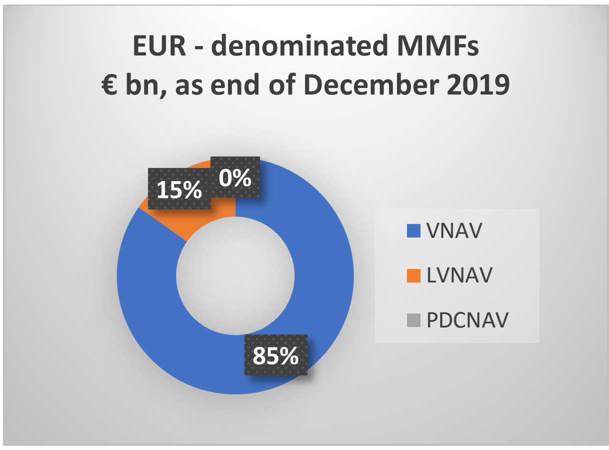
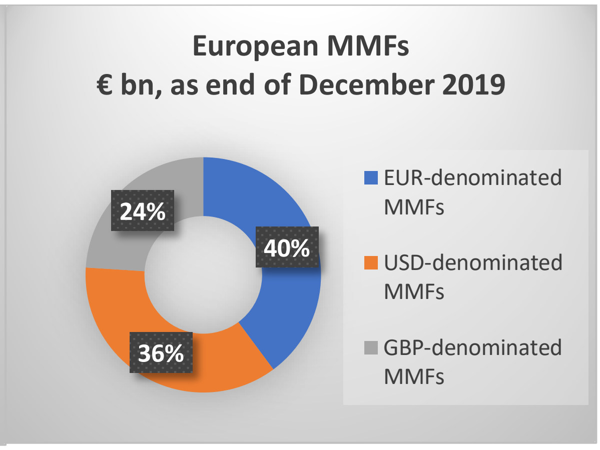
Highlights regarding French MMFs during the COVID-19 crisis

SOME FIGURES[1]

Money market funds are important investment vehicles in France. At the end of August 2020, the net assets of French MMFs reached € 361.6 bn, including € 303 bn for standard MMFs and € 58 bn for short-term MMFs. They amount to 41% of French retail funds managed within the European mutual fund format (UCITS). They are all managed as VNAV (Variable NAV) funds and they make the bulk of Euro-denominated MMFs throughout Europe.





Euro-denominated MMFs represent € 528 bn as of end of December 2019 and they are predominantly VNAV funds (€ 448 bn, ie 85%), the rest are LVNAVs (€ 80 bn) and PDCNAVs (€ 0,1bn). 62,5% of euro-denominated MMFs are standard MMFs and 37,5% are short-term MMFs. 40% of the total € 1325 bn of MMFs domiciliated in Europe are Euro-denominated MMFs.

OUR ANALYSIS : MAIN TAKE-AWAYS

Despite important redemptions, especially in March 2020 (-52.4 bn euros), French VNAV money market funds managed the outflows and proved resilient during the COVID crisis, as explained in the French AMF's 2020 Markets and Risk Outlook[2]. Despite the significant net outflows in March, overall inflows

[1] Data sources: for French market data, the source is Banque de France and for European market data, the source is Broadridge. Figures/metrics are calculated by AFG.

[2] French AMF's 2020 Markets and Risk Outlook : The main difficulties in fact appeared in the segment of money market instruments, where the market froze up, posing the problem of the valuation of money market funds at the very time when they were faced with significant redemption requests: about €50 billion for French funds, i.e. as much as during the 2007 crisis, but within just two weeks this time (versus a semester in 2007). Non-financial companies contributed to this exit move in order to meet their cash requirements, and also because of a probable

over the first 8 months of 2020 amount to +48.6 bn euros. Taking into account the lack of visibility induced by the evolution of the pandemic and to deal with possible increased redemption requests, the proportion of cash in portfolios has been increased since March 2020 to reach an average of 16% of the fund's net assets.

The **main conclusion** of this episode regarding French VNAVs is linked to two points:

1- Unlike the 2008 episode, no issue is to be reported linked to the composition of the portfolio, especially in terms of the quality of assets; funds are sane and resilient in their construction and composition.

2- Exogenous shock to money markets : As the sanitary Covid-19 crisis took in March a global dimension and impacted both real economy and financial markets, money markets underwent a sudden series of brutal imbalances where

- many corporate withdrew their money (from credit lines, deposits and MMFs) to face a brutal drop in their revenues due to the economic quasi shutdown trigged by the pandemic
- in consequence, MMFs stopped purchasing MMIs and requested bids from the banking system to buy some of their holdings in order to rebuild their cash buffers
- eventually, banks – already impacted by their corporate clients' funding requests - could not anymore absorb these flows, thus concentrating the liquidity stress, in a context that got worse with the looming quarter end.

ELEMENTS OF ANALYSIS

Underlying market halt: MMFs are dependent on the well-functioning of the underlying market (money markets) to operate. They are an important player of this market, but not the only one. Many other actors are part of this ecosystem and are investing in money market instruments CDs, CPs, govies, short term bonds, repos, etc… we can't assume that MMF can keep providing liquidity whilst the functioning of the underlying market is totally impaired. Back to some shutdown episodes in the US, even US government MMFs were not able to provide liquidity in case of sharp redemptions due to the absence of liquidity in the Tbills market. **Suggestion** : AFG thus totally agrees with FSB's suggestion regarding the **increase in the transparency to be given to investors about the nature and risks of MMFs** : *"…any documents used for marketing must include a statement that the risk of loss of the principal is to be borne by the investor. More transparency around the conditions under which the risk can crystallise and disclosure to investors could enable investors to better assess the risks they are exposed to, via their investments in MMFs."*

PEPP/ CSPP: we recall the usefulness of an efficient coordination between the industry of MMFs and authorities (including central banks: whether national or European), especially in times of crisis. Indeed, MMFs are players in money markets, where ECB and national central banks have the power of intervention to obtain orderly functioning markets (as well as for market issuance or secondary markets with the necessary continuous presence of intermediation, ie market banks). In particular, ECB programs like PEPP, CSPP are more than welcomed to restore confidence in the market. The announcement of PEPP had immediate effects in terms of reopening of market quotes. **Suggestion** : Even if each crisis is different, we think however that the experience of this crisis should be useful to lead to **more reactivity and transparency on the operational details** (as well as to trigger a program

preference for bank deposits seen as safer in this crisis. This dash for cash explains why all assets including gold saw their value decline in the depths of the crisis.
The re-correlation of these asset prices in the event of a major shock illustrates the limits of the benefits of diversification. Central banks' intervention was ultimately able to restore the functioning of the market for money market instruments, where both issuance and trading were able to resume at the same time. Since French money market funds have in the meantime seen the return of net inflows, their investment in the most liquid and short term assets has substantially increased as a precautionary measure.

or to halt it when the market has taken over). It is useful to identify the ultimate beneficiary of the program by category and be able for instance to **dedicate a part of such a program to MMFs**, as they are fully part of this market. The Fed support came in to offer a liquidity window to Prime US MMFs, knowing that there was no doubt on the assets' quality. Also, the improvement of the market sentiment by the announcement of the PEPP on 03/18 came quite late vis a vis the early signs of the crisis visible already in late February/early March through signs of liquidity tensions and spread widening for instance. In current markets, spikes of volatility and market sell off are very sharp and quick; 18 days before intervention seems too long. We suggest a more thorough and real time monitoring of market indicators enabling, if needed, central banks' action at earlier stages. We also suggest **more coordination between Central Banks** as well as more intensive sharing of common intelligence in order to **be able to use a same wide array of types of intervention.**

Regarding possible **behavioural "run" effects** as described by the Fed paper "Runs and Interventions in the Time of COVID-19: Evidence from Money Funds" it is easier for VNAV funds not to be prone to such effects, which have a valuation as closest as possible to the markets to avoid any incentivisation to a first mover advantage because of a constant NAV type cliff effect. We question the fact that "fees and gates" Prime and LVNAV funds mechanisms would be solely responsible for a possible cliff effect. They were precisely added to avoid the valuation gap to the constant NAV, identified as a source for a first mover advantage.

Precise calendar of market halt and fund net outflows : before any conclusion is drawn, a subtle analysis should be done by type of money market funds (LVNAV, VNAV) but also other types of funds (including ETFs) and by region… regarding the net outflows and the timing at which it took place, in parallel to the market halt ; our view is that French VNAV funds did not experience anticipated outflows, but only redemptions linked to the need for cash concomitant to the market halt and the urgent need for financing working capital needs because of massive drops in revenues due to a generalized lockdown especially for corporates[3] which was very specific in that crisis;

Need for cash : French VNAV MMFs are subscribed mainly by institutional investors. At quarter end for instance, their outflows are generally important and are dealt in anticipation in a business as usual manner by the asset managers. During the crisis, the need for cash expressed by some of them, especially corporates, amounted to high levels of redemptions from MMFs. MMFs are liquid funds that were used in priority compared with other types of assets, even if the redemption was high almost in all asset classes. Other European countries, where MMFs were not part of the funds' spectrum, suffered outflows from other types of funds. If the general COVID 19 crisis (which is a sanitary crisis and in no way inherent to money markets) would have continued, the need for cash would have been expressed also by redemption in the other asset classes. We would thus like to highlight that it should be recognized that it is also "normal" to expect that MMFs are experiencing earlier redemptions compared to other asset classes and where a major shock arises it is expected that risks are re-correlating and all markets suffer alike. This is also why, **while acknowledging the important economic role played by the MMFs, the reaction of regulators should not over-emphasize MMFs' case in this global crisis.** Like the French AMF explained: *"The re-correlation of these asset prices in the event of a major shock illustrates the limits of the benefits of diversification. Central banks' intervention was ultimately able to restore the functioning of the market for money market instruments, where both issuance and trading were able to resume at the same time. Since French money market funds have in the meantime seen the return of net inflows, their investment in the most liquid and short term assets has substantially increased as a precautionary measure."*

[3]AMF: "they were faced with significant redemption requests: about €50 billion for French funds, i.e. as much as during the 2007 crisis, but within just two weeks this time (versus a semester in 2007). Non-financial companies contributed to this exit move in order to meet their cash requirements, and also because of a probable preference for bank deposits seen as safer in this crisis. This dash for cash explains why all assets including gold saw their value decline in the depths of the crisis."