Americans for Financial Reform Education Fund

April 11, 2022

Vanessa A. Countryman
Securities and Exchange Commission
100 F St NE
Washington, DC 20549

Re: Money Market Reforms (File No: S7-22-21)

Secretary Countryman,

The Americans for Financial Reform Education Fund appreciates this opportunity to comment on the Securities and Exchange Commission's (the "Commission") proposal to reform the $4.64 trillion Money Market Mutual Fund (MMMF) market[1] which has had to be bailed out by policymakers twice in the last 12 years.

As the sudden outflows from Money Market Mutual Funds in March 2020 and September 2008 have shown, MMMFs are higher-yielding alternatives to bank deposits, but in times of economic stress face the possibility of capital losses because they are primarily invested in illiquid, short-term securities and are not insured by the Federal Deposit Insurance Corporation (FDIC).

Money market mutual funds have received significant inflows as bank deposit-like substitutes over the past few decades due in large part to the lighter regulatory requirements they are subject to compared to banks. However, in March 2020, after the second bailout in just 12 years, via the Federal Reserve's Money Market Mutual Fund Liquidity Facility, it has become apparent that MMMFs have been unfairly benefitting from an implicit government guarantee without being subject to FDIC and Global Systemically Important Bank (G-SIB) surcharges that the banks with which they compete must pay for.

To create more resilient Money Market Mutual Funds, the Commission should amend Rule 2a-7 and require higher liquidity buffers, extend floating Net Asset Values (NAVs) to government funds, implement swing pricing to end the incentives for investors to be the first to sell, and expand Form N-CR reporting to better disclose fund returns from special, temporary sources.

Greater liquidity buffers will better protect fund investors

[1] Investment Company Institute. Money Market Mutual Fund Assets. Jan 27, 2022. https://www.ici.org/research/stats/mmf

We support the Commission's proposed changes to Rule 2a-7 that would raise MMMF's daily liquidity buffers to 25% of total assets from 10% and weekly liquidity buffers to 50% from 30%.

These thresholds would have withstood the worst of the market volatility. As the Commission notes, he largest weekly redemption experienced by an institutional prime fund in March 2020 was 55% while the largest daily outflow was 26%. As the Commission highlights, following the volatility MMMFs experienced in March 2020, average daily liquid assets rose to 44% and weekly liquid assets to 56% showing these thresholds are also reasonable.

Liquidity fees and redemption gates will only amplify runs in times of stress

We also support the Commission's proposals to remove liquidity fees and suspend redemption gates as concerns over their imposition may only encourage already nervous investors to proactively redeem from Money Market Mutual Funds.

If the Commission amends Rule 2a-7 to raise the daily and weekly liquidity buffers of MMMFs, making them more resilient under stressed conditions, there is little need to impose additional liquidity fees and redemption gates.

Prime funds that were offered to institutional investors such as pension funds, insurance companies, and hedge funds in particular saw some of the heaviest preemptive withdrawals in March 2020. Even though a number of those funds had weekly liquid assets greater than the 30% threshold where funds could suspend redemptions, analysis from the President's Working Group in December 2020 suggested that investor concerns over their investment being locked up for 10 days drove many to redeem.[2] As a result $125 billion were withdrawn from U.S. prime money market funds in March, representing 11% of those total assets under management.

Because a major appeal of Money Market Mutual Funds is the ability to immediately redeem them for cash without incurring costs or penalties – unlike other short-term instruments where redemptions bear costs, such as Certificates of Deposits (CDs) and illiquid commercial paper - the threats of redemption gates and liquidity fees can perversely incentivize MMMF investors to redeem first and ask questions later.

Floating NAVs should be implemented across all MMMFs

A major recurring problem for Money Market Mutual Funds stems from the mismatch between the stable price the funds offer to their investors and the fluctuating value of the underlying assets.

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[2] President's Working Group on Financial Markets. Overview of Recent Events and Potential Reform Options for Money Market Funds. December 2020. https://home.treasury.gov/system/files/136/PWG-MMF-report-final-Dec-2020.pdf

At their core, Money Market Mutual Funds are engaging in liquidity transformation by investing in assets such as commercial paper that can be illiquid and sometimes take days to sell while offering their own investors instant liquidity.

While in calm markets, the ability for investors in government MMMFs to redeem at a stable share price (usually $1.00) is an attractive feature, by instead subjecting them to the same floating NAVs as prime and municipal funds were subject to on October 2016 investors can more clearly understand that they are investing in an asset whose underlying portfolio fluctuates daily rather than a bank deposit.

Some MMMF investors may be uncomfortable with floating NAVs, especially retail investors, but floating NAVs make clear the differences between MMMFs and bank deposits leaving investors better informed about the tradeoffs between higher yields and the certainty of an insured deposit account.

Swing pricing should be implemented to disincentivize large early withdrawals

We support the Commission's move to implement partial swing pricing which would allow MMMF managers to adjust their fund's NAVs to incorporate the effect a large seller would have on the remaining investors in the fund.

In highly volatile markets, it is likely that many MMMFs will be trying to sell similar assets at the same time and early sellers benefit from being able to sell at the initial NAV because that NAV does not reflect the costs of the managers having to sell additional assets at discounted prices to meet additional redemptions.

Similar to the fears of redemption gates, MMMF investors may be concerned about absorbing the costs of a manager's sudden forced sales and preemptively decide to try and sell first, in the process creating a feedback loop of selling even though the funds have ample capital to meet redemption requests.

Partial swing pricing, where NAV adjustments are only applied when transactions are made over a certain threshold compared to full swing pricing where the NAV is adjusted for all transactions, leaves investors the flexibility to redeem some capital that they may immediately need while still discouraging large preemptive redemptions.[3]

Swing pricing has found success in Europe where sell orders must be received by noon Central European Time (CET) to give the fund manager four hours from when the NAV is set to match sell orders with any buy order and accurately assess the impact of the any additional sales it

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[3] Vanguard. Why Vanguard is moving to partial swing pricing. May 20, 2019. https://www.vanguardinvestor.co.uk/articles/latest-thoughts/how-it-works/swing-pricing

would still need to conduct on its portfolio. It is worth noting that MMMFs in Europe managed to handle the market volatility seen in March 2020[4]

However, to properly implement swing pricing, existing structural considerations must be carefully considered, including the situation of investor intermediaries such as 401K plan administrators who currently have agreements in place to process redemption requests at a fund's NAV as of 4PM Eastern Time. Under swing pricing, such arrangements would certainly need to be modified across all of the various financial intermediaries who provide capital to Money Market Mutual Funds.

For this reason, in implementing partial swing pricing, we strongly urge the Commission to coordinate with the Department of Labor on its own set of rules regarding retirement plan investments in MMMFs to ensure the issues around implementation are adequately addressed.

SEC's Form N-CR needs to include disclosure of utilization of special programs

Finally, the Commission should consider including additional disclosures over Form N-CR to provide investors with greater clarity about how much of the fund is invested in special programs that may be temporary and later replaced.

Investors and regulators should be able to clearly see how much a MMMF depends on external sources of support to operate. This is because MMMFs in the current, benign low interest rate environment continue to rely on facilities operated by the Federal Reserve. This comes after MMMFs already had to borrow $58 billion under the Money Market Mutual Fund Liquidity Facility in 2020 and $200 billion under the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF) in 2008.[5]

J.P. Morgan's Fixed Income strategists estimate that prime MMMFs, at the end of November 2021, allocated 16% of their portfolio into the Federal Reserve's Overnight Reverse Repo Facility[6] that was adjusted on June 16, 2021 to pay 0.05% from 0%.

Given that Form N-CR currently requires MMMFs to report portfolio defaults, implementation of liquidity fees or redemption gates, and other affiliates of the fund sponsor providing financial support to the fund, it would be logical for the Commission to extend reporting to include other external sources so that investors have clear information on how much MMMFs rely on special benefits such as those from the Federal Reserve's Overnight Reverse Repo Facility.

Such disclosures over Form N-CR would help investors understand the extent to which their managers are hard pressed to find adequate liquid assets in a low interest rate environment. As

[4] Kashyap, Anil; Kohn, Donald, and Wessel, David. Brookings Institute. What is swing pricing? Aug 3, 2021. https://www.brookings.edu/blog/up-front/2021/08/03/what-is-swing-pricing/

[5] Anadu, Kenechukwu et al. Federal Reserve Bank of Boston. The Money Market Mutual Fund Liquidity Facility. Sep 27, 2021. https://ssrn.com/abstract=3951479

[6] Roever, Alex et al. J.P. Morgan. US Fixed Income Strategy. Dec 17, 2021.

J.P. Morgan's strategists have suggested, higher liquidity requirements under the Commission's proposal could lead to MMMFs pledging more of their liquid assets into the Federal Reserve's Overnight Reverse Repo Facility. Therefore, investors should have a sense of how much MMMFs would have to seek other sources of returns if such temporary programs ended.

Clearly, several short-term market participants have become more reliant on the Overnight Reverse Repo Facility as evidenced by the $250 billion additional capital that flowed into the facility overnight following its 5 bps increase to reach $755 billion. Since then that amount has only gone higher with $1.45 trillion pledged at the end of November[7] and hitting a peak of $1.9 trillion at the end of 2021.[8]

Conclusion

The Commission's proposals to reform Money Market Mutual Funds under changes to Rule 2a-7 will better inform and protect investors.

AFREF specifically recommends:

- Raise the weekly liquidity buffers to 50% of total assets from 30% and daily liquidity buffers to 25% from 10%, thresholds which would have withstood the volatility in March 2020
- Remove redemption gates and liquidity fees to prevent MMMF investors, who primarily value having immediate access to their capital, from preemptively redeeming in times of market stress
- Require all MMMFs including government funds to float their Net Asset Values (NAVs) to remind investors that in exchange for the higher yields, MMMFs are not equivalent to bank deposits and have portfolios that fluctuate in value
- Coordinate with the Department of Labor in implementing partial swing pricing, allowing small orders to be processed, while discouraging a first mover advantage in larger redemptions, or encouraging larger orders to be spread out over a longer period of time
- Expand required disclosures under Form N-CR to require MMMFs to report how much of their fund's assets that are dependent on special programs such as the Federal Reserve's Overnight Reverse Repo Facility whose terms are subject to change in the future

We appreciate the Commission's consideration of these important matters. For further discussion, please contact Andrew Park at andrew@ourfinancialsecurity.org.

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[7] Fulmer, Sean. Yale School of Management. The Federal Reserve Remains Unconcerned As Usage of its Reverse Repo Facility Approaches $1 Trillion. Jul 23, 2021. https://som.yale.edu/blog/the-federal-reserve-remains-unconcerned-as-usage-of-its-reverse-repo-facility-approaches-1-trillion

[8] Federal Reserve Bank of St. Louis. Federal Reserve Economic Data. Overnight Reverse Repurchase Agreements: Treasury Securities Sold by the Federal Reserve in the Temporary Open Market Operations. Jan 28, 2022. https://fred.stlouisfed.org/series/RRPONTSYD

Sincerely,

Americans for Financial Reform Education Fund