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On Closer Look, a Very Different Picture of Funds' Role in the Commercial Paper Market

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New analysis by ICI shows that prime money market funds did not pull back significantly from the commercial paper market during the height of the market turmoil and "dash for cash" triggered by the COVID-19 health crisis in March 2020.

That's not what the President's Working Group on Financial Markets report on money market funds (PWG Report) suggests. That report notes that two categories of prime money market funds—public institutional funds and retail funds—reduced their holdings of commercial paper 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." The implication: prime money market funds helped fuel the meltdown in the commercial paper market.

Experiences of US Money Market Funds
During the COVID-19 Crisis

The PWG Report leaves out three critical facts, and taking those into account produces a very different picture of prime money market fund activity in the commercial paper market—especially when combined with new ICI research on the daily purchases and sales by those funds.

What does the PWG Report fail to say?

- First, the time period the PWG analyzed straddles the March 18 announcement of the Federal Reserve's Money Market Mutual Fund Liquidity Facility (MMLF)—a facility designed to buy commercial paper from prime money market funds. Two-thirds of the reduction in prime funds' commercial paper holdings cited by the PWG—$23 billion of the $35 billion—occurred *after* the Fed's announcement and was driven by funds' sales of commercial paper that were ultimately pledged to the facility. Those sales did not destabilize the commercial paper market—indeed, the Fed explicitly stated that sales to the MMLF helped relieve stresses.
- Second, prime money market funds' sales of commercial paper during the market turmoil were a small share of the $28.8 billion decline in outstanding nonfinancial and financial commercial paper in the week ended March 18. Public institutional and retail prime money market funds together reduced their holdings of such commercial paper during that week by only $5.6 billion—accounting for only 19 percent of the total reduction. The rest—81 percent of the decline—was driven by other participants in the commercial paper market.
- Third, sales of commercial paper to the MMLF after March 18 were driven largely by prime money market funds' efforts to keep their weekly liquid assets well above the 30 percent threshold that could trigger fees or gates on the funds. In other words, funds

sold commercial paper to avoid a regulatory tripwire that is a legacy of the prior round of money market fund reform in 2014.

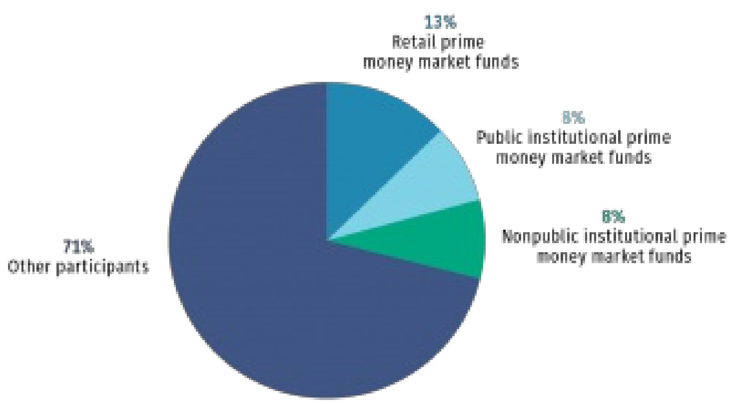
Taken together, these three critical facts undermine claims that prime money market funds caused the commercial paper market to freeze in March 2020. They also demonstrate that regulators must examine the activities and behavior of *all* market participants before proposing reforms for prime money market funds. 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.

In this blog post, I'll discuss the first two sets of facts above—the experience of prime money market funds during the market turmoil prior to the Fed's March 18 MMLF announcement. In a related post, I'll present new research on how prime money market funds used the MMLF to keep their weekly liquid assets well above the 30 percent threshold—a regulatory constraint that effectively precluded funds from using much of their existing liquidity to meet redemptions.

Despite Outflows, Prime Funds Did Not Shed Commercial Paper Heavily Before March 18

ICI's examination of prime money market funds' role in the commercial paper market starts with simple but often-overlooked facts: money market funds are not the only player in that market.

Figure 1
Prime Money Market Funds Are Not the Only Participants in the Short-Term Funding Markets
February 2020



Sources: Investment Company Institute, Federal Reserve Board, and SEC Form N-MFP

As Figure 1 shows, prime money market funds of all types held a little more than one-quarter (29 percent) of commercial paper outstanding at the end of February 2020, prior to the COVID-fueled market upheaval in March.

When governments imposed strict mandates and social distancing, prime money market funds had to deal with the global "dash for cash." In the week of March 10–17, retail and public institutional prime money market funds had outflows of $64.3 billion, yet they reduced their holdings of commercial paper issued by nonfinancial companies and financial institutions by only $5.6 billion (Figure 2, left). Those same funds' holdings of asset-backed commercial paper saw a decline of merely $0.6 billion (Figure 2, right).[1]

Figure 2
Prime Money Market Funds' Reduction in Commercial Paper Holdings Was Modest
Billions of dollars, change in prime money market funds' holdings for the week ended March 17, 2020, and change in not seasonally adjusted marketwide commercial paper outstanding for the week ended March 18, 2020

Sources: Federal Reserve Board and iMoneyNet

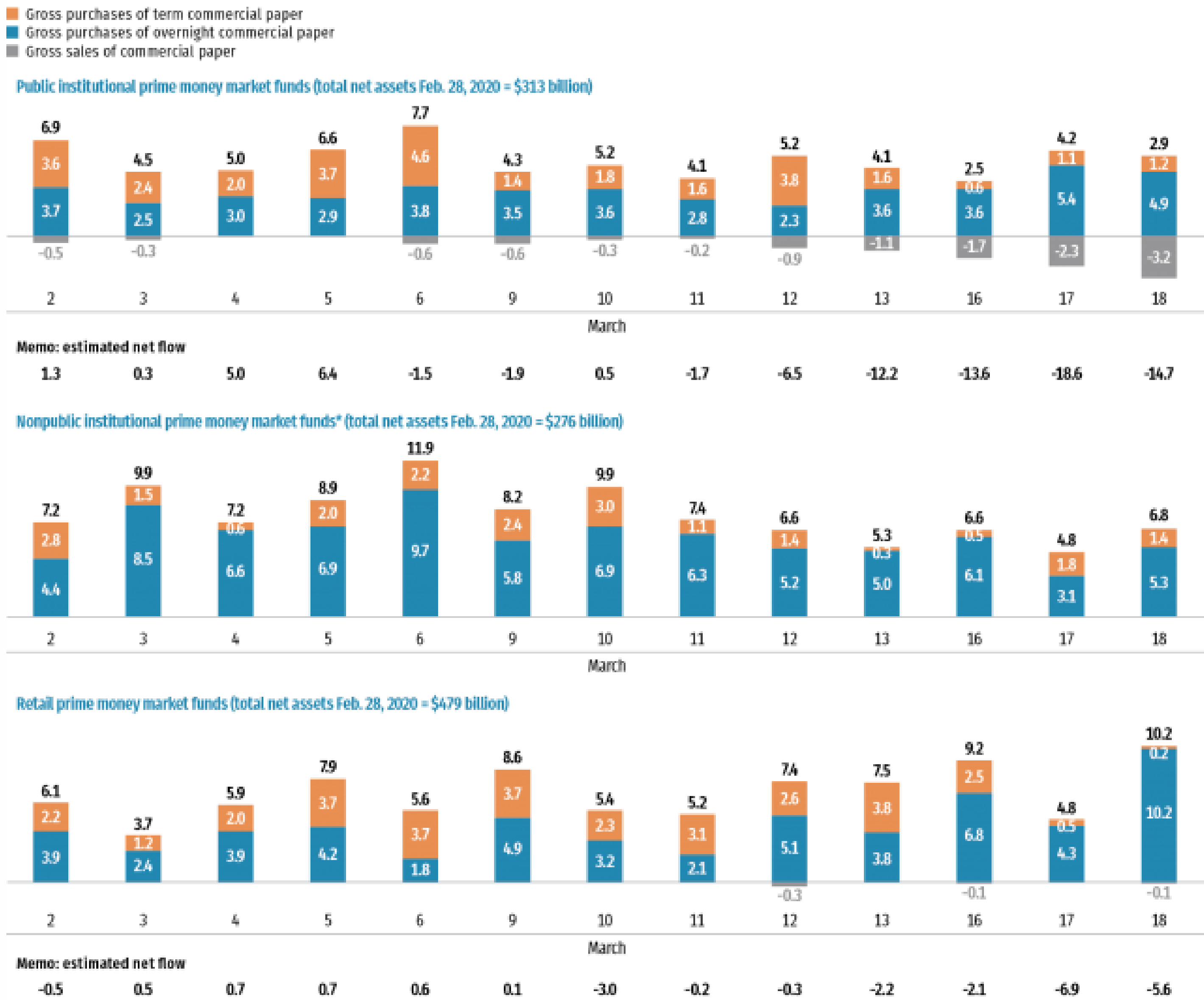
Taken together, retail and public institutional prime money market funds reduced their holdings of commercial paper by only $6.2 billion in the week ended March 17—hardly a wholesale pullback in commercial paper funding. The reduction represented less than 10 percent of the $64.3 billion in outflows from these funds, challenging the narrative that outflows forced these prime money market funds to shed commercial paper heavily during this critical week. Instead, public institutional prime funds largely met redemption requests by rolling off repurchase agreements, and retail prime money market funds met their more modest redemptions by reducing their holdings of certificates of deposit (CDs) issued by foreign banks.

A Closer Look: ICI's Survey on Money Market Fund Activities

To help improve understanding of these events, ICI Research conducted a survey of ICI's 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. 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.

That survey provided insights on the daily purchases and sales of commercial paper by prime money market funds during the critical period prior to the announcement of the MMLF. Figure 3 sums up the results. The chart is complex, but the message is simple—prime money market funds' sales of commercial paper (gray bars) ranged from modest (public institutional funds) to negligible (retail funds) to none (nonpublic institutional funds).

Figure 3
Prime Money Market Funds' Commercial Paper Sales Ranged from Modest to None
Billions of dollars, March 2–March 18, 2020



*Daily estimated net flows of 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.

Sources: ICI survey of prime money market funds and iMoneyNet

Figure 3 shows another crucial fact: even as they faced redemptions, prime money market funds continued to*purchase* commercial paper during the market turmoil. Faced with investors' demands for liquidity and the need to keep their weekly liquid assets above 30 percent, funds moved their purchases toward overnight paper (blue bars) and away from longer-dated or term commercial paper (orange bars). But they continued to buy.

Getting the Full Picture

ICI is committed to working with policymakers to further strengthen money market funds' resilience to severe market stress. Our data, as presented in our letter to the Securities and Exchange Commission on the PWG Report, illustrate the need for policymakers to examine the activities and behavior of all market participants as they pursue that goal.

See also "Previous Reform Made Prime Funds Less Resilient This Time Around"

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[1] Weekly data on commercial paper holdings by nonpublic institutional money market funds are not available.

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