MUFG

Mitsubishi UFJ Kokusai Asset Management Co., Ltd.

1-12-1, Yurakucho, Chiyoda-ku, Tokyo 100-0006, Japan
Tel.+81-3-5221-6200
www.am.mufg.jp

16 August 2021

Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2, CH-4002 Basel,
Switzerland
By email: fsb@fsb.org

Mitsubishi UFJ Kokusai Asset Management

RE: Comments on the FSB Consultation Report: "Policy Proposals to Enhance Money Market Fund Resilience"

Dear Sir / Madam,

Mitsubishi UFJ Kokusai Asset Management appreciates the opportunity to comment on the Financial Stability Board's ("FSB") consultation report on the Policy Proposals to Enhance Money Market Fund Resilience, released on 30th June 2021. First of all, we will start by discussing the function and operation of Japanese MRF (Money Reserve Fund, which is equivalent to MMF in overseas), and then we will comment on the appropriateness of your policy proposals.

(1) Functions of MRFs in Japan

(i) Role of MRF in Japan

Money market investment trusts in Japan included products such as Medium-term Government Bonds Fund, MMF (Money Management Fund), and MRF (Money Reserve Fund).

- Medium-term Government Bonds Fund: Settled in 1980, liquidated in 2016. Investment in medium-term interest-bearing government bonds with maturities of 2 to 4 years.
- MMF: Settled in 1992, liquidated in 2016. Investment in money market instruments such as short-term public and corporate bonds, negotiable deposits, and commercial paper.
- MRF: Settled in 1997, to the present. Established as a settlement fund for the asset management accounts of securities companies. MRF is operated in the same way as MMF, but it is controlled more strictly in terms of the ratings and duration of investment targets. In addition to having the characteristic of a fund as a settlement account, it has functions such as daily liquidity and cashing.

Each of these funds is a daily settlement type fund and provides daily short-term liquidity as an investment trust. Under an MRF fund, the amount exceeding the principal of 1 yen per unit is paid as dividends on a daily basis (accumulated as accounts payable) in the course of daily settlement, subscription and redemption, and 1 yen per unit is kept in order to allow a fund to be subscribed. In other words, the mechanism is such that if the amount falls short of the principal of 1 yen per unit, no additional fund can be subscribed.

As the negative interest rate environment gradually became apparent from around 2014, there were concerns about whether the principal of the fund could be maintained due to a decrease in the number of money market instruments that could maintain the principal as investment targets and the risk of liquidity shortage. As a result, it was decided in 2016 that all of these daily settlement-type funds, except for the MRF, were to be liquidated early. One of the reasons why the MRF was not liquidated early was that it was an important fund incorporated into the settlement process as a settlement fund in the asset management accounts of securities companies.

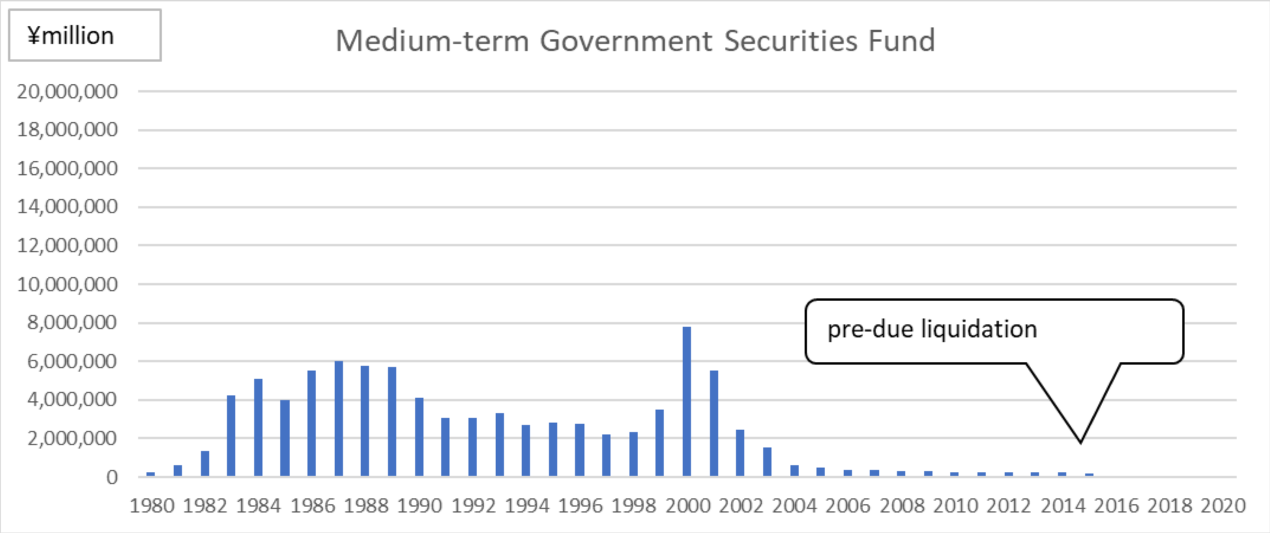
MRF is typically used as a pool of proceeds from the sale of stocks, bonds, investment trusts and such financial instruments by individual investors through a securities company. Or MRF is automatically purchased with funds deposited in the asset management account to purchase stocks, bonds, investment trusts and such securities. Such pooled funds for purchase are managed by the MRF until the actual purchase of securities, and the MRF is redeemed from the account on the purchase date of the targeted securities when the funds are paid and appropriated for the purchase. At the time, the MRF is settled on a daily basis, and the principal is always maintained at 1 yen per unit. This enables the MRF to be properly redeemed and appropriated for the purchase of securities, thus establishing a settlement system. Looking at cases where the principal is below par or MRF cannot be redeemed due to market fluctuations, if the principal falls below par due to market fluctuations on a respective date, the immediate processing of subscription or partial redemption for MRF will become impossible and the immediate cashability will be lost, causing a delay in settlement. Even if it is cashable, if only 999,000 yen in cash can be raised against the scheduled purchase of stocks worth 1,000,000 yen, the purchase in that amount cannot be made, disrupting the securities transactions of individual investors, and the continual settlement chain will collapse, causing a systemic risk.

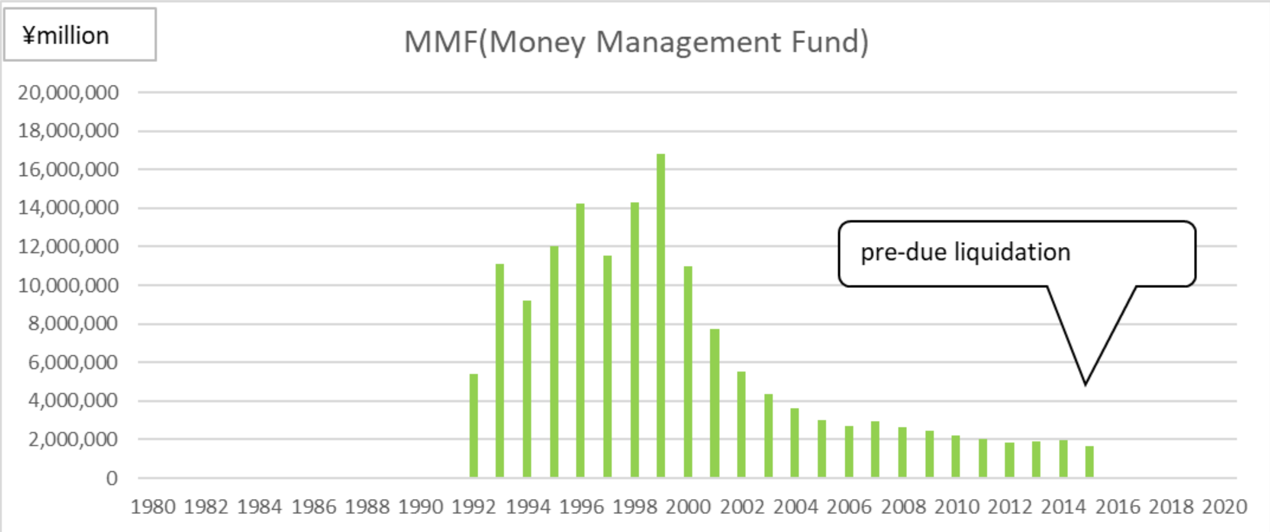
Since the introduction of the negative interest rate policy announced by the Bank of Japan on January 29, 2016 (went into effect on February 16, 2016), financial instruments with negative interest rate have become the mainstream in the money market. As measures to maintain the MRF principal, the following primary measures have been implemented:

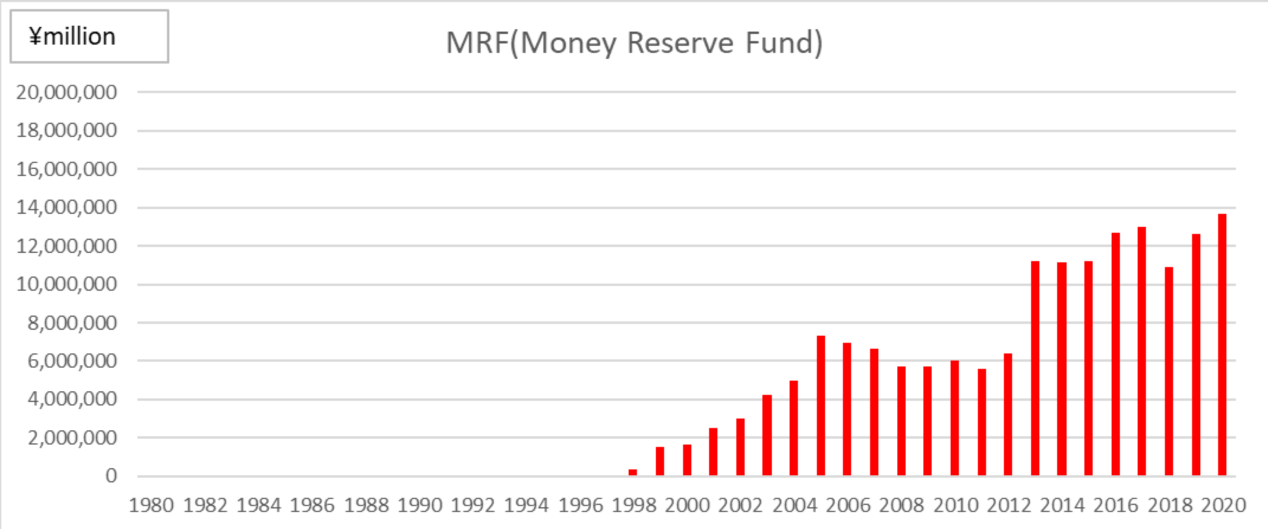
- waiver of trust fees and other expenses by the management company, etc.;
- negative interest charges on investee money trusts are to be borne not by investors but by the management company/securities companies;
- amendments of Financial Instruments and Exchange Act, in which “exemption from the prohibition of compensation” to provide for the potential shortfall in the principal.

Mitsubishi UFJ Kokusai Asset Management Co., Ltd.
1-12-1, Yurakucho, Chiyoda-ku, Tokyo 100-0006, Japan
Tel.+81-3-5221-6200
www.am.mufg.jp

＜Net Asset Value of Daily Settlement Type Funds＞







Data from The Investmetn Trusts Association, Japan

1-12-1, Yurakucho, Chiyoda-ku, Tokyo 100-0006, Japan
Tel.+81-3-5221-6200
www.am.mufg.jp

(ii) Regulations related to MRF in Japan

In order to maintain the principal of MRF as described in (i) above, and in response to the Policy Recommendations for Money Market Funds issued by the IOSCO, laws and regulations have been amended.

- ➢ Financial Instruments and Exchange Act: Article 42-2, item (vi) (Expansion of exemption to the application of prohibition of compensation of loss related to investment trusts for settlement)
- ➢ Rules of The Investment Trust Association, Japan "Rules governing the operation of MMFs":
  - Strictly limiting the acquisition and holding of MRFs to individual investors
  - Making the rating standards for securities in holding stricter than those for MMFs
  - Setting the average life in line with international standards: 90 days for WAL and 60 days for WAM
  - Setting valuation standards based on the amortized cost method in line with the international standards; e.g. internal and regulatory reporting standards for when the total value of the divergence between the market value and the appraised value exceeds a certain threshold
- ➢ Response by the management company, trustee, and distribution companies:
  - No receiving trust fees, trustee fees, etc. (Elimination of negative factors for net asset value)
  - If a money trust with negative interest rate is an investment target, such negative-rate charges shall be treated outside the trust assets and be borne by the company, not by the investor

(iii) Money market environment and MRF operations in Japan

As part of the investor behavior in Japanese daily settlement-type funds, there were no major redemption or such events in the past financial crises, at the time of the collapse of Lehman Brothers in 2008, or at the time of the market turmoil due to COVID-19 in March 2020, and there was no case when liquidity risk became apparent in Japan. This is due to the following main factors: MRF is a fund for settlement for an asset management account, beneficiaries are less likely to hold the fund for the purpose of pursuing profits, and MRF is considered to be equivalent to a bank deposit, serving as a means for evading risk rather than the fund from which beneficiaries need to escape to flight-to-quality. The FSB Report also analyzes that Japan did not experience stress at the time of the financial crisis triggered by the bankruptcy of Lehman Brothers and also under the market turmoil caused by COVID-19.

[In the past, there was a risk of a loss of principal due to the large-scale redemptions of Yamaichi MMFs caused by the voluntary closure of Yamaichi Securities (the principal did not fall below par after all) and a loss of principal in public and corporate bond investment trusts, such as MMF, caused by the bankruptcy of Enron (in this case, there was a shortfall of principal). These cases, however, were due to specific credit risk, and we view that they do not correspond to cases applicable to measures for bolstering resilience of MMFs to be applied uniformly under the MMF mechanism recommended by the FSB and the IOSCO.]

Due to the negative interest rate policy announced by the Bank of Japan on January 29, 2016 and enforced on February 16 of the same year, the negative interest rate environment has penetrated the market, and the amount of financial assets that can be invested through an MRF has decreased. Currently, the portfolio assets are approximately 80% in money trusts with negative interest rate charges and approximately 20% in commercial paper. As previously explained, the management company/distribution securities companies bear the negative charges in money trusts with negative interest rate charges and waiver the trust fees, etc., to maintain the net asset value of 1 yen per unit. Under such portfolio, liquidity is extremely high. Therefore, even should a liquidity risk stress occur, we will be able to adequately manage the stress under the current situation and therefore recognize that the vulnerabilities in Japan are smaller than those of MMFs in other jurisdictions.

Also, even if the investment environment is improved with the normalization of the interest rate market and the investment in securities recovers, it is unlikely that liquidity risk will materialize in the Japanese MRF market in view of the strict laws and regulations described above, product attributes and functions, and investor behavior among other factors.

(iv) Essential functions: Points to keep in mind when considering the policy proposals

We believe that there are points to note when applying the FSB's policy proposals to the functions and specific features of Japanese MRFs, as indicated below:

➢ 1 yen per unit should be maintained.
- Policy proposals include many measures that affect the redemption price, which is not appropriate to maintain 1 yen per unit.
- Although it is possible to assume the policy burden outside the trust assets, it is necessary to take into consideration the equality between the surrender beneficiary and the remaining beneficiary, and to sort out who should bear the burden, the beneficiary or the company.
- We also believe that it is difficult to systematize this mechanism because MRFs are widely used by both large and small securities companies.
- We do not recognize the need to implement further measures on top of the loss compensation measures currently covered by Japanese laws and regulations.

➢ Based on the current portfolio of MRFs in Japan, it is judged that there are few vulnerabilities.
- Under the current situation where money trusts account for 80% and CPs account for 20% of the portfolio, we believe that liquidity, though not robust, can be secured even in the event of large-scale redemptions. We view that the application of the proposed measures would be excessive and would not be effective even if implemented.
- Although some measures are considered to be effective under normal interest rate market conditions, we view that the implementation of such measures is premature in the current Japanese market environment, and it is considered appropriate to monitor the market environment to determine the timing of their application.

(2) Opinions to the Consultation

＜Overall＞

Q1 What are the key vulnerabilities that MMF reforms should address? What characteristics and functions of the MMFs in your jurisdiction should be the focal point for reforms?
A1 In view of the fact that risks did not become apparent in Japan under the stress of the financial crises in 2008 and 2020 and considering the current interest rate market environment in Japan and its unique operation of MRFs, we do not believe that it is appropriate to discuss vulnerabilities and implement uniform measures alongside other jurisdictions. We think it would be recommended to judge the appropriateness of various measures and the timing of their application while monitoring the monetary policy, interest rate environment, investment behavior of individual investors and other factors.

Q2 What policy options would be most effective in enhancing the resilience of MMFs, both within individual jurisdictions and globally, and in minimising the need for extraordinary official sector interventions in the future?
A2

1-12-1, Yurakucho, Chiyoda-ku, Tokyo 100-0006, Japan
Tel.+81-3-5221-6200
www.am.mufg.jp

The current MRF portfolio in Japan comprises 80% in money trusts and 20% in commercial paper. Although this composition is not intended to be constructed arbitrarily, we don't view it as being vulnerable. Since each jurisdiction has its own legal system and market practices, it is not appropriate to apply policy options globally on a uniform basis, and the decision on application should be made by each jurisdiction. Some jurisdictions have already applied some measures while others may not have adopted measures due to the circumstances of each jurisdiction.

Q3 How can the use of MMFs by investors for cash management purposes be reconciled with liquidity strains in underlying markets during times of stress?
A3 MRF in Japan has the role and function equivalent to those of bank deposits in securities companies. Under the current market environment, MRFs are not preferred as products for pursuing yields, and because their portfolio is unique in that 80% of the holding are money trusts, there is no stress (or minimal stress).

＜Forms, functions and roles of MMFs＞

Q4 Does the report accurately describe the ways in which MMFs are structured, their functions for investors and borrowers, and their role in short-term funding markets across jurisdictions? Are there other aspects that the report has not considered?
A4 The FSB consultation report analyzes and describes the unique points of MRFs in Japan compared to MMFs in the world in terms of the environment, beneficiary attributes, management status and forms of holding. We assume such analysis and description were provided since the main point of the discussion in the report is what measures to take in comparison with MMFs in the world. We think it would have been better if the discussion was developed to include the argument that measures need not be applied to Japanese MRFs.

Q5 Does the report accurately describe potential MMF substitutes from the perspective of both investors and borrowers? To what extent do these substitutes differ for public debt and non-public debt MMFs? Are there other issues to consider?
A5 We view that the substitutive role of Japanese MRFs is limited from the perspective of investors and borrowers, and there is no need for potential MRF substitutes. We have already considered VNAV products under the current negative interest rate environment, but there was no needs among investors in addition to that, the environment was not such that we can invest in public nor non-public debt products. Therefore these will unlikely hold as products.

＜Vulnerabilities in MMFs＞

Q6 Does the report appropriately describe the most important MMF vulnerabilities, based on experiences in 2008 and 2020? Are there other vulnerabilities to note in your jurisdiction?
A6

The MRF market in Japan did not experience stress from the financial crises in 2008 and 2020 (as stated in the FSB report). With regard to the risk of a loss of principal, we believe that there is no other point to keep in mind since the amended Financial Instruments and Exchange Act allows the exclusion of MRFs from the prohibition of compensation.

＜Policy proposals to enhance MMF resilience＞

While specific policy options are indicated, in light of the following characteristics of MRF in Japan, we view that it would be difficult to take part in the globally uniform adoption of policy options:

- Product attribute: 1 yen per unit is maintained, and if there is a shortfall of principal, no additional fund can be subscribed
- Since MRF has a settlement function in an asset management account, restrictions there are limited
- Current portfolio composition: 80% money trusts and 20% CP, resulting in an extremely high liquidity
- Preferences of MRF beneficiaries: Low moneymaking/profit-taking purpose
- Local restrictions, such as Japanese laws & regulations and voluntary rules

The table below outlines the main policy options and their appropriateness to Japanese MRF.

<Representative policy option and their appropiateness to Japanese MRF>

	Point of View				
	Maintaining per value (Yen 1 per unit)	Settlement function	Current portfolio (nearly cash)	Investor's behaviour	Regulation
Swing Pricing	×	×	×	—	▲
Minimum Balance at Risk	×	×	×	×	▲
Capital buffer	○	▲	▲	—	◎ (capital compensation)
Removal of ties between regulatory thresholds and imposition of fees and gates	▲	▲	×	—	▲
Removal of stabel NAV	×	×	▲	×	▲
Limits on eligibles assets	▲	×	▲	×	▲
Additional liquidity requirements and escalation procedures	▲	×	▲	—	▲

◎: already conducted, ○: acceptable, ×: intolerable, —: N/A, Not applicable

▲: ineffective, or some obstacles to be amended in law / rules

Q7 Does the report appropriately categorise the main mechanisms to enhance MMF resilience? Are there other possible mechanisms to consider? Should these mechanisms apply to all types of MMFs?
A7 In the past, the FSB and IOSCO have made policy proposals to address the vulnerability of general collective investment schemes. We see that, based on those proposals, analyses on MMFs were conducted and measures tailored to the characteristics of MMFs were identified. However, not all of these measures are uniformly applicable to MMFs across all jurisdictions, and we view that the appropriateness of such measures should be judged in accordance with each jurisdiction and market environment.

Q8 Does the assessment framework cover all relevant aspects of the impact of MMF policy reforms on fund investors, managers/sponsors, and underlying markets? Are there other aspects to consider?
A8 Yes, we think the aspects to consider are covered. In the case of Japan, we believe that special consideration should be given to the product characteristics of MRFs and their impact on settlement functions in the market.

Q9 Are the representative policy options appropriate and sufficient to address MMF vulnerabilities? Which of these options (if any) have broad applicability across jurisdictions? Which of these options are most appropriate for public debt and non-public debt MMFs? Are there other policy options that should be included as representative options (in addition to or instead of the current ones)?
A9 As mentioned above, responses should be taken according to the circumstances of each jurisdiction and market environment, and we think it is difficult to make a decision to apply them uniformly across jurisdictions. The table above shows the appropriateness/inappropriateness of each policy option.

Q10 Does the summary assessment of each representative option adequately highlight the main resilience benefits, impact on MMFs and the overall financial system, and operational considerations? Are there any other (e.g. jurisdiction-specific) factors that could determine the effectiveness of these options?
A10 The aspects to consider and their suitability are shown in the table above.

Q11 Is the description of variants and the comparison of their main similarities/differences vis-à-vis the representative options appropriate? Are there other variants to consider?
A11 We believe that each option has been properly analyzed and the impacts of options have been sufficiently reviewed.

Q12 Are measures to enhance risk identification and monitoring by authorities and market participants appropriate complements to MMF policies? Which of these measures are likely to be most effective and why? Are there

1-12-1, Yurakucho, Chiyoda-ku, Tokyo 100-0006, Japan
Tel.+81-3-5221-6200
www.am.mufg.jp

other measures to consider?
A12 In response to IOSCO's Peer Review, MMF vulnerability countermeasures have been adopted in each jurisdiction, and under such circumstances, recognition of the liquidity risk and its monitoring would be properly effected. Also in Japan, as mentioned above, daily settlement funds (except for MRFs) have been liquidated before their subscription periods, and the remaining MRFs are also subject to strict self-regulatory rules. In the current market environment, however, the MRF portfolio has an unusual structure (80% money trust, 20% CP), and as a result for better or worse, it has been able to achieve robust liquidity. We therefore view that the status of liquidity risk recognition and monitoring is more than sufficient. However, if asked whether they are effective, the response might be “Not effective.”

＜Considerations in selecting policies＞

Q13 Are the key considerations in the selection of policies to enhance MMF resilience appropriate? Are there other considerations that should be mentioned?
A13 We believe that the considerations and analyses provided in the policy proposals are sufficient and appropriate.

Q14 Which options complement each other well and could potentially be combined? What are the most appropriate combinations to address MMF vulnerabilities in your jurisdiction? Which combinations are most effective for different MMF types and their functions?
A14 Overlapped adoption of policy options may only complicate the implementation and may not be very meaningful, as a result. Each policy evaluation in regard to Japanese MRF is shown in the table above, and we have no opinion on combinations.

Q15 To what extent should authorities seek to align MMF reforms across jurisdictions? Is there a minimum set of policies or level of MMF resilience that should be considered at the international level to avoid fragmentation and regulatory arbitrage?
A15 As the beneficiaries of Japanese MRFs are limited to domestic individual investors, and the targets of investment are short-term yen-denominated financial assets, we do not think that MRFs will affect the systemic risk that has become a continuing international concern. We are not sure how much the cross-border distribution of MMFs of each jurisdiction and their interaction with each other exist and have impact, but we have no particular opinion on the standardization of cross-border application.

Q16 Does the report accurately describe problems in the structure and functioning of STFMs and how these have interacted with MMFs in stress periods?
A16 We observe that the analyses and descriptions in the report are appropriate.

1-12-1, Yurakucho, Chiyoda-ku, Tokyo 100-0006, Japan
Tel.+81-3-5221-6200
www.am.mufg.jp

Q17 What other measures should be considered to enhance the overall resilience of STFMs? How would those measures interact with MMF policy reforms and how effective are they likely to be in preserving market functioning in stress times?
A17 Japan is in an unusual environment with negative interest rates, and we feel the market is on a different plane from the discussions for other jurisdictions.

<Additional considerations>

Q18 Are there any other issues that should be considered to enhance MMF resilience?
A18 Nothing in particular.