

April 12, 2021

Vanessa A. Countryman, Secretary  
U.S. Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549-1090

Submitted electronically via [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

RE: SEC Request for Comment on Potential Money Market Fund Reform Measures in President's Working Group Report, File No. S7-01-21, Release No. IC-34118

Dear Ms. Countryman:

We appreciate the opportunity to provide our comments to the Securities and Exchange Commission (the "Commission" or "SEC") on potential reform options for money market funds as highlighted in the December 2020 report of the President's Working Group on Financial Markets ("PWG Report").<sup>1</sup> Vanguard has managed money market mutual funds ("MMFs") since 1981.<sup>2</sup> On behalf of our shareholders, who currently invest approximately \$375 billion in our MMFs, we are deeply committed to working with the Commission and other financial regulatory authorities to strengthen the money market industry for the benefit and further protection of investors.

Vanguard believes MMFs are an important choice for retail investors' cash management and principal preservation needs. For more than a decade, we have been actively involved in researching and evaluating MMF reform proposals including SEC amendments to Rule 2a-7 that were implemented in 2010 and 2014. Those changes enhanced MMFs' credit quality, liquidity self-provisioning, and disclosure, thereby reducing the likelihood that a future systemic market disruption would threaten these funds.

In March 2020, the economic shock of the COVID-19 pandemic led to an unprecedented flight to liquidity and safety by investors and other market participants. Not surprisingly, government MMFs had significant inflows as investors sought the principal preservation, stability, and safety that they offer. Prime MMFs experienced significant redemptions and the commercial paper ("CP") market froze. While retail prime MMFs experienced far less redemptions than institutional prime MMFs as a percentage of the

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<sup>1</sup> Request for Comment on Potential Money Market Fund Reform Measures in President's Working Group Report, 86 Fed. Reg. 8938 (Feb. 10, 2021), available at <https://www.govinfo.gov/content/pkg/FR-2021-02-10/pdf/2021-02704.pdf>.

<sup>2</sup> Vanguard is one of the world's leading asset managers. As of February 28, 2021, Vanguard managed approximately \$7.3 trillion in assets globally on behalf of more than 30 million investors. Vanguard's core purpose is to take a stand for all investors, to treat them fairly, and to give them the best chance for investment success.

market, we agree with SEC staff analysis that the frozen CP market had ripple effects because of its connections to other participants in the financial system.<sup>3</sup>

As a result of this volatility, Vanguard looked closely at its MMF offerings and in August 2020 announced that Vanguard Prime Money Market Fund would be reorganized into a government MMF. We recognized that retail investors prioritize stability when selecting money market investments and the change in investment strategy would enable the fund to continue to meet investors' expectations while providing a competitive yield over the long term. Our decision to exit prime also took into account changing market dynamics that warrant review by financial market regulators so that the short-term markets are more resilient in the case of another similar event. Having carefully considered the relevant tradeoffs associated with the product – money market mutual funds – and the markets in which they invest – we offer the following comments for the Commission's consideration.

Vanguard supports a floating NAV for all prime MMFs, including retail prime. Prime MMFs have concentrated exposure to commercial paper and other short-term debt issued by banks and other financial firms that are essential for the availability of credit and liquidity in the financial markets. We support further consideration of whether retail tax-exempt MMFs should preserve a stable \$1.00 NAV or adopt a floating NAV structure. The short-term municipal securities markets are a unique category of securities that may warrant different regulatory treatment when compared to prime MMFs. We also support elimination of fees and gates for all types of MMFs, as these tools triggered – rather than reduced – fund outflows in March 2020. As the Commission turns its attention to potential additional MMF reforms, we encourage reform solutions that are tailored to the funds most likely to experience de-stabilizing redemptions.

Part I of this letter provides an executive summary of our comments. Part II discusses Vanguard's MMFs and our investors' experiences in March 2020, and offers our views on structural reforms to prime MMFs and tax-exempt MMFs and the markets in which they invest. Part III offers our views on the effectiveness of fees and gates as a regulatory tool to prevent or halt MMF runs in a liquidity crisis.

## I. Executive Summary

We summarize our key points below, each of which is discussed in Parts II-III of this letter.

- **We support a floating NAV for all prime MMFs.** As we have seen, the structure of the CP market puts stress on both CP issuers and prime MMFs whether institutional or retail. Given market structure constraints and the potential volatility in underlying prime assets, a floating NAV can help ensure that fund values fluctuate with these markets providing more flexibility and resilience than a stable NAV fund. A floating NAV also helps set investor expectations that NAVs may fluctuate during periods of market stress.
- **We support further consideration of whether retail tax-exempt MMFs, with additional protections, can continue to sell and redeem shares at a stable \$1.00 NAV.** We understand

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<sup>3</sup> See SEC Division of Economic Risk and Analysis, *U.S. Credit Markets Interconnectedness and the Effects of the COVID-19 Economic Shock* (Oct. 2020), available at [https://www.sec.gov/files/US-Credit-Markets\\_COVID-19\\_Report.pdf](https://www.sec.gov/files/US-Credit-Markets_COVID-19_Report.pdf). “The secondary trading in CP/CD generally is limited to the dealers marketing CP/CD programs. In March, because of the COVID-19 economic shock, these dealers were constrained in supporting these markets. This market characteristic also contributed to the lack of liquidity in this market.” *Id.* at 23.

regulatory concerns associated with redemption activity out of tax-exempt money market securities in March 2020 but encourage the Commission to consider whether tax-exempt MMFs, because of the contractual sources of liquidity and credit quality of the underlying instruments, should be treated more like government MMFs (with a stable NAV) or more like prime MMFs (with a floating NAV).<sup>4</sup> Weighing these considerations, on balance we think these funds could continue to support a stable NAV if additional liquidity protections are put in place. To that end, we recommend that the Commission consider requiring shorter weekly average maturities (“WAMs”) in tax-exempt MMFs as an additional measure to improve resilience and further protect shareholders from potential market price deterioration and liquidity pressures.

- **We support elimination of fees and gates for all types of MMFs.** One of the PWG Report options is removal of the tie between weekly liquid asset thresholds and the imposition of liquidity fees and redemption gates. Based on our observation that fees and gates had the unintended consequence of triggering preemptive runs on institutional prime MMFs in March 2020, regulators should consider eliminating this tool. A simple floating NAV product structure, more consistent with traditional mutual funds, would avoid that dynamic. In addition, we support enhanced liquid asset requirements in both prime and tax-exempt MMFs.
- **Policymakers should consider what additional steps should be taken to ensure sufficient liquidity exists in the short-term markets during times of stress.** Though the product reforms outlined above would eliminate any knock-on run risk exacerbated by the MMF structure, we firmly believe that MMF reform alone does not – and cannot – eliminate liquidity risk in the underlying short-term wholesale funding markets. Policymakers should look closely at these markets, their tools and the various events surrounding March 2020 volatility, to improve resiliency in this critical segment of our markets.

## II. Vanguard’s MMFs and our investors’ experiences during March 2020

Disruptions in the short-term funding markets in response to the COVID crisis share some similarities and some notable differences compared to market disruptions during the global financial crisis. In 2008, credit concerns in the financial sector and ultimately the bankruptcy of Lehman Brothers impaired the NAV of the Reserve Primary Fund. This “breaking of the buck” accelerated a broad-based investor run, primarily by institutional investors, on the prime asset category and prompted intervention by both the Federal Reserve and the U.S. Treasury. March 2020 also saw an investor run on a category of MMFs. However, in this instance, it was triggered by corporations and pensions rapidly redeeming out of a subset of MMFs: institutional prime MMFs.

### Prime MMFs

The sudden halting of the U.S. economy in March 2020 drove certain institutional investors, primarily corporations, to rapidly maximize balance sheet liquidity by drawing down credit facilities and converting short-term investment portfolios into government MMFs or bank deposits. Being professional investors, holders of institutional prime MMFs were closely monitoring weekly liquidity levels in their funds, aware that as they approach the 30% regulatory threshold, the imposition of redemption fees and

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<sup>4</sup> As of September 2020, prime MMFs accounted for approximately 20% of total industry net assets as compared to tax-exempt MMFs which represented under 3% of total industry net assets. See Report of the President’s Working Group on Financial Markets, Overview of Recent Events and Potential Reform Options for Money Market Funds (Dec. 2020), available at <https://home.treasury.gov/system/files/136/PWG-MMF-report-final-Dec-2020.pdf>.

gates becomes a greater possibility. Based on our experience as a manager of retail prime MMFs, we believe the desire to “get out before fees and gates” accelerated selling activity by institutional investors.<sup>5</sup> In response, managers of publicly-offered institutional prime MMFs looking to raise liquidity were forced to sell securities, which began to drive market prices to distressed levels. For the month of March 2020, \$94 billion was redeemed out of institutional prime strategies, representing more than 34% of institutional prime AUM as of February 2020.

Retail prime MMFs invest in the same universe of securities as institutional prime MMFs and these conditions began to negatively impact fund valuations and constrain the ability of many retail fund managers to effectively manage liquidity. However, the stresses faced by retail prime funds were less severe compared to their institutional counterparts and investor redemptions were not as substantial (representing 10% of retail prime AUM as of February 2020).

Vanguard Prime Money Market Fund, a retail prime fund, experienced an even lower percentage of redemptions (4% of assets in February 2020 compared with 10% for the broader retail prime category). Our prime fund experienced less stress due to the fact that we managed the fund conservatively with a higher allocation to government securities, lower credit risk exposure, and a higher liquidity level than institutional prime MMFs.

Over the course of the third week of March, the Federal Reserve created the Commercial Paper Funding Facility (“CPFF”) to support CP issuers, and one day later announced the Money Market Mutual Fund Liquidity Facility (“MMLF”). The inclusion of a Treasury Money Market Guarantee program within the CARES Act stimulus package also served to calm markets during this period, though it was not activated. We believe that, had the Federal Reserve not intervened so early and so aggressively to support institutional MMFs, the retail prime category may have experienced greater strains.

In order to reduce the likelihood that official sector interventions will be needed to prevent or halt MMF runs, and to address stresses in short-term funding markets, we recommend that the Commission consider requiring that all prime MMFs float the NAV and be subject to the valuation procedures of traditional (non-MMF) mutual funds.

#### Tax-Exempt MMFs

While tax-exempt securities are not “default risk-free,” they are broadly among the highest quality credit securities available in the market for three primary reasons. First, unlike borrowers in the taxable credit markets, municipalities provide essential public services, possess the power to tax, and have exhibited downgrades and defaults at a significantly lower rate than similarly-rated corporate borrowers. Second, there remain notable legal obstacles that prevent many of the largest borrowers in the municipal market from filing for bankruptcy. Third, in the municipal market, variable rate demand notes (“VRDNs”) play a critical role in providing investors with contractual weekly or even daily liquidity on significant parts of the universe of available securities. Similar structural sources of liquidity are not as abundant for prime MMFs.

In March 2020, certain longer-dated (30 to 365 day) securities in the municipal money market asset category experienced a degree of distress that was comparable to what was experienced in the broader commercial paper market. We believe these stresses were a function of market liquidity and not a

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<sup>5</sup> Vanguard manages an institutional prime MMF solely for internal cash management purposes but does not publicly offer any institutional prime MMFs.

rapid deterioration in the actual or perceived credit risk of municipal issuers. Although all municipal securities bear some element of credit risk, as described above, they are generally issued or guaranteed by governmental authorities with broad-based taxing powers or by providers of essential public services. The overall issue in the municipal category in March was the selling pressure from many market participants, and not selling pressure from municipal MMFs which only comprise about three percent of the overall municipal market. Other market participants raised cash by selling short-term municipal securities. Their selling drove these securities' market value to meaningful discounts and consequently placed downward pressure on shadow NAVs of MMFs across the industry.

A second important differentiator with respect to municipal MMFs is the composition of the product's ownership base, which skews significantly to individual investors over institutions. Prior to the onset of COVID, approximately 91% of municipal MMF assets were held by households, compared to just 59% for the broad prime MMF market at the end of February 2020. Similar to the experience of retail prime funds and their investors discussed above, individual shareholders of municipal MMFs were much more subdued compared to institutions with respect to their redemption activity in March 2020, with only 7% of assets redeemed that month.

Lastly, with respect to understanding the sources and drivers of stress in the municipal MMF industry in March 2020, we believe it is important to view the episode through the lens of the security types unique to this segment of the market. Roughly three-quarters of the municipal MMF universe is comprised of VRDNs, which provide contractual liquidity on a daily or weekly basis. These securities pay fluctuating rates of interest and their par tender feature minimizes volatility in VRDN prices, even during times of market stress. The remaining one-quarter of available municipal money market securities are fixed rate and are offered generally with tenors of 30 to 365 days, making them more comparable to the longer-dated commercial paper market. It was this latter security type that bore the brunt of the market stresses in March 2020.

For the reasons discussed above, we recommend that the Commission consider whether tax-exempt MMFs, because of the contractual sources of liquidity and credit quality of the underlying instruments, should be treated more like government MMFs (with a stable NAV) or more like prime MMFs (with a floating NAV). The Commission should also consider enhancements to risk management, such as requiring a shorter WAM to improve resilience and further protect shareholders from potential market price deterioration and liquidity pressures. We have adopted a shorter WAM limit in managing our tax-exempt MMFs as a matter of internal policy.

### **III. We support elimination of fees and gates**

While removing the tie between liquidity thresholds and fees/gates is a reasonable reform option, we believe the better question to ask is whether fees and gates proved to be an effective regulatory tool in preventing or halting runs. We believe they did not. Based on our observation of events in March 2020, we believe the threat of redemption gates and liquidity fees being imposed on institutional investors made institutional prime MMFs less resilient and more prone to investor runs. We agree with the analysis of the SEC staff that some institutional investors feared that if they were not the first to exit their institutional prime fund, then there was a risk that they would be subject to redemption gates in the event the fund breached the 30% weekly liquid asset limit.<sup>6</sup> In reality, the liquidity buffer became a floor that

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<sup>6</sup> See DERA Economic and Risk Outlook, SEC Division of Economic Risk and Analysis (Nov. 19, 2020), available at [https://www.sec.gov/files/DERA\\_Economic-And-Risk-Outlook\\_Report\\_Nov2020.pdf](https://www.sec.gov/files/DERA_Economic-And-Risk-Outlook_Report_Nov2020.pdf).

accelerated institutional shareholder redemptions due to uncertainty about the imposition of liquidity fees or gates, rather than serving as a liquidity cushion.<sup>7</sup>

The 2008 global financial crisis was a credit crisis. Subsequent reforms addressed credit risk through floating NAV structures. In contrast, the 2020 COVID crisis was a liquidity crisis. The runs that some MMFs in the industry experienced were not credit-related – they were largely caused by institutional investors attempting to get out ahead of the imposition of fees and gates. This aspect of the 2014 MMF reforms should be re-evaluated and consideration given to raising liquid asset requirements.

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In summary, we support a simple approach to MMF reforms – a floating NAV for retail prime MMFs, a stable NAV and shorter WAMs for tax-exempt MMFs, and eliminating fees and gates for all types of MMFs. We believe this approach is far superior to the other reform options in the PWG Report.<sup>8</sup> While the other reform options may have some benefits, the Commission should carefully consider unintended negative consequences for investors and significant regulatory, disclosure, and operational challenges associated with them.

We appreciate the opportunity to submit these comments and welcome further discussion. If you have any questions or wish to discuss our comments in greater detail, please contact Natalie Bej at [REDACTED] or Laura J. Merianos at [REDACTED].

/s/ Gregory Davis

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Gregory Davis  
Chief Investment Officer  
The Vanguard Group, Inc.

cc: The Honorable Allison Herren Lee, Acting Chair  
The Honorable Caroline A. Crenshaw  
The Honorable Hester M. Pierce  
The Honorable Elad L. Roisman  
Sarah G. ten Siethoff, Acting Director, Division of Investment Management

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<sup>7</sup> See Investment Company Institute, *Experiences of U.S. Money Market Funds During the COVID-19 Crisis*, Report of the COVID-19 Market Impact Working Group (Nov. 2020), available at [https://www.ici.org/pdf/20\\_rpt\\_covid3.pdf](https://www.ici.org/pdf/20_rpt_covid3.pdf) at 34.

<sup>8</sup> In particular, we do not support capital buffers, swing pricing, minimum balance at risk, sponsor support or liquidity exchange bank requirements as reform options that would be in the best interests of investors.