

Andrés Portilla
Managing Director
Regulatory Affairs



April 12, 2021

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

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

Dear Ms. Countryman:

The Institute of International Finance (IIF) and its member firms welcome the opportunity to contribute to the work of the Securities and Exchange Commission (SEC) on potential reform measures for Money Market Funds (MMFs), as highlighted in a recent report of the President's Working Group (PWG) on Financial Markets (Report).¹ These SEC and PWG efforts are significant contributions to the initiatives being undertaken at the global level by the G20, the Financial Stability Board (FSB) and the International Organization of Securities Commissions (IOSCO) to enhance the non-bank financial intermediation (NBFi) sector while preserving its benefits. It also comes at a time when other jurisdictions, including the European Union, are reviewing potential reforms for MMFs.

In this letter, we have focused on providing high-level comments on the potential policy measures described in the Report. The Report describes the stress in short-term funding markets in March 2020 and analyzes how pressures on prime and tax-exempt MMFs and interconnections among various U.S. short-term funding markets contributed to (or, in some cases, mitigated) risks during the ensuing market turmoil.²

¹ The Institute of International Finance is the global association of the financial industry, with more than 450 members from more than 70 countries. Its mission is to support the financial industry in the prudent management of risks; to develop sound industry practices; and to advocate for regulatory, financial and economic policies that are in the broad interests of its members and foster global financial stability and sustainable economic growth. IIF members include commercial and investment banks, asset managers, insurance companies, sovereign wealth funds, hedge funds, central banks, and development banks.

² [*"Report of the President's Working Group on Financial Markets - Overview of Recent Events and Potential Reform Options for Money Market Funds"*](#) (December 2020)

The Report of the President's Working Group on Financial Markets

We agree with the statement in the Report that, “[t]he orderly functioning of short-term funding markets is essential to the performance of broader financial markets and our [U.S.] economy more generally.” Indeed, in the U.S., short-term funding markets are critical for the financing of federal, state, and local governments, and both U.S. and overseas financial and non-financial companies meet their credit needs in part through the U.S. short-term funding markets. These markets play an important role in maturity transformation. MMFs play a critical role in the efficient functioning of the short-term funding markets, including as significant purchasers of commercial paper. MMFs provide important investment opportunities and cash management vehicles for a wide range of institutional and retail investors with different objectives and behaviors as regards redemption. We encourage the SEC to consider the entire MMF ecosystem, including both the supply and the demand sides, when evaluating proposals for reform.

The IIF recognizes that the previously enacted MMF reforms in 2010 and 2014 have contributed to improving MMF liquidity and transparency, which, in turn, has strengthened the resilience and functioning of the overall short-term funding markets. We agree that those reforms have contributed significantly to the mitigation of credit, interest rate and liquidity risks and stresses in short-term markets. Those reforms also contributed to the overall resilience of the MMF sector. However, the COVID-19 crisis has revealed some further structural vulnerabilities in short-term funding markets that should be addressed through an increased focus on market structure, as contrasted with market participants.

We believe that targeted and proportionate measures should be applied to address the specific segments of the MMF sector that experienced significant stress in the March 2020 market turmoil. As noted above, a range of investors with different behaviors and redemption patterns utilize MMFs to meet their investment objectives and not all MMFs experienced the same liquidity and redemption pressures during the March 2020 market turmoil. In particular, retail and government MMFs were resilient to the market stresses. In contrast, institutional prime MMFs experienced significant outflows. It is to this latter category of MMFs that we encourage the SEC to focus its attention.

March 2020 market turmoil

Financial markets endured significant market turmoil in the first half of 2020, including the U.S. Treasury market. Concerns about the economic impact of the growing COVID-19 pandemic triggered a ‘flight to safety’ to cash and short-term holdings, which placed a stress on short-term funding markets where spreads widened, and tenors shortened. The markets experienced a period of high volatility and illiquidity, the market for some short-term funding instruments including commercial paper (CP) was severely limited, and prime MMFs experienced rapid outflows until central banks, namely the U.S. Federal Reserve, announced a series of measures to support market liquidity. Regulatory and supervisory measures, as well as fiscal stimulus, complemented the Federal Reserve’s interventions.

Given the need for extraordinary market intervention, we understand the importance of further research and consideration into the specific risk factors and markets that contributed to the March

2020 market turmoil and the need for both the official and private sectors to consider how the resilience of the short-term funding markets can be improved and strengthened.

As part of that further research and consideration we encourage the SEC to take into account the impact of market structure on the resilience of short-term funding markets. In particular, we note the bilateral nature of the CP market, which can impede effective intermediation. To prevent or mitigate the impact of future CP market disruptions, the SEC could examine the potential for moving away from a single source of liquidity towards a standardized ‘all to all’ platform for CP trading. Other markets may have operational complexities which make intermediation less efficient than could be the case if those markets could be streamlined. For example, the Report notes that there are a large number of individual issues, or CUSIPs, in the private short-term debt markets, which adds complexity to intermediation.

We agree with the Report’s view that dealers in CP markets (as well as issuing dealers and banks) *“have not had a substantial role in making secondary markets in CP and other private short-term debt instruments that prime MMFs hold.”* and that *“there was no reason to expect dealers to take a materially increased intermediation role in these assets in March [2020]”*. Accordingly, we reiterate our encouragement to focus attention on market structure rather than on market participants.

Comments on Specific MMF Reform Measures

The Report describes a number of potential policy measures that could be taken to reduce the risk that structural vulnerabilities in prime and tax-exempt MMFs could lead to or exacerbate stresses in short-term funding markets. Some of the potential reforms would apply only to prime and tax-exempt MMFs, while other potential reforms could apply to MMFs more broadly.

One such potential policy measure that we believe has considerable merit would be to remove the tie between MMF liquidity requirements and fee and gate thresholds. To address the ‘rush to the exits’ that occurred in certain MMFs, particularly prime funds, the SEC should provide MMF governing bodies with greater flexibility and discretion to impose liquidity fees and redemption gates by decoupling those fees and gates from the weekly liquid asset threshold. A MMF’s governing body could make a determination that liquidity fees or redemption gates are in the best interest of the fund and its investor without that determination being tied to a certain level of liquidity.

We do not believe that some of the other potential policy measures discussed in the Report would be helpful in alleviating possible future short-term funding market stress. Specifically, we believe that swing pricing is operationally complex in the context of MMFs. The Report notes the implementation challenges of swing pricing and the fact that some MMFs strike their NAVs multiple times per day. Swing pricing would impede same day and intraday settlement, which is important to many investors. We also believe that there would be major challenges in calibrating a swing price in a manner that internalizes transactional costs for redeeming investors, as the cost/benefit equation can change over time and shift rapidly in times of stress. Liquidity fees can serve a purpose similar to swing pricing with fewer implementation challenges and impediments and we believe it is the better mechanism to allocate some of the transactional costs to redeeming shareholders, when necessary.

We also do not favor the imposition of capital buffers to absorb losses when a fund suffers a significant decrease in NAV or a run. We believe that the imposition of a capital buffer in a size sufficient to absorb a significant decrease in a fund's NAV would substantially increase the costs of MMFs and, thus, render MMFs less able to perform their important role of funding a wide range of market participants (with different credit risk profiles) and facilitating maturity transformation. Returns to MMF investors would be negatively impacted by the costs of establishing and maintaining the buffer. The imposition of a large mandatory buffer would fundamentally change and could potentially destabilize the MMF market and the MMF sector.

The establishment of a chartered liquidity exchange bank (LEB), in which prime and tax-exempt MMFs would be required to be members, would be operationally complex and impractical; in our view, the costs and risks of an LEB far outweigh any potential benefits. The Federal Reserve's Section 23A restrictions on affiliate transactions would impose significant constraints on LEB support to MMFs absent a clear exemption, which would not be likely under Federal Reserve policy and precedent. The need for access to the Federal Reserve's discount window could also prove problematic. The risk that an LEB member could become a bank holding company would necessitate the major restructuring of MMFs to avoid this risk.

Global NBF context

We would like to highlight several work programs and initiatives currently underway among the global financial services standard-setting bodies. The FSB has announced in its 2021 Work Programme that one of the key deliverables this year would be *"policy proposals to enhance MMF resilience and a report on progress in the work programme for strengthening NBF resilience"*.³ IOSCO has also stated that it will further contribute on *"to FSB policy work relating to MMFs and the underlying short-term funding-markets"*.⁴ We encourage the SEC to recommend to the FSB that it ensures that its review and further work on enhancing the resilience of the MMF sector takes a holistic approach that encompasses the underlying markets, in particular the CP markets. We believe that a holistic review would take into full consideration the important interconnections between CP market dysfunction in March 2020 and MMF stresses during that period.

On March 26, 2021, the European Securities and Markets Authority (ESMA) issued a consultation report on EU Money Market Fund Regulation: https://www.esma.europa.eu/sites/default/files/library/esma34-49-309_cp_mmf_reform.pdf.

ESMA is seeking feedback on potential reforms of the EU MMF regulatory framework in light of the lessons learned from the difficulties faced by MMFs during the COVID-19 crisis in March 2020. These potential reforms include decoupling regulatory thresholds from suspensions and gates to limit liquidity stress, requiring usage of swing pricing and/or anti-dilution levies or redemption fees, increasing liquidity buffers, requiring floating net asset values, and amending the prohibition on sponsor support.

We appreciate the attention that is being given at both global and jurisdictional levels to these important issues. However, we are concerned about the potential for these initiatives to lead to regulatory fragmentation, conflicting or duplicative regulation or supervision, or potential barriers

³ FSB 2021. *"FSB Work Programme for 2021"* (January)

⁴ IOSCO 2021. *"IOSCO Board Priorities - Work Program 2021-2022"* (February)

to market access or to a level playing field for all market participants given the global nature of financial markets and participants. We particularly encourage the SEC to coordinate with ESMA as many similar reforms are under consideration in both markets.

SEC coordination and active engagement in global efforts could help reduce regulatory and market fragmentation by carefully aligning measures to address the need for greater resilience in U.S. MMFs and short-term funding markets with measures being taken by global standard setters and by regulators in other key markets. We reiterate the IIF's frequent calls to maximize to the greatest extent possible, taking into account local specificities, globally harmonized regulation and the application of the principle of 'same activity, same risk, same regulation'.

The IIF appreciates the SEC's request for comments on the Report. We remain committed to active participation and engagement in the discussion of potential reforms.

Sincerely,

A handwritten signature in dark ink, appearing to read 'Andrés Portilla', with a stylized, cursive script.

Andrés Portilla
Managing Director
Regulatory Affairs
Institute of International Finance