

MARKET INSIGHTS

ISSUE #2 October 2020

MONEY MARKET FUNDS IN EUROPE – STATE OF PLAY

European money market funds have resisted well the Covid-19 crisis, confirming the effectiveness of the Money Market Fund Regulation in providing investors with a safe vehicle for managing their liquidity.

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The entry into force of the EU Money Market Fund Regulation (MMFR) resulted in a decline in the number of Money Market Funds (MMFs) available to investors, especially in the smaller domiciles. This is due to the more stringent regulatory requirements set out in the MMFR and the increased cost of regulatory compliance. However, the total net assets in European MMFs were hardly affected, reflecting the importance European investors place in European MMFs.

In this report, we also evaluate the impact of the pandemic-induced market stress on the gross sales and redemptions recorded by MMFs in March 2020 and their portfolio holdings and total net assets.

Our evidence shows that despite unique liquidity challenges affecting the market for short-term instruments in the second half of March 2020, all MMFs were fully able to meet investor redemption requests and no European MMF was required to consider the imposition of redemptions fees or gates.

The successful navigation of all EU MMFs throughout the pandemic was in no small part attributable to the enhanced regulatory requirements imposed by the MMFR. As funds were well prepared with high levels of liquidity, investors and regulators had full transparency into portfolio holdings, and MMF managers had tools to manage liquidity throughout. In sum, Covid-19-induced money market volatility proved to be a real test for the EU's MMFR regime and one that the European MMF industry navigated successfully, notwithstanding the very limited effects of the ECB's intervention.

BASIC TYPES OF MONEY MARKET FUNDS

MMFs are open-ended, collective investment schemes, investing in short-term debt instruments issued by a variety of financial and non-financial corporate entities, sovereign governments and related agencies, as well as supranational bodies. The issuance of such instruments constitutes an essential source of financing for these entities and one that often supplements, or replaces, traditional bank financing through loans, especially for non-financial companies. Typically, money market instruments include commercial paper (CP), certificates of deposit (CDs), short term bonds, as well as bank deposits and repurchase agreements (repo and reverse repo). From an investors' perspective, MMFs are very efficient cash management tools, especially for corporates with large cash balances to be diversified away from traditional bank deposits.

The new EU regulation

Following the approval of the MMFR in 2016, the new rules governing European MMFs came into effect between July 2018 (for new MMFs) and January 2019 (for existing MMFs).

The MMFR introduced a specific authorisation procedure for all MMFs that are managed or marketed in the EU, along with prescriptive rules on eligible assets, portfolio diversification, procedures to assess the quality of fund holdings and related governance, risk management obligations, stress-testing, asset valuation and Net Asset Value (NAV) calculation rules. These are complemented by investor transparency and regulatory reporting requirements. Noteworthy is also an explicit requirement preventing any form of “external support” intended to guarantee the liquidity of the MMF or sustain its NAV.

The MMFR distinguishes between three main types of MMFs:

- Public Debt Constant Asset Value (CNAV) MMFs
- Low Volatility Net Asset Value (LVNAV) MMFs
- Variable Net Asset Value (VNAV) MMFs

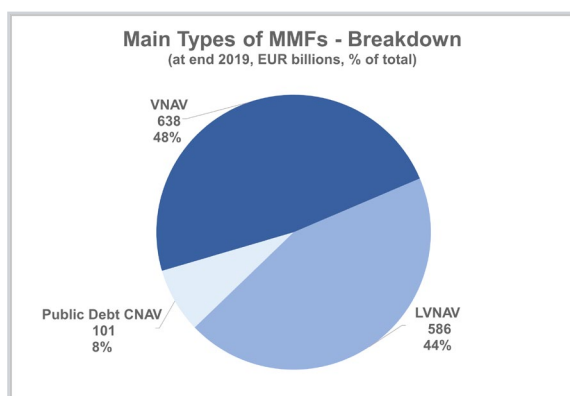
What are CNAV and LVNAV MMFs?

Public debt CNAV and LVNAV MMFs use amortised cost accounting to value their assets and maintain a net asset value (NAV), or value of a share of the fund, at €1/£1/\$1. CNAV MMFs must invest a minimum of 99.5% of their assets in public debt. Units/shares in a LVNAV MMF can be purchased or redeemed at a constant price, as long as the value of the assets in the fund do not deviate by more than 0.2% from par (i.e. the 20 basis point “collar”). CNAV and LVNAV MMFs accounted for 8% and 44% respectively of the UCITS MMF market at the end of 2019.

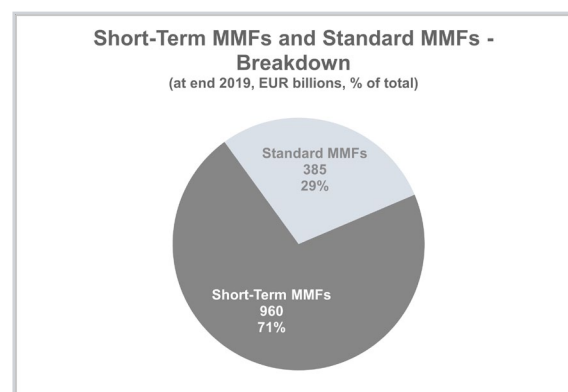
What are VNAV MMFs?

VNAV MMFs refer to funds that use mark-to-market accounting to value their assets. The NAV of these funds varies with the changing value of the assets and - in the case of an accumulating fund - by the amount of income received. At the end of 2019, VNAV MMFs represented 48% of total MMFs.

The MMFR also distinguishes between Short-term and Standard MMFs. Short-term MMFs are required to adhere to tighter investment rules than Standard MMFs. Three types of fund may be categorised as Short-term MMFs: Public Debt CNAV, LVNAV and Short-term VNAV. Standard MMFs must be variably priced and therefore all Standard MMFs are VNAV funds. Short-term MMFs accounted for 71% of the MMF market at the end of 2019, with standard MMFs accounting for the remainder.



Source: EFAMA and IMMFA

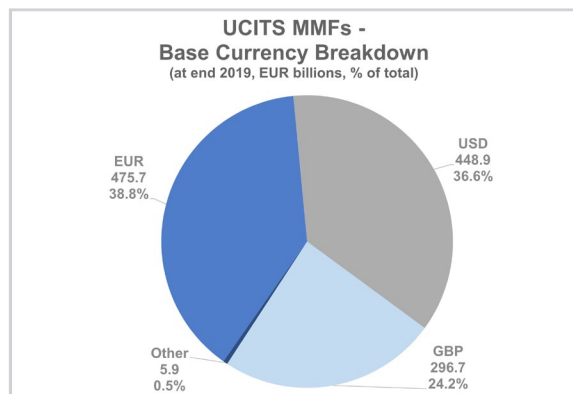


Source: Morningstar

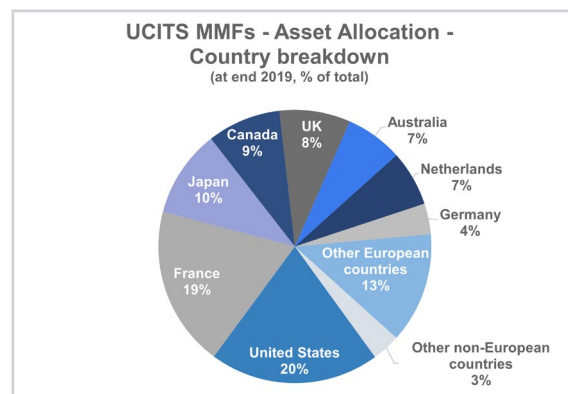
The vast majority of MMFs (96%) were registered as UCITS at the end of 2019, with Ireland holding the largest market share of MMF net assets (44%), followed by Luxembourg (27%) and France (23%). In terms of number of UCITS MMFs, Luxembourg ranked first with 192 funds, followed by Ireland (108) and France (90).

MMFs can also be classified by base currency. Three main base currencies accounted for 99.5% of UCITS MMF net assets at the end of 2019. The euro took first place with 38.8% of net assets, followed by the U.S. dollar (36.6%) and the pound sterling (24.2%).

As regards the portfolio holdings, 20% of the short-term paper held by UCITS MMFs at the end of 2019 was issued in the United States, whereas short-term securities issued in France represented 19% of MMF assets. Japan (10%), Canada (9%) and the United Kingdom (8%) complete the top five. All European countries combined, including the UK, accounted for 51% of total UCITS MMF asset holdings.



Source: Morningstar

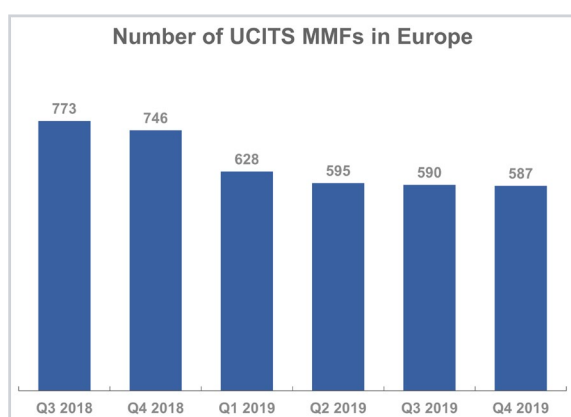


Source: Morningstar

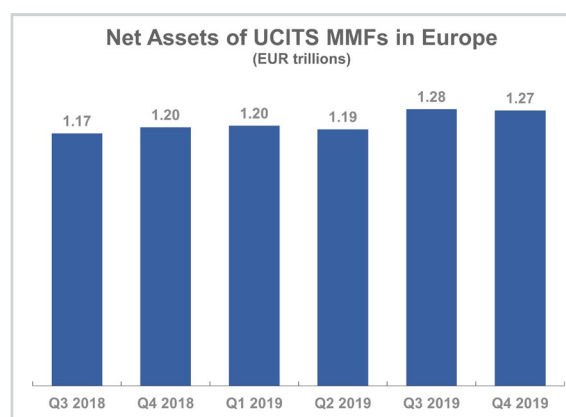
Comparing the asset breakdown by base currency and issuing country shows that MMFs with the U.S. dollar or pound sterling as a base currency invested a substantial proportion of their assets in securities issued in a non-base currency country. Often, countries such as Japan, Australia or Canada (or companies based there) issue short-term debt in a major currency, to attract more international investors. MMFs can also invest in non-base currency denominated debt and hedge the currency exposure. The MMFR does require all non-base currency exposures to be fully hedged.

THE IMPACT OF MMFR ON THE UCITS MMF MARKET

The stringent regulatory requirements imposed by the MMFR resulted in a 16% decline in the number of UCITS MMFs in the first quarter of 2019, as a number of asset managers chose to close down their MMFs or transform them into short-term bond funds. This applied particularly to small MMFs where extra costs of complying with the MMFR was considered to be too high. Despite the substantial decline in the number of MMFs, the total net assets of European MMFs declined by less than 1% in Q1 2019, reflecting the value placed in MMFs by European investors.



Source: EFAMA

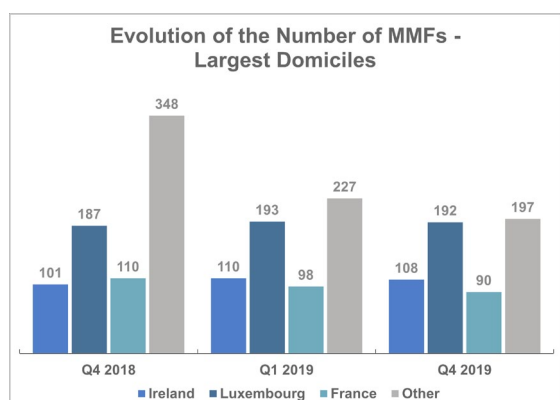


Source: EFAMA

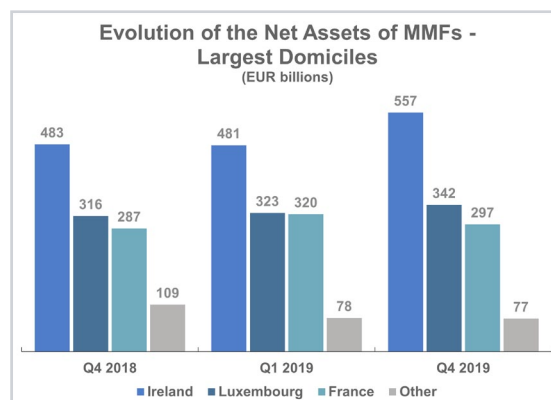
The decline in number of UCITS MMFs was uneven across Europe¹. In Luxembourg and Ireland, the number of funds has remained stable since the end of 2018, whereas their net assets have increased. On the other hand, the number of MMFs domiciled in France has declined, with their net assets remaining stable.

1. See the annex for an overview of all European countries.

In the smaller MMF domiciles, grouped together in the 'Other' category, the number of MMFs dropped significantly; this was the case in Croatia, Greece, Spain and the United Kingdom. In some countries, all MMFs were transformed into non-MMF funds or were closed down; this was the case in Austria, Bulgaria, Poland and Sweden. Between Q4 2018 and Q4 2019 the number of MMFs domiciled in the 'Other European countries' dropped by 43%, with their respective net assets declining by 30%.



Source: EFAMA



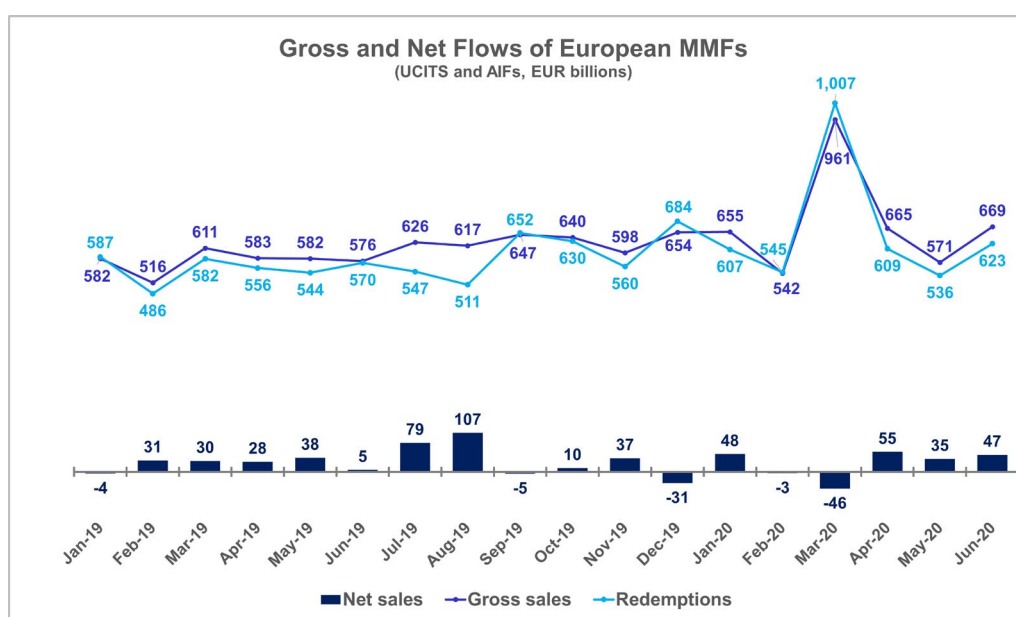
Source: EFAMA

COVID-19 AND MMFS IN THE FIRST HALF OF 2020

As a result of the surge in the number of Covid-19 infections and the lockdown measures taken in early March 2020, investors in European MMFs began to raise cash to prepare for the worst. Consequently, MMFs began experiencing significant withdrawals, far more sizeable than those normally expected to meet companies' end-of-quarter needs. This resulted in a sharp increase in redemptions, which nearly doubled from EUR 545 billion in February to EUR 1,007 billion in March 2020.

At the same time, MMFs recorded a sharp increase in gross sales, from EUR 542 billion in February 2020 to EUR 961 billion in March 2020. This was a result of certain investors moving into MMFs, viewing these as safe, diversified assets that would protect them from the disruptions and volatility in the capital markets.

These developments led to net outflows from UCITS MMFs amounting to EUR 46 billion in March 2020, the highest net monthly outflows ever recorded. Despite this situation, no MMF had to impose trading suspensions and all MMFs were fully able to meet investor redemption requests. No LVNAV MMF breached its 20-basis point "collar". As financial markets started to recover in April, gross sales and redemptions dropped with net sales returning to positive territory.

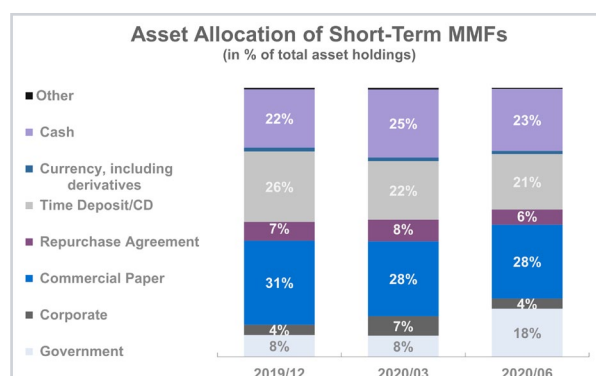


Source: EFAMA

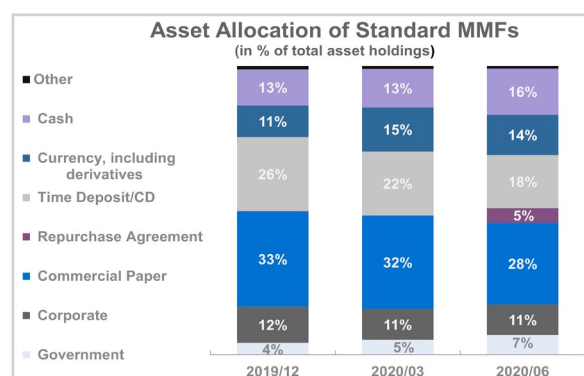
The following points highlight important factors that help explain the reaction of investors in March.

- With the market swiftly rotating into a “risk-off” mode and given investors’ sudden preferences for cash, banks’ corporate clients soon began drawing funds from their revolving credit facilities to meet short-term liabilities and other contingent funding needs. This exacerbated the abnormal cash demands being imposed on all banks, at a moment when they could also no longer meet their funding needs by issuing shorter-term instruments, especially commercial paper.
- As traditional large buyers of financial corporate paper, European MMFs prepared to meet rising redemptions and paired back their purchases of such paper (especially of longer-dated paper).
- As liquidity conditions in the underlying money markets worsened, large institutional investors, such as insurers and pension funds, were also obliged to liquidate their sizeable MMF holdings in order to raise cash to meet increasing margin calls from their derivative counterparties. At the same time, dealer banks’ availability to act as market-makers in supporting money market liquidity - often by buying back CP and time deposits/CDs from MMFs - began to dwindle in the face of rising balance sheet constraints.
- Yet, as the chart on gross and net flows of European MMFs illustrates, a simultaneous increase in gross sales resulting from investors’ preference for safer assets managed to partially offset the severity of the net outflows recorded.

Investors’ reaction to the Covid-19 crisis led to some reshuffling in the portfolio holdings of MMFs. Shares of commercial paper and time deposits/CDs were lower at the end of March 2020 than at the end of 2019, mostly in favour of cash in the case of short-term MMFs and currency/derivatives in the case of standard MMFs.



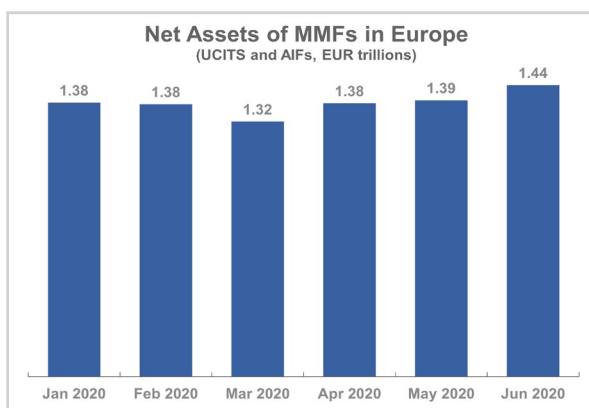
Source: Morningstar



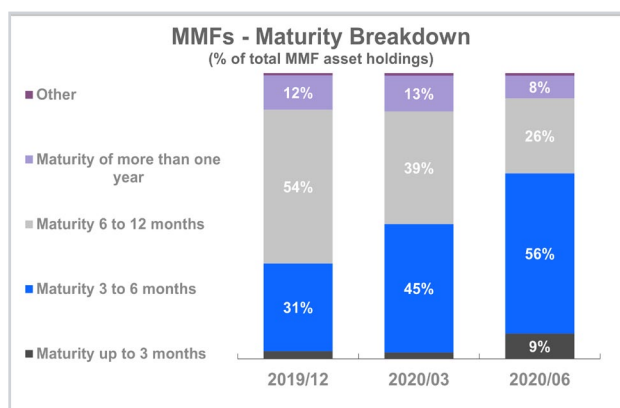
Source: Morningstar

European MMFs also responded to the crisis by adjusting the maturity composition of their asset holdings, towards assets with shorter maturities. The share of 6-12 months debt dropped from 54% at the end of 2019 to 39% at the end of March 2020, whereas the share of 3-6 months debt rose from 31% to 45%. By end of June 2020, the maturity composition had even more tilted to short-term instruments, with the share of 3-6 months debt increasing further to 56% and the percentage of 6-12 months debt dropping to 26%.

Net assets of European MMFs reflected the trends in the net sales. They dropped by more than 4% in March but started to increase again as soon as April to reach EUR 1.44 trillion at the end of June, compared to EUR 1.32 trillion at the end of March and EUR 1.38 trillion at the end of 2019.



Source: EFAMA



Source: Morningstar

CONCLUDING REMARKS

The growth in MMF net assets occurred against the backdrop of resolute actions by governments and monetary authorities across the world to mitigate the impact of the Covid-19 crisis.

However, it should be noted that the ECB's Pandemic Emergency Purchase Programme (PEPP), announced on 18 March 2020, only brought limited relief to European MMFs. Unlike the decisive support offered to money markets in the United States via the creation of several facilities by the Federal Reserve, including the Money Market Mutual Fund Liquidity Facility (MMLF), the ECB's PEPP only covered debt issued by non-financial companies and denominated in euros. With European MMFs invested predominantly in short-term instruments (commercial paper and certificates of deposit) issued by financial institutions and denominated for the most part in non-euro currencies (U.S. dollar or pound sterling) the effect of the ECB's intervention was minimal.

Despite this, European MMFs proved resilient, thereby demonstrating that the financial reforms taken in response to the global financial crisis, including the adoption of the MMFR, have been successful in avoiding a repeat of the 2008 market disruptions.



THE VOICE OF THE EUROPEAN INVESTMENT MANAGEMENT INDUSTRY

EFAMA represents 28 Member Associations, 60 Corporate Members and 24 Associate Members. At end Q2 2020, total net assets of European investment funds reached EUR 17.1 trillion. These assets were managed by almost 34,200 UCITS (Undertakings for Collective Investments in Transferable Securities) and more than 29,100 AIFs (Alternative Investment Funds).

More information is available at www.efama.org. Follow us on Twitter @EFAMANews or LinkedIn @EFAMA.

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EU transparency register: 3373670692-24

ANNEX

	Number of UCITS MMFs				UCITS MMF net assets (EUR millions)			
	Q4 2018	Q1 2019	Q4 2019	Q2 2020	Q4 2018	Q1 2019	Q4 2019	Q2 2020
Austria	2	0	0	0	32	0	0	0
Belgium	8	9	10	10	9,615	6,452	2,843	10,720
Bulgaria	1	0	0	0	0.3	0	0	0
Croatia	21	7	2	2	956	120	1	1
Cyprus	0	0	0	0	0	0	0	0
Czech Republic	1	1	1	0	265	425	624	0
Denmark	1	1	1	1	33	33	33	33
Finland	5	2	1	1	1,299	370	244	229
France	110	98	90	90	287,087	320,333	296,742	305,785
Germany	16	13	13	13	2,518	2,175	2,083	2,245
Greece	22	14	9	9	528	476	336	325
Hungary	0	0	0	0	0	0	0	0
Ireland	101	110	108	109	483,351	481,147	557,305	595,973
Italy	8	5	4	3	3,189	2,414	1,772	2,355
Liechtenstein	31	31	34	34	3,097	3,162	3,474	3,316
Luxembourg	187	193	192	189	316,024	323,136	341,979	406,183
Malta	1	1	1	1	48	46	39	27
Netherlands	0	0	0	0	0		0	
Norway	48	50	53	49	10,523	10,934	10,472	9,363
Poland	43	0	0	0	10,946	0	0	0
Portugal	2	2	2	2	182	182	247	244
Romania	0	0	0	0	0	0	0	0
Slovakia	0	0	0	0	0	0	0	0
Slovenia	4	3	3	3	79	61	56	74
Spain	38	35	9	9	6,800	7,714	3,774	3,929
Sweden	32	0	0	0	20,218	0	0	0
Switzerland	18	18	18	17	15,492	16,220	19,471	21,151
Turkey	23	22	22	24	2,121	4,580	5,970	5,354
United Kingdom	23	13	14	14	21,534	23,047	25,378	24,040
Europe	746	628	587	580	1,195,936	1,203,028	1,272,845	1,391,346