

PIMCO

Via Electronic Submission

April 19, 2021

Vanessa Countryman  
Office of the Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

RE: File No. S7-01-21, Potential Money Market Fund Reform Measures in President's Working Group Report

Dear Secretary Countryman,

Enclosed please find a recent PIMCO viewpoint, "Revisiting Money Market Reform," which outlines PIMCO's views on several policy options discussed in the December 2020 President's Working Group report on Money Market Fund (MMF) reform. We weigh the merits of reevaluating existing MMF regulations and imposing new regulations as well as outline obstacles to the imposition of swing pricing in the United States.

We would be happy to discuss any of these or other related issues with you further.

Sincerely,



Libby Cantrill  
Managing Director, Head of Public Policy  
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# Revisiting Money Market Reform

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Pandemic-induced volatility prompts policymakers to consider money market reforms – again.

Regulated money market funds (MMFs) in the U.S. have become an intense area of focus for policymakers – yet again. After these funds performed poorly in the global financial crisis of 2008, policymakers spent several years deliberating and implementing extensive changes in 2010 and again in 2016. These changes were intended to make both government and prime (credit) MMFs less vulnerable to market volatility and better positioned to meet investor liquidity demands, especially during periods of broad-based market illiquidity.

While these regulatory changes were well-intentioned – and some achieved their policy goals – prime MMFs, in particular, ran into issues *again* during the unprecedented market turbulence of March 2020. Several fund sponsors and the Federal Reserve had to step in to shore up the funds, causing many policymakers to call for additional reforms.

## WHAT SHOULD BE DONE?

Last December, the President's Working Group on Financial Markets published a thoughtful post-mortem on the performance of MMFs and several potential options for reform (read the report [here](#)); the SEC now seeks comment on those policy options. While we believe the sources of the market turmoil were multifaceted and largely related to underlying market structure issues (as we describe in our February paper, "[Lessons From the March 2020 Market Turmoil](#)"), we nevertheless think it

behooves policymakers to look at existing MMF regulation with fresh eyes and consider new reforms. While not exhaustive, below we opine on some of the policy options enumerated in the President's Working Group paper that may deserve more study; they include:

- **Reconsidering existing MMF regulations regarding gates and fees:** A key reform implemented after the 2008 financial crisis allowed for MMF boards to impose fees and gates on redemptions if a fund's liquidity threshold (the weekly life average of assets or "WLA") fell below 30%, a threshold published daily on fund websites. The logic was that the threat of fees and gates would discourage redemptions specifically when a fund's liquidity may be more constrained.

While well-intentioned, the practical impact of this policy last year was the opposite of the goal:<sup>1</sup> As MMFs' liquidity thresholds crept closer to 30%, redemptions among institutional *and* retail investors increased out of fear that gates would be imposed. As prime MMFs and dealer balance sheets became increasingly constrained, there were no alternative avenues to sell even high quality liquid assets, such as bank commercial paper (CP) or certificates of deposit (CDs). Several funds had few options other than seeking help from their respective fund sponsors, or eventually from the Fed's Money Market Mutual Fund Liquidity Facility (MMMLF).

A possible solution would be to simply eliminate the 30% threshold trigger, thereby removing any sort of manufactured line in the sand that could unwittingly create an incentive for redemptions. A MMF could still impose gates, but only after it sought SEC approval (similar to today's policy governing open-end mutual funds). Regardless, we believe a reevaluation of current policy is needed.

- **Imposing a floating net-asset-value (NAV) for all prime MMFs:** Another reform implemented after the 2008 crisis required institutional prime MMFs to use a floating NAV to price their funds rather than using a stable NAV (usually at a \$1.00), which had been a sacrosanct characteristic of MMFs. This change aimed to mitigate the so-called first-mover advantage that had historically caused periods of heavy redemptions or "runs" on certain MMFs. The thinking behind a floating NAV was that if investors were not concerned that a fund's NAV may decline below the \$1 fixed NAV and "break the buck," they might have less incentive to make redemptions during periods of volatility.

The reason for applying this policy to only institutional and not retail prime MMFs was the view that institutional investors were more likely than retail investors to redeem funds during periods of stress – a view supported by the experience in the financial crisis. However, in the first quarter of 2020, retail prime MMFs also saw heavy redemptions similar to those made by institutional prime MMFs during the global financial crisis.

Thus, while imposing a floating NAV for all prime MMFs would not necessarily be a panacea and would not immunize institutional prime MMFs from redemptions like those of March 2020, we believe that imposing a floating NAV for *all* investors in prime MMFs could deliver two key benefits. One, it may help to discourage herd redemption behavior across all prime MMFs, *and* two, it may enhance transparency about the underlying performance of credit-sensitive assets within prime MMFs, thereby helping to align investors' expectations to the reality of the portfolio.

- **Swing pricing not yet practical in the United States:** One oft-mentioned reform – by the President's Working Group, the Financial Stability Board, and the Federal Reserve, among others – is to require swing pricing for MMFs, thereby imposing costs on investors making redemptions (by "swinging" the NAV lower in times of heavy redemptions).

Broadly speaking, we are supportive of swing pricing as one tool in a fund's liquidity toolbox. Swing pricing can be an appealing way to apply fund transaction costs to large redemptions and can be attractive to long-term investors (conceivably mitigating runs on funds). It is not a panacea, however, and should be viewed in the context of other liquidity tools. In the U.S., unlike Europe, there are significant limitations to making swing pricing practicable.

Swing pricing works in Europe because of early cut-offs for receiving subscription/redemption orders prior to NAV timing for European funds. In the U.S., however, subscriptions and redemptions historically have been accepted until the NAV cut-off, including by intermediaries, who typically report flows to funds with a delay – often 12 hours or more. Because of this, swing pricing is not currently operationally practical in the U.S. Of course, funds in the U.S. could move up the cut-off time for receiving subscription/redemption orders (to the morning prior to NAV timing) and/or require intermediaries to report flows more promptly. However, this would require significant industrywide investment and be a sea change in how MMFs operate, especially for MMFs that offer multiple NAV valuation times throughout the day.

## CONCLUSION

We believe investors should be mindful of the issues with liquidity that have arisen in times of market stress. Policymakers can make meaningful improvements on this front by reconsidering MMF regulations regarding gates and fees, imposing a floating NAV for all prime MMFs, and reassessing the practicality of swing pricing in the United States.

In our view, the March 2020 bout of illiquidity was largely driven by concerns about credit risk spurred by the pandemic. Investors often view MMFs as synonymous with cash: They expect principal preservation and daily liquidity, with little to no mark-to-market impairment or volatility. Government and Treasury-only MMFs, which invest in only the most liquid securities with effectively no credit risk, often have these characteristics. However, prime MMFs do not always, as they invest in securities that *do* have credit risk – usually CP or CDs of banks and other higher-rated companies.

We believe that investors can invest in these types of credit securities if they have access to proper resources to evaluate suitability for the given credit risk and the ability to tolerate

some volatility and illiquidity, which may require a longer holding horizon than current MMFs are designed to address. To this point, PIMCO closed its prime MMF in 2016, moving its investors into our governments-only MMF. This trend of government funds absorbing prime funds accelerated following the challenges experienced during the March 2020 crisis.

Over the next year, there will likely be an evolving dialogue with respect to money market reform among policymakers, investors, and fund managers. We are encouraged by the

thoughtful menu of policy options that has been proffered by the President's Working Group and look forward to further dialog as policymakers – once again – think about how to make this area of the market even more resilient while ensuring it continues to fulfill its important function in the marketplace. As for prime MMF investors, we believe they should evaluate upcoming policy changes to ensure that more credit-oriented strategies are appropriate investments for cash management.

1. See <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD666.pdf>

A "safe haven" is an investment that is perceived to be able to retain or increase in value during times of market volatility. Investors seek safe havens to limit their exposure to losses in the event of market turbulence. All investments contain risk and may lose value.

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