IMMFA

INSTITUTIONAL MONEY MARKET FUNDS ASSOCIATION

Financial Conduct Authority
Asset Management and Funds Policy Team
12 Endeavour Square
London
E20 1JN

21st July 2022

Re: IMMFA Response to Financial Conduct Authority and Bank of England Discussion Paper DP22/1 on Resilience of Money Market Funds

Dear Sir or Madam,

IMMFA welcomes the opportunity to reply to the Financial Conduct Authority's Discussion Paper on Money Market Fund reforms, published jointly with the Bank of England and endorsed by the Treasury.

The Institutional Money Market Fund Association (IMMFA) is the trade association which represents the European short term money market fund (MMF) industry. IMMFA's mission is to promote and support the development and integrity of the MMF industry by engaging with and informing policy makers and, amongst other things, providing a primary point of contact.

IMMFA has 27 members, consisting primarily of asset managers but also custodial banks and other firms. Of the 27, 18 are asset managers. IMMFA MMFs assets under management are currently EUR880bn EUR equivalent. This is comprised almost exclusively of institutional funds, denominated in three main currencies, USD, GBP and EUR, of which USD is the largest (USD499bn), followed by GBP (GBP225bn) and EUR (EUR124bn). Although the overwhelming majority of IMMFA MMFs are stable NAV in the form of either LVNAV (76%) or PDCNAV (19%), IMMFA represents all fund types and many of our members offer a range of funds. IMMFA MMFs are domiciled in Ireland and Luxembourg (with one exception) and are all rated AAA (MMF rating) by one or more authorised credit rating agency.

As of the end of the first quarter 2022, the ECB recorded total European MMF assets under management as EUR1,377bn, meaning that IMMFA MMFs (EUR834bn equivalent at that time) accounted for 60% of the total market.

The UK investor base is a vital part of IMMFA's distribution, consistently accounting for around 40% of total funds. With GBP225bn under management, 77% of which were sold to UK investors in 2021, sterling denominated MMFs are a very significant sector of the European MMF market.

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Summary

IMMFA believes that the reforms introduced under European Money Market Fund Regulation 2017/1131 (EU MMFR) were highly effective in enhancing the resilience of MMFs. However, the March 2020 crisis illustrated certain areas where regulation had not operated as intended and IMMFA therefore supports efforts to address such areas with targeted, proportionate reforms. In particular,

- We support the recommendation to delink liquidity thresholds from the possible imposition of fees and gates. Removing the linkage frees up liquidity buffers to be used as we believe they were intended, namely, to meet redemptions during times of stress, avoiding the need for MMFs to sell assets into a stressed market and effectively removing first mover advantage. We believe the positive impact of this is being underestimated.

- We support the proposal that all MMFs include the use of liquidity management tools (LMTs). The choice, calibration and activation of such tools should, in our view, be left to the discretion of the fund manager.

- Although swing pricing is a useful tool in other fund types, we do not support its application to MMFs for operational and structural reasons which we explain in our response. MMFs are structured in such a way that they hold high levels of liquidity to meet redemptions, whereas other fund types typically sell assets in order to do so. Swing pricing would also impact the ability of funds to offer same day value and settlement which we believe it is vital to preserve. We recommend that the existing regime for use of LMTs be leveraged as this can achieve the same economic outcome as swing pricing.

- We do not support the removal of the stable NAV from the Low Volatility NAV (LVNAV) category. There is little, if any, evidence to substantiate the suggestion that the stable NAV was a factor in fund outflows during the March 2020 crisis. On the contrary, Variable NAV (VNAV) funds in both the US and Europe experienced substantially similar levels of outflow to LVNAVs suggesting that valuation methodology was not a key determinant. The LVNAV withstood a major stress event and continued to perform as intended, demonstrating the structure's resilience.

- We believe that removal of the stable NAV would deprive investors of the LVNAV's core utility value and leave them with limited equivalent alternatives given the dynamics of the bank deposit market. The investor utility of the LVNAV fund is reflected in its 46% (EUR650bn equivalent) share of total European AUM. If the stable NAV were removed, we would expect the overall MMF market to shrink, impacting issuers who rely on the ECP and CD markets for flexible, efficient short-term funding. Investors may be forced into less transparent and less regulated alternatives which would not reduce systemic risk.

- We find that requiring MMFs to hold significantly higher quotas of public debt would not only be very challenging from a practical perspective but also introduce new and unnecessary risks. Furthermore, it would be regressive in significantly impairing the role of MMFs in providing a vital source of disintermediated funding to private sector

issuers. Such additional quotas should only be contemplated if accompanied by structural measures to address market supply and demand imbalances.

- We agree with the FCA that the focus should be on asset side liquidity rather than liability side measures. Delinking would significantly enhance asset side liquidity.

We remain committed to enhancing the resilience of MMFs through appropriate measures which ensure that their utility value as an important cash management product is retained and we look forward to engaging further with the UK authorities, in particular on any areas where you decide to consult the industry in more depth.

Yours faithfully,

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IMMFA Response to Discussion Paper Questions

Q1: At what point might higher minimum liquid asset requirements start to affect the operation of and demand for MMFs? What impacts might you anticipate? How would you quantify that effect for different levels of DLA and WLA? For example, at an additional 20 to 40 percentage points for minimum WLA (as applied to both LVNAV and VNAV funds)

In our view the current levels of liquidity for LVNAV and PDCNAV MMFs are appropriate. We base this on a number of factors:

- Delinking minimum liquidity thresholds from fees and gates, a targeted reform widely supported by a range of stakeholders, would enable LVNAV[1] MMFs to access their liquidity during times of stress and in circumstances when it is in the best interests of investors to do so. The current levels of 10% DLA and 30% WLA were more than sufficient to meet the elevated redemptions experienced during the crisis and therefore, in our view, remain appropriate. It was the ability to access that liquidity which was at stake.
- Given the 'bright line' created by the link between the 30% minimum WLA and the possible use of fees and gates, MMF managers prudently manage levels of liquidity in excess of the required minimums to allow for a margin of comfort. This means that they can remain above regulatory minimums without having to sell assets during normal times. Setting higher levels of minimum liquidity would reduce flexibility. This liquidity could also become trapped as the voluntary buffer above the regulatory minimum would likely be reduced and would, in any case, certainly be less than the 30% which would become available under delinking. This perversely risks an outcome where MMF managers may have to sell assets more frequently and so runs counter to the objective of creating a counter cyclical buffer to be utilised during times of stress. The objective of delinking should be to make the Weekly Liquid Assets (WLA) truly available, as designed.
- Higher liquidity levels may also create challenges for MMF managers in investing larger amounts of very short cash. The impact of prudential legislation significantly reduced appetite on the part of banks for non-operating cash, making it highly challenging for MMFs to find a home for liquidity at certain times of the year, such as reporting dates. Whilst this may be manageable for USD denominated MMFs, problems can be acute in EUR and GBP and show no signs of abating. Whilst a requirement for banks to operate on averaged balance sheet ratios is intended to alleviate such reporting date issues, the problems have shown no signs of abating and are in our opinion unlikely to be entirely resolved by averaging.
- Absent a European facility for absorbing excess liquidity in the system, such as the heavily utilised Federal Reserve's Overnight Reverse Repurchase Programme (RRP), which indirectly benefits USD offshore MMFs, these challenges are likely to continue or indeed be exacerbated by other factors such as the Bank Levy. The higher the liquidity levels, the more problematic it becomes for MMFs to invest daily or weekly liquidity around periods such as quarter and year ends. (See also our comments on the Federal Reserve's RRP facility in Q2).

[1] For the purposes of this discussion, we exclude PDCNAVs which did not have pressure on liquidity and are much less likely to do so. The point mainly pertains to LVNAVs.

- We note that short term and standard VNAVs hold less liquidity than LVNAVs and PDCNAVs despite, in the case of standard VNAVs, having significantly more permissive investment parameters. In our view, liquidity characteristics should be consistent across fund types.

Q2: What is your view on the feasibility of a requirement for UK MMFs to only invest in public debt? Do you think such an option would need to permit reverse repurchase agreements secured on public debt to be feasible? How should requirements take into account differences in the liquidity between different types of public sector debt?

What is the feasibility of a requirement for UK MMFs to only invest in public debt?

To date, PDCNAV MMFs have been effectively confined to USD, reflecting the depth of the underlying USD government market and, to some extent, the influence of US investor patterns. Current PDCNAV AUM are USD162bn, GBP3.05bn and EUR0.044bn. The feasibility of requiring UK MMFs to invest exclusively in public debt therefore varies dramatically by currency. Public debt assets in GBP and EUR are subject to very different supply and demand dynamics from the USD market, which creates significant price distortions around reporting dates. Mandatory quotas in GBP and EUR would consequently, in our view, add pricing volatility and introduce unnecessary risk.

GBP denominated UK regulated/domiciled MMFs

- In our view it is not feasible to require GBP denominated UK MMFs to invest exclusively in public debt.
- As the FCA note (4.19), lack of supply in the UK Treasury bill and short gilt market would seriously inhibit the ability of a GBP denominated fund to invest exclusively in public debt assets. GBP denominated LVNAVs currently have GBP213bn in AUM, compared to UK T bill supply of less than GBP40bn. The maturity of UK T bills would also have to be considered as the most common bills are issued with a three- and six-month maturity, whilst an MMF has to at all times maintain a weighted average maturity (WAM) of less than 60 days.
- Insufficient supply of short-term public debt assets would likely force MMFs to buy longer dated assets to fulfil their obligations. This may be incompatible with MMF WAM requirements and would add to interest rate sensitivity, price volatility and maturity transformation.
- As noted by the FCA, having a single investor base dominant in the short-term gilt market would lead to distortions and impair secondary liquidity. ESMA similarly notes that a mandatory quota introduces other risks such as magnifying pricing pressure on public debt assets in the event of a sovereign debt crisis.[2]

Do you think such an option would need to permit reverse repo secured on public debt to be feasible?

- Although under such an option the inclusion of reverse repo secured on public debt would certainly be recommended as it provides equal or indeed (being

[2] ESMA Opinion, paragraph 52, p.23.

predominantly overnight) superior liquidity, it would not of itself solve the problem of lack of supply and so make the proposition feasible. Reverse repo transactions are subject to severe capacity constraints around bank reporting dates, as noted in our response to Q1, so although its inclusion would add some flexibility, the supply problem and concomitant exposure to pricing distortions, particularly around reporting dates, would certainly remain.

- Whilst there is normally a plentiful supply of short-term government debt denominated in USD, even this can vary according to market dynamics. We note that in the US onshore market, where qualified USD funds can access the Federal Reserve's Overnight Reverse Repo Facility (RRP), supply and demand dynamics have led to very high levels of usage, in excess of USD1trn since August 2021 and currently USD2.16trn.[3] This demand exists despite the US Treasury market being the deepest government debt market in the world. Offshore USD MMFs do not qualify for the RRP although they benefit indirectly from its presence. There is no such comparable facility in Europe to absorb excess liquidity.

Points applicable more generally

- Requiring a prescriptive allocation to a certain asset class increases susceptibility to shocks specific to that sector. Increased exposure to public debt could be counter-productive in the event of a sovereign debt crisis or credit concerns about sovereign risk, such as occurred in 2011. Fixed quotas reduce the portfolio manager's flexibility making it harder to respond to changes in the market environment.
- AAA MMFs do not typically make use of derivatives although this is allowed under the MMFR. This means that all investments must be in the base currency of the fund, so it is not an option to source public debt through use of a cross currency hedge or to shorten the duration by use of an interest rate swap. Investors in IMMFA MMFs would not be comfortable with these elements which would, in any case, make the paper less liquid.
- Many investors require their MMFs to have a diversified investor base as this reduces concentration and adds to fund resilience. A diversified investor base increases fund liquidity and make the fund less vulnerable to trends which reflect a particular investor sector. This makes growth in the sector from such a small base highly problematic.
- In the event where LVNAV and short term VNAV MMFs ceased to exist and investors only had the option of PDCNAVs, investor diversification would be adversely impacted by the lack of scale, making it more likely that investors leave the sector rather than have a larger footprint in a reduced fund type. This would be likely to force investors into other more opaque and less regulated products.
- A forced shift into public debt would have significant implications for private sector funding (CP and CD issuance). This is addressed in more detail in Q3.

How should requirements take into account differences in the liquidity between different types of public sector debt?

[3] https://www.newyorkfed.org/markets/desk-operations/reverse-repo

- Although public debt assets will in general be more liquid, liquidity between various issuers can, as the FCA also suggest, be subject to meaningful divergencies. These are driven by both relative credit worthiness and methods/characteristics of issuance (e.g., auctions versus dealer panel 'best efforts', listings, repo-ability). Such issues become more acute when there is a lack of supply in the underlying government market.
- Given liquidity is driven by a number of variables such as credit worthiness and amounts issued, as well as by methods of distribution, identifiers, market making conventions and market conditions it would be challenging to define what generically constitutes liquidity however, we note that not all assets that would qualify as 'public debt' would share the same liquidity characteristics e.g., sovereigns versus agencies, differences in depth of the various jurisdictions.
- In the US onshore market Government MMFs can count US Treasuries towards Daily Liquid Assets (DLA) and US agency Discount Notes of up to 60-day maturity towards WLA. This bifurcation reflects the underlying relative liquidity, although agency paper is full faith and credit of the US government. This concept would broadly hold true in the UK with the difference that public debt would effectively be confined to issuance of UK Treasury Bills and Gilts, since there is no agency market and are no other guaranteed issuers who would offer comparable size and liquidity. However, due to supply constraints, even very short dated public debt assets can display significant differences in liquidity and related price volatility. For instance, short UK Gilts can behave very differently from UK Treasury Bills.
- In EUR the situation is further complicated by there being multiple sovereign issuers as well as a significant number of state guaranteed issuers, many of which display very different trading characteristics. This market fragmentation undermines assumptions about the inherent liquidity of public debt.
- The proposal to require MMFs to hold more of their assets in public debt is underpinned by the assumption that public debt will in most circumstances be more liquid, which we agree with, although, as noted, liquidity can vary. This clearly conflicts with the current 17.5 % cap on 'highly liquid' holdings (effectively meaning public debt) which, in the case of LVNAV and PDCNAV MMFs, can currently count towards WLA and highlights that 17.5% is an arbitrary limit (Article 17 (7)). We discuss this further in Q8.
- Having multiple eligible sources of high-quality assets for both liquidity and the entire portfolio supports the ongoing efforts of the FCA to mitigate concentration risk and trigger events originating with single products or issuers/sectors in the market.

Q3: What is your view on the impact of a maximum limit on holdings of private sector assets? For example, a maximum of 40%? How might issuers respond if there was a change in demand for those assets from MMFs?

- The *de facto* corollary of a cap on private sector assets is an equivalent increase in public sector assets. The challenges associated with mandatory public debt holdings are addressed in our response to Q2.
- In principle we are averse to the introduction of prescriptive private (or, conversely, public debt) quotas on the basis that they would introduce additional and

unnecessary risks and are not the most effective way of enhancing liquidity. We believe that portfolio managers should have flexibility and discretion over how to meet liquidity requirements in the best interest of investors. The fulfilment of liquidity requirements should operate in line with the general principles of portfolio management whereby the exercise of discretion allows investment managers to take an informed professional view. This in turn creates diversification and competition between funds which is in the interests of investors.

- The goal should be to allow portfolio managers to source liquidity in any given market conditions as these conditions can change dramatically not only due to a 'black-swan' systemic event such as the March 2020 crisis, but due to fluctuations in market supply and demand which have become a recurrent source of price dislocation, particularly in GBP and EUR.

How might issuers respond if there was a change in demand for those assets from MMFs?

- Placing a cap on holdings of private sector assets would clearly restrict funding to private debt issuers since MMFs currently provide a valuable source of short-term, flexible, cost-efficient borrowing to a range of private sector issuers. This source of funding cannot readily be replaced.
- Issuers may respond by a combination of seeking other funding sources, increasing their levels to attract new investors, or shrinking their balance sheets and associated commercial activities. We address these outcomes individually below.
    i. In the case of other funding sources, these are limited. The European CP and CD markets currently offer the most cost efficient and flexible source of short-term funding which cannot be readily replaced. Those issuers able to access the deep US CP market are likely to be already doing so in conjunction with their European borrowings. The US CP market favours very large issuers with strong name recognition and being USD denominated, involves FX hedging.
    ii. Corporate issuers would have to revert to reliance on bank debt which would have a significantly negative impact on their funding costs and flexibility. A regression towards bank lending would undermine the key objective of having disintermediated capital markets which can deliver efficiency and mitigate risks by providing diverse sources of liquidity. This increased reliance on bank funding would be combined with constraints on banks themselves who are the largest users of the CP and CD markets.
    iii. Alternatives for financial issuers would be limited. To maintain existing levels of activity, they would have to issue longer term which increases funding costs and greatly reduces flexibility.
    iv. Increasing funding levels for short-term debt is likely to be only marginally effective in the absence of investors. Issuers are also very protective of their borrowing levels and highly sensitive to appearing distressed. Increased funding levels would also ultimately be passed on through business channels and permeate into the real economy.
    v. The most likely outcome would be a shrinkage of balance sheet and the associated economic activity, with possible consequences for lending to the real economy.

Q4: What is your view on the relative benefits and costs of the different types of asset requirements, such as increasing minimum DLA or WLA, requiring minimum public sector debt holdings, or imposing a maximum limit on holdings of CD/CP (or a combination of those measures)? Please consider increased resilience for MMFs in times of financial markets stress as part of your answer. If possible, please provide data to support your views.

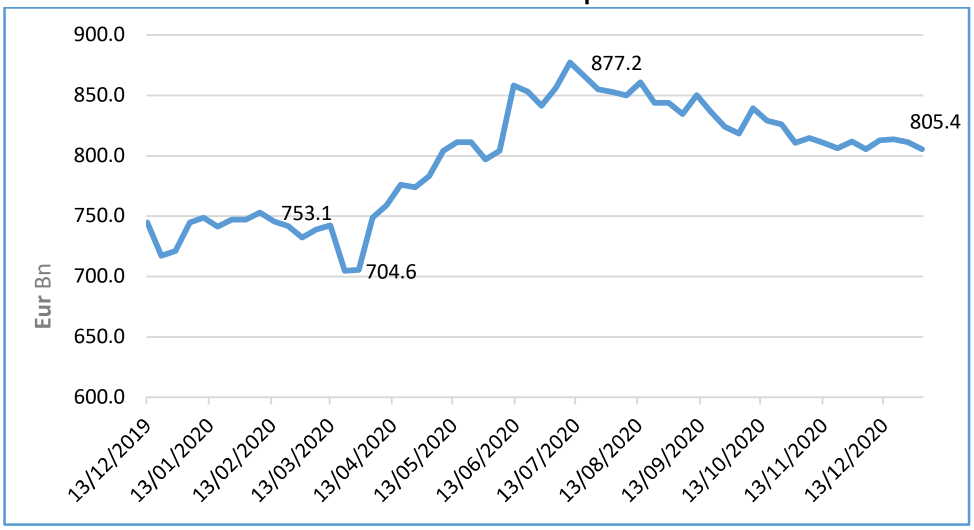
- We support efforts to enhance fund resilience and believe the focus should be on liquidity. In our view, liquidity, and therefore resilience, will be significantly enhanced by delinking, the benefit of which is being underestimated.
- Under normal circumstances MMFs will comfortably meet redemptions from their DLA which will in turn be organically replenished by a roll down of WLA. This is an important point which is often overlooked: MMFs are structured in such a way that they do not sell assets to meet redemptions under normal circumstances, since redemptions are met from DLA.
- In a stressed scenario, MMFs may need to temporarily dip into their buffers to meet elevated redemptions, as experienced in the crisis. Delinking would free up liquidity buffers to be used for this purpose, as we believe was the intention, and avoid MMFs being forced sellers into markets where liquidity is constrained.
- Mandatory quotas are not the optimal way to improve liquidity and, in our view, would introduce additional and unnecessary risks (see our response to Q2). In summary, requiring minimum public debt quotas increases maturity transformation and sensitivity to interest rate moves, reduces manager flexibility with regard to their view on duration, exposes funds to supply constraints and the concomitant price volatility around reporting dates, and creates concentration risk both for the fund and for the marketplace where dominance by one investor sector would have adverse implications for secondary liquidity (as noted by the FCA).

Q5: Do you agree that the regulatory links discussed in the 'Threshold effects related to liquidity levels' section exacerbate first mover advantage and can drive additional unnecessary investor redemptions in a stress? If so, how much of a problem does it cause and how would you quantify it? Would you support a proposal to remove such links? If possible please provide data to support your views.

- Yes, we agree with this analysis and support the proposal to remove the link. Our experience of investor behaviour is that the 30% WLA threshold became a 'bright line', inadvertently leading to pre-emptive redemptions and thereby creating procyclical risk. This is supported by the fact that IMMFA AUM recovered quickly once markets stabilised and by early July 2020 had increased 22% from the 20 March 2020 low of EUR704bn[4] to a new high of EUR877bn.

[4] Compared to a pre-crisis high of EUR753bn on 7 Feb 2020

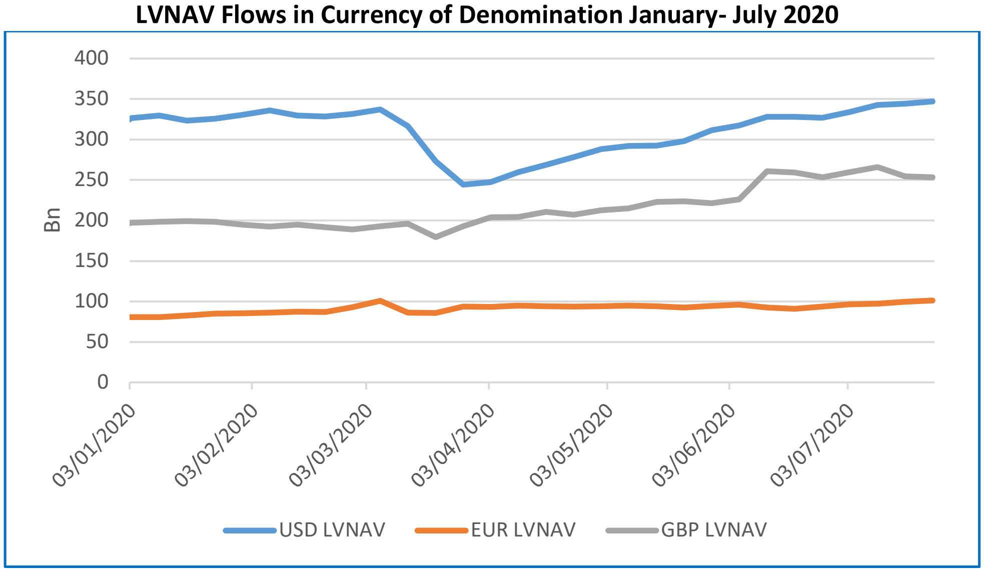
IMMFA AUM 2020 EUR equivalent



Source: IMMFA/iMoneyNet

- The 30% WLA threshold is highly transparent and became the focal point of investor attention at the expense of a more holistic view of fund metrics.
- Investor behaviour was also influenced by US conventions where a simple breach of the 30% is required, whereas the MMFR has the dual requirement of a 30% breach combined with a daily net outflow of more than 10% of assets, as highlighted in the FCA's recent (non-Handbook) guidance. This partially accounts for the fact that USD denominated LVNAVs (where decisions impacting global treasury actions may be made from the US) were subject to higher outflows than EUR or GBP, where the investor response was more muted. The fact that USD investors typically show more fluidity because they have a scalable 'risk-off' alternative in the form of PDCNAVs also meant that USD LVNAVs were more susceptible to outflows.

LVNAV Flows in Currency of Denomination January- July 2020



Source: IMMFA/iMoneyNet

- Removing the formal link increases usable liquidity, as intended by the regulation for just such a crisis scenario in the market, and significantly reduces first mover advantage risk.

Q6: What is your view on whether authorities should approve the activation of liquidity fees or the imposition of gates?

- As the FCA suggest, fund managers are best placed to 'make a judgement about whether the introduction of liquidity fees and gates is in the best interest of investors. We believe the fund manager should choose the type, timing, and calibration of liquidity management tools (LMTs).
- Authorities will not have a much less granular understanding of the underlying investors and their typical behaviour than the fund manager.
- It would be very challenging for authorities to act on a sufficiently timely basis in a stress event.
- Activation by authorities means it is hard to target and address idiosyncratic risk. Unless activation were applied across a whole sector, which could be an unnecessary amplification in the event of an isolated issue, it would be likely to lead to contagion.

Q7: Do you agree that the usability of liquidity resources could be improved by changes to how they are defined, such as defining requirements as an average over a period, or allowing authorities to change aspects of the requirements in a stress? What other changes should 39 DP22/1 Annex 1 Financial Conduct Authority I Bank of England Resilience of Money Market Funds be considered that might make liquidity resources more usable? Which changes might be most effective at making buffers more usable? If possible please provide data to support your views.

- It is important to establish the fundamental premise that buffers are there not to act as a floor, but to be used in times of need. Removing the link between minimum liquidity thresholds and the possible imposition of fees and gates is the necessary first step towards achieving such an understanding. We believe that delinking is the best way to make liquidity more usable and crucial to changing perception.
- Usability of buffers would not be sufficiently improved by authorities making countercyclical adjustments to liquidity requirements during times of stress and if the link is removed there would be no additional benefit from authorities doing such. Furthermore, having an external trigger risks creating another bright line.
- The focus should be on investor disclosure and education as to the repercussions of temporarily dipping into the liquidity buffer. Regulatory guidance and clarification that buffers are there to be used, such as provided by the FCA, would be welcomed. This could help reduce any stigma attached to a fund using its liquidity buffers. In this respect the recent (non-Handbook) guidance provided by the FCA on parts of the UK MMF Regulation is helpful in that it clarifies elements which may be concerning to investors and notes the broad requirement that any such fund 'adopt as a priority objective the correction of that situation'. (Article 24.2)

- Additional measures such as averaging requirements over a period, would be unlikely to have a meaningful impact. Although the principle of averaging is *prima facie* appealing, investors would be likely to continue to concentrate on the daily levels since these would still be available on a timely and fully transparent basis. Since we are against reducing the current levels of transparency, we would not recommend that actual daily levels be made opaque in favour of publishing an average.

Q8: Under what circumstances do MMF managers consider selling assets to meet redemptions? How might that change as a result of policy options aimed at making liquidity buffers more usable (including policies that aim to reduce threshold effects, and policies that change how liquidity requirements are defined)?

- Unlike other types of open-ended mutual funds, MMFs are structured in such a way that they do not anticipate selling assets to meet redemptions, as noted above. Redemptions are typically met using daily liquidity assets (DLA) which are continually replenished through the rolldown of WLA. Accordingly, an MMF will not be required to sell assets unless its DLA buffer is exhausted.
- The focus on the 30% WLA threshold meant that fund managers felt they should maintain liquidity in excess of the required minimum, meaning in some cases funds turned to selling assets rather than approach the minimum threshold.
- Changes to how liquidity is defined (e.g., by introducing quotas for public debt, or moving to average requirements) are unlikely to be effective policy responses (see answer to Q2 above). We do, however, believe that the definition of liquidity should be consistent between different fund types and here we draw attention to an important distinction between VNAV and LVNAV/PDCNAV MMFs regarding the definition of WLA, which is more stringent for the latter in that it includes additional constraints on assets which can count towards WLA. In the case of LVNAVs (and PDCNAVs) the 17.5 % cap on the amount of 'highly liquid assets' which can count towards WLA places an arbitrary limit on their ability to contribute to liquidity. Subject to Article 17 (7), *'highly liquid'* assets have a residual maturity of *up to 190 days* and can be redeemed and settled in *one* working day. In the case of VNAVs the definition of liquidity is significantly more permissive, allowing for the inclusion of any '*money market instrument or unit or shares of other MMFs*' up to 7.5 % of the 15% WLA requirement, provided they can be redeemed and settled within *five* days. We believe the definition of liquidity should be consistent from a definition perspective for funds offering same daily liquidity.
- The above 17.5% cap appears particularly incongruent given policy proposals to increase mandatory public debt holdings aimed at improving liquidity.
- Changes to liquidity requirements that increase the levels for stable NAV MMFs are in our view not required provided thresholds are delinked from fees and gates.
- Delinking would be an effective policy response as it would reduce the need to sell assets in a stressed market by making the fund's liquid assets available and usable.

Q9: Are you aware of any cases in which a sterling MMF uses or has used liquidity fees or swing pricing? If yes, please provide details if possible.

- To our knowledge no MMF, sterling or other denomination, and certainly no IMMFA MMF imposed fees or other LMTs in the March 2020 crisis or at any point since the financial crisis of 2007.
- Strains in the 2007 global financial crisis were most concentrated in the US market and, in Europe, in the EUR denominated MMF sector which preceded the current standard MMF fund type designation.
- No MMFs currently use swing pricing. It would be operationally complex for MMFs to do so and likely to impact their ability to offer T+0 settlement, a key tenet of their utility and a central value proposition to investors.
- With respect to proposals in general to use swing pricing, we would highlight the following:
    i. Swing pricing is an effective tool for other open-ended funds which differ from MMFs in that they are typically fully invested and therefore must sell assets in order to fund redemptions, usually by selling a representative pro-rata slice of the portfolio. Crucially, they also have a longer settlement basis e.g., T + 2 or 3. In the case of MMFs, the funds are structured in such a way that they hold liquidity in order to meet redemptions rather than selling assets to do so. This contrasts with MMFs which specifically hold substantial liquidity buffers to meet redemptions.
    ii. LVNAV and PDCNAV MMFs already benefit from provisions for the use of liquidity management tools, in the form of liquidity fees, at their disposal, which could achieve substantially the same economic result as swing pricing.
    iii. Swing pricing would undermine a central value proposition of MMFs by impacting the ability of providers to offer same day settlement which is a vitally important feature for investors. This would also run counter to global efforts to accelerate settlement.
    iv. Swing pricing would be an unfamiliar and relatively complex concept for some MMF investors.
    v. Swing pricing may undermine the integrity of the stable NAV.
    vi. Swing pricing is less appropriate for the securities held by MMFs which are already conservatively priced to the bid side since regulation (EU MMFR article 29.3(a)) requires that assets be valued on ‘the more prudent side of bid or offer’. With bid prices being the more prudent side, there is nowhere lower to swing. This differs from other types of open-ended mutual funds which use mid pricing.
    vii. Swing pricing will not solve the challenges associated with a liquidity event. Those investors who need cash for operational reasons, as was the case for many during the 2020 crisis, will continue to redeem. Other measures would be more effective in countering first mover advantage, such as delinking.

Q10: Do you agree that UK MMF rules should be clear on the need for the manager to avoid material dilution? Please explain your response.

- We agree that in certain circumstance anti-dilutive mechanisms may be the appropriate way of allocating a cost of redemption and to this extent we agree that managers should avoid material dilution 'by ensuring that the costs of liquidity, where material, are substantively passed on to redeeming investors' (4.45).
- The current regulation on fees and gates is clear and includes both discretionary and mandatory provisions in that whilst imposing a liquidity fee is optional in a scenario where WLA drops below 30% and this is accompanied net outflows exceeding 10% of assets, if WLA fall below 10% the manager is required to take action by either applying a liquidity fee on redemptions or suspending redemptions (article 34 (b)).
- Delinking minimum thresholds from fees and gates would make it appropriate to provide more structured guidance on the application of LMTs but this guidance should in our view remain high level and avoid being prescriptive or introducing new threshold effects.
- We feel that MMF rules are clear on material dilution. We note the FCA's point that LVNAVs are 'set up to tolerate a certain defined amount of dilution' (4.38) in the form of the collar. LVNAV funds would transact at a variable price when outside the 20bps collar, and we feel that this is an appropriate threshold at which 'material dilution' be passed to investors, one which strikes a balance between investor utility (rounding to a stable NAV when within 20bps) and investor protection (not rounding when outside 20bps).
- We believe that the interest of shareholders will best be served if the details of choice, timing, and calibration of LMTs are left to the individual fund managers who should have demonstrable processes in place to provide against material dilution.
- See our response to Q9 for views on swing pricing which, although an effective tool for other open-ended funds, we do not find to be appropriate for MMFs given that redemptions are designed to be met out of cash, meaning that gains or losses in the portfolio are not realised through the selling of assets to pay out redemptions.
- More prescriptive rules risk the creation of new bright lines (see below).

Q11: Do you think UK rules should be specific on how MMF managers should avoid material dilution in the way their funds are run, for example, with rules and guidance relating to LMTs? Please explain your answer.

- We believe that the application of LMTs in terms of choice, timing, and calibration, should be left to the manager's discretion as they are best placed to protect the interests of investors.
- The March 2020 crisis differed from the 2008 crisis in that it was a liquidity not a credit event. Different tools may be appropriate to different events, and it therefore makes sense that MMFs have a broad toolkit at their disposal, one that can be flexed to the environment.
- Prescriptive criteria on mandating and specific parameters and calibration for the application of LMTs risk creating new threshold effects which, as the FCA note, are to be avoided.

- It may be helpful to distinguish between forms of LMT through a waterfall of the options given that gates, for instance, have far more adverse consequences for the investor than do fees.

Q12: Do you have any comments on the current MMFR valuation rules in relation to this issue?

- We believe the current valuation rules for LVNAV and PDCNAV MMFs to be appropriate and that the 20bps and 50bps thresholds for LVNAV and PDCNAV MMFs respectively are also fair.
- In the case of LVNAV MMFs, the partial application of amortised cost accounting and the use of 2-digit rounding together allow for a stable NAV to be maintained within the prescribed 20 bps limit. Any mark to market losses which the portfolio may have sustained are not realised unless the assets are sold. Selling assets should not be required given the structurally high levels of liquidity held specifically to meet redemptions, providing that this liquidity is made accessible by delinking.
- Amortisation is an appropriate method of accounting for short-term investments which are typically held to maturity, and in the LVNAV it is only applied to assets under 75 days and only to those within 10bps of the market value. The full portfolio is marked to market at least once a day to ensure that the NAV remains within the 20bps threshold.
- In the case of PDCNAVs it is appropriate to amortise the whole portfolio and to have a wider limit of 50bps given that these funds hold 99.5% public debt where volatility can be expected to be lower. In times of stress, PDCNAVs are also likely to receive inflows rather than suffer outflows (see chart of USD fund flows in Q19 below).
- The combination of amortised cost accounting and rounding enables the fund to maintain a stable NAV which forms the basis of investor utility.

Q13: Do you have any comments on the macro-prudential swing pricing option?

- We agree with the FCA who note that macro-prudential activation would be challenging for the authorities. Authorities would have to define stress periods and choose the parameters despite lacking granular detail. They would also have to act swiftly in a stress scenario which is also likely to be challenging.
- It may not be appropriate to apply a blanket approach across all funds or multiple funds given the different underlying investor bases, flow patterns and portfolio positioning, therefore a macro-prudential approach may impact a fund when not appropriate to do so.
- The activation of swing pricing would also restrict redemptions to end of day only. This is because calculation of the swing factor comes at the end of the day after the receipt of all trades and requires both the custodian and manager to communicate and agree the swing factor and price prior to processing a transaction. This would bring forward MMF cut off times and remove the intraday trading currently offered, further limiting MMFs from providing investor utility.

- In the event of idiosyncratic stress confined to one or a small number of funds, any activation of precautionary measures by macro-prudential authorities could lead to risk contagion.
- Fund managers are uniquely placed to understand and anticipate the likely behaviour of their fund investors. This behaviour is likely to differ significantly between funds according to the make-up of the investor base.

Q14: Do you think the investor protection and possible financial stability harms set out for LVNAVs are, or could be material? Please explain and provide evidence, including any relevant data, to support your conclusion on this.

- As discussed above the link between minimum liquidity thresholds and fees and gates in LVNAVs resulted in the unintended consequence of the regulatory provision contributing to procyclicality. This can be addressed by the targeted reform of delinking.
- There is little or no evidence to suggest that LVNAV collars were a source of instability in the crisis. LVNAV investor redemptions were driven largely by concerns over the 30% WLA bright line, the need for cash resulting from the impact on cash flows of a widespread economic shutdown and the resultant market volatility, and concerns that access to that cash would become restricted. The majority of LVNAVs stayed comfortably within their collars, despite a 'black swan' event which led to extraordinarily stressed markets. (See NAV deviations in Appendix 1) The LVNAV fund type therefore in our view, demonstrated the appropriateness of its structure and its resilience in continuing to perform as intended and providing transparency to investors on the underlying mark to market pricing.
- We do not agree that offering a stable NAV also creates structural cliff edge at very low interest rates (4.54). EUR denominated LVNAV MMFs have operated in a negative interest rate environment since 2015. Since the implementation of the MMFR in 2019 and the prohibition of the reverse distribution mechanism (RDM), this has been achieved by creating an accumulating share class to complement the pre-existing distribution share class. Fund managers are operationally prepared to move to accumulating share classes should this be required. Investors are offered the opportunity to redeem or convert. (See more detail in answer to Q17)
- The LVNAV structure offers investors transparency on the NAV whilst at the same time providing a degree of price stability which is core to its utility value.
- We note that with the anticipated gradual withdrawal of quantitative easing, interest rates are expected to rise from the current extraordinarily low levels.
- Although the current regulation reflects a desire to protect against a credit event such as occurred in the previous crisis, in our view the impact of a major credit event, causing a significant write-down, would be equally detrimental for a VNAV as for an LVNAV.

Q15: Do different types of investor (e.g., retail, corporate or financial) value stable NAV offerings differently? What would be the implications for those investors if the stable NAV features of the LVNAV funds were removed?

- IMMFA MMFs comprise 96% stable NAV funds and are overwhelmingly institutional (the main exception being professional investors such as local authorities who have not opted up).
- The LVNAV sector currently stands at USD323bn, EUR108bn and GBP213bn (as of 8 July 2022). At of year end 2021, LVNAVs alone collectively accounted for the equivalent of EUR694bn which represented 47% of total European AUM. If PDCNAVs are included, this figure rises to 57%.
- The IMMFA investor base is attached in Annex 2 and consists of a wide variety of corporates, insurance companies, asset managers and pension funds, public sector entities (including local authorities, charities, and foundations) and financial institutions.
- The stable NAV is particularly important to corporate investors as it is treated as cash or cash equivalent for accounting purposes, whereas there is considerable uncertainty around the treatment of VNAV MMFs as such. Many UK investors in particular, value the LVNAV. The GBP denominated LVNAV sector is currently GBP213bn, 77 % of which are sold to UK investors. The exception to this is in jurisdictions such as the US and France where the authorities have provided explicit guidance that VNAVs can be treated as cash or cash equivalent.
- LVNAVs are also widely used by pension funds, insurance, and liability driven investment managers as the best solution for their collateral pools which frequently place cash in MMFs. This means the cash is available for draw-down in order to be posted as cash margin for derivative transactions. Intra-day access is particularly relevant for these investors.
- As a generalisation, financial investors are more comfortable with an element of volatility although some also have a strong preference for stable NAV MMFs for operational reasons such as daily sweeps.
- If the stable NAV were removed from the LVNAV, we anticipate that many investors would leave the sector due to:
    1. Uncertainty around the accounting treatment (cash equivalence) of VNAV MMFs.
    2. The need to adapt and update treasury management systems or accounting processes to accommodate VNAV.
    3. The lack of a stable NAV alternative given that PDCNAVs are currently only scalable in USD.
    4. Loss of scale in the sector which would lead to greater investor concentration, reducing resilience. Many large investors take the size and liability diversification of their MMF investments into account when investing as this is a factor in liquidity, so loss of scale can become self-fulfilling. Even if these investors may be comfortable with a VNAV, they may be uncomfortable with the loss of scale in the sector as those investors who do require the stable NAV reduce their presence.
- Since the ability to invest in the nearest stable NAV alternative, a bank deposit, would be limited, the combined outcome of the above factors could result in the movement

of cash to other less regulated and less transparent products, such as ETF digital assets, for cash management which could move rather than mitigate risk in the liquidity sector.

Q16: What alternatives are there for MMF users who specifically need capital value preservation? How do the costs and risks of those alternatives compare with MMFs?

- The most obvious alternative for an MMF investor is a bank deposit. However, deposits have both limitations and drawbacks:
    i. Prudential legislation has dramatically reduced bank appetite for non-operating cash, capping demand for short term deposits. Many investors would struggle to find sufficient capacity amongst their deposit counterparties
    ii. Deposits represent single counterparty credit exposure versus the highly diversified collateralised risk of an MMF.
    iii. Longer term deposits have less flexibility and may be subject to breakage fees.
    iv. In order to find deposit taking capacity investors may have to use banks with lower credit ratings thereby taking on more risk, as happened with the Icelandic banks in the 2008 crisis.
- Direct investments will be costly as they require significant back-office resources, custody facilities and in-house expertise to monitor a variety of credits. Smaller investors are likely to lack the economy of scale necessary to make such resources viable. They would also be unlikely to get the execution levels of an MMF which is able to deal in size and to manage and benefit from multiple counterparties.
- In terms of liquidity risk, direct investments will be subject to the same liquidity constraints during periods of market stress, meaning it may be harder for an investor to redeem their cash. This creates the risk of payment defaults and could add to systemic risk. Credit risk is also likely to be increased given that economies of scale allow MMFs to dedicate significant resources to credit analysis. Only the largest investors would be able to replicate this.
- Reverse repo (secured on government collateral) is low risk, but it is onerous and complex in terms of documentation, which creates costs, and would only be an option for the largest investors. It also requires settlement and safe custody facilities which also incur significant costs and entail operational risks. Supply will also be subject to the same or even greater constraints than deposits i.e., limited around reporting dates and only available to existing banking clients.
- VNAV MMFs may be an alternative for some investors, likely those financial investors who are more comfortable with volatility, but for non-financial investors a move to VNAV is likely to involve costs in updating treasury management and accounting systems and further outlays on auditor opinions which can be time consuming and onerous. The outcome of auditor opinions is also uncertain.
- Some financial investors who are more comfortable with NAV volatility have other serious concerns around the impact of loss of scale in the sector it increases investor concentration and the associated risks (see Q15 above).

- Short-term VNAVs are required to hold less liquidity than LVNAVs (7.5% DLA versus 10% and 15% WLA versus 30%), therefore in a stress event they carry substantially the same risks.
- Since standard VNAVs have significantly more permissive parameters in terms of duration and portfolio composition, they carry more risk due to increased maturity transformation and lower liquidity requirements.
- Given the above obstacles to the alternatives which are most comparable to MMFs, investors are likely to be pushed towards less regulated and less transparent products.

Q17: For investors in sterling government MMFs, what was the impact of moving from distributing to accumulating share classes and the associated end of the stable NAV offering? Were there any implications for the accounting treatment of those MMFs? Were there any other costs associated with the change? If possible please provide data to support your views.40 DP22/1 Annex 1 Financial Conduct Authority I Bank of England Resilience of Money Market Funds

- When sterling government MMFs moved to an accumulation share class due to negative yields there were some investors who left the product. This was due to two reasons: 1) a negative yield/return was being passed on to investors and 2) the operational convenience of a constant NAV was taken away. Investors could continue to achieve a non-negative return and constant value by moving to a different product such as deposits or LVNAV MMFs.
- The MMF category remained the same (PDCNAV) and therefore the accounting treatment was unchanged.
- There was additional cost to investors in respect of the additional risk being taken to achieve their goals (bank credit risk via deposits or LVNAV MMFs compared to government risk). The operational cost of conversion was borne by the MMF providers themselves.
- By way of background, when returns of EUR denominated MMFs moved to a negative yield in 2015 the industry introduced the reverse distribution mechanism ('RDM') as a solution. RDM allowed funds to cancel/redeem a number of shares from an investor's account equal to the negative yield due on their investment, on a daily basis, replacing the monthly dividend distribution. This enabled funds to maintain a stable price of 1.00 per share, thus preserving the utility value of the constant NAV.
- After MMFR became effective in 2019, European MMFs were no longer able to use RDM to distribute negative yields. This led to the industry bodies, fund providers and NCAs finding a solution in the form of the accumulating share class.
- MMFs typically separate capital and income for accounting purposes, distributing the income, in a positive yield environment, as cash or, more often, as additional shares. Accumulating share classes also distinguish between income and capital and roll negative accrued income into the daily NAV. Capital stability continues to be maintained on the same basis as before, enabling the fund to continue to be classified as an LVNAV or PDCNAV as appropriate.
- EUR denominated LVNAV MMFs offering accumulating shares have continued to operate as LVNAVs and sterling denominated government funds (PDCNAVs) have

continued to operate as PDCNAVs, adhering to the relevant requirements including with respect to liquidity levels and portfolio composition. Since the funds continued to operate as an LVNAV or PDCNAV, in most cases there were no accounting implications for investors.

- Subsequently, many MMFs have offered both distribution and accumulating share classes side by side for many years.
- As with the transition into negative rates for EUR denominated MMFs, a move from distributing to accumulating share classes for sterling government MMFs did not entail an end to use of the PDCNAV category. When sterling MMFs invested in governments moved into negative yield territory, investors were offered the option to redeem or convert to accumulating share classes. As noted above, the funds continued to operate according to their designated fund type.
- As some investors preferred the operational simplicity of a stable NAV afforded by a distribution share class and were reluctant to accept negative yields, there were some outflows into alternative products, likely those which had non-negative yields, such as LVNAVs or bank deposits. It is worth noting that such alternatives would have been more limited in the case of the EUR investor given the magnitude and length of time of negative rates.
- Assets in the accumulating share class of a sterling government MMF continue to be valued using amortised cost, as they were in the distribution share class. Since it is only negative income that is reflected in the daily change in NAV, capital stability is maintained as before. The only change to the NAV will result from negative accrued income. (This would be the same for an accumulating share class in a positive rate environment.)
- There were costs associated with the move from distributing to accumulating but as noted, these were borne by the fund managers.

Q18: If stable NAV was no longer permitted for UK LVNAV MMFs, and assuming no other changes (e.g. to liquidity requirements), what do you expect to happen to demand for LVNAV funds relative to VNAV funds? What value would there be in retaining LVNAV as a UK MMF type?

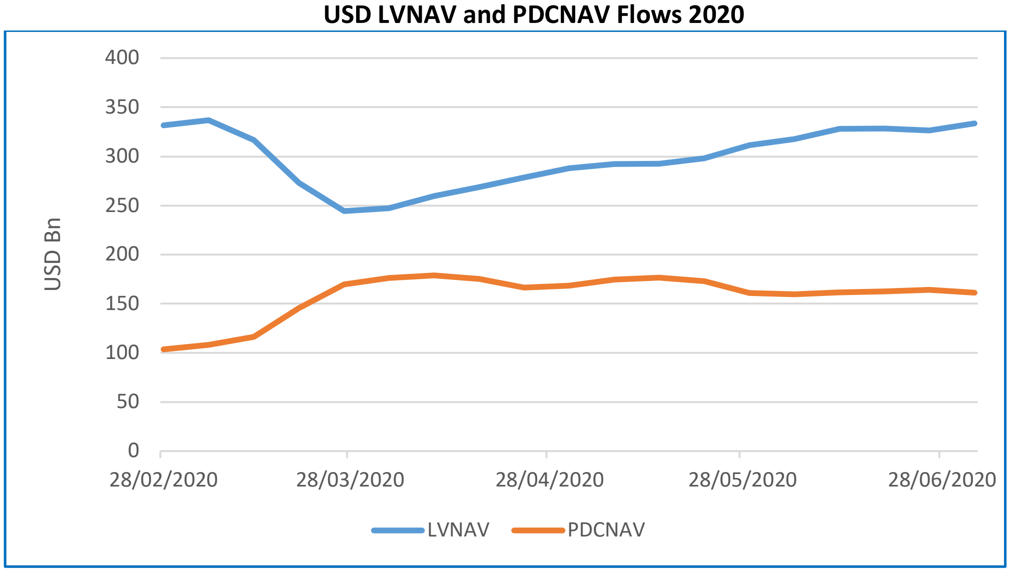
- The core utility of the LVNAV fund type is the ability to round to a 2-digit price and thereby maintain a stable NAV. Removal of this ability would certainly suppress demand significantly and would be likely to trigger migration out of the MMF sector as a whole.
- Investors would recognise that an LVNAV with a fluctuating NAV is just a VNAV (albeit with higher liquidity requirements). There would be little benefit in remaining in an LVNAV given the utility of the stable NAV had been removed. Therefore, we would expect that the subset of investors who can tolerate a variable NAV would be likely to move to a short-term VNAV fund rather than remain in an LVNAV with a fluctuating NAV (all else being equal, AAA ratings etc.)
- The concomitant loss of scale would have a knock-on impact for remaining investors and become self-fulfilling as concentration risks increased. Many investors rely on the MMF investor base being diversified and size and broad appeal are factors in achieving diversification.

- As discussed above, although some investors could transition to VNAVs, many would not be able to do so due to their internal requirement to have a stable NAV and the implications for cash and cash equivalence.
- The GBP LVNAV sector is currently GBP213bn of which 77% are sold into the UK, so this point has particular implications for many UK investors.
- The higher liquidity levels in LVNAVs relative to VNAVs reflected the LVNAV's use of the stable NAV. It would be inconsistent to maintain higher liquidity levels if the stable NAV were removed and the fund operated with a variable NAV.
- We see no value in maintaining the LVNAV without the stable NAV element. The creation of multiple VNAV structures adds unnecessary complexity and does not contribute to the stated objectives of making MMFs more resilient. It also further fragments the market and opens the possibility of investors arbitraging risk by shifting from a VNAV with lower liquidity thresholds to a VNAV with higher liquidity thresholds in a stress event, making redemptions harder to manage and increasing overall risk. Such flows occurred in March 2020 from USD LVNAVs into USD PDCNAVs where PDCNAVs offered a risk-off option (not available in sterling). Such flows were sustainable because LVNAVs hold higher levels of liquidity but may become destabilising if amplified in a sector where liquidity requirements are lower.

Q19: Should UK public debt CNAV MMFs continue to be permitted to operate with a stable NAV?

- Yes, PDCNAVs should definitely be permitted to continue to operate with a stable NAV. They have very limited volatility and although currently only scalable in USD, serve an important role in providing investor choice.
- PDCNAVs are likely to have inflows at times of stress and Since PDCNAVs hold 99.5 % public debt the volatility of their assets is very low. For this reason, they offer a 'flight to quality' option at times of stress and can be expected to benefit from inflows as was the case for USD PDCNAVs in March 2020, illustrated below.

USD LVNAV and PDCNAV Flows 2020



Source: IMMFA/iMoneyNet

- We see no reason to curtail their use of the stable NAV and on the contrary, feel their growth should be facilitated.

Q20: In what way might these three types of liability side policy options (reducing dealing frequency, imposing notice periods, and imposing minimum settlement periods) impact MMFs' ability to meet MMF investor needs? How might investors respond to these options? How might it affect investor liquidity management? What alternative cash management options do investors have, and what costs and risks are associated with the alternatives?

- Investors use MMFs as a safe home for their short-term cash needs. The three suggested options would reduce the liquidity of MMFs for investors, thereby removing a core part of their utility. If investors have to wait to get access to their cash, they are less likely to use MMFs to the same extent in future. Furthermore, in the event of stress, such a mechanism may lead to more pre-emptive redemptions. Given access to liquidity is paramount during a time of market stress, investors may pull more cash from MMFs than they necessarily require for fear of having to wait longer to access cash in the future.
- Since the implementation of MMFR there has been a broad sweep of rules which have heightened the importance of moving intra-day cash around the financial system, for instance, for collateral and margin requirements where T+0 settlement is a prerequisite. At the same time banks have reduced their balance sheets and curtailed their deposit activity in light of prudential regulation, making MMFs even more important to liquidity management. In our view there should be recognition of the consequences for MMFs of these two contradictory pieces of financial reform and also of the vital role which MMFs play in bridging the disjunction between protecting the banking system and facilitating system-wide liquidity for a wide range of participants.
- The ability to redeem on a same day basis is vital to many MMF investors and liability side policies which reduce MMF's ability to do so would significantly impact the utility of MMFs, likely leading to a shift out of the sector.
- Deferred redemptions would make investor liquidity management much less flexible and in times of stress could lead to payment defaults, adding to systemic risk.
- Alternatives are covered in detail in Q16 above. In summary, deposit capacity is limited, deposits may have to be longer, breakage can incur fees, investors may be forced to go down the 'quality tree'; other types of investment fund are likely to hold and therefore provide less liquidity; reverse repo is onerous and only available to larger investors, it is also subject to supply limits; there are obstacles to direct investment which also entails costs and other risks.
- The need for liquidity would remain and although cash flows can to some extent be predicted, in a crisis such as the one experienced in 2020, the need for immediate cash would again arise. Whether their money is held in deposits, other fund types or in direct investments, disaggregated investors are likely to hold less liquidity than an MMF which structurally holds high cash buffers. This means liquidity risk in the system does not go away, it is merely shifted elsewhere.
- Disaggregated cash would be less transparent to regulators.

Q21: Which investors value intra-day settlement vs end of day settlement (T+0), T+1 or T+2-day settlement?

- The ability to transact on a T+0 basis is crucial for IMMFA investors and is regularly cited as one of the key MMF characteristics which they value.
- T+0 is particularly important for liability driven investors and corporate treasurers who use MMFs to manage operational cash (see Q15 above).
- In addition to offering same day value, LVNAV pricing allows managers to price and settle at multiple points intra-day. In the case of a tax or acquisition payment, or indeed any transaction where late payment might have a penalty or other consequences, such timing considerations are crucial. Investors may wish to withdraw their money a day earlier rather than settle late in the day and risk missing the payment cut off deadline, in which case they would have to deposit money with a bank which once again raises the question of capacity constraints in the deposit market.
- Intra-day settlement can also be very important to global investors who are operating across both Asian and European time zones.

Q22: The UK authorities are not aware of any MMFs in non-UK jurisdictions imposing limits on dealing frequency, or having non-zero notice periods, as a matter of general practice. Do you have any information to the contrary?

- We do not have information to the contrary.

Q23: Do you agree with our assessment that policy options to increase the liquidity of MMFs' assets could achieve the outcome of reducing MMF liquidity mismatch such that these liability side options may not become necessary?

- Yes, we do agree that the focus should be on fund liquidity.
- The link between liquidity thresholds and the possible imposition of fees and gates reduced the effectiveness of the regulation by creating a powerful disincentive against using the available liquidity. Its removal would be a far more effective reform that liability options and would render such liability reforms unnecessary.

Q24: Would liquidity-based redemption deferrals introduce the sort of regulatory threshold problems covered in the 'Threshold effects related to liquidity levels' section?

- Yes, since unfettered access to cash is crucial to the investor, introducing deferrals tied to liquidity levels would likely lead to the same type of investor behaviour that we saw in March 2020 (pre-emptive redemptions, first move advantage etc.)
- We are against liquidity deferrals and agree with the FCA's conclusion that a focus on asset side liquidity is preferable to liquidity-based redemption deferrals and that the latter are likely to introduce new threshold effects.

- The liability options suggested are based on the assumption of a liquidity mismatch of such an order that it threatens the fund's ability to meet redemptions. This perceived mismatch would be effectively eliminated by delinking which would free up the ample liquidity structurally held by an MMF specifically to meet redemptions.

Q25: Is there a way to design liquidity-based redemption deferrals which avoids threshold effects? Would such a design be useful for MMF managers or investors or both?

- We do not feel there is a way to do it without introducing threshold effects. It may be worth considering adding redemption deferrals to the Liquidity Management Tools to be used at the discretion of the MMF manager, however, they would have to be purely discretionary and not based on an underlying liquidity or other threshold.
- We reiterate that asset liquidity initiatives are preferable and have no liquidity-based redemption referrals to suggest which would be acceptable to investors and which would not introduce new risks.

Q26: On what occasions has redemption-in-kind been used for MMFs in the past? Under what kind of circumstances or conditions might it be used in the future? What benefits does it provide to investors?

- As the FCA note, for redemption in kind to be effective, transactions must be instantaneous and friction-free for all investors. In our view this is not achievable.
- Redemption in kind requires investors to have the ability to take delivery of the assets, i.e., have their own settlement or safe custody accounts.
- Redemption in kind may be a useful tool to have available in a fund prospectus but only for use in a wind-down scenario *not* as a liquidity management tool. In such a situation, where a fund is being wound down and assets being liquidated to pay back investors, investors would be given the choice of taking delivery of the assets and holding them to maturity, rather than realising less value through a forced sale. Only those investors with custody arrangements or their own settlement accounts would be able to avail themselves of the option. Such a scenario would clearly take place over a more extended period of time than the normal redemption of an MMF and would therefore serve no purpose in terms of liquidity management.
- In our view redemption in kind therefore does not bring investor benefits.
- Appropriate application of LMTs would be a more effective means of allocating a cost of liquidity.

Q27: What are the current barriers to offering redemption-in-kind to investors, either in normal or in stressed market conditions? How might those barriers be reduced or overcome?

- There are a number of barriers to redemption in kind under both normal and stressed conditions.
- Redemption in kind would, as noted, require investors to have the necessary settlement or safe custody facilities in place to take delivery, which in many cases

they will not have. It would also require that assets be divisible into the relevant fractional amount, which is unlikely to be the case with money market instruments. In most cases these have relatively high denominations (in many cases 100,000 and in some cases as much as 500,000) as they are not considered retail instruments. Any such procedure, even if operationally practicable, would require a significant amount of time and would therefore not solve a liquidity issue.

- As noted by the FCA, investors would in likelihood still need to sell the instruments. It would seem slightly unfair to pass this burden onto investors when an asset manager is unable to liquidate securities. Investors are likely to have less liquidity than an MMF since MMFs benefit from a broad range of established counterparty relationships who have commercial incentives to make markets where possible and who would be selling in standard market size.
- Redemption in kind could be compared to a triparty repo investor having to unwind the securities underneath the repo in the event of default. This would be highly unusual, would only happen *in extremis*, and would be difficult for all concerned.
- We see no realistic prospect of overcoming the above limitations. Appropriate application of LMTs would be a more effective means of allocating a cost of liquidity

Q28: Do you have any other comments on the use of redemption in kind for MMFs?41 DP22/1 Annex 1 Financial Conduct Authority I Bank of England Resilience of Money Market Funds

- None

Q29: Do MMF managers effectively manage investor concentration? If you are a manager, how do you monitor investor concentration in practice?

- Yes, MMF managers effectively manage investor concentration. Stress tests are performed with reference to investor type and investor concentration which will dictate a minimum level of liquidity required to be held. Investment managers have robust KYC procedures in place to ensure that they know their customer and flow patterns.
- The challenge that was presented at the onset of the pandemic was the fact that almost all, certainly many, investors behaved in a similar manner – drawing liquidity due to cash needs arising from the exogenous shock of economies being shut down or due to market volatility leading to margin calls. Redemptions came from financial investors, hedge funds, corporates, local authorities and charities as everyone almost simultaneously sought to shore up their cash management reserves.
- Many investors have fund concentration limits themselves i.e., they limit the amount of any one fund that they, as a single investor, hold.
- Fund concentration limits are also monitored by rating agencies. We note that all IMMFA MMFs are AAA rated by one or more credit rating agency.

Q30: What is your view on hard limits, or a maximum percentage any one investor (or several investors or investor types) could invest in any one MMF?

- Hard limits and maximum percentages for an investor or investor group are not required provided that liquidity is managed appropriately. MMFs have robust KYC processes in place and risks are monitored on an ongoing basis.
- Hard limits could be anti-competitive by forcing an investor to seek another home for their liquidity when they have reached a limit. This could also encourage pro-cyclical redemption behaviour leading to further redemptions when a fund is decreasing in size.
- Generic assumptions based on investor type can be very misleading as investors within the same category can be driven by very different factors and behave very differently. For instance, various corporate investors were impacted in very different ways by the pandemic.

Q31: What is your view on disclosing to investors in general the degree of investor concentration? For example, the percentage held by the top 10 shareholders of an MMF?

- Large investors are currently publicly disclosed in the annual and semi-annual reports for many MMFs, with an appropriate time lag.
- We are not convinced that further public disclosure to investors would be beneficial as it may risk influencing investor behaviour in a negative way (prompting pre-emptive redemptions).
- Regulatory reporting and rating agency reporting currently includes further levels of detail.
- There could be benefit in reporting to regulators with an explanation as to how liquidity is managed, however, we would warn against frequent public disclosure.

Q32: Do you have any views on the additional 'policies to absorb losses'?

- We agree with the FCA that loss absorbing solutions are probably not optimal.
- Due to the lack of leverage employed by MMFs it should not be required for them to hold loss absorbing capital. Such a requirement would render them uncompetitive due to the cost of capital versus the risk/returns that MMFs offer.

Q33: Do you have any views on underlying money market issues?

- Far from operating in isolation, MMFs constitute on part of a complex ecosystem. Like other markets based financial products they rely on bank intermediation which broke down during the COVID crisis as banks themselves experienced unprecedented calls on their liquidity combined with challenges to their ability to raise funds. Some of these issues could be alleviated by reforms addressed at improving underlying market liquidity. Such reforms would also make MMFs more resilient by improving their operating environment.

- We attach our paper on 'Improving resilience in the short-term funding markets' in which we recommend areas for consideration.

Q34: Are there other threshold effects that may act to exacerbate MMF redemptions in a stress that have not been covered in this DP?

- No

Q35: Are there any other potential rules changes to address MMF vulnerabilities that could have net benefits? If possible please provide data to support your views.

- The FSB paper explored a number of alternatives but in our view, these were not realistic means of adding to fund resilience.
- We believe that regulators and policy makers should consider measures which would increase the resilience of the broader short-term funding markets, including improved transparency and harmonisation. Improving the functionality of the short-term funding markets would help make prospective MMF reforms more effective. We have suggested that MMFs should have access to a programme or facility such as the Federal Reserve's Reverse Repo Facility, for the placement of excess cash (see our attached paper on improving resilience in the short-term funding markets).
- We have also previously argued (in the Bank of England Call for Evidence on 'Access to the Bank of England payments infrastructure and balance sheet for payments firms', January 2020) that MMFs should have the ability to deposit directly with the Bank. Prudential banking reforms have significantly reduced the appetite for non-operating deposits, causing significant market distortions around reporting dates which creates additional challenges for MMFs and undermines market functionality.

Q36: What are the advantages and disadvantages of MMFs as cash management type products for different types of users compared to other solutions, such as bank deposits? Are there any barriers to persons who need cash management services from using bank deposits, instead of MMFs? Do MMFs provide unique benefits to certain kinds of end users, and if so what are these? Would any of the possible reform options in the DP significantly impact MMFs' ability to provide these specific benefits?

- MMFs offer a low cost, efficient, scalable, and transparent cash management investment tool that offers market-based returns and allows investors to outsource their liquidity management thereby saving on resources and costs. The combination of these benefits is unique to MMFs.
- There is currently a diverse range of providers which ensures competition on fees.
- The stable NAV component of the PDCNAV and LVNAV fund types is key to their utility because of the designation of cash or cash equivalence. The VNAV alternative comes with considerable uncertainty around this. Reforms which remove the stable NAV from the LVNAV would impact a large section of the investor base who are either unable to invest in VNAV funds or have a very strong preference for the LVNAV.

- Compared to bank deposits MMFs offer diversified collateralised risk versus single exposure bank counterparty, and access to issuers that may otherwise not be available to many investors.
- There are significant barriers to deposits as a straightforward replacement for MMFs given that post Basel III, the bank deposit market is subject to severe capacity limitations. Deposits may be limited by both institutional relationship, size, and maturity.

Q37: Should the UK authorities consider rule changes to the information MMFs are required to disclose to investors?

- Fund providers are required to report monthly under the MMFR but in practice most do so more frequently as well as providing information over and above the stated requirements. This information could be beneficial to regulators, policy makers and investors and therefore it may be worth considering formalising more regular provisions.
- The UK authorities could, on their side, provide a clear definition of a qualifying money market fund (QMMF). The fact that the definition is currently ill defined, putting the onus on clients to decide what qualifies, is an impediment to broader market functionality.

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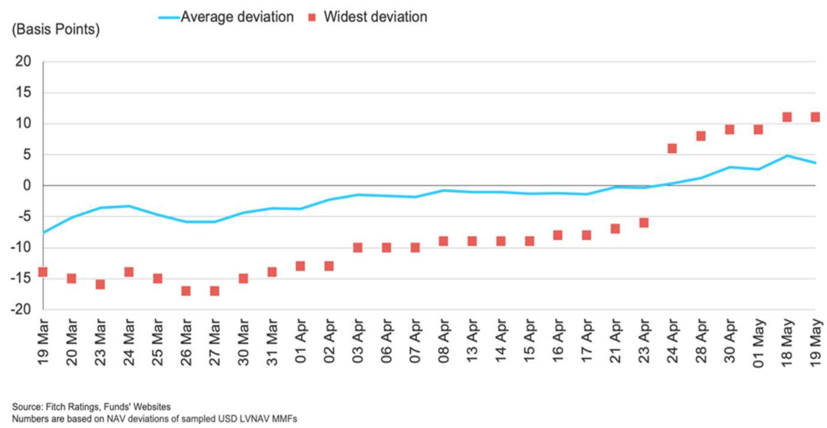
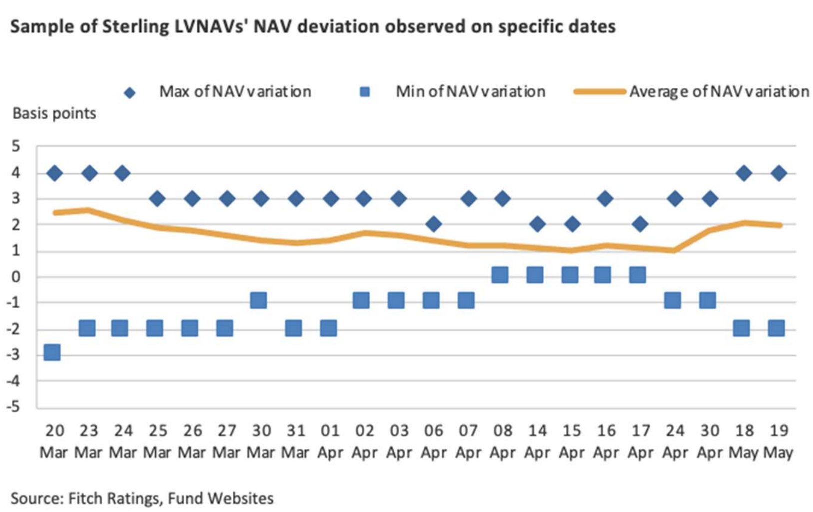
Appendix 1

NAV deviations

The charts below show NAV deviations for Fitch rated AAA LVNAV MMFs in USD and GBP



Sterling NAV Deviations Fitch AAA rated LVNAV MMFs



EUR NAV deviations are not shown as due to the negative Euro rates most EUR MMFs generate negative yields which are accommodated by offering accumulating share classes.

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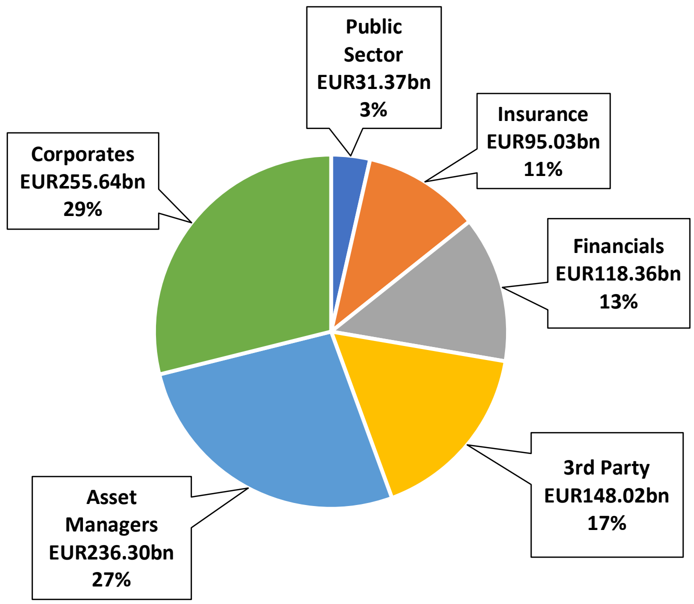
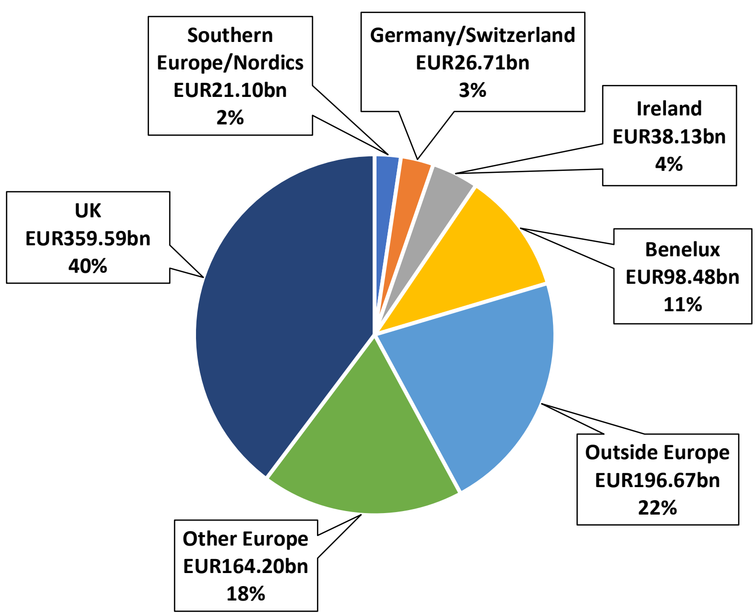
Appendix 2

IMMFA Investor Base Year-end 2021 (EUR equivalent)

By Type



By Location



Source: IMMFA