Japan Securities Dealers Association
JSDA

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Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel, Switzerland

Comments on "Policy Proposals to Enhance Money Market Fund Resilience"

Dear Sir/Madam:

The Japan Securities Dealers Association[1] (JSDA) appreciates the opportunity to provide the following comments on "Policy Proposals to Enhance Money Market Fund Resilience" published on June 30, 2021 by the Financial Stability Board (FSB).

We would like to express our appreciation for FSB in its ongoing initiatives to address MMF vulnerabilities, which became apparent following the market turmoil caused by the COVID-19 pandemic in March 2020.

The JSDA primarily consists of financial institutions conducting the securities business in Japan. It is a self-regulatory organization that establishes self-regulatory rules regarding the securities broking and dealing business, as well as monitors and enforces said rules.

While asset management companies which manage MMFs are not members of the JSDA, the securities companies and banks that sell MMFs to investors are. In Japan, there are instruments called Money Reserve Funds (MRFs) that are classified as MMFs. MRFs, which are specifically prescribed under Japanese laws and regulations to be used for the purpose of settlement and pooling retail investor cash, and play an important role in retail investors' transactions. Since changes in MMF regulations may hinder the smooth use of settlement funds for such securities transactions, and may have a significant impact on retail and other investors; market participants including securities companies; and the proper functioning of the securities market as a whole; we hereby submit our comments to the public consultation.

We hope that the following comments will be thoroughly considered when discussing a broad range of policy options to enhance MMF resilience going forward.

[1] The Japan Securities Dealers Association (JSDA) is an association that functions as both a self-regulatory organization and as an interlocutor between market participants and various stakeholders, including government authorities. Its legal status is a Financial Instruments Firms Association authorized by the Prime Minister. Both functions operate independently. The JSDA is made up of approximately 490 members that include securities firms and other financial institutions running securities businesses in Japan.

- **Responses to Each Question**

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)?

(Opinion)
We believe that redemption fees and swing prices should not be applied to MMFs that are more cash-like. Moreover, even if redemption fees and swing prices are hypothetically applied to more investment-like MMFs, these costs should be borne solely by investors selling shares in large quantities, rather than uniformly across all investors trading the funds or fund beneficiaries. Furthermore, while such new regulations can potentially discourage investors' fund redemptions and reduce adverse effects on other beneficiaries, when applied to existing MMFs/MRFs in Japan, there is a concern that large investors will withdraw their capital when the regulatory changes are announced, as the nature of the instruments will change significantly.

Therefore, as described in the comment below for Q15, we believe that the regulators of each jurisdiction should be allowed to select regulatory options as deemed appropriate depending on the risks within each jurisdiction; striking a balance among the regulation's benefits, costs, and possibility of incurring unintended consequences.

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?

(Opinion)
The JSDA believes that, rather than considering a minimum set of policies to be adopted across jurisdictions, the discretion should be left to the individual authorities to select the specific policy options for MMF reform that are appropriate given the magnitude of the risks of MMFs and likelihood of regulatory arbitrage specific to that jurisdiction. If the FSB proposes a minimum set of policy options or policy combinations that are required to be adopted across jurisdictions, then it must also explicitly state that certain types of MMFs that are determined and can be reasonably explained by each authority as not susceptible to regulatory arbitrage between jurisdictions can be excluded from the scope of said policies.

In particular, when discussing policy options, MMFs which are marketed solely to retail investors should be considered separately from the MMFs that corporations and institutional investors can use for cash management and investment, as the risk of mass redemption and regulatory arbitrage are completely different. This distinction is also essential for the securities market to function properly as a recipient of investment from retail investors. In this regard, it is a significant oversimplification and thus inappropriate that the combination of specific policy options discussed in 6.2 of the report is described in terms of only two categories based on the MMF's intended functions (*i.e.*, cash-like versus investment-like).

For example, in Japan, the only MMFs currently being managed are Money Reserve Funds (MRFs), which are specifically prescribed under Japanese laws and regulations to be used for the purpose of settlement and pooling retail investor cash, and play an important role in retail investors' transactions. Furthermore, MRFs in Japan have the following unique circumstances.

(1) The AUM of MRFs in Japan is extremely small compared to the AUM of MMFs in the US and Europe.

The total net assets of MRFs in Japan is $126 billion as of the end of June 2021[2]. This accounts for only 1.4% of the total worldwide MMF assets under management (AUM), which stands at $8.8 trillion, according to the public consultation report. It is also only 2.6% of that of the US—the largest MMF market in the world with $4.8 trillion of AUM. Furthermore, compared to the end of June 2015, the AUM of MRFs increased by only 12.6%, and while the markets of other jurisdictions have experienced a significant increase in MMF AUM, such a phenomenon has not been observed in Japan.

(2) MRF transactions are limited, by the JITA's self-regulatory rules, to retail investor transactions that are using the funds for the purpose of settling securities at domestic securities companies[3].

Article 1 of the Rules Concerning the Management of MMFs, etc. of the Investment Trusts Association, Japan (JITA), a self-regulatory organization, prescribes that MRFs shall be acquired or held by individuals who are natural persons and intended to be used in the exchange of money related to securities transactions with securities companies in Japan. The investors of MRFs are therefore 100% retail investors, and MRFs can be considered highly domestic products. Consequently, by nature, MRFs in Japan have only the slightest possibility to be used for regulatory arbitrage between jurisdictions.

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[2] Based on statistics published by the JITA, *Changes in Assets of Publicly Offered Investment Trusts*. Converted into USD at USD1:JPY110.
https://www.toushin.or.jp/statistics/statistics/data/#long-term_time-series_date

[3] Since MRF has a settlement function in securities transactions of retail investors and plays an extremely important role in terms of convenience of individual securities transactions, the Bank of Japan decided that negative interest rate were not applicable up to certain amount of MRF, when it introduced negative interest rates in 2016.

(3) No significant outflows of funds have been observed in the past, even during times of market stress.

A withdrawal of funds large enough to damage underlying fund assets has never been observed in MRFs even during the market stresses in 2008 and 2020, and vulnerabilities such as those seen in other jurisdictions did not become apparent.

As can be seen from these unique circumstances, cross-border capital inflows to MRFs are unlikely to occur, and the market size of MRFs is extremely small. Therefore, the selection of policy options for MRFs should be proportionate to the aforementioned risks of the jurisdiction and the product. This is also aligned with the general principle of "Proportionality: Regulatory measures should be proportionate to the risks shadow banking poses to the financial system" underlined in the report "Shadow Banking: Strengthening Oversight and Regulation[4]" published by the FSB in 2011.

In addition, if a minimum set of regulations is required uniformly across all jurisdictions in order to address issues that have emerged in a few markets, these regulations will be applied even to financial products in jurisdictions where the risk is conceivably separate from other jurisdictions—despite, for example, a low or nearly negligible risk of regulatory arbitrage. In consequence, for certain jurisdictions, the cost and unintended impact/adverse effect of adopting the regulation may greatly outweigh its benefits. The idea that regulators should consider externalities also aligns with the one of the basic principles—"Focus: Regulatory measures should be carefully designed to target the externalities and risks the shadow banking system creates"—touched upon in the aforementioned FSB report.

The rules applied to MRFs already include provisions to ensure a certain degree of liquidity; however, if regulation is adopted that limits investment assets to a greater degree than the current rules—such as limiting the qualified assets of more cash-like MMFs to public debt instruments—it is possible that most MRFs will be unable to continue managing assets under negative interest rate conditions.

Furthermore, if a retail investor's settlement money pooled in a MRF is taken out of the MRF and transferred into a bank, this represents a loss to the capital market of valuable potential funds for investment. Also, the convenience for retail investors is significantly impaired; it will take more time and be more costly for the full settlement of the securities transaction as they would need to transfer

[4] FSB, "Shadow Banking: Strengthening Oversight and Regulation -Recommendations of the Financial Stability Board"
https://www.fsb.org/wp-content/uploads/r_111027a.pdf

money from a bank account to securities account with non-negligible transfer fees.

Considering the possibility that a uniform minimum requirement of policies may have unintended effects, each regulatory authority should be allowed to select appropriate policy options for their respective jurisdictions by weighing the possible benefits and costs, including the adverse effects, of adopting the regulation.

Sincerely yours,

HISHIKAWA Isao
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Japan Securities Dealers Association