Comments for "Money Market Fund Systemic Risk Analysis and Reform Options"

IOSCO General Secretariat:

Please see below Comments for "Money Market Fund Systemic Risk Analysis and Reform Options" report from CSRC Department of Fund Supervision. We prepared the comments based on industry consultation with money market fund managers in China.

I. "Systemic Risk Analysis" Section

1. Definition of MMFs (Question 1)

The definition of MMFs in this report or the target for the principals used for this report should be broader than just those with "daily liquidity". Some of the very short term redemption (weekly/monthly) fixed income funds should also be included in the category. Their requirements for credit quality and liquidity management are very similar to those of MMFs.

2. MMFs and short term funding markets (Question 3)

The relationship between MMFs and short term funding markets and the risk MMFs create for short term funding markets and its participants depends on the market share MMFs has in the short term funding market. It is important to note that this market shares are vastly different across jurisdictions.

3. Sponsor support (Question 4)

Sponsor support is very important. As many previous crises had shown, after a massive market drop, there is often a quick correction. If there is liquidity support during the critical period, many of the funds could survive the runs. This is similar to when a commercial bank experiences bank run, it will have a much better chance of surviving if the central bank could provide support. However, sponsor support only

provides limited buffer for the investors, as soon as the market sense uncertainties, the run could continue.

4. Importance of ratings (Question 8)

Since institutional investor's portfolios often have restrictions related to ratings, rating downgrades during a crisis could lead to forced sales and further contagion effects. One possible solution is to set minimum lead times between rating adjustments, this will provide more transparency for the timing of the rating adjustments, providing institutional investors additional opportunities to make portfolio adjustment decisions ex-ante of the rating change. This could lessen the amount of forced sell offs post the rating changes. Also, efforts should be made to strengthen the independence and fairness of third party rating agencies, there should be encouragement of further competition. Finally, most of the MMFs and short term fixed income funds are rated AAA although there are still difference in risk level. Further categorization or differentiation of AAA rated products would be helpful for better understanding and management of credit and liquidity risks.

5. Systemic risk analysis, other factors to consider (Question 11)

The report may want to mention that for each jurisdiction, regulatory decisions should be made based on the development stage and systemic importance of MMFs within the jurisdiction. An important reason why some developed markets are tightening regulations of MMFs is because MMFs hold an important position in the short term funding markets. Therefore MMFs are systemically important due to its function. However, MMFs vary in terms of scale and stages of development across the jurisdictions, and it is not representative or the norm for MMFs to hold a systemically important position in the financial markets. For emerging markets where MMFs are still at early stages of development and have not taken a prominent role in the short term funding markets, MMFs are just a minor participant in the short to medium term funding markets. Their scale, trading volume and overall importance does not justify systemic risk related regulations at the moment.

II. "Policy Options" Section

1. **Mandatory move from CNAV to VNAV (Question 12)**

There are various views on this issue:

a) Some industry participants believe the current CNAV is better. Since a mandatory move to VNAV only would not be able to prevent redemption runs during extreme market conditions. While in normal market conditions, CNAV is better for MMF's development. MMF is attractive due to its ability to provide relatively stable returns. If converted to VNAV, fund NAV will fluctuate with the market price of the underlying instruments. Investors could face loss of principals in the short run, dramatically decreasing the attractiveness of MMFs to some investors. Furthermore, once converted to VNAV, many institutional investors may have to rebalance portfolio, potentially leading to massive shift of assets from MMFs into bank deposits. Therefore, a framework that uses CNAV with a limit on its deviation from "shadow price", similar to the one used in China, will likely be a superior option to mandatory conversion to VNAV.

b) Some in the industry think CNAV and VNAV could co-exist. Some securities could use CNAV while others use VNAV. The focus of the reform options should be on how to minimize the risks related to the use of CNAV method.

c) If VNAV is used, some industry participants recommended a better understanding of VNAV MMFs. Efforts should be made to ensure a smooth transition from CNAV to VNAV. Further, mandatory change to VNAV may have broad and deep impact on investors, therefore time and investor education are needed before VNAV could be fully accepted.

2. **NAV buffers (Question 13)**

NAV buffers need to have a large enough scale in order to be effective and credible. The returns for MMFs are fairly low, while building up a NAV buffer will certainly increase cost. In the current age where base rates are near 0%, this additional cost may further deter investors from holding MMFs.

3. Insurance (Question 14)

The use of insurance products may create additional conflict of interest. The added regulatory requirements will also be too complex and burdensome for the funds.

4. Bank like regulations (Question 15)

MMF is an investment product by nature. Investors take on risk or share profit through the fund shares they hold, which is very different from the products under the banking regulations. In order for MMFs to develop healthily, MMFs should not be regulated like commercial banks. Instead, they should be regulated by the securities regulators along with the other mutual fund products.

5. Marked-to-market valuation (Question 19)

Since some of the instruments held by MMFs may have market prices that fluctuate often and broadly, market-to-market valuations may decrease the stability of MMF's NAV, which is not beneficial for guiding investors to make long term and rational investments. This method of valuation will also add additional cost and complexity to the valuation process. Further, given the market prices for certain instruments could only be estimated, the cost of constantly estimating these prices could be high.

6. Exceptions to marked-to-market principal (Question 20)

Valuation methods for MMFs should be highly uniform if not identical. Therefore room for differences in interpretation of the assumptions used for valuations could lead to issues.

7. Know your shareholders (Question 22)

Requiring fund management companies to know and analyze the backgrounds of their fund shareholders would be impractical and difficult to implement. Given most of the mutual fund products are distributed by external parties, fund management companies have limited opportunities to engage with fund shareholders directly and have limited shareholder information. An alternative solution is to segment shareholders using product design, focusing on attracting or repelling certain types of investors. Once investors are segmented by product, fund management companies could manage the liquidity of each product accordingly.

8. Redemptions in-kind (Question 26)

Many of the instruments held by MMFs have large minimum denomination and are traded only in OTC or inter-bank exchanges. The distribution of such securities to MMF investors would have many practical challenges and it would create more difficulties for the investors.