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FSB's Final Report on Policy Proposals to Enhance Money Market Fund Resilience

[33827]

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TO: ICI Members
Investment Company Directors
ICI Global Members
Global Advocacy Coordination Advisory Committee
Global Regulated Funds Committee
Global Regulated Funds Committee - Asia
Independent Directors Council
Money Market Funds Advisory Committee
Operations Committee
SEC Rules Committee SUBJECTS: International/Global
Money Market Funds RE: FSB's Final Report on Policy Proposals to Enhance Money Market Fund Resilience

The Financial Stability Board (FSB) issued its final report (Report) 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 report reflects public feedback received on a consultative version of the report published in June 2021. 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.

The Report notes that the FSB will, working with IOSCO, review progress made by member jurisdictions in adopting reforms to enhance money market fund resilience. The review process involves a "stocktake" to be completed by the end of 2023 of the measures adopted by FSB member jurisdictions. This stocktake will be followed up by 2026 with an assessment of the effectiveness of these measures in addressing risks to financial stability.

IOSCO also plans to revisit its 2012 policy recommendations for money market funds in light of the framework and policy toolkit in this Report. Finally, in response to the feedback from the public consultation, the FSB and IOSCO intend to carry out follow-up work, complementing money market fund policy reforms, to enhance the functioning and resilience of short-term funding markets.

Section 2 describes the forms, functions, and roles of money market funds, including in the context of broader short-term funding markets, to provide a basis for the assessment of the effects of different policy options. This section also describes the different types of money market funds across jurisdictions, the role of money market funds as part of a broader short-term funding ecosystem, the use of money market funds by investors and borrowers, and potential substitutes.

Section 3 discusses money market fund "vulnerabilities" that can be mutually reinforcing: they are susceptible to sudden and disruptive redemptions, and they may face challenges in selling assets, particularly under stressed conditions, most notably during the 2008 global financial crisis and the March 2020 "dash for cash." This section also discusses the drivers of dealer behavior in the short-term funding markets during the March 2020 turmoil.

Section 4 considers a range of policy options to address money market fund vulnerabilities, by examining how these options would affect the behavior of money market fund investors, fund managers and sponsors, as well as the options' broader effects on short-term funding markets, including the impact on the use of potential money market fund substitutes. 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.

Mechanisms to impose the cost of redemptions on redeeming investors

- Swing pricing or economically equivalent measures such as anti-dilution levies that impose on redeeming investors the cost of their redemptions. Variants include having authorities mandate the use of this tool, 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.

Mechanisms to absorb losses

- Minimum balance at risk that would make a portion of each shareholder's money market fund balances available for redemption only with a time delay to ensure that redeeming investors remain partially invested in the fund over a certain period of time.
- Capital buffers financed by fund managers or sponsors. Variants include permitting discretionary sponsor support or external liquidity support such as through a liquidity exchange bank.

Mechanisms to reduce threshold effects

- Removing the tie between money market fund liquidity and fee and gate thresholds.[1] Variants include requiring money market funds to get permission from authorities before activating fees or gates, countercyclical liquidity buffers, or investor concentration limits.
- Eliminating stable NAV.

Mechanisms to reduce liquidity transformation

- 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).
- Additional liquidity requirements that would require money market funds to hold minimum 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).

Section 5 discusses other potential measures that may be considered (in addition to money market fund reform) to enhance risk identification and monitoring by fund managers and authorities, and to improve the functioning of the short-term funding markets. These include reinforced fund-level and sector-wide stress tests, additional money market fund reporting requirements to authorities to enhance their ability to monitor risks and to provide harmonization of reporting requirements across jurisdictions.

This section also discusses disclosure and reporting requirements relating to the short-term funding markets generally, including data on primary markets (e.g., volume and yield at issuance, and outstanding amount by type of issuer, rating, and maturity), secondary markets (volume and prices), dealer inventories, and holdings by investor type. The Report notes that authorities might consider adopting measures to improve the functioning of the commercial paper and CD markets, although it notes that it is not clear that such measures would change the limited incentives of market participants to trade or of dealers to intermediate, particularly during stress periods.

Section 6 provides considerations in selecting money market fund policy options and combinations of options, noting that since a single policy option on its own may not address all vulnerabilities, policymakers should consider a combination of options to address the vulnerabilities prevalent in their jurisdiction (which may differ across fund types) and deliver sufficient enhancements to money market fund resilience.

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endnotes

[1] The Report notes that this option on its own "would not be sufficient to mitigate all vulnerabilities stemming from the operations of [money market funds]." Report at 32.