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Comments on Consultation Report on MMFs
"MONEY MARKET FUND SYSTEMIC RISK ANALYSIS and REFORM OPTIONS"

Capital Market Authority
Sultanate of Oman

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(Mail dated 1st June 2012 from ordmem@iosco.org)

Question 1:

Do you agree with the proposed definition of money market funds? Does this definition delimit an appropriate scope of funds to be potentially subject to the regulatory reform that the FSB could require to put in place, with an objective to avoid circumvention and regulatory arbitrage?

The basic definition for MMF should cover two issues. One is NAV and the second is it should be distinct from other investment funds. Hence it is an Investment fund that holds the objective to earn interest for the holders while maintaining NAV and maintaining portfolios which are comprised of short-term securities. Besides, MMFs are heterogeneous in character. MMFs also fit into CIS. Considering this the definition, probably, should reflect these characteristics. The proposed more or less covered the all the characteristics of MMFs. However more refinement in the definition is required. FSB regulations are fine and suitable to regulate these funds. Regulations for these funds in the respective countries where normally different types of funds are floated should adopt as per the requirements. Implementation of globally accepted principles and approach is a challenging task before IOSCO.

Question 2:

Do you agree with the description of money market funds' susceptibility to runs? What do you see as the main reasons for this susceptibility?

Basically the money market fund's purpose is to provide investors with a safe place to invest easily accessible cash-equivalent assets characterized as a low-risk, low-return investment. We do agree with the description of MMFs susceptibility to runs. However, the impact of financial crisis in 2008 changed the entire concepts of many financial instruments including MMFs. In fact there was no exception to the any instrument due to sub-prime effect. Among all, the

investors' behavior or panic or psychological nature shown greater impact on MMFs and finally resulted in heavy redemptions and more in case of institutional investors as observed.

Question 3:

Do you agree with the description of the role of money market funds in short-term money markets? To what extent this role may create risks for short-term funding markets and their participants? Are there changes to be taken into account since the 2007-2008 experience? What are the interdependencies between banks and MMFs and the risks that are associated?

Yes. Needless to say that there is a greater link between banks and MMFs due to funding short-term. Obviously, this follows with credit risk. Experiences during 2007-2008 may not take holistically to conclude the issue. The financial crisis's impact has a cascading effect on MMFs too. At the same time it should not ignored totally. There should be proper regulations for the disbursement of the short-term credit especially for MMFs. One of the main reason for this is the MMFs are concentrated in two major countries scoring around 90% of the total where the financial crisis took birth.

Question 4:

What is the importance of sponsor support for MMFs? What is the respective percentage of bank versus non-bank sponsors in the MMF industry? Are there differences among MMFs depending on their sponsors? What are the potential systemic risks of support or protection against losses provided by sponsors?

The sponsor support for MMFs are shown better safety and having risk bearing capacity historically. Even today it is an accepted structure in many countries. In fact banks took lead to sponsor MMFs and other non-banking institutions also playing a significant role. It is not advisable to give away with the sponsors. It is difficult to accept that the sponsor support has become an unreliable business model. To some extent we do agree that, due to increasing size of the industry, leading to contagion effects. In case of sponsored MMFs the risk factor must be addressed seriously by tight regulations.

Question 5:

Do you agree with the description of MMF benefits? Are there other benefits of MMFs for investors than those outlined in this presentation? What are the alternatives to MMFs for

investors? How has investor demand for MMFs recently evolved? What would lead investors to move away from MMFs to other financial products?

Yes. There are benefits of MMFs. The point is not the number of benefits matters rather the intensity of the issue. In case of crisis the liquidity plays a dominant role in MMFs. Secondly the support from the sponsors. Even the role of non-sponsor institutions also matters. These factors along with the expected NAV by the investors determine the benefits of the MMFs. Investors have multiple financial/ investment instruments across the markets. Diversification from the MMFs is mainly depends on returns (after tax) taking economic and political factors in to consideration. And most importantly it depends on the needed liquidity.

Question 6:

Do you agree with the proposed framework comparing money market funds and bank deposits? Are there other aspects to consider?

The comparison of any financial / investment instrument to with similar instrument defiantly results in some similarities and non-similarities. But each instrument is different from the other in many aspects. The same with the MMFs. Three factors viz., liquidity, risk, and returns plays significant role in opting between bank deposits and MMFs.

Question 7:

Are there other similarities or differences between CNAV and VNAV funds which would be useful for the analysis? Is there evidence (based on representative samples) showing differences in the fluctuation of the funds' NAV depending on their model? What is the extent of the use of amortized cost accounting by VNAV funds? Has this practice evolved over time?

Most of the similarities and differences are explained. However, one of the major differences between CNAV and VNAV is NAV values. In case of VNAV, which mainly depends on market fluctuations, the investor indirectly accepted the market effects. However in case of CNAV the investor is assured his returns and the investor can plan his future investments, which is uncertain in case of VNAV. At the same time to avail gains the investor has wait for long time in case of CNAV. The accounting process- amortization is advisable in both the cases. Yes. NAV defiantly depends on the model chosen. There must be evidences in some

other countries, which we are unable to at present because at present our market is not experienced with MMFs.

Question 8:

What is the importance of ratings in the MMF industry? What is the impact of the monitoring function of credit rating agencies for MMFs? What are the potential systemic risks associated with ratings in the MMF industry?

There is absolute necessary to make rating as mandatory. Now the question to be answered here is how many rating agencies rate the same Fund, which one accepted and why? There are no straight answers. One of the solutions is to mandatory implementation of CRA's code and makes them accountable for misgivings. The regulators' role in this is very significant. CRA must market accepted methodology in rating the Funds. This will probably solve the issue to a larger extent. Apart from all CRA must try their best get confidence of the investors on their ratings. If CRA taken care of methodology, accuracy in data collection, and adopting impartial method of rating the associated systemic risks can be eliminated.

Question 9:

Are existing rules adequately addressing risks regarding the management of collateral from money market funds? What are the risk management processes currently in place with regard to repo and securities lending transactions? Do MMFs present unique issues with regard to their use of repo markets or would general policy recommendations that the FSB may issue regarding repo markets be applicable?

Our market is not yet experienced with repo market as well as securities lending in MMFs. To our knowledge collateral management for MMFs is an issue before many markets. We agree that the FSB's general policy recommendations will certainly address the issue.

Question 10:

Are the above-mentioned changes in the environment of MMFs relevant factors to take into consideration? What are some of the implications for regulatory options? Are there other aspects to consider?

The points mentioned in the report are definitely having significance in designing the policies issues for MMFs and very relevant too. Reforms in tri-party repo markets will be having tremendous implications on the MMFs. The role between banking and non-banking institution in floating the MMFs must be clearly defined and uniform policy for both may not be sufficient, certain issues which affect the non- banking institutions may be addressed exclusively.

Question 11:

Do you agree with the systemic risk analysis and the rationale for reform presented in this section? Are there other factors to consider?

We agree the coverage of the factors related to systemic risk and the rational for reforms. However, the big question before this issue is that the role of regulators in clarifying applicable requirements to MMFs and CISs. There is uniformity in the types of the MMFs. Further, for the banking institutions floating MMFs the role of central bank also matters. There should be proper understanding between these two regulators and have to take all the factors before framing the regulations and while addressing the policy issues.

Question 12:

Do you agree with the benefits of imposing a mandatory move from CNAV to VNAV, which would amount to prohibiting the use of amortized cost valuation for any securities held by a MMF? Are the challenges identified in the US context valid in other jurisdictions currently authorizing CNAV funds? How could these challenges be overcome?

Yes there are certain major benefits for moving from CNAV to VNAV including prohibiting the use of amortized cost valuation. The fundamental question to be addressed here is that is it possible to make this move as a mandatory across the globe? If it is done it is excellent. Once for all MMFs industry will be free from many risks and to build the investors' confidence. In our opinion it is not necessarily the challenges faced by US market have valid in other jurisdictions on CNAV Funds. The challenges are country specific; hence it has to be addressed separately. However uniform policy is a guiding factor for MMFs.

Question 13:

What would be the main effects of establishing a NAV-buffer? What would be the most practical ways to implement such buffers? Should various forms of NAV-buffers be allowed or

should regulators favor a single option? What would be a realistic size of the NAV-buffer and what would be the impact in terms of costs for running MMFs? In the case of subordinated shares, could the option be seen as creating a securitization position, with associated requirements in terms of retention?

Among the four alternative versions for creating the NAV buffer the sponsor – funded NAV buffer looks most appropriate. On observation no version is risk free. There are multiple advantages as well as limitation for the each version of adopting NAV buffer. The selection of the suitable method mainly depends on the investors' behavior, their appetite for the investment, risk bearing capacity and most importantly implication of direct taxes. Hence it is difficult pinpoint single method suitable for universal application. It is challenge before the regulator to select and make it mandatory only one version of NAV buffer. With reference to the subordinated shares, subject to portfolio risk, it can be seen as creating a securitization position. However due the limitations how far this option is satisfies the need.

Question 14:

Do you agree with the description of the challenges associated with the establishment of a private insurance? Are there ways to address them?

Insurance coverage is one of best solutions for resolving the short term cash, risk, re4ducing capital loss for the investors etc. Private Insurance companies have to play big role in this. Obviously, this is a challenge before the authorities to implement effectively. We agree that the description has covered the challenges associated with the establishment of private insurance.

Question 15:

Do you agree with the description of the challenges and potential second-round effects of a conversion of MMFs into special purpose banks? Are there ways to circumvent those effects?

The idea of creating one more layer in the financial infrastructure to accommodate MMFs providing a separate identity is welcome. Now the issue is it is necessary? MMFs are one of the important investment vehicles for the investors. But how many countries are really giving importance for this instrument both in development as well as reforming regulatory structure. Around 90% of the industry is concentrated in two regions. These factors are to be considered before implementing the idea besides evaluating its pros and cons.

We have been experiencing the loopholes in the present banking system across the globe. . In fact banks are birth places for most of the financial crimes. Even today, there is need of addressing many types of risks faced by the banking industry. It is advisable to correct the existing system before adding one more layer to this even though it is not fully banking system. Regulators have to look into these issues before drawing conclusions.

Question 16:

What are the main advantages and drawbacks of two-tier system(s)? Would it be sufficient to address the risks identified? What could be the conditions applicable to CNAV funds? What could be the potential impact on investor demand? Should certain funds be exempted from certain risk limiting conditions due to their holdings?

Option to investors between CNAV and VNAV instruments is welcome. However the risks associated with each product remain the same, but there is choice for arbitraging between risky and less risky instruments. To larger extent this method addresses the risks. The impact on investors demand is not significant because they have option to move from one asset to another. Exemptions may not serve the purpose.

Question 17:

Do you agree with the suggestion that reserving CNAV funds for only certain investors (i.e. retail or institutional investors) would face practical challenges and would not be sufficient to address the risks identified?

In any market conditional investment may not be advised. Restricting investment by one segment of the investors for the financial instruments is not to be encouraged. Secondly, it gives an opinion that as if this branch of investors is only responsible for the expected risk as if other segment is safe and risk free which is not true in reality. In our opinion reserving the investment only for certain investors eliminate the risks associated.

Question 18:

Regarding the different structural alternatives described in Section 1, what are the benefits and drawbacks of the different options described above? How could they be prioritized? What are the necessary conditions for their implementation?

With reference to different alternatives, it is preferred to have one of the best structures like having both banking and non-banking structure and allowing both CNAV and VNAV options to all types of investors. However, clear rules, policies should be in place. Further, it is the responsibility of the regulators to design the policy, as far as possible, risk free for all the segments of the investors. In addition strict vigilance is necessary.

Question 19:

What are the main benefits and drawbacks of imposing the use of marked-to-market accounting for all the instruments held by MMFs? What is the availability of market prices for securities commonly held by money market funds? Are there situations where this general principle could not be applied?

For price transparency it is advisable to accept 'mark to market' method which is widely accepted and adopted. However the issue is availability of the prices. A suitable and acceptable methodology must be prepared and implemented by the Funds for the non-availability of prices. In case of CNAV this principle may not be suitable. Because the NAV is constant, this again depends on market fluctuations. A group of investors still prefer to have CNAV hence an option to implement this principle of mark to market may be given for this type of funds.

Question 20:

Should the use of amortized cost accounting be limited, and, if so, how? Are general restrictions on funds' WAM or WAL preferable? Are there practical impediments (e.g. availability of prices) to imposing stricter requirements on the use of amortized cost accounting than current existing regimes? What would be the potential effects on MMFs' investment allocation and short-term funding markets? What monitoring should be implemented? What conditions are advisable? In particular, please describe the rationale, feasibility and effects of limiting the residual maturity of instruments to [30-60-90-other] days. What materiality threshold could be proposed?

Alternative method for Mark to market i.e., Fair Value approach for certain portfolios are welcome by following CIS principles. The restriction to use of amortized cost accounting justifies avoiding matrix pricing and higher cost involved. This helps to provide greater price privacy too. The option – one – i.e. limiting the type of instruments allowed to adopt amortized cost accounting by considering maturity, credit quality etc. is welcome. The general restrictions like WAM or WAL is preferable. However WAM is more appropriate over the other. There will be direct impact on short term funding markets. Strict vigilance must

be adopted specifically, when the MMFs are more concentrated by the non-banking institutions.

Question 21:

What are the main benefits and drawbacks of imposing global liquidity restrictions? Should there be restrictions regarding (daily/weekly) liquid assets as well as regarding illiquid assets? Are global definitions of (daily, weekly) liquid and illiquid assets practical? Are there other conditions to consider (e.g. regarding the concentration of assets)?

Maintaining certain percentage of funds in liquid assets and reducing the percentage of illiquid assets always provides a buffer and safety which in turn helps to meet the redemption pressure. This is main restricted Fund-wise. Only through experience one can learn the benefits and drawbacks of global liquidity restriction. It is even difficult to visualize the success of this method. When we look at the definitions for liquid and illiquid – there is no uniformly accepted definitions for these assets. How far this is practicable is a big question. Basically one has to think the necessity of this and its benefits for the global investor community.

Question 22:

To what extent are managers able to "know their customers" and anticipate redemptions? Are there practical obstacles for managers to "know their customers" (e.g., in the case of platforms, omnibus accounts) and how could they be addressed? What are the main features of the funds' investor base to take into consideration from a liquidity risk management point of view? Should conditions, e.g., regarding the concentration of the investor base be considered? Would this requirement allow fund managers to better understand and manage the risks to which the fund is exposed?

Understanding and knowing, investors' behavior more particularly retail investors, as far as perfectly is essential. This can be made it possible by conducting Investors Meet and by conducting occasional investor surveys. To reduce all types of risks to a larger extend some regulators are issuing mandatory rules to know the investor by the market intermediaries providing services to investors. This mainly helps to address the omnibus accounts. In our opinion, for better understanding and managing the risk it is better to concentrate on

understanding the changes in attitudes and behavior of the investors rather than on their concentration in a particular Fund.

Question 23:

Would such a liquidity fee generate a pre-emptive run? If so, when and are there ways that pre-emptive run risk could be reduced? How would shareholders react to the liquidity fee? Would it cause shareholders to transfer their MMF investments to alternative investment products? If so, which types of shareholders are most likely to make such transfers and to which products and will such a shift in investment create new systemic risks or economic, competitive, or efficiency benefits or harm? Would MMF board directors be able to impose a liquidity restriction despite potential unpopularity with investors and competitive disadvantage imposed on the fund? At what level such a liquidity trigger should be set?

There are no straight answers for this. Keeping the liquidity feature, the Fund has to maintain the balance between redemption restrictions and charging liquidity fee. In both the cases there are some plus points and setbacks. It is impossible to conclude which method is most appropriate. In case of higher the liquidity fee charged there is every possibility that investors look for alternative products and move. This is a general phenomenon, trend and behavior of the investors those who give importance for the liquidity. To address the issue i.e., liquidity restriction by the board of directors, however advantage it is, have to conduct research and have through knowledge of the behavioral attitude of the investors to decide on the implementing the liquidity restrictions.

Question 24:

How would shareholders react to a minimum balance requirement? Would it cause shareholders to transfer their MMF investments to alternative investment products? If so, which types of shareholders are most likely to make such transfers and to which products and will such a shift in investment create new systemic risks or economic, competitive, or efficiency benefits or harm?

There are some advantages for both investor and the Fund by redemption restriction by putting minimum balance requirement. This provision along with other discussed above like charging liquidity fee etc. should be looked holistically. As such the question is similar to above there is no direct answer for this type of

questions. An extensive survey, including the questions related to economic, competitive, efficiency benefits etc. etc., probably gives better idea. At present we are lack of results of historical surveys.

Question 25:

What are the benefits of using bid price for valuing the funds? Are there other options (such as anti-dilution levy) which could be explored to reduce shareholders' incentive to redeem?

Valuation of fund by adopting Bid Price method has its own advantages and disadvantages too. However the success depends on the timing of the market of adoption and the behavior of the investors besides proper regulatory mechanism in place. It seems that the focus is on redemptions and how best to reduce it. Redemption mainly depends on liquidity and NAV besides other factors. The Bidding method should be used cautiously and it should not affect the investors' interest. Anti-dilution option may not work as a permanent solution.

Question 26: What are the benefits and drawbacks of allowing redemptions-in-kind? Are there practical impediments to implementing this option (e.g. some portfolio securities cannot easily be divided)?

This is one of the best options we suggest. Investors should have options to choose this option. Secondly partial acceptance in kind may be allowed. This indirectly helps the investors to build up their portfolios in the specified securities. The role of regulator is to frame proper guidelines for the adoption of the method by the Fund. The issues like 'non-transferable securities in certain jurisdictions' and 'in-divisible and large blocks 'can be addressed by the respective regulators. In electronic trading the issue loses its importance.

Question 27:

What are the benefits and drawbacks of requiring gates in some circumstances? Which situations should trigger gates to be imposed to redeeming investors? Would it be enough to permit gates in some jurisdictions? Would there be a risk of regulatory arbitrage?

Application of 'Gate' method is a negative approach which is not advisable IN GENERAL. Besides the functional objective of mutual fund is to provide liquidity to

the investors as well as to the market disturbs. The basic objective disturbs if the gate made as a tool to reduce or restrict the redemption pressure even during the crisis. Fund management should plan of crisis management by adopting a method of insurance. If there is no proper risk management especially to meet the redemption pressures during the crisis the goodwill of the FUND and confidence on the MMFs goes down.

Question 28:

Do you agree with the suggestion that the establishment of a private liquidity facility faces challenges that make the option unworkable or do you see ways to circumvent these challenges?

Yes. We agree and suggest implementing this option. This is one of the best risk management methods which can be adopted during the crisis. However as stated in the report precaution is absolute necessary before implementing. The right regulatory measures and mechanism must be in place. If it is rightly used this method is having more benefits as compared to drawbacks.

Question 29:

What are the main benefits and drawbacks of the provisions included in current regimes referring to external CRA ratings? Are there alternatives to credit ratings that reasonably can be substituted?

The reports explained most the issues related to referring to ratings. By analysis this it is clear that ratings are useful to the larger extent but, at the same time is not the only tool for identification or rating of either instrument or performance of the Fund. Secondly, external rating should not be made mandatory because of the one important reason that CRAs are accountable. The risk still exists. Since this industry is having experience in the market, most of the regulators already taken sufficient and efficient risk measures by adopting prudent rules and regulations, code of corporate governance etc. Still lot to be done in the area of external referring to rating and Iosco's did commendable in this. The proposed report on alternative standards and definitions of creditworthiness of the instruments by IOSCO on the recommendations of FSB may show remedy for this.

Question 30:

What are the benefits of MMF ratings? Should a greater differentiation between MMF ratings be encouraged? To what extent are investors restricted in their investments to 'Triple-A' rated funds? What alternatives could there be (e.g. from other third parties)? What initiatives could be proposed to educate investors about MMF ratings?

There are multiple benefits of the rating. It gives the knowledge about the quality of the instrument which paves for investment decision. But the multiple ratings by the different CRAs lead to investors confusion and doubts about the financial instruments too. Secondly there is uniform methodology adopted by the CRAs, besides there are not accountable. The regulator job is most important in this aspect. Rating is a guiding factor for investment. Triple –A rating definitely have positive impact on investing in a particular instrument but the wise investor also look into other factors also. Restrictions in Triple –A rated instruments may not be a solution to reduce the risk. Investors must be aware of the methodology adopted by the various CRAs and the reasons for different ratings for the same instrument. The role of Financial Advisor is significant in this aspect.

Question 31:

In addition to the options explored in the four sections above, do you see other areas to consider which could contribute to reinforcing the robustness of MMFs?

Almost all possible options and theirs pros and cons are explained in the study. However there is no straight and direct answer for the issue. These options are to be used based of the financial and regulatory infrastructure of the respective jurisdictions. Let us look in to the following.

1. The CRAs are not accountable for their own ratings.
2. Multiple ratings for the same instrument by different CRAs.
3. No uniform accepted methodology for rating.
4. There are circumstances that the same instrument is degraded by the same CRA with in very short time.
5. In most of the jurisdictions CRAs are not regulated by the market regulators.
6. Role of independent Rating Agencies and their responsibilities.
7. Implementation of code of corporate governance and professional ethics for CRAs.

There should be clear clarity and accountability while addressing the above issues. Probably this may solve the issues discussed in the report. The role of market regulators, international bodies are very important to achieve this.

Question 32:

Do differences between jurisdictions require different policy approaches or would a global solution be preferable, notably to ensure a global level playing field?

To our knowledge it is very difficult to fix up global solution for the CRA's policy. A general guidance and the overall methodology to be adopted by the regulators might help the individual regulators to frame the regulations as required by them. Each jurisdiction is separate in itself with regard to investment culture, investors behavior in their investment decisions, financial institutions infrastructure, regulatory structure etc. hence, in our opinion, it is better to have different policy approach for each jurisdictions.

Capital Market Authority Sultanate of Oman, June 2012

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