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Subject: Public Comment on Money Market Fund Systemic Risk Analysis and Reform Options

Dear M. Ben Salem:

Please find below Fitch ratings' comments in response to IOSCO's consultation report 'Money Market Fund Systemic Risk Analysis and Reform Options'.

Fitch's comment focuses primarily on those questions that touch on Fitch's rating criteria and related surveillance/research. It also addresses two specific areas in IMMFA's recent public comment to IOSCO on money market systemic risk and reform options (dated 25 May 2012) that relate to money market fund ratings criteria, as we wanted to clarify Fitch's position and correct any misunderstandings.

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?

We feel it's important to point out what we see as a significant misunderstanding or outdated view with respect to Fitch's MMF rating criteria and the topic of 'sponsor support' in IMMFA's response to IOSCO. On page 13 under Question Eight, IMMFA states that: "Broadly speaking, Standard & Poor's rating relates to credit risk; Moody's to credit and liquidity risk; and Fitch's to credit and liquidity risk, and to an assessment of the likelihood of sponsor support." This comparison and characterization is misleading and misrepresents our MMF rating criteria.

As required by regulation, our rating criteria is reviewed at least annually and revised as needed. We encourage you to focus on Fitch's updated MMF rating criteria report, which was published in March 2012. When rating MMFs, Fitch considers first and foremost the credit, liquidity and market risk of a MMF's portfolio, and in combination how these factors impact a fund's NAV stability and liquidity.

Fitch also takes into consideration the multi-dimensional role played by the fund's sponsor/manager in our criteria and ratings actions. However, this view of the sponsor is holistic and addresses the importance of the various roles played by the sponsor, including internal controls, investment decision-making, operational support, and acting as a potentially source of stability to the fund in times of stress.

For MMFs rated AAAmmf, Fitch states that the fund sponsor would typically be rated (or deemed to be rated) investment-grade and demonstrate an appropriate level of financial resources. We do not, however, opine on whether a sponsor is likely support a fund and nowhere does Fitch's current criteria refer to an 'assessment of likelihood of sponsor support.' On the contrary, we clearly state say: "Fitch recognizes that the fund sponsor is under no obligation to provide various forms of support to a MMF that is under stress."

Other credit rating agencies are in a better position to discuss their criteria and whether IMMFA's response to IOSCO is fully accurate. However, Fitch believes the areas of focus by all three credit rating agencies when rating MMFs are far more similar than suggested on Page 13 of the IMMFA response.

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?

Fitch expects the rated funds to be managed in a manner consistent with the assigned ratings and our MMF criteria. That said, our criteria allows for some reasonable 'cure' period when a portfolio deviates from published criteria. Fitch's MMF rating criteria expressly states that "a short grace period to remedy temporary deviations could be afforded….Fitch will seek to understand the cause of the deviation (from criteria) and dialogue with the fund management team whether a credible and achievable near-term remedial plan is in place." In Fitch's opinion, a short-term grace period in order to implement a remediation plan better serves the intended user of our ratings – investors – by avoiding unnecessary forced selling.

As a result, MMFs may temporarily deviate from the parameters outlined in the MMF rating criteria, provided a credible and achievable remediation plan is in place to address the deviation. Sustained, material adverse deviations will lead the rating to be placed on Rating Watch Negative (RWN) or lowered.

For rated MMFs, Fitch receives surveillance reports on a weekly basis normally, including portfolio holdings, redemption/subscription activity, portfolio NAV, WAM, WAL, and yield, among other data items. At any time, and in particular during periods of heightened credit and/or liquidity stress or material NAV deviation, Fitch reserves the right to seek information on a more frequent basis. This regular surveillance is an essential component of the MMF ratings process.

Fitch also performs periodic site visits and meets with senior managers responsible for portfolio management, credit analysis, risk management, operations, and legal/regulatory issues. In addition to these periodic meetings, Fitch may request access to senior management and other relevant parties, such as fund boards of directors, accountants, or legal counsel, as events may warrant. In addition to information provided by the investment manager or its representatives, Fitch considers other relevant external views, when available, such as industry or fund analysis from independent sources, including the media and trade publications, sell side research, and government reports or statistics.

Funds' surveillance information, key metrics, and analytical data are publicly available and regularly updated in the Funds Surveillance section of Fitch's Web site at www.fitchratings.com/FAM > Surveillance.

MMF snapshot reports are also published on a monthly basis, providing consistent and comparable portfolio analytics across all U.S. and European MMFs publicly rated under Fitch's Global Money Market Fund Rating Criteria. All data are based on fund surveillance reports received by Fitch from the fund administrators and fund managers.

Question 21 and Question 22:
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)?

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?

Liquidity risk is a function of the asset holdings and maturity profile of those assets, as well as the concentration risk of shareholders and their relative stability in times of stress. Fitch's criteria consider both dimensions, focusing on daily and weekly liquidity.

An MMF portfolio should be conservatively managed to meet potentially sudden, large investor outflows, at times of stress in which secondary market liquidity would be reduced or absent. The table below describes Fitch's criteria for eligible daily and weekly liquid assets. Fitch believes that maintaining some natural liquidity, especially in a stressed environment, through securities maturing overnight and within one week allows MMFs to reduce reliance on the secondary market liquidity to meet redemptions.

A well-diversified investor base helps mitigate the risks of large single withdrawals and simultaneous redemptions from investors affected by similar economic factors. Therefore, the ability of a fund to meet redemptions is closely related to the composition and diversification of shareholders by type and concentration.

Baseline levels of 10% daily portfolio liquidity and 25% weekly are viewed as consistent with 'AAAmmf' ratings. These baseline levels may be adjusted to take into consideration unique aspects of a fund's shareholder base, the overall level of concentration/redemption risk facing the fund, the results of any liquidity stress testing undertaken by the fund manager, and any other backup liquidity arrangements. For example, a fund with a high concentration in one type of shareholder or an over-reliance on less stable fund flows may need an additional liquidity buffer, whereas a more retail-orientated fund with a diversified shareholder base may be able to operate with lower levels of available liquidity.

As an additional portfolio liquidity consideration, Fitch analyzes rated MMF investments in assets that are judged to be nonmarketable or characterized by reduced secondary market liquidity and/or excessive price volatility. Exposure to such securities is considered in the context of overall portfolio composition and liquidity profile vis-à-vis the fund's shareholder base.

Daily and Weekly Liquid Assets

Liquidity Bucket	Eligible Assets
Daily Liquidity	
	Cash held with a custodian rated at least 'A' and/or 'F1' or equivalent.
	Overnight repurchase agreements.
	Shares of MMFs rated 'AAAmmf' by Fitch or the equivalent.
	Securities that will mature or are subject to a demand feature from an appropriately rated provider that is exercisable by the noteholder and payable within one business day.
	Direct obligations issued by highly rated sovereign governments benefiting from strong market liquidity[a], provided such obligations are issued in the portfolio base currency with remaining maturities of 397 days or less.
Weekly Liquidity	
	All of the above, plus:
	Securities that will mature or are subject to a demand feature from an appropriately rated provider that is exercisable by the noteholder and payable to the fund within five business days.
	Securities issued by highly rated supranational or government agencies benefiting from strong market liquidity[a] and with remaining maturities of 95 days or less.

[a]Securities rated in the 'AA' category or higher that benefit from strong market liquidity as measured by market size, trading volumes, and any other metric Fitch may consider relevant.

Source: Fitch

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?

MMF ratings are used by investors, such as corporate treasurers, local authorities, private banking clients, and other types of institutional investors. The key benefits of MMF ratings that they value, according to feedback we regularly receive, include:

- The risk mitigating elements provided by MMF rating criteria on credit, market and liquidity risks
- A clear profiling of rated MMFs, independent from the fund manager
- The ongoing monitoring of rated MMFs performed by credit rating agencies
- The regular and comparable information on rated MMFs available through our publications and web tools

Fitch assigns MMF ratings on a unique scale denoted by the 'mmf' subscript, ranging from 'AAAmmf' to 'Ammf'. Such MMF ratings are relative measures of a fund's capacity to meet its investment objectives of capital preservation and shareholder liquidity through managing credit, market, and liquidity risks, based on Fitch's criteria. Fitch notes that, currently, most MMFs are rated at the 'AAAmmf' level as there is little demand from fund managers and investors for 'AAmmf' or 'Ammf' ratings.

We strongly believe the market would benefit from greater use of the full MMF rating scale to better differentiate between the wide universe of MMFs with different regulatory frameworks and risk profiles. In addition, investors would benefit from the regular surveillance on funds conducted by rating agencies on a broader range of MMFs they invest in.

To that end, Fitch believes long-term educational efforts are necessary as there is little apparent demand from institutional investors for MMF ratings below AAAmmf. In fact, we are aware of instances where moneys have moved very rapidly out of MMFs that have been subject to modestly negative ratings activity, to a degree that was disproportionate to the magnitude of the rating action. We strive to contribute to these efforts through our regular communications, research and rating methodology developments, as well as through our direct interactions with investors.

Ratings are announced via press releases and can be accessed on Fitch's website (www.fitchratings.com), together with the relevant criteria report, which is regularly reviewed and updated. Ratings are updated at least annually and each update is subject to a press release.

In addition, Fitch publishes analytical information, comments and reports on a regular or ad hoc basis to inform MMF investors and other market participants on key features and developments relating MMFs.

Fitch's regular publication includes:

- Funds' surveillance information, key metrics, and analytical data, which are available and updated monthly in the Funds Surveillance section of Fitch's Web site at www.fitchratings.com/FAM > Surveillance.

- Monthly MMF snapshot reports also published on a monthly basis, which provides consistent and comparable portfolio analytics across all U.S. and European money market funds publicly rated under Fitch's Global Money Market Fund Rating Criteria. All data are based on fund surveillance reports received by Fitch from the fund administrators and fund managers.

- Quarterly or semi-annual sector update reports on US and European MMFs, commenting on major developments relating to MMFs in these regions and providing data on Fitch-rated MMFs or more broadly on the larger universe of MMFs, when data is available.

We are sure you would agree that it's important for investors and regulators to fully understand the methodology supporting MMF ratings. We sincerely hope this comment contributes to that end and are available to answer any questions you may have.

We appreciate your time and attention.

Sincerely,

Roger Merritt
Managing Director
Global Head – Fund and Asset Manager Rating Group