BlackRock

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RE: CP28/23 Updating the regime for Money Market Funds

BlackRock[1] is pleased to have the opportunity to respond to the Financial Conduct Authority's (FCA) consultation on proposed new measures for Money Market Funds (MMFs).

MMFs play an extremely important role for a wide range of investors, including many UK corporates, local authorities, charities, pension funds and insurance companies. In recent years, market changes and regulatory reforms have heightened the importance of intra-day cash movement, and at the same time, regulatory capital pressures have reduced the capacity of banks to have this cash move through their balance sheets. Combined, these factors have meant that short-term markets (and MMFs more specifically) have played a more important role in liquidity management for a wide range of companies and market participants.

This segment of the market experienced sharp stresses in March of 2020 because of COVID 19 and an overall flight to liquidity, as well as in September 2022 due to volatility in UK gilt markets. In both of these episodes, MMFs played a critical role in ensuring that end users who needed liquidity were able to access it, despite volatility and stress in the underlying markets. And while it is important to say that in neither of these notable stress episodes did European MMFs breach regulatory thresholds as they are set out today, we do believe that it is important to reflect on these scenarios and draw conclusions to further improve the existing regulatory framework for MMFs.

With that in mind, we are supportive of efforts to ensure that the regulatory regime continues to effectively underpin the resilience of all MMFs, and we believe that generally, the FCA's proposed changes to the regime focus on the right areas to advance this aim. However, we do believe that certain aspects of the proposals merit further consideration.

More specifically:

- **We believe that the FCA's focus on the functionality and calibration of liquidity buffers is the right tool to underpin MMFs resilience**. Most MMFs generally meet redemptions through using cash on hand (overnight or daily liquid assets), rather than by selling assets like most other mutual funds. An MMF's ability to fund redemptions on any given day will therefore be primarily tied to holding an appropriate level of Daily Liquid Assets (DLA). Weekly Liquid Assets (WLA) are also an important metric of resilience as they are

[1] BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

effectively the MMF portfolio's ability to organically replenish cash on hand over a five day period.

- We are highly supportive of the FCA's proposal to remove the linkage between breaches of minimum WLA requirements and the need for Boards to consider imposing liquidity fees or gates. This requirement created a behavioural incentive in March 2020 for managers to shorten the maturity of portfolios and increase liquidity well above regulatory minimums – often by selling assets to reposition portfolios – which was ultimately procyclical against the backdrop of the underlying market stress. Removing this link will make MMFs – and short-term markets more widely – far more resilient in times of stress.

- We also believe the FCA's proposed increase in minimum DLA requirements from 10% to 15% is appropriate for all daily dealing MMFs which settle redemptions on an intraday/ same day basis.

- While we believe an increase to WLA requirements also merits consideration as part of efforts to enhance MMF resilience, we believe that the proposed 50% WLA minimum is too high. In our minds, liquidity calibrations should be set against realistic estimates of potential outflows that the liquidity is expected to provision against. We not see evidence of short-term outflows in MMFs (where we have data granularity) that would necessitate WLA levels this high across the sector. If there are examples of MMFs with outflows to this level outside our data set, we believe it is likely that these are most likely explained by idiosyncratic factors which are best addressed through other provisions (e.g. client concentration risks through the FCA's proposal for enhanced KYC requirements), as opposed to calibrating system-wide liquidity levels on them as a basis. While a high degree of liquidity makes MMFs more resilient to outflows, there is also a risk that the requirement to carry a high degree of liquidity can make MMFs vulnerable to disruptions and discontinuities in short term markets which can place – at times significant- constraints on market participants' ability to place cash and secure short-term assets.

- **While there should be more uniformity in how liquidity is defined across different types of MMFs, we are concerned that applying the same liquidity levels across different types of funds will reduce the tools available to investors to manage their cash positions in different ways.** The EU MMF Regulation clearly establishes a range of different fund types to meet different needs; applying the same calibration of liquidity requirements across all of them would blur the lines between them and in some cases remove their distinct value proposition to investors. We think it is sensible to set different liquidity requirements for MMFs based on distinguishing factors such as maturity profile, yield objectives, or different dealing/ settlement profiles.

- **We are strongly supportive of the FCA's proposed approach to LVNAV MMFs.** The ability of LVNAV MMFs to deal at a share price rounded to two decimal places replicates some of the utility of a true stable NAV fund within defined tolerances (as we have outlined in previous submissions to UK authorities, we do not see LVNAV MMFs as 'stable NAV' MMFs) – a feature which is of tremendous value to investors. We strongly disagree with the idea that there are inherent cliff edge risks in the structure, but we fully recognise that there are operational risks which must be managed around the potential for collar breaches. We believe the FCA's proposed resilience measures address these risks and will further underpin the resilience of this important fund structure.

In conclusion, we largely welcome the FCA's proposals as a solid foundation for enhancing the resilience of MMFs while preserving the critical role they play in serving a wide range of UK investors and acting as a valuable store of liquidity that underpins broader systemic resilience. However, we believe that for these aims to be fully realised, specific elements of the proposal should be further considered and slightly recalibrated.

We have set out below in more detail our feedback in response to the specific questions posed in the CP. We remain at your disposal should you wish to discuss further any issues raised our response.

Yours faithfully,

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

Money Market Funds (MMFs) are an important tool for a wide range of investors, including many UK corporates, local authorities, charities, pension funds and insurance companies and play an important role in underpinning financial stability by providing an efficient store of liquidity which can be moved on an intraday basis. We are supportive of measures to further increase MMF resilience, and overall, we are encouraged by the FCA's focus on liquidity provisioning as the bulwark of MMFs' resilience to outflow pressures. However, in our response, we have highlighted some areas which we believe should be considered further to achieve an optimal outcome and avoid unintended consequences.

Firstly, the application of increased liquidity requirements across **all** MMFs regardless of their structure is likely to have the effect of eliminating the use case for client cash segmentation within the MMF suite, in particular Standard MMFs. Increasing weekly liquidity levels on these portfolios to mirror the short term MMFs will erode the differentiation in value proposition and therefore undermine the use case for these funds in the current MMF landscape. We believe there is a strong case to be made to differentiate liquidity requirements across MMFs based on distinguishing criteria such as portfolio maturity, yield objectives, or dealing/ settlement profile.

Secondly, we believe that the proposal to raise the minimum Weekly Liquid Assets (WLA) level to 50% is disproportionate to the level of outflows we have seen in recent severe market stress scenarios. Furthermore, it could have a detrimental effect on the ability of MMFs to navigate periods of dislocation in the short-term liquidity market (including the GILTS market) particularly around quarter-end and year-end pressure where pricing volatility and an overall capacity constraint is often seen.

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

We are strongly supportive of the FCA's recommendation to remove the linkage between a breach of WLA requirements from the need for the fund board to consider imposing liquidity fees or redemption gates.

We believe that these measures – which are a feature of European Public Debt CNAV (PDCNAV) and LVNAV MMFs and were a prominent feature of US prime VNAV MMFs in March 2020 – had a pro-cyclical effect on many MMFs in the market stress of March 2020. Removing this linkage will therefore make MMFs more resilient and should even have a positive effect on mitigating feedback loops into short-term markets more generally.

Unlike most mutual funds, MMFs are designed to meet outflows using cash on hand, not by selling assets to fund redemptions. LMTs (Liquidity Management Tools), whilst important, should therefore be considered as tools used in extreme scenarios – for example when cash on hand is insufficient and when paying a redemption could have a dilutive effect on remaining investors.

In normal circumstances, the role of WLA is to ensure MMF portfolios are well-positioned to organically replenish cash buffers (Daily Liquid Assets or DLA). However, in March 2020, the move to increase WLA was, in many instances, an effort to ensure that WLA remained well above minimum levels to reassure investors that there was no risk of funds needing to impose redemption gates or fees. This supports the conclusion that a wide range of policymakers and industry have come to support, which is the need to remove the linkages between the WLA levels and the escalation procedures whereby a fund board must consider whether to impose redemption gates or fees.

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

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

Other options discussed were dynamic liquidity levels in a stressed environment, calculation of liquidity buffers and appetite to sell assets if gates are de-linked.

We believe that the most important barometer of an MMF's liquidity resources is its DLA, from which liquidity for redemptions are met. WLA is an important additional metric of an MMF's ability to replenish this 'cash at hand'.

The linkage between WLA levels and the requirement for Boards to consider redemption fees or gates created a strongly procyclical incentive on European MMFs to increase WLA levels beyond what may have otherwise been necessary, during market conditions when the cost of doing so (generally by selling longer-dated assets) was high. However, we should be clear that this procyclical incentive did not necessarily mean that WLA were unable to serve their primary purpose to organically replenish the cash the fund hand on hand.

In our view, if these buffers are realistically calibrated and constructed in a way that gives MMF managers the appropriate flexibility to hold liquidity in a way that reflects the changing market conditions at any given time, they should serve their intended purposes effectively. We agree with the proposal to 'delink' LVNAV/PDCNAV MMFs' liquidity buffers. They create a 'hard stop' mentality for some investors and as a result, an overhanging dilemma when portfolios are stressed. This means that managers must be wary that they can't fully utilise the liquidity of their portfolio given it is often monitored closely by investors despite no actual threat to fund liquidity just perceived operational issues for clients.

We agree with the FCA's proposal that each MMF should select one LMT to use in these circumstances – we expect that most MMFs would ultimately choose a liquidity fee for this purpose.

This also mirrors the EU UCITS/AIFMD provisions which were recently agreed, and which will take effect in the coming years.

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.

We view the related questions focusing on the calibration and composition of liquidity buffers as perhaps the most important questions in the FCA's Consultation Paper.

Liquidity buffers play a central role in MMFs' ability to meet redemptions – and therefore, to withstand periods of severe stress.

We believe it is appropriate to consider increases to MMFs' minimum DLA and WLA requirements. However, we believe the FCA's proposal that **all types of MMFs carry 50% WLA is overly conservative** and could have the detrimental effect of creating potential vulnerabilities for funds in the future.

Firstly, we believe that when it comes to liquidity thresholds there should be a **distinction made between Standard and Short-term MMFs**. Settlement cycles, duration and minimum credit rating exposures are all aspects which distinguish these funds for investors and managers and as a result many Standard funds are not targeted at clients requiring daily liquid access. We lay out more detail for the necessary distinction in Question 6. We would be supportive of all Short-term MMF types having consistent DLA and WLA given their investor expectations of liquidity requirements.

Overall, however, we are encouraged by the direction of the proposals and the focus on quantity and quality of liquidity to improve the resilience of MMFs. Calibration of DLA and WLA are key considerations:

- DLA – which is cash on hand during the trading day and must be placed as an overnight exposure (either unsecured or secured via reverse repo) – is the primary metric of an MMFs' ability to fund a net outflow on any given day.

- WLA – which is assets maturing over the next week, along with other types of highly-liquid assets which are generally easily sold with little or no price impact (e.g., government debt) – are a metric of an MMF portfolio's ability to organically replenish daily liquidity/ cash in the near term. It is therefore a **reasonable proxy for an MMF's ability to withstand significant outflows over a multi-day short term period**.

In assessing the appropriate calibration, we agree with UK authorities that DLA and WLA should be sufficient to underpin MMFs' ability to withstand outflows under 'severe but plausible' market stress scenarios.

However, an important consideration to underline for guiding the calibration of the respective requirements is **whether MMFs will have the ability to place liquidity on an overnight or short-term basis** in all market conditions to fill these liquidity requirements. If a MMF were unable to secure overnight balance sheet capacity with a bank counterparty, or a sufficient supply of short-term paper, it would create scenarios whereby MMFs would be unable to meet minimum thresholds.

Given the short-term markets can be discontinuous around year-end and quarter-end, this is not a hypothetical scenario.

While recent rate increases have alleviated some of the stresses in short-term markets around these periods, the underlying causes (constrained bank balance sheet capacity around capital reporting and levy dates) have not gone away and, whilst not as acute, stresses remain. Equally, a move to decrease rates in future could see these stresses re-emerge.

In calibrating WLA, we believe that these levels be set against realistic estimates of potential outflows that the liquidity is expected to provision against.

In March 2020 and September 2022, Money Market Fund Reform (MMFR) underwent a real live 'stress test' in the form of a market-wide liquidity strain. While most European MMFs had to deal with extremely challenging market conditions, no fund (where we have data in the short-term MMF market) was unable to meet investor redemptions. We laid some of this out in our 2022 View Point.

The direct evidence indicates that MMFR has been largely effective in ensuring that sufficient liquidity is available through DLA requirements; redemption levels in March 2020 show that the existing short-term MMF minimum DLA requirement of 10% was sufficient to meet outflow pressures during the strain. That said, we do think that the minimum DLA could be raised to 15% as proposed by the FCA, which would further bolster MMFs' resilience if such a market scenario were to occur in future. We believe that this is an appropriate calibration in that it would likely not create notable risks that the market could not absorb that level of liquidity on an overnight basis. Given that available cash is the first test of an MMF's ability to withstand a sudden demand for liquidity, we think it is appropriate for al daily dealing MMFs which settle redemptions on an intraday/ same day basis.

In assessing the FCA's proposed increases in both DLA and WLA, we looked at data on the outflows (net redemptions) experienced each day by both BlackRock LVNAVs and other peer funds in March 2020 and September 2022, against the amount of DLA and WLA each fund held at the time show the industry LVNAV funds that witnessed the most significant redemptions. In our data, we observed no European short-term MMF, neither LVNAV or short-term VNAV (granular daily data on flows and portfolio composition of Standard VNAV MMFs is not readily available), experienced redemptions over their DLA levels which would have required them to sell assets to meet outflows.

We equally do not see any examples of 5 day outflow levels that warrant the 50% WLA requirement. If there is an example of a fund seeing this level of redemption (e.g., outside our data set), we believe it is likely to be explained by idiosyncratic events or circumstances (for example, a small fund where the movement of a small number of large clients could have a destabilising effect; or a fund with a very concentrated client base). Therefore, calibrating the WLA of all MMFs around such an example would be overly-conservative, especially considering that other elements of the FCA's proposal (e.g., KYC rules, stress testing) should greatly reduce these idiosyncratic risk events.

While we did not observe any instance of daily redemptions exceeding the DLA that short-term MMFs were holding, we did see many MMFs seeking to raise their levels of WLA through asset sales in March 2020. As per Q2, we believe this was an effort to ensure that WLA remained well above minimum levels to reassure investors that there was no risk of funds needing to impose redemption gates or fees. Removing this factor as suggested would enable more flexibility in managing WLA levels and allow the manager the ability to utilise their full WLA bucket.

We therefore don't believe it is necessary to increase WLA requirements to as high as 50%. While a high degree of liquidity makes MMFs more resilient to outflows, there is also a risk that the requirement to carry a high degree of liquidity can make MMFs vulnerable to disruptions and discontinuities in short term markets which can place – at times significant- constraints on market participants' ability to place cash and secure short-term assets.

We consider 40% WLA to be a more realistic and consistently attainable level without distorting the market and losing flexibility in managing the fund. While holding 50% WLA is not unachievable in most circumstances, any regulatory minimums are avoided by managers who will have incentives to hold liquidity levels over and above the requirement to avoid investor stress/inquiries.

The WLA bucket is made up of DLA, assets maturing in the next 5 days, and other highly liquid, qualifying assets. An increased requirement for MMFs to hold a minimum of 50% will have knock-on consequences for the market and fund functioning.

- Firstly, MMFs experience natural cycles of increased flow volatility in the funds at quarter-end and year-end as a normal course of business for clients looking to build up their cash balances. As a result, we already see extreme pressure in the short-end (overnight and 1 week) market often resulting in pricing pressures due to lack of supply. Any increased minimum requirements during these periods or more generally will likely exacerbate the issues. There are considerable balance sheet constraints around these stress periods which limit the ability to make deposits and enter reverse repo transactions. This is a stark difference to the US domestic onshore market which have the benefit of a Reverse Repurchase Program (RRP). In the US, the Federal Reserve acts as the 'cash *taker*' (as opposed to a liquidity *provider*) of last resort by allowing eligible non-bank counterparties, including US MMFs, to place cash with the Fed through a Reverse Repo. Without a similar market structural adaptation in Euro or Sterling markets, requiring MMFs to hold levels of cash that they would routinely struggle to place around quarter-ends and year-end would introduce vulnerabilities at regular intervals in exchange for theoretical resilience to a redemption scenario even greater than that experienced in March 2020 and September 2022.
- Secondly, the inevitable emphasis on GILTS if higher WLA is required also comes with issues. Aside from the observation that government debt is not immune to episodes of price volatility, the more important point from a financial stability perspective could be about concentration risk. The fact that pension funds made up such a significant part of the investor base for long-dated GILTS undoubtedly meant that a portion of the UK yield curve was particularly vulnerable to a shock that affected that group of investors in September 2022. While the FCA consultation rejects the consideration of a public debt quota for MMF's, the increased requirement for WLA will likely push managers to adopt larger positions in public debt, therefore and a scarcity of short-dated public debt, especially in EUR and GBP, could create the risk of MMFs becoming an overly concentrated investor base in these securities.

In stressed market conditions, funds haven't struggled to raise daily or weekly liquid assets to above 50% but supply dynamics, especially in the Sterling market, don't make this sort of strategy conducive to optimising fund performance or client outcomes in the long term. US funds benefit from a very deep Treasury market which can be relied upon for meeting liquidity requirements. Our concern is that a consistent requirement for greater than 50% WLA across all managers will be harder to maintain given the relatively shallow supply of UK GILTS and T-Bills eligible for the WLA calculations.

Increasing MMF resilience to liquidity shocks is important and using Public Debt within liquidity levels can help, but mandating minimum WLA levels too far will increase MMF risk in other ways. Demand for Public Debt securities has significantly increased due to several factors in recent times, such as Basel III implementation and sees the market constrained, particularly around quarter end pressure points which are amplified at year end reporting periods where pricing volatility is often seen.

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

Above and beyond the concerns laid out in Q5, we think it is important to consider the broad application of the proposed liquidity levels across all MMF types (short-term LVNAV and short-term VNAV as well as Standard VNAV funds). Standard VNAV funds currently operate with more flexible portfolio rules generally (liquidity requirements, minimum and maximum duration criteria, as well as a wider investible universe of underlying securities) compared to short-term funds. In our experience the UK investor base tends to use them in different ways to short-term funds, primarily for longer-term strategic cash allocations. As a result, they tend to experience less volatility in flows.

We don't see any reason to align minimum liquidity buffers with all fund types and believe if this policy is carried through, Standard VNAV's will essentially become obsolete as they won't have the flexibility to differentiate themselves from their Short-term peers, they will lose the ability to ladder longer maturities and generate the associated return enhancement. The point here isn't that increased liquidity for Standard MMF's won't make them more resilient, the point is they are a different product where risk is accounted for in investor allocation from the outset with a different advised investment horizon and a different utilisation purpose for clients.

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

As noted in Q5, our view is that an increase of the DLA level to 15% is likely to bolster the resilience of MMFs given the reliance on daily liquid assets to meet immediate outflow pressures in times of shock. Similarly, a rise in WLA to 40% could improve the ability of managers to replenish DLA levels more quickly while not having too large a negative impact on the supply-side dynamics of the fund's ecosystem. Emphasis on resilience will likely remain on the DLA in shock scenarios.

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? Do you have views on what public sector debt should be permitted in this derogation, and what the appropriate level should be?

The derogation to allow public debt make-up of WLA should be extended regardless of whether proposals to require WLA above 30% for MMFs are also enacted. We also believe generally that the definition of liquidity should be more consistent across all MMF types.

Improving the optionality and flexibility of highly liquid and high-quality assets to meet liquidity requirements for investors is a useful additional tool and public debt paper is sufficiently liquid to act as a WLA substitute.

Furthermore, we would encourage regulators to consider the calibration of levels such as the 17.5% to reflect more accurately a risk assessment of the liquidity and implication of the levels and instruments involved.

While we strongly believe that highly liquid government debt is an important liquidity management tool in many circumstances, we are also encouraged to see the FCA's decision not to impose specific minimum public debt requirements. The current structure and scale of the UK debt market present obstacles to this as mentioned in Q5. While the concept of minimum public debt holdings might mean that an MMF has assets to sell that remain largely liquid even in stressed markets, it would also make the MMF vulnerable to price volatility risks pertaining to circumstances that an MMF manager would be easily able to predict and avoid were they not forced to hold a minimum allocation to these assets.

Due to underlying constraints in the supply of short-term public debt (especially in GBP and EUR), MMFs would likely be forced to buy longer-dated public debt in the secondary market to fulfil minimum holding requirements. This would create significant price fluctuation risks for all kinds of MMFs, especially around quarter and year-end when government debt trades at a heavy premium.

Again, we emphasise the importance of manager flexibility here. Rather than mandating types of holdings or higher minimums, the funds are most flexible when the manager is given more control over underlying investments and as a result the fund is more liquid and resilient.

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?

Further to our previous response to Q6, we think it's helpful to consider the divergence of Short-term vs Standard VNAV MMF's, their liquidity dynamics, investor make-up, and investor utilisation. Short-term MMF's are generally used by UK investors as operating or core cash vehicles, drawn upon sometimes daily with an expectation that large flows could happen at any time for a multitude of reasons. This is because when clients look to invest in these funds these are the broad expectations laid out as cash equivalent vehicles. Standard MMF's are not usually considered to be cash equivalent in the UK and don't suffer from the same degree of flow volatility. This can be evidenced throughout the March 2020, 2022, GILT crisis as well as the 2023 United States banking tumult. As noted in Question 6, the liquidity requirements as well as expectations are different for investors in this type of fund. We believe the divergence is significant here and should be considered.

Furthermore, when managing liquidity, as previously noted in Q5, portfolio managers benefit considerably from optionality and flexibility. MMF units are one of the most efficient, high-quality, and liquid investments a manager can make. Clearly for Standard VNAV funds, being able to utilise a highly liquid, very high-quality asset in MMF units is advantageous and beneficial to underlying shareholders and fund managers especially when flows aren't intrinsically linked to short-term MMF flows due to differing investor make-up and market dynamics between the fund types.

However, we do also note that the concern could be referring to the stability of the fund issuing the units and how a liquidity run on MMF's could cause a contagion effect and a doubling down of pressure on the fund issuing the units initially. Again, here we think distinguishing between products and their investors is important. Standard MMF's don't face the same investor liquidity requirements and should be considered in a different category when analysing liquidity risk, and therefore contagion risk.

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

We agree that managers should consider investor concentration and the risks of correlated investor withdrawals ('KYC' requirements).

MMFs' ability to provide investors with liquidity during recent periods of market stress were aided by existing MMFR (Article 27) requirements for managers to establish, implement and apply KYC requirements and obtain KYC information from intermediaries. Whilst not the sole factor, these requirements help inform managers' portfolio construction and appropriate liquidity levels within MMF portfolios.

It is important to note that redemptions from Short-term MMFs are generally met from daily liquidity and proposals to enable more effective use of these liquidity levels are welcome, such as 'de-linking.' As stated above, KYC is an important factor in managing appropriate liquidity levels however, we think that too mechanistic or explicit KYC restrictions would not be beneficial.

Hard concentration limits would be too blunt a tool; even investors with similar business models can have very different liquidity requirements and would set limits would miss the nuance of those requirements. A mechanistic approach to KYC liquidity requirements could create forced liquidity 'cliff edges' that would not otherwise occur.

MMF managers should closely monitor and effectively manage investor concentration. With existing reporting, managers and fund boards are best placed to effectively manage corresponding liquidity levels in line with the MMF investment objectives without explicit mandatory caps. That said, some rating agency and investors' own eligible investment criteria look to large investor concentrations as the minimum liquidity level, but we think that existing KYC requirements for Article 27 are sufficient.

One enhancement we would be supportive of is consistency in intermediary reporting, though at existing levels of granularity. If more detailed information from intermediaries on beneficial owners was required, this would need to be carefully balanced with data privacy and regulatory reporting requirements. Similarly, we have no objection to the submission of periodic data to relevant regulatory authorities, but not of public disclosure. Without the understanding of each client and client type, we think public disclosure could be detrimental rather than additive to MMF resilience.

Another enhancement we would be supportive of, as expanded on in questions 17-20, is use of MMF shares for collateral purposes. The most significant MMFs outflow periods post MMFR have seen correlation with market systemic stress leading to margin calls where investors had stored liquidity in MMFs in case of margin posting requirements, which are then redeemed, posted as cash, and frequently reinvested in similar underlying money market instruments. As expanded on later, making MMF shares themselves portable for such collateral movement, would remove short term financial management pressures, reduce friction in margin movements and increase MMF resilience.

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?

Commercial borrowing is not seen as a practical solution for managing liquidity risk due to its cost and size. Banks may not have an appetite for such a facility, and the fees would be a drag on the fund's return. Additionally, there are concerns about the implications for fund ratings and the risk to fund shareholders. As a result, MMFs would be highly unlikely to use such a facility.

MMF composition consist of diversified high credit quality, or public debt, money market instruments. A commercial counterparty borrowing facility is not likely to add significant, if any, value where the MMF is superior in weighted credit exposure to any single entity providing a facility. In stress market scenarios, as exemplified by the banking crisis of 2023, such facilities from commercial counterparties are unlikely to be available, notwithstanding MMF typically see flight to quality inflows in such scenarios.

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 strikes a balance between preserving the value of MMFs and providing investor protection. The proposals allow MMFs to operate as usual while enhancing the manager's ability to handle redemption stress. The FCA's approach differs from the US, where fees are complex and challenging to implement.

We do however disagree with the DP's characterisation of 'stable NAVs' as inherently allowing dilution by dealing at a par price. Unrealised mark-to-market fluctuations on assets in the portfolio and dilution are entirely different concepts.

It is vital to note that MMF's meet redemptions through cash at hand (DLA) where there is no cost to be passed on. Dilution occurs when the cost of funding a redemption is not fully borne by the redeeming investor, but rather, incurred by the fund, and hence the remaining investors. Dilution risks are only present in MMFs when outflows exceed cash on hand, and the fund would need to sell assets to meet redemptions – this is when LMTs should be used by managers to avoid dilution.

DLA is therefore the most important factor in MMF's ability to meet redemptions and as this cash at hand price does not fluctuate, nor does it generate transaction costs, therefore redemptions & subscriptions are not dilutionary in the same way as they are for other open-ended funds.

LMTs are important for passing on liquidity costs to redeeming investors in stress environments and avoiding such shareholder dilution. The FCA has decided not to pursue swing pricing, which we agree is ill-suited to MMFs. Instead, MMFs need tools that can be used only in the extreme circumstance whereby a redemption cannot be funded in its entirety with cash on hand and the fund needs to sell assets to raise additional liquidity. For this purpose, a liquidity fee is the most appropriate tool.

In the case of an LVNAV it is also worth noting that any divergence beyond the 20bp collar would be passed on to redeeming investors through the mark-to-market NAV price.

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

We support the FCA's pragmatic approach that allows MMFs to operate as normal while preserving their utility value. The proposed measures extend the powers of fund suspension and require MMFs to have at least one additional anti-dilution tool. The use of LMTs should be left to the discretion of the fund manager and Board. The FCA's approach hardwires existing good practice followed by most UK MMF managers and we agree should not be applied to other open-ended funds.

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

While we acknowledge the importance of exploring redemption scenarios of MMFs in stress testing which our funds conduct daily per the UK requirements, we question the utility of the approach being suggested in CP (consultation paper) 23/28.

The new proposed rules require MMF managers to test a fund's ability to meet the redemptions that would ensue were an LVNAV to breech its 20bps collar. In point 5.7 of the CP, the authors recognise the fact that there has yet to be a case where a UK or EU LVNAV MMF breached its collar.

As such any redemption scenarios against which the fund would be stressed would be purely hypothetical and would have to be determined by a set of qualitative factors and/or manager intuition. While this in principle is not an issue as hypothetical scenarios are part of any stress testing toolkit, we would argue it is not appropriate here given the intention to assess the potential for contagion.

To determine the systemwide effects of such a scenario it would be vital that the results submitted by each MMF manager be comparable and aggregable. However, the hypothetical and qualitative nature of these stress tests would result in non-comparable results across different managers and, in our view, relative to the intention of the stress test would make the exercise redundant.

If the FCA wishes to stress test MMFs for contagion potential, we suggest they devise a redemption scenario in the event of a breach and propose that all MMF managers stress test their Short-term MMF’s ability to meet these redemptions. In this case, while there will need to be an acknowledgment of the inherent uncertainty in such an approach, there would be the ability to analyse the systemwide impact on LVNAVs should the assumptions in the scenario materialise.

As noted, the funds already conduct rigorous stress testing to identify scenarios that could adversely affect each MMF. Managers must consider certain factors, at a minimum, including changes in rates and in the level of redemptions. Managers must test the impact of the factors on, at a minimum, the NAV of the MMF 43 and the ability to meet redemption requests. The tests carried out by stable NAV managers must estimate for different scenarios the difference between the constant NAV per unit and the NAV per unit. Where necessary, the manager must take action to strengthen the robustness of the MMF.

LVNAV funds can move to a VNAV structure and in our view bear the same redemption pressures as Short-term VNAVs (notwithstanding the fact that the current DLA requirements in Short-term VNAV's could lead to more price pressure indirectly). As a result, we think there should be consistency in stress testing all Short-term MMFs in the same way.

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

As mentioned in Q2 and in previous consultations with regulatory bodies we deem it important to distinguish the term 'stable NAV' in the context of an LVNAV – while the ability to round the price to a 2 decimal place price within the collar approximates the utility of a stable NAV to the MMF investor, LVNAV funds do not have a stable NAV like a CNAV MMF does. This has important operational, control and oversight implications, which makes an LVNAV closer to a VNAV than CNAV MMF from those perspectives. An LVNAV's ability to round to 2dp within a 20-basis point collar is an important investor utility. However, LVNAV do not cease to operate if a 20bp collar is exceeded and its ability to move to a mark-to-market NAV (rounded to 4dp) price via operational resilience is an important investor utility.

We strongly agree with the proposal's decision to retain the 'stable' dealing NAV and advocate for an operational framework that caters to both business-as-usual and the most extreme scenarios. We concur with the proposal's objective to ensure consistency in operational and communication readiness across the MMF industry.

We have established a "break-glass" framework that covers our LVNAV and PDCNAV funds end-to-end, from heightened monitoring at given NAV threshold deviations to implementing the switch in dealing with NAV. This framework covers all aspects of the operational and communication process, and it is periodically reviewed to ensure relevance and seamless applicability. In line with the proposal's suggestion, external communication includes both direct investors and intermediaries with whom our investors have a direct relationship, including distributors and platforms.

We concur with the proposal to ensure there is an explicit pre-contractual warning as it relates to the dealing NAV. In our view, this should take form within the fund prospectus. The dealing NAV for LVNAV funds is likely well covered in prospectuses across the industry because of the EU MMF Regulation, and consistency for PDCNAV funds should be applied. Alongside the prospectus sit the account opening forms and KIID/ PRIIPs KID and we believe the generic investment disclosures remain appropriate, i.e., stating an MMF is an investment vehicle, not a deposit, and therefore at risk of capital loss.

For funds offering intraday liquidity, we agree the prospectus should disclose how this behaviour changes in the event the dealing NAV is adjusted.

We also concur with the proposal to enforce communication around the NAV differential at the given thresholds of 15bps and 30bps for LVNAV & PDCNAV funds respectively. This aligns with our approach of maintaining high levels of product oversight and transparent engagement with regulatory supervisors and can be incorporated into our existing framework.

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

We strongly agree with the proposal's decision to retain the ability of LVNAV MMFs to deal at a 2 decimal place rounded NAV and support the proposal's recommendations to bolster the operational resilience of these funds in extreme events.

To reiterate however, we do think it is important to consider LVNAV MMF as VNAV funds which retain the ability for investors to transact at an NAV rounded to 2 decimal places (a 'stable NAV') provided their mark-to-market NAV does not deviate by more than 20 basis points. At that point, provided requisite operational resilience, as well as clarity for investors and supervisors they should operate as Short-term VNAV MMF and round NAV to 4 decimal places.

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 are very encouraged that the FCA is interested in exploring the concept of posting and accepting MMF units as collateral generally. We believe it has the potential to greatly reduce frictions within the system and enhance financial stability for MMFs in the context of margin requirements.

A key feature of the post-crisis regulatory reforms has been the increased collateralisation of counterparty risk – this is especially true in derivatives markets, whether centrally cleared or in bilateral margining arrangements. This has greatly increased the need for cash to move through the system on an intraday basis and heightened the importance of a place to store cash and liquidity. Simultaneously, post-crisis reforms have disincentivised banks from holding this type of cash on their balance sheet and created demand pressure on alternate short-term assets for liquidity purposes.

MMFs are an incredibly important tool for many market participants as a store of cash collateral and liquidity positions, both resulting from margin receipts or to fund margin requirements related to their derivatives positions.

The ability to use MMF units as collateral offers a strong alternative to cash. It also offers a strong alternative to directly holding high quality assets of the nature held within a MMF, providing investors a liquid solution with greater operational ease and higher returns. Holding MMFs further increases the diversity of investors' collateral holdings while reducing concentration risk given the lack of dependence on a single type of security (i.e., GILTS, deposits, commercial paper etc).

The consequential consideration for use of MMFs in the collateral context is the impact on MMF flows. The ability to post MMF units as collateral in clearing and margining arrangements would negate the need for share conversion to cash, thereby reducing redemption pressures on MMFs from this sector during times of market volatility and alleviating the counterparty pressure to find somewhere to place the cash.

In the market volatility of both March 2020 (primarily in EUR) and in September 2022 (in GBP), MMFs experienced redemptions pressures corresponding to increased margin requirements. It is important to note that MMFs played an important role to help ***underpin* financial stability** in these episodes by continuing to provide liquidity to users, despite the clear outflow pressures placed on the funds. Both episodes highlight the value of finding ways to increase the transferability of MMF shares where they are used as liquidity stores for users with margining and collateral needs.

Increased adoption of MMF units as collateral will ensure a more circular flow of collateral related cash remains within the MMF universe. The potential for wider adoption in both bilateral and cleared margin contexts is operationally greatly enhanced by technological advancement in the form of tokenisation.

The advent of tokenisation will further help stem the redemption impact on a given MMF. It offers a transferability framework that reduces the frictions of MMF share mobility for direct posting as collateral for margin, in lieu of share redemption for cash.

There is strong appetite across the clearing ecosystem for greater use of MMFs in the context of collateral posting, yet some critical regulatory framework gaps hinder their advancement.

Firstly, cash posted as variation margin typically receives a zero percent haircut. Whilst Short-term MMF are frequently considered cash & cash equivalent and provide diversified exposure to money market instruments, their capital weighting for collateral receivers is not well defined. The ability to look through to MMF portfolio holdings, as well as consistency of treatment, would therefore be important to wider adoption.

Secondly, the eligibility of acceptance of different MMF fund types and domiciles differs. Further consistency of eligibility rules and/ or equivalence when posted for margin purposes would mitigate this complexity and frequent barrier.

Finally, while this question focuses on non-centrally cleared derivatives, in our view that it is crucial that eligibility for use of MMF should be expended for CCPs to use and accept for cleared margin purposes. This should particularly, and possibly exclusively, be the case for those MMFs that meet look-through highly liquid secure investment criteria such as Public-Debt CNAV MMF. Regulatory barriers are a blocker for centrally cleared adoption.

In summary, the seamless portability of MMF units would reduce operational friction, reduce fungibility of cash movement, reduce MMF outflows and reduce short-term funding market pressure in periods of market stress, whilst still providing investors with liquidity and underpinning financial stability. There is however a need for regulatory change to support more broad-based adoption of MMF units and unlock the centrally cleared market.

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

Addressing ambiguity and barriers to posting and accepting MMF units as collateral would be in the interest of all parties.

As stated above, cash posted as variation margin typically receives a zero percent haircut. Whilst Short-term MMF are frequently considered cash & cash equivalent and provide diversified exposure to money market instruments, their capital weighting for collateral receivers is not well defined. The ability to look through to

MMF portfolio holdings, as well as consistency of treatment, would therefore be important to wider adoption.

There is also inconsistency across regulation in the definition of the concepts of highly liquid assets and explicit recognition of certain asset classes. E.g., EMIR eligibility of UCITS funds on a look through basis yet lack explicit recognition of reverse repo (which MMF use to place cash overnight on a secured basis, heavily backed by government collateral).

The eligibility and acceptance of different MMF fund types and domiciles differs. The varying legal frameworks across jurisdictions can pose a challenge to accepting MMFs as collateral, in particular the cross-border complications limit the range of eligible funds that can be posted. Firms accepting third-country funds must demonstrate that the legal framework for these funds provides comparable risk management protections to those applied for UK UCITS.

Explicitly stating the eligibility of MMFs for cleared collateral, and most specifically certain types of MMFs (e.g., PDCNAVs for centrally cleared), would remove ambiguity and blockers.

Regulatory challenges aside, there are operational inefficiencies in the transferability of MMF shares across parties which are significantly addressed through tokenisation (please see response to Q19 for more details).

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

Despite their holdings in high-quality assets, MMFs are at present not widely used for collateral purposes due to the inefficiencies that arise when from the lack of a common data record shared across ecosystem participants. As a result, there is a perpetual need for reconciliation between the various parties involved in a collateral transaction even within a single market.

The most critical advantage of tokenisation is the removal of technological and operational challenges or barriers to posting MMF units as collateral. The ability to transfer the title of their corresponding MMF units to the counterparty receiving the cash collateral, instead of redeeming units for cash, will benefit MMF stability, market liquidity and clearing transparency, while reducing the associated operational risk of a lengthier process flow.

This transfer of title could be possible either digitally via tokenisation or on the normal share register via a transfer agent/custodian. The enhanced advantage of tokenisation is instant transfer, that need not be restricted to the current market settlement time constraints for MMFs (fund cut-off) given no physical impact on MMF AUM.

The ability to use distributed ledger technology (DLT), allows all permissioned participants to have a common view of trade and settlement status thereby increasing transparency and reducing operating risk. Settlement of collateral could therefore be affected on a Delivery Versus Payment, Delivery Versus Delivery, or Payment basis in a riskless manner effectively eliminating counterparty settlement risk and facilitating frictionless, real-time transfer.

What is important is that both counterparties need to be in the same custodial network**.**

To reap the full benefits of tokenisation, widespread adoption of the technology is required and will necessitate market participants to modify their existing operational processes. The rise of DLT may lead to fragmentation in the market as different platforms and standards emerge hindering interoperability.

It is important to note that transfer of MMF for margin purposes via permissioned DLT is not, and should not be considered, analogous with other uses of DLT such as coins and crypto currencies. Instead, the tokenisation reflects, and allows for transfer of, MMF share ownership.

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

Perceived risks associated with MMFs arise from the fact that in times of extreme market stress, such as seen at the start of the global pandemic, holders are forced to sell their fund shares to raise cash to post as collateral. With the advent of tokenisation, MMFs can instead be posted directly as collateral which would obviate the need to liquidate, and in effect would reduce the perceived systemic risk present within the current (non-tokenised) MMF model.

Enhancing the utility of MMFs as a collateral instrument would induce a virtuous circle of enhanced adoption which would in turn create even greater utility as collateral by broadening the universe of market participants who would be willing to accept MMFs as collateral. This would reduce the need for an investor to make a redemption from an MMF in order to post margin, instead being able to transfer shares in the fund directly. By reducing the outflows during times of market volatility, MMFs are in turn made far more resilient. Furthermore, the immutable and auditable nature of DLT, means that tokenisation can provide a robust and transparent record of transactions ensuring compliance with AML and KYC regulations.

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

At this stage, it is difficult to pin-point any such changes without a full comprehensive review including other teams such as Compliance and Portfolio Compliance Group for coding impacts, an operation we will undertake if the drafting is implemented.

We would suggest that the FCA and HMT should provide a waiver for MMF managers and MMFs with complying with any inadvertent changes.

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

No, we have no feedback. We agree with the proposed drafting and do not believe MMFs should take any direct or indirect exposure to any commodities.

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

We believe the inclusion of reverse repurchase agreements, adequately collateralised should be included in the definition. Formerly classifying reverse repurchase agreements as Money Market instruments would avoid confusion for some clients who deem reverse repurchase agreements as ineligible as a result of their lack of explicit inclusion, despite MMFR allowing for reverse repurchase agreements separately.

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

Yes, we agree.

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

Clarifying the allowance for MMFs to deposit funds with the Debt Management Office (DMO) or similar entities would be beneficial. We advocate not only for this clarification but also for broadening the DMO's role or other mechanisms to facilitate liquidity absorption beyond just GBP.

As previously mentioned in response to question 5, the availability of a mechanism for liquidity placement is essential for managing increased liquidity requirements effectively. Any notable rise in these requirements should be paired with accessible facilities that enable MMFs to allocate their additional liquidity efficiently, especially since market limitations could severely impact this process during periods of financial reporting or market stress.

The Federal Reserve's RRP facility serves as a key distinction between the liquidity management approaches in the US and European markets. In the US, MMFs are obliged to maintain higher liquidity levels but benefit from a dedicated facility for this purpose. As liquidity's systemic importance grows, and MMFs serve increasingly as a vehicle for storing and circulating liquidity, it is critical for MMFs to have ample avenues for liquidity distribution.

For such a solution to effectively address liquidity absorption challenges, public institutions, including the DMO, must offer uninterrupted access at reasonable pricing. We propose the introduction of equivalent arrangements for EUR and USD to support a more comprehensive liquidity management framework.

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?

We agree that MMF's should be able to enter reverse repurchase agreements that can be terminated by giving prior notice of no more than 5 days and that it would align with WLA definition. However, in practice we are unsure exactly how beneficial this will be. The extension from 2-5 days is unlikely to notably increase balance sheet available to MMFs as banks are likely to treat 5 day the same as overnight, and as such, MMFs are unlikely to extend from 2 to 5-day reverse repurchase agreement exposure.

As per question 23 we believe it would be beneficial to clearly establish that reverse repurchase agreements should be considered Money Market Instruments.

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?

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?

We agree that the derogation is not necessary for the UK or Sterling market.

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

With regards to the incorporation of the first seven out of eight of the European Securities and Markets Authority (ESMA) guidelines into the FCA Handbook, we believe that this is a sensible and efficient approach. However, in section 5.6.4 of the proposed Handbook, which pertains to the additional stress testing scenarios around LVNAVs MMFs NAVs exceeding the 20bps collar, we do not believe this to be appropriate or useful for reasons outlined in our response to question 14 above.

While we welcome the intention to remove the burdensome aspects of Article 19 of the UK MMFR, we find that aspects of the final proposal could have the opposite effect and indeed could be likely to disincentivise improvements in the industry. Specifically, the requirement that each process update would require a full re-underwriting of issuer assessments in our mind creates a level of additional burden on the MMF manager such that it discourages continual improvement. We suggest including language along the lines of “at the discretion of the manager” highlighting the fact that the manager will know the assessments that the procedural changes.