ESMA CONSULTATION PAPER
DRAFT GUIDELINES ON THE REPORTING TO COMPETENT AUTHORITIES UNDER ARTICLE 37 OF THE MMF REGULATION

RESPONSE FROM THE INVESTMENT ASSOCIATION

14 FEBRUARY 2019

EXECUTIVE SUMMARY

The Investment Association[1] (IA) welcomes the opportunity to provide its feedback on the consultation by ESMA on its draft guidelines on the reporting requirements under article 37 of the Money Market Fund (MMF) Regulation.

Our key points in relation to the response are as follows:

- Lessons should be learned from the challenges of the implementation of AIFMD IV regulatory reporting, in particular the importance of allowing sufficient time after publication of specifications for both NCAs and managers of MMFs to develop systems and processes necessary for reporting, and only one version of the XML schema should be used by all NCAs at any one time. Where changes are made to the XML, a reasonable implementation period will need to be allowed to ensure all NCAs and managers of MMFs are able to transition to the new XML at the same time.

- The zero tolerance approach to percentages in AIFMD Annex IV reporting has resulted in high numbers of exceptions that require time consuming manual interventions to rectify. Small tolerances should be allowed to percentage totals to account for rounding errors, in order to avoid a large number of exceptions which will be time consuming and costly to rectify.

- Managers of MMFs with annual reporting requirements should be permitted to report, at their own choice, on a quarterly basis where this is more straightforward for them operationally, but this should not create or imply a higher standard of compliance for those funds over those that elect to report annually.

- The proposed definition of the NAV for the purposes of reporting under the MMF Regulation is inconsistent with the method specified in articles 30 (1), 31(1) and 32(1), ie that the NAV is the sum of the value of all assets of the MMF and the sum of all the liabilities of the MMF. The definition of the NAV for the purposes of reporting should be aligned with calculation of NAV per unit in the MMF Regulation.

- We see no value in managers of MMFs reporting the results from the same half yearly stress testing in two quarterly reports, and also ask that ESMA clarify whether the reporting of stress testing under article 37 is also intended to satisfy the reporting requirement in article 28(5).

If you would like to discuss the responses given to any of the questions in this response further, please contact Peter Capper at the Investment Association on +44 20 7831 0898 or at peter.capper@theia.org.

[1] The IA champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage nearly £7.7 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. More information can be viewed on our website.

GENERAL COMMENTS

1. ESMA makes a number of references to the AIFMD Annex IV reporting in the consultation paper. There is value in using the experiences gained in the AIFMD reporting and applying these to the reporting to NCAs required under the MMF Regulation. But there have been considerable difficulties and challenges with the implementation of the AIFMD Annex IV reporting and it is important that lessons are learned from this experience in order to avoid similar issues with the reporting under the MMF Regulation.

2. One of the lessons that should be applied from the AIFMD Annex IV reporting experience is not to underestimate the implementation time needed not only by the industry, but also by NCAs, to implement the reporting requirements from the date the validation rules and XML schemas are made available. Developing the necessary systems and processes will take several months at minimum, particularly to develop automated solutions that will be necessary for larger firms to be able to efficiently deliver on their reporting obligations. ESMA's decision to use the ISO 20022 Standard for the format of the MMF reports, while in our view the right one in the longer term, will differ from the format used for the AIFMD reporting templates and therefore will require managers of MMFs to undertake further development. This will impact on the time required to feasibly implement.

3. The experience of AIFMD suggests that both NCAs and the industry will require considerably longer than the three month implementation period implied by the statements that the reporting validation rules and XML schemas are to be "expected to be published by the end of 2019", and that the first reporting will commence in Q1 2020. It is imperative that both regulators and managers of MMFs have enough time from when the validation rules and XML schemas are published to sensibly prepare for the reporting requirements. The IA suggests that if ESMA is not able to make these documents available by the end of June 2019, the IA suggests that ESMA defers the first quarterly reports to at least the second half of 2020 to allow sufficient time for both regulators and the industry to properly prepare for implementation.

4. In addition, only one version of the XML schema should be in use across all member states at any one time. The decision by some NCAs to proceed with implementation using version 1.1 of the XML schema in the implementation of Annex IV reporting, instead of the later version 1.2 of the XML schema adopted by most NCAs hindered AIFMs with reporting obligations in more than one EU member state from being able to implement a pan-EU reporting solution. This situation should be avoided for reporting under the MMF Regulation. Where changes are made to the XML, a reasonable implementation period will need to be provided for to allow sufficient time for NCAs and managers of MMFs to transition to the new XML at the same time.

5. Another lesson from the AIFMD Annex IV reporting is that overly strict tolerances, particularly on summing percentage figures that have been rounded (and often converted from absolute figures that were rounded), are likely to result in a large volume of exceptions. Correcting these has invariably resulted in firms having to use manual workarounds, which have proved time consuming and costly. We are therefore disappointed that ESMA is proposing to adopt the same approach of zero tolerances for the reporting of percentages under the MMF Regulation. The IA proposes that ESMA minimises the possibility of percentages fields leading to exceptions by allowing percentages to be quoted to a larger number of decimal places before being rounded, and allowing a small tolerance when the percentage figures are totalled.

6. A lot of fields in the AIFMD Annex IV reporting were also left to the interpretation of AIFMs, ultimately leading to inconsistencies. Many of these have since been addressed through ESMA Q&As and guidance from NCAs, but it is important that sufficient guidance is provided to minimise ambiguities in the reporting process. As we note in our response, there are several fields where we believe further guidance from ESMA would be helpful.

RESPONSES TO QUESTIONS

Question 1: Are you of the view that there could be merits for managers of MMFs subject to yearly reporting in accordance with article 37(1) of the MMF Regulation to report on a quarterly basis so that their corresponding operational process is less burdensome?

7. The merits for managers of MMFs subject to yearly reporting in accordance with article 37(1) of the MMF Regulation (a "small MMF") instead reporting on a quarterly basis will depend on the firm, their wider fund range, the particulars of the MMF and the operational procedures of the firm. There are merits for firms, particularly for those with MMFs close to the threshold or who have other MMFs in reporting these on a quarterly basis to align operational practices and to have consistency of operations. As such, we agree that managers of MMFs with annual reporting obligation should be able to elect to report quarterly, provided this is at the sole discretion of manager, and they can elect at any point to move from reporting these funds on a quarterly to an annual basis.

8. It should be recognised by national competent authorities that where MMF managers elect to report small MMFs on a quarterly instead of an annual basis, this is likely to be for operational reasons, and quarterly reporting should not become, or seen to be, a "gold standard" of reporting for small MMFs. It is important that managers of small MMFs who find it operationally more straightforward to report on an annual basis, such as those firms that only manage small MMFs, are not pressured into reporting on a quarterly basis or made to feel there is an expectation on them to report quarterly.

Question 2: Do you identify potential situations in which managers of MMFs do not have any information to report on MMFs other than those listed above (e.g. certain types of situations of liquidation of the MMF?

9. It is possible that some MMFs subject to the last reporting flag may have limited information to report, eg if the fund has already been liquidated (which given the highly liquid nature of the instruments held by MMFs, could be a fairly short period), or whose assets have been merged into another MMF by way of an in specie transfer of assets. A manager of a small MMF that has been reporting quarterly chooses instead to report annually (see our response to question 1) would have no information to report.

Question 3: Do you agree that the MMF Guidelines could specify which sources should be used by managers of MMFs if the base currency is not included in the list of currencies for which the ECB provides an exchange rate? If yes, which sources should be used in your view?

10. For the purposes of consistency, we agree it would be helpful for the MMF Guidelines to specify the sources that should be used. We suggest that where the base currency of a MMF is not included in the list of currencies for which the ECB provides an exchange rate, the sources used should be widely available, eg from other central banks (such as

the Bank of England) or from those data providers identified as being most widely used by asset managers.

Question 4: Do you identify any other issue that would need to be specified in relation to the above section on "general principles" of the reporting template?

11. We agree it is important for ESMA to specify those fields that are mandatory, conditional and optional. For AIFMD Annex IV reporting, it has also proved useful for AIFMs to have free text fields to provide comments on reported elements, especially where there are unusual figures or anomalies. The free text fields enable the AIFM to explain these figures, reducing the need for the NCA to follow up with the AIFM, and these are likely to prove useful for reporting under the MMF Regulation, enabling managers of MMFs to be able to offer explanations for certain figures.

12. For fields where percentages are reported, the explanation of the reporting format (ie reporting the percentage as a number between 1 – 100) is useful, but the no tolerance approach to adding percentages has been very unhelpful for AIFMD. Where rounded figures are used, then converted in percentages that are then rounded, there will inevitably be small rounding errors when these percentages are totalled. This has been one of the main causes of reports being rejected, and can usually only be remedied by making manual adjustments to the original figures, before these are converted into percentages. This process can take several attempts to do successfully, and will then require the report to be submitted manually, thus preventing the firm from being able to utilise an automated solution. The additional manual work required to perform this intervention increases the man hours, and therefore the overall cost of the reporting requirement.

13. The IA therefore recommends that small tolerances are built into the report where percentages are used, firstly allowing percentages to be reported to several decimal places (sizeable errors in percentage totals are most likely to arise from rounding errors when figures have to be rounded too to a small number of significant figures), then allowing sensible tolerances when the total percentages marginally under or overshoot the 100%. The emphasis on accuracy should be on the actual figures (prior to being converted into percentages) rather than the percentages, rather than requiring the former to be adjusted to make the rounded percentages work.

14. The IA notes that paragraph 12 states that the reporting validation rules and XML schemas are "expected to be published by the end of 2019". The experience of AIFMD suggests that regulators, as well as the industry, will require considerably longer than the three month implementation period this implies if the first reports to regulators are to commence in Q1 2020. Indeed, many regulators were simply not ready to receive the first AIFMD Annex IV reports in January 2015. It is imperative that both regulators and the industry have sufficient time to prepare properly for the reporting requirements, and the validation rules and conditions will need to be made available much sooner if the Q1 2020 date for reporting to commence is to be feasible. If ESMA is not able to make these documents available by the end of June 2019, the IA suggests that ESMA defers the first quarterly reports to at least the second half of 2020 to allow sufficient time for both regulators and the industry.

15. Additionally, the IA recommends that only one version of the XML schema be in use across jurisdictions at any one time. One of the issues encountered with AIFMD Annex IV reporting was that a second version of the XML schema, version 1.2, was issued soon after the first version, version 1.1 was issued. While most NCAs opted to

implement version 1.2, a small number opted to continue proceeding with implementation using version 1.1. This hindered AIFMs with reporting obligations in more than one EU member state from being able to implement a pan-EU reporting solution, again increasing the work and cost involved with the implementation and the initial operation of the reporting requirements. The IA urges ESMA to learn the lessons of the difficulties with implementing the AIFMD XML schema, ensuring only one version of the XML schema is in use at any one time and a sensible transition timetable that all NCAs can manage is agreed for implementing updates to the XML schema.

Question 5: Do you agree that if an MMF is composed of different share classes that differ in relation to their base currency the base currency that should be included in field A.1.12 should be the base currency as specified in the accounting documents of the MMF or are you of the view that in that case the base currency of the largest share class should be included in field A.1.12? Would you see merit in aligning the inception date mentioned above in section X with the first reporting date, as defined in section II?

16. We agree the base currency used should be the currency indicated as the base currency in the prospectus for the MMF, and which is specified in the reference accounting documents of the MMF.

17. The guidance should clearly specify the date that should be used as the "inception date". We see merit in using the date when authorisation was granted, particularly for funds that were in existence before their authorisation as MMFs.

Question 6: Do you identify any other issue that would need to be specified in relation to the above section on the block 1 of the reporting template?

18. Field A.1.16 requires the "ECB code (MFI ID code) of the manager of the MMF" to be reported. We would like ESMA to clarify what it is expecting to be reported in this field, since our understanding is that it is only the MMF that is a monetary financial institution (MFI), not the manager of the MMF. As such, only the MMF will have a MFI ID code. If the manager of the MMF is not a MFI, it will not have a MFI code and therefore this field would ordinarily be left blank.

19. In respect of mergers, we suggest there is more flexibility for a MMF that has been merged into another MMF or liquidated to be able to report within 30 days of the end of the reporting "period", rather than "quarter" in which it has been liquidated, particularly if this aligns with the reporting of other MMFs managed by the manager. MMFs being merged or liquidated are more likely to be smaller MMFs that have proved subscale or experienced high outflows, hence are more likely to be on annual reporting cycles. This additional flexibility will be helpful especially if the liquidation is in the second half of the year or if there are delays in the liquidation such determining final liabilities, creditors etc.

20. Section II.23 of the consultation paper refers to including the "Last reporting flag" into the reporting template. We would welcome additional clarification with regards to applying this flag to newly launched funds. Similarly, Section II.29 refers to another flag "MMF Reporting Change Frequency Code". We would welcome additional clarification as to whether this is a mandatory field and whether the values would be yearly, quarterly, not applicable etc.

Question 7: Are you of the view that the abovementioned specification leaves too much room for interpretation and would lead to data that is not comparable? Are you of the view that settlement periods should be taken into account and that, as a consequence, the last part of the abovementioned specification ("if it has as a non-negligible impact on the liquidity profile of the MMF") should be removed?

21. We are concerned that the reference to "time delay for having the proceeds of the sale available on a cash account" is ambiguous to determine its liquidity profile bucket. An explicit reference to the settlement period of an instrument would be preferable.

22. The limitation on assigning only one liquidity period to each assets is too conservative for MMFs, particularly those holding large holdings in government or supranational instruments in line with the derogation in article 17(7). For these relatively liquid positions, it may be possible to liquidate tranches of the overall position at near or at carrying value in shorter periods than it would be to liquidate the entire position, and therefore it should be permissible to split these larger holdings across several buckets. In practice, if assets need to be liquidated to meet redemptions (rather than relying on maturities) it is likely only a proportion of each asset would be sold, rather than an entire position liquidated, in order to maintain the appropriate portfolio spread. To avoid false flags the liquidity reported should properly reflect the underlying liquidity of the MMF, particularly given liquidity is an important feature of MMFs.

Question 8: Do you have any views in relation to the abovementioned formula on how to measure the monthly portfolio volatility or are you of the view that another formula would be welcome?

23. The formula presented for the monthly portfolio volatility of the NAV and (where applicable) the shadow NAV seems appropriate.

Question 9: Do you identify any other issue that would need to be specified in relation to the above section on the block 2 of the reporting template?

24. The statement in paragraph 79 that for the purposes of reporting under the MMF Regulation, "the total value of assets equals the NAV" is inconsistent with articles 30 (1), 31(1) and 32(1), which specify that the NAV is the sum of the value of all assets of the MMF (calculated on a mark to market, mark to model or amortised cost basis depending on the type of MMF) <u>and</u> the sum of all the liabilities of the MMF, which is then divided by the number of outstanding units or shares of the MMF to give the NAV per unit or share. We suggest that the NAV for the purposes of reporting under the MMF Regulation should be consistent with the method prescribed in articles 30-32 of the MMF Regulation, ie the sum of the total value of the assets and the liabilities of the MMF. If the intention of the reporting requirements is to capture only the total value of the assets of the MMF, then fields A.4.1 and A.4.2 should be relabelled.

25. The method for calculating the cumulative return should be specified to avoid inconsistencies in interpretation, eg should income be included in the calculation, and should these be compounded?

26. We do not agree that the most representative share class will necessarily be the largest. This could change over the reporting period, and could lead to inconsistencies.

We suggest that the manager of the MMF should determine the most representative share class, based on principles of representation such as which are its primary target investors, which share class is most widely available to those investors, etc.

27. The monthly portfolio volatility figures should be viewed in the context of these being MMFs where the base volatility is very low. Changes could therefore appear more significant than they are in practice if this context is not taken into consideration.

Question 10: Do you identify any other issue that would need to be specified in relation to the above section on the block 3 of the reporting template?

28. For managers of MMFs with quarterly reporting periods, we see no value in them reporting a second time the results of previously reported stress tests where no stress tests have been undertaken during that period. Furthermore, we note that there is nothing in the MMF Regulation that specified the dates on which the manager of the MMF is required to undertake it's testing, and therefore do not believe the guidelines should specify that stress testing should be conducted on the last day of the year, rather it should be left to the manager of the MMF to identify which dates are most suitable to conduct the stress testing.

29. Where the manager of a MMF elects to conduct its stress testing more frequently than the minimum requirement under article 28(3) of twice a year, the guidance should clarify that where available, the manager of the MMF can provide the results of the most recent stress test where these differ from those previously reported.

30. ESMA should also clarify if the reporting of the results of the stress testing and action plan in this report (required under Article 37) is intended to satisfy the requirement in article 28(5) to provide the extensive report on its stress tests and action plan to its competent authority. If this latter requirement is being treated by regulators as a separate requirement, then annual reporting MMFs should be able to provide only the more recent of the two stress tests conducted.

Question 11: With the respect to the CFI codes to be provided, do you identify any eligible asset not included in the table in the Annex of the Guidelines?

31. We have not identified any eligible assets not included in the table in the Annex of the Guidelines.

Question 12: Do you agree with the proposals of ESMA in relation to the domicile of the abovementioned assets?

32. We do not agree that the country of the counterparty should be used for listed derivatives. Instead, the country of the issuer of the underlying should be used, or for listed index derivative covering more than one country, we suggest the "supranational/multiple regions" category is used.

Question 13: Do you agree that a category "supranational/multiple regions" should be included in the potential geographical areas to be chosen? If yes, could you provide examples of assets for which you would choose that category?

33. We agree this category should be used, noting MMFs can hold money market instruments issued by supranational institutions, and derivatives with underlying indices that cover instruments issued in multiple jurisdictions.

Question 14: Do you agree that the clean price of the money market instrument (A.6.12), this field should always be reported in absolute terms (in monetary values, not in percentages)? Which of the 2 abovementioned options on the "base currency" mentioned in field A.6.13 would you favour: currency of the asset or the currency of the MMF?

34. We agree that the clean price of the money market instrument should be reported in field A.6.12 in monetary values not in percentages.

35. We favour the currency of the MMF being used rather than the currency of the asset for consistency across the reporting.

Question 15: With respect to fields A.6.23 to A.6.25, would you identify any cases where there is no sponsor of an eligible securitization or asset backed commercial paper?

36. Fields A.6.23 to A.6.25 should be optional, so they can be left blank for any eligible securitisations or ABCs for which there is no sponsor.

Question 16: Do you identify other potential contract types that would need to be included in the list above in relation to field A.6.39?

37. [Members – please advise if any categories are missing in the list given on page 37 of the consultation paper]

Question 17: Do you see merits in clarifying what should be the name of the underlying as referred to in Field A.6.45? If yes, which specifications would you expect?

38. We do not see merits in specifications for the name of the underlying in field A.6.45.

Question 18: Are you of the view that ESMA should further specify what is meant by "exposure" in fields A.6.91 and A.6.92? If yes, which types of specifications would you suggest?

39. No – the definitions of gross exposure ESMA has provided for these fields in the draft guidelines are clear.

Question 19: Do you identify any other issue that would need to be specified in relation to the above section on the block 4 of the reporting template? In particular, in your view, how would the NAV of the MMF compare to the sum of the values of the fields on total market values (and quantity) of money market instruments, securitisation and ABCP, financial derivative instrument, unit or share of other MMF, deposit or ancillary liquid asset, repurchase agreement and reverse repurchase agreement (A.6.16 and A.6.11, A.6.34 and A.6.29, A.6.54, A.6.67 and A.6.69, A.6.80, A.6.91)? Do you have any comments on the table “CFI codes for eligible securities” included in the annex of the Guidelines?

40. As noted in our response to question 9, the NAV should be the sum of the values of the assets and liabilities of the MMF. Therefore, the sum of the values entered in fields A.6.16 and A.6.11, A.6.34 and A.6.29, A.6.54, A.6.67 and A.6.69, A.6.80, and A.6.91 will not necessarily equal the NAV.

41. Where no official CFI code is set for an asset by the national numbering agency, we do not believe firms should be expected to generate their own CFI. We therefore believe those fields should be designated as optional.

Question 20: Do you identify any other issue that would need to be specified in relation to the above section on the block 5 of the reporting template?

42. With respect to the exchange rate referred to in field A.7.12, ESMA is of the view that it should be specified that this reported exchange rate should be the exchange rate at the end of the month corresponding to the reporting of fields A.7.8, A.7.9 and A.7.11 or, if not available at that date, the preceding last available exchange rate. This same exchange rate should be used when filling in EUR all fields A.7.8, A.7.9 and A.7.11.The MMF guidelines could therefore include the corresponding specification:

> “With respect to the exchange rate referred to in field A.7.12, this reported exchange rate should be the exchange rate at the end of the month corresponding to the reporting of fields A.7.8, A.7.9 and A.7.11 or, if not available at that date, the last preceding available exchange rate. This same exchange rate should be used when filling in EUR all fields A.7.8, A.7.9 and A.7.11.”

43. Regarding field A.7.3, whilst additional clarification is provided in terms of the corresponding investor group classifications for European System of accounts (ESA) 2010, we would like to understand whether another framework would be allowed as well. In particular, will this field replace the CBI sector codes for Ireland? We would also like ESMA to clarify what the criteria are for determining which group an investor belongs to.

44. Finally, in recent years there has been a trend towards greater intermediation of investor holdings, particularly for retail investors but also increasingly for professional investors. The majority of the holdings of retail investors are now held in intermediated beneficial arrangements, such that the manager of the MMF will only have sight of a bulk nominee on its unit register. Although many professional investors still opt for direct register holdings, an increasing number are using institutional dealing platforms, resulting in their holdings also appearing in the main register under a nominee holding. Managers of MMFs, and other types of funds, have difficulties in getting intermediaries controlling these nominees to provide them with information on the underlying investors, even where this is not personal information (which intermediaries are understandably reluctant to provide). We therefore welcome recognition of this by

ESMA, and provision for managers of MMFs to provide estimated figures on the split between professional and retail investors. Should NCAs want more specific information on the underlying holdings, it may be necessary for NCAs to place obligations on intermediaries to provide information to managers of MMFs in order for them to satisfy their reporting obligations.

Question 21: Do you identify any other issue that would need to be specified in relation to the above section on the block 6 of the reporting template?

45. We have not identified any other issues in block 6.