

Resilience of the commercial paper market

The ICMA Commercial Paper and Certificates of Deposit Committee (CPC) released a report on the [European Commercial Paper and Certificates of Deposit Market](#) in the wake of the global pandemic. A lack of liquidity in the commercial paper market at that time led to issuers having difficulty issuing commercial paper, while banks reined in their balance sheets and investors turned to high-rated credits, SSA issuers and shorter durations. In spite of this, the US commercial paper market remained open and with the intervention of European central banks, money market funds (MMFs) did not need to introduce redemption fees or gates, or suspend redemptions, and a crisis was averted.

Notwithstanding that outcome, regulators have been considering ways to increase the resilience of MMFs against future shocks, including looking at the Money Market Fund Regulations (MMFR) and money market instruments themselves. For instance, a recent [report on the MMFR](#) from the European Commission to the European Parliament concluded that: (i) the MMFR passed the liquidity stress test of COVID-19, but there is scope to further increase the resilience of MMFs (such as decoupling liquidity management tools from regulatory liquidity thresholds), and (ii) there is scope to increase the resilience of short-term markets generally.

A functioning capital market depends on liquidity; in commercial paper, liquidity is adequate but thin. In primary terms, although it is an oft-used funding tool, there are a limited number of dealers involved in commercial paper programmes, it is not significantly profitable, and dealers are subject to regulatory constraints (Liquidity Coverage Ratio) and risk limits which affect their ability to make a market. Secondary trading is very limited, and with short-term maturities, most investors are buy-to-hold, so liquidity is largely provided by dealer banks buying back previously-placed paper.

With a view to enhancing liquidity in commercial paper, the FSB and FCA have been undertaking a series of targeted roundtables, including an issuer roundtable, in which ICMA was invited to participate. This resulted in a good understanding of the importance of commercial paper as a funding tool, and a rich discussion on measures to increase liquidity in the secondary markets. The outcome of this work is at an exploratory stage for the moment, with potential output expected later in the year. Initial suggestions have included more and better transparency on commercial paper issuances, potential use of all-to-all platforms (mindful that issuers rely on dealers – especially in times of stress – for market colour, so it is very much an intermediated market, and platforms would not *per se* be a source of liquidity) and diversifying the commercial paper investor base to encourage corporate issuers to become liquidity providers.

With respect to transparency, a survey conducted by ICMA of the CPC concluded that, although more and better transparency would be helpful, it would not revolutionise primary issuance and could in fact be inadvertently detrimental, and it would not necessarily catalyse any further secondary market activity. As for extending the pool of liquidity providers to corporates, a short survey of the [ICMA Corporate Issuer Forum](#) concluded that corporates might be encouraged to invest directly and trade in and out of commercial paper, rather than through MMFs, if there were better liquidity which would allow divestment at all times, direct investment yields out-performed MMFs, and there was better price visibility. Therein lies the obvious conundrum that the regulators are grappling with.

Elsewhere, ESMA in its paper [Regulatory Constraints and Money Market Funds Reforms](#) has also suggested reforms related to market structure and transparency, including incentives for dealers to provide liquidity in time of stress. ESMA has also proposed that improvement in liquidity of money markets could come from other sources, including external support from MMF sponsors (mindful of creating contagion between the MMF and its wider banking group), a liquidity exchange bank, or central banks (although this might encourage MMF managers to take more risks, and might lend MMFs a more cash-like veneer due to a public backstop). Finally, it suggests setting a limit on possible sales by MMFs by type of instrument.

Standardisation of documentation has also been mooted as a possible liquidity enhancement measure; but it is unlikely that this alone would revolutionise the market, or increase liquidity. Documentation is generally well established in larger markets, such as US commercial paper, STEP and NeuCP, and elsewhere is subject to local domestic nuances. So standardisation of documentation is more likely to be effective only as one of a series of incremental steps, if the correct balance is struck between a potentially global effort and certainty of a successful outcome.

Whatever the result of the regulatory deliberations, ICMA stands ready and well-placed with the CPC to assist with the delivery of any agreed mandate on commercial paper. Any members who are interested in our work on commercial paper and certificates of deposits are encouraged to join the CPC.



Contacts: Katie Kelly
katie.kelly@icmagroup.org
