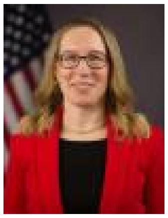
# Statement on Money Market Fund Reforms



**Commissioner Hester M. Peirce**

**Dec. 15, 2021**

I thank the staff of the Divisions of Investment Management ("IM") and Economic and Risk Analysis ("DERA") and the Office of the General Counsel for their hard work on this release and on money market mutual fund issues over the years. The March 2020 COVID-instigated market crisis renewed public and regulatory interest in money market funds. In the almost two years since, the Division of Investment Management has been at the center of the discussion—including by contributing to last year's President's Working Group ("PWG") report.[1] Members of the IM staff, along with their colleagues in DERA, have pored over the PWG's findings and recommendations, as well as the more than 50 comment letters[2] generated by the Commission's February request for comment.[3] Under greater than usual pressure, brought on by heightened public interest and aggressive deadlines, the staff has produced a thoughtful recommendation. I cannot support today's proposal, however, because it suffers from the same flaw as the existing rule: too much regulatory prescription and too little room for experimentation by funds.

The proposal does include one important reform: eliminating the link between a liquidity threshold and fees and gates. Hindsight being what it is, the folly of the link seems obvious, but I did not anticipate when the Commission adopted the rules making the availability of fees and gates contingent on breaching the liquidity threshold that investors would react as they did in March 2020—redeeming as the funds neared the threshold allowing the imposition of fees and gates. Accordingly, to promote money market fund stability during times of market stress, I support the proposed removal of this link from Rule 2a-7.

The rest of the proposal, however, could undermine the objective of making money market funds more resilient. Not only would the proposal remove the link between the liquidity threshold and fees and gates, it would limit funds' ability to use these tools as they deem appropriate. As proposed, a fund could only suspend redemptions as part of winding down the fund, and a fund's board would be restricted from imposing redemption fees of more than 2% of the value of shares redeemed, pursuant to rule 22c-2. In addition, the proposed amendments would *increase* the daily and weekly liquid asset minimums to 25% and 50% respectively, up from their current levels of 10% and 30%, and put in place a breach reporting regime when a fund falls below half of its daily and weekly liquid asset minimums. Will the desire to remain on the right side of these high regulatory thresholds cause funds to sell illiquid securities during times of stress, as some did during March 2020? Will anxious shareholders get skittish and redeem as funds near these arbitrary thresholds?

The proposal also would require a complex mandatory swing pricing regime for institutional prime and institutional tax-exempt money market funds. Swing pricing is supposed to result in redeemers bearing the costs associated with their redemptions during times of market stress, but commenters question the efficacy of swing pricing. One commenter, for instance, questioned whether swing pricing's effect on a money market fund's net asset value would be large enough to move the needle on an investor's decision to redeem -- a point augmented by the fact that investors will have no foreknowledge of when swing pricing might be activated.[4] Further, this same commenter suggested that having to bear a portion of remaining investor costs would have no effect on redemption behavior.[5] The proposed version of swing pricing—with its market impact factors—may differ from what commenters envisioned, but I remain unconvinced that the addition of complexity and subjectivity to swing pricing calculations will succeed in altering investor decision making. Commenters also pointed to the real operational difficulties associated with swing pricing,[6] something today's release also acknowledges.

The proposal, if finalized in its current form, likely would continue the trend of driving more money into government funds. Doing so may serve the government's need for a buyer for its securities, but would leave investors, issuers of commercial paper, and markets worse off.

My preferred approach to addressing money market funds' vulnerability to redemptions during times of market stress is to let funds and investors find a model that works for them. Instead of higher thresholds and prescriptive mandates, the Commission could propose a more principles-based approach. Such a rule would allow fund managers, and in turn, investors, to decide the best approach or combination of approaches to increasing money market fund resilience. For example, some might implement swing pricing; others might choose liquidity fees and gates; others might find ways to reward non-redeeming shareholders; and others might opt for contractual share reductions, a method this proposal would forbid. The resulting heterogeneity would allow for market choice, enable us to see what works, and make the financial system more resilient by diminishing the likelihood that problems at one money market fund would spill over to other funds, which in turn might reduce the urge of those in government to rush in with industry-wide rescues. George Mason University economist Lawrence White said it well when he observed that "[t]he goal of a robust financial system calls for a diverse ecosystem of mutual funds, not a monoculture that is susceptible to a single disease. Top-down restrictions promote a monoculture."[7]

A principles-based approach puts the responsibility for fund resilience where it belongs—with the fund and its shareholders. By contrast, some might assume that an approach that relies on regulatory micromanagement comes with a promise of government support if the regulator's design proves faulty under market stress.

I appreciate that the proposal includes alternative approaches and many questions, which should make for a productive comment period. I look forward to learning from the wisdom of the commenting public and to continuing my discussions with my colleagues and the staff in Investment Management and DERA. I am always open to revising my position based on what I learn.

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[1] The Report is appended to the Commission's release (*infra* note 3) and also is available on the Treasury Department's website at home.treasury.gov/system/files/136/PWG-MMF-report-final-Dec-2020.pdf.

[2] Comments are available at https://www.sec.gov/comments/s7-01-21/s70121.htm.

[3] *See* Request for Comment on Potential Money Market Fund Reform Measures in President's Working Group Report, Release No. IC-34188 (February 4, 2021), available at https://www.sec.gov/rules/other/2021/ic-34188.pdf.

[4] Letter of Fidelity Management and Research Company LLC to the Secretariat of the Financial Stability Board (Aug. 16, 2021), P.20 https://www.fsb.org/wp-content/uploads/Fidelity.pdf ("Even in periods of stress, we do not believe that the swing factor would move the NAV by an amount sufficient to deter redemptions.").

[5] *Id*. ("In our experience managing a wide array of U.S. money market funds for more than 45 years and interacting directly with investors through our broad and extensive distribution businesses, investors in U.S. money market funds are not motivated to redeem by the potential for bearing a portion of the costs that others' redemption behavior may impose on the fund.").

[6] One commenter, for instance, stated that funds will be unable "to receive and review complete daily investor flow information in sufficient time to know, or make reasonable high confidence estimates of, investor activity to determine if a fund's NAV should be swung." Comment Letter of Fidelity Management & Research Company LLC

(Apr. 12, 2021), Pp.28-9 https://www.sec.gov/comments/s7-01-21/s70121-8662947-235324.pdf. As other commenters have pointed out, for money market funds that offer pricing multiple times a day and same-day settlement – features that are critical to corporate and other institutional investors using these funds to manage daily operating cash or meet payroll, for instance – swing pricing may make it impossible for these funds to meet basic institutional investor needs. *See, e.g.*, Comment Letter of the Investment Company Institute (April 12, 2021), P.20 https://www.sec.gov/comments/s7-01-21/s70121-8662926-235321.pdf.

[7] Lawrence H. White, "Money-Market Mutual Funds: Restrictions, Run-Proofing, and Regulatory Pretense," Cato Institute – Cato At Liberty, March 1, 2016, 10:18 a.m., https://www.cato.org/blog/money-market-mutual-funds-restrictions-run-proofing-regulatory-pretense. Accessed December 13, 2021.