IMMFA

INSTITUTIONAL MONEY MARKET FUNDS ASSOCIATION

IMMFA Insights

The Utility of Money Market Funds to Investors and Issuers

April 2021

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EXECUTIVE SUMMARY

MMFs provide a vital cash management tool for investors and an invaluable source of flexible, efficient funding for a wide range of issuers, thereby contributing to financing the real economy. Prudential regulations mean that there is no appetite on the part of banks to absorb this liquidity via deposits, leading investors to seek alternatives. For many investors it is not a viable option to manage such investments in-house. MMFs allow investors to outsource cash management expertise at minimal operational cost by providing a low-risk alternative that is fully and diversely collateralised by high grade instruments. MMFs are both highly regulated and transparent.

INTRODUCTION

IMMFA is a trade association which represents the European money market fund (MMF) industry, seeking to promote and support its development. IMMFA member funds consist primarily of Low Volatility Net Asset Value (LVNAV) and Public Debt Constant Net Asset Value (PDCNAV) MMFs which are AAA rated by one or more credit rating agencies.[1] Assets under management by IMMFA MMFs were the equivalent of EUR805bn as of year-end 2020, compared to a total market size of EUR1.445tr.[2]

WHY ACCESS TO MMFS MATTERS FOR INVESTORS

The institutional money market fund (MMF) industry provides a vital and efficient liquidity management vehicle for a *wide range of investors* both in Europe and beyond, including corporates, insurers, banks and investment firms, pension funds, asset managers such as private equity or venture capital trusts, local authorities, universities and charities. These investors value the key objectives of an MMF, namely, *to preserve capital and to maintain liquidity; yield is a secondary consideration*.[3] In order to meet these objectives, MMFs operate under several layers of existing Directives and Regulations in the EU.[4]

IMMFA MMFs also have AAA ratings from one or more credit rating agencies. Many institutional investors make the AAA rating a prerequisite in their investment policies. The AAA ratings criteria reinforce the conservative regulatory requirements.

Regulatory changes have significantly reduced the appetite of banks to take in deposits, driving the need for investors to find an alternative. MMFs have filled this need, by providing a scalable, transparent alternative which enables investors to diversify risk and outsource cash management expertise.

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[1] LVNAV and PDCNAV MMFs are MMF categories introduced under European Money Market Reform based on a 'Constant' NAV in contradistinction to a 'Variable' NAV (VNAV). The constant NAV concept is based upon a tradeable NAV per share of one €, $ or £, whereas a VNAV has a variable or 'floating' share price.

[2] ECB data warehouse.

[3] These objectives refer to the IMMFA fund universe and may not apply to other sectors, such as the Standard VNAV market which dominates in France.

[4] European Union Money Market Fund Regulation (EU) 2017/1131, (MMFR).

LACK OF BANK APPETITE FOR CASH DEPOSITS

Banking regulation enacted in the wake of the global financial crisis of 2008/2009 significantly reduced the appetite for wholesale short-term deposits, driving the need for investors to seek alternatives in money markets. MMFs serve an important purpose in providing a suitable alternative in the form of a simple, accessible and low-cost solution for investors wishing to preserve liquidity, spread their credit risk and achieve returns in line with those on wholesale money market interest rates. *Importantly, MMFs also provide investors same day access to cash as they settle on a 'Trade+0' basis. This flexibility is a key tenet of their utility.*

For many investors it is not economically viable to manage their own portfolio. It is operationally burdensome and resource intensive for investors to maintain the necessary expertise in-house, which requires the ability to track a large number of alternative credits, custody arrangements, back-office capacity and relationships with dealers. Only the very largest investors would be able to replicate the diversity and execution of an MMF.

Furthermore, if investors were to manage their investments in house, or use segregated accounts as opposed to pooled investment funds, this reallocation outside the MMF sector would not necessarily enhance financial stability. In the absence of MMFs, liquidity would be shifted to a less transparent and less regulated part of the system. In a systemic event such as March 2020, when the liquidity needs of investors triggered elevated fund redemptions, investors would still have the requirement for cash and would still need to liquidate investments to meet those needs, resulting in the same pressure but elsewhere in the system.

MMFs allow investors to outsource cash management expertise at minimal operational cost by providing a low-risk alternative that is fully and diversely collateralised by high grade instruments, rather than taking single name, concentrated exposure to banks.

THE INVESTMENT ACTIVITY OF MMFS SUPPORTS SHORT TERM FUNDING IN THE CAPITAL MARKETS, INCLUDING BANK FUNDING.

The real economy depends on both bank lending and market-based financing. A strong market-based channel of intermediation in the economy diversifies funding and reduces over-reliance on the banking sector. In so doing it creates diversity for investors, thereby reducing risks to financial stability and improving market resilience. The development of a more diversified financial system, complementing bank finance with capital markets, was a key building block of the Capital Markets Union (CMU) Action Plan; short-term markets and MMFs can play a key role in that aim.

The deep pool of liquidity created by MMFs is a vital source of funding to a wide range of short-term issuers including banks, sovereigns, supra-nationals, agencies, corporates and other financial institutions. These issuers are able to borrow through the Commercial Paper (CP), Certificate of Deposit (CD) or government bill markets by tapping into demand from MMFs. Such short-term debt is easily accessed, attractively priced and flexible, allowing issuers to manage fluctuating or seasonal cash flow and working capital requirements at competitive funding levels and at the same time to diversify their investor base. For most investment grade non-financial borrowers this is more efficient than bank borrowing. For banks themselves it provides an efficient means of financing trading books and represents a crucial alternative source of funding.

Banks dominate the issuance landscape in European short-term markets. Low Volatility Net Asset Value (LVNAV) MMFs, which account for 84% of IMMFA MMFs[5], typically hold at least 70% of their paper in bank debt, thereby providing a vital source of funding to the financial sector. As a response to economic conditions and the pandemic in 2020, many global central banks launched facilities to provide banks with liquidity. The success of these programmes means that banks are currently in a position of excess liquidity. However, these programmes are finite, and as they mature, short-dated funding needs will once again need to be met by the markets through the issuance of short-term debt.

FUNDING OF AGENCY, SUPRANATIONAL DEBT AND ASSET BACKED PAPER

MMFs are also key purchasers of Sovereign, Supranational and Agency (SSA) debt. Increases in fiscal spending due to the Pandemic mean that many SSA issuers have increased borrowing requirements. MMFs have helped to absorb this supply. In Europe it is key to note that Public Debt Constant Net Asset Value (PDCNAV) MMFs, which invest in government debt, predominantly restrict themselves to explicitly sovereign paper and so cannot support the increased supply of agency and supra-national commercial paper. This means that appetite from LVNAV MMFs, which account for approximately 47%[6] of the total European market, is an important component of their funding.

PROVIDING FUNDING TO THE REAL ECONOMY

Corporate funding is still heavily bank intermediated in Europe. Although high grade non-financial paper is very sought-after by MMFs, many corporate issuers lack the requisite credit ratings to access the short-term debt market or to be eligible for AAA rated fund purchases. Providing a channel for bank financing is therefore an important means of indirectly funding the real economy.

MMFs are also key buyers of asset backed commercial paper which is an important conduit for many European businesses (often SMEs and unlisted firms) to access wholesale capital market funding in order to meet their working capital needs.

MMFS CONTRIBUTE TO THE SYSTEM-WIDE FUNCTIONING OF THE FINANCIAL MARKETS

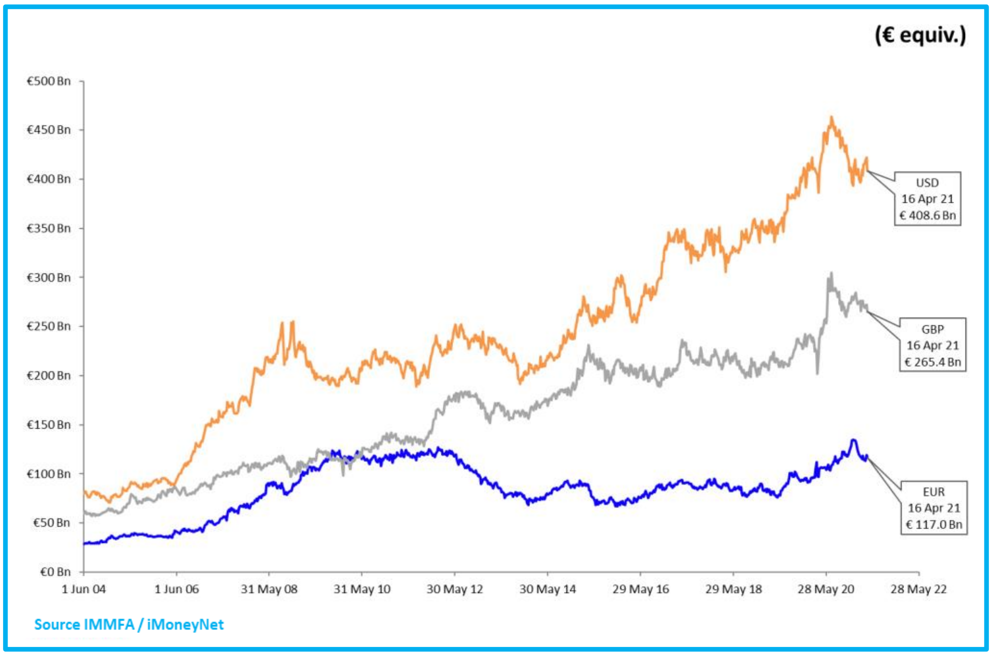
MMFs connect with other parts of the short-term markets ecosystem and are used by pension funds, insurance companies and other types of asset managers to manage their cash flows, thereby enabling cash to move efficiently around the financial system.

[5] The remaining 16% is in Public Debt Constant Net Asset Value (PDCNAV) funds which buy government paper.
[6] ESMA 'Vulnerabilities in money market funds', March 2021, p.62. Total LVNAV MMFs (which include IMMFA MMFs) are said to be EUR591bn of EUR1.248tr, source ESMA, Lipper. As of December 25, 2020, IMMFA LVNAV MMFs were EUR675bn equivalent (sources IMMFA and iMoneyNet), 47% of EUR1.445tr total market (source ECB data warehouse)

GROWTH IN ASSETS UNDER MANAGEMENT

IMMFA AUM have grown steadily since inception and ended 2020 7% higher year on year. Investors swiftly returned to MMFs after markets stabilised, indicating their confidence in the underlying structure.

IMMFA Assets under Management, by Currency, Euro Equivalent



CONCLUSION

Bank regulation has made it less efficient for companies to hold cash with banks who no longer have the appetite to absorb the available deposit volumes. In this environment MMFs provide investors with a much-needed alternative which allows them to reduce the risks associated with the investment of cash, both in terms of preservation of principle and maintenance of liquidity. In so doing, MMFs play a vital role in the eco-system of the short-term markets, providing a range of borrowers with a crucial and efficient source of short-term credit.

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