FINANCIAL STABILITY BOARD

11 October 2021

Policy proposals to enhance money market fund resilience

Overview of the responses to the consultation

1. Introduction

The consultation report[1] with policy proposals to enhance MMF resilience was published on 30 June 2021 and the comment period closed on 16 August. The FSB received responses from various stakeholders, the large majority of which came from fund managers and their trade associations (mainly in the US and Europe). The remaining responses came from banks or banking associations, and from other trade associations and think tanks. All non-confidential responses have been published on the FSB's website[2].

In addition, the FSB organised a virtual public workshop on 12 July to gather further feedback on the consultation report. Over 250 people attended the workshop, and a recording of the event is available on the FSB website[3].

In general, the FSB's view is that substantial changes are not needed to the report in response to consultation feedback, as it did not introduce major new elements to the analysis. Respondents from outside the asset management industry were generally in favour of further MMF reforms. By contrast, responses from the industry were generally against MMF reforms other than the removal of ties between regulatory liquidity thresholds and the ability to impose fees and gates, although many industry respondents expressed agreement with the use of mechanisms to allocate liquidity costs to redeeming investors (and especially anti-dilution levies), and to a lesser extent with the removal of stable net asset value (NAV) MMFs. Most respondents also expressed support for work to enhance the functioning of short-term funding markets (STFMs).

This document summarises the comments raised in the public consultation and sets out the main changes made to the final report in order to address them.

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1 FSB (2021), *Policy proposals to enhance money market fund resilience: Consultation Report*

2 See here.

3 Available here.

2. Summary of feedback received

Overall

Comments received

Many of the respondents from the asset management industry argued that problems in MMFs were a symptom rather than a cause of the market dislocations experienced in March 2020. In their view, MMFs were perceived as one of the most liquid instruments to use in order to meet other cash needs and for this reason experienced large flows. Industry respondents argued that MMF redemptions from certain types of funds did not contribute to increasing the cost of short-term funding for borrowers. They also argued that problems were exacerbated by the fact that dealers' balance sheets were under pressure because of the large volume of various assets being sold relative to the dealer capacity.

The same respondents argued that the main issue was the lack of functioning in underlying short-term funding markets rather than problems with MMFs themselves. They pointed out that no MMF had to rely on suspensions and that all redemptions were met. However, one respondent pointed out that the shadow NAV of some funds came close to breaking the 20bp collar in the EU, while in the US one fund's NAV dipped below the 30% Weekly Liquid Assets (WLA) threshold for one day, which allowed this fund to impose a liquidity fee or gate. Respondents highlighted the crucial role of the link, present in the US and in Europe, between the breaching of liquidity thresholds and the ability of funds to impose liquidity fees or gates. One respondent provided results from a simulation that, it argued, shows that if liquidity thresholds in US MMFs were not linked to the possibility of fees and gates, the funds would have been better able to use their liquidity buffers and meet redemptions for five weeks without any central bank interventions.

A number of respondents also argued that, if there is any doubt about whether MMFs are 'cash-like' or 'investment-like,' this should be resolved in favour of the latter. Many respondents argued that investors are aware of this issue and that disclosure documents clearly state that these are investment products, that the capital is potentially at risk and that they are not deposit accounts.

Some respondents highlighted the different behaviour of government and non-government MMFs and suggested that reforms (if any) should be limited to the latter type of funds which experienced outflows.

When discussing policy proposals, on the basis of the arguments above, the majority of respondents from industry believes that there is no fundamental flaw in the current regulatory framework for MMFs in different jurisdictions. Most of these respondents are in favour of only limited reforms to remove the link between the breaching of liquidity thresholds and the ability to impose fees or suspend redemptions.

Most respondents from outside the industry, however, argued that the March 2020 turmoil highlighted that MMFs are vulnerable, and some argued that they could impose material financial stability costs on society and that they benefit from an implicit government guarantee at least in some jurisdictions. These respondents generally were in favour of reforms to the MMF structure to make sure that these societal costs are borne by MMFs and their investors. Policy options mentioned included swing pricing, the imposition of stricter limits on assets that MMFs can buy, and the use of MBR and of capital requirements.

Most respondents, both from the industry and other stakeholders, were in favour of additional work to explore ways to improve the liquidity of the underlying STFMs. In a small number of cases, they argued that prudential requirements for banks should be part of this review.

Response to comments

Some clarifying edits have been made to the report but the overall narrative has not changed. The consensus of the FSB membership, as reflected in its November 2020 *Holistic Review of the March Market Turmoil*[4], is that the March 2020 turmoil highlighted issues in MMFs that were subject to a very high level of redemptions in an illiquid market. The consultation report did not argue that MMFs caused the stress in the underlying markets, but that they contributed to (and were impacted from) it as a result of their structure and the fact that they rely on markets that are not liquid in times of stress to meet investor redemptions. Central banks intervened to re-establish the orderly functioning of markets and not simply to assist MMFs, but MMFs were among the entities that experienced high liquidity pressures during March 2020.

Interventions to increase the resilience of MMFs and to improve liquidity in underlying markets are not mutually exclusive and, on the contrary, are likely to reinforce each other.

It is also clear that, irrespective of what disclosure documents state, many MMF investors treat their fund holdings as if they are cash-equivalent, or at least very similar to cash even if they know that the investments in those funds are not guaranteed.

Forms, functions and roles of MMFs

Comments received

There was general agreement among respondents that the report accurately describes how MMFs are structured and the functions they fulfil for investors and borrowers. Respondents particularly appreciated the acknowledgement that MMF markets have their own jurisdictional specificities and, therefore, that a one-size-fits-all approach to MMF reforms may not be appropriate.

However, a number of respondents wanted more emphasis on the fact that MMFs are only a part (albeit an important one) of the broader STFMs ecosystem. In particular, they suggested more analysis of the dealer incentives to make markets in times of stress and called for a holistic review of the broader ecosystem.

Some respondents disagreed with the statement made in the report that commercial paper (CP) and negotiable certificates of deposit (CD) markets are 'structurally illiquid' in normal times. They argued that they have no problems selling these instruments even if trading is relatively rare as dealers usually buy back the paper they placed with their clients.

There was general agreement among respondents that the alternatives to MMFs presented in the report are well described. However, many respondents disagreed that these alternatives

[4] FSB (2020), *Holistic Review of the March Market Turmoil*

are good substitutes for MMFs. The argument made was that while these alternatives could indeed grow as a consequence of a shrinking MMF market, they would not individually provide all the benefits to investors and borrowers (and even regulators in terms of regulation and transparency) that MMFs offer.

Respondents also argued that a shift from MMFs to other segments of the market would lead to unintended consequences and a potential increase in risk if money flows to less regulated and less transparent segments of the market. They argued that the impact of the growth of substitutes on financial stability and the orderly functioning of the markets should be further analysed and taken into account in the assessment of the policy options.

Response to comments

The consultation report already referred to potential future work to enhance the resilience of STFMs. In response to the feedback from the public consultation, the FSB and IOSCO intend to carry out follow-up work, complementing MMF policy reforms, to enhance the functioning and resilience of STFMs.

As for the claim by some respondents that it is not difficult to sell CP and CD in normal times, the report already states that this is usually the case. Dealers do buy back the paper they placed with clients if asked to do so. However, the market is not set up for secondary-market trading of these instruments in any depth because, given the buy-and-hold nature of these investments, there is usually little demand for intermediation services even in normal times.

It is correct to point out that no substitute for MMFs can have the exact same characteristics of those funds (and a substitute that had all of the characteristics of MMFs also would likely share their vulnerabilities). However, the alternatives in the report do share some of the specific features of MMFs, i.e. the provision of principal stability, daily liquidity, risk diversification and returns consistent with prevailing money market rates. Not all substitutes share all of these characteristics, but they are close enough that investors and borrowers may use them if the size of the MMF industry were to shrink. The assessment of policy options takes into account the potential financial stability effects associated with a move to these substitutes. However, a detailed assessment of such a move was not within the remit of the report and is the responsibility of individual jurisdictions.

Vulnerabilities in MMFs

Comments received

Some industry respondents rejected the conclusion that the March 2020 turmoil highlighted significant vulnerabilities in MMFs. They pointed out that the stress was mainly due to the lack of liquidity in STFMs (as opposed to the credit crisis of 2008) and argued that MMFs' problems were a result of the problems in STFMs. In their view, central banks did not 'bail out' MMFs and their interventions were not necessary to rescue them. Some respondents argued that institutional MMF outflows are usually large at the end of the quarter and that the graphs presented by the FSB overstate the problem by not taking this feature into account.

According to these respondents, any MMF vulnerability apparent in earlier crises has already been resolved by existing regulations. In addition, MMF reforms on their own would not eliminate problems in the underlying markets and hence future interventions by central banks to restore market confidence cannot be ruled out.

However, other respondents from the industry are more nuanced and point towards the existence of the link between liquid assets and the ability to impose fees and gates (with the additional voluntary buffer of liquidity above the Weekly Liquid Asset requirement serving as the true liquidity available to satisfy redemptions), the constant NAV of some funds and the inability to sell assets in stressed conditions as clear vulnerabilities.

One respondent highlighted another potential vulnerability in MMFs, namely their exposure to the banking sector given that they hold large amounts of financial CP and CDs issued by banks, and that banks are currently the main intermediaries for CPs and CDs.

As previously mentioned, respondents from outside the industry were less sanguine on structural vulnerabilities in MMFs: they argued that these are clearly present and have manifested themselves twice in the last 15 years.

Response to comments

The FSB disagrees with the interpretation by some industry respondents that the March 2020 episode did not highlight significant MMF vulnerabilities. It is true that STFMs were also disrupted over that period and that MMFs were not the cause of the stress. However, the vulnerabilities identified in the report – namely, that MMFs are subject to sudden and disruptive redemptions, and they may face challenges in selling assets, particularly under stressed conditions – have been studied extensively in the academic literature and documented in a number of other reports, including the FSB Holistic Review. They are also consistent with the very high level of redemptions and the stress experienced by MMFs in March 2020.

To assess the claim that MMF outflows tend to be high at the end of each month and quarter, and therefore that the graphs presented in the report overstate the problem, the FSB looked at outflows from French, Irish, Luxembourg and US funds for a number of years between 2010 and 2020, and found no evidence to explain a substantial portion of the redemptions experienced in March 2020. The consultation report already states that MMF reforms would not, on their own, solve the structural fragilities in the underlying markets. It notes that authorities might therefore consider adopting measures to improve the functioning of CP and CD markets. It also notes that, while useful in their own right, it is not clear that such measures would change the limited incentives of market participants to trade or of dealers to intermediate, particularly during stress periods.

Overall, some clarifying edits were introduced in the report in response to these comments, but the narrative on vulnerabilities has not changed.

Policy proposals to enhance MMF resilience

Comments received

Respondents generally agreed that the FSB had identified the relevant mechanisms to enhance MMF resilience and did not suggest additional mechanisms that should be considered.

Most respondents agreed that the assessment framework was comprehensive and included all the relevant aspects. However, some respondents argued that the FSB should take a more holistic approach as MMFs are only one of the participants in the wider ecosystem and that therefore all participants in STFMs should be analysed.

Numerous respondents underlined that the representative policy options should only address the vulnerabilities that became evident due to liquidity pressures in 2020 and specifically mentioned the ties between the potential imposition of fees and gates and liquidity thresholds, and, in several cases, internalising liquidity costs for redeeming investors. In their view, reforms should not target any credit-related aspects of MMFs, since the latter had already been addressed in the current regulatory framework and reforms undertaken since 2008.

Due to different market and product structures across jurisdictions, respondents confirmed that a one-size-fits-all reform solution would be challenging, and not even desirable.

However, there was near total consensus that a removal of the regulatory linkage of liquidity requirements to fees and gates would be an appropriate policy option to address the pressures MMFs experienced in 2020. Respondents underlined that it would enable MMFs to use their available liquidity to the full, act as a countercyclical release, and eliminate any cliff edge that spurred investors to redeem. Furthermore, the removal could make other options relating to additional restrictions on or higher requirements for eligible assets unnecessary, since generally MMFs hold sufficient liquid assets. This conclusion was not shared by all respondents, as some others were of the view that tightening liquidity requirements for MMFs would be warranted. Tighter liquidity requirements, coupled with the removal of ties between liquidity requirements and the imposition of fees and gates, would – according to those respondents – allow MMFs to use their buffers in stressed conditions and thereby reduce their vulnerabilities. Moreover, some respondents were concerned about the uncertainty resulting from the triggering of fees and gates if they were not linked with regulatory thresholds in the future. To address this issue, a few respondents suggested increased overnight liquidity requirements for USD-denominated MMFs not domiciled in the US. One respondent suggested setting aside a releasable percentage of the WLA that funds must carry to allow for a smoother absorption of redemptions.

Although there was no consensus on this policy option, a number of respondents were open to abolishing constant or low volatility NAV MMFs in some jurisdictions (e.g. retail prime MMFs in the US and to low volatility net asset value (LVNAV) funds in Europe).

Responses showed some openness to consider the application of a liquidity or anti-dilution fee in stress situations. They largely preferred this option to swing pricing, which was seen as an impractical and unviable way to internalise liquidity costs. There was a strong push among US-based respondents to place the decision when to use this fee and how to calibrate it at fund board level. European respondents seemed more open to also consider an involvement by regulatory authorities in this decision.

One respondent favoured a move towards limiting MMFs to exclusively public debt holdings. Others, however, expressed doubt that this would be a viable option outside of the US due to the shortage of short-term government paper. Even a requirement that LVNAV funds hold more government paper for instance could run into difficulties according to those respondents, due to the shortage of short-term government paper.

There was very little support among respondents for loss absorption options, such as MBR or a capital buffer. With very few exceptions, these were seen as ineffective against redemption pressures and punitive for the MMF business model. Respondents argued that these options were not necessary as credit risk issues are no longer important for MMFs following the reforms that had been previously introduced. On the other hand, one participant in the July public consultation workshop noted that the MBR's loss-absorption function could be useful if exercised when a fund is liquidated, a possibility not mentioned in the report.

Response to comments

Some edits to the report have been introduced to help dispel possible misunderstandings on the part of the respondents. A notable one is the fact that the FSB is not advocating the selection of representative options over the alternatives (variants), but rather that the representative options illustrate the mechanisms used to improve MMF resilience and that all options should be considered by jurisdictions to the extent that they are relevant for addressing the vulnerabilities they identify. In particular, there might be several options to achieve the desired outcome for each mechanism. For example, if swing pricing is particularly difficult to put in place for MMFs in a jurisdiction, it may be appropriate for that jurisdiction to adopt other policies (such as liquidity fees or anti-dilution levies) as long as they are implemented in a manner that is likely to pass on to redeeming investors the costs they impose on the fund without creating incentives for pre-emptive runs. For instance, in MMF jurisdictions such as the US and Europe, the possibility of using a liquidity fee is already in place but restricted to specific circumstances and almost never used. A proper implementation of such a policy without creating incentives for pre-emptive runs should allow fund managers to use it regularly.

In addition, the report has been edited to provide more clarity on the MBR option, which a few respondents appear to have viewed as a holdback of a portion of every redemption or as creating a buffer of less-valuable shares. The report now also mentions that a fund's liquidation could be one of the rare events in which MBR shares absorb losses.

Risk monitoring and short-term funding markets

Comments received

Most respondents agreed with the description of STFMs in the consultation report. However, some respondents disagreed with the statement in the report that prudential requirements were not a dominant factor in determining dealer behaviour. In their view, these requirements did have a significant impact on the behaviour of dealers and they argued that the success of the temporary regulatory relief provided as part of central bank liquidity schemes as evidence to support this assertion. They encouraged the FSB to look at this issue in more depth.

A minority of responses disagreed that similarities in MMF portfolios may present contagion risk, noting that larger issuers benefit from greater liquidity by being able to sell their paper to MMFs and that high standards in credit risk management are sufficient to mitigate this risk.

Most respondents were supportive of all the measures, mentioned in box 6 of the report, to enhance the overall resilience of STFMs. While recognising the role of stress testing to achieve a higher level of resilience, some of them were not in favour of any additional stress testing requirements, arguing that existing requirements in some jurisdictions are already extensive enough.

A significant minority of respondents argued that central bank facilities that have been used as emergency measures should be formalised and be made available at all times. These respondents specifically mentioned having a permanent repo facility accessible to MMFs, including MMFs' assets in central bank asset purchase programmes, and even central banks acting as market makers of last resort in short-dated government bills during stress periods.

Response to comments

Few changes are required to the report, given that the responses mainly agreed with its characterisation of risk monitoring and STFMs. Central bank interventions in underlying markets raise a broad range of other issues that are outside the scope of this exercise. In any case, as noted in the report, enhancing MMF resilience will help address systemic risks and minimise the need for future extraordinary central bank interventions to support the sector.

Considerations in selecting policies

Comments received

Very few respondents addressed these issues in depth. Most respondents simply expressed support for some policy options and argued that the best combination of policy options coincides with their preferred ones. One respondent suggested that policies should be combined considering four objectives, namely to: 1) focus on challenges revealed during the March 2020 market stress; 2) address market structure issues in underlying markets; 3) ensure the viability of MMFs; and 4) avoid the need for external support. One respondent argued that the selection of combinations of policies was of secondary importance and that what mattered was whether authorities see MMFs as cash-like or investment-like. Two other respondents agreed that the chosen options should not be overly complicated.

With few exceptions, respondents were not in favour of adopting common international standards on MMFs over and above the ones that are already in existence. However, in some limited cases respondents highlighted the potential for regulatory arbitrage, especially for those MMFs denominated in the same currency but active in different jurisdictions, and argued that consistency of regulation would be necessary in this case. Some respondents also highlighted the need to harmonise the definition of MMFs across jurisdictions.

Response to comments

Very few changes to the report are necessary to take into account the comments received on potential combinations of different options.

With respect to the need for international coordination, the report now clarifies that, as shown by the experience of March 2020, there are important cross-border considerations to be kept in mind. International coordination and cooperation on implementing policy reforms is critical to mitigate spillovers and avoid regulatory arbitrage.

Additional considerations

Comments received

Respondents mainly re-iterated the need to consider MMFs in the context of the overall STFM ecosystem. However, a few respondents suggested additional areas of focus to the FSB.

Some suggested that the use of MMF shares as eligible collateral in bilateral margin calls should be considered. They highlighted that, in March 2020, some investors withdrew cash from MMFs to pay margin calls and asserted that receivers of the cash collateral invested at least some part of it into securities similar to those owned by MMFs. In their view, allowing MMF units to be posted directly as margin would avoid investors redeeming from MMFs to post cash collateral, only for this to be reinvested in money market instruments by the collecting counterparty.

Others argued that the interplay between the Basel framework and policy measures for MMFs or STFMs should be analysed by the FSB before finalising any recommendations.

Other issues mentioned are the need for further coordination between central banks and securities regulators; reconsidering the accounting treatment of MMF shares, which may have strengthened their perception as cash instruments on the part of some investors; and avoiding additional (costly) reporting requirements for MMFs.

Response to comments

These comments do not require changes to the final report as the report already acknowledges the importance of STFMs and includes findings (Box 3) about the role of prudential regulations as a driver of dealer behaviour in those markets.

As regards the suggestion to allow MMF shares to be used as collateral in margin calls, this is not precluded for initial margin[5] if MMF shares meet the collateral criteria (e.g. low credit, liquidity and market risks) in the CPMI-IOSCO *Principles for Financial Market Infrastructures* (for centrally cleared margin obligations) and the BCBS-IOSCO *Margin requirements for non-centrally cleared derivatives* (for bilateral margin obligations).

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5 For centrally cleared transactions variation margin is generally required to be paid in cash so that it can be passed through to positions that are in the money.