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

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Invesco
43-45 Portman Square, London W1H 6LY
United Kingdom

Telephone/Switchboard +44 (0)20 7543 3500
Facsimile +44 (0)20 7543 3588
www.invesco.co.uk

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Dear Madam, Sir,

Please find attached Invesco's response to the Financial Stability Board (FSB) consultation report on policy proposals to enhance money market fund (MMF) resilience.

Invesco welcomes the opportunity to respond to the consultation and thanks the FSB for its constructive engagement with stakeholders.

Yours sincerely,

Michael O'Shea
Senior Public Policy Manager

Direct: +44 (0) 207 034 3819
Mobile: +44 (0) 7597 119 233
Email: michael.oshea@invesco.com

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Registered in England at
Perpetual Park, Perpetual Park Drive
Henley-on-Thames, Oxfordshire, RG9 1HH, UK
Group VAT No. GB 245 0557 71

Invesco response to FSB consultation report on policy proposals to enhanced MMF resilience

Q1. What are the key vulnerabilities that MMF reforms should address? What characteristics and functions of the MMFs in your jurisdiction should be the focal point for reforms?

The reasons for the market stress of March/April 2020 are multifaceted. The unprecedented 'dash for cash' brought about by the Covid-19-related economic and social measures introduced by governments around the world led corporates and investors to shore up their liquidity positions in the face of economic uncertainty.

As a vital liquidity management tool for corporates and investors, MMFs experienced notable redemptions during this period and came up against challenging conditions in short-term funding markets (STFMs) as dealers and intermediaries stepped back from providing liquidity in the secondary market for high-quality, short-dated money market securities. This was primarily due to constraints on their balance sheets due to selling in other markets ahead of stress in the money market space.

However, despite deteriorating conditions in STFMs, MMFs met investor needs throughout the period. No MMF had to suspend dealings, use redemption gates, apply liquidity fees or utilise any other liquidity management tools affecting investors' ability to redeem. Moreover, we note that no CNAV or LVNAV MMF breached their 20bps NAV collar.

So, while policymakers and regulators are understandably taking the opportunity to consider whether recent MMF reforms have contributed towards a more resilient liquidity management proposition for investors, it is important to consider that MMFs do not operate in isolation and that a more holistic review of the ecosystem in which MMFs operate – i.e., STFMs – is required.

Q2. What policy options would be most effective in enhancing the resilience of MMFs, both within individual jurisdictions and globally, and in minimising the need for extraordinary official sector interventions in the future?

Notwithstanding our response to Q1 regarding the need for a more holistic review of the ecosystem in which MMFs operate, it is our view that regulatory provisions linking weekly maturing assets and net daily redemption thresholds to the potential application of liquidity fees or redemption gates impacted investor behaviour by creating a perceived 'first-mover advantage' for investors in CNAV and LVNAV MMFs and incentivised pre-emptive investor redemptions as MMFs' weekly maturing assets moved towards the 30% threshold.

Removing the tie between liquidity buffers and potential fees and gates should contribute towards alleviating redemption pressures on CNAV and LVNAV MMFs, in particular during periods of macroeconomic and underlying financial market stress, and would allow managers of such funds to draw down on liquidity buffers should they require. Implementing this reform should therefore be a priority for policymakers.

Q3. How can the use of MMFs by investors for cash management purposes be reconciled with liquidity strains in underlying markets during times of stress?

As identified in the consultation, MMFs function to provide "principal stability, daily liquidity, risk diversification and returns consistent with prevailing money market rates." They invest in high-quality, short-dated money market securities which provide significant organic liquidity within the fund and the fastest maturing segment of this organic liquidity is captured within MMF liquidity buffers.

Of course, regulatory provisions linking weekly maturing assets and net daily redemption thresholds to the potential application of liquidity fees or redemption gates made it effectively impossible for MMFs to draw down on the so-called liquidity buffers during the March/April 2020 period. Removing the tie between liquidity buffers and potential fees and

gates should contribute towards reconciling the MMF investment proposition and the operation of STFMs in particular during periods of market stress.

However, as alluded to in our response to Q1, MMFs do not operate in isolation and a more holistic review of the ecosystem in which MMFs operate – i.e., STFMs – is required. MMF reform alone should not be viewed by policymakers and regulators as the solution to all of the issues faced in STFMs last year.

Q4. Does the report accurately describe the ways in which MMFs are structured, their functions for investors and borrowers, and their role in short-term funding markets across jurisdictions? Are there other aspects that the report has not considered?

Overall, we acknowledge the FSB's consideration of the forms, functions and roles of MMFs, and find the report's assessment of the different types of MMF structure, both within and across jurisdictions, sufficiently comprehensive and accurate. Additionally, we note the FSB's acknowledgement of the important role that MMFs play in STFMs, their core functions for both issuers and investors, as well as their general economic value globally. Finally, we also welcome the FSB's focus on the "crucial role" of intermediaries and dealers in STFMs which serves to provide a more holistic overview of the ecosystem in which MMFs operate.

However, while it is positive that the FSB considerations in respect of the role of intermediaries and dealers in STFMs are included within its overall assessment of the STFM ecosystem, it is unfortunate that those same considerations are not further reflected upon and extrapolated in the broader context of potential policy reform. This is particularly unfortunate given the FSB states in the report that "MMF reforms by themselves will not likely solve the structural fragilities in STFMs. Authorities might therefore consider adopting measures to improve the functioning of CP and CD markets."

Indeed, it is the case that constraints placed on dealer balance sheets following recent changes to prudential rules hampered their ability to provide sufficient liquidity in STFMs. Dysfunction in underlying markets consequently led to increased margin calls, requiring many institutional investors to shore up their liquidity positions. It is therefore crucially important that policymakers take a holistic approach to reviewing how STFMs operate, including the underlying financial market infrastructure, rather than seeing another round of MMF reform as an answer to all of the issues that may have arisen from the March/April 2020 Covid-19-related market-wide liquidity event.

Q5. Does the report accurately describe potential MMF substitutes from the perspective of both investors and borrowers? To what extent do these substitutes differ for public debt and non-public debt MMFs? Are there other issues to consider?

While the FSB does consider potential substitutes for MMFs, this is by no means an in-depth assessment of the ability or willingness of identified substitutes to meet the liquidity or funding needs of current MMF stakeholders (i.e., investors and borrowers). Given the important role that MMFs play in providing an effective liquidity management vehicle for investors, and in providing short-term funding to the wider economy, policymakers must consider more closely the potential impact of ineffective reforms from the perspectives of both MMF providers and broader STFM participants.

For example, it is possible that, if policymakers were to pursue disproportionate regulatory reforms (some of which we outline in subsequent sections), some MMF providers would be forced to exit the market as the viability of operating such products would be undermined. Through a diminishing number of MMFs that can meet stakeholders' needs, or through the application of disproportionate regulatory constraints, or the two combined, STFM participants might instead seek to rely on other (potentially less transparent) products offered by banks or non-bank financial institutions for their liquidity or funding needs. Not only could such a situation transfer potential issues/risks elsewhere in the market without mitigating them effectively, but it could have a significant impact on the short-term funding of the wider economy.

More specifically, some of the identified substitutes may not work for current MMF stakeholders. For example, in Europe, it is the case that the mandates of some institutional investors (i.e., those required to use 'Qualifying MMFs' for liquidity management purposes under MIFID II) do not allow for direct investment in money market instruments or, in some cases, short-term bond funds. In any case, it is not our view that disaggregating investments by institutional investors in money market instruments would necessarily lead to a reduction in risk. Indeed, it could increase risk and would undoubtedly increase costs.

Q6. Does the report appropriately describe the most important MMF vulnerabilities, based on experiences in 2008 and 2020? Are there other vulnerabilities to note in your jurisdiction?

It is worthwhile to consider the perceived idiosyncratic vulnerabilities of MMFs discussed in the consultation in the broader context of the Covid-19-related March/April 2020 liquidity event. The unprecedented 'dash for cash' brought about by economic and social measures introduced by governments around the world led corporates and investors to shore up their liquidity positions in the face of economic uncertainty. It is important therefore that the FSB has sought to draw a clear distinction between credit and liquidity events in examining the impact of the latter on the operation of MMFs.

Regarding the focus on perceived vulnerabilities relating to liquidity transformation, it is our view that the liquidity transformation 'gap' in an MMF is already very narrow relative to other investment vehicles and would narrow further with the removal of the regulatory tie between the weekly maturing assets and net daily redemption thresholds from provisions relating to the potential application of liquidity fees or redemption gates. This would allow the buffers to genuinely be used for their intended purpose – i.e. to meet redemptions, including during periods of macroeconomic and underlying financial market stress. Difficulties experienced by MMFs in accessing liquidity in respect of longer-dated securities in the secondary market would have been far less prevalent if MMFs were able to draw down on their liquidity buffers during the March/April 2020 period.

Linked to this, we believe that, as identified by the FSB in Box 3, the "clear limits in the ability of dealers to intermediate [STFMs/CP and CD markets]" during the March/April 2020 period is a significant contributing factor to the difficulties experienced by all STFM participants which cannot be understated, nor overlooked. This is particularly pertinent due to the fact that these "clear limits" are at least partly attributable to prudential regulation and should therefore be revisited as part of a holistic review into operation and effectiveness of the STFM ecosystem.

The FSB also considers whether certain types of investor in MMFs may amplify redemption risk, with the broad conclusion that "institutional investors have proven to be especially sensitive to market developments and can increase the likelihood of disruptive redemptions." Fund providers must comply with KYC requirements, which operate alongside various internal risk procedures to manage concentration risk and measures to anticipate cash flow requirements. We therefore note that not all investors within a given investor 'type' will behave the same way during a crisis, with the economic implications of the Covid-19-related March/April 2020 liquidity event providing evidence that corporate cash flows and liquidity needs differ vastly according to their sector.

As such, we would advise against any attempt to determine ex-ante where certain types of investor might sit on a spectrum of pre-supposed volatility as, in our experience, this would simply not match up to the reality of investors' dynamic liquidity needs. Hence, as asset managers, and as part of both our fiduciary and regulatory duties, we engage with our MMF investors on an ongoing basis to understand their investment objectives and liquidity needs in order that we can best position our MMFs

Q7. Does the report appropriately categorise the main mechanisms to enhance MMF resilience? Are there other possible mechanisms to consider? Should these mechanisms apply to all types of MMFs?

Insofar as they represent an overview of the discussions currently taking place among global regulators in respect of potential MMF reform options, the categories set out on p27 of the consultation are understandable and, as far as we are aware, generally reflect the considerations of other regulatory bodies (e.g., the U.S. President's Working Group on Financial Markets, the European Securities and Markets Authority etc.).

In particular, we support further consideration of the following potential MMF reform options:

<u>Removal of tie between liquidity buffers and potential fees and gates</u>:
We strongly support the proposal to decouple the weekly maturing assets and net daily redemption thresholds from provisions relating to the potential application of liquidity fees or redemption gates. The regulatory tie between these provisions created a perceived 'first-mover advantage' for investors in CNAV and LVNAV MMFs and incentivised pre-emptive investor redemptions as MMFs' weekly maturing assets moved towards the 30% threshold. Indeed, this tie has made it effectively impossible for MMFs to draw down on the 30% liquidity buffer.

Overall, removing the tie between liquidity buffers and potential fees and gates should contribute towards alleviating redemption pressures on CNAV and LVNAV MMFs, in particular during periods of macroeconomic and underlying financial market stress, and would allow managers of such funds to draw down on liquidity buffers should they require.

Regarding the potential application of redemption gates, this should remain a matter for the fund board and should only be used as a last resort to protect investors where all other liquidity management tools have failed to be effective. Requiring MMFs to obtain permission from or to notify in advance the local competent authority when gating a fund is not advisable as, at the very least, it infers an additional layer of governance around the potential gating of a fund which, depending on complexity, could be to the detriment of investors in time-critical situations.

Additionally, granting the local competent authority a pivotal role in the governance of gating an MMF could prove problematic from a liability perspective were investors to pursue litigation around such an action.

Sponsor support:

Invesco supports the prohibition of external support to MMFs in Europe and encourages EU policymakers when contributing to the forthcoming review of the EU MMFR, to retain the prohibition provisions as they exist currently. We strongly reject any proposal to "soften or amend the express ban of external support in… times of stress" as we believe such an approach would send the wrong signal to investors in MMFs (e.g., it could represent some kind of guarantee on investment) and, from a provider perspective, would create an uneven playing field between MMFs providers that form part of or are sponsored by banking groups and other MMF providers.

Notwithstanding the above, while we acknowledge the FSB's intention in setting out policy reform options and variants, it is our view that, if implemented, the vast majority of the options and variants would not serve, in practice, to enhance the resilience of MMFs or, more importantly, improve the operation and effectiveness of the STFM ecosystem. Therefore, we do not support the following potential MMF reform options:

Swing pricing:

it is important to reiterate that MMFs already have the option to apply liquidity fees that adequately reflect the cost of accessing liquidity to facilitate redemptions to ensure that shareholders who remain in the fund are not unfairly disadvantaged when other shareholders redeem. As such, we do not see the need to legislate for additional anti-dilution levies seeking the same outcome, i.e. to (1) reflect the cost of liquidity, (2) potentially reduce first-mover advantage, and (3) act as a price adjustment mechanism that can be applied in preference to the application of gates

In addition, requiring MMFs to use swing pricing would be operationally challenging, if not impossible, due to the practical difficulty in reconciling our same day settlement mechanism, a characteristic of MMFs which our clients value highly, with the operation of our stringent governance framework that we have in place to regulate the use of swing pricing for other fund ranges. Indeed, we agree with ESMA that for "MMFs using amortised cost valuation, systematic swing pricing would not be appropriate".

Ultimately, requiring MMFs to use swing pricing would not address the fundamental underlying market structure issues that market participants experienced during the Covid-19-related March/April 2020 liquidity event, nor would it, in our view, profoundly alter investor redemption behaviour during periods of economic uncertainty.

Minimum balance at risk (MBR):

Requiring MMFs to operate a MBR policy would, in our view, effectively undermine the investment proposition that MMFs offer and serve only to push investors away from MMFs and increase reliance on other (potentially less transparent) products offered by banks or non-bank financial institutions for their liquidity management needs. We do not believe that investors would seek to use MMFs as a means to preserve capital and manage liquidity if a portion of their assets were to be held back upon redemption.

Capital buffer:

MMFs are not credit institutions that accept cash deposits, but risk-managed and transparent investment vehicles that seek primarily to deliver capital preservation and liquidity management for investors. Therefore, we do not believe that the

imposition of bank-like policies on MMFs, such as requiring the operation of a capital buffer on top of existing and stringent liquidity rules, is an appropriate means to enhance the resilience of MMFs.

For example, there is no evidence to suggest that, were MMFs to have operated capital buffers during the March/April 2020 period, investors would have acted any differently in terms of their redemption behaviour. Indeed, further constraining the operation of MMFs in an already challenging low interest rate environment would undoubtedly call into question the viability of providing such investment products - it is possible that some MMF providers would be forced to exit the market.

Liquidity exchange bank (LEB):

Notwithstanding any issues relating to the interpretation of rules pertaining to external support, we do not believe that establishing an LEB funded on an ongoing basis by MMFs, asset managers and third-parties will enhance MMF resilience. First, there are significant challenges in assessing the appropriate size of the LEB given that it is not possible to accurately predict future stress events or market crises, and therefore the liquidity challenges that may be faced by MMFs as they participate in short-term money markets.

Questions (and uncertainty) around the size of an LEB give rise to additional issues (and uncertainties) regarding the funding of such a facility. In an already challenging and protracted low interest rate environment, requiring MMFs to provide significant funding for the establishment of an LEB would undoubtedly call into question the viability of providing such investment products - it is possible that some MMF providers would be forced to exit the market.

Ultimately, an LEB would have to be established on a global basis so as to accommodate all relevant MMFs, money market instruments and currencies. At the very least, this poses significant questions around the governance and operation of such a facility, and how MMFs of different structures and jurisdictions would be able to contribute to and participate in such a facility.

It is possible that investors could see MMFs' membership of an LEB – wrongly – as a liquidity guarantee, which could impact how investors perceive and invest in MMFs, and exacerbate rather than mitigate redemption pressures during periods of economic stress.

Removal of stable NAV:

We do not see a need to eliminate CNAV and/or LVNAV MMFs. Indeed, no evidence has been presented by regulatory authorities to suggest that eliminating these types of MMF structure would resolve the issues that resulted from the Covid-19-related March/April 2020 liquidity event faced by market participants and investors alike, or would enhance the operation and effectiveness of STFMs.

It is also the case that, during the March/April 2020 period, VNAV MMFs faced significant redemption pressures and likewise came up against the same underlying market liquidity issues as CNAV/LVNAV MMFs, as investors in VNAV MMFs also sought to bolster their cash positions. Investor behaviour was not structure specific and so policymakers should not view the removal of the stable NAV MMF structure as a way to enhance the resilience of MMFs.

Limits on eligible assets:

MMFs already hold substantial amounts of liquidity to meet redemptions and we believe that removing the regulatory tie between the weekly maturing assets and net daily redemption thresholds from provisions relating to the potential application of liquidity fees or redemption gates will provide a further substantial boost to their liquidity resilience.

Q8. Does the assessment framework cover all relevant aspects of the impact of MMF policy reforms on fund investors, managers/sponsors, and underlying markets? Are there other aspects to consider?

Generally, we believe that the assessment framework, in its analysis of and comparison between potential MMF reform options, is sufficiently extensive and offers a reasonable view of the varying impacts of the potential MMF reform options on fund investors, managers/sponsors, and underlying markets. However, for reasons outlined above, the FSB's assessment framework does fall short in some areas.

Q9. Are the representative policy options appropriate and sufficient to address MMF vulnerabilities? Which of these options (if any) have broad applicability across jurisdictions? Which of these options are most appropriate for public debt and non-public debt MMFs? Are there other policy options that should be included as representative options (in addition to or instead of the current ones)?
In line with our response to Q7, we believe there to be one clear reform option that has the potential to genuinely enhance MMF resilience and has broad applicability across jurisdictions, and that is the removal of the regulatory tie between the weekly maturing assets and net daily redemption thresholds from provisions relating to the potential application of liquidity fees or redemption gates.
Q10. Does the summary assessment of each representative option adequately highlight the main resilience benefits, impact on MMFs and the overall financial system, and operational considerations? Are there any other (e.g. jurisdiction-specific) factors that could determine the effectiveness of these options?
In line with our response to Q8, we believe that the summary assessment of each representative option offers a reasonable view of their perceived resilience benefits, impact on MMFs and the overall financial system, and operational considerations. Nevertheless, while we acknowledge the FSB's intention in assessing policy reform options and variants, it is our view that, if implemented, the vast majority of the options and variants would not serve, in practice, to enhance the resilience of MMFs or, more importantly, improve the operation and effectiveness of the STFM ecosystem.
Q11. Is the description of variants and the comparison of their main similarities/differences vis-à-vis the representative options appropriate? Are there other variants to consider?
In line with our responses to Q8 and Q10, we believe that the description of variants and the comparison of their main similarities/differences vis-à-vis the representative options is appropriate. Nevertheless, while we acknowledge the FSB's intention in assessing policy reform options and variants, it is our view that, if implemented, the vast majority of the options and variants would not serve, in practice, to enhance the resilience of MMFs or, more importantly, improve the operation and effectiveness of the STFM ecosystem.
Q12. Are measures to enhance risk identification and monitoring by authorities and market participants appropriate complements to MMF policies? Which of these measures are likely to be most effective and why? Are there other measures to consider?
We do not take the view that further strengthening already comprehensive and robust fund-level stress testing requirements is likely to enhance the resilience of MMFs or, more importantly, improve the operation and effectiveness of the STFM ecosystem. Fund-level stress testing is already calibrated very conservatively and, in fact, requires consideration factors such as (a) hypothetical changes in the level of liquidity of the assets held in the portfolio of the MMF and (b) hypothetical macro systemic shocks affecting the economy as a whole. As such, we do not necessarily see the need to introduce an additional layer of sector-wide stress testing. The risk here is that, where potential vulnerabilities are identified at a sector-level, authorities could intervene to require all managers to take the same actions at the same time, potentially creating a herd effect and possibly amplifying the potential vulnerabilities identified. Regarding reporting, in our view, EU MMFs already provide sufficiently detailed reporting to supervisory authorities. Existing requirements are already a significant undertaking involving custodians, administrators and transfer agents, and it is not clear that increasing the frequency of reporting from quarterly to monthly will meaningfully improve supervisory authorities 'live' understanding of the positioning of an MMF, its investors or the sector as a whole. Indeed, beyond existing regulatory reporting requirements, MMFs also publicly disclose fund data on a daily basis, including information on key MMF characteristics such as assets under management (AuM), weighted average maturity (WAM), weighted average life (WAL), 1-day and 7-day liquidity values, as well as annualised net yield.

Finally, regarding disclosure and reporting requirements on STFMs, we agree with the FSB's assessment that "MMFs are generally subject to reporting requirements unlike other investors in money markets." As such, we support further consideration of measures that would 'level-up' the transparency obligations to which all STFM participants are subject.

Q13. Are the key considerations in the selection of policies to enhance MMF resilience appropriate? Are there other considerations that should be mentioned?

As with any potential regulatory change initiative, it is important to consider in-depth the relative merits and interoperability of various options that may be brought together to create a package of reforms to achieve an agreed regulatory or supervisory outcome. We therefore acknowledge the FSB's efforts in seeking stakeholder input in this regard.

However, fundamentally, we do not believe that a significant overhaul of the regulatory framework governing the operation of MMFs is required. As set out in our responses to Q7 and Q9, we believe there to be one clear reform option that has the potential to genuinely enhance MMF resilience and that is the removal of the regulatory tie between the weekly maturing assets and net daily redemption thresholds from provisions relating to the potential application of liquidity fees or redemption gates.

Q14. Which options complement each other well and could potentially be combined? What are the most appropriate combinations to address MMF vulnerabilities in your jurisdiction? Which combinations are most effective for different MMF types and their functions?

Fundamentally, we do not believe that a significant overhaul of the regulatory framework governing the operation of MMFs is required. As set out in our responses to Q7 and Q9, we believe there to be one clear reform option that has the potential to genuinely enhance MMF resilience and that is the removal of the regulatory tie between the weekly maturing assets and net daily redemption thresholds from provisions relating to the potential application of liquidity fees or redemption gates.

While there may be merit in seeking to tweak technical parts of the MMF rulebook, for example clarifying rules on external or sponsor support in the context of public authority interventions during periods of macroeconomic and underlying financial market stress, we have significant reservations in respect of the vast majority of the potential MMF reform options and variants discussed in the FSB consultation.

In our view, the options and variants, whether considered individually or collectively, would not serve, in practice, to enhance the resilience of MMFs or, more importantly, improve the operation and effectiveness of the STFM ecosystem. Neither would they change investor behaviour in respect of the use of MMFs, in particular during periods of economic difficultly, other than to seek alternatives to MMFs altogether where the fundamental investment proposition changes (e.g., as a result of forced changes to settlement profile, or the imposition of a MBR policy).

Q15. To what extent should authorities seek to align MMF reforms across jurisdictions? Is there a minimum set of policies or level of MMF resilience that should be considered at the international level to avoid fragmentation and regulatory arbitrage?

The FSB is right to recognise the differences in approach to MMF regulation across jurisdictions, and the report correctly notes that currency of denomination is an important consideration, in particular given the different dynamics in sovereign debt markets across relevant jurisdictions.

We welcome the coordinated international approach to potential MMF reform being led by the FSB and, as a key policy reform option viable at least for the two largest MMF markets globally (the U.S. and Europe), we encourage the FSB to put the removal of the regulatory tie between the weekly maturing assets and net daily redemption thresholds from provisions relating to the potential application of liquidity fees or redemption gates at the heart of its future policy recommendations in respect of MMFs.

Q16. Does the report accurately describe problems in the structure and functioning of STFMs and how these have interacted with MMFs in stress periods?

Insofar as it represents the structure and functioning of STFMs, and the impact thereof on MMFs in particular during periods of macroeconomic and underlying financial market stress, we consider that the report is generally reflective of the key issues experienced by STFM participants, including in respect of the effect of prudential requirements in determining dealer behaviour (Box 3) and the potential benefits of reporting relevant underlying CP and CD market data (Box 5). It also raises pertinent points in respect of potential measures worthy of further consideration for CP and CD markets, i.e. changes in microstructure, increased transparency and reporting (Box 6).
Q17. What other measures should be considered to enhance the overall resilience of STFMs? How would those measures interact with MMF policy reforms and how effective are they likely to be in preserving market functioning in stress times?
Policymakers undoubtedly need to reflect on and improve the operation and effectiveness of STFMs, in particular during periods of macroeconomic and underlying financial market stress. Given that the FSB states MMF reforms by themselves will not likely solve the structural fragilities in STFMs", it is important that policymakers consider further the viability of potential reforms referenced in our response to Q16. Specifically, this refers to the recalibration of prudential requirements impacting dealer behaviour, 'levelling-up' the reporting obligations to which all STFM participants are subject, and targeted improvements to the functioning of the CP and CD markets.
Q18. Are there any other issues that should be considered to enhance MMF resilience?
No response provided.

– ENDS -