HSBC

Global Asset Management

September 24, 2010

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West, Suite 1903, Box 55
Toronto, ON M5H 3S8
Fax: 416-593-2318

RE: **BCN 2010/21** Notice and Request for Comment - Proposed Amendments to National Instrument 81-102 Mutual Funds, National Instrument 81-106 Investment Fund Continuous Disclosure and related Consequential Amendments

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

Dear CSA Member(s):

We are in agreement with the need to strengthen the regulatory framework for Money Market Funds in Canada. We hope our comments further aid your efforts to protect investors in Money Market Funds. In addition, we believe a level of global consistency in money market regulations is valuable in terms of the investors understanding of money markets funds, particularly those investors who operate on a global basis. Secondly, Canada's position as a jurisdiction providing money market funds will be further enhanced as an industry leader. We would like to stress that our comments are generally based upon keeping regulatory global consistency of money market funds. However, it should be noted that our own internal guidelines will be more conservative in some instances. We request your consideration on the following items with regard to the proposed **Section 2.18 Money Market Fund**:

MAXIMUM INDIVIDUAL ASSET MATURITY AND DEFINITION OF FLOATING RATE SECURITIES (FRNS)

We propose the addition of a maximum term maturity of 397 days consistent with Securities and Exchange Commission's (SEC) Rule 2a-7 regulations for all securities inclusive of FRNs.

- In line with keeping global consistency of regulations, and still protecting investors, we would suggest the maximum tenor for all securities be changed to 397 days which would include a 397 days maturity maximum for FRNs within the definition under 2.18 (a) subsection (iv).

- The principles of subsection (iii) should apply to subsection (iv) to limit the exposure of money market funds to the risks associated with longer terms to maturity
- While shorter reset intervals to the reference rate limits the risks associated with changes to this reference rate, it does not limit the risks associated with changes to the required credit margin to this reference rate. Changes to credit premiums can have a material impact to the value of floating rate obligations and can limit their ability to reset near par value [Subsection (iv)(B)].
- Focus on the reset interval does not address the increased liquidity risk premium of longer-term obligations.
- It is noted that the proposal includes a limit on the weighted average final term to maturity of the portfolio of assets to 120 days. This is a positive development; unfortunately, this does not completely control the variance of the terms to maturity of the floating rate obligations within Money Market Funds.

MAXIMUM ISSUER CONCENTRATION

We request your consideration in lowering the Maximum Issuer Concentration.

- National Instruments, Section 2.1 Concentration Restriction currently limits the maximum exposure to any one non-government issuer to 10% of the net assets of the mutual fund. These diversification benefits can be significantly increased by lowering the maximum concentration to a suggested 5%. As was witnessed in the recent credit crisis, limited diversification may not have adequately smoothed the unsystematic risk events that would have impacted the principal value of certain securities, thereby jeopardizing the stability of the net asset value of the portfolio.

DEFINITION OF REQUIRED CASH OR READILY CONVERTIBLE TO CASH OVERNIGHT AND WITHIN ONE WEEK

We request your consideration in redefining the new liquidity requirements of subsection (d).

- Liquidity is defined in the proposal as cash or readily convertible into cash. As discussed in the Securities and Exchange Commission's (SEC) Rule 2a-7 Proposals, the definition of "readily convertible into cash" should be strengthened to define securities that mature or provide the legal right to receive cash. Certain funds may interpret the current form as holding the 'ability' to dispose of the security, while this assumption requires the support of a liquid market. It is important that a reasonable level of redemptions can be met by the natural liquidity of the portfolio.
- In addition, we would suggest increasing the required liquidity levels for overnight and within one week in line with the Securities and Exchange Commission's (SEC) Rule 2a-7 regulation to require 10% overnight and 30% within one week. The timely delivery of client redemptions is important to the credibility of the industry necessitating a higher required liquidity level. Encapsulated in the definition of overnight and one week cash should be a consideration of government securities within the money market fund as per the Securities and Exchange Commission's (SEC) Rule 2a-7 where all government securities are considered liquid within one day. The one week definition would also add government agency securities that mature within 60 days.

MAXIMUM WAM RESTRICTION

We request your consideration in lowering the Weighted Average Maturity limit to 60 days.

- Weighted Average Maturity is referred to here as defined by subsection (b)(ii).
- Reducing the minimum weighted average maturity limit from 90 days to 60 days will bring the Canadian regulatory framework for Money Market Funds in line with the U.S. SEC's proposal to Rule 2a-7 and the European regulator CESR's definition of a short term money market fund. The rationale for the reduction is provided by the SEC in that the lower level of volatility experienced by securities with shorter maturities provides greater assurance that the Fund can maintain a stable net asset value. These shorter maturities also tend to dampen the effect of interest rate risk and credit spread risk on the portfolio and therefore help dampen any resulting deviations from the CNAV.

EMBEDDED DERIVATIVES AND OPTIONS

We request your consideration in adding new restrictions to assets with embedded derivatives or options.

- Options and derivatives should not be exercised other than with the agreement of the Fund. This is important for notes commonly known as 'fixed-to-floaters' that can have final floating rate terms of up to 100 years if the call option is not exercised by the issuer at the end of the fixed coupon period. These notes are surprisingly common in Canadian Money Market Funds.

FOREIGN EXCHANGE EXPOSURE WITHIN MONEY MARKET FUNDS

We request your consideration in eliminating the allowance on foreign currency exposure.

- Subsection (c) currently allows for 5% of net assets to be denominated in a foreign currency. Volatility in the foreign exchange market can be significant and can have a material impact on the principle value of securities denominated in a foreign currency. The transactional exchange of foreign currency also adds additional counterparty risks. Even if the foreign exchange exposure is on a fully hedged basis, it is very difficult to fully eliminate any foreign exchange risk. In addition, hedged assets are inherently less liquid with the hedge having to be unwound at the time of sale of the asset. In order to remain consistent with your proposal to protect the objectives of Money Market Fund investors, we recommend eliminating the exposure to securities and cash denominated in a currency other than that which the net asset value of the mutual fund is calculated as this can only introduce additional risk into the funds with limited benefit to the shareholders.

MARK TO MARKET COMPARISON TO AMORTIZED COST

We request your consideration in requiring internal monitoring of the "marked-to-market" net asset value per unit of Money Market Funds that currently use the amortized cost method.

- A Money Market Fund aims to maintain a per unit / share amount at a constant value. The amortized cost method is the generally accepted valuation principle for determining the net asset value per unit for the purpose of the purchase and redemption of units, as this method provides a reasonable approximation of the fair value of short-term fixed income securities. Changes to the credit standing of an issuer or interest rates can significantly impact the market value of a security and there is a risk that the fund may not be able to maintain a constant net asset value per unit.
- We request your consideration in introducing a requirement for constant net asset value Money Market Funds to compare the market price of each security and the fund at a minimum frequency with the amortized cost valuation. Material differences should be investigated and an escalation procedure should be established to confirm eligibility for ongoing investment. We would suggest that the frequency of comparison of the mark to market and the amortized cost should be at least weekly in order to capture any meaningful deviation from amortized cost at the fund and security level as soon as possible.
- We would not recommend public disclosure of this "marked-to-market" net asset value, as per 2-A7 requirements, as it could have an unintended effect of causing greater instability within the money market funds.

We thank you for this opportunity to provide our comments and apologize for the tardiness of our submission.

Best regards,

Jim Huggan
Chief Investment Officer, North America
HSBC Global Asset Management (Canada) Limited.