Amundi
ASSET MANAGEMENT

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FSB - Policy Proposals to Enhance Money Market Funds Resilience Consultation report

Amundi AM comments

Executive summary

Amundi is the European largest asset manager by assets under management and ranks in the top 10 globally. It manages 1,729 billion euros of assets, as of end of 2020, across six main investment hubs in Boston, Dublin, London, Milan, Paris and Tokyo. Amundi offers its clients in Europe, Asia-Pacific, the Middle East and the Americas a wealth of market expertise and a full range of capabilities across the active, passive and real assets investment universes. Clients also have access to a complete set of services and tools. Headquartered in Paris, Amundi was listed in November 2015.

Amundi is also a leading and longstanding actor in managing liquidity funds, with 222 billion euros of assets as of end of 2020, out of which 180 billion euros of money market funds (MMFs) domiciled in the European Union, thus following the European Money Market Fund Regulation (MMFR).

Amundi is notably the world largest manager of euro-denominated MMFs, with 175.4 billion euros of assets as of end of 2020. Most MMFs under its management belong to the VNAV (Variable Net Asset Value) type category and are domiciled in France. It also operates in the LVNAV (Low Volatility NAV) MMF market by offering two Luxembourg-domiciled funds, AAA-rated and denominated in euro and USD respectively.

We welcome the opportunity to provide a response to this Consultation report on Policy Proposals to Enhance Money Market Fund Resilience.

This Consultation occurs after, notably, the launch of the "Request for Comment on Potential Money Market Fund Reform Measures in President's Working Group Report" by the Security and Exchange Commission last February, and the "Consultation Report on the EU Money Market Fund Regulation", by the European Securities and Markets Authority last March.

We naturally fully support the will of the FSB to draw the conclusions of March 2020 events where public and financial authorities had to intervene on different fronts, notably on short-term funding markets (STFMs), whose liquidity was significantly damaged by an urgent and widespread need for cash.

However, there is, in our view, a considerable risk in assessing that MMFs were the trigger of this liquidity crisis while they only revealed it. Accordingly, considering that the recently-applied MMF regulations need to be deeply reformed will contribute to missing the target. In this respect, while the report provides i) a useful and detailed description of MMF market and regulatory environment and ii)

a fair analysis of interactions between MMFs and STFMs, we would like to **share some concerns over the tonality of the report.**

Indeed, the report refers to MMF vulnerabilities that would have emerged from the Covi19 crisis, while we do consider that the difficulties MMFs encountered in March 2020 mainly stemmed from a disruption in the functioning of STFMs. Our perception is that the report underestimates the potential options that could be explored to improve the liquidity of STFMs, especially under stressed conditions. On this respect, we think that a lot can be achieved, on both player and instrument areas. Similarly, the report devotes a disproportionate share to the different options that are supposed to address MMF vulnerabilities: some of these options are unrealistic or potentially dangerous for MMFs' very existence.

We thus strongly recommend taking into account the following points when reviewing the different rules that MMFs have to comply with in their different jurisdictions:

- **MMFs' functions and roles are precious**. Indeed, for years, MMFs have brought various and valuable benefits to real economy by continuously offering smooth and reliable solutions to both borrowers and investors in the short term part of financial markets. It appears in the report that none of the different substitutes for these functions provide, on an incontestable manner, higher benefits than MMFs do.

- **Covid19 pandemic triggered a liquidity crisis by disrupting the balance of STFMs**. The succession of events observed globally in March 2020 – generalization of lock-down measures, sudden and crucial need for cash, rapid freezing of short term financial markets, intervention of public and financial authorities – has little to do with the 2007-2008 crisis. In one case, a deep credit crisis affected huge parts of financial assets. In the other case, an external and massive shock stroke simultaneously the economic and financial spheres.

- **MMF entered the Covi19 crisis in a strong and resilient shape**. The different MMF reforms that had come into force months, or a few years, prior the apparition of the new coronavirus enabled MMFs to enter this exceptional crisis with sound assets. More generally, the reliability and overall quality of MMFs was not challenged by their users, either before, during or after March 2020 turmoil. This has been evidenced by the strong and rapid return of MMF's clients on the subscription side as early as April 2020 until now. **We thus do not share the view that a "moral hazard" context prevailed when assessing the March 2020 events**.

- **Central bank interventions to fix functioning of STFMs should be deeply analyzed**. It is, in our view, of utmost importance to recall the context that surrounded those interventions. First, money-market instruments had not been, until March 2020, targeted by any quantitative easing policy. This was clearly not the case when it comes to other fixed income instruments, like asset-back securities, credit and public bonds (and even equities in some jurisdictions), that had been purchased (and still are) by different central banks years before the pandemic outbreak. In addition, **operational issues** encountered when implementing purchase of money market instruments should not be overlooked: central banks and market dealers had to define, on a an emergency mode, aggravated by the work-from-home generalization, new processes adapted to the specific transaction channels where money market instruments were operated.

Against this background, our response to this consultation is intended to be constructive by recommending regulators acting on regulations of both STFMs and MMFs.

First and foremost, liquidity of STFMs needs to be improved by favoring reforms on both fronts of actors and instruments. The targeted actions should focus on market transparency, instrument standardization, review of prudential and liquidity rules applied to banks when purchasing commercial papers (CPs), incentivisation of market dealers, enhancement of links between dealers and central banks, facilitation of processes granting refinancing eligibility to CPs. Such reforms would not only considerably reduce the risk of March 2020 events repeating, but they will help money market players, including MMFs, to rely on more accurate market data, for the good of their respective functioning processes.

With respect to MMF regulation, we do believe that the various reforming processes released in the aftermath of 2007-2008 crisis have provided efficient and well-fitted frameworks in the jurisdictions where they have been implemented. Then, **it would be detrimental adopting disrupting policies in the area of MMF regulation,** as this would impair the whole equilibrium of STFMs, thus the key financial tools used by real economy players. This being said, it cannot be ignored that Covid19 pandemic has triggered a dramatic, unprecedented and unforeseeable shock on large parts of the economic and financial environments. This is the reason why we share the view that **MMFs' resilience could be enhanced through targeted adjustments of existing regulation.**

Taking the example of MMFR these adjustments could be defined as follows:

- **Adjustable exit fees** could be made mandatorily available for all MMFs, as an anti-dilution levy likely to be used in times of exceptionally stressed conditions. The resort to such a liquidity management tool not only could reduce the redemption flows but also guarantee the permanence of fair treatment owed to all MMF users.
  The mechanism and/or the decision process that will govern the triggering of such tool will also have to be precisely defined taking into account possible undesired effects, once the exit fees effectively activated. Moreover, the **calibration of such fees will have to rely on accurate and incontestable market data**. This means that such adjustment will require to significantly improve the standardization and transparency of STFMs before being effectively imposed to MMF managers.

- **The "Know your customer" policy (Art. 27 of MMFR) could be enriched with level 2 or 3 guidance**, as it is already the case for the "Credit quality assessment" policy. This guidance could require each MMF to define an **additional liability-driven buffer of liquid assets**. The level of this buffer would derive from each MMF's stresses liability structure. The "liquid assets" eligible to this buffer would have to be defined under this guidance.

We consider that these proposals could be adopted in all the jurisdictions, as their objective is to strengthen MMF autonomy / resilience during time of exceptional stress.

Overall

1. What are the key vulnerabilities that MMF reforms should address? What characteristics and functions of the MMFs in your jurisdiction should be the focal point for reforms?

It is indisputable that in March 2020, MMFs had to cope with challenging conditions as the liquidity of STFMs had suddenly deteriorated. However, we do not share the view that i) MMFs' exposure to "sudden and disruptive redemptions" in episodes of stress or ii) MMF's difficulties in selling assets because of the "limited liquidity" of CP and negotiable CDs, constitute *per se* vulnerabilities in MMFs. Such assessments tend, in our view, to confuse the causes and the consequences of the unprecedented shock that affected the economic and financial environment in a whole during the Covi19 crisis in March 2020

On the contrary, thanks to the well-fitted reforming process of global regulation that had taken place in the wake of the Global Financial Crisis (GFC), MMFs entered the Covid19 crisis in a strong and resilient shape that enabled them to **go through this "full scale stress test".** Indeed, the quality of their assets was undoubtedly sound, their liquidity buckets were comfortable, while redemptions were only motivated by a vital need of cash by their holders or by seasonal quarter-end operations. MMFs, as key players in both sides of the STFMs, acted – or reacted - as a censor of the severity of the crisis, rather than as a trigger of "exacerbation of financial stress". More specifically, when focusing on European MMFs, it is worth mentioning that ECB emergency measures did not specifically target MMFs, but all the players of SFTMs, including i) dealers, through the relaxing of some solvency and liquidity rules, which helped them re-enter the market, and ii) non-financial CP issuers, through the Pandemic Emergency Purchasing Programme (PEPP). In addition, we would like to recall that although the effective implementation of such measures took some time, no disruptive event, like NAV suspension for example, occurred during the crucial month of March 2020.

We then favor some targeted adjustments of current regulation, that we detail in the responses to next questions (notably question 2), aimed at enhancing MMFs' autonomy / resilience in periods of stress, but only as part of an overall global review of STFMs' functioning, where we consider that a lot can be achieved.

As regards the characteristics and functions of MMFs that should be the focal point for reforms, our strong belief lies in the two following assessments:

- As their name rightly suggests, MMFs are collective schemes invested in money markets. Whatever their types (stable/low volatile or floating/variable NAV), their investment universe (public or non-public debt markets), **MMFs should always be considered as investment-like, rather than cash-like, vehicles**, as their portfolios' holdings are primarily made of tradable market instruments. The non-guaranteed, non-supported profile of MMFs under the current European Regulation (MMFR) is in our view a solid reminder towards users of MMFs that the latter are an investment-like solution to manage their excess liquidity. Correlatively, it should be also recalled that as investment vehicles, MMFs' liquidity is mechanically dependent on underlying markets' one.

- By smartly and regularly linking borrowers and investors within the STFMs, **MMFs play an instrumental role in the way they facilitate a smooth funding of real economy**. As the FSB report correctly implies, no real alternative could dominate MMFs, either for issuers – when considering other options to raise short term money -, or for investors, when considering other options to manage their excess liquidity.

Regulators should then make sure that any contemplated reform option would not weaken the two features described above.

2. What policy options would be most effective in enhancing the resilience of MMFs, both within individual jurisdictions and globally, and in minimising the need for extraordinary official sector interventions in the future?

As mentioned in our response to question 1, we strongly believe that MMF recently-reviewed regulations helped MMFs to face the most extreme episode of Covi19 crisis (on a financial stability standpoint). Accordingly, central bank interventions, though they provided a decisive relief to market functioning, should be viewed in their full context. As an example, commercial papers (CPs), though representing a significant part of debt markets**, had not been targeted by ECB's APP (Asset Purchasing Programme) until March 2020**. By way of comparison, asset-backed securities, public sector and credit sector bonds have been regularly purchased by ECB for years. Importantly as well, financial CPs, which represent the main part of European MMFs' holdings, have not been part – obviously - of any purchasing programme launched by ECB. Moreover, building-up the different channels enabling ECB and NCBs (National Central banks) to purchase CPs **required some time, as it had never been implemented before**. Lastly, operational issues raised by the lock-downs and their related work-from-home mode exacerbated the stress sentiment then prevailing. Thus, it would be unfair, in our view, to conclude that "extraordinary official sector interventions" which took place last year, targeted the sole MMF sector.

This being said, and in the light of March 2020 events, we consider that resilience / autonomy of MMFs could be further enhanced through amendments focusing on the management of their liabilities.

First, we advocate for MMFs to be mandatorily equipped with an appropriate Liquidity Management Tool (LMT) that would take the shape of an **adjusted exit fee set-up**. In case of exceptional market stress and shrinking liquidity, such a tool could be activated. It would then play its role of Anti-Dilution Levy (ADL) by making sure that remaining MMFs' holders would not subsidize exiting ones at times when the cost of liquidity reaches material thresholds above which the fair treatment of shareholders could be weakened. However, the crucial issue of the conditions where such LMT would be effectively activated has yet to be addressed.

- If left at the sole hands of asset managers, there is a real risk of "stigma" by which such a decision will eventually be avoided. Reversely, any exit fee activation on a given MMF could trigger unexpected redemptions on other MMFs.
- If activated under a rule-based approach, there is also a risk of a false signal, with unforeseeable impact on investors' behavior.
- Assuming that only extreme and exceptionally stressed conditions could lead to envisage restraining the liquidity of MMFs, the decision could be left to an expert group in liaise with local regulator(s). However, here again some questions would have to be addressed. What would be the scope of application of such a disruptive decision: should it be applied to all types of MMFs? (In Europe, CNAV, LVNAV, VNAV), to all categories? (In Europe, Short Term,

Standards), to all currencies? (In Europe, EUR, GBP, USD, others). The timing would also bear a crucial importance, given the specificities of MMFs, which are mainly traded on a same-day settlement mode.

In any case, prior to any reform in this respect, it would be of utmost importance to first enhance underlying markets' transparency and standardization. Indeed, the calibration of exit fees is another key element that requires a reliance on accurate and incontestable market parameters.

Second, we believe that there is room for **enhancing MMFR provisions on "KYC" policy (Know You Customer)** through level 2 or 3 additional guidance, as it is already the case for Credit Quality Assessment provisions. Such guidance could impose asset management companies to assess their own need for an additional bucket of liquid assets. The level of this additional liquidity buffer would derive from each MMF's stressed liability structure and the assets to be considered as "liquid" (thus eligible to the composition of the liquidity buffer) would have to be defined.

3. How can the use of MMFs by investors for cash management purposes be reconciled with liquidity strains in underlying markets during times of stress?

As previously mentioned, it would be misleading to affirm that MMFs are disconnected from the markets in which they are permanently invested. As a long-standing manager of MMFs, we believe that an overwhelming part of customers are perfectly aware of this close link between MMFs and underlying markets. This link is visible through different parameters like yield, volatility and, obviously, liquidity. We then do not consider that the use of MMFs by investors need to be "reconciled" with liquidity strains in underlying markets during times of stress.

Our view is that the dramatic worsening of the pandemic, in March 2020, triggered a very comprehensible need for cash by a growing number of companies and institutions. Such a sudden and exogenous shock was unanimously seen as an unprecedented event, which deeply affected a large part of developed countries. Liquidity strains in STFMs that accompanied this shock logically affected all money market players, including MMFs. A majority of market dealers could first manage to absorb the wave of sales (on the primary market, coming from corporate issuers, and on the secondary market, coming from MMFs). However, as their liquidity and solvency ratios were swiftly deteriorating, bids vanished, which led to a freeze of STFMs.

Despite i) the very challenging situation that MMFs had to face, and ii) the fact that public interventions not only took some time to be implemented but also - as long as European MMFs are concerned - did not target the bulk of European MMFs' portfolios, i.e. financial CPs, it is worth noting that no MMFs had to suspend their NAV calculation during this particularly stressed episode.

We then believe that STFMs are definitely the area that future reforms should focus on. In that prospect, both players and instruments should be targeted by regulators, so as underlying markets keep on functioning during periods of exceptional stress like the one that occurred in March 2020.

When it comes to MMFs, we reiterate that some targeted measures could contribute to enhance their resilience (see response to question 2).

Forms, functions and roles of MMFs

4. Does the report accurately describe the ways in which MMFs are structured, their functions for investors and borrowers, and their role in short-term funding markets across jurisdictions? Are there other aspects that the report has not considered?

On a general standpoint, the report accurately describes MMFs, their structures, their functions and their role in STFMs across jurisdictions.

1- We particularly commend the mention (last § of p8) underlining the specificity of EU MMF market, where less than half of MMFs are EUR-dominated (45% of AuM). **This means that 55% of European MMFs are denominated in currencies (USD and GBP) that are not supervised by the local central bank.**

2- We also agree with the way benefits provided by MMFs to both investors and borrowers are described in the report. Indeed,

- By purchasing and, most of the time, rolling, a significant part of money market instruments (including financial and non-financial Commercial Papers), MMFs represent a key, stable, reliable, strongly-regulated source of funding for real economy, particularly in the private sector.
- By providing their holders with diversified, low volatile, competitive collective schemes, MMFs are seen as one of the most efficient means to invest excess liquidity.

Preserving such efficient and valuable functions should then be a key driver when assessing the possible reforms of MMF regulations across jurisdictions.

3- However, we would like to make a few points regarding this part of the report:

- In the Box 1 (p10), the report refers to a category of "ultra-short term bond funds", which would "not be considered as MMFs in the US, while regulated in the EU as MMFs". This assessment bears, in our view, a misleading interpretation, as we have not any knowledge of a strict, legal definition of "ultra-short term bonds" either in the US or in the EU jurisdiction. Indeed, this could lead to the conclusion that all European "ultra-short term bond funds" - as far as it is possible to identify them accurately, are regulated as MMFs. This is definitely not the case. In other words, **European Standard MMFs cannot be defined as "ultra-short term bond funds", as they abide specific rules defined by MMFR.**

- Last § of p12: it is important not to distinguish between volumes and liquidity, especially when analyzing STFMs. The latter differ from broader bond market in a number of structural and technical features, such as:

    - Mostly buy-and hold driven
    - Generally low volumes on secondary market
    - Limited number of players
    - Specific settlement channels
    - Modest arbitrage opportunities

- Limited range of maturities

Obviously, these features increase the specificity of STFMs when compared with other fixed income markets. However, getting a bid under normal market conditions has never been an issue, which means that **liquidity, defined as the rapidity and easiness to sell a position, remains high in STFMs.**

In addition, there is a striking contradiction when the report notes i) that liquidity is "limited in secondary markets" and ii) that "dealers have limited economic incentives to make markets (…) given narrow bid-ask spreads". Indeed, narrow bid-ask spreads generally mirror liquid markets like, for example, government bonds. Our analysis is that market dealers' incentive in purchasing such instruments has considerably shrunk due to the **continuous tightening of solvency and liquidity rules attached to such deals in the last years.** This is exactly the reverse situation when it comes to government instruments, where regulation has continuously favored their holdings and trading by banks in the last decade.

5. Does the report accurately describe potential MMF substitutes from the perspective of both investors and borrowers? To what extent do these substitutes differ for public debt and non-public debt MMFs? Are there other issues to consider?

On a general standpoint, we agree with the report when listing the different potential MMF substitutes from the perspective of both investors and borrowers. However, we consider that none of the identified substitutes, either on the investment side, or in the borrowing side, could provide better or more efficient services than MMFs have done for decades.

Investment side

We agree with the assessment made in the second § of the section 2.4 of the report. It rightly underlines that deposits offer less diversification for large investors (which is a euphemism). In fact, deposits offer no diversification at all, not only for large investors, but also for smaller ones. In addition, it is worth recalling the risk-asymmetry of bank deposits, when considering **the possibility to see the bank entering in a resolution mode**. As a reminder, the latter is one of the area where banking regulation has evolved the most since the Global Financial Crisis (GFC) of 2007/2008.

Reversely, we do not share the assessment made in the third §, regarding public debt MMFs as potential substitutes of non-public debt MMFs offering "investors safety and liquidity". This analysis implicitly assumes that public-debt asset class is irrevocably immune from any credit or liquidity crisis. Yet, such events happened in the US (successive episodes of shutdown issues observed in the last decade in relation to the vote by Congress to heighten the public debt ceiling) and in the EU (sovereign crisis in 2011 and in the following years). **Moreover, the perception that public debt is an all-times safe heaven could be falsely enhanced by the global quantitative easing policies implemented globally within the hard-currency areas for years.**

<u>Borrowing side</u>

As the report suggests, bank loans represent the main candidate for replacing MMFs in providing short term funding to CP issuers. The report also rightly underlines that such a substitute would provide **less diversification and higher funding costs to borrowers.**

With respect to the arrival of other institutional investors, identified as a substitute of MMFs in the report, we hardly understand in what extent this could improve financial stability. Not to mention the increased volatility that STFMs would undergo, due to a **less regular and much more opportunistic presence of such investors, when compared with MMFs.**

To summarize, we firmly believe that MMFs efficiently perform a two-sided function (provider and taker of liquidity) with no credible alternative.

To investors, MMFs provide a diversified, low volatile, strongly regulated solution for investing excess liquidity. Asset managers' expertise on markets, credit analysis or portfolio management can be fully exploited at a limited and mutualized cost.

To borrowers, MMFs provide a continuous presence on the buy side of STFMs, and help short-term market rates to keep a smooth and measured trend.

This demonstrates the crucial role of MMFs as a stable intermediary between investors and borrowers in the short end of debt markets. By being continuously present on the buy-side of STFMs, we can also affirm that MMFs do their bit to the medium to long term funding of real economy. Accordingly, regulators of all jurisdictions should primarily seek to preserve MMFs' virtuous functions when assessing the potential changes in MMF regulation.

Vulnerabilities in MMFs

6. Does the report appropriately describe the most important MMF vulnerabilities, based on experiences in 2008 and 2020? Are there other vulnerabilities to note in your jurisdiction?

As mentioned in our response to question 1, we believe that MMFs entered the Covid19 crisis with strengths rather than with vulnerabilities, especially when compared to 2008 events. Indeed, no concern was recorded regarding the credit quality of their holdings, the structure of their portfolios or the level of their daily or weekly liquidity ratios. No defiance either was recorded among **MMF users, who swiftly went back using these vehicles once financial markets recovered**, helped by exceptional measures taken by both financial and political authorities across the world.
Indeed, the sudden and violent nature of the shock caused by the pandemic and its frightening consequences (as then perceived by most market and economic participants) rapidly convinced authorities to take emergency measures, pursuing a single objective: prevent a collapse of financial markets and economies, on a "whatever it takes" mode.

Given the growing need for cash in front of the drop in revenues and/or the surge in spending needs, STFMs soon saw their liquidity ailing then freezing, preventing any market player (including, but not only, MMFs) from disposing their assets.

In such circumstances, we strongly disagree with the assessment of the last § of p18, which states that “large redemptions in MMFs contributed to sharp increase in the cost of short-term funding for borrowers”. **This provides an unfortunate confusion between the origin of the liquidity crisis that occurred in March 2020 and its immediate consequences**. Moreover, widening of credit spreads not only affected STFMs, but also the other parts of debt markets, where MMFs are obviously absent.

Consequently, we reiterate our belief that most efforts of regulators should focus on measures that will help STFMs keep on functioning during stress periods.

As regards the vulnerabilities attributed to MMFs in the report, we would like to make the following comments:

Susceptibility to sudden and disruptive redemptions

- First § p 23: as most collective schemes, MMFs perform liquidity transformation. The current MMF regulation precisely addresses possible liquidity mismatch issues by imposing a series of rules (quality of assets, weighted average life and maturity, liquidity ratios, mark to market valuation, know your customer, stress tests), that other fixed income funds do not have to follow. As a reminder, this regulatory framework helped MMFs to prevent any suspension of their NAV during March 2020.

- Second § p23: as mentioned in our response to question 1, MMFs should be considered as **investment-like rather than cash-like schemes**. This is in our view a key feature embedded in their very name (“money market funds”, i.e. funds invested in money markets). We consider that this feature is clear enough in the current MMF regulation, which leaves no doubt regarding the nature of the assets held by MMFs (mostly money market instruments), and mandates asset managers to disclose the fact that in no way, the value of MMFs is guaranteed.

- To summarize, we consider i) that the current MMF regulation already addresses most of the features that could, separately or collectively, trigger huge redemptions in MMFs, and ii) that the wave of outflows that MMFs faced in March 2020 only stemmed from the urgent need of cash that arose from the Covid19 crisis.

Challenges in selling assets to meet significant redemptions

- Second §, p24: we do not share the view that “CP and negotiable CDs, typically have little secondary-market trading”. Indeed such a statement suggests that STFMs provide poor liquidity even under normal market conditions (please refer to our response to question 4). Indeed, most of the time, MMFs are able to meet redemption requests without resorting to any sale in the STFMs. This being said, it is also true that MMFs have generally no difficulty to dispose their assets in the market, when the level of redemptions requires doing so.

- Third §, p24: we tend to agree with the assessment that “similarities in MMF portfolios may present contagion risks among MMFs”.

It is important, in our view, to recall that such similarities stem from two objective factors. First, recent reforms in MMF regulation have **limited the eligible assets that MMF managers are allowed to purchase. Second**, non-standard policies that central banks have implemented for years (for example LTROs / TLTROs in the EU), together with the tightening of banks' liquidity ratios (for example, LCR and NSFR) have **significantly reduced banks' short-term funding needs.** This induced MMFs' investment universe to shrink further, and explains the "similarities" mentioned in the report.

In such a context of scarce investment opportunities, we would like to recall that Standard MMFs (mostly euro-denominated) invest in a wider range of maturities than other EU MMFs. Hence, for this category of MMFs, the contagion risk due to overlapping positions across the different MMFs remains modest. This point is key, especially when contemplating reform options aimed at tightening further the limits on eligible assets (p37 of the report)

Policy proposals to enhance MMF resilience

7. Does the report appropriately categorise the main mechanisms to enhance MMF resilience? Are there other possible mechanisms to consider? Should these mechanisms apply to all types of MMFs?

When analyzing the table 3, displayed p27 of the report, we do not have particular comments regarding the categorization of the main mechanisms to enhance MMF resilience. Yet, we would like to make some points for each of them:

Impose on redeeming investors the cost of their redemptions

As mentioned is our response to question 2, requiring MMFs to resort to an anti-dilution levy (ADL) could be envisaged in order to enhance MMFs' autonomy in period of exceptional stress, i.e. of the same magnitude as March 2020 crisis.

However, **we do not consider swing pricing as the relevant representative option associated to such a mechanism.** Indeed, while this anti-dilution levy fits well with bond funds, where NAV are generally traded at least on a "day + 1" settlement mode, it would be impracticable when applied to MMFs, where NAV are traded, most of the time, on a same-day settlement mode. In addition, the report states that "swing pricing would not be compatible with stable NAV, because it causes fluctuations in a fund's NAV". **A workable substitute to swing pricing could take the shape of adjustable exit fees.** Such a set-up, easier to implement, would similarly facilitate the reach of the primary and secondary objectives defined in the table 3 of the report.

Absorb losses

As a preliminary comment, we consider that the current MMF regulation correctly addresses the way potential losses recorded in a MMF are supposed to be absorbed. Indeed, as for any collective investment vehicle, MMFs' risks are naturally borne by their holders. This is precisely underlined in MMFR (for example) where MMFs are clearly described as non-guaranteed schemes, moreover with a specific article (Art 35) banning any kind of external support[1]

1 *In the US, sponsor-support can be performed under certain conditions.*

granted to a MMF. In addition, all the provisions covering the mark-to-market[2] methodology, that MMFs must apply when evaluating their assets, enhance the framework in which market losses are meant to be borne by MMFs' holders.

Therefore, we believe that this mechanism is already active, so there is no need to contemplate options in relation with it. In addition, the two representative options that the report relates to this mechanism are, in our view, either unworkable on an operational standpoint (Minimum balance at risk), or potentially lethal for MMFs (Capital buffer).

Reduce threshold effects

This mechanism is specifically dedicated to CNAV and/or LVNAV MMFs. Our footprint in this market is quite modest (less than 2% of our MMF's assets), compared with VNAV MMFs, that are not exposed to any cliff or threshold effects, as they apply a full mark to market methodology when pricing their assets.

Hence, addressing threshold effects in CNAV / LVNAV MMFs should be made through the lens of the way these funds price their assets.

Indeed, we would like to recall, as far as MMFR is concerned, that CNAV and LVNAV MMFs have been dedicated a series of specific articles or paragraphs (Art 29, §6 and §7, Art. 31, 32, 33, 34), notably covering the conditions under which these funds can maintain a cost amortization methodology when pricing their assets.

This being said, none of the three LVNAV funds (in EUR, USD and GBP) we used to manage in March 2020 experienced any pre-emptive redemption that could have been motivated by a fear to be gated otherwise.

Reduce liquidity transformation

As already mentioned, a MMF, like any other investment fund, performs liquidity transformation. Nevertheless, unlike any other fund, a MMF has to comply with a specific set of rules covering all aspects of their management: strictly defined investment universe, credit quality of assets, limited average life and maturity (WAL / WAM), minimum daily and weekly maturing assets ratios, "know your customer" provisions, stress tests, mark to market, etc.). This closely regulated and recently defined framework, undoubtedly helped MMFs to cope with March 2020 crisis with no significant damages, and eventually no disruptive event like NAV suspension.
We then believe that such a toolkit (i.e. MMF regulation) constitutes a strong shield against liquidity shocks.

This being said, Covi19 crisis taught market and economic players, whether in the private or in the public space, that exceptional, sudden, exogenous shocks, though unforeseeable, could happen and trigger dramatic domino effects within both economic and financial spheres. Without the swift intervention of political and financial authorities, many parts of real economy and financial markets would have collapsed with unpredictable consequences. **And**

2 *Except for CNAV and LVNAV MMFs, that may derogatorily resort to a cost amortization methodology. VNAV MMFs apply a "full mark to market" methodology*

here, it would be misleading to suggest that any moral hazard context was the cause of such prompt and massive interventions.

This is the reason (e.g. the fact that Covid19 crisis happened) why we consider that the monitoring of the liquidity transformation performed by MMFs could be further improved. However we are not in the view that the two representative options, as described in the report (table 3, p27), would be efficient.

Notably the first one, that would impose additional limits on eligible assets, could even harm MMFs' effective functioning. Indeed, it is widely admitted that the difficulties MMFs faced in March 2020, when selling their assets, were not due to the quality of the latter, but to the actual closing of STFMs. Tighter limits on eligible assets would have provided no help to facilitate the disposal of instruments that markets could not absorb anymore, whatever their quality and/or their maturity.

Moreover, as mentioned in our response to question 6, adopting such an option would mechanically increase the "similarities in MMF portfolios" already pointed out by the report as a contagion risk factor. **More limits on eligible assets = more contagion risk.**

Similarly, we do not favor the implementation of the second representative option, e.g. additional liquidity requirement and escalation procedures. At least, not in the way it is envisaged in the report.

Indeed, rather than imposing an additional systematic constraints on MMF assets, we would suggest to adapt, within MMF regulation, the provisions covering the "know your customer" (KYC) policy as defined in MMFR Art. 27.

This adjustment could take the shape of level 2 or 3 clarification. Such clarification should notably specify more details when describing the procedures that asset manager are required to define in order to "establish, implement and apply" (…) "with a view to anticipating the effect of concurrent redemptions by several investors, taking into account at least the type of investor, the number of units or shares in the fund owned by a single investor and the evolution of inflows and outflow"[3]

Thus, similarly to the paragraph of MMFR dedicated to "Internal credit quality assessment procedure", (Art. 19), this approach could be adopted when ruling the procedures that an asset manager should follow in the KYC area.

One of the main requirement could obviously be the calibration of a **liability-driven liquidity buffer.**

The eligible assets of this additional liquidity buffer could also be defined in this level 2 or 3 provision. We have identified two types of instruments that could be considered as part of this buffer. Firstly, **commercial papers issued by banks and maturing in less than one month** are usually extremely easy to sell, particularly to their issuer. This is due to the fact that the LCR (Liquidity Coverage Ratio) "value" of these instruments drops to zero when reaching the 30-day residual maturity, not to mention that their short maturity increases their intrinsic

[3] *Extracts from MMFR, Art. 27.*

liquidity. Secondly, **assets referred to in Article 17(7) of MMFR** could also be part of the additional buffer, given the nature of their issuers.

8. Does the assessment framework cover all relevant aspects of the impact of MMF policy reforms on fund investors, managers/sponsors, and underlying markets? Are there other aspects to consider?

Please, see our responses to questions 4, 5, 6 and 7.

9. Are the representative policy options appropriate and sufficient to address MMF vulnerabilities? Which of these options (if any) have broad applicability across jurisdictions? Which of these options are most appropriate for public debt and nonpublic debt MMFs? Are there other policy options that should be included as representative options (in addition to or instead of the current ones)?

As mentioned in our response to question 7, we have identified two mechanisms that could enhance MMFs' resilience in case of exceptional stress: i) impose on redeeming investors the cost of their redemptions and ii) reduce liquidity transformation. For each of them the relevant representative options that could be explored are:

- Adjustable exit fees, activated in case of exceptional liquidity crisis
- Definition and calibration, by the asset manager, at each fund level, of a liability-driven liquidity buffer, supported by level 2 or 3 (for EU) clarifications of regulation's KYC provisions.

Concerning the question whether such options could have broad applicability across jurisdictions, our answer would be yes, even though the proposed implementation of the second one derives from EU MMFR.

In addition, we would like to make the following comments, linked to the part 4.3 of the report.

<u>Representative option: swing pricing (and variants)</u>

The description and assessment made by the report rightly mentions, or suggests, that swing-pricing option may bear some drawbacks when being effectively implemented in MMF ecosystem. One of these drawbacks lies in the operational issues that such option would raise:

- Incompatible with same-day settlement profile of most MMFs (third §, p29 of the report)
- Incompatible with stable NAV funds (last §, p28 of the report)

In addition, as a rule-based tool, there is a risk of pre-emptive redemptions by investors anticipating changes in the tool's parameters (first §, p30 of the report).

This is the reason why we rather suggest to mandate MMFs to resort to adjustable exit fees (in period of stressed markets) as a variant to swing pricing.

Should this option be selected in the MMF reform process, we strongly recommend the following:

- **Keep a level playing field within each jurisdiction. Notably, as far as MMFR is concerned, all types of MMFs should adopt the same exit-fee set-up.**
- **Make sure that prior to any implementation of such tool, STFMs reforms are orderly undertaken** so as market inputs used to calibrate the exit-fee are reliable and accurate. Indeed, it is of utmost importance that the level of exit fees fairly reflects the effective cost of liquidity charged to redeeming investors.

Minimum balance at risk (MBR)

As mentioned in our response to question 7, the underlying mechanism of this option, i.e. "absorb losses", does not need to be activated, as the current regulatory framework, especially in the EU, clearly identifies the MMF user as the risk taker when investing in such schemes. Moreover, this does not differ from any other types of mutual funds. Consequently, we do not think this option could bring any benefit to MMFs when facing stressed markets. On the top of that, implementing such a reform would raise a great number of operational issues, not to mention the disastrous impact it will likely have on MMF users. We thus strongly recommend policy-makers not to retain this option.

Capital buffer

This option, as the MBR, derives from the "absorb losses" mechanism. We then consider, as well, that this reform option will not provide any benefit to MMFs. On this respect, the report rightly lists the negative side effects and risks that such an option would generate, should it be adopted:

- Disproportionate increase of costs for operating MMFs (third §, p32 of the report), leading to a potential extinction, or hyper-concentration of the industry.
- Relevance, appropriateness of the capital buffer calibration (fourth §, p32 of the report)
- Jeopardize and skew the credit selection process, towards either over-conservative or over-risky stance, among fund managers.

Limit on eligible assets / Additional liquidity requirements and escalation procedures

Although the underlying mechanism of this option is worth being analyzed, we strongly believe that **limiting further eligible assets will have negative consequences on MMF management, at each fund's level, but also on a financial stability standpoint.** Indeed, we would like to recall that MMFs entered Covi19 crisis with sound portfolios, made of high quality assets. Only the rapid halt in STFM functioning put MMFs in a challenging situation when trying to dispose part of their assets. Requiring MMF portfolios to hold more "assets with short maturities and/or more government instruments" will only lead to **more overlapping positions across MMFs and less direct funding for real economy**. Moreover, as the report rightly assesses, this option may instill some instability in STFMs as issuers would have to structurally reduce their issuance tenors (third §, p37 of the report) and face a rise in rollover risk.

10. Does the summary assessment of each representative option adequately highlight the main resilience benefits, impact on MMFs and the overall financial system, and operational considerations? Are there any other (e.g. jurisdiction-specific) factors that could determine the effectiveness of these options?

Please, see our response to question 2, 7 and 9.

11. Is the description of variants and the comparison of their main similarities/differences vis-à-vis the representative options appropriate? Are there other variants to consider?

Please, see our response to question 2, 7 and 9.

Notably, we propose two variants to representative options attached to the first and fourth mechanism mentioned in the report (impose on redeeming investors the cost of their redemptions and reduce liquidity transformation)

12. Are measures to enhance risk identification and monitoring by authorities and market participants appropriate complements to MMF policies? Which of these measures are likely to be most effective and why? Are there other measures to consider?

As mentioned in Box 5 of the report, several jurisdictions already provide stress test, transparency and reporting requirements. This is the case in the EU where specific articles are dedicated to these topics in MMFR, Art.28, completed by ESMA Guidelines, Art.36 and Art.37.

Stress tests notably are already granular enough and cover all investment risks (market, credit, liquidity...). Indeed, the current framework is efficient, as it is also expected to be reviewed by ESMA once a year, in order to adapt the various shocks defined in these scenarios. We can furthermore mention that an updated calibration has been issued in December 2020, taking into account more stringent shocks, and very recently implemented in the different EU jurisdictions.

In addition, in the light of our proposition to enrich the “know your customer” policy provisions (with level 2 or 3 adjustments), we think that the management companies could strengthen this stress test framework by performing additional granular shocks. The fund manager has a good knowledge of the potential vulnerability and is in a position to take the appropriate decision. For example, when a MMF is more concentrated or is more likely to have volatility on subscriptions / redemptions, the manager should perform ad-hoc scenarios, and take the relevant measures to reduce risks (in this case increase the liquidity buffers). We think that this framework must be defined by the management company only, and has to be described in a dedicated procedure that may be reviewed by the regulator.

As regards reporting requirements to authorities, we do not see need for further enrichment of current regulation framework. The Covid19 crisis experience has taught us that shocks can considerably differ by their nature, their intensity and the way they may affect economic and financial environment. Producing reporting on an industrial mode takes time and mobilizes significant resources, especially when the regulation changes. Moreover, during stressed periods, portfolio structures may change on a daily basis and the key parameters at stake when addressing risks are highly dependent on the nature of the stress. It is thus important to make a distinction between i) detailed, pre-defined, standard reporting that fund managers provide to authorities on a regular basis, and ii) emergency specific

reporting, whose content is by definition impossible to foresee, that authorities may request from asset management companies under stressed conditions.

Considerations in selecting policies

13. Are the key considerations in the selection of policies to enhance MMF resilience appropriate? Are there other considerations that should be mentioned?

Section 6.1 of the report addresses the prioritisation of MMF policy options. We do not see need for prioritizing any of the two representative options we suggest to explore in order to enhance MMF autonomy in times of exceptional stress (e.g. adjustable exit fees and liability-driven additional buffer of liquid assets). However, as already noticed previously, the representative option related to adjustable exit fees can be effective and workable only once STFM regulatory environment is itself reviewed in order to enhance / improve the transparency and standardization of its relying instruments, CPs notably.

14. Which options complement each other well and could potentially be combined? What are the most appropriate combinations to address MMF vulnerabilities in your jurisdiction? Which combinations are most effective for different MMF types and their functions?

Our view is that the best scenario would be to combine the two representative options we propose to explore, and apply them across the different jurisdictions. An alternative scenario would be to first adopt the option related to the KYC policy (e.g. leading to liability-driven additional buffer of liquid assets calibrated at each fund's level). In a second stage, once STFMs have been orderly reformed, the implementation of the second option (e.g. adjustable exit fee), could follow.

15. To what extent should authorities seek to align MMF reforms across jurisdictions? Is there a minimum set of policies or level of MMF resilience that should be considered at the international level to avoid fragmentation and regulatory arbitrage?

As the report rightly points out, there are differences between jurisdictions, which makes a single policy exercise hard to achieve. We think that with respect to international coordination the resilience of MMFs is already achieved globally through IOSCO's "Policy Recommendations for Money Market Funds". While some targeted changes can be added, aiming for more uniformity could undermine the goal of preserving the economic utility of these short-term funding markets in each jurisdiction. Money markets are by nature fragmented, notably by the currency and the scope of action of central bank authorities. MMFs naturally reflect this reality. As also noted in the report, similarities in MMF may present contagion risks among MMFs and, as already mentioned in our response to Question 6, recent reforms to MMF regulation have already limited the eligible assets that MMFs are permitted to purchase.

As a result, MMFs need to be considered in light of the specific characteristics of their jurisdiction and market, which means that not all the options identified are globally transposable. For example the US flight to quality in the United States from Prime MMFs to Government MMFs has not occurred in

Europe for Euro-denominated funds. Thus, for non-public debt MMFs in Euro, a move of investors into Government MMFs is not viable and would not necessarily provide investors with security and liquidity. Indeed unlike in the US, there is no single Government debt in Europe.

Another huge difference between U.S. and European regulations is that one allows sponsor support while the other prohibits it.

This being said, we are in the view that the two representative options we propose (adjustable exit fees activated in case of exceptional liquidity crisis + definition and calibration, by the asset manager, at each fund level, of a liability-driven liquidity buffer) could be easily applied across the different jurisdictions to the benefit of the whole MMF industry and financial stability.

Short-term funding markets (STFMs)

16. Does the report accurately describe problems in the structure and functioning of STFMs and how these have interacted with MMFs in stress periods?

The report accurately describes problems in the structure and functioning of the STFM on several points:

- dealers limited capacity to intermediate large one-directional flows;
- higher capital and liquidity requirements affecting how dealers manage their balance sheet capacity;
- leverage ratio requirements limiting the expansion in repo activity, contributing to sharp increases in rates;

However, we do not agree when the report states that “prudential requirements were not a dominant factor in determining behavior” and we consider that concerns about quarter-end regulatory disclosures probably contributed to limiting appetite for balance sheet use in a more extensive way than described. Indeed, capital and liquidity requirements reliefs by the ECB in March only began to take their full effect after the turn of the quarter end.

These main problems in the structure and functioning of the STFMs participated to MMF vulnerabilities, while interacting very negatively in periods of very strong imbalance in the market, when all investors desperately scramble to raise cash. These problems need to be accurately assessed in order to initiate corrective measures aiming at smoothening the functioning of money markets.

17. What other measures should be considered to enhance the overall resilience of STFMs? How would those measures interact with MMF policy reforms and how effective are they likely to be in preserving market functioning in stress times?

It is worth repeating that MMFs are dependent on the well-functioning of STFMs to operate and one cannot assume that MMFs can keep providing liquidity whilst the functioning of the underlying markets is totally impaired. The sudden disappearance of market liquidity can concern a large number of assets and may even affect “the highest quality government assets”, as illustrated by Bank of England Speech “Seven Moments in Spring: Covid-19, financial markets and the Bank of England’s balance sheet operations”:

"The sharp pickup in asset price volatility, as markets struggled to process the news about the onset of the virus, increased margin calls – forcing funds to unwind some of their basis trades, selling USTs to generate cash. Initially these trades were conducted quietly. But as time went on, their speed and size – running to hundreds of billions of dollars – began to overwhelm dealers' intermediation capacity, which was itself shrinking as the result of rising volatility and the operational challenges of remote working. Rising transaction costs and the breakdown in arbitrage relationships began feeding on themselves: a classic 'doom loop' (Chart 2)." *"What was unique about this process, and potentially disastrous for the financial system, was that even the highest quality government assets were not good enough. Just like high street companies facing evaporating revenues, market participants needed cash. In the days that followed, this so-called 'dash for cash' would spread to every corner of the global financial system."*

Thus, we think that measures intended to enhance the overall resilience of STFMs are very likely to be the most effective ones in preserving market functioning in stress times and have far greater relevance than the FSB report assumes. The report does acknowledge that the authorities might consider adopting measures to improve the functioning of CP and CD markets. But we regret to see that it also expresses doubts by stating that "it is not clear that such measures would change the limited incentives of market participants to trade or of dealers to intermediate, particularly during stress time". Thus, we believe that the improvement of market liquidity is key and must necessarily be achieved through:

- Market transparency,
- Instruments standardization,
- Eligibility to ECB refinancing operations,
- Favoring Dealers' market making through the review of Basel III capital treatments
- Consolidation of the link between money market players and Central Banks.

As regards the first objective, underlying markets should benefit from more transparency and smoother functioning. And a lot can be achieved: standardization of instruments, market transparency (with the *Banque de France* - sponsored NeuCP market as an example to follow), incentivization of dealers, and facilitation of processes granting CPs' eligibility to refinancing operations. While we fully understand Central Banks' reluctance to intervene, we also believe that ensuring the good functioning of markets is in their remit. We favor also in times of stress the adoption of capital and liquidity reliefs to banks buying back eligible assets, thus incentivizing them to hold bigger inventories, while recognizing highly rated CPs as High Quality Liquid Assets in capital ratios.

In terms of interaction with MMF policy reforms, we do believe, as earlier mentioned, that prior to the effective implementation of any ADL in MMFs, a significant improvement in money market transparency will have to be achieved, so LMT triggering and related calculations will rely on accurate and unquestionable market indicators. Daily transparency on issuance and transaction information, as well as information on the types of investors in money markets and the trends of their investment, should be made easily accessible.

Additional considerations

18. Are there any other issues that should be considered to enhance MMF resilience?