European Money Market Funds Reform

An overview of our plans for the HSBC Global Liquidity Fund range

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HSBC Global Asset Management

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Jonathan Curry
Global CIO Liquidity and CIO USA

Introduction

Following the new regulation finally being passed by the European Union in July 2017, existing money market funds ("MMF") such as the HSBC Global Liquidity Funds will have to comply with the new rules by 21st January 2019.

As we have communicated previously, the changes can be simplified into two parts; structural changes to the industry and changes to the risk profile of MMFs.

The most significant changes are structural, with the introduction of a new type of MMF, the Low Volatility NAV fund ("LVNAV"), being the most significant change to the industry.

In terms of changes to the risk profile that short term MMFs must comply with, we have always managed these funds in a conservative manner and our existing guidelines already meet or are more conservative than the requirements of the new regulation in most areas. Where they do not meet the new requirements, they will be easily adapted to do so and we have started the process to implement these changes.

Our approach

We are running a formal change project, overseen by a dedicated project manager with a variety of defined workstreams and accountable executives across the various functions and disciplines to ensure that we will be fully ready for the new rules, including working with our key suppliers.

A key focus is on the conversion of the current CNAV Global Liquidity Funds to the new LVNAV model. This is based on our belief that LVNAV funds are a very credible alternative to Prime Constant NAV ("CNAV") funds, and we expect them to attract a significant proportion of CNAV cash, in part as we believe investors will value those features similar to existing CNAV prime funds that many use today. The feedback we have received to date from investors supports our original assertion with almost all investors looking to the LVNAV funds as the fund of choice for the future.

In addition, we have already have a range of Public Debt funds (that invest in government securities) registered and we intend to launch these at the appropriate time based on client demand. We will also continue to evaluate whether there is client demand for Variable NAV ("VNAV") prime funds, and would register and launch these if required. And, whilst not directly influenced by the new regulations, we intend to launch new solutions for Ultra Short Duration cash which include a fresh approach for separately managed accounts and potentially pooled funds.

Planned Fund Range by 21st January 2019

Fund Type	Currencies	Comments
LNAV Prime Funds	• USD, EUR, GBP, CAD, AUD*	• Planned conversion of existing CNAV Prime Funds

* AUD CNAV fund due for launch January 2018, and subsequently would be converted to LVNAV

Potential Additional Funds Based on Client Demand

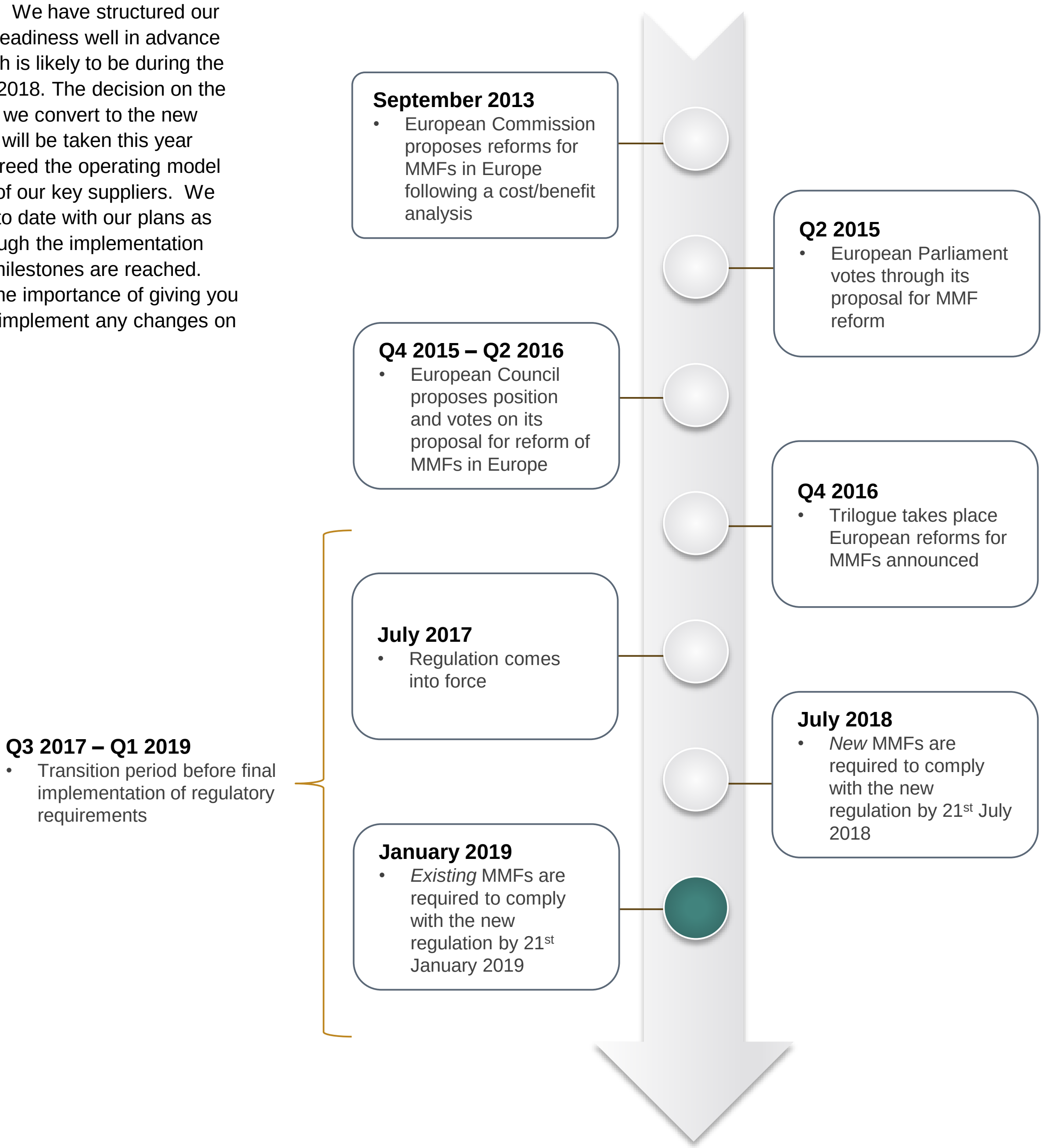
Fund Type	Currencies	Comments
CNAV Public Debt Funds	• USD (Treasury & Government), EUR, GBP	• Currently registered, launch subject to client demand
VNAV Prime Funds	• USD, EUR, GBP, CAD	• Registration and/or launch subject to client demand
VNAV Ultra Short Debt Fund**	• USD, EUR, GBP	• Separately managed accounts already available. Pooled funds being evaluated for potential 2018 launch.

** Not a money market fund

Timeline

The new rules have been a long time in the making and will apply for existing MMFs by 21 January 2019. We have structured our project to target readiness well in advance of that date, which is likely to be during the fourth quarter of 2018. The decision on the specific date that we convert to the new LVNAV structure will be taken this year once we have agreed the operating model with the support of our key suppliers. We will keep you up to date with our plans as we progress through the implementation project and key milestones are reached. We understand the importance of giving you sufficient time to implement any changes on your side.

European MMF regulation Timeline



What do Investors need to be thinking about, and doing, in the intervening period?

The following are examples of the types of activities that you need to start planning for;

- Engage with your fund provider(s) and satisfy yourself with their approach to the new rules; for example how are they preparing, and what is the planned fund range?
- Understand any changes that will need to be undertaken to the investment or credit profile of your existing MMFs and what this means for the risk and return profile of the MMF. We expect the new rules to mean a number of providers will need to change some of their guidelines and come into line with more stringent rules.
- Investment and risk policies and guidelines are likely to need to be updated, which requires early planning to meet existing schedules for Board / Investment Committee reviews and approvals.
- Cash and treasury systems may need to be updated, and you need to engage with any MMF investment platforms that are used to understand their approach.
- Internal and external auditors need to revalidate LVNAV funds as being “cash and cash equivalent”. We will be providing some support in this area in the near future.

Our commitment to you

We will continue to keep you informed of our plans, including specific dates you need to be aware of as they are confirmed. We are planning a targeted series of updates and knowledge sharing over the coming months, intended to give you the information and tools you need to understand the changes that are taking place. This series builds on the communications we have already been providing in 2017 that have outlined the regulatory process and the key details of the new rules. Going forward our communications will include;

Knowledge Sharing

- Analysis of the features of LVNAV funds, including back-testing of price volatility to illustrate how they compare to today's CNAV funds
- An example of a business case that a Treasurer might take to seek approval for LVNAV from their risk and investment committees
- An illustration of what typically constitutes "cash and cash equivalent"
- Frequently Asked Questions and other technical details you need to know about how LVNAV funds will work

Communicating HSBC Plans

- Periodic updates on our project and plans
- Formal communication of fund change / live dates
- Shareholder communications including Prospectus changes

It is also critical we have your feedback on our plans, and how they fit with your expectations on cash investments - in the build up to, and beyond, the implementation dates - and we will continue to work hard to be your trusted partner.

Conclusion

The new rules mean considerable change for the industry, but we believe the new LVNAV funds are a very credible alternative to today's CNAV prime funds. This document provides you with further information that we believe you need to keep abreast of the changes, as well as to inform you of our plans and how we will continue to keep you updated you in the coming months.

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Key risks

- 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.
- Credit risk. Issuers of debt securities may fail to meet their regular interest and/or capital repayment obligations. All credit instruments therefore have potential for default. Higher yielding securities are more likely to default.
- Derivative risk. The value of derivative contracts is dependent upon the performance of an underlying asset. A small movement in the value of the underlying can cause a large movement in the value of the derivative. Unlike exchange traded derivatives, over-the-counter (OTC) derivatives have credit risk associated with the counterparty or institution facilitating the trade.
- Asset backed securities (ABS) risk. ABS are typically constructed from pools of assets (e.g. mortgages) that individually have an option for early settlement or extension, and have potential for default. Cash flow terms of the ABS may change and significantly impact both the value and liquidity of the contract.
- Operational risk. The main risks are related to systems and process failures. Investment processes are overseen by independent risk functions which are subject to independent audit and supervised by regulators.
- MoneyMarket Fund risk. The fund aims to maintain a stable share price through investment in low risk, short-term securities. The market value of the securities held by the fund will fluctuate. During adverse market conditions there is no guarantee that a stable net asset value will be maintained.

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