Compliance assessment of the implementation of the Recommendation of the European Systemic Risk Board of 20 December 2012 on money market funds (ESRB/2012/1)

March 2019

Compliance assessment and follow-up evaluation
Compliance Report – Implementation of Recommendation ESRB/2012/1 by the European Commission
March 2019
Contents

Recommendation of the European Systemic Risk Board of 20 December 2012 on money market funds (ESRB/2012/1) 44

Introduction 45

Section 1 – Objective of the ESRB Recommendation 47

Section 2 – Assessment methodology 50
Methodological principles 50
Grading methodology 52
Weights assigned to the Recommendations 54

Section 3 – Assessment results 57
Summary of assessment results 57
Recommendation A – Mandatory move to variable net asset value 59
Recommendation B – Liquidity requirements 65
Recommendation C – Public disclosure 71
Recommendation D – Reporting and information sharing 76

Annex A: Members of the assessment team 83

Abbreviations 84
Compliance assessment and follow-up evaluation

On 20 December 2012 the European Systemic Risk Board (ESRB) adopted Recommendation ESRB/2012/1 on money market funds (hereinafter the “Recommendation”), which was addressed to the European Commission. In line with the Recommendation and with Article 17 of the ESRB Regulation, the ESRB conducted a compliance assessment of the implementation of this Recommendation.

The overall assessment of the implementation of the Recommendation was conducted by the assessment team in two different stages. Given that the European Commission is the sole addressee of the Recommendation, compliance should be assessed on the basis of the Commission’s Proposal for a Regulation on money market funds (hereinafter the “Proposal for a Regulation”)). However, the final Regulation is the result of a trilogue between the Commission, the European Parliament and the Council, which ultimately led to Regulation (EU) 2017/1131 on money market funds (hereinafter the “Regulation on MMFs”).

In the first stage, the assessment team assessed the European Commission’s Proposal for a Regulation (see Annex I). This assessment was conducted on the basis of the “act or explain” mechanism pursuant to Article 17 of the ESRB Regulation, and referred to the interim report provided by the Commission and the Proposal for a Regulation. This first assessment is, therefore, the formal assessment envisaged in the Recommendation. However, when this first ESRB assessment was being finalised, the EU legislative process was about to be concluded, and it was expected that some key aspects of the final Regulation on MMFs would differ from the Commission’s initial proposal. Therefore, at the meeting of the ESRB’s Advisory Technical Committee on 23 February 2017 it was decided that, to retain the relevance of the work already undertaken by the assessment team, a second evaluation should be conducted to evaluate the

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5 On 30 June 2013 the Commission provided the ESRB with an interim report laying out its reasoning and planned further steps concerning regulating money market fund (MMF) market in the European Union. On 4 September 2013 the Commission published its Proposal for a Regulation of the European Parliament and of the Council on MMFs.
forthcoming Regulation on MMFs and to gain a better understanding of the implications of the current regulatory environment for MMFs.

As a result, in the second stage, the assessment team evaluated the Regulation on MMFs (see Annex II) to complement the formal assessment. This evaluation should not be considered a formal assessment but rather an analysis of the content of the Regulation on MMFs against the provisions set out in the Recommendation. In fact, the Regulation on MMFs was adopted under the ordinary legislative procedure and the European Parliament and the Council are not addressees of the Recommendation. Therefore, Article 17 of the ESRB Regulation (on the follow-up of ESRB recommendations) did not apply.

With this two-stage approach, the ESRB is able to provide an overall assessment of the current regulatory status quo. This makes it possible to gain a better understanding of the implications of the current regulatory environment for MMFs.

The assessment documentation was approved for publication by the ESRB’s General Board on 5 February 2019.

Summary of the results of the compliance assessment and the follow-up evaluation

The assessment of the Proposal for a Regulation is the formal compliance assessment envisaged in the Recommendation and was concluded in February 2017. Overall, the assessment team found the European Commission’s Proposal for a Regulation to be largely compliant with the Recommendation.

The assessment team’s subsequent follow-up evaluation of the Regulation on MMFs is for information purposes only. It is a stand-alone evaluation of the content of the Regulation on MMFs in the light of the policy proposals in the Recommendation. Regarding its conclusions, if this follow-up evaluation were a formal compliance assessment, the overall grade given to the Regulation on MMFs would also be largely compliant.

Tables 1 and 2 illustrate the results by individual recommendation:
Table 1: Results of the formal compliance assessment of the European Commission’s Proposal for a Regulation

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Weight</th>
<th>Compliance grade</th>
<th>Numerical grade</th>
<th>Weighted numerical grade</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>30%</td>
<td>Partially compliant</td>
<td>0.63</td>
<td>0.19</td>
</tr>
<tr>
<td>B</td>
<td>30%</td>
<td>Fully compliant</td>
<td>1.00</td>
<td>0.30</td>
</tr>
<tr>
<td>C</td>
<td>20%</td>
<td>Fully compliant</td>
<td>0.93</td>
<td>0.19</td>
</tr>
<tr>
<td>D</td>
<td>20%</td>
<td>Largely compliant</td>
<td>0.88</td>
<td>0.18</td>
</tr>
<tr>
<td>Overall assessment</td>
<td></td>
<td>Largely compliant</td>
<td></td>
<td>0.85</td>
</tr>
</tbody>
</table>

Table 2: Results of the follow-up evaluation of the Regulation on MMFs

<table>
<thead>
<tr>
<th>Recommendations</th>
<th>Weight</th>
<th>Compliance grade</th>
<th>Numerical grade</th>
<th>Weighted numerical grade</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>30%</td>
<td>Largely compliant</td>
<td>0.75</td>
<td>0.23</td>
</tr>
<tr>
<td>B</td>
<td>30%</td>
<td>Fully compliant</td>
<td>1.00</td>
<td>0.30</td>
</tr>
<tr>
<td>C</td>
<td>20%</td>
<td>Fully compliant</td>
<td>0.93</td>
<td>0.20</td>
</tr>
<tr>
<td>D</td>
<td>20%</td>
<td>Largely compliant</td>
<td>0.83</td>
<td>0.17</td>
</tr>
<tr>
<td>Overall assessment</td>
<td></td>
<td>Largely compliant</td>
<td></td>
<td>0.89</td>
</tr>
</tbody>
</table>

Even though the grade of the overall assessment is, in both cases, “largely compliant”, there are two differences between the formal compliance assessment of the Proposal for a Regulation and the subsequent follow-up evaluation of the Regulation on MMFs that are worth noting. Given that Article 35 of the Regulation on MMFs prohibits sponsor support, the assessment team considered the two sub-recommendations on sponsor support (sub-recommendations C2 and D1(a)) not to be applicable within the follow-up evaluation and therefore adjusted the weights within sub-recommendations C and D. Another difference results from the content of the Regulation on MMFs in relation to the use and disclosure of amortised cost as a valuation methodology, which led the assessment team to grade sub-recommendations A2 and C3 as “fully compliant” (compared with “largely compliant” in the compliance assessment). Although these changes resulted in a slight increase in the weighted numerical grades, this had no material influence on the overall assessment grade, which remained “largely compliant”.

Tables 3 and 4 illustrate the results by sub-recommendation:

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6 Owing to the creation of two new types of MMF: public debt MMFs with a constant net asset value and MMFs with a low volatility net asset value.
### Table 3: Results of the formal compliance assessment of the European Commission’s Proposal for a Regulation by sub-recommendation

<table>
<thead>
<tr>
<th>Sub-recommendations</th>
<th>Recommendations</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Weight</td>
</tr>
<tr>
<td>A1</td>
<td>50%</td>
</tr>
<tr>
<td>A2</td>
<td>50%</td>
</tr>
<tr>
<td>B1</td>
<td>33%</td>
</tr>
<tr>
<td>B2</td>
<td>33%</td>
</tr>
<tr>
<td>B3</td>
<td>33%</td>
</tr>
<tr>
<td>C1</td>
<td>40%</td>
</tr>
<tr>
<td>C2</td>
<td>30%</td>
</tr>
<tr>
<td>C3</td>
<td>30%</td>
</tr>
<tr>
<td>D1 (a)</td>
<td>25%</td>
</tr>
<tr>
<td>D1 (b)</td>
<td>25%</td>
</tr>
<tr>
<td>D1 (c)</td>
<td>25%</td>
</tr>
<tr>
<td>D2</td>
<td>25%</td>
</tr>
</tbody>
</table>

### Table 4: Results of the follow-up evaluation of the Regulation on MMFs by sub-recommendation

<table>
<thead>
<tr>
<th>Sub-recommendations</th>
<th>Recommendations</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Weight</td>
</tr>
<tr>
<td>A1</td>
<td>50%</td>
</tr>
<tr>
<td>A2</td>
<td>50%</td>
</tr>
<tr>
<td>B1</td>
<td>33%</td>
</tr>
<tr>
<td>B2</td>
<td>33%</td>
</tr>
<tr>
<td>C1</td>
<td>55%</td>
</tr>
<tr>
<td>C2</td>
<td>n.a.</td>
</tr>
<tr>
<td>C3</td>
<td>45%</td>
</tr>
<tr>
<td>D1 (a)</td>
<td>n.a.</td>
</tr>
<tr>
<td>D1 (b)</td>
<td>33%</td>
</tr>
<tr>
<td>D1 (c)</td>
<td>33%</td>
</tr>
<tr>
<td>D2</td>
<td>33%</td>
</tr>
</tbody>
</table>

Full details on both assessments are to be found in the attached documents (Annex I and Annex II).
Annex I – Compliance report on the implementation of Recommendation ESRB/2012/1 by the European Commission

Recommendation of the European Systemic Risk Board of 20 December 2012 on money market funds (ESRB/2012/1)
Introduction

This report provides a compliance assessment of the implementation of Recommendation ESRB/2012/1 on money market funds7 (hereinafter the “Recommendation”) by its addressee, the European Commission. On 30 June 2013, the Commission provided the ESRB with an interim report laying out its reasoning and planned further steps on the regulation of the money market fund (MMF) market in the European Union (EU). On 4 September 2013, the Commission published its Proposal for a Regulation on MMFs8 (hereinafter the “Proposal for a Regulation”), thus initiating the EU legislative process in accordance with Article 294(2) of the Treaty on the Functioning of the European Union (TFEU).

The Commission is the sole addressee of the Recommendation. The ESRB therefore decided to start the follow-up to its Recommendation pursuant to Article 17 of the ESRB Regulation9 based on the interim report provided by the Commission and the Proposal for a Regulation10.

The Recommendation addressed a number of specific policy recommendations to the Commission regarding the regulation and supervision of MMFs with the aim of reducing the systemic risks arising from them. In particular, the ESRB recommended ensuring, through EU legislation, a change from a constant net asset value (CNAV) model to a fluctuating net asset value (NAV) model, the introduction of stricter liquidity requirements, the public disclosure of specific information by MMFs and the adoption of enhanced reporting obligations to supervisory authorities for MMFs.

This assessment report was approved for publication by the ESRB General Board on 5 February 2019.

10 The European Parliament and the Council adopted their proposals for EU legislation on MMFs on 29 April 2015 and 15 June 2016 respectively. When this ESRB follow-up assessment was being finalised in January 2017 the EU legislative process was in its final stage but was not yet fully completed, and the final legislative text was not publicly available.
Section 1 – Objective of the Recommendation

The objective of the Recommendation was to reduce the systemic risks arising from MMFs. The Commission was recommended to use relevant EU legislation to ensure implementation of the change from a CNAV model to a fluctuating NAV model, the introduction of stricter liquidity requirements, the public disclosure of specific information by MMFs and the adoption of enhanced reporting obligations to supervisory authorities for MMFs. More specifically, the Recommendation set out the following policy objectives:

**Recommendation A – Mandatory move to variable net asset value**

The Commission is recommended to ensure that the relevant EU legislation:

(1) requires MMFs to have a fluctuating net asset value;

(2) requires MMFs to make general use of fair valuation and to restrict the use of amortised cost accounting to a limited number of predefined circumstances.

**Recommendation B – Liquidity requirements**

The Commission is recommended to ensure that the relevant EU legislation:

(1) complements the existing liquidity requirements for MMFs by imposing explicit minimum amounts of daily and weekly liquid assets that MMFs must hold;

(2) strengthens the responsibility of MMF managers regarding the monitoring of liquidity risk;

(3) ensures that national supervisory authorities and MMF managers have in place effective tools, for example temporary suspensions of redemptions, to deal with liquidity constraints in times of stress resulting from both fund-specific and market-wide developments.

**Recommendation C – Public disclosure**

The Commission is recommended to ensure that the relevant EU legislation:

(1) requires specific disclosure by MMFs, also in their marketing material, that draws the attention of investors to the absence of a capital guarantee and the possibility of principal loss;
(2) requires that MMFs refer in their public disclosure to possible sponsor support, capacity for support or protection only if such support or protection is a firm commitment by the sponsor, in which case it must be recognised in that sponsor’s accounts and prudential requirements;

(3) requires MMFs to disclose their valuation practices, particularly regarding the use of amortised cost accounting, as well as to provide appropriate information to investors regarding applicable redemption procedures in times of stress.

**Recommendation D – Reporting and information sharing**

1. The Commission is recommended to ensure that the relevant EU legislation:

(a) requires that any instances of sponsor support that may have an impact on the price of the MMF are reported by the MMF or its manager, and the sponsor, to the competent national supervisory authority, together with a full description of the nature and size of such support;

(b) enhances regular reporting by MMFs;

(c) ensures that competent national supervisory authorities, where relevant, share the information referred to in points (a) and (b) with other national supervisory authorities within the same Member State, or from other Member States, the European supervisory authorities, the members of the European System of Central Banks and the ESRB.

2. The Commission is recommended to promote the development of harmonised reporting and a harmonised dataset as mentioned in paragraph 1(b), and the organisation of information sharing mentioned in paragraph 1(c).

The Recommendation also set out further detailed compliance criteria for each of the policy recommendations.
An assessment of compliance with and implementation of each ESRB recommendation must be carried out following the “act or explain” mechanism in accordance with Article 17 of the ESRB Regulation. For this assessment, the addressee of a recommendation (in this case the Commission) can either (i) take action in response to a recommendation and inform the ESRB of such action, or (ii) take no action, provided that it can properly justify the reasons for inaction. The ESRB subsequently analyses the information provided and assesses whether the action taken duly achieves the objective of the recommendation or whether the justification provided for inaction is sufficient. This analysis results in a final compliance grade being assigned to each addressee.

Recommendation ESRB/2012/1 established the following timeline for the Commission to provide information about its compliance with the Recommendation:

- By 30 June 2013, the Commission was requested to deliver to the ESRB an interim report containing a first assessment of the implementation of these Recommendations
- By 30 June 2014, the Commission was requested to deliver to the ESRB and the Council a final report on the implementation of these Recommendations.

On 30 June 2013, the Commission provided the ESRB with an interim report laying out its reasoning and planned further steps concerning the regulation of the MMF market in the EU. On 4 September 2013, the Commission published its Proposal for a Regulation, thus initiating the EU legislative process in accordance with Article 294(2) of the TFEU.

The Commission did not provide a final report on the implementation of the Recommendation by 30 June 2014. In its letter of 19 April 2016 to the ESRB Secretariat, the Commission explained that the legislative procedure for the adoption of the MMF legislation pursuant to Article 294 of the TFEU was still ongoing. It also explained that it does not control the legislative process and only has the right of legislative initiative. Indeed, as co-legislators, the European Parliament and the Council only adopted their positions in accordance with the ordinary legislative procedure under Article 294 of the TFEU at a much later stage, on 29 April 2015 and 17 June 2016 respectively. The Commission suggested that the ESRB conduct the assessment on the follow-up to the Recommendation based on its interim report of 30 June 2013 and its Proposal for a Regulation.

By April 2016 the Council had not yet formulated its position on the MMF dossier and the trilogue negotiations between the Commission, the European Parliament and the Council had not started. Since the Commission was the sole addressee of the Recommendation, the
ESRB followed the Commission’s argument that it only has the right to initiate legislation and can neither control the legislative process nor ensure a particular outcome. The ESRB therefore decided to start the follow-up to its Recommendation pursuant to Article 17 of the ESRB Regulation and to base its assessment on the interim report and the legislative Proposal for a Regulation.

On 5 July 2016, the Advisory Technical Committee (ATC) approved the establishment of an assessment team mandated to carry out the follow-up assessment of compliance with the Recommendation. The members of the assessment team are listed in Annex A to this report.

Methodological principles

The assessment followed the methodology provided in the Handbook on the follow-up to ESRB recommendations (hereinafter the “Handbook”), which was published in April 2016. It was carried out by an assessment team of six assessors appointed by the ATC and chaired by the Head of the ESRB Secretariat (see Annex A).

The follow-up report is based on the following documentation provided by the Commission:

- the Commission’s interim report of 30 June 2013;
- the Commission’s Proposal for a Regulation;
- the impact assessment accompanying the Proposal for a Regulation;
- the Commission’s letter to the ESRB Secretariat of 19 April 2016.

The draft version of the final follow-up report was sent to the Commission for comment on 14 November 2016, in line with the principle of effective dialogue. The Commission provided its comments to the assessment team on 2 December 2016.

The following material was also taken into account for the purposes of the assessment:

- International Organization of Securities Commissions (IOSCO) Policy Recommendations for Money Market Funds, final report of 9 October 2012;
- Committee of European Securities Regulators (CESR) Guidelines on a common definition of European money market funds, 19 May 2010;
There was no need to develop separate assessment criteria, given that the Recommendation specifies detailed compliance criteria for each sub-recommendation. Moreover, the assessment team did not deem it necessary to further specify implementation standards for the purpose of this assessment because the Recommendation has only one addressee. There was therefore no need for a methodology to ensure comparability in the assessment of compliance and implementation by multiple addressees. Instead, the assessment focuses on the content and economic substance of the provisions in the Proposal for a Regulation, taking into account in particular the appropriateness of these provisions for achieving the policy objectives of the Recommendation, as further specified in the compliance criteria and explained in the Annex to the Recommendation.

The status of the legislative proposal of the Commission was deemed to be legislation enacted. This means that the assessment was based solely on the content and economic substance of the Commission’s Proposal for a Regulation, as if this draft regulation were legally in force. In contrast, the respective positions of the European Parliament and the Council, and the legislative text (which was at that time not yet public) that resulted from the negotiations in November 2016, were not taken into account.

The assessment team applied the principle of “four-eyes review”. This means that two members of the assessment team each analysed the implementation of one of the four Recommendations (A, B, C and D) and assessed compliance. The other team members then discussed and reviewed each of these assessments. Finally, the assessment team jointly applied a consistency check to the overall assessment, decided on the grading for each Recommendation and assigned an overall assessment grade.

Grading methodology

A four-step grading methodology was used to reach a single grade for the addressee as the final result of the follow-up assessment, in line with the Handbook. This methodology is necessary to ensure full transparency of the single overall compliance grade and a high level of objectivity throughout the assessment process, while still allowing room for high-quality expert judgement, which can easily be identified and reviewed in order to understand the rationale behind particular grades.

Step I: Assessing the compliance grade for each sub-recommendation
When assessing compliance with the Recommendations, the implementation of each sub-recommendation and its respective compliance criteria is graded according to the following grading scale:

### Table 1 – Grading scale

<table>
<thead>
<tr>
<th>Grading scale for action</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fully compliant (FC)</td>
<td>The addressee complies entirely with the requirements.</td>
</tr>
<tr>
<td>Largely compliant (LC)</td>
<td>Requirements have been met almost entirely and only negligible requirements remain to be implemented.</td>
</tr>
<tr>
<td>Partially compliant (PC)</td>
<td>The most important requirements have been met; certain deficiencies affect the adequacy of the implementation, without resulting in a situation where the given recommendation has not been acted upon.</td>
</tr>
<tr>
<td>Materially non-compliant (MC)</td>
<td>Requirements have been fulfilled to a degree, resulting in a significant deficiency in the implementation.</td>
</tr>
<tr>
<td>Non-compliant (NC)</td>
<td>Almost none of the requirements have been met, even if steps have been taken towards implementation.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Grading scale for inaction</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sufficiently explained (SE)</td>
<td>A complete and well-reasoned explanation for the lack of implementation has been provided; if one or more of the sub-recommendations are intended to address a particular systemic risk that does not affect a particular addressee, such justification/explanation may be considered sufficient.</td>
</tr>
<tr>
<td>Insufficiently explained (IE)</td>
<td>The explanation given for the lack of implementation is not sufficient to justify the inaction.</td>
</tr>
</tbody>
</table>

### Step II: Calculating the grades for each specific Recommendation

Each compliance grade is converted into a numerical grade (see Table 2), in order to be weighted and aggregated into a single compliance grade for each sub-recommendation (note that IE is equal to NC in its numerical value), as set out in the following table:
Table 2 – Conversion table: compliance grades to numerical grades

<table>
<thead>
<tr>
<th>Compliance grade</th>
<th>Numerical grade</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Action</strong></td>
<td></td>
</tr>
<tr>
<td>FC</td>
<td>1</td>
</tr>
<tr>
<td>LC</td>
<td>0.75</td>
</tr>
<tr>
<td>PC</td>
<td>0.50</td>
</tr>
<tr>
<td>MC</td>
<td>0.25</td>
</tr>
<tr>
<td>NC</td>
<td>0</td>
</tr>
<tr>
<td><strong>Inaction</strong></td>
<td></td>
</tr>
<tr>
<td>SE</td>
<td>1</td>
</tr>
<tr>
<td>IE</td>
<td>0</td>
</tr>
</tbody>
</table>

**Step III: Calculating the overall grade for the whole Recommendation**

The weighted average of the numerical grades attributed to each sub-recommendation is calculated according to the pre-agreed weighting scheme, i.e. the respective weights of each sub-recommendation.

**Step IV: Converting the overall numerical grade to an overall level of compliance**

The overall compliance grade is determined using the conversion table below:

Table 3 – Conversion table: numerical grades to compliance grades

<table>
<thead>
<tr>
<th>Numerical grade</th>
<th>Compliance grade</th>
</tr>
</thead>
<tbody>
<tr>
<td>[0.90-1.00]</td>
<td>FC</td>
</tr>
<tr>
<td>[0.65-0.90]</td>
<td>LC</td>
</tr>
<tr>
<td>[0.40-0.65]</td>
<td>PC</td>
</tr>
<tr>
<td>[0.15-0.40]</td>
<td>MC</td>
</tr>
<tr>
<td>[0.00-0.15]</td>
<td>NC</td>
</tr>
</tbody>
</table>

Finally, the level of compliance is colour-coded:
<table>
<thead>
<tr>
<th>Table 4 – Colour codes for levels of compliance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Positive grades</strong></td>
</tr>
<tr>
<td>FC – Actions taken fully implement the Recommendation</td>
</tr>
<tr>
<td>LC – Actions taken implement almost all of the Recommendation</td>
</tr>
<tr>
<td>SE – No actions were taken but the addressee provided sufficient justification</td>
</tr>
<tr>
<td><strong>Mid-grade</strong></td>
</tr>
<tr>
<td>PC – Actions taken only implement part of the Recommendation</td>
</tr>
<tr>
<td><strong>Negative grades</strong></td>
</tr>
<tr>
<td>MN – Actions taken only implement a small part of the Recommendation</td>
</tr>
<tr>
<td>NC – Actions taken are not in line with the nature of the Recommendation</td>
</tr>
<tr>
<td>IE – No actions were taken, and the addressee did not provide sufficient justification</td>
</tr>
</tbody>
</table>
Weights assigned by the assessment team

The assessment team assigned the following weights to Recommendations A, B, C and D and the respective sub-recommendations:

Table 5: Weights of each Recommendation and of the respective sub-recommendations

<table>
<thead>
<tr>
<th>Recommendation weights</th>
<th>Sub-recommendation weights</th>
</tr>
</thead>
<tbody>
<tr>
<td>A 30%</td>
<td>A1 50%</td>
</tr>
<tr>
<td></td>
<td>A2 50%</td>
</tr>
<tr>
<td></td>
<td>B1 33%</td>
</tr>
<tr>
<td>B 30%</td>
<td>B2 33%</td>
</tr>
<tr>
<td></td>
<td>B3 33%</td>
</tr>
<tr>
<td></td>
<td>C1 40%</td>
</tr>
<tr>
<td>C 20%</td>
<td>C2 30%</td>
</tr>
<tr>
<td></td>
<td>C3 30%</td>
</tr>
<tr>
<td></td>
<td>D1 (a) 25%</td>
</tr>
<tr>
<td></td>
<td>D1 (b) 25%</td>
</tr>
<tr>
<td></td>
<td>D1 (c) 25%</td>
</tr>
<tr>
<td>D 20%</td>
<td>D2 25%</td>
</tr>
</tbody>
</table>

Weights of Recommendations A, B, C and D

In terms of economic relevance for safeguarding financial stability, Recommendation A (on the use of variable net asset values and the general use of fair value accounting) and Recommendation B (on liquidity requirements) are relatively more important than Recommendation C (on public disclosure) and Recommendation D (on reporting and information sharing).

First, MMFs with a constant net asset value (CNAV MMFs) are particularly vulnerable to runs. The two main interlinked factors related to this risk are the “trigger effect” and the insufficient liquidity buffer in the event of massive early redemptions. The adverse dynamic of the trigger effect reflects the deposit-like characteristics, in the perception of many investors, of CNAV MMFs. This perception is prone to a sudden switch from a “good” to a “bad” equilibrium, which typically creates tail risks, i.e. high-impact risks which occur very rarely. Misalignments between the NAV and the shadow prices of the portfolio increase the probability of runs. The more gradual and smooth fluctuation of MMFs with a variable net asset value (VNAV MMFs) limits this effect.

The second-most critical aspect of MMFs is liquidity. The liquidity buffer is the first line of defence in the event of massive unexpected redemptions. This buffer has to be sufficiently large and consist of cash or very liquid assets (i.e. assets with a short maturity and/or with very modest bid-ask
spreads, even under stressed market conditions). It is important to consider both residual maturity and market liquidity because empirical evidence shows that a security with a very short residual maturity (for instance, only a few days) can sometimes – in stressful market conditions – be less liquid than a similar security with a longer maturity (for instance, five years).

Given the particularly high importance of the valuation and liquidity aspects from a financial stability perspective, Recommendations A and B were each assigned higher relative weights of 30%, and Recommendations C and D were each assigned lower relative weights of 20%.

**Weights of the sub-recommendations within each Recommendation**

The sub-recommendations within Recommendations A, B and D were equally weighted, as the sub-recommendations were deemed to be equal in terms of economic substance and importance for achieving the policy objective of the Recommendation.

For Recommendation C, the issue of clearly informing MMF investors about the absence of a capital guarantee, thereby highlighting to investors the possibility of principal loss, was deemed to be relatively more important with regard to investor behaviour and financial stability. Therefore, sub-recommendation C1 was assigned a relative weight of 40% within Recommendation C, while sub-recommendations C2 and C3 were each assigned relative weights of 30%.
Section 3 – Assessment results

Summary of assessment results

The results of the assessment for each sub-recommendation are summarised in Table 6. The compliance grade for each sub-recommendation is converted into a numerical grade, which is then weighted as described above.

<table>
<thead>
<tr>
<th>Sub-recommendations</th>
<th>Recommendations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weight Compliance grade</td>
<td>Numerical grade</td>
</tr>
<tr>
<td>A1</td>
<td>50% PC</td>
</tr>
<tr>
<td>A2</td>
<td>50% LC</td>
</tr>
<tr>
<td>B1</td>
<td>33% FC</td>
</tr>
<tr>
<td>B2</td>
<td>33% FC</td>
</tr>
<tr>
<td>B3</td>
<td>33% FC</td>
</tr>
<tr>
<td>C1</td>
<td>40% FC</td>
</tr>
<tr>
<td>C2</td>
<td>30% FC</td>
</tr>
<tr>
<td>C3</td>
<td>30% LC</td>
</tr>
<tr>
<td>D1 (a)</td>
<td>25% FC</td>
</tr>
<tr>
<td>D1 (b)</td>
<td>25% FC</td>
</tr>
<tr>
<td>D1 (c)</td>
<td>25% LC</td>
</tr>
<tr>
<td>D2</td>
<td>25% LC</td>
</tr>
</tbody>
</table>

The overall compliance grade is determined using the conversion table, in accordance with the ESRB Handbook. After reaching a single compliance grade for each sub-recommendation, a final grade is calculated for each Recommendation using the weights assigned to each sub-recommendation and the conversion table (see Table 2).

This provides weighted numerical grades for Recommendations A, B, C and D, which are finally aggregated to produce an overall compliance grade. The results of the assessment are summarised in Table 7.
Table 7: Results for each Recommendation and overall assessment result

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Weight</th>
<th>Compliance grade</th>
<th>Numerical grade</th>
<th>Weighted numerical grade</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>30%</td>
<td>Partially compliant</td>
<td>0.63</td>
<td>0.19</td>
</tr>
<tr>
<td>B</td>
<td>30%</td>
<td>Fully compliant</td>
<td>1.00</td>
<td>0.30</td>
</tr>
<tr>
<td>C</td>
<td>20%</td>
<td>Fully compliant</td>
<td>0.93</td>
<td>0.19</td>
</tr>
<tr>
<td>D</td>
<td>20%</td>
<td>Largely compliant</td>
<td>0.88</td>
<td>0.18</td>
</tr>
<tr>
<td>Overall assessment</td>
<td></td>
<td>Largely compliant</td>
<td></td>
<td>0.85</td>
</tr>
</tbody>
</table>

The European Commission is assessed to be:

- partially compliant with regard to Recommendation A;
- fully compliant with regard to Recommendation B;
- fully compliant with regard to Recommendation C;
- largely compliant with regard to Recommendation D.

Overall, the European Commission is assessed to be largely compliant with regard to Recommendation ESRB/2012/1 on MMFs.
Recommendation A – Mandatory move to variable net asset value

Assessment of sub-recommendation A1

Sub-recommendation A1 recommends that the Commission ensure that the relevant EU legislation requires MMFs to have a fluctuating net asset value.

Moreover, the Recommendation sets out the following compliance criteria for sub-recommendation A1.

MMFs should be required to use only the variable net asset value model. In particular, rounding share prices to the nearest unit should be prohibited. Transitional arrangements for a compulsory move to the variable net asset value model would be needed. It is therefore recommended to have a sufficiently long transition period for existing MMFs, during which the constant net asset value model can still be maintained to allow for the necessary adjustments. The transitional period for existing constant net asset value funds could be at least two years after the final publication of the applicable rules. Moreover, the shift to variable net asset value funds should be carefully announced, well before the requirement is implemented, by disclosure of the MMFs on the effect of the change.

The Proposal for a Regulation stipulates comprehensive prudential requirements for MMFs and managers of MMFs. These encompass rules on the eligibility of assets (Articles 8-13), diversification and concentration (Articles 14-15), internal credit quality assessment and rating processes (Articles 16-20), the risk management of MMFs (Articles 21-25), valuation (Articles 26-28), restrictions on external support (Articles 35-36) and transparency (Articles 37-38).

However, the Proposal for a Regulation does not provide for prohibition of CNAV MMFs or a mandatory transformation of CNAV MMFs into VNAV MMFs, as recommended by the ESRB. Instead, Chapter V (Articles 29-34) provides for specific prudential requirements for CNAV MMFs. In particular, Article 30 stipulates that CNAV MMFs must establish and maintain at all times an NAV buffer of at least 3% of the total value of their assets. This NAV buffer must be held in a segregated, protected reserve account. The NAV buffer may not be included in the calculation of the (constant) NAV of CNAV MMFs. There are also rules on the use and replenishment of the buffer. Importantly, a CNAV MMF that breaches the buffer in a qualified manner pursuant to Article 33(2) will automatically cease to be a CNAV MMF and will be converted into a VNAV MMF.

On this issue of CNAV MMFs and the use of amortised cost accounting for the valuation of the net asset values of MMF units or shares, the ESRB was not the only financial institution to express concerns from a financial stability perspective. Following an assessment of the
causes of the financial crisis, several international financial institutions highlighted the need for structural reform of the MMF markets. At the Seoul Summit in November 2010, the G20 leaders asked the Financial Stability Board (FSB) to develop recommendations to strengthen the oversight and regulation of the shadow banking system. In response, the FSB identified some crucial issues that needed to be addressed, including a mandatory shift to variable net asset valuation, capital and liquidity requirements for CNAV funds and other possible regulatory approaches.

Furthermore, IOSCO has considered possible regulatory approaches for CNAV MMFs, particularly in Recommendation 10 of its Policy Recommendations: “MMFs that offer a stable NAV should be subject to measures designed to reduce the specific risks associated with their stable NAV feature and to internalise the costs arising from these risks. Regulators should require, where workable, conversion to a floating/variable NAV. Alternatively, safeguards should be introduced to reinforce stable NAV MMFs’ resilience and ability to face significant redemptions.”

The FSB subsequently reviewed the IOSCO Policy Recommendations and endorsed them as an effective framework for strengthening the resilience of MMFs. The FSB specified that “the safeguards required to be introduced to reinforce stable NAV MMFs’ resilience to runs where such conversion is not workable should be functionally equivalent in effect to the capital, liquidity and other prudential requirements on banks that protect against runs on their deposits.”

The ESRB Recommendations are consistent in substance with the IOSCO Policy Recommendations of October 2012 and share the same policy objectives. As with the IOSCO Recommendations, the key objective of the ESRB Recommendations in the context of financial stability regarding the MMF market in the EU is to reduce the vulnerability of MMFs to the risk of an investor run. However, while striving for the same policy objective, the ESRB Recommendation was stricter with regard to financial stability concerns about CNAV MMFs than the IOSCO Recommendation: sub-recommendation A1 required a general conversion of CNAV MMFs into VNAV MMFs. The Commission explained to the ESRB that it had followed the IOSCO Recommendations in its Proposal for a Regulation. However, the Commission did not follow the specific ESRB Recommendation to require all MMFs to convert to a fluctuating NAV model. The

ESRB clearly favours this regulatory path as the best approach to reducing systemic risk related to potential investor runs on MMF markets in a crisis.

With regard to CNAV MMFs, the ESRB deems the approach taken by the Commission to be a substantial deviation from sub-recommendation A1 and a second-best solution only. The ESRB continues to believe that Recommendation A addresses the risks pertaining to CNAV MMFs with regard to financial stability more comprehensively, and that there are several risks associated with the approach set out in the Proposal for a Regulation. These are explained in Chapter IV.2 of the Annex to the Recommendation. Nonetheless, the ESRB acknowledges that the Proposal for a Regulation is, on the whole, in line with regulatory standards for MMF markets proposed by international financial institutions. The proposed regulatory framework introduces prudential safeguards against significant investor redemptions. Its comprehensive prudential rules, including but not limited to liquidity requirements and the additional NAV buffer regime for CNAV MMFs, address the underlying systemic risks to some extent and function quite similarly to those that protect against runs on bank deposits.

The compliance criteria for Recommendation A1 include two additional elements: a sufficiently long transition period and the careful announcement to market participants of the transformation of CNAV MMFs into VNAV MMFs. Since the Commission decided not to introduce a mandatory conversion to VNAV MMFs, these two additional compliance criteria do not apply and were not assessed separately.

While the ESRB acknowledges that the Proposal for a Regulation is, on the whole, in line with the regulatory standards proposed for MMF markets by international financial institutions, the approach taken by the Commission with respect to sub-recommendation A1 is assessed as a substantial deviation from this specific ESRB Recommendation and a second-best solution only.

The Proposal for a Regulation is graded “partially compliant” with sub-recommendation A1.

Assessment of sub-recommendation A2

<table>
<thead>
<tr>
<th>Sub-recommendation A2 recommends that the Commission ensure that the relevant EU legislation requires MMFs to make general use of fair valuation and to restrict the use of amortised cost accounting to a limited number of predefined circumstances.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Moreover, the Recommendation sets out the following compliance criteria for sub-recommendation A2.</td>
</tr>
</tbody>
</table>
Recommendation A does not imply a full prohibition of amortised cost accounting. However, amortised cost accounting should only be permitted to be used where it is deemed to allow for an appropriate approximation of the price of the instrument.

If the use of amortised cost accounting is continued, restrictions on the residual maturity of the instrument concerned should be implemented, with the aim of reducing the risk of discrepancy between its price and its amortised cost; in setting such restrictions, careful consideration should be given to the maturity profile of the assets of MMFs based in the EU.

Chapter IV of the Proposal for a Regulation sets out valuation rules for MMFs. Article 26(2) of the Proposal for a Regulation stipulates marking to market as the general valuation principle for MMF assets, whenever possible. Where marking to market is not possible or market data are not of sufficient quality, Article 26(4) allows the use of marking to model as a substitute for marking to market.

However, Article 26(5) also allows CNAV MMFs to value their assets using the amortised cost method. Moreover, according to Article 26(5), CNAV MMFs may only make use of amortised cost accounting in addition to marking to market and marking to model. This is accompanied by requirements regarding the “shadow price” of CNAV MMFs, i.e. the difference between the constant NAV valued at amortised cost and the NAV valued in accordance with Article 26(2)-(4). In particular, pursuant to Article 27(6), the difference between these valuations must be continuously monitored. Importantly, the use of the NAV buffer in accordance with Article 31, which is the only form of external support allowed for CNAV MMFs, is also linked to the difference between the CNAV and the fluctuating NAV. Article 37 lays down requirements on transparency towards investors about the valuation methods used by MMFs, the procedure to equalise the CNAV and the NAV per unit or share, and the role and functioning of the NAV buffer.

The Proposal for a Regulation also stipulates requirements and limitations on the management of CNAV MMFs. The assets of MMFs must be valued at least on a daily basis pursuant to Article 26(1). A CNAV MMF may not be offered in the form of a “standard MMF” as set out in Article 22(5). This limits CNAV funds to the “short-term MMF” type, as defined in Article 2(13), which is designed to offer money market rate returns combined with the highest level of security for investors. Through the requirements pursuant to Article 21, the credit and duration risks of this type of fund are kept low, with a weighted average maturity (WAM) of 60 days and a weighted average life (WAL) of no more than 120 days.

The ESRB recommended restricting the two mechanisms that allow MMFs to obtain stability of the NAV, i.e. a constant NAV, when market prices of the underlying assets (i.e. the “shadow prices”) fluctuate. These mechanisms are the possibility of “rounding share prices to
the nearest unit”, which sub-recommendation A1 states should be prohibited (as specified in the compliance criterion), and the use of the amortised cost accounting method. The ESRB did not prohibit the use of the “penny rounding method” per se, however, only the possibility of rounding the share price to the nearest unit. Sub-recommendation A2 does not imply full prohibition of amortised cost accounting either.

The Proposal for a Regulation explicitly allows the possibility of rounding share prices to the nearest percentage point or its equivalent when the NAV is published in a currency unit (Article 27(5)) but restricts the use of this kind of “penny rounding method” to CNAV MMFs only.

With regard to restricting the residual maturity of instruments that are valued at amortised cost, the ESRB policy stance is in line with the IOSCO Recommendation, which recommends limiting the use of amortised cost accounting to securities with a residual maturity of up to 90 days. All other instruments in MMFs’ portfolios should be valued by either marking to market or marking to model. However, in the explanatory part of the Annex to its Recommendation (page 25), the ESRB explicitly notes that even instruments with a residual maturity below 90 days can give rise to interest rate and credit risk sensitivities. It also notes that MMFs in the EU hold a high proportion of assets with a maturity of less than 90 days, thus reinforcing the respective IOSCO Recommendation as a prudential minimum standard.

The Proposal for a Regulation does not prohibit MMFs from maintaining a constant NAV. Consequently, it does not prohibit the use of amortised cost accounting in general. The compliance criteria do not imply full prohibition, but merely restriction to a limited number of predefined circumstances. By restricting the use of amortised cost accounting to short-term CNAV MMFs and by imposing stricter requirements on their portfolios in terms of WAL and WAM, the Commission arguably limits the scope for accounting at amortised cost to predefined circumstances, while at the same time requiring safeguards against false investor perceptions about the nature of CNAV MMFs. However, the restrictions envisaged in the Proposal for a Regulation on the residual maturity of instruments that may be valued at amortised cost, i.e. portfolio-level WAL and WAM limits of no more than 60 and 120 days respectively, are more lenient than the benchmark of instrument-specific maturity limits of no more than 90 days, as recommended by IOSCO and in line with the ESRB’s policy stance.

The Proposal for a Regulation is graded “largely compliant” with sub-recommendation A2.
Recommendation B – Liquidity requirements

Assessment of sub-recommendation B1

**Sub-recommendation B1** recommends that the Commission ensure that the relevant EU legislation complements the existing liquidity requirements for MMFs by imposing explicit minimum amounts of daily and weekly liquid assets that MMFs must hold.

The Recommendation sets out the following compliance criteria for sub-recommendation B1.

To define the size and composition of the minimum buffers of liquid assets, the following elements should be taken into account:

(a) the trade-off between the size of the buffers to be imposed and the type of assets to be considered as eligible;

(b) minimum amounts of both daily and weekly liquid assets should be defined;

(c) in order to reduce the reliance of MMFs on secondary market liquidity, the definition of liquid assets (apart from cash) should primarily consider the residual maturity. Accordingly, instruments defined as daily and weekly liquid assets should have a residual maturity within one and five business days respectively;

(d) when defining the buffers, the risks associated with possible optional maturities of assets should be considered. These options can be based on different parameters, including techniques with counterparty risk exposure such as puttable (e.g. puttable bonds), cancellable (e.g. cancellable options) and callable (e.g. recallable repo techniques);

(e) other interconnection effects, notably with the banking sector, which may impact the availability of the assets eligible for the liquidity buffers.

The Proposal for a Regulation stipulates comprehensive liquidity and portfolio requirements for MMFs in Articles 21 and 22, distinguishing between short-term and standard MMFs and providing for daily and weekly liquidity requirements. For both short-term and standard MMFs, at least 10% of assets must be daily maturing assets and at least 20% must be weekly maturing assets. Additionally, maximum WAM and WAL rules are defined for the portfolio level of MMFs.

Further to the definitions in Article 2(20) and (21), Recital 35 specifies that, to determine the eligibility of assets for inclusion in the daily and weekly liquidity buckets, the legal redemption date of the asset should be used. Recital 35 also specifies that the possibility of terminating a contract on a short-term basis can be taken into account and provides two examples:
(i) if a reverse repurchase agreement can be terminated with prior notice of one day, it should count as a daily maturing asset; and (ii) if the manager can withdraw money from a deposit account with prior notice of one day, it may count as a daily maturing asset.

The Proposal for a Regulation specifies minimum amounts of both daily and weekly liquid assets (Articles 21 and 22) and types of eligible assets. Article 8 defines the asset categories that MMFs may invest in and limits them to money market instruments, deposits with credit institutions, financial derivatives and reverse repos. Articles 9 to 13 specify further requirements for the eligible asset categories, including specific requirements regarding financial derivatives and reverse repos. The second paragraph of Article 1(1), together with Article 2(1) defining short-term assets, generally limits the residual maturity of assets eligible for MMFs to two years.

Interconnectedness with credit institutions is limited through diversification (Article 14) and concentration (Article 15) limits. Reliance on external support is restricted either to exceptional circumstances subject to prior supervisory approval (Article 36) or, in the case of CNAV MMFs, to maintain an NAV buffer of 3%, which is to be paid to a protected reserve account and must be maintained at all times.

Under the Proposal for a Regulation, MMFs must limit their investments to short-term and liquid instruments of high credit quality and hold minimum amounts of daily and weekly liquid assets. The requirements on liquidity and eligibility of assets and the diversification and concentration limits set high standards for MMFs. The definition of maturity refers to the residual length of time until legal maturity, which is the date when the principal of an eligible instrument is to be repaid in full and may not be subject to any optionality.

The Proposal for a Regulation is graded “fully compliant” with sub-recommendation B1.

Assessment of sub-recommendation B2

The Commission is recommended to ensure that the relevant EU legislation strengthens the responsibility of the funds’ managers regarding the monitoring of liquidity risk.

The Recommendation sets out the following compliance criteria for sub-recommendation B2.

MMFs should be required to adjust their holdings of minimum buffers of liquid assets depending on their risk profile and investor base.
Compliance Report – Implementation of Recommendation ESRB/2012/1 by the European Commission

March 2019

Section 3 – Assessment results

28

MMFs should perform regular stress tests based on multiple adverse scenarios – both fund-specific and general ones – impacting their liquidity profile.

MMFs should have contingency plans in place to cope with such periods of stress.

Article 24 requires MMF managers to establish and apply comprehensive “know your customer” (KYC) policies that involve exercising due diligence. MMF managers are required to have a good knowledge of their investor base, including their cash needs, degree of financial sophistication, risk aversion and links between investors.

The aim of Article 24(2) is to limit the impact of redemptions by single investors on the liquidity of MMFs by limiting the exposure of a single investor to the value of the daily maturing assets. Moreover, the MMF manager must ensure that redemptions by any single investor do not materially impact the overall liquidity profile of the MMF. MMF managers therefore have to adapt their holdings of daily maturing assets and the liquidity profile of their funds in accordance with the results of the customer due diligence procedures.

Under Article 25, MMF managers must establish stress testing processes to identify possible changes in the economic environment that could have unfavourable effects on the MMF. There are a number of parameters that managers must take into consideration. The stress tests need to be based on objective criteria and cater for severe but plausible scenarios. Based on these regular stress tests, managers are required to take action to strengthen the risk management of the MMFs and, in particular, take the necessary actions regarding the liquidity position and asset quality of their funds. For CNAV MMFs, the stress tests must also estimate the influence of the scenarios on the difference between the fluctuating and the constant value of CNAV funds and the potential impact on the NAV buffer.

Article 25(3) and (5) requires asset managers to strengthen the robustness of MMFs, including taking action to reinforce the MMFs’ asset liquidity or quality if a stress test reveals weaknesses. Action plans must be set out in writing, approved by the Board of Directors and maintained for at least five years.

ESMA is tasked with issuing guidelines, taking into account the latest market developments, to establish common practices for stress testing the MMF financial sector.

The Proposal for a Regulation is graded “fully compliant” with sub-recommendation B2.

Assessment of sub-recommendation B3
Sub-recommendation B3 recommends that the Commission ensure that the relevant EU legislation ensures that national supervisory authorities and fund managers have in place effective tools, for example temporary suspensions of redemptions, to deal with liquidity constraints in times of stress resulting from both fund-specific and market-wide developments.

The Recommendation sets out the following compliance criteria for sub-recommendation B3.

National supervisory authorities and fund managers must have the necessary tools in place to deal with exceptional redemption requests from investors.

The Proposal for a Regulation does not itself lay down specific rules concerning procedures in the event of heavy redemption pressure owing to significant market stress. Tools to handle such liquidity problems are provided for in the AIFM Directive\(^{13}\) and the UCITS Directive\(^{14}\).

Under Article 84(2) of the UCITS Directive, an undertaking for collective investment in transferable securities (UCITS) may, in accordance with the applicable national law, the fund rules or the instruments of incorporation of the investment company, temporarily suspend the repurchase or redemption of its units. Furthermore, each Member State may allow its competent authorities to require the suspension of the repurchase or redemption of units in the interest of the unit holders or of the public. The supervisory powers of authorities competent for the supervision of UCITS under Article 98 of the UCITS Directive include requiring the suspension of the issue, repurchase or redemption of units in the interest of the unit holders or of the public. Moreover, pursuant to the supervisory powers granted in Article 108 of the UCITS Directive in general, the competent authorities have the power to take action against infringements of any law, regulation or administrative provision or any regulation laid down in the fund rules or in the instruments of incorporation of the investment company.

In accordance with Article 16(2) of the AIFM Directive, managers of alternative investment funds (AIFs) are required to ensure that, for each AIF that they manage, the investment


strategy, the liquidity profile and the redemption policy are consistent. AIF managers are free to stipulate flexible redemption rules in their terms and conditions, including special procedures for stressed times. Article 23(1)(h) of the AIFM Directive only requires proper disclosure to investors. Under Article 46(2)(j) of the AIFM Directive, the competent authorities of AIF managers may require the suspension of the issue, repurchase or redemption of units in the interest of the unit holders or of the public. Moreover, pursuant to the supervisory powers granted in Article 46 of the AIFM Directive in general, the competent authorities have the power to require the cessation of any practice or adopt any type of measure to ensure that AIF managers comply with the requirements of the AIFM Directive.

Under Article 1 of the Proposal for a Regulation, its scope encompasses collective investment undertakings that require authorisation under either the UCITS Directive or the AIFM Directive. Therefore, the rules under the UCITS and the AIFM Directives apply to all MMFs in the EU. The particular rules that will apply depend on whether an MMF falls under the UCITS Directive or the AIFM Directive. Liquidity management tools have therefore already been established for all MMFs.

The Proposal for a Regulation does not by itself address the issue of crisis management tools for MMFs in the event of massive redemption requests in exceptional circumstances. In this regard, the Proposal for a Regulation focuses on risk management techniques, such as KYC policies, and on rules enhancing the liquidity profile of MMFs, e.g. regarding asset quality and daily maturing and weekly maturing assets. However, Article 1 of the Proposal for a Regulation builds on both the UCITS and the AIFM directives, which enable both the managers and competent authorities of MMFs to apply appropriate crisis management tools with regard to investor redemptions in exceptional circumstances. Accordingly, the Proposal for a Regulation and the above-mentioned directives work together to achieve the policy aims underlying sub-recommendation B3.

The Proposal for a Regulation is graded “fully compliant” with sub-recommendation B3.
Recommendation C – Public disclosure

Assessment of sub-recommendation C1

Sub-recommendation C1 recommends that the Commission ensure that the relevant EU legislation requires specific disclosure by MMFs, also in their marketing material, that draws the attention of investors to the absence of a capital guarantee and the possibility of principal loss.

The Recommendation sets out the following compliance criteria for sub-recommendation C1.

The product information of MMFs should draw the attention of investors to the absence, or limitation, of a capital guarantee and the possibility of principal loss.

Under Article 37(2)(a) of the Proposal for a Regulation, any document of an MMF used for marketing purposes must clearly include the statement that the MMF is not a guaranteed investment. Additionally, under Article 37(3), any communication by the MMF or its manager to investors or potential investors must in no way suggest that an investment in the units or shares of the MMF is guaranteed.

The possibility of principal loss is addressed by Article 37(2)(c), according to which any document of an MMF used for marketing purposes must clearly include the statement that the risk of loss of principal has to be borne by the investor.

The Proposal for a Regulation includes provisions that require MMFs and MMF managers to clearly inform investors about the absence of capital guarantees for MMFs and warn them about the possibility of principal loss.

The Proposal for a Regulation is graded “fully compliant” with sub-recommendation C1.

Assessment of sub-recommendation C2

Sub-recommendation C2 recommends that the Commission ensure that the relevant EU legislation requires that MMFs refer in their public disclosure to possible sponsor support, capacity for support or protection only if such support or protection is a firm commitment by the sponsor, in which case it must be recognised in that sponsor’s accounts and prudential requirements.
The Recommendation sets out the following compliance criteria for sub-recommendation C2.

Any references in the information of MMFs to possible sponsor support, capacity for support or protection should only be allowed if such support or protection is a firm commitment on the part of the sponsor, in which case it must be recognised in the accounts and prudential requirements of that sponsor.

Chapter VI (Articles 35 and 36) of the Proposal for a Regulation contains rules on the preconditions under which MMFs may receive external support. With regard to CNAV MMFs, Article 35 stipulates that they may only receive external support through the NAV buffer in accordance with Articles 30-34. Non-CNAV MMFs are generally prohibited from receiving external support, pursuant to Article 35(2). However, Article 36 allows external support for non-CNAV MMFs in exceptional circumstances, if justified by systemic implications or adverse market conditions. Even in such cases, the granting of external support is subject to restrictions on its amount and duration. Importantly, the granting of such external support is subject to prior approval by the competent authority, which must also be satisfied that the provider of the external support is financially sound and able to provide the support without any adverse effects.

Additionally, the Proposal for a Regulation envisages disclosure requirements concerning the provision of external support: under Article 29(2)(g), the rules or instruments of incorporation of CNAV MMFs must clearly state that such MMFs may not receive any external support other than through the NAV buffer mechanism. Under Article 36(3), non-CNAV MMFs are required to inform their investors immediately in writing and in a clear and comprehensible way if they receive external support owing to exceptional circumstances. Moreover, Article 37(2)(b), which refers to both CNAV MMFs and other MMFs, requires that any documents of an MMF used for marketing purposes clearly include the statement that the MMF does not rely on external support for guaranteeing the liquidity of the MMF or stabilising the NAV per unit or share.

Under Article 30(7), CNAV MMFs are required to establish, ex ante and in writing, clear and detailed arrangements with the entity expected to fund the replenishment of the NAV buffer. These arrangements must contain an explicit commitment to fund the replenishment and require the entity to fund the replenishment using its own financial resources. In this way, Article 30(7) ensures that such external support is a firm and ex ante commitment by the sponsor. The arrangements for the replenishment and the identity of the entity expected to fund the replenishment must also be disclosed in the fund rules or instruments of incorporation of CNAV MMFs.
For other MMFs, external support is limited to exceptional circumstances and requires prior approval by the competent authorities. Article 36(2) even requires the agreement of the relevant supervisory authority when the provider of external support is an entity subject to prudential supervision, to ensure that the external support granted by such entities is backed up by adequate own funds.

The Proposal for a Regulation provides the legal framework for limited external support for MMFs. The rules require either detailed arrangements in writing or the approval of the competent authorities, both ex ante, establishing firm commitments on the provision of external support. The accounting and prudential treatment of such external support is not stipulated in the Proposal for a Regulation. It depends on the prudential status of the entity granting such support. The Proposal for a Regulation restricts external support to predefined cases and provides for proper transparency towards investors.

The Proposal for a Regulation is graded “fully compliant” with sub-recommendation C2.

Assessment of sub-recommendation C3

Sub-recommendation C3 recommends that the Commission ensure that the relevant EU legislation requires MMFs to disclose their valuation practices, particularly regarding the use of amortised cost accounting, as well as to provide appropriate information to investors regarding applicable redemption procedures in times of stress.

The Recommendation sets out the following compliance criteria for sub-recommendation C3.

The information should further explain to investors the procedures in place regarding the valuation of the instruments, including information on the use of amortised cost accounting, the assumptions underlying this valuation method, and the associated risks.

Investors should be made aware of procedures which may be used in the event of significant market stress or heavy redemption pressures and which may impact their redemption possibilities.

Regarding valuation practices, Chapter IV (Articles 26-28) of the Proposal for a Regulation deals with the valuation of MMF assets and the calculation of MMFs’ NAV per unit or share. It contains rules on how MMFs have to value individual investment assets and calculate the NAV per unit or share, as well as the frequency of both sets of valuations. While there is a general rule favouring mark-to-market valuation (Article 26(2)), MMFs may also use marking-to-model valuation when marking to market is not possible or market data are not of sufficient quality (Article 26(4)).
For non-CNAV MMFs, valuation at amortised cost is prohibited by Article 26(4). Only CNAV MMFs may value assets at amortised cost in addition to the other valuation methods (Article 26(5)).

**Article 37 stipulates requirements for transparency towards MMF investors, including in relation to MMFs’ valuation practices.** Under Article 37(4), investors in an MMF must be clearly informed of the method or methods used by the MMF to value its assets and to calculate the NAV. Under Article 37(5), CNAV MMFs are required to clearly explain to investors and potential investors the use of the amortised cost method and of rounding of the constant NAV per share or unit. However, the Proposal for a Regulation does not contain the requirement to specifically inform and explain to investors the underlying assumptions and associated risks of amortised cost accounting.

**The Proposal for a Regulation does not itself lay down specific rules on procedures in the event of heavy redemption pressures owing to significant market stress.** Tools to handle such liquidity problems are provided for in the AIFM and UCITS Directives. The transparency requirements in Article 37 apply in addition to the requirements under the UCITS and AIFM Directives. Both directives include provisions specifying the procedures in the event of massive redemption requests by investors owing to significant market stress (see also the assessment of sub-recommendation B3).

**Under Article 84 of the UCITS Directive, MMFs have can temporarily suspend redemptions in exceptional circumstances.** Under Article 69 in conjunction with Annex I, Schedule A, Sections 1.12 and 1.13 of the UCITS Directive, the sales prospectus of UCITS funds must contain information on the procedures and conditions of issue and sale of units, as well as procedures and conditions for repurchase or redemption of units and circumstances in which repurchase or redemption may be suspended.

**Similarly, under Article 16 of the AIFM Directive, the managers of AIF MMFs may use special arrangements to cope with supervening illiquidity of the fund assets.** Under Article 23(1)(h) of the AIFM Directive, disclosures to investors must contain a description of an AIF’s liquidity risk management, including the redemption rights both in normal and in exceptional circumstances, and the existing redemption arrangements with investors.

**The Proposal for a Regulation stipulates requirements for transparency towards MMF investors, including in relation to MMFs’ valuation practices.** Investors must be clearly informed of the method or methods used by MMFs to value their assets and to calculate the NAV. Regarding CNAV MMFs, the transparency requirements encompass information concerning the use of the amortised cost method and of rounding of the constant NAV per share or unit. However, there is no explicit requirement to explain to investors the underlying assumptions and
associated risks of amortised cost accounting. Requirements to inform investors of the procedures, including temporary suspension of redemptions, in the event of massive redemption requests owing to significant market stress are stipulated in the UCITS and AIFM Directives, which, in addition to this Proposal for a Regulation, apply to MMFs. Abolishing the use of CNAV and limiting the use of amortised cost accounting for MMFs are at the core of the ESRB Recommendations on MMFs.

Given that the Proposal for a Regulation does not envisage explicit requirements to explain to investors the underlying assumptions and associated risks of amortised cost accounting, the Proposal for a Regulation is graded “largely compliant” with sub-recommendation C3.
Recommendation D – Reporting and information sharing

Assessment of sub-recommendation D1(a)

Sub-recommendation D1 recommends that the Commission ensure that the relevant EU legislation requires that any instances of sponsor support that may have an impact on the price of the MMF are reported by the MMF or its manager, and the sponsor, to the competent national supervisory authority, together with a full description of the nature and size of such support.

The Recommendation sets out the following compliance criteria for sub-recommendation D1(a).

Any instances of sponsor support for an MMF that may have an impact on the price of the MMF should be reported by the MMF (or its manager) and the sponsor to the responsible national authority, including a description of the nature and size of the support.

Under Article 35(2) of the Proposal for a Regulation, non-CNAV MMFs may not receive any external support, except in exceptional circumstances and subject to prior approval by the competent authority pursuant to Article 36. Article 35(3) specifies what constitutes "external support". Moreover, external support is subject to specific conditions. Under Article 36(3), the MMF must immediately inform its investors in writing about receiving such external support. Under Article 35(1), a CNAV MMF may not receive any external support other than an NAV buffer, subject to the requirements of Chapter V (Article 29-34) of the Proposal for a Regulation.

Regarding the reporting of instances of external support, Article 36(1) requires the prior approval of the competent authority in each instance of such external support for a non-CNAV MMF. Additionally, where the sponsor is an entity subject to prudential supervision, Article 36(2) requires an agreement on the provision of such support to be reached with the supervisory authority of the sponsor.

For CNAV MMFs, external support is limited to the use of the NAV buffer established in accordance with Article 30. The arrangements, as well as the development and use of the NAV buffers by CNAV MMFs, are subject to the approval of, notification to and ongoing scrutiny by the competent authorities (Article 29(2)(b) and (c), and Articles 32 and 34). The size and evolution of the NAV buffer must be reported to the competent authorities on a quarterly basis pursuant to Article 38(2)(c). The competent authority must assess the financial strength of the entity expected to fund the replenishment of the NAV buffer. No explicit reporting obligation on the part of the sponsor or entity expected to fund the replenishment is envisaged.
With regard to non-CNAV MMFs, the Proposal for a Regulation generally prohibits ex ante external support. External support is limited to exceptional circumstances and requires prior approval by the competent authority. For CNAV MMFs, external support is limited to a pre-funded NAV buffer mechanism, which is subject to strict requirements. In addition, the Proposal for a Regulation provides for ongoing supervisory scrutiny of the NAV buffer framework. Both transparency towards investors and quarterly reporting to competent authorities are required. Arguably, the framework for the provision of external support under the Proposal for a Regulation is stricter than the reporting obligations under sub-recommendation D1.

The Proposal for a Regulation is graded “fully compliant” with sub-recommendation D1(a).

Assessment of sub-recommendation D1(b)

<table>
<thead>
<tr>
<th>The Commission is recommended to ensure that the relevant EU legislation enhances regular reporting by MMFs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Recommendation sets out the following compliance criteria for sub-recommendation D1(b).</td>
</tr>
<tr>
<td>Regular reporting by MMFs to supervisory authorities or central banks should at least include a sufficiently detailed breakdown of MMFs’ assets and liabilities in order to allow the authorities to monitor the fund’s liquidity position and the nature and quality of its underlying assets.</td>
</tr>
<tr>
<td>If the MMF continues to use the CNAV model, the regular reporting also needs to include separate detailed information for the CNAV funds, including information on their shadow price.</td>
</tr>
<tr>
<td>If amortised cost accounting is still used by MMFs, regulators should have access to regular information on the extent to which this valuation practice is used and in which cases.</td>
</tr>
</tbody>
</table>

Article 38 stipulates comprehensive requirements for MMF managers to report to the competent authorities, at least on a quarterly basis. Under Article 38(1) and (2)(e) and (f), MMFs are required to report detailed information on the assets held in portfolios, as well as their liabilities, on at least a quarterly basis. The reporting requirements are further specified in Article 38(2). Under Article 38(2)(b), the reporting must also include portfolio indicators, such as the total value of assets, NAV, WAM, WAL, maturity breakdown, liquidity and yield.

Under Article 26(5), only CNAV MMFs may also use the amortised cost method to value their assets in addition to the marking-to-market method. However, under Article 27(6) the difference between the NAV and the CNAV must be continuously monitored and, in accordance with Article
31 on the use of the NAV buffer, the MMFs must calculate both the CNAV and the NAV, i.e. the “shadow price” per unit or share following the relevant valuation methods. The difference between these valuations will be either credited or debited to the NAV buffer reserve account. Supervisory reporting is required in this regard under Article 38(2)(b) and (c) on the NAV and the size and evolution of the NAV buffer.

**Under Article 38(2), final sentence, the competent authorities may also solicit additional information from all types of MMF.** According to Article 38(3), ESMA is tasked with developing a harmonised reporting template via implementing technical standards. Moreover, Article 38(4) requires ESMA to establish a central database of all MMFs, to which the competent authorities have access. Article 42 requires the competent authorities and ESMA to cooperate with each other and to exchange supervisory information.

**The Proposal for a Regulation provides for comprehensive requirements for MMFs to report to the competent authorities, on at least a quarterly basis, with a detailed breakdown of the assets and liabilities, the portfolio indicators and the evolution of NAV buffers in the case of CNAV MMFs.** ESMA is tasked with establishing a common reporting template and a central supervisory database.

**The Proposal for a Regulation is graded “fully compliant” with sub-recommendation D1(b).**

**Assessment of sub-recommendation D1(c)**

The Commission is recommended to ensure that the relevant EU legislation ensures that competent national supervisory authorities, where relevant, share the information referred to in points (a) and (b) with other national supervisory authorities within the same Member State, or from other Member States, the European supervisory authorities, the members of the European System of Central Banks and the ESRB.

**Article 42(1) provides for information sharing between competent authorities of MMFs and managers of MMFs, if different.** Article 42(2) and (3) provide for cooperation and exchange of all information and documentation between the competent authorities and ESMA. In addition, all information to be reported to competent authorities pursuant to Article 38 must be transmitted to ESMA, in accordance with Article 38(4). ESMA is tasked with collecting this information and establishing a central database for supervisory purposes. The ECB will have the right to access this central database for statistical purposes (Article 38(4), last sentence).
For UCITS funds, Article 101(2) of the UCITS Directive requires the competent authorities to provide each other with the information required for the purposes of carrying out their duties. For AIFs, the AIFM Directive provides for the exchange of information between competent authorities and with ESMA and the ESRB, where this is relevant for monitoring and for responding to the potential implications of the activities of individual AIFs or AIFs collectively for the stability of systemically relevant financial institutions and the orderly functioning of markets (Article 53(1) of the AIFM Directive). Moreover, Article 15 of the ESRB Regulation provides the general legal basis for the ESRB to access relevant information and supervisory data.

The Proposal for a Regulation contains provisions on supervisory cooperation and the exchange of information between competent authorities and with ESMA. Its rules complement those in the UCITS and AIFM Directives. However, the framework for cooperation and exchange of information does not include the EBA and EIOPA, the two other ESAs within the European System of Financial Supervision, or the national central banks (NCBs), as member institutions of the European System of Central Banks. Moreover, the ECB is granted access to the central database for statistical purposes only. The Proposal for a Regulation does not provide for information sharing or access to ESMA’s central database, even for aggregated data. Access to such data in an aggregated format, as a minimum, would be required for the purposes of financial stability analysis and macroprudential policy in line with sub-recommendation D1(c).

The Proposal for a Regulation is graded “largely compliant” with sub-recommendation D1(c).

Assessment of sub-recommendation D2

The Commission is recommended to promote the development of harmonised reporting and a harmonised dataset, as mentioned in paragraph 1(b), and the organisation of information sharing, as mentioned in paragraph 1(c).

The Recommendation sets out the following compliance criteria for sub-recommendation D2.

Measures should be taken that promote the development of harmonised reporting and a harmonised dataset on MMFs, and which can also be used for macroprudential purposes, covering the previously mentioned points. Any such measures should take into account the existing reporting requirements MMFs are already subject to, such as the balance sheet reporting of monetary financial institutions (ECB/2008/32).
To ensure that there are no impediments to the sharing of the aforementioned information between prudential authorities and central banks, whether at the national, cross-border or European level.

**Under Article 38(3), ESMA is required to develop a reporting template for all supervisory reporting requirements specified in Article 38(2).** The Commission will then adopt the corresponding implementing technical standards, in accordance with Article 15 of the ESMA Regulation. This will promote the development of a harmonised dataset and harmonised reporting for the MMF sector in the EU, which can, in principle, be useful for macroprudential oversight and policy.

However, access to and exchange of these supervisory data are limited to the applicable competent authorities, ESMA and the ESRB, subject to Article 15 of the ESRB Regulation, while the other ESAs and the NCBs are not granted access. The ECB is only granted access to the central database for statistical purposes.

The Proposal for a Regulation envisages a role for the Commission to promote harmonised reporting and a harmonised dataset on MMFs in the EU. The Proposal for a Regulation also requires information to be shared among supervisory authorities. However, limiting data access to MMF supervisors and excluding the EBA, EIOPA and the NCBs will, in practice, hamper the use of these data for macroprudential policy purposes.

**The Proposal for a Regulation is graded “largely compliant” with sub-recommendation D2.**
## Annex A – Members of the assessment team

<table>
<thead>
<tr>
<th>Name</th>
<th>Role and Organization</th>
</tr>
</thead>
<tbody>
<tr>
<td>Francesco Mazzaferro</td>
<td>Head of the ESRB Secretariat</td>
</tr>
<tr>
<td></td>
<td>Chair of the assessment team</td>
</tr>
<tr>
<td>Ines Seibel</td>
<td>German Federal Financial Supervisory Authority (BaFin)</td>
</tr>
<tr>
<td>Carlo Gola</td>
<td>Banca d’Italia</td>
</tr>
<tr>
<td>Dimitra Michala</td>
<td>Luxembourg Financial Sector Supervisory Commission (CSSF)</td>
</tr>
<tr>
<td>Maxence Dillenschneider</td>
<td>Luxembourg Financial Sector Supervisory Commission (CSSF)</td>
</tr>
<tr>
<td>Melanie Wulff</td>
<td>Deutsche Bundesbank</td>
</tr>
<tr>
<td>Koen van der Veer</td>
<td>European Central Bank (ECB)</td>
</tr>
</tbody>
</table>

**ESRB Secretariat**

<table>
<thead>
<tr>
<th>Name</th>
<th>Role</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alexander Trachta</td>
<td>Assessment team secretary</td>
</tr>
</tbody>
</table>
Abbreviations

Compliance grades:

FC  fully compliant
LC  largely compliant
PC  partially compliant
MN  materially non-compliant
NC  non-compliant
IE  inaction insufficiently explained
SE  inaction sufficiently explained

Other abbreviations:

AIF  alternative investment fund
AIFM  alternative investment fund manager
CNAV  constant net asset value
CNAV MMF  money market fund with a constant net asset value per share or unit
EBA  European Banking Authority
ECB  European Central Bank
EIOPA  European Insurance and Occupational Pensions Authority
ESAs  European supervisory authorities
ESMA  European Securities and Markets Authority
ESRB  European Systemic Risk Board
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>KYC</td>
<td>“know your customer”</td>
</tr>
<tr>
<td>MMF</td>
<td>money market fund</td>
</tr>
<tr>
<td>NAV</td>
<td>net asset value</td>
</tr>
<tr>
<td>NCB</td>
<td>national central bank</td>
</tr>
<tr>
<td>UCITS</td>
<td>undertaking for collective investment in transferable securities</td>
</tr>
<tr>
<td>VNAV</td>
<td>variable net asset value</td>
</tr>
<tr>
<td>VNAV MMF</td>
<td>money market fund with a variable net asset value per share or unit</td>
</tr>
<tr>
<td>WAL</td>
<td>weighted average life</td>
</tr>
<tr>
<td>WAM</td>
<td>weighted average maturity</td>
</tr>
</tbody>
</table>

Recommendation of the European Systemic Risk Board of 20 December 2012 on money market funds (ESRB/2012/1)
Introduction

On 20 December 2012 the European Systemic Risk Board (ESRB) adopted Recommendation ESRB/2012/1 on money market funds\(^\text{15}\) (hereinafter the “Recommendation”), which was addressed to the European Commission. In line with the Recommendation and with Article 17 of the ESRB Regulation\(^\text{16}\), the ESRB conducted a compliance assessment of the implementation of this Recommendation.

The overall assessment of the implementation of the Recommendation was conducted by the assessment team in two different stages. When the first ESRB assessment (based on the interim report provided by the Commission and its Proposal for a Regulation) was being finalised, the EU legislative process was about to be concluded, and it was expected that some key aspects of the final Regulation on money market funds (MMFs) would differ from the Commission’s initial proposal. Therefore, at the meeting of the ESRB’s Advisory Technical Committee on 23 February 2017 it was decided that, to retain the relevance of the work already undertaken by the assessment team, a second evaluation should be conducted to evaluate the forthcoming Regulation on MMFs and to gain a better understanding of the implications of the current regulatory environment for money markets funds.

In the first stage, the assessment team assessed the European Commission’s Proposal for a Regulation. As the Commission is the sole addressee of the Recommendation, the ESRB decided to start the follow-up to its Recommendation, pursuant to Article 17 of the ESRB Regulation, based on the assessment of the interim report and the Proposal for a Regulation. This first assessment, which was conducted on the basis of the “act or explain” mechanism, is the formal assessment that should take place under the framework provided by the Article 17 of the ESRB Regulation (on the follow-up of the ESRB Recommendations).

In the second stage, the assessment team evaluated the Regulation on MMFs\(^\text{17}\). This evaluation should not be considered a formal assessment but rather an analysis of the content of

\(^{15}\) Recommendation of the European Systemic Risk Board of 20 December 2012 on money market funds (ESRB/2012/1) (OJ C 146, 25.5.2013, p. 1).


the Regulation on MMFs against the provisions set out in the Recommendation. In fact, the Regulation on MMFs was adopted under the ordinary legislative procedure and the European Parliament and the Council are not addressees of the Recommendation. Therefore, the assessment of the Regulation on MMFs is not subject to the "comply and explain" mechanism applied to ESRB recommendations pursuant to Article 17 of the ESRB Regulation. Finally, this assessment report will be sent to the Council for information only.

With this two-stage approach, the assessment team is able to provide an overall assessment of the current regulatory status quo and to gain a better understanding of the current regulatory environment for MMFs.

This report was approved for publication by the ESRB’s General Board on 5 February 2019.
Section 1 – Objective of the ESRB Recommendation

The Recommendation addressed a number of policy recommendations to the Commission regarding the regulation and supervision of MMFs with the aim of reducing the systemic risks arising from them. In particular, the ESRB recommended that the Commission ensure, through EU legislation, a change from a constant net asset value (CNAV) model to a fluctuating net asset value (NAV) model, the introduction of stricter liquidity requirements, the public disclosure of specific information by MMFs and the adoption of enhanced reporting obligations to supervisory authorities for MMFs:

- **Mandatory move to variable net asset value (VNAV):** “MMFs should be required to have a fluctuating net asset value. In this way, their investment features will be strengthened and their bank deposit-like features reduced. This requirement will reduce the incentive of investors to run, increase price transparency and reduce interconnectedness in the financial system. MMFs are further requested to make general use of fair valuation, while the use of amortised cost accounting should be limited to a number of pre-defined circumstances.”

- **Liquidity requirements:** “Existing liquidity requirements should be enhanced by imposing explicit minimum amounts of daily and weekly liquid assets that MMFs must hold. The responsibility of fund managers to monitor the liquidity risk should be strengthened. Finally, effective tools should be in place, for example through temporary suspensions of redemptions, to deal with liquidity constraints in times of stress resulting from both fund-specific and market-wide developments.”

- **Public disclosure:** “The marketing material of MMFs should draw the attention of investors to the absence of a capital guarantee and the possibility of principal loss. Any public information that would give the impression of sponsor support or capacity for such support should be prohibited unless this support is a firm commitment, in which case it must be recognised in the sponsor’s accounts and prudential requirements. Finally, it should include a description of the valuation practices, in particular as regards the use of amortised cost accounting, and the possibility of suspending subscriptions and redemptions, also in times of stress.”

- **Reporting and information sharing:** “Any instances of sponsor support should be reported to the responsible national supervisory authorities, which should share this information with other relevant national and European authorities. The regular reporting of MMFs should be further enhanced and harmonised. Where relevant, competent national supervisory authorities should share information with other relevant authorities (domestic, foreign or European).”
More specifically, the Recommendation set out the following policy objectives.

**Recommendation A – Mandatory move to variable net asset value (VNAV)**

The Commission is recommended to ensure that the relevant EU legislation:

(1) requires MMFs to have a fluctuating net asset value;

(2) requires MMFs to make general use of fair valuation and to restrict the use of amortised cost accounting to a limited number of predefined circumstances.

**Recommendation B – Liquidity requirements**

The Commission is recommended to ensure that the relevant EU legislation:

(1) complements the existing liquidity requirements for MMFs by imposing explicit minimum amounts of daily and weekly liquid assets that MMFs must hold;

(2) strengthens the responsibility of MMF managers regarding the monitoring of liquidity risk;

(3) ensures that national supervisory authorities and MMF managers have in place effective tools, for example temporary suspensions of redemptions, to deal with liquidity constraints in times of stress resulting from both fund-specific and market-wide developments.

**Recommendation C – Public disclosure**

The Commission is recommended to ensure that the relevant EU legislation:

(1) requires specific disclosure by MMFs, also in their marketing material, that draws the attention of investors to the absence of a capital guarantee and the possibility of principal loss;

(2) requires that MMFs refer in their public disclosure to possible sponsor support, capacity for support or protection only if such support or protection is a firm commitment by the sponsor, in which case it must be recognised in that sponsor’s accounts and prudential requirements;

(3) requires MMFs to disclose their valuation practices, particularly regarding the use of amortised cost accounting, as well as to provide appropriate information to investors regarding applicable redemption procedures in times of stress.

**Recommendation D – Reporting and information sharing**

1. The Commission is recommended to ensure that the relevant EU legislation:

(a) requires that any instances of sponsor support that may have an impact on the price of the MMF are reported by the MMF or its manager, and the sponsor, to the competent national supervisory authority, together with a full description of the nature and size of such support;
(b) enhances regular reporting by MMFs;

(c) ensures that competent national supervisory authorities, where relevant, share the information referred to in points (a) and (b) with other national supervisory authorities within the same Member State, or from other Member States, the European supervisory authorities, the members of the European System of Central Banks and the ESRB.

2. The Commission is recommended to promote the development of harmonised reporting and a harmonised dataset as mentioned in paragraph 1(b), and the organisation of information sharing mentioned in paragraph 1(c).

The Recommendation also set out further detailed compliance criteria for each of the policy recommendations.
Section 2 – Assessment methodology

In general terms, an assessment of compliance with and implementation of each ESRB recommendation is carried out following the “act or explain” mechanism in accordance with Article 17 of the ESRB Regulation. In such an assessment, the addressee of a recommendation is required to inform the ESRB of action taken in response to a recommendation or to properly justify the reasons for inaction. The ESRB subsequently analyses the information provided and assesses whether the action taken duly achieves the objective of the recommendation or whether the justification provided for inaction is sufficient. This analysis results in a final compliance grade being assigned to the addressee.

In this particular case, the assessment report is the deliverable resulting from the follow-up evaluation performed by the assessment team, consisting of a stand-alone evaluation of the content of the Regulation on MMFs in the light of the policy proposals of the Recommendation. For this evaluation, considering that the Council and the European Parliament are not addressees of the Recommendation, no “act or explain” mechanism (as stipulated in Article 17 of the ESRB Regulation) was used. However, whenever possible, and once any necessary changes had been made, the methodology provided in the ESRB Handbook on the follow-up to ESRB recommendations (hereinafter the “Handbook”) was followed to allow some degree of comparability between this assessment report and the report on the compliance assessment, as well as a better understanding of its conclusions.

Finally, this assessment report will be sent to the Council for information only.

Methodological principles

The follow-up evaluation followed, where applicable, the methodology provided in the Handbook. Nevertheless, this evaluation should not be considered a formal assessment but rather an evaluation of the content of the Regulation on MMFs, considering the provisions set out in the Recommendation. The evaluation was carried out by an assessment team of six assessors.

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18 As mentioned previously, the Commission is the sole addressee of the Recommendation.
19 The same methodology was used in both the assessment of the Regulation on MMFs and the assessment of the European Commission’s Proposal for a Regulation.
appointed by the Advisory Technical Committee and chaired by the Head of the ESRB Secretariat. The assessment work was conducted with the support of the ESRB Secretariat (see Annex A).

The follow-up evaluation referred to the content of the Regulation on MMFs, which entered into force in July 2017. The following material was also taken into account for the purposes of the assessment:

- International Organization of Securities Commissions (IOSCO) Policy Recommendations for Money Market Funds, final report of 9 October 2012;
- Progress report of the Council of the European Union on the Proposal for a Regulation on money market funds, 17 December 2014;
- Final report on technical advice, draft implementing technical standards and guidelines under the MMF Regulation, European Securities and Markets Authority, 13 November 2017.

There was no need to develop separate assessment criteria, given that the Recommendation specifies detailed compliance criteria for each sub-recommendation. Instead, the assessment focuses on the content and economic substance of the provisions of the Regulation, taking into account in particular the appropriateness of these provisions for achieving the policy objectives of the Recommendation, as further specified in the compliance criteria and explained in the Annex to the Recommendation.

The assessment team applied the principle of “four-eyes review”. This means that two members of the assessment team each analysed and graded the Regulation on MMFs against one of the four Recommendations (A, B, C and D) in the Recommendation. The other team members then discussed and reviewed each of these assessments. Finally, the assessment team jointly applied a consistency check to the overall assessment, decided on the grading for each recommendation and assigned an overall assessment grade.
Grading methodology

A four-step grading methodology was used to reach a single grade as the final result of the follow-up evaluation, in line with the Handbook. This methodology is necessary to ensure full transparency of the single overall compliance grade and a high level of objectivity throughout the assessment process, while still allowing room for high-quality expert judgement, which can easily be identified and reviewed in order to understand the rationale behind particular grades.

Step I: Assessing the compliance grade for each sub-recommendation

When assessing compliance with the Recommendations, the implementation of each sub-recommendation and its respective compliance criteria is graded according to the following grading scale:

<table>
<thead>
<tr>
<th>Table 1 – Grading scale</th>
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<table>
<thead>
<tr>
<th>Grading scale for action</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fully compliant (FC)</td>
<td>The addressee complies entirely with the requirements.</td>
</tr>
<tr>
<td>Largely compliant (LC)</td>
<td>Requirements have been met almost entirely and only negligible requirements remain to be implemented.</td>
</tr>
<tr>
<td>Partially compliant (PC)</td>
<td>The most important requirements have been met; certain deficiencies affect the adequacy of the implementation, without resulting in a situation where the given recommendation has not been acted upon.</td>
</tr>
<tr>
<td>Materially non-compliant (MC)</td>
<td>Requirements have been fulfilled to a degree, resulting in a significant deficiency in the implementation.</td>
</tr>
<tr>
<td>Non-compliant (NC)</td>
<td>Almost none of the requirements have been met, even if steps have been taken towards implementation.</td>
</tr>
</tbody>
</table>

Grading scale for inaction

| Sufficiently explained (SE) | A complete and well-reasoned explanation for the lack of implementation has been provided; if one or more of the sub-recommendations are intended to address a particular systemic risk that does not affect a particular addressee, such justification/explanation may be considered sufficient. |
| Insufficiently explained (IE) | The explanation given for the lack of implementation is not sufficient to justify the inaction. |

This methodology is necessary to ensure the full transparency of the single overall grade and a high level of objectivity throughout the entire evaluation process, while still allowing room for high-quality expert judgement, which can easily be identified and reviewed in order to understand the rationale behind particular overall grades.
Step II: Calculating the grades for each specific Recommendation

Each compliance grade is converted into a numerical grade (see Table 2) in order to be weighted and aggregated into a single compliance grade for each sub-recommendation (note that IE is equal to NC in its numerical value).

Table 2 – Conversion table: compliance grades to numerical grades

<table>
<thead>
<tr>
<th>Compliance grade</th>
<th>Numerical grade</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Action</strong></td>
<td></td>
</tr>
<tr>
<td>FC</td>
<td>1</td>
</tr>
<tr>
<td>LC</td>
<td>0.75</td>
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<tr>
<td>PC</td>
<td>0.50</td>
</tr>
<tr>
<td>MC</td>
<td>0.25</td>
</tr>
<tr>
<td>NC</td>
<td>0</td>
</tr>
<tr>
<td><strong>Inaction</strong></td>
<td></td>
</tr>
<tr>
<td>SE</td>
<td>1</td>
</tr>
<tr>
<td>IE</td>
<td>0</td>
</tr>
</tbody>
</table>

Step III: Calculating the overall grade of the whole Recommendation

The weighted average of the numerical grades is calculated according to the pre-agreed weighting scheme, i.e. the respective weights of each sub-recommendation.

Step IV: Converting the overall numerical grade to an overall level of compliance

The overall compliance grade is determined using the conversion table below.

Table 3 – Conversion table: numerical grades to compliance grades

<table>
<thead>
<tr>
<th>Numerical grade</th>
<th>Compliance grade</th>
</tr>
</thead>
<tbody>
<tr>
<td>[0.90-1.00]</td>
<td>FC</td>
</tr>
<tr>
<td>[0.65-0.90]</td>
<td>LC</td>
</tr>
<tr>
<td>[0.40-0.65]</td>
<td>PC</td>
</tr>
<tr>
<td>[0.15-0.40]</td>
<td>MC</td>
</tr>
<tr>
<td>[0.00-0.15]</td>
<td>NC</td>
</tr>
</tbody>
</table>

Finally, the level of compliance is colour-coded:
Weights assigned to the Recommendations

The weights assigned by the assessment team to Recommendations A, B, C and D and the respective sub-recommendations are shown in the table below.

<table>
<thead>
<tr>
<th>Recommendation weights</th>
<th>Sub-recommendation weights</th>
</tr>
</thead>
<tbody>
<tr>
<td>A 30%</td>
<td>A1 50%</td>
</tr>
<tr>
<td></td>
<td>A2 50%</td>
</tr>
<tr>
<td></td>
<td>B1 33%</td>
</tr>
<tr>
<td>B 30%</td>
<td>B2 33%</td>
</tr>
<tr>
<td></td>
<td>B3 33%</td>
</tr>
<tr>
<td></td>
<td>C1 55%</td>
</tr>
<tr>
<td>C 20%</td>
<td>C2 n.a.</td>
</tr>
<tr>
<td></td>
<td>C3 45%</td>
</tr>
<tr>
<td></td>
<td>D1 (a) n.a.</td>
</tr>
<tr>
<td>D 20%</td>
<td>D1 (b) 33%</td>
</tr>
<tr>
<td></td>
<td>D1 (c) 33%</td>
</tr>
<tr>
<td></td>
<td>D2 33%</td>
</tr>
</tbody>
</table>

The weights applied to Recommendations A to D are equal to those adopted in the compliance report. An adjustment was made for Recommendations C and D, owing to the fact that sub-recommendations C2 and D1(a) were considered not applicable.

Weights of Recommendations A, B, C and D
The assessment team considers that, from a financial stability perspective, valuation and liquidity aspects would have a higher economic relevance. Recommendations A and B are therefore each assigned higher relative weights of 30%, and Recommendations C and D are each assigned lower relative weights of 20%.

The shift from constant to variable valuation is deemed one of the most critical issues because MMFs with a constant net asset value (CNAV MMFs) were considered to be particularly vulnerable to runs. The two main interlinked factors related to this risk are the trigger effect and the insufficient liquidity buffer in the event of massive early redemptions. The adverse dynamic of the “trigger effect” reflects the deposit-like characteristics, in the perception of many investors, of CNAV MMFs. This perception is prone to a sudden switch from a “good” to a “bad” equilibrium, which typically creates tail risks, i.e. high-impact risks which occur very rarely. Misalignments between the constant NAV (amortised cost valuation) and the “shadow” NAV (mark-to-market or mark-to-model valuation) increase the probability of runs. A more gradual and smooth fluctuation of MMFs with a variable net asset value (VNAV MMFs) limits this effect.

Another critical aspect of MMFs is liquidity. The liquidity buffer is the first line of defence in the event of massive unexpected redemptions. This buffer has to be sufficiently large and consist of cash or very liquid assets (i.e. assets with a short maturity and/or with very modest bid-ask spreads, even under stressed market conditions). It is important to consider both residual maturity and market liquidity because empirical evidence shows that a security with a very short residual maturity (for instance, only a few days) can sometimes— in stressful market conditions – be less liquid than a similar security with a longer maturity (for instance, five years).

Weights of the sub-recommendations within each Recommendation

Within Recommendations A and B the sub-recommendations are deemed to be equal in terms of economic substance and importance for achieving the policy objectives of the Recommendation. Therefore the weights of the sub-recommendations are equally weighted.

For Recommendation C, given that Article 35 of the Regulation on MMFs prohibits sponsor support, sub-recommendation C2 concerning the disclosure of sponsor support was considered not to be applicable.

Regarding sub-recommendations C1 and C3, it was deemed that, in terms of investor behaviour and financial stability, the issue of clearly informing MMF investors about the absence of a capital guarantee was relatively more important than the disclosure of valuation practices. Sub-recommendation C1 was therefore assigned a relative weight of 55% and sub-recommendation C3 a weight of 45%.
With regard to Recommendation D, given that the Regulation on MMFs now prohibits sponsor support to money market funds, sub-recommendation D1(a) on reporting sponsor support was considered to be not applicable. The remaining three sub-recommendations, D1(b), D1(c) and D2, were assigned equal weights of 33%.
Section 3 – Assessment results

Summary of assessment results

The results of the assessment for each sub-recommendation are summarised in Table 6. The compliance grade for each sub-recommendation is converted into a numerical grade. The numerical grades are then weighted in accordance with the weight of each sub-recommendation to obtain the numerical grade for each Recommendation. Finally, once again, for each Recommendation the numerical grade is converted into a compliance grade.

Table 6: Assessment results for each sub-recommendation and Recommendation

<table>
<thead>
<tr>
<th>Sub-recommendations</th>
<th>Recommendations</th>
<th>Weight</th>
<th>Compliance grade</th>
<th>Numerical grade</th>
<th>Weighted numerical grade</th>
<th>Numerical grade</th>
<th>Compliance grade</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td></td>
<td>50%</td>
<td>PC</td>
<td>0.50</td>
<td>0.25</td>
<td>0.75</td>
<td>Largely compliant</td>
</tr>
<tr>
<td>A1</td>
<td></td>
<td>50%</td>
<td>FC</td>
<td>1</td>
<td>0.50</td>
<td></td>
<td></td>
</tr>
<tr>
<td>A2</td>
<td></td>
<td>50%</td>
<td>FC</td>
<td>1</td>
<td>0.33</td>
<td></td>
<td></td>
</tr>
<tr>
<td>B</td>
<td></td>
<td>33%</td>
<td>FC</td>
<td>1</td>
<td>0.33</td>
<td>1.00</td>
<td>Fully compliant</td>
</tr>
<tr>
<td>B1</td>
<td></td>
<td>33%</td>
<td>FC</td>
<td>1</td>
<td>0.33</td>
<td></td>
<td></td>
</tr>
<tr>
<td>B2</td>
<td></td>
<td>33%</td>
<td>FC</td>
<td>1</td>
<td>0.33</td>
<td></td>
<td></td>
</tr>
<tr>
<td>B3</td>
<td></td>
<td>33%</td>
<td>FC</td>
<td>1</td>
<td>0.33</td>
<td></td>
<td></td>
</tr>
<tr>
<td>C</td>
<td></td>
<td>55%</td>
<td>FC</td>
<td>1</td>
<td>0.55</td>
<td>1.00</td>
<td>Fully compliant</td>
</tr>
<tr>
<td>C1</td>
<td></td>
<td>55%</td>
<td>FC</td>
<td>1</td>
<td>0.55</td>
<td></td>
<td></td>
</tr>
<tr>
<td>C2</td>
<td></td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>1.00</td>
<td>Fully compliant</td>
</tr>
<tr>
<td>C3</td>
<td></td>
<td>45%</td>
<td>FC</td>
<td>1</td>
<td>0.45</td>
<td></td>
<td></td>
</tr>
<tr>
<td>D</td>
<td></td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>D1 (a)</td>
<td></td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>0.83</td>
<td>Largely complaint</td>
</tr>
<tr>
<td>D1 (b)</td>
<td></td>
<td>33%</td>
<td>FC</td>
<td>1</td>
<td>0.33</td>
<td></td>
<td></td>
</tr>
<tr>
<td>D1 (c)</td>
<td></td>
<td>33%</td>
<td>LC</td>
<td>0.75</td>
<td>0.25</td>
<td></td>
<td></td>
</tr>
<tr>
<td>D2</td>
<td></td>
<td>33%</td>
<td>LC</td>
<td>0.75</td>
<td>0.25</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Once a single compliance grade for each Recommendation is reached, an overall grade for the Regulation on MMFs with regard to the whole Recommendation is determined. The overall grade results from the weighted average of the grade given to each Recommendation. The results of the assessment are summarised in Table 7.
Table 7: Results for each Recommendation and overall assessment result

<table>
<thead>
<tr>
<th>Recommendations</th>
<th>Weights</th>
<th>Compliance grade</th>
<th>Numerical grade</th>
<th>Weighted numerical grade</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>30%</td>
<td>Largely compliant</td>
<td>0.75</td>
<td>0.23</td>
</tr>
<tr>
<td>B</td>
<td>30%</td>
<td>Fully compliant</td>
<td>1.00</td>
<td>0.30</td>
</tr>
<tr>
<td>C</td>
<td>20%</td>
<td>Fully compliant</td>
<td>0.93</td>
<td>0.20</td>
</tr>
<tr>
<td>D</td>
<td>20%</td>
<td>Largely compliant</td>
<td>0.83</td>
<td>0.17</td>
</tr>
<tr>
<td>Overall assessment</td>
<td></td>
<td>Largely compliant</td>
<td></td>
<td>0.89</td>
</tr>
</tbody>
</table>

If this follow-up evaluation was a formal compliance assessment, the Regulation on MMFs\(^{21}\) would be:

- largely compliant with Recommendation A;
- fully compliant with Recommendation B;
- fully compliant with Recommendation C;
- largely compliant with Recommendation D.

Overall, the Regulation on MMFs would be largely compliant with the Recommendation.

\(^{21}\) Please note that, as mentioned before, this follow-up evaluation has no addressees (the Commission is not the addressee of this follow-up evaluation on the Regulation on MMFs).
Recommendation A – Mandatory move to variable net asset value

Assessment of sub-recommendation A1

Sub-recommendation A1 recommends that the Commission ensure that the relevant EU legislation requires MMFs to have a fluctuating net asset value.

Moreover, the Recommendation sets out the following compliance criteria for sub-recommendation A1.

MMFs should be required to use only the variable net asset value model. In particular, rounding share prices to the nearest unit should be prohibited. Transitional arrangements for a compulsory move to the variable net asset value model would be needed. It is therefore recommended to have a sufficiently long transition period for existing MMFs, during which the constant net asset value model can still be maintained to allow for the necessary adjustments. The transitional period for existing constant net asset value funds could be at least two years after the final publication of the applicable rules. Moreover, the shift to variable net asset value funds should be carefully announced, well before the requirement is implemented, by disclosure of the MMFs on the effect of the change.

Article 3 of the Regulation on MMFs stipulates that MMFs must be set up as one of the following types: (a) a VNAV MMF; (b) a public debt CNAV MMF; (c) an MMF with a low volatility net asset value (LVNAV MMF). Therefore, strictly speaking, the Regulation on MMFs does not envisage a prohibition of CNAV MMFs or a mandatory transformation of CNAV MMFs into VNAV MMFs, as recommended by the ESRB. Nonetheless, it envisages specific prudential requirements for public debt CNAV and LVNAV MMFs in Articles 24, 28, 31, 33 and 34.

What is new about the Regulation on MMFs is that it introduces two new types of MMFs: LVNAV MMFs and public debt CNAV MMFs, both of which are allowed to use amortised cost accounting under specific circumstances. For the purposes of assessing sub-recommendation A1, it is useful to provide some background information on the financial features of the LVNAV MMFs, comparing these new classes of funds with the traditional CNAV and VNAV funds.

Box 1 – Financial features of LVNAF MMFs

In normal market conditions, traditional CNAV MMFs are able to maintain a stable NAV. This is because the difference between the market prices of the assets they hold and the amortised cost...
value of the fund’s assets is usually small and the maturity of the assets held is short. However, they would have to “break the buck” (i.e. the NAV falls below the constant NAV of, for example, 1 EUR or 1 USD per share) if there were a material deviation between the constant NAV based on amortised cost accounting and the shadow NAV (i.e. the NAV based on a mark-to-market or mark-to-model valuation of the portfolio). The investors’ expectation is that the fund never “breaks the buck”. When this very rare event occurs, a jump from a “good” to a “bad” equilibrium (a “liquidity run”) can be observed. As in the case of bank deposits, the run is a “self-fulfilling prophecy” because the unexpected event might trigger a synchronised overreaction by the investors.

Traditional VNAV MMFs must use the mark-to-market valuation to value their assets, and, based on market practices, the price of their shares is rounded to the nearest basis point. Therefore, the NAV of these MMFs is more sensitive to market movements, although under normal market conditions the value of shares in a VNAV MMF undergoes modest fluctuations owing to the very conservative portfolio management. If new information arises, or certain events occur, markets will re-price and investors might sell their assets in bulk at the same time. In such cases, all types of MMFs can be affected by massive redemptions in similar ways. However, although investors in CNAV MMFs do not expect to be hit by capital losses, investors in VNAV funds are aware that re-pricing may occur.

The low-volatility NAV MMF and public debt CNAV MMF

What is new about the Regulation on MMFs is that it introduces two new types of MMF: LVNAV MMFs and public debt CNAV MMFs, both of which are allowed to use amortised cost accounting under specific circumstances.

LVNAV MMF may only use amortised cost accounting for assets with a residual maturity of up to 75 days and a maximum deviation at instrument level between the amortised cost valuation and the mark-to-market/model valuation of 10 basis points. In addition, the units of an LVNAV MMF may only be bought and sold at a constant price if, at portfolio level, the constant NAV does not deviate from the shadow NAV by more than 20 basis points. If there is a deviation of more than 20 basis points, the MMF will move to a VNAV. These features lower the expectation of redemption at par and therefore reduce the cliff effect that could potentially be experienced by traditional CNAV MMFs. The label (or name) of this class of funds along with the transparency requirements laid down in Article 36(3)(a) of the Regulation on MMFs, which requires any document of an MMF used for marketing purposes to clearly state that the MMF is not a guaranteed investment, sends a clear signal to the investors that it is not a capital guarantee product, and that principal losses could occur. Moreover, the Regulation on MMFs requires that the shadow NAV is published daily. These features should reduce not only the cliff effect but also moral hazard because investors are aware of the possibility of losing money.

In LVNAV MMFs the risk of runs should therefore be contained. This is because the principal loss is no longer an unexpected tail-risk event (which might trigger panic among the investors even when the fund’s portfolio is not seriously affected), but rather an infrequently occurring situation perceived by the investors as negative but not necessarily as a jump from a “good” to a “bad”
equilibrium. In other words, since the investors’ expectations under the LVNAV regime incorporate ex ante the possibility of capital losses and they can observe the shadow NAV on a daily basis, the potential panic owing to an unexpected tail-risk event occurring should be contained, reducing the deposit-like characteristics of this class of funds. The risk of redemptions owing to negative market circumstances clearly remains, but eliminating this risk is neither requested by the Recommendation (which always uses the word “reducing” not “eliminating”), nor necessarily achieved by the VNAV regime. Furthermore, a fundamental component of the LVNAV MMFs, which aims to mitigate the liquidity risk, is the “policy package” (i.e. liquidity fees and redemption gates, low interconnectedness with sponsor entities thanks to the prohibition of sponsor support and strict diversification limits with one institution, daily and weekly liquidity requirements, day-to-day disclosure of the shadow NAV, etc.).

Public debt CNAV MMFs invest at least 99.5% of their assets in instruments issued or guaranteed by public entities, reverse repos secured with government debt and in cash. This category of MMFs can deliver a constant NAV in the light of specific valuation criteria (see sub-recommendation A2). Furthermore, targeted liquidity requirements are envisaged for public debt CNAV MMFs (see Recommendation B).

By July 2022, the Commission will review whether changes should be made to the public debt CNAV and LVNAV regime according to Article 46 of the Regulation on MMFs. In addition, a report on the feasibility of establishing an EU public debt product will be presented.

The introduction of two new classes of funds (LVNAV MMFs and public debt CNAV MMFs) requires a specific (and differentiated) assessment of the various types of MMFs. Therefore, in line with the methodology adopted pursuant to a formal assessment:

- With regard to VNAV MMFs, the Regulation on MMFs would be deemed to be “fully compliant” with the Recommendation.

- With regard to public debt CNAV MMFs, the ESRB would deem the approach adopted by the Regulation on MMFs to be a deviation from the compliance criteria of sub-recommendation A1, and therefore public debt CNAV MMFs would be considered “partially compliant”.22 Not introducing a mandatory conversion of CNAV MMFs to VNAV MMFs does not address the risks to financial stability that the Recommendation aimed to

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22 The ESRB’s compliance assessment, which has the Commission as its addressee, underscored that Recommendation A addressed the risks pertaining to CNAV MMFs with regard to financial stability more comprehensively and that there were several risks associated with the approach of not introducing a mandatory conversion to VNAV.
address. However, the assessment team acknowledges that the Regulation on MMFs introduces comprehensive prudential safeguards against significant investor redemptions (including but not limited to liquidity requirements) which address the underlying systemic risks to some extent and function quite similarly to those that protect against runs on bank deposits.23

- **The introduction of LVNAV MMFs would be deemed to be “fully compliant” with the Recommendation.** The reason for grading the introduction of LVNAV MMFs as “fully compliant” is that it removes, or at least limits, the “deposit-like” characteristics of traditional CNAV MMFs. The difference between LVNAV MMFs and VNAV MMFs is not the possibility of a changing NAV (both can be subject to fluctuating NAVs), but the fact that the LVNAV MMFs have a band of tolerance for using a constant NAV, outside of which a variable NAV must be used. This tolerance is linked to the “limited” use of the amortised cost method. The Recommendation does not envisage completely abolishing the use of amortised cost accounting for MMFs. On the contrary, the Recommendation explicitly allows for a “restricted use of amortised cost accounting to a limited number of predefined circumstances”. Allowing a “limited” use of amortised cost accounting implies (by definition) some tolerance in the fluctuation of the NAV.

**Overall, according to the methodology which would be adopted in a formal assessment, if this follow-up evaluation was a formal compliance assessment, the Regulation on MMFs would be graded “partially compliant” with sub-recommendation A1.**

**Assessment of sub-recommendation A2**

<table>
<thead>
<tr>
<th>Sub-recommendation A2 recommends that the Commission ensure that the relevant EU legislation requires MMFs to make general use of fair valuation and to restrict the use of amortised cost accounting to a limited number of predefined circumstances.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Moreover, the Recommendation sets out the following compliance criteria for sub-recommendation A2.</td>
</tr>
<tr>
<td>Recommendation A does not imply a full prohibition of amortised cost accounting. However, amortised cost accounting should only be permitted to be used where it is deemed to allow for an appropriate approximation of the price of the instrument.</td>
</tr>
</tbody>
</table>

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23 See also page 18 of the Compliance Report (Annex I).
If the use of amortised cost accounting is continued, restrictions on the residual maturity of the instrument concerned should be implemented, with the aim of reducing the risk of discrepancy between its price and its amortised cost; in setting such restrictions, careful consideration should be given to the maturity profile of the assets of MMFs based in the EU.

Chapter IV of the Regulation on MMFs sets out valuation rules for MMFs:

- **The assets of MMFs must be valued on at least a daily basis pursuant to Article 29(1) and using mark-to-market, whenever possible (Article 29 (2)). Where the use of mark-to-market is not possible or the market data are not of sufficient quality, Article 29(4) of the Regulation on MMFs allows the use of mark-to-model as a substitute for mark-to-market.**

- **For public debt CNAV MMFs and LVNAV MMFs the use of amortised cost accounting is also allowed**, pursuant to Article 29(6) and (7).

- **For LVNAV MMFs, two further requirements were introduced regarding the use of amortised cost**: only an asset of LVNAV MMFs that (i) has a residual maturity of up to 75 days may be valued by using the amortised cost method; (ii) provided that the shadow price of that asset does not deviate by more than 10 basis points from its price calculated in accordance with the amortised cost method (Article 29(7)).

- **For public debt CNAV MMFs and LVNAV MMFs, restrictions also exist with regard to the residual maturity of the instruments which might be valued using amortised cost accounting.** Such restrictions arise from the fact that public debt CNAV MMFs and LVNAV MMFs may not be offered in the form of a “standard MMF”, as set out in Article 25(3) of the Regulation on MMFs. This limits them to the form of a “short-term MMF”, as defined in Article 2(14) of the Regulation. Short-term MMFs are designed to offer money market rate returns combined with the highest level of safety for investors. Through the respective portfolio rules set out in Article 24 of the Regulation on MMFs, the credit and duration risks of this type of fund are kept at low levels, with a weighted average maturity (WAM) of 60 days and a weighted average life (WAL) of no more than 120 days.

Most importantly, the Regulation on MMFs increases transparency.

- **The difference between the shadow NAV of public debt CNAV MMFs/LVNAV MMFs and their NAV valued using amortised cost must be disclosed.** It has to not only be monitored continuously but also published daily on the public section of the MMF’s website, in accordance with Article 31(4) and Article 32(4) of the Regulation on MMFs. Publishing this difference may also reduce investor expectations of redemption at par and thus the risk of an investor run.

- **Requirements for transparency to investors regarding the valuation methods used by MMFs are also imposed.** In particular, pursuant to Article 36(5), public debt CNAV MMFs
and LVNAV MMFs must clearly explain any use of the amortised cost method or of rounding or both.

The Regulation on MMFs does not prohibit MMFs from maintaining a constant NAV and therefore does not prohibit the use of amortised cost accounting in general. Nevertheless, the compliance criteria in the Recommendation do not imply the requirement for a full prohibition of amortised cost accounting but only a restriction of its use to a limited number of predefined circumstances. By restricting the use of amortised cost accounting to short-term public debt CNAV MMFs and LVNAV MMFs and by imposing stricter requirements on their portfolios in terms of WAL and WAM, the Regulation on MMFs arguably limits the scope for accounting at amortised cost to predefined circumstances, while at the same time maintaining safeguards for both public debt CNAV MMFs and LVNAV MMFs. Additionally, it should be highlighted that with regard to public debt CNAV MMFs and LVNAV MMFs, the portfolio-level limits regarding WAM and WAL of no more than 60 and 120 days respectively, as envisaged in the Regulation on MMFs, are more lenient than the benchmark of instrument-specific maturity limits of no more than 90 days recommended by IOSCO and in line with the Recommendation. The additional requirements allowing LVNAV MMFs to value assets by the amortised cost method, namely a residual maturity of up to 75 days and with a maximum deviation from the shadow price of no more than 10 basis points, are in line with IOSCO’s Recommendation.

Furthermore, the principle of fair valuation may be considered satisfied given the obligation for public debt CNAV MMFs and LVNAV MMFs to publish the shadow NAV daily on their website. By increasing transparency, this disclosure might reduce shareholders’ incentive to run (large redemption requests).

Overall, according to the methodology which would be adopted in a formal assessment, if this follow-up evaluation was a formal compliance assessment the Regulation on MMFs would be graded “fully compliant” with sub-recommendation A2.
Recommendation B – Liquidity requirements

Assessment of sub-recommendation B1

Sub-recommendation B1 recommends that the Commission ensure that the relevant EU legislation complements the existing liquidity requirements for MMFs by imposing explicit minimum amounts of daily and weekly liquid assets that MMFs must hold.

The Recommendation sets out the following compliance criteria for sub-recommendation B1.

To define the size and composition of the minimum buffers of liquid assets, the following elements should be taken into account:

(a) the trade-off between the size of the buffers to be imposed and the type of assets to be considered as eligible;

(b) minimum amounts of both daily and weekly liquid assets should be defined;

(c) in order to reduce the reliance of MMFs on secondary market liquidity, the definition of liquid assets (apart from cash) should primarily consider the residual maturity. Accordingly, instruments defined as daily and weekly liquid assets should have a residual maturity within one and five business days respectively;

(d) when defining the buffers, the risks associated with possible optional maturities of assets should be considered. These options can be based on different parameters, including techniques with counterparty risk exposure such as puttable (e.g. puttable bonds), cancellable (e.g. cancellable options) and callable (e.g. recallable repo techniques);

(e) other interconnection effects, notably with the banking sector, which may impact the availability of the assets eligible for the liquidity buffers.

The Regulation on MMFs stipulates comprehensive liquidity and portfolio requirements for MMFs in Articles 24 and 25, distinguishing between short-term and standard MMFs and providing for daily and weekly liquidity requirements.

- For both public debt CNAV MMFs and LVNAV MMFs, at least 10% of assets must be daily-maturing assets and at least 30% must be weekly-maturing assets, whereby certain public debt instruments with residual maturities of up to 190 days may also be included in the weekly buffer, up to a limit of 17.5%. The inclusion of such public debt instruments in the weekly buffer illustrates a trade-off between the size of the imposed liquidity buffer and the type of assets considered eligible. The same holds true for the inclusion of money market instruments and the units/shares of other MMFs in the weekly buffer for VNAV MMFs.
• For short-term VNAV MMFs and standard MMFs, at least 7.5% of assets must be daily-maturing assets and at least 15% must be weekly-maturing assets, whereby money market instruments and the units/shares of other MMFs may also be included in the weekly buffer, up to a limit of 7.5%, if they can be redeemed and settled within one week.

• Additionally, maximum WAM and WAL limits are defined for short-term and standard MMFs at portfolio level.

• Further to the definitions in Articles 2(18) and (21), Recital 38 of the Regulation on MMFs specifies that, to determine the eligibility of assets for inclusion in the daily and weekly liquidity buckets, the legal redemption date of the asset should be used. Recital 38 of the Regulation also specifies that the possibility of terminating a contract on a short-term basis can be taken into account and provides two examples: (i) if a reverse repurchase agreement can be terminated with prior notice of one day it should count as a daily-maturing asset; and (ii) if the manager can withdraw money from a deposit account with prior notice of one day it may count as a daily-maturing asset.

The Regulation on MMFs also outlines the types of eligible assets. Article 9 defines the asset categories that MMFs may invest in and limits them to money market instruments, eligible securitisations and asset-backed commercial paper (ABCPs), deposits with credit institutions, financial derivatives, repurchase agreements, reverse repurchase agreements and units or shares of other MMFs. Articles 10 to 16 specify further requirements with regard to the eligible asset categories, including specific requirements regarding financial derivatives and reverse repurchase agreements. Regarding the definition of short-term assets, Articles 1(1)(b) and 2(1) of the Regulation on MMFs generally limit the residual maturity of assets eligible for MMFs to two years.

Risks associated with possible optional maturities of assets were also considered. Related provisions for the WAL can be found under Article 24(1) and Article 25(1) of the Regulation on MMFs.

Interconnectedness with credit institutions is mitigated through the implementation of various diversification (Article 17 of the Regulation on MMFs) and concentration (Article 18 of the Regulation on MMFs) requirements applicable to MMFs. In addition, external support is prohibited by Article 35 of the Regulation on MMFs to limit the contagion effects of the potential failure of an MMF.
Article 15(7) of the Regulation on MMFs gives the Commission the power to adopt delegated acts specifying liquidity and credit quality requirements applicable to assets received as part of a reverse repurchase agreement. On 10 April 2018, the European Commission adopted a delegated Regulation\(^24\), which applied from 21 July 2018 (with the exception of Article 1, which will apply from 1 January 2019). This delegated Regulation was based on the technical advice provided by ESMA.\(^25\)

In conclusion, pursuant to the Regulation on MMFs, these types of entity must limit their investments to short-term and liquid instruments of high credit quality and hold minimum amounts of daily and weekly liquid assets. In fact, the requirements on liquidity, eligibility of assets, diversification and concentration limits in the Regulation on MMFs set high standards for MMFs. This Regulation therefore addresses the Recommendation to complement existing liquidity requirements for MMFs by imposing explicit minimum amounts of daily and weekly liquid assets that MMFs must hold.

Overall, according to the methodology which would be adopted in a formal assessment, if this follow-up evaluation was a formal compliance assessment the Regulation would be graded “fully compliant” with sub-recommendation B1.

Assessment of sub-recommendation B2

| The Commission is recommended to ensure that the relevant EU legislation strengthens the responsibility of the funds’ managers regarding the monitoring of liquidity risk. |
| The Recommendation sets out the following compliance criteria for sub-recommendation B2. |


\(^{25}\) On 20 January 2017, the European Commission sent a formal request to ESMA for technical advice on possible delegated and implementing acts related to the Regulation on MMFs. On 24 May 2017, ESMA launched a public consultation on its draft technical advice under the MMF Regulation, which ran until 7 August 2017.
MMFs should be required to adjust their holdings of minimum buffers of liquid assets depending on their risk profile and investor base.

MMFs should perform regular stress tests based on multiple adverse scenarios – both fund-specific and general ones – impacting their liquidity profile.

MMFs should have contingency plans in place to cope with such periods of stress.

**Article 27 of the Regulation on MMFs requires MMF managers to establish and apply comprehensive “know your customer” (KYC) policies that involve exercising due diligence with a view to anticipating the effect of concurrent redemptions by several investors.**

Additionally, in cases where the value of the units or shares held by a single investor exceeds the amount of the corresponding daily liquidity requirement of an MMF, MMF managers have to consider that investor’s cash needs, the risk aversion of the different investors and close links to different investors. Furthermore, the MMF manager has to ensure that the exposure of a single investor does not materially impact the liquidity profile of the MMF. MMF managers, therefore, have to adapt the holdings of daily maturing assets and the liquidity profile of their funds in accordance with the results of the customer due diligence procedures.

**Pursuant to Article 28 of the Regulation on MMFs, MMF managers have to establish stress testing processes to identify possible changes in the economic environment.** There are a number of parameters that have to be taken into consideration, i.e. hypothetical changes in the level of liquidity of the MMF’s assets and hypothetical levels of redemption. The stress tests need to be based on objective criteria and cater for severe but plausible scenarios. For public debt CNAV MMFs and LVNAV MMFs, the stress tests must also estimate the influence of the scenarios on the difference between the constant NAV and the NAV calculated using the mark-to-market or mark-to-model valuation methodology.

**Based on these regular stress tests, where necessary, managers are required to take action to strengthen the robustness of the MMF, including actions that reinforce the liquidity or the quality of the assets of the MMF (Article 28(4) of the Regulation on MMFs).** In addition, where stress tests reveal any vulnerability of the MMF, the manager has to draw up an extensive report with the results of the stress testing and a proposed action plan. Such documents must be submitted for examination to the respective board of directors, which has to approve a final action plan (Article 28(5) of the Regulation on MMFs). The extensive report and the action plan must be submitted for review to the competent authority, which will ultimately send it to ESMA (Article 28(6) of the Regulation on MMFs).
On 21 March 2018, ESMA published its guidelines for stress test scenarios under Article 28 of the Regulation on MMFs. These guidelines will be updated once a year to take account of the latest market developments as well as at the end of 2018 to clarify which scenario should be used for the quarterly reporting to the national competent authorities (NCAs) by management companies. They describe good practices for each of the six stress test criteria listed in the Regulation on MMFs: (i) liquidity of assets; (ii) credit risk of assets; (iii) interest rates and exchange rates; (iv) hypothetical levels of redemption; (v) spreads among indexes to which interest rates of portfolio securities are tied; and (vi) macroeconomic shocks.

In conclusion, Article 27 of the Regulation on MMFs provides for due diligence processes regarding the investor base.

On the basis of these KYC processes, managers have to adjust the holdings of daily maturing assets and the liquidity profile of their funds. Article 28 of the Regulation on MMFs requires managers to perform regular stress tests and, dependent on the outcomes, to strengthen the robustness of the MMF and to draw up an extensive report with the results of the stress testing and a proposed action plan. Therefore, the Regulation addresses the recommendation to strengthen the responsibility of the funds’ managers regarding the monitoring of liquidity risk.

Overall, according to the methodology which would be adopted in a formal assessment, if this follow-up evaluation was a formal compliance assessment the Regulation would be graded “fully compliant” with sub-recommendation B2.

Assessment of sub-recommendation B3

The Commission is recommended to ensure that the relevant EU legislation ensures that national supervisory authorities and fund managers have in place effective tools, for example temporary suspensions of redemptions, to deal with liquidity constraints in times of stress resulting from both fund-specific and market-wide developments.

The Recommendation sets out the following compliance criteria regarding sub-recommendation B3.

National supervisory authorities and fund managers must have the necessary tools in place to deal with exceptional redemption requests from investors.

With regard to VNAV MMFs, the Regulation does not itself provide for specific rules concerning procedures in the event of heavy redemption pressures owing to significant
market stress. However, tools to handle such liquidity problems are provided for in the AIFM Directive\textsuperscript{26} and the UCITS Directive\textsuperscript{27}. The rules of these Directives apply to all types of MMF in the EU since, pursuant to Article 1 of the Regulation on MMFs, its scope encompasses collective investment undertakings that require authorisation either under the UCITS Directive or the AIFM Directive. Liquidity management tools have therefore already been established for VNAV MMFs.

Regarding public debt CNAV MMFs and LVNAV MMFs, Article 34 of the Regulation on MMFs states that managers of these MMFs must establish, implement and consistently apply prudent and rigorous liquidity management procedures for ensuring compliance with the relevant weekly liquidity thresholds. According to Articles 39 and 41 of the Regulation on MMFs, the competent authorities must be provided with the powers to ensure compliance with the Regulation and take the appropriate measures where an MMF or the manager of an MMF fails to comply with the requirements set out in Article 34 of the Regulation.

In conclusion, with regard to VNAV MMFs, the Regulation does not by itself address the issue of crisis management tools for MMFs in the event of massive redemption requests. However, Article 1 the Regulation on MMFs builds on both the UCITS and the AIFM Directives, which enable both the managers and competent authorities of MMFs to apply appropriate crisis management tools with regard to investor redemptions in exceptional circumstances. Furthermore, Article 34 of the Regulation on MMFs provides that public debt CNAV MMFs and LVNAV MMFs have the necessary tools in place, i.e. liquidity fees on redemptions, redemption gates and suspension of redemptions, to deal with exceptional redemption requests from investors. Furthermore, Articles 39 and 41 ensure that national supervisory authorities have the powers to enforce the appropriate use of such tools. Accordingly, the Regulation on MMFs and the above-mentioned Directives work together to achieve the policy aims underlying sub-recommendation B3.

Overall, according to the methodology which would be adopted in a formal assessment, if this follow-up evaluation was a formal compliance assessment the Regulation would be graded “fully compliant” with sub-recommendation B3.


Recommendation C – Public disclosure

Assessment of sub-recommendation C1

Sub-recommendation C1 recommends that the Commission ensure that the relevant EU legislation requires specific disclosure by MMFs, also in their marketing material, that draws the attention of investors to the absence of a capital guarantee and the possibility of principal loss.

The Recommendation sets out the following compliance criteria for sub-recommendation C1.

The product information of MMFs should draw the attention of investors to the absence, or limitation, of a capital guarantee and the possibility of principal loss.

Article 36(3)(a) of the Regulation on MMFs provides that any document of an MMF used for marketing purposes must clearly include the statement that the MMF is not a guaranteed investment. Additionally, pursuant to Article 36(4), no communication by the MMF or its manager to investors or potential investors may suggest that an investment in the units or shares of the MMF is guaranteed.

The possibility of principal loss is clearly addressed by Article 36(3)(d) of the Regulation on MMFs, according to which any document of an MMF used for marketing purposes must clearly include the statement that the risk of loss of principal is to be borne by the investor.

In conclusion, the Regulation on MMFs includes provisions that require MMFs and MMF managers to clearly inform investors about the absence of capital guarantees for MMFs and warn them about the possibility of principal loss, as recommended.

Overall, according to the methodology which would be adopted in a formal assessment, if this follow-up evaluation was a formal compliance assessment the Regulation would be graded “fully compliant” with sub-recommendation C1.

Assessment of sub-recommendation C2

Sub-recommendation C2 recommends that the Commission ensure that the relevant EU legislation requires that MMFs refer in their public disclosure to possible sponsor support, capacity for support or protection only if such support or protection is a firm commitment.
The Recommendation sets out the following compliance criteria regarding sub-recommendation C2.

Any references in the information of MMFs to possible sponsor support, capacity for support or protection should only be allowed if such support or protection is a firm commitment on the part of the sponsor, in which case it must be recognised in the accounts and prudential requirements of that sponsor.

**Article 35(1) stipulates that an MMF must not receive external support.** As detailed in Article 35(2), external support means direct or indirect support offered to an MMF by a third party, including a sponsor of the MMF, to guaranty the liquidity or stabilise the NAV per unit or share of the MMF.

Additionally, under Article 36(3)(c) the Regulation envisages disclosure requirements concerning the prohibition of external support. Any document of an MMF used for marketing purposes must clearly indicate that the MMF does not rely on external support.

In conclusion, the Regulation does not permit external support for MMFs and any document of an MMF used for marketing purposes must clearly indicate that the MMF does not rely on external support. As for the Recommendation, it does not prohibit external support per se but sets transparency requirements with regard to possible sponsor support.

Overall, if this follow-up evaluation was a formal compliance assessment, sub-recommendation C2 would be deemed to be "not applicable".

**Assessment of sub-recommendation C3**

Sub-recommendation C3 recommends that the Commission ensure that the relevant EU legislation requires MMFs to disclose their valuation practices, particularly regarding the use of amortised cost accounting, as well as to provide appropriate information to investors regarding applicable redemption procedures in times of stress.

The Recommendation sets out the following compliance criteria regarding sub-recommendation C3.
Regarding valuation practices, Chapter IV (Articles 29 to 33) of the Regulation on MMFs deals with the valuation of MMF assets and the calculation of MMFs’ NAV per unit or share. It contains rules on how MMFs have to value individual investment assets and calculate the NAV per unit or share, as well as the frequency of both sets of valuations. While there is a general rule favouring mark-to-market valuation (Article 29(2)), MMFs may also use marking-to-model when marking-to-market is not possible or market data are not of sufficient quality (Article 29(4)). Only public debt CNAV MMFs’ and – under certain conditions – certain LVNAV MMFs’ assets may be valued at amortised cost (Article 29(6) and (7)).

Article 36 stipulates requirements for transparency to MMF investors, including in relation to the valuation practices of MMFs. Pursuant to Article 36(5) of the Regulation on MMFs, investors in an MMF must be clearly informed of the method or methods used by the MMF to value its assets and to calculate the NAV. Pursuant to Article 36(5) of the Regulation, public debt CNAV MMFs and LVNAV MMFs are required to clearly explain to investors and potential investors the use of the amortised cost method and the use of rounding the constant NAV per share or unit.

Deviating from the compliance criteria of sub-recommendation C3, the Regulation does not contain the requirement to specifically inform and explain to investors the underlying assumptions and associated risks of amortised cost accounting. However, both public debt CNAV MMFs and LVNAV MMFs are required to publish, on a daily basis, the difference between the constant NAV per unit or share and the NAV as calculated on a mark-to-market or mark-to-model basis, as the case may be (Article 31(4) and Article 32(4) of the Regulation on MMFs, respectively). In addition, in accordance with Article 33(2) of the Regulation on MMFs, potential investors in an LVNAV MMF must be warned in writing of the circumstances in which they will no longer be able to redeem or subscribe at a constant NAV per share or unit.

The Regulation on MMFs does not itself provide for specific rules concerning procedures in the event of heavy redemption pressures owing to significant market stress, except for public debt CNAV MMFs and LVNAV MMFs, in which respect Article 34 of the Regulation introduces certain liquidity tools and disclosures. Tools to handle such liquidity problems, however, are provided for in the AIFM and UCITS Directives.
The transparency requirements in Article 36 of the Regulation on MMFs apply in addition to the requirements under the UCITS and AIFM Directives. Both Directives include provisions specifying the procedures in the event of massive redemption requests by investors owing to significant market stress (see also the assessment of sub-recommendation B3).

Pursuant to Article 84(2)(a) of the UCITS Directive, UCITS MMFs have the possibility of temporarily suspending redemptions in exceptional circumstances. Pursuant to Article 69 in conjunction with Annex I, Schedule A, Sections 1.12 and 1.13 of the UCITS Directive, the sales prospectus of UCITS funds must contain information on the procedures and conditions of issue and sale of units, as well as procedures and conditions for repurchase or redemption of units, and circumstances in which repurchase or redemption may be suspended.

Similarly, pursuant to Article 16 of the AIFM Directive, the managers of AIF MMFs may use special arrangements to cope with supervening illiquidity of the funds’ assets. Pursuant to Article 23(1)(h) of the AIFM Directive, disclosures to investors must contain a description of the liquidity risk management of an AIF, including the redemption rights both in normal and in exceptional circumstances, and the existing redemption arrangements with investors.

In conclusion, the Regulation stipulates requirements for transparency to MMF investors, including MMFs’ valuation practices. Investors must be clearly informed of the method or methods used by MMFs to value their assets and to calculate the NAV. Regarding the use of amortised cost, which is only allowed for public debt CNAV MMFs and LVNAV MMFs, the transparency requirements encompass information concerning the use of the amortised cost method and the use of rounding the constant NAV per share or unit. Even though there is no explicit requirement to explain to investors the underlying assumptions and associated risks of amortised cost accounting, the fact that they must publish daily the difference between the constant NAV and the mark-to-market or mark-to-model NAV (and investors in LVNAV MMFs must be warned about the circumstances in which they will no longer be able to redeem or subscribe at a constant NAV per unit or share) serves the same purpose. In the light of this, the deviation from the compliance criteria of sub-recommendation C3 does not appear significant. Requirements to inform investors of the procedures, including temporary suspension of redemptions, in the event of massive redemption requests owing to significant market stress are stipulated in the UCITS and AIFM Directives, which, in addition to this Regulation, apply to MMFs. Furthermore, certain liquidity tools and disclosures are envisaged by the Regulation for public debt CNAV MMFs and for LVNAV MMFs.

Overall, if this follow-up evaluation was a formal compliance assessment, the Regulation would be graded “fully compliant” with sub-recommendation C3.
Recommendation D – Reporting and information sharing

Assessment of sub-recommendation D1 (a)

Sub-recommendation D1 recommends that the Commission ensure that the relevant EU legislation requires that any instances of sponsor support that may have an impact on the price of the MMF are reported by the MMF or its manager, and the sponsor, to the competent national supervisory authority, together with a full description of the nature and size of such support.

The Recommendation sets out the following compliance criteria for sub-recommendation D1(a).

Any instances of sponsor support for an MMF that may have an impact on the price of the MMF should be reported by the MMF (or its manager) and the sponsor to the responsible national authority, including a description of the nature and size of the support.

Article 35 of the Regulation on MMFs outright prohibits any form of direct or indirect external support, including support by a sponsor of an MMF that is intended for or in effect would result in guaranteeing the liquidity of the MMF or stabilising the NAV per unit or share of the MMF. Recitals 5 and 49 of the Regulation on MMFs further reiterate and explain the general prohibition of external support to MMFs. In particular, according to Recital 5, “sponsors are often forced to support their sponsored MMFs that are losing value due to reputational risk and fear that panic could spread into sponsors’ other businesses. Depending on the size of the MMF and the extent of the redemption pressure, sponsor support could reach proportions that exceed their readily available reserves. Therefore, an MMF should not receive external support.”

Furthermore, Article 36(3) of the Regulation on MMFs stipulates full transparency to investors about the fact that MMFs do not rely on external support for guaranteeing the liquidity of the MMF or stabilising the NAV per unit or share.

The aim of sub-recommendation D1(a) is not to prevent sponsor support per se. Rather, the rationale of this recommendation is that the implicit and discretionary nature of support by
sponsoring banks can be a source of systemic risks. In addition, as illustrated in the Annex to the Recommendation, sub-recommendation D1(a) should be read in conjunction with sub-recommendation A1, which requires MMFs to have a fluctuating net asset value. Taking into account the fact that the Regulation does not fully comply with sub-recommendation A1, the Regulation does not exceed the expectations with regard to external support. Instead, given that external support is prohibited by the Regulation, the recommendation that sponsor support is to be reported to the competent national supervisory authority is not applicable.

Overall, if this follow-up evaluation was a formal compliance assessment, the sub-recommendation D1(a) would be deemed to be “not applicable”.

Assessment of sub-recommendation D1(b)

The Commission is recommended to ensure that the relevant EU legislation enhances regular reporting by MMFs.

The Recommendation sets out the following compliance criteria for sub-recommendation D1(b).

Regular reporting to supervisory authorities or central banks by MMFs should at least include a sufficiently detailed breakdown of MMFs’ assets and liabilities in order to allow the authorities to monitor the fund’s liquidity position and the nature and quality of its underlying assets.

If the MMF continues to use the constant net asset value model, the regular reporting also needs to include separate detailed information for the CNAV funds, including information on their shadow price.

If amortised cost accounting is still used by MMFs, regulators should have access to regular information on the extent to which this valuation practice is used and in which cases.

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28 As observed in the Basel Committee on Banking Supervision’s Guidelines on identification and management of step-in risk: “The recent global financial crisis showed that banks sometimes have incentives beyond contractual obligation […] to “step in” to support unconsolidated entities to which they are connected. […] Prominent examples of credit or liquidity support provided by banks were observed during the crisis, including […] money market funds (MMFs),”

29 A fluctuating net asset value would reduce the need for and the importance of sponsor support.
Article 37 of the Regulation on MMFs stipulates comprehensive requirements for managers of MMFs to report to the competent authorities on at least a quarterly basis. Upon request, managers of MMFs must also provide the relevant information to the competent authority of the manager, if different from the competent authority of the MMF itself. The Regulation envisions a quarterly reporting frequency. An exemption is made for small MMFs (i.e. whose assets under management do not exceed EUR 100 million), which have to report only annually. The reporting requirements are comprehensive and include information regarding the use of amortised cost accounting and constant net asset valuation. Articles 31 and 32 of the Regulation on MMFs require the difference between the constant NAV per unit or share and the NAV per unit or share (i.e. the shadow internal NAV) to be published daily on the public section of the website of the MMF.

The reporting required under the Regulation on MMFs is in addition to the reporting already required under the AIFM Directive and the UCITS Directive. If necessary and justified, competent authorities may require additional information.

Article 37(4) of the Regulation on MMFs requires ESMA to develop draft implementing technical standards (ITS) to establish a harmonised reporting template containing all the information managers of MMFs are required to send to the competent authority of the MMF. Commission Implementing Regulation (EU) 2018/708 laying down implementing technical standards with regard to the template to be used by managers of money market funds when reporting to competent authorities was published on 17 April 2018.30 This Regulation is based on the draft implementing technical standards submitted to the Commission by ESMA.31

Overall, if this follow-up evaluation was a formal compliance assessment, the Regulation would be graded “fully compliant” with sub-recommendation D1(b).

Assessment of sub-recommendation D1(c)


31 ESMA held an open public consultation on the draft implementing technical standards on which this Regulation is based, analysed the potential related costs and benefits, and requested the opinion of the Securities and Markets Stakeholder Group established by Article 37 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council.
The Commission is recommended to ensure that the relevant EU legislation ensures that competent national supervisory authorities, where relevant, share the information referred to in points (a) and (b) with other national supervisory authorities within the same Member State, or from other Member States, the European supervisory authorities, the members of the European System of Central Banks and the ESRB.

Article 37(5) of the Regulation on MMFs requires all supervisory data reported to NCAs under Article 37 to be shared with ESMA. ESMA is tasked with collecting the data and creating a central database of all MMFs established, managed or marketed in the EU for supervisory purposes. Pursuant to Recital 51 of the Regulation on MMFs, the data should be used to facilitate a collective analysis of the potential impacts of the MMF market in the EU. The ECB will have limited access to this database for statistical purposes.

Article 43 of the Regulation on MMFs stipulates requirements for cooperation among the competent NCAs and between the NCAs and ESMA. With regard to UCITS funds, the UCITS Directive requires the competent authorities to provide each other with the information required for the purposes of carrying out their duties (Article 101(2) of the UCITS Directive). Concerning AIFs, the AIFM Directive provides for the exchange of information between competent authorities and with ESMA and the ESRB, where this is relevant for monitoring and responding to the potential implications of the activities of individual AIFs or AIFs collectively for the stability of systemically relevant financial institutions and the orderly functioning of markets (Article 53(1) of the AIFM Directive). Moreover, Article 15 of the ESRB Regulation provides the general legal basis for the ESRB to access relevant information and supervisory data.

The NCAs are required to communicate information with each other, where such information is relevant for monitoring and responding to the potential implications of the activities of individual MMFs or MMFs collectively for the stability of systemically relevant financial institutions and the orderly functioning of markets in which MMFs are active. In such cases, ESMA and the ESRB must also be informed (Article 43(3) of the Regulation on MMFs, last sentence), and should forward that information to the competent authorities of the other Member States. In addition, the ESRB may ask for access to relevant data pursuant to Article 15 of the ESRB Regulation.

In conclusion, the Regulation contains provisions regarding supervisory cooperation and the exchange of information between competent authorities and with ESMA. The respective rules complement the rules in the UCITS and AIFM Directives. However, the framework for cooperation and exchange of information does not include the EBA and EIOPA, the two other European supervisory authorities (ESAs) within the European System of Financial Supervision, or
the national central banks (NCBs), as member institutions of the European System of Central Banks. Moreover, the ECB is granted access to the central database for statistical purposes only. Therefore, the Regulation does not provide for information sharing or access to ESMA’s central database even for aggregated data, which in line with sub-recommendation D1(c) would be required for the purposes of financial stability analysis and macroprudential policy.

**Overall, if this follow-up evaluation was a formal compliance assessment, the Regulation would be graded “largely compliant” with sub-recommendation D1(c).**
Assessment of sub-recommendation D2

The Commission is recommended to promote the development of harmonised reporting and a harmonised dataset, as mentioned in paragraph 1(b), and the organisation of information sharing, as mentioned in paragraph 1(c).

The Recommendation sets out the following compliance criteria regarding sub-recommendation D2.

Measures should be taken that promote the development of harmonised reporting and a harmonised dataset on MMFs, and which can also be used for macroprudential purposes, covering the previously mentioned points. Any such measures should take into account the existing reporting requirements MMFs are already subject to, such as the balance sheet reporting of monetary financial institutions (ECB/2008/32).

To ensure that there are no impediments on the sharing of the aforementioned information between prudential authorities and central banks, whether at the national, cross-border or European level.

Pursuant to Article 37(4) of the Regulation on MMFs, ESMA is required to develop draft ITS to establish a harmonised reporting template that contains all the information from supervisory reporting pursuant to Article 37. This promotes the development of a harmonised dataset and harmonised reporting for the MMF sector in the EU that can, in principle, be useful for macroprudential oversight and policy. Commission Implementing Regulation (EU) 2018/708 laying down implementing technical standards with regard to the template to be used by managers of money market funds when reporting to competent authorities was published on 17 April 2018.32 This Regulation is based on the draft implementing technical standards submitted to the Commission by ESMA.33

However, access to and exchange of these supervisory data is limited to the respective competent authorities, ESMA and the ESRB, subject to Article 15 of the ESRB Regulation, while

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33 ESMA held an open public consultation on the draft implementing technical standards on which this Regulation is based, analysed the potential related costs and benefits, and requested the opinion of the Securities and Markets Stakeholder Group established by Article 37 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council.
the other ESAs and the NCBs of the ESCB are not entitled to access such data. The ECB is only granted access to the central database for statistical purposes.

In conclusion, the Regulation envisages a role for the Commission to promote harmonised reporting and a harmonised dataset on MMFs in the EU. The Regulation also requires information to be shared among supervisory authorities. However, limiting data access to MMF supervisors and excluding the EBA, EIOPA and the NCBs may, in practice, hamper the use of these data for macroprudential policy purposes.

Overall, according to the methodology that would be adopted in a formal assessment, the Regulation would be graded “largely compliant” with sub-recommendation D2.
Annex A: Members of the assessment team

Francesco Mazzaferro  Head of the ESRB Secretariat and Chair of the assessment team

Jürgen Aschoff  Deutsche Bundesbank

Carlo Gola  Banca d’Italia

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Technical contributions and assistance from Gilda Sophie Prestipino (ESRB Secretariat), Anna Dobrzańska, Margaux Morganti and Amy Dunne (formerly at the ESRB Secretariat) are also acknowledged.
Abbreviations

I. Compliance grades:

FC  fully compliant
LC  largely compliant
PC  partially compliant
MN  materially non-compliant
NC  non-compliant
IE  inaction insufficiently explained
SE  inaction sufficiently explained

II. Other abbreviations:

AIF  alternative investment fund
AIFM alternative investment fund manager
CNAV  constant net asset value
CNAV MMF money market fund with a constant net asset value per share or unit
EBA European Banking Authority
ECB European Central Bank
EIOPA European Insurance and Occupational Pensions Authority
ESAs European supervisory authorities
ESMA European Securities and Markets Authority
ESRB European Systemic Risk Board
EU European Union
<table>
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<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>FSB</td>
<td>Financial Stability Board</td>
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<tr>
<td>KYC</td>
<td>know your customer</td>
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<td>LVNAV</td>
<td>low volatility net asset value</td>
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<tr>
<td>LVNAV MMF</td>
<td>money market fund with a low volatility net asset value</td>
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<tr>
<td>MMF</td>
<td>money market fund</td>
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<tr>
<td>NAV</td>
<td>net asset value</td>
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<tr>
<td>NCB</td>
<td>national central bank</td>
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<tr>
<td>UCITS</td>
<td>undertaking for collective investment in transferable securities</td>
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<tr>
<td>VNAV</td>
<td>variable net asset value</td>
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<tr>
<td>VNAV MMF</td>
<td>money market fund with a variable net asset value per share or unit</td>
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<tr>
<td>WAL</td>
<td>weighted average life</td>
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<tr>
<td>WAM</td>
<td>weighted average maturity</td>
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