THE INVESTMENT ASSOCIATION

EC Targeted Consultation on the functioning of the Money Market Fund Regulation – Further Feedback

The Investment Association offers further feedback on some of the questions raised in its response to the European Commission's targeted consultation on the Money Market Fund Regulation, in particular providing explanations for some of the responses given where the characters limits were insufficient or the option to provide feedback was not given due to the options selected. This feedback should be read alongside the responses given by the IA in the survey.

Question 3. If LVNAV were not available anymore, what impacts would you expect on you, and other relevant stakeholders? Please explain:

The LVNAV MMF is an essential part of the sterling MMFs marketed in the UK, most of which are domiciled in the EU and exported to the UK. Around 97% of sterling MMFs are LVNAV MMFs, amounting to £249.1bn in September 2020[1].

The availability of a stable NAV MMF that can invest in non-public securities is particularly important for UK investors in sterling MMFs. UK accounting practices allow MMFs with stable prices to be treated as a cash equivalent. The majority of UK corporate treasurers therefore prefer stable NAV MMFs over variable NAV MMFs, although both types are available in sterling. These MMFs are also able to facilitate same day liquidity, which is valued by UK institutional clients.

Sterling LVNAV MMFs service a wide range of institutional investors, providing greater diversification of risk and better yields than bank deposits. These include financial services providers, corporate enterprises, charities and local governments. The majority of MMFs offered to UK investors are LVNAV MMFs as this best meets their requirements, ie this is driven by investor demand. Feedback from our members suggest that while some investors, particularly those in the financial services sector, may be willing to switch to VNAV MMFs, the majority are likely to stop using MMFs altogether were the LVNAV MMF structure no longer to be available, or prevented from using amortised cost accounting and rounding of share prices to the nearest percentage point to maintain a stable price.
In theory some of this market could be serviced by Public Debt CNAV MMFs - there are a small number of Public Debt CNAV MMFs available in sterling. But overall our members advise that markets in sterling public debt are simply insufficient to support the demand for stable NAV MMFs in sterling. In addition, while meeting the needs of some investors, sterling Public Debt CNAVs will provide less issuer diversification and lower yields, and therefore will be less attractive to most current LVNAV investors.

[1] Source: EFAMA, November 2020 (https://www.efama.org/sites/default/files/files/20%2011%20European%20MMFs%20%20Covid-19%20-%20EFAMA%20Final%20Report%20%28November%202020%29_0.pdf)

Another possibility for some investors would be to invest in short term funding markets directly. For most investors, this will be less efficient and more costly, as they will not benefit from pooling, and few investors will have sufficient scale to achieve the same levels of diversification. Moreover, most corporate, charity and local government investors will not want to navigate the complexities of investing directly in money market instruments, in the unlikely event they even have the resources, expertise and facilities to do so. They will more directly be exposed to low liquidity levels in short term funding markets – unlike in a pooled vehicle, where redeeming investors can be netted off against incoming investors, they will have to find willing buyers in the secondary markets themselves. With the exception of the larger financial services providers and largest corporations and institutions, the option to invest directly in short term debt markets will not be a feasible option for sterling LVNAV MMF investors.

This essentially leaves bank deposits as the most likely alternative for the majority of LVNAV MMF investors. While it may appear a straightforward solution, this will significantly increase their counterparty risk exposure and almost eliminate any diversification. It is far from apparent that this additional business will be welcomed by banks - our members report that banks are increasingly reluctant to offer large deposit accounts to their corporate, charity and local government clients on competitive terms.

Overall, were the LVNAV MMF structure no longer to be available, we anticipate based on member feedback that the impact on providers of sterling MMFs, the majority of which are based in the EU, and on investors in those MMFs would be hugely damaging. Moreover, the IA does not believe the case has been made for significant reform or abolition of LVNAV MMFs on the basis of how they performed during the March 2020 crisis. While a number of LVNAV MMFs serving institutional investors came under redemption pressures, this was equally true of VNAV MMFs servicing institutional investors – the majority of redemption pressures were driven by the sudden and unexpected need for liquidity by investors due to the increased market volatility and the economic impact of lockdowns arising from the rapid spread of Covid, rather than anything inherent in the LVNAV structure. In light of this, the IA views proposals to abolish the LVNAV MMF structure as a wholly disproportionate and unsupported policy response to the March 2020 crisis, and strongly recommends that the EU Commission retains the LVNAV MMF as a structure permitted to use amortised cost accounting and the rounding of share prices to the nearest percentage point to maintain a stable NAV.

Question 5. What elements of the MMFR could in your view be improved?

To what degree is it important to improve the regulatory triggers for LMTs?

As noted in our response to several questions, the IA believes it is important to remove the perceived link between liquidity thresholds and the activation of liquidity management tools in LVNAV MMFs. In our view, this is best achieved through the deletion of Article 34 of the MMFR.

Related to this, the IA welcomes the policy intention to allow MMFs to breach their liquidity thresholds during stressed market conditions. However, we do not believe it should be necessary for MMF managers to seek a time limited approval from this from its national regulator, The time required for waiving the threshold requirements may not be easy to determine, and any time limit set by a regulator will likely prove arbitrary. We suggest it should be sufficient to require MMF managers to notify their national regulator that the threshold has been breached, and to prioritise the restoration of liquidity levels above threshold at the earliest opportunity, having regard to the interests of investors.

The IA is not in favour of the introduction of mandatory thresholds of public debt securities for LVNAV MMFs, or short term or standard VNAV MMFs. For sterling MMFs in particular, the level of issuance and secondary market activity in short term sterling public debt securities is simply not large enough to support any significant investment by MMFs. We understand that similar challenges will arise for euro denominated MMFs, where activity is likely to be concentrated around a small number of eurozone public issuers. For any such reforms to be feasible, these would need to be preceded by reforms to sterling and euro issuance and the secondary market frameworks.

The IA is also not convinced that adequate justification has been given to increase liquidity thresholds of MMFs, especially not to the levels proposed by the ESRB in its recommendations to the Commission. Despite coming under significant redemption pressures, no MMFs were even required to breach their liquidity thresholds to meet redemptions during the March 2020 crisis, and therefore had more than sufficient liquidity to spare (through existing liquidity thresholds) to meet redemptions. In addition to maintaining the minimum liquidity thresholds required under the MMFR, managers typically maintain a further buffer of liquid assets over this, to minimize the risk of liquidity thresholds being breached, and will typically increase these thresholds during times of market uncertainty, as well as month and quarter ends, when redemptions are usually at their highest levels. Increasing the liquidity thresholds will result in buffers being increased over the new thresholds, likely resulting in funds holding excess liquidity to the detriment of investor returns.

Question 5. (Continued) - Explanations for elements of the MMFR which do not need improvement and where amendments could be detrimental

In this section, the IA gives its explanations for elements of the MMFR which in its view cannot be improved and should not be amended, hence were not selected in the IA's response to question 5:

Disclosure and/or transparency:

We see no reason to for any further disclosure or transparency requirements. Transparency standards for MMFs already greatly exceed those for almost all other fund types (with the possible exception of ETFs). The majority of MMF managers already publish or report portfolio information and risk metrics on a daily basis, which is available to supervisors, and daily inflows and outflows are typically reported to regulators on a daily basis. This information is considered sufficient by investors in MMFs, and should be sufficient to meet the requirements for regular monitoring by supervisors.

In particular, we do not believe the reporting frequency for the more detailed regulatory reports to national competent authorities should be increased beyond the existing quarterly requirements (and annual for smaller MMFs). This will impose significant additional burdens on MMF managers and national competent authorities, and it is unclear that there would be any additional benefit for supervisors beyond the daily information already available to them, as mentioned in the previous paragraph.

Finally, it is also worth noting that due to delays in finalizing the technical standards, quarterly MMF reporting was not operationalized until September 2020. As such, it is not possible to conclude that this reporting was ineffective during the March 2020 crisis as at that time it had not been implemented.

We are not aware of any significant issues arising with AIFMD in respect of securitisation vehicles, and in particular of any securitisation vehicles established by AIFMs that have inappropriately been classified as AIFs. The Securitisation Regulation appropriately addresses securitisation vehicles, and we do not see the need for any further measures to be introduced to the AIFMD in respect of securitisation vehicles.

Limitations on the use of amortised cost method

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Scope:

We do not consider that any changes to the scope of the MMFR are required.