Statement

Statement on Proposed Money Market Fund Reforms

Commissioner Allison Herren Lee

Dec. 15, 2021

Today, the Commission is once again proposing reforms for money market funds after once again observing vulnerability in these products during times of financial market stress -- this time during the events in March 2020 at the beginning of the pandemic.[1] The 'dash for cash' that occurred at that time put severe stress on these funds and prompted federal intervention in the form of a backstop for the second time in just over a decade.[2]

It is clear that money market funds continue to raise both investor protection and market stability concerns. And while I support the success of these products, and I preliminarily support today's proposed reforms, I look forward to reviewing public comment on how best to address the complex challenges these products pose.

Since their creation in the 1970s, money market funds have grown and evolved to become an integral part of wholesale funding markets.[3] They serve a variety of roles within the financial system and are held by a broad swath of investors – businesses, non-profits, 401(k) plans, and many others.[4] The growth in size of this asset class has been notable, expanding from roughly $2 billion in the mid-1970s to roughly $4.6 trillion today.[5] They serve as a critical source of financing to a variety of borrowers, and have also been large investors in the commercial paper market.[6] These funds are generally designed to provide principal stability and liquidity, and frequently serve as short-term cash management vehicles for investors.[7] As a result, money market fund investors have been considered to be generally less tolerant than other mutual fund investors to incurring even small losses.[8]

But, of course, these funds are indeed capable of incurring losses, and they suffer from inherent structural vulnerabilities. Thus, the Commission engaged in an analysis of the money fund rules in the aftermath of the 2008 financial crisis when the Reserve Primary Fund "broke the buck," prompting widespread redemptions and prompting the Federal Reserve to step in and create a liquidity facility to support credit supply.[9]The 2010 reforms were largely designed to enhance liquidity and create more transparency for the public and the Commission about a money market fund's holdings.[10]

Those reforms were tested in March 2020 when money funds were under stress again.By that time, the Commission had completed additional reforms in 2014, subjecting the funds to valuation and risk-limiting regulations – such as the requirement for institutional prime and institutional tax-exempt funds to use a "floating" net asset value.[11]Perhaps even more significant than the floating net asset value requirement, the Commission gave funds tools to stem heavy redemptions with liquidity fees and redemption gates. Commissioner Stein (and others) expressed concern at that time about the use of fees and gates in this way, noting that the possibility of a redemption gate could instead *incentivize* investors to redeem ahead of others.[12] Her concerns proved largely correct.

As uncertainty about the pandemic loomed, investors sought stability and capital preservation by moving into cash and short-term government securities.[13] This created severe pressure in short-term funding markets, and investors sought heavy redemptions in institutional prime and tax-exempt money funds.[14]In fact, the potential imposition of fees and gates as a result of decreases in fund liquidity appeared to fuel redemption behavior.[15]

Hence today's proposal is a necessary continuation of our focus on addressing weaknesses of these funds, and providing investors and markets with key information about them. I'd like to highlight three significant areas of today's reforms: increasing liquidity thresholds, removing the fees and gates requirements, and an obligation for certain funds to use swing pricing they have net redemptions.[16]

I look forward to comment in each of these areas. Specifically, I'm interested in the foreseeable impacts of swing pricing. Will it disincentivize first movers to help stem a run as contemplated? How might it impact investor choice?

In addition, I'm pleased to see the proposal includes a requirement to notify both boards and the public when liquidity drops below certain thresholds. Broadly, the idea is not to discourage the use of liquidity in times of stress, but to offer transparency once significant amounts of liquidity have been drained (essentially once half of the liquidity reserves have been utilized). But, is that enough? Should the Commission require reporting *whenever* a fund's liquidity drops below the regulatory requirements? Are investors likely to overreact to such reporting or would the increased transparency help them make better decisions? These are just a few of my questions – and I welcome the public's views and robust, data-driven analysis and comment on all of the questions in today's proposal.

Finally, before I conclude my remarks today, I want to thank the staff in the Division of Investment Management, the Division of Economic and Risk Analysis, and the Office of the General Counsel– some of whom have worked on money fund reform for over a decade. You have been tireless and astutely inquisitive in developing today's recommendations. I greatly appreciate your continued dedication to developing a strong regulatory framework so that money market funds can better withstand inevitable future market stresses.

Thank you.

---

[1] *See infra* text accompanying nn.13-15.

[2] *See, e.g.*, Press Release, U.S. Department of Treasury: Treasury Announces Temporary Guaranty Program for Money Market Funds (Sept. 29, 2008), *available at* https://www.treasury.gov/press-center/press-releases/Pages/hp1161.aspx; Press Release, Federal Reserve Board announces establishment of a Commercial Paper Funding Facility (CPFF) to support the flow of credit to households and businesses (Mar. 17, 2020), *available at* https://www.federalreserve.gov/newsevents/pressreleases/monetary20200317a.htm (CPFF will provide a "liquidity backstop to U.S. issuers of commercial paper" as a result of the strain on the commercial paper market in March 2020).*See also* Federal Reserve Policy Tool, Money Market Mutual Fund Liquidity Facility, *available at* https://www.federalreserve.gov/monetarypolicy/mmlf.htm (establishing the Money Market Mutual Fund Liquidity Facility on March 18, 2020 in an effort to enhance market functioning and flow of credit to the economy).

[3] Protecting Investors: A Half Century of Investment Company Regulation (May 1992), at 506, *available at* https://www.sec.gov/divisions/investment/guidance/icreg50-92.pdf (providing a high-level description of the process through which money market funds were borne).

[4] *See* ICI Report of the COVID-19 Market Impact Working Group: Experiences of US Money Market Funds During the COVID-19 Crisis (Nov. 2020) ("2020 ICI Report"), at Figure 3.2, *available at* www.sec.gov/comments/credit-market-interconnectedness/cll10-8026117-225527.pdf.Money market funds typically invest in short-term assets.*See, e.g.*, 2020 ICI Report, at Figure 3.3; Federal Reserve Money Market

Funds: Investment Holdings Detail (Oct. 1, 2021), *available at* https://www.federalreserve.gov/releases/efa/efa-project-money-market-funds-investment-holdings-detail.htm. *See, e.g.*, Matthew P. Fink, The Rise of Mutual Funds: An Insider's View (Jan. 2011), at 80-82.

[5] ICI Money Market Fund Assets (Dec. 9, 2021), *available at* https://www.ici.org/research/stats/mmf; 2020 ICI Report, at 3 (noting that in 1980, assets in money market funds totaled $75 billion and by 2020, they exceeded $4.6 trillion).*See also* Matthew P. Fink, The Rise of Mutual Funds (Jan 2011), at 82 (noting that money market fund assets went from less than $2 billion in 1974 and exceeded $3 trillion in 2007).

[6] *See, e.g.*, 2020 ICI Report, at 6 (noting that "[p]rime money market funds provided $432 billion in financing to businesses and financial institutions through holdings of commercial paper ($213 billion; 21 percent of commercial paper outstanding) and CDs ($217 billion; 12 percent of CDs outstanding), and Eurodollar deposits ($2 billion).").

[7] *See* 2020 ICI Report, at 6 (noting that "[m]oney market funds provide the bulk of their funding to the federal government. As of June 2020, money market funds had assets of $4.6 trillion. Of that, $4.1 trillion (88 percent) was in short-term US Treasury securities, US agency debt, and repos, most of which is collateralized by US government securities").*See also* Financial Stability Board, Final Report: Policy Proposals to Enhance Money Market Fund Resilience (Oct. 11, 2021), at 13 (*available at* https://www.fsb.org/wp-content/uploads/P111021-2.pdf). ICI Report of the Money Market Working Group (Mar. 17, 2009) ("2009 ICI Report"), at 15, *available at* https://www.ici.org/system/files/attachments/pdf/ppr_09_mmwg.pdf.

[8] Money Market Fund Reform; Amendments to Form PF, Investment Company Act Release No. 31166 (July 23, 2014) [79 FR 47735 (Aug. 14, 2014)] ("2014 Amendments"), at text accompanying n.34, *available at* https://www.sec.gov/rules/final/2014/33-9616.pdf.*See also* 2009 ICI Report, at 15; Patrick E. McCabe, The Cross Section of Money Market Fund Risks and Financial Crises (Sept. 12, 2010), at 6, *available at* https://www.federalreserve.gov/pubs/feds/2010/201051/201051pap.pdf, (noting that "[b]ecause of the relative safety of their portfolios and sponsors' practice of absorbing losses when they have occurred, MMFs are usually recipients of flight-to-quality *inflows* during periods of high uncertainty and market turmoil.").

[9] *See, e.g.*, Press Release, U.S. Department of Treasury: Treasury Announces Temporary Guaranty Program for Money Market Funds (Sept. 29, 2008), *available at* https://www.treasury.gov/press-center/press-releases/Pages/hp1161.aspx.*See also* 2014 Amendments, at pp.29-32.

[10] Money Market Fund Reform, Investment Company Act Release No. 29132 (Feb. 23, 2010) [75 FR 10060 (Mar. 4, 2010)], *available at* https://www.sec.gov/rules/final/2010/ic-29132.pdf. *But see* Statement of SEC Chairman Mary L. Schapiro on Money Market Fund Reform (Aug. 22, 2012), *available at* https://www.sec.gov/news/press-release/2012-2012-166htm (stating that the three Commissioners at the time would not support a proposed structural reforms to money market funds that were intended to "reduce their susceptibility to runs, protect retail investors and lessen the need for future taxpayer bailouts").

[11] The floating NAV requirement was designed to disincentivize heavy redemptions in times of market stress.*See* 2014 Amendments, at Section III.B.

[12] Statement of Commissioner Kara M. Stein (Jul. 23, 2014), *available at* https://www.sec.gov/news/public-statement/2014-07-23-open-meeting-statement-kms (noting that "while a gate may be good for one fund because it stops a run in that fund, it could be very damaging to the financial system as a whole").

[13] Report of the President's Working Group on Financial Markets: Overview of Recent Events and Potential Reform Options for Money Market Funds (Dec. 2020) ("2020 PWG Report"), at 11, *available at* https://home.treasury.gov/system/files/136/PWG-MMF-report-final-Dec-2020.pdf.

[14] Staff of the Division of Investment Management, Primer: Money Market Funds and the Commercial Paper Market (Nov. 9, 2020), at 2, *available at* https://www.sec.gov/files/primer-money-market-funds-commercial-paper-market.pdf (discussing the commercial paper market in March 2020, and particularly noting that money market funds may have decreased their commercial paper holdings due to anticipated investor redemptions).*See also*

2020 PWG Report, at 14 (noting that “[a]mong institutional prime MMFs offered to the public, outflows as a percentage of fund size exceeded those in the September 2008 crisis.”).

[15] Shelly Antoniewicz, Previous Reform Made Prime Funds Less Resilient This Time Around, (Apr. 21, 2021), at 3, *available at* https://www.ici.org/system/files/2021-05/21_view_covid_mmf2_print.pdf (noting that “respondents to the ICI’s survey reported that a major factor for accessing the MMLF was to bolster their prime funds’ weekly liquid asset ratios—keeping them well above the 30 percent tripwire.”).*See also* 2020 PWG Report.

[16] Today’s reforms also include recommendations to specify calculations for “dollar-weighted average portfolio maturity” and “dollar-weighted average life maturity,” require money market funds to file reports on Form N-CR in a structured data language, and require money market funds to disclose more information about the composition and concentration of their shareholders.