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INSTITUTIONAL MONEY MARKET FUNDS ASSOCIATION

IMMFA Response to FCA Consultation Paper CP23/28

Updating the regime for Money Market Funds

7 March 2024

We welcome the opportunity to respond to the FCA's Consultation Paper 'Updating the regime for Money Market Funds'.

Introduction to IMMFA

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 30 members, consisting primarily of asset managers but also custodial banks, credit rating agencies and technology providers. Of the 30, 17 are asset managers. IMMFA MMFs assets under management (AUM) as of February 2024 were EUR1,021bn EUR equivalent. This was comprised almost exclusively of institutional funds, denominated in three main currencies, USD, GBP and EUR, of which USD is the largest (USD616bn), followed by GBP (GBP227bn) and EUR (EUR184bn).

Although the overwhelming majority of IMMFA MMFs are stable NAV in the form of either LVNAV (78%) or PDCNAV (18%), many of our members also offer a range of funds including short term and standard VNAVs. The overwhelming majority of IMMFA MMFs are domiciled in Ireland and Luxembourg, with a small amount in the UK, and are all rated AAA (MMF rating) by one or more authorised credit rating agency.

As of the end of 2023, the ECB recorded total European MMF assets under management as EUR1,710bn, meaning that IMMFA MMFs (EUR1,005bn equivalent at that time) accounted for 59% of the total market. A breakdown of the market and IMMFA's share are shown below.

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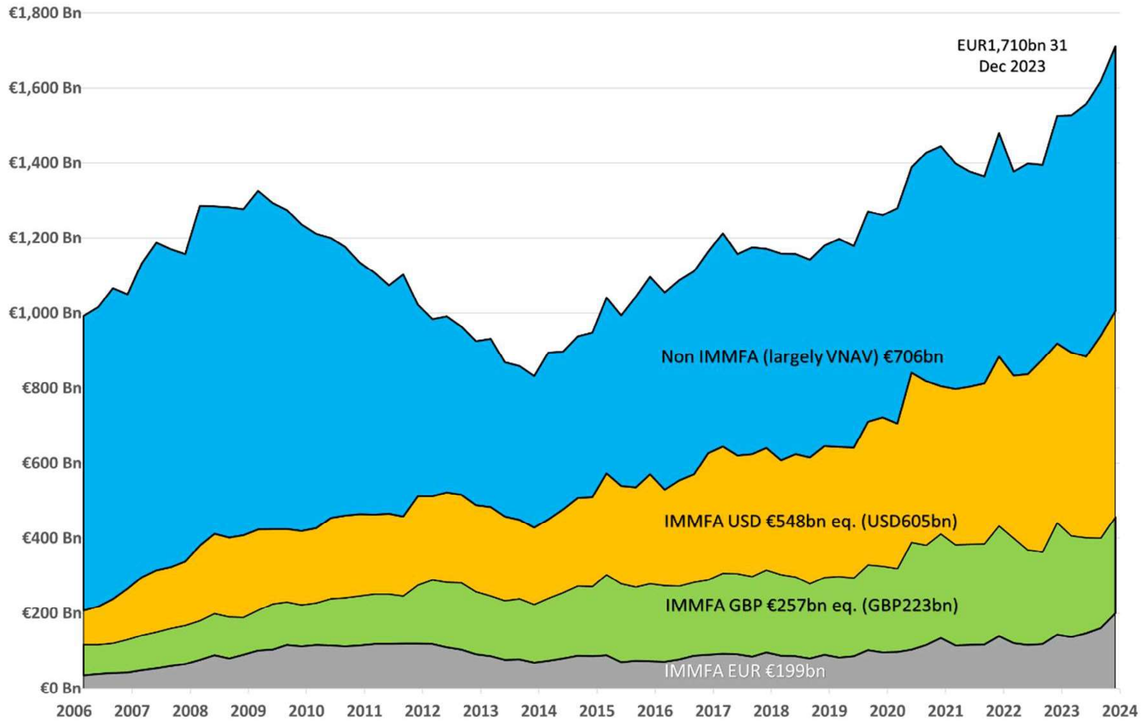

Source: ECB, IMMFA, iMoneyNet

Summary

- We agree with the FCA's overall approach which focuses on liquidity as the primary means of enhancing resilience.
- We support the proposal to delink minimum liquidity thresholds from the possible imposition of liquidity management tools. This will be a crucial component in making buffers more usable. It will reduce the likelihood of procyclical outflows and thereby increase fund resilience.
- We welcome the FCA's consideration of the use of MMFs as margin collateral for non-centrally cleared derivatives and the related discussion of tokenisation to facilitate this. We believe this would reduce the volatility of flows driven by margin calls, increase fund resilience and contribute to broader financial stability.
- We welcome the FCA's recognition of the utility of the LVNAV and the decision to allow it to continue to operate subject to certain other provisions to enhance the structure's robustness including enhanced KYC measures and operational resilience.
- Similarly, we welcome the FCA's decision not to pursue other measures such as mandatory debt quotas, which we have advocated against and to focus instead on liquidity.

- On the other hand, we find the proposed increases to liquidity levels, particularly to 50% weekly liquid assets (WLA), to be too high. The 50% level is, in our view, based on overly conservative assumptions, in particular that zero asset sales would be possible.
- We feel 50% WLA is unwarranted given the resilience which MMFs have demonstrated in recent stress events and the benefit which delinking will entail in making buffers more usable.
- 50% WLA would be very challenging to meet in all market conditions given capacity constraints in the overnight bank deposit and reverse repo markets particularly around reporting dates.
- Any such significant increase in liquidity should be accompanied by provision of a facility to absorb excess liquidity, making it possible for MMFs to be sure they could maintain the required levels at all times.
- We have suggested that a level less than 40% would be sufficient to ensure resilience of LVNAV (and PDCNAV) MMFs. Most of our comments apply to these types of fund given that they constitute the overwhelming majority of IMMFA AUM (96%).
- We do think there is a compelling case for calibrating the liquidity requirements differently from other types of MMFs to recognise differences in portfolio construction, fund pricing (variable NAV funds) and/or settlement profile.

Q1: What, if anything, do you consider to be unintended consequences of this intervention?

Overall, we feel that the FCA has focused on the correct areas and approached the question of resilience the right way. Resilience is the ability to meet redemptions and as such a focus on liquidity as the appropriate mechanism to enhance resilience is the right one. However, we feel that the calibrations proposed by the FCA are somewhat too conservative.

An unintended consequence may be that funds are forced to hold WLA in the form of more overnight cash for which there is little bank appetite, particularly over month and quarter ends.

The CP proposes significantly higher minimum holdings of liquidity. In our view, as we will go on to expand in subsequent questions, the proposed levels are overly conservative. Our concern is that the higher minimum liquidity requirements could result in increased liquidity hoarding by MMFs. Like many other stakeholders, we support the removal of the regulatory link between the possible imposition of gates and fees from minimum thresholds. Whilst 'delinking' will remove the technical requirement to consider taking action, we anticipate that nevertheless investors will continue to focus on the highly visible WLA limit given the simplicity and visibility of this liquidity metric.

Although the threshold is likely to remain a focal point for investors, we want to avoid a situation where MMFs feel pressure to hold a buffer in excess of the agreed higher amount rather than risk dipping below it. The higher the requirement, the more painful this would be both in terms of impact on investor yields and in sourcing capacity in the market to absorb the additional amounts. The object of delinking is that buffers should be seen to be usable, and it is vitally important that this be the case.

Articles 24 and 25 (2) of MMFR provide for a fund unintentionally and temporarily deviating from the stated requirement 'for reasons beyond the control of an MMF, or as a result of the exercise of redemption rights' and require that the MMF 'adopt as a priority the correction of that situation, taking due account of the interests of is unit holders or shareholders.' The FCA FG 22/3 Guidance published with a view to clarifying the situation under which an MMF might impose fees or gates, also reminded market participants of expectations in such an event. We support an approach which recognises that a fund may make temporary use of liquidity buffers and think that guidance to such effect will remain helpful. We believe that this was the original intention of the regulation, rather than imposing a hard limit in all circumstances. We discuss this in more depth below.

Given market constraints, 50% is a large amount of liquidity to be sure of placing at all times. The FCA is relying heavily on the presumption that because MMFs have held more than the *minima* in recent years this is readily achievable. Although MMFs have been holding more than the minimum requirements, it has at times been problematic, particular during periods of severe capacity constraints around reporting dates. These strains are unlikely to go away and we would emphasise that the regulation has to work for the long term and to accommodate possible future changes in the market environment.

Weekly liquidity is relatively uncommon primarily because very few issuers want to issue one-week commercial paper. Consequently, it is already the case that the majority of weekly liquidity is in fact daily liquidity (in the form of overnight deposits or reverse repo) or a roll-down of longer dated assets.

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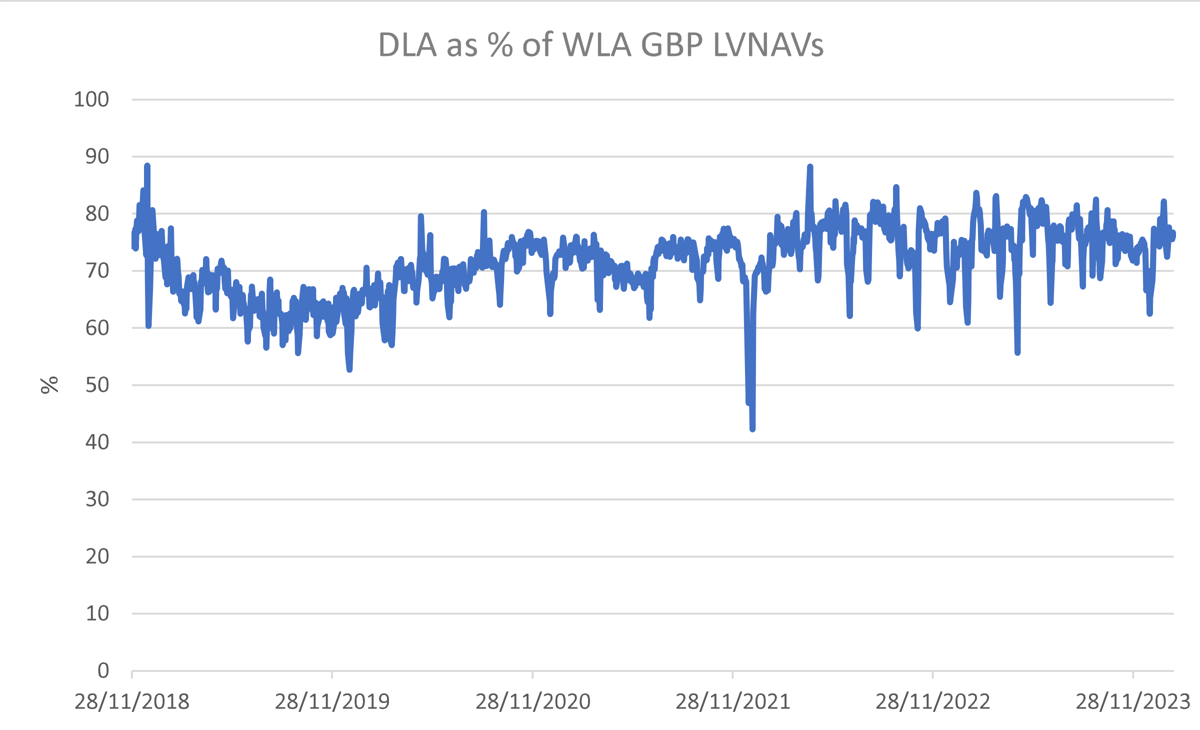

Source: iMoneyNet

If managers have to hold a minimum of 50% in WLA, there will be fewer assets rolling down, and as a result, managers will have to hold more overnight. This will be challenging given the lack of bank appetite for very short cash.

At certain times there may not be overnight capacity in the market, creating an increased likelihood that MMFs may have to reject subscriptions which is detrimental to investors as they search for a safe home for their cash. In the event of MMFs rejecting subscriptions, for instance around reporting dates, investors may be forced to consider other cash management solutions. Given they may not have the alternative of bank deposits, such products are likely to be more risky and less transparent to both investors and regulators.

Given the reduced replenishment from roll-down, combined with an absence of new issue one-week assets which are very rare, effectively, each new inflow will likely have to be invested in overnight liquidity to maintain the 50% WLA. Finding sufficient overnight opportunities will be challenging given the absence of a facility to absorb cash such as exists in the US market in the form of the Federal Reserve's overnight reverse repurchase facility (RRP).

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Q2: Do you agree with our proposal to 'delink' stable NAV MMFs' liquidity buffers? Please give your reasons.

Yes, we support the delinking of liquidity buffers from the potential imposition of fees and gates in the case of stable NAV MMFs. This is something we have consistently advocated for, along with other stakeholders, and we believe that this as a stand-alone measure would significantly increase the resilience of MMFs by making buffers more usable. Removing the bright line would reduce investor incentives to redeem as the threshold was approached and thereby also reduce the pressure on managers to sell assets due to concerns that approaching the threshold *could* trigger redemptions. We welcome the growing consensus amongst international standard setting bodies and regulatory authorities on this.

We would also contend that the increased resilience entailed by delinking means that the proposed increases to liquidity levels, in particular the 50% WLA, are overly cautious.

During the events of March 2020 which prompted the 'dash for cash', the link operated as a 'bright line', inadvertently encouraging pre-emptive redemptions and increasing procyclical stress. This has been documented in the academic literature. Studies by Avalos and Xia (2021), Darpeix (2021) and Dunne and Giuliana (2021) show that liquidity ratios were key drivers of redemptions in the case of LVNAVs. Removal of the link will help reduce the investor focus on WLA and thereby make liquidity more usable. Delinking should enable managers to draw on liquidity buffers both during normal conditions to meet unforeseen redemptions and at times of stress, as we believe was the original intention.

Q3: Do you agree that we should revoke FG22/3, but retain its guidance on managers returning the fund to the relevant regulatory minimums as Handbook guidance in MMFs?

Yes, we agree the guidance should be retained and also recommend additional guidance on regulatory expectations around the use of buffers.

The FG22/3 guidance was timely and helpful in clarifying the conditions under which managers of those MMFs permitted to run a 'stable' NAV are required to impose or consider imposing fees and gates. During the 'dash for cash' episode, there was investor concern that a breach of the 30% WLA threshold would necessarily or likely result in the imposition of fees and gates. This assumption was particularly prevalent amongst US based USD investors who based their assumptions on regulation in the US domestic market and applied the same logic to their offshore USD MMF investments. The fact that MMFR had been drafted in a more nuanced way did not lessen the concern. This was one factor in why US LVNAVs[1][2] experienced significantly higher levels of redemptions than those denominated in EUR or GBP. Another important factor was that PDCNAVs provided an alternative in USD and such an alternative is not available in GBP or EUR where PDCNAV MMF AUM are negligible.

Although the clarification offered by FG22/3 would no longer be strictly necessary once thresholds are delinked, the guidance also reminded market participants that as per articles 24 and 25 of MMFR, managers needed to prioritise a correction in the event where liquidity ceased to meet the requirements. Reinforcing MMFR which states that the interests of shareholders should be taken into account, the guidance expanded on this by explicitly stating that this included the need to balance the speed of correction against investor outcomes. We agree that it would be helpful to retain such guidance specifically noting, as it does, that articles 24 and 25 provide for and envisage that MMFs may drop below minimum liquid asset requirements due to the exercise of subscription and redemption rights or for reasons beyond the manager's control.

The existence of a WLA threshold will mean that there is always a line of varying degrees of brightness. Given our concerns, noted above, that investors may remain focused on the WLA limit (due to factors such as habit and transparency), we think guidance could perhaps be expanded further on expectations as to how funds may use their liquidity buffers at certain times including normal periods and during times of market stress, as this would help reduce the brightness of the line.

In summary, it is important that managers should feel able to use the increased buffers, including to meet unforeseen redemptions.

Q4: Do you have any overall comments on our policy position on other options to increase the usability of MMF liquidity resources?

We agree with the FCA's decision not to propose changes to the calculations and not to give regulatory powers to change liquidity levels dynamically in a stress event.

As per our response to question 3 above, another option to increase the usability of liquidity resources could be further guidance on the expectations around the use of liquidity. It would be helpful to clarify that it is expected that funds will use their liquidity buffers at certain times including during normal periods as well as times of market stress and around reporting windows. Enhancing FG22/3 with explicit acknowledgement that liquidity buffers are designed to be used when needed would be helpful in this regard.

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[1] Quoted in ESMA opinion on review of money market fund regulation p.24 (Feb 2022)

[2] PDCNAVs did not experience outflows.

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Q5: Do you agree with the proposed increases in minimum daily and weekly liquidity to 15% and 50% of assets respectively for all UK MMF types? Please explain your reasoning.

The ability to meet redemptions is clearly the most important aspect of fund resilience and we support the FCA's approach in focusing on the adequacy of liquidity provisions.

The proposed increase to 15% DLA is more manageable than the increase to 50% WLA which we think is overly conservative. As noted above, an increase in WLA will mean that funds hold more DLA. It is important that the number be achievable and, based on our view of the IMMFA fund universe, a WLA number between 30 and 40% for such funds would still be compatible with the authorities' financial stability objectives especially given the increased usability afforded by delinking.

For any increase of this magnitude to be workable it has, in our view, to be accompanied by the provision of some sort of repository facility/facilities for the absorption of excess liquidity by a government entity.

The recently published HMT draft statutory instrument indicates that the determination of equivalence for an overseas fund regime will consider key factors including liquidity levels. It therefore seems probable that any EU domiciled funds would have to meet the same or substantially similar liquidity requirements. As noted above, IMMFA GBP AUM are currently GBP227bn, with the overwhelming majority domiciled in Ireland and Luxembourg. We therefore suggest that capacity constraints would be far greater than may have previously been assumed.

15% DLA

Since redemptions are met from cash on hand, DLA levels are a crucial measure of resilience. Funds typically run levels in excess of the minimum requirements (as noted by the FCA 3.38). As illustrated above, a high percentage of WLA consists of DLA. An increased WLA target would also likely result in funds holding more DLA. Based on our view of the IMMFA fund universe, although we regard 15% as more than is required, we anticipate that such a level would be more manageable than the proposed increase in WLA.

50% WLA

In our view, the proposed 50% WLA level is too conservative. Such a high WLA level is not justified for a number of reasons which we outline below. It would also be very challenging for MMFs to meet at all times and in all market conditions. Again, we emphasise the importance of a repository to absorb excess liquidity if MMFs are to meet a significantly higher requirement.

Delinking will make existing buffers significantly more usable

The current link between liquidity thresholds and the possible imposition of liquidity management tools creates an investor incentive to pre-emptively redeem. Delinking will reduce the focus on the WLA threshold and free up liquidity, making it more usable and increasing fund resilience. We expect that the removal of the risk of gates and fees based on liquidity thresholds will change investor behaviour. This will provide funds with significant additional flexibility in meeting unanticipated redemptions. The impact of this is being underestimated in our view and is not being adequately reflected in the proposed increase to 50% WLA. The Bank's modelling is based on historical outflows without allowing for a benefit from delinking.

Outflows do not justify 50%

The outflows experienced during two severe stress events, the 'dash for cash' of 2020 and the UK Gilt crisis of September 2022, do not warrant an increase to 50%. We would argue that MMFs have already demonstrated an ability to withstand 'severe but plausible' outflows which is the FPC's objective, each time without dipping much if at all into current WLA minimums. As per our comments above, basing the requirement on historical outflows fails to take into account the benefit derived from delinking which will bring incremental resilience.

The outflows during the March 2020 crisis were the highest and we look at these below.[3]

[3] 5 day sequential outflows, source iMoney Net.

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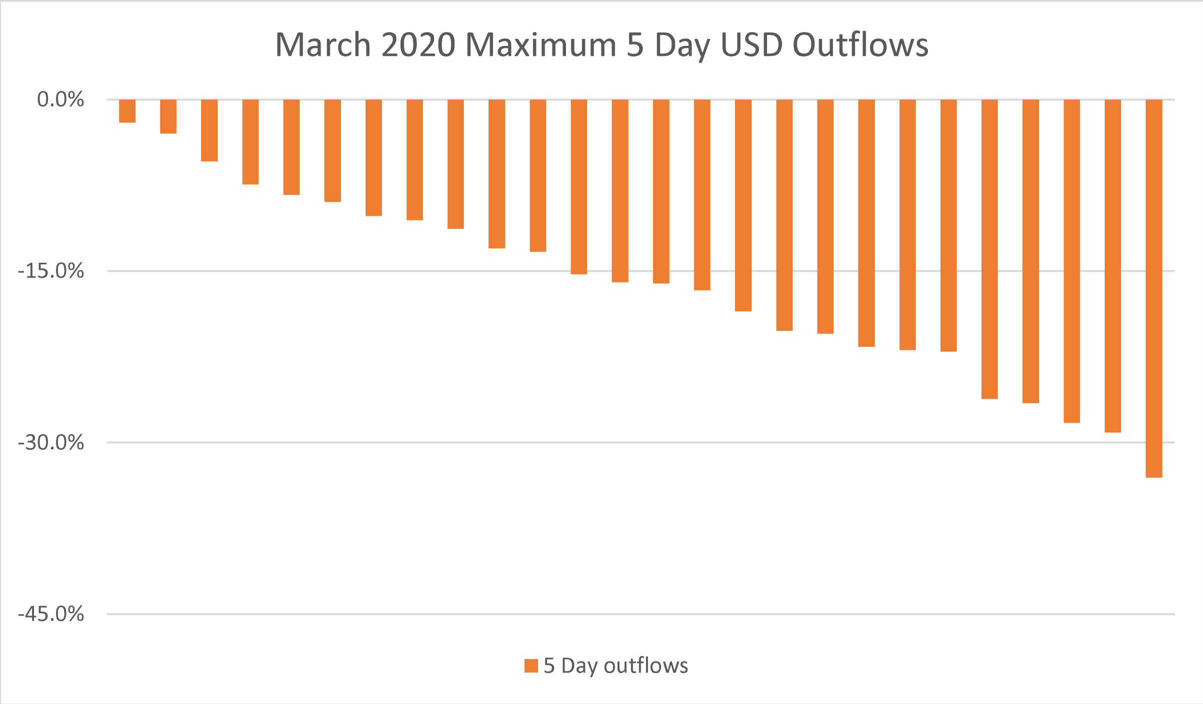

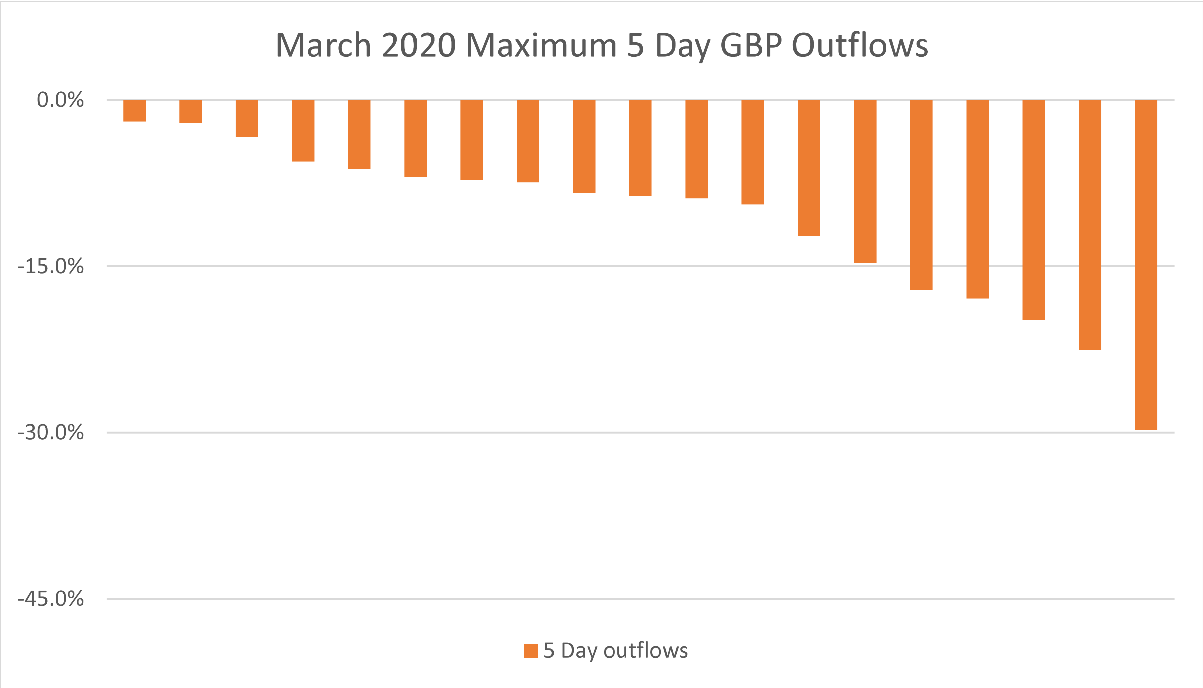

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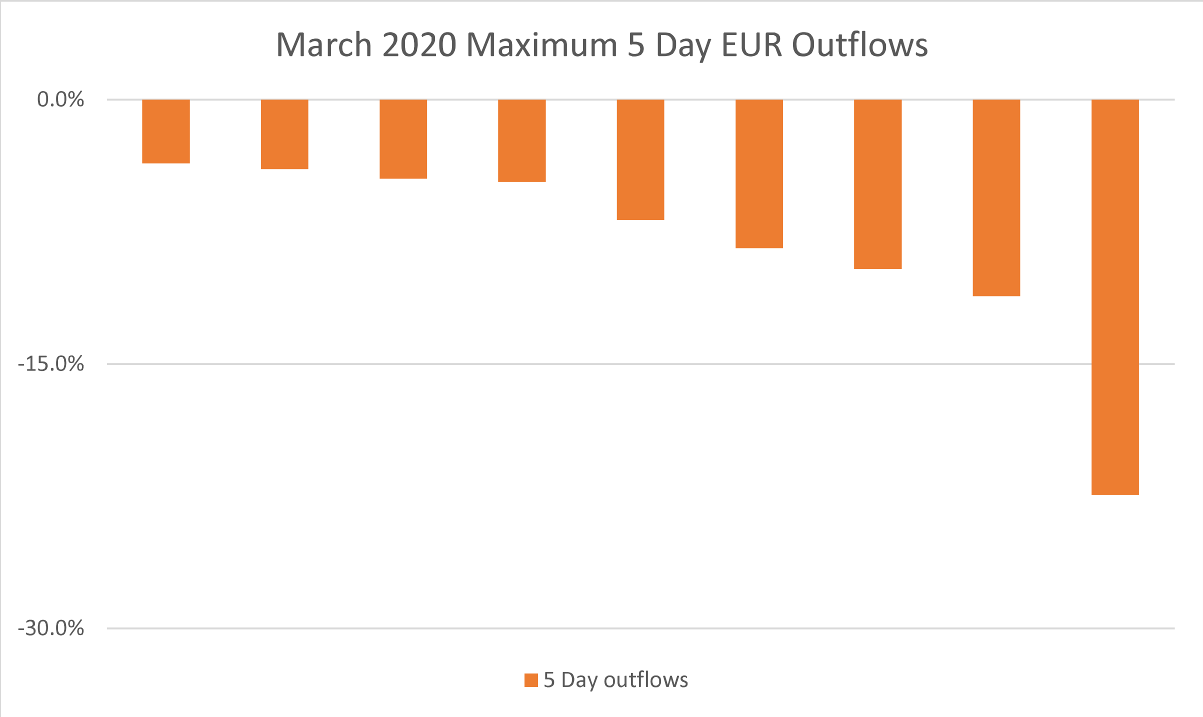

Source: iMoneyNet

Although the FCA note that central bank actions helped stabilise markets during both episodes (3.34), we would like to observe that although clearly intervention was critical in stabilising the broader markets, European MMFs benefitted only indirectly. European asset purchase programmes established during the COVID-19 crisis did not reflect the asset base of MMFs.

During the stress period of March 2020, USD LVNAVs suffered heavier outflows than GBP or EUR LVNAVs. This was for reasons mentioned above with respect to delinking, in particular US onshore investor behaviours which drove flows in offshore USD funds. Delinking, which is being implemented in the US, was supported by the European authorities and is being proposed by the UK, would mean that this will not be a key driver of redemptions in future. GBP and EUR LVNAV investors were considerably less reactive but will likewise benefit from reduced investor concerns around the consequences of a threshold breach.

We note that there were a small number of significant outflows relating to smaller funds. In some cases these were anticipated by the manager in question and in one case there is a data discrepancy. In the latter case, the data base which shows the heavy outflow has this followed by a similar inflow the following day. We note the risk in allowing such outlying data, which may in such cases be explicable, to be a determining factor in decisions for the majority of funds.

We understand the intention to align regulation across jurisdictions globally to the extent that this is practicable and that therefore the US SEC's adoption of increased levels of 25% DLA and 50% WLA is clearly relevant in this context. However, there is a very significant difference in the US market in that due to the existence of the Fed's overnight reverse repurchase facility the market is structurally able to absorb liquidity. This means the higher levels are achievable for managers. There is no such structural mechanism in Europe which makes it far harder for funds to place excess liquidity. We discuss this below in response to question 25.

Although the FCA recognises differences between currencies (Annex 4, 7), the proposed increases do not take such nuances into account and are applying the worst-case scenario to all funds. Forcing funds to hold excess liquidity is economically inefficient and this effect will be more acute in some currencies than others given the differences in worst case outflows observed. Given the overwhelming majority of funds were comfortably able to meet redemptions during recent severe stress scenarios, we question whether it is right that idiosyncratic cases should result in all funds being subject to significantly increased liquidity levels. It should be possible to address idiosyncratic risk with the FCA's proposed measures on enhanced stress testing and KYC which will further mitigate client concentration risk.

The Bank's modelling is overly conservative in assuming zero asset sales

The 50% WLA level is premised on an assumption that it would not be possible to achieve any asset sales. Although clearly secondary markets have at certain times of stress been impaired, particularly during the 'dash for cash' in March 2020, fund experience varied, and some funds report that they were able to sell assets. It is worth noting that a number of MMFs who report selling assets were doing so not to meet redemptions but to bolster buffers as the threshold was approached, an effect which would be greatly reduced by the removal of the bright line. We feel that to assume zero asset sales is overly conservative. This is particularly cautious assumption given that LVNAVs and PDCNAVs will be holding a portion in highly liquid government debt which should remain more liquid.

Furthermore, the decision not to allow for even highly liquid assets being sold appears to be somewhat at odds with the FCA's approach to the 17.5% derogation for highly liquid assets which the FCA propose to extend to all fund types. Whether this is extended or not, highly liquid assets eligible to count towards WLA will remain a component of the regulation. Whilst on the one hand the derogation offers a benefit to holding them, on the other the model assumes that they have zero liquidity.

It is worth noting here that secondary market liquidity was less impacted during the gilt crisis of September 2022 when not all funds were faced with increased redemptions. Many funds did not experience outflows whilst some funds were sellers, other funds had liquidity which provided secondary demand.

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The FCA's additional measures provide a more targeted solution than a blunt 50%

As mentioned above, the FCA's proposals to make stress testing and KYC more robust and targeted will address fund specific issues. The FCA's KYC proposals require that a manager take appropriate action to strengthen robustness including reinforcing liquidity or improving portfolio quality (3.77). These measures, in combination with an increase in the range of 30-40% WLA for LVNAV and PDCNAV MMFs and the benefit of delinking, should be sufficient. This approach is both more targeted and economically efficient. In our view, it provides a better framework and one which is less blunt than applying a uniform 50%.

Reducing pressure from margin flows

We welcome the FCA's decision to consult on the use of MMFs as eligible collateral for non-centrally cleared derivatives. We have consistently advocated that facilitating the acceptance of MMFs as margin collateral would be a means of reducing pressure on redemptions. We go into this in more detail below but summarise here by suggesting that facilitating and permitting the use of MMFs as margin collateral would help neutralise a contagion channel to insurance and pension funds and therefore reduce liquidity needs.

Capacity constraints on placement of liquidity

Any increased liquidity levels must be ones that are workable and achievable at all times, including quarter and year ends, and we are not confident that this would be the case for the proposed 50%. The proposed level assumes that the conditions which have applied in recent years, and which have allowed MMFs to run levels in the range of 40-50%, can be relied upon at all times, including year ends, in the future. We would suggest that the new level should not be premised only on what has worked most of the time in recent years, but also on what we can be assured will work in the long term, in all market conditions.

There remain significant balance sheet capacity constraints around reporting periods which limit the ability to place deposits and enter into reverse repo transactions at such times. The recent publication by the ICMA on liquidity in the European sovereign bond markets notes that parts of the European repo markets (of which the UK accounts for 12.8%) do not work well over calendar year ends and certain quarter ends and that this is a direct consequence of regulatory reporting requirements. [4]We do not see these pressures significantly alleviating given the prudential regulatory regime. The forthcoming changes to the ECB remuneration of the minimum reserve requirements may also have a severe impact on banks' willingness to take deposits.

[4] ICMA Liquidity and resilience in the European Sovereign bond markets, March 2024, p.20

There is a very important difference in the US domestic market in that US onshore MMFs have the benefit of the Federal Reserve's Overnight Reverse Repurchase (RRP) Facility. The RRP absorbs excess liquidity from the system and the largest users (95%) are US MMFs which deposit cash in exchange for government collateral. No such facility exists in the UK or elsewhere in Europe. We expand on this in response to question 26 regarding regularising the ability of MMFs to deposit with the DMO.

The ability to deposit with the DMO, if unlimited and appropriately priced could offer something similar in GBP but would not address the issue of excess liquidity for European domiciled USD or EUR denominated funds. With respect to GBP denominated funds, alternatively, the UK would need to increase the depth and supply of UK Treasury Bills to provide sufficient short, highly liquid assets.

Limitations on banks' balance sheet to take overnight liquidity combined with limited UK Treasury Bill supply will significantly hamper the ability of GBP MMFs to manage higher weekly liquidity. Due to the current regulatory environment, overnight funding is costly for banks since it is punitive when calculating key regulatory ratios.

Risk implications of capacity constraints around reporting dates

As noted above, there is particular stress leading up to and over key reporting periods such as year-end as banks pare down their balance sheets. The reduction in market capacity to absorb excess liquidity creates a significant imbalance that forces MMFs to adopt investment strategies to avoid regulatory breaches that are not desirable for the fund and its shareholders.

1. MMFs may have no choice but to leave cash with their custodian as a substitute for overnight investment given the lack of available reverse repo and deposit capacity.

   This would likely have a material explicit cost as funds would be charged on the nominal cash amount on balances left on account, rather than simply receiving an interest rate that is less than the current market rate.

2. Leading up to year-end, MMFs are currently forced to invest in term securities to avoid leaving too much cash with their custodian (after exhausting all overnight deposit and reverse repo capacity) or violating diversification limits.
   a. Term investments that mature in the new year will be negatively impacted as lower turn rates suppress the yields on such investments. It is also not always possible to trade short dated paper as banking regulation metrics mean issuers can refuse to issue short dated paper over the turn, restricting options for MMFs.
   b. The shift in the supply/demand equilibrium at year-end will have a negative impact on the implied and realized rates for the turn. We have seen overnight

trades over the turn (such as reverse repo) clear at negative rates and completely detached from the Bank Rate, while term rates up to 3 or 4 month periods have also been completely dislocated from market pricing.

c. Once over the turn (or reporting period) when the market conditions normalize, the term investments that were utilized solely to manage the year end capacity challenges will be carrying unrealized losses negatively impacting portfolio MTM NAVs until they mature. Additional risks include realizing losses if the same assets must be sold.

3. To mitigate the risks above, MMFs may simply turn away subscriptions, which can create significant issues for MMF investors.

4. MMFs will diligently canvas their shareholders about their liquidity needs at year-end, but there is always an unknown risk that there are material swings in shareholder flows further intensifying the challenges referenced above.

Significant increases in liquidity requirements would clearly exacerbate capacity constraints. Sterling is the shallowest market in this respect and many members report challenges in placing liquidity around reporting periods. The chart below of average DLA and WLA for GBP LVNAVs[5] illustrates the pattern of reduced liquidity around year ends.

The average for year end 2023 WLA was 37% suggesting that some funds would struggle to achieve even a level of 40% and that 50% would be extremely challenging.

[5] AUM range from GBP200bn to GBP250bn.

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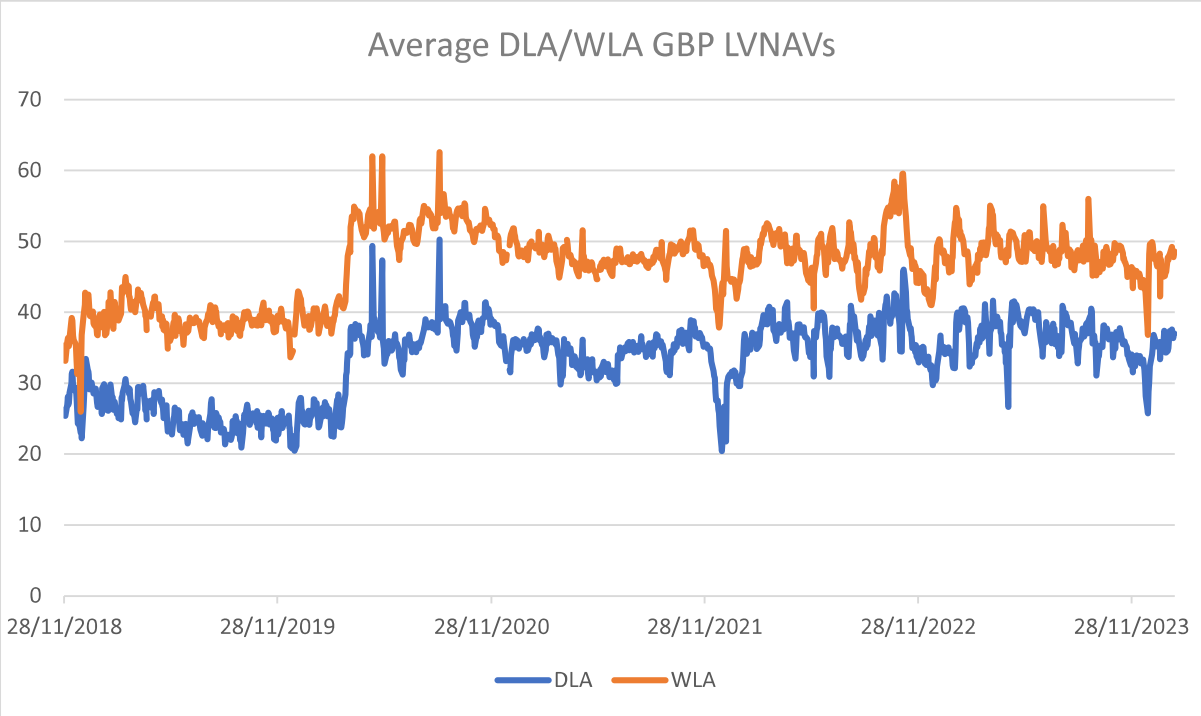

Source: iMoneyNet

Unlike in the US and/or EU, the supply of government securities is limited in the UK. The current UK T Bill outstanding is around GBP73 bn. This compares to GBP227bn currently in IMMFA GBP MMF assets. As observed in the report, funds currently hold a very low amount in Bills, reflecting the intense competition for such assets.

UK T Bill auctions attract significant investor demand. Current auctions can be around 5 times oversubscribed. Supply in the secondary market is limited as most investors invest in the Bills on a buy to hold basis. Increasing weekly liquidity would drastically increase demand in a market where supply is already very limited.

EU domiciled funds are also limited in their ability to invest deposits with UK banks as they are now classified as third country and as such subject to equivalent prudential supervision.

Concentration of bank risk

Absent a facility to absorb liquidity, MMFs have no alternative for the placement of cash other than bank deposits or reverse repo. Significantly higher liquidity requirements would concentrate risk in banks and furthermore, given the lack of counterparty appetite, into a relatively narrow set of banks, especially in sterling.

Other risks

We also have concerns that funds may be forced to barbell in order to maintain yields an outcome which may not result in an overall reduction in risk. Generally, funds try to ladder their maturities as this provides a more continuous flow of assets rolling down and is an important factor in the replenishment of WLA. This relates to our comments around the specific risks associated with reporting date constraints above but is a more general observation.

Impact of harmonised liquidity requirements across all fund types

With respect to the FCA's proposal to apply the same liquidity requirements across all fund types, whilst we are supportive of a more consistent approach to the composition and definition of liquid assets, we do see a case for differentiating the calibration of minimum liquidity requirements of different types of MMF based on what we see as potentially distinguishing factors, such as differing maturity profiles, different pricing mechanisms or different settlement profiles, underlining their distinct investor use cases. As an example, aligning the liquidity parameters of standard and short term MMFs would reduce their differentiation and the possible viability of standard MMFs as a separate structure.

To put this question in context, a number of IMMFA members offer standard VNAV funds, and a small number of AAA rated standard MMFs are included in the IMMFA universe. Altogether, VNAVs account for approximately 40% of the total European market and the sector is heavily dominated by standard VNAVs. It is clear that standard MMFs play an important role in the market.

As a starting point, we welcome the FCA's conclusion that since both stable and variable NAV funds suffered heavy outflows during the 'dash for cash', there is no strong evidence to indicate that LVNAVs showed less resilience. The fact that both fund types had similar outflows would very strongly suggest that share price valuation was not a key driver. Since both US onshore prime funds, which are VNAV, and EUR Standard VNAV funds also experienced heavy outflows we have argued that the focus on the pricing mechanism of the stable NAV funds and the assumption that it makes LVNAVs less resilient have been unwarranted.

However, we do see a basis for differentiating the minimum liquidity requirements for VNAV MMFs given standard VNAVs in particular represent a different proposition.

LVNAV and PDCNAV MMFs attract safety focused investors ***prioritizing*** capital preservation and daily liquidity, while standard VNAVs offered by IMMFA members or included in the IMMFA universe typically appeal to more yield-driven investors with a longer investment horizon. Their more flexible investment guidelines enable standard VNAV funds to earn incremental returns over short-term MMFs (including short-term VNAVs) by extending duration when attractive to do so.

Proposing equal liquidity requirements on standard MMFs would clearly have a greater detrimental effect on their returns given that the current calibrations permit lower liquidity levels for VNAVs. It is questionable whether the standard VNAV structure would be economically viable at 50% WLA unless managed to an extreme barbell which we would argue would be a riskier proposition than that of funds with more laddered portfolios.

Diminishing the yield competitiveness of standard VNAVs would align them more closely with short-term MMFs thus blurring the differential between the two in the perception of investors.

Importance of improving liquidity of short-term funding markets

A final point is that improving overall market functionality would also help overall fund liquidity. We note the FCA's comments (6.26) that there are no immediate steps that can viably be taken to increase liquidity of the short-term funding markets but reiterate the importance of addressing issues such as transparency and standardisation over time.

In summary, we find that the proposed 50% WLA requirement is overly conservative and more than is justified by previous outflows during extreme stress events once the benefit of delinking is factored in. It may also lock funds into managing liquidity at an even higher level. Even without the latter effect, 50% would be extremely challenging given the lack of market capacity for overnight bank deposits and reverse repo and the absence of a facility to absorb excess liquidity.

Q6: Do you agree with our assessment of the market impact? Are there other factors we should consider?

The FCA's market impact notes that sterling MMFs have consistently held close to 50% WLA since March 2020 and concludes that the actual required increase would be much smaller than suggested by the increase in minimum requirements (3.43). Whilst it is true that funds have held levels close to 50% since March 2020, they have also had significant dips even in non-stressed markets and this flexibility is a crucial factor.

A crucial difference between the current situation where funds voluntarily hold in excess of the minimum and the proposed higher requirements is that portfolio managers currently benefit from flexibility and optionality which is vital. In the event of capacity constraints around quarter or year ends, which continue to be more challenging than other times, funds can choose to run a lower amount. This is very different from being locked in to a minimum

50%. The proposed levels would, in our view, increase the risk to short-term funding markets around reporting dates.

The market assessment (3.44) finds no day-to-day issues with market capacity and notes that changes in overnight rates around year end have been temporary. We would not agree that there have been no issues with market capacity and feel this understates the very significant albeit temporary difficulties arising from severe dislocations around recent year ends. A normalisation in interest rates has helped alleviate dysfunction by providing higher yields and reducing the risk of negative rates around year end, but it should be remembered that funds spend months carefully managing their liquidity ahead of crunch points by ensuring that deposit and repo balances are maintained with their counterparties in order to have a balance sheet allocation over year end. This balancing act can easily be disrupted by changes to counterparty appetite.

The market impact assessment takes a broader view by considering all GBP funds as opposed to those just domiciled in the UK but does not consider USD or EUR funds which are marketed into the UK. Although a more plentiful supply of US T bills and the existence of the Fed's RRP facility, which indirectly benefits offshore funds USD liquidity, make USD easier to manage, it has been very challenging to manage EUR (as well as GBP) at times.

The implementation of the latest Basel (3.1) bank reforms which revise capital requirements upwards may increase costs which will only exacerbate this phenomenon. An appropriate transition period would be required, as the FCA suggest in 3.45.

Q7: Do you agree with the resulting balance between daily and weekly liquidity requirements? How does the balance between these elements impact resilience?

We comment above in answer to question 5 on the primary function of DLA as a means of meeting redemptions and therefore as the crucial measure of resilience. Whilst WLA is also an important measure in that it replenishes DLA through the roll down of assets and, as the FCA note, indicates ability to withstand stress over a more sustained period, the focus on WLA and the 'bright line' created by the link between the minimum threshold and the possible imposition of fees and gates led to undue investor focus on it as a liquidity metric.

We agree that MMFs typically hold more than the minimum DLA and that increases in WLA are likely to be partially met by assets that are also eligible to be included as DLA (3.38). This is due to market dynamics and the absence of issuance of WLA assets (as issuers have no need for such short maturities and avoid the associated rollover risk). An increase in WLA is therefore likely to translate into an increase in DLA.

In particular, if WLA is increased to 50%, the average DLA is likely to be considerably in excess of 15%. As the Bank of England modelling has indicated that 15% is sufficient to meet the largest daily redemptions needs, this implies that the 50% WLA will result in MMFs holding far more DLA than is necessary. This economic inefficiency will impact yield and also diversification.

The proposed increase in DLA to 15% is more manageable than the 50% WLA. Given market capacity constraints and the absence of a facility similar to the Fed's Overnight Reverse Repo Facility (RRP), 50% WLA is problematic.

Q8: Do you agree that the stable NAV MMF WLA derogation (to include highly liquid government debt as WLA up to a limit of 17.5 % of total assets) should be extended to VNAVs? Please give reasons for your answer. Do you have views on what public sector debt should be permitted in this derogation and what the appropriate level should be?

As per our comments in response to question 5, we feel it is appropriate for liquidity thresholds to be calibrated differently according to fund type. This having been said, we agree with the FCA's approach in aiming for greater consistency in the composition and definition of liquid assets. In effect this means that if highly liquid government debt is considered to meet the definition of WLA for stable NAV MMFs then it would be consistent to extend this to VNAVs. We note that not all government debt would be highly liquid, and that credit quality should be a determining factor.

We are also pleased that the FCA has decided not to impose minimum public debt requirements as we were opposed to these for reasons which the consultation acknowledges. We agree that the current structure and scale of the UK debt market represent serious obstacles to this (see comments above on UK T Bill capacity). The same is true, albeit it to a lesser extent, in EUR where there have at times also been severe price dislocations.

Q9: Do you agree that the WLA derogation allowing VNAV MMFs to include money market instruments or units of other MMFs within their WLA up to a limit of 7.5 % of total assets should be removed?

As per the above (question 8) we believe that the interpretation of liquid assets should be defined more precisely.

Q10: Do you agree with our proposed rules changes to strengthen and broaden the existing MMFR KYC requirements for managers of all MMFs?

We are supportive of thorough KYC good practice and understand that this should take into consideration the potential for correlated behaviour where groups may act together. Our members already take into account the possibility that investor concentration could destabilise a fund by causing correlated redemptions. Correlated behaviour has been observable both during the dash for cash and the UK Gilt crisis where margin sensitive investors redeemed in order to post cash collateral (as noted in 3.76). We discuss below how this risk could be mitigated by the use of MMFs as collateral in questions 17-18.

We welcome the FCA's decision not to pursue hard limits and public disclosures as these are not solutions. Investors within a given category (corporates, for instance) can be subject to very different drivers and public disclosures could be subject to misunderstanding and trigger redemptions.

The FCA's proposals to formally broaden and strengthen existing KYC requirements by the introduction of additional factors such as concentration and correlated investors appear reasonable. It is also reasonable to consider the consequences of a collar breach in the case of an LVNAV.

We note that 2023 ESMA Guidelines on stress test scenarios under the MMF Regulationalso support this approach in that they recommend MMF managers identify investor types and conduct simulations to infer their behaviour (based also on historical redemptions)[6].

Reinforcing liquidity and improving portfolio quality, reducing maturity (3.77) are appropriate responses.

We would query the practicality of the action 'changing the investor base'. This would seem to imply an ability to bring additional investors in, asking certain investors to redeem or refusing others the right to subscribe which may not be a practicable business approach.

We look forward to engaging with the FCA on such guidelines.

Q11: What do you see as the advantages and disadvantages of a commercial borrowing facility for MMF liquidity during a stress? How likely would you be to use such a facility?

We do not see commercial borrowing as a practical/viable solution and think it is better to manage liquidity risk through other measures which improve resilience. The cost and the size required to make an impact would be prohibitive.

There are a number of obstacles and objections to commercial borrowing. Firstly, we doubt there would be bank appetite for any such facility. We see no appetite for an unsecured facility as banks are unlikely to want to lend for short periods under a facility which would be triggered because of a stress situation when such a situation could impair the fund's ability to

[6] ESMA's Final Report on Guidelines on stress-test scenarios under the MMF Regulation, published on 19 December 2023.

repay. In an uncommitted facility, a lender may insist on clauses which would allow them not to advance funds where such impairment might be deemed likely.

This would be less likely with a committed facility, but this would require a margin which would be prohibitively expensive. There would be an undrawn fee which would be ongoing and an additional rate-based fee in the event of a drawdown. The fee would be a huge drag on the fund's return and only provide the benefit of having a facility that would be used in extremis. In the event of its being drawn, the cost would likely be paid for by the remaining investors, rather than the redeeming investors – unless some other hold-back/gating/liquidity fee was imposed.

Access to such a facility may give bank sponsored managers a competitive advantage. It would also be difficult to size. It could also contravene the prohibition of external support and create a challenging dynamic re the independence of fund versus sponsor.

With respect to the question of how likely a fund would be to use it, we think this would be a matter of last resort as there would be stigma around using it and it would introduce leverage to an otherwise unlevered product.

Assuming that the facility would be secured, whilst in principle such a facility would appear to be of benefit, in practice, we feel that funds would be unlikely to use it when needed, i.e., during a period of stress, due to uncertainty regarding its broader impact on the fund.

If, at the expiry of the loan, the fund was unable to repay the bank, the bank would seize the MMF assets which potentially would result in losses or impaired repayment for investors. This is clearly something the fund manager would be at great pains to avoid. In theory, money good assets expected to perform could be pledged and a tenor negotiated so that maturing assets could offset loan principal. However, the cost of such a facility would be punitive.

A commercial borrowing facility would be called upon, if at all, during periods of market stress which would be likely to coincide with banks experiencing stress themselves and therefore be most reluctant to makes funds available.

IMMFA MMFs portfolios consist of top tier diversified (largely A1/F1/P1) risk and in terms of credit exposure are likely superior to the single counterparty credit exposure that would arise from such a facility. There are also concerns that secured borrowing would have implications for fund ratings given the implications of encumbering fund assets and the associated risk to the fund shareholders.

As per our comment above, MMFs would be highly unlikely to use such a facility.

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Q12: Do you have any comments on our overall policy approach to the issue of passing on the costs of liquidity to redeeming MMF investors?

The FCA's policy approach hits a sensible and pragmatic balance between preserving the utility value of MMFs and providing the necessary investor protection. The proposals allow MMFs to continue with their current *modus operandi* whilst at the same time strengthening the manager's ability to manage redemption stress. We welcome recognition of the importance of a very high degree of NAV stability to many MMF investors.

We are pleased to see that the FCA's approach differs from the US, where the calculation and application of fees is complex and operationally challenging. We also welcome the FCA's decision to discount other options such as changes to valuation, obligatory implementation and prescriptive requirements.

Liquidity management tools (LMTs) are an important instrument in passing on material costs of liquidity to redeeming investors and thereby avoiding share holder dilution. IMMFA is supportive of their use of and from that position has argued that MMFs should be required to incorporate the use of at least one LMT. We have also argued that the timing and calibration of LMTs should be left to the discretion of the fund manager and Board who are uniquely positioned to apply them in the best interest of shareholders.

We welcome the decision not to pursue swing pricing which although suited to some other types of open-ended funds, we believe to be ill-suited to MMFs. As the FCA note, MMFs are unlike other open-ended funds in that they hold large amounts of liquidity specifically to meet redemptions rather than selling down a pro-rata slice of the portfolio.

We note that in the case of an LVNAV, any divergence beyond the 20bp collar would be passed on to redeeming investors via a switch to mark to market pricing.

Q13: Do you agree with our proposed rules on requirements for liquidity management procedures and tools for UK MMFs?

We agree with the pragmatic approach that recognises the challenges peculiar to MMFs by allowing funds to continue to operate as normal, thereby preserving their utility value.

We support the additional limited measures which extend the powers of fund suspension in the best interest of unitholders to include MMFs that are not FSMA authorised and require MMFs to have at least one additional antidilution tool (in addition to suspension) as set out in their prospectus. We have advocated that the use of LMTs should be left to the discretion of the fund manager and Board and welcome the recommendation that this be the case.

We note that the FCA's approach is consistent with the proposed changes to EU MMFR as part of the EU AIFMD II/UCITS review which is also a positive.

As the FCA note (4.24) the proposed rules simply hardwire existing good practice followed by most UK MMF managers.

We note that the FCA's approach should not be taken to apply to other open-ended funds.

Q14: Do you agree with our proposed rules on the enhancing stress testing for stable NAV MMFs?

We find the proposed rules on enhanced stress testing to be proportionate.

Managers will be required to consider the probability and consequences of a collar breach which we agree will prompt the manager towards taking any necessary action to repair the situation.

Q15: Do you agree with our proposed rules on the enhancing operational resilience for stable NAV MMFs?

We agree that managers of a stable NAV fund should ensure that they are operationally ready to deal at a floating NAV. It is important to remember that an LVNAV does not cease to operate if the 20bps collar is breached, as we have emphasised in our engagement. In such an event, the fund moves to variable NAV pricing and subscriptions and redemptions are not processed until a NAV strike. We recognise however, that continuity is based on a smooth transition to the variable price and that therefore it is vital that managers should be prepared for this. This is, we believe, already a matter of good practice on the part of our members but it makes sense to reinforce such practice with the addition of appropriate rules.

We agree with the importance of maintaining an orderly market and avoiding disruption. The rules include an important obligation to keep investors adequately informed, as should be the case. We would add that public disclosure should be proportionate and avoid inadvertently creating bright lines in the regulation.

Steps to include intermediaries and formalising communication plans are helpful.

Q16: Do you have any comments on our overall policy approach to stable NAV operation in the UK MMF regime?

We welcome the FCA's recognition that the LVNAV model has widespread investor utility and the decision to support its continued operation. The utility of the LVNAV is, as the FCA note, due to the fact that it is typically treated as cash equivalent for accounting purposes, and the lack of market alternatives. Although, as also noted, a small number of MMFs came close to a collar breach during the 'dash for cash' and the UK Gilt crisis, we did not observe that NAV deviations were a key driver of redemptions in either stress event. In the 'dash for cash' many investors urgently needed liquidity. Pressure on outflows was compounded by investor concerns about the consequences of a breach of the 30% minimum WLA threshold. This threshold risk will be substantially mitigated by delinking which should reduce redemption pressure in any future event and thereby help funds to minimise NAV deviations. In the UK Gilt crisis, investors were again driven by the need for cash, in this case to raise money for margin calls. NAV deviations were not a driver but rather the result of a rapid repricing of the curve which at one point reflected expectations of an emergency intra-meeting hike from the Bank of England.

We note that the proposed enhanced stress testing rules together with the proposed higher liquidity levels (and the consequent reduction in weighted average maturity) represent a conditional solution to the perceived threshold risk associated with the stable NAV structure, and in particular the LVNAV collar. Like the authorities, we are seeking and will support a pragmatic solution which preserves the utility value of a stable NAV MMF but enhances investor protection. We have concerns that the proposed additions to liquidity requirements go beyond what is required to achieve such a solution.

The FCA has correctly identified the ability of an MMF to switch to a floating NAV as a key aspect of operational resilience. Since no LVNAV has broken its collar, this functionality has not been tested and although we believe managers have processes in place for such an event, we are supportive of the FCA's proposals to reinforce preparedness. The proposals seem to be a proportionate way to mitigate operational risk.

Q17: In your view, what are the advantages and disadvantages of investors posting and accepting MMF units as collateral for non-centrally cleared derivatives?

We believe that permitting and facilitating the use of MMFs as collateral for meeting the margin requirements collateral would further contribute to system wide stability and market functionality. MMFs have demonstrated both their resilience and the importance of their role in providing liquidity during recent stress events and this role will only become more important as the need to move liquidity around the system efficiently increases with a drive towards the centralised clearing of the derivatives.

Whilst the use of MMFs as margin collateral in uncleared transactions is technically permissible under EU regulatory requirements, there are a number of regulatory and operational barriers (which we delineate below in response to question 18). This results in margin being, in practice, predominantly posted (and collected) in the form of cash.

It was clearly observable during the March 2020 'dash for cash' that margin calls were a key driver of MMF redemptions for a certain sector of the investor base, primarily consisting of European pension funds and insurance companies who had purchased EUR denominated

MMFs. In a volatile market, sudden and/or dramatic moves in interest rates can result in these margin sensitive investors redeeming their MMF investments in order to meet increased calls for cash collateral. ESMA also reached this conclusion in their working paper 'Margin calls a new driver of MMF redemptions' [7]This correlation was again observable in September 2022 when UK gilt prices were subject to historically unprecedented moves and, as a consequence, UK pension funds employing LDI strategies experienced pressure on liquidity in order to meet increased collateral requirements. These investors exhibited the same behaviour in redeeming MMFs that had been used to store cash. Once markets stabilised, these flows were reversed, resulting in renewed and record inflows into GBP MMFs.

The correlation of outflows and margin calls is particularly observable for MMFs denominated in EUR and GBP which are often used by investors with exposure to interest rate swaps and other types of derivatives to manage the liquidity component of their portfolios. Analysis of the IMMFA investor base suggests that this is particularly important for the sterling market. The proportion of IMMFA GBP denominated MMFs sold to asset managers (including pension funds) is 51%, as compared to 32% in EUR and a much lower 18% in USD. Similarly, the percentage sold to insurance companies is respectively 18% in GBP, 6% in EUR and 4.5% in USD.

Once the investor has redeemed their MMF investment and posted cash, the receivers of the cash collateral, such as depository or custodial banks, have to reinvest the additional cash into liquid assets. This results in the collecting agent reinvesting in assets which are very similar to those owned by the redeeming MMFs, and in some cases into MMFs themselves. This circular scenario whereby investors redeem from MMFs to post cash collateral, only for this to be reinvested in money market instruments by the collecting counterparty has a detrimental procyclical impact as one form of liquidity is redeemed only to be recycled into another.

The advantages of investors being able to post and accept MMF units as collateral for non-centrally cleared derivatives would include:

- MMF assets would be retained in the MMF structure as opposed to liquidity being recycled.
- Market wide pressure on liquidity would be mitigated.
- The resultant reduction in procyclical flows would contribute to financial stability.
- The reduction in MMF redemptions would be conducive to continuity of short-term funding for issuers.
- Intra-day automated movements save time and processing.

[7] ECB Working paper 2800 'Margin calls as a new driver of MMF redemptions'.

- Removal of the issue of a 1pm fund cut-off time would extend the period during which liquidity is available/can be transferred.
- Potential increased returns for investors. The impact of Basel 3 is likely to mean a further reduction in bank appetite for non-operating cash deposits. This will likely be reflected in the lower returns offered by custodial and depository banks currently holding margin in the form of cash. Allowing such banks to accept MMFs as collateral would broaden the investible universe.
- Increased ability to meet rising demand for collateral. The ability to avail of the use of MMFs as an alternative to cash is helpful in the context of Uncleared Margin Rules (UMR) particularly given the objectives of Phases 5 and 6 to broaden the scope of counterparties subject to the margin rules, which will increase industry demand for collateral.
- Reduction in credit exposure to custodial banks. As noted by ISDA, 'reinvesting cash into a money market fund may also reduce custodian risk in the event of a custodian bankruptcy because cash posted as collateral is attributed to the custodian's balance sheet and securities such as money market funds are not' [8].The alternative is that investors carry on posting cash. In many cases recipients do not want cash, for reasons such as liquidity coverage ratios.

By increasing fund resilience and reducing flow volatility we think the above advantages outweigh the disadvantages, but we consider the disadvantages below. These are primarily associated with the use of tokenisation which may be a necessary step in effecting the use of MMFs as margin collateral.

- Whilst we expect tokenisation to bring benefits, including facilitating the use of MMFs as collateral (discussed in questions 19 and 20 below), it would be harder for an MMF manager to know the underlying client if the client holds MMF units in the form of freely transferable tokens.
- It raises questions around limiting investors/subscriptions if once someone is in the eco system they can buy unlimited tokens.
- It still does not become a payment option therefore investors will still need to redeem to cash in order to spend cash.

Whilst our comments above apply to uncleared margin, in principle eligibility could subsequently be extended to cleared margin and other use cases (using tokenised MMF shares as a method of payment) and IMMFA has advocated for the broader application and more holistic approach. Permitting the use of MMFs as collateral for cleared transactions

[8] ISDA Cash as eligible collateral, 2019: https://www.isda.org/a/DX5TE/ISDA-SOP-Cash-and-MMF-11.6.19.pdf

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would require a change to EMIR technical standards. In addition, they would need to be admissible collateral for CCPs.

Under current EU regulations, CCPs cannot accept MMF units as collateral. Although clearing members and CCPs are permitted to hold government MMFs in the US under CTFC rules, in the EU all MMFs are currently excluded under EMIR. This was revisited by ESMA in November 2021, but the conclusion was to continue to exclude them on the basis that regulatory changes were ongoing. Since CCPs often use a small number of commercial banks, MMFs would allow them an important means of diversifying credit exposure.

Q18: What specific barriers are there, if any, to posting and accepting MMF units as collateral for non-centrally cleared derivatives?

There are a number of operational and regulatory barriers to the posting and accepting of MMF units as collateral for non-cleared derivatives which we outline below. Some of the operational barriers could be overcome by the use of tokenisation but this would not remove the regulatory challenges which relate to interpretative issues and technical standards.

- Transferability: MMF units are not transferable like a bond and rely on a custodian effecting a book entry transfer. Tokenisation should make this operationally simpler by improving intra-day settlement and removing fund cut off constraints (see below).
- The haircuts have to be economically viable which is not the case currently. MMFs are treated as equity rather than debt which makes the haircuts prohibitive.
- UCITS funds must be eligible on a ‘look-through’ basis i.e., the assets they hold should be eligible outright. Since private MMFs such as LVNAVs invest heavily in bank paper and to a lesser extent in corporate paper, their assets may disqualify them from eligibility. Whilst this may be less of an issue for PDCNAVs, even for a these there may be obstacles. A further problem with PDCNAVs is that they only exist at scale in USD (as noted by the FCA), have limited traction in GBP, and are minimal in EUR.
- The inconsistent interpretation, across legislation, of concepts such as highly liquid and low risk is a barrier. For instance, under EMIR the use of UCITS (including MMFs) as collateral is allowed where the UCITS is limited to investing in cash and low risk debt securities. EMIR is silent on whether a reverse repurchase agreement backed by government debt is acceptable in this context and there is no clear regulatory guidance to the effect that it is. MMFR on the other hand, clearly envisages that a reverse repurchase agreement backed by government debt can be a high quality, low risk asset. PDCNAVS are in practice and by design the safest most low risk UCITS/MMF available, yet the lack of clarity as regards EMIR definition of low risk means that counterparties may not be willing to accept them as collateral.

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- There may be a question mark over whether collateral schedules would meet ISDA standards.
- There are cross-border regulation inconsistencies.

Q19: What do you see as the advantages and disadvantages of tokenisation in overcoming the operational barriers for use of MMF units as collateral?

The use of tokenisation would make it operationally easier to pass MMF units between parties. This functionality would be particularly useful with respect to using MMF units as collateral. We list the advantages and disadvantages below.

Advantages:

- Tokenisation would help with the technological and operational barriers in posting MMF units as cash collateral.
- It would enhance mobility, support delivery and increase transparency across the life cycle of a trade.
- It would make transfer of ownership less frictional by facilitating intra-day movement and settlement.
- It could reduce or eliminate the constraint of the existing 1pm fund cut-off time.
- It could obviate the need for custodians to update a shareholder register (and thus reduce processing time and operational barrier). Tokens representing the units would be traded and recorded on a distributed ledger which results in faster, cheaper and frictionless transactions.
- Investors would benefit from increased resilience in their collateral.
- Collateral providers would benefit from additional transparency.

Disadvantages:

- It would not remove the regulatory challenges.
- Tokenisation technology is still at a stage of relative infancy and the legal status, lack of case law and explicit regulatory provisions are issues that need to be addressed.

Q20: How could MMF tokenisation in general interact with the proposals to increase MMF resilience?

The ability to post and accept MMFs as collateral would lower redemption pressure during a ‘dash for cash’ event or a period of extreme market volatility resulting in flow volatility due to margin calls. MMF units could be passed between parties rather than having to be redeemed to cash to transfer value. This would improve MMF resilience and contribute to broader financial stability.

Q21: Do you have any comments on the proposed drafting in MMFS? In light of the explanations given in Appendix 1, are there are any areas where you consider we may have inadvertently changed the policy?

We have no comments on this point.

Q22: Do you have any feedback on our proposed drafting of MMFS with regard to the definition of 'commodities'?

MMFR did not define commodities and this proposed drafting rectifies that omission.

We agree with the definition.

It would not be compatible with the objectives of an MMF to invest in commodities and on this basis IMMFA MMFs do not do so. We support the intention to clarify this.

Q23: Do you agree that the Handbook should revert to original intention of EU MMFR Article 10?

The original intention was to ensure that MMFs should not buy unregulated or unlisted paper. We agree that the unintended loophole should be closed.

Q24: Do you agree that these modifications do not make a material change to MMF rules?

Yes, we agree these are not material changes. IMMFA MMFs do not buy commodities or unregulated assets.

Q25: Do you agree that MMFs depositing cash with such public bodies should be regularised with explicit text in regulation?

It would be very helpful to clarify that it is permissible for an MMF to place a deposit with the DMO or other like body and we understand that the intention is to make this clearer rather than to effect a broader change In line with our previous comments concerning the importance of there being an outlet for MMF liquidity, we would go further and suggest an expansion of the role of the DMO or other means of providing a facility to absorb liquidity, not just in GBP.

As discussed above in relation to question 5, we regard the existence of some avenue for the placement of liquidity as a *sine qua non* for significantly increased liquidity levels. We think that any significant increase in liquidity requirements must be accompanied by facility allowing MMFs the means of placing that additional liquidity otherwise current market constraints will make this extremely challenging around reporting periods.

The existence of the Federal Reserve's RRP facility is a crucial difference between the US and European markets in that whilst US MMFs are required to hold higher levels of liquidity, they have a home for it. As the role of liquidity becomes systemically more important and MMFs increasingly act as the means by which that liquidity can be stored and moved around the system, it becomes vital that MMFs have sufficient outlets for that liquidity.

To be an effective solution to the problem of liquidity absorption, any such public institution, the DMO included, has to provide continuous access at an appropriate pricing level.

We suggest that other similar arrangements with similar entities be included for EUR and USD.

Q26: Do you agree that UK MMFs should be able to enter into reverse repurchase agreements that can be terminated by giving prior notice of no more than 5 days?

Whilst this *prime facie* appears to be a helpful in enabling MMFs to meet higher liquidity thresholds, in practice it would have very limited material benefit if any.

The vast majority of repo activity is conducted overnight, and banks will treat 5 day the same as overnight so an extension from 2 to 5 days will not lead to an expansion of balance sheet availability for MMFs and so will not make a material difference to supply of assets to meet the WLA requirement.

It would also create conflict between the existing EU rules with a 2-day limit and UK rules and funds domiciled in the EU would have to comply with the stricter limit. Given the largest sterling funds are domiciled in the EU, this would not help.

We do see an advantage in mitigating settlement risk as there would be less rollover but do not see this as a 'gamechanger' with respect to WLA.

Q27: Does the Handbook drafting setting out the requirements of UK MMFR Articles 17(7)(a)-(d) represent a material change from the UK MMFR?

We have no comments on this point.

Q28: Do you agree that these provisions are not relevant to the UK financial sector and can be deleted without affecting the operation of MMFs in the UK?

The derogation in 17 (6) allows a maximum of 20% of assets in a single body where the structure of the market is such that there are insufficient viable financial institutions to meet that diversification requirement.'

This was intended for smaller EU Member States and we would agree that it is not necessary for the UK market which has a plentiful supply of issuers. However, we have concerns over

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how this might be considered in the case of non-UK domiciled funds seeking equivalence in the future in the event that EU regulation was not aligned on this point.

Q29: Do you agree with the overall approach to stress testing, reporting and supervisory requirements? Please set out the reasons for your answer.

We have no issues with the overall approach to the above. We note that ESMA update their calibrations on an annual basis and have recently made their stress testing scenarios significantly more severe.

Q30: Do you have any comments on our cost benefit analysis?

The cost of higher liquidity buffers only takes the static AUM of UK domiciled funds into consideration. The cost would be materially higher if the rules were applied to represent more accurately AUM of MMFs offered/distributed in the UK that are not domiciled in the UK. The costs would also be even larger if Standard MMFs were included.