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CEO, Americas

August 16, 2021

The Secretariat
Financial Stability Board
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Submitted via email to: fsb@fsb.org

Re: Policy Proposals to Enhance Money Market Fund Resilience: Consultation Report

Dear Sir/Madam:

J.P. Morgan Asset Management ("JPMAM")[1] is pleased to provide comments on the Financial Stability Board's (FSB) Consultation Report on Policy Proposals to Enhance Money Market Fund Resilience.[2] JPMAM is one of the largest managers of money market funds (MMFs) globally, with over $710B in assets under management. In the US, we manage over $460B in MMFs, across government and treasury MMFs (~$360B), institutional prime MMFs (~ $79B), retail prime MMFs (~$8B), and tax-exempt MMFs (~$12B). In Europe, we manage approximately $210B across the Low-Volatility Net Asset Value (LVNAV), Public Debt Constant NAV (PDCNAV) and Variable NAV (VNAV) MMF categories.

As was the case for many other MMF providers, JPMAM's non-public debt funds saw substantive redemptions in March 2020, as a result of global financial markets' reaction to COVID-19 and the actions taken by various governments to combat it.[3] As such, we are supportive of policymakers' efforts to consider reform measures to improve the resilience of MMFs, as well as short-term funding markets (STFMs), while preserving the important functions they perform. We applaud the FSB for undertaking a thorough assessment of the potential impacts and consequences, to investors and markets more broadly, of the various policy options being considered.

In order for reforms to be effective and to fulfil the objectives of policymakers, it is important they are appropriately calibrated and contextualized. At the peak of the pandemic-related market stress, there was an unprecedented demand for liquidity, which created significant strain across global

[1] J.P. Morgan Asset Management is a marketing name for the investment management subsidiaries of JPMorgan.

[2] Financial Stability Board, Policy Proposals to Enhance Money Market Fund Resilience, Consultation Report, June 30, 2021 ("Consultation").

[3] These market forces have been well explored elsewhere. *See, e.g.,* "The Impact of COVID-19 on Economies and the Financial Markets," Report of the COVID-19 Market Impact Working Group, ICI, October 2020, available at https://www.ici.org/pdf/20_rpt_covid1.pdf; Financial Stability Board, "Holistic Review of the March Market Turmoil," Nov. 17, 2020, available at https://www.fsb.org/wp-content/uploads/P171120-2.pdf.

financial markets, including STFMs. The significant tightening of market liquidity and the resulting dislocation permeated many areas of the market, including longer-dated government bonds, longer-term agency securities, corporate bonds, FX markets and global equities. In all of these markets, access to, and the preservation of, liquidity became paramount. As investors faced extraordinary uncertainty, the desire to hold cash prompted many companies – even those on strong financial footing – to draw down credit lines, issue debt, sell marketable securities, and redeem from MMFs. The market volatility only abated following public sector intervention, although the extent to which MMFs were able to avail themselves directly of such support differed across jurisdictions.

Below we provide our views on the Consultation, including:

- The challenges faced by MMFs, on both the asset- and liability-side, and an assessment of potential MMF substitutes, where we have reservations on their effectiveness and availability;
- The various policy options presented, where we:
    - outline our support for removing the tie between liquidity thresholds and the potential imposition of fees and gates, which we believe would be the most effective reform option;
    - offer recommendations regarding potential modifications to the use of liquidity fees, incorporating certain elements of swing pricing; and
    - discuss the drawbacks of the other options presented, some of which would undermine the viability of MMFs.

We conclude by offering observations on risk monitoring and STFMs more broadly.

I. Forms, functions and roles of MMFs

a. Form, function and roles of MMFs

MMFs perform a critical role for investors, borrowers and the financial markets more generally. While successive rounds of reforms, notably in the US and EU, have resulted in substantively different markets, the core tenets of capital preservation and liquidity remain common features. For investors, MMFs are highly-valued investment vehicles that offer same-day liquidity, diversification of credit risk and relatively higher returns. For borrowers, MMFs are a crucial source of funding, enabling those with a sufficiently high rating to utilize low-cost capital, ultimately supporting the activities of the real economy. Importantly, as the Consultation recognizes, MMFs are part of a broader ecosystem that collectively form STFMs. It is crucial to adopt a holistic view, as reforms to MMFs alone will not be sufficient to address the observed challenges in broader STFMs.

One element of the Consultation worth highlighting is the use of a "stable" NAV. This is achieved through the adoption of amortized accounting and represents a critical consideration for certain MMF investors; indeed, some investors are restricted to such funds through their internal investment policies. The use of a stable NAV is subject to prescriptive regulatory requirements, ensuring sufficient and adequate investor protection. For example, LVNAV MMFs are required to operate both an asset- and fund-level collar, in addition to only being permitted to use amortized accounting for assets with residual maturity of up to 75 days. Moreover, LVNAVs are required to hold substantively higher levels of liquidity – both daily and weekly – than VNAVs, which use either a mark-to-market or mark-to-model valuation method.

b. Potential Substitutes

JPMAM welcomes the analysis of potential substitutes. While in theory the identified alternatives may perform a similar function to that of MMFs, in practice, they are not as readily available or interchangeable as suggested. Notwithstanding the key point that these substitutes also exhibit vulnerabilities, as noted by the FSB, there are material differences when compared to MMFs and/or significant practical challenges, which mean they are unlikely to be meaningfully utilized by investors or issuers.

From an investor perspective, the two alternatives most frequently referenced are bank deposits and direct investments into the underlying instruments. Regarding bank deposits, the implementation of post-global financial crisis (GFC) prudential rules has reduced the appetite amongst banks to accept investors' short-term operating cash, given the implications for their own regulatory requirements.[4] Indeed, the aversion of banks for such assets has been a key contributory element to the growth of the MMF sector. We note similar challenges exist with the proposed greater use of repurchase agreements (repos), which would also present significant operational burdens for investors, including collateral and margining requirements.

With regards to direct investment, we broadly agree with the drawbacks referenced by the FSB. Only certain large investors will have the internal capacity, resources and necessary expertise to be able to invest directly. For those that are able to do so, they will no longer benefit from the laddered liquidity offered by MMFs, the regulatory provisions related to credit quality/risk, or the investment and risk management expertise offered by providers of MMFs. In addition, they would not benefit from the economies of scale from being in a pooled investment vehicle. In periods of severe market stress and where the market is ostensibly moving in one direction, as was the case in March 2020, this would arguably leave investors worse-off: if such investors required liquidity on short notice and were seeking to liquidate their position, they would have become forced sellers in a market in which, for a certain period of time, there were few buyers. This is likely to have resulted in a more significantly detrimental impact on the real economy.

[4] *See, e.g.,* Peter Coy, "Jamie Dimon May Soon Turn Away Deposits, and He's Not Happy," *Bloomberg Businessweek*, Mar. 22, 2021 (quoting JP Morgan Chase & Co. Chief Executive Officer Jamie Dimon's comments, prior to the Federal Reserve's announcement, that if the temporary provisions expired, the bank would have a financial incentive to turn away deposits, and noting that the bank had reduced deposits by $200 billion within months after a previous change to the SLR).

The FSB also highlights the use of public debt MMFs as an alternative to non-public debt funds. While the comparatively lower yield offered by public debt MMFs may deter certain investors, a more material issue is capacity and supply-side constraints. For example, in Europe, the PDCNAV segment consists almost entirely of USD-denominated funds, with Sterling- and Euro-denominated funds collectively representing approximately 3 percent of total assets under management. Consideration should be given to the impact of further demand for Government MMFs on the US Treasury market, which, despite being the deepest and most liquid market in the world, also experienced market liquidity dislocations during March 2020 and are part of the ongoing review by policymakers.[5]

Another identified alternative is short-term fixed income funds. We note that in addition to having a different accounting treatment, which is a key consideration for MMF investors, these funds are likely to invest in longer-term assets, be subject to a greater degree of credit risk and maintain lower levels of liquidity relative to MMFs. In light of the current interest rate environment, one would expect those investors that could tolerate such risk in search of higher yield to have already done so. As such, we do not anticipate there being significant demand for such vehicles from current MMF investors.

Following successive rounds of reforms, MMFs represent a highly regulated and highly transparent investment vehicle, which effectively matches investors with those in need of short-term funding. While new substitutes may arise, we note that none have yet done so which offer the same utility to MMF investors. Similarly, should these operate in a relatively less regulated environment, investors may need to accept higher risk and policymakers may have less visibility of market developments.

It is also important to consider the potential substitutes from a borrower perspective. Issuers of short-term debt will need to find alternative means of funding. Given balance sheet constraints, the availability of bank loans will likely be limited. The FSB suggests an alternative funding source may be through direct investment by large institutional investors. In addition to our previous comments regarding the challenges and risks of direct investment from an investor perspective, we note such activity would likely need to be incentivized by a yield uplift, which is highly unlikely in the current environment and may also result in higher costs for borrowers themselves.

II. Vulnerabilities in MMFs

The key challenge faced by financial markets during March 2020 was the lack of market-wide liquidity. For MMFs, this crystallized into specific challenges on both the asset- and liability-side. Regarding the latter, as the entire market grappled with the ongoing uncertainty, investors' immediate need for operating cash and the need to enhance their own liquidity positions resulted in extraordinary levels of drawdowns from MMFs (as well as other available sources of on-demand liquidity). This translated into pressure on the asset-side for MMFs. While MMFs entered the

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[5] *See, e.g.,* Financial Stability Board "Holistic Review of the March Market Turmoil", November 7, 2020.

period of stress with significant levels of liquidity within their portfolio, much of this could not be utilized, due to investor concerns over the consequences of a fund falling below the 30 percent minimum weekly liquid assets (WLA) threshold. This resulted in MMFs effectively being forced to raise liquidity in the already highly stressed secondary market.

When considering the experience of MMFs, it is important to note the impact of MMF reforms. Regulatory reforms have had an overall positive impact on the industry and fund investors, creating increased transparency and improved resilience, as well as reducing the risks MMFs may transmit to the wider financial system. However, one aspect of reforms which did not work as intended is the link between minimum liquidity thresholds and the use of fees and gates, inadvertently resulting in procyclicality. Analysis of redemption flow data, together with feedback we received from our clients, indicates that investors were concerned about the possibility of gates being imposed as a MMF's WLA approached the 30 percent threshold, causing increased pressure on outflows. The 30 percent threshold became a "bright line" that investors were highly sensitive to and resulted in MMFs being unable to use the inherent liquidity within the fund, as doing so may have precipitated further redemptions. As such, MMFs needed to transact in the secondary market, in order to maintain additional liquidity over and above minimum regulatory requirements and assuage investor concerns.

Also, while post-GFC prudential reforms have been effective in strengthening bank balance sheets, they have altered the incentives for undertaking discretionary market-making activities. In normal market conditions, this is typically not an issue, with banks able to accommodate the relatively low levels of secondary market activity in money market instruments and given the high levels of liquidity held by MMFs, where assets within the WLA will generate cash due to the natural maturity schedule without the sale of any position.

In light of the above considerations, JPMAM believes that removing the tie between regulatory thresholds and the imposition of fees and gates would be the most effective reform option. This would enhance the resilience of MMFs in two ways: by making it easier for MMFs to use their WLA to meet redemptions, thereby reducing the need to sell longer-dated assets into stressed markets, and by reducing the bright line effect as WLA declines.

III. Policy proposals to enhance MMF resilience

As noted above, JPMAM generally agrees with the FSB that MMFs face risks on both the liability side (*i.e.,* investors incentivized to redeem) and the asset side (*i.e.,* potential difficulties in selling assets). We would stress, however, that there are substantial interdependencies between the two, such that a measure to enhance one may have positive spillovers for the other.

We believe the redemption pressure experienced by non-public debt MMFs in March 2020 was driven primarily by two factors, in addition to cash flow uncertainty, as a result of the economic shutdown. First and foremost, we believe investors were concerned about the possibility of gates being imposed as MMFs' WLA approached 30 percent. Secondly, some investors were concerned about deteriorating market conditions and declining prices, causing them to seek to stem losses.

Based on these observations, we believe the most impactful policy options would be to 1) reduce threshold effects by removing the tie between the 30 percent WLA threshold and the imposition of fees and/or gates; and 2) modify redemption fees to facilitate their use, when appropriate, to impose on redeeming investors the cost of their redemptions (an alternative to swing pricing). Each of these is discussed in more detail below, after which we address the other policy options discussed in the Consultation, *i.e.,* those designed to absorb losses and reduce liquidity transformation.

a. Reduce threshold effects

i. Removal of ties between regulatory thresholds and imposition of fees/gates

Based on conversations with JPMAM institutional prime and LVNAV clients, we understand that many of them perceived the 30 percent WLA buffer as a "bright line" not to be crossed, and were particularly concerned about the risk of gates. To preserve its 30 percent WLA holdings while meeting investor redemptions, JPMAM, like other MMF sponsors, sold longer-dated assets into the secondary market, creating further downward pressure on the prices of those assets and exacerbating stresses in both the secondary markets and on MMFs specifically.

We believe that the removal of the tie between consideration of fees and gates and the 30 percent WLA threshold is the single most impactful change regulators could make. As the Consultation observes, "this option would reduce the likelihood of preemptive runs by investors in MMFs," and make MMF "managers more willing to use their WLA buffers to meet redemptions, thus reducing the need to sell less liquid assets."[6]

While the impact of this change on the liability side of MMFs (investors being incentivized to redeem) is obvious, we believe the Consultation may underestimate the impact of such an action on the asset side. Both US prime and EU LVNAV funds hold nearly one third of their assets in highly liquid assets that could not be used to meet redemptions. If those assets had been usable, there would have been substantially fewer assets being liquidated, which would have reduced liquidity stress and decreased the downward pressure on prices. This would have lessened the motivation of investors who were driven to redeem by deteriorating market conditions and declining prices. Indeed, whereas the Consultation states that high outflows in VNAV funds (*i.e.,* those not subject to fees and gates) suggests that this option on its own would not be sufficient to mitigate all vulnerabilities,[7] we would observe that to the extent this option diminishes downward pressure on asset prices, it could absolutely improve conditions even for VNAV funds.

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[6] *See* Consultation at 34.

[7] *See* Id.

The Consultation identifies countercyclical buffers as a variant of this approach, whereby an element of the current WLA, or an additional buffer over and above existing requirements, would be made "releasable" during periods of market stress. JPMAM supports the principle that liquidity buffers should operate in a countercyclical manner. However, as the FSB observes, it would be less effective since "investors would still have incentive to redeem preemptively as focal points would still be associated with the possible imposition of fees and gates."[8] We agree. In practical terms, it is unclear how the decision framework to release the buffer would be established, monitored and, if necessary, invoked. Regarding the latter, regardless of whether it is invoked at the behest of the regulator or the manager (following prior authorization from the regulator), this could create a new "bright line" that would signal market stress to MMF investors, causing them to redeem, and may have a potential contagion effect on other market participants.

We believe the same beneficial result, namely that MMFs are able to use existing liquidity within a fund to meet redemptions during times of stress, will be more easily achieved if gates and fees are not linked to the 30 percent threshold, *i.e.,* if MMFs do not risk accelerated redemptions as they approach 30 percent due to investor fear of gates or fees.

ii. Removal of stable NAV

The Consultation also identifies the removal of stable-NAV MMFs as a means of reducing thresholds effects. We believe this is not warranted by the experience of MMFs during the COVID-19 market stress. All types of non-public debt MMFs experienced significant outflows, suggesting the accounting methodology used by the fund was not the key determinant behind investor behavior. Meanwhile, European investors continue to highly-value stable NAV MMFs; such funds offer a higher degree of operational simplicity and a number of additional safeguards relative to VNAVs, including higher minimum daily and weekly liquidity requirements. Eliminating these funds would effectively encourage investors into sub-optimal substitutes, as noted previously.[9]

b. Impose on redeeming investors the cost of their redemptions

As the FSB notes, "one way to mitigate the risks stemming from the first-mover advantage for redeeming investors is to reduce their incentive to redeem by imposing directly on them the costs of their redemptions."[10] We agree. The Consultation then discusses swing pricing, as the representative option for this mechanism, and identifies challenges with this approach. These include difficulties in determining liquidity costs where trading activity is thin and transparency is poor, and also that "without guidance or requirements from authorities, fund managers may

[8] Id at 35.

[9] *See* Section I.b.

[10] *See* Consultation at 28.

implement swing pricing inadequately or may not use it."[11] While we believe these challenges are surmountable, the swing pricing mechanism presents additional challenges, not identified in the Consultation, which would substantially limit the appeal and utility of MMFs. A more workable alternative would take certain elements of swing pricing and adapt them to the existing redemption fee mechanism.

i. Challenges with applying swing pricing to MMFs

JPMAM employs swing pricing on the vast majority of our Luxembourg- and UK-domiciled long-term (non-MMF) UCITS funds, and we have been supportive of the SEC's efforts to encourage the use of swing pricing in mutual funds in the US.[12] As discussed below, certain elements of swing pricing can and should inform how we might reimagine redemption fees for MMFs. In particular, the swing factor, which is designed to impose transaction costs experienced by the fund on the relevant investor, could translate into a fee. However, swing pricing itself, as currently employed in Europe, does not make sense for MMFs for several reasons.

As a preliminary matter, the concept of a swing threshold is not meaningful for MMFs. A swing threshold is the level of net flows at which a fund would determine to swing the NAV (*e.g.*, a fund might swing the NAV if a fund experiences a net 5 percent inflow or outflow). This makes sense in the context of long-term funds, because while such funds typically maintain some cash and overnight assets with which to meet redemptions, a larger flow will require transactions in the underlying portfolio, imposing the costs swing pricing is intended to address.

MMFs, on the other hand, routinely hold substantial amounts of short-term and maturing assets, and regularly see predictable, high levels of inflows and outflows (*e.g.,* at month and quarter end); indeed, JPMAM maintains a "cash flow calendar" that tracks expected subscriptions and redemptions, with input from client-facing representatives, to assist in cash flow management. Moreover, given the short duration of MMF assets generally, portfolio managers can plan for these redemptions by allowing assets to mature, rather than transacting in the secondary market. Thus, tying the execution of a NAV adjustment to net flows, as with swing pricing, does not make sense.

Additionally, to assess daily net flows for purposes of determining whether the swing threshold has been met, MMFs would likely need to suspend intraday settlement, a feature of MMFs that is highly valued by investors. Same-day settlement (once per day) could also be compromised. This is because all daily flows must be received, and the NAV calculated, before a price can be swung, meaning that intra-day pricing could not incorporate a swing. The end-of day operational process

[11] Id at 29.

[12] *See, e.g.,* Letter from George C.W. Gatch, CEO- Global Funds Management & Institutional, J.P. Morgan Asset Management, to Brent Fields, Secretary, Securities and Exchange Commission, dated Jan. 13, 2016, available at https://www.sec.gov/comments/s7-16-15/s71615-67.pdf (supporting the SEC's proposal to permit US-registered mutual funds to employ swing pricing).

typically takes several hours, so unless a fund stopped accepting transactions earlier in the day, which itself may have significant implications, it would be unlikely to offer same-day settlement.

Finally, we expect sweep platforms would experience significant operational complexities with swing pricing. Certain types of sweep products, such as round-trip sweeps, would not be able to invest in a MMF that settled on a T+1 basis. Additionally, cash and cash equivalent status, a coveted feature for corporate treasury investors, could be impacted if settlement were to shift to T+1 from T+0.

ii. Modified redemption fees

We believe redemption fees, with some modifications, could be an effective mechanism to impose on redeeming investors the cost of their redemptions. Under current rules, fees are treated as essentially interchangeable from gates in the first instance, *i.e.,* as an option for boards to consider when a MMF breaches regulatory thresholds. At 10 percent WLA, when a liquidity fee is required unless the board determines otherwise – or in Europe, unless suspension of redemptions is deemed more appropriate – fees become a blunt instrument to disincentivize redemptions and recoup liquidity costs. We believe a more nuanced approach to fees could be beneficial, drawing on certain elements of swing pricing.

As a preliminary matter, for investors, we observe that fees are a more tolerable intervention than gates. Investors in institutional prime MMFs, which have floating NAVs, clearly recognize these funds do not maintain a stable value. This is unambiguously set out in fund documentation, including the fund prospectus. While investors are comfortable with the concept that liquidity may come at a cost, in contrast, gates deny investors access to their cash entirely, which is highly problematic when a client has cash flow demands. Thus, it is worth considering an approach to fees as a remediation tool separate from, and to be used earlier than, gates. Importantly, we believe the existence of such a tool could be useful in educating clients away from viewing the 30 percent WLA as a bright line.

Moreover, while current rules regarding fees are not prescriptive,[13] we believe there is an opportunity to incorporate a framework similar to that used for swing pricing, to make fees more dynamic and reflective of the true cost of liquidity to those demanding it. Such an approach is likely to be more palatable to investors than a static 1-2 percent fee, imposed at the board's discretion. And, while swing pricing as currently used by mutual funds is operationally infeasible and conceptually problematic for MMFs, MMFs have already built an operational framework for the implementation of fees.[14]

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[13] While the board retains discretion to adjust the default liquidity fee under current rules, there is little specific guidance as to how they might do so.

[14] We acknowledge that fees continue to present operational challenges. However, unlike swing pricing, which would impose such challenges on a daily basis, the approach we are proposing would only be implicated in distressed market conditions, and so would permit intraday redemptions in the ordinary course.

Under our proposed approach, funds could be required to maintain detailed policies and procedures (*i.e.,* a "playbook"), reviewable by their supervising authorities to ensure they were sufficiently robust, that provide the board with clear direction on when to impose redemption fees and how to calculate them. We believe MMF sponsors are better positioned than boards to assess both when a fee should be imposed, and the right level of the fee; and further, that it is preferable to conduct this analysis ahead of time and have a decision tree prepared for the board, rather than expecting the board to make difficult determinations during periods of market stress.[15] While we envision that the playbook would provide clear direction to the board on when to act, we expect the board would retain the discretion to decline imposing a fee if was not deemed in the best interest of shareholders.

In developing the playbook, funds could consider a range of factors including net redemptions (single day, rolling average, cumulative, or other); WLA and other portfolio-specific characteristics (investor concentration, diversification of holdings, etc.); and market-based liquidity metrics (*i.e.,* indications that non-WLA might not be readily sold). A fund might also look to such liquidity metrics to determine how much the fee should be. The fee could be adjusted up or down daily based on market conditions (assuming the test for imposing a fee continues to be met). Similar to the current practice for swing pricing, any fee recouped would be returned to the fund, which would protect remaining investors from the dilutive effects of the redemption activity.

Finally, authorities would need to consider the appropriate disclosure to clients regarding the fee. Ideally, clients would understand the fee sufficiently to accept the risk, while not having enough information to attempt to redeem preemptively (before a fee was imposed). Fund sponsors' swing pricing disclosures for Luxembourg-based UCITS, which provide a general description of the approach and factors considered, could serve as a useful template.[16]

c. Mechanisms to absorb losses

The Consultation describes a number of mechanisms designed to absorb losses and thereby enhance investor confidence in MMFs' ability to maintain principal stability. Options include minimum balance at risk (MBR), capital buffers, and a liquidity exchange bank (LEB). Below we share our reservations with respect to these options.

[15] We also would not support a "dictate" approach, whereby a regulator would determine when MMFs should impose fees. Not all funds are managed the same; what may necessitate a fee in one fund may not be the case in others. Additionally, such an approach could create moral hazard, if funds knew that risky management on their part would result in the entire industry being penalized.

[16] *See, e.g.,* Swing pricing: The J.P. Morgan Asset Management approach in the Luxembourg domiciled SICAVs JPMorgan Funds and JPMorgan Investment Funds, Sept. 23, 2020, available at https://am.jpmorgan.com/content/dam/jpm-am-aem/emea/lu/en/communications/lux-communication/swing-pricing-ce-en.pdf (explaining how swing pricing works and listing generally the factors considered in determining the appropriate level of the swing factor); *see also* Franklin Templeton, Investor Education, Swing Pricing, available at https://www.franklintempleton.lu/investor/resources/investor-tools/swing-pricing.

i. Minimum balance at risk (MBR)

Under the MBR approach, a portion of each shareholder's MMF shares would be available for redemption only with a time delay; in the event the fund experienced losses during the period after an investor redeemed but within the holdback period, that investor would still share in those losses through a reduction in value of the holdback. Such an approach would create enormous operational challenges for MMFs and would likely substantially decrease the desirability/value proposition of these funds for investors. Further, to the extent investors did remain, we believe such an approach could actually create a heightened level of restlessness among investors, who might seek to anticipate the market scenarios that could cause them to lose their MBR, and exit the funds at the earliest signs of distress. For these reasons, we do not support the MBR.

From an operational perspective, MBRs would require significant structural changes to MMFs, which would be costly and challenging to implement. Specifically, transfer agents would need to develop technology that could compute and reset average account balances, and restrict applicable shares in investor accounts that are held direct at funds and through financial intermediaries. MBR data would also need to be integrated in transfer agent recordkeeping systems, shareholder servicing interfaces, and transaction processing, as well as for other servicing interfaces utilized by clients.

Moreover, we believe that an MBR approach would dramatically reduce the appeal of MMFs to investors. Investors use MMFs in large part because they are deemed as "cash equivalent." An MBR holdback could call that designation into question. Fiduciaries such as retirement plans, trustees, and investment advisers may be legally prohibited from using MMFs with these embedded redemption restrictions for their clients; similarly, sweep programs, which rely upon the ability to move all investors' cash on daily basis, would not be able to leverage MMFs with MBR guidelines. To the extent investors did elect to remain in MMFs that employed an MBR, we believe these investors might seek to anticipate market stress and redeem before an MBR holdback was declared.

ii. Capital buffers

Under a capital buffer approach, a MMF provider would be required to hold a specified amount of assets to absorb potential losses. We are strongly opposed to this option. As the Consultation observes, the cost of such an approach would likely drive further industry consolidation, and could potentially make prime MMFs economically unviable, even for the largest managers. Additionally, if the capital buffer were to trigger applicable accounting rules requiring consolidation of MMFs onto the sponsor's financial statements, many MMF sponsors would likely find it cost-prohibitive to offer MMFs.

Moreover, we do not believe capital buffers are warranted in light of the experience of the MMF sector during the pandemic-related market stress. In principle, it is not clear that capital buffers are suitable tools to address market-wide *liquidity risk*. Indeed, as was referenced in the Report of the

President's Working Group on Financial Markets[17] and in supporting academic literature, capital buffers are typically designed to protect against credit-related losses. Furthermore, the existence of capital buffers may lead some investors to believe that MMFs are a deposit-like product, rather than an investment vehicle, given that capital buffers are a prominent feature of the prudential framework for banks.

iii. Sponsor support

Another option for loss absorption considered in the Consultation is permitting MMF sponsors to provide financial support to their MMFs, such as to absorb losses or provide liquidity. It noted, however, that the discretionary nature of sponsor support contributes to uncertainty about who will bear risks in periods of stress, potentially upsetting investor expectations and generating further stress.[18] It further notes that such support increases the interconnectedness between MMFs and other financial institutions, and that permitting it could favor MMFs with sponsors that are affiliated with banks or other financial institutions. We agree with each of these concerns except the last: for a bank-affiliated sponsor, reserving the ability to support a MMF is likely to require the bank to hold risk-based capital, the cost of which could significantly decrease the profitability of MMFs relative to other product offerings. As such, sponsors may simply choose to exit the market. In addition, we are concerned that funds that remain could be incentivized to take on additional risk, both to recoup the cost of capital and because they could rely on sponsor support as a backstop, creating moral hazard.

iv. Liquidity exchange bank (LEB)

The concept of a LEB or liquidity facility for MMFs received strong industry attention and support after the 2008 financial crisis, including from JPMAM.[19] The existence of a liquidity backstop could provide investors with assurance that liquidity will be available when needed, potentially reducing preemptive redemptions. This effect would be even more pronounced if the LEB had access to Federal Reserve liquidity through the discount window.

However, further exploration of the LEB concept exposed substantial challenges. As a preliminary matter, the regulatory requirements associated with establishing such a facility would be extremely complex. Perhaps more importantly, as a stand-alone facility (*i.e.,* without access to the discount

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[17] *See* President's Working Group on Financial Markets, "Overview of Recent Events and Potential Reform Options for Money Market Funds", U.S. Department of the Treasury, December 22, 2020, available at https://home.treasury.gov/system/files/136/PWG-MMF-report-final-Dec-2020.pdf

[18] Consultation at 33.

[19] *See, e.g.,* Letter from George C.W. Gatch, Chief Executive Officer, IM Americas, J.P. Morgan Asset Management, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated Jan. 10, 2011, available at https://www.sec.gov/comments/4-619/4619-45.pdf ("We believe that the Liquidity Facility is the best single option presented in the Report to address the objective of further mitigating the risk of runs on money market funds…"). *See also* Letter from Paul Schott Stevens, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated Jan. 10, 2011, available at https://www.sec.gov/comments/4-619/4619-49.pdf.

window), the LEB would struggle to raise capital from its members (MMFs) in a timely fashion. Even once fully capitalized at the same ratio proposed in 2011 (1.3 percent of prime assets),[20] such a facility would have only had a nominal ability to absorb assets in March 2020. At this ratio, the LEB would have held approximately $12B; in order to maintain a consistent WLA against shrinking AUM,[21] prime MMFs needed to raise an additional $100B in WLA during March 2020.

An LEB could have a more meaningful impact if it were able to borrow from the Federal Reserve. Again, looking at the 2011 proposal, if it were capitalized at the same ratio today and could leverage that capital, the LEB would have had a capacity of approximately 3.3 percent of prime AUM, or $30B. However, this still represents only about one third of the non-WLA sold by prime MMFs in 2021. To the extent any permissible policy option could implicate borrowing from the Fed in times of stress, we would observe that the Money Market Mutual Fund Liquidity Facility (MMLF), which has now been utilized twice to great effect, could achieve a similar outcome with far less cost and complication.[22]

d. Mechanisms to reduce liquidity transformation

The Consultation observes that the redemption terms of the underlying assets in MMFs do not match the daily liquidity offered by the funds; because MMFs offer daily liquidity at no cost, investors are likely to redeem MMFs before other assets when they need to raise liquidity, and this incentive to redeem is likely to increase when market liquidity becomes scarce. To address this vulnerability, the Consultation explores methods of decreasing liquidity transformation, such as by limiting eligible assets to those with shorter duration and/or higher liquidity, or by increasing liquidity requirements by mandating a level of assets that can be converted to cash over a 2-week period.[23] We do not think such an approach would be additive.

As a preliminary matter, we do not believe that the challenges MMFs encountered in March 2020 were caused by insufficient WLA, but rather by a practical inability to use those assets to meet redemptions due to investor fears about gates. If MMFs were able to use their WLA without exacerbating investor concerns, there would have been substantially less need to sell longer-dated assets into stressed markets. Regarding liquidity transformation, which is highlighted in the Consultation as a particular vulnerability for MMFs, we note that regulatory requirements, particularly in relation to minimum liquidity thresholds and restrictions on portfolio maturity,

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[20] *See* Letter from Paul Schott Stevens, *supra* note 19, at Appendix p. 18 (showing notes and equity of approximately $24B against $1.65T in prime AUM).

[21] AUM in prime MMFs declined from $1.1T at YE2019 to $936B Mar. 31, 2020.

[22] At its peak, the MMLF had $53B outstanding. *See* Daleep Singh, "The Fed's Emergency Facilities: Usage, Impact, and Early Lessons," Federal Reserve Bank of NY, July 8, 2020, at exhibit 7.7, available at https://www.newyorkfed.org/medialibrary/media/newsevents/speeches/2020/sin200708/Singh_HVPP_exhibits_7.7.pdf.

[23] Consultation at 37-38.

explicitly limit the extent to which this can be undertaken by MMFs. For example, if a triple-A rated LVNAV, which is subject to weighted average maturity (WAM) duration limits of 60 days, is 10 percent invested in daily assets, and a further 25 percent in one-week, then it can at a maximum only invest the rest of the portfolio in securities with an average maturity of 74 days.

Another option offered by the Consultation, requiring a band of biweekly liquid assets, makes intuitive sense as a way of ensuring a more even distribution of maturities ("laddering").[24] However, MMFs typically already hold assets with a well-distributed range of maturities, with longer-dated positions constantly rolling down towards maturity. Moreover, there is a very limited issuance market for assets in the biweekly maturity range, nor do we expect that new demand from MMFs would enhance issuance, because such offerings are not desirable from an issuer's perspective.

Most short-term credit instruments purchased by MMFs are issued by banks, which are subject to strict liquidity requirements. The Liquidity Coverage Ratio (LCR), which requires banks to maintain sufficient assets to meet outflows over a 30-day stressed period, creates incentives for banks to issue longer-dated securities. Conversely, instruments that mature within 30 days count *against* their LCR. Given that banks would therefore be unlikely to issue securities with this duration, the only meaningful way to acquire them would be in the secondary market (*i.e.,* by purchasing longer-dated issuance that is nearing maturity), which we expect would inflate the price of these securities, ultimately causing them to provide no more yield than overnight or weekly assets. Moreover, these biweekly assets would roll into the WLA bucket after a week, creating continual pressure to source new biweekly assets. Ultimately, we expect that MMFs would meet a biweekly requirement by simply increasing their WLA. As noted above, we do not think this would be additive if MMFs were permitted to use their WLA to meet redemptions.

IV. Observations on short-term funding markets and risk monitoring

a. Short-term funding markets

While we recognize the need to examine the resilience of MMFs following the experiences of March 2020, it is important to note that the challenges were not isolated to MMFs alone. As market participants demanded cash, a number of market forces, some of them self-perpetuating, caused liquidity to tighten. We applaud the FSB for considering whether complementary measures in other areas of the short-term funding market ecosystem are warranted. We believe this is a necessary component to ensure reforms are effective.

For example, dealers were limited in their ability to intermediate trading in short-term, high-credit-quality assets in March 2020, due to the volume of assets being sold relative to the size of dealer

[24] Consultation at 38. The Consultation links this option with escalation procedures when regulatory thresholds are breached. In such circumstances, MMFs would be required to use price-based tools such as liquidity fees or swing pricing first, before quantity-based tools or gates. This escalation is consistent with how we would expect redemption fees to be used, as discussed in Section III.b.ii.

balance sheet capacity and the resulting upward pressure on capital and liquidity requirements. The supplementary leverage ratio (SLR) and liquidity coverage ratio (LCR) calculations have been frequently cited by market participants as factors limiting bank participation.[25] While these standards clearly enhanced the stability of the banking sector, as evidenced by banks' resilience during March, the constraints banks faced in deploying that capital and liquidity during times of market stress limited their ability to alleviate volatility in March. These calculations could be reexamined with the goals of maintaining banks' resilience while enhancing their ability to intermediate during times of crisis.

As an alternative to altering the SLR or LCR calculations, policymakers could consider changes to their crisis management toolkit to make it easier and less balance sheet intensive for primary dealers to facilitate liquidity in secondary markets during liquidity stress events that are not credit-driven. For example, in the U.S., the Primary Dealer Credit Facility (PDCF) would have likely stemmed the need for launching the Commercial Paper Funding Facility (CPFF) and the MMLF, if the PDCF had been structured with the balance sheet neutrality (no risk-weighted capital or leverage capital charges) of the MMLF. A swift uptake in usage of the PDCF to add liquidity to short-term debt markets would have been beneficial to all holders and issuers of such instruments (not just MMFs).

As the Consultation observes, some market participants have also suggested enhancements to the market infrastructure for commercial paper (CP) and other high-credit-quality short-term debt.[26] These markets are currently highly dependent on dealer intermediation. Given limited balance sheet capacity and risk management limits adapted to the prevailing market conditions, when dealers did bid on these assets, they frequently did so at substantial discounts; those prices then were applied in vendor pricing models that are used by MMFs and other market participants, driving asset prices down further. Taking steps to enhance liquidity in this market could have the dual benefit of adding buyers and improving vendor pricing, thereby reducing "panic" selling.

Another factor driving a liquidity shortfall during March was the margin required by derivatives central counterparties (CCPs), particularly for exchange-traded derivatives.[27] While CCPs generally remained resilient, it became apparent in March that their initial margin (IM) models were excessively procyclical. As a result, the period of market volatility triggered a significant number and

[25] *See, e.g.,* BlackRock Viewpoint, "Lessons from COVID-19: Market Structure Underlies Interconnectedness of the Financial Market Ecosystem," Nov. 2020, available at https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-lessons-from-covid-19-market-structure-november-2020.pdf, at 11; ICI MMF Report, *supra* note **Error! Bookmark not defined.**, at 20.

[26] *See* Consultation at n. 44, citing BlackRock Viewpoint, "Lessons from COVID-19: US Short-Term Money Markets," July 2020, available at https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-lessons-from-covid-19-us-short-term-money-markets-july-2020.pdf.

[27] *See* Securities and Exchange Commission, Division of Economic and Risk Analysis, "U.S. Credit Markets Interconnectedness and the Effects of the COVID-19 Economic Shock," Oct. 2020, available at https://www.sec.gov/files/US-Credit-Markets_COVID-19_Report.pdf, at 27 (observing that "incremental IM is a net drain of liquidity from the markets into CCPs").

magnitude of IM breaches and subsequent IM increases, creating a procyclical demand for cash by derivatives market participants;[28] much of this cash was held in MMFs. We understand that global standard-setters, including IOSCO, the Committee on Payments and Market Infrastructures (CPMI) and the Basel Committee on Banking Supervision (BCBS), are examining margin dynamics and we are supportive of this work; a key focus should be on whether enhancements are required to the anti-procyclicality measures within CCPs' margin models.

While we do not believe that any of the proposed market structure changes in isolation would have alleviated the liquidity challenges faced by MMFs in March 2020, we believe these and other potential policy measures could further enhance the resilience of the short-term funding markets to events such as those experienced in March 2020. It is unlikely that reforms to MMFs alone would address the underlying market issues highlighted during March 2020.

b. Risk monitoring

Finally, the FSB notes that enhanced stress-testing requirements could be an additional component of reforms. JPMAM recognizes the usefulness of stress testing, and considers it an important element of our broader risk management framework. While reforms to stress testing may incrementally improve the preparedness of managers, we do not believe it will necessarily enhance the resilience of the MMF sector nor how managers respond to rapidly deteriorating market conditions. It would be extremely difficult to stress test for all possible scenarios, particularly 'black swan' events such as that witnessed in March 2020; regardless of whether stress testing makes use of hypothetical or historical scenarios, the data may not fully correspond with rapidly evolving market conditions. On the other hand, an overly-prescriptive approach may risk stress-testing becoming a form of tick-box exercise. As such, it is important that policymakers carefully calibrate any further reforms in this area.

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JPMAM appreciates the opportunity to comment on the FSB Consultation. We would be pleased to provide any further information or respond to any questions that the Secretariat or FSB staff or members may have.

Very truly yours,

/s/ John T. Donohue

John T. Donohue
CEO, Americas

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[28] *See, e.g.,* Bank for International Settlements, "The CCP-bank nexus in the time of Covid-19," BIS Bulletin No. 13, May 11, 2020, available at https://www.bis.org/publ/bisbull13.pdf (discussing the effects of procyclicality in margining).