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Dear Sir/Madam,

RE: FSB Consultation Report: Policy Proposals to Enhance Money Market Fund Resilience

The Investment Association (IA) welcomes the opportunity to contribute to the discussions on the policy proposals put forward by the FSB. As one of the key buyers of short-term debt, money market funds (MMFs) support the real economy. MMFs are a critical vehicle, both for institutional investors and for corporate funding channels.

MMFs combine the protections offered by the asset segregation and diversification requirements of funds with cash-like assets. In this way, MMFs provide support for the real economy by providing a facility to hold liquidity, which can be drawn on when needed. Most MMFs used by UK investors are UCITS domiciled in Ireland or Luxembourg, and are recognised by the FCA for sale in the UK.

Our members manage MMFs predominantly domiciled in Ireland, Luxembourg and the UK. Given the cross-jurisdiction nature of our members' involvement in MMFs, the IA has primarily focused its engagement on the response issued by EFAMA (European Fund and Asset Management Association). We therefore endorse and support the response issued by EFAMA. It should also be noted that as our experience is primarily in European (including the UK) MMFs, our comments relate to these MMFs and not necessarily to MMF structures used in other non-European jurisdictions.

Proposed reforms to MMF structures

The IA is concerned that, while policy makers are rightly considering the lessons to be learned from the Covid-19 crisis, particularly the market turmoil experienced in March 2020, too much focus is being placed on MMF structures rather than on the Short Term Funding Markets (STFMs) themselves. MMF structures in Europe underwent significant

reform following the 2008 Global Financial Crisis, with the MMF Regulation coming into force in July 2018. It is our view that the MMF Regulation significantly strengthened the resilience of European MMFs, which was demonstrated by the fact that, despite being placed under the severest liquidity stresses during March 2020, no European MMFs needed to suspend dealing or impose redemption gates. As such, while improvements can and should be considered, we do not believe that the case for far reaching reforms to MMF structures along the lines proposed by the FSB has been proved.

In particular, the IA does not believe that the case has been made for the entire abolition of stable NAV MMFs, such as the Public Debt Constant NAV (CNAV) and Low Volatility NAV (LVNAV) MMF structures provided for under the European MMF Regulation. The challenges experienced by MMFs in 2020 were by no means restricted to these MMF structures – similar challenges were faced by institutional Variable NAV (VNAV) MMFs, as noted by EFAMA in its November 2020 position paper[1] . This suggests that abolishing stable NAV MMFs is not the solution to addressing the challenges faced by MMFs during the March 2020 market turmoil.

A great strength of the MMF Regulation is that is provides for different structure types that suit different client bases. Being able to offer a stable NAV MMF in the form of a LVNAV MMF, or a VNAV MMF according to client needs, is invaluable to money managers. The constant price feature of LVNAVs is popular with corporate investors in the UK – for corporate treasurers, a constant NAV simplifies accounting processes. The constant price feature also enables LVNAV MMF managers to offer intraday withdrawals and same day settlement, since the redemption price is known (being constant). Managers of LVNAV MMFs operate within a strict 20 basis points collar, and a constant price is only used provided the mark-to-market or mark-to-model NAV of the assets remains within 20bps of the constant NAV of the MMF. LVNAV MMFs also hold a buffer of weekly maturing assets, in most cases substantially higher than the minimum 30% required under the MMF Regulation.

Were LVNAV MMFs be forced to convert to VNAV MMFs, it is likely a number of their current customers would stop using MMFs, not least due to the accounting challenges that would arise. As noted, MMFs help corporations and other institutions diversify their cash risk, noting that unlike private individuals these do not generally benefit from deposit protection schemes. The proposal to remove stable NAV funds therefore puts these benefits at risk.

Of the reforms proposed by the FSB, the IA sees the greatest benefit from the proposal to remove the ties between regulatory thresholds and the imposition of fees and gates. The experience of the March 2020 crisis was that the regulatory thresholds were seen as a floor, through which MMFs could not breach, rather than as a liquidity buffer that could be drawn on in times of crisis. As such, MMF managers substantially increased their allocations of weekly maturing assets and maintained these for a number of months after the March 2020 crisis. The ability to use these buffers when MMFs temporarily experience high redemptions without investors fearing the automatic or likely imposition of liquidity tools would be invaluable, on the understanding that restoring the reserves of weekly maturing assets to above the thresholds will be an immediate priority for the MMF. It is essential that MMF managers are able to protect the interests of investors by being able to utilise liquidity tools, such as the ability to be able to impose fees and gates, but these

[1] European MMFs in the Covid-19 market turmoil: Evidence, experience and tentative considerations around eventual future reforms, EFAMA November 2020

should be used at the discretion of the board of the MMF to use when they are needed to protect the interests of investors, not imposed arbitrarily.

The IA regards swing pricing as a valuable tool in open-ended funds for ensuring the costs of selling assets to meet redemptions are borne by the redeeming investors, and not the remaining investors in the fund, thus avoiding the effects of dilution. The UK funds industry has long used tools to manage dilution, such as dual pricing, swing pricing and anti-dilution levies. However, there are challenges to using swing pricing in MMFs, especially in LVNAV and short term VNAV MMFs, and the IA does not believe this is likely to be a useable tool for these funds. An anti-dilution levy is more likely to be a more workable solution for MMFs, though applied at a standard rate, as proposed by EFAMA, to enable this to be operationally feasible when applied to intraday redemptions and settlement.

Short Term Funding Markets

While the analysis in the FSB consultation report identifies significant issues with the operation of STFMs, limited consideration has been given in the report to reforming STFMs to improve their functioning and efficiency. IA members identified the main concern during the March 2020 crisis as being the lack of participation from broker dealers in banks during this period. This was partly due to operational and communication challenges brought about by the sudden need for staff to work remotely, and also due to the reluctance of banks to take additional capacity in a time of uncertainty.

Although the lack of broker dealer activity during the March 2020 crisis was extreme, our members have observed the reduction in broker dealer activity as being part of a longer term trend. Regulations introduced post the 2008 Global Financial Crisis means banks are now subject to stricter capital requirements, limiting the assets they are able to take on their balance sheets. As a result, the role of bank dealers has been limited to purely intermediating the markets. They are no longer capable of taking longer term proprietary positions in any size or duration. As such the secondary market in STFMs is essentially other MMFs. The lack of alternative participants means that if all MMFs are facing the same pressures, as happened in March 2020, the market moves in the same direction. This is an issue with the functioning of STFMs, not the structure of MMFs.

The IA therefore believes greater consideration needs to be given of potential reforms to improve the functioning, transparency, efficiency and participation of STFMs in order to address the issues seen in the March 2020 crisis. Potential reforms could include a recalibration of the capital requirements of banks to re-incentivise them to participate in STFMs, greater use of standardisation in short term issuance, improved platform based electronic trading and intermediation and improving transparency of trading and pricing information. In this respect, the IA supports the use of industry codes such as the Bank of England's UK Money Markets Code, which has recently been updated, and the European Central Bank's proposed Short Term European Paper (STEP) initiative. The EFAMA response explores proposals in more detail, which we endorse.

Finally, we note that respondents have only been given six weeks to consider their responses to the significant reforms proposed in this consultation report, in a period falling within the summer holiday season when many practitioners are on leave. This has inevitably limited the capacity of respondents to address the proposals raised by the FSB, and we consider that a broader holistic review of STFMs as well as MMF structures and further stakeholder engagement is needed before proceeding with any of the reforms

outlined in the consultation. We would welcome the opportunity to discuss these issues with you in more detail.

Yours faithfully,

Peter Capper
Fund & Investment Risk Specialist