IOSCO Response From SWIP

1) Definition of Money Market Funds

Money market funds that should be captured within the scope of the review should be short term money market funds as defined by ESMA/CESR definitions in their 2010 documents. Funds that are designed to give liquidity and capital preservation ahead of return should be the focus of the study.

2) Susceptibility to Runs

We disagree with the statement

"In general, MMFs are vulnerable to runs because shareholders have an incentive to redeem their shares before others do when there is a perception that the fund might suffer a loss."

Investors, who tend to be large institutional clients, make a conscious effort to diversify their risk by investing in MMF's, and are aware of the structure and mechanics of the funds. One of the arguments often mentioned is that investors have the belief that the £ (or € or $) per share is guaranteed. If they did think this then why would investors 'flee' when there is a stressed market event? The redemption of units in a fund is a typical reaction for any investor who has fears over the risk profile of a fund, or pending market events. It is therefore the responsibility of a fund manager to ensure that the fund has sufficient liquidity to meet client redemptions, whilst also ensuring a low underlying risk profile. Indeed one of the first indicators of the crisis were runs on VNAV funds that were unable to price assets accurately during the sub-prime crisis in 2007. CNAV funds were a relative safe haven during this period as investors sought the lower risk investments sought by these funds.

There have been arguments around maturity transformation making a MMF susceptible to systemic risk. This however is true of all debt funds, regardless of type of underlying investment, and whether of CNAV or VNAV type. All debt funds are maturity transformation vehicles whereby they take investments and invest in longer dated assets. Investors should be encouraged to assess the risk of the fund prior to any potential problems the fund might have. As such, it is the stress of the markets that encourages an investor to 'run', not the CNAV/VNAV nature of the fund.

"Several features of MMFs, their sponsors, and their investors contribute to the run risk of MMFs. For example, although a constant, rounded NAV fosters an expectation of safety, MMFs are subject to credit, interest-rate, and liquidity risks. Thus, when a fund incurs even a small loss because of those risks, the constant, rounded NAV may subsidize shareholders who choose to redeem at the expense of the remaining shareholders."

This statement masks what might be considered as the true underlying reason for MMF CNAV behaviour. The funds are (or at least should be) managed to ensure that the shadow NAV of the fund stays as close to the CNAV value as possible. The incurrence of small losses, rather than impacting the shadow

NAV are often adjusted in the yield the fund pays to investors, rather than having any significant impact on the shadow NAV. In fact it is generally only a default event (such as happened with Lehmans and Prime Reserve) that causes the shadow NAV to see any significant impact. Therefore the creation of a strict framework to ensure the accuracy of a shadow NAV would dispel any doubts about the accuracy of a shadow NAV. Having a clear responsibility to maintain assets in line with a clearly discernible market value would mean funds always have a shadow NAV that is in line with the objectives of the fund to maintain a stable NAV and protect capital.
Determining an accurate market price is an issue that is not always straight forward. As a fund provider with a VNAV fund within our fund suite we have often had to employ amortised cost in pricing assets for the VNAV fund as market pricing is often based on a generic yield curve. Assets which do not price accurately against a generic yield curve can therefore show large unrealistic gains or losses on re-pricing. Buying assets that have to be marked against vastly different yield curves creates price volatility, and this is something that investors do not like to see. Stability in pricing of a fund goes a long way to encouraging an investors that their investment is 'safe'. Consequently moving all cash funds to VNAV could precipitate much quicker runs than CNAV funds, and therefore the systemic risk from funds could in fact be increased.
As such, the 'fostering an expectation of safety' is not necessarily a bad thing. We want investors to believe their investment is safe. Clearly MMF's are not guaranteed and this should be clearly stated in all Fund literature. However, through prudent management the Fund Manager will look to deliver stability for investors. This can best be achieved by ensuring the risk profile and pricing volatility of the fund stays low, not through the provision of guarantees or capital support.

"MMF's instead have relied historically on discretionary sponsor capital support to maintain a constant NAV."

This statement we fundamentally disagree with. Whilst there have been industry examples of this stance, we would not agree with this genaralisation and would instead stress that at no time running our CNAV funds have we ever relied on sponsor support. Instead we have relied on conservative fund management and ensuring the amortised cost of assets tied with the market value. Our marketing material makes it quite clear that there are no sponsor guarantees and that the value of investment can go up as well as down as is standard on any OEIC fund.

"Finally, because investors have come to regard MMF's as extremely safe vehicles that meet all withdrawal requests on demand (and that are, in this sense, similar to bank deposits), MMF's have attracted highly risk-averse investors (possibly more so in the case of constant-NAV funds) who are particularly prone to flight when they perceive the possibility of a loss. It is likely that these features mutually reinforce each other in times of crisis."

We would not be in disagreement that funds attract risk-averse investors. However this means that funds should be managed with this in mind, not trying to chase yield and outperform each other. Carrying too much risk, either

through lower rated investments, lower levels of liquidity, or otherwise non-stable priced assets, is irresponsible when the investors are looking for low risk investments. The purpose therefore of the regulation should be to ensure that funds are not managed with excessive risk, and have adequate credit and liquidity restrictions and controls in place.

3) Importance to Short Term Funding Markets

It is clear that short term funding markets are important to bank funding. The size of bank balance sheets means that it is impossible for them to fund themselves strictly through retail depositors. One argument against MMF's is that the institutional cash invested in MMF's would instead be left in bank accounts instead of invested in MMF's. We see this is a clearly flawed argument. MMF's provide a clear service to investors in diversifying their investments, giving an outsourced provision of credit research and administration of their treasury business. A lack of MMF's however would not mean that institutional investors would no longer seek this type of benefit through different schemes such as segregated accounts. Investor behaviour in terms of risk tolerance is likely to be even lower in such a situation, and the diversification benefits of MMF's are likely to be reduced as segregated accounts would be concentrated on an ever decreasing number of 'too big to fail' banks. The diversification benefits of MMF's would be lost as flighty investors ensure that the risk of loss in their capital is minimised. There are also clear disadvantages in terms of liquidity.

The issue around bank reliance on the short term money markets is perhaps a better way of addressing the issues around systemic risk of MMF's. ILAS regulations in the UK have meant that bank liquidity is clearly targeted at longer term funding, however this is currently not a level playing field as other banking markets do not have such restrictions and a competitive disadvantage exists for banks that are curtailed in this manner, and knock on impacts can feed through into the wider economy where this exists. Clearly defined regulations around bank liquidity should exist across international banking markets.

It should be noted here though that imposing increasingly restrictive limits on MMF's means that bank funding and MMF investments increasingly diverge. As more MMF's are required to keep more cash in shorter dates, this is contrary to the funding profile regulators wish to see from the banks. This would be exacerbated if MMF's no longer existed and investors were forced into segregated arrangements which have poorer liquidity. It would force all corporate treasurers to have a far tighter control over their liquidity profile and cash requirements. This is clearly not advantageous for banks, for treasurers or for fund managers.

4) Sponsor Support

Sponsor support is not a sustainable source of risk mitigation. Supporting funds as a sponsor is uneconomical as the fees that are generated by the funds are low compared to the cost of a bail out of a bad investment. Sponsors are important in ensuring there are adequate resources given to the money market funds business in terms of personnel, structure, systems, research and

operations, however bailing out bad investments is not a way forward. Sponsor support further reinforces the idea that a fund is guaranteed. Investors instead should be clearly obliged to carry out due diligence on the fund they are investing in to ensure they are comfortable with the risk and return profile of the underlying assets in the fund.
Further, it could perhaps be argued that it should be defined in Regulation that it is forbidden for a provider to support their fund, ensuring the current will they / won't they uncertainty is avoided, and we can be explicit that the risks of investing in a fund lie with the investor. The fund providers reputation and future income will depend on maintaining the integrity of the fund.
At all times it should be transparently stated for investors in any scheme, marketing or promotional materials what the risks on investing any fund.

5) Benefits to Investors

When a corporation is invested in a MMF with a well diversified shareholder base they benefit from the collective cash flow of the pool. Meaning when one institution is spending money another may be investing money. This effect smoothes the cash flow picture and allows the length of the investment horizon to be increased. This benefits the investors as the fund manager can run a portfolio with a potentially longer weighted average maturity there by increasing the return potential for the investors, while still being conservatively managed to continue providing same day liquidity. This also benefits the counterparties being invested in, as more assets can be invested longer term so helping their funding requirements.
A good MMF will be run by a highly experienced fund management and credit analysis team. This means the investor is benefitting from expertise in portfolio construction and an additional layer of credit analysis. Not just relying on the credit agencies to help them with managing credit risk. In addition good fund managers will also run robust risk management procedures on their portfolios stress the assets against credit moves, interest rate moves and fund redemptions. Funds are also in OEIC structures so they are governed by an independent board of directors who are there to look after the interests of the investor. This also means the assets of the Fund are protected in a defined legal structure which is separate from the organisation managing the assets, thereby adding additional independence and security.
The final point we agree less with. We are not convinced that MMF's are correct for the retail environment. A retail customer would be better protected by the deposit insurance backing of central banks if they have their money invested directly into regulated banks, rather than in MMF's. However if MMF's for retail investors are to exist, separate regulation should perhaps exist to protect retail investors.
With regards to alternatives, there are currently not many in the market place other than a segregated approach. This has an advantage to the client in that they can set their own investment restrictions but the disadvantages are considerable.

- No benefit from sharing your cash flow. Assets would have to be much shorter.

- No pooling of deals. The market would see thousands of extra deals going through the market making settlement far less efficient and dealing rooms over run with deal enquiries
- No external fund management of credit process if clients run their own cash, totally reliant on the rating agencies (see local authorities and Icelandic Banks)
- No credit quality or liquidity regulation on the segregated mandates so far less regulatory oversight on investment process.

6) Similarity to Bank Deposits

We strongly disagree with any similarities being drawn with a bank deposit and a MMF. MMF's are not bank deposits, and investors are fully aware of this. Indeed all funds should have to make it quite explicit through their marketing material that the funds are not deposits in an account; they are making an investment into a pooled, managed fund.
Investing in MMF's is a conscious decision by investors to diversify risk and outsource their credit risk analysis. There is no link between MMF's and bank deposits other than bank deposits, and similar low risk investments being part of the investment universe of the funds.

7) CNAV vs VNAV

VNAV funds are a red herring in this debate around MMF's. Investor behaviour in a 'run' situation is being dictated by a fear over losing the value of their investment. This fear exists regardless of the type of fund that an investor holds. We saw during the credit crunch that it was VNAV 'enhanced' cash funds that first experienced runs due to their inability to accurately price assets linked to sub-prime mortgages. This in turn caused a panic amongst investors who sold units in other enhanced funds and caused a liquidity crisis as everyone sought to sell similar assets in a market with no liquidity.
CNAV funds had a similar experience when the Prime Reserve fund 'broke the buck' due to the Lehman's default, a time which saw unprecedented lack of confidence in the banking sector itself. At this time there were large redemptions in prime money market funds as investors were fearful of contagion and losing money on their investments.
None of the above however can be contributed to the NAV calculation or accounting methodology used by the underlying funds. There was simply a panicked market of fearful investors, who wished to take their investments and place them in 'government-style' treasury funds.
A lot has been made about the fact CNAV funds do not reflect the underlying value of assets within them. This is untrue. A CNAV fund can only keep the CNAV value of £/$/€ per share if the underlying value of the assets within the fund is within a very small tolerance of that value. If a CNAV fund was forced to float its share price then this may in fact increase investor redemption behaviour. A fund showing a small profit (setting aside any tax implications) could see investors flood to sell units to crystallise their gain, similarly the fund would likely see no new investments as investors would shun a fund showing a NAV of greater than par as it would inevitably lead to crystallising a loss when selling units. Maintaining the CNAV in fact allows the fund to

ensure that investors only use the fund for liquidity purposes and removes any arbitraging opportunities.
Lastly, we discuss the use of amortised accounting within VNAV funds. As stated in the point about enhanced funds during the crisis, pricing assets in a low liquidity environment can be extremely difficult. How can you price something accurately when you cannot sell it? We have also seen recent examples whereby through a volatile swap market, issuing yields dramatically vary. Can a single market curve accurately price all these variables accurately? At many times during the last few years, amortised accounting has indeed been the most accurate way to price assets, and restriction in its use may mean inaccurately priced funds and the type of investor behaviour described above which would simply exacerbate the systemic risk.

8) *Rating Agencies*

Rating agency involvement in MMF certainly in Europe has evolved from the lack of a unifying 2a-7 rule to define the parameters on MMF's. Rating agencies have therefore been a driver in creating minimum standards for MMF investments, liquidity, investor diversification and other measures. Investors have also taken fund ratings as a means to invest in funds, with many linking the requirement for a fund rating, in some cases multiple ratings, to their investment policies. Additionally, rather than just any rating, investors are wedded to the 'triple-A' prefix to a rating. Consequently, the triple-A standard set by a rating agency becomes the minimum criteria for MMF Investment Guidelines. Investors seem unwilling to deviate from this and we have seen any fund put on negative watch suffer large redemptions. A recent example of this on a CNAV fund did not result in a breaking of the buck, showing the increased robustness of the CNAV product. Any change to rating agency involvement in MMF's however, will mean a fundamental change to approach for many, if not all, European MMF investors.

The systemic risk from CRA involvement in MMF's is mainly linked to their minimum rating requirements. As bank ratings deteriorate below the minimum rating criteria dictated by the rating agencies methodology MMF's are forced to either sell assets, reduce exposure in their size or tenor, or simply remove counterparties from approved lists. While many of these restrictions are valid moves to reduce credit risk in funds, many are unnecessary restrictions of otherwise safe investments and counterparty usage. Rating agencies are become very intransigent in their application of their methodologies, as has been shown by recent decisions to put certain funds on negative watch as they held paper deemed to be of insufficient quality post a downgrade of an issuer. This behaviour is dangerous and has the potential to cause a run on a fund. As exists in other rated funds in other asset classes, the rating should instead perhaps be given to the fund manager, rather than the fund itself. Ratings for fund managers or fund management houses could be harder to achieve, harder to maintain, not be clustered around the top rating, and create a situation where investors are encouraged to look at a fund managers abilities to run a

product, rather than assuming 'all funds are the same' – something that can exist when funds are rated as triple A by the same agencies.

9) *Repo Markets*

Although not hugely active in reverse repurchase transactions, we firmly believe that MMF's should only engage in secured lending transactions when the collateral involved is of the highest quality, namely government bond assets, and we'd be comfortable with any regulation that was brought in to limit MMF's to this.

10) *MMF environment*

There are 2 other significant factors that have affected MMF's since the credit crunch that we think should be taken into consideration. Firstly the change to liquidity requirements as defined by the changes to the 2a-7 rule in the US and the revised IMMFA Code of Practice. These measures have decreased the risk profiles of MMF's considerably, ensuring a fund must hold at least 10% of assets in next day maturing assets in order to ensure being able to meet investor redemption demand. Furthermore there is a requirement to hold 20% (IMMFA) or 30% (2a-7) of assets maturing within 1 week. These changes have been deployed by the MMF industry and have seen great improvements in a funds ability to negotiate distressed markets (as we saw through the US rating downgrade, and the European sovereign crisis). If anything this area of ensuring MMF's have plenty of natural liquidity is perhaps one that could be strengthened further by increasing the proportion of assets in next day assets. Secondly we would like to highlight the increased use of stress testing amongst funds. All funds are now required to be stress tested on a regular basis, currently at least monthly, we at SWIP run a stress test on a weekly basis. This stress testing analyses the risk profile of a fund by re-pricing the entire fund, based on shifts to yield curves, credit spreads and then assesses the impact of the newly priced fund under various redemption scenarios, up to 50% of the fund size. This extreme scenario testing of a funds risk profile will pre-empt any fund breaking the buck as it will flag any increase in a funds credit risk, a decrease in a funds' liquidity, or deterioration in a funds' shadow NAV. With these controls in place fund providers have clear oversight into the funds risk profile and ensures remedial action can be taken prior to a fund getting into any significant problems.

11) *Systemic Risk Analysis*

We would agree with the first and second assertions made in the paper.
"CNAV funds combine a set of characteristics which may increase their vulnerability to systemic risk"

This statement we fundamentally disagree with. As we discussed in the response to 7) the accounting methodology and NAV calculation, have nothing at all to do with systemic risk, or the risk of runs, rather this is a function of investor fear over market dislocation. Similarly, use of amortised accounting also does not increase systemic risk. VNAV funds are equally susceptible to runs and as such should not be differentiated from CNAV funds in this manner. Indeed as we

mentioned in the answer to Question 2) VNAV funds in fact accelerated the crisis due to the inability to accurately price assets linked to the sub-prime crisis, and runs were experienced from funds in this sector. This inability to price assets in a crisis is something that should also be addressed, as we detailed in 2).
In general we would like to ensure that any regulatory changes are an enhancement to the industry rather than creating unintended consequences that would mean the industry has trouble surviving. MMF's provide an incredibly important service to investors, through diversification of investments, outsourced detailed credit analysis, ease of administration, and pooled liquidity. This can clearly be seen as a driver of the importance of funds due to the scope of their continued use, particularly in the US where returns, for providers and investors, are at all time lows.

12) *Moving from CNAV to VNAV*

As we have discussed at length already a change from CNAV to VNAV would not mitigate against redemption runs and systemic risk. Instead we should be trying to create a framework where we can have more confidence in the CNAV value being an accurate price for the fund. As we have discussed in many circumstances amortised accounting is the fairest way to value an asset, however in circumstances where there is a clear discrepancy between a market price for an asset and its amortised cost, we would prefer to see a framework introduced that ensured that funds re-aligned the amortised cost of the asset(s) through withholding of income. As concerns raised seem to be that the amortised cost of assets is not an accurate reflection of the value of the underlying assets, then a framework to ensure this would alleviate these concerns. A distressed asset which shows deviation away from market prices could be negatively amortised for a short cure period, until it accurately reflected market prices again. This in turn means that the fund pays out a lower interest rate (yield) as it offsets income accrued with realigning a distressed asset with its market price. Again the share price does not need to fluctuate during this period, only the return that a fund pays to investors. Again a strong framework around ensuring amortised costs are accurate is a far better solution than fluctuating a share price with all the potential issues that would create. The lower yield also removes the moral hazard around funds paying out higher yields while holding assets that are distressed. Further, it also means that investors in the fund at the time of the distressed asset are those that are impacted through the reduced yield rather than building a pre-emptive buffer, as proposed in 13). This solution also allows adjustments to be made prior to significant loss events occurring as amortised cost values are kept up to date and in line with market pricing. Again as in 2) we need to ensure that market prices are clearly calculable, and differentiate clearly between different issuers, rather than simply being generically derived from a single curve.
Once the asset is re-aligned with market prices the fund would then have the ability to amortise the asset back to its redemption (or in a defaulted asset the expected recovery value). Investors who have received a lower yield through the period of negative amortisation would then be incentivised to remain in the fund in order to receive the retained income from the fund during that period.
Further benefits of these measures would mean that fund managers would know that running a fund with excessive risk would mean in the event of a distressed asset being in the fund it would result in their fund losing the excessive yield competitiveness. As such there is a clear incentive for Fund Manager's to ensure that the risk in the fund is not likely to cause large deviations in the funds yield as

this may create a signal of distress for investors to leave the fund. As such consistency and appropriate risk levels will be encouraged, and funds taking excessive risks in distressed markets will be unable to continue to pay out higher yields to investors while holding assets that have a market price far lower than the value it is held in the fund. Clearly, the Scheme, Marketing or Promotional literature of the Fund would require to transparently stipulate the adopted approach.

13) *NAV Buffer*

As discussed in 12) we think that a pre-emptive NAV buffer solution is not the best way to prevent systemic risk. Firstly, existence of a buffer means that investors would be under the impression that their investment is guaranteed. This may potentially mislead the investor community. Existence of a NAV buffer also has the potential to encourage portfolio managers to chase riskier investments, knowing a 'bail-out' buffer is available to offset losses that could occur, either in whole or in part. Again this is not something that should be encouraged. The 'NAV re-alignment' solution we mentioned in 12) means that funds are on an even playing field and are still incentivised to avoid riskier investments, on the basis that any loss of value on an asset would be deducted from the yield (and consequently the funds market competitiveness) rather than being immediately bailed out by a buffer accrued in previous years.
Creation of a NAV buffer would also take many years to achieve anything of a size that mitigates against any significant loss of value event. In such a low yielding environment this may stretch the resolve of investors to breaking point if a large percentage of their net income was being withheld to offset currently non-existent losses to bail out future holders of the fund.
It has been suggested a sponsor funded NAV buffer should be created. Over and above the issues around implied guarantees this gives, we also believe that fund sponsors will be unwilling to provide unlimited capital to funds to create a buffer, and the fund does not generate enough in fee income to offset the cost of capital that would be incurred by providing the buffer. Providers would also potentially have to place the whole fund on their balance sheets which would be unacceptable to them. It is an uneconomical solution, and something that would potentially kill the industry.

14) *Private Insurance*

This solution also creates the moral hazard mentioned in 13) around less scrupulous portfolio managers chasing higher yielding, riskier assets with the knowledge that protection around the fund exists. However we feel more fundamentally that this solution is unworkable due to the cost involved, premiums would be too high, and as we have seen from credit enhancement in the ABS market this is generally unworkable in a distressed market.

15) *Conversion to Special Purpose Banks*

We would emphasise again that MMF's are not and should not be thought of in any way as Banking products. They are investment funds that invest in short dated bank issued debt. The nature of the par per share aspect of MMF's we have shown in previous answers is due to the short term stable nature of the

vast majority of MMF assets, and the need to diminish arbitrage opportunities for investors.

16&17) *Two-tier system*

Taking the ideas mentioned in 16) and 17) together, we believe that a two tier system is potentially a workable solution, however the tiering should be based on the underlying investor base, not on over-complicated rules regarding the accounting methodology, or the NAV pricing. As we have clearly set out in previous answers the methodology of pricing and accounting does nothing to mitigate against systemic risk.
As institutional investors are sophisticated with a clear ability to differentiate between risky funds and non-risky funds, they make a conscious decision to invest in their chosen funds. Retail investors are perhaps less sophisticated with regards to the underlying investments they are in, and consequently do not 'run' from funds as aggressively in distressed markets. This pattern of behaviour we feel means that retail investors should therefore have a greater level of protection than institutional investors, and therefore separate regulation should perhaps exist for retail funds. We would argue that institutional investors however should not have the same level of protection, and instead as sophisticated investors should be encouraged to do due diligence on the funds that they invest in. This again encourages portfolio managers to run their funds with low risk as their reputation is reliant on the success of the fund in avoiding default events and significant losses that would impact their competitiveness.
Where a two-tier system would not work is if CNAV or VNAV funds were given an advantage over one another. Any two-tier system where one type of fund is given advantageous treatment over another would inevitably lead to the destruction of the other fund type, whilst doing nothing to remedy the potential systemic risk of the industry.

18) *Summary and Prioritisation*

In summary, we feel that the options as laid out in 12) – 17) do not in themselves provide a realistic solution to the systemic risk problem. We do see potential in the idea of creating more protection for retail clients invested in MMF's, through clearly defined separate regulation around funds that are intended for a retail investor base. Secondly we also would offer the NAV re-alignment framework as a preferred solution to allay fears over CNAV and amortised accounting accuracy, and a clear preference to building pre-emptive NAV buffers.
No other option above do we see as a viable proposal.

19) *Marked to Market Accounting*

We have already covered the continued benefits of amortised accounting in previous answers, and believe that its continued use, allied to a strong framework of NAV repair built around comparing assets to a clearly defined market price and ensuring that amortised cost is accurate. The main issues we find with marked to market pricing for all assets is that clear and defined

market prices for privately dealt OTC money market assets are incredibly difficult to accurately maintain on an ongoing accurate basis. Pricing clarity in money markets is difficult as CD's and CP trades can be dealt directly with issuing banks at levels that are far removed from the underlying pricing yield curves. This lack of clarity around prices means that some marked to market prices can be incorrect; meaning a VNAV fund employing marked to market pricing can be mispriced. We have seen many occasions recently in markets dislocated by the European sovereign crisis, where 3 month assets were trading 50-60 bps above the prevailing yield curve. Following the LTRO actions by the ECB and the consequent moves in the swap rates, the same 3 month assets are now issuing at 30-40bps below the prevailing yield curve. Capturing this type of movement in asset pricing is incredibly difficult and can show funds showing large positive or negative moves in its shadow NAV. Amortised cost pricing can smooth out these large negative or positive moves, and ensures that the assets are priced consistently for the short period of time the assets are within the fund.

Marked to market pricing is far easier to maintain when assets are on a regulated exchange or non-privately issued, so a treasury bill fund can easily adapt to marked to market pricing, whereas a prime MMF would have far more difficulty. The practical impact of being able to price an entire MMF on a daily basis would also mean same day liquidity would be difficult to achieve. Instead funds would have to employ a degree of historic pricing.

20) *Restrictions on Amortised Accounting*

Again as per answers to previous questions, amortised accounting we feel is the most accurate methodology for pricing assets in short term money markets. If restrictions are to be created over its use we would again encourage the NAV re-alignment framework assessing the market value of the assets against amortised cost to ensure accuracy, and negative amortisation to re-align assets with market when over a certain tolerance.

If further restrictions are applied to the use of amortised accounting with regards to a maximum tenor, we may see all funds simply buying assets within this time frame in order to ensure its continued use. A restriction of say 90 days, could mean an entire MMF industry consolidating all its purchases within a 90 day time period. This would a) not be good for the banking sector who would find that the MMF funding they receive would be very short and therefore capital would have to be held against the liabilities, expensive for the banks to receive and a lower return for investors. This has the potential to feed through into the wider economy, as a) corporate treasurers get a lower return on their cash balances and could be tempted to seek higher returning in alternative investments, and b) banks see longer term funding reduce and are less able to lend on into the wider economy.

Again there is a potential moral hazard to consider that portfolio managers may seek higher risk assets to offset the lower returns on offer within a 90 day period, as other asset types are unavailable as longer than 90 days in maturity. Restriction on the use of amortised accounting is a possible solution, however the consequences of such restrictions must be thought through very carefully by regulators.

Rather we would recommend a framework around ensuring that amortised pricing is accurate when compared to a market price, as detailed in 12). This framework ensures amortised accounting is used responsibly, and 'breaking the buck' is far more difficult as distressed assets are kept in line with market values.

21) *Liquidity Restrictions*

As we have already discussed, the imposition of minimum liquidity requirements for MMF's has already had a significant impact in allowing funds to negotiate the recent dislocations in markets caused by the downgrade in the US credit rating and the European debt crisis. This creation of natural liquidity by MMF's is the simplest way of ensuring that MMF's are capable of surviving a period of market stress where secondary liquidity has disappeared. Larger balances for next day and sub-1 week maturities are an easy way of mitigating against runs from investors, and also ensuring the risk profile of the fund stays low. As we have mentioned previously more allocation to next day maturities is a possible next step for regulators, and most MMF's already run nearer 20-30% of assets in next day maturities. Indeed in line with the Bank of England changes to ILAS regulations around required liquidity for banks, a regulator could dictate a variable amount for overnight liquidity to be available, raising the amount when markets are distressed and reducing the amount when tensions ease. This would have obvious knock on impacts to bank funding, but nevertheless could decrease the risk of a fund running out of liquidity. It would also encourage funds to run more assets that are highly liquid as having to raise liquidity amounts quickly due to regulatory requirements would mean keeping a highly liquid portfolio.
Definitions of illiquid assets are difficult to justify, when an asset class that is liquid and a counterparty that is highly rated could be difficult to sell when there are simply no buyers in the market, or everyone owns the issuer already and therefore liquidity in the market can be poor for a particular name. Liquidity can also be affected by market sentiment around asset types, country risk, pricing volatility and issuer specific concerns. As such creating a defined illiquid asset is difficult, however with reference to past price volatility would suggest asset types such as ABS and VRDN's with legal maturity dates longer than the expected maturity, private placement FRN's and assets that are either unrated, or carry a rating lower than the highest available short term debt rating category (P2, A-2, F2) could all be considered illiquid.

22) *Know Your Customer*

Having knowledge of an investor base is an important factor in ensuring a fund is not subject to unexpected redemption pressure. All funds should have a team of Client Liaison professionals who should be pro-active in engaging with clients around potential for large movements in and out of MMF's. This enables portfolio managers to pre-plan liquidity measures, and means remaining investors are not affected. MMF's should also be required to have a widely diversified investor base, and not have large concentrated investments from a small number of investors making up a fund without holding sufficient liquidity against them(exceptions can be made for internal and omnibus

accounts which can be mandated within large organisations to remain invested in such a vehicle). This liquidity coverage and diversity of investor base has been incorporated into Moody's recent fund rating methodology and they look to ensure that a fund has adequate liquidity to meet redemptions from its largest 3 investors. As such we would be comfortable with any requirements for a fund to have in place structure around its knowledge of its investor base. It should also be noted that MMF portals can add additional issues for a fund provider's activities with their investors. Portals sell their services on the basis that they are a convenience tool for corporate treasures, providing an electronic platform where a treasurer can trade on a range of MMF's. These services have evolved further, where some now offer a service to aggregate the underlying stocks of the individual funds and calculate a level of risk analysis. While on the face of it this is helpful to the investor community it can also lead to mis-representation of the underlying risks in a portfolio, this offering should be at least scrutinised by a sufficiently qualified body before being offered to the investor community. This however is not the only issue they pose. There is a danger that when an investor trades through a portal it adds an extra layer in the relationship change, so interfering or lessening the relationship the fund provider has with the end investor. It can also create an environment where investors chase yield, moving money around from fund to fund depending on who had the best yield the day before, undermining the principle of shared liquidity. Finally certain portal providers will run omnibus accounts where there is no transparency of the underlying holders. This makes the process of managing underlying share holder diversity impossible and accordingly it should perhaps be removed as a practice.

23) *Liquidity Fee*

Liquidity fees or redemption levy's exist in many MMF prospectuses however their use remains limited. We feel that where the use of a redemption levy is left to the discretion of a MMF manger, or board, then there is a clear disincentive to use it. Clearly systemic risk is mainly caused by funds receiving more redemption requests than they can cope with, and the lack of ability to meet investor demand through natural liquidity can mean funds fire-selling assets at below market levels in order to meet redemptions, this can cause the shadow NAV to deteriorate and the marked to market price of the remaining assets to fall. Consequently the fund can break the buck. A transparent levy would be fair to all investors and would be an appropriate tool to manage the Fund, especially in scenarios of this nature. In all cases, the Scheme Documentation would have to provide detailed information to the Investor in order that informed investment decisions could be taken at all times. One solution may be for the Regulators to set certain conditions or criteria where the levy must be applied and to legislate more comprehensively on this basis. Effectively, this would in certain circumstances replace discretion with mandatory obligations. We feel that unless there is an external regulator insisting upon the application of a levy, then there is little chance of a fund ever choosing to apply it. The redemption levy also has the potential to put investors off ever investing in funds if it were to be applied unilaterally, as this would mean an immediate loss on investment effectively being realised. That would drive investors away from funds altogether into alternative less

transparent vehicles. We believe if there was the potential for a redemption levy to be applied in distressed funds, this again encourages more due diligence prior to investment from the client base.
Such a levy should only be applied if either the market is severely dislocated and secondary liquidity dries up, in a default event whereby a counterparty with a highest short term debt rating is unable to repay debt, or if a MMF is observed as breaking the buck, and there is a risk of all investors in MMF's redeeming to invest in Government style funds. These scenarios do have the potential to cause a run on MMF's and therefore the liquidity fee could be levied against redeeming investors in this type of distressed market, again however this would only be possible if the funds were told it was compulsory to apply, otherwise they would use their natural liquidity until there was nothing left, and the fire-sale of assets begins.
As such a redemption levy we feel is a proposal that could work to mitigate systemic risk, however one that must be carefully considered to ensure that investors are not encouraged to seek other investments. Initial feedback from investors does appear to show that investor base is opposed to such measures being introduced.

24) *Minimum Balance Requirement*

Maintenance of a minimum balance within funds we feel is an impractical way to mitigate against investor redemption risk. There is a huge complexity of its management within a fund with potentially many hundreds of investors, and the need to hold back investments for a set period would very quickly ensure that more time would be spent modelling investments in and out of funds than there would be time spent managing them. This proposal is unworkable from a management of the fund point of view, and also we believe unworkable from an investor point of view. Investors use MMF's often for large investments over short periods of time and therefore having no certainty over the ability to redeem their investment would force them to use alternative vehicles which may exhibit different criteria. A far better way to manage client redemption requests is to manage natural liquidity and have good information about client intentions for their investment (as discussed in 22).

25) *Bid Price Valuation*

As discussed previously, fund valuation and asset pricing plays very little part in dictating investor behaviour in a 'run' situation. As such this proposal we believe would not provide any benefits. Liquidity fees as discussed in 23) would be a far more effective influence on investor behaviour.

26) *Redemptions in kind*

Redemptions of assets, or in-specie transfers are included in many funds prospectuses already. This type of redemption is however only feasible for large scale redemptions where a vertical slice of assets is a practical solution. Redeeming a large number of small redemption requests it is however impractical to use in-specie transfers of assets. Many smaller investors would also not have the ability to take receipt of assets. In-specie transfers are also

easier to achieve over a longer time period than same day or even t+1 or 2. There tends to be a requirement to plan the transfer over many days, and therefore the proposal is one that could only work in isolated cases.

27) *Gating Redemptions*

Again redemption gating is permitted in many funds prospectuses, and is a useful tool for funds who have large redemption requests in a short period of time. Maximising the amount of redemption proceeds paid out within a short period of time allows the funds shorter dated assets to roll shorter, and help the funds liquidity position to recover. The potential drawbacks to widespread gating would be deciding when and what investors to gate. A set percentage of redemptions being permitted on a given day could be influenced by large transactions at end of day. Would it be a pro-rata of all redemption requests on a given day, would the first redemption requests received be permitted in full, but any over a certain percentage be delayed. All fund providers have a responsibility to Treat Customers Fairly, and therefore gating of redemptions would suggest that all investors would have to have a pro-rata amount redeemed on a daily basis. Clearly this could have knock on impacts in the wider economy, as cash held in funds could be locked up for days on end, and normal cashflows cannot be met, such as wage payments, etc. The administration of such a gating policy if it were to be enforced on a unilateral basis has the potential to cause issues for investors, and therefore, despite being in favour of gating being permitted by funds, we feel it is inappropriate for gating to be a widespread solution. We feel liquidity fees are a far better way of influencing investor behaviour in a distressed market.

28) *Private Liquidity Facility*

Liquidity backstops are obviously effective way of ensuring funds have recourse to secondary liquidity, selling assets through a liquidity backstop would ensure a fund could always meet investor redemptions. The issue would be who would provide such a backstop. As central banks have stated that they are keen to avoid any further government intervention there seems to be little scope for any liquidity backstop being provided.

29 & 30) *Substitution for CRA ratings*

Ratings exist as described in 8) as a measure of risk that a fund exhibits as defined by the various CRA's against their standardised methodology. We also went into some detail as to the reasoning behind the requirement for investors to hold Triple-A rated funds. This creates risk for the funds as any sign of rating deterioration can prompt investors to redeem units and the fund experience a run. The benefits of these ratings though do however include an external party monitoring a funds risk profile, ensuring that the fund is adequately managed, and there are sufficient resources and controls in place. As such MMF ratings are a comfort to investors however this can quickly turn to a sign for panic.

Substitution of these ratings, as long as investors are comfortable with the replacement methodology and terminology, could be viable. CRA's do have differing methodologies and reasoning behind their fund ratings, and perhaps taking a best of approach would provide investors with some comfort. That said however the issues surrounding the CRA ratings we described in 8) could simply be transferred to the replacement. The question therefore remains should funds be rated at all? Again if there is a unilateral set of criteria set out by a 2a-7 style rule for MMF's worldwide then perhaps fund ratings would not be necessary. If investors are not deterred from investing in the funds as unrated entities, then lack of a rating could be a way of removing the influence CRA's have in adding to the likelihood of a fund experiencing a run. Alternatively ratings could exist for fund managers and houses rather than funds, and therefore less arduous restrictions could therefore exist around the funds, and an environment could exist where in order to achieve diversification between funds investors have to get used to investing in managers who do not have the 'top' rating from a rating firm.

31) *Other factors*

As we have discussed in this document, we believe that the proposals to improve liquidity, robust stress testing, a framework to ensure accurate amortised priced assets (allied to improved market pricing methodology use throughout the market), and selective imposition of redemption levies, in-specie transfers and redemption gating can be effective risk mitigation.
We are also keen to promote transparency within the industry, and full disclosure of holdings to investors on a regular basis should be mandatory.
In order to provide investors with further confirmation that under certain circumstances a Money Market Fund could be caused to close every fund should be required to publish a 'living will' , which would specify the process around which a fund would close and highlight processes , options available to investors and likely timescales that would occur.
This has the advantage of creating clarity in investors' minds concerning the possibility of closure and the process that would be adhered to in that event.

32) *Jurisdictions*

Lack of clear definitions of MMF's properties and restrictions have created a situation where similar funds in different jurisdictions have different limitations, different risk profiles and are invested in dramatically different assets. Clarity and uniformity between jurisdictions would mean that all MMF's have a clearly defined regulatory landscape, and there is no advantage from one geographical area to another. This will mean all funds are on a level playing field, and investors are aided in their due diligence in analysing and comparing funds. It may also mean a large re-assessment in terms of eligible assets across jurisdictions, as 'older'/more evolved markets have adapted various non-vanilla investment assets for their MMF's against the newer markets which are more vanilla in nature. Clarity in definitions and restrictions across markets would therefore improve monitoring and regulation of MMF's.