Response to the FSB Consultation Paper

"Policy Proposals to Enhance Money Market Fund Resilience"

MANAGEMENT SUMMARY

The International Swaps and Derivatives Association ("ISDA") has more than 960 member institutions from 77 countries. Members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers.

ISDA appreciates this opportunity to comment on the consultation paper "Policy Proposals to Enhance Money Market Fund Resilience"[1] (the "consultation paper").

Our comments are focused on Money Market Fund ("MMF") resiliency specifically as it pertains to using MMFs as eligible collateral for both cleared and uncleared margin. Further, our focus is on the most widely used MMFs for such purpose, which are public debt MMFs, not non-public debt MMFs. As such, our comments below solely apply to public debt MMFs.

General Comments

The consultation paper is another positive step towards enhancing MMF Resilience.

We welcome the work the FSB has done with this consultation paper in seeking to provide detailed policy proposals on MMF Resilience which would advance financial stability, especially during times of market volatility, as the industry experienced in March 2020.

ISDA members use MMFs as a cash reinvestment tool for derivatives' collateral, and therefore, liquidity and accessibility, and in some cases liquidity parameters, are paramount.

It is also important to note that the derivatives market is a global market. As such, aligning MMF reform, for MMFs with similarly liquid underlying public debt instruments - in the context of collateral eligibility - will allow for a harmonized market, reduce regulatory conflicts and facilitate substituted compliance or

[1] https://www.fsb.org/2021/06/fsb-seeks-feedback-on-its-policy-proposals-to-enhance-money-market-fund-resilience/

equivalence determinations. It would also be helpful if counterparties from two different jurisdictions are allowed to not only chose which jurisdiction's rule they want to apply (for instance for uncleared margin), but also be free to post MMF from either jurisdiction. This is particularly important where jurisdictions already have robust regulatory frameworks for MMFs in place. The FSB's work should not undermine those frameworks already in place, as that could negatively impact liquidity and impair access.

When reviewing the multiple proposed policy options, along with the experience with public debt funds' stability during the March 2020 market volatility, our members have concluded that the MMF reforms of the past have proven effective for the most creditworthy public debt MMF in the US and public debt Constant NAV ("CNAV") funds in the EU. Further policy options, as contemplated, will likely decrease liquidity and increase costs to end investors participating in the public debt MMF markets.

1. Functions served by MMFs and MMF vulnerabilities

With respect to ISDA members using MMFs as eligible collateral, one way in which MMFs are used as a cash reinvestment option is when posting variation margin for uncleared derivatives; cash is posted from the pledgor to a collateral account at the custodian, and then the custodian sweeps the cash daily into a MMF that has been previously agreed to by both counterparties. This eliminates overnight custodian risk that could be associated with keeping cash within the collateral account. Additionally, it is expected that entities subject to Phase 5 (September 2021) and Phase 6 (September 2022) of the uncleared margin rules may also use cash as initial margin. Reinvestment into a MMF will be a common process when posting cash in this circumstance, particularly in consideration both of initial margin segregation rules and these counterparties' whom wish to reduce custodian risk.

Another way in which ISDA members use MMFs as eligible collateral is as a cash reinvestment option, when selecting public debt MMFs as initial margin at a Central Clearing Party ("CCP"). Generally, under this model, a clearing member will post cash with the CCP, and the CCP will reinvest cash into one or more eligible MMFs, as directed by the clearing member.[2]

ISDA has also proposed in the past that CCPs should be allowed to invest cash margin in the most conservative and liquid public debt MMFs.

In certain interest rate environments, posting cash is optimal for investment performance compared to posting non-cash collateral, and as such a wide variety of entities use cash for both uncleared and cleared margin. Entities likely to use public debt MMFs as a reinvestment option when posting cash as initial margin for both cleared and uncleared derivatives include hedge funds, mutual funds or UCITs, pension funds/schemes, CCPs' clearing members (e.g., futures commission merchants or "FCMs"), and insurance companies that may not hold assets that can be used as eligible collateral. These entities may not have a MMF or Treasury/government bond trading function and therefore would incur additional operational costs and potential performance drag if transforming other types of assets into eligible collateral if not posting cash to be reinvested into a MMF. Another reason to use cash and a MMF as a

[2] MMFs for CCP cash reinvestment are currently used in the US only, but ISDA supports a permission for CCPs in Europe and elsewhere to use MMFs for collateral reinvestment of margin cash.

reinvestment solution for eligible collateral is the MMF's liquidity and cash-like qualities. This makes recalling collateral from a counterparty or CCP a simple and prompt process.

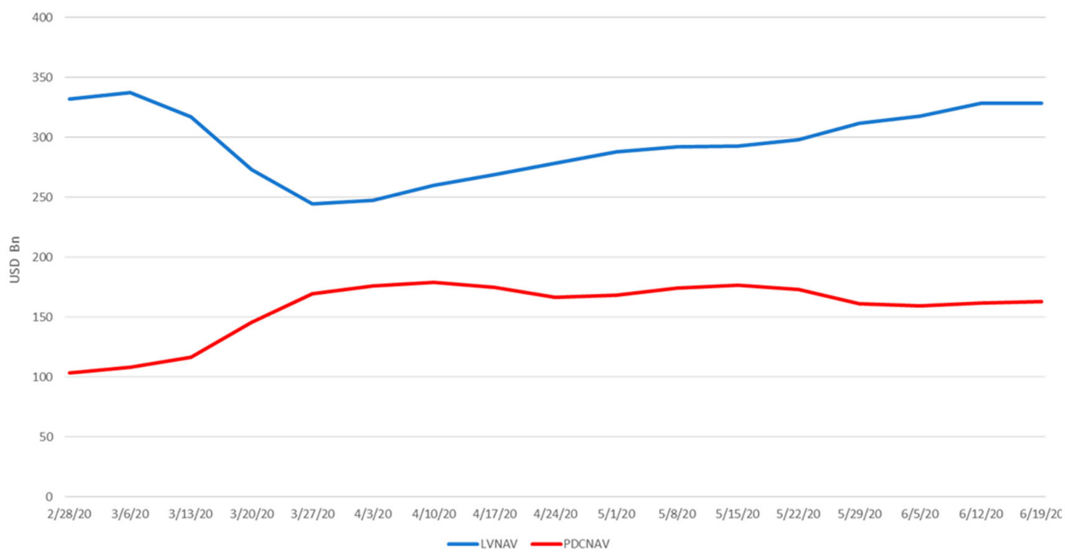
For uncleared derivatives, the pledging and receiving counterparty determine the public debt MMF (or MMFs) used for this purpose at the time of onboarding or by document amendment. This is documented between counterparties in their credit support annex ("CSA") or collateral trading agreement ("CTA") and also the documentation with the custodian, usually known as the account control agreement ("ACA").

For cleared derivatives[3], the public debt MMF to be used, or multiple MMFs which may be used, is established ex ante pursuant to a CCP's collateral eligibility policy and would be disclosed on a CCP's website. These policies are adopted pursuant to a CCP's local regulatory requirements, which includes requirements for the market, liquidity and credit risk of the collateral (e.g., CFTC Regulation 1.25 establishes requirements relating to MMFs).

In our members' experience, the MMFs typically used for eligible collateral are public debt MMFs, the focus of this comment letter. Public debt MMFs did not contribute to problems in the Short Term Funding Market ("STFM") during recent episodes of stress, and in fact helped provide stable investment options (as evidenced by the inflows during the market's March 2020 volatility). As demonstrated in the European domiciled USD denominated data referenced below, Public Debt Constant NAV ("PDCNAV") funds experienced inflows during the March 2020 timeframe compared to outflows in non-public debt MMFs, otherwise described as Low Volatility NAV ("LVNAV"). Investors migrated from the LVNAV to PDCNAV MMFs because of the risk that fees and gates would be imposed by the LVNAV funds. Similarly, this transfer occurred in the US onshore market where investors moved out of Prime Institutional funds into Government-Only/Treasury-Only funds, and because many offshore USD denominated MMFs are managed by investors headquartered in the US, the onshore behavior in Europe followed a similar pattern.

[3] For CCPs that at present use/offer the possibility to invest cash collateral in MMF.

USD LVNAV & PDCNAV Fund Flows



Source: iMoneyNet/IMMFA

The below section includes responses to the following sections, as applicable to our members' use of MMFs for eligible collateral:

2. **Description of the policy option and what it aims to accomplish;**
3. **Effects on investor behaviour;**
4. **Effects on fund managers and sponsors; and**

ISDA is providing comments to the policy options that relate to the important aspects of MMFs as eligible collateral, including liquidity and stable valuation.

Swing Pricing

We do not support this policy option for public debt MMFs as it may negatively impact liquidity and MMFs' cash-like qualities. A key benefit of MMFs to be used as eligible collateral is the same-day settlement treatment, making it a highly liquid asset for collateral pledgors who are posting cash to a counterparty and coordinating cash reinvestment into MMFs. Swing pricing may negatively impact the same day settlement attributes of MMFs and reduce the valuable use of the asset, leaving counterparties few other solutions for posting liquid assets and instead having to convert cash into another type of eligible collateral prior to posting to counterparties and incurring more overhead and trading costs and performance drag to the end-investor.

Swing pricing would undermine the important value of a stable NAV and would reduce price certainty.

In contrast to swing pricing, a redemption fee imposed at the discretion of the fund's board of directors may serve as a deterrent to redemption of MMF shares in a volatile market with stressed market conditions.

Minimum Balance at Risk

We do not support this policy option for public debt MMFs as our members' primary requirement of MMFs is a form of highly liquid collateral. Adding a liquidity restriction by requiring a minimum balance to be left with the fund is not a reasonable solution for collateral purposes and may jeopardize the use of MMFs as collateral going forward. Additionally, with respect to cleared derivatives' margin, this policy option would conflict with CFTC Regulations 1.25(b)(1) and 1.25(c)(5) which generally state that any investments of cash by FCMs or derivatives clearing organizations ("DCOs") into MMFs should be convertible to cash within one business day, and highly liquid. Further, the ability for FCMs and DCOs, as well as other types of clearing members and CCPs, to manage any potential liquidity obligations would also be impaired under this policy option.

If MMFs could not be used as a cash collateral reinvestment option, pledging counterparties would have to transform their cash into other types of eligible collateral prior to posting to their receiving counterparties. This could result in additional operational and trading costs and performance drag to the end-investor.

Capital Buffers

Capital buffers would be an additional liquidity threshold beyond Daily Liquidity Available (DLA) and Weekly Liquidity Available (WLA), which are already in place. We do not think additional buffers are necessary for public debt MMFs in light of their demonstrated liquidity during stress periods. The capital buffer would also increase costs to the fund and reduce returns, which run on already very tight margins.

Further, we do not support the variant of sponsor support as a requirement for public debt MMFs; this could result in reduced competition among MMFs with only highly capitalized firms like large banks able to afford the sponsorship. It could also reduce returns to the end-investor as asset managers may have to increase management fees to afford the risk of the sponsorship.

Nor do we support the concept of the Liquidity Exchange Bank (LEB) for public debt MMFs as it is unproven, and depends on central bank support, which we are not in a position to endorse due to unknown costs and operational challenges in times of market stress.

Removal of ties between regulatory thresholds and imposition of fees and gates

This policy option is focused on non-public debt like funds, and because our members primarily use public debt funds for derivatives' margin calls, we will not provide a comment on this topic.

Removal of stable NAV

Our members value the stable NAV attributes of a MMF, and we do not support removing it for public debt MMFs. Posting cash for reinvestment to a MMF is done primarily to reduce custodian risk while preserving principal of the collateral posted. Without a stable NAV, the value of the MMF could significantly reduce and leave the collateral balance lower from day to day, even though the cash that was posted from day to day would have the same value during the same time horizon.

Removing the stable NAV would increase counterparty risk because the value of the cash collateral originally posted could decrease and pledging counterparties would have to transform their cash into other types of eligible collateral prior to posting to their receiving counterparties. This could result in additional operational and trading costs and performance drag to the end-investor.

Limits on eligible assets

As our comments are focused on public-debt MMFs, we will not provide comments on this policy option for non-public debt MMFs.

Additional liquidity requirements and escalation procedures

Based on the inflows to public-debt MMFs – not redemptions and outflows - in the market volatility of March 2020, we do not think public debt MMFs should be required to implement additional liquidity requirements and escalation procedures.

5. **Broad impacts on the stability and functioning of STFMs.**

Because our members' interests are focused on the use of public debt MMFs as eligible collateral, we will not comment on the broader impacts on the stability and functioning of STFMs.

However, we do encourage the FSB to consider the importance of global harmonization and the value of substituted compliance or equivalence determinations (as appropriate) between different jurisdictions' regulatory regimes, given the global nature of the derivatives markets.