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	State Street Corporation
Activity	Other
Are you representing an association?	☐
Country/Region	Europe

Introduction

Please make your introductory comments below, if any:

<ESMA_COMMENT_MMFR_1>
State Street welcomes the opportunity to provide input on the ESMA consultation paper on the legislative review of the EU Money Market Funds Regulation (MMFR). State Street is one of the world's leading providers of financial services to institutional investors, with $40.3 trillion in assets under custody and/or administration and $3.6 trillion[1] in assets under management, as of 31 March 2021. Across our significant European operations, we are both a service provider to money market funds (MMFs) (e.g. fund accounting) and a manager of MMFs, through our investment management arm, State Street Global Advisors.

As has been widely noted, the market turmoil in March and April 2020 was a real-life stress-test of global financial markets. As the magnitude of the COVID-19 pandemic became more apparent, governments responded by effectively imposing a near-total shutdown of global economic activity. This resulted in an exceptional and unprecedented demand for liquidity, with particularly acute pressure being felt in short-term funding markets. The MMF sector, as a highly-visible and transparent constituent of short-term funding markets, also faced heightened liquidity challenges. This experience has resulted in further scrutiny of MMFs. While State Street is broadly supportive of efforts being undertaken to improve the resilience of MMFs, we believe there are a number of important elements that should be recognised, in order to better contextualise last year's events and, more pertinently, ensure any future reforms are effective.

Firstly, one should distinguish between the market stress in March 2020 and the global financial crisis (GFC) in 2008. The latter was an endogenous event, primarily driven by credit and solvency concerns of certain large financial institutions that subsequently permeated all aspects of the economy. In March 2020, it was an exogenous shock that initiated outside of financial markets, namely a global public health crisis, that precipitated a sudden and unprecedented increase in the demand for liquidity, impacting even traditionally the safest financial instruments (e.g. US Treasuries). From an MMF-specific perspective, the flows in 2008 were primarily driven by concerns over Constant Net Asset Value (NAV) funds potentially 'breaking the buck', whereas in March 2020, outflows largely represented market participants seeking to preserve and protect their own liquidity positions.

Secondly, MMFs were not the cause of the pandemic-related market volatility. Without seeking to downplay the severity of the issues faced by MMFs, the significant outflows observed did not instigate but rather followed the initial dislocation experienced by broader short-term markets, amid an ever-increasing demand for liquidity by investors. More recently, some commentators have posited the idea that MMFs may have exacerbated market conditions by disposing of their less liquid assets to meet redemptions and sought to

[1] Assets under management as of 31 March 2021 includes approximately $60 billion of assets with respect to SPDR® products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated.

build up their holdings of weekly liquid assets (WLA). However, for fund types for which the primary purpose is the provision of liquidity and the preservation of principal, such as MMFs, this seems entirely logical in light of market events and we believe was reflective of prudent risk management.

Thirdly, for reforms to be meaningful and effective, we believe it is crucial that policymakers consider addressing underlying structural issues in short-term funding markets. Despite significant market developments, short-term funding markets remain highly intermediated and dependent on banks for the provision of secondary market liquidity. However, as seen in March 2020, broker-dealers were either unable or unwilling to engage in discretionary market-making, resulting in MMF managers being unable to utilise secondary market liquidity. The withdrawal of broker-dealers may have been an unintended consequence of post-GFC prudential reforms which, while undoubtedly have improved the resilience of the banking sector, may have altered incentives regarding their market-making activities.

Keeping these observations in mind, we believe that any future reforms that seek to address the challenges observed in March and April 2020 should be underpinned by the following key principles:

1. **Focus on challenges revealed during the market stress:** notably given it was a market-wide liquidity event, reforms should be focused on addressing liquidity risk. This includes ensuring the usability of the inherent liquidity within an MMF.
2. **Address underlying market structure issues:** reforms should not be targeted at MMFs alone but also consider underlying structural issues, in both the short-term funding market and fixed-income markets more broadly, in order for reforms to be truly effective.
3. **Ensure the ongoing viability of all European MMF-types:** there is significant scrutiny on Low-Volatility NAV (LVNAV) MMFs, despite their experience being comparable to other types of MMFs. We continue to believe LVNAVs play a critical and valuable role in financial markets, and that the outcome of the reform process should not deprive investors of a valuable investment vehicle nor issuers of a crucial source of funding.
4. **Avoid the need for external support:** reforms should mitigate the potential need for external support, whether that be from the public sector or indeed the fund sponsor and/or its affiliates. However, we believe there should also be recognition that during periods of extreme market stress, or 'black swan' events, normal market functioning may only be restored through policymaker intervention. This has been reflected in recent commentary by various stakeholders, including by Mark Carney, former Governor of the Bank of England and Chair of the Financial Stability Board (FSB).

Notwithstanding the above, we believe the framework introduced by the MMFR has proven to be largely effective. This is demonstrated by the fact that investor redemptions from MMFs were met in full, despite the market stress, and no fund was required to impose fees/gates or suspend redemptions. This suggests that the review of the MMFR should be based on targeted amendments rather than a fundamental overhaul.

<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>
We recognise that MMFs faced heightened stress as a result of the market volatility in March 2020. As the economic impact of the pandemic permeated across global financial markets, market participants tapped their various sources of liquidity, including MMFs, to ensure the robustness of their own positions. The extraordinary nature and unprecedented speed at which this occurred certainly did create challenges for the MMF sector, on both the asset- and liability-sides. However, there are a number of aspects of ESMA's assessment and vulnerabilities outlined in the consultation where we would welcome clarification or that we would question.

We broadly agree with the commentary set out in paragraph 19 of the consultation, which briefly highlights that the experience of MMFs in Europe was not homogenous. We would go further in noting that while USD LVNAVs did face comparable outflows to EUR Standard Variable NAV (VNAV) MMFs, the outflows from LVNAVs denominated in EUR and GBP were relatively more muted. Regarding USD Public Debt Constant NAV (PDCNAV) MMFs, as noted by ESMA, these observed substantial inflows. However, the inflows into PDCNAV far exceeded the outflows from USD LVNAV, indicating that it was not purely a substitution effect but rather that PDCNAVs became an investment vehicle of choice for a range of investors. A similar phenomenon occurred in the US market, albeit on a much larger scale.

With regards to support provided by public authorities, notably the interventions made by central banks, we acknowledge the crucial role this played in restoring confidence and the orderly-functioning of markets more broadly. Nevertheless, we believe it is important to highlight the differences between the various programmes implemented and the extent to which they provided direct support to the MMF sector. For example, the European Central Bank's (ECB's) Pandemic Emergency Purchase Programme (PEPP) could not be utilised by a large part of the sector. In particular, the eligibility criteria for assets that could be purchased effectively precluded access by LVNAVs, which primarily hold commercial paper (CP) issued by financial institutions, or 'financial CP'. Once this had been clarified by the ECB in the weeks following its initial announcement, our internal analysis suggests that less than 2% of our holdings may have been eligible. Once again, we do not wish to downplay the hugely important effect central bank interventions had in calming broader financial markets but statements that all MMFs benefitted from direct public sector support are not an entirely accurate reflection of what occurred last year.

In terms of the liquidity of underlying markets, we would agree with the references made by ESMA to vulnerabilities in underlying short-term markets and the significant dependence on bank intermediation for secondary market liquidity. Regarding the former, the lack of transparency is just one factor, as acknowledged by ESMA in paragraph 23. An aspect that we do not agree with is the description that the asset classes in which MMFs invest are "not very liquid even in normal times…". While true that activity in secondary markets may be low, given the buy-to-hold nature of money market instruments and their short maturity, which could suggest low-liquidity when using turnover-based metrics, the fact remains that when MMFs look to sell assets in normal market conditions, they will usually find a willing buyer. Related to this, we believe it is important to distinguish between illiquid securities and securities that become illiquid due to exceptional market conditions. In addition, we do not necessarily agree with the statement in paragraph 27,

that MMFs sold assets to meet investor redemptions. As mandated under the MMFR, MMFs hold sizable amounts of their portfolio in daily and weekly-maturing assets. As investors increasingly prioritised access to liquidity and more closely scrutinised a fund's WLA, which is linked to the potential imposition of fees and gates, MMF managers were selling assets to maintain their buffers and indeed hold additional liquidity over and above the minimum regulatory thresholds, to further assuage investor concerns. We expand on this further in our response to Question 4 of the consultation.

Regarding regulatory constraints, notwithstanding our view of the general effectiveness of the MMFR, there are certain provisions that may not have operated as intended. We would agree with ESMA's reference to the role of redemption fees and gates, and more specifically the link to the minimum weekly liquid assets requirement, which introduced a degree of procyclicality amongst investors and prevented managers from using the organic liquidity within a fund. On the other hand, we do not necessarily agree with the suggested trade-off in LVNAVs between maintaining sufficient WLA and remaining within the 20-basis points (bps) portfolio-level collar. In paragraph 40, ESMA states this may be down to the potential mark-to-market losses, as funds sell longer-dated assets to generate further liquidity, resulting in a material deviation between the mark-to-market NAV and the constant NAV. We note that there are provisions in the MMFR to mitigate against this, notably the 10bps asset-level collar and the restriction on using amortised cost for assets with a residual maturity of up to 75 days (Article 29.7 of the MMFR).

Finally, with regards to the role of credit ratings agencies and MMF ratings in particular, we do not see this as a vulnerability. A small segment of MMF investors are bound by their investment policies to only invest in vehicles with a 'AAA' rating, although investors more broadly value the additional independent assurance they provide, over and above the Regulation. In spite of this, we are not aware that concerns around ratings were a key driver behind investor behaviour. Similarly, from a manager perspective, there were other priority factors that we considered more prominently during the peak of the market turmoil.

<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>

While we acknowledge the formal basis of the current consultation is the legislative review mandated under Article 46 of the MMFR, in practice and as illustrated in the various reform options, the primary driver is the experience of MMFs during the market stress in March and April 2020. However, on the basis of the latter, we do not believe the particular and, in our view disproportionate, focus on LVNAVs is necessarily warranted. As has been recognised by various policymakers, including ESMA in the consultation, LVNAVs were not the only type of MMFs to have faced significant challenges during the market volatility. Furthermore, we would reiterate our previous comments that some of the challenges faced by participants in short-term funding markets, including MMFs, were due to underlying market structure issues. This is acknowledged by ESMA in the consultation paper. Admittedly, the scope of the review is limited to MMFs. However, we would caution against the notion that some of the structural issues could be addressed through reforms to MMFs alone.

We do welcome the comprehensive assessment criteria proposed by ESMA. In line with our previous comments, we believe the MMFR has proven to be largely effective and, as such, any reforms should be targeted. Therefore, we believe it a sensible approach to thoroughly consider the impact of each of the potential reforms, including the impact on financial markets more broadly, which recognises the important role played by MMFs.

With regards to investor behaviour, it is clear that certain provisions within the MMFR did not operate as intended by policymakers and, rather than provide reassurance during periods of market stress, exacerbated investor concerns. We expand on this aspect further in our response to subsequent questions in the consultation.
<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>
We are strongly supportive of the proposal to de-couple regulatory liquidity thresholds from the potential imposition of fees and gates. As investors prioritised access to liquidity during the peak of the market stress, the 30% WLA requirement effectively became a "bright line" that investors were highly sensitive to. As was noted by ESMA in its 2021 Trends, Risks and Vulnerabilities (TRV) Report, there is evidence indicating that funds with lower WLA faced higher outflows. While this was particularly the case in the US market, where fees and gates are perhaps not as established as they are within either the UCITS or AIFMD frameworks, we note this was also a driver behind investor behaviour in Europe, despite the nuances in legislation governing MMFs between the two jurisdictions.

In practical terms, this resulted in the counterintuitive scenario whereby MMFs had a substantial portion of their portfolio invested in WLA that was unusable. Furthermore, MMFs became forced sellers in a deteriorating market, in order to hold additional liquidity over and above the regulatory thresholds, as a means to further assuage investor concerns. Indeed, at certain points, data collected by the Institutional Money Market Funds Association (IMMFA) reveals that some MMFs were holding in excess of 45% of their portfolio in weekly maturing assets.

As such, we believe the first option presented by ESMA would improve the resilience of MMFs, by enabling them to use the inherent liquidity within the fund during periods when it is most needed and also dampen the notion of first-mover advantage amongst investors. We note that in the US, following the 2010 reforms and prior to the 2014 round of reforms for MMFs, there were minimum liquidity requirements that were not directly linked to the potential use of fees and gates. Anecdotal evidence suggests that during episodes of stress in the intervening period, MMFs were able to manage liquidity in the best interests of their investors, without being subject to the same dynamics as in March 2020. Where funds did make use of their liquidity buffers, they were temporarily limited to actions that restored their WLA in line with minimum regulatory requirements. Similarly, we believe it will make risks more salient for investors, as they may have a better understanding of the liquidity within a MMF and thereby make them less likely to pre-emptively redeem. We would emphasise that in supporting the removal of the link between the WLA and fees and gates, we are not proposing to reduce the current liquidity thresholds nor the level of transparency that is currently

available. These are standalone provisions within the MMFR and the requirement to comply will not change as a result of de-coupling.

In paragraph 89 of the consultation paper, ESMA suggests that one approach to achieve this could be to simply remove the reference to Articles 34.1(a)(i) and 34.1(a)(ii) of the MMFR. While we would support such a proposal, we note that it does not include Article 34.1(a)(iii), concerning the potential suspension of redemptions. We believe this would undermine any mitigation of first-mover advantage, as investors are equally as, if not more, sensitive to a suspension of redemptions. Rather, we would support the removal of Article 34.1(a) in its entirety. Given the majority of LVNAV MMFs are structured as UCITS, the fund board will still be permitted to use any of these tools where it is in the best interests of the investor, as is the case for other types of UCITS funds.

With regards to the second option, on reforming the conditions for imposing redemption gates, while we agree that investors are likely to be less concerned with liquidity fees than redemption gates, as it still permits access to their cash for a price, we believe it would be less effective than simply de-coupling. We are generally of the view that the decision to use any liquidity management tool (LMT) is best left to the discretion of the fund and its board. Introducing further steps into this process would be inefficient, as it may cause a timing issue, as well as do little to mitigate first-mover advantage. We would note that, given redemption gates are an exceptional-LMT, we are already required to notify National Competent Authorities (NCAs) of their use.
<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>
The potential use of swing pricing in the context of MMFs has garnered significant attention from policymakers, both internationally and within Europe. State Street is fully supportive of swing pricing as an ordinary-LMT across open-ended funds more broadly; it is a tool that is widely used in the Member States in which it is available, and in different market conditions. The most common form of swing pricing in operation in Europe is “partial swing pricing”, which typically works by applying an adjustment to the price of a fund (“swing factor”), where redemptions exceed a pre-specified amount (“swing threshold”). This ensures subscribing/redeeming investors bear the transaction costs related to their subscription/redemption, with the intention to protect the fund’s long-term investors’ holdings from being diluted by such activity. We are strongly supportive of efforts by NCAs to increase the availability of swing pricing across all EU Member States.

Notwithstanding this general position, we have strong reservations regarding the applicability of swing pricing to certain MMFs, as noted by ESMA in the consultation paper. In particular, from an operational perspective, given swing pricing and other types of anti-dilution levies (ADL) are based on net flows (which are only known at end-of-day), it would be incompatible with the intra-day liquidity and T+0 settlement

offered by LVNAV and PDCNAV MMFs, which are key components of their value proposition for investors. We note this is one of the primary reasons why, to date, swing pricing has not been used for these types of MMFs, despite being available to them as UCITS. These same challenges are not present in the case of Standard VNAV MMFs, which will often have a settlement cycle in line with other short-term fixed income funds i.e. T+1 or longer. A move away from same-day settlement could significantly alter demand from certain investors for these types of MMFs and subsequently result in them in seeking alternative investment vehicles. We expand further on the implications of this in our response to Question 5, both from a market and policy perspective.

In addition, as touched upon by ESMA in the potential drawbacks, it is not clear whether swing pricing would be effective in addressing market challenges and run-risk during 'black swan' events, such as in March and April 2020. Although the primary objective of swing pricing is to protect remaining investors, it can assist in mitigating first-mover advantage within a given fund. However, swing pricing is not typically utilised to address market-wide events, and where the entire market is effectively moving in one-direction (i.e. everyone is looking to build up liquidity) it is unlikely to be able stem market-wide redemption pressure.

We do not believe this would necessarily be overcome should the decision to implement swing pricing be taken by the relevant NCA or indeed ESMA, as opposed to by the fund. On the contrary, this could increase the redemption pressures from investors across the sector; whereas, previously they may have sought to withdraw from a given fund, they may now look to withdraw from all MMFs in advance of the breach of the swing threshold and the application of the swing factor. As a general observation, we support ESMA's view that the decision to use LMT shall remain the responsibility of the fund.

Given the challenges highlighted with swing pricing above, which to an extent also apply to other forms of ADL which are based on net flows, policymakers would effectively be left with liquidity fees. One advantage of liquidity fees, in the context of MMFs and relative to swing pricing, is that they can be applied to individual redemptions and therefore without necessarily compromising intra-day liquidity. We note that under the MMFR, these are already available to funds, where the conditions specified in Art 34.1(a) are satisfied. As noted in our response to Question 3, we would support removing the conditionality for the use of liquidity fees (and redemption gates), which should be available for use at the discretion of the fund manager and/or the board when in the best interests of the fund and its investors.

With regards to potential alternative options, we are part of industry efforts to explore different fee mechanisms that would help mitigate first-mover advantage, provide certainty to policymakers with regards to their usage and are operationally viable within the different MMF structures. These discussions are currently ongoing.

<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>

We fully agree with the need to make MMF liquidity buffers more usable and ensure they operate in a countercyclical manner, which we believe was the intention of the co-legislators at the time the MMFR was negotiated. However, we do not necessarily believe this requires an increase in the current liquidity buffers. Under the MMFR, LVNAVs and PDCNAVs are required to hold 30% in weekly maturing assets although, in practice during March 2020, they held significantly more. Furthermore, we would caution against the notion that higher liquidity buffers imply greater resilience, which we note would have an associated cost e.g. from an issuer perspective, this may reduce the availability of more long-term funding.

In our view, the most effective way to ensure buffers are usable and serve their intended purpose is to remove the link between fees and gates and the minimum weekly liquid assets requirement. As noted previously, this link was one of the key challenges faced by MMFs, which prevented a manager from utilising the inherent liquidity of the fund, resulting in the counterintuitive scenario of funds facing heightened investor redemptions due to liquidity concerns despite having a significant proportion of their funds invested in WLA. We believe this is an operationally simpler approach than the options outlined by ESMA.

In addition, we would support the removal of the limit imposed by Article 24.1(g), which effectively states that sovereign, supranational or agency debt can only count for up to a maximum of 17.5% of the 30% WLA regulatory requirement for an LVNAV or PDCNAV MMF. During the negotiations on the MMFR, the rationale behind this provision was unclear. However, in light of market events and with greater focus being placed on short-term MMFs investing in highly liquid securities and having usable liquidity, this appears to be an unnecessary constraint and indeed potentially counterproductive. We firmly believe that securities that are widely-regarded as highly liquid should be treated as such for regulatory purposes.

Should ESMA wish to proceed with the options set out in the consultation paper, we would favour Option 1, whereby liquidity buffers would automatically adjust where certain conditions are met. We would emphasise the need to exercise caution from an operational perspective, lest the trigger for the automatic adjustment itself induces procyclicality and potentially acts as an amplifier of redemption risk. Should the decision to reduce the buffers be taken by the relevant NCA, it is crucial that a clear framework is established, including with regards to key decisions and timelines, to ensure there is no detrimental effect on an individual fund's ability to act in the best interests of its investors. With regards to the impact this option may have on the behaviour of fund managers, we do not believe this would alter a MMF's liquidity management in normal conditions, as they would still be required to maintain 30% of their portfolio in weekly maturing assets. From a portfolio perspective, provided there is no increase in the minimum WLA requirement, it should not materially affect the assets in which they invest.

We do not support Option 2, whereby MMFs would be required to hold an additional buffer based on the results of stress tests. While stress testing is a helpful tool, it is one of many used to inform a manager's approach to liquidity risk management. We would caution against over-reliance on a single tool; in the case of stress testing, regardless of whether the manager uses historical scenarios or hypothetical scenarios, the input data can quickly become stale, particularly during stressed market conditions, and as such will not be the most appropriate reference point for future actions. We note that ESMA also states this additional buffer would be non-public. Although we understand the intention behind this, we believe this reduced level of transparency would increase uncertainty amongst investors, potentially exacerbating first-mover advantage. Furthermore, this would not make risks more salient to investors.

We would also not be in favour of Option 3, whereby funds with a larger share of "volatile institutional investors" could be required to hold larger buffers, as this would be operationally very difficult to implement. Although Article 27 of the MMFR, which establishes a 'know your customer' (KYC) policy for MMF

managers, requires procedures to be in place to anticipate redemption behaviour by investors, neither the profile of a fund's investors nor their behaviour is static. With regards to the latter, it is difficult to forecast how individual investors would react to a sudden deterioration of market conditions, which could be informed by a multitude of factors. This determination could be further complicated where investors use an intermediary, as the information would not be readily available to the manager.
<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>
State Street is strongly opposed to the proposal to potentially eliminate either the PDCNAV or LVNAV category. We continue to believe that LVNAVs and PDCNAVs offer a valuable proposition to both investors and issuers, which could not be easily replicated by alternatives. In light of this, any proposal which does not permit these funds to continue to perform their important functions will be to the detriment of a range of market participants and financial markets more broadly. Moreover, we believe that the PDCNAV fund type should not be considered within this proposal given, as has been recognised by ESMA, they were the recipients of net inflows during the market volatility.

We do not believe requiring all MMFs to adopt a floating NAV to be a solution nor do we believe it is justified based on the experience of MMFs during the market stress in March and April 2020. As has been commented on by various policymakers, including by ESMA in the consultation paper, both VNAVs and stable-NAV MMFs experienced significant outflows. As such, it is not clear to us how this would reinforce the resilience of the sector. In addition, when considering the experience in other jurisdictions, and notably the US market, we note that Institutional Prime MMFs, which have utilised a floating NAV following the implementation of the 2014 Securities and Exchange Commission (SEC) reforms, also observed significant outflows.

In the consultation, ESMA has suggested that this proposal could be one way of removing any potential procyclical behaviour caused by regulatory thresholds, given the same link between liquidity fees and redemption gates is not a feature of VNAVs. In our view, this is a disproportionate response; the link between fees and gates and WLA is not an inherent feature of either the LVNAV or PDCNAV, or their predecessor fund-types in Europe, but rather a regulatory requirement imposed by the MMFR. In light of its clear unintended consequences, we believe the most appropriate way forward would be to make targeted changes to the regulatory framework, so that the provisions can operate as envisioned by policymakers. Similarly, it is not immediately clear to us why the response to a market-wide liquidity event would be to effectively mandate conversion to VNAVs, which are required to hold comparatively lower levels of liquid assets (both daily and weekly) under the MMFR.

In the event that LVNAVs are prohibited, some investors will likely leave the sector altogether rather than invest in different types of MMFs. Given certain investors are required by their internal investment policies to invest in 'AAA'-rated funds and/or vehicles that are treated as cash-and-cash-equivalent for accounting purposes, they are unlikely to be permitted to invest in VNAVs. As highlighted earlier in this response, as part of the 2014 SEC reforms in the US, Institutional Prime MMFs were required to float their NAVs, having previously been permitted to operate with a constant NAV. During the implementation of these rules, one

of the key dynamics observed was the shift of approximately USD 1 trillion of investment from Institutional Prime to Government MMFs. This is unlikely to be mirrored in Europe, given supply-side challenges, particularly with regards to EUR and GBP-denominated funds; currently 97% of assets in PDCNAV MMFs are in USD-denominated funds, with EUR-denominated funds holding approximately €100mn and GBP-denominated funds holding c.£3bn. As such, these do not present scalable alternatives to LVNAV MMFs.

When considering potential destinations for investors outside of the MMF sector and in other parts of the market, two options that are frequently raised are whether investors could place their surplus cash in bank deposits or could invest in the underlying money market instruments directly. With regards to the former, it is well documented that following the post-GFC prudential reforms, banks have been less willing to accept short-term operating cash from investors, given this is relatively more expensive to accommodate from a balance-sheet/capital perspective. Consequently, it should not be assumed that investors would simply switch to the banking sector. Regarding investing directly in underlying money market instruments, we note that not all investors have this capability internally. For those that do, they are potentially exposing themselves to more significant liquidity and counterparty risk. When invested in MMFs, investors will benefit from the laddered maturity within the fund, which ensures there is organic liquidity being generated to meet redemptions. However, should they invest directly, when market conditions are deteriorating rapidly – as was the case in March 2020 – they may struggle to generate the necessary liquidity, which could further exacerbate market stress.

Furthermore, there are certain investors who, in their search-for-yield and taking into account the above, particularly in the current market environment, may seek alternatives in less visible and more thinly-regulated parts of the market. We believe this would be a sub-optimal outcome from a policy perspective.

The above assessment has focused on the investor perspective but there are also likely to be significant ramifications from an issuer perspective. Although a complete picture is difficult to determine, LVNAV MMFs are significant holders of financial CP, thereby acting as an important source of funding for banks and their activities to support the real economy. In line with ESMA's assessment criteria, should LVNAVs be prohibited, it is not clear who would step in the void and fill this funding gap, and also whether they would be more "stable" than MMFs. MMFs do also invest in non-financial CP. Although this is relatively small, in principle, further diminishing a source of market-based finance for the real economy is not consistent with the aims and objectives of the EU's Capital Markets Union agenda.
<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>
In our view, we do not believe there is a need to clarify the provisions set out in Article 35 prohibiting external support. From a market participant's perspective, the examples set out in Article 35.2 provide the requisite specification; we agree with ESMA's interpretation set out in July 2020 that affiliate transactions are permitted provided they are not at an inflated price or seek to provide either implicit or explicit liquidity support.

It is our understanding that a key area of confusion with regards to this provision during the market volatility was whether the definition of "third-party" included public-sector authorities and, more pertinently, whether this precluded central banks from providing direct support to the MMF sector. Based on our recollection of

negotiations on the MMFR, this was not the intention of either the Council or European Parliament, nor the European Commission. We have no objections to such clarifications being made in the Level 1 text, to ensure preparedness for future episodes of market volatility, if this is indeed the clarification that ESMA believes is necessary.

We do not support a softening of this provision or a potential amendment that introduces an ex ante requirement that sponsor support should be provided. As ESMA notes in paragraph 143, this would likely favour bank-owned providers of MMFs, potentially leading to industry consolidation. Given there are only a limited number of MMF providers currently, we do not believe this will further improve the resilience of the sector. On the contrary, we believe such a step would have adverse implications for financial stability, as it would undermine efforts to reduce the interconnectedness between the bank and the non-bank sectors, which was a key motivation for co-legislators.

In terms of the potential impact on investor behaviour, in theory, this could assuage potential concerns. However, it is unlikely to eliminate first-mover advantage or run risk, particularly if there is any uncertainty over when a sponsor may intervene. In addition, we believe this would obscure the risks for investors rather than make them more salient. Regarding the impact on fund managers, theoretically this could result in excessive risk-taking and moral hazard, as there would be an effective guarantee provided by the sponsor. In practice this is unlikely, given the other stringent provisions of the MMFR.

<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>
As highlighted previously in our response, neither our experience nor our response to the challenges during the market volatility were significantly influenced by ratings. As a result, we would question the need to fundamentally reform the current provisions of the MMFR in this regard and whether this presents a solution that would reinforce the resilience of the sector.

While the MMFR has substantively reduced any perceived mechanistic reliance on ratings, they continue to provide a valuable additional and independent source of assurance for a range of investors. For some investors in LVNAV and PDCNAV MMFs, a 'AAA'-rating is a prerequisite under internal investment policies, implying any downgrade would result in some outflows. This is not necessarily the case for the VNAV sector, where ratings are not a prominent feature. Despite this, during March 2020, our engagement with our investors responsible for the largest redemptions highlighted that none were motivated by concerns regarding a potential ratings downgrade.

From a manager perspective, we would reiterate that credit ratings were not a key consideration in how we managed the fund; our priority was on ensuring sufficient liquidity and, to a lesser extent, in ensuring we remained within the 20bps portfolio-level collar. One of the reasons behind this is that, in many instances, the MMFR is either aligned or more stringent than the conditions outlined by the ratings agencies. In line

with this, any proposed changes in this area would not materially change a manager's approach to liquidity risk management or the assets in which they invest.

Should ESMA decide to bring MMF ratings within the scope of the EU Credit Rating Agencies (CRA) Regulation, it should be appropriately calibrated, given MMF ratings are not exactly the same as credit ratings. Furthermore, it is imperative that this does not result in any undermining of the independence of the ratings process or their methodology.

<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>
Stress testing is a very helpful tool and an important element of the broader framework for managers when assessing liquidity risk. The stress tests highlight potential consequences of, or conditions that might lead to, extreme scenarios, helping to identify risks that may not have been taken into account by the investment team. While reforms to stress testing may improve preparedness and be more informative for managers and NCAs, we do not believe it will necessarily enhance the resilience of the MMF sector nor how managers respond to rapidly deteriorating market conditions, as was the case in March and April 2020. One reason for this is the data used in stress-testing may not fully correspond with real-life market conditions.

In the consultation, ESMA has suggested that it receive the stress test reports directly from managers. We fully agree that ESMA should have readily-available access to this information but believe it is more a matter of supervisory coordination. Our preference would be that MMFs continue to provide these reports to their local NCA, who is then required to pass this information onto ESMA in a timely fashion. In addition, ESMA has also suggested further specifying the corrective measures to be undertaken by the manager in the event that a vulnerability has been identified. We fully appreciate the desire of policymakers to introduce more certainty in the actions to be taken by the fund manager. We would caution, however, against an overly-prescriptive approach that diminishes the ability of the manager to act in the best interests of the fund and its investors.

The provisions in Article 28 of the MMFR have been further augmented by ESMA through Guidelines, most recently in December 2020. These Guidelines are notably more stringent than the previous testing framework, further reducing the need for reforms in this area.

<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>
The MMFR has introduced a detailed reporting framework for fund managers. We note that during the market volatility in March 2020, many MMF managers were also subject to ad-hoc and exceptional information requests by their respective NCA. We believe that this approach, which provides NCAs with regular information while enabling them to request more information as and when they deem necessary, is sufficient.

With regards to the assessment criteria presented by ESMA in the consultation, we do not believe reforms in this regard would improve the resilience of the MMF sector. Furthermore, it is not expected to influence investors' behaviour, given these reports are not made available to them, or the way in which managers approach liquidity risk management.

<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>
We are fully supportive of efforts to improve transparency in short-term funding markets in Europe. As noted by ESMA in paragraph 172 of the consultation paper, providing detailed information on both the asset- and liability-side of MMFs is already a feature of current MMF reporting obligations; nevertheless, we are open to exploring further if and how this can be augmented to ensure policymakers have the information they need.

We would like to highlight two points of caution in this context. Firstly, while MMFs are an important segment in short-term funding markets, they are not the only participants. Therefore, if the intention of policymakers is to obtain a more granular understanding of market-wide dynamics, this will not be achieved through additional disclosures by MMFs only. Secondly, it is difficult to predict or assume with a high degree of confidence how individual investors may respond to different market conditions. This includes those that are seemingly within the same category, i.e. not all institutional investors will react in the same manner, which will be determined by a wide range of factors. For example, during the market volatility, certain investors were subject to additional pressure from margin calls, whilst others were not. Similarly, certain investors with international operations may have taken a global approach whereby they re-positioned their holdings from USD LVNAVs to USD PDCNAVs. Therefore, any potential extrapolation on the basis of investor category with regards to redemption risk or potential spillovers is likely to be challenging and potentially misleading.

<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>

We have strong reservations regarding the proposal for a liquidity exchange facility (LEF). We recognise the appeal of this option for policymakers, in that it seeks to establish an industry-led mechanism to alleviate liquidity pressure, but we believe it would undermine the ongoing viability of the MMF sector. The LEF could make it prohibitively costly to operate an MMF, thereby diminishing the resilience of the sector and ultimately to the detriment of financial stability more broadly, as well as distort the incentives for investors and managers.

As highlighted by ESMA, there are a number of outstanding operational questions. Firstly, it is not clear what the appropriate size of any facility should be. If we consider the US Money Market Fund Liquidity Facility (MMLF), the eventual drawdown was in the region of $55 billion. However, as has been commented on by a number of US market participants and observers, a key element of the success of the MMLF was that it was in theory without any upper limit. Indeed, any limit on the size may have created a form of first-mover advantage and resulted in its use to a significantly greater extent. In addition, there would remain questions over whether this would be sufficient to address a market-wide stress event; while such forecasting may be easier to determine regarding credit risk, it is likely to be a more challenging task with regards to liquidity risk. As noted in our introductory comments, there are certain instances whereby market functioning can only be restored through public-sector intervention. If this is still ultimately required, it further limits the appeal of an LEF.

Should an appropriate size be calibrated, there is also the consideration of how this would be funded. If this cost were to be imposed on managers, in the current interest rate environment, then it is very plausible that many managers will simply choose to exit the market. This may lead to some of the financial stability challenges highlighted in our response to Question 6. For those that choose to remain, if any, this may create incentives to take on excessive risk, as the manager searches for sufficient yield to provide to investors, cover its own costs and ensure there is sufficient funding for the LEF. Related to this, the proposed LEF could create potential moral hazard, as there will be a sense that any challenges faced by an individual MMF would be mutualized and picked up by the LEF.

From an investor perspective, similar to our comments regarding sponsor support, this may help to address investor redemption concerns. However, any uncertainty over when such a facility can be accessed will mean there is residual first-mover advantage dynamics. We would also echo the point that it obscures the risks of investing in MMFs, rather than making them more transparent. Given the LEF would need to be pre-funded, this implies an additional cost to investors including in normal market conditions. Consequently, certain investors may withdraw from MMFs and seek to place their cash elsewhere; as noted, this could result in sub-optimal outcomes.

<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>
We do not see a need to provide further clarity regarding the scope of the MMFR, which we believe to be sufficiently clear.

<ESMA_QUESTION_MMFR_13>