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August 2, 2021

ICI Draft Comment Letter on FSB's Consultation Report on Money Market Funds; Comments due to ICI on Monday, August 9

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TO: Money Market Funds Advisory Committee RE: ICI Draft Comment Letter on FSB's Consultation Report on Money Market Funds; Comments due to ICI on Monday, August 9

As you know, the Financial Stability Board (FSB) issued its Consultation Report (Report) seeking comments on policy proposals to enhance money market fund resilience, including with respect to the appropriate structure of the sector and of underlying short-term funding markets. The proposals form part of the FSB's work on non-bank financial intermediation and are intended to inform jurisdiction-specific reforms and possible adjustments to IOSCO's policy recommendations for money market funds. ICI is planning to file a comment letter on Friday, August 13, 2021. A draft of ICI's comment letter is attached and briefly summarized below. Please provide comments to the draft by Monday, August 9, 2021.

Executive Summary

The Report discusses a range of policy proposals for further reform of money market funds. After careful review, we believe removing the tie between money market fund liquidity and fee and gate thresholds holds the most potential for addressing policymakers' concerns with the least negative impact. As such, we discuss this policy proposal first. The other policy proposals are discussed in the same as order as set forth in the Report.

- Removal of tie between money market fund liquidity and fee and gate thresholds. We believe removing the tie between money market fund liquidity and fee and gate thresholds holds the most potential for addressing the FSB's concerns with the least negative impact. The regulatory tie between liquidity and fee and gate thresholds made money market funds more susceptible to financial market stress in March 2020 and would likely do so again in future periods of stress. ICI's data supports the conclusion that this regulatory tie was likely a dominant trigger for redemptions as opposed to the conditions of the funds. (Section 3.1)

Policy options that impose the cost of redemptions on redeeming investors

- Swing pricing. We do not support swing pricing for money market funds. Swing pricing is not necessary for money market funds because they already have the ability to impose liquidity fees (anti-dilution levies), which serve a similar purpose and are a more appropriate tool for money market funds. Swing pricing also would likely strip money market funds of their defining characteristics (such as multiple daily net asset value (NAV) strikes per day and same-day settlement), impose excess costs to overcome unnecessary and complex structural challenges, and cause confusion among investors in periods of stress. Indeed, we do not believe that there are any potential benefits to employing swing pricing as a tool for money market funds that serve the FSB's overarching goals for reform. Moreover, swing pricing (and other policy options that impose the cost of redemptions on redeeming investors, including anti-dilution levies) 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 3.3.1.1), capital buffers (Section 3.3.1.2), and liquidity exchange bank membership (Section 3.3.1.3). We believe such 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, these options have significant drawbacks, ranging from potential 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.

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. We do not believe that adding an additional layer of regulatory approval before the activation of fees and gates would lessen the cliff event of this regulatory constraint or 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 shareholders, 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 shareholder redemptions, and adopt "know your customer" policies and procedures to assure that it undertakes appropriate efforts to identify risk characteristics of its shareholders. We believe the flexibility of the current regulatory regime is appropriate because it recognizes that different money market funds may have different needs. As such, we do not support a "one-size-fits all" investor concentration limit. (Section 3.4.3)

- Eliminating stable NAVs. We oppose requiring all money market funds to float their NAVs. We are highly skeptical that such a requirement would 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 must be data driven and should consider the types of assets readily available in various jurisdictions. Such limits also should not be so onerous as to materially impact money market funds' ability 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 public debt instruments only. 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. Also, unlike bank deposits, money market funds provide investors with a competitive market rate of return. (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 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. ICI strongly opposes any sort of redemption restriction that would impair investor liquidity when liquidity is readily available within a money market fund. 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 with a direct source of short-term financing. (Section 3.5.1.3)

- Redemptions in kind during periods of stress. We do not believe that 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 shareholders) would be an effective solution for the issue at hand. Investors would be likely to 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. Difficult operational hurdles also cause us to question the practicality of this approach. We believe that 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, should be data driven and not so high as to materially impact money market funds' ability to serve as direct sources of financing for businesses and financial institutions 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 shareholders, such as situations when a fund seeks to liquidate. (Section 3.5.2)

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