INVESTMENT COMPANY INSTITUTE®

April 12, 2021

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Report of the President's Working Group on Financial Markets: Overview of Recent Events and Potential Reform Options for Money Market Funds (December 2020)

Dear Ms. Countryman:

The Investment Company Institute (ICI)[1] appreciates the opportunity to provide its views on the President's Working Group (PWG) Report on Money Market Funds (PWG Report or Report).[2] Today, over 50 million retail investors, as well as corporations, municipalities, and other institutional investors, rely on the $4.9 trillion money market

[1] The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$29.1 trillion in the United States, serving more than 100 million US shareholders, and US$9.6 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in Washington, DC, London, Brussels, and Hong Kong.

[2] *See* Request for Comment on Potential Money Market Fund Reform Measures in President's Working Group Report, SEC Release No. IC-34188 (February 4, 2021), available at www.sec.gov/rules/other/2021/ic-34188.pdf. The Report is appended to the Securities and Exchange Commission's (SEC) release and also is available on the Treasury Department's website at home.treasury.gov/system/files/136/PWG-MMF-report-final-Dec-2020.pdf. According to the SEC, comments received will enable it and other relevant financial regulators to consider more comprehensively the potential policy measures the Report identifies and help inform possible money market fund reforms. Following the comment period, the SEC anticipates conducting discussions with various stakeholders, interested persons, and regulators to discuss the options in the Report and the comments it receives.

fund industry[3] as a low cost, efficient, transparent, cash management vehicle that offers market-based rates of return.[4]

Money market funds also are an important source of direct financing for governments (federal, state and local), businesses, and financial institutions, and of indirect financing for households. Without money market funds, governments, institutions, and individuals would need to seek more expensive, less transparent, and less efficient forms of financing.

ICI and its members are committed to working with US and international policymakers to strengthen the money market fund industry for the benefit and further protection of investors and the performance of broader financial markets and the economy more generally. We hope our comments below will be helpful to the SEC, the PWG, international financial regulators, and others as they consider how best to advance toward this important policy goal.

Executive Summary

Money market funds did not cause the stresses in the short-term funding markets last March.[5] US public institutional and retail prime money market funds accounted for just 19 percent of the reduction in financial and nonfinancial commercial paper outstanding during the week-ended March 18, immediately before the Federal Reserve announced its Money Market Mutual Fund Liquidity Facility (MMLF) and accompanying regulatory capital relief for dealers. Other market participants accounted for 81 percent of the decline. Therefore, money market funds should not be viewed as the main contributor to the freezing of the commercial paper market. In addition, even at the height of the liquidity crisis, money market funds, including institutional prime money market funds,

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[3] All references to money market funds in this letter refer to US money market funds that are registered with the SEC under the Investment Company Act of 1940 and that comply with applicable SEC rules, and, in particular Rule 2a-7. Data are as of March 31, 2021 and include nonpublic institutional prime money market funds. Nonpublic institutional prime money market funds are not offered for sale to the general public but are registered under the Investment Company Act and comply with Rule 2a-7. Asset managers use these funds, often referred to as "internal prime cash management funds" or "central prime cash funds," as internal cash management vehicles for their long-term mutual funds. For an overview of the US short-term funding market, including the role and growth of money market funds within that market, *see* Investment Company Institute, *Report of the Money Market Working Group* (March 17, 2009) (2009 MMWG Report), available at www.ici.org/pdf/ppr_09_mmwg.pdf, at Section 2.

[4] Yields on money market funds are typically higher—sometimes substantially so—than rates banks generally offer on money market deposit accounts (MMDAs). Since 1990, ICI estimates that money market fund shareholders have earned an estimated $550 billion more in dividend income than they would have earned in MMDA interest.

[5] *See* Section 4 and Investment Company Institute, "Experiences of US Money Market Funds During the COVID-19 Crisis," *Report of the COVID-19 Market Impact Working Group* (November 2020) (2020 ICI Money Market Fund Report), available at https://www.ici.org/pdf/20_rpt_covid3.pdf.

still had liquidity to meet new redemptions if they had meaningful opportunity to use part of their 30 percent weekly liquid asset buffers.

To the extent policymakers seek to mitigate the possibility of future distress in the short-term funding markets, they should prioritize the examination of the activities and behavior of *all* market participants. Only by doing so will policymakers make progress toward their goal of making the financial system more resilient in the face of a liquidity shock of the nature experienced in March 2020.

- *ICI research results—March 2020 events*. Prime money market funds did not pullback significantly from the commercial paper market (*i.e.,* did not sell large quantities of commercial paper and/or significantly reduce purchases of newly-issued commercial paper) in the first half of March 2020. In the aggregate, prime money market funds remained fairly steady purchasers of newly-issued commercial paper—although these purchases were more heavily weighted toward overnight commercial paper. In addition, prime money market funds sold only small amounts of commercial paper and certificates of deposit (CDs) in the secondary market before March 18. Experiences varied across different types of prime money market funds. Public institutional prime money market funds' sales of commercial paper and CDs were remarkably limited, given their outflows. Further, retail prime sold only small amounts of commercial paper and CDs, while nonpublic institutional money market funds in aggregate sold *no* commercial paper or CDs before March 18. Public institutional prime and retail prime money market funds sold commercial paper and CDs that were ultimately pledged to the MMLF after it was announced but did so primarily to raise and keep weekly liquidity asset levels well above the 30 percent regulatory threshold, which was being viewed by investors as a redemption trigger due to the SEC's 2014 reforms. (**Section 4**)

Supported by ICI's analysis of data, the evidence demonstrates the actual role money market funds played in the liquidity events of March 2020. It is in this context that ICI is providing comments on the ten options set forth in the Report for further reform of money market funds. ICI and its members have previously analyzed and offered feedback on many of these options.[6] Our examination of the reform options as well as

[6] *See e.g.*, Letter from Paul Schott Stevens, President and CEO, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (September 17, 2013) (2013 ICI Letter to SEC), available at www.sec.gov/comments/s7-03-13/s70313-200.pdf; Comment Letter of the Investment Company Institute on Financial Stability Oversight Council, *Proposed Recommendations Regarding Money Market Mutual Fund Reform,* Docket No. FSOC-2012-0003 (January 24, 2013) (2013 ICI Letter to FSOC), available at www.ici.org/pdf/13_fsoc_mmf_recs.pdf; Letter from Paul Schott Stevens, President & CEO, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (January 10, 2011) (comment letter to the 2010 President's Working Group Report on Money Market

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other reform ideas, which we understand have been suggested in the Financial Stability Board (FSB) and International Organization of Securities Commissions (IOSCO), has led us to the same conclusion the PWG apparently reached: there is no “silver bullet” for safeguarding money market funds against the severest market distress scenarios that are beyond the control of money market funds. The reform options should be evaluated by comparing the impact they will have on the ability of money market funds to carry out their important role in the financial system (*i.e.*, preservation of their key characteristics) *against* the likely practical impact any money market reforms will have on making the overall financial system more resilient. This should be the focus and overall goal of policymakers. Any new reforms for money market funds must be measured and appropriately calibrated taking into account the costs and benefits these funds provide to investors, the economy, and the short-term funding markets.

We have divided the ten reform options into three categories:

1. **Reforms that could advance the goals of reform**—options with the most potential for addressing policymakers’ concerns while preserving key characteristics of money market funds;

2. **Reforms that do not advance the goals of reform and do not preserve the key characteristics of money market funds**—options with significant drawbacks, ranging from potential detrimental impacts on money market funds, their investors, and the market to regulatory, structural, and operational barriers to implement; and

3. **Reforms that are unlikely to address policymakers’ goals of reform**.

Reforms that could advance the goals of reform

- *Removal of tie between money market fund liquidity and fee and gate thresholds*. We support the reform that would remove the tie between the 30 percent and 10 percent weekly liquid asset thresholds and the imposition of fees and gates. The regulatory tie between liquidity and fee and gate thresholds made money market funds more susceptible to financial market stress in March 2020 and would likely do so again in future periods of stress. ICI’s data supports the conclusion that this regulatory tie was likely a dominant trigger for redemptions as opposed to the conditions of the funds. (**Section 3.1.1**)

Fund Reform Options (File No. 4-619)) (2011 ICI Letter to PWG), available at https://www.ici.org/pdf/11_sec_pwg_com.pdf; Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (September 8, 2009) (commenting on the SEC’s proposed money market fund reforms); 2009 MMWG Report, *supra* note 3.

  - *Modifications to redemption fee considerations*. Although we support delinking fees and gates from liquidity thresholds, we believe that a more nuanced approach to fees should be considered. Redemption fees can be an appropriate tool for money market funds but should only be triggered when a fund is facing unusual circumstances, such as a period of heavy redemptions associated with stress in the financial markets at large. To make this powerful tool even more useful to fund boards (and therefore more likely to advance the goals of reform), we recommend a regulatory approach to fees that is separate from that of gates. (**Section 3.1.1.1**)

- *Money market fund liquidity management changes*. We believe an increase in the weekly liquid asset requirement—consistent with what most funds already maintain as a matter of conservative liquidity management—could make money market funds more resilient. We do not support creating a new category of liquid assets or imposing penalties on sponsors that fall below the weekly liquid asset threshold. (**Section 3.1.2**)

Reforms that do not advance the goals of reform and do not preserve the key characteristics of money market funds

- *Swing pricing*. We do not support swing pricing for money market funds. Swing pricing is not necessary for money market funds because they already have the ability to impose liquidity fees, which serve a similar purpose and are a more appropriate tool for money market funds. Swing pricing also would likely strip money market funds of their defining characteristics (such as multiple daily net asset value (NAV) strikes per day and same-day settlement), impose excess costs to overcome unnecessary and complex structural challenges, introduce complex tax reporting issues, and cause confusion among investors in periods of stress. Indeed, we do not believe that there are any potential benefits to employing swing pricing as a tool for money market funds that serve the PWG's overarching goals for reform. (**Section 3.2.1**)

- *Capital buffers*. We oppose a reform that would require money market funds or their advisers to maintain capital against money market fund assets. The likeliest impact of a capital buffer requirement would be to impel money market fund sponsors to exit the business, depriving investors, issuers, and the economy of the benefits these funds provide. (**Section 3.2.2**)

- *Sponsor support requirements*. We oppose a reform that would establish a regulatory framework governing when a sponsor would be required to provide sponsor support. This reform option suffers from many of the same drawbacks as imposing capital buffer requirements on fund advisers. (**Section 3.2.3**)

- *Minimum balance at risk (MBR*). We oppose an MBR, which would make a portion of each shareholder's recent balances in a money market fund available for redemption only with a time delay to ensure that redeeming investors still remain partially invested in the fund over a certain time period. We believe the likeliest impact of an MBR requirement would be to drive investors as well as intermediaries away from money market funds. (**Section 3.2.4**)

- *Liquidity exchange bank membership.* We oppose a reform that would require prime and tax-exempt money market funds to be members of a private liquidity exchange bank. Over ten years ago, ICI, with assistance from its members, outside counsel, and consultants, spent about 18 months developing a preliminary framework for a private liquidity facility, including how it could be structured, capitalized, governed, and operated. There were many drawbacks, limitations, and challenges to creating such a facility that we described in our framework and that are noted in the PWG Report. Each of these impediments remains today. (**Section 3.2.5**)

Reforms that are unlikely to advance the goals of reform

- *Floating NAVs for all prime and tax-exempt money market funds*. We oppose requiring retail prime money market funds and retail tax-exempt money market funds to float their NAVs. Floating the NAV for retail money market funds is not necessary and more generally, it does not reduce risk in any meaningful way. Floating NAVs also could eliminate key benefits for retail investors and introduce tax reporting issues. (**Section 3.3.1**)

- *Countercyclical weekly liquid asset requirements*. A countercyclical weekly liquid asset requirement would not improve the usability of weekly liquid assets. Current rules do not preclude funds from using weekly liquid assets to meet redemptions or prohibit funds from falling below the 30 percent threshold. Still, in March 2020, money market funds were not able to use their weekly liquid assets to meet redemptions because investors feared the mere possibility of fees or gates. (**Section 3.3.2**)

- *Reform of conditions for imposing redemption gates*. Rather than reforming conditions for imposing redemption gates (such as requiring funds to obtain permission from the SEC or lowering the weekly liquid asset threshold at which gates could be imposed), gates should be limited to extraordinary circumstances that present a significant risk of a run on a fund and potential harm to shareholders, such as those contemplated under Rule 22e-3 under the Investment Company Act. (**Section 3.3.3**)

We discuss each of these reforms and ICI's research in greater detail below.

1. Introduction

In an effort to contain the spread of COVID-19 in February-March 2020, governments around the world contemporaneously shut down their economies. A health crisis forced an economic crisis, which, not surprisingly, disrupted the financial markets. By mid-March, after problems had already appeared in the Treasury bond market, the short-term funding markets, including the markets for municipal debt, commercial paper and bank CDs, came under sharp stress as corporations and other investors "dashed for cash" to reduce risk and hoard cash in the face of great economic uncertainty (even fear) resulting from the health crisis. Liquidity dried up, short-and long-term credit markets ceased to function, and the flow of credit to the economy evaporated. These dynamics affected all market participants and each part of the financial system, not only the non-bank sector. Importantly, money market funds did not cause the stresses in the short-term funding markets last March.[7] To prevent economic and financial collapse, governments and central banks around the world introduced a broad array of monetary policy measures and market liquidity programs to help virtually every sector of the economy.[8]

The FSB and IOSCO—including key US regulators—have been reviewing why these interventions were necessary and what, if any, reforms might be appropriate to increase the resilience of certain parts of the global financial ecosystem. In the international fora, money market funds are the first to be assessed against this policy objective.

In the United States, the PWG Report represented an important step in the process of reviewing and assessing the March 2020 events, with specific focus on money market funds as a participant in the short-term funding markets. To this end, the Report first provides an overview of the SEC's 2010[9] and 2014[10] money market fund reforms, including how different types of money market funds have evolved since the 2007-2009 global financial crisis. The Report then discusses outflows from certain money market

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[7] *See* 2020 ICI Money Market Fund Report, *supra* note 5.

[8] For a discussion of the key US government actions, *see* Investment Company Institute, "The Impact of COVID-19 on Economies and Financial Markets," *Report of the COVID-19 Market Impact Working Group* (October 2020) (2020 ICI COVID-19 Report), available at www.ici.org/pdf/20_rpt_covid1.pdf, at 46-58.

[9] *See* Money Market Fund Reform, SEC Release No. IC-29132 (February 23, 2010) (2010 SEC Reform Release), available at available at www.sec.gov/rules/final/2010/ic-29132.pdf. For a summary of the SEC's 2010 reforms, *see* www.ici.org/mmfs/reforms/sec_reforms/statements/10_mmfs_2010sec; for a detailed analysis of their effectiveness, *see generally* S. Collins, E. Gallagher, J. Heinrichs, and C. Plantier, "Money Market Mutual Funds, Risk, and Financial Stability in the Wake of the 2010 Reforms," *ICI Research Perspective* (January 2013), available at www.ici.org/pdf/per19-01.pdf.

[10] *See* Money Market Fund Reform; Amendments to Form P-F, SEC Release No. IC-31166 (July 23, 2014) (2014 SEC Reform Release), available at www.sec.gov/rules/final/2014/33-9616.pdf. A table summarizing the current money market fund regulatory requirements, incorporating both the SEC's 2010 and 2014 reforms, is available at www.ici.org/mmfs/current/16_mmf_reg_summ.

funds in March 2020 and how these events may have contributed to general stress in short-term funding markets before the Federal Reserve, with the approval of the Treasury Department, established facilities to support short-term funding markets. Without endorsing any particular course of action, the Report then discusses various reform measures that policymakers could consider, individually or in combination, to improve the resilience of money market funds and the broader short-term funding markets.

In response to the SEC's request for comment and in recognition of the importance international regulators are placing on studying new reforms of money market funds, ICI respectfully submits its analysis of the role of money market funds in the March 2020 events and the Report's reform options and their effect on the efficacy of money market funds as an efficient and highly-diversified cash management vehicle for investors and an important source of financing to governments, businesses, financial institutions, and households.

2. Considering Money Market Fund Reform and Events of March 2020 Within a Holistic Review of All Financial Regulatory Areas

In recognition of the importance of money market funds to investors and the economy, ICI and its members support the goals of the SEC and other regulators in making these funds more robust under adverse market conditions.

Given the tremendous benefits money market funds provide to investors and the economy, it is imperative to preserve this product's key characteristics. Money market funds are a liquid and diversified cash management tool for investors and a key source of funding for governments and the private sector. As of the end of February 2020, US money market funds held $3.1 trillion in short-term Treasury and agency securities and repurchase agreements, along with $811 billion in short-term municipal debt, bank CDs, and commercial paper.[11] At the same time, prime money market funds, including nonpublic institutional money market funds, which in February 2020 accounted for 29 percent of the commercial paper market, are an important source of short-term funding for banks and other financial institutions that provide funding for households and businesses.

It is further worth noting that money market funds should be viewed by regulators as the *preferred* mechanism to access the short-term funding markets. Since money market funds often invest in hundreds of different underlying securities, they provide

[11] These figures include nonpublic institutional money market funds.

investors diversification that would otherwise be difficult, if not impossible, to replicate and manage through an individual portfolio or through a single bank.[12]

Therefore, policymakers should focus on the core objective: to strengthen money market funds even further against adverse market conditions for the benefit of short-term funding markets and enable them to meet extraordinarily high levels of redemption requests without the need for central bank liquidity support except in the most extreme circumstances. Indeed, as we consider the future of our markets in the wake of this pandemic, and the role of money market funds within the markets, we question those who say that money market funds must be regulated so aggressively that central bank intervention would *never* be needed again to provide liquidity support in the face of great economic shock. Such views claim that eliminating any future possibility of central bank support would avoid moral hazard. Of course, money market funds should be responsible for robust liquidity risk management and subject to appropriate rules and regulations. But holding money market funds at fault for central bank intervention intended to calm financial markets during a time of extreme uncertainty around a global catastrophe should not be the starting point for any discussion of reforms.

We also urge policymakers and regulators to consider any new reforms of money market funds only in the context of the broader global financial markets and perform a true holistic review of the events of March 2020 and the causes of the crisis. To this end, regulators should first recognize that although prime money market funds are an important source of financing in the short-term funding markets, they are neither the only participant in these markets nor do they account for the majority of the financing

[12] For an overview of the key characteristics of money market funds that make them attractive to both retail and institutional investors, *see* 2009 MMWG Report, *supra* note 3 at 23-29. Accounting rules also have facilitated the use of money market funds for the investment of cash by institutional investors. US Generally Accepted Accounting Principles (GAAP) defines "cash equivalents" as short-term, highly liquid investments that are both (1) readily convertible to known amounts of cash, and (2) so near maturity that they present insignificant risks of changes in value because of changes in interest rates. Generally only investments with original maturities of three months or less are considered cash equivalents. Examples of cash equivalents include Treasury bills, commercial paper, and money market funds. The SEC's 2014 money market fund adopting release reaffirmed that under normal circumstances, a money market fund with a floating NAV and/or a money market fund with the ability to impose fees or gates still meets the definition of a cash equivalent. The release goes on to state, however, that if events give rise to credit and liquidity issues for money market funds, including the imposition of a fee or gate, shareholders would need to reassess whether their investments in money market funds continue to meet the definition of a cash equivalent. *See* 2014 SEC Reform Release, *supra* note 10, at 133-135, 177-179. Treating money market fund shares as cash equivalents is important to fund investors because, among other things, the investors may have debt covenants that require them to maintain certain levels of cash and cash equivalents. If corporate investments in money market funds are not cash equivalents, they would instead be considered investment securities held for trading purposes under GAAP.

supplied in these markets.[13] Regulators also should recognize that the experiences of money market funds in March 2020 were dependent on their asset types and investor clienteles.[14] Government money market funds served as a liquidity vehicle of choice—investors, seeking to preserve or bolster their liquidity, poured hundreds of billions of dollars into these funds. As such, no case exists for applying fundamental changes to government money market funds.

On the other hand, the experiences of prime and tax-exempt money market funds in March 2020 largely mirrored their investor base. Public institutional prime money market funds[15] saw significant outflows as a percentage of their assets but represented only 8 percent of the US commercial paper market. In contrast, nonpublic institutional prime money market funds (which also represented 8 percent of the commercial paper market) had much smaller outflows than their publicly offered counterparts. Accordingly, nonpublic institutional prime money market funds should not be under consideration for reforms. Similarly, outflows from retail prime and retail tax-exempt money market funds were quite modest. Reforms, therefore, should be tailored to reflect those differences.

Building further money market fund resilience also requires policymakers to look for ways to improve the short-term funding market itself. It was the structure of that market during times of stress—not the action of money market funds—that was at the heart of the ensuing challenges of March 2020. Likewise, policymakers should investigate whether regulatory requirements on key market players, such as particular elements of the capital requirements on banks, may have exacerbated the significant liquidity shortfall last March.

3. Consideration of PWG Reform Options

The Report discusses ten options for further reform of money market funds. ICI and its members have previously analyzed and offered feedback on many of the possible reforms outlined in the Report.

[13] For a discussion of the short-term funding markets in March 2020 and the role money market funds played in that market, *see* Section 4.

[14] For an overview of the experiences of various types of money market funds during the COVID-19 crisis, *see* 2020 ICI Money Market Fund Report, *supra* note 5, at 12-16.

[15] Public institutional prime money market funds are publicly available for sale to institutional investors such as businesses, insurance companies, and nonprofit organizations. Individuals can, and often do, purchase public prime institutional money market funds through broker-dealers, variable annuities, 529 plans, individual retirement accounts, and 401(k) and similar retirement plans.

3.1 Reforms that Could Advance the Goals of Reform and Preserve Key Characteristics of Money Market Funds

After careful review, we believe there are two reform options that hold the most potential for addressing policymakers' concerns with the least negative impact.

3.1.1 Removal of Tie Between Money Market Fund Liquidity and Fee and Gate Thresholds

The SEC's 2010 reforms made money market funds more resilient by adding minimum liquidity levels. Four years later, the SEC's 2014 reforms, which became effective on October 11, 2016, permitted funds to impose fees or gates if their weekly liquid assets dropped below 30 percent. The Report suggests that definitive thresholds for the permissible imposition of liquidity fees and redemption gates may have the unintended effect of triggering preemptive investor redemptions as funds approach the relevant thresholds. This reform would remove the tie between the 30 percent and 10 percent weekly liquid asset thresholds and the imposition of fees and gates when doing so is in the best interest of the fund, without reference to any specific level of liquidity.

We agree that the tie between liquidity and fee and gate thresholds made money market funds more susceptible to financial market stress in March 2020 and would likely do so again in future periods of stress.

As it turned out, the 2014 reforms swapped one kind of redemption trigger event for another. That is, by requiring institutional prime money market funds to float their NAVs, the SEC addressed the possibility that fears of breaking the buck would trigger outflows from these funds. On the other hand, adding the possibility of a liquidity fee or gate to the 30 percent weekly liquid asset threshold caused investors in March 2020 to redeem heavily when a fund started approaching that level—a level that only had significance because of the bright line drawn by the 2014 reforms rather than actual difficulties in the fund's ability to meet redemptions.

ICI member firms indicate and ICI data confirms that by mid-March 2020 institutional investors accelerated their redemptions for those institutional prime money market funds that started *approaching (not reaching)* the 30 percent weekly liquid asset threshold because these investors knew that under the 2014 reforms reaching 30 percent would lead to the potential imposition of fees or gates.[16] ICI member firms

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[16] 2020 ICI Money Market Fund Report, *supra* note 5, at 32-35. This observation was echoed in an October 2020 report by the SEC's Division of Economic and Risk Analysis, which noted that "some investors may have feared that if they were not the first to exit their fund, then in the event the fund breached the 30 percent WLA [weekly liquid asset] limit, there was a risk that they could be subject to restrictions on withdrawals known as "gates." This anticipatory, risk-mitigating perspective potentially further accelerated redemptions." *See* Securities and Exchange Commission, Division of Economic and

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reported that outflows began in some institutional prime money market funds as early as when their weekly liquid assets starting falling below 40 percent and accelerated when whose weekly liquid assets fell below 35 percent.[17] Given that investors could not predict how a fund board might act if the fund reached this threshold, the 30 percent weekly liquid assets requirement in effect became a hard liquidity floor rather than a liquidity cushion to absorb higher-than-usual redemptions, as it was meant to be.[18] As discussed in **Section 4**, this regulatory constraint necessitated prime money market funds need to divest longer-dated securities in favor of securities that qualified as weekly liquid assets.

Although outflows accelerated among institutional prime funds, it is important to point out that even by the time the Federal Reserve announced the MMLF at the height of the liquidity crisis (March 18), institutional prime funds still maintained robust liquidity buffers. That said, their weekly liquid assets were being depleted, which increased the number of institutional prime money market funds with weekly liquid assets in the 30 to 35 percent range.[19] Despite this stressful period, *only one institutional prime money market fund had weekly liquid assets of less than 30 percent* and even then by a small margin (at 27.4 percent).[20] Therefore, even before the Federal Reserve announced the

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Risk Analysis, *US Credit Markets: Interconnectedness and the Effects of the COVID-19 Economic Shock* (October 2020), available at www.sec.gov/files/US-Credit-Markets_COVID-19_Report.pdf. Secretary of the Treasury Janet Yellen, before her nomination as Treasury Secretary, also expressed concern about the fees and gates requirement when she lamented that the SEC's 2014 money market fund reforms "did something that almost all [economists], including most people in the Fed…are very unhappy about, they allowed funds or insisted that they impose gates and redemption fees once liquidity fell below a minimum. Most economists thought that the erection of the gates by one fund would cause outflows [and] contagion as people tried to avoid having that happen to them. I think that's exactly what happened." *See* Remarks delivered at a Bookings Institution webinar, "A Decade of Dodd-Frank" (June 30, 2020), available at www.brookings.edu/events/a-decade-of-dodd-frank/.

[17] ICI member firms also noted that online trading platforms—which institutional investors use to purchase and sell money market funds—often automatically send investors electronic notices when a fund's weekly liquid assets drop below a certain amount (*e.g.*, 35 percent).

[18] Although Rule 2a-7 imposes specific minimum requirements on the amounts of daily and weekly liquid assets, it does not prohibit a fund from dipping below these requirements. Rather, it provides specific remedies for restoring liquidity in cases where these minimum levels are breached. In particular, whenever a fund's daily liquid assets account for less than 10 percent of its total assets, the fund is prohibited from acquiring any new asset other than a daily liquid asset. Similarly, if a fund's weekly liquid assets make up less than 30 percent of its total assets, the fund cannot acquire any new asset other than a weekly liquid asset. These conditional restrictions on fund management are designed to help rebuild a fund's daily and weekly liquidity levels whenever these levels become too low.

[19] *See* 2020 ICI Money Market Fund Report, *supra* note 5, at Figure 3.17.

[20] *Id.* at Figure 3.18. Even though its weekly liquid assets dipped below 30 percent, this fund did not impose fees or gates. By March 20, this fund's weekly liquid assets increased to 40.6 percent.

creation of the MMLF, institutional prime money market funds were able to meet new redemption requests.

This data suggests that some institutional investors were primarily focused on whether funds would hit the 30 percent level rather than whether there was actual evidence of the fund having difficulty meeting redemption requests. This caused much stronger outflows from institutional prime money market funds with weekly liquid assets below 35 percent compared to other institutional prime money market funds.[21] At the same time, retail prime money market funds, which like institutional prime money market funds have the option of imposing fees or gates if weekly liquid assets fall below 30 percent, saw little difference in the average daily outflows with weekly liquid assets below 35 percent.[22] As the Report acknowledges, this is likely because amid periods of stress for money market funds, institutional investors, "who may have large holdings and the resources to monitor risks carefully, have redeemed shares more rapidly and extensively than retail investors."[23]

These outcomes are contrary to the SEC's rationale for adding liquidity requirements to Rule 2a-7 in 2010—to ensure money market funds had a minimum percentage of their assets in highly liquid securities that can be readily converted to cash to pay redeeming shareholders.[24] The SEC stated: "[A] fund should be able to use those [daily and weekly] assets to pay redeeming shareholders even in market conditions (such as those that occurred in September and October 2008) in which money market funds cannot rely on a secondary or dealer market to provide immediate liquidity."[25]

Thus, the 30 percent threshold established by the 2014 reforms became a redemption trigger, rather than the condition of the fund being the trigger. It was a real-life example of the tail wagging the dog.

Consider further that before the 2014 reforms, institutional prime money market funds regularly dipped below 30 percent with no adverse consequences. The SEC's own analysis showed that if the triggering threshold for gates and fees was between 25 and 30 percent weekly liquid assets (rather than at 15 percent as the SEC proposed), some

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[21] *Id*. at Figure 3.19.

[22] *Id*. at Figure 3.20.

[23] PWG Report at 6.

[24] Before 2008, money market funds did not experience problems in meeting redemption requests because they could find buyers for their securities. This is attributable, in part, to the extremely liquid and deep markets for the low risk eligible securities permitted by Rule 2a-7. The events of 2008 demonstrated that large forced sales of securities can disrupt any market, even the market for securities that qualify as eligible securities. As a result, the SEC added (for the first time) daily and weekly asset requirements to ensure money market funds maintained a minimum ready supply of cash to fund redemptions.

[25] 2010 SEC Reform Release, *supra* note 9 at 57.

funds would have crossed this threshold every month except one during the period March 2011 and October 2012.[26]

ICI conducted a similar analysis (Figure 1) examining the period from immediately after the effective date of the 2010 reform (June 2, 2010)–which imposed the 30 percent weekly liquid assets requirement–to just before the effective date of the 2014 reform (October 11, 2016)–which tied the 30 percent weekly liquid assets to gates and fees. Our analysis found that prime and tax-exempt money market funds made frequent use of their weekly liquidity buffer. During this period, 68 percent of prime money market funds and 10 percent of tax-exempt money market funds dropped below the 30 percent threshold at least once (top panel, Figure 1). In addition, in nearly all (97 percent) of the weeks between June 2, 2010 and October 11, 2016 at least one prime money market fund fell below the 30 percent threshold (bottom panel, Figure 1) and in 18 percent of the weeks at least one tax-exempt money market fund did as well. These observations stand in stark contrast to those from just after the 2014 reforms were effective through February 25, 2020 when no prime or tax-exempt money market funds crossed the 30 percent weekly liquid asset threshold.

FIGURE 1

Before the Effective Date of the 2014 Reforms, Over Two-Thirds of Prime Funds Dipped Below 30 Percent Weekly Liquid Assets At Least Once

Number of funds with at least one week with weekly liquid assets below 30 percent

	Prime		Tax-exempt	
Time period	Number	Percent of total	Number	Percent of total
June 2, 2010 - October 11, 2016	162	68%	21	10%
October 19, 2016 - February 25, 2020	0	0%	0	0%

Number of weeks in which at least one fund had weekly liquid assets below 30 percent

	Prime		Tax-exempt	
Time period	Number	Percent of total	Number	Percent of total
June 2, 2010 - October 11, 2016	323	97%	60	18%
October 19, 2016 - February 25, 2020	0	0%	0	0%

Sources: ICI calculations of iMoneyNet and SEC form N-MFP data

By coupling the option to impose liquidity fees or gates with the 30 percent weekly liquid asset requirement, the SEC's 2014 reforms may have negatively affected the

[26] As originally proposed, the liquidity fees and gates provisions would have been triggered if a fund's weekly liquid assets fell below 15 percent. Explaining why it had proposed this threshold, the SEC noted that 15 percent "would indicate distress in a fund, but also [be] one that few funds would cross in the ordinary course of business, allowing funds and their boards to avoid the costs of frequent unnecessary consideration of fees and gates." Money Market Fund Reform; Amendments to Form PF, SEC Release No. IC-30551 (June 5, 2013), available at www.sec.gov/rules/proposed/2013/33-9408.pdf, at 176-177.

benefits of this liquidity buffer.[27] It is important to reiterate that the 30 percent weekly liquid asset buffer became a floor that accelerated shareholder redemptions due to uncertainty about the imposition of liquidity fees or gates. To be a true buffer, it should serve as an extra source of liquidity in times of stress.

3.1.1.1 Modifications to Redemption Fee Considerations

As noted above, this PWG reform option would remove the tie between the liquid asset thresholds and the imposition of fees and gates when doing so is in the best interest of the fund, without reference to any specific level of liquidity. As noted above, we support delinking fees and gates from liquidity thresholds; however, we also believe a more nuanced approach to fees should be considered.

Although redemption fees can be an appropriate tool for money market funds, they should only be triggered when a fund is facing unusual circumstances, such as a period of heavy redemptions associated with stress in the financial markets at large. In contrast to fees, gates deny investors access to their cash, which is highly problematic when investors have immediate cash flow demands. As such, we recommend gates be limited to extraordinary situations as discussed in **Section 3.3.3**.

A redemption fee, particularly one meaningfully higher than the cost of liquidity, should discourage redemptions but still allow the fund to continue to provide liquidity to shareholders. If shareholders choose to redeem, the fee should be large enough to benefit remaining shareholders by mitigating liquidation costs and potentially rebuilding NAVs. Shareholders truly in need of liquidity should have access to it, but at a cost that serves as a deterrent to redemptions and reflects the premium that market participants place on liquidity during periods of market stress.

To make this powerful tool even more useful to fund boards (and therefore more likely to advance the goals of reform), we recommend a regulatory approach to fees that is separate from that of gates. Specifically, we recommend the SEC consider requiring funds to maintain detailed, board-approved policies and procedures that provide the board with high level guidance for *when* to impose redemption fees and *how* the fund's adviser should calculate them. Thus, rather than linking the possible imposition of fees to a one size fits all approach of just one metric (*i.e.*, level of weekly liquid assets), an individual fund might develop a multi-factor approach that includes other relevant metrics such as net redemptions, portfolio-specific characteristics (*e.g.*, liquid assets,

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[27] "Using this information to inform our choice of the appropriate level for a weekly liquid asset threshold, we are proposing a 15 [percent] weekly liquid assets threshold to balance the desire to have such consideration triggered while the fund still had liquidity reserves to meet redemptions but also not set the trigger at a level that frequently would be tripped by normal fluctuations in liquidity levels that typically would not indicate a fund under stress." *Id*. at 178. Despite receiving general industry support for the threshold as proposed, the SEC set the threshold level for discretionary fees and gates at less than 30 percent weekly liquid assets when it adopted its reforms in 2014.

investor concentration, diversification of holdings), and market-based metrics that might provide a more accurate picture of a fund's need to impose redemption fees.[28] These metrics also would help the board consider the appropriate fee. Finally, the SEC would need to carefully assess the appropriate level of shareholder disclosure regarding the fee. Importantly, the required disclosure should balance an investor's need to understand the risk of fees with a fund's need to avoid triggering preemptive investor redemptions.

3.1.2 Money Market Fund Liquidity Management Changes

Under Rule 2a-7, money market funds are subject to daily and weekly liquid asset requirements and must disclose these amounts each day on the funds' websites. One potential policy reform would make changes to these liquidity requirements, such as creating an additional category of assets with slightly longer maturities (*e.g.*, biweekly liquid assets), increasing existing thresholds, and/or if a fund's weekly liquid assets fell below the regulatory minimum, adding penalties such as requiring the escrow of fund management fees if a fund's weekly liquid assets fell below the regulatory minimum. Increasing existing thresholds is an option worth exploring in more detail, but not the other proposals.

3.1.2.1 New Category of Liquid Assets

The Report suggests that an additional tier of liquidity may make money market funds more resilient to significant redemptions by ensuring they maintain assets that will soon become weekly liquid assets and limiting "barbell" strategies where a fund offsets its short-term assets with "riskier" longer-term assets that enhance returns but increase the riskiness of the fund's portfolio.

Members believe, however, that a new category of liquid assets, such as biweekly liquid assets, would add complexity without any real benefit. Among other things for example, commercial paper is generally issued in overnight, weekly, 30, 60, or 90-day increments, biweekly issuance does not exist. Thus, funds could only meet a biweekly requirement by purchasing longer-dated securities and letting them mature into a two-week bucket or by holding higher percentages of weekly liquid assets as noted below.

3.1.2.2 Increase Existing Thresholds

From 2010 to January 2021, institutional prime money market funds on average held 44 percent of their assets in weekly liquid assets, and retail prime money market funds held on average 41 percent of their assets in weekly liquid assets—exceeding the 30 percent

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[28] We note that for European low volatility NAV (LVNAV) money market funds (which are primarily used by institutional investors) if the fund's weekly maturing assets fall below 30 percent of total assets and its net daily redemptions on a single working day exceed 10 percent of total assets, the board of directors of the management company has the discretion to impose liquidity fees or gates.

threshold by significant margins and illustrating that these funds seek to operate with substantial liquidity on hand in the normal course of business.

Therefore, an increase in the weekly liquid asset requirement—consistent with what most funds already maintain as a matter of conservative liquidity risk management—could make money market funds more resilient. Any such increase, however, should be data driven and not so high as to materially impact money market funds' ability to serve as direct sources of financing for businesses and financial institutions and indirect financing for households or make it difficult (or impossible) to continue to attract investors by providing a return that is above that of a Treasury or government money market fund.

3.1.2.3 Impose Sponsor Penalties

Imposing a penalty on managers for falling below the weekly liquid asset threshold would shift investment risks from fund investors to advisers and discourage fund sponsors from offering such products. Fund advisory fees compensate the adviser for managing the fund as a fiduciary and agent and for providing ongoing services that the fund needs to operate. Advisers are not compensated for bearing investment risks of the fund. Consequently, they should not be punished for using a fund's liquid assets—as originally designed—to meet redemptions.

Imposing a penalty on managers also runs counter to the purpose of liquidity buffers (which are meant to be used), creates another cliff event, and is unnecessary because managers already have incentives to avoid falling below regulatory minimums. Funds are highly cognizant of staying within regulatory boundaries even without penalties. Moreover, investors, particularly institutional investors, carefully monitor weekly liquid asset levels and seem to prefer funds that maintain weekly liquid assets above the minimum. In addition, imposing a penalty for dipping below the weekly liquid asset minimum would disincentivize fund managers from using their liquid assets when they most need them to meet redemptions, such as during the market turmoil of March 2020.

3.2 Reforms that Do Not Advance the Goals of Reform and Do Not Preserve the Key Characteristics of Money Market Funds

We believe at least five of the PWG's reform options would not advance the goals of reform and would not preserve the key characteristics of prime and tax-exempt money market funds beneficial to financial system and the broader economy. Specifically, these options have significant drawbacks, ranging from potential detrimental impacts on money market funds, their investors, and the markets, to complicated regulatory, structural, and operational barriers to implement. Indeed, we believe the likeliest impact of any of these options would be to decrease the utility and attractiveness of these products to investors and cause fund sponsors to exit the industry–a result that the PWG has never stated as being an objective of new reforms.

3.2.1 Swing Pricing Requirement

To provide money market funds a tool to mitigate potential dilution that can result from costs associated with redemption activity and to manage fund liquidity, the Report proposes swing pricing as a possible reform option.[29] Swing pricing allows a fund to "demutualize" portfolio transaction costs by adjusting its NAV per share by a swing factor once the level of net redemptions from the fund exceeds a predetermined swing threshold established by the fund. In effect, swing pricing requires two actions—identifying whether the threshold has been triggered and, if triggered, then an additional step in the valuation process, whereby a fund measures daily redemption activity and adjusts (or swings) the per-share NAV. When the per-share NAV is "swung" down, redeeming shareholders would receive less for their shares, essentially allowing funds to impose estimated costs directly on those redeeming shareholders.[30] For reasons elaborated below, ICI and its members believe swing pricing would not advance policymakers' goals of reform or preserve the key characteristics required by investors of money market funds. Further, swing pricing raises complex tax reporting issues that would require guidance from the Treasury Department and Internal Revenue Service (IRS) to resolve.

3.2.1.1 SEC Concluded Earlier that Swing Pricing is Not Necessary for Money Market Funds

Swing pricing is not necessary for money market funds because they already have the ability to impose liquidity fees, which serve a similar purpose and are a more appropriate tool for money market funds. In 2016, the SEC amended Rule 22c-1 under the Investment Company Act to permit, but not require, open-end mutual funds to implement swing pricing.[31] The SEC intentionally excluded money market funds from using swing pricing.[32] Although the SEC believed that swing pricing could serve as a useful tool for other open-end funds, the SEC explained that money market funds already have extensive tools at their disposal that could accomplish comparable goals to swing pricing, such as liquidity requirements that are more extensive than those imposed on other funds and the possibility of imposing liquidity fees on redemptions

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[29] With swing pricing, a fund also may choose to implement an upward swing in which the NAV is adjusted upward once net purchases exceed a particular threshold, thereby imposing the costs of transactions on transacting shareholders. The Report does not specifically address upward swing pricing, however, and thus this section focuses on downward swing pricing employed when certain redemption thresholds are triggered.

[30] At the same time, buyers would purchase shares at the reduced NAV.

[31] *See* Investment Company Swing Pricing, SEC Release No. IC-32316 (October 13, 2016), available at www.sec.gov/rules/final/2016/33-10234.pdf, at 24-25.

[32] *Id*. at 24-25. The SEC also excluded exchange-traded funds.

when weekly liquid assets fall below a certain threshold.[33] The SEC explained that "money market fund liquidity fees allocate at least some of the costs of providing liquidity to redeeming rather than non-transacting shareholders, and generate additional liquidity to meet redemption requests."[34] The SEC concluded that the liquidity fee regime under Rule 2a-7 serves a similar purpose to swing pricing and "is a more appropriate tool for money market funds to manage the allocation of liquidity costs than swing pricing."[35]

The SEC also noted that unlike other types of open-end funds that may be required under swing pricing procedures to adjust their NAV from time to time, money market funds investors are "particularly sensitive to price volatility."[36] To this end, the SEC believed that "liquidity fees would be used only in times of stress when money market funds' internal liquidity has been partially depleted."[37] Since money market funds continue to be subject to extensive liquidity requirements, can still levy liquidity fees under certain conditions, and remain sensitive to price volatility, we believe the SEC's 2016 conclusions that liquidity fees rather than swing pricing are more appropriate for money market funds continue to hold true.

3.2.1.2 Swing Pricing Would Eliminate Important Money Market Fund Features

To successfully implement swing pricing, a fund needs timely and reasonably accurate daily fund flow information before calculating and publishing the fund's NAV. Without it, the fund would be unable to determine with certainty whether it has crossed its swing threshold on a given day. Swing determination is complicated further if a fund needs to obtain fund flow information from intermediaries, such as broker-dealers,

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[33] *Id*. at 24-25.

[34] *Id.* at 24.

[35] *Id*.

[36] *Id*. The SEC has previously identified potential disadvantages to swing pricing for mutual funds generally, including: "(i) increased performance volatility and tracking error (in addition to changes in the values of portfolio assets, a fund's NAV would be affected by flow-driven swing pricing adjustments); (ii) inability to know in advance the precise impact of swing pricing on particular purchase and redemption requests, and resulting lack of transparency to investors; and (iii) all orders on a given day receive the same adjusted NAV, regardless of whether the size of an individual shareholder's order alone would create material trading costs for the fund." *Id*. at 56.

[37] *Id*. at 25. The SEC also noted that in Europe, UCITS use "dilution levies," which in many respects are similar to liquidity fees, as a distinct tool separate from swing pricing. "While many UCITs use swing pricing as a matter of normal course, dilution levies may be considered a liquidity risk management tool that is used in connection with stressed conditions." *Id*.

platforms, and portals, which generate much of the funds' order volume and fund flow activity.[38]

Swing pricing is particularly challenging for money market funds that include key features, such as pricing multiple times per day and same-day (T+0) settlement.[39] These essential features allow money market fund shareholders to sell shares and receive the proceeds from their redemptions on the same day, often within hours. Specifically, these features are critical for corporations, government entities, not-for-profits, and other institutional investors to effectively and efficiently manage their day-to-day operating cash, meet payroll and other liabilities, and maintain appropriate levels of liquidity on a daily basis. Forcing funds to give up these features to make swing pricing work would fundamentally change the nature of the funds and their utility to investors.

Rule 22c-1(a) under the Investment Company Act requires funds and dealers in fund shares to transact fund shares at the NAV next computed after receipt of an order to buy or redeem. In calculating a fund's NAV, the fund manager follows established, board-approved valuation policies and procedures.[40] In practice, long-term funds, which typically settle T+1, commonly cut off orders, value all portfolio investments, and price their shares as of 4:00 pm (ET). Many money market funds (including institutional prime floating NAV money market funds), however, perform this process multiple times a day and offer T+0 settlement to help their institutional investors with their daily cash management needs. T+0 settlement requires a fund to compute its NAV, receive and process redemptions, and complete Fedwire instructions after the fund's closing time (typically 4:00 pm ET) but before the Federal Reserve's 6:45 pm ET Fedwire cutoff time.

The NAV calculation process for all floating NAV funds is largely similar.[41] Before each NAV strike, the fund accountant (which can be the fund manager or a different service provider) transmits a file listing the fund's portfolio investments to a pricing vendor. The vendor inserts the current market price for each investment into the file and transmits it to the fund accountant. The fund accountant then applies a series of controls to validate the prices received. After researching and resolving any exceptions

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[38] For a discussion regarding how the industry distribution model and the use of intermediaries complicates the use of swing pricing, *see* Investment Company Institute, "Evaluating Swing Pricing: Operational Considerations," (November 2016) (2016 ICI Swing Pricing Paper), available at www.ici.org/pdf/ppr_16_evaluating_swing_pricing.pdf.

[39] Although some money market funds provide T+1 settlement, these funds are typically designed for retail investors.

[40] For a discussion regarding the funds' NAV calculation and dissemination process, *see* 2016 ICI Swing Pricing Paper, *supra* note 38, at 5-6.

[41] Stable NAV money market funds, such as retail prime, retail tax-exempt, and government money market funds have two NAVs: the stable $1.00 NAV that uses amortized cost and penny rounding and the shadow NAV that uses mark-to-market prices. The shadow NAV is calculated at least daily.

generated by the controls, the fund accountant uses the reviewed prices (and fair values, as necessary) to value the fund's investments and calculate its NAV. The NAV is then disseminated through a variety of methods to the fund's transfer agent, intermediary distribution partners, media outlets, and shareholders.

Money market funds would face even more daunting challenges. Because receipt of shareholder flow information is fundamental to determining first whether the threshold has been crossed and then to swing the NAV on any given day, it is unlikely a money market fund could gather this information before the NAV calculation process and still have sufficient time to calculate, apply, and potentially correct the application of a swing pricing mechanism multiple times a day and/or still accommodate same day settlement *and* meet the Federal Reserve's current cutoff time to provide Fedwire instructions for the transmittal of redemption proceeds to institutional investors.[42] The process is further complicated and meaningfully delayed if intermediaries generate any of the funds' order volume and fund flow activity as the funds would need to depend on these intermediaries to deliver the information in a timely and reliable manner. Funds need the order flow to fairly and accurately assess whether the threshold has been crossed before applying a swing to the NAV, which would be used for the transactions of the redeeming investors.

In sum, to accommodate swing pricing, money market funds would need to implement earlier order deadlines for shareholders and place pressure on intermediaries to furnish flow information earlier in the day (as there is no existing regulatory requirement). The former would greatly disrupt shareholders' ability to manage their cash flow and daily liquidity (because it would likely eliminate important features such as multiple NAV strikes and same-day settlement); the latter may not even be practicable and, as such, far from certain.

3.2.1.3 Swing Pricing is Not Needed During Normal Market Conditions

The Report suggests that if swing pricing is available and used occasionally in "normal" times, it can help investors understand that they bear liquidity risks in a money market

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[42] Applying swing pricing while also allowing for multiple NAV strikes per day and/or T+0 settlement would require funds to estimate net transactions before each NAV strike on a daily basis. Such estimations, especially during periods of market stress when a money market fund would be most likely to use swing pricing, could be particularly challenging, which could lead to more frequent corrections. Current fund valuation policies typically provide that a fund should correct pricing errors "when discovered, and fund sponsors, should reimburse shareholders experiencing a material economic loss due to the errors." *See* Investment Company Institute, *SEC Valuation and Liquidity Guidance for Registered Investment Companies – Compendium, Volume 1,* Investment Company Institute (August 2015), available at www.ici.org/pdf/pub_15_valuation_update_vol1.pdf, at 203; *see also* 2016 ICI Swing Pricing Letter, *supra* note 38.

fund, making its use in stress events "less unsettling for investors."[43] Under normal conditions, however, money market fund portfolios are highly liquid and large investor flows can be met easily with minimal transaction costs—making it highly unlikely that swing thresholds would be triggered.

3.2.1.4 Swing Pricing Would Create Complex Tax Reporting Problems

Implementing swing pricing would create significant tax reporting complexities for retail investors. Both stable and floating NAV money market funds are exempt from the gross proceeds tax reporting requirements generally applicable to brokers and funds under the tax laws.[44] This means that retail investors do not receive IRS Forms 1099-B, which are used to report capital gains and losses, from money market funds in which they invest.[45] Because stable NAV money market funds transact at $1.00, shareholders do not have gains or losses upon redemption, making this reporting unnecessary. Stable NAV money market funds thus do not have systems to track shareholders' holding periods or cost basis, which are required to determine capital gains and losses.

When the money market fund reforms were adopted in 2014 to require a floating NAV for all prime and tax-exempt money market funds sold to institutional investors, the Treasury regulations also were amended to ensure that the exemption from gross proceeds reporting continued to apply, regardless of whether the NAV remained stable. The Treasury Department and the IRS recognized the difficulties and costs associated with requiring floating NAV money market funds to comply with the tax reporting requirements. Notably, given the nature of money market fund investments, tracking cost basis and holding periods for every share lot and reporting every redemption would have been overwhelmingly complex.

Instead, the Treasury regulations permit shareholders to use the "NAV method" to report gains and losses from money market funds.[46] This method allows investors to aggregate gains and losses for the calendar year on their tax returns, rather than reporting individual transactions.[47] Importantly, the NAV method is a shareholder-level

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[43] PWG Report at 30.

[44] Internal Revenue Code section 6045; Treas. Reg. § 1.6045-1(c)(3)(vi).

[45] Brokers and mutual funds are not required to report gross proceeds to certain institutional investors such as corporations, financial institutions, insurance companies, and other regulated investment companies. Treas. Reg. § 1.6045-1(c)(3)(i).

[46] Treas. Reg. § 1.446-7.

[47] Specifically, under the NAV method, gain or loss from shares in a floating NAV money market fund generally equal: (1) the aggregate fair market value of the shareholder's shares in the money market fund at the end of the computation period (generally the taxable year or any shorter period), minus (2) the aggregate fair market value of the shareholder's shares in the money market fund at the end of the prior
continued

option that requires the shareholder to track purchases, redemptions, and dividend reinvestments; it does not require funds to report any additional information to investors.

The Treasury Department and the IRS also clarified in 2014 that the "wash sale" rule (which prevents taxpayers from taking an immediate loss from the sale of securities if substantially identical securities are purchased within six months of the sale) does not apply to redemptions in floating NAV money market funds.[48] Absent this change, a taxpayer who redeemed shares at a loss and acquired new shares in the same money market fund through an automatic dividend reinvestment plan would not have been permitted to take the loss upon the sale.[49]

If stable NAV money market funds are required to implement swing pricing, the tax reporting requirements will need to be addressed. Investors who redeem shares during the swing pricing period would have losses (or gains) on those shares because the NAV would be below (or above) the price at which the shares were purchased. Further, investors who purchase shares during the swing pricing period would have a cost basis of something other than $1.00; when the investor redeems those shares, it would result in capital gain or loss, depending on the redemption price.

As noted above, money market funds are not required to report gross proceeds and cost basis to shareholders and currently do not have the systems to do so. The costs of requiring them to build the necessary capability would far outweigh the benefits to funds or shareholders. Absent guidance from the IRS, retail shareholders in a stable NAV money market fund that implements swing pricing would be responsible for tracking their cost basis and holding period for every share lot in the money market fund, and for reporting gain or loss on every redemption. These investors could use the NAV method to simplify their tax obligations, but this assumes that the shareholders are aware of and understand this option. This would lead to significant shareholder confusion, especially if swing pricing occurs infrequently. Discussions with the Treasury Department and the IRS would need to take place to address the tax reporting and

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period, minus (3) the shareholder's "net investment" in the money market fund. "Net investment" is equal to the aggregate cost of shares purchased during the period (including reinvested dividends) minus the aggregate amount received upon taxable redemptions during the same period. The character of the gain or loss is the same as that of the underlying shares in the hands of the investor. If the character is capital, it is short-term capital gain or loss. If the shares in the money market fund otherwise would give rise to both ordinary and capital gain or loss, then all gain or loss from the shares in that fund must be treated as capital gain or loss.

[48] Rev. Proc. 2014-45, 2014-34 I.R.B. 388.

[49] Instead, under the wash sale rule, the amount of the capital loss is added to the cost basis of the replacement shares, so that the loss is recognized when the replacement shares are later sold. *See* Internal Revenue Code section 1091.

other issues, including applicability of the wash sale rule, to ensure that retail shareholders are not unduly burdened.[50]

In sum, we agree with the SEC's conclusions that swing pricing is not necessary for money market funds because they already have the ability to impose liquidity fees, which serve a similar purpose and are a more appropriate tool for money market funds. Further, swing pricing would likely strip money market funds of key characteristics (such as multiple daily NAV strikes per day and same-day settlement), impose excess costs to overcome unnecessary and complex structural challenges, introduce complex tax reporting issues, and cause confusion among investors in periods of stress. Indeed, we do not believe that there are any potential benefits to employing swing pricing as a tool for money market funds that serve the PWG's overarching goals for reform.

3.2.2 Capital Buffer Requirements

The idea that money market funds or their advisers should maintain capital against money market fund assets is a flawed one, attempting to treat money market funds like banks.[51] It also is a proposal intended to address defaults on or credit quality concerns with money market fund portfolio assets that result in downward pressures on a money market fund's NAV and potentially cause a money market fund to break the buck (as occurred in 2008). This proposal does not address market liquidity issues (as occurred during March 2020).[52]

Over the years, ICI has analyzed several variations on the capital buffer idea: requiring fund advisers to commit capital; requiring funds to raise capital in the market; or having

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[50] The exemption to the wash sale rule in Rev. Proc. 2014-45 does not apply to stable NAV money market funds. It is unclear whether a money market fund that implements swing pricing still would be considered a stable NAV fund under this guidance.

[51] At its core, adding a capital requirement to money market funds appears to stem from incorrectly likening these funds to banks. Money market funds are not banks. Banks use leverage; hold long-term, often highly opaque investments; may have substantial off-balance sheet commitments; and have deposit insurance. Banks extend loans to businesses, consumers, and households. These loans are often highly illiquid; they may have maturities of 10 to 30 years and unique characteristics. Also, because loan characteristics may be unique, they can be hard to value. As a result, banks may be unable to quickly liquidate their assets when faced with deposit outflows. In the United States, banks are required to hold capital to protect the Federal Deposit Insurance Corporation, depositors, and other creditors from losses that may arise from holding a portfolio of illiquid, opaque assets. Money market funds, on the other hand, are highly restricted by regulations such as Rule 2a-7 on the maturity, liquidity, diversification, and credit quality of their securities, and do not have insurance. Investors in money market funds are shareholders, not creditors.

[52] We note that in 2013-2014, policymakers considered (and ultimately rejected) capital buffers for money market funds. For example, in 2014, the SEC concluded that capital buffers would not achieve its regulatory goals as well as the reforms that it had adopted, including a floating NAV requirement for institutional prime and institutional tax-exempt money market funds. *See* 2014 SEC Reform Release, *supra* note 10.

funds build a capital buffer by retaining fund income (rather than distributing income to fund shareholders).[53] In each case, we have found that the likeliest impact of a capital buffer requirement would be to impel money market fund sponsors to exit the business, depriving investors, issuers, and the economy of the benefits these funds provide.

3.2.2.1 Sponsor/Adviser Capital

Imposing capital buffer requirements on a fund adviser would transform the essential nature of a money market fund by interposing the adviser between the fund and its investors, requiring the adviser to guarantee a portion of the fund. Currently, fund advisers do not allocate capital to absorb losses because, as with all securities products, investors bear the risks of investing in funds. To be sure, some money market fund advisers have at times voluntarily provided financial support to their funds.[54] But these advisers did so as a business decision, subject to certain regulatory requirements. Requiring all fund advisers to take a first-loss position would be a radical departure from the current agency role that fund advisers play and what is contemplated under the federal securities laws. The mutual fund structure, including that of money market funds, is designed so fund advisory fees compensate the adviser for managing the fund as a fiduciary and agent and for providing ongoing services that the fund needs to operate. Advisers are not compensated for bearing investment risks of the fund.

The cost of providing a capital buffer also likely would be significant. Under money market funds' current structure, small and highly infrequent losses are spread across a large number of fund investors and a large asset base. If advisers are required to commit capital, small losses would be concentrated in a single investor (the adviser) and across a small asset base (the value of the capital buffer). The adviser could face large percentage losses on its capital buffer investment and thus would require a compensatory rate of return.

After steadily recovering from an extended period of near-zero interest rates between 2009 and 2015, short-term interest rates slid back into near-zero territory as the

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[53] *See e.g.*, 2013 ICI Letter to FSOC, *supra* note 6; Investment Company Institute, "The Implications of Capital Buffer Proposals for Money Market Funds" (May 2012) (2012 ICI Capital Buffer Paper), available at www.ici.org/pdf/ppr_12_mmfs_capital_buffer.pdf. For this analysis, ICI considered capital buffer levels ranging from 1.5 percent to 3 percent of fund assets.

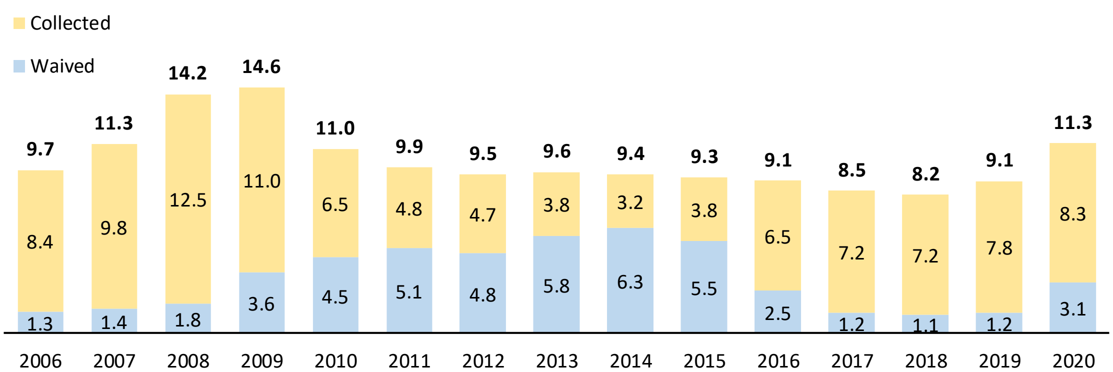
[54] The term "financial support" includes any: (i) capital contribution, (ii) purchase of a security from the fund in reliance on Rule 17a-9, (iii) purchase of any defaulted or devalued security at par, (iv) execution of letter of credit or letter of indemnity, (v) capital support agreement (whether or not the fund ultimately received support), (vi) performance guarantee, or (vii) any other similar action reasonably intended to increase or stabilize the value or liquidity of the fund's portfolio; excluding, however, any (i) routine waiver of fees or reimbursement of fund expenses, (ii) routine inter-fund lending, (iii) routine inter-fund purchases of fund shares, or (iv) any action that would qualify as financial support as defined above, that the board of directors has otherwise determined not to be reasonably intended to increase or stabilize the value or liquidity of the fund's portfolio. *See* Part C of Form N-CR.

COVID--19 crisis began to shutter parts of the US economy in March 2020. This places money market fund sponsors back under strain as most money market funds adopted expense waivers[55] to ensure that net yields (the yield on a fund after deducting expenses) do not fall below zero. In 2020, money market funds waived an estimated $3.1 billion in expenses compared with $1.2 billion in 2019 (Figure 2). Although money market fund sponsors also collected more fees in 2020 than in 2019, they waived 27 percent of the total fees they collected in 2020—more than double what they waived in 2019. More importantly, this near-zero interest rate environment is currently projected to persist through 2023,[56] which means money market funds are facing another extended period of expense waivers.

FIGURE 2

Fees Collected and Waived by Money Market Funds

Billions of dollars, annual



Memo: money market fund total net assets (trillions of dollars)

2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
2.3	3.1	3.8	3.3	2.8	2.7	2.7	2.7	2.7	2.8	2.7	2.8	3.0	3.6	4.3

Note: Does not include nonpublic institutional prime money market funds.
Source: Investment Company Institute calculations of iMoneyNet data

Requiring sponsors to pledge capital, even seemingly modest levels, risks further industry consolidation. Between 2008 and 2016, forty-three percent of money market fund sponsors exited the business (Figure 3). From 2016 through 2019, the number of sponsors leveled out as interest rates rose and markets showed signs of growth but dropped in 2020. As sponsors re-face pressures to waive expenses for the next few years, requiring capital buffers may cause more sponsors to leave the money market

[55] ICI uses the term *expense waivers* to refer to fee waivers and/or expense reimbursements.

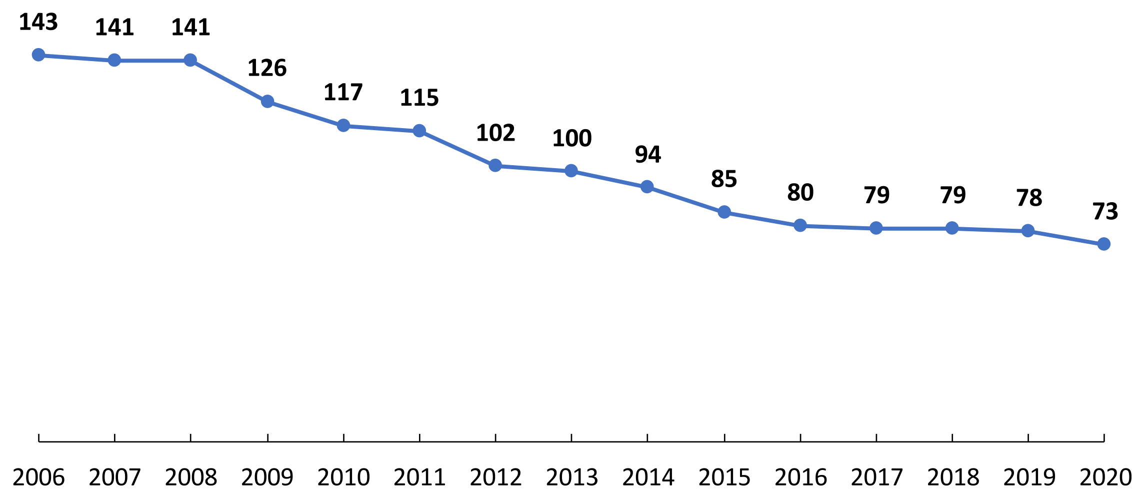
[56] *See* Federal Reserve Board: Press Release—Federal Reserve issues FOMC statement (December 16, 2020) and Summary of Economic Projections of the Federal Open Market Committee (December 16, 2020), available at www.federalreserve.gov/newsevents/pressreleases/monetary20201216a.htm and www.federalreserve.gov/monetarypolicy/fomcprojtabl20201216.htm, respectively.

fund business or move away from prime and tax-exempt money market fund products, which may lower sources of finances in those underlying markets.

FIGURE 3

The Number of Money Market Fund Sponsors Has Declined By About Half Since 2006

Year-end



Source: Investment Company Institute

Even in a more normal interest rate environment, advisers would have difficulty passing the cost of the required capital on to fund shareholders. Rule 2a-7's risk-limiting provisions effectively place a ceiling on what a prime money market fund may earn. Yields on Treasury funds set a floor on the yields that prime money market funds may return to investors after expenses, which in turn limits the fees that prime funds may charge. No rational investor would invest in a prime money market fund that offered a return below that of a Treasury or government fund.

In addition, any proposed increase in a fund's advisory fees must be put to a shareholder vote. Shareholder votes can be costly to undertake, and outcomes are not guaranteed. Even if shareholders accepted a fee increase, the necessary increase could be so large as to reduce the net yield on a prime fund below that of a Treasury money market fund. All else being equal, an increase in a fund's advisory fee will lower the fund's net yield. Any desire to offset the effect on the fund's yield by holding riskier and, therefore, higher yielding securities would be constrained by the risk-limiting provisions of Rule 2a-7 and would run directly counter to the goals of regulators.

3.2.2.2 Requiring Funds to Raise Capital in the Market

Market-provided capital also is not a feasible option for the money market fund industry. Adding subordinated debt or equity would turn a rather simple product—the money market fund—into a considerably more complex offering. Small funds and small fund complexes likely would find it difficult and costly to issue and roll over subordinated securities, resulting in further industry consolidation and raising a barrier to entrants. Finally, issuing subordinated debt would add "rollover risk" to money markets funds, because investors in this class of money market fund shares may well be reluctant to roll over their investments in times of market stress. Thus, the capital would disappear just when it might actually be needed.

A market-raised capital buffer would reduce the yield available to senior shareholders, and subordinated investors would have a highly levered—and hence potentially volatile—investment.[57] The compensation subordinated investors would demand for assuming such volatility would reduce the yield available to the senior share class. Another aspect of a market-raised capital buffer is that the smaller the capital buffer, the larger the potential losses to the subordinated investors. While the fund would be required to raise less capital, the resulting subordinated securities would be more levered, more volatile, and therefore more expensive and difficult to sell. Finally, it is unclear how well this structure would protect senior share class investors during times of market stress.[58]

3.2.2.3 Shareholder Capital Through Retained Income

Yet another alternative to raising capital is to allow money market funds to build a buffer internally by retaining part of their income over time. Under this method of building capital, a portion of the income generated by the fund's investments is retained by the fund—rather than distributed to shareholders—causing the fund's mark-to-market NAV to rise over time. Because of tax and economic considerations, however, a fund likely would need many years to build such a buffer.[59] As the analysis in the ICI

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[57] As previously discussed, concentrating losses to a smaller investor base and smaller asset base results in the subordinated investors taking on the potential for large percentage losses on their investments. They would demand a compensatory rate of return.

[58] Several other issues also could complicate the use of this structure. To be marketable, the subordinated securities would need to obtain a credit rating (and thus be structured as debt), but for various reasons, credit rating agencies would not be likely to treat the securities as debt. The legal structure of the subordinated securities—whether they are issued by the fund or issued by a special purpose bankruptcy remote entity—also would pose challenges.

[59] The Internal Revenue Code limits the speed at which a within-fund capital buffer can be built. To qualify as a regulated investment company (RIC) under the tax laws, a mutual fund, including a money market fund, must meet certain asset and diversification tests. A fund that satisfies these qualification tests may deduct from its taxable income an amount equal to the dividends it pays to its shareholders, effectively eliminating tax at the fund level, provided that the fund distributes at least 90 percent of its income (other than capital gains) each fiscal year. Failure to satisfy the distribution requirement would result in double taxation, at both the fund and shareholder levels. A fund may retain up to 10 percent of its income and all its capital gains for the fiscal year but will be subject to tax on those retained amounts at regular corporate rates. In addition, RICs are subject to an excise tax unless they distribute, by
continued

2012 Capital Buffer Paper shows, under plausible assumptions, building such a buffer might take a typical prime money market fund 10 to 15 years.[60] The exact horizon depends on whether short-term interest rates rise somewhat more quickly than is currently expected, how investors respond to a buildup of a within-fund capital buffer, and the willingness of advisers to continue to absorb the cost of maintaining large fee waivers. Indeed, in years with low interest rates, funds would not have the ability to accumulate, or increase substantially, a capital buffer. The burden of funding the buffer would automatically return to the sponsor, which as discussed above, may raise significant competitive and other concerns.

3.2.3 New Requirements Governing Sponsor Support

During times of market stress, such as the global financial crisis of 2007-2009 and the COVID-19 crisis, sponsor support has been a tool for stabilizing money market fund share prices and providing liquidity. The Report notes that the discretionary nature of sponsor support, however, contributes to uncertainty about who will bear risks in periods of stress, including when there is a run on a money market fund. Currently, money market fund sponsors may provide support to their funds pursuant to certain conditions under Rule 17a-9 under the Investment Company Act and must make public disclosure of any "financial support"[61] to increase transparency on Forms N-CR and N-MFP. The proposed reform would establish a regulatory framework to govern when a sponsor would be *required* to provide support. This reform option suffers from many of the same drawbacks as imposing capital buffer requirements on fund advisers.

As noted above, money market fund sponsors act as agents for their funds and are not compensated for bearing investment risks of their funds. Rather, fund investors retain, and should expect to retain, all investment risks. Disclosure to investors of that fact, and of the nature of these risks, is clear and unambiguous. On the other hand, requiring fund sponsors to provide financial support to their money market funds creates a

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December 31, at least 98 percent of ordinary income earned in the calendar year and 98.2 percent of capital gains earned during the 12-month period ending on October 31, plus 100 percent of any previously distributed amounts. Because of these two distribution requirements, RICs generally distribute substantially all their income and capital gains each year. As a result, a money market fund could at most set aside 10 percent of its annual income (assuming it has income) toward a capital buffer. The fund, however, would be subject to corporate tax (currently 21 percent) on the amount retained plus excise tax (4 percent) on the under-distribution. This would reduce the amount that a money market fund could set aside to at most 7.58 percent or less of its income in any given year. Further, the amount retained would be reduced by an additional 4 percent excise tax for each year in which the amount is not distributed. In other words, the original 7.58 percent retained in year 1 would be reduced to 7.28 percent in the second year, 6.99 percent in the third year, and so on. The excise tax thus would reduce each year any amount of capital buffer held by a money market fund.

[60] *See* 2012 ICI Capital Buffer Paper, *supra* note 53.

[61] Although the PWG Report does not define the term sponsor support, the terms sponsor support and financial support, as defined in *supra* note 54, are generally used interchangeably in the United States.

guaranteed fund, which introduces clear moral hazards. Indeed, the prospect of guaranteed sponsor support may make investors less careful in their choice of funds.

3.2.4 Minimum Balance at Risk

An MBR is a potential reform that would make a portion of each shareholder's recent balances in a money market fund available for redemption only with a time delay to ensure that redeeming investors still remain partially invested in the fund over a certain time period.[62] Under this proposal, investors who redeem all of their available shares, would still share in any losses incurred by the fund during that timeframe. The size of the MBR would be a specified fraction of the shareholder's maximum recent balance (less an exempted amount). The PWG asserts that a "strong form" of MBR also would "subordinate" a portion of redeeming shareholders' MBRs so they absorb any losses before other non-redeeming shareholders, creating a disincentive to redeem. The PWG notes that the MBR mechanism could be used in a floating NAV money market fund to allocate losses only under certain rare circumstances, such as when the fund suffers a large drop in NAV or is closed.

The hypothesis is that the MBR could prevent or mitigate redemption pressure by removing investors' incentives to be among the first to redeem (the so-called first-mover advantage), while also making explicit the fact that money market funds entail risks to their investors.

In our judgment, the MBR would not advance the goals of reform for three primary reasons: investors would not invest in money market funds with these redemption restrictions; an MBR may actually increase the likelihood of a run; and MBR-type restrictions are costly, operationally complex, and difficult to implement. Indeed, the likeliest impact of an MBR requirement would be to drive investors as well as intermediaries away from these money market funds.

3.2.4.1 Investors Will Reject Funds with MBR Restrictions

An MBR type restriction would impair a core mutual fund investor protection and reverse more than 80 years of SEC practice in fund regulation. Under the Investment Company Act, one hallmark feature of mutual funds, including money market funds, is

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[62] In 2012-2013, policymakers considered (and ultimately rejected) an MBR proposal that would have required fund sponsors and intermediaries to restrict 3 percent of a shareholder's highest account value in excess of $100,000—a "hold back" to absorb first losses if a fund could not maintain its $1.00 NAV. *See e.g.*, Proposed Recommendations Regarding Money Market Mutual Fund Reform, Financial Stability Oversight Council, FSOC-2012-0003 (November 2012), available at www.treasury.gov/initiatives/fsoc/Documents/Proposed%20Recommendations%20Regarding%20Money%20Market%20Mutual%20Fund%20Reform%20-%20November%2013,%202012.pdf. Like capital buffers, the MBR concept, as envisioned in 2012-2013, was intended to address defaults on or credit quality concerns with money market fund portfolio assets (as occurred in 2008) and not market liquidity issues (as occurred during March 2020).

that they issue "redeemable securities," meaning that the fund stands ready to buy back its shares at their current NAV. Section 22(e) of the Investment Company Act generally prohibits funds from suspending the right of redemption and from postponing the payment or satisfaction upon redemption of any redeemable security for more than seven days, except under extraordinary circumstances that are delineated in the statute or determined by SEC rule. Under this authority, in 2010, the SEC adopted Rule 22e-3, which exempts money market funds from Section 22(e) to permit them to suspend redemptions and postpone payment of redemption proceeds—but only in very limited circumstances, *i.e.,* to facilitate an orderly liquidation of the fund.[63] The SEC used this authority again in 2014 to permit a money market fund to gate its fund for up to 10 business days in a 90-day period if the fund's weekly liquid assets fall below 30 percent.[64] By contrast, the MBR would permanently alter the ability of money market fund shareholders to redeem all of their shares on a daily basis.

Throughout the history of money market funds, investors have benefited from the convenience and liquidity of these funds. Retail investors use money market funds as a tool that provides a current money market rate of return on cash that is awaiting investment or other disposition, that is held as savings, or that constitutes the principal component (for stable NAV money market funds) of an investment or retirement portfolio. Institutional investors—which for these purposes include corporations of all sizes, state and local governments, securities lending operations, bank trust departments, securities brokers, and investment managers—use money market funds as a cost-effective way to manage and diversify credit risk, while providing same-day liquidity with market-based yields.

ICI strongly opposes any sort of redemption restriction that would impair this investor liquidity when liquidity is readily available within the money market fund. Investor reaction to continuous redemption restrictions, such as the MBR, also suggests that imposition of an MBR would greatly reduce investor use of these money market funds. We surveyed corporate treasurers and other institutional investors when the MBR was

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[63] *See* 2010 SEC Reform Release, *supra* note 9. When it adopted Rule 22e-3, the SEC noted that the rule "is intended to reduce the vulnerability of investors to the harmful effects of a run on the fund, and minimize the potential for disruption to the securities markets." *Id*. at 98. The SEC recognized, however, that permitting suspension of this statutory protection should be limited to extraordinary circumstances, stating: "Because the suspension of redemptions may impose hardships on investors who rely on their ability to redeem shares, the conditions of the rule limit the fund's ability to suspend redemptions to circumstances that present a significant risk of a run on the fund and potential harm to shareholders. The rule is designed only to facilitate the permanent termination of a fund in an orderly manner." *Id*.

[64] *See* 2014 SEC Reform Release, *supra* note 10. According to the SEC, the purpose of these amendments is to allow the board of a money market fund to "impose gates to benefit the fund and its shareholders by making the fund better able to protect against redemption activity that would harm remaining shareholders, and to allow time for any market distress to subside and liquidity to build organically." *Id*. at 113.

first proposed in 2012.[65] At that time, 90 percent of these investors indicated that they would reduce their usage of money market funds, or stop using them altogether, if MBR restrictions were put in place. Preliminary discussions with members today suggest that investor reaction would be similar.

The MBR requirement, in itself, also would remove these money market funds as a viable option in many instances. Fiduciaries, such as retirement plans, trustees, and investment advisers, may be legally prohibited from using money market funds with constant redemption restrictions for their clients because such restrictions would impair clients' liquidity and be punitive in nature.

3.2.4.2 MBR Restrictions May Increase Investor Redemptions

Although the PWG suggests that an MBR would provide a disincentive for shareholders to redeem in times of stress, we believe that such a restriction would actually *increase* a shareholder's likelihood of redeeming during a financial crisis. Indeed, members have suggested that, with a portion of their balances held back and subordinated, shareholders would be more likely to redeem at the slightest sign of stress in the markets, given the punitive and complex nature of the MBR.

3.2.4.3 MBR Restrictions Pose Significant Operational Challenges

An MBR also would create serious operational issues that would reduce or eliminate the usefulness of many services that money market funds and financial providers extend to investors. In 2012, ICI issued a paper that focused on the operational implications of an MBR concept.[66]

Investors can purchase and redeem money market fund shares directly from fund sponsors or through a wide array of platforms, portals, and financial intermediaries such as broker-dealers and retirement plans.

Implementing a proposed freeze on shareholders' assets would require changes to myriad complex systems that extend well beyond those under the control of the funds themselves. Fund complexes, intermediaries, and service providers have developed these systems to communicate and process significant volumes of money market fund transactions on a daily basis through a variety of mechanisms on behalf of investors. To apply continuous redemption restrictions accurately and consistently across all investors in certain money market funds, each of these entities, including intermediaries, would need to undertake intricate and expensive programming and other significant and costly system changes. The costs of these changes would likely be prohibitive, particularly if

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[65] *See* Investment Company Institute, "Operational Impacts of Proposed Redemption Restrictions on Money Market Funds" (2012), available at www.ici.org/pdf/ppr_12_operational_mmf.pdf, at 3.

[66] *See id.*

such changes greatly curb investor interest in these money market funds, as members and surveys clearly indicate would happen. It would be difficult for intermediaries, in particular, to justify such expense given the size of the money market fund assets under consideration for reform.

The likely consequences of an MBR requirement thus are mutually reinforcing. Fund complexes, intermediaries, and service providers would be hard-pressed to justify undertaking the significant costs of compliance with the restrictions in the face of the rapid shrinkage of these money market fund assets. The total effect would be to drive users away from these money market funds and disrupt short-term financing for the economy.

3.2.5 Require Liquidity Exchange Bank Membership

This reform would require prime and tax-exempt money market funds to be members of a private liquidity exchange bank that would provide a liquidity backstop during periods of market stress. Over ten years ago and in response to the June 2009 Treasury Department paper on financial regulatory reform,[67] which called for exploring measures to require money market funds "to obtain access to reliable emergency liquidity facilities from private sources,"[68] ICI developed a preliminary framework for a private liquidity facility, including how it could be structured, capitalized, governed, and operated.[69]

At that time, we believed a liquidity facility could address many of the risks and challenges of the 2007-2009 global financial crisis to stable NAV prime money market funds provided that: prime money market funds participating in the liquidity facility would be permitted to use amortized cost and continue to seek to maintain a stable NAV; the cost of participation was reasonable given the yield environment at that time; and the liquidity facility was a factor when regulators considered bank liquidity and capital requirements for banks that sponsor money market funds.

Our framework also described many drawbacks, limitations, and challenges to creating a private liquidity facility that are now listed in the PWG Report. In 2014, the SEC adopted different money market fund reforms, including a floating NAV requirement for all prime and tax-exempt money market funds sold to institutional investors and new fee and gate tools for all prime and tax-exempt money market funds, including retail funds. As a result of those reforms, the prime money market fund industry, including the

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[67] *See Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation* (June 17, 2009), available at www.treasury.gov/initiatives/Documents/FinalReport_web.pdf.

[68] *Id.* at 38.

[69] For details regarding the proposed liquidity facility, including its estimated costs and challenges, *see* 2011 ICI Letter to PWG, *supra* note 6, at 23-31.

number of prime fund sponsors, substantially shrunk. When we originally considered a liquidity facility in January 2011, prime money market funds' assets totaled $1.6 trillion and there were 105 prime fund sponsors. Today, the prime money market fund industry is vastly more concentrated—with total net assets of $541 billion among just 27 sponsors as of January 31, 2021. Given the significant costs and other challenges of establishing a viable liquidity facility that could provide meaningful liquidity for money market funds in stress events, members have indicated that they would simply stop sponsoring money market funds if membership to a liquidity facility was required.

3.3 Reforms That Are Unlikely to Advance the Goals of Reform

We believe three reform options are unlikely to address the liquidity-related stresses that were evident in March 2020.

3.3.1 Floating NAVs for All Prime and Tax-Exempt Money Market Funds

Retail prime money market funds and retail tax-exempt money market funds currently can sell and redeem shares at a stable share price (*e.g.*, $1.00). This reform would require that these money market funds sell and redeem their shares at a price that reflects the market value of a fund's portfolio consistent with the current floating NAV requirements for institutional prime and institutional tax-exempt money market funds that the SEC adopted in 2014. The Report suggests that a floating NAV may address the incentive of money market fund shareholders to redeem shares in times of fund and market stress based on the fund's valuation and pricing methods, and to improve the transparency of pricing associated with money market funds.[70] We are highly skeptical that such a requirement would reduce risks in any meaningful way. Floating NAVs also could eliminate key benefits to retail investors and introduce tax reporting issues.

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[70] The SEC adopted the floating NAV requirement for certain money market funds in 2014 because it believed the floating NAV would "reduce the first-mover advantage inherent in a stable NAV fund, by disincentivizing redemption activity that can result from investors attempting to exploit the possibility of redeeming shares at the stable share price even if the portfolio has suffered a loss." Securities and Exchange Commission, "SEC Adopts Money Market Fund Reform Rules," press release (July 23, 2014) (2014 SEC Press Release), available at www.sec.gov/news/press-release/2014-143. They noted that "the size of institutional investors' holdings and their resources for monitoring funds provide the motivation and means to act on this incentive" and "that institutional investors redeemed shares at a much higher rate than retail investors from prime money market funds in...September 2008." 2014 SEC Reform Release, *supra* note 10, at 144. The floating NAV amendments also "are intended to reduce the chance of unfair investor dilution and make it more transparent to certain of the impacted investors that they, and not the fund sponsors or the federal government, bear the risk of loss." *See* 2014 SEC Press Release. Accordingly, the SEC explained that the floating NAV is designed "for those funds that are more vulnerable to credit events (compared to government funds) and that have an investor base more likely to engage in heavy redemptions (compared to retail investors)." 2014 SEC Reform Release, *supra* note 10, at 147.

3.3.1.1 Floating NAVs are Unlikely to Significantly Reduce Redemption Activity

As the Report acknowledges, a floating NAV did not stop heavy redemptions in March 2020 for institutional prime money market funds. Indeed, the other features of these funds and the nature of the money market itself still make certain money market funds susceptible to sudden, high redemption requests.[71]

First, a floating NAV does not alter investors' views about whether money market funds are low risk-investments. Under normal conditions, the shadow prices of stable NAV money market funds and the market prices of floating NAV money market funds' portfolios generally deviate very little from $1.00. This is simply a reflection of the fact that all money market funds invest in very short-term, high-quality, fixed-income securities and the price of these securities deviates little from their amortized cost value absent a large interest rate movement or credit event. Regardless of their valuation method, money market funds continue to be exposed to interest rate and credit risk. When risk intolerant investors seek to move away from certain funds or broad sectors of the markets during future crises, the transition would continue to be potentially disruptive.

Moreover, the short-term funding market itself historically is susceptible to liquidity pressures. Lenders in this market typically need ready access to their cash and have a low tolerance for financial risk. Borrowers depend on these markets to meet their immediate funding needs. Rollover issuances are a very high percentage of the outstanding short-term securities. During periods of financial stress, risk intolerant investors can and do move quickly out of the markets, leaving large supply and demand imbalances, which can cause volatility in short-term interest rates.

The combination of these factors results in the short-term funding market and money market funds operating for long periods of time in relative tranquility punctuated by stress events. Investors' desire to have exposure to the short-term funding market, either directly or through money market funds, declines during these periods of stress. The Report suggests that floating the NAV could reduce the likelihood of investors wanting to move away from the short-term funding market during these events. We disagree. Indeed, experiences in March 2020 suggest otherwise. Institutional prime money market funds had floating NAVs but still experienced large redemptions. On the

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[71] A floating NAV does not avert redemptions during periods of market stress. *See e.g.*, 2013 ICI Letter to SEC, supra note 6; 2013 ICI Letter to FSOC, *supra* note 6; *Perspectives on Money Market Mutual Fund Reforms*, written testimony of Paul Schott Stevens, President and CEO, Investment Company Institute, before the US Senate Committee on Banking, Housing and Urban Affairs (June 21, 2012), available at www.ici.org/pdf/12_senate_pss_mmf_written.pdf; 2011 ICI Letter to PWG, *supra* 6; 2009 MMWG Report, *supra* note 3, at 105-107.

other hand, retail prime money market funds with stable NAVs experienced much more modest redemptions.[72]

The experience in Europe of certain money market funds likewise demonstrates that floating NAV funds also can face strong investor outflows during periods of market turmoil. For example, in March 2020, French floating NAV money market funds, lost about 16 percent of their February month-end assets.[73]

For these reasons, we remain doubtful that floating the NAV for retail money market funds is necessary and more generally, that it reduces risks in any meaningful way.

3.3.1.2 Floating NAVs Could Eliminate Key Benefits to Retail Shareholders

The Report acknowledges that elimination of a stable NAV for retail prime and tax-exempt money market funds would be a dramatic change for these funds. One very significant concern, as the Report notes, is whether investors would continue to use such a product. We believe the answer is no. A floating NAV would reduce the value and convenience of money market funds to individual retail investors. For example, brokers and fund sponsors typically offer investors a range of features tied to their money market funds, including ATM access, check writing, and ACH and Fedwire transfers. These features are generally only provided for stable NAV products. The stable NAV also enables the processing of cash balances through cash sweep programs, in which all customer cash balances are "swept" into investments in shares of money market funds that are owned by the customers but transacted through fund accounts registered to a broker-dealer or a bank. Sweep programs cannot typically accommodate floating NAVs.

3.3.1.3 Floating NAVs Would Introduce Tax Reporting Issues

Floating NAVs would introduce new tax reporting issues for retail investors. As noted above in **Section 3.2.1.4**., both stable and floating NAV money market funds are exempt from certain tax reporting requirements under the tax laws. Because stable NAV money market funds transact at $1.00, their shareholders do not have capital gains or losses. Floating NAVs would cause these shareholders to realize capital gains and losses in connection with each redemption transaction and require them to track their cost basis and report capital gains and losses on their tax returns. When the money market fund reforms were adopted in 2014 to require floating NAVs for institutional prime and institutional tax-exempt money market funds, the Treasury regulations also were

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[72] For a description of money market fund flows during March 2020, *see* 2020 ICI Money Market Fund Report, *supra* note 5, beginning at 12.

[73] For a more detailed discussion of the experience of European money market funds during the COVID-19 crisis, *see* Investment Company Institute, "Experiences of European Markets, UCITS, and European ETFs During the COVID-19 Crisis*," Report of the COVID-19 Market Impact Working Group* (December 2020), available at www.ici.org/pdf/20_rpt_covid4.pdf, at 13-16.

amended to address and streamline certain tax reporting requirements for floating NAV money market funds. Specifically, the Treasury regulations permit shareholders to use the "NAV method" to report gains and losses from floating NAV money market funds. Importantly, the NAV method is a shareholder-level tax accounting method that requires the shareholder to track purchases, redemptions, and dividend reinvestments. This means that for the first time, retail money market fund shareholders would be required to track and aggregate their transactions to calculate and report their capital gains and losses. This would likely lead to tax compliance problems and significant shareholder confusion that would diminish the utility of the product for these investors.

3.3.2 Countercyclical Weekly Liquid Asset Requirements

The Report expresses concerns that prime and tax-exempt money market funds that were close to the 30 percent weekly liquid asset threshold may have determined not to use their liquid assets to meet redemptions to avoid prohibitions on purchasing assets that are not weekly liquid assets; raising investor concerns about the potential imposition of fees or gates; and potential scrutiny resulting from public disclosure of low weekly liquid amounts. To address these concerns, the Report proposes a countercyclical weekly liquid asset requirement that could automatically reduce minimum weekly liquid asset requirements in certain circumstances, such as when net redemptions are large or when the SEC provides temporary relief from weekly liquid asset requirements. Any thresholds linked to a fund's minimum weekly liquid asset requirements (*e.g.*, fees or gate thresholds) also would move with the minimum.

As the Report acknowledges, current rules do not preclude funds from using weekly liquid assets to meet redemptions or prohibit funds from falling below the 30 percent threshold. Indeed, as discussed above, before the 2014 reforms that tied a fund's ability to impose a fee or gate to the weekly liquid asset thresholds, money market funds regularly dipped below 30 percent without raising questions about the resiliency of the funds. Thus, at that time, money market funds in effect could already avail themselves of a countercyclical liquidity buffer. In March 2020, money market funds were not able to use their weekly liquid assets to meet redemptions because investors feared the mere possibility of fees or gates if a fund dipped below 30 percent. We therefore do not believe this reform will improve the usability of weekly liquid asset requirements.

3.3.3 Reform Conditions for Imposing Redemption Gates

To provide tools intended to slow an investor run should it occur, the 2014 SEC reforms gave fund boards new fee and gate tools for all prime and tax-exempt money market funds. Under the fee and gate provisions, boards are permitted to impose liquidity (redemption) fees of up to 2 percent or to temporarily suspend redemptions (gates) if the fund's weekly liquid assets falls below 30 percent.[74] Although liquidity fees provide investors continued access to cash redemptions, gates stop redemptions altogether for up to ten business days. Based on the experience of certain money market funds last March (primarily, institutional publicly offered prime money market funds), the Report expresses concern that rather than making money market funds more resilient, the mere prospect of gates may have caused investors to engage in preemptive runs. To this end, members report that investors view access to their money as paramount during a period of market stress and are less concerned with "losing a few pennies" through, for example, a fee.

In response to this concern, the Report includes a potential reform that would reduce the likelihood that redemption gates may be imposed by, for example, requiring funds to obtain SEC permission, requiring fund boards to consider liquidity fees before gates, or lowering the weekly liquid asset threshold at which gates could be imposed (*e.g.*, 10 percent). Another option would be to reform gate rules to make gates "soft" or "partial" if redemptions on a particular day exceed a certain amount. For example, with "soft" gates a fund could reduce each investor's redemption pro rata to bring total redemptions below that amount, with remaining redemption amounts deferred to the next business day (and continuing daily deferrals until all redemption requests are satisfied).

Rather than reforming conditions for imposing redemption gates, we believe gates should be limited to extraordinary circumstances that present a significant risk of a run on a fund and potential harm to shareholders, such as those contemplated under Rule 22e-3 under the Investment Company Act, which permits a money market fund to suspend redemptions *only* to facilitate an orderly liquidation of the fund. Indeed, we believe that if thresholds for gates remain (even if substantially lower), they could still be focal points for preemptive runs.

4. ICI Research: March 2020 Events and the Role of Money Market Funds

The short-term funding markets provide financing to a range of borrowers, including governments (federal, state, and local), businesses, and financial institutions, which in turn often use the funding to lend to households through auto loans, consumer finance loans, home equity lines of credit, and credit card lending. Prime money market funds purchase commercial paper and CDs, which are an important source of financing in the short-term funding markets. The March 2020 liquidity crisis placed severe strains on and impaired the functioning of the short-term funding markets.

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[74] In addition, funds must impose a 1 percent liquidity fee if weekly liquid assets fall below 10 percent of total assets, unless the fund's board determines that imposing the fee is not in the best interests of the fund.

As discussed below, prime money market funds did not significantly reduce their funding in these markets in the days leading up to the Federal Reserve's announcement of the MMLF on March 18. This evidence raises questions about the priority policymakers—especially those focused on financial stability—have given to deciding on new regulatory reforms of money market funds when they have not yet done an analysis of *all* market participant activities in the short-term funding markets.

As of the end of February 2020 (prior to the onset of the turmoil in financial markets from the COVID-19 healthcare crisis), prime money market funds held $324 billion in commercial paper and $352 billion in CDs (Figure 4). These holdings represented 29 percent and 14 percent of the total outstanding amount of commercial paper and CDs, respectively. This means that other market participants held the bulk of outstanding commercial paper (71 percent) and outstanding CDs (86 percent) at the end of February 2020.

Prime money market fund holdings of commercial paper and CDs are further divvyed up across the three types of prime money market funds–retail,[75] public institutional,[76] and nonpublic institutional.[77] Of these three categories, retail prime money market funds held the largest shares of outstanding commercial paper (13 percent) and CDs (7 percent) at the end of February 2020.[78] Public institutional prime money market funds, which have been a focus of regulators and policymakers in the past year, held relatively small shares of outstanding commercial paper (8 percent) and CDs (5 percent).[79] Nonpublic institutional prime money market funds held 8 percent of outstanding commercial paper and only 2 percent of outstanding CDs at the end of February 2020.[80]

[75] Retail prime money market funds are publicly available for sale only to "natural persons"—in other words, individual investors. *See* Rule 2a-7(a)(21).

[76] For a description of public institutional prime money market funds, *see supra* note 15.

[77] For a description of nonpublic institutional prime money market funds, *see supra* note 3.

[78] As of the end of February 2020, retail prime money market funds had $479 billion in total net assets.

[79] As of the end of February 2020, public institutional prime money market funds had $313 billion in total net assets.

[80] As of the end of February 2020, nonpublic institutional prime money market funds had $276 billion in total net assets.

FIGURE 4

Although an Important Source of Financing, Prime Money Market Funds Are Not the Only Participants in the Short-Term Funding Markets

February 2020

	Total amount outstanding	Prime money market fund holdings		Memo: Percentage of total amount outstanding, by prime fund type		
	Billions of dollars	Billions of dollars	Percentage of total amount outstanding	Retail	Public institutional	Nonpublic institutional
Taxable short-term	$11,880	$1,041	9%	4%	3%	2%
Short-term Treasuries[1]	4,563	101	2	1	0	1
Repurchase agreements[2]	2,586	219	8	4	3	2
Short-term agency debt[3]	1,016	45	4	0	0	4
Commercial paper	1,136	324	29	13	8	8
Certificates of deposit[4]	2,579	352	14	7	5	2

[1]This category includes marketable Treasury securities that are held by the public and are due to mature by the end of February 2021.
[2]This category includes repurchase agreements with primary dealers, including gross overnight, continuing, and term repurchase agreements on Treasury, agency, mortgage backed, and corporate securities.
[3]This category includes debt issued by Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System that is due to mature by the end of February 2021; it excludes agency-backed mortgage pools.
[4]This category reflects large (or jumbo) certificates of deposit, which are issued in amounts greater than $100,000. This category also includes claims on foreigners for negotiable certificates of deposit and nonnegotiable deposits payable in US dollars, as reported by banks in the United States for those banks or those banks' customers' accounts.
Sources: Investment Company Institute, SEC form N-MFP, Federal Reserve Board, US Treasury Department, Fannie Mae, Freddie Mac, Federal Home Loan Banks, Federal Reserve Bank of New York, and Bloomberg

As the PWG Report recognizes, during the March 2020 dash for cash, *all* investors—not just prime money market funds—were scrambling for liquidity and were forced to navigate the resulting stress in the short-term funding markets, including the commercial paper market.[81] The analysis presented in this section is intended to shed light on how the three types of prime money market funds (public institutional, nonpublic institutional, and retail) navigated the unprecedented market strains during March 2020. We focus on prime money market funds' participation in the markets for commercial paper and CDs in the first half of March 2020, as well as their participation in the MMLF.[82]

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[81] PWG Report at 11 ("Amid escalating concerns about the economic impact of the COVID-19 pandemic in March 2020, market participants sought to rapidly shift their holdings toward cash and short-term government securities. This rapid shift in asset allocation preferences placed stress on various components of short-term funding markets").

[82] Recognizing that further measures were necessary to provide liquidity to the short-term funding markets, the Federal Reserve announced the creation of the MMLF the evening of March 18, 2020. This facility, which began operations on March 23, allows banks to borrow from the Federal Reserve by pledging as collateral eligible securities that they purchase from prime money market funds beginning on March 18 2020. For a detailed description of the MMLF, *see* 2020 ICI COVID-19 Report, *supra* note 8, at 50.

Specifically, we conducted a survey of our members to gather data on public institutional, nonpublic institutional, and retail prime money market funds' daily gross purchases and gross sales of commercial paper and CDs from March 2 to March 18, 2020—the period before the announcement of the MMLF—and detailed information on any assets that were ultimately pledged to the MMLF starting on March 19.[83]

Our main findings from our analysis include:

- Contrary to popular impressions, prime money market funds, in aggregate, sold only small amounts of commercial paper and CDs in the secondary market before the MMLF was announced on March 18, 2020. This underscores our earlier findings that prime money market funds did not trigger the distress in the short-term funding markets.[84]

- Public institutional and retail prime money market funds accounted for just 19 percent of the reduction in financial and nonfinancial commercial paper outstanding during the week-ended March 18. Other market participants accounted for 81 percent of the decline. To the extent policymakers are looking to mitigate the possibility of future distress in the short-term funding markets, they should prioritize examining the role of other market participants.

- Consistent with the PWG Report, we found that experiences differed across the three categories of prime money market funds. Public institutional prime money market funds' sales of commercial paper and CDs were remarkably limited, given their outflows. Retail prime money market funds sold only small amounts of commercial paper and CDs, and nonpublic institutional money market funds in aggregate sold *no* commercial paper or CDs before the Federal Reserve announced the MMLF on March 18.

- Public institutional prime and retail prime money market funds sold commercial paper and CDs that were ultimately pledged to the MMLF after it was announced on March 18, 2020, but did so primarily to raise weekly liquidity asset levels and keep well them well above 30 percent. Retail prime money market funds, though accounting for 60 percent of the assets of public prime money market funds, accounted for only one-fourth of the MMLF activity, and those funds reported selling MMLF eligible collateral exclusively to keep their weekly liquid assets well above 30 percent.

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[83] Eighteen prime money market fund sponsors responded to the survey. These respondents represented 70 percent of the number of prime money market funds and 95 percent of prime money market fund assets as of February 2020.

[84] *See* 2020 ICI Money Market Fund Report, *supra* note 5.

4.1.1 Prime Money Market Funds Did Not Pull Back Significantly from the Commercial Paper Market

Some policymakers and regulators have stated that outflows from prime money market funds were a significant driver of stress in the commercial paper market in March 2020.[85] They theorize that because prime money market funds had sizeable outflows, these funds were forced to pullback from the commercial paper market (*i.e.,* shrink their holdings of commercial paper) by selling large amounts of commercial paper on the secondary market and/or significantly reducing their purchases of newly-issued commercial paper to raise cash to fund redemptions. They further theorize that these actions of money market funds put undue stress on the commercial paper market. Before considering any money market fund reform options, however, it is important to examine how last year's events, and the actions of all market participants, not just money market funds, led to significant strains in the short-term funding markets last March.

The PWG Report states that structural vulnerabilities of money market funds can amplify market stress and purports to show that prime money market funds' actions in March were particularly outsized relative to other holders of commercial paper. According to the PWG Report, public institutional prime and retail prime money market funds reduced their commercial paper holdings by $35 billion from March 10 to March 24, and "this reduction accounted for 74 percent of the $48 billion overall decline in outstanding commercial paper over those two weeks."[86]

This statement invites readers to assume *inaccurately* that public institutional and retail prime money market funds were responsible for the bulk of the decline in the commercial paper market before the Federal Reserve's announcement of the MMLF on March 18. However, two-thirds of the $35 billion decline in public institutional and retail prime money market funds' holdings of commercial paper during that two-week

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[85] *See, e.g.,* Federal Reserve Board Governor Lael Brainard, "Some Preliminary Financial Stability Lessons from the COVID-19 Shock," (Speech at the Institute of International Bankers) (March 1, 2021), available at www.federalreserve.gov/newsevents/speech/brainard20210301a.htm, ("The run in March forced MMFs to rapidly reduce their commercial paper holdings, which worsened stress in short-term funding markets. Funding costs for borrowers shot up, and the availability of short-term credit at maturities beyond overnight plunged."); International Monetary Fund, *Global Financial Stability Report: Markets in the Time of COVID-19* (April 2020), available at www.imf.org/en/Publications/GFSR/Issues/2020/04/14/global-financial-stability-report-april-2020, (stating that prime money market funds seeking to "reduce their commercial paper holdings to raise cash and build liquidity buffers in response to actual and expected investor outflows" contributed to the US commercial paper market freezing).

[86] PWG Report at 11-12. Typically, prime money market funds hold commercial paper to maturity and then repurchase newly-issued commercial paper in the primary market with the proceeds from the matured paper (*i.e.*, rollover). In stressed markets, prime money market funds may reduce their purchases of newly-issued commercial paper and/or seek to sell commercial paper that has not yet matured in the secondary market.

period were attributable to sales that occurred *after* March 18 and were primarily for the purposes of accessing the liquidity offered through the MMLF to keep the level of their weekly liquid assets well above 30 percent. According to ICI's survey, public institutional and retail prime money market funds sold $23 billion in commercial paper from March 19 through March 24 to banks that ultimately pledged the commercial paper as collateral to the MMLF.[87] The PWG's analysis should have ignored these sales because they did not add to market stresses (in fact, the Federal Reserve explicitly noted that sales to the MMLF helped relieve stresses).[88]

If the PWG's analysis had focused on changes in the commercial paper market before the Federal Reserve announced the MMLF, the picture changes dramatically: despite substantial outflows, public institutional and retail prime money market funds did not pullback significantly from the commercial paper market in the week preceding the MMLF announcement. From March 10 through March 17, public institutional and retail prime money market funds together had outflows of $64.3 billion,[89] yet they reduced their holdings of commercial paper issued by nonfinancial companies and financial institutions by only $5.6 billion (Figure 5).[90] Furthermore, this reduction accounted for only 19 percent of the $28.8 billion change in outstanding nonfinancial and financial commercial paper in the week-ended March 18.[91] Public institutional and retail prime money market funds also had very little change in their holdings of asset-backed commercial paper in the week-ended March 17—a mere $0.6 billion decline.[92] In short,

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[87] In addition, as prime money market funds were actively seeking to keep their weekly liquid asset ratios well above 30 percent, it is highly likely that this commercial paper had a remaining maturity of greater than one week. As a result, because this commercial paper likely had not matured, it could not have contributed to the decline in the market-wide outstanding commercial paper cited in the PWG Report.

[88] *See* M. Cipriani, G. La Spada, R. Orchinik, and A. Plesset, "The Money Market Mutual Fund Liquidity Facility," *Liberty Street Economics* (Federal Reserve Bank of New York blog) (May 8, 2020), available at libertystreeteconomics.newyorkfed.org/2020/05/the-money-market-mutual-fund-liquidity-facility.html.

[89] Public institutional prime money market funds saw outflows of $52.6 billion and retail prime had outflows of $11.7 billion.

[90] Public institutional prime money market funds reduced their holdings of nonfinancial and financial commercial paper by $6.6 billion and retail prime funds increased their holdings by $1.0 billion in the week ended March 17.

[91] There is a one-day mismatch between the change in prime money market funds' commercial paper holdings for the week-ended March 17 and the change in market-wide commercial paper outstanding for the week-ended March 18. iMoneyNet collects weekly holdings of money market funds as of Tuesdays and the Federal Reserve publishes weekly outstanding commercial paper as of Wednesdays. We assume the statistics cited in the PWG Report for the two-week period ended March 24 had a similar timing mismatch between the iMoneyNet and the Federal Reserve commercial paper data.

[92] Public institutional prime money market funds reduced their holdings of asset-backed commercial paper by $2.5 billion and retail prime funds increased their holdings by $1.9 billion in the week-ended March 17.

over this period, other holders, not public institutional and retail prime money market funds, accounted for the bulk of the changes in outstanding nonfinancial and financial commercial paper and outstanding asset-backed commercial paper.

Taken all together, public institutional and retail prime money market funds reduced their holdings of commercial paper by only $6.2 billion ($5.6 billion + $0.6 billion) in the week-ended March 17—hardly a wholesale pullback in commercial paper funding. Moreover, this $6.2 billion reduction represented only 10 percent of the $64.3 billion in outflows these funds experienced over this period, challenging the narrative that outflows forced public institutional and retail prime money market funds to shed commercial paper heavily during this critical week.[93] Instead, public institutional prime funds largely met redemption requests by rolling off repurchase agreements,[94] and retail prime money market funds met their more modest redemptions by reducing their holdings of CDs issued by foreign banks.[95]

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[93] Public institutional prime money market funds reduced their holdings of commercial paper by a total of $9.1 billion ($6.6 billion in financial and nonfinancial commercial paper and $2.5 billion in asset-backed commercial paper) in the week-ended March 17, representing 17 percent of the $52.6 billion in outflows these funds experienced over this period. Retail prime money market funds *increased* their holdings of commercial paper by a total of $2.9 billion ($1.0 billion in nonfinancial and financial commercial paper and $1.9 billion in asset-backed commercial paper) in the week-ended March 17 even as they experienced $11.7 billion in outflows over the period.

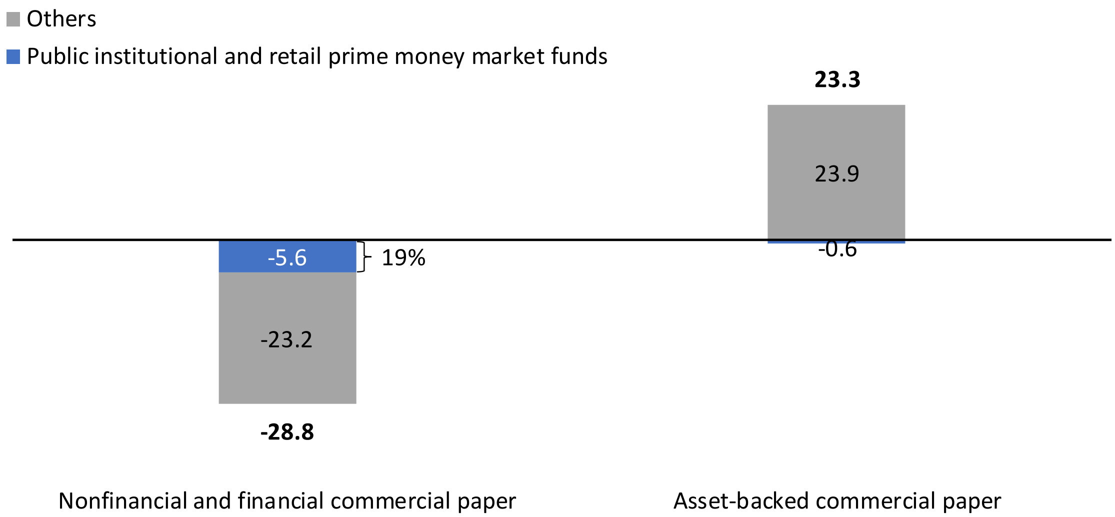
[94] According to iMoneyNet, public institutional prime money market funds reduced their holdings of repurchase agreements by $31.8 billion in the week-ended March 17. This reduction represented 60 percent of the $52.6 billion in outflows these funds experienced over this period.

[95] As reported by iMoneyNet, retail prime money market funds reduced their holdings of "foreign bank obligations," which include eurodollar and yankee dollar CDs by $11.1 billion in the week-ended March 17. This reduction represented 95 percent of the $11.7 billion in outflows these funds experienced over this period.

FIGURE 5

Other Holders Accounted for the Bulk of the Decline in Nonfinancial and Financial Outstanding Commercial Paper in the Week Preceding the MMLF Announcement

Billions of dollars, change in prime money market funds' holdings for the week-ended March 17, 2020 and change in not seasonally adjusted market-wide commercial paper outstanding for the week-ended March 18, 2020



Memo: estimated outflows of prime money market funds week-ended March 17 = $64.3 billion

Sources: Federal Reserve Board and iMoneyNet

Results from ICI's survey also provide evidence that prime money market funds were not dumping commercial paper in the secondary market in the days leading up to the announcement of the MMLF on March 18. As shown in Figure 6, nonpublic institutional prime funds (middle panel) did not sell any commercial paper from March 2 through March 18 and retail prime money market funds (bottom panel) sold only $500 million in the week before March 18.

Although public institutional prime money market funds (top panel) did sell increasingly more commercial paper into the secondary market as outflows rose leading up to March 18, the magnitude of these gross sales was fairly modest relative to trading in the commercial paper market (as measured by commercial paper transactions of primary dealers). In the week-ended March 18, primary dealers conducted $82.6 billion in purchases and sales of commercial paper.[96] In that same week, public institutional prime money market funds' gross sales totaled $9.0 billion in commercial paper, representing only 11 percent of primary dealers' gross transactions.[97]

[96] Source: Federal Reserve Bank of New York, "Primary Dealer Statistics."

[97] In addition, the $9.0 billion in gross sales of commercial paper in the week-ended March 18 represented only 14 percent of the $65.6 billion in outflows from public institutional prime funds.

Moreover, there is reason to believe that money market funds' limited sales of commercial paper were more a reflection than a cause of strains in the short-term funding markets. Notably, primary dealers may not have needed to allocate their scarce capital toward intermediating these sales. According to data from the Federal Reserve Bank of New York, primary dealers' inventories of commercial paper actually fell by $588 million in the week-ended March 18.[98] This means that if they had intermediated these trades, they acted on an agency basis (*i.e*., they transacted the trades on behalf of clients and did not hold the securities as part of their inventories on their balance sheets) and not on a principal basis.

Prime money market funds, like other investors in the short-term funding markets, sought to maintain an unusually high degree of liquidity given the pandemic-related events of March 2020. To accomplish this objective, prime money market funds shifted their gross purchases significantly towards overnight commercial paper in the week-ended March 18 (Figure 6). From March 2 to March 11, public institutional prime money market funds' gross purchases of overnight commercial paper (top panel, blue bars) accounted for 57 percent, on average, of their daily gross purchases of commercial paper. This average rose to 71 percent in the week-ended March 18. Retail prime money market funds similarly moved their daily purchases to overnight commercial paper (bottom panel, blue bars)–from an average of 55 percent over the March 2 to March 11 period to 76 percent in the week-ended March 18.

Nonpublic prime institutional funds (middle panel, blue bars) also tilted their purchases towards overnight commercial paper, but the increase was relatively small. Over the March 12 to March 18 period, overnight paper accounted for an average of 82 percent of nonpublic institutional prime funds' daily gross purchases of commercial paper, up modestly from a daily average of 78 percent from March 2 to March 11. These funds tend to keep the bulk of their assets at very short maturities even in "normal" times because they operate as internal cash funds for families of long-term mutual funds.

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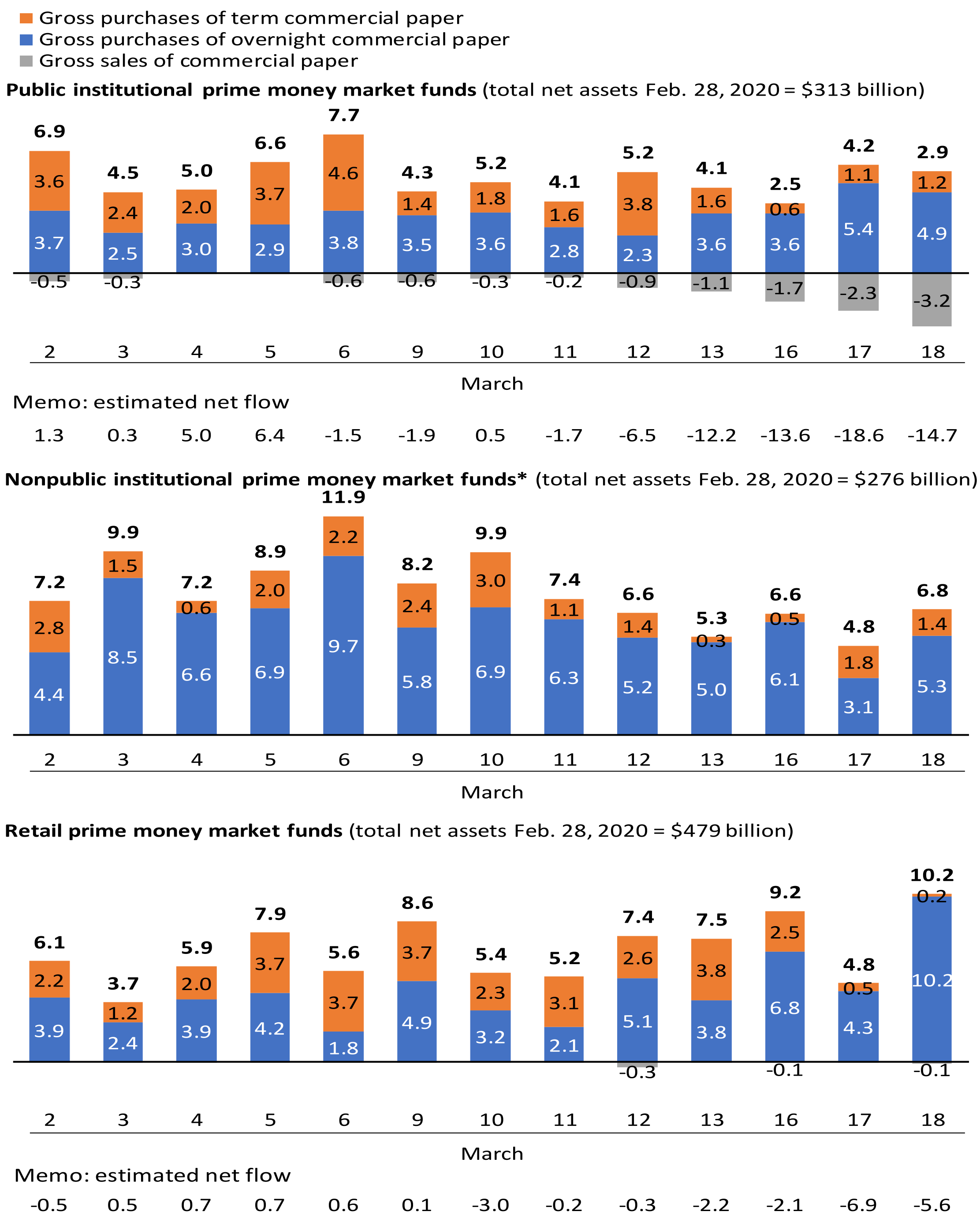
[98] Source: Federal Reserve Bank of New York, "Primary Dealer Statistics."

FIGURE 6

Public Institutional Prime Money Market Funds Had Modest Sales of Commercial Paper and Other Prime Funds Had Little to None

Billions of dollars, March 2–March 18, 2020



*Daily estimated net flows nonpublic institutional prime money market funds are unavailable.

Note: Nonpublic institutional prime money market funds are registered under the Investment Company Act and comply with Rule 2a-7.

Source: ICI survey of prime money market funds and iMoneyNet

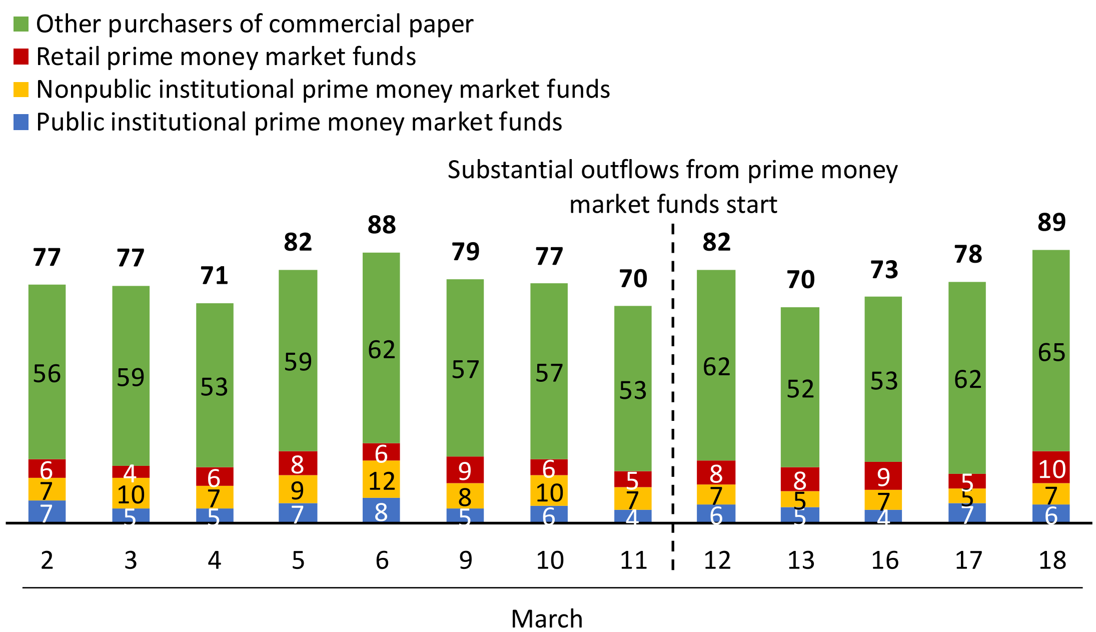
Our survey results highlight yet another way in which prime money market funds did not pull back from the commercial paper market in the run-up to the announcement of the MMLF. In particular, they continued to *purchase* commercial paper in the critical week ending March 18 (Figure 7). Moreover, they continued to make purchases at about the same rate as before they began seeing substantial outflows on March 12.

Figure 7 highlights another key fact policymakers need to acknowledge as they consider potential reforms for prime money market funds: what role did other holders of commercial paper play during this critical period in March 2020? Prime money market funds are neither the only players in the commercial paper market, nor do they account for the bulk of the financing supplied in this market. As the figure shows, other entities (*i.e.*, investors other than prime money market funds) accounted for the majority of commercial paper purchases from March 2 to March 18. By the same token, at critical points, other entities accounted for most of the decline in purchases of commercial paper. For example, total newly-issued commercial paper fell by $12 billion from $82 billion on March 12 to $70 billion on March 13. Other market participants accounted for $10 billion, or 80 percent, of this decline.

FIGURE 7

Prime Money Market Funds Remained Fairly Steady Purchasers of Commercial Paper

Total new daily purchases of commercial paper (CP), by selected sector, billions of dollars



Memo: share of total CP issuance that was purchased by money market funds

27% 24% 25% 29% 29% 27% 27% 24% 25% 26% 27% 21% 26%

Note: Nonpublic institutional prime money market funds are registered under the Investment Company Act and comply with Rule 2a-7.

Sources: Investment Company Institute survey of prime money market funds and Federal Reserve Board

4.1.2 Prime Money Market Funds Moderately Reduced Their Purchases of CDs

Based on results from ICI's survey, prime money market funds in the aggregate reduced their gross purchases of CDs by a moderate $20.3 billion in the week-ended March 18, 2020 compared with the previous week. These actions likely reflected efforts by prime money market funds to boost their daily liquidity to meet current redemptions and keep their weekly liquid asset ratios well above the 30 percent threshold (CDs typically have fixed, longer maturities, such as one, three or six months that do not qualify as daily or weekly liquid assets until closer to maturity).

Retail prime money market funds, which tend to have a more stable investor base, generally invest in CDs more than public and nonpublic institutional prime funds.[99] As retail prime money market funds faced increasing outflows in the week-ended March 18, they began to limit their purchases of CDs (Figure 8, bottom panel). For the week-ended March 18, retail prime money market funds purchased a total of $7.6 billion in CDs, down from a total of $20.7 billion in the prior week-ended March 11. Also, despite outflows in the week-ended March 18, retail prime money market funds sold only a small amount ($1.8 billion) of CDs on the secondary market.

Nonpublic institutional prime money market funds' purchases of CDs generally tend to be sporadic as these funds usually purchase short-term securities that help maintain their high levels of daily and weekly liquidity. In the week-ended March 18, nonpublic institutional prime money market funds made $2.6 billion in gross purchases of CDs, down modestly from $6.6 billion in purchases the week-ended March 11 (Figure 8, middle panel). In addition, nonpublic institutional prime money market funds did not have any sales of CDs on the secondary market in the week-ended March 18.

Public institutional prime money market funds' purchases of CDs tend to be relatively small on a daily basis as these funds also seek to maintain high levels of daily and weekly liquid assets. In the week-ended March 18, public institutional prime money market funds made $0.8 billion in gross purchases of CDs, down from $4.2 billion in purchases the week-ended March 11 (Figure 8, top panel). Public institutional prime money market funds sold a modest $8.0 billion in CDs on the secondary market in the week-ended March 18.

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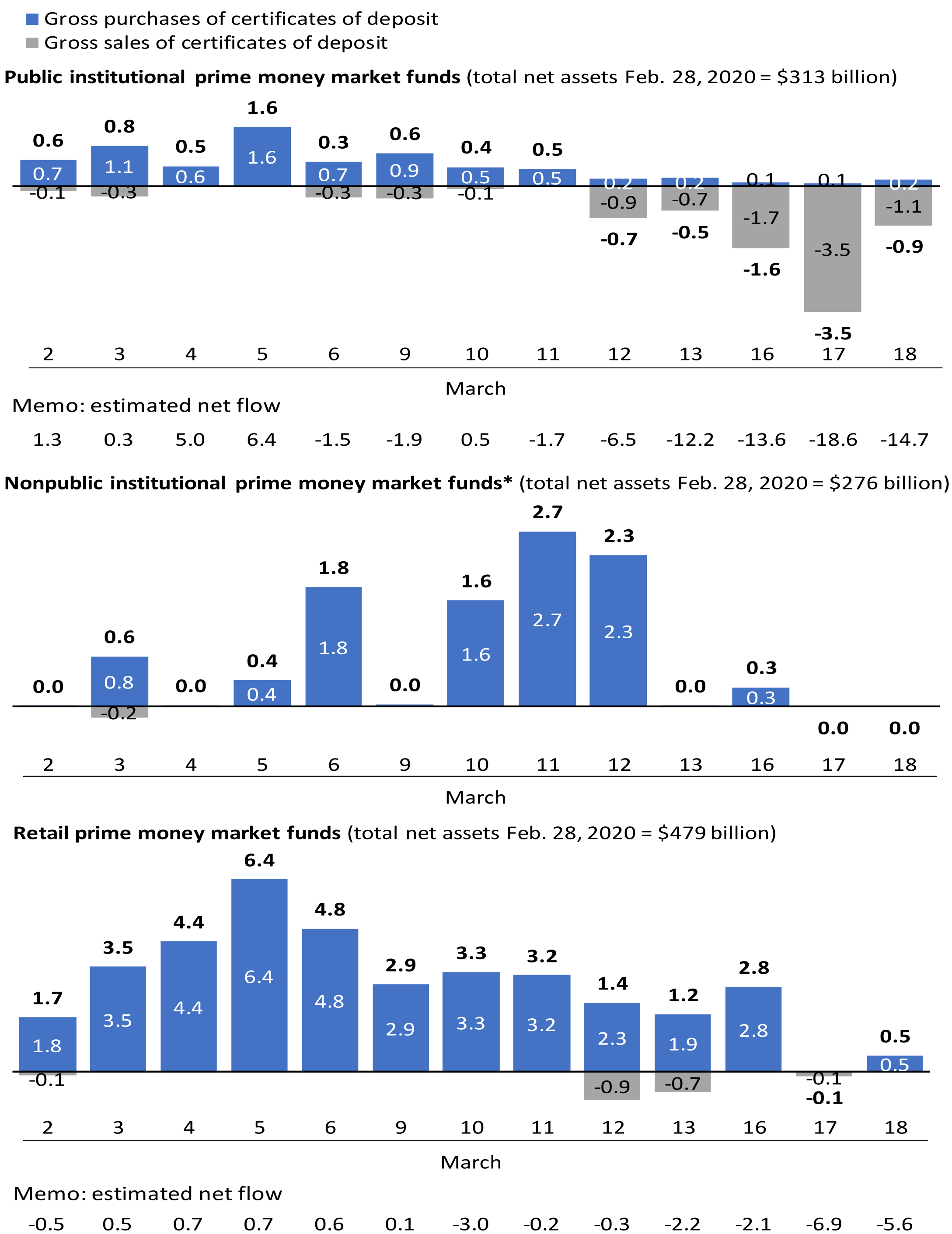
[99] *See* Figure 4.

FIGURE 8

Public Institutional Prime Money Market Funds Had Modest Sales of CDs

Billions of dollars, March 2–March 18, 2020



*Daily estimated net flows nonpublic institutional prime money market funds are unavailable.

Note: Nonpublic institutional prime money market funds are registered under the Investment Company Act and comply with Rule 2a-7.

Source: Investment Company Institute survey of prime money market funds

4.1.3 Public Institutional and Retail Prime Money Market Funds Utilized the MMLF to Keep Weekly Liquid Assets Well Above 30 Percent

Although prime money market funds sold only modest amounts of commercial paper and CDs in the critical week-ended March 18, this likely was, in part, a function of the logjam already present in these markets. Against this setting, as investors "dashed for cash" in the face of great uncertainty, prime money market funds began to see outflows. This situation created three extremely challenging circumstances for prime money market funds: (1) the need to accommodate investors' desire to redeem to build cash; (2) an inability to sell term commercial paper and CDs in markets that were already deeply impaired; and (3) a regulatory constraint (linking their weekly liquid assets to fees and gates) that effectively precluded funds from using 30 percent of their weekly liquid assets to meet redemptions. This regulatory constraint necessitated prime money market funds need to divest longer-dated securities in favor of securities that qualified as weekly liquid assets.

The Federal Reserve, highly cognizant of these circumstances, cut this Gordian knot on March 18 by announcing the MMLF.[100] According to ICI's survey, public institutional and retail prime money market funds began selling eligible securities on March 19 to banks which then ultimately pledged those securities as collateral to the MMLF. Although the MMLF did not begin operations until March 23, dealers were given immediate regulatory capital relief on eligible securities they accepted from prime money market funds for the purposes of pledging to the MMLF. This regulatory relief enabled prime money market funds to begin selling eligible securities on March 19 that banks could hold and then pledge to the MMLF beginning on March 23.

By March 25, public institutional and retail prime money market funds had sold nearly $40 billion in eligible securities that were ultimately pledged to the MMLF (Figure 9). As of April 21, the last date survey respondents reported selling eligible securities for the purpose of accessing the MMLF, 36 public institutional and retail prime money market funds had sold a cumulative total of $51.6 billion in eligible securities that were earmarked for the MMLF. Public institutional prime money market funds sold $38.7 billion ($23.0 billion in commercial paper and $15.7 billion in CDs) and retail prime money market funds sold $12.9 billion ($8.9 billion in commercial paper and $4.0 billion

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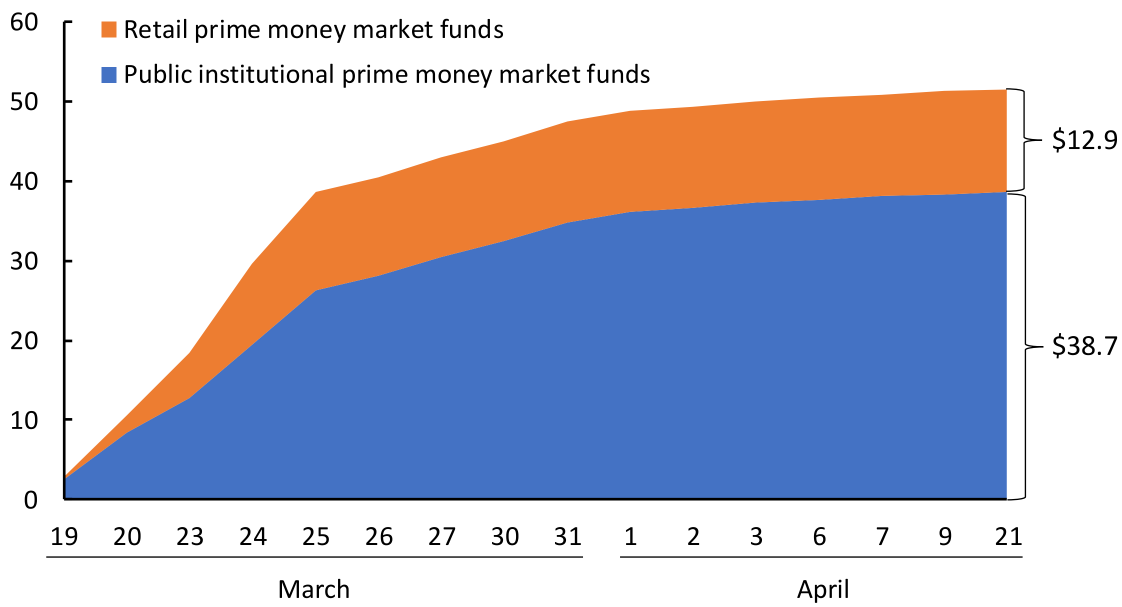
[100] *See, e.g.*, Federal Reserve, "Money Market Mutual Fund Liquidity Facility FAQs," available at www.federalreserve.gov/monetarypolicy/files/mmlf-faqs.pdf (stating that "In the days prior to the initiation of the program, some [money market funds] experienced significant demands for redemptions by investors. Under ordinary circumstances, they would have been able to meet those demands by selling assets. Recently, however, many money markets have become extremely illiquid due to uncertainty related to the coronavirus outbreak … The MMLF will assist [money market funds] in meeting demands for redemptions by households and other investors, enhancing overall market functioning and the provision of credit to households, businesses and municipalities.")

in CDs).[101] Nonpublic institutional prime money market funds did not sell any eligible securities for the purposes of accessing the MMLF.

FIGURE 9

Public Institutional and Retail Prime Money Market Funds Drew Nearly $52 Billion from MMLF

Billions of dollars



Source: Investment Company Institute survey of prime money market funds

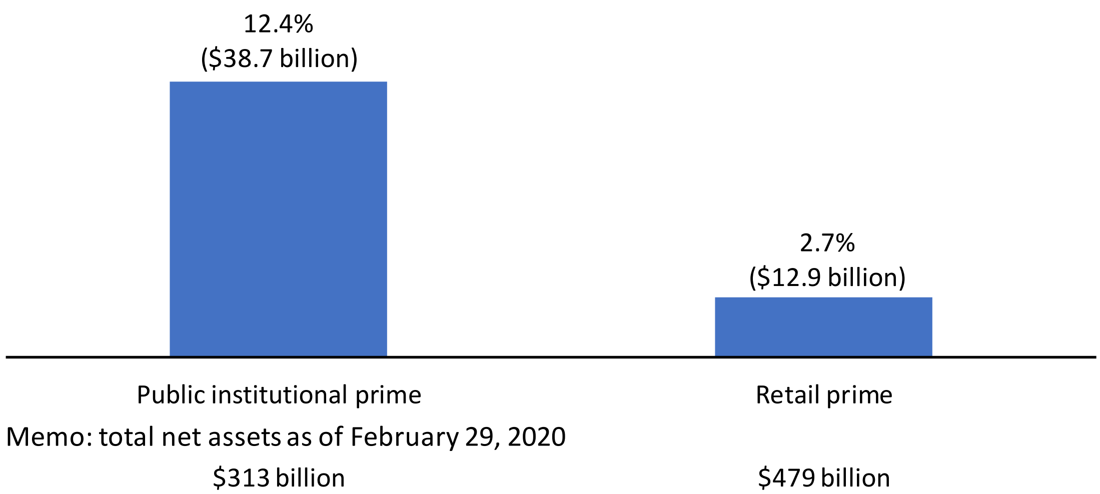
Providing perspective, the total amounts drawn on the MMLF by public institutional and retail prime money market funds represented a small share of their assets (Figure 10). Public institutional prime money market funds' total draw of $38.7 billion represented a little over 12 percent of their assets as of February 2020. Retail prime money market funds' total draw of $12.9 billion represented just under 3 percent of their February assets.

[101] According to ICI's survey, 17 tax-exempt money market funds sold $1.3 billion in municipal securities for the purposes of accessing the MMLF.

FIGURE 10

Public Institutional Prime Money Market Funds Drew Larger Share of Their Assets from MMLF Than Retail Prime Funds

Total drawn from MMLF as a percentage of February 2020 month-end total net assets



Source: Investment Company Institute

Survey respondents reported that a major factor for drawing on the MMLF was the need to shore up their weekly liquid asset ratios to well above 30 percent, supporting the observation that investors were more focused on the 30 percent threshold set by the 2014 reforms rather than the actual condition of the individual fund. As redemption requests progressively increased, public institutional and retail prime money market funds began to deplete their weekly liquid assets. For the public institutional prime money market funds that utilized the MMLF, their asset-weighted weekly liquid asset ratio dropped from a peak of 43.4 percent on March 12 to 39.3 percent on March 19 (Figure 11). Although the retail prime money market funds that utilized the MMLF experienced smaller outflows in both dollar terms and as a percent of their assets than public institutional prime money market funds that utilized the MMLF, they too saw a decline in their weekly liquid assets from a peak of 40.6 percent on March 16 to 39.0 percent on March 19 (Figure 12).

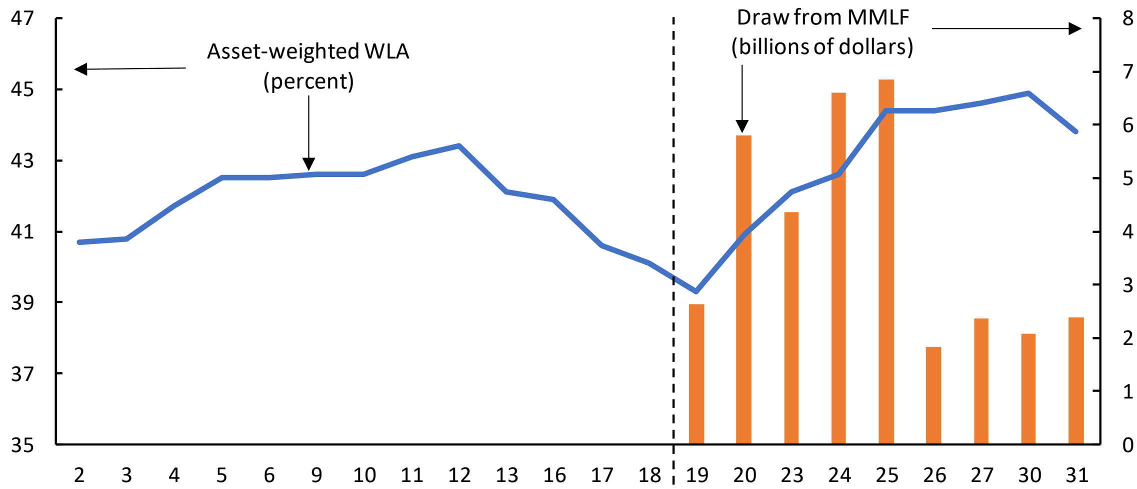
The public institutional and retail prime money market funds that sold eligible securities for the purposes of the MMLF still had ample liquid assets, but 30 percent of their assets were untouchable because the weekly liquid asset threshold was tied to the potential imposition of fees or gates. In addition, investors, particularly those in public institutional prime money market funds, were focused intently on their funds' weekly liquid asset ratios and redeemed more heavily from funds whose weekly liquid asset ratios dropped below 35 percent. Essentially, public institutional and retail prime money market funds' floor on weekly liquid assets was more like 35 percent.

After prime money market funds utilized the MMLF, their weekly liquid asset ratios jumped quickly, even while continuing to experience outflows. Public institutional prime money market funds' asset-weighted weekly liquid asset ratio rose from 39.3 percent on March 19 to 44.4 percent on March 25 (Figure 11). For retail prime funds, their asset-weighted liquid asset ratio rose from 39.0 percent on March 20 to 44.2 percent on March 25 (Figure 12).

FIGURE 11

Public Institutional Prime Money Market Funds Utilized MMLF to Raise and Keep Weekly Liquid Assets Well Above 30 Percent

Public institutional prime money market funds that drew on MMLF, daily, March 2020



Memo: estimated net flows as a percentage of assets

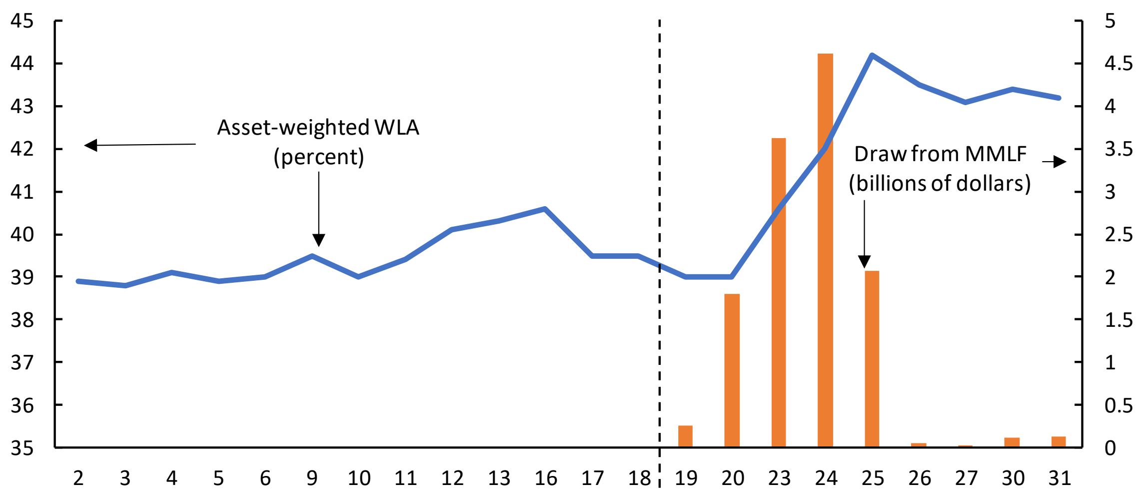
-0.4 0.4 1.4 1.9 -0.5 -0.3 0.0 -0.2 -1.9 -3.8 -4.3 -6.2 -5.1 -5.5 -3.0 -2.6 -0.6 -0.2 -0.2 0.9 0.1 -1.1

Sources: Investment Company Institute, iMoneyNet, and Crane Data

FIGURE 12

Retail Prime Money Market Funds Also Utilized MMLF to Raise and Keep Weekly Liquid Assets Well Above 30 Percent

Retail prime money market funds that drew on MMLF, daily, March 2020



Memo: estimated net flows as a percentage of assets

-0.3 0.1 0.4 0.3 0.3 0.0 -1.0 0.0 0.1 -1.0 -0.7 -2.1 -1.9 -1.8 -2.2 -1.2 -2.0 -0.7 -0.7 -0.7 -0.3 -0.2

Sources: Investment Company Institute and iMoneyNet

5. Conclusion

ICI and its members appreciate the opportunity to comment on the PWG Report. We are committed to working with policymakers to further strengthen money market funds' resilience to severe market stress. If you have any questions, feel free to contact me at (202) 326-5824 or eric.pan@ici.org.

Sincerely,

/s/ Eric J. Pan

Eric J. Pan
President & CEO

cc: Allison Herren Lee, Acting Chair, Securities and Exchange Commission
Hester M. Peirce, Commissioner, Securities and Exchange Commission
Elad L. Roisman, Commissioner, Securities and Exchange Commission
Caroline A. Crenshaw, Commissioner, Securities and Exchange Commission

Janet L. Yellen, Secretary of the Treasury
Jerome Powell, Chair, Board of Governors of the Federal Reserve System
Rostin Behnam, Acting Chair, Commodity Futures Trading Commission