6 May 2022

Dear Madam or Sir,

RESPONSE TO THE TARGETED CONSULTATION ON THE FUNCTIONING OF THE MONEY MARKET FUND REGULATION

We welcome the opportunity of responding to this important consultation, and have participated as a member of IMMFA in the debates related to the IMMFA response to the consultation. While we agree in general with the IMMFA response, we would also like to emphasize that we fully support the idea of removing the CNAV and LVNAV as we believe that would enhance MMF resilience for the following reasons:

1. Money Market Funds (MMFs) provide a very important utility to many investors including Corporates, Investment Funds and Local Authorities. They also provide crucial liquidity and funding in the short term money markets. We believe that any reform must ensure that MMFs can continue to be attractive to both investors and to providers and should be designed to promote liquidity in the short term cash market.
2. The COVID crisis in March/April 2020 caused two main points of stress for MMFs:
    (i) Shadow NAV deviation (the move in the yield curve caused by emergency central bank rate cuts) demonstrated a systemic weakness of LVNAV pricing model and became a focus for regulators, rating agencies and investors. We shortened the WAMs of our funds as the crisis developed and therefore did not experience much of a deviation but we believe this was a problem for many other MMFs in the market with some rumoured to have an 18bp deviation, just 2bps from breaching the corridor.
    (ii) The impact of post 2008 banking regulations has made it expensive for banks to fund at the short end of the curve and to hold short term investments. They are no longer able to act as market makers and cease to act as intermediaries during times of market volatility. When banks withdraw from the market in this manner liquidity disappears and the market struggles to function, this is also evident at key reporting dates such as quarter and year ends. As MMFs are regulated to hold more liquidity and banks continue to be regulated away from the short end of the curve this tension will remain and periods of extreme illiquidity will continue. Some relaxation of banking regulation in this area or central bank liquidity provision is required to address this long term issue.
3. We would be fully supportive of a regulatory move to remove all LVNAV and CNAV and adopt a floating NAV for all MMFs as it would remove the risks highlighted in 2.i above. The shadow NAV deviation cliff edge risk and the associated first mover advantage (for those who disinvest before the shadow NAV deviation corridor is breached) are, in our view, not widely understood by investors. A move to VNAV would remove this cliff edge risk and make the funds more transparent. No other investment funds

allow this price smoothing methodology or non MTM pricing and we believe that this anomaly is unnecessary and should be removed.

4. Many investors are permitted to only invest in funds which are classified as 'cash and cash equivalent' or take comfort in their ability to meet this classification. In our opinion, Short Term Money Market VNAV funds meet the requirements under IAS 7, although this determination is typically made by an external auditor. We are aware that there is judgement and inconsistency in the application of the relevant rules across audit firms and jurisdictions which typically favours a stable NAV over the VNAV due to the constant price. We would welcome the publication of guidance that clarified the acceptance of VNAV funds as 'cash and cash equivalent' which would improve their acceptance as a replacement for constant priced funds.
5. Current VNAV regulation permits more flexibility with lower liquidity buffers. If all MMFs were valued on a VNAV basis there would be greater transparency and investors would be treated more fairly. Currently, more sophisticated investors who understand how the NAV deviation occurs in LVNAVs have first mover advantage as deviations approach the corridor limit. This issue does not exist in a VNAV. In our experience VNAVs endured less stress than LVNAVs during the stresses of March/April 2020. Investors would require some education on the benefits of this move as some have a definite preference for LVNAV, however some clear explanation of the benefits should overcome this. If LVNAVs continue to be permitted then there will continue to be confusion as to the differences between LVNAV and VNAV structures. We are concerned that the shadow NAV deviation cliff edge risk and the associated first mover advantage for those who disinvest before the corridor is breached is not widely understood by investors. Furthermore, same day VNAV structures are not as well developed as they might be as most of the market still uses LVNAV for short term MMFs. A move to VNAV for all funds will focus providers, custodians and asset valuation providers to invest more in same day VNAV infrastructure so there is no loss of utility in removing LVNAVs such as later fund closures or earlier payment runs.
6. Modifications to existing MMF Regulations are welcomed but should not make MMFs less competitive and investor friendly:
    i. Capital buffer or Sponsor support – In our opinion either of these options would force all Asset Managers out of the MMFs market, would force consolidation, reduce competition and reduce choice for investors.
    ii. Liquidity buffers – Liquidity buffers are a sensible control for MMFs but they should be refined to reduce the current cliff edge effect they have. Liquidity buffer averages or temporary allowable utilisation would make them far more effective and would permit the utility they are designed to provide.
    iii. Fees/Gates/Swing Pricing – These should all be allowable tools but it should not be prescribed by regulation as to when they should be used as this provides cliff edge risk and potential first mover investor advantage. Regulation should dictate that the use of these measures is at the discretion of the Fund Boards. All actions of the boards should be to the benefit and protection of the investors and the board should use these measures to protect investors when and where appropriate.

iv. Changing the permissible asset mix to force MMFs to hold more Government debt would need to be done in conjunction with more T-Bill issuance by the DMO as there is nowhere near enough supply to meet the required demand.

It is in this context that abrdn responds individually to the European Commission consultation on the functioning of the money market funds regulation and the reason why we will respond only to certain questions, where we would like to emphasize our position.