

April 12, 2021

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



**RE: Request for Comment on Potential Money Market Fund Reform Measures in President’s Working Group Report (Release No. IC-34188; File No. S7-01-21)**

Dear Ms. Countryman:

Charles Schwab & Co, Inc.<sup>1</sup> (“CS&Co”) and Charles Schwab Investment Management<sup>2</sup> (“CSIM” and, collectively with CS&Co, “Schwab”) appreciate the opportunity to provide comments to the Securities and Exchange Commission (the “Commission”) on the potential money market fund reform measures outlined by the President’s Working Group on Financial Markets (“PWG”) in its December 2020 report, “Overview of Recent Events and Potential Reform Options for Money Market Funds” (the “PWG Report”).<sup>3</sup>

Schwab is one of the largest managers of money market fund assets in the United States, with 21 money market funds and \$164 billion in assets under management as of March 31, 2021. Approximately \$90 billion of those assets are in prime funds (including a retail fund with two share classes and an institutional fund with a floating net asset value); \$16 billion are in eight tax-exempt municipal money market funds; and \$58 billion are in 10 government money market funds. Money market funds provide investors with stability, convenience, liquidity and yield. Schwab’s money market fund offerings predominantly appeal to, and are used by, individual retail investors and investment advisers who service individual investors to help manage their cash.

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<sup>1</sup> The Charles Schwab Corporation (NYSE: SCHW) is a leading provider of financial services, with 31.5 million active brokerage accounts, 2.1 million corporate retirement plan participants, 1.5 million banking accounts, and \$6.9 trillion in client assets as of February 28, 2021. Through its operating subsidiaries, the company provides a full range of wealth management, securities brokerage, banking, asset management, custody, and financial advisory services to individual investors and independent investment advisors. Its broker-dealer subsidiaries, CS&Co, TD Ameritrade, Inc., and TD Ameritrade Clearing, Inc., (members SIPC, <https://www.sipc.org>), and their affiliates offer a complete range of investment services and products including an extensive selection of mutual funds; financial planning and investment advice; retirement plan and equity compensation plan services; referrals to independent, fee-based investment advisors; and custodial, operational and trading support for independent, fee-based investment advisors through Schwab Advisor Services. Its primary banking subsidiary, Charles Schwab Bank, SSB (member FDIC and an Equal Housing Lender), provides banking and lending services and products. More information is available at <https://www.aboutschwab.com>.

<sup>2</sup> As of December 31, 2020, Charles Schwab Investment Management, Inc. managed approximately \$549.2 billion on a discretionary basis and approximately \$37.5 billion on a non-discretionary basis. CSIM provides non-discretionary advisory services to the Schwab Trust Bank Collective Investment Trusts, including research and recommendations relating to asset allocation, portfolio construction, cash-flow monitoring and advisor selection and retention. Some trusts include multiple unit classes. More information is available at [www.schwabfunds.com](http://www.schwabfunds.com).

<sup>3</sup> 86 Fed. Reg. (February 10, 2021) at 8938.

## Overview

Schwab has been an active participant in the debate over money market fund regulation for well over a decade. We were supportive of the Commission’s 2010 reforms to Rule 2a-7, which strengthened money market funds by increasing transparency and reducing the risk of runs.<sup>4</sup> In 2012, an op-ed piece<sup>5</sup> in *The Wall Street Journal* by Schwab CEO Walter Bettinger proposed that prime money market funds for institutional investors be required to have a floating net asset value (“NAV”). A version of this proposal was ultimately adopted by the Commission in 2014.<sup>6</sup> At the time, Schwab advocated for separate rules for institutional prime money market funds and retail prime money market funds, arguing that “imposing a floating net asset value solution across all money market funds would be a fundamental change to a product upon which individual investors have come to rely for four decades.”<sup>7</sup>

Schwab believes that the 2010 and 2014 reforms to Rule 2a-7 enhanced the stability of money funds and the funds’ ability to continue to function in illiquid markets. However, with the benefit of our experiences in this most recent crisis, we believe additional reforms could further strengthen the resiliency of money funds, particularly in more volatile markets. To that end, Schwab now believes that serious consideration should be given by the Commission to requiring all prime and municipal money market funds to have a floating NAV. While we by no means believe that the current money fund model is unsustainable or requires immediate reform, we nonetheless recognize that there are always ways to enhance products to increase their transparency and viability. In that spirit, we now believe that a floating NAV may reinforce to investors the fluctuating value of their investments and diminish any belief that the \$1 constant net asset value is the equivalent of a guarantee of their investment. We also argue that government money market funds, which have far fewer vulnerabilities, should continue to be permitted to operate as constant NAV products with a stable price of \$1 per share.

In an era of extraordinary transparency for investors, the constant NAV for prime and municipal money market funds has become an anachronism. It may suggest to investors that the value of assets in all money market funds is the same – \$1 per share – and that it does not fluctuate. Of course, the value of a share of a money market fund does fluctuate, albeit within a very small range, typically hundredths of a penny. But tiny fluctuations are still fluctuations. The current structure of money market funds, combined with a history of intervention by the Federal Reserve, may create an expectation that assets in a money market fund are guaranteed to always remain \$1 per share – an expectation that simply is not accurate. This misalignment makes these funds more susceptible to runs in periods of market volatility, exacerbates stress in the short-term funding markets, and increases the likelihood that government institutions and taxpayer dollars will again be needed to reduce future potential stresses.

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<sup>4</sup> See comment letter from Koji Felton, senior vice president, Charles Schwab Investment Management, September 4, 2009, available at: <https://www.sec.gov/comments/s7-11-09/s71109-61.pdf>.

<sup>5</sup> Bettinger, Walt, “Time for Compromise on Money-Fund Reform.” *The Wall Street Journal*, November 23, 2012.

<sup>6</sup> *Money Market Fund Reform; Amendments to Form PF* (File No. S7-03-13), adopted July 23, 2014. 79 Fed. Reg., at 47736.

<sup>7</sup> Comment letter from Charles Schwab Investment Management, Inc., to the Financial Stability Oversight Council on the “Proposed Recommendations Regarding Money Market Mutual Fund Reform (Docket Number FSOC-2012 0003),” January 17, 2013 (“Schwab FSOC Letter”). Available at: <https://www.regulations.gov/comment/FSOC-2012-0003-0055>.

It has been our general experience that many retail investors understand how money market funds work today; specifically, they understand that there is no implicit or explicit guarantee attached to their investment in a money market fund. Nevertheless, we acknowledge that not all retail investors have that same depth of understanding and that policymakers, regulators and the media alike continue to suggest that there is a risk of investor confusion about these products. Therefore, as we outline below, Schwab believes that the time has come to consider whether the stable \$1 per share price of prime and municipal money market funds is based on an accounting convention whose time has passed.

We recognize that requiring prime and municipal money market funds to operate with a floating NAV does not specifically address the liquidity concerns that triggered market volatility in March 2020 – a key goal of the PWG. Therefore, we believe additional reforms are critical. To that end, we also recommend adopting the PWG’s recommendation to remove the link between a money fund’s weekly and daily liquidity levels and the imposition of fees and gates. Schwab also supports structural reforms that will increase transparency and liquidity in the short-term markets. These reforms will benefit retail investors and improve the resiliency of these important short-term cash management solutions.

### **The President’s Working Group Report**

In March 2020, the COVID-19 economic shock led to a rapid escalation in redemption requests, primarily from prime institutional money market funds, as investors sought liquidity and safety in the face of an uncertain economic environment. In its October 2020 report on the crisis,<sup>8</sup> Commission staff notes, “Over a two-week period from March 11 to 24, net redemptions from publicly-offered prime institutional funds totaled 30 percent (about \$100 billion) of the funds’ assets.”<sup>9</sup> By contrast, the report notes, “for prime retail MMFs, outflows as a share of assets in March 2020 totaled \$33 billion, or 7 percent of assets.”<sup>10</sup> Outflows from prime funds were only slowed by the Federal Reserve’s decision on March 18, 2020, to create the Money Market Mutual Fund Liquidity Facility (MMLF), which restored market liquidity and stabilized market conditions. During the period of uncertainty in the early weeks of the COVID-19 outbreak in the United States, assets flowed at a record pace into government money market funds – \$838 billion in March and \$347 billion in April, according to the staff report.<sup>11</sup>

The situation was not isolated to money market funds. The liquidity of the markets in which money market funds invest was impacted by high redemption levels across a broad array of products. Indeed, the entire market saw severe declines in value during this period. The S&P 500 index, for example, dropped 28.5% between March 4 and March 23.<sup>12</sup> Nor was the flight to safety unique to prime institutional money market funds; ultra-short-term and short-term bond funds also saw significant redemptions during this period. Importantly, products like ultra-short-term bond funds did not require direct sponsor or government support during this period because

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<sup>8</sup> SEC Staff Report, *U.S. Credit Markets: Interconnectedness and the Effects of the COVID-19 Economic Shock*, October 5, 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).

<sup>9</sup> *Id.*, at 25.

<sup>10</sup> *Id.*, at 25.

<sup>11</sup> *Id.*, at 25.

<sup>12</sup> Based on a March 4 closing price of 3,130.12 and a March 23 closing price of 2,237.40, according to historical tables available at [www.finance.yahoo.com](http://www.finance.yahoo.com).

their NAVs fluctuated based on market conditions – exactly as investors in these types of products would have expected.

It is important to put the volatility during this period in money market funds in context. During March 2020, the mark-to-market NAV of Schwab’s retail prime money market fund offering, the Schwab Value Advantage Money Market Fund (SWVXX), ranged from a high of \$1.000682 on March 4 to a low of \$0.999483 on March 27. During a period of extraordinary volatility, the fund’s mark-to-market price varied by only 0.12%. Of course, because of the accounting methodology in place for money market funds, the fund’s price never wavered from \$1.00 per share. And indeed, seven days after the low, on April 3, the mark-to-market value of a share in the fund was back above \$1, at \$1.000003. Even during times of market stress, prime money market funds were extremely resilient. But the reality is that for an investor with \$10,000 in the fund, the mark-to-market value of that investment fluctuated by \$12. Schwab believes strongly that money market funds are not broken and are not in need of immediate reform. Nevertheless, we believe the product can be improved by making transparent that the price of a share can and does fluctuate, so that investors can make better informed decisions about their investment choices.

Despite the reforms of 2010 and 2014, investors in prime money market funds in March 2020 behaved in a similar manner as they did during the 2008 financial crisis: institutional investors redeemed a large percentage of shares of prime funds rapidly, while retail investors redeemed fewer shares and did so much less rapidly. But the actions of institutional investors clearly affected retail investors. Although institutional investors and retail investors were segregated in different funds, both types of funds invest in the same type of instruments. As a result, liquidity issues in institutional prime funds exacerbated liquidity issues in retail prime funds. As was the case in 2008, it was action by the Federal Reserve that stemmed the tide of redemptions, stabilized money market funds, helped rebuild liquidity across markets and averted broader contagion across the financial system. It is clear that while the 2010 and 2014 reforms enhanced money funds’ ability to withstand a liquidity crisis, they did not address the short-term market structure issues that caused the crisis (which still persist), nor did they change investor behavior in times of crisis.

The PWG Report provides background on the evolution of money market funds, describes the 2010 and 2014 reforms and examines the volatility in March 2020 that resulted from the COVID-19 economic shock. The report notes that “pressures on prime and tax-exempt MMFs again revealed structural vulnerabilities in MMFs that led to increased redemptions and, in turn, began to contribute to and increase the general stress in short-term funding markets.”<sup>13</sup> The report goes on to say, “While many of the post-2008 MMF reforms added stability to MMFs, the events of March 2020 show that more work is needed to reduce the risk that structural vulnerabilities in prime and tax-exempt MMFs will lead to or exacerbate stresses in short-term funding markets.”<sup>14</sup> The report then outlines 10 policy measures that could address these risks and suggests three overarching goals for reform: 1) addressing the structural vulnerabilities in money market funds; 2) improving the resilience and functioning of short-term funding markets;

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<sup>13</sup> 86 Fed. Reg., at 8943.

<sup>14</sup> *Id.*, at 8945-6.

and 3) reducing the likelihood that government interventions or support will be needed to halt future runs on MMFs and stresses in the short-term funding markets.<sup>15</sup>

Among the 10 proposals, Schwab strongly endorses the removal of the tie between money market funds liquidity and the thresholds created in the 2014 reforms for the imposition of fees and gates. In particular, it has become clear that investors see the requirement that a fund must hold at least 30 percent of its total assets in Weekly Liquid Assets (or “WLAs”) as a “bright line” for fund boards’ imposition of liquidity fees and/or redemption gates rather than allowing WLA to serve the need for which it was originally intended: to meet investor redemptions without imposing additional strains on the funds. As the PWG Report notes, “preliminary research indicates that prime fund outflows accelerated as WLAs declined, suggesting that the potential imposition of a fee or gate when a fund’s WLA drops below 30 percent encouraged institutional investors to redeem before that threshold was crossed.”<sup>16</sup> During the March crisis, portfolio managers at Schwab increased WLAs to avoid even approaching the 30 percent threshold, knowing that even getting close to the threshold would increase investor anxiety and potentially spark redemptions. As a result, weekly liquid assets were well above the threshold throughout the crisis.<sup>17</sup>

The 30 percent threshold was intended to act as a cushion, ensuring enough liquidity capacity during times of market stress. But in reality, the requirement acts as a cliff, with funds unable to access that liquidity without sparking a potential run on the fund. That forces funds to increase WLAs well above the 30 percent threshold in order to create that cushion, an action that can contribute to broader market illiquidity. This was the case in March 2020, when most money market funds were seeking liquidity at the same time, exacerbating the market stress. Schwab believes that fund boards should have the option of imposing fees and/or gates when it is in the best interest of the fund and its investors, not when the weekly liquid assets level reaches the 30 percent or some other random threshold. Regardless of whatever other reforms the Commission proposes, we believe this change to be critical to the efficient operation of money market funds in the future. We agree with the comments of the Investment Company Institute, the Securities Industry and Financial Markets Association and other industry participants on this issue.

We expect other commenters will address the pros and cons of each of the other nine policy proposals in the PWG Report. Schwab instead will focus the balance of its comments on the other policy recommendation in the report that we believe merits serious consideration: requiring all prime and municipal money market funds to have a floating NAV.

### **Floating NAVs for all Prime and Municipal MMFs**

The primary benefit of requiring all prime and municipal money market funds to operate with a floating NAV is that it eliminates any chance of a fund’s “breaking the buck” by seeing its share price drop below \$0.995, the threshold below which an MMF can no longer continue rounding its price to the stable \$1 per share. Two key features of money market funds that attract investors are price stability and liquidity. But the structure of money market funds creates a situation in

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<sup>15</sup> *Id.*, at 8947.

<sup>16</sup> *Id.*, at 8945.

<sup>17</sup> The Schwab Value Advantage Money Market Fund, for example, increased its WLAs from approximately 37% at the end of February 2020 to about 43% by early April.

which a fund could break the buck, leaving investors unable to redeem shares at full value. That dynamic creates the potential for a first-mover advantage, whereby early redeemers are likely to get full value for their shares, while losses are concentrated among later redeemers and non-redeemers. Later redeemers could also find that liquidity fees and/or redemption gates have been imposed, reducing their opportunity to redeem their shares at the full price or fully redeem their investments. With a floating NAV, fund sponsors simply redeem each investor's shares at the market price. A floating NAV does not remove the first-mover advantage, in that early redeemers are likely to get a better price than late redeemers in a falling market, but this is no different than other types of floating NAV mutual funds and thus familiar to investors.

The PWG notes that “some retail prime MMFs experienced declining market-based prices in March [2020], but none of these funds reported a market-based price below \$0.9975.”<sup>18</sup> The report goes on to say that “some retail tax-exempt MMFs also had declining market-based prices. Although none of these funds broke the buck, one fund reported a market-based price below \$0.9975.”<sup>19</sup> Interestingly, the report notes that there appeared to be no correlation, in either retail prime MMFs or in retail tax-exempt MMFs, between outflows and a decline in market-based prices. This suggests that retail investors are not focused on the market-based prices of their money market fund holdings, or, to the degree that they were aware, they were unconcerned, given the relatively modest fluctuations compared to other assets. For some, it raises concern that despite the disclosure, education and detailed NAV data made available by asset managers, some investors may not have been aware of the risk to their investment had the market-based price of their shares continued to decline. Advocates of money market fund reform often use this kind of evidence to suggest that retail investors believe that their assets in any type of money market fund are guaranteed to remain \$1 per share, regardless of market circumstances.

We originally advocated for a separation of prime fund investors into institutional and retail categories, and while this change has helped, over time it has not proven to wholly insulate retail investors from the actions of institutional investors. Institutional investors diligently monitor the markets throughout any given trading day. Consequently, in volatile market conditions, such as those that occurred in March 2020, institutional investors are more able to move quickly to reduce risk. In contrast, most retail money market fund investors do not track their money fund investments with the same degree of diligence and may not be aware in real-time of price movements in their money market funds. But while retail investors may not track real-time fluctuations, this last crisis demonstrated, as was the case in 2008, that retail investors tend to follow institutional investors' lead, even when they are not co-mingled in the same investment vehicle. That behavior accentuates the impact on retail investors because institutional funds hold the same security types and trade in the same markets. When retail money funds experienced redemptions in March 2020, they were selling assets into a market that was already struggling to absorb large amounts of the same securities being sold by institutional money fund investors.<sup>20</sup> As such, notwithstanding that retail investors were redeeming out of money market funds at a slower rate and on a delayed basis, the retail money market funds were nonetheless adversely impacted by the behavior of institutional investors. It underscores the idea that segregating

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<sup>18</sup> 86 Fed. Reg., at 8945.

<sup>19</sup> *Id.*, at 8945.

<sup>20</sup> Indeed, the PWG's own research suggests that retail investor outflows from prime money market funds in March 2020 were both smaller than outflows from institutional prime funds and delayed: “The redemptions from retail prime MMFs in March began a couple days after those for institutional funds.” *Id.*, at 8945.

institutional and retail investors into separate funds, as the 2014 reforms did, proved not to be wholly sufficient to shield retail investors from the behavior of institutional investors.

Schwab recommends that government money market funds be permitted to remain as constant NAV funds. This limited exception is warranted because government money market funds are required to invest almost entirely in government-backed securities and Treasury bills, which are backed by the full faith and credit of the United States. They do not raise the credit issues faced by prime and municipal funds, and it is clear from investor behavior in March 2020 that both institutional and retail investors continue to have strong faith in these funds as a place of safety. Such funds have not historically needed to rely on the Federal Reserve support programs that were put in place in 2008 and 2020. We believe they should remain an option for investors.

We acknowledge that significant investor education will have to take place before any transition from a constant NAV to a floating NAV for retail prime and municipal money market funds. The industry will need to spend time and effort to educate investors that floating NAV funds can and should remain a core element of an investor's cash-management strategy, but that, like all investments, returns are not guaranteed. A lengthy transition period is likely to be necessary to ensure investors understand the changes. The Commission will also need to resolve whether floating NAV funds should continue to be permitted to call themselves "money market funds," as well as whether floating NAV money market funds should continue to be governed by Rule 2a-7. While we acknowledge that there may be bumps for the short-term financing markets during the transition period, we are confident that those markets will have improved resiliency and functioning as a result.

We also considered the possibility that a category of prime and/or municipal money market funds could retain a constant NAV, provided that those funds have a capital buffer, the costs of which are borne by the fund's sponsor (and, to some degree, the fund's investors). However, we do not believe this is practicable given the regulatory constraints on money market funds and the complexities of implementing and administering a capital buffer. As a result, we are not convinced this would be an effective solution.<sup>21</sup>

Schwab is committed to offering a range of liquidity solutions to retail investors, and, if the Commission concludes that new rules requiring prime and municipal money market funds to have a floating NAV are appropriate, the firm expects to continue offering both constant NAV government money market funds and floating NAV prime and municipal money market funds to retail investors after the transition period. Schwab believes that these various fund types will remain an important cash management option for investors. Given the uncertainty of the outcome and timing of any potential money market fund reform, the firm plans to maintain its current product offerings until such time as it can assess the requirements of any new rules adopted by the Commission.

Requiring retail prime and municipal funds to have a floating NAV may also reduce the likelihood that official sector interventions and taxpayer support will be needed to halt future MMF runs. Similar to other types of floating NAV mutual funds, there would be no expectation

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<sup>21</sup> We would also note that such a solution does not solve for the liquidity concerns articulated in the PWG Report, underscoring the need for broader market reforms aimed at ensuring liquidity is available in times of market stress.

by investors of government support or intervention. A floating NAV, however, is not a panacea, as can be seen from the fact that redemptions in March 2020 were larger and faster in institutional prime money market funds, which already have a floating NAV, than in constant NAV funds. What such a change will do is remind investors that the price of a share is not guaranteed to remain stable. In addition, the removal of thresholds should give funds more flexibility to increase and, critically, access their liquidity in times of stress. Both the \$0.9950 threshold (for breaking the buck) and the 30% WLA threshold (for imposing fees and/or gates) currently act as bright lines that accelerate investor behavior as the fund approaches those trigger points. Removing those thresholds should permit funds more flexibility for accessing additional liquidity in times of stress.

We also acknowledge that this change could have wider implications for the financial system, particularly the banking sector, which could see significant inflows from investors seeking a stable return and the guarantee against losses provided by federal deposit insurance. Those inflows have a variety of implications for banks, including, potentially, the need for banks to increase capital in order to meet federal capital buffer requirements.

Finally, Schwab believes strongly that the events of March 2020 were not specific to money market funds and, therefore, is also supportive of any structural reforms that bring greater liquidity and transparency to the short-term markets. Improving the liquidity of short-term securities is the best way to address frozen markets across all investment types, not just money market funds. The emergence of a global pandemic caused an unprecedented liquidity crisis across a wide variety of markets in March 2020. We believe that our recommendations – indeed, any of the PWG’s reform recommendations – will not be effective unless paired with structural reforms to these markets. Improving underlying market liquidity, particularly in the repo and commercial paper markets, would minimize price dislocation and reduce volatility. We support the perspective of other commenters, including the Investment Company Institute, on this issue.

## **Conclusion**

Schwab recommends that the Commission consider whether efficient operation of the short-term funding markets would be better served by requiring that prime and municipal money market funds transparently and accurately reflect the reality that their net asset value is not constant. Doing so would also reinforce to retail investors that their investment carries risk and is not guaranteed. Such a requirement could supplement our other key recommendations – structural reforms that increase liquidity in the short-term markets and the severing of the link between the 30% weekly liquidity levels and the ability of a fund board to impose fees and gates – and result in a stronger, more stable market environment that will reduce the likelihood of government intervention and improve the functioning and resiliency of the markets.

Thank you very much for the opportunity to offer our perspective on these issues. We would be happy to answer questions or provide any additional information as the Commission continues to explore this topic.

Sincerely,



Rick Wurster

Executive Vice President, Schwab Asset Management Solutions

cc: Allison Herren Lee, Acting Chair, Securities and Exchange Commission  
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