ICI INVESTMENT COMPANY INSTITUTE ICI Global

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Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

The Investment Company Institute, including ICI Global,[1] appreciates the opportunity to provide its views on the Financial Stability Board (FSB) Consultation Report on Policy Proposals to Enhance Money Market Fund Resilience (Report). Money market funds (which the International Investment Funds Association estimates to be about $4.7 trillion in the Americas, $1.7 trillion in Europe, and $2.0 trillion in the Asia-Pacific)[2] are an important source of direct financing for governments, businesses, and financial institutions and of indirect financing for households. Money market funds are highly regulated, transparent, diversified, and low cost. Limiting the availability of money market funds will not reduce the demand for the type of financing currently provided by money market funds. Instead, governments, businesses, and financial institutions would likely seek more expensive, less transparent, less diversified, and less efficient forms of financing, which may have negative implications for the global financial system.

ICI and its members are committed to working with international policymakers, especially through the FSB and the International Organization of Securities Commissions (IOSCO), to strengthen money market funds, the financial markets, and the economy more generally against liquidity events like the one caused by the COVID-19 crisis. Because the United States is the largest money market fund market with $4.5 trillion in assets under management and represents 53 percent of the global money market fund industry, our responses, and the detailed economic analysis that supports our responses, focus mainly on the experiences of

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[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 $31.5 trillion in the United States, serving more than 100 million US shareholders, and $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] Data as of March 2021. ICI compiles worldwide regulated open-end fund statistics on behalf of the International Investment Funds Association.

these US funds during March 2020.[3] We ask, however, that the reasoning presented in this letter also be considered with respect to the FSB's evaluation of money market funds in other markets around the world.

As part of our response to the consultation, we also are attaching as an appendix to this letter a summary of a roundtable ICI hosted in April 2021 with eight leading money market fund providers. The roundtable conducted a close examination of the operation of money market funds during the March 2020 period, analyzing proprietary data and asking fund managers to recount the behavior of money market funds and money market fund investors.

Executive Summary

Given the important role of money market funds in the financial system, policymakers should evaluate any reform options by comparing their impact on the ability of money market funds to fulfill this role (*i.e.*, preservation of their key characteristics) *against* the likely practical impact any money market fund reforms will have on making the overall financial system more resilient. 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. To this end, ICI and its members have previously analyzed and offered detailed and concrete feedback on many of the policy options set forth in the Report and appreciate the opportunity to do so again in this consultation.[4]

- *Money market funds were neither the first nor the largest targets of the government and central bank intervention programs that helped a broad range of financial market participants during the COVID-19 crisis, and the relevant program should not be described as a "bail-out" of money market funds*. In an effort to contain the spread of COVID-19 in February-March 2020, governments around the world contemporaneously shut down their economies. As a result, liquidity dried up, short-and long-term credit

[3] For a summary of the current US money market fund regulatory requirements, *see* www.ici.org/mmfs/current/16_mmf_reg_summ.

[4] *See e.g.*, Comment letters on the President's Working Group (PWG) Report on Money Market Funds from Eric J. Pan, President and CEO, Investment Company Institute, to Vanessa Countryman, Secretary, Securities and Exchange Commission (April 12, 2021), (2021 ICI Letter to PWG), available here; (May 12, 2021) available here; and (June 3, 2021) available here; 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 PWG Report on Money Market Fund Reform Options (File No. 4-619)) (2011 ICI Letter to PWG), available at 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); 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.

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. 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.[5] Money market funds were just one of many market participants that benefited from the broad, calming effect of the Federal Reserve's actions. Contrary to the popular conception of a "bail out," the amount of assets attributable to the Federal Reserve's action toward money market funds was limited compared to other actions taken by the Federal Reserve for the benefit of other sectors of the global financial system. The action also did not result in any losses to the Federal Reserve. **(Section 1)**

- *ICI research—March 2020 events.* As supported by ICI's analysis of data, the evidence clearly shows that money market funds did not cause the stresses in the short-term funding markets in March 2020. The March 2020 "dash for cash" impacted *all* investors—not just US prime and European non-public debt money market funds. Money market funds are just one participant in global short-term funding markets. Therefore, policymakers should give high priority to examining the performance of all players in the market and their impact on market liquidity before finalizing policy options. Without understanding the role of other players, merely imposing new restrictions on money market funds would not address policymakers' concerns. **(Section 2)**

- *Removal of tie between money market fund liquidity and fee and gate thresholds*. Removing the tie between money market fund liquidity and fee and gate thresholds is the best approach to addressing the challenges money market funds experienced in March 2020. 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 acted as a trigger for preemptive redemptions rather than the conditions of the funds. Specifically, ICI conducted a simulation study that shows that the tie increased the rate of redemptions at a pace that would rapidly overwhelm the available weekly liquid assets of a typical institutional prime money market fund in about two weeks. In contrast, without the tie, the simulation shows that even with significant redemptions this same fund *would still have had 25 percent of its assets in weekly liquid assets after five weeks into the crisis* without any central bank assistance.

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[5] 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. For a discussion of the EU and UK central bank responses, *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) (2020 ICI COVID-19 European Report), available at www.ici.org/system/files/private/2021-04/20_rpt_covid4.pdf, at 11-12.

The simulation shows that, in the absence of the tie, existing liquidity risk management requirements developed by market regulators are quite robust, capable of handling even extreme market stress events like March 2020. **(Section 3.1)**

Policy options that impose the cost of redemptions on redeeming investors

- *Swing pricing*. Although European long-term funds use swing pricing, swing pricing would not make money market funds more resilient and actually would create problems during times of market stress. Money market funds already have the ability to impose liquidity fees (anti-dilution levies), should their boards determine they are appropriate. Swing pricing also would likely strip money market funds of features that are key to investors (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, and cause confusion among investors in periods of stress. Moreover, swing pricing would be difficult for authorities to mandate during periods of stress. **(Section 3.2.1)**

Policy options that absorb losses

- *Minimum balance at risk (MBR)* **(Section 3.3.1)***, capital buffers* **(Section 3.3.2)***, and liquidity exchange bank membership* **(Section 3.3.2.1)**. These policy options would not advance the FSB's goals of reform and would not preserve the key characteristics of money market funds beneficial to the financial system and the broader economy. Specifically, such options have significant drawbacks, ranging from detrimental impacts on money market funds, their investors, and the markets to complicated (and costly) regulatory, structural, and operational barriers to implement. 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. If some skeptics of money market funds think this impact is desirable, then they should be transparent in their reasons for supporting these reforms and not attribute their support to making money market funds more resilient.

Policy options that reduce threshold effects

- *Modifications to fees and gate considerations*. The tie between liquidity and fee and gate thresholds made money market funds more susceptible to financial market stress in March 2020 and could likely do so again in future periods of stress. Adding an additional layer of regulatory approval before the activation of fees would neither lessen the cliff event of this regulatory constraint nor meaningfully impact the usability of a fund's weekly liquid assets. On the other hand, gates should be limited to extraordinary circumstances that present a significant risk of a run on a fund and potential harm to investors, such as when a fund seeks to facilitate an orderly liquidation of a fund. **(Section 3.4.1)**

- *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 3.4.2)**

- *Investor concentration limits*. In addition to specific minimum daily and weekly liquid assets, current US regulations require a money market fund to maintain sufficient liquidity to meet reasonably foreseeable investor redemptions and adopt "know your customer" policies and procedures to assure that it undertakes appropriate efforts to identify risk characteristics of its investors. The flexibility of the current regulatory regime is appropriate because it recognizes that different money market funds may have different needs depending on, for example, their investor bases. As such, we do not support a "one-size-fits-all" investor concentration limit. **(Section 3.4.3)**

- *Eliminating stable NAVs.* We do not support requiring all money market funds to float their NAVs. For example, requiring US retail prime money market funds to float their NAVs is not necessary and more generally, it does not reduce risks in any meaningful way. Floating NAVs also could eliminate key benefits for retail investors. **(Section 3.4.4)**

Policy options to mitigate the impact of large redemptions and reduce liquidity transformation

- *Limits on eligible assets.* Any proposal that would limit eligible assets for money market funds and require the funds to invest a higher proportion of their asserts in shorter-dated and/or more liquid instruments risks reducing the benefits of these funds and consequently must be data driven, including considering the types of assets readily available in various jurisdictions. Such limits also should not be so onerous as to materially impact the ability of money market funds to serve as direct sources of financing for businesses and financial institutions or make it difficult (or impossible) to continue to attract investors by providing a return that is above that of a public debt money market fund, such as a US Treasury or government money market fund. **(Section 3.5.1)**

- *Limit money market funds to public debt money market funds.* We strongly oppose a policy option that would constrain money market funds to hold only public debt instruments. Non-public debt money market funds (*i.e.*, US prime and European LVNAV and VNAV money market funds) play an important role in capital markets by providing an efficient means for institutional and retail investors to access the short-term funding markets and a low-cost short-term financing option to the private sector. **(Section 3.5.1.1)**

- *Fund-specific liquidity level requirements.* Requiring money market funds to maintain liquidity buffers based on its own characteristics, such as investor base or the outcome of its fund-specific stress tests, is generally consistent with current US liquidity requirements. Not surprisingly, prime money market funds' weekly liquid assets have exceeded the 30 percent minimum by a significant margin since liquidity requirements were first added to SEC Rule 2a-7 in 2010. **(Section 3.5.1.2)**

- *Non-daily dealing and liquidity-based redemption deferrals*. The inability of investors to have same-day liquidity from money market funds, even in normal market conditions, would destroy the ability of investors (both institutional and retail) to use money market funds as liquid investments on a daily basis. The likeliest impact of this policy option would be to drive investors away from these money market funds, thus depriving businesses and financial institutions of a direct source of short-term financing. **(Section 3.5.1.3)**

- *Redemptions in-kind during periods of stress*. Requiring money market funds to make certain large redemptions "in-kind" (*i.e*., through the distribution of a proportionate amount of their portfolio instruments to redeeming investors) would be an ineffective solution for the issue at hand. Investors would likely work around the requirement such as by allocating investments among multiple funds in amounts below the anticipated redemption threshold. Developing regulatory standards that would establish appropriate circumstances and threshold levels would present significant challenges. Even if this could be established, we are concerned that an in-kind redemption requirement, if triggered, could exacerbate market dislocations. In addition, the practicality of this approach is limited by difficult operational hurdles. Although rarely invoked, funds already have the ability to redeem in-kind if operational or business conditions allow. As such, funds' current authority to redeem shares in-kind *voluntarily* appropriately enables them to assess the advisability of this approach under the circumstances facing the fund and the market at the time. **(Section 3.5.1.4)**

- *Additional liquidity requirements and escalation procedures*. We believe 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 (provided such liquidity requirements are delinked from fees and gates). Any such increase, however, must be data driven and not so high as to materially impact the ability of money market funds to serve as direct sources of financing for businesses and financial institutions or make it difficult (or impossible) to continue to attract investors by providing a return that is above that of a public debt money market fund, such as a US Treasury or government money market fund. We also agree that fees should be considered before gates and recommend that gates be limited to extraordinary circumstances that present a significant risk of a run on a fund and potential harm to investors, such as situations when a fund seeks to liquidate. **(Section 3.5.2)**

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 US 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.[6]

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. Beginning on March 3, 2020, the US Federal Reserve began taking a number of increasingly strong measures to restore liquidity and the flow of credit to the economy. These included:

- On March 3, cutting the federal funds rate by 50 basis points with a subsequent 100 basis point cut on March 15;
- From March 9 through March 16, sharply increasing its limits on the Federal Reserve's overnight and term repo operations from a total of $125 billion to $2.1 trillion;
- On March 15, authorizing $700 billion in purchases of US Treasury and US agency securities in coming months and on March 23 reiterating its commitment to purchase these securities in amounts sufficient to support smooth market functioning which was widely interpreted as unlimited–the Federal Reserve Bank of New York stated it would purchase $625 billion in the coming week alone;
- On March 15, easing lending terms on established foreign currency swap agreements and on March 19 establishing new swap lines with nine additional foreign central banks–ultimately lending nearly $450 billion dollars to foreign central banks; and
- On April 9, announcing programs providing up to $2.3 trillion to support lending to households, businesses, and state and local governments through various facilities; and
- Establishing a range of other facilities to provide liquidity to market participants.[7]

For example, on March 17, the Federal Reserve created two facilities to support the flow of credit to households and businesses. One facility, the Primary Dealer Credit Facility (PDCF), would lend to primary dealers against "eligible collateral," which included investment grade

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[6] For a detailed discussion of ICI's research of the March 2020 events and the role of money market funds, *see* 2021 ICI Letter to PWG, *supra* note 4, at Section 4; "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 www.ici.org/system/files/private/2021-04/20_rpt_covid3.pdf.

[7] For a detailed discussion of these measures, *see* 2020 ICI COVID-19 Report, *supra* note 5, at 46-58.

corporate debt, commercial paper, municipal securities, mortgage-backed securities, asset-backed securities, and equities. The other facility, the Commercial Paper Funding Facility (CPFF), would purchase highly rated commercial paper directly from issuers. Although the PDCF and the CPFF were intended to add liquidity to the fixed-income markets, their structures and terms posed challenges.[8]

Only after all of these other measures were taken did the Federal Reserve establish the Money Market Mutual Fund Liquidity Facility (MMLF) on March 18. This facility, which began operating on March 23, lent to banks (not to money market funds) that acquired US Treasury and agency securities and highly rated commercial paper from money market funds, including those securities that banks purchased from prime money market funds beginning on March 18.[9]

The terms of the MMLF were flexible, increasing the chances that the facility would strongly supplement the PDCF and CPFF. The cost of borrowing was significantly lower than the CPFF's rate. In addition, the program was non-recourse, meaning banks would not be required to make the Federal Reserve whole if a security eventually defaulted, and, on March 19, the Federal Reserve provided relief from certain regulatory capital requirements to banks that borrowed under the MMLF, indicating that the Federal Reserve recognized that bank capital standards were indeed restricting the flow of credit.

Eventually, assets attributable to the MMLF totaled $53 billion at its peak in April 2020. Although $53 billion is by no means insignificant, the rise in the Federal Reserve's assets attributable to the MMLF was relatively limited in comparison to the amounts other intervention programs added to the Federal Reserve's balance sheet.[10] In addition, a week after announcing the MMLF, the Federal Reserve publicly predicted that "the Board does not expect at this time that advances under the MMLF will result in any losses to the Federal Reserve or the taxpayer."[11] And this prediction proved accurate as the Federal Reserve later reported that it profited from the MMLF by over $300 million in interest and fees.[12]

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[8] For a discussion of those challenges, *see* id at 49. The PDCF provided close to $36 billion in lending at its peak in mid-April 2020 and the CPFF provided nearly $13 billion in lending at its peak at the end of May 2020.

[9] Federal Reserve Board, "Federal Reserve Board Broadens Program of Support for the Flow of Credit to Households and Businesses by Establishing a Money Market Mutual Fund Liquidity Facility (MMLF)," news release (March 18, 2020), available at www.federalreserve.gov/newsevents/pressreleases/monetary20200318a.htm. Showing the urgency and the rapid pace at which the Federal Reserve was responding to events, the MMLF was announced at 11:30 pm ET.

[10] See 2020 ICI Money Market Fund Report, *supra* note 6, at 38 (Figure 3.22).

[11] Federal Reserve, Report to Congress Pursuant to Section 13(3) of the Federal Reserve Act: Money Market Mutual Fund Liquidity Facility, available at www.federalreserve.gov/publications/files/money-market-mutual-fund-liquidity-facility-3-25-20.pdf.

[12] Federal Reserve Banks Combined Financial Statements, As of and for the Years Ended December 31, 2020 and 2019 and Independent Auditors' Report, available at www.federalreserve.gov/aboutthefed/files/combinedfinstmt2020.pdf, at 22.

The FSB and IOSCO 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 system.

The Report focuses specifically on money market funds. Without endorsing any particular course of action, the Report discusses a range of policy proposals that policymakers could consider with respect to money market funds. Policy options are grouped according to the main mechanism through which they aim to enhance money market fund resilience. The Report also presents other options that can be considered as variants or extensions of the representative options.

In response to the FSB's request for comment on the Report, ICI respectfully submits its analysis of the role of money market funds in the March 2020 events and the Report's policy options.

2. Considering Money Market Fund Reform and the Events of March 2020

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. Indeed, investors view money market funds as a vehicle of choice to access the short-term funding markets. Since money market funds often invest in hundreds of different underlying securities, they provide investors diversification that would otherwise be difficult, if not impossible, to replicate and manage through an individual portfolio or through a single bank.[13]

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.[14] At the same time, US prime money market funds, including nonpublic institutional money market funds, which in February 2020 accounted for just 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.

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[13] 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 4, at 23-29. Accounting rules also have facilitated the use of US 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 (i) readily convertible to known amounts of cash and (ii) 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. Cash equivalent examples include Treasury bills, commercial paper, and money market funds. 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.

[14] These figures include US nonpublic institutional floating NAV money market funds.

Money market fund flows during the COVID-19 crisis were shaped by the efforts of businesses, households, and governments to preserve or build liquidity.[15] At the peak of the financial market uncertainty associated with COVID-19, there was a massive demand for liquidity, which created obvious strains in the short-term markets. Indeed, during the March 2020 "dash for cash," *all* investors—not just those investing in US prime and European non-public debt 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.

Importantly, policymakers should note that even during the height of the crisis, US prime money market funds did not pull back significantly from the commercial paper market before the Federal Reserve's MMLF was announced on March 18, 2020. US public institutional and retail prime money market funds reduced their overall holdings of commercial paper by only $6.2 billion (a $5.6 billion reduction in nonfinancial and financial commercial paper holdings and a negligible $600 million reduction in asset-backed commercial paper holdings) in the week before the MMLF was announced. The $5.6 billion reduction accounted for just 19 percent of the total reduction in financial and nonfinancial commercial paper outstanding during the week-ended March 18, meaning that 81 percent of the decline is attributable to entities that were *not* US prime money market funds.

In the days following, prime money market funds sold $23 billion in commercial paper to the MMLF. Those sales, although reducing money market funds' holdings of commercial paper, did not shrink the commercial paper market because the holdings were simply transferred to the Federal Reserve. Consequently, these sales did not add to market stress.[16] In fact, the Federal Reserve explicitly noted that sales to the MMLF helped relieve stresses in the short-term funding markets.[17] One way the MMLF provided relief in the short-term funding markets was by helping prime money market funds keep their weekly liquid assets well above 30 percent, thus calming investors' fears about the potential for funds to impose fees or gates.

It is therefore inaccurate to suggest that money market funds caused the short-term funding markets, and in particular, the commercial paper market, to freeze up in advance of the Federal

[15] See 2020 ICI Money Market Fund Report, *supra* note 6. Indeed, 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.

[16] For a detailed discussion of ICI's research of the March 2020 events and the role of money market funds, *see* 2021 ICI Letter to PWG, *supra* note 4, Section 4.

[17] *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. Moreover, in its March 25, 2020 report to Congress on the MMLF, the Federal Reserve concluded that "the Board does not expect at this time that advances under the MMLF will result in any losses to the Federal Reserve or the taxpayer." Federal Reserve, *Report to Congress Pursuant to Section 13(3) of the Federal Reserve Act: Money Market Mutual Fund Liquidity Facility*, available at www.federalreserve.gov/publications/files/money-market-mutual-fund-liquidity-facility-3-25-20.pdf.

Reserve's announcement of the MMLF on March 18.[18] Indeed, even as US prime money market funds experienced substantial outflows in the week before the MMLF was announced, *they also continued to make gross purchases of commercial paper*, albeit tilting them increasingly toward overnight issuances to maintain liquidity. As discussed below in Section 3.1, the regulatory tie between weekly liquid assets and fees and gates made money market funds *less resilient* to redemptions and *more dependent* on financial intermediaries.

The FSB states that the COVID-19 crisis revealed reluctance or inability by certain banks to act as dealers in such circumstances and that the March 2020 turmoil revealed different expectations between investors about the role of dealers in providing liquidity in these markets in stress. To this end, we agree with other commentators that have recommended measures that would adjust bank regulations to enable banks and their dealers to expand their balance sheets to provide market liquidity during stress without materially reducing the overall resilience of those firms.[19]

In its Report, the FSB also acknowledges that money market fund reforms by themselves will not likely solve the structural fragilities in the short-term funding markets. We agree with this point. 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. We therefore encourage policymakers, working together with the industry, to consider measures that would improve the functioning of those markets.[20]

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[18] *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 [2020] forced [money market funds] 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/globalfinancial-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).

[19] *See e.g.*, *Task Force on Financial Stability*, Brookings Institution (June 2021), available at www.brookings.edu/wp-content/uploads/2021/06/financial-stability_report.pdf, at 11-12. Specifically, the report recommends permanently excluding reserves from the supplementary leverage requirement (SLR) or considering a countercyclical component of the SLR to be released in stress. *Id*. at 40-42.

[20] For a discussion of measures to improve the Treasury market, *see id*. at 43-45 and Group of Thirty Working Group on Treasury Market Liquidity, *U.S. Treasury Markets: Steps Toward Increased Resilience*, Group of Thirty (2021), available at group30.org/publications/detail/4950, at 9-14. For an example of a similar government and industry initiative, *see* the Task Force on Tri-Party Repo Infrastructure ("Task Force") at www.newyorkfed.org/tripartyrepo/index.html. The Task Force was formed in September 2009 to address potential systemic risk concerns associated with the infrastructure supporting the triparty repo market. The Task Force membership included representatives from multiple types of market participants that participate in the tri-party repo market, as well as relevant industry associations, including ICI. Federal Reserve and SEC staff participated in meetings of the Task Force as observers and technical advisors.

3. Consideration of FSB Policy Proposals

The Report discusses a range of policy proposals 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.[21] After careful review, removing the tie between money market fund liquidity and fee and gate thresholds is the best approach to addressing the challenges money market funds experienced in March 2020. As such, we will discuss this policy proposal first. The other policy proposals will be discussed in the same order as set forth in the Report.

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

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 and not tied to definitive thresholds. 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 investors. If investors choose to redeem, the fee should be large enough to benefit remaining investors by mitigating liquidation costs and potentially rebuilding NAVs. Investors truly in need of liquidity should have access to it, but at a cost that may serve as a deterrent to redemptions and reflects the premium that market participants place on liquidity during periods of market stress.

Under current rules, money market funds (such as prime money market funds in the United States and CNAV and LVNAVs in the European Union) may impose fees or gates if their weekly liquid assets drop below 30 percent.[22] 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 policy option would decouple the tie between the 30 percent and 10 percent weekly liquid asset thresholds and the potential imposition of fees and gates for money market funds that currently have such a tie.

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

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[21] *See e.g.*, *supra* note 4.

[22] For example, in the United States, a prime money market fund's board can impose fees and gates if a fund's weekly liquid assets drop below 30 percent. When weekly liquid assets fall below 10 percent, the fund must impose a 1 percent fee on all redemptions unless the fund's board determines that such a fee is not in the best interest of the fund or that a lower or higher fee is more appropriate. In the European Union, for public debt CNAVs and LVNAVs, fees and gates are to be considered when the fund's weekly liquid assets fall below the 30 percent requirement and daily outflows exceed 10 percent. Full gating (suspension) of redemptions or fees become mandatory once weekly liquid assets fall below 10 percent. In addition, in the European Union, money market funds can impose partial gates, but in the United States only full gates (suspension of redemptions) are possible.

a fund started approaching that level—a level that only had significance because of the bright line drawn by the tie rather than actual difficulties in the fund's ability to meet redemptions.

ICI member firms indicate, and ICI data confirm, 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 reaching 30 percent could lead to the imposition of fees or gates.[23] ICI member firms 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 those weekly liquid assets fell below 35 percent.[24] Given that investors could not predict whether a fund would impose a fee or a gate if the fund reached this threshold, 30 percent in effect became a hard liquidity floor rather than a liquidity cushion to absorb higher-than-usual redemptions, as it was meant to be.[25] Indeed, this regulatory constraint necessitated prime money market funds' need to divest longer-dated securities in favor of securities that qualified as weekly liquid assets.[26]

Although outflows accelerated among US institutional prime money market funds, it is important to point out that even by the time the US Federal Reserve announced the MMLF at the height of the liquidity crisis (March 18), institutional prime money market funds still maintained robust liquidity buffers. That said, their weekly liquid assets were being depleted,

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[23] 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 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. US 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/.

[24] ICI members 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).

[25] Although SEC Rule 2a-7 under the Investment Company Act of 1940 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.

[26] See 2021 ICI Letter to PWG, *supra* note 4, Section 4.

which increased the number of institutional prime money market funds with weekly liquid assets in the 30 to 35 percent range.[27] Despite this stressful period, *only one US 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).[28] At the height of the crisis after three weeks of market turmoil and before the Federal Reserve announced the creation of the MMLF, institutional prime money market funds, though faced with significant redemptions, had plentiful liquidity levels that would have been sufficient to weather a severe liquidity event had money market funds been able to access this liquidity.

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.[29] At the same time, US retail prime money market funds, which like US 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.[30]

3.1.1 ICI Fees and Gates Simulation Study

Evidence suggests that removing the tie between money market fund liquidity and fee and gate thresholds may be sufficient to address policymakers' concerns regarding money market funds. To test this conclusion, ICI conducted a simulation study. The simulation shows that the tie increased the rate of redemptions at a pace that rapidly overwhelmed the available weekly liquid assets. On the other hand, without the tie, the redemptions—although significant—could largely have been met by natural replenishment of weekly liquid assets as term securities neared their maturity dates and without the need for the sale of assets for a much longer period of time.

The simulation was based on actual daily redemptions in March 2020 and other data-based assumptions of a hypothetical US institutional prime money market fund under two scenarios. The first scenario assumes, consistent with current regulatory requirements, that an institutional prime money market fund has the option of imposing redemption restrictions ("fees or gates") if the fund's weekly liquid assets fall below 30 percent. The second scenario assumes that an institutional prime money market fund does not have the option of imposing redemption restrictions whatever its level of weekly liquid assets ("no fees or gates").[31]

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[27] *See* 2020 ICI Money Market Fund Report, *supra* note 6, at Figure 3.17.

[28] *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.

[29] *Id*. at Figure 3.19.

[30] *Id*. at Figure 3.20.

[31] *See* 2020 ICI Money Market Fund Report, *supra* note 6, at 34-36.

Consistent with money fund providers' experiences in March 2020, assets fall more quickly under the "fees or gates" scenario once the institutional prime money market fund's weekly liquid assets fall below 35 percent because investors, concerned that the fund may impose fees or gates once the 30 percent level is breached, redeem more heavily (blue line in the top panel of Figure 1). To meet these heavier redemptions, the fund burns through its weekly liquid assets at a rapid pace, entirely depleting the fund's weekly liquid assets within two weeks (blue line in the bottom panel of Figure 1).

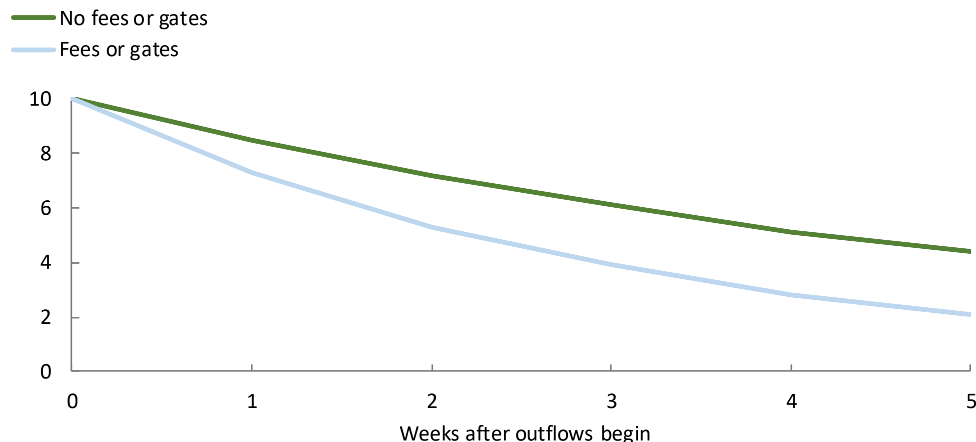
Under the "no fees or gates" scenario, the institutional prime money market fund faces lower (although still very significant) redemptions because investors do not fear the imposition of fees and gates. This in turn implies a gradual reduction in the fund's weekly liquid assets; weekly liquid assets decline as the fund meets redemptions, but are replenished to a significant degree as other, somewhat longer-dated, assets roll into the fund's weekly liquid asset bucket. Under this scenario, the analysis shows that *even after five weeks into the crisis* the fund still had 25 percent of its assets in the form of weekly liquid assets with which to meet redemptions (green line in the bottom panel of Figure 1).

FIGURE 1

Option of Imposing Fees or Gates May Have Caused Destabilizing Feedback in Prime Money Market Funds

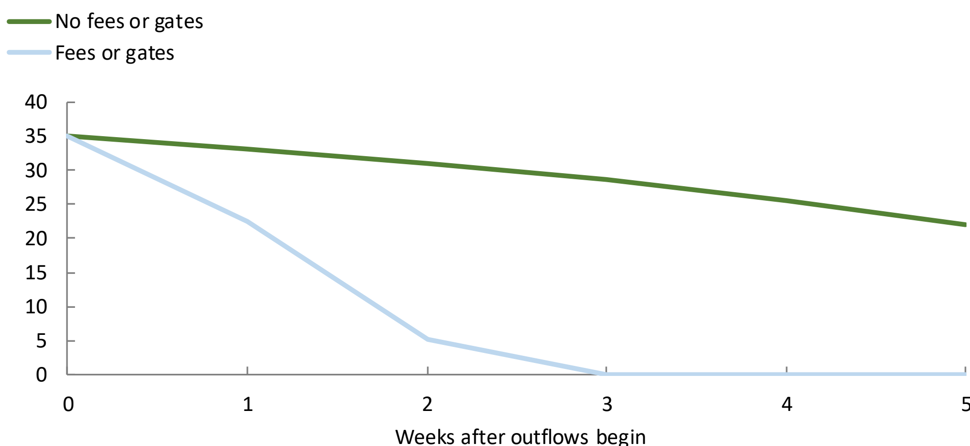
Investors redeem more heavily and fund assets fall faster with option to impose fees or gates...

Simulated total assets, billions of dollars



...Causing the fund to use its weekly liquid assets more quickly

Weekly liquid assets as a percentage of total assets



Note: Simulations assume that the fund starts with $10 billion in assets. The case of "fees or gates" assumes, as under the SEC's 2014 Rule 2a-7 amendments, that the fund has the option of imposing fees or gates if its weekly liquid assets fall below 30 percent. The case of "no fees or gates" assumes that the fund does not have the option of imposing either fees or gates at any level of weekly liquid assets, consistent with Rule 2a-7 before the SEC's 2014 amendments. For more information surrounding this figure, *see* 2020 ICI Money Market Fund Report, *supra* note 6.

These outcomes confirm that the purpose for the liquidity requirements in money market fund regulations—to ensure money market funds have a minimum percentage of their assets in highly liquid securities that can be readily converted to cash to pay redeeming investors—was turned on its head. Thus, regrettably, the 30 percent threshold became a reason for investors

to redeem out of a fund rather than a reason to remain in the fund.[32] It is important to reiterate that the 30 percent weekly liquid asset buffer became a floor that accelerated investor redemptions due to uncertainty about the imposition of liquidity fees or gates. To be a true buffer, it must serve as an extra source of liquidity in times of stress.

3.2 Policy Options That Impose the Cost of Redemptions on Redeeming Investors

As possible policy proposals, the Report discusses swing pricing or economically equivalent measures such as anti-dilution levies (*e.g.,* liquidity fees) that impose on redeeming investors the cost of their redemptions. Variants include having authorities mandate the use of swing pricing, including specifying minimum parameters (for the swing factor or anti-dilution levy) to limit the discretion of fund managers in case of a systemic crisis.

Swing pricing is not necessary for money market funds because they already have the ability to impose anti-dilution levies/liquidity fees. Requiring money market funds to impose swing pricing also would likely strip them 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, and cause confusion among investors during periods of stress. Indeed, we do not believe that there are any potential benefits to employing swing pricing for money market funds (either as a discretionary tool for fund managers or as a systemic risk tool mandated by authorities) that serve the FSB's overarching goals for reform.

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 policy option.[33] 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 investors would receive less for their shares, essentially allowing funds to impose estimated costs directly on those redeeming investors.[34] For reasons elaborated below, ICI and its members believe swing pricing would not advance policymakers'

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[32] Before the effective date of the SEC's 2014 money market fund reforms, which tied the liquidity thresholds (added in 2010) to fees and gates, prime money market funds regularly dipped below 30 percent with no adverse consequences. *See* 2021 ICI Letter to PWG, *supra* note 4, at 13-14.

[33] 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 investors. 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.

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

goals of reform or preserve the key characteristics required by investors of money market funds.[35]

3.2.1.1 Swing Pricing is Not Necessary for Money Market Funds

First and foremost, swing pricing is not necessary for money market funds because they already have the ability to impose liquidity fees/anti-dilution levies, which serve a similar purpose should their boards determine they are appropriate.[36] In fact, the Report acknowledges that anti-dilution levies are "economically equivalent" to swing pricing.

Since money market funds continue to be subject to extensive liquidity requirements, can use anti-dilution levies/liquidity fees under certain conditions, and remain sensitive to price volatility, we believe liquidity fees (delinked from fees and gates) rather than swing pricing are more appropriate for money market funds.

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, platforms, and portals, which generate much of the funds' order volume and fund flow activity.[37]

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.[38] These features allow money

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[35] Further, swing pricing raises complex tax reporting issues for US money market funds that would require guidance from the Treasury Department and Internal Revenue Service (IRS) to resolve. *See* 2021 ICI Letter to PWG, *supra* note 4, at 22.

[36] 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. *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. The SEC intentionally excluded money market funds from using swing pricing. 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. *Id*. 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." *Id*. 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." *Id.*

[37] For a discussion regarding how the industry distribution model in the United States 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.

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

market fund investors to sell shares and receive the proceeds from their redemptions on the same day, often within hours. This in turn allows 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.

In the United States, 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.[39] 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. In the United States, money market funds often settle T+0, which 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. Many money market funds (including institutional prime floating NAV money market funds) perform this process multiple times a day and offer T+0 settlement to help their institutional investors with their daily cash management needs.

The NAV calculation process for all floating NAV funds in the United States is largely similar.[40] 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 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 investors.

Money market funds would face even more daunting challenges if they were required to incorporate swing pricing into the process for calculating multiple NAVs throughout the day. Receipt of investor flow information is fundamental to determining first whether the swing threshold has been crossed. 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 Fedwire 6:45 pm ET cutoff time. The process is further complicated and meaningfully delayed when intermediaries generate any of the fund's order volume and fund flow activity; in that case, the

[39] For a discussion regarding the US NAV calculation and dissemination process, *see* 2016 ICI Swing Pricing Paper, *supra* note 37, at 5-6.

[40] US 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.

fund would need to depend on its intermediaries to deliver the flow information in a timely and reliable manner. It is doubtful that intermediaries could deliver the order flow information as promptly as would be needed.

In sum, to accommodate swing pricing, money market funds would need to impose earlier order cutoff times on investors and place pressure on intermediaries to furnish flow information earlier in the day. The former would greatly disrupt investors' 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 Would be Difficult to Mandate During Periods of Stress

As a variant option to swing pricing, the Report suggests in normal times the activation of swing pricing would be left to the discretion of the managers, and during periods of stress the swing pricing parameters (threshold, minimum factor) would be calibrated by authorities and be based on systemic risk indicators common to all funds, as well as specific fund-level factors.

The variant is likely to cause substantially more problems than it solves. During a crisis, regulators would need to set swing thresholds and factors in real time, balancing the goal of slowing redemptions against the legitimate needs of investors to obtain cash, which would likely be quite challenging. Most importantly, however, as the Report acknowledges, this approach could actually trigger runs during periods of stress; during a crisis, investors might anticipate that regulators would impose low thresholds and high swing factors and to avoid that would redeem early, much as they did in March 2020 in anticipation of the *possibility* that funds could impose fees and gates.

3.3 Policy Options That Absorb Losses

The Report proposes policy options to absorb losses when money market funds experience sudden and disruptive redemptions that cause asset prices to deteriorate. These include an MBR, capital buffers, and a liquidity exchange bank. The first two options are intended to address credit default events (*e.g.*, Lehman Brothers in 2008), not liquidity crises such as in March 2020. All three options face severe regulatory, structural and operational impediments that would make prime money market funds economically unviable.

3.3.1 Minimum Balance at Risk

An MBR would make a portion of each investor's 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.[41] Under this proposal, investors who redeem all

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[41] In 2012-2013, US policymakers considered (and ultimately rejected) an MBR proposal that would have required fund sponsors and intermediaries to restrict 3 percent of an investor'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-

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 investor's maximum recent balance. Also, a portion of redeeming investors' MBRs would be used to absorb any losses before other non-redeeming investors, creating a disincentive to redeem.

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.

An MBR is unlikely to meet the FSB's objectives. An MBR is intended to address credit events, not liquidity events such as in March 2020. Moreover, there would be significant operational challenges to monitoring investors' recent high balances (which could vary intra-daily) *and* ensuring that their redemptions do not exceed the MBR level. In addition, institutional investors are likely to find such restrictions cumbersome, leading them to shift away from money market funds.

3.3.1.1 Investors Will Reject Funds with MBR Restrictions

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 US 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 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 the 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 first proposed in 2012.[42] 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. Discussions with members today suggest that investor reactions would be similar.

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).

[42] *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.

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.

3.3.1.2 MBR Restrictions May Increase Investor Redemptions

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

3.3.1.3 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.[43]

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 investors' assets would require changes to myriad 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 such changes greatly curb investor interest in these money market funds, as members and surveys clearly indicate would happen.

3.3.2 Capital Buffer Requirements

The idea that money market funds or their managers/sponsors should maintain capital against money market fund assets is a flawed one, attempting to treat money market funds like

[43] *See id.*

banks.[44] 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).[45]

Over the years, ICI has analyzed several variations on the capital buffer idea, including requiring fund managers/sponsors to commit capital.[46] 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.

Imposing capital buffer requirements on a fund manager/sponsor would transform the essential nature of a money market fund by interposing the manager between the fund and its investors, requiring the manager to guarantee a portion of the fund. Currently, fund managers do not allocate capital to absorb losses because, as with all securities products, investors bear the risks of investing in funds. At times, some US money market fund managers have voluntarily provided financial support to their funds.[47] But these managers did so as a business decision, complying with applicable regulatory requirements. Requiring all fund managers to take a first-

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[44] 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 SEC 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.

[45] 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* 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.

[46] *See e.g.*, 2021 ICI Letter to PWG, *supra* note 4; 2013 ICI Letter to FSOC, *supra* note 4; 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.

[47] In the United States, the term "financial support" includes any: (i) capital contribution, (ii) purchase of a security from the fund in reliance on SEC 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 SEC Form N-CR.

loss position would be a radical departure from the current agency role that fund managers play and what is contemplated under the US and international securities laws. The mutual fund structure, including that of money market funds, is designed so fund advisory fees compensate the manager for managing the fund as a fiduciary and agent and for providing ongoing services that the fund needs to operate. Managers 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 managers are required to commit capital, small losses would be concentrated in a single investor (the manager) and across a small asset base (the value of the capital buffer). The manager 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 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[48] to ensure that net yields (the yield on a fund after deducting expenses) do not fall below zero. In 2021, money market funds are estimated to waive $8.0 billion in expenses compared with $3.1 billion in 2020 and $1.2 billion in 2019 (Figure 2). Although money market fund sponsors are estimated to collect about the same level in fees in 2021 and 2020, they are expected to waive 71 percent of the total fees they were entitled to collect in 2021—a stark increase over what they waived in 2020. More importantly, this near-zero interest rate environment is currently projected to persist through 2023,[49] which means money market funds are facing another extended period of expense waivers.

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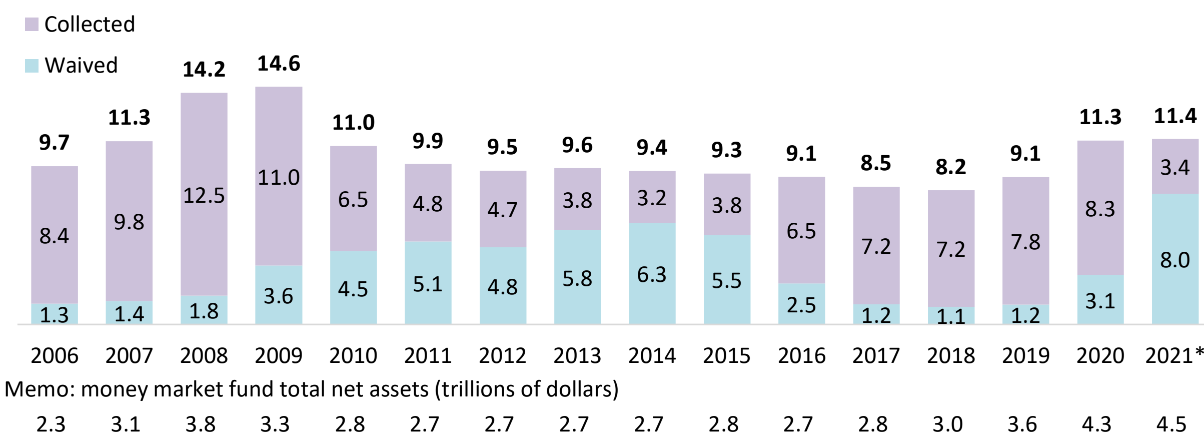
[48] ICI uses the term *expense waivers* to refer to fee waivers and/or expense reimbursements.

[49] *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.

FIGURE 2

Fees Collected and Waived by Money Market Funds

Billions of dollars, annual



*For the fees collected and waived, data for 2021 are annualized. For money market fund total net assets, data are as of June 30, 2021.

Note: Data do not include nonpublic institutional prime money market funds.

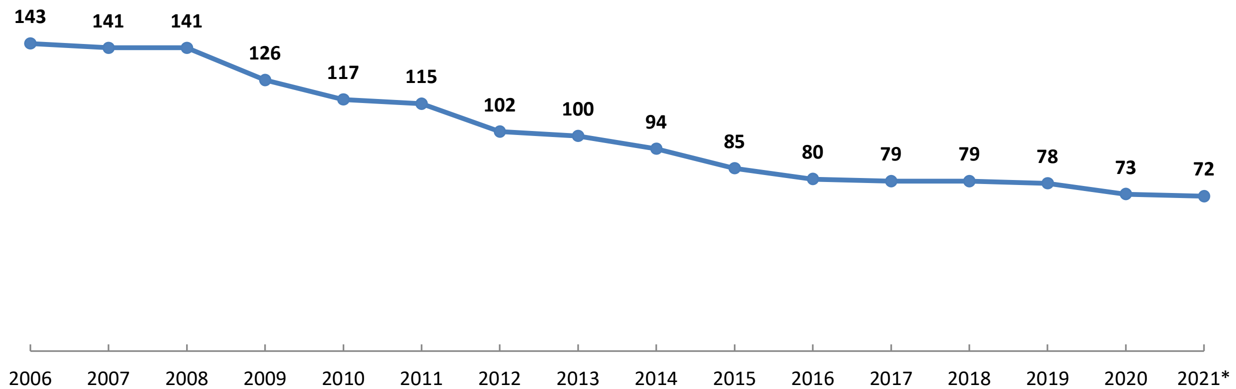
Sources: Investment Company Institute and iMoneyNet

Requiring sponsors to pledge capital, even seemingly modest levels, risks firms leaving the market. Between 2008 and 2016, 43 percent of US 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 to 72 sponsors in June 2021. As sponsors face renewed pressures to waive expenses for the next few years, requiring capital buffers may cause more sponsors to leave the money market 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



*Data are as of June 30, 2021.

Source: Investment Company Institute

Even in a more normal interest rate environment, managers would have difficulty passing the cost of the required capital on to fund investors. The risk-limiting provisions (under either SEC Rule 2a-7 or the EU's MMF Regulation) effectively place a ceiling on what a money market fund may earn. Yields on government (public-debt) 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 government/public-debt fund.[50]

3.3.2.1 Require Liquidity Exchange Bank Membership

A variant to capital buffers is a proposal that would require money market funds to be members of a private liquidity exchange bank that would provide a liquidity backstop during periods of market stress. This proposal, if viable, might have helped address liquidity issues in March 2020. Viability, however, is extremely doubtful. Over ten years ago and in response to the June 2009 US Treasury Department paper on financial regulatory reform,[51] which called for

[50] In addition, in the United States any proposed increase in a fund's manager 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 government money market fund. All else being equal, an increase in a fund's 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 SEC Rule 2a-7 (or the MMF Regulation) and would run directly counter to the goals of policymakers.

[51] *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.

exploring measures to require money market funds "to obtain access to reliable emergency liquidity facilities from private sources,"[52] ICI developed a preliminary framework for a private liquidity facility, including how it could be structured, capitalized, governed, and operated.[53]

As we noted at the time, however, it would need to overcome some significant hurdles. To ensure sufficient capital, regulators would have to require all funds to participate. Required capital levels could, however, be so high as to render money market funds economically unviable, especially for smaller providers. To reduce the chances of this, regulators would have needed to be very patient, allowing the facility to build capital over a lengthy period, perhaps ten years or more. The facility would have needed to obtain a bank charter and have access to the Federal Reserve's discount window. In any event, these challenges were ultimately deemed insurmountable. There is no reason to believe that these challenges would not remain if the idea of a liquidity exchange bank were resuscitated.

3.4 Policy Options to Reduce Threshold Effects

In addition to removing the tie between money market fund liquidity and fee and gate thresholds as discussed above, the Report also considers variants of this proposal including requiring money market funds to get permission from authorities before activating fees or gates, countercyclical liquidity buffers, or investor concentration limits. The Report also proposes eliminating stable NAVs.

3.4.1 Modifications to Fee and Gate Considerations

Under this variant, current rules tying liquidity levels to the potential use of fees and gates would remain, but money market funds would need to receive the approval of authorities to activate fees and gates. As noted above, the tie between liquidity and fee and gate thresholds made money market funds more susceptible to financial market stress in March 2020 and could likely do so again in future periods of stress. We do not believe that adding an additional layer of regulatory approval before the activation of fees would lessen the cliff effect of this regulatory constraint or meaningfully impact the usability of a fund's weekly liquid assets. Instead, as noted in the Report, during periods of stress, liquidity management would be made more difficult and less timely if money market funds must obtain regulatory permission before using this tool.

In contrast to fees, gates deny investors access to their cash, which is highly problematic when investors have immediate cash flow demands. Based on the experience of certain money market funds in March 2020, the mere prospect of gates may have caused investors (especially institutional) to engage in preemptive redemptions. 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. As such, we recommend

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[52] *Id.* at 38.

[53] For details regarding the proposed liquidity facility, including its estimated costs and challenges, *see* 2011 ICI Letter to PWG, *supra* note 4, at 23-31.

gates be limited to extraordinary circumstances that present a significant risk of a run on a fund and potential harm to investors, such as those contemplated under SEC 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.

3.4.2 Countercyclical Weekly Liquid Asset Requirements

The Report proposes a countercyclical weekly liquid asset requirement that could automatically reduce minimum weekly liquid asset requirements during times of stress. Any thresholds linked to a fund's minimum weekly liquid asset requirements (*e.g.*, fee or gate thresholds) also would move with the minimum.

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, before the SEC's 2014 reforms that tied US money market funds' ability to impose a fee or gate to the weekly liquid asset thresholds, money market funds regularly dipped below 30 percent without raising any questions about the resiliency of the funds.[54] Thus, before the implementation of the fees and gates threshold, 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 policy option will improve the usability of weekly liquid asset requirements.

3.4.3 Investor Concentration Limits

This policy option would require money market funds to disclose investor concentration and restrict the portion of shares that can be owned by a single investor. Under current US regulations, in addition to specific minimum daily and weekly liquid assets, a money market fund must maintain sufficient liquidity to meet reasonably foreseeable investor redemptions, as well as other commitments it has made to investors. As a complement to these requirements, the SEC also imposes a requirement that money market funds adopt "know your customer" policies and procedures to assure that funds undertake appropriate efforts to identify risk characteristics of their investors and to plan their holdings of liquid assets accordingly.

We believe the flexibility of the current regulatory regime is appropriate because it recognizes that different money market funds may have different needs depending on, for example, their investor bases. As such, we do not support a "one-size-fits-all" investor concentration limit. Individual money market funds are in a better position to set limits as to the scope of their policies and procedures. Indeed, concurrent redemptions of several investors may have a material effect on a fund's ability to satisfy redemptions even if the investors' individual redemptions alone would not have such an effect.

[54] See 2021 ICI Letter to PWG, *supra* note 4, at 13-14.

Instead, we believe investor concentration, as well as other portfolio-specific characteristics, should be considerations for when to impose redemption fees/anti-dilution levies and how the fund's manager should calculate them. Indeed, rather than linking the possible imposition of fees to the 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, 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.[55]

3.4.4 Eliminating Stable NAVs

Stable NAVs are a feature of government and retail money market funds in the United States, public debt and LVNAV money market funds in the European Union, and virtually all money market funds in China and Japan. This policy proposal would require that all 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 US institutional prime money market funds and European VNAV money market funds. The Report suggests that a floating NAV may address the incentive of money market fund investors 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.[56] 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.

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[55] 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.

[56] 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 45, 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 45, at 147.

3.4.4.1 Floating NAVs are Unlikely to Significantly Reduce Redemption Activity

As the Report acknowledges, a floating NAV did not stop redemptions in March 2020 for money market funds with floating NAVs, such as US institutional prime money market funds or French VNAV money market funds.[57]

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 regardless of their valuation method absent a large interest rate movement or credit event.

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. And liquidity buffers ensure that money market funds are able to meet redemption requests during times 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. There is no evidence that floating the NAV discourages redemptions. In March 2020 US Institutional prime money market funds had floating NAVs but still experienced large redemptions while at the same time US retail prime money market funds with stable NAVs experienced much more modest redemptions.[58]

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[57] For a more detailed discussion of the experience of European money market funds during the COVID-19 crisis, *see* 2020 ICI COVID-19 European Report, *supra* note 5, at 13-16. A floating NAV does not avert redemptions during periods of market stress. *See e.g.*, 2013 ICI Letter to SEC, *supra* note 4; 2013 ICI Letter to FSOC, *supra* note 4; *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* note 4; 2009 MMWG Report, *supra* note 4, at 105-107.

[58] For a description of money market fund flows during March 2020, *see* 2020 ICI Money Market Fund Report, *supra* note 6, beginning at 12.

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

3.4.4.2 Floating NAVs Could Eliminate Key Benefits to Retail Investors

One very significant concern, as the Report notes, is whether investors would continue to use such a product. We believe the answer is no. In the United States, a floating NAV would reduce the value and convenience of money market funds to 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.[59]

3.5 Policy Options to Mitigate the Impact of Large Redemptions and Reduce Liquidity Transformation

The Report includes policy proposals that place limits on eligible assets by requiring money market funds to invest a higher portion of their assets in shorter-dated and/or more liquid instruments. Variants include requiring money market funds to hold public debt instruments only (*i.e.*, permit only government money market funds) or setting each money market fund's required liquidity buffer based on its own characteristics, such as investor base or the outcome of fund-specific stress tests. Other options include changing the terms of redemptions for money market fund shares rather than increasing the liquidity of their assets (*e.g.*, non-daily dealing, redemptions in-kind, liquidity-based redemption deferrals that would allow only a fraction of each redemption request to be met on the same day).

The Report also includes a policy proposal that would subject money market funds to additional liquidity requirements by requiring them to hold additional amounts of assets that can be readily converted to cash over a two-week period or less and escalation procedures when regulatory thresholds are breached (*e.g.*, price-based tools such as liquidity fees or swing pricing and/or quantity-based tools such as notice or settlement periods). We discuss each of these policy proposals below.

3.5.1 Limits on Eligible Assets

One potential policy proposal would limit eligible assets for money market funds and require the funds to invest a higher portion of their assets in shorter-dated and/or more liquid instruments. The Report suggests that placing limits on eligible assets may make money market funds more resilient to large redemptions by reducing "liquidity transformation"—making them

[59] The floating NAV also would introduce new tax reporting issues for US retail investors that would lead to tax compliance problems and significant investor confusion that would diminish the utility of the product for these investors. For a discussion of these issues, see 2021 ICI Letter to PWG, *supra* note 4, at 36-37.

less dependent on liquidity conditions in the markets for the assets they hold and reducing the first-mover advantage for redeeming investors.

Any such changes risks reducing the benefits of these funds and, consequently must be data driven, including considering the types of assets readily available in various jurisdictions, such as availability to government securities and overnight repo. Such limits also should not be so onerous as to materially impact the ability of money market funds 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 public debt money market fund, such as a US Treasury or government money market fund.

3.5.1.1 Limit Money Market Funds to Public Debt Money Market Funds

A variant of this policy option would be to constrain money market funds to hold public debt instruments only, which would effectively restrict money market funds to government money market funds. We strongly oppose this policy option. Not only have we presented empirical evidence disputing the assertion that the COVID-19 market event revealed fundamental weaknesses with non-public debt money market funds (*i.e.*, US prime and European LVNAV and VNAV money market funds), we also note that these funds play an important role in the capital markets by facilitating an efficient means for institutional and retail investors to access the short-term funding markets and providing low-cost short-term financing to the private sector. Indeed, money market funds are much more efficient and diversified (especially for large balances) than banks at intermediating between the needs of short-term investors and corporate issuers.

3.5.1.2 Fund Specific Liquidity Level Requirements

Another variant would require each money market fund to maintain liquidity buffers based on its own characteristics, such as investor base or the outcome of its fund-specific stress tests. Although the Report seems to suggest this variant proposal would be a new requirement for money market funds, it is generally consistent with current US regulation of money market funds. As noted above in Section 3.4.3, in addition to specific minimum daily and weekly liquid assets, US money market funds must maintain sufficient liquidity to meet reasonably foreseeable investor redemptions, as well as other commitments it has made to investors. As a complement to these requirements, the SEC also imposes a requirement that money market funds adopt "know your customer" policies and procedures to assure that funds undertake appropriate efforts to identify risk characteristics of their investors and to plan their holdings of liquid assets accordingly.

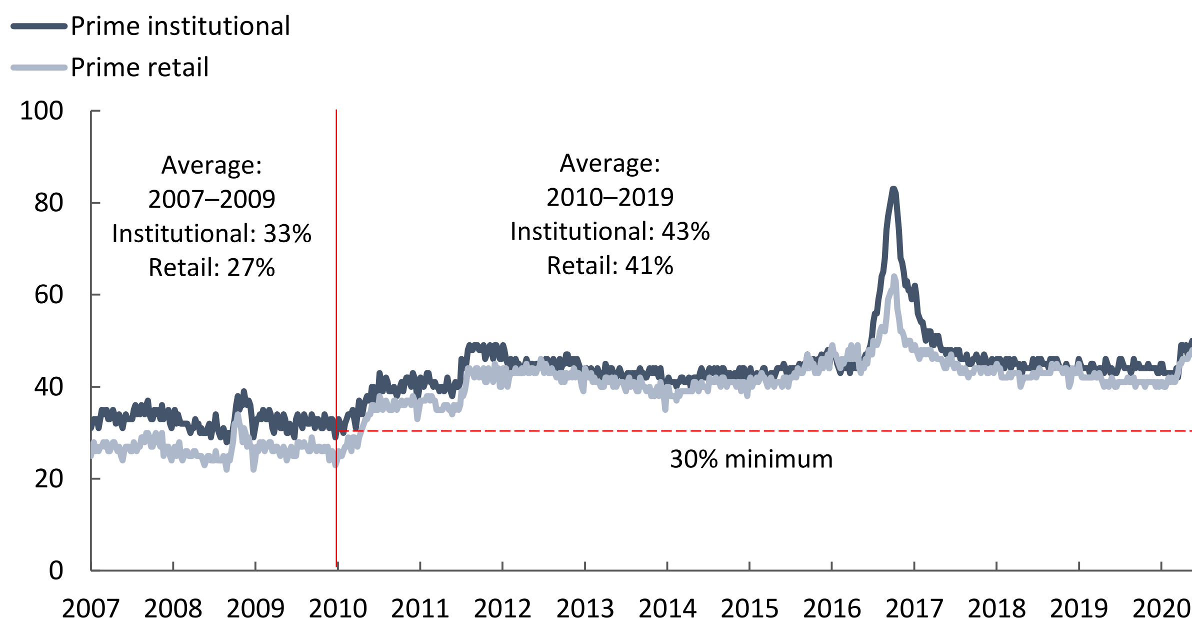
Not surprisingly, since 2010 (when the SEC first added the liquidity requirements to Rule 2a-7), US prime money market funds' weekly liquid assets (as a percentage of their portfolios) have exceeded the 30 percent minimum by a significant margin—on average by 12 to 15 percentage points—illustrating that these funds operate conservatively (Figure 4). Likely reflecting a response to the SEC's 2014 reforms permitting funds to impose fees or gates if their weekly

liquid assets fall below the 30 percent minimum, the weekly liquid asset levels for US institutional prime and retail prime money market funds averaged slightly higher from 2014 to 2019 than from 2010 to 2013.

FIGURE 4

Prime Money Market Funds Are More Liquid After the Global Financial Crisis

Average weekly liquid assets of prime money market funds, percentage of fund assets, weekly, January 2, 2007–June 30, 2020



Note: The large spike in weekly liquid assets from roughly June 2016 to May 2017 reflects prime money market funds transitioning their portfolios ahead of the SEC's October 2016 deadline for institutional prime money market funds to use floating NAVs. Prime money market funds, especially institutional funds, expected to (and did) see large outflows as investors shifted to government money market funds. Averages for 2010–2019 exclude observations from June 2016 to May 2017.

Source: 2020 ICI Money Market Fund Report, *supra* note 6

3.5.1.3 Non-daily dealing and liquidity-based redemption deferrals

The Report also includes variant policy options that would prohibit money market funds from offering daily redemptions. Instead, the frequency of redemptions would be aligned with the liquidity of the assets, such as weekly or biweekly redemptions. Investors also would be subject to a notice period between the day of redemption and the settlement of the money market fund shares.

Similar to the MBR policy proposal discussed above, ICI strongly opposes any sort of redemption restriction that would impair investor liquidity when liquidity is readily available within the money market fund. Throughout the history of money market funds, investors of all types have benefited from the convenience and liquidity of these funds. The inability of investors to have same-day liquidity from money market funds, even in normal market conditions, would destroy the ability of investors (both institutional and retail) to use money

market funds as a liquid investment on a daily basis. The likeliest impact of this policy option therefore would be to drive investors away from these money market funds—thus depriving businesses and financial institutions of a direct source of short-term financing—and encouraging them to seek more expensive, less transparent, less diversified, and less efficient financing from other sources, which may have negative implications for global financial stability.

3.5.1.4 Redemptions In-Kind During Periods of Stress

The Report discusses another variant policy option that would require redemptions (presumably of a certain size) to be made through the distribution of a proportionate amount of the money market fund's securities to the redeeming investor during periods of stress. These "in-kind" redemptions currently are permitted, but due to operational and other reasons, are rarely invoked. In 2010, the President's Working Group on Financial Markets also proposed a similar concept,[60] but commenters, including ICI,[61] expressed concerns with this approach. We reiterate those concerns below.

3.5.1.4.1 Unintended Consequences of Mandatory Redemptions In-Kind

The experience of the fund industry makes it clear that redemptions in-kind are very unpopular with investors. This method of meeting redemptions places the burden for holding or custodying, valuing, and liquidating underlying portfolio securities, with all the attendant costs, directly on the investor. Many investors are not prepared, as a practical matter, to address valuation obligations and other consequences of holding these instruments directly.

The supposed regulatory attractiveness of imposing a redemption in-kind requirement lies in this very unpopularity—one theory being that investors would avoid requesting redemptions in large amounts, absent an urgent need for those funds. According to this theory, fewer investors would make these redemption requests, thus alleviating the pressure on money market funds to sell securities into a declining market.

The problem with this theory is that investors more likely would work around the requirement (*e.g.*, by carefully allocating investments among multiple funds in amounts below the anticipated in-kind redemption threshold to preserve flexibility in meeting cash needs). Funds engaging in the "know your investor" analysis would see smaller investor positions. In the event of a true market crisis, however, these investor redemptions could quickly mount across the industry, which would risk freezing the short-term credit markets as multiple funds seek to meet smaller, but more numerous, redemption requests.

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[60] See Securities and Exchange Commission Release No. IC-29497 (November 3, 2010), available at www.sec.gov/rules/other/2010/ic-29497.pdf. The Report is appended to the SEC Release and also is available on the Treasury Department's website at www.treasury.gov/press-center/press-releases/Documents/10.21%20PWG%20Report%20Final.pdf.

[61] 2011 ICI Letter to PWG, *supra* note 4 at 42-45.

Moreover, investors that do trip the threshold and need immediate liquidity (or that lack the expertise in directly managing money market instruments) will have no option but to sell the securities received into a falling market, thus undermining a main goal (*i.e.*, mitigating the sales of money market instruments at fire-sale prices) of this approach.

3.5.1.4.2 Difficulties Determining the Appropriate Trigger

Presumably, a requirement to redeem shares in-kind would be the exception and not the rule, thus necessitating regulations to identify some circumstance or event (in the fund's portfolio or the market) that would occasion redemptions in-kind, and some threshold level of redemptions (whether by a given investor or by investors in the aggregate) to which the in-kind requirement would apply. Implementing such standards presents significant challenges. The trigger could be set either on a fund-by-fund basis or on a market-wide basis. A fund-by-fund trigger would require any fund that reached a pre-determined criterion (*e.g.*, liquidity levels, a NAV of a certain number of basis points or lower) to immediately institute a mandatory redemption in-kind process. A market-wide trigger could be imposed on a prudential basis by a regulatory authority. In either case, a suitable trigger point is difficult to determine in advance and would condition investors to redeem their shares in advance of the trigger event.

3.5.1.4.2.1 Fund-by-Fund Triggers

A fund-by-fund trigger would be ineffective and carry a strong likelihood of sparking a cascade of redemptions. Almost certainly, the trigger would be information that should be disclosed to investors, permitting them to structure their money market fund investments across multiple funds in amounts low enough to ensure ongoing liquidity. As funds enter periods of net redemptions, however, investors intending to be below the threshold may seek to redeem shares to stay below the threshold or to avoid having to monitor the size of their positions in a shrinking fund. Those redemptions would in turn place additional downward pressure on the market. Furthermore, while it is unclear how the investors of other funds would react to one fund's imposition of mandatory redemptions in-kind, it may cause them concern, leading them to redeem securities in unaffected funds when they otherwise would not have done so.

3.5.1.4.2.2 Market-Wide Triggers

A market-wide trigger declared by a regulatory authority carries the same risk as the fund-by-fund approach. Indeed, indications of market fragility may cause investor flight from money market funds before the government announced mandatory in-kind redemptions. Such redemptions would again place additional downward pressure on an already declining market. Imposing redemptions in-kind on all money market funds, moreover, would be overbroad and unfair to funds that hold sufficient liquid assets. Not all funds experienced the same level of investor redemptions during March 2020 (or during other periods of stress for that matter).

3.5.1.4.3 Operational Hurdles

Redeeming money market fund shares in-kind presents operational problems for both the fund and its investors. Since money market funds often invest in hundreds of different underlying securities, creating a vertical slice of the portfolio for a redeeming investor can be a complex and challenging process. Depending on the composition of its portfolio, a fund may not be able to transfer title to certain securities or instruments held in the fund, such as privately placed securities, master notes, or term repurchase agreements, which require the consent of the issuer prior to transfer. In other cases, the client may not meet eligibility standards to hold the securities directly (*e.g.*, Rule 144A restricted securities can only be transferred to a qualified institutional buyer). Some instruments may not be permitted to be divided among many investors (*e.g.*, commercial paper is typically issued in denominations of $100,000 or more). Even if a security can be divided, transferring only a portion of a fund's holding of a particular security could leave the fund with an odd lot position that is difficult to trade, except at a discounted price. As a result of these and other transferability limitations, a greater proportion of other securities that are not subject to transfer restrictions would need to be distributed; however, it is unlikely these securities have the same maturities, sector concentrations, yields, and other characteristics as the securities that cannot be transferred. Indeed, even if substitutions could be made, each redemption in-kind would leave the fund more concentrated in non-transferable, restricted securities, and odd lots, to the detriment of the remaining investors.

Even if securities could be identified that were capable of fair division, getting them to clients' accounts could prove challenging. Investors would have to establish brokerage or custody accounts in advance, and pay ongoing fees for those accounts, on the off-chance of being required to accept securities from their money market fund. Similarly, financial intermediaries that maintain omnibus accounts would have the burden of further allocating in-kind securities to their underlying customers. This requirement would increase investor costs, with doubtful benefits to the markets.

We believe that funds' current authority to redeem shares in-kind voluntarily (although rarely invoked) appropriately enables them to assess the advisability of redemptions in-kind under the circumstances facing the fund and the market at the time. A mandatory "one-size-fits-all" approach likely would cause far more problems than it solves, either for the fund or money market funds generally.

3.5.2 Additional Liquidity Requirements and Escalation Procedures

The Report includes an option that would subject money market funds to additional liquidity requirements by mandating that they hold minimum amounts of assets that can be readily converted to cash over a two-week period or less. In addition, the use of liquidity management tools would be structured around escalation procedures when regulatory thresholds are breached. In such circumstances, money market funds would be required to use price-based tools such as liquidity fees or swing pricing first, then quantity-based tools (notice or settlement periods), before using gates.

According to ICI data, from 2010 to January 2021, US institutional prime money market funds on average held 44 percent of their assets in weekly liquid assets, and US retail prime money market funds held on average 41 percent of their assets in weekly liquid assets—exceeding the 30 percent 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 (provided such liquidity requirements are delinked from fees and gates). Any such increase, however, should be data driven and not so high as to materially impact the ability of money market funds to serve as direct sources of financing for businesses and financial institutions or make it difficult (or impossible) to continue to attract investors by providing a return that is above that of a public debt money market fund, such as a US Treasury or government money market fund.

As discussed above, we agree that fees should be considered before gates. Indeed, we recommend that gates be limited to extraordinary circumstances that present a significant risk of a run on a fund and potential harm to investors, such as situations when a fund seeks to liquidate.

Conclusion

ICI appreciates the opportunity to comment on the FSB Report. We are committed to working with policymakers to further strengthen money market funds' resilience to severe market stress. We would welcome the opportunity to present our views in more detail to FSB members. If you have any questions, please feel free to contact me at +1-202-326-5824 or eric.pan@ici.org.

Sincerely,

/s/ Eric J. Pan

Eric J. Pan
President & CEO

cc:

Randal K. Quarles, Chair, Financial Stability Board
Klaas Knot, Vice Chair, Financial Stability Board
Dietrich Domanski, Secretary General, Financial Stability Board
Ashley Alder, Chair, International Organization of Securities Commissions
Tajinder Singh, Acting Secretary General, International Organization of Securities Commissions

Appendix

INVESTMENT COMPANY INSTITUTE® ICI Global

A Study of the Performance of Money Market Funds and the Short-Term Funding Markets During March 2020

Investment Company Institute Roundtable
April 29, 2021

Summary of Proceedings and Key Points

The Investment Company Institute (ICI) organized a two-hour roundtable to investigate the activities of money market funds, their investors, and the short-term funding markets during the weeks before the Federal Reserve announced the Money Market Mutual Fund Liquidity Facility (MMLF) on March 18, 2020 and in the days following. The purpose of the roundtable was to study the experience of money market funds during the liquidity crisis through analyzing proprietary data and asking fund managers to detail the behavior of money market funds and money market fund investors in March 2020.

Over 160 international regulators, policymakers, industry participants, and academics attended the roundtable. The moderator of the roundtable was Professor Erik Sirri, a professor of finance at Babson College and former Director of Trading and Markets and Chief Economist at the US Securities and Exchange Commission (SEC). Audience members had the opportunity to ask questions.

Part One of the roundtable consisted of ICI economists Sean Collins and Shelly Antoniewicz presenting their research about money market funds' portfolio activities during March 2020.

Part Two of the roundtable consisted of fund managers from eight of the most significant money market fund providers describing their personal experiences managing money market funds during the March 2020 period, their interactions with investors, and the choices made regarding the portfolios.

The following are the key points made during each part of the roundtable.

Part I—Presentation by ICI Economists (see attached presentation slides)

ICI Research on money market funds' portfolio activities during March 2020

- Prime money market funds pulled back very little from the commercial paper market before the Federal Reserve announced the MMLF on March 18, 2020.
    - For example, for the week ended March 17 (the day before the Federal Reserve announced the MMLF), prime money market funds on net reduced their holdings of commercial paper by only $6.2 billion relative to outflows of $64 billion. Moreover, prime money market funds continued to make gross *purchases* of commercial paper, although

tilting them increasingly toward overnight issuances as the month wore on to build liquidity.

- The statements in the President's Working Group Report ("From March 10 to March 24, [prime] funds cut their [commercial paper] holdings by $35 billion. This reduction accounted for 74 percent of the $48 billion overall decline in outstanding [commercial paper] over those two weeks.") are misleading because they do not distinguish between the activity of prime money market funds before versus after March 18.
  - Survey data show that two-thirds of the reduction in prime money market funds' commercial paper holdings ($23 billion) represented sales to the MMLF *after* March 18. Because these sales just moved assets from money market funds to the Federal Reserve's balance sheet, they did not contribute to the decline in commercial paper outstanding, in turn suggesting that prime money market funds did not significantly contribute to the liquidity issues in the commercial paper market.
- The regulatory tie between weekly liquid assets and fees and gates made prime money market funds *less resilient* to redemptions and *more dependent* on financial intermediaries.
- Prime money market funds accessed the MMLF primarily to keep weekly liquid assets above 30 percent.

Part II—Discussion by Money Market Fund Managers

March 2020 events represented a unique liquidity crisis arising from the COVID-19 pandemic

- Unlike the global financial crisis of 2007-2009, which was a credit crisis, the turmoil that gripped financial markets in March 2020 originated from businesses, households, and financial institutions' sudden and immediate need for liquidity (a "dash for cash") to protect against the uncertainty caused by the COVID-19 pandemic and government-imposed economic shutdowns.
- COVID-19 triggered an *extremely* rapid financial crisis—the most crucial elements unfolding quickly over 45 days—from mid-February to end of March.
- Fund managers viewed communication with investors as a first line of defense during the crisis, starting in early March and continuing through May. Fund managers fielded daily calls with investors, posted website commentaries, and held market update calls that attracted hundreds of investors. Topics included the Federal Reserve's actions, market and fund liquidity, market pricing, portfolio maturities, and the prospect of imposing fees or gates. Unlike the global financial crisis, investors were not concerned about credit issues, but focused on liquidity.
- As the virus began to spread globally in February and early March, fund managers positioned their portfolios to reflect increased uncertainty about the state of the economy *(e.g.*, building liquidity and limiting or reducing term investments).

Markets exhibited stress before prime money market funds experienced outflows

- Fund managers saw liquidity problems first arise in early March in the repo market and the market for US Treasuries. Liquidity problems in the short-term credit markets occurred later.

- The first Federal Reserve programs on March 9 and March 12, which preceded the MMLF by a week, were "massive" increases in the Federal Reserve's overnight and weekly term repo limits designed to address disruptions in Treasury financing markets.

  - For example, normally the difference between bid-ask spreads for "off-the-run" Treasuries (bonds that are not the most recent issue of a given maturity) and "on-the-run" Treasuries (the most recently issued bond of a given maturity) are narrow. This was not the case in early March 2020 when the difference between these spreads jumped, something that happens only during periods of stress, indicating dislocations in the Treasury market.

- To fully understand what happened in the short-term funding markets in March 2020, it is also important to look at events on a day-to-day basis. For example, as the virus and government shutdowns spread from region to region, the equity markets started falling rapidly. From late February to early March, premiums on credit default swaps for investment grade corporate debt had widened substantially, and the difference between 3-month LIBOR and the federal funds rate (also known as the FRA-OIS spread)—a proxy for stress in the interbank lending market—also had widened substantially. These events took place *many days before* money market funds in aggregate began to see meaningful daily outflows.

- It is also important to keep in mind that there were added liquidity pressures in mid-March 2020 because of corporations' and other institutional investors' normal cash management needs. In the United States, for example, corporations with specified fiscal year-ends (including June 30 and September 30) were required to make estimated tax payments by Monday, March 16. In normal circumstances, prime money market funds build liquidity to meet these predictable flows. But managing even these normal and predictable flows became more challenging by mid-March as the fixed-income markets froze.

- Markets were stressed, yet still functioning by Friday, March 13. But over the weekend after people in the United States were sent home *en masse*, the Federal Reserve cut the federal funds rate by 100 basis points (and took other unprecedented actions) on Sunday, March 15. On Monday, March 16, market participants faced completely frozen short- and long-term markets.

- When the Federal Reserve cuts rates, a fund manager typically "extends out the curve" (*i.e*., invests in instruments with longer maturities) because money flows into the fund. Reflecting the very atypical market conditions in March 2020, including the Federal Reserve's March 15 actions, outflows instead increased from prime money market funds on March 16.

Role of intermediaries has evolved since 2008 impacting the functioning and liquidity of the short-term funding markets

- In the face of uncertainty about the virus and the economy, *all* market participants, *not just money market funds*, demanded liquidity during the week of March 16.
    - Sellers seeking liquidity found it difficult, if not impossible, to find buyers for even very high-quality short-term credits. Bids for short-term credits were generally absent.
    - Dealers, who normally provide multiple competitive bids for money market instruments, were facilitating trades only as agents (if they could find willing buyers) because they too needed to maintain liquidity and adequate capital.
- Regulatory constraints, intertwined with the global pandemic, dramatically changed the willingness and ability of dealers to act as intermediaries. In addition, by mid-March (and quarter-end), dealer balance sheets were tight and under more strain given the dislocations in the Treasury and other markets, corporations drawing down on their bank lines, and normal quarter-end demands.
- Under normal market conditions, secondary market trading in money market instruments is limited because these securities, being short-dated, generally mature quickly, obviating the need to sell them to raise cash. The events of March 2020, however, demonstrate the importance of reliable secondary market liquidity when funds and other market participants are seeking to liquidate positions in the short-term funding markets but finding no bids for high-quality, short-term money market instruments.

Regulatory tie between weekly liquid assets and potential for fees and gates made prime money market funds less resilient to investor redemptions and more dependent on financial intermediaries during stress events

- The SEC's 2014 linking of liquidity fees or redemption gates to the 30 percent weekly liquid asset threshold created a tripwire for investors. In March 2020, to avoid the mere possibility that funds *could* impose fees and gates if weekly liquid assets fell below 30 percent, investors preemptively redeemed as funds' weekly liquid assets started falling toward (but not reaching) the 30 percent threshold. For some funds, this happened as their weekly liquid assets fell close to or below 35 percent and, in a few other cases, as soon as weekly liquid assets reached 40 percent.
- Investors treated the 30 percent threshold as an event that would automatically trigger fees and gates. This effectively locked up 30 percent of prime money market funds' highly liquid assets, preventing fund managers from touching any of these liquid assets to meet redemptions.
- Investors were concerned about their continued access to liquidity if a fund were to impose a gate (a regulatory requirement that differentiates prime money market funds from other cash alternatives in the short-term funding markets) and less concerned about the possibility of fees or, more generally, about the possibility of losing principal. Questions from investors regarding liquidity levels (*e.g.*, are you at or near 40 percent? 35 percent? 33 percent?) were

much more common than questions or concerns regarding the fund's net asset value. Investors simply ignored a third of the portfolio's liquid securities.

- There also is a misperception that a money market fund's portfolio is bifurcated into liquid (*i.e.*, weekly liquid assets) and illiquid (*i.e.*, everything else) securities. This misperception fails to take into account that non-weekly liquid assets quickly roll down the maturity curve, converting naturally to weekly liquid assets as time passes. For example, securities that now mature in two weeks automatically become weekly liquid assets next week.
- Money market funds are transparent products. Investors' ability to track weekly liquid asset levels on a daily basis, combined with a fear of gates, also helped drive their behavior.
- The 30 percent weekly liquid asset requirements should not be linked to the prospect of a fee or a gate. Before fees and gates were linked to the liquidity thresholds, funds were able to use the liquidity buffers to meet redemptions, such as in 2011 when the European banking crisis caused significant shifts from prime money market funds that funds met in good order. This is evidence that weekly liquid asset buffers work, but not when linked to gates.

Prime money market funds used the MMLF to keep their weekly liquid assets well above 30 percent

- Prime money market funds used the MMLF primarily to keep their weekly liquid assets well above the 30 percent weekly liquid asset threshold, not because they were yet in immediate danger of having redemptions overwhelm available weekly liquid assets held by the fund.
- During March 2020, except for assets naturally maturing into weekly liquidity, converting non-weekly liquid assets into cash or something that could be a weekly liquid asset was important and very difficult before the MMLF.
- Once the Federal Reserve indicated that it was willing to add liquidity to the markets, market participants felt more comfortable staying in the short-term funding markets, including in prime money market funds. Consequently, prime money market funds' use of the MMLF was relatively limited, according to ICI survey data, just 12 percent of the assets of public institutional prime money market funds and 3 percent for retail prime.

MMLF provided liquidity for the entire short-term funding markets and all participants in those markets

- The MMLF, which was just one among many Federal Reserve facilities and actions, helped restore liquidity and the flow of credit to the entire short-term markets. It is inaccurate to characterize the MMLF as a "bail out" for money market funds.
- Even though money market funds represented a minority of the commercial paper market, money market funds were a useful conduit for the Federal Reserve to channel funds to the short-term funding markets. Money market funds are a counterparty through which the Federal Reserve can conveniently provide liquidity to the markets for commercial paper and bank certificates of deposit, which benefits all market participants.

- The MMLF provided a "broad calming" effect for all participants in the short end of the market (including participants that did not have direct access to the MMLF, such as individual investors and offshore money market funds), slowed redemptions, and allowed fund managers to refocus their attention and energy on optimal portfolio positioning. In addition, intermediation returned, and the frozen short-term funding markets began thawing.

Addressing problems in the short-term funding markets requires more than just reforms to money market funds.

- Money market funds are just one participant in the short-term funding markets. Eliminating money market funds would not make these markets more resilient, and the short-term funding markets will continue to be a source of stress to the financial system.

- The March 2020 market volatility underscores the need to consider strengthening the resiliency of liquidity in the short-term funding markets.

- Before considering money market fund reforms, policymakers should focus instead on the functioning of the short-term funding markets, which are "flawed and broken," especially during periods of stress. One roundtable participant provided the following analogy to describe how the short-term funding market functions by comparing it to a highway and money market funds and other products to cars and trucks on the highway:

  > *[L]et's imagine . . ., we had a highway in the US, a major highway, let's call it Route 95, that's essential to commerce, runs from Florida to Maine. Let's imagine that road was only safe to drive on when it was blue skies and sunny. And the second it rained, you got 100 car pile-ups. That's essentially the [short-term funding market]. It really only works on blue sky sunny days, when markets are functioning efficiently. And as soon as we get a crisis, we've seen it time and time again, it freezes. You get the equivalent of 100 car pile-ups. So you can talk about which cars are allowed to drive on that highway or what safety features they should have, or should we have 18 wheelers or not. It doesn't really matter as long as that is the case. . . . [R]egulators and we, as an industry, need to focus on this and create a more resilient [short-term funding market]. So that when it's raining or when it's sunny, this market functions, because right now, I don't think it does.*

April 29, 2021

ICI Roundtable on Money Market Funds

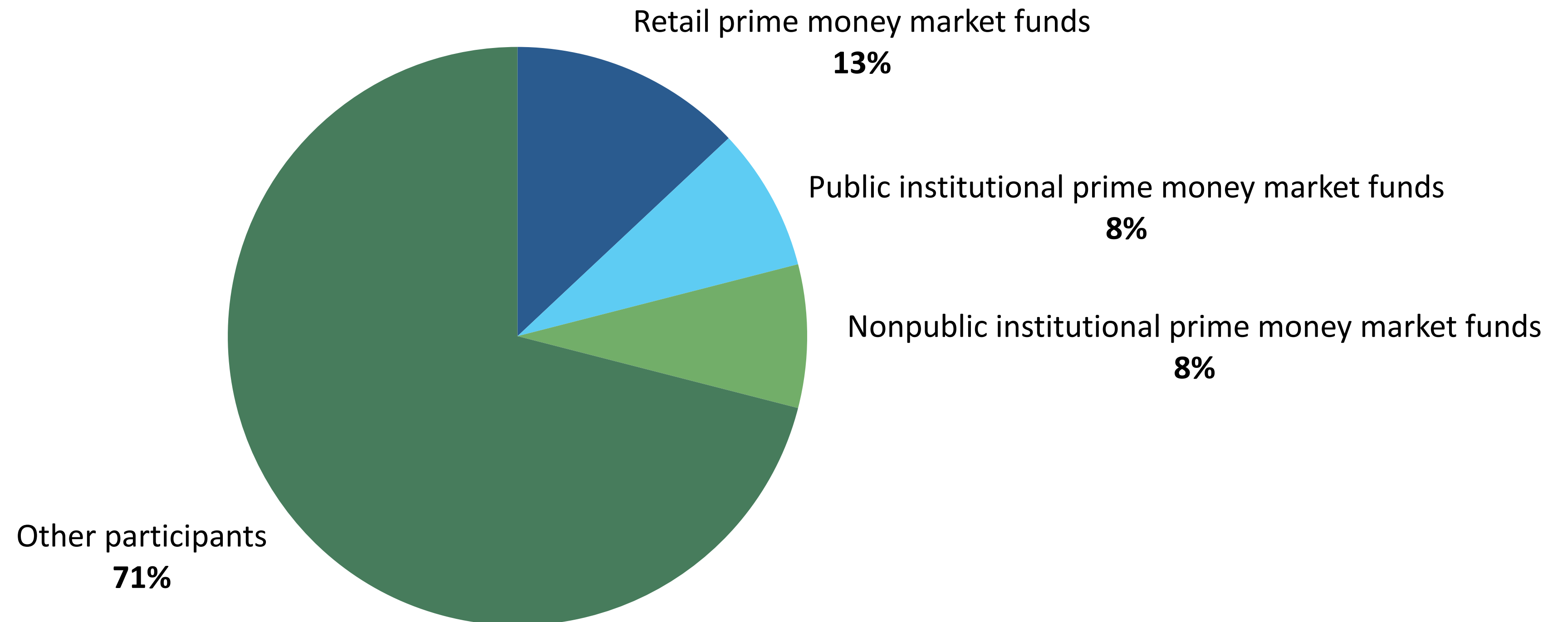
Sean Collins—Chief Economist
Shelly Antoniewicz—Senior Director, Financial and Industry Analysis

Key Takeaways

- Activities of ***all*** short-term market participants must be reviewed.
- Prime money market funds pulled back very little from the commercial paper (CP) market before the Fed announced the MMLF on March 18, 2020.
- Regulatory tie between weekly liquid assets (WLA) and fees and gates made prime funds **less resilient** to redemptions and **more dependent** on financial intermediaries.
- Prime funds accessed the MMLF to keep WLAs above 30% tripwire.

Prime Money Market Funds Are Not the Only Participants in the Commercial Paper Market

Share of commercial paper market held by money market funds and others, February 2020



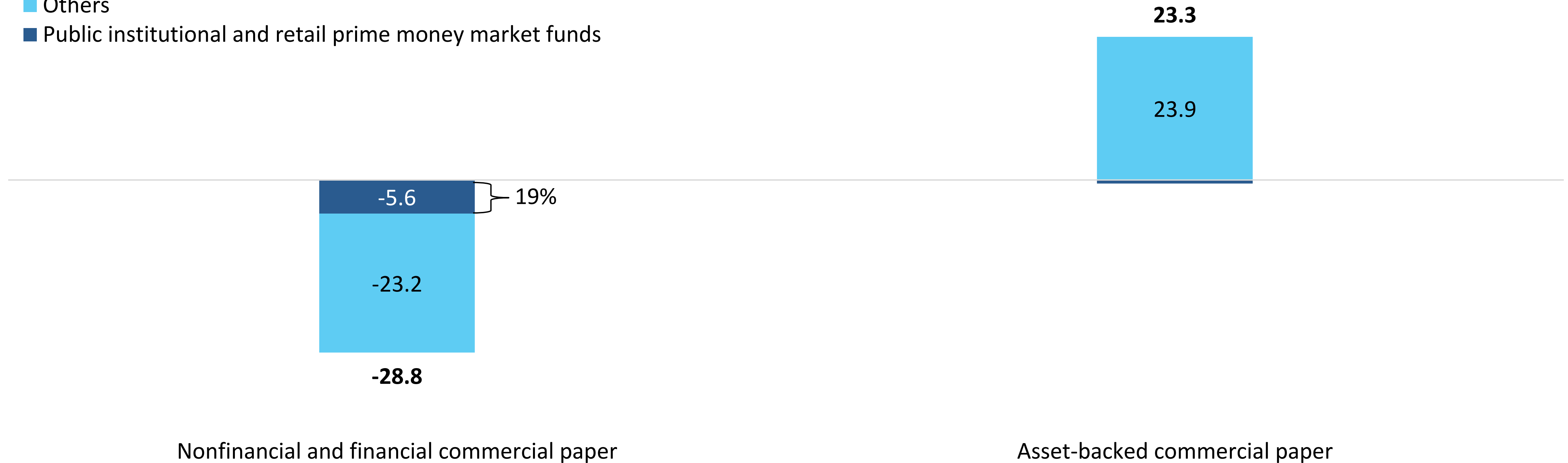
Note: Nonpublic institutional prime money market funds are registered under the Investment Company Act and comply with Rule 2a-7.
Sources: Investment Company Institute, Federal Reserve Board, and SEC Form N-MFP

Revisiting the Narrative That Money Market Funds Fueled Meltdown in the Commercial Paper Market

- **Narrative:** prime money market funds, faced with large redemptions, sold CP heavily.
- **Example from PWG Report:**
  - "From March 10 to March 24, prime funds reduced their CP holdings by $35 billion, accounting for 74 percent of the $48 billion overall decline in outstanding CP over those two weeks."
- **The reality:**
  - The two-week period straddles the March 18 announcement of the MMLF.
  - Two-thirds of the reduction in prime funds' CP holdings—$23 billion of the $35 billion—represented sales to the MMLF *after* March 18.
  - Those sales, rather than adding to stress in the money markets, helped relieve it.

Prime Money Market Funds Reduced Their Commercial Paper Holdings Only Modestly Before March 18

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

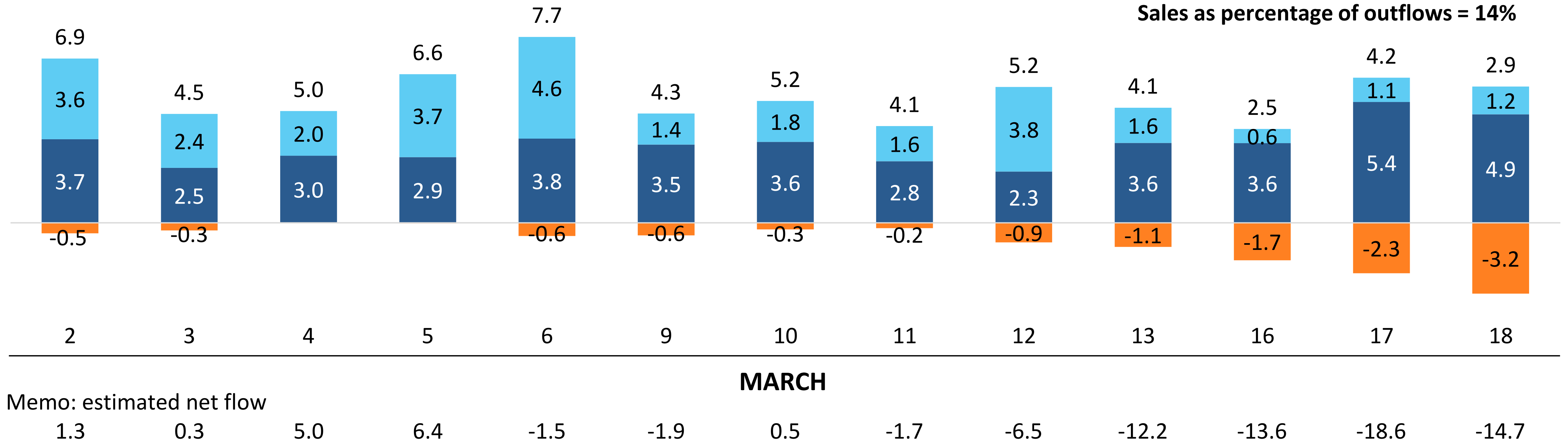


Memo: estimated outflows of prime money market funds, week ended March 17 = $64.3 billion

Sources: Federal Reserve Board and iMoneyNet

Sales of Commercial Paper Represented Only 14% of Outflows in Week Before MMLF Announced

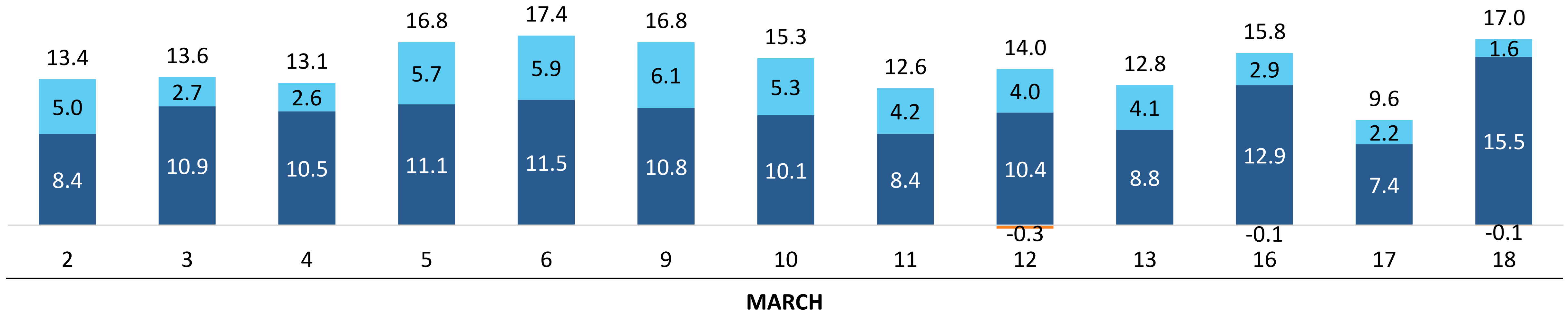
Public institutional prime money market funds, billions of dollars, March 2–March 18, 2020



Sources: ICI survey of prime money market funds and iMoneyNet

Other Prime Funds Sold Minuscule Amounts of Commercial Paper

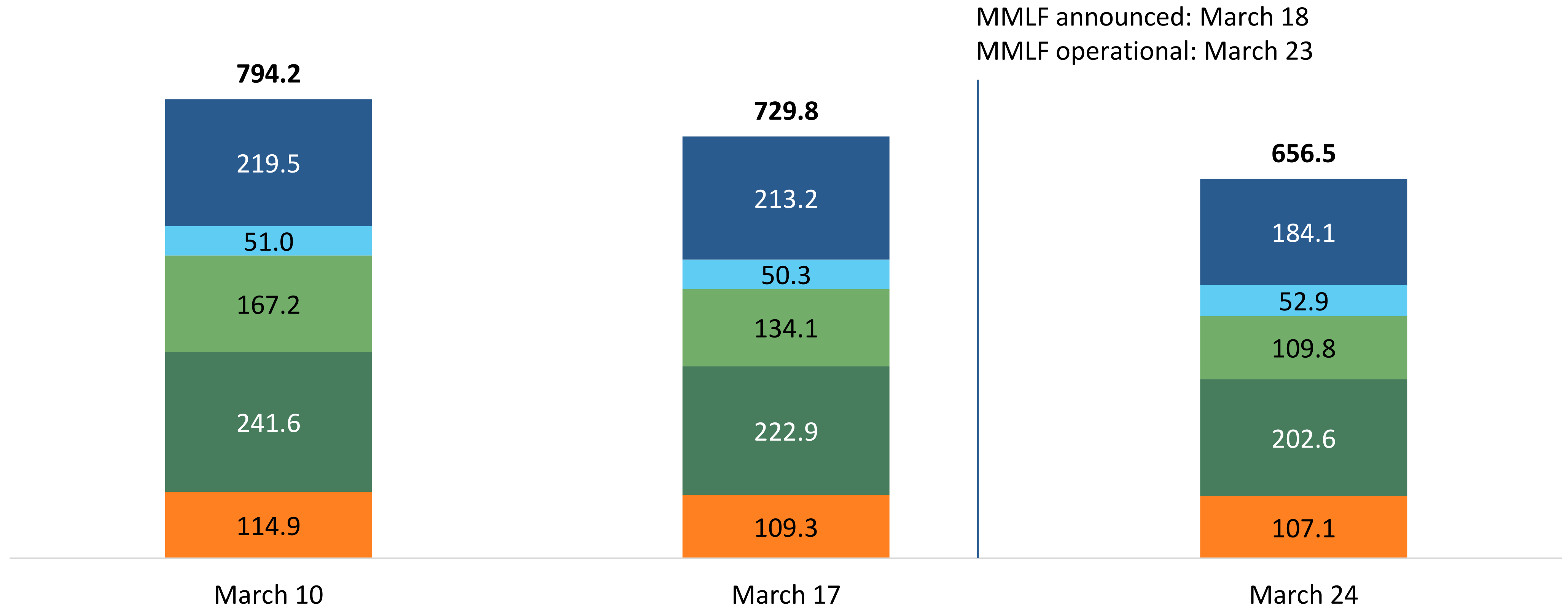
Nonpublic institutional and retail prime money market funds, billions of dollars, March 2–March 18, 2020



*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

Prior to MMLF Prime Funds Met Redemptions By Running Down Repo and CDs

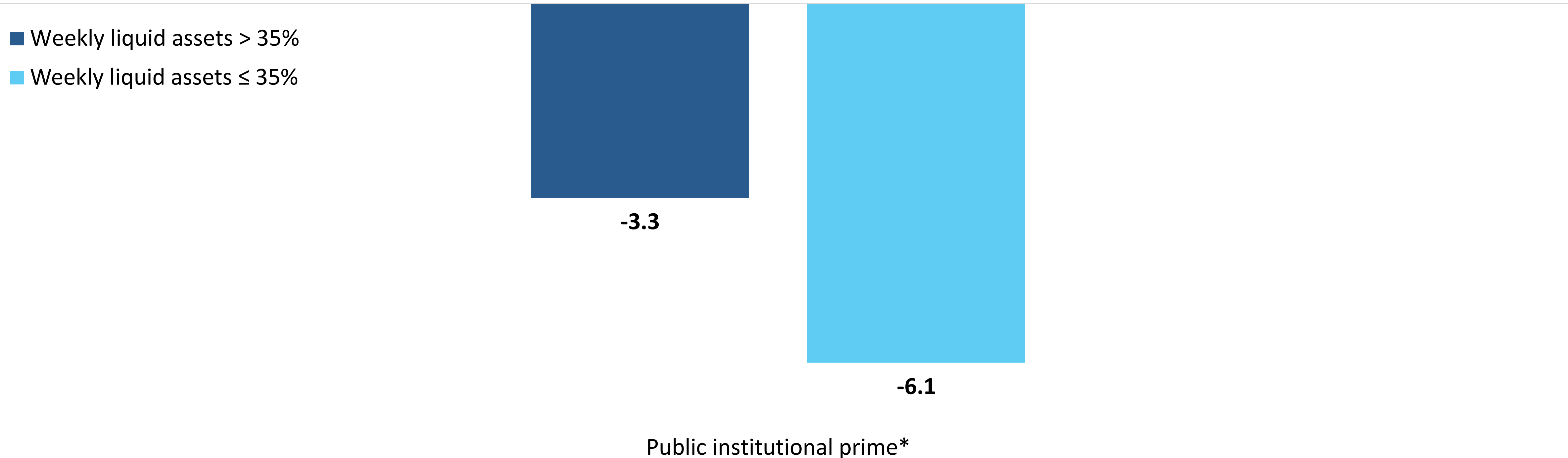
Public institutional prime and retail prime money market funds, billions of dollars



Source: iMoneyNet

Option to Impose Fees/Gates Made Prime Funds Less Resilient to Redemptions

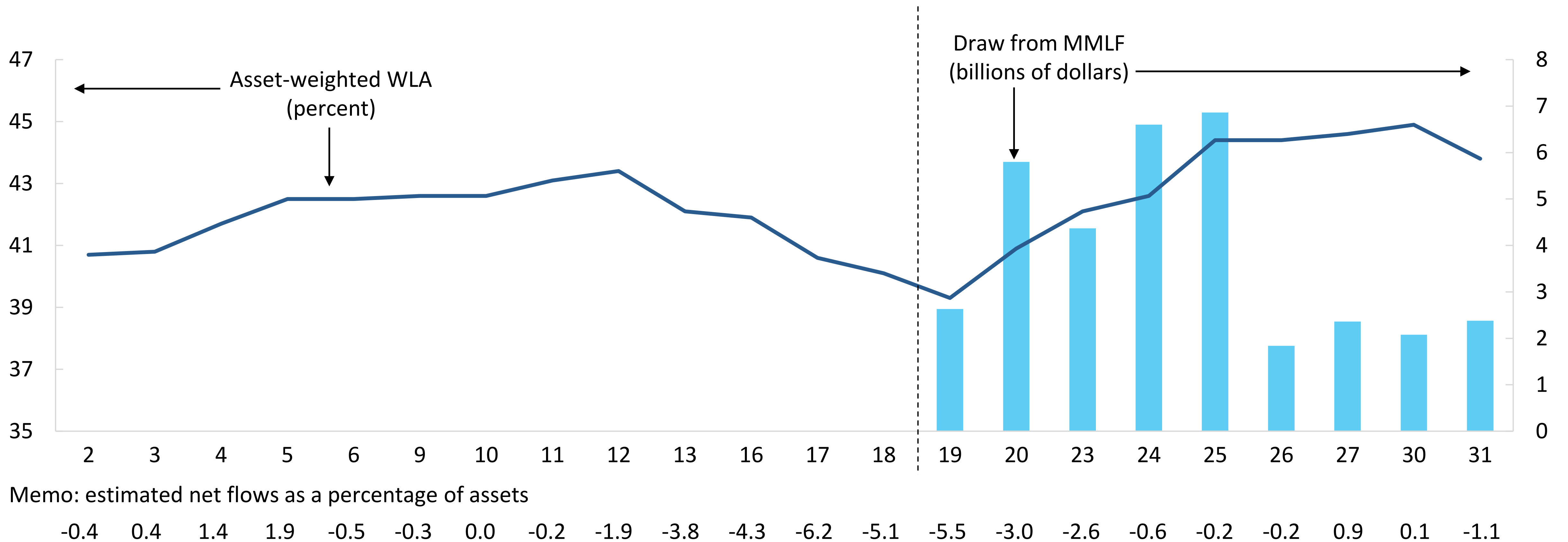
Average daily percent change in assets of public institutional prime money market funds, March 17–March 24, 2020



*The difference between the average daily percent change in assets for retail prime funds with weekly liquid assets greater than 35 percent and retail prime funds with weekly liquid assets of 35 percent or less is not significantly different from zero at standard levels of significance.
Source: Investment Company Institute tabulations of Crane data

Prime Funds Used MMLF to Keep WLA Well Above 30% Tripwire

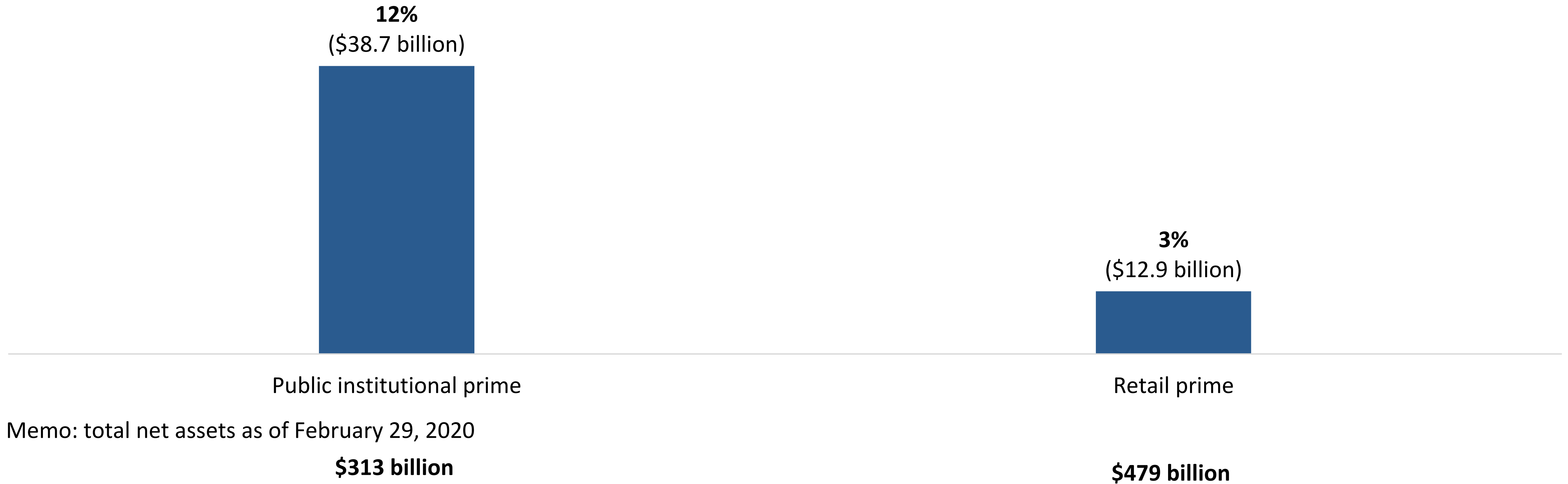
Public institutional prime money market funds that drew on the MMLF, daily, March 2020



Sources: Investment Company Institute, iMoneyNet, and Crane Data

Prime Money Market Funds' Use of the MMLF Was a Small Share of Their Assets

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



Note: Nonpublic institutional prime money market funds did not access the MMLF.
Source: Investment Company Institute

Summary

- Prime money market funds pulled back very little from CP market.
- Tie between WLA and fees/gates made prime funds less resilient.
- Activities of all short-term market participants must be reviewed.