For professional and institutional clients only **June 2013**

Money Market Fund (MMF) reform in the US

Keep calm and carry on

By Jonathan Curry, Global Chief Investment Officer, Liquidity

Executive summary

The Securities Exchange Commission ('SEC') has proposed a set of regulations for MMFs that it believes will further reduce 'run' risk and the knock on impact to the broader financial system of a 'run' from MMFs.

The release of the reform proposals is another step in a long process, and one that is unlikely to be completed before 2015. However, it is an important step and, with the expected increase in media coverage of the topic, we think it is an opportune time to update you on our thoughts on the proposals.

This paper sets out the background to the MMF reform debate along with:

- an overview of the proposed reforms,
- HSBC Global Asset Management's views on the proposed reforms,
- the expected time line for implementation of the reforms, and
- the potential implications for you as an investor in MMFs.

We do not expect the proposed reforms will remove the utility value that MMFs have provided to investors; namely professional credit management, credit diversification, a high degree of liquidity, and a competitive return compared to short term money market interest rates all achieved through one transaction. For this reason we believe that investors will continue to use MMFs as part of their day-to-day cash investment solutions.

In addition, there will be time for investors and providers of MMFs to adjust to these changes with the reforms not expected to take effect until 2015 or 2016. While some of the proposed changes are significant, we believe investors and providers will adjust to the changes which will maintain MMFs as an attractive investment option for those looking for a home for their cash.

Background

The SEC has been considering the reform of MMFs for over two years since the '2010' reforms. This followed the decision by the Financial Stability Board to classify MMFs as part of the 'shadow banking' system as they are susceptible to 'runs' and threaten financial stability. The rationale for these opinions is as follows. Investors view MMFs as a potentially safe and more diversified alternative to bank deposits. During a crisis, as asset prices fall, a MMF may not be able to offer immediate redemption at par. Not all fund sponsors will be willing or able to provide 'support'. Investors perceive a risk and 'run'; consequently the fund has to sell assets to meet redemption requests. This exacerbates the fall in the price of a fund's NAV which can lead to systemic risk due to MMFs role in financing the real economy and their link to sponsors.

HSBC
Global Asset Management

Money Market Fund (MMF) reform in the US

Keep calm and carry on

Background (continued)

Early on in the debate, a small, but influential, number of former and current regulators suggested the answer to the problem of systemic 'run' risk in MMFs was best addressed by requiring 'constant net asset value ('CNAV')' or 'stable price' MMFs to allow the price of the funds to fluctuate. The theory was that if investors were used to the price of a MMF fluctuating they would be less likely to 'run' during a crisis. These early opinions have shaped the debate, and led to reform options being focused on CNAV funds. We have wondered whether regulators would have focused instead on heightened 'run' risk in variable net asset value ('VNAV') funds rather than CNAV funds if Dexia Bank, an issuer widely held by European VNAV funds, rather than Lehman Brothers, an issuer held in a CNAV fund that defaulted, had not been bailed out…

An overview of the key reforms proposed by the SEC

The SEC released its proposal for MMF reform on June 5th. The regulation is comprehensive and includes two headline proposals which are presented separately but may be combined into a single reform proposal.

Alternative 1: Floating NAV

- Prime institutional MMFs would be forced to convert to a floating NAV, with a price rounded to four decimal places;
- Prime retail MMFs and government MMFs would be exempt from this requirement and could therefore continue to transact at a stable NAV.

Alternative 2: Liquidity Fees and Redemption Gates

- All MMFs could continue to maintain a stable NAV, but would be able to use liquidity fees and redemption gates in times of stress;
- A MMF would be required to implement a liquidity fee of up to 2% on redemptions if the level of that fund's weekly liquid assets fell below 15%;
- At the same weekly liquid asset threshold, a MMF would be permitted to impose a temporary suspension on redemptions of up to 30 days;
- Government MMFs would be exempt from this requirement, but could voluntarily opt into it.

Alternative 3: The combined proposal

- The Commission made it clear that it is considering whether to combine these proposals into a single reform package. Under the combined reform proposal, prime institutional MMFs would have to convert to a floating NAV and all non-government MMFs would have the ability to impose liquidity fees and/or liquidity gates.

The following is a summary of some of the other significant changes we see in the proposed regulation:

1. Enhanced disclosure requirements for MMFs, including:
   - disclosing market-based NAVs and liquidity levels on a daily basis;
   - new disclosure requirements for material events impacting the MMF and its investments; and
   - a disclosure of historic and future instances;
2. MMF portfolio holdings, which are currently filed with the SEC and publicly available on a 60-day delay, would now be available immediately upon filing with the SEC;
3. Managers of un-registered, or private "liquidity funds", would have to provide the same level of portfolio holdings to the SEC as providers of registered MMFs;
4. Stronger requirements for diversification of investments, including: aggregating holdings in affiliated parties for the purpose of considering diversification; removing existing exemptions from diversification limits and ensuring sponsors of asset backed securities vehicles are aggregated for the purpose diversification limits;
5. The stress testing requirements introduced in 2010 would be further enhanced.

Money Market Fund (MMF) reform in the US

Keep calm and carry on

HSBC Global Asset Management's opinion on the SEC's proposed reforms

HSBC Global Asset Management has been heavily involved in the debate on the reform of MMFs, and we are pleased to see a number of reforms that we have supported included in the SEC's proposal. HSBC Global Asset Management has advocated the introduction of a trigger based liquidity fee since 2011, similar to the liquidity fee proposed by the SEC. While we differ on the trigger mechanism and the amount of the liquidity fee proposed by the SEC, we continue to believe that a trigger based liquidity fee is the most effective solution for limiting a run on a MMF in a time of market disruption.

In addition, HSBC Global Asset Management supports the strengthened diversification requirements included in the proposed reforms. In fact, the proposed requirements around treatment of affiliated issuers and asset-backed security vehicle sponsors are similar to the existing requirements within HSBC Global Asset Management's internal investment guidelines for managing money market funds.

However, we are disappointed with a number of the regulatory proposals. In particular, HSBC Global Asset Management remains of the view that converting a MMF to VNAV does not make a MMF less prone to run-risk, a view we believe is supported by evidence of investor behaviour in VNAV MMFs during past instances of market dislocation.

In addition, we have concerns about the effectiveness and potential impact of releasing underlying portfolio information for MMFs, including market based NAVs per share and liquidity levels, on a daily basis as required by the proposed reforms.

The timeline for implementation

The release of the SEC's reform proposals is an important step forward. However, there is still much to be done and a long timeframe before the final regulation is expected to be implemented.

We have outlined below the steps to be taken before the regulation is live, with an **estimated** timeframe. As with all regulations, it is difficult to predict timing with a high degree of confidence. There are many factors that may change the estimated timeline, not least potential changes to the regulation itself. One important factor determining the ultimate timeframe, and the reforms themselves, is whether the Financial Stability Oversight Council ('FSOC') considers the reforms proposed by the SEC as meeting their requirements for the reform of MMFs.

Q2 2013 – Q3 2013 – The SEC seeks public comments on their proposals within 90 days of publication on the public register and subsequently holds hearings

Q3 2013 – Q4 2013 – The SEC reviews public comments, drafts final rules and votes to enact

Q1 2014 – 2015/2016 – Transition period before regulation is required to be implemented

Money Market Fund (MMF) reform in the US
Keep calm and carry on

The potential implications of the reform proposals on the investors in MMFs

Fundamentally, we do not believe that the proposed reforms will remove the utility value that MMFs have provided to investors: professional credit management, credit diversification, a high degree of liquidity, a competitive return compared to short term money market interest rates, all achieved through one transaction. For this reason we believe that investors will continue to use MMFs as part of their day-to-day cash investment needs. In addition, we believe a number of the changes are positive and have the potential to make MMFs even more resilient to any severe market stresses in the future.

However, there are a number of implications of the proposed regulation that we believe investors will need to consider, particularly in respect to the proposed conversion to VNAV:

1. Comfort with a small level of volatility in the yield of the fund. We are working on an estimate of the expected volatility using historic fund data to provide the necessary context.
2. Determine whether MMFs will remain “cash and cash equivalents” from an accounting perspective. While we do not provide tax advice (and you will need to engage with your own tax advisor), we are seeking tax opinions on this.
3. Determine the tax treatment of a VNAV MMF with your tax advisor. While we do not provide tax advice (and you will need to engage with your own tax advisor), we are seeking opinions on this.
4. If your investment policy stipulates that you must only invest in a CNAV MMF, this will require updating.

Clearly, the proposals will also require MMF providers, custodians, administrators, and the SEC to adapt to these changes. In the interim, we will continue to represent to the SEC and others, reforms that we believe are in the best interests of our clients. We will prepare for the changes created by the new regulation, and will support our clients as they prepare for the changes.

If you have any questions on any aspects covered in this paper or any question on MMF reform, please contact your HSBC Global Asset Management sales representative.

Important information

This document is intended for professional clients only and should not be distributed to or relied upon by retail clients.

The contents of this document are confidential and may not be reproduced or further distributed to any person or entity, whether in whole or in part, for any purpose.

The material contained herein is for information only and does not constitute investment advice or a recommendation to any reader of this material to buy or sell investments.

This document is not intended for distribution to or use by any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation. This document is not and should not be construed as an offer to sell or the solicitation of an offer to purchase or subscribe to any investment.

HSBC Global Asset Management (UK) Limited has based this document on information obtained from sources it believes to be reliable but which it has not independently verified. HSBC Global Asset Management (UK) Limited and HSBC Group accept no responsibility as to its accuracy or completeness.

This document is intended for discussion only and shall not be capable of creating any contractual or other legal obligations on the part of HSBC Global Asset Management (UK) Limited or any other HSBC Group company. Care has been taken to ensure the accuracy of this document but HSBC Global Asset Management (UK) Limited accepts no responsibility for any errors or omissions contained therein.

continued/...

Important information (continued)

This document and any issues or disputes arising out of or in connection with it (whether such disputes are contractual or non-contractual in nature, such as claims in tort, for breach of statute or regulation or otherwise) shall be governed by and construed in accordance with English law.

The views expressed above were held at the time of preparation and are subject to change without notice.

Any forecast, projection or target where provided is indicative only and is not guaranteed in any way. HSBC Global Asset Management (UK) Limited accepts no liability for any failure to meet such forecast, projection or target.

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. Where overseas investments are held the rate of currency exchange may also cause the value of such investments to fluctuate. Investments in emerging markets are by their nature higher risk and potentially more volatile than those inherent in some established markets. Stock market investments should be viewed as a medium to long term investment and should be held for at least five years. Any performance information shown refers to the past and should not be seen as an indication of future returns.

To help improve our service and in the interests of security we may record and/or monitor your communication with us.

HSBC Global Asset Management (UK) Limited provides information to Institutions, Professional Advisers and their clients on the investment products and services of the HSBC Group.

This document is approved for issue in the UK by HSBC Global Asset Management (UK) Limited, who are authorised and regulated by the Financial Conduct Authority.

www.assetmanagement.hsbc.com/uk

24124/0613/ex100614/FP13-0973

Money Market Fund (MMF) reform in the US

Keep calm and carry on

Important information (continued)

HSBC is a global organization that operates in many different jurisdictions worldwide. Where appropriate, HSBC entities are registered with appropriate regulatory authorities in the jurisdictions in which they are required to be registered to carry on their respective business activities. HSBC Securities (USA) Inc. (HSI) is an HSBC broker dealer registered in the United States with the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended. HSI is also a member of the Financial Industry Regulatory Authority (FINRA). HSI is not authorized by, or registered with, the Financial Services Authority in the United Kingdom or with any other non-U.S. regulatory authority. The contents of this material are not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law or regulation. No HSBC entity makes any representation that the contents of the material are appropriate for use in all locations, or that the transactions, securities, products, instruments or services discussed are available or appropriate for sale or use with all investors or counterparties.

HSBC Money Market Funds

Investors should consider the investment objectives, risks, charges, and expenses of the investment company carefully before investing. The prospectus contains this and other important information about the investment company. For clients of HSBC Securities (USA) Inc., please call 1-888-525-5757 for more information. For other investors and prospective investors, please call the Funds directly at 1-800-782-8183 or visit our website at www.investorfunds.us.hsbc.com. Investors should read the prospectus carefully before investing or sending money.

An investment in the Fund is not insured or guaranteed by the FDIC or any other government agency. Although the fund will attempt to maintain a stable NAV of $1.00 per share, you may lose money investing in this fund.

HSBC Global Asset Management is the marketing name for the asset management businesses of HSBC Holdings Plc. HSBC Global Asset Management (USA) Inc. serves as the investment adviser to the HSBC Funds. Foreside Distribution Services, L.P., member FINRA, is the distributor of the HSBC Funds and is not affiliated with the Advisor. HSBC Securities (USA) Inc., member NYSE, FINRA, SIPC is a sub-distributor of the HSBC Funds. Affiliates of HSBC Global Asset Management (USA) Inc. receive fees for providing various services to the funds.

Investment products are provided by Registered Representatives of HSBC Securities (USA) Inc., member NYSE/FINRA/SIPC, a registered Futures Commission Merchant, a wholly-owned subsidiary of HSBC Markets (USA) Inc. and an indirectly wholly-owned subsidiary of HSBC Holdings plc.

It is important to remember that there is no guarantee that a stable net asset value will be maintained. 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. Where overseas investments are held the rate of currency exchange may cause the value of such investments to go down as well as up. Any performance information shown refers to the past and should not be seen as an indication of future returns.

There are important differences in how the strategy is carried out in each investment vehicle. Investors should carefully consider the investment objectives, risks and fees of the strategy carefully before investing. A separately managed account may not be suitable for all investors and a minimum asset level is required. Please refer to the Form ADV Part 2A for important information about the investment manager.

Investment products:

• ARE NOT A BANK DEPOSIT OR OBLIGATION OF THE BANK OR ANY OF ITS AFFILIATES	• ARE NOT FDIC INSURED	• ARE NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY	• ARE NOT GUARANTEED BY THE BANK OR ANY OF ITS AFFILIATES	• MAY LOSE VALUE

All decisions regarding the tax implications of your investment(s) should be made in connection with your independent tax advisor.

CA13-06-07