CENTER FOR CAPITAL MARKETS COMPETITIVENESS

April 12, 2021

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Potential Money Market Fund Reform Measurers in President's Working Group Report – S7-01-21

Dear Ms. Countryman:

The Center for Capital Markets Competitiveness ("CCMC") is pleased to provide comments on the Request for Comment issued by the Securities and Exchange Commission ("SEC" or "Commission"), on "Potential Money Market Fund Reform Measurers in President's Working Group Report."

Money market funds (MMFs) exist for the ease of short-term cash management and investment and provide economic benefits to issuers and investors, including individuals, governmental entities, and businesses. As of September 30, 2020, total industry MMF net assets were $4.9 trillion, demonstrating the importance of these investment vehicles for the operation of short-term markets.[1]

For many businesses, including those that make up the membership of the U.S. Chamber of Commerce (the "Chamber"), MMFs are the preferred way to manage fluctuations in cash and to ensure adequate cash flow when needed. Businesses across the country benefit from MMFs in two ways—as an investment tool for working capital and as a market for the instruments they issue to finance short-term funding needs. Cash inflows and outflows don't always line up, and MMFs act as a financial intermediary in helping businesses offset these discrepancies.

When companies have a temporary cash shortfall, they often turn to short-term financing instruments, such as commercial paper to bridge the gap. MMFs are significant purchasers of commercial paper, making them a reliable and accessible source of short-term funding for companies. Commercial paper is typically used by companies for financing things like payroll, inventory, and meeting other short-term liabilities. Many businesses prefer commercial paper to bank loans for short-term financing because of the ease and efficiency in issuing commercial paper as well as the lower interest rate.

The Commission enacted amendments to Rule 2a-7 in 2010, with amendments in 2014with the objectives of making MMFs "more resilient to certain short-term market risks" addressing "risks of

[1] Overview of Recent Events and Potential Reform Options for Money Market Funds (Rep.). (2020, December). Retrieved https://home.treasury.gov/system/files/136/PWG-MMF-report-final-Dec-2020.pdf

investor runs in money market funds, while preserving the benefits of the funds."[2] From a financial stability standpoint, a primary policy objective was to prevent the need for public sector intervention to support liquidity in these markets.

The market volatility experienced in March 2020 was the first significant test of these rules' effectiveness. Despite the reforms, the Federal Reserve Board, with the support of the U.S. Treasury Department, intervened in short-term markets via liquidity facilities authorized under Section 13(3) of the Federal Reserve Act including the Money Market Mutual Fund Liquidity Facility (MMLF). The Chamber does not believe inadequate regulation of MMFs was central to the liquidity crisis experienced in short-term funding markets; however, we do believe modest reforms to financial regulation could improve investor confidence in financial markets.

The Financial Stability Board (FSB), on November 17, 2020, issued a report entitled "Holistic Review of the March Market Turmoil."[3] The FSB's report discusses the March 2020 market turmoil, the propagation of the market shock, and intervention by the public sector (e.g. central banks). The FSB's report mentions "some investors in open-ended investment funds may have faced incentives to redeem ahead of others," but, in general, takes a holistic review of short-term funding markets, including the role of the banking system and central counterparties. This stands in contrast to a report issued in by the President's Working Group on Financial Markets in December 2020.

In December 2020, the President's Working Group on Financial Markets issued a report on "Overview of Recent Events and Potential Reform Options for Money Market Funds" ("the Report"). The Report explains the importance of money markets to the U.S. financial system, analyzes the regulations imposed on MMFs, in 2010 and again in 2014, following the Global Financial Crisis (2007-2008) ("GFC"), calls for new reforms to MMFs, and discusses the likely costs and benefits of implementing such reforms. The SEC's request for information almost exclusively focuses on Rule 2a-7, in contrast to the holistic approach taken by the FSB.

The Chamber offers the following perspectives with the goal of ensuring that short-term funding markets, including MMFs, remain a viable source of liquidity for issuers and investors:

I. Role of money markets in U.S. financial system and views on regulations in response to Global Financial Crisis (GFC)

II. U.S. Regulators, including the SEC, should take a holistic approach to considering changes to short-term funding markets

III. Proposals to Improve Rule 2a-7 and Capital Requirements for Covered Banks

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[2] SEC Adopts Money Market Fund Reform Rules. (2014, July 23). Retrieved from https://www.sec.gov/news/press-release/2014-143 and
SEC Approves Money Market Fund Reforms to Better Protect Investors (2010, January 27). Retrieved from https://www.sec.gov/news/press/2010/2010-14.htm

[3] *Holistic Review of the March Market Turmoil* (Rep.) (2020, December 17). Retrieved from https://www.fsb.org/wp-content/uploads/P171120-2.pdf

IV. Concerns with Certain Proposals to Reform Rule 2a-7

I. Role of money markets in U.S. financial system and views on regulations in response to GFC

MMFs are a critical instrument for issuers in need of low-cost, short-term financing and investors interested in a low-risk investment return.

The Chamber expressed concerns when the Commission instituted new rules for MMFs in 2010 and then again in 2014. In general, the 2010 reforms required MMFs to publicly disclose portfolio holdings each month, introduced new liquidity requirements, and required funds to manage credit risks. The primary feature of the 2014 reforms was requiring all prime and tax-exempt funds available to institutional investors switch from a fixed net asset value (NAV) to a floating NAV.

MMFs are an important source of funding for the commercial paper markets. SEC staff issued a report as recently as November 2019 noting the significance of MMFs to the commercial paper market. In fact, MMFs on average, hold approximately 20% -- or $225 billion – of commercial paper.[4] The holding of commercial paper by MMFs has decreased from upwards of 40 percent as recently as 2012.[5] Many businesses prefer the option to issue commercial paper over bank loans, in many instances, because it permits them to reduce their counterparty credit risk.

The Report notes that MMFs have decreased their investment in commercial paper over the years, pointing to the increase in investment in government securities; however, it fails to point to the new regulatory requirements imposed on these funds. Therefore, the report effectively ignores the possibility of a causal relationship in the shift of assets out of prime MMFs that may have been caused by increased regulation under Rule 2a-7.

The Chamber urges caution in pursuing new regulation of money market mutual funds that is not guided by history and informed by all available facts. Specifically, the Commission should consider if changes to Rule 2a-7 will decrease the demand for certain MMFs, and where markets will reallocate capital.

II. U.S. Regulators, including the SEC, should take a holistic approach to considering changes to short-term funding markets

The SEC should avoid tunnel vision when considering reforms to short-term funding markets. Reforms to MMF regulation may be necessary to improve market functioning, but these reforms should be carefully considered as part of the broader regulatory structure for financial markets. The SEC should

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[4] *Financial Accounts of the United States: Flow of Funds, Balance Sheets, and Integrated Macroeconomic Accounts* (Rep.). (2020, First Quarter). Retrieved https://www.federalreserve.gov/releases/z1/20200611/z1.pdf

[5] *Money Market Funds: Helping Businesses Manage Cash Flow* (Rep.) (2013, September). Retrieved from https://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/17003_CCMC-Money-Market.pdf

promote a holistic review of short-term markets via its positions on the President's Working Group on Financial Markets, the Financial Stability Oversight Council (FSOC), and FSB.

The GFC confirmed the need for a holistic approach to financial regulation. Financial institutions, investors, and issuers are connected via various market mechanisms that permit for the allocation of credit and liquidity across our economy and are subject to supervision by the appropriate financial regulators. Reforms that view markets through regulatory silos will not meet the objectives of promoting a resilient financial system and the efficient allocation of capital.

The FSB's recently issued report, "Holistic Review of the Market Turmoil" is a well-informed and measured discussion of market challenges. Importantly, the report finds that, in contrast to the GFC, "the shock originated outside of the financial system" – this suggests that MMFs, and their regulatory structure, were in no way a *cause* of financial instability in March 2020. The report suggests reviewing G20 reforms implemented in response to the GFC; understanding the risks in nonbank financial intermediation and the interactions with the banking system; and, assessing policies to address systemic risks that do not compromise resiliency in other parts of the system or financing provided to the real economy.

As part of this review, the Chamber expects the FSB to consider if a reduction in the utility of certain MMFs, or a decrease in the number of size of funds due to the imposition of new regulations, would impact financial stability. This would inevitably mean that issuers and investors would move their activity to other types of MMFs (perhaps from institutional prime funds to government funds), bank products, or possibly outside of the regulated financial markets. An increase in demand for liquidity from banks, for example, could simply mean a shift in market activity from MMFs to credit products like term loans and lines of credit.

III. Proposals to Improve Rule 2a-7 and Capital Requirements for Covered Banks

The Chamber supports reforms to financial regulation that will promote liquidity in financial markets. We believe some modest reforms to MMF rules, that do not decrease their utility for issuers or investors, merit discussion. Additionally, we believe reforms to certain regulations governing capital and liquidity requirements in the banking system are essential to holistically support liquidity in short-term funding markets.

If the SEC determines that updates to Rule 2a-7 are warranted, the Chamber strongly recommends that they be narrowly applied to address funds that experienced demonstrable liquidity challenges in March 2020. There is evidence that institutional prime funds (for various reasons, including the tie between gates and fees discussed below) experienced the greatest outflows in March 2020. In fact, government MMFs performed well during the market volatility in March 2020 and experienced significant *inflows* as investors sought the liquidity and stability that government MMFs provide. In addition, prime funds available to retail investors (as opposed to those available to institutional investors) did not experience significant issues in March 2020. While some redemptions in these funds did occur, the funds were not under significant stress. Accordingly, we believe any reforms under consideration to Rule 2a-7 should not be applied to funds other than institutional prime.

a. Change Tie Between Gates Fees

The Chamber encourages the Commission to focus any review of MMF regulation on the removal of the tie between liquidity fee and redemption gate thresholds. We agree with the Report's assessment that, "Definitive thresholds for permissible imposition of liquidity fees and redemption gates may have the unintended effect of triggering preemptive investor redemptions as funds approach the relevant thresholds."

One of the reforms to Rule 2a-7 in 2014 authorized the boards of non-government MMFs to institute liquidity fees and redemption gates on investors to disincentivize runs.[6] These reforms were well-intentioned, but the regulatory linkage between the MMF's requirement to maintain 30 percent weekly liquid assets (WLA) and the imposition of redemption gates may have been a contributing factor to an unnecessary run on institutional prime MMFs in March 2020.

MMF boards have discretion to impose fees or gates when WLAs fall below 30 percent of total assets and generally must impose a fee of 1 percent if WLAs fall below 10 percent, unless the board determines that such a fee would not be in the best interest of the fund or that a lower or higher (up to 2 percent) liquidity fee is in the best interest of the fund. In practice, as experienced by market behavior in March 2020, these reforms created unintended issues for institutional prime funds.

The tie between gates and fees thresholds created a new "break the buck" mentality among some institutional investors despite the absence of actual liquidity risk. Staff at the Federal Reserve Bank of New York foresaw this possibility when it published research in 2014 entitled, *"Gates, Fees, and Preemptive Runs,"* finding that redemption gates could have the opposite effect as intended – they may actually encourage runs in some cases.[7] The conclusion of the report finds that, "Rules that provide intermediaries, such as MMFs, the ability to restrict redemptions when liquidity falls short may threaten financial stability by setting up the possibility of preemptive runs." The report also points out the possibility of behavior that may be economically irrational noting, "…given the similarity of MMF portfolios, is that a preemptive run on one fund might cause investors in other funds to reassess whether risks in their funds are indeed vanishingly small." Requiring the fund's board to meet when the 30% WLA threshold is breached caused investors confronting market uncertainty in March 2020 to be concerned about draconian redemption measures being imposed by the board despite the fund's relatively high liquidity and no requirements to impose gates and fees.

Reforms to Rule 2a-7 should improve the signaling about the board's intentions to investors. The Chamber strongly supports research by the SEC to better understand investor behavior regarding the possibility of fund boards imposing gates and fees. This research should inform changes to Rule 2a-7 that delink gates and fees.

b. Change Bank Capital and Liquidity Rules

We believe the SEC, via its positions on the President's Working Group on Financial Markets, FSOC, and FSB should emphasize the importance of a holistic review of the regulatory structure for

[6] SEC Adopts Money Market Fund Reform Rules. (2014, July 23). Retrieved from https://www.sec.gov/news/press-release/2014-143

[7] Cipriani, M., Martin, A., McCabe, P., & Parigi, B. (2014, April). Federal Reserve Bank of New York Staff Reports: Gates, Fees, and Preemptive Runs (Staff Report No. 670). Retrieved from https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr670.pdf

short-term markets. Changes to banking regulation, including more flexibility under the Liquidity Coverage Ratio (LCR), merit serious discussion as part of a holistic review.

We recognize bank capital regulation is outside the scope of the SEC and the Report, but believes it merits inclusion in a holistic discussion on reform of short-term funding markets. Banks play a central role as intermediaries and liquidity providers for commercial paper. In March 2020, banks understandably withdrew from short-term markets when faced with uncertainty and requirements to maintain their own capital and liquidity requirements. The FSB November 2020 report underscored the role of banks as market-makers and liquidity providers, and included discussion for possible causes, including regulation imposed after the GFC, for their retrenchment from short-term markets in March 2020. The FSB's report finds, "…Market-making capacity by banks may have become constrained… and reductions in risk appetite, regulatory constrains and operational challenges may have reduced dealers' capacity to intermediate larger flows in some core funding markets."[8]

In 2018, the Chamber authored a report that foresaw these challenges, in part, expressed concerns about some aspects of the new Basel capital standards being procyclical. For example, the capital conservation buffer is intended to be drawn down during a recession, and thus serve as a counter-cyclical tool, however, we argued, "current regulatory practice makes it unlikely that the buffer will be used for its intended purpose in a recession."[9] Federal banking regulators issued the following statement in March 2020, but banks chose to not breach their capital buffers, "The Board, FDIC, and Office of the Comptroller of the Currency (agencies) are encouraging banking organizations to use their capital and liquidity buffers as they respond to the challenges presented by the effects of the coronavirus."[10]

There is also evidence that banks' ability to serve as intermediaries and liquidity providers for short-term markets, including for commercial paper, were constrained by the LCR. The LCR requires covered banks to hold enough high-quality, liquid assets (HQLA) to cover projected net cash outflows over a 30-day stress period. In general, HQLA may include central bank reserves, government debt, corporate debt, and some municipal debt that can be easily and quickly converted into cash.

Federal banking regulators should amend the LCR to expand the definition of HQLA to include the highest rated commercial paper to improve bank intermediation in short-term funding markets. This would reduce disincentives for banks to intermediate in commercial paper markets without undermining their safety and soundness. Despite the prevalent market uncertainty in March 2020, commercial paper was redeemed at par just a few weeks later, suggesting there were no significant credit issues.

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[8] *Holistic Review of the March Market Turmoil* (Rep.) (2020, December 17). Retrieved from https://www.fsb.org/wp-content/uploads/P171120-2.pdf

[9] Angel, J. (fall 2018). Impact of Bank Regulation on Business Lending. U.S. Chamber of Commerce Center for Capital Markets Competitiveness. Available at https://www.centerforcapitalmarkets.com/wpcontent/uploads/2018/09/CCMC_RestoringSmallbizLendingReport_9.10.18-1.pdf

[10] Statement on the Use of Capital and Liquidity Buffers. (2020, March 17). Retrieved from https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20200317a1.pdf

IV. Concerns with Certain Proposals

The Report includes ten separate potential policy measures for MMFs. We are especially concerned with three of these policy measures given the attention they have been provided by some policymakers and the likelihood that they would all but eliminate the utility of MMFs. None of these three policy measures would solve the critical issue experienced by the money market industry in 2020 – namely, liquidity pressures in institutional prime funds. Because these three measures concern matters other than the amount and availability of liquidity in funds, none of these measures would have been effective in curtailing the pressures experienced in March 2020 had they been in place at the time.

a. Swing Pricing

We are concerned about the growing discussion of instituting "swing pricing" for MMFs. Swing pricing has recently been opined on in public speeches by policymakers and is the subject of discussion in the Report. Complete discussion, however, about the complexities of swing pricing, especially in U.S. markets, has yet to occur.

Swing pricing is intended to impose the fund's *trading costs* associated with an investor's redemption from a fund directly on that redeeming investor. The more overall shares that are redeemed from the fund, the costlier the redemptions. This is accomplished by reducing ("swinging" down) the fund's NAV when a certain percentage of shares are redeemed.

Federal Reserve Board Governor Lael Brainard recently gave a speech that, in part, touted the benefits of swing pricing. She stated, "swing pricing could be helpful, because it reduces the first-mover advantage for running from a fund by imposing a cost when redemptions are high."[11] We do not believe swing pricing would be effective for curtailing runs, but would impose substantial technical challenges.

Trading costs are minimal for securities held by MMFs. If there were a large wave of redemptions, the trading costs do not create any meaningful dilution in the funds. As a result, swinging the NAV by an amount based on trading costs would be relatively small. This "swing" in price would then need to be compared against an investor's desire to redeem shares. There would be relatively low disincentive given the increased desire to redeem shares in the face of relatively low increase in trading costs.

Instituting swing pricing in the U.S. would be a herculean technology infrastructure undertaking. It is unclear if fund sponsors, their custodians, transfer agents, broker-dealers and retirement plan recordkeepers would be interested in realizing enormous start-up costs and ongoing compliance costs. It is notable that non-money market U.S. mutual funds have had the option to implement swing pricing since the SEC adopted its swing pricing rule in 2016. However, to our knowledge, no U.S. mutual fund has done so to date because of the enormous obstacles that would need to be overcome, many of which would need to be solved by other companies (e.g. broker-dealers, retirement plan recordkeepers) that are unaffiliated with the fund sponsor. Furthermore, it bears mentioning that unlike in the European Union, as referenced by Governor Brainard, institutional prime funds offered in the U.S. strike their NAV's more than once per day. The Report is correct to point out that that swing pricing "could

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[11] Brainard, L. (2021, March 1). Some Preliminary Financial Stability Lessons from the COVID-19 Shock. Retrieved from https://www.federalreserve.gov/newsevents/speech/brainard20210301a.htm

lead to increased concentration and a reduction in the overall size of the MMF industry,"[12] which as we describe above, could increase the cost of capital in short-term markets and have serious unintended consequences for financial stability.

b. Minimum Balance at Risk

The Report discusses implementing a "minimum balance at risk" (MBR) requirement for MMFs. According to the Report, an MBR is a portion of each shareholders' recent balances in a MMF that would be available for redemption, only with a time delay, to ensure that redeeming investors remain partially invested in the fund over a certain time period. Unfortunately, such a change would likely reduce the utility of the fund for investors and issuers. The MBR would effectively require investors, after redeeming their shares, to assume the risk of ex-post facto losses if the fund's NAV were to decrease over a certain period. The Report includes appropriate discussion of the administrative challenges of regularly calculating MBR but fails to mention that investors may need to reserve for potential time-delayed losses. This raises questions about under what market conditions investors would need to reserve, or be required to reserve, to account for their MBR.

Furthermore, such a requirement would not address liquidity pressures in institutional prime funds, which was the central issue faced by the MMF industry in March 2020. It is unclear how holding back a portion of each shareholder's redemption would have materially addressed the liquidity pressures felt by institutional prime funds as investors in these funds increased redemptions in mid-March 2020.

c. Capital Buffer Requirement

Finally, the Chamber wishes to express objection to instituting a capital buffer requirement for MMFs. The Report states that a capital buffer(s), could be structured in a variety of ways, to provide dedicated resources within or alongside a fund to absorb losses and can serve to absorb fluctuations in the value of a fund's portfolio. Instituting a capital buffer requirement on MMFs appears to confuse bank regulation with the, albeit limited, risk-taking that is central the economics of MMFs.

A capital requirement would be extremely challenging to administer and would by its very definition decrease the return provided to investors. MMFs are not currently organized to include a capital requirement. There are many unanswered questions about how this would be implemented and how the SEC would enforce compliance with such a regulation. Furthermore, the financing of the capital buffer, either by the fund sponsor, or investors, would decrease the fund's return, and thus overall utility as an efficient liquidity management tool.

The Report itself identifies the primary issue with a capital buffer. Because it is designed to provide loss absorption from fluctuations in the value of a fund's portfolio, it is not intended to, and would not, address the liquidity pressures felt by institutional prime funds in March 2020. The events of March 2020 did not involve concerns with asset quality and, thus, did not involve fluctuations in the value of funds' portfolios. As a result, instituting a capital buffer would not meet one of the Report's

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[12] *Holistic Review of the March Market Turmoil* (Rep.) (2020, December 17). Retrieved from https://www.fsb.org/wp-content/uploads/P171120-2.pdf

three stated goals of reform – to remove any structural vulnerabilities that created stresses in March 2020.

Lastly, because institutional prime funds already have a floating NAV, a capital buffer in these funds is unnecessary. Capital buffers are designed (in theory) to delay the moment at which a fixed NAV fund is forced to transition to a floating NAV (i.e., "breaks the buck") because of deteriorations in the valuation of the securities it holds. Capital buffers would serve no purpose whatsoever in funds that already operate with a floating NAV. In addition, because floating NAV funds (i.e., institutional prime funds) experienced the greatest outflows in March 2020, capital buffers would not have provided any meaningful benefit had they been in place at the time.

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The Chamber appreciates the Commission soliciting feedback from the public before rushing to implement changes to Rule 2a-7. We believe a measured approach, that holistically considers all aspects of short-term funding markets and that preserves the unique benefits provided by MMFs to investors and issuers, is warranted. While reforms to Rule 2a-7 may be appropriate for funds that experienced significant outflows in March 2020, financial regulators should also consider if there are opportunities to improve upon regulation that would limit disincentives for banks to intermediate in short-term funding markets. If the Commission determines Rule 2a-7 are necessary, we would encourage a close review of market behavior by investors confronted by the tie between gates and fees.

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