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Felix Grenfell Bozek and Liam Browne  
Financial Conduct Authority  
12 Endeavour Square  
London E20 1JN  
Submitted electronically to: cp23-28@fca.org.uk

### **Re: Updating the regime for Money Market Funds**

Dear Mr. Bozek and Mr. Browne:

ICI Global<sup>1</sup> appreciates the opportunity to provide feedback to the Financial Conduct Authority (FCA) on its consultation paper on updating the regime for money market funds (MMFs).<sup>2</sup> ICI's members include mutual funds, UCITS, and exchange-traded funds, and similar funds offered in jurisdictions around the world, and these include MMFs based in the United Kingdom (UK), the European Union (EU), and United States (US). In its consultation, the FCA sets out proposals with an objective "to enhance the resilience of MMFs domiciled in the UK...."<sup>3</sup> ICI Global and its members are committed to working with policymakers to strengthen the MMF industry for the benefit and protection of investors and the performance of broader financial markets and the economy more generally.

MMFs are an important part of the financial system, providing a source of direct financing for governments, businesses, and financial institutions, and offering investors an important cash management tool and vehicle for short-term savings. Policymakers should evaluate any reform options by comparing their impact on the ability of MMFs to fulfil this role (*i.e.*, preservation of their key characteristics) against the likely practical impact any MMF reforms will have on making the overall financial system more resilient. Any new reforms for MMFs must be measured and appropriately calibrated, taking into account the costs and benefits these funds

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<sup>1</sup> [ICI Global](#) carries out the international work of the [Investment Company Institute](#), the leading association representing regulated investment funds. With total assets of \$42.6 trillion, ICI's membership includes mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and UCITS and similar funds offered to investors in Europe, Asia, and other jurisdictions. ICI's mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. ICI Global has offices in Brussels, London, and Washington, DC.

<sup>2</sup> FCA, [CP23/28 Updating the regime for Money Market Funds](#) (6 December 2023) (the Consultation).

<sup>3</sup> *Id.* at 3.

provide to investors, the economy, and the short-term funding markets. It is essential that MMFs remain widely available, well regulated, and transparent.<sup>4</sup>

While the retained Money Market Fund Regulation (MMFR) provides a robust liquidity risk management framework to protect investors and the financial system, we support the UK government's efforts to implement a regulatory framework that is tailored to the UK market. We welcome the UK's efforts to do so in a manner that maintains MMFs' role as critical cash management vehicles that meet the needs of investors.

Before addressing the specific elements of the FCA's proposal, we wish to highlight an important consequence of any changes to the UK MMF liquidity requirements that must be considered in the analysis – the impact on the forthcoming HM Treasury (HMT) determination of whether the EU and UK MMF frameworks are equivalent. As the FCA states, approximately 10 percent of the sterling MMF market by assets under management (AUM) are domiciled in the UK, with 90 percent by AUM domiciled and authorised in the EU. The FCA's proposed changes to minimum liquid asset requirements would result in more stringent liquidity requirements for UK-domiciled MMFs than those required of EU-domiciled MMFs. On the one hand, if HMT were to determine that the EU framework is not equivalent, then 90 percent of the existing sterling MMFs would no longer be permitted to be marketed in the UK. On the other hand, if HMT were to determine that the EU framework is equivalent, the UK-domiciled MMFs would be required to maintain higher liquidity than EU-domiciled MMFs. In either case, the disparity in regulatory frameworks could cause confusion for investors. Accordingly, we urge UK authorities to consider ways to proceed that avoid outcomes that would cause confusion in the markets, constrain the availability of MMFs in the UK, or put UK-domiciled MMFs at a competitive disadvantage.

As for the FCA's proposed changes to the retained MMFR, we support the FCA's determination to not propose certain other policy options discussed in the FSB's 2021 report on policy proposals to enhance money market fund resilience.<sup>5</sup> In particular, we strongly agree with the decision to not propose to mandate use of liquidity management tools (LMTs), such as macro-prudential swing pricing, in accordance with parameters set by authorities. While the

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<sup>4</sup> ICI and ICI Global have engaged extensively on this subject with other policymakers that have evaluated MMF frameworks following the COVID crisis, including the Financial Stability Board (FSB), whose reports the FCA references. We refer the FCA to our responses to those consultations and proposals, which include the extensive collection of data and analytical resources we developed on regulated funds, including MMFs. See ICI, [Report of the COVID-19 Market Impact Working Group, The impact of COVID-19 on Economies and Financial Markets](#) (October 2020); ICI, [Report of the COVID 19 Market Impact Working Group, Experiences of US Money Market Funds During the COVID-19 Crisis](#) (November 2020); ICI, [Report of the COVID-19 Market Impact Working Group, Experiences of European Markets, UCITS and European ETFs During the COVID-19 Crisis](#) (December 2020); ICI and ICI Global, [Response to ESMA Consultation Paper on the EU Money Market Fund Regulation – legislative review](#) (29 March 2021); ICI, [Letter from Eric J. Pan to Vanessa Countryman regarding Report of the President's Working Group on Financial Markets: Overview of Recent Events and Potential Options for Money Market Funds \(December 2020\)](#) (12 April 2021); ICI, [Letter from Eric J. Pan to Financial Stability Board regarding Policy Proposals to Enhance Money Market Fund Resilience: Consultation Report](#) (13 August 2021); ICI, [Letter from Eric J. Pan to Vanessa Countryman regarding Money Market Reforms](#) (8 August 2022); ICI Global, [Letter from Michael N. Pedroni to Financial Stability Board regarding Request for Public Feedback on Thematic Peer Review on Money Market Fund Reforms: Summary Terms of Reference](#) (8 September 2023).

<sup>5</sup> See FSB, [Policy Proposals to Enhance Money Market Fund Resilience, Final Report](#) (11 October 2021).

Consultation proposes to require MMF managers to have access to specific tools (*i.e.*, suspensions and an anti-dilution levy or adjustment), we welcome the proposed flexibility fund managers would have to implement these LMTs, including how to respond when there is a breach of liquid asset limits and how to calibrate LMTs and activation thresholds. We support the position that fund managers should exercise this discretion in a manner that prioritises the best interest of investors.

In addition, we support the proposed changes for enhancing stress testing and operational resilience for stable net asset value (NAV) MMFs.

We also offer the following comments, which we describe more fully below:

- We strongly support the removal of the regulatory link between liquidity levels in MMFs and the need for a manager to consider or impose tools such as liquidity fees or redemption gates, because such a regulatory link makes MMFs more susceptible to financial stress.
- Given the removal of the regulatory link, we do not believe that it is necessary to increase the weekly liquid asset (WLA) requirements. If the FCA nevertheless determines to increase the liquid asset requirements, we would recommend a WLA increase to 40 percent, rather than the 50 percent that has been proposed.
- While we support the retained “know your customer” (KYC) provisions, we do not support the proposed revisions, which would fail to achieve the intended outcomes of enhancing MMF resilience and mitigating risks associated with correlated investor behaviour.

In response to question 11, we also explain below that we do not believe that a commercial borrowing facility for MMF liquidity during a stress event would be viable.

### **1. Support Removal of Liquidity Threshold Link**

We support the FCA’s proposal to remove the regulatory link between liquidity levels in stable NAV MMFs and the need for a manager to consider or impose tools such as liquidity fees or redemption gates. As the FCA notes, there is evidence that, in the EU and US, identical or similar regulatory links drove investor redemptions. ICI’s data on the US market indicates, and our members report, that the possibility of a gate especially caused investors in March 2020 to redeem heavily when a fund started approaching the 30 percent threshold—a level that only had significance to investors because of the bright line drawn by the regulatory tie. In the EU, what had been intended as a liquidity buffer for funds, instead became a hard liquidity floor. Fund managers were compelled not to use their holdings to finance redemption requests in March 2020, fearing that a breach would induce redemption requests as investors anticipated the imposition of LMTs.<sup>6</sup> Thus, the regulatory link made MMFs more susceptible to financial stress in March 2020 and could likely do so again in future periods of stress if it is not removed.

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<sup>6</sup> See European Commission, [Report on the functioning of MMFR](#) (20 July 2023) (EC MMFR Report) at 11.

We, therefore, strongly support the removal of the regulatory link. We also agree with the FCA’s observation that doing so is a global trend, as the US determined to remove the regulatory link in its amended MMF rule,<sup>7</sup> and the European Commission stated in its most recent report on the adequacy of the MMFR that “there could be scope to further increase the resilience of EU MMFs, notably by decoupling the potential activation of liquidity management tools from regulatory liquidity thresholds.”<sup>8</sup>

## **2. Recommend No Increase to Minimum Weekly Liquid Assets**

The FCA proposes to increase liquidity buffers for all MMF types to WLA of 50 percent and minimum daily liquid assets (DLA) of 15 percent. We recognise the importance of liquidity buffers for all MMF types and support clear, strong portfolio liquidity requirements. When considering the appropriate levels for minimum liquid asset requirements, it is important to recognise that, in addition to any specific minimum WLA and DLA requirements, MMFs must seek to maintain sufficient liquidity to meet reasonably foreseeable investor redemptions. Moreover, as a complement to these requirements, MMFs must comply with KYC requirements, where they identify risk characteristics of their investors and plan their holdings of liquid assets accordingly.

### ***a. Removing the Regulatory Link Will Enhance the Existing, Well-functioning Requirements***

In light of these requirements and the removal of the regulatory link, the current WLA and DLA requirements are appropriate and do not need to be increased. Aside from the effects of the regulatory link, the current MMFR framework has been shown to operate well in periods of market stress. As the European Commission found in its recent report on the functioning of the MMFR, the MMFR “successfully passed the test of liquidity stress experienced by MMFs during the COVID-19 related market turmoil of March 2020, the recent interest rate increases, and related financial asset re-pricing.”<sup>9</sup> In addition, no EU- or UK-domiciled MMF needed to impose redemption fees and/or gates or suspend redemptions during these stressed events.

The removal of the regulatory link will enhance the resilience of MMFs. In addition to removing the threshold effect, delinking will allow MMF managers to access liquidity that they have been unable to access because of investors’ fear of the mere possibility of fees or gates if a fund were to dip below 30 percent. Accordingly, MMF managers will be able to more freely use all existing liquid assets to meet redemptions—as was intended. That “increase” in access to liquidity occurs by the simple removal of the regulatory link.

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<sup>7</sup> See US Securities and Exchange Commission, [Money Market Fund Reforms](#) (12 July 2023).

<sup>8</sup> See EC MMFR Report. See also ESMA, [ESMA opinion on the review of the Money Market Fund Regulation, Final Report](#) (14 February 2022).

<sup>9</sup> EC MMFR Report at 21.

***b. The Bank of England’s Modelling has Overly Restrictive Assumptions***

The FCA’s proposal to increase the WLA to 50 percent is based on modelling by the Bank of England (BoE) that contains two assumptions that, in our view, are overly restrictive and consequently may materially overstate the results. For example:

1. The model assumes that MMFs cannot sell any assets into the secondary market. While this assumption is somewhat more plausible during stressed periods for those short-term securities that do not have a secondary market,<sup>10</sup> and, for which MMFs have traditionally held to maturity (*i.e.*, commercial paper (CP) and certificates of deposit (CDs)), the same cannot be said for highly liquid government issued or guaranteed assets (HQLA), such as UK gilts, US Treasuries, and EU member state government bonds. UK MMFs are permitted to hold up to 17.5 percent of such HQLA as part of their WLA requirements, as long as one could reasonably expect to sell those assets in one business day. Imposing a no-sale restriction on HQLA does not realistically reflect how MMFs manage their internal liquidity and effectively assumes that none of those assets are available to help meet redemption requests, which can significantly understate MMFs’ actual usable liquidity in the BoE model.

This restriction also feeds into the BoE model’s identification of the “least” resilient funds. Because MMFs cannot use HQLA to meet redemptions in the BoE model, those MMFs in which HQLA represents a higher share of their WLA will, by design, have a lower capacity under the model to sustain redemptions over any period and at any level of WLA than MMFs with a lower share of HQLA. In reality, these “least” resilient MMFs could very well be just as resilient as the other MMFs if the model allowed them to sell HQLA to meet redemptions.

2. The model introduces an “accelerator” function, which assumes larger redemptions as fund levels of WLA-eligible assets approach the regulatory threshold. In this regard, this accelerator function captures the scenario where investors redeem MMF shares, purely in the belief that LMTs could be implemented by the fund due to a breach of the regulatory threshold. While such an assumption accurately represents the current UK MMFR framework, it does not accurately reflect this Consultation where the regulatory link is removed. As pointed out above, removing the regulatory threshold, which has previously acted as a binding constraint, will allow portfolio managers to access more liquidity to meet redemption requests.

When these two overly restrictive assumptions are removed, we believe the BoE model will show that MMFs can sustain higher redemption rates with WLA at a level lower than the

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<sup>10</sup> Liquidity in these securities can be found during stress events but generally at deeply discounted prices. In fact, a recent working paper by ESMA has suggested that the development of a secondary market for short-term debt instruments is the best way to increase the resiliency of MMFs. See Baes, M; Bouveret, A & Schaanning, E (2023): “[Bang for \(breaking\) the buck: Regulatory constraints and money market funds reforms](#)”, ESMA Working Paper No. 2, 2023.

proposed 50 percent. Consequently, before any finalisation of WLA requirements, we encourage the BoE to undertake further modelling with more realistic assumptions.

***c. If the FCA Increases Requirements, We Recommend a More Modest Increase in WLA***

If the FCA nevertheless determines to increase the minimum liquid asset requirements based on data and the historical experience of UK-domiciled MMFs, the FCA should consider a more modest increase for the WLA to 40 percent, rather than the proposed increase to 50 percent. As noted above, under a revised framework that removes the regulatory link, MMFs will have additional access to liquidity.

Reforms for MMFs must be measured and appropriately calibrated. An increase of the WLA that is too high could present challenges for MMFs in accessing sufficient liquidity in the market and could reduce returns for investors. MMFs typically manage liquidity conservatively, with a generally accepted industry practice of holding assets at significant margins above regulatory minimums, which helps to manage periods of tighter liquidity, such as end of quarter and end of year. This practice should be considered in determining market capacity and an appropriate WLA requirement. Although the SEC increased the WLA to 50 percent in the US, such an increase would be significantly more challenging to practically implement for the UK market. This is because US MMFs can invest their surplus cash in the Federal Reserve's Overnight Reverse Repurchase facility, while UK MMFs do not have access to a similar facility that would provide an investment option for surplus cash. While the FCA acknowledges MMF managers' concerns that their ability to place cash overnight are particularly acute in the UK and EU at the end of quarter and end of year, the Consultation does not address these concerns.<sup>11</sup> Developing an overnight reverse repurchase facility for sterling that is able to absorb excess liquidity could mitigate these concerns. We appreciate that the FCA declined to pursue this issue at this time, but we recommend its future consideration to support MMFs' efficient liquidity management.

***d. The Impact of the Proposed Requirements on VNAV Funds Is Disproportionate***

In the Consultation, the FCA proposes that the increases to WLA and DLA apply to all MMFs – public debt CNAV funds, low volatility NAV (LVNAV) funds, and variable NAV (VNAV) funds (both short-term and standard) – recognising that the increases for VNAV funds are significantly greater. The FCA rationalises this disparate impact on VNAV funds because “[t]here has not been strong evidence to date that LVNAVs are more vulnerable to outflows than VNAVs.”<sup>12</sup> Although VNAVs comprise the majority of UK-domiciled funds (14 of 17), the FCA does not cite data analysing the performance of VNAV funds in the UK market. Moreover, beyond the general reference to similar outflows, the FCA does not determine that the liquidity risks associated with all MMFs are comparable, such that it is appropriate for all MMFs to be subject to the same WLA requirement.

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<sup>11</sup> See Consultation at 24-26.

<sup>12</sup> *Id.* at 26.

In particular, we would argue that standard VNAV funds—which have a higher maximum weighted average maturity (WAM) of 6 months compared with other types of MMFs which have a maximum WAM of 60 days—should not be subject to the higher proposed DLA/WLA requirements. The proposed increased liquidity requirements would likely force these funds to “barbell” their portfolios—hold a higher share of longer-dated securities—to continue to provide a reasonable yield differential from other types of MMFs. Investors consider standard VNAV funds to be more akin to ultra-short bond funds and expect yields on standard VNAV funds to be comparable to ultra-short bond funds. In addition, most standard VNAV funds generally do not provide same-day settlement of redemptions; rather, redemptions are settled on a T+1, T+2, or T+3 basis, which allows these funds more time to sell securities to meet redemptions thereby lessening the need for an increase in their liquidity requirements.

The FCA suggests that the impact on VNAV funds is mitigated by the proposal to extend the derogation that permits MMFs to include specified HQLA as up to 17.5 percent of their WLA. Currently, the derogation applies to stable NAV funds, whereas VNAV funds are permitted to include money market instruments or units of other MMFs within their WLA, up to a limit of 7.5 percent of total assets, provided the assets can be redeemed and settled within five working days. We generally support the extension of the derogation to VNAV funds, though we question the FCA’s conclusion that it fully mitigates the disproportionate increase in WLA for VNAV funds.

We separately are concerned that the cap of 17.5 percent of HQLA is unduly restrictive for all MMFs, considering the liquidity of the assets. Indeed, the SEC does not apply a limitation to the percentage of WLA that can be met by HQLA. In times of stress, this cap could present an unnecessary constraint that discourages funds from adjusting their portfolios to rely on such liquid assets.

In sum, we have significant concerns that the proposed increase to WLA for VNAV funds is disproportionately large, particularly for standard VNAV funds, and recommend that the FCA consider the performance of UK-domiciled VNAV funds prior to determining that there is a need to adjust WLA for VNAV funds and the appropriate extent of any such adjustment.

### **3. Support the Retained “Know Your Customer” (KYC) Requirements**

Article 27 of the retained MMFR,<sup>13</sup> sets forth a thorough set of investor due diligence considerations for MMF managers relating to investor concentration and behaviour. Pursuant to the retained provisions, MMF managers model the liabilities of the fund to manage concentration, anticipate investors’ redemption demands, and address risks of concurrent investor redemptions. The retained provisions also require MMF managers to take appropriate action to strengthen the robustness of the MMF if the manager determines that there is a risk of material adverse effect on the operation of the MMF from the simultaneous redemption of several investors. These actions may include reinforcing the liquidity of the MMF or improving the quality of the MMF’s portfolio of assets.

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<sup>13</sup> Proposed to be transferred to Section 5.5 of the FCA Handbook.

The Consultation proposes to expand these requirements in response to concerns that existing considerations and actions that MMF managers must take are focused on the impact of one or a few large holdings of single investors. According to the Consultation, the proposed revisions would require MMF managers to consider and take action in response to risks from wider correlated investor behaviour. The revised text aims to provide further detail on the actions that MMF managers may consider, including “changing the investor base,”<sup>14</sup> (e.g., reducing the concentration of one or a relatively small number of investors or of investors who may show correlated redemption behaviour). In addition, an LVNAV MMF manager may consider reducing the weighted average maturity of the MMF’s portfolio to reduce the fund’s sensitivity to rate changes, if the manager determines that a significant proportion of investors would redeem if the redemption price were equal to the fund’s NAV.

We support the retained provisions of Article 27. A robust KYC program and framework for identifying and addressing concentration risk are essential components of the comprehensive framework for managing risks. We do not support, however, the proposed enhancements to Article 27 and are concerned that the provisions would not achieve the intended outcomes of enhancing MMF resilience.

The Consultation indicates that the proposed revisions are intended to address concerns regarding investor behaviour in response to recent unforeseen and unprecedented scenarios.<sup>15</sup> The proposed revisions would require fund managers to enhance their forward-looking modelling to mitigate the risks from these scenarios. There are, however, limits to predictive modelling, given the heterogeneity of a fund’s investor base. Even an exhaustive and detailed consideration of client profiles will yield a partial analysis of behaviour, particularly in scenarios that are, by definition, unforeseen and unprecedented. We are therefore concerned that such analysis would not be sufficiently useful for the intended purpose. Even if the proposed revisions were implemented, fund managers’ ability manage the identified risks would not be enhanced beyond that which is already required under Article 27.

Further, although the proposed revisions specify additional actions that managers may consider to address risks associated with correlated investor behaviour, this action does not address the market-driven cause of the correlated behaviour, which is external to the fund. Indeed, if an MMF manager were to follow the proposed revisions and adjust the investor base of one fund by allocating the investments of investors at risk of correlated behaviour across a broader number of funds, the manager may address risks associated with correlated behaviour at the fund level. However, spreading the correlated redemption risk across a broader range of funds does not make the investors less likely to exhibit correlated behaviour.

We therefore recommend that the retained provisions of Article 27 of the MMFR be included in the FCA handbook without the proposed revisions.

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<sup>14</sup> Consultation at 32.

<sup>15</sup> *See id.* at 3-4.

#### 4. A Commercial/Private Borrowing Facility is Not Viable

In question 11 in the Consultation, the FCA asks about the advantages and disadvantages of a commercial borrowing facility for MMF liquidity during a stress.<sup>16</sup> We can offer insights we drew from work we undertook over ten years ago (which we note is prior to substantial recent changes to MMF frameworks). ICI developed a preliminary framework for a private liquidity facility for prime MMFs in the US, including how it could be structured, capitalised, governed, and operated.<sup>17</sup> We noted at the time, however, that such a facility would need to overcome some significant hurdles, including its substantial initial and ongoing costs and vast regulatory complexity. Among these challenges, regulators would have to require all funds to participate to ensure sufficient capital. Yet, required capital levels could be so high as to render MMFs economically unviable, especially for smaller providers. Ultimately, these challenges were deemed insurmountable.

Despite the passage of time since we undertook this work and the substantial intervening changes to MMF frameworks, we believe that these challenges remain relevant today.

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We appreciate your consideration of ICI Global's comments. If you have any questions or would like to discuss our comments further, please feel free to contact Annette Capretta (ACapretta@ici.org), Kirsten Robbins (Kirsten.Robbins@ici.org), or me (Michael.Pedroni@ici.org).

Sincerely,

/s/ Michael N. Pedroni

Michael N. Pedroni  
Chief Global Affairs Officer, ICI, and  
Head of ICI Global

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<sup>16</sup> See *id.* at 31.

<sup>17</sup> See Letter from Paul Schott Stevens to Elizabeth M. Murphy, [Re: President's Working Group Report on Money Market Fund Options \(File No. 4-619\)](#) (10 January 2011) at 23-31.