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

29 March 2021

European Securities and Markets Authority

Date: 29 March 2021

Responding to this paper

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

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

2. contain a clear rationale; and

3. describe any alternatives ESMA should consider.

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

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

Instructions

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

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

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

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

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

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

Publication of responses

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

Data protection

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

Who should read this paper?

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

General information about respondent

Name of the company / organisation	Institutional Cash Distributors (ICD) - LTD
Activity	Exchange or Trading System
Are you representing an association?	☐
Country/Region	International

Introduction

Please make your introductory comments below, if any:

<ESMA_COMMENT_MMFR_1>
Institutional Cash Distributors (ICD), LTD is a UK-based entity providing an agnostic investment portal to institutional investors, namely treasury professionals in corporations and local authorities who use money market funds and other short-term instruments as safe, liquid investments for cash balances. Our trading platform is used by more than 400 clients across 65 industries in 43 countries. In the U.S., ICD is headquartered in San Francisco as Institutional Cash Distributors, LLC.

ICD brings together institutional investors with more than 40 fund companies offering money market products. We service over $5 trillion in money market trading annually across the UK, Europe and the U.S. It is from this vantage point that ICD offered comments to the Securities Exchange Commission in response to their Request for Comment on Potential Money Market Fund Reform Measures in the President's Working Group Report **(File No. S7-01-21)** and to the Financial Stability Board (FSB) and International Organization of Securities Commissions (IOSCO) during a 21 April 2021 Virtual Stakeholder Outreach Meeting on Enhancing the Resilience of Money Market Funds. ICD was the only money market trading portal invited from the private sector to take part in that meeting.

From our unique vantage point today, we respond to ESMA's Consultation Report: EU Money Market Fund Regulation – legislative review. In short, ICD believes that by looking at the U.S., ESMA already has evidence that funds perform worse where reforms have been enacted for eliminating stable NAV and strengthening the tie between liquidity and suspensions or gates.

In responding to ESMA, ICD has addressed select questions on these areas of reform and their impact on the resilience of money market funds, the effects on investor behaviour, effects on fund managers, and the broader impacts on stability and functioning of short-term markets.
<ESMA_COMMENT_MMFR_1>

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

<ESMA_QUESTION_MMFR_1>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_MMFR_1>

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

<ESMA_QUESTION_MMFR_2>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_MMFR_2>

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

<ESMA_QUESTION_MMFR_3>
ICD supports decoupling regulatory thresholds from suspensions/gates. When the commercial paper market seized in mid-March 2020 in the U.S, prime MMFs had ample liquidity to cover significant redemptions. As redemptions outpaced purchases, however, the weekly liquid assets (WLA) of some funds were heading towards 30%. Many of our clients decided to redeem their prime MMFs because they were concerned a gate would be imposed if weekly liquidity fell below 30%. From an early March high, our client average daily balance of U.S. Prime assets on ICD Portal dropped 80% by the middle of that month. In Europe, where the fees and gates provision are less onerous, the outflows and asset rotation from our platform was not as significant, decreasing 30% over that same period. A more direct tying of fees and gates to 30% liquidity in the U.S. caused greater stress around the market liquidity crisis.

Further decoupling would make it much easier for MMFs to tap into that liquidity buffer should they need to do so. If there are still concerns about liquidity, increasing liquidity buffers could help offset some of the concerns around the potential to drop below thresholds and enable funds to dip into those liquidity buffers more regularly.
<ESMA_QUESTION_MMFR_3>

Q4 i) Do you agree with the above assessment of the potential need to require MMFs to use swing pricing and / or ADL / liquidity fees and the corresponding proposal of amendment of the MMF Regulation (including the above list of corresponding potential benefits and drawbacks)? ii) If you are of the view that swing pricing might not be workable for certain types of MMFs, which instruments would you suggest as an alternative for these types of MMFs going forward? When

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

<ESMA_QUESTION_MMFR_4>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_MMFR_4>

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

<ESMA_QUESTION_MMFR_5>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_MMFR_5>

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

<ESMA_QUESTION_MMFR_6>

I. Impact on the resilience of MMFs

i. How would the policy option work in mitigating the structural vulnerabilities of MMFs?

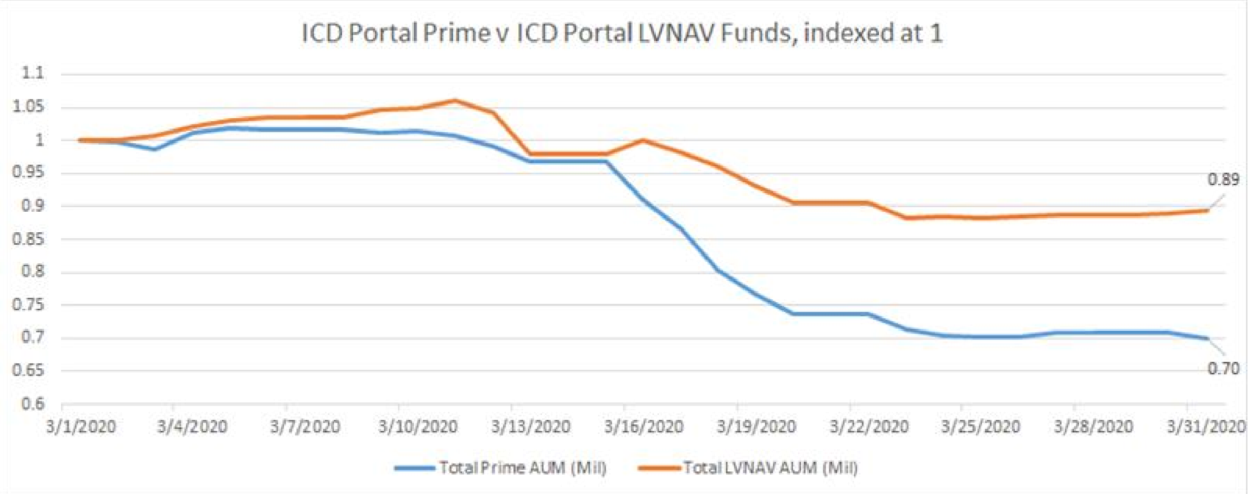
Amending MMF regulation to eliminate stable NAV funds could have the unintended consequences, as we've seen in the U.S., of small losses due to temporary dislocation in mark-to-market valuation for investments designed to be held to maturity. It will potentially cause additional investor outflows, above and beyond what ordinarily would be expected with a stable NAV product that values itself at amortized costs. In addition, the unintended result of the proposal to switch from LVNAV to VNAV will result in significantly less utilization of the funds.

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

If we look at evidence from the U.S., the resilience of LVNAV funds can be seen both prior to reform and more recently in March 2020. According to Crane Data, a year prior to MMF reform (31 October 2015) prime fund assets hovered at $863 billion. Even at times when cash levels are at an all-time high, prime still tracks at more than 20% below the pre-reform period. As a result of reform mandates to switch to VNAV funds, prime assets have been reduced 22% to $676 billion, as of 31 May 2021, according to Crane Data's institutional prime money market fund index, diminishing this instrument as a useful investment tool for treasury groups.

Further evidence of the resilience of LVNAV can be seen from March 2020, when reforms were in place. From the period 1 March 2020 – 31 March 31 2020, ICD saw significantly more pronounced outflows of VNAV funds in the U.S. (30%) versus LVNAV funds (11%) in Europe [Figure 1].

Figure 1.



Source: ICD Data

II. Effects on investor behaviour

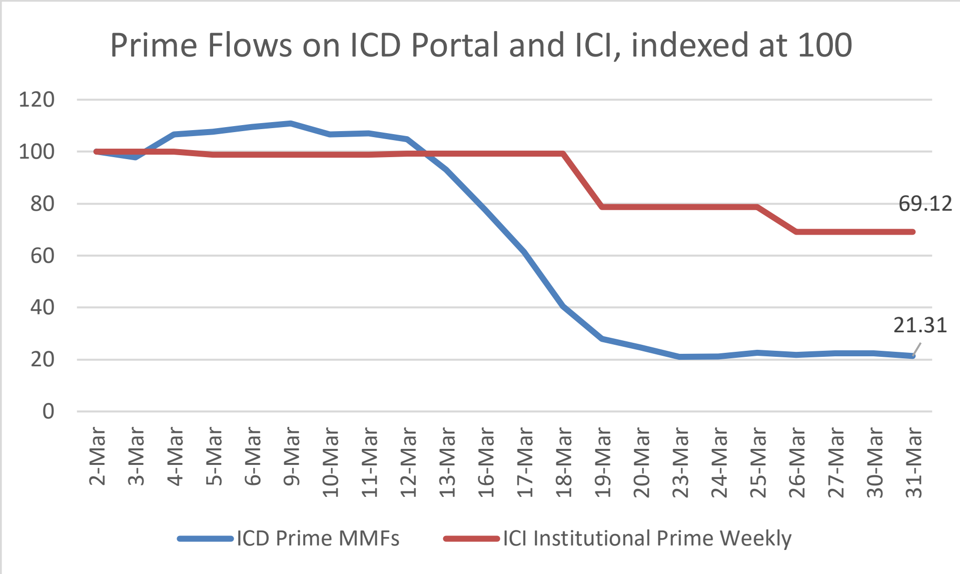
i. From a micro perspective (viewing the MMF in isolation), how would the policy option effect investors' incentives to redeem during stress events?

From what we saw in the U.S. where VNAV was already in place, we saw significantly elevated selling versus Europe in part because there were losses captured due to the temporary dislocation of the mark-to-market, which was not replicated in Europe where the funds are still valued at amortized cost.

ii. From a macro perspective, how would this option mitigate the effects of a generalized "dash for cash" as seen in March 2020?

What we saw from both ICD client data and industry data overall was that it exacerbated the "dash for cash" [Figure 2].

Figure 2.



Sources: ICD Data; Investment Company Institute (ICI)

iii. Does the option effectively shift MMF risks to investors?

While it shifts the mark-to-market risk more directly to investors, it exacerbates mass redemptions by having minute and temporary dislocations in mark-to-market valuations, causing investors to sell in larger numbers where the amortized cost methodology still exists.

IV. **Broader impacts on the stability and functioning of short-term markets**

i. Where are investors likely to move if MMFs become less attractive as a result of the policy option?

Removing LVNAV and mandating floating NAV would make banks more systemically significant. VNAV funds would become more of an accounting burden to investors, who then would be moving money into bank deposits, further concentrating risk in that sector. In addition, investors may look to invest directly in securities themselves, potentially without the infrastructure in place to hold the securities or the expertise to assess the credit risk of a single issuer.

ii. What alternative sources of short-term funding are available for borrowers that currently rely on MMFs for financing?

Diminishing the usefulness of MMFs as investment vehicles will significantly restrict corporate funding options, having a down-stream impact for smaller borrowers. As commercial paper accounts for a significant amount of underlying assets in MMFs, the impact of reducing corporate borrowing options will make large corporations more dependent on commercial banks for funding, which in-turn would squeeze-out smaller corporations who rely on these banks today.

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

Switching to VNAV for those trading funds from Asia would make settlement T+1 because investors would have to wait for the price in order to settle.
<ESMA_QUESTION_MMFR_6>

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

<ESMA_QUESTION_MMFR_7>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_MMFR_7>

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

<ESMA_QUESTION_MMFR_8>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_MMFR_8>

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

<ESMA_QUESTION_MMFR_9>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_MMFR_9>

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

<ESMA_QUESTION_MMFR_10>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_MMFR_10>

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

<ESMA_QUESTION_MMFR_11>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_MMFR_11>

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

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

<ESMA_QUESTION_MMFR_12>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_MMFR_12>

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

<ESMA_QUESTION_MMFR_13>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_MMFR_13>