Financial Stability Board
Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

16th August 2021

HSBC Asset Management Response to FSB Policy Proposals to Enhance Money Market Fund Resilience

Dear Sir or Madam,

HSBC Asset Management is HSBC's core investment business dedicated to managing assets for institutions and individuals worldwide, with USD612.4 billion in total assets under management. As part of the HSBC group, we have local liquidity expertise across both core and emerging markets, with Liquidity assets accounting for USD 133.0 billion (or 21.7% of HSBC Asset Management's total assets under management). We have more than 25 year's experience in management money market assets, and operate global and local funds across 10 currencies with investment professionals located around the world. This includes funds domiciled and regulated in Europe, the Americas and Asia. We operate LVNAV (in Europe), CNAV and VNAV funds, in both credit and public debt strategies.

HSBC Management treats Liquidity management as a separate discipline and has allocated dedicated resources accordingly. There are teams of portfolio managers, credit analysts, risk managers and client service teams focused on our Liquidity business. This focus, and deep experience managing a wider range of fund types, across a number of different markets, means we are well positioned to understand the needs of our investors and the markets in which we operate.

We are pleased to have the opportunity to respond to this important consultation. We are supportive of any and all efforts to consider potential policy measures to improve the resilience of MMFs and short term funding markets. We have carefully considered the presentation of vulnerabilities and each of policy proposals set forth in your report and provided responses below. We are happy to support continued engagement with you on this report.

Yours sincerely,

Jonathan Curry

Global Chief Investment Officer Liquidity

1. **What are the key vulnerabilities that MMF reforms should address? What characteristics and functions of the MMFs in your jurisdiction should be the focal point for reforms?**

Our key observations from market crisis of 2020

- MMFs withstood a major market dislocation in 2020, continuing to provide liquidity and stability of principal (in the case of LVNAV and CNAV MMFs) despite the lack of liquidity provided by 'market makers' and issuers.
- The ability of MMFs to continue to function as designed during the crisis was driven by the regulatory reforms implemented in 2016 in the US and 2019 in Europe, the actions of managers of MMFs in their management of MMFs during the crisis and, indirectly in the case of EU MMFs, the actions of regulators.
- It is overly simplistic to assert that the actions of ~~EU~~ regulators supported all MMFs and was therefore the reason that MMFs were able to continue to function during the crisis. For example, for LVNAV funds that primarily invest in bank debt, the program put in place in the EU had very limited direct benefit as bank debt was not eligible for the program. However, the general improvement in market liquidity fostered by the program was indirectly supportive.
- Our experience with our client base was that investors were solely focused on our funds WLA levels. The 'bright line' of 30% weekly liquid assets ('WLA') that was created by US regulation and the linkage of the level of WLA to the need for a Fund's Board to consider the implementation of a liquidity fee or gate was the major driver of investor focus on this level. Some investors decided to redeem from any MMF that approached this level due to this 'bright line' exacerbating the liquidity challenges for some MMFs.
- The fund construct (Public Debt Constant Net Asset Value PDCNAV, Low Volatility Net Asset Value LVNAV, Variable Net Asset Value VNAV) was not a factor in whether a MMF faced challenges due to redemptions. In some cases, both VNAV and LVNAV MMFs faced heightened redemptions. It is worth noting that where heightened redemption activity did occur it tended to be currency specific. For example, in the case of LVNAV funds it was focused in some USD funds and in the case of VNAV funds it was focused in some EUR funds.
- The orderly functioning of the major money markets was halted for a period during the market wide crisis in 2020. The actions taken by certain central banks to support markets during this period, and the direct support to MMFs provided by the Federal Reserve to US domiciled MMFs was welcome. This provided the catalyst for the wider money markets to begin the process of normalisation that ultimately occurred over a period of a few months. This normalisation allowed monetary policy transmission to operate as desired, short-term funding markets to deliver the funding required and for cash to move around the system as designed. Whilst it is critical to ensure that regulation minimises the probability of market breakdowns occurring, to a degree they are inevitable. It is in this type of scenario that the type of actions taken in 2020 are necessary to restore the orderly functioning of markets for the benefit of financial system stability and wider society. With an ecosystem as large as a major global money market and the significant benefits of such central banks actions, the concept of moral hazard in relation to one type of market participant is deminimus.

2. What policy options would be most effective in enhancing the resilience of MMFs, both within individual jurisdictions and globally, and in minimising the need for extraordinary official sector interventions in the future?

Our key recommendations for further reform of MMFs and the wider money markets

- Remove the 'bright line' that has been created by the most recent MMF regulation in relation to the 30% WLA that has made this, and the DLA buffer, unusable. Ensure this can be used consistently across all jurisdictions and the decision remains with the fund board.
- Explore the principle of an asymmetric 'dynamic' WLA level that is adjusted in relation to changing individual client concentration and client type concentration levels. The principle should be explored in partnership between regulators, providers of MMFs and other key stakeholders.
- Maintain liquidity fees as the optimal anti-dilution levy for MMFs. The liquidity fee mechanism delivers the protection for investors that remain invested in an MMF during a period of redemptions, act as a 'circuit breaker' if applied by removing the incentive to redeem, are operationally feasible and maintain the utility value of an MMF to investors. For further detail see our response to question 10.
- Maintain the troika of PDCNAV, LVNAV and VNAV fund constructs. Empirical evidence supports the fact that the fund construct does not change the sensitivity of a MMF to redemptions. Maintaining the three constructs preserves the utility value of MMFs for all investors and ensures that MMFs continue to provide diversified short-term funding to the real economy.
- A review on the current operating model of the major global money markets to identify opportunities to make the money markets more resilient and better able to function normally during periods of market stress. Due to the breadth of participants in the money markets and the key role that regulators play in their operation the review should be coordinated or sponsored by regulators.

3. How can the use of MMFs by investors for cash management purposes be reconciled with liquidity strains in underlying markets during times of stress?

We are of the view that MMFs are appropriately structured to satisfy large outflows owing to the requirement to run 10% in daily liquidity and 30% in weekly liquidity. The funds had sufficient liquidity to fund redemptions but were unable to use that buffer because of the bright line created by the tie to fees and gates. Removing this link removes the cliff edge effect and will allow funds to operate the liquidity buffers as intended. Given the short-term nature of the underlying holdings and the mandated levels of daily and weekly maturing assets combined with the limitation on portfolio duration, short-term MMFs generate large amounts of liquidity organically, without the necessity to sell assets.

There was a lack of liquidity in the underlying markets during the height of the Global Pandemic, but feel this was largely related to post Global Financial Crisis banking reforms. Those reforms clearly had a positive effect on reinforcing bank balance sheets, which was evident during the recent crisis, however, banking reforms also reduced bank appetite for cash deposit taking (increasing demand from investors for alternatives such as MMFs) but more importantly reduced bank balance sheets and thus the provision of secondary market liquidity – a fact that should not be understated when analysing the larger picture of market illiquidity.

Despite the reduction of bank balance sheets, we believe there is ample liquidity under normal market conditions. MMFs typically employ a buy and hold strategy where naturally liquidity from maturities will service redemptions. This is clearly demonstrated with LVNAV funds that are required to hold a minimum of 30% in weekly maturing assets and rarely have to sell assets under normal market conditions. In reality much of the Weekly Liquidity Asset (WLA) requirement is fulfilled by overnight assets such as reverse repurchase agreements and overnight deposits, further enhancing the natural liquidity of a MMF. On occasions where MMFs are required to sell assets, such as to rebalance a portfolio, there is sufficient liquidity to execute (even for the largest of funds). MMFs can reasonably expect to sell paper back to the dealer from which it was originally purchased, or in some cases the issuer directly, at a minimal bid-offer spread. The dealer can typically find another buyer for the paper or may hold the paper for a short while. However, the banking reform referenced earlier has made it much less likely that dealers will run their own positions and hold paper to maturity or at best not to the scale this activity was conducted prior to the banking reforms.

In addition, the lack of secondary market trading volumes should not be read to imply that money market instruments such as certificates of deposit and commercial paper are 'illiquid'. As with any instrument its liquidity will be determined by the levels of supply and demand in the market. In our experience, we acknowledge that at the peak of the Covid crisis, price spreads on various short-term funding markets, including CPs and CDs, reached 2008 levels exceeding by more than 10x price spreads in normal conditions. The Covid stress event was marked by a need to sell similar types of assets across investors in the money markets, which given the limited absorption capacity of the underlying markets, created some price spread widening. It is worthwhile to mention that this is not limited to this type of instruments but to most financial assets. The Covid crisis resulted in a significant risk in terms of volatility and price spread, but also exchanged volumes which demonstrate market tension and not necessarily a liquidity deadlock situation. However, in normal market conditions, we observe very narrow price spreads demonstrating a high demand for this type of instruments and ease of selling if required. Our data supports our view that there is a balance in supply and demand in the different money markets we operate in globally during normal market conditions leading to the ability to sell assets at a narrow bid / offer spread. A market dislocation can to lead to an imbalance in supply and demand leading to a reduction in liquidity and the subsequent widening of the bid / offer spread. A period of less liquidity during a period of market stress should be expected and does not imply a lack of liquidity at all times. We are happy to share this data if this would be helpful.

In fact, the FSB report itself recognizes that bid / ask spreads are narrow which in the opinion of the report is a driver of the lack of economic incentive for dealers to make a market in money market securities. The report therefore supports our view that a narrow bid / ask spread is a reflection of a liquid market and therefore contradicts the assertion elsewhere in the report that CP and CD markets are illiquid in all market conditions.

The observation regarding increased liquidity risk from portfolio overlap is not one with which HSBC agrees with. The conclusion that illiquidity was partly a function of all MMFs holding the same names over simplifies the issue and detracts from the real issue that in times of stress MMFs, and other investors, are all seeking liquidity at the same time. The failure of the dealer community to provide enough liquidity was not primarily related to concentration of issue holdings, but to the previous mentioned change in banking regulations, combined with a dramatic increase in the demand for liquidity from all investor types, not just from MMFs. It is also worth noting that the illiquidity experienced was not confined to bank issued paper, with MMFs experiencing difficult selling high quality agency paper and, in some cases, sovereign paper. The issue at the peak of the crisis in late March was exacerbated by quarter end where, even in normal conditions, market liquidity is lower.
We are supportive of efforts to improve liquidity in the money markets, including efforts to incentivise the dealer community to provide more liquidity and reviewing the operating model of the major global money markets. Given the report recognises that banks may be unable to make markets in periods of stress when flows are substantial and one-directional (page 21), it is important to explore what can be done to alleviate stress at such times. We would add that in a market based financial system it is not possible to eradicate all risk.

Forms, functions and roles of MMFs

4. **Does the report accurately describe the ways in which MMFs are structured, their functions for investors and borrowers, and their role in short-term funding markets across jurisdictions? Are there other aspects that the report has not considered?**

The report represented a more balanced assessment of fund structures and it was helpful to that the consequences of the options presented considered the risk that cash could shift out of MMFs creating issues for funding. It was also helpful that it provided insight into the role of dealers and their incentives, though we feel the report fails to follow through on the implications of these observations. We suggest that further work is required to ensure the implications are clear.

Through our response we have highlighted the proposals that threaten the utility of the product or force contraction in yields could make it less attractive to investors e.g. swing pricing or non daily dealing etc. That lack of utility will drive investors elsewhere in the system introducing new risks or transferring existing risks into a more opaque and less regulated part of the system. Disaggregated investments will not necessarily represent less systemic risk.

We note that there is a strong rationale for investors valuing MMFs' cash-like qualities. MMFs represent the least risky investment vehicle for those aiming to preserve capital and have access to liquidity. The robust regulatory framework and the high levels of transparency give comfort that these objectives will be met. MMFs are also specifically designated 'cash equivalent' for accounting purposes in certain jurisdictions, including France and the USA. However, investors recognise that MMFs carry risk and are not guaranteed products (a distinction which some of the proposed reforms would blur). EU MMFR contains provisions to ensure that these risks are clearly communicated. The European investor base for MMFs is predominantly institutional and institutional investors are likely to have a more sophisticated understanding of the risks associated with their investments. There is also little evidence to suggest that other cash-like instruments such as direct investments (proposed as a substitute) performed better in the crisis.

HSBC Asset Management

5. **Does the report accurately describe potential MMF substitutes from the perspective of both investors and borrowers? To what extent do these substitutes differ for public debt and non-public debt MMFs? Are there other issues to consider?**

The report successfully identifies some potential substitutes for MMFs that were worthy of consideration, however, we do not see substitutes being as readily available as the report suggests, nor as offering equivalence in terms of either utility or risk profile.

Whilst substitutes for investors may arise to fill a vacuum left by MMFs, we see a strong likelihood of such substitutes introducing new risks or transferring existing risks into a more opaque and less regulated part of the system. As noted in the report on page 16, accounting rules are a crucial consideration with regard to whether such substitutes would count as 'cash equivalent', a vital factor for many corporate investors.

We encourage regulators globally to reverse their current approach of considering MMFs as part of the problem to considering MMFs as part of the solution. All the alternatives suggested would ultimately create greater fragmentation of the investor base in STFMs, the consequence of which is a reduction in the ability of regulators to support the delivery of functioning STFMs, a reduction in transparency for regulators and all key stakeholders in STFMs, a rise in the cost of funding for issuers in the STFMs and a reduction in returns for equivalent or lower risk for investors in STFMs.

We consider the various alternatives below.

From the perspective of investors.

Deposits

Growth in bank deposits as a substitute to MMFs is unlikely in our opinion. The Basle III reforms have materially reduced the appetite for non-operational deposits for the majority of developed market banks globally. Whilst the report notes this as a factor 'in some jurisdictions' we believe it over estimates the appetite of banks to absorb assets in deposits that are currently invested in MMFs. This factor is exacerbated by the fact that for investors to have equivalent liquidity to investing in a MMF, all deposits would have to be placed overnight or at best within 1-week. Basle III rules penalise shorter dated deposits further reducing the appetite of banks to accept deposits of shorter maturity. Consequently, this could encourage investors to extend the duration of the deposits they place in order to find an investment option for their liquidity thus bringing a different type of liquidity risk into the system. The lack of capacity in the bank deposit market could also force investors to place deposits in lower credit quality banks for investors that are arguably less equipped to do so.

Given bank aversion to short-term assets which do not benefit their regulatory ratios, we do not see deposits as a scalable alternative. In our view, the report is therefore wrong to conclude that financial stability can be improved by banks taking on more deposits as MMFs decline.

Repo

The issues we highlight for bank deposits as a substitute also apply to repo. A lack of capacity negates the use of repo and, for any limited capacity, encourages investors to extend duration increasing their liquidity risk and to place deposits with lower credit quality banks and accept low quality collateral to attract banks to borrow via repo markets. Repo also brings with it added operational complexity and risk that many investors are not equipped to manage.

Short-term Bond funds

We do not see short-term bond funds as a substitute for MMFs. Short-term bonds are not designed as an investment option for an investors working capital. The minimum investment horizon for this type of fund is typically 6-months or greater. The investment horizon for an investors working capital is typically much shorter than this. As such, any investment solution for working capital should have liquidity risk management as a key part of its design and risk control processes.

Periods of market stress over the last 15 years have also demonstrated that these type of funds can also experience redemption activity. Investors with genuine cash needs redeem working capital cash and in a scenario where this is invested in short-term bond funds liquidity risk is exacerbated given the absence of liquidity buffers in these type of funds.

The majority of investors require their working capital to be invested in investments that can be considered cash and cash equivalent. Short-term bonds funds globally and EU Standard MMFs are not considered cash and cash equivalent, except in France where the latter are considered cash and cash equivalent. This factor meaningfully reduces an investor's appetite for short-term bond funds as a viable investment for working capital.

Direct Investment

Direct investments would be significantly less transparent to regulators and would bring with it other drawbacks noted above such as create greater fragmentation of the investor base in STFMs, the consequence of which is a reduction in the ability of regulators to support the delivery of functioning STFMs, a rise in the cost of funding for issuers in the STFMs and a reduction in returns for equivalent or lower risk for investors in STFMs. As noted by the report (page 17), direct investment 'does not offer liquidity on demand' which, the report concludes, mitigates systemic risk. This lack of access to liquidity could create other pressures in the economy, such as failure to pay supply chains or dividends, or to meet margin calls, resulting in defaults.

The practical considerations of direct investments must also be considered. Many investors are not equipped to operate day-to-day in these markets and are not able to justify the cost of doing do. Maintaining the necessary expertise in-house is operationally burdensome and resource intensive, requiring an ability to track a large number of alternative credits, custody arrangements, back-office capacity and relationships with dealers.

As with bank deposits, direct investment does not offer the investor the same level of diversification (as noted on page 25), which will further diminish its appeal and force investors to take additional unwanted risk.

The regulatory disclosures and reporting requirements to supervisors under the extensive provisions of EU MMFR mean that MMFs offer regulators far greater transparency than disaggregated investments whether they be in cash, other fund types, direct investments or segregated accounts.

Public Debt MMFs

The major drawback of public debt MMFs as a substitute to Prime MMFs is the lack of supply of short-term government debt eligible for these funds in the majority of the major currency MMFs globally. For example, IMMFA GBP LVNAVs and short-term VNAVs were £236bn in AUM as of 16th July 2021. UK T bill outstandings are currently only £62.5bn and they are in high demand from banks as HQLA as well as from pension funds and local authorities. Similarly, the pool of very highly rated and liquid government securities in Euro is essentially limited to German *Bubills* and French *Bons du Trésor á taux fixes* (BTFs). Of the five major MMF currencies globally (USD, EUR, RMB, GBP and INR) it is only the USD short-term government debt market that has had the capacity to become an alternative to Prime MMFs.

In addition to this practical consideration, the lower returns offered by public debt MMFs relative to Prime MMFs and other potential substitutes may discourage investors from selecting these funds as an alternative. Although this switch did occur at the time of the implementation of US MMF reforms in 2016.

New Substitutes

The suppression of MMFs could, as the report suggests, lead to the 'emergence of new substitutes' (page 17) but it is hard to see how any such new products, which must try to replicate the key features of MMFs, could present less systemic risk given the exceptionally robust levels of regulation and the high levels of transparency surrounding MMFs. For instance, in the case of ETFs, these would be fully invested, have a longer settlement cycle, and would still rely on market makers who would have the same reluctance to intermediate CP and CDs in a liquidity crisis. Also, ETFs are typically not treated as cash equivalent for accounting purposes, an important limiting factor.

We concur with the observation that 'potential substitutes also exhibit vulnerabilities' (page 18). As investors are forced to take on more risk, the attraction of new unregulated asset classes, such as crypto currencies, should also not be dismissed.

In our view it is highly likely both existing and new substitutes would simply 'shift the risks to other parts of the financial system' (page 17). We note the report concludes that the potential for such risk shifting should not delay reforms, though we would suggest a cautionary approach given that disaggregating funds may not mitigate systemic risk.

From the perspective of Borrowers

Firstly, it is important to note that with regard to the fact that MMFs reduced their asset purchases during the crisis and the related impact on borrowers, this was entirely prudent given the fiduciary duty of MMFs to their shareholders.

In general, the demise of Prime MMFs would concentrate funding by short-term investors in a smaller range of borrowers in the short-term debt markets. This is simply driven by the fact that for many short-term investors they do not have the credit analysis expertise to be as diversified across the range of borrowers globally. For a small number of borrowers this phenomenon would increase their access to funding but at the cost of far greater number of borrowers that would see a reduction in their access to funding.
For working capital requirements such as funding receivables, non-financial issuers currently able to issue CP or, in the case of smaller companies, fund via bank sponsored ABCP programmes, may be forced to look to companies which offer supply chain financing (such as Greensill). These companies are significantly less regulated and transparent.

The report suggests that an additional source of funding may be large institutional investors, such as insurance companies and pension funds, that normally invest outside money markets (pages 17 and 26). It is very unclear why such investors would be motivated to invest in money markets if they have not done so to date. On the contrary, it is probable they would be involved already if the products suited their objectives, given the market is mature. Short-term investments are unlikely to suit the risk-return objectives of such longer-term investors. Some such large institutions are already investing their short-term cash in direct investments. The absence of MMFs will not give existing investors access to new names or opportunities, therefore their current credit limits will continue to cap exposure. The incentives to invest in money market instruments (MMIs) will not be increased by reforms unless they result in substantially higher yields, which would be a sub-optimal outcome for borrowers.

From a borrower's perspective, new funding sources may be fragmented, unreliable and come from unregulated sources. This may create additional risk rather than making funding more resilient in times of market stress.

Vulnerabilities

6. Does the report appropriately describe the most important MMF vulnerabilities, based on experiences in 2008 and 2020? Are there other vulnerabilities to note in your jurisdiction?

The report focuses on the 'structural vulnerability stemming from liquidity mismatch'. The liquidity transformation gap in a MMF is already very narrow relative to other investment vehicles and indeed deminimus when compared to banks where an average loan book is measured in years whereas a MMF is measured in days. The roll down of the portfolio is rapid and despite the very limited maturity transformation the funds are still holding at least 30% of the portfolio in overnight and assets up to 1 week that can be liquidated within 1 working day. Therefore, funds are running a significantly higher buffer to cover liquidity requirements than banks do.

The key is to be able to utilise that liquidity and the existing tie between liquidity buffers and gates and fees created the bright line that meant managers could not utilise the buffer as intended. Many redemptions in March 2020 were driven by genuine cash needs for operating purposes or margin requirements, not only by investors pre-emptively anticipating the potential imposition of fees and gates. Delinking would remove the incentive to redeem pre-emptively thereby mitigating the regulatory threshold vulnerability. Redemptions driven by a genuine need for cash can be met from structural liquidity, provided funds can access that natural liquidity. Additionally, in the event that stress exceeds certain boundaries, the use of a liquidity or redemption fee could allocate the costs of redemption more fairly and be calibrated to reduce first mover advantage. The inability to sell assets would be far less material if MMFs could use their buffers, as was intended, to meet redemptions during times of stress.

The report correctly distinguishes between the impact of a credit crisis and a liquidity crisis (page 18). In our view, the EU MMFR successfully mitigated the idiosyncratic risks associated with a credit crisis. Those reforms also intended to make MMFs more robust from a liquidity point of view, but the buffers could not operate as intended. This should now be addressed with a view to enhancing resilience further.

The report also locates a 'key vulnerability' in the underlying instruments held by private debt MMFs which are said to be illiquid even in normal conditions. This conclusion extrapolates a lack of liquidity from the low levels of trading in normal markets, whereas these are buy-to-hold, short maturity instruments which by their nature trade infrequently. Whilst we wholeheartedly support efforts to improve the underlying liquidity of CP and CDs, particularly in Europe where the markets are fragmented, by looking at the market infrastructure surrounding them, we note that they were not the only instruments to suffer.[1] The illiquidity was a function of a much broader market dislocation and MMIs could not be expected to be immune to circumstances which equally affected other far more liquid markets, including even US treasuries. In our view, the inability of banks to provide intermediation was a major factor in this and at least partly attributable to prudential regulation. In our view the key vulnerability is not in the instruments themselves so much as the ability of the short-term credit markets to function adequately in a stress event.

The report goes on to state that stable NAV funds are particularly exposed to credit risk (page 23). We would suggest that the stable NAV MMF sector, which consists of AAA[2] rated funds subject to 10% and 30% DLA and WLA liquidity requirements plus a range of stringent criteria, is significantly *less* risky from a credit perspective. The standard VNAV model allows for much more

[1] The ICMA are working on a White Paper which looks at the fragmentation of European CP and CD markets.
[2] AAA MMF rating.

duration risk and longer final maturities, combined with *lower* levels of liquidity. With respect to the NAV collar, we restate that despite severe market challenges no funds broke their NAV collars. We note also that LVNAVs only amortise the portion of their portfolio which is under 75 days and less than 10bp away from the mark to market price. Furthermore, the overwhelming majority of LVNAV MMFs, which are managed by IMMFA members and therefore subject to the IMMFA code of practice, mark to market their holdings on a daily basis through independent third-party sources. Despite elevated redemptions in USD denominated LVNAV MMFs, average NAV deviations for AAA rated MMFs remained well within the collar. In the case of Sterling, NAV deviations were muted and on average were positive. (Euro NAV deviations are not strictly comparable as most yields are negative, meaning that shares 'decumulate'. See Appendix A for NAV deviations)

Policy proposals to enhance MMF resilience

7. Does the report appropriately categorise the main mechanisms to enhance MMF resilience? Are there other possible mechanisms to consider? Should these mechanisms apply to all types of MMFs?

We agree that the report is thorough in considering a wide range of mechanisms, their variants and their potential impact.

We are of the view that the removal of the ties associated with WLA is the clearest way to make MMFs more resilient by making liquidity buffers accessible to meet redemptions in times of stress. Current MMF regulation is very effective at mitigating idiosyncratic risks and delinking would further enhance resilience.

The proposals around capital buffers, LEB, sponsor support are more typical of banking regulation and not appropriate for investment funds. It is important to maintain a clear distinction between these two types of regulation to continue to ensure that MMFs are properly perceived as a non-guaranteed product by investors. Proposals of this type are designed to absorb credit losses rather than address liquidity risk. The ability to absorb credit losses was addressed in Europe under EU MMFR and previous reforms in the US when such options were considered but ruled out.

8. Does the assessment framework cover all relevant aspects of the impact of MMF policy reforms on fund investors, managers/sponsors, and underlying markets? Are there other aspects to consider?

We agree that the report gives consideration to all aspects but it is our view that it overestimates the extent to which the suppression of MMFs would propagate the ready growth of alternatives such as bank deposits (see our response to Q5 for more detail). In our view it is highly likely both existing and new substitutes would simply 'shift the risks to other parts of the financial system' (page 17). The report assumes that the cumulative effect of this implies less risk which we do not agree with. Shifting risk around the system to areas with less transparency and regulation and may actually increase systemic risk should cash investors park cash in less liquid alternatives.

The increased costs and removal of key elements of the utility MMFs could undermine the viability of MMFs.

9. Are the representative policy options appropriate and sufficient to address MMF vulnerabilities? Which of these options (if any) have broad applicability across jurisdictions? Which of these options are most appropriate for public debt and non-public debt MMFs? Are there other policy options that should be included as representative options (in addition to or instead of the current ones)?

We believe a combination of the removal of ties between regulatory thresholds and the imposition of fees, gates and suspensions combined with the use of liquidity fees (as opposed to swing pricing) to be the most appropriate solution.

The other options addressed in the answer to Q10 either challenge the utility of the product or threaten its viability and as such they are not appropriate options. This will have the effect of reducing investor choice and / or redirecting the cash into alternatives that may be less regulated or less transparent.

The current regulation for Public Debt CNAVS (PDCNAV) does not require further enhancement. Investors made pre-emptive redemptions from Prime MMFs into PDCNAVs because of the perceived risk of gates / fees on Prime funds created by the link to liquidity thresholds. This behaviour was observed in both the US and Europe where investors who are headquartered in the USA, did not differentiate on the different triggers around gates and fees between European and US domiciled funds. The highly liquid nature of the short-term high quality public debt like UST Bills at all times (including times of market stress) combined with the WLA calculation afforded by the MMFR makes (made) breaching the 30% WLA trigger virtually impossible. PDCNAVs offer a lower risk option which can be valuable at times of 'flight to quality'. It should be noted that neither EUR nor GBP PDCNAV funds are at the scale to absorb the same migration of cash.

10. Does the summary assessment of each representative option adequately highlight the main resilience benefits, impact on MMFs and the overall financial system, and operational considerations? Are there any other (e.g., jurisdiction-specific) factors that could determine the effectiveness of these options?

Same day settlement is a key feature of MMFs and the proposals around swing pricing or delayed settlement are not workable thereby threatening the utility of the product. The other options, namely capital buffers, liquidity exchange bank membership and minimum balance at risk will reduce the viability of MMFs. Without MMFs, investors will seek to place cash into other areas of the market which may not benefit from the same transparency or risk management.

We fully support the removal of the tie between thresholds and gates, fees and suspensions, and a consideration of how liquidity fees could best be customised to enhance their efficacy.

Considerations for each variant:

Representative Option: Swing Pricing

Liquidity Management Tools should be available to all fund types and should be operated at the discretion of the fund board to avoid the creation of any new bright lines and allow the tools to operate in the best interest of all investors.

Liquidity Fees are the most appropriate tool

The Liquidity Fees are designed to allow a MMF to manage a severe liquidity event, ensuring the cost of providing liquidity is borne by any investors that redeem rather than those that remain in the fund. We suggest that these are applied consistently to all fund types i.e. including VNAV funds and not just CNAV or LVNAV. Their purpose is to pass on the cost of redemptions and acting as a disincentive to remaining investors to redeem. Fees are a disincentive to trading and should act to reduce the likelihood of applying gates which is more impactful to the fund and to its investors. We note that the likelihood of using these measures is reduced by the ability to use the liquidity buffers as a countercyclical tool as they were intended.

A Liquidity fee is focused on investors that redeem from a fund. Based on our experience that the mid to offer spread does not widen significantly during a period of market stress, or at any other time, it is not necessary to apply any form of fee or charge on investors subscribing into a fund. Indeed, this could create a disincentive to invest in an MMF at a time when it would be beneficial. A MMF must act in the interest of all investors and may not chose to use them which may be the appropriate decision for a given circumstance. It is not possible to legislate for all possible market permutations and as such we propose it is useful to have a framework to operate fees, and indeed any of the other liquidity management tools but not a hard trigger as we have seen with liquidity thresholds this can create a bright line and result in pro-cyclical redemption behaviour.

The level of fee is defined in advance of the dealing day and therefore investors have greater visibility on the fee as they are advised at the time of their redemption where as a swing is applied at the end of the day once all dealing has been completed. The latter will impact the utility of MMFs to investors as they do not have time to react whereas a liquidity fee notified at the point of transaction gives the investor the choice to source cash elsewhere or deal with the shortfall created by the application of the fee.

Swing prices are not an appropriate tool for MMFs

The proposal to add swing pricing does not address any specific structural vulnerability. We argue that the key tools, Liquidity Fees, to support the management of a stressed market event already exist and they should be maintained. The provisions to link these tools to Liquidity thresholds should be removed to allow funds to use the liquidity within the portfolio in a countercyclical way. Swing pricing does not address the fundamental issue of underlying market illiquidity which was caused by widespread market disruption. That market dislocation was driven by the withdrawal of intermediaries from even the most liquid markets. A swing price would not have made a difference in managing redemptions on the fund. Funds could have triggered Liquidity Fees and any other ADL tool like Swing Pricing should they have needed to but this was not required.

By design, MMFs are structured to hold liquidity that is sufficient to meet redemptions and therefore does not need to sell a full slice of assets in order to meet redemptions in a normal market environment as is the case with other long term mutual funds. Swing pricing is designed to be used for those fund types where the fund sells less liquid assets in order to meet redemptions which may impact remaining investors. This is not the case with MMFs which are structured to meet redemptions by design therefore it is rare to sell longer dated less liquid assets to meet redemptions

Aside from the operational challenges created by Swing pricing it reduces the utility of the product for investors and as such we expect that investors will choose to place their cash outside of MMFs. The reduction in utility is driven by two components:

(i) The swing factor will bring a second dimension to price volatility in the NAV of the fund over and above market price moves which would be misleading for investors during normal market conditions. We expect this will lead to pre-emptive redemptions in stressed market conditions as investors will be unable to judge the full potential impact to the value of their holding.

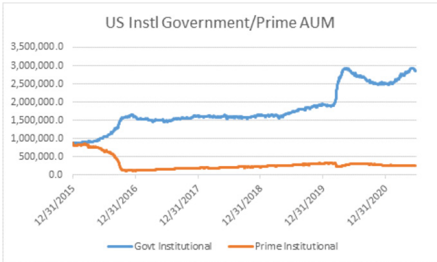
(ii) Contrary to liquidity fees, swing pricing applies to both redemptions and subscriptions which would favour subscribing issuers at the expense of the current fund holders.

Challenges with operating the swing mechanism

Swing Pricing, is particularly ill adapted to LVNAV or PDCNAV funds for the following reasons:

- Pricing basis
  - Swing pricing is effective for longer term mutual funds where the assets are priced at mid. Under Article 29 of EUMMF a LVNAV fund is required to price its assets at the most prudent of bid and offer and as such the funds are priced at bid. The fact that the fund prices at bid negates the impact of the swing.
  - There is a lack of transparency of private markets which makes it challenging to assess market prices. We support any and all efforts to increase the transparency which better supports all of the measures proposed. We support ESMAs suggestion in their consultation that more transparency is needed.
- Timeline for decision making & processing
  - Decision point – the determination of a swing is made after the fund has closed for dealing which prohibits application on a same day settlement fund or a fund running an intraday payment model. Moving the funds to T1 settlement will remove the utility of the product.
  - Decision makers - the complexity and timing around the decision to apply any of the liquidity mechanisms creates challenges in bringing multiple external stakeholders into the decision. Rather than regulator triggered decisions we would suggest that it is more appropriate to ensure there is a robust framework governing the application of these measures and prompt reporting to the regulator.
  - Time to process – the time needed to determine and process the results of a swing do not work for a same day settlement fund or a fund running an intraday payment model. Eliminating this capability of the product reduces its utility and will drive investors elsewhere.
- Downstream impact to distribution partners – all distribution platforms would need to process the effect of the swing also which further prohibits the ability to apply this feature on a same day fund.

- Impacts the viability of the product longer term: The lack of certainty over the application and scale of the swing will create challenges for investors. Greater transparency over the details could create another bright line in and of itself. The NAV applicable to their deal will be subject to both asset pricing volatility and the impact of net flows on the day which will prove difficult for clients to attribute. A lack of certainty or understanding on the product or its features will drive investors elsewhere. From December 2015 to end Dec 2016, $770bn flowed out of the Prime Institutional money fund industry in reaction to the conversion to VNAV. Through our engagement with US institutional clients, that there are corporates in the US today who would invest in Prime money market funds, but their treasury management system or accounting platform still cannot support the variable NAV.



- May become another bright line – more sophisticated investors may seek to withdraw their cash in anticipation of swing price in advance creating a potential redemption issue in and of itself.

- PDCNAVs should be excluded from the application of swing pricing as they are unlikely to experience the same redemption pressure as either Prime LVNAVs and VNAVS.

Representative Option: Minimum Balance at Risk (MBR)

We strongly oppose the adoption of a MBR requirement for MMFs, as this would change the product characteristics significantly and will drive investors away. The concept is intended to cover default not to address liquidity issues. A similar proposal (for 3% holdback to absorb first losses if a fund could not maintain stable NAV) was considered and rejected in the US in 2012-13. It is not clear how a MBR would mitigate liquidity risk, other measures such as the liquidity fee are more effective in this regard.

It is also not clear how an MBR would operate and we do expect this will be an operationally challenging to implement and administer not just for the funds themselves but also for their intermediaries which may make the product unworkable. We also expect there could be challenges with the subordination of shares in a given jurisdiction. Investors are likely to reject such an option and direct their investment elsewhere.

As noted by the report on page 31, MBR may affect the accounting treatment of MMFs by calling the designation of ‘cash equivalent’ into question. Investors are unlikely to invest in MMFs with redemption restrictions. Capital preservation is a key investor objective which MBR would undermine.

Representative Option: Capital Buffers

We do not support capital buffers for a number of reasons. It is not evident that capital buffers would mitigate the issues arising from a market liquidity event. The application of capital buffers to MMFs would not improve funds' ability to access liquidity in the underlying market. Buffers are more typical in banking regulation because banks are highly leveraged and hold long-term assets. MMFs, on the other hand, are not leveraged (they are 100% capitalised by the assets) and hold short-term assets. In the case of MMFs, they are not guaranteed products and investment risk is intended to be carried by the investors. In this respect buffers could make MMFs less investment-like by blurring the bank/fund distinction. They would also increase the interconnectedness of the bank and non-bank financial sectors which policymakers have aimed to reduce.

Capital buffers threaten the viability of MMFs as they would be prohibitively expensive, particularly in a low to negative yield environment. We expect that will drive industry consolidation thereby reducing investor choice. Costs are likely to be passed on to investors by reducing returns Yields on government funds set a floor on the yields that a non-public debt fund can return to an investor, which in turn limits the extent to which the additional cost of capital buffers could be passed on to investors since no investor would invest in a non-public-debt MMF which offered a lower return than a government or public-debt MMF.

As noted by the report, we would agree that some investors would seek higher yielding alternatives and that a shift into short-term bond funds presents similar or, we would argue, greater risk.

Capital buffers favour bank sponsors, although it is important to note that banks will not want the risk of having to consolidate funds on balance sheet. Buffers also create moral hazard by giving a misleading impression that a fund has some sort of guarantee.

Variant options

Sponsor Support

As one of the original proposers of the prohibition on sponsor support, nothing during the events of 2020 leads us to change our continued support for principle of the prohibition of sponsor support. We saw no evidence in client behaviour that suggested the lack of availability of sponsor support brought forward any redemption activity. The reasons for our support remain unchanged and are as follows:

- MMFs are an investment product where the risks and rewards belong to its investors. The investor's risks of ownership of a MMF are clearly stated in its prospectus and in its marketing materials.

- A level of ambiguity about who owns the risk when investing in a MMF developed amongst some investors pre the Global Financial Crisis. This ambiguity developed due to the sponsor support of MMFs that took place at times pre the current regulation. The current regulation removes that ambiguity.

- The availability of sponsor support could lead some investors to misunderstand and misprice the risks they are subject to.

- There is an incentive for both fund sponsors and, arguably, regulators to maintain a level of ambiguity of risk ownership in a MMF. We believe any ambiguity of risk ownership must continue to be removed so risk is correctly priced.

The availability of sponsor support can also lead to potential competition issues. On the one hand it is suggested that bank owned asset managers have a greater ability to provide support so benefit from this type of regulation. On the other hand, the potential consequences of the provision of support on the capital and liquidity ratios of a bank in practice make support punitive to provide for a bank owned asset manager. The opposite is the case for a non-bank owned asset manager.

Requiring LEB Membership

The establishment of an LEB is likely to be logistically complex, lengthy, costly and impractical. It is uncertain whether it would mitigate the liquidity requirements we saw during the March 2020 crisis. The facility would need to cover all currencies in all jurisdictions in order to be effective which is challenging from a legal & regulatory perspective.

The size and scale of such a facility is challenging to get right, the facility would need to be substantial enough in size to cover extreme deterioration of liquidity in a stressed market scenario. We reference IOSCO's comment where they noted that, for a LEB to be effective, "its structure and operations would have to be carefully designed to ensure that the facility has sufficient capacity during a crisis and that the facility itself is not vulnerable to runs. A depleted facility could trigger or amplify a run on MMFs."[3].

The cost of the facility would be borne by MMFs increasing costs which will inevitably be passed on to investors. This will make the product less attractive particularly in the low rate environment of today. This could drive AUM elsewhere in the financial system giving rise to the risks we have highlighted elsewhere in this response. It could drive manager consolidation as managers may be unwilling to bear the funding cost of such a facility in normalised market conditions & therefore reduced competition in the industry. That cost may drive increased risk taking in the sector where managers seek to balance the cost of funding such a facility.

It could be argued that it will increase moral hazard in the system where MMFs are inadvertently encouraged to take excessive risk, that may have the effect of syndicated risk across the industry.

Given that the facility would need to cover all currencies, it would be complex to establish from a regulatory perspective. We agree with IMMFAs viewpoint that in order to have a meaningful impact any such facility would arguably need the ability to borrow from the Central Bank, somewhat negating the intention to make any such need for intervention necessary.
If the LEB is to operate like a commercial bank it would be better, in our view, to incentivise existing banks to fulfil their normal market making capacity.

Representative Option: Removal of Ties Between Regulatory Thresholds and Imposition of Fees and Gates

The Weekly Liquid Asset (WLA) buffers were designed to be utilised to fund redemptions and we believe they are an important feature supporting the resilience of MMFs. Allowing the fund to dip below 30% to fund redemptions is well understood in the manager community however this was proven not to be the case in the investor community as the limit became a bright line triggering pre-emptive redemptions. The limit that was designed to reduce vulnerability in MMFs has become a catalyst for increased outflows in March 2020 which could become self-reinforcing and MMFs *became forced sellers of assets*, not in order to meet redemptions, but to boost levels of WLA. We believe the removal of the tie is a key proposal that will enhance the resilience of MMFs going forward. Decoupling liquidity levels from fees and gate would encourage investors to look at a fund more broadly whilst also enabling fund managers to utilise the liquidity buffer

[3] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD379.pdf

in the best interest of those investors, for the purpose the buffers are truly intended for, including assisting in the ability of a fund to meet redemptions in times of stress

This point is proven out by the utilisation of WLA limits by the MMF industry prior to their implementation into regulation. In Europe members of IMMFA have followed the code of practice requiring its members to maintain 10% DLA and 30% WLA since the Global Financial Crisis During periods of market dislocation such as the Eurozone sovereign crisis, MMFs did not experience heightened redemption activity because the linkage between DLA and WLA and fees and gates did not exist. The buffers were available for funds to use as intended and investors were not focused on them as they were in the March 2020 crisis because of the link to triggering gates and fees was not there.

The report suggests that this reform could increase uncertainty for investors regarding the use of fees and gates and that MMFs may be reluctant to use them due to stigma.

The considerations around the application of a gate or a fee would not change in that the fund / fund board must consider the most appropriate course of action taking into account the interests of shareholders. Fees were not deployed during the crisis because they were not triggered. If they had been triggered the fund board must consider the most appropriate course of action.
As proven by the experience of market dislocations since the GFC and the implementation of WLA limits by industry code of practices, MMFs benefitted from the ability to use the buffers. The absence of a link or trigger did not generate uncertainty during those events.

With regard to the concern raised around replenishing WLA levels it should be noted that the regulation requires the funds to maintain WLA thresholds and as such the manager will seek to replenish these levels each day otherwise the fund would be the subject of an active breach. The decoupling of the trigger simply allows the buffers to be used in the way they were intended; it does not negate the need to replenish the limits.

Variant options

Authorities Activating Fees
The practical implications of a regulator activating fees must be taken into account. The factors for consideration are multiple and may move quite quickly in a stressed market. The fund must ensure it is responsive and timely in its decision making and we believe the fund managers working with the fund board are best placed to understand the particular circumstances of the fund and its clients. A delay in this process, even if the outcome was not to activate fees, could generate uncertainty in and of itself and act to increase investor redemptions in the period following a delay. Regulatory intervention could, in effect, become a new bright line for investors and have unintended consequences.

Concentration Limits
In our opinion a key element of liquidity risk management is control of individual investor concentration levels and of investor type concentration levels. This is as important as the liquidity profile of the assets themselves. Since the GFC we have applied these type of controls as part of our liquidity risk management process. Therefore, we believe this option merits further exploration and we would encourage regulators to engage in further exploration with us and other asset managers that have a similar position. We do note that there may be challenges to effectively write these type of controls into regulation without creating other trade- offs.

However, we do see potentially significant benefits in closer consideration of client concentration and investor profiling.

Countercyclical Buffers
As noted previously, the regulation technically permits the countercyclical use of buffers since it does not prohibit MMFs from falling below 30% and therefore in theory availing themselves of WLA to meet redemptions. However, this did not work in practice because of the link with fees and gates. Regulatory relief from buffers could be important were the link to fees and gates maintained but we believe that delinking fees / gates from liquidity thresholds is a far more effective solution allowing them to be used as they were intended thereby improving MMF resilience.

The practical implications of an intervention by the regulator need to be considered as time delays or uncertainty could create their own issues and have the unintended consequence of triggering investor redemptions. Without delinking the WLA from fees and gates the bright line remains and MMFs could experience pre-emptive redemptions in the way they did in March 2020.

Adding a secondary buffer without removing the link to gates and fees will simply have the effect of moving the bright line. Adding a regulatory trigger to allow its use introduces the potential for time delays which may not be practical to operate under and may generate redemption activity arising from any perceived uncertainty.

Representative Option: Removal of Stable NAV
We see no basis for the removal of stable NAV funds. The March 2020 crisis was agnostic to fund structure or how the NAV of the fund is calculated. The elimination of CNAVs or LVNAVS will not address the underlying issues in the short term market that drove this crisis. US Institutional Prime VNAV funds and EUR Standard VNAV were under the most strain and as noted by various policymakers peak outflows in USD LVNAV and EUR Standard VNAV were substantially similar. The impact of outflows on LVNAV funds was different given the minimum liquidity threshold under the regulation is twice that of the WLA required by European VNAV funds. There was sufficient liquidity to cover redemptions but this could not be used.

Investors value the utility of LVNAV and CNAVs funds, they often require them for their own internal procedures or processes and they are the practical solution for sweeps, intraday settlement and trade execution. The variable NAV can provide a valuable option for investors comfortable with the fluctuating NAV model but not all investors can deal with them. Importantly, it should be noted that a variable asset valuation methodology does not in itself address liquidity problems, if this were the case we should have seen significantly reduced outflows from VNAV funds and this was not the case in either the US or Europe.

Removing LVNAVs will reduce investor choice and the supply of private credit. We expect investors to shift into PDCNAVs but note that the scale is not available in GBP and potentially EUR. Investor flows since the regulatory reforms implemented in 2019 shows strong support for the LVNAV structure. Continued growth in LVNAV AUM since the events of March 2020 demonstrates the ongoing appeal of the product. It is our view that it is important to preserve investor choice.

For many investors the inclusion of LVNAV MMFs as cash equivalent for the purposes of accounting is very important. VNAV MMFs are considered as cash equivalent in France but this is not the case in other jurisdictions. Indeed, there is not consistent designation within jurisdictions which would render the product ineligible for many investors.

Some investors require an MMF to have an objective to maintain a constant NAV for other regulatory reasons, for example in the UK under the FCA requirements for CASS 7 client money "its primary investment objective must be to maintain the net asset value of the undertaking either constant at par (net of earnings), or at the value of the investors' initial capital plus earnings"

PDCNAV funds saw inflows in March and were the most robust and resilient of all the MMF types during the period of stress and as such we see no reason to remove this fund structure. The European PDCNAV market consists of 97% US Dollar denominated funds. PDCNAV MMFs in Sterling are only GBP3bn and in Euro EUR0.1bn, reflecting a lack of investor demand to date. This means that PDCNAV MMFs in Euro and Sterling do not currently provide a scalable alternative to LVNAV MMFs.

Representative Option: Limits on Eligible Assets
MMFs are already structured to maintain high levels of liquidity with the purpose of meeting redemptions but were unable to use that liquidity because of the bright line created by the link to fees and gates.

Holding Higher Buffers
Increasing the level of the buffer simply moves the bright line unless the link to fees and gates is removed. As noted elsewhere, the buffer did not operate as intended due to investor concerns about the imposition of a fee or gate and consequently funds were forced to sell assets not to fund redemptions but to boost WLA levels. Decoupling fees and gates from the WLA level would allow funds to use the buffers as intended.

The practical implications of holding higher buffers should also be considered. The report correctly identifies the issue of rollover risk where issuers, such as banks, are not interested is issuing shorter dated paper. Shorter paper does not contribute to liquidity ratios and increases refinancing risks for banks. There are also very significant supply constraints in the overnight deposit and reverse repo market which can limit the extent to which MMFs can simply increase these assets. These constraints can be particularly acute on reporting dates. Stable NAV MMFs, which are typically rated AAA[4], have stringent requirements on counterparties and collateral which limit them to high quality risk.

The EU MMFR currently contains a cap on the quota of highly liquid assets that can count to the 30% WLA buffer. An LVNAV or PDCNAV WLA buffer can only contain up to 17.5% in "highly liquid" assets up to 190 days which can be redeemed and settled within one working day. This is generally considered to refer to sovereign, supranational or agency debt and the cap therefore appears to be an unnecessary additional constraint. Given the objective is to ensure that funds have sufficient liquidity that is usable, the restriction makes little sense and in the context of the Eurosystem proposal to hold more public debt it makes even less sense.

4 AAAmmf/Aaa mf/AAAm money market fund ratings. All IMMFA MMFs are AAAmmf/Aaa mf/AAAm by one or more of Fitch Ratings, Moodys Investor Services and S&P Global Ratings

Eurosystem Proposal to Hold More Public Debt
Prime MMFs often hold a small weighting to public debt for the liquidity benefits that public debt can bring. As part of the review of the further regulation of MMFs we are of the opinion that further consideration should be given to regulation prescribing a minimum weight to public debt in Prime MMFs.

However, there are a number of issues that should be considered as part of this review. These are outlined below:

Flexibility should be provided to increase the level of daily liquid assets OR a minimum level of public debt
To avoid the potential of creating another trigger for investors to monitor, flexibility should be allowed to either hold an additive allocation to the existing minimum daily liquid assets OR hold an additive minimum level of public debt. This flexibility would also help alleviate the supply issue outlined below.

Credit quality considerations for Eurozone public debt for EUR MMFs
Whilst we understand there is political sensitivity to recognizing publicly the differential in credit quality between different Eurozone country public debt, the difference in credit quality does impact the liquidity characteristics of the debt. For a minimum level of public debt to be affective only Eurozone country public debt that has demonstrated consistent liquidity during periods of market stress should be eligible.

Only public debt in the base currency of the issuing country should be eligible
Public debt issued in a currency other than the base currency of the issuing country should not be eligible for any minimum public debt weight. This debt is less liquid during periods of market stress and therefore would not deliver the benefits intended. For example, public debt issued by the Republic of Belgium in EUR would be eligible but Republic of Belgium debt issued in GBP would not be eligible.

In certain cases, the current level of supply in short term public debt is insufficient to allow for a minimum level of public debt in MMF regulation
The current level of supply in short-term public debt is an important consideration. For example, the supply of short term UK government debt is insufficient to allow for a minimum level of UK public debt in MMF regulation for GBP MMFs.

Whilst there are a number of considerations of including a minimum weight to public debt for Prime MMFs we do believe it justifies further dialogue between key stakeholders. We would appreciate the opportunity to discuss this further with regulators.

Variant options on Limits on eligible assets

Limit MMFs to Government Debt
There are significant supply constraints in Euro and Sterling as noted under the response to the Eurosystem proposal to hold more public debt. Given market limitations, this option would only be potentially viable if MMFs were given access to something akin to the US Federal Reserve's RPP. Even with this facility, supply is not always adequate despite the unparalleled depth of the US treasury market. As noted, this would effectively limit MMFs to government MMFs. There has been limited investor demand for public debt MMFs in Euro and Sterling to date. Supply

constraints would in any case limit the extent to which government MMFs could substitute for non-public debt MMFs outside of the US market.

Buffers Based on Investor Concentrations
We believe it is worth exploring the principle of an asymmetric 'dynamic' WLA level that is adjusted in relation to changing individual client concentration and client type concentration levels. The principle should be explored in partnership between regulators, providers of MMFs and other key stakeholders.

Redemption in Kind
Redemptions in kind would not be possible within an appropriate time frame. They require significant amounts of planning as assets are transferred between custodians and the process can take days to complete. In addition, some of the assets held by MMFs are non-transferable (such as deposits and reverse repo). It would take longer to arrange a redemption in kind than to liquidate and provide cash therefore defeating the purpose of the solution.
Also, it should be noted that this option is only available to large institutional investors who have the scale and resources to establish an operating model with a custodian as a custody account is required to receive and safekeep the securities. Not all MMF investors have such accounts and so would be incurring additional costs for a service only required *in extremis*.

Non-daily Dealing
Same day settlement is a key feature of a MMF and without it MMFs will lose their utility. Extending settlement cycles would affect their 'cash equivalence' which is also a very important factor to some investors, particularly corporates. Enabling MMFs to access their inherent liquidity will go a long way to mitigating the impact of large redemptions. It can be combined with other measures, such as use of liquidity fees, to ensure that the overall impact is to reduce liquidity transformation.

Liquidity Based Redemption Deferrals
Deferring portions of a redemption payments effectively breaks the same day settlement utility and creates uncertainty for the investors. As above, this could also impact the cash equivalence status driving investors to consider alternatives outside of MMFs. Deferral triggers would likely incentivise investors to redeem early in cases of stress for fear that they may have future redemptions deferred.

Representative Option: Additional Liquidity Requirements and Escalation Procedures
With regard to additional liquidity requirements please see the response on the eligible assets question. We do not support the idea to increase liquid assets from 1 to 2 weeks as it is unnecessary and adds undue complexity without bringing a benefit. The repo market is effectively an overnight market, reflecting the fact that banks use repo to finance their trading books. Bank appetite for deposits does not increase between 1 and 2 weeks as neither has value from a prudential ratio perspective. Most issuers will not issue very short paper because they require security of funding whereas issuing very short paper merely increases their rollover risk. Given the lack of additional supply, in practical terms an extension from 1 to 2 weeks would simply mean the inclusion of additional assets rolling down. This would not provide a material benefit.

Most managers, including ourselves have liquidity protocols surrounding the use of escalation procedures which would provide for gates being imposed only after fees. The framework for the application of fees could be customised by building on manager protocols and playbooks in conjunction with the relevant NCA. Providing a framework for the use of fees, as distinct from gates, could help allay investor concerns about the latter, since investors have a far greater aversion to gates than to fees.

As noted, regulatory thresholds would remain focal points for investors.

11. Is the description of variants and the comparison of their main similarities/differences vis-à-vis the representative options appropriate? Are there other variants to consider?

We are in favour of reforms that are proportionate and support the resilience of the product while maintaining its utility and viability. We have provided detailed feedback on the representative options and variants above. From a thematic point of view, a number of the variant options are also characterised by a move away from manager discretion towards macroprudential intervention. Given that in a crisis situation time is of the essence and therefore practical considerations become paramount, we strongly recommend risk management be located with the board and /or fund manager.

12. Are measures to enhance risk identification and monitoring by authorities and market participants appropriate complements to MMF policies? Which of these measures are likely to be most effective and why? Are there other measures to consider?

We do not believe that additional reporting and stress testing are the solution to addressing the challenges observed in March 2020. The existing reporting and stress testing frameworks are comprehensive and detailed. Stress testing is already calibrated very conservatively.

In Europe, the reporting requirements are extensive and it takes significant effort across managers, custodians, administrators and transfer agents to compile it each month. It is already particularly onerous when compared to other fund types. Given the scale and the effort to produce the reporting, it is challenging to accelerate its delivery and any requirement to do so must be considered in the context of the value it could during a crisis. Reporting by its nature is lagged and backward looking and given the short nature of MMF investments, a 'live' view of the fund could look very different compared with the regulatory filing. Since the crisis, European regulators have been receiving daily reporting on key indicators which proved helpful while managing through the crisis.

Altering reporting requirements or frequency while managing a significant market dislocation risks distracting managers or service providers who are focused on the increased activities arising from such an event e.g. increased investor activity and queries, increased or more challenging market trading activity, valuation checks/challenges, tolerance breaches to be investigated and reported to regulators, etc. Demanding additional reporting during the busiest time would create more operational stress on the system and risk that the core role of ensuring the smooth running of MMFs could be jeopardised.

We would be very supportive of more transparency in the short-term markets including post-trade information and on outstandings.

Considerations in selecting policies

13. Are the key considerations in the selection of policies to enhance MMF resilience appropriate? Are there other considerations that should be mentioned?

Investors withdrew cash because of real operational requirements on their side. If an investor places their cash into alternatives it follows that they will need to withdraw or liquidate from those alternate sources also which could generate strain in other parts of the system.

The key considerations are appropriate although in our view the risk of substitutes being insufficient and failing to equate to MMFs is underestimated.

14. Which options complement each other well and could potentially be combined? What are the most appropriate combinations to address MMF vulnerabilities in your jurisdiction? Which combinations are most effective for different MMF types and their functions?

We believe it is key to delink fees and gates from liquidity thresholds allowing the funds to use the buffers in a countercyclical fashion as intended.

MMFs already have liquidity management tools at their disposal and in particular liquidity fees. The ability to utilise the liquidity buffers in times of stress coupled with the ability to apply fees to manage redemption flow supports the objective of building resilience.

15. To what extent should authorities seek to align MMF reforms across jurisdictions? Is there a minimum set of policies or level of MMF resilience that should be considered at the international level to avoid fragmentation and regulatory arbitrage?

Whilst recognising the different constructs of MMFs globally and the markets they operate in it would be helpful to have some key principles that are consistent on a global basis. We would support a more uniform approach to the definition of a MMF across jurisdictions. The report suggests ultra-short bond funds would be a substitute for MMFs but in Europe standard VNAVs are the equivalent of ultra-short bond funds in the US. Ultra-short bond funds which are not designated MMFs would, as noted by the FSB, represent substantially the same or, in our view, greater risks.

The report is right to recognise the differences in jurisdictions. In our view, it is important to reflect the different market dynamics between the US and Europe and the fact that even within a given jurisdiction, funds are not homogenous. For instance, the report correctly notes that currency of denomination is an important consideration. The US market benefits from one currency, the deepest treasury market in the world and significantly better data transparency. Another point of divergence is the definition of an MMF, which is broader in Europe. European reforms have been successful in improving fund resilience and we continue to support the European prohibition on external support.

Short-term Funding Markets (STFMs)

16. **Does the report accurately describe problems in the structure and functioning of STFMs and how these have interacted with MMFs in stress periods?**

We agree with the observation that there was a lack of liquidity in the underlying markets during the height of the Global Pandemic, but feel this was largely related to post Global Financial Crisis banking reforms. Those reforms clearly had a positive effect on reinforcing bank balance sheets, which was evident during the recent crisis, however, banking reforms also reduced bank appetite for cash deposit taking (increasing demand from investors for alternatives such as MMFs) but more importantly reduced bank balance sheets and thus the provision of secondary market liquidity – a fact that should not be understated when analysing the larger picture of market illiquidity.

Despite the reduction of bank balance sheets, we believe there is ample liquidity under normal market conditions. MMFs typically employ a buy and hold strategy where naturally liquidity from maturities will service redemptions. This is clearly demonstrated with LVNAV funds that are required to hold a minimum of 30% in weekly maturing assets and rarely have to sell assets under normal market conditions. In reality much of the Weekly Liquidity Asset (WLA) requirement is fulfilled by overnight assets such as reverse repurchase agreements and overnight deposits, further enhancing the natural liquidity of a MMF. On occasions where MMFs are required to sell assets, such as to rebalance a portfolio, there is sufficient liquidity to execute (even for the largest of funds). MMFs can reasonably expect to sell paper back to the dealer from which it was originally purchased, or in some cases the issuer directly, at a minimal bid-offer spread. The dealer can typically find another buyer for the paper or may hold the paper for a short while. However, the banking reform referenced earlier has made it much less likely that dealers will run their own positions and hold paper to maturity or at best not to the scale this activity was conducted prior to the banking reforms.

In addition, the lack of secondary market trading volumes should not be read to imply that money market instruments such as certificates of deposit and commercial paper are 'illiquid'. As with any instrument its liquidity will be determined by the levels of supply and demand in the market. In our experience during normal market conditions there is a balance in supply and demand in the different money markets we operate in globally leading to the ability to sell assets at a narrow bid / offer spread. A market dislocation can lead to an imbalance in supply and demand leading to a reduction in liquidity and the subsequent widening of the bid / offer spread. A period of less liquidity during a period of market stress should be expected and does not imply a lack of liquidity at all times.

The observation regarding increased liquidity risk from portfolio overlap is not one with which HSBC agrees with. The conclusion that illiquidity was partly a function of all MMFs holding the same names over simplifies the issue and detracts from the real issue that in times of stress MMFs, and other investors, are all seeking liquidity at the same time. The failure of the dealer community to provide enough liquidity was not primarily related to concentration of issue holdings, but to the previous mentioned change in banking regulations, combined with a dramatic increase in the demand for liquidity from all investor types, not just from MMFs. It is also worth noting that the illiquidity experienced was not confined to bank issued paper, with MMFs experiencing difficult selling high quality agency paper and, in some cases, sovereign paper. The issue at the peak of the crisis in late March was exacerbated by quarter end where, even in normal conditions, market liquidity is lower.

We would also like to comment on the statement implying that the liquidity of a MMF depends on the liquidity of its assets. This would seem a logical statement but in fact does not consider the normal functioning of a MMF or the impact WLA thresholds have on fund manager behaviour. The normal functioning of MMFs means, as previously mentioned, that there is a significant amount of natural liquidity from the requirement to hold 10% in assets maturing overnight and a total of 30% in asset maturing within one week. This in turn means that, under normal conditions, MMFs are unlikely to be selling assets meaning there is not the obvious link between the liquidity of the underlying assets and the liquidity of the fund that one might believe. Perversely, it is the requirement to hold 30% WLA that give some credibility to the statement. Instead of this liquidity requirement within funds being used to service redemptions, fund managers were actually selling assets to maintain the mandated liquidity levels removing the benefit of having 30% WLA – this is the “bright line” issue that is referenced elsewhere in this paper. This could in part be addressed by making these types of liquidity buffer more useable in times of stress.

We believe that increasing the liquidity of the underlying markets has a very large effect on the resilience of MMFs. We are supportive of efforts to improve liquidity in the money markets, including efforts to incentivise the dealer community to provide more liquidity and reviewing the operating model of the major global money markets, including in the EU. We believe it may be possible to learn from the functioning of other financial markets that could be applied to improve the operating model and therefore liquidity of these markets. We encourage regulators to support, participate and perhaps lead any review of this type. HSBC Asset Management would be happy to support and participate.

We believe that policy makers should aim to improve underlying market functioning. We particularly support measures which may improve the limited incentives for dealers to intermediate during stress periods. In our view, this requires consideration of prudential regulations such as temporary relief measures – capital and liquidity ratios- which can be effective. It also requires changes in the ‘microstructure’, such as the report suggests (page 41) including more standardisation and greater transparency.

The report concludes that ‘prudential requirements were not a dominant factor’ whereas we find that they did have a material impact in changing banks’ appetite and capacity for intermediation.

17. What other measures should be considered to enhance the overall resilience of STFMs? How would those measures interact with MMF policy reforms and how effective are they likely to be in preserving market functioning in stress times?

Enhancing the overall resilience of STFMS has a number of different aspects.

The Underlying Instruments

As stated above (Q16), we do not regard the liquidity of the underlying MMIs as being the determining factor in the seizing up of secondary markets in March 2020. We attribute this to a far deeper cause, namely, the sudden withdrawal of dealer intermediation. However, we certainly support efforts to improve underlying liquidity through increased convergence on market standards and practices, greater transparency and improved data. The European CP market has grown to be significant and now represents an enormously important funding source for a wide range of issuers who value its cost efficiency and flexibility. However, the pan-European market remains deeply fragmented. Divisions arise because of differences between local versus international jurisdictions which determine legal frameworks, regulation and settlement, and because, outside local markets, issuers also borrow in a number of different currencies, predominantly Dollars and Sterling. The CD market, which predates CP and historically followed different conventions, is now increasingly but not completely integrated with CP and is similarly fragmented ('Yankee' CDs trade differently from Euro CDs, for instance). Moves to reduce market fragmentation need to look at the market infrastructure (data, platforms, legal frameworks etc.). The lack of homogeneity in both CP and CD markets has a direct consequence on the efficient functioning of markets, for example, it led to very different outcomes with regard to eligibility for asset purchase programmes. For instance, some, but not all, STEP[5] labelled paper may have been considered eligible. These matters require further analysis and dialogue with all the relevant stakeholders, including dealers, issuers, investors and platforms.

The Role of Intermediators in Times of Stress

The report identifies a number of the factors which led banks to pull back from their customary market making role (Box 3). The widespread withdrawal of dealer intermediation had far-reaching consequences for other parts of the short-term eco-system, including MMFs. In some cases, banks were even unable to provide liquidity in their own name, which appears unprecedented. Measures which provided temporary regulatory relief combined with those which sought to assure banks about the availability of liquidity at reasonable cost (such as the targeted longer-term refinancing operations (TLTRO), the pandemic emergency longer-term refinancing operations (PELTRO) and collateral easing measures) were effective in enabling banks to resume their secondary market activity, demonstrating the importance of this function and the ability of central banks to manage their ability to do so.

Asset Purchase Programmes in Times of Stress

As noted in our response to Q2, there was significant variation in the effectiveness of central bank intervention. European asset purchase programmes were of little or no direct benefit to MMFs. Asset eligibility was limited, insufficiently defined and inconsistently applied by participating central banks. Ensuring that such programmes, if and when implemented, are appropriately designed, targeted and communicated would enable markets to recover more quickly.

[5] The Short Term European Paper (STEP) initiative was launched in 2006 with the objective of fostering integration of European markets.

Those asset purchase programmes initiated during the market crisis that directly supported the wider money markets allowed monetary policy transmission to operate as intended, short-term funding markets to deliver the funding required by the real economy and for cash to move around the system as designed.

Whilst it is critical to ensure that regulation minimises the probability of market breakdowns occurring, to a degree they are inevitable. It is in this type of scenario that the type of actions taken by certain central banks in 2020 are necessary to restore the orderly functioning of markets for the benefit of financial system stability and wider society. With an ecosystem as large as a major global money market and the significant benefits of such central banks actions, the concept of moral hazard that is argued is created by such public sector interventions in relation to one type of money market participant is immaterial and ignores the wider benefit of stabilising markets that accrues to the financial system and society.

A root and branch review of the operation of the major global money markets to determine enhancements that will support their functioning during all market conditions

To summarise, we propose a ‘root and branch’ review on the current operating models of the major global money markets to identify opportunities to make the money markets more resilient and better able to function during periods of market stress. Due to the breadth of participants in the money markets and the key role that regulators play in their operation, the review should be coordinated or sponsored by regulators.

Additional considerations

18. Are there any other issues that should be considered to enhance MMF resilience?

We would recommend that policy makers consider the use of MMFs as eligible collateral for bilateral margin calls. One of the key drivers of the extraordinary flows observed by MMFs during the height of the turmoil in March was due to investors responding to increased margin calls, as a result of the extreme market volatility. This was particularly the case for MMFs denominated in Euro and Sterling which are often used by liability driven investment (LDI) investors to manage the liquidity component of their portfolio. In order to meet margin calls, investors withdrew cash from MMFs, although when markets (and therefore margin levels) normalised, these flows returned. Receivers of the cash collateral, such as CCPs, had to reinvest the additional cash collateral into securities similar to those owned by MMFs.

As such, we would encourage policymakers to further consider the use of MMFs for the purposes of collateral for bilateral margin requirements. While we are not questioning the appropriateness of margin requirements, which were a cornerstone of the post-2008 reforms and a key commitment of G20 Leaders at the Pittsburgh Summit, we believe policymakers can take a number of steps in order to mitigate the market-wide pressure as described above.

In conclusion, we believe MMFs demonstrated high levels of resilience in what were extremely challenging circumstances. We believe this resilience could be enhanced further by some of the measures discussed above. On this basis, we do not see other issues to be considered. Discussion of how to implement liquidity fees to ensure their maximum efficacy will involve further detailed analysis and dialogue with regulators.