How Do Prime MMFs Manage Their Liquidity Buffers?

Viktoria Baklanova, Isaac Kuznits, Trevor Tatum[1]

Based on data filed by money market funds (MMFs) on Form N-MFP, this article offers insights about the composition of prime MMFs' liquidity buffers. The analysis shows that prime MMFs mainly rely on government securities and repos to meet their daily and weekly liquidity thresholds. Prime MMFs' investments in government securities increased during the pandemic, reaching an all-time high of 38% of their portfolios in August 2020.

MMF liquidity

Many investors use MMFs to manage their liquidity needs given that MMFs invest in short-term, high-quality debt securities that, under normal market conditions, exhibit limited price volatility. MMFs typically provide somewhat better returns than holding assets in cash. Institutional investors, in particular, make significant subscription and redemption requests on a frequent basis, especially during stressed market conditions.[2] To meet investor needs for liquidity, MMFs are expected to hold a sufficient amount of assets that can be quickly converted to cash. Since 2010, SEC rules have included minimum liquidity requirements for MMFs, including a minimum of 10% of investments in daily liquid assets (DLA) and a minimum of 30% of investments in weekly liquid assets (WLA).[3] MMFs report the size of their DLA and WLA to the public daily on their websites. MMFs also report these metrics to the SEC monthly on Form N-MFP. Using these data, this article examines the composition of prime MMFs' daily and weekly liquidity buffers from October 2016 through May 2021, a period that includes the heightened market volatility in March 2020 and the economic uncertainty that followed.

If an MMF's portfolio falls below the 10% DLA or 30% WLA threshold, it may not acquire any assets other than DLA or WLA until these thresholds are met.[4] A prime MMF may impose liquidity fees or temporarily suspend redemptions if the fund's WLA declines below 30% of its total assets.[5] To date, no MMF has used these tools. On average, prime MMFs have historically maintained DLA and WLA well above the regulatory minimums (Figures 1 and 2).

---

[1] This is an article by the staff of the Division of Investment Management's Analytics Office of the U.S. Securities and Exchange Commission (SEC). The SEC, as a matter of policy, disclaims responsibility for any private publication or statement of any of its employees. The views expressed herein are those of the authors and do not necessarily reflect the views of the SEC or other members of the SEC staff.

If you have any questions or comments about this report, please contact Viktoria Baklanova (baklanovav@sec.gov), Isaac Kuznits (kuznitsi@sec.gov), or Trevor Tatum (tatumt@sec.gov) in the Division of Investment Management's Analytics Office.

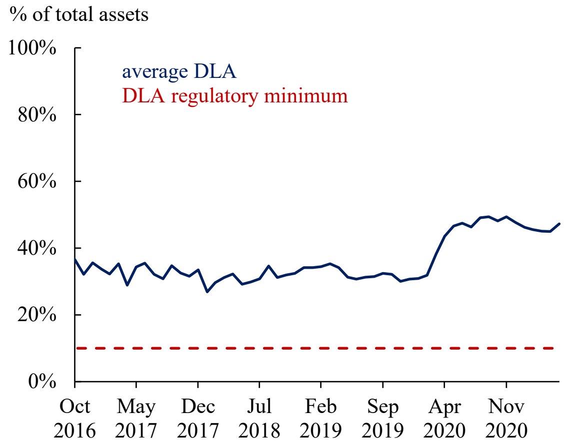
[2] *See* Report of the President's Working Group on Financial Markets, "Overview of Recent Events and Potential Reform Options for Money Market Funds" (December 2020).

[3] *See* rule 2a-7(d)(4). Tax-exempt MMFs are not required to maintain 10% of their total assets in DLAs.

[4] *See* rule 2a-7(d)(4)(iii).

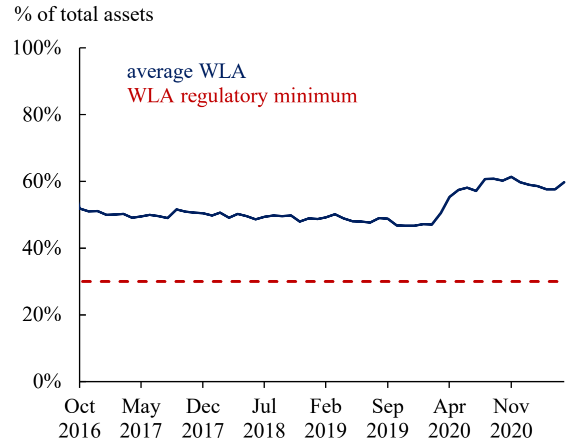
[5] *See* rule 2a-7(c)(2)(i).

Figure 1: Prime MMFs' average DLA are well in excess of the regulatory minimum of 10% of total assets



Source: Form N-MFP

Figure 2: Prime MMFs' average WLA are well in excess of the regulatory minimum of 30% of total assets



Source: Form N-MFP

Prime MMFs have historically maintained high levels of DLA and WLA

DLA are expected to be readily available to meet investor redemptions and generally include cash and securities that mature within one business day (or have a daily demand feature). In addition, MMF holdings of Treasury securities qualify as having daily liquidity.[6] WLA include cash, securities that mature within five business days (or that funds can redeem for cash within one week), Treasury securities, and certain government agency securities with remaining maturities under 60 days.[7]

Prime MMFs can invest in a broad range of short-term, high quality fixed-income instruments such as U.S. Treasury bills, federal agency notes, bank obligations such as certificates of deposit (CD) or time deposits (TD), commercial paper (CP), repos, and obligations of states, cities, or other types of municipal agencies. Because many of these assets do not qualify as daily or weekly liquid assets, unexpected and rapid shareholder redemptions from a fund may cause DLA or WLA to fall below their regulatory minimums. For example, at the onset of the pandemic in March 2020, investors withdrew $125 billion from prime MMFs causing a general reduction of WLA, which approached the 30% threshold for some funds and fell below 30% in one case.[8] However, according to Form N-MFP filings, no prime MMF reported DLA declining below the 10% threshold in March 2020, suggesting that these funds maintained available liquidity to meet daily redemptions up to 10% of the funds' total assets.

---

[6] *See* rule 2a-7(a)(8).

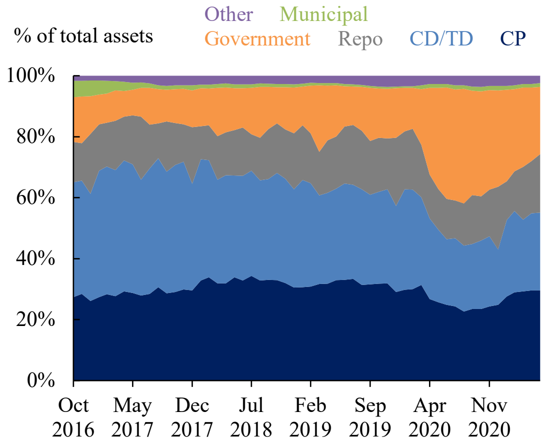
[7] *See* rule 2a-7(a)(28).

[8] *See*, Baklanova, Kuznits, and Tatum "Prime MMFs at the Onset of the Pandemic" SEC Staff Analysis (April 2021).

Investments in government securities and repos account for the majority of liquid assets

Since October 2016, when the last round of the 2014 MMF reforms was implemented, prime MMFs, on average, have allocated approximately 29% of their investments to CP and 31% to banks' CD or TD (Figure 3). During the same period, prime MMFs typically invested approximately 16% of their assets in repos and 19% of their assets in government securities. The share of government securities in prime MMFs increased during the pandemic, reaching an all-time high of 38% of these funds' portfolios in August 2020.

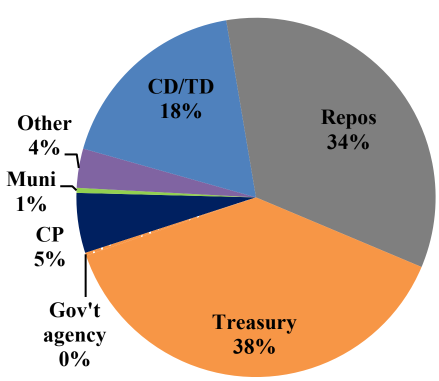
Figure 3: Prime MMF portfolios comprise mainly CP, bank obligations, repos, and government securities



Source: Form N-MFP

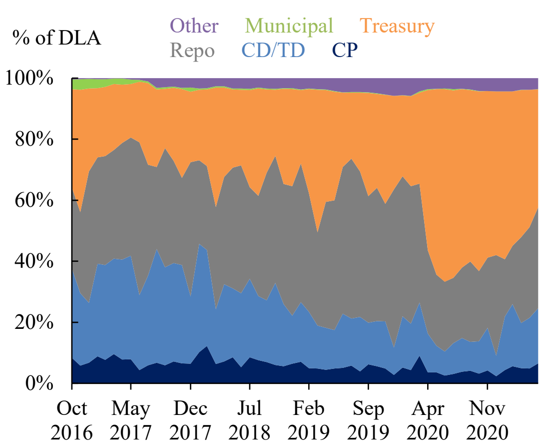
Prime MMFs typically invest in repos and Treasury securities to meet the majority of their DLA requirements, given that most repo investments have overnight maturities and, as explained above, Treasury securities are considered daily liquid assets. Since October 2016, prime MMFs have invested an average of 72%, of their DLA in repos and Treasury securities (Figure 4).[9] At the onset of the pandemic, the share of Treasury securities in DLA increased and reached an all-time high of 63% of prime MMF portfolios in June 2020, while the share of repos declined to 23%, below the historical average (Figure 5). On the other hand, even though prime MMFs invest a larger part of their assets – 61%, on average – in CP and banks' CD or TD, these assets account for less than a quarter of DLA.

Figure 4: Investments in Treasury securities and repos account for 72% of prime MMFs' DLA



Note: percentages are based on average monthly allocations to each asset type since October 2016
Source: Form N-MFP

Figure 5: The share of Treasury securities in prime MMFs' DLA increased sharply during the pandemic



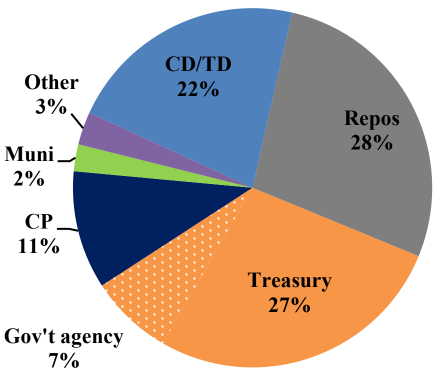
Source: Form N-MFP

Prime MMFs' investments in Treasury and government agency securities account, on average, for 35% of these funds' WLA (Figure 6). Investments in repos account for 28% of WLA, on average. Similar to the DLA observations, the share of government securities prime MMFs used as WLA increased during the pandemic, reaching an all-time high of 59% in June 2020 (Figure 7). CP and banks' CD or TD account, on

[9] *See*, Baklanova, Kuznits, and Tatum "Primer: Money Market Funds and the Repo Market" SEC Staff Analysis (February 2021).

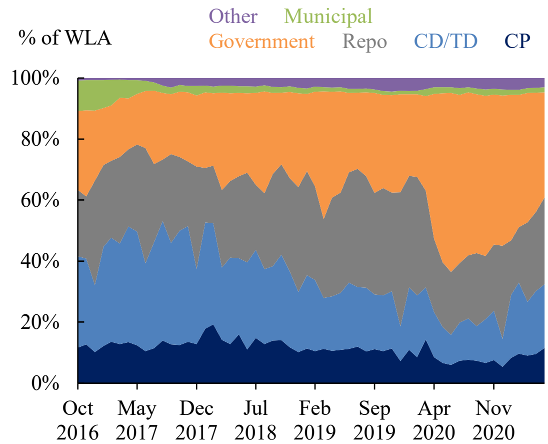
average, for 33% of prime MMFs' WLA. In 2020, amidst the pandemic, prime MMFs reduced the use of CP and banks' CD or TD for WLA purposes well below the historical average, reaching an all-time low of 5% of WLA (for CP) and 9% of WLA (for CD and TD) in December 2020.

Figure 6: Investments in repos, Treasury and government agency securities account for 62% of prime MMFs' WLA



Note: percentages are based on average monthly allocations to each asset type since October 2016
Source: Form N-MFP

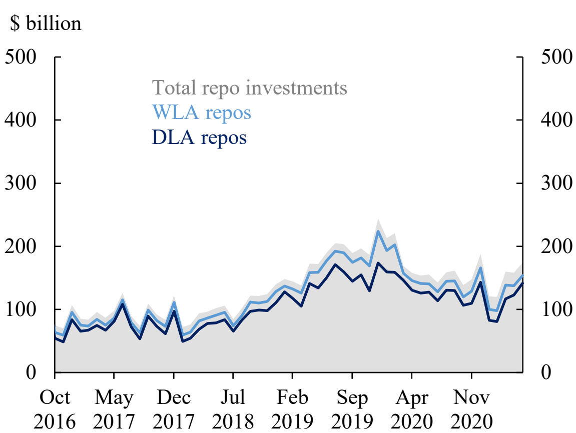
Figure 7: The share of government securities in prime MMFs' WLA increased sharply during the pandemic



Source: Form N-MFP

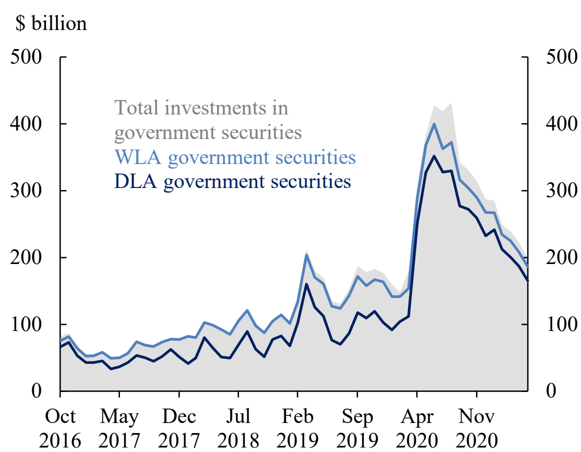
The data show that nearly all prime MMF investments in repos have historically been used to meet DLA and WLA thresholds (Figure 8). In addition, most prime MMF investments in government securities are used as WLA (Figure 9). In contrast, only a small portion of total CP investments by prime MMFs are used as DLA (5% of the total CP investments, on average) and WLA (11% of the total CP investments, on average) (Figure 10). Lastly, only 18% of prime MMF investments in banks' CD and TD, on average, are used as DLA and 22% of these investments, on average, are used as WLA (Figure 11).

Figure 8: Nearly all prime MMFs' repo investments are used as DLA and WLA



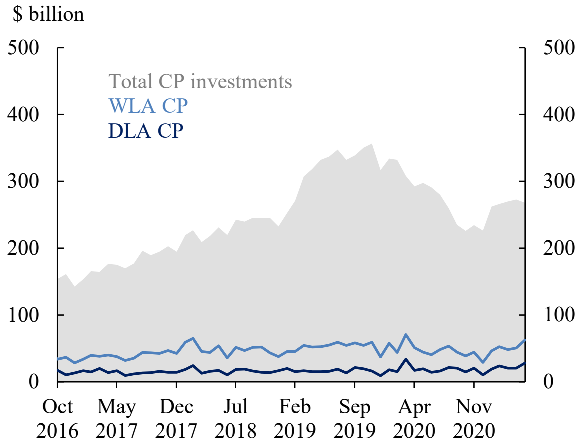
Note: repos back by all types of collateral are included.
Source: Form N-MFP

Figure 9: Nearly all prime MMFs' investments in government securities are used as WLA



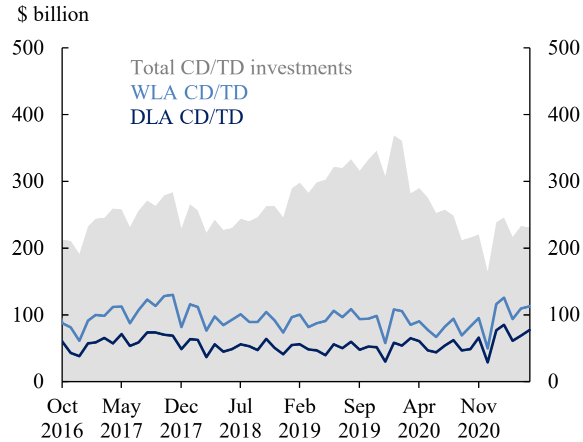
Source: Form N-MFP

Figure 10: Only a limited amount of prime MMFs' CP investments are used as DLA or WLA



Source: Form N-MFP

Figure 11: Historically, around a quarter of prime MMFs' CD/TD investments have been used as WLA



Source: Form N-MFP