Stephen A. Keen
[redacted]

April 29, 2021

Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090
Filed via E-mail

Re: Potential Money Market Fund Reform Measures in President's Working Group Report (File No. S7–01–21)

Dear Ms. Countryman:

I am writing to comment[1] on the process for developing proposals for the further reform of money market fund regulations. Although my questions and comments are prompted by the Report of the President's Working Group on Financial Markets (the "PWG") *Overview of Recent Events and Potential Reform Options for Money Market Funds*, issued December 22, 2020 (the "Report"),[2] I do not wish to comment on any of the reforms considered in the Report. Rather, I would like to remind the Securities and Exchange Commission (the "Commission") of the importance of conducting careful fact finding and analysis as to the behavior of money market funds ("MMFs") and their shareholders during March 2020 before developing any reform proposals.

Although none of the current commissioners were at the Commission during the adoption of the major reforms to Rule 2a-7 in 2014, the current Acting Director of the Division of Investment Management ("IM"), Sarah ten Siethoff, was and should be able to confirm my observations. In my view, the Division of Risk, Strategy, and Financial Innovation's *Money Market Fund Study: Response to Questions Posed by Commissioners Aguilar, Paredes, and Gallagher (Experience through the Financial Crisis, Efficacy of 2010 Reforms, and Potential Economic Effects of Future Reforms)*, issued November 30, 2012 (the "2012 MMF Study"),[3] was a key step in the reform process. Frankly, the actions prior to the 2012 MMF Study, including the previous PWG report, the MMF roundtable and the Financial Stability Oversight Council recommendations, struck me as a waste of time due to their superficial analysis of the failure of the Reserve Primary Fund and its aftermath.

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1 These are my personal comments and do not reflect the views of the law firm or attorneys with whom I am associated, or of any of my former or current clients. I have not received any compensation or inducement for these comments nor coordinated with anyone else commenting on the Report.

2 Reprinted as the Appendix to Release No. IC–34188, 86 Fed. Reg. 8938 (2021).

3 https://www.sec.gov/files/money-market-funds-memo-2012.pdf.

I am happy that I waited to file these comments until after the Analytics Office of IM released its report on *Prime MMFs at the Onset of the Pandemic: Asset Flows, Liquidity Buffers, and NAVs*[4] (the "Prime MMFs Report") because the Commission may already be progressing along the path I would recommend. The Prime MMFs Report was more targeted than the Division of Economic and Risk Analysis ("DERA") study of *U.S. Credit Markets Interconnectedness and the Effects of COVID–19 Economic Shock*,[5] issued on October 5, 2020 (the "Staff Interconnectedness Report") and referred to in the Report. The Prime MMFs Report also begins to use the trove of data the Commission has collected through Form N-MFP filings, supplemented by even more detailed information available on MMF websites.

The gist of my recommendation is that IM and DERA should do more analysis of this data and use the Commission's examination authority to fill any holes in the information. Although I have suggested some specific questions for the Commission's staff to consider, the Prime MMF Report illustrates the importance of testing assumptions against the data. For example, conventional wisdom was that MMFs managed by banks and investment banks would be less likely to suffer redemptions because investors would believe they have more resources with which to support their MMFs. Yet the Prime MMFs Report finds "funds with advisers owned by the largest U.S. banks designated as global systemically important banks ("G-SIBs") accounted for 56% of the outflows in the third week of March even though these funds managed only around 28% of net assets in publicly offered prime institutional MMFs." This could suggest that requiring advisers to provide fund support may not be effective in preventing large scale redemptions.

I also believe the Commission should be more rigorous than the PWG in defining what constitutes structural "vulnerability" and "resilience." For the reasons discussed below, I believe that tax-exempt MMFs demonstrated resilience in March 2020 and that some structural "vulnerabilities" in the commercial paper market may be due more to the issuers than to the MMFs.

1. Questions for Further Analysis

My suggested questions for further analysis by IM and DERA that would be germane to possible MMF reforms are as follows.

- What were the historical cash flows of the funds which filed Forms N-CR in March 2020 ("Supported Funds") compared to comparable funds (e.g., prime institutional funds of similar size)? Were there earlier indications that the cash flows of Supported Funds were more volatile than other prime or tax-exempt funds?
- Into what sales channels were the Supported Funds distributed?

[4] https://www.sec.gov/files/prime-mmfs-at-onset-of-pandemic.pdf.

[5] https://www.sec.gov/files/US-Credit-Markets_COVID-19_Report.pdf.

- Did the boards of directors of the Supported Funds meet to consider whether to impose a liquidity fee or suspend redemptions? If they met and determined not to do so, is there a reason their decision was not publicized?
- Did the portfolio composition of the Supported Fund that reported a market-based NAV below $0.9975 differ significantly from other tax-exempt MMFs? Had this Supported Fund previously incurred realized losses? Did it have a longer weighted average maturity than the average tax-exempt MMF at the end of February 2020?
- Comparing the portfolios of prime MMFs at the end of February against the end of March 2020, were there particular CP issuers that the MMFs chose not to roll over? Were there particular CP issuers that MMFs rolled over for shorter maturities? If prime MMFs took uniform actions as CP matured (either not rolling over or rolling over for a shorter maturity), this would be consistent with a reaction to general market conditions. On the other hand, treating some CP issuers differently may be consistent with reevaluation of the relative impact of the pandemic shut downs on different issuers or industries.
- Who were the market participants who "reported concerns that the imposition of a fee or gate by one fund, as well as the perception that a fee or gate would be imposed by one fund, could spark widespread redemptions from other funds, leading to further stresses in the underlying markets?" Did these participants redeem from MMFs and was this the primary reason?
- Did any tax-exempt tender option bonds and variable rate demand notes ("VRDNs") reach their interest rate caps?
- The Staff Interconnectedness Report indicates that the amount that corporations drew on revolving credit lines in the first quarter of 2020 was more than five times the amount of commercial paper not renewed by prime MMFs. What other liquidity demands drove these drawings?
- Did any dollar-denominated UCITS MMFs invoke swing pricing? If so, what prices did they use?

Undoubtedly the Commission and its staff could find more trenchant questions upon a careful review of the reform options outlined in the Report.

2. Tax-Exempt Money Market Funds

The Report's alarm at redemptions from tax-exempt MMFs puzzles me. According to IM's Money Market Fund Statistics, at the end of February 2020, the weekly liquid assets of tax-exempt retail MMFs were over 70% and of tax-exempt institutional MMFs were over 80%. The Report states that outflows from tax-exempt MMFs (of both types) from March 12 to 25, 2020, were 8%, and these funds reduced their holdings of VRDNs, presumably those with seven-day demand features, by 16% during the period from March 9 to 23. To attract buyers of the VRDNs, remarketing agents reportedly increased the SIFMA 7-day municipal swap index yield 392 basis points on March 18.[6]

While it is possible that a "spike in the SIFMA index yield [could cause] a drop in market-based NAVs of tax-exempt MMFs,"[7] the drop should have been immaterial. This index is set on Wednesday[8] and adjustments to VRDN rates take effect on Thursday. Unless the 392-basis point increase would have caused a VRDN's interest rate to exceed its cap, the change in the index should have just increased the yield on the VRDNs without adversely affecting their price. Why would anyone sell a VRDN at a discount on Wednesday when they know its interest rate will increase nearly 4% the next day?

The Report states that one tax-exempt MMF nevertheless reported a market-based NAV of less than $0.9975 and required sponsor support. But this should not have been due to a drop in the price of its seven-day VRDNs. I expect it more likely that the fund (a) had already realized losses from earlier sales of portfolios securities, (b) sold longer-term portfolio holdings in response to redemptions in March and (c) redemptions during March increased the significance of these realized losses. In all events, it would be helpful for DERA to include such details in its analysis.

I also think it unlikely that tax-exempt MMFs sold holdings to maintain their weekly liquid assets above 30% of their net assets. It is more likely that the fund had to sell longer-term holdings to maintain an average weighted maturity of not more than 60-days. A MMF with a portfolio structured like the average retail tax-exempt MMF reported in the February 2020 Money Market Fund Statistics, with weekly liquid assets comprising 70.7% of its net assets, would have its weighted average maturity extend from 31.5 days to 60 days after 53.8% of its shares were redeemed (assuming it disposed of only weekly liquid assets to fund the redemptions). Over 36% of the assets of such a MMF would still consists of weekly liquid assets, so the MMF would not be near the point when its board of directors could consider imposing a liquidity fee or temporarily suspending redemptions.

Most importantly, I cannot understand why the Report cites these events as structural vulnerabilities rather than as examples of resilience. Seven-day VRDNs are designed to provide liquidity for tax-exempt MMFs to meet redemptions. Liquidity providers and remarketing agents are paid fees to backstop this liquidity; fees that are reflected in the interest rate so the tax-exempt MMFs effectively bear the cost of this liquidity. In addition to these fees, in the event the VRDNs cannot be remarketed, remarketing agents can increase the interest rate (up to a cap) in order to compensate themselves for the capital required to carry the inventory. The municipal issuers of the VRDNs feel the effect of these increased interest rates, but (particularly in light of the

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[6] Report at 8944-45.

[7] Report at 8945

[8] https://www.sifma.org/resources/research/about-the-municipal-swap-index/.

Federal Reserve's interest rate policies since 2007) the interest paid over the life of the VRDN should still be well below that of a fixed-rate bond. If the VRDN structure is no longer favorable, the issuers and liquidity providers have the option to convert these notes to a fixed-rate mode and remarket the notes on that basis.

In summary, I cannot find a structural problem with tax-exempt MMFs. They are structured to handle redemptions well in excess of those experienced in March 2020. Whatever may have been true of the rest of the municipal bond market, I am not convinced that tax-exempt MMFs required any intervention by the Federal Reserve or the Treasury.

3. Commercial Paper

Commercial paper ("CP") has a similar structural liquidity feature to VRDNs that should have mitigated the disruptions experienced in the CP market in March 2020. To receive the prime quality ratings required by MMFs, a CP issuer must "maintain sufficient liquidity, normally in the form of committed credit facilities and liquid assets, such that they are expected to be able to withstand losing access to both short-term and long-term debt markets for at least a year."[9] This should prevent the failure to "roll-over" CP from disrupting the funding available to the CP issuer, although it may increase the cost of funding.

The Staff Interconnectedness Report states that "[b]orrowers drew down over $275 billion in revolvers in 2020Q1,"[10] which is well in excess of the "$48 billion overall decline in outstanding CP over [the] two weeks [from March 10 to March 24" referred to in the Report.[11] Yet, we know that not all CP issuers drew on their revolvers. I found the statements of Scott Krohn, the Treasurer of Verizon, at the October 5, 2020, meeting of the Fixed Income Market Structure Advisory Committee intriguing.

> We saw the disruption of the CP markets. We activated our emergency liquidity planning playbook at the end of February. And, you know, our choice was do we go to the market and just test it, or, you know, do we draw on our revolver. And I think, as Sonali pointed out, there was a record draw on bank revolvers as part of this crisis.
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> And what we actually were looking for is a -- given the taint associated with drawing on revolvers was a -- just a standalone, short-term credit facility. And as a sign of how the banks were in a much different position this time versus last time [in September 2008], the banks just said, "No.

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9 Moody's Investors Service, *Cross-Sector Rating Methodology: Short-Term Ratings* at 2 (May 10, 2019).

10 Staff Interconnectedness Report, *supra* note 5, at 5.

11 Report at 11-12.

> We prefer you drawing your revolver. We're so busy helping other clients." And again, maybe this is more Verizon but they incurred [encouraged?] -- just drawing revolver. And we decided not to do that because we still think there is a taint associated with that.
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> So we tapped the markets on March 17th. And, you know, again, this crisis on March 17th felt as bad as the Lehman crisis ….
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> …
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> The Fed came in and turned this market from a crisis into an issuing opportunity, not only re-implementing all the programs that they had in '08/'09 but doing many more in addition to cutting rates to zero. So even with our crisis offering on March 17th, we issued at 3 percent for a 10-year, which was 50 basis points -- only 50 basis points higher than our all-time low for a 10-year issuance.[12]

On March 17th the Federal Reserve announced the establishment of the Primary Dealer Credit Facility and the Commercial Paper Funding Facility; the Money Market Mutual Fund Liquidity Facility was not announced until the next day. Perhaps the MMF facility was not that critical to stabilizing the credit markets?

The larger question is what "taint" did Verizon think would be associated with drawing on their credit facility? Given the circumstances, with investors preserving liquidity rather than rolling over CP, it seems unlikely that the market would have interpreted Verizon drawing on an existing credit line as indicative of a unique weakness of Verizon. Indeed, Verizon's ability to place 10-year debt during the middle of the two-week period highlighted in the Report suggests that the market did not react adversely to Verizon's need to raise capital.

Another important question is why liquidity providers failed, during both the 2008 financial crisis and March 2020, to make markets in the CP they supported. While liquidity providers for CP, unlike those for VRDNs, do not have a legal obligation to purchase CP, I would think that they have a financial incentive to do so. Given the choice, I would expect a liquidity provider to choose to buy CP for 99% of its face amount rather than funding 100% when the CP matures. This would (i) reduce the cash outlay for the CP, (ii) potentially increase the liquidity provider's return, as the issuer must repay the face value and (iii) possibly increase the willingness of CP holders to extend the CP, given the evident support in the secondary market.

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[12] Transcript of U.S. Securities and Exchange Commission, Fixed Income Market Structure Advisory Committee Oct. 5, 2020 Meeting at 37-38, https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-100520-transcript.pdf.

My surmise is premised, however, on an expectation that the back-up facilities will be drawn as the CP matures. Without this expectation, taking CP into inventory will guarantee outlays that may have been avoided when the issuer obtained another source of funding. I do not counsel banks and investment banks, so it is likely that there are other reasons (e.g., capital requirements, collateral requirements of the discount window) for the reluctance of the liquidity providers to make markets in the CP they support. I cannot understand, however, what this problem has to do with MMFs.

In summary, the behavior of MMFs during March 2020 should not have created a problem for CP issuers. MMFs that shortened the tenors of their CP were still providing funding. MMFs that allowed CP to mature rather than rolling the CP over should have reasonably expected the issuers to draw down their committed credit facilities or arrange other financing (as Verizon did). The unwillingness of these issuers to switch to another source of funding was a problem of their own making, not of any structural weakness in MMFs.

4. Recommendations

I urge the Commission to learn from its experience during the proposal and adoption of the amendments to Rule 2a-7 in 2014. The Chairwoman's recalcitrance in authorizing the 2012 MMF Study and request for the Financial Stability Oversight Council to intercede served only to delay consideration and adoption of the eventual reforms. I do not know why the Commission chose to give MMFs with fluctuating NAVs or tax-exempt MMFs the power to impose a liquidity fee or temporarily suspend redemptions, but if it was to placate the Treasury Secretary and Chairman of the Federal Reserve Board, the choice was counterproductive.

The Commission has the data, staff, and historical perspective to evaluate the behavior of MMFs in March 2020 on its own and propose its own solutions to any problems it identifies. I recommend that the Commission direct DERA and IM to work together on this. In addition, the Commission should request comments on their reports, as it did with the 2012 MMF Study. This will provide an opportunity for interested parties, including other federal regulators, to provide additional data and challenge or confirm the reports' conclusions. With a clear understanding of agreed upon and disputed facts, the Commission will be in a position to make sound policy decisions.

Finally, any reforms to Rule 2a-7 will be irrelevant if the Commission and other authorities continue to allow issuers of stable-dollar cryptocurrencies to pay interest on their currencies without registering as investment companies or obtaining bank charters.

Sincerely,

/s/ Stephen Keen