VIEWS OF THE BANKING INDUSTRY ON THE AMENDMENTS TO THE MMF REGULATORY REGIME PROPOSED BY THE ESMA IN 2021

PRESENTATION TO THE ECB MONEY MARKET CONTACT GROUP

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SOCIETE GENERALE

OBJECTIVES OF THE ESMA REFORM

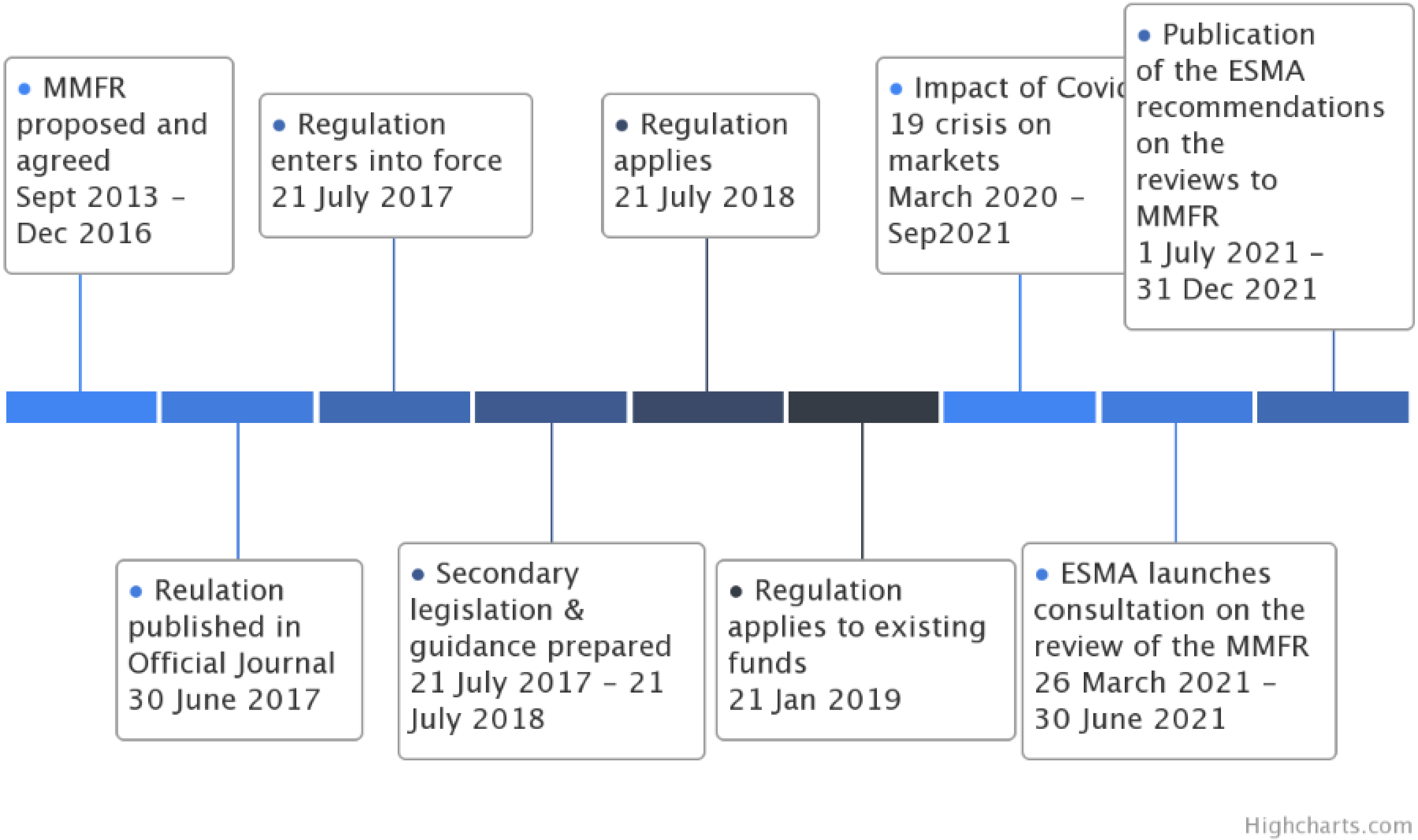
- **The MMFR Reform is required by the regulatory text (Art 46) and due before 21 July 2022**

- **The Covid-19 Crisis posed numerous challenges to MMFs, resulted in an acute lack of liquidity for money-market instruments and underlined the need for further amendments of the original text**

- **ESMA launched the public consultation in March 2021 with the following double objective for the amendment :**
  - Enhance MMF resilience and ensure there is no impact on financial stability case of stress
  - Avoid interventions from Central Banks

  ➔ The areas of reform were defined accordingly

TIMELINE OF MONEY MARKET FUNDS REGULATION



IDENTIFIED AREAS OF THE REFORM : POLICY OPTIONS 1/2

1/ Reforms targeting the liability side of MMFs

- Decouple regulatory thresholds (Weekly Liquid Assets) from suspensions/gates to limit pre-emptive outflows and further liquidity stress
- Require MMFs to use swing pricing (adjustment of entry and exit charges) and/or anti-dilution levies / redemption fees to help reduce redemption requests under stress and to transfer the redemption cost to the exiting investor

2/ Reforms targeting the asset side of MMFs

- Increase liquidity buffers, review their calibration (differentiate need per investor type as for banks' LCR) and/or make them usable/countercyclical (relaxed in times of stress).

3/ Reforms targeting both the liability and asset side of MMFs

- Review the status of certain types of MMF such as the stable NAV and LVNAV

4/ Reforms that are external to MMFs themselves

Assess whether the role of sponsor support should be modified (amend the current requirement of article 35 of the MMFR under which sponsor support is prohibited)

IDENTIFIED AREAS OF THE REFORM : POLICY OPTIONS 2/2

5/ Other proposals

- Amend/specify the rules on ratings of MMFs
- Disclose money market instruments (MMIs) main categories of investors to regulatory authorities
- Strengthen the role of MMF stress-testing (including from a system-wide perspective)
- Further harmonize and enhance international MMFs reporting framework
- Set-up a liquidity exchange facility (“LEF”) funded by MMF or asset managers. This LEF could serve as a centralized source of liquidity and/or credit during periods of stress. This could mitigate liquidity pressures on MMFs and reduce the benefit of ‘first mover advantage’ for investors resulting in an accelerating spiral of investor redemptions and asset fire-sales
- Further clarify the scope of the MMF Regulation.

FAVOURABLE DEVELOPMENTS FROM A BANK'S POINT OF VIEW

- ✓Reduced incentives to early, pre-emptive redemptions; reduced options to exit at no cost limit amounts redeemed for a given date; increase redemption notice periods (MMFs should be a less liquid option to investors than bank accounts);
- ✓Reflect better the cost of liquidity at all times and especially in times of market stress, adjust entry or exit prices
- ✓Establish the ability to execute bank paper redemptions at prices that may be different from the valuation; translate these variations into the exit prices
- ✓Reduced incentives to overbuild liquidity buffers
- ✓Relaxed liquidity buffers in times of stress to avoid self-feeding phenomena
- ✓Enhanced stress testing and BAU models
- ✓Increase the capacity of CP/CD dealers to offer liquidity on the secondary market
- ✓Centrally cleared trading platforms may be a solution to enhanced liquidity and transparency on primary and secondary markets

ADDITIONAL REMARKS TO THE REVIEW OF THE REGULATORY TEXT

- MMFs are the main providers of term money-market liquidity for banks by the means of short-term debt issued by banks, but while banks' short-term paper is eligible to ECB refinancing operations, MMFs do no have access this facility. Also, banks have no incentive to hold other banks' short-term debt (for regulatory reasons such as LCR, leverage ratio etc). There is no real liquidity backstop for investors holding banks' short-term debt, which increases the risk of illiquidity in times of acute stress
- Is it desirable that the market should be self-sustained at all times, even during severe and acute stress on the global, real, economy such as was the case in March 2020 ? Or should it be accepted that Central Banks may intervene in such extreme cases ?
- Should liquidity buffers be increased with the purpose to cover all extreme, global and economy-wide situations such as the one we witnessed in March 2020 ? What would be the cost vs benefits ?
    - Central Banks may need to maintain higher levels of excess liquidity
    - Investors may be incentivized to take more risk in order to compensate lower yields