Investment Company Institute — The Asset Management Industry Serving Individual Investors

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August 13, 2021

ICI Comment Letter on FSB's Money Market Fund Proposals

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TO: ICI Members
Investment Company Directors
ICI Global Members
Money Market Funds Advisory Committee SUBJECTS: Money Market Funds RE: ICI Comment Letter on FSB's Money Market Fund Proposals

As you know, the Financial Stability Board (FSB) issued its Consultation 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 filed a comment letter today, which is attached and briefly summarized below.

Executive Summary

Given the important role of money market funds in the financial system, the letter urges policymakers to 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.

- 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 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. 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.

- 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.
- 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. 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.

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.

Policy options that absorb losses

- Minimum balance at risk (MBR), capital buffers, and liquidity exchange bank membership. 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.
- 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.
- 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.
- 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.

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.

- 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.
- 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.
- 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.
- 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.
- 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.

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