

Fitch Ratings 2020 Outlook: Global Money Market Funds

Global Reforms Continue to Support Stable Outlook

Fitch’s Sector Outlook: Stable

Fitch Ratings expects the combination of relatively higher yields versus bank deposits and potential continued market volatility to support steady demand for US money market funds (MMFs) in 2020. While the pace of growth may be slower in 2020, cash will likely continue to flow into the sector despite the Fed’s reversal in monetary policy.

Fitch anticipates stable conditions for European MMFs in 2020. Attention to liquidity risk management will increase in 2020, when reporting on ESMA’s stress test guidelines takes effect. A disruptive ‘no-deal’ Brexit would be unlikely to adversely affect European MMFs given most funds have approval for continued marketing in the UK via applying the temporary permissions regime.

Fitch expects an overall stable environment for Chinese MMFs in 2020. However, growth may come under pressure in the near term due to negative real yields, tight regulation and competition from wealth management products (WMPs). Several troubled small regional commercial banks required external support in 2019; however, these issues did not affect rated funds, which invest only with the highest-rated Chinese banks. Nonetheless, these events warrant increased investor monitoring of funds’ portfolio allocations.

Fitch’s Rating Outlook: Stable

Fitch forecasts broad stability in its global MMF ratings in 2020 supported by high quality, diversified investments, appropriate liquidity relative to investor composition, proactive risk management by MMF managers and continued adherence to updated regulatory frameworks.

Market Disruption a Wildcard

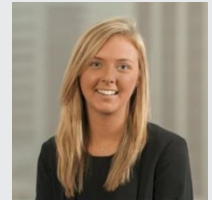
In the event of a more severe market dislocation, MMF flows could be more volatile, with a spike in inflows if MMFs are perceived to be a safe haven or a spike in outflows if MMFs hold underlying assets perceived to be at risk. Ratings would be sensitive to sustained, severe outflows, although this risk is mitigated by rated funds’ conservative credit and market risk positioning and high liquidity levels.

What to Watch

- US money fund AUM set to grow, with environmental, social and governance (ESG)-focused products capturing some assets as investors place greater emphasis on responsible investing.
- Weekly liquidity levels among Fitch-rated EMEA MMFs are overall sufficiently high. Fitch anticipates European investor and fund attention to liquidity risk management will increase in 2020 when reporting on ESMA’s stress test guidelines takes effect.
- Whether there will be further large outflows from Chinese money funds in 2020 and the impact of further credit events among Chinese banks on Chinese MMFs.

Alexandra Kelly, Associate Director

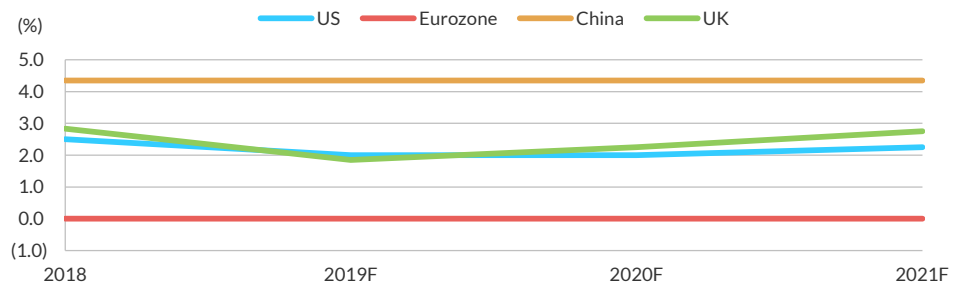
“Fitch Ratings’ outlook for money market funds in 2020 is stable, underpinned by funds’ conservative credit, market and liquidity risk profiles. Sustained, severe outflows could pressure ratings, although Fitch believes funds will broadly see continued growth in 2020, notably among funds adopting ESG strategies in response to emerging investor demand.”



ESG in Money Market Funds

Fitch considers ESG an established implicit concept in MMFs, with market attention turned to explicit ESG strategies only recently within MMFs. Fitch observes that the “exclusions” approach is the most common, and also the longest standing filter in the MMF universe that asset managers implement. Fitch anticipates that future developments in the ESG MMF sector may move beyond exclusions to other ESG techniques, such as portfolio “tilts” with higher exposures to higher ranked ESG issuers, or potentially to issuers showing the strongest improvements in ESG factors. The addition of an ESG filter to a MMF may increase its propensity to sell securities, in the event of the development of new ESG risks. Fitch believes this may make ESG MMFs’ portfolio compositions marginally more volatile than non-ESG MMFs’.

Global Interest Rate Forecast



F – Forecast.
Source: Fitch Ratings.

U.S. Money Market Funds

AUM Expected to Grow

Fitch expects a continued re-allocation of MMF assets towards prime funds in 2020, due to the yield differential with government funds and other cash products, net asset value (NAV) stability and fund managers' growing track record managing liquidity post-reform. As of October 31, 2019, prime money fund assets were USD1.1 trillion, up by 49% year over year and up by 122% since reforms first went into effect in October 2016. Both institutional and retail money funds have experienced inflows since the beginning of 2019. Given the backdrop of slowing global growth and trade policy uncertainty, Fitch expects the trend into US money funds to continue.

Stable Rates Forecast for 2020

Fitch's September 2019 Global Economic Outlook forecasts that the Fed will maintain rates at existing levels in 2020, which may support greater stability in MMF yields. While money fund yields declined slightly after the Fed cut interest rates three times throughout 2019, the average net yield for prime funds at October 31, 2019 was 1.62%, which is still 1.46 percentage points above the 0.16% average rate paid on money market deposit accounts by banks as of the same date. Investor sensitivity to the yield differential among cash products could create challenges for MMF managers, particularly as liquidity levels have declined. Average weekly liquidity for prime institutional and retail funds was 47% and 41%, respectively, as of October 31, 2019, compared to 46% across both categories, as of October 31, 2018, and 72% and 51%, respectively, as of October 31, 2016.

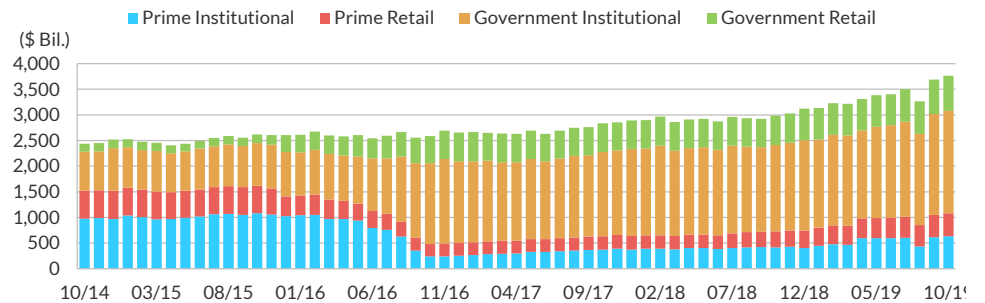
ESG Funds Growing

The US market is showing increasing interest in ESG in the money market space, with the launch of new funds and the conversion of existing funds. However, movement into these products continues to be slow. We have found fund managers primarily perform their own ESG research while incorporating data from third parties, and fully integrate ESG factors into their normal credit screening process. We expect more fund managers to incorporate ESG into their products as existing ESG funds attract more assets. ESG screening has been a neutral factor in Fitch's ratings of MMFs.

Growing Repo Exposure

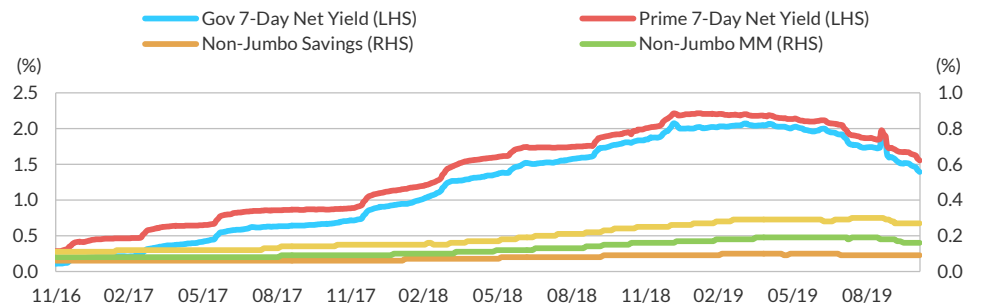
Repurchase agreements (repos) continue to dominate MMF portfolios, representing 32% of all outstanding money market securities as of October 31, 2019. Participation in the repo services offered by the Fixed Income Clearing Corp has continued to grow since 2017 when MMFs first began investing in the product, increasing 124% between October 2018 and October 2019 and up significantly since October 2017 when repo balances with the FICC were only USD12 billion. Fitch expects utilization of sponsored repo to continue to increase throughout 2020, especially considering that the number of sponsoring entities is likely to expand. Fitch-rated MMFs maintain limited exposure to any one repo counterparty.

Money Fund Assets by Fund Type



Source: Fitch Ratings, Crane Data.

Money Fund Rates Grow at a Higher Rate than Bank Deposits



Source: Fitch Ratings, iMoneyNet, FDIC.

Top Repo Counterparties in U.S. Money Funds

Rank	10/31/18			10/31/19		
	Counterparty	Value (\$ Bil.)	As % of Outstanding Repo	Counterparty	Value (\$ Bil.)	As % of Outstanding Repo
1	BNP Paribas	130	13	FICC	166	14
2	RBC	82	8	BNP Paribas	121	10
3	FICC	74	8	RBC	82	7
4	Credit Agricole	51	5	JP Morgan	69	6
5	Wells Fargo	51	5	Wells Fargo	66	6
6	Barclays	49	5	Barclays	55	5
7	JP Morgan	42	4	Credit Agricole	53	4
8	HSBC	40	4	Mitsubishi	50	4
9	Mitsubishi	38	4	Societe Generale	46	4
10	Nomura	34	3	Bank of America	42	4

Source: Fitch Ratings, Crane Data.

European Money Market Funds

Liquidity Risk Management in Focus

Fitch views the weekly liquidity levels of rated MMFs as sufficiently high with around 50% weekly liquidity on average as of end-September 2019. Investor and fund attention to liquidity risk management will increase in 2020 when reporting on ESMA's stress test guidelines take effect. ESMA published stress test guidelines on liquidity, redemption levels, credit risk, interest rates and exchanges rates in July 2019.

Majority of Funds Satisfy ESMA Concentration Test

Based on a sample of 47 Fitch-rated MMFs' liquidity levels at end-September 2019, 81% had sufficient liquidity to cover the redemption of their top two investor accounts, in line with the spirit of ESMA's concentration stress test. For the 19% with weekly liquidity levels below the sum of their top two investor accounts, the top two accounts were typically either internal money or omnibus accounts consisting of multiple underlying investors, mitigating redemption risk

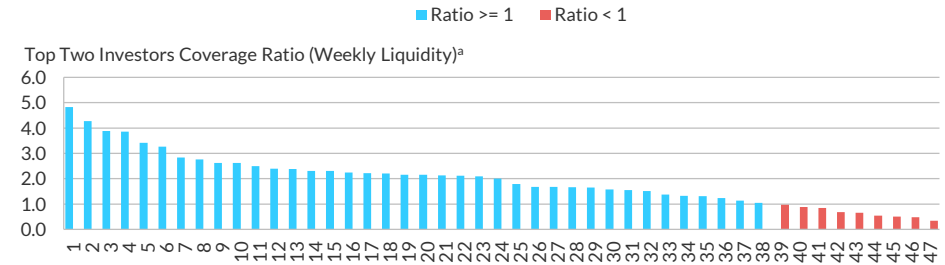
Brexit Uncertainty Manageable

Fitch views a material disruption to money funds post a disruptive 'no-deal' Brexit as unlikely. Most funds have been granted approval via applying for temporary permissions regime, while seeking full UK authorisation, to temporarily continue operating and marketing in the UK if the passporting regime falls away abruptly. Average exposure to UK entities across Fitch-rated prime sterling MMFs increased to 17% at end-September 2019 from 13% at end-August 2018, with government securities and certificate of deposits as the most popular security types.

Upcoming Review of LVNAV and CNAV Regulation

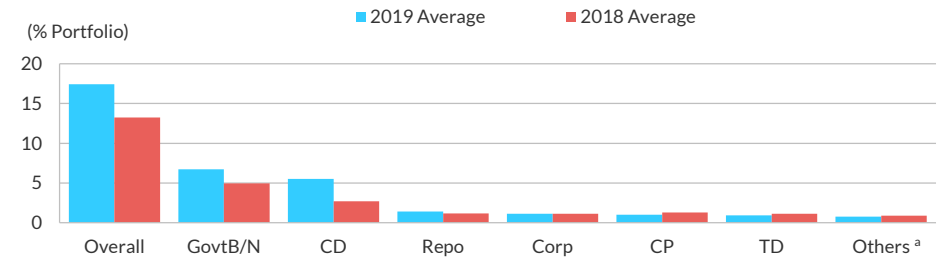
Fitch views the upcoming review of the 2017 MMF regulation as a key uncertainty facing the low volatility NAV (LVNAV) segment (approximately USD0.67 trillion as of end-September 2019). The five-year review due by 21 July 2022 under Article 46 in MMF Regulation will focus on LVNAV and public debt CNAV MMFs. The European Commission will assess the viability of LVNAV MMFs as an alternative to non-EU public debt CNAV MMFs, as well as the feasibility of establishing an 8% EU public debt quota for public debt CNAV MMFs. The scope of the review has created a degree of uncertainty for the future of LVNAV and public debt CNAV MMFs, and the outcome will directly affect the industry landscape in the short-term MMF domain. As of end-September 2019, 57% of European MMF AUM is under the scope of the five-year review, with VNAV (both short-term and standard) MMFs representing the remaining 43%.

81% Funds had Weekly Liquidity Level at Above the Sum of Top Two Investor Accounts



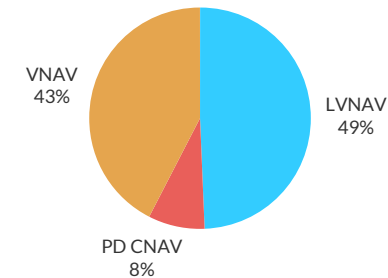
^aCalculated with end-Sep weekly liquidity levels and investor concentration info gathered periodically. Source: Fitch Ratings, Asset Managers.

Sterling Prime MMFs' Average UK Exposure Increased by 4pp at end-Sept. 2019



^aOthers include ABCP, agency securities and cash. Note: End-Sept. 2019 vs. end-Aug. 2018 surveillance data. Chart shows average exposure across Fitch-rated prime sterling MMFs to UK entities overall, and breakdown by security types. Source: Fitch Ratings, Asset Managers.

Five-Year Review Covers LVNAV (49%) and PD CNAV (8%)



Note: VNAV includes short-term and standard VNAV funds. Source: Lipper, Imoney.net.

Chinese Money Market Funds

Growth Under Pressure

Fitch expects the growth of Chinese MMFs to come under pressure in the short- to medium-term as a result of negative real yields, tight regulatory requirements, and competition from certain WMPs provided by banks. Total assets in Chinese MMFs declined to CNY7.1 trillion (USD1.0 trillion) by September 2019 from a peak of CNY8.9 trillion (USD1.3 trillion) in 2H18. Some short-term WMPs provided by commercial banks have emerged as competitors to MMFs. The rules governing these WMPs are less stringent than for MMFs, allowing investment in a wider range of underlying assets, with lower credit quality and longer maturities, while utilizing greater leverage. This has thus far allowed WMPs to deliver higher yields, in the absence of material credit stress.

Real Yields Turn Negative

Real yields (i.e. net of inflation) of Chinese MMFs turned negative in April 2019, the first time since Chinese MMFs began their rapid expansion in 2013. Fitch expects further outflows if the real yield remains negative. The market average seven-day yield of Chinese MMF yields declined to 2.5% by September 2019 from 4.6% at end-2017.

Regulatory Conversion with International Counterparts

Chinese regulators have followed their international counterparts to introduce the variable valuation method to evaluate Chinese MMFs. The China Securities Regulatory Commission had approved the first batch of variable NAV (VNAV) MMFs at end-July 2019. Investor appetite for VNAV funds remains unproven, and realized NAV movements are likely to be larger and/or more frequent than in the US due to the greater level of risk that Chinese MMFs are permitted to incur.

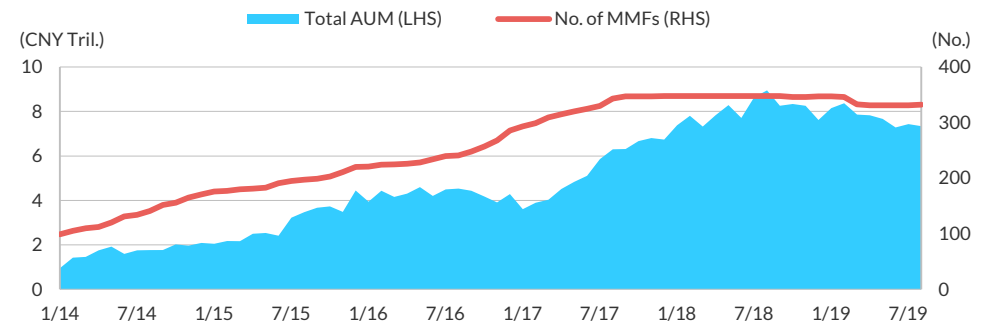
Yu'E Bao Still Large, But Declining

The Chinese MMF market has become more diversified as a result of the country's largest MMF, Yu'E Bao's, reduced size and assets flowing into other funds. This redistribution means the sector is now more comparable to the US and Europe in terms of top-five fund concentration, although Yu'E Bao continues to hold a disproportionately large share of the total Chinese MMFs' AUM.

Chinese Bank Stress Warrants Monitoring

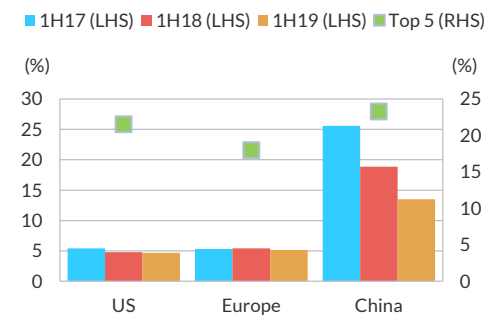
Recent stress at small regional banks in China, including the coupon skip of Jinzhou Bank and the state takeover of Baoshang Bank, highlights the credit vulnerability of these entities, and by extension, Chinese MMFs which invest in them. Thus far, the Chinese government has taken steps to moderate the effects on the broader financial system, but they may also seek to gradually weaken investors' assumption of implicit state support and encourage greater differentiation of risk-pricing between financial institutions. These dynamics make it imperative for MMFs to choose their investments/counterparties selectively.

Chinese Money Funds AUM Started to Shrink Since 2H18



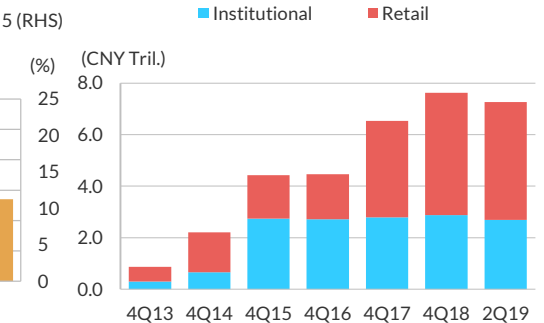
Source: AMAC.

Market Share of the Largest MMF



Source: Fitch Ratings, Wind Information, ICI Global.

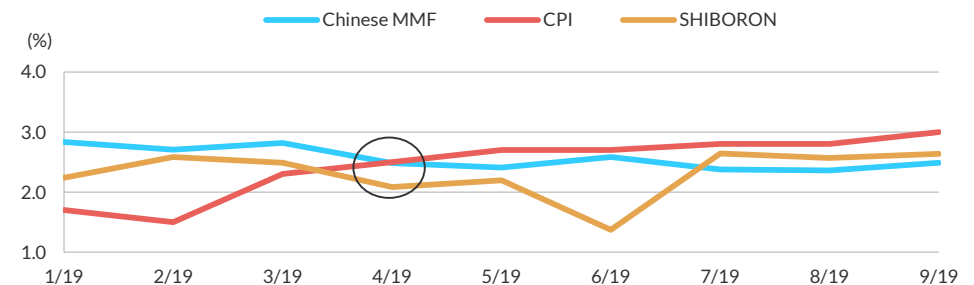
Retail Demand Dominate the Market



Source: Wind Information.

Chinese MMFs Real Yields First Time Turned Negative

(Average Seven-day Yield)



Source: Fitch Ratings, Wind Information.

Outlooks and Related Research

2020 Outlooks

[Global Economic Outlook \(September 2019\)](#)

[US Prime Money Market Fund Risk to Chinese Issuers Manageable](#)

[Chinese Money Market Funds: Declining Yields, Regulation and Competing Products Signal Slowing Growth](#)

[ESG in Money Market Funds: Implicit to Explicit Transition Underway](#)

Analysts

Minyue Wang

+44 0203 530 1406

minyue.wang@fitchratings.com

Li Huang

+ 86 21 6898 7978

li.huang@fitchratings.com

Alexandra Kelly

+1 646 582 4814

alexandra.kelly@fitchratings.com

Kimberly Green

+1 646 582 4042

kimberly.green@fitchratings.com

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTPS://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2019 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.