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August 18, 2023

# European Commission's Report on the Adequacy of the MMF Regulation

[35408]

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TO: ICI Members  
ICI Global Members  
Europe Regulatory and Policy Committee  
Money Market Funds Advisory Committee  
SEC Rules Committee SUBJECTS: International/Global  
Money Market Funds RE: European Commission's report on the adequacy of the MMF Regulation

On July 20th, the European Commission (Commission) published a report<sup>[1]</sup> on the adequacy of the Money Market Fund Regulation<sup>[2]</sup> (MMFR), which has been in application in the EU since January 2019. The report finds that the current EU regulatory framework for MMFs successfully withstood the real-time tests of the COVID-19 pandemic (March 2020), the Russian invasion of Ukraine (February 2022), the UK mini-budget (September 2022) and the banking sector turmoil (March 2023). The report concludes that the MMFR's safeguards have been working as intended. The Commission does not express support for the reforms proposed by the Financial Stability Board (FSB),<sup>[3]</sup> European System Risk Board (ESRB),<sup>[4]</sup> or the European Securities and Markets Authority (ESMA).<sup>[5]</sup> It does, however, suggest that MMFs could be made more resilient by decoupling the activation of LMTs from regulatory liquidity thresholds and recognizing that structural problems exist in the short-term funding markets. While the latter issues are external to MMFs and thus outside of the analysis's scope, the Commission finds nonetheless that they would merit deeper analysis, including at the international level.<sup>[6]</sup>

## Background

In the EU, the majority of MMFs are domiciled in Ireland, Luxembourg, and France. Until the entry into force of the MMFR in January 2019, MMFs in the EU operated under the rules of the UCITS Directive. The MMFR introduced a dedicated regulatory regime for MMFs, addressing the credit and liquidity risks that had been experienced by EU MMFs during the 2008 financial crisis. The MMFR created a new type of fund, the Low Volatility Net Asset Value (LVNAV)<sup>[7]</sup> to replace CNAVs invested in non-public debt and banned "external support."<sup>[8]</sup> It introduced liquidity buffers, eligible assets lists, diversification requirements, valuation and credit quality assessments. It also harmonized investor protection rules and

enhanced the transparency requirements to investors and NCAs.

## Market Structure

The report provides a snapshot of the EU MMF market structure, based on 2021 year-end data. Assets held by EU MMFs total about EUR1.5 trillion, of which 46% are LVNAV, 31% standard VNAV, 12% short-term VNAV and 11% public debt CNAV. Ireland is home to the largest share of EU MMFs (42%), followed by Luxembourg (26%) and France (25%). EU MMFs are mainly denominated in Euro (42%). USD MMFs account for 31% of the total, and GBP MMFs for 22%.

Public debt CNAV and LVNAV are mostly denominated in USD and GBP and domiciled in Ireland and Luxembourg. They attract almost exclusively (95% and 99% respectively) institutional investors. EUR-denominated MMFs are primarily VNAVs, mostly domiciled in France and attract a higher percentage of retail investors (13% for short-term VNAV, and 12% for standard VNAV).

## Market Developments

The report analyzes the impact of market dynamics during the March 2020 pandemic-related volatility, the tensions that followed the invasion of Ukraine by Russia in February 2022, the UK mini-budget turmoil, and the more recent banking crisis, including the collapse of Silicon Valley Bank, in March 2023. It draws conclusions from each event.

- March 2020. In March of 2020, the demand for liquid and safe assets increased suddenly, amid market indices dropping by more than 30% within weeks. MMFs exposed to private markets (EU LVNAVs and VNAVs and US prime MMFs) experienced significant outflows.[\[9\]](#) The report posits that there may have been concerns among investors that managers may have resorted to using LMTs (fees and gates) to remain within the regulatory minimum weekly maturing assets of 30%, and that these concerns may have been greater in the US due to the investors' lower familiarity with such tools.

The report ascribes central bank intervention in late March 2020 to "the magnitude of the crisis and the global economic situation triggered by the pandemic" and recognizes that "these interventions primarily aimed at restoring confidence in the depth and liquidity of short-term funding markets".[\[10\]](#) While it does acknowledge that they helped slow redemption requests and improved the liquidity of the underlying money markets, the report also observes that the inability of some segments of the financial markets to absorb "significant and sudden increases in selling pressures" may derive from the fact that "the liquidity supply by dealers was more constrained and less responsive to sudden increases in demand than before."[\[11\]](#) Despite these challenges, and with the caveat that CBs did intervene to support markets, no EU MMF introduced fees or gates or suspended redemptions, and no LVNAV needed to be converted into VNAV for breaching the 20 bps collar.

- Russian Invasion of Ukraine. Russia's invasion of Ukraine and related geopolitical tensions have impacted financial markets, particularly in commodity prices and related derivatives prices. Because of the characteristics of the assets in which EU MMFs invest, they were not significantly exposed to interest rate risk and suffered no significant losses or outflows, which were balanced. No EU MMF had to introduce gates or fees or suspend redemptions.
- UK Mini-Budget. When in September 2022 market turmoil spread from the UK to the EU MMFs with exposures to the UK, EU MMFs (particularly in Ireland, where more than

half of the MMF investor base by amount is from the UK) denominated in GBP suffered outflows linked to the need, notably by funds with liability-driven investment strategies, to access liquidity following increased margin calls and forced sales. Five funds experienced outflows of more than 10% shortly after the announcement of the UK "mini budget" on 23 September 2022.[\[12\]](#) The situation quickly reversed following the intervention of the Bank of England to support the gilt market. One LVNAV fund came close to breaching the regulatory limit for NAV deviation, but no EU MMF had to introduce gates or fees or suspend redemptions.

- **Banking Sector Turmoil.** As for the March 2023 stress in the banking sector, the report observed no significant impact on EU MMFs. The collapse of SVB led to a shift towards MMFs, which offered higher yields and more flexibility, and a similar dynamic could be observed in EU MMFs following the takeover of Credit Suisse by UBS. EUR 17.7 bn flowed into EUR-denominated MMFs in March 2023 alone.

## **Regulatory Developments at the International Level**

Pandemic related events triggered a strong push to further strengthen the regulatory framework for MMFs. This has resulted in several proposals by the FSB, ESRB, and ESMA to reform the regulatory framework for MMFs, to limit systemic risks and to ensure that the MMF sector can withstand a potential future liquidity or market stress.[\[13\]](#) The Commission found that the policy options proposed by the different authorities and institutions can be grouped as follows: (1) reduce the risk of runs (notably by removing the deposit-like features of certain MMFs), (2) strengthen the liquidity of MMFs and their ability to absorb losses, and (3) other measures to prepare for future crises. It provides analysis of each policy option.

**Reduce risks of runs.** International organizations and supervisory bodies suggested following the US SEC's lead in transforming LVNAVs into VNAVs[\[14\]](#) and prohibiting the use of amortized accounting for LNVAVs. The analysis found no evidence that using amortized accounting harms investors or creates systemic risk (contrary to what was asserted by the FSB, the ESRB and ESMA). The Commission opposes these structural changes that would lead to the disappearance of the EU LVNAV product in a market with limited economically viable alternatives.

**Strengthen MMFs' liquidity and loss-absorption capacity.** The report questions the ECB's suggestion to relax limits on eligible public debt assets on the grounds that it would concentrate MMFs investments in these securities, which are not immune from volatility (as the UK mini-budget turmoil has shown). The report rejects proposals to increase minimum holding of liquid assets because there would be significant implementing challenges and such action may lead to unintended consequences. Similarly, imposing capital buffers is rejected because it relies on untested assumptions requiring significant operational adjustments leading to cost increases likely resulting in some funds closing.

**Other Measures.** The report considers other measures that have been put forward by ESMA, the FSB, and other stakeholders relating to reporting, stress testing, and strengthening supervision. The Commission notes that these measures merit further assessment.

## **Feasibility of Establishing a Minimum Public Debt Quota**

The Commission also considers the feasibility of the suggestion, included in the original MMFR, to establish a minimum 80% EU public debt quota.[\[15\]](#) The Commission concludes the quota would be unfeasible in practice on two grounds. First, given the predominant structure of the EU market, there is a mismatch between public debt instruments and the denominations of funds, which cannot be solved through imposing a quota. Second, the

quota could increase risks to financial stability. With banks and MMFs targeting the same instruments, risks of contagion would increase due to common underlying exposures amplifying a feedback loop between financial and sovereign risk.

## Conclusions

The report finds that the MMFR was successful in creating a regulatory environment resilient enough to withstand several major shocks since its entry into force. The Commission is satisfied that the safeguards introduced by the MMFR are working as intended, and is in favor of allowing CNAVs and LVNAVs to continue using amortized cost method.

The report is critical of the policy options being advanced by prudential and supervisory bodies in the name of strengthening the ability of MMFs to face high levels of redemptions and protect financial stability. The Commission acknowledges that "MMF managers manage liquidity with a holistic approach including staggered maturities, use of reverse repo transactions and the characteristics of their investor base (including investor concentration)." [16] Finally, the report finds that including "additional hard thresholds would introduce rigidity in the implementation of asset managers' liquidity risk management policies, such as stress tests, with potential unintended effects." [17]

## Next Steps

Given the conclusions of the report, it is unlikely that the Commission will propose changes to the current MMFR in the near future.

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## Notes

[1] European Commission, Report from the Commission to the European Parliament and the Council on the adequacy of the MMF Regulation (July 20, 2023), available from [https://finance.ec.europa.eu/system/files/2023-07/230720-report-money-market-funds\\_en.pdf](https://finance.ec.europa.eu/system/files/2023-07/230720-report-money-market-funds_en.pdf) (COM Report). Article 46(1) requires the Commission to assess the functioning of the MMFR from a prudential and economic perspective, consult with ESMA, and where appropriate the ESRB, and prepare the report.

[2] Regulation 2017/1131 on money market Funds (June 14, 2017), available from <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R1131&qid=169119561328>).

[3] FSB, [Policy Proposals to Enhance Money Market Fund Resilience](#) (FSB MMF Policy Proposals) (October 11, 2021), available from <https://www.fsb.org/wp-content/uploads/P111021-2.pdf>.

[4] ESRB, [Recommendation on reform of money market funds](#) (ESRB MMF Recommendation) (December 2, 2021), available from [https://www.esrb.europa.eu/pub/pdf/recommendations/esrb.recommendation220125\\_on\\_reform\\_of\\_money\\_market\\_funds~30936c5629.en.pdf](https://www.esrb.europa.eu/pub/pdf/recommendations/esrb.recommendation220125_on_reform_of_money_market_funds~30936c5629.en.pdf). See also ESRB, Report on the economic rationale supporting the ESRB Recommendation of 2 December 2021 on money market

funds and assessment (January 25, 2022), available from [https://www.esrb.europa.eu/pub/pdf/reports/esrb.ascreport220125\\_economic\\_rationale\\_MMFS\\_Recommendation~dbd5e76776.en.pdf?8a309b1310559a270fdf626b4b07f5e5](https://www.esrb.europa.eu/pub/pdf/reports/esrb.ascreport220125_economic_rationale_MMFS_Recommendation~dbd5e76776.en.pdf?8a309b1310559a270fdf626b4b07f5e5).

[5] ESMA, [ESMA opinion on the review of the Money Market Fund Regulation](#): Final report (ESMA MMFR Opinion) (February 14, 2022), available from [https://www.esma.europa.eu/sites/default/files/library/esma34-49-437\\_finalreportmmfreview.pdf](https://www.esma.europa.eu/sites/default/files/library/esma34-49-437_finalreportmmfreview.pdf).

[6] Indeed, as the report notes, the FSB and IOSCO are exploring how to enhance the functioning and resilience of short-term funding markets, focusing on commercial paper and certificate of deposit markets, recognizing the complement to MMF policy work. See IOSCO, IOSCO Board Priorities - Work Program 2023-2024 (April 5, 2023), available from <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD731.pdf>.

[7] LVNAVs are allowed to use amortized cost accounting to offer a stable redemption price, but only as long as the value of the underlying assets does not deviate by more than 20 basis points from the market value of the fund's net assets. See COM Report at 5.

[8] ESMA separately clarified the definition of external support to mean "direct or indirect support offered to an MMF by a third party, including a sponsor of the MMF, that is intended for or in effect would result in guaranteeing the liquidity of the MMF or stabilizing the NAV per unit or share of the MMF." ESMA, Public Statement, Actions to mitigate the impact of COVID-19 on the EU financial markets - External support within the meaning of Article 35 of the MMF Regulation (July 9, 2020), available from [https://www.esma.europa.eu/sites/default/files/library/esma34-39-1096\\_esma\\_statement\\_mmfr\\_art35.pdf](https://www.esma.europa.eu/sites/default/files/library/esma34-39-1096_esma_statement_mmfr_art35.pdf).

[9] EU domiciled LVNAVs experienced outflows of EUR 51.4 bn during March 2020 and faced challenges to sell their commercial papers and certificates of deposit as banks were unwilling or unable to buy back these papers, including their own papers. See COM Report at 10.

[10] *Id.* at 12.

[11] *Id.*

[12] ESMA, TRV Risk Monitor, Report on Trends, Risks and Vulnerabilities, No. 1, 2023 (February 9, 2023), available from [https://www.esma.europa.eu/sites/default/files/library/ESMA50-165-2438\\_trv\\_1-23\\_risk\\_monitor.pdf](https://www.esma.europa.eu/sites/default/files/library/ESMA50-165-2438_trv_1-23_risk_monitor.pdf).

[13] See, FSB MMF Policy Proposals, ESRB MMF Recommendation, and ESMA MMFR Opinion.

[14] See SEC, Money Market Fund Reforms; Form PF Reporting Requirements for Large Liquidity Fund Advisers; Technical Amendments to Form N-CSR and Form N-1A, (July 12, 2021), available from <https://www.sec.gov/rules/final/2023/33-11211.pdf>.

[15] Article 46(2) of the MMFR requires the Commission to conduct this feasibility assessment.

[16] COM report at 19.

[\[17\]](#) Id.

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