ACT TREASURY EXCELLENCE AS STANDARD

HSBC Asset Management

GLOBAL CASH MANAGEMENT IN 2022

IN NUMBERS

$6tn

industry with the US being the largest market

–

$4.4tn

US domestic money market fund assets

–

$1tn

international AAA-rated money market fund assets

–

€609.5bn

total US and Europe domestic ESG money market fund assets

€235bn

total Chinese offshore RMB money market fund assets

Sources: iMoneyNet as at 30 June 2021; Wind, data as of 30 December 2021; Converted into USD from RMB9,449bn; Fitch Ratings as at 30 June 2021.

Quick links

INTRODUCTION

THE ASSOCIATION OF CORPORATE TREASURERS HAS BEEN DELIGHTED TO WORK WITH **HSBC GLOBAL ASSET MANAGEMENT** ON *THE TREASURER*'S **GLOBAL CASH INVESTMENT RESOURCE HUB**.

The Global Cash Investment Resource Hub is a web-based library of information produced for the first time, as the online successor to the 2019 printed guide. The Hub provides a very useful set of resources for all treasurers when looking at their cash investments. These resources have been developed to help corporate treasurers navigate the complexities of devising and implementing an investment policy, to explore the factors that impact investment decision-making, and explain the various investment instruments available in different countries around the world.

Our policy and technical team has provided all the material for the Treasury Resources section, and here you can find resources designed to help you, whatever your position or challenge, from the basics of creating a governance framework through to guidance on designing an investment policy. Irrespective of how mature you feel your practices are, it is worth looking at the wealth of material provided to ensure your own

arrangements and processes remain fit for purpose.

The experts at HSBC have provided thought-leadership articles looking at Ultra Short Duration Bond Funds and money market funds regulation, as well as providing liquidity spotlights on India, Hong Kong, China and Australia.

We look forward to adding new material in the future, but in the meantime we thought treasurers would find it useful to have this downloadable guide containing the material that has been featured on *The Treasurer*'s Global Cash Investment Resource Hub this year.

Warm regards.

Caroline Stockmann FCA DChA AwardCMF CertT HonFCT
Chief executive, Association of Corporate Treasurers (ACT)

Setting the scene: HSBC

Liquidity and cash management have, of course, always been a critical component of a treasurer's responsibilities. However, as uncertainty continues to influence the global economic outlook, treasury departments will not only have to continue to carefully manage their cash, but at the same time also find suitable risk-adjusted returns on excess funds. While some major central banks have started the process of unwinding stimulus, short-term interest rates are still expected to remain low in historic terms, even if above the current ultra-low levels that treasurers have had to navigate for many years.

Whatever the prevailing market conditions, the fundamental principles for a treasurer remain the same: managing the risks associated with investing cash both in terms of the preservation of capital and maintaining sufficient liquidity. Unfortunately, in the recent climate, seeking liquidity and capital preservation while earning enhanced yields is complex, to say the least.

An added challenge is the growing interest in sustainable investment solutions. One of the key features of the COP26 conference in Glasgow in 2021 was the large presence of 'BIG' business and finance, reflecting the increased pressure from all stakeholders for rapid company adoption of more sustainably focused business practices, financing and investment solutions. The search for sustainably invested solutions presents an opportunity for treasurers to align their treasury operations with their organisation's wider sustainability objectives. However, this is complicated by pervading claims over 'greenwashing' and a current lack of consistency in determining how exactly these solutions define and achieve sustainable objectives.

Global data trends confirm that the COVID-19 pandemic is far from over, meaning there is no escaping the need for continued caution from a treasury management point of view, and ensuring access to near-term liquidity will likely still be at the forefront of the treasurer's priorities. At the same time, they will need to work to counter the impact of low and negative yields, through optimising the level of surplus cash on the balance sheet and in some cases by looking for new cash investment solutions where appropriate.

Look under the bonnet

As has been the case in many areas of financial markets and related activity, money market funds (MMFs) have not been immune to regulation since the global financial crisis. The impact of the pandemic on markets has refocused regulator attention on the efficient operation of financial markets, with added focus on MMFs that access those markets on behalf of their investors. Regulatory reviews and consultations were launched in 2021 with participant stakeholders, both in the US and the EU. Treasurers who typically prize the current structure and utility value of MMFs will need to be aware of any resulting legislative changes and understand if or how that impacts them.

There can be a perception of homogeneity among MMFs, in terms of risk profile and returns, which is partly driven by the granular regulation in the major markets. The over-reliance by some investors on fund ratings, as an alternative to doing due diligence on different funds and fund managers, has also meant that the differences that exist between funds' risk management can be overlooked, or simply not understood. We need to dispel the myth that all MMFs are the same; how credit risk is set, the credit matrix followed, the fund's client diversification strategy and how risk generally is managed, needs to be accurately understood to compare and contrast. And in the case of funds that are promoted with environmental, social and governance (ESG) considerations, how does that manager define and achieve this? Simply looking to a fund rating or a small set of metrics will not reveal the important differences in risk that exist between MMFs. Looking below the surface, doing your own, proper due diligence is critical.

Ultra Short Duration strategies

Treasurers with longer-term cash who are able to look down the credit-quality spectrum and further out in terms of maturity could consider Ultra Short Duration solutions to pick up additional yield on strategic cash reserves for which the investment horizon is at least six to 12 months. Investors can take advantage of Ultra Short Duration strategies to provide additional income and total return potential, with a relatively low level of additional volatility.

Simply put, Ultra Short Duration strategies are the next step along the risk curve from a MMF, and take on additional interest-rate duration and credit risk beyond the constraints of a MMF. Fund solutions in this space are variable net asset value (VNAV), compared to the majority of MMFs, which (typically within the EU) are constant or low volatility NAV.

While Ultra Short Duration Bond Funds (USBFs) can typically invest in maturities out to three years, they aim to maintain a much shorter effective duration of six months or less, generally affording some protection against inflation. This ultra-short duration reduces the fund's sensitivity to interest-rate fluctuations and comes with the added flexibility to invest opportunistically in maturities out to three years. These strategies can be delivered in pooled fund form or as segregated mandates set up to meet an individual investor's specific requirements and guidelines

Sustainability to drive returns

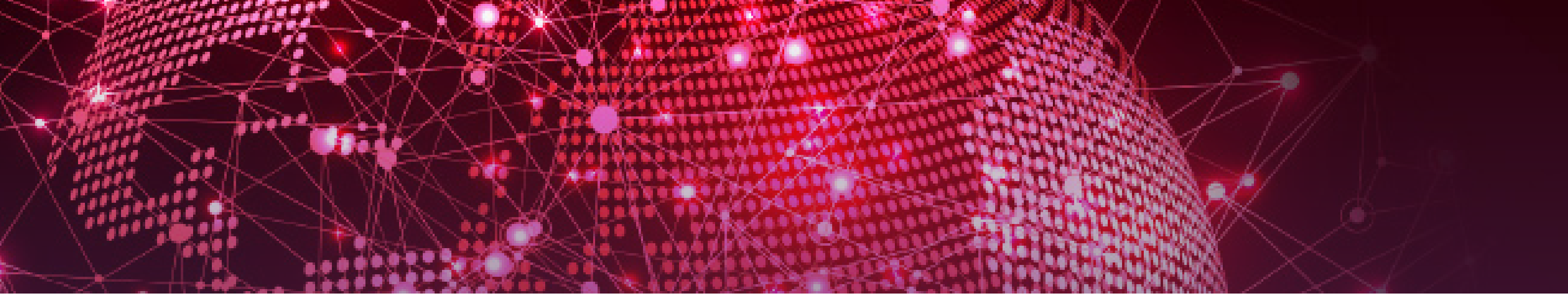
With pledges made by more than 450 financial institutions in 45 countries, COP26 has been like none other, and will be seen as an inflection point for global climate recovery. The architecture of the global financial system is transforming, shifting climate change from the fringes to the forefront of finance. Along with financial institutions, the presence of big business at COP26, in larger numbers than ever before, reflects a major shift towards sustainability across all areas of corporate activity, including treasury.

Over the past 12 to 24 months, we have seen much greater interest in investments focused on sustainability across all asset classes, and treasurers are experiencing this, too. Improving ESG performance on treasury activity, coupled with only modest yield sacrifices forecast over the interest-rate cycle, has set ESG on course to becoming more mainstream for cash investments.

We launched our first ESG fund – the HSBC Sterling ESG Liquidity Fund – in October 2021 and the extremely positive response we have seen from investors in terms of helping to seed the fund has confirmed the interest in such a solution. Investors are looking for a robust ESG investment process that clearly differentiates itself from existing 'non-ESG' MMFs. An ESG investment process that includes a focus on engagement with issuers to promote change in practices to improve their sustainability performance is also resonating strongly with treasurers. Put simply, there must be a clear definition of how it will achieve its sustainability objectives.

Launching a new MMF is always a major undertaking from a manager's point of view, and it can present a challenge for investors, who may require a certain minimum fund size. But because of the interest in investing in sustainable solutions, investors have been able to look beyond that to support the nascency of ESG MMF solutions.

Even though ESG MMFs still represent a small slice of the ($6 trillion) current MMF sector, continued global investor focus around sustainability and delivering on global climate change goals has set ESG investing for a rapid climb. Pressure from clients, shareholders and regulators, paired with requirements to align investment practices



with wider organisational corporate social responsibility commitments, are further driving ESG integration for treasurers.

As treasurers work towards applying ESG principles to their investment portfolios, they will face novel challenges, such as the lack of standardised methodologies in applying an ESG lens to the investment process. The perception of homogeneity is certainly not the reality. Investors will have to get used to data that they may not currently be familiar with, such as MSCI ESG scores, to name but one, and working with different research providers of sustainability ratings.

Helping our clients to build that awareness and knowledge is critical across all our financial disciplines and solutions. Only when treasurers are confident and comfortable with these new investment processes, and fully understand the implications for the exact make-up of money market securities within ESG funds, the liquidity and regulatory requirements, can they move towards deeper integration of corporate sustainability to meet increasingly pressured investment, regulatory and stakeholder demands. Over time, this can only help a treasurer enhance their approach to sustainable investing, and ensure they are selecting the strategies that best achieve that.

Investment outlook for major money markets

From a market perspective, we entered 2022 as a challenging period with clear risks affecting all financial stakeholders. At the time of writing, our base case is that inflation will be transitory and that the current heightened levels of inflation in the major developed market economies will begin to fall in the second half of 2022 as supply constraints ease and base effects come into play. However, we do expect to see some requirements for interest-rate rises in some of the major market economies in 2022, most notably in the US and the UK. Clearly, in the current environment, material risks to any base case projections in the market are set to continue, be that from monetary policy misjudgement or from the effects of the ongoing pandemic.

Nevertheless, weighing up the opportunities, risks and conditions impacting the current financial markets, there is scope for optimism. There is sufficient liquidity in the market looking for safe and attractive investments, which paired with ripe new areas of green investments and ESG opportunities as well as Ultra Short Duration strategies, makes a strong case for adding measured risk to portfolios. The market continues to innovate with new products being developed to respond to customer demand, including the increasing availability of ESG MMFs, green deposits and green commercial paper. For corporate treasurers and investment managers, this provides an opportunity to revisit investment strategies, ensure it remains fit for purpose and is aligned with the key strategic objectives of their organisation. ●

Jonathan Curry is global chief investment officer for liquidity and chief investment officer of HSBC Global Asset Management (USA) Inc

ULTRA SHORT DURATION BOND FUNDS


81.438
87.072
92.595
44.353
22.242
99.529
26.073

Seeking the right balance between risk and return

In the pursuit of an improvement in yield for longer-term cash holdings, beyond that provided by money market funds (MMFs), treasurers have access to various fixed-income investment options. The key is finding a suitable risk-adjusted strategy, where an increase in the yield for cash that can be locked away for longer is delivered without significantly increasing risk. Compared to other longer-term investment strategies, the case for Ultra Short Duration Bond Funds (USBFs) is compelling, demonstrating better risk-return characteristics than many other fixed-income strategies.

USBFs are open-ended bond funds that occupy the investment space between MMFs and Short Duration Fixed Income Bond Funds. "USBFs represent a strategy for many seasons, and aim to improve returns over MMFs for less liquid cash, without significantly increasing risk," explains Andrew Dickinson, HSBC's EMEA liquidity investment specialist.

USBFs provide investors with an interesting option. "An investment manager has the flexibility to use both securities seen in either MMFs or Short Duration Bond Funds, but more importantly can implement interest rate and credit strategies that could closely match either of these fund types," says Dickinson.

The hybrid nature of USBFs means they can frequently deliver superior returns to MMFs, over longer investment horizons, under different credit and interest-rate environments, including periods of stress in financial markets or when interest rates are increasing.

Market performance

Due to the strong focus of USBFs on corporate bonds, a full investment grade, short-dated corporate bond index, such as a 0–1 year Corporate Index, can provide a good indication of the expected performance of an ultra-short duration strategy. Where held for six months or longer, analysis shows that USBFs frequently outperform MMF returns.

The same observation can be made in times of market stress. "In 2008, the BaML 0–1 year US Corporate Index outperformed all Prime USD Liquidity Funds, but also significantly outperformed the BaML 1–3 year US Corporate Index, while exhibiting less volatility," confirms Dickinson, who adds: "Outperformance of Liquidity Funds has been the case for all years since 2006, including those periods of market stress, such as the global financial crisis in 2008, the European debt crisis in 2011 and the global coronavirus pandemic in 2020."

The reason behind the improved performance is that an USBF invests in a series of short-maturity assets. "As with all investment strategies, avoiding defaults is key, so when a bond matures, those proceeds can be invested at current yields. In times of stress, yields can be rising quite rapidly, but with a stream of constant maturities an investment manager can continually reinvest at new high yields," explains Dickinson.

With the prospect of rate increases, investors may wonder whether the timing for investment in USBFs is optimal. In the UK, for example, we have already seen rate increases, while in the US, the Federal Reserve looks set to increase rates a further six times this year, following an initial increase in March. However, as USBFs actively manage their investment exposures, they can offer investors some form of protection against rate hikes. USBFs can buy securities that are one year or more, or longer-dated Floating Rate Notes to protect against any rate increases. Indeed, the yield difference between a MMF and an USBF is the widest for more than a decade.

"Investing in an USBF now could potentially see significant performance benefits over a MMF, particularly if central banks do not deliver the full extent of the rate increases the market has priced in," confirms Dickinson.

Diversification benefit

USBFs reflect market investment opportunities and, as a result, USBFs in different currencies will often have different exposures. In sterling, for example, USBFs tend to hold more asset-backed securities, due to the lower number of corporate issuers in the market. In other currencies, such as euro or US dollar, exposure to corporate issues will be greater, reflecting a broader and deeper market.

While most investors buy USBFs to improve returns for cash with a longer investment horizon, they also offer investors a means of diversification. Buying into an USF potentially provides a broader range of investments and a broader sector exposure, away from the financials typically held by MMFs. "One of the other advantages of an USBF is the diversification. Typically, liquidity funds hold around 80–90% in financial issuers, whereas an USBF would often have less than 50%. That means that investors are getting exposure to a different universe of issuers who don't finance their operations using the types of securities that MMF managers are comfortable holding, such as commercial paper or certificates of deposit," says Dickinson.

The US dollar market, being the broadest and deepest, offers the most diversification and can be accessed by sterling investors. "As a sterling investor, it is possible to access the US dollar market through buying a hedged share class of a US dollar USBF. This will remove currency risk and allow access to a whole range of corporate issuers that don't issue in sterling. These include a wide range of investment-grade domestic US corporates, normally not accessible to sterling investors," he adds. This broader and deeper market also helps in implementing any sustainable investment objectives that USBFs may have.

Characteristics of an USBF

Superior returns are typically delivered through a mix of longer-dated securities and lower-quality investment-grade investments. This additional interest rate and credit exposure, when managed appropriately, enables investors to improve their investment returns without materially increasing risk. Even though the majority of USBFs allow average maturities as long as 12 months, in order to effectively manage risk, this will › frequently be managed to six months or less. Similarly, exposure to lower-rated securities will be actively managed, typically capping exposure to BBB-rated securities at 25% – often with no exposure permitted to the lowest investment-grade securities rated BBB-.

Notable characteristics

When comparing Liquidity Funds and USBFs, the key differences are:

- USBFs can invest in longer maturity securities, typically out to three years, and have longer average maturities.
- Exposure to low-quality investment-grade credit is probable, along with an overall greater exposure to credit reflected in a longer weighted average life.
- USBFs are bond funds that when seeking a fund rating will be assigned a bond fund rating. While the same designation (AAA, AA, A) is used for both bond funds and MMFs, it is important for an investor not to assume this means the same level of risk.
- USBFs are variable net asset value, hence influenced by mark-to-market prices creating an element of price volatility.
- Same-day settlement is not a feature of an USBF, with typical settlement periods of two days or longer.
- The investment horizon is longer for USBFs and not intended for daily cash flows.
- USBFs do not typically meet the IAS7 accounting definitions for cash and cash equivalents.

Which USBF is appropriate?

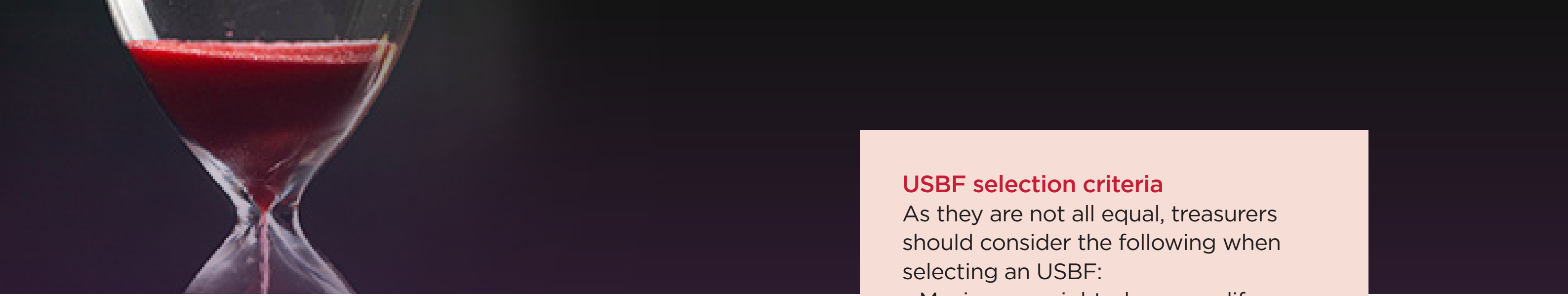
Obtaining an accurate sense of the USBF offering is challenging due to the fact that there is no regulatory definition for USBFs – unlike MMFs that are governed by a relatively narrow set of rules in Europe and the US.

Comparison of Liquidity, Money Market and Ultra-Short Duration Fund criteria

	Liquidity	Standard Money Market	Typical Ultra-Short
Benchmark	7 Day	3 Month	3-12 Month
Yield vs Liquidity	-	+5-10bps	+20-40bps
Max weighted average mark (WAM)	60 Days	180 Days	12 Months
Max weighted average life (WAL)	120 Days	365 Days	18 Months
Max Maturity	397 Days	2 years (FRN)	3 years
Min Credit Rating	A-1/P-1	A-2/P-2	A-3/P-3
Fund Rating	AAA-m	AAA-f / S1	AA-f / S1
Settlement Period	T+0	T+1	T+2
Daily Liquidity	10%	7.5%	N/A
Weekly Liquidity	30%	15%	N/A
NAV Type	LVNAV	VNAV	VNAV

Past performance should not be seen as an indication of future returns. The value of investments and any income from them can go down as well as up and investors may not get back the amount originally invested.

Source: HSBC Asset Management as of 30 September 2021. The level of yield is not guaranteed and my rise or fall in the future.
Any views expressed above were held at the time of preparation and are subject to change without notice. For illustrative purposes only.



Varying interpretations of USBFs therefore exist in the market, with some funds exposed to maturities as long as five years, or to asset classes such as mortgage-backed securities.

Unfortunately, fund ratings are of little help for comparison purposes. An USBF is effectively a very short-dated bond fund where fund ratings are more focused on risk budgeting, with investment managers using that risk budget to meet the objectives of the fund. "There are many ways to use that risk budget," explains Dickinson. "An investment manager could buy a significant amount of lower-quality investment-grade credit and balance that with exposure to government securities, while another investment manager may choose to focus exposure to high-quality AA or A-rated credit – both strategies would likely receive the same fund rating."

Crucially, that means that comparing USBFs is not a simple case of comparing ratings, nor should the bond fund rating of an USBF be compared to the MMF rating of a Liquidity Fund.

As it comes down to the USBF manager to set the criteria, it is crucial that corporate treasurers undertake their own due diligence and look carefully at the investment objectives of the USBF, along with the respective risk characteristics.

A viable supplement to MMFs

Since the global financial crisis of 2008, USBFs have demonstrated their ability over longer investment horizons to frequently outperform Liquidity Funds and other MMFs. Selecting the right USBF is key, and a treasurer should consider the selection criteria above and how they might fit into an investment policy designed for longer-term cash investments.

USBF selection criteria

As they are not all equal, treasurers should consider the following when selecting an USBF:

- Maximum weighted average life of the fund to gauge the overall interest-rate exposure;
- Maximum maturity of any individual security to understand how that interest-rate exposure could be distributed;
- Minimum credit ratings allowed for any issuer;
- Maximum exposure to that rating to gauge the level of exposure to lower-quality credit; and
- The types of securities that are permissible, such as mortgage-backed or asset-backed securities.

With interest rates rising, now is a good time for treasurers to review their investment strategies. While MMFs present a more secure and convenient cash-investment solution, USBFs represent a viable supplement for those treasurers who have successfully segmented their cash balances, where they can enjoy an improvement in return without taking a significant increase in interest rate or credit risk.

Andrew Dickinson is a liquidity investment specialist for HSBC Asset Management, where he has responsibility for engineering and delivering various strategically important product-development and growth initiatives. Andrew joined HSBC in 2018 and has worked in the asset management industry for more than 25 years. During this period, Andrew has worked as a portfolio manager, managing both fixed-income and money-market portfolios in various currencies; he has also been responsible for the leadership of the money-market businesses at both Credit Suisse and Aberdeen Asset Management. Andrew holds a BA (Hons) degree in Economics and Computer Science from the University of the West of England.

The importance of credit

An Ultra Short Duration Bond Fund (USBF) can present a viable solution for treasurers seeking to improve yield, reduce volatility of returns (versus Short Duration strategies) and diversify exposure away from banks and sovereigns, typically used in a money market fund (MMF). With the appropriate credit strategy, the right USBF can achieve these objectives, without significantly increasing risk. Following on in the USBF series, this second article will focus on the importance of credit in an USBF and the reasons why investors should carefully consider the credit risks, which need to be specifically managed to meet the objectives.

Credit is important in many types of fixed-income funds, but more so in an USBF that aims to reduce volatility and preserve capital over the medium term. In low interest rate environments, credit will deliver a large proportion of the overall fund yield, and although as interest rates increase, credit will deliver a smaller proportion of the overall yield, the credit element of an USBF will remain responsible for the majority of the improved yield over MMFs.

A treasurer's credit strategy should consider default risk, credit and credit rating, migration risk and the potential impact of market or geopolitical events on credit, or particular sectors and holdings. "An appropriate credit strategy is key to meeting the objectives of an Ultra Short Duration Bond Fund and investors should consider carefully the types of credit exposures a fund may take and the sizing of those exposures," explains Andrew Dickinson, HSBC's EMEA liquidity investment specialist.

Default risk

Default risk relates to the possibility that an issuer is unable to meet their obligations, by not paying coupons or not repaying principle on the date of maturity. The default of an issuer can have a serious impact on the return of an USBF and can significantly compromise the aim to preserve capital over the medium term.

The risk of a default impacting a fund can be lowered by having effectively diversified exposures and focusing on high-quality investment-grade issuers, while limiting exposures to lower-quality investment-grade issuers.

Fitch Global Corporate Finance Average Cumulative Default Rates: 1990–2021

(%)	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
AAA	0.11	0.23	0.36	0.49	0.62	0.76	0.91	1.06	1.21	1.37
AA	0.05	0.05	0.05	0.05	0.05	0.06	0.06	0.06	0.06	0.08
A	0.05	0.14	0.24	0.33	0.43	0.55	0.73	0.89	1.09	1.27
BBB	0.12	0.33	0.60	0.88	1.22	1.55	1.81	2.08	2.40	2.77
BB	0.60	1.68	2.74	3.77	4.65	5.45	6.06	6.59	7.11	7.63
B	2.09	5.14	7.66	9.32	10.43	11.31	12.11	12.50	12.57	12.78

(1) The AAA default rate has been impacted by the default of Lehman Brothers Financial Products Inc in 2008; a AAA rated subsidiary of Lehman Brothers Inc

Source: Fitch Ratings

The table above shows the historical default rates for various ratings bands over a rolling one- to 10-year period between 1990 and 2021. As shown, it is clear that the probability of default for a AAA or AA is very low. However, it is also true that the probability of default of lower-quality investment grade is also relatively low and that default rates do not increase significantly until ratings move below BBB. Investors frequently view BBB- as the lowest credit rating, when in fact it is the lowest investment-grade credit rating that actually falls in the middle of the full rating spectrum. It is not until credits are rated BB or lower that rating agencies consider the credit risk to be speculative.

Dickinson therefore concludes: "The risk of default is low for all investment-grade credit, meaning BBB-rated securities can be considered suitable investments for an Ultra Short Duration Bond Fund." He goes on to say: "High exposures to BBB should still be avoided due to increased volatility of returns versus higher-quality investment-grade credit, which the default data does not reflect and, increased credit migration risk."

Migration risk

Credit migration risk refers to the risk of a change in credit rating and, given the low default probabilities for investment-grade credit, is considered more important when managing overall volatility in an USBF. Aside from systemic risk, the risk of downgrade is one of the main sources of potential credit volatility. Key for the treasurer is the focus on the possibility of downgrades that have the potential to introduce volatility, rather than upgrades to credit quality. Managing volatility from migration risk, or other sources, is essential in an USBF, which is why many funds have average maturities of less than six months.

The table over the page shows the percentage of issuers in each ratings band that remained at that rating (or migrated to a different rating) averaged annually between 1990 and 2021.

"The table shows that as we move down the credit-rating spectrum, typically the probability of credit migration increases and with this, so too the probability of increased volatility. This should be managed by having small exposures to lower-quality credit and to individual lower-quality issuers," explains Dickinson.

USBFs do typically limit exposure to BBB securities, and it is true that USBFs seeking a fund rating will naturally have the level of exposure to lower-quality credit capped. This should not stop treasurers from asking questions about overall exposure to lower-quality credits and limits to individual issuers.

"Aside from limits on overall exposure to BBB-rated credit and limits on individual BBB-rated issuers, HSBC Asset Management further manages risk by not buying the lowest-quality BBB- investment-grade credits from the outset," says Dickinson. "This means if a BBB credit is downgraded by one notch, it still meets our investment-grade credit requirement, giving more time to carefully consider whether to hold, or perhaps sell the downgraded security."

Relative value and risk

There are currently nearly 700 investment-grade corporate issuers with debt outstanding in USD with maturities of zero to three years. This represents a significant opportunity set for USBF managers with USD funds, but also needs significant credit research resource to analyse. Credit rating agencies provide a valuable service, but these official ratings form just a part of the process that an investment manager should follow when making credit-investment decisions for USBFs. Internal research and views on relative value and risk between sectors and issuers within sectors is key, which ultimately leads to decisions about investments and exposures.

Relative value and risk are important for USBFs, as they often employ a 'buy and hold' strategy regarding credit. This is largely because an USBF invests in a series of short-maturity assets, which means that an investment manager has a stream of constant maturities that can then be reinvested. However, the frequently prohibitive cost of selling very short securities may outweigh the return the new investment might generate. Although the short average tenor of instruments means the focus of an investment strategy can be changed more easily during periods of stress and uncertainty, it is important to get the initial investments correct, backed by solid credit research and due diligence.

Relative risk also needs to be considered and may lead to exposure limits to particular sectors or even issuers that may have the potential to be adversely impacted by current market conditions or events.

"When considering relative risk, we are not just looking at default and migration risk," explains Dickinson. "We are looking more deeply at sectors or issuers that might be more volatile under particular market conditions. A frequently cited example is McDonald's and a company such as ExxonMobil. One is a consumer non-cyclical rated BBB+, while the other is an energy company rated AA-. Yet the exposures to both may be similar or possibly even lower for ExxonMobil, due to increased volatility of returns in the energy sector."

Credit is a key driver of yield improvement for USBFs, but it is vital that the credit exposure is managed appropriately to meet the key objectives of any USBF. Many of these funds will themselves have ratings, but these are very different from, and should not be confused with, the ratings assigned to debt issuers. Furthermore, two funds with the same rating could have significantly different holdings and exposure limits. So, confirming

Fitch Global Corporate Finance Transition Matrices: 1990–2021

Average Annual

(%)	AAA	AA+	AA	AA–	A+	A	A–	BBB+	BBB	BBB–	BB+	BB	BB–
AAA	88.77	2.98	1.72	0.34	0.11	0.11	-	-	-	-	-	-	-
AA+	0.94	77.39	11.30	3.92	0.31	0.63	0.16	-	-	-	-	-	-
AA	0.06	2.51	74.93	10.93	4.27	0.64	0.12	0.12	0.06	0.12	-	-	0.06
AA–	0.03	0.08	3.41	80.64	8.92	2.07	0.50	0.16	0.24	-	-	-	-
A+	-	0.04	0.12	4.65	79.05	8.74	1.59	0.67	0.42	0.13	-	0.04	-
A	0.01	-	0.14	0.37	4.59	80.96	7.75	1.34	0.61	0.22	0.15	0.07	0.03
A–	-	-	0.06	0.07	0.64	5.52	77.88	8.60	1.54	0.61	0.13	0.07	0.49
BBB+	-	-	0.01	0.08	0.25	0.55	5.93	77.39	7.73	1.44	0.50	0.14	0.21
BBB	-	-	0.04	0.10	0.05	0.18	0.60	7.39	76.96	6.85	1.10	0.71	0.15
BBB-	0.01	0.01	0.01	0.03	0.06	0.03	0.17	0.76	9.90	74.77	5.45	1.26	0.92
BB+	-	0.06	-	-	0.06	0.06	0.06	0.23	1.31	13.08	64.88	7.15	2.74
BB	-	-	-	-	-	-	-	0.19	0.45	2.75	11.12	64.82	7.50
BB–	-	-	-	-	-	-	0.07	0.10	0.27	0.50	2.96	11.72	59.77

Source: Fitch Ratings

the importance to look closely at the risk characteristics of any fund, a crucial point made by Jonathan Curry, HSBC's global chief investment officer for liquidity, in his article titled *Time to get Proactive*, to carefully "look under the bonnet" when selecting any fund.

Considerations for treasurers when looking at credit within an USBF

- Do not rely solely on the fund rating, as this is based on more than just the credit rating of the underlying securities.
- BBB securities are suitable investments for USBFs, but it is important to understand how exposure to this credit rating band is managed.
- Exposure management can include limits to BBB securities, limits to particular sectors or issuers, or only purchasing debt from issuers with a minimum BBB+ or BBB credit rating.
- The default risk for BBB issuers is not significantly high versus other investment-grade ratings bands.
- Migration risk is often overlooked and is key when managing volatility.
- Relative value across sectors is important when seeking to improve return, but it is not always true that high credit quality will reduce volatility. ●

Andrew Dickinson is liquidity investment specialist at HSBC Asset Management Ltd

REGULATORY FRAMEWORK


81.438
87.072
92.595
44.353
22.242
26.073

An introduction to money market funds

Why do investors choose MMFs?

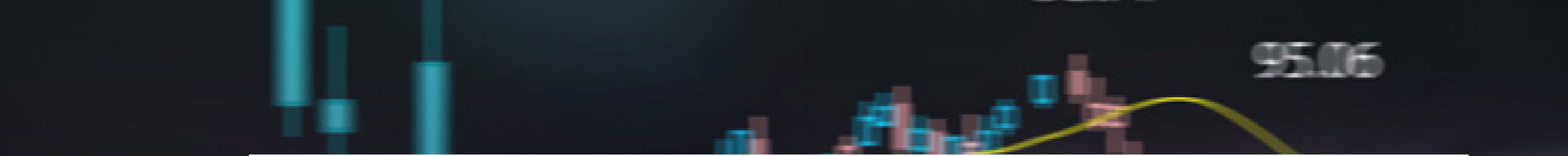
A MMF provides a number of benefits to investors in relation to comparable products such as bank deposits or direct purchase of short-term money market securities:

- Safety and liquidity: The primary objective of MMFs is to maintain stability of capital, and to provide daily access to cash or investments.
- Diversification of credit risk: MMFs have highly diversified investment portfolios, with limits on exposures to any one issuer. This can provide a greater degree of diversification compared with single-issuer credit risk.
- Credit risk management: Rather than relying on the ratings provided by the credit rating agencies alone, the use of professional fund managers who can undertake their own credit assessment using a range of complex tools reduces counterparty credit risk.
- Professional management: Investors have access to professional investment management and operational expertise.
- Yield: These funds offer competitive money market yields as a result of pooling investor assets in a range of money market securities.
- Working capital: These funds offer same-day settlement, which allows customers to use the fund for working capital management.
- Transparency: A range of information is offered by MMF providers in order to help investors better understand the risks of their investment, including factsheets displaying metrics such as weighted average maturity (WAM), credit breakdown and country exposure, as well as more detailed portfolio holdings reports providing a snapshot of the fund’s portfolio on any given day.
- Low costs: MMFs generally offer low, transparent management fees, which include custody and administration fees.

Who uses MMFs?

Any institutional investor looking for a secure home for surplus short-term cash balances, for example:

A money market fund (MMF) can be broadly defined as an investment fund whose objective is to provide investors with security of capital and daily liquidity. It seeks to achieve that objective by investing in a diversified portfolio of high-quality, low-duration money market instruments. The return on a MMF tends to follow short-term interest rates with a low level of volatility.



- Corporates;
- Insurance companies;
- Pension funds;
- Non-bank financial institutions (for example, asset managers, hedge funds, private equity firms, property funds);
- Local authorities;
- Charities;
- Universities and educational bodies; and
- Central banks and sovereigns.

How are MMFs rated?

All three of the principal credit rating agencies provide MMF-specific ratings, which fall on a scale from AAA to C or D, with a suffix (mmf, m or –mf) to denote that it is MMF-specific. These show the agencies' opinions on a fund's ability to preserve capital and provide liquidity. Each of the rating agencies has differing criteria, but with similarities regarding a fund's governance, and assets and portfolio characteristics. A minimum 'AAA' MMF rating (for short-term MMFs) is a relatively common requirement in many treasury investment policies.

How are MMFs regulated?

As investment products, MMFs (and their managers) are subject to a variety of regulations in terms of how the funds are operated, as well as how they are marketed. In Europe, there are specific MMF regulations, which define and set rules for different types of MMFs, which in summary are:

- Public debt MMFs, which only invest in government securities, and which are highly liquid;
- Short-term MMFs, which invest in credit (for example, bank- or corporate-issued paper) as well as government securities, and which are highly liquid; and
- Standard MMFs, which take additional credit and duration risk, and are less liquid than short-term MMFs. These are most prevalent in the domestic French market.

When international MMFs are referred to in Europe, including the UK, this typically means short-term MMFs, which is what most investors understand as a fund offering daily liquidity.

What is the typical yield?

MMFs typically generate yields competitive with normal overnight or one-week short-term interest rates (for example, SOFR, ESTR or SONIA). The funds do not have a benchmark.

How is the yield generated?

A MMF typically accrues interest income on a daily basis and either distributes that income in the form of a dividend or accumulates the income in the form of accumulating shares. Dividend income can be either distributed monthly or reinvested in new shares.

How are MMFs valued?

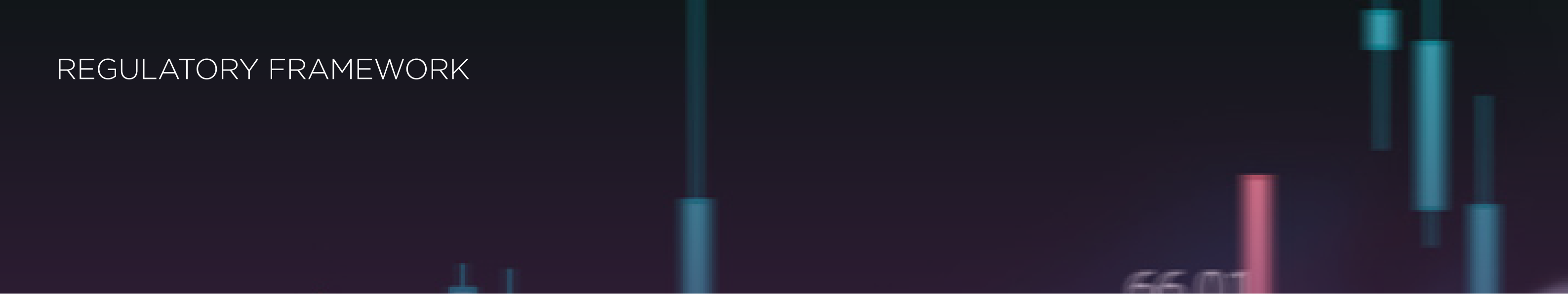
MMFs can either have a stable net asset value (NAV), which means the unit price remains at a constant \$1/£1/€1, or a variable NAV, which means the unit price can move up or down. In Europe, short-term MMFs are often 'low-volatility NAV' funds, which means they can offer a constant dealing price of \$1/£1/€1 subject to certain rules and thresholds.

Do MMFs qualify as cash and cash equivalent?

Short-term MMFs are often classified as cash and cash equivalent across many markets, as they offer short-term investments in highly liquid securities that are readily convertible to cash. Any final determination, however, would always be made by an investor's auditors.

How do MMFs compare to bank deposits?

A bank account balance or deposit provides exposure to a single counterparty (i.e. HSBC) in a single asset class (i.e. a bank deposit). MMFs provide an easy way for an investor to access a diversified investment across counterparties and asset classes through a single investment. MMFs could be viewed



as complementary to bank accounts and deposits, providing the client with additional choice in achieving their cash investment goals while broadening the products and balances they give to their bank. Investments in MMFs are with an investment company (which invest in a range of money market instruments), whereas bank deposits are placed on the balance sheet of a banking entity.

What do MMFs invest in?

Funds invest in a range of high-quality money market instruments such as bank deposits, commercial paper, certificates of deposit and short-term debt instruments. To be 'triple A' rated by most credit rating agencies, the WAM of the portfolio should be less than 60 days – this is also a regulatory requirement in many markets. Most MMF providers produce regular holdings reports to provide full transparency of the assets held by a fund.

How does a treasurer invest in a MMF?

While this can differ between asset managers, once an account has been opened, deals can usually be placed direct via phone, automated options or online through proprietary and third-party portals. Treasurers should be aware of cut-off times and minimum investments.

What currencies are MMFs available in?

MMFs are available in a variety of currencies globally, either as local funds typically available to domestic investors, or international funds that are available cross-border in a number of jurisdictions. Treasurers should be aware of the differences in local MMF regulations and practices, which may differ from international norms.

Is there a fee for investing in a MMF?

MMFs typically charge a management fee that is calculated based on the amount invested and is deducted from the gross yield of the fund, much like a spread on a deposit interest rate. The fee is inclusive of management, administration and custody fees.

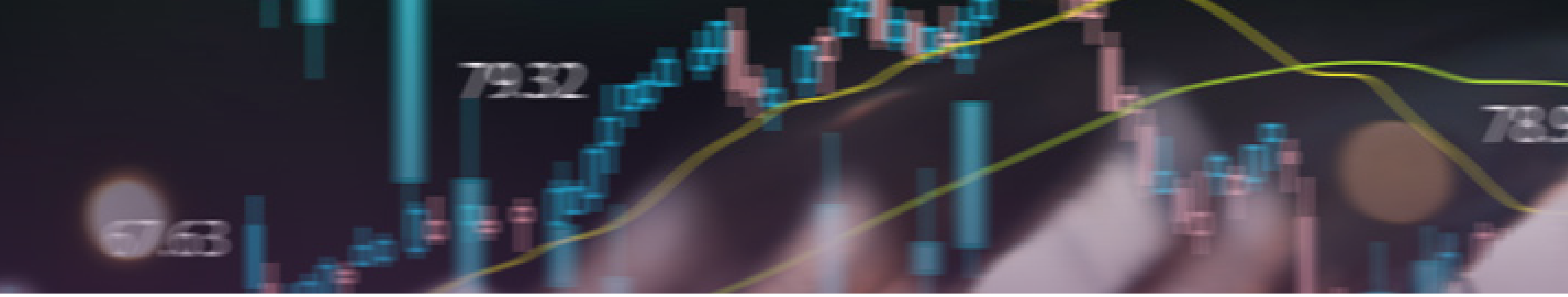
Are MMFs guaranteed?

MMFs are investment products and as such are not in any way guaranteed.

What should treasurers look for in a MMF provider?

When selecting providers, some key requirements are:

- The experience of the team managing the funds, and how long the provider has been running MMFs as an asset class;
- The investment philosophy and approach to risk;
- The diversity of their investor base (for example, across geographies and industry sectors) and what the approach is to investor concentration;
- The range and scale of currencies they offer matched to an understanding of your requirements;
- The options available to trade into the MMF (for example, online, phone, etc) aligned to your requirements;
- Their performance over the long term, including how they have managed funds through times of market disruption;
- How the fund and manager incorporate sustainability into their investment processes and philosophy;



- Their client relationship and servicing model, as well as client reporting;
- The approach to sharing knowledge and 'thought-leadership'; and
- Overall relationship with financial services providers.

Are MMFs impacted by banks' capital and liquidity rules (for example, Basel III)?

As mutual funds, MMFs are not bank balance sheet products and therefore are not directly impacted by Basel III and other rules for capital and liquidity (which can drive the way banks value certain customer deposits). While there are some indirect implications for MMFs given that many of the instruments invested in are bank issued, MMFs remain an important option for cash investing, including where investors are seeking alternatives to short-term bank deposits.

How can sustainable investing be applied to a MMF?

There are a number of ways sustainability can be applied to MMFs, however, it is important an investor understands how these are applied and what the sustainable outcome is when comparing funds. The following are examples of environmental, social and governance (ESG) investment approaches:

- ESG integration is a process of including the evaluation of ESG performance in the credit process. An issuer is evaluated based on how they address ESG risks in addition to financial data. This typically results in the same investable universe as a regular (non-ESG) issuer.
- Sector screening is a process that removes issuers from the investable universe based on the activities of the sectors in which they operate. However, issuers in the eligible money market universe are typically financial institutions, sovereign and government agencies that do not operate in the screened-out sectors. Therefore, this typically results in no meaningful change in the investable universe.
- A best-in-class investment strategy incorporates ESG factors and identifies the highest-scoring ESG performers in the money market universe, meaning that investments are only made in issuers who have a better track record in managing ESG risks. This approach typically results in a meaningful change in the investable universe.
- Issuer engagement is an important process to help drive change and encourage issuers to address identified shortcomings and ensure companies are aware of how their ESG performance is considered in investment decisions by the MMF manager.

What are SFDR Article 6, 8 and 9 funds?

The EU's sustainable finance regulation created three categories of funds, each with an increasing focus on sustainability. Asset managers self-assign their funds based on their fund's investment guidelines. Article 6 funds can integrate E, S and G concerns in their credit analysis, but do not have any sustainability-related fund objectives. Article 8 funds include sustainability-linked fund objectives, but they are secondary to others (for example, preservation of capital, provision of liquidity or yield). Article 9 funds' sustainability objectives are the primary objective of the fund – more important than other considerations.

Regulators' review of money market fund regulation (as of April 2022)

Regulators and other bodies in a number of markets – most notably in Europe and the US – are in the process of reviewing the rules under which money market funds (MMFs) operate. In Europe, this is part of the scheduled review planned for 2022 that was written into the existing rules, but a key element of international reviews is also in the context of the market stresses seen in 2020 due to the impact of the COVID-19 pandemic.

It is important to note that any potential rule changes have not yet been agreed, and even when the typically lengthy legislative process starts, further changes are likely before they are finally signed off ahead of any implementation timetable. Therefore, while the process is reaching one of the critical stages, we are still some way off knowing what the final rule changes will be – if any – and in turn how long before they would need to be implemented.

This April 2022 update explains where European regulators are in that process, the key proposals for the European Commission to consider and, finally, what (and when) the expected next steps are likely to be.

Current status

During 2021 several regulators and other bodies conducted their own review of MMF regulations in Europe as well as in the US, some of which also included consultations where industry participants were able to provide their feedback. In Europe, this included the European Securities and Markets Authority (ESMA), the European Systemic Risk Board (ESRB) and the European Central Bank (ECB) – all of whom have now published the results of their reviews and issued their thoughts and proposals, the most recent of which was ESMA on 16 February 2022.

These and other proposals are just that – proposals and thoughts – and we are now at the point that the European Commission will conduct its own review ahead of making its formal proposals for passage through

"WE ENCOURAGE INVESTORS TO PARTICIPATE IN THE DIALOGUE WITH REGULATORS TO ENSURE THEIR OPINION AND NEEDS ARE HEARD BY THE REGULATOR, INCLUDING BY ENGAGING WITH THEIR RESPECTIVE TREASURY TRADE ASSOCIATION"

HSBC ASSET MANAGEMENT

the European legislative process. The review is expected to be completed in July 2022, ahead of attempting to pass this through the European legislative process. The Commission may decide to conduct a public consultation as part of its review, and if given the opportunity, we encourage investors to participate in any chance for dialogue with regulators to ensure their opinion and needs are heard by the regulator, including by engaging with their respective treasury trade association.

Key review focus areas to date

The reviews conducted by ESMA and others looked at a number of areas they perceived as vulnerabilities, including the susceptibility of MMFs to outflows, the liquidity of underlying markets and the ability of MMFs to sell assets under stressed conditions, and the continued adequacy and appropriateness of existing MMF regulations.

Looking at ESMA, the ESRB and the ECB together, there are several areas of their proposals that overlap, but also areas that differ on potential rule changes – a reminder that the Commission must now make its own determination and these reviews to date are simply inputs to that review, not binding proposals.

The following are some of the thoughts that have been forthcoming from these three main reviews, with short-term LVNAV funds in mind…

Liquidity buffers	The ESRB and ECB advocate an increase to the minimum daily and weekly liquidity levels a MMF must operate with, including a specified minimum public debt holding. ESMA does not propose any change to existing liquidity levels but notes the ESRB proposal. The proposals also contain a common theme of allowing funds to go below minimum buffer levels subject to certain conditions to make the buffers usable. This is part of a consistent view that there should be a decoupling of buffers from liquidity gates and fees, where a perceived 'bright line' or hard linkage has developed (despite never being part of EU rules).
Liquidity management tools	The proposals all contain elements of MMFs needing to have at least one liquidity management tool (for example, liquidity fees that MMFs already have in their prospectus today).
Structure of MMFs	The ECB does not believe any changes are required to the existing LVNAV construct if liquidity buffers are enhanced as above. ESMA and the ESRB advocate retaining LVNAV as a fund type but believe the use of amortised cost and rounding should be removed.
Reporting	ESMA and the ESRB recommend an increase in frequency of reporting by MMFs to their competent authorities as well as some enhancements to what is reported.
Stress testing	ESMA and the ESRB recommend better coordination (by ESMA) of stress tests as well as additional test scenarios.
External support	There are no recommendations to change the current rule; that MMFs cannot receive external/sponsor support.
External ratings of MMFs	ESMA's opinion is MMF ratings could come under the regulatory framework used for credit ratings to ensure they are subject to minimum standards.
Review clause	The ESRB proposes a further review of MMF regulations in five years' time.

HSBC's thoughts

In HSBC's response to a number of the consultations that have been conducted, we have noted that MMFs withstood a major market dislocation in 2020, while continuing to provide liquidity and stability of principal despite a lack of market liquidity – which we believe demonstrates the effectiveness of current MMF regulations in Europe and the US. HSBC is supportive of any efforts to ensure MMFs continue to be as resilient as possible and where they continue to meet investor needs.

In 2021, we also provided feedback that the relevant authorities should review the current operating model of the major global money markets more generally, to identify opportunities to make the money markets themselves more resilient and better able to function normally during periods of market stress.

The following summarises our stance on potential future rule changes to European MMFs:

- The decoupling of the relationship between liquidity buffers and liquidity management tools, and therefore the removal of the 'bright line' (which was never part of EU rules but which in effect has made the buffers unusable) would be a positive step.
- If this decoupling is adopted, then we believe that the minimum liquidity levels in current MMF regulations could continue to be appropriate.
- We support maintaining current public debt CNAV, LVNAV and VNAV fund constructs. The current LVNAV construct has been proven to work for investors, and empirical evidence supports the fact that the fund construct itself does not change the sensitivity of a MMF to outflows (for example, LVNAV vs VNAV).
- We believe liquidity fees are the optimal liquidity management tool to use as an anti-dilution levy, which delivers the protection for investors that remain invested in a MMF during a period of redemptions. HSBC's funds already contain these powers.
- Additional reporting and stress testing can be supported and may help the monitoring of and consistency of approach by MMF providers.

Next steps in the regulatory process

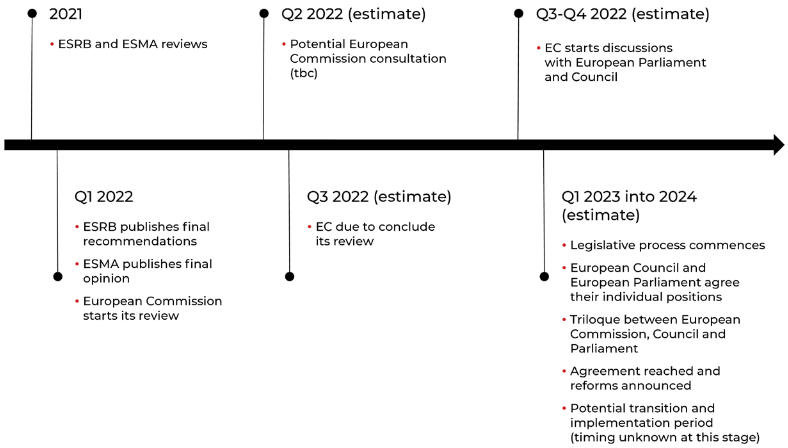
The European Commission will now review the various proposals and submissions, and is due to report on its own proposals in July 2022. The Commission may choose to conduct a public consultation, although at time of writing, this is not confirmed. As already noted, any opportunity for investors and their industry associations to voice their needs or concerns should be welcomed.

Once the Commission has completed its review, its proposals will then start their passage through the European legislative process. This includes being reviewed and voted on at the European Parliament, the European Council and ultimately a trilogue between the three bodies. These processes can take a considerable amount of time and the Commission's proposals could be rejected or amended at any point through these steps. Once final votes are completed, it is expected there would be a transition and implementation phase (assuming any changes); meaning that in reality, any changes may not take effect until well into 2023, and most likely beyond.

It is interesting to note that the current set of European MMF regulations took more than four years to go live once the Commission

Potential European Commission timeline

Note these are purely HSBC estimates at this point in time.



had completed its review, although there is an expectation this will be accelerated (if/where possible) this time around.

Conclusion

MMFs successfully navigated the market crisis in 2020, demonstrating the effectiveness of current MMF regulations in Europe. We are supportive of any efforts to ensure MMFs are as resilient as possible where they continue to meet investor needs in the future, and will continue to actively engage with regulators and other bodies to help shape the debate.

As noted already, any potential changes to MMF rules are not confirmed, and it is for the European Commission to complete its review. Even then, any potential changes need to complete their passage through the various EU bodies that will vote on the proposals which, history shows, can be a slow process and can result in changes to the proposal along the way.

Nonetheless, we are now approaching a phase where potential changes will become clearer – even if they are subject to further change and some way off from actually being implemented. With this in mind, it will be critical for investors to stay close to developments and where the opportunity arises to voice their needs through any public consultation by the Commission.

Hugo Parry-Wingfield is the EMEA head of liquidity investment specialists for HSBC Asset Management. Based in the UK, he has responsibility for the development of the liquidity capability strategy in the region and leads a team of investment specialists covering HSBC's Global Liquidity solutions. Parry-Wingfield joined HSBC in 2013 and has been working in the cash management and banking industry for more than 25 years. He joined from Citibank's Treasury and Trade Solutions business, where he was co-head of the EMEA liquidity and investment business.

LIQUIDITY SPOTLIGHTS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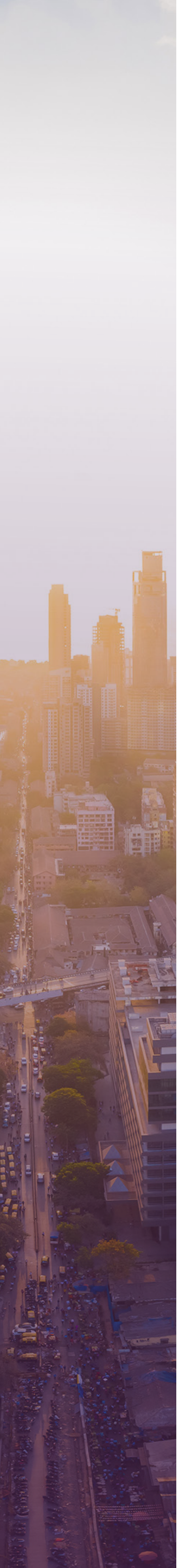
INDIA

Overview of the key factors that impact investment decision-making in India and highlighting the various investment instruments that are locally available.



Market scale and scope

- Debt market instrument volume traded $2,115,000 (CY 2021).
- Assets under management (AuM) of the Indian mutual fund industry 38.90 trillion rupees at 31 January 2022. Total AuM by mutual fund industry constitutes around 24% of the deposits held by the banking industry.

Key stakeholders

- **Reserve Bank of India (RBI)** – India's central bank.
- **Securities and Exchange Board of India (SEBI)** – primary regulator for all funds and asset management and credit rating agencies.
- **Association of Mutual Funds in India (AMFI)** – trade body for mutual funds sector.
- Main **credit rating agencies** in India: Brickwork Ratings, Credit Analysis and Research Ltd (CARE); Credit Rating Information Services of India Limited (CRISIL); Fitch Ratings India Private Limited; Investment Information and Credit Rating Agency of India (ICRA); ONICRA Individual Credit Rating Agency of India; and SMERA.

The liquidity fund industry in India has grown significantly since the first liquid mutual fund was launched in 1997. For corporate treasurers considering investing in the Indian market, it is important to be aware of some key differences between more widely used international money market funds (MMFs) and domestic Indian rupee funds. Ensuring that locally domiciled funds fit within the risk parameters of existing treasury policies and align to treasury objectives is key, in order that they efficiently support a corporate's strategic objectives in India.

Country specifics

There are a range of different fund types in India that fall under the broad banner of 'liquidity funds'. For international investors the naming conventions of these funds can be confusing when compared with those in Europe or the US. For example, in India there are cash funds, overnight funds and MMFs, each with different features and risk profiles.

Portfolio characteristics – In India, most treasuries (local as well as global corporations) tend to use overnight funds or cash funds, as appetite for volatility has reduced. Overnight funds tend to run minimal interest-rate risk other than the small amount of extremely short Treasury bills (T-bills) they might tend to hold for efficient management of overnight reverse repo margin purposes (a recent development). Credit risk is overnight risk. Cash funds invest in debt and money market instruments with a maximum tenor of 91 days, which tends to be shorter than the global standard of 365/397 days. However, from a valuation perspective, all instruments are daily mark-to-market and hence subject to market risk.

Credit ratings – International funds are typically rated using a MMF rating methodology by one or more of the global credit rating agencies (CRAs), such as Moody's, Standard and Poor's and Fitch. By applying their standard 'international rating scale', an effective comparison can be made of credit strength across issuers in different countries. The rating scale and methodology used for domestic issuers in Indian rupee liquidity funds only relates to issuers domiciled in India and is therefore only a comparison of credit strength of issuers in the domestic Indian market. While the symbology (i.e. letter-based ratings) used is similar, no comparison can be made across the different scales and methodologies. Below is an example of two issuers that have both an international and local rating:

- State Bank of India is rated domestically AAA by ICRA and globally Baa3 by Moody's.
- Power Finance Corporation is rated domestically AAA by ICRA and globally Baa3 by Moody's.

Asset pricing – As a result of market reforms, all instruments in a money market or bond fund in India now have one common price. "This is unique to India and a significant improvement, as prior to this it was fairly common for a bond to have different prices from different fund houses, thereby making performance comparisons difficult, unlike in the equity space," says Gordon Rodrigues, CIO – liquidity, Asia-Pacific HSBC Global Asset Management (Hong Kong) Ltd.

Charges – On cash funds a graded fee is imposed as an exit charge if investments are redeemed within seven days. Exit charges do not apply on other types of liquidity funds. This also levels the field, given the minimum seven-day lock-in for term deposits in the banking system.

Portfolio instruments

Indian liquidity funds can invest into a range of money market securities, which corporate treasury functions are not typically able to access directly, largely for operational reasons such as requiring a custodian to settle the securities. Among the other benefits to corporate treasurers, investing in a liquidity fund can offer indirect exposure to these instruments.

Fixed income

	Government securities and treasury bills	Corporate bonds public and private sector	Certificates of deposit (CDs)	Commercial paper (CPs)	Reverse repo
Currencies	INR	INR	INR	INR	INR
Execution	Both online and voice (OTC)	Voice (OTC)	Voice (OTC)	Voice (OTC)	Both online and voice (OTC)
Settlement	Guaranteed by local exchanges	Guaranteed by local exchanges	Guaranteed by local exchanges	Guaranteed by local exchanges	Guaranteed by local exchanges
Regulator	RBI	RBI/SEBI	RBI	RBI/SEBI	RBI
Issuers	Sovereign	Liquid up to local rating long-term rating AA	Liquid up to local rating short-term rating A1+ (Top)	Liquid up to local rating short-term rating A1+ (Top)	Sovereign and private corporate bonds can be repo
Settlement cycles	– T+1/T+2 (All confirmations to be completed on T)	– T+2 (Exchange traded) and T+0 to T+2 (OTC)	T+0 to T+1 (OTC)	T+0 to T+1 (OTC)	T+0
Issued at discount/par	Up to one year maturing instruments discounted/more than one year at par	Bonds – at par, commercial papers – at discount	At discount	At discount	At par

Mutual funds

	Cash Fund	Money Market Fund	Overnight Fund	Ultra Short Duration	Low Duration
Fund Rating	ICRA A1+ mfs (mutual fund structure)	N/A	ICRA A1+ mfs	ICRA A1+ mfs	Not rated
Instruments Commonly Used	Money Market Instrument (Commercial Paper, Certificates of Deposit), Corporate/ Public Sector Unit Debt Instrument, Corporate Bonds/ Debentures, Treasury Bills, Tri-Party Repo (TREPS), Reverse Repo	Money Market Instruments (Commercial Paper, Certificates of Deposit), Treasury Bills, Tri-Party Repo (TREPS), Reverse Repo	Tri-party Repo (TREPS), Reverse Repo	Money Market Instruments (Commercial Paper, Certificates of Deposit), Corporate/ Public Sector Unit Debt Instrument, Corporate Bonds/ Debentures, Treasury Bills, Tri-Party Repo (TREPS), Reverse Repo	Money Market Instruments (Commercial Paper, Certificates of Deposit), Corporate/ Public Sector Unit Debt Instrument, Corporate Bonds/ Debentures, Treasury Bills, Tri-Party Repo (TREPS), Reverse Repo
Minimum Credit Rating of Instruments (local ratings)	AAA or Equivalent	AAA/ AA or Equivalent	AAA or Equivalent	AAA / AA or Equivalent	AAA/ AA or Equivalent
Average Local Credit Rating of Portfolio	A1+	A1+	A1+	A1+/AAA	A1+/AAA
Maximum Tenor	91 Days	Assets with original maturity not more than 365 days	1 Working Day	No Restriction	No Restriction
Maximum Weighted Average Maturity (WAM)	91 Days	Up to 12 months	1 Working Day	Portfolio Macaulay Restriction	Portfolio Macaulay Restriction
Minimum Investment	INR 5,000/-	INR 5,000/-	INR 5,000/-	INR 5,000/-	INR 5,000/-
Total Expense Ratio (Annualised)	Other than Direct Plan - 0.23%, Direct Plan - 0.13%	N/A	Other than Direct Plan - 0.26%, Direct Plan - 0.11%	Other than Direct Plan - 0.49%, Direct Plan - 0.23%	Other than Direct Plan - 0.63%, Direct Plan - 0.22%
Settlement Subscription	T-0 if fund sighted before 1.30pm	T+1	T-0 if fund sighted before 1.30 pm	T+1	T+1
Settlement Redemption	T+1	T+1	T+1	T+1	T+1
Exit Load Breakdown	Day 1 - 0.0070%, Day 2 - 0.0065%, Day 3 - 0.0060%, Day 4 - 0.0055%, Day 5 - 0.0050%, Day 6 - 0.0045%, Day 7 onward - NIL	NIL	NIL	NIL	NIL
Accounting	VNAV	VNAV	Money placed in a reverse repo at a certain rate fixed on 1 working day, minus expense of the fund would be the net return.	VNAV	VNAV
Valuation	Mark to Market (MTM)	MTM	MTM to the extent of T-bills held for reverse repo margin; Otherwise, duration is overnight	MTM	MTM

Types of Indian liquidity mutual funds

Corporate treasurers considering investing in Indian liquidity funds need to look beyond the naming conventions (which can be confusing) to understand the significant differences with international liquidity funds. In particular, treasurers should carefully consider duration, the maximum tenor of the securities the fund can purchase and the maximum weighted average maturity (WAM).

"OUR APPROACH TO LIQUIDITY MANAGEMENT REMAINS BROADER THAN REGULATION DICTATES, INCLUDING ASSET TYPE GUIDELINES, IMPOSING A MAXIMUM TENOR A FUND CAN HOLD IN AN ASSET TYPE BASED ON THE LIQUIDITY OF THAT INSTRUMENT IN THE MARKET, AND TARGETING INDIVIDUAL CLIENT AND CLIENT SECTOR CONCENTRATION LIMITS"

GORDON RODRIGUES

Identifying the right fund manager

In their investment manager selection process, it is incumbent on treasurers to identify those fund managers that can demonstrate an investment philosophy that is aligned with their own risk appetite. Alignment will be evident in the investment guidelines set by an investment manager to govern all aspects of the portfolio management, from asset types and issuer concentration to duration and liquidity requirements.

While investment guidelines should always follow the prevailing regulatory framework, some managers will go beyond the regulatory constraints and offer a more conservative fund than the regulation requires.

Fund manager differentiation criteria include:

- Frequency of disclosure: SEBI requires reporting every two weeks, while some managers offer more frequent reporting, such as weekly disclosure.
- Credit concentration: SEBI requires concentration to a single bank group to be limited to 20%, and to individual banks within that group to 10%. Some fund managers may set a more prudent limit, for example, setting limits based on local credit ratings that are more restrictive than those set by SEBI. As a result, these managers may limit the fund exposure to a single bank group rated AA+ to 15%, with not more than 5% in any single entity; and for those with a rating lower than AA+, the exposure would be 5% at group and entity level.
- WAM: SEBI sets a maximum of 91 days for cash funds, and fund managers may choose to operate with a significantly lower WAM of, say, 60 days (which is closer to international standards).
- Provision of technology capabilities and tools: The extent to which a fund manager may facilitate straight-through processing and other techniques that reduce manual intervention, improve controls and simplify reporting.
- Liquidity risk management: Liquidity ladders may vary across managers, and in recent years SEBI has imposed minimum liquidity requirements on investment managers to improve the reliance of liquidity funds. In early 2020 SEBI introduced an overnight liquid assets ratio called liquidity

ratio-redemption at risk based on the investor size and concentration profile of the fund. This percentage needs to be maintained in overnight assets, including government bonds and T-bills. Furthermore, as recently as December 2021, SEBI introduced a 30-day asset requirement via a similar ratio called liquidity ratio-conditional redemption at risk. "These changes bring market convention in India more in line with our own internal guidelines on liquidity management, which are typically more conservative than required by regulation and another step towards regulatory parity between India and European domiciled funds," says Rodrigues.

Market developments

Environmental, social and governance/ sustainable investments

While environmental, social and governance (ESG) funds make up just 1% of total MMF assets, sustainable investment solutions continue to grow broadly across all asset classes and now represent approximately one-third of all global assets under management. Investor appetite varies from region to region, and across Asia ESG interest remains low by comparison. Where it does occur, it is typically from US- or European-headquartered companies that have a top-down approach, imposed on local treasury centres in the region. Interest in sustainable investments is likely to grow – especially given the 2021 announcement that India would achieve net zero emissions by 2070.

Global bond index inclusion

Just as China did two years ago, India is hoping to join the global bond indices in 2022. Inclusion is not just beneficial from a macroeconomic standpoint, but for Indian companies the potential uptake in foreign capital inflows into the government bond market will see overall costs of borrowing falling, helping local companies with their capital requirements. Foreign investors will be able to access a substantial, diversified pool of Indian corporate issuers that previously may have been overlooked or inaccessible. ●

Gordon Rodrigues is the chief investment officer for the liquidity business in Asia-Pacific at HSBC Asset Management (Hong Kong) Ltd. Prior to that he was the head of Asian rates, FX and liquidity in the Asian fixed income team within HSBC Asset Management in Hong Kong. He has been working in the financial industry since 1992. Rodrigues joined HSBC Global Markets, India, in 1994 as a treasury sales specialist covering corporate and institutional clients and traded credit products on the fixed income trading desk from 1998–2002. Rodrigues moved to HSBC Asset Management India in 2002 to set up the fixed income investment team and headed the team till 2007, before relocating to Hong Kong.

HONG KONG

The key factors impacting investment decision-making for corporate treasurers in Hong Kong, along with the specific details of the various investment instruments available locally.

Market scale and scope

As at end of December 2021, outstanding amount (source HKMA):

- Short-term (<1 year) fixed-rate debt securities (original maturity) – HK$271.7bn.
- Short-term (<1 year) floating-rate debt securities (original maturity) – HK$39.8bn.
- Exchange Fund Bills (91/182/364 days) – HK$1.25tn.

Key stakeholders

- **Hong Kong Monetary Authority (HKMA)** – Hong Kong's central bank.

Regulatory bodies:

- **The Securities and Futures Commission (SFC)** – regulator for Hong Kong's securities and futures markets.
- The **Mandatory Provident Fund Schemes Authority (MPFA)** – regulator for privately managed pension fund schemes.

Synopsis

In recent years, the SFC has taken steps to increase the regulatory alignment of the local money market fund (MMF) industry with global standards. As a result, domestic funds are more in line with global asset managers, who typically apply their global standards to operations in Hong Kong. The relatively broad set of regulations means that treasurers have to look at the individual fund managers and funds to determine the degree to which a specific fund is aligned with their group-investment policies.

Market overview

Hong Kong's money market, though developing, is not as evolved as the rest of China or of India, despite Hong Kong's status as an International Financial Centre (IFC). Although Hong Kong has a bilateral repo market, it does lack a wide and/or deep repo market or exchange-traded repo set-up. The absence of this crucial funding source for financial institutions and investment option for MMFs is a clear limitation when compared to other financial hubs. The global financial crisis of 2008/9 and the euro crisis of 2010/11 resulted in banks being downgraded.

Counterparty risk became a more prominent concern, compelling investors to look to ring-fencing their surpluses away from banks. Banks also started to pull away from non-operational institutional deposits. Basel III culminated in banks selectively pulling back their exposures to a number of sectors and companies on the basis of creditworthiness.

"WHEN I ARRIVED IN HONG KONG IN 2007, THERE WERE APPROXIMATELY 10 TO 15 ISSUERS (INCLUDING GLOBAL ISSUERS) ISSUING HK$ COMMERCIAL PAPER. TODAY THAT SAME GROUP NUMBERS APPROXIMATELY 70 TO 100 ISSUERS"

GORDON RODRIGUES

The result of these developments led to the rise in demand for MMFs in Hong Kong and consequent increase in issuers coming to the money and debt capital markets as a means to diversify their funding sources.

There are two types of MMFs catering to different markets with different regulators: MPFA funds, regulated by the MPFA, represent the larger of the two and focus on the pensions market; standard MMFs are used by corporates and financial institutions, and are regulated by the SFC. In recent years the SFC has made efforts to align its MMF regulations with global standards (such as those from IOSCO).

Country specifics

Portfolio characteristics (SFC-regulated MMFs)

Environmental, social and governance/ sustainable investments

- Settlement: Most MMFs settle on T+1/T+2 upon redemption with only one HK$ fund offering same-day settlement (T0) and a AAA Fitch rating.
- Concentration: Compared with the global 10% standard, issuer concentration for banks (if considered a substantial financial institution) in Hong Kong is broader and can be as high as 25%, provided the investment does not exceed 10% of the issued capital and reserves of the institution.
- Instruments: Portfolios are more deposit-orientated compared to holdings of certificates of deposit or commercial paper. It is not unusual for deposits to be broken subject to agreement by both parties.
- Weighted average maturity: Limit of 60 days, which is in line with global standards.
- Liquidity restrictions: The minimum daily liquidity asset (DLA) requirement is 7.5% of net asset value (NAV) and the weekly liquidity asset (WLA) requirement is 15% of NAV. However, unlike other global standards, the DLA and WLA requirements exclude government securities or T-bills that do not physically mature within one day or one week.

Credit ratings

There is no minimum credit rating for issuers.

Asset pricing

Most SFC-regulated MMFs are variable net asset value funds, although they tend to follow an amortised valuation, which is the case for most funds on the Hong Kong market.

Charges

There are no exit charges applied on redemptions of MMFs.

Currencies available

There are some locally domiciled US-dollar-denominated MMFs, which are typically used by retail investors or institutional investors with specific requirements (for example, the need for Hong Kong-domiciled assets due to local insurance regulations).

Identifying the right fund manager

The current regulatory framework in Hong Kong remains relatively broad compared with other large financial markets, which results in significant variations on how

Portfolio instruments

Instrument	Types	Comments
Bank deposits	Demand deposits, time deposits, savings accounts	Similar to other Asian markets, corporate treasuries in Hong Kong tend to be over-banked, relying heavily on bank deposits
Certificates of deposit	Issued at discount or interest bearing at par	Mostly restricted to high-net-worth individuals or large treasuries able to cover costs of having custodial accounts
Treasury bills	Issued at discount	HKMA issues Exchange Fund Bills with maturities ranging from one week to 12 months. Minimum denomination of HK$500,000
Commercial paper	Issued at a discount	Available, but not widely used as a method of short-term investment. Mostly used by institutional investors with a wide variety of global issuers
Repurchase agreements		Not popular among corporate treasuries; available on a bilateral basis only

funds operate compared with domestic and global alternatives.

Many of the businesses operating in Hong Kong are part of global enterprises that are supported by global treasury policies. The greater the degree to which a local MMF is aligned with global standards, the easier it is to use these funds from a governance and risk-acceptance perspective. In other words, when selecting the right fund manager and fund, the more aligned they are with global treasury policies and international norms, the quicker the internal approval-application process, and the lower the associated risks of monitoring different funds with different investment rules.

As SFC regulation of domestic MMFs has evolved, there are increasing similarities with the regulation governing international MMFs. However, as much as the table above highlights similarities between SFC and EU MMFs, it also shows significant variations, providing scope for domestic managers in Hong Kong to manage funds differently. Investors therefore need to be fully aware of the philosophy, objective and internal investment constraints and/or guidelines of a manager to ensure they fall within treasury policy. Particularly so with regards to the minimum credit ratings, external fund ratings, diversification, duration and liquidity requirements.

Fund comparison: SFC versus EU MMFs

	SFC MMF	EU MMF (LVNAV)
Fund rating	Not required	Not required, although STMMFs are typically rated by one or more credit rating agency
WAM	60 days	60 days
WAL	120 days	120 days
Concentration per issuer		
Government	100% but max 30% per issue	100% but max 30% per issue
Bank	10% with ability to go up to 25% if it is a substantial financial institution, but not exceed 10% of issued capital and reserves of the institution	15%
Any other issuer	10% max	15%
Max exposure to a group	20% or 25% in case of a substantial financial institution provided the investment does not exceed 105 of issued capital and reserves	15%
Max exposure to asset-backed securities	15%	15%
Max exposure to a reverse-repo counterparty	15%	15%
Credit rating	No minimum credit rating	A1/P1/F1-rated securities
Max maturity for government securities	Two years	397
Max maturity for non-government securities	One year	397
DLA	7.5% in hard physical maturities only	10%
WLA	15% in hard physical maturities only	30% (includes DLA)
Borrowing	Up to 10% of the fund to meet redemptions or operating expenses can be done via repo, too	Not permitted
Investing in other SFC-approved funds	Up to 10% max	Other MMFs not permitted
Stress testing	Periodic stress testing to be carried out by the manager to monitor the fund's liquidity	Periodic stress testing to be carried out by the manager to monitor the fund's liquidity
Valuation methodology	VNAV with amortised accounting	Amortised cost accounting for securities up to 75 days. Securities over 75 days at market/model. Securities more than 10bp away from market to be valued at market or model
Settlement cycle	Most funds operate on a T+1/T+2 redemption basis	T+0
Use of derivatives	May use financial derivatives for hedging purposes only, for example, managing currency risk if underlying assets are not in the currency of the fund	May use financial derivatives for hedging purposes only, for example, managing currency risk if underlying assets are not in the currency of the fund

Also worthy to note is the fact that in certain regards, the constraints set by the credit rating agencies and the internal investment guidelines of managers of international funds may be more conservative from a diversification and risk perspective than the regulation actually requires. Hence, in reality, a domestic fund in Hong Kong may be further distinguished in practice than the comparison between the regulatory frameworks may imply.

In addition to the investment approach adopted, investors also need to understand:

- The level of (customised) disclosure a particular fund will provide (such as frequency and reporting channel); and
- The level of technology used to support dealing, settlement and reporting activities (see Market developments below).

Market developments

Exchange-traded funds (ETFs)

While the market for ETF MMFs remains nascent, demand for ETF MMFs in Hong Kong is expected to rise as demand for passive funds continues to grow across all asset classes.

Institutional/rated MMFs

Most of the MMFs in the Hong Kong market are T+1 or T+2 on redemption and unrated. Globally, institutional MMFs are normally rated and T-0 funds, with subscription/same-day redemption, and this market is expected to expand over the next few years.

"Our HSBC Global Money Fund is the only HKD money market fund, domiciled in Hong Kong to be rated AAA (Fitch Ratings) and is T0," explains Gordon Rodrigues, CIO – liquidity, Asia-Pacific, HSBC Asset Management (Hong Kong) Ltd.

As the Hong Kong banking deposit system gets more disintermediated and interest rates rise, the attractiveness of MMFs (with daily same-day liquidity in the overnight to one-month range) is expected to see continued demand.

Environmental, social and governance (ESG)/sustainable investments

Investor appetite for ESG across Asia remains low compared to the US and Europe. ESG in Hong Kong is, however, gaining increasing interest on the fixed-income side. But for ESG MMFs, Hong Kong is still far behind the markets in Europe and America. That said, a number of fund managers are launching funds that invest in Asian issuers of sustainable bonds, green bonds, sustainability-linked bonds, transition bonds and social bonds.

Portals and platforms for ease of access and straight-through processing

The use of electronic/digital platforms is less prevalent in Hong Kong compared with other IFCs. However, adoption levels are increasing as the benefits of portals in dealing execution, providing robust audit trails, reducing the level of manual intervention and generally supporting a robust controls infrastructure become clearer and less expensive to implement and maintain. ●

Gordon Rodrigues is CIO – liquidity, Asia-Pacific at HSBC Asset Management (Hong Kong) Ltd

CHINA

Essential rundown of the key fundamentals impacting investment decision-making for corporate treasurers in China, along with the specifics of the various investment instruments available.

Market scale and scope

- China has the world's second-largest stock exchange by market capitalisation and strong retail investor base with a high appetite for investment risk.
- China is the world's third-largest jurisdiction in terms of money market funds (MMFs) after the US and Europe.
- At the end of 2021, the size of the MMF market was ¥5 trillion ($1.5 trillion) in terms of assets under management (AuM).
- MMFs made up 37.3% of China's mutual funds by AuM at the end of 2021 – down from 67% at the end of the first quarter of 2018.

Key stakeholders

- The **People's Bank of China (PBoC)** – the central bank with regulatory responsibilities for financial institutions.
- The **China Securities Regulatory Commission (CSRC)** – the main regulator for China's securities and futures industry.

Synopsis

China's financial markets are less than 20 years old with the first MMF launched in 2003. The market has grown significantly with an Alibaba-linked fund being the world's largest MMF, at one point reaching $268bn in March 2018 before AuM fell back modestly as a consequence of regulation and fund manager action to reduce individual investor concentrations.

Retail investors make up approximately 60% of the domestic MMF investor base overall, with much of the growth attributable to the accessibility of funds via mobile technology. The exponential growth of MMFs combined with the high proportion of retail investors has prompted the CSRC and PBoC to reform regulation covering MMFs to improve transparency and protect investors, in particular placing limits on lower-quality assets and requiring greater levels of liquidity. The development of regulations is expected to extend towards interest rate and liquidity risk, and to apply new rules in relation to counterparty and credit risk.

As ever, an understanding of the local market and the risk profile of funds is essential for the corporate treasurer, particularly since there are further regulatory moves planned for 2022 to reduce systemic financial risks by encouraging diversification across both end investors and distribution channels.

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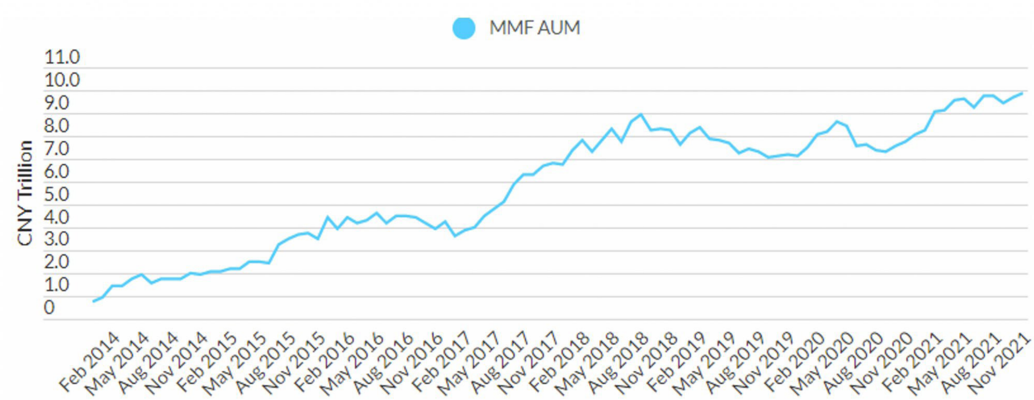


Source: Fitch Ratings, Asset Management Association of China

Market overview

For multinational companies operating in China, a notable feature is the difficulty around repatriating cash. As it's complicated and potentially costly for corporate treasurers to move cash offshore, having a treasury policy that accommodates the use of MMFs and understanding the domestic market for MMFs is all the more important. This is particularly important since MMFs run by domestic and international providers typically have very different risk profiles, with domestic providers being more return driven and retail centric.

MMFs comprised 37.3% of China's mutual funds by AuM at the end of 2021, down from a high of 67% at the end of the first quarter of 2018. This reflects both an increased level of regulation, but also an increase in the overall size of the investment market, which authorities have been keen to support with preferential policies to encourage the development of the domestic mutual funds industry. This includes a tax exemption on dividends generated by funds, including MMFs.

The domestic MMF industry is predominantly made up of prime market funds, which are almost entirely senior debt funds and based on the constant net asset value model. There are six funds that operate as variable net asset value, but these represent less than 1% of the market.

Many of China's MMFs have internet-based distribution models and China is well ahead of other markets in its use of mobile and online payment platforms such as AliPay and social media platforms like WeChat as distribution channels. This has made investing in MMFs easily accessible to retail investors where demand has been high, influencing the risk profiles of domestic funds to reflect the retail markets' focus on return. The higher proportion of retail investors can result in volatility in flows in and out of the fund. Consequently, the size of a fund does not necessarily reflect the stability of a fund, with one large fund losing 15% of its AuM in a single week due to the herd mentality often associated with retail investors.

Diverging from international MMF norms, only a small proportion of China's MMF industry is rated by a credit rating agency. Currently, Fitch is the only international rating agency to assign ratings to Chinese MMFs of which there are just three, with a combined AuM of ¥114bn as of April 2022. However, a MMF rating in China is unique and designed to specifically serve the needs of the domestic market, and the rating is denoted with a country-level suffix 'AAAmmf(chn)'.

Corporate treasurers will need to be aware of variances between the rating criteria of Chinese MMFs and international alternatives they may be more familiar with. For example, while Fitch's rating criteria limits Chinese MMFs to 75 days weighted average maturity (WAM) versus the regulatory maximum of 120 days, it remains higher than the maximum 60 days WAM by which international alternatives are constrained.

The market is quite concentrated with the top 10 fund managers accounting for some 47% of the industry by AuM at the end of 2021.

China has a broad market in terms of investment instruments. In addition to MMFs, there is a thriving interbank and exchange-traded repo market. There are also: agency bonds (which are policy bank bonds); central bank bonds; commercial paper issued by state-owned enterprises and by corporates; medium-term notes; time deposits; and standard certificates of deposit.

Country specifics

Portfolio characteristics

- Settlement: –T+1 day.
- WAM, weighted average life (WAL) and weekly liquidity: In China, depending on investor concentration, regulation requires funds to maintain differing levels of risk metrics for the above as shown in the table below. The higher the investor concentration, the lower the regulatory WAM and WAL, and higher the weekly liquidity. Fitch AAAmmf(chn)-rated funds need to maintain a minimum of 20% weekly liquidity.
- WAM: Compared to the WAM global norm of 60 days, Fitch AAAmmf(chn) funds run to a maximum WAM of 75 days.
- Liquidity fees: Of up to 1% apply in China.
- Overnight (o/n) liquidity: Funds must hold a minimum of 5% overnight, while Fitch AAAmmf(chn)-rated funds need to carry a minimum of 10% in o/n liquidity.
- Management fees: Range from 25bps to 30bps.
- Leverage: The regulator permits funds to be leveraged, but sets a limit of 20%.

Credit ratings

Issuance from both banks and non-banks must carry a minimum AA+ rating (China local rating scale), however, regulation permits exposure to banks below AA+ with board approval and public disclosure. So, funds could potentially assume more credit risk.

Charges

There are no exit charges applied on redemptions of MMFs.

Identifying the right fund manager

Corporate treasurers will need to consider whether or not their existing global policies can accommodate the risk characteristics of

Weighted average maturity (WAM), weighted average life (WAL) and weekly liquidity

	Top 10 investors hold >50%	Top 10 investors hold >20%	Top 10 investors hold <20%
Max. weighted average maturity (days)	60	90	120
Max. weighted average life (days)	120	180	240
Min. weekly liquidity (%)	30	20	10

Source: China Securities Regulatory Commission, Fitch

Portfolio instruments breakdown

Instrument	Issuer/counterparty	Regulator	Max tenor	Settlement	Par/disc
Repo – interbank	Per counterparty	CBIRC	182 days	T0	
Repo – stock exchange	CSDC	CSRC	182 days	T1	
Negotiable certificate of deposit (NCD) – only breakable deposits	Banks	CBIRC	1 year		
Term deposit (TD) – only breakable deposits	Banks	CBIRC/CSRC	1 year	T0	Par
Agency bonds	Policy banks		<=397 days		
Government/central bank	MOF/PBOC		<=397 days		
Commercial paper (CP)/ medium-term note (MTN)	Corporates	CBIRC/CSRC	<=397 days		
ABS (not commonly used)	Corporates/banks	CBIRC/CSRC	<=397 days		

Fund comparison table for China

	EU MMF (LVNAV)	HSBC Jintrust MMF	Fitch AAAmmf(chn)	CSRC, top 10<=20%	CSRC, top 10 (20%, 50%]	CSRC, top 10> 50%
Liquidity ladder	10% O/N, 30% weekly	15% O/N, 25% weekly	10% O/N, 20% weekly	5% O/N, 10% weekly	5% O/N, 20% weekly	5% O/N, 30% weekly
WAM	60 days	75 days	75 days	120 days	90 days	60 days
WAL	120 days	90 days	120 days	240 days	180 days	120 days
Minimum issuer rating (non-bank)	A1 minimum for S&P rated funds	F1/A-1/P-1 (ST) or A- (LT), and AAA China local	F1/A-1/P-1 (ST) or A- (LT)	AA+ China local		
Minimum issuer rating (bank)	A1 minimum for S&P rated funds	F1/A-1/P-1 (ST) or A- (LT), and AAA China local	F1/A-1/P-1 (ST) or A- (LT)	Need FM board approval if below AA+ China local, and publicly disclosed		
Government	100% but maximum 30% per issue	100%	100%	100%		
Agency/ policy bank	100% total	50% total	50% total	100%		
Corporate	5% each	30% total, 5% each	10% each	10% each		
Time deposit	10% each (100% total)	50% total	Can technically take 15% each for Big Six banks	100% total		
Settlement cycle	T+0	T+1	T+1	T+1		

domestic Chinese funds and, if not, to what extent the policies may need to be extended. The extent to which the policies need to be more accommodative may also influence manager selection, since the risk profiles of funds run by international fund providers – which target institutional investors – are typically lower than those of domestic funds, which are geared to retail investors. Critical to manager selection is an understanding of the investment philosophy of a particular fund manager and how this translates into risk management.

Investors should consider:

- How tight their own internal guidelines are compared to China's regulation;
- Whether they follow a rules-based risk management process;
- Whether pre-trade and post-trade risk metrics are checked by systems and monitored by risk or compliance teams;
- Whether the fund manager has an internal credit rating system and strong credit research resources;
- Whether the fund carries an external rating, giving an additional layer of oversight.

Overall, it will be incumbent on corporate treasurers to apply sound due-diligence practices to manager selection, which should also consider operational risk, particularly given the relatively young nature of the market.

Market and regulatory developments

In line with the global trend towards tighter regulation of financial markets, the PBoC and the CSRC are proposing tougher rules for a class of MMFs referred to as 'Important MMFs' (defined as MMFs with more than ¥200bn in AuM, or with more than 50 million investors). These proposals would require funds to set aside a minimum 40% of management fees as a risk provision, up from the current 10%.

Custodians and distribution channels would need to set aside a minimum of 20% of their fees as a risk reserve.

According to Fitch, the added costs could lead fund providers to cap fund sizes and/or investor numbers, potentially leading to the introduction of new funds, to accommodate demand.

Environmental, social and governance (ESG)

ESG is currently not a significant focus among investors in domestic Chinese MMFs. However, from a bond market perspective the PBoC and CSRC are beginning to look at ESG issues, in the wake of China's statement that it will be net carbon-neutral by 2060. Focus and activity in this space are therefore likely to increase and, as domestic investors' sentiment towards ESG-orientated solutions grows, so will the availability of solutions to meet demand.

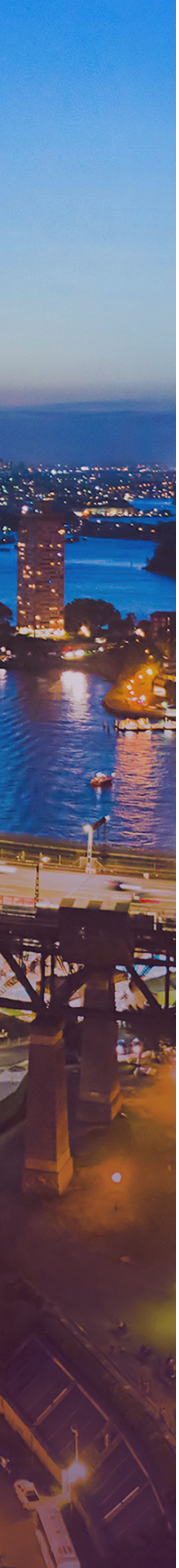
Technology

While retail investors can take advantage of mobile investing and 'one-click' investments, the technology space is less appropriate for the corporate treasurer from a governance and controls perspective. The nature of the Chinese market and requirements around setting up joint ventures with entities in China have hindered the development of third-party platforms by established international providers. However, in most instances, fund managers have their own portals such as HSBC Jintrusts portal for institutional MMF investors. Similarly, domestic banks operate portals catering to banks and non-banking financial institutions operating locally, and there are a growing number of domestic third-party distribution-only portals available. ●

Gordon Rodrigues is CIO – liquidity, Asia-Pacific at HSBC Asset Management (Hong Kong) Ltd

AUSTRALIA

Concise compendium of the key fundamentals impacting investment decision-making for corporate treasurers in Australia, along with the specifics of the various investment instruments.



Market scale and scope

- At the end of 2021, Australia's market for managed funds stood at A$4.48 trillion funds under management. Cash funds, which can broadly be broken down into two types – money market funds (MMFs) and enhanced cash funds – amounted to A$33.6bn.
- The use of MMFs for liquidity management remains at a nascent stage by comparison to other developed markets.
- The role of MMFs in the Australian short-term funding market is significantly smaller compared to overseas markets.
- Australia's MMF investor base is heavily weighted towards the institutional and superannuation segments.

Key stakeholders

- The **Reserve Bank of Australia (RBA)**, the central bank.
- The **Australian Prudential Regulation Authority (APRA)**, an independent statutory authority that supervises banking, insurance and superannuation institutions.
- The **Australian Securities and Investment Commission (ASIC)**, the principal regulator of fund managers, responsible for registering Australian management investment schemes, licensing fund managers and monitoring their compliance with financial services laws.

Synopsis

Driven by a domestic investor base dominated by institutional investors and superannuation funds and the relatively minor role MMFs have in Australian short-term funding markets, regulators' emphasis has remained on industry guidance rather than prescriptive MMF regulation seen in other markets such as the US or Europe.

Further distinguishing domestic Australian MMFs from international alternatives is the market convention for fund valuations, which is fully mark-to-market or variable net asset value (VNAV). Australian domestic funds are also less likely to carry an external credit rating, which is the standard for international funds.

However, while the Australian market for MMFs is relatively small – representing less than 1% of the market for managed funds – it nonetheless provides cash-investment solutions to investors seeking credit diversification while maintaining liquidity.

Market overview

Investment in Australia's managed funds market is dominated by institutional investors and superannuation funds. In 2021, the market was split between retail investors (13%), institutional investors (40%) and superannuation funds (47%). The high proportion of institutional and superannuation fund investors has influenced the evolution of the Australian domestic MMF segment of the industry as risk profiles, valuation methodologies and fund features required by these investor types may be different to those typically required by corporate treasury or retail investors.

Most MMFs use the VNAV methodology with funds being mark-to-market on a daily basis. By comparison, the norm for international prime MMFs is to use a methodology known as low volatility net asset value (LVNAV), in which securities out to 75 days can be valued using amortised cost accounting. As a result of using VNAV and running typically longer-duration portfolios, following recent aggressive tightening by the RBA, a number of

"THIS IS PROBABLY THE MOST SIGNIFICANT DIFFERENCE BETWEEN AUSTRALIA AND OTHER IMPORTANT MMF JURISDICTIONS. AS FUNDS USE MARK-TO-MARKET VALUATIONS – AND THEREFORE VNAV – MMFS IN AUSTRALIA CAN SHOW NEGATIVE RETURNS"

GORDON RODRIGUES

Australian domestic funds are showing negative returns. However, as most investors are institutions or superannuation funds that invest over a medium-term horizon, short-term instances of negative rates are not considered critical.

Other key features of Australian MMFs include:

- A light-touch regulatory framework;
- Breakdown of instruments held and their credit rating;
- No requirement for MMFs to hold solely credit-rated instruments; and
- Low diversification within funds themselves.

The regulatory environment

With retail investors only a small part of the investment landscape in Australia, there is only a very small amount of regulation aimed specifically at MMFs – apart from a stipulation under the Corporations Act of 2001, that the name of the fund must not be misleading or deceptive. The regulators have clear rules for the standardisation of naming conventions of MMFs to distinguish between 'money market funds' and 'enhanced' money market funds, which may have very different risk profiles and to reduce the risk of mis-selling.

When ASIC looked at MMF regulation in the wake of the 2008 global financial crisis, it concluded that exposure to systemic risks such as fund redemption was low given the main characteristics of the market, including:

- Most MMFs have short-term maturity profiles and therefore low levels of volatility;
- A lack of significant mismatch between liquidity and redemption terms, with the majority of MMFs being able to divest their holdings relatively efficiently; and
- Only a limited exposure of retail and wholesale investors to MMFs.[i]

As a result – and given existing provisions (such as the existing Corporations Act, which allows funds to freeze redemptions) – there has been no new legislation or regulation, unlike other major jurisdictions. Overall, regulation is light touch, but with a strong expectation that guidance is adhered to by fund managers.

Fund holdings and strategy

Australian domestic MMFs are highly concentrated around bank instruments with certificates of deposit (CDs) issued by the main four banks typically representing 65–80% of most funds, with only limited diversification into smaller banks. As a result, investors achieve only limited diversification of counterparty risk – especially as all funds would tend to have similar exposures to the same issuers. By comparison, international MMFs offer greater diversification through issuers in markets beyond Australia, including Japan, South Korea, New Zealand, Hong Kong, China, Europe and the US, and so offer greater issuer and geographical diversity.

While there is no requirement for Australian domestic MMFs to hold rated instruments, in practice they hold highly rated ones, with very limited exposure to assets that are slightly less liquid, such as term repurchase agreements, securitised debt or lower ST rated A-2 assets. The market is therefore narrow, but of a reasonable high quality.

In 2017, Australia's Financial Services Council (FSC) issued a guidance note setting out expectations in terms of investment objectives and vehicles.[ii] The FSC categorised MMFs as either short term or standard (otherwise known as enhanced cash funds) and expected funds:

- Should include high-quality money market instruments and other low-duration money market instruments;
- Should not take on exposure to equities or commodities;
- Should only use derivatives in line with the fund's investment strategy; and
- Should prohibit or limit investment in securitised products (with some exceptions).

MMFs must impose concentration limits and/or diversification ratios to reduce a fund's exposure to a single entity, the FSC guidance states. However, exposure to money market instruments issued by major Australian banks should be capped at 70% of the MMF portfolio and exposure to non-major, non-government money market instruments to be capped at 15% of the portfolio. The regulators are mindful of international standards and apply liquidity limits that are similar to those in Europe (see below). Thus, guidance suggests that a 10% minimum should be invested in daily liquid assets and 30% in weekly liquid assets.

Overall, the landscape for Australian MMFs can be characterised as rigorous in terms of its guidance – fund managers can largely be expected to hold to ASIC and FSC guidance – but low in statutory regulation, in part due to the concentration around high-quality assets and instruments.

Credit ratings – In contrast to international MMFs, Australian onshore MMFs are typically unrated, although there are instances of both international and domestic investment managers obtaining ratings for Australian domestic MMFs.

In line with corporate treasury expectations, the market convention for international MMFs is that they are typically rated by one or more credit rating agencies.

Country specifics

Portfolio characteristics

- Settlement: Settlement cycles for AUD MMFs vary and are typically longer than those of international funds for which the market convention is T+0.
- Weighted average maturity (WAM): 60 days, in line with international norms (for enhanced cash funds, WAM is 365 days or less).
- Weighted average life (WAL): 120 days, a bit longer than the 90-day international norm.
- Management fees: Fees vary between client segments as well as for factors such as the stability of cash being invested, but typically within a range of 10–20 bps for institutional investors.
- Credit risk: More than 50% of fund must be invested in major banks or A1+ rated instruments; this is in the nature of guidance.
- Leverage: Only permitted for short-term borrowing to manage redemption requests and limited to 10% of AuM.

Identifying the right fund manager

Corporate treasurers typically operate within a range of well-defined risk parameters from counterparty risk tolerance to diversification constraints. Identifying a MMF that sits within these parameters requires careful consideration of the manager's investment philosophy, the regulatory regime under which they operate, as well as constraints a manager must adhere to, to maintain a fund credit rating.

Diversification

A key benefit to investing in MMFs is to achieve greater diversification via pooled investment vehicle. However, as highlighted earlier, domestic Australian MMFs are typically less diversified both from an issuer and geographical perspective than international alternatives.

Duration

Onshore funds tend to be benchmarked against the Bloomberg AusBond Bank Bill

Fund comparison table

	EU MMF (LVNAV)	FSC 'Short-term money market fund' – guidance
Liquidity ladder	10% O/N, 30% weekly	10% O/N, 30% weekly
WAM	60 days	60 days
WAL	120 days	120 days
Minimum issuer rating (non-bank)	A1 minimum for S&P rated funds	>50% of fund must be invested in major banks or A1+ rated instruments. Remainder in minimum A2 short-term rating, or A- long-term rating
Minimum issuer rating (bank)	A1 minimum for S&P rated funds	
Government	100% but maximum 30% per issue	35% each
Agency/ policy bank	100% total	35% each
Corporate & FI	5% each	Major Australian bank 35%, non-major 15% each
Time deposit	10% each (100% total)	15% each
Leverage	Not permitted	Only permitted for short-term borrowing to manage redemption requests and limited to 10% of AUM
Settlement cycle	T+0	Varies between managers

Index and therefore tend to have portfolios with higher WAMs to achieve yields in line with benchmark. By contrast, offshore funds are not managed to a benchmark; instead, they have a reference benchmark for comparison, typically the RBA cash overnight rate. This could be a strong consideration for corporate treasurers sensitive to negative returns in a rapidly rising rate environment where a fund with a longer WAM will be slower to reflect the rate hikes.

Credit risk

Treasurers need to make sure onshore funds selected would invest only in the highest short-term rates instruments or only liquid asset types, if that is their global investment policy, given the absence of a prescriptive regime.

Liquidity risk

Liquidity risk management should consider both asset and liability factors. In jurisdictions where minimum daily and weekly liquidity buckets are not mandated by regulation, it's important to understand a manager's internal liquidity policy, in particular how they define the type of assets that can be used and the maximum tenor and percentage weight for each asset type. Liability factors should include individual client concentration limits and client sector limits for those sectors that exhibit herding behaviour during periods of market stress.

ESG risk

As a minimum, managers should be able to demonstrate how risks arising from environmental, social and governance (ESG) factors are managed within their credit process and internal credit scoring, a process known as ESG integration. Where designated ESG MMFs are being considered, a manager must be able to evidence a material impact on the MMF investment universe achieved using the ESG investment methodologies they have adopted.

Market and regulatory developments

- Notwithstanding the limited diversification benefits due to the high concentration around domestic bank CDs, Australia's onshore MMFs operate in a relatively low-risk, high-quality investment space.
- There are no current plans to change the regulatory framework governing Australia's onshore MMFs and therefore there is greater emphasis on investors to understand the risk profile of a MMF solution.
- Sustainability – Given the highly constrained investment universe for onshore funds, the scope to develop an onshore ESG MMF is limited. As treasurers move to adopt more sustainable treasury practices, the demand for ESG MMFs is most likely to be met through international alternatives given the much broader investment universe available to them. ●

[i] Report 324 *Money market funds*, Australian Securities & Investments Commission, 2012, p5
[ii] FSC Guidance Note No 35: *Money Market Funds Naming Convention*, 2017, p7

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TREASURY RESOURCES


81.438
87.072
92.595
44.353
22.242
99.529
26.073

Summary guide to educational material

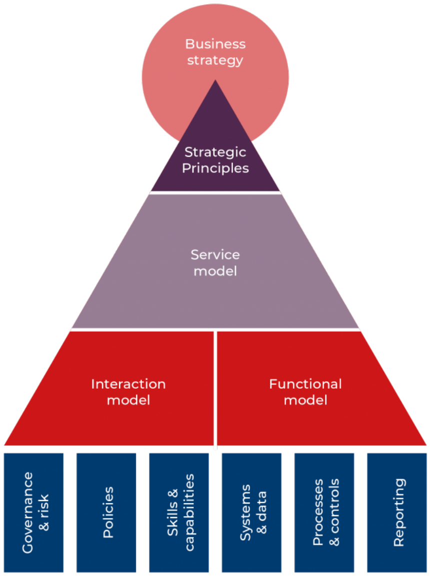
One activity all treasury functions have in common is cash management. But what can it include and if you're starting from scratch, what do you need to consider?

The Treasurer's Global Cash Investment Resource Hub provides you with all you will need to build a cash management function. It starts with establishing a governance framework and then explains how to set a risk management framework to support this, along with practical examples from industry. A key component of any framework is a treasury policy and the Hub includes a section on what it can include.

Defining a vision for the management of treasury activities

A treasury target operating model requires alignment of the model with the business strategy to ensure it is fit for purpose. To do this, the following questions should be considered to help define the vision for the management of treasury activities across the group:

1	What should the scope and role of treasury-related risks be? **(Strategic Principles)** The strategic principles guide the definition, operation and implementation of the target-operating model
2	Who should treasury deliver its services to, and how should these services be delivered? **(Service model)** The service model describes the key operating standards for the management of treasury risks, taking into account the 'as is', good practice and the business context
3	How will treasury ensure it has adequate linkages both internally and externally to manage treasury risks? **(Interaction model)** The interaction model details the interrelationships, dependencies and linkages between the various risk management hubs and between treasury and its customers and stakeholders
4	How will risks be managed at a local and group level to ensure that it is optimised? **(Functional model)** The functional model outlines the key activities required to manage these risks to agreed standards
5	What specific policies, processes, people and technology are needed to support the delivery of the operating model? **(Target Operating model)** The operating model defines key operating requirements.



Visit the hub

hub.treasurers.org

Having established the governance framework, the Hub then goes on to provide practical resources to help create good practice in the following areas:

- **Cash forecasting**
- **Operational cash and liquidity management**
- **Working capital management**
- **Cash concentration techniques**
- **Cash segmentation techniques**
- **Balancing liquidity and yield when it comes to investment strategies**
- **The use of technology to support effective cash management**
- **Dealing with trapped cash**