S&P Global
Ratings

S&P Global Ratings Response to Consultation on the Functioning of the EU Money Market Fund Regulation (MMFR)

S&P Global Ratings welcomes the opportunity to respond to the European Commission's Consultation on the Functioning of the EU Money Market Fund Regulation (MMFR).

For any questions of comments related to our response please do not hesitate to contact David Henry Doyle, Head of Government Affairs & Public Policy, EMEA, S&P Global (davidhenry.doyle@spglobal.com).

13 May 2022

Reference to 'Credit Rating' in the Consultation

During our review of the Commission MMFR consultation, we noted a reference to "the role of credit rating" (sic) under question 5: 'What elements of the MMFR could in your view be improved and to what degree this is important?'.[1]

It was unclear whether this was a reference to the use of credit ratings by a MMF manager when determining the credit quality of a MMF's holdings or, perhaps, an inadvertent conflation of the term 'MMF rating' with 'credit rating'.

We note that any potential conflation may stem from the ambiguous language in Article 26 of the MMFR which refers both to 'MMF Ratings' in its title while also referring to 'external credit ratings' as well as the EU Credit Rating Agency Regulation (CRAR) in its main provision.[2]

If the reference in the consultation relates to the use of credit ratings by MMF managers when gauging credit quality of the MMF's assets we would note, as ESMA does that:

> "To reduce over-reliance on external ratings, the MMF Regulation requires MMFs to perform internal credit quality assessment. External credit ratings in their portfolio may be considered, but they cannot be mechanically relied upon."[3]

Alternatively, in the event that the reference may have been an inadvertent conflation of the terms 'MMF rating' and 'credit rating', this short paper is aimed at clarifying the difference between MMF ratings and credit ratings.

[1] European Commission's Consultation on the Functioning of the EU Money Market Fund Regulation, page 7 – Link.
[2] EU Money Market Fund Regulation, Article 26 – Link.
[3] Final Report, ESMA opinion on the review of the Money Market Fund Regulation, page 7, footnote 12 – Link.

MMF Ratings Provided by S&P Global Ratings

As S&P Global Ratings highlighted in our response to ESMA Consultation Report on the Legislative review of the EU Money Market Fund Regulation, it is important to recognize that conceptual differences exist between MMF ratings and credit ratings.[4]

MMF ratings provided by S&P Global Ratings are called Principal Stability Fund Ratings (PSFR). A PSFR is a forward-looking opinion about a fixed-income fund's capacity to maintain stable principal NAV and to limit exposure to principal losses due to credit risk. PSFRs are assigned according to S&P Global Ratings' Principal Stability Fund Rating Methodology published on 23 June 2016 (methodology). In this response, we refer to PSFRs as "MMF ratings" in line with ESMA's terminology in the Consultation Report.

S&P Global Ratings assigns MMF ratings based on funds' ability to maintain NAV stability. We assign MMF ratings by assessing management, credit quality and portfolio concentration, which we view as the keys to NAV stability. We assign MMF ratings on a scale from 'AAAm' to 'Dm', depending on whether a default has occurred and the relative risk of one occurring. We impute a concept of default since these are not debt obligations and focus upon the shareholder expectation of cash upon demand as the basis of the imputed promise on which we assign our MMF ratings.

MMF ratings are identified by the 'm' suffix to distinguish the MMF rating from an S&P Global Ratings issue or issuer credit rating and are neither commentaries on yield levels paid by the fund, nor are they commentaries on loss of principal due to negative yields.

ESMA notes this clearly in its final report on the MMFR Review by stating that, "MMF ratings are different from credit ratings: they do not assess credit risk but rather the ability of MMF to preserve capital and maintain liquidity."[5]

In addition, as ESMA points out in paragraph 50 of its Consultation Report:

> "Since MMF ratings do not typically meet the definition of a credit rating as set out under the CRA Regulation, they are not considered credit ratings and therefore do not fall within the scope of the regulatory requirements of the CRA Regulation".

For this reason, MMF ratings provided by S&P Global Ratings are indeed not subject to the EU CRAR. However, S&P Global Ratings largely applies the same rigorous standards to MMF ratings as to our credit ratings, including the development and review of the MMF methodology, to the processes for assigning MMF ratings, and to carrying out surveillance on MMF ratings. MMF ratings are also released publicly.

Methodological Transparency and Independence of MMF Ratings

We believe that MMF rating methodology should be clear, transparent, rigorous, and apply appropriate governance processes. We also agree that the methodology to assign ratings to MMFs should not incorporate mechanistic triggers between the use of liquidity management tools by the MMF and

[4] S&P Global Ratings Response to ESMA Consultation report on the Legislative Review of the EU Money Market Fund Regulation, June 2021 – Link.

[5] Final Report, ESMA opinion on the review of the Money Market Fund Regulation, page 7 – Link.

assigning a certain level of rating. S&P Global Ratings' methodologies for MMF ratings – like the methodologies for our credit ratings – are transparent and are made public for all stakeholders.

With regard to the benefits of MMF ratings, we believe that the market benefits from access to a range of different opinions about the strength of a MMF. S&P Global Ratings' methodology is applied consistently across markets allowing investors to compare funds on a like for like basis.

Given the cash-like role of MMFs, S&P Global Ratings would consider a MMF in default if investors failed to receive redemption proceeds within five business days after the request, consistent with our view of investor expectations. We would therefore assign a rating of 'Dm' if a MMF were to suspend payments for more than five business days, reflecting investor expectations given the role these funds play as sources of liquidity for other market participants. Our five business day standard to determine a default aligns with the maximum grace period that we apply when looking at timely repayment of short-term debt obligations under our credit rating definitions.

S&P Global Ratings undertakes weekly monitoring of the rated funds' portfolio holdings to analyze whether the funds are consistent with the methodology metrics for the assigned MMF rating. Surveillance frequency may increase during times of market stress or when a fund is experiencing pressures in maintaining a stable NAV. Under the PSFR methodology, if a MMF is experiencing NAVs which fall beyond the range indicated for its rating category, we would likely lower the fund's rating unless we view the fund's management as capable of stabilizing the NAV within the requisite cure period.

During the March 2020 volatility, S&P Global increased its surveillance on funds to daily when their NAVs rapidly approached 0.9985. Our surveillance reverted to weekly upon determining that pricing on the underlying securities stabilized, liquidity levels returned to normal, and NAVs remained greater than 0.9985. S&P Global Ratings did not carry out any negative rating action on MMFs during the events of March 2020 or through the remainder of the year. Negative rating actions on MMFs include downgrades or placement on CreditWatch with negative implications.

S&P Global Ratings also did not assign a negative outlook to the MMF sector. In our opinion, given the nature of their investment portfolios, all MMFs rated by S&P Global Ratings in March 2020 had sufficient flexibility to use liquidity management tools and cure periods to maintain NAV stability. This assessment was reflected in their MMF ratings.

S&P Global Rating's PSFR methodology is included in financial institutions criteria which can be found here: https://disclosure.spglobal.com/ratings/en/regulatory/ratings-criteria/-/articles/criteria/financial-institutions/filter/all

S&P Global Ratings' methodologies can be found here:
https://disclosure.spglobal.com/ratings/en/regulatory/ratings-criteria

S&P Global Ratings' definitions can be found here:
https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/504352.

MMF Rating Methodologies & Liquidity Management Tools

With regard to the question of transparency, we noted that paragraph 144 of ESMA's Consultation Report suggested that MMF rating methodologies used by CRAs may limit the flexibility available to MMFs to deal with large redemptions. In this context, we would like to highlight a number of features of S&P Global Ratings' methodology which are designed to provide flexibility during changing market conditions.

The use of a liquidity management tool by a MMF does not have an automatic effect on an S&P Global Ratings MMF rating. Our methodology allows for the use of liquidity management tools including suspending fund redemptions and payments in kind (defined as facilitating investor redemptions by delivering securities instead of cash).

In 2011, S&P Global Ratings introduced "cure periods" to take account of changing market conditions and the need for a degree of flexibility under certain circumstances. Cure periods provide MMFs time to adjust to changing market or portfolio conditions prior to considering a rating action for breach of methodology metrics. In cases where large redemptions may lead to a breach of portfolio metrics (for example, related to diversification, weighted average maturity, or credit quality), the methodology provides a range of cure periods for the MMF to rebalance and realign its composition to metrics consistent with the fund's rating.

Again, we agree that the methodology to assign ratings to MMFs should not incorporate mechanistic triggers between the use of liquidity management tools by the MMF and assigning a certain level of rating. However, in some situations, use of a liquidity management tool could lead to what we consider a default by the MMF.

For example, given the cash-like role of a MMF we would consider it to be in default if investors cannot receive the proceeds of a redemption request within five business days. We consider it to be appropriate for MMF ratings to have the tools to reflect such an outcome.

We believe that our approach of weekly surveillance, which increases in frequency during market stress, combined with respective cure periods gives a MMF significant capacity to adjust to changing conditions before a rating action would occur. Additionally, we have regular interactions with portfolio managers to understand market conditions and to assess the impact on rated MMFs.

Conclusion

With respect to the question posed in the Commission consultation, and as suggested by ESMA, we would like to ensure there is a well understood distinction between 'MMF ratings' and 'credit ratings' in any further policy initiatives concerning MMFs.

Moreover, we welcome ESMA's finding in its Final Report on the review of the MMFR that:

> "The majority of respondents did not see merit in amending the regulatory framework on the ratings of MMFs, given in their view, these ratings have not played a key role in the difficulties faced by MMFs during the March 2020 crisis."[6]

In this context, we note that the Financial Stability Board also did not make any specific recommendations concerning MMF ratings (or, indeed, credit ratings) in its Final Report on Policy Proposals to Enhance Money Market Fund Resilience.[7]

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[6] Ibid., page 8.

[7] Financial Stability Board, Final Report on Policy Proposals to Enhance Money Market Fund Resilience – Link.

In this respect, we consider that it is not appropriate for regulation to decide the nature of a CRA's opinions about a MMF. For example, we do not support the concept that regulation would decide when a MMF rating could change or what would constitute a default.

In the EU CRA Regulation (CRAR), by way of comparison, Article 23 specifically recognizes the need for CRA methodologies and credit ratings to be independent and free from external interference. We believe that this same principle of non-interference in methodologies should apply in the context of MMF ratings and other products or services provided by CRAs.

By contrast, we believe that it could be helpful to address any residual confusion between 'MMF ratings' and 'credit ratings' under any future review of the MMFR. For example, by correcting the wording of Article 26 which may potentially conflate 'MMF ratings' (in the title) with 'external credit ratings' in its main text.