

January 14, 2013

Secretariat of the Financial Stability Board  
c/o Bank for International Settlements  
CH-4002 Basel  
Switzerland  
Submitted via email: [fsb@bis.org](mailto:fsb@bis.org)

**RE: Financial Stability Board Consultation on Strengthening Oversight and Regulation of Shadow Banking – Work Stream 2: Money Market Funds**

Dear Sir/Madam

**Executive Summary**

J.P. Morgan Asset Management (“JPMAM”)<sup>1</sup> supports regulatory reforms that address structural vulnerabilities and decrease systemic risk in money market funds (“MMFs”). The reforms enacted by the US in 2010 and subsequently reflected in the Institutional Money Market Funds Association (“IMMFA”) Code<sup>2</sup>, in conjunction with the guidelines set down by the European Securities and Markets Authority (“ESMA”)<sup>3</sup>, were very effective in reducing risk taking, improving liquidity and disclosure, and have been important in ensuring the stability of the short-term fixed income markets; however, concerns remain about the susceptibility of MMFs to run risk, as well as the implicit support investors believe is provided by fund sponsors. The Financial Stability Board (“FSB”) has requested feedback on a series of recommendations proposed by the International Organization of Securities Commissions (“IOSCO”)<sup>4</sup> to address these risks, and JPMAM appreciates the opportunity to provide its perspective on these proposals, presenting a constructive assessment. There also exists a series of other policy measures that regulators should consider, including standby liquidity fees and enhanced transparency to investors, which could further reduce risk and aid investors in understanding the true nature and risk of their investments.

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<sup>1</sup> J.P. Morgan Asset Management (“JPMAM”) is the marketing name for the asset management business of JPMorgan Chase & Co.

<sup>2</sup> Institutional Money Market Funds Association, *Code of Practice*

<sup>3</sup> European Securities and Markets Authority, *Guidelines on a common definition of European money market funds*, CESR/10-049

<sup>4</sup> International Organization of Securities Commissions, *Policy Recommendations for Money Market Funds: Final Report*, October 2012

To demonstrate our commitment to enhanced transparency, three US-domiciled MMFs advised by JPMAM began to disclose their market-based net asset value (“NAV”) on January 14, 2013; JPMAM expects that other MMFs in our global range will follow this process in the near future. More frequent availability of market-based valuations will allow investors to better understand the nature of MMF risks and make more informed decisions regarding their investments in MMFs.

### Discussion of JPMAM in the MMF Industry

JPMAM appreciates the opportunity to comment on the FSB’s Consultative Document: Strengthening Oversight and Regulation of Shadow Banking. This response addresses the proposals from *Work Stream 2: Money Market Funds*.

JPMAM is one of the largest MMF managers in the world, with fund assets under management of \$412 billion<sup>5</sup>. In Europe, JPMAM manages nine ESMA-compliant “short-term money market funds” and one ESMA-compliant “money market fund”, totalling \$151 billion<sup>6</sup> in assets under management, including the JPMorgan Liquidity Funds – US Dollar Liquidity Fund, the largest stable NAV MMF in Europe, with assets of \$74.3 billion<sup>7</sup>. In the United States, it provides investment management services for 13 MMFs registered under the Investment Company Act of 1940 with assets totalling \$250 billion<sup>8</sup>.

### Role and Benefits of MMFs

By serving as an intermediary between borrowers seeking short-term funding and investors searching for a low risk cash management solution, MMFs perform a vital role in the process of capital creation and the short-term fixed income capital markets. These funds, which serve a broad range of investors all with similar objectives, have the following characteristics which have made them useful investment vehicles:

1. Daily liquidity. MMFs provide a convenient vehicle to invest incremental, often unpredictable, daily cash flows. Customers also benefit from the cash flow diversification achieved by the scale created through commingling their activities with other shareholders.
2. Administrative convenience. As currently structured, MMFs provide administrative efficiency. Tax and financial bookkeeping is simplified by the consolidation of investments into a single vehicle. The number of cash management transactions is greatly reduced and the need to track gains and losses separately from ordinary income is effectively eliminated as a result of the current ability to use amortized cost (stable NAV) accounting.

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<sup>5</sup> J.P. Morgan Asset Management, as of December 31, 2012

<sup>6</sup> Ibid.

<sup>7</sup> Ibid.

<sup>8</sup> Ibid.

3. Credit risk management. By regulation and standard practice, MMFs transact in a broadly diversified, low risk mix of investments. Advisory firms maintain professional staffs and due diligence processes to monitor, approve, trade and construct portfolios consistent with regulatory and professional standards. Replicating the professional standards is costly even for the largest corporate investors.
4. Competitive returns. MMFs are able to achieve competitive after-fee returns, making them a cost effective means of managing liquidity. The scale created by commingling of customer assets allows MMFs to more effectively structure investment tenors.
5. Sound governance. In the EU, MMFs will generally be regulated pursuant to EC Directive 2009/65, and therefore conform to the ESMA guidelines on MMFs. Further, UCITS<sup>9</sup> funds are governed by a Board of Directors and the assets held by an independent, regulated credit institution. In the US, MMFs are regulated under the Investment Company Act of 1940 and are governed by independent Boards of Trustees charged to oversee the fund's activities.

### Crisis of 2007-2009, and Financial Reform

While investors and policymakers appreciate the usefulness of MMFs, there is ongoing concern about whether there are systemic risks arising from this market. As observed by IOSCO<sup>10</sup>, although MMFs did not cause the crisis of 2007-2009, this period did highlight their vulnerability to significant redemptions and the implications thereof to the broader markets. The bankruptcy of Lehman Brothers Holdings Inc. and the collapse of the Reserve Primary Fund were quickly followed by a run on risk assets, including substantial redemptions from MMFs, and the freezing of short-term credit markets. Assets in US credit MMFs dropped by \$466 billion in September 2008 alone<sup>11</sup>, while \$122 billion flowed out of IMMFA short-term money market funds in Europe over the same period (see Exhibit 1).

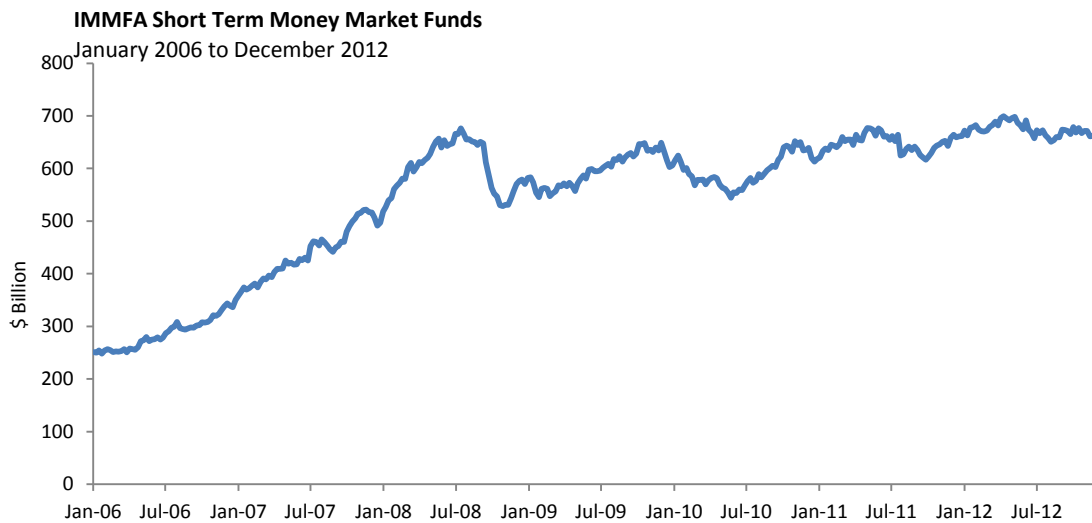
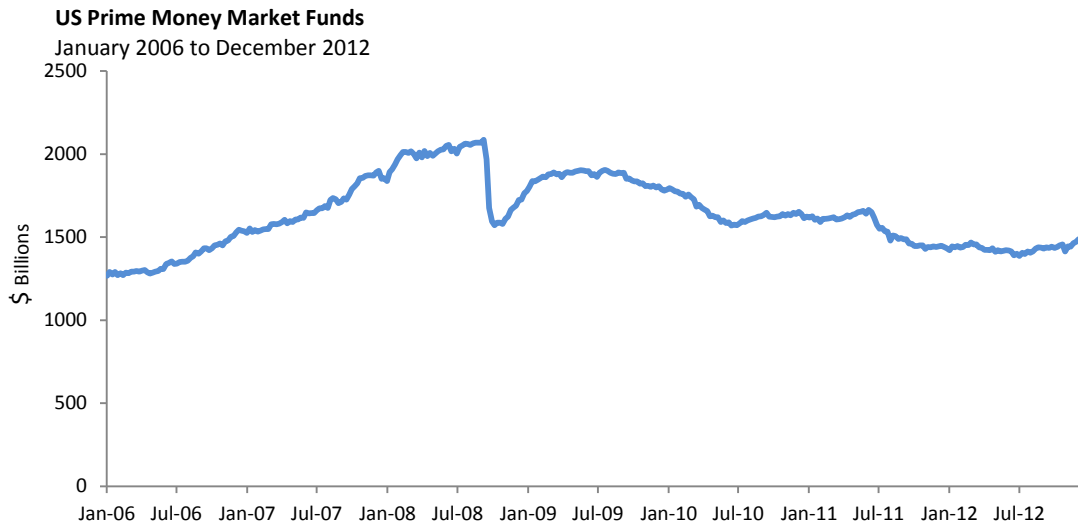
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<sup>9</sup> Undertaking for Collective Investments in Transferable Securities

<sup>10</sup> International Organization of Securities Commissions, *Policy Recommendations for Money Market Funds: Final Report*, October 2012

<sup>11</sup> iMoneyNet, September 2008 data

*Exhibit 1 – US and European money market fund assets<sup>12</sup>*



Since the crisis, there has been significant debate within the MMF industry and among regulators on the central role that MMFs play in the global markets, and the risks that they pose. In the intervening period since the start of the crisis, market participants and regulatory bodies have worked together to implement a significant set of reforms to the regulatory framework in which MMFs operate.

<sup>12</sup> US Money Market Funds – iMoneyNet, January 1, 2013; IMMFA Short Term Money Market Funds – iMoneyNet, December 28, 2012. Weekly data shown.

In Europe, a common definition of “money market fund” was established by ESMA. The guidelines published by ESMA comprised a series of impactful restrictions, including restrictions of weighted average maturity (“WAM”), weighted average life (“WAL”) and credit quality (see Exhibit 2).

*Exhibit 2 – Overview of ESMA classifications*

	<b>ESMA short-term money market funds</b>	<b>ESMA money market funds</b>
<b>NAV</b>	Either stable or floating NAV	Floating NAV
<b>Residual security maturity</b>	Equal to or less than 397 days	Equal to or less than two years provided interest rate reset date is less than 397 days
<b>WAM</b>	Equal to or less than 60 days	Equal to or less than six months
<b>WAL</b>	Equal to or less than 120 days	Equal to or less than 12 months
<b>Credit ratings</b>	Instruments must hold one of the two highest short-term credit ratings (A-2/P-2/F2 or above)	Instruments must hold one of the two highest short-term credit ratings (A-2/P-2/F2 or above). In addition sovereign issuances are permitted down to investment grade.

In the US, the Securities and Exchange Commission (SEC) made substantial enhancements in 2010 to Rule 2a-7 of the Investment Company Act of 1940, which governs the management of US stable NAV MMFs. The changes have resulted in significantly higher levels of liquidity, more conservative portfolios with higher average credit quality, and a more conservative maturity structure, including restrictions on WAM and WAL. Board powers to limit redemptions in connection with a liquidation, and enhanced transparency and reporting were also added (see Exhibit 3).

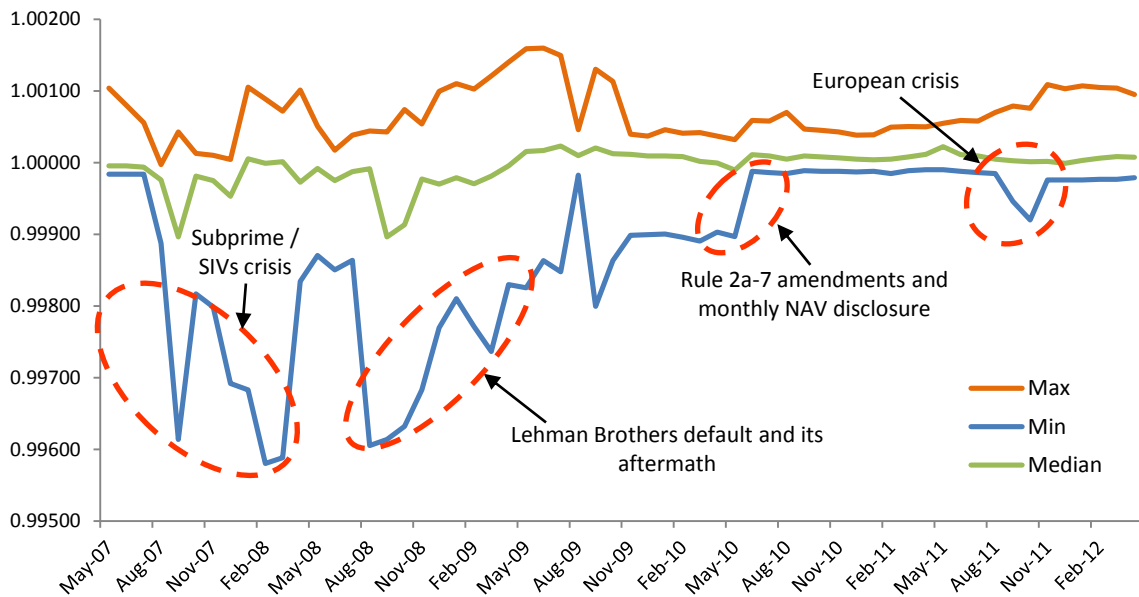
*Exhibit 3 – Overview of enhancements to Rule 2a-7*

<b>Credit quality</b>	Reduced exposure limit for second-tier securities Second-tier securities cannot be purchased with remaining maturities more than 45 days
<b>Diversification</b>	Restrictions on single issuer limits Higher collateral requirements for repurchase agreements for look-through treatment
<b>Liquidity</b>	Reduced exposure limits for illiquid securities <sup>13</sup> Minimum 10% of assets to have daily liquidity Minimum 30% of assets to have weekly liquidity
<b>Maturity</b>	Reduced weighted average maturity limits from 90 days to 60 days Weighted average life limited to 120 days
<b>Stress testing</b>	Boards to monitor the impact of hypothetical events such as interest rate changes, higher redemptions and changes to credit spreads
<b>Transparency</b>	Monthly disclosure of portfolio holdings to shareholders Monthly filings of portfolio holdings and calculation of market-based NAV with the SEC
<b>Board powers</b>	Boards permitted to suspend redemptions and postpone payments of redemption proceeds to facilitate an orderly liquidation

<sup>13</sup> Securities that cannot be sold within seven days at approximately the value ascribed to them by the fund

The reforms introduced in the EU and the US have already improved liquidity, reduced risk taking, improved disclosure, and have been important to ensuring the stability of the short term fixed income markets. As evident in Exhibit 4, the amendments to Rule 2a-7 resulted in a sharp decline in market-based NAV volatility in the US. In particular, the market volatility associated with the European sovereign debt crisis did not materially affect market-based NAVs. The 2011 crisis precipitated a run on risk assets in multiple asset classes across multiple European countries. Despite this, Exhibit 4 shows a smoothing of NAVs and a stemming of flows. This demonstrates that the 2010 reforms were substantial improvements that acted to greatly reinforce the industry’s ability to weather a significant crisis.

*Exhibit 4 – Impact of changes to Rule 2a-7 – Fitch rated US credit MMF market NAVs<sup>14</sup>*



Regulators have expressed concern about continued systemic risks resulting from run risks, as well as the potential implicit backing of the funds at a fixed euro/dollar by sponsors. In particular, regulators have identified the potential for MMFs to have a destabilizing effect on financial markets if there were a run with significant numbers of investors redeeming shares within a short period of time. A central concern that has been articulated is that MMFs that operate a constant NAV (“CNAV MMFs”) are particularly susceptible to runs because: a) investors are unaware of the market risks associated with these funds and b) the stable NAV creates a first mover advantage for early redeemers in the context of a market crisis.

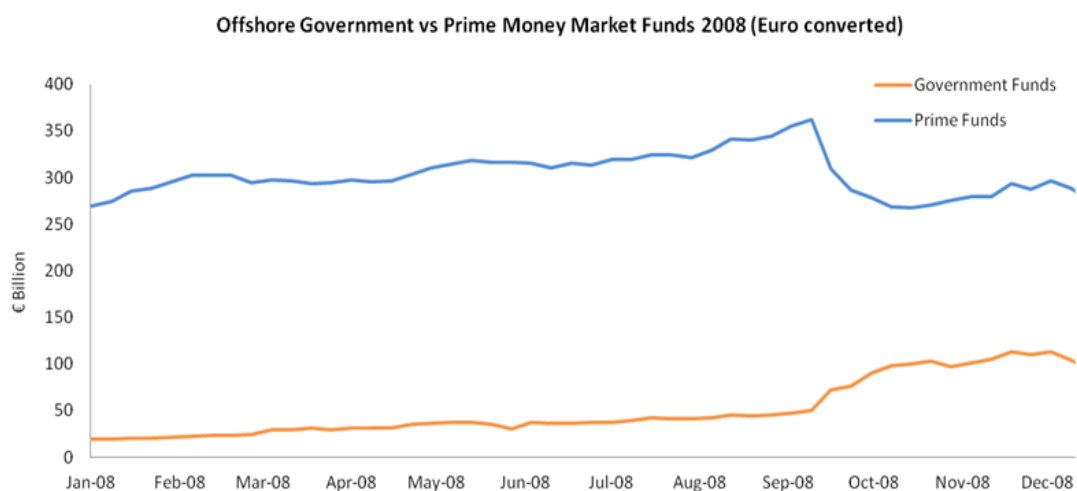
We share concerns about potential systemic issues and the proper disclosure to shareholders, as well as MMFs’ susceptibility to runs, which present challenges regarding equitable treatment among shareholders.

<sup>14</sup> Source: Fitch Ratings, Crane Money Fund Symposium, 2012

While the 2010 reforms in Europe and the US were essential, JPMAM believes further enhancements can preserve the many beneficial attributes of MMFs while addressing these concerns. Below we will provide our thoughts on the FSB/IOSCO recommendations and some additional commentary on other related industry matters.

As Exhibit 5 shows, only credit funds suffered runs on their assets and posed a systemic risk to the wider markets during the crisis. Government and treasury funds were a safe haven for investors leaving credit funds during the 2008 crisis, and government and treasury debt enjoyed excellent liquidity across the term spectrum. These factors separate government funds from credit funds, and we are unaware of evidence that government and treasury funds experienced runs or posed any systemic risk. As a result, the scope of any proposed reforms should be limited to credit MMFs at this time.

*Exhibit 5 – Offshore government versus credit MMF assets 2008<sup>15</sup>*



### Core Components of the FSB Proposal

The FSB endorsed the fifteen policy recommendations for MMFs published by IOSCO in October 2012<sup>16</sup>. JPMAM is similarly in agreement with many of these recommendations, with specific comments as expressed in this document.

***Recommendation 1: Money market funds should be explicitly defined in CIS regulation***

***Recommendation 2: Specific limitations should apply to the types of assets in which MMFs may invest and the risks they may take***

***Recommendation 7: Money market funds should hold a minimum amount of liquid assets to strengthen their ability to face redemptions and prevent fire sales***

<sup>15</sup> iMoneyNet, data as of December 28, 2012

<sup>16</sup> International Organization of Securities Commissions, *Policy Recommendations for Money Market Funds: Final Report*, October 2012

Explicitly defining MMFs in EU regulation, and setting restrictions on permitted investments, WAM, WAL, etc, is a logical development for fund regulation in Europe. Such regulation is already in place in respect of US-domiciled MMFs, under Rule 2a-7. In Europe, positive steps have already been taken in this regard with the development of the ESMA guidelines, which set out restrictions on eligible investments, credit quality, residual maturity, WAM, WAL, etc, and have established a robust framework for the control of the principal risks to which MMFs are exposed (interest rate risk, credit risk and liquidity risk).

In particular, consideration should be given to the effect that new European restrictions governing liquidity may have in reducing the level of risk in MMFs. The requirement for MMFs to hold an appropriate proportion of their assets in cash or securities that are sufficiently liquid to meet reasonably foreseeable shareholder redemptions is an important safeguard for the industry and for the wider financial markets.

Liquidity restrictions effectively mitigate risk. The level of liquid assets in a MMF takes on its greatest importance during a crisis, when the actions of some quick-acting investors may adversely impact remaining shareholders. During such a situation, an appropriate level of liquidity in a MMF can limit the impact of a run on remaining shareholders.

In the US, the 2010 introduction by the SEC of tighter liquidity standards was highly effective in reducing risk in MMFs (as evidenced in Exhibit 4). Similar liquidity requirements are already reflected in the IMMFA Code of Practice. Consideration should be given to introducing similar requirements expressly into European regulation. Taking the US/IMMFA standards a step further, a 50% monthly liquidity requirement could complement the daily and weekly requirements and provide additional safeguards to MMFs.

The FSB should also consider further clarification of requirements governing diversification. The increased diversification of underlying portfolio assets in combination with the other measures described above would be a reasonable way to reduce risk in European MMFs. Enhancements to the credit related portfolio constraints could act to further minimize the potential of a defaulted security having a material impact on the overall value of these portfolios. Building on this by applying exposure limits based on long-term issuer ratings and tenors could be an effective measure for reducing the impact credit events have on the perception of risk in a MMF portfolio.

The prudent management of credit risk is clearly paramount for a MMF, given that a credit event (or the perception that one is imminent) can facilitate a run. Implementing additional requirements that assist MMFs from taking on excessive credit exposures to a single entity and creating additional transparency around these exposures would further protect investors and reduce the likelihood of a run triggered by a credit event in a MMF portfolio.

Any regulation of EU MMFs should be introduced as part of the existing UCITS regulation, rather than developing a separate regulatory regime specifically for MMFs. The UCITS brand represents a globally-recognised standard that investors trust, and many have accordingly hard-coded the requirement for eligible MMFs to be UCITS-compliant into their internal investment policies.



*Recommendation 4: Money market funds should comply with the general principle of fair value when valuing the securities held in their portfolios. Amortized cost method should only be used in limited circumstances.*

*Recommendation 10: MMFs that offer a stable NAV should be subject to measures designed to reduce the specific risks associated with their stable NAV feature and to internalise the costs arising from these risks. Regulators should require, where workable, a conversion to floating/variable NAV. Alternatively, safeguards should be introduced to reinforce stable NAV MMFs' resilience and ability to face significant redemptions.*

The FSB drew particular attention to IOSCO's Recommendation 10 that CNAV MMFs should be converted into floating NAV ("FNAV") where workable.

In the US, CNAV MMFs currently hold \$2.70 trillion in US investors' cash assets<sup>17</sup>, and in Europe, CNAV MMFs comprise €493 billion<sup>18</sup>. There are a few important features of these funds, including same day settlement and the €1.00 NAV, which leads to simplicity in the accounting and tax treatment utilized by investors.

A requirement for CNAV MMFs to float NAVs would fundamentally reshape the product and its ability to deliver these core benefits to investors. Floating the NAV has the benefits of providing transparency of market values to investors and reducing the possibilities for transaction activity that result in non- equitable treatment across all shareholders; however, it will likely give rise to a number of consequences for investors and market participants that should be examined rigorously and addressed in order to arrive at a constructive solution.

To implement a floating NAV solution that preserves the utility of CNAV MMFs for cash managers, a move to FNAV will need to carefully consider and address the following considerations:

#### **Accounting Treatment for Investors**

Due to the nature of CNAV MMFs, they have generally been classified as **cash equivalents**. The Financial Accounting Standards Board ("FASB")'s Generally Accepted Accounting Principles ("US GAAP") codification defines cash equivalents as short-term, highly liquid investments that have both of the following characteristics: a) readily convertible to known amounts of cash, and b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. US GAAP currently provides a specific exemption for MMFs to allow them to be treated as cash and cash equivalents, provided that the NAV is stable and not impaired. This definition reinforced the efficacy of CNAV MMFs as a cash investment solution for investors and serves as a critically important attribute of the product as it enables those investors to include their CNAV MMF assets in net leverage ratios which may have material implications for the availability and cost of financing as well as compliance with any debt covenants.

The introduction of a floating NAV regime may create uncertainty for businesses, both large and small, and their accountants with respect to the appropriate balance sheet classification for FNAV MMFs going forward<sup>19</sup>. The treatment of FNAV MMFs as cash equivalents is warranted

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<sup>17</sup> The Investment Company Institute, January 2, 2013

<sup>18</sup> IMMFA, January 2013

<sup>19</sup> Local regulation in France already specifically defines FNAV MMFs as "cash and cash equivalents".

for several reasons. The portfolios of these funds are comprised of instruments which if held directly would typically be classified as cash equivalents (e.g. T-bills, short-term agency obligations, commercial paper, repurchase agreements). Overall weighted average maturity and life of the underlying money market portfolio is sufficiently short (ie a maximum of 60 days and 120 days respectively) to limit to a de minimis amount the fluctuation in the underlying value of the portfolio. The classification of FNAV MMFs as a cash equivalent is essential to the investors that invest in MMFs. If FNAV MMF regulations are adopted, regulators should work with the FASB/IASB<sup>20</sup> to ensure that a specific exemption is provided in US GAAP/IFRS<sup>21</sup> to allow investors, pursuant to UCITS, to continue to receive cash equivalent treatment.

### **Tax Treatment of Gains and Losses**

Careful consideration should be given to the diversity of tax regimes across European member states. In particular, there will be operational impacts on fund administrators who have to produce, together with the FNAV, a range of bespoke tax numbers for a variety of countries in Europe (for example, Germany, the United Kingdom, Austria and Switzerland). It may be that system enhancements are required to continue to support such tax reporting after this change. It is likely, for those countries that do not apply tax transparency principles, that gains in a FNAV MMF will be considered as capital rather than income. This may have different tax impacts for investors depending upon if there is a different tax rate for income and capital gains for that particular investor. The UK operates a simplified tax reporting system for CNAV MMFs which apply for UK reporting fund status – the FNAV MMF would not qualify for this simplification.

### **Operational Issues will Require Significant Transition Time**

A move to a floating NAV will require workflow and operational changes to multiple processes in order to accurately price and settle fund share activity on a daily basis.

- Existing pricing and valuation infrastructure is not set up for supporting a FNAV and same day settlement. In order to maintain same day settlement, the infrastructure supporting MMFs, including pricing mechanisms, will require significant enhancements and partnership with industry vendors.
- Many transfer agents cannot currently support a floating NAV with same day settlement (t+0) and would need to enhance recordkeeping systems to accommodate this new fund type. The cash versus fund share activity and other daily audit controls will condense to the end of the day, introducing additional time constraints and *heightened risks*.
- Financial intermediaries distribute MMFs via various channels including a significant amount through sweeps and portals. Each will need enhancements. The stable NAV is the mechanism that facilitates the efficient movement of assets into and out of the products on a daily basis. Certain channels may no longer be supported in the floating NAV scenario. Many financial intermediaries are not set-up for a daily floating NAV for MMFs and have said that a significant amount of programming would be necessary to support a change.

Consideration should be given to providing a significant implementation/transition time so that the operational issues above can be effectively worked through and solved. A long transition time could help to mitigate run risk and disruption of funds as investors elect to monitor the

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<sup>20</sup> International Accounting Standards Board (“IASB”)

<sup>21</sup> International Financial Reporting Standards (“IFRS”)

impact of the new FNAV requirements and avoid a higher concentration of investors to a smaller less diversified universe of MMFs.

### **Industry Viability and Outflow**

Investors have expressed strong concerns about the complexity from an accounting, tax and operational perspective associated with FNAV MMFs under the current regulatory framework. Recent market surveys of existing US corporate treasurers found that between 77% and 79% of respondents would reduce or eliminate the use of MMFs if their per share NAVs were forced to float<sup>22</sup>. In addition, accessibility would likely be materially diminished for those that remain active: automated investment sweeps are a dominant access point for MMF investing activity, with our own corporate treasury survey's finding 52% of US investors utilizing this kind of service to facilitate investments of their excess cash<sup>23</sup>.

An implication of the various FNAV-related operational issues is that the number of intermediaries capable of making sweeps to MMFs available to their underlying investors should be expected to shrink materially, particularly in the near-term as the industry adjusts and market participants gauge outflow and reallocation activities by investors. The market feedback to date implies that this sort of structural change may result in a substantial reduction in assets, investors and intermediaries participating in the credit MMF segment; however, some of the market feedback may be due in part to the level of uncertainty and collateral effects that are triggered by a change of this scale. Although it is difficult to quantify, some proportion of these investors may be encouraged to remain active participants in the credit funds if the industry and regulators establish a comprehensive set of proposals and policies.

### ***Recommendation 6: Money market funds should establish sound policies and procedures to know their clients.***

Requirements that enable managers to have a better understanding of the type of investors in the funds will allow managers to better manage for risks that may arise from high shareholder concentration and to better monitor subscription and redemption cycles. These would be positive steps for the industry's ability to manage potential MMF risks.

IOSCO is correct to acknowledge the current practical impediments in monitoring investors in omnibus accounts. Steps to encourage distributors/agents to provide better information to MMF managers on the underlying investor bases in omnibus accounts, in terms of concentrations, investor types and trading patterns, would be protective for existing MMF investors and therefore positive for the industry.

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<sup>22</sup> See Treasury Strategies Inc, *Money Market Fund Regulations: The Voice of the Treasurer*, Findings and Conclusions, Floating NAV Proposal, (April 2012), pg 11 and Association for Financial Professionals and RBS, *2012 AFP Liquidity Survey, Report of Survey Results*, Key Findings of the 2012 AFP Liquidity Survey, (July 2012) pg 3

<sup>23</sup> J.P. Morgan Asset Management, *J.P. Morgan Asset Management Global Liquidity Survey 2011*, Cash and Liquidity Concentration, (2011), pg 31

*Recommendation 9: Money market funds should have tools in place to deal with exceptional market conditions and substantial redemptions pressures*

In Europe, UCITS funds provide a number of safeguards in this respect. The UCITS Directive provides for the temporary suspension of redemptions in exceptional circumstances and where suspension is justified having regard to the interests of the shareholders. This ability to suspend is a powerful tool for situations where the market conditions may cause a "run" on the fund. Suspension would allow the fund to stabilise and reduce first mover advantage. In accordance with Luxembourg law, fund prospectuses must specify the conditions under which the Board of Directors of the funds has the power to suspend the issue, redemption and switch of shares in the funds.

European regulation and practice also allows the operation of what is sometimes referred to as a "gate" or "scaling provision". For example, if redemptions of more than 10% of the total number of shares in issue of any fund are received on a particular day, such redemptions may be postponed to the next day. These redemption requests are then given priority over other requests on subsequent days. Although not frequently utilised, this form of gating provides relief for the fund in circumstances where a substantial number of redemption requests are received. This, combined with the ability to suspend, provides the funds with significant protection to deal with exceptional market conditions and substantial redemption pressure.

**Standby Liquidity Fee/Gates**

There have been numerous proposals discussed globally regarding standby liquidity fees ("SLFs"), and "gates" that suspend redemptions. These proposals have considerable merit and should be given serious consideration; however, it is important to recognize the benefits and limitations of SLFs and this form of gating.

Broadly speaking, proposals have focused on a "trigger point" that activates a liquidity fee and gate. For example, the trigger point could be tied to some combination of a fund's liquidity level and the market-based NAV, eg when weekly liquidity falls below 7.5% or the market-based NAV reaches 0.9975. Once a fund hits a trigger point, a gate is imposed suspending redemptions. The fund's Board of Directors may then choose to re-open the fund, provided shareholders pay a non-refundable liquidity fee, suggested to be 1% of redemption proceeds to redeem their shares.

In particular, the standby character of these proposals appropriately balances the goal of allowing MMFs to operate normally when not under stress, yet promote stability, flexibility and reasonable fairness when stressed. If a run on a fund has begun, such a gate can help to mitigate that run. Funds that re-open with a SLF will require investors to pay an appropriate charge for the liquidity they require. Investors who do not need liquidity will not be disadvantaged by remaining in the fund.

However, such gates and SLFs with objective triggers will prompt investors of those funds to require full and frequent disclosure of those objective triggers. Any fund that is in jeopardy of breaching a trigger will likely see significant redemptions ahead of the actual trigger event. Therefore, it is important to recognize the limitation of SLFs: they do not prevent an initial run, but they do provide a useful tool to slow the run after it has begun.

## Capital

In our experience, liquidity concerns are fuelled by credit events. In the past sponsor capital used at the discretion of sponsors has generally been effective in preventing idiosyncratic risk in a single fund leading to a broader systemic issue across the industry and short term funding markets.

There are a number of ways that capital could be funded, ie by sponsors, shareholders or third parties, and a number of ways it could be structured, ie first loss reserve used only upon liquidation or a buffer that absorbs day-to-day fluctuations in market-based values. While there are some distinct benefits to capital, there are also challenges that should be addressed.

### *Benefits*

- Accessing a dedicated amount of sponsor support only upon the liquidation of a fund and providing a fixed amount of capital makes investors more cognizant of the limits of capital protection.
- A dedicated amount of sponsor support could lead to "right sizing" the industry. Those sponsors managing larger credit funds would be required to have the appropriate access to capital.
- A dedicated amount of sponsor support can be made available more quickly and aligns the interests of the sponsor with the investors' interests of proper risk taking and credit oversight. Shareholder capital aligns the cost of liquidity and the €1.00 NAV of the fund to the shareholder.

### *Challenges*

- To the extent that sponsors are required to provide a dedicated amount of sponsor support, additional guidance would be necessary to clarify that consolidation of the MMF is not required onto the financial statements of the sponsor under the applicable accounting rules.
- Given a low rate environment (such as that currently experienced in markets globally), the amount of time required to build up a sufficiently-sized buffer by withholding shareholder income would leave investors exposed for an extended period of time until the buffer grows to sufficient size.
- Capital that is not dynamic in funding can "lag" as assets in a MMF grow, leaving the actual support available underfunded.
- Capital requirements can create barriers to entry. With regard to shareholder funded buffers, once existing funds have fully funded their required buffers, new funds would be challenged to attract investors. Investors who delay their share purchases would receive all the benefits of the reserve but incur none of its costs. With regard to a dedicated amount of sponsor support, sponsors without access to capital would find it difficult to enter or remain in the market.

Size of the capital support is key. JPMAM has conducted extensive work on this topic, which we are happy to share with regulators. Given the high quality nature of the assets held in MMF portfolios, the optimal capital level must strike an appropriate balance, addressing MMF risks such as minimizing credit default risk, without becoming uneconomical for sponsors or investors. Our research suggests the optimal size is within a range of between 50bps and 100bps. Additionally, where capital support is utilized as a first loss position upon liquidation,

the level of capital available can be tied to a MMF's highest asset levels. This can result in a structure whereby, as redemptions accelerate and cause the unrealized loss per share to increase further, the amount of capital support available per share increases accordingly, providing further capital support to the remaining shareholders that do not redeem their shares.

Ultimately, the capital's source – sponsor or shareholder – is less important than applying consistent risk measures across the industry and ensuring the capital is callable and useable under a proper regulatory framework. The key is that capital be funded upfront and that it remains dynamic in order to be consistently appropriately sized for any asset growth.

*Recommendation 13: MMF documentation should include a specific disclosure drawing investors' attention to the absence of a capital guarantee and the possibility of principal loss.*

*Recommendation 14: MMFs' disclosure to investors should include all necessary information regarding the funds' practices in relation to valuation and the applicable procedures in times of stress.*

As the industry and regulators continue to work towards a constructive solution, JPMAM believes the theme of transparency should play a central role. Transparency and disclosure are strong themes already embedded in European regulation via the UCITS Directive. UCITS law provides for extensive disclosure in the prospectus, the Key Investor Information Document ("KIID") and the half-yearly and annual reports. These contain an overriding requirement that the prospectus contains the information necessary for investors to be able to make an informed judgement of the investment proposed to them and in particular of the risks of such investment. A clear and easily understandable explanation of the fund's risk profile must also be included. The prospectus must also contain certain other detailed information regarding the fund's operation, for example details of the types and characteristics of the units, the types of investments made by the UCITS and its use of financial derivatives. The valuation rules must be set out in the prospectus and this includes any method used in times of stress.

The combination of the requirements for the prospectus, KIID, and half-yearly/annual reports provides a robust disclosure regime for the protection of investors in UCITS funds, into which further enhancements such as specific risk disclosures could be built.

Recognizing the central role of transparency, on January 14, 2013, three US-domiciled credit MMFs advised by JPMAM began disclosing their market-based NAVs each business day. All redemptions and subscriptions for the funds will continue to be processed using the stable NAV determined under the amortized cost method of accounting consistent with the provisions under Rule 2a-7. (The funds' per share market-based NAVs have historically been calculated at least weekly, and since December 2010, have been disclosed monthly to the SEC and released to the public on a 60 day lag.)

The steps that JPMAM is taking will not impact the operation of the funds and will allow investors to continue to rely on the funds for short-term liquidity and investment diversification, while providing an additional layer of disclosure. This will allow investors to better understand the nature of MMF risks and make more informed decisions regarding their investments in MMFs.

JPMAM expects that other MMFs in our global range will follow this process in the near future.

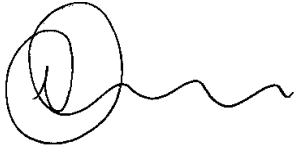
## Conclusion

JPMAM appreciates the opportunity to comment on the FSB's recommendations. We acknowledge regulators' efforts to research, consult and define a set of solutions to ensure the stability of the MMF industry and the broader financial system, while preserving the viability of this industry for investors and the short-term capital markets.

It is evident that there is no single "solution" to address the systemic concerns around MMFs; however, a combination of several thoughtful initiatives, selectively applied and rigorously implemented, could have a significant impact in addressing their structural vulnerabilities and the risks they present.

We would be pleased to provide any further information or respond to any questions that the FSB may have.

Sincerely

A handwritten signature in black ink, consisting of a large, stylized initial 'J' followed by a series of loops and a wavy line extending to the right.

Jonathan P Griffin  
Managing Director, JPMorgan Asset Management Europe