**Question 18. [To NCAs/EU bodies]** What supervisory actions do you take when unmitigated liquidity mismatches are detected during the lifetime of an OEF?

**Question 19.** On the basis of the reporting and stress testing information being collected by competent authorities throughout the life of a fund, how can supervisory powers of competent authorities be enhanced to deal with potential inconsistencies or insufficient calibration between the LMTs selected by the manager for a fund or a cohort of funds and their assets and liabilities liquidity profile? How can NCAs ensure that fund managers make adjustments to LMTs if they are unwilling to act? How could coordination be enhanced at the EU level?

**Question 20. [To asset managers]** What measures do you find particularly effective to measure and monitor liquidity risk in stressed market conditions?

*MMF managers take into consideration the natural liquidity in the portfolio in the form of Daily Liquid Assets (DLA) and Weekly Liquid Assets (WLA).*

MMFs invest in paper (CP/CDs) that is traded OTC rather than on an exchange, but an indication of market liquidity can be achieved by getting bids from brokers and dealers who are active in the paper. Depending on the paper, this will be a designated dealer or a money market broker active in the name.

Managers also look at expected flows, and investor concentration on an ongoing basis but particularly in times of stress.

We would strongly challenge the assumption that in a stress event money market instruments have zero liquidity. Although it is hard to measure liquidity in a stress event, our experience has been that some assets remain liquid. Although dealer balance sheets become more constrained, dealers will continue to intermediate albeit to a more limited extent. This has been the experience of a number of our member funds during the events of March 2020 and the UK gilts crisis. In the latter event, there were investors who remained unaffected by the volatility in the gilt market and who were actively buying in the secondary market, enabling dealers to pass through paper without using balance sheet.

It should be noted that in many cases MMFs, being a store for short term cash, expect to have frequent redemptions and that as such redemptions are not always a sign of stress. Managers will take into account the typical and expected behaviour of their underlying shareholders when deciding on the appropriate levels of liquidity.

**Question 21. [To asset managers]** What difficulties have you encountered in measuring and monitoring liquidity risks and their evolution? Are there enough tools available under the EU regulations to address liquidity mismatches?

*MMFs hold structurally high levels of liquidity to meet redemptions which limits the mismatch. MMFs have the ability use liquidity management tools but the usage of these should be delinked from minimum liquidity thresholds.*

As noted above, unlike other types of fund, MMFs structurally hold large amounts of cash to meet redemptions which means they should not have to sell assets. This mitigates the liquidity mismatch. Even during recent stress events, IMMFA MMFs were able to meet redemptions through their cash and to meet their regulatory requirements.

MMFs hold significant amounts of liquidity. The current requirement is 10% in daily liquid assets (DLA) and 30% in weekly (WLA) for Low Volatility Net Asset Value (LVNAV) and Public Debt Constant Net Asset Value (PDCNAV) MMFs and 7.5% and 15% respectively for both Short term and Standard Variable Net Asset Value funds. In practice, due to the fact that there are limited one-week assets available, much of the weekly liquid assets is held in overnight deposits or reverse repo, and so is also available to meet redemptions.

The ability to use liquidity buffers when needed will enable managers to manage liquidity risk more effectively. Difficulties arose because the 30% WLA requirement became a 'bright line' during the events of March 2020, resulting in investors redeeming as funds approached the threshold. For some funds, this resulted in having to sell assets rather than use the available liquidity. Delinking minimum thresholds from the possible imposition of fees and gates would make liquidity usable, further enhancing the MMF's ability to meet unusual levels of redemption. We believe this was the original intention of the liquidity buffers.

Under MMFR and UCITS, MMFs have the ability to use liquidity management tools such as redemptions fees and gates. As noted in the Commission's review of the effectiveness of MMFR, MMF resilience will benefit from the AIFMD UCITS review of LMTs. We support MMFs having at least one liquidity tool to be used at the discretion of the manager who would apply when in the best interest of the investor to do so.

**Question 22. [To asset managers]** [What are the challenges in calibrating worst-case and stress-case scenarios related to redemptions and margin calls?](#)

*MMF managers take the concentration and likely behaviour of investors into consideration.*

MMFR introduced new KYC requirements for MMF managers. Accordingly, managers are already required to take into account the concentration and likely behaviour of their fund shareholders. As a matter of course, managers will take into consideration whether fund investors are margin sensitive and therefore likely to be subject to

collateral calls during periods of market volatility and will manage their liquidity accordingly.

In terms of challenges in calibrating, margin calls can vary depending on the individual investor's exposure, for instance long or short duration, swaps, repo, or equity exposure. The asset manager will also not necessarily know what other collateral the investor holds. They may have other MMF holdings or government securities they could sell for instance.

Even during periods during which market volatility reached levels which were historically unprecedented, such as March 2020 and the UK Gilt crisis in 2022, MMFs continued to meet redemptions.

MMF stress tests have subsequently been recalibrated by ESMA to factor in scenarios which were extreme.

#### **Stress testing**

**Question 23. [To NCAs and EU bodies]** *When monitoring or using results of liquidity stress tests, are you able to timely collect underlying fund data used by managers and the methodology used for the simulation? Are there other aspects that you find very relevant when monitoring the stress tests run by managers?*

**Question 24. [To NCAs and EU bodies]** *How do you use information collected from stress tests at fund level for other supervisory purposes and for monitoring systemic risks?*

**Question 25. [To NCAs and EU bodies]** *What are the main benefits and costs of introducing a stress test requirement at the asset management company level and how could this be organised?*

#### **Other NBFIs**

**Question 26.** *What are your views on the preparedness of NBFIs operating in the EU in meeting margin calls, and on the ways to improve preparedness, taking into account existing or recently agreed EU measures aimed at addressing this issue? Please specify the NBFi sector(s) you refer to in your answer?*

*MMFs are actively used by margin sensitive investors such as pension funds and insurance companies as a store for cash. Moves towards more centralised clearing of derivatives have increased the importance of this role. Margin sensitive investors are more likely to redeem during periods of market volatility. Facilitating the use of MMFs as margin collateral would mitigate the risk of procyclical pressure.*

As noted above, MMFs served a vital function in providing liquidity during the recent liquidity stress events including the March 2020 'dash for cash' and the September



2022 turmoil in the UK gilt market. On both occasions, as market volatility led to spikes in margin collateral calls, there was an observable correlation in MMF flow activity in terms of, initially, more redemptions as margin sensitive investors redeemed MMF investments to post cash collateral. On both occasions, outflows were swiftly followed by substantial inflows, with a brief period of elevated redemptions reflecting market volatility, followed by sustained subscriptions directly thereafter.

In many cases, cash needed for collateral is redeemed from MMFs, only to be reinvested into MMFs or a very similar money market assets when posted. Enabling MMFs to be posted directly as margin collateral would mitigate this procyclical pressure and thereby contribute to overall systemic resilience.

IMMFA responded to the FSB's June consultation report on 'Liquidity Preparedness for Margin and Collateral Calls' recommending that authorities consider facilitating the use of MMFs as margin collateral for this reason. The ability to tokenise MMFs will make them more portable, removing some of the operational barriers, but regulatory obstacles remain.

In 2021 ESMA consulted on highly liquid financial instruments under the investment policy of central clearing counterparties, including the suitability of MMFs as cash investments. IMMFA responded recommending that Public Debt Constant Net Asset Value MMFs (PDCNAV), which invest 99.5% in government assets, be included. ESMA concluded that due to the likely review of the regulatory framework, they should continue to be excluded. On the basis that PDCNAVs did not experience stress during recent periods of financial instability, and indeed benefitted from outflows, we recommend that this be reconsidered.

**Question 27.** What are relevant risk metrics or tools that can be used to effectively monitor liquidity and margin preparedness across all NBFI entity types? Please provide examples specifying the sector you refer to.

#### **Pension Funds**

**Question 28.** How can current reporting by pension funds be improved to improve the supervision of liquidity risks (e.g. stemming from exposure to LDI funds, other funds or derivatives), while minimising the reporting burden? What can be done to ensure effective look-through capability and the ability to measure the impact of unexpected margin calls? Please provide examples also for other NBFI sectors.

**Question 29.** What would be the benefits and costs of a regular EU-wide liquidity stress test for pension funds and with what frequency? What should be the role of EU authorities in the preparation and execution of such liquidity stress tests?



### Short-term funding markets

**Question 30.** What would be the benefits and costs of creating a framework or a label in EU legislation for certain money market instruments (such as commercial papers) to increase transparency and standardisation? Should the scope of eligible instruments to such framework/label be aligned with Article 3 of Directive 2007/16/EC<sup>60</sup>? If not, please suggest what criteria would you consider for identification of eligible instruments.

*A label could be helpful in achieving improved transparency and standardisation bringing greater market efficiency, reduce operational friction and could facilitate market intermediation particularly in times of stress. Standardisation would help avoid inconsistent outcomes in terms of what is/is not eligible for asset purchase programmes.*

As noted earlier, the European CP market has proven highly successful in providing efficient short-term funding. Although largely ‘buy to hold’, it provides sufficient levels of liquidity in normal conditions. The fragmentation does, however, act as a drag on overall market efficiency and is not conducive to liquidity in a stress event.

The various types of commercial paper are all unsecured<sup>7</sup> senior debt and have substantially similar legal frameworks. Since the programme type is not a determinant of risk, MMFs are typically ‘agnostic’ as to the paper they buy as long as it can settle efficiently. However, this can vary according to type, with features including ISINs, denominations, settlement times and clearing dependent upon market-of-origin conventions. The lack of holistic oversight also means that data availability also varies.

We are in favour of measures which support improved transparency and standardisation and in particular of measures which would also support the ability of dealers to intermediate at times of stress.

With respect to benefits and costs we make the following points:

- Distinctions between the various types of paper can have very important implications in a stress event when it is crucial that repo eligibility should be clear and consistent. This was not the case during the COVID 19 crisis, something which impeded dealers’ ability to intermediate. A number of variables determine whether paper is eligible for repo or not, including the type or label. Market liquidity could be very significantly enhanced by allowing all high-quality CP (regardless of type) or CDs to be eligible as central bank collateral.

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<sup>7</sup> With the exception of asset backed CP where the structure may be based on asset securitisation, with or without other recourse.

- Greater transparency and standardisation could help the development of generic curves which would likely be helpful in developing a repo market for CP/CDs.
- Greater pricing transparency would also help in price discovery which is important to investors. The challenge is to achieve a level of transparency which is compatible with issuer sensitivity regarding their funding costs. Some issuers may be reluctant to reveal their pricing more widely.
- The market has evolved into one of 'end placement' and issuers have been averse to having secondary paper compete with primary issuance.
- The STEP label was an attempt to standardise issuance practices, but many ECP issuers failed to see the benefit in changing their programmes given there are legal costs and resources required.
- The introduction of NEU CP has successfully standardised issuance in France. NEU CP remains primarily domestic and is supported by a large domestic MMF investor base.
- To be successful, any label would have to include the ECP market which is the largest sector.
- Given the market is well established, there are limited new programmes. Changes to documentation would therefore mean existing issuers incurring legal costs which may be significant. It is unclear the incentive to the issuers would be sufficient.
- Similarly dealers are unlikely to be motivated given they operate on very low margins, unless there is a clear benefit (and no cost) to them. The reduction in operational friction could be one incentive.
- Most importantly, bank intermediaries rely on being able to repo assets (such as bonds, governments, asset backed securities etc) to a central bank as collateral in exchange for cash during a stress event. Due to local variations as to what was counted as eligible or ineligible for asset purchase facilities and differences between individual central banks during the 'dash for cash', some CP was much more liquid than others, even though the credit quality was the same. This was a very unsatisfactory outcome. Greater standardisation across markets could contribute to resolving this by encouraging the consistent treatment of paper of the same credit quality.

**Question 31.** Would the presence of a wider range of issuers (notably smaller issuers) to fund themselves on this market, and therefore diversify their funding sources, be beneficial or detrimental to financial stability?

*The market already benefits from a diverse range of issuers. The presence of smaller issuers would not necessarily help financial stability and could introduce vulnerabilities. They are unlikely to meet the credit criteria of institutional investors such as MMFs, or other typical money market investors who are likewise naturally looking for high quality, rated issuers offering high levels of financial transparency and*

*able to issue in volume. We would suggest that such issuers use Asset Backed Commercial Paper as a means of funding.*

Demand in the Commercial Paper market is driven by investors, including MMFs, seeking high quality, usually highly rated issuers. MMFs are additionally subject to the rigorous requirements of MMFR governing concentration, diversification, credit quality and credit assessment processes. Issuers which allow MMFs to meet these requirements tend to be large for a number of reasons:

- The costs of ratings would be less economically viable for a small issuer.
- There are costs involved for any investor in doing the internal credit research required to approve exposure to a given issuer. Under MMFR, MMFs must not rely wholly on credit ratings and will, like most other investors, also do their own analysis. This use of resources is only justifiable if there is sufficient issuance to ensure a targeted level of exposure. In other words, the issuance has to justify the time and effort expended on credit approval. This means small issuers are not attractive propositions.
- The same logic would apply to other types of investor with the possible exception of those who are prioritising yield and willing to take on more risk (which would not include MMFs). Many cash managers are seeking to *minimise* credit risk and CP allows them to diversify.
- CP issuance is highly flexible, and a lot of issuance is effectively ‘tailor made’ to meet investor demand. Investors therefore prefer issuers which issue regularly because it makes it more likely they will be able to obtain their preferred maturity, currency and size. This in turn allows the issuer to achieve a lower cost of funds because they are responding to investor led demand. A smaller issuer will not have the flexibility to do this.
- Post prudential reforms, bank balance sheets are used more conservatively. This means dealers typically intermediate on the basis of finding another buyer rather than taking inventory onto their own books. The larger the issuer, the more likely that a wide range of investors will also have credit approval to purchase the name, meaning that if an investor wants to sell it will be easier (because the dealer can just pass the paper through without using their balance sheet).
- MMFs are required to diversify their credit risk under Article 18 (1) of MMFR which states that an MMF cannot hold more than 10% of the instruments, securitisations or ABCPs issued by a single body. Given the resources involved in conducting credit analysis, this limits the appeal of small issuers.
- Smaller issuers who cannot for the above reasons access the market directly, but who find bank funding expensive, may have the option to sell certain types of assets such as receivables to an Asset backed Commercial Paper (ABCP) conduit. The ability of an ABCP issuer to aggregate assets and to enhance the credit makes them appealing alternatives to many CP investors who are

seeking high quality rated paper. We support any measures to encourage such securitisation.

- Smaller non-financial unrated or lower rated borrowers often issue in their local domestic CP markets where they are 'household names'. In these cases, investors rely on local knowledge and familiarity. This can be the case in France for instance, where non-financials account for a greater share of issuance<sup>8</sup> but is much less likely in the ECP market where international institutional investors such as MMFs, but also other types of fund, corporate treasuries, central banks and supra-nationals will require large, active issuers who are highly rated for the reasons given above.

**Question 32.** What are your views on why euro-denominated commercial papers are in large part issued in the 'EUR-CP' commercial paper market outside the EU? What risks do you identify? Please provide quantitative and qualitative evidence, if possible.

*Issuance of 'EUR-CP' (which we take to mean Euro Commercial paper issued in EUR currency) outside the EU reflects both the requirements of the issuers and the depth and success of the ECP market which serves a global issuer and investor base, providing a broad and diversified flexible source of funding. It does not constitute a risk.*

The fact that a high volume of euro-denominated CP is issued under ECP programmes traded outside the EU reflects the size and importance of the ECP market. This does not constitute a risk. The range and depth of issuance provides MMFs with the benefit of risk diversification. The ECP market is the largest CP market (estimate USD1 trillion) in Europe, followed by the French domestic market. Although small by comparison to the US domestic market, ECP has a well-established history and significant investor depth. It serves a global issuer and investor base, providing a broad and diversified funding base and a wide range of investment opportunities. It set the original standard for documentation under English law and this framework remains familiar and appealing to many issuers.

The ECP market was multiple currency from its origin, allowing issuance in USD, GBP and later EUR, as well as other smaller currencies (see q31). Many issuers prefer the breadth and depth of the ECP investor base to a domestic market where a concentration of like investors can leave the issuer vulnerable to funding disruption. The ECP market allows them to tap into EUR investor demand both within and beyond the EU, whilst at the same time taking advantage of USD and GBP demand.

The UK or GBP denominated market is not a separate subset of the ECP market, it is an integral part of it.

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<sup>8</sup> 20% before the March 2020 crisis, AMF Detailed analysis of the portfolios of French MMFs during the Covid-19 crisis, Darpeix and Mosson.

Another important driver of issuance is the fact that a number of the largest issuers are from Australia, Canada and Japan, meaning that they do not have large deposit bases in EUR and therefore have to fund themselves in the wholesale markets.

In the case of investors, in addition to MMFs, these include Central Banks, official institutions, pension funds, insurance companies and global corporate treasuries. These institutions hold a variety of currencies, including EUR. Again, they have a history of familiarity with ECP. ECP would have been more accessible historically because it settled through established international clearing systems rather than locally.

With respect to the role played by MMFs in this context, although the overwhelming majority of French domiciled MMFs are denominated only in EUR, IMMFA MMFs (mostly domiciled in Ireland and Luxembourg) are denominated in USD, GBP and EUR and as such are looking for assets in a variety of currencies. There are also both IMMFA and non IMMFA MMFs denominated in smaller currencies such as AUD and NZD. IMMFA EUR denominated MMFs currently have EUR221bn in AUM.

ECP can be sold into most jurisdictions except for the US market where there are restrictions on unregistered securities. It is therefore likely to reach a much wider investor base than any market which has grown out of domestic or local demand such as the French market. This was particularly the case when domestic markets were highly idiosyncratic, localised and unattractive to international investors for reasons of documentation, tax and settlement. The successful French market, now issued in the form of NEU CP, grew out of demand from a large French MMF investor base and is mostly, although no longer by any means exclusively, denominated in EUR.

The main risk to ECP funding is always ‘rollover risk’ in that it is short term, and investors only renew if the credit outlook and liquidity conditions continue to make reinvestment appropriate. For this reason, issuers avoid becoming overly reliant on short-term funding and indeed banks are now prevented from doing so by the liquidity ratios introduced under prudential banking reforms. Also for this reason, issuers will prefer a deep, diversified investor base.

**Question 33.** What could be done to improve the liquidity of secondary markets in commercial papers and certificates of deposits?

CP and CDs are distinct in being ‘buy-to-hold’ products. They have short maturities and are issued on a bespoke basis which matches the needs of issuer and investor. The lack of secondary trading activity *in normal times* should not necessarily be viewed as a market weakness. Investors, including MMFs, may on occasions require liquidity or seek to reposition their portfolios from time to time, but they do not typically seek to actively trade CP. Many issuers prefer that their paper be placed with

end investors (as opposed to trade in the secondary market) as this is more likely to protect their pricing. Given these market characteristics, dealers are able to provide sufficient liquidity in normal market conditions.

The liquidity of secondary markets depends on the ability of dealers to intermediate. As the capital allocation to trading books has reduced in line with prudential regulation (which has clearly been instrumental in successfully reducing bank risk) this ability has become more constrained and elusive in a stress event. This is a cautionary example of the market's interconnectivity and how unintended consequences can emerge in which risks are moved around but not eliminated.

Other factors such as greater transparency of data and harmonisation between the various markets could help to a degree, as per our comments above. They may also attract new investors at the margin. We certainly support any measures to improve transparency and standardisation as these can only contribute to overall market functionality and resilience. But as noted by the FSB, there is a significant challenge in arriving at uniform policy responses. It is important to remember that secondary liquidity is based on dealers remaining motivated to intermediate even at times of stress when they are most balance sheet sensitive. Given the nature of the market, it is likely to remain dealer intermediated.

We would suggest the following other measures which would help and could have more impact on secondary liquidity in a stress event:

- Clarity and consistency on asset eligibility for asset purchase programmes is crucial to help dealers at such times, as per our comments above. All CP/CDs of the same credit high quality should be treated equally.
- Broader central bank eligibility of CP in money market operations would enhance the repo-ability of CP and provide another funding option for dealers.
- We would also suggest that high quality CP be counted as High Quality Liquid Assets (HQLA) in capital ratios as this would significantly improve the dealers' ability to manage inventory. The rules on this appear to be inconsistent or subject to interpretation.
- Capital and liquidity relief under Basel rules, providing relief to dealers during times of stress would enable dealers to continue to provide a secondary market.
- Developing a dedicated repo market would help dealer funding. Improved transparency and standardisation could help this.

Trading platforms could improve price discovery and contribute to liquidity, but the market will continue to rely on dealer expertise and intermediation. The key objective should be to facilitate this.

**Question 34.** Considering market practice today, is the maturity threshold for ‘money market instruments’ (up to 397 days) in the Eligible Asset Directive 2007/16 sufficiently calibrated for these short-term funding markets?

*We see no reason to change the maturity threshold.*

Anything longer has more price volatility so should not be called a money market instrument.

**Question 35.** Do you think there is a risk with the high concentration of this market in a few investors (MMF and banks)? Please elaborate.

*With respect to CP, MMFs, although large, are not the only large investors. There are many other investors in the market, including central banks, official institutions and agencies who are significant buyers of very high-quality paper. Banks are typically issuers not investors.*

There are also other large institutional investors, such as pension funds, insurance companies and corporate treasuries who invest. Normalisation of interest rates has encouraged investors to actively manage their cash and made CP and CDs a more appealing alternative to deposits.

The growth of MMFs reflects demand for a place to store liquidity outside banks as banks’ appetite for deposits has been reduced by prudential regulation. It also reflects the fact that liquidity has become systemically more important due to factors such as a move towards the central clearing of derivatives.

Given that short term cash has gravitated towards MMFs, it is important to recognise that MMFs need to be able to invest that liquidity at all times. This is why we have recommended that there be a facility similar to the Federal Reserve’s Reverse Facility (RRP) which absorbs excess cash.

Growth in the MMF sector should be viewed as a positive in that it provides valuable funding for issuers and a cash management option for investors.

The question refers to investment being concentrated in MMFs and banks. Banks are typically issuers rather than investors. If banks do buy, they are likely to primarily be buyers of government assets as these count towards their HQLA. MMFs on the other hand, are dominated by funds which can buy private assets. Although government (PDCNAV) MMFs are substantial in USD (USD191bn), they are relatively small in GBP (GBP6.5bn) and EUR (EUR5.3bn).<sup>9</sup>

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<sup>9</sup> All numbers are IMMFA MMFs.



**Question 36.** How could secondary markets in these money market instruments attract liquidity and a more diverse investor base, while relying less on banks buying back papers they have helped to place?

Greater transparency and standardisation across markets could encourage new investors at the margin. However, as noted above, like all market-based finance, money market instruments and CP/CDs in particular, require dealers to intermediate. Encouraging a more active repo market could help.

Authorities should also consider what could be done to help dealers intermediate at times of stress as per our response to question 33 above. Most CP is high quality, tier 1 rated and has a short maturity and as such is a low-risk asset class in which it should be possible to facilitate dealers making markets.

**Question 37.** What are the benefits and costs of introducing an obligation to trade on trading venues (regulated markets, multilateral trading facilities and organised trading facilities) for such instruments?

For the reasons noted in our response to Question 38 below, it is not practicable to require MMIs to be transacted on a trading venue.

**Question 38.** Can the possibility to trade on a regulated venue increase the chances of secondary market activities in a systemic event, for instance by acting as a safety valve for funds that need to trade these assets before maturity (especially when facing strong redemption pressures, like for MMFs)?

MMFs are amongst the largest buyers of money market instruments. While it may be possible to attract other buyers into the market, they would have to be of a significant size in order to make a difference to market liquidity as MMIs typically trade in large size. As a result, the money markets are dealer intermediated markets. Dealers provide the requisite expertise to assess and price risk, and historically had the balance sheet capacity, although this is now much more constrained. So while the ability to trade on a regulated exchange may help at the margin, the benefit is likely to be small unless there were a sufficient number of natural real money buyers willing to buy during times of stress.

In our view, transacting on a trading venue is not practicable. The major obstacle to intermediation in a stress event is the scarcity of balance sheet. In other longer-term products this is navigated by the use of asset purchase programmes. The same logic should apply to CP, i.e. that high quality assets should be eligible to repo. Eligibility must be clear and consistent across jurisdictions and dealers must be able to transact in a timely fashion. This was not the case in Europe in March 2020.



**Commodities markets**

**Question 39.** How would you assess the level of preparedness of commodity derivatives market participants in terms of meeting short-term liquidity needs or requests for collateral to meet margins? Please rank from 1 to 5 (lowest to highest) the level of preparedness for the following participants by sector: insurance companies, UCITS funds, AIFs, commercial undertakings, investment firms, pension funds.

**Question 40.** In light of the potential risk of contagion from spot markets or off-exchange energy trading to futures markets, do you think that spot market participants should also meet a more comprehensive set of trading rules for market participation and risk management? Please elaborate on your response.

**Question 41.** How can it be ensured that the functioning of underlying spot energy markets and off-exchange energy trading activity does not lead to the transmission of risks to financial markets?

**Other markets**

**Question 42.** To what extent do you see emerging liquidity risks or market functioning issues that can affect liquidity in other markets? Can you provide concrete examples?

**Question 43.** What are other tools than those currently available under EU legislation which could be used to contain systemic risks generated by potential pockets of excessive leverage in OEFs?

**Question 44.** What are, in your view, the benefits and costs of using yield buffers<sup>61</sup> for Liability-Driven funds, such as it was done in Ireland and Luxembourg, to address leverage?

**Question 45.** While on average EU OEFs are not highly leveraged, are there, to your knowledge, pockets of excessive leverage in the OEF sector that are not sufficiently addressed? Please elaborate with concrete examples.

**Question 46.** How can leverage through certain investment strategies (e.g. when funds invest in other funds based in third countries) be better detected?

**Question 47.** Are you aware of any NBFIs sector entities with particularly high leverage in the EU that could raise systemic risk concerns?

**Question 48.** Do stakeholders have views on macroprudential tools to deal with leverage of NBFIs that are not currently included in EU legislation?

**Question 49. [To NCAs and EU bodies:]** Are you able to timely identify (financial and synthetic) leverage pockets of other NBFIs (such as pension funds, insurance

companies and so on), especially when they are taken via third parties or complex derivative transactions? Please elaborate on how this timely detection of leverage could be obtained?

**Question 50.** How can it be ensured that competent authorities can effectively reconcile positions in leveraged products (such as derivatives) taken via various legal entities (e.g. other funds or funds of funds) to the ultimate beneficiary?

#### **Commodities markets**

**Question 51.** What role do concentrated intraday positions have in triggering high volatility and heightening risks of liquidity dry-ups? Please justify your response and suggest how the regulatory framework and the functioning of these markets could be further improved?

**Question 52.** Do you have concrete examples of links between banks and NBFIs, or between different NBFI sectors that could pose a risk to the financial system?

**Question 53.** What are the benefits and costs of a regular EU system-wide stress test across NBFI and banking sectors? Are current reporting and data sharing arrangements sufficient to perform this task? Would it be possible to combine available NBFI data with banking data? If so, how?

**Question 54.** Is there a need for arrangements between NBFI supervisors and bank supervisors to ensure timely and comprehensive sharing of data for the conduct of an EU-wide financial system stress tests? Please elaborate.

**Question 55.** What governance principles already laid out in existing system-wide exercises in the EU, such as the one-off Fit-for-55 climate risk scenario analysis or the CCP stress tests conducted by ESMA, could be adopted in such system-wide stress test scenario?

**Question 56. [To NBFIs and banks]** In your risk management practices, do you run stress tests at group level, and do you monitor the level of interconnectedness with (other) NBFIs (within and beyond your own sector; e.g. portfolio overlaps)?

**Question 57.** How can we ensure a more coordinated and effective macroprudential supervision of NBFIs and markets? How could the role of EU bodies (including ESAs, ESRB, ESAs Joint Committee) be enhanced, if at all? Please explain.

#### **Enhanced coordination mechanism (implementation and adoption of NMMs)**

**Question 58.** How could the currently available coordination mechanisms for the implementation of macroprudential measures for OEFs by NCAs or ESAs (such as leverage restrictions or powers to suspend redemption on financial stability grounds) be improved?

**Question 59.** What are the benefits and costs of introducing an Enhanced Coordination Mechanism (ECM), as described above, for macroprudential measures adopted by NCAs?

**Question 60.** How can ESMA and the ESRB ensure that appropriate National Macroprudential Measures (NMMs) are also adopted in other relevant EU countries for the same (or similar) fund, if needed?

**Question 61.** Are there other ways of seeking coordination on macroprudential measures and possibly of reciprocation? What could this system look like? Please provide concrete examples/scenarios and explain if it could apply to all NBFIs sectors or only for a specific one.

#### **Supervisory powers of EU bodies**

**Question 62.** What are the benefits and costs of improving supervisory coordination over large (to be defined) asset management companies to address systemic risk and coordination issues among national supervisors? What could be ESMA's role in ensuring coordination and guidance, including with daily supervision at fund level?

We are supportive of more supervisory convergence and consistent application of regulatory standards in order to ensure a level playing field and single rule book. In the case of MMFs, collaboration across NCAs generally works well when required and they have the appropriate technical expertise and skillset to supervise funds.

Rather than a fundamental shift in supervision, we would be in favour of finessing the existing structure through incremental steps aimed at further improving coordination and encouraging consistent application of the regulation.

In our view, supervision should be applied consistently across all management companies and not be determined by size. Management company size is not an appropriate metric in measuring the potential risks identified in the consultation.

Given the intention is to foster convergence, a parallel regime for large asset managers would run the risk of a differentiated treatment of market players hindering competitiveness and fairness.

**Question 63.** What powers would be necessary for EU bodies to properly supervise large asset management companies in terms of flexibility and ability to react fast? Please provide concrete examples and justifications.

In our view, supervision should be applied consistently across all management companies and not be determined by size.

**Question 64.** What are the benefits and costs of having targeted coordinated direct intervention powers to manage a crisis of large asset management companies? What could such intervention powers look like (e.g. similar to those in Article 24 of EMIR)?

**Question 65.** What are the pros and cons of extending the use of the Enhanced Coordination Mechanism (ECM) described under section 6.1 to other NBFIs sectors?

**ESAs and ESRB's powers during emergency situations**

**Question 66.** What are the benefits and costs of gradually giving ESAs greater intervention powers to be triggered by systemic events, such as the possibility to introduce EU-wide trade halts or direct power to collect data from regulated entities? Please justify your answer and provide examples of powers that could be given to the ESAs during a systemic crisis.

**Integrated supervision for commodities markets**

**Question 67.** What are the benefits and costs of a more integrated system of supervision for commodities markets where the financial markets supervisor bears responsibility for both the financial and physical infrastructure of the commodity futures exchange, including the system of rules and contractual terms of the exchange that regulate both futures and (cash/physical) forward contracts?

**International coordination**

**Question 68.** Are there elements of the FSB programme on NBFIs that should be prioritised in the EU? Please provide examples.