irish funds

Irish Funds
Ashford House,
18-22 Tara Street
Dublin 2 D02 VX67
t: +353 (0)1 675 3200

5th Floor,
Square de Meeûs 37
1000 Brussels
t: + 32 (0)2 791 7693

e: info@irishfunds.ie
w: irishfunds.ie

Response to the Consultation Paper issued by the FSB in relation to Policy Proposals to Enhance Money Market Fund Resilience

Introductory comments

Introduction

The Irish Funds Industry Association ("**Irish Funds**") is the representative body for the international investment fund community in Ireland. Irish Funds represents fund managers, administrators, depositaries, transfer agents, professional advisory firms and other specialist firms involved in the international fund services industry in Ireland. Ireland is the largest European fund domicile for money market funds ("**MMFs**"), with net assets in Irish domiciled MMFs amounting to EUR 589 billion or approximately 45% of total European domiciled MMF assets (source: Central Bank of Ireland, March 2021 and EFAMA, Q1 2020). All MMF product types (LVNAV, PDCNAV and VNAV (short-term and standard) MMFs) are established in Ireland. The most predominant product type by assets is LVNAV (approximately 78% of total net assets), followed by PDCNAV (approximately 17%) and VNAV (approximately 5%) (source: Central Bank of Ireland, 2020). Given the prevalence of MMFs in Ireland, this Consultation is particularly important for Irish Funds and we welcome the opportunity to comment.

Comment re format of our response

We understand that the G20 meetings in October 2021 mean that the Financial Stability Board is operating on a very challenging timeline with respect to the Consultation and that it can only provide a very limited period of time for the submission of responses. In order to ensure that the views of the members of Irish Funds are provided to you prior to the deadline, we have therefore not sought to address each of the specific 18 questions posed in the Consultation and instead we have focussed on the key points we wish to make.

Specific comments

Key vulnerabilities

The Consultation describes as key vulnerabilities the susceptibility of MMFs to sudden redemption requests and their exposures to hard-to-sell assets. It goes on to note that policies aimed at enhancing the resilience of MMFs "could be accompanied" by reforms relating to the short-term funding markets ("STFMs").

We believe that the primary cause of the stresses experienced by MMFs in the March 2020 period was the inefficient functioning of STFMs and that such inefficiencies should be considered to be the key vulnerability and therefore the primary focus of reform efforts.

It is worth recalling that the European regulatory regime for MMFs was significantly enhanced in 2019 with the primary goal of strengthening the resilience of MMFs, to ensure that failure of a MMF would not cause contagion. The March 2020 crisis has been a real life proving ground for the EU money market fund reforms in this regard. Given that MMFs have proven sufficiently resilient to withstand this challenge

(ie, no EU MMF failed to meet redemption requests), it can be said that the EU MMF reforms achieved their goal and strengthened the resilience of MMFs.

However, MMFs do not exist in a vacuum and their ability to meet redemption requests inevitably depends on functioning STFMs. What the EU MMF reforms did not seek to do was tackle the issues in those STFMs and so these remain a vulnerability, for all market participants including MMFs. As the March 2020 liquidity pressures cannot be attributed to the design or functioning of MMFs, the focus of post-pandemic financial reforms should not be on them but instead on the broader money markets and in particular those segments thereof in greater need of increased resilience.

Extraordinary official sector interventions

European MMFs did not benefit from any official interventions targeted to support the MMF industry and, looking back at the March 2020 period, it is clear now that no such interventions were required. Official interventions in Europe were aimed at restoring confidence to the economy as a whole (or even more specifically, to the non-financial sectors of it). The fact that such interventions were necessary to support the economy as a whole cannot itself reasonably justify the imposition of additional requirements on MMFs.

Demand for cash

The Consultation accurately states the outflow data for MMFs in March 2020 but needs to consider all of the causes for such outflows. While pandemic-related demands for cash on investors were obviously relevant, so too were the typical quarter-end demands witnessed at every quarter end (related to, for example, the needs of corporates nearing quarter-ends in accounting terms or pension funds needing to make payments). It would be a mistake to conclude that the increase in redemption demands between February 2020 and March 2020 related solely to pandemic-related cash requirements.

Substitutes for MMFs

Broadly speaking, the Consultation accurately describes a range of potential MMF substitutes, as well as their main drawbacks. However, we would note the following:

- First, the Consultation states that "*Direct investment does not offer liquidity transformation, as investors directly bear the cost of liquidating assets, so this substitute is likely more resilient than MMFs*". While it is accurate to state that investors would bear the cost of liquidating assets, they would also be less able than an MMF to liquidate assets. Such investors (pensions, insurance companies etc.) would therefore be less able to meet their own requirements (margin calls, cash flow) with the result that this substitute could have a greater systemic risk than that posed by MMFs.

- Second, any potential substitute needs to be considered from the perspective of three different stakeholders: investors, issuers and regulators. While any given substitute may meet the needs of one those, we do not believe there is a substitute which offers an acceptable, comparable outcome to MMFs for all three of them.

Link between regulatory thresholds and fees/gates/suspensions

We agree with the Consultation conclusion that the removal of the explicit link between regulatory thresholds and the potential imposition of fees, gates or temporary suspensions would reduce the likelihood of pre-emptive runs by investors in MMFs. As such, we support this proposal.

Regulatory imposition of fees/gates/suspensions

We do not support the proposal that regulators be empowered to impose fees or gates. Such a power would incentivise investors to redeem pre-emptively before regulatory intervention and would defeat the purpose of removing the link between regulatory thresholds and fees/gates/suspensions. Furthermore, we do not believe that regulators would be comfortable or capable (given the practicalities of making these decisions in tight time frames) to assume these powers.

Swing pricing / anti-dilution levies

- There would be significant operational challenges to implementing a mechanism which passes liquidity costs directly to investors via an adjustment to the NAV (swing pricing) and we do not believe such a mechanism would achieve the stated objectives, for the following reasons:

- The primary driver of redemption requests in March 2020 was investor need for cash and the primary impediment to meeting that need was the market wide liquidity crisis. Swing pricing would not change that.

- Timing of Decision: As the decision to implement swing pricing (where partial swing pricing is used) would have to take place after dealing cut-off, it would be difficult to implement where an intraday, advanced payment model is utilised (noting that this is an important function and feature of MMFs for many investors).

- Visibility and Pricing: At present and absent changes to the STFMs, there is not enough visibility into pricing (and pricing is not quick enough) to enable an accurate assessment of liquidity costs in the time that would be needed in order to calculate an accurate swing factor. Fixed charges would address this problem but would not accurately pass on liquidity costs to investors.

The alternative to swing pricing is anti-dilution levies (i.e., entry/exit charges imposed separately to the NAV). European MMFs already have the ability to impose such levies, albeit this ability is tied to liquidity thresholds. Once decoupled from mandated liquidity thresholds, anti-dilution levies can be used to impose liquidity costs on redeeming investors during times of market stress without creating a cliff-edge effect which incentivises early redemption. The alternative to mandated thresholds for such fees is fund-specific, manager-designed parameters. The Consultation suggests that such parameters could be set by regulators, but regulatory authorities are typically not better placed than managers to make decisions of this nature and it is not clear on what basis a regulatory authority would feel suitably placed to make such a decision.

Elimination of stable NAV funds

It is worth bearing in mind that notwithstanding the availability of variable NAV MMFs in the EU, investors have chosen to invest over half of EU MMF assets in stable NAV MMFs (public debt constant NAV MMFs and low volatility NAV MMFs). Investors clearly see a benefit from these MMF structures. If either structure was to be eliminated, that should only occur where it has been clearly proven that the risk of those structures outweighs the benefits which they bring to investors. But that is not the case - events during the COVID-19 March crisis have simply not proven that the elimination of constant NAV funds is necessary or warranted. On the contrary, these MMF structures have demonstrated resilience during the COVID-19 March crisis and have not experienced issues that were not also felt by variable NAV MMFs and investors in short-term markets generally.

In Europe, consideration around the elimination of constant NAV type MMF structures was carried out at length and in detail for a number of years while a new regulatory framework for MMFs was drafted

and negotiated. This debate should only be reopened if significant new evidence has been discovered in the interim which brings to light facts or data which was unknown at that time. But there is no such evidence and in fact, the resilience demonstrated by constant NAV MMFs during the COVID-19 March crisis (including the fact that no such MMFs imposed gates, suspensions or redemption fees) proves that the previous reforms achieved their goal of strengthening resilience.

Redemptions in kind

The Consultation refers to redemptions in kind as a potential liquidity management tool. Redemptions in kind take significant amounts of planning, as assets are transferred across custodians. In addition, some assets are non-transferable (deposits, repo) and not all MMF investors will be capable or willing to open and maintain a custody account to receive assets. As such, redemptions in kind will almost inevitably take longer and cost more than simply liquidating and providing cash and therefore we do not believe they are a suitable liquidity management tool.

Limits on eligible assets and investor behaviour

The Consultation notes that this option would diminish the yields offered to investors and result in a modest shift to substitutes. It is worth noting that while a given investor may hold less assets in MMFs, they are still likely to redeem first from MMFs in times of need. As such, the MMF will potentially see a higher percentage of redemptions, as that investor seeks to redeem the entirety of its holding, as opposed to only part.

Global proposals

The Consultation considers the extent to which authorities should seek to align MMF reforms across jurisdictions. We agree with the point noted in the Consultation that there are considerable differences across jurisdictions, in terms of investor profiles, currency and available substitutes, and we believe that these differences mean that there is no acceptable one-size-fits-all policy response. That having been said, certain specific parts of an overall policy response may be suited to more than one jurisdiction, e.g., the removal of the explicit link between liquidity levels and the imposition of liquidity management tools in both Europe and the US.

Minimum capital at risk / capital buffer

The cost of either a minimum balance at risk or capital buffer would likely outweigh the utility, leading to investors moving to substitutes. In addition, there are several uncertainties regarding how either a minimum balance at risk or capital buffer would operate in practice. For instance:

- How would MBR size, length of holding, release, use, be determined?
- Could an investor ever get all of their money out? Presumably yes during normal times, but how are they defined?
- The legality in a given jurisdiction of the subordination of shares may not be clear
- MBR shares would be difficult to value – presumably they are worth less than regular shares, but how much so? This would have an impact in a number of ways, including on constant NAV funds and the accounting treatment of MMFs
- How would a buffer be funded? How would that impact yield or a level playing field between managers?