ESMA consultation on EU money market fund regulation

Insight Investment Europe response

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Insight INVESTMENT

BNY MELLON | INVESTMENT MANAGEMENT

Insight Investment manages c.EUR750bn of assets under management for institutional clients such as European pension schemes and insurance companies. Our European entity, Insight Investment Europe manages approximately 150 funds and we believe we are the 4th largest asset manager in Ireland. Insight Investment Europe manages over EUR 140bn of assets under management including a number of money market funds.

We welcome the consultation by ESMA on this important topic and happy to support ESMA in this process. Please find below our responses to the consultation questions.

Q1: 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?

Yes, we agree with the assessment provided. We also request you refer to the consultation response provided by Institutional Money Market Funds Association ("IMMFA") on this question. It is also worth noting that during March/April 2020 many managers were selling assets not only to meet redemptions, but also to maintain or boost regulatory liquidity buffers even when there were no redemptions.

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?

Ratings are important to investors. Investment managers' behaviour in stressed conditions is usually driven by regulatory constraints rather than rating constraints, although this may change if regulatory constraints are eased going forward. Typically, rating constraints are more important in normal market conditions.

Q2: i) Do you agree with the above assessment on the potential MMF reforms related to the review of the MMF Regulation?

Yes, we agree with the assessment provided.

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?

No comment.

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.

We would strongly support de-coupling regulatory liquidity thresholds from suspension and gate requirements. We would support removal of this requirement altogether, allowing the relevant fund Board to use its discretion to apply suspensions and gates as and when required in the best interests of the fund. It is important to note that when making these decisions the Board is subject to strict governance requirements including the need to consider all potential measures available to them before imposing gates or suspension.

During March 2020 events, many managers were selling assets not because of redemption but to boost liquidity buffers. We think decoupling the thresholds from suspension/gates would reduce these types of behaviours and potentially reduce asset sales that were not linked to investor redemptions.

If these rules were indeed removed it would be important to ensure that rating agencies' methodologies are also modified accordingly. It would be important to ensure that rating agency limits do not become a driving factor of behaviour in stressed conditions.

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)?

We do not support the use of swing pricing mechanism for a number of reasons. Applying swing pricing would eliminate the price certainty features provided by CNAV and LVNAV funds and would be similar to migrating to VNAV funds from an investor perspective. We do not support CNAV and LVNAV funds migrating to VNAV funds for a number of reasons as set out in our response to question 6 below.

Application of swing pricing would also likely harm those investors relying on cash or cash equivalents accounting treatment of CNAV and LVNAV funds, and these investors may be forced to exit if they are not able to secure the same accounting treatment for a fund with swing pricing.

We do however support the ability to apply ADL if the board determines it is appropriate to do so. ADL is different to swing pricing in that the fund's NAV for all investors do not change. Only investors that exit are charged a fee based on the exist cost for their redemption. While this is also not ideal for an investor expecting stable NAVs, in an extreme circumstance of stress, it may be beneficial for the fund and for all investors if the fund had the ability to apply ADL to redemption before gating and suspensions are considered. Applying ADL above a threshold of redemption would provide some of the benefits of swing pricing (i.e. applying the cost of exit to the NAV of the investor redeeming) without all investors losing the benefit for CNAV and LVNAV funds.

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.

We support the ability to apply ADL.

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?

Option 1: Our preference would be for a complete decoupling of regulatory thresholds from suspension/gates etc, however in the absence of that we would support this as a secondary measure. We believe a regulator reducing its required buffer in times of stress would provide additional leeway that can help to bring some stability in stressed conditions. While this may not change investor behaviour, it can reduce the pressure for assets to be sold from MMFs purely to maintain regulatory thresholds when there are no investor redemptions. However, our preference would be for de-linking of regulatory thresholds from suspension/gates altogether.

Option 2: We would not support any thresholds being calibrated to stress test results. Portfolio stress test results can become out of date quickly and also become irrelevant in stressed conditions when there are likely to be large redemptions changing the composition of portfolios. We would support the ability of buffers to be relaxed, but that is already covered in Option 1.

Option 3: We would not support this.

- It could disadvantage some funds over others – for example, funds with a high concentration of institutional investors, even if they are managed more prudently than a comparable retail fund.
- The profile of investors in a fund can significantly change over time, particularly with large redemptions which are more likely in stressed conditions, so any data used to analyse this can quickly become out of date.
- Finally, this can cause an unintended consequence of institutional investor-dominated funds being deemed to be more risky, even when managed prudently, thereby fuelling exit from these funds which will bring greater instability rather than stability to this market.

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.

We would support making liquidity buffers countercyclical as outlined in Option 1 of question 5(i). However, we think these would only work in practice if:

- the move to reduce the buffers is applied across the entire money market fund universe, not only to certain types (e.g. CNAV or LVNAV funds) and most definitely not to specific funds, as this could be seen as a 'stigma' by investors; and

- the relaxation should also ideally follow pre-set rules. This would help both investment managers as well as reduce the risk of investors interpreting this in the wrong way. If that cannot be done, there should be a clear decision-making body that can act in a timely fashion as would be required in times of a crisis.

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.

Our investors, being predominantly long-term institutional investors such as pensions funds and insurers, choose CNAV and LVNAV funds because they require certainty of unit price of the funds before they trade.

We believe that eliminating CNAV and LVNAV funds and replacing them with standard VNAV funds would significantly alter the cash-like nature of MMFs. We understand that VNAV funds may not receive the cash or cash equivalents accounting treatment that CNAV or LVNAV funds receive. This would make these funds far less attractive for investors which could lead to many investors exiting MMFs altogether and investing into other asset classes such as bank deposits for their cash or cash equivalents. This does not reduce overall financial stability as it would increase credit risk to these institutions and therefore negatively impact overall systemic risk.

Furthermore, we do not believe that changing CVNAV and LVNAV funds to VNAV funds brings greater stability in the market. Investors exited VNAV funds similarly to CNAV and LVNAV funds during the crisis.

Finally, the stress that some MMFs faced in March 2020 was due to a number of factors, including the increased demand for cash (often called the ‘dash for cash’) arising from margin calls from cleared and non-cleared contracts and issues in the repo markets which prevented this demand from being met as easily as would be desired. We would support strengthening the repo markets through improved bank capital rules and other mechanisms which will bring greater stability in the market at a time of increased liquidity need and variation margin calls.

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.

We would encourage sponsor support to be allowed. While we understand the nuances and subtleties of this discussion, we believe an outright ban on sponsor support (as currently set out in the MMF Regulations)

could reduce the stability of MMF funds.

We would welcome the ability of a sponsor to be allowed to buy assets at a fair price from an MMF. ESMA currently only permits this if it is with a counterparty the MMF trades with. However, the sponsor in many situations is not such an entity. These restrictions prevent certain MMFs from accessing sponsor support that might otherwise be available to them, thereby potentially increasing market instability in times of stress.

While not all MMF funds would be able to benefit from sponsor support, arguably the whole market would benefit to an extent if the current restrictions were eased. If sponsored MMFs are stabilised in stressed conditions and are not forced to sell assets, this could reduce the size of any issues faced by the MMF industry and potentially help to reduce the overall systemic risk and for fire sale of assets in the market. This in turn would boost market confidence that all MMF are capable of withstanding significant stresses.

While we understand that amending or removing the sponsor support rule may create a concern about potential market concentration, consolidation, and change in structures, we believe the risk benefits of this should outweigh any concerns of an impact on market structure .

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 42 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.

Ratings are important to investors. Investment managers' behaviour in stressed conditions is usually driven by regulatory constraints rather than rating constraints, although this may change if regulatory constraints are eased going forward. Typically, rating constraints are more important in normal market conditions.

However, if the regulatory rules are made less stringent to bring greater stability to MMFs, it would be important to ensure that rating agencies' methodologies are modified accordingly so that rating agency limits do not become a driving force of behaviour in stressed conditions.

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.

We would support ESMA addressing the co-ordination issue, acknowledging that the untested current framework in Article 28 may be sufficient to meet these objectives. One way to address this may be for information to be calculated to the same date, and for ESMA to receive the information from NCAs on a timely basis.

We would not support the specification of further corrective measures based on MMF stress tests as this information can quickly be out of date and not show the full picture. Instead, we welcome engagement with supervisors if there is a concern. We consider that suitable mechanisms for this already exist.

Further prescriptive rules on corrective measures based on stress tests results would likely add to further instability of funds in stressed conditions.

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.

We believe current reporting obligations are already sufficiently detailed and frequent. We are keen not to increase this further. We are not convinced that increased reporting will bring greater stability to MMFs.

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.

We are happy to disclose the MMF's instruments to the regulator, as we currently already do.

We are less comfortable with disclosing underlying investors' category classification. As explained in our answer to question 5 we are concerned about regulators inferring the stability of an MMF based on its investor type. We do not believe this link should be made for the following reasons.

- It could disadvantage some funds over others – for example, funds with a high concentration of institutional investors, even if they are managed more prudently than a comparable retail fund.
- The profile of investors in a fund can significantly change over time, particularly with large redemptions which are more likely in stressed conditions, so any data used to analyse this can quickly become out of date.
- Finally, this can cause an unintended consequence of institutional investor-dominated funds being deemed to be more risky, even when managed prudently, thereby fuelling exit from these funds which will bring greater instability rather than stability to this market.

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:

• What should be the appropriate size of such a pooling vehicle as the LEF?

• 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?

• How long would it take to establish such a LEF?

• Under which conditions would the LEF be activated?

• Who would be responsible for activating the LEF

It is difficult to provide feedback without more detail, but we provide some thoughts below.

- An assessment would be required as to whether such a fund could be sufficiently capitalised to be effective when required, without it breaking the business model of MMFs.
- We believe it is unlikely that a facility could be created that would be economically or operationally viable for MMFs, which are low margin funds.
- It is typically considered the role of central banks, not MMFs, to ensure liquidity remains in underlying short-term instruments.
- If a facility is created, it should be global and eligible for all currencies and impartial as to who the manager is.

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.

No comment.

Contact

Main contact	Vanaja Indra
Title	Market and Regulatory Reform Director
Email	vanaja.indra@insightinvestment.com