

MEMO# 30815

August 4, 2017

ICI Global Letter on ESMA's Money Market Funds Consultation Paper

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August 4, 2017 TO: ICI Members

ICI Global Members

Equity Markets Advisory Committee

Money Market Funds Advisory Committee SUBJECTS: International/Global

Money Market Funds RE: ICI Global Letter on ESMA's Money Market Funds Consultation Paper

As previously reported, the European Securities and Markets Authority (ESMA) has published a [Consultation Paper](#) (CP) on the EU's Money Market Funds Regulation (MMFR). The key proposals relate to asset liquidity and credit quality, the establishment of a reporting template, and stress test scenarios. ICI Global has filed a comment letter on the CP, which is attached and summarized below. The letter focuses on ESMA's proposed technical advice relating to the liquidity applicable to the collateral received as part of a reverse repurchase agreement (reverse repo) and ESMA's proposed guidelines on stress test scenarios.

Although the letter does not specifically comment on the proposed reporting template, the letter notes that we do not agree with ESMA's statement in paragraph 186 within that section that the "destruction of shares is not allowed under the MMF Regulation." The cancellation or "destruction" of shares is a widely-accepted mechanism that operates in accordance with the Undertakings for Collective Investment in Transferable Securities directive provisions. Also called a reverse distribution mechanism, share cancellation is an approved mechanism (often requiring a shareholder vote) that some money market funds have used effectively to deal with negative interest rates applicable for certain currencies. The letter notes that we are not aware of any reference in the MMFR that would prohibit this mechanism, and nor do we believe the mechanism is inconsistent with the MMFR.

Specifically, our comments are as follows:

Reverse Repo Collateral Liquidity Requirements

- *Haircuts on Government Collateral Are Inconsistent with FSB Principles.*
Minimum numerical floors for haircuts of governmental reverse repo collateral conflict with the FSB's regulatory framework for haircuts on non-

centrally cleared securities financing transaction and creates a disproportionate and unnecessary divergence from the agreed upon international approach to transactions backed by government securities.

- *ESMA's Focus on Haircuts Is Unnecessary and Problematic.* Minimum numerical floors for haircuts of government reverse repo collateral would put money market funds at a disadvantage relative to other reverse repo buyer/cash lenders; would tend to require that money market funds conduct a collateral analysis that may have no bearing on their decision to extend credit to a seller; and are potentially higher than the haircuts prevailing in the market for some government collateral.
- *Stress Testing Collateral Liquidity Would Not be Beneficial.* The reverse repo collateral that is permitted under the MMFR generally corresponds to securities that the European Banking Authority (EBA) found to be of "extremely high liquidity and credit quality" or of "high liquidity and credit quality." Any stress testing that a money market fund performs on this collateral should replicate the EBA results, and therefore, would not enhance the quality of permitted reverse repos.
- *Recommendations on Reverse Repo Collateral Liquidity Requirements.* We urge ESMA not to adopt the minimum haircuts proposed in Option 1(ii) or the stress testing requirements for collateral under either Option 1 or Option 2.

Guidelines on Stress Test Scenarios

- *ESMA Should Adopt a Principles-Based Approach to Stress Testing.* The current US requirements, which were adopted in 2010 and refined in 2014, set forth principles for sound stress testing practices and oversight, but do not attempt to quantify specific parameters or criteria that would require irrelevant testing. Such an approach accommodates the needs and profiles of different types of money market funds. We are concerned that ESMA's proposed approach (Option 3)—which would attempt to specify certain quantitative (or detailed) criteria—would not allow for such variations and could reduce the effectiveness of the funds' stress testing. We urge ESMA to follow the SEC's principles-based approach to money market fund stress testing, which is similar to Option 1.

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[Attachment](#)

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