



# **The European Association of Corporate Treasurers**

Interest Representative Register ID: 9160958318-89

## **Position Statement on the Commission Proposal for Regulation of Money Market Funds**

**29 October 2013**

### **The European Association of Corporate Treasurers (EACT)**

*The EACT is a grouping of national associations representing treasury and finance professionals in 18 countries of the European Union. We bring together about 12,000 members representing 6,500 groups/companies located in the EU. We comment to the European authorities, national governments, regulators and standard-setters on issues faced by treasury and finance professionals across Europe.*

*We seek to encourage the profession of treasury, corporate finance and risk management, promoting the value of treasury skills through best practice and education.*

*Our contact details are provided on the final page of this document.*

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### **1 – Introductory comment**

The EACT notes the publication by the European Commission of a Proposal for a Regulation on Money Market Funds (MMFs) on 4 September 2013.

The EACT understands the Commission's aim of ensuring financial stability and the concern that some MMFs might be systemically important when subject to important runs. We however advocate for a legislative response which is proportionate to the risks involved and which would preserve the availability of MMFs. Access to MMFs is important not just for European businesses but for organisations such as charities seeking to invest cash in a highly liquid and low risk medium.

The EACT supports a stable financial sector that meets the essential service requirements of the real economy. As a result of the financial crisis, an unprecedented regulatory overhaul of the financial system has been and is still underway. Whereas many of these measures are necessary in order to stabilise the financial system, it is becoming increasingly clear that some have major impact and unintended consequences for the real economy as the end-users of financial services.

## **2 – Our concerns over the proposal for Regulation**

Money Market Funds are an **important cash management tool for businesses**: these need to be able to deposit their short-term cash balances whilst strictly adhering to the principle that security (lowest level of risk) is paramount, followed by liquidity (fast access to cash by liquidating the investment) and then followed by yield. In the current very low interest rate environment yield is of very limited importance and certainly subordinate to security and liquidity.

The use of MMFs is not limited to the commercial sector; in many Member States investment of surplus funds in MMFs is a key activity for charities and public as well as ‘third’ sector organisations. For all these economic actors MMFs have historically offered minimum risk, good access to cash and acceptable returns.

**It is our view that there is one fundamental flaw in the Commission’s proposal. This concerns the removal of external credit ratings [section 2.1 below]. We are also concerned that by introducing what is in effect an obligatory requirement for a capital buffer to be held by Constant Net Asset Value (CNAV) funds the proposal will eliminate the CNAV product, which for some participants in the real economy is an acceptable and important investment medium [section 2.2 below]. Taking these two points together MMFs will lose their role in cash management. We believe that the overall result will have a damaging impact on the real economy and increase rather than decrease financial systemic risk [section 2.3 below].**

### ***2.1 - The role of credit ratings***

There appears to be a fundamental error in the Commission’s articulation of the issues around the use of credit ratings. The Regulation rightly stresses the need for an MMF to be rigorous in its assessment of the credit quality of instruments in which it plans to invest (Recital 29). We support the Commission in this view, even though it stretches credulity to imply (as the Commission does) that without regulatory action an MMF might in some way be casual about the risks of the investments it makes.

The proposal then makes an unexplained (and inexplicable) leap from its view on the need for internal rigour in risk assessment to introducing a bar on MMFs soliciting or paying for a rating by a credit rating agency (Article 23).

Investors in MMFs appreciate the oversight provided by independent ratings and incorporate external ratings criteria in their internal policies and controls; ratings then act as a filter to weed out completely inappropriate funds. Investors do this because it is impossible for them to support internally the standard of credit analysis undertaken by credit rating agencies. Sound corporate governance requires that the investment of an organisation's assets – and especially financial assets such as cash – is safeguarded as far as possible by processes that are robust and externally verifiable, rather than wholly dependent on subjective internal judgment as the Commission proposal appears to suggest. Ratings very effectively support this governance principle.

The description above applies to organisations of all sizes within the real economy and in at least some Member States. It is especially true of SMEs, charities and public or third sector bodies. In the absence of ratings it becomes effectively impossible for these organisations to invest in MMFs because the scale of the analysis would be too large. Whilst this outcome may be welcomed by some, the legislators need to reflect on whether the resultant concentration of short-term investable liquidity in a small number of acceptably rated banks globally is desirable and whether this actually increases global systemic risk.

The Commission's proposal seizes on the legislative drive to reduce dependence on ratings – the principles of which we support – whilst at the same time failing to understand how ratings are actually used by the real economy. MMF ratings help to reduce risk and therefore play their own vital part in supporting the growth objectives of the EU. If the soliciting of credit ratings was to be prohibited, real economy users of MMFs would need substantial time to adjust their internal policies and practices and therefore the assessment of the appropriateness of a limitation on the use of credit ratings should be deferred to the review of the Regulation.

***We strongly urge the legislators to delete Article 23 and add an additional sub point to Article 45 as follows:***

***(f) assess the possibility of limiting the use of credit ratings by MMFs and its impact on MMF investors***

## ***2.2 - The introduction of a capital buffer***

The regulation introduces (Article 29) a requirement for CNAV funds using amortised cost accounting to hold a 'NAV buffer' of 3%. No such requirement is imposed on VNAV funds. This proposal is made as a necessary and sufficient measure to protect investors against 'run risk' in CNAV funds. As a proposal it ignores the more measured approach being taken by authorities in the United States, who are focusing on rules and processes (such as liquidity gates) that institutionalise protection against run risk without imposing capital requirements on MMFs.

The MMF industry has clearly shown in its responses to the proposal that the cost of such a capital buffer renders CNAV funds unviable, not just in the current interest rate environment but also in any reasonably foreseeable change in that environment. It is expected that in response CNAV funds will be converted to VNAV funds. Whilst VNAVs are widely used in many Member States, in others the investment policies pursued by such funds – and the absence of a stated commitment to maintain a fixed value – renders the funds unacceptable for real economy participants that refuse to take such risks with short-term cash balances.

A further adverse consequence arises from uncertainty about whether VNAV MMFs would in all Member States qualify for accounting treatment as ‘cash or cash equivalent’. The alternative – which is that VNAV funds are classified as short term investments on companies’ balance sheets – would make such investments even more unattractive in those Member States where the accounting treatment is more rigorous. If companies nonetheless invested in VNAV MMFs this could potentially have an adverse impact on their own credit ratings, as the investor perception would be that the companies involved are now more risky as a result of holding less free “cash” than before.

The Commission appears to believe that run risk is an issue but that it is *only* an issue for CNAV funds (as no proposals are made that would result in a requirement to hold capital buffers for VNAV funds). There is no logic in this approach unless it is simply seen reflecting an intention on the Commission’s part to eliminate CNAV funds by whatever means possible.

There are some real economy participants who consider that run risk is at least as great an issue for VNAV as for CNAV funds. Those users of MMFs who take this view are content to rely on their own internal management controls and on external credit ratings to monitor and minimise this risk as far as possible. If the legislators are convinced by the argument that MMFs create systemic risk (which we are not) then logically the same approach to capital buffers should apply to VNAV as to CNAV funds.

We believe that a more appropriate approach to reducing the perceived risk in both CNAV and VNAV funds is to require better disclosure and transparency; we would also support adoption of some of the elements seen in the US, such as liquidity gates and liquidity fees. The latter address run risk both by making withdrawals difficult and by placing the cost of withdrawals unequivocally with the investors involved rather than with all the MMF’s investors.

***We strongly urge the legislator to make the following amendments:***

- ***Delete Articles 29 to 34 and the second, third and fourth sentences of article 37(5)***
- ***Replace the above-mentioned Articles with:***
  - ***Revised Article 29 (could also be new Article 37(6) in the transparency section): "A CNAV MMF other than a Government Liquidity CNAV MMF [Government Liquidity MMF: a MMF which***

***aims to achieve its investment objective by investing its assets in the highest quality securities issued or guaranteed by governments, supranational or public international bodies and may enter into reverse repurchase agreements (cash investments) which are collateralised with the same high quality securities on a short term basis] or manager of a CNAV MMF other than a Government Liquidity CNAV MMF shall publish on at least a weekly basis the mark-to-market price of the CNAV MMF and the proportion of weekly maturing assets of the CNAV MMF"***

- ***Revised Article 30: "A CNAV MMF other than a Government Liquidity CNAV MMF or manager of a CNAV MMF other than a Government Liquidity CNAV MMF shall impose a 1% redemption fee if the proportion of weekly maturing assets of the CNAV MMF falls below 10%. A CNAV MMF other than a Government Liquidity CNAV MMF or manager of a CNAV MMF other than a Government Liquidity CNAV MMF may impose a temporary suspension of redemptions to facilitate the introduction of such a fee. The proceeds from the redemption fee shall be invested in the CNAV MMF to the benefit of remaining shareholders. If, after 30 days, the liquidity of the CNAV MMF is not repaired, the CNAV MMF shall be liquidated"***

### ***2.3 - The impact on the real economy***

We make the point above that the bar on credit ratings (Article 23) will make it impossible for most real economy organisations to invest in MMFs, whether these are CNAV or VNAV.

We also identify that in those member states where CNAV funds are currently acceptable but VNAV funds are not, the conditions imposed by the Commission's proposal (Articles 30 and 31) will have the effect of eliminating the CNAV product. This essential tool for real economy cash management will be closed off and many CNAV investors will not be willing to switch to VNAV funds.

The Commission has itself admitted (FAQ 14 of the FAQ document supporting its regulatory proposal<sup>1</sup>) that if CNAV investors removed their funds from the sector *"This could [therefore] have some negative repercussions on the entities that rely on the MMFs to get their funding"*. The Commission uses this as an argument to support the capital buffer approach but in doing so ignores the fundamental issues of viability (let alone the issue of the loss of credit ratings).

We consider that the proposed Regulation will result in the following scenario:

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<sup>1</sup> New rules for Money Market Funds proposed – Frequently Asked Questions: Commission Memo/13/764

- CNAV funds will rapidly close; any which choose to remain will drain capital from banks (to create capital buffers) leading to a leveraged reduction in funding available to support core economic recovery objectives
- Investors will refuse to commit funds to either CNAV or VNAV funds without the comfort of credit ratings
- Short-term liquidity in real economy organisations (which would previously have been invested in MMFs) will become concentrated in a small number of banks with the highest credit ratings, increasing the 'too-big-to-fail' problem; many of these banks will be run from outside the EU
- Real economy issuers that have been reliant on MMFs as investors will put further pressure on banking systems struggling to support the growth agenda
- The EC is committed to try to increase the use of capital market funding in Europe. This Regulation will undoubtedly reduce capital market activity
- Overall financial systemic risk will increase rather than decrease as a result of the Regulation

***We suggest that the legislators need urgently to take account of the flaws in the regulatory proposal as well as likelihood of the scenario described above.***

## **The European Association of Corporate Treasurers**

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